

**ALASKA STATE LEGISLATURE**  
**SENATE RESOURCES STANDING COMMITTEE**

April 8, 2016

3:30 p.m.

**MEMBERS PRESENT**

Senator Cathy Giessel, Chair  
Senator Mia Costello, Vice Chair  
Senator John Coghill  
Senator Peter Micciche  
Senator Bert Stedman

**MEMBERS ABSENT**

Senator Bill Stoltze  
Senator Bill Wielechowski

**COMMITTEE CALENDAR**

SENATE BILL NO. 130

"An Act relating to confidential information status and public record status of certificates from the oil and gas tax credit fund; relating to a minimum for gross value at information in the possession of the Department of Revenue; relating to interest the point of production; relating to lease expenditures and tax credits for municipal applicable to delinquent tax; relating to disclosure of oil and gas production tax credit entities; adding a definition for "qualified capital expenditure"; adding a definition for information; relating to refunds for the gas storage facility tax credit, the liquefied "outstanding liability to the state"; repealing oil and gas exploration incentive credits; natural gas storage facility tax credit, and the qualified in-state oil refinery repealing the limitation on the application of credits against tax liability for lease infrastructure expenditures tax credit; relating to the minimum tax for certain oil and expenditures incurred before January 1, 2011; repealing provisions related to the gas production; relating to the minimum tax calculation for monthly installment monthly installment payments for estimated tax for oil and gas produced before payments of estimated tax; relating to interest on monthly installment payments of January 1, 2014; repealing the oil and gas production tax credit for qualified capital estimated tax; relating to limitations for the application of tax credits; relating to oil and expenditures and certain well expenditures; repealing the calculation for certain

lease gas production tax credits for certain losses and expenditures; relating to limitations for expenditures applicable before January 1, 2011; making conforming amendments; and nontransferable oil and gas production tax credits based on oil production and the providing for an effective date." alternative tax credit for oil and gas exploration; relating to purchase of tax credits.

- HEARD & HELD

HOUSE BILL NO. 247

"An Act relating to confidential information status and public record status of certificates from the oil and gas tax credit fund; relating to a minimum for gross value at information in the possession of the Department of Revenue; relating to interest the point of production; relating to lease expenditures and tax credits for municipal applicable to delinquent tax; relating to disclosure of oil and gas production tax credit entities; adding a definition for "qualified capital expenditure"; adding a definition for information; relating to refunds for the gas storage facility tax credit, the liquefied "outstanding liability to the state"; repealing oil and gas exploration incentive credits; natural gas storage facility tax credit, and the qualified in-state oil refinery repealing the limitation on the application of credits against tax liability for lease infrastructure expenditures tax credit; relating to the minimum tax for certain oil and expenditures incurred before January 1, 2011; repealing provisions related to the gas production; relating to the minimum tax calculation for monthly installment monthly installment payments for estimated tax for oil and gas produced before payments of estimated tax; relating to interest on monthly installment payments of January 1, 2014; repealing the oil and gas production tax credit for qualified capital estimated tax; relating to limitations for the application of tax credits; relating to oil and expenditures and certain well expenditures; repealing the calculation for certain lease gas production tax credits for certain losses and expenditures; relating to limitations for expenditures applicable before January 1, 2011; making conforming amendments; and nontransferable oil and gas production tax credits based on oil production and the providing for an effective date." alternative tax credit for oil and gas exploration; relating to purchase of tax credit

- <PENDING REFERRAL>

**PREVIOUS COMMITTEE ACTION**

BILL: SB 130

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

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/19/16	(S)	READ THE FIRST TIME - REFERRALS
01/19/16	(S)	RES, FIN
04/04/16	(S)	RES AT 3:30 PM BUTROVICH 205
04/04/16	(S)	Heard & Held
04/04/16	(S)	MINUTE(RES)
04/05/16	(S)	RES AT 3:30 PM BUTROVICH 205
04/05/16	(S)	Heard & Held
04/05/16	(S)	MINUTE(RES)
04/06/16	(S)	RES AT 3:30 PM BUTROVICH 205
04/06/16	(S)	Heard & Held
04/06/16	(S)	MINUTE(RES)
04/07/16	(S)	RES AT 3:30 PM BUTROVICH 205
04/07/16	(S)	Heard & Held
04/07/16	(S)	MINUTE(RES)
04/08/16	(S)	RES AT 3:30 PM BUTROVICH 205

**WITNESS REGISTER**

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

**POSITION STATEMENT:** Testified in opposition to SB 130.

DAN SECKERS, Tax Counsel  
ExxonMobil Corporation  
Anchorage, Alaska

**POSITION STATEMENT:** Testified that SB 130 is a "very concerning piece of legislation."

JOE REESE, Sr. Managing Tax Counsel  
BP Alaska  
Anchorage, Alaska

**POSITION STATEMENT:** Testified in opposition to SB 130.

SCOTT JEPSON, Vice President  
External Affairs  
ConocoPhillips  
Anchorage, Alaska

**POSITION STATEMENT:** Testified on ConocoPhillips's fiscal and development strategy and how SB 130 would affect it.

PAUL RUSCH, Vice President

Finance

ConocoPhillips

Anchorage, Alaska

**POSITION STATEMENT:** Testified in opposition to SB 130.

DAVID WILKENS, Sr. Vice President

Hilcorp Alaska, LLC

Anchorage, Alaska

**POSITION STATEMENT:** Testified in opposition to SB 130.

TOM WALSH, Member

Board of Directors and Executive Committee

Alaska Support Industry Alliance (Alliance)

& Founder and Managing Partner

Petrotechnical Resources of Alaska (PRA)

Anchorage, Alaska

**POSITION STATEMENT:** Testified in opposition to SB 130.

#### **ACTION NARRATIVE**

[3:30:13 PM](#)

**CHAIR CATHY GIESSEL** called the Senate Resources Standing Committee meeting to order at 3:30 p.m. Present at the call to order were Senators Stedman, Costello, Coghill, and Chair Giessel.

#### **SB 130-TAX;CREDITS;INTEREST;REFUNDS;O & G**

**[Contains discussion of companion bill HB 247.]**

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**CHAIR GIESSEL** announced consideration of SB 130. She welcomed invited testimony from the Alaska Oil and Gas Association (AOGA).

[3:30:50 PM](#)

**KARA MORIARTY**, President and CEO, Alaska Oil and Gas Association (AOGA), Anchorage, Alaska, said her testimony today on SB 130 represents the thoughts and sentiments of each of the diverse AOGA members. She related that on matters of tax, AOGA requires unanimous consent for testimony.

She said there is no denying it; legislators have a tremendous challenge facing them - cutting budgets, loss of revenue, laying people off, and the oil and gas industry is facing similar challenges. Currently, the policy for the oil industry places an emphasis on production, investment and jobs. While the Industry

is responding and doing its best to weather the storm, it also recognizes the value of investment and jobs to Alaska, and is doing its part to sustain what it can in the interest of long term sustainability for everyone. Changing policies will have further negative impacts on the industry, which will be costly for the state in the long term.

She said the legislature has been asked for the sixth time in 11 years to examine and change oil tax policy. No other industry has had so many changes to its fiscal structure in Alaska, and she can find no other jurisdiction in the world that has considered changing oil tax policy more than Alaska has in the last decade.

Nevertheless, Ms. Moriarty said, here they all are in a low price environment considering changes to the oil industry, and the only reason the administration is asking the legislature to change the policy again is because of low oil prices. More money is needed for government. Commissioner Hoffbeck said two months ago that the motivation to look at oil tax credits was the budget and that the motivation was not to redefine oil and gas taxes.

But regardless of the motivation, the administration's final proposal in SB 130 does both: it increases taxes on the industry to generate more government revenue and it redefines oil and gas taxes. As they consider SB 130 she encouraged them to ask AOGA and all the individual companies who will testify, the administration and consultants four important questions:

1. Will the governor's proposal increase production?
2. Will it make Alaska more or less competitive?
3. Will SB 130 provide predictability?
4. Will SB 130 provide stability?

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MS. MORIARTY stated that the last major change in tax policy occurred three years ago in SB 21 and it was 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 industry agreed. 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, Alaskans, and the state as a whole get through this low-priced environment.

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Objectives like stability and predictability are important in any business setting; but Ms. Moriarty emphasized, don't lose sight of the real prize: more oil and gas production.

For the first time since 2002, production has increased (slide 3) from March 2015 to March 2016, an increase of over 4,000 barrels/day (a 1 percent increase).

It is also important to look at the forecast for the outlying years. Two and a half years ago in December 2013, the production forecast for this fiscal year was 487,600 barrels per day. In about three months production will be increased by over 33,000 barrels/day for a total of 520,000 barrels/day even though oil prices have plummeted. The next few years are forecasted to bring similar results even though the price forecast today is \$50 less per barrel than the price forecast was in 2013. The spring production forecast, which was released yesterday, is still about 55,000 barrels a day more when looking out to 2022. She concluded that more production is always good for the state regardless of oil price.

Speaking of prices, she said, they are the lowest in more than a decade, which of course, has had a huge impact on the state's revenues. While it is significant that the state has historically received 85-90 percent of its revenue from the oil industry, it's important to recognize that her industry receives 100 percent of its revenue from the price of oil. She related that a friend said, "We are price takers; we are not price makers."

MS. MORIARTY said these low prices are causing the industry to be cash-flow negative. This means industry is not collecting enough revenue each day to cover their daily bills, and the oil and gas industry is no different than any other business that does not have enough cash flow to pay its expenses. The cut backs are seen in the dramatic increase in project delays and deferrals, rigs going idle, and most painfully, Alaskans losing jobs.

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MS. MORIARTY said industry recognizes that state employees are also losing jobs in this tough environment. The House's operating budget estimates 50-75 fewer state employees. But for the oil and gas industry the job loss has been even more severe. By the end of June this year, over 1,000 Alaskans will no longer

be working directly for the oil and gas industry and that does not include the contractor workforce.

MS. MORIARTY added that Alaska is a high-cost environment and according to the DOR Spring Sources Book (that has up-to-date numbers) the average cost of producing a barrel of oil on the North Slope and getting it to market before a company pays even one penny of tax is around \$50/barrel. And despite this they are here testifying about legislation to add significant additional cost to the industry by raising the production tax and eliminating incentives. She said, "Let me be clear. If you raise taxes and/or reduce credits, there will be a negative impact. This is not about politics; it's about economics."

MS. MORIARTY said industry is cash-flow negative and some companies may already be burning through savings to pay for operations. Their reserves are not unlimited. If a company has about \$100 million to spend in Alaska and the government wants to take another \$10 or \$20 million more, they will have no choice but to further eliminate operating and/or capital expenditures. This means less investment, less production, less long-term state revenues, and even more Alaskans without a job. In the interests of time, she wouldn't belabor each section and concern they have with the governor's bill, but a few key concerns will follow.

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The first key concern is the minimum tax. The governor's proposal would increase the minimum gross tax from 4 percent to 5 percent, and although a 1 percent point increase may not sound significant, it represents at least a 25 percent increase for those companies who already pay the minimum tax. Additionally, the governor's proposal will forbid companies from using any earned or available tax credits to reduce the minimum tax below the new 5 percent floor. It is likely that there will be companies, large and small, that have earned new oil tax credits or loss credits from prior year investments for exploration and drilling and prior year losses while also operating in the red due to low oil prices, and using those tax credits is the only way they can continue to invest in the state. This 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 a flagrant money-grab that is large enough to cause substantial negative impacts on all producers at today's oil prices.

MS. MORIARTY said the smaller companies or newcomers to the state who have yet to make a profit in Alaska are not required to pay the 4 percent minimum production tax under the current law, but under the governor's proposal, they would go from paying zero (because they don't make a profit) to immediately being hit with a 5 percent gross value tax.

Additionally, the proposal would change the way the minimum tax is determined and would prevent producers 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, which actually accounts for a tax increase.

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Another major concern even though the administration has testified that it is preserving the NOL credits (net operating loss credits), industry contends that they become virtually useless under the proposal. It would prevent the use of the NOL 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 10-year limit on a company to apply unused NOL credits. All of these changes to the NOL essentially eliminate the value of the credit in the first place, and that will impact companies' decisions.

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Another change that causes concern is arbitrarily limiting cash credits to \$25 million per company per year. Even the smallest of projects cost in the \$500 million to \$1 billion range, and imposing a \$25 million limit per company is unreasonable and 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 when those investments were made. It is bad business for the state to basically say after the fact that it is not going to allow companies to realize the true economics of their developments as originally promised.

Eliminating two important credits for Cook Inlet and Middle Earth is also dangerous. As for Cook Inlet, these tax credits were unequivocally the driver for several key investments in the region that have already lead to substantial increases in production and jobs. AOGA does not view these credits as a cost; they are an investment by the state, which reaps it clear

benefits. For example, one of the Department of Revenue (DOR) many slides show that the state has paid out over \$8 billion in credits from FY07 to FY16. However, that figure implies a huge capital investment of \$30 to \$40 billion by the private industry, and during that same timeframe, the state has also collected over \$32.8 billion in total additional tax revenues.

MS. MORIARTY said AOGA fundamentally disagrees with the administration that Cook Inlet has gas that is in search of a market. 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 and any decline will inevitably result in higher utility rates for consumers and increase the likelihood of gas shortages.

One provision that isn't talked about much, but is still important, is section 39 that defines the state's outstanding liability in the broadest of terms. It says that the state could deny or delay tax credits payments for virtually any outstanding and alleged liability even if it was with a state agency completely unrelated to taxes.

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MS. MORIARTY said although there are plenty more aspects of this bill that warrant further discussion, she wanted to conclude by addressing the proposed increase in the interest rate. It's crazy for industry to have to compound interest after it takes the DOR six years to do an audit. AOGA supports the current rate and believes it is reasonable, particularly considering the lengthy statute of limitations. Because the DOR has a track record of taking all six years to complete audits, under this proposal, there could be scenarios where the interest payment could be more than the actual tax bill, itself.

She explained that Governor Hammond was first to establish an equitable policy for Alaska of one-third for the state, one-third for the industry, and the remaining third for the federal government. During the ACES regime, government take climbed to a high level, which in turn was part of the reason SB 21 was introduced as an effort to normalize total government over a broad range of prices.

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As Mr. Mayer from enalytica described, government take is about 62 percent in a price range of \$60-150/barrel. That is why it is important to look at the production tax in conjunction with the

rest of the fiscal system. As the Division of Oil and Gas Director, Corri Feige, stated in House Resources testimony, companies lump taxes and royalties all together in one bucket of cost, and any increase in production taxes will impact overall government take. At today's prices, due to the regressive nature of royalty, government take exceeds 100 percent, and SB 130 would increase government take for all fields and for gas as well.

Finally, Ms. Moriarty said, the governor's proposal will not add more oil to the pipeline. There is no plausible scenario under which increasing taxes by \$782 million will result in increased production. Assuming the state sees a 10 percent production decline because of less investment, it would also see a reduction in royalties of \$793 million over the next five years, based on DOR Resource Sources Book data. This demonstrates that it doesn't matter if prices go back to \$60 or \$80/barrel if production declines.

While the administration has testified that SB 130 will provide certainty and predictability, she could assure them that none of her member companies sees any certainty or predictability from it. In fact, the message it would send is that Alaska may be having a bit of an "identity crisis." She asked how many companies regardless of industry will beat down Alaska's doors to invest when they count on their taxes being increased at times of high commodity prices and then again when prices are low.

MS. MORIARTY said she is not before them asking for a tax decrease or for relief while members struggle through these extremely low oil prices and difficult economic times. She only asks that the legislature not "kick us while we're down because of low prices." She asked that their policy encourage explorers and new entrants and ensures that current producers remain committed to Alaska.

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CHAIR GIESSEL asked if carrying the NOLs forward is a loss of value to producers and how important the NOL is to them.

MS. MORIARTY answered that the NOLs are extremely important. The NOL, itself, implies that it's a loss. Being able to apply those ensures that companies can continue investing when they are not making money.

CHAIR GIESSEL asked if the state's reimbursement fund for credits were depleted and companies had to carry forward any of the credits including the NOLs, what that would mean in terms of their value.

MS. MORIARTY answered that individual companies could talk specifically to their own economics, but if they thought they were going to be able to carry that loss forward and can no longer do that, it very much changes their economics and whether they decide to invest in this low price environment.

CHAIR GIESSEL said Mr. Alper showed them a chart yesterday of his projection of the .028 fund out of which credits are paid. A formula based in statute (depending on the price of a barrel of oil) determines how much money is in that fund, and this year \$73 million was appropriated to it. Last year the fund had \$700 million, because additional money was appropriated. If the fund were limited and companies had to carry credits forward, he didn't know what that would mean in fiscal terms.

MS. MORIARTY answered that each company has different economics and the DOR commissioner was commissioner when that statute was created. When he testified to House Finance, he talked about the intent of the fund. But talking about economics, obviously not being able to have that credit and then not being able to apply it is like it goes away. For those companies it will have a severe impact on whether they are able to invest in Alaska.

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SENATOR COGHILL said they have to figure out how to work with an industry that already is losing money, because there wouldn't be any great use for a net operating loss without losses. They have gone into this negative valley both as a state and an industry and he didn't think it was wrong for them both to look for ways of dealing with it.

One of the ways he tries to balance the discussion is illustrated by the state's partnership with industry in raising taxes but also incentivizing things that were beneficial to the state. Because he wanted to be able to make "value calls" on what the state wants and what the industry needs, as well as the cash call, he asked what the timeframe was for industry's \$5 billion investment.

MS. MORIARTY answered since SB 21 passed on April, 2013, there has been an additional \$5 billion of investment announced from the industry both in the Cook Inlet and on the North Slope.

SENATOR COGHILL said that significant investment is what brought the oil curve from a stand-even to a low-positive 1 percent raise in the decline rate, which is not a decline rate right now. That was a win for both in a high price environment. But neither the industry nor the state anticipated the current low price environment. However, the state also made some significant investments and stated that he would be watching where that cash flow balance is. A lot of the \$5 billion investment went into infrastructure, operations and maintenance, and what are considered "sunk costs." The NOL carry forward, because it's really not a credit, just stacks up and becomes numbers that will have to be paid back some day, and because of that their value is minimal.

He doesn't mind stacking the credits up and going through the valley as long as the infrastructure remains whole and healthy, and is able to produce when they get to the other side of the valley. He didn't want the infrastructure - the cash investment and the "sunk costs" - to be of no value. The NOLs and increased base tax eat into available cash right now, but the sunk costs are still there he reasoned. He was faced with making the judgement call of how to "kind of hunker down" with industry to go through this valley of low oil prices without messing that field up.

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CHAIR GIESSEL said she understands the importance of Ms. Moriarty's policy questions (referring to slide 2), and stated that legislators have three questions of their own that relate to all taxes:

1. How does it affect Alaska families?
2. How will this affect Alaska businesses?
3. Will it affect Alaska jobs?

Last week Chair Giessel said she talked to a registrar of over 10 years in one of her district's schools who said in January she had five families withdraw and she had never had that many withdraw before. Four of them were families that had lost jobs in the oil industry and they were moving out of state. So, legislators see the impact of the low price environment and the decisions industry has to make, but it affects their constituents, as well. That is the balance they are looking for, too.

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SENATOR COSTELLO asked if Ms. Moriarty's member companies had related communications from the investment community in relation to the price environment or just having this bill before them. Specifically, she was interested in the companies that might be eligible for the cashable credits.

MS. MORIARTY answered that the investor community is very nervous. They first started getting extremely nervous after the governor's veto of the \$200 million in the credit fund, because it was completely unexpected. That caused a ripple effect through the investment community, whether it's private equity firms, banks, and so on, and that has not gone away.

She said that one of her member companies was ready to go forward with a gas project in Cook Inlet, but decided to wait until they see what is happening in Juneau. That could be seen in the letter from Caelus.

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SENATOR COSTELLO asked if the oil price rebounds slowly, which is anticipated, would those companies put their plans on hold or exit Alaska.

MS. MORIARTY answered that it depends on what the legislature does with tax policy. Prices can go up, but if companies don't feel Alaska is a stable environment, and if it is going to continue to raise taxes, the oil price may not matter.

CHAIR GIESSEL thanked Ms. Moriarty for her testimony and invited Mr. Seckers to testify.

[4:06:15 PM](#)

DAN SECKERS, Tax Counsel, ExxonMobil Corporation, Anchorage, Alaska, said SB 130 is a "very concerning piece of legislation." Addressing Senator Costello's question, he said ExxonMobil is committed to Alaska. They had been here for many years and will continue to pursue attractive investment opportunities; they look forward to being here for many years to come. Alaska remains a very important component of ExxonMobil's investment portfolio.

He underscored that ExxonMobil recognizes the difficulty legislators face as policymakers in tackling the state's current budget problems while still trying to protect current revenue streams and trying to keep Alaska as a very competitive place to do business. Tax policy decisions fundamentally impact the economic health of the state and those companies that are doing

business in the state. Those tax policy decisions will move Alaska either towards or away from its vision of the future for oil and gas development. The need for Alaska to maintain a competitive and stable fiscal regime that attracts and encourages long-time, critical investments and future investments to develop its resources especially in today's low price environment is one of the most important issues the state faces, ExxonMobil believes.

MR. SECKERS said they appreciate the need to close the state's fiscal gap, but ExxonMobil believes that any tax policy change should be weighed against the potential negative impacts on the state's long-term investment climate. The real question before legislators seems to be whether or not raising taxes on the oil and gas industry at a time when the DOR has testified that the companies are losing money is consistent with their vision of Alaska's future, and if they believe that such action will lead to more jobs, lead to more investment, lead to more production, and lead to more long-term sustainable state revenues, or will it in fact, just make matters worse?

MR. SECKERS said ExxonMobil supports AOGA's testimony that SB 130 represents a significant tax increase on the oil and gas industry. They also agree with the comments made by the legislative consultants, enalytica, that SB 130 represents further instability in Alaska's tax and fiscal policy, and undermines the economics and investments that were made in the past and those that are being contemplated for today and into the future. SB 130 will not improve Alaska's overall investment climate; it will not lead to more industry jobs; it will not help maintain or increase production, and it will not lead to sustainable, long-term revenues for the state. In fact, ExxonMobil believes it will do the exact opposite.

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He said SB 130 will create a major disincentive for companies to invest in the high cost, high risk, environment that is Alaska and reduce Alaska's global competitiveness. For those reason ExxonMobil opposes SB 130.

MR. SECKERS said the impacts of SB 130 can be summarized into three categories: one is substantive law changes, another are procedural changes, and the other is the overall state policy concerns. SB 130 affects each and every one of those categories in a profoundly negative way. While ExxonMobil believes SB 130 as a whole is a bad bill, its key impacts are first: it raises the minimum tax from 4 to 5 percent, which represents a

substantial regressive tax increase. It represents a minimum of 25 percent increase. As the legislature's consultant testified that under today's low prices, the state is already at or above 100 percent of total government take. Raising taxes on companies in that scenario on the very activity of producing oil and gas is not a wise nor a long term feasible solution and it is not sound tax policy.

Secondly, Mr. Seckers said, hardening the minimum floor in section 17 will prevent companies from realizing the true economics of their investments by preventing critical tax credits from being used to reduce or offset the minimum tax. Disallowing companies from using any earned or available tax credits to reduce their minimum tax would represent an immediate and significant tax increase, and it would penalize those companies who made prior year investments even while they were losing money. It would also penalize companies that continue to make current investments or are planning to make future investments from realizing the true economics of their investment despite the low price environment. He said that AOGA summed it up correctly in saying that this provision will affect large or small companies; those that have new oil tax credits, exploration credits, loss credits, and who may be in a loss position today because of low prices and who are depending on those credits to help continue to make investments in the state.

Further, this provision would deny that economic recovery when they need it the most. This provision, by announcing to the world that Alaska is willing to adversely affect the economics of prior and future investments simply for short term revenue needs, would significantly and negatively impact Alaska's investment climate and the perception of Alaska's investment climate to any future investor.

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MR. SECKERS stated that section 17 of SB 130 doesn't stop there. "This 'bad boy' has a double-edged sword." Preventing a company from fully utilizing its tax credits from any month against its total production liability for the year is nothing but a "disguised tax increase."

He explained that the production tax is an annual tax, not a monthly tax. It is paid in monthly installments from monthly estimates. This proposal would, in effect, migrate the tax into more of a monthly tax which is a significant change, and the repeated suggestion that this bill only affects the per-barrel credits or the legacy field credits is simply not true. This

section of the bill has the potential to impact every single tax credit. This means that companies with small producer tax credits, exploration credits, and loss credits could each be at the risk of losing tax credits, or worse, having them deferred or actually losing them, and "that is a tax increase."

MR. SECKERS explained that the production tax is an annual estimated tax that a company files 12 monthly installments for, and a lot of variables go into that. One is the fact that companies can only claim one-twelfth of its estimated expenses, not actual expenses, every month. They can only take one-twelfth of fixed credits or carry overs from a prior year in any given month. That is why the payments are called estimates. "True ups" are filed at the end of the year and on March 31 of the next year and those reflect the total economics of the entire year of operations. This bill would require almost perfect estimates to be filed for numbers they can't possibly know. If they don't hit it exactly, any credit they could have claimed the next month or at the end of the year will either be deferred or it will be lost forever, and some of these credits do not carry forward.

[4:16:28 PM](#)

Another hidden tax increase is in section 31 that keeps gross value at the point of production from going below zero. He explained that the production tax is not filed on a field by field basis like the Economic Limit Factor (ELF) used to be; it is a segment by segment tax. When PPT was put in place, which is the foundation of the current law, it created four segments: Cook Inlet, Cook Inlet gas, Middle Earth and the North Slope. Separate returns are not filed for Prudhoe Bay, Kuparuk or Endicott; they file one for the entire segment, which is the North Slope. Thus if a company is producing from a remote field, the gross value of that unit goes negative (because of marine transportation costs or pipeline costs, the value of those investments (in a pipeline or in marine tankers) are not lost, because it is all consolidated at the end of the year as one economic segment of activity. This provision says no, the gross value can't go below zero, and therefore the costs that drove it there are now lost forever. "That is a tax increase. That they never tell you; that is a disguised tax increase."

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MR. SECKERS said section 8 addresses confidentiality and this provision would allow the DOR to make significant taxpayer confidential and sensitive information available to the public. This information is currently confidential and rightly so. ExxonMobil, even they are partners with BP and ConocoPhillips in

various fields, remain competitors with them and are prevented by federal law from discussing and disclosing certain information. In addition, they are bound by their shareholders from disclosing sensitive proprietary, and maybe commercially advantageous, information. The section 8 provision would allow the DOR to release almost anything regarding company activities, and this is particularly important in looking at the net operating loss (NOL), which is determined by looking at what a company sold a product for all and all its costs way down through the value chain. Would that make their contracts open for disclosure, because that is how they get their revenue?

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MR. SECKERS said along with all the tax increases, SB 130 has procedural changes that could also raise taxes. Section 2, the hardening of the minimum tax floor and the inability to use credits on a monthly basis, is made retroactive to January 1 of the year. That means by the time this bill reaches its ultimate conclusion, taxpayers would have already filed a number of estimated installments based on current law. Retroactively applying these changes onto companies that have already filed installments could expose them to punitive action.

SB 130 would reduce Alaska's overall global competitiveness. Raising taxes when many companies are reporting record losses on the very activity that this bill is trying to tax is poor tax policy, and Ms. Moriarty numbers are correct: it costs companies more to produce a barrel of oil on the North Slope than the oil is currently worth. All are losing money. Raising taxes on companies like that at that time will force them to reexamine short and long-term investment behavior and is inconsistent with the state's long term vision of promoting oil and gas development.

MR. SECKERS said ExxonMobil is committed to Alaska and wants to be here for a long time. They look forward to investing in all attractive investment opportunities, but if taxes are increased, especially in this economic environment, they will have no choice but to reevaluate all their investment decisions.

[4:24:28 PM](#)

SENATOR COSTELLO asked him what is happening in other areas of the world. How are other governments responding to the low commodity prices?

MR. SECKERS answered that he couldn't speak about all the jurisdictions, but when he talked to the legislative consultant,

Mr. Mayer, he said most countries' regimes are looking to incentivize or encourage continued investment in their states. He is not aware of any jurisdiction that is trying to raise taxes or government take when companies are losing money.

[4:25:35 PM](#)

SENATOR STEDMAN said when legislators look at tax code, no matter which one Alaska is in - PPT, ACES or SB 21 - complexity is enemy to both, and instability doesn't do anybody any good. Currently, the system is way too complex. Even the legislature has a hard time understanding under certain price environments what its side of the table is going to look like.

The current tax code provides for a 35 percent tax with some credits moving around. He personally had never seen a firm pay the 35 percent tax rate since the state has had it and didn't think he ever would, because of the deductions it allows. In trying to find a way of stabilizing this environment, he was not so sure they shouldn't go back and listen to some previous testimony from another major back during PPT when the proposal was 8, 10, or 15 percent or even zero.

SENATOR STEDMAN said he had a 13-page amendment that would just have a time out on taxes below \$55. It would get rid of all the credits and complexity and allow the state to collect royalties and income tax (which he doubts there is any at low prices), property tax, which you can't get away from, and zero out severance. Would that increase or decrease stability?

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MR. SECKERS commented that it's hard to provide a detailed response without seeing the entire proposal, because of all the variables. Would prior investment be grandfathered or would the losses just disappear all of a sudden? He also cautioned that when companies look to invest, they look at the total government take, the bottom line. But he admitted that it was an interesting concept.

He underscored the desirability of stability and said that constantly reviewing tax law is troubling. He strongly suggested running it by a consultant and getting an idea of how it would rank Alaska globally in terms of fiscal competitiveness.

SENATOR STEDMAN said it wouldn't be retroactive and wouldn't take place until the end of this calendar year. But he wanted to know if Mr. Seckers thought it would be a tax increase or a tax decrease in this price environment.

MR. SECKERS replied that it is hard to project that on every company, because they are all different. It may be a tax decrease for a company that is in a current taxpaying position. For companies with a lot of credits it may be neutral, but they might lose the benefit going forward.

[4:32:34 PM](#)

CHAIR GIESSEL said section 27 provides that a company gets a transferable or cashable credit based on percent of Alaska resident hire of and asked if it applies to ExxonMobil.

MR. SECKERS answered that provision relates to cashable, refundable credits and under law, ExxonMobil doesn't qualify for them and he also has a concern about the constitutionality of such a provision. However, he said that ExxonMobil has a very high level of Alaskan employment.

SENATOR STEDMAN said he has very few constituents who work in the oil patch, but a couple of young guys worked at Point Thomson and were very impressed with the operation there and want to stay working in the industry.

CHAIR GIESSEL said one of her constituents announced at a community meeting that she is a contract housekeeper at the Point Thomson development and was very excited about it.

[4:35:44 PM](#)

JOE REESE, Sr. Managing Tax Counsel, BP Alaska, Anchorage, Alaska, said BP is a member of AOGA and supports the testimony Ms. Moriarty provided earlier today on SB 130. He said the success of Alaska's oil and gas tax policy is critical to BP, to the AKLNG Project, and to all Alaskans who depend on the successful exploration, development, and production of Alaska's oil and gas resources. A durable, predictable, administrable tax policy must be in place to unlock those benefits.

From BP's perspective, he said a durable tax policy means that BP can count on it being the same tomorrow as it is today. A predictable tax policy means it can be modeled and from an investment perspective BP can determine how the tax policy will impact their investment decisions. Administrable means they can file their tax return accurately and when it's due. These are the three things BP thinks about when they consider tax policy.

MR. REESE said BP is committed to maintaining a safe and compliant business in Alaska that is sustainable. Over the past

two years there has been a 70 percent drop in oil price. In 2015, BP paid approximately \$263 million in taxes and royalties. That resulted in a financial loss of \$194 million. These are publically available numbers that are in their 20F filing.

Under the current market conditions, he said BP's business in Alaska is spending more than it is bringing in and that is not sustainable. As a result, BP is taking the very difficult decision to undertake a 17 percent reduction in force and is working with their Prudhoe Bay working interest owners to analyze the activity level at Prudhoe Bay and adjust it according to the current price environment.

SENATOR MICCICHE joined the committee.

[4:38:40 PM](#)

MR. REESE said a 1-percent increase in the minimum tax equates to approximately six months of rig time at Prudhoe Bay; it's a significant increase in taxes and cost to their business. He repeated that operating under a predictable, durable, and administrable oil and gas tax policy is essential to maintaining the activity level of Prudhoe Bay and the long term viability of the AKLNG Project.

SENATOR COSTELLO said the administration is asking to go from 4 to 5 percent and some are considering that to actually be a 25 percent increase and asked what he means when he says a 1-percent increase.

[4:40:49 PM](#)

MR. REESE clarified that the 1 percent raise from 4 to 5 percent is a 25 percent increase in the minimum tax. He added that BP is committed to complying with tax laws in a responsible manner and to having open and constructive relationships with tax policy makers. One of the major costs of BP's business in Alaska is the oil production tax, and while BP is currently cash-flow negative, they still pay oil production tax, because certain cash costs are not deductible such as their investment in the AKLNG Project and other specifically delineated restrictions.

At current prices, Prudhoe Bay doesn't currently receive oil production tax credits, but BP doesn't support limiting the production tax credits under SB 21. That is because it would negatively impact the oil and gas industry as a whole including the many companies that made investments, created jobs, and added production in Alaska based off of that tax policy.

Just as the industry is struggling to make ends meet, the state also faces severe budget shortfalls and BP recognizes that. While reasonable people may disagree about how to make changes to improve the current oil and gas tax policy, now is not the right time to increase taxes on businesses that are struggling to make ends meet, and it would further inhibit their ability to maintain their activity level at Prudhoe Bay. Near term changes in the state's oil and gas tax policy will have long term consequences for all.

[4:41:55 PM](#)

MR. REESE said the presenters before him had hit the highlights of the issues with SB 130 and he wanted to touch on six items. He wouldn't belabor them because they had been stated before.

One is the administration has proposed an increase in the minimum tax from 4 to 5 percent and it does represent a 25 percent tax increase that equates to approximately six months of rig time at Prudhoe Bay. It would have a chilling effect on additional investment in Alaska.

Second, the administration is proposing an artificial limitation to the use of credits. Their concern that law provides for production tax to be calculated on an annual basis using forecasted prices and estimated costs as opposed to actual numbers, and having an end-of-the-year "true-up." The new provision in SB 130 would cap the amount of credits that could be used based on what a company claims in a given month. BP doesn't believe that would lead to a predictable or administrable tax policy, because it would be impossible to file tax returns correctly at the time they are due.

Third, the administration is proposing a material increase in the interest rate for tax overpayments and underpayments. The current rate is 3 percent over the federal fund rate and it is calculated using simple interest methodology. The administration has proposed a significant increase to that and for the interest to be compounding. However, Mr. Reese pointed out, the administration typically takes the full six years of the statute of limits to provide companies with their assessments and as that interest clicks along, 7 percent compounded could be up to \$.55 per dollar, a significant amount of interest before a company ever knows there is an issue. That does not allow for predictability when they model their activities.

Fourth, the administration proposed a limitation on use of the Net Operating Loss (NOL) tax credit, which would penalize people

who made investment decisions based on the tax law and now that they are in a position where the cash flow doesn't meet the expenses, they wouldn't be allowed to utilize that NOL going forward. BP believes that is not durable or predictable.

Fifth, Mr. Reese said, the administration has proposed an erosion of taxpayer confidentiality. Mr. Reese emphasized that the production tax is a self-reporting tax much like the income tax, and the quid pro quo for that is that the taxpayer, because they give the information to the DOR or the IRS, in return they get confidentiality of that data. It's different than a property tax, for instance, where the government looks at market indicators of a property, sets the value, assesses the tax, and you pay the tax. That's public. The difference really comes down to anti-competitive behavior. How will that information be used? Will their competitors be able to see BP's commercial dealings and will that lead to anti-competitive behavior? And secondly, there is a constitutional question around violating privileges and immunities to be forced to provide confidential information and have that be disclosed by someone.

For both reasons, BP believes that taxpayer confidentiality and the erosion of taxpayer confidentiality is bad tax policy.

[4:45:45 PM](#)

Last, Mr. Reese said, retroactive and mid-year changes to law or regulations make it extremely difficult if not impossible to administer the tax. BP can't file its returns accurately if the game changes mid-way. Again, he said BP is committed to maintaining safe operations in Alaska that are sustainable and they are committed to complying with tax laws and developing relationships with tax policy makers. They support a predictable, administrable oil and gas tax policy and that's why they do not support SB 130.

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SENATOR MICCICHE said everyone agrees that transparency with the public is good when possible, and asked him to explain the problems with taxpayer confidentiality.

MR. REESE explained the best analogy to use is everyone's individual income taxes. The federal income tax is a self-reporting system. This means the taxpayer writes down on his return his income, deductions, and credits and submits that under penalties of perjury to the IRS, and then they review and determine whether it has been reported accurately or not. That

is a very similar system to the production tax, which is a self-reporting system.

The concern is that the appetite for disclosure is never satisfied until everything is disclosed, and as an individual in the community, he would not want his income taxes shown to his neighbor; it's none of their business. In the business context, there are anti-trust laws that require BP to act in a competitive way, and if they are forced to disclose their commercial relationships to their competitors, especially in a place like Alaska where there aren't as many competitors as there may be in the Lower 48, one can quickly get to a spot where there is anti-competitive behavior going on that would violate federal law.

Secondly, a company has a constitutional right to not incriminate itself regarding whether they know about a violation of the law or not and they can't be forced to give up their constitutional right to keep confidential information that will be used only to administer the tax.

SENATOR MICCICHE said that was a partial answer, and asked if he were to disclose details of a commercial contract how that could disadvantage BP in competition with other companies.

MR. REESE answered that he is not an anti-trust attorney, but he could share a simple example of how that information could be used to manipulate the marketplace. If a party was forced to disclose their contract for a helicopter, and they had retained that helicopter to perform services for them and they paid them a certain amount. If their competitors were to have access to that information, then they could go to the same helicopter operator and say I want a better deal, \$99 instead of the \$100 that the first party was charged. So now it's no longer a free market, competitive environment. Private information can be used to manipulate the marketplace.

CHAIR GIESSEL said one of the arguments made by the administration to increase the interest rate and compound it for tax returns is their assertion that companies short-pay their taxes. So, this would be a motivator for companies to not do that. She asked if that is a realistic argument.

MR. REESE answered that is just false and a little bit offensive. He elaborated:

They are basically accusing us of lying or maybe even less than basically, and we have every incentive to pay our tax when it is due. We want to pay the right amount of tax. We want to pay the right amount of tax when it's due. We sign a return under penalties of perjury, and none of us would intentionally do anything that would jeopardize ourselves in that regard.

Secondly, he said, many laws are already in place to discourage short-paying taxes. "BP does not short-pay their taxes," Mr. Reese stated. A provision would have to be created to resolve uncertain tax issues.

[4:54:19 PM](#)

SENATOR STEDMAN said this is the same question he asked the ExxonMobil representative. Why not take the severance tax to zero in trying to get some stability and fairness in the state's tax structure. His amendment uses the trigger price of \$55 and it is not retroactive.

MR. REESE responded that a simple tax policy is easier to administer, but he would have to model Senator Stedman's proposal to see how it impacts business. He said there are four areas of government take in Alaska, at a minimum: one is royalty, one is production tax, one is property tax, and the last is state corporate income tax. Those all represent costs to the business and the more their costs go up the less activity they are able to conduct in the state. If their costs go down, then they can make judgments about increasing their activity.

SENATOR STEDMAN said severance tax, of the four components they struggle with, is the hardest to resolve. That is where the instability lies, and making it zero would simplify that matter. He asked Mr. Reese to comment.

MR. REESE agreed that the production tax gets the most attention and it has been the most volatile of the four taxes. For them the equation is simple: an increase to the production tax increases their costs and reduces their investment; a reduction to production tax reduces their costs and allows them to increase their investment.

[4:58:20 PM](#)

SCOTT JEPSON, Vice President, External Affairs, ConocoPhillips, Anchorage, Alaska, introduced himself.

PAUL RUSCH, Vice President, Finance, ConocoPhillips, introduced himself.

MR. JEPSEN related that ConocoPhillips is not a member of AOGA, so they may have some slight differences of perspective, but by and large they are basically aligned.

He walked them through the activities that ConocoPhillips has embarked upon since SB 21 was passed in 2013 and then took a few minutes to talk about how ConocoPhillips has reacted to the current economic environment. Mr. Rusch would walk them through SB 130 and talk about their key concerns. They would conclude with a few observations.

Since SB 21, Mr. Jepsen said, ConocoPhillips has done a number of things: added two rigs to the Kuparuk rig fleet, which helped stem the decline out of the Kuparuk River field, and ordered two new rigs to be built, one which has already been delivered. The other one will be delivered later this year. Prior to SB 21, ConocoPhillips had three rigs in its rig fleet between Alpine and Kuparuk. Since then, they have averaged about 5 - 6 rigs for the two fields, but they are down to four right now. One rig was sent over to BP, but they will pick up another rig later this year and be back up to 4 rigs later this year. More rigs leads to more production.

ConocoPhillips has also invested \$500 million in bringing on stream the first new drill site at Kuparuk in 13 years, drill site 2S. It will produce about 8,000 barrels/day. They have also embarked upon expanding their viscous oil production at West Sac in the Kuparuk field called 1H-News (North East West Sac). It is similar to drill site 2S in terms of the kind of production they expect to get, the amount of money it cost to develop, and the people they used to construct it. However, they have deferred drilling on 1H-News in response to low oil prices.

MR. JEPSEN said they had built the modules and transported them to drill site 1H on the North Slope. They are powered up to stay warm for drilling next year and 1H-News should see first oil in 2017.

MR. JEPSEN said that ConocoPhillips has also been pursuing their new developments in the National Petroleum Reserve Alaska (NPRA) having received the key permits for Greater Mooses Tooth (GMT) 1 and have made the decision to move forward on it. It is about 9 miles west of CD-5 (this development is moving west). It will cost about \$900 million to develop and a peak gross rate of

30,000 barrels a day is expected. Hundreds of construction jobs will be generated and first oil is anticipated in 2018. Right now they are in the process of ordering materials and finalizing their engineering.

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ConocoPhillips has another development 9 miles west of GMT1 called GMT-2. It will be a bigger development than GMT-1, but its engineering is not as far along as it is for GMT-1. It will cost in excess of \$1 billion and take about 700 people to construct it. He didn't have an estimated production rate at this time.

MR. JEPSEN said ConocoPhillips made the decision to pursue CD-5 in 2012 before SB 21 was passed having spent quite a few years since 2002 trying to get it permitted. They were hopeful that they had made a good decision.

5:04:07 PM

The last thing Mr. Jepsen said they had done since 2013 is drill two exploration wells at NPR-A. They shot seismic over the GMT-1 area so they could better ascertain the size of the field and plan its development. This year they are drilling three wells in NPR-A; two of them are about 9 miles west of GMT-2 and the other, called Hyperion, is off of CD-5.

MR. JEPSEN said he wanted to correct the record about a number of things. One is that none of their production qualifies for the GVR. Some of it could potentially, but they felt the regulatory requirements would be difficult and expensive to meet, and didn't even file for it. So, the comment that all fields since 2002 are getting the GVR is not accurate.

To put things in context, ConocoPhillips has a total of three rigs in the Lower 48: one in the Bakken and 2 in the Eagleford. One of the reasons they are continuing to pursue their development in Alaska is because of the positive investment climate, especially after SB 21 was passed. Ramping down activity in Alaska is not easy. It's not like in the Lower 48 where you have short-term rig contracts and can go pick up a Jones rig next week. There is a lot of momentum when things are rolling and it is difficult to shut them down.

Right now BP is their key partner at Kuparuk and Anadarko is their key partner at NPR-A, and BP supports ConocoPhillips in these decisions. They have momentum and want to try to keep that momentum going and hopefully outlast this trough in oil price.

If the price doesn't go up, they will have to take measures to try to get back to a neutral cash flow, at least.

5:07:00 PM

He said slide 4, labeled "Capital Spending Trends," had a line plot that showed oil price versus time and a bar chart in the upper left corner that showed ConocoPhillips's corporate capital expenditures during the same time period. They peaked at about \$17 billion in 2014 and have been ramping down at a steady decrease that mirrors the price of oil since then. Their capex is down about 63 percent from 2014.

Slide 4 provided a graph of ConocoPhillips's investments in Alaska since 2012 and a graph of the percentage of their Alaska investments relative to ConocoPhillips's total corporate capital expenditures was below it. During the key ACES years of 2007-2012, and when oil prices were considerably higher than they are today, ConocoPhillips averaged about \$800 million per year.

After SB 21 passed, in partial response to the better investment climate, ConocoPhillips started to ramp up its investments. This year (late 2015) they had anticipated spending about \$1.3 billion in Alaska, but that has been ramped back to about \$1 billion, still a pretty healthy-sized investment.

MR. JEPSEN said the bottom plot showed the percentage of their Alaska expenditures relative to their total corporate expenditures, which has been coming up as a total percentage. The take away message here is that ConocoPhillips is investing differentially in Alaska and for all the reasons he mentioned earlier.

5:09:20 PM

He said that slide 5 graphed the "crux of the issue." The "Y" axis shows net cash flow; the "X" axis shows ANS West Coast price and the different colored bars show how much the state is making, how much the federal government takes in income tax, and how much the investors get from the North Slope in the blue.

The state's share excludes tax credits other than the per barrel production tax credits. The reason? It's pretty difficult to figure out how and when they are going to be taken, or if the state will allow them or not. It's one of the discretionary items that the state has in its control. In the current price environment the state has positive cash flow and the investors are negative. It stays that way up until somewhere north of

\$50/barrel. But even above that price, the state's share is larger than the investor's share under the current tax regime.

MR. JEPSEN said that there have been comments that severance tax isn't high enough or it should be higher, but ConocoPhillips and others in the industry don't just look at severance tax when they make their investments, they look at total government take. It plays the biggest part in their assessment of the fiscal framework in the areas in which they invest. Severance tax goes up as the price goes up, and it's a majority of the free cash flow. He turned the presentation over to Mr. Rusch to give his perspective on these key items.

[5:10:52 PM](#)

MR. RUSCH said slide 6 identifies key concerns with SB 130, a number of which have been detailed by previous presenters. However, these represent some very important issues for the industry. The previous slide demonstrating that the industry is losing money is the strongest argument against increasing the minimum tax from 4 to 5 percent and will continue in that position until upwards of \$50/barrel.

ConocoPhillips' net cash flow last year was a negative \$100 million-plus, at \$52/barrel. Oil price is now south of \$40/barrel. If prices don't improve they will be in an even worse position that will result in reduced investment in Alaska.

The concern they have with hardening the floor is that they will lose the ability to use those losses, and those are real losses on expenditures made in Alaska at a time when the industry is losing money. ConocoPhillips continues to be committed to Alaska and wants to invest for the future, but with that restriction those investments effectively got more expensive.

[5:13:17 PM](#)

MR. JEPSEN commented that just because they are in a negative cash flow does not mean they incur net operating losses. A fair amount of expenses and costs don't get included when calculating NOLs. Last year, for example, ConocoPhillips was not in an NOL situation. He wasn't sure about this year.

[5:13:36 PM](#)

MR. RUSCH said they just received their tax audit from 2009, which was six years and three months after the end of that calendar year. Interest was accruing for that entire period. That interest clock doesn't start when the audit is done; it starts in the first month of the year.

ConocoPhillips also just closed out their 2006 audit, but the appeal process took nine years. That is not a trivial amount of time and compound interest component can actually be greater than the underlying audit issues.

He said the current system, partly because it is a net tax system, has a fair level of uncertainty about the deductibility of certain expenses. In one year an item may be deductible and the following year it may get challenged. The bottom line is that uncertainty makes it very difficult to predict what the final tax assessment will be.

[5:15:35 PM](#)

MR. RUSCH said the DOR has expressed concern that oil companies might migrate the per-barrel tax credits across months. The tax law is very clear that it is an annual tax, and the suggestion that it isn't goes against the clearer guidelines that are already in statute.

He also pointed out that a significant amount of confidential data is already being reported to the DOR and the DNR about and companies are in no way saying they aren't going to comply with that.

[5:17:27 PM](#)

MR. JEPSEN observed in summary that any significant change in the tax law just reemphasizes their concern about the inability of the State of Alaska to implement a stable oil and gas fiscal policy. It's only been 19 months since SB 21 was ratified by the voters. They understand the state's fiscal issues, but ConocoPhillips is basically in the same position. Everyone has to do something to manage their way through this, and asking just industry to solve the problem is not fair.

He said ConocoPhillips makes multiple billions of dollars of investments in Alaska and since 2007, it has paid over \$26 billion to the State of Alaska. However a pattern of tax instability raises the question whether or not Alaska actually competes for capital relative to other places where their money can be invested. The most damaging thing about continual changes in tax policy is what it does to a corporations' long-term philosophy for investing in Alaska.

MR. JEPSEN added that they thought the House Resources Committee Substitute (CS) was a vast improvement and amendments are being taken right now. So, they will see what comes out of that and

tell them what they think. He repeated if there are increases in tax that increase their costs, they will take it out of what they are spending today. They don't have excess cash flow to spend on taxes.

[5:19:33 PM](#)

SENATOR STEDMAN asked to go back to slide 5 and said it is helpful for industry to use the same dataset as the state does, the Revenue Sources Book. It shows in FY17 there will be \$570 million in credits but when they get applied is up in the air. The Revenue Sources Book used \$39/barrel and the chart uses \$40/barrel. It would be helpful to have that bar chart parsed when the NOLs are discussed.

SENATOR STEDMAN said the state continually tries to get a stable tax environment, but they never seem to get there and it might actually be making it worse, to the point where the state has trouble understanding it. He asked Mr. Jepsen's thoughts on just getting rid of the severance tax - "Take it to zero."

[5:21:32 PM](#)

MR. JEPSEN responded that he would have to look at that in terms of their past investments, their current investments, and the price framework they intend to be in, and see if it makes sense. "Is it substantially better, and is it worth going down that path?" It sounds intriguing, but one of the concerns would be that it is just another substantial change in the tax framework, and there is no guarantee that after next year someone wouldn't think they gave away the farm with a zero severance tax and want to revisit it.

[5:22:59 PM](#)

SENATOR STEDMAN said both sides of the table are trying to get stability, because this isn't good for the state's business nor the industry's business, and they are in business together. So, jointly nobody wins in this game.

He asked if CD-5 is on private land and how that works with the tax code. It's not a loaded question, but more of an informational question, because most of the time they talk about what is on state land.

MR. JEPSEN responded that CD-5 is a combination of Arctic Slope Regional Corporation (ASRC) minerals and federal minerals. So production there is predominantly coming off of state lands and ASRC lands. ASRC obviously gets the royalties from their

production and 50 percent of the royalties from the federal production come back to the State of Alaska. Those royalties is directed to be spent on the villages in the National Petroleum Reserve Alaska (NPRA) that surround that, basically for the benefit of the North Slope Borough.

CD-5 is located on Kuukpik Corporation surface land, so it's the first development that is on Native-owned surface land. ConocoPhillips has worked very closely with the Village of Nuiqsut and Kuukpik Corporation and the ASRC in its development. So far, they are drilling wells and fully expect to see their initial expectation of about 16,000 barrels a day of average production.

SENATOR STEDMAN said he thought it was good to point it out, because it is a significant issue that the committee and the public should know about.

MR. JEPSEN emphasized that they do pay severance tax even if the development is on private land or federal lands.

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CHAIR GIESSEL pointed out an important fact: that ConocoPhillips does something that the other two majors don't. It reports its quarterly profits and losses in a procedure that is called "separate accounting." She asked him why ConocoPhillips does that.

MR. JEPSEN corrected her that it's not "separate accounting;" it's called "segment reporting."

CHAIR GIESSEL asked him to explain why they do that.

MR. RUSCH answered that they don't do it voluntarily, because it puts a bit of a microscope on their results. It's purely driven by Securities and Exchange Commission (SEC) reporting requirements. What triggered it for ConocoPhillips was their upstream/downstream business, which simply made their upstream business smaller. As they created the segments to report, Alaska became a material segment for SEC reporting.

SENATOR MICCICHE asked why ConocoPhillips is investing heavier in Alaska than in the rest of the Lower 48. ConocoPhillips' Alaska capex went from 6 percent in FY12 to 13 percent in FY15 and to 16 percent in FY16.

MR. JEPSEN answered that ConocoPhillips ramped up investments in Alaska after passage of SB 21 and have a lot of momentum going now and think they have some good opportunities here. Momentum is important because it's difficult to get the permits and rigs in place as well as alignment with the partners. Once a project gets started, ramping down is equally difficult. If you think there's an opportunity you want to maintain that optionality to continue with the level of investment that you have. Right now they have a lot of stuff in place and are "investing in the future," although they aren't making money in Alaska.

5:29:16 PM

DAVID WILKENS, Sr. Vice President, Hilcorp Alaska, LLC, Anchorage, Alaska, said Hilcorp is the largest privately held oil and gas company in the U.S. It is headquartered in Houston, Texas, and has operations in the Gulf Coast of Texas and Louisiana, the northeast U.S. in Ohio and Pennsylvania, as well as Alaska's Cook Inlet and the North Slope. It was founded in 1989 and has 1400 full time employees. Just over 500 of those employees support their Alaska operations and 90 percent are Alaskans including himself.

MR. WILKENS said Hilcorp operates approximately 53,000 gross barrels of oil per day and 150 million cubic feet of gross gas sales per day from approximately 500 producing wells for a net production of approximately 57,000 barrels of oil equivalent per day. Hilcorp's assets are primarily, although not exclusively, older fields with extensive production histories of steady and predictable performance that carry an incredible amount of opportunity for getting more oil and gas out of the ground. It's the company's business model. They do it safely and responsibly while extending production lives through efficiency in thousands of small-scale projects.

MR. WILKENS said the state needs to attract more companies like Hilcorp as its infrastructure continues to age. Hilcorp's production in Alaska is approximately 40 percent of what it produces company-wide. So, their success in Alaska is critical to their overall company's success. From Hilcorp's perspective, the credits in question have resulted in more investments in Alaska, and more production both on the North Slope and in Cook Inlet.

He said it's no secret that Hilcorp has been a big part of reviving energy security in Southcentral Alaska. Over the past four years they have invested over \$1 billion in projects and have drilled over 50 wells in the Cook Inlet area. As a result

of this investment and the increased production, they are sending more oil to be refined and used in Alaska.

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Due to Hilcorp's significant investments over the past four years, Mr. Wilkens said, they are now making longer term gas supply commitments at a lower price out into the year 2023. They continue to stand by their commitment to serve Alaskan's energy needs first and are working to ensure a reliable and affordable energy source for Alaska's largest population hub.

MR. WILKENS reminded them that prior to Hilcorp's entry into Alaska in 2012, brown outs were a widespread concern as well as the need for utilities to import natural gas to meet demand. Expecting outages, many people bought electric generators, but he is proud that with Hilcorp's results none of those generators were needed.

He said that Hilcorp's success certainly didn't come without challenges. Developing oil and natural gas in the Cook Inlet basin carries a very high cost of production coupled with annual decline rates that vary from 15-50 percent. The simple fact is that if they did not continue spending money on projects that bring on new production the declines cannot be curbed. So, Hilcorp believes it is in their best interest and the state's best interest to continue spending dollars on trying to produce more oil and gas in the Cook Inlet basin. Victory can't be declared or Alaska will be back in the same boat it was in at the end of 2011. It's also no secret that Alaska's tax credit system and the Cook Inlet Recovery Act were key drivers in bringing Hilcorp to Alaska and their investments to date.

Since 2012, Mr. Wilkens said, Hilcorp has spent \$3.5-4 billion total in capital and acquisition costs in Alaska. Those investments were aimed at one primary goal: increasing oil and gas production. And since 2012, they have increased production by about 40 percent. How do they do it? The answer is simple. They have and continue to make significant investments, investments that were encouraged by the state's tax credit program and investments that did just exactly what the credits were intended to do: increase energy supply for Alaskans.

Their success has been meaningful to many, including the state. Increase production levels of oil and natural gas in the Cook Inlet basin has resulted in increased royalty rates, property taxes, and jobs. One example of this is looking at their monopod offshore platform. In January 2012 right after Hilcorp took over

operations, the realized oil price was approximately \$95/barrel. Production on the monopod was 600 barrels per day, a marginal rate for an offshore platform that has a high operating cost.

[5:37:07 PM](#)

Because of the marginal rate and low profitability from the monopod, it qualified for royalty relief under HB 185 that was passed in 2003. The royalty rate was reduced to help maintain profitability for the platform so it would not be shut in or permanently abandoned. As the royalty owner, the state's take from the monopod at that time was approximately \$90,000 per month. This was when oil was \$95 a barrel.

Over the past four years, Mr. Wilkens said Hilcorp has done over 150 projects on the monopod, most of which were smaller in scope, and has increased production to approximately 3,000 barrels of oil a day. Because of the increase in production, the state's royalty share is back up to the standard 12.5 percent and even with prices at \$35/barrel, the state's royalty take from the monopod has increased to about a half-million dollars per month, five times more royalty going to the state despite prices declining by 60 percent. Furthermore, and probably more important, their success at the monopod has added 20-plus years of production life and approximately 8 million barrels of future oil production. The monopod is not an isolated anomaly. Since Hilcorp's entry into the Cook Inlet area in 2012, oil production has doubled, which has increased oil royalty to the state in these four years by over \$70 million. And even though oil prices are lower this year, estimated oil royalties will be approximately \$10 million more this year than what they were right before Hilcorp took over.

[5:39:46 PM](#)

Hilcorp's success in increasing oil production over the past four years has also increased future estimated oil production by 20-30 million barrels in the Cook Inlet area. That is just the oil. That's meaning future royalty to the state. He said, "We need more results like this."

He also offered that the state needs a system in place that is stable, predictable and incentivizes - not penalizes - continued investments. Hilcorp's Cook Inlet success is a good example of the state putting good policy in place aimed at achieving a positive result and then getting one.

MR. WILKENS remarked that the credits Hilcorp earned were "absolutely reinvested in the state." They have managed to work

their way above the 50,000/barrel/day mark through both projects and acquisitions and a lot of hard work. Breaking the 50,000/barrel/day mark means they can no longer cash-in the credits in question, but other budding companies can still use those credits, and Hilcorp is a company that always welcomes competition and encourages other companies, especially in Alaska, to succeed. Hilcorp wants to help promote a healthy industry throughout the state, because an active industry means additional service companies will not only stay but maybe even come to Alaska, which will in turn lower costs.

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MR. WILKENS said a lot of the discussion regarding the credits has involved the Cook Inlet basin, primarily because they were wildly successful. Their success in the Cook Inlet is what has fueled Hilcorp's interest in expanding to the north in November, 2014, when they purchased three of BP's fields on the North Slope: Milne Point, Endicott, and North Star. When Hilcorp took over operations there, all three fields were producing approximately 36,000 gross barrels/day. Today, they are producing about 37,000 gross barrels/day and after a year of working these assets, he is very excited about the opportunities he sees. They have a comprehensive list that they can invest in for years to come: wells needing to be drilled, projects that will put more oil in the pipeline and support hundreds if not thousands of jobs in Alaska.

Hilcorp has one drilling rig running on the North Slope today and would like to pick up a second before the end of 2016. But in today's price environment and in the face of an uncertain state fiscal structure, it is yet to be determined what projects move forward and when. They have to be very thoughtful with every penny they spend.

MR. WILKENS said investment budgets are shrinking and they compete with other oil and gas producing areas throughout the world, and within Hilcorp, as well. He wants Hilcorp's investment dollars to come to Alaska. They have to continue to work hard to build efficiencies and cut costs while ensuring it is done safely and without causing harm to the environment. "Cutting costs, not corners, is the only way we will survive this downturn," he said.

[5:44:12 PM](#)

He asked legislators to recognize that change creates uncertainty and uncertainty affects investments and jobs, and investments, whether for exploration or development, are the

only way to increase production. Increasing production is the only way to get out of this spot. Alaska can't afford to have less production.

MR. WILKENS said that he had worked over the past 30 years in several other basins throughout the U.S. and internationally and can say with confidence that Alaska has changed its tax policy more in the past few years than he has seen in other areas in decades. He wants to keep Alaskans working and to increase production, but his company simply isn't going to continue to invest hundreds of millions of dollars in Alaska nor is his owner going to let him take a loan out to pay his tax bill. That is just not what they are going to do, and the only other choice is to cut something out.

He concluded by saying that the uncertainty they are in threatens their ability to plan their investments, and the decisions they make today will impact the economics and the opportunities to increase tomorrow's production both in the Cook Inlet and the North Slope.

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SENATOR COSTELLO related that the director of the Alaska Tax Division, Ken Alper, came before the committee and basically said they tried to incentivize activity and that happened. The state got what it wanted with the credits, and now it's going to pull them back. She asked him to respond to that way of thinking.

MR. WILKINS answered that in his view the tax credit system incentivizing the behavior the state wants worked beautifully for the Cook Inlet. Without them, Cook Inlet would have had an "out of business" sticker in 2011/12. The state propped it up with wonderful success. If the implication is that they are going to call victory and be done, Cook Inlet will be back in the same boat very soon. He added that policy that incentivizes the behavior the state wants can work on the North Slope, as well. He explained that Hilcorp reacts to policies the state sets and the tax credit system is one of the things that brought them to Alaska in the first place.

[5:47:50 PM](#)

CHAIR GIESSEL said SB 130 addresses transferable credits in section 27 and bases them on Alaska resident hire, and asked if Hilcorp takes advantage of those and if so, how he feels about the requirement that they will be based on the percent of Alaska hire.

MR. WILKINS responded that he isn't the tax person and that Hilcorp is proud of the fact that they have 90 percent Alaskans working. He could see where tying the credits to that would result in changing numbers and tying it to something arbitrary like that might not be sound tax policy. There is also the constitutional question.

SENATOR MICCICHE asked him to comment on the effect commodity price of gas has on Hilcorp and others if the incentives had been lower if they kept the attractive delta with Henry Hub that they had last year.

MR. WILKINS answered that Hilcorp can no longer take the cashable credits as they have worked themselves out of those. But other companies are budding that can take advantage of them and they are very important to them. On the gas side of Hilcorp's business, their investment decisions to drill all the wells were based on predictability and stability. Hilcorp is not a "build and flip" type of company. When they make a decision they enter in and their track record is that they are in for the long haul. Their business model uses a 5 to 10 year period to get their money back. Before they came into Alaska they studied the fiscal landscape, and the gas side is more stable than on the oil side and that is a good thing.

SENATOR MICCICHE said Hilcorp operates largely in his district, its effects on his community with the resurgence in the Cook Inlet has been undeniable and positive. They are very appreciative not only of the energy supply but for the employment, increased property taxes, and all kinds of other things.

CHAIR GIESSEL noted that where Mr. Wilkens works used to be her district and recognized how much his company contributes to the community in not just jobs, but to non-profit organizations like senior centers and other community endeavors.

MR. WILKINS accepted her recognition on behalf of the Hilcorp employees.

[5:52:25 PM](#)

TOM WALSH, member of the Board of Directors and Executive Committee, Alaska Support Industry Alliance (Alliance), said he is also the founder and managing partner of Petrotechnical Resources of Alaska (PRA), but he is testifying on behalf of the Alliance in opposition to SB 130 based on the negative impacts

to client companies and his own company. He said that PRA had experienced a decline in activity and revenue much like many other Alliance members in every sector of the industry in Alaska from major and small independent oil and gas producers and explorers to Native corporations, state, local and federal government agencies, and the Southcentral Alaska utility companies.

In 2010-12 Mr. Walsh said he was in Juneau stating that Cook Inlet was running out of gas and now they are seeing a major turn-around because of the credits. The oil and gas business in Alaska has a tremendous breadth of skills and experience across the full spectrum of disciplines. Two of PRA's employees are recognized experts in the current oil tax statutes, regulations and processes. PRA was established in 1997 and has grown steadily over the years to a peak staffing level of 102 employees in early 2012. Recently, due to the depressed oil price and associated crisis in the industry, employment numbers have declined to levels not seen in the past decade.

5:54:57 PM

MR. WALSH said PRA's payroll is down to 48 employees and they haven't seen the bottom yet. Last year, PRA had 55 contract employees supporting the Prudhoe Bay unit operator, BP Exploration Alaska, Inc., and presently they have 15 contract employees at BP. Activity levels have crashed in the last year impacting everyone in the oil and gas industry including the major producers and large and small independents, alike. The service industry has been hit very hard. It has seen significant layoffs at CH2M and Parker Drilling among others. The Alliance has surveyed member companies and can account for over 2,000 layoffs in the industry in the last year. PRA has lost over one-half of its business and employees.

He said that last week, BP faced one of the most difficult times in memory with respect to employee layoffs in Alaska, and globally. After significant cuts last year, approximately 17 percent of the remaining employees in Alaska were informed of their pending layoffs. His phone had been ringing all week with severed employees looking for work, which simply does not exist.

On another sad note, Mr. Walsh said, Caelus Energy announced this week that they will delay development of its Nuna Field for at least one year due to the low oil price and the uncertainty of Alaska's tax structure. All of PRA's clients have been impacted by this continual uncertainty in tax structure; even the perception of instability has major impact on the industry.

The investment community, which has been backing exploration and development projects, has all but vanished in Alaska making it difficult to impossible to finance oil and gas projects.

He said SB 130, if adopted, could mortally wound an already critically ill oil and gas industry in Alaska. Raising taxes and removing credits is a bad idea under any circumstance and is fatally flawed policy in the current price environment. Raising taxes on the industry in this moment is analogous to selling oil stocks at a low point in the market. Alaska is heavily invested in oil and gas even to a fault, and selling out now by raising taxes and further crippling the partners who have developed the state's most valuable resource in good times and have for the last six decades, and who are now in a cash negative status is simply irrational, he said.

He countered that since PRA is down by 50 percent in contracts and revenue, perhaps he should double his hourly consulting rates to correct for that downturn in business and see how many of his clients agree to pay it. He didn't think many would.

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SENATOR COSTELLO asked how Mr. Walsh would respond to community leaders across Alaska whose message on an hourly basis is to do it all: cut the budget, address the credits and taxes, raise revenue, and change the Permanent Fund, and if you don't do it all you are not representing what the people of Alaska want you to do. This has been a constant and consistent message since the beginning of session and before. He must be aware of it. People are joining arms and marching in lock-step saying every industry must pay and fairness must be the value they put forward when, in fact, all they have heard in this committee meeting is that taxing an industry that is losing money just doesn't get you a good result.

MR. WALSH responded that the challenge is tremendous, but her last point is the critical one. The industry is hemorrhaging; all the companies he is aware of are in a cash negative situation with these low oil prices, and that's not just in Alaska, but globally. So there is a major ongoing crisis and raising the taxes is absolutely the wrong thing to do at this point. It will just accelerate the decline of the industry in Alaska, and we can't afford to do that.

CHAIR GIESSEL thanked Mr. Walsh.

6:02:26 PM

CHAIR GIESSEL adjourned the Senate Resources Standing Committee meeting at 6:02 p.m.