

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

February 18, 2013

3:31 p.m.

MEMBERS PRESENT

Senator Cathy Giessel, Chair
Senator Fred Dyson, Vice Chair
Senator Peter Micciche
Senator Click Bishop
Senator Anna Fairclough
Senator Hollis French

MEMBERS ABSENT

Senator Lesil McGuire

COMMITTEE CALENDAR

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."

- 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

WITNESS REGISTER

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

POSITION STATEMENT: Supported SB 21.

BILL ARMSTRONG, President and CEO
 Armstrong Oil and Gas
 Denver, Colorado

POSITION STATEMENT: Supported SB 21.

PAT FOLEY, Manager
Land and External Affairs
Pioneer Natural Resources, Alaska
POSITION STATEMENT: Supported SB 21.

BART ARMFIELD, CEO
Brooks Range Petroleum Corporation
Anchorage, Alaska
POSITION STATEMENT: Supported SB 21.

KEN THOMPSON, Co-Owner
Alaska Venture Capital Group (AVCG)
Parent company for Brooks Range Petroleum
POSITION STATEMENT: Preferred SB 21 with some changes.

BRADFORD KEITHLEY, Partner and Co-Head
Oil and Gas Practice
Perkins Coie, LLP
POSITION STATEMENT: Talked about how the current oil tax structure should be changed, if at all.

BILL CORBUS, member
Make Alaska Competitive (MAC) Coalition
Juneau, Alaska
POSITION STATEMENT: Supported SB 21.

DAVID TRANTHAM, representing himself
Bethel, Alaska
POSITION STATEMENT: Opposed SB 21 in its current form.

NOEL WOODS, representing himself
Palmer, Alaska
POSITION STATEMENT: Supported SB 21.

LANCE ROBERTS, representing himself
Fairbanks, Alaska
POSITION STATEMENT: Supported moving the SB 21 forward.

KEN HALL, representing himself
Fairbanks, Alaska
POSITION STATEMENT: Supported the "sentimental concepts of fair to Alaskans" embodied in SB 21.

MAYNARD TAPP, representing himself
Anchorage, Alaska
POSITION STATEMENT: Supported the concept of SB 21.

STEVE PRATT, Executive Director
Consumer Energy Alliance Alaska
Anchorage, Alaska
POSITION STATEMENT: Supported SB 21.

RICK ROGERS, Executive Director
Resource Development Council (RDC)
Anchorage, Alaska
POSITION STATEMENT: Supported SB 21.

LAURIE FAGNANI, MSI Communications
Anchorage, Alaska
POSITION STATEMENT: Said SB 21 was a step in the right direction
to increasing production.

ALLISON GRIFFITH, representing herself
Anchorage, Alaska
POSITION STATEMENT: Supported SB 21.

MICHAEL JESPERSON, representing himself
Anchorage, Alaska
POSITION STATEMENT: Said SB 21 was better than the alternatives,
although it could be improved in terms of durability.

ANDY ROGERS representing himself
Palmer, Alaska
POSITION STATEMENT: Supported SB 21.

JOHN STURGEON
Concord Forest Products
Anchorage, Alaska
POSITION STATEMENT: Supported SB 21.

GAIL PHILLIPS, representing herself
Anchorage, Alaska
POSITION STATEMENT: Supported a durable and simple tax policy.

RENEE SCHOFIELD, representing herself
Ketchikan, Alaska
POSITION STATEMENT: Supported SB 21.

SCOTT HAWKINS
Advanced Chain Supply International
Anchorage, Alaska
POSITION STATEMENT: Supported SB 21.

TOM LAKOSH, representing himself

Anchorage, Alaska

POSITION STATEMENT: Said the tax issue needed more analysis.

MERRICK PEIRCE, representing himself

North Pole, Alaska

POSITION STATEMENT: Opposed SB 21.

KIMBERLY METCALFE, representing herself

Juneau, Alaska

POSITION STATEMENT: Opposed SB 21.

KELLY WALTERS, representing himself

Anchorage, Alaska

POSITION STATEMENT: Opposed SB 21.

JERRY AHWINONA, representing himself

Anchorage, Alaska

POSITION STATEMENT: Opposed SB 21.

KATE VAY, representing herself

Soldotna, Alaska

POSITION STATEMENT: Opposed SB 21.

ACTION NARRATIVE

[3:31:27 PM](#)

CHAIR CATHY GIESSEL called the Senate Resources Standing Committee meeting to order at 3:31 p.m. Present at the call to order were Senators Dyson, Bishop, French, Fairclough, and Chair Giessel.

SB 21-OIL AND GAS PRODUCTION TAX

[3:31:53 PM](#)

CHAIR GIESSEL announced SB 21 to be up for consideration.

[3:32:25 PM](#)

KARA MORIARTY, Executive Director, Alaska Oil and Gas Association (AOGA), Anchorage, Alaska, said they are the professional trade association of the oil and gas industry. She said the changes in SB 21 were reviewed and unanimously approved by the full membership. The Role of AOGA and individual companies should not be to tell Alaska how to structure its tax system, but to relate how it is affecting them, so they can make informed decisions about how it.

[3:34:49 PM](#)

She said the greatest and most urgent challenge facing Alaska today is the decline of oil production on the North Slope and that saying any change in tax structure that reduces tax revenues below the projection in the Revenue Sources Book is a "giveaway" is a red herring about oil taxes. It's just not true. Industry has had to spend at least \$2 billion each year to slow the production decline from what it would naturally be in order to even approach the level of production published in the Revenue Sources Book. Just like any other investment industry makes here, these investments must beat the competition elsewhere.

Another false concept assumes that production in the Revenue Sources Book is all that will be produced; no additional revenue or production resulting from a tax reduction is calculated in it. If a tax reduction makes investments here more competitive, companies will want to make more investments here for that upside and they will do so even though they lack the gift of prophecy and cannot know beforehand exactly what the upside will turn out to be.

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She said it would be useful for them to identify principles they want the tax system to embody, and AOGA believes Governor Parnell's' four principles offer an excellent cornerstone. It needs to be fair to Alaskans, to increase production, and to be simple and be durable. They suggest adding a fifth principle, because the challenge facing Alaska is not that there are too many companies pursuing opportunities here, but too few. So Alaska should avoid tax changes that artificially create winners and losers.

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MS. MORIARTY said that AOGA wholly endorses eliminating progressivity, because it destroys one of the few strategic advantages that Alaska has, which lies in its economic remoteness. It costs about \$9.42 to ship a barrel of oil from the North Slope to the West Coast (WC) according to the 2012 Fall Revenue Sources Book. This starts Alaska off with a \$9.42 disadvantage compared to outside competition, so other parts of an Alaska investment must be pretty strong in order to overcome it. If oil prices turn out to be higher than projected, nearly 100 percent of each extra dollar in price flows into the gross value at the point of production (GVPP) and then after royalties and taxes flows straight to the investors' bottom line. This improves the economic performance of an Alaskan investment relative to an equally competitive one outside, because the

Alaska baseline was \$9.42 a barrel lower and an additional \$1 in price is a larger percentage of that baseline than for the percentage of the outside investment. This can be particularly significant to potential investors who are bullish on prices.

Currently, progressivity in conjunction with a 25 percent base rate will take half of each dollar from higher prices when the WC price is \$138, the one strategic advantage that Alaska's economic remoteness provides. And the more bullish one is on prices the more this advantage is undone because they will see higher rates for progressivity at those high prices in their investment analysis.

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SENATOR MICCICHE joined the committee.

Secondly, Ms. Moriarty said progressivity is extraordinarily complicated for calculating the amount of progressivity for any particular item that affects the taxpayers' production tax value (PTV). This complexity exists because the tax rate for progressivity depends on the taxpayers' PTV/bbl and then the resulting rate is applied to very PTV that set the rate. This circularity in the tax calculation leads to some bizarre effects. For example, simply the fact that oil prices fluctuate during a year instead of remaining perfectly flat increases that tax even though the average of the fluctuating prices is the same as the flat price. And the greater the fluctuation the greater the tax from progressivity becomes. There is no objective economic or financial reason for the tax to go up, instead this occurs entirely because the progressivity calculation is circular.

She said in general tax credits represent a direct reduction in the amount that a potential investor puts at risk by spending money on the equipment and facilities. It is important to re-enforce that there is no tax credit liability for the state at all until an investor invests here, so it costs nothing to offer the credit until the investment is made. At that point the tax credit has already succeeded in what it was supposed to do - attract additional investment.

[3:42:17 PM](#)

SENATOR DYSON said it was different for explorers who have no production.

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MS. MORIARY said she would get to that in a moment and that the first component the bill addresses the qualified expenditure credit (QCE). While eliminating progressivity would improve the competitiveness of Alaskan investment, she said, eliminating the QCE credit would claw back a big chunk of that money and undo a significant part of that competitive improvement. This is because the benefit of the QCE credit depends only on how much is invested here while the benefit from ending progressivity depends on the price of oil relative to the producer's lease expenditures. So for every producer there is a price below which the lost QCE credit would start to outweigh the benefit from the end of progressivity and exactly where that crossover comes on factors specific to each individual company is an unknown, because for competitive reasons that isn't talked within AOGA. It would depend on how much oil they produce, where it is sold, the cost to deliver it and other expenditures. So they feel that repeal of the QCE credits is likely to do the one thing that they don't want to do, which is to create winners and losers artificially among the producers. AOGA doesn't see any sound tax policy justification for doing so.

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She said they endorse extending the small producer tax credit under AS 43.55.024 from the present sunset date of 2016 to 2022 and encourage the same extension for the exploration tax credits. She reasoned that the state had sound policy reasons for creating those tax credits and those reasons are just as valid today as they were then. The purpose of the small producer tax credit was to attract new players to Alaska who might otherwise have been deterred from coming here by its remoteness, northern climate and resulting challenges of higher than average costs and expenses. The success of the credit in doing this is a fact that cannot be denied. Testimony has indicated that the small producer tax credit has made a material difference both for AOGA members and other companies who are here in their decisions to do business and invest in Alaska.

MS. MORIARTY said the purpose and justification the exploration credits under AS 43.55.025 are equally plain and clear. If exploration is to occur in a timely fashion so any resulting production can be transported through existing infrastructure, the exploration tax credits are a direct way of bringing that exploration about and these types of credits should be extended as well.

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MS. MORIARTY said AOGA had some concern about limiting the transferability of the current carry-forward annual-loss tax credit. These credits arise every year for any active explorer that finds something and finally has production that has a tax to apply the credit against. At present, explorers can only realize immediate benefit from them by selling them to other taxpayers or cashing them in with the state. Such sales and cash-ins would stop the North Slope explorers who instead would be able to hold the credit for up to 10 years for possible use against tax on their own future production, assuming they find some. During this 10-year shelf life the unused credits would compounded annually at the rate of 15 percent. This bill's only exception to this ban would be for a transfer made in conjunction with the sale or other transfer. To prevent hoarding of credits to get the 15 percent annual increase the bill denies the 15 percent increase for each year when they could use their credits but don't. This would be an effective deterrent against abuse that might otherwise occur. So, in general if sales and transfers of these annual loss tax credits are to be limited at all, then the proposed limitations would be a reasonable way to do it. Their major concern is that the 10-year shelf life for using the credit is unrealistically short. It is not the norm for a producer to go from lease sale to production in 10 years; 15 years is more in line with actual experience. Without this 15 percent annual increase in the unused credits, AOGA would oppose the ban on transferability, because it will destroy the incentives the credit is supposed to provide.

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MS. MORIARTY said AOGA supported the gross revenue exclusion (GRE), but was concerned it wouldn't apply to a majority of the current production. Fields likely to lose out on getting any GRE are Prudhoe Bay, Kuparuk, Lisburne, Milne Point, Endicott, Niakuk, Point McIntyre, Alpine, the Prudhoe Bay satellite fields and the Kuparuk satellite fields.

She referenced slide 6 from Econ One's presentation last week that showed economically recoverable oil and gas resources at \$90/bbl (which totals 29 billion barrels of oil and barrel equivalents of gas). Of this total the slide showed 10.4 billion in ANWR and NPRA, another 9.9 billion in the Chukchi Sea, 5.8 in the Beaufort Sea and 3 billion in the central North Slope. This means that more than half of the resource lies in the federal OCS outside Alaska's jurisdiction to tax. Current federal law does not allow for any OCS revenue sharing even though the congressional delegation is trying very hard to change that. So the only direct revenues the state would see from the OCS are

property taxes or for the instate portion of a pipeline to connect it to TAPS. Another 34 percent is in ANWR over which Congress gives approval for development and the Department of Interior could turn the NPRA into a bird sanctuary. So, of the 29 billion barrels on the slide, only 3 billion on the North Slope have the potential to contribute significantly to Alaska's wellbeing in the near and mid-term future. Of that, 2.5 billion comes from fields she didn't think would achieve the gross revenue exclusion.

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MS. MORIARTY said AOGA is continuing to search for ways to include the GRE with the legacy fields in a manner that would be acceptable to the state and the legislature. It may turn out that a different approach may be necessary to encourage new production from legacy fields. So for now all they can say is not enough is being done in the bill to improve the economic competitiveness of the legacy fields.

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MS. MORIARTY said there are some components not addressed in SB 21 that they believe would make a better tax policy. The first would be to repeal the minimum tax in AS 43.55.011(f) that targets North Slope production. That tax is based on the gross value of the production instead of the regular tax that is based on the net. The rationale for adopting it was to protect the state against low petroleum revenues when prices are low. The minimum tax only complicates potential new investors' analysis of what their tax would be if they were to invest here instead of someplace else. So consequently, it has probably driven investments away.

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Next she noted that the statute of limitations and statutory interest provisions are interrelating, but sometimes not in an obvious way. The statute of limitations under .075 is six years from the date when the tax return was filed for the tax being audited while the limitation period for other taxes is only three years. The statutory rate of interest under AS 43.05.225(1) for tax underpayments is 5 percentage points above the annual rate charged member banks for advances by the 12th Federal Reserve District as of the 1st day of that quarter or the annual rate of 11 percent. Because the Federal Reserve rate is very low, the 11 percent is the applicable rate. So, taxpayers are required to make monthly estimated tax payments for each calendar month's taxable production, but the final tax amount for the entire year is reported on March 31 of the

following year and it requires that any additional tax to be paid at that time. The statutory interest starts to accrue on any underpayment from that March 31 true up date. So, in practical terms there are two different formulas. The first one at three years is \$.38; the second one, the six-year statute of limitations increases that to \$.92. So, for each dollar of uncertainty there is about \$.38 of additional uncertainty due to the difference between the two. So, she said it is the combination of the six-year statute of limitations plus the interest rate of 11 percent that is harmful for a taxpayer and any would-be taxpayer.

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When speaking about uncertainty and audit assessments six years after filing the tax returns, she said many people think that oil companies could calculate their correct tax liability under the ACES tax, and she thought so, too, before she started working with AOGA's tax committee. But in reality, due to the complexity of ACES it is impossible to know beforehand what the department's calculation will turn out to be. They don't want a statutory fix to the regulations, but if the department chooses to defer making calculations and similar determinations that are necessary in order to be able to calculate the correct amount of tax, they would want to either shorten the period for making those determinations from six years back to three or eliminate the 11 percent minimum interest rate or both.

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MS. MORIARTY said joint interest billings is still a concern, because the DOR regulations reflect an assumption that each non-operating partner has information in addition to the operator's billings to them that allows them to determine which expenditures are deductible as allowed lease expenditures and which are not instead of starting with the joint interest billings that participants in a unit or other joint operations receive from the operator. This assumption is unrealistic. And even if there was some merit to it, the regulations ought to audit each participant separately regarding that participant's interpretation of which expenditures are deductible and which are not. They are not asking to put the regulations on a different track, but some in the department believe that the repeal of two sections, .165(c) and (d), in ACES specifically authorizes the department to rely on joint interest billings and means that the department can't legally rely on them now. AOGA disagrees with that position and it is at odds with what the department testified to in 2007, but they do think it would be

appropriate to restore language that allows the department to rely on joint interest billings if they choose to do so.

3:58:35 PM

SENATOR FRENCH said he was glad she ended with a production slide, because he was wondering if AOGA had an estimate of the number of additional barrels of production that would come on line should they embrace the changes to ACES in her presentation.

MS. MORIARY answered it's hard to predict what the additional barrels would be. If investors can make more money in Alaska they would want to invest more here, but she couldn't say what that would translate into in terms of barrels.

SENATOR BISHOP asked if all AOGA's member companies are represented on the tax committee.

MS. MORIARY answered yes.

4:00:16 PM

BILL ARMSTRONG, President and CEO, Armstrong Oil and Gas, Denver, Colorado, said their subsidiaries 70 and 148 LLC are in Alaska as well as in Cook Inlet. He supported SB 21 saying he still sees big potential in Alaska. He put a lot of time into a power point presentation and had some slides showing the inevitable day when TAPS becomes obsolete and Alaska's tax regime being sandwiched somewhere between Venezuela and Russia, but he had positive ones as well showing the North Sea resurgence in 1993 when the tax laws were reformed there (something that could happen to Alaska if it was done).

He had a map of the Permian Basin (located in Texas and New Mexico) in the 1950s (with about 5,500 wells) that would be very similar to the North Slope today, which would show about 5,000 wells. Well, today the Permian Basin has 150,000 wells and he sees big potential outside of the legacy fields on the North Slope to do lots and lots of drillings particularly with the new technology. He also had slides showing how the energy boom is happening in Lower 48 has totally resurrected production declines in North Dakota, New Mexico and Texas.

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But then he saw other industry presentations and decided he'd rather just come up here and talk about Alaska from the heart and what he sees: "I think what we really need is a lot more common sense."

MR. ARMSTRONG said he didn't do these kinds of presentations very often, so he wanted to open a dialogue with them to kick around ideas. First he wanted to give them a little background on his company. Armstrong is the most active and successful independent oil company in Alaska. Three of the most recent developments in Alaska - two on the North Slope and one in Cook Inlet - originated in his office. The Oooguruk field operated by Pioneer was generated and created by Armstrong before they went to Dallas, Texas, became Pioneer Natural Resources and came back up to Alaska. The same thing goes for the Nikiatchuq field that is operated by Eni; Armstrong originated the idea, did all the geophysical and engineering work, et cetera - and brought Eni up here. Most recently they brought in a different set of partners and are the recent developers of the North Fork Field, the sixth largest field in Cook Inlet.

MR. ARMSTRONG said they are the most active explorers on the North Slope today and are currently partnered with Repsol. They drilled \$200 million worth of wells last year and are drilling another \$200 million worth of wells this year. He thought Armstrong was the largest lease holder in the state on the North Slope outside of the legacy fields. He and his partners put "their own dough" on the table. He has one of the best oil finding companies in the country and they are "big-big believers" in what the state could be. Armstrong has found oil all over the world and had been successful all through the US; they are in the Bakken, Louisiana, the Rockies, Michigan, California and now in Alaska.

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He said their business model is pretty simple: they go to a play where they see big time potential, do all the geophysical and hard work - "really get our hands dirty with the data." Most of the time these are dead-end runs, but if they find something to worth pursuing they lease it try to make land trades and put it together; then they go out and look for partners. He said Alaska is "so wickedly expensive" that he has decided to defer his business model and look for bigger more capitalized companies he can talk into coming here and teaming up with him. So in a way he said he is a "walking talking Chamber of Commerce" for Alaska. He is a member of a group of oil and gas executives called "All American Wildcatters" and they derisively now call him the "new Mr. Alaska" after Robert Anderson of ARCO who had passed away. This group always asks him how much oil he has found and how much money he has made (because of the perceived difficulties up here): how can you possibly get into facilities

because the guy who controls them doesn't want you to plan up there, and even if you solve all the regulatory, permitting and headaches - not to mention the cold weather and remoteness - when you find something, the state takes a majority of the profits.

He said the Lower 48 boom is unprecedented. All other oil producing states were facing the same production decline curve as Alaska, and they have all reversed them by actively pursuing the new technologies that make heretofore non-commercial lousy fields commercial again, and he said, "that boom has completely, utterly totally skipped Alaska."

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MR. ARMSTRONG stated that a rig count is when a rig is actually running and drilling in a given region and as of three weeks ago Alaska had six. Rig counts have always been used as a "report card" of an area's health; right now Texas has 819 rigs running, North Dakota has 178, and Oklahoma has 190. "Alaska has six...it's pathetic!" He said, "running six rigs is so anemic! There is no way you are going to turn that curve around with six rigs running." That shows you exactly what industry thinks of Alaska and this body should ask why.

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CHAIR GIESSEL asked how he thought SB 21 will help that.

MR. ARMSTRONG said Alaska has to change the game, not just on tax reform, although that is "a massively great first start." But he explained when you get right down to it, oil and gas companies are not about finding and producing oil and gas; "they're about making money." And being sandwiched between Venezuela and Russia is not where they want to be. So, they are drilling in the Eagleford, the Bakken, in Oklahoma and the Great Wash. "That deafening silence you hear is the number of people that are up here."

MR. ARMSTRONG said there are certain things about Alaska that you can't change. It's cold, the weather sucks especially on the North Slope and it's remote. It will always be expensive, although not as expensive as it is now, and it will always take longer to do things because it is so remote. But the playing field could be a lot more attractive from a tax and a regulatory permitting standpoint.

[4:15:08 PM](#)

SENATOR MICCICHE asked if any states that were primary producers hadn't turned around their production.

MR. ARMSTRONG replied California was doing "a pretty bad job of it" and has the same environmental regulatory issues not to mention their "massive tax rates." New York, which is a very tiny producer, is still flat-lined because they don't allow this technology to be applied in their state.

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SENATOR BISHOP said he was "a breath of fresh air" and asked him to elaborate on the facilities access issue.

MR. ARMSTRONG said he supported SB 21 although it's not perfect. He thought the guys in the legacy fields needed a break, too. He wasn't saying that because they are buddies, in fact it's probably the opposite. His relationship with ConocoPhillips is a little bit like Ike and Tina Turner (he being Tina Turner). They don't make it easy.

[4:19:09 PM](#)

SENATOR DYSON noted that the decline curve was very steep long before the tax regime was changed. In fact it had the economic limit factor (ELF) which made the second largest oil field in North America - Kuparuk.

MR. ARMSTRONG responded that he came up because of ELF, but he wouldn't have come up under ACES.

SENATOR DYSON said his point was that the decline curve looked even steeper with ELF (that reduced taxes) than it does after ACES. He asked if he thought the decline curve would head up instead of down if the state did everything it could on permitting and change the tax regime to something more favorable to the explorers and the legacy fields.

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MR. ARMSTRONG responded that almost every state in the Lower 48 had a decline curve that looked like ours prior to 2009. A lot of it was because of low oil prices and those years were without the new technological advances in the last half dozen years. He said the big guys want them to believe that all the oil on the North Slope is in the legacy fields, but he disagreed. He thought instead of having isolated fields at Prudhoe Bay, Kuparuk and Alpine and a couple others, the North Slope could be one gigantic green blob of production. He explained that it is hard to find a well on the North Slope that was non-commercial

in 1985 when it was drilled that would not be commercial using today's new technology. He didn't know if you could get production up over 1 million barrels a day, but flattening it out and extending the life of that pipeline is a real possibility. There has been only one version of a modern frac/horizontal well on the North Slope in the Oooguruk Field so far, and it was a massive success. It's showing that the technology is going to work up here.

[4:23:19 PM](#)

SENATOR FAIRCLOUGH said she had heard that the legacy fields are the only ones that could create the quickest return on dollars as far as putting more oil in the pipe in the short term and asked how to get more holes in the ground.

MR. ARMSTRONG said he totally agreed with that and answered that Commissioner Sullivan was doing a pretty good job of streamlining the permitting and regulations, and that couldn't be done overnight. Making the tax laws positive for the guys outside of the big legacy fields was another piece. He said oil companies come up here for money; when the tax laws, the regulatory environment, and facilities access are better and you see the success of a Pioneer or his partnership with Repsol - people follow those successes. He didn't predict a thundering herd coming to the North Slope right away, but he thought it would be a lot better than six active rigs. There needs to be 65, 70 or 100 rigs up here to keep that decline curve flat. It's not that much when you think of other places that have three times that amount.

SENATOR FAIRCLOUGH asked if anything else specific was happening in other regimes that incentivize production.

MR. ARMSTRONG said he was okay with the state getting out of the way. A majority of these other states have a very low, simple tax structure typically on the gross and below 10 percent. He said Alaska has to be better than being competitive; there isn't a magic number; there is no sweet spot in terms of government take. You just need to find a way to get these people up here with tax credits, reasonably small takes, and royalty relief until you get your money back or corporate tax relief. He wasn't going to make any specific proposals other than the fact that the bill is at least a step in the right direction.

[4:27:56 PM](#)

SENATOR MICCICHE said he thought Mr. Armstrong was refreshing and he like the fact that he was a privately owned company and

hadn't gone through the school of "corporate speak." Mr. Armstrong had done some great things in this state and he wanted Alaska to be invited to the party. He asked how nimble the All American Wildcatters are and expressed the fear is that we make a change and put a lot of cupcakes out there and no one comes to the party. The people of Alaska worry about making that change without seeing any results.

MR. ARMSTRONG said there is no guarantee, "but if you ain't got nothing you got nothing to lose." They were talking about production that is not there now and outside of the existing units. If you lay out the cupcakes and no one comes - although he liked to think they would - you are no worse off. For instance, Prudhoe Bay was a Lisburne idea when they stumbled into the Sadle-Rochit; Kuparuk River Unit was a Lisburne idea when they stumbled into the Kuparuk sand; and Alpine Field was a Kuparuk idea when they stumbled into the Jurassic Alpine sand. "This is an absolute adage: if you're not pulling the trigger, you're not going to shoot anything." You need to get people looking up here to get lucky. He didn't think they would find another Prudhoe Bay or Kuparuk, but some Alpines are out there and that was pretty good; some low grade reservoirs are out there that have been drilled through in the past. We need to get those guys up here who know how to do these unconventional plays, like Armstrong, and give it a crack, "Because, it might really work fantastic." He related how he passed on Bakken fives times and it worked; Alaska has way better resources.

CHAIR GIESSEL thanked him for his thoughts and invited Mr. Foley from Pioneer Natural Resources to testify.

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PAT FOLEY, Manager, Land and External Affairs, Pioneer Natural Resources, Alaska, said he felt he had been following Bill Armstrong's footsteps since 2003. He said in May he would become the president of Pioneer, but he would try to not get bogged down in talking about Pioneer, because this was really about tax policy. So, he wanted to give them a little bit of insight about what goes through his [Pioneer's] mind when allocating capital and what would make investing in Alaska more attractive for them.

MR. FOLEY said Pioneer is a largish independent worth about \$19 billion (stocks, market capitalization plus debt); it has about 3,500 employees and a 2013 capital budget of about \$3 billion. They will make a little bit of money from Alaska but their core business is in Texas; they do business in Colorado and Kansas,

too. Pioneer is the first independent on the North Slope; they have 70 employees and everyone is an Alaskan. They have from 150 to 300 contractors working with them depending on what they are doing. In a normal year it's about 150, but last year they had a large exploration program and this year they have another appraisal program going on, so that number swells to almost 300. Pioneer makes about 6,000 barrels of oil a day at Oooguruk and they hope to see production rates increase there by 40 or 50 percent over the next year, because of some of the success Mr. Armstrong mentioned.

He said Pioneer came up to Alaska in 2002 when Mr. Armstrong encouraged them for a Kuparuk play. In getting to Kuparuk, they drilled through the Nuksut and realized that all the really good Nuksut was not on the leases they got from Bill but right next door on ConocoPhillips' land. So they made a deal with them and now their Oooguruk development is primarily based in Nuksut; they recently expanded into the Torok where they have a little bit of a Kuparuk play. The point was that "Bill" got them excited about a play; they came up looking for one thing and found something else. "It's that serendipity. You drill wells; you're exposed to upside and sometimes that upside works out for you."

He said Pioneer owns 70 percent of the Oooguruk Unit; their partner is Eni and together they have spent over \$1 billion in developing and producing 12 million-plus barrels; Pioneer has enjoyed the benefit of receiving \$270 million in credits from the state. They look at the state as their investment partner. Pioneer got about 7 percent of all the credits the state has given out so far.

MR. FOLEY said they came here during the ELF regime (for them that meant a zero tax rate) and honestly for the projects they thought they would become involved with they never thought they would pay a production tax. But the day after sanctioning their project, they got a call from Governor Murkowski who said there was going to be some tax changes, but they would be better off. They wondered how they could be better off than zero, but his proposal was for a 20 percent tax rate and for 20 percent credits and when they looked at the value of those credits upfront and paying some tax on the other end, he was right. Pioneer was actually marginally better off. But then things started to escalate; ACES came along and then progressivity. Since they made their commitment to develop their project, the fiscal environment has become poorer rather than more attractive and SB 21 provides an opportunity to turn that around.

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MR. FOLEY explained that the Oooguruk project is an island off shore drill site. He said their next project is called Nuna, an Inupiat word that means "on the land." From this onshore site they will laterally drill into the Torok Unit (offshore). They drilled one exploration well in phase 1 of Nuna and it was very successful; this winter they drilled a second appraisal well, which is just finishing up as he speaks. If that is successful, phase 2 will expand into the southern part of that unit. They are pumping very large mechanical diversion fracs (2 million pounds). While it's not big compared to some of the Lower 48 fracs, it's substantially bigger than what people have pumped up here before. So far everything looks really good.

If Nuna is successful, it's about 50 million barrels of oil and will cost another \$1 billion. They have actually acquired all the required permits from the North Slope Borough and have the permit they need from the Corps of Engineers, but he is still waiting for the state permit. He had been slugging away on it for two years now and had been working very diligently with the DNR. Oooguruk is about 14,000 barrels of oil a day, peak, and first oil is in 2015.

MR. FOLEY said for him to get the funding he will have to compete against a whole number of opportunities that Pioneer has in the Lower 48. When they first came up here, Alaska had a much greater attraction than the Lower 48, and it hasn't gotten any worse, but the Lower 48 resource potential is enormous, because of the explosion of shale plays.

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He said the key things that really help drive projects and help the economics is quick payback, quick cycle times (make investment today and start making oil soon), and operational flexibility. He explained what he meant saying their projects in the Lower 48 have "a gas pedal and a brake." They can react very quickly to changes in the economy - the oil price, activity and the success of their neighbors. It's a lot harder to do in Alaska where he has one rig for an offshore drill site that works 365 days a year that he can't shut down or send home. It doesn't have a brake or an accelerator.

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SENATOR DYSON asked what the state could do to ease the regulatory process.

MR. FOLEY replied that permitting just takes a long time in Alaska and he thought one of the problems was staffing in the department. The people are good, but there just aren't enough of them. He said Pioneer has \$3 billion to spend in 2013 and will probably spend it all in Texas.

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SENATOR MICCICHE asked him to define "operating margins" and tell them why the Lower 48 is superior.

MR. FOLEY replied that costs for the exact same services are substantially more in Alaska than they are in Texas or anywhere in the Lower 48. The exploration rigs don't get to work 365 days a year; they work in the winter. Companies have to capitalize the cost of that rig; it's just an expensive place to do business. It's not a complaint; it's a great place to do business, but it's hard and it's expensive.

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SENATOR MICCICHE asked if production taxes enter into the equation.

MR. FOLEY answered the production tax is just one part of the whole fiscal environment. The other side of government take is the industry take; the more the government gets the less he gets. In Alaska their industry take is less than many other places they do business. It's just a reality. Pioneer is also burdened by net profit share leases.

Pioneer will spend a total of \$3 billion next year, he said; \$2 billion of that will come from free operating cash flow and about \$600 million will from joint ventures (they have two large ones in Texas - Sinchem, a Chinese company, and Reliant). Their 2013 budget is based on \$85/bbl WTI price (which is equal to \$100/bbl for ANS) and \$3.25 gas.

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MR. FOLEY said revising the tax structure is a wonderful idea and that they support the governor's four key principles, but the bill as currently written doesn't achieve all of those principles. On the positive side, it eliminates progressivity and extends the small producer credit that Pioneer was involved in creating that helped little people come up here and establish a toe hold.

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On the negative side, it disadvantages small new projects and Pioneer will be worse off under the proposed tax change than they are under ACES, and the real reason is because they will lose all the QCE credits. They came to the state and invested \$1 billion and over \$100 million in the appraisal of Nuna, all with an expectation that they would be able to enjoy capital credits. Now they are concerned that may change.

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He presented slide 11 that ranked the players in Alaska by enterprise value: ExxonMobil at \$400 billion; Shell, Chevron and BP in the \$200 billion range; Eni, ConocoPhillips, Statoil, Anadarko, Repsol, Apache are in the \$50 billion range; Pioneer comes in at \$19 billion; then there is a bunch of other private players that had no publicly available data.

MR. FOLEY said because the cycle time takes 10 years in Alaska from first idea to the first barrel of oil, increased production will come from one of the players that are already doing business here and they need to incentivize every single one of them.

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What is an independent? Mr. Foley said an independent is a non-integrated oil company; it doesn't do marketing and refining. They are responsible for drilling 94 percent of all the wells in America.

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SENATOR MICCICHE asked if applying credits against production only was a disincentive in SB 21.

MR. FOLEY said he would come to that in a minute. The reason the independents aren't here is because of the cost structure, which is where Alaska falls to the bottom of the list in terms of CAPEX and OPEX. He explained that Pioneer looks at projects with CAPEX in the \$25-20/bbl range \$10-20/bbl for OPEX. However, he said they ran Econ One's slide of a typical project in Alaska that coincidentally was very similar to Nuna (\$1 billion project and 50 million bbl/oil) at \$100 WC discounting it 12 percent and found that a new project would be \$115 million better off under the new tax proposal than under ACES. But that is not how Pioneer sees the world at all. Econ One's work said you spend all your capital in the first three years, oil peaks and then you have relatively flat operating costs. But Pioneer sees very substantial capital expenditures for the first eight years and

oil ramping up so it peaks at year 8, and then operating costs climb for a time.

MR. FOLEY related that he provided all of this information back to Econ One, but they looked at it and delivered a different economic answer with that input. He ran that project through the model for three different players: a brand new entrant, a company like Pioneer and a bigger company, and without the capital expenditure credits the costs are 20 percent higher and the new entrant was disadvantaged by \$92 million under SB 21.

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SENATOR FAIRCLOUGH asked why their models were different from Econ One's (that used today's dollar not net present value (NPV)).

MR. FOLEY answered that Econ One showed both and admitted that although Pioneer discounts at 10 percent like most companies in the industry, he used 12 percent and if you ran this project at 10 percent, that \$92 million would be smaller. A small producer like Pioneer would be \$66 million worse off.

Why is this project better for Pioneer than for a new entrant? It's pretty simple. The new entrant doesn't get credits anymore; all he can do is offset tax through that loss carry forward. But he's not making any production, so he doesn't get that benefit until several years down the road. Pioneer, because it already has production, gets the benefit of the loss sooner, and that is why it is more attractive to them.

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They modeled a company with production of 10,000 bbl/day (twice as much as Pioneer) and escalated operating costs by 10 percent (not a legacy producer) to show a company that is already paying taxes and getting to enjoy the benefit of the loss immediately; they are only \$13 million worse off than under SB 21. He 12 percent NPV, but if you ran it at 10 percent, it would almost be a wash, which he thought was the administration's goal. They wanted to reduce the credits upfront in exchange for lowering the tax rate on the other end.

He summarized that everyone says a lot of money had been spent on credits and where did it all go? About 42 percent of those credits had been spent on drilling new wells and he could guarantee that every one of them delivered new oil.

SENATOR FRENCH remarked that this was the strongest presentation made today so far, particularly the close examination of Econ One's numbers versus someone who has a little more experience in the field in making projects come together. It's stunning to find out if they had not done their homework they would have passed a bill last year that would have impacted a small project like the one being discussed here by \$92 million for a new entrant or by \$66 million for a small producer.

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MR. FOLEY said people will ask what could be done to make the bill more helpful and it's really simple: lower the tax rate and keep the credits alive. The credits matter to a company like his, because they reduce the upfront capital needed for a project. He believed the administration tried to design a bill that would compensate by taking the credits away and allow the losses to escalate at 15 percent. But if you think in simple and discount it 10 or 12 percent, why is that not a wash? The answer is there are so many rules about how that escalation works: the first two years don't count, the year you use it doesn't count and if you didn't pay a tax because you're a small producer those dollars don't get to escalate. His point was that for a company like Pioneer and this project the value of that 15 percent escalation on the loss carry forward just doesn't compensate for the loss of the credits.

SENATOR BISHOP complimented him on his Alaska hire record.

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BART ARMFIELD, CEO, Brooks Range Petroleum Corporation, Anchorage, Alaska, supported SB 21. He said they would probably echo a lot of the same positions as the previous speakers, but he wanted to show it to them in a different manner.

The key elements in SB 21 for Brooks Petroleum were the capital credits under .023(a) and the ability to cash in certificates in a single year versus 50 percent one year and the other 50 percent in the second. The problem is that they only get to experience that for a single year, because they are eliminated December 31, 2013. To offset that, he suggested extending .023(a) or applying the credit policy in .023(1), Cook Inlet policy, to the North Slope. A .023(1) credit allows 40 percent for all intangible well work in the Cook Inlet. A third option would be to redefine the .025 exploration incentive credit.

MR. ARMFIELD said Brooks Range supported eliminating progressivity and maintaining the 25 percent base tax.

He said not being able to apply for the loss carry forward credits on a cash basis after December 31, 2013 was also a problem for a small independent, but the 15 percent was a benefit. He supported extending the small producer credit in .024(c) from 2016 to 2022.

He said while they support the GRE concept, the actual language says that it doesn't not contain lands that were in a unit on January 1, 2003 and the problem with that is that two of their near term development projects, Mustang and Tofkat, were actually in a unit in 2003 and wouldn't qualify.

He said the reasons they came to Alaska from the Lower 48 were the big reserves that are available. An acceptable cost of doing business in early 2000 was \$6 to \$8 million per well; today they cost \$20 to \$25 million per well. In 2000 the tax policy was not an impact consideration (under ELF); it was a tax structure used in other lower 48 properties, but it has changed twice and now they are considering another one.

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MR. ARMFIELD said they also envisioned a cyclical change in focus from the majors lessening their activity on the North Slope - much as occurred in the mid-continent, Rocky Mountains, Gulf of Mexico - and that they would move on and smaller independents would come in and pick up the slack as they existed the area.

When they came to Alaska the biggest draw was its world class reserve base. But those are being challenged by the high cost of oil, the new technology and unconventional plays taking place in the Lower 48. The perception of high taxes and changing the tax regime so frequently both make Alaska an unattractive place to invest in; you can't adhere to a 5-10 year business plan.

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Key elements people look at in coming to Alaska are:

- they must have the desire to really be in Alaska
- they need to understand the business from a geological setting to permitting, to lease administration, to Native relations to politics
- the must have the financial capacity to fully execute a program

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Brooks Petroleum currently uses the QCE (.023(a) credit, but it would like to get out of the loss carry forward credit, because

that means they are still losing money in Alaska. They like small producer credit and would like it extended to 2022.

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MR. ARMFIELD said in the groups he speaks with everyone feels Brooks Petroleum receives the .025 exploration credits, but they never have. Even though they are an exploration company, none of their leases come even close to being able to qualify, because of having to be three-miles outside around any existing well and 25-miles from producing units in order to qualify for it.

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He said Brooks' was the only exploration company drilling in Alaska in 2011 and of the \$1 billion in credits the state had paid out they had received \$69 million, \$7 million of which came to them in 2011. He compared the impacts of ACES and SB 21 to their Mustang development. Brooks Petroleum would have received \$205 million under ACES for the Mustang development and the full field development associated with that would generate \$1.2 billion in royalty, tax burden and progressivity to the state. Conversely, under SB 21 using the same numbers and applying the same strategy, but receiving no credit support in 2014/15/16, that \$205 million credit investment by the state was reduced to \$81.5 million. That would require this project to support an additional \$124 million worth of capital infusion that was not planned for under the ACES program.

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The peak throughput of their five near term projects, Mustang through the Badami Expansion, was 55,000 bbl/day. That \$561 million in credit support would throw off \$4.4 billion in revenues to the state at an average \$300 million per year. He asked them to imagine replicating what Brooks Range is doing with 10 other companies.

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SENATOR FRENCH asked if the loss of the credits threaten his five listed projects.

MR. ARMFIELD answered yes, not so much in terms of never getting done; someone would do them, but the pace would be much slower.

CHAIR GIESSEL asked how his loan with the Alaska Industrial Development and Export Authority (AIDEA) was affecting him.

MR. ARMFIELD replied that the AIDEA loan is strictly a financial arrangement consisting of principle, interest and a defined

term. That was in the Brooks Range portion and didn't get credit support.

CHAIR GIESSEL asked if that was moving his project forward.

MR. ARMFIELD answered yes; ADIEA provided the best financial option at the time for the Mustang development.

SENATOR MICCICHE asked the expected dates of first oil for those five projects.

MR. ARMFIELD replied Mustang was planned to come on Q3 2014, Appaloosa was planned for 2016/17, Tofkat was planned for mid-2016, Beechey Point was planned for mid/late 2015, and Badami - since it was close to underutilized facility infrastructure and pipeline and they have the ability to drill from existing gravel and infrastructure - was soonest at Q3/4, 2014.

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MR. ARMFIELD said all of their leases are burdened with a one-sixth royalty position, which would generate \$2.1 billion for the state. Other leases are a one-eighth royalty position, which generates \$1.6 billion. That means they are already paying \$542 million more than other companies and compounded with the anticipated elimination of \$561 million in capital credits that means this project is impacted to the tune of \$1.1 billion. He urged a minor change in SB 21 that could have a dramatic effect on their business: retain the capital and loss carry forward credits that could generate a return of \$3 billion a year to the state.

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KEN THOMPSON, Co-Owner, Alaska Venture Capital Group (AVCG), parent company for Brooks Range Petroleum, said he supported SB 21 with some changes. He was a former president of Arco Alaska and had served on the Board of Directors of Pioneer Natural Resources. He said AVCG invests only on the North Slope; they don't have any oil production currently, but they do have 105,000 acres in three core areas and a joint venture (JV) partnership with Ramshorn Exploration, an affiliate of Neighbor's Industries. To date they have invested just under \$200 million.

In 2004, AVCG formed an operating subsidiary, Brooks Range Petroleum Corporation, and since that time they have had six discoveries and acquired three discoveries that were drilled by other companies in the 70s and 80s that they think are now

commercial. They have four development oil projects on the North Slope in permitting and conceptual engineering, the most important being the 44 million/bbl Mustang Field, their anchor development. A lot of their leases are in unitized blocks; they have 570 sq. mi. of modern 3D seismic, one of the largest holdings of modern 3D seismic on the North Slope.

He said that AVCG and Ramshorn had drilled more exploration wells on the North Slope than any other company in the last six years. Literally almost one-third of all the exploration activity on the North Slope state lands has been done by their company. In the last two years Repsol has exceed their number. Their first production cash flow will be in Q3 2014. Their four development units will be coming on from 2014 through 2016 and have 770 barrels of recoverable oil.

SENATOR GIESSEL asked if he liked SB 21 or continuing ACES.

MR. THOMPSON said he'd choose SB 21. He added that the production profile of over 50,000 barrels/day could stop the decline on the North Slope if one or two more independents like his could continue to explore.

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SENATOR GIESSEL thanked Mr. Armfield and Mr. Thompson for providing their testimony and recognized Mr. Brad Keithley.

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BRAD KEITHLEY, Partner and Co-Head, Oil and Gas Practice, Perkins Coie, LLP, said the five key things to look at in redoing the oil tax structure to increase oil production over the remaining life of Alaska's resources are competitive rates, durability, neutrality, simplicity/predictability and alignment.

The goal is to grow the pie. The objective any oil reform needs to have is to increase production over the remaining life of Alaska's resources. Alaska needs an additional recovery of 7.5 billion barrels or 4 billion barrels beyond just staying on the status quo. To put that in context, Prudhoe Bay has 25 billion barrels of oil in place.

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MR. KEITHLY said the level of investment needed to maintain the status quo in 2006 dollars was roughly \$1 to \$1.5 billion and double that is needed to get to the 3 percent decline range, so they should look at what would get that additional investment up here.

The first key thing to look at is having competitive rates over a full spectrum of prices and for a long period of time (10-20 years) so companies can test economics against prices they anticipate occurring during that entire period.

Since PFC said in the medium to long term the floor price is roughly \$70 a barrel, SB 21 needs to be evaluated using that price perspective. However, he pointed out that taxes ACES, according to Econ One, are actually lower than SB 21 at that price level and that it's important to make sure they don't replicate the current problem going forward. The problem with ACES right now is that it is uncompetitive at high prices and we don't want to enact a statute that would make us uncompetitive at low prices.

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The second key factor was durability. Investors are looking out 10-25 years and whether the tax structure will remain durable over the entire term of the investment.

SENATOR DYSON asked what his statement "no durability mechanisms included not established by contract or economic stabilization clause" meant.

MR. KEITHLEY explained in many jurisdictions throughout the world, when the fiscal regime is settled with the investor it is settled by contract. In third world companies a lot of times that is backed up by World Bank agreements that enable arbitration and other protections if the fiscal contract changes. That gives the investor fiscal certainty over the term. Another way to do that is through an "economic stabilization clause" which essentially says if the taxes are raised in one area we'll lower government take in another area so that the level of take across the years is held the same. That is done in countries that have other industries and may raise the corporate income tax or do other things.

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SENATOR DYSON said that would be very difficult to do in Alaska given its constitution that says you can't bind a future legislature. He asked if he had any ideas for a solution.

MR. KEITHLEY said yes, and they would take more time to explain than the committee had now, but he did think that Alaska had the capability of entering into some sort of economic stabilization clause with producers or entering into contracts with producers

through the use of the royalty provisions. SB 21 doesn't do it, but that's okay if they expect the tax structure to stay the same through the life of the investment.

MR. KEITHLEY said according to a news article that the BC prime minister was trying to solve the same problem basically - raising taxes on LNG - by negotiating with the industry and arriving at a common agreement about what the levels of take would be.

He said another way of achieving durability is to just assume the fiscal structure will remain durable throughout the life of a project. To some degree that is what Alaska relied on and people had been testifying that they had invested based on the tax structure remaining in place. But since the early 2000s Alaska has changed its tax structure periodically (for various reasons) in a way that has fostered the perception that it will not remain durable.

MR. KEITHLEY said the Institute for Social and Economic Research (ISER) indicated that Alaska's fiscal policy had a gap in it, right in the middle of the time when investors are going to expect to be getting the revenues that they predicated their investments on. And whether it's correct or not, they will have the perception that when that fiscal gap shows up, the state will change its tax policy again and the economics that they had predicated their investments on are going to be undermined. So Alaska has to set up a situation that has no durability and SB 21 doesn't have it either. In addition, there are no negotiations going on with producers that would lead to durability. The consequence of that is that investors will look at the short term for investments and SB 21 may lead to those, but it will not lead to the type of long term investments that are needed in order to level the decline curve.

Durability is perhaps the most significant issue that SB 21 faces Mr. Keithley stated, and it's unlikely that a legislature would feel comfortable including durability provisions in the statute. He emphasized:

A necessary part of this process is not only to fix the oil tax, but we have to fix our fiscal policy. If we don't fix our fiscal policy we're leaving investors with the impression that okay we've got it done for the short term, so you can make your short term investments now. Those will pay out. But we don't have a long term solution in place and you need to be

concerned about what's going to happen about half-way through your investment cycle.

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MR. KEITHLEY said the third criterion was neutrality, which means the extent to which government is out of the way in trying to direct investments. ACES provided incentives to certain types of investments and "penalized" other types of investments by charging them a higher rate in order to provide the subsidies to the favored investments, which dis-incentivized investments in the existing fields and maybe over-incentivized investments in exploration areas. A good tax structure is neutral across all investment opportunities and doesn't try to second guess the market.

He said SB 21 does a good job of increasing neutrality, but it doesn't go all the way there. Testimony about legacy fields revealed that Alaska has had a history of finding ways to increase ultimate recovery inside of existing fields. When production first started at Prudhoe Bay the recovery rate of the 25 billion barrels was expected to reach 40 percent, and today using new technologies that has increased to more than 60 percent. It's important to remember that each 1 percent improvement in Prudhoe's recovery rate equals an additional 250 million barrels of ultimate recovery, the equivalent of discovering another 250 million-barrel field.

For context he showed an Econ One slide showing the expected field size on the North Slope was 32-54 million barrels. So, improving the recovery rate in Prudhoe Bay by 1 percent you get 250 million barrels. It's important to recognize that improving the recovery rate plays an important role in improving production, but SB 21 doesn't deal with that. It gives GREs to new fields outside existing units and to new PAs inside existing units, but continues to in some sense penalize the production for existing fields. So, it's important to find a way to provide neutrality.

SENATOR MICCICHE said the state has 3 billion barrels of oil economically recoverable on the North Slope at \$90/bbl (under ACES) and asked if the curve changes under SB 21 especially at \$110/barrel.

MR. KEITHLEY said that was a question for Econ One to answer, and he was using their slide to demonstrate the size of the fields people expect going forward and comparing those to the improving recovery rates.

SENATOR MICCICHE added that the 1 percent should incrementally improve as the cost to produce comes down or the profit increases.

MR. KEITHLEY said the 1 percent in Prudhoe Bay will always be 250 million barrels, because the oil in place is 25 billion barrels - the math is always the same - so the economics of making the investment necessary to achieve the 1 percent will improve or be penalized if the GRE isn't extended there. SB 21 does not provide a level playing field for those investments, because they are inside existing fields.

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SB 21 does a good job in the area of another key criterion, simplicity/predictability. It doesn't have a lot of room for interpretation or have a lot of recalculations and or require a lot of regulations.

His final category was aligning the state with producers in growing the pie. A lot of conversations right now are interpreted by investors as arguing about who gets what share of the existing pie, not about growing it. SB 21 doesn't change that. Before SB 21, Alaska relied on indirect policy tools, trying the carrot approach of creating fiscal incentives and the stick approach of creating regulatory action at Pt. Thomson, but the state hasn't aligned with investors in trying to grow the pie. It has essentially tried to drive the industry from the backseat. He sincerely believed the state needed to adopt the mindset of an investor in putting its money and effort into things that produce the greatest returns. When you look around the world, the most successful model is in Norway that has created a co-investment vehicle that partners with industry in identifying new opportunities.

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In summary he said that SB 21 is better than ACES but material concerns remain. SB 21 is not competitive at a full range of anticipated prices for long term investments and unlike horseshoes being close isn't good enough. Durability is a huge significant issue - he went so far as to say that to some degree messing with the oil tax structure is sort of like playing with deck chairs on the Titanic. Investors won't make the long-term investment Alaska needs without a fiscal policy that demonstrates to them that it's not likely to change in the middle of their investment cycle. Neutrality is significantly better with expanding the GREs to new participating areas in SB

21, but bias remains against important investment opportunities. Increasing the ultimate recovery rate in existing fields has always been a way that Alaska has benefited in terms of increased production and recovery and this needs to remain on the playing field if we are going to fix the decline problem. SB 21 doesn't gain any on the alignment issue - we're sort of stuck in the same rut we have been in.

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MR. KEITHLEY had three recommendations: adopt SB 21 with amendments, make the tax structure competitive across all anticipated prices not just the high end and avoid a tax increase at the lower end, provide GRE or similar incentives for investments designed to increase ultimate recovery in existing fields (don't penalize them). And while it is beyond the purview of this committee, the Finance committee must identify and deal with the fiscal policy concerns the state faces - if we're going to have long term investment.

There are long term fixes on the table: the ISER study does an excellent job of talking about developing a sustainable budget and the Finance Committee should take it up as part of this issue. Finally, he recommended holding hearings on Norway's co-investment model, because the state needs a game changer in terms of aligning the state's interests with industry. DNR Commissioner Sullivan said Alaska needs \$4 billion more per year in order to achieve an oil economy it wants to have. He reminded them that Norway's permanent fund concept came from them looking at Alaska, so we can learn things from other countries and regimes, too. The second largest oil discovery in the world was led by science in the North Sea last year when Petoro identified opportunities that other companies had overlooked. There are benefits from the state contributing to the effort to try to develop its resources and it's important to hold hearings on those and take advantage of those opportunities.

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SENATOR GIESSEL thanked Mr. Keithley.

[6:08:46 PM](#)

At ease from 6:08 to 6:10 p.m.

[6:10:11 PM](#)

SENATOR GIESSEL reconvened the hearing at 6:10 p.m. and invited Mr. Corbus to testify.

BILL CORBUS, member, Make Alaska Competitive (MAC) Coalition, Juneau, Alaska, said he was a former commissioner of Revenue during 2003 to 2006 and supported SB 21. He participated in the ELF aggregation formulation of the PPT and watched with dismay as ACES was passed. He supported particularly the removal of the extreme progressivity tax increase at high oil prices, the gross revenue exclusion and modifying the tax credit system that will result in credits being granted when production begins. He said something is urgently needed to increase investment on the North Slope and to turn around the declining oil production. If they modify SB 21 he urged adopting a severance tax system that is competitive at a range of oil prices with similar provinces such as the Gulf of Mexico, Texas, North Dakota or Alberta.

SENATOR GIESSEL thanked him for his service to the state and his testimony.

[6:13:02 PM](#)

DAVID TRANTHAM, representing himself, Bethel, Alaska, testified in opposition to SB 21 in its current form. He said the governor supports a tax that is fair, but this bill would not be fair to small operators and independents on the North Slope, particularly regarding eliminating a contribution to revenue sharing on page 2, line 2. Small operators and independents will help the state get back to 1 million barrels a day in the pipeline much faster than the large operators.

SENATOR FAIRCLOUGH responded that the governor was not proposing to eliminate the contribution to revenue sharing (which remains whole), but proposing to fund it using corporate income tax, because he is eliminating progressivity.

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NOEL WOODS, representing himself, Palmer, Alaska, said he appreciated previous testimony on SB 21. He said there is so much opposition to developing the state's resources and the permitting process takes so long. When you're trying to do a project, time really is money.

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LANCE ROBERTS, representing himself, Fairbanks, Alaska, supported them doing some measure of oil tax reform and supported the governor's third point of simplifying the tax structure and eliminating progressivity or going to a smaller number of brackets. He supported moving SB 21 forward.

KEN HALL, representing himself, Fairbanks, Alaska, said he supported the "sentimental concepts of fair to Alaskans" embodied in SB 21. And it must be fair not only to those who are still coming into the workforce, but those in the future, too. New production is needed here; other regions had either increased production or stymied the decline. He said SB 21 needs to have incentives for companies to develop the legacy fields, because realistically that is where the oil is. The state needs to be competitive and have a durable tax policy. Writing a C-grade paper in this circumstance will not provide the necessary incentives to increase production and just tweaking it won't do.

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MAYNARD TAPP, representing himself, Anchorage, Alaska, testified in support of the concept of SB 21. He encouraged them to simplify the tax, get competitive, stop the decline curve, and make a plan that is longer than for two years.

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STEVE PRATT, Executive Director, Consumer Energy Alliance Alaska, Anchorage, Alaska, said there are several reasons to change the tax regime in Alaska. Consumers have a direct interest in consuming competitively priced energy supply from domestic sources and also have a direct interest in robust overall economic activity to maintain livelihoods. According to ISER, at least 30 percent of Alaskans are dependent on oil and gas exploration and development for employment. Development of Alaska's abundant resources is vital to the energy security of the entire nation as well as the state. Alaska needs to be able to compete for global investment dollars. The current progressivity is a disincentive, because at the current high prices other states' production is going up, but not in Alaska.

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RICK ROGERS, Executive Director, Resource Development Council (RDC), Anchorage, Alaska, said they could support the governor's four guiding principles but the real giveaway is the oil that's locked in the ground, because we're looking at maximizing short term tax revenue at the expense of encouraging investment and production for the long term. If a less aggressive tax regime could cut the decline rate by half, over \$8 billion new dollars would be circulating in Alaska's economy. He said the business community is fearful of what continued TAPS throughput decline will do to the state's economy as a whole. He quoted Lynden Johnson who said, "The most dangerous thing you can do to any businessman in America is keep him in doubt and keep him guessing on what our tax policy is;" and Calvin Coolidge who

said, "The method of raising revenue ought not impede the transaction of business; it ought to encourage it."

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LAURIE FAGNANI, MSI Communications, Anchorage, Alaska, testified that SB 21 is a step in the right direction. More than 50 percent of their revenues come from oil and gas industry and the decisions made today impact her company and the people who work there. Every day she worries about being competitive in her industry; if the answer is no, then she changes her strategy. She maneuvers to a better position, because if they can get it cheaper someplace else, they will. That's how the market place works.

ALLISON GRIFFITH, representing herself, Anchorage, Alaska, said she was advocating for oil tax reform in whatever form it takes. She had lived here all her life and worked for an Alaska owned company since 1978, virtually her whole career. She spoke for a lot of people who had also invested their lives here.

[6:36:37 PM](#)

SCOTT HAWKINS, Advanced Chain Supply International, Anchorage, Alaska, supported the governor's four principles and SB 21. His was an oil and gas services company employing about 230 Alaskans in direct support of the industry in Alaska. He said Alaska had been missing out on a worldwide boom for all the reasons pointed out by previous speakers. He concurred with Mr. Keithley's comments about achieving alignment with the producers and having a stable durable tax policy.

[6:39:23 PM](#)

MICHAEL JESPERSON, representing himself, Anchorage, Alaska, said SB 21 is better than the alternatives, although it could be improved in terms of durability. But it needs to get passed so we can start getting some investments.

[6:40:43 PM](#)

ANDY ROGERS representing himself, Palmer, Alaska, testified in support of oil tax reform and SB 21 in particular.

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JOHN STURGEON, Concord Forest Products, Anchorage, Alaska, supported SB 21. He manages one of the few timber operations left in Alaska. If he operated under the same progressivity as the oil companies he would have been out of business many years ago. If they want Alaska's economy to thrive, they must provide

the incentives to encourage people in Alaska to invest and the current oil tax structure is a disincentive.

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GAIL PHILLIPS, representing herself, Anchorage, Alaska, said she supported the work the committee had done to find a reasonable and long term solution to the oil tax conflict. She was a former member of the legislature and congratulated them on their great stamina and said it's up to them to make Alaska competitive again with a durable and simple tax policy.

[6:45:31 PM](#)

RENEE SCHOFIELD, representing herself, Ketchikan, Alaska, testified in support of SB 21. She urged the committee to pass tax reform that was fair and durable and to do it this session. She said they really want family to be able to stay, live and work in Alaska. Her business is not in the oil industry, but everything is impacted by their decisions.

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TOM LAKOSH, representing himself, Anchorage, Alaska, asked the committee to honor its oath of office to evaluate the long term benefits to Alaskans from development of its resources. He said the benefit of the different tax regimes to Alaskans hadn't been sufficiently or competently analyzed. He said there may be some merit in looking at the Norway model. The committee should also commission further analysis that is consistent with their mandate to get the maximum benefit of the resource here for the long term.

[6:51:05 PM](#)

MERRICK PEIRCE, representing himself, North Pole, Alaska, opposed SB 21 asking how often legislators questioned the reckless policy of having only one source of revenue. He had worked with Governor Palin and DOR Commissioner Bryan Butcher doing transition work in 2006 with a significant emphasis on getting a fair return for our oil. SB 21 is supposed to accomplish more TAPS throughput, but that hypothesis has been thoroughly refuted by Bill Wielechowski. Even if we had more throughput there is no guarantee that the price of oil will not be \$40 next year and then Alaska will have massive deficits.

He said to ask themselves what they could do with the \$1 to \$2 billion per year that SB 21 would cost us if the money is used to find new alternative revenue sources. SB 21 offers zero guarantee of any return on investment and there is clear evidence that ramping up production and over-supply of the ANS

market drives down profits. Smart producers will take that money and invest it outside of Alaska. The Asian market is very interested in Alaska LNG and we have trillions of dollars of gas under the North Slope that is not being monetized, because we refuse to invest billions of dollars to build the infrastructure to get the gas to market. Alaska has keen competition from 19 LNG projects in North America alone.

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KIMBERLY METCALFE, representing herself, Juneau, Alaska, testified in opposition to SB 21. She said ACES was a very reasoned approach and she was against giving back to an industry that makes millions in profits from Alaska's oil and we need it so much. In 2007 the legislature made a conscious choice to save for the future that produced budget surpluses and allowed the state to save billions of dollars in the budget reserve. Through strategic tax incentives it also attracted new oil explorers here. Today we have more jobs in the oil industry, more capital investment in the oil and more new exploratory wells than when ACES passed. This is major progress. The decline in oil flowing through the pipeline has continued due to maturation of the Kuparuk and Prudhoe Bay fields.

She said the governor's tax giveaway would create ongoing budget deficits and cripple the state's competitiveness; this year the Anchorage and Juneau school districts announced hundreds of layoffs and are looking at the loss of more. Alaska cannot cut oil taxes and still have a viable education system.

KELLY WALTERS, representing himself, Anchorage, Alaska, testified in opposition to SB 21. He said the evidence is pretty clear that taxes are not related to throughput in the pipeline. We have 30 years of low tax policies and yet the pipeline's throughput has declined. There are a lot of other problems and issues around throughput, but taxes isn't one of them. Prior to 2006, 15 of 19 fields on the North Slope had zero taxes, and the state's own data shows that investment still declined.

[7:01:44 PM](#)

JERRY AHWINONA, representing himself, Anchorage, Alaska, testified in opposition to SB 21. He had lived in Alaska all his life. He thought the current law was working. Alaska has the biggest bank account of any state in the nation and due to ACES a lot of people are coming up who want our natural gas. Russia just took a stake in our Pt. Thomson development. So, we have a lot potential to keep a lot of our future intact.

7:03:18 PM

KATE VAY, representing herself, Soldotna, Alaska, testified in opposition to SB 21. Keep ACES intact she said, because it works great! Don't give the state's resources away. How will the money be replaced? She pointed out that Alaska is a safe place to extract oil; we don't have terrorism, wars or an unstable political regime.

CHAIR GIESSEL thanked everyone for their testimony and held SB 21 in committee.

7:04:50 PM

Finding no further business to come before the Senate Resources Standing Committee, Chair Giessel adjourned the meeting at 7:04 p.m.