

TESTIMONY OF EXXONMOBIL
ON ALASKA'S INVESTMENT CLIMATE
TO THE ALASKA SENATE FINANCE COMMITTEE
MARCH 5, 2013

Mister Chairman, members of the Committee:

For the record, my name is Dan Seckers. I am ExxonMobil's Tax Counsel, based in Anchorage. I want to thank the Committee for the opportunity to express ExxonMobil's views on Alaska's current investment climate and the impacts of Alaska's oil and gas production tax or ACES.

Let me begin by underscoring what many of you have likely heard ExxonMobil say throughout the years - that Alaska has been and continues to be an important component of ExxonMobil's world-wide investment portfolio. We have had a presence in Alaska for over 50 years and have been a key player in Alaska's oil industry development. We are the operator of Point Thomson, hold the largest working interest at Prudhoe Bay (36.4%) and are the largest lease holder of discovered Alaska gas resources. We are committed to Alaska and its future and expect to be involved here for many years to come.

Let me also state that ExxonMobil continues to support Governor Parnell's efforts toward substantive reform of ACES. We appreciate his willingness to champion this

difficult issue for the past two years and his committed effort again this legislative session. The need for Alaska to develop a competitive, stable fiscal regime that attracts the levels of investments that Alaska's North Slope requires is one of the most, if not the most, important issues facing the State. We believe the Governor's four core "principles", as emphasized in his State of the State speech that any reform of ACES:

- Be fair to Alaskans
- Encourage new oil production
- Simplify and restore balance to Alaska's fiscal system
- Make Alaska competitive for the long term

can form the foundation of a successful, long-term taxation policy for the State.

The Governor has not been alone in his efforts. Many members of the Legislature have worked hard the past two years to examine and understand the impact of ACES on Alaska's global competitiveness. That hard work has been having a positive effect as it appears legislators and most Alaskans now recognize that Alaska's production tax system is not well designed to tackle the production decline and attracting investments to develop new production.

Consistent with the testimony we have given over the past several years, ExxonMobil believes that the changes made to Alaska's oil and gas production tax since 2005 have had a negative impact on business activity in Alaska and Alaska's overall investment

climate. Fundamentally, the progressivity component of the ACES tax regime, on top of an already high base tax rate, creates a major disincentive to invest in the high-risk, high-cost opportunities available in Alaska. These two features must be addressed for any tax policy to be successful in meeting the State's desired production and long-term revenue goals.

Two aspects of the current tax policy, however, are pro-development. The deduction of operating and capital expenditures before applying the tax rates recognizes the high cost of doing business in Alaska. The further tax credit for capital expenditures rewards those who invest in future production and infrastructure. These are key components of the current ACES whose benefits should be reflected in any revised tax policy the State is considering.

As the Legislature's and State's own consultants have indicated over the previous two legislative sessions and during recent hearings in your Committee and other committees, Alaska has one of the highest and most punitive tax systems in the world. The high progressivity is directly impeding Alaska's global competitiveness. To significantly grow state revenues, secure jobs and stem the production decline, it is essential that Alaska's tax structure encourages long-term development of all of Alaska's resource potential.

As the Governor has stated, Alaska's fiscal regime must be competitive and durable for the long term. ExxonMobil values a predictable fiscal environment in which to make

long term investment decisions. Our investments are capital intensive and are evaluated over timeframes of decades. Any change in the fiscal regime has a direct impact on how we view stability of the Alaskan fiscal environment, which in turn impacts how we evaluate the risk basis of future investment decisions. Because of the nature and magnitude of the risks associated with any oil or gas investment, coupled with the long lead time required to recoup that investment, stable fiscal terms are key to any investment decision.

To date, Alaska has produced more than 16 billion barrels of oil from the North Slope, and according to the Department of Natural Resources there are over 5 billion barrels of known resources remaining. These undeveloped resources represent a substantial opportunity, but their development is at risk under the current ACES tax system. Oil production today is less than one-third of the peak oil production of more than 2 million barrels per day in 1988, and annual production continues to decline.

You have heard about the continued and alarming decline of North Slope oil production from the Department of Revenue, State consultants and individuals that have testified earlier. But it is important to reemphasize that industry currently invests more than \$1 billion per year just to maintain current North Slope oil production decline at six to seven percent. The substantial majority of that annual investment is in the legacy fields – Prudhoe Bay and Kuparuk. Absent that continued investment, the annual production decline would likely be in the range of 12 to 15 percent annually. Without meaningful

tax reform that includes Alaska's legacy fields, Alaska can expect production declines to continue.

Production from the legacy fields not only provides the majority of the State's revenues, it sustains the current North Slope infrastructure and the operation of TAPS, which are critical to enabling new production. The infrastructure from these legacy fields has been leveraged historically for satellite developments, such as Pt. McIntyre, Orion, Borealis and other non-legacy fields to economically process and transport their oil from the North Slope to refinery destinations. If the large legacy fields did not exist, it is unlikely any of these other developments would have been economic.

Without healthy legacy fields, the prospects of any future new fields or developments become even more economically challenged and the probabilities of Alaska reaching its desired goal of long-term sustained production levels more difficult.

Encouraging increasing investment to keep these key fields healthy is therefore at least as important as encouraging investment in exploration and development of new fields. For any tax reform to contribute to the Governor's stated objectives for Alaska's long-term production, it must also be applicable to the legacy fields where the State's near and long term economic future rests.

Considerable attention has been placed on making Alaska more competitive relative to other regimes. While that focus is extremely important, it is only part of the overall

picture. Benchmarking government take against other producing areas is a useful tool for gauging basic competitiveness, but does not provide the full picture of investment health. As the Department of Revenue and various consultants have testified, spending on the North Slope has remained relatively flat since the enactment of ACES. But what needs to be clarified is that the majority of that spending has been for maintenance and upkeep to sustain existing operations, not for new development. Under ACES, the State has not attracted the new investment needed to increase production.

Complicating Alaska's production decline is its high exploration, development and production costs. Alaska is one of the most expensive places in the world to develop and produce oil and gas. Many factors contribute to Alaska's higher costs including:

- Severe arctic conditions, placing limitations on when drilling and other operations can be undertaken
- Environmental challenges
- Remote location of the resource and distance to market
- Restriction of exploration opportunities

These are complications that Alaska faces that most other areas do not; but they do factor into the economic decisions being taken by investors and need to be considered when assessing what is Alaska's optimum production tax regime.

ExxonMobil is willing to accept the risks of long-term, capital intensive investments when a stable tax structure allows and encourages investment and ensures a corresponding opportunity for upside potential. Upside factors such as increased production and higher prices can compensate for risks taken by investors, because companies are certainly negatively impacted when lower than expected production or prices occur. The high marginal tax rates under the progressive structure of ACES take away the upside potential and reduce the attractiveness of those capital intensive investments, compared to other locations where the upside benefit can be retained.

Alaska faces significant challenges. As I mentioned, costs are high and production continues to decline. We all need to work together to achieve the right balance – as Governor Parnell stated - a balance that maximizes the benefit to Alaskans while encouraging industry to continue to invest in Alaska.

ExxonMobil recognizes the difficulty you face as policy makers in tackling the State's tax policy while protecting current revenue streams and addressing the revenue problems just over the horizon due to the production decline. We appreciate how hard and difficult that task is.

Today's production rates are the product of government policies, technical work, and investment decisions that in many cases were made decades ago. Increasing production rates in the decades to come will result from sound policies, decisions, and commitments that are made by this Legislature. As policy makers, you will need to

decide whether Alaska's current high production tax regime is the right course for Alaska or if another course is necessary to harness the remaining resource potential, given the high costs and steadily declining oil production rates we as Alaskans face.

It is important to recognize that any decision made by this Legislature impacts much more than tax revenue in the near term and in the future. Decisions made today will influence the life of production in existing fields and investments required to develop Alaska's remaining resource potential. This will in turn impact jobs for Alaskan workers, revenue for many Alaska businesses, infrastructure that benefits Alaskan communities, and set the stage for the future of Alaska for many generations to come.

As I indicated, ExxonMobil fully supports the Governor's and this Legislature's efforts to reform ACES and to make Alaska's investment climate globally competitive. To maximize its resource potential while receiving a fair share of the resource revenues, Alaska needs a long-term resource development policy that will encourage increasing investment. The reform of ACES needs to result in a competitive, stable and predictable fiscal environment that will encourage investment at all price levels and incentivize the development of remaining resources that are economically challenged, including both new fields and resource development opportunities in existing fields. ExxonMobil believes the key focus of the reform needs to create a balanced program using a combination of changes to progressivity, the base tax rate and capital expenditure tax credits to provide a competitive balance of government take across all price bands.

Let me conclude by reiterating that ExxonMobil is committed to Alaska and to pursuing competitive investment opportunities here in the future. Unfortunately, the resource and cost structure in Alaska is becoming increasingly challenging. It is ExxonMobil's firm belief that passage of meaningful changes to ACES this year will support additional investments in Alaska that will lead to greater development and production as well as economic opportunities for Alaskans.

ExxonMobil looks forward to working with the Administration, the Legislature, industry and the people of Alaska in the pursuit and development of Alaska's oil and gas resources.

Thank you again Mister Chairman for the opportunity to present these written comments to you and your Committee.