SB114

Senate Finance

May 1, 2023

IN3NERGY

be in the know

OVERVIEW

- The traditional oil and gas business is headed into unchartered territory adding new levels of risk
- Items such as tax rate and credits are just part of the state's complex fiscal system
- Does SB114 incentivize the right behavior and will it sustain a long-term future for oil and gas in Alaska, and a future where production is stable and growing so TAPS can continue to operate?

OUR EXPERIENCE

Working on Alaska Oil Taxes:

- 2006 – 2012 Administration/Governor

  PPT, ACES, LNG, Gas vs Oil
- 2016 – 2022 LB&A

  SB21, HB111, LNG, Ballot Initiative

  General Industry Training

Career Covers Three Perspectives:

- Big Oil Operations
- Big 3 Service Company
- Government Advisor

WHAT WE BRING TO THE TABLE

IN3NERGY EXPERIENCE

- Fiscal system consulting around the globe, including Alaska
  - Contracted by DOR, Governor, Legislature, and now AOGA
- One of a handful of people that have worked Alaska petroleum tax issues from PPT through to the present
- Some views shared today have been shared previously over the last 17 years while working here in Alaska
- Our starting point is always that stable, attractive fiscal systems are designed and administrated based on agreed goals and drivers that are durable over the longer term
- Alaska needs to decide what its primary drivers are

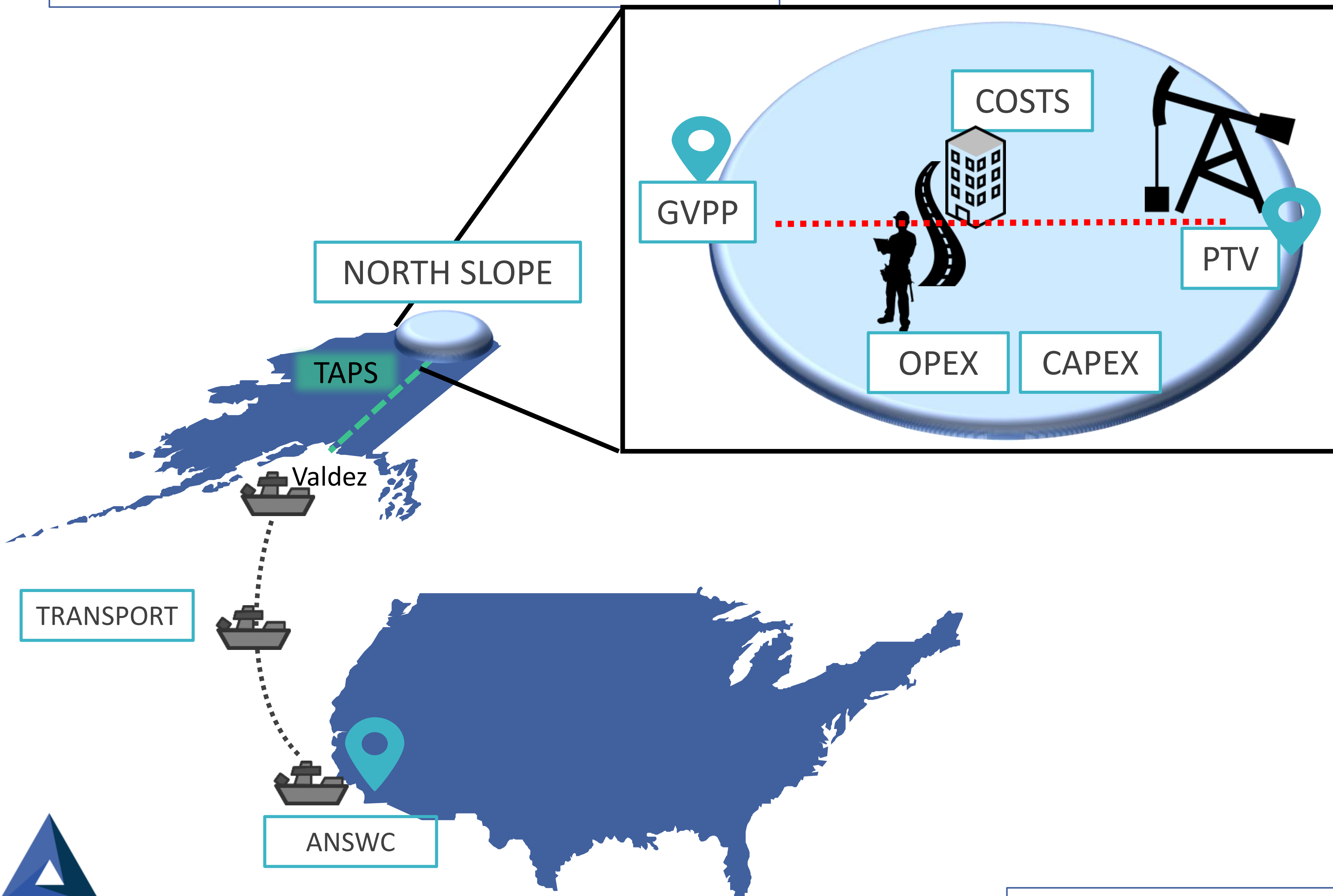
GLOSSARY

ALASKA FISCAL REGIME

ACES	Alaska Clear Equitable Share
AGIA	Alaska Gasline Inducement Act
ANS	Alaska North Slope
ANS WC	ANS West Coast
AS	Alaska Statute
CAPEX	Capital Expenditures
CI	Cook Inlet
DNR	Department of Natural resources
DOG	Division of Oil & Gas
DOR	Department of Revenue
ELF	Economic Limit Factor
GVPP	Gross Value Point of Production
KRU	Kuparuk River Unit
ME	Middle Earth
NPRA	National Petroleum Reserve
NS	North Slope
OPEX	Operating Expense
PBU	Prudhoe Bay Unit
PF	Permanent Fund
PPT	Petroleum Profits Tax
PTV	Production Tax Value
RIK	Royalty in Kind
RIV	Royalty in Value
TAPS	Trans Alaska Pipeline System

UNDERSTANDING ALASKA'S TAX CODE

WHAT ARE THE VARIOUS PIECES



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UNDERSTANDING ALASKA'S TAX CODE

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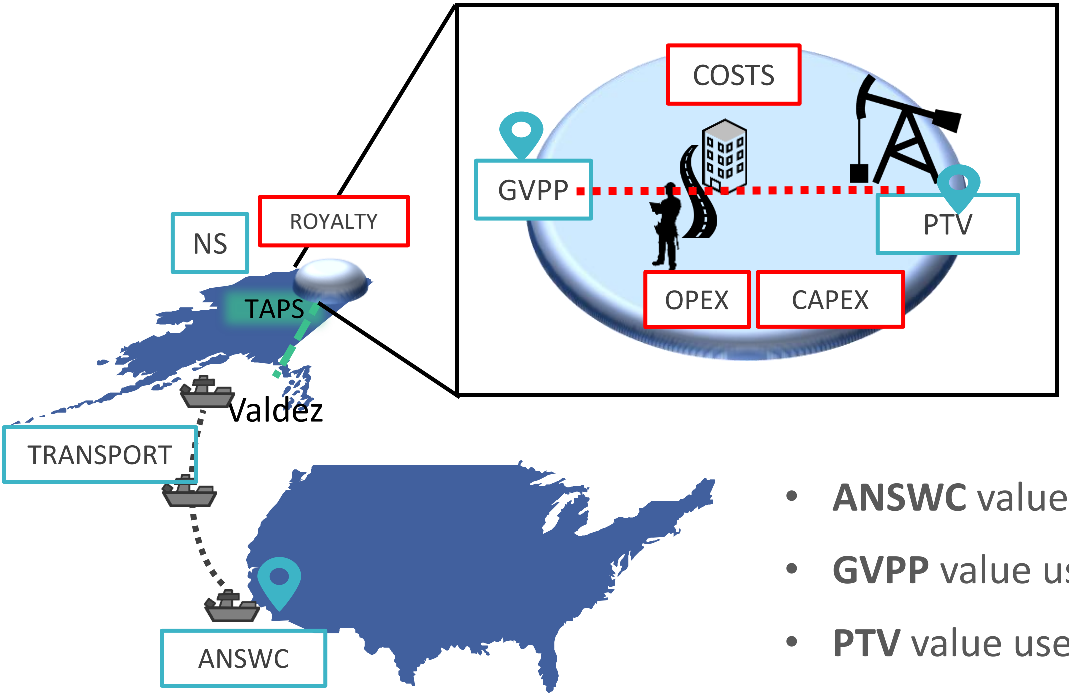

- **ANSWC** value used to set the gross tax percentage
- **GVPP** value used to calculate the gross minimum tax
- **PTV** value used to calculate the preliminary net tax
- **GVPP** value used to determine the allowable credit level which is then subtracted from the preliminary net tax
- Tax owed is the greater of gross or net after credits
- UNLESS the unit is GVR eligible in which case:
  - GVPP is reduced by 20% or 30%
  - Flat $5 per barrel credit which can pierce the gross minimum tax floor and take the tax owed to zero

OVERVIEW

TAX SYSTEM DESIGN

- After 40+ years working with dozens of petroleum fiscal systems:
  - There is no ideal or best petroleum fiscal system
  - Each government has a unique set of circumstances, resources & drivers
  - Governments need to balance their needs with the global competition for investment capital

- While change is constant in the industry, recent global events and pressures are massively shifting how producers think about, plan and do business

- Alaska finds itself facing a common government conundrum:
  - Does it place priority on fulfilling short term revenue needs knowing how much extra it takes could possibly negatively impact longer term revenues needed to fund the state for future generations?

- Fiscal system design is part science and part art

SAME PLAYING FIELD

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SAME PLAYING FIELD

FACTS VERSUS HYPERBOLE

- SB114 aims to “level the playing field” among producers, targeting in particular corporate filing status. But a fiscal system should also be able to properly differentiate between:
  - Existing vs new producers
  - Existing vs new fields
  - Single project vs multi-projects
  - TAPS financial interest vs no TAPS financial interest
  - New field developer vs aging field harvester
  - Large vs Mid vs Small producer

- Part of the complexity of the Alaska petroleum tax system is it has tried to address many differences and nuances, often creating unintended consequences that have to be addressed again in the future

SAME PLAYING FIELD, SAME FACTS

FACTS VERSUS HYPERBOLE

- In order to make an informed decision on SB114 the legislature needs to ensure that they:
  - Understand the terminology of AS43.55 and order of operations
  - Insist statements of ‘fact’ are backed with independent data
  - Be aware things are not taken out of context and improperly referenced

- We have reviewed the recently submitted public comments, as well as past ballot initiative public data, and believe there are some misconceptions that should be cleared up:
  - Alaska has been receiving its 1/3 share of the wealth
  - Alaska’s overall percentage state take is among the highest in the US
  - Producers deducting from income money they spent is not a giveaway or loophole, but something that is fundamental to almost all petroleum fiscal systems and business taxation in general

FOR THE MAXIMUM BENEFIT OF THE PEOPLE

THE ALASKA CONSTITUTION

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

- This is a common government stewardship role for natural resources
- Constitutional or stewardship obligations are often quoted as reason to raise taxes
- Alaska needs to have a common, transparent understanding of what "maximum benefit" is to ensure suggested changes, like SB114, work toward that end
- The definition of maximum benefit always boils down to a balance issue between short-term needs and long-term growth
- The challenge is always to try and find that sweet spot
    - Where state needs are met, state goals are achieved, and producers have a sustainable business climate to operate within

ACHIEVING ALASKA'S 1/3 "FAIR SHARE"

MOST OFTEN QUOTED DEFINITION

- The most often quoted definition of fair share comes from the writing of Governor Hammond, wherein he notes that at the time of the approval for TAPS the producers, Alaska and the federal government agreed to an even split of the resultant "wealth", giving 1/3 to each party
- This split has often been misrepresented as an agreement to a 1/3 split of revenue, but instead it is a split of "wealth", or profit
- It is impossible to give producers just a 1/3 split of gross revenue, as that amount would not even cover costs to operate and royalties

If "share" is on gross (versus net) then there would be no producers in Alaska

	$/bbl
Oil Price	80
Transportation and Costs	40
Royalty	10
Total Out of Pocket for the Producer	50
Producer 1/3 Share of $80/bbl Revenue	27
Only has $27/bbl to cover $50/bbl Out of Pocket	
Loss to Producer	(23)

The 1/3 share split should only be discussed as a split of the after-cost value

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ACHIEVING ALASKA'S 1/3 SHARE

FROM PROMOTIONAL MATERIAL FOR 2020 BALLOT INITIATIVE

- This graphic suggests that in the long run Alaska has received its 1/3 share of the oil wealth
- With a $403 billion total wellhead value (net) of Alaska production, the states portion of $141 billion represents a 35% share
- The remainder of the $527 covered expenses, federal taxes and producer share

Petroleum Revenue Over Time

- Since 1978 (first fiscal year of TAPS), Alaska has received $141 billion in petroleum revenue
  - GROSS ✗ Market value of all Alaskan oil was $527 billion (27%)
  - NET ✓ Wellhead value of all Alaska oil was $403 billion (35%)

Robin Brena presentation , Quoted as a "Ken Alper Slide"
Modified for emphasis

TAX DECREASE GREATER THAN OIL PRICE

TRYING TO IMPLY PER BARREL CREDITS WERE THE CAUSE

- It has been incorrectly presented that during a time period the % decrease in oil taxes paid was greater than that decrease in oil price, caused by per barrel credits
- The difference in percentages had nothing to do with credits, as at the low price the preliminary net tax was less than the gross min tax

- Costs do move up and down with oil price, although with a time lag
- The seeming disproportionate drop in taxes paid is because the $43/bbl case has low PTV ($3/bbl) due to heavy cost burden

	$/bbl	$/bbl	delta
ANSWC	**113**	**43**	-62%
- transport	10	10	
GVPP	103	33	-68%
- costs	30	30	
PTV	73	3	-96%
tax rate	35%	35%	
Net Tax	25.55	1.05	-96%
Credits	3	8	
Final net	22.55	-6.95	
Gross floor	4.12	1.32	-68%
Greater of	22.55	1.32	-94%

TAKEAWAYS

SAME PLAYING FIELD

- There needs to be a transparent understanding of what it means to steward the state’s natural resource for the maximum benefit of the people
- There are many statements being made that are not supported by facts
- If the statements being made are true and that Alaska has truly been too generous, not taken its fair share of the wealth and offered too many giveaways and incentives, then why aren’t oil companies knocking down the doors to get their own overly generous share of the pie?

CHANGING LANDSCAPE

TODAY VERY DIFFERENT THAN THE PAST

DIFFERENCES OVER THE YEARS

Late 70s

- Much of the world closed to oil investment
- Coming off the heels of the oil embargo
- Alaska offered world class resources and energy security

Mid 2000s

- Countries competing for investors
- Several new prolific basins
- Emerging life cycle players
- Private equity funding

Today

- Many calling for the end of fossil fuels
- Financial institutions refusing to fund
- Green movement has great momentum

The headwinds facing producers today are not the normal cyclical issues of the past: e.g. oil embargo, global politics, war, economic crashes, pandemics, etc

The current global green movement is a major fundamental shift of direction leading to a much riskier and uncertain future

WHAT IS DIFFERENT NOW VS THE PAST?

DIFFERENCES OVER THE YEARS

Late 70s	Mid 2000s	Today
• Much of the world closed to oil investment • Coming off the heels of the oil embargo • Alaska offered world class resources and energy security	• Countries competing for investors • Several new prolific basins • Emerging life cycle players • Private equity funding	• Many calling for the end of fossil fuels • Financial institutions refusing to fund • Green movement has great momentum
• Dollars readily available • Energy Security	• Barrels readily available • Fiscal system versus fiscal system • Technology opening new resources • Differing expectations of investors	• Peak oil • Dwindling Investors • Balance sheet funding • Short cycle vs long cycle

WHAT IS DIFFERENT NOW VS THE PAST?

DIFFERENCES OVER THE YEARS

Prior presentations on Alaska’s competitive position, at best are a starting point but by no means indicative of where Alaska stands today and what Alaska needs to do to be competitive and attract investment

The 1/3, 1/3, 1/3 sharing concept does not make Alaska competitive

Today, Alaska (long lead time, high cost, environmentally sensitive) needs a ***COMPELLING*** fiscal system, not just a competitive fiscal system, to attract much needed investment

Every other regime is trying to figure out how to navigate the new ‘green’ world

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CONFRONTING CLIMATE CHANGE

WHY ALASKA'S OFFERING MUST BE COMPELLING

- When will climate change mitigation efforts diminish demand for oil?
  - Projects with long lead times and extended periods of production, like most in Alaska, are at high risk of not proceeding
  - Developments with quick cycle times, like shale developments, are now much more desirable
- Oil company reaction to the green movement covers a wide range
  - Remain steadfast
  - Retool
- What is the timing of technology development and approvals for critical non-fossil fuel alternatives (and their significant impact on fossil fuel demand):
  - e.g. airplanes, electronics, medical equipment, pharmaceuticals

TAKEAWAYS

ALASKA NEEDS A COMPELLING TAX SYSTEM

- We used to think the world would reach peak oil production and decline because of diminished resources, but today peak oil will likely be determined by the push for greener renewable energy

- In a transition away from fossil fuels, what is Alaska's overall plan of how to respond and achieve maximum value for its resources?
  - Finite and undetermined period of time for oil revenues
  - The state needs producer partners in this transition

- What long term plan necessities is the state considering?
  - New developments
  - Future power and heat
  - Field abandonment
  - Facility abandonment
  - Changes to shipping rules
  - Refinery shut downs
  - Carbon taxes
  - Etc.

- ***The past is no longer a good indicator of the future. New scenarios need to be evaluated and new plans agreed***

COMPLEX SYSTEM

CAN'T CHANGE ONE PART WITHOUT IMPACTING THE WHOLE

- Government take is but one piece
- Alaska has an overly complex system for administering energy taxation
  - Numerous allowed and disallowed costs
  - Price triggers versus profit triggers
  - Net tax system but with a gross tax floor
  - Many different degrees of differentiation
- Over the last decade, $100s of Billions spent in countries and states with higher government take than Alaska. So clearly, rate alone is not the determinant issue
- ***Most people and policy makers don't understand how the Alaska system works and compares in total to other regimes***

TAKEAWAYS

MORE TO A TAX SYSTEM THAN TAX RATE, SHARE

- Historically, tax system terms other than the headline rate have driven producer investment decisions
- The uncertainty surrounding future demand has created an elevated level of risk
- Producers will very likely give preference to regimes that offer the rapid recovery of capital along with uplift to compensate for the time value of money
- Producers evaluate projects based on their out of pocket costs, not just those allowed by a regime's tax code. Therefore their economics will be no where as good as you are calculating for them

SB114 BASICS

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WHAT IS DRIVING THIS LEGISLATION?

APPEARS TO BE SOUND BITE, NOT GOAL DRIVEN

- "**Windfall profits**" ignores the offsetting asset write downs during 2 downturns in the 2010-2020 period; producing oil at a loss
- "**New, lower federal corporate tax rate**" ignores lowered for all US operations/operators. Also ignores changes in taxation outside the US
- **"Closing loopholes"** There are no loopholes, only persons or companies paying their taxes based on how the tax code is written. State knew of Hilcorp corporate status before their purchases
- "**We're just reducing government subsidies [the tax credits]**" ignores that each aspect of the fiscal policy is part of a multifaceted system that is all part of an overall package; any change disrupts the balance of the overall system
- "**Level the playing field**" but instead of improving terms for new players, which would greatly help in bringing on new oil, SB114 appears to worsen terms for legacy players
- "**It's just a small rate change. We're still lower than many countries with investment**." Incorrectly boils regime differences down to a single factor, government take

SB114 ATTEMPTING ONE-OFF CHANGES TO A COMPLEX INTEGRATED TAX SYSTEM

PETROLEUM IS A MAJOR SOURCE OF GOVERNMENT INCOME

- Alaska remains, and will remain for some time, highly dependent on petroleum revenues
- Therefore, what are Alaska's goals for oil and gas production in the state?
  - Is it simply to generate revenue now?
  - What about the future?
- Does SB114 move the state closer to any agreed long term goals?
- SB114 appears to be short-term revenue stop gap solution
- Historically each time a one-off change has been made, unintended consequences have arisen
  - To be expected with a complex system of interconnected parts

CLOSE CIT “LOOPHOLE”

ATTRACTING NEW PRODUCERS

INCENTIVE OR DISINCENTIVE

- Section 1 looks to be specifically targeting one company to force them to pay Alaska corporate income tax

- Justified as 'leveling the playing field'
  - Which producer is being harmed by the 'uneven' playing field?
  - How will a level field improve production or incentivize investment?

- Revitalizing old mature fields is very different to developing new fields
  - Some of Alaska's legacy fields are over 40 years old
  - Mature field, or old field, operations are different to new field operations

- A 'level' playing field always inherently helps some operations and penalizes others
  - Old versus new
  - Conventional versus unconventional
  - High unit cost versus low unit cost

- Unclear how SB114 in this regard will attract new players or capital

DANGERS OF WRONG CHANGES

PRODUCER AND ALASKAN IMPACTS

- Numerous state agencies knew of the different form of incorporation when the sale and purchase of North Slope assets was approved
- Private investment was attracted to the state under one set of economic circumstances, which will be negatively altered if SB114 passes
- If this should somehow impact the producer, it is the only operator with critically important Cook Inlet operations as well
- As Alaska's fields mature, unit costs go up and margins grow smaller. Instead of attracting the right kind of investors, this move could stop other needed mature field experts from coming to Alaska
- In a period of growing shareholder activism, privately held companies offer Alaska a producing partner not under those same pressures

TAKEAWAYS

ALASKA CORPORATE INCOME TAX

- LLCs and S Corporations are the preferred structure for single owner or several-member owned companies. These companies are smaller, nimbler and have fewer resources

- SB114 sends a negative message to small, independent oil and gas companies that may be considering investing in Alaska. In particular, the Cook Inlet basin, where all natural gas producers are S Corporations

- Smaller, privately owned companies have begun investing in Alaska as they are generally less susceptible to pressure from activists

- Smaller privately owned companies typically have more efficient management structures that allow them to make quick capital allocation and investment decisions

- Being less susceptible to pressure from activist groups these smaller entities can better align with Alaska's long-term interests

REDUCE SLIDING SCALE CREDITS

REDUCING THE CREDITS

ALASKA'S FAIR SHARE

- ACES was a 25% base tax with positive progressivity and numerous investment incentives

- MAPA is a 35% base tax with negative progressivity and a reduced number of incentives

- The per barrel credits were not a "giveaway" but part of the core value of a package of terms to hit an overall effective tax rate

- During hearings on SB21 an extremely large number of modeling runs were made and presented covering a very wide range of possible prices

- Even though forecasts at the time did not predict the very high and low prices experienced since 2013, the modeling did cover the full range

HIGH LEVEL LOOK AT CREDITS

DEPENDENT ON OIL PRICE, ROYALTY AND COSTS

- In3nergy (2019) – “The long term DOR forecast is for **prices to remain in the range of $70 per barrel.** … …… With this in mind, it is **unlikely**, but not impossible, to envision that the contemplated reduction in tax credits would **severely hamper any planned or possible spending.”**
- At $70 per barrel our modeling suggested roughly only $5 per barrel of credits being needed to reach the gross minimum tax floor, so a change from $8 to $5 should not have an impact or be problematic
- The minute you change oil price, transportation cost, OPEX or CAPEX, the resulting economics and impacts will change
- Much like our modeling, the fiscal note initially of SB114 impacts shows the possible impacts for one set of price and costs. It doesn’t take much of a change to either price or costs to change the position to no real impact or possibly a substantially large impact

TAKEAWAYS

SB114 AND ALASKA'S FISCAL SYSTEM

- The sliding per barrel credits are part of an integrated package

- Credits and deductions are standard global mechanisms in fiscal systems
  - Per barrel credits are not giveaways
  - OPEX and CAPEX deductions are not giveaways

- The large credit level below $80 was to offset the regressive impact of royalty and the gross minimum tax

- If passed, the reduced credits will impact each taxpayer differently, thus influence future investments differently

- At the current cost structure there is a 'sweet spot' for the use of maximum credits around $80. As prices fall, the lack of taxable income negates the need for credits

CREDITS LINKED TO SPENDING

LINKING CREDITS TO CAPITAL SPENDING

RINGFENCING

- SB114 would place a ringfence around North Slope units for the purpose of linking the use of per barrel credits to the level of capital spending

- This most likely will not incentivize, but hurt, both legacy operations and new field development operations

- For the legacy fields, SB114 as written flat out incentivizes the wrong type of spending. In mature fields you want to spend relatively more money on things like well workovers (OPEX) than on new facilities (CAPEX)

- For new fields, substantial CAPEX will be spent before the first barrel of production, thus not generating any credits. SB114 as written would suggest a less optimum development for both the producer and the state just to earn per barrel credits

LINKING CREDITS TO CAPITAL SPENDING

Spending Disincentive

- At low prices, for legacy and new fields little to no credits are needed given the gross minimum tax floor
- Thus, at low prices this section of the bill provides no incentive for investment
- At high prices, the stair step reduction, plus the $3 reduction, in credit level lessens the amount of credits that can be used
- Thus, like at low prices, high prices will not provide much of an incentive to increase capital spending
- SB114 needs to be modeled across a broad range of price and cost structures so a truly informed decision can be made

TAKEAWAYS

LINKING CREDITS TO CAPEX

- SB114 clearly introduces a new layer of ringfencing to the North Slope
- SB114 provides minimal incentive for increased capital spending for either legacy fields or new fields
- At low prices and low PTV, the gross minimum tax renders most available credits useless, providing no value to the producer, thus no incentive for CAPEX spending
- Similarly, at high prices, use of credits will not be that great as they are reduced by the step down process or a lower PTV from increased costs

FINAL TAKEAWAYS

OVERALL TAKEAWAYS

IT'S THE OVERALL SYSTEM AND NOT THE PARTS

- The world has changed significantly since the days of PPT ACES and SB21 therefore Alaska must have COMPELLING terms to attract producers & $$
- The pace of the green movement has introduced a significant time risk making projects and regimes with rapid and full return of capital a priority. Alaska currently offers neither of those and SB114 makes it worse
- On Corporate Income Tax, SB114 can be viewed as reneging on a deal. Also, the fiscal note fails to capture the increased production and lowered unit costs Hilcorp has brought versus the bp status quo
- At low prices, credits are not needed because of the gross minimum floor. At high prices they become less available due to the step down and increasing costs
- Ringfencing the NS will likely not incentivize capital spending

OVERVIEW

- The traditional oil and gas business is headed into unchartered territory adding new levels of risk
- Items such as tax rate and credits are just part of the state's complex fiscal system
- Does SB114 incentivize the right behavior and will it sustain a long-term future for oil and gas in Alaska, and a future where production is stable and growing so TAPS can continue to operate?

THANK YOU

QUESTIONS?

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