

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 1, 2017

1:02 p.m.

MEMBERS PRESENT

Representative Andy Josephson, Co-Chair
Representative Geran Tarr, Co-Chair
Representative Dean Westlake, Vice Chair
Representative Harriet Drummond
Representative Justin Parish
Representative Chris Birch
Representative DeLena Johnson
Representative George Rauscher
Representative David Talerico

MEMBERS ABSENT

Representative Mike Chenault (alternate)
Representative Chris Tuck (alternate)

COMMITTEE CALENDAR

HOUSE BILL NO. 111

"An Act relating to the oil and gas production tax, tax payments, and credits; relating to interest applicable to delinquent oil and gas production tax; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 111

SHORT TITLE: OIL & GAS PRODUCTION TAX; PAYMENTS; CREDITS

SPONSOR(S): RESOURCES

02/08/17	(H)	READ THE FIRST TIME - REFERRALS
02/08/17	(H)	RES, FIN
02/08/17	(H)	TALERICO OBJECTED TO INTRODUCTION
02/08/17	(H)	INTRODUCTION RULED IN ORDER
02/08/17	(H)	SUSTAINED RULING OF CHAIR Y23 N15 E2
02/08/17	(H)	RES AT 1:00 PM BARNES 124
02/08/17	(H)	Heard & Held
02/08/17	(H)	MINUTE(RES)
02/13/17	(H)	RES AT 1:00 PM BARNES 124

02/13/17	(H)	Heard & Held
02/13/17	(H)	MINUTE(RES)
02/17/17	(H)	RES AT 1:00 PM BARNES 124
02/17/17	(H)	Heard & Held
02/17/17	(H)	MINUTE(RES)
02/20/17	(H)	RES AT 1:00 PM BARNES 124
02/20/17	(H)	Heard & Held
02/20/17	(H)	MINUTE(RES)
02/22/17	(H)	RES AT 1:00 PM BARNES 124
02/22/17	(H)	Heard & Held
02/22/17	(H)	MINUTE(RES)
02/22/17	(H)	RES AT 6:30 PM BARNES 124
02/22/17	(H)	Heard & Held
02/22/17	(H)	MINUTE(RES)
02/24/17	(H)	RES AT 1:00 PM BARNES 124
02/24/17	(H)	Heard & Held
02/24/17	(H)	MINUTE(RES)
02/27/17	(H)	RES AT 1:00 PM BARNES 124
02/27/17	(H)	Heard & Held
02/27/17	(H)	MINUTE(RES)
02/27/17	(H)	RES AT 7:00 PM CAPITOL 106
02/27/17	(H)	Heard & Held
02/27/17	(H)	MINUTE(RES)
03/01/17	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

RICH RUGGIERO, Consultant
 Legislative Budget and Audit Committee
 Alaska State Legislature;
 Managing Partner
 Castle Gap Advisors
 Castle Gap Energy Partners
 Houston, Texas

POSITION STATEMENT: Provided a PowerPoint presentation, entitled "HB 111," dated [3/1/17], and answered questions.

ACTION NARRATIVE

[1:02:43 PM](#)

CO-CHAIR GERAN TARR called the House Resources Standing Committee meeting to order at 1:02 p.m. Representatives Tarr, Birch, Parish, Rauscher, Johnson, Talerico, Westlake, Josephson, and Drummond were present at the call to order.

HB 111-OIL & GAS PRODUCTION TAX; PAYMENTS; CREDITS

1:03:20 PM

CO-CHAIR TARR announced that the only order of business would be HOUSE BILL NO. 111, "An Act relating to the oil and gas production tax, tax payments, and credits; relating to interest applicable to delinquent oil and gas production tax; and providing for an effective date."

1:04:25 PM

RICH RUGGIERO, Consultant, Legislative Budget and Audit Committee, Alaska State Legislature; Managing Partner, Castle Gap Advisors, Castle Gap Energy Partners, provided a PowerPoint presentation, entitled "HB 111," dated [3/1/17]. Mr. Ruggiero noted that his previous presentations have discussed oil and gas tax provisions that were not directly "on point" to HB 111. In his experience, [governments] with an issue before them may fail to see the "whole environment," and his previous presentations intended to give the committee a better understanding of all of the factors of Alaska's oil and gas tax environment. Further, in making changes to Alaska's petroleum tax environment, there is a need to establish long-term goals and short-term needs. In the past decade, Alaska has experienced an increase in spending, an arresting of decline, and an increase in production. Mr. Ruggiero advised Alaska's system is one of the most complex petroleum taxation systems.

MR. RUGGIERO stated a goal of any taxation system is durability - not stability - because durability can be attained with frequent changes; in fact, he said, "As long as changes are made in a responsive manner to the market and the circumstances, you can have a large number of changes and still be deemed a stable place to do business." Furthermore, infrequent changes in the wrong direction can make a system unstable [slide 2]. Mr. Ruggiero discussed long-term goals, or guiding principles, and short-term objectives, such as production flowing through the Trans-Alaska Pipeline System (TAPS) and addressing the challenges to state government due to low income from petroleum operations [slide 3]. He observed Alaska has made major structural and narrowly focused changes to its current tax system over the last six or seven years.

1:09:57 PM

REPRESENTATIVE JOHNSON returned attention to slide 2 and asked how HB 111 would fulfil the first short-term objective of

keeping industry activity as high as possible during a period of low to negative margins. [Response is found later in the meeting.]

MR. RUGGIERO said he would address HB 111 beginning with slide [6] of his presentation. He continued with observations and pointed out the goal of Alaska's current taxation legislation is to create balances between big and small, and new and incumbent industry parties in a complex system. In response to Representative Johnson, he said that the model on net operating loss (NOL) that was previously provided to the committee, is correct, although one part needs to be corrected and he would make changes to the model - based on new understanding from the administration - as soon as possible. He stated that the complexity of Alaska's tax system requires significant state resources to administer, and significant taxpayer resources are required to understand and file taxes. Mr. Ruggiero said he would provide corrected data to the committee as soon as possible [slide 4].

[1:13:21 PM](#)

MR. RUGGIERO referred to the previous committee presentation [on 2/27/17] of an alternative option to current law, which was to show how to simplify Alaska's tax system and return it to a common business model of revenue minus expenses times tax, without multiple complicating factors. He explained that the model was meant to show a simplified option and was not a recommendation for dramatic changes to Alaska's taxation system [slide 5].

[1:14:58 PM](#)

REPRESENTATIVE BIRCH referred to a slide presented at the committee's work session [2/27/17], which compared Senate Bill 21 [passed in the Twenty-Eighth Alaska State Legislature] with "stepped net" [income] and showed that the two systems result in nearly identical [state] take. He asked if the aforementioned graph was affected by the incorrect NOL model.

MR. RUGGIERO responded the aforementioned model was unaffected and is accurate. Continuing, he grouped the suggested changes within HB 111 into two categories. The first category is increasing taxation, including items that minimize the downside risk for the state at low prices as follows: raising the gross minimum, hardening the floor, changing the conversion rate on net operating losses (NOLs) from 35 percent to 15 percent, and

reducing the per barrel credits. In order to address the state's short-term need, it is understandable to increase state take; however, he cautioned that regimes make changes to government take for a variety of reasons, including the situation Alaska is facing, and raising taxes when others are not "is not something that would absolutely view Alaska in a good light." Conversely, a change in minimum take by 4 percent or 5 percent in Alaska may be balanced by the fact that other jurisdictions are leasing acreage for 20 percent royalty or more. Mr. Ruggiero cautioned that for a project, the gross minimum, including royalty, is the first hurdle to clear. Furthermore, he suggested the legislature and administration model the impacts of changing the minimum and the per barrel credits across a \$50-\$80 range in oil price [slide 6].

[1:20:32 PM](#)

REPRESENTATIVE BIRCH advised the ultimate downside risk to the state is no production, which is zero [revenue]; also, raising the gross minimum tax to 5 percent creates a higher hurdle to investment that may compromise Alaska's ability to compete in a world market for investment capital. He restated the real risk is no production because the royalty share will always be there.

MR. RUGGIERO explained that because Alaska has long lead times, "shut[ting] down the investment engine" could postpone the return of investments for years, even with incentives in place. The taxation policy must balance the state's current needs with the risk of shutting down investment and thereby production. For example, the committee should consider the impact of changes to the taxation policy on the three recent large discoveries, which are very important to the state.

MR. RUGGIERO said the other category of changes brought by HB 111 is how to handle credits. Alaska is very unique in converting NOLs to credits and then offering cash for credits, which at the time [the tax system was devised] was deemed necessary to attract new investment and "players" to the state. Although effective, the system is very complex, and he opined the state can still attract new investment with other options; in fact, around the world, regimes allow investors to recover their costs - within a set of rules and guidelines - at production, either immediately or over time. He questioned the need for converting NOLs to credits, and said, "If it becomes the same, whether I deduct the NOL and apply the tax and then the barrel credits or I apply the 35 tax and then the \$8 barrel and then subtract the NOL credit - tax credit - and it comes out

the same, why go through all that?" Mr. Ruggiero recommended allowing existing producers to carry forward and offset NOLs against future taxable income, in a manner similar to other jurisdictions. He acknowledged there are some places that have unique or additional credits, as opposed to converting costs to credits.

MR. RUGGIERO further recommended that non-producers' NOLs created by exploration, appraisal, and development activity resulting in production, should be carried forward as costs, which could later be recovered through the project's production revenues. He remarked, "In some locations, those NOLs ... do receive some degree of uplift to compensate for the time it takes between exploration, appraisal, and that ultimate first oil into a pipeline." He said for non-producers, where NOLs are created by exploration but result in a dry hole, the NOL can be converted to a cashable credit at a percentage; however, payment of the credit is subject to a set of prerequisites, such as data delivery, payment of all service contractors, and the relinquishment of all leases. This type of payout is not paying a company for leaving, but paying a company to take the risk of coming to Alaska and putting in an exploration well. The credits reduce the risk of exploration and the state participates as an indirect investor in the exploration. Finally, he acknowledged the state has outstanding credits to pay and suggested offering a degree of uplift until funds are available to pay the credits [slide 7].

[1:28:58 PM](#)

REPRESENTATIVE RAUSCHER asked whether such an offer would be accepted.

MR. RUGGIERO said his experience has shown both outcomes; some oil companies have found such an offer acceptable, while others have found it completely unacceptable. In further response to Representative Rauscher, he explained a "person" in a contract is defined as the pertinent entity.

CO-CHAIR TARR noted that one goal [of HB 111] is to remain competitive for new entrants and smaller oil and gas companies. She asked for further explanation of uplift opportunities for the benefit of non-producers and exploration companies.

MR. RUGGIERO explained that if an exploration company has a discovery and turns the project over to another company for development, "the NOLs would go with the project," thus the

second company would use the credits after it took the field into production. On the other hand, tax is assessed by company and not by project, so the exploration company could bring in partners; at that point, the question is how the NOLs would be divided between the working interests in the property. Mr. Ruggiero suggested the division of the NOLs may be determined between the parties at the time the joint venture is formed. In his experience, divisions can be based entirely on each party's working interest, or the exploratory company may keep all the tax breaks for use against future income. He said he was unsure whether Alaska law dictates that "things have to work one way or the other, I believe that they'd leave it up to the commercial arrangement between the parties."

CO-CHAIR TARR asked how such a tax system would keep Alaska competitive and attractive for new investment.

MR. RUGGIERO acknowledged Alaska is at a disadvantage when compared to most places in the world, due to its higher cost structure and harsher work environment. To overcome these disadvantages, the state must offer terms that are a little bit better than the average that are offered around the globe and also maintain an overall tax structure that is competitive. To do so, the tax structure should allow NOLs and use uplift to compensate companies for the time value of money and to create a sense of urgency. For example, a government may compensate companies based on a certain timeframe to get a project to production, with incentives for earlier production and penalties for delays.

[1:35:30 PM](#)

CO-CHAIR JOSEPHSON asked how a seismic company would be affected if its earned NOLs remained with a project after the seismic company departed.

MR. RUGGIERO said he was unsure. He explained that in the case of a speculative seismic shoot, the company could sell its datasets of the survey and then would have income, which could be offset against costs. For corporate income tax purposes, there are clear guidelines for income and expenses, but he said he was unsure how the seismic company's NOLs would be handled from a petroleum tax perspective.

CO-CHAIR JOSEPHSON turned the subject to publically available data delivery and transparent information, which has not yet been addressed by Alaska law. He referred to Mr. Ruggiero's

comments that companies wouldn't come to Alaska and invest a lot of money without intending to be successful; in addition, it has been suggested that the state should have a system of prior approval [regarding oil and gas prospects]. If the quality of a play is known, he asked whether "all comers should expect to receive some future benefit or whether the state should assert some sort of jurisdiction or discretion over that."

MR. RUGGIERO pointed out the state grants rights to companies to extract the state's resource. Therefore, the state can include any requirements on licenses to extract, or within leases, subject to agreement. As the steward of the resources, the state needs access to - and rights to use - any data created through activity on state land. He acknowledged there is a degree of competitiveness to balance; for example, some information can be released and shared, but companies may seek to keep information that they have developed confidential for a period of time. Generally, in countries that have production sharing contracts, any and all data - and all derivative works on the data - are owned by the state. He continued:

The state is generally allowed to use as much of that as they need to encourage investors on new acreage, new license rounds, et cetera, because it's in their best interest that they get highest value on the bid, but also that time and money is not spent doing things when they've already got a bit of an idea of where a good spot is, versus where a bad spot is, based on all the surrounding data that they have. So, this is where you'll find that balance but generally, outside the U.S., you'll find that the governments that control minerals, they control all the data.

[1:40:10 PM](#)

CO-CHAIR TARR asked how converting from credits to carry forward losses would impact non-producers, and how that change would situate Alaska - relative to other regimes - related to incentives that are available to non-producers.

MR. RUGGIERO observed that when a producer comes into a new regime and has a new development, the producer is able to carry and recover its costs [of development] into the production period; however, "If you're an explorer and you have a dry hole, in most places, that's your cost: 100 percent." Thus, offering a conversion to credit, and subsequently to cash, is an incentive that puts Alaska a notch ahead of other places where

the costs of exploration are usually a 100 percent loss. For producers, some countries allow project ring fencing - a method of taxation where losses on one project are allowed to be used against income in another project. Alaska allows "ring fencing by operator" which allows an operator to lump together all of its projects in Alaska for tax calculations. Mr. Ruggiero said his recommendations on slide 8 are very consistent for operators who have a discovery and will ultimately be a producer, and are an incentive for new players to explore in Alaska, because an explorer who is unsuccessful is able to cash in credits.

CO-CHAIR TARR asked if the foregoing recommendations would make Alaska less competitive, relative to other locations.

MR. RUGGIERO opined no.

REPRESENTATIVE BIRCH stated at the time of a lease sale data and the terms and conditions of the lease are disclosed. He asked how frequently other regimes make changes to a lease after a company has complied with the terms of the lease and made a discovery.

MR. RUGGIERO acknowledged there is a tendency for governments to "meddle with the system" because after every election there is a new administration and a new "view"; in fact, in most of the world, the extraction of hydrocarbons is contractual, even though contracts are not always honored. It is not uncommon to find governments changing terms agreed to in previous contracts because circumstances have changed over time.

[1:45:15 PM](#)

CO-CHAIR JOSEPHSON referred to a document, entitled "A Net Profits Tax is very Volatile to Price," provided by the Tax Division, Department of Revenue, and included in the committee packet. The document shows tax as a percent of gross value at the point of production (GVPP) over a spread of different prices: at \$80 per barrel the state's take would be 10 percent and at \$100 per barrel it would be 18 percent. He returned attention to slide 6 and Mr. Ruggiero's previous comment that increasing the minimum tax would create a larger hurdle for investors. He asked if the current tax system is fair to the State of Alaska when tax as a percent of GVPP is 4 percent at \$60 per barrel and 18 percent at \$100 per barrel.

MR. RUGGIERO remarked:

What I can tell you is that where that stands, I think, is very favorable, relative to other regimes where [the regimes] invest. So, if you're talking about an \$80 world and only a net 10 percent tax - granted that lumped on top of that is royalty, and states see it as corporate income tax, federal corporate income tax - you get an overall non-operator take that is very competitive. Whether that's fair to the state or not, that's not for me to decide.

MR. RUGGIERO indicated slide 8 is not specific to HB 111 and is also relevant to other proposed bills regarding oil and gas. He recommended the following:

- stay with a net tax because the state is most competitive when taxing profitability and not revenue
- stay with ring fencing by operator because ring fencing by project adds complexity
- simplify where possible
- base sliding scales on margin if used
- establish a data transparency program

[1:49:01 PM](#)

REPRESENTATIVE RAUSCHER asked for an explanation of a comprehensive data transparency program.

MR. RUGGIERO recalled previous discussion that the legislature could make more informed decisions if it had more "disaggregated" information; in fact, other regimes in the world are much more transparent, and he suggested the state attach data transparency conditions to future licenses, credits, uplifts, or incentives.

REPRESENTATIVE RAUSCHER questioned whether some data is withheld because release would compromise [a company's] competitive edge.

MR. RUGGIERO opined a private, for-profit company will release only what it has to because the information can be used by its competitors. In his experience, governments have been able to optimize [production] in their country and minimize costs for facilities and other entities, and he provided an example. He acknowledged it is uncomfortable to give away competitive advantage, but governments with the most data can increase competitive advantage and provide informed advice.

REPRESENTATIVE WESTLAKE noted that oil, gas, and mining industries are important to his district, and the related tax system is extremely complicated. He stated his support for the "idea for dry holes." Although provisions of previous tax structures have inadvertently caused problems, previous legislators acted "with the best information that they had in front of them." He agreed revisiting the tax system is necessary, and asked whether the state should make incremental changes, to prevent severe impacts to his district and other districts, or change the bulk of the system.

MR. RUGGIERO recommended fixing the system and making it simple, although doing so is not easy, and would require political will and time. However, as the system is simplified, the legislature could add durable and self-correcting pieces so future legislatures don't have to revisit every individual provision of the legislation.

[1:54:11 PM](#)

CO-CHAIR TARR asked if eliminating credits and using carry forward losses instead helps a system become more self-correcting because it is more responsive to actual costs.

MR. RUGGIERO explained when NOLs are converted to a credit at a percentage, the tax rate that will be effective at the time the [credits] are actually used cannot be known. He cautioned against trying to predict the future, and instead urged the committee to allow the losses to be carried forward as they are for corporate income taxes. For example, for the purpose of calculating corporate income taxes, a carry forward loss is created in a year when the taxpayer's effective net rate is zero, but then is carried forward and used to offset future income [at the effective tax rate at the time the NOL is used]. In further response to Co-Chair Tarr, Mr. Ruggiero said the current system has a 35 percent [tax] base with negative progressivity, therefore, as stated before, [the effective tax as a percent of GVPP is 4 percent at \$60 per barrel, 10 percent at \$80 per barrel, and 18 percent at \$100 per barrel]. He remarked:

So, when you convert something today, you don't know if it's going to be one year, two years, or three years - if you've got a major development, you're going to be accumulating some very large NOLs. And if you convert them to credits, it may be several years down the road before you use them. And if you don't

know what the price is going to be ... - certain things get used at different effective rates, and get converted - and you don't know what the absolute tax rates going to be in the future. ... So as not to create any potential differences in the future, just ... carry it forward as a loss, [and] use it when it comes up.

MR. RUGGIERO added the aforementioned mechanism is also used in production sharing contracts. He continued:

They don't call them carry forward losses, they're just unrecovered costs and they get carried forward as costs. They aren't converted to anything else. And ultimately when there's enough cost oil in the system, they get to recover those costs. And then anything after that is deemed profit oil, and then whatever the split is on the profit oil, that's how that is distributed between the parties.

CO-CHAIR TARR suggested the committee reconsider, based on recommendations, the elimination of cashable credits, which was a provision in the original bill. She reviewed the following: The cashable credits for which the state pays cash are reflected on the expense side of [an accounting spreadsheet], and the NOLs used against tax liability are reflected on the revenue side of a spreadsheet as a reduction in the revenue the state would receive after the company [that earned the loss/credit] became profitable, and at which point the loss would be deducted against any of the company's profit prior to applying taxes.

CO-CHAIR TARR then asked for details on steps for the state to take if it were to have prior approval of projects, noting that suggestions have been made that the state review plans of production and plans of development as a project progresses. She asked for Mr. Ruggiero's opinion on strategic ways to protect the state's status as a co-investor.

[2:00:47 PM](#)

MR. RUGGIERO was unsure of the steps already undertaken by the Department of Natural Resources (DNR), the Alaska Oil and Gas Conservation Commission (AOGCC), and the Department of Environmental Conservation (DEC) to review projects. During his experience in the North Sea working with three countries, oil and gas projects went through three to five governmental reviews before being approved for development; projects were reviewed by

governmental agencies ranging from reservoir engineers to treasury officials, beginning at the initial scoping of the project, up to very detailed analysis. At the time of a company's formal submission for approval to develop the project, "it was just a rubber stamp exercise," because the governments' issues and concerns about the size of the infrastructure, pipelines, optimum costs, and efficient operations were addressed earlier. The governments slightly influenced the scheduling of projects, but companies were made aware well in advance. Mr. Ruggiero told of recently concluding a 12-month review process for a 25-year project in Asia; while he was negotiating his contract, the government reviewed all aspects of the project in detail. He remarked:

The dialogue within those reviews helped me get terms in that contract that they might not otherwise have given me, because we had these detailed reviews and they were able to understand what I was planning on doing and what my needs were, as opposed to what my wants were.

CO-CHAIR TARR asked if governments ever refused a project during a particular review phase and if so, whether affected companies were given an opportunity to reevaluate and propose an alternative.

MR. RUGGIERO said he was told no many times; however, refusals were helpful for companies to "define where the boundary line is," and also allowed companies to propose potential changes to a government's conditions, and he gave an example. He remarked:

It was always a process that allowed us to bring forth the, the innovation, the technology, and whatnot that we thought we could add to, and get them to change some of the rules and the requirements that they otherwise had had in place.

CO-CHAIR TARR asked if any part of the approval process was linked to incentives or regime investment.

MR. RUGGIERO said, "Whatever was in place as the petroleum fiscal system, once I got approval, then I had to do everything within that petroleum fiscal system." For example, one project had requirements linked to it because of its size, capital commitment, and the 10 years of company fiscal stability that was needed to overcome the risk of development at that time.

[2:07:23 PM](#)

REPRESENTATIVE BIRCH questioned whether the aforementioned 25-year agreement gets revisited periodically or is a contractual arrangement.

MR. RUGGIERO answered it is a contractual agreement.

[2:07:45 PM](#)

[Co-Chair Tarr handed the gavel to Co-Chair Josephson.]

REPRESENTATIVE TALERICO returned attention to slide 3 and asked whether the long-term goals and short-term objectives are listed from most to least important.

MR. RUGGIERO indicated yes.

[2:08:34 PM](#)

The committee took an at-ease from 2:08 p.m. to 2:10 p.m.

[Co-Chair Josephson handed the gavel back to Co-Chair Tarr.]

[2:10:01 PM](#)

CO-CHAIR TARR observed per barrel credits and gross value reduction (GVR) are incentive opportunities. She asked Mr. Ruggiero whether "the interplay" of changing from cashable credits to carry forward losses should influence the use of per barrel credits, or gross value reduction (GVR), as incentives.

MR. RUGGIERO said:

I don't think there's an interplay between the two. But it does bring dynamics of, "If you have a GVR and you've got the per barrel, how much of the per barrel credit do you use?" I know you've had that issue of migrating of the per barrel credits, but, also, how much of the NOL that you use. Is it only up to the point where the minimum tax takes effect, or do you have to use it all to get to zero and then the minimum tax applies? ... When you have all these moving parts you get all these different questions as to how the different aspects interplay between each other.

CO-CHAIR TARR expressed her understanding that Mr. Ruggiero's previous recommendation to use bracketed profit margins [on which to base the tax rate instead of oil price] and thereby eliminate some other provisions - because incentives wouldn't be used, and taxes would be based on profitability - would change the dynamic.

MR. RUGGIERO clarified the aforementioned option would take away unnecessary levers and would attain the same effective tax rate without worrying about migrating credits; he reiterated the tax would be based on simple income minus allowable costs.

CO-CHAIR JOSEPHSON questioned whether one benefit of reducing complexity is to make the system easier to audit and understand.

MR. RUGGIERO said exactly; audits should be "orders of magnitude easier" as would be compliance by taxpayers. Further, the proposal would eliminate many administrative costs, and avoid many disputes between the companies and government.

CO-CHAIR TARR asked if simplifying audits and payments would give a company higher confidence to invest in a new project, regardless of a long lead time. For example, the current per barrel credits are based on the price of oil, so companies have to adjust for variability that might occur in future prices to determine a project's economics; in addition, removing some aspects of the system and focusing on profit margins may make an investment decision easier for a company.

MR. RUGGIERO responded that simplifying the system allows for the use of a much simpler economic model that has less of a chance for mistakes. In fact, companies can make a more predictive model based on an expected base rate, production curve, cost, and price forecast. With a simpler system, he said companies would only have uncertainty in whether future legislatures would change tax rates at any of the various bracket points.

[2:15:31 PM](#)

REPRESENTATIVE PARISH stated that he is leery of net systems because they do not clearly incentivize cost savings on the part of companies as well as do gross production systems; in addition, net systems are also harder to administrate. He asked if it is feasible to create a bracketed gross system tied to price, which would approximate the current tax environment or, "Are gross systems just going to be inherently more punishing

for these actors or those actors?" Further, he inquired as to how the state could level the playing field for non-producer, new entrants in a gross system.

MR. RUGGIERO said it is possible to build a gross system to mirror a net system, but it would not be accurate after the cost structure changed. He continued:

The minute the cost structure changes, then you're getting results different than what you're trying to, to model. And, the one thing that we do know ... from one of the charts that I've copied from Ken Alper and the administration, we've seen sort of the all-in transportation, OPEX, CAPEX numbers change from plus or minus [\$]15 to up over \$40 a barrel in just 10 years. And if you tried to build a gross [system] off of where you're at today ..., in a few years you'll be grossly wrong and you'd be fixing it again.

MR. RUGGIERO, in response to Representative Parish's second question, said he is unsure what could be done to level the playing field under a gross system.

[2:18:42 PM](#)

REPRESENTATIVE PARISH stated his concern that net systems create a "perverse incentive." He pointed out, "Generally, refining is a profitable business, and that those profits are made and typically kept in Texas, is just too bad for us." He opined net systems allow an externalization of value; for example, for a company making little profit, and suffering some losses in Alaska, Alaska production can result in greater profit, but that is profit that Alaska cannot tax. Representative Parish urged for incentives that do not encourage significant increases in costs, noting that costs have almost tripled in the last 10 years. Under a net system, some of those costs are borne by the state and the federal government, and he asked how the legislature could mitigate that.

MR. RUGGIERO acknowledged every system has "pros and cons," and agreed that under a net system, oil companies can "gold plate." However, in his experience, oil companies that have a high cost structure do not last very long, regardless of government deductions. Countries with net systems can mitigate risk through detailed review processes; for example, governments learn from each project and operator, which helps governments compare projects and whether costs are prudent. Although

Alaska's costs have tripled, the costs can still be prudent - even with the best minds and systems, costs can be expected to go up when oil prices escalate.

2:22:26 PM

REPRESENTATIVE PARISH returned attention to a point raised in the presentation that one of the most glaring deficiencies of Alaska's system is the inability of the state to find out which companies charge more than others. Although he was told by an executive that he had no business knowing what Alaska taxes were paid by the executive's company, the same company reported the amount of taxes it paid in Alaska to the government of Great Britain, which is how Representative Parish obtained the figure. He asked Mr. Ruggiero what the State of Alaska could do "to hold them to the same standard of disclosure."

MR. RUGGIERO restated that the legislature is the steward of the state's resources, and any future lease agreements and/or offered incentives should include requirements, such as for disclosure. [Speaking from his experience as a representative of an oil company], he said, "I would not disclose anything more than I had to because I never know when a piece of data is going to help me or hurt me." The legislature needs to determine whether it garners enough information to make well-informed decisions and if not, it is within the legislature's purview to get the information necessary.

REPRESENTATIVE PARISH pointed out the most important leases to the state have already been established; even though pertinent stipulations could be added to new leases or leases up for renewal, the legislature is not able to alter existing leases.

MR. RUGGIERO agreed.

REPRESENTATIVE TALERICO, [addressing the issue of transparency and the collection of data from the oil and gas industry], assured the committee the state gets "an overall number." He pointed out that other taxing authorities, such as municipalities, keep individual tax payments as proprietary information for a certain amount of time, depending on the competitive nature of a taxpayer's business. He asked, "To some degree, as we collect that type of information, wouldn't there always be - I'll call it a grace period - but isn't there always a cushion there so that we're not directly providing [information to competitors] ...?" Citizen legislators do need to have good data, but he cautioned that legislators may lack

sufficient expertise in the industry and therefore, need to rely on the expertise of DNR and AOGCC when working with the producers of oil and gas. He inquired as to what level of detail the committee seeks - whether down to the nuts and bolts - and advised that the committee could "bury ourselves with, with data, that without serious education, it would be very difficult for us to determine -- when we talk about expenditures and things like that" Representative Talerico restated the committee needs to have a level of trust in the Division of Oil and Gas, DNR, and AOGCC, which work directly with producers, and provide valuable information.

MR. RUGGIERO agreed. Ten years ago, his company was told that it "could almost double the recovery off North Slope and arrest the decline if we just spent a certain amount of money," although details were not provided about the work, how fast [the recovery] would come, or how constant the rate of recovery would be. He opined the state did not have enough information to propose investments that made sense, or that were economic for the industry, but simply encouraged the companies to increase production. He added:

So, it's that type of information that I believe that you need. And as a state, I don't know if it's public or whether it's just you know, confidentially through agencies like the DNR and AOGCC to where then you can rely on them when they come in and testify that they've looked at it, they think this is viable, they would recommend the following. But, somewhere the state, I think, needs to understand that so that way prudent decisions could be made, relative to the taxation system you've got in place, to make the right things happen.

[2:30:02 PM](#)

CO-CHAIR TARR acknowledged the difference in what the state needs and what the public needs; however, [as a legislator] she said she has not had enough information to fully understand certain issues. Part of the challenge regarding taxes is that information gleaned by the Department of Revenue (DOR) from proprietary information cannot be shared [with the legislature]. In fact, DOR may recognize a problem, but a change proposed by DOR cannot be supported by information from tax returns. Co-Chair Tarr noted legislation has been introduced related to public disclosure of credits and incentives offered by the state.

MR. RUGGIERO spoke to the fact that in Alaska, 95 percent of the information about oil and gas is presented by DOR, which has a confidentiality obligation; however, in other tax regimes, the equivalent of DNR presents information on production and spending because most of its data is not confidential.

CO-CHAIR TARR referred to [Amendment 45, which had been moved but failed to be adopted during the House Resources Standing Committee's discussion of] House Bill 247 [passed in the Twenty-Ninth Alaska State Legislature]. She related that the amendment had intended to address this issue by requiring policymakers to sign confidentiality agreements and restricting access to documents and photographing of documents. She questioned whether said actions are consistent with the level of security necessary for such information and if policymakers should seek better access.

MR. RUGGIERO responded that policymakers need access to information by whatever route available, so they can make informed decisions.

[2:34:23 PM](#)

CO-CHAIR JOSEPHSON returned attention to the cost of oil production in Alaska, restating that these costs have increased 150 percent in the last 10 years. The increase in lease expenditures and transportation components has been linked with the rising cost of oil, and he asked why the costs did not fall as oil prices have fallen, but are "stuck at \$40."

MR. RUGGIERO answered that information from DOR indicated that production costs in 2014-2015 have fallen [document not provided]. He explained there is a lead-lag effect between the movement in the price of oil and the movement in costs, and companies have responded to low oil prices through reductions and belt-tightening. However, production costs do not drop as far as oil prices because there are fixed components such as salaries and benefits, which actually grow with time and inflation. A closer analysis would be required to determine which costs are directly impacted by oil prices.

CO-CHAIR TARR noted that one provision under consideration is a change to the per barrel credit which would result in an increase to the effective tax rate. She returned attention to a document, entitled "A Net Profits Tax is very Volatile to Price" and pointed out a mistake in that at \$80 oil price, the tax as

percent of GVPP is 8.4 percent, not 10 percent as shown. If adjustments are made to the per barrel credit that put Alaska at the 10 percent rate, she queried whether Alaska would remain competitive. Co-Chair Tarr said her focus is to minimize the downside risk as long as the low-price environment persists, and the state should earn more at this time. However, Alaska's long-term goal is to remain competitive.

MR. RUGGIERO suggested finding the right "tipping point" is difficult as each company reaches different investment decisions. He opined making the aforementioned change is "a minor movement"; however, the additional tax is a large sum of money that will not go unnoticed. Therefore, it is a good idea to keep long-term goals and short-term objectives in mind, although they sometimes conflict, particularly with a treasury shortfall to consider.

[2:39:22 PM](#)

CO-CHAIR TARR summarized that the committee is still evaluating: the elimination of cash credits, which would be replaced by carry forward losses; improvements to data transparency for the public and the legislature; stage-gate approaches; recommendations on how to remain competitive; and whether provisions of HB 111 are too aggressive. She recognized that Alaska is currently in a very different economic environment than it was when Senate Bill 21 was enacted.

[HB 111 was held over.]

[2:41:59 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 2:41 p.m.