Written Testimony for CSHB 247(RES)

Submitted by Sarah Obed
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The Honorable Mark Neuman
The Honorable Steve Thompson
Co-Chairs of House Finance Committee
Alaska State Capitol
Juneau, Alaska 99811-1182

My name is Sarah Obed, and I am the vice president of external affairs for Doyon, Limited ("Doyon"). Doyon is the state-chartered Alaska Native Claims Settlement Act regional corporation for Interior Alaska. Doyon has over 19,300 shareholders, most of whom reside within the State. Doyon is the largest private land owner in the State, and one of our highest priorities is the continued exploration for oil and gas resources on State owned lands in the Minto Flats/Nenana Basin, as well as on Doyon-owned lands near Steven's Village.

Tax Credits support Exploration and Development in Middle Earth

The structure of the Alaska oil and gas production tax is vital to the exploration and development of areas of the state sometimes referred to as "Middle Earth," which encompasses all areas of the state south of the North Slope and outside of Cook Inlet. Middle Earth includes the Nenana Basin and Yukon Flats in central Alaska where Doyon holds oil and gas interests, including over 400,000 acres of state leases. Middle Earth also includes Kotzebue, Copper River, Bristol Bay, and the Aleutians. These areas are uniquely situated and the opportunities and challenges for economic development and oil and gas exploration and development are dramatically different than the opportunities and challenges on the North Slope and in Cook Inlet.

Currently there is no oil and gas production in Middle Earth and the prospective basins are unexplored or underexplored, with no commercial discoveries. Federal and state studies indicate that many of the basins in Middle Earth are highly prospective areas for oil and gas. Some areas are near infrastructure and could be quickly developed to bring oil and gas into production in the near future. There are great opportunities for major oil and gas discoveries that could accelerate economic development and provide jobs, local sources of gas to communities, revenues from royalties, lease rentals, and taxes, and also valuable well and seismic data.

There are several Middle Earth projects that are moving forward and production tax rates and credits impact these projects and the appetite for investment in them. Doyon has been drilling wells and shooting seismic in the Nenana Basin and Yukon Flats for the last several years, is currently building a road and pad for one additional well, is currently shooting seismic, and has moved forward with permitting and contracts for services and equipment. Doyon has advanced its projects from unknown to the demonstration of an active hydrocarbon system and has methodically de-risked the Nenana Basin prospect to a 1-in-2 chance of success for gas and a 1-in-5 chance for oil. These prospects are roughly 40-60 miles from the Trans-Alaska Pipeline and the likely route of a major gas line, and can provide gas to Fairbanks. These projects are already spurring economic development and providing revenue to the state and localities — Doyon pays the state over $1.2 million in lease rentals annually.

The oil and gas production tax credits are vital to Middle Earth exploration and development, but the amount of credits associated with Middle Earth activity is miniscule compared to the total amount of credits in the state. Total rebates to Doyon for 2005-2016 are estimated to be only $62-65 million. However, if there is an oil discovery in 2016, a simple royalty calculation for Doyon's mean production estimate would be: 70 million barrels x $60/bbl = $525,000,000 in oil royalties alone. Further, that estimate is for just one of several similar traps identified in Doyon's most recent 3-D seismic survey, which covered less than 10% of the area Doyon is actively exploring. Success with one of these traps strongly suggests that there will be success with many others. There are also significant opportunities for gas production, estimated to yield enough gas to supply Fairbanks for over 20 years. In addition, over 30 local groups will provide services for Doyon's 2016 programs and over 150 people will be directly employed. Such opportunities are repeatable throughout the basin.

Overwhelmingly, Doyon's oil and gas exploration investment dollars in the Nenana basin have gone into State of Alaska and Alaska Mental Health Trust ("MHT") lands. In addition to 400,000 acres in 78 state leases, Doyon holds about 9,500 acres in a Mental Health Trust lease. By comparison, Doyon owns only about 43,000 acres in the basin. The vast majority of seismic Doyon has gathered has been on State lands and of the two wells drilled, one was on a State lease and the other on a MHT lease. The road access constructed by Doyon has been on public land — State, MHT and City of Nenana. The pad for the well to be drilled by Doyon this summer is on a State lease, other traps imaged in the central part of the basin are on shared lands, and traps in the northern and southern parts of the basin will all be on state lands. The State and MHT will continue to benefit from lease rentals and will benefit from royalties if production commences. Further, production from all lands in Alaska, public and private, is subject to production taxes.

HB 247 ("the Bill") leaves intact certain elements of the oil and gas production tax that are very important for Middle Earth exploration and development, in recognition of the lack of commercial discoveries and infrastructure. For instance, Middle Earth production will benefit from a ceiling tax rate of 4% of the gross value at the point of production for 7 years after the start of commercial production. This ceiling was clearly intended to help "jump-start" Middle Earth production. The Bill also does not change the alternative credit for exploration under AS 43.55.025, which benefits seismic exploration and exploration drilling, and sunsets January 1, 2022 for Middle Earth projects (July 1, 2016 everywhere else).

However, the Bill *as introduced* would repeal the tax credits that have been the most vital to exploration and development in Middle Earth and Cook Inlet, specifically: the 20% qualified capital expenditure credit under AS 43.55.023(a) (QCE) and the 40% well lease expenditure credit under AS 43.55.023(*l*) (WLE). Further, this repeal would be effective July 1, 2016 — in the middle of Doyon's drilling season. Doyon decided to drill a well this summer based on the reasonable expectation of receiving these credits, and a repeal at that time would catch the project in mid-stride. The repeal of these credits, which are based upon capital expenditures, will also hamper Middle Earth development and production. In addition, if production commences and continues after the 7-year sunset date of the Middle Earth tax ceiling, oil production will bear the 35% tax rate, yet Middle Earth only has a 25% loss credit under AS 43.55.023(b) (Loss Credit), compared to the North Slope where the tax rate and Loss Credit are both 35%.

The House Resources Committee substitute would repeal the QCE and WLE credits, which have been critical for Middle Earth projects. However, the date of the repeal would be farther into the future rather than during the upcoming summer drilling season. This change is important for Doyon's 2016 exploration drilling project. The House Resources Committee substitute would also reduce the Loss Credit to 10% in 2017, which exacerbates the difference between the 35% tax rate and Loss Credit rate discussed above. In sum, the repeal of the QCE and WLE and reduction of the Loss Credit would hamper Middle Earth exploration and development.