SENATE FINANCE COMMITTEE
March 4, 2013
1:36 p.m.

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CALL TO ORDER

Co-Chair Meyer called the Senate Finance Committee meeting to order at 1:36 p.m.

MEMBERS PRESENT

Senator Pete Kelly, Co-Chair
Senator Kevin Meyer, Co-Chair
Senator Anna Fairclough, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Senator Cathy Giessel; Janak Mayer, Upstream Manager, PFC Energy.

SUMMARY

SB 21 OIL AND GAS PRODUCTION TAX

SB 21 was HEARD and HELD in committee for further consideration.

#sb21
SENATE BILL NO. 21

"An Act relating to appropriations from taxes paid under the Alaska Net Income Tax Act; relating to the oil and gas production tax rate; relating to gas used in the state; relating to monthly installment payments of the oil and gas production tax; relating to oil and gas production tax credits for certain losses and expenditures; relating to oil and gas production tax

credit certificates; relating to nontransferable tax credits based on production; relating to the oil and gas tax credit fund; relating to annual statements by producers and explorers; relating to the determination of annual oil and gas production tax values including adjustments based on a percentage of gross value at the point of production from certain leases or properties; making conforming amendments; and providing for an effective date."

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JANAK MAYER, UPSTREAM MANAGER, PFC ENERGY, introduced himself. He explained that the focus of PFC Energy was related to above ground risk, and the issues that the oil and gas companies face that did not come from the subsurface. He furthered that PFC Energy dealt with issues of supply and demand in welled oil markets; regional markets for natural gas; competition analysis and strategy; political risk in various parts of the world; and the question of fiscal terms and project economic analysis.

Mr. Mayer acknowledged Senator Olson and Senator Hoffman's presence in the committee.

Mr. Mayer discussed the PowerPoint, "Senate Finance Committee, Alaska Fiscal System Discussion Slides" (copy on file).

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Mr. Mayer looked at page 3, "Regressive and Progressive Regimes."

2 potential reasons to desire a progressive element in Alaska’s fiscal regime:
-To counteract regressive elements in the regime to achieve something close to neutrality
-To go beyond neutrality, to ensure a higher level of take for the state in high price environments

Regressive and Progressive regimes imply very different outlooks on risk and reward, for government and the private sector:
-Regressive regimes limit risk to the state, placing large downside risk on the private sector, protecting the state in low price or high cost environments

-In return, regressive regimes offer outsized returns in high price environments.
-Progressive regimes involve the state bearing more price and cost risk, in return for a higher share of returns in good times.

Perhaps the single biggest problem with Alaska's current fiscal regime is that it involves elements that are both strongly regressive and strongly progressive.
-It seeks to place downside risk on the private sector, while taking most of the returns in high price environments.
-It is this combination that makes it particularly unattractive from an investment perspective.

Mr. Mayer highlighted page 4, "Royalty Only Base Production." Even with just a 12.5 royalty on base production, a fixed royalty is regressive at low prices; at $40/bbl the royalty and property tax consume all divisible income.

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Mr. Mayer looked at page 5, "Royalty Only $18/bbl New Development, Standalone." He stated that with the 16.7 percent royalty that generally applies to newer leases, an $18/bbl new development faces more than 70 percent government take at $65/bbl. He pointed out that the company would not break even until it hit $18/bbl. He remarked that the royalty only option would be very profitable for the state, assuming production occurred at oil prices. He furthered that the bottom left chart displayed the cash flow development, beginning at $100 per barrel. He stated that the yellow bars represented the initial Capex facilities costs; the light blue bars represented the drilling capital costs; the green represented the revenue that is collected once production commences; the red bars represented the operating costs; and the purple bars represented the government take. He furthered that the dashed line on the graph represented the off-tax cash flow of the investments. He remarked that there was negative cash flow in the early years, which turned into positive cash flow as production occurred. He remarked that the black line was essentially the difference between the top bars and the bottom bars on the graph.

Mr. Mayer discussed page 6, "Royalty Only, $25/bbl New Development, Standalone." He stated that a high-cost $25/bbl development may face more than 70 percent government take at $85/bbl. He explained that the break-even cost for the company would be approximately $100/bbl.

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Mr. Mayer explained page 7, "Base Production." He stated that the Alaska Clear and Equitable Share Act (ACES) layers onto the regressive fixed royalty a highly progressive profit-based production tax. The gross-based minimum tax also increases the regressive nature at the low end. The result is very high levels of government take at both very low and high prices.

Mr. Mayer looked at page 8, "ACES-$18/bbl New Development, Standalone." He stated that standalone new developments face particularly high government take- although this is partly offset by the significant downside risk the state takes through reimbursable credits. He looked at the cash flow line on the chart, at $100/bbl, was no longer as far negative as the capital and drilling cost. He also pointed out that there would be negative government take in the early years, as the capital credits contributed to the cost of the project. He stated that the new development, on a stand-alone basis, was an even higher government take than the base production. This was because of a combination of the higher royalty and the inability to write the cost off against the royalty.

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Mr. Mayer highlighted page 9, "ACES-$25/bbl New Development, Standalone." He stated that the downside exposure to the state from reimbursable credits to small producers is potentially significant for high-cost projects in low price environments. He remarked that the cash flow analysis chart differed from the previous charts. He stated that the slide was based on what might occur at $50/bbl. He remarked that the negative purple bars in the early stage of capital spending were greater than the corresponding relatively small amount of government take that occurred at the tail-end of $50/bbl.

Mr. Mayer discussed page 10, "Alaska Base Production Under UK North Sea Regime." He explained that by comparison, pure

profit-tax based regimes like the UK North Sea can be completely neutral over an indefinite range of prices, with or without some progressivity at low prices. He stated that the UK North Sea regime was completely neutral, because it did not have the fixed royalty, property tax, or other regressive components. He stressed that the UK North Sea regime was a strictly profit based taxation system. He explained that a pure profit based taxation system could be designed to target any level of government take. He stated that their system created a small amount of progressivity at low price levels, but at a certain price level, it reached its target level of government take. That government take was maintained at all price levels, at all cost structures for base production.

Co-Chair Kelly wondered if the $18/bbl was a capital expenditure. Mr. Mayer responded that the $18/bbl was both drilling and facilities capital expenditures.

Mr. Mayer answered some of Senator Dunleavy's previous questions related to changes to fiscal regimes to match some of the more competitive environments. He stated that Alaska had a greater degree of change over recent years than most every other comparable regime. He remarked that constant change was a great disincentive to investment, because investments were made on a 10 to 20 plus year time horizon. He stressed that the fiscal system was ultimately was determines the economics of a growing investment.

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Mr. Mayer highlighted page 11, "Alaska $18/bbl Development Under UK North Sea Regime." He explained that by comparison, pure profit-tax based regimes like the UK North Sea can be completely neutral over an indefinite range of prices, with or without some progressivity at low prices. He stated that the UK had experienced a number of changes to its fiscal regime. He explained that, in 2003, the UK took away a significant component to reduce government take. He explained that, recently, the UK turned to North Sea oil and gas production as a source of additional revenue. He pointed out that the chart displayed to two components of government take: corporate income tax and supplementary tax. He remarked that the UK substantially increased the rate from 20 percent to 32 percent. He remarked that, in order to encourage reinvestment, the UK government developed the Brownfield Allowance that reduces

government take to attempt to stimulate investment. He also shared that Australia recently experienced significant changes to its fiscal regime. He pointed out that in Australia had federalized oil and gas production. He explained that there was a federal profit-based production tax system off-shore in Australia, which was known as the Petroleum Resource Rent Tax (PRRT). He furthered that on-shore production had been at the jurisdiction of the states in Australia, but was recently changed to match the PRRT.

Mr. Mayer looked at page 13, "ACES- Base Production." He remarked that there were a number of ways to achieve a level of neutrality at the 60 percent mark. He stated that ACES was a regime that gave 65 percent to 75 percent government take. He stated that the original Senate Bill 21 took out the progressivity and capital credits, which would create a slightly regressive regime. He noted that there were two key issues: 1. the proposal was regressive, because the only component was a flat 25 percent profit-based production tax, and 2. the capital credit would eliminated, therefore causing a tax increase at lower price levels.

Mr. Mayer discussed page 15, "Government Take Under SB 21 and ACES Capex Sensitivity."

> As noted in PFC Energy testimony on 1/31/13, at low oil prices, Relative Government Take under SB 21 is higher than under ACES, due to the impact of low or no progressivity, combined with the elimination of the 20 percent capital credit under SB 21.
>
> The oil price level at which this occurs is highly sensitive to annual levels of capital spending, since CAPEX both reduces the oil price level at which progressivity kicks in under ACES, and determines the size of the available capital credit under ACES.
>
> Looking at a single year of production also slightly raises this neutrality point, since over many years, inflation reduces the real price level at which progressivity starts under ACES.
>
> For mature, producing assets with a low ongoing CAPEX requirement ($10/bbl), SB21 represents a reduction in government take at prices above ~$75, however for

capital intensive new developments in existing units, that neutrality point can be as high as $110/bbl.

It is thus important to understand that one impact of the removal of the 20 percent capital credit under SB 21 is that for companies with high development costs relative to overall production, it can represent a tax increase at current prices.

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Mr. Mayer looked at slide 16, "Regimes for Comparison: CS SB 21.

CS SB 21:
-35 profit-based production tax, $5/bbl allowance, 30 percent GRE for certain new production.

-Production-based allowance curves the tax-rate down at lower process, creating a progressive element that achieves relative overall neutrality.

-Overall relative neutrality removes potential for "gold-plating incentives."

-Progressive element being determined on gross basis removes issue of oil vs. gas 'decoupling.'

-Gross Revenue Exclusion reduces the overall level of government take for incentivized projects.

-Elimination of capital credit and carry forward of NOL credit reduces downside risk to state, but carries a cost in terms of project economics.

Mr. Mayer stressed that an exploration credit would not put more oil in the pipeline.

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Senator Hoffman wondered if Alaska the production goal of 400 to 600 million barrels of oil per day could be compared with other similar, exploration-based regimes. Mr. Mayer replied that he did not know the answer.

Mr. Mayer looked at page 17, "$5 Production Allowance is like Reverse Progressivity." He explained that the

production allowance is referred to as a "credit", so it would be easy to compare it to the capital credit. He stressed that the production allowance was really a substitute for progressivity. He explained that the production allowance was a different form of progressivity, because the production allowance set a top maximum rate. Progressively, as the price decreases, the allowance subtracts further away from the top maximum rate. He stated that the slide displayed a simplified and stylized tax calculation.

Mr. Mayer continued to discuss slide 17. He remarked that there was $2.5 billion at the point of production in the $60/bbl case. He furthered that $30/bbl lease expenditures would result in $1.5 billion.

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Mr. Mayer highlighted page 18, "GRE Increases the Price Level at Which Production Tax, and 'Progressivity', Apply." He remarked that the slide was exactly the same as the previous slide, but with the application of the Gross Revenue Exclusion (GRE). He stated that the GRE was set at 30 percent, and applied throughout the slide.

Mr. Mayer looked at page 19, "Both Share Similarities with UK Brownfield Allowance."

> The UK's fiscal regime is a relatively simple one, with two core components - a Corporate Income Tax (CIT) of 30 percent, and a Supplemental Resource Tax (SRT) of 32 percent, levied on the CIT tax base.
>
> The UK Brownfield Allowance is an income exclusion, used in calculating the SRT. Up to a total £250mm of income can be excluded, with up to 20 percent of the exclusion amount allowed in a given year. For projects subject to the additional Petroleum Tax (pre-1993 projects), the exclusion is up to £500mm of income Because it is a fixed exclusion, it has a greater impact at lower oil prices
>
> Projects are individually assessed for qualification, and for the total amount of relief available. Qualifying projects are incremental projects increasing production from mature fields.

A 100mmb incremental development, with costs of $25/bbl, could see its government take reduced by to anywhere from 3 to 11 percentage points, depending on the oil price level

Mr. Mayer highlighted page 20, "Alaska $18/bbl Development under UK North Sea regime." He noted the curving downward of a fixed total, as lower price levels were reached. He stated that the committee substitute was not unlike what was represented in the slide.

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Mr. Mayer discussed page 21, "Regimes for Comparison: Bracketed Progressivity (Net)."

Bracketed Progressivity (Net):

25 percent Profit-based Production Tax
Bracketed progressivity with the following thresholds and rates:
- $30 PTV – 5 percent
- $42.5 PTV – 10 percent
- $55 PTV – 15 percent

20 percent capital credit maintained, but carried forward to production for producers with no liability

Overall relative neutrality removes potential for 'gold-plating incentives.'

Progressive element being determined on net basis does not entirely remove issue of oil vs. gas 'decoupling', but low degree of progressivity minimizes impact.

Gross Revenue Exclusion not included in modeling, but could be applied to incentivize new projects.

Carryforward (without escalation) of credits reduces some downside risk to state, while retaining a cost-progressive element. Escalation could also be included to compensate for time value of money foregone.

Mr. Mayer highlighted page 22, "Regimes for comparison: Bracketed Progressivity (Gross)."

Bracketed Progressivity (Net):
20 percent Profit-based Production Tax – lower rate needed to when progressivity on gross to prevent a tax increase at lower price levels for higher cost producers.

Bracketed progressivity with the following thresholds and rates:

$70 ANS West Coast Crude – 5 percent
$90 ANS West Coast Crude– 10 percent
$110 ANS West Coast Crude– 15 percent
$130 ANS West Coast Crude– 20 percent

20 percent capital credit maintained, but carried forward to production for producers with no liability.

Overall relative neutrality removes potential for 'gold-plating incentives.'

Progressive element being determined on net basis does not entirely remove issue of oil vs. gas 'decoupling', but low degree of progressivity minimizes impact.

Gross Revenue Exclusion not included in modeling, but could be applied to incentivize new projects.

Carryforward (without escalation) of credits reduces some downside risk to state, while retaining a cost-progressive element. Escalation could also be included to compensate for time value of money foregone

Mr. Mayer highlighted page 24, "ACES – Base Production." He stated that the committee was already familiar with ACES.

Mr. Mayer highlighted page 25, "CS SB 21 Base Production." He explained that the committee substitute had even lower government take than the original proposal. He stated that the slide used assumptions of only $10/bbl and cost from production solely from the mature fields. He noted that there was a constant 64 to 65 percent government at the relevant price levels, except for very low price levels. At very low price levels, the regressive nature of the royalty took over. In that instance, there would be a very high

government take. He noted that from $50/bbl the government take stayed at the 64 to 65 percent range. He noted the even corresponding split in value between the company and the state.

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Mr. Mayer discussed page 26, "Bracketed Progressivity (Net) Base Production." He remarked that a net progressivity would result in a similar regime to the proposed senate bill. He remarked that there would be slightly lower government take at $80/bbl; and a slightly higher government take at a higher price levels.

Mr. Mayer spoke to page 27, "Bracketed Progressivity (Gross) Base Production." He remarked that this slide represented a theory that was virtually indistinguishable from the committee substitute and almost all price levels.

Mr. Mayer highlighted page 28, "ACES-$18/bbl New Development, Standalone." He remarked that he had already explained the government take under ACES.

Mr. Mayer highlighted page 30, "CSSB21 $18/bbl New Development, Standalone, no GRE." He remarked that there would be lower government take from $65/bbl and higher. He pointed out that there would be high government take from $65/bbl and below, which was the impact of not having the credits. He remarked that there was an overall flattening at the 67 percent mark, which could be argued to be higher than one might want for new development, if one was to be truly competitive. He remarked that the display excluded the GRE.

Mr. Mayer explained page 31, "Bracketed Progressivity (Net) $18/bbl New Development, Standalone." He remarked that the display would be essentially 62 percent at $80/bbl to $100/bbl. He felt that the display was a result of the credits, because the credits did not occur for the standalone new development up front. The cash flow chart did not show the purple bar contributing to the capital expense, because those credits would carry forward to production.

Mr. Mayer looked at page 32, "Bracketed Progressivity (Gross) $18/bbl New Development, Standalone." He remarked that this slide was very similar to slide 32. He pointed

out the lower government in the $80/bbl to $100/bbl range, because of the impact of maintaining the credits.

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Mr. Mayer displayed page 33, "CS SB 21, $18/bbl New Development, Standalone, with GRE." He stated that the committee substitute was very similar to the original version, but new development looked substantially more attractive in the $80/bbl to $100/bbl price range. He stressed that the addition of the GRE would substantially alter the attractiveness as it related to new development, because it reduced the amount of overall production tax and substantially adjusted the point at with the production tax occurred. He stressed that the addition of the GRE would greatly reduce government take: 61 percent government take at $80/bbl down to 57 percent at $100/bbl. He looked at the bracketed progressivity versus CS SB 21 with the GRE, and noted that the impact was in the government take cash flow at the tail-end. He explained that peak production in the early years would contribute relatively little production tax. He pointed out that the GRE made a difference by carrying forward the cash flow.

Mr. Mayer highlighted page 34, "ACES $18/bbl New Development, Incremental." He explained that the slide represented an analysis based on the portfolio of an existing producer at $18/bbl new development. He stressed that there would not be a large amount to deduce from the price, other than there would be substantial levels of government take under ACES, as well as substantial contribution to the overall initial production costs through the capital credit at buy-down, which would reduce the tax burden on the producer.

Mr. Mayer discussed page 36, "Bracketed Progressivity (Net) $18/bbl New Development, Incremental." He remarked that the slide showed a lower level of government take in the $80 to $100 range, as well as with the net of progressivity.

Mr. Mayer highlighted page 37, "Bracketed Progressivity (Gross) $18/bbl New Development, Incremental." He remarked that the slide was a virtually indistinguishable comparison between the gross and CS SB 21.

Mr. Mayer discussed the competitiveness of SB 21. He looked at page 49, "Regime Competitiveness-$80/bbl." He stated

that the slide compared regimes as it concerns overall levels of government take to the broadest range of international competitors. He pointed out that the biggest competitors with Alaska were the other North American regimes, the North Sea, and Australia. He remarked that, under ACES, at $80/bbl for new development, was one of the highest in the world, and only second behind Norway.

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Co-Chair Meyer queried a definition of "OECD." Mr. Mayer replied that OECD stood for the Organization for Economic Corporation and Development, which was the "club" for developed countries.

Co-Chair Meyer wondered if the OECD countries were considered the free market countries. He specifically queried the difference between the OECD highlighted countries versus those highlighted in blue. Mr. Mayer responded that the OECD countries that had per capita gross domestic product (GDP) that were near the United States (US) level or no less than half of the US GDP.

Vice-Chair Fairclough wondered if the production competitiveness these countries would be similar to the displayed analysis. Mr. Mayer responded that it would depend on how one would define "competitiveness." He remarked that the most desirable hydrocarbons in the world entailed an ability to maintain a level of government take that Alaska could not maintain. He pointed out that Ireland was not an immediate competitor, because it had a favorable fiscal regime with little to no oil production. He stressed that the slide was intended to give a global context, but noted that there could be a chart that had only immediate competitive regimes.

Vice-Chair Fairclough wondered if there would be a different matrix to determine the competitiveness based on government take as it relates to production. Mr. Mayer responded that in terms of reaching a sustainable government take, there were two key determinants of what the level would be for any country: 1) the size and desirability of the resources; and 2) the cost of producing those resources. He explained that if there were large, low-cost resources, there could be a high level of government take.

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Vice-Chair Fairclough stressed that Alaska was not in first place in total production, and remarked that the comparison graph might be representing regions that compete differently than Alaska. She furthered that there were some regimes that had young government structures, so those regimes were in flux. She specifically mentioned North Dakota, but felt that they had not developed environmental sensitivity, so restrictive regulations could be put in place as they continue to produce oil and gas. Mr. Mayer replied that large producers tended to have large economics, and had a high level of government take. He agreed that South Dakota had a small government take, because that was part of incentivizing development at an early stage.

Co-Chair Meyer wondered if the price point of $80/bbl to $100/bbl was the Alaska North Slope (ANS) price or the West Texas Intermediate (WTI) price. He furthered queried the reason why there was such a large premium between ANS and WTI. Mr. Mayer responded that ANS traded almost indistinguishable from the global marked crude, Brent Crude. He stated that ANS was considered an imported barrel, because it came through the port as any other imported barrel. He explained that WTI formerly traded at a slight premium to Brent Crude, but WTI currently traded at a deep discount to Brent Crude. He stressed that the WTI was traded at a discount, because of the massive increase in the lower 48 oil production.

Co-Chair Meyer wondered if the $15 premium with ANS would be maintained, or would it be reduced after the pipeline system development. Mr. Mayer replied that PFC Energy felt that the disconnect between WTI and Brent would be maintained as long as the US unconventional resources remained at the current level of performance. He remarked that pipeline capacity could moderate that impact.

Senator Hoffman requested a chart that reflected the impact on the state treasury at $80, $100, $120, and $140 per barrel. Mr. Mayer agreed to provide that information.

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Senator Bishop wondered what would happen to ANS pricing if Alaska resumed 1 million barrels per day production. Mr. Mayer responded that it would depend on the question of the happenings of the overall North American market.

Mr. Mayer looked at page 50, "Regime Competitiveness-$100/bbl." He noted that the slide showed that Alaska was on the same level as Norway regarding the level of government take. He remarked that ACES, for an existing producer, was lower, but remained above $70 per barrel. He noted that the $80 per barrel, new development without the GRE reflected relatively high governments take at 67 percent. Once the GRE is applied, an aggressive level of competitiveness would occur. He pointed out that once the level of $120 per barrel is reached, the disparity between CS SB 21 for new development with the GRE versus everything else increased; $140 per barrel reflected an even greater disparity.

Co-Chair Meyer wondered if the existing producer would share 64 percent at $100 per barrel. Mr. Mayer replied that the existing producer would share 64 percent at $100 per barrel under CS SB 21.

Co-Chair Meyer noted that under the legislation, with the GRE included, the government share would drop below 60 percent. Mr. Mayer agreed, and furthered that new development would share between 65 and 69 percent without the inclusion of GRE. He remarked that eliminating the capital credit and relying on the GRE resulted in losing a cost-responsive element in the system. He remarked that the capital credit was a self-stabilizing element in the system, which could achieve some impact on new development, because it achieved lower overall level of government take in the $80 to $100 per barrel range.

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Co-Chair Meyer queried the cost to the state in regards to using capital credits versus GRE. Mr. Mayer replied that one must first determine the desired level of government take. He remarked that the capital credit had a greater impact on the front end of the cash flow, so it may have a greater impact on the state early on. He remarked that a percentage point of government take depended greatly on how the tax was structured.

Co-Chair Meyer wondered what Mr. Mayer's opinion of what the government's take should be. He noted that the inclusion of the GRE would put the government take at 60 percent, so it would make Alaska attractive to producers. He wondered if that level would make Alaska too attractive. Mr. Mayer replied that being too attractive, for completely new areas, was positive. He stressed that the rate should apply to areas that were not currently producing. He pointed out that the rate should not reduce government take on existing production. He furthered that existing production, incremental production, and new production should each be separated with the qualifier that there is an incentive substantial new production from the new fields. He felt that reducing the rate and making it overall neutral would make Alaska competitive, but that strategy would reduce revenue on existing production. He felt that there needed to be mechanisms to maintain revenue, like the GRE, in order to differentiate between existing versus new production. He stated that the GRE would be a mechanism under the existing structure that would combine cost and production in order to distinguish a tax rate on different forms production. He stressed that the GRE was intended to effectively lower the tax rate on certain targeted forms of production by reducing the effective rate without tracking the costs that apply to different forms of production.

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Co-Chair Meyer remarked that Norway and some other countries had an uplift tax credit, to encourage production of new oil from existing reservoirs. He felt that the majority of Alaska's undeveloped oil was waiting in the legacy fields. He wondered if there should be an incentive for the legacy fields, like a 10 percent GRE, or targeted capital tax credit. Mr. Mayer responded that the GRE was relied upon as a means to encouraging new production competitive; he felt that the GRE for incremental production in legacy fields was imperative. He stated that the executive should be allowed discretion, rather than legislation to the tax code. He remarked that it was nearly impossible to define "incremental production" in the tax code.

Co-Chair Meyer wondered if there should be a targeted tax credit on the wells. Mr. Mayer responded that limiting the capital credit to a particular form was not an ideal

solution, because often productive wells were pulled offline in order to bring a new well online.

Senator Hoffman stated that DOR estimated that in 2015, the GRE could cost the treasury $825 million. He remarked that the credit was only a one-time allocation, but the GRE could eventually be even more expensive to the state treasury. Co-Chair Meyer agreed, and felt that the issue of the GRE deserved further discussion.

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Vice-Chair Fairclough suggested an investment model strategy that was utilized in other oil tax regimes. She wondered if there should be a committee that was a review board much like the Permanent Fund Board, which would use the $400 million in capital credits, and choose investment partnerships under a specific kind of exploration criteria. She noted that PFC Energy had indicated that Alaska's administration needs flexibility, but the legislative body wanted to be the oversight regarding the direction of the board. She wondered if the board should have oil expertise and financial investment strategy to examine where Alaska's dollar could have the greatest benefit to Alaska. Mr. Mayer responded that there was merit to that idea. He stated that there were a number of existing bodies in the state, which had an investment role in the state treasury.

Vice-Chair Fairclough remarked that each investment had a different set of scenarios that could not be predicted in the legislature.

Senator Dunleavy agreed with Vice-Chair Fairclough, but felt that the idea for a board did not go far enough. He remarked that there needed to be an exploration of an independent vehicle that made business investments for the state. He stressed that the board should have Alaska's interests, and felt that there could be feedback from a trusted outlet that was concerned with Alaska's future.

Senator Bishop agreed with Senator Dunleavy, and would like to hear more input from the client.

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Co-Chair Meyer stated that the industry would be sharing their input with the Senate Finance Committee on the following day.

Mr. Mayer looked at targeting neutrality directly. He discussed page 54, "Alaska $18/bbl Development Under UK North Sea Regime." He remarked that one could set up a system that looked at base production at a particular series of assumptions around costs and production profiles; but as the cost level increased, the result was different. He stressed that nothing was perfectly opposite to the regressive element of the fixed royalty.

Mr. Mayer highlighted page 55, "Alaska $18/bbl Development Under Norway Regime." He stated that Norway was one of the highest government take regimes, but had a very different downside than Alaska. He explained that Alaska had similar levels of government take at the high end, but Norway fell right away as divisible income decreased. He pointed out that Norway had no fixed royalty, and he also mentioned that Australia's regime was similar to Norway.

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Mr. Mayer discussed page 56, "Targeting Neutrality //

-All of the preceding regimes seek to compensate indirectly for the regressive nature of the fixed royalty and ad valorum tax by inserting a roughly equal and opposite progressive element

-Inevitably, the match must be imperfect

-At low prices, government take is still very high – and for high cost developments, the fixed royalty can create a high level of price downside risk, particularly in conjunction
with the gross minimum tax

-The only way to create a completely neutral regime is to counteract the regressive elements directly – either by eliminating or perfectly opposing them

Since royalties are contractual, and ad valorum taxes shared with local government, if this were desired, putting in place a perfect offset might be easier than elimination

All that would be required to achieve this would be a fully reimbursable tax credit equal to the amount of royalty and ad valorum tax paid

A completely neutral regime could increase downside price risk to the state, but would also lead to an even sharing of risk and reward

Many major OECD oil producing states with profit-based taxes have chosen to eliminate regressive elements altogether - i.e. Australia, UK, Norway – because of the distorting impact such elements have on investment

-The following slides model a 42.5 percent Profit-Based Production

-Tax rate, combined with a fully reimbursable tax credit equal to the amount of royalty and ad valorum tax paid (or the eventual elimination or one or both of those elements

Mr. Mayer looked at page 57, "Profit Tax Only (Royalty and Ad Valorum Reimbursed) Base Production."

Mr. Mayer highlighted page 58, "Profit Tax Only (Royalty and Ad Valorum Reimbursed) $18/bbl New Development, Standalone."

Mr. Mayer discussed page 59, "Profit Tax Only (Royalty and Ad Valorum Reimbursed) $18/bbl New Development, Incremental."

Mr. Mayer noted that a property tax would have approximately 65 percent government take at every possible price deck.

Senator Bishop surmised that the proposal would allow the company to choose where to invest, because there was no GRE or incentive for downhill work, etc. Mr. Mayer agreed, and furthered that there were many discussions regarding specific incentives. He stated that the approach would only set the level of overall government take, and reflect a reasonable share.

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Vice-Chair Fairclough wondered if OCED experienced similar historical patterns as different countries became more mature in their relationships with industry. Mr. Mayer responded that the evolution of the global fiscal systems have been very simple fixed royalties and also a greater focus on trying to tax profit directly, rather than taxing volume and gross revenue. He stated that tax royalty arrangements were fairly normal before the 1960s. He stated that the 1960s and 1970s held two great oil shocks, and coincided a post-colonial period. He explained that many of the colonial counties examined their resource wealth, and felt that they were not benefitting enough from the resource wealth compared to the companies.

Co-Chair Meyer discussed housekeeping.

SB 21 was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

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The meeting was adjourned at 3:32 p.m.