SB 107
Oil Subsidy Reform

Senator Bill Wielechowski

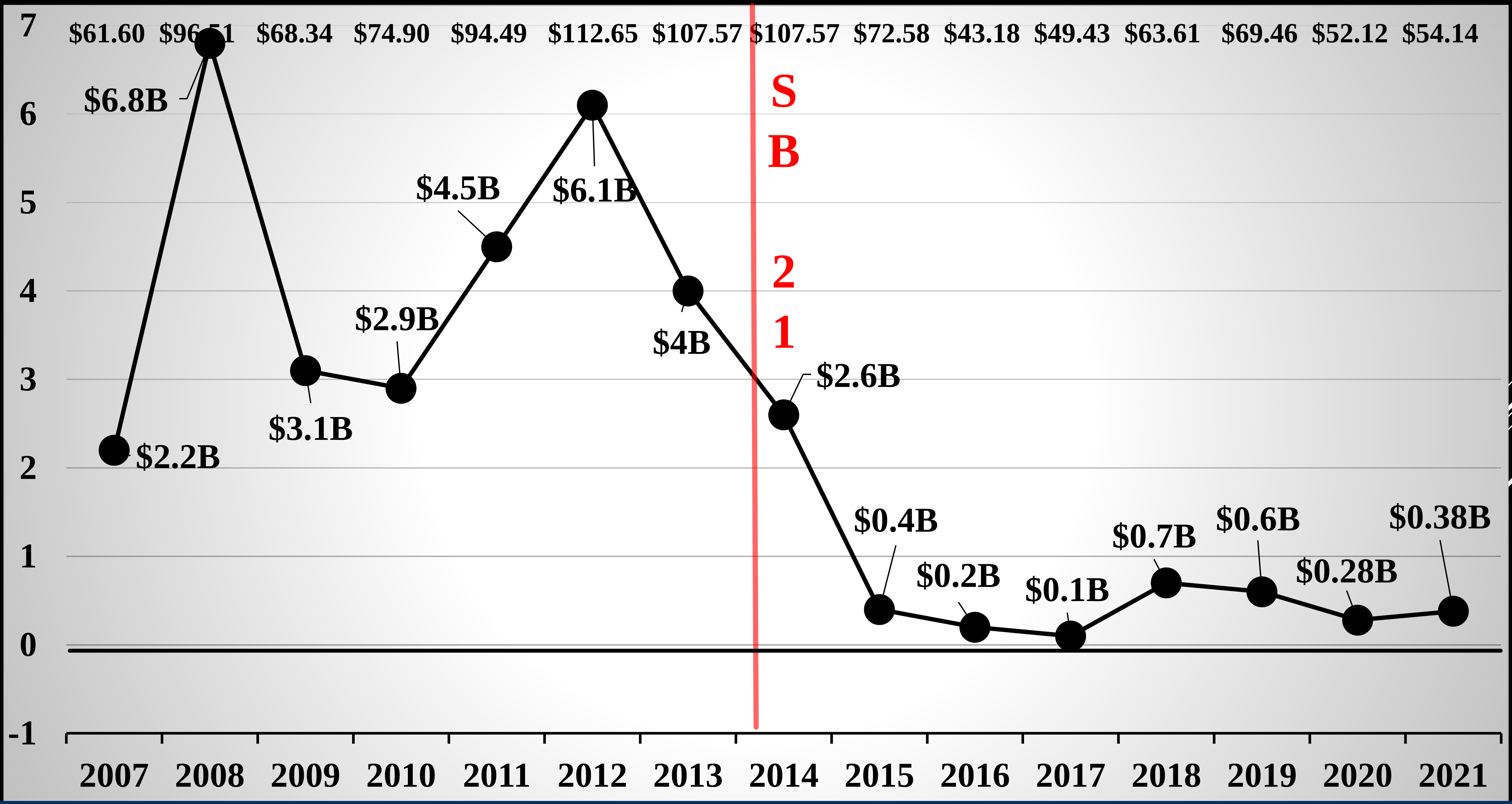
Senate Finance Committee

May 13, 2022

"The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for the maximum benefit of its people."

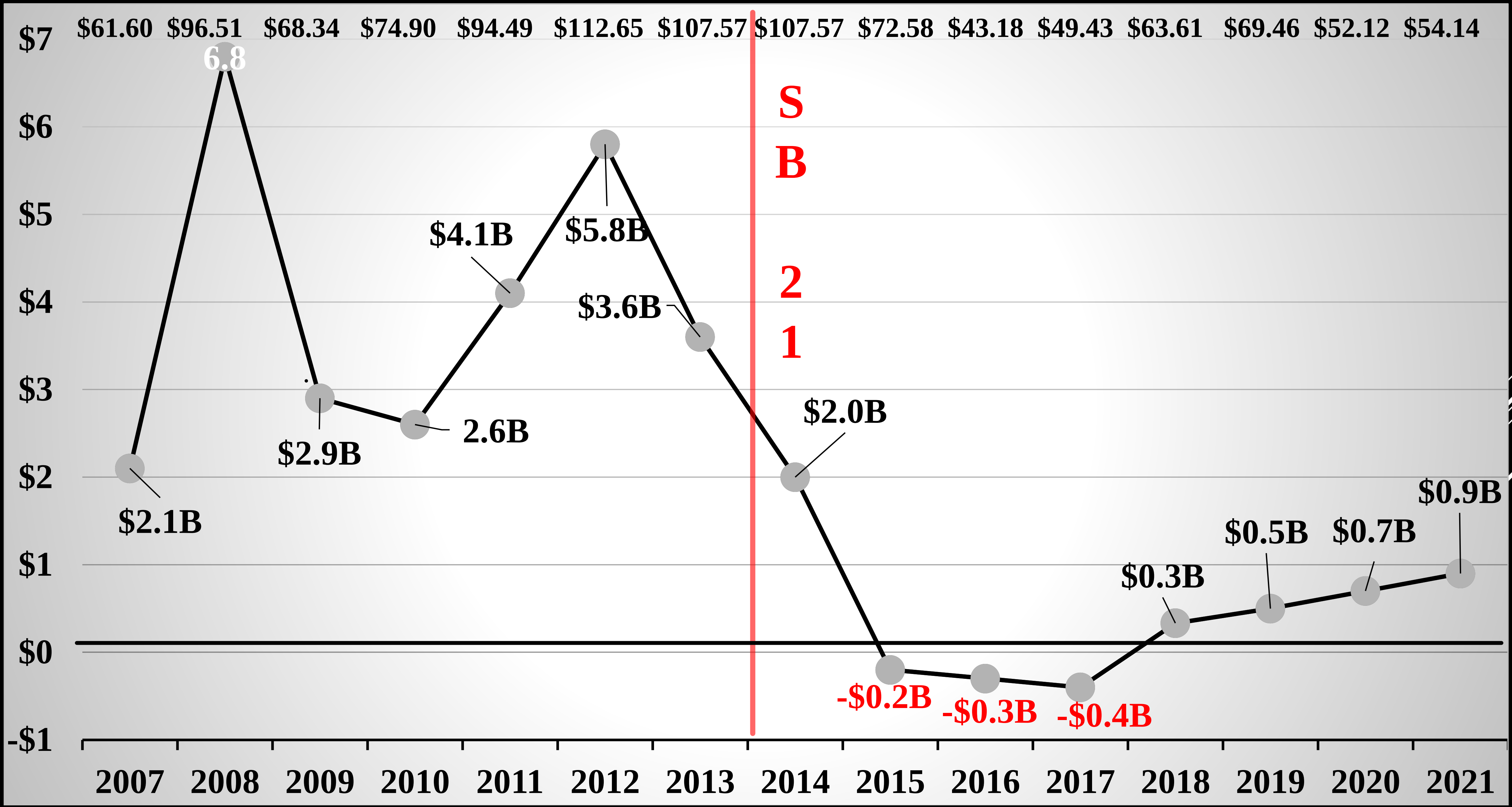
-Article 8, Section 2, Constitution of Alaska

Production Revenues Before Credits 2007-2021



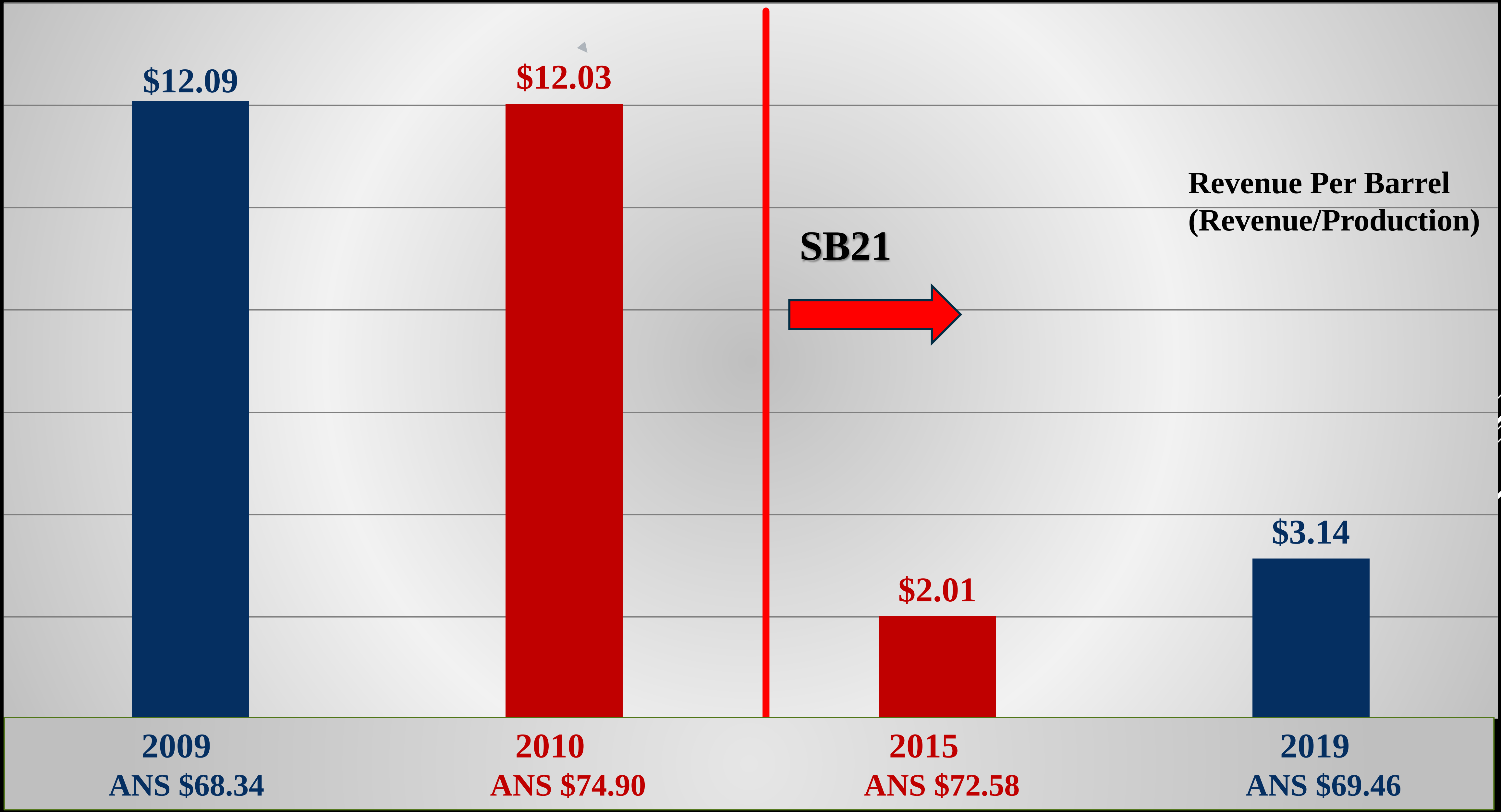
Source: Alaska Department of Revenue, Tax Division, Fall Revenue Sources Book 2015 (FY 2007 - 2013 Data) & 2021 (FY 2014 - 2021)

Production Revenues After Credits 2007-2021



Source: Alaska Department of Revenue, Tax Division, Fall Revenue Sources Book 2015 (FY 2007 - 2013 Data) & 2021 (FY 2014 - 2021)

Comparative Production Tax Revenue



Source: Ballot Measure 1 Supporting Documents- Presentation 2020

Production Tax Revenue After Credits

$28B

2007-2013

SB 21

2014

$1.3B

2015-2021

Source: Alaska Department of Revenue, Tax Division, Fall Revenue Sources Book 2015 (FY 2007 - 2013 Data) & 2021 (FY 2014 - 2021)

Alaska is Consistently the Most Profitable Region in the World for ConocoPhillips

Table 1: ConocoPhillips Adjusted Net Earnings (ANE) and ANE per Barrel of Oil Equivalent (BOE) in Selected Geographical Areas, 2012 through the First Quarter of 2022
(ANE in Millions of $)

Year	Alaska		Lower 48		International		Global Total	
	ANE	ANE per BOE	ANE	ANE per BOE	ANE	ANE per BOE	ANE	ANE per BOE
2012	$ 2,301	$ 29.60	$ 713	$ 4.27	$ 4,533	$ 18.82	$ 6,734	$ 11.69
2013	$ 2,177	$ 29.82	$ 784	$ 4.37	$ 4,881	$ 21.96	$ 7,061	$ 12.52
2014	$ 2,077	$ 31.10	$ 861	$ 4.43	$ 4,574	$ 15.21	$ 6,609	$ 11.60
2015	$ 482	$ 7.42	$ (1,763)	$ (8.86)	$ 289	$ 0.91	$ (1,724)	$ (2.97)
2016	$ 233	$ 3.57	$ (1,893)	$ (10.67)	$ (558)	$ (1.69)	$ (3,308)	$ (5.78)
2017	$ 652	$ 9.81	$ (444)	$ (3.05)	$ 1,471	$ 5.06	$ 739	$ 1.47
2018	$ 1,637	$ 24.11	$ 1,686	$ 11.64	$ 2,994	$ 11.72	$ 5,331	$ 11.38
2019	$ 1,441	$ 18.11	$ 948	$ 5.76	$ 1,647	$ 6.65	$ 4,036	$ 8.20
2020	$ (32)	$ (0.44)	$ (544)	$ (3.86)	$ 413	$ 2.07	$ (1,040)	$ (2.52)
2021	$ 1,406	$ 19.55	$ 5,231	$ 18.37	$ 2,350	$ 10.91	$ 8,000	$ 13.99
2022 Q1	$ 561	$ 30.60	$ 2,774	$ 32.23	$ 1,129	$ 22.10	$ 4,289	$ 27.59

Source: Legislative Research Services Report 22.019, May 2022

Alaskans Recover Too Little Under Low Oil Prices

- When prices dropped 62% a few years ago, Alaska’s share of revenue fell 109%.
- During 2016 and 2017, when oil prices were lower, ConocoPhillips lost $4.6 billion worldwide while making $1.8 in Alaska.
- Producers can adjust project timing, budgets, and costs and should bear some of the downside risk at low prices.

Alaskans are Compensated for Our Oil In Two Ways

- Royalties are the compensation the producer pay to Alaska as the landowner.
- Production taxes are what Alaska receives as the sovereign owner of the resource.

Producers pay less in royalties and taxes in Alaska

- In Alaska, the average royalty is only 12.5% and the average SB 21 production tax is 4%, for a total Alaskan share of 16.5%
- In North Dakota, the average royalty is 18.7% and the average production and severance is 10% of the gross, for a 28.7% total

SB 107 Makes Four Modest but Needed Reforms

- Creates transparency by giving legislators and the public the information we need to evaluate our oil tax policies
- Closes a loophole that allows producers to deduct expense from different fields
- Establishes a true minimum tax rate and adds slight progressivity
- Eliminates the unnecessary deductible production tax credits

SB 107 Only Applies to Large Established Fields

Only applies to fields that produced an average of 40,000 barrels a day in the last calendar year and over 400 million barrels over the life of the field

The only fields this would currently apply to are the Prudhoe Bay Unit, Kuparuk River Unit, and the Colville River Unit (aka Alpine)

New and developing fields would not be impacted by this bill.

Prudhoe, Kuparuk, and Alpine are Low-Cost, High-Profit Fields

- 2018 data showed that at $63/barrel, Prudhoe has a profit margin over costs of $40 per barrel
- Operating, capital, and transportation costs were only $25/ barrel
- Legislative Research Services analysis of ConocoPhillips annual reports have shown that they made twice as much per barrel on these three fields as the did anywhere else in the world

SB 107 Makes Two Reforms to the Current Net Calculation

- Eliminates the $8 per barrel credit.
- Raises the net profits tax by 15% above $50 per barrel.
- The first $50 of production tax value per barrel would be taxed at the current 35% rate and anything above that would be taxed at a 50% rate.
- These reforms only apply to the three legacy fields.

The $8 Per Barrel Credit is Unnecessary for the Profitable Legacy Fields

- In 2018, these credits cost Alaska $742 million from Prudhoe Bay alone.
- Producers have a legal duty under their leases to invest in and produce oil from these fields without incentives.
- The producers would continue to produce without these credits, because they have done so for decades and the profit margins in these fields are among the highest in the world.
- No new investment or production has ever been linked to the per barrel credits.

Capital Investment in Prudhoe Bay has Plummeted from $826 million in 2013 to Only $86 Million in 2021

Alaska Department of Revenue
Tax Division

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Page: 2 of 2

Reported ANS Lease Expenditures and Capital Lease Expenditures:
CY 2012 - CY 2021

Revised March 21, 2022 by Economic Research Group

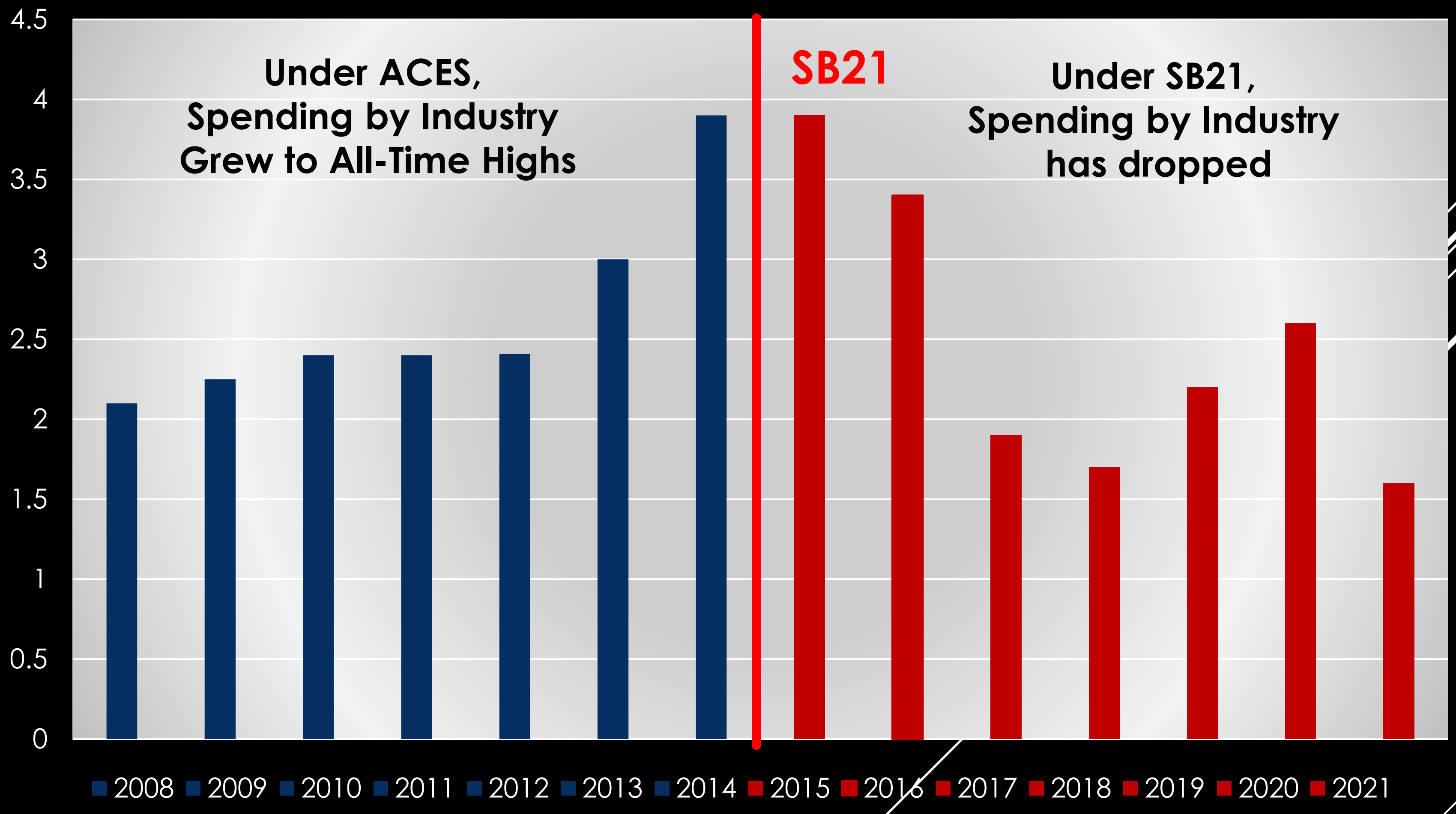
Total Lease Expenditures ($ Millions)										***Preliminary***
	CY 2012	***CY 2013***	***CY 2014***	***CY 2015***	***CY 2016***	***CY 2017***	***CY 2018***	***CY 2019***	***CY 2020***	***CY 2021***
Prudhoe Bay Unit	$2,145	$2,335	$2,659	$2,534	$1,977	$1,677	$1,372	$1,700	$1,137	$997
All Other ANS	$3,356	$3,911	$4,660	$4,952	$2,990	$2,415	$3,280	$3,599	$3,385	$2,680
Total ANS	**$5,501**	**$6,246**	**$7,319**	**$7,486**	**$4,967**	**$4,093**	**$4,652**	**$5,299**	**$4,522**	**$3,677**

Qualified Capital Expenditures ($ Millions)										***Preliminary***
	CY 2012	***CY 2013***	***CY 2014***	***CY 2015***	***CY 2016***	***CY 2017***	***CY 2018***	***CY 2019***	***CY 2020***	***CY 2021***
Prudhoe Bay Unit	$591	$826	$877	$773	$476	$356	$202	$391	$119	$86
All Other ANS	$1,887	$2,394	$3,065	$3,285	$1,555	$1,162	$1,622	$1,935	$1,815	$1,320
Total ANS	**$2,479**	**$3,220**	**$3,942**	**$4,058**	**$2,031**	**$1,518**	**$1,824**	**$2,326**	**$1,934**	**$1,406**

The operator received approximately *$715 million in credits* in Fiscal Year 2021.

Oil Industry Investment In North Slope Oil Fields

(In Billions)



Source: Alaska Department of Revenue, Tax Division, Fall Revenue Sources Book Historic Data

From FY 2014 – FY 2022, we have lost $6.1 Billion to the Per-Barrel Credit, while receiving just $5.2 Billion in Production Tax Revenue.*

	Credits Used Against Tax Liability [4,5]										
	North Slope										
9	Qualified capital expenditure, AS 43.55.023(a); Carry-forward annual loss, AS 43.55.023(b); Well lease expenditure, AS 43.55.023(l)	306	486	332	0	*	*	*	*	*	*
10	Transitional Investment Credit: AS 43.55.023(i)	*	*	0							
11	Per taxable barrel credit, AS 43.55.024(i)-(j) [6]			516	524	86	536	1,001	1,037	613	740
12	Small producer credit, AS 43.55.024(a)(c)	*	*	*	*	*	*	*	*	*	*
13	Credits under AS 43.55.025 [2]	*	*	*	*	*	*	*	*	*	*
14	**Total North Slope**	**347**	**536**	**907**	**575**	**120**	**570**	**1,034**	**1,061**	**621**	**787**

*Net of cashable credits refunded to the taxpayers.
Source: Alaska Department of Revenue, Tax Division, Revenue Sources Spring Update 2022

From FY 2023 – FY 2031, we will lose another $11.0 Billion to the Per-Barrel Credit, while receiving just $8.9 Billion in Production Tax Revenue.*

Credits Used Against Tax Liability [4,5]

	North Slope										
9	Qualified capital expenditure, AS 43.55.023(a); Carry-forward annual loss, AS 43.55.023(b); Well lease expenditure, AS 43.55.023(l)	128	0	0	0	0	0	0	0	0	0
10	Transitional Investment Credit: AS 43.55.023(i)										
11	Per taxable barrel credit, AS 43.55.024(i)-(j)6	1,058	952	1,104	1,257	1,265	1,252	1,218	1,225	1,280	1,424
12	Small producer credit, AS 43.55.024(a)(c)	1	1	1	1	0	0	0	0	0	0
13	Credits under AS 43.55.025 [2]	0	0	0	0	0	0	0	0	0	0
14	**Total North Slope**	**1,187**	**953**	**1,105**	**1,257**	**1,265**	**1,252**	**1,218**	**1,225**	**1,280**	**1,424**

*Net of cashable credits refunded to the taxpayers.
Source: Alaska Department of Revenue, Tax Division, Revenue Sources Spring Update 2022

SB 107 Closes a Loophole by Requiring Each Field be Treated Separately

Current law allows producers to use expenses from more expensive fields to lower their tax rates on the highly profitable legacy fields.

This bill requires that oil and gas production taxes be calculated separately for these three major fields.

Sound policy and common sense dictate that the production taxes for our largest and most profitable fields should be based on the actual costs of producing oil from each of those fields.

NPR-A Development is Reducing Alaska’s Production Revenue

- ConocoPhillips is currently developing on federal lands in the NPR-A and deducting these costs from their production taxes on the legacy fields.
- If this loophole is not closed, it would likely cost Alaska $300 million per year over the next decade.
- Alaska is subsidizing fields that we will receive little royalties or production taxes on.
- This loophole creates a competitive disadvantage for new producers, since unlike their competitors they do not have other Alaskan fields they can deduct their expenses from.

SB 107 Reforms the Alternative Gross Minimum Tax

- Currently this is based on the greater of the alternative gross minimum tax calculation or gross calculation (percentage of wellhead value), or the tax on production tax value or net calculation (percentage of profits).
- SB 107 maintains this basic structure, while reforming it to be fairer for Alaskans

Reforming the Alternative Gross Minimum Tax

- SB 107 raises the minimum rate from 4% to 10% and raises this floor by 1% (to a maximum of 15%) for every $5 dollars over $50/ barrel oil price
- The current 4% minimum is a “soft” floor and producers argue it can be less. SB 107 makes the minimum rate a true minimum.

Profitability on the Average Barrel of Oil Produced from Prudhoe Bay in FY 2018: Order of Operations

Step One: Market Value

	Price	Barrels (Thousands)	Value ($millions)
2018 Production / Day		290.5	
Production / Year		106,033	
Share of North Slope Total		56%	
Market Price	**$ 63.61**	106,033	**$ 6,744.7**
Est. Royalty and Federal Barrels		13,254	
Taxable Barrels		**92,778**	

Notes: Volumes per Revenue Sources Book (Fall 19) Table C-1. Includes production from three areas: "Prudhoe Bay," "PBU Satellites," and "Greater Pt. McIntyre." The "PBU Satellites" Category includes Milne Point which would likely need to be backed out of these calculations.

Royalty barrels are approx. 12.5% of total production.

Profitability on the Average Barrel of Oil Produced from Prudhoe Bay in FY 2018: Order of Operations

Step Two: Wellhead Value

	Price	Barrels (Thousands)	Value ($millions)
Market Price	**$ 63.61**	106,033	**$ 6,744.7**
Transport			
TAPS	$ 5.84		
Marine	$ 3.28		
Quality Bank	$ (0.17)		
"Other"	$ 0.17		
Total	$ 9.12		
Total Wellhead Value	**$ 54.49**	106,033	**$ 5,777.7**
Royalty Barrels	**$ 54.49**	13,254	**$ 722.2**
Gross Value at POP	**$ 54.49**	92,778	**$ 5,055.5**

Notes:

- **Tariffs from RSB table B-1. Excludes "feeder tariff" component because that does not apply to PBU production.**
- **Transport cost includes any embedded profits for vertically integrated companies**

Profitability on the Average Barrel of Oil Produced from Prudhoe Bay in FY 2018: Order of Operations

Step Three: Lease Expenditure Deductions

Status Quo / SB 21 Method	Price	Barrels (Thousands)	Value ($millions)	note
Gross Value of Taxable Oil	**$ 54.49**	92,778	**$ 5,055.5**	
Lease Expenditures				
Operating Expend.	$ 15.59		$ 1,446.3	$2,581 million slope wide
Capital Expend.	$ 8.97		$ 832.2	$1,485 million slope wide
Total	$ 24.56		$ 2,278.5	
Production Tax Value (PTV)	**$ 29.93**	92,778	**$ 2,777.0**	

SB 107 / Ringfence Method	Price	Barrels (Thousands)	Value ($millions)	note
Gross Value at POP	**$ 54.49**	92,778	**$ 5,055.5**	
Lease Expenditures				
Operating Expend.	$ 12.84		$ 1,191.0	$1,191 million
Capital Expend.	$ 2.26		$ 210.0	$210 million
Total	$ 15.10		$ 1,401.0	
Production Tax Value (PTV)	**$ 39.39**	92,778	**$ 3,654.5**	

Notes: Status Quo based on all North Slope lease expenditures divided among all taxable barrels. SB 107 based on actual DOR-reported Prudhoe Bay lease expenditures for calendar year 2018.

By using the actual expenditures for the field, PBU is actually $877 million more profitable than if the producers are able to shift costs from other work on the North Slope.

Profitability on the Average Barrel of Oil Produced from Prudhoe Bay in FY 2018: Order of Operations

Step Four: Comparative Production Tax Calculation
Gross Minimum Tax

	Status Quo				Senate Bill 107			
	Rate	Per Barrel	Barrels (Thousands)	Value ($millions)	Rate	Per Barrel	Barrels (Thousands)	Value ($millions)
Gross Value of Taxable Oil		$ 54.49	92,778	$ 5,039.7		$ 54.49	92,778	$ 5,039.7
Production Tax Value (PTV)		$ 29.93	92,778	$ 2,761.2		$ 39.39	92,778	$ 3,639.7
Gross Tax	4%	$ 2.18	92,778	$ 202.2	13%	$ 7.08	92,778	$ 657.2

Notes: Gross calculation is based on wellhead value, which is the same under both tax plans.

The SB 107 gross tax is 13% based on the $63.61 market price:

It is 10% below $50, 11% from $50.00 to $54.99, 12% from $55 to $59.99, 13% from $60 to $64.99, 14% from $65 to $69.99, and 15% at $70 and above.

Profitability on the Average Barrel of Oil Produced from Prudhoe Bay in FY 2018: Order of Operations

Step Five: Comparative Production Tax Calculation Net Tax and "Higher Of"

	Status Quo				Senate Bill 107			
	Rate	Per Barrel	Barrels (Thousands)	Value ($millions)	Rate	Per Barrel	Barrels (Thousands)	Value ($millions)
Gross Value of Taxable Oil		$ 54.49	92,778	$ 5,039.7		$ 54.49	92,778	$ 5,039.7
Production Tax Value (PTV)		$ 29.93	92,778	$ 2,761.2		$ 39.39	92,778	$ 3,639.7
Net Tax Calculated	35%	$ 10.48	92,778	$ 971.9	35%	$ 13.79	92,778	$ 1,279.1
Per Barrel Credit	$8	$ 8.00	92,778	$ 742.2	$ -	$ -	92,778	$ -
Net Tax Payable		$ 2.48	92,778	$ 229.7		$ 13.79	92,778	$ 1,279.1

	Status Quo				Senate Bill 107			
	Rate	Per Barrel	Barrels (Thousands)	Value ($millions)	Rate	Per Barrel	Barrels (Thousands)	Value ($millions)
Gross Tax	4%	$ 2.18	92,778	$ 201.6	13%	$ 7.08	92,778	$ 655.2
Net Tax Payable		$ 2.48	92,778	$ 224.2		$ 13.79	92,778	$ 1,273.9
Higher Of Gross and Net Taxes		$ 2.48	92,778	$ 229.7		$ 13.79	92,778	$ 1,279.1

Notes: The production tax increase is $11.31 / taxable barrel.
Of this, $8.00 is results from the elimination of the per-barrel credit, plus $3.31 due to the impact of the ringfence.

Profitability on the Average Barrel of Oil Produced from Prudhoe Bay in FY 2018: Order of Operations

Step Six: Summary of Other Revenues

	Status Quo				Senate Bill 107			
	Rate	Per Barrel	Barrels (Thousands)	Value ($millions)	Rate	Per Barrel	Barrels (Thousands)	Value ($millions)
Total Wellhead Value		$ 54.49	106,033	$ 5,777.7		$ 54.49	106,033	$ 5,777.7
Royalty Value (less field costs)		$ 54.07	13,254	$ 716.6		$ 54.07	13,254	$ 716.6
Equivalent Royalty Per Barrel		$ 6.76		$ 716.6		$ 6.76		$ 716.6
Lease Payments and Bonuses		$ 0.13		$ 13.7		$ 0.13		$ 13.7
Production Tax		$ 2.48	92,778	$ 229.7		$ 13.73	92,778	$ 1,273.9
Est. Property Tax		$ 1.90	106,033	$ 201.7		$ 1.90	106,033	$ 201.7
Est. Corporate Income Tax		$ 0.35	106,033	$ 37.2		$ 0.33	106,033	$ 34.7
Total State and Local Revenue		$ 11.62		$ 1,199.0		$ 22.85		$ 2,240.7

Notes: 1. Royalty value assumes 12.5% of production less 42c / bbl "field cost" per settlement.
2. Property Tax estimate per barrel is based on approx. $18 billion "upstream" tax assessment x 20 mils divided among all North Slope production.
3. Corporate Income Tax estimate based on total statewide collections divided by total production. Corporate Income Tax under SB 107 adjusted based on increased production tax reducing remaining taxable income.

Profitability on the Average Barrel of Oil Produced from Prudhoe Bay in FY 2018: Order of Operations

Step Seven: Federal Tax and Bottom-Line Profit

	Status Quo				Senate Bill 107			
	Rate	Per Barrel	Barrels (Thousands)	Value ($millions)	Rate	Per Barrel	Barrels (Thousands)	Value ($millions)
Production Tax Value (PTV)		$ 29.93	92,778	$ 2,777.0		$ 39.39	92,778	$ 3,654.5
Less Production Tax		$ 2.48	92,778	$ 229.7		$ 13.79	92,778	$ 1,279.1
Less Corporate Income Tax		$ 0.35	106,033	$ 37.2		$ 0.33	106,033	$ 34.7
Income after all state and local		$27.10		$ 2,510.1		$ 25.28		$2,340.7
Federal Corporate Income Tax	21%	$ 5.69		$ 527.1	21%	$ 5.31		$ 491.6
After Tax Profit		$21.41		$ 1,983.0		$ 19.97		$1,849.2

Notes: Overall profitability appears relatively similar.
However, this is because the SB 107 impact includes both:

1) The actual production tax changes, and
2) The use of the ringfence, which limits Prudhoe Bay deductions to actual field costs.

The $877 million in “off field” spending would be applied to separate tax calculations on the fields where they were incurred, or would be carried forward to be used after new fields come into production

SB 107 Provides Much Needed Transparency

- Requires filings and supporting information for producers in the three legacy fields to be made public.
- Alaska owns the land and oil being produced and have invested billions in subsidies for these fields. It is only fair that Alaskans have the information needed to see if these investments are wise.
- Without having access to the true revenues, costs, and profits of each producer of these three major fields, legislators are left to make oil policies based on fear and misinformation.

Our Own Consultants Have Advised Us to Improve Transparency

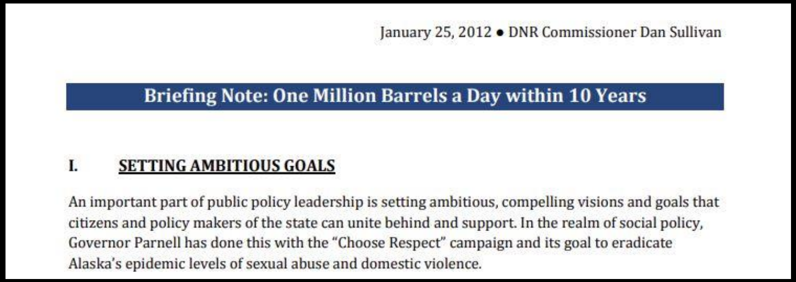
"Richard Ruggiero, Legislative Consultant, Castle Gap Advisors, Alaska State Legislature, Juneau, Alaska, said 10 years ago, as a member of the Gaffney Cline team he wrote in a memo that basically Alaska was one of the most opaque places with respect to data coming from the oil companies for this body to be able to make its policy decisions. And today it remains the same. *The state is actually making decisions with a whole lot less information than similar bodies in the other governments he works for*…

"He said for legislators to make good durable decisions and understand how well the credits are working they need another layer of information and detail. One difference he still sees today is that the Tax Division is the one talking about production and it is bound by confidentiality of the tax return it gets…

"[I]f he could make a suggestion he would say that *elsewhere in the world much more information changes hands than in Alaska, and that data is available to the government for setting policy* with respect to what acreage it makes available, to what data that helps others come in, and data to inform making tax policy."

-Senate Resources Committee Minutes, March 1, 2017

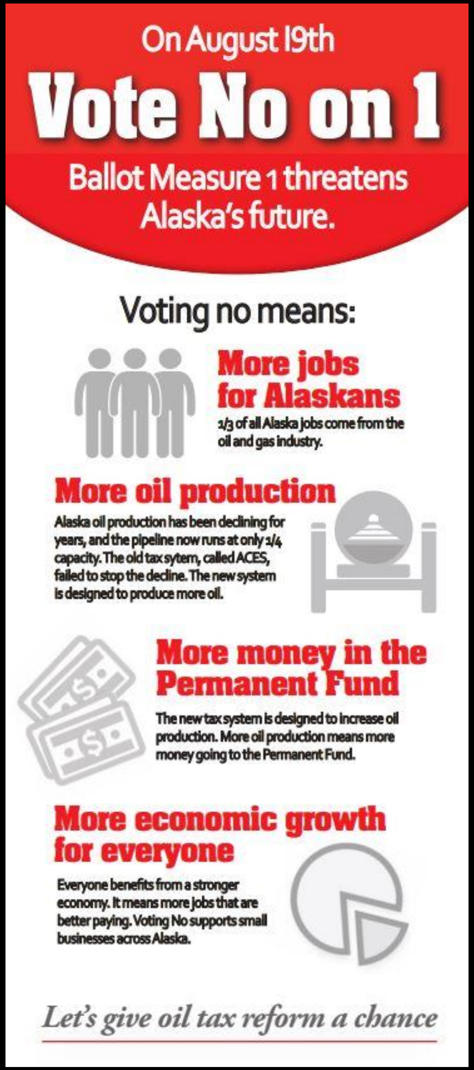
Alaskans Have Heard a Lot of Promises About Alaska's Oil Tax Law

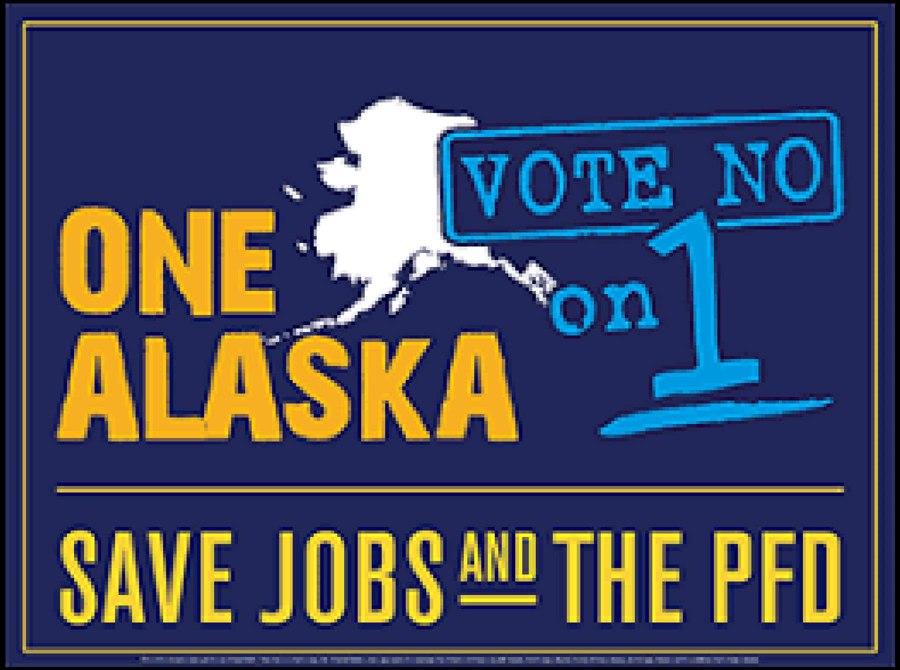

January 25, 2012 ● DNR Commissioner Dan Sullivan

Briefing Note: One Million Barrels a Day within 10 Years

I. SETTING AMBITIOUS GOALS

An important part of public policy leadership is setting ambitious, compelling visions and goals that citizens and policy makers of the state can unite behind and support. In the realm of social policy, Governor Parnell has done this with the "Choose Respect" campaign and its goal to eradicate Alaska's epidemic levels of sexual abuse and domestic violence.





"Oil Production is Quite Insensitive to the Tax Structure"*

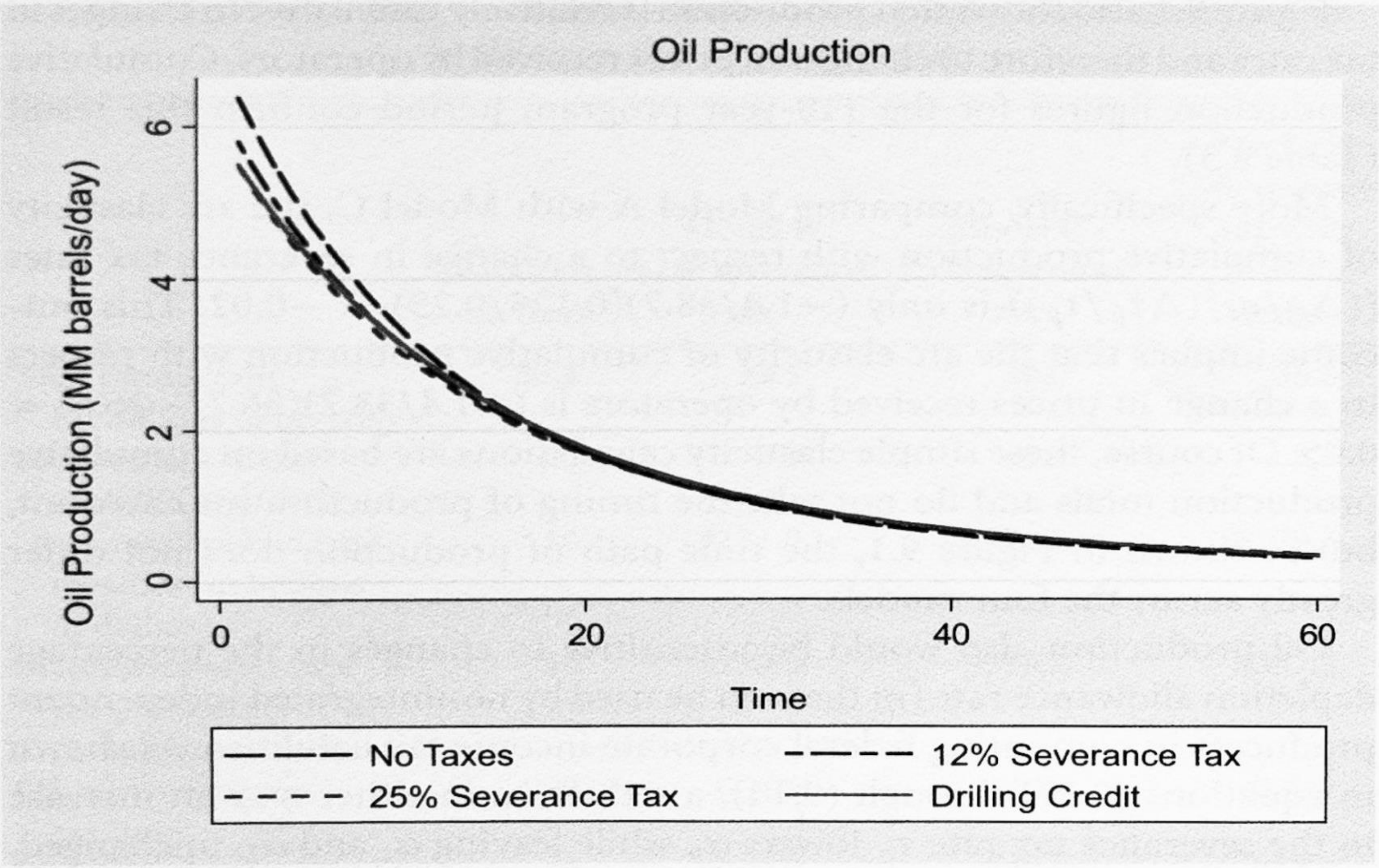
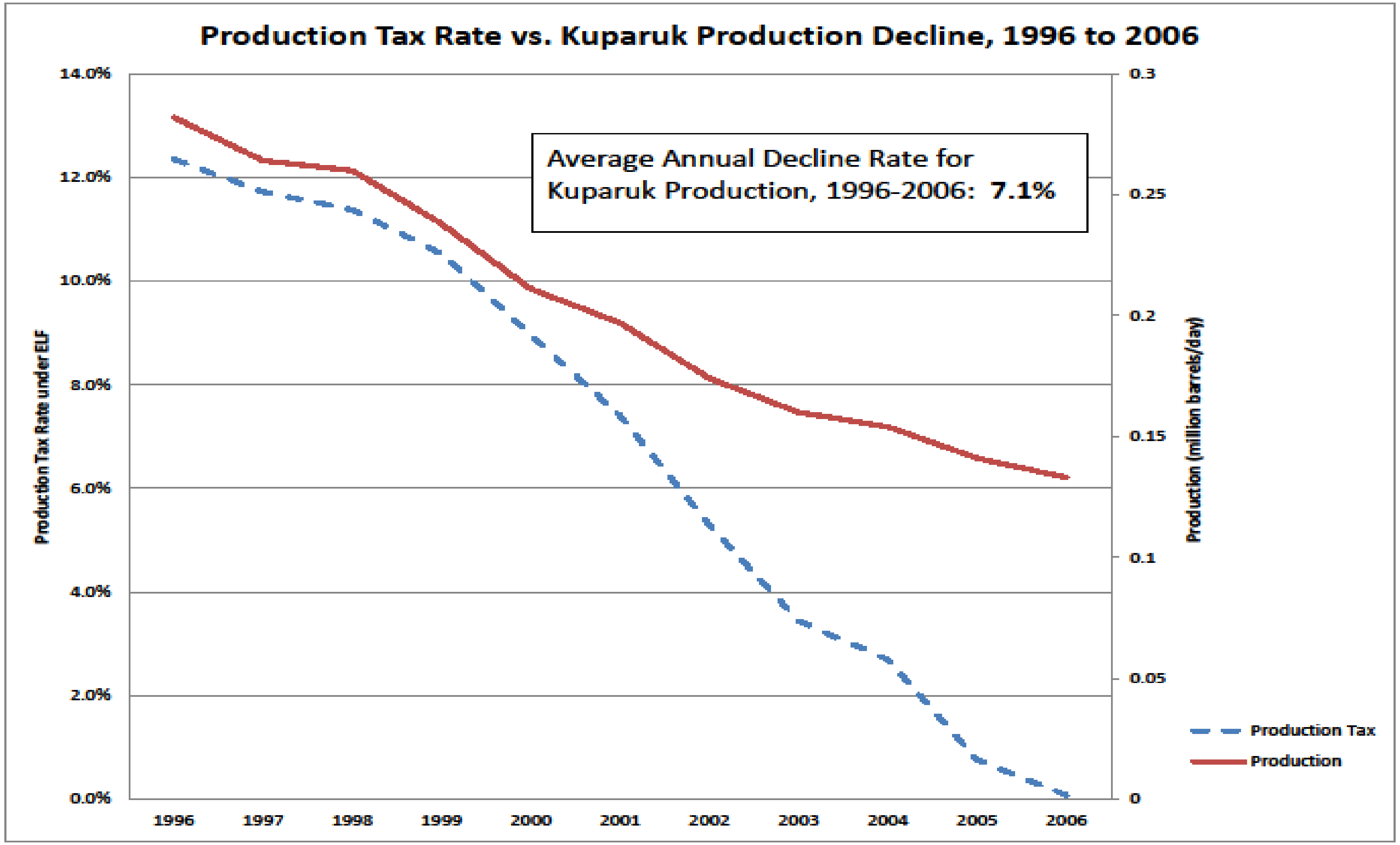


Figure 9.1. Oil production is quite insensitive to the tax structure in the U.S. case.

State Tax Policy and Oil Production

*Dr. Shelby Gerking's testimony before the Senate Resources Committee, 2/1/12

Under Our Old System of Extremely Low Taxes (ELF), Production Declined Dramatically at Kuparuk & Elsewhere:



The SB 21 Referendum was held on 8/19/14

Oil jobs peaked at <u>15,300</u> in August 2014, the month of the Referendum

On September 15, 2014, the front page of the Alaska Dispatch News:

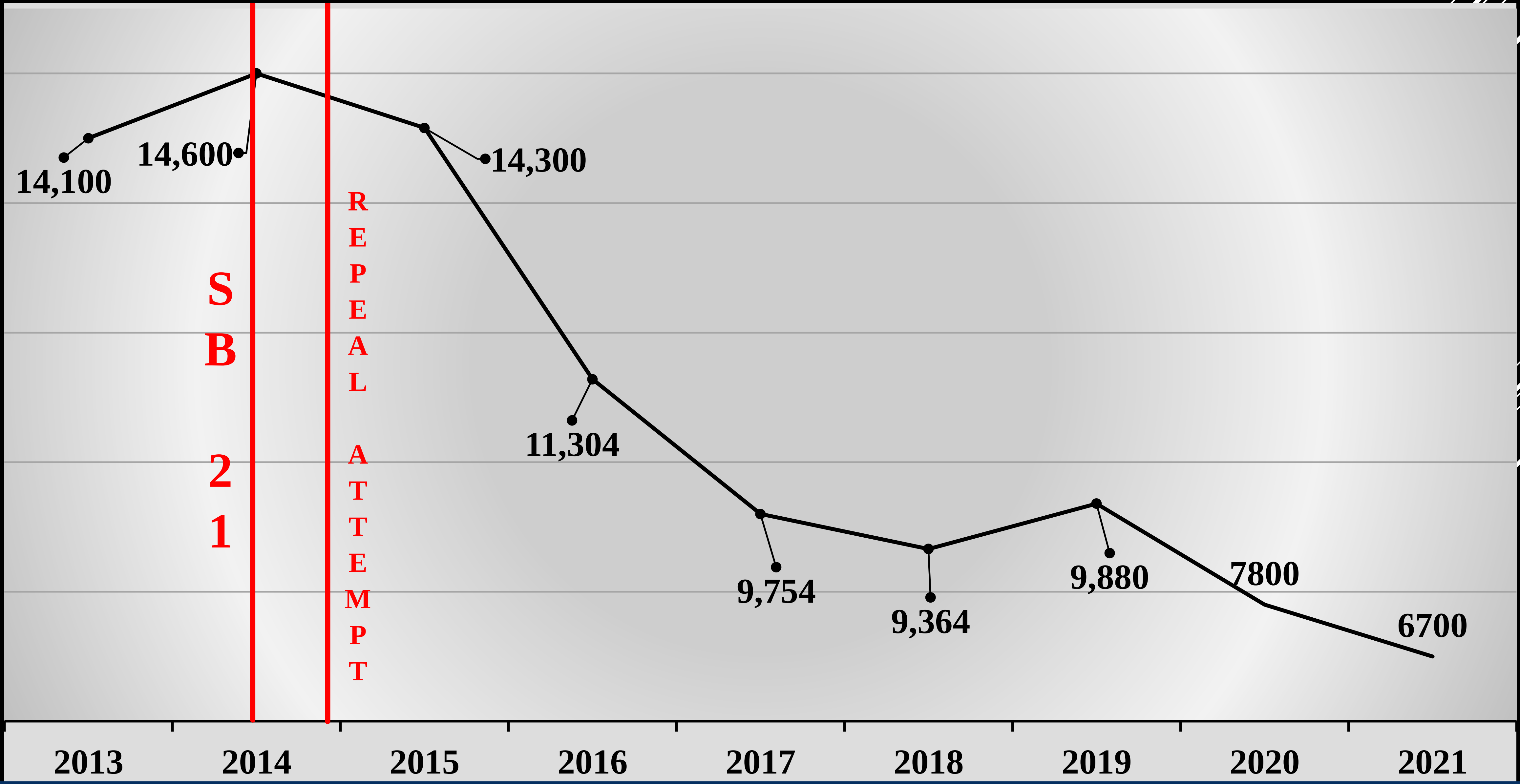
BP to reduce Alaska workforce by 475 early next year

Author: Alex DeMarban   Updated: September 28, 2016   Published September 15, 2014

Oil giant BP will cut close to one-fifth of its Alaska workforce of employees and direct contractors as a result of the sale of a chunk of its Alaska assets to Hilcorp, the company announced Monday.

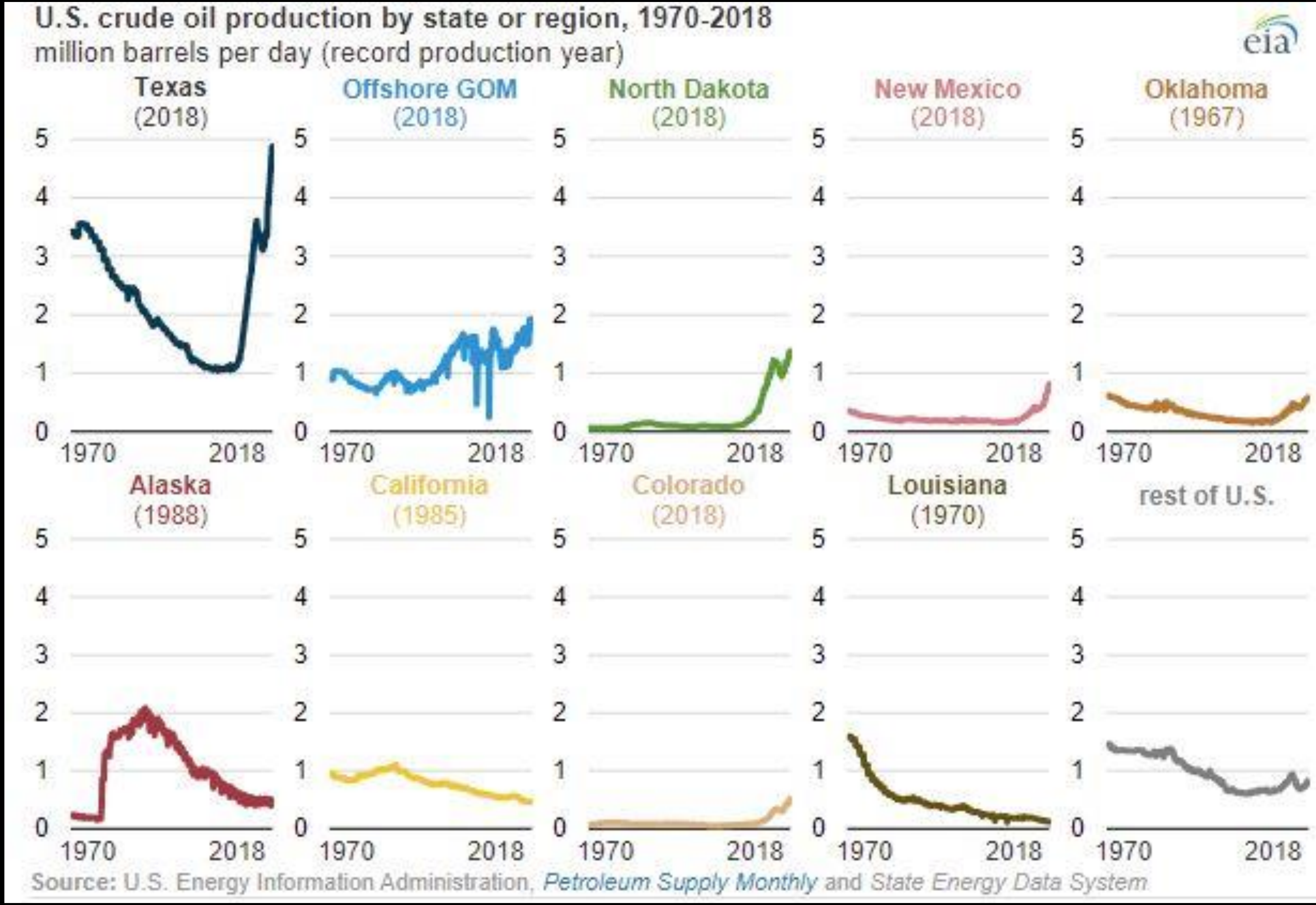
The reduction consists of 200 individuals, primarily BP employees, who have been offered jobs by Hilcorp, as well as an additional 275 employees and direct contractors who have not been offered positions, said Dawn Patience, a spokeswoman with BP Exploration Alaska.

Alaska Oil and Gas Jobs 2013-2021



Source: Alaska Department of Labor & Workforce Development, Alaska Economic Trends Annual Jobs Forecast (2012 -2021)

Production Has Risen Across the Country While Falling in Alaska



Questions?

Senator Bill Wielechowski

Senate Finance Committee

May 13, 2022