

HOUSE FINANCE COMMITTEE  
March 29, 2006  
2:37 p.m.

CALL TO ORDER

Co-Chair Chenault called the House Finance Committee meeting to order at [2:37:50 PM](#).

MEMBERS PRESENT

Representative Mike Chenault, Co-Chair  
Representative Kevin Meyer, Co-Chair  
Representative Richard Foster  
Representative Mike Hawker  
Representative Jim Holm  
Representative Reggie Joule  
Representative Mike Kelly  
Representative Beth Kerttula  
Representative Carl Moses  
Representative Bruce Weyhrauch  
Representative Bill Stoltze, Vice-Chair

MEMBERS ABSENT

None

ALSO PRESENT

Steve Marshall, President, British Petroleum-Alaska; Angus Walker, Commercial Vice President, British Petroleum-Alaska; Tom Williams, Alaska Tax Counsel, British Petroleum; John Zager, General Manager, Chevron-Alaska, Kevin Tabler, Manager, Lands & Government Affairs, Chevron-Alaska

PRESENT VIA TELECONFERENCE

None

SUMMARY

**Presentations by Producers:  
British Petroleum  
Chevron**

HB 488 "An Act repealing the oil production tax and gas production tax and providing for a production tax on the net value of oil and gas; relating to the relationship of the production tax to other taxes; relating to the dates tax payments and surcharges are due under AS 43.55; relating to interest on overpayments under AS 43.55; relating to the treatment of oil and gas production tax in a producer's settlement with the royalty owner;

relating to flared gas, and to oil and gas used in the operation of a lease or property, under AS 43.55; relating to the prevailing value of oil or gas under AS 43.55; providing for tax credits against the tax due under AS 43.55 for certain expenditures, losses, and surcharges; relating to statements or other information required to be filed with or furnished to the Department of Revenue, and relating to the penalty for failure to file certain reports, under AS 43.55; relating to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue, under AS 43.55; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the oil and gas production tax; relating to the deposit of money collected by the Department of Revenue under AS 43.55; relating to the calculation of the gross value at the point of production of oil or gas; relating to the determination of the net value of taxable oil and gas for purposes of a production tax on the net value of oil and gas; relating to the definitions of 'gas,' 'oil,' and certain other terms for purposes of AS 43.55; making conforming amendments; and providing for an effective date."

HB 488 was heard and HELD in Committee for further consideration.

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HOUSE BILL NO. 488

"An Act repealing the oil production tax and gas production tax and providing for a production tax on the net value of oil and gas; relating to the relationship of the production tax to other taxes; relating to the dates tax payments and surcharges are due under AS 43.55; relating to interest on overpayments under AS 43.55; relating to the treatment of oil and gas production tax in a producer's settlement with the royalty owner; relating to flared gas, and to oil and gas used in the operation of a lease or property, under AS 43.55; relating to the prevailing value of oil or gas under AS 43.55; providing for tax credits against the tax due under AS 43.55 for certain expenditures, losses, and surcharges; relating to statements or other information required to be filed with or furnished to the Department of Revenue, and relating to the penalty for failure to file certain reports, under AS 43.55; relating to the powers of the Department of Revenue, and to the disclosure of certain information required to be

furnished to the Department of Revenue, under AS 43.55; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the oil and gas production tax; relating to the deposit of money collected by the Department of Revenue under AS 43.55; relating to the calculation of the gross value at the point of production of oil or gas; relating to the determination of the net value of taxable oil and gas for purposes of a production tax on the net value of oil and gas; relating to the definitions of 'gas,' 'oil,' and certain other terms for purposes of AS 43.55; making conforming amendments; and providing for an effective date."

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STEVE MARSHALL, PRESIDENT, BRITISH PETROLEUM-ALASKA, provided the committee with a written copy of his testimony (copy on file.) He related that he has been watching the oil tax proceedings over the last few weeks with a lot of interest. He emphasized the significance of the bill in front of the committee. He opined that it is important to provide the best information so that the legislature can make the most informed decision. He noted concern about the changes made to the bill and the focus of the discussions. He stated that the bill is moving in the wrong direction and has the potential to hurt Alaska. He wondered if the lure of the short-term revenues would jeopardize the long-term benefits.

Mr. Marshall pointed out that the common ground between the industry and the state is production. The common enemy is the natural decline of oil and there are ways to offset that decline with investment, technology, new ideas, and new recovery techniques. He spoke about the danger of polarization between the industry and the legislature.

Mr. Marshall related that a final concern is one of consequence. He said he wished he shared the confidence of consultants that increasing taxes will not reduce investment. As a significant investor in Alaska the last five years, he said that one of his roles has been to seek capital to sustain business. It is a challenge faced every year. What is being contemplated is going to make his job more difficult every year with projects that will compete less favorably than they will today.

Mr. Marshall emphasized that the right question to ask now is what is the tax structure and rate that would encourage additional investment, increase production, maximize recovery, and provide the state with a fair share.

Mr. Marshall spoke of high prices and profits as part of the reason British Petroleum (BP) is in Alaska. He maintained

that high prices masks production decline. The underlying decline of fields is about 15 percent. Through investment, that is restored to about 6 percent. He said the industry has failed to meet projections in recent years for a variety of reasons such as project delays, less productive wells, operational difficulties, and the inherent challenges in working with a mature basin like the North Slope.

Mr. Marshall pointed out that Alaska has a business plan that goes out 50 years. He spoke of personal pride to be involved with the creation of a business plan called the "bridge to gas". It involves maximizing the light oil production for the past 28 years as well as bringing on the technologies that can access heavy oil. It is through providing investments in the infrastructure that will lower the unit costs.

Mr. Marshall spoke of the privilege to have led 5,000 employees and contractors who run the day-to-day operations. The 50-year plan is a reflection of their dreams and hopes. He shared the excitement of how BP employees have responded to the challenges of the future. He spoke of being ready for future challenges.

Mr. Marshall addressed lack of appreciation for BP's contributions. He responded to the criticism that BP is not exploring enough. He clarified that BP's business is about maximizing recovery and adding barrels using technology. He gave an example of technology that has the potential to add 400 million barrels of additional reserves recovery on the North Slope, a big discovery. Another example would be an extra 1 percent recovery at Prudhoe Bay, or 250 million barrels. New technology has the potential to pay off hugely.

Mr. Marshall concluded that he is hopeful that the House Finance Committee will re-direct the dialogue to achieve a balanced structure that results in an infusion of capital, reduces decline, creates growth in state revenue, provides a better balance at high oil prices, and secures a healthy oil business that bridges to gas and beyond. BP is willing to provide information and follow-up so that the most informed decision can be made.

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Co-Chair Meyer inquired about the relationship of the 50-year plan and the justification to London of capital expenditures each year. He wondered about starting out with a tax rate that may be too high, but could be adjusted later on.

Mr. Marshall spoke of the challenge of producing a business plan that addresses a vast array of investments and projects

that are profitable and not too risky. Every year the company requests a specific amount of capital. This year it was about \$590 million for Alaska business. One of the key measures is the economic merit. Tax rate - production tax, royalty, federal tax, corporate taxes - is one of the factors, as are the capital cost and operating cost. When those costs are put into the economic equation it makes those investments at a higher tax rate, less competitive than they are today. It becomes harder to attract capital to them.

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Co-Chair Meyer asked what would happen if the tax rate changes and BP reports back to London and chooses not to invest in Alaska because it is no longer competitive, and after a couple years that tax rate is lowered. He wondered if BP could recover the lost capital.

Mr. Marshall spoke of the difficulty of restoring production after such a loss. He pointed out that BP is trying to sustain a more stable level of activity, which is a better way to run the business. It is not easy to bring back new rigs, get them drilling again, and fill in the gap. He suggested that the industry has had to struggle to keep up with that 6 percent decline.

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Co-Chair Meyer agreed that the state shares the goal of lessening decline and increasing production. He stated that BP is re-investing about \$600 million. He asked if the 20 percent credit is of more value than the 20 percent tax rate.

Mr. Marshall replied that the most important thing is production, in terms of providing revenues to the state or to the industry. Production will out trump tax rate. "Growing the pie will always be better than a bigger slice of the pie." When comparing tax rate vs. incentives - tax rate will always out trump incentives. 20/20 as proposed in the governor's bill, for BP in 2006, at current prices and with a \$590 million capital investment, results in an effective tax rate of about 13 percent. Under ELF, the current tax rate is about 5.5 percent. BP sees that as doubling the tax rate. Growing the barrels attracts higher taxes, but also higher royalties. No amount of incentives can offset a significant increase in tax rate.

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Co-Chair Chenault addressed the 15 percent decline in production, which drops to 6 percent due to investment. He

asked Mr. Marshall to elaborate on "delays in large projects".

Mr. Marshall responded that some of the large projects have been late and costly. North Star was delayed due to legal challenges and ended up costing \$1.2 billion instead of \$400 million. There have been delays in small projects, as well. He gave an example of a well that was not ready before June and had to be put into suspension until December when the ocean froze again.

Co-Chair Chenault asked if the delays are caused by the corporation, by lack of investment capital, or by legal or permitting problems.

Mr. Marshall said it is not lack of capital. The industry has experienced a shortage of people out of college needed to sustain the industry. BP has hired 200 people, many of them engineers, in order to fulfill the investments.

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Representative Weyhrauch asked if Mr. Marshall said no amount of incentives or tax credits could overcome a problematic tax rate. Mr. Marshall said yes. In the analysis of 20/20, if the incentive is increased a nominal amount there is some positive impact. He described the example of 20/20 translated to 13 percent as the "best comparison that can be made against today".

Representative Weyhrauch asked about tradeoffs and the intent of the bill to induce incentives to develop oil, which is on a decline. He summarized BP's point of view as being willing to accept a tax rate that is smaller than the one in the CS, with certainty for the long term, and with no interest in tax credits or incentives. He noted that the incentive part of the bill is not the committee's concern. Mr. Marshall countered that the economic analysis of any project going forward reflects both the incentives and the tax rate. The incentives are a factor, but the net effect of the tax rate has more of an impact on the economic attractiveness of any individual project than the incentive itself. Ultimately, it is the relative attractiveness of the project today vs. the attractiveness of the project in the future that is one of the key drivers for the investment.

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Representative Weyhrauch pointed out that ELF was amended in 1989. He asked if the bill is adopted today, in 2006, if that is the end of the useful life of a taxation scheme. He inquired if there are other international models to look at to determine the useful life of a tax program. Mr. Marshall

said he does not know if 17 years is the correct amount of time. He noted that this project is unprecedented, very large, and a significant investment. BP is looking for a period of certainty for oil that allows a healthy oil business to exist, which will underpin a healthy gas business.

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TOM WILLIAMS, ALASKA TAX COUNSEL, BRITISH PETROLEUM-ALASKA, discussed how the tax structure is viewed in terms of how well suited it is for the industry's situation as well as for the. He elaborated on the history of the ELF tax structure in Alaska. Oil resources are being depleted and it becoming more challenging to produce it. He mentioned that the current structure might not be the most suitable one for the future.

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ANGUS WALKER, COMMERCIAL VICE PRESIDENT, BRITISH PETROLEUM-ALASKA, referred to a handout entitled "BP Presentation on CSHB 488 (PPT)" (copy on file.) He addressed the decline of production in the North Slope of Alaska as shown on Slide 5. The historical basin decline has been around 6 percent per year since peak production in 1988. There was a period of flattened production in 2000-01 with the addition of Alpine and Northstar.

Mr. Walker highlighted the Department of Revenue production forecasts. These forecasts have been continually revised downward. The latest forecast projects a decline of 3 percent per year. He asked why the industry and the Department of Revenue continually overestimate production and fail to meet expectations when the resources are there. He explained that the first reason is that the industry is overly optimistic and some things have proven more difficult and expensive, such as viscous oil. Some projects take longer and some projects don't work. That is the nature of the oil and gas business. The primary reason is the unrealistic expectation of investment in Alaska. A 3 percent decline is forecast and investment must double to support the industry. Production is "King" in terms of revenue to the state - 100,000 barrels of production is \$500 million less in revenues at today's prices. It is of great concern that production is declining and the forecasts are continually being revised downwards.

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Mr. Walker referred to Slide 6 - Investment Offsets Decline. He explained three decline rate scenarios and what would happen if investment were stopped in the North Slope. Production would decline very rapidly and terminate around

2012. The green line, the 6 percent decline line, is the extrapolation of historical decline. In order to achieve 6 percent, the industry is spending between \$1 billion and \$1.5 billion a year. One should not underestimate the effort that goes into achieving that 6 percent decline: a workforce of 5,000 and between \$600-\$700 million in capital, and about \$1 billion in operating costs. To move to a 3 percent decline requires an investment of between \$2 billion to \$3 billion a year. Unless investment is attracted to Alaska the forecast will be revised downward in the future.

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Mr. Walker addressed Co-Chair Meyer's question about setting too high of a tax rate. He emphasized that production would fall quickly, after 2-3 years on the wrong decline line, and would be impossible to recover from.

Representative Holm referred to Mr. Marshall's presentation where he stated that BP is investing \$500 million into Alaska operations. He requested clarification about a mention of investing \$1 billion to \$1.5 billion into Alaska to keep the industry going.

Mr. Walker responded that the \$1 billion to \$1.5 billion is the investment required by the whole industry on the North Slope. The \$2 billion to \$3 billion is what would be required to meet the 3 percent decline line. He related that the current level of investment, which has been attracted to Alaska and predicated on the ELF tax system, is looking at a \$1 billion increase in taxes at current prices under the new system. A tax increase does not equate to an increase in investment. The new 20/20 tax structure would result in less investment than is currently being made. Many examples around the world show that lowering taxes increases investment.

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Representative Kerttula pointed to BP's profit, which allows for continued investment on the North Slope. She referred to the United Kingdom and Norway where taxes were raised in juxtaposition with certain incentives. She requested a response to those two concerns.

Mr. Walker put off the question of comparison to other regimes to later on in the presentation. He spoke of recent excellent profits as a function of high prices. He said that when prices are very low, no profits are made. Everyone benefits from high prices.

Representative Kerttula noted that the committee's purpose is to try to determine a balance between the state and the industry.

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Mr. Marshall spoke of disappointment with the Badami Fields reservoir that was more compartmentalized than expected. He noted that there have been a number of examples of fields which have disappointed and are not reflected in profits. He spoke of a dry hole experience loss in the Mukluk project. He asked the committee to consider the risks that the industry has taken.

Representative Kerttula asked how long ago Badami was. Mr. Marshall said that it was restarted last year. Investments were made in the late 1990s, and production was started in 1998-9 and did not achieve expected rates.

Mr. Walker reiterated that decline is the most important issue facing the industry and the state.

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Mr. Walker referred to Slide 7 to discuss the industry's strategy and how BP is addressing the decline. The strategy is to create a 50-year business in Alaska by focusing on the large known resources that exist on the North Slope such as light oil, viscous oil, and gas. The future is very different than the past and it has many challenges. Technology is being pursued to develop the Liberty Field and heavy oil. BP has been investing in infrastructure to get ready for the future and has spent \$1 billion on four ships and \$400 million to update the pipeline. Each of these investments is designed to reduce costs and increase the wellhead value of oil for the benefit of the industry and the state. Mr. Walker noted that 200 people have been hired this year for the additional projects and investments.

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Representative Kerttula asked if the costs spent on TAPS would go through the normal process with the state paying one-quarter of the cost.

Mr. Walker explained that the costs spent on TAPS are incorporated into the tariff that is paid by all users of the system. He explained how the investment in the ships results in a reduction of shipping costs, which results in a higher wellhead value, which results in higher royalties to the state.

Representative Kerttula pointed out that the state ends up paying a quarter on every dollar spent on TAPS.

Mr. Williams explained that it is not the TAPS settlement methodology. It is the fact that if it goes into the

tariff, both the royalty and severance tax are based on the net value. They work the same way.

Mr. Walker noted that BP would spend \$14 billion over the next ten years in Alaska to execute this strategy. Half will be spent on gas - half on oil. The total is double what has been spent in recent years on the upstream portion of the business. In order to deliver the strategy, BP is concerned that the wrong outcome from these deliberations would be a tax that is too high for the industry.

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In response to a question by Representative Hawker, Mr. Williams explained that once the new pipeline is built, the new gas would be found to fill it.

Representative Hawker referred to the Administration's high volume and low volume scenarios. He observed that there is a presumption of a long-term scenario that every 3 to 6 years new reserves would be brought on line. BP's scenario appears to be more linear. He questioned if BP anticipates new discoveries.

Mr. Walker observed that the state's assumption is flat and then declines on the new gas line scenario. Based on recent history, it is known that the North Slope is declining. BP's view is that the new gas line scenario is too optimistic.

Representative Hawker pointed out that they were talking about "new oil" not new gas. Mr. Walker agreed. Representative Hawker asked if Mr. Walker believes that the state's model is not as realistic as the industry believes. Mr. Walker noted a problem in Alaska of the massive resource base and said that any of the scenarios are possible in total volume - in the sense that the oil is there. The questioned is, can the development occur in light of investments. The industry agrees that there would be more oil development if the gas line were built. It would take issue with the assumption that an alpine-type field is discovered every three years. The industry's profile is based on multiple, repetitive investments in existing fields.

Mr. Walker added that the strategy is to concentrate on the known resource base, since that is where the oil is. He acknowledged the importance of exploration.

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Representative Joule referred to the model of the 50-year vision and questioned if a model has been developed for offshore oil. Mr. Walker explained that development of

Liberty is the only oil included in federal waters. The view is specific to BP. An industry view would look different.

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Mr. Walker reviewed Slide 8, the link between production and revenue. There are three decline scenarios that show the volume of oil until the North Slope is shut down. Operating expenses and industry investments were included. If BP were successful in moving to a 3 percent decline, production would double. The cost to operate would also double. The industry investment required above operating expense would increase from \$20 billion to \$60 billion.

Mr. Walker reported that the affect on state revenue was reviewed. There would be an impact on the whole of Alaska in terms of jobs, industry, infrastructure, etc. The total state revenue derived from property tax, royalty, state corporate income tax, and severance tax was included. It is clear that the most important aspect is to get "volume down the pipeline", in terms of generating revenue for the state. He maintained that PPT is relatively unimportant. He suggested that a production tax could be set at zero if it stimulated investment.

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Representative Holm noted that the assumption is that it is in the best interest of the state of Alaska to insure the fastest use of a non-renewable resource. Mr. Walker responded that if the decline continues at the same rate, industry would not be able to support the infrastructure. Once the oil has declined, the industry will be gone. The decision is how long can the industry last and how much oil can be brought out of the ground. The industry will not return after it leaves, that is why Alaska is being encouraged to develop as much of its resource as it can while it still has infrastructure to support it.

Mr. Marshall maintained if that is successful, it could last 30-40 years or longer. He explained that the industry continues to find new ways to maximize recovery. There is a finite limit of oil. The challenge is to get to the technical limit, which has changed. Sustaining momentum is the key.

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Representative Hawker referred to slides 3 and 8 and noted a discrepancy. Mr. Walker explained that slide 3 refers to an investment of two to three billion on an annual investment. Slide 8 looks at spending more money over a longer period of time.

Mr. Walker concluded that less investment means less revenues and more investment means more revenues. The question is what is necessary to increase investment.

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Mr. Walker reviewed Slide 9 and the impact of the tax rate. He concluded that the tax rate does matter. The state of Alaska already has one of the highest tax rates. He maintained that progressivity would result in a tax rate of 75 percent. He compared Alberta's tax rate and noted that they have been successful in attracting development by reduction taxes. Their tax rate is 39 percent until a project pays out, when it reverts to 54 percent. The Gulf of Mexico has also been successful in attracting investment.

Representative Holm questioned what a marginal tax rate of 61 percent included. Mr. Walker responded that leaseholder royalties were included. He explained that all taxes paid were included: property tax, royalty, federal income tax, severance tax, and corporate income tax.

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Representative Kerttula wondered if all other states' severance taxes are comparable to Alaska's. Mr. Walker said he does not have the numbers. Mr. Williams indicated that every state could have a severance tax and most of them do. In 1977, Louisiana had the highest severance tax of 12.5 percent. Alaska is at 12.25 percent. He discussed lower rates of taxes based on category of well. He described West Virginia's severance tax.

Representative Kerttula asked what the offset is. Mr. Walker said the numbers are an amalgamation of all taxes paid. Representative Kerttula asked about commonality between states.

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Mr. Marshall added that as BP looks at comparisons between countries and states, the missing ingredient is geology. A 100 million barrel field found in Alaska is different than one found in Norway or in West Texas. The costs are different and the efficiencies do not compare. An important ingredient in the economic analysis is capital efficiency.

Mr. Williams restated Representative Kerttula's question about commonality factors. The primary assumption is that there is a 1/8<sup>th</sup> royalty. He noted that there is a 35 percent corporate federal income tax rate, which is another major common element. Most of the states have a 5-8 percent severance tax rate.

Representative Kerttula asked why Alaska is already the highest cost region to operate and if that is based on PPT. Mr. Walker pointed out that the yellow bar, AK ELF, is the current situation. Mr. Walker commented that the UK is an excellent role model for any country looking to increase investment. He referred to two quotes by Daniel Johnston:

The "gross benefits" to the UK Government go way beyond direct tax revenues and royalties received from the upstream sector of the petroleum industry. The economic impact of the industrial hyperactivity in the UK sector of the North Sea, a direct result of the "lenient" terms of the 1990's, is difficult to measure.

The UK offshore became the most active offshore province in the world. Reducing the Government take in the following years managed to sustain that boom. Activity and employment in the British petroleum sector is healthy and robust.

He spoke to the difficulty of comparing two systems.

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Representative Hawker asked if the UK recently increased their tax structure by 10 percent. Mr. Walker said that is correct. The UK increased their corporate income tax. Representative Hawker noted the UK's tax reduction mode previously vs. raising taxes now. Mr. Walker responded that the country made decisions based on its needs to attract new players and stimulate investment. Now they are reversing those trends. Representative Hawker asked for a copy of that report.

Mr. Walker concluded by stating that Alaska has lots of oil and gas, but declining production. Significant investment is needed to stem the decline. Maximizing production will maximize state revenues and benefits to Alaska. With a 20 percent tax rate, Alaska will have the highest tax rate and the highest cost structure in the U.S. The bill as drafted will not maximize benefits to Alaskans. The UK and Alberta have successfully attracted significant investment and increased production by reducing taxes and are thus great role models.

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Co-Chair Meyer noted that the common goal is to get as much oil as possible down the pipeline. He pointed out that 20/20 is the highest tax rate in the U.S. He asked how Alaska would compete domestically with such a high rate. He asked if the industry is proposing a smaller number. Mr. Walker responded that the right answer for Alaska is a rate

less than 20/20, but BP has agreed not to oppose the governor's bill because it is a steppingstone to gas.

Representative Kelly asked if three different tax rates would work better for the different types of fields. Mr. Walker said that the vast resources in Alaska are in existing fields and the focus should be on incentivizing development across the board. He said there should be one rate.

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Representative Hawker referred to Slide 12, critiques and challenges of the proposed bill. He said he tends to agree with the points made. He noted that complexity is not a good objective in tax structures. He asked for a comment on WTI not being a proxy for ANS crude. Mr. Williams explained that WTI is a sweet crude and has low sulfur content. North Slope oil is moderately sulfurous, which puts it in a different category. During windfall times, those who have trouble are the ones who are least flexible. "Spot prices" is the marketplace and is based on real sales. The composition of North Slope oil is going to move away from that of WTI. There will be more viscous oil that is ANS and will be more expensive to refine. It will move further away from WTI. He explained that wherever the windfall threshold is, eventually a point will be reached that matches it. All of the value out of the ground is consumed by the cost of getting it out of the ground.

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Representative Hawker noted that three major producers dominate ANS, which allows for manipulation. Mr. Marshall responded that ANS is a unique market because of the Jones Act, which only allows transport between U.S. ports. West Texas has access to many refineries, but ANS is restricted to the West Coast. WTI is not a good benchmark because the market is weak. Many refineries have tried to copy ANS. BP tries to maximize the value of ANS to Alaska. The goal is to get full benefit for every barrel of Alaskan crude.

Mr. Williams added that there were a handful of export transactions allowed during the Clinton administration. Representative Hawker related that back when there was a surplus, there was more of an ability to affect the West Coast market. Mr. Marshall did not want to leave an impression that the market could be manipulated. One of the challenges that ANS faces is that it is difficult to find a buyer.

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Representative Kerttula asked about the profit side of the industry in Alaska compared to other places. Mr. Walker replied that if it costs less to get oil out of the ground, and there is less tax, then there would be more profit. Representative Kerttula requested more information.

Representative Holm suggested that the higher tax rate is needed is because the value of oil has increased. He asked about the rate of return at \$60 per barrel. Mr. Walker said BP is excited about current prices. BP does not make a profit until oil is above \$22.50 per barrel. BP can justify the 20/20 tax due to adjusting the share between the industry and the state at higher prices.

Representative Holm noted that the increase value between \$25 and \$60 is \$11 billion a year. Mr. Walker responded that their analysis shows a significant reduction in industry take under PPT and a balancing of state take. He offered to share that information.

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Representative Kelly noted that when prices so high they are a lot less sensitive to BP's investment. Concern is higher at \$30 than at \$60. Mr. Walker replied that he would sleep better at night if prices were high. He repeated what happens at a \$22.50 situation and noted that there are many factors involving doing business in Alaska.

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Representative Foster requested a copy of the slide. Mr. Walker said it is a compilation of page 12 of the written testimony.

Mr. Williams addressed Representative Kelly's concerns. He said \$33 is not a high price today, but in 1980 it was the price that Sohio put on North Slope oil delivered on the West Coast. Minus inflation those prices have not since been matched at today's prices. It would be equivalent to \$72 per barrel today.

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Representative Joule inquired about the 50-year vision in Slide 4. He maintained that the legislature is at a disadvantage because it lacks information about gas. He wondered if the legislature is supposed to trust the industry on oil because much would be made up for in gas.

Mr. Williams replied that in due course, the legislature will get to see the details of the gas contract. The bill should be considered as the right thing to do for oil. The

oil industry needs to be healthy and investment needs to be attracted to Alaska.

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Representative Weyhrauch asked if the oil industry would be amenable to resolve all disputes through binding arbitration, without appeal. Mr. Williams said he could not take a position on that.

AT EASE: [4:39:40 PM](#)

RECONVENE: [4:51:09 PM](#)

#### BRITISH PETROLEUM PRESENTATIOIN

JOHN ZAGER, GENERAL MANAGER, CHEVRON-ALASKA, referred to a handout "Chevron - Alaska Area" (copy on file) throughout his presentation. He discussed the current asset base formed by the combination of heritage Chevron and Unocal assets. Both companies have been active in Alaska for many years. Chevron is the 4<sup>th</sup> largest producer in the state and the 3<sup>rd</sup> largest operator. It has 382 employees or full time contractors, 272 of which are based on the Kenai Peninsula, with a payroll of more than \$45 million. Chevron supports other companies by supplying them energy: Tesoro, Enstar, Chugach Electric, Agrium and Aurora Power. Chevron is the only producer in the state with a relative balance of assets in the Cook Inlet and on the North Slope.

Mr. Zager referred to Slide 3, which portrays the North Slope fields, a net production of about 16,000 barrels of oil equivalent per day (BOEPD). He reported that Chevron owns a little bit of most of the major fields and 50 percent of the fields in ANWAR that have been leased.

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Mr. Zager showed Slide 4, the Cook Inlet assets both offshore and onshore. In recent years exploration has taken place in the Kenai area. Slide 5 depicts pictures of assets in Trading Bay, which has difficult operating conditions. Chevron takes great pride in the environmental care used in this area.

Mr. Zager noted that most of his testimony would focus on Cook Inlet assets. Cook Inlet is different than the North Slope assets and deserves special consideration regarding the new tax regime. Slide 6 depicts Cook Inlet Offshore. He described the percent of barrels that are water cut and how costly it is to operate this area.

Slide 7 shows Trading Bay Unit, the single biggest asset in Cook Inlet. It has decreased drastically in the number of barrels per day and has a greater percentage of water cut.

Slide 8 depicts the Cook Inlet net oil production history, which has declined from about 12,000 barrels per day to 6,400.

Slide 9 shows the Cook Inlet Offshore oil and the high operating costs and risks. Cook Inlet Offshore cannot afford an additional tax burden. He spoke of earnings, which involves adding back depreciation. Further production declines will raise breakeven prices even further.

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Slide 10, Chevron Cook Inlet Strategic Study, deals with when Chevron acquired Unocal in 2005. A strategic study was done and it was determined that there are incremental investment opportunities in Cook Inlet. In February 2006, Chevron announced a decision that it would retain all of the Cook Inlet assets, with the intent to begin a multiyear investment program. Chevron will retain the current office locations. Alaska is now a major part of Chevron's portfolio.

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Slide 10 deals with the fact that the Cook Inlet reinvestment program was evaluated using the current severance tax assumption (zero severance tax). He explained that when modeled under the proposed 20/20 PPT, the economics on some projects are degraded and some projects are improved. Overall, it results in poorer economics for the program. He addressed the fact that oil taxes will go up dramatically. It will cause investment decisions to be reconsidered. Higher taxes will cause less capital to be spent. Enhanced PPT terms could significantly expand the list of economic projects in the investment program and significantly extend the life of offshore oil production.

Representative Hawker asked about the surtax that is being charged on the gross price of oil. Mr. Zager agreed that the surtax should be based on net rather than on gross. He shared a concern on the cash flow of the net profits tax.

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Mr. Zager referred to Slide 12 - "Cook Inlet Production Forecast with Four Year Capital Plan". He highlighted the decline without further investment. In about 2009, Trading Bay would be depleted. With investment the projection would be held flat for four years.

Slide 13 - "Alaska Oil Production - January 2006 BOPD". Cook Inlet is only about 2 percent of the state's production of oil. He mentioned that the benefit of the impact of tax

on Cook Inlet oil for the state would be insignificant. Slide 14 depicts the same information with gas added in. He spoke of how important gas is to the Anchorage area. He defined the strategic value of these assets as making sure production is there for future years.

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Mr. Zager asked the committee to consider Cook Inlet as different than the North Slope. Slide 15 shows reasons to lower taxes and provide incentives for additional Cook Inlet investment. He pointed out that gas is running out, and he suggested alternatives such as coal, nuclear, hydroelectric power, and L & G import, and addressed their difficulties. He spoke of a current lack of significant exploration. He said that production tax is a pass through on most utility contracts. Oil redevelopment will maintain and add new jobs and will extend field life. Cook Inlet competes for capital with other areas in North America and does not compete for global capital. Under PPT, Alaska will have the worst fiscal terms in the U.S.

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Mr. Zager explained that Slide 16 lists Cook Inlet provisions in the bill to date. The House Resources version of the bill has no incentives for Cook Inlet. The Senate Resources version provides a 5,000 BOPD exemption, but fails to provide any real help to Cook Inlet. He suggested two reasons given not to consider a Cook Inlet provision. The first is that it complicates the bill. The second reason is that the system must be uniform over the entire state. He argued that there are statutes that distinguish geographic areas.

Slide 17 refers to the Senate version of PPT. He related the Senate formula for the 5,000-barrel exemption. Chevron produces 40,000 a day and would get 187 barrels credit out of the 5,000. He noted the amount for other producers. The reduction would be trivial for Chevron.

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Mr. Zager reviewed Slide 18, which shows that any Cook Inlet provision should be specific to Cook Inlet. When looking at incremental investments in the state, total business must be considered. Credit sits on the bottom and anything that raises the "boat" engages the tax. Anything above 5,000 would be hit by the PPT tax. He summarized that any provisions for Cook Inlet must be specific to Cook Inlet or areas outside of the North Slope.

Mr. Zager stated that the biggest disappointment of the House Resources CS is that it does not recognize the unique

value and challenged position of the Cook Inlet. He concluded that the revisions, as proposed, would lower the economics of capital investments in the Cook Inlet and put the capital program in jeopardy. Without capital the McArthur River Field will be gone in about four years, and with it the critical mass for Cook Inlet oil industry.

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Representative Holm asked what price of oil the four-year capital assumption was based on. Mr. Zager acknowledged that it was based on a price lower than the current price. Representative Holm suggested that \$60 barrel oil was "pretty good" for the four-year plan.

Mr. Zager pointed out that the breakeven point is well above \$25-\$30 per barrel.

Representative Holm noted that Chevron had spoken against severance taxes. Mr. Zager disagreed with Representative Holm's statement. He concluded that the lower the tax the better.

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Mr. Zager discussed ideas to help Cook Inlet producers, as summarized on Slide 20. He observed that Cook Inlet could be left under the current system. There could also be a special exemption for Cook Inlet. He added that PPT could apply to Cook Inlet, adjusted to lower tax rates.

Mr. Zager concluded that the balance of the original bill is gone. He spoke in support of a 20 percent tax rate and a tax credit of \$12 million as replacement for a \$73 million standard deduction. He pointed out that the transition capital credit was taken out of the CS. He noted that progressivity is a big issue, especially for Cook Inlet. He argued against windfall taxes. He noted that pricing cycles are not measured in terms of days. Decisions are made based on distribution, field size, well productivity, and prices.

Mr. Zager reiterated the difference between WTI and ANS. He observed that gas and North Slope oil are tied to WTI. He noted that many of the contracts in the Cook Inlet are not tied to Henry Hub. He emphasized that Chevron does not support progressivity, but maintained that if it is included, the indexing price should be also included. He did not think the commencement date of April was realistic. He spoke to the interest rate and the penalty.

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Mr. Zager reviewed Slide 22. He discussed the issue of "get it now" vs. "grow the pie". He was optimistic that the pie

could be grown. He observed that consultants would someday leave and "we will be left to deal with our decisions". He maintained that over the coming years, investors would vote with their dollars. He emphasized that the original industry support was astounding, however, investors are now concerned with the House Resource version of HB 488. He expressed concern that the CS would discourage investment in Alaska.

Mr. Zager summarized that Chevron could not support the CS in its current form. He urged the committee to return to the original PPT terms, while inserting a Cook Inlet provision. He recommended inclusion of an additional 5% capital credit (20/25) for heavy oil or tertiary recovery projects statewide. Chevron has been in Alaska for many years and intends to continue an active exploration and production operation in the state if a sound and stable fiscal regime can be offered.

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KEVIN TABLER, MANAGER, LANDS & GOVERNMENT AFFAIRS, CHEVRON-ALASKA, clarified that Chevron is not asking "not to be taxed", but to maintain their current tax, without additional tax.

Co-Chair Meyer clarified that the state receives an ELF payment in addition to royalties, property tax, and income tax. He agreed that the natural gas from Cook Inlet is vital to Alaska. He also agreed that Cook Inlet is a small amount in the whole oil production picture and suggested that Chevron be exempted from PPT. Mr. Tabler observed that there is a domino affect once a platform goes down. There are number of reasons the base should be maintained.

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Co-Chair Meyer pointed out that Cook Inlet has been explored since the 50's and estimated that if there were additional resources that they would be found. Mr. Zager noted that there are some potential reserves at deeper levels. There are always possibilities.

Representative Kelly referred to SB 185 and asked how the credits would affect Chevron. Mr. Zager responded that one well would be affected. The intent was for a broad interpretation. Chevron got a small part of what they expected due to the narrow interpretation. There are stringent limits on what qualifies.

Co-Chair Chenault noted that SB 185 was not intended for Cook Inlet. It was modified to cover Cook Inlet.

ADJOURNMENT

The meeting was adjourned at 5:48 PM.