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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.

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Repsol is a new player on the North Slope. 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 shown to be oil rich and with lower exploratory risk than other regions. It is an area that met Repsol's objectives to balance our exploration portfolio with lower risk, in onshore oil opportunities in a stable environment, preferably in OECD countries. 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. Repsol has invested in offshore Alaska, both in the federal waters of the Beaufort Sea where we have interests in 71 blocks and the Chukchi Sea where we have 93 blocks. However, 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. House Bill 110 was introduced on the 18th of January, 2011. Repsol viewed the terms of the proposed HB 110 favorably and we were 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. By the 7th of March, 2011, Repsol completed negotiations to secure its North Slope position and announced its entry into the State of Alaska lands through a partnership with Armstrong Oil and Gas and GMT Exploration.

The process of meaningful oil and gas tax reform has continued over the last two years. Repsol firmly believes that Governor Parnell's new proposal now before the Senate Finance Committee as CS SB 21 (RES.), addresses many of the shortcomings of ACES that were causing Alaska to be uncompetitive in attracting oil and gas investment. First and foremost, it proposes to remove the progressive nature of ACES which is what deterred investments in Alaska at the very time that investment was being stimulated in other states by rising oil prices. It is counterintuitive that Alaskans would want investment to leave their state and go to North Dakota, Texas, California or Oklahoma as oil prices increased, yet that is exactly what ACES encourages. Repsol believes that Alaska should reap the benefits of higher oil prices, but that the increase should be shared fairly and that investors should be encouraged to invest more, rather than less, as prices increase. Repsol and other companies have long argued that the current progressive tax structure is detrimental to new investment in Alaska and we endorse the repeal of progressivity that is proposed in CS SB 21 (RES.).

Repsol and other companies look to benefit from several tax credits, namely the Qualified Capital Expenditure Credit, or QCE credit, the Small Producer Credit and the Exploration Credit. These credits have encouraged newcomers like Repsol to come to Alaska in what would otherwise be an unattractive investment climate. The credits have the effect of reducing our initial capital investments in the early phases of investment, especially during the exploration phase. With these credits, Alaska was subsidizing our initial investment in return for a larger piece of future production revenues for Alaska, if any. In essence, the taxpayers of Alaska were partially insuring and mitigating our potential losses from an unsuccessful exploration program in order to stimulate more exploration and to develop marginal fields that might otherwise be uneconomical to develop. The credits have certainly encouraged Repsol and its partners to enter into a robust exploration program that will result in total investments of some half billion dollars in our North Slope leases by year end of 2013. The credits do not, however, encourage long term developments of any discovery when those developments must compete against developments in states with more favorable tax regimes. These credits help to reduce the cost of coming to Alaska, but we invest in exploration with the expectation that we can have a long term, economical development of any discovery. Oil companies must consider the full life cycle economics of a project when making investment decisions, not just the early economics of exploration. While the credits have encouraged exploration, in most cases they are not enough to offset the negative aspects of progressivity when considering the full life cycle economics of development and production, which are the stages where more intensive investment and job creation occur. We are encouraged that the Bill proposes the extension of the Small Producer Credit and the Exploration Credit. These credits will continue to motivate new players and new exploration. We would like to see the continuation of the QCE in some form, at least for the near term, but we recognize the tradeoff that is offered by the Bill. We must acknowledge that there are scenarios in which the terms of the Bill are less favorable to new developments. Those scenarios occur when oil prices are low. The threshold value will vary somewhat between companies, depending on their individual circumstances. While we would prefer that the Qualified Capital Expenditure Credits continue, we view that the value from elimination of the progressivity at higher oil prices will offset the protection offered at lower oil prices by the QCE credit.

Our analysis in the preceding paragraph is based on Repsol's individual circumstances. We understand that there could be situations besides low oil prices in which the continuation of the QCE will be more attractive for some investments than the elimination of progressivity will be. Some companies with limited access to capital, or those that are investing in marginally economic projects, may find that the QCE credit is preferable to the elimination of progressivity. This is not Repsol's case.

Repsol makes investment plans on a multi-year cycle, looking ahead more than one year at a time. Major investment decisions are based on full life cycle economics, as was our decision to invest in onshore North Slope exploration. Future investment decisions to develop any discovery will also be based on full life cycle economics that result from a number of assumptions including, among others, our forecast of the future price of oil. Our major investment decisions are based on our long term outlook for oil prices, capital costs, operating costs, availability of investment capital and other major factors. We do not change those investment decisions based on short term price fluctuations, but only if our long term projections change. With Repsol's current forecasts, the provisions of the Bill are more favorable to Repsol for future investments and will encourage more investment than under the current terms of ACES.

Repsol views the "carry-forward annual loss" tax credit, with compounding interest rate, as a positive step to address the loss of the buy-back of QCE credits by the State. However, Repsol has concerns about the proposed 10 year "shelf life" of the carry-forward annual loss, especially given that we will no longer be allowed to transfer those credits to other companies. In many cases, it may take an oil company more than 10 years from initial investment in exploration until significant production revenues are earned to claim the credits. Repsol views the 10 year limitation on use of the credits as too restrictive and strongly encourages the legislature to increase the period of time that an investing company may use these credits to 15 years or to allow transfer or sale of the unused credits to other taxpayers.

As stated earlier, the positions in this statement represent the views of a newcomer to the North Slope. While Repsol has a favorable opinion of the Bill, we must not forget that new production is not the only contributor to TAPS throughput. We have not attempted to analyze the Bill from the perspective of the established producers. We encourage and support the State to continue its efforts to incentivize increased production from the existing legacy fields. This production is vital to maintaining sufficient oil volumes in the pipeline. Legacy producers, new explorers such as Repsol, and all Alaskans need and want the same thing – increased production in TAPS.

Repsol is pleased that Governor Parnell has taken steps to address many of the concerns that Repsol has with the Alaska tax structure under ACES. While we believe that there is still substantial room for improvement, overall the proposed bill is a viable cornerstone for tax reform that we consider significant and meaningful in returning Alaska's competitiveness for investment opportunities.

The proposed reform is fair to Alaskans and will encourage more production as well as investment. The proposed Bill goes a long way to simplify what was a very complex tax regime and it will restore a balance in which the State and the companies investing in Alaska will both benefit from in the longer term. Alaskans will see more investment in the North Slope if CS SB 21(RES.) is passed and signed into law. This additional investment can only lead to more oil in TAPS, and in the long term, more revenue for Alaska and more high paying jobs for Alaskans. Our hope is that the legislature and all Alaskans will see the wisdom in this approach to North Slope investment.

Thank you.