

HOUSE FINANCE COMMITTEE
March 23, 2011
8:07 a.m.

8:07:43 AM

CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 8:07 a.m.

MEMBERS PRESENT

Representative Bill Stoltze, Co-Chair
Representative Bill Thomas Jr., Co-Chair
Representative Anna Fairclough, Vice-Chair
Representative Mia Costello
Representative Mike Doogan
Representative Bryce Edgmon
Representative Les Gara
Representative David Guttenberg
Representative Reggie Joule
Representative Mark Neuman
Representative Tammie Wilson

MEMBERS ABSENT

None.

ALSO PRESENT

Representative Mike Hawker; Senator Cathy Giessel; Bart Armfield, Vice President, Operations, Brooks Range Petroleum Corporation; Marilyn Crockett, Executive Director, Alaska Oil and Gas Association; Ralph Portell, Tax Manager, BP Exploration Alaska.

PRESENT VIA TELECONFERENCE

Ken Thompson, Managing Director, Alaska Venture Capital Group (AVCG); Claire Fitzpatrick, Chief Financial Officer, BP Alaska.

SUMMARY

HB 110 PRODUCTION TAX ON OIL AND GAS

HB 110 was HEARD and HELD in committee for further consideration.

#hb110

HOUSE BILL NO. 110

"An Act relating to the interest rate applicable to certain amounts due for fees, taxes, and payments made and property delivered to the Department of Revenue; relating to the oil and gas production tax rate; relating to monthly installment payments of estimated oil and gas production tax; relating to oil and gas production tax credits for certain expenditures, including qualified capital credits for exploration, development, and production; relating to the limitation on assessment of oil and gas production taxes; relating to the determination of oil and gas production tax values; making conforming amendments; and providing for an effective date."

8:08:16 AM

BART ARMFIELD, VICE PRESIDENT, OPERATIONS, BROOKS RANGE PETROLEUM CORPORATION (BRPC), offered a PowerPoint presentation, "Brooks Range Petroleum Corporation, 10-Year History and Project Milestones" (copy on file).

Mr. Armfield informed the committee that Brooks Range Petroleum Corporation (BRPC) had been working from the North Slope since 2001. The corporation had three core areas spread across the North Slope, stretching from Nuiqsut, to Beechey Point, to south of Point Thomson. The BRPC gross North Slope acreage totaled 240,000 acres. The corporation had accumulated the positions strategically with specific operational ideas and expectations for each unit. The Beechey Point unit, located in the central portion of the slope, was considered the near-term, development phase of the BRPC master plan. The corporation had been active in the area long enough for results to progress to the point of nearing actual development sanctioning, pending an engineering report due in the near future. The corporation had drilled, and was near the bottom of a well at the southeast corner of the Miluveach Unit, near Nuiqsut. He stated that this was the only exploration well that had been drilled on the North Slope

in in the current year. The acreage position in the east, south of Point Thomson, was considered more strategic in for long term planning.

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Mr. Armfield directed attention to a timeline at the bottom of Slide 1. He relayed that the Alaska Venture Capital Group (AVCG) was formed in 2000. The AVCG is comprised of a consortium of lower 48 mid-continent oil and gas companies and is the parent company of BRPC. The group used the period of 2001 through 2006 to acquire acreage, hire technical staff and solidify the business program. In 2007 the first well was drilled at the Beechey Point Unit. Now, in 2011, the corporation was drilling another exploration well and was on the edge of sanctioning a development program.

Representative Gara asked what the sanctioning and development program meant in relation to the corporation's commitment to produce in the area. Mr. Armfield replied that a third-party engineering report concerning the reserves that were discovered in past activities. If the reserve numbers came back indicating that there were enough barrels to progress a development program, the corporation would take the report to the working interest owners and request that the development be sanctioned and progressed forward. He stated that the corporation had plans for production in 2013.

Mr. Armfield continued with Slide 2 of the presentation.

- o WIO's represented by BRPC are committed to Alaska and currently have a \$ 154 MM investment that needs to perform
- o Current business plan approved by our investors has a timeline which reflects first oil and revenues from production in mid 2013
- o Each year we delay, has an adverse effect on the investments ROI and IRR
- o Current economic models used by BRPC, marginally support an acceptable IRR on smaller targeted accumulations with an assumption that reserve base would expand to include other prospect potential in the project area
- o An increase in tax rate and a reduction in capital credits would have a negative reaction

when applied to current models most certainly moving the project to an un-economic portfolio position and would shorten our active participation on Alaska's North Slope

- o Increased capital credits, lowering of the base rate and progressivity when applied to our model would assure an attractive IRR, and would foster a more aggressive prospect portfolio and in turn, provide encouragement to our WIO's for added funding for our NS projects.
- o Elevate the interest level of other players with a watchful eye on Alaska

Mr. Armfield reiterated that BRPC was the only entity drilling an exploration well in the current year. He offered that BRPC had been forced into the solitary driller position because it had \$154 million invested, and the working interests owners of the corporation needed to see a return in the investment. The current business plan had approved development and production by 2013. He stressed that the internal pressure to make the investment perform were as significant as the external pressure. Each year that the project was delayed cut into the internal rate of return and the return on investment. The corporation maintained the goal of becoming a producing entity. The models currently used were geared toward finding smaller, viable projects to get established and then add to those projects over time.

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Mr. Armfield testified that an increase in the base rate, progressivity or the status quo would affect revenue streams into the future.

Co-Chair Stoltze asked what kind of affect an increase would have. Mr. Armfield replied that it would negatively affect the return on investment. Naturally, an increase in capital credits, and a decrease in base rates and progressivity, would have a positive effect on investment.

Mr. Armfield acknowledged that because BRPC was a very small entity, the corporation's performance would be heavily scrutinized. He believed that if a small company could come into Alaska and turn a profit, any sized company could. He said that HB 110 would be helpful in getting new

entities interested in working in Alaska. Mr. Armfield stated that the decline of oil production in the state was cause for concern. He revealed that a common goal between the state and the industry was to slow or level the decline of oil production and throughput in Alaska. He believed HB 110 would set the stage to find a positive solution to the problem of decline.

Mr. Armfield cited the top three elements that would operate once BRPC made return on its investment, as listed on Slide 3:

- Revise the progressivity surcharge to the "bracketed tax structure" with calculations made annually instead of monthly
- Cap the total tax at 50 percent when oil prices top \$92.50/bbl
- For development of new fields outside existing production units, the base tax rate will be 15 percent instead of 25 percent and cap the total tax at 40 percent

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Vice-chair Fairclough queried difference between an "explorer" and a "producer." She asked why a company would explore under the current tax regime. Mr. Armfield answered that as explorers BRPC had a business plan that indicated a revenue producing stream by 2013. The corporation needed to get a return on the already invested \$154 million as soon as possible. He understood that it would behoove BRPC to wait until the changes from HB110 took affect before drilling. However, the corporation was not in yet production and could not afford to wait another year.

Vice-chair Fairclough suggested that companies operating in the state understood the tax regime when they began exploration. She wondered if an argument could be made around why companies would willingly enter into exploration, knowing the tax regime was less than advantageous.

Mr. Armfield reiterated that BRPC was an unusual corporation. The corporation had working interest owners that had been told a revenue stream would be established by 2013. He admitted that the current tax regime did have an

adverse effect on BRPC, but being in a position to become a revenue producer was more important than waiting another year.

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Representative Wilson asked if BRPC had examined the tax regime upon deciding to come to Alaska in 2000. Mr. Armfield replied that when AVCG made the decision to come to Alaska, oil was \$9 per barrel. He reiterated that AVCG was a group of investors made up of small, independent, second and third generation, family-owned oil and gas companies. With oil at \$9 per barrel, available projects would have generated a very small cash flow. Group members had agreed that there would not be enough profit to pursue smaller accumulations. The thinking was that more money could be made in Alaska because of the much larger reserves. The price of oil remained \$9 per barrel, but the hope was that the cost of doing business in Alaska would be lower. Currently, with oil at \$105 per barrel, the small accumulations from 2000 are producing some return. Some of the members of AVCG had turned their activity elsewhere, but retained small holdings in the state.

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Representative Wilson asked whether AVCG would have made the decision to come to Alaska if Alaska Clear and Equitable Share (ACES) had been in place in 2000. Mr. Armfield thought that it would have been less likely that the group would have made the same decision to come to Alaska if ACES had been in place at the time.

Representative Costello wondered about the nature of the conversations concerning Alaska that BRPC had when seeking partnerships with other producers. Mr. Armfield replied that the group had been in partnership with a company called Bow Valley, which was acquired by Dana Petroleum. When Dana Petroleum reviewed the 20 percent position it had acquired in Alaska, it elected not to participate in the state. Dana Petroleum requested that BRPC buy them out of their share, which took AVCG to a position of 50 percent. The group has continued to work to lower its position percentage, but has had trouble acquiring new partners.

Representative Doogan asked if the group had acquired pipeline space to deliver any oil it may produce.

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Mr. Armfield replied that the Trans-Alaska Pipeline System (TAPS) was a common carrier. If the group could get their product to TAPS there would be no problem. The objective was to tie into common carriers and transport the oil to TAPS. The group did not anticipate any problems to that end.

Representative Gara understood that the project at Beechey Point would move forward upon the completion of the engineering report that showed the anticipated reserves, even if ACES remained the same. Mr. Armfield responded that the Beechey Point project had begun 10 years ago, and the economics that the group had in place showed that a certain level of reserves would ensure the project moved forward. If the reserves came in less than anticipated, and depending on the impact of HB 110, a recalculation may be in order and a new presentation would be made to working interest owners. He reminded the committee that AVCG had other ventures that needed to produce revenue, instead there was \$154 million producing zero return. He felt that some form of return was better than none.

Representative Gara understood that if the engineer's reports showed the reserves that were expected, the group planned to move ahead with the project. Mr. Armfield said that the group would present the report to the working interest owners. The decision would ultimately be made by the partners.

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Representative Gara understood that it was difficult for smaller producers to produce a modest sized field without their own processing facility. He queried the plans for a processing facility at Beechey Point. Mr. Armfield relayed that the group planned to build its own processing facilities. Small, portable, component modules would be applied to the project. The facilities would expand or contract depending on the throughput. As other project areas progressed, facilities could be relocated to new project areas.

Mr. Armfield concluded with Slide 4, "HB 110, Opportunity to Change the Current Trend", a line graph, which depicted

the decline in forecasted oil production over the next 38 years. He argued that HB 110 had a strong chance of positively impacting the throughput decline. He thought the activity levels generated from the changes outlined in HB 110 would change the decline curve, create jobs and expand the vendor base. The change in the high cost of exploration and development timelines could create more business on the North Slope.

Co-Chair Thomas asked if HB 110 were to pass, when the state could expect to see exploratory wells begin to produce oil. Mr. Armfield stated that according to the current timeline results could be expected in three to five years.

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KEN THOMPSON, MANAGING DIRECTOR, ALASKA VENTURE CAPITAL GROUP (AVCG) testified that AVCG was the parent company of BRPC. He presented the Power Point presentation, "House Bill 110 House Finance Committee Testimony by AVCG, LLC." He cited Slide 2, "Agenda":

*Purpose: Present ideas to re-incentivize investment and increase the competitiveness of Alaska relative to other oil basins with **one common State & Industry Goal** in mind: **LEVEL ALASKA'S OIL PRODUCTION***

Mr. Thompson relayed that if the state and the industry had the goal of dividing "fixed-pie" revenues, conflict would be ever present. He believed that changes in the tax structure would lead to growth in the industry resulting in increased revenue for the state. Another giant field on the North Slope was not necessary; several small companies producing modest amounts would level production. He hoped that the state could move from the position of losing \$2 million, to a position of having no decline. He shared that the company approached working with the state from an investor standpoint. The company hoped to raise more capital for exploration and production. Mr. Thompson informed the committee that he was calling in via teleconference because he was currently in the Lower 48 soliciting additional partners to share the risk with AVCG. He thought that HB 110 would help the company in attracting new partners to the state. He stressed that some fields in the North Slope were declining, and offered that the state and industry together could focus on the next frontier of

development in an effort to level the decline. He stated that oil source rocks, low-permeability sand and exploration with smaller fields could level production in the next several years.

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Mr. Thompson stated that AVCG was growth company. The company currently had no production, but he stressed that the only way forward for the company was upward. He reiterated his hope that the company would play a major role in leveling oil production in the state.

Mr. Thompson cited Slide 3, "AVCG & BRPC: Entity Comparison." He told the committee that his job as lead director was to attract new investors. He said that there were 15,000 attendees at the North American Prospect Expo in 2009. Twelve companies approached the AVCG booth at the expo and all twelve queried Alaska's tax regime. The company was down to one potential investor. He said the investors lead negotiator requested information on what Alaska planned to do to change the tax regime in order to incentivize major new investment.

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Mr. Thompson cited Slide 4, "AVCG JV Leasehold Portfolio." He reiterated that the company had approximately 240,000 acres in the North Slope and a well was currently being drilled west of the Kuparuk River Unit. He added that AVCG owned 50 percent of the overall acres. Houston, Texas based Ramshorn Investments, Inc. owned 25 percent and TG World Energy Corporation, out of Calgary owned 25 percent.

Mr. Thompson continued to Slide 5, "Attracting New Investors In the Face of Global Competition for Capital." He stated that 12 companies had initially expressed an interest in investing in the Alaska project, 11 of which had eventually revoked support. He repeated that companies were not likely to invest in the state due to the tax regime.

Mr. Thompson shared that AVCG had been optimistic when Bow Valley was bought out by Dana Petroleum. However, Dana Petroleum had elected not to participate on the North Slope because of better tax treatment and higher returns in the

North Sea. He reiterated Mr. Armfield's statement that AVCG was currently searching for a partner to shoulder the 50 percent interest.

Mr. Thompson explained that substantial tax incentives enacted in 2009 encouraged the development in the UK North Sea. In the North Sea new fields were exempt from the 20 percent surcharge until the first \$13 billion in profits was made. The tax changes the UK made in 2009 increased first quarter drilling for 2010 by 29 percent; the second 133 percent. New production was anticipated. The company, Noble Energy, declined to join in the Alaska investment, opting instead to invest in Israel. The prospectivity and tax structure in Israel were more appealing than Alaska. The government take was less in Israel and producers were recovering 200 percent of their investment.

Mr. Thompson continued. He stated 138 wells per month in North Dakota and would soon surpass Alaska in daily oil production. The suspension of severance tax for initial development and expedited state permitting had attracted investors.

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Mr. Thompson continued to Slide 6, "Frasier: Alaska is 68 of 133 in terms of overall attractiveness." The slide indicated that Alaska was average in its overall attractiveness; falling behind Alberta, but in front of Iran.

Mr. Thompson Slide 8, "AVCG's Recommendations to Assist in Achieving the Common Goal of No Decline":

- Revise the progressivity surcharge to the "bracketed tax structure" with calculations made annually instead of monthly
- Cap the total tax at 50 percent when oil prices top \$92.50/bbl
- For development of new fields outside existing production units, the base tax rate will be 15 percent instead of 25 percent and cap the total tax at 40 percent

A bracketed structure with reduced base rate and cap and a reduced base tax rate for new fields with a lower cap would attract more investor partners for AVCG et al to increase small field development and establishment of the North Slope's first "open access" facility sharing processing facilities.

- Accelerate the payment for exploration and other qualified capital investments to one year vs. two years

The acceleration of credit recovery payments to a one year cycle would allow for AVCG and its partners to consider drilling 3 exploration wells per year instead of an average of 2 per year...a chance for more discoveries sooner

- Increase the tax credits for "qualified capital" investments from the current 20 percent to 40 percent

An increase in qualified capital credits to 40 percent would provide immediate impact to BRPC's project investment base and would extend our ability to encourage additional and continued capital investment from our current WIO's therefore providing more opportunities for successful discoveries and future development projects

- Extend indefinitely the "Small Producer Tax Credit" of \$12MM a year from expiring on May 1, 2016 (or certainly extend another 5 years to May 1, 2021 then re-assess at that time). This is an item not currently in current bills but would be helpful in attracting new long-range development capital for BRPC and others like our company.

Currently, we have a sanctioning proposal in front of our WIO's that projects first oil and revenues in 2013. With the Small Producers Credit expiring in May 2016, the development would be limited to a 3 year use of this credit. We would propose an extension through 2021 to allow our first project the full credit to attract new investors.

Mr. Thompson addressed Slide 9, which was a line graph that illustrated the outcomes of both maintaining the status

quo, and the positive adjustments due to the passage of HB 110. He asserted that the AVCG would continue an exploration program in the state regardless of the passage of HB 110. He relayed that there were 16 new prospects in the Southern Miluveach Unit and that the tax changes outlined in HB 110 would attract capital investors. He strongly believed in the "Next Frontiers" Development plan depicted on Slide 9, which listed:

- Smaller field exploration with regional processing
- Lower-permeability sands with new tech
- Oil source rock shales
- Viscous oil, NS shore, NS gas

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Mr. Thompson insisted that the plan would increase revenue for the state and end decline in production. He reiterated his full support for HB 110.

Representative Gara asked if the AVCG would appreciate the state considering delaying taxation until production was online, as was done by some of the foreign regimes mentioned in the presentation. Mr. Thompson replied that getting all involved parties aligned behind an entirely different tax system would be difficult and time consuming. He thought that the most effective solution would be to examine the current system and modify it to attract new capital investors. He stated that he had worked with over 20 countries that had a system in place where the tax rate was low until the company recouped its capital, and then the tax rate would be increased. He said that the tax credits that Alaska currently had in place had been helpful to the industry. The money saved by the credits had been used for further seismic and drilling activity. None of the savings had been distributed to AVCG members.

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Representative Gara wondered if an increase in the tax credits would be sufficient to increase exploration, and had lack of access to existing processing facilities on the North Slope made it difficult for smaller companies to produce. He asked if a credit toward the building of processing facilities be worth consideration Mr. Thompson responded that faster payment of the exploration tax credit

would be helpful. Currently the credits were paid out over two years, 50 percent per year. He said that AVCG would use the money to further drilling in the state, and could consider drilling a third well during a routine year. He stressed that AVCG was currently Alaska's number one exploration company. He said that the company wanted to build its own processing facilities and possibly rent them out to other developers. He concluded that tax credits for shared processing facilities would be helpful.

Vice-chair Fairclough pointed to Slide 6 of the presentation. She noted that Alaska fell in the middle of the overall attractiveness scale and queried the reason that AVCG was advocating for tax regime changes. Mr. Thompson replied that Alaska could maintain the status quo, and the state and the industry could remain in conflict over who should benefit most from the funds made off of mediocre production activity, or changes could be made which would greatly increase capital spending and level Alaska's production. He offered that it was a matter of maintaining the status quo or making a positive adjustment.

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Vice-chair Fairclough understood that the Alaska's investment attractiveness had more factors than just the taxation issue. Mr. Thompson responded that the first factor that investors examined was prospectivity. Second was the tax regime. Many companies had stopped exploring on the in the central North Slope area because the prospects had fallen. He did not think that any amount of tax change would increase exploration in that particular area, except for small companies like AVCG. He believed that the unassessed areas of the North Slope contained massive amounts of oil in low permeability reservoirs and oil source rock shales. He concluded that Alaska's prospectivity was attractive, but maintained that the tax regime was unattractive to capital investors.

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MARILYN CROCKETT, EXECUTIVE DIRECTOR, ALASKA OIL AND GAS ASSOCIATION, (AOGA) remarked on the components of the CS

for HB 110 that were of concern to AOGA. She referred to the handout, "Comments of the Alaska Oil and Gas Association on CSHB 110(RES), March 23, 2011."

Ms. Crockett read from the section "Progressivity Rates/Bracketing/Tax Cap":

AOGA supports the provisions in CSHB 110(RES) which establish bracketing of the progressivity rates and caps progressivity at 25 percent, for a maximum rate of 50 percent for progressivity and the base rate combined. Under the current form of ACES, at \$30, the taxpayer pays at the 25 percent base rate. But as the taxable Production Tax Value (PTV) raises above \$30, the progressivity feature kicks in, and instead of applying the higher tax rate to just the incremental dollar, the current tax system reaches back and taxes the entire original \$30 at the higher rate. Each time the PTV per barrel increases further beyond \$30, all prior dollars are taxed at the higher rate instead of just that further increase. This approach is what creates such high marginal tax rates, and creates an imbalance in the risk-reward investment environment in Alaska. Removing the upside to the degree the progressivity feature does makes it much more difficult to compete for investment dollars with other areas that are not as fiscally challenged as investments here in Alaska. CSHB 110(RES) adds much needed stability and predictability to the tax. As companies realize higher prices and greater PTV, the State likewise continues to share in those benefits. In addition, capping progressivity and the base tax at the 50 percent combined rate under CSHB 110(RES), rather than the current 75 percent, also provides the impetus needed to motivate companies to undertake the high risk projects on which the future economic health of Alaska will depend.

This change creates a business climate where the reward is commensurate with the risk and keeps the needs of the State and the producers in a more appropriate balance.

You will be hearing from our member companies regarding this risk/reward and the need for an adequate upside, and the challenges they face when presenting projects to their respective Boards. The

competition for these dollars is real and anything to move Alaska to a more competitive position will make those arguments more palatable and possible.

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Ms. Crockett read from the section "Annual-v-Monthly":

The revenues that are used in the calculation of the progressivity are actuals, reflecting current production and current prices. They are subject to the seasonal swings in production or market pressures of price. In calculating the PTV, though, the deductible lease expenditures are the actual expenses for the whole year, with 1/12 of the annual total being allocated to each month during the year.

We support moving from a monthly calculation of progressivity to an annual calculation to synchronize the revenues with the expenses, avoid the mismatching, and more accurately reflect the philosophy behind what a progressivity feature should look like.

Ms. Crockett read from the section "Tax Credit Incentives Extended To North Slope":

CSHB 110(RES) expands the existing 40 percent *well lease expenditure* tax credit currently available only to qualifying expenditures in "Middle Earth" and the Cook Inlet Sedimentary basin.

The well lease expenditure concept was introduced and enacted into law in May 2010 in connection with chapter 16, 2010 Session Laws of Alaska (the Cook Inlet Recovery Act).

A well lease expenditure is the subset of qualified capital expenditures (QCE) that currently define the scope of capital spending that qualifies for the 20 percent QCE credit under sub-section .023(a). Thus, within the QCE "bucket" are a set of costs that would be eligible for a full 40 percent tax credit instead of the usual 20 percent QCE credit. The definition of WLE as *intangible drilling and development cost* (IDC) has several advantages. First, IDC is a concept that is well-defined in oil and gas tax law. Second, WLE is consistent with language already existing in the PPT

ACES framework. Producers will not have to wait for the DOR to write regulations that describe what is included and not included in the WLE.

Lastly, since labor costs may be included in IDC, the 40 percent WLE credit indirectly supports hiring and job creation. In sum, AOGA strongly endorses this special category of QCE that is targeted for the credit uplift because 1) this category of expenditure is tied directly to in-field drilling; 2) includes labor costs; and 3) is a convenient and readily accessible accounting designation.

Ms. Crockett continued to the section "Lower Tax Rates For New Field Development":

AOGA cautiously supports this proposal for new field development, which represents a significant reduction in the implied tax burden. However, it raises several questions. First, as with other provisions in CSHB 110(RES), the implied lag in the effective date is problematic.

The provisions in sections 6 and 8 of CSHB 110(RES) are silent on the treatment of lease expenditures for new field development. Since the proposed change in base tax and progressivity is driven by the PTV associated with new field development, some form of ring-fencing production, revenue and costs is implied.

AOGA favors addressing the matter of cost allocation in statute rather than through regulation.

Lastly, and most importantly, it is important to incentivize ALL new oil. This means new oil associated with new field development and from exploration, as well as new oil from existing producing fields using in-field drilling, secondary recovery, and tertiary recovery techniques.

Ms. Crockett continued to the section "Reducing the Interest Rate on Tax Under and Over Payments and the Statute of Limitations":

AOGA supports the Administration's proposed reductions to the statutory interest rate on tax under and over

payments and the statute of limitations for performing tax audits.

Unfortunately, the provision reducing the timing of the statute of limitations in the version of the bill before you now was deleted in the previous committee. We encourage you to reinstate it.

The time period for which the Department can audit a taxpayer's tax return is three years from the date of the filing of the tax return for all taxes except for the production tax. With the enactment of ACES, the statute of limitations for auditing production tax returns was increased to six years. We never understood why that change was needed when the three-year audit period has worked successfully for all other taxes and can be extended and re-extended any number of times as appropriate and taxpayers were generally willing to do so.

Under the current interest rate provisions, after three years, interest represents at least 38¢ for each dollar of additional tax claimed. But after six years the accrued interest grows to at least 92¢ for each dollar of additional tax claimed. The longer statute of limitations, coupled with the high interest rates, mean a greater likelihood that audit disputes will be litigated instead of settled, because the interest, which under state law cannot be compromised or abated, represents such a substantial portion of the amounts at issue even at the very beginnings of the disputes.

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Ms. Crockett testified that AOGA supported the legislation.

Representative Edgmon asked if assurances could be made that productivity would increase with the passage of the legislation. Ms. Crockett answered that time would tell; recent history had shown that activity and investment levels were down. She thought that the bill presented a more positive and attractive fiscal regime than the system currently in place.

RALPH PORTELL, TAX MANAGER, BRITISH PETROLEUM EXPLORATION ALASKA, introduced his support staff.

CLAIRE FITZPATRICK, CHIEF FINANCIAL OFFICER, BRITISH PETROLEUM (BP) ALASKA, testified in support of HB 110. She believed the legislation would address three key issues:

1. Alaska is not competitive. So it is not getting the level of investment that it could.
2. The pipeline is 2/3 empty as there isn't the level of investment required to put more barrels in the pipe.
3. There would be more jobs if there was more activity.

Ms. Fitzpatrick stated that with 85 percent of the states unrestricted funds coming from the oil industry, Alaska needed a healthy oil industry to ensure a long-term, sustainable future. She shared that she was in London attending a series of meetings to advocate for Alaska activities. She opined that she remained at a significant disadvantage relative to the other locations being represented there. The other locations were able to demonstrate that their opportunities were providing a better risk reward balance than Alaska was able to demonstrate with the projects and fiscal structure it has.

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Ms. Fitzpatrick referred to the Power Point presentation, "House Finance Committee BP Alaska Testimony - Claire Fitzpatrick, CFO March 23, 2011, and cited Slide 2, "Balanced Fiscal Systems Investments." She said that in the past the state had had a more balanced fiscal system and that at that time BP had been in a position to make substantial investments in a number of properties. Not only did BP make production investments, they also invested in support opportunities with upgrades to pipelines and the tanker fleet. Since the change in production tax in 2007 investments in capital and expense had shifted to where opportunities demonstrated the best risk reward return. Because of the way the production tax worked all of the upside earnings went to increased taxes, which leaves little share for investors. British Petroleum was responsible for meeting the fiduciary expectations of their investors and as a result less was being invested in Alaska.

Ms. Fitzpatrick continued to Slide 3, "U.S. Production is growing; Alaska production isn't," which was a line graph depicting that production in the Lower 48 had rose as oil prices had risen, and Alaska had continued to decline. The following graph on Slide 4 illustrated that the trend could also be seen in terms of well activity and drilling footage.

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Ms. Fitzpatrick reiterated the importance that Alaska remained competitive in the industry.

Ms. Fitzpatrick continued to Slide 5, "Less money being spent on new oil since ACES," which was a bar graph that illustrated BP operated fields production adding investments, after adjusting for inflation. She felt that Alaska had a policy choice to make; did Alaska want less oil production, or more oil production. More oil production would require more investments, which would result in more jobs. She opined that there was considerable oil left on the North Slope, yet the pipeline was two-thirds empty. She relayed that Alaska needed to attract billions of dollars to drill and produce enough to stem decline. She stressed that Alaska was far removed from the markets that used the oil, and that the cost for goods were higher in the state than elsewhere. She added that the real challenge to more production was the state tax system.

Ms. Fitzpatrick testified that BP supported the legislation. She explained Slide 6, "Governor's Bill (HB 110) – A step in the right direction":

- BP continues to support this bill
 - Improves competitiveness and encourages investment

- What we like
 - Bracket structure for progressivity
 - ✓ Incentivizes investment
 - ✓ Rebalances risk reward

 - Additional credits for drilling investments
 - ✓ Incentivizes production adding investments

 - Reduction in statute of limitations and punitive interest rate

- ✓ Increases certainty, removes unfair provision
- Annual calculation of production tax rather than monthly
 - ✓ Matches costs with revenues and increases predictability

Ms. Fitzpatrick explained that tax reform was the single most important thing that the state government could do to promote the increase in oil production. Tax reform would draw oil industry investment, which would slow the decline, put more oil into the pipeline and create many jobs over many years. She noted that tax credits had a significant place in the tax fiscal structure. The tax bracketing and the lower progressivity rate were crucial parts of successful reform. She thought that the state and the investors had mutual interests and should be working toward the common objective of putting more barrels in the pipeline.

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Ms. Fitzpatrick discussed Slide 7, "Increased investment = Alaskan jobs and production":

- BP will re-evaluate the entire inventory of opportunities
 - Note: BP owns 26 percent of Prudhoe Bay - investments require other working interest owner approvals
- Opportunities that could become competitive if bill is passed:
 - Increased drilling, potentially adding another Rig in service
 - Increased wellwork
 - Gas Partial Processing /I - PAD
 - Evaluate 'at scale' development viscous opportunities
 - Increased R&D spending to develop heavy oil
- The sooner the bill takes effect, the sooner increased activity can happen

Ms. Fitzpatrick reminded the committee that BP had warned the state that projects would be impacted by the 2007

passage of the higher production tax and the removal of the price upside. She emphasized that Alaskans were working on the projects that had to be shut down at that time, whether they were employed by BP or Alaskan based contractor companies. She anticipated more drilling after the passage of HB 110, which would provide 100 jobs per drill rig. She stated that BP had plans for a 50, new well, I-PAD program and a new gas processing plant, which would assist in the extraction of the thicker oil out of the more difficult reservoirs in the western area of Prudhoe Bay. She contended that under the current tax system it did not make economic sense to invest the over \$2 billion those projects would cost. She compared Alaska with North Dakota, noting that North Dakota was more attractive to investors. She asserted that it was becoming increasingly difficult to lure investors to Alaska. She concluded that HB 110 would significantly improve the prospect of retaining investor funding to move forward with projects currently on hold.

[9:38:39 AM](#)

Representative Gara referred to testimony given by Ms. Fitzpatrick during a past House Resources Committee meeting. Representative Gardener had asked if the state could expect more exploratory wells if HB 110 were to be passed. Ms. Fitzpatrick had responded:

"BP doesn't do what's referred to as traditional exploratory wells. Within our existing units we believe there are significant resources we'd rather focus our attention on."

Representative Gara understood by the response that with HB 110, BP's focus would be on development wells within existing fields and not on exploration wells. Ms. Fitzpatrick responded that the definition of exploration wells was very technical. Technically, the corporation would be focusing on development wells, recompleting wells and well work. She communicated that it was not BPs current intention to drill what was technically classified as an exploration well.

Representative Gara related that according to numbers provided by the Alaska Oil and Gas Conservation Commission (AOGCC), the number of development wells rose in 2010 to 157, the highest number since 2005. He admitted he had hoped to hear that BP's plan was to continue with more

exploration. Ms. Fitzpatrick repeated that more exploration was not in the corporation's current plan.

Representative Wilson referred to Slide 5. She asked whether the numbers would rise back to those seen in 2007, were the legislation to pass. Ms. Fitzpatrick replied that the expectation was that BP would spend more money on production adding activity if HB 110 passed. She could not attest to the distribution between wellwork recompletions versus new wells, but the overall aim would be to get more production in the pipeline.

[9:42:16 AM](#)

Representative Wilson wondered how many jobs were anticipated to be created by BP with the passage of HB 110. Ms. Fitzpatrick said that if an additional rig were added it would create approximately 100 jobs. If HB 110 passed and was successful in bringing in significant projects, more jobs would be created. Some of the job creation would be within the corporation, but the bigger difference would be seen by Alaskan contract companies who support the oil industry.

Representative Doogan wondered what reaction BP would have if the legislature reported out a bill with the same basic provisions as HB 110, but that stipulated that all payments to industry be made after the fact. Ms. Fitzpatrick said it would depend on how "after the fact" was defined, which would have an impact on what became economic. The value of receiving cash flow now would differ from cash flow in 15 years.

Representative Doogan clarified that "after the fact" referred to oil actually moving through the pipeline.

[9:45:47 AM](#)

Ms. Fitzpatrick said that if wells were going to be drilled to get oil into the pipeline in 12 to 18 months, the tax benefits associated would be minimal. However, investing in a project with two to three years of research concerning the application of technology, that would then be applied to a seven-year construction period the value of the project deteriorates because of the delay in receiving the tax benefits.

Representative Doogan asked whether BP would support a bill that did not pay out credits until oil was in the pipeline. Ms. Fitzpatrick related that BP would be less supportive of the hypothetical legislation because it would negatively impact the economics. Theoretically, projects might not be as competitive as they could be and could lose out to other opportunities elsewhere. She said that BP would work with whatever the legislature passed in order to get as much investment as possible, provided it made competitive and economic sense.

Representative Guttenberg noted that BP was a 26 percent owner in Prudhoe Bay and the dominant owner in TAPS, including the terminal, which produced substantial revenue. He wondered if the low-flow and liability of a shutdown should be a major responsibility for BP. He asked whether a feeling of responsibility came into calculation during BP business decisions. Ms. Fitzpatrick replied that she was separated from some of the decisions and details concerning TAPS and low-flow. Her upstream decisions were based on tariff information provided by midstream companies. The delivery system for the oil was not disclosed, only the cost of getting the oil to market was revealed. She said that when she made upstream decisions they were not made from an economic perspective of TAPS, but by considering if the upstream project was competitive and relative to other opportunities. Clearly, on a business perspective BP had an interest in TAPS therefore it was in the best interest for BP that as many barrels as possible flowed through the pipe. She stated that the entities had to remain separate under Federal Energy Regulatory Commission (FERC) rules.

[9:49:47 AM](#)

Representative Guttenberg wondered if BP took the health of TAPS into consideration when going forward with development plans. Ms. Fitzpatrick replied that getting the oil to market was a consideration. Whether the oil was going via TAPS, rail cart, or truck was not an economic consideration for the corporation. She assumed that the Alyeska Pipeline Service Company would consider what investment was necessary in order to maintain an appropriate flow rate for TAPS. The cost would be built into the tariff, which would be considered by BP. If the upstream activity were no longer viable, then BP would conclude that the upstream activity was not economic.

Representative Gara asked how many exploration wells had BP developed in Alaska. Ms. Fitzpatrick said she would need to research the question.

Representative Gara requested the history of BP exploration wells spanning the last three fiscal regimes. Ms. Fitzpatrick replied that she would provide the information to the committee.

[9:53:38 AM](#)

Representative Gara asked whether BP had earned an excess of \$7 billion over the last four years. Ms. Fitzpatrick said yes. She imagined that the number of taxes paid by BP surpassed any earnings over the same period of time.

Representative Gara wondered whether paying out credits over one year instead of two, or increasing the credits to allow for the building and expansion of processing facilities would make a positive difference even if the tax rates remained the same. Ms. Fitzpatrick responded that the changes that would make the most significant difference in BP's areas of investment would be changes to the area around bracketing and annual monthly charges.

Representative Hawker spoke to three issues raised during debates in House and Senate Resources Committees, and in the committee, concerning the legislation. One prevailing opinion was that Alaska's competitiveness was a non-issue. He said that there were specific claims in House Resource Committee that competitiveness was not a factor in industry decision making. Secondly, there was consistent and continuous concern that industry was failing to make a solid commitment to the state in exchange for state concessions. Thirdly, was the premise that new, additional exploration credits would result in increased oil production. He asked if competitiveness was an issue, and if so what were competitors offering that was giving them the edge over Alaska. He requested assurances that the state could expect industry to change behavior with the passage of the legislation. He probed whether additional exploration credits were the best way to get significantly more production into TAPS as quickly as possible.

[9:58:19 AM](#)

Ms. Fitzpatrick answered that competitiveness was an issue. The question came down to the amount of return that would be seen by BP shareholders. She said it was a matter of weighing the value of other opportunities against opportunities in Alaska. Specifics that were considered were: what were the rock types, how far from market was the location, and overall project cost. A variety of scenarios were considered while looking at the risk/reward balance of a project.

Ms. Fitzpatrick she could not give a definitive reply assuring increased production if HB 110 passed the legislature. She stated that her hopes that the bill would pass was informing the nature of the conversations she was currently having with possible investors in London, England. She stressed that time was of the essence.

Ms. Fitzpatrick thought additional exploration credits would prove beneficial. She did not believe it was the best way to get significantly more volume in the pipeline as quickly as possible. She explained that the fastest way to get significant volume in the pipeline quickly was to focus on how to allow for more competitive investment in existing fields.

[10:03:28 AM](#)

Representative Hawker reiterated that the legislature hoped for a firm commitment from industry in the event that a change was made to Alaska's tax regime. He wondered if the HB 110 debates were being followed by industry.

Ms. Fitzpatrick replied HB 110 was currently being discussed in London.

[10:06:09 AM](#)

#

ADJOURNMENT

The meeting was adjourned at 10:06 AM.