

SENATE FINANCE COMMITTEE

May 1, 2023

1:39 p.m.

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CALL TO ORDER

Co-Chair Olson called the Senate Finance Committee meeting to order at 1:39 p.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Donny Olson, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Click Bishop
Senator Jesse Kiehl
Senator Kelly Merrick
Senator David Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Kara Moriarty, President and Chief Executive Officer, Alaska Oil and Gas Association; Rich Ruggiero, CEO, In3nergy; Robin O. Brena, Managing Attorney, Brena, Bell, and Walker.

PRESENT VIA TELECONFERENCE

Mark Myers, Former Commissioner, Department of Natural Resources, International Energy and Natural Resources Consultant.

SUMMARY

SB 114 OIL and GAS PRODUCTION TAX; INCOME TAX

SB 114 was HEARD and HELD in committee for further consideration.

#sb114

SENATE BILL NO. 114

"An Act establishing an income tax on certain entities producing or transporting oil or gas in the state; relating to the oil and gas production tax; and providing for an effective date."

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KARA MORIARTY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ALASKA OIL AND GAS ASSOCIATION, (AOGA) introduced herself.

RICH RUGGIERO, CEO, IN3ENERGY, began with slide 10 of the presentation, "SB 114 Senate Finance May 1, 2023" (copy on file):

- SB114 aims to "level the playing field" among producers, targeting in particular corporate filing status. But a fiscal system should also be able to properly differentiate between:
 - Existing vs new producers
 - Existing vs new fields
 - Single project vs multi projects
 - TAPS financial interest vs no TAPS financial interest
 - New field developer vs aging field harvester
 - Large vs Mid vs Small producer
- Part of the complexity of the Alaska petroleum tax system is it has tried to address many differences and nuances, often creating unintended consequences that have to be addressed again in the future

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Mr. Ruggiero addressed slide 11, "Same Playing Field, Same Facts":

- In order to make an informed decision on SB114 the legislature needs to ensure that they:
 - Understand the terminology of AS43.55 and order of operations
 - Insist statements of 'fact' are backed with independent data
 - Be aware things are not taken out of context and improperly referenced
- We have reviewed the recently submitted public comments, as well as past ballot initiative public

data, and believe there are some misconceptions that should be cleared up:

- Alaska has been receiving its 1/3 share of the wealth
- Alaska's overall percentage state take is among the highest in the US
- Producers deducting from income money they spent is not a giveaway or loophole, but something that is fundamental to almost all petroleum fiscal systems and business taxation in general

Mr. Ruggiero pointed to slide 12, "For the Maximum Benefit of the People":

"The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the state, including land and water, for the maximum benefit of its people"

- This is a common government stewardship role for natural resources
- Constitutional or stewardship obligations are often quoted as reason to raise taxes
- Alaska needs to have a common, transparent understanding of what "maximum benefit" is to ensure suggested changes, like SB114, work toward that end
- The definition of maximum benefit always boils down to a balance issue between short term needs and long term growth
- The challenge is always to try and find that sweet spot
 - Where state needs are met, state goals are achieved, and producers have a sustainable business climate to operate within

Mr. Ruggiero pointed to slide 13, "Achieving Alaska's 1/3 'Fair Share'":

- The most often quoted definition of fair share comes from the writing of Governor Hammond, wherein he notes that at the time of the approval for TAPS the producers, Alaska and the federal government agreed to an even split of the resultant "wealth", giving 1/3 to each party
- This split has often been misrepresented as an agreement to a 1/3 split of revenue, but instead it is a split of "wealth", or profit

- It is impossible to give producers just a 1/3 split of gross revenue, as that amount would not even cover costs to operate and royalties

If "share" is on gross (versus net) then there would be no producers in Alaska

Mr. Ruggiero addressed slide 14, "Achieving Alaska's 1/3 Share":

- This graphic suggests that in the long run Alaska has received its 1/3 share of the oil wealth
- With a \$403 billion total wellhead value (net) of Alaska production, the states portion of \$141 billion represents a 35 percent share
- The remainder of the \$527 covered expenses, federal taxes and producer share

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Mr. Ruggiero looked at slide 15, "Tax Decrease Greater Than Oil Price":

- It has been incorrectly presented that during a time period the percent decrease in oil taxes paid was greater than that decrease in oil price, caused by per barrel credits
- The difference in percentages had nothing to do with credits, as at the low price the preliminary net tax was less than the gross min tax
- Costs do move up and down with oil price, although with a time lag
- The seeming disproportionate drop in taxes paid is because the \$43/bbl case has low PTV (\$3/bbl) due to heavy cost burden

Mr. Ruggiero addressed slide 16, "Takeaways":

- There needs to be a transparent understanding of what it means to steward the state's natural resource for the maximum benefit of the people
- There are many statements being made that are not supported by facts
- If the statements being made are true and that Alaska has truly been too generous, not taken its fair share of the wealth and offered too many giveaways and incentives, then why aren't oil companies knocking

down the doors to get their own overly generous share of the pie?

Mr. Ruggiero looked at slide 18, "Today Very Different Than the Past":

The headwinds facing producers today are not the normal cyclical issues of the past: e.g. oil embargo, global politics, war, economic crashes, pandemics, etc. The current global green movement is a major fundamental shift of direction leading to a much riskier and uncertain future.

Mr. Ruggiero highlighted slide 19, "What is Different Now vs. the Past?"

Late 70s

- Much of the world closed to oil investment
- Coming off the heels of the oil embargo
- Alaska offered world class resources and energy security
- Dollars readily available
- Energy Security

Mid 2000s

- Countries competing for investors
- Several new prolific basins
- Emerging life cycle players
- Private equity funding
- Barrels readily available
- Fiscal system versus fiscal system
- Technology opening new resources
- Differing expectations of investors

Today

- Many calling for the end of fossil fuels
- Financial institutions refusing to fund
- Green movement has great momentum
- Peak oil
- Dwindling Investors
- Balance sheet funding
- Short cycle vs long cycle

Mr. Ruggiero pointed to slide 20, "What is Different Now vs. the Past?"

Prior presentations on Alaska's competitive position, at best are a starting point but by no means indicative of where Alaska stands today and what Alaska needs to do to be competitive and attract investment

The 1/3, 1/3, 1/3 sharing concept does not make Alaska competitive Today, Alaska (long lead time, high cost, environmentally sensitive) needs a COMPELLING fiscal system, not just a competitive fiscal system, to attract much needed investment Every other regime is trying to figure out how to navigate the new 'green' world

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Senator Bishop asked about the WTI be folded into the Brent "basket."

Mr. Ruggiero replied that he could not provide an informed position.

Senator Kiehl looked at slide 10, and wondered whether there was enough information to build a tax system for all.

Mr. Ruggiero replied that there was an examination of the impact of alternative energy.

Senator Kiehl wanted to ensure that there was enough information to run the scenarios and make the predictions.

Mr. Ruggiero pointed to slide 21, "Confronting Climate Change":

- When will climate change mitigation efforts diminish demand for oil?
 - Projects with long lead times and extended periods of production, like most in Alaska, are at high risk of not proceeding
 - Developments with quick cycle times, like shale developments, are now much more desirable
- Oil company reaction to the green movement covers a wide range
 - Remain steadfast
 - Retool

- What is the timing of technology development and approvals for critical non fossil fuel alternatives (and their significant impact on fossil fuel demand):
 - e.g. airplanes, electronics, medical equipment, pharmaceuticals

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Mr. Ruggiero looked at slide 22, "Takeaways":

- We used to think the world would reach peak oil production and decline because of diminished resources, but today peak oil will likely be determined by the push for greener renewable energy
- In a transition away from fossil fuels, what is Alaska's overall plan of how to respond and achieve maximum value for its resources?
 - Finite and undetermined period of time for oil revenues
 - The state needs producer partners in this transition
- What long term plan necessities is the state considering?
 - New developments
 - Future power and heat
 - Field abandonment
 - Facility abandonment
 - Changes to shipping rules
 - Refinery shutdowns
 - Carbon taxes
 - Etc.

The past is no longer a good indicator of the future. New scenarios need to be evaluated and new plans agreed

Mr. Ruggiero addressed slide 24, "Can't Change One Part Without Impacting the Whole":

- Government take is but one piece
- Alaska has an overly complex system for administering energy taxation
 - Numerous allowed and disallowed costs
 - Price triggers versus profit triggers
 - Net tax system but with a gross tax floor
 - Many different degrees of differentiation

- Over the last decade, \$100s of Billions spent in countries and states with higher government take than Alaska. So clearly, rate alone is not the determinant issue
- Most people and policy makers don't understand how the Alaska system works and compares in total to other regimes

Mr. Ruggiero discussed slide 25, "Takeaways":

- Historically, tax system terms other than the headline rate have driven producer investment decisions
- The uncertainty surrounding future demand has created an elevated level of risk
- Producers will very likely give preference to regimes that offer the rapid recovery of capital along with uplift to compensate for the time value of money
- Producers evaluate projects based on their out of pocket costs, not just those allowed by a regime's tax code. Therefore their economics will be nowhere as good as you are calculating for them

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Mr. Ruggiero pointed to slide 27, "What is Driving this Legislation?"

- "Windfall profits ignores the offsetting asset write downs during 2 downturns in the 2010 2020 period; producing oil at a loss
- "New, lower federal corporate tax rate ignores lowered for all US operations/operators. Also ignores changes in taxation outside the US
- "Closing loopholes" There are no loopholes, only persons or companies paying their taxes based on how the tax code is written. State knew of Hilcorp corporate status before their purchases
- "We're just reducing government subsidies [the tax credits] ignores that each aspect of the fiscal policy is part of a multifaceted system that is all part of an overall package; any change disrupts the balance of the overall system
- "Level the playing field but instead of improving terms for new players, which would greatly help in bringing on new oil, SB114 appears to worsen terms for legacy players

- "It's just a small rate change. We're still lower than many countries with investment." Incorrectly boils regime differences down to a single factor, government take

Mr. Ruggiero pointed to slide 28, "SB 114 Attempting One-off Changes to A Complex Integrated Tax System":

- Alaska remains, and will remain for some time, highly dependent on petroleum revenues
- Therefore, what are Alaska's goals for oil and gas production in the state?
 - Is it simply to generate revenue now?
 - What about the future?
- Does SB114 move the state closer to any agreed long term goals?
- SB114 appears to be short term revenue stop gap solution
- Historically each time a one off change has been made, unintended consequences have arisen
 - To be expected with a complex system of interconnected parts

Mr. Ruggiero looked at slide 30, "Attracting New Producers":

- Section 1 looks to be specifically targeting one company to force them to pay Alaska corporate income tax
- Justified as 'leveling the playing field'
 - Which producer is being harmed by the 'uneven' playing field?
 - How will a level field improve production or incentivize investment?
- Revitalizing old mature fields is very different to developing new fields
 - Some of Alaska's legacy fields are over 40 years old
 - Mature field, or old field, operations are different to new field operations
- A 'level' playing field always inherently helps some operations and penalizes others
 - Old versus new
 - Conventional versus unconventional
 - High unit cost versus low unit cost
- Unclear how SB114 in this regard will attract new players or capital

Mr. Ruggiero pointed to slide 31, "Dangers of Wrong Changes":

- Numerous state agencies knew of the different form of incorporation when the sale and purchase of North Slope assets was approved
- Private investment was attracted to the state under one set of economic circumstances, which will be negatively altered if SB114 passes
- If this should somehow impact the producer, it is the only operator with critically important Cook Inlet operations as well
- As Alaska's fields mature, unit costs go up and margins grow smaller. Instead of attracting the right kind of investors, this move could stop other needed mature field experts from coming to Alaska
- In a period of growing shareholder activism, privately held companies offer Alaska a producing partner not under those same pressures

Mr. Ruggiero discussed slide 32, "Takeaways":

- LLCs and S Corporations are the preferred structure for single owner or several member owned companies. These companies are smaller, nimbler and have fewer resources
- SB114 sends a negative message to small, independent oil and gas companies that may be considering investing in Alaska. In particular, the Cook Inlet basin, where all natural gas producers are S Corporations
- Smaller, privately owned companies have begun investing in Alaska as they are generally less susceptible to pressure from activists
- Smaller privately owned companies typically have more efficient management structures that allow them to make quick capital allocation and investment decisions
- Being less susceptible to pressure from activist groups these smaller entities can better align with Alaska's long term interests

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Mr. Ruggiero looked at slide 34, "Reducing the Credits":

- ACES was a 25 percent base tax with positive progressivity and numerous investment incentives
- MAPA is a 35 percent base tax with negative progressivity and a reduced number of incentives
- The per barrel credits were not a "giveaway" but part of the core value of a package of terms to hit an overall effective tax rate
- During hearings on SB21 an extremely large number of modeling runs were made and presented covering a very wide range of possible prices
- Even though forecasts at the time did not predict the very high and low prices experienced since 2013, the modeling did cover the full range

Mr. Ruggiero addressed slide 35, "High Level Look at Credits":

- In3nergy (2019) --"The long term DOR forecast is for prices to remain in the range of \$70 per barrel With this in mind, it is unlikely, but not impossible, to envision that the contemplated reduction in tax credits would severely hamper any planned or possible spending."
- At \$70 per barrel our modeling suggested roughly only \$5 per barrel of credits being needed to reach the gross minimum tax floor, so a change from \$8 to \$5 should not have an impact or be problematic
- The minute you change oil price, transportation cost, OPEX or CAPEX, the resulting economics and impacts will change
- Much like our modeling, the fiscal note initially of SB114 impacts shows the possible impacts for one set of price and costs. It doesn't take much of a change to either price or costs to change the position to no real impact or possibly a substantially large impact

Mr. Ruggiero looked at slide 36, "Takeaways":

- The sliding per barrel credits are part of an integrated package
- Credits and deductions are standard global mechanisms in fiscal systems
 - Per barrel credits are not giveaways
 - OPEX and CAPEX deductions are not giveaways
- The large credit level below \$80 was to offset the regressive impact of royalty and the gross minimum tax

- If passed, the reduced credits will impact each taxpayer differently, thus influence future investments differently
- At the current cost structure there is a 'sweet spot' for the use of maximum credits around \$80. As prices fall, the lack of taxable income negates the need for credits

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ROBIN O. BRENA, MANAGING ATTORNEY, BRENA, BELL, AND WALKER, discussed the presentation, "Comments to Senate Finance Senate Bill 114 By Robin O. Brena" (copy on file). He looked at slide 2, "Speaker Introduction":

Robin O. Brena is a lifelong Alaskan. He is the founder and managing attorney of the law firm Brena, Bell and Walker, P.C. (BB and W). BB and W has been named a Fortune 500 "Go To" law firm, an INTL "Client's Choice Construction Law Firm of the Year in Alaska," and a Global Law Experts "Commercial Litigation Law Firm of the Year."

Robin has decades of experience litigating complex, multi-party oil and gas, taxation, and regulatory matters on behalf of major oil companies, municipalities, public utilities, and Alaskans. He has successfully litigated several cases in which greater than one billion dollars was at issue.

Robin has a B.A. degree from New College, an M.B.A. degree from the Atkinson Graduate School of Management, a J.D. degree from Willamette University College of Law, and an L.L.M. degree from the University of Miami School of Law.

Robin has been repeatedly named as one of the "Top Attorneys in Alaska"; as one of Alaska's "Super Lawyers" in the areas of oil and gas, public utilities, and business litigation; as the Leading Complex Civil Law Trial Attorney of the Year (Alaska); as a Lifetime Charter Member of "Best Attorneys of America"; as one of America's Top 100 Attorneys

(Alaska); and as a Lawyer of Distinction for excellence in Oil and Gas law.

Robin is licensed to practice law in the State of Alaska and the State of Texas, as well as to practice before the U.S. Supreme Court, the D.C. and Ninth Circuit Court of Appeals, and the U.S. Tax Court. He has taught and guest lectured at UAA and Willamette College of Law. He was also the Chairman of the Oil and Gas Subcommittee for Governor Walker's transition team.

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Mr. Brena looked at slide 3, "The Legislature's Constitution Duty":

Article VIII Section 2:

The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for the maximum benefit of its people

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Mr. Brena addressed slide 4, "Primary Mechanisms to Realize the Maximum Benefit for Alaskan's Oil":

- Corporate Income Taxes
- Royalties
- Production Taxes

Mr. Brena discussed slide 5, "Corporate Income Taxes Underperform":

- Since 1977 when production for the Alaska North Slope began, all the major producers in Alaska have operated as publicly traded C Corporations
- As a publicly traded C Corporation, BP paid corporate income tax in Alaska
- When BP sold its Alaskan interests to Hilcorp the income associated with BP's former interests was no longer subject to corporate income tax in Alaska simply because Hilcorp does not operate as a C Corporation

- All major producers in Alaska should continue to be subject to paying corporate income tax in Alaska

Mr. Brena addressed slide 6, "Royalties and Production Taxes Underperform":

- Other States
 - Texas: 29.6 percent of Gross (NC)
 - North Dakota: 28.7 percent of Gross (NC)
- Alaska Before SB21: 27 percent of Gross (1977 2014)
- Alaska Since SB21: 16.5 18 percent of Gross (2015 2022)
 - \$4.5B total production taxes
 - \$5.6B total per barrel credits

Mr. Brena highlighted slide 7, "Royalties Underperform":

- Typical Royalties
 - 25 percent: Texas/Arkansas/Private
 - 20-25 percent: Louisiana/Colorado/New Mexico
 - 16.7-20: North Dakota/Wyoming/Utah/Fed Offshore
- Alaska's Royalties
 - 12.5 percent: Alaska

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Mr. Brena discussed slide 8, "Production Taxes Underperform."

Mr. Brena highlighted slide 9, "Prudhoe Bay Unit Underperforms (2018)."

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Mr. Brena displayed slide 10, "Production Tax Credits Underperform."

Mr. Brena pointed to slide 11, "Production Tax Credits Underperform (O and G Jobs)."

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Mr. Brena discussed slide 12, "Reasons for Underperformance":

- Lack of Legislative Oversight
- Lack of Transparency

- Unnecessary Complexity
- Corporate Tax Structure Not Kept Current
- Royalty Too Low
- Production Tax Rates Too Low
- Unnecessary and Excessive Credits
 - Legal Duty / Sufficient Economics / Benefits Should Exceed Credits
 - Credits Tied to Actual Investment
 - Giving Production Credits to Fields in Production for Decades Without Credits
- Underestimating Our Current Oil Wealth"

Mr. Brena addressed slide 13, "Economic Impacts of Senate Bill 114":

- The Source of Additional State Revenues is Critical to Alaska's Economy
- Senate Bill 114 Will Help Alaska's Economy
 - It will retain a higher portion of our oil wealth in Alaska that would otherwise leave Alaska.
 - This will add new money into Alaska's economy that will have a multiplier impact.
- Many Other Potential Sources of Revenue Will Hurt Alaska's Economy
 - Income taxes and sales taxes primarily reallocate money already in Alaska's economy.
 - This reallocation from the private to the public sector will hurt Alaska's economy.
- The Alaskan Economy Will be Much Better Off if the State Funds its Budget Deficit by Retaining More of our Oil Wealth in Alaska than by Taxing Alaskans.

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MARK MYERS, FORMER COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, INTERNATIONAL ENERGY AND NATURAL RESOURCES CONSULTANT (via teleconference), provided his professional background. He stated that the objective of his testimony was to provide a balanced perspective.

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Mr. Myers continued with his testimony. He remarked that the companies had created a system to show how they have managed their net profits to the government. He warned against modeling that had been paid for by vested interests, and urged to look for biases in the approach.

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Mr. Myers continued with his testimony. He remarked that there would be a significant decline of the use of oil worldwide. There would be less future investment in Alaska. He noted that the transformation would be more significant than the shale revolution.

Mr. Myers continued with his testimony. He recommended that SB 21 should not be credited for the new fields.

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Senator Bishop wondered about the WTI being folded into Brent, and its impact on ANS prices. He also asked about polymers.

Mr. Myers replied that Brent was a lighter crude oil than ANS, and noted that Brent often had a higher value, so it could have overall a positive impact. He stated that polymers were helpful in water zones in the recovery of the oil.

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Co-Chair Olson stated that public testimony would be postponed to another day.

SB 114 was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

[3:13:39 PM](#)

The meeting was adjourned at 3:13 p.m.