

SENATE FINANCE COMMITTEE  
March 19, 2018  
9:02 a.m.

[9:02:53 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair  
Senator Anna MacKinnon, Co-Chair  
Senator Click Bishop, Vice-Chair  
Senator Peter Micciche  
Senator Gary Stevens  
Senator Natasha von Imhof

MEMBERS ABSENT

Senator Donny Olson

ALSO PRESENT

Senator Cathy Giessel; Sheldon Fisher, Commissioner Designee, Department of Revenue; Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue.

SUMMARY

^PRESENTATION: SPRING REVENUE FORECAST

[9:03:21 AM](#)

Senator MacKinnon reviewed the agenda for the meeting and acknowledged Senator Giessel in the audience. She invited the testifiers from the Department of Revenue to the table.

SHELDON FISHER, COMMISSIONER DESIGNEE, DEPARTMENT OF REVENUE, was pleased that the department had released the Spring 2018 Revenue Forecast early. He introduced the presentation, "Spring 2018 Revenue Forecast" (copy on file).

Commissioner Fisher showed slide 2, "FORECASTING METHODS: Timeline":

- Early April 2017: Spring 2017 Forecast
- Late April 2017: Spring 2017 Alternative Scenario
- 4% Production Decline Scenario, Letter to Co-Chairs
- Used in modeling by Department of Revenue, Office of Management and Budget, and Legislative Finance
- October 2017: Preliminary Fall 2017 Forecast
- Non-standard, provided to assist special session
- December 2017: Final Fall 2017 Forecast and Revenue Sources Book
- March 2018: Spring 2018 Forecast
- December 2018: Fall 2018 Forecast and Revenue Sources Book

Commissioner Fisher reported that the department was continuing the discussion and the series of forecasts produced by the department going back to the Spring of 2017. He indicated the department updated the production and price forecasts and some other assumptions. He would begin by talking about the production forecast, move to the price forecast, then finish by pulling together some other items.

Commissioner Fisher displayed slide 4, "PRODUCTION FORECAST: ANS History and Forecast by Pool," which showed a historical perspective of production in history. He noted the leveling out and flattening of production, a positive development for the state and for revenues.

Commissioner Fisher discussed slide 5, "PRODUCTION FORECAST: ANS FY 2017 Versus FY 2018," containing a line graph that showed the actual production represented in the solid lines. Currently, the state averaged about 518,000 barrels per day of production against the forecast of 533,000 barrels per day. He highlighted the assumption for the remaining months of the year. The department was forecasting that production both in the last quarter and for the year would be modestly below where it was in FY 17. He indicated that in the last 10 years the fourth quarter represented about 25.5 percent of the year's production. The department's assumption was in line with that trend for FY 18 actual production.

Senator von Imhof asked if the drop was attributed to a particular field or a general decline on the North Slope.

Commissioner Fisher responded that the slide did not reflect a long-term decline in the department's view of production. The long-term production was largely in line with what the department expected previously. There were a couple of factors. Overall, the weather had been warmer over the most recent winter. Production was usually healthier in a colder climate, as the equipment operated better allowing producers to accomplish more. Also, there had been a couple of events that had affected specific properties that resulted in a decline. He asked Mr. Stickle to provide more detail.

DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE, expounded on what the commissioner had stated. He reported that in looking at the unit-by-unit analysis of the forecast versus the previous year, Kuparuk Production was forecasted to increase. Prudhoe Bay's production was down due to warmer weather having a significant impact. There had also been some technical issues at some of the other fields such as Point Thompson and Alpine that were factored into the forecast.

[9:08:20 AM](#)

Commissioner Fisher referenced slide 6, "PRODUCTION FORECAST: ANS Comparison," which looked at the long-term forecast. It showed the expected production decline for FY 18. Looking forward the forecast was in line with a modest increase over the fall forecast. He asked if there were questions about production.

Senator Micciche commented that the department leaned toward the 33 percent mark and asked the commissioner to explain.

Commissioner Fisher did not understand the reference to 33 percent.

Senator Micciche pointed to the Spring 2018 high case, the forecast, and the spring 2018 low case. He commented that some other entities predicted closer to the midpoint, whereas, the department predicted in the lower third.

Commissioner Fisher responded that the production forecast was primarily prepared by the Department of Natural Resources (DNR). He stated that the mid-case was intended to be a P50. In other words, it was 50 percent likely it would be the forecast number, or 50 higher or lower. The scenario suggested that DNR anticipated there was more upside opportunity, the reason for a larger scale to the upside rather than the downside. He explained that it was about the probabilities in different scenarios in terms of what DNR saw as opportunities versus risks in the forecast.

Co-Chair MacKinnon noted that the committee had considered many revenue forecasts. She recalled a past forecast that showed a 12 percent decline over the next ten years, which had been changed to a flat projection.

Commissioner Fisher referred back to slide 2. He replied that in the April 2017 forecast the administration came forward with a 12 percent decline. Soon thereafter, the department came forward with a 4 percent production decline scenario. It was not a new forecast but a reduced decline. In the special session and in the fall forecast the forecast was revised to be flat.

Co-Chair MacKinnon appreciated the department being conservative in its approach when presenting numbers. However, it had an impact in terms of planning purposes. She recalled that in April 2017 when the numbers were published Senate finance pushed back significantly on the 12 percent decline when the state had seen increased production. She was glad that the production level was flat. She relayed that the document was available to the public online.

[9:13:29 AM](#)

Commissioner Fisher continued to slide 8, "PRICE FORECAST: Impact of Spare Capacity: Short Term," which showed the Energy Information Agency (EIA) attempting to predict supply and demand for oil into the future. He highlighted the vertical orange [yellow] line representing the difference between actuals and the forecast period. The oil industry had been through a period where the demand had been greater than the supply represented by the orange line [brown] versus the blue line. The green bars were declining suggesting that actual inventory was shrinking. The Energy Information Agency anticipated in the following quarters it

would change and world production would again exceed consumption. He noted the range was tight in either direction. In the future EIA anticipated a growing inventory for the coming few quarters which would start to shrink as seen in the far right of the slide.

Commissioner Fisher moved to slide 9, "PRICE FORECAST: Brent Forecasts Comparison to DOR ANS Forecast: FY2018," which showed a line graph entitled 'Real Oil Prices and Forecasts.' The solid black line reflected the actual numbers from the period. He noted that the price of oil was approximately \$50/bbl in July 2017 and climbed to almost \$70/bbl during the period. The average to-date was just over \$59/bbl. The department was assuming in nominal dollars that the price of oil would stay above \$64/bbl for the remaining months of the year resulting in a forecast price of about \$61/bbl during FY 18. The red line represented the New York Mercantile Exchange (NYMEX) futures price. He explained that if someone wanted to buy oil in the future, the red line reflected what a person would pay. The red line on the chart represented real dollars. The forecast was largely consistent (slightly above) with what the NYMEX futures would predict for the price of oil.

Co-Chair MacKinnon suggested that the revenue forecast set the line for the calculation on credits due companies that were owed money from the State of Alaska. She asked if the threshold was correct at \$60.

Commissioner Fisher indicated that part of the presentation reviewed the credits calculation. He conveyed that \$60 was the difference between whether the pool of money set aside to pay credits was 10 percent or 15 percent. If the price of oil was above \$60 the production tax due would be 10 percent. If the price of oil was below \$60 the production tax due would be 15 percent. He would be walking through the calculation and how the forecast had changed.

Co-Chair MacKinnon noted that the legislature was in a precarious situation between \$59/bbl and \$61/bbl. She was looking at 25 percent production. She thought it was an active choice to state a number. It appeared that the administration was anticipating an average of about \$61/bbl. She asked if she was accurate.

Commissioner Fisher stated that the administration's forecast assumed that oil would stay slightly above \$64/bbl between the present day and the end of the fiscal year which would result in an average price for the fiscal year of \$61/bbl.

9:18:08 AM

Senator von Imhof referenced slide 8 and thought the right-hand side of the graph represented the heart of the matter. She thought the commissioner had been correct when he stated that the ranges (seen at the height of the green bars) were shorter than the ones seen in 2015. She thought it had been a good thing when supply and demand had reached an equilibrium to some degree. She noted that the moved up and down on the chart. She asked if the Department of Revenue's (DOR) research showed that, as the price crept up past \$65/bbl, fracking became more prevalent and banks started lending again. She thought they were nimble and quick and could have an impact on supply. She asked how confident the commissioner was about the green bars.

Commissioner Fisher accepted that the price forecast was one source of data. He thought as he reviewed the price forecast, he would show the committee that there were multiple views and opinions of which the department did not try to duplicate. The department tried to do a broad survey of the different intelligent and thoughtful organizations that had a significant amount of resources behind them. He suggested that the consensus around demand was narrower than the consensus around supply. He elaborated that there seemed to be a narrow range of what people thought about how the demand curve could vary and change. There was a substantial range in terms of how people viewed what the supply of oil would be. He would try to walk through the information. The department had tried to pick a case that was reasonable. There were certain scenarios that could change it meaningfully one way or the other.

Co-Chair MacKinnon asked if it was fair to say Oil Producing and Exporting Countries (OPEC) trying to control output had helped to globally stabilize the price. The price was moving upwards because producers were producing less.

Commissioner Fisher answered in the affirmative. He thought that there was more discipline from Russia and other OPEC nations.

Co-Chair MacKinnon explained that producers who could be flexible in where they went and how fast they could drop drills were influencing the increase in fracking. From the perspective of Oil Producing and Exporting Countries (OPEC), Alaska was starting to pull in a greater percent of oil production in the world. She indicated that it might not please those that were controlling and producing less. It was benefiting Alaska on the price side and the production side. She asked if her statement was fair.

Commissioner Fisher thought that Co-Chair MacKinnon had made a perceptive comment. He elaborated that the dynamic of how Shale or OPEC would react, how certain countries like Venezuela, and other factors would determine where the price of oil would land. There were several different people interpreting the facts differently which lead to the range in the forecast.

Co-Chair MacKinnon mentioned that Saudi Arabia was going to a similar process as Alaska. The high price of oil had benefitted the people of Saudi Arabia. However, in a low-price environment the country struggled to produce revenue to distribute or invest in communities. Saudi Arabia was also looking at a sovereign wealth fund model. She asked if the commissioner could provide any additional information on the matter.

Commissioner Fisher affirmed that Saudi Arabia had struggled to balance its budget at current oil prices. For a time, the country thought it was in its interest to produce additional oil to try to bring discipline into the market place through lower prices. He surmised that the country recognized that it was harmed when prices dropped substantially. He thought that the country, as well as other oil-dominant countries, were observing what was happening in the U.S. and shale oil. He noted the comment made earlier about one of the impacts of lower pricing on the shale industry and how it had become more efficient and capable of producing oil at declining oil prices. It would continue to impact the supply of oil and how the world would respond to different events. He indicated there was a time when OPEC had more control over the price of oil, but as shale had become a swing producer it was more difficult

to control. The department's view was that at slightly over \$60/bbl the various supplies, shale in particular, became economical, and there was a meaningful amount of supply at those prices. As he moved through the presentation, it would be apparent that others saw things differently.

9:25:15 AM

Co-Chair MacKinnon asked if the presentation would address cost. The commissioner had alluded to Americans stepping up when things got tough. She pointed out that in the price forecast, producers in Alaska had found a way to lower costs. The state was seeing the benefit of flat production or increased production as experienced in the previous 2 years. The state was also benefiting from lower costs to extract some of the hydrocarbons on the North Slope. She asked if she was accurate in her assessment.

Commissioner Fisher answered in the affirmative. He noted that a portion of the presentation would discuss the cost for Alaska. The department had not put together a presentation that talked about other regions of the world regarding their cost structures.

Senator Micciche thought it was fair to say that even conventional players had brought down their costs of production globally. He thought producers had become more efficient. He wondered if the improvements seen in the revenue forecast were the price of oil and the reduction of what could be written off by the companies. He asked if the topic would be covered in the presentation.

Commissioner Fisher indicated the senator was correct and that the facts about Alaskan producers would be discussed later in the presentation.

Commissioner Fisher reviewed slide 10, " PRICE FORECAST: Brent Forecasts Comparison to DOR ANS Forecast: Short-Term," which showed a line graph entitled "Real Oil Prices and Forecasts." The slide showed a short-term forecast in real dollars. The black line showed actuals, and the dotted portion of the line reflected the forecast. The blue portion of the line showed the analysts' forecast. The department's forecast was in line with the analysts' forecast. The green line on the slide was EIA short-term energy outlook. The Energy Information Agency produced a short-term energy outlook updated monthly as well as an

annual outlook. He pointed out that the price point for the next couple of years was on the high end of the range of the existing forecasts. He reminded members that the NYMEX forecast represented long-term futures prices. In fairness, there was not a significant amount of volume in long-term futures beyond a year. Outside of a year or 18 months NYMEX became a less reliable predictor of price.

Commissioner Fisher referenced slide 11, "SHORT-TERM PRICE FORECAST," which displayed a data table that showed the forecast in nominal prices. The forecast grew from \$63/bbl in FY 19 to about \$75/bbl. He noted that the forecast largely stayed flat in real terms. He reiterated that NYMEX was slightly below the department's pricing in the short-term. He began to comment on EIA short-term forecast but referred back to slide 10. The Energy Information Agency's prediction for calendar year 2018 and 2019 was \$62/bbl. He pointed out that Alaska's fiscal year falls into what EIA was predicting on a monthly basis as a dip in oil prices. Averaging EIA's monthly prices over FY 19, it predicted a \$60/bbl price for oil as reflected on slide 11.

Commissioner Fisher continued to discuss slide 11. In looking at EIA's annual prediction, they were more bullish expecting higher prices. He would discuss the underlying assumptions in their numbers. He continued that the analysts' average did not go beyond 3 years. Their average price was in line with the department's forecast. They were more optimistic in their numbers for FY 20 and FY 21. In FY 22 the analysts saw another decline down to a nominal amount of \$64/bbl.

[9:31:16 AM](#)

Co-Chair MacKinnon asked if EIA's long-term forecast considered China or the Asian markets switching over from coal to a hydrocarbon or possibly natural gas.

Commissioner Fisher commented that what Co-Chair MacKinnon suggested was part of it, and EIA was mindful of the changes. He believed it had more to do with EIA's view of what was happening with supply. He indicated that EIA believed the world was under-investing in oil production and that the investment would not keep up with demand. Over time, an imbalance would result in driving up prices.

Co-Chair MacKinnon asked if it was reflective of renewable energy or other energy production versus hydrocarbons.

Commissioner Fisher stated that renewables would impact demand. Renewables would be a factor, but he also thought demand would grow as economies expanded. He reiterated there were different views around demand, but they tended to be narrow in scope. He speculated that there was more of a consensus about what would happen on the demand side. Some believed there would be more growth and others believed the growth would be slower. The difference in the predictions was largely around supply.

Co-Chair MacKinnon clarified that the commissioner meant "shale" rather than "shell." The commissioner responded in the affirmative.

Senator Micciche thought EIA's considerations were across all various probabilities. They discussed usage and conversion probabilities with generation, transportation, and manufacturing. It was a portion of their evaluation. He suggested that those things affected their evaluations particularly in the out years regarding their consideration of renewables and other opportunities. He asked if he was correct.

Commissioner Fisher agreed with Senator Micciche. He did not intend to imply that analysts did not anticipate impacts from renewables and other factors. He commented that there seemed to be a narrower range of variability around assumptions in demand than there was in supply.

[9:34:45 AM](#)

Commissioner Fisher turned to slide 12, "PRICE FORECAST: Analyst Brent Forecasts Comparison to DOR ANS Forecast: Short-Term," which showed a line graph entitled "Real Oil Prices and Forecasts." The graph was focused on the short-term analysts' forecasts. He pointed out that the analysts did not like to predict beyond a few years forward. The solid blue line was the average and the 2 dotted lines represented 25 percent of the highest analysts and 25 percent of the lowest analysts. The span was between the low \$50 to high \$70 range before settling in the mid \$70 mark by the end of the forecast period. He pointed out that the analysts forecasted a decline in the price of oil. Whereas, the department saw the forecast remaining flat.

Commissioner Fisher turned to slide 13, "PRICE FORECAST: Differences in Analyst Forecasts," which showed a table with the detail of what was driving the differences in the forecasts. He noted that analysts predicting low versus high all predicted growing demand. Even the analysts that believed the price would be low thought the demand for oil would continue to grow. They saw it growing at a slower rate. On the high side, analysts saw demand growing more rapidly. The Energy Information Agency had its short-term forecast being more steady or flat and their long-term forecast being moderate in demand. He reported that EIA had a reference case, a high case, and a low case, which he would discuss further. He stated that the real difference between analysts was on the supply side. Analysts that saw a low price believed that there would be a supply blow-out where there would be strong production in the U.S. market as well as in OPEC countries. Analysts that saw a high oil price saw the price of shale oil being flatter due to discipline in the financial markets and access to capital. They also saw disruptions in other parts of the world in countries like Venezuela. The combination would drive the price up in the near-term. He also mentioned that EIA had a long-term thesis that the world was underinvesting in production.

Co-Chair MacKinnon acknowledged that Senator Bishop had joined the meeting.

[9:38:04 AM](#)

Senator Micciche thought analysts had become more conservative over the last couple of years. He asked if the commissioner could provide the portfolio of analysts to the committee. Commissioner Fisher could provide the list as well as the forecast from each analyst.

Commissioner Fisher displayed slide 14, "PRICE FORECAST: Bullish Analyst Example: Guggenheim, Short-Term. He explained that he had chosen a couple of analysts' examples. Guggenheim was forecasting the price of oil between \$72 and \$80 in the 2018-2019 period. Their view was that India and China would add about 5.4 million barrels of oil in terms of demand. They also believed electric vehicle usage would be offset by demand growth in non-auto consumption, and cold weather would increase the demand for oil. In terms of supply, they viewed that OPEC had limited

spare capacity, shale production would not grow as expected because of new exploration and production discipline, and potential disruptions to Iran and Venezuela's exports would push the world market higher.

Commissioner Fisher discussed slide 15, "PRICE FORECAST: Bearish Analyst Example: Citi, Short-Term." The Bearish analysts anticipated a price of between \$49 and \$57 in the 2018-2019 period largely driven by a blow-out of supply. The demand assumptions were flat, and they did not see the increase that the analysts from Guggenheim saw coming from China and India. They saw a significant supply going into the market place driven by U.S. production.

Commissioner Fisher referenced slide 16, "PRICE FORECAST: Median Analyst Example: Deutsche Bank, Short-Term." The analysts from Deutsche Bank saw a price comparable to the state's prediction at \$62 for the following few years. They saw modest demand growth and supply that was largely able to meet demand. They saw drivers that made it difficult for OPEC to continue to maintain agreements as they had. There might be a breakdown or production above agreed amounts as well as a leveling out of production in the U.S. They saw a steady state from where Alaska was currently.

[9:41:46 AM](#)

Commissioner Fisher advanced to slide 17, "PRICE FORECAST: Brent Forecasts Comparison to DOR ANS Forecast: Long-Term," which reviewed a long-term forecast rather than a short-term forecast. The analysts started to fall off of the page because they did not tend to predict long-term price forecasts. He noted that the green line on the graph represented EIA's reference case.

Commissioner Fisher continued to slide 18, "PRICE FORECAST: EIA Brent Cases from 2018 Annual Energy Outlook: Long-Term - Real Oil Prices and Forecasts," which showed a line graph containing a low case, a reference case, and a high case for EIA. The three EIA forecast cases had a wide range between them. In the out years there was a low of about \$30 and a high of about \$140.

Commissioner Fisher spoke to slide 19, "PRICE FORECAST: Differences in EIA Projection Cases," which showed a table illustrating the difference between the forecast cases from EIA. He noted that on the demand side the reference case

was a moderate demand versus the low case which was a slowing global demand. The high case was a growing global demand. The larger question was what would happen with supply. In the low case, EIA saw higher OPEC production and lower costs for non-OPEC exploration (mostly in the U.S.). As a result, a lower price in the market place was adequate to bring the supply necessary to meet demand. In looking at the reference case, OPEC production was flat, and the U.S. was the largest contributor for non-OPEC oil. However, a price increase was required in order to meet the demand requirement. In the high case scenario OPEC production was falling and costs were growing substantially higher for non-OPEC development. Therefore, a higher price was necessary for the market to balance.

Commissioner Fisher reviewed slide 20, "PRICE FORECAST: Nominal ANS Price Distribution," which showed a line graph with colored lines showing P10 to P90 scenarios from the fall forecast. The dotted black line represented the department's current spring forecast. The graph showed that in the near-term, the department was materially high than what it predicted in the fall. In the long-term, the department continued to believe that in 2028 the market would be in the \$75 range.

Commissioner Fisher referenced slide 21, "PRICE FORECAST: Spring 2018 Forecast compared to Prior Forecast," which showed a line graph entitled "Real Oil Prices and Forecasts." He highlighted the dotted line which was the fall forecast in real terms. The dashed line was the department's spring forecast. The department continued to have a long-term view that, in real terms, oil at about \$63/bbl worked for the world economy. There was enough production to meet demand in real terms, and Alaska would get there faster than the department expected in the fall.

Commissioner Fisher turned to slide 22, "PRICE FORECAST: UGF Revenue Under Selected Price Paths," which showed a set of alternative sensitivities for the committee's consideration. Under each forecast was the undesignated general funds (UGF) associated with that forecast. He would not review all of the numbers but thought the chart provided a perspective on what the alternative cases looked like and their associated revenue impacts.

[9:46:38 AM](#)

Commissioner Fisher indicated the next portion of the presentation was the cost forecast which would be presented by Mr. Stickel.

Mr. Stickel displayed slide 24, "COST FORECAST: North Slope Capital Lease Expenditures," which showed the North Slope capital expenditure forecast for the spring forecast compared to the fall forecast. It detailed some of the comments made earlier in the presentation about cost reductions in the oil patch. The department had reduced the capital expenditure forecast for the next several years compared to the fall forecast. There were 2 large contributors. One was continued cost reductions by producers on the slope, not necessarily a reduction in activity by the producers. They had been able to bring down costs and get concessions out of some of the service providers. The second contributor was some delay in projects by the non-producers. The department had seen very little activity by non-producers in the most recent winter compared to what the department expected. One major example was that the Pikka unit announced that it cancelled its drilling program for the following winter. The department continued to forecast that activity would pick up again in FY 19 and beyond as reflected in the chart.

Mr. Stickel advanced to slide 25, "COST FORECAST: North Slope Operating Lease Expenditures," which showed the same picture for operating expenditures. There was a slight reduction for 2018 and 2019 primarily due to some of the cost reductions at the existing units beyond FY 19. In FY 23 there was an increase in the operating expenditures from a little under \$3 billion per year to about \$3.5 billion per year when some of the new fields were expected to come online including Pikka, Placer, Mustang, and Moose's Tooth. Once those fields came on line there would be an increase in operating expenditures.

Mr. Stickel indicated that slide 26, "COST FORECAST: North Slope Transportation Costs," showed the largest change the department made on the cost forecast from the fall forecast. He referenced a settlement that had reduced tariff rates by about \$1/bbl. He pointed to the FY 18 tariff forecast which included a half-year of the change. He continued that from FY 19 and beyond the department reduced its transportation costs by about \$1/bbl. For FY 19 the transportation cost change resulted in about a \$46

million increase to the revenue forecast versus what it would have been under the old tariff cost forecast.

Co-Chair MacKinnon asked who the developer was for the Pikka project.

Mr. Stickel stated that the operator was Armstrong. His understanding was that the operatorship was transferring to Oil Search sometime in the current month.

Co-Chair MacKinnon asked if the state's failure to pay the tax credits had possibly impacted the operator.

Mr. Stickel thought it was reasonable to assume that the lack of tax credit payments was somehow associated with the reduced activity during most recent fiscal year.

[9:50:55 AM](#)

Mr. Stickel moved to slide 28, "Explanation of Statutory Appropriation":

- Statutory guidance in AS 43.55.028
  - Appropriation is 10 or 15 percent of "taxes levied by AS 43.55.011"
- Department calculates statutory appropriation based on production tax before application of any credits
- Credits are not set out in AS 43.55.011, therefore department adopted an interpretation based on tax before credits
  - Calculated and provided to Legislature in 2015-2018 sessions
  - Published in RSB beginning fall 2016
  - Incorporated into Governor's budget beginning 2017
- Legislative Legal opinion: "ambiguous" as to whether to calculate on tax before or after credits
  - Court precedent to interpret ambiguous tax statute in favor of taxpayer
  - Department was aware that credits had been used to secure loans and finance projects; awareness influenced interpretation favoring taxpayer
  - Interpretation consistent with spirit of the program and intent of legislature to market Alaska resource development with commitment to pay credits within a short-term timeline

Mr. Stickel reported the department receiving questions about the statutory appropriation, how it was calculated, and why. He relayed that Alaska Statute (AS) 43.55.028 was the section of the production tax statutes that referenced tax credits. There were several subsections within AS.43.55. The tax credit guidance mentioned either 10 percent or 15 percent of taxes levied under AS 43.55.011 for the statutory appropriation. He continued that when the state's price forecast was \$60 or greater it was 10 percent of the taxes, and when the price forecast was below \$60 it was 15 percent of the taxes. He explained that when the department was looking at it a few years prior, AS 43.55.011 laid out the production tax calculation - the minimum tax or the 35 percent net profits tax.

Mr. Stickel continued that other sections of statute, particularly AS 43.55.023, AS 43.55.025, and AS 43.55.025, laid out the different credits. The department's interpretation was to calculate the statutory appropriation based on the production tax before credits in AS 43.55.011 because there were no credits out of AS 43.55.011. The department had provided the information to the legislature and the administration beginning in 2015. The department had published the statutory appropriation in the Revenue Sources Book beginning in Fall 2016 and it was incorporated into the 2017 governor's proposed budget. There had been some question as to whether the appropriation should be based on tax before or after credits. The department's understanding was that there was a Legislative Legal Services Opinion that the statutory guidance was ambiguous and precedent. The department thought the best practice of interpreting such an ambiguous statute would be in the benefit of the tax payer.

Co-Chair MacKinnon asked if the department's current calculation was consistent with past calculations. She would be supporting the accepted practice that had been used versus recalculating a percentage based on a new interpretation. She thought that, although a new calculation could be valid, it should be introduced in a piece of legislation changing statute, rather than trying to rewrite it on the fly.

Senator Micciche wondered if the administration's consistent opinion was to calculate the tax before credits.

Commissioner Fisher responded affirmatively. He stated that the administration had consistently taken that position. He thought that until the current year, it had been the way the legislature talked about the subject. He suggested that the governor's proposed tax credit legislation (which proposed to bond in order to pay tax credits) assumed that the calculation was based on the tax before credits. The administration believed that the right thing to do was to maintain the current interpretation because it was right and because it had been relied upon by industry and would be the least disruptive to industry to continue with the administration's interpretation.

[9:55:30 AM](#)

Senator Micciche assumed there was significant amount of weight based on the court precedent of interpreting ambiguous tax statute in favor of the tax payer in the past. He asked if he was accurate.

Commissioner Fisher concurred. He added that there was some deference given to the department assigned to interpret the statute. He believed both weighed in favor of maintaining the status quo.

Co-Chair MacKinnon reminded the audience that the legislature was bicameral, and the other body had drafted a new interpretation of the number the state should currently pay for tax credits. As a result, it was creating instability and uncertainty in an industry whose revenue greatly affected Alaska. she understood not wanting to pay the state's bills, but she did not support not paying what the State of Alaska owed.

Mr. Stickel spoke to slide 29, "Illustration of Tax and Credit Calculations," which showed how the department arrived at its statutory appropriation calculation. The department was estimating the appropriation for FY 19 to be \$184 million which consisted of primarily North Slope production. It also included some calculation for Cook Inlet and private land owner royalties. The slide showed the calculation for the North Slope oil portion of the statutory appropriation. He highlighted the estimated per barrel tax of about \$1.65 billion at the 35 percent tax rate before application of the per barrel credit. At the 10 percent rate the FY 19 appropriation would be \$165 million.

If Cook Inlet and some smaller pieces were added, the amount would total \$184 million.

Co-Chair MacKinnon asked if any of the unpaid tax credits were owed to the largest three oil companies. She referred to her earlier question regarding the Pikka project and the state not living up to past obligations of planned payment history.

Mr. Stickel replied that the credit statutes stated that only companies with less than 50,000 barrels of oil equivalent per day production qualified for state purchase of credits. He confirmed that the big three oil companies did not qualify.

Co-Chair MacKinnon opined that the Senate was belaboring the subject because the investment in paying the state's obligation increased production. She continued that while she watched some projects languish, they did not have the capital to move forward. Producers had anticipated being paid based on Alaska's previous ability to pay 100 percent of its tax credit obligation in a given year. The state fell back to the statutory interpretation, which she thought was understandable given the current fiscal situation. The new calculation created instability.

Senator von Imhof commented that initially when the governor's budget came out in the prior December, the tax credit payment was estimated to be about \$206 million. She noticed \$184 million in the footnote on the slide and wondered if it was a new number.

Mr. Stickel answered in the affirmative and added that the following slide provided greater detail on the change from \$206 million to \$184 million.

Mr. Stickel reviewed slide 30, "FY 2019 Statutory Credit Appropriation":

Key Changes from Fall 2017 to Spring 2018:

- Gross value increased
  - \$7 higher wellhead value □ \$1.2 billion higher gross value
- Tax before credits increased
  - \$1.2 billion more profit x 35% = \$400 million
- Different Statutory Appropriation Multiplier

- Appropriation is 15% of tax before credits when price forecast <\$60, 10% when price forecast is \$60+
- Estimated Statutory Appropriation is \$184 million
  - Down from \$206 million in Fall 2017
  - Based on tax before credits for North Slope plus Cook Inlet and private landowner royalty

Mr. Stickel relayed that the slide addressed the question of why the department changed the statutory appropriation estimate. He explained that with higher oil prices and lower costs, the department estimated about \$1.2 billion of increased value for FY 19 versus what it had previously forecasted. The amount was about \$400 million in increased tax before applying credits at the 35 percent rate. However, although the profit increased, the department was using a 10 percent rather than a 15 percent multiplier. The multiplier change had to do with the \$60 threshold that had been discussed earlier. The price forecast had gone from the high \$50 range up to \$63 and using the 10 percent multiplier. Therefore, the statutory appropriation was slightly less than the fall forecast.

[10:00:57 AM](#)

Senator Micciche was curious if the administration was pushing the tax credit bonding bill conveying the effects of it over the following several years.

Commissioner Fisher stated that the bill was a priority of the administration. He spent more of his time trying to advance the tax credit bill than most other subjects. He thought that the bill made sense for the industry and for Alaskans. Essentially, the state was paying for the cost of the bonds through a discount that the producers or the credit holders were willing to accept. The administration saw the bill as a win-win. It would put Alaskans back to work and bring additional production on line sooner bringing in additional royalty and tax revenue for the state. He thought that the administration had been clear with credit holders that the fall forecast would change in the spring, and the change would potentially impact the offer that was made under the proposed bill. He indicated that the department would have to redo the calculation with the new numbers. He noted the department had shared with credit holders the expected discount based on the fall forecast. The department would provide the updated discount

amount once the calculations were done again. He believed that producers would continue to see significant value in the proposal. The forecast did not change his interest and the administration's interest in seeing the bill move forward.

Co-Chair Hoffman asked, as chairman of the operating budget, how he should proceed should he continue to follow the governor's path. He asked the commissioner if he felt he was making headway in convincing the legislature to pass the bill.

Commissioner Fisher was concerned about the bill, as the House had not scheduled a hearing yet. He could not give Co-Chair Hoffman assurance that the bill would pass. If the bill did not pass, it would be the administration's position that the legislature should appropriate an additional \$147 million. There was \$27 million in the current budget to cover interest costs.

Co-Chair Hoffman asked, with less than 30 days left of the 90-day session, when the commissioner would be able to determine the success or failure of the legislation. He thought it was necessary to know that information in order to move forward with the budget process. He asked if leaving \$27 million as the only payment was an option. He wondered, if the bill did not pass, whether the administration planned to submit a supplemental request in the following year.

Commissioner Fisher hoped that there would be more clarity in the following two weeks. His goal would be to see that the budget was either the full amount of \$184 million, or \$27 million with the bill passed. He thought it would be harmful to the industry and Alaska's economy to delay a decision until a supplemental appropriation was approved.

[10:06:05 AM](#)

Co-Chair Hoffman thought the House was scheduled to act in the immediate future - in the current or following week. He believed the commissioner's timeline was stretched out too far.

Co-Chair MacKinnon suggested that the committee might glean whether the House intended to act on the piece of legislation based on the operating budget that was sent

over to the Senate. She thought if the House sent over an operating budget with only \$27 million in it, it might be fair to assume that they would be passing a bill. She did not look favorably at tying pieces of legislation together as a way of passing other legislation. She hoped that all legislators would do what was best for Alaska rather than playing games with pieces of legislation. She found that the Senate would do what was right by stepping up to pay the state's obligations based on what was owed and the Alaska State Statute. She looked forward to negotiations with the other body and their concerns. She was aware of several concerns by the House. She hoped that everyone would work together.

Senator Micciche thought it was unlikely that one of the major companies would repurchase the credits being above the minimum tax in the current price range. He asked if he was correct.

Commissioner Fisher stated that Senator Micciche's comment was largely correct. At the current price point, the major companies were paying the tax at the alternative minimum. The credits would not allow them to go below the minimum. They did not see value to purchasing the credits at the present time. He noted that Mr. Stickel had mentioned a settlement around the Trans-Alaska Pipeline System (TAPS) litigation. There would be some additional liability on behalf of the major companies of about \$150 million. The department anticipated that the major companies might buy between \$100 mill and \$125 million in credits. The state had about \$800 million of outstanding credits presently and anticipated another \$200 million in the next couple of years. In the scheme of things, the major companies purchasing \$125 million in credits did not change the dynamic for the state or the industry.

Senator Micciche referenced peripheral revenue changes the legislature made over the previous several years. He did not have any desire to change oil taxes further, as the legislature had made some significant changes, including the minimum tax. There were several different ways the state benefited from the minimum tax change. He thought there had been a diversification of revenues, some of which were more peripheral than others.

Commissioner Fisher asked the senator to rephrase his question.

Senator Micciche reiterated that the changes the legislature made to the Cook Inlet and the North Slope credit program and the change to the minimum tax provided other peripheral revenue advantages that were not often highlighted by the news or talked about amongst the public. He argued that the legislature had made some significant differences that were not realized.

Commissioner Fisher thought the senator was accurate. He worried about the amount of change that had occurred in the industry. It was difficult for businesses to plan when there was a high degree of structural change.

10:11:00 AM

Mr. Stickel referenced slide 31, "CREDITS FORECAST: Outstanding Tax Credit Obligations," which showed a bar graph entitled "Ending balance of credits available for repurchase, assuming statutory appropriation for FY 2019+." He explained the slide showed a status quo view of how the department saw the next several years playing out. If the legislature made the statutory appropriation each fiscal year but did not pass the bond purchase bill, the department estimated about \$946 million of tax credits available for state purchase in FY 19 and beyond. He continued that the department estimated that \$125 million would be purchased by the major producers to offset some of the TAPS related liabilities for previous calendar years leaving a balance of \$821 million of credits available for state purchase. If the statutory appropriation was made each year, under the scenario on the slide, the balance of credits would be exhausted in FY 23.

Commissioner Fisher would discuss the revenue forecast specifically in the following portion of the presentation.

Vice-Chair Bishop referred back to slide 4. He noted the production curve compared to the rest of the world. He advocated getting the state's debt paid off as soon as possible in order to keep production increasing rather than decreasing. He believed production was the key to capturing high prices.

Co-Chair MacKinnon noted that it also added 25 percent royalty at a minimum, if not 33 percent to the corpus of the Permanent Fund which would help in Alaska's future to

ensure a dividend could be paid under whatever statutory language the state wound up with when the state came out of the current fiscal situation. She was aware of people who believed the state should not pay its bills if it could not pay a full dividend. However, looking at the long-term picture, she argued that the way the legislature ensured a long-term dividend was to ensure that there was money in the Earnings Reserve Account (ERA), the corpus of the Permanent Fund continued to grow, and the corpus was inflation-proofed over time. The Senate had passed two different pieces of legislation to ensure the future of the dividend to Alaskans and to move through paying of the state's obligations.

[10:14:43 AM](#)

Commissioner Fisher turned to slide 33, "FORECAST CHANGE: Comparison of Spring 2018 and Fall 2017 Forecasts," which showed a table showing the changes between the spring and fall forecast in terms of oil price, production, leases, and transportation costs. It also depicted the difference in terms of UGF petroleum revenue.

Commissioner Fisher displayed slide 34, "UGF Relative to Price per Barrel, FY 2019," which showed a helpful chart. The chart allowed observers to think about what happened to UGF revenues as the price of oil changed. He noted that it was interesting that the state's forecast was at an inflection point. He considered that for every \$1 increase, the state would receive approximately \$75 million of additional revenue. Conversely, for every \$1 decrease, the state would receive about \$30 less. The reason for the difference in numbers was because at \$63 companies were at their inflection point between a profits tax and the minimum tax. The math was slightly different. Below that price point a change resulted in about a \$30 million change in revenue. Above the amount it was about \$75 million.

Commissioner Fisher referenced slide 36, "REVENUE FORECAST: 2017 to 2019 Totals," which showed the revenue forecasts between FY 17, FY 18, and FY 19. He pointed to the table with a high-level view. The unrestricted general funds had grown about \$1 billion between FY 17 and FY 18 then a much more modest growth. He pointed out the big difference under 'Other Revenue,' where the department's assumptions had declined largely driven by the change of investment revenue. He mentioned that the Permanent Fund had

experienced a very strong year in FY 17 in terms of returns. He continued that FY 18 assumed 8 months of actual returns and an expected return of 6 percent in the last 4 months of the year. He reported that FY 19 was more consistent with the long-range PF assumption of 6.5 percent return on investment.

10:17:56 AM

Commissioner Fisher reviewed slide 37, "WRAP-UP: Changes to 10-Year Unrestricted Revenue Outlook," which showed how production, price, and UGF had changed from the fall forecast to the current spring forecast. He pointed out that for FY 18 the department was predicting a little over \$250 million of additional revenue. From FY 19 and beyond revenue leveled out to about \$200 million. The chart provided a sense of the additional revenue that would be available for the state. He did not believe that the increase would completely address the fiscal challenges the state faced without other measures, but thought the state was moving in the right direction.

Co-Chair MacKinnon agreed that the state was moving in the right direction. She noted additional revenue, a slight decline in production, reduced operating expenses benefiting the transportation charges along with the lawsuit mentioned. She thought the department had brought positive news since the prior forecast. She surmised that the legislature had challenging times ahead for both legislative bodies to reach an agreement in addressing Alaska's fiscal challenges. However, she opined that the state had the means to take care of itself should the legislature choose to act. She thought several years ago the Senate's message was that it was time to act. She believed the same was true presently. She professed that the sooner the legislature acted, the safer and more secure the remaining reserves would be to produce interest to help close the fiscal gap.

Vice-Chair Bishop complimented the administration for its' comprehensive overview.

Co-Chair MacKinnon concurred with Vice-Chair Bishop. She appreciated the timing of the forecast, as it allowed the legislature to use it in consideration of the budget.

Co-Chair MacKinnon discussed the agenda for the following day.

#  
ADJOURNMENT

10:21:22 AM

The meeting was adjourned at 10:21 a.m.