State of Alaska
Department of Revenue
Commissioner Bryan Butcher

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The Honorable Lyman Hoffman
The Honorable Bert Stedman
Co-Chairs, Senate Finance Committee
Alaska State Senate
Juneau, Alaska 99801

February 8, 2011

SUBJECT: Response to Questions asked of the Department of Revenue at the January 25, 2011 forecast overview in the Senate Finance Committee

Dear Senators Hoffman and Stedman:

The purpose of this document is to respond to several questions that were asked of the Department of Revenue during the department's overview of the Fall 2010 revenue forecast before the Senate Finance Committee on January 25, 2011. The questions are organized into five categories below: general questions, production questions, price questions, lease expenditure questions, and credits questions. The questions posed at the hearing and the answers to those questions follow.

GENERAL QUESTIONS:

The committee requested information about the status of the Chief Economist position, and a summary of our recruiting attempts.

The Chief Economist position has been vacant since March 2008. The department has recruited for the Chief Economist position five times since 2008 without a successful hire. We have experienced difficulty attracting applicants with the desired qualifications at the salary range offered.

- An Alaska-only recruitment at a Range 24 which ended in April 2008, resulted in four applicants; only one applicant met minimum qualifications, one interviewed and that individual withdrew their application.
- A national recruitment at a Range 26 which ended in February 2009, resulted in one applicant who did not meet the minimum qualifications.
- A national recruitment at a Range 26 which ended in April 2009, resulted in eight applicants; four met the minimum qualifications; four interviewed, the successful candidate declined the job offer.

- A national recruitment at a Range 26 which ended in October 2009, resulted in eight applicants; one barely met the minimum qualifications; one interviewed, an applicant not selected.
- A national recruitment at a Range 26 which ended in April 2010, resulted in eight applicants; none of the applicants met the minimum qualifications.

PRODUCTION QUESTIONS:

(1) The committee requested information about the status of the Liberty project and how this relates to our production forecast.

The Anchorage Daily News reported on December 1, 2010 that construction of the drilling rig at the Liberty project is being temporarily suspended to review certain systems including power, mud control, ventilation, and safety systems. A further article in the Anchorage Daily News on February 1, 2011 stated that BP is now expecting to begin production at Liberty in 2013. In the department's Fall 2010 revenue forecast, Liberty is forecast to begin production in FY 2012, with peak production of about 39,000 barrels per day in FY 2013. The department will revisit the timing of the Liberty development for the next revenue forecast. Also, it is important to note that the Liberty field is located in federal waters, not in state waters. Therefore, although delays at Liberty affect production, pipeline throughput, and employment, the impact on state revenue is much smaller than if the field were on state land and subject to production taxes and state royalties.

(2) The committee requested information about the life cycle of a typical oil basin and how Alaska compares.

A production profile typical for an oil basin in general is represented by a period of production growth, followed by a production peak, and then a long period of declining production. Oil production in Alaska peaked in FY 1988 and has declined at an average rate of about 5% annually since. Over the last 10 years, the decline rate was about 4.2% and the department forecast is for an average decline rate of about 3.2% annually through FY 2030.

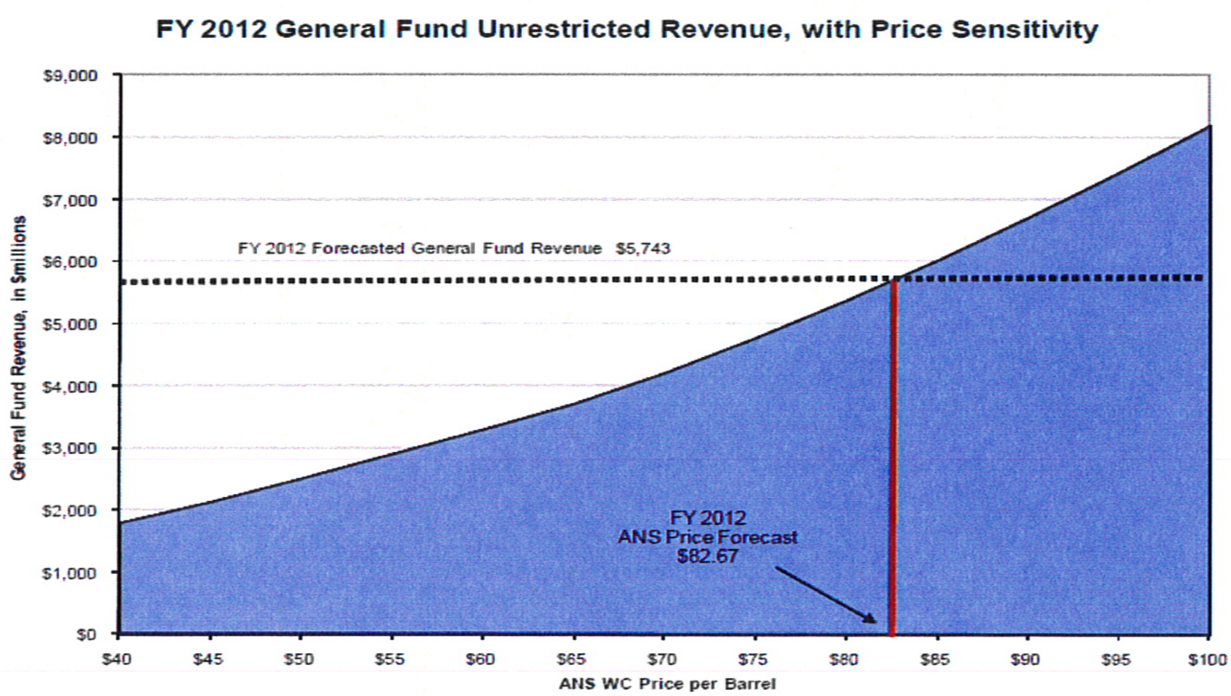
Comparing Alaska's oil production profile to other oil basins is a complicated task that would require an in-depth analysis of each oil basin, including technical and geological analysis and the timing of new field developments. However, Alaska's rate of production decline does not appear to be unusual for a mature oil basin. According to data from the Energy Information Administration (EIA), oil production in the United Kingdom has declined at an average rate of 6.6% annually from the peak in 1999 through 2009. Oil production in Norway has declined at an average rate of 4.6% from its peak in 2001 through 2009, also according to the EIA.

A study recently published in the "Energy Policy" journal examined oil production declines in Norway.[1] The authors found that production from "giant" oil fields in Norway declined at an average rate of 13% annually, and for smaller "dwarf" oil fields the average decline was 21% per year. With double-digit decline rates expected for individual fields, new and incremental production is an important component of achieving a single-digit decline rate or stable production.

PRICE QUESTIONS:

The committee requested information about high and low price forecast scenarios and how those prices would affect revenue forecasts.

The department prepared an analysis of revenues across a range of oil prices and published this information in Appendix A-2 of the Fall 2010 Revenue Sources Book for FY 2011-FY 2013. The matrices provided allow the reader to estimate what General Fund Unrestricted Revenue might be under oil prices that are higher (or lower) than the department's official price forecast. The figure below shows a graphical representation of FY 2012 revenues across a range of ANS prices. For example, at the department's ANS price forecast of $82.67 per barrel, unrestricted revenue is forecast to be approximately $5.7 billion. If prices instead averaged $100 per barrel, unrestricted revenue could be about $8.2 billion. On the other hand if prices averaged $65 per barrel, expected unrestricted revenue would be about $3.7 billion.



[1] Mikael Hook, Kjell Aleklett, A decline rate study of Norwegian oil production, Energy Policy, Volume 36, Issue 11, November 2008. (http://www.sciencedirect.com/science/article/B6V2W-4TF69H9-3/2/4bbba298f1d70b29e0b82b1a0f2876d4)

LEASE EXPENDITURE QUESTIONS:

(1) The committee requested information about historical operating expenditures, with and without the "standard deduction."

The department has been in consultation with the Department of Law regarding the disclosure of this information. We will report back to the committee on this issue once we have a determination from the Department of Law.

(2) The committee requested information about the share of oil company capital expenditures attributable to various types of activity such as new exploration, developing new production, and capital required to maintain existing operations. The committee was specifically interested in details of the forecasted $400 million increase in capital spending between FY 2011 and FY 2012.

The increase in capital spending forecasted for FY 2012 is based on company-reported expenditure projections as of the Fall 2010 forecast. A review of the expenditure projections shows that a majority of the increase in capital expenditures is anticipated to occur in currently producing units.

The department does not require operators to provide information about the specific uses of their projected capital expenditures, but some operators do provide that information for certain units. Also, the Production Tax Audit section of the department receives some specific information about historical capital spending as part of their auditing of capital expenditures that are claimed on tax returns. The department has been in consultation with the Department of Law regarding the disclosure of this information. We will report back to the committee on this issue once we have a determination from the Department of Law.

(3) The committee requested information about lease expenditures specific to the Point Thomson Unit, including labor expenses and credits generated.

The table below shows lease expenditure information for the Point Thomson Unit for fiscal years FY 2008 – FY 2010. Credits for qualified capital expenditures at the Point Thomson Unit are also shown, calculated as 20% of the qualified capital expenditure total. We could not show labor expenses at Point Thomson, as those have not been separately reported.

Point Thomson Unit Lease Expenditures and Credits* (in millions)

	FY 2008	FY 2009	FY 2010
Qualified Capital Expenditures	$27.9	$152.0	$419.0
Total Lease Expenditures	$29.0	$157.6	$420.0
Capital Credits (calculated)	$5.6	$30.4	$83.8

*NOTES:
Lease expenditures shown are before exclusions and are from company reported data restated to accommodate a fiscal year format.
Capital credits are calculated based on 20% of qualified capital expenditures shown above.

(4) The committee requested lease expenditure information for three units: Prudhoe Bay, Kuparuk, and Colville River (Alpine).

The table below presents lease expenditure information for Prudhoe Bay and Kuparuk units for fiscal years FY 2008- FY 2010. Colville River Unit information cannot be reported separately due to confidentiality constraints.

Total Company Reported Lease Expenditures for Prudhoe Bay and Kuparuk, FY 2008- FY 2010

	Prudhoe Bay Unit		Kuparuk Unit	
	Qualified Capital Expenditures	Total Lease Expenditures	Qualified Capital Expenditures	Total Lease Expenditures
FY 2008	$ 685	$ 1,620	$ 422	$ 854
FY 2009	$ 766	$ 1,728	$ 337	$ 779
FY 2010	$ 639	$ 1,828	$ 277	$ 732

Amounts shown are in $ Millions
Expenditures are shown before exclusions.
Total expenditures include the "standard deduction" per AS 43.55.890 through December 31, 2009
Expenditures are reported as annual expenditures and restated as fiscal year estimates.
Source: Company reported information from monthly information forms and annual tax returns.

CREDITS QUESTIONS:

The committee asked several questions relating to production tax credits.

A representative of the department is planning to be available the week of February 7 to meet with the committee and address credit-related questions.

Sincerely,

Bruce Tangeman
Bruce Tangeman
Deputy Commissioner