

ACES PRODUCTION TAX UPDATE

February 4, 2010

Alaska Department of Revenue

ACES and Oil and Gas Investment

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- ACES Overview
 - ▣ Tax Structure
 - ▣ Incentivizing New Investment
- ACES Status Report
 - ▣ Revenue comparison
 - ▣ Lease Expenditure Experience and Forecasts
 - ▣ Standard Deduction Experience
 - ▣ Oil and Gas Employment Figures
 - ▣ Drilling Activity Levels

ACES Overview

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- **Production Tax Value (PTV)** is the market price transportation costs and Allowable Lease Expenditures
 - ▣ Allowable Lease Expenditures include operating and capital expenditures
- **Base tax rate** of 25% on PTV
- **Progressive Surcharge Rate**
 - ▣ Triggered when a company's PTV reaches \$30 per barrel
 - ▣ $\$30.00/\text{bbl} < \text{PTV} < \$92.50/\text{bbl}$ = Surcharge adds 0.4% to tax rate for each additional \$1 increase in PTV, until combined tax rate reaches 50%
 - ▣ $\$92.50/\text{bbl} < \text{PTV} < \$342.50/\text{bbl}$ = Surcharge adds 0.1% for each additional \$1 increase in PTV until combined tax rate reaches the maximum of 75%

ACES Overview

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How the Tax is Calculated

$$\begin{array}{rcl} \text{Production Tax Value (PTV) X Base Tax Rate} & = & \text{Base Tax} \\ & & + \\ \text{PTV X Progressive Surcharge Rate} & = & \text{Progressive Surcharge} \end{array}$$

Pre-Credit Tax Bill

Total Taxes Before Credits

Credits

Credits Applied Against Taxes

Final Tax Bill

Total Production Taxes Owed

ACES Overview (cont.)

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□ Tax Credits

- \$12 million for **small producers** (< 50,000bbl/yr.)
- 20% for qualified **capital** expenditures
- 30% - 40% for qualified **exploration** expenditures
- 25% of **losses carried forward**

Example 1: New Entrant

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- A new entrant with no current production pursues an exploration project requiring \$200 million in investment
- Company receives a 20% - 40% investment credit (depending on location), worth \$40 - \$80 million
- Company also receives an additional 25% credit for its “tax loss”, worth up to \$50 million

Example 1: New Entrant (cont.)

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- The total credits of \$90 - \$130 million, can be:
 - ▣ Directly recouped (cash) from the state
 - ▣ Transferred to a person that does pay tax, so that the Transferee pays \$90 - \$130 million less in tax
- Either way, State pays \$90 - \$130 million for the exploration; company pays \$70 - \$110 million.
- If the exploration effort fails, the state never recoups this money.

The state bears the risk for failure as does the new entrant

Example 2: Incumbent Producer

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- Incumbent with current production pursues a development requiring \$200 million investment
- Company receives a 20% capital investment credit, worth \$40 million
- By reducing their PTV, the company reduces their taxes due by the total capital expense multiplied by the tax rate:
 $\$200 \text{ million} * 25\%$, worth \$50 million; plus
 $\$200 \text{ million} * \text{progressivity surcharge rate}$ (which is reduced due to the drop in PTV)

Example 2: Incumbent Producer (cont.)

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- Deductions and credits total more than 45% of the \$200 million, greater than \$90 million
- State pays more than \$90 million of the new development's capital cost; true investment cost for the incumbent is less than \$110 million
- If the development fails, the state never recoups this money

The state bears the risk for failure as does the incumbent investor

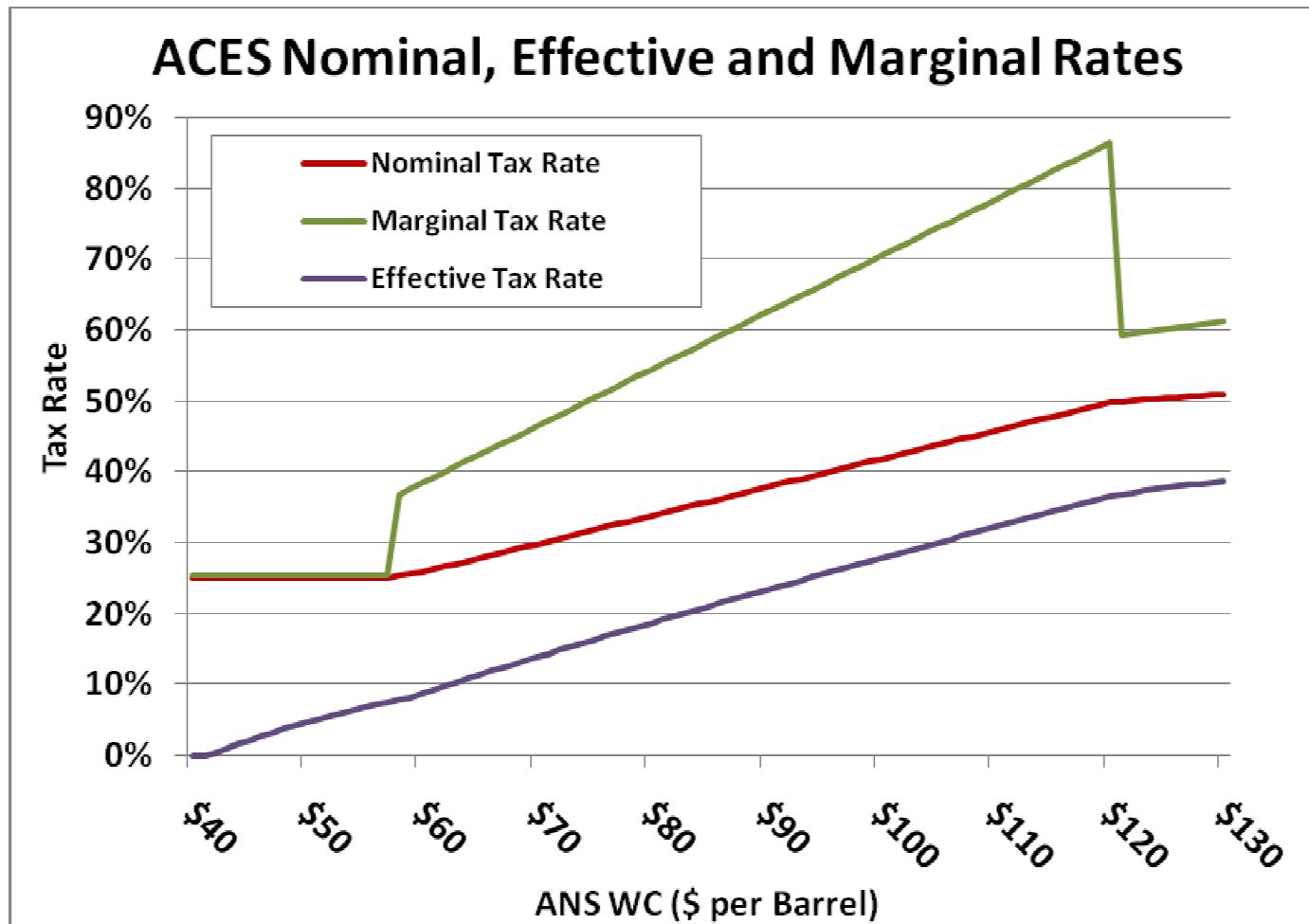
Key Points

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- For the state there is no cash flow difference in providing a credit to a new entrant and an incumbent: **cutting a check (new entrant) is no different from a reduction in tax revenue (incumbent)**
- In both cases the state is an investor: real money leaves the treasury, **sharing the risk born by the active investor**
- ACES incentivizes investment **because state bears risk and reduces explorers/producers costs**
- ***Tax credits, along with the net-based structure, make the state the largest investor in exploration and new development activities***

ACES Tax Rate

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* Based on \$26 combined transportation and lease expenditure deductions

ACES and Oil and Gas Investment

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ACES Status Report

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Requested by the Commissioner to review experience with ACES to date

- ▣ Prepared by DOR Economics Technical Team
- ▣ Released on January 14, 2010

DOR Analysis of ACES

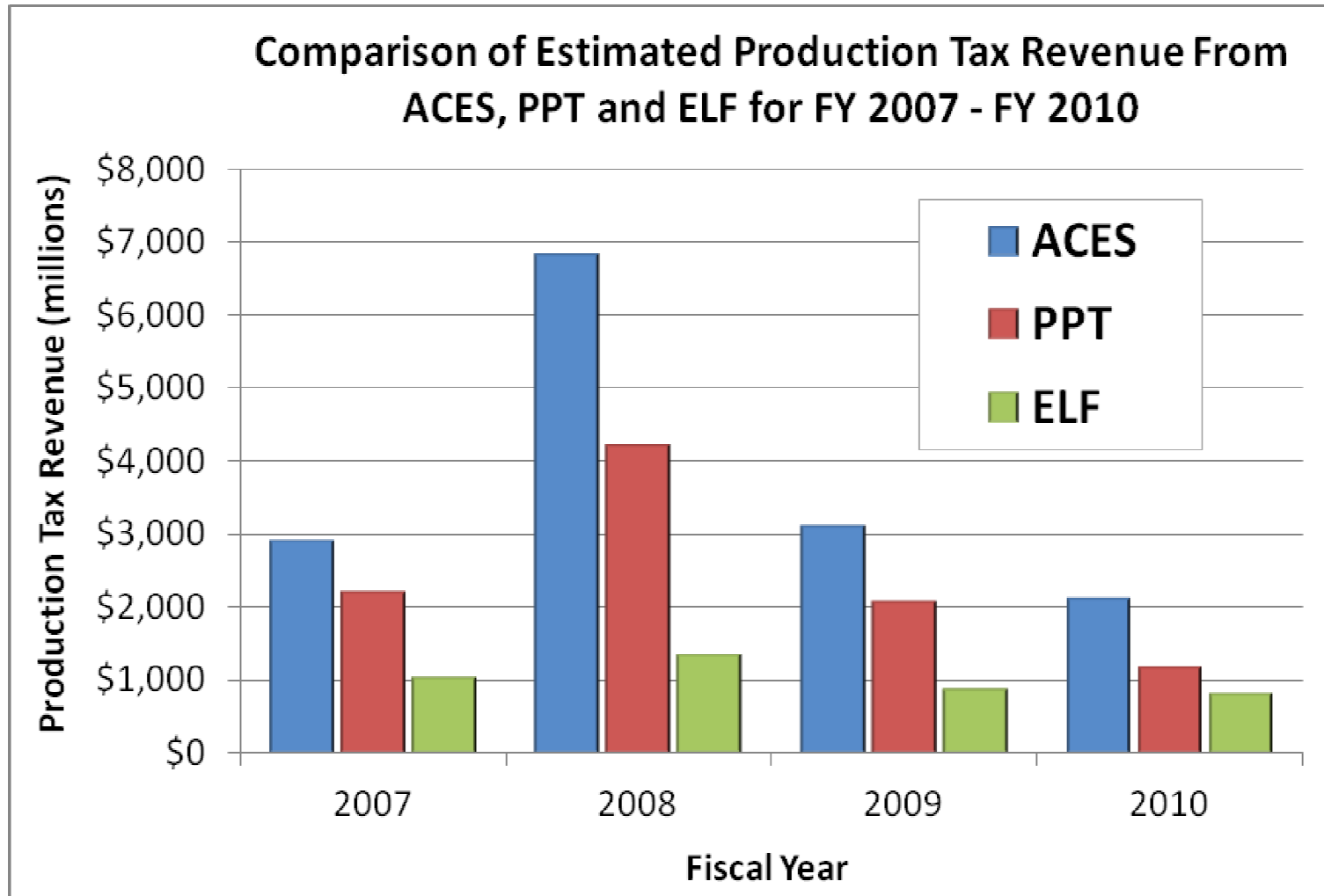
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In conjunction with the ACES Status Report, and in response to inquiries from legislators, the department reviewed several sources of available information to gauge industry response to the recent tax changes. Sources included:

- ▣ Taxpayer Data
- ▣ Dept. of Labor Data
- ▣ AOGCC Data
- ▣ DNR Data

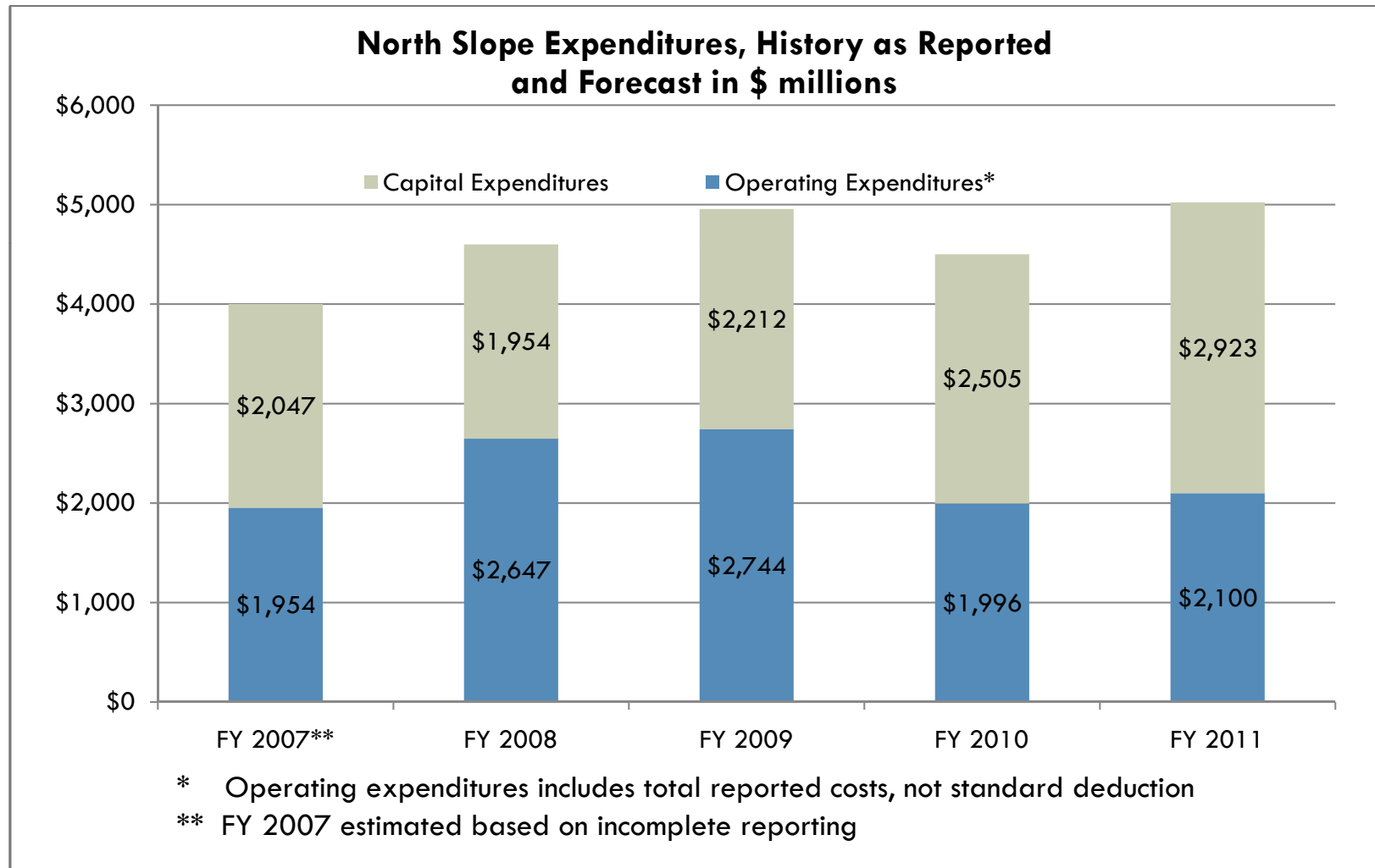
Revenue Under Various Tax Systems

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North Slope Expenditures

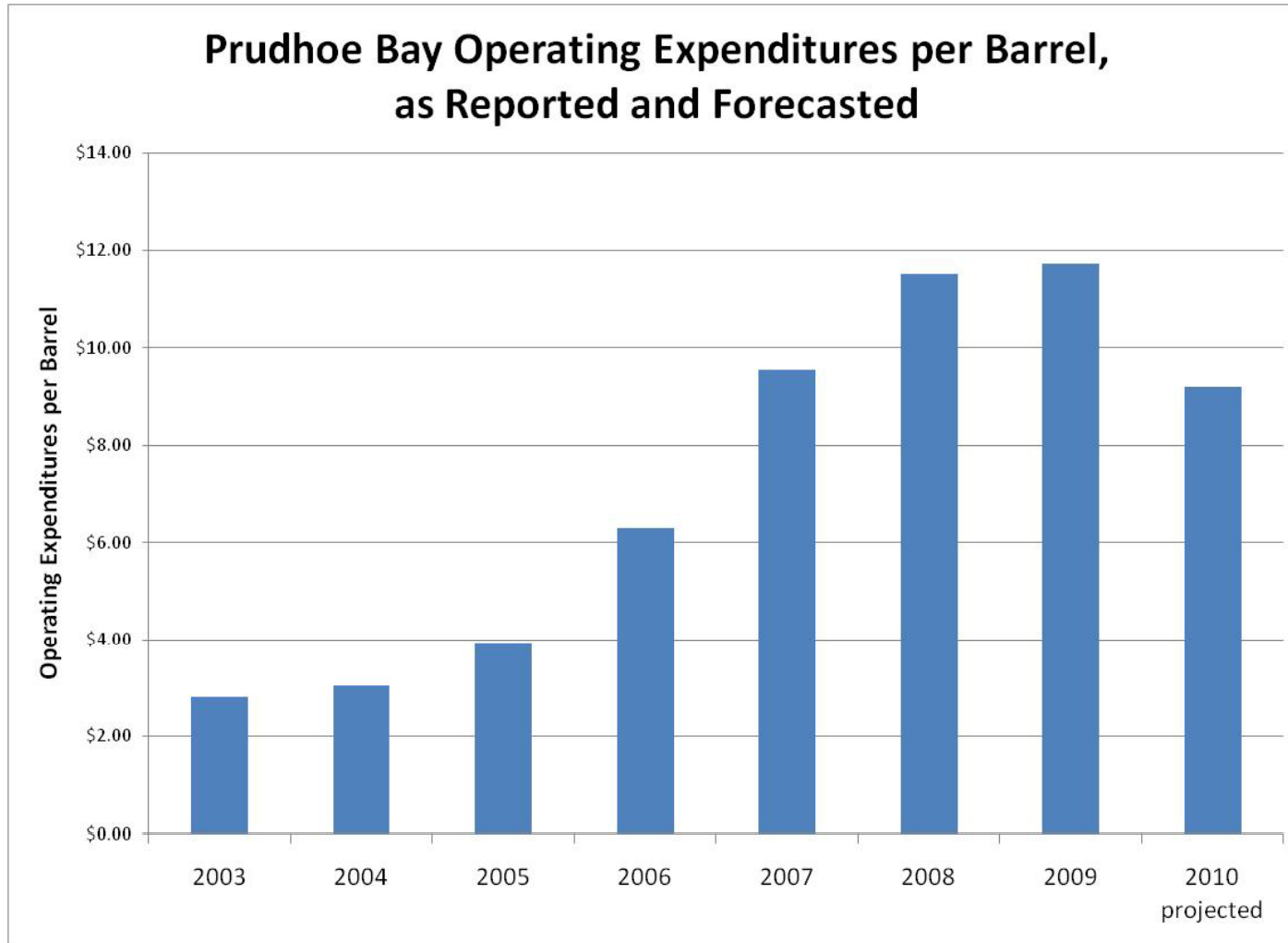
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Historical Trends - Prudhoe Bay

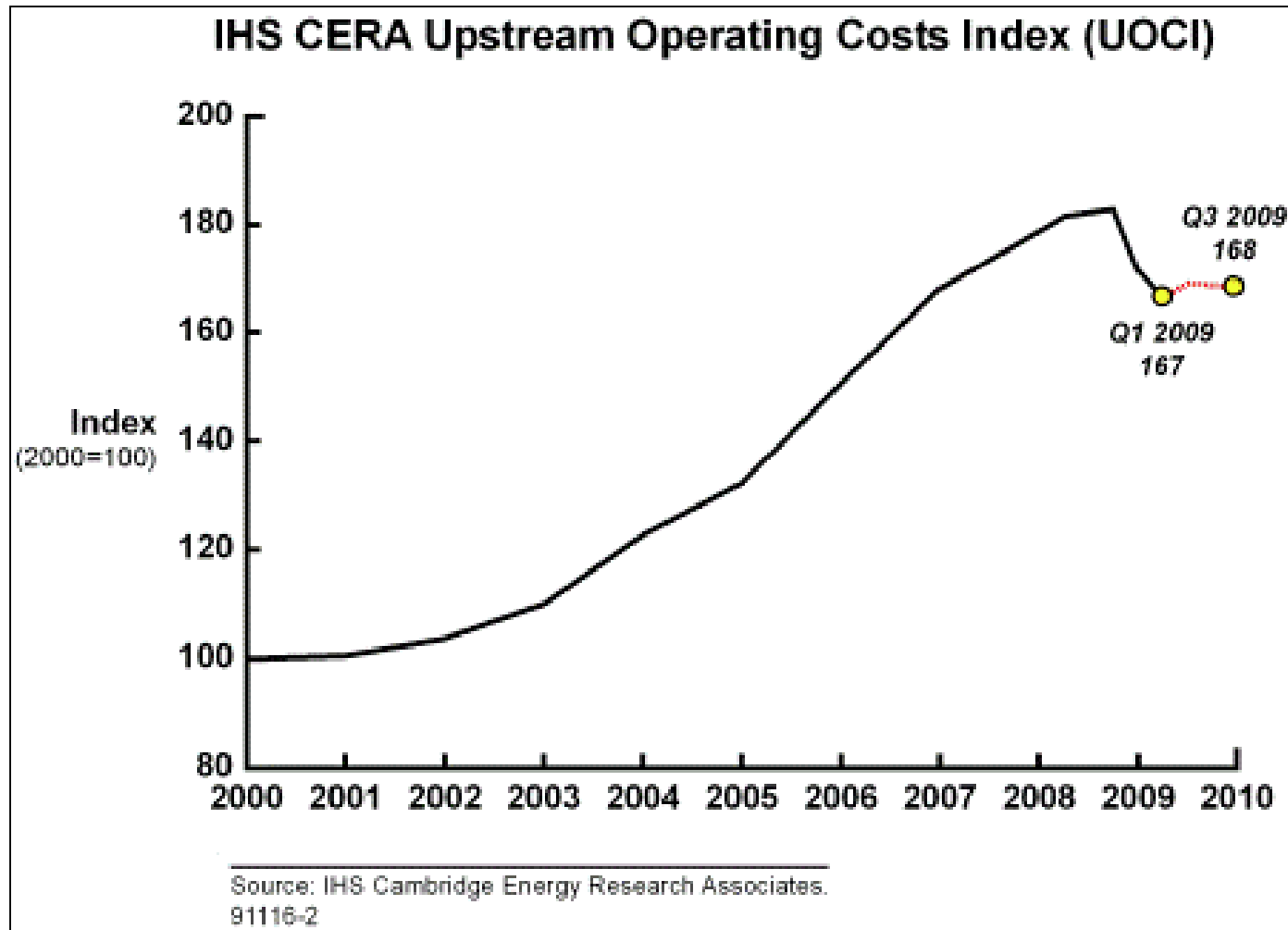
Operating Costs

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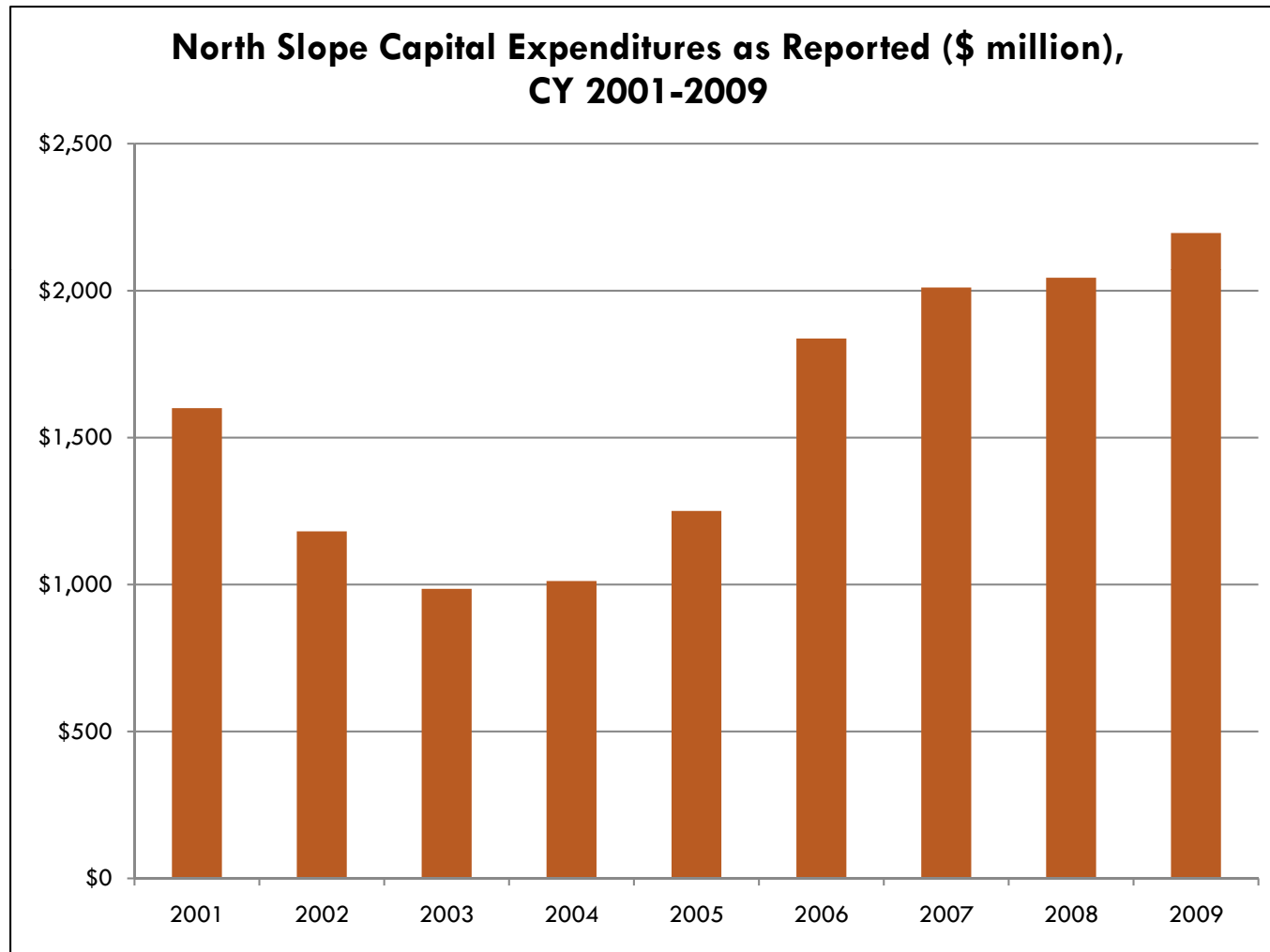
Historical Trends – Worldwide Upstream Operating Costs

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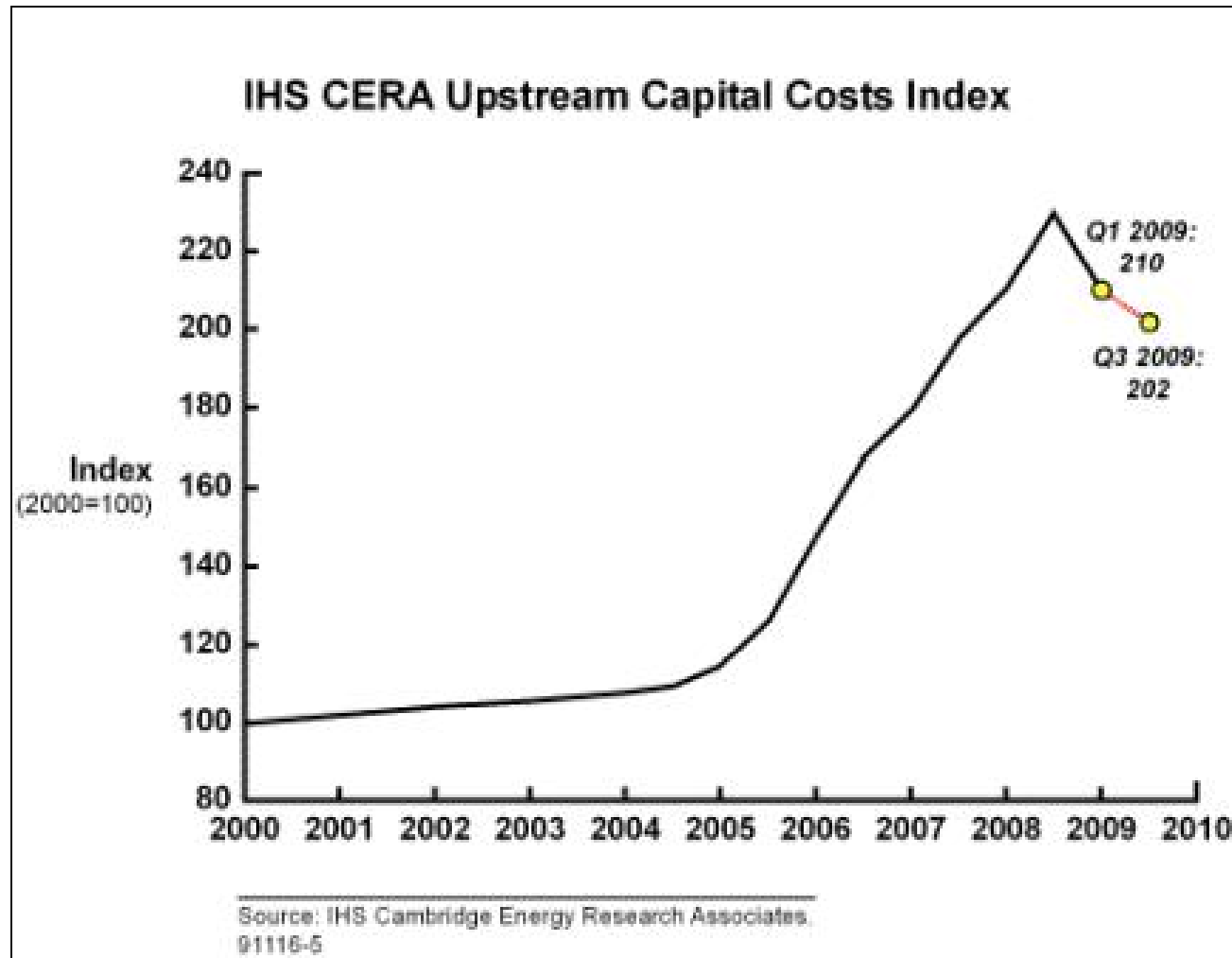
Historical Trends – North Slope Capital Expenditures

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Historical Trend – Worldwide Upstream Capital Costs

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Are the Increasing Spending Levels due to Maintenance Costs?

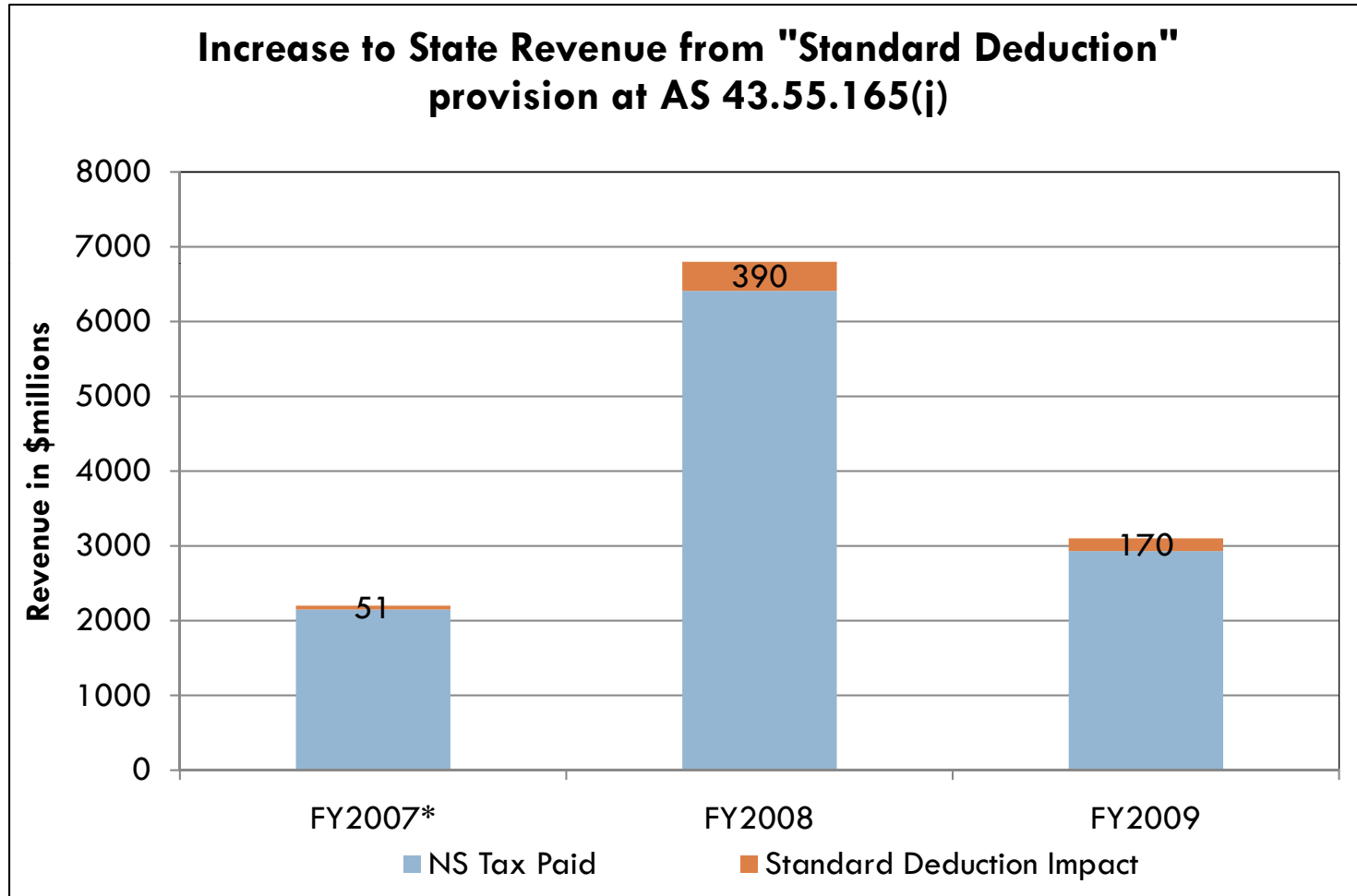
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CAPEX- Capital expenditures (“CAPEX”) on pipeline repairs at Prudhoe Bay increased after corrosion incidents in 2006. However, the majority of growth in capital expenditures since 2007 is attributable to drilling, seismic and other production related projects.

OPEX - Since 2007, the proportion of total operating expenditures (“OPEX”) related to major repairs does not appear to be the key driver in the growth of total operating expenditures

Effect of Standard Deduction Provision

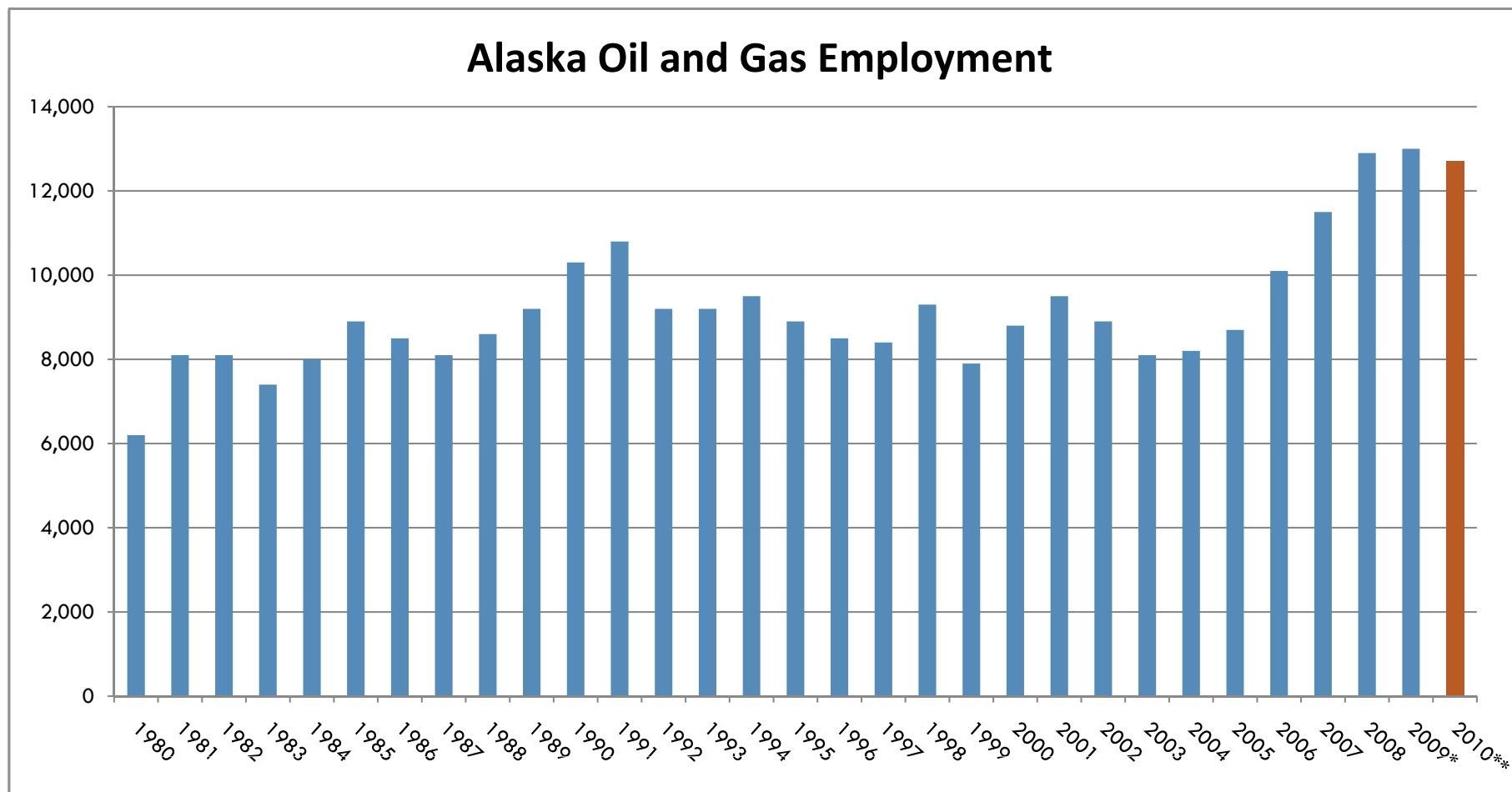
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*Standard Deduction in place for half of FY 2007.

Oil and Gas Industry Employment 1980-2009

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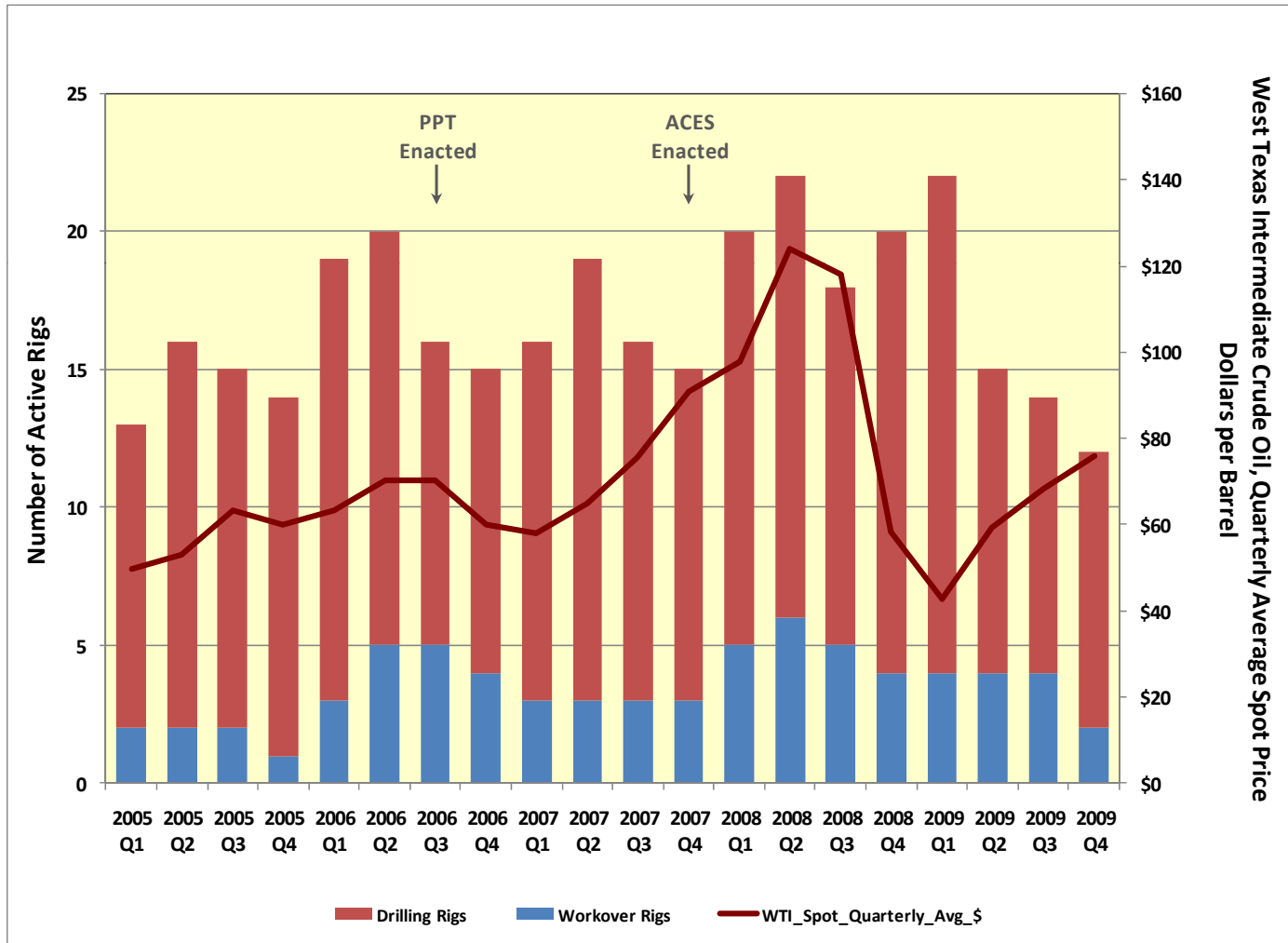


*Estimates for 2009 are preliminary; revised as of February 3, 2010.

**Forecast.

Active Drilling Rigs in Alaska 2005-2009

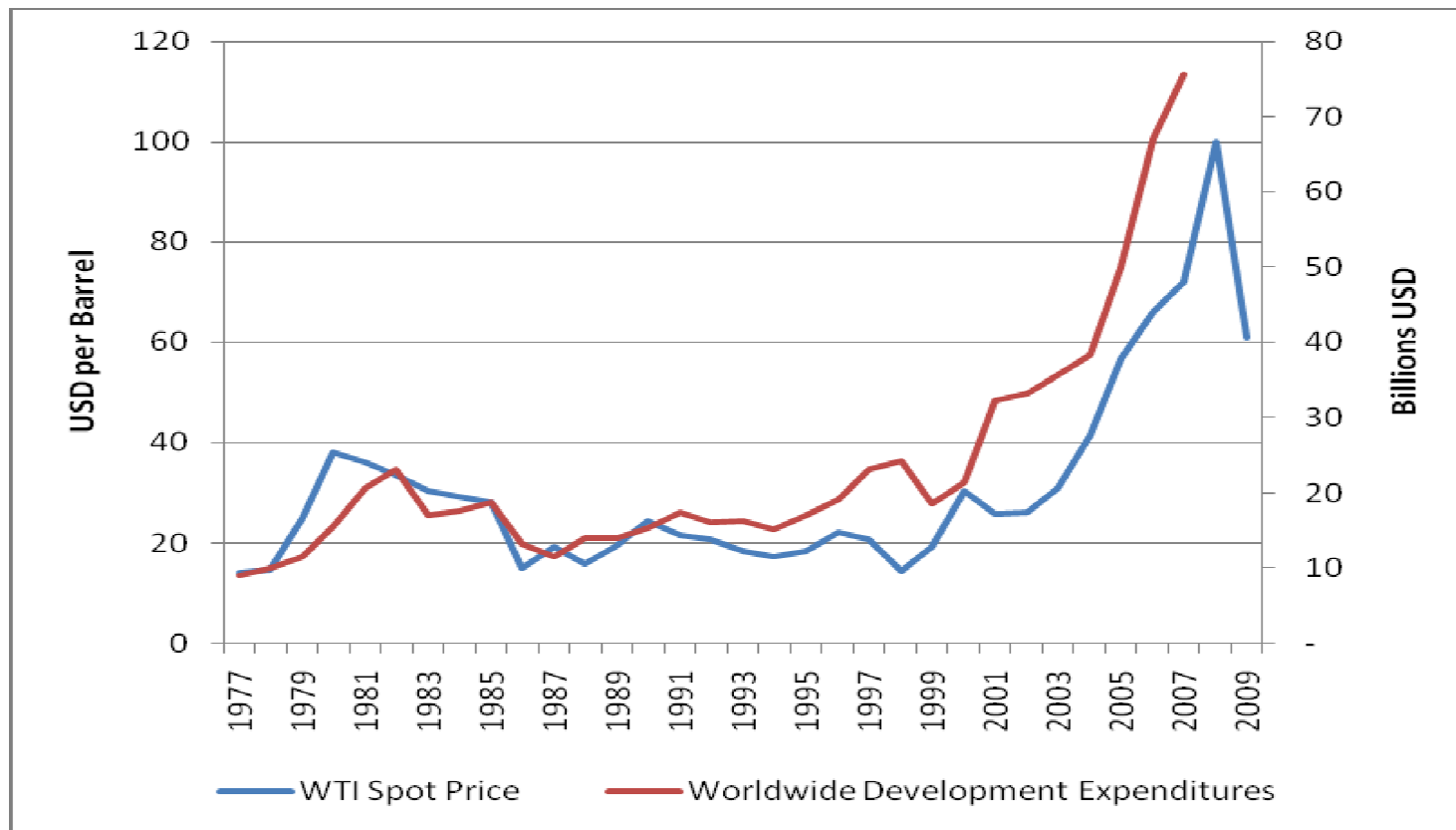
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Development Expenditures Strongly Correlated with Oil Prices

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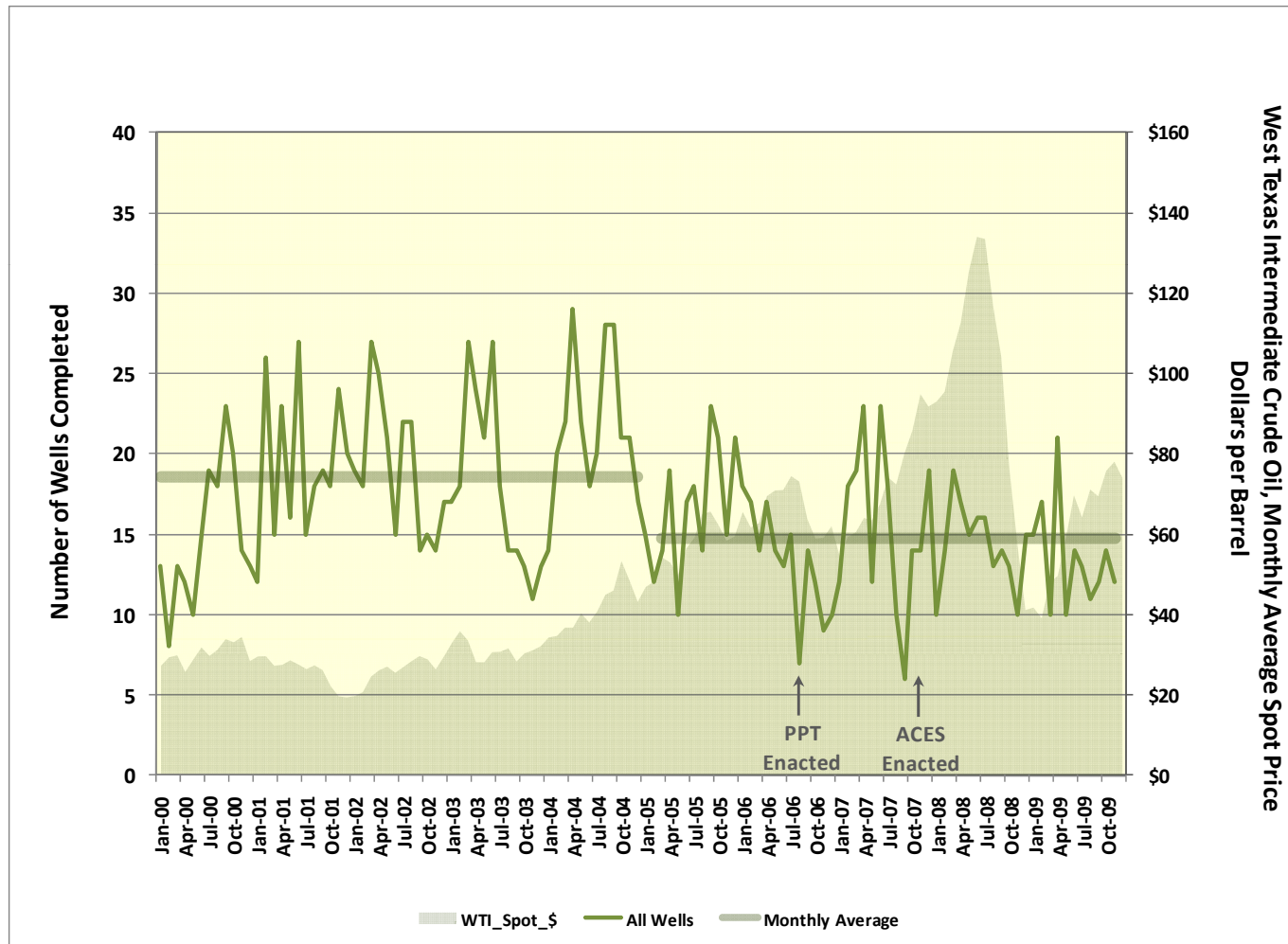
Historical WTI Price and Worldwide Development Expenditures of EIA Surveyed Companies



Source: EIA Financial Reporting System data on development costs (data available thru 2007 only). Note, this survey does not reflect a consistent set of companies. WTI prices from BP Statistics and the Wall Street Journal.

Wells Completed 2000-2009

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Companies Drilling in Alaska During the Last Year - by Region

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North Slope

- ☐ Anadarko
- ☐ BP
- ☐ Brooks Range
- ☐ Conoco Phillips
- ☐ ENI
- ☐ Pioneer
- ☐ Savant
- ☐ Ultrastar

Cook Inlet

- ☐ Aurora
- ☐ Marathon
- ☐ Unocal

Interior

- ☐ Rampart
- ☐ Rutter & Wilbanks

Conclusions from the Analysis

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In general, the information does not indicate that changes in the tax system have had a direct negative impact on industry activity in the state

In fact, the data would indicate that the investment incentive provisions of ACES are contributing to increased levels of expenditure

The End