

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

February 16, 2011

1:03 p.m.

**MEMBERS PRESENT**

Representative Eric Feige, Co-Chair  
Representative Paul Seaton, Co-Chair  
Representative Peggy Wilson, Vice Chair  
Representative Alan Dick  
Representative Neal Foster  
Representative Bob Herron  
Representative Cathy Engstrom Munoz  
Representative Berta Gardner  
Representative Scott Kawasaki

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Representative Carl Gatto  
Representative Mike Hawker  
Representative Craig Johnson

**COMMITTEE CALENDAR**

OVERVIEW: ALASKA OIL & GAS PRODUCERS

- HEARD

**PREVIOUS COMMITTEE ACTION**

No previous action to record

**WITNESS REGISTER**

MARILYN CROCKETT, Executive Director  
Alaska Oil & Gas Association (AOGA)  
Anchorage, Alaska

**POSITION STATEMENT:** Provided a PowerPoint presentation on how the oil and gas industry in Alaska is affected by the state's tax regime and offered support for HB 110.

KEN SHEFFIELD

President  
Pioneer Natural Resources Alaska  
Pioneer Natural Resources  
Anchorage, Alaska

**POSITION STATEMENT:** Provided a PowerPoint presentation on how his company is affected by Alaska's tax regime and offered support for HB 110.

WENDY KING, Vice President, External Affairs  
ConocoPhillips Alaska, Inc.  
Anchorage, Alaska

**POSITION STATEMENT:** Provided a PowerPoint presentation on how her company is affected by Alaska's tax regime and offered support for HB 110.

BOB HEINRICH, Vice President, Finance,  
ConocoPhillips Alaska, Inc.  
Anchorage, Alaska

**POSITION STATEMENT:** Assisted Ms. King during her presentation for ConocoPhillips Alaska, Inc.

CLAIRE FITZPATRICK, Senior Vice President for Alaska Operations,  
Chief Financial Officer  
BP Exploration (Alaska), Inc.  
Anchorage, Alaska

**POSITION STATEMENT:** Provided a PowerPoint presentation on how her company is affected by Alaska's tax regime and offered support for HB 110.

DALE PITTMAN, Alaska Production Manager  
ExxonMobil  
Anchorage, Alaska

**POSITION STATEMENT:** Provided a PowerPoint presentation on how his company is affected by Alaska's tax regime and offered support for HB 110.

#### **ACTION NARRATIVE**

[1:03:39 PM](#)

**CO-CHAIR PAUL SEATON** called the House Resources Standing Committee meeting to order at 1:03 p.m. Representatives Seaton, Feige, Wilson, Kawasaki, Gardner, and Munoz were present at the call to order. Representatives Herron, Foster, and Dick arrived as the meeting was in progress. Representatives Gatto, Hawker, and Johnson were also present.

**OVERVIEW: Alaska Oil & Gas Producers**

[Contains discussion of HB 110]

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CO-CHAIR SEATON announced that the only order of business is presentations from the oil and gas industry.

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MARILYN CROCKETT, Executive Director, Alaska Oil & Gas Association (AOGA), noted that AOGA is the oil and gas trade association in the state of Alaska. Its members include the in-state explorers and producers, the three in-state refiners, and Alyeska Pipeline Service Company. She said AOGA's goal is to have a vital oil and gas industry that contributes to a vibrant economy for the state (slide 3). The association provides a forum for discussion and consensus on various policy positions, including HB 110.

MS. CROCKETT related that production from currently producing fields will continue to decline over the forthcoming years (slide 4). The new oil projected to come on line in the future includes production from current units of these fields. She explained that the apparent flattening of the production decline is based on projections from the Department of Revenue (DOR), and while the department does a good job of forecasting, no forecast is 100 percent accurate.

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MS. CROCKETT, in response to Representative Gardner, said that the new oil depicted on slide 4 does not include production from the federally owned outer continental shelf (OCS). In further response, she said she will be showing slides later in her presentation that depict what new production from the OCS would do to the curve of the production decline. She clarified that slide 4 is based entirely on DOR's projections.

MS. CROCKETT, returning to her presentation, pointed out that in [2020] half of the state's production will come from existing fields and half from new oil.

MS. CROCKETT compared the Department of Revenue's 2005 production forecast with today's production forecast (slide 5). For the year 2010, the 2005 DOR production forecast was for

832,000 barrels of oil per day, while the 2010 DOR forecast was for 644,000 barrels per day, a decline of 188,000 barrels a day. For the year 2015, the 2005 DOR production forecast was for 762,000 barrels per day, while the 2010 DOR production forecast was for 608,000 barrels per day. While DOR does the best it can with the information it has at a particular point in time, she said that project economics can shift. She therefore cautioned to not get comfortable with what appears to be a flattening of the production curve on slide 4 because history has shown the reality is that the production continues to decline.

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MS. CROCKETT provided a further example of how production levels may not be reflected in the estimate prepared by the Department of Revenue (slide 6). She related a recent announcement that production from the Liberty field has been delayed. The impact of Liberty's delay is a reduction from the 2010 DOR production forecast of 5,000 barrels a day in 2012, another 39,000 barrels per day in 2013, and 31,000 barrels per day in 2014.

MS. CROCKETT noted that in 10 years, half of Alaska' production will come from new oil (slide 7). Even with this new oil, however, the state will still experience a decline of 124,000 barrels per day in 10 years. Almost 100 percent of the production [in 2020] will come from oilfields that are located within current unit boundaries. A great deal of the new oil will come from investments within existing unit boundaries - Prudhoe Bay, Kuparuk, and Alpine.

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MS. CROCKETT addressed North Slope oil production with production from the OCS (slide 8). She noted that when this slide was put together the production projection for 2007 was greater than what actually happened. However, the slide is still a good depiction of what would happen with OCS production, which is that production would increase to nearly 2 million barrels per day.

MS. CROCKETT pointed out that a challenge faced by industry in Alaska is the long lead time associated with development (slide 9). Alaska is very remote, has a tough climate, and is away from infrastructure. For example, Nikaitchuq took about 6 years to come on line from the time the field was discovered, which is an aggressive time line. Oooguruk took 5 years from discovery to production. Liberty was discovered in 1997, but production

there has yet to start. It has been 10 years and counting since the discovery at Alpine West (CD-5). New production takes time to bring into the queue and no new projects are coming into the queue.

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MS. CROCKETT noted that to get to field discovery and new production, exploration wells must be drilled (slide 10). In 2010 three exploration wells were drilled, but only one of those was a true exploration well for oil. The other two were wells drilled at Point Thomson and were categorized as exploration by the Alaska Oil and Gas Conservation Commission (AOGCC) because that field is not in production right now. For 2011 only one exploration well has been permitted.

MS. CROCKETT said another indicator of activity levels is the status of lease holdings (slide 11). The total acres under lease in Alaska include lands in the National Petroleum Reserve-Alaska (NPR-A), state offshore, federal offshore, and the North Slope. In 2008 the total number of acres under lease peaked at just over 9 million acres, declining since then. [Between 2005 and 2010] the number of lease acres relinquished to the state has increased dramatically.

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REPRESENTATIVE KAWASAKI asked how many acres have been released in Alaska's arctic leases versus other leases across the world.

MS. CROCKETT replied she does not know, but will try to research that information for members.

REPRESENTATIVE KAWASAKI said that to compare Alaska's tax regime to those across the world he would like to know whether exploration wells outside of the North Slope are being actively drilled as opposed to within Alaska. In response to Ms. Crockett, he confirmed that he is talking about the number of wells drilled as well as the amount of acres under lease.

MS. CROCKETT said she will try to get the requested information, but that information on lease holdings could be problematic because some regimes do not have a leasing program.

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REPRESENTATIVE HERRON asked whether the leases that were relinquished could have been an error in judgment at the time of their selection. He requested that this information be provided to the co-chairs.

CO-CHAIR SEATON surmised that Representative Herron is asking whether these leases were explored, found nonproductive, and let go or whether they were let go without exploration.

REPRESENTATIVE HERRON responded, "That helps as well."

CO-CHAIR SEATON further requested that Ms. Crockett provide the acreage that was released by each company.

MS. CROCKETT replied that the acreage released by company is public information and she would provide members with a map in this regard.

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CO-CHAIR FEIGE, following up on Representative Kawasaki's request, asked Ms. Crockett to also provide a comparison of acres under lease that have been added to the totals. In response to Ms. Crockett, he clarified that if companies are relinquishing acres in Alaska it would be important to note whether they are also relinquishing acres in other provinces or acquiring acreage in other provinces because this would give an indication of the relative competitiveness of Alaska.

MS. CROCKETT agreed to try to provide this information.

CO-CHAIR SEATON understood that this might be a challenge because many places have a production sharing agreement in which the agreement is cancelled if things do not happen within a certain timeframe.

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REPRESENTATIVE GARDNER commented that slide 11 implies to her that the leases were released because of Alaska's tax system. She maintained, however, that there could be a host of reasons for relinquishing the acreage and therefore she is interested in who relinquished them and why.

MS. CROCKETT agreed that there are a number of reasons for why the leases were relinquished and said she will provide that characterization. However, she continued, there is no question

in AOGA's mind, or the minds of some of the companies that have left the state, that a number of factors impacted their decision to leave, including Alaska's fiscal regime.

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MS. CROCKETT, returning to her presentation, stated that AOGA supports HB 110 and supports the governor's goals of making Alaska more competitive, creating more jobs, and increasing production (slide 12). She related that AOGA thinks the number one threat facing Alaska right now is declining production through the Trans-Alaska Pipeline System (TAPS).

MS. CROCKETT outlined AOGA's position on the elements of HB 110 (slide 13). She said AOGA supports the provision for progressivity rates, bracketing, and tax cap. Under the current system, each time the production tax value (PTV) increases beyond \$30 [per barrel] all dollars prior to that amount are taxed at the higher tax rate instead of just the incremental tax rate. The bracketing in HB 110 would not reach back like the current system and would add stability and predictability to the tax. As companies realize higher prices and greater production tax value, the state would likewise continue to share in those benefits. Additionally, HB 110 would cap the base rate and progressivity at 50 percent of the combined rate rather than the current 75 percent; this would motivate companies to undertake the high risk projects on which the future economic health of Alaska will depend. A business climate would be created where the reward is commensurate with the risk and keeps the needs of the producers and the state in a more appropriate balance.

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MS. CROCKETT offered AOGA's support for the provision in HB 110 that would change the calculation for the payment of tax from monthly to annual. The current system of progressivity creates a huge mismatch by using each month's actual gross value at the point of production while deducting one-twelfth of the actual expenses. This result is achieved at the annual true-up on March 31 of the following year. In making estimated monthly payments the mismatch is compounded because taxpayers have used the actual gross value at the point of production for the entire year to calculate the PTV with the estimated lease expenditures, thus resulting in a progressivity rate for the month.

CO-CHAIR SEATON asked whether the annual true-up goes back and calculates the actual expenses per month.

MS. CROCKETT replied it does, but it does not annualize the production tax value; it annualizes the lease expenses that were paid on a monthly basis based on production and the gross value each month, and that component does not true up on March 31.

CO-CHAIR SEATON understood the true up goes back and does actual expenses in the month they occurred.

MS. CROCKETT responded correct.

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MS. CROCKETT, turning back to her presentation, said AOGA supports 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 endorsed the provision in HB 110 that would expand the 40 percent well lease expenditure tax credit to production on the North Slope, a credit that is currently available only to qualified expenditures in the Cook Inlet basin. This credit targets qualified capital expenditures for infield drilling, which would enhance production from currently existing fields and this credit includes labor costs, which would impact jobs. Additionally, the credit is a recognized, convenient, and readily accessible accounting designation. Also, this proposal has the advantage of an earlier effective date, thus potentially jump starting production that is needed to stem the decline.

MS. CROCKETT noted that the proposed effective dates are of concern to AOGA, but not enough to oppose the bill. The effective dates differ for the various provisions of the bill and the delay of these effective dates in a staggered fashion does not reflect the urgency of the need for this legislation; instead, the delayed effective dates will protract commercial decisions over the next several years. Production decline in Alaska is an immediate issue and the delayed effective dates for provisions that would enhance production ignore this immediate problem.

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REPRESENTATIVE P. WILSON inquired whether Ms. Crockett is suggesting that all of the effective dates happen at the same time or that they need to be sooner.

MS. CROCKETT replied that in 2012 the amendments for the tax credit provisions become effective, in 2013 the progressivity provisions become effective, and in 2014 the statute of limitations shifts from six years to four years. She said she has provided supporting testimony for those provisions of the bill that AOGA thinks will make a difference in industry investment, but some of those provisions would not go into effect for two, three, or four years, which delays the certainty associated with those particular provisions.

REPRESENTATIVE HERRON asked what the advantages are of an immediate effective date.

MS. CROCKETT responded that the advantage is certainty. As companies sit down to make investment decisions they will have the certainty that they can move forward based on the law that is on the books.

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CO-CHAIR SEATON pointed out that it will take time for DOR to write the new regulations, and the question in the meantime is how to have stability, continuity, and full knowledge of the details that would be provided by these regulations when the companies are preparing their taxes.

MS. CROCKETT allowed that that is a valid point for new legislation establishing new ground rules. However, all of the provisions in HB 110 already have a complementary section in statute and regulation that would be amended. Therefore, the effort required by the Department of Revenue to produce amendments to the regulations and to get them adopted will be significantly less than it would be for a brand new taxation regime. The provisions in HB 110 would be relatively simple changes to the current regulations.

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CO-CHAIR SEATON said he is less secure in this than is Ms. Crockett, one reason in particular being the ring fencing that would be introduced on the North Slope with any new developments within existing units. Companies with both new and existing fields will have two different [tax] rates and regulations will be needed to direct how those expenses are taken and categorized because right now all the expenses and credits are companywide. Additionally, there is the bracketing provision which was seen

as a problem by industry in previous years when such jumps were being considered. A tremendous amount of restructuring will need to be done by DOR to incorporate those items.

MS. CROCKETT concurred that the new rate for new fields is a new concept, but said AOGA does not see that as overwhelming in terms of regulation drafting. Also, AOGA does not see challenges with bracketing progressivity.

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REPRESENTATIVE KAWASAKI commented that [DOR] is still working on some of the 2006 petroleum production profits tax (PPT) filings. He then noted the tax regime has been changed twice in the four years he has been in the legislature. He inquired whether AOGA would rather have some certainty for a period of years versus changing the tax regime every other year.

MS. CROCKETT answered that AOGA would prefer that the State of Alaska and the legislature adopt a policy position that recognizes that production is declining, investment is declining, and something needs to be done about it. The two aforementioned tax changes were significant tax increases on oil and gas production; HB 110 represents a tax decrease on oil and gas production and recognizes some of the challenges that production faces in the state of Alaska. Thus, AOGA believes that HB 110 is a step in the right direction to addressing some of those challenges.

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REPRESENTATIVE KAWASAKI recalled previously DOR testimony that during the first few years of Alaska's Clear and Equitable Share (ACES) investment was up, as was the number of jobs and capital expenditures, and the price of oil was very high at the time. He cautioned that the proposed changes are being made without any clear and concise information from the Department of Revenue.

MS. CROCKETT said AOGA's concern is that time is going to pass both the industry and the legislature by. The quest for perfect information sounds good on the surface, but perhaps once every piece of data and information is on legislators' desks, production on the North Slope and in Alaska may have declined to the point that there will be another problem to deal with in terms of production.

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REPRESENTATIVE P. WILSON noted that the proposed base tax rate reduction from 25 percent to 15 percent would be for forever. She asked whether it might be wise to establish a timeline of 10 years.

MS. CROCKETT clarified that the aforementioned provision is the proposed new rate for new fields. She said AOGA supports this provision because it is important for developing new fields and new players. While the incentive would still be there for a certain provision with an expiration deadline, the degree of certainty associated with the provision would not be there.

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REPRESENTATIVE GARDNER inquired whether the producers agree with the state's forecast that half of Alaska's production will be from new oil (slide 7). She also requested additional explanation regarding the statement on slide 7 that 98 percent of the production in 2020 will be from oilfields located in current unit boundaries.

MS. CROCKETT replied that AOGA's observations were taken from DOR's forecast book. She suggested that members look at the chart in the book's appendix that has the numbers for production anticipated year by year. Units and the satellite fields associated with those units can be identified and the drilling activity within those units characterized to see where some of this new oil would be coming from as opposed to brand new fields. She offered to provide that information to members.

REPRESENTATIVE GARDNER asked whether she is correct in understanding that the concept of new oil from legacy fields is that satellite fields reached from an existing unit would be called new oil.

MS. CROCKETT responded that it is a combination of all of those.

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REPRESENTATIVE GARDNER surmised that some of the timeline between discovery and production has to do with the U.S. Environmental Protection Agency (EPA) and the U.S. Army Corps of Engineers. She suggested that members think about what the legislature can do in this regard, one such suggestion being to get a permit coordinator at the federal level to try to keep

things moving forward. She requested that AOGA provide the committee with suggestions in this regard.

REPRESENTATIVE GARDNER, regarding the number of exploration wells drilled on the North Slope, stated that the implication is that there is a lack of interest because of the fiscal regime or other reason. However, regarding the two wells at Point Thomson, she said she heard there were actually five wells planned but the EPA exerted jurisdiction over three of them for permitting. Thus, not drilling those three wells may have been for reasons other than those being discussed today.

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The committee took an at-ease from 1:48 p.m. to 1:49 p.m.

[1:49:24 PM](#)

KEN SHEFFIELD, President, Pioneer Natural Resources Alaska (Pioneer Alaska), Pioneer Natural Resources, first offered his company's support for HB 110, saying the bill would bring better balance to the state's severance tax structure, increase drilling activity, put more oil in the pipeline, and produce more jobs for Alaskans. He said he will be sharing some forecasts about Pioneer's future activity; hence he has included a disclaimer slide in his presentation (slide 2).

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MR. SHEFFIELD stated that while Pioneer Natural Resources is a large independent oil/gas company listed on the New York Stock Exchange, it is about one-tenth the size of the other operators on the North Slope (slide 3). Pioneer is in the top 10 of the most active drillers in the U.S.; last year Pioneer ranked seventh in the U.S. in footage drilled. Like most independents, most of Pioneer's assets are heavily focused on the Lower 48, with 95 percent of Pioneer's reserves and about 90 percent of its production derived from the Lower 48.

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MR. SHEFFIELD reported that Pioneer Alaska began its business in Alaska from scratch in 2003 (slide 4). It has gone from no employees to 60 full-time Alaska employees plus about 120 Alaska contract workers on the North Slope. Pioneer Alaska made a huge commitment to the state in 2006 when it sanctioned the world class Oooguruk Project. In 2008, Pioneer Alaska became the

first independent operator on the North Slope. Operating in a challenging environment, Pioneer Alaska is applying everything that technology provides to make this successful. His company would not be where it is today without the solid support from the State of Alaska and the other producers on the North Slope.

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REPRESENTATIVE KAWASAKI inquired how Alaska's royalty relief provisions played into Pioneer Alaska's decisions to construct and operate Oooguruk.

MR. SHEFFIELD replied that Pioneer Alaska was granted royalty relief prior to the sanction of this project. At that time, about 2006, oil prices were approximately \$30 per barrel and Pioneer Alaska was looking at sanctioning a project in the hundreds of millions in a very remote offshore arctic environment. The company worked with the State of Alaska through existing [law] to successfully secure royalty relief.

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REPRESENTATIVE KAWASAKI asked whether royalty relief was one of the company's main reasons for coming to Alaska.

MR. SHEFFIELD responded that royalty relief was not what his company was looking for. When drilling its exploration wells, his company was hoping to hit large, high productivity oil reservoirs that would not require having to apply for royalty relief in order to sanction the project. However, a low quality reservoir was what was found and the economics were tough, so the company applied for royalty relief. He pointed out that the royalty relief phases out when the project pays out.

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REPRESENTATIVE GARDNER inquired whether the application process for royalty relief was onerous or unnecessarily challenging.

MR. SHEFFIELD answered that it was a fairly exhaustive and challenging process to demonstrate the economic need for some sort of relief. The complexities of making a big decision like that, the risks, what future prices are going to be, what production is going to be, and what costs are going to be make it extremely difficult for a producer and a government to get on the same page. But, the State of Alaska did work with Pioneer and royalty relief was approved.

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MR. SHEFFIELD, returning to his presentation, said Pioneer's focus when it came to Alaska in 2002 was on growing the company through exploration around the world (slide 5). At that time, Pioneer had an active exploration program in the deep water Gulf of Mexico and on the continent of Africa, and had just started exploration in Alaska. When considering entry into Alaska, Pioneer put together a scorecard to compare Alaska against the company's legacy assets in the Lower 48 (slide 6). What stood out was the tremendous resource potential in Alaska and the general lack of competition, although Pioneer recognized that Alaska would be more challenging from a regulatory perspective. When looking at profitability in Alaska, however, Pioneer could see there would be challenges, one challenge being the long project cycle times. For example, in Texas a well can be drilled and put into production in just a few months, but in Alaska it takes several years. Additionally, the execution risk is challenging in Alaska as is the capital cost. But, Pioneer thought the operating margins in Alaska could potentially be better than the Lower 48 given the zero severance tax for lower rate producing fields like Oooguruk under the Economic Limit Factor (ELF) tax regime in place at that time. Plus, there were exploration incentives in place at that time as well.

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REPRESENTATIVE HERRON asked whether it would have taken big ticket items or small increments to have moved the checkmarks from Alaska's column to the Lower 48 column, and vice versa.

MR. SHEFFIELD replied that it was more of a "back of a cocktail napkin" type of analysis. Picking the best place to explore is a lot like picking the best stocks. While there is technical and economic information, the money is spent and the hope is that the predictions are correct. Therefore, he allowed, such an analysis is somewhat subjective.

REPRESENTATIVE HERRON remarked that the scorecard's two columns represent black and white to him, yet there are hundreds of shades of gray. So, to characterize something as either on or off seems over-simplistic to the complex legislation that is being looked at.

MR. SHEFFIELD said this scorecard was an internal assessment of the pros and cons of making Pioneer's initial investments in the

Alaska and it really did not pertain to the fiscal policy, although that was one of the components that was looked at.

2:00:20 PM

REPRESENTATIVE GARDNER requested further elaboration about the scorecard regarding the terms oil bias, regulatory process ease, and resource competition.

MR. SHEFFIELD explained that regarding the term oil bias, the rocks in the North Slope are usually filled with oil rather than gas, which is a good thing. The regulatory process is a combination of state, federal, and local jurisdictions, and in Alaska the process is significantly more complex and time consuming than in the Lower 48. Regarding resource competition, he said the State of Alaska was and continues to hold regular land sales, which is a good thing. Pioneer found that few companies showed up at Alaska's lease sales relative to lease sales held in other petroleum provinces.

REPRESENTATIVE GARDNER commented that members would like to hear any suggestions Pioneer has about how to improve the state's regulatory process.

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MR. SHEFFIELD, continuing his presentation, noted that Pioneer participated in 11 exploration wells from 2003-2007 (slide 7). Some of the wells were operated by Pioneer and some were operated by ConocoPhillips with Pioneer as a minority partner, particularly in the NPR-A. Of those 11 wells, 1 had a commercial discovery, which became the Oooguruk development. Oil was found in nearly all of the wells, but the quality of the reservoirs was generally insufficient to make an economic development.

MR. SHEFFIELD said Pioneer spent a couple of years doing the engineering and assessments for the Oooguruk project (slide 8). Pioneer sanctioned the project in January 2006 and went on to make it a reality. The total cost of the project will be in excess of \$1 billion. Over 600 people were on the site during peak construction in 2007. The first production was established in June 2008 and average production in 2010 was about 10,000 barrels a day. Pioneer sees the gross resource potential being in the range of 120-150 million barrels, although how much of that will be economic remains to be seen. Pioneer is quickly wrapping up the original project that was envisioned and over

the next few years all of the wells originally planned will have been drilled. The challenge for Pioneer is finding that next opportunity in Alaska to grow its business.

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MR. SHEFFIELD reviewed changes that have occurred over Pioneer's eight years in Alaska (slide 9). Technology continued to drive opportunities in Pioneer's business. Oil and gas prices moved much higher, along with the cost of doing business. Prices have provided a financial incentive to develop some of the lower tier resources in North America and around the world. Resource development plays - shales, tight sand reservoirs, coal seams, and such - have clearly taken center stage in the Lower 48 for oil and gas investment. Lastly, Alaska's severance tax system changed twice during the last eight years.

MR. SHEFFIELD related that the combination of two technologies, horizontal wells and fracture stimulation, has created a boom of activity across the Lower 48 (slide 10). Multiple stimulations are now being done along the horizontal well bores in petroleum reservoirs. In 2004 less than 10 percent of the wells drilled in the U.S. were horizontal wells, but by the end of 2009 that number was nearly 50 percent (slide 11).

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MR. SHEFFIELD noted that rising prices and technology have fueled the growth in resource plays, and represent the primary competition for his Alaska team when it is competing for funds (slide 12). Over the past eight years oil prices have gone up from around \$30 a barrel to over \$100 and now back down to about \$80. Over that same time period natural gas prices in the Lower 48 have gone up from about \$3 to \$8 and now back down into the range of \$4-\$5. Gas prices have fallen because these successful resource plays have increased the gas supply. Oil and gas shales in the U.S. have taken center stage and are attracting tens of billions of dollars of capital (slide 13). The geography of those shales happens to be near infrastructure and in states with very favorable fiscal policies.

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MR. SHEFFIELD reviewed the history of Alaska's severance tax over the past eight years (slide 14). Prior to 2007 the economic limit factor (ELF) was in effect and was the regime under which Pioneer sanctioned the Oooguruk project. Under ELF

low rate fields paid low or next to no severance tax. In 2007, during the construction phase of Oooguruk, the petroleum production profits tax (PPT) became law. The PPT allowed for a 20 percent tax credit on the front end, a 22.5 percent tax on the net profits on the back end, and a progressivity element. In 2008, the first year of production at Oooguruk, Alaska's Clear and Equitable Share (ACES) became law. Under ACES the 20 percent investment tax credit stayed the same, the base tax rate increased to 25 percent, the progressivity became aggressive and was not indexed, and the maximum tax rate became 75 percent.

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MR. SHEFFIELD addressed the issues that Pioneer Alaska is facing in the future as it tries to grow its business in Alaska (slide 15). He said the reservoirs being developed at the Oooguruk island drill site are the Kuparuk and the Nuiqsut. In the next two to three years all wells will have been drilled and the sanction development completed. Pioneer Alaska is therefore trying to build its next big thing, which it hopes will be the Torok Reservoir - a very low quality, but fairly large reservoir. One well was drilled into the Torok in 2009 and two more wells are now being drilled from the island to further evaluate that reservoir and to install a waterflood pilot. Based on the results of that waterflood pilot, Pioneer Alaska hopes to develop the reservoir by building a gravel pad onshore and directional drilling into the reservoir. Whether to take this next step is a half-billion-dollar decision.

MR. SHEFFIELD, in response to Representative P. Wilson, said horizontal drilling can reach out as far as 3 miles depending upon how deep the reservoir is.

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MR. SHEFFIELD elaborated further on the Torok development (slide 16). Two onshore drill sites will be tied into Pioneer Alaska's existing infrastructure, and as many as 25 development wells may be drilled. Moving forward with development of this large, but challenged, oil resource is contingent upon success of the waterflood pilot and meeting the economic and competitive hurdles.

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MR. SHEFFIELD said his team competes against other projects when it goes before Pioneer's management and board (slide 17). The

primary competition comes from the Spraberry field in west Texas in which Pioneer is the largest operator, producing about 46,000 barrels equivalent per day. Pioneer has over 20,000 development locations in that field and these will keep Pioneer busy for 20 years or more. They are high margin, predictable wells in a fiscal environment of low taxes and no progressivity. Pioneer is currently running about 30 rigs in this area and will be ramping up to 40 rigs by 2013, the expectation being a doubling of production. Also competing with Pioneer Alaska is the Eagle Ford shale development in south Texas, which has a gross resource potential of about 150 trillion cubic feet (slide 18). Over 100 rigs, of which 7 belong to Pioneer, are currently running on this huge, profitable, liquids-rich play. Pioneer's production is only a couple of thousand barrels a day, but the hope is to be running 16 rigs in that play by 2013 and the forecast is for 40,000 barrels a day net, which is almost eight times as big as what Pioneer Alaska has been able to develop in Alaska over the last eight years.

[2:17:07 PM](#)

MR. SHEFFIELD, in response to Representative Kawasaki, said the Spraberry wells are oil wells that produce a lot of gas, although he does not know the exact split since that is not his area. Processing of that gas produces natural gas liquids and he estimates that the barrel of oil equivalents from those wells is a little more than 50:50. He offered to follow up further if members desired.

MR. SHEFFIELD, returning to his presentation, reviewed Pioneer's scorecard for Alaska today (slide 19), saying that the greater resource potential is now in the Lower 48. Additionally, given Alaska's permitting challenges, Pioneer now perceives the execution risk going forward as being greater in Alaska than it was eight years ago.

[2:19:23 PM](#)

REPRESENTATIVE KAWASAKI asked whether Pioneer Alaska is an oil company that is developing gas or a gas company that is developing oil. He said his reason for this question is that this would affect the scoring of the resource potential.

MR. SHEFFIELD replied, "We are an oil and gas company." He said that Pioneer, like most other independents in the Lower 48, is shifting investment more toward the oil side because the price differential for oil on a British Thermal Unit (BTU) equivalent

basis is probably more than three times the value of gas. Gas is the most abundant thing in the Lower 48 and Pioneer is not moving completing away from gas, but in the near term investments are quickly moving toward liquids.

[2:20:53 PM](#)

MR. SHEFFIELD closed his presentation (slide 20), reiterating that Pioneer Alaska is wrapping up its original plans at Ooguruk and in about two years will be facing another major investment decision. He said he is hopeful the pilot for the Torok Formation will be successful, but that if it is it will have to compete against formidable competition for funding. Pioneer's vision of the Ooguruk expansion is that it would be in excess of 10,000 barrels a day. The new project would create about 500 construction jobs and about 100 development jobs. He said HB 110 will have a positive, material impact on Pioneer's decisions going forward. The combination of the increased well credits and the indexing of progressivity "really moves the needle" and gets the tax system into what Pioneer feels is a better balance.

[2:22:35 PM](#)

CO-CHAIR FEIGE inquired whether Mr. Sheffield has been contacted by the Department of Labor & Workforce Development regarding which jobs on the North Slope are for maintenance and which are for exploration.

MR. SHEFFIELD replied that he personally has not been contacted and does not believe any of his staff has been contacted.

[2:23:27 PM](#)

REPRESENTATIVE GARDNER observed that the Ooguruk project has spanned the ELF, PPT, and ACES tax regimes. She asked how much the state has participated in that capital expenditure in terms of credits and did Pioneer participate in the transitional look back when the state went from the PPT to ACES.

MR. SHEFFIELD responded that Pioneer has been the beneficiary of the credits from both PPT and ACES. He estimated that about \$180 million has been received since the beginning of Ooguruk. He offered his belief that some credits for transitional investment expenditures (TIE) were also received. In response to Co-Chair Seaton, he agreed to confirm the exact amounts of the aforementioned and get back to members.

[2:25:10 PM](#)

The committee took an at-ease from 2:25 p.m. to 2:29 p.m.

[2:29:43 PM](#)

WENDY KING, Vice President, External Affairs, ConocoPhillips Alaska, Inc., said that by way of HB 110 the governor and his team are choosing a brighter future for the oil and gas industry than what the status quo would lead to (slide 2). ConocoPhillips Alaska agrees with the administration that HB 110 would make Alaska more competitive, would create more jobs for Alaskans, and would have the probability of increasing production into the Trans-Alaska Pipeline System (TAPS). She emphasized that ConocoPhillips Alaska sees that there is more potential on Alaska's North Slope. The challenge faced by the industry is that the costs are higher today to produce a barrel of oil, the technology requirements are greater, the reservoirs are more complex, and finding the remaining oil is harder. For example, at Kuparuk, a field operated by ConocoPhillips Alaska, the publically available figure is that about six billion barrels of oil are in place. A 1 percent increase in recovery at Kuparuk is 60 million barrels of oil, which would mean 10,000 more barrels per day for 15 years. This is the kind of prize that ConocoPhillips thinks is out there and is why HB 110 is a step in the right direction.

[2:32:24 PM](#)

MS. KING allowed there are elements of Alaska's Clear and Equitable Share (ACES) tax structure that are working and should remain. The biggest challenge with the ACES tax structure is the progressivity piece. This is because when oil prices are high companies are generating a significant cash flow by where they can reinvest. But with the steep progressivity, that cash flow is paid out in taxes rather than coming back to the parties to be able to reinvest. A look at what happened in Alaska during the high oil prices of 2008 shows that what happened in the Lower 48 did not happen in Alaska.

MS. KING pointed out that there is a lot of capacity in Trans-Alaska Pipeline System (TAPS) due to the substantial production decline (slide 3). But probably more significant is the challenge of keeping the pipeline operating once the flow decreases to 500,000 or 300,000 barrels of oil a day. The recent shutdown of TAPS showed that the challenge of moving a

low flow is real. She said HB 110 would set out a framework by where those low flow challenges could get pushed to the future.

[2:34:59 PM](#)

REPRESENTATIVE HERRON inquired whether the difference should be split between the historical decline rate and the Department of Revenue's forecast, which some say is overly optimistic.

MS. KING replied that she will address the uncertainty of the production forecast later in her presentation. However, she said there is no doubt the production forecast over the next 10 years is an uncertainty. ConocoPhillips looks at ranges and can only look at its own asset base for forecasting. For the North Slope asset base, ConocoPhillips must use the publically available information in the DOR production forecast.

[2:36:23 PM](#)

MS. KING addressed U.S. production changes between 2003 [and 2010] using data from the Energy Information Administration (EIA) for those states that produce more than 50,000 barrels of oil per day (slide 4). North Dakota, Mississippi, and Utah had the greatest production increases over the last eight years, she related. Texas is still producing about 1 million barrels of oil a day, which is roughly what it was producing back in 2003. Over that same timeframe Alaska's production declined more than 30 percent, a steeper decline than many of the other oil producing states in the U.S.

[2:37:38 PM](#)

REPRESENTATIVE GARDNER observed that slide 4 does not depict production, rather it depicts changes. The slide makes it appear that North Dakota, Mississippi, and Utah have huge productions when they do not compared to Alaska, rather they just had a huge change in production.

MS. KING responded that this information is available on the Energy Information Administration's website. She recalled that production in Texas was about 1.1 million barrels a day in 2003, declining to about 1 million [in 2010]. In 2003 Alaska produced 1 million barrels of oil a day, but declined to about 650,000 barrels over that same timeframe. She further recalled that North Dakota is predicted to surpass Alaska's production in the future.

[2:38:42 PM](#)

MS. KING reported that oil production in the Lower 48 declined [between 2003] and 2005, stayed steady until 2008, then significantly increased between 2008 and 2010 (slide 5). Oil prices spiked in 2008, particularly in the third quarter, then pulled back in 2009, and again picked up in 2010. The annual average number of oil rigs working in the Lower 48 increased from about 150 [in 2003] to over 500 [in 2010]. This increased oil rig activity in the Lower 48 saw a corresponding increase in production - oil prices went up, oil rig activity went up, oil production went up. Right now in the Lower 48, a combination of different types of liquid-rich plays is driving this increased drilling activity with the high price environment.

[2:40:28 PM](#)

MS. KING compared Alaska's oil production for this same time period and pointed out that Alaska's production declined from about 1 million barrels of oil a day [in 2003] to about 600,000 barrels a day [in 2010]. Over this same timeframe, the annual average rig count in Alaska stayed flat - rig activity in Alaska did not increase with the increase in oil price like it did in the Lower 48. Another disturbing trend is that even though the number of oil rigs has stayed flat, the production decline has not been offset. This as a function of the oil prospects being more challenged. It does not mean that industry does not want to pursue them, it just means that the zones being targeted may have more water in them or cross multiple fault blocks or the sand quality is not as good or the oil quality may not be as good. That challenged oil impact is starting to show in how the wells are being able to offset what is happening in Alaska's oil production decline.

[2:41:39 PM](#)

MS. KING compared the forecast for oil production in Alaska with the forecast for the Lower 48 using information from the Energy Information Administration, Annual Energy Outlook (AEO) 2011 Reference Case (slide 6). She explained that onshore production is the biggest portion of oil production in the Lower 48, and it is expected to grow another 26 percent over the 12-year period [of 2008 to 2020]. Lower 48 offshore production is expected to grow by 44 percent over this same time period. She noted that this forecast was put together after the Gulf of Mexico spill occurred. The forecast for Alaska is a decline of 39 percent over the next 10 years, which calculates to about 400,000

barrels of oil a day by the turn of the next decade. She reminded members that Alyeska Pipeline Service Company has said that low flow problems will start at 500,000 to 300,000 barrels of oil a day. Thus, the EIA is saying that Alaska will be facing that low-flow problem in the next decade.

[2:43:13 PM](#)

REPRESENTATIVE KAWASAKI asked whether the aforementioned forecast includes new oil.

MS. KING answered that she cannot make an assumption because the EIA does not outline in the forecast where it the information, it just has a plot of Alaska production.

REPRESENTATIVE KAWASAKI commented that the Department of Revenue forecast in the AOGA presentation shows a tapering off at 600,000 barrels and not changing from today, and that forecast includes new oil.

MS. KING said she will be further discussing this projected decline later in her presentation.

[2:44:09 PM](#)

MS. KING, returning to her presentation, directed attention to a map depicting the most recent status of acreage on the North Slope (slide 7). She noted that exploration activity is the frontend of what the industry is; it is the feedstock for finding new fields. The land is studied, acquired, explored, and if successful it is appraised, and if economic or commercially viable it will be developed. ConocoPhillips has been the state's largest explorer, particularly over the last decade. Since 1998 ConocoPhillips has drilled 56 exploration wells on the North Slope, 20 of them in the National Petroleum Reserve-Alaska (NPR-A). For many years ConocoPhillips was the state's largest acreage holder.

[2:45:50 PM](#)

MS. KING addressed the amount of activity that took place under the former ELF structure, saying that since development of Alpine there have been a number of exploration wells and lots of activity trying to find and develop new prospects. However, a transition is now occurring. When a company acquires a lease it must determine whether it can convert the lease into something that is commercially viable in the term of that lease. At this

time, approximately 50 percent of that lease acreage has been dropped. The conclusion that could be taken is that there is not potential on the North Slope; however, she said she thinks it is combination of factors that affect whether parties are moving forward with those leases. What draws her attention are the active leases that are still held, such as Prudhoe and Kuparuk, which have potential and are some of the state's most valuable barrels. The publically available figure for Prudhoe Bay is 30 billion barrels in place and 6 billion for Kuparuk. One percent additional recovery at Prudhoe Bay would be 300,000 million barrels. Thus, the potential is there and it is the state leases where the state has royalties, not federal lands like the NPR-A.

[2:47:46 PM](#)

CO-CHAIR SEATON asked how much of the dropped acreage belonged to ConocoPhillips.

MS. KING replied that she will have to look that up and will provide the committee with the exact figure immediately after the hearing. She added that ConocoPhillips went from being one of the largest acreage holders on the North Slope to not, so a sizeable portion of the dropped acreage was from her company.

[2:48:09 PM](#)

CO-CHAIR SEATON presumed that plays were not there in the dropped parcels. He related that the main thing being looked at in a tax rate change is to get production into TAPS. If the tax system is changed, the dropped parcels would not be developable until they go through another round of acquisition, in which case the state is looking at a very long lead time for those dropped parcels to come into play.

MS. KING concurred that the highest probability for getting oil in the short term is from existing units; significant potential is left in Prudhoe, Kuparuk, and Alpine, but it is more challenged. Given a number of issues there is uncertainty in NPR-A leasing, but there are active leases around the Alpine satellite areas (slide 7).

[2:50:19 PM](#)

REPRESENTATIVE KAWASAKI inquired how much the Alpine West fields played into ConocoPhillips's decision to drop acreage in NPR-A.

MS. KING responded that since approval of the environmental impact statement (EIS) for Alpine West CD-5 in October 2004, the fiscal regime has changed three times. Most exploration companies would consider [CD-5] the first commercial oil development in NPR-A, and the delays clearly indicate a risk that all parties would consider when deciding whether to explore in NPR-A. She said she believes that the permitting challenges of CD-5 affect what is happening here. Additionally, in its updated forecast for NPR-A the U.S. Geological Survey downgraded the oil, saying there is more likelihood of gas. There are significant challenges on NPR-A with respect to upside balancing because under the current fiscal regime the upside is gone if oil is found.

[2:52:06 PM](#)

REPRESENTATIVE KAWASAKI asked how oil in NPR-A is treated in regard to royalty.

MS. KING answered that it is a mixture of federal and private royalties in NPR-A. Some of ConocoPhillips's satellites have private royalties to Native corporations and the rest have U.S. Bureau of Land Management (BLM) royalties. She understood that a portion of the federal royalties on NPR-A come back to the state through revenue sharing.

REPRESENTATIVE KAWASAKI surmised that uncertainty in royalties and a number of other factors are related to the reduction in lease holdings.

MS. KING replied that there is no uncertainty in the royalty because when a lease is acquired the federal or private royalty terms are known. The challenge with [NPR-A] is uncertainty and downside; the upside is not necessarily seen. When deciding whether to acquire a lease, one more step back creates a real challenge in the balance of risk and reward. A lot of factors are in play and a fiscal structure that takes away the upside really mitigates how a company views an investment decision to cover the downsides.

[2:54:17 PM](#)

MS. KING, turning back to her presentation, explained that ConocoPhillips compiled its capital and operating expenditures for Prudhoe, Kuparuk, and Alpine [from 2005 to 2009]. These expenditures were divided into a maintenance/replacement/repair category and a development category that would add new barrels

(slide 8). The increase in investment over these years is not attributable to ACES; rather, it is substantially associated with maintenance/replacement/repair activity. This maintenance activity is very important for keeping oil in TAPS and for keeping base oil production, otherwise a much larger production decline would occur than what is being seen now. The drop off in development investment from 2008 to 2009 is because of the risk/reward balance.

MS. KING referenced a slide that the committee previously received from the Department of Revenue outlining the total capital expenditures going to new fields and those going to already-producing fields. She said coupling that DOR slide with slide 8 really outlines what is happening to investment and where that investment is going in the three major North Slope fields.

[2:56:14 PM](#)

MS. KING discussed the impact of progressivity on a discounted cash flow basis for a \$1 billion investment on a federal offshore lease [in the outer continental shelf] compared with a State of Alaska onshore lease (slide 9). She explained that the only variable in the two comparison graphs is the oil price; all other possible variables remain the same. Under the federal offshore environment, both the investor's and the government's returns increase as oil prices increase. Under the federal fixed percentage system, neither party's increase is disproportionately bigger than the other's. However, this is not the case under the Alaska onshore environment. At a price of \$25, the investor loses money due to gross taxes and royalty. At \$50 the state receives revenue but the investor is still in a negative position. At \$75 and above the investor's increase in revenue is disproportionately smaller than the government's increase. When total government take is factored in at the one peak spot, the marginal tax rate is \$.92 on the dollar. This dramatic shift in government and investor take is because progressivity applies to every dollar that is earned.

[2:59:17 PM](#)

REPRESENTATIVE P. WILSON surmised the figures would be different if the federal example was for onshore, such as the NPR-A, rather than offshore.

MS. KING explained that the federal example for the outer continental shelf means it is beyond the three-mile zone.

Anything within the three-mile zone is subject to the ACES production tax. The difference for the state is significant if that \$1 billion investment is on NPR-A versus state lands because the state would get royalty; for industry, however, both onshore NPR-A leases and onshore state leases are subject to the same production tax. In further response, Ms. King reiterated that NPR-A leases are subject to the ACES production tax because the reserve is within the state's taxing jurisdiction, therefore the NPR-A is subject to the bottom graph depicted on slide 9.

[3:00:44 PM](#)

MS. KING, continuing her presentation, noted that the source for the estimated number of barrels remaining on the North Slope, as depicted on slide 10, is the 2009 DOR production forecast and the graph represents the accumulated production from 2010-2050 for various fields. When the sum of expected production from the core fields of Kuparuk, Prudhoe, and Alpine is compared to the sum of the Point Thomson, Nikaitchuq, Liberty, and Oooguruk fields, it can be seen that even though the core fields are declining they will still have a lot of production. This is not to say that developing the other fields is unimportant, it is to show that the big prize is within the core fields. She recollected a saying she heard as a young engineer: "Big fields get bigger." Another way of saying this is, "You find oil where you already found oil." That is why ConocoPhillips thinks there is a prize to be had at Kuparuk, Prudhoe, and Alpine; it is just that it will be more costly and challenging to do so.

[3:02:35 PM](#)

MS. KING noted that Alaska North Slope (ANS) gas and the OCS Chukchi are significant prizes to be had (slide 11). However, she continued, they have limited ability to influence Alaska's production curve over the next 10 years. Alaska's production changes will therefore come from the current fields and from the more recent developments. The natural decline rate of the Kuparuk, Prudhoe Bay, and Alpine fields is between 10 and 16 percent, meaning that in 10 years the daily production will be down to 200,000 barrels. ConocoPhillips projects that the decline rate can be reduced to 6 percent through significant investment, which ConocoPhillips estimates to be in excess of \$3 billion per year. A 6 percent decline rate would mean a daily production of 400,000 barrels at the turn of the decade. However, the Department of Revenue's latest forecast is for a 2 percent decline rate over that timeframe. These differences illustrate that there is a level of uncertainty in the

production forecast for the next 10 years. All of this is significant because [HB 110] is a critical bridge to these growth projects. If the unit cost per barrel goes up or the North Slope costs must be borne by these incremental projects, the economic threshold for ANS gas and OCS will go up. The governor's bill would provide steps to work with industry to change the decline basis. The fiscal improvement outlined in HB 110 would lead to increased investment, which in turn would increase production and extend the life of TAPS, increase jobs, and lay a foundation for future growth through ANS gas and OCS development.

[3:06:12 PM](#)

MS. KING related her company's reasons for supporting HB 110 (slide 12). She said that within ConocoPhillips's portfolio, most everything on which a discovery has been made has been unitized, including leases in NPR-A. Therefore, ConocoPhillips sees the bracketing of progressivity as a critical component of HB 110 because it is one of the most significant impacts on investment decisions. Bracketing is a critical step in supporting some of those longer-term growth projects within the core fields and existing units that would help to mitigate the production decline. The improved well credits in HB 110 would help with the short-term push by stimulating workover activity on the North Slope. She offered ConocoPhillips's suggestion that the language for well credits be clarified to say that well workover activities are included. The bill's changes to the audit period, interest rate, and monthly versus annual progressivity are administrative improvements. A concern, however, is that an effective date for progressivity of 2013 will delay the effect of the whole bill as industry will delay decisions accordingly, given that the effective date could be changed in the next legislative session. Therefore, ConocoPhillips suggests that the effective date be accelerated by a year. She added that HB 110 is a step in the right direction. Alaska is at the point of making a choice between figuring out how fast production will decline versus an investment policy that encourages moving new developments forward. A balanced fiscal policy can achieve a different future and create a bridge to bigger projects.

[3:09:50 PM](#)

CO-CHAIR SEATON inquired as to how much ConocoPhillips has invested in the federal OCS off of Alaska.

MS. KING replied that right now her company's only portfolio is in the Chukchi Sea where \$506 million was invested in the lease round in 2008. Since then ConocoPhillips has spent tens of millions of dollars on gathering baseline science data and engaging local stakeholders.

[3:10:33 PM](#)

CO-CHAIR FEIGE asked whether ConocoPhillips has been contacted by the Department of Labor & Workforce Development about a breakdown on which jobs are going to maintenance and which to exploration and construction.

MS. KING responded that she has spoken to Commissioner Bishop several times over the past few weeks and has provided him with the maintenance/replacement/repair information shown on slide 8. ConocoPhillips does not necessarily have a good handle on how much of the jobs, but it will provide a breakdown of the spending that is going between those buckets.

[3:11:20 PM](#)

REPRESENTATIVE HERRON inquired whether the chairman/CEO of ConocoPhillips said anything about Alaska when he spoke at yesterday's conference in New York. He further inquired whether this dialog will be part of ConocoPhillips's annual analyst meeting in mid-March.

MS. KING answered that she did not see yesterday's presentation. She added that one of the company's senior vice president's gave a presentation recently and she does not remember a specific reference to Alaska in that presentation. Much of the company's focus has been on growing its liquid-rich plays in the Lower 48. From her meetings with senior management she can say that the marginal tax rate definitely has an impact on how ConocoPhillips views the investment climate, particularly when Alaska's project risks are seen. While Alaska is a key part of ConocoPhillips's portfolio, it is not necessarily where the company is focusing in the short term as far as growth in production. However, Alaska is something the company would like to see grow if a more balanced fiscal structure can be had.

[3:13:21 PM](#)

MS. KING, in response to Representative Munoz, confirmed that ConocoPhillips holds U.S. Bureau of Land Management (BLM) leases

within NPR-A; additionally some are private Native corporation leases on NPR-A.

REPRESENTATIVE MUNOZ asked whether those lands will be subject to the federal inventoring for possible wild land designation [in NPR-A] that is currently happening through the BLM.

MS. KING replied that it appears a wild land designation could affect the leases that ConocoPhillips already holds, although she cannot yet draw conclusions. ConocoPhillips is looking at this right now and discussions are planned with the U.S. Department of Interior.

REPRESENTATIVE MUNOZ, referencing the U.S. production changes depicted on slide 4, inquired whether ConocoPhillips is invested in the states that are shown as having large production changes, those states being North Dakota, Mississippi, Utah, Colorado, Kansas, and Montana.

MS. KING responded she has been out of the Lower 48 for awhile, but she can definitely say she has colleagues working in North Dakota on the Bakken shale play and in offshore Gulf of Mexico. Additionally, she is confident that ConocoPhillips has people working in Oklahoma, Texas, Utah, and Louisiana.

[3:15:34 PM](#)

REPRESENTATIVE HERRON inquired whether the committee co-chairs should ask the Department of Revenue to carefully reconsider its predictions on the rate of oil production decline.

MS. KING answered it is difficult for her to speak about what the Department of Revenue should do on its production forecast because the department has access to more information than does ConocoPhillips. In its production forecasts, ConocoPhillips tends to at a range - the probability of different outcomes is looked at and weighed. She said she does not know how the department weighted and risked its production profiles.

[3:16:36 PM](#)

REPRESENTATIVE FOSTER understood ConocoPhillips Alaska competes for investment dollars with other worldwide opportunities and that altering ACES would make its position more competitive for those dollars. He asked whether a summary of ConocoPhillips's worldwide portfolio could be provided to members.

MS. KING replied that ConocoPhillips has put a number of reports into the public domain, and the analyst's presentations are some of the most helpful ways to get an indication of where the company is investing in a particular year. Last week ConocoPhillips announced a significantly strong budget for investment for exploration and production, and next week the company will disclose what portion of that is Alaska. Once the 2010 actuals and the 2011 figure are in the public domain, she will prepare an update to the maintenance/replacement/repair graph (slide 8). The company is increasing investment in exploration and production activity in a diverse set of assets around the world. When making an investment decision in Alaska, the most important thing being looked at is whether that investment decision stands on its own. Downside risks, such as producing more water from a well than was anticipated or hitting gas instead of oil, are balanced against knowing that if they occur there is also an upside. That risk/reward balance is what the industry is built on, but if the upside cannot be seen it is difficult for those to be attractive investment opportunities. She reiterated that ConocoPhillips is spending money on growing its liquids portfolio around the world.

[3:19:25 PM](#)

REPRESENTATIVE FOSTER inquired where Alaska falls in the spectrum of competitiveness for ConocoPhillips.

MS. KING responded that Alaska has one of the highest marginal tax rates in ConocoPhillips's worldwide portfolio. If oil price goes up a dollar, and 90 cents on that dollar goes to pay governments, it affects how the company makes an investment decision.

BOB HEINRICH, Vice President, Finance, ConocoPhillips Alaska, Inc., offered to provide members with a recent graph depicting that information.

[3:20:16 PM](#)

CO-CHAIR SEATON, referencing a Department of Revenue graph presented at an earlier hearing, related that at a price of \$120 [per barrel] the effective tax rates are about 34 percent. He asked whether ConocoPhillips agrees that that is the effective tax rate when the whole system is melded together.

MS. KING said she thinks the graph that is being referred to plots only the effective rate of production tax. There are two

differences - the total government take and the marginal piece of that. While she has seen a marginal tax rate quoted as only 87 percent, she calculates that at the peak it is closer to 92 or 93 percent because federal income tax was not incorporated into that. She said she is unaware of ConocoPhillips looking at the analysis from the state and seeing the numbers very differently from the Department of Revenue.

MR. HEINRICH added that taking the credits into account reduces the total line down, which impacts where the endpoint is, but it does not change the shape of the curve.

[3:21:42 PM](#)

CO-CHAIR SEATON directed attention to the effective tax rates reported on page 2 of the ConocoPhillips [Consolidated Income Statement for 2009 and 2010]. He noted that the effective tax rate depicted for exploration and production (E&P) for all of 2009 was 34.4 percent for the U.S. and 66.6 percent for international; the effective tax rate depicted for E&P for all of 2010 was 36.2 percent for the U.S. and 48.6 percent for international. He asked why it is being said that Alaska needs to change its tax regime to be more competitive with regimes that are taxing ConocoPhillips at twice the rate of Alaska.

MS. KING answered that 2008 is the year that sticks out because in that year ConocoPhillips did not see the benefit of higher oil prices within the state of Alaska. The oil price in third quarter 2008 was about \$115 and in fourth quarter 2009 the price was \$69, yet both quarters generated exactly the same net income. That is the challenge when ConocoPhillips looks at its financials. In 2008 ConocoPhillips paid \$3.4 billion in production taxes alone to the State of Alaska.

[3:24:52 PM](#)

CO-CHAIR SEATON reiterated his previous question.

MR. HEINRICH said he believes the line items in this report are the federal taxes and do not include the production taxes paid in states.

MS. KING added that royalty is also not included in those line items.

MR. HEINRICH interjected that it would have to be broken apart.

CO-CHAIR SEATON requested that an explanation of the line items be provided to the committee.

[3:26:25 PM](#)

REPRESENTATIVE GARDNER recalled an earlier hearing at which members heard that the information the Department of Revenue receives on the returns from companies does not allow the department to reach firm conclusions as to whether the credit claims fall under maintenance/replacement/repair investment or development projects. She asked whether ConocoPhillips Alaska concurs with that.

MR. HEINRICH replied that ConocoPhillips does provide a lot of information to the Department of Revenue. He said he does not believe that in the forecast basis the capital is broken out in categories that separate maintenance from development capital. As well, he said he does not believe that information for the actual filings is built up in a way that would allow the department to do that for the actuals. In response to Co-Chair Seaton he agreed to confirm this in writing.

[3:28:18 PM](#)

REPRESENTATIVE GARDNER expressed her concern about the provision that reduces the audit period to four years. She understood that under the petroleum production profits tax (PPT) the audit period took longer than that because of accommodating that tax change and a shortage of auditors. She asked how long the ELF tax audits took on average.

MS. KING offered her belief that the audit period under ELF was three years and she is confident that the audits would have been completed within that time period.

CO-CHAIR SEATON interjected that under ELF it was just a tax on per barrel, so there was no net and no costs.

REPRESENTATIVE GARDNER clarified that her question is whether it actually took three years to do those audits.

MR. HEINRICH explained that the audits did not occur during the full three-year period; they tended to begin sometime during that period and end prior to the three years.

CO-CHAIR SEATON suggested that DOR be asked this question when it is before the committee next week.

REPRESENTATIVE GARDNER said this does not give her a great deal of confidence that a four-year audit period can be met. She noted that because many of the auditors at the department are new it has been hard to get definitive answers in this regard.

[3:30:23 PM](#)

REPRESENTATIVE GARDNER posited that what the state is trying to do with its tax structure is encourage reinvestment in Alaska when oil prices are high. For example, if the price of oil goes up and puts ConocoPhillips into a higher marginal tax rate, the company could reinvest that extra dollar of value into a capital project in Alaska to lower its tax rate.

MR. HEINRICH responded that capital expenditures are part of the calculation that determines a company's petroleum production profits tax (PPT) value. So, in effect it is a reduction of PPT value which sets where a company is on the progressivity curve. He agreed that those dollars spent would have the effect of reducing the current year or current month progressivity rate.

MS. KING added that just prior to this hearing she looked at a plot showing the effect of and the increasing of capital expenditure credits on that. However, the progressivity portion of this curve is so steep at those higher ends that even though the capital expenditure credit provides an element, it does not change the shape of the curve and does not balance that risk and reward. It a valuable component during lower prices, but at high prices the progressivity really drives the shape of the government take.

[3:32:00 PM](#)

REPRESENTATIVE GARDNER noted that because the North Slope is not ring-fenced the cost of development for other fields can be applied against the taxes that might come out of the North Slope. She asked whether this means that a major investment in a challenged field could effectively cut ConocoPhillips's tax bill to the state. She further asked how much that factors into investment decisions.

MS. KING agreed there is no ring-fencing across the North Slope and that ConocoPhillips is a net taxpayer. There is a benefit in that, she said. It is motivating in helping other developments move forward whether or not they are in the fields themselves, so challenged oil could be within Kuparuk; therefore

all of those are projects that would be valuable if they could compete for the investment.

[3:33:17 PM](#)

CO-CHAIR SEATON asked whether ConocoPhillips would consider challenged oil that is not currently developed in Kuparuk to be new oil from a new reservoir and therefore subject to the proposed new oil tax rate or would the company say that that oil would be under the existing tax regime.

MS. KING answered that the statute as drafted in HB 110 is clear that that is within an existing unit and would get the provisions of an existing unit. From a practical point of view, ConocoPhillips would not want to complicate the tax by trying to do that if the oil is going through the same facilities.

[3:35:11 PM](#)

CLAIRE FITZPATRICK, Senior Vice President for Alaska Operations, Chief Financial Officer, BP Exploration (Alaska), Inc. (BP Alaska), stated that the passage of ACES increased BP Alaska's overall tax burden and from her perspective it is an unsustainable level if her company wants to access Alaska's resources. The ACES production tax is BP Alaska's largest tax and not its only tax as it also pays state royalties, state income tax, state property tax, and various other state assessments. Thus, when making investment decisions BP looks through the lens of all of the taxes not just a single tax. BP Alaska competes for investments and competes against other U.S. and worldwide projects inside BP. Those other people are equally passionate about getting funding for developing their resources and progressing their projects. From where she is sitting, Alaska is not winning that competition. The risk/reward balance is not helping as there is insufficient upside. There has not been a constructive dialogue around being in partnership for the common goal of developing the resources and getting barrels in the pipe. Additionally, ACES limits the commercial viability when compared to other opportunities around the world. She further pointed out that as an operator at Prudhoe she only owns 26 percent, so when she is enthusiastic about something she must ensure that the other working interest owners are also equally enthusiastic about that the same item.

[3:38:16 PM](#)

MS. FITZPATRICK related that independent evidence shows Alaska is uncompetitive (slide 1). The 2007 Wood Mackenzie Petroleum Fiscal Index Report ranked Alaska at 97 out of 103 jurisdictions around the world. The 2010 report ranked Alaska 117 out of 129. She said her focus is not on Alaska's specific ranking, but on whether she can get the amount of investment needed to progress the opportunities in Alaska. If the answer to that is no, then the key for her is how to make Alaska more competitive so she is more successful in getting the funds to get those projects moving. A lot of factors go into investment decisions: the price cannot be controlled, the geology of the reservoirs cannot be controlled, and costs cannot be controlled, although she works hard to influence that.

[3:40:54 PM](#)

MS. FITZPATRICK said this is about how to make Alaska competitive. There are variables within the legislature's gift to decide whether to move Alaska to a more competitive position (slide 3). She said her colleagues in BP around the U.S. can be dismissive, saying Alaska will never produce all the things it thinks it is going to. When taking forward activities to seek investment, she is competing with other projects and is at disadvantage because the Alaska projects are always going to underperform relative to the other Lower 48 states. Given Alaska's location and its high costs, she is not as successful in getting investment dollars as she wants to be and she is confident that she is not as successful as Alaska's legislators want her to be.

MS. FITZPATRICK pointed out that production is rising in the Lower 48, but declining inside [Alaska] (slide 4). Some of that is being driven by price and that wells in the Lower 48 can be brought on line faster than can most wells in Alaska. There is a steady uptick in activity in the Lower 48, yet BP Alaska's operated footage in Alaska is steadily declining (slide 5). She related that during testimony on ACES in 2007, she stated that BP Alaska would not stop its activity, but she clearly stated that ACES would impact her ability to attract the level of investment to actually make a difference in the decline curve.

[3:42:05 PM](#)

MS. FITZPATRICK pointed out that it is not just the value of an isolated well; the revenue generated from a well or wells must also fund the cost of actually running the North Slope. The facilities on the slope are old and she must keep looking at

when and how to upgrade the facilities as the mix of oil changes. The camps, roads, and large infrastructure must be maintained. Putting all of those things together is when she starts to look at Alaska's competitiveness relative to the other opportunities within BP's portfolio.

[3:43:06 PM](#)

REPRESENTATIVE KAWASAKI, regarding the return BP receives on its Alaska investments as compared to its returns from other states (slide 3), surmised that BP does not make a decision based specifically on Alaska versus the U.S. because BP is a global company.

MS. FITZPATRICK replied that the decisions are made on a variety of bases. As a global company BP wants a global portfolio and will look to keep its activities in Alaska going. Decisions are also made on a strategic basis regarding where to move some of its investments, in which case it looks at both a global and a U.S. portfolio and the mix across the two. So, when bringing a project forward she may be competing against something in Angola and also something in any of the other Lower 48 states. Decisions are made on two levels: one is the totality of her business and its health and the other is the individual project.

[3:44:24 PM](#)

CO-CHAIR SEATON requested Ms. Fitzpatrick to provide the committee with a slide that depicts her company's Alaska return compared to the returns on its international investments. He said such a slide would help in understanding Alaska's competitiveness on both a U.S. and international basis.

MS. FITZPATRICK responded that she can provide details of BP's global portfolio. In regard to fiscal terms around the world, she related that the Wood Mackenzie database gives the details of the fiscal regimes in every location around the world. She noted that some investments are individually negotiated contracts with commercially sensitive terms that she is not in the position to share.

CO-CHAIR SEATON clarified that it would be acceptable for the slide to depict company share data in the same format as on slide 3. He said he is aware that Indonesia has an 85:15 split and Iraq has a 98:2 split.

[3:46:16 PM](#)

REPRESENTATIVE GARDNER understood that the terms of earlier leases do not have deadlines but they do have a duty to develop. She asked how this duty to develop is factored into decisions when BP is weighing international opportunities.

MS. FITZPATRICK, answering specifically to Alaska, offered her belief that the duty to develop is for things that are commercially viable, and this is the development that BP is continuing. Regarding obligations under the lease to do certain activities, BP does factor those in, but does this in terms of what the consequences would be if they were not done, what the value is of that in terms of commercial viability. There will be times when it is determined that something is not commercially viable for BP and BP will choose to relinquish that particular lease, and this could be in Alaska or elsewhere internationally.

[3:47:44 PM](#)

REPRESENTATIVE KAWASAKI noted that ConocoPhillips provides consolidated reports and breaks out its level of investments in Alaska versus other provinces, but BP does not do that. He inquired whether BP could show a limited number of people the numbers to prove the case of the level of investment in Alaska.

MS. FITZPATRICK replied that BP does not provide the details publically about Alaska because it is not required to do so under U.S. Securities and Exchange Commission (SEC) regulations. However, ConocoPhillips is required under SEC regulations to release this information because of the size of its Alaska business relative to its global portfolio. Regarding whether BP would be willing to release some information, she said it would depend on what information is specifically requested.

[3:48:51 PM](#)

CO-CHAIR FEIGE, in relation to the duty to develop economic projects, asked whether a lowering of the tax rate would make more of BP Alaska's existing reservoir economic to develop.

MS. FITZPATRICK responded that specific projects were pushed off as being no longer viable once ACES passed. If HB 110 is passed, she would go back to look at their viability and would then see whether her own internal organization as well as the other working interest owners are willing to get on board to progress them.

3:49:32 PM

CO-CHAIR SEATON recalled that in 2005 Mr. [David] Van Tuyl was asked how things could be changed to incentivize more development and his response was that BP was fully investing in every project that made sense at the time. Co-Chair Seaton surmised that Ms. Fitzpatrick is saying that BP is now not investing in those projects or that there are projects BP is not investing in because of ACES. He inquired whether it is the aspect of ACES that at high oil prices the marginal profit is not high enough, because obviously projects are profitable and economic to do. He requested an explanation of how it is that BP is saying it is not going to invest in economic projects unless there is a tax change to make them more economical.

MS. FITZPATRICK answered that she would not say that BP is saying that it is not investing in things that are economic. Rather, it is the definition of economic, the definition of commercially viable. If 1 cent is made is that worth the investment and the risk? For some of the projects deferred in 2007 and 2008, BP was not yet at the stage in 2005 of actually saying it was ready to invest in them. Some of that is going to be around technology evolved; also, when doing planning, there is the long lead time in activities. Oil prices in the 10-15 years prior to 2005 probably averaged \$20-\$25. She estimated that future prices will be in the ranges of \$60 and \$80 and said things that were marginal at that time might now be economic. She must look at the totality of an investment plus the potential upside for doing that investment, and if that is not competitive relative to other opportunities then she will be unable to compete to get the money to progress the project. She said there are projects that she would like to get the money to progress if she can have the opportunity to demonstrate that they are more competitive relative to other opportunities.

3:52:46 PM

CO-CHAIR SEATON said he still does not understand why a company would not go forward with an economic project because it is not as competitive with someplace else in the world, given that the 20 percent credit and 80 percent tax deduction in Alaska would equal the full cost of the project.

MS. FITZPATRICK replied that there are two aspects. One is that the marginal tax rate applies to revenue, not investment. Therefore, the tax shield from an investment is actually

considerably lower than that. There is still a tax shield that would be based off the base rate, the progressivity at the time of making the investment, plus the tax credit - and it could be 45, 50, or 55 percent depending on the price. The other aspect is the full life cycle. When making an investment, a consideration is the revenue stream once the investment actually turns into production. If that revenue is taxed at the marginal tax rate the totality of the life cycle might not be commercially viable relative to something else. Thus, on the pure investment, she said she does not actually get the aforementioned 80 percent scenario.

[3:54:41 PM](#)

CO-CHAIR SEATON surmised that Ms. Fitzpatrick's commercial liability is based on relative value versus elsewhere in the world, instead of whether she is actually making money in Alaska.

MS. FITZPATRICK responded that it is both, depending on the size of the project, the risk, the time scale, and a range of other factors. She will be able to progress a project that has a short life cycle and that looks good. However, a more challenged project that requires investment in technology to progress it must have the whole life cycle taken into account, and that may not be commercially viable.

[3:55:26 PM](#)

REPRESENTATIVE GARDNER asked how much exploratory acreage BP holds in Alaska. She requested a history of BP's exploratory wells for the last two years of ELF and any exploratory wells under PPT and ACES. She further asked whether BP's interest in holding exploratory acreage or drilling wells would change if the fiscal regime changed dramatically.

MS. FITZPATRICK agreed to get back to members with the specific data items, but said the general answer is that BP does not do traditional exploration wells. Within its existing units, BP believes there are significant resources and prefers to focus its attention on how to access them rather than focusing on what BP believes would be smaller pockets of resource elsewhere. She said she thinks that would be a better option for getting more barrels into the pipe, particularly within a shorter timeframe.

[3:56:38 PM](#)

REPRESENTATIVE KAWASAKI requested that a slide similar to [slide 5] be provided that shows the number of wells drilled worldwide and in Alaska. He said the point [in slide 5] appears to be that there is less drilling in the fields operated by BP Alaska.

MS. FITZPATRICK answered that the trend is generally less, although it was up a bit in 2010 depending on the amount of multi-laterals that BP had to drill to try to access the targeted volumes.

[3:57:44 PM](#)

REPRESENTATIVE KAWASAKI, [regarding slide 5], noted that for [the footage drilled] in 2006, the tax season would have been 2005 in which the decisions were made and would probably have been under ELF. In 2006 it would have been under PPT, and ACES is 2009. He observed that there was an increase in the footage drilled in 2010 and asked the reason for that increase.

MS. FITZPATRICK replied that the footage depicted includes all of the footage associated with multi-laterals, and when several sidetracks must be done to access the targeted hydrocarbons it increases the footage drilled without necessarily increasing the barrels in the pipe. She said she will make a valiant attempt at getting the worldwide wells drilled, but she cannot commit to actually achieving it.

[3:58:49 PM](#)

MS. FITZPATRICK, turning back to her presentation, pointed out that BP Alaska's actual spend on revenue generating, i.e. that which would directly put barrels into the pipe in the short term, is flat to declining (slide 6, top graph). When adjusted for price inflation based upon the producer price inflation index, the spend on a real basis is actually going down even though in real terms it is looking like it is flat (slide 6, bottom graph). That reflects the basis that there are still good wells to be drilled. However, investment decisions are made ahead of time: in 2005 the average price was about \$30 or \$32 and that was the amount of money she was spending. In 2010 the price was near \$65 or \$70. Logic would tell her, however, that if there was a lot of good opportunities and they were competitive, that would have been a substantially higher number.

[4:00:06 PM](#)

REPRESENTATIVE HERRON inquired whether the committee co-chairs should ask the Department of Revenue to carefully reconsider its projections.

MS. FITZPATRICK responded that she has not personally gone through the study in detail. She said she does not know what assumptions were used in the department's decline curve regarding existing fields versus new activities, and that is where the committee's questions would be better addressed. In further response, she said she could not encourage or discourage whether the co-chairs ask the department to reconsider its projections.

[4:01:59 PM](#)

MS. FITZPATRICK, continuing her presentation, offered her belief that there is a lot of opportunity in Alaska if something is done to make the state more competitive (slide 7). She noted that there is a lot of challenged oil as well as a lot of light oil. The question is how projects in Alaska stand out relative to other locations. Last year BP committed \$20 billion of net investment and not a single one was an Alaska project. She said it is not from lack of trying that she is unable to get the dollars needed for Alaska.

[4:02:51 PM](#)

REPRESENTATIVE FOSTER asked how long it might be before an increase in exploration investments would be seen if changes were made to ACES with an effective date in two years. He further asked Ms. Fitzpatrick's opinion about a sunset of the changes and going back to ACES if in four years there was no activity.

MS. FITZPATRICK, regarding a timeline, answered that it depends on the type of activity, so there would be things across the entire timeframe. Drilling activities, subject to access to risk, could be progressed faster, and there could be some of those opportunities. Projects on which work was done but then they were deferred might not be as long. Projects starting from pure exploration could be 5-7 years. Regarding a sunset, she explained that she must make investment decisions based on the tax regime that is in place at the time. If there is a sunset, then she would have to assume in her entire economics that it is going to sunset. Therefore, a sunset provision would hamper investment decisions in the short term.

4:05:14 PM

REPRESENTATIVE KAWASAKI inquired what the lead time was for the sanctioned projects listed on slide 7 [Gulf of Mexico, Egypt, North Sea, Azerbaijan, Canada, North Africa, Angola, TNK BP].

MS. FITZPATRICK replied that from discovery to sanction the time will vary, but based on the industry average it would range from three to six years depending on the size, scale, and complexity.

REPRESENTATIVE KAWASAKI understood that the Gulf of Mexico would be a favorable place; however, Angola, North Africa, Azerbaijan, Russia, and Egypt would not at all be favorable. He asked how Ms. Fitzpatrick would justify \$20 billion in sanctioned projects in those unfavorable areas while at the same time saying that Alaska is uncompetitive.

MS. FITZPATRICK responded that many, many factors go into making an investment decision. "It is not a straight on-off switch, nor is it a case of if the answer is 42 it is yes." It depends on the size of the resource, the quality of the resource in terms of any price differential, its location relative to infrastructure, the cost of doing business in that location, and the quality of the rocks. While nothing can be done about Alaska's location from market or the complexity of the hydrocarbon structures on the North Slope, which of the numerous factors can be influenced if the objective is to make Alaska more attractive for investment?

4:08:02 PM

REPRESENTATIVE KAWASAKI inquired where Alaska would stand in overall competitiveness with BP if its tax regime was changed to be one of the most competitive in the world.

MS. FITZPATRICK answered that it is only going to be relative, how far up the curve Alaska wants to go. From her perspective, HB 110 will make a positive step in the right direction and will give opportunities to bring new and more activities into Alaska and get more barrels in the pipe. She allowed that she would like the bill to go further. It is whether the state wants to take the step to see if it is actually going to get some of the things it wants, and if that has not made Alaska competitive enough, further changes can be made to make the state even more competitive.

4:09:09 PM

MS. FITZPATRICK, concluding her presentation, noted that due to the limited time left in the hearing she will address the technicalities of the bill in a letter to members. However, she said that, overall, HB 110 will make a difference and is a step in the right direction. Some of the things that she thinks will come back in as a result of the bill and will be helpful to both BP Alaska and the state include drilling, increased well work, and the gas partial processing plant, which is a \$1.7 billion project with 50 wells and new pad. The sooner the bill takes effect the sooner she can get an answer from the head corporate office in terms of getting more funds. Alaska is uncompetitive. It has lots of resource, but the resource is high cost and challenged. It is a choice of whether the state wants to work together to get more barrels in the pipe, and if so, then HB 110 is a step that will help get there.

[4:10:54 PM](#)

CO-CHAIR SEATON asked whether BP Alaska has a position on moving the tax floor. In response to Ms. Fitzpatrick, he confirmed he is meaning the point at which the minimum tax takes effect.

MS. FITZPATRICK replied that BP Alaska recognizes that if there is going to be a risk/reward switch, which BP Alaska is supportive of at one end, she would like there to be no floor; however, she appreciates from the state's perspective the desire to have one.

[4:11:34 PM](#)

REPRESENTATIVE KAWASAKI expressed his desire to see Alaskans hired. He cited a 2009 report on oil industry top employers which states that 26 percent of BP Alaska's workers are nonresidents. The report also states that the average quarterly wages for nonresidents in oil and gas extraction is roughly 30 percent more than for residents. The report's appendix states that 48 percent of new hires for oil and gas are nonresidents and 42 percent for oil field services. He said he will be providing further data that shows Alaskans are not being hired.

MS. FITZPATRICK agreed to provide a response in writing.

[4:13:51 PM](#)

CO-CHAIR FEIGE inquired whether BP Alaska has been contacted by the Department of Labor & Workforce Development regarding the

number of jobs in the various categories of maintenance and construction.

MS. FITZPATRICK responded that she will check and get back to the committee in this regard.

[4:14:23 PM](#)

DALE PITTMAN, Alaska Production Manager, ExxonMobil, paraphrased from the following written statement [original punctuation provided]:

Let me start by saying that Alaska has been and continues to be an important component of ExxonMobil's world-wide investment portfolio. We have had a presence in Alaska for over 50 years and have been a key player in Alaska's oil industry development, investing over \$12 billion dollars to date. We are the operator of Point Thomson, hold the largest working interest at Prudhoe Bay (36.4%) and the largest lease holder of discovered Alaska gas resources. We expect to be involved in Alaska for many years to come and will continue to evaluate potential development opportunities.

At the outset, so our position is clear, let me say that ExxonMobil supports the presentation you heard today from the Alaska Oil and Gas Association. I do not intend to repeat the thorough technical comments from that testimony.

As for our specific comments, I would like to state, consistent with our prior testimony during the hearings on both the PPT and ACES, and on the proposed tax reform legislation last session, that ExxonMobil believes the changes made to Alaska's oil and gas production tax since 2005 have had a negative impact on business activity in Alaska and Alaska's overall investment climate. Alaska's current production taxes are simply too high to stimulate the additional investment required to fully develop Alaska's oil and gas resources.

It is for this reason ExxonMobil is pleased to see that the Administration recognizes the need for material change to Alaska's current oil and gas production tax system. We are encouraged by Governor

Parnell's desire to see increased investments and further oil and gas development. We support his efforts to reform ACES and believe HB 110 is a good first step towards what we hope is a thorough review and revision of Alaska's production tax regime to allow the state to fully develop its vast resources.

ExxonMobil supports HB 110, and if enacted in its current form, we would expect investment activity in Alaska to increase, resulting in a corresponding benefit of more work for Alaskans. With passage of the Governor's proposed changes to ACES in its current form, we anticipate that industry will reexamine the inventory of Alaska North Slope opportunities and move forward with those projects that are made competitive by the reduced production tax burden. For example, the proposed enhanced in-field drilling tax credits and reduction to the progressivity tax would allow us to consider additional drilling and well work activity at the Prudhoe Bay Unit. This kind of developmental drilling in the core field on the North Slope is critical to Alaska's future, particularly over the next five to ten years. Production decline must be stemmed until new developments can be discovered, progressed and brought on production.

[4:17:56 PM](#)

While the enhanced in-field drilling tax credits and reduction to the progressivity tax are much needed revisions to ACES, we would urge earlier effective dates to accelerate the resulting ramp up in investment activity, Alaskan jobs and future state revenues.

However, merely providing additional tax credits while keeping the overall effective rate of the ACES tax too high is not the long term solution to improving Alaska's investment climate. While the system of tax credits under ACES does provide significant incentives for investing in capital assets to explore for, develop, and produce more oil and gas, the deduction of lease expenditures or the allowance of a tax credit is simply part of the calculation about how much tax a producer owes. The bottom line is that, between PPT and ACES, the industry's production tax obligations have more than tripled over the past five years.

ExxonMobil supports the Governor's proposal as an important first step, but additional reform of ACES is needed.

Additional reforms are needed to improve Alaska's overall investment climate over the long term. Evaluation of a further reduction in the production tax rates should also be considered. Even with the Governor's proposal, Alaska's production taxes are high in comparison to other investment alternatives, making Alaska one of the most expensive states in which the oil and gas industry does business.

As you have heard in prior testimony or may have read in recent newspaper articles, spending on the North Slope has remained relatively flat since the enactment of ACES. But what needs to be clarified is that the majority of that investment has been for maintenance or production enhancement efforts for existing operations, not for new exploration and development opportunities that would bring on new production. It is also worth noting that costs for this investment activity have gone up, so while some may argue there has been additional investment, it doesn't necessarily translate into more activity. For example costs to drill a well have increased over the years, so higher spend on drilling does not necessarily mean more wells are being drilled.

[4:20:06 PM](#)

Alaska is currently producing approximately 600,000 barrels of oil per day from the North Slope. Industry currently invests more than \$1 billion per year just to maintain current North Slope oil production decline at six to seven percent. Without that continued investment, the annual production decline would be in the range of 12 to 15 percent annually.

The Alaska Department of Revenue is forecasting the production from Alaska's currently producing fields to decline by 60,000 barrels of oil per day this year. It goes on to predict that current field production will decline to half of its current 600,000 barrels of oil per day in just seven years, a decline of over

300,000 barrels of oil per day. Allow me to put the challenge of stemming that decline in perspective.

Alaska's newest development, the Nikaitchuq field, is scheduled to produce first oil early this year. The field has been more than six years in planning, development and construction and carries a total cost of over \$2 billion dollars. The field is forecasted to reach production of about 25,000 barrels per day four years from now. So using this as an example, it would take the startup of two to three Nikaitchuq equivalent fields every year in perpetuity just to hold North Slope production at 600,000 barrels of oil per day. Pioneer's Oooguruk field is another example. It would take three to four fields the size of Oooguruk every year to match the forecasted North Slope production decline. Clearly, the current outlook for development falls far short, and new fields are urgently needed to stem this decline.

Such development will only occur if there is an improvement in the Alaska investment climate. Alaska production tax policy is key to fostering a favorable investment climate.

[4:21:52 PM](#)

Alaska's overall high production tax rates discourage investment. Companies like ExxonMobil are willing to accept the risks of long-term, capital intensive investments when there is a stable and competitive tax structure that encourages investment and ensures a corresponding opportunity for upside potential. When you take away the upside potential through a high progressivity tax you reduce the overall attractiveness of those capital intensive investments, which in turn could lead to reduced investment and resource recovery and, in the long-term, diminished state revenues. Let me reemphasize this point, while higher taxes may bring additional revenues in the short-term, it's reasonable to anticipate that any reduction in investment will decrease production and significantly reduce those revenues in the longer term.

As many of you heard me testify last year, time in the oil and gas industry is not measured in business

cycles. It is measured in decades and in generations. Today's production rates are the product of government policies, technical work, and investment decisions made years ago. Increasing production rates in the decades to come will be a direct result from sound policies, decisions, and commitments that are made today. The Governor's proposed ACES changes are clearly a significant step in the right direction towards much needed reform of Alaska's high oil and gas production tax system.

4:23:16 PM

Alaska needs a long-term resource development policy that will encourage increasing investment to maximize its resource potential while receiving a fair share of the resource revenues; addressing its high level of government take is a start. The reform of ACES needs to result in a competitive, stable and predictable fiscal environment that will encourage investment, recognize that the remaining resources are economically challenged, including both new fields and resource development opportunities in existing fields. The primary driver of Alaska's long-term resource development policy should be to maximize the development of its resource base, not just maximize short-term state revenues.

Let me conclude my testimony by reiterating that while we hope to continue to pursue investment opportunities in Alaska in the future, the resource and cost structure in Alaska is becoming increasingly challenging. Governor Parnell's proposed changes to ACES are a good start to needed fiscal reform - but more is still needed.

ExxonMobil looks forward to working with the Administration, the legislators, industry and the people of Alaska in the future pursuit and development of Alaska's oil and gas resources.

4:24:32 PM

CO-CHAIR SEATON referenced the upside potential mentioned in Mr. Pittman's testimony and inquired whether ExxonMobil considers the provision in HB 110 to reduce the floor for downside potential to be a significant factor.

MR. PITTMAN replied that ExxonMobil has not considered it at this point to be significant, but he will check and get back to the committee with a specific answer.

4:25:25 PM

REPRESENTATIVE HERRON related that some people believe there is time until 2018 to fill the pipe. However, he said he thinks it is much earlier. He asked whether 2013 is more realistic for the state to do something.

MR. PITTMAN responded that 2013 would be appropriate as far as to act. He said he finds the suggestions that TAPS will continue to produce through the mid-2020s with no additional investment to be optimistic. There are some downside cases that suggest that may be only 7-8 years away.

4:26:26 PM

REPRESENTATIVE HERRON recalled testimony by a consultant to the governor, saying he thought the consultant was knowledgeable. He related that a question asked of the consultant was whether HB 110 as currently written would effectively translate into guaranteed exploration and the consultant's answer was no. He asked whether Mr. Pittman agrees with this answer of no.

MR. PITTMAN replied that he would not agree with no, but he would agree that it may not directly correlate because of the other factors that have been discussed today. Cost, commodity prices, and supply and demand in other areas of the world make it hard to say that HB 110 will guarantee increased exploration. One of the various factors impacting those decisions that cannot be controlled is the Mother Nature aspect, such as not finding the quality of rock that was expected. However, between the state and producers there are four prime factors that can be controlled: technology, state and federal government take, development cost, and operating cost. He said he thinks industry and the state should be aligned to help minimize those to improve the opportunity for Alaska resources.

4:28:14 PM

REPRESENTATIVE KAWASAKI commented that he has not yet heard any convincing evidence from any speaker that the investment will come back to Alaska, that there will be more Alaska jobs, and that industry will explore more. He noted that a graph put out

by the Department of Revenue shows that the production decline started in 1987, and between 1987 and 2005, when the very favorable ELF gross production tax was in effect, there was still not the production required to fill the pipe. Therefore, in substantive terms, how will industry's investment change should HB 110 pass and ACES is rewritten.

MR. PITTMAN responded that the decline curve is currently as flat as it has ever been since peak production; Alaska has a world class resource capable of immense volumes of production. To answer the question about continuing to invest or increasing the need to invest, he said he is convinced that [ExxonMobil] is clearly aligned to keep the pipeline flowing; that is good for the state and good for future resource recovery. The kind of volume increases that are possible on the scales that ExxonMobil is currently working are pretty challenging to affect the kind of slopes that are seen when starting at 2 million barrels a day. However, it is possible today to affect 100,000 barrels over a year. Some of it is going to take things that we do not yet know how to do, and more interest needs to be attracted in making those investments.

[4:31:08 PM](#)

CO-CHAIR SEATON noted that the percent decline in production was steeper when Alaska had lower tax rates. The slope of decline was greater under the lower PPT rate than it has been since instituting ACES. According to information the committee just received from the Alaska Oil and Gas Conservation Commission (AOGCC), the decline in production/developmental wells occurred in 2004 and then leveled off, so that drop occurred before the PPT. He allowed that there are other factors as well, but said he is having a hard time making the link with ACES, as portrayed by industry, when the number of developmental wells went down prior to the enactment of PPT and ACES. He requested that the companies submit a written explanation of this to the committee.

[4:34:30 PM](#)

CO-CHAIR FEIGE, regarding the changing numbers of developmental wells and when they occurred, inquired whether the correlation was with the price of oil.

MR. PITTMAN answered that there are so many variables it will be difficult to draw a direct correlation to any individual variable, but ExxonMobil will do its best not to have just

supposition and will look at the data. He agreed that the price of oil is a factor.

CO-CHAIR SEATON pointed out that the AOGCC data does include in the background the price of oil, so the price of oil can be directly looked at.

[4:35:35 PM](#)

REPRESENTATIVE HERRON asked whether the committee co-chairs should request the Department of Revenue to conduct a careful reconsideration of its production rate decline graph.

MR. PITTMAN replied that he cannot tell the co-chairs what to tell the commissioner, but when he looks at the data the questions that come to his mind are what the assumptions were that went into that data and what are the current assumptions that would add to that data.

[4:36:45 PM](#)

REPRESENTATIVE KAWASAKI inquired whether ExxonMobil has an exit strategy for the North Slope.

MR. PITTMAN responded no, ExxonMobil intends to be in Alaska and intends to find ways to work with its colleagues, industry, and Alyeska Pipeline Service Company, but that is tempered with his knowledge and experience of how long it takes to effect those changes.

[4:37:32 PM](#)

CO-CHAIR SEATON, regarding Mr. Pittman's testimony that the remaining resources are economically challenged, noted that the current tax regime is a companywide regime. No tax occurs below all costs rolled out and then the base rate applies for the next \$30. For an economically challenged field that takes \$60 to produce, the base tax rate is 25 percent on the next \$30 above that, so there is no progressivity for Alaska North Slope \$90. Regarding economically challenged oil, he asked how progressivity becomes the crucial factor in decision making when it does not start until \$30 after all expenses are rolled out.

MR. PITTMAN answered that when looking at investments, ExxonMobil runs a full suite of possibilities and many of those will be at the higher-end prices, which will only occur 15-20 percent of the time. Coupled with the downside prices that

occur 15-20 percent of the time, it does impede the viability of future projects. Many of them could be on the edge and that could be enough to push them over, and the aforementioned is one of those types of projects.

[4:39:38 PM](#)

CO-CHAIR SEATON offered his appreciation to all of the witnesses for their testimony.

[4:40:23 PM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 4:40 p.m.