Oil Tax Reform—Arresting TAPS Throughput Decline



House Finance Committee

Friday, April 5, 2013

Commissioner Daniel S. Sullivan, DNR
Commissioner Bryan Butcher, DOR

Outline



PART I: Current Context–Opportunities & Challenges

PART II: Is the Current Tax System Working for Alaskans?

PART III: Production, Production, Production

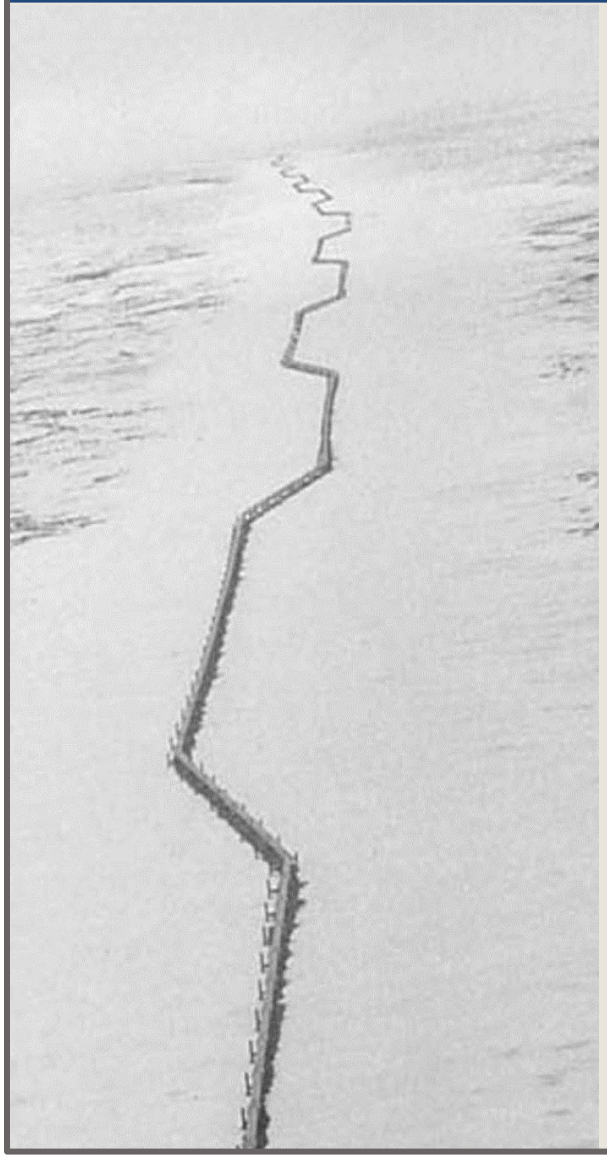
Part I



Current Context–Opportunities & Challenges

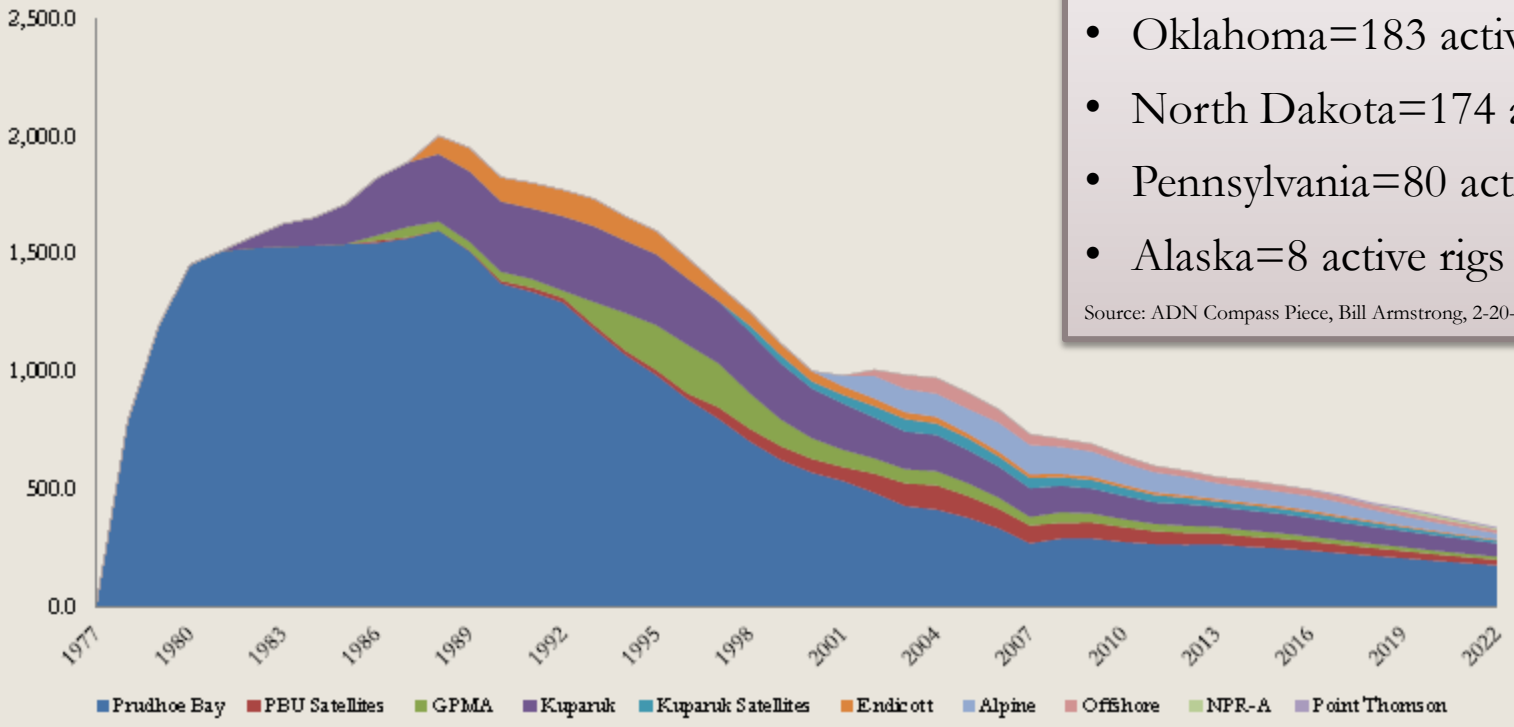
TAPS

- A Critical State & National Energy Asset -



- TAPS has transported over 16.3 billion barrels of oil and natural gas liquids since June of 1977. Production peaked at 2.2 million barrels per day in the late 1980s, representing 25% of U.S. domestic production
- Since its peak, however, throughput has steadily declined; today, TAPS is 2/3 empty and declining at an average of 6% per year
- TAPS throughput decline threatens economic disruption and the very existence of our pipeline
- 90% of state revenues come from oil production
- We must encourage industry to invest in exploration and development of conventional and unconventional resources on state and federal land, onshore and offshore
- TAPS has plenty of capacity for increased throughput
- Most near-term critical economic issue facing the state
- Most urgent issue facing the state – two and half years of studies

Production History



2013 Rig Count:

- Texas=830 active rigs
- Oklahoma=183 active rigs
- North Dakota=174 active rigs
- Pennsylvania=80 active rigs
- Alaska=8 active rigs

Source: ADN Compass Piece, Bill Armstrong, 2-20-13

Source: Alaska Department of Revenue Fall 2012 Revenue Sources Book: http://www.tax.alaska.gov/programs/documentviewer/viewer.aspx?2682f

Massive Resource Base

- USGS estimates that Alaska's North Slope has more oil than any other Arctic nation
  - **OIL:** Est. 40 billion barrels of conventional oil *(USGS & BOEMRE)*
  - **GAS:** Est. over 200 trillion cubic feet of conventional natural gas *(USGS)*
- Alaska has world-class unconventional resources, including tens of billions of barrels of heavy oil, shale oil, and viscous oil, and hundreds of trillions of cubic feet of shale gas, tight gas, and gas hydrates

- Alaska's North Slope has already produced more than 16 billion barrels of oil to date
- At year-end 2010, the Energy Information Agency (EIA)(federal Department of Energy) put remaining North Slope reserves at 3.7 billion barrels of oil
- Reforms now can create enormous future opportunities and benefits

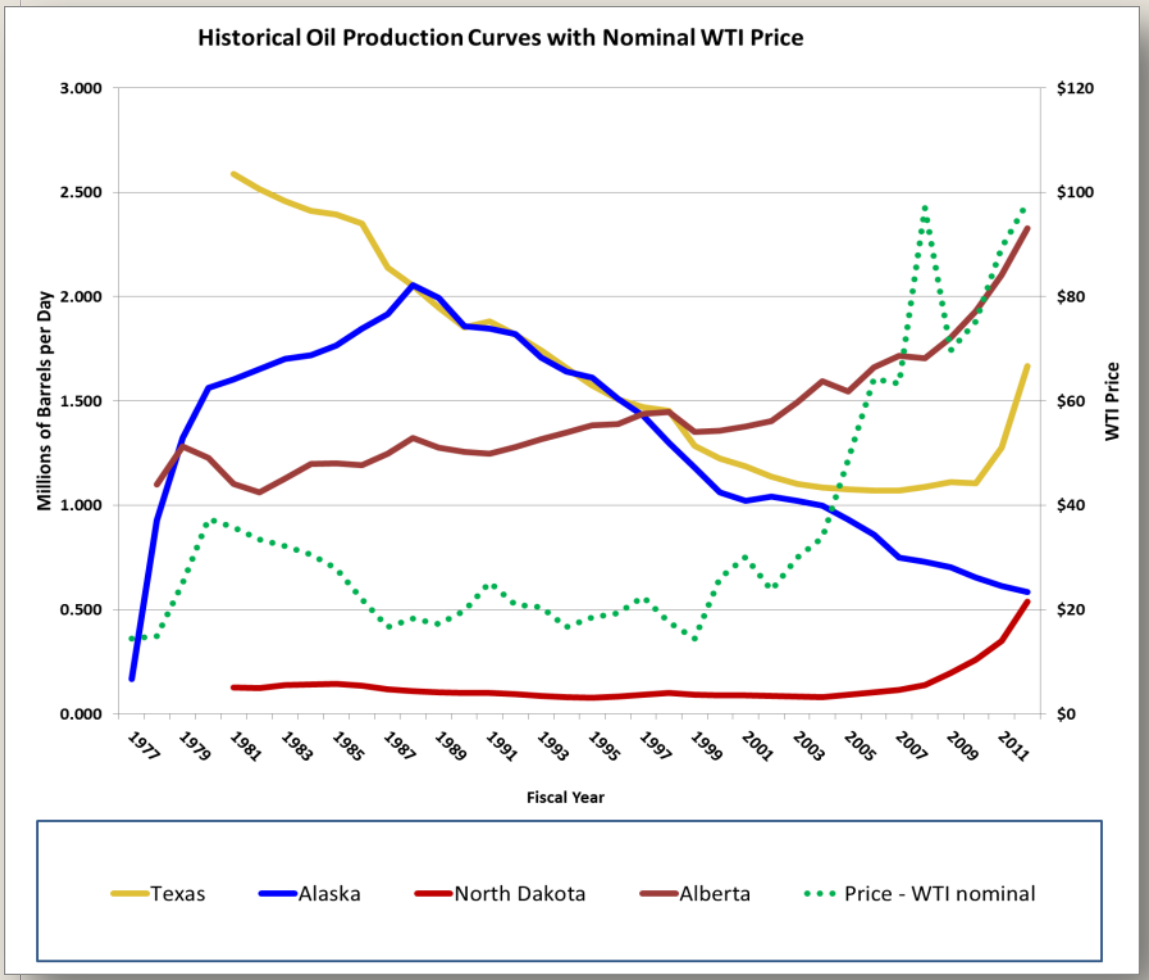
Compared to most hydrocarbon basins, Alaska is relatively underexplored, with 500 exploration wells on the North Slope, compared to Wyoming's 19,000.



Other Basins Have Turned Decline Around

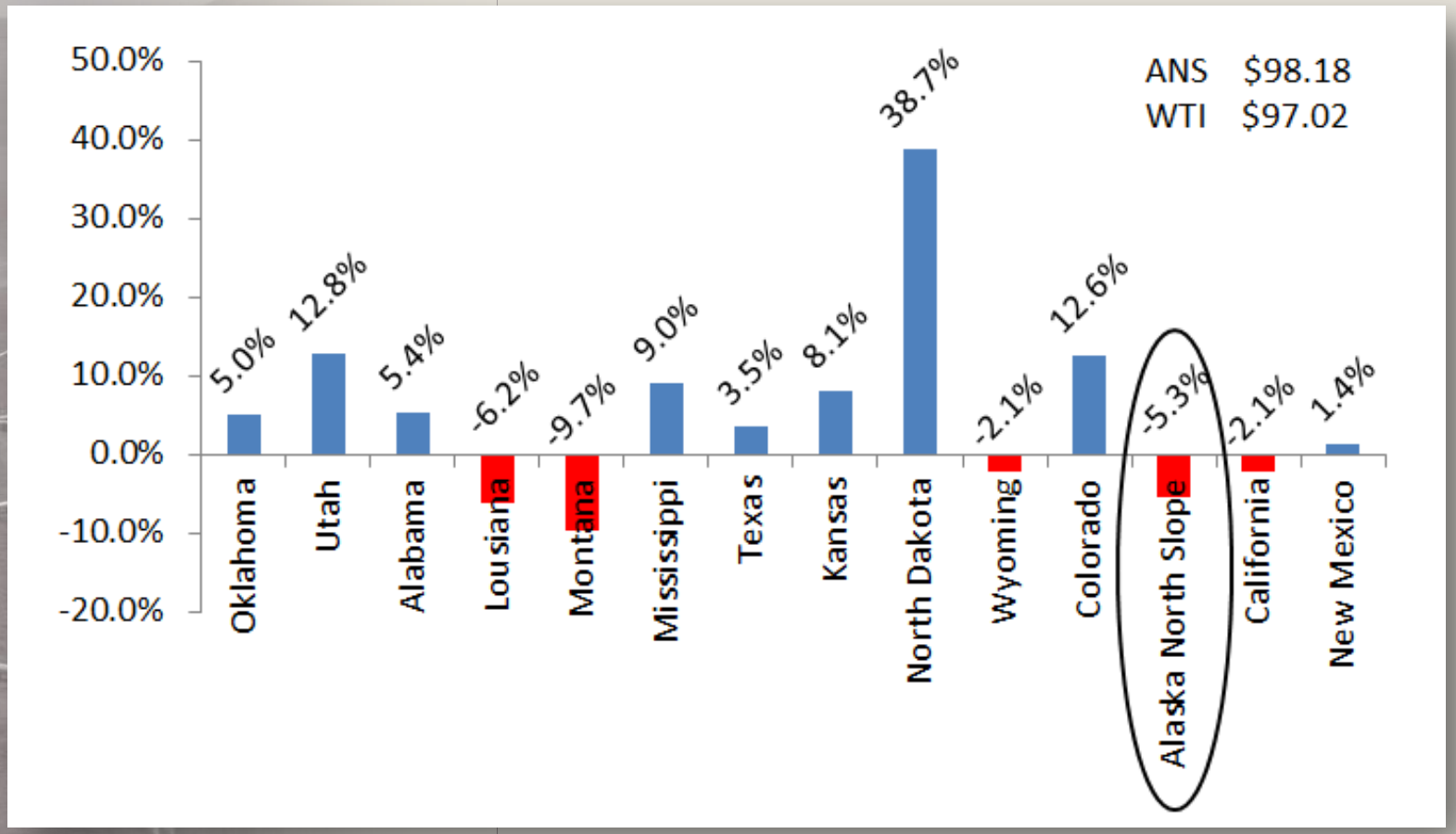
- Historical Oil Production -

How Did Our Competition Fare When Prices Spiked?



Change in Average Daily Oil Production by State—2007-2008

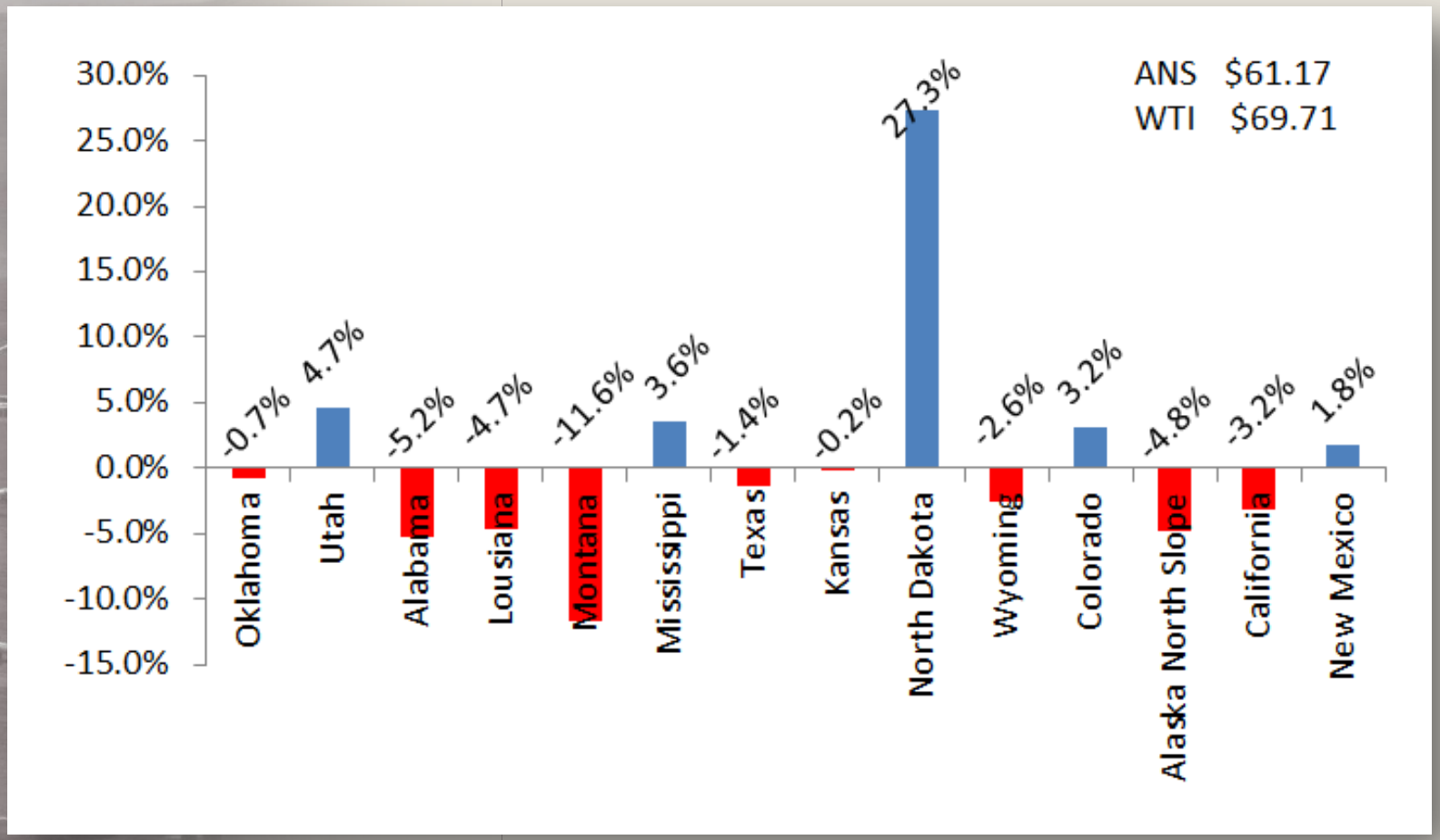
- Prepared by DOR, Economic Research Group (March 18, 2013)-



Source: EIA Crude Oil Production By State. Link: http://www.eia.gov/dnav/pet/pet_crd_crpdn_adc_mbblpd_m.htm

Change in Average Daily Oil Production by State—2008-2009

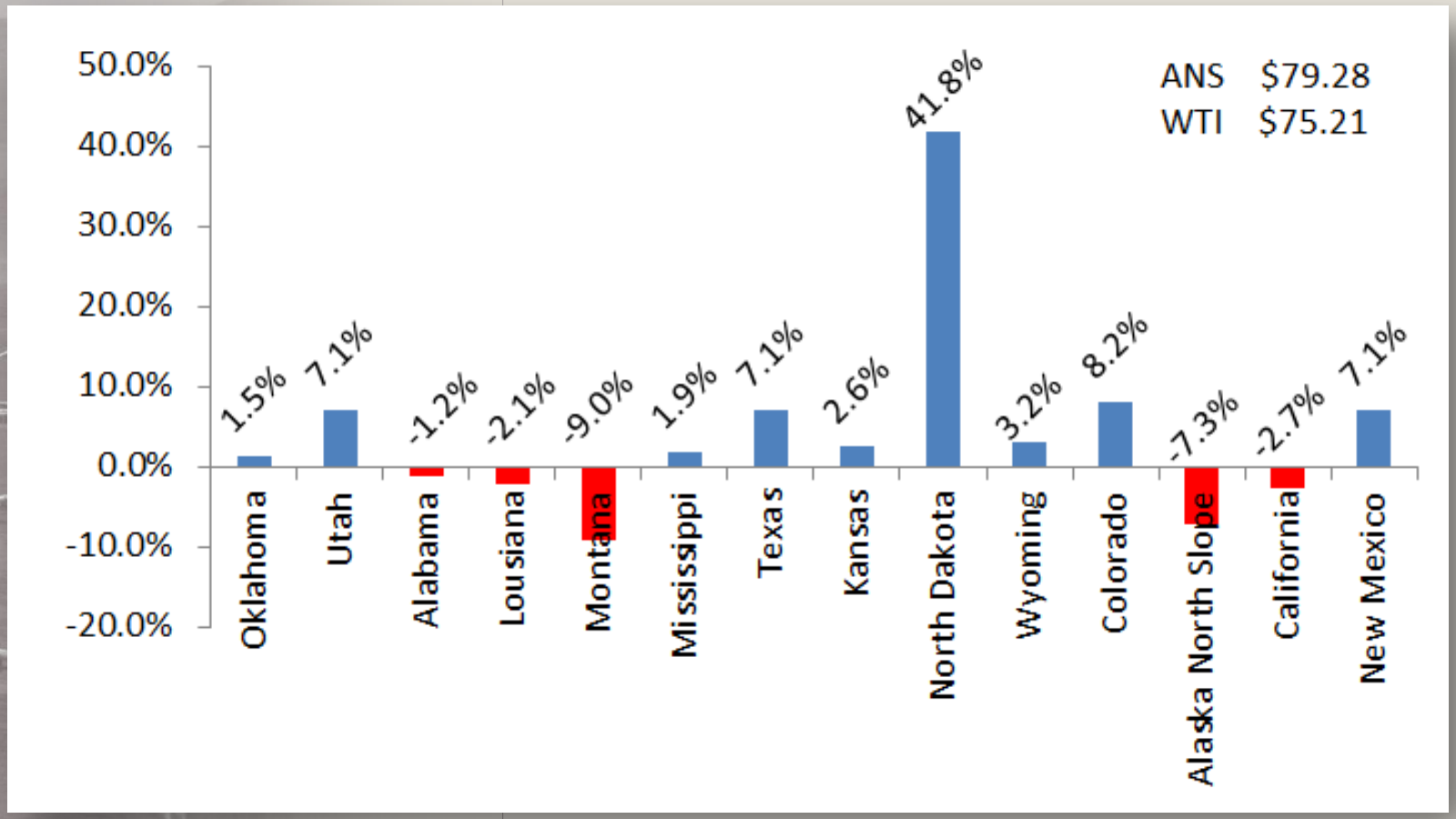
- Prepared by DOR, Economic Research Group (March 18, 2013)-



Source: EIA Crude Oil Production By State. Link: http://www.eia.gov/dnav/pet/pet_crd_crpdn_adc_mbblpd_m.htm

Change in Average Daily Oil Production by State—2009-2010

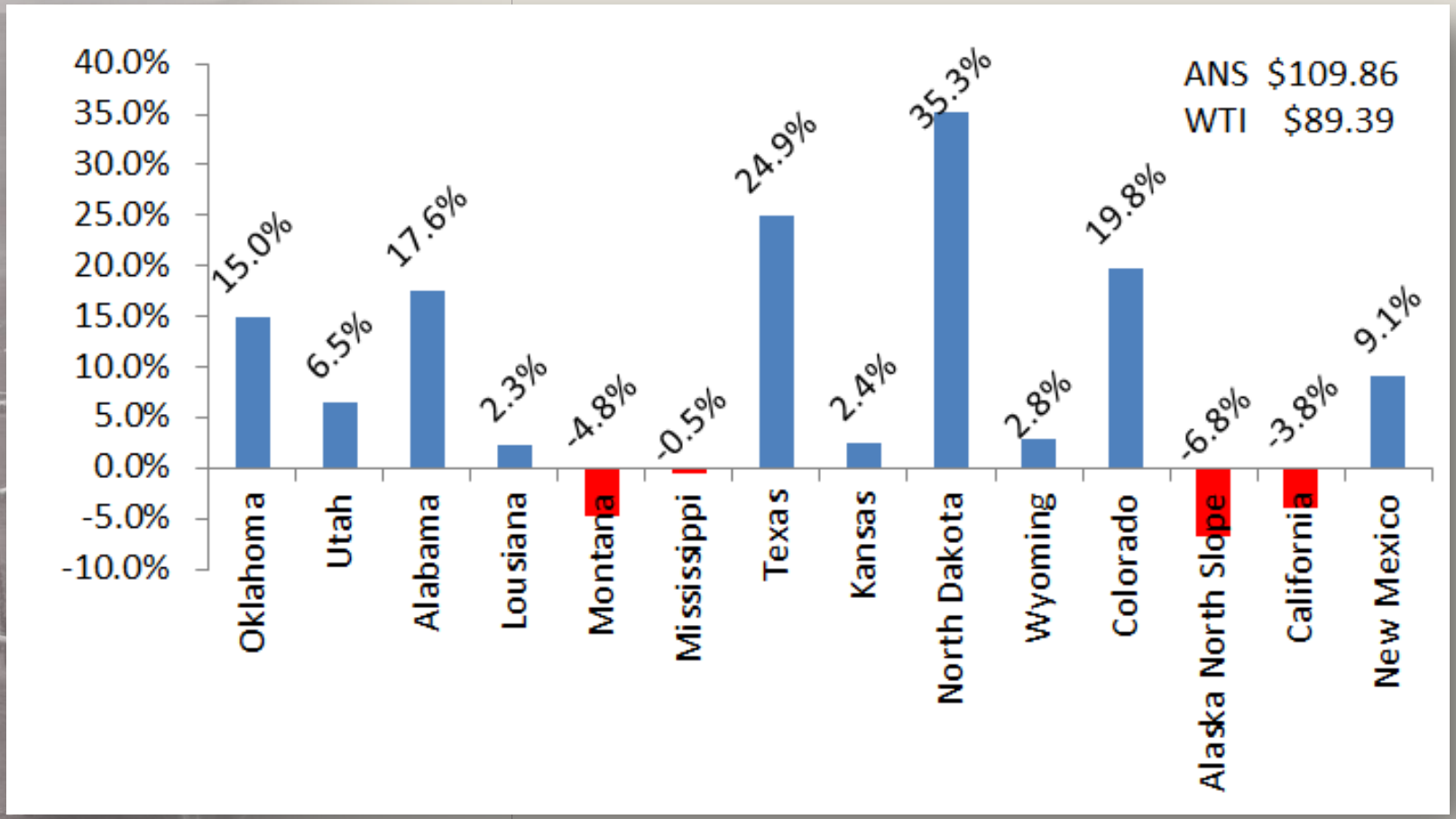
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Source: EIA Crude Oil Production By State. Link: http://www.eia.gov/dnav/pet/pet_crd_crpdn_adc_mbblpd_m.htm

Change in Average Daily Oil Production by State—2010-2011

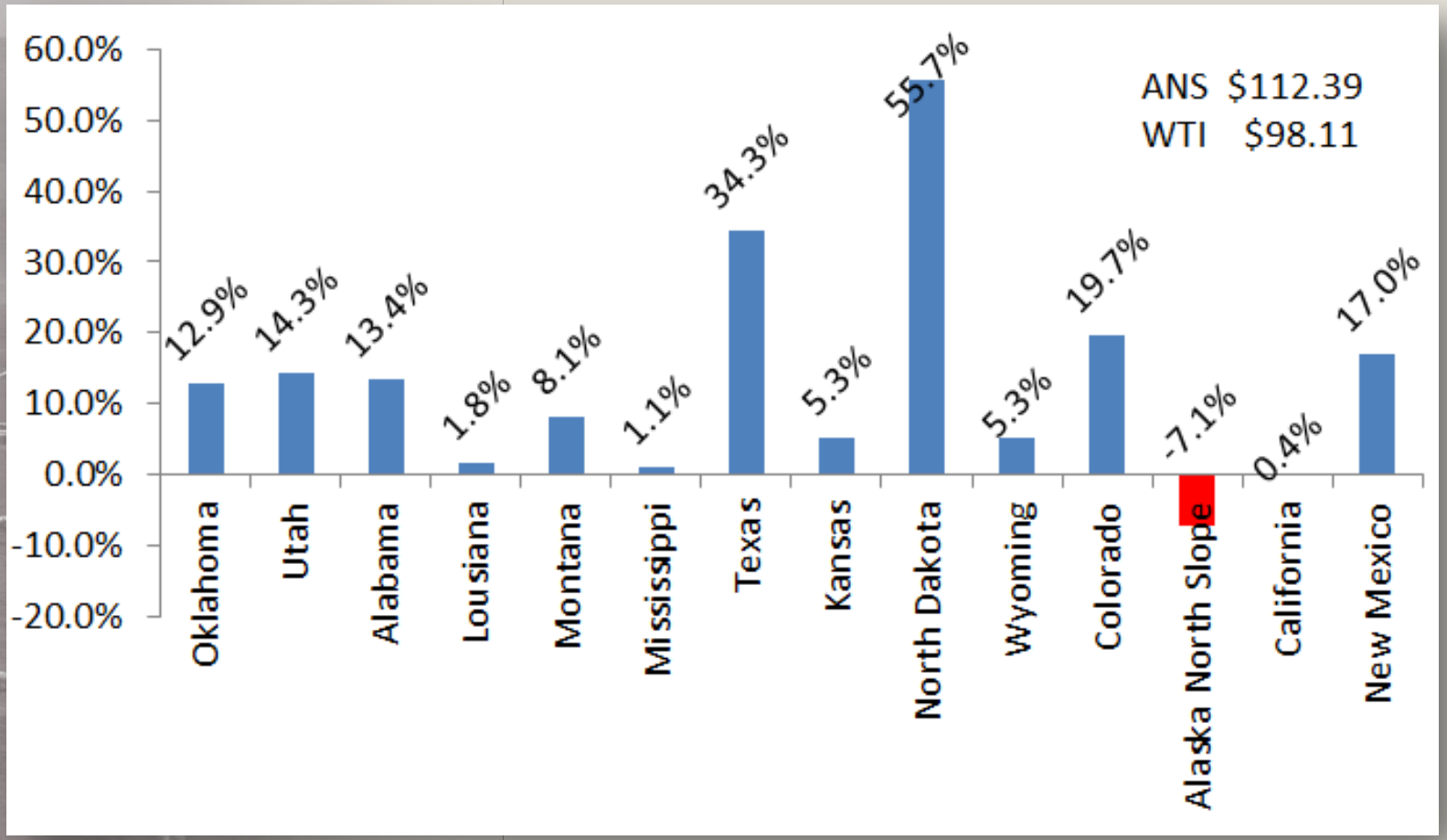
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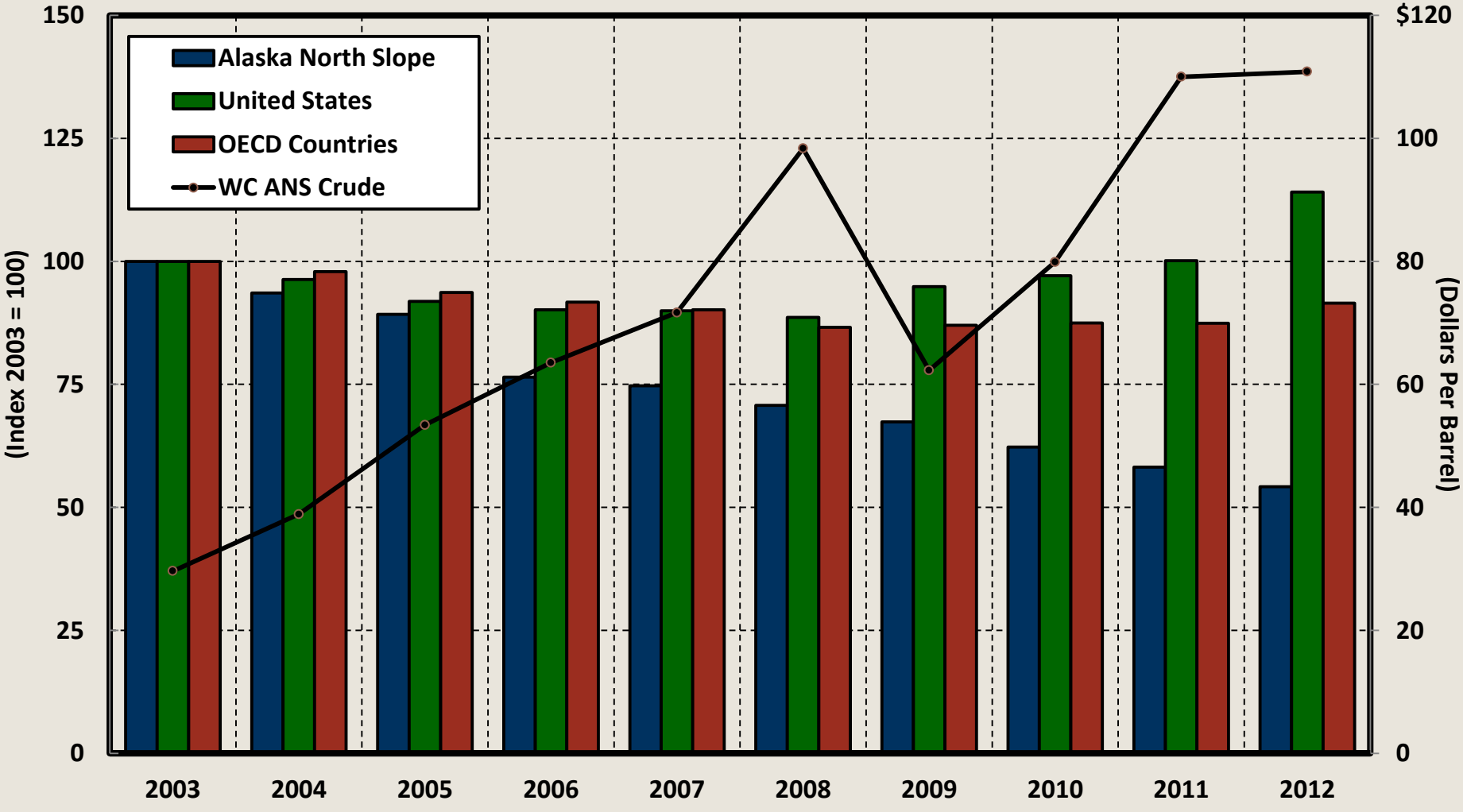
Change in Average Daily Oil Production by State—2011-2012

- Prepared by DOR, Economic Research Group (March 18, 2013)-



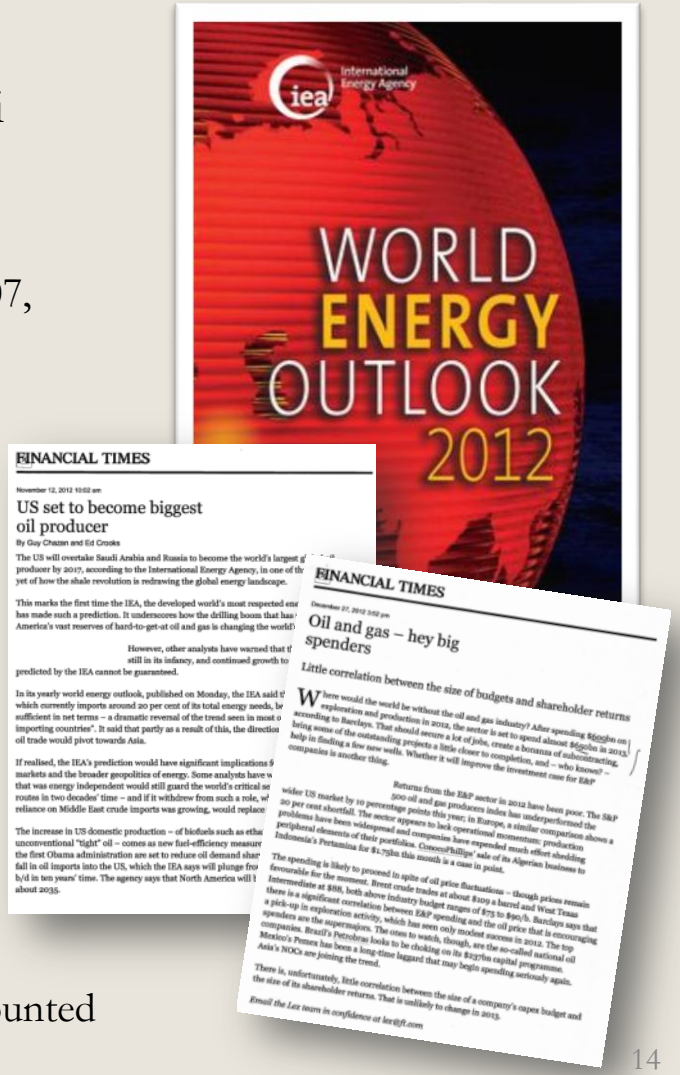
Source: EIA Crude Oil Production By State. Link: http://www.eia.gov/dnav/pet/pet_crd_crpdn_adc_mbblpd_m.htm

Crude Oil Production:
AK North Slope vs. U.S. & OECD Countries, 2003-2012



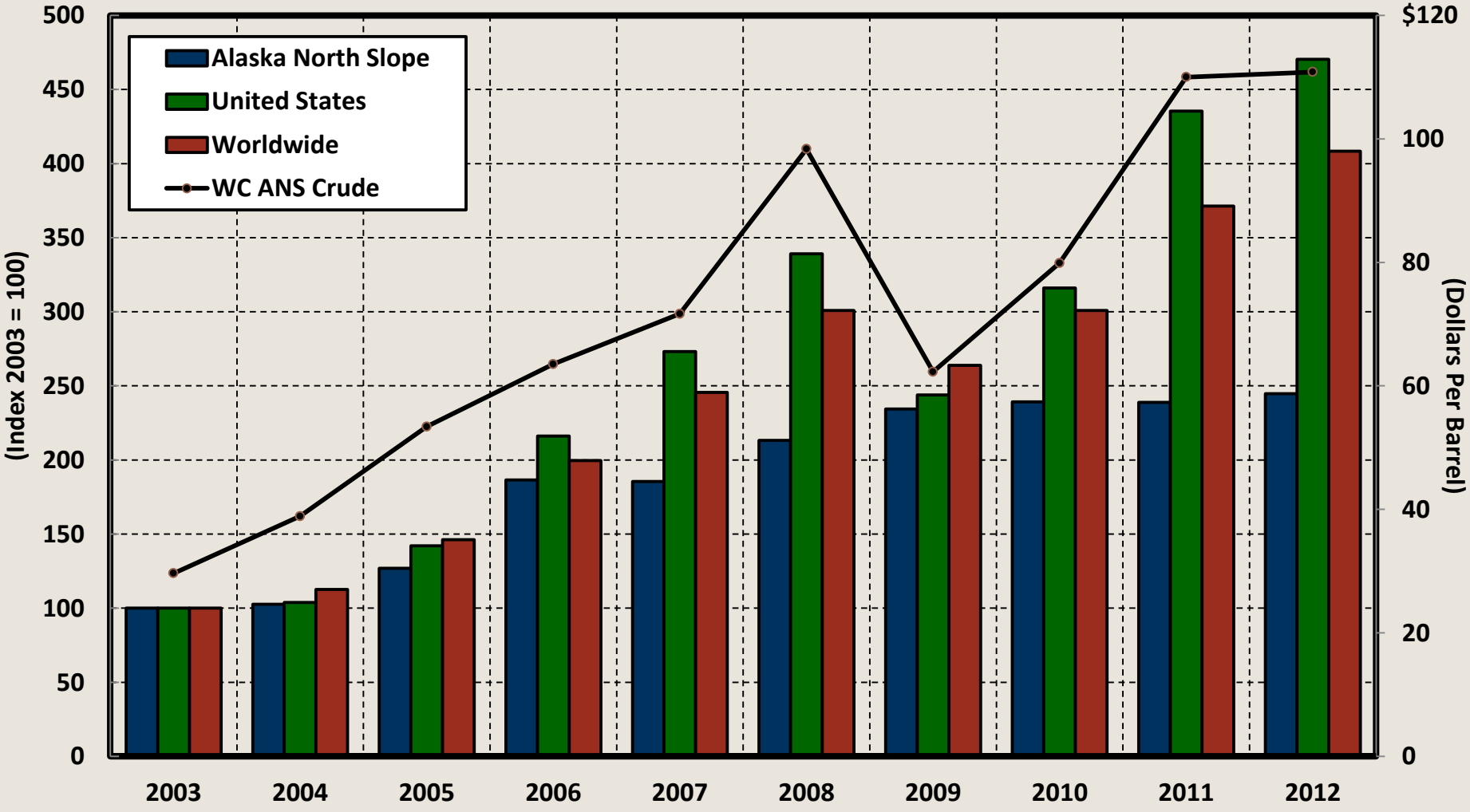
Capital Investment & the U.S. Energy Renaissance

- Global and U.S. hydrocarbon boom
- IEA World Energy Outlook 2012 – U.S. to overtake Saudi Arabia and Russia to become the world's largest global oil producer by the second half of this decade
  - Congressional Research Service report found that since 2007, all increases in U.S. oil and gas production occurred outside federally controlled areas, with oil and gas production on federal lands decreasing by 7% and 33% respectively
- **Financial Times, November 12, 2012 – *"U.S. set to become biggest oil producer"***
- **Financial Times, December 27, 2012 – *"Oil and gas – hey big spenders"***
  - 2012 - $600 billion on exploration and production in oil and gas industry
  - 2013 projected - $650 billion on exploration and production in oil and gas industry
  - Alaska - one of the world's great hydrocarbon basins – accounted approximately half of 1% of these expenditures in 2012



Est. Capital Spending for Exploration & Development:

AK North Slope vs. U.S. & World Spending*, 2003-2012



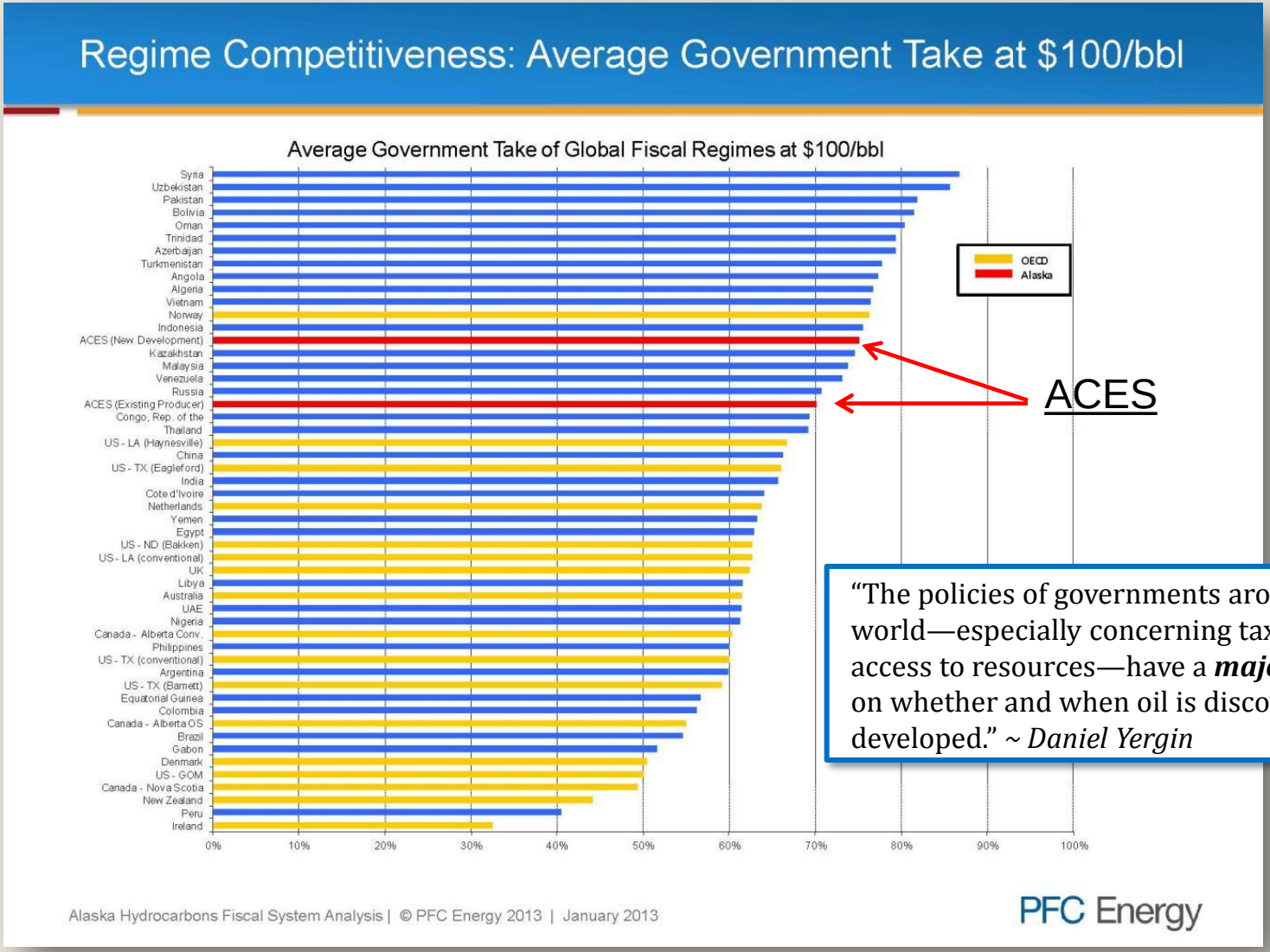
* North Slope based on tax return information; U.S. based on top 50 public companies; worldwide based on top 75 public companies

Part II

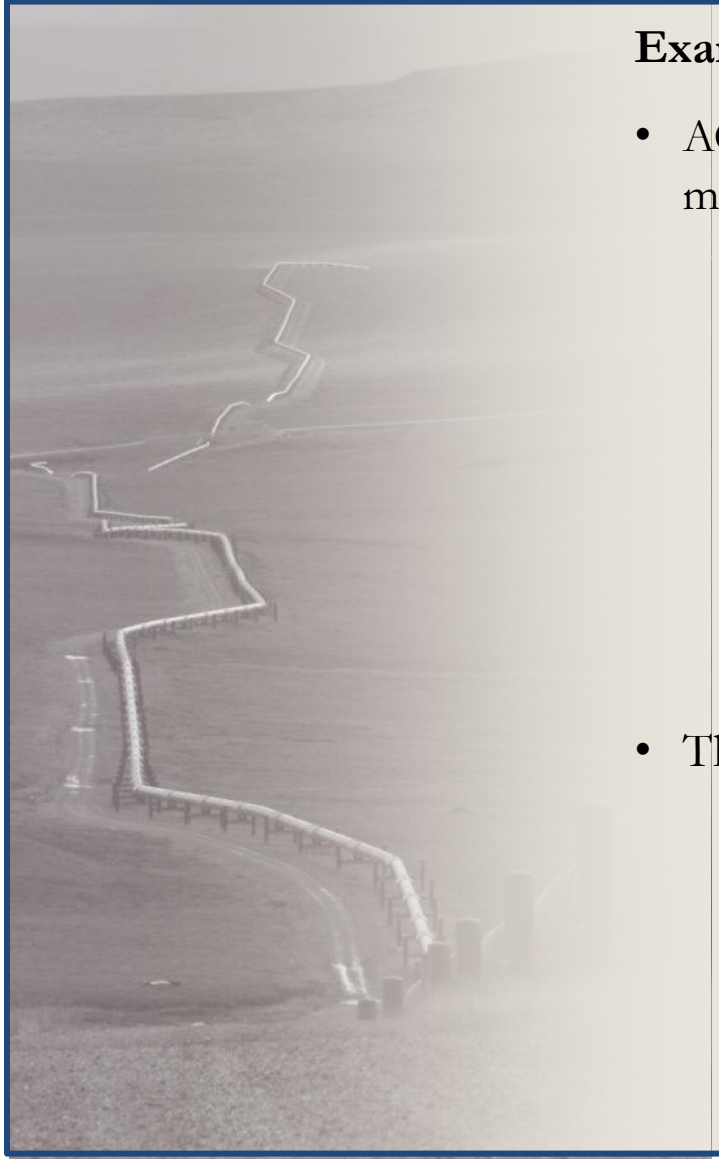


Is the Current Tax System Working for Alaskans?

Average Government Take at $100/bbl



Current System is Not Working for Alaskans



Examples of the Real Giveaway

- ACES has taken away most of the incentive to produce more barrels and more profit at higher prices
  - In FY08, North Slope oil averaged $96.51 per barrel and the total production tax collected was $6.8 billion
  - By next fiscal year (FY14), prices are forecasted to be $13 higher at $109.61, but the total production tax collected is estimated to be $3.8 billion – a decrease of more than $3 billion in unrestricted general fund revenue
- The Ultimate Giveaway:
  - Comparing year-end 2011 and year-end 2012, there were ~40,000 fewer barrels of oil per day flowing through TAPS
  - Approximately 14.6 million barrels a year = $1.46 billion in lost economic activity and value

New Entrants in Alaska's Current Tax System

- ***Secure Alaska's Future—Oil*** is the State's comprehensive strategy to increase TAPS throughput to one million barrels a day

  I. Enhance Alaska's global competitiveness and investment climate

  II. Ensure the permitting process is structured and efficient

  III. Facilitate and incentivize the next phases of North Slope development

  IV. Promote Alaska's resources and positive investment climate to world markets

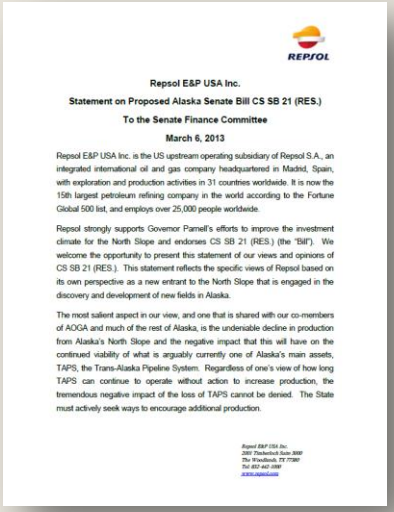


- **Governor Parnell's 2013 State of the State: *"Our problem is not below the ground. Our problem is above the ground."***
  - The missing piece is meaningful tax reform
  - "Our state's prosperity has always rested on natural resources. Tonight, that foundation is at risk, not because we are running out of oil, but because we are running behind the competition."

New Entrants in Alaska's Current Tax System

- Repsol Example -

Excerpts from March 6, 2013, letter to the Senate Finance Committee



Repsol E&P USA Inc.

Statement on Proposed Alaska Senate Bill CS SB 21 (RES.)

To the Senate Finance Committee

March 6, 2013

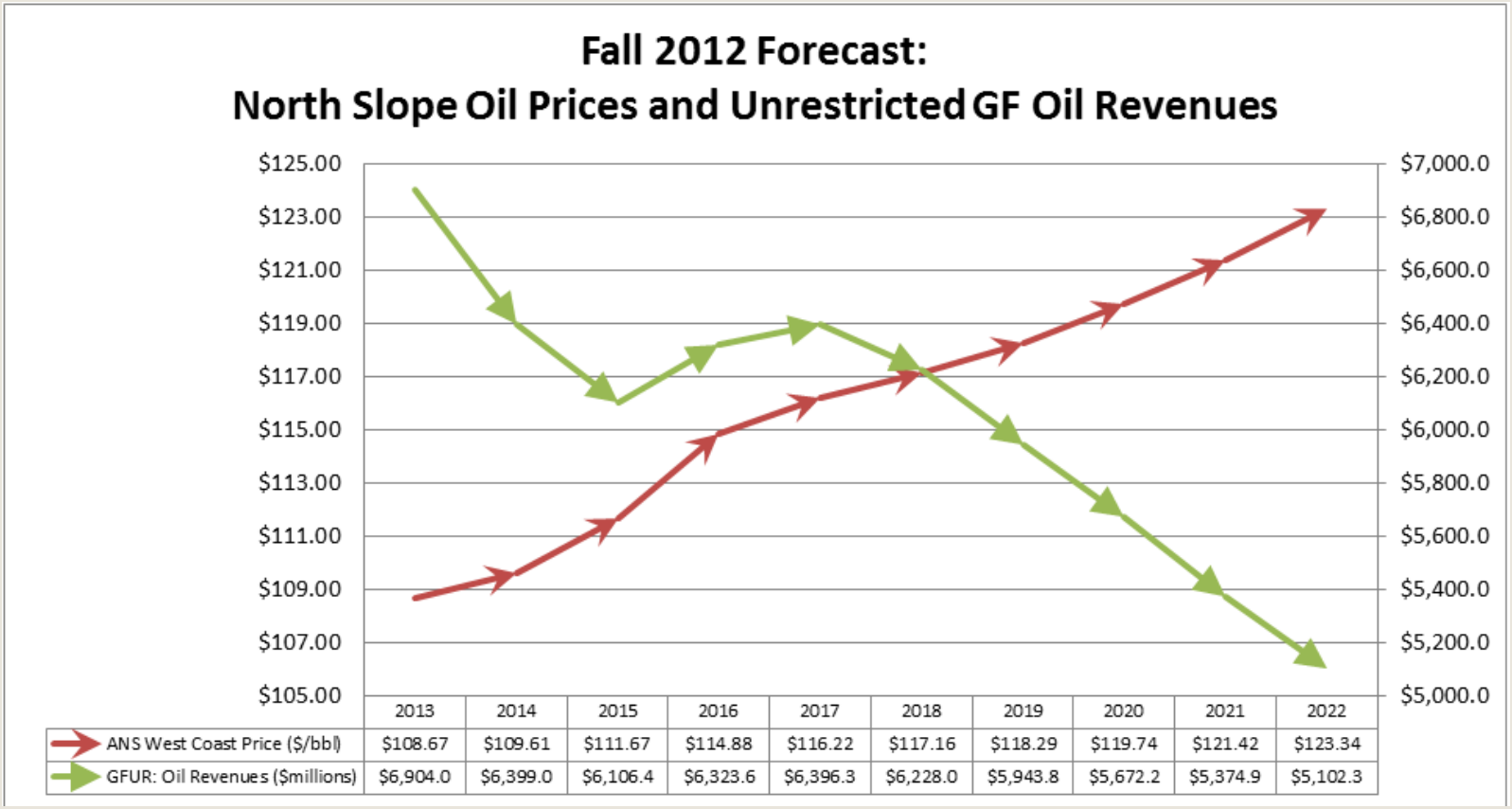
Repsol E&P USA Inc. is the US upstream operating subsidiary of Repsol S.A., an integrated international oil and gas company headquartered in Madrid, Spain, with exploration and production activities in 31 countries worldwide. It is now the 15th largest petroleum refining company in the world according to the Fortune Global 500 list, and employs over 25,000 people worldwide.

Repsol strongly supports Governor Parnell's efforts to improve the investment climate for the North Slope and endorses CS SB 21 (RES.) (the "Bill"). We welcome the opportunity to present this statement of our views and opinions of CS SB 21 (RES.). This statement reflects the specific views of Repsol based on its own perspective as a new entrant to the North Slope that is engaged in the discovery and development of new fields in Alaska.

The most salient aspect in our view, and one that is shared with our co-members of AOGA and much of the rest of Alaska, is the undeniable decline in production from Alaska's North Slope and the negative impact that this will have on the continued viability of what is arguably currently one of Alaska's main assets, TAPS, the Trans-Alaska Pipeline System. Regardless of one's view of how long TAPS can continue to operate without action to increase production, the tremendous negative impact of the loss of TAPS cannot be denied. The State must actively seek ways to encourage additional production.

- We came to the North Slope in 2011, after many years of reviewing numerous opportunities and turning them down. We considered the North Slope to be an especially promising area that has been shown to be oil rich and with lower exploratory risk than other regions.
- Offsetting these positive aspects were the extreme climate, and a short exploration season in a remote, expensive and environmentally sensitive area with little established infrastructure. **The biggest negative factor, however, was a tax system that did not encourage long-term investment.**
- With regards to investment in onshore state lands, we found that in all but the best scenarios, **the progressive nature of the ACES petroleum tax structure did not allow for returns that were competitive with opportunities in the lower forty-eight states or other parts of the world.**
- This view changed in early 2011 when it appeared that serious reform of the ACES tax structure would be enacted…[Repsol was] convinced that the State of Alaska was serious about providing the necessary incentives for new investment. We were also convinced that if we waited for meaningful tax reform to be enacted, we would risk being lost in the rush of companies to Alaska to invest in North Slope exploration and development projects.

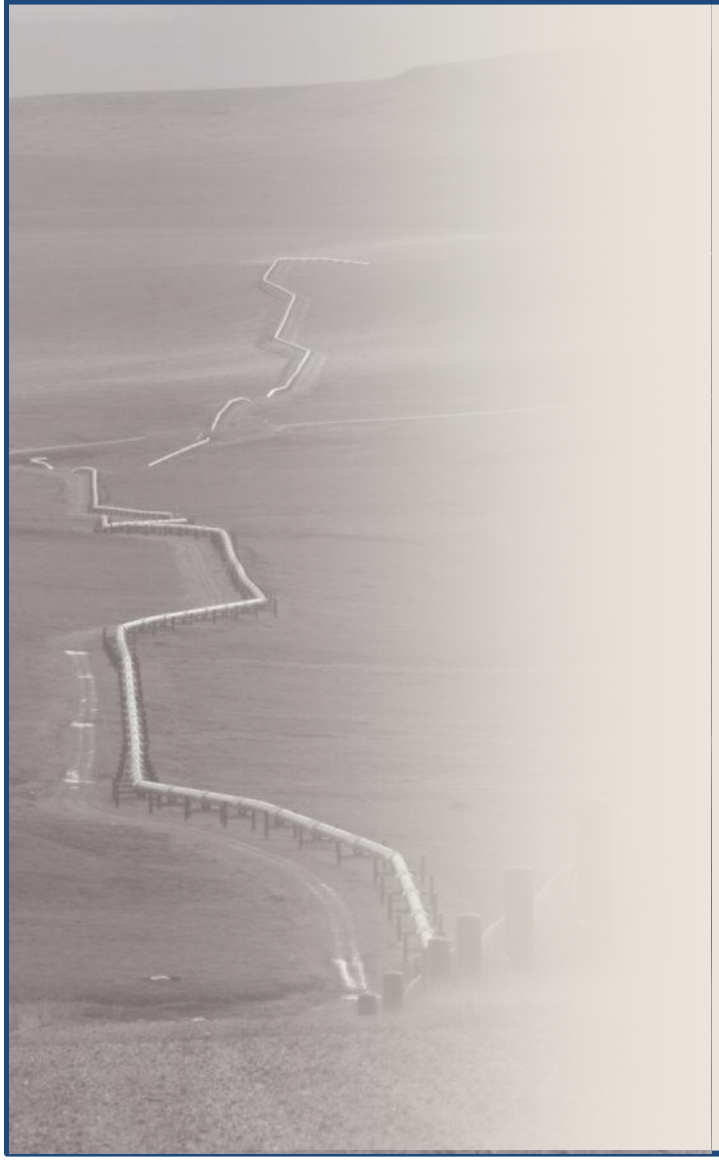
North Slope Oil Prices & Unrestricted GF/UR Revenues



	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
ANS West Coast Price ($/bbl)	$108.67	$109.61	$111.67	$114.88	$116.22	$117.16	$118.29	$119.74	$121.42	$123.34
GFUR: Oil Revenues ($millions)	$6,904.0	$6,399.0	$6,106.4	$6,323.6	$6,396.3	$6,228.0	$5,943.8	$5,672.2	$5,374.9	$5,102.3

- Under ACES – by 2022 oil prices will have to rise to $123.44 per barrel for unrestricted general fund oil revenues to meet the forecast
- If oil prices do not rise further or if they fall, this revenue decline becomes much more severe

The Challenge



- If we do not make the changes today to encourage the investment that will pay dividends tomorrow we are dooming our future to deficits and decline
- If you are evaluating this challenge based simply on the range of the fiscal note, you are missing the scale of the obstacle we face in the future
- $1.3 billion less in revenues will require more than $4,000 in new revenues per job in Alaska[1] – those revenues will have to come from somewhere

[1] $1.3 billion divided by 320,600 (AK Department of Labor, February 2013 Total Non-Farm Wage and Salary)

Part III



Production, Production, Production

Oil Tax Reform
- Principles -

- Tax reform must be fair to Alaskans
- Encourage new production
- Simple so that it restores balance to the system
- Durable for the long-term



CS SB21(FIN)'s Major Components are Focused on Incentivizing Production

ACES

- Qualified Capital Credit
  - Based on 20% of qualified capital expenditures
  - To generate an additional $100 million in capital credits a company must spend $500 million
  - $500 mm x 20% = $100 mm

CS SB21(FIN)

- Per Barrel Credit
  - Based on taxable production
  - To generate an additional $100 million in credits a company must produce an additional 20 million barrels
  - 20 mm x $5 = $100 mm
- Gross Revenue Exclusion
  - Tax benefit for new production
  - Newer units (2003 and after)
  - New participating areas in legacy units
  - Expansions of participating areas in legacy units

Status Quo of Continued Decline is Unacceptable

- This is about Alaskans' future—present citizens and future generations
- We clearly have the resource base to turn our oil production decline around
- The status quo of continued decline when there is a global investment boom and literally every other basin in the United States is increasing production is unacceptable
- ACES, although well-intentioned, is significantly contributing to our production decline as well as discouraging potential new entrants.
- As production continues to decline, the strain on the state will only grow
- Tax reform must focus on incentivizing production
- "The ANCSA Regional Association is calling on state leaders to continue moving on an oil tax reform bill. Tax reform for the oil and gas industry that results in increased production will give communities across the state access to important economic opportunities. Association members stress the importance of new and increased production with long-term benefits to Alaskans." – March 28, 2013