

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

April 17, 2017

1:00 p.m.

MEMBERS PRESENT

Senator Cathy Giessel, Chair
Senator John Coghill, Vice Chair
Senator Natasha von Imhof
Senator Bert Stedman
Senator Shelley Hughes
Senator Kevin Meyer
Senator Bill Wielechowski

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 111(FIN)(EFD FLD)

"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; relating to carried-forward lease expenditures based on losses and limiting those lease expenditures to an amount equal to the gross value at the point of production of oil and gas produced from the lease or property where the lease expenditure was incurred; relating to information concerning tax credits, lease expenditures, and oil and gas taxes; relating to the disclosure of that information to the public; relating to an adjustment in the gross value at the point of production; and relating to a legislative working group."

- 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
 03/01/17 (H) Heard & Held
 03/01/17 (H) MINUTE(RES)
 03/01/17 (H) RES AT 6:00 PM BARNES 124
 03/01/17 (H) Heard & Held
 03/01/17 (H) MINUTE(RES)
 03/06/17 (H) RES AT 1:00 PM BARNES 124
 03/06/17 (H) Scheduled but Not Heard
 03/06/17 (H) RES AT 6:30 PM BARNES 124
 03/06/17 (H) Heard & Held
 03/06/17 (H) MINUTE(RES)
 03/08/17 (H) RES AT 1:00 PM BARNES 124
 03/08/17 (H) Heard & Held
 03/08/17 (H) MINUTE(RES)
 03/08/17 (H) RES AT 6:00 PM BARNES 124
 03/08/17 (H) Heard & Held
 03/08/17 (H) MINUTE(RES)

03/09/17 (H) RES AT 5:00 PM BARNES 124
 03/09/17 (H) -- MEETING CANCELED --
 03/10/17 (H) RES AT 1:00 PM BARNES 124
 03/10/17 (H) Heard & Held
 03/10/17 (H) MINUTE(RES)
 03/11/17 (H) RES AT 12:00 AM BARNES 124
 03/11/17 (H) -- MEETING CANCELED --
 03/13/17 (H) RES AT 1:00 PM BARNES 124
 03/13/17 (H) <Bill Held Over from 3/11/17>
 03/14/17 (H) RES AT 3:00 PM BARNES 124
 03/14/17 (H) -- Continued from 3/13/17 Meeting at
 1:00 PM --
 03/15/17 (H) RES RPT CS(RES) NT 4DP 4DNP 1AM
 03/15/17 (H) DP: PARISH, DRUMMOND, JOSEPHSON, TARR
 03/15/17 (H) DNP: TALERICO, BIRCH, RAUSCHER, JOHNSON
 03/15/17 (H) AM: WESTLAKE
 03/20/17 (H) FIN AT 1:30 PM HOUSE FINANCE 519
 03/20/17 (H) Heard & Held
 03/20/17 (H) MINUTE(FIN)
 03/21/17 (H) FIN AT 9:00 AM HOUSE FINANCE 519
 03/21/17 (H) Heard & Held
 03/21/17 (H) MINUTE(FIN)
 03/21/17 (H) FIN AT 1:30 PM HOUSE FINANCE 519
 03/21/17 (H) Heard & Held
 03/21/17 (H) MINUTE(FIN)
 03/22/17 (H) FIN AT 9:00 AM HOUSE FINANCE 519
 03/22/17 (H) -- Continued from 3/21/17 at 1:30 PM --
 03/22/17 (H) FIN AT 1:30 PM HOUSE FINANCE 519
 03/22/17 (H) Heard & Held
 03/22/17 (H) MINUTE(FIN)
 03/23/17 (H) FIN AT 1:30 PM HOUSE FINANCE 519
 03/23/17 (H) Heard & Held
 03/23/17 (H) MINUTE(FIN)
 03/24/17 (H) FIN AT 1:30 PM HOUSE FINANCE 519
 03/24/17 (H) Heard & Held
 03/24/17 (H) MINUTE(FIN)
 03/25/17 (H) FIN AT 10:00 AM HOUSE FINANCE 519
 03/25/17 (H) Heard & Held
 03/25/17 (H) MINUTE(FIN)
 03/27/17 (H) FIN AT 1:30 PM HOUSE FINANCE 519
 03/27/17 (H) Heard & Held
 03/27/17 (H) MINUTE(FIN)
 04/07/17 (H) FIN AT 1:30 PM HOUSE FINANCE 519
 04/07/17 (H) Heard & Held
 04/07/17 (H) MINUTE(FIN)
 04/08/17 (H) FIN AT 1:00 PM HOUSE FINANCE 519
 04/08/17 (H) Moved CSHB 111(FIN) Out of Committee

04/08/17 (H) MINUTE(FIN)
 04/09/17 (H) FIN RPT CS(FIN) NT 4DP 4DNP 2NR 1AM
 04/09/17 (H) DP: GARA, GUTTENBERG, SEATON, FOSTER
 04/09/17 (H) DNP: WILSON, THOMPSON, PRUITT, TILTON
 04/09/17 (H) NR: ORTIZ, GRENN
 04/09/17 (H) AM: KAWASAKI
 04/10/17 (H) MOVED TO BOTTOM OF CALENDAR
 04/11/17 (H) TRANSMITTED TO (S)
 04/11/17 (H) VERSION: CSHB 111(FIN)(EFD FLD)
 04/12/17 (S) READ THE FIRST TIME - REFERRALS
 04/12/17 (S) RES, FIN
 04/13/17 (S) RES WAIVED PUBLIC HEARING NOTICE,RULE
 23
 04/13/17 (S) FIN WAIVED PUBLIC HEARING NOTICE,RULE
 23
 04/14/17 (S) RES AT 3:00 PM BUTROVICH 205
 04/14/17 (S) Heard & Held
 04/14/17 (S) MINUTE(RES)
 04/15/17 (S) RES AT 9:00 AM SENATE FINANCE 532
 04/15/17 (S) Heard & Held
 04/15/17 (S) MINUTE(RES)
 04/15/17 (S) FIN AT 9:01 AM SENATE FINANCE 532
 04/15/17 (S) <Pending Referral> Uniform Rule 23
 Waived
 04/15/17 (S) FIN AT 2:00 PM SENATE FINANCE 532
 04/15/17 (S) <Pending Referral> Uniform Rule 23
 Waived
 04/15/17 (S) RES AT 2:00 PM SENATE FINANCE 532
 04/15/17 (S) Heard & Held
 04/15/17 (S) MINUTE(RES)
 04/17/17 (S) RES AT 1:00 PM BUTROVICH 205

WITNESS REGISTER

KARA MORIARTY, President and CEO
 Alaska Oil and Gas Association (AOGA)
 Anchorage, Alaska
POSITION STATEMENT: Spoke in opposition to HB 111.

DAN SECKERS, Tax Counsel
 ExxonMobil
 Anchorage, Alaska
POSITION STATEMENT: Spoke in opposition to HB 111.

DAMIAN BILBAO, Vice President of Commercial Ventures
 BP Alaska
 Anchorage, Alaska

POSITION STATEMENT: Spoke in opposition to HB 111.

PAUL RUSCH, Vice President of Finance
ConocoPhillips
Anchorage, Alaska

POSITION STATEMENT: Spoke in opposition to HB 111.

CASEY SULLIVAN, Director of Government and Public Affairs
Caelus Energy LLC
Anchorage, Alaska

POSITION STATEMENT: Spoke in opposition to HB 111.

JEFF HASTINGS, Chair and CEO
SAExploration (SAE)
Anchorage, Alaska

POSITION STATEMENT: Spoke in opposition to HB 111.

PAT GALVIN, Chief Commercial Officer
Great Bear Petroleum
Anchorage, Alaska

POSITION STATEMENT: Spoke in favor of a stable tax system.

ACTION NARRATIVE

[1:00:28 PM](#)

CHAIR CATHY GIESSEL called the Senate Resources Standing Committee meeting to order at 1:00 p.m. Present at the call to order were Senators Stedman, Hughes, Coghill, and Chair Giessel.

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

[1:00:51 PM](#)

CHAIR GIESSEL announced consideration of HB 111 [CSHB 111(FIN)(efd fld) was before the committee]. She noted that HB 111 was first heard on April 14, 2017, and two hearings were held on April 15. The first hearing today will have invited testimony, and the hearing at 5:00 p.m. will allow for public testimony.

Senators Wielechowski and Von Imhof joined the committee.

[1:01:13 PM](#)

KARA MORIARTY, President and CEO, Alaska Oil and Gas Association (AOGA), Anchorage, said her presentation has been unanimously approved by oil-producing AOGA members. The association represents the majority of oil and gas producers, refiners, and

exploration companies in Alaska, as well as the Alyeska Pipeline Service Company, which transports oil from the North Slope to Valdez.

[1:03:01 PM](#)

MS. MORIARTY referred to slide 3 of her presentation and said that the oil and gas industry is Alaska's economic driver, which may seem like a bold statement, but one third of all jobs in Alaska can be attributed to that industry. For every direct job, she said, another 20 jobs are created in the state's economy. Her data is from three years ago, and it will be updated by the end of May. With current low oil prices, it is still the largest contributor to the state's unrestricted revenue. At low prices, Senate Bill 21 [passed in 2013] provides a higher tax to the state than ACES would have. The industry was cash-negative in 2016, but state and local governments received over \$2.1 billion in revenue. "No other industry in Alaska comes even close to this level of economic activity," she stated.

MS. MORIARTY said policy makers often make goals, and the industry often looks at how a policy will impact measures of success, including production, investment, competitiveness, revenues, and "fair share." Four out of those five can be measured objectively, but fair share is subjective and in the eye of the beholder, she explained. She said that production is extremely important. Last fiscal year there was a three percent increase in production. It was the first increase in production in almost 14 years. She said the industry is on track for another stable year in production. March of 2017 was a good month for the industry and for Alaska. The average production in March was 565,000 barrels per day through TAPS [Trans-Alaska Pipeline System].

[1:06:00 PM](#)

MS. MORIARTY said that was higher than any month since December, 2013. It is higher than any March since 2012, so it is not necessarily seasonal. It is a trend, she said, and is really remarkable. The volumes this year so far are right around 558,000 barrels per day. This first quarter is the highest since 2013. "So, good news for us." She said her next chart is older, and it was used in 2012 by a former legislative consultant. It shows what investment has been in that decade and oil prices. As prices spiked, investment followed it in the Lower 48 and was relatively flat in Alaska. A chart from the Department of Revenue (DOR) shows the spending stayed relatively flat from 2007 to 2012 but spiked after the passage of Senate Bill 21.

SENATOR MEYER joined the committee.

1:08:00 PM

MS. MORIARTY stated that it is remarkable how the spending has stayed the same vis-à-vis oil prices. "It's just something that we wanted to point out to you." Why is investment important? Alaska needs it, she said. She showed oil production projections from the Energy Information Administration from October, 2016, and pointed out the projections for Alaska production without new investment. It does not include any new projects, and it is following a trend line without new investments. The red line represents TAPS minimum throughput, which is around 300,000 barrels per day. She said that the Alyeska Pipeline Service Company is aggressively pursuing ways to manage the pipe below that minimum, "in fact, even today they have to do temperature monitoring, more frequent pigging, additional investment, heat into the line." Admiral Barrett (President of the Alyeska Pipeline Company) has said that the engineering problem of economically transporting smaller amounts of oil is yet to be solved, but it does not mean that it won't happen.

1:09:48 PM

MS. MORIARTY said there are exciting recent discoveries. One of AOGA's main selling points when marketing is that Alaska has about one third of the nation's reserves. "So, it's not like Alaska is running out," she said, but the remaining oil is challenging and more expensive to produce. Over the last 12 to 18 months there have been many major discoveries, and she is excited about them. If Smith Bay, Conoco's Willow project, Armstrong's unit, and Hilcorp's Liberty project come online in ten years, the average daily production will be over 500,000 barrels in the next decade.

MS. MORIARTY said the previous slide would look different if that oil gets produced. She said stability is important, and she noted that Castle Gap Advisors told the committee that changes occur. It is just a matter of the changes being in the right direction with regard to stability. For the past 12 years there have been many changes to Alaska's tax policy. She provided a chart of those changes. In the industry's view, five out of seven changes are tax increases, some significant, and increasing taxes is the wrong direction. Some say that industry has asked for over half of these changes, and that is simply not true. "We actually opposed over half of the changes." The industry had major concerns with components of Senate Bill 21, as well. She presented a chart showing what regions do as oil prices changed over the past 15 years. Alaska is not on the

chart from January, 2016, but if IHS Energy was aware of House Bill 247, Alaska would have been the only orange box representing an increase in government take in that column. Not many regions were increasing taxes that year.

[1:13:48 PM](#)

MS. MORIARTY said another parallel when looking at the chart is what Alaska does for other industries that rely on a commodity price. What does Alaska do when other commodity prices fall out? She asked about fishing, mining, or emergencies. The industry never came to Alaska, she said, asking for anything more. "We were just asking to not make any changes in this low-price environment." Regarding fair share, as a mom with three kids she knows that fair is in the eyes of the beholder. This is the government take today; it is not the government take under HB 111, she noted. At every oil price, the state takes more money than industry and the federal government, even as companies are cash-negative. HB 111 would increase the state's portion at a variety of prices.

[1:15:43 PM](#)

MS. MORIARTY said it is important for the Department of Revenue to share the governor's four goals and concerns for tax reform. The first goal is to transition Alaska away from the business of providing cash credits and rebates to the oil and gas industry. The second is to reduce the state's liability related to potential large future investments. The third is to defer the state's direct participation in the cost of a new project until it comes into production, and fourth is to have the oil industry participate as part of the overall fiscal plan for Alaska. Maybe the fourth goal should be that the oil and gas industry should participate more, because it already participates in the fiscal plan for Alaska, she stated. This bill will just add more to that level of participation.

MS. MORIARTY said individual companies will talk about which components of HB 111 will impact them the most, but AOGA wants to summarize its view of the bill. It is important for the public to recognize that the bill eliminates more than cash credits. She stated that there is a lot of attention on Alaska getting out of the business of making cash payments to the industry, but the payments are not something the industry created; the state created the policy of cash payments to those who produce less than 50,000 taxable barrels per day. The bill removes that policy. It eliminates "another portion of the gross value reduction, which was already reduced last year in House Bill 247." It devalues the net operating loss and eliminates the

sliding scale per barrel credit, which is not and never has been a cashable credit. She has heard during this legislative session that the sliding scale credits were generous and that it would not be a big deal to eliminate them. She said it is important to remember that the sliding scale credits are a fundamental part of the tax system. They are not credits in the true meaning of what the public thinks credits are. When Senate Bill 21 was originally drafted, the tax rate was 25 percent, and during the modeling the department and the legislature discovered that it was a very regressive tax, and the effective tax rate was dramatically lower at low prices. So, they worked together, she said, to create nothing more than a math formula that kept the effective tax rate stable at about 25 percent over a range of prices, and they created an element of progressivity in the system. "Like most net tax systems, we never pay the full tax rate; trying to create a system where industry pays 35 percent or higher would be draconian, at best," she added.

[1:20:04 PM](#)

MS. MORIARTY said the math formula was created to keep the effective tax rate at about 25 percent using this per-barrel tax credit. Consultants have described it that way, and the DOR recognizes it as does the current tax director. He testified in June, 2015, saying that the sliding scale credits are integral and are offsets to an otherwise high tax rate. He said that it is hard to consider them a credit in the context of an inducement to doing work. She stated that her point is that changing or eliminating them will change the structure of SB 21 and will be an immediate tax increase on fields that provide over 90 percent of current production.

[1:21:37 PM](#)

MS. MORIARTY said a key aspect to recognize is there are other provisions that alter SB 21, such as changing the base tax rate, creating progressive higher tax brackets, changing the NOL [net operating loss] credit to a carry-forward loss deduction, eliminating the 10 percent GVR [gross value reduction], hardening the minimum tax floor, and creating burdensome ring fencing for the administration of costs and deductibility of costs. She added that most of the provisions have nothing to do with cash credits, "and we would argue most of these go way beyond the governor's stated goals."

[1:22:43 PM](#)

MS. MORIARTY addressed the NOL conversion and said HB 111 eliminates cash payments to the industry by changing the net operating loss credit, because that is really the only credit

after HB 247 goes into effect that will remain on the North Slope. The proposal is "that we'll just simply convert those credits to a deduction, add a little bit of an uplift for time value of money, and we'll be good to go." However, legislative consultants and companies have confirmed, through modeling, that there is no way the industry can be made whole by converting the NOL from a credit to a carry-forward loss deduction. There will not be 100 percent trade off, she explained, even with uplift, because of "the way our tax structure works." If the goal is to preserve as much value for the NOL credits as possible, the bill needs to have mechanisms to allow for continued new investment. Companies absolutely need to recover 100 percent of their costs with some type of uplift.

[1:25:15 PM](#)

MS. MORIARTY referred to page 18 of her presentation and said some people have suggested that the carry-forward deductions are a subsidy, because cash credits are a subsidy. "Well, that's not true." Net operating loss deductions allow for the recovery of essential costs when companies lose money, so it is just how a net-based system works. The NOL encourages continued investments for those losing money, because they can recover the money. The recovery of a NOL is critical, and impeding the recovery by decreasing the value or adding a time limit "does affect the timing of when that benefit is realized, and it doesn't matter if you're a producer or an explorer or an investor," she stated.

[1:27:40 PM](#)

MS. MORIARTY noted that not allowing the full recovery of costs means it is not a net-based tax system, "because companies will be paying more than the net." Carry-forward deductions are the only proper way to account for spending money in a net-based system; you have to recognize the need for full cost recovery, she declared. There are other changes to SB 21, and frankly, they don't have much to do with refundable, cashable tax credits. On the section changing gross value at the point of production, the committee's own consultant pointed out that this provision is a flaw, she said, because it prevents part of a taxpayer's real cash expenditures from ever being used.

MS. MORIARTY said HB 111 is a significant tax increase. There is no way to get around that. She said she thinks both consultants on Saturday called it an incredible tax increase, and one said the fiscal note from the Department of Revenue might be a little low. She said she wants to leave the committee with pictures, because AOGA is preparing for a really fun anniversary in June. She showed the Prudhoe Bay discovery well when it was surrounded

by a pristine environment. The anniversary is for the start of production and the completion of TAPS, which was a project that people said could not be done. They did it anyway, she noted, and it changed the landscape of Alaska's economy. She also showed a photo of Smith Bay exploration work last winter, where people are saying it is too expensive and will never be done. She asked that the version of HB 111 that passed the House be voted down.

[1:30:05 PM](#)

SENATOR STEDMAN referred to page 12 of the presentation and noted that the spring forecast is \$55. He asked if the industry or DOR could "count the cash and split up in bars, and we can compare it." There are no numbers indicated, and he asked to see how the cash flow will match with the bars on the chart. He said that it would be nice to actually look at the dollars collected and the expenses that the industry "has participated in."

CHAIR GIESSEL said she will request that.

SENATOR STEDMAN referred to the PPT [Petroleum Profits Tax of 2006] when there was about \$2.5 billion in lease expenditures, "and we're trying to double it to stimulate production." "If we take historic '14, it looks like the operating costs have dropped about \$300 million, but the capital costs from '14 to this recent spring update is about \$1.6 billion." He said that the point of his question is, "if we have right at about \$2 billion in capital expenditures, where in '14 we had right under \$4 billion, and to keep the old field alive, I guess my concern is the next several years, as far as production versus capital expenditures, and I was wondering if she had any comments on that." It is something we have tried to keep an eye on over the years, regardless of the tax structure, he added. Old fields take a lot of money to keep running.

MS. MORIARTY responded that specific investments should be addressed by the companies. It is an important component, and they have done everything they can to become more efficient. It is not unusual for companies to seek efficiencies, she added. That means the contracting community has also reduced their costs, because they need the business. When prices go back up, there will be a corresponding increase in those costs, because those contractors will be looking to recover.

[1:33:50 PM](#)

SENATOR VON IMHOF referred to page 17 of the AOGA presentation stating that a mechanism needs to be established to maintain as

much value as possible. Ms. Moriarty also said the per-barrel credit is fundamentally important to maintain a competitive tax structure, yet by putting together the different presentations, it is the same per-barrel credit that gets in the way to fully realize the NOL. "How do we address that conundrum?"

MS. MORIARTY said that is something that AOGA is looking at and trying to identify ways that that could happen. She said she is hopeful that the legislative consultants can help the committee with that. It could come down to the ordering of how the credits are applied, she said, and what could be allowed to pierce the minimum tax floor. There are lots of levers, and looking at recalculating the tax and those mechanisms, "you might get to the answers. We don't have a perfect solution identified for you."

SENATOR STEDMAN said it looks like there is a fundamental flaw in Alaska's tax structure dealing with the per-barrel credit, and it creates anomalies that inhibit the ability to allow these costs to go forward in a normal cost recovery process. It is important for viewers to realize that this is done everywhere in the world on a net tax system; this is not out of the ordinary to recover costs, he explained. What is out of the ordinary is the cash payments that have the state in its financial jam, as opposed to carrying them forward to use against production at the time of production. It will be challenging to work through this, which is a fundamentally fatal flaw. How do we get back to treating our oil basin like other sovereigns around the world where we don't disadvantage the industry by not allowing them full-cost recovery? If we don't allow that, we will be at a disadvantage and less attractive.

MS. MORIARTY said it is important to remember that the per-barrel credits have never been cashable and have to be earned in the current year, so there has to be a reordering of how the tax system works to allow for as much as possible retaining that value of the current NOL system.

CHAIR GIESSEL thanked her and said that was a great hearing on Saturday from the consultant.

[1:38:08 PM](#)

DAN SECKERS, Tax Counsel, ExxonMobil, Anchorage, said it is troubling that the industry is being asked to testify on an attempted tax increase, especially when the industry is struggling. This would be the seventh change in under 13 years, he added. It is not helping and is undermining confidence in the

tax system. He said to make no mistake, the bill is nothing more than an adverse tax increase. It is a significant rewriting of SB 21, especially with today's prices, which many believe will be the same in the future. He said ExxonMobil believes SB 21 is working as intended, because investments and production is up, and it's been a help to the economy. Alaska needs to remain globally competitive, and the committee substitute will not help attract investments but will make matters worse. Ms. Moriarty did a great job highlighting concerns with the bill, and he will not belabor what the committee has already heard.

MR. SECKERS said it sounds great for revenue, but how will it work with the interplay on the North Slope and between various companies? He asked if the committee has given it enough attention to what this really will do? The bill has been pushed pretty quickly. He said many of the features of the bill have been brought up before. There are some hidden little mine fields that have been brought in through HB 247 by the administration. Most of those are bad ideas, he opined, and that is why they were not enacted last year. "Why would you want to enact them again this year?" He said the committee substitute will not help the economy; it will do the exact opposite. It sounds good to drop the tax rate from 35 to 25. If that happened and the per-barrel credits were taken away, isn't that SB 21 as proposed? Those two components were there, he said. "Why isn't that acceptable? Didn't you guys support that then?" The answer is no, he said. He told the committee to go back and look at the testimony by ExxonMobil. "We opposed that," he said, because the rate is too high, especially with current prices. The sliding scale per barrel credits were put in to mitigate what is a very high rate of tax.

MR. SECKERS said he saw Mr. Marks' testimony, and he was fascinated how he showed the competitive lines. Removing the tax credits and lowering the tax rate should go hand in hand, but it will raise the tax on industry on the North Slope by up to 300 percent for the price ranges that will occur in the foreseeable future. "As policy makers, you honestly think that that's going to make Alaska more competitive or less?" He asked if the industry will spend more money if the cost of doing business goes up. "Why would our industry react differently than if you did that to, say, fishermen, restaurant owners, or Walmart?" He said Exxon is big, but hardening the floor will deny companies that made money this year that need to recover costs from prior years today in this current environment. It will discourage investment and it will create a disincentive to make those investments.

MR. SECKERS said the NOL is a very troubling piece of the puzzle. He believes that NOLs are not subsidies. The tax is based on a net system, and the recovery of loss is a central component since it balances revenues and expenses. It affects the competitiveness of a project tremendously. He said to ask if it is in the best interest of the state. A NOL is not a badge of honor; it means that a company was making critical investments, even though they were losing money, to employ Alaskans, with the expectation that they can get it back without limitation. "But it gets worse than that. Ask yourself from a practical perspective how will this actually work, okay?" This bill would require ring fencing to be put around fields that lose money, which sounds great in theory. He suggested putting a ring fence where "you can only recover your costs against that one field." The consultants have shown that when you start doing that, it changes the investment portfolio and the rate of return on that field. He said the likely thing that will happen is that if the bill goes into effect, he will get a call from his manager asking if investments will put the company in a loss. He said he will not be able to predict the future, but maybe the investment doesn't go forward since the economics have changed. "What does that mean? Is the investment going to stall now and wait? I can only drill so many months in a year...might as well wait until the fall." He said maybe the investment never goes forward, and "who wins in that environment?"

[1:46:26 PM](#)

MR. SECKERS asked how the bill will affect the dynamics between partners. He said if two companies want to invest in a field, it will drive one of them into a loss, but not the other one, so "are they going to see eye-to-eye on how that investment will go?" He said he is not talking about the one having better capital rating or better borrowing. He said he is talking about the tax policy driving a very distinct conversation between the partners, "and who's going to win in that environment? How's that going to turn out? I don't know." He asked if anybody has thought about that. "What happens if I have two companies that are spending? They're going to put another field out there. Company A is spending a lot more. Company B is maybe not spending so much." Company A gets to enjoy immediate recovery of all their costs in that year, he explained. He said his company files a consolidated segment-based tax. It isn't a field-by-field tax but one on activities on the North Slope as a whole to encourage going to a producing field from a nonproducing field.

MR. SECKERS said a producing field helps fund exploration, because a company will say, "I got more money coming from here; I can use it here." Ring-fencing in this state could really change the economics on investments. He asked what policy the state is trying to drive to. Alaska will reward companies that spend less, because they can write off their costs today, and penalize companies that spend more and drive them into a loss. "If that's what you want, that could be a practical outcome of the policy you put in place," he opined. He asked the committee what the problem is they are trying to solve. He said he has heard the concern of companies buying other companies, and they will acquire losses. If that is the issue, don't apply a shotgun to a solution that only requires a 22. He told the committee not to penalize everything in the North Slope.

[1:48:53 PM](#)

MR. SECKERS said this is a unique environment, and "they say ring fencing is common in other parts of the world." He noted that he has not practiced international law in a long time, but his understanding is that most of them—not all of them—when they ring fence, they ring fence a project. "We have a slope-wide tax basis, not a project filing basis, so how's this going to work?" If there are five fields, for example, and four are producing and one has a loss, the four can be consolidated. That changes the fundamental structure of SB 21 in the segment reporting. "You're being asked to underwrite a tax that's been on the books for 11 years in a matter of a week and a half," he said. The bill was pushed through without anybody looking at the economic consequences, other than nice words. The gross value at the point of production can't go below zero, but the administration never really describes what that will do. He said he files a consolidated tax return. "I'm sorry, it's not our fault that the oil is located far away in many places," he added. This policy will say that the state wants his company to explore in the far-reaching fields, "and I'm sorry it costs so much to get it to market." It's not Texas or North Dakota, and it is expensive. "So, what's the policy of the state going to be?" If a field has economic issues, it gets buffered by the revenue of another field. This policy will encourage exploring, "but shame on you if you're too far away from any of the existing facilities, because if you do, and prices fall, bingo, we're going to raise your taxes on that field—and that field alone." He said he is concerned about the policy of the state—to sit there and drive a policy that is a step change to attack a single field. This will have implications for any field that comes on far away from existing facilities. Enacting this legislation is a leap in the wrong direction, he concluded, and will double or quadruple

ExxonMobil's taxes at low prices, which is when Alaska wants investments. He said we are all struggling, but he questioned raising taxes on a struggling company.

[1:53:19 PM](#)

SENATOR STEDMAN said he believes Mr. Seckers is referring to the current tax structure where "we're in a minimum tax environment." Under the proposed bill, "we'd be outside the minimum tax, therefore dropping into another set of calculations," which would increase the dollars the industry would be paying the state. "So, we basically have two separate tax structures on top of each other, one being the minimum tax somewhere in the high sixties and down, and north of that price, falling into the 35 percent net profits tax."

MR. SECKERS said he is correct. What happens in the current price range is that a lot of companies are in the minimum tax, and this would triple their taxes. For companies that are not in the minimum tax, "then that will get lumped out of that," and there could be a mathematically infinite tax increase.

SENATOR STEDMAN said there was a spring forecast a couple of days ago. The net profit that we are talking about splitting up is \$1.3 billion. Of that, the state's minimum tax spread was about \$38 million. "Therein lies the discussion of the minimum tax and where it should be applicable, where it shouldn't, and how do we deal with it." He said he does not have any answers, but it is exciting to see the profitability come back so robust in the oil basin, "because when they're not healthy, neither are we." He said he does not want to see a tax change every time the price forecast changes. Since the PPT, the legislature has never looked at ring fencing on the micro level, but the state basically ring-fences Cook Inlet and middle earth, which is the center part of the state. North of 68 degrees, everything was consolidated, because the state wanted to get to more remote locations, like Smith Bay and Pt. Thomson. He suggested being very careful with the ring fencing in order not to negatively impact the economics.

MR. SECKERS agreed with his comments. He said not to be swayed by what sounds good in concept while not understanding how it will actually work. Part of the attraction of high tax rates is in consolidating the economics on the North Slope. One field can help the development of another, and ring fencing would cut that avenue off. It can cause some disconnect between partners, and there is no winner.

SENATOR WIELECHOWSKI asked if Mr. Seckers thinks SB 21 is adequate for getting the kind of investment Alaska needs in order to increase oil production.

MR. SECKERS said he believes that the forecast shows that production is up. He said a lot of people fixate on production tax and see that the state is giving it away or selling it at a deep discount. That is one piece of the puzzle, and people need to look at the entire economic model. The industry pays a high regressive royalty, and they pay property tax when they start work, which is a regressive tax. They are also subject to income tax. He said SB 21 is working and has been beneficial to the state.

SENATOR WIELECHOWSKI asked if that is a change in his position, because he testified previously that SB 21 would not increase investment and production.

MR. SECKERS said he initially opposed it, but everybody knows it is a radical improvement over ACES. When it changed, he said it would lead to more investment and increased production. The rate is still high. "I don't believe our testimony has changed in that regard," he stated.

[2:00:56 PM](#)

SENATOR STEDMAN said his previous comment about the \$1.3 billion increase in production tax value and the \$38 million going into the minimum tax, we do pick up royalties of \$88 million, "so you need to add those two together to see the whole magnitude of what's going on." If projects don't go forward, Alaska does not get the royalty, he added. Then he said he had just looked at the wrong column, and he clarified that it is a \$438 million revenue increase to the state, not \$88 million.

[2:02:52 PM](#)

DAMIAN BILBAO, Vice President, Commercial Ventures, BP Alaska, Anchorage, said BP is opposed HB 111 because it is a tax increase and takes Alaska "out of the game" for investments. It would impact BP cash flow by approximately \$90 to \$180 million when oil is between \$55 and \$65 per barrel. That financial impact is about what BP spends on drilling in any given year. Policy matters, and Senate Bill 21 has made Alaska more competitive. Alaska is competing with other places, and in the last few years the competition has become domestic. The tax increase will make production more expensive and will require more technology to offset the taxes.

[2:05:00 PM](#)

MR. BILBAO showed two graphs by consultants Wood Mackenzie comparing investments in different regions. The comparisons are indexed to a common starting point of 2003, he said. The Lower 48 investments surged beyond global growth and Alaska growth. As oil prices grew, investments moved with it. As oil prices began to decline in 2014, Alaska investments grew when other regions declined. He said his company believes that is because of SB 21. After 2014, production increased in other regions and flattened out in Alaska. "We've seen, over the last two years, a fundamentally different production profile in Alaska than we've seen in any other place that we operate."

[2:07:45 PM](#)

MR. BILBAO turned to a US government graph showing production from 1990 and pointed out the 2014 increase in tight oil production, and he said that reflects technology. "You see a US Lower 48 growth in production of almost 5 million barrels of oil per day." In the mid-1980s, Alaska accounted for about 25 percent of US oil production. Today, it is less than 5 percent. As investment is allocated, there are many other places, even in the US, where that investment can go, "and you can see how technology is making that investment grow in the Lower 48." In the last year, rigs are returning to the Lower 48 and they are three times more efficient than they were a few years ago.

[2:09:11 PM](#)

MR. BILBAO said that for legal reasons there is no Y axis on the next chart, which represents the "17 different locations across the BP upstream portfolio and the amount of cash they generated in 2016." The chart represents free cash before federal taxes, he explained. Alaska reflected a cash loss within the BP upstream portfolio. Alaska is different because of its location, and that affects BP's bottom line. There are three things that move the investment: efficiency, use of technology, and fiscal policy. "We saw SB 21 make Alaska more competitive and we saw it attract investment." It delivered additional production, but at these oil prices, "you can see how Alaska performed within BP."

[2:11:07 PM](#)

MR. BILBAO said fiscal policy is entirely within the sovereign's control. He showed a graph representing four different North Slope decline rates. A black line represents the version [of HB 111 tax policy] that was presented last week. "I think that averages out to about 5 percent decline," he said. The line is highlighted against a 2 percent decline and did not assume a flat production going forward. He said the 2 percent decline

reflects SB 21. The graph also shows an 8 percent decline, which is more of what was happening prior to SB 21. Without material investment, the fields on their own perform at a decline rate in the mid-teens, he stated, which is conservative. For each decline, the royalty is calculated at a fixed price. He said his point is that depending on the rate of decline, there will be a fundamentally different royalty value to the state. If Alaska's tax policy continues to deliver a 2 percent decline, the total royalty value to the state would be over \$12.5 billion, versus a revenue sources book of around \$10.5 billion. The more historic 8 percent decline would have a \$9.5 billion royalty value.

[2:13:53 PM](#)

MR. BILBAO noted that Alyeska warns of a technological challenge when the rate is less than 300,000 [barrels per day] of oil through TAPS, which should be considered while looking at decline rates. He said BP has principles of tax policy that Alaska should adopt. A policy should encourage more oil down TAPS from all players, he said. It should extend the life of "backbone" fields, Prudhoe Bay and Kuparuk, which make up the vast majority of oil down TAPS. A new or smaller field requires oil to layer on top to flow efficiently. A policy should encourage more independents, which is good for the state and for the industry. He finds that SB 21 delivers more production from the legacy fields, and there has been more material discovery on the North Slope in the last few years than has been seen in a very long time. A policy cannot pick winners and losers, because there are unintended consequences from differentiating between one field or one company and another. The industry is very quick to act on those unintended consequences, he stated, and it is best to avoid them. He is proud that BP is celebrating 40 years of Prudhoe Bay production, and he believes there's many more years to play for—with the right policy, but not with HB 111.

[2:16:02 PM](#)

SENATOR VON IMHOF referred to page 6 of the presentation and said that the green line is the decline in production under Senate Bill 21, and that line does not go below the 300,000-barrel threshold needed for TAPS.

MR. BILBAO said 300,000 is not a hard line but the start of less efficiency and more difficult operations of TAPS. The slower the oil flows down TAPS, the more problems arise, but Alyeska is focused on solving the problem. The 2 percent is indicative of a more competitive policy like SB 21. Lower costs extend the life of legacy fields and mitigate risks of the midstream challenge by years, not months.

[2:18:05 PM](#)

SENATOR STEDMAN recalled that prior to SB 21, there was ACES, and the forecast was a 2 percent decline going out for decades. The green line is not surprising, and the red line would be extremely alarming. He asked which projects can be directly related to SB 21 tax policy. He said he has never gotten a complete list of projects. As the fiscal terms get more favorable to the industry, they create a stimulus. That is pretty basic, but he would like to know if the industry can pinpoint which barrels are attributable to that policy.

MR. BILBAO said the fundamental difference with today's policy is that it challenges the industry to do more. The per-barrel credit effectively places the additional burden on the producer to go find a way to deliver more production in the same field. There is something incredibly energizing about what is happening now. Anybody in any company is managing the fields and facilities differently, and the results speak for themselves. The fact that more oil flowed down TAPS in 2016 than in the year before is unbelievable. He said he remembers "being in this body a few years ago during the SB 21 debate being challenged whether there would be any new oil that resulted from SB 21, much less flat production." It is remarkable that they are all sitting here today talking about that and looking at "1-Q-2017 numbers," he said. It is the way we are working together. One of the biggest changes is actually on base management. There have been new pads, but the way industry has managed the base, and the people in the office who have done that, is almost revolutionary.

SENATOR STEDMAN said a consultant noted that Alaska has one of the most complex tax systems. He asked Mr. Bilbao to explain upstream, midstream, and downstream and if BP has any exposure to anything besides upstream. Price is about \$10 above what is shown in the chart. We all want to be in the black, he said.

[2:22:54 PM](#)

MR. BILBAO said the chart includes regional pictures, not just production of oil and gas fields. In Alaska, the chart reflects BP's upstream producing fields and the midstream investments in the pipeline and the ships. The graph reflects cash flow delivery for that region. In Alaska, BP has been cash-flow negative for the last couple of years, he said, but it has been working hard to be more efficient. He expects BP to be in the black in 2017, but it is not a sustainable business model. "We

believe we've turned the corner, but we'll have to see where we are at the end of the year."

SENATOR WIELECHOWSKI asked where Alaska ranks on the chart for profits in 2016.

MR. BILBAO said if the chart depicted profits, it would still be in the red.

SENATOR WIELECHOWSKI asked if the recent Journal of Commerce article was incorrect to say that BP made \$85 million, with most of that in Alaska.

MR. BILBAO said that is part of the picture. The company files a 20F that reflects its upstream business, so when talking about Alaska, BP includes its midstream ownership of TAPS and the cost of ships. It all costs money, so BP incurred a loss in 2016, and referenced a correction article by the same publication on that.

SENATOR WIELECHOWSKI asked about the internal rate of return and net present values in Prudhoe Bay. What do they look like under SB 21 and HB 111 using forecast numbers?

[2:25:50 PM](#)

MR. BILBAO said BP does not provide the economic returns for individual projects. "You are talking about a wide range of investment opportunities," he said, like new pad construction, new rigs, and opportunities in other fields. In Alaska there are a lot more projects that BP wants to progress, and the most important thing is that BP continues to focus on making Prudhoe Bay and its Alaska businesses competitive, independent of price. In the past the company has tended to rely on price "to save us." It is trying to move away from that and to where it drives the performance and makes the business more competitive. If BP makes the business more competitive, it will compete for more capital and more projects. If costs go up, that makes the business less competitive.

SENATOR WIELECHOWSKI asked how to determine competitiveness. What rate of return is a competitive number for BP? He said he would like the legislature to know what these numbers are under different taxes. How can the legislature make sure that BP is getting the return that it needs?

[2:28:12 PM](#)

MR. BILBAO said it is important to consider the financial impact and the economic impact of a tax policy. "If I own a house and I

am struggling to pay the mortgage, it doesn't really matter that renovating the bathroom is a good return investment," if there is no money to pay for it, he said. If BP is not making money, it will be challenging to compete for an investment opportunity. It is important to consider both. For what the legislature should be looking at, it should be looking at the amount of oil flowing down TAPS. That is an outcome, and the policy in SB 21 is meant to encourage a certain outcome, and that is production, and that is what the state is getting. Also, there are more players on the North Slope, which is the result of SB 21. The policy has been successful. He said if the state is trying to support a project, it is trying to pick one project over another, and the industry will be quick to react to the unintended aspects of that, which you would not want. He said not to get into the game of picking losers and winners. The current policy is good for investment.

SENATOR WIELECHOWSKI said if BP does a deal with Conoco, the "numbers people" will figure out a reasonable rate of return. What is a reasonable rate of return to encourage production and investment? What is a reasonable net present value, so the legislature knows what to shoot for in a tax structure?

MR. BILBAO said he doesn't have a number; he can only tell the committee the consequences of state policy. The current policy encourages investment and exploration, but the policy of HB 111 would not do a lot of that.

[2:32:10 PM](#)

SENATOR WIELECHOWSKI asked what financial metrics the policy makers should be looking at.

MR. BILBAO said projected economic metrics don't drive the outcomes. The financial and development outcomes tell the state if its policies are working. Either companies are producing more, or they are not. If they are getting a 3 percent or a 30 percent rate of return, as long as they are out there producing for you, then your policy is working. The metrics should not matter to a sovereign. "Right now, you're generating the outcome you want," he said.

[2:33:39 PM](#)

CHAIR GIESSEL said she was in Alaska when TAPS was built, so she is interested in making sure that the flow continues. She added that she is very, very pleased to see the leveling out of the decline. It was more than a 3 percent increase when considering

BP pulled it up from its decline, but how many Alaskans have lost their jobs at BP?

MR. BILBAO answered that over the last three years, the number of employees went from 2,700 to 1,700 due to divestment of certain fields, and he does not know about contractors and the multiplier effect. It is significant; those are our friends and neighbors. About 80 percent of BP employees are Alaska residents or qualify for the Alaska PFD, he added.

SENATOR HUGHES noted that Mr. Bilbao said that BP experienced a loss in 2016. She asked what that was.

MR. BILBAO said there was about \$80 million profit on the field side and a loss of \$200 million "on the pipe and shipping side." If you only care about the \$80 million, "our view is that HB 111 would take care of that as well and wipe that out."

[2:36:40 PM](#)

SENATOR STEDMAN said if Alaska gets the policy right, it gets the jobs. It is an extremely complex tax system. It seems like we will be in the minimum tax for the foreseeable future, and the net profits tax will probably not be implemented. He asked about the inefficiency the state is imposing on BP and state employees with this overly complex tax code.

MR. BILBAO said that nothing is as difficult as changing the tax code, reeducating people, and building new models.

[2:38:41 PM](#)

PAUL RUSCH, Vice President of Finance, ConocoPhillips, Anchorage, said Senate Bill 21 is working and has resulted in increased investment in Alaska. Referring to page 2 of his presentation, he said the ERD (extended reach drilling) rig was sanctioned in 2016. It is a game changer for ConocoPhillips on the North Slope. It will reach more resources, he explained, and will be operating in 2020. He said Greater Moose's Tooth 1 was sanctioned in 2015, and work is progressing for first oil in 2018, including a busy construction season this winter. It will cost \$900 million and should produce 30,000 barrels of oil per day. He expects a GMT2 [Greater Moose's Tooth 2] project in 2018. Each will provide about 600 to 700 construction jobs during development. Other projects represent about \$3 billion in gross of expenditures and about 50,000 barrels per day. He noted the exploration work announced earlier this year at the Willow site. It is still under appraisal, but it is expected to provide

200,000 barrels per day. ConocoPhillips is active in the December 2016 lease sale.

MR. RUSCH referred to a bar chart on the capital expenditures of ConocoPhillips, which is up to \$1 billion. The percentage of spending in Alaska relative to total ConocoPhillips capital has gone from 6 percent to 20 percent since 2012, driven by the reductions in expenditures around the world and low prices. ConocoPhillips has had smaller reductions in Alaska than elsewhere. This is an indication that Alaska is competing favorably under Senate Bill 21.

[2:44:04 PM](#)

MR. RUSCH turned to page 3 of his presentation. He said the net cash flow is on the left side, and it shows that the state always has the largest share. When investors are losing money, the state is still making some, so the government take is infinite. The next chart shows the percentage increase in production taxes under HB 111 relative to the current system. It is a significant increase in taxes, especially in the \$50 to \$80 price range. The bill was described as a modest tax increase that was fixing the tax credit problem, and the chart shows that the bill is a large increase in production taxes.

[2:46:58 PM](#)

MR. RUSCH showed his next chart of the competition that Alaska is facing for investment dollars. It focusses on unconventional oil in the Lower 48 and Canada. The data are specific to ConocoPhillips but are likely indicative the industry. It portrays the cost of supply for 15 billion barrels, and each bar represents a specific set of resources, he stated. On the left are projects that have a cost of supply in the single digits, and it goes up to \$50 per barrel. It captures all costs: development, operating, and fiscal terms. Unconventional resources are represented by the yellow bars, and ConocoPhillips has 7 billion barrels of unconventional resources in the Lower 48 with a cost of supply of about \$35 per barrel. He said Alaska cost of supply is close to \$50 per barrel. The company has a cheaper alternative to Alaska, so it is trying to bring down the costs. He said the cost of supply for the CD5 project in Alaska was brought down from \$66 to \$40 per barrel.

[2:50:24 PM](#)

MR. RUSCH said production taxes are part of the cost of supply, so they can make Alaska projects less competitive to the Lower 48 alternatives. He presented the key concerns with HB 111 on slide 6. The main concern is an increase in cost since the

company has lower cost opportunities. Additionally, HB 111 puts an end to the three-year interest period that was established last year, and it is punitive because it applies a high interest rate for a time that is largely controlled by the state. The audit process in Alaska has a six-year statute of limitations, and that is set by the state. Beyond that is an appeal process, which is largely controlled by the state, so it could be six to nine years before an audit is resolved, he said. This schedule can lead to tax assessments that are larger than the initial audit findings. As part of HB 247, the interest was effectively doubled, but it reduced the audit period. Under HB 111, incentives for shortening the audit period have been removed.

[2:53:11 PM](#)

MR. RUSCH said there has been a lot of discussion on hardening the floor, and there is some confusion on whether this is a hard floor. Testimony from last year suggested that "we did not have a hard floor." The recent advisory bulletin put out by DOR attempts to harden the floor, which conflicts with the SB 21 statutes. He stated that any efforts to harden the floor will erode the value of tax credits or the GVR benefits.

[2:54:20 PM](#)

MR. RUSCH suggested that the NOL provisions in HB 111 need some improvement. ConocoPhillips is not eligible for the reimbursable credits, but it supports the change in the NOLs from a credit to a carry-forward deduction. However, there are issues in the ability to fully recover these expenses. The combination of the ring fencing and the reduction in value after seven years will erode the value of the NOLs. He said that ring fencing will reduce the value of a discovery like Willow, and the disclosure requirements of NOLs are too broad and effectively release the entire tax return, which could disclose the cost of a drilling rig, for example, violating antitrust rules. Alaska has a complex tax system, and the ring fencing could create administrative burdens. He concluded that SB 21 is working, and increasing taxes will make Alaska less competitive.

SENATOR STEDMAN referred to page 3, which looks like it was created after the 2016 fall revenue source book. He asked for the calculation to be run with updated figures, because at low prices royalties become more dominant for the state, "and clearly we're coming out of a state of low prices, so it would give us a better feel to have the spring forecast numbers. He expressed appreciation for including percentages on the chart.

[2:59:17 PM](#)

SENATOR WIELECHOWSKI referred to slides 3 and 4, and at \$60 per barrel, it shows the state getting 46 percent of the take, and it looks like that is \$5 billion, which would be over \$2 billion, and the next slide shows a 100 percent tax increase. He asked if the state's production tax increased by 100 percent to \$4 billion.

MR. RUSCH said numbers on slide 3 includes all taxes and royalty, not just production tax. The tax increase on slide 4 includes only the production tax.

[3:00:36 PM](#)

SENATOR WIELECHOWSKI asked what increase Mr. Rusch calculates for all taxes.

MR. RUSCH said he did not have that figure. He said he tried to be very transparent. The bill addresses production tax, not royalty or other taxes.

SENATOR WIELECHOWSKI said it is confusing, because the previous chart includes all of that. What would the total take be at \$60 per barrel? Is it a lot less than 100 percent?

MR. RUSCH said he did not know.

[3:02:54 PM](#)

CASEY SULLIVAN, Director of Government and Public Affairs, Caelus Energy LLC, Anchorage, said Caelus Energy is a privately-held independent exploration and production company that started in 2011 and came to Alaska in 2014. [CEO] Jim Musselman has had a series of worldwide successes. First with Triton Energy, which was faltering, and Mr. Musselman arrived and quickly moved it to one of the largest independent companies headquartered in the US. Triton brought a difficult deep-water field near Equatorial Guinea from exploration to development in 14 months. Mr. Musselman and his team then started Kosmos, which had a significant discovery with the Mahogany 1 well that is now part of the Jubilee field. It is a deep-water play, he added, and it went from exploration to production in 40 months. The team consists of worldwide, successful oil finders and producers.

MR. SULLIVAN said that Pioneer Alaska, "kind of our legacy company here," came to Alaska in 2002 and was the first independent on the North Slope. The net profits tax system encouraged new independents, and it worked in many ways, and Caelus is an example of that. Caelus Energy has operated the Ooguruk unit since 2008. That field is a structure that Mr.

Musselman found attractive, and it took five years to go from sanction to production, a record time for an offshore island, he noted. "We are already working and finding great success here in Alaska."

MR. SULLIVAN said Mr. Musselman is in Alaska because it is abundant with resources. Many had shied away from investing here, but the passage of Senate Bill 21 was a signal that Alaska was open for business. That occurred at the same time Pioneer was looking to divest. "We're glad he made that decision, and we hope that Alaskans are too," he stated. He showed a map of the North Slope, with the areas in blue representing Caelus Energy lease holdings. The middle area is the flagship Oooguruk unit, and it produces 5 million gross barrels of oil annually. Caelus Energy was responsible for about 25 percent of the recent annual increase in production. Good policy allows it to invest and use technology to increase reservoir capacity. On the eastern shore is about 350,000 acres of exploration area. "We immediately shot a great deal of high-resolution, 3-D seismic into that area," he said, and there are very exciting prospects to explore for in the next couple of years. He pointed out the Smith Bay area on the map that Caelus Energy acquired in 2015. He said most of this activity happened after SB 21, because it is a balanced system that encourages legacy and independent fields on the North Slope. Caelus is the type of company Alaska was looking for, and he hopes it will be here for the next 40 years.

[3:09:36 PM](#)

MR. SULLIVAN said the discussion often focusses on what the new projects will cost the State of Alaska instead of on the benefits to the state. The Nuna development is the onshore companion to the Oooguruk field and has up to 150 million barrels, which should produce 25,000 barrels per day at peak production. It was discovered, appraised, and shelved under the ACES tax regime, but the Caelus team has looked at it and realized it is an opportunity to get new oil into the pipeline as soon as possible, he said. There is a 22-acre pad and road, and there are two wells ready to go. One of the wells delivered an IP [initial production] rate of 2,800 barrels a day, so Caelus needs investor confidence now, so it can get right to work in constructing the modules and installing some of those flow lines. For Alaskans, this project will deliver 300 jobs during construction and 300 during production, he said. Under House Bill 247, "which is sort of what we live under," and Senate Bill 21, Caelus Energy would earn about \$151 million in refundable credits, but the state would get back—in the

lifecycle of this field—close to \$2 billion in royalties and taxes.

[3:11:32 PM](#)

MR. SULLIVAN said the project that has been in the news is Smith Bay, which is truly a world-class discovery. Other companies had been in the area doing seismic work, and Caelus Energy used that data for an exploration program. "I can't say enough about the Alaskan contractor workforce—they are able to get into these remote environments...and explore and do it safely and swiftly." It is really remarkable, he added. In Caelus Energy's leases alone, there are close to 6 billion barrels of oil, and maybe with the surrounding area there are 10 billion barrels. Caelus Energy looks at analogs of projects and believes that the recovery factor is 30 or 40 percent, so that makes about 2 billion recoverable barrels. He said he has heard that Smith Bay will drown the state in ongoing deferred taxes and net operating losses, and that is valid, but a project like this is of national and state significance that can provide oil and jobs for the next 40 or more years. "This is a really exciting time for Alaska, not just Smith Bay, but Willow, Nanushuk — this is exciting times, and policy does matter." At the peak, there will be thousands of construction jobs for the pipeline, roads, and facilities, he said, and there will be close to 200,000 barrels per day during the peak. That means \$28 billion to Alaska in royalties, wages, and taxes. The company hopes to build another well this winter, but it is dependent on what happens in the legislature, he advised.

[3:14:26 PM](#)

MR. SULLIVAN said the next generation of development from Caelus Energy can add billions of barrels and thousands of jobs. He showed a slide that represents the tension in the current policy debate. Will the legislature create a policy that encourages development and puts Alaskans to work and provides more revenue to the state, "or are we going to create a policy that is going to lock up those resources for future generations for a short-term gain?" He said the current policy is balanced and attracts investment. Caelus Energy opposes HB 111 as it stands, as it represents a significant tax increase and will hamper new field development.

[3:15:29 PM](#)

MR. SULLIVAN said Caelus Energy has been very transparent about what prices it needs to get projects moving, which is somewhere in the mid-sixties. His chart on page 8 shows that the price needs to be higher "to be able to take those projects off the

shelf." He stated that Alaska's tax director, Ken Alper, said the impacts of the policy on new oil would be a tax increase at lower prices due to the hard floor.

[3:16:55 PM](#)

MR. SULLIVAN said that because Caelus Energy is not subject to the minimum tax floor now, it is able to use credits to go beneath that. Hardening the floor creates an infinite tax increase, because the tax goes "from zero to the adjusted 3.2." Referring to the next slide of his presentation, Mr. Sullivan said the original profits-based system leveled the playing field for new and legacy operators, and that was the goal. New developments have a much higher hurdle, and analytica, the legislature's former-consultants said that the NOL credit aimed to equalize tax impacts. It did, but this bill considers it an alternative to that credit. Senate Bill 21 created a competitive system and made a conscious effort to encourage new oil and new players. Last year, House Bill 247 was billed as reforming Cook Inlet, but it made significant changes to the North Slope and to new players through the GVR and the capped credits.

[3:18:06 PM](#)

MR. SULLIVAN said Caelus Energy is not insensitive to the situation that Alaska is in; these low-price environments impact everyone. "If we're out of the cashable credit business, that's one future," but he asked the state to make sure that it takes care to make the small players as whole as possible. The shift from a NOL credit to a deduction is a major tax increase because of the low price and the hard floor. The bill also time-limits the carry forward, which is a valid conversation, but it can become a permanent loss in deduction value. "Hey, you're going to spend a dollar today, but tomorrow you'll get half of it or you're going to lose some of it. Sorry." That does not make great policy, he exclaimed. In the bill, there is no uplift, which was recommended by consultants to help the time value of money. The hard-minimum tax floor for the GVR fields is a significant tax increase: from zero to 3.2. The \$5 per-barrel credit for GVR fields enacted in SB 21 was an incentive for new fields. It was meant to be an offset to high royalty rates, he stated. "We would encourage that you consider that continue to be allowed to be used against the floor," he added. Every regime allows for cost recovery, and if Alaska doesn't, it will be at the bottom rung of competitiveness.

[3:20:33 PM](#)

MR. SULLIVAN stated that Alaska's policy goal should be more production. "Let's get more in the pipe." The fiscal system

should be competitive to keep players moving forward, including full recovery of costs. Caelus Energy is 100 percent Alaskan, but it competes for capital against other types of projects "in different variations." He asked policy makers to encourage the secondary market. There is an opportunity to be able to redeem tax certificates with another taxpayer, and that should be allowed in a way that works for both parties, he said. The last couple of vetoes were very impactful to his company and to Alaska's reputation. Is Alaska open for business? He asked that the legislature help make good on those outstanding tax certificates in a way that gets Alaskans back to work.

[3:22:10 PM](#)

CHAIR GIESSEL said it sounds like Caelus Energy acknowledges that Alaska cannot afford to give cash credits any more.

MR. SULLIVAN said it would be great to continue the program, because small producers could recoup their costs in a timely way. Legacy producers spend a dollar and they can offset that in their next month, he explained. "We spend a dollar and we have to wait sometimes a year and a half, if not more, to be able to recoup that same level of cost." He said Caelus Energy is not encouraging the removal, but it knows that the state is in a tough position. The company is running its economics without cashable credits, because it has not been paid in the last couple of terms.

[3:23:24 PM](#)

SENATOR WIELECHOWSKI referred to the statement by Castle Gap Advisors on page 9 of the presentation regarding every regime allowing the deduction of costs. He asked if that is true in a gross tax regime like in Texas and North Dakota.

MR. SULLIVAN said that the statement refers to net tax systems.

SENATOR WIELECHOWSKI said Alaska's tax director, Mr. Alper, has testified that a project like Smith Bay could cost \$10 billion. With a 35 percent net operating loss cashable credit, that would be an enormous outlay for the state. What alternatives are there to cashable credits?

[3:24:34 PM](#)

MR. SULLIVAN said that is a good question. The cashable credits are capped, so "we would only get \$70 million for that, and there are some of those loss carry-forwards," but the state would get the reward of jobs and royalties. The State of Alaska could do other things. For example, Caelus Energy does not need

to be in the business of owning a road to Smith Bay or owning a pipeline, so infrastructure development can play a critical role. A \$10 billion project without the road could be a \$9 billion project. Processing facilities do not need to be owned by Caelus. Native corporations could partner with industry, but those come with a cost, too, he acknowledged.

SENATOR STEDMAN recalled that only one other regime in the world has cashable credits, so, clearly, it is an anomaly. It is a sizable obligation that the state cannot meet, and that is why it needs to change course and get back into the norm of how things are structured worldwide, he said. He looks forward to working with Caelus Energy to come up with something in order to go forward with Smith Bay. This is a \$10 billion enterprise that is several years out, and he asked what financial help the state has provided thus far.

MR. SULLIVAN said Caelus Energy is not afraid of cashable credits going away even though they lower the entrance hurdles of new projects, but if there are changes, please make the system competitive. Moving from a credit to a deduction is not equal. "What we're trying to figure out is how you make that deduction work in a way that is less complex but works also for the new entrants."

SENATOR STEDMAN said he was asking about Smith Bay in particular, because it is a game changer and might be the size of Kuparuk or bigger.

MR. SULLIVAN said the program was over \$100 million to execute, so the state would carry 75 to 80 percent of those costs through its NOL and exploration credit program. The company has certificates for a portion of those costs, and it will probably receive certificates for the second part of those costs. The state is not on the hook for anything yet, because it has not paid.

[3:28:43 PM](#)

SENATOR STEDMAN said that the people at home should recognize that the state has been helpful and aggressive in increasing production by not putting the entire burden on the industry. There are billions out in credits, and sometimes the state does not get due recognition for those cash credits or the many other types of credits.

[3:29:12 PM](#)

SENATOR MEYER asked when the Nuna site will produce.

MR. SULLIVAN answered that the Nuna oil development is on a cutting edge in that it is getting price opportunity in the mid-fifties, but it is waiting to see what happens in the legislature. "If we could buy pipe this spring, we could actually install that next winter, install the modules, and we're confident in first oil by late 2018, early 2019." He said they would predrill a number of those wells, so they would get into peak production fairly quickly.

SENATOR MEYER asked if the price of oil needs to be \$70.

MR. SULLIVAN said the price needs to be in the mid-sixties for some time "to really help progress that project."

[3:30:35 PM](#)

SENATOR WIELECHOWSKI asked what sort of uplift percentage rate is fair for a project like Nuna or Smith Bay. He asked about the timeline.

MR. SULLIVAN said fair and customary are two different things. Uplift rates vary. Some are 10 percent compounded, and some are the cost of capital, which is closer to 15 or 20 percent. He suggested working with consultants to find a balance to benefit the state and the companies. The goal is to drill an appraisal well in Smith Bay, which is like a development well. It will be fracked and will "flow that back to the surface." If it shows that there are quantities for deliverability, "we'll engage in the EIS process," which takes three years. It will be six to seven years before first oil, he concluded.

CHAIR GIESSEL asked if drilling "this winter" means 2018.

MR. SULLIVAN said yes, the company would mobilize all the equipment at Pt. Lonely and then drilling would most likely commence January to March of 2018.

CHAIR GIESSEL asked if it will be a year before conducting a flow test and knowing if this project is even profitable.

MR. SULLIVAN said yes. There is oil, but he does not know "if we can flow that oil."

SENATOR COGHILL said the state is considering the value of cash input. "Just like you have to deal with the cost/value question, you can see that we're struggling with it as well." He asked how

ring fencing will impact Caelus and if it will cut it off from other partnerships.

MR. SULLIVAN said the previous testifiers articulated the difficulties with ring fencing. It would really hamper Caelus Energy's investment cycle and investments in outer areas if it could not recoup those costs against current producing fields. Credits in Alaska have supported new independents, and "in many ways we are kind of the poster child of that, and everything that is on this slide really did receive a great deal of benefit from the State of Alaska, and that might not have happened without some of those assistance." He said Caelus Energy is not unappreciative of the help the state agencies have provided to move projects forward.

[3:35:08 PM](#)

JEFF HASTINGS, Chair and CEO, SAEExploration (SAE), said SAE is managing partner of Kuukpik SAE, which is a joint venture with the village of Nuiqsut. He noted that his team was founded in Alaska and has been partnered with the Kuukpik Corporation for over 20 years, employing an average of 400 people per year. The Kuukpik SAE joint venture is a consistent revenue source for the corporation, the village, and hundreds of other Alaskan families. He said the company preferentially hires Native Alaskans, and it has over an 80 percent Alaska hire rate. Kuukpik SAE primarily uses Alaska subcontractors and suppliers.

[3:36:56 PM](#)

MR. HASTINGS said the core business of Kuukpik SAE is collecting seismic data; "we create the images, so the doctor can see how to operate on the patient." It is typically the first to enter exploration areas, "so we're kind of the pointy end of the spear." The images are used to afford greater success in drilling wells and is critical to any exploration program, he added. Through SB 21, new seismic technology is producing higher resolution images of the subsurface, which has a direct correlation to new discoveries.

[3:38:18 PM](#)

MR. HASTINGS said the next slide shows the 190 Alaskan suppliers that support our efforts every year. Then he showed an example of how Alaskans benefit from a single seismic program. The Aklaq program earned \$49 million for Alaskan contractors and suppliers, he noted. Seismic creates images of the subsurface so companies can decide where to lease and where to drill. Kuukpik SAE does not drill or develop oil, but its data is typically sold or licensed to oil companies. "That ultimately was

contemplated in the tax credit system when it was first created," he stated. There were special provisions to encourage companies to collect seismic data so there would be more exploration drilling. The state agreed to pay tax credits to companies to invest in seismic work, and when the data is used by an oil company, the state "gets a piece of that action—or a refund for a particular tax credit." The state will also own the seismic data, he explained, and it can do whatever it wants with the data after 10 years.

[3:40:55 PM](#)

MR. HASTINGS showed a chart of historic seismic investment and programs in the state from 2012 to 2017. The vertical axis shows the dollars spent, and he noted that after SB 21, seismic work increased. "It allowed us to compete for global dollars and create the type of environment that the seismic data resulted in new reserves in Alaska." It was not only legacy producers, but it was independents going to work. These were seismic companies that were creating the seismic data with no intent on producing, he explained. The chart shows the tax appropriation cut in the fall of 2016 and the second cut in the summer of 2017. The vetoes in 2015 and 2016 had several negative effects on the seismic industry. Capital spending slowed down with contractors, and there was no visibility or confidence in the state's willingness to settle what it owed. The capital that was available to small companies, like Kuukpik SAE, is all but dried up, he said. Many contractors are waiting to be paid for work done up to two years ago. "You asked the companies to invest in seismic and exploration drilling, and the companies did just that," he said. They did so because the state was willing to help fund them, and now the state is not paying the bills and rules are being reinterpreted, which has resulted in a stalled system. The seismic sector is typically the first to go.

[3:44:24 PM](#)

MR. HASTINGS said there is no clear timeline for paying tax credits. "When will the 0-25 credits be processed?" The seismic tax credits are simple applications and have been sitting in DOR for over a year. He explained that recent interpretations of the regulations have eliminated a thin secondary market; the DOR tax division advisory bulletin, 2017-01, said that legacy field producers cannot use any of the tax credits to reduce their tax below the 4 percent minimum. It effectively eliminates his company's ability to sell the few certificates it has been issued to other qualified taxpaying companies.

[3:45:33 PM](#)

MR. HASTINGS said the state can help by creating a timeline for processing the seismic exploration credits. It was never envisioned that a seismic explorer would drill for oil, he stated, the obligation was to fund the seismic program and provide the data to the state. Also, "we need to reestablish the secondary market" by allowing tax credits to be used by producers to reduce their tax below the 4 percent minimum. Alaska needs to restore confidence and show that it can be competitive. The state created the program, which is the first step in putting more oil down the pipeline.

[3:46:59 PM](#)

MR. HASTINGS said his company has answered the call and has delivered the data, and now the state has to live up to its end of the deal. Kuukpik SAE has two options, and one is to file for bankruptcy and leave its vendors hanging. He noted that he has an office in Senator Meyer's district and has been in Alaska since 1986. His company chose, instead, to restructure and work with its subcontractors to find a way to extend the payments to allow the state time to pay its bills. By restructuring, the company eliminated 98 percent of shareholder equity, many of which were held by employees. Seismic data is the basis for exploration, so "you can think of us as the canary in the coal mine. We've been hit hard by the state's unwillingness to pay for the exploration tax credit, and if the canary's having problems breathing, the rest of the miners are going to have the same effect." There have been difficult choices, and HB 111 will further damage the industry.

CHAIR GIESSEL said she appreciated his testimony.

SENATOR VON IMHOF referred to the applications for tax credits that DOR has been holding and asked about their value.

MR. HASTINGS said the .023 credits that are currently being processed under the 120-day statutory minimum is about \$32 million. The .025 credits are around \$44 million.

SENATOR VON IMHOF asked about the connection of the tax credits and HB 111.

MR. HASTINGS said his point is that there is already an issue with the tax credit payments. By creating ring fencing around where capital expenses can be used, "then how does an exploration company transfer those credits back in if there is a secondary market?"

SENATOR MEYER said it is depressing, because it sounds like there is not much activity on the North Slope these days.

MR. HASTINGS said his 2018 forecast has the same or less seismic activity as in 2017, which is down from the apex.

SENATOR MEYER said seismic has to occur before any discovery, so it is not a good sign. He asked how much the state owes him.

MR. HASTINGS said, "We currently have certificated \$24 million worth of .023 credits, and we are an assigner of another \$77 million worth of credits that have yet to be issued."

[3:53:36 PM](#)

SENATOR STEDMAN said that is not a fun position for anyone to be in, but no sovereign gives an open-ended call to the treasury—nowhere in the world. There are limits put on severance tax, or, in this case, there is a credit bank that we fund, and there's a calculation for that for the minimum funding, and we're funding that. He said his point is that it is getting caught up in a down draft, because it is just not done to have open-ended calls on the treasury, or there would be no treasury. "So, how do we work ourselves out of this mess?" There needs to be a solvent state and a solvent industry to move forward, and there has been good news lately. There is more oil out there to find. This is not the end, it may be the beginning. "So, we'll try to work through these budgetary issues, but we have a mechanism that was put in place to protect the treasury on the downside, and I recognize, at the end of the day, these credits either are directly paid by the state or they're sold and someone else deducts it, and at the end of the day it comes out of the cash flow coming to the state." He said he does not have any answers to that, but it is not up to just one branch of government.

[3:55:45 PM](#)

MR. HASTINGS said that the Colville River area "has been shot over and shot over for decades," and companies are making large discoveries now with new technology and [higher] resolution seismic data. Bills such as SB 21 allowed the state to participate financially so that that type of technology could be used to increase production, and that needs to continue to happen. He said everyone understands not having an open-ended treasury bill, and the legislature worked hard to put the proper appropriations into the budget that were vetoed and cut. He said that when his company is faced with the same types of scenarios, it finds a way to bridge that gap. The state has a huge savings account and has billions of dollars of in-ground reserves that

the state will get royalty for, he said. The commodity price is depressed, but the state has the assets available to find a way to pay its bills.

[3:58:26 PM](#)

SENATOR HUGHES asked if Kuukpik SAE had made any arrangements with producers regarding credits prior to the advisory bulletin. She asked if that would handle the \$100 million.

MR. HASTINGS said the company had a secondary market that it was selling credits to. There was a willing buyer and a willing seller, and it was a very equitable deal. "We were satisfied with the monies that we were recovering even though they weren't large lump sums; they were enough to help cash flow our company."

SENATOR HUGHES asked if the advisory bulletin came out in January.

MR. HASTINGS said the one he referenced came out about two weeks ago.

SENATOR HUGHES asked if that was "enough to turn this around for you."

MR. HASTINGS said the downward arrow on his slide represents all seismic programs that were acquired by a seismic explorer, a seismic company, an independent, or a legacy producer. Although the commodity price is dropping, "we're seeing a deterioration in the confidence in the Alaska industry." He noted that the committee has heard all day long what SB 21 did for the state. As the confidence begins to erode, people take global dollars to other places. He said his company might be able to sustain itself "in a two-seismic program environment," but to put more oil down the pipe, which is what we are all here to do, "we need to do something to incentivize people to go to work."

SENATOR HUGHES asked if a provision to allow producers to use Mr. Hastings' credits would increase the activity. The chart shows a decrease in activity. "If we're doing away with the capital credits, would this provision not only help you recoup, but also increase the activity, because, as Senator Meyer brought up, that really has so much to do with what we might see in the future and is important to be ongoing?"

MR. HASTINGS said he worked as a prime contractor and seismic explorer. When he was a seismic explorer, "those are capital

dollars that we commit to a program and then we license to the industry." If there is a market that includes a secondary market or a payment plan that can be depended on, from the state, "then, yes, we would invest in more seismic programs."

SENATOR MEYER asked if Alaska is the only place he works.

MR. HASTINGS answered that his company started in Alaska in 2008, and that forced it into a more global market. It now services about 15 countries worldwide, but Alaska is still the foundation of the company.

PAT GALVIN, Chief Commercial Officer, Great Bear Petroleum, Anchorage, said the committee has not heard from a true exploration company yet today, but that is what Great Bear Petroleum is. It is exploring on the North Slope and has expended \$250 million to date on three exploration wells and on about 500,000 acres of 3-D seismic, which has identified a number of very attractive conventional prospects where Great Bear intends to do exploratory drilling next winter. The company is under same stress as other companies since it has no cash flow, he said, and it has a tremendous obligation to its creditors. Great Bear borrowed against the tax credits, but the state did not pay, "so we have no cash to pay the lenders." He needs to know if the state is going to identify a plan to pay off the tax credits in a reasonable period of time.

MR. GALVIN noted that HB 111 ends the cash payments for tax credits. His concern is if his company will "be able to recover our costs of exploration when we actually have production and recover that against our revenue before the tax is calculated." He said, under his company's economic model, being able to deduct those expenses if they are not available as a credit will be "an absolutely essential part of our recovery for our investors." It will be the number one consideration as it tries to attract other investors. There are other provisions in HB 111, that are problematic, he added, but there are a lot of moving parts, so he will not go through the bill's specifics. There is political pressure to change the oil tax system, and Great Bear Petroleum respects that. As a company that will be subject to the tax system, it needs stability and something that it can rely on. The last 10 years have not been stable, and the state needs equilibrium.

[4:08:55 PM](#)

SENATOR HUGHES asked how ring-fencing affects explorers.

MR. GALVIN said it depends on how it will be defined. As a new company, Great Bear does not have production, but its portfolio of prospects is likely to come on line in a series as opposed to all at once, so as the company invests in capital for the initial development it will be spending a significant amount of additional capital just to put the infrastructure in place, which would then be used for the economics of the next project. If the projects are ring-fenced, it could significantly affect the ability to spread the costs from the additional production and make it not economic. The identity of his company was originally tied to the unconventional resource "that we see on our acreage—the shale resource." The shale resource can be developed eventually, and it may be huge, but unconventional oil development in Alaska at current prices is not economic for the initial investment and the infrastructure required. He said the company believes that by developing conventional resources, that infrastructure can then be used to economically develop the unconventional oil. Ring fencing may preclude that option.

[4:11:12 PM](#)

SENATOR MEYER stated that when Great Bear came to Alaska, Mr. Galvin was the commissioner [of the Alaska Department of Revenue], and there were high hopes that the company was going to drill a lot more than three wells. He asked if the company has only drilled three wells because the original plan was to target unconventional oil.

MR. GALVIN answered that there was "strong misconception about some initial testimony that was done by our founding president who is no longer with the company." The president testified as to what an unconventional development would look like, and he provided information showing that hundreds of wells would be required in order to develop an unconventional resource, similar to projects in Texas and the Bakken [formation]. Mr. Galvin explained that the testimony was not a statement of what Great Bear was going to do in the next three to five years. "It was a statement of if we make a discovery and are able to develop the unconventional resources, this is what's going to come, and the state better be prepared to support that if it wants to see that take place."

MR. GALVIN noted that Great Bear did drill the first two wells and identified that the shale resource does exist, but it then encountered the cost environment on the North Slope, and the drop in oil prices, making the unconventional play beyond its reach. However, Great Bear was fortunate that it identified the need for 3-D seismic and was able to acquire that each year for

the last five years. The seismic identified a number of conventional prospects "that we believe will be able to support the economics of the North Slope, even in today's price environment." What the president said may happen, but it will be "a number of years out, once we've built out the infrastructure in that area."

CHAIR GEISEL announced that a hearing for public testimony will be held at 5 p.m. today, and she held HB 111 in committee.

4:14:15 PM

There being no further business to come before the committee, Chair Geisel adjourned the Senate Resources Committee meeting at 4:14 p.m.