

ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE

February 28, 2006

12:34 p.m.

MEMBERS PRESENT

Representative Jay Ramras, Co-Chair
Representative Ralph Samuels, Co-Chair
Representative Carl Gatto
Representative Gabrielle LeDoux
Representative Kurt Olson
Representative Paul Seaton
Representative Harry Crawford
Representative Mary Kapsner

MEMBERS ABSENT

Representative Jim Elkins

OTHER LEGISLATORS PRESENT

Representative Ethan Berkowitz
Representative Eric Croft
Representative Les Gara
Representative Berta Gardner
Representative Reggie Joule
Representative Vic Kohring
Representative Norman Rokeberg

COMMITTEE CALENDAR

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."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 488

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

| | | |
|----------|-----|------------------------------------|
| 02/21/06 | (H) | READ THE FIRST TIME - REFERRALS |
| 02/21/06 | (H) | RES, FIN |
| 02/22/06 | (H) | RES AT 12:30 AM HOUSE FINANCE 519 |
| 02/22/06 | (H) | Heard & Held |
| 02/22/06 | (H) | MINUTE(RES) |
| 02/23/06 | (H) | RES AT 12:30 AM HOUSE FINANCE 519 |
| 02/23/06 | (H) | Heard & Held |
| 02/23/06 | (H) | MINUTE(RES) |
| 02/24/06 | (H) | RES AT 12:30 AM HOUSE FINANCE 519 |
| 02/24/06 | (H) | Heard & Held |
| 02/24/06 | (H) | MINUTE(RES) |
| 02/25/06 | (H) | RES AT 10:00 AM SENATE FINANCE 532 |
| 02/25/06 | (H) | Joint with Senate Resources |
| 02/27/06 | (H) | RES AT 12:30 AM CAPITOL 124 |
| 02/27/06 | (H) | Heard & Held |
| 02/27/06 | (H) | MINUTE(RES) |
| 02/28/06 | (H) | RES AT 12:30 AM CAPITOL 124 |

WITNESS REGISTER

RICHARD OWEN, Alaska Production Manager
ExxonMobil Corporation;
Vice President, ExxonMobil Alaska Production
Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 488.

MARTIN MASSEY, U.S. Joint Interest Manager
ExxonMobil Corporation
Houston, Texas

POSITION STATEMENT: Testified in support of HB 488.

DAN SECKERS, Alaska Tax Counsel
ExxonMobil Corporation
Anchorage, Alaska

POSITION STATEMENT: Testified that research has indicated that under PPT, ExxonMobil's tax would increase by approximately \$100 million.

KEN KONRAD, Vice President of Gas
BP Alaska
Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 488.

TOM WILLIAMS, Alaska Tax Counsel
BP Alaska
Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 488.

ANGUS WALKER, Commercial Vice President
BP Alaska
Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 488.

RAYMOND HALL, Senior Tax Economist
BP Group
Aberdeen, Scotland

POSITION STATEMENT: Testified that removing ELF and replacing it with the proposed PPT is a move in the general direction of improved simplicity. Discussed the fiscal regimes of Norway and the U.K., and compared them to Alaska.

ACTION NARRATIVE

CO-CHAIR RALPH SAMUELS called the House Resources Standing Committee meeting to order at [12:34:37 PM](#). Representatives Ramras, Samuels, Gatto, Olson, and Seaton were present at the call to order. Representatives LeDoux, Crawford, and Kapsner arrived as the meeting was in progress. Also in attendance were Representatives Berkowitz, Croft, Gara, Gardner, Joule, Kohring, and Rokeberg.

HB 488-OIL AND GAS PRODUCTION TAX

CO-CHAIR SAMUELS announced that the only order of business would be 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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RICHARD OWEN, Alaska Production Manager, ExxonMobil Corporation; Vice President, ExxonMobil Alaska Production, relayed that if HB 488 was simply a tax increase, ExxonMobil Corporation ("ExxonMobil") would actively oppose it. At current prices, ExxonMobil expects its production tax payment would increase by \$50-\$100 million per year. However, ExxonMobil is prepared to move forward under the proposed system since it balances revenues to the State of Alaska and producers across a range of oil prices, provides incentives for new investment, and includes a transition provision for recent investments. He remarked that most importantly for ExxonMobil, the Petroleum Production Tax (PPT) proposal provides a predictable and durable tax system, which along with the appropriate gas pipeline fiscal contract

terms will allow the Alaska Natural Gas Pipeline project to move forward to the next phase. As far as specific concerns about this bill, they center around whether the high tax rate and resulting increase in taxes will hinder full development of the remaining oil resources on the North Slope.

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MR. OWEN noted that ExxonMobil has had presence in Alaska for over a half century, investing more than \$11 billion in the State of Alaska's economy. ExxonMobil's activities date back to 1954 when it conducted a comprehensive study of the territory's oil and gas potential. Over the years, ExxonMobil explored most of the major hydrocarbon plays in Alaska including: the Gulf of Alaska, St. George and Navarin Basins, Norton Sound, Beaufort Sea, Cook Inlet, and of course, the North Slope where it was a participant in the 1968 Prudhoe Bay number one discovery well. ExxonMobil is proud of the role it has played in Alaska - exploration, initial field development, construction of the Trans-Alaska Pipeline System (TAPS), development of new technology, and the promotion of efficient reservoir management practices.

MR. OWEN further noted that currently, ExxonMobil has working interests in Prudhoe Bay, Kuparuk River Unit, Endicott, and Granite Point. It's the operator of the Point Thomson Unit and the largest interest holder in the Prudhoe Bay. ExxonMobil's current working interest oil production is approximately 180,000 barrels per day (B/D), and it's the largest owner of discovered gas resources. ExxonMobil's Alaska production represents approximately 4 percent of its worldwide oil and gas production, and is primarily from Prudhoe Bay and near-by satellite fields. He remarked that Prudhoe Bay and Point Thomson have significant remaining potential, but at higher cost and risk.

MR. OWEN stated that one of ExxonMobil's objectives in the gas pipeline fiscal contract negotiations has been to reduce the risk associated with fiscal change by working with the State of Alaska to establish a predictable and durable fiscal environment in which to make long term investment decisions. Any change in the fiscal regime for oil had a direct impact on how ExxonMobil views the stability of the Alaska fiscal environment, which impacts how it evaluates ongoing investment decisions. He relayed that ExxonMobil understands the State of Alaska's desire to obtain additional tax revenue at higher oil prices. He opined that one of the most challenging tasks that the legislature can undertake is how to change the oil tax system

without damaging the industry. He remarked that as Governor Murkowski has correctly stated on many occasions, the North Slope is one of the most expensive places in which the [oil and gas] industry operates. He added that tax systems need to be carefully designed to ensure that the desired objectives are achieved without resulting in unintended consequences, such as reduced investments and lower reserve recovery. One of the many questions that ExxonMobil is asked is, why is it and other producers seeking durability and predictability for oil in parallel with negotiating a fiscal contract for a gas pipeline.

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MR. OWEN answered that the gas on the North Slope is contained in the same reservoirs as the oil and is produced through the same facilities. He explained that for a gas project to be viable, ExxonMobil needs the fields that produce both oil and gas to be viable, underpinned by predictable and durable fiscal terms. A commitment of billions of dollars to build the natural gas pipeline requires confidence that the base oil business will remain healthy for the long-term. In regard to the current oil production severance tax system, the Economic Limit Factor (ELF), he opined that it has been effective at encouraging investment and mitigating production decline. He stated that the ELF was designed to allow the State of Alaska to increase the production tax while not stifling investment in marginal fields. The ELF scaled down the production tax rate when a field became more marginal, reducing the economic limit to which a field could be produced and ultimately allowing more reserves to be recovered. He further stated that the 1989 ELF amendment significantly increased the production tax on Prudhoe Bay and the Kuparuk River Unit, while providing an incentive to encourage the development of smaller fields. That 1989 amendment worked as intended, with many small and marginal fields coming on stream over the past 17 years. The ELF lowered the tax rate on those fields, supporting their commercial viability.

MR. OWEN relayed that while ExxonMobil would like to have more Prudhoe Bays and Kuparuk River Units, it and the rest of the industry haven't found any. Consequently, the focus for the past ten years has been on the development of these smaller satellite fields. Satellites are generally not economic as stand alone developments and have required both new technology and connection to existing infrastructure to be commercially viable. He stated that many of these fields produce viscous oil contained in lower quality reservoirs requiring significantly

higher costs, which adds to the risks for development. He added that this is especially true for the Polaris and Orion viscous oil developments, with oil that literally flows like molasses. Developing these fields has required new technology, more expensive drilling and completion techniques, new production-handling equipment, and extensive modifications to existing facilities to process these viscous production streams. He informed the committee that since 2000, ExxonMobil has invested over \$250 million in the engineering, drilling, and construction of associated facilities for the development of Aurora, Borealis, Midnight Sun, Polaris, and Orion. He added that significant additional capital is required over the next several years to fully develop these resources.

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MR. OWEN remarked that today these fields are mitigating the decline of oil production on the North Slope, contributing 50,000 B/D gross and are expected to recover over 500 million barrels gross. Under the ELF formula, many of these smaller satellite fields paid little or no production tax. Even though these fields were paying little production tax, they did, and continue to, contribute substantial amounts to Alaska in royalties, property taxes, income taxes, and jobs for Alaskans. Over the past five years, ExxonMobil and other working interest owners have also extended the primary Prudhoe Bay enhanced oil recovery (EOR) technology to some of these satellite fields. He informed the committee that since 1998, ExxonMobil has invested over \$30 million in tertiary recovery projects at Point McIntyre, Eileen West End, and Borealis, which are expected to produce an additional 60 million barrels gross. While tertiary projects recover additional oil, the production profile results in slower oil recovery and longer payout periods. These satellite EOR projects are in the early stages of development. The major investments have been made, but the oil production benefits will not be received until many years out. The ELF provision of the existing production severance tax made these economically challenged projects commercially viable.

MR. OWEN stated that taken together, the recent Prudhoe Bay satellite and EOR development projects developed over 560 million barrels gross. While the resulting production tax under ELF was relatively minor, Alaska's royalty oil would total 70 million barrels, which at today's oil prices is worth roughly \$4 billion. He opined that the ELF system has worked well for industry and the State of Alaska by encouraging significant new investment. However, he explained it's also recognized that ELF

can be considered a somewhat regressive system in that it does not reflect "profitability" or "cost" in the division of gross revenue between the state and the producers as oil prices rise and fall. He said that the assumption that a well is marginal at 300 B/D does not necessarily hold in the current high oil price environment, yet this assumption typically contributes to a reduced ELF factor based on the current formula. He added that as a global oil and gas producer, ExxonMobil operates across a wide array of fiscal systems.

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MR. OWEN relayed that it's most important that the system recognize the quality of the resources so that the potential developments will be commercially viable and attract capital. The quality of resource pertains to the size and nature of the oil and gas reservoirs, the cost and technology required to develop those reservoirs, the distance to market, as well as the tax and royalty system that applies, including the long-term stability of that system. He explained that countries that are experiencing significant industry investment have achieved the proper balance in their fiscal regimes. He informed the committee that ExxonMobil's assessment of the remaining oil resource suggests future growth opportunities will come from: complex EOR projects; development of smaller, more marginal oil accumulations; and the innovative development of viscous and heavy oil resources. These opportunities will require the development and application of new technology, higher unit development costs, and more complex operations to deliver a given production rate. These resources are much lower in quality as compared to Prudhoe Bay and Kuparuk River Unit, though they face the similar challenges associated with arctic conditions and distance to market. Therefore, he reiterated that ExxonMobil is concerned that the administration's proposal is weighted towards a higher tax, which may prevent some of Alaska's challenged resources from being developed.

MR. OWEN, in regard to the administration's PPT proposal, explained that this proposal represents a tax based on profits, which results in a sharing of the risks and the rewards across a range of prices. The State of Alaska will receive a higher share of the revenues when prices are high and will accept lower taxes during periods of low prices. The proposal moves from the regressive ELF system to a progressive system. He added that ExxonMobil affiliates have significant experience in profit-based progressive systems around the world and they work well, as long as they have properly taken into account the nature of

the resource base. In regard to the key features of the PTT proposal, he commented that HB 488 represents a major step-change in Alaska's current production tax system. He opined that the bill appropriately addresses this step-change by including a transition plan so that recent investment decisions are not adversely impacted. The bill provides a transition allowance over the next six years based on capital investments made in the last five years. He stated that ExxonMobil believes that this transition plan is appropriate because the benefits from these recent investments have not yet been fully received.

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CO-CHAIR RAMRAS inquired as to the amount of money ExxonMobil has invested over the past five years.

MR. OWEN replied approximately \$800 million. In further response to Co-Chair Ramras, he said that ExxonMobil has generated over \$22 billion in corporate profits over the past five years.

CO-CHAIR SAMUELS inquired as to the profits ExxonMobil has generated over the past five years in Alaska.

MR. OWEN explained that ExxonMobil doesn't separate its profits by state, but stated that ExxonMobil's production in Alaska represents about 4 percent of its worldwide production.

CO-CHAIR RAMRAS asked how much [money] ExxonMobil has invested as well as earned in Alaska.

MR. OWEN answered that ExxonMobil has invested \$800 million. Its worldwide profits have been approximately \$22 billion per year. He said that ExxonMobil's worldwide earnings in 2005 were \$36 billion and added that it invested \$170 million in Alaska. In response to Co-Chair Ramras, he answered that BP produced 180,000 barrels of oil.

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MR. OWEN restated that ExxonMobil believes that this transition plan is appropriate because the benefits from these recent investments have not yet been fully received. Oil and gas companies invest large sums of money years ahead of first production and are at risk for price, development cost, production rates, and ultimate reserve recovery. He added that in most cases, it takes many years, often more than five years,

for a return on oil or gas investment. For example, satellite and tertiary recovery investment decisions during the last five years were made under the ELF structure anticipating a lower tax relative to that proposed under the PTT bill. He opined that the State of Alaska appropriately provided this incentive so that these challenged and costly projects would be commercially viable. He remarked that it's not appropriate to suddenly increase taxes on these investments without providing some form of consideration. The transition provision recognizes that past investments were made under the ELF structure and somewhat reduces the increased tax treatment to which these projects will now be subjected.

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MR. OWEN remarked that to avoid penalizing these recent investments, the transition provisions included in this bill are essential.

REPRESENTATIVE GARA commented that a few countries have increased their taxes in recent years and asked which of those countries where ExxonMobil invests have granted a credit for investments prior to the tax change.

MR. OWEN answered that he didn't have that information with him. In most cases, when countries make a major change in their tax provisions, they provide some kind of transition arrangement in order that there isn't just this step-change in the tax system.

MARTIN MASSEY, U.S. Joint Interest Manager, ExxonMobil Corporation, explained that ExxonMobil has contractual arrangements with countries such that the terms are solidified for the lifetime of the resources. Countries might change tax regimes, but it has no impact on those arrangements. He added that in many cases there is some sort of a transition.

REPRESENTATIVE BERKOWITZ asked for an example of a regime that has changed its taxing, and the corresponding lookback.

MR. OWEN clarified that the lookback investment attempts to consider the impact of the higher tax rate on the revenue stream from previous investments. He added that to some extent, it's recognizing a transition from the current average tax rate to a substantially higher one. Rather than adversely impacting some of those recent decisions, a transition arrangement arises. He explained that one of the easiest ways to generate the transition arrangement is by means of a production profit tax,

which is a deduction for recent spending on investments over the previous five years.

REPRESENTATIVE BERKOWITZ commented that when there's an assertion made that there's a certain course of conduct that's taking place in other jurisdictions, it would be helpful if [the State of Alaska] could get some substantiation for that in order that it have a more superior method of devising its own policy.

MR. MASSEY responded that ExxonMobil already has contractual arrangements with regimes around the world, which results in the predictability and stability of its investments regardless of changes in price.

REPRESENTATIVE BERKOWITZ said it would be helpful to know what those regimes are and the nature of those contractual arrangements. He added that it would also be helpful to know of regimes where ExxonMobil doesn't have contractual arrangements, what the regimes are, and the lookback provisions that have been made.

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CO-CHAIR RAMRAS asked what the effective ELF rate ExxonMobil is paying to aggregate the oil production in Alaska is.

DAN SECKERS, Exxon Tax Counsel, ExxonMobil Corporation, replied that for ExxonMobil's Alaska operations, it's approximately 9 percent.

REPRESENTATIVE SEATON commented that there was a recent 10 percent tax rate increase in the United Kingdom (U.K.). He asked, "Did they make any kind of backward looking adjustment on that, or do you have investments in the U.K.?"

MR. OWEN confirmed that ExxonMobil does have investments in the U.K., but added that he didn't have that data with him.

REPRESENTATIVE SEATON inquired as to whether ExxonMobil has a contractual arrangement with the U.K. such that ExxonMobil remained at the previous [tax] rate, even though the U.K. has increased its tax rate.

MR. MASSEY explained that ExxonMobil doesn't operate under a contractual arrangement in the U.K. He added that the U.K. [tax] system has been in place, and oil and gas investment activities have existed there, for many years. He said, "You're

basically operating under a system that has been modified year after year." ExxonMobil pays the taxes under the current system [in the U.K.]

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MR. OWEN discussed the tax rate and investment tax credits. He expressed ExxonMobil's concern that a 20 percent tax rate will not support the growth opportunities remaining on the North Slope, which he described as primarily complex EOR projects, development of small oil accumulations, and innovative development of viscous and heavy oil resources. He noted that these opportunities have challenged economics. While the investment tax credit of 20 percent will enhance the present value economics of new investments, the 20 percent tax rate will result in lower overall cash flow. He stated that the impact on all economic parameters must be carefully weighed before a decision to invest is made. The combination of a 20 percent credit along with a 20 percent tax rate may not be adequate to support development of all of the remaining opportunities.

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MR. OWEN strongly recommended that the legislature not increase the proposed tax rate or reduce the proposed tax credits. He discussed another feature of the PPT bill, which is royalty settlement methodology. HB 488 addresses many of the longstanding issues that have divided the State of Alaska and the industry over the years. For example, too many years and too much money have been spent in disputes over how to value a single barrel of crude oil or a single molecule of gas. He opined that it made little sense in the past and it makes little sense today for the State of Alaska to have separate divisions determining the value of oil and gas - one for royalty and one for taxes. There is only one value in the market place. He explained that HB 488 allows the State of Alaska to value a producer's oil and gas using the producer's royalty settlement agreement, which was negotiated with, and approved by, the Department of Revenue (DOR). This will provide certainty to a producer on the value on which to pay its royalty and production taxes and will reduce the administrative and audit costs to both the State of Alaska and the industry.

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MR. OWEN noted that under current prices, the industry will pay more in taxes as compared to the current production tax system.

However, ExxonMobil needs predictability and durability under which to gauge investment decisions. He said that no one wants to invest money in a project to have the rules changed, reducing the attractiveness of the investment. He remarked that the transition provision is an important feature of this bill necessary to provide relief for the abrupt change caused by the new PPT system. The State of Alaska decided to weight the proposal to a higher tax, which may make it difficult to progress the remaining future development opportunities. It's most important that the quality of the resources be factored into the design of the tax system. He informed the committee that ExxonMobil wouldn't support a higher tax rate or lower credits than proposed in the bill.

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MR. OWEN explained that HB 488 seeks to balance revenues to the State of Alaska and the producers across a range of oil prices and provides incentives for new investments, which is a clear objective of the State of Alaska. Most importantly, ExxonMobil believes that the new system, coupled with appropriate gas pipeline fiscal contract terms, will lead to a predictable and durable tax system, which will enable the Alaska gas pipeline project to move forward to the next phase. He noted that potential changes to the features of the PTT bill must be carefully considered to avoid upsetting the balance contained within the bill. He concluded that HB 488 is important for Alaska and the producers. It is one part - a very important part - of a series of related issues that the legislature will need to address to ultimately provide the necessary fiscal environment to stimulate oil production and to progress the Alaska gas pipeline project.

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MR. OWEN explained that the fiscal contract that is being finalized under the authority of the Stranded Gas Development Act will incorporate this PPT legislation by reference in order to provide fiscal stability. ExxonMobil is currently working with the administration on how best to incorporate this bill into the fiscal contract. He noted that the fiscal contract will soon be released for public and legislative comment. Following the regular session, ExxonMobil understands that the governor will call a special session so the legislature can vote on the contract. He further noted that for that reason, it's important that HB 488 be enacted in its present form prior to that special session. ExxonMobil has been in Alaska for over 50

years and its future business plans show continued activity in Alaska for at least 50 years. He informed the committee that ExxonMobil is on the verge of taking the next step to commercialize Alaska's North Slope gas and asked the committee to support the administration's efforts in this regard.

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CO-CHAIR SAMUELS stated that the first \$73 million made is tax-free and inquired about ExxonMobil's position on that.

MR. OWEN responded that ExxonMobil understands why the administration proposed a \$73 million allowance - it is trying to reduce the barriers for new entrants and explorers in the oil and gas [industry] in Alaska. To some extent, ExxonMobil believes that HB 488 has the potential to create an unlevel playing field. However, he reiterated that ExxonMobil understands - and agrees with - what the administration is trying to do.

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REPRESENTATIVE BERKOWITZ commented that a threat - if the legislature adjusts the oil tax, the producers will walk away from the gas pipeline - is implicit in Mr. Owen's testimony. He asked, "Is that an accurate assessment?"

MR. MASSEY said he wouldn't characterize it as a threat. ExxonMobil believes that the administration has proposed a bill that provides the predictability and durability that it needs. The focus of the negotiations has been to arrive at a predictable, durable regime, under which companies are able to make their investments. He added that ExxonMobil believes that the tax rates may be too high and that there may be development opportunities on the North Slope that will not go forward because of the tax rate the governor/administration selected.

REPRESENTATIVE BERKOWITZ remarked that the only people who are unaware of what's in this proposed gas pipeline bill is the legislature. It is being asked to craft a gas tax without having seen a pipeline deal, which he opined, is going to be a difficult thing to do. He relayed that he'd feel more comfortable if the gas pipeline bill were produced in order that the legislature conduct an analysis how it fits into an oil and gas tax.

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CO-CHAIR SAMUELS clarified that the legislature is discussing HB 488 and instructed the committee to refrain from discussing extraneous oil and gas issues.

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REPRESENTATIVE GARA commented that for the tax system to be fair, the legislature needs to research what the resulting profit margins would be for the various companies. The current profit margins are "massive." He relayed that consultants have advised that producers need to be able to project, with some comfort, in the range of 15 percent or more profit margin on development. He inquired as to the profit margin ExxonMobil needs to project in order for a project to be a "go."

MR. OWEN informed the committee that ExxonMobil doesn't consider single parameters in its economic analyses. ExxonMobil considers a range of parameters: internal right of return, net present value, actual value, the amount of money the project would generate, the quality of the resource, and the technical and geological risks that exists. [The economic analysis] depends on all of those parameters and/or risks weighed together, which results in how ExxonMobil feels about moving forward with an investment. In further response to Representative Gara, in regard to ExxonMobil's earnings, he explained that when one looks at them as cents earned on dollars of sales, they vary from 1 cent per dollar of sales up to about 20 cents per dollar of sales. 1 cent per dollar of sales is like the automotive industry, while 20 cents per dollar of sales is like the pharmaceutical industry. The oil industry, and Exxon Mobil, are around 8-10 cents per dollar of sales, which is right in the middle of the pack. He clarified that there's a lot of money being invested and there are a lot of sales, so the total earnings are very large numbers. However, when the numbers are normalized on the cents per dollars of sales, they're actually in line with most of the [industries].

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REPRESENTATIVE GARA remarked that under the current system, ExxonMobil can anticipate essentially a 0 percent production tax for most fields it develops. He surmised that ExxonMobil's profits have probably increased by "hundreds of percent" as oil prices increased from \$20 [per barrel] to \$60 [per barrel]. He observed that the aforementioned doesn't seem to have affected

ExxonMobil's current investment decisions because they seem somewhat similar this year to what they were three years ago. He said:

In the face of that, why should we believe that adopting a new tax structure that slightly increases the tax and gives you a 20 percent credit is going to cause you to change your investment behavior, more than a system that charged you essentially a 0 percent tax on new fields and in which you've seen profits go up multiple fold, but investments haven't gone up multiple fold.

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MR. OWEN surmised that Representative Gara's question is whether this [bill] would change ExxonMobil's investment into the future. He responded that ExxonMobil believes that this 20 percent tax rate is a significant increase and may lead to it not developing all of the resources that exist on the North Slope. He added that when ExxonMobil considers some of its near-term investments, this PPT proposal results in a credit which helps the present value of investments, but [the PPT proposal] significantly increases the tax which is paid over the long-term. When one considers the analysis that the administration's consultant conducted, it was all around certain size opportunities and quality opportunities. He relayed that there are some marginal investments in which it's not clear whether this proposal will allow all of them to go forward due to the tax rate. In near-term, ExxonMobil is continuing to advance. Prices are currently quite high and ExxonMobil is currently investing similar to previous years, although it has increased its activity in drilling. In the long-term, when ExxonMobil faces the challenged areas - heavy oil opportunities, EOR, and very small pools - they are going to be marginal investments. He reiterated that ExxonMobil is concerned about this [proposed] tax rate.

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CO-CHAIR RAMRAS inquired as to how much [money] ExxonMobil donated back to the communities in Alaska in 2005.

MR. OWEN answered approximately \$500,000. He added that ExxonMobil currently has about 20 employees in Alaska, which isn't a large employee base.

CO-CHAIR RAMRAS requested that Mr. Owen inform the committee as to what the ELF tax payment was in 2005, or projected in 2006, versus what it would be under the PPT regime.

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MR. SECKERS replied that in 2005, ExxonMobil's production tax was approximately \$300 million. He added that research has indicated that under PPT, ExxonMobil's tax would increase by approximately \$100 million. Under PPT, the tax would be calculated by subtracting ExxonMobil's cost associated with producing the particular revenue from its total revenue.

[1:20:12 PM](#)

REPRESENTATIVE CROFT commented that it makes a great deal of difference whether the legislature is talking about a stand alone PPT law of general application wrapped into a 10-, 15-, or 20-year contract, or as a precondition to the gasline contract. He asked, "Does ExxonMobil see passage of HB 488 in it's current form or something very near it, as a precondition to the gas agreement that you've apparently concluded?"

[1:21:49 PM](#)

MR. MASSEY responded that "precondition" and "threat" are not words that he would use. He added that once the terms of the contract are written, consistent with the bill, it will allow ExxonMobil to move to the next phase of the gas pipeline.

REPRESENTATIVE CROFT asked, "Do you have a legal right under whatever you've signed on the gasline agreement to pull out if we make significant changes?"

MR. MASSEY responded that the administration has arranged to first address the bill. Once the bill is addressed, how the oil bill is written into the contract and the actual contract itself will be made available for public comment, legislative review, and a decision to ratify it in order that the governor is able to sign it.

REPRESENTATIVE CROFT remarked that it either is or isn't a component of the gas pipeline agreement, which [the legislature] hasn't seen.

MR. MASSEY stated that it is ExxonMobil's position that the oil fiscal stability will be addressed in the gas pipeline contract.

[1:25:37 PM](#)

CO-CHAIR SAMUELS clarified that HB 488 does nothing for fiscal certainty, which will be a separate discussion.

REPRESENTATIVE LEDOUX observed that ExxonMobil keeps using the terms "predictability" and "durability." She asked, "Actually, wouldn't any bill, as long as it was encompassed in a contract, provide you with predictability?"

MR. OWEN answered that one of the fundamentals is the health of the oil industry. The reason that ExxonMobil wants to see the predictability and durability long-term is that the underlying healthy oil business is needed for the gas business. He noted that oil and gas are inextricably linked.

REPRESENTATIVE LEDOUX clarified that as long as that was encompassed in some sort of contractual provision, it would provide predictability and durability.

[1:27:36 PM](#)

REPRESENTATIVE SEATON noted that ExxonMobil said that its ELF was approximately .9 in Alaska. He inquired as to whether the ELF stimulated Alaska investment or whether PPT, with the credit and full allowance, will better stimulate ExxonMobil's investment in Alaska.

MR. OWEN confirmed that the ELF encouraged investment. ExxonMobil invested and developed a large number of satellite fields and progressed EOR projects. He said that the way in which PPT is structured provides some incentive. There are some projects that would do better under ELF, and some projects that would do better under PPT. Under PPT, there may be some projects that aren't commercially viable.

[1:29:37 PM](#)

REPRESENTATIVE SEATON clarified that HB 488 applies to gas production across the state, not just the North Slope gas pipeline.

[1:30:48 PM](#)

MR. MASSEY relayed that ExxonMobil's focus on the gas side has been to define the terms through the gas pipeline fiscal

contract. ExxonMobil recognizes and understands that gas needs to be dealt with in the PPT deal because there may be some gas that isn't part of a fiscal contract. With its North Slope gas, ExxonMobil intends to work with the administration and the legislature on how to deal with it and the royalties and taxes associated with the gas through the fiscal contract.

[1:31:28 PM](#)

REPRESENTATIVE SEATON asked, "At this point in time, do you even care whether gas is changed from the gas ELF system and gas credit system to the PPT system? Is this PPT system that is set for oil totally applicable to gas production?"

MR. MASSEY, in regard to gas on the North Slope, relayed that it's ExxonMobil's position to deal with that through the fiscal contract.

[1:32:14 PM](#)

REPRESENTATIVE SEATON clarified that ExxonMobil is not concerned about gas in this PPT bill because its gas is going to be associated with the contract on the North Slope.

REPRESENTATIVE ROKEBERG inquired as to whether ExxonMobil expects any changes in its investments due the change in leadership in the company.

MR. OWEN replied no. He noted that ExxonMobil is continuing with the way it currently does business and opined that it's been a very seamless transition. ExxonMobil will continue to evaluate opportunities with its partners on the North Slope.

[1:33:18 PM](#)

REPRESENTATIVE ROKEBERG inquired as to whether, under the terms of PPT, ExxonMobil would be receptive to an increased tax credit for viscous oil in the frontier exploration.

MR. OWEN replied that there are opportunities that exist that ExxonMobil is concerned about, which would be difficult to progress under the current 20 percent tax rate and 20 percent credit rate. Therefore, there may be some opportunities that would be enabled if there were higher credits for those activities and likewise for exploration. He noted that there are already incentives for exploration and credits for explorations that exist. In regard to heavy oil, ExxonMobil

thinks it's one of the opportunities in which it's going to be difficult to progress, as well as more challenging than some of the others. He said, "If you're asking me will extra credits help projects move forward, I think the answer is yes."

REPRESENTATIVE ROKEBERG continued that if the legislature were to increase the tax credit for something specific, would ExxonMobil be receptive to a change in the tax rate that would be more aggressive in the account of high oil prices.

1:35:23 PM

MR. OWEN explained that at this stage, ExxonMobil has looked at this proposed bill and it has some reservations about the tax rate and whether it will allow all of the development opportunities. ExxonMobil believes that this bill currently balances the needs of the State of Alaska's with the needs of the producers. Therefore, he stated that ExxonMobil is able to move forward with this bill. He noted that any changes to this bill will have to be looked at very carefully to see what impact they will have on the overall ability to progress the resource base. He clarified that Representative Rokeberg discussed two different concepts - differentiating credits and increased progressivity on the price - which would have to be looked at to determine how they balance out in terms of whether a healthy industry is maintained.

REPRESENTATIVE ROKEBERG asked how this tax would effect the Point Thomson development.

MR. OWEN answered that the most likely development of Point Thomson option is through the gas pipeline.

1:38:15 PM

REPRESENTATIVE BERKOWITZ stated that DNR just filed an application for a right-of-way through Point Thomson and asked whether ExxonMobil had any comment on that.

MR. OWEN relayed that ExxonMobil has been waiting for DNR to issue it for public comment, and now that it has been issued, ExxonMobil will review it and then comment on it.

1:38:43 PM

CO-CHAIR SAMUELS, in regard to the royalties, asked whether ExxonMobil thinks that private royalties should be treated

differently than State of Alaska royalties by the industry. Currently in HB 488, the private royalties and state royalties are treated differently in terms of cost recovery from the industry. He asked, "How do you balance out the fact that the royalties from the State of Alaska get treated one way and the private royalties get treated another way?"

MR. OWEN responded that it's not an area that ExxonMobil has really delved into.

[1:39:54 PM](#)

REPRESENTATIVE GARA relayed that the money from the production tax eventually is deducted from the State of Alaska corporate income tax. He clarified that when the committee asks how much more money will it raise, the committee means in total, not how much more money will it raise in the severance tax prior to that being deducted from the State of Alaska corporate income tax. He further clarified that the committee is referring to the total net to the State of Alaska, not the pre-deduction net.

REPRESENTATIVE SEATON further clarified that the tax would be due monthly and that there's a provision that if a company pays 90 percent of the tax, it won't owe interest on it until March of the following year. Federally, if one underpays his/her taxes, he/she owes interest, but there isn't a penalty if he/she is at that 90 percent. He asked, "Do you have any problems with proceeding in that same like manner with the state?"

[1:42:04 PM](#)

MR. MASSEY stated that under the current bill, there's a provision that allows ExxonMobil to pay its taxes based on 90 percent. If ExxonMobil is within that 90 percent, it would not have any interest or penalties due, which is very similar to the federal law. The federal law has a number of different tests one can use - 100 percent of the prior year's tax and 90 percent of the current year's tax.

[1:42:53 PM](#)

REPRESENTATIVE SEATON, in regard to the federal tax, clarified that if a company is within 90 percent, it doesn't owe a penalty, but it still owes interest on the tax due. He asked, "If this is due monthly, why should the state say you're not going to owe interest on the underpayment?" He further asked,

"Is there any reason that you can see why the State of Alaska shouldn't work under that same system?"

MR. MASSEY answered that it's more of a policy call for the State of Alaska.

1:44:50 PM

MR. SECKERS, explained that in 2005, using current prices, ExxonMobil's production tax gross revenue from Alaska would have been approximately \$3.1 billion. From that, the royalty that ExxonMobil would have paid would be subtracted. Under ELF, \$500 million in royalties would have been subtracted from the \$3.1 billion total revenue. He added that the gross revenue for 2005 would have been about \$2.8 million. He said that the effective tax rate for ExxonMobil's gross operations in Alaska under the aggregated ELF would have been around 11.2 percent. ExxonMobil's tax in 2005 would have been approximately \$350 million. Under PPT, ExxonMobil would start with the taxable revenues and subtract the \$73 million allowance, subtract its total lease operations expenses, which would have been approximately \$400 million. Next, ExxonMobil would apply the flat tax rate of 20 percent, resulting in a \$537 million dollar tax. The credit is only 20 percent of ExxonMobil's qualified capital expenditures, which is approximately \$190 million. ExxonMobil's credit would have been approximately \$40 million, leaving it an extra tax bill of approximately \$500 million, with an effective tax rate close to 16 percent.

REPRESENTATIVE GARA remarked that's the additional production tax ExxonMobil will pay, but then it's deducted from its corporate income tax. He clarified that the committee wants to know how much extra the State of Alaska will receive.

MR. SECKERS responded that if ExxonMobil then subtracted it from its corporate income tax, it would probably remove approximately another. The maximum tax rate in Alaska is 9.4 percent. Assuming that ExxonMobil was at that rate, the maximum additional reduction it would get would be approximately 9 percent of that total amount, which would be approximately another \$50 million.

CO-CHAIR SAMUELS added that ExxonMobil would save [money] in federal taxes also.

MR. SECKERS informed the committee that under the current aggregated ELF system, the corporate income tax would be approximately \$100 - \$120 million for the State of Alaska.

[1:50:14 PM](#)

REPRESENTATIVE GATTO clarified that what ExxonMobil's figures show is that under PPT, it's going to pay more taxes.

MR. SECKERS noted that it's never advantageous to pay more taxes just to get the deduction.

REPRESENTATIVE GATTO asked, "What is your penalty, not just from the State of Alaska, but overall?"

[1:53:33 PM](#)

CO-CHAIR RAMRAS remarked that he advocates this transition to PPT, and said the committee is discussing total government take and the state taking more at the expense of the federal government. He opined that it's beneficial to Alaska and perhaps detrimental to the portion of Alaska revenues which are paid to the federal tax return. He requested that ExxonMobil discuss the shift in tax payments to the State of Alaska as well as the deductibility on the federal return.

[1:55:49 PM](#)

MR. SECKERS explained that from the gross revenue, the first government take that ExxonMobil pays would be a royalty to the State of Alaska. Of that total revenue, ExxonMobil would pay property tax, which is about 2 percent, corporate income tax, and production tax. Production tax is a deductible item for the calculation of state income tax. He mentioned that Alaska looks at ExxonMobil worldwide income and takes a portion of that based on a number of factors. When ExxonMobil calculates its worldwide taxable income on its federal return, it takes deductions for the amount of severance tax it paid to Alaska as well as other taxes it paid. Then ExxonMobil calculates the federal taxable income based on that. It is reduced by what ExxonMobil paid to the State of Alaska, but it's not dollar for dollar, because it's a deduction off of the tax.

[1:57:50 PM](#)

CO-CHAIR SAMUELS relayed that the committee has gotten the impression that at \$60 per barrel, the biggest loser in this tax

plan was ConocoPhillips and the second biggest loser was the federal government. He asked whether that was correct.

REPRESENTATIVE CRAWFORD observed that the oil and gas industry is cyclical. The higher the highs are, the lower the lows are. He noted that current prices are really high and said that he would like to know what PPT, as proposed, would collect at \$12, \$24, \$36, and \$48 per barrel as well as at the current prices. He said, "I don't trust that oil prices are going to stay as high as they are today. I think that they're headed down at some point and I think they're going to head down like a rock."

[2:00:17 PM](#)

REPRESENTATIVE SEATON referred to the effective tax rate of PPT versus the current ELF. At \$20 per barrel, effectively it's at half the current tax rate, which would be 7 percent under ELF and 3.5 percent under PPT. He asked, "How significant is that downside protection at low oil prices in the PPT formula for Exxon[Mobil]?"

MR. OWEN remarked that PPT is a tax on profit or profitability, so it's hard to design a profit-based tax system that doesn't do that. He described it as progressive by nature; as profits become lower, the take becomes lower too. It's all part of the shift from one system to another system, and there's a natural progressivity with a PPT system in that it provides lower tax take for the State of Alaska at lower prices and higher tax take at higher prices. He opined that it's important because it's part of the step to a new structure.

REPRESENTATIVE SEATON reiterated his interest in determining how significant the downside protection when prices are low or lower is in agreeing to a PPT-style system. He asked, "Does that really matter much to you at all?"

[2:02:54 PM](#)

MR. OWEN confirmed its significance. He added that ExxonMobil has considered this [PPT] system and ExxonMobil believes that it ultimately provides balance across a range of prices, including both low and high prices. He expressed ExxonMobil's understanding of the desire to shift from a regressive ELF system to a more progressive PPT system.

[2:03:37 PM](#)

REPRESENTATIVE BERKOWITZ inquired as to ExxonMobil's long-range forecast for the price of oil and the associated probability.

MR. OWEN declined to answer.

REPRESENTATIVE BERKOWITZ explained that the committee is attempting to put together a tax rate/tax proposal that's supposed to be sustainable over a wide range of time and prices.

MR. MASSEY responded that ExxonMobil doesn't have an idea as to the future price [of oil]. He opined that the key is whether the legislature has designed a system, given its assessment of the resources that remain to be developed on the North Slope, that will attract investment to those opportunities and enable them to move forward. He explained that ExxonMobil doesn't use one price, rather it looks at investments across a range of prices in order that it can understand how viable an opportunity is going to be.

The committee took an at-ease from [2:07:05 PM](#) to [2:20:55 PM](#).

KEN KONRAD, Vice President of Gas, BP Alaska, informed the committee that last week, after more than two years of negotiations and a lot of hard work on all side, BP reached a very finely balanced agreement with the administration on a predictable and durable fiscal contract with the State of Alaska. The fiscal contract will establish clear rules governing payments-in-lieu of taxes BP would make to the State of Alaska, including a PPT payment incorporated by reference from this legislation. He noted that once ratified, the fiscal contract will enable a gas pipeline to advance in partnership with the State of Alaska as an equity participant. Much of what's contained in the PPT legislation was born in part out of the fiscal contract negotiations BP has been in with the administration.

MR. KONRAD said oil and gas co-exist in the same underground reservoirs. They are produced together through the same wells, flow together through the same flowlines, and are processed together in the same facilities. Some fields have more oil than gas and some fields have more gas than oil or condensate. He noted that it is exceedingly rare that one is produced without the other. Because oil and gas co-exist physically and are produced together through the same investments made in well and facilities, they are also linked economically.

[2:24:08 PM](#)

MR. KONRAD continued that this inextricable physical and economic linkage is widely recognized by governments and investors around the world. North American royalty contracts cover both oil and gas. Internationally, production-sharing contracts include terms for both oil and gas. He relayed that general oil and gas tax laws across the U.S. and internationally always address both oil and gas. Governments want to know how much money they will receive from oil and gas production. Similarly, investors need to know how much they will pay governments when oil and gas is produced and sold, and make their investments accordingly. The economic linkage of oil and gas is particularly acute in Alaska when considering a gas pipeline, given the unique operating challenges on the North Slope and the criticality of economies of scale. He informed the committee that the producers and the State of Alaska currently have a problem. Alaska North Slope (ANS) oil production has been declining for over 15 years and has been on an unsustainable trajectory. He noted that investment by the industry has been insufficient to limit decline.

[2:25:37 PM](#)

MR. KONRAD conjectured that unless the entire industry, in partnership with the State of Alaska, is able to maintain economic levels of oil production to support and maintain vital North Slope infrastructure for many decades to come, a gas project can't be successful - it simply can't be burdened with the cost of uneconomic oil production. Investors need confidence that the fiscal regime will be sufficiently competitive to attract the enormous amounts of additional capital needed to maintain economic levels of ANS oil production for decades. He said that providing this confidence benefits both the State of Alaska and investors against its common enemy - production decline. Building a gas pipeline is effectively a commitment by the major producers to maintain vital North Slope infrastructure for another 40-50 years, which he opined is a daunting challenge. He relayed that there is a question as to whether there will be enough investment to stem the long-term decline in ANS production, sufficient oil production to keep the unit costs of operating the Trans-Alaska Pipeline System (TAPS) at an economically viable level, and sufficient oil production to cover the operating and maintenance investment costs of operating aging production facilities. He said that answer can be yes because BP knows the oil is up there. Billions of barrels of oil that might otherwise be left behind in producing fields can be accessed. Viscous oil in and around existing

infrastructure that was discovered decades ago holds promise. Exploration near existing fields and beyond in areas like National Petroleum Reserve-Alaska (NPR-A) may have potential.

[2:27:19 PM](#)

MR. KONRAD remarked that the aforementioned is all very difficult. ANS production is declining for a reason - not for lack of oil, but for a lack of profitable ways to extract it. The totality of industry costs and taxes are high. However, BP believes that with the right technology and the right fiscal regime, these historically unprofitable investments can be made viable so industry can convert resources into production to sustain ANS infrastructure. He relayed that this is why oil taxation policy should appropriately balance risks and rewards to enable this additional investment. Even prior to this proposed tax increase, investment has been insufficient to prevent ongoing production decline. He opined that the legislature needs to very carefully consider the impacts of a very large tax increase on future investment and long-term production. He further opined that this is an important decision and it shouldn't and can't be a shortsighted decision based on next year's budget or political calculus.

[2:28:33 PM](#)

MR. KONGRAD posed the questions whether North Slope investment will increase or decrease as a result of significantly higher taxes and whether the long-term decline in oil production will increase or decrease as a result. He also asked what the "knock-on" revenue effects on royalty, State of Alaska corporate income tax, and ad valorem taxes (AVT) if investment is impacted; and whether a high tax rate at modest prices is appropriate. He discussed the evolution of PPT and the fiscal contract negotiations. Since the onset of the fiscal contract negotiations and years before, BP has sought to make clear the importance of having a competitive and durable fiscal platform for both oil and gas to underpin a massive gas investment. He stated that including both in the fiscal contract is important for two fundamental reasons among others. First, it provides confidence that the level of taxation will be competitive to enable the additional investments needed to mitigate the ongoing decline in ANS oil production, so vital infrastructure can be maintained for another 40-50 years. Second, it protects BP from after the fact tax increases on its business after a gas pipeline has been built and it has no choice but to pay and produce regardless. He noted that is what happened as TAPS

entered service some 30 years ago. He reiterated that both a competitive and durable tax regime are essential and should align well with the goals of the State of Alaska.

MR. KONRAD said that in the summer of 2005, the administration advised BP that although it respected the importance to investors of having competitive and durable rules for both oil and gas in the fiscal contract, it didn't see the ELF regime as properly suited as a long-term solution. The concern being the tax base underpinning ELF was declining with time. He explained that the concept of a PPT-type structure was proposed by the administration to fix the so-called ELF problem. BP responded that if populated with balanced numbers, PPT could be a viable long-term structure with potentially positive attributes for both the state and the industry. In this regard, BP agreed to move off its preferred position, which was to simply utilize the existing ELF-based system for the duration of the fiscal contract. At that time, the mutually agreed upon goals of both sides for PPT included: all barrels should be subject to taxation, the state should receive a balanced and proportionate share of the price/profit upside, and additional investment should be stimulated to reduce long-term production decline.

[2:32:12 PM](#)

MR. KONRAD relayed that proposals were discussed intermittently through year-end, and it was clear that there was a significant difference of opinion as to what numbers would create a balanced PPT that met these goals. During that time, the State of Alaska initially proposed and held to a 20 percent tax rate. The sponsor group had proposed a tax rate of 12.5 percent, which BP estimated would have increased State of Alaska revenues by hundreds of millions of dollars per year at current prices and tens of billions of dollars over the long term relative to ELF. BP believes that it would also have stimulated more investment, more jobs, and most critically, more long-term production.

MR. KONRAD stated that on Saturday, February 18th, following a long and, at times, difficult negotiation, BP was able to agree [with the administration] and conclude the gas portion of the fiscal contract with the state. The following day, BP made another PPT proposal for the Alaska to consider in advance of the planned executive meeting. He said that this proposal made a very substantial move towards the administration's position, while providing more support for investors at low to moderate prices, where everyone agrees Alaska investments are extremely challenged. On Monday, February 20th, the governor outlined to

BP executives his 20/20 PPT proposal. The proposal BP had made to the administration the day before was rejected. BP has agreed with the governor that it will not oppose rates and figures in the proposed PPT legislation. BP has made the extremely difficult decision to accept the governor's terms as a means to finalize a fiscal contract. BP believes that this PPT is at the far outer fringe of what should be seen as a reasonable or plausible range of outcomes. He remarked that BP also needs to be very frank with this legislature by saying upfront that it doesn't believe the 20 percent rate will maximize investment or in turn maximize long-term production. He opined that although the PPT structure has significant merit, and BP supports it, the overall size of the tax increase outweighs other benefits and goes well beyond optimum.

[2:35:11 PM](#)

CO-CHAIR RAMRAS asked what happened with TAPS 30 years ago.

TOM WILLIAMS, Alaska Tax Counsel, BP, explained that there's a list of one dozen changes that were made in the decade after the pipe was ordered in 1968 that impacted Prudhoe Bay, the pipeline, or both. He noted that the changes are published in the Anchorage Chamber of Commerce report. There was a 3 percent/4 percent severance tax and disaster severance tax that had been enacted following the flood in Fairbanks. It replaced a stepped-rate severance tax/consolidated severance tax in 1972. There was also a cents per barrel floor that was put in and a credit for state royalties on the cents per barrel floor, which had the effect of setting a floor on the combined royalty and severance tax revenues. In 1973, after there was legislation in Congress and threatened legislation in Congress about the delays over building the oil pipeline due to litigation, a special session was called by Governor Egan, in which AS 43.56 property tax was enacted. In addition, the conservation tax was enacted, the right-of-way leasing act was amended, the cents per barrel royalty credit was repealed, and the rates were changed. In 1974/1975, the severance tax was changed to say that if the sales price that someone is selling his/her oil and gas for doesn't represent the prevailing value, the department could require the tax to be paid on the basis of that prevailing value. Previously, it had been on the basis of prevailing price. Also in 1975, there was an enactment of a temporary 2-year tax on oil and gas reserves. In 1977, ELF was enacted and a tax increase replacing these tiered steps with a base rate of 12.25 percent times the ELF for oil, and a base rate of 10 percent for gas, with a slight different ELF formula for ELF.

In 1978, there was separate accounting. He added that there were also a couple of changes to the income tax, which had impacts on Prudhoe Bay. They were not directly targeted, but they did have adverse effects.

[2:38:56 PM](#)

REPRESENTATIVE BERKOWITZ inquired as to who was present at the PPT negotiations.

MR. KONRAD responded that BP, ConocoPhillips, and ExxonMobil were present at the PPT negotiations, along with the administration.

REPRESENTATIVE BERKOWITZ inquired as to whether it's BP's understanding that the legislature establishes the tax.

MR. KONRAD confirmed yes and added that it was always the intent that the legislature would endorse and approve [the tax].

REPRESENTATIVE BERKOWITZ expressed his concern in regard to Mr. Konrad's characterization of this as a negotiation.

MR. KONRAD clarified that BP was negotiating with the administration.

CO-CHAIR SAMUELS clarified that HB 488 is before the committee and the legislature will make the final determination.

[2:41:56 PM](#)

REPRESENTATIVE CRAWFORD relayed that he's not convinced that a 20/20 regime is the correct one. It seems to him that the higher the legislature makes the credit, the more incentive there is for companies to drill and produce. Therefore, he surmised that the legislature should possibly increase the credit. He said that BP stated that at 12.5 percent, the State of Alaska would maximize its tax dollars or revenue over the long term. In regard to the 12.5 percent tax rate, he noted that he'd like to see the charts that BP used to make that case during negotiations with the governor. He remarked that he wants to maximize the revenue for the State of Alaska as well as have a healthy oil industry. He reiterated that he would like to see BP's charts that exemplified how a 12.5 percent tax rate would be more beneficial than a 20 percent tax rate.

MR. KONRAD clarified that BP thought [the 12.5 percent] tax rate would maximize investment, not that it was optimum.

REPRESENTATIVE CROFT, in regard to what happened in the 1970s, explained that the State of Alaska had a tax system for Cook Inlet, which was not ready for Prudhoe Bay. He said that he keeps hearing the idea that the legislature needs to lock-in and take away the right to change the tax structure for 30 years, or some discrete period of time, because of something that happened in the 1970s. He inquired as to whether it's BP's position that changes in the 1970s created a tax regime for the pipeline that it couldn't make an adequate profit on. He added that it seems to him there has been a "pretty unbroken series" of tax concessions. He said that every time the industry has brought forward a particular instance in which a tax concession was needed, the legislature responded.

[2:47:33 PM](#)

MR. KONRAD responded that the gas pipeline is a large, risky project and that stability and risk reduction is important to that project.

REPRESENTATIVE CROFT noted that the legislature has been able to establish a tax structure which is responsible as well as to give concessions where they're needed over the last 30 years, and he believes that the legislature will be able to do so [in the future].

[2:48:31 PM](#)

REPRESENTATIVE SEATON, in regard to HB 488 pertaining to oil and gas, mentioned that he was presuming that the tax structure for ANS pipeline gas would be negotiated at a different time. He remarked that what he's hearing from BP is that even though the base tax rate of oil is 12.5 percent and the base tax rate of gas is 10 percent, in rolling gas into the PPT bill, the consideration isn't on current production of gas, rather on the future [production of gas]. He questioned whether BP is going to analyze PPT as it applies to gas production and whether it's beneficial, other than in the case of a potential pipeline.

MR. KONRAD answered that today BP plans to focus entirely on oil and added that it expects to begin debate when the fiscal contract is released in 2-3 weeks.

[2:50:13 PM](#)

REPRESENTATIVE SEATON explained that his problem with the bill is that there is a tax on both oil and gas and no one is discussing the ramifications of PPT on gas in Alaska. He expressed his concern regarding rolling gas into HB 488 without any known analysis to the committee of what the effect on the current gas industry would be. He noted that ELF for gas is different than ELF for oil.

CO-CHAIR SAMUELS interjected that Representative Seaton's question would be more appropriate for DOR.

[2:51:54 PM](#)

CO-CHAIR SAMUELS mentioned that BP only produces gas on the North Slope.

MR. KONRAD confirmed that BP only produces gas on the North Slope.

REPRESENTATIVE SEATON asked whether BP cares that current gas is in HB 488.

MR. KONRAD said BP does care that current gas is in HB 488.

REPRESENTATIVE SEATON surmised that BP is only interested in gas in relation to a future contract, not in the current gas production.

MR. KONRAD corrected that BP is interested in all of it because of the common goal.

CO-CHAIR SAMUELS added that BP's gas tax structure will be in a contract.

MR. KONRAD further added that it's also important that the industry be successful because BP is designing a project that's dependent on a third of its throughput from gas that hasn't yet been found and developed.

[2:53:25 PM](#)

REPRESENTATIVE ROKEBERG mentioned that as a member of the Anchorage business community in the 1960s and 1970s, there was significant discussion regarding the lack of stability of petroleum taxes at that time. He added that other factors

included: stop and start, ability to move forward on TAPS, typical oil patch problems, and volatility of prices.

[2:55:09 PM](#)

CO-CHAIR SAMUELS requested that Mr. Konrad state BP's position on the connectivity between [HB 488] and the gas contract, realizing that the legislature could pass [HB 488] and vote no on connectivity. The legislature could also pass [HB 488], vote yes on connectivity, and no on the gas pipeline contract because it doesn't like that particular contract.

[2:56:37 PM](#)

MR. KONRAD informed the committee that BP supports full review of anything related to the fiscal contract by the administration, full legislature, the people of Alaska, and the court systems. He remarked that has nothing to do with fiscal stability, rather being competitive and attracting investment for 40 more years. Because this is a large, quite risky, and low return investment, BP is trying to reduce the risks and fiscal stability of its payments is important in allowing the project to advance.

REPRESENTATIVE CRAWFORD inquired as to how HB 488 will affect gas.

CO-CHAIR SAMUELS asked BP's view if there isn't a gasline.

[2:59:49 PM](#)

MR. KONRAD, in response to Representative Crawford, informed the committee that BP doesn't have gas in Cook Inlet or Nenana.

CO-CHAIR SAMUELS asked what BP's view would be on the language on gas in HB488 if a liquified natural gas (LNG) line or third party pipeline were proposed.

MR. KONRAD said BP hasn't looked at it through that lens.

[3:01:32 PM](#)

ANGUS WALKER, Commercial Vice President, BP Alaska, noted that BP only has leases on the North Slope and in the Beaufort Sea. He referred to slide 1, a profile of historical production from 1977 through 2005. The North Slope has produced over 15 billion barrels of oil to date, and while BP looks back with envy at the

days of peak production, it is clear that the business today is very different than it was 20 years ago. He stated that to date, BP has invested \$24 billion to create the Alaska business existing today. BP has paid over \$32 billion of tax to the State of Alaska and \$24 billion of tax to the federal government. In total, BP estimates that the North Slope participants have generated \$120 billion in taxes for the State of Alaska and the federal government since first production in 1977. In addition, as an industry, more than 34,000 jobs are generated in Alaska every year.

[3:05:43 PM](#)

REPRESENTATIVE BERKOWITZ inquired as to how much profit BP has made during that time period.

MR. WALKER responded that he doesn't have that number [with him], but would be able to make it available.

[3:06:05 PM](#)

MR. WALKER continued that the harsh reality is that since production peaked in 1988, production has declined at an average of 6 percent. He noted that natural decline of these fields is around 15 percent. The industry has managed to stem decline to, on average, 6 percent over the last ten years by investing \$1-\$1.5 billion per year in the North Slope [oil and gas] business. He stated that ELF has worked as intended. Many of the smaller fields on the North Slope would not have been developed without ELF. While not all of this production pays production tax, it all pays property tax and royalty and state income tax. He remarked that ELF has and continues to encourage investment in these small or less productive fields, and has played a significant role in stemming overall North Slope decline. However, BP recognizes that ELF was designed as a surrogate for profitability and while it has been effective, it is not perfect in today's price environment. It is for that reason that BP is supportive of adopting the PPT structure proposed by the administration.

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MR. WALKER relayed that one of the most important issues for the committee to consider is the impact PPT will have on the decline of the Alaska North Slope. He referred to slide 2 from Roger Marks' presentation last week. He explained that it shows two forecasts of future production - the lower blue forecast

represents a future without gas and the upper pink line represents a future where the oil business is revitalized by gas. In response to Representative Croft, he clarified that the blue line is without a gas line.

CO-CHAIR SAMUELS added that doesn't include the barrels of oil equivalent (BOE), just the excess oil stimulated through gas exploration and development.

MR. WALKER confirmed that Co-Chair Samuels was correct and added that he is referring to oil only.

[3:09:07 PM](#)

MR. WALKER, in regard to what it will take to keep the oil business healthy, said the simple answer is to stem decline. He explained that the black line on slide 3 displays the history of North Slope production and the colored lines look forward to the future. With no investment, the natural decline of the fields would be the lower red line and within 10 years, the business would be gone. In response to Representative Croft, he further explained that the slide represents the North Slope in totality. The production is gross production on the North Slope and the investments are gross investments by industry.

[3:11:24 PM](#)

MR. WALKER mentioned that the green line assumes that [the industry] carries on investing at the rate it is currently investing, which is \$1-\$1.5 billion per year and the decline continues along the same historic trend. [The industry] has declined at an average of 6 percent per year for the last 15 years. He added that there's no reason to believe that wouldn't be the same story in the future with the same investment into the industry. In that scenario, the industry has a life out to 2025, which he noted is not long enough to support a gas pipeline project. In order to support the gas pipeline project, he said that the oil business needs to be healthy and the life of the oil business has to be extended for as long as possible - at least until 2050. The oil industry would need to stem decline of the North Slope to an average of 3 percent per year, which BP estimates would require \$2-\$3 billion of capital - or twice the capital that's currently being invested. In response to Representative Guttenberg, he clarified that the assumption in the case of the red line/zero investment line is that there are no new oil fields; in the case of the 3 and 6 percent decline lines, with higher investments, that oil will either

come from the existing fields, or it may come from new oil fields.

[3:13:47 PM](#)

MR. WALKER relayed that BP shares the challenge of keeping Alaska competitive and believes that Alaska's part is to maintain stability and keep it attractive to investors, while the industry's part is to provide technology, innovation, and investment. In BP's opinion, the tax regime the legislature approves will directly impact how attractive Alaska is and what the future decline will be. He opined that it's in the interest of all that Alaska focus on growing the pie, rather than taking an increasing share of a declining pie. In response to the question, where will the industry find all this oil to stem decline, he said Alaska has a huge resource base. To date, BP has produced 15 billion barrels, but there are 17.5 billion barrels remaining that it's aware of. The remaining 14 billion barrels consist of: 3.5 billion barrels of light oil in the existing reservoirs, 1 billion barrels of viscous oil which BP has started to produce, 3 billion barrels of heavy oil lying in shallow formations below the permafrost, and 6 billion barrels of gas which BP is working "so hard" to get to market.

[3:15:34 PM](#)

CO-CHAIR SAMUELS added that currently in the bill, there isn't an exclusion or extra tax credit for heavy oil. He explained that in Alaska, there is a method for royalty reduction negotiations. He said that instead of talking about a different tax/cost recovery method for heavy oil, where there already is a royalty reduction, and realizing that the chances of making a profit are smaller, the State of Alaska wants to incentivize that through a royalty reduction, rather than going through the battle of cost-shifting back and forth and a constant fight between the industry and the State of Alaska. He asked, "Do you think that's a realistic "big picture" view of how [the State of Alaska] could incentivize the heavy oil development through royalty reduction, rather than cost recovery?"

[3:17:12 PM](#)

MR. WALKER responded that BP considered very long and hard about whether there should be a separate credit for viscous heavy oil versus conventional activity, and it recommended very strongly to the administration that that be the case. He opined that all of the work of the analysts has shown that heavy and viscous

oils are very difficult to produce and need extra help. Having different levels of credit would work because it has very capable processes in place for tracking where it spends capital. In regard to royalty relief, he stated that many countries are introducing either royalty abolition or royalty reduction where they want to stimulate activity on an enduring basis. As a result, investors can make large investments, knowing what the rules are for the future. He said, "Absolutely, if you could find a way of changing royalty and make that enduring, then it would be a very effective thing to do."

[3:18:42 PM](#)

MR. WALKER continued that the scale of this known resource greatly exceeds that expected from future exploration. Future discoveries are expected to be of the order of 50-150 million barrels. He noted that it's not to say that exploration should stop, rather exploration to stem the decline of the North Slope can't be relied upon. While BP isn't exploring in the conventional sense, it is adding barrels. BP is not only looking to develop its share of the 1.75 billion barrels, but it's also looking to make it even bigger. Every time BP increases the recovery efficiency by just 1 percent, it accesses an additional 600 million barrels. He noted that every 1 percent is equivalent to another Alpine.

[3:19:50 PM](#)

REPRESENTATIVE CROFT asked what Mr. Walker meant when he said that BP is not exploring in the traditional sense.

MR. WALKER answered that BP is exploring in the sense that it's spending large amounts of its capital applying innovative technologies within the boundaries of the field which it currently operates. He added that some of these technologies are risky. For example, the \$100 million BP is going to spend at Endicott on its innovative EOR program. If it works, BP could apply that across the whole of the North Slope.

REPRESENTATIVE CROFT stated that a tax regime has a particular effect on the level of investment. Expanding the exploration in the summer or a reduction in the TAPS tariff would have as much impact, particularly those two combined, as a change in the tax structure. He said tax structure isn't the only thing that moves the legislature along those lines - there's significant things that the legislature can do in terms of regulations or in terms of the cost of bringing the oil to market.

3:21:59 PM

MR. WALKER remarked that at the end of the day, BP needs to get more barrels through the pipeline and whatever it can do to do so helps. Some of that is going to come from exploration, but the United States Geological Survey (USGS), on every resource assessment that BP has seen, says that it doesn't have the big exploration prospects or fields left to be found in Alaska. Therefore, the explorers will be finding things, and BP hopes they find things because it wants them to fill up TAPS. He added that BP wants them to keep as much oil going through the system as possible. He further added that the harsh reality is that BP can't rely on exploration, but it will help.

REPRESENTATIVE CROFT inquired as to whether reducing the TAPS tariff would help fill the [pipe]line.

MR. WALKER said the TAPS tariff is set by the tax settlement methodology (TSM) and reflects the costs of running TAPS.

REPRESENTATIVE CROFT asked whether a reduction would help spur innovation.

MR. WALKER surmised that it would, theoretically, if that was the appropriate thing to do.

3:23:09 PM

REPRESENTATIVE GARA stated that Mr. Walker talked about the possibility of a different tax on heavy oil than regular oil and the way the proposal is currently structured, it's the same tax regardless of whether the oil is heavy or light. He asked, "What would you say about a system that taxed conventional oil a little bit higher than is being proposed, but then had a special, lower tax for harder to develop fields and heavy oil?"

MR. WALKER acknowledged that there are many other structures that could be thought of and BP is open to consider those.

REPRESENTATIVE GARA mentioned that he's heard generalizations regarding the price of oil which is necessary to make heavy oil commercially viable. Acknowledging that it's different from field to field, he requested a "general thumbnail" of the price at which BP believes that heavy oil production on the North Slope would be profitable.

MR. WALKER responded that it's very different from field to field. He surmised that Pedro van Meurs' analysis showed that the point at which one can make heavy oil economic is significantly higher than it is for conventional oil because of the course and flow rates involved.

[3:25:04 PM](#)

CO-CHAIR SAMUELS asked what BP thought would be the most efficient way, if it was cost neutral, to avoid the litigation and the constant conflict between the State of Alaska and industry, if the legislature wanted to incentivize heavy oil.

MR. WALKER answered something that is clear and durable. The abolition of royalty would be clear, durable, and easy to administer. As soon as complexities are introduced, the systems have to be designed to match. He opined that systems can be managed where costs for different fields are being tracked in order that the credit system BP proposed would be the next easiest thing to administer, and the final complexity would be having different tax rates for different fields. He clarified the order - royalty abolition, then differential credits, then different tax rates. He acknowledged the importance of something that genuinely stimulates investment.

[3:26:56 PM](#)

REPRESENTATIVE ROKEBERG opined that it's time for the legislature to negotiate with the producers. He expressed his interest in a proposal that would increase the tax rate as a matter of progressivity on the high side, and to raise tax incentives for viscous oil, heavy oil, and frontier exploration. He asked, "Could we not balance that by keeping within the same structure?" He added that therefore, there's a linkage between any tax increase with a credit increase outside the realm of royalty reduction because those wouldn't be in the same specific area of taxation. He further asked, "Should we balance it within this bill?"

[3:28:30 PM](#)

MR. WALKER replied that there are many levers in [HB 488] and the governor's proposal sets all of the levers in a certain place. He mentioned that it's important that it's balanced and there is an enduring tax system that is able to offer the appropriate compensation for those who take a risk by investing in the industry.

[3:29:26 PM](#)

REPRESENTATIVE CRAWFORD, in regard to enduring, attempted to clarify whether Mr. Walker is referring to the ceiling and not the floor on taxes.

MR. WALKER said that it's within [the legislature's] purview to offer incentives to stimulate any particular activity.

[3:30:08 PM](#)

MR. WALKER informed the committee that to develop the 14 billion barrels that BP knows about would require well in excess of \$100 billion. He noted that kind of investment can only come from the major oil companies of the world. He said:

It thus mystifies us why so much of the testimony given to this committee by Pedro van Meurs focused on the impact of PPT on new entrants when the future of the North Slope is dependent on making Alaska attractive to major oil companies.

MR. WALKER concluded that this is the reality of the industry, the 6 percent decline, and the large capital investments that the industry is going to have to make to stem that decline.

[3:31:18 PM](#)

REPRESENTATIVE GATTO, in response to \$100 billion to [develop] 14 billion barrels, surmised that the first barrel would be a lot cheaper than the last barrel, and that BP has no intention of getting the very last barrel, which he said could easily cost \$1 million. He asked, "In your estimate of that 14 billion remaining, how much is a reasonable amount to get out before you just give up?"

[3:31:48 PM](#)

MR. WALKER clarified that the \$100 million is a "headline" number. He said BP doesn't know what it will take and whether it's even possible to produce some of that oil. With a 3 percent decline to 2050, BP would produce 7.5 billion barrels of the 17.5 [billion barrels] left.

REPRESENTATIVE GATTO remarked that the other oil, not classified as heavy, but solid, that exists on top is an enormous resource.

He asked, "Is there anything that you have/that anyone has even suggested as a way to tap into that, prior to the time when you simply exhausted your presence in Prudhoe Bay?"

[3:33:06 PM](#)

MR. WALKER acknowledged that is a huge challenge to develop that very heavy, solid oil. He noted that BP has a team of people working collaboratively across the industry. [The team] is looking at all of the technologies that have been applied in Venezuela and Canada. He added that over the next 10 years, BP is going to conduct a series of pilots on the North Slope in order to test which technology is appropriate for the North Slope for implementation in an Arctic environment and the kinds of reservoirs in Alaska. After that period of trials, BP hopes to have identified the technology and the way it can apply it to exploit that resource base. He noted that's a huge resource base - 20 billion barrels in place. At the moment, BP is assuming up to 15 percent recovery. If one is able to get 25 percent of it, that would be an extra 2 billion barrels.

[3:34:11 PM](#)

REPRESENTATIVE GARA stated that over the last few years, according to State of Alaska projections, as oil has gone from \$20 per barrel to \$60 per barrel, profits have increased six fold on the North Slope from approximately \$1 billion to \$7 billion this year. That hasn't affected the major producers' investment decisions in a similar way - investments haven't increased as much as profits have. He asked, "What can you tell us about why they're giving you \$73 million tax-free under this proposed bill, and whether that \$73 million in profit that we give you tax-free will lead to increased investment given the track record?"

MR. WALKER said that the \$73 million has not been put in HB 488 for [BP's] benefit. He said, "We don't like it." He elaborated that the \$73 million provision creates an uneven playing field for the incremental investments that BP makes versus the incremental investments that a small company would make.

REPRESENTATIVE GARA said that the additional money BP has received in the past few years hasn't increased its investment substantially. He asked whether he is reasonable in assuming that offering \$73 million tax-free in profit won't lead to a substantial increase in investment.

MR. WALKER informed the committee that the inclusion of the \$73 million will make no difference to BP's investments in Alaska. He added that the structure of the tax, the ultimate structure of the fiscal regime, will make a difference in its investments and the industry as a whole.

[3:36:53 PM](#)

REPRESENTATIVE BERKOWITZ mentioned his assumption that BP has conducted an analysis as to the optimal incentive. He asked, "If taxes decreased to zero, would you be able to tell me that all kinds of development would happen in Alaska?" He said, "Or if the taxes increased to 100 percent, I'm sure you'd say everything would stop and there's a continuum along these." He expressed his curiosity in regard to what that continuum resembles for BP.

MR. WALKER responded that it's too difficult because BP is unable inform [the legislature] as to the correct structure - where the tipping point is when BP gets exactly the correct balance between industry take and state take to stimulate the future that BP desires. He added that large increases in taxes won't attract large increases in investment in Alaska.

REPRESENTATIVE BERKOWITZ inquired as to whether it would be less true if they are masked with large increases in tax incentives for investment/exploration development.

MR. WALKER replied that BP looks at the package as a whole - the increase in tax with the benefit that it would get for investing. He noted that BP is currently investing between \$600-\$700 million per year, and \$450 million of that is in the upstream, thus it would benefit from this credit. He relayed that BP takes that into account when it calculates its tax.

REPRESENTATIVE BERKOWITZ expressed his frustration regarding the lack of information provided for the legislature. He relayed that the legislature doesn't know whether a 15, 20, 25, 30, or 50 percent tax incentive makes a difference.

MR. WALKER responded that BP doesn't know what the balance point is. He mentioned that the core principle is that if taxes are increased, there will be a reduction in investment because Alaska will be less competitive.

[3:40:07 PM](#)

REPRESENTATIVE BERKOWITZ, in regard to the percent of market value, described the "mother of all models," which is a combination of probability and outcome determination. He relayed that it seems to him that when the legislature is discussing billions of dollars, that somewhere someone has run that kind of modeling. He expressed his skepticism in regard to that kind of modeling not being made available to the legislature, which makes him question a lot of the assumptions that are being put forward.

MR. WALKER relayed that BP is able to model the impact on its business with certain development scenarios. He referred to DOR's production curves, in which it has modeled four different cases for different outcomes, depending on the amount of resource that's developed. He added that BP can't predict the link between the fiscal regime, the resource, and the investment made, but there's definitely a link - it's cause-and-effect.

[3:41:45 PM](#)

REPRESENTATIVE BERKOWITZ, in regard to investment decisions, commented that the parameters seem to revolve around market conditions, cost of extraction, and the fiscal regime. The focus that the legislature has had in the hearings thus far has solely been on the fiscal component of it. He said that the cost component of extracting Alaska's resource will decrease in part because the TAPS settlement is going to be restructured shortly. He noted that there is also a significant change in the market - there's no longer highs of \$30 [per barrel], rather lows of \$30 [per barrel] are being projected. He opined that in that new regime, there should be a greater impact on investment decisions and whatever "tinkering" around the legislature might do with the tax rates on the margin in the severance tax. He expressed his wish that there'd be more attention paid to that component of BP's investment decisions, rather than solely making it seem as if the legislature "tinkers" with 5 or 10 percent on the severance tax.

MR. WALKER corrected that the legislature isn't "tinkering" with it, rather doubling it, and even tripling it if BP were not to invest. It's a significant increase in tax and the burden on the industry. He reiterated that he is unable to inform the committee as to what the link is between the increase in tax and BP's investment, or the tax reduction and what it does to the investment, but assured the committee that there's a link.

[3:43:43 PM](#)

CO-CHAIR SAMUELS commented that Mr. Walker is correct in saying that the legislature is considering, depending on what the effective tax rate is, doubling or tripling it, depending on the investment level. He clarified that the total government take is not being doubled or tripled, it's 5-10 percent and the legislature is only tweaking one component.

[3:44:57 PM](#)

CO-CHAIR RAMRAS asked what the severance tax rate is that BP pays when it aggregates its Alaska oil fields.

MR. WALKER answered that it's currently 5.5 percent. He noted that under the 20/20 provision, it would increase to 13.2 percent. If BP chose not to invest capital in that year, then it would be 17 percent.

CO-CHAIR RAMRAS further asked, "If you chose not to invest any capital, why wouldn't it be 20 percent?"

MR. WALKER answered because BP receives deductions for operating expenses.

[3:46:11 PM](#)

REPRESENTATIVE BERKOWITZ remarked that the operating expenses are currently deductible under the corporate income tax. The deductible under the federal income tax is the basis for BP's state corporate income tax, and then there's another subsequent opportunity to deduct the operating expenses again.

MR. WILLIAMS explained that it's a different tax. BP deducts its expenses for state income tax and federal income tax purposes - two different taxes. If one is taxing a net income or profit, then in order to calculate that, one has to look at what the expenses are. He remarked that if as a philosophical matter, that's unacceptable, this structure isn't a good one to be pursuing. He added that it's a function of the structure of the proposal before the committee - it's on net value, not on gross value. The ELF was the gross value approach in attempt to deal with rising costs over time. The PPT structure attempts to deal with rising costs directly by subtracting them out. He noted that it's the standard of measure that the legislature chooses to use on which its going to levy the tax.

[3:47:40 PM](#)

MR. WALKER, in response to Representative Seaton, explained that the pink on slide 5 is the assumption that once a gas pipeline is built, BP will want to fill its capacity in it. He added that is yet to find gas. He noted that slide 5, "A 50 year vision," is the graphic BP uses when it describes its vision for its business in Alaska. It displays BP's net production from the Alaska North Slope from 1977 to what it hopes it will be out to 2050. He said that the future will be very different than the past with three businesses - light oil, viscous/heavy oil, and gas - built on top of each other, all of which must be healthy. He noted that in the past, there was only one business - the light oil business.

[3:49:55 PM](#)

CO-CHAIR RAMRAS requested that Mr. Walker explain how the transition provision is strategic in this 50-year vision.

MR. WALKER responded that the transition provisions in the PPT bill aren't strategic over a vision for 50 years. The transition provisions are a recognition of the very significant increase in tax that the PPT bill represents, and a compensation for the fact that BP had made some very large investments.

CO-CHAIR RAMRAS inquired as to whether Mr. Walker would be able to quantify how much that was over the last five years.

MR. WALKER replied that over the last five years, BP has spent \$3.5 billion, \$2.4 billion of which was in the upstream business and therefore, would carry forward from the transition provisions which are in the bill.

[3:51:21 PM](#)

REPRESENTATIVE BERKOWITZ, in regard to the \$2.4 billion, questioned whether any of it has been accommodated under the ELF structure. He noted that some of that \$2.4 billion is five years old and has had five years of benefiting from ELF. He opined that there should be some "laddering".

MR. WALKER clarified that the five years is a recognition of the significance of the tax increase and with BP having made major investments, it softens the "blow" of it. He noted that it's part of the package which was negotiated with the governor.

REPRESENTATIVE GARA commented that it's his position that in the past five years, BP has benefited financially from [the legislature's] decision to under-tax its oil. He suggested that Mr. Walker explain how [the five years] isn't a second benefit.

MR. WALKER informed the committee that BP doesn't make any profit at low [oil] prices. At \$20 [per barrel], BP makes zero profit. BP is in Alaska because in the "good years" it makes a decent profit. He relayed that BP has to have a few "good years" to compensate for the "lean years."

[3:53:51 PM](#)

REPRESENTATIVE CROFT described his conception that in the decline of major oil fields, independents become more important. He asked, "Why am I mistaken about that for Prudhoe Bay?" He opined that the paradigm should be one in which the major companies hand off their big finds in order that the independent companies exploit it.

[3:54:41 PM](#)

MR. WALKER acknowledged Alaska's huge resource base, which is yet to be exploited. BP's conviction that Alaska needs major oil companies is due to the scale of the investments and the technological challenge, in order to fully exploit the resource base. He added that it's not to say that the independent/small companies are not important. They have a real role to play and will do things which BP won't focus on - like exploring for these small [oil] fields which are yet to be discovered. In further response to Representative Croft, he relayed that BP is on the verge of some major investments. He said, "You could almost say the basin is going to recreate itself on the back of viscous oil and gas." He noted that the normal life cycle of a basin is not "playing out" on the North Slope.

[3:56:18 PM](#)

MR. WALKER mentioned that once the [gas] pipeline is built, it will be BP's intention to keep its share of the pipe full. He clarified that the shaded portion of slide 5 represents the gas it would take to fill up the pipeline.

REPRESENTATIVE LEDOUX, in regard BP not making a profit at \$20 per barrel, asked if [HB 488] was in effect, at \$20 per barrel, whether the State of Alaska would receive any revenue.

MR. WALKER replied that under the current system, at low [oil prices] BP still pays royalty, corporate income, property, and production taxes. Therefore, at low [oil] prices, BP still pays considerable revenues to the State of Alaska and the federal government, regardless of whether it is making a profit.

REPRESENTATIVE LEDOUX asked, "What about under this new PPT at \$20 per barrel?"

MR. WALKER answered that at \$20 per barrel, BP would make a small profit. The nature of that change is that at low prices, the State of Alaska receives slightly less and BP makes a small profit, estimated to be approximately 5 percent of the total take. When the legislature moves from \$20 per barrel at the status quo to the PPT, BP will actually make a small profit.

REPRESENTATIVE LEDOUX asked, "At \$20 per barrel, is the State of Alaska better off under the current system, or better off under this new PPT?"

MR. WALKER responded that at \$20 per barrel, the State of Alaska would get more revenue under the current system. He surmised that a well-constructed profit-based tax would be better for the State of Alaska in the long term to stimulate investment and activity.

[3:58:45 PM](#)

REPRESENTATIVE SEATON commented that BP's graph displayed 25/50 as the crossover point at which the State of Alaska is taking more on the production tax side under ELF than it would under PPT. He continued that if the legislature remained at DOR's long-time projection and with the 5-year clawback provision, the State of Alaska would not only be receiving less [money], but would actually be paying \$170 million per year in tax credits.

[3:59:45 PM](#)

CO-CHAIR RAMRAS explained that BP isn't allowed to receive the credit when the price of oil falls below \$40 per barrel.

MR. WALKER confirmed that Co-Chair Ramras is correct. The transition credit wouldn't be available until the price of oil was above [\$40 per barrel].

REPRESENTATIVE GATTO inquired as to whether the clawback provision is eliminated if the price of oil remains above \$40 per barrel for the next five years.

MR. WALKER explained that the bill is structure in a way such that if the price of oil is above \$40 per barrel, on average through the year, then BP will receive the benefit of the transition credit. If the price of oil is below \$40 per barrel, then that credit rolls forward to a future year in which the price of oil is high.

CO-CHAIR RAMRAS suggested that BP "rethink it" and added that it reads poorly.

[4:01:11 PM](#)

MR. WALKER responded that it was a result of a negotiated outcome. BP's early proposals to the administration didn't have any transitions provisions in them because the headline tax rate was more reasonable - 12.5 percent. He continued that BP faces enormous challenges in creating this future, and attractive and stable fiscal terms are key in making this happen; without it BP's vision will not come true.

[4:01:56 PM](#)

RAYMOND HALL, Senior Tax Economist, BP Group, opined that when fiscal regimes are being compared, it's important to focus on the basin in context. For example, how mature the basin is, the cost structure that prevails in the basin, what the geology looks like, how big and risky the prospects are, whether there's infrastructure in the basin, and how close it is to markets. He remarked that as a general rule, one can make the observation that a high tax burden will generally equate to lower investment levels and conversely, a lower tax rate will generally equate to higher investment levels. He relayed that BP is looking to see whether the regime is equitable for both the investors and the government. BP is also looking to see whether the regime is simple to understand and administer. He noted that most countries don't score very well on the simplicity criteria. He said that Alaska has a fairly complex "cocktail of taxes." Removing ELF and replacing it with the proposed PPT is a move in the general direction of improved simplicity.

[4:07:04 PM](#)

CO-CHAIR SAMUELS, in regard to the allocation of overhead and cost recovery, asked, "Do you think that we invite a lot of litigation down the road?" He further asked, "How do you mitigate that under the context of you want the plan to be simple and understandable?"

[4:07:44 PM](#)

MR. WILLIAMS replied that one of the things that mitigates it is that the wheel has already been invented in this area. BP is the operator of Prudhoe Bay and incurs expenditures on behalf of itself and its partners operating the unit. BP bills those out to its partners and doesn't have a license from its partners to spend their money. Things like that don't show up in those joint venture billings to BP's partners. There's a set of accounting rules which have been agreed upon for the Prudhoe Bay operating unit regarding what goes in and out. He said this legislation allows flexibility for DOR to examine those rules.

CO-CHAIR SAMUELS inquired as to whether the State of Alaska would be able to access those audits.

MR. WILLIAMS explained that the legislation grants [DOR] the authority to ensure that the audit system is as it's represented among the partners, and also is working as it's intended. The [DOR] also has the authority to deal with situations in which there may be partners, but they're not substantial enough for it to be in their economic interest to incur the cost of an audit.

[4:11:43 PM](#)

CO-CHAIR SAMUELS relayed that he's been approached by some who want to have more in statute and some who want to have more in regulation. He asked, "What would be your view as far as the rules on cost and overhead allocation?"

MR. WILLIAMS informed the committee that there are operating agreements. He mentioned that there's also the Council of Petroleum Accountants Societies (COPAS), which is a set of accounting principles for billing between partners.

[4:13:00 PM](#)

CO-CHAIR SAMUELS expressed his concern regarding the possibility of COPAS in statute, and if/when the [principles] are changed, [the legislature] would have to return to the process yet again.

MR. WILLIAMS relayed that the objective is as much certainty as possible in order that the tax functions as the State of Alaska expects, and the industry is aware of what it owes and is able to calculate it correctly. He remarked that the problem with being simple is that this is a tax of general application. He noted that this is aiming to attract new [investors] to Alaska.

REPRESENTATIVE BERKOWITZ mentioned that [the legislature] immediately assumed that it had to go in a PPT direction. He further mentioned that he hasn't heard much discussion as to whether that's the only course the legislature could take, or whether there are better courses. He asked, "Do increases in the corporate income tax make sense? Are there other options?"

[4:16:01 PM](#)

MR. WALKER responded that there are a number of different options that [the legislature] could look at in terms of changing [the State of Alaska's] fiscal regime. He opined that the key issue is how to stimulate investment on Alaska's North Slope to mitigate the historical decline. He added that PPT, with the structure that was presented by the administration, could work very well for Alaska over the long term, granted [the legislature] "gets the numbers right." He said, "It's a well-considered proposal, it's a well-considered structure and we believe it would work, provided that the numbers are right."

REPRESENTATIVE GARA mentioned that BP has chosen to compare [the State of Alaska] to one regime that taxes at a higher rate, Norway, and four regimes that tax at a lower rate. He relayed his understanding that most places with substantial reserves of oil have a 60 percent or higher tax rate. He asked for examples of "bigger oil-producing places" which have a higher than 60 percent rate. He further asked, "Can you tell us why you've chosen not to compare Alaska to the places with higher taxes?"

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MR. HALL explained that his presentation is based on comparing tax and royalty regimes in which the basin is at a similar stage in its life cycle. He note that Alaska started out in the 1970s, similar to Norway and the U.K. To that extent, [Norway and the U.K.] are comparable and all three of these basins have already entered a decline, a mature phase. He further noted that a production-sharing contract regime has different dynamics. For example, the overall level of take is quite low, and a lot lower than Alaska. Conversely, at high [oil] prices,

the take may well be higher. He mentioned other factors including the cost structure and the size of the resource.

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MR. WALKER added that BP was conscious of Pedro van Meurs' report as he chose Norway and the U.K. as the two boundary conditions for his analysis. He opined that it's appropriate that BP focuses on the same regimes.

REPRESENTATIVE GARA expressed his concern regarding comparisons being made to places in which the taxes are lower and not to places in which the taxes are higher. He opined that it's creating the impression that [the legislature] is adopting a very high tax, rather than adopting a very low tax in comparison to many other places [the committee] is not discussing.

MR. WALKER replied that it's certainly BP's opinion that [the legislature] is adopting a high tax for the resources on the Alaska North Slope.

[4:21:06 PM](#)

MR. HALL discussed the principles of a fiscal regime designed for profit, in which the preference is to see taxes levied on profits, rather than on revenues. He mentioned the changes BP has seen in a number of mature basins, in which taxing has moved away from revenues/royalties to exclusively profits. He remarked that competitive is probably the most important attribute. In designing a fiscal regime, one must ensure that the regime reflects the realities of the basin including: cost structure, level of maturity, what the exploration resembles, whether one is able to make discoveries and whether they will be small, whether it's high or low risk, whether it requires new technology or whether it can be done with conventional technology. Therefore, there's a whole range of factors that need to be considered in assessing whether the basin is competitive. He noted that there are hundreds of different fiscal regimes around the world and there is no one regime that's best for all circumstances.

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MR. HALL explained a chart which ranks the leading oil and gas producers around the world in 2004. The U.S. is number two in the world, while Norway is number six, and the U.K. is number nine. Therefore, these are very important basins in terms of

production of both oil and gas. He noted that the Lower 48 is still a massive producing province on a global basis. In regard to the marginal tax rates which apply in these basins, he informed the committee that there is a marginal tax rate of 45 percent in the Gulf of Mexico and 50 percent in the U.K.

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REPRESENTATIVE GARA expressed his understanding that in some of these countries, the oil is privately owned and one pays an additional portion to the private owner. He asked, "For the countries where the oil is privately owned and you're making a private payment, is that included in the rate?"

MR. HALL replied that it's included in the rate, but there's virtually no privately-owned petroleum in the U.K. or Norway. He said that under the current ELF regime, Alaska's tax rate is 56 percent, and the proposed PPT would increase its tax rate to 61 percent. Norway's tax rate is 78 percent. He relayed that the manner in which capital is treated and depreciation operates also needs to be considered. For example, in the U.K., a company receives 100 percent relief from its investment as it spends it. For a new project in the U.K., a company won't pay any tax until that project has achieved payback on the investment. He noted that Norway provides uplift of 30 percent.

REPRESENTATIVE BERKOWITZ expressed his understanding that production rates in the U.K. and Norway are in decline, despite these massive incentives for investment. He opined that incentives for large-scale projects are of minimal utility in creating investment.

MR. HALL relayed that in his experience, the simplest way to incentivize investment is by means of a low tax rate. He commented that a low headline tax rate predominantly attracts investment. He noted that there has been a trend in mature basins away from taxes on revenues to taxes on profits. When the U.K. started in the 1960s, there was a royalty with a rate of 12.5 percent which applied to all production. That was progressively abolished for new developments in 1983 and for all developments in 2003. Similarly in Norway, there was a royalty rate ranging from 8 to 16 percent. That was abolished for new developments in 1986, on all gas production in 1992, and will be phased out for all oil fields by the end of this year. He mentioned that there are provisions to exempt the Gulf of Mexico's production in deep water from royalty. It applies up to the first 88 million barrels of cumulative production.

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REPRESENTATIVE BERKOWITZ, referring to recent controversy regarding short payment of royalties in the Lower 48, asked whether that would affect these numbers.

REPRESENTATIVE GARA asked, "Aren't these places that you're comparing us to much more mature than Alaska is?"

MR. HALL contended that they'd straddle Alaska. He remarked that Norway is probably significantly less mature than Alaska and the U.K. is at an equivalent state of maturity. There is still significant offshore exploration potential left in the U.K., on the order of 9 billion BOE. In Norway, the exploration potential is significantly greater than that, on the order of 20 billion BOE. He noted that there are large parts of Norway that are yet to be explored.

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MR. HALL, in regard to the U.K. production profile, explained that there was an initial peak in the early 1980s, followed by decline and a second peak in the 1990s. Government policy in the U.K. has always been focused on trying to ensure that the basin is self-sufficient - all the requirements to consume oil and gas are met by domestic consumption. The real challenge the basin currently faces is that it's likely that the U.K. will become a major importer of oil and gas in the years ahead. He relayed that the overall direction of policy has been to maximize recovery and encourage exploration and as many players into the basin as possible. He noted that the U.K. has 142 licensees. The resource ownership is spread amongst a large number of players.

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MR. HALL stated that the U.K. has been very successful in attracting exploration activity. During the mid to late 1990s, there were more exploration and appraisal dollars spent in the U.K. than virtually any other basin in the world. It has subsequently fallen due in part to a tax increase in 2002. The U.K. attracts a disproportionate amount of exploration activity "on the back of" an attractive and appropriate fiscal regime. He explained that there was a very significant fiscal reform in 1993, which reduced the marginal tax rate from an excessive 80 percent to 30 percent, enduring for approximately 10 years. For

that 10-year period, the tax regime for oil and gas producers was exactly the same as the tax regime for any other part of British industry. He stated that this tax regime led to a dramatic increase in investment in the basin and production.

[4:35:19 PM](#)

CO-CHAIR SAMUELS observed that the upper trend started earlier and asked whether there were other factors involved.

MR. HALL responded that it's very difficult to say what the evolution of the production would have been had the tax not changed, but there's a great deal of anecdotal evidence from the major producers and the new entrants that came into the basin, citing the tax change as the principle enabling factor leading to their dramatic increase in investment in the basin.

[4:37:00 PM](#)

CO-CHAIR SAMUELS asked whether the U.K., in addition to decreasing the tax rate, provided incentives in the five-year period between 1989 and 1994.

MR. HALL responded that when this change occurred in 1993, essentially all incentives were swept away for new investment and projects. It was the tax regime that applied to any other industry.

CO-CHAIR SAMUELS remarked that in PPT, [the legislature] is examining the tradable tax credits. He noted that as the tax rate dropped in the U.K., it also had incentives.

[4:38:22 PM](#)

MR. HALL responded that for a new entrant in the basin in the U.K. in the 1990s, there were no specific incentives that came along without investment. There was simply a very low tax rate of 30 percent.

REPRESENTATIVE BERKOWITZ inquired as to whether there was anything else happening in the early 1990s that would have affected exploration and production.

MR. HALL responded that there was a continuous profile of activity. He noted that there was the Piper Alpher disaster in the North Sea in 1988, which led to a significant focus on

safety. As a result, the focus on new developments was diluted during that time period.

[4:39:33 PM](#)

REPRESENTATIVE BERKOWITZ asked, "If you were to draw that line backwards prior to 1985, would the slope of the line, aside from that dip that happened as a result of the environmental problems, would that be more linear?" He surmised that the dip at that point was a deviation from where events would have gone and that there was a factor that brought the production down.

MR. HALL replied that one very important factor is oil price. He said, "If we go back in real terms in 1980, the oil price was significantly higher than it is now. In real terms the price in 1980/1981 was about \$90 in today's money." He noted that there was a catastrophic collapse in the oil price in 1986, falling to \$10 [per barrel] in nominal terms. That huge change in the oil price, in the span of about 18 months, transformed the economics overnight - there was a worldwide crisis in the industry. He added that a lot of investments which were previously economic when the oil price was \$90 [per barrel], overnight, were no longer economic.

[4:41:17 PM](#)

REPRESENTATIVE BERKOWITZ asked, "Of the factors that led to the increase in production, which would you weigh as more significant: the increase in market price or the reduction in the tax rates?"

MR. HALL contended that it's comprehensively the reduction in the tax rate.

REPRESENTATIVE GARA said he'd much rather have long, stable production at a high tax rate than short-term production at a low tax rate with nothing left in 20 years. He surmised that if [the U.K.] kept the rate at 80 percent, production would have increased slightly, remained level, and lasted much longer. He further surmised that [the U.K.] reduced [the marginal tax rate] to 30 percent and produced all of its oil in a span of 15 years and all of a sudden, it declined in 2005. He asked, "Is that a possibility of what happened - you spent all of your oil because you attracted it at a low tax rate?"

MR. HALL disagreed. He explained that since the production peaked, a lot of the major operators are finding that the fields

in production, as they mature, are beginning to decline much faster than anticipated. He noted that there was also a tax increase in 2002, which led to a reduction in investment, which also had an impact on the subsequent evolution of production in the basin. This is what happened to the government tax revenue from the oil and gas industry over a similar period. The tax change occurred in 1993 and subsequently, the tax yield from the basin increased. For example, in 2001, the overall tax yield in the basin was five times what it was in 1991, even though the oil price was broadly the same in real terms. He further explained that it's an example of a government cutting taxes and tax rates and encouraging investment and activity, which led to higher production, which gave the government more tax. He said that this is a classic example of how cutting tax can benefit all of the parties engaged in the industry.

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MR. HALL contended that the differences between Norway and Alaska are much greater than the similarities. Eleven of the 14 largest fields in the North Sea are in Norway. These fields are of very high quality and have very good reservoir characteristics. He noted that the Statfjord field has a recovery factor of 70 percent. He further noted that Norway is very close to the major markets in Europe. Norway's overall production is still growing, although oil production has been declining for the last 3-4 years. However, gas production is still rising very dramatically. He surmised that Norway's production will continue to increase for another 3-4 years. He noted that the state plays a very significant role in Norway through its ownership of resources. The Norwegian state directly owns one third of the resources in existing fields. There are two major Norwegian companies, which have a very large state ownership - Statoil, which is 70 percent owned by the Norwegian state and until 2000, was 100 percent owned; and Norsk Hydro, which is 44 percent owned by the Norwegian state. He relayed that this is important in the context of the implementation of policy. When the state owns so much of the resource base, directly or indirectly through its agents, it tends to own a lot of the prime acreage, operate all of the key fields, and make most of the key decisions, which effect development of the basin. He said it's easier to sustain a high tax rate when the majority of the participants paying that tax are government. This largely explains why Norway has been able to hold its tax rate at the level it has - the state has such a strong role in the basin. The international oil companies own

about one third of the resource base in Norway. However, there is no state company or state-owned company in the U.K.

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REPRESENTATIVE ROKEBERG inquired as to the amount the British government, as well as the royal family, own of BP.

MR. HALL answered that the British government doesn't have any ownership in BP. In further response to Representative Rokeberg, he relayed that there's a history of the British government having a large stake in BP. He opined that the government's remaining stake in BP was diluted in the 1980s so it got rid of its remaining stake in BP in the 1980s.

REPRESENTATIVE SEATON asked, "What difference does it make to the profitability or the investment by an international oil company that two thirds of the oil in those basins are owned by another state or a different oil company?" He remarked that if they're willing to pay those tax rates and develop those fields, he would presume that if it wasn't a profitable venture for them and they wanted to participate, Statoil and Norway State would be developing all of the oil there.

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MR. HALL said the big difference between the perspective of an independent company and a government investing is that governments tend to have much lower cost of capital. Therefore, [governments] are able to afford projects that companies can't.

REPRESENTATIVE SEATON added that if there's some relationship that changes, the international oil companies are still participating at that tax rate in those fields.

MR. HALL said the companies that are in Norway are there because they like the quality of the opportunities. One can gain access to some very large, high quality fields and reserves. He noted that there are relatively few foreign companies involved in Norway and there are only 34 foreign licensees. The Norwegian government is taking significant steps to encourage more companies to enter the basin. For example, it recently announced an exploration incentive about 18 months ago. If one is not paying tax in Norway and is a new company/new entrant, spending \$100 on exploration in a given year, the government will reimburse \$78 at the end of that year. He remarked that the exploration drilling density on the U.K. side of the median

line in the North Sea looks completely different from the corresponding exploration drilling density on the Norwegian side. He reiterated that there has been a very low exploration density in Norway and the government is concerned with attracting more exploration activity into the basin. He said the view across the industry is that [the Norwegian government] will continue to struggle to attract new companies, even with a tax of 78 percent; one can make more money elsewhere for the same investment.

[4:54:44 PM](#)

REPRESENTATIVE ROKEBERG surmised, "Is that not why the Norwegian government spun off their interest in Norse Hydro and Statoil, which are now two publicly traded companies, so [the Norwegian government] could generate more private sector participation?"

MR. HALL surmised that the Norwegian government is trying to make Statoil, in particular, act like an international oil company. In addition to developing resources in Norway, Statoil now has a very active international investment program. Statoil is diversifying and trying to create a company which is comparable to all other international oil and gas companies.

MR. WALKER added that Norway can afford to charge such a high marginal tax rate because it has the resources that companies are still willing to invest in. Norway has been growing its production for 30 years. Oppositely, [Alaska] has been declining for 15-17 years at 6 percent, and the investment isn't flowing to Alaska to stem that decline. He said, "To envy the tax rate of a country with such high quality resources, I would offer to you would be a dangerous thing to do."

REPRESENTATIVE LEDOUX inquired as to whether BP had the opportunity, when Norway was instituting its taxes, to negotiate with or speak to the Norwegian government, and if so, what BP told it about its tax structure.

[4:56:40 PM](#)

MR. HALL relayed that in recent years, there have been a number of efforts made by the industry to engage in dialog with the Norwegian government to convince them to reform its tax system, encourage more investment, and encourage more companies to enter into the basin. The Norwegian governor has yet to respond. He said Norway is a small country, with a small population and a fantastic resource base, unlike the U.K., which has a large

population and is consuming most of what has been produced. Norway is able to export nearly all of that production and earn a fabulous amount of income from doing so. Therefore, [Norway] hasn't seen the same pressures that the U.K. faces.

REPRESENTATIVE LEDOUX asked if BP has been telling the Norwegian government the same thing it has been telling the Alaska - if its taxes remain high, it's going to discourage investment.

MR. HALL confirmed yes and added that the figures support that on exploration. He reiterated that the U.K. has been very successful in attracting exploration funds. Throughout the 1990s, there was more exploration and appraisal investment in the U.K. than in virtually any other basin in the world. In contrast, the investment in Norway has been much lower. There was only one large discovery in Norway during that period and outside that discovery, there hasn't been much success. Hence, the Norwegian government is now very much actively addressing the need to encourage more exploration activity. He relayed that [Norway] is still focusing on incentives in hope that it doesn't have to adjust the headline tax rate. He surmised that Norway will struggle to attract more exploration dollars into the country until it addresses the headline tax rate.

[4:59:08 PM](#)

MR. HALL discussed the deepwater province of the Gulf of Mexico. During the period of 1993-2004, the Gulf of Mexico had the highest level of exploration and appraisals of any basin. He noted that [BP] has been very successful in discovering reserves [in the Gulf of Mexico], which had the second highest volume of discovered reserves during that period. The aforementioned has translated into very rapid growth in production. In the mid-1990s, [BP's] production [in the Gulf of Mexico] was approximately 200,000 barrels per day. [BP's production] has already increased to approximately 1.5 million barrels per day and is projected to be 2.5 million barrels per day within a few years. He explained that the fiscal regime has played a part in bringing this about. The tax rate in the Gulf of Mexico is 45 percent at its highest. If one receives deepwater royalty relief, [the tax rate] is about 35 percent. He stated that [the Gulf of Mexico] is an example of a low tax environment in the U.S., which has been very successful at attracting investment and exploration dollars and translating that into production.

MR. HALL said [the Gulf of Mexico] isn't an easy environment and BP is using some very challenging technology. He said water

depths are absolutely phenomenal. BP has developed fields in excess of 2,000 meters of water with cutting edge technology. He opined that this is very important to the U.S. in order to boost domestic production and in the context of the global concern regarding energy security. He described it as an example of a low/stable tax involvement encouraging activity. He discussed heavy oil in Alberta, Canada, and stated that in the mid-1990s investment was fairly modest in this basin. It significantly increased, and by 2005 the investment was \$7 billion in one year. The prediction is for that to increase to nearly \$10 billion in a few years. He noted that investment in Alaska is approximately \$1-\$1.5 billion. He explained that oil price has had an impact, but that it's important to highlight the very key fiscal reform that the Canadian government introduced in the mid-1990s. Essentially, the way the regime works is that the royalty rate is 1 percent until that project has secured payout. That payout calculation includes an allowance for a risk-free rate of return. In addition to that, one will pay the federal and state taxes, which total approximately 39 percent. In regard to post-payouts, the royalty rate is increased to 25 percent. He explained that the marginal tax rate on this heavy oil production is at a maximum of 39 percent pre-payout, and at a maximum of 54 percent post-payout. He added that it needs to be recognized that there already are phased reductions in federal tax in Canada, which will reduce both of those rates by approximately 4 percent by 2007. Thus, if one invests in heavy oil in Canada, in a few years the pre-payout will be approximately 35 percent, and post-payout will be approximately 50 percent.

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MR. HALL continued that this is leading to a huge increase in activity, both in investment and in production. By 2010, production from the heavy oil province in Alberta, Canada, is expected to reach approximately 2 million barrels per day.

REPRESENTATIVE GARA, in regard to the 50 percent tax rate, inquired as to whether that's exclusively for heavy oil.

MR. HALL confirmed yes; that is a regime which is specifically designed to encourage heavy oil.

[5:05:25 PM](#)

MR. HALL discussed various fiscal regimes in North America in comparison to Alaska under the current ELF and the proposed PPT.

Marginal tax rates include: 39 percent pre-payout in Alberta; 45 percent in Gulf of Mexico deepwater; low 50s percent in Colorado, Wyoming, Texas, Oklahoma, and California; and 61 percent [under the proposed PPT] in Alaska [compared to 56 percent under the ELF]. He concluded that in comparing fiscal regimes, one needs to go beyond just looking at headline tax rate by looking at the context of the basin. He acknowledged the clear relationship between the fiscal policy and the overall level of basin activity. A higher tax burden will generally lead to less investment, while a lower tax burden will encourage investment - as demonstrated by the U.K., Gulf of Mexico, and Alberta. He said one of the risks that might emerge is Alaska being perceived as having the highest tax rate as well as cost structure in North America. He surmised that those two elements may make it difficult for Alaska to attract the investment it needs to ensure that its potential is fully developed.

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MR. WALKER defined government take as the ratio of the total taxes BP pays to the total taxes plus the profit it makes - the government's share of the proceeds from the industry. In Alaska, BP pays a royalty, production tax, property tax, and income tax, and in addition, a federal income tax. He noted that some of the Alaska taxes are deductible for federal income tax. He discussed a chart which displayed the total government take at different oil prices for both the current ELF-based system and PPT. He noted that the status quo, which is the current ELF-based system is the blue dashed line and the 20/20 PPT is the green line. At low prices, BP doesn't make a profit. He mentioned that regardless, BP continues to pay royalty, property tax, and state income tax, which results in a government take of greater than 100 percent.

[5:11:52 PM](#)

REPRESENTATIVE BERKOWITZ inquired as to the number of barrels BP produces in Alaska.

MR. WALKER answered that this year, BP expects to produce approximately 262,000 barrels per day. He noted that 262,000 is BP's net share and not all of that goes down TAPS because some is used as natural gas liquids (NGLs) on the [North] Slope for injecting for EOR, and BP moves some gas over to the Northstar Unit for enhanced oil recovery. Therefore, the sales volume is probably closer to 250,000 barrels per day on average.

REPRESENTATIVE GARA stated that according to the DOR, which has a model displaying corporate profits at various [oil] prices, at \$20 per barrel, it's projected that next year, North Slope [oil] companies will make approximately \$950 million in profit on \$4.3 billion in gross revenue, which is a 20 percent profit margin. He added that BP is estimating something quite different.

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MR. WALKER clarified that BP is discussing profit in the true sense of profit after it has deducted the associated expenses that accompany that profit. He stated that BP's annual expenses in Alaska total \$1.1 billion.

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MR. WALKER explained that in calculating its profit, BP has to [subtract] all of the expenses, capital costs incurred to produce/develop those barrels, transportation costs - the net cost of flowing through the pipeline as well as the shipping, and the taxes it pays.

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REPRESENTATIVE BERKOWITZ stated that ConocoPhillips Alaska, Inc. estimated its total costs as approximately \$10 per barrel and added that he can't imagine BP's cost differing significantly.

MR. WALKER reiterated that to calculate the profit, one needs to factor in the total cost, operating cost, capital cost, transportation cost, tax cost of royalty, production tax, property tax, state income tax, and federal income tax.

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MR. WALKER continued that under PPT, the government take is approximately 70 percent at the moderately high price of \$30 per barrel. He described this government take as very high. At current oil prices, the government take is approximately 60 percent. Under the [PPT] regime, it would be approximately 61 percent at \$60 [per barrel]. He advocated that it's very important that BP makes a good, reasonable prices when the [oil] prices are high. He said that if [the legislature] takes that away, there's no reason to be in Alaska.

[5:17:36 PM](#)

REPRESENTATIVE SEATON surmised that Mr. Walker is saying that BP's investment over time on the North Slope is based on the anticipation that oil will be \$50 or \$60 per barrel.

MR. WALKER replied that BP is presenting the reality of its business today, with the kind of costs that it has to produce oil on the North Slope. He said, "It's absolutely the case that in Alaska you have a few good years, as you look back through history, and then you have a lot of years where we've made a very marginal return." He added that BP needs those good years to average out [the bad years] and receive a reasonable return. He said Alaska is a mature business with a challenged resource. In BP's opinion, [the legislature] should be concerned about overtaxing the industry, rather than under taxing it.

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MR. WALKER discussed the impact of moving from the status quo of the ELF-based system to PPT. At \$20 per barrel under ELF, BP doesn't make a profit. At \$60 per barrel under ELF, BP's share is greater than the State of Alaska's share, which is how the system is currently designed.

CO-CHAIR RAMRAS, in regard to PPT, remarked that [the legislature] has the opportunity, if it handles things correctly, to be partners with the oil companies in risk as well as to reap the [benefit] during high cycles of oil prices.

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MR. WALKER, in response to Representative Rokeberg, informed the committee that BP has investments all over the world and each investment will have a different set of characteristics. When [oil] prices are low in Alaska, BP is "making a loss" and is being carried by other places around the world. When [oil] prices are high, BP has to make a good/reasonable profit in order to make Alaska attractive to be in BP's portfolio. In response to Representative LeDoux, he explained that the normal convention is that the industry makes a profit and the government takes a share. When the government take is above 100 percent, the industry profit is negative. Therefore, the total tax reduced by BP's loss is greater than 100 percent.

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REPRESENTATIVE GARA stated that by DOR's [calculations], there is a much greater corporate share than state share at \$40 and \$60 per barrel, even under PPT.

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MR. WALKER, in regard to the impact on government take under PPT, noted that at \$20 [per barrel], BP would make a very modest profit, which he acknowledged as the impact of introducing a profit-related tax. At \$60 [per barrel], BP and the State of Alaska's shares are approximately equal. He stated that the overall impact of PPT and the tax rates that have been chosen in the bill is to "squeeze" BP's profit from the status quo to PPT. He said, "We're paying more tax, therefore we have less profit."

[5:26:09 PM](#)

MR. WALKER discussed what the impact of PPT would be on future investments. He acknowledged that it's true to say that in most cases the rate of return increases with the PPT system. However, rate of return is just one economic measure and BP considers a suite of economic measures: rate of return, net present value, and total cash flow from any project. He remarked that at the end of the day, BP would be paying more tax, therefore it would be making less [of a profit]. Instead of going to the investor, the money would be going to the state.

MR. WALKER said decline is a problem. Alaska has been in decline because profitability has been insufficient to attract capital, not due to a lack of resources. He noted that large increases in investment are required. To stem ongoing decline and attract the required investment of \$50-\$100 billion, PPT must work for the major investors. He noted that capital is mobile, and international investment flows to basins where it can earn a profit. He opined that profit-based taxes are superior to revenue-based taxes. He further opined that the PPT structure has merit and could serve Alaska well for the long-term. He further noted that higher taxes means less investment. He opined that the 20 percent tax rate is very high and will not maximize investment and production on the Alaska North Slope.

REPRESENTATIVE BERKOWITZ asked, "What rate would?"

MR. WALKER answered that it's very difficult for BP to say which one would, but certainly lower than 20 percent.

REPRESENTATIVE BERKOWITZ, in response to BP's statement that [the 20 percent tax rate] isn't going to maximize investment, surmised that there's a point at which BP believes it will maximize investment.

MR. WALKER said the existing tax regime is attracting between \$1-\$1.5 billion to the North Slope. In order to stem decline and create a future that underpins gas, \$2-\$3 billion needs to be attracted to the North Slope. He commented that the concept of adding an additional \$1 billion of tax onto the existing tax bill goes against the notion of attracting more investment.

[5:30:09 PM](#)

REPRESENTATIVE BERKOWITZ relayed that some of the independent [companies] will point to the high cost of transportation through TAPS and on BP, ExxonMobil, and ConocoPhillips tankers as being a significant barrier to entry. He noted that it goes beyond the State of Alaska's tax as well as some of the privately erected barriers to entry.

MR. WALKER agreed that small companies/independents have a very important role to play. He reiterated that the majority of the investment is going to have to come from the major [oil] companies.

[5:32:01 PM](#)

MR. WALKER noted that oil needs gas and gas needs oil. In order for the gas project to proceed and for the gas [industry] to be healthy, it needs to be underpinned with a healthy oil [industry].

REPRESENTATIVE GARA requested information regarding BP's statement that it doesn't make a profit at \$20 per barrel.

MR. WALKER assured Representative Gara that BP is losing money in Alaska at \$20 per barrel. He noted that BP has a portfolio of assets and Alaska is only one of them.

REPRESENTATIVE GATTO commented that in order to have maximum investment, the tax [rate] needs to be reduced to 0 percent and in addition, a bonus needs to be offered.

[5:33:59 PM](#)

CO-CHAIR RAMRAS asked, "As good corporate citizens, how much does BP give back to the communities across the state annually?"

MR. WALKER answered that in 2005, BP gave \$7.6 million [to Alaska]. He added that will be substantially higher in 2006.

CO-CHAIR SAMUELS asked, "Do you think that all royalty owners should be treated the same under the law?"

MR. WILLIAMS responded that the private royalties are problematic because the typical royalty owner doesn't bear a share of the costs. However, the cost of producing oil from that private land reduces the tax burden for the oil company. He asked, "How do you allocate the benefit of those costs? Do you allocate any benefit of those costs to the royalty interest, which isn't paying any of those costs?" He answered, "You could say no, why not have a flat-rate royalty, say 5 percent tax for private royalties where the landowner is the royalty collector." Eventually, when one gets to the end of fuel life or there are low oil prices for a temporary period of time, the working interest owner, the oil company, may have zero PPT. At the same time, the royalty owner pays in full because it's based on the gross value of the royalty. On the hand, the royalty owner isn't paying any tax. He mentioned that if the [legislature's] goal is to have the royalty owners' share to be the same under the new system as it was under the old [system], then a tweak needs to be made to HB 488. He stated that the simplest thing is to break it out as a separate rate for private royalties.

[HB 488 was held over]

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at [5:38 PM](#).