

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 1, 2016

1:00 p.m.

DRAFT

MEMBERS PRESENT

Representative Benjamin Nageak, Co-Chair
Representative David Talerico, Co-Chair
Representative Craig Johnson
Representative Kurt Olson
Representative Paul Seaton
Representative Andy Josephson
Representative Geran Tarr

MEMBERS ABSENT

Representative Mike Hawker, Vice Chair
Representative Bob Herron

COMMITTEE CALENDAR

HOUSE BILL NO. 247

"An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax for certain oil and gas production; relating to the minimum tax calculation for monthly installment payments of estimated tax; relating to interest on monthly installment payments of estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition for "qualified capital expenditure"; adding a definition for "outstanding liability to the state"; repealing

oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payments for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures applicable before January 1, 2011; making conforming amendments; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 247

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

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/19/16	(H)	READ THE FIRST TIME - REFERRALS
01/19/16	(H)	RES, FIN
02/03/16	(H)	RES AT 1:00 PM BARNES 124
02/03/16	(H)	Heard & Held
02/03/16	(H)	MINUTE(RES)
02/05/16	(H)	RES AT 1:00 PM BARNES 124
02/05/16	(H)	-- MEETING CANCELED --
02/10/16	(H)	RES AT 1:00 PM BARNES 124
02/10/16	(H)	Heard & Held
02/10/16	(H)	MINUTE(RES)
02/12/16	(H)	RES AT 1:00 PM BARNES 124
02/12/16	(H)	Heard & Held
02/12/16	(H)	MINUTE(RES)
02/13/16	(H)	RES AT 1:00 PM BARNES 124
02/13/16	(H)	-- MEETING CANCELED --
02/22/16	(H)	RES AT 1:00 PM BARNES 124
02/22/16	(H)	Heard & Held
02/22/16	(H)	MINUTE(RES)
02/24/16	(H)	RES AT 1:00 PM BARNES 124
02/24/16	(H)	Heard & Held
02/24/16	(H)	MINUTE(RES)
02/25/16	(H)	RES AT 8:30 AM BARNES 124
02/25/16	(H)	Heard & Held
02/25/16	(H)	MINUTE(RES)
02/25/16	(H)	RES AT 1:00 PM BARNES 124
02/25/16	(H)	Heard & Held
02/25/16	(H)	MINUTE(RES)
02/26/16	(H)	RES AT 1:00 PM BARNES 124

02/26/16	(H)	Heard & Held
02/26/16	(H)	MINUTE(RES)
02/27/16	(H)	RES AT 10:00 AM BARNES 124
02/27/16	(H)	Heard & Held
02/27/16	(H)	MINUTE(RES)
02/29/16	(H)	RES AT 1:00 PM BARNES 124
02/29/16	(H)	Heard & Held
02/29/16	(H)	MINUTE(RES)
02/29/16	(H)	RES AT 6:00 PM BARNES 124
02/29/16	(H)	Heard & Held
02/29/16	(H)	MINUTE(RES)
03/01/16	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

DANIEL SECKERS, Tax Counsel, Upstream Business Services
ExxonMobil Corporation
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 247.

J. Benjamin Johnson, President, CEO
BlueCrest Energy Inc.
Fort Worth TX

POSITION STATEMENT: Provided a PowerPoint presentation about the investment value of the current tax credits and the impacts that HB 247 would have on his company.

DAVID WILKINS, Senior Vice President
Hilcorp Alaska, LLC
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 247, testified that the current system of tax credits is an example of good policy that has achieved positive results.

BRUCE WEBB, Senior Vice President
Furie Operating Alaska LLC
Anchorage, Alaska

POSITION STATEMENT: Assisted in providing a PowerPoint presentation regarding the impacts that HB 247 would have on his company.

DAVID ELDER, Chief Financial Officer
Furie Operating Alaska LLC
League City, Texas

POSITION STATEMENT: Assisted in providing a PowerPoint presentation regarding the impacts that HB 247 would have on his company.

ACTION NARRATIVE

1:00:00 PM

CO-CHAIR BENJAMIN NAGEAK called the House Resources Standing Committee meeting to order at 12:59 p.m. Representatives Nageak, Talerico, Olson, Seaton, and Johnson were present at the call to order. Representatives Josephson and Tarr arrived as the meeting was in progress.

HB 247-TAX;CREDITS;INTEREST;REFUNDS;O & G

1:00:11 PM

CO-CHAIR NAGEAK announced that the only order of business is HOUSE BILL NO. 247, "An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax for certain oil and gas production; relating to the minimum tax calculation for monthly installment payments of estimated tax; relating to interest on monthly installment payments of estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition for "qualified capital expenditure"; adding a definition for "outstanding liability to the state"; repealing oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payments for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures

applicable before January 1, 2011; making conforming amendments; and providing for an effective date."

CO-CHAIR NAGEAK noted that the committee will continue hearing invited testimony from the oil and gas industry regarding the potential impacts of HB 247.

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REPRESENTATIVE JOHNSON requested that Mr. Seckers of ExxonMobil Corporation provide his qualifications as a tax expert.

DANIEL SECKERS, Tax Counsel, Upstream Business Services, ExxonMobil Corporation, stated that was previously a chief appeals officer for the Internal Revenue Service (IRS), has an undergraduate degree in accounting, a minor in economics, two masters degrees, and two law degrees of which one is Masters in Law on Taxation. He has worked for ExxonMobil Corporation ("ExxonMobil") for nearly 30 years and has done Alaska taxes, international taxes, and transactional taxes.

REPRESENTATIVE JOHNSON commented that he wants the committee to know it is dealing with people who are qualified.

CO-CHAIR NAGEAK requested that all witnesses provide comment on the impacts that the changes proposed in HB 247 would have on their respective companies.

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MR. SECKERS thanked the committee for listening to ExxonMobil's views on this troubling legislation. He stated that in today's economic environment, ExxonMobil is committed to Alaska and continues to actively pursue all attractive investment activities in the state. ExxonMobil has had a presence in Alaska for over nine years, has invested over \$20 billion to date, and Alaska remains a very important part of ExxonMobil's worldwide investment portfolio. He recognized that legislators, as policy makers, have the very difficult task of trying to resolve the state's budget problems, trying to maintain current revenue streams, and yet trying to maintain Alaska as a competitive and attractive place for companies to invest.

MR. SECKERS said tax policy decisions fundamentally impact the economic health of Alaska and the companies that are doing business in the state. ExxonMobil believes that tax policy decisions need to move the state forward, not away from, its

vision of oil and gas development. It is critical for legislators to maintain every stable and competitive investment environment. ExxonMobil believes the question that really is before the committee is whether or not to raise taxes on the oil and gas industry at the very time when the companies are reporting significant losses on the very activities that HB 247 is trying to tax. Is it sound tax policy for legislators to do that? Do legislators believe that such action will actually help the state weather these hard times or make matters worse?

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MR. SECKERS said he will break down his comments into three areas: substantive law changes, procedural changes, and tax policy changes. He said ExxonMobil agrees with yesterday's testimony from the Alaska Oil and Gas Association (AOGA), and from each of the other companies, that HB 247: represents a significant tax increase on the oil and gas industry; will not improve Alaska's overall investment climate; will not lead to more jobs or opportunities in the state; and will not help, maintain, or increase oil and gas production levels. ExxonMobil believes that HB 247 will do the exact opposite and for these reasons ExxonMobil opposes HB 247.

MR. SECKERS first addressed the substantive provisions of the bill. He said raising the minimum tax from 4 percent to 5 percent is a tax increase of at least 25 percent on companies on the North Slope on their gross revenues. Raising taxes on companies that are reporting record losses, losses on the very activity that HB 247 is trying to tax, is not sound tax policy. The hardening of the minimum tax floor is also very troubling. Section 17 of the bill would prevent companies from realizing the true economics of their investments by preventing critical tax credits from being used to offset the minimum tax. Disallowing companies from using earned or available tax credits to reduce the minimum tax would represent an immediate and significant tax increase. It would penalize companies that have made prior year investments even when they were losing money. It would penalize companies today that are continuing to make investments even though they are losing money and that are continuing to make investments despite the low price environment. The impacts of Section 17 were summed up well when yesterday AOGA stated that both large and small companies that may have new oil tax credits, exploration credits, drilling credits, tax loss credits, sliding scale credits, new oil credits, and that may be in a loss due to low prices, are all going to be at risk to having such valuable credits either

denied or deferred. In either case, it is a current year tax increase.

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MR. SECKERS offered ExxonMobil's belief that in order to maximize investment in Alaska it is critical to provide investors the opportunity to capture the economic benefit of the investments they've made, especially given the inherent downside long-term risks of capital investments on the North Slope. Section 17 will significantly and negatively impact Alaska's investment climate and the perception of Alaska's investment climate to any future investors by announcing to the world that Alaska is willing to adversely affect the economics of prior, current, and future year investments simply for short-term revenue needs.

MR. SECKERS said Section 17 is also troubling because it would further increase taxes by preventing a company from fully utilizing all available earned or available tax credits from any month to offset the tax for the entire calendar year. This is nothing more than a disguised tax increase, he continued. The production tax is an annual tax that is paid in monthly installments and it has been that way since this provision was put on the books back with the production profits tax (PPT). It is not and has never been a monthly tax. But this change in Section 17 would, in effect, convert, or at least migrate, this tax to more of a monthly tax. This is a significant change in substantive law. Despite what the administration may be alluding to by focusing only on sliding scale tax credits, this provision is much broader than that. This provision would impact every single tax credit available under the production tax law. That means companies with all the credits - small producer credits, Middle Earth credits, and tax loss credits, all of them - would be at risk to having tax credits deferred, or worse, lost forever. That is a tax increase.

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REPRESENTATIVE OLSON asked whether ExxonMobil has done any models on Section 17 that are not proprietary and therefore available to the committee.

MR. SECKERS responded that any modeling done on the bill by ExxonMobil would have confidential data. However, he noted, ExxonMobil agrees with the presentation provided by analytica and he therefore Representative Olson could run his question

through analytica for modeling purposes. He reiterated that Section 17 is troubling and is without question a tax increase.

REPRESENTATIVE OLSON inquired whether Mr. Seckers knows of any other political subdivisions, provinces, states, countries, or emirates that have a tax mechanism that has changed six times in ten or eleven years.

MR. SECKERS replied, "Not to my knowledge."

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REPRESENTATIVE SEATON referred to Mr. Seckers' statement that it has not been monthly since PPT. He said his recollection is that the progressivity element in the taxes was specifically monthly, so it would seem like this element is comparative to that more than to PPT.

MR. SECKERS answered that Representative Seaton is correct that the progressivity piece that was present under PPT and Alaska's Clear and Equitable Share (ACES) was a monthly determination of the rate for that particular month, but tax itself was a year tax. He said the tax itself is calculated on a yearly basis as provided in statute and is the way the Department of Revenue (DOR) has administered the tax since its inception.

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MR. SECKERS continued his testimony regarding Section 17, saying that the monthly payments made by ExxonMobil are estimates. A lot of variables go into it - for example, estimates of the company's expenses as well as estimates of one-twelfth of the company's credits. There is then a final true-up at the end of the year so the taxpayer can determine and pay the tax based on the entire calendar year of operations.

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REPRESENTATIVE SEATON offered his understanding that the progressivity was a monthly calculation that was not trued up at year end or annualized later. To his knowledge, he continued, the sliding scale was put in there specifically to be the progressivity piece and reverse going at low prices, but was specifically put in there to emulate the progressivity that was had in the previous tax bill. It was pretty clear that that was providing progressivity. He requested Mr. Seckers to comment in this regard.

MR. SECKERS responded that, in regard to the sliding scale tax credits, he cannot address the intent behind the thoughts of each legislative member. He agreed it was put on the books as an offset to the elimination of progressivity. He said that the regulations in law today, as well as the way the statutes work, clearly allow that credits that could be used in one particular month are still available for the entire calendar year. So, while the sliding scale credits were determined on a monthly basis, should the economics of that month change, and the economics for the entire year change, the credits that would otherwise have been used that couldn't have been used in a particular month are still available for the entire calendar year. He said Representative Seaton is correct in the sense that the determination of the sliding scale credits is based on monthly production, but it is an annual tax in terms of its actual determination for the year.

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MR. SECKERS returned to his testimony. He said Section 31 would prevent the gross value at the point of production from going below zero, thereby increasing the production tax by changing the way the gross value at the point of production is determined and applied. He allowed that this change may sound harmless at times, and that intuitively it may seem to make sense that a gross tax at the point of production should not go below zero, that there should not be a negative tax. However, he continued, this provision represents another tax increase. It would adversely impact the economics of investments and penalize those producers that made prior-year investments and would create uncertainty as to how a company is to calculate its tax return. Currently, if the price of oil fluctuates, or a company's marine transportation or pipeline tariff costs are such that it forces the gross value at the point of production to go negative at a particular field or unit, the economics of that investment are not lost. Why? Because when a company files its tax return under current law, it is not filed on a field-by-field or unit-by-unit basis; rather, it is filed by segments. In Alaska there are four segments that were created under PPT: two for Cook Inlet oil and gas, the North Slope, and Middle Earth. For the North Slope, ExxonMobil files a consolidated return for the entire segment. So, if there is a negative gross value at the point of production because of an expensive investment or an investment with troubled economics, the negative gross value at the point of production gets offset or combined with the company's gross value of the entire segment and therefore the

economics of that investment are not lost. That's a very valuable thing when companies look at making investments. This provision would instead say that those costs are now lost, that the gross value at the point of production from that field or unit will now be limited to that field or unit. The law doesn't say that, this provision just says it cannot go below zero. There is no indication of how [DOR] is going to apply that. Does that mean by segment or by field? Based on what was testified by the Department of Revenue, a company would have to interpret it by field. If that's the case, then that's a substantive change in the law because it is not determined by field - it is consolidated and a company files one return of all the company's gross value at the point of production minus the expenses. This would be nothing more than a tax increase.

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REPRESENTATIVE TARR understood that the concern is whether it is applied per field or per segment since it is currently being done by segment. She asked whether ExxonMobil would still oppose the provision if it was instead more specific to say that it would be applied per segment.

MR. SECKERS replied certainly, because it would still be a tax increase. The only difference there is if the whole segment is going negative for any big company, then everyone is in a world of hurt. The point is that what will happen by applying this section is that the investments a company has made for its pipeline, its tankers, and so forth - if it forces the economics of that particular investment to go negative - then the company would lose recovery of that part of its economic investment, which would be a change in the tax law and therefore a tax increase.

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REPRESENTATIVE JOSEPHSON maintained that it is a transparent tax increase, not a disguised tax increase as stated earlier by Mr. Seckers. The administration has a number of measures to raise revenue given the state's fiscal situation, he said, and these were not hidden to Mr. Seckers and these are understood by Mr. Seckers.

MR. SECKERS allowed Representative Josephson is right in the sense that it would be apparent to someone who knows what he/she is looking at. However, the reason he chose those words is because HB 247 is being couched as a tax credit reform bill.

[Section 31] has nothing to do with tax credits, it goes to the gross value at the point of production and substantively changes the way a tax is calculated. When the bill was first testified to, this was just glossed over as basically conforming language and it was an alarming provision for that reason. It wasn't flushed out until very later on, causing him concern that "a fast one" was being pulled.

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REPRESENTATIVE JOSEPHSON addressed the issue of monthly versus annual calculation raised by Representative Seaton. He argued that if kept in its current form, and price variability is such that companies cannot use all the credits in a month and so some are carried over, then the state would bear that variability in just about every instance.

MR. SECKERS responded, "Not with the provision as drafted." There are more variables that could cause that event, he said. For example, a company's expenses can go up and down, some expenses are unknown until the end of the year and that's why they are estimates. But, the law says that if, for example, a company claims 12 credits in a given month but should have only claimed 11, then the company must refund that back, it has underpaid its tax at that point. This law says, "oh by the way you claimed 11, you could have claimed 12, you had 12, you can only claim 12, sorry, you don't get to keep them." He noted that consultant Janak Mayer of analytica stated that this is a one directional tax increase, it doesn't go back and forth.

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REPRESENTATIVE SEATON referred to Mr. Seckers' statement that if this was applied by segment [the costs] would be lost. He asked whether Mr. Seckers was meaning they were lost in that year or would roll over as net operating loss credit.

MR. SECKERS answered he is not certain this has ever been tested because he's unaware of a tax credit that's had a negative gross value at the point of production, but he is not saying it hasn't happened. He explained that the calculation would start with the gross value at the point of production to the extent there is negative to it, and then the lease expenditures would be subtracted to determine the net operating loss. He offered his belief that the net operating loss would be increased by those additional deductions and suggested that Mr. Alper [Director of the DOR Tax Division] be asked this question.

REPRESENTATIVE SEATON stated, "We would be doing basically the same thing as the net loss carry forward as we have now, it would just be that the tax wouldn't go below zero in any one year."

MR. SECKERS replied the law is very specific that a company cannot have a negative tax, the worst it can go is to zero.

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MR. SECKERS continued his testimony and offered his agreement with the comments made yesterday by Mr. Foley of Caelus Energy Alaska about the removal of the gross revenue exclusion from the determination of a net operating loss. He said he agrees with Mr. Foley that it is in the law and is an incentive to help develop smaller fields and those with troubled economics. Mr. Seckers said it is a provision that is clearly a tax increase and one that will make those fields more difficult to produce.

MR. SECKERS stated that Section 8 of the bill raises significant concerns in regard to the disclosure of tax credit information.

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REPRESENTATIVE TARR noted that the committee is trying to come up with a reasonable resolution that potentially meets in the middle. In regard to the proposed \$25 million cap, she asked whether there is an amount that Mr. Seckers would consider reasonable. She recounted that yesterday no one who testified would give her a number.

MR. SECKERS qualified he isn't sure he understands the question, but said the proposed "\$25 million annual limit applies to the ability of refundable credits for a company to say this is the most you can have the state refund in any given year subject to other limitations - the local hire and things of that nature." ExxonMobil has never qualified for that, he continued, has never had a refundable credit and will not ever have a refundable credit as long as it can keep its production high enough. So, it may be unfair for ExxonMobil to comment on this provision.

REPRESENTATIVE TARR noted that ExxonMobil would have to use the proposed change against its future tax liability. She inquired whether this is what ExxonMobil is considering a substantive tax increase.

MR. SECKERS answered absolutely. From a general policy point of view when companies make investments and prices tank, they're in a loss position through no fault of their own and they want to recover some of that economic investment. Yesterday the Alaska Oil and Gas Association (AOGA) said that this is critical to some of the companies to continue to make necessary investments in the state - those companies need the recovery today. To deny that recovery by forcing them to be unable to use it against, say, the minimum tax is a pretty big tax increase and, in his opinion, is a major substantive change.

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REPRESENTATIVE JOSEPHSON recalled Mr. Seckers' statement that under Senate Bill 21 there can never be a negative tax. But, he said, it's the credits that can drive it underneath the zero floor and there have been some instances where the net operating loss put the state in a position of paying more than 100 percent of the costs of development.

MR. SECKERS replied that the aforementioned is a two-part question. What he is meaning by a negative production tax, he explained, is that a company cannot go to the state saying it has a negative production tax of \$100 and is owed a check. Under the law, a company goes to zero and that's it; if there is a loss it is carried forward to use against future opportunities or against future production tax or is possibly certificated and transferred. So, a company cannot get a negative current year production tax. As for the ability of the Net Operating Loss (NOL) to go above the cost of development, he said he is uncertain how that gets there. That is not to say that a company couldn't, for example, have a gross revenue exclusion or stackable credits, of which the number can get pretty high. But, in order to have an NOL, a company spends the \$1 and gets a 35 percent recovery, so the company is still out 65 cents. To the extent that that number can get over 100, he said he has not seen it. He suggested asking a smaller company this question.

REPRESENTATIVE JOSEPHSON asked whether Mr. Seckers would agree that it is egregious if it was shown that it could [get over 100].

MR. SECKERS responded it would depend on what the policy of the state is in terms of trying to encourage whatever is causing that investment to go that low - it would have to be a pretty risky investment with a lot of costs. From a tax practitioner's point of view, he said he is not certain he has ever seen that,

so his knee-jerk reaction is that it's pretty rare. However, if the state says it's happening to certain taxpayers, then he believes the state but he has not seen it.

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MR. SECKERS resumed his testimony about Section 8 of the bill, which would allow the Department of Revenue (DOR) to make public information concerning a taxpayer's uses of tax credits as well as information concerning the activities of that taxpayer that gave rise to those tax credits. This information is currently confidential and for good reasons. ExxonMobil is partners with BP, Conoco, and others at Prudhoe Bay and other fields. As partners, certain information is shared in the co-development of the field. But, on a global scale the companies are competitors and, as such, are bound by certain laws to keep certain things confidential; for instance, prices and taxpayer sensitive information. To now allow DOR the liberty of publishing this kind of data, with who knows what limit or no limit, is troubling. He said he agrees with yesterday's testimony by BP, AOGA, Conoco, and others that this is a troubling section. Going down this path opens it up to a risk of full disclosure of taxpayer sensitive, as well as confidential, information.

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REPRESENTATIVE TARR imagined that if this legislation went forward as written, the regulations implementing this provision would be more specific and the companies would have an opportunity to participate in that process to define it. She asked whether this gives Mr. Seckers any level of comfort that ExxonMobil would be able to participate or whether Mr. Seckers thinks it needs to be more clearly defined in the statute.

MR. SECKERS answered that the administration of the tax law belongs to the Department of Revenue, but the regulatory process is not always a give and take. Many times industry will present comments that don't go anywhere. His personal preference is that there always be language in the statute that is extremely clear, extremely point, so that the regulations cannot vary from it. If open-ended language is given to allow the department to interpret it and issue regulations, those regulations can get changed without legislators knowing it and therefore there is not as much check and balance as going through the statutory process.

REPRESENTATIVE TARR requested Mr. Seckers to suggest some changes that would make this grey area more clear.

MR. SECKERS agreed to look at it and said he will try to run it through AOGA so that it would be a consolidated view from the industry.

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REPRESENTATIVE SEATON recalled conversation from yesterday that divulging Net Operating Loss Credits would yield taxpayer information. He asked whether excluding those from the process would have that same consequence to ExxonMobil where it wouldn't relate to taxpayer information, it would simply be the amount that the state is paying to individual companies and projects. He pointed out that legislators are at a loss without knowing where hundreds of millions of dollars are being spent; the money is just gone and legislators cannot find out to make policy.

MR. SECKERS allowed it is a good point and said he understands the concerns. Clearly, he continued, the Net Operating Loss Credit is one of the most concerning because in order to get to that number there could theoretically be a lot of data as well as sensitive data relating to how that credit was earned. The general notion of publishing information by specific taxpayers raises red flags in that it may allow one company to gain favor over another in public press and things of this nature. The devil is in the details, it depends on how it is written and how it is administered and what it actually relates to. He suggested that it could possibly be done by field or unit as opposed to individual companies because companies are investing jointly in that well. That may be a way to provide information that is not so concerning but yet gives legislators the information they need regarding credits. It is really more field or unit specific in this case, he reiterated, than it is the individual taxpayer.

REPRESENTATIVE SEATON said he would appreciate it if Mr. Seckers could suggest a reasonable compromise in this regard.

MR. SECKERS replied he will go back to AOGA to see if language can be found that everyone agrees with - something that is good for one should be good for all. He said he isn't trying to hide behind AOGA, but an advantage of AOGA is that it is looking at it from a global industry perspective, and the stronger the industry is in the state, the stronger is everyone.

1:32:41 PM

REPRESENTATIVE OLSON asked whether, from ExxonMobil's perspective, there is anything in HB 247 that is salvageable.

MR. SECKERS responded that ExxonMobil believes that as a whole HB 247 is a bad bill. He said he is not certain he sees anything in the bill that would make Alaska's investment climate better or that would lead to more jobs or more production. From the perspective of ExxonMobil it is troubling legislation.

1:33:32 PM

MR. SECKERS returned to his testimony to discuss the procedural matters of HB 247. As if the bill isn't bad enough, he said, two of the provisions are made retroactive to January 1. Any time there is a retroactive tax provision there is concern from a tax practitioner perspective. He pointed out that, not only from a business perspective and a policy perspective about investments and judging the regime, by the time the bill was passed taxpayers would have already filed several monthly installments under the current law. This retroactive change would put all the taxpayers at risk of having filing incorrect monthly installments and put all taxpayers at potential risk of penalties and interest through no fault of their own. It would also jeopardize investment decisions that the companies are making, commitments on expenditures, and so forth. Making any law retroactive is troubling and is bad tax policy.

MR. SECKERS reiterated ExxonMobil's belief that enacting HB 247 would impact Alaska's global overall effectiveness and competitiveness. Raising taxes when many companies are reporting record losses, losses on the very activities that HB 247 is trying to raise taxes on, is poor tax policy. This bill will force companies to re-examine short-term and long-term investment behavior and is inconsistent with the state's long-term vision of promoting oil and gas development. The state enacted the PPT and ACES in recent years with the goal of increasing taxes as prices rose. Enacting HB 247 will signal to the global investment community that Alaska's tax policy is to raise taxes when industry makes money and then again when industry loses money. ExxonMobil believes Alaska needs to remain globally competitive for critical capital investments. Increasing taxes on companies that are losing money today will not lead to more jobs, will not lead to more investment, will not lead to more production, and will not lead to more long-term sustainable state revenues.

1:36:12 PM

MR. SECKERS again said Alaska remains a very important component of ExxonMobil's worldwide portfolio; that the company has been in Alaska a long time and looks forward to being in the state for a lot longer. ExxonMobil will continue to pursue attractive investment opportunities in the state, but if HB 247 is passed and the state raises taxes when the company is losing money on the North Slope, then all those opportunities are diminished.

MR. SECKERS concluded by stating that the need for Alaska to maintain a competitive and stable fiscal environment that attracts and encourages critical long-term investments, especially in today's low price environment, is one of the most, if not the most, important issues facing the state. As policy makers, legislators need to decide whether increasing taxes on companies that are losing money, losing money making investments that every Alaskan needs the companies to make, including his own company, is sound long-term policy and will lead to jobs, investments, and sustainable revenues. Is it sound tax policy? ExxonMobil believes the answer to that question is no.

The committee took a brief at-ease.

1:38:47 PM

J. Benjamin Johnson, President, CEO, BlueCrest Energy Inc., began his PowerPoint presentation on HB 247 by noting that while BlueCrest Energy Inc. ("BlueCrest") is a Texas-based company now, it has Alaskan roots. He said he grew up in Kenai, graduated from school there, and worked his way through college on the Cook Inlet platforms and on Prudhoe Bay. After college he worked for ARCO and worked on some of the early engineering studies for Prudhoe Bay and Kuparuk. BlueCrest management has over 40 collective years of experience in Alaska. Since BlueCrest only operates in the Cook Inlet, he said he will limit his testimony to those issues that apply to BlueCrest. He noted that BlueCrest concurs with the Alaska Oil and Gas Association's (AOGA's) presentation to the committee yesterday. He continued:

First, I want to emphasize that with regard to what BlueCrest is doing in the Cook Inlet, the tax program has been a very, very good investment for the State of Alaska. The credits have been a tremendous success in attracting outside investment in the industry, and

most importantly, generating significant royalty and tax income for the state throughout the future.

As I'll explain today, BlueCrest is in Alaska as a direct result of the state's incentive programs. And it is the state's investment - in the forms of the credits - that have facilitated our success in the Cosmopolitan Unit. I'm going to show you that the state's investments in Cosmopolitan tax credits will provide high returns to the state even at low oil prices. In fact, the tax credit investments under the current laws can actually provide higher rates of return to the state than the average investments of the permanent fund.

Secondly, I'd like to just give you a really quick overview of Cosmo, [the Cosmopolitan Unit], and I'll explain the difference between our onshore oil and our offshore gas developments. And I'll show you ... both BlueCrest's calculations and our summary of the DOR's calculations on the value of the tax credits. Lastly, I'll wrap up with just our specific factors in the existing draft of HB 247 and their impact to BlueCrest in particular.

[1:41:30 PM](#)

MR. JOHNSON turned to slide 2, "Cosmopolitan Project Area," to describe this project that is located in the Cook Inlet. He said the field is three miles offshore and is just a few miles north of Anchor Point. All of these are state leases, he noted. BlueCrest also has an onshore surface-use lease where the drill site and production facilities are located. Moving to slide 3, "1967: Pennzoil Found the First Oil - Drilled from Offshore," he outlined the history of the Cosmopolitan Unit. Pennzoil first discovered the Cosmopolitan oil accumulation in 1967 when it drilled an offshore well at Anchor Point. However, that well just barely clipped the edge of the accumulation and there was no way Pennzoil could know what was there. And since 1967 was about the time that Prudhoe Bay was discovered, everyone's focus subsequently turned to the North Slope.

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MR. JOHNSON drew attention to slide 4, "2007: ConocoPhillips and Pioneer had drilled 3 wells and 3D," to continue the history of the Cosmopolitan Unit. He said:

In the late 1990's, ARCO/ConocoPhillips got interested in the area again, and they called it the "missed-pay" prospect thinking that Pennzoil may have just missed it. Well, in 2001 and 2003, ConocoPhillips drilled two new wells, and Pioneer purchased ConocoPhillips' interest and drilled another new well. Pioneer also acquired 3-D seismic over the area and what that showed was that it looked like there was a big dome down there, but they couldn't see anything in the middle of the dome on the top because it had what looked like it could be a gas cloud. There was no way Pioneer could really tell what the shape of the top of it looked like. They knew there was definitely producible oil down at the bottom but they didn't know, couldn't know what was up top. By 2010, Pioneer had already developed a plan to develop the field they were ready to go when in 201 their board of directors decided to invest in West Texas shale plays rather than in the Cook Inlet.

Well, about that time, BlueCrest had just formed by a group of former major oil company executives, each of whom have extensive experience in developing large oil and gas assets. So, our plan was to look for, to find some oil and gas properties that could potentially be improved using our backgrounds and knowledge of industry technology. Now, we evaluated dozens of acquisition opportunities around the US (offshore California, Gulf of Mexico, Wyoming, Colorado, Texas, Louisiana and Alaska). Alaska's huge handicap was, and it continues to be, that the exploration, development and operating costs in the state are at least 300 percent of any other major hydrocarbon basin in the US. But we ultimately decided to invest in Alaska because, through the credit programs, the state was investing in itself, and that investment - the state's credits - offset the higher cost of drilling and development. So we acquired our interest in Cosmo in 2012, and our team came up with a new idea. Our concept was to drill a vertical well offshore.

[1:44:45 PM](#)

MR. JOHNSON moved to slide 5, "2013: BlueCrest Drilled a Vertical Well from Offshore," and continued:

In 2013, we drilled the Cosmopolitan State Number 1 well. It passed through every geologic zone from the sea floor down to about a mile and a half deep. As it turns out, almost every sand we penetrated down for the mile deep was full of producible natural gas. And then all the sands below that to the bottom of the well were full of oil. So, we also completed a vertical seismic profile in the well and then we were able to clear up some of the questions about the previous seismic data. We flow-tested several of the larger new gas sands and a couple of the newly discovered oil zones. We took samples of the rocks, gas, and oil. In summary, not only did we confirm the existence of the two previously known oil sands that Pennzoil, ConocoPhillips, and Pioneer had encountered, we also discovered at least six new large gas zones and four more oil zones.

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MR. JOHNSON turned to slide 6, "Cosmopolitan Unit Development Concept," and explained:

The Cosmopolitan Unit is really two separate development projects, just one on top of the other, they're not connected. The oil zones are deep enough that we can reach them from an onshore drill site about three miles away using a very powerful drilling rig. The gas zones are just simply too shallow to make drilling from [onshore] a possibility. So the gas zones will need to be developed by drilling gas wells offshore with a jack-up rig and then producing that through platforms and back to our onshore oil production facility.

... Given the success of our 2013 drilling program with the Cosmo well, we then were faced with the challenge of how to pay for the development of this new field. I mean right now, BlueCrest is a small private company with a single focus of developing the Cosmopolitan Unit. The members of our management team now all have extensive technical and business experience in developing projects like this, but the potential costs of Cosmo far exceeded our personal financial capabilities. So we teamed with a group of oil industry investors and then we ... very carefully

created our plan for financing the development of Cosmopolitan.

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MR. JOHNSON outlined the life-cycle cash flow of a typical project. Displaying slide 7, "Typical Project Life-Cycle Cash Flow," he stated:

This next chart shows the cumulative cash flow over time for a typical life cycle of a successful oil or gas development. The very beginning here is the exploration phase. And when you see this [curve] go down below the horizontal axis that means that ... the company at this point is spending more money than they're bringing in. So, if it's pointed down we're losing money. If it's pointed up we're starting to increase. What's important to understand is that we never get to the point where we break even until we're all the way back up over that horizontal axis. Only at that point can we make the very first profits on this deal.

We need to understand that the first part of any project is exploration and it is spending money that we may or may not get back. At this stage there's no assurance, in exploration there is no assurance that anything is going to be found. The only way to know that an area will be productive is to spend money to drill expensive wells, and then test them if it looks like there's something there. The vast majority of exploration prospects are, in fact, dry holes - the money spent will never be recovered. Just because you drill a lot of wells doesn't mean you're going to discover anything. I mean if there's nothing down there, drilling wells won't make it appear. On the other hand, and very important to understand, you'll never be able to get to the development phase of a successful project if you haven't made the discovery and haven't drilled those exploration wells. So, both pieces are very important.

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MR. JOHNSON continued his explanation of slide 7:

But in the minority situation, like we're in now with Cosmo, where the exploration process was successful, the really huge cost of developing the field comes into play. In other basins of the world, people aren't so concerned about the environment and the way things are done, and that's not the way it's done in Alaska. We take a very strong stance on the environment and safety and it costs money to that, but we do it right. ... Before we sell the first barrel of oil from a well, we have to be ready to make that work and that's what we're doing with Cosmo right now. We've got a well that would produce, but we've been working two years on the facilities to be able to turn it on and produce it - the gas pipeline that's connected, all of that has to be done up front. So, it's important to understand that no profits can be generated on an oil and gas development project until that curve has crossed back up and become positive.

... Remember this represents a successful exploratory project that has been developed. The vast majority, industry statistics now at two-thirds to 90 percent of all exploration projects do not find economic oil or gas. So, for the industry to survive, we have to be at least able to generate enough profits on successful developments to pay for the losses on the exploration phase.

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MR. JOHNSON addressed slide 8, "Cosmopolitan Progress as of 03/01/2016," to talk specifically about Cosmopolitan. He said:

Right now, we're just a couple of months away from starting up. We'll have production from that first old well that was drilled. In order to do that, we have spent two years building these production facilities and the drill site. Then we bring in our new drilling rig (in fact it's the most powerful drilling rig in Alaska) and start spending over \$40 million a well to bring on this new oil and gas. So here we are in March. After years of working on this project and investing all the money we have, we're just about ready to start the new drilling. And that new drilling is going to occur mostly in the second half of this year. And HB247 is proposing that tax credits end on July 1 of this year, even though that

is just the culmination of what we have been working on.

These pictures show you the progress we've made. ... We're 38 acres on the site ... we've got room for 20 wells. The first phase of this is 10,000 barrels a day of capacity. We have a 50-person man camp. We're also designed to allow for a lot of expansion of this facility as needed. ... We are on schedule and on budget for starting the first oil production in April of this year.

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MR. JOHNSON continued his discussion of slide 8:

With regard to the offshore gas, we're at a point now where we could begin the drilling the gas wells this year and set one or two platforms next year. Without the benefit of the tax credits, the gas is just simply too expensive to do right now. We could begin production of the Cosmo gas in 2018 if we started right now. The issue is if we're not able to start this year, we risk losing the existing offshore drilling rig that's been ... in Seward right now waiting for us. If the rig owners take the rig out of Alaska, we're afraid that it could be a long time before we're able to get another one back in the Cook Inlet that would be available for us to use; we understand there could be others in, but one that we could use.

... Thanks to the work that Hilcorp has done in the Cook Inlet, there are sufficient supplies of gas in the Cook Inlet that have already been developed to meet the requirements for several years for Southcentral users. There is not enough gas developed to allow re-opening of the Agrium facility or allow for significant new uses such as mines or LNG distribution throughout the rural communities of Alaska. As this Committee has heard in previous presentations, there is a lot of Cook Inlet gas that has recently been discovered, including Cosmo in those numbers. But discovery is just the first phase of actually bringing new gas to market. It takes many years to bring a new gas field on production, and if

we don't get started soon, we're risking a serious shortage years down the road.

1:53:16 PM

MR. JOHNSON drew attention to slide 9, "Tax credits for development of previously discovered proven reserves are a solid, low-risk investment for Alaska." He discussed what the tax credits mean to Alaska from a successful development project like Cosmopolitan. He said that when used for development of new proven reserves in the state, the tax credits are without question a valuable low-risk investment. He maintained that speaking of the credits as costs or a give-away ignores the value that is received by the state. The tax credits make projects work and they bring new sources of long-term revenues to the state for decades to come.

MR. JOHNSON turned to slide 10, "Summary of DOR Analysis Cook Inlet Oil Development 2/19/2016, Net Cash Benefit to State With Continued Tax Credits at Various Oil Prices," and continued:

At Cosmo, we're sitting on a large proven resource of future oil and gas that now simply requires additional investments to bring it to full production. Last December, Representative Seaton here asked the Department of Revenue for its analysis on the impact to the state on development of a new Cook Inlet oil field. On February 19, DOR produced its analysis and DOR's analysis modeled an example Cook Inlet field that is basically equivalent to a conservative forecast for Cosmopolitan. It assumed 50 million barrels of ultimate oil recovery and a maximum oil producing rate of about 17,000 barrels a day, which would represent the low side of our future Cosmo expectations. The total capital costs it assumed were about \$600 million, and it assumed that the full tax credits under existing law would continue indefinitely into the future. So, it assumed no changes to the tax law.

This chart is a summary of the calculations the DOR provided in their letter to Representative Seaton. It includes a summary of the total net benefit received by the state and municipalities, including taxes and royalties. We contend that you certainly need to consider the entire benefit of the state to look at the return on the investment from the tax credits

here. You can't reasonably exclude the bulk of the value - that is the royalties that are received as a benefit of these credits. So this chart shows that the tax credits for this example Cook Inlet field break even at about \$35 a barrel. At about \$60 a barrel, the state would net double the amount of the tax credits paid. Basically that would be \$900 million received for the \$300 million in tax credits, or a net of \$600 million on that chart.

[1:55:50 PM](#)

MR. JOHNSON moved to slide 11, "Summary of DOR Analysis Cook Inlet Oil Development 2/19/2016, Comparison to Permanent Fund NPV Return (6.15%) to State at Various Oil Prices Assuming All Tax Credits are Continued In Full." He stated:

DOR also provided the calculations that showed the impact of the tax credits as a pure investment, with a head-to-head discounted-cash-flow comparison to the investments by the permanent fund. According to DOR, the permanent fund's September 2015 earnings were at 6.15 percent. So if an alternative investment earns less than 6.15 percent, it would have a worse performance than the average investments in the permanent fund. On the other hand, if it earned more than 6.15 percent, it would be a better investment than the average of the permanent fund.

So, this chart shows that, even in the case where there are never any changes to the tax system in the Cook Inlet (that is, all credits stay in place forever and there's no oil production taxes until 2022), the state's investment in those credits for the example field is still better than the average investment in the permanent fund as long as oil prices over the next 30 years average about \$44 a barrel. And it makes a profit for the state at any price greater than about \$35 a barrel.

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MR. JOHNSON drew attention to slide 12, "Specific Comments on HB 247 - Section 21," to provide comments on the specific portions of the bill that apply to BlueCrest and the Cosmopolitan Unit. He said:

First of all, the termination of the 023(a) and (1) credits will result in a significant reduction of our ability to continue making the investments in the Cosmo wells in particular in a low oil price environment. It's been said that the NOL credits in the Cook Inlet are somehow duplicative with the (a) and (1) credits, but ... it's not really the case for BlueCrest. From the beginning of 2017, we'll be on production with our two new wells and we may not be in an NOL situation at that point depending on oil price. To make matters even any worse, in the event that the 023(a) and (1) credits were terminated and we were to be able to claim an NOL credit in the future, the NOL credit would only be 25 percent instead of the 35 percent that ... would apply to the North Slope.

We've done some interesting analyses of the value to the state in keeping the 023(a) and (1) credits as they apply to Cosmopolitan. We looked at the effective return using just a simple and a conservative calculation looking at only the incremental royalty for each new Cosmo well drilled. And this calculation doesn't include production taxes that would be paid after 2022 under the existing law, nor does it include property taxes.

Of course, we've also looked at the impact the loss of the (a) and (1) credits would have on us. We could be drilling Cosmo wells for the next five to seven years, we have a lot of locations to be drilling to there. For each new well we have to decide if the return to BlueCrest is worth spending the investment. The bottom line is that, particularly in periods of low oil prices, these (a) and (1) credits allow us to continue drilling the Cosmopolitan oil wells at approximately \$10 a barrel lower oil prices. So, that would encourage us, it would allow us then, to be able to drill at lower oil prices and get these wells on production. And that's likely to be an important factor in our 2017 drilling program next year.

[1:59:03 PM](#)

MR. JOHNSON addressed slide 13, "State's Investment Return From Individual New Cosmopolitan Well Royalties." He said the chart depicted on the slide is an undiscounted cash flow including

only the royalties from the .023(a) and (l) credits. He reviewed the chart as follows:

A 100 percent on investment here means that 100 percent of the tax credit would be repaid out of increased royalties over the life of the new well. And what this shows is that these (a) and (l) credits break even at about an average oil price of \$24 a barrel. At \$40 a barrel the total return would be 170 percent, and at \$60 a barrel the return is about 250 percent. Now this is BlueCrest's analysis, not DOR's, but it's actually pretty similar to DOR's calculation that they had done for their entire example Cook Inlet field. They showed about 300 percent return at \$60 oil. So you can see that continuation of these credits for Cosmo, at least for Cosmo, are likely to be a good investment for the state.

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MR. JOHNSON turned to slide 14, "Specific Comments on HB 247 - Section 26," to comment on the proposed \$25 million per year limitation. He said this limitation doesn't recognize the differences in qualified investment made by different parties. He continued:

This [\$25 million limitation] is particularly damaging to small companies like BlueCrest who have invested in good faith based on the tax policy in existence when we entered into the commitments on our investments. We came to Alaska based on these credits. We invested our cash, we borrowed a lot of money and committed to spending a lot more - all based on these tax credits. The timing of the receipt of those payments for the credits is paramount in our ability to make the payments on the loan used for making those investments.

MR. JOHNSON moved to slides 15-16, "Specific Comments on HB 247 - Section 27," and said:

BlueCrest, along with the ... entire rest of the industry, tries really hard to hire as many Alaskan workers as is practical. ... Adding in the further restriction of reducing the credit payment by amount of the percentage of non-Alaskan workers is just

simply impractical. In our case, for example, we've hired 100 percent Alaskans for our full-time operator positions at Cosmopolitan. And, to my knowledge, I think our drilling staff is the same percentage. We've always offered Alaskan companies the opportunity to bid on new contract jobs and we've have employed over 100 different Alaskan companies in the construction of our Cosmo facilities. But Alaska companies have got to be competitive, of course, both from a cost and quality standpoint. Sometimes there are specialized fields that are needed in construction and drilling that [is] just simply not available from Alaskan companies. So, we've tried to do everything we can to ... let Alaskan crafts people work. For example, we've given Alaskan welders several extra tries to pass the required welding quality test. We didn't do that to other people, but we have for Alaskans. Now, of course, we're zero tolerance on drug testing, no matter where the worker is from. ... Bottom line, we support Alaska hire, but it doesn't make sense to penalize companies after-the-fact for their business decisions....

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REPRESENTATIVE JOSEPHSON remarked that Mr. Johnson made a good case relative to BlueCrest's oil fields on the net return to the state, essentially arguing it's a win-win, which is compelling. He asked whether Mr. Johnson has any arguments relative to the gas credits.

MR. JOHNSON replied that BlueCrest has those calculations and they look similar to the oil calculations. However, he said, the gas is a function of when it's going to be sold, what will the price be in the future, and right now there are a lot of uncertainties about that. BlueCrest has not commenced the gas development at this phase.

[2:03:18 PM](#)

REPRESENTATIVE TARR requested Mr. Johnson to talk about the relative importance of Well Lease Expenditure Credits, given she thinks those and the other Capital Credits are what will go away for BlueCrest's Cook Inlet operations and then BlueCrest would have to rely on the net operating loss (NOL). She noted that the committee has tried to talk about the different phases of

development and making sure the state has enough activity in each phase for providing supply going forward.

MR. JOHNSON responded that AS 43.55.023(a) and (1) are the Well Lease Expenditure Credits: 20 percent is rebated on tangible type equipment, which is pipeline facilities, and 40 percent is paid on the intangibles, which is the majority of drilling of the wells. BlueCrest will be finished with the facilities by July 1 or certainly by the end of this year. However, the really big costs begin with drilling. Each well is roughly \$40 million and the credits received, even without the NOL if the company is in a cash positive position, are really significant for BlueCrest determining the economics of whether it can afford to drill the wells. In high oil prices the economics are great whether or not the credits are there. In low oil prices it really makes a difference and BlueCrest's discounted cash flow analysis showed that these credits effectively make a difference of anywhere from \$10 to \$14 a barrel price difference, so it is important to BlueCrest.

[2:05:35 PM](#)

REPRESENTATIVE TARR posed a scenario in which the 20 and 40 percent credits were scaled back rather than eliminated. She asked whether there is a way to assess the relative impact of the credits becoming less generous; for example, the 40 percent credit being scaled back to 20 percent.

MR. JOHNSON answered that BlueCrest would have to look at each one of those. He said 20 percent is certainly better than zero because maybe it makes a difference of \$4 a barrel in the oil price versus the \$10 that was calculated for the 40 percent. He advised that BlueCrest will have to base its spending in the future on whatever changes, if any, are made to these credits.

[2:06:37 PM](#)

MR. JOHNSON reviewed slide 17, "Specific Comments on HB 247 - Section 46." Of all of the bill's provisions, he said, the single most important point to BlueCrest is the timing of the implementation of the changes, whatever those changes may be. He explained:

It's now March, and the proposed changes are supposed to take place on July 1. BlueCrest being small as we are has had to be very, very careful in our financial planning process. Before we ever started the oil

development project, we made sure that we'd have enough funds to allow us to complete construction of everything - the onshore drill site facilities, bring in the most powerful drilling rig, and to drill at least the first two new oil wells. So, our calculation showed that we would need approximately \$525 million to get to that point of self-sufficiency where we wouldn't have to be going and borrowing more money or asking our investors for more, and that should occur in early 2017 for us, depending on oil price. In order to make ... that work, our shareholders invested approximately \$200 million in cash. We've borrowed \$30 million from [Alaska Industrial Development and Export Authority (AIDEA)] for a loan on the drilling rig.... We obtained a \$150 million high-interest development loan. ... To date we have received \$24 million in tax credits, and that goes into that formula, and the balance is \$121 million to get us up to \$525 [million]. That \$121 million is what ... we would receive, hopefully we will receive, from the tax credits on the investments that we've made basically for 2015 and 2016 spending under the current tax laws. We've spent a lot of money to get to the point where we can now start drilling, but an abrupt termination of these tax credits on which we've based our entire financial planning would be devastating.

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MR. JOHNSON continued:

We've finally reached the point, by completing all this work and spending all this money, to where we'll finally have our drill site and rig ready to drill the second half of this year. We need the production from the first new wells to pay for the costs we have spent so far. Those drilling costs, at least through early 2017, are all based on the assumption that we will be able to obtain the credits under existing law for those investments and be fully paid for those credits on time. We've done all this work and we've spent all this money to date, and it only seems reasonable for us to ask to be able to claim the existing credits for the spending that is the result of our investments made in good faith based on the expectation that the state would honor its share of the investments.

We need to be able to be able to get to the finish line here. Not paying the credits that were the basis for the investments we've made over the last couple of years, as close as we are, is kind of like saying "well, you can spend the money for a new house, but you can never move into it." We've got to get to the finish line.

2:09:39 PM

MR. JOHNSON concluded with slide 18 which states, "When we are driving on slippery icy roads, the most dangerous thing we can do is suddenly slam on the brakes!" He said:

In conclusion, I'd like to reemphasize the importance of phasing into any changes over a reasonable time period. Everyone in this room today understands that when we are faced with driving on dangerous, icy, slippery roads - like the State of Alaska and Alaska's oil and gas industry is faced with right now - the most dangerous thing we can do is suddenly slam on the brakes.

2:10:09 PM

REPRESENTATIVE SEATON inquired whether Mr. Johnson is asking that the credits earned through the credit expiration date be paid on time or asking that those credits be extended beyond their statutory expiration date.

MR. JOHNSON replied yes, BlueCrest is definitely expecting that it will receive the credits in a timely manner as they have been earned under current law. A change in current law on July 1 will result in a huge impact to BlueCrest in terms of the amount of credits because the last half of 2016 is the company's largest, most expensive drilling expenditure time. By the end of 2016, early 2017, BlueCrest will have to make an economic decision about what to do drilling-wise. But, he pointed out, BlueCrest has already committed that money for all of 2016, the company has already signed contracts for the money to be spent the last half of 2016.

2:11:26 PM

REPRESENTATIVE TARR recalled Mr. Johnson mentioning that the Net Operating Loss Credit should be 35 percent like it is for the

North Slope producers. She noted that BlueCrest has different levers it can pull here. The state is trying to incentivize certain behaviors. Say, for example, the Well Lease Expenditure Credit and the .023(a) and (l) credits go away, and then that other change happens simultaneously. That is different once BlueCrest is producing net positive. She asked how that makes things look favorability-wise.

MR. JOHNSON responded that the NOL Credit is important for a company just getting started and has been important for BlueCrest. The .023(a) and (l) credits are important as BlueCrest goes down the road drilling and continuing to drill. BlueCrest has five to seven years of drilling that it could do at Cosmo. The .023(a) and (l) credits facilitate drilling at a lower oil price, these credits make the economics more feasible to drill those wells.

[2:12:53 PM](#)

REPRESENTATIVE TARR surmised Mr. Johnson is anticipating a situation where BlueCrest is net positive but continuing to drill, and so the company is ineligible for a Net Operating Loss Credit but wants to have a credit that would help incentivize the continued drilling activities.

MR. JOHNSON answered yes, and that is what the .023(a) and (l) credits do. For example, if BlueCrest had \$10 million of positive cash flow, what would the company do with that? The company's plan is to reinvest everything it gets. If that is applied against an NOL Credit in a new well that costs \$40 million, then instead of being able to claim the credit on all \$40 million BlueCrest would get credit on only \$30 million of it. But if the company is in a positive cash flow of, say, \$40 million and it drills one well, that just brings the company to \$0 and the company never gets a credit at all. That's why the .023(a) and (l) credits are important for continued development after a company has started up and finally made it to the positive point.

[2:14:14 PM](#)

REPRESENTATIVE TARR remarked that she is trying to think about what other opportunities there are for how to address this without unintended consequences that are more costly than the state can afford. She posed a scenario in which a company could claim credits for its drilling activity for a certain number of

years, and asked whether Mr. Johnson would see that as being an appropriate application.

MR. JOHNSON replied that that's a tough decision legislators are faced with. He said industry will take whatever is done into account and will make actions based upon that. Most importantly, he cautioned, is that the action taken not be done immediately - that industry be given some time so it can plan accordingly. For example, a few months to July 1 is impossible to plan for, but one to three years can be planned for. If the credits go down, the result will be less development; if the credits apply to exploration, then the result will be less exploration also. That's a choice that legislators have to make.

The committee took an at-ease from 2:16 p.m. to 2:20 p.m.

[2:20:19 PM](#)

DAVID WILKINS, Senior Vice President, Hilcorp Alaska, LLC, noted that he is fairly new to Alaska and is a petroleum engineer with 30 years of industry experience all over the world and U.S. He said he moved his family to Anchorage last summer to lead the Hilcorp Alaska, LLC, ("Hilcorp") team and looks forward to continuing the legacy of responsible development of Alaska's resources so that his children might also have the opportunity to live and work here. He noted that Hilcorp is the largest privately held oil and gas company in the U.S., is headquartered in Houston, Texas, and operates in the Gulf Coast of Texas and Louisiana as well as the Northeast U.S. Hilcorp entered into the Cook Inlet in 2012 and into the North Slope in 2014. Founded in 1989, Hilcorp has over 1,350 full-time employees. Just over 500 employees support Hilcorp's operations in Alaska, of which 90 percent are Alaska residents.

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MR. WILKINS said that Hilcorp operates approximately 53,000 gross barrels of oil a day in Alaska and 150 million cubic feet of gross gas per day from approximately 500 producing wells, for a total net production to Hilcorp of approximately 57,000 barrels of oil equivalent (BOE) per day. He continued:

Hilcorp's assets are primarily, although not exclusively, older fields with extensive production histories, steady and predictable performance that carry an incredible opportunity for getting more oil

and gas out of the ground safely and responsibly while extending production life through efficiency and thousands of smaller scale projects. We hope the state sees a need to attract more companies like Hilcorp as fields and infrastructures continue to age here in Alaska.

That brings me to why I sit before you here today. Hilcorp's production in Alaska represents approximately 40 percent of what we produce company-wide, so our success here in Alaska is critical to Hilcorp's overall success. I absolutely agree with all of what the Alaska Oil and Gas Association [(AOGA)] presented yesterday on HB 247. It's our view that the credits in question have resulted in more investments here in Alaska and we stand by our commitment to serve Alaska's energy needs first.

It's no secret that Hilcorp has been a big part of reviving the energy security in Southcentral Alaska. Over the past four years we've invested over a billion dollars in projects and have drilled over 50 wells in the Cook Inlet Area. As a result of this investment and the positive results, we're sending more oil to be refined and used here in Alaska and we're currently making gas supply commitments into the year 2023 with local utilities and continue to work to ensure a reliable and affordable energy source for Alaska's largest population hub. As you are well aware, prior to Hilcorp's entry into Alaska, there was widespread concern that utilities would need to import natural gas to meet demand. I've heard numbers like LNG [liquefied natural gas] imports being on the \$10-\$20 per MCF [thousand cubic feet] basis, which would have been a very bad impact on the economies in Southcentral Alaska.

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MR. WILKINS continued:

These commitments certainly don't come without challenges. Developing oil and gas in the Cook Inlet basin carries a very high cost of production coupled with decline rates that vary from 15-50 percent annually depending on the field. Let me restate that. We have wells in areas in the Cook Inlet that lose

half of their production in one year. The simple fact is that if we are not spending money on projects that bring on new production we cannot curb these declines and we will very quickly get back into the situation we were in prior to 2012 to where supplies were in question. So we believe it is in both Hilcorp's best interest and the state's best interest that we continue to spend dollars on trying to produce more oil and gas in the Cook Inlet as well as on the North Slope.

It's also no secret that Alaska's tax credit system and the Cook Inlet Recovery Act were key drivers in bringing Hilcorp to Alaska and in our investments to date. Since 2012, Hilcorp has spent \$3.2 billion dollars in capital and acquisition costs here in Alaska. Those investments were aimed at one primary goal - increasing oil and gas production. Since 2012 we have increased our organic, meaning non-acquisition, production by approximately 40 percent in the Cook Inlet. A lot of people ask how we do it, and the answer is simple. First, we have talented and dedicated people here in Alaska and, second, we have and continue to make significant investments; investments that were encouraged by the state's tax credit program and investments did just what the credits meant to do - increase energy supply needs for Alaska.

[2:28:14 PM](#)

MR. WILKINS continued:

I would argue that our success has been meaningful to many, including the state. Increased production levels of oil and natural gas in the Cook Inlet basin has resulted in increased royalty, property taxes, jobs, and more. One example of this is looking at our Monopod offshore platform. In January 2012, right after Hilcorp took over operations, the realized oil price was approximately \$95 a barrel. Production from the platform was approximately 600 barrels of oil a day, a marginal rate for an offshore platform in high operating costs. As the royalty owner, the state's take from the Monopod at that time was approximately \$90,000 per month - again, that was when oil prices were \$95 a barrel. Because of this marginal rate and

low profitability, the Monopod qualified for royalty relief under House Bill 185 that was passed in the year 2003. The royalty rate was restructured to help maintain profitability for the platform so that it would not be shut-in and/or permanently abandoned. Over the past four years, Hilcorp has done over 150 projects on the Monopod alone, most of which were smaller in scope, and we have increased production to a current rate of approximately 3,000 barrels of oil a day. Because of this increase the state's royalty share is back up to the standard 12.5 percent take and even with oil prices at \$35 a barrel, the state's royalty take from the Monopod has increased from \$90,000 a month to over a half a million dollars a month. That's over a ten time increase in royalty barrels and a five time increase in dollars going to the state despite oil prices declining 60 percent. Furthermore ... the Monopod platform was probably one to two to three years from being plugged. Because of the increase, we have increased and extended the Monopod 15-20 years and added on the reserves on the books 8 million barrels of oil.

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MR. WILKINS continued:

I would offer we need more results like this. I would also offer that the industry needs a system in place that incentivizes, not jeopardizes, continued investment of this type of activity. It's a really good of example of the state putting good policy in place aimed at and achieving a positive result and we delivering the result.

I can tell you today that the credits Hilcorp earned were absolutely reinvested in Alaska. Our current production rates prove it. We have managed to work our way above the 50,000 BOE per day mark through acquisition and a lot of hard work. Breaking the 50,000 mark means we can no longer cash in the credits that HB 247 proposes to take away. But other budding companies, like you heard from BlueCrest and Furie you're going to hear form, can. And Hilcorp is a company that always welcomes competition in the market. We want to help promote a healthy industry throughout the state. As others have said, an active

industry means additional service companies will be attracted to Alaska, which creates competition and will help drive down costs.

A lot of the discussion around HB 247 has involved the Cook Inlet basin, primarily because of the notable increase in production and activity that the existing tax structure intended to generate and was wildly successful. Our success in the Cook Inlet is what fueled Hilcorp's interest in expanding to the North Slope. And we did just that in November 2014 when we purchased 20 percent of BP's assets on the Slope.

[2:33:04 PM](#)

MR. WILKINS continued:

It's been over just a year since we arrived on the North Slope and I am very excited about the amount of opportunity we see on the Slope. We have a comprehensive list of projects that we can invest in - small and big - facility recompletes, drilling, we see lots of opportunity. Projects that will put more oil in the pipeline and support literally hundreds, if not thousands, of jobs in the state of Alaska.

But, in today's price environment and in the face of an uncertain state fiscal structure, it's difficult to determine what projects will move forward and when. We have been very, very thoughtful with every penny we spent. We have to continue to work hard to build efficiencies and cut costs while ensuring we do it safely and protecting the environment. Cutting costs, not corners, is the only way we will survive the current downturn.

I know we aren't the only ones faced with difficult decisions and realities during this challenging time. I also recognize the members of this committee and the legislature have much to consider about what's best for the state and our future. In closing, I'd just like to remind you that the uncertainty we are currently facing threatens our ability to plan our investments and that the decisions you make today will impact the economics and the opportunities to increase tomorrow's production both in the Cook Inlet and the North Slope.

2:34:50 PM

REPRESENTATIVE OLSON inquired whether the platforms in Cook Inlet are all being worked on.

MR. WILKINS replied that Spark, Spur, Dillon, and Baker have opportunity to them but are not producing right now. He said Hilcorp is doing everything it can to lower the costs and save them for another day. Currently, Hilcorp is looking as to whether it can make investments to turn those platforms back on.

REPRESENTATIVE OLSON asked whether platforms A and C belong to Hilcorp.

MR. WILKINS responded yes, Hilcorp recently acquired platforms A and C from XTO Energy Inc., but right now those platforms are not making money.

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REPRESENTATIVE JOHNSON commented that it is heard from both big and small producers that they want stability, and he is interested in stability for his constituents. He asked whether HB 247 would enhance stability for his constituents so there would be no need for rolling blackouts.

MR. WILKINS answered that over the last four years Hilcorp has invested a lot of money, especially in oil production. In regard to natural gas production, the issue in 2012 was that there wasn't availability, especially over a longer period of time, to give confidence in the market. He said he thinks Hilcorp has demonstrated through significant investment that it has brought stability and extra capacity to the market, as well as deliverability in the places it needs to be. Hilcorp is convincing the local utilities that, yes, that capacity is there and at the same time Hilcorp is providing that gas at an affordable rate for the customers. If Hilcorp doesn't spend the continued investments the wells are going to decline and it could very quickly return to the situation where there isn't enough gas to meet the market demands. He, too, is concerned going forward about the stability, but as long as Hilcorp keeps doing what it is doing and bringing on new gas....

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REPRESENTATIVE JOHNSON understood that Hilcorp is working on contracts to the year 2023. He inquired as to what effect, if any, HB 247 would have on Hilcorp's ability to fulfill those contracts.

MR. WILKINS replied that Hilcorp is very confident it has the projects to bring on to meet the demands in the future. Hilcorp doesn't execute on those projects today because it doesn't need to deliver the gas today. But Hilcorp is very confident that when it needs to deliver that, it will do the projects, spend the money, and bring the gas on. All that said, Hilcorp hasn't stopped looking for new gas. Hilcorp is drilling exploration wells and will continue to look for new gas and new oil in the Cook Inlet basin. Hilcorp will be drilling a new well on the Monopod in the next two weeks and Hilcorp plans to do an exploration well or two in the Kenai area. Hilcorp just finished drilling an exploration well in the Kenai area that unfortunately wasn't successful. Hilcorp spent over \$12 million on that well, but the geology there is very complex and Hilcorp is trying to employ new technology to find new oil and gas in that area.

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REPRESENTATIVE JOSEPHSON remarked that the testimonies of Mr. Wilkins and Mr. Johnson have been very interesting. He recounted that the legislature's consultant, Janak Mayer of analytica, told the committee that the Cook Inlet credits are exceptionally generous and Mr. Mayer questioned their sustainability. Representative Josephson further recounted that Mr. Mayer seemed to be speaking as the secondary source as if he'd spoken to someone who is a primary source of the data. Representative Josephson further recounted that yesterday Mr. Armstrong noted that this is the most generous tax regimen in the world. He asked whether Mr. Wilkins thinks these are sustainable.

MR. WILKINS responded that all he knows from his perspective is that they've worked, they've done what they intended to do. Hilcorp is in a little different situation. It has invested billions of dollars and is not looking to get that money back in a year or two; Hilcorp is making long-term decisions. Right now Hilcorp is looking to get its money back over a five to ten year period. Hilcorp is all the time projecting its long-term investment and what Hilcorp desires is predictability and sustainability in the fiscal regime so it can make decisions. From the tax credit standpoint, he would still argue that

Hilcorp has done exactly what the state wanted it to do and the state benefitted from the work that Hilcorp has done.

REPRESENTATIVE JOSEPHSON thanked Mr. Wilkins for that work.

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REPRESENTATIVE OLSON understood that Hilcorp now has some of the longer gas contracts in the inlet, primarily to ENSTAR Natural Gas Company ("ENSTAR"). He inquired whether, if the tax structure changes during that period, Hilcorp is allowed to pass that on to ENSTAR or Hilcorp is stuck with whatever was in effect when it signed the contracts.

MR. WILKINS answered that Hilcorp has multiple contracts and all the time Hilcorp is renewing and giving contracts. He said the price of gas is actually coming down because Hilcorp has been successful. Hilcorp looks to be successful and provide energy needs to Southcentral Alaskans that's affordable and reliable.

REPRESENTATIVE OLSON posed a scenario in which the tax goes up significantly and Hilcorp is in the middle of a contract. He asked whether that is an allowable item that Hilcorp can pass on to ENSTAR.

MR. WILKINS replied that he would see it that way. He said Hilcorp incorporates the tax credits into its overall long-term decisions and investment decisions. Hilcorp is a little different than some of the other companies that are using the tax credits because Hilcorp incorporates that in its decision making. Hilcorp is going to spend money in Alaska doing projects and doing them economically as Hilcorp sees it can. So, the tax credits going away will have an impact on Hilcorp's investments, on the level of Hilcorp's investments, but he still sees Hilcorp meeting the energy needs and meeting the market for the foreseeable future for the life of its contracts.

[2:43:58 PM](#)

REPRESENTATIVE SEATON recalled that enalytica told the committee that \$5-\$7 per thousand cubic feet (MCF) is sufficient price to produce the most expensive gas in the world. He noted that the [November 2012 consent decree between the State of Alaska and Hilcorp Alaska, LLC,] will go [until sometime in 2017]. He further noted that Hilcorp is working on contracts through the year 2023. He stated that [legislators] are in a dilemma with a \$3.8 billion deficit and yet these refundable tax credits were

\$500 million this last year and are estimated to be \$623 million next year. Taking \$1,000 from every resident's dividend would just about equate to the \$623 million that will be provided in reimbursable tax credits. Therefore, he is trying to figure out where, as a policy, [the legislature] breaks this where the credits are needed. He said it seems to him that the credits for gas in Cook Inlet are liked, but given the price structure of Cook Inlet gas, they're really not needed. He requested Mr. Wilkins to comment on this statement.

MR. WILKINS responded that Hilcorp is an example of where the tax credits worked and both benefitted. He said he appreciates that the state needs to make difficult choices, but all of the companies are faced with the same dilemma. There isn't a magic elixir decision here. Will removing the tax credits impact investment in Alaska? Yes. How much? It will depend on the levels that are being talked about.

[2:46:31 PM](#)

REPRESENTATIVE SEATON related that he has been thinking about how to parse which credits to pay and which credits must be withdrawn. He asked whether Mr. Wilkins would see it as being reasonable if those people who have committed to final investment decision (FID) and have a DNR-approved plan of development were grandfathered for some period of time.

MR. WILKINS answered that it is tough for him to say without knowing all the specifics. He said Hilcorp would welcome the opportunity to evaluate and provide comment. He added that he agrees with ExxonMobil's comment that a response can be provided from an industry perspective through AOGA because he does not want to make a comment that is favorable to Hilcorp but detrimental to another company.

REPRESENTATIVE SEATON clarified that he is not asking a "gotcha question" but is trying to figure out how to move forward in the current economic environment, what is the state's net present value on investments, and how to give companies enough latitude to amortize their investment and decision making. The state cannot invest in everything. He urged Mr. Wilkins to talk with others and provide the committee with ideas on how to parse things.

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REPRESENTATIVE TARR offered her understanding that Hilcorp's development for the Cook Inlet is separate from the company's development for the North Slope. She said she thinks she is seeing very different scenarios for these two areas in terms of the generosity of the credits. She inquired as to which credits have been used by Hilcorp.

MR. WILKINS replied he is not a tax person and therefore doesn't have specific line-by-line answers. But, he said, Hilcorp takes the tax credits very seriously and the credits get incorporated into all of Hilcorp's investment decisions. Within a company like Hilcorp, dollars can go several places and he would love for capital dollars, investment dollars, to come to Alaska to where Alaska benefits and to where Hilcorp benefits. Hilcorp takes everything into account when making those investment decisions because they can go to Texas, Louisiana, or elsewhere.

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REPRESENTATIVE TARR stated that the very generous bonuses that went to Hilcorp employees is something her constituents have reacted to. This is a consideration here, she said, because she represents an area where 39 percent of the families in one of the neighborhoods make less than \$25,000 per year. So, for her constituents it seems there is opportunity to make adjustments in the system that seem fair.

MR. WILKINS responded that if the implication is that Hilcorp took money from the state to pay the bonuses, the answer to that is categorically no. He explained that Hilcorp uses any kind of tax credit to promote the projects within Alaska and increase production, which Hilcorp has demonstrated. He said he has been with Hilcorp for 10 years and the aforementioned bonus program was the latest of two bonus programs.

REPRESENTATIVE TARR understood the other bonus program was a car.

MR. WILKINS continued his response and said that Hilcorp met both of its bonus programs. This last program was started five years ago in 2010 before Hilcorp was in Alaska. Hilcorp went to its employees and told them it wanted a long-term incentive goal to incentivize the behaviors that the company wants. For five years Hilcorp planned on paying those by having a systematic measure to reward the employees when they were successful. Hilcorp also views that as a compensation; it's a long-term compensation incentive within Hilcorp and the company benchmarks

those against other companies. Lots of companies in the U.S. have long-term incentive programs. Some give stock options, but Hilcorp gives what it calls "a BHAG bonus - Big Hairy Audacious Goal" and it's a five-year goal. The actual program is to double the size of the company: double production, double reserves, double equity value of the company. When looking at the structure of the program on a per-year basis, the goal is actually less per employee than what Hilcorp provides in healthcare and so is not out of line at all. What does the company get when its employees do that? It gets 1,350 employees pulling every day for a common goal. When the goal was started in 2010, did Hilcorp anticipate oil prices crashing? No. The company had to decide whether to honor its commitment because it impacted the bottom line and it hurt. Over half of Hilcorp's employees are field workers, hard-working folks that got energized about this goal. When he talked to employees about what they did with their bonus, some people said they paid down debt, some sent kids to college that otherwise wouldn't have, and one person bought a house. He said he knows Hilcorp did the right thing - a deal is a deal - and he is proud of doing that.

REPRESENTATIVE TARR appreciated Mr. Wilkins response and said members feel similarly in terms of the expectations of Alaskans of having a deal on receiving a permanent fund dividend or other programs. It is a challenge to balance those things, she added, and it will be difficult to work through.

The committee took a brief at-ease.

[2:56:59 PM](#)

BRUCE WEBB, Senior Vice President, Furie Operating Alaska LLC, explained that Furie Operating Alaska LLC ("Furie") started out as Escopeda Oil Company buying the first leases in the Cook Inlet between 2002 and 2006. The president at the time, Mr. Danny Davis, formed a unit and tried to get investors involved in what would be a very expensive endeavor bringing a jack-up rig to explore the offshore Cook Inlet resources. Escopeda found such an individual, a German citizen with a German investment company, and in October 2010 Escopeda became Furie Operating Alaska LLC. The company's main investments came from Germany and those investments were raised by touting the State of Alaska as its business partner. The state, through the tax credit program, basically subsidized Furie's exploration and development. It was widely praised in Europe that the State of Alaska was a partner in trying to get more exploration and development in the Cook Inlet. Furie was able to bring up the

Spartan 151 jack-up rig in August 2011, the first time in 20 years that a jack-up rig had been in the Cook Inlet. Furie has been on the leading edge of everything throughout this project, there has been one hurdle after another. Furie is proud to say that it has drilled five different wells in five years and put in the first platform in the Cook Inlet in about twelve years.

MR. WEBB played a video showing the magnitude of the project and the number of employees and contractors involved in the jack-up rig. The video starts in Corpus Christi, Texas, he explained, with the monopile structure being made and then all the facilities being constructed. The rig moves from the Gulf of Mexico through the Panama Canal up to Seattle and then into the Cook Inlet.

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MR. WEBB stated that, without a doubt, this project would not have happened without the tax credit program. While other Cook Inlet explorers have talked about wells that cost \$12-\$40 million, he continued, drilling a well in the offshore Cook Inlet is \$60-\$80 million - a huge investment. When Furie went into this with the tax credit program it had a 10-year goal in mind and certain financial commitments to make along that goal. If the tax credit program goes away, he said, it will have a significant impact on the company. Furie just set the platform and first production was in November [2015]; to date about 700 million cubic feet (MMCF) has already been produced. Furie's first real contract starts in April, but even that contract doesn't meet just the debt commitment. Furie's debt commitment doesn't fully get met until the contract that was just signed last week that starts April [2018]. So, between 2016 and 2018, Furie has this period of being at the bottom of the curve (the curve as was discussed by Mr. Johnson of BlueCrest) and will not start moving up until 2018, and that is with the tax credits. If the tax credits go away, Furie's ability to explore and do further developments will really be hindered.

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MR. WEBB, regarding the unintentional consequences mentioned by Representative Tarr, noted that the Kitchen Lights Unit is 83,000 acres; Furie just developed a 300 acre area that's going to have significant gas reserves and the gas price in the Cook Inlet has already gone down. But, if Furie doesn't continue to meet exploration and development targets, the Department of Natural Resources will systematically reduce those 83,000 acres

down to just what is the producible area. What does that mean to the state? That means that those leases go back up for bid. How many companies are going to bid on a lease with the price of oil at \$30? Then, when they do start getting the leases there is going to be a non-contiguous ownership so it will probably take decades before a contiguous unit is formed and a company has the ability to bring up another jack-up rig. Furie has a new jack-up rig that will be arriving in Homer next week. Without the tax credit program, Furie probably won't be able to keep that rig here. That's just the economics. The exploration and development window in the Cook Inlet is only six months, so Furie must pay for that rig during the six months that it is not using it. It is too costly [to keep the rig] unless a company has a goal and a financial structure in place that can be relied upon. The bottom line is that Furie came into this with a tax structure that it thought was reliable and could be counted on, and now it's being changed in the middle of Furie's game. This is not going to be good for the company. In just the last year, two Cook Inlet producers have already filed bankruptcy and one has left the state. This is a very expensive environment, especially the offshore, and the offshore is where the biggest resources are. Furie has huge wells, but they are very expensive to get to the market and it is going to take Furie 10 years before it starts seeing a profit.

[3:07:05 PM](#)

DAVID ELDER, Chief Financial Officer, Furie Operating Alaska LLC, began the PowerPoint presentation regarding the impacts that HB 247 would have on Furie Operating Alaska LLC. Turning to slide 1, "Overview: Tax Credits = Jobs," he said the bottom line is that Furie never would have undertaken a project as large as this without the tax credits. Furie did exactly what the tax credits were intended to do: a small independent exploration and production company that could move quickly and was willing to make these commitments came to the Cook Inlet, and over a five-year period it developed and began producing significant new natural gas reserves. The tax credits support investment in the state, they create jobs, they bring revenue, and Furie is just at the phase now where it will begin making its repayment back to the state for the benefits it has received. Furie has invested \$700 million in Alaska over the last five years, and over the next two to three years will invest another planned additional amount of approximately \$300 million, depending on what happens with the credits.

MR. ELDER noted that Furie's investment horizon has to be long. The unique nature of the Cook Inlet gas markets, the contract structures that are in place, mean that it takes a while for Furie's cash flows to build up to the point where it breaks even and meets all of its obligations to the state as well as to lenders and investors. Furie is looking at probably a seven to ten year horizon before it has recovered its investment in the Cook Inlet. Furie estimates that it employed over 300 people in Alaska at the peak of its construction phase last year. Furie likes to compete, it's a little guy that has come on the scene to help compete and lower prices. The declining prices in the natural gas market in Southcentral Alaska reflect, in part, what Furie has done, as well as other people's investments. If Furie doesn't have these tax credits going forward, the company will be forced to significantly reduce its investment, probably to absolute minimum levels. The ability to continue to explore and develop the 84,000 acres could be significantly lost to Furie.

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MR. ELDER addressed slide 3, "Tax Credits Help Alaskans by Supporting Development," and said the lower energy prices are going to benefit the people of Southcentral Alaska. It is going to help produce new jobs and every month it will save families when they pay their utility bills. Furie uses over 100 local companies as vendors. Furie is lowering the risk of shortfalls in natural gas in the future. While Furie respects what other people have said on their ability to continue to increase reserves, the company's studies show that it is going to be critical to the Southcentral region that Furie continue to develop these resources offshore.

MR. ELDER stressed that all of the tax credits have benefitted Furie. The company needed the 20 percent credit for tangible spending, he said, and the 40 percent on intangibles has been critical because of the high cost of drilling a well in the Cook Inlet. Offshore is automatically more expensive. Furie totally agrees with the figure of at least 300 percent more expensive that was presented earlier. Regarding keeping rigs on contract 365 days a year, he noted that Furie brought some of the first new supply vessels back up to the Cook Inlet. A lot of these resources materials, as well as some specialized skills, must be brought up from the Lower 48. The 25 percent loss credit is critical in the early phases of development. Provided that the other credits are retained, Furie will be very happy when it gets to a point where it no longer qualifies for loss credits and becomes a positive taxpayer.

3:12:07 PM

MR. ELDER moved to slide 4, "Benefits for Alaska," and reiterated that Furie helped create 300 jobs this [past] summer. He provided some examples of the results of Furie's investment and the payback that Furie will begin giving to the state. For the first five years, Furie paid \$3 million in local property taxes, an average of \$350-\$600 a year. Furie estimates that in 2016 it will be paying close to \$5 million annually, which reflects the investment in property, plant, and equipment that the company has done. Furie has paid lease rentals to the state of about \$1.6 million, and is very conservatively predicting that it will be paying royalties of \$300 million to the state [over the life of the reserves].

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REPRESENTATIVE SEATON recalled that enalytica, the legislature's consultant, provided committee members with three different scenarios, of which one was a constrained market for gas in Cook Inlet. In that scenario, he related, the state was in a net present value loss over the entire life of the development, regardless of the gas price; it was only with an unconstrained market that it turned around the other way. He asked whether a constrained market will be maintained such that it will be a huge investment up front that will not be recovered. He said committee members are trying to balance the scenarios provided by the consultants to putting massive amounts of credits for a large project if it isn't going to pay the state back over time unless it is an unconstrained market.

MR. ELDER replied that Furie recognizes and appreciates the constraints had by the state. Industry is now going to see a lot of hurt and loss of jobs and Furie appreciates that the state has residents who struggle and work hard. He said his answer to the question is that in the early phases Southcentral was having brownouts, prices were rising, and there were shortages that justified generous incentives at the time because of having to mobilize. Furie sees significant resources that will enable it to justify the investment and deliver the supply. However, he pointed out, to the largest companies it is not large enough. Companies like Furie that are capital constrained must pay more for those investment dollars. So, at least in the beginning of these developments, the credits were absolutely critical. Part of the challenge of this market is that it is a unique, localized market. But, because of the contracting of

the utilities and the need to lock in supply, a cycle is being seen of where there is now gas supply but it will take a couple of years to get that supply into the market. So, there is continued need of these credits to do that. Over the long run Furie could see the credits being phased reduced at some point in time, but his message today is that Furie needs certainty in the next few years to complete what it has already started.

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REPRESENTATIVE SEATON inquired whether plans of development and final investment decisions is the correct point for decision making of where a timeframe is given to continue, but the state would no longer be able to financially do speculation and leasing of new areas without there being a final investment decision.

MR. WEBB responded that that is very hard to answer because if the state gives certainty to Furie for this current development, it gets the company over the hurdle and allows it to meet its commitments for its future gas contracts and do some additional development drilling to maybe get more gas contracts in the future. However, the problem is that future exploration and development is so expensive. Until Furie gets to where it has profit, it is unable to commit to the type of investment needed to find another field and set another platform; Furie cannot do that out of its pocket.

[3:18:23 PM](#)

MR. ELDER resumed his presentation. He drew attention to the list of about 100 local businesses on slide 5, "Alaska Partners Supporting Exploration and Development," and said that these businesses provided both services and goods to Furie. He noted that the list includes local operations of multi-national oil and gas service companies as well as local hardware stores and vendors that rely upon income from Furie's operations to help employ people and support their businesses.

MR. ELDER turned to slide 6, "Tax Credits Helped Furie Bring Cheaper Gas to Southcentral Alaska," and said the tax credits have done what [the legislature] told Furie it wanted the company to do. Furie developed more natural gas which increased supply. Under its first contract with Homer Electric Association Furie is selling significantly lower than the consent decree pricing. The other day Furie signed a new gas contract that will provide a large amount of gas significantly

below the Hilcorp pricing and below the pricing in the renewed Hilcorp and Chugach Electric Association contracts. The tax credits have done that. Furie estimates that that is worth \$75 million a year to the residents of Southcentral Alaska and that does not take into consideration the jobs that can be retained through lower cost energy sources.

[3:20:13 PM](#)

MR. ELDER moved to slide 7, "General Comments about HB 247," and specified that these comments are from a Cook Inlet perspective only. He said that repeal of the 40 percent and 20 percent credits [AS 43.55.023(a) Qualified Capital Expenditure (QCE) Credits and AS 43.55.023(l) Well Lease Expenditure (WLE) Credits] will definitely have a negative impact on future investment, at least for Furie. Retention of the 25 percent loss credit [AS 43.55.023(b)] is helpful, but it is not adequate with the repeal of the other credits, especially with the \$25 million limitation on purchase of the cash credit certificates. The proposed changes have really hit and hurt Furie's ability to finance its operations. Small companies have to borrow money and get competitive money, he explained, and Furie has to pay back that money this year. If changes are not made [to HB 247's proposals], Furie will have a hard time paying back its lenders. He also noted that the proposed change of July 1, rather than a phase-out over a reasonable time period, will cause confusion and loss because Furie put its plans in place two years ago.

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REPRESENTATIVE OLSON asked whether HB 247 will have any impact on Furie's long-term contracts that are already in place; for example, whether Furie will be able to pass that on to Homer Electric Association and others that it has sold gas to.

MR. WEBB answered no. The contracts are based on firm prices and firm commitments, so there is no way for Furie to re-enter the negotiation and say it now wants a higher gas price because the tax credits changed and now Furie is at a loss. Furie would be stuck, it negotiated a gas price and has to stick with it.

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REPRESENTATIVE OLSON postulated that depending upon the length of the contract, Furie could have new gas coming into it that was done under a different structure. He asked whether Furie would still have to sell that gas at the original price.

MR. WEBB replied that if Furie had a new contract it could negotiate a different price and that price would be based on what Furie's investments and capital costs are. However, for the contracts that Furie has right now, the price is set.

REPRESENTATIVE OLSON presumed that Furie doesn't have 100 percent of the gas for the contracts, so Furie would have gas coming in that was under a different well, but he understood that Furie would have to sell that gas at the same price.

MR. WEBB responded correct, under Furie's last contract it has to drill three more wells.

REPRESENTATIVE OLSON concluded that Furie could then be competing on that.

MR. WEBB answered right, Furie has to drill the wells no matter what.

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REPRESENTATIVE JOSEPHSON inquired whether the contracts with the Homer Electric Association are confidential or public.

MR. WEBB replied that they are public through the Regulatory Commission of Alaska (RCA).

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MR. ELDER returned to his presentation. He displayed slide 8, "Tax Credits Enable Development Companies to Access Low Cost Capital," and noted the importance of the tax credits to financing. Regarding unintended consequences, he stated that the actions last year on the line-item veto and the confusion that that generated throughout the financial community froze Furie's borrowings at that time. Furie is thankful that members of the legislature, the governor's office, and the Department of Revenue took time to meet with potential lenders, because only through that was Furie able to access that funding. Those actions instantly cost Furie \$30 million in funding and hit Furie right in the largest development phase it had ever done. Furie was eventually able to get a lot of that back through discussions with the state. The problem Furie has right now is that lenders are unsure whether Furie will get paid the 2015 credits it has earned and lenders have stopped lending in 2016.

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REPRESENTATIVE JOSEPHSON allowed the veto was very significant in terms of its impact, but said that if he were counsel to the oil companies he would have advised each time he met with his client that the statute says the state only has to pay 10 percent. He inquired whether Furie was aware of this.

MR. ELDER responded that Furie was aware. But, he added, the state had a history of not doing that and there was faith in that. When Furie started the applications were submitted quarterly and were processed and paid within about six or seven months. Furie recognized that changes were occurring and restructured its programs. All Furie is trying to do is use the existing program to finalize and fund a program that started two years ago. Furie is asking for certainty. A question was asked earlier about what is most important - the absolute level of the credits or this current system and dependability? He would say that a company like Furie has to have that certainty because it has to meet its financial obligations. Furie needs the credits, but certainty is needed too.

[3:25:53 PM](#)

REPRESENTATIVE TARR observed the bullet on slide 8 about being able to access low cost capital and pointed out the provision in HB 247 for a fund under the Alaska Industrial Development and Export Authority (AIDEA) from which companies could borrow. She asked whether that fund could be similarly used to leverage low cost capital for the investments.

MR. ELDER answered that the \$25 million limit is not enough. The cost of capital for a development stage company is extremely high, he explained, and such a company also has the constraints of how to fit in a different lender with the company's other lenders that don't want to get any collateral or consideration of anybody else. Just \$25 million won't do it, especially when combined with the \$25 million cap on these credits. While helpful, it isn't enough. Furie has talked to AIDEA in the past, but it was explained that the risk of oil and gas investment doesn't necessarily fit what AIDEA's investment profile is.

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REPRESENTATIVE TARR pointed out that another piece of legislation [HB 246] would capitalize the aforementioned fund

and would provide another opportunity to revisit the cap, at which time Furie could provide comment as to what would be more favorable to advancing its projects.

MR. ELDER replied that he does have some good ideas on that but didn't have a chance to talk about them during his last visit with [DOR Commissioner] Hoffbeck. He suggested that a fund be structured that financed these credits; this would allow the state some flexibility and give industry certainty.

MR. ELDER thanked the committee for the opportunity to comment on HB 247.

[HB 247 was held over.]

[3:28:17 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at [3:28] p.m.