

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

February 28, 2006

3:34 p.m.

MEMBERS PRESENT

Senator Thomas Wagoner, Chair
Senator Ralph Seekins, Vice Chair
Senator Ben Stevens
Senator Fred Dyson
Senator Bert Stedman
Senator Kim Elton

MEMBERS ABSENT

Senator Albert Kookesh

OTHER MEMBERS PRESENT

Senator Gene Therriault
Senator Hollis French

COMMITTEE CALENDAR

SENATE BILL NO. 305

"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: SB 305

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

02/21/06	(S)	READ THE FIRST TIME - REFERRALS
02/21/06	(S)	RES, FIN
02/22/06	(S)	RES AT 3:30 PM BUTROVICH 205
02/22/06	(S)	Heard & Held
02/22/06	(S)	MINUTE(RES)
02/23/06	(S)	RES AT 3:30 PM BUTROVICH 205
02/23/06	(S)	Heard & Held
02/23/06	(S)	MINUTE(RES)
02/24/06	(S)	RES AT 3:30 PM BUTROVICH 205
02/24/06	(S)	Heard & Held
02/24/06	(S)	MINUTE(RES)
02/25/06	(S)	RES AT 9:00 AM BUTROVICH 205
02/25/06	(S)	-- Reconvene from 02/24/06 --
02/25/06	(H)	RES AT 10:00 AM SENATE FINANCE 532
02/25/06	(S)	Heard & Held
02/25/06	(S)	MINUTE(RES)
02/27/06	(S)	RES AT 3:30 PM BUTROVICH 205
02/27/06	(S)	Heard & Held
02/27/06	(S)	MINUTE(RES)
02/28/06	(S)	RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

RICHARD OWEN, Production Manager and Vice President
ExxonMobil Alaska
Anchorage Alaska

POSITION STATEMENT: Delivered ExxonMobil's presentation on PPT.

DAN SECKERS, Tax Counsel
ExxonMobil Alaska
Anchorage AK

POSITION STATEMENT: Commented on SB 305.

MARTY MASSEY, Joint Interest Manager for the United States
ExxonMobil
Anchorage AK

POSITION STATEMENT: Commented on fiscal contract negotiations
related to SB 305.

TOM WILLIAMS, Tax Counsel
BP Alaska
Anchorage AK

POSITION STATEMENT: Commented on SB 305.

ACTION NARRATIVE

CHAIR THOMAS WAGONER called the Senate Resources Standing
Committee meeting to order at [3:34:36 PM](#). Present were Senators
Elton, Dyson, Stedman, Ben Stevens and Chair Wagoner.

SB 305-OIL AND GAS PRODUCTION TAX

CHAIR WAGONER announced SB 305 to be up for consideration and
that this was the second day of the stakeholders meeting. The
first presenters would be from ExxonMobil - Richard Owen, Marty
Massey and Dan Seckers.

RICHARD OWEN, Production Manager and Vice President, ExxonMobil
Alaska, introduced Marty Massey, Joint Interest Manager for
ExxonMobil U.S., who was leading the gasoline contract
negotiations, and Dan Seckers, ExxonMobil tax counsel for
Alaska. He said if this measure were simply a tax increase,
ExxonMobil would actively oppose it. At current prices, he
expected ExxonMobil's production tax payments would increase by
\$50 million to \$100 million per year. But the proposed system
balances revenues to the state and producers across a range of
oil prices. It provides incentives for new investments and
includes a transition provision for recent investments. Most
importantly, the PPT provides a predictable and durable tax
system which, along with the appropriate gas pipeline fiscal
contract terms would allow Alaska natural gas pipeline project
to move to the next phase.

Specific concerns about the bill centered around whether the
high tax rate and resulting increase in taxes would hinder the
full development of the remaining oil resources on the North
Slope.

ExxonMobil in Alaska

MR. OWEN said that ExxonMobil has had a presence in Alaska for over a century and has invested more than \$11 billion in the state's economy. Over the years, EM explored most of the hydrocarbon plays in Alaska and participated in the 1968 first Prudhoe Bay discovery well. He is proud of the role EM has played in Alaska through exploration, initial field developments, construction of TAPS, development of new technology and the promotion of efficient reservoir management practices.

Currently, EM has working interests in Prudhoe Bay, Kuparuk, Endicott and Granite Point. We are the operator of the Point Thomson Unit and the largest interest holder in the Prudhoe Bay field. Our current working interest production is approximately 180,000 B/D and we are the largest owner of discovered gas resource. Our production from Alaska represents approximately 4 percent of EM's worldwide oil and gas production. Our Alaskan production is primarily from Prudhoe Bay and the near-by satellite fields. Prudhoe Bay, along with Point Thomson, has significant remaining potential, but it comes at higher cost and risk.

[3:38:33 PM](#)

SENATOR SEEKINS arrived.

MR. OWEN continued:

Historical Context

One of ExxonMobil's objectives in both the gas pipeline fiscal contract negotiation and the debate on oil taxes has been to reduce the risk associated with fiscal changes by working with the State of Alaska to establish a predictable and durable fiscal environment in which to make long term investment decisions. To that end, any change in the fiscal regime for oil has a direct impact on how we view the stability of the Alaskan fiscal environment, which in turn, impacts how we evaluate ongoing investment decisions.

We understand the State's desire to obtain additional tax revenue at higher prices. One of the most challenging tasks that the Legislature can undertake is how to change the oil tax system without damaging the industry. As Governor Murkowski has correctly

stated on many occasions, the North Slope is one of the most expensive places in which our industry operates. Tax systems need to be carefully designed to ensure that the desired objectives are achieved and that any change does not result in unintended consequences, such as reduced investments and lower reserve recovery.

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One of the many questions that we are asked is why are ExxonMobil and other producers seeking durability and predictability for oil in parallel with negotiating a fiscal contract for a gas pipeline. The answer is fairly simple. The gas on the North Slope is contained in the same reservoirs as the oil and is produced through the same facilities. For a gas project to be viable, we need 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.

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Existing System-ELF

With that context in mind, I'd like to make a few comments about the current oil production severance tax system - the Economic Limit Factor or ELF and, in particular, how it has been effective at encouraging investment and mitigating production decline.

The ELF was designed to allow the state to increase the production tax while not stifling investment in marginal fields. The ELF scared 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.

The 1989 ELF amendment significantly increased the production tax on Prudhoe Bay and Kuparuk 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.

While we would like to have more Prudhoe Bay's and Kuparuks, we, and the rest of 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. Many of these fields produce viscous oil contained in lower quality reservoirs requiring significantly higher costs, which adds to the risks for development. 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-equipment and extensive modifications to existing facilities to process these viscous production streams.

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. Significant additional capital is required over the next several years to fully develop these resources. 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 and contribute substantial amounts to the state in royalties, property taxes and income taxes, and in jobs for Alaskans.

Over the past five years, we and other working interest owners have also extended the primary Prudhoe Bay enhanced oil recovery (EOR) technology to some of these satellite fields. Since 1998, Since 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 a 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.

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Taken together, the recent Prudhoe Bay satellite and EOR development projects developed over 560 million barrels. While the resulting state's production tax under ELF was relatively minor, the state's royalty oil would total 70 million barrels, what at today's oil price is worth roughly \$4 billion. The bottom line is that the ELF system has worked well for industry and for the state of Alaska by encouraging significant new investment.

However, it is 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 revenues between the state and producers as oil prices rise and fall. 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. As a global oil and gas producer, ExxonMobil operates across a wide array of fiscal systems. It is most important that the system recognize the quality of the resource so that the potential development will be commercially viable and attract capital. When I say the quality of the resource, I mean 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. Countries that are re-experiencing significant industry investment have achieved the proper balance in their fiscal regimes.

ExxonMobil's assessment of the remaining oil resource suggests future growth opportunities will come from complex enhanced oil recovery 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, though they face the similar challenges associated with arctic conditions and distance to market. Therefore, as stated earlier, we are concerned that the administration's proposal is weighted towards a higher tax, which may prevent some of Alaska's challenged resources from being developed.

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MR. OWEN continued to comment on the PPT proposal:

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 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. ExxonMobil affiliates have significant experience in profit-based progressive systems around the world and they work well as long as they are properly taking into account the nature of the resource base.

PPT system: Transition

This bill represents a major-step change in Alaska's current production tax system. The bill appropriately addresses this step-change by including a transition plan so that recent investment decisions are not adversely impacted. This bill provides a transition allowance over the next six years based on capital investments made in the last five years. We believe 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. In most cases it takes many years, often more than five years, for a return on oil or gas investment to occur.

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For example, satellite and tertiary recovery investment decisions made during the last five years

were made under the ELF structure anticipating a lower tax relative to that proposed under the PPT bill. The state appropriately provided this incentive, the ELF, so that these challenged and costly projects could be made commercially viable. It is not appropriate to suddenly increase the taxes on these investments without providing some form of consideration. The transition provisions recognize that past investments were made under the ELF structure and somewhat reduces the increased tax treatment to which these projects will now be subjected. To avoid penalizing these recent investments, the transition provisions included in this bill are essential.

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CHAIR WAGONER asked for examples of any other state or country that have transition provisions for a change in taxation.

DAN SECKERS, Tax Counsel for ExxonMobil Alaska, replied with several examples. One example was our own federal government that repealed percentage depletion for integrated oil companies in its 1975 Tax Reform Act. It provided provisions allowing those with contracts to continue to use percentage depletion for the duration of those contracts.

Another example was when investment tax credits were repealed by the federal government in the 1980s - at first a company was allowed to recover an investment over five years and then the law was changed to three years. That tax credit was still allowed for five years, but additional investments were no longer eligible for them and got less favorable depreciation.

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SENATOR STEDMAN said he didn't hear an answer to the question and asked again what countries use transition provisions in relation to the oil industry.

MR. OWEN replied that ExxonMobil has production sharing contracts around the world and tax changes don't apply to them, because their activities are covered by those contracts. He said he would look for examples of this type of transition arrangement.

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SENATOR BEN STEVENS asked if he meant the terms of their contracts around the world locked in their royalty payments and

severance taxes for a period of time so that any modification wouldn't apply to them.

MR. OWEN replied yes; most of those contracts are single government-type arrangements with severance tax, royalty and income tax built-in and, "It doesn't change over time."

SENATOR BEN STEVENS asked how long a typical contract ran.

MARTY MASSEY, Joint Interest Manager for the United States, ExxonMobil Corporation, replied that it varied across the board and depended largely on the quality and life of the resource - but some are for 50 to 60 years. Some contracts are written until every barrel has been produced out of the entire block.

SENATOR BEN STEVENS asked if the contractual terms that are entered into prior to production are locked in during the life of that contract.

MR. MASSEY replied yes.

SENATOR STEDMAN asked if reopeners are a standard clause in those contracts.

MR. MASSEY replied that ExxonMobil's contracts have been negotiated around the world and their terms vary accordingly. Some of them have reopeners and some of them don't - depending on what allowed the investment to go forward.

[3:55:50 PM](#)

SENATOR SEEKINS remarked, "Some of those reopeners, I think, are called revolutions, Senator Stedman - regime changes."

[3:56:08 PM](#)

SENATOR THERRIAULT arrived.

[3:56:59 PM](#)

SENATOR SEEKINS recapped his understanding of ExxonMobil's testimony:

I made this investment decision when I knew the severance tax was going to be an average of 7 percent based on the ELF or however it came down. Now, we're going to go to 14.5 percent with the 20/20 program, roughly. That's a rough approximation from what I've heard. So...I'd like to have some consideration for that. I'm not entitled to it under any government

program. It isn't that I'm going to lose some of my other standard deductions in either state or federal income tax. It's just good faith.... Am I correct?

MR. OWEN replied yes. It is just a mechanism by which to achieve some consideration for previous investments. However that concept may be deceptive, because some of them were made in fields, which may have been paying no production tax at all and would now be paying 20 percent. Part of it is the underlying health of the investment climate and if they would regret some of the investments they made. They want a transition plan so they can move from one tax regime to another.

SENATOR SEEKINS remarked that they wouldn't regret it as much if oil stays at \$60-plus a barrel as they would if it declined to what more people are predicting will be the long-term rate.

MR. OWEN replied that was right. When those decisions were made, the focus was on what the price risk would be, not on what the tax structure would be.

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MR. OWEN said that he was also concerned that the 20/20 rate may not support development of all opportunities remaining on the North Slope, which are now primarily complex development of viscous and heavy oil. He explained:

These opportunities have challenged economics and with investment credits of 20 percent will enhance the present value economics of new investments. The 20 percent tax rate will result in a lower overall cash flow. The impact on all of the economic parameters must be carefully weighed before a decision to progress an investment is made. The combination of a 20 percent credit along with a 20 percent tax rate may not be adequate to support the development of all of the remaining opportunities. It's with this in mind that we recommend that the legislature not increase the proposed tax rate or reduce the proposed tax credits.

MR. OWEN said that this bill also addressed many of the long-standing issues that have divided the state and the industry over the years. He said:

It made little sense in the past and makes little sense today for the state 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 marketplace. SB 305 allows the state 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 Natural Resources. This will provide certainty to a producer on the value in which to pay its royalty and production taxes and will reduce the administrative and audit costs to both the state and industry.

Under current prices, ExxonMobil and industry will pay more in taxes as compared to the current production tax system. However, as I said in my opening comments, we need predictability and durability under which to gauge investment decisions. No one wants to invest money in a project only to have the rules changed, reducing the attractiveness of the investment. The transition provision is an important feature of the bill necessary to provide relief for the abrupt change caused by the new PPT system.

The administration decided to weight the proposal to a higher tax, which may make it difficult to progress the remaining future development opportunities. It is most important that the quality of the resources be factored into the design of the tax system. Given our view of the resources, we would not support a higher tax rate or lower credits than proposed in the bill.

SB 305 seeks to balance revenues to the state 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. And most importantly for ExxonMobil, we believe 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 project to move forward to the next phase. Potential changes to the features of the PPT bill must be carefully considered to avoid upsetting the balance contained within the bill.

In conclusion, this bill 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.

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. We are currently working with the Administration on how best to incorporate this bill into the fiscal contract.

4:03:33 PM

CHAIR WAGONER stated that some people have said the tax credits aren't high enough and asked if he would support a higher credit rate.

MR. OWEN replied that he understood the balance this bill created between the tax rate, the credit rate, the transition and other provisions. Higher tax credits would change the bill and its impacts would need scrutiny. However, he said, in general, incentives help investment.

4:04:45 PM

SENATOR STEDMAN said he has heard a lot of discussion on predictability and durability of the tax regime for business in the state and he understands that the proposal is progressive and the royalty and property taxes are regressive, but together they are fairly neutral. He asked Mr. Owen to comment on that.

MR. OWEN stated that he would have to review a new proposal to see if it provided the same balance this bill has.

SENATOR STEDMAN asked if it was in the best interest of both parties to have a fair system that would not put one party or another at a disadvantage in the long run.

MR. OWEN replied yes and ExxonMobil wants a system that is viewed as fair and equitable by all parties. He thought everyone was looking at the proposal across a wide range of prices to see whether they believe it achieves that end.

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SENATOR ELTON said he struggles with some of Mr. Owen's conclusions. A major one is what the state does now with the oil tax will enable the Alaska gas project to move forward to the next phase and, "We don't know what the next phase is on this side of the table."

Senator Elton elaborated that Mr. Owen has testified that he was working with the administration currently on how to best incorporate this bill into a fiscal contract he felt like he was being asked to make a decision without knowing what Plan B was - assuming the oil tax was Plan A. That situation compels him to look at the tax as a stand-alone issue. He asked if they wouldn't prefer the legislature to just consider a fair stand-alone oil tax that could be rolled into a gas pipeline contract.

MR. MASSEY replied yes, the legislature should look at how this tax would do what the State of Alaska wants in terms of encouraging investment and allowing the remaining opportunities to come on stream. He explained:

What we want to communicate with you is that as part of the gas pipeline fiscal contract negotiations, we believe this bill, if incorporated in the contract, will provide the predictability and durability we need to advance to the next phase of a gas pipeline project. I know at this point in time, many of you don't have the terms... of what we've negotiated with the fiscal contract. And I hopeful within the next couple of weeks here we're able for everyone to see what the gas pipeline contract terms look like.... That was the reason for our comments.

SENATOR ELTON asked if he is suggesting that he doesn't see a gas pipeline contract happening without this bill.

MR. MASSEY replied that this bill provides on the oil side what they need to progress the gas pipeline. If it were changed in some way, it would have to be reevaluated. He also speculated that if the legislature determined what would encourage investment and maintain a healthy oil business for the state, that would probably work for the fiscal contract. He said:

We're on the verge of commercializing this gas. We're going to invest billions of dollars for this thing to go forward. We need to make sure we understand the fiscal regime under which we're going to make those investments.

[4:13:55 PM](#)

SENATOR DYSON asked if he meant to imply that if the legislature and the governor offered them a 30-year contract under existing

oil tax law, ExxonMobil wouldn't have been able to go forward with the contract.

MR. MASSEY replied that the governor never made that offer to ExxonMobil, but he recognized that the state's oil tax system needed to be overhauled.

SENATOR DYSON said, "I think you just said no," and asked if this bill did anything, particularly concerning investment credits, to make a gas pipeline contract more probable.

MR. OWEN replied that one aspect of it that does help is the credits and how they apply to Pt. Thompson, particularly, because it would be a major contributor of the gas for a pipeline project.

SENATOR DYSON asked if it would be clearer to say this tax system is necessary to progress the pipeline if it is a provision in the contract that extends for 20 or 30 years.

MR. OWEN replied that is exactly what he is saying. He wants to incorporate this bill in with the contract because alone, it provides no certainty that the tax won't be changed in the near future.

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SENATOR THERRIAULT referred to page 10 of Mr. Owen's comments on the valuation issue and said he understands that there are different systems - the Department of Revenue's and the Department of Natural Resources' - and they may result in as much as a \$1 difference in the value of a barrel of oil and the PPT proposal is the lower of them. He asked if the price differences in the methodologies are correct.

MR. OWEN replied that small differences do occur and those are largely due to whether prices are rising or falling and are not a fault of the formula, itself.

SENATOR THERRIAULT said he thought this part of the bill still wasn't clear to him and the committee might want to consider using the higher number of the different methodologies. He asked if Mr. Owen had an opinion on the \$73 million tax-free allowance.

MR. OWEN replied no. He elaborated that he understood the administration proposed a \$73 million allowance to address some of the barriers for new entrants into the market and he agrees

that there are barriers to exploration and development in Alaska, but he does have some concerns about whether that would create an unlevel playing field, especially in forming partnerships. He felt it was the administration's policy decision.

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CHAIR WAGONER said the allowance doesn't impact big corporations the same as small ones and asked if there are other ways to put that incentive in the bill.

MR. OWEN replied that should be addressed by the administration.

[4:21:08 PM](#)

CHAIR WAGONER asked if the \$73 million allowance would incentivize ExxonMobil to do more.

MR. OWEN replied that the \$73 million would be the first of their deductions. It wouldn't play in the exploration step.

SENATOR THERRIAULT said, relative to the look back provision, that yesterday BP used a graph of expenditures for development of one of their fields that was relatively flat for four years and then spiked in the fifth year. He asked if ExxonMobil's expenditures had been flat or had peaks, as well.

MR. OWEN replied about their expenditures over the last five years had been relatively flat at about \$190 million per year.

MR. MASSEY added that it's important to understand not only the level of investment, but also the kinds of things they are investing in. ExxonMobil has been investing in developing viscous oil fields and those take a long time to receive the benefits from those investments. That's why the transition provision is so important.

[4:23:18 PM](#)

CHAIR WAGONER asked what additional incentive would help for developing viscous oil.

MR. OWEN replied that an increase in credit would help improve the cash flow of any investment because it represents the ability to offset some of the upfront investment. High credits help the cash flow economics, although that is not the only parameter they look at when making decisions. The tax rate takes a lot of cash out of the project.

[4:24:55 PM](#)

SENATOR THERRIAULT asked if this level of credit encourages ExxonMobil to spend additional dollars on the gas pipeline. What level of incentive causes them to change their decision.

MR. OWEN replied that it is very complex question. They have a whole range of resource opportunities, some are more challenged than others. They also have a whole range of investment parameters in looking at whether a project is commercially viable or not. "We are that the tax rate that is being proposed at the moment and the credit rate - that combination may not allow us to develop all of the resource on the North Slope."

[4:28:23 PM](#)

SENATOR STEDMAN asked if the industry is sensitive to how the government take is sliced up, because consultants have lumped them together in one category.

MR. OWEN replied that they are focused on what their return is and are less focused on how the government take might be divided up.

MR. MASSEY added that there are varying levels of take across the globe and there is a good reason. They look at the quality of the resource that is within a basin and figure out how much the government could take and still attract investment. The countries that have a lot of investment activity have the balance right.

[4:29:54 PM](#)

SENATOR STEDMAN said they would have more debate on comparing investment climates. He asked how unique he thought Alaska is.

MR. OWEN replied that is the heart of the question. The resources are becoming more unique. Kuparuk and Prudhoe Bay have been developed and the remaining resources are smaller and challenged opportunities in a harsh environment.

SENATOR STEDMAN said Norway and Britain come up a lot as a comparison and asked if those are just a rabbit trail. As policy makers, they are trying to strike a balance. He stated, "Clearly, we want the oil industry to stay here and we want you to expand. We've got the same general goals." But, he felt a real hesitation in their willingness to share information with the legislature.

MR. OWEN replied that you can find different levels of government take around the world. Some of those have low government take and are struggling and others have high government take and are doing well. The ones that work have found the right balance between their tax system and their resources. Alaskans need to find the right system that will work in Alaska. He wasn't sure that studying more countries over seas would help in those deliberations.

SENATOR ELTON asked if tradability of the credits makes this a better bill than if they weren't there from the perspective of a major producer on the North Slope and of a smaller company.

MR. OWEN replied that tradability of credits is an important feature, especially for the smaller companies that have to get through the first expensive years. It's less important for large companies with lots of assets. He would hope to have the production to offset the credits.

[4:36:11 PM](#)

SENATOR THERRIAULT said the legislature doesn't want the tax system to become destabilized with changing gas and oil prices, because that would drive investment away or create pressure from constituents to change the system, which is what is happening with ELF today. He understood that at least one company advanced a tax proposal that was progressive with regards to price and he asked what opinion Mr. Owen had about the currently proposed flat 20 percent tax whatever the price of oil and gas goes to.

MR. OWEN agreed that they are after a system that would create a healthy industry that is fair to all parties at a range of prices and the legislature needs to make sure the PPT meets the needs of both parties. The question of increased progressivity, price tiers and things like that have been discussed, but aren't in the proposed bill from the administration. Producers would have to look at any other proposals and ask if it would still allow them to move forward with predictability and durability.

SENATOR THERRIAULT asked if tax incentives are constitutional. He mentioned the Kuno v. Daimler Chrysler case that is currently before the U.S. Supreme Court could turn tax incentives across the nation on its head.

MR. OWEN responded that he was not familiar with the case, neither was Mr. Seckers.

SENATOR THERRIAULT said one of the legislative consultants said that shut down costs would be part of the life of a field, but the bill allows shut down and removal of facilities that have been in place for 30 years to be against the production tax. He wasn't sure of the legitimacy of something like that or dragging the expense forward to the point where production starts going down naturally and any revenue the state might receive goes to expenses of shut down costs.

MR. OWEN replied that as shut down costs occurred they would flow through lease expenditures and be a deduction for the PPT. This is distinct from reserves, which are usually done as book entries when you haven't actually spent the money.

SENATOR THERRIAULT asked if he saw differentiating between new facilities they put in place under PPT versus all of the old infrastructure that has been in production for 30 years.

MR. MASSEY replied they are trying to put a system in place that will be here for many years. He was not anticipating major abandonment costs. They would be paying tax for 30 to 50 years under this new system until abandonment would occur. So, he thought it would be appropriate for those investments to be included under this bill.

CHAIR WAGONER explained that one of the reasons Senator Therriault asked that question is while his field is younger, Cook Inlet has four platforms that are currently shut in and they are concerned about how those expenditures will be accounted.

MR. MASSEY responded that his comments were directed to Prudhoe Bay that would be there for a long time.

[4:46:05 PM](#)

SENATOR ELTON asked if he deducted demobilization from net profit.

MR. OWEN replied that he didn't think abandonment costs would generate a credit; rather they would be lease expenditures. Reserves are usually carried as book entries and this bill is about modeling cash investments.

SENATOR ELTON asked on if the demobilization deposits to an account would be deducted from gross profit.

MR. MASSEY replied when earnings are set aside, the money has to be set aside from earnings in a particular year. Money is not set-aside in an account, it comes out of your cash flow in a given year.

MR. SECKERS added from a federal tax point of view, you can't take an expense for dismantlement on the tax return until the expense was actually incurred.

[4:48:52 PM](#)

SENATOR ELTON asked if the state determines net profits under PPT, they would not include anything that was set aside for future abandonment.

MR. OWEN replied yes.

SENATOR STEDMAN asked if there is anywhere else on the planet with which to compare Alaska and how can legislators establish a comfort range without doing that.

MR. OWEN replied that the legislature's and the governor's consultants have provided a large data base showing government take across a range of countries and different environments. Going through the committee hearings is exactly the right process. He thought that once the legislature goes through the same deliberations the governor did, they would come up with a similar conclusion.

[4:52:53 PM](#)

SENATOR THERRIAULT said that he tried to get people who had worked for the industry to be part of the legislature's team for perspective. One of the things they have told them to expect is when people are in a deal-making mood to put everything on the table and see what you can add to it. He asked what they asked to have added to the deal.

MR. MASSEY replied nothing was added after the major provisions of the gas contract were completed on Saturday.

As Richard said, we think it will give us the balance we need, the predictability and durability we need when we write it into the fiscal contract to allow the gas to go. When you think about it, that's got to be the major thing that we're working on - getting the gas to go. And in the end we got comfortable with it.

SENATOR THERRIAULT asked how many dollars are spent in Alaska procuring equipment as opposed to spent out-of-state.

MR. OWEN replied that most of their investments in Alaska are operated by others and those procurement activities are conducted by others. Most of their dollars flow through joint venture accounts to operators in Alaska.

SENATOR THERRIAULT said he was trying to understand the economy that would come into being with the buying and selling of credits and said the smaller independents that don't have production on which to offset their credits would be marketing them. They would be bought at somewhat of a discount, so there would be some leakage of the investment money that would have occurred to the state treasury. He asked if they should rely on the market or should the state have a refund so the treasury has no loss.

MR. OWEN replied that he thought any leakage would be lost from the new entrant who wasn't able to capture the full value of their credit.

SENATOR THERRIAULT explained that the new company would get 90 cents on the dollar and the company that bought it gets the full dollar. But the dollar gets expensed back to what would have accrued as PPT tax. So it, in effect, comes out of the treasury. Instead, an explorer could make their investment. They don't have PPT tax to offset, so they would just come to the state for a rebate directly from the treasury.

MR. OWEN replied that could probably be done, but that would be a policy question for the legislature.

SENATOR THERRIAULT asked if they got into a low price scenario where the state wasn't generating a lot of taxes, would producers likely stop playing in the credit-buying market.

MR. OWEN replied that that was a hypothetical question that was difficult to answer, because he wouldn't know what the market would look like or any number of other things.

SENATOR THERRIAULT asked if they currently buy credits under the existing system.

MR. OWEN replied yes.

SENATOR THERRIAULT said he wanted the department to give them an idea of what the going rate is for credits.

CHAIR WAGONER asked if those credits had been purchased under SB 185, exploration credits.

MR. OWEN replied yes.

[5:01:10 PM](#) Recess [5:49:41 PM](#)

CHAIR WAGONER announce that BP Alaska would start its presentation with Current Realities on the North Slope

Ken Konrad, Vice President of Gas for BP Alaska introduced ANGUS WALKER, Commercial Vice President, BP Alaska, who recognized that the PPT and the subsequent gas contract were some of the most important things coming before the legislature. He introduced Ray Hall, Senior Tax Economist, and Tom Williams, Tax Counsel, who is widely credited as the creator of the economic limit factor (ELF).

MR. WALKER started on slide 6, which was a view of production from the North Slope since 1977 through 2005. It has produced over 15 billion barrels of oil to date. BP has invested \$24 billion creating the business it has today and has paid \$32 billion in tax to the state of Alaska and \$24 billion in tax to the federal government.

Since peaking in 1988, production has declined on an average of 6 percent per year. The ELF has worked as intended and the production profile shows small wedges that come from satellite fields that would have otherwise been challenged to develop. 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.

He referenced slide 8 that shows two DOR scenarios for oil development on the North Slope. One was production if the gas line wasn't built and the other showing a forecast of oil production assuming a gas pipeline is built.

He agreed with DOR that the future without gas looks very different than with it. Without gas, the future is definitely shorter and less exciting. "But, it's clear, also, to us that the foundations of the gas business will be on top of the oil business and to have a healthy gas business, we need to maintain

a healthy oil business for the next 45 years. Both parts of the business must be health."

5:56:40 PM

To keep the business healthy, Mr. Walker said the decline must be stemmed. If BP were to stop investing on the North Slope today, the fields that have been developed would decline at 15 percent or greater per year. But, BP and industry is investing as an industry \$1 billion to \$1.5 billion per year in existing fields.

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CHAIR WAGONER asked at what point in barrels per day does the pipeline cease to be economically viable to operate.

MR. WALKER replied that is not known, but significant investments will have to be made as certain flow rates get reached. He said that 17.5 billion barrels are left of known oil and gas resource, but the challenge is developing it and getting to market. He emphasized that nothing in his presentation relates to ANWR and that the impact of the tax on the major producers should be an important part of their consideration along with the smaller investors. He said that the real opportunity is to exploit the known resource on the North Slope, which is three times larger than the estimate of what is left to be found.

6:04:43 PM

He concluded with a picture of their 50-year vision, which shows that the future is very different than the past. The challenges of the decline on the North Slope and development of a viscous resource are enormous, but a good fiscal regime is key.

RAYMOND HALL, Senior Tax Economist, BP Alaska, said he would try to put Alaska in a global context and compare it to similar tax regimes around the world. He said it is critical to understand the context in which it was designed. Critical factors are the basin maturity, basin cost structure, the nature of the opportunities themselves, where is the basin located in terms of markets. In general, a higher tax burden will result in less investment and, conversely, lower tax burden will result in greater investment. The regime should be equitable and should provide returns to the investor consistent with the risks he is undertaking. It should be simple, although most are not simple. The PPT is a step in the right direction, being simpler than ELF. Stability is another important characteristic. The tax

should be levied on profits and not revenues. He pointed out that royalty is a tax on revenue.

Trends can be noticed in mature basins that the royalty burden is alleviated or removed altogether. Perhaps the most important feature is that the regime must be competitive and efficient. It should reflect the nature of the opportunities that are present. Context is critical.

[6:12:12 PM](#)

Slide 4 indicated that the United States is the second largest producer of oil and gas in the world with the vast bulk of it coming from the Lower 48 states. Norway is the sixth largest producer of oil and gas and UK comes in at ninth. The tax rate comparison slide showed the ELF at 56 percent and the PPT at 61 percent.

SENATOR FRENCH clarified that those figures accounted for total government take including federal; and in reality the PPT accounted for a 5 percent increase in total government take, but the federal tax would go down.

[6:15:27 PM](#)

SENATOR BEN STEVENS clarified that they are referencing industry financials, not just BP.

MR. HALL agreed.

SENATOR THERRIAULT reflected that ConocoPhillips said the total government take went up to 67 percent under the PPT and some of Dr. van Meurs' graphs indicate just under 60 percent. He asked if BP had conferred with other companies and if they have a disagreement on the total government take.

MR. HALL replied that there are different numbers. This graph represents marginal take, which is the take on the extreme - meaning if a company made an extra \$100, how much of that would go to the government. He said he could check them against ConocoPhillips' numbers.

[6:17:20 PM](#)

MR. HALL said the marginal tax rates tell only part of the story. One should also contemplate the treatment of capital cost relief. For example, in the UK, following tax reform in 2002, a company gets 100 percent relief for capital investment. This translates into no tax whatsoever until the project has secured payback on the investment. Norway has a combination of "uplift"

and a high tax rate that results in 93 percent relief for every \$1.00 spent. The UK has no royalty at all. Both UK and Norway levy all their taxes on profit. He reiterated that companies look for tax based on profit rather than revenue.

MR. HALL said the UK wants to be self-sufficient in its energy needs. So, the initial development of the basin proceeded very rapidly in the 1970s. Self-sufficiency was secured by 1980 and has endured until now. But, UK will need to start importing oil and gas within the next few years. Government policy has been focused on maximizing development and exploration in the Basin.

He said in 1993 the tax was substantially reformed which reduced the marginal rate on new developments from in excess of 80 percent down to 30 percent. That attracted more investment than any other basin in the world, 142 licensees. The 30 percent rate has endured for nearly 10 years.

[6:23:15 PM](#)

CHAIR WAGONER asked if there was a lag between development and production when the UK tax cut took place in 1993.

MR. HALL replied he yes, but the rate at which it increased subsequent to the tax change in 1993.

SENATOR ELTON asked when the marginal tax rate in the UK went from 30 to 40 in 2002 did that include a claw back provision on the 100 percent capital allowances.

MR. HALL replied that the important change in 2002 that accompanied that increase was that the government changed the way it allowed depreciation. Prior to 2002, only 25 percent of investments could be written off per year. It took a significant number of years for that investment to secure relief against tax. The UK government gave the companies the ability to offset their investments fully in the year it occurred. He clarified that:

There was no need for a transitional arrangement. If you make an investment in a new project in the UK, you pay no tax on that project until you have secure paper, which is to say, very unusual if you look around the world.

CHAIR WAGONER said that is similar to Alaska's royalty reduction.

[6:27:14 PM](#)

SENATOR SEEKINS disclosed that his daughter's husband is employed by BP.

MR. HALL explained regarding slide 9 that indicated lower tax created much more development and production. In short, he said:

The government reduced its share of the pie, but produced a much-increased pie that more than compensated for the reduction in the headline rate. So, it just sort of demonstrates that if we can focus on making the pie as big as possible, that's a much more productive conversation than getting into a discussion around who gets what slice.

[6:30:19 PM](#)

He thought there were far more differences between Alaska and Norway than there are similarities. Norway has some wonderful large fields that have been discovered and they are much less mature than in the UK.

In Norway, oil production has peaked, but gas production is growing rapidly and will probably keep going for the next three or four years before it starts to flatten out. However, one of the big differences in Norway is the role of the state, which directly owns one-third of the resource and owns a significant stake in the two largest players. It is able to sustain a high tax rate because it is essentially going from one pocket of the state to the other pocket of the state. "This is a very important distinction and I think it explains a lot...."

Norway is also trying to encourage new companies into their basin and has recently introduced an incentive for exploration such that if you are a newcomer and not currently paying tax and you spend \$100 on exploration, they will send you a check at the end of the year for \$78. They are also trying to get more acreage to new entrants to encourage them. But if you talk to new entrants, the 78 percent tax rate is a major continuing barrier to attract new entrants into the basin when just next-door at the UK, they would pay a much lower tax.

The Gulf of Mexico (GOM) had the most active global exploration in 1993 to 2004 and the second highest volume of discovered reserves of any basin in the world. It had rapid growth in production despite a challenging deep-water environment. A key-

enabling factor has been the low tax rate of 45 percent that applies there. The deep-water royalty relief is 35 percent. He emphasized that production of oil is very leading edge because of the depth and extreme weather conditions there. But, this is an example of a low tax rate encouraging and promoting high activity levels.

[6:35:33 PM](#)

SENATOR ELTON said that previous testimony has acknowledged that nobody expects to find any more big fields in Alaska. He thought it might be easier to make an investment decision in the Gulf, not because of the tax rate, but because of the possibility of finding larger quantities of oil.

MR. WALKER responded that the Alaska resource base is huge, but it is challenged by comparison. It is that challenge combined with the fiscal terms that not attracting investment.

SENATOR ELTON restated that he heard before that Alaska has no other huge bodies of gas and oil and he asked if larger companies weigh the possibility of finding a larger resource base in their decision on where to develop.

MR. WALKER replied that he was right. There is a fundamental difference between the resource base in the Gulf of Mexico where there is a good chance of finding some large fields through exploration. In Alaska, the fields that can be found will be small and possible marginal. Activity needs to be stimulated on the 14 billion barrels of oil they know exists.

It's a different resource base, but we would advocate the principal is the same. We still need investment dollars and they need to be spent on developing the oil and gas that's discovered already rather than exploring for new oil and gas, which is clearly more appropriate in the Gulf of Mexico.

[6:38:01 PM](#)

MR. HALL continued by comparing Alaska to Alberta, Canada, where an investment boom is taking place in their heavy oil industry, about \$10 billion annually. Alaska's investment is between \$1 billion and \$1.5 billion. In Alberta, production is expected to exceed 2 million barrels a day in a few years and go on to in excess of 3 million barrels a day within the next 10 years.

To encourage that development, the Canadian government introduced a major fiscal reform in 1995 consisting of 1 percent

royalty until a project achieves payback, which includes an allowance for a nominal return based on the risk-free Canadian bond rate. Federal and state taxes have to be paid in addition and those take the marginal rate to 39 percent; post payback the rate would increase because of the higher royalty to 54 percent. The federal tax rate already has a phased reduction that will reduce the marginal tax rate further so that by 2007 it will be around 35 percent. The top tax rate post payout would be around 50 percent. "This reform has had a major impact in stimulating a huge amount of investment and a huge amount of activity in this heavy oil province."

[6:41:41 PM](#)

MR. HALL said that slide 13 compared tax rates in other states and Canada. Albert heavy oil has 39 percent pre-payout, GOM has 45 percent and most of the other 48 states are around the low 50 percents. Alaska with the proposed changes would be 61 percent, the highest marginal tax rate in North America.

[6:42:30 PM](#)

SENATOR FRENCH asked how BP is comfortable with Alaska's tax rate if it's the highest in North America.

MR. WALKER replied that is what concerns BP. Alaska needs to attract twice as much capital as it is attracting today to stem the decline and to extend the Slope another 50 years. The PPT structure has merit and could serve Alaska well over the long term, but the 20 percent tax rate is too high. "That is one of the key points in our testimony today."

[6:44:25 PM](#)

SENATOR ELTON asked of how much of the government take in the three states of Texas, Oklahoma, California is attributed to royalty oil. It seems that a large part of Alaska PPT is royalty oil.

MR. HALL said he didn't have those figures with him. In summary, he said there is a clear correlation between stable fiscal policy and basin activity and Alaska is moving to the position where it will have the highest marginal tax rate in North America and in combination with the highest cost structure in North American may not be conducive to investment.

SENATOR ELTON said his whole theme is higher taxes mean lower production and asked to explain his use of "may."

MR. WALKER replied that there is a hard link between fiscal take and activity.

MR. KONRAD added that the PPT has many positive attributes, and BP will stand by their word on the 20/20, but he didn't know if that would ultimately attract capital to the basin.

[6:50:01 PM](#)

SENATOR BEN STEVENS asked to go to slides 5, 6 and 13. He explained why the marginal rate that applies to profit in the UK comparison is not valid in Alaska - because the UK has 100 percent cost recovery and that puts it in another realm where all the capital costs have been absorbed. In Alaska, the cash flow or marginal revenue is taxed immediately, but in the UK it wouldn't be taxed until all capital costs were fully recovered.

MR. HALL replied there are many different ways of expressing relative taxes and he chose to do it on a marginal tax rate, because that is simpler. Another way to do it would be to look at the average tax rate or the overall government take over the life of the project. But he thought those would give the same relative positions and Alaska's ranking would be unchanged.

[6:53:38 PM](#)

SENATOR BEN STEVENS said the only other country with a higher cost structure than Alaska is Canada's heavy oil sands.

MR. HALL responded that the example he showed the committee was just a heavy oil tax regime. There are other tax regimes in other provinces of Canada. But they are less than the proposed change in Alaska.

SENATOR BEN STEVENS didn't disagree, but wanted to point out that other regions with a higher cost structure appear to have incentivized investment by deferring royalty until after payout and deferring the tax rate to prepay out and basing them on the rate of return (ROR), a more complicated system.

MR. HALL said the ROR isn't that complicated and was used widely in production sharing contracts around the world; a lot of the new ones are being negotiated are based on an ROR mechanism. "Canada has gone down that road in a major way and it has proven to be very successful."

SENATOR BEN STEVENS observed:

I just find that the information is intriguing in the fact that the areas that have had the most increase in production...that are in the top producing regions of the globe - the areas that have had the largest increases in production may also have a higher tax rate, but they have a significant mechanism for capital cost recovery, whether it be a CCR or an uplift agreement or a ROR mechanism that is not imbedded in this proposal. Those are the areas that have attracted the investment to increase production. We should consider that if our objective is to maintain or increase production.

SENATOR STEDMAN asked if the ROR is a fairly progressive system versus the regressive nature of the royalty and tax scenario.

MR. HALL responded that with ROR, the tax burden is much less with low price than it would be at high prices. Also, marginal projects would have a lower tax burden because the overall tax take is based on the rate of return creating an automatic balancing mechanism.

SENATOR STEDMAN asked what kind of stimulus Alaska should use to extend production out 50 years.

MR. WALKER replied that the balance of the PPT components must be right and only time will tell. Basically he feels that the tax burden is at the high end of the scale, but the credit system effectively stimulates investment.

SENATOR BEN STEVENS said they have to look at how other countries attract investment.

SENATOR THERRIAULT asked if he meant they should look at other systems or the overall take.

SENATOR BEN STEVENS clarified that he meant they have to keep in mind how different regimes approached adding production and why they may have had a higher tax system as the end result. They offered greater up-front incentives than what Alaska has ever had or what is contained in the bill.

SENATOR THERRIAULT asked if he participates in ROR systems and what is the rate of return. Does it vary widely?

MR. HALL replied BP participates in a number of ROR production sharing contracts - Angola, Azerbaijan, in particular. They vary

significantly and are matched to the individual opportunities within each of the countries. Government take will vary significantly.

SENATOR THERRIAULT said the problem with the current system is because it wasn't sensitive to price and that's unfair to the state. The system, itself, caused the instability which brought them to changing the tax.

MR. WALKER remarked that there is very little profit to be made in Alaska at low prices and, therefore, at medium to high prices, they have to make a reasonable profit. That is why progressivity in Alaska is very dangerous.

SENATOR THERRIAULT countered that at high prices, the state's take might go down. That's not stable for the government.

[7:07:36 PM](#)

SENATOR FRENCH said that earlier he mentioned BP had invested \$24 billion to create their Alaska business and they had paid over \$32 billion in taxes to the state of Alaska and \$24 of tax to the federal government. The number missing was how much his company had profited.

MR. WALKER replied, "We were asked exactly the same question in the House and we said that we'd go back and look. I think it's a public record - our profits. So, therefore, we would go back and make that available."

SENATOR STEDMAN said the tax could be considered unfair to one side or the other at different times and they didn't want a tax that would put the industry in the position of retarding its growth.

MR. WALKER responded that he shares that concern. One of the great things about profit-based structures is that they are taxes on profit. He hoped a system that was designed on that would be durable.

[7:10:22 PM](#)

MR. WALKER used his last five slides to explain the effects of PPT on BP's business in Alaska.

[7:10:56 PM](#)

SENATOR FRENCH couldn't resist mentioning that part of his equation required him to calculate their profit, but yet he didn't have that figure handy.

MR. WALKER responded that he wanted their profits for the last 30 years.

SENATOR FRENCH asked if he had it for all the relevant periods he was illustrating.

MR. WALKER replied that he used real data to project profit for 2006. [He explained his graphs of government take.] The proposal allows BP to make a modest profit at low prices, but at medium to high prices, the government take is increased. At \$30, the government take is 70 percent on BP's business in Alaska.

[7:13:38 PM](#)

SENATOR ELTON asked what the cross-over point is for ELF and PPT.

MR. WALKER replied for BP it is \$30 - ANS, West Coast.

SENATOR ELTON was startled that BP doesn't make a profit at \$20 per barrel. "You just need to convince me."

[7:15:44 PM](#)

MR. WALKER replied that he would be happy to show him and he wished it were different. Back at his charts, he reiterated that Alaska is a tough place to make money at low to medium prices, because of the cost environment and the fiscal regime. The reason people invest in Alaska is that in the years when price is higher, they will make more. Those years have to cover the lean years. "We need to leave a reasonable profit for the industry at medium and high prices, because we certainly don't get it at low prices."

[7:16:29 PM](#)

SENATOR FRENCH referenced a DOR chart that indicates at \$20 a barrel, industry profit is 22 percent. He asked him to reconcile those figures with BP's.

MR. WALKER replied they should check whether the DOR figures include capital depreciation, a key element in profit calculations.

[7:19:20 PM](#)

SENATOR THERRIAULT asked what happens at \$100 a barrel.

MR. WALKER answered that he would have to develop numbers at \$100.

[7:21:07 PM](#)

MR. WALKER concluded his remarks saying that decline is a problem and large increases in investment are required to stem the tide - up to \$100 billion would be required in their Alaska business. He believed the PPT system has merit and could work well for Alaska and the industry for a long time to come but, "Clearly the numbers have to be right." Higher taxes mean less investment and the 20 percent tax rate will not maximize investment and production from ANS. Finally, he said, "Oil needs gas and gas needs oil. For gas to work, we need a healthy oil business and we need a healthy oil business that's going to be there for another 40 or 50 years to underpin gas."

MR. WALKER thanked the chairman for the opportunity to testify.

[7:23:15 PM](#)

SENATOR STEDMAN asked if fiscal regimes around the world are upping their take.

MR. HALL replied yes, but it's a bit patchy. It's important to take a long-term view. Six years ago the price of oil was \$10. History shows that you don't get sustained periods of high commodity prices. They go in cycles and prices will eventually go down.

[7:25:31 PM](#)

SENATOR THERRIAULT said the PPT proposes using the producers' royalty settlement agreement of DNR and Department of Interior, but they can vary as much as \$1. He understands that this is the lowest number. He asked him to comment on the different valuation methodologies.

TOM WILLIAMS, Tax Counsel, BP, replied that there are three settlements with DNR - Arco, BP and Exxon. ConocoPhillips is heir to the Arco settlement. Everyone else on the North Slope who has a royalty settlement has chosen one of the three. They don't come to the same netback value, but they all have a provision that allows DNR to reopen the methodology that is being used to calculate the netback price. The idea for the BP royalty settlement came from the administration and using the Department of Interior settlement is only available if you don't have state lands. The point is that BP is already using this methodology to report to the state so, "We don't have to reinvent a wheel."

This legislation gives the Department of Revenue a lot of discretion about what methodology it would use. BP wants a system that they understand and report and pay and know it was done right. The royalty approach in the PPT has a mechanism to allow for changing markets and that is lacking in some of the other approaches.

CHAIR WAGONER thanked them for their presentation and adjourned the meeting at [7:32:07 PM](#).