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The Honorable Eric Feige
The Honorable Paul Seaton
Co-Chairs, House Resources Committee
Alaska State Capitol, MS3100
Juneau, AK 99801-1182

Dear Co-Chairs Feige and Seaton:

Thank you for the opportunity to testify and provide BP's perspective on HB110 last week. In this letter I hope to provide further details and data as appropriate, to support my testimony and also to answer some questions that were raised during the testimony.

In my testimony I made the following key points:

1) Numerous industry indicators show that Alaska's current production tax structure is unsustainably high and is driving down investment. Due to an uncompetitive tax structure, Alaska is loosing out in the race with other provinces to secure its fair share of investments. BP's own experience is that passage of ACES has resulted in many of Alaska's opportunities becoming uncompetitive.

2) A rebalancing of the tax system is necessary to kick start new investments that will ensure long term activity on the North Slope. HB 110 is a required first step in that direction and will encourage more activity.

3) Certain additional changes to the bill will further increase Alaska's competitiveness.

The trend and evidence are clear. If the production tax system is not changed, investment will not increase and oil production will continue to decline.

Do nothing and we can predict the future. Indeed, we can see it beginning to happen. Pass HB 110 and the future of Alaska's oil production will be brighter and have a chance of competing for more investment.

I would like to elaborate further on a few of these points.

Alaska is not competitive

A number of companies operating in Alaska, including BP, had testified in 2007 that ACES was an overly harsh fiscal regime that would make Alaska opportunities uncompetitive in the global context. Three years after the passage of ACES, there are actually a number of independent reports that corroborate this very fact. In mine and others testimonies, you heard about the Wood Mackenzie report. The exact ranking is just of academic importance – the key fact is that the Alaska tax regime does deter investments.

There are numerous industry indicators that show Alaska is behind in investment and activity when it should be up or on par with other oil producing provinces. The only factor that has changed over the past 5 years, as prices have increased, is Alaska's oil tax system -- especially the enactment of ACES in 2007. Therefore, while the rest of the world is enjoying growth in oil investment, Alaska is seeing stagnation and production decline.

Reducing the fiscal impact to investment is proven to increase activity and investment.

The proof of what a balanced fiscal system can do to increase activity and investment is evidenced in Alaska. The reduction in tourism taxes led to an increased number of cruise ships to Alaska; the combination of reduced tax burden and targeted credits increased activity in Cook Inlet; and film industry credits increased film production in Alaska.

Attached are a number of articles that support the same principle. They all show that investment is up in other regions and fiscal terms make a difference.

- Tight Oil in the Rocky Mountains – Wood Mackenzie analyzes the investment boom in the Rocky Mountains to gain access and develop the challenging tight oil shales. One reason, the fiscal terms are in better balance with the risks and reward.
- Western Canada land sale: Alberta makes history in 2010 – A change in fiscal terms opened the floodgates of oil industry activity in Alberta.
- Alaska and Arctic Canada – a review of 2010 – "Alaska – another lackluster year". Drilling – "This marks the third straight year of declining exploration activity on the slope."
- 2010 year in review – Gulf Coast region – Heavy investment in shale plays drove Gulf Coast regional activity in 2010.

There is not one factor to look at to determine if Alaska is competitive and drawing its fair share of investment. There are many indicators: drilling activity is down, independent studies show Alaska is not competitive, production is in decline, the number of exploratory wells being drilled is down, the number of new projects sanctioned to start construction is down, the low interest in lease sales, the number of lease relinquishments, the amount of contract work. And the list can go on. When you compare these and other factors/indicators to the rest of the world, oil industry activity is up and booming.

The evidence is clear; Alaska is losing out on the oil industry investment boom (see attached Wall Street Journal article). It is also well established that reducing the fiscal burden increases investment.

Yes, many factors weigh on a company's investment decisions. But fiscal policy is always a big factor, and that is the main one in your control. This is a lever the state government can use to lift Alaska oilfield investment.

HB 110 is a good first step in the right direction of rebalancing ACES, and will lead to additional activity

BP believes that a rebalancing of the tax system is required for the reasons quoted above as well as in my testimony. HB 110 attempts to rebalance the profit sharing between the State and the oil companies and is a good and necessary step in the right direction. My testimony addressed BP's views of the various bill provisions, and is summarized below:

a) **Brackets:** Introduction of brackets provides a more balanced approach in sharing upside potential. It rebalances progressivity and is viewed by BP as the most important provision in the bill that will help make Alaska opportunities more competitive. A bracketing approach is analogous to personal federal income taxes and represents a more transparent, widely accepted and understood tax methodology. The bracketing also reduces the high marginal tax rate issue so often noted as an issue with ACES.
b) **Capital Credits for Drilling:** I believe the credits will result in increased drilling on the North Slope, and BP supports their introduction. The drilling credits will direct the producers to invest more toward drilling and create more cash flow for other investments. We do have a suggested technical change in the clarifying language of the section 16 AS 43.55.023(n)(1). The reference to IRC 263(c) and regulations thereunder are inconsistent with the term "well workover". Generally, "well workover" activity is not considered "incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas". Therefore, by simply changing the "or" preceding "well workover" to an "and" will resolve this conflict and allow intangible drilling costs and well workover costs to qualify for the credit. This will avoid ambiguity.
c) **Changes to Interest Rate:** An 11% interest rate as currently exists is punitive. It introduces incentives in the system to delay settlements because of the ability to earn windfall interest on the settlement amounts. The changes recommended by HB 110 are more reasonable and aligned with good tax policy.
d) **Statute of Limitations** – HB 110 seeks to reduce the statute of limitations from 6 years to 4 years. BP supports this measure. Retaining materials and institutional knowledge needed to answer detailed forensic audit questions six years after occurrence is very difficult and expensive. The current audit period of 6 years is much longer than the more standard 3 year provision in most tax codes, including the IRS.

e) **Change to annual system from current monthly system** – Oil companies, the State, and the Department of Revenue all plan activity and budgets on an annual basis. Calculation of taxes on a monthly basis introduces uncertainty and errors in all forecasting and planning activity. Because the progressivity regime is not symmetrical, increased tax in a month of high prices is not offset by reductions for months with low prices. The result is an unplanned and uncontrollable tax on oil price volatility – something that, we believe, was never intended, was not anticipated and is not sound tax policy. The HB110 change resolves this issue and is supported by BP.

Some of the key provisions of HB110, such as bracketing provisions, do not become applicable until 2013. This will mean a delayed response in investment. BP would rather see tax reform – and the investment response -- come earlier than 2013. We are confident that over time an improved tax regime will lead to more investments, jobs and production. BP for its part will commit to relooking at the entire opportunity set, and especially those investments that had to be deferred with ACES. We fully expect that opportunities will emerge as competitive and will be pursued. In my testimony I alluded to some of them such as increased drilling, I-Pad and more R&D spending. Once again it is probably appropriate to mention that BP is a 26% interest owner in Prudhoe Bay, and we will need our working interest owner's cooperation to increase activity levels, but we do expect that they will view the changes favorably.

Some additional changes that could further increase Alaska's competitiveness

HB110 is a good step, but there is more that should be considered For instance, we can have a substantial reserve base on the Slope and forecasted production, but if we don't have a way of getting it off the Slope, it's meaningless. As you've undoubtedly heard and we just recently experienced, TAPS is facing challenging times with regard to flow and temperature. We need to implement the provision of this bill immediately rather than stagger the implementation to facilitate investment at the earliest opportunity.

I would like to draw your attention to the distinction in the DOR's production forecasts between current production and new development. The current production and exploitation of the known reserves at Prudhoe, Kuparuk and other currently producing fields is critical to the base flow provided to TAPS throughput. BP currently spends a significant portion of our capital and operational expense to maintain the "current" production at the legacy fields simply to keep the decline at its current 10%. In addition, it is our additional investment in pursuing the "new development" within the legacy fields that reduces the decline to the current 6%-7% decline. Without these investments the decline will rapidly increase to 15%+. The DOR's production forecast captures the effect of the anticipated spend required to keep this decline from falling off any more than what it already is. Any enticement to further production within these known fields will keep TAPS operating at a level which will provide the opportunity for new development to come on line and enhance the flow of oil down TAPS.

Response to Questions from the Committee:

There was a request for data concerning the number of wells drilled world wide. The Attached Table 7, from the API Basic Petroleum Data Book shows the number of wells drilled around the world. Consistent with the point I was making, the drilling around the world is trending upward. This is consistent with a higher oil price environment. Unfortunately, due to the limited upside potential caused by the ACES production tax system, Alaska is not participating in the growth and increased activity normally driven by the expectation of higher oil prices. As I presented, the drilling, measured by footage drilled, is trending downward.

There was a request for more countries to be added to our Company Share slide. We looked at the United Kingdom and Norway as they are both 'tax and royalty' regimes as is the US. We found UK to be materially better with a company share of 50%+. Norway was better than the current ACES system but it was not so dramatic. Other countries where BP operates are difficult to model in this "snap-shot" manner because the commercial arrangements are contractual in nature and the commercial terms are based on full-cycle economics. Freezing the terms at any one point in time distorts the full-cycle investment/economics. The better approach to measuring and comparing such complex fiscal systems is using a discounted cash flow over the life of the project. Wood Mackenzie used such an approach when comparing fiscal systems. Alaska is 117 out of 129 countries studied.

Yours faithfully,

Claire Fitzpatrick

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