

SENATE FINANCE COMMITTEE

April 13, 2016

1:47 p.m.

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CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 1:47 p.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair
Senator Pete Kelly, Co-Chair
Senator Peter Micciche, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Randall Hoffbeck, Commissioner, Department of Revenue; Ken Alper, Director, Tax Division, Department of Revenue; Kara Moriarty, President and Chief Executive Officer, Alaska Oil and Gas Association; Dan Seckers, Tax Counsel, ExxonMobil Corporation; J. Patrick Foley, Senior Vice President, Alaska Operations, Caelus.

PRESENT VIA TELECONFERENCE

Joe Reese, Alaska Tax Manager, BP; Dave Wilkins, Senior Vice President, Hilcorp Energy, Anchorage; Ed Kerr, Director, Armstrong Oil and Gas, Denver; Pete Stokes, President, Alaska Support Industry Alliance, Anchorage.

SUMMARY

SB 130 TAX;CREDITS;INTEREST;REFUNDS;O and G

SB 130 was HEARD and HELD in committee for further consideration.

HB 247 TAX;CREDITS;INTEREST;REFUNDS;O and G

HB 247 was SCHEDULED but not HEARD.

Co-Chair MacKinnon discussed the day's schedule.

#sb130

SENATE BILL NO. 130

"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."

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, explained that the governor's total fiscal plan had three components: the use of earning's reserve; reduction in expenditures; and increased revenues. He stated that the bill would address two of the three components. He explained that the bill reduced the size of the credit outlay on an annual basis, and it also had a provision for additional revenues related to the "hardening of the floor" and the change from the 4 percent to the 5 percent minimum tax. He stated that the administration recognized that Department of Revenue (DOR) could not offer stability to the industry without necessary funds to sustain the credit program. He shared that there were over thirty meetings with various members of industry, and with those within the financial community in order to understand the impacts of the legislation and the veto from the year prior.

Senator Dunleavy wondered if the proposed legislation was a change to previously oil and gas tax reform legislation [SB 21]. Commissioner Hoffbeck replied that the "hardening of the floor", and the rate change from 4 percent to 5 percent were related to SB 21. He explained that that all of the Cook Inlet credits were related to Alaska's Clear and Equitable Share (ACES), not SB 21. He stated that the governor did not want to revisit SB 21, but there was a consideration to raise the minimum tax rate.

Senator Dunleavy queried whether the calculations showed that the state would be better served under ACES. Commissioner Hoffbeck replied that the state was in a unique situation, because the net operating losses had allowed tax rates to move to zero, so there was not much difference between SB 21 and ACES-unless there was a comparison related the number of credits.

Senator Dunleavy asked if the state would better under ACES.

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KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, replied that the answer would have been affirmative the year prior. He explained that the minimum tax in SB 21 was far stronger than ACES, and the state was receiving \$3 million to \$4 million more than ACES.

Senator Dunleavy surmised that the state was not "better off" under ACES. He wondered if the state would be better under ACES or SB 21, if the price of oil resumed to \$60 or \$70 per barrel. Commissioner Hoffbeck replied that as the prices increases, the state was still in the minimum tax regime. Therefore, the state was "better off" under SB 21.

Senator Dunleavy asked if some tax credits started prior to ACES. Commissioner Hoffbeck replied in the affirmative.

Senator Dunleavy stressed that the SB 21 was not detrimental to the state.

Co-Chair MacKinnon outlined the schedule for the meeting.

Mr. Alper discussed the presentation, "Oil and Gas Tax Credit Reform - CS SB 130(RES)," (copy on file). He wanted to highlight the basic features of the current and original version of the bill.

Mr. Alper addressed slide 2, "History of Oil and Gas Production Tax Credits":

FY 2007 thru 2015, \$7.4 Billion in Credits
North Slope

- \$4.3 billion credits against tax liability
 - Major producers; mostly 20 percent capital credit in ACES and per-taxable-barrel credit in SB21
- \$2.1 billion refunded credits
 - New producers and explorers developing new fields

Non-North Slope (Cook Inlet and Middle Earth)

- \$100 million credits against tax liability
 - Another \$500 to \$800 million Cook Inlet tax reductions (through 2013) due to the tax cap still tied to ELF
- \$900 million refunded credits (most since 2013)

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Mr. Alper discussed slide 3, "History of Oil and Gas Production Tax Credits," which showed a regional breakdown of the refunded credits. He explained that it was a North Slope-centered regime, until the Cook Inlet Recovery Act. Over the most recent two years, the regime became mostly non-North Slope operators. He stressed that it was mostly Cook Inlet, and there were a limited number of Middle Earth credits and were not available to report because of confidentiality.

Mr. Alper turned to slide 4, "Forecast of O & G Revenue and Tax Credits."

Mr. Alper showed slide 5, "Work Done Since Last Session":

- Governor's line-item veto capped FY16 spending at \$500 million
 - Temporary liquidity crisis; many meetings with industry and others to help reassure lenders
- Multiple presentations with history, current practice, and possible changes
 - Joint Resources in Kenai, June 17
 - Three "regional" presentations to Senate Working Group September through November
 - All presentations on BASIS; we're prepared to go through similar information for the committee
- Development of reform legislation including plan for transition from current system

Co-Chair MacKinnon wondered if the referenced documents were available on the DOR website. Mr. Alper replied that the documents were available on BASIS.

Mr. Alper spoke to slide 6, "Major Bill Themes":

1. Reduce the state's annual cash outlay
2. Protect Net Operating Loss credits as a playing field leveler between legacy producers and newcomers
3. Limit repurchases
4. Strengthen the minimum tax
5. Be more open and transparent

6. Honor and pay credits earned to date and through any transition period

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Mr. Alper discussed slide 7, "Major Bill Concepts in Governor's Proposal":

1. Exploration Credits- sunset and transition
2. Cook Inlet Drilling Credits- phase out while retaining operating loss credits
3. Repurchase Limits- limit cash outlay
4. Remove Exceptions / Loopholes
5. Strengthen Minimum Tax- prevent certain credits from going below the floor, plus increase to 5 percent
6. Other Provisions- technical cleanup, transparency, interest rate reform

Mr. Alper showed slide 8, "Changes made in Senate Resources":

- Kept and improved many of the technical fixes, including inadvertent "double dip" credit for new oil on the North Slope
- GVR "new oil" reverts to legacy after 5 years
- Phased out all Cook Inlet credits in 2018, while also establishing a zero tax on Cook Inlet oil and gas
- Increased repurchase "cap" to \$85 million / company / year without large company exclusion
- Removed changes to minimum tax "floor," transparency provisions, and migrating credits
- 7 percent+Fed / compounding interest only for 3 years
- Surety bond for local creditors / bankruptcy protect
- Alaska Hire precedence for credit repurchase

Mr. Alper recounted that the Senate Resources Committee had passed out the bill the previous day.

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Mr. Alper presented slide 9, "Current Status of CSHB247 (FIN) amended":

- Also kept and improved many of the technical fixes
- GVR "new oil" reverts to legacy after 7 years
- Reduced Cook Inlet credits to NOL only on faster timeline; Cook Inlet tax working group
- Increased repurchase "cap" to \$100 million / company / year without large company exclusion
- Partially hardened minimum tax: credits can reduce to 2 percent, retains 4 percent hard floor for per-barrel credits
- Removes transparency provisions and several smaller provisions
- 5 percent+Fed / compounding interest only for 4 years
- Surety bond for local creditors / bankruptcy protect
- Alaska Hire precedence for credit repurchase

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Mr. Alper moved to slide 10, "Summary of Fiscal Impact" which was a comparison of fiscal notes between the governor's original bill, the House version, and the current committee substitute. He remarked that the actual fiscal note was more detailed, and contained 15 or 20 line items that addressed individual provisions of the bill. There was a yellow line on the bottom that showed the total of the revenue increases and the spending decreases. The fiscal note would be forthcoming with a narrative later in the day. The House version of the fiscal note was amended, so the current fiscal note was slightly different. He remarked that the bill was somewhat smaller in FY 17, primarily because of the effective date. The governor's bill attempted to do more on July 1 of the current year, but the committee versions had adjusted most changes to at least January of 2017. He stated that the committee substitute contained approximately \$55 million from the elimination of the Cook Inlet tax credits. The \$15 million of North Slope credits elimination was due to the interplay of the gross value reduction, which could be used to increase the size of a net operating loss to create some artificially high NOL credits. The House version had similar numbers on those provision, and a floor-hardening revenue items that added another \$95 million in additional revenue in FY 18 and FY 19. The governor's bill was much larger in comparison, because of the fully hardened 4

percent floor; and the \$25 million per company cap, which would have material impact in delaying certain credit payments.

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Mr. Alper discussed slide 11, "Content of Future Presentations":

We have provided nine different presentations to three prior committees; all are on BASIS

- History and development of our credit system
- History and application of the minimum tax
- Various credits and how they have been used, which ones haven't been, and what is sunseting
- Current application status, impact of Spring Revenue Forecast, and NOL Carry-forward issue
- Details and modeling of specific bill provisions
- Explanation of changes made in prior committees
- Life cycle modeling of typical new projects, with impact of legislation

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Vice-Chair Micciche referred to slide 2, and expressed appreciation for the outline of the slide. He queried the approximate GF revenue from FY 07 to FY 15. Mr. Alper responded that the production tax revenue was approximately \$27 billion. The total oil and gas revenue was higher than that, and agreed to provide that information.

Vice-Chair Micciche queried the non-North Slope revenue. Mr. Alper stated that the production tax would be close to zero. He agreed to provide specific information about royalties, but surmised that it would be approximately \$10 million to \$20 million a year.

Vice-Chair Micciche wanted to know the production tax for 2007 through 2015, and the royalties for 2007 for 2015 for the two segments.

Vice-Chair Micciche referred to slide 4, and stated he would like to see the graph calculated to include the years 2007 through 2015. He stressed the SB 21 had nothing to do with the \$4.1 billion budget gap, and asserted that the state was in better shape than it would have been. He felt

that eliminating royalty caused speculation about whether the administration believed that there were fields in the state that would be so expensive to produce where it may be appropriate to settle for royalty rather than no production at all. He queried further explanation of that philosophy. Mr. Alper replied that the information on slide 4 included 70 percent of the royalty, which was the royalty that was subject to appropriation for use in the annual budgets. The other 30 percent was deposited into the corpus of the Permanent Fund and was effectively "untouchable." He agreed that the state received value from the royalty. He shared that, before 2008 when the prices spiked in net profits tax, the state made more from royalty than it had in production tax. He shared that there was a previous document that addressed where the state received royalty in different ownership statuses. He shared that the state did not necessarily receive royalty if it was not from state land. He shared that the National Petroleum Reserve of Alaska (NPRRA) allowed for a restricted one-half royalty to the state, but was restricted to certain community use. He explained that private land allowed for a gross tax of 5 percent of the royalty. He stated that the possibly development of the Arctic National Wildlife Reserve (ANWR) would allow for 90 percent of the federal royalty, which was unrestricted and the best overall scenario. He stressed that it was important to recognize that the state did not always receive the royalty, but the credit obligation fell to the state, anywhere in the state where the expenditures occur.

Vice-Chair Micciche would like to provide a comprehensive view. He remarked that there was a reduction of the cost of oil transportation in locations where there may be a lower proportion of royalty. He announced that he had many questions, but would wait to ask them.

Co-Chair MacKinnon urged Vice-Chair Micciche to put his questions into the record.

Vice-Chair Micciche stated that he would email his questions.

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Senator Bishop commented that the whole problem was not an issue of the mechanics of SB 21, but rather the issue related to the price of oil. Mr. Alper concurred, and

thought if there were flaws in the tax system it was related to not contemplating what would occur at very low prices in the tax system.

Senator Hoffman wondered if the administration planned to address the problem of "stackable credits" in the future. He understood that those credits would be approaching almost \$2 billion. He queried the administration's plan to address those credits. He remarked that the increase in oil price would be used to fund government, and not to pay credits. Commissioner Hoffbeck agreed to provide that information. He shared that looking beyond a couple of years adjusted the forecast on credits, because the industry plans were unknown. He agreed to provide a forecast based on the Revenue Sources Book. He shared that the appropriation level determined the availability of funds to pay the credit.

Senator Hoffman wondered whether the administration was concerned about the unpaid credits reaching \$2 billion. He specifically asked if the level of unpaid credits was a concern, and how those credits would be paid. Commissioner Hoffbeck stated that the backlog of credits was a big concern of the state. He remarked that there were also discussions regarding the credit payment limits per year, which result in greater numbers of unpaid credits.

Co-Chair MacKinnon stressed that the legislature had approved more credits to be paid, but the administration vetoed those approval. She disagreed with the assertion that the legislature did not fund the credits, because the state owed \$400 million more that would have been paid and off the books.

Senator Dunleavy thanked Mr. Alper for comments regarding the unknown oil price decrease. He stressed that the conversations around SB 21 often focused on the assumption that the oil price would continue to climb to \$140 per barrel. He wondered if oil production was predicted to increase in the coming year. Commissioner Hoffbeck responded in the affirmative. He stated that the following two years showed slight "uptick" in production, and then it was predicted to fall after that.

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Co-Chair MacKinnon had heard a request from Vice-Chair Micciche and Senator Hoffman to show consistent date ranges portrayed in the slides. She looked at slide 2, and wondered if there would be a representation of 2007 to 2015 credit pay out. She looked at slide 3, and noted a request to match the same dates to update it to 2007 to 2015. She also asked for the same details for slide 4 as related to the stackable credits. She wondered if that was a correct request from Senator Hoffman. Senator Hoffman replied in the affirmative.

Co-Chair MacKinnon queried a list of the current applications for credit. She also wondered how many were based on the vetoes, and reiterated that the legislature had approved payment of the credits. She looked at slide 8, and noted the indication that both bodies had a \$250,000 a surety bond that was based on paying Alaskans as a result of a company's behavior. She recalled that the administration rationale for the veto by ensuring that Alaskan's debt was paid first. She queried language that was not available as inclusion in the bill. Mr. Alper stated that currently the state could withhold a credit, if a company owed taxes. He furthered that the bill expanded that law by stating that the state could withhold the credit, if the company owed a royalty or other non-tax obligation. He felt that it was a technical provision that had survived in a modified form through the various versions of the bill.

Co-Chair MacKinnon felt that the provision should not be considered "technical", because companies went bankrupt from that impact.

Co-Chair Kelly recalled a presentation that stated that losing 8 to 10 percent of production would result in a loss of more royalties that the state could ever recover by scaling back the tax credits. He queried an analysis on that issue. Commissioner Hoffbeck replied in the negative.

Co-Chair Kelly felt that the state may lose royalty, if the state was not careful in adjusting the tax credits. He stressed that the tax credits were created to enhance production. He queried an estimate of the gains and losses in revenue as related to the tax credits. Commissioner Hoffbeck replied that there was a difficulty in the analysis, because there could be a delay as related to a price increase and eventual oil production.

Co-Chair Kelly stated that the state had adjusted its tax policy frequently, so the state could adjust to price hikes and reductions based on his observation.

Co-Chair MacKinnon asked for an analysis to examine the interplay of the tax credits.

Co-Chair MacKinnon thanked the finance committee staff.

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Co-Chair Kelly asserted that Prudhoe Bay was reducing three rigs.

Senator Bishop offered to share the rig counts.

Co-Chair Kelly wondered if the rig reductions were factored into the future tax credits and revenue. Mr. Alper stated that the BP announcement had been factored in to the spring revenue forecast, and the others were not included in the forecast.

Co-Chair Kelly queried any other rig reductions. He thought ConocoPhillips had plans to reduce rigs.

Vice-Chair Micciche remarked that the committee took its time in evaluating SB 21. He wanted to ensure that the administration kept resources available. He stressed that the discussion related to many different types of revenue. He wanted to understand the impacts of the changes to the oil and gas tax policy across the entire state. He did not want to make any hasty decisions, and result in a net negative to the state in the long run.

Co-Chair Kelly did not think ConocoPhillips was "laying down a rig" rather they stated that they were spending \$400 million less year to year.

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KARA MORIARTY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ALASKA OIL AND GAS ASSOCIATION, stated that AOGA was the professional trade association for the oil and gas industry. She stressed that her testimony represented the thoughts and sentiments of each member of AOGA; and the testimony was approved by unanimous consent. She understood that the legislature faced a tremendous challenge in the economic times. She stressed that the oil and gas industry was facing similar challenges such as loss of revenue; budget cuts; and employee layoffs. She noted that the legislature was asked for the sixth time in eleven years to examine and change oil tax policy. She remarked that no other industry had faced so many changes to its fiscal structure in Alaska. She added that there was no other jurisdiction in the world that had considered changing oil tax policy more than Alaska. She felt that the only reason that the tax policy change was under consideration was because of oil prices. The administration had shared with AOGA that the bill would not have been introduced, if the state did not need more money to operate the government. She stressed that SB 130 did more than reform credits. She asserted that the bill increased taxes on the industry to generate more money for state services; and it redefined oil and gas taxes.

Ms. Moriarty discussed the presentation "Senate Finance Committee," (copy on file). She displayed slide 2, "Policy Questions for SB 130":

- What effect will the policy have on overall oil and gas production in the state?
- Will the policy make Alaska more or less competitive 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?

Ms. Moriarty moved to slide 3, "Alaska has MORE production - FIRST time since 2002," which showed a graph of historical and forecasted TAPS throughput. She stated that, in August 2014, voters decided that the state's current

fiscal policy was good for Alaska, and AOGA agreed. She stated that the oil and gas industry had announced more than \$5 billion of additional spending across Alaska since April 2013. The increased spending could not have occurred at a better time, because no one knew that prices were going to crash. She stressed that those investments had helped the industry sustain itself. She asserted that Alaskans and the state as a whole were better because of those investments, as everyone was attempting the low price environment. She understood that stability and predictability in any business setting, but more oil and gas production was the ultimate objective for Alaskans and its oil and gas industry. She announced that for the first time since 2002, there was a production increase. She stated that from March 2015 to March 2016 there was an increase of just over 4000 barrels a day, which was just under a 1 percent increase. She also looked at the outlying years. She stated that the slide showed a chart which was the fall forecast from 2013, and the current spring forecast of 2016. She noted that the industry was on track to have production at around 520,000 barrels per day by the end of the fiscal year, which was an increase of almost 33,000 barrels over the projection from 2.5 years prior. She noted the 2013 fall forecast showed the 2023 projection was around 400,000 barrels per day. She remarked that, even in the current low price environment, there was a higher production forecasted by almost more than 50,000 barrels per day in five years. She was puzzled as to why she had to explain why increased production was positive for Alaska. She shared that some people had suggested that the state was not receiving value for its oil, so it did not matter that there was increased production. She wanted to explain how the current tax structure was generating more revenue for the state, even in the low price environment.

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Ms. Moriarty turned to slide 4, "Hilcorp's Monopod example":

January 2012

- Price: \$95/barrel
- Production: 600 bpd
- Royalty to State: \$90,000/month

Today, April 2016

- Price: \$35/barrel

- Production: 3,000 bpd
- Royalty to State: \$500,000/month
- Added 20+ years production life & 8 million barrels of future production

Since Hilcorp's entrance in 2012:

- Oil production doubled
- Oil royalty increased \$70 million

Ms. Moriarty discussed slide 5, "Importing foreign crude for Alaska refineries." She remarked that the Cook Inlet Recovery Act only focused on gas, and the benefit was not supposed to be for oil fields. She remarked that there was a value added benefit to increased production in the Cook Inlet. She shared that the slide was from a presentation by Tesoro in 2009 for an AOGA legislative education seminar. She stated that, in 2009, Cook Inlet production was at "rock bottom." The slide illustrated where Tesoro was importing oil in 2009. At that time, Cook Inlet production was so low, and North Slope Crude was not always available. She shared that Tesoro had operated the refinery on the peninsula since the 1960s. She stressed that, without the increase in oil production, Tesoro would need to once again look outside Alaska for oil to refine to meet the needs of Alaska's transportation and construction needs. She stressed that the imported oil would invariably cost more, because of transportation costs, which would cause Alaskans to pay more for the Tesoro products.

Ms. Moriarty showed slide 6, "Low oil prices taking their toll on jobs." She understood the significance of the 85 to 90 percent of the state revenue from oil, she stressed that the oil and gas industry received 100 percent of its revenue based on the market price of what it produces. She asserted that the industry was a "price taker" not a "price maker." She stated that the low prices had caused the industry to be cash-flow negative.

Ms. Moriarty moved to slide 7, "At current prices, industry has negative cash flow before tax":

Estimate Average March 2016 ANS Price	\$38.11
Transportation Costs	(\$10.50)
Total Operating Expenditures	(\$19.47)
Total Capital Expenditures	(\$19.97)

Total Average Cost Per Barrel Before Tax (\$49.94)

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Ms. Moriarty showed slide 8, "CS Avoids Making Regressive System Even More So":

State of Alaska making negative production tax in today's prices; but overall government take is still high

Floor hardening of original bill shifts up government take in lower oil prices

In times of high investment/low prices (as in 2016), effective government take exceeds 100 percent.

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Ms. Moriarty discussed slide 9, "Specific Concerns with CS for SB 130":

Nuclear Bomb for Cook Inlet

GVR Limits/Elimination = Lost value for projects

Changing Value of GVR/NOL

Set limits on credits-discouraging investments by smaller company

Interest rates increase significantly

Retroactivity provisions

Alaska Hire provisions

Ms. Moriarty moved to slide 10, "Concerning provisions not in CS":

Raising the minimum tax by at least 25 percent for companies

"Hardening" the floor

Confidentiality protections jeopardized

Disguised tax increase through the change of the application of Gross Value at the Point of Production

Ms. Moriarty showed slide 11, "Policy Changes = Economic Impacts":

AOGA is not asking for assistance from the state of Alaska in this downturn, but does ask for careful consideration of any policy changes.

In this price environment, any change will have a negative impact on industry and will result in Alaskans losing jobs, less production, and less long-term revenues for the state.

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Co-Chair Kelly referred to slide 3, but noticed that he was referencing the incorrect slide.

Vice-Chair Micciche queried further detail on slide 7. Ms. Moriarty agreed to provide further information.

Co-Chair Kelly referred to slide 3, and surmised that the fall forecast was before a change. Ms. Moriarty explained that the fall forecast in 2013 was created in December, which was after the legislature had adopted SB 21.

Co-Chair Kelly stated that the bill in question was not SB 21, but pointed out that there was legislation which changed how the production estimates were viewed. He stated that the legislation reverted to a more conservative production estimate. He pointed out that without normalizing, there may be an "apples to oranges" comparison. Ms. Moriarty stated that AOGA needed to utilize the public data provided by DOR. Therefore, if there was a change to the methodology, AOGA would have no way to change the estimates.

Co-Chair Kelly asserted that the estimates on the slide may have been normalized.

Co-Chair MacKinnon pointed out that Mr. Alper was nodding in the affirmative. She asked for further explanation.

Co-Chair Kelly wondered if the estimates were normalized. Mr. Alper stated that the department had transitioned to a different method of forecasting, in which they applied a risk factor and probabilities.

Senator Bishop asked if Mr. Alper agreed with the change in methodology for accounting barrels of oil.

Mr. Alper agreed that the risk factors made sense, but there were some "hitches" in the formula that DOR was looking to adjust going forward.

Senator Bishop noted that there were some who had disagreed with the methodology changes.

Co-Chair Kelly remarked the numbers were normalized and the 2013 numbers were more conservative compared with the current numbers.

Co-Chair MacKinnon shared that Co-Chair Kelly's comments were directed at slide 3 of the presentation.

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DAN SECKERS, TAX COUNSEL, EXXONMOBIL CORPORATION, expressed concern about the bill. He stated that Alaska was an important part of ExxonMobil's worldwide portfolio. He announced that ExxonMobil understood the difficulty in attempting to address the current budget concerns while maintaining Alaska as a competitive place to conduct business. He felt that tax decisions fundamentally impacted the economic health of the state, and the companies that conduct business in the state. He stressed that the tax policy decisions would either move Alaska toward or away from its vision of long-term oil and gas development. He stated that maintaining a stable fiscally attractive environment was possibly the most important issue to the legislature. He questioned whether increasing taxes on the oil and gas industry at a time when DOR had proven that the companies were losing money and recording significant losses was consistent with the state's vision and belief that there would be more investment, jobs, production, and long-term state revenues.

Mr. Seckers thought the CS was improved from what was originally introduced by the governor. He stated that AOGA endorsed Ms. Moriarty's testimony. Although the CS was an improvement from the original version, but was still extremely troubling. He echoed Ms. Moriarty's assertion that the CS represented another significant examination of the tax policy, which added uncertainty to the companies. He felt that continued changes led to instability and investment concerns. He stated that the tax changes also increased the interest rate. He remarked that the concept in the CS of increasing the interest to 7 percent plus prime, and then stopping the increase after three years was an interesting concept. He argued that the concept only addressed the symptom, but not the problem. He asserted that the problem was long length of time of the DOR audits. He shared that ExxonMobil received its 2009 assessment on March 31, 2016, which was six years after the filing of the return. He did not believe that the bill would move Alaska into increasing its overall investment climate or increasing jobs. He announced that ExxonMobil opposed the committee substitute. He explained that the CS was only an improvement from the original version, because it removed some punitive sections: 1. Hardening of the minimum tax floor. He felt that it was a critical piece of the bill that was removed. He explained that preventing companies from realizing the true economics of their investments, by preventing critical tax credits from being used to offset the minimum tax would have represented an immediate and significant tax increase; and would have penalized companies who made prior year investments and who were considering current year investments from making those investments, because the economics would be damaged. He stressed that the large or small companies, who may have new oil tax credits, small producer credits, or tax loss credits would not be able to use those credits in the low price environment.

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Mr. Seckers felt that the CS was also improved by the removal of the increase of the overall 25 percent, which was a significant tax on gross revenues. He highlighted the change of the substantive law in determining how the gross value at the point of production would be determined. He remarked that, under the original bill, the gross value at the point of production would have been changed to reflect

that it could not fall below zero. He explained that the production tax was not a unit-by-unit tax, rather it was a segment-by-segment tax: Cook Inlet, Middle Earth, and the North Slope. He shared that the gross value only falls below zero because of the decrease in price; and the marine transportation and pipeline costs. He shared that disallowing the recovery of those costs was a substantive change in the law and an immediate tax increase for those fields affected. He stressed that it would change the economics of the small fields. He addressed the problem of "sliding" credits month to month. He disagreed with the assertion that it would only impact the monthly sliding scale tax for legacy fields. He explained that the proposal would have affected every tax credit. He stressed that the tax was an annual tax, which was a collection of the twelve estimates. He felt that, disallowing credits to be used against another month required perfect estimates. He remarked that the law required the use of annualized costs, so there were no actuals at the time of the monthly estimate.

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Mr. Seckers addressed the issue of confidentiality. He remarked that ExxonMobil was partners with BP, ConocoPhillips, and other companies on the North Slope; but ExxonMobil also remained competitors with those companies. He stressed that ExxonMobil was bound by federal law not to discuss or disclose certain information; and it was bound by its shareholders not to disclose or discuss sensitive proprietary information. He stressed that making certain information public was damaging to companies, took away competitive advantages, and was unlawful. He appreciated that the confidentiality provision was removed in the current CS. He restated that the committee substitute was an improvement from the original bill, but was still a concerning piece for industry in the Cook Inlet. He stressed that reintroducing any of his highlighted provisions would dramatically reduce Alaska's overall global competitiveness by raising taxes on companies. He asserted that the legislation was not an income tax or property tax bill. He stressed that the legislation was a production tax bill. He announced that, currently, producing a barrel of oil on the North Slope caused ExxonMobil to lose money. He wondered if taxing companies on an activity that was currently losing money was in the long-term best interest of the state.

Chair Kelly queried the impact of hardening of the floor, and how the net operating loss (NOL) related to the floor hardening. Mr. Seckers replied that no one wanted an NOL, because no company wanted to invest money to lose money. He stressed that the NOL was only a loss. He stated that the production tax was akin to an income tax. He explained that the concept was to equate or balance revenues and expenses. He stated that, under the law, instead of carrying the loss forward, it automatically converted to equal credit and was carried forward. The companies use it to fund current operations.

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Co-Chair Kelly requested an analysis regarding substantive law. Mr. Seckers mentioned substantive changes in law, including the migration of credits back and forth. He explained that a carried forward credit would be denied, because a company may not be able to appropriate number of credits. He stated that another substantive change was the gross value at the point of production. He explained that, under current law, the company filed a segment consolidated return. He did not feel that the change encouraged the small field development.

Co-Chair MacKinnon remarked that the presenters had taken more than their allotted time.

Senator Bishop thought a low-priced environment tested the quality of a partnership.

Co-Chair MacKinnon stressed that the remaining speakers would be given 10 minutes each.

[3:23:34 PM](#)

J. PATRICK FOLEY, SENIOR VICE PRESIDENT, ALASKA OPERATIONS, CAELUS, discussed the presentation "Senate Finance SB 130 Testimony," (copy on file).

Mr. Foley discussed slide 2, "Caelus Energy Alaska: Key Facts and Information":

Privately-held E&P company focused exclusively on Alaska's NS

\$2Bn capital investment in Alaska since 2002

Less \$300MM 2016 capital budget

Total Alaska workforce is equivalent to over 600 full-time positions

Less 70 full-time Alaska employees

Nearly 400 contractors on the North Slope today

Operational Highlights & Accomplishments:

23MMBO gross cumulative production since 2008

4MMBO gross annual production 2015

2015 best safety record, 0.65 OSHA recordable injury rate

Longest Oooguruk well length to date: 23,209' MD (ODS N-7i)

Direct Financial Benefits to the State:

\$67 MM paid in royalties to the State of Alaska

\$60 MM paid to the State of Alaska / NSB in property taxes

Proven and Potential Reserves:

less than 85 MMBO remaining at ODS

less than 100 MMBO remaining at Nuna

350,000 undeveloped State of Alaska leases on the North Slope

Mr. Foley moved to slide 3, "North Slope Exploration and Development Program," which showed a map depicting Caelus projects on the North Slope. He stated that Caelus had drilled two exploration wells in Smith Bay. Caelus had spent over \$100 million on the wells in Smith Bay, and was encouraged by the results caused by those wells, and hoped to be back the following year with more delineation. He stated that the program earned both NOL credits and exploration incentive credits. He stressed that, without the credits, the wells would not have been drilled. He furthered that the Oooguruk Unit was the cornerstone of his business, which produced nearly 20,000 barrels per day. He stated that Caelus had recently been forced to put the rig on standby. He stated that Nuna was currently on hold until

prices recover. He stated that Caelus also had a block of exploration leases in the eastern North Slope, which was approximately 350,000 acres. He stressed that Caelus was struggling to survive in the current price environment. He remarked that Caelus had been operating in the state in 2002, and had yet to make a profit.

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Mr. Foley turned to slide 4, "Alaska: An Attractive Investment Opportunity?":

World Class Resources? Yes

Access to Substantial Leasehold of Interest? Yes

Access to G&G Data and Information - Yes

Expert Contractor Community? Yes

Hospitable Regulatory Environment? Yes

Access to Existing Infrastructure? Yes

Favorable Logistics? No - remote, harsh conditions, seasonal limitations

Favorable Fiscal Regime? Yes, under SB21. No, under proposed system changes

Stable Fiscal Regime? No, 5 significant changes in a decade

Lender and Equity Provider's Confidence?

Historically low participation and experience

Confidence in stability is low

Apollo has backed Caelus

Other equity providers are "watching"

Bank of America committed but spooked by change

ING backed out when changes began

Wells Fargo disengaged when changes began

Mr. Foley spoke to slide 5, "Alaska Oil Tax Policy - Integrated Tax System." He stated that the slide was borrowed from enalytica. He looked at the dashed line, which represented the government take. He explained that

the government take was the percentage of profits that the government received, and one-minus government take was what the company was entitled. He noted that, on the far left side at \$40 per barrel, there was 100 percent government take. He announced that the slide represented "the beauty" of SB 21, and showed an absolute flat 65 percent government take over a very broad range of prices. He believed that the past tax policies were created without the assumption that prices would be so low.

Mr. Foley discussed slide 6, "CS SB 130 (RES) AM / CS HB 247 (FIN)am":

Current Bill Provision(s)

CS SB 130 (RES) AM

LIMITS GVR to 5 years
CAPS earned credits to \$85 MM per company
Min Tax: No change from current law

CS HB 247 (FIN) AM

LIMITS GVR to 7 years
CAPS earned credits to \$100 MM
NEW Alaska hire provision of 80 percent
HARD 2 percent floor

Mr. Foley moved to slide 7, "CS SB 130 (RES) AM / CS HB 247 (FIN) AM":

5-year GVR limit has major impact on project value

Project is marginal at \$60/bbl; elimination of GVR can wipe out all value at that price

Because most tax liability occurs after end of major spending, short GVR limit provides little benefit

5-year GVR limit destroys over 60 percent of project value at \$60/bbl, relative to status quo

Impact of 10 year limit much lower; 15 year limit preserves almost all of status quo value

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Mr. Foley showed slide 8, "Nuna: A Project on the Bubble":

First oil Late 2018 IF Prices recover and confidence
in favorable / stable fiscal terms exist

Caelus holds 100% interest
100+ MMBO 2P reserves
20,000 to 25,000 BOPD peak production in 2021

Economically Benefits Alaska

300 FTE contractor construction jobs for two
years

300 FTE contractor drilling jobs for 4 to 5 years

\$1.75 Bn in future payments to the State of
Alaska

\$900MM in future royalty payments*
\$500 MM in future NPSL payments*
\$250 MM in future production tax
payments*
\$100 MM in future Ad Valorem taxes

\$250MM in future NOL cash payments from the State
of Alaska

*Values are undiscounted based upon a Flat \$70/bbl
Brent Price Assumption

Mr. Foley spoke to slide 9, "Closing thoughts":

Alaska has Great Resource Potential

Alaska needs more exploration & production
companies to fully develop its petroleum
resources

Caelus continues to be very optimistic on Alaska

SB 21 is a balanced system that is working for
Alaska

Recommendations

GVR

10 - 15 years

Credit caps

Greater than \$100 mm

Minimum Tax Floors

Allow small producers to use credits against

Thoughtful policy considerations:

Will policy increase production?

Short- and Long-Term Vision

[3:35:16 PM](#)

Senator Bishop addressed slide 8, and noted the concerns of the confidentiality provisions in the bill. He queried the number of credits for the project. Mr. Foley relayed that the work was done at a \$70 per barrel price. He stressed that it was not the current price, but it was the environment required to move the type of project forward. He remarked that the upfront assistance provided by the state was \$250 million. He furthered that the revenue to the state was \$1.75 billion when the project moved forward

Senator Bishop felt that the general public did not understand oil and gas tax credits; and personally found it difficult to understand the analytical portions. He understood the desire to get a portion of over \$1.5 billion. Mr. Foley replied that the state's return was nearly a six times multiple.

Senator Bishop remarked that the state should be able to see the basic principles.

Mr. Foley was fearful that he was portrayed as part of the problem, but he believed that he was part of the solution. He argued that the state's short term cost investment, but would help to set up a future of jobs, royalty, and production taxes that would be six times more than the value of the credits.

Co-Chair MacKinnon wondered if Caelus has reduced costs. Mr. Foley replied that the company had eliminated some staff, which had eliminated the general administrative costs by approximately 25 percent. He furthered that Caelus had also reduced capital. The capital that was intended for spending in 2016 had been reduced by nearly one-third.

[3:39:36 PM](#)

JOE REESE, ALASKA TAX MANAGER, BP (via teleconference), supported the testimony provided by AOGA earlier in the meeting. The success of Alaska's oil and gas tax policy was critical to BP, the AKLNG project, and to the many Alaskans who benefit directly and indirectly from the successful exploration, development, and production of Alaska's oil and gas. He remarked that a durable, predictable, and administrable oil and gas tax policy must be in place to unlock the benefits. He shared BP saw a durable policy as a tax policy that was the same tomorrow and today. He stated that BP saw predictable as the ability to model with reasonable certainty the outcome of the tax policy. He shared that BP saw administrable as the ability to file the taxes and tax returns in an accurate and timely manner. He stressed that BP was committed to maintaining a safe, compliant, and sustainable business in Alaska. He noted that in two years, there was a 70 percent drop in oil price. He shared that, in 2015, BP paid approximately \$263 million in royalties and taxes, which resulted in a financial loss of \$194 million. He announced that under the current market conditions, BP's Alaskan business was spending more cash than it was bringing in. As a result, BP had undertaken a 17 percent reduction of workforce; and the Prudhoe Bay working centers had reduced activity levels. He remarked that Prudhoe Bay economics were at a point where tax increases in the cost structure would result in lower activity levels and would be detrimental to its Alaskan business. He shared that a 1 percent increase in the minimum taxes was equal to approximately 6 months of rig work on Prudhoe Bay. He stressed that operating under a predictable, durable, and administrable oil and gas tax policy was essential to maintaining the activity level at Prudhoe Bay and long-term viability of the AKLNG project. He stressed that BP was committed to complying with tax laws in a reasonable manner, and to have an open and constructive relationship with tax policy makers.

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Mr. Reese stressed that one of the major costs to BP's business in Alaska was oil production tax. He shared that while BP was currently taxed for negative, it still paid oil production tax, because some investments were not deductible for oil production tax purposes. At current prices, Prudhoe Bay did not attract oil production tax credits. He remarked that, while Prudhoe Bay did not currently receive the oil production tax credits, BP did not support limiting the production tax credits provided in SB 21, because it would negatively impact the oil and gas industry as a whole. He understood that the state was facing severe budget shortfalls at the same time as the industry was struggling to make any profit. He did not feel that it was not the time to make changes that would increase taxes and further inhibit the industry's ability to maintain its activity level at Prudhoe Bay. The near-term changes to the state's oil and gas tax policies would have long-term consequences for everyone.

Mr. Reese remarked that four of six of his concerns with the legislation were removed in the committee substitute from the Senate Resources Committee. He would acknowledge those issues. He remarked that the administration had proposed an increase to the minimum tax, and BP felt that it was a 25 percent tax increase and would have a "chilling" effect on additional investment. He remarked that the provision had been removed in the current CS. He shared that the administration had imposed an artificial limitation on the use of credits within a year, and Mr. Seckers had addressed some examples with the issue. He acknowledged the provision's removal in the CS. He stressed that SB 130 was a tax increase, which meant less money available for investment.

[3:47:12 PM](#)

DAVE WILKINS, SENIOR VICE PRESIDENT, HILCORP ENERGY, ANCHORAGE (via teleconference), agreed with the testimony by AOGA president, Kara Moriarty. He shared that Hilcorp operated in both Cook Inlet and the North Slope. He announced that Hilcorp had over 500 full-time employees, and over 90 percent of those employees were Alaskan residents. He stated that Hilcorp operated approximately 53,000 gross barrels of oil per day, and produced and sold 150 million cubic feet of gross gas sales per day from approximately 500 producing wells. The total net production

to Hilcorp of approximately 57,000 barrels of oil equivalent per day. Hilcorp's overall success came primarily from acquiring and operating older fields with extensive production histories; and steady and predictable performance that carry opportunity for retrieving more oil and gas out of the ground safely and responsibly, while extending the production life through efficiency and thousands of smaller scale projects. He felt that the state needed to attract more companies like Hilcorp as the fields and infrastructure in Alaska continue to age. He asserted that Hilcorp's production in Alaska represented approximately 40 percent of what was produced company-wide, so the success in Alaska was critical to Hilcorp's overall success.

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ED KERR, DIRECTOR, ARMSTRONG OIL AND GAS, DENVER (via teleconference), felt that the discussion should be conducted in a conversational manner. He shared that Armstrong Oil and Gas was operational in Alaska since 2001, both in the North Slope and Cook Inlet. He shared that there were various developed fields that were currently producing in Alaska.

Mr. Kerr felt that SB 21 was working. The development by Armstrong provided for 120,000 barrel per day facility. In other words, Armstrong anticipated producing 120,000 barrels of oil per day. The result of that production would be jobs, significant revenue to the state, and significant revenue for the North Slope Borough. He stressed that there was a partnership with the state to develop the reserves. He stressed that any tax policy change would have a profound and long lasting impact beyond what anyone can contemplate. He stressed that keeping the tax law in its current state was the best option. He remarked that investment drives production, and production drives revenue for the entire industry. He understood that everyone was affected by the low oil prices. He felt that leaving the tax policy unchanged would have a greater effect on the state's revenue interest than changing the tax policy. He stressed that the main focus should be on investment.

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Mr. Kerr expressed his desire to work with the legislature to fix the problem. He noted that currently there was no

focus on the small producer credit and exploration credit. He remarked that the current leases had a higher royalty than the legacy leases, so that was already an increased revenue stream for the state, but was an impediment on his company. He shared that there were limits on the NOL credits that could be purchased. He noted the interplay between the GVR and NOLs, and the sunset of the GVR. He stressed that should that state keep a consistent tax policy in the form of SB 21, everyone would benefit.

[4:12:33 PM](#)

PETE STOKES, PRESIDENT, ALASKA SUPPORT INDUSTRY ALLIANCE, ANCHORAGE (via teleconference), shared that the alliance had 600 member companies that employed over 30,000 Alaskans, but had recently declined due to the layoffs as a result of the low price of oil. He opposed both SB 130 and HB 247, because it would result in decreased investment and decreased future production from the industry. He stressed that there were many questions to industry about what could be weathered in a tax increase. He felt that the type of question reflected a goal to raise revenue, rather than maintain a tax policy that incentivized investment to lead to increases in production and provided a steady revenue stream to the state for a long period of time.

Co-Chair MacKinnon appreciated the responsiveness of the testifiers. She discussed the following meeting's agenda.

SB 130 was HEARD and HELD in committee for further consideration.

#hb247

CSHB 247(FIN) AM

"An Act relating to interest applicable to delinquent tax; relating to the oil and gas production tax, tax payments, and credits; 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 oil and gas lease expenditures and production tax credits for municipal entities; relating to a bond or cash deposit required for an oil or gas business; establishing a legislative working group to study the tax structure for oil and gas

produced south of 68 degrees North latitude; and providing for an effective date."

HB 247 was SCHEDULED but not HEARD.

#

ADJOURNMENT

4:17:01 PM

The meeting was adjourned at 4:16 p.m.