State of Alaska

Department of Revenue

Commissioner Bryan Butcher

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The Honorable Eric Feige
State Capitol Room 126
Juneau AK, 99801

February 24, 2011

The Honorable Paul Seaton
State Capitol Room 102
Juneau AK, 99801

SUBJECT: Response to Questions from House Resources Meeting on February 23, 2011

Dear Representatives Feige and Seaton:

The purpose of this document is to respond to follow-up questions from the House Resources Committee meeting on February 23, 2011. The requests/questions and responses follow.

1) **Provide additional information on the $90-$92 oil price figure generated under the provisions of HB 110 to cover the Governor's FY12 budget request.**

   The Governor's proposed FY 12 budget, with proposed amendments as of February 16, 2011, includes a total authorization to spend $5,466.2 million of Unrestricted General Funds, after accounting for transfers and savings.

   In information provided to the committee, we indicated that an ANS West Coast oil price of approximately $90 to $92 per barrel would be required to generate unrestricted revenue of $5,466 million, assuming all provisions of HB 110 were in effect prior to the start of FY 12. Note that this is a hypothetical exercise because as currently written the major provisions of the bill would not take effect until after FY 12.

   The following table shows the composition of FY 12 unrestricted revenue under three scenarios: ACES using our Fall 2010 forecast price assumption, ACES using a price of $91 per barrel, and HB 110 using a price of $91 per barrel, assuming HB 110 were in place.

FY 2012 Unrestricted revenue compared with Proposed FY 12 Budget (in $millions)			
Revenue Components	**ACES @ Forecast price ($82.67/bbl)**	**ACES @ $91.00/bbl**	**HB 110 @ $91.00/bbl**
Production tax	$2,738	$3,633	$2,668
40% well lease expenditure credit*	$0	$0	($300)
Royalties	$1,667	$1,842	$1,842
Corporate Income tax – oil & gas	$555	$555	$555
Property tax	$102	$102	$102
Non-petroleum revenue	$683	$683	$683
Total Unrestricted Revenue	**$5,744**	**$6,815**	**$5,550**
Proposed FY 2012 Budget	$5,466	$5,466	$5,466
Amount Over (Under) Budget	**$278**	**$1,349**	**$84**

*A mid-range estimate of $300 million was chosen for the well lease expenditure credit amount.

Source: DOR forecast model updated with HB 110 provisions, Fall 2010 forecast for production, costs, and revenues other than production tax & royalty.

If HB 110 is passed as currently written, many of the key provisions would not take effect until after FY 12. An ANS price of around $81 would be needed to balance the budget in FY 12 if HB 110 passes as currently written. The following table shows the components of total unrestricted revenue used to derive this estimate.

FY 12 Oil Price necessary to cover proposed FY 12 budget under HB 110 (in $millions)	
Revenue Components (in $ millions)	**HB 110 @ $81.00/bbl**
Production tax (most HB 110 provisions not yet effective)	$2,557
Royalties	$1,632
Corporate Income tax – oil & gas	$555
Property tax	$102
Non-petroleum revenue	$683
Total Unrestricted Revenue	**$5,529**
Proposed FY 2012 Budget	$5,466
Amount Over (Under) Budget	**$63**

Source: DOR forecast model updated with HB 110 provisions, Fall 2010 forecast for production, costs, and revenues other than production tax & royalty.

2) **What price of oil would be required in FY17 to provide enough revenue to cover the Governor's FY12 budget request?**

The Governor's proposed FY 12 budget, with proposed amendments as of February 16, 2011, includes a total authorization to spend $5,466.2 million of Unrestricted General Funds, after accounting for transfers and savings.

In FY 17, an ANS West Coast oil price of approximately $95 per barrel would be required to generate unrestricted revenue of more than $5,466 million, assuming HB 110 passes as written. The Department is forecasting an ANS West Coast oil price of $102.90 for FY 2017.

The following table shows the composition of FY 17 unrestricted revenue under three scenarios: ACES using our Fall 2010 forecast price assumption, ACES using a price of $95 per barrel, and HB 110 using a price of $95 per barrel, assuming all provisions of HB 110 were in place.

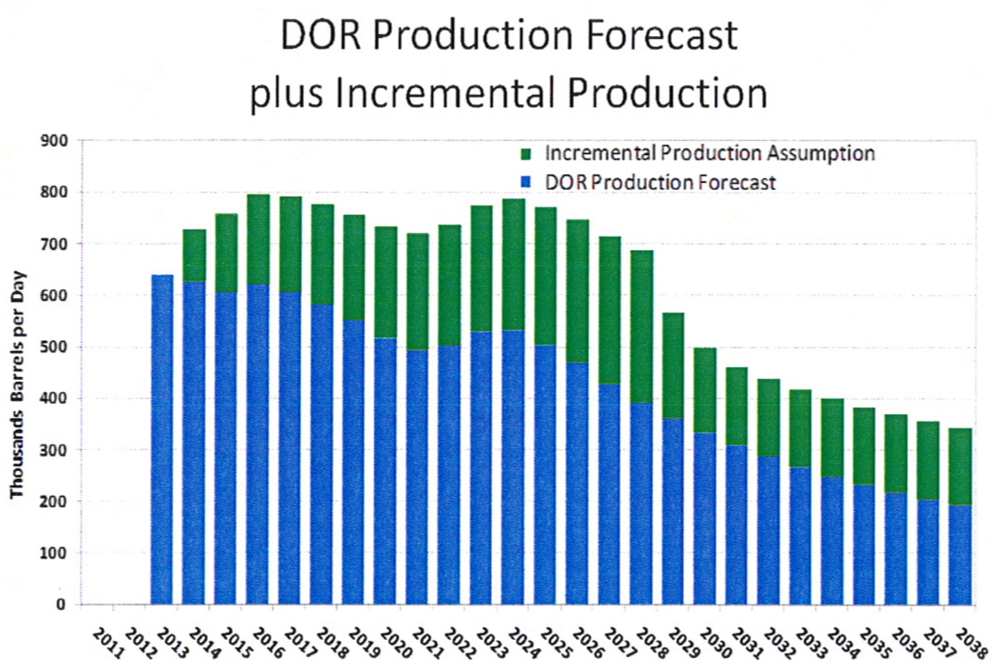
FY 2017 Unrestricted revenue compared with Proposed FY 12 Budget (in $millions)

Revenue Components (in $ millions)	ACES @ Forecast price ($102.90/bbl)	ACES @ $95.00/bbl	HB 110 @ $95.00/bbl
Production tax	$4,631	$3,646	$2,618
40% well lease expenditure credit*	$0	$0	($300)
Royalties	$1,829	$1,670	$1,670
Corporate Income tax – oil & gas	$700	$700	$700
Property tax	$90	$90	$90
Non-petroleum revenue	$742	$742	$742
Total Unrestricted Revenue	**$7,993**	**$6,848**	**$5,520**
Proposed FY 2012 Budget	$5,466	$5,466	$5,466
Amount Over (Under) Budget	**$2,527**	**$1,382**	**$54**

*A mid-range estimate of $300 million was chosen for the well lease expenditure credit amount.
Source: DOR forecast model updated with HB 110 provisions, Fall 2010 forecast for production, costs, and revenues other than production tax & royalty.

3) **What is the best case scenario where oil revenue declines under HB 110 in the early years, and then recovers in later years due to additional oil production incentivized by the bill? When would revenue under HB 110 become higher than revenue under current law?**

The following charts have been prepared to illustrate the potential impact of incremental production on state revenue. This illustration does not constitute a "best case scenario" but rather one single potential outcome out of a very wide range of possible production and price scenarios. The assumptions used are based on the Fall 2010 production and price forecasts and on recent industry testimony and as such, can be considered as neither excessively optimistic nor conservative. This scenario does not represent a Department of Revenue forecast or expectation. The analysis assumes that following the enactment of HB 110, incremental production beyond what is included in the Department's current production forecast would come from state lands. For this analysis, production included in the Department's forecast is assumed to be taxed at a 25% base rate and a maximum progressivity of 25% under HB 110. For illustration purposes, incremental production has been assumed to follow a profile similar to that presented by Great Bear Petroleum, as described in their 18th February, 2011 testimony[1]. This incremental production is assumed to come from currently non-unitized fields, which under HB 110, would be taxed at a 15% base rate and a maximum progressivity of 25%.

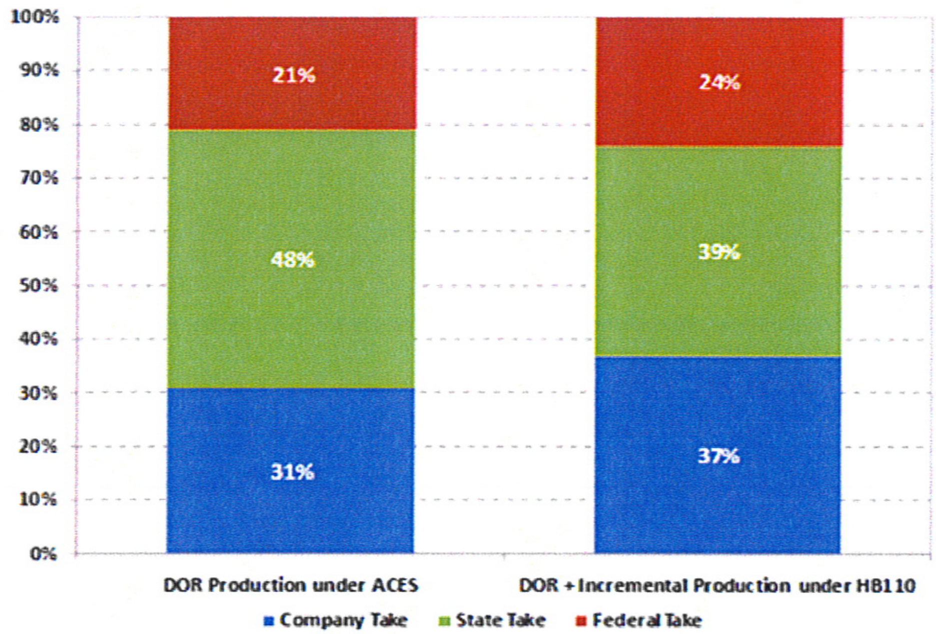


Source: DOR Production Profile; Fall 2010 Revenue Sources Book.
Incremental Production: Great Bear Petroleum; 18 February, 2011.

Overall, the enactment of HB 110 under this set of assumptions would reduce the "State Take" (all state revenues including production tax, royalty, corporate income tax and property tax) from 48% to 39% of profits. Overall "Government Take", which also includes federal corporate income taxes, would be reduced from 69% to 63%.

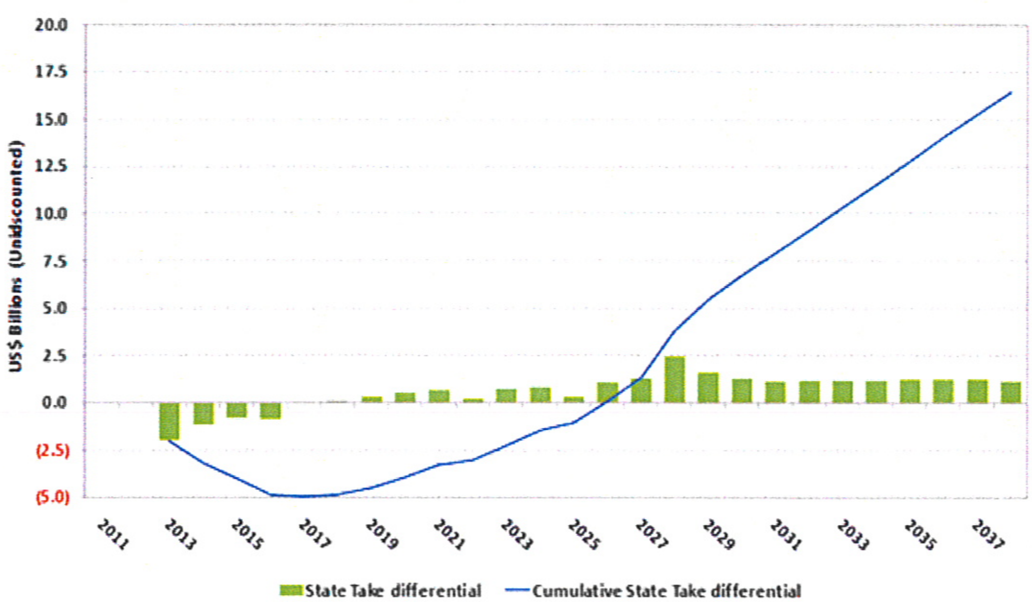
[1] Production starts in 2014 with 295 thousand barrels per day peak in 2028. Note: Great Bear Petroleum labels this as a 'Potential Oil Production Profile' and lists certain assumptions used in the preparation of this profile in their testimony.

Company, State and Federal share of profit under ACES and HB 110 (with incremental production)



However, while the relative State Take decreases under HB 110, it is applied to a "larger pie", which includes the assumed incremental production. Over the 2013 to 2038 period, total state revenue under HB 110, with the incremental production, would be $17 billion higher than it would be under ACES with no incremental production.

Additional state revenue under HB 110



Note: State Take for DOR + Incremental Production under HB110 minus State Take for DOR Production under ACES

Under the assumptions used, state revenue under HB 110, with the incremental production, would be higher than under the status quo beginning in 2018. Cumulative state revenue under the HB110 scenario starts exceeding what would have been received under ACES in 2026. As stated earlier, this is but one many potential scenarios as incremental production could conceivably be greater, or lower, than assumed for the purpose of this illustration.

We hope our responses fully answer your questions.

Sincerely,

Bruce Tangeman
Deputy Commissioner