

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

February 29, 2016

1:02 p.m.

MEMBERS PRESENT

Representative Benjamin Nageak, Co-Chair
Representative David Talerico, Co-Chair
Representative Mike Hawker, Vice Chair
Representative Bob Herron
Representative Craig Johnson
Representative Kurt Olson
Representative Paul Seaton
Representative Andy Josephson
Representative Geran Tarr

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE BILL NO. 247

"An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax for certain oil and gas production; relating to the minimum tax calculation for monthly installment payments of estimated tax; relating to interest on monthly installment payments of estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition for "qualified capital expenditure"; adding a definition for "outstanding liability to the state"; repealing

oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payments for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures applicable before January 1, 2011; making conforming amendments; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 247

SHORT TITLE: TAX;CREDITS;INTEREST;REFUNDS;O & G

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/19/16	(H)	READ THE FIRST TIME - REFERRALS
01/19/16	(H)	RES, FIN
02/03/16	(H)	RES AT 1:00 PM BARNES 124
02/03/16	(H)	Heard & Held
02/03/16	(H)	MINUTE(RES)
02/05/16	(H)	RES AT 1:00 PM BARNES 124
02/05/16	(H)	-- MEETING CANCELED --
02/10/16	(H)	RES AT 1:00 PM BARNES 124
02/10/16	(H)	Heard & Held
02/10/16	(H)	MINUTE(RES)
02/12/16	(H)	RES AT 1:00 PM BARNES 124
02/12/16	(H)	Heard & Held
02/12/16	(H)	MINUTE(RES)
02/13/16	(H)	RES AT 1:00 PM BARNES 124
02/13/16	(H)	-- MEETING CANCELED --
02/22/16	(H)	RES AT 1:00 PM BARNES 124
02/22/16	(H)	Heard & Held
02/22/16	(H)	MINUTE(RES)
02/24/16	(H)	RES AT 1:00 PM BARNES 124
02/24/16	(H)	Heard & Held
02/24/16	(H)	MINUTE(RES)
02/25/16	(H)	RES AT 8:30 AM BARNES 124
02/25/16	(H)	Heard & Held
02/25/16	(H)	MINUTE(RES)
02/25/16	(H)	RES AT 1:00 PM BARNES 124
02/25/16	(H)	Heard & Held
02/25/16	(H)	MINUTE(RES)
02/26/16	(H)	RES AT 1:00 PM BARNES 124

02/26/16 (H) Heard & Held
02/26/16 (H) MINUTE(RES)
02/27/16 (H) RES AT 10:00 AM BARNES 124
02/27/16 (H) Heard & Held
02/27/16 (H) MINUTE(RES)
02/29/16 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

KARA MORIARTY, President/CEO
Alaska Oil and Gas Association (AOGA)
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 247, discussed the long-term viability of the oil and gas industry in Alaska.

BILL ARMSTRONG, President
Armstrong Oil & Gas
Denver, Colorado

POSITION STATEMENT: Answered questions during the discussion of HB 247.

ACTION NARRATIVE

[1:02:26 PM](#)

CO-CHAIR BENJAMIN NAGEAK called the House Resources Standing Committee meeting to order at 1:02 p.m. Representatives Hawker, Seaton, Josephson, Talerico, and Nageak were present at the call to order. Representatives Johnson, Herron, Olson, and Tarr arrived as the meeting was in progress.

HB 247-TAX;CREDITS;INTEREST;REFUNDS;O & G

[1:03:08 PM](#)

CO-CHAIR NAGEAK announced that the only order of business would be HOUSE BILL NO. 247, "An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax for certain oil and gas production; relating to the minimum tax calculation for monthly installment

payments of estimated tax; relating to interest on monthly installment payments of estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition for "qualified capital expenditure"; adding a definition for "outstanding liability to the state"; repealing oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payments for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures applicable before January 1, 2011; making conforming amendments; and providing for an effective date."

[1:03:49 PM](#)

KARA MORIARTY, President/CEO, Alaska Oil and Gas Association (AOGA), provided a PowerPoint presentation with coinciding written testimony [included in the committee packet]. After her initial introduction, Ms. Moriarty paraphrased from her written testimony, starting at the second paragraph, which read as follows [original punctuation provided]:

AOGA is a professional trade association whose mission is to foster the long-term viability of the oil and gas industry in Alaska for the benefit of all Alaskans. Thank you for the opportunity to testify today on House Bill 247, Governor Walker's oil and gas tax policy proposal.

Slide 2

AOGA represents the majority of oil and gas producers, explorers, refiners, transporters and marketers in Alaska. Our current members include: Alyeska Pipeline Service Company, BlueCrest Energy, BP, Caelus Energy, Chevron, ExxonMobil, Hilcorp, PetroStar, Shell, and Tesoro. Although I am here on

behalf of a varied and diverse group of companies, my testimony today represents the thoughts and sentiments of each and every member. On matters related to tax, AOGA requires unanimous consent on testimony.

Before I address the bill before you, I believe it is prudent to discuss the current state of the oil and gas industry in Alaska. In order for each of you to make an informed decision, it is important to understand and appreciate the industry from a context broader than mere tax revenue.

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REPRESENTATIVE HAWKER noted that the administration had advised the legislature to get its analysis of HB 247 from the industry. He emphasized the importance of that advice in serving as the basis for understanding how HB 247 would impact the [oil and gas] industry.

1:07:03 PM

MS. MORIARTY expressed her thanks to Representative Hawker and related the degree to which she takes the testimony seriously as the reason she would exceed her 20-minute suggested time for testimony. She said she will discuss the impact in broad terms while many company representatives will discuss specifically how the proposed legislation would impact their company. She then directed attention to slide 3 and continued paraphrasing from her written testimony, which read as follows [original punctuation provided]:

Slide 3

The state revenue depicted on this table represents the total state revenue generated in fiscal year 2015, restricted and unrestricted state revenue. The unrestricted portion of the \$2.3 billion was \$1.7 billion, representing 75% of the state's total unrestricted revenues.

In addition, the industry paid \$447 million in property taxes to local governments. Again, for greater context, the mining industry generates \$83.7 million in state revenue and pays \$18 million in taxes to local governments.

It would be imprudent to discuss the oil and gas industry's contributions to Alaska without mentioning jobs. Based on data from the most recent McDowell Group report on jobs and wages in the industry and data in the 2015 Department of Revenue Sources Book (RSB), the oil and gas industry is, without question, a main driver in fueling Alaska's total economy.

When you combine jobs from direct industry employers like AOGA members, plus the jobs provided from indirect industry employers such as the multitude of Alaska based contractors, plus the induced jobs created by those employees spending money in their communities, there are 51,000 private sector Alaskan jobs created by the oil and gas industry according to the McDowell Group's estimates. The McDowell Group also modeled the number of state employees and other jobs created in Alaska's economy through state spending, acknowledging that the overwhelming majority of that spending is attributable to the oil and gas industry. McDowell Group found that an additional 60,000 public sector jobs would not exist without the industry's fiscal contributions. All told, the McDowell Group concluded that 111,000 jobs generating \$6.45 billion in wages result from the oil and gas industry's presence in Alaska. By comparison, the mining industry generates about 8,700 jobs in Alaska.

Slide 4

To put it in more simple terms, more than 1/3 of Alaska's jobs are tied to the oil and gas industry. For every direct job the industry provides, 20 additional jobs are created throughout Alaska's economy. The McDowell Group found that no other industry comes close to that magnitude of multiplier.

Finally, you have undoubtedly read headlines regarding the industry being forced to lay-off direct employees in this current, low price environment. It is not just oil industry families that are dealing with the adverse effects of downsizing, contractions in the industry are felt across Alaska, as every dollar earned by an oil and gas employee generates \$8 additional dollars in wages throughout the state.

Slide 5

It is easy for the cynical to tell anecdotal stories about getting on an airplane next to a worker who lives out of state coming or going from the North Slope. Although the industry for a variety of reasons cannot dictate where an individual must live, companies consistently strive to hire as many eligible Alaskans as possible. According to the most recent Department of Labor (DOL) report the statewide average for all resident hire, across all industries is about 80% Alaskan hire. Many AOGA member companies actually have a higher rate of resident hire than the statewide average. For example, Caelus Energy has more than 85% Alaska hire and over 400 contractors working on the Slope this year. Alyeska has a 94% Alaska hire rate, with 20% of their employees being of Alaska Native heritage. 100% of BlueCrest operations staff are Alaska residents, while 70% of the construction workers at their Cosmopolitan project are state residents. Petro Star boasts 97% Alaska hire.

1:13:00 PM

In 2014, BP spent \$2.2 billion in Alaska, with 72% of that spend with Alaska companies; they currently have a 79% Alaska hire rate.

MS. MORIARTY added that ExxonMobil Corporation has engaged and worked with more than 100 Alaska companies in its construction of Point Thomson, 80 percent of which are Alaskans. She continued paraphrasing from her written testimony, which read as follows [original punctuation provided]:

89% of Hilcorp's workforce are Alaskans. In addition, industry supports scholarships and training programs to increase the resident hire. For example, Alyeska alone spends \$2 million each year to hire, train and develop Alaska Native employees.

Would the industry like to hire more Alaskans? Of course they would. It makes good business sense to hire Alaskans, as it is both more efficient and economical to do so.

What does not make good business sense is the provision in Section 27 of the bill to limit the

repurchase of refundable credits to just a percentage of the certificate equal to that company's percentage of Alaska resident hire in the previous calendar year, including Alaska hire by the company's contractor work force.

Basing the repurchase of tax credits on a company's local hire percentage would make it difficult, if not impossible, for operators to plan and evaluate investments because their contractors' and subcontractors' Alaska hire percentages are outside the operator's control. This uncertainty will, in turn, discourage potential new investment here.

In addition, a resident-hire limitation on the amount of an otherwise well-earned tax credit certificate that can be cashed out also raises significant issues under the U.S. Constitution, and an earlier Alaska-hire preference attached to the construction of the Trans-Alaska Pipeline System was struck down by the U.S. Supreme Court. The inevitable legal battle would drag out in court, and the unanswered question would cloud Alaska's tax system with uncertainty until there was a ruling. We note that the U.S. Supreme Court recently heard oral arguments involving an Alaskan issue, the Sturgeon case, it has taken nine years for that case to wind its way through the legal system to reach the highest court. Does Alaska want to create further uncertainty over local hire?

Finally, if it is good policy to put local hire conditions on how the oil and gas industry is taxed, one might expect similar proposals for other industries operating in Alaska. But the Administration isn't proposing anything like that, even though some industries employ much higher rates of non-Alaskans than ours.

Slide6

As I already indicated, Alaska's oil and gas industry is a major contributor to state government, both in terms of revenue generated for state spending as well as the jobs created by the industry. You can see from this table that, since statehood, oil and gas has been the source for 85% of the state's

unrestricted revenue, totaling \$141 billion dollars. This figure has not been adjusted for inflation, so in the total in today's dollars would be far greater.

Slide 7

As you discuss a change in Alaska's oil and gas tax policy, this slide is a reminder that in the last decade there have already been 5 major changes in tax policy. As the President of Hilcorp stated last week, "I started in the oil business right straight out of school, during the real boom in the 70's/early 80's in Midland, Texas. I'm not aware of the fiscal system ever changing in the State of Texas since I've been working in the oil and gas industry. I've been in Alaska four years, and we've debated it 3 or 4 times." He went onto to say, "More than anything, changing rules and taxes every few years is a sure way to scare investment away."

Slide 8

Of course, the last major change in tax policy occurred three years ago with the passage of SB 21, followed by the referendum to repeal the new law in August 2014. Voters decided the state's current fiscal policy was good for Alaska, and we would agree that Alaska has proved to be competitive, has attracted new jobs and investment, and will ultimately result in more production to the state.

Since April 2013, when the bill passed the legislature, industry has announced more than \$5 billion in additional spending across the state. That increased spending could not have happened at a better time, as the investments made in the last 18-24 months are helping the industry sustain itself in this low price environment.

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Slide 9

But what has the increased investment meant in terms of production? As you can see from this chart, using data from the Department of Revenue, production on the North Slope has stabilized and was basically

flat from 2014 to 2015, which is particularly significant when considering an historical trend of 5-6% annual decrease.

The states own forecast shows the power of a competitive fiscal system. The blue line is historical production in Alaska for the last decade, the black line is the forecast from December 2013, and the red line is the forecast from just this past December.

If you look at the chart to the right, and look out a few years to the year 2020, and compare this year's forecast to the forecast released in the Fall of 2013, after SB 21 had passed but had not yet been enacted. After approximately two years under this tax system, you will see the Department of Revenue is forecasting 50,000 barrels per day more than what they were forecasting in 2013. To provide further context, the price forecast in the Fall 2015 forecast is \$50/barrel less for 2020 than it was in the 2013 forecast. Even with the much lower price forecast, the production forecast is still 50,000 barrels per day more.

Slide 10

There has been a lot of conversation about "new oil" or oil that qualifies for the gross value reduction or "GVR". The purpose of the GVR was to lower the effective tax rate on new production as a way to incentivize new production. Some have recently asserted that all new oil after 2002 will pay zero taxes if prices are under \$70 per barrel. I will discuss government take on all oil, including GVR, later in the presentation, but I would like to point out, that the DOR is forecasting that GVR will average about 8% of our overall production for the next 15 years. So while bringing on new fields and new oil is important to Alaska's future, our legacy fields will continue to provide the lion's share of production for years to come.

Slide 11

Looking to Cook Inlet, you will see a tremendous oil production success story. The Division of Oil and Gas Director Corri Feige mentioned these statistics

during her presentation last week. You can see there has been an increase of over 100% since 2009. The investments made to increase Cook Inlet production have made a significant impression on the local economy. Additionally, our member company Tesoro refines every barrel of oil possible that travels the short distance to their refinery. A December 2015 Econ One study for the Senate Finance Committee reported that Alaska refineries supply the majority of the State's demand in the Southcentral and Interior regions. When oil production was lower in Cook Inlet the Tesoro refinery was importing oil to refine from as far away as Africa, just to meet these in state needs. Econ One also went on to say "We estimate that the total value added to Alaska's economy by the two refiners currently in operation (Tesoro and PetroStar) is approximately \$153 million per year.

[1:23:32 PM](#)

MS. MORIARTY added, "In comparison, the governor recently announced the impact of the [Alaska] Marine Highway System is just under that, at \$100 million per year. So the ferry system has an economic impact of \$100 million and our two in-state refineries ... [have] the benefit of \$153 million." She continued paraphrasing from her written testimony, which read as follows [original punctuation provided]:

The [refining] industry provided \$23.2 million in revenue annually to the State in the form of revenue in kind (RIK) purchases over and above the revenue in value (RIV) alternative and \$9.3 million in property and income taxes." Having a local source of supply for the refinery is good for value added manufacturing in Alaska.

Slide 12

It is impossible to have this conversation without acknowledging the ominous and unprecedented drop in oil prices. Prices today are not only the lowest we've seen in a decade, but when adjusted for inflation, they are the lowest since the mid-1980's. In less than two years, the industry has experienced a 70% drop in oil prices. You are well aware of the impact this has had on the State of Alaska's revenues. You have historically received 85-90% of your revenue

from oil. As significant as that is, it's important to recognize that the industry receives 100% of its revenue based on the market prices for what it produces. As my friends in other industries will tell you, we are price takers, we are not price makers.

Slide 13

Every industry operating in Alaska fully understands that Alaska is an expensive and logistically challenging place to do business. I imagine that concept was expressed by the mining industry last week, and it is particularly true for the oil and gas industry.

The following chart demonstrates that while oil and gas development costs grew 90% since 2000, inflation grew only 40% during the same period. In other words, over the past fifteen years, costs have surged more than two times the rate of inflation. This is yet another compelling factor and financial stressor on industry in Alaska, which compounds the difficult decisions these companies are making to cut costs and increase efficiencies while safely and reliably producing oil and gas.

Slide 14

Invariably, companies are forced to operate despite the current oil price environment; this can result in projects being delayed and deferred. Perhaps most painfully, it also results in Alaskan jobs being lost. This chart shows the relationship between the low price on slide 11 and the high costs on slide 12. It looks eerily similar to the charts you as policy makers are reviewing in terms of the state's revenue and expenses.

The oil and gas industry is cash flow negative, at least as much as the state sees itself as being.

Slide 15

As I alluded to before, the high cost environment in Alaska is even more difficult to navigate during this unprecedented low price environment. According to the Department of Revenue's Fall Sources Book, the

estimated average cost of producing a barrel of oil on the North Slope -before a company pays even one penny of tax -is \$52/barrel. To reiterate, companies spend \$52 to produce each barrel before they pay any corporate income tax, property tax, or production tax in Alaska. One need not be an economist or Rhodes scholar to understand that, in a \$30 a barrel world with \$52 costs, oil companies are in an untenable position in Alaska.

Yet despite this, here we are, testifying about legislation to add additional costs to the industry by raising the production tax. It is not surprising that Department of Oil and Gas Director Feige testified last week that companies are gravely concerned about any substantive changes to tax policy. "Changes in taxes generally are lumped into the bucket... of cost. At a time when prices are low, that sets off some alarm bells."

[1:29:00 PM](#)

Intuitively, it seems like poor long-term policy to choose to increase the costs to the industry at a time when companies spending is already out of balance with their revenues by over \$20/barrel before they pay the existing taxes. If additional taxes are levied on the industry, forcing them to be even more out of balance, you can be sure that the industry would have to make more severe cuts in expenditures that are needed to maintain and grown the state's production.

The Department of Revenue Tax Director suggested to me a few weeks ago that if industry were to *simply* eliminate all capital expenditures, the industry would be able to "break even" at these prices. This astonishing suggestion discounts the significant role that capital investment plays for maintenance and the integrity of industry operations. Absent continued capital spending, the State can say good-bye to the currently forecasted additional 50,000 barrels per day in 2020. As misguided as that line of thought might be, it does highlight the fundamental question at the core of this discussion. How badly are you willing to mortgage Alaska's future for nominal and short-term gains today?

It will be very challenging for the industry to reduce operating expenses, without further reductions in the workforce.

Any increase in this environment will have a negative impact on the industry and on the state's future.

Slide 16

As you weigh yet another change in tax policy, there are policy questions that need to be answered:

-What effect will the policy have on overall oil and gas production in the state?

-Will the policy make Alaska more competitive or less on a global scale?

-Will the policy provide stability to the industry and the state of Alaska?

-Will the policy provide predictability to companies looking to make huge investment decisions?

The Department of Revenue has frequently said that industry will be testifying to the impact of their proposed changes, and I have no doubt each company will do that, but I encourage you to ask each individual company over the next several days their view of these questions.

Slide 17

The Administration's proposal represents the sixth major tax change in the last 11 years. Prior changes came from unprecedented high oil prices, or endeavored to incentivize development in the state and make Alaska more competitive.

However, the motivation behind this current proposal is not to improve the fiscal system for the industry or create incentives for further development and increased production. Rather, it is purely driven by the state's desire for more money, now. As Director Alper said on February 12th, "It is a tax increase. I don't think we are attempting to disguise that."

Slide 18

Raising taxes when prices go up, and then raising them again when prices go down, undercuts stability and predictability. The Administration acknowledges the industry is suffering tough economic times; in fact, according to their testimony last week, if prices average around \$40/barrel for 2016, the industry will suffer more than \$1 billion "loss" in the state of Alaska. If the state keeps the current structure and does nothing, spending a \$1 billion more than industry is taking in will have a negative impact on Alaska's economy, considering the industry is the largest private economic driver in the state.

Yet it is clearly the intention of the state to raise taxes on an industry with negative cash flow-and not by small margins. To add another half-billion impact to the industry with the passage of HB 247 will only accelerate cutbacks by the industry, which will affect the number of Alaskans working, the amount of cash that circulates through the economy, and ultimately, the future health and growth of the industry.

[1:34:25 PM](#)

Slide 19

Under Governor Hammond, Alaska first established an equitable policy of one-third government take for the state, one-third for the federal government, and the last third for industry. During the ACES regime, government take climbed to a higher level, which, in turn, led directly to SB 21 in an effort to normalize total government take over a broad range of prices.

As Janak Mayer from analytica explained last week, with the slide that Rep. Josephson will hang on his door, government take is about 62% in a price range from \$60-150, including government take on new oil, or gross revenue reduction oil.

Contrary to Director Alper's testimony two weeks ago, HB 247 increases government take. In fact, Mr. Mayer demonstrated and explained "that the cumulative

impact of the proposed changes would be to shift up government take in lower oil prices. In times like today, the effective government take exceeds 100%.

Rep. Josephson summarized it well by saying, "Industry suffering so much -that we (the State) are getting all the money."

Slide 20

Two weeks ago, AOGA submitted specific comments for each section of the bill that causes the industry concern two weeks ago, and in the interest of time, I will not belabor each and every point. However, I do want to comment on a few of the substantial concerns we have with the bill.

The governor's proposal would increase the minimum gross tax from 4% to 5%. Although a one percentage point increase might not sound significant to some, [in] reality, it represents at least a 25% increase for those companies who already pay the 4% minimum tax.

Additionally, the Governor's proposal would forbid companies from using any earned or available tax credits to reduce the minimum tax below the new 5% floor. It is likely that there will be companies, large and small, that have earned "new oil" tax credits or exploration, drilling or tax loss credits from prior year investments, while also operating in a loss position due to low oil prices. For those companies, using those tax credits is the only way they can also continue to invest in the state. The proposal would delay, or possibly deny, vital economic recovery at the very time companies need it the most.

In other words, raising the minimum tax affects everyone, and the proposed increase is large enough to cause substantial negative impacts on all producers at today's oil prices. It is poor tax policy to engage in nothing more than a flagrant money grab at a time when the State should be encouraging industry to continue making vital investments.

For smaller companies or newcomers to the state who have yet to make a profit in Alaska, they don't

pay the 4% minimum tax, so under the governor's proposal, they would go from paying zero in production tax because they don't make a profit, to immediately being hit with a 5% gross tax, a punitive tax increase described by Director Alper as an "infinite increase."

Additionally, the proposal would change the way the minimum tax is determined and would prevent a producer from taking the actual tax credits available for a month to the extent they are greater than the initially estimated amount. Both of these incremental changes amount to a fundamental change in how the tax is calculated and will result in a tax increase.

Another major concern relates to the change in the net operating loss (NOL) tax credits. The Administration has testified that they are preserving the NOL credit, but we contend that under the current proposal the NOL credits become virtually useless.

NOL tax credits are utilized both on the North Slope and Cook Inlet and were established to help level the playing field for new companies trying to get a foothold in Alaska and allow all companies making critical investment to truly understand the economics under which those investments were made. Under SB 21, NOLs provide an even level of government support for capital investments on the North Slope.

[1:39:48 PM](#)

HB 247 would prevent the use of NOL tax credits to reduce the minimum tax. This change is analogous to the federal government not allowing a company's losses to be applied against its corporate income tax. Additionally, the proposal imposes a ten year limit for a company to apply unused NOL credits.

MS. MORIARTY added that even though the NOL credits can be deferred, it essentially changes their value and the deferral itself is a tax increase because the company was not expecting to have to pay that same level of tax if prices dropped and if the company defers the NOL credit to be applied in a future year it has to pay the tax, though, in the current year. She continued paraphrasing from her written testimony, which read as follows [original punctuation provided]:

Again, the proposed changes in HB 247, essentially eliminate the value of the NOL tax credit. Without question, changing the value of the NOL will have a tremendous impact on companies and effectively discourage future investment.

There are several other major changes proposed to credits, both for the North Slope and Cook Inlet. Setting arbitrary limits of \$25 million per company, when even the "smallest" of projects range in the \$500 million - \$1 billion range, is unreasonable and will be a strong disincentive for future investment. Eliminating or discouraging cash rebates for companies that may not yet have production or profits, strongly disadvantages new companies, especially considering that they invested in good faith based on the tax policy in place when the investments were committed. For the State to basically say, after the fact, that it is not going to fund its share of the new developments, as originally promised, is just wrong and potentially puts some of these new companies out of business.

Eliminating two important credits for Cook Inlet and "middle earth" is also dangerous as the Cook Inlet drilling tax credits were unequivocally the driver for several key investments in the region that have already led to increased production and jobs. The state has benefitted from several new, smaller companies into the state, making new discoveries that would positively increase the State's future revenues from royalties and taxes on that new production. These credits are not a "cost". They are an investment by the state with a good return. Companies have already entered into contracts and made large financial commitments for spending over at least the next year. Abruptly terminating those credits after they have made substantial good faith investments and commitments over the next year is bad faith on the state's part and will chill these types of investments in the future.

And, we fundamentally disagree that Cook Inlet has gas in search of a market as has been asserted by the Administration. DOR, DNR and enalytica have all testified that additional investments are necessary to

meet the increasing demand of Alaska's residents. Without continued investment, gas production will rapidly decline. Any decline will inevitably result in higher utility rates for consumers and increase the likelihood of gas shortages.

The proposed revisions in Section 39 of HB 247 define "outstanding liability to the state" broadly as "an amount of tax, interest, penalty, fee, rental, royalty, or other charge for which the state has issued a demand for payment that has not been paid when due and, if contested, has not been finally resolved against the state." Thus, the State could deny or delay tax credit payments for virtually any outstanding and alleged liability, regardless of whether it is pending adjudication. If a taxpayer had an existing dispute with a state agency unrelated to taxes, it could be deemed an outstanding liability to the state and the tax credit used to satisfy that liability; or if an audit was pending, the tax credit could be delayed until the conclusion of the audit.

[1:44:46 PM](#)

This revision, absent further clarification or modification, would provide the State with the power to arbitrarily deny or delay any tax credit, or to apply them against unresolved and unrelated disputes, including those utilized by in-state refiners. This could have a major impact on both refineries. According to a recent report by Econ One for the Department of Natural Resources: "Alaska's refineries are relatively small in size and technologically simple. [This] puts Alaska's refiners at a disadvantage relative to larger, more efficient refineries ... [which] becomes greater when refinery utilization outside the state drops, meaning that refiners have spare production capacity. Refiners of Alaska's size and complexity are generally the first to close or idle units in this environment."

It is extraordinary then that in this price environment and the challenges it presents to our instate refineries, Petro Star and their parent company Arctic Slope Regional Corporation are investing over \$20 million on an asphalt expansion in North Pole, scheduled to come online this summer.

Creating increased uncertainty with this provision causes understandable concern to my members.

Although there are plenty more aspects of this proposal that warrants further discussion, I will conclude by addressing the proposed increase in the interest rate. AOGA supports the current rate and believes it is reasonable, particularly considering the lengthy statute of limitations that provides the Department of Revenue with six years to audit a company's production tax return. As Director Alper stated on February 12 in front of this committee, "When there is a change in an oil and gas tax return, it is almost always in the State's favor. We're looking for more money."

[1:47:00 PM](#)

Slide 21

Stated succinctly and candidly, HB 247 fails to encourage increased production, fails to make Alaska more competitive for future investment, and fails to provide stability and predictability. This will, without question, result in lower long term production and revenues to the state. On one hand the Administration has said that it "is not predicting new or lesser activity through the enactment of this bill." On the other hand, the Administration has also stated that "It's reasonable to say that corporate decisions might be made differently if a limitation was put on that (tax credits)."

Enalytica agrees, stating that "limiting refundable credits would increase capital needs." In this price environment, it will be incredibly challenging to find funding for those increased capital needs. Enalytica went on to say, "for projects currently under development, a July effective date would have major adverse impacts."

HB 247 makes a series of incremental changes that could be characterized by investors as "quite scary." And as Mr. Mayer explained last week, "incrementally taking more slivers without fundamental changes to the system which can be more concerning than fundamental

changes -because fundamental changes can be accepted if stable, but this creates 'oh dear', when environment is tough, folks are going to come back year after year to get another slice."

Slide 22

Raising taxes on companies that are reporting losses or are in negative cash flow positions is neither a prudent nor feasible long-term solution, and is certainly not sound tax policy. While we appreciate the need to close the state's fiscal gap, AOGA would advise against taking even more from the oil and gas industry when it is more important for the state to encourage these companies to continue to make critical investments in our collective future. To cripple the oil industry is a misguided attempt to address short-term concerns that will actually result in greater long-term harm to the state's economy.

Compounding the negative impact of the highly burdensome changes in Governor Walker's latest oil and gas tax policy proposal is the provision that all but one of these changes would become effective on July 1, 2016, while one is retroactive to January 1, 2016. It is now [almost March], and companies' operational plans for the full calendar year have already begun to be implemented. Contracts for the entire year have already been entered into, work has commenced, and financial commitments have been made by the companies -all based on the existing tax structure. Any sudden reduction in the tax credits and/or increase in the taxes on such short notice would therefore be, in effect, a retroactive tax change. This would result in a long-term serious impact to Alaska's oil and industry, and have an intensely negative impact on the state's reputation throughout the global banking and financial community.

[1:50:41 PM](#)

Whether or not the Governor's proposal is enacted, the oil and gas industry will still be the largest annual contributor to state government by far.

The oil and gas industry will contribute 7.5 times more than the Governor's proposed income tax, 50

times more than the proposed revenue from mining, and 37 times more than from commercial fishing.

When will it be time for the State to realize that, despite the rhetoric and misconceptions, the industry is not immune from financial hardship? Increasing taxes on the industry that is the largest contributor to state government during a time when that industry is suffering major financial loss will result in long-term negative repercussions to the state's overall economy. Forcing the industry to reduce investments through excessive tax increases in today's economic downturn will lead to a reduction of industry jobs, a reduction of oil and gas production, and a certain reduction in future revenues to the State, all of which will only serve to exacerbate the revenue crisis the state currently faces. This is not a sound tax policy. This is not in the State's best interest.

In the spirit of "Let's pull together", and in order to make it through the current economic downturn, we cannot emphasize enough that imposing significant tax increases and eliminating access to critical incentives does nothing to increase production. It creates more harm to Alaska's largest industry and the state's economy as a whole.

The industry is not before you today asking for a tax decrease or for relief while we struggle though extraordinarily low prices. We do ask, however, that you consider that the industry has supported 85% of Alaska's revenue since statehood, and at this trying time, you do no harm to the long-term viability of the oil and gas industry in Alaska, for the benefit of all Alaskans.

[1:53:01 PM](#)

REPRESENTATIVE JOSEPHSON remarked that when Ms. Moriarty had quoted him there should have been a question mark at the end of the quote, because he did indicate some incredulity and surprise at Mr. Mayer's testimony that because the state has a royalty it's in an arguably better position. He said he was not making a statement of fact, but rather his responding to Mr. Mayer's testimony. He noted that fundamentally his main question was, after hearing from the mining and alcohol and tobacco

industries, each industry could make the same arguments Ms. Moriarty made. Therefore, at the end of the day, even if the legislature used the earnings reserve in some beneficial way to help the people of Alaska, the legislature is left with nearly a multi-billion dollar deficit. He offered that the only option, in taking the collective wisdom of all of the industries, is to impose taxes on Alaskans. He noted that Ms. Moriarty had discussed "pulling together," and he asked her to respond.

MS. MORIARTY recognized the challenging position that the legislature is facing. She stated she was in agreement with the mining testimony last week because the points were the same for the oil and gas industry: In a low commodity price environment and when industry is already struggling, additional taxes will only make a bad situation worse. She said taxing the largest economic drivers for the state "will not increase the feeling that maybe Alaska's going into a recession." She noted there has been some speculation as to whether or not Alaska is in a recession, but people are nervous and feeling that things are maybe not going in the right direction. She stressed the oil and gas industry is saying that increasing taxes on them will compound the problem in a different way, in that it may help the state short-term for its revenue, but there will be repercussions. She reminded the committee that every direct job impacts 20 more jobs throughout the economy; therefore, the industry currently creates 11 public sector jobs for every job that it creates. She described it as a delicate balance and stated that her testimony advised the committee of the impact [HB 247] would have on the oil and gas industry.

[1:56:28 PM](#)

REPRESENTATIVE TARR referred to the slide depicting North Slope production as stable, to which Ms. Moriarty had commented that the difference is 50,000 barrels, and asked about the source of that number. She reminded the committee that the fall 2013 forecast was after the previous administration decided to change the way it performs forecasting with a more conservative approach. It is not entirely genuine to use those numbers, she stated, in the way Ms. Moriarty suggested.

MS. MORIARTY advised that AOGA relies on the state's forecast and said she cannot speak to the methodology. After Senate Bill 21 was passed, while the public considered the referendum, the forecast for 2020 was almost 400,000 barrels per day and currently the forecast is for 460,000. She opined it was clear that production has stabilized, in that production for 2015 was

approximately 519,000 barrels per day and that is the exact forecast for this fiscal year.

REPRESENTATIVE TARR stated that that is an issue to be revisited with Mr. Alper because that conversation, under the previous administration and the way it was reported in the news, was a methodology [DOR] suggested was done in partnership with the industry, and the industry did actually have some influence over that change.

MS. MORIARTY responded that the industry always has input on the forecast and she was not suggesting it does not. She emphasized that every administration has taken the information industry shares with it in order for [DOR] to determine a forecast. She continued:

I'm just saying if you used our production forecast numbers, which we don't release because we don't talk about it collectively because that would break anti-trust ... rules. We can't talk about production and price forecast. That's why we rely on the Department of Revenue. So, they always take what the industry tells them and makes a forecast.

REPRESENTATIVE TARR recalled that that was a pretty controversial change and there were questions about how that might be manipulated and how the legislature would review those numbers going forward. She reiterated that she would like to hear from the department on that as well.

[1:59:45 PM](#)

REPRESENTATIVE SEATON noted the diversity in features of HB 247. He expressed particular concern with tax credits, specifically state expenditures on the reimbursable tax credits. He explained the tax credits are a direct expenditure from Alaska's reimbursable cash to companies and that the industry cuts its expenditures when they are having financial problems. He reiterated Representative Hawker's comment about the committee relying on Ms. Moriarty to explain the specific impacts the elimination of these credits would have on individual projects. He said the Cook Inlet credits are the largest portion of the money being discussed and pointed out that the state would never even recover its capital expenditures if the credits were on expenditures over the entire life of the project.

REPRESENTATIVE SEATON mentioned slide 16 from the consultant analytica's presentation [to the House Resources Standing Committee, on 2/27/16], explaining that in the current constrained gas market the net present value (NPV) to the state of those credits ranges between negative \$125 million to \$50-60 million in net losses. Another insight from analytica, he related, was that worldwide, a natural gas price of \$5-\$6 per thousand cubic feet (Mcf) would be sufficient to make even the most challenged gas deposit profitable and economic. He further explained the state is trying to figure out how to proceed with seemingly unneeded credits in a high price environment, such as Cook Inlet where the price is about \$7. He asked Ms. Moriarty if she could explain what the impacts would be on individual projects if those tax credits were eliminated while there was still a high priced gas market.

MS. MORIARTY requested clarification of the question.

[2:03:29 PM](#)

REPRESENTATIVE SEATON said there were two portions of support for economic development of [Cook Inlet] projects: tax credits and high priced gas. Both the administration and the legislature's consultants have advised that the higher price of gas would be economically sufficient to do the projects and he therefore wanted to know whether the higher price for gas is enough to make projects economic and what the effect of eliminating the tax credits would be.

MS. MORIARTY advised that tomorrow there will be testimony from people operating in Cook Inlet specifically and they will answer that question. She stated that categorically from the industry as a whole, the elimination of the tax credits would have a negative impact on investments, especially with an effective date of July 1. She opined that tomorrow BlueCrest Energy will discuss a gas project that is specifically on hold because of the uncertainty surrounding whether the tax credits will be available. Regardless of the price environment for gas, she said, the industry as a whole is still in a negative cash flow position; therefore, making those investments in the timeframe is still very challenging. She stated that the tax credits were absolutely necessary to bring those companies to Alaska. She added, "You wouldn't have had the hundreds of millions of dollars of investment over the last six years that have increased the Kenai Peninsula Borough's tax revenues, and increased the workforce and property values in that community without the tax credits."

2:06:08 PM

REPRESENTATIVE JOSEPHSON noted he supported "the Agrium bill" and that even though it meant a reduction to the state, he saw that the case was made. He said he also sees Ms. Moriarty's point of view. Notwithstanding that, he recollected that Mr. Mayer, during his testimony at a prior meeting, had offered his understanding that the industry in Cook Inlet believed that the tax credits that exist in the inlet are not sustainable, because they are too generous. He asked for Ms. Moriarty's response to Mr. Mayer's comment.

MS. MORIARTY responded that she has not had any direct conversation with Mr. Mayer since two sessions ago, and she offered her understanding that he did have conversations with individual companies; therefore, she encouraged Representative Josephson to ask the Cook Inlet companies that question to determine where [Mr. Mayer] may have obtained his information.

2:07:38 PM

REPRESENTATIVE HERRON referenced slide 20 regarding specific concerns with the bill and slide 16 regarding the four policy questions. He advised that when the governor's bill makes its way out of committee it won't be the governor's bill as there will be changes. "Obviously there must not be any good points that you've put on that sheet," he said. He asked Ms. Moriarty to describe the [most critical concerns] on which the committee should focus by highlighting which were bad and which were ugly.

MS. MORIARTY replied it is impossible to advise which ones are "evil, bad, and sort of ugly," because for various companies the proposals will have different impacts based on the company. Therefore, AOGA is saying, holistically, that all of these changes will have a negative impact on every single company. For example, when increasing the minimum tax by at least 25 percent. A company that is already paying the minimum tax is faced with a 25 percent hit. A company that isn't paying a tax right now and has production, but hasn't made a profit or was given a small producer exclusion, goes from "zero to five." A company that doesn't pay tax now has an "infinite increase." The point is, she related, that all of these changes have a different impact based upon the company, which is why each of the companies will testify.

2:10:02 PM

REPRESENTATIVE JOSEPHSON referred to the first couple slides and speculated that in some respects the industry might like the fact that the state is trying to wean itself from dependence. At the same time, he said, he occasionally feels as though each time the legislature tries to be the 18-year-old moving out of the house, the industry wants to remind the legislature, "No, you can't leave, you must stay with us." He requested Ms. Moriarty to respond.

MS. MORIARTY agreed the industry would "love for the state to have a diversified economy, make no mistake about it." She pointed out that the industry has been the largest contributor to state government, not by choice, but by the policy put in place by the state. She stated the industry takes its role responsibly. Its employees are good corporate citizens who provide large amounts of community service. She reiterated that the industry would love to have a diversified economy, but she opined that increasing taxes as a way to try to solve a fiscal crisis does not provide any stability or predictability. She continued, "Because all we see as the industry is: you raise taxes when prices go up; you raise taxes when prices go down; what's going to happen next year if you pass everything and you're still a billion dollars short for whatever reason?" She asked, "So, does that mean you're going to come back to us again and again and again?" She reiterated that HB 247 would not provide stability to the industry.

[2:12:23 PM](#)

REPRESENTATIVE JOHNSON opined that he looks at this as pay me now or pay me later. He said [the state] can extract the wealth from the oil industry now and lose it later because of lack of production in those areas of things, such as exploration, that the state would be missing out on. He said he would like to see effort spent regarding the loss of production versus taking the money now, some of the balance is missing. He indicated his dilemma is in answering the question: "Do we take it now when we, quite frankly, have more savings than we will maybe in ten years when the lack of production really catches up and we really drop down and TAPS [Trans-Alaska Pipeline System] becomes an issue?" He requested an analysis on what the state would forego in revenue by doing this now based upon exploration and investment. He said he would like to see an apples to apples comparison, including cost.

MS. MORIARTY noted that Representative Hawker had remarked that the administration [had advised the legislature to obtain an impact analysis from the industry], and she indicated that [the industry would provide that information]. However, she said that what Representative Johnson was discussing was something that the industry cannot really do. She questioned where the credibility would be if the industry told the state that under HB 247 it would experience a \$50,000 loss. She explained the industry can take the state's projection and make assumptions but it would be much better if it came from a third-party, such as Econ One or Wood Mackenzie, thus AOGA would encourage a third-party analysis.

[2:14:57 PM](#)

REPRESENTATIVE JOHNSON noted that if taxes are raised, production will drop; if taxes are not raised, investment and production will go up. He described it as a timing issue and asked whether his assessment was accurate.

MS. MORIARTY stated that Representative Johnson's assessment is not off base in that Janet Weese, from BP and the AOGA board chair, in January discussed that tipping point and where it may lie. Ms. Moriarty agreed that the legislature could increase taxes on the industry, but questioned how that would impact investment decisions, which in turn would impact production 4-15 years from now. She warned that the industry is already at a tipping point in a cash negative position; therefore, the state's actions could have long-term consequences.

[2:15:59 PM](#)

REPRESENTATIVE HAWKER referred to Ms. Moriarty's previous testimony that the industry participants themselves are actively and regularly engaged with the Department of Natural Resources (DNR) and to some degree the Department of Revenue (DOR) in the preparation of the Revenue Sources Book by providing access to a certain amount of confidential production information. He asked whether the members of AOGA will continue to work with the state toward the spring update of the Revenue Sources Book and provide information as to the potential decreases in production the legislature can expect to see if this legislation is enacted.

MS. MORIARTY agreed that those are confidential conversations the companies have with DOR and therefore she cannot speak to those questions. She said the companies have ongoing

relationships with all regulatory agencies and stated that that is a good question for the companies.

[2:17:07 PM](#)

REPRESENTATIVE JOSEPHSON referred to concerns raised by DOR, and possibly others, regarding the statute and that the current operating budget only funds 10 percent of the credits that are likely to be requested for repayment. He asked whether the current statutory authority allowing the governor to pay only 10 percent creates anxiety that there should be greater balance so that the likelihood of payment is there for the industry.

MS. MORIARTY replied that HB 247 does not provide any further stability to that. The bill could pass with all of the problematic provisions, such as the \$25 million limit, in-state hire, companies with gross revenues of more than \$10 billion can't pay, and that it can't be against the net operating loss. All those provisions could go into place and next year the governor could only put in \$40 million for the tax credit fund if that was the 10 percent number [of operating budget funds]. From AOGA's standpoint, HB 247 provides no stability, no predictability, and no certainty.

[2:18:56 PM](#)

REPRESENTATIVE SEATON noted that a production increase of 8,000 barrels per day in Cook Inlet would equal 2,920,000 barrels of increased production for \$400 million in tax credits. If the credits and that production rate continued, the [cost to the state] would be \$136 per barrel. He asked whether, even with a factor of 10 percent, the industry would expect the state to continue that kind of price support by extending credits based on the amount of production received.

MS. MORIARTY responded that it all goes back to what was happening to production before those credits were in place and whether that is the type of production the state wants for Cook Inlet and the state. She pointed out that AOGA is saying that those credits have been essential in increasing production, essential in providing more royalties and property and corporate income tax both to the state and the local governments, and they are providing jobs. The industry will respond to the policies set by the legislature, she said.

REPRESENTATIVE SEATON asked whether the industry would expect the state to give credit price support of \$136 per barrel, which

would be the increased production for that kind of credit support seen in Cook Inlet.

MS. MORIARTY reiterated that that policy would be the purview of the legislature and the industry will respond to whatever policy is in place.

REPRESENTATIVE SEATON stated:

I guess you're in here testifying that we should keep the credits in place, and that policy is what we should keep in place for credit support for additional production in Cook Inlet. And I guess if that's your testimony, that's ... fine. And if you're just saying we should figure out what's good for us and ... just take that ... policy decision, that's fine too.

MS. MORIARTY interjected that the policy in place has increased production, and should the committee believe that is a good policy that should be continued, then the committee should probably keep the Cook Inlet tax credits in place. In the event modifications should be made to the credits, the industry will modify its response, which will likely have an impact on investment and production.

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REPRESENTATIVE HAWKER stated that Ms. Moriarty's response to Representative Seaton confused him. He said he understands the question as Cook Inlet currently producing an additional 8,000 barrels per day and the state having invested approximately \$400 million in frontend credits. He asked whether many of those credits are exploration as well as frontend-loaded credits on establishing a level of production. Investing that much money now will result in a long-term stream of production that will continue for years and will not require an equal level of support. He offered his understanding of Ms. Moriarty's response as follows: "No, we have to put that same amount in every year to get that same amount of production every day."

MS. MORIARTY offered her understanding that Representative Seaton had asked her whether she thinks the amount of credits currently being given are sustainable, to which she had responded that [those credits] have "worked to increase investments that will have an increased production over the life of those fields and investments." She said she could not predict "whether it's \$440 million for another ... six years,"

because the price environment will self-correct. In this price environment people are going to reduce their investments, which would result in a reduction on the amount of credits paid whether or not the system is changed. She continued:

I mean unfortunately we'd like to keep the same level of spend but when price is only \$30 it's probably not going to be the same level of spend. ... Maybe I misunderstood the question, but my point was is we think the credits have been very important for Cook Inlet production and investment.

[2:24:29 PM](#)

REPRESENTATIVE HAWKER described the discussions as "apples and oranges," and said he would like witnesses to address the frontloaded nature of credits and the long-term nature of production arising from those credits. He noted that he will not be able to attend some committee meetings and he would like someone to bring up that issue.

[2:24:58 PM](#)

REPRESENTATIVE TARR advised that Hilcorp made front page news for giving a bonus of \$100,000 to each of its employees, to the tune of over \$100 million. She asked how AOGA expects the Alaskan public to react to that information and then the response that Hilcorp is hurting.

MS. MORIARTY responded that the company made a five-year commitment to its employees and, even in this tough economic time, decided to honor that commitment, which she described as the company putting forth that it cares about its workforce. With respect to the state being in a deficit and AOGA asking for no additional increases on the industry, she noted that Hilcorp had purchased fields on the North Slope and is part of the \$52 a barrel. Currently Hilcorp has a negative cash flow of about \$22 per barrel, and the legislature is asking Hilcorp to add costs to that at a time that it will cause an impact to either its capital spend or operational spend. Making a policy decision to raise taxes on an industry that has negative cash flow is the legislature's prerogative, but the industry is saying that that policy will impact its investment and production.

REPRESENTATIVE TARR commented that her constituents do not view the company as having tough times when they read about over \$100

million in employee bonuses. She said, "That doesn't ring the alarm bells that ... bad things are happening to them."

MS. MORIARTY said the industry is hurting and stated that several hundreds of jobs have been lost from ConocoPhillips, BP, and others in the state. She advised that with the continuation of these prices combined with an increase in taxes there will be more job losses seen in Alaska.

[2:27:47 PM](#)

REPRESENTATIVE NAGEAK opined that both the private and public sectors honor their commitment to their employees. He declared that the state gives raises every year even when money is low.

REPRESENTATIVE TARR commented the action of the legislature, until the final negotiations last year, was to not honor those. She opined that was probably not the best example.

[2:28:48 PM](#)

The committee took an at-ease from 2:28 to 2:34.

[2:34:08 PM](#)

BILL ARMSTRONG, President, Armstrong Oil & Gas, explained he did not have a prepared statement or a PowerPoint today but was going to speak "from the heart." He explained he wanted his time before the committee to be a question and answer session. He noted things he wanted to discuss with the body today include: where the price of oil is and where it is headed; the recent announcement of his company's new discovery; state oil tax policy, specifically HB 247; and the Trans-Alaska Pipeline System (TAPS). Mr. Armstrong articulated he wanted everyone to know how much he loves Alaska. His company has been in Alaska for 15 years. He opined the state and his [current and former] companies have worked well together and that their ventures have been mutually beneficial. He mentioned he was the first one to independently own and operate a field on the North Slope, and he pointed out it is the sixth largest field on the North Slope. He further pointed out the second field to ever be put into production, which he noted is now the fourth biggest field, also originated from his office. He announced that recently his company and its Spanish partner, Repsol, found a field that may possibly be the second biggest field on the North Slope. He said Armstrong Oil & Gas is a private company and he believes in the state, both its potential and future.

2:38:24 PM

REPRESENTATIVE HAWKER clarified that Mr. Armstrong is alluding to the high prospectivity of the Colville Delta project. He reported that some of the DNR numbers he has heard are 100,000 barrels a day and noted this is an environmentally sensitive and difficult area to develop. He requested Mr. Armstrong to give the committee some sort of confidence in the company's ability to overcome the environmentalists' objections.

MR. ARMSTRONG replied the discovery is named Pikka, a name he hopes to change, and is located between the Alpine Field and the Kuparuk River Unit. He said the Pikka discovery is not in a massively sensitive area such as the Chukchi Sea or areas that have a very high profile. ConocoPhillips and Atlantic Richfield Company (ARCO) already have five pads in the delta and have shown the resources in the area can be developed. The first three pads at the Pikka discovery planned for development are east of the river, not in the delta. The company went with an environmental impact assessment (EIA) as opposed to an environmental audit (EA). He added he did not feel the EIA was necessary but it was done at the request of DNR, Nuiqsut Village, and the Native corporations. He said simple gravel roads will be used, and oil on vertical support members, small pads, and long-reach wells and therefore he didn't expect much in the way of environmental impact nor in objections.

REPRESENTATIVE HAWKER congratulated Mr. Armstrong.

MR. ARMSTRONG described when he came to Alaska in 2001, all the big companies had essentially written off Alaska for any prospects; BP and Exxon decided they were not going to drill any more wildcat wells, and the general thesis was that all the big fields had been found. He explained the pipeline was declining and had peaked out at 2 million barrels a day and was on its way down to something noncommercial, but he did not believe that to be true. He described the new field as being shallow and "very old fashioned." He further described it has multiple "pays," a 23 percent porosity, 150 feet of pay, and huge oil columns. He explained it has not been fully appraised yet, but the company has already found over 1 billion barrels. He added that "the wells are going to be good, fast production" and said this discovery could "really add a big jolt to TAPS."

Mr. Armstrong declared that it is getting difficult to produce and there are discussions about "heating it up" and adding more

pigs and compressors, but the best way to keep TAPS going is more oil. In reference to the decline curve from Ms. Moriarty's presentation he proclaimed [his company and Repsol] are not going to flatten it, but increase it. The oil field is really good and will last a long time, he said, and Armstrong Oil & Gas and Repsol have put a lot of effort into it. He reported they have seven penetrations in one zone and four in another that have already been appraised, and multiple others. He advised, "As a group, as a state, you have to get wells drilled," because if wells aren't drilled oil won't be found. There is room to find more fields like his and Repsol's on the North Slope. Easier access to the land and a better permitting process are needed; it is not a diminishing asset, it can increase.

[2:45:53 PM](#)

REPRESENTATIVE HAWKER inquired how Mr. Armstrong would respond to someone who said he didn't need the state's financial incentives because he was doing so well.

MR. ARMSTRONG replied that without the state's incentives he would not have come to Alaska in the first place. The competition the state has is not with other oil companies, he opined, it's with other regions. He declared this price dip won't last. Pretty much across the globe, regions are making terms better by giving tax incentives or re-trading their policies, he said, with the exceptions being Congo, Madagascar, Tanzania, and Alaska. He posited, "To make things worse when things are bad, you are kind of in rare company."

[2:48:42 PM](#)

REPRESENTATIVE HAWKER requested Mr. Armstrong to identify, specifically to the North Slope, which state incentives brought him here and which keep him here. He also asked Mr. Armstrong to talk about his Cook Inlet experience and offer advice on how to keep it developing.

MR. ARMSTRONG answered that Armstrong Oil & Gas was active in Cook Inlet for four or five years because of the credits. He said, "The production in the Cook [Inlet] was dropping like a rock and you know exactly what was needed in Southcentral to keep the schools heated and the hospitals open, and there was a day of reckoning that was going to come within a ... half dozen years or so and you all put together a series of very generous tax credits." He described it as the "greatest tax regime on the planet," and it worked. He explained he was able to put

together a project with a field of about 100 billion cubic feet (Bcf) and a 25 mile pipeline and sold into the Southcentral gas market. He said he didn't have an opinion about the credits because he hasn't worked there in so long, but that they did work. As for the North Slope, he said he has had the "dis-privilege" of having five different tax regimes since 2001, something that is extremely unusual. The economic limit factor (ELF) was the tax regime that helped him come here, because it was set up for developments that didn't have a huge field. Following ELF, Governor Frank Murkowski created the petroleum production tax (PPT), which was the beginning of the "progressive quasi windfall profits tax." But, he said, things went completely off the rails with Alaska's Clear and Equitable Share (ACES) and he left the state at that point. He deemed ACES as ridiculous and said no one could make any money with ACES in play. He said he met with Governor Sean Parnell and knew he would reform it because it was not sustainable. Governor Parnell did reform it, with Senate Bill 21, and it was good and was working. While Senate Bill 21 was extremely complicated it made Alaska competitive with the continental U.S. At that time he came back to Alaska, as did Jim Musselman with Caelus and Jeff Hildebrand with Hilcorp, and it marked the beginning of people coming to Alaska. He said the lifespan of Senate Bill 21 was during this collapse. He said no opinion can be said in this current financial environment. Everybody is dropping rigs like crazy and in every exploratory region.

[2:55:18 PM](#)

REPRESENTATIVE HAWKER stated that he has always appreciated Mr. Armstrong's unabashed honesty.

REPRESENTATIVE TARR stated the legislature was trying to figure out the specific impact to current projects if changes were made right now. She opined that in comparing different tax regimes, referencing Mr. Armstrong's statement that ACES was bad, there was concern about companies like his because of capital credits being structured so generous. She offered her assumption capital credits were essentially the same as operating loss. She stated the legislature is also trying to figure out if the credits being used incentivize wanted behaviors. She asked Mr. Armstrong, with the exception of his previous statement about wanting people to drill wells, to explain in the context of his work which credits does he believe to be favorable.

MR. ARMSTRONG replied the big one is the 35 percent net operating loss credit, because it enables the industry to

weather the time it takes to drill wells and get production online. He mentioned he didn't want to upset any of the oil guys in the room, but exploratory credit "is peanuts in the scheme of things." He shared with the committee there is an internal name for HB 247: "Hell bent 24/7 to run every oil company off the North Slope."

[2:58:29 PM](#)

REPRESENTATIVE OLSON expressed his desire to address the Cook Inlet stampede. He explained it was primarily "Tom Wagner's baby." He reported he thought Mr. Wagner was crazy when he first discussed it, but then he started to make more and more sense and turned it into a real asset. He explained to Mr. Armstrong it didn't really attract a lot of attention from [companies outside of Alaska], with the exception of his. Representative Olson agreed with Mr. Armstrong's assessment of HB 247. He said he had heard that the only place HB 247's tactics were being used was in third world countries and thanked Mr. Armstrong for confirming that information.

[2:59:32 PM](#)

REPRESENTATIVE JOSEPHSON inquired as to the historic timing of Mr. Armstrong coming to Alaska and which incentives he found attractive in 2001.

MR. ARMSTRONG responded that Alaska is blessed with one of the best petroleum systems in the world. All of the problems are above ground - permitting, environmental extremism, tax laws, and facilities access - but below ground it is fantastic. The North Slope is really not very "picked over," unlike most other places in the Lower 48, but is geologically terrific. He asked if the committee remembered the charter agreement that he thought to be expired. He elaborated that it was the product of the legislature's realization that production peaked in 1990 and was on its way down. Mr. Armstrong described that at the time there was an oligopoly on the North Slope because BP and ARCO were pushing people away by not working with them and limiting seismic access, well information, and land trades. These were the series of events that led to the creation of the charter agreement, which was ostensibly an "open for business sign." In answer to Representative Josephson's question about what brought him to Alaska, he indicated it had been the charter agreement and all the business opportunities for oil and gas exploration.

[3:03:05 PM](#)

REPRESENTATIVE HAWKER admitted he was not aware of any such agreement and asked whether Mr. Armstrong was referring to the BP/ARCO merger agreement.

MR. ARMSTRONG answered no, and offered that it was only about four pages in length and was quite "loose."

[3:04:02 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:04 p.m.