

**ALASKA STATE LEGISLATURE**  
**SENATE SPECIAL COMMITTEE ON TAPS THROUGHPUT**

February 7, 2013

3:36 p.m.

**MEMBERS PRESENT**

Senator Mike Dunleavy, Co-Chair  
Senator Peter Micciche, Co-Chair  
Senator Anna Fairclough  
Senator Lesil McGuire  
Senator Berta Gardner

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Senator Cathy Giessel  
Senator Hollis French

**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."

- MOVED SB 21 OUT OF COMMITTEE

**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)

**WITNESS REGISTER**

MICHAEL PAWLOWSKI, Special Assistant  
Oil and Gas Project Manager  
Department of Revenue  
Anchorage, Alaska

**POSITION STATEMENT:** Responded to questions on SB 21.

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

**POSITION STATEMENT:** Responded to questions on SB 21.

**ACTION NARRATIVE**

[3:36:57 PM](#)

**CO-CHAIR PETER MICCICHE** called the Senate Special Committee on TAPS Throughput meeting to order at 3:36 p.m. Present at the call to order were Senators Gardner, Fairclough, McGuire, Co-Chair Dunleavy, and Co-Chair Micciche.

He noted the presence of Senator Giessel and Senator French.

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

[3:37:10 PM](#)

CO-CHAIR MICCICHE announced that the purpose of the meeting was to offer a letter of intent to SB 21, version A, and to discuss SB 21 further. He reminded the committee that amendments should be specific to TAPS throughput.

SENATOR GARDNER moved to adopt Amendment 1, labeled 28-GS1647\A.1:

**AMENDMENT 1**

Page 9, line 30, through page 11, line 3:  
Delete all material.

Re-number the following bill sections accordingly.

Page 11, line 29, through page 12, line 17:  
Delete all material.

Re-number the following bill sections accordingly.

Page 13, line 15, through page 16, line 25:  
Delete all material.

Re-number the following bill sections accordingly.

Page 18, line 14, through page 19, line 4:  
Delete all material.

Re-number the following bill sections accordingly.

Page 23, line 15:  
Delete "Sections 2, 5, 6, 22 - 24, and 26"  
Insert "Sections 2, 5, 6, 16 - 18, and 20"

Page 23, line 17:  
Delete "Sections 3 and 21"  
Insert "Sections 3 and 15 of this Act"

Page 23, line 18:  
Delete "Sections 7, 11, 13, 14, and 25"  
Insert "Section 7 - 10 and 19"

Page 23, lines 20 - 21:  
Delete all material.

Page 23, line 24:

Delete "Sections 3, 7, 11, 13, 14, 17, 21, and 25"

Insert "Sections 3, 7 - 10, 12, 15, and 19"

Page 23, line 31:

Delete "Sections 1, 2, 5, 6, 9, 10, 12, 15, 20, 22 - 24, and 26"

Insert "Sections 1, 2, 5, 6, 16 - 18, and 20"

Page 24, line 2:

Delete "sec. 30"

Insert "sec. 24"

SENATOR FAIRCLOUGH objected for discussion purposes.

SENATOR GARDNER stated that she understood it was Chair Micciche's desire to move the Letter of Intent, in which many of her concerns are addressed. However, she opined that it was important to discuss the bill as a committee and to talk specifically, on the record, about areas of improvement.

CO-CHAIR MICCICHE asked Senator Gardner if she would like to speak to her amendment.

SENATOR GARDNER explained the purpose of Amendment 1. She said the intent of existing credits under ACES is to boost production, create jobs and help fill the pipeline by rewarding investment. She related that the Governor's proposal removes that incentive, paving the way for investment elsewhere. It rolls back taxes enabling profits to be spent as companies wish.

SENATOR GARDNER reported that she received a response to questions she sent to the Department of Revenue that would further explain her reasoning. She said the progressive net profits tax encourages reinvestment. She concluded that eliminating progressivity and the 20 percent capital credit creates a "double whammy" and is a mistake.

SENATOR GARDNER explained that she is trying to show how capital credits incentivize capital investment in Alaska. She stressed that tax credits are an important part of the tax system.

[3:42:14 PM](#)

MICHAEL PAWLOWSKI, Special Assistant, Oil and Gas Project Manager, Department of Revenue, explained how the capital credits act in SB 21. He said the Governor's bill is built around four core principles. The capital credits, which are

proposed to be eliminated in the bill, are being done to balance the exposure the state has through several systems of growth. Under low price environments, as prices drop, the revenues the state receives go down. At the same time, the level of credit exposure is based purely on the capital spending of the company. The balance between those two falls out of balance to the state.

He said the best example of how that works is found on page 3 of the fiscal note, looking at the relationship between the revenues that come in and the credits that come out. Line 1 shows that revenue impacts of the elimination of the production tax is subsequently balanced by the limitation of the credits for qualified capital expenditures. The qualified capital expenditures credit is purely based on capital spending. In that process there is no ability to tie it directly to new production.

SENATOR FAIRCLOUGH stated that Amendment 1 is a complicated amendment and a complicated conversation about progressivity and the interaction between the credits proposed in SB 21. She pointed out that she is very interested in what happens at the intersection between realigning the credit structure and progressivity. She said it remains a consideration. She said she cannot determine how the amendment affects that consideration so she will vote against the amendment.

[3:45:44 PM](#)

CO-CHAIR MICCICHE believed that Amendment 1 was specifically credit related and another proposed amendment was about progressivity.

SENATOR GARDNER explained that Amendment 1 seeks to eliminate the portions of SB 21 that delete capital credits.

CO-CHAIR MICCICHE noted that the letter of intent requests that the next committee "Evaluate specific production-related credits allowed under ACES for inclusion in SB 21 as a direct incentive for costs that deliver production. Require that credits are charged against actual production to eliminate currently-existing negative revenue liability to the state."

MR. PAWLOWSKI pointed out that the Governor's bill seeks to eliminate the qualified capital expenditure credit, but maintain the 25 percent loss carry forward credit. However, the treatment of the loss carry forward credit is changed so that the credit is truly taken against production revenues. He said that Amendment 1, page 2 lines 17 - 19 - the treatment of Section 23

- would upend that relationship of tying the credits to when there is tax revenue to pay for them.

CO-CHAIR MICCICHE commented that there are members that share an interest in investigating the carry forward credits. He believed that would occur in the Senate Resources Committee.

SENATOR FAIRCLOUGH maintained her objection.

A roll call vote was taken. Senator Gardner voted in favor of the motion to adopt Amendment 1 and Senators Fairclough, McGuire, Dunleavy, and Micciche voted against it. Therefore, Amendment 1 failed by a 1:4 vote.

[3:48:41 PM](#)

SENATOR GARDNER moved to adopt Amendment 2, labeled 28-GS1647\A.4:

#### **AMENDMENT 2**

Page 23, line 3, following "section,":

Insert "for the first seven years immediately following the commencement of production subject to tax under AS 43.55.011(e),"

SENATOR FAIRCLOUGH objected for discussion purposes.

SENATOR GARDNER explained that she supports having a lower tax rate to encourage new production and to help smaller companies "get off the ground." She did not think the provision needed to pertain to the entire lifetime of a field, just long enough to enable companies to recover their investments. She proposed a seven-year timeline for the 20 percent exclusion.

MR. PAWLOWSKI said the evolution of the provision is a good indication of the joint work between the Department of Natural Resources and the Department of Revenue. He requested Mr. Balash address the reason for the long duration of the 20 percent exclusion.

[3:49:41 PM](#)

JOE BALASH, Deputy Commissioner, Office of the Commissioner, Department of Natural Resources, commented on the rates of production in specific fields and the pace of development. He said for a new field like Ooguruk or Nikaitchuq, there is a small initial amount of production in the first year, followed

by an increase as more wells are brought into production over the course of years. He suggested that limiting the time to seven years would cut off the impact and value of the GRE too early in the life of some of those wells. He said DNR looked at life cycle economics and long-term incentives and the tradeoffs between tax credits, tax rates, and the GRE. They came to the conclusion that there is so much variability in the way fields are developed, that having an artificial cut off for the GRE would affect decision making in a negative way.

SENATOR FAIRCLOUGH asked why seven years was selected.

SENATOR GARDNER said it was modeled after the Middle Earth provision of seven years.

CO-CHAIR MICCICHE pointed that every member of the committee is representing Alaskans. He noted that the recommendation in Amendment 2 is referred to in the Letter of Intent for consideration in Senate Resources. It says, "Evaluate a time limit into the future for the 20 percent Gross Revenue Exclusion." He said that the committee did not state a specific time limit, but requests that it is considered with the best number possible.

[3:52:52 PM](#)

SENATOR FAIRCLOUGH maintained her objection.

A roll call vote was taken. Senator Gardner voted in favor of Amendment 2 and Senators Fairclough, McGuire, Dunleavy, and Micciche voted against it. Therefore, Amendment 2 failed by a 1:4 vote.

[3:53:25 PM](#)

SENATOR GARDNER moved to adopt Amendment 3, labeled 28-GS1647\A.5:

### **AMENDMENT 3**

Page 10, line 19, through page 11, line 3:  
Delete all material.

Renumber the following bill sections accordingly.

Page 11, line 29:  
Delete "sec. 11"  
Insert "sec. 9"

Page 13, line 15, through page 16, line 25:  
Delete all material.

Renumber the following bill sections accordingly.

Page 18, line 14, through page 19, line 4:  
Delete all material.

Renumber the following bill sections accordingly.

Page 23, line 15:  
Delete "Sections 2, 5, 6, 22 - 24, and 26"  
Insert "Sections 2, 5, 6, 18 - 20, and 22"

Page 23, line 17:  
Delete "Sections 3 and 21"  
Insert "Sections 3 and 17 of this Act"

Page 23, line 18:  
Delete "Sections 7, 11, 13, 14, and 25"  
Insert "Sections 7, 9, 11, 12, and 21"

Page 23, line 20:  
Delete "Sections 9, 10, 12, 15, and 20 of this Act apply"  
Insert "Section 10 of this Act applies"

Page 23, line 24:  
Delete "Sections 3, 7, 11, 13, 14, 17, 21, and 25"  
Insert "Sections 3, 7, 9, 11, 12, 14, 17, and 21"

Page 23, line 31:  
Delete "Sections 1, 2, 5, 6, 9, 10, 12, 15, 20, 22 - 24, and 26"  
Insert "Sections 1, 2, 5, 6, 10, 18 - 20, and 22"

Page 24, line 2:  
Delete "sec. 30"  
Insert "sec. 26"

SENATOR FAIRCLOUGH objected for discussion purposes.

SENATOR GARDNER explained that the 25 percent net operating loss credit levels the playing field between the producers and the small independents still in a development phase. Whereas, the producers can deduct development costs from their taxable

income, those still in a development phase cannot. The net operating loss credit (NOL) compensates for the discrepancy and helps get the development project off the ground by boosting project economics early on before revenue is being generated. It is one of the ways the state can really help support newcomers to the fields. While some developers have sufficient cash to make it through the costly and risky development phase, others don't. The change in SB 21 will particularly harm those seeking to develop costly oil and the more remote and challenged fields.

She said, in addition, the 15 percent interest rate proposed in SB 21 on the deferred net operating loss credits is too high, creating an unnecessary liability for Alaskans. It will double in five years with the 15 percent compounded interest rate applied - the envy of any investor.

CO-CHAIR MICCICHE said Deputy Commissioner Bruce Tangeman from the Tax Division of the Department of Revenue was available to answer questions.

[3:55:22 PM](#)

MR. PAWLOWSKI emphasized that it was important to distinguish between the benefit given to an investor by the net loss carry forward versus the deductions available under progressivity. He referred to previous presentations by Econ One and PFC Energy, which showed that the current system for a new entrant is dramatically worse in terms of government take, internal rate of return, and net present value than it is for an incumbent producer. The reason for that is because of the deductibility around progressivity - the extra ability to buy down the tax rate. The net operating loss credit, which Amendment 3 refers to, mimics the base rate power that a spending by an incumbent has in the current system. Both an incumbent and a new entrant each have the 25 percent base rate; however, in that a new entrant does not have a tax rate yet, they don't get the same benefit of the 25 percent deduction. The net operating loss carry forward was created to make an equal playing ground for both the incumbent and the new entrant.

He related that the Governor's treatment of the bill is to carry those credits forward and apply them when there is production and the state has the revenues from that production to pay for the credit obligation. To protect the new entrant, the interest or increase in the value of the credit of 15 percent was chosen because it is very similar to the cost of capital for the opportunity the company would have had under ACES, if the state had just handed them a check. The balance of the 15 percent

number was chosen because under SB 21 the state would no longer be writing a check for the credit, but rather, requiring that the company carry the credit forward against production.

He pointed out that Amendment 3 would de-link the relationship of the proposal of taking credits against revenues and move it back to the cash payment. He stated that the issue Senator Gardner pointed out is an important one. There are instances where the credit payment from the state is important to companies that don't have the access to capital to pursue the high cost development challenges in Alaska. For companies that do have the cash, the improvement in the life cycle economics of SB 21 is what drives development decisions. The administration saw that it was important to improve the overall economic viability of the project itself so that natural forces in the market place can start to work.

3:59:21 PM

CO-CHAIR MICCICHE inquired if a company without financial backing would be as likely to stem the decline of throughput as a company with "pockets," with the changes proposed in SB 21.

MR. PAWLOWSKI emphasized that all companies have an important role. The administration is concerned with small entrants that have found reasonable reserves of oil and tried to obtain capital, but have not been able to. The current credit system is not overcoming that problem. The administration is seeking to improve the lifecycle economics in the life of projects so that small companies can participate in their efforts to explore and develop in Alaska. He did not want to identify winners and losers in the conversation.

4:01:20 PM

CO-CHAIR MICCICHE asked if the changes were primarily guarding against "the check" having a liability for a smaller company as opposed to enjoying the revenue benefits of the company that is making it on its own.

MR. PAWLOWSKI said from the Department of Revenue's perspective, the point was to match up when the state was giving a benefit, to when the state was receiving the revenues to pay for the benefit, especially when looking at expansionist spending. Matching up the cash flows is really important for the long term durability of the system.

MR. BALASH emphasized the second of the Governor's principles - incentives are geared to encouraging new production. The

Department of Natural Resources sees the credit system today as it operates, both through the QCE and the NOL system, as an incentive that rewards spending. Spending is a necessary part of getting to production, but it is not the direct link. The department's treatment of the NOL credit, in providing the interest mechanism and restricting its applicability to future production tax liabilities, ensures that the company can only take advantage of that credit once they've gotten to point of producing oil.

CO-CHAIR MICCICHE pointed out that the idea in Amendment 3 is contained in the Letter of Intent. It says, "Evaluate removing the Net Operating Loss provision in SB 21."

[4:03:47 PM](#)

SENATOR FAIRCLOUGH maintained her objection to Amendment 3.

A roll call vote was taken. Senator Gardner voted in favor of Amendment 3 and Senators Fairclough, McGuire, Dunleavy, and Micciche voted against it. Therefore, Amendment 3 failed by a 1:4 vote.

[4:04:33 PM](#)

SENATOR GARDNER moved to adopt Amendment 4, labeled 28-GS1647\A.6:

#### AMENDMENT 4

Page 1, line 2, following "rate;":

Insert "**relating to the minimum tax on oil and gas production;**"

Page 2, following line 18:

Insert a new bill section to read:

"\* **Sec. 3.** AS 43.55.011(f) is repealed and reenacted to read:

(f) Except for oil and gas subject to (i) of this section and gas subject to (o) of this section, the provisions of this subsection apply to oil and gas produced from each lease or property within a unit or nonunitized reservoir that has cumulatively produced 1,000,000,000 BTU equivalent barrels of oil or gas by the close of the most recent calendar year and from which the average daily oil and gas production from the unit or nonunitized reservoir during the most recent calendar year exceeded 100,000 BTU equivalent barrels. Notwithstanding any contrary provision of

law, a producer may not apply tax credits to reduce its total tax liability under (e) of this section for oil and gas produced from all leases or properties within the unit or nonunitized reservoir below 10 percent of the total gross value at the point of production of that oil and gas. If the amount of tax calculated by multiplying the tax rate in (e) of this section by the total production tax value of the oil and gas taxable under (e) of this section produced from all of the producer's leases or properties within the unit or nonunitized reservoir is less than 10 percent of the total gross value at the point of production of that oil and gas, the tax levied by (e) of this section for that oil and gas is equal to 10 percent of the total gross value at the point of production of that oil and gas. In this subsection, "total gross value at the point of production" means the gross value at the point of production as adjusted by AS 43.55.160(f), if applicable."

Renumber the following bill sections accordingly.

Page 5, line 27:

Delete "sec. 4"

Insert "sec. 5"

Page 6, line 19, through page 7, line 5:

Delete all material and insert:

"(B) for oil and gas produced from leases or properties subject to AS 43.55.011(f), 10 percent of the gross value at the point of production of that oil and gas [THE GREATEST OF

(i) ZERO;

(ii) ZERO PERCENT, ONE PERCENT, TWO PERCENT, THREE PERCENT, OR FOUR PERCENT, AS APPLICABLE, OF THE GROSS VALUE AT THE POINT OF PRODUCTION OF THE OIL AND GAS PRODUCED FROM THE LEASES OR PROPERTIES DURING THE MONTH FOR WHICH THE INSTALLMENT PAYMENT IS CALCULATED; OR

(iii) THE SUM OF 25 PERCENT AND THE TAX RATE CALCULATED FOR THE MONTH UNDER AS 43.55.011(g) MULTIPLIED BY THE REMAINDER OBTAINED BY SUBTRACTING 1/12 OF THE PRODUCER'S ADJUSTED LEASE EXPENDITURES FOR THE CALENDAR YEAR OF PRODUCTION UNDER AS 43.55.165 AND 43.55.170 THAT ARE DEDUCTIBLE FOR THE OIL AND GAS UNDER AS 43.55.160 FROM THE GROSS VALUE AT THE POINT OF PRODUCTION OF THE OIL AND GAS PRODUCED FROM THOSE

LEASES OR PROPERTIES DURING THE MONTH FOR WHICH THE  
INSTALLMENT PAYMENT IS CALCULATED];"

Page 9, line 30:

Delete "sec. 7"

Insert "sec. 8"

Page 11, line 29:

Delete "sec. 11"

Insert "sec. 12"

Page 23, line 15:

Delete "Sections 2, 5, 6, 22 - 24, and 26"

Insert "Sections 2, 3, 6, 7, 23 - 25, and 27"

Page 23, line 17:

Delete "Sections 3 and 21"

Insert "Sections 4 and 22 of this Act"

Page 23, line 18:

Delete "Sections 7, 11, 13, 14, and 25"

Insert "Sections 8, 12, 14, 15, and 26"

Page 23, line 20:

Delete "Sections 9, 10, 12, 15, and 20"

Insert "Sections 10, 11, 13, 16, and 21"

Page 23, line 24:

Delete "Sections 3, 7, 11, 13, 14, 17, 21, and  
25"

Insert "Sections 4, 8, 12, 14, 15, 18, 22, and  
26"

Page 23, line 31:

Delete "Sections 1, 2, 5, 6, 9, 10, 12, 15, 20,  
22 - 24, and 26"

Insert "Sections 1, 2, 3, 6, 7, 10, 11, 13, 16,  
21, 23 - 25, and 27"

Page 24, line 2:

Delete "sec. 30"

Insert "sec. 31"

SENATOR FAIRCLOUGH objected for discussion purposes.

SENATOR GARDNER opined that a goal of ACES, and also of SB 21,  
is to provide a balance between encouraging investment and

production and protecting the interest of the state. She related that Amendment [4] provides an alternative minimum tax of 10 percent of the gross value at the point of production as a protection against low oil prices. It is applied after the 20 percent reduction SB 21 creates for new oil - the gross revenue exclusion. It specifies that producers may not apply tax credits to reduce their production taxes below the 10 percent floor. The floor would apply only to fields that have already produced a billion barrels of oil and are still producing 100,000 barrels per day, on average - essentially Prudhoe and Kuparuk. The floor would kick in under \$70 per barrel. Oil prices have been much lower in the past. If the state takes less from profits when oil prices are higher, it needs to protect itself when oil prices are low.

CO-CHAIR DUNLEAVY clarified that Amendment 4 was before the committee.

SENATOR GARDNER said that was correct.

[4:06:27 PM](#)

MR. PAWLOWSKI commented that in considering Amendment 4 it is important to reach back to the Governor's principles. There has been some discussion of progressive versus regressive systems. Under the Governor's proposal, the fairness principle is what Senator Gardner has spoken to in that, at low prices, the state takes a higher share of the revenue. He said that principle exists under SB 21 naturally because of the repeal of the credits and the combination of the fixed base rate that has not been reduced. Amendment 4 would move that regressivity by putting a 10 percent gross floor in, perhaps even higher than it would exist under SB 21. It would have the effect of taking a bill that is already slightly regressive and potentially making it more regressive.

SENATOR GARDNER responded "with the limited application to the two biggest fields in North America, only."

A roll call vote was taken. Senator Gardner voted in favor of Amendment 4 and Senators Fairclough, McGuire, Dunleavy, and Micciche voted against it. Therefore, Amendment 4 failed by a 1:4 vote.

SENATOR GARDNER said she would not offer Amendment 5, but she believes that progressivity needs to be retained.

[4:08:58 PM](#)

CO-CHAIR MICCICHE referred to the Letter of Intent and read the section that applies to progressivity. It says, "Evaluating employing progressivity as a tool to level the proportion of take for Alaskans across the various oil price environments." He concluded that everyone agrees there may be a place to "flatten the tax."

He asked Senator Gardner if the statement, "Consider bracketing progressivity at varying rates as the price of oil varies," should be eliminated from the Letter of Intent.

SENATOR GARDNER suggested amending the statement by removing the words "bracketing" and "at varying rates."

CO-CHAIR MICCICHE asked if there were any further amendments. He asked if the administration wished to make closing comments.

MR. PAWLOWSKI voiced appreciation for the committee's work.

CO-CHAIR MICCICHE commented that the administration is not finished with its work on the bill. He praised the departments for their work. He said he appreciates Senator Gardner's comments.

SENATOR GARDNER appreciated Co-Chair Micciche's efforts at keeping the dialogue open and getting questions answered.

SENATOR GARDNER noted that she received answers from DOR in response to questions she submitted, some of which relate to the Letter of Intent. She read item 7 in the letter from DOR:

The higher IRR's for ACES incumbents result entirely from the "buy-down" effect. Additional investment under ACES allows an incumbent to 'buy-down' its tax rate on existing production. Under the ACES system a producer can earn those higher IRR's, but only if it reinvests in Alaska to buy down its tax rate. It cannot earn those returns if it chooses to distribute its profits to shareholders, which is vitally important to management, not to mention shareholders.

She said this was exactly the information she wanted.

SENATOR GARDNER said the quote is on page 3, slide 7.

SENATOR GARDNER remarked about how the additional investment under ACES allows the company to buy down its existing tax rate

on production. Under ACES, a producer earns those high IRR's only if it re-invests in Alaska to buy down its rate. That is exactly the intent of ACES, and SB 21 lacks this provision.

[4:14:15 PM](#)

MR. PAWLOWSKI pointed out that some of the questions were specific to the administration's consultant, Econ One. The consultant's opinion continues in that sentence, "In this sense, the profits (and associated higher IRR's) are somewhat 'captive' and may not be viewed as being of same quality (i.e., comparable) to profits earned in other jurisdictions where no such strings are attached." He said the administration looks forward to talking through the efficiencies of the incentives.

CO-CHAIR MICCICHE thought it was important to consider the entire answer. It implies that the IRR is one factor and should not be viewed in isolation. He summarized that IRR calculations that vary greatly from most other opportunities should be taken with "a grain of salt."

SENATOR FAIRCLOUGH asked that the response from DOR be included in the public record.

CO-CHAIR MICCICHE expressed appreciation to the administration.

[4:16:19 PM](#)

SENATOR GARDNER stated that she can't sign on to the Letter of Intent at this time, but she does not object to the committee's moving it forward.

[4:16:43 PM](#)

SENATOR FAIRCLOUGH said she appreciates the complexity of the tax structure that both industry and the administration face every day. She noted that she believes in the principles the Governor has brought forward. She stated that she believes that Alaska is not competitive for a variety of reasons and the state needs to make some changes to make sure that industry can flourish and Alaskans can have confidence in their tax system to know that it is in place to benefit all Alaskans. The process of changing the tax system should be bicameral and bipartisan in efforts to make sure Alaskans' future is secure.

She said she agrees that there is a correlation between a regressive nature and when progressivity is removed. She wants Alaskans to share in the benefits as the price of oil increases. She said this committee has not been able to see how the credits proposals will affect the bottom line and she looks forward to

that future discussion. She wished for a conversation with the administration about why simplicity is better than progressivity.

She did not want the record to reflect that she is in total agreement about progressivity, because the current rate is too high. She said she is trying to understand the issue on behalf of her constituents. She spoke of a goal to see new explorers in Alaska, as well as new exploration in the legacy fields. She stated support for the committee's Letter of Intent and appreciation for all positions. She hoped that in the future amendments could be viewed sooner. She said she appreciates that the chair was able to provide an opportunity for Alaskans to have a say. She also voiced appreciation for Co-Chair Micciche's leadership and for Senator Gardner's contributions.

CO-CHAIR MICCICHE reminded the public that this is not an oil tax committee.

CO-CHAIR DUNLEAVY said looking at ACES and SB 21 has been an enlightening experience, as has taking a look at Alaska and its future. He hoped Alaska was not at the end of the golden age for oil. He said the goal is to find a way to continue oil production. This process has been one of turning over stones and will continue to be so. He said although the current topic is focused on oil, it will morph from oil into business investment in Alaska and personal spending policies. He said many non-oil industries are watching the tax process and Alaska's future. The question is whether Alaska will become a destination for investment and job growth. Alaska's fiscal policy will continue to be discussed in the future.

[4:23:46 PM](#)

CO-CHAIR DUNLEAVY moved to report SB 21, labeled [28-GS1647\A], from committee with individual recommendations and the accompanying fiscal notes.

SENATOR GARDNER objected.

A roll call vote was taken. Senators Fairclough, McGuire, Dunleavy, and Micciche voted in favor of reporting SB 21 and Senator Gardner voted against it. Therefore, the motion to report SB 21 was passed by a 4:1 vote.

CO-CHAIR DUNLEAVY moved to report the Letter of Intent. No one stated objection.

CO-CHAIR MICCICHE read the Letter of Intent:

The Senate Special Committee on Trans Alaska Pipeline System (TAPS) Throughput was formed specifically to evaluate solutions designed to reverse or significantly reduce the historical decline in the quantity of oil produced from leases or properties north of 68 degrees North latitude and shipped through the Trans Alaska Pipeline System. The Committee recognizes that oil revenue is extremely important to the State of Alaska and currently funding over 90% of Alaska's essential services and critical infrastructure including education, public safety, health and social services and transportation. The Committee is also aware that projected declines in the Trans Alaska Pipeline System throughput may compound the operational and cost issues that could jeopardize the viability and safe operation of the Trans Alaska Pipeline System.

The Committee was the first to consider SENATE BILL 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."

The Committee held six meetings with the intent of framing the discussion around SB 21 through a lens of evaluating direct impacts to the TAPS production decline. The Committee process was designed for fairness and equal participation by majority and minority members. The Committee included expert consultant, agency, the Alaskan public and industry testimony in the process through many productive hours and publicly-available meetings evaluating the

potential positive and negative effects on production through revised Alaska oil tax policy. Most importantly, the Committee provided over five hours of Committee time for public testimony from every LIO in the state, as well as telephonically from any location. Every Alaskan that chose to address the Committee was warmly welcomed and given the opportunity to share their support and/or concerns.

The Committee has arrived at several key findings after completing the process of evaluating SB 21 and the effects of oil tax on production. They include:

- Regarding oil revenue that funds the vast majority of governmental functions for the people of Alaska, there are many factors in which the State has little control, including the price of North Slope oil. Total government take through oil taxation is the only lever under the control of the people of Alaska.
- The ACES tax structure has likely contributed to advancing the decline of oil production and throughput in TAPS, primarily due to a lack of competitiveness with other OEDC producing regions.
- When evaluating with increased production as a primary objective, ACES credits should have been more specifically directed toward projects resulting in production and less toward general spending.
- Specific incentives and a competitive oil tax regime in Alaska will likely result in additional production-related spending.
- There has been a direct correlation in other OEDC producing regions between production-related spending and increased production.
- Current fiscal spending policies appear to have an adverse effect on the business climate and willingness to invest in the State of Alaska. Policies must deliver the clear message to the business community that Alaska will not continue taxing to fund unsustainable levels of government spending.
- Although SB 21 is an adequate platform from which a respectful dialogue can begin, in the current form the bill may not adequately provide production credit incentives and opportunities; a level revenue proportion for Alaskans; and protections for Alaska hire and re-investment.

The Committee's intent to pass the bill to the Senate Resources Committee in the original form for further processing is in no way an expression of support by Committee members for SB 21 in current form. In fact, most members have expressed concern for key concepts that would require revision prior to supporting the bill as it moves through the legislative process.

Key concerns being passed through this letter with an expectation of consideration moving forward will be communicated in two sections. The first section below includes throughput-related Committee recommendations:

- Evaluate providing a guarantee of investment in Alaska and a further incentive for stemming production decline from leases or properties north of 68 degrees North latitude by fixing the amount of production used in determining the reasonable transportation costs to determine transportation deduction costs for pipelines and gas treatment plants under the Oil and Gas Production Tax and Oil Surcharge, AS 43.55, so that producers receive a benefit for increased oil production and throughput in the Trans Alaska Pipeline System but incur a corresponding limitation on deductions due to throughput declines after December 31, 2015.
- Evaluate expanding the application of the Gross Revenue Exclusion in units formed before 2003 (Legacy Areas). The Senate Resources Committee should specifically inquire about expansions of existing Participating Areas, increasing recovery factors in existing Participating Areas, and Participating Areas that contain oil with an API gravity of 20 degrees or less.
- Evaluate specific production-related credits allowed under ACES for inclusion in SB 21 as a direct incentive for costs that deliver production. Require that credits are charged against actual production to eliminate currently-existing negative revenue liability to the State.

The Committee is united in several philosophies that are also recommendations to be considered in SB 21, not related to throughput, including:

- Firm incentives for Alaska Hire and Alaska Purchase,

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CO-CHAIR MICCICHE commented that Senator Dunleavy and he are interested in evaluating a program for incentivizing Alaska hire and Alaska purchase.

- Evaluating significant and specific incentives for unconventional and heavy oil,
- Evaluating a production credit system for producers willing to provide propane fuels for the people of rural Alaska in areas unlikely to receive natural gas distribution if/when a natural gas pipeline is constructed, and
- Evaluating employing progressivity as a tool to level the proportion of take for Alaskans across the various oil price environments.

Although not supported unanimously by the Committee, yet in the spirit of fairness for all Committee members, the Minority Committee member has requested the following considerations to be passed onto the Senate Resources Committee:

- Evaluate a time limit into the future for the 20% Gross Revenue Exclusion.
- Evaluate removing the Net Operating Loss provision in SB 21.
- Evaluate adding a 10% minimum gross tax at the gross value at the point of production.
- Consider progressivity as the price of oil varies.

The Senate Special Committee on Trans Alaska Pipeline System (TAPS) Throughput will continue to convene to identify and evaluate additional mitigation solutions for operational and regulatory TAPS production-related obstacles in the future. The Committee looks forward to the constructive dialogue and additional processing that will occur within the Legislature related to SB 21 the remainder of this session.

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CO-CHAIR MICCICHE said the letter would be respectively submitted to the Senate Resources Committee on February 7, 2013.

CO-CHAIR MICCICHE called for a vote on the accompanying Letter of Intent.

A roll call vote was taken. Senators Fairclough, McGuire, Dunleavy, and Micciche voted in favor of adopting the Letter of

Intent and Senator Gardner voted against it. Therefore, the motion was passed by a 4:1 vote.

CO-CHAIR MICCICHE summarized that both the Letter of Intent and SB 21 have passed from committee. He noted that all committee members see room for improvement for SB 21 as it moves through the process. He said SB 21 passes with individual recommendations, attached fiscal notes, and the accompanying Letter of Intent.

He thanked the committee members, the administration, and staff for their hard work on SB 21.

SENATOR GARDNER reiterated that Co-chair Micciche has done a good job leading the committee. She said her vote against the letter was due to being unfamiliar with the content.

CO-CHAIR MICCICHE stressed that the most important accomplishment was to begin a dialogue on a bill that will require further hard work. He thanked the public for their testimony.

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There being no further business to come before the committee, Co-Chair Micciche adjourned the Senate Special Committee on TAPS Throughput at 4:35 p.m.