

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

April 24, 2012

1:27 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 Lance Pruitt  
Representative Kurt Olson  
Representative Dan Saddler  
Representative Pete Petersen  
Representative Chris Tuck  
Representative Anna Fairclough  
Representative Craig Johnson  
Representative Mike Doogan  
Senator Cathy Giessel

**COMMITTEE CALENDAR**

HOUSE BILL NO. 3001

"An Act relating to adjustments to oil and gas production tax values based on a percentage of gross value at the point of production for oil and gas produced from leases or properties north of 68 degrees North latitude; relating to monthly installment payments of the oil and gas production tax; relating to the determinations of oil and gas production tax values; relating to oil and gas production tax credits including qualified capital credits for exploration, development, or production; making conforming amendments; and providing for an effective date."

- HEARD & HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB3001

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

04/18/12	(H)	READ THE FIRST TIME - REFERRALS
04/18/12	(H)	RES, FIN
04/20/12	(H)	RES AT 1:00 PM HOUSE FINANCE 519
04/20/12	(H)	Heard & Held
04/20/12	(H)	MINUTE(RES)
04/21/12	(H)	RES AT 10:00 AM HOUSE FINANCE 519
04/21/12	(H)	Heard & Held
04/21/12	(H)	MINUTE(RES)
04/21/12	(H)	RES AT 2:00 PM HOUSE FINANCE 519
04/21/12	(H)	Heard & Held
04/21/12	(H)	MINUTE(RES)
04/23/12	(H)	RES AT 9:00 AM HOUSE FINANCE 519
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04/24/12	(H)	RES AT 1:00 PM HOUSE FINANCE 519

**WITNESS REGISTER**

TONY REINSCH, Senior Director  
Upstream & Gas  
PFC Energy  
Washington D.C.

**POSITION STATEMENT:** Testified and answered questions during the presentation by the PFC Energy on Global Strategy and portfolio overviews of major Alaska producers.

**ACTION NARRATIVE**

1:27:30 PM

**CO-CHAIR PAUL SEATON** called the House Resources Standing Committee meeting to order at 1:27 p.m. Representatives P. Wilson, Herron, Dick, Munoz, Gardner, Kawasaki, Feige, and Seaton were present at the call to order. Representative Foster

arrived as the meeting was in progress. In attendance from the House Special Committee on Energy were Representatives Pruitt, Olson, Saddler, Petersen, and Tuck. Also in attendance were Representatives Fairclough, Johnson, and Doogan and Senator Giessel.

**HB 3001-OIL AND GAS PRODUCTION TAX**

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CO-CHAIR SEATON announced that the only order of business would be a presentation by the PFC Energy on Global Strategy and the Portfolio Overview of Major Alaska Producers.

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TONY REINSCH, Senior Director, Upstream & Gas PFC Energy, stated he will review the global portfolios of the three major producers in Alaska: BP Exploration (Alaska) Inc. (BP), ConocoPhillips, and ExxonMobil Corporation (ExxonMobil). He said all three companies are in the midst of substantial strategy changes which impact their global operations and portfolios. He characterized this as an unusual happening for companies of this size in the oil and gas sector. This committee and Alaska have been examining how Alaska fits into the rapidly changing and unusually dynamic global portfolio situation for these companies as they move forward to achieve their target strategies and objectives. Further, the committee will consider how Alaska can position itself to be part of the solution rather than potentially becoming part of the problem.

MR. REINSCH began his PowerPoint presentation on "Global Strategy & Portfolio Overview of Major Alaska Producers" by reviewing BP [slide 25]. He stated that BP is the second largest global oil company in the world, second only to ExxonMobil in terms of annual production. BP secures roughly half of its global production from Russia and Central Asia, in particular, in Russia with its joint venture with TNK-BP. The signature event for BP in the past few years was the Macondo oil spill in the Gulf of Mexico. This event has resulted in the company restructuring its portfolio, divesting over \$30 billion in assets - upstream, midstream, and downstream - with the vast majority of its divestiture being upstream assets. He highlighted that BP acquired roughly \$28 billion in assets in other jurisdictions and arenas. He concluded that the company took advantage of this signature event to restructure its portfolio, which would ordinarily have drawn a very negative

response from analysts and investors. He pointed out that BP has been able to pare down the non-core elements of its portfolio, yet still maintain all on-going and prospective capital projects during its geographic divestiture. As a result, BP has been able to dedicate its production from the Macondo oil spill to the fund oil spill reparations for the damages incurred.

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MR. REINSCH summarized that BP has pared down, in terms of the number of companies and projects; however, it has bulked up in terms of its future growth. He outlined BP has been focused on three activities: deepwater development, global gas, and developing giant oil fields in Russia, Iraq, and Alaska. The company has committed \$20 billion in net investments into 16 projects in the past two years. This type of aggressive capital spending will likely impact BP's return on capital employed in a negative fashion; however, it will provide them with a competitive growth rate in terms of their peers. He reviewed BP's overview figures: 2011 reserves of 17,330 million barrels of oil equivalent (mmbOE); 2011 production at 3,400 barrels of oil equivalent per day (mboe/d); April 2012 market capitalization cap at \$133 billion; April 2012 price earnings ratio of 6.15; 2011 corporate revenue at \$375 billion; and 2011 upstream capital, which is estimated at \$17 billion.

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CO-CHAIR SEATON asked for an estimate of the restructured company's ability to expand investment in Alaska.

MR. REINSCH explained his presentation would cover an initial broad overview of each company - identify the drivers - and then hone in on the Alaska assets and identify four or five challenges each company faces that could affect development in the state.

MR. REINSCH turned to a map titled "BP Global Areas of Upstream Operations" that visually identifies BP's global ventures, including production in 16 of 26 Countries, in which BP is currently involved [slide 26]. He described the core as new venture, focus, harvest, and exit areas. He highlighted that BP has divested Pakistan and Chilean assets, and BP has tried to divest Argentina through the sale of BP's joint venture interest in Pan America Energy (PAE) and it would like to divest in Argentina. He pointed out the areas on the slide that are

depicted in yellow, represent the majority of company growth. He stated that a number of harvest areas exist in which BP is managing mature portfolios or mature field declines - which would be the case in Alaska. The United Kingdom (UK) would be a matter of a mature portfolio decline, which is much more widespread.

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REPRESENTATIVE SADDLER asked for a definition of core versus focus.

MR. REINSCH answered that core would represent the areas of current material production, or areas in which the majority of the production occurs versus focus areas, which are areas that are receiving a considerable amount of capital injection with the objective of building core areas into focus areas.

MR. REINSCH moved to a map titled "BP Global Production Portfolio - 2010" [slide 27] with bubbles of various sizes representing production levels. He noted each circle is segmented by asset type which includes conventional onshore, conventional shallow, deepwater, oil sands, other, and unconventional production. For example, in Trinidad and Tobago 100 percent of BP's production has been conventional shallow production whereas 100 percent of Russia's production is conventional onshore production. He highlighted a few of the major production areas, noting the U.S. is the second largest producing country, being driven by deepwater developments in the Gulf of Mexico. He pointed out that BP is a significant gas producer in the onshore Lower 48, with a growing focus on unconventional production as is the case for all of the countries with significant acreage in the Lower 48 basins. He predicted that the potential in Alaska is tied to Prudhoe Bay resources and to gas commercialization at some point. The largest producing country for BP is Russia, representing approximately a quarter of BP's output with the potential for development of mature fields and strong interest in Arctic expansion.

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REPRESENTATIVE GARDNER asked Mr. Reinsch to discuss the limitations arising from the TNK-BP joint venture and whether the company is a Russian national company.

MR. REINSCH said TNK-BP is a joint venture, which is how BP was able to enter Russia. BP has only been allowed to operate in Russia with TNK-BP as a partner. He recalled that about a year ago BP attempted to execute a joint venture with Rosneft - the biggest Russian oil company - which was stopped by TNK-BP's threat of court action. He indicated that the purpose of the proposed joint venture was to position BP for Arctic development in the Kara Sea. He concluded by reporting that ExxonMobil secured the joint venture with Rosneft in November 2011. In further response to Representative Gardner, responded that TNK-BP is a private venture.

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REPRESENTATIVE TUCK related his understanding that BP may be leaving Russia.

MR. REINSCH answered that BP wanted the joint venture with Rosneft. Clearly, not being able to secure the joint venture will constrain BP, but the company has no intention of leaving Russia. In fact, Russia has begun to generate good net cash flow for BP, returns on the investments have been made, and BP is moving forward in a more comfortable manner despite these restrictions.

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REPRESENTATIVE OLSON asked whether any other company could have survived the financial problems that resulted from BP's Gulf of Mexico Macondo event.

MR. REINSCH indicated that perhaps four or five companies could have survived the \$40 billion hit on their portfolios; however BP has handled it in an artful manner. He suggested that if analysts had been polled six months after the Macondo oil spill they would have predicted the company would have been sold since the share price had dramatically dropped.

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MR. REINSCH reported that an interesting development has been BP's 2011 joint venture with Reliance Energy, LLC - a private corporation in India - in the deepwater offshore project on the east coast of India, which is expected to hold a significant gas resource that it hopes to market to India. He characterized India as one of the fastest growing energy markets in the world.

This joint venture illustrates how BP has restructured its company.

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REPRESENTATIVE TUCK asked for examples of projects that would fit into the "Other" asset types. He added none were listed; however he indicated Mr. Reinsch does not need to answer the question at this time.

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REPRESENTATIVE SADDLER asked whether any non-Chinese companies are producing oil and gas in China.

MR. REINSCH responded that ExxonMobil, Shell Western E&P Inc. (Shell), and BP are all hoping to position themselves in China. He pointed out that BP has tried on two occasions to establish a joint venture in China, with China National Petroleum Corporation (CNPC) or the China National Offshore Oil Corporation (CNOOC) - their deepwater company - similar to the one it has in Russia; however, BP encountered difficulty in using the same approach. He suggested that BP is at the point of strategizing for entry and growth, but all of the major oil companies have an interest in supplying energy to China or engaging in the basins. He related that Shell is likely the most advanced at this point.

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REPRESENTATIVE GARDNER noted that the high growth in Angola is now challenged with startup of several unsanctioned projects.

MR. REINSCH answered that BP's West Africa portfolio has moved into an almost "treadmill" stage since BP must add new volumes and projects simply to keep up with the decline in the deepwater projects under production. He explained the unsanctioned projects represent projects that BP could bring into production, but have not yet; however, he anticipated the projects would be sequenced in and would effectively hold BP's production flat.

REPRESENTATIVE GARDNER asked whether there are any parallels with Alaska in that framework.

MR. REINSCH responded that there certainly will be the possibility since the African deepwater assets will go into rapid decline. He noted the projects are built to have very

short peak periods to keep the net present value figures competitive in BP's portfolio. In response to Representative Tuck, Mr. Reinsch confirmed that BP's global production includes oil and gas.

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MR. REINSCH referred to a chart, titled "Total Portfolio Evolution: BP vis-à-vis the Competition" [slide 28]. He related that this slide represents BP's peer group - it compares the annual production on the vertical axis and the blue lines on the graph show the movement over time for each company indicated. He noted that BP and ConocoPhillips Company (ConocoPhillips) are the only two companies who are forecast to deliver production declines between now and 2015, while all of the other companies are predicted to deliver volume growth. He highlighted the analysis covers two periods: 2000-2010 and 2010-2015. He explained that during the first period, BP grew through Russia, Trinidad and Tobago, liquefied natural gas (LNG) development, and Angola deepwater development. This expansion has been offset by declines in Europe - 600,000 barrels of production loss - and in North America during 2000-2010 with the Lower 48 onshore declines and Alaska's Prudhoe Bay declines. He predicted that BP will decline in the short run due to post-Macondo asset divestiture combined with curbed activity in the Gulf of Mexico's deepwater.

MR. REINSCH predicted the net effect will be that BP will shrink over the next few years. He discussed how BP's portfolio is financed [slide 29]. He described the chart, noting anything above the line represents a cash deficit and anything below the line represents a cash surplus. He highlighted this illustrates that the U.S. has been a leading generator of cash flow for BP during 2000-2010. The region that has moved most from deficit to surplus has been the West Africa portfolio, which generated a significant amount of cash flow as the deepwater developments moved into production. He reported on the evolution of the portfolio, which depicts anticipated future growth [slide 30]. He stated this chart examines seven major regions from 2001-2020, with the dotted line at 2012. He referred to Europe, noting the initial core for BP has been in steady decline for the last decade. He summarized that BP has been fighting a decline rate where stability in production would be a significant achievement; however, the fight can only be maintained for a short period of time. He emphasized that North America, Russia and Central Asia are the major areas of production for BP. He noted that Sub-Saharan Africa and Angola

projects have been substantial in adding to BP's cash flow, but these projects are still a relatively small part of their global portfolio.

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REPRESENTATIVE TUCK asked for clarification on whether this is based on millions of barrels of oil per day equivalent (mboe/d).

MR. REINSCH answered that it is based on thousands of barrels of oil per day equivalent (mboe/d). In further response to Representative Tuck, Mr. Reinsch answered that natural gas is included in the oil equivalent and the analysis includes all liquids and gas production, including natural gas liquids, crude oil, and condensate. He indicated that gas is converted to an oil equivalent in all of PFC Energy's work to a ratio of 6 to 1 - 6,000 thousand cubic feet (MCF) of gas to one barrel of oil.

REPRESENTATIVE TUCK commented that Alaska's tax structure has a barrel of oil equivalency for natural gas, which he thought was unique to Alaska.

MR. REINSCH explained that some companies may use slightly different conversion rates, such as 6.2 or 6.3 to 1; however, these conversion rates will be stipulated if they deviate from the standard industry rate of 6 to 1.

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REPRESENTATIVE PRUITT referred to Sub-Saharan Africa on the prior slide represents a substantial amount of their cash flow; however, he said that slide 30 seems to indicate it does not represent a substantial amount, which seems incongruous.

MR. REINSCH said that the Angola venture has been well invested over the years to create an infrastructure for deepwater development. He stated that the fields are now producing and Angola operates under production sharing contracts. As production begins, the amount the company receives would cost back at an accelerated rate, ranging from 60 to 80 percent of the revenue, which is effectively a ceiling on capital recovery. The remaining 20-40 percent is split between the company and the government on the basis of the fiscal terms for revenue sharing. Thus during the early years of production there is a dramatically disproportionate share of cash directed to the companies as a means for them to recover their investment capital. He acknowledged that these projects look bad on paper

until production. He highlighted that from the government's perspective as production comes on the oil companies take 70-90 percent of the revenue being generated while the government receives a relatively small amount; however the government does not take any risk in the development. He concluded that the companies take the risk so they get paid back first, which is why it seems as though an inordinate amount of cash flow is coming out of Angola for a relatively small amount of production.

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REPRESENTATIVE SADDLER asked how the tax regimes will change over the life cycle of a region. He referred to West Africa and the tax system in place at the start of the development and asked whether the tax regime investment would "chase the profitability."

MR. REINSCH responded that an imbalance exists between the institutional capacity of the governments in Africa, Sub-Saharan Africa, and parts of South America. He emphasized that he has not found any oil and gas company who would not prefer stability and a competent partner to instability and a less competent or sophisticated partner when developing a basin or oil and gas resources. However, many of these companies have no idea what they are getting into so frequently a government will sign a production contract for development with an expectation of a certain number of barrels of resource. Later on governments often will adjust or reallocate the contract if the production reaches unexpected success. He emphasized that stability in fiscal terms is important, as the changes will impact the developers and financiers.

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MR. REINSCH discussed "Global Production: Country Growth Project Analysis" [slide 31]. He explained this chart predicts the number of projects in 2015 which are anticipated in a specific jurisdiction. He pointed out the vertical axis indicates the thousands of barrels of oil equivalent per day (mboe/d) in 2015 and the horizontal axis lists the number of projects. He summarized that this chart looks at new sources and ventures being entered into by BP including oil and gas. He identified the circles or bubbles on the chart that indicate crude oil versus gas or liquids versus gas. A bright red bubble would represent 100 percent gas and a dark green bubble would be 100 percent oil. He reported that Azerbaijan's project is BP's

Azeri-Chirag-Guneshli's (ACG) oil project in the Caspian Sea; Russia is a mix; and the Asia-Pacific Region consists of more gas development. He stated in the U.S. that 11 projects are anticipated: nine deepwater and two in Alaska; however, hundreds of various wells are not shown in this analysis, instead, this slide represents the discrete major capital projects. He said that PFC Energy sees the unconventional gas and oil sands delivering materiality for BP in a post-2020 timeframe versus being current drivers of BP's portfolio and growth.

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REPRESENTATIVE FEIGE inquired as to what is meant by AGS weighted.

MR. REINSCH explained it is a typo which should read "AGS gas weighted." In response to Representative Gardner, Mr. Reinsch explained that zero percent oil is depicted with red circles and 100 percent oil depicted by dark green circles or bubbles.

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MR. REINSCH discussed the BP in Alaska map [slide 32]. He explained that the purple areas on the slide represent BP-operated blocks and the blue ones represent BP-non-operated licenses or areas. He related that overlaid on the map are the major fields or horizons being developed with green being oil and red being gas.

CO-CHAIR SEATON asked to have the colors on the slide defined for those who are looking at charts without colors.

MR. REINSCH pointed out the locations on the North Slope and explained the operations, including North Star, Liberty, Point Thomson, and Prudhoe Bay. He summarized "BP Alaska Activity & PFC Energy Assessment" [slide 33]. He highlighted the greater Prudhoe Bay area, comprised of a 26 percent working interest operated by BP, and Point Thomson, which is 32 percent BP working interest and is a non-operated project. He described Alaska during the 2010 timeframe, as referenced in the slide, noting that BP produced about 173 thousand barrels of oil equivalent per day (mboe/d), which represents 17 percent of BP's total U.S. production and 5 percent of their global production - all oil, all gas, all liquids on a global basis. He reiterated that Alaska within BP's global portfolio only represents 5 percent and that figure is currently declining. He contrasted

this with ConocoPhillips Alaska, Inc. (ConocoPhillips) whose 2010 production of 244,000 mboe/d represents 36 percent of ConocoPhillips U.S. production and about 14 percent of their global production. He predicted that the ConocoPhillips production will rise as a share of their global production as the ConocoPhillips portfolio becomes more focused. He noted ExxonMobil - the smallest of the three producers in Alaska - produced 117,000 mboe/d or 14 percent of ExxonMobil's U.S. production in 2010. He predicted this will be a smaller share in 2011 as the XTO Energy Inc. acquisition takes hold. He related, in terms of materiality, the overall global resources represent three percent for ExxonMobil, five percent for BP, and 14 percent for ConocoPhillips. In further response to questions, he reiterated that ConocoPhillips's 2010 production was 244,000 thousand barrels of oil equivalent per day (mboe/d) and BP's Alaska percentage was 17 percent.

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REPRESENTATIVE SADDLER asked whether that information will be provided in a chart.

MR. REINSCH offered to provide it.

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MR. REINSCH identified the challenges that BP is faced with in order to achieve the company's objectives and exercise strategies [slide 34]. He pointed out six core issues. First, BP must re-establish its operator profile in the global deepwater arena. Clearly, BP suffered as a global deepwater operator. He stated that BP acquired the deepwater Devon development in Brazil, prior to the Macondo incident; however, Brazil substantially delayed the approval of the project. Despite the Macondo incident, BP has greater deepwater exposure than any of its peers. He offered his belief that BP will continue to rely on deepwater as one of its core growth drivers. Secondly, BP will need to resolve the shareholder relationship issues within the TNK-BP Joint Venture. This joint venture has constrained BP's ability to grow in Russia. Third, BP must complete the portfolio rationalization process. At some point BP must start growing again and exploit the assets it has accumulated. Fourth, BP must determine a path forward in the Brazil deepwater. One of the major resource discoveries are the "pre-salt" fields in the Santos and Campos basins, which has been unfolding in the energy sector, yet it is one of the most technically challenging to develop. He noted that Brazil's

state owned company, Petrobras, has been awarded operatorship of all pre-salt developments in the area. Thus BP has been examining how it can grow since it cannot operate in Brazil. Fifth, BP must accelerate development of U.S. onshore unconventional gas resources. BP sold its entire Permian Basin and Western Canada assets to Apache Corporation (Apache), thereby downsizing its conventional oil and gas position in the U.S. at a very high value; however BP still has substantial resources - 10 trillion cubic feet (TCF) of resources - remaining in the Shell gas plays to accelerate development. Finally, BP must accelerate development of its oil sands leases. He noted BP has significant lease holdings in the oil sands in Canada. These are asset developments that make a lot of sense for their portfolio, which would provide a stable asset over long periods of time to offset their substantial global portfolio comprised of deepwater development with high production rates and steep declines. He emphasized that it will be important for BP to have this balance in their portfolio as they continue to expose themselves to deepwater development.

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CO-CHAIR SEATON asked for the analyst's perspective on the challenges. He asked how much of an effect a tax change would mean for the company in the next 3-5 years and if tax regime changes would be the driving determination for BP.

MR. REINSCH answered that is a simple question with a complicated nuanced set of answers. First, Alaska has three assets types: the legacy fields, the new developments of lower quality crude oil, and natural gas. He suggested that any company would need to consider these areas separately each with a set of unique values. He said he has been a fan of tools and targets in the realm of fiscal regimes. He acknowledged that incentives are necessary to accelerate production in a legacy or mature field in decline. He predicted that a change in the tax royalty regime will impact the economics of those developments and to the extent it could enhance the competitiveness of the returns of the projects, it should attract incremental capital from the corporate budget. He pointed out that all companies look to maximize the efficient use and allocation of their available capital resources, which represents the dialogue and discussion in the business and corporate level. Certainly, a tax change would improve the climate, but it is unknown as to whether it would attract the capital investment.

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CO-CHAIR SEATON reiterated that it would be good to have advice about each company on the probability of what would tip the scales.

MR. REINSCH said that part of the challenge will be the particular joint venture is operating agreement's structure in Alaska with respect to the large assets. He noted it is not a majority rules decision on whether to undertake capital expenditure programs, but unanimity. Alaska would need to look for the weakest link. He identified ExxonMobil as the weakest link, in terms of for whom Alaska is the least relevant in terms of the current production as part of their global portfolio. He also suggested that in terms of natural gas assets, it could also be ExxonMobil, as well. When considering field-by-field within portfolios, attracting capital to a project development must be agreed upon by all parties involved. He reviewed the post-Macondo actions. He said PFC Energy thought it was clear that BP would need to divest a large part of its portfolio in order to move forward. In that regard, Alaska absolutely stood out, since Alaska would have a lot of value for a company who is an advanced oil recovery specialist. He briefly discussed that BP divested its Forties Field - its crown jewel asset in the North Sea - years ago to Apache, since the company is a specialist in recovering any last bit of value out of an asset. He stated that an enhanced recovery specialist would want to operate wherever the company puts its capital. He described getting into this specific joint operating agreement as a difficult the environment, plus it wasn't likely BP would want to leave, but they may have been interested in divesting certain assets that were less suitable than the direction BP was heading. He was uncertain about what conversations actually took place. He acknowledged he is merely sharing PFC Energy's external thought processes. He recapped that it represents an environment that doesn't lend itself to what normally would take place, which is asset churn in and out of the portfolios on a field-by-field basis. He related the dialogue is different and it makes Co-Chair Seaton's question more difficult to answer in a definitive, objective way.

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CO-CHAIR SEATON acknowledged it is a difficult question that requires speculation to answer. He said one of the underlying assumptions is this will make a difference with all three parties in the field in [Prudhoe] Bay. He reiterated that if all the companies must agree to changes it is important to

understand the various and significant pulls for the companies with respect to their portfolios. He recalled Mr. Reinsch mentioned the UK's Forties Field in the North Sea. He asked when it was divested, since that project is as an example of a mature basin that experienced an increase, following a rate of decline due to the Apache Corporation's (Apache) technologies.

MR. REINSCH answered that Apache bought the Forties Field from BP based on an agreement on the remaining reserves. He recalled that about ten years ago Apache produced the reserves, yet the remaining reserves are larger than they were when it was taken over. He did not attribute this additional resource to magic, but rather that Apache's management and focused ability on the further development of a field differs from BP's global portfolio interests. He speculated that it was more important for BP to put their management towards Russia and deepwater Gulf of Mexico productions. He likened Apache's work as a classic example of what enhanced recovery and focused development can mean to a large mature asset.

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REPRESENTATIVE PRUITT queried whether BP has had the ability to spend what is needed to maintain its investments, and whether it will impact Alaska's investments if BP does not have the funds to invest.

MR. REINSCH answered the way BP executed its restructuring post-Macondo has allowed BP to enter areas in earlier stages of development and move forward without the financial stress that had been anticipated. He pointed out BP is involved in high-cost frontier developments in the lower tertiary - ultra-deepwater - the Brazil deepwater, noting the TNK-BP Russia venture is also cash generating. He returned to the chart "How the Portfolio is Financed: Sources and Uses of Cash" [slide 29]. He stated that what is saving companies is the current \$100 plus per barrel price of oil that has shifted the line between cash deficit and cash surplus. The vast majority of the BP portfolio has been in a cash surplus. He stated that BP is not stressed from a financial or a debt perspective; however, the dividend and share buyback policies impacted the company's treasury and cash flow. All of these companies create capital discipline through hurdle rates that basically have dividend and share buyback as the opportunity cost of each dollar of capital invested. The company reaches a point at which either the internal rate of return or the net present value accruing to the capital investment cannot compete with the value the company

gets from dividend or buying back shares and the impact that will have on the share price. He pointed out that the treasury's function is set the criteria and identify the capital BP has available and to inform the units it may not have all the free cash flow and capital at its disposal for upstream oil and gas development. Within that context Alaska is no more or less competitive. He said that BP did sell off a certain amount of producing properties and has seen its production decline so producing assets have value and while no one is looking to get rid of producing assets, the state will still compete. He concluded that BP is not capital constrained.

REPRESENTATIVE PRUITT questioned why BP did not get rid of the Alaskan assets when BP was divesting its assets.

MR. REINSCH cautioned that PFC Energy was not party to the discussion; however he would have expected it to be a consideration. Still, the Alaskan assets may not have been on the table due the structure of the joint operating agreement in Alaska. He highlighted that the operating agreement was structured to keep the three core companies in place, which might have been a blocking factor. Alaska has benefited over the decades from the agreement, but it also makes it difficult for other companies to enter.

REPRESENTATIVE PRUITT and how many companies can step in with that structure in place that would have the capital to invest.

MR. REINSCH answered it would be a small set, likely 8-10 companies, but there are options.

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REPRESENTATIVE SADDLER asked whether the complex ownership situation in Alaska is unique and if it should be simplified.

MR. REINSCH responded that the joint operating agreement is not unique and is quite common in global portfolios. He explained it would not be common for smaller field developments or bidding on leases, but in a large field like Alaska this structure is often seen. He could not comment on the complicated unwinding that would be necessary.

CO-CHAIR SEATON related his understanding that only one other agreement has the veto power by the participating owners.

MR. REINSCH noted the unanimity aspect is somewhat unique.

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REPRESENTATIVE SADDLER inquired as to whether over time some companies will migrate towards natural gas fields while others will migrate towards oil development.

MR. REINSCH asked for clarification on whether he is speaking to these three companies or to other companies.

REPRESENTATIVE SADDLER answered that he is interested in both.

MR. REINSCH responded that the book of how basins mature and how competitor landscapes changes over time is currently being played out in both West Texas and Alberta in the western sedimentary basin. Again, he noted those are onshore basins with multiple play types and multiple field sizes. He said that Alaska and the MacKenzie Delta regions are somewhat unique since they are very large field developments with a very high cost of capital expenditures. He did not think a small startup company would move assets to production, nor does Alaska have the existence of thousands of fields of varying sizes with onshore asset churn. He suggested that isn't even the environment in the North Sea, which arguably could be a closer analogy. Even in the North Sea large numbers of fields consist of different sizes. Additionally, technology ranges from shallow to deepwater development, which has become much more widespread among the service sector and oil and gas companies that have enriched the competitor landscape. However, the 25-26 largest publically traded E&P companies or upstream oil and gas companies account for over 80 percent - moving towards 90 percent - of the North Sea production, including Norway and Norwegian shelf, the UK and North Sea combined. He summarized that the number of companies is a relatively small number of very sophisticated players.

REPRESENTATIVE SADDLER said he is not advocating breaking up ownership.

[2:49:48 PM](#)

REPRESENTATIVE FEIGE referred to the slide 29 chart titled, "How the Portfolio is Financed: Sources and Uses of Cash." He asked what price the dotted black line represents.

MR. REINSCH answered that the dotted line reflects the movement of prices over time and clearly these are data points over the

last decade. He related that is a creation of a line of cash flow equal to capital expenditures. He explained that if all else is equal when the oil prices increase the line tends to shift up so for the same amount of capital expenditure the company would have an increased cash flow. In response to Representative Feige, he agreed if the price dropped the line would go down and regions in cash surplus would shift into cash deficit.

REPRESENTATIVE FEIGE then referred to the operating agreements in Prudhoe Bay and said that it seems unlikely an independent company such as Apache would come in and function on its own. He asked whether any of the three big producers could afford to give up the cash flow in Prudhoe Bay.

MR. REINSCH responded that it a qualitative question. He referred to the materiality numbers for Alaska within the global portfolios. Clearly, ConocoPhillips would be the company that would be most reluctant to do so. Additionally, he said he would argue that Alaska is core to ConocoPhillips, rather than being in a harvest status, since Alaska is a material part of this company's global portfolio to a greater degree than for the other companies. None of the companies have an interest in moving away from the prospectivity and the opportunities in Alaska, nor has he heard any of the companies make a suggestion they wish to exit. However, he has heard the companies say they have opportunities and need to attract capital. He pointed out that different kinds of opportunities attract capital and competition within different parts of each company's portfolio. He suggested the dialogue is likely that they need to structure to be robust across a range of prices to move forward and will see what they can accomplish rather than to say if Alaska doesn't do what they say they'll leave.

[2:53:35 PM](#)

REPRESENTATIVE GARDNER recalled other BP lawsuit issues including misadventures on the North Slope, and asked whether some companies would be reluctant to move forward with BP as a partner.

MR. REINSCH said that BP is considered a competent partner, although a series of red flags have been raised. Even so, the company has addressed the issues, and restructured to focus on efficiency and capabilities versus financial and corrective actions have been taken.

REPRESENTATIVE GARDNER pointed out BP has had issues including fines for sacrificing pipeline maintenance for dividend payments and the threat of a lawsuit with the TNK-BP group. She pointed out that BP is an operator on the North Slope and asked whether these problems have made other companies question the partnership agreement.

MR. REINSCH answered he would be surprised if that were the case since BP is well regarded as a competent technically-able competitor. He suggested that a series of incidents have raised red flags; however, BP has responded by changing its internal processes, management structures, and putting into place a different type of internal decision-making process with a greater focus on efficiency and technical capabilities and a lesser focus on financial enhancements. He reiterated that BP has recognized deficiencies and has taken actions to address them. In further response to Representative Gardner, he answered that the global players and larger players prefer to have control over their assets; however, the reality is that no individual company, including ExxonMobil has the personnel, managerial project management, or technical capability to operate everything in their portfolios. He pointed out that is the reason operator/non-operator positions are a part of this business. He said it is better for companies to focus their energies on the parts they operate and to monitor their joint operator closely. He noted non-operators must shadow everything the other companies are doing. He concluded that one of the unique aspects of the arrangement is the companies can make their opinion known and can stop things.

[2:58:10 PM](#)

REPRESENTATIVE TUCK recalled Mr. Reinsch's earlier discussion on striving to make the legacy fields economically competitive. He further recalled he had pointed out that BP is not a specialist in getting the last oil out of an area. He asked whether it would be beneficial for Alaska to ensure that tax credits are invested in Alaska. He clarified that the state doesn't know the company's desire to develop assets elsewhere or if any other obligations exist. He asked for the best way to ensure the investments happen in Alaska.

MR. REINSCH responded that question relates to one of his colleague's area of expertise; however he related his understanding that Alaska's short term two-to-four-year requirement is to obtain an increase in production so tools and targets suggest that the focus should be to reward any increment

to production as directly as possible and implement any fiscal changes to do so. He cautioned that the farther away from the targeted activity, the less likely it is that the outcome will be the one anticipated.

3:00:09 PM

REPRESENTATIVE OLSON noted that 70 percent of BP's stock is held in pension plans in the UK and U.S. and for that reason alone the governments have not been taking any action likely to force the company into bankruptcy. Additionally, Alaska has a significant amount of stock in the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the Alaska Permanent Fund. Thus everyone in the room has a piece of BP. He reiterated that everyone wants to work with them.

3:01:15 PM

CO-CHAIR SEATON asked to focus on the job of incentives of tax changes to increase production. He returned to Mr. Barron's chart on the Forties Field. He related his understanding that the production turned around when BP sold their interest in the Forties Field to an operator with enhanced oil recovery ability. He asked why the state would expect a tax regime to have an effect on BP since this is the same operator who spun off the Forties Field when BP could not turnaround the decline.

MR. REINSCH answered that the core of the answer goes to the question of materiality. When BP made the decision to divest the Forties Field, the field had declined to the point that it was a fairly small producing asset in a large asset portfolio and BP was in the process - as does each company - of high grading its portfolio. He surmised BP assessed where to direct its management expertise although he acknowledged BP had the technical ability to focus on the Forties Field. However, the Forties Field became Apache's number one or number two global asset. Thus transiting the asset to a smaller company it now became Apache's core within their worldwide operations, whereas it had ceased to be that for BP. He emphasized that at 166,000 barrels per day Alaska is very material for BP. He offered his belief that these volumes are important to these companies, the legacy fields are a transition asset, the companies prefer not to divest, and all three have the capabilities to attract capital and conduct enhanced recovery.

REPRESENTATIVE GARDNER commented that there may be elements of the decision-making process not related to the internal rate of

return or net present value and possibly elements exist over which Alaska has no control of whatsoever. She said there may not be tools in Alaska's tool box that the state hasn't dreamed of yet.

3:06:39 PM

MR. REINSCH turned to ConocoPhillips Alaska, Inc., to review a similar set of charts. He described the company overview and substantive restructuring it underwent from 2010-2012 which he characterized as remarkable [slide 35]. In March 2010, ConocoPhillips faced declining production, a declining share price, and lagging financials so it announced a pathway that some termed a shrinking-to-grow strategy. The company took a hard look at their portfolio and divested the elements that were not going to move the company forward. ConocoPhillips targeted a \$15 billion asset reduction and focused largely on upstream assets, but also some refining and downstream assets. The company took returns and paid down debt, issued dividends to shareholders to retain their loyalty, and positioned itself for future growth from a smaller, but higher value asset portfolio on a global basis. In July 2011, ConocoPhillips de-integrated itself from an upstream, pure exploration and production (E&P) company and took its downstream and product assets to a separate stand-alone company called Phillips 66. He characterized the company in 2006 as one too large to compete with independent companies such as Apache and Anadarko Petroleum Corporation (Anadarko), but too small to compete with ExxonMobil Corporation (ExxonMobil) and Shell Global (Shell) on the basis of efficiency, since ConocoPhillips was not involved in big capital projects that would have given it row (c) efficiency numbers. In 2006, ConocoPhillips bought Burlington Resources, Inc., which has headed off growing production and reserves; however, unfortunately, months before the peak of U.S. gas prices. Thus ConocoPhillips bought a very large conventional gas portfolio in the U.S. and has been fighting that ever since. He pointed out their reserves indicate the company is exactly where it was five years earlier so in many respects they have "returned to where they came from."

3:13:18 PM

MR. REINSCH offered his belief that ConocoPhillips is still too large to compete with the independents and too small to compete on efficiency with the global players. He said their new CEO has been charged with charting a new strategic path forward. ConocoPhillips's portfolio has been built on global gas, a

liquid natural gas (LNG) portfolio, a maturing oil sands portfolio in Canada built around in-situ development based on steam-assisted gravity techniques - underground as opposed to the big mining operations other companies have pursued - and on unconventional resources, including shale gas and shale oil plays. Currently, of the three companies being reviewed today within that portfolio, Alaska is the most material to ConocoPhillips. He characterized Alaska as an obvious role for ConocoPhillips's portfolio. He pointed out that at \$93 billion ConocoPhillips is smaller than BP and ExxonMobil. He emphasized that the startling impact of the rationalization program is the very large negative compound average growth rate over the last three years of negative 30.68 percent. He explained the result has been to enhance the importance of Alaska in ConocoPhillips's global portfolio.

[3:12:45 PM](#)

MR. REINSCH provided a map titled "ConocoPhillips: Global Areas of Upstream Operations" [slide 37]. This map indicates ConocoPhillips's portfolio, including that it is active in 22 countries, with production in 15, and North America, including Alaska as its core. He said one of ConocoPhillips's calling cards, is - uniquely amongst its peer companies - that ConocoPhillips derives over 75 percent of its production from Organisation for Economic Co-operation and Development (OECD) countries. The benefits of that are stability, security, and protection; however, they are involved in largely mature basins, which have high costs.

[3:13:36 PM](#)

REPRESENTATIVE TUCK recalled him defining the difference between core and harvest. He noted what may be a harvest for some companies may be a core for another. He assumed that it may be the attitude held by the company which determines whether it is a core or harvest mode. He recalled the core area as the area of material current production and the harvest area as one to derive capital to move into the core areas. He asked for further clarification.

MR. REINSCH replied that the allocation of countries or basins into these categories requires a bit of art. Part of what PFC Energy would provide is the role of assets within the different portfolios. He related from an external, objective standpoint or perspective and assessment of ConocoPhillips, Alaska is core and material to this company and this assessment is expected to

remain so into the future - both for its current producing assets and for the growth opportunities that ConocoPhillips seeks. Additionally, it has become even more material due to the downsizing of ConocoPhillips global portfolio. He turned to BP and ExxonMobil, in particular, and said that setting aside the gas, Alaska represents a relatively small part of their portfolio. He pointed out these companies have been managing a decline as efficiently as possible, which has generated significant cash flow. He pointed out that part of that cash flow has been put towards other opportunities in their portfolio - just as Alaska was built from free cash flow from other producing jurisdictions. The PFC Energy sees a difference in Alaska's role within the three portfolios.

[3:17:17 PM](#)

CO-CHAIR SEATON recalled that Alaska represents about 36 percent of ConocoPhillips's U.S. production, but Alaska represents about two-thirds of their liquid production since U.S. gas is not valuable. He asked how that affects their materiality with such a high percentage of liquids rests in Alaska.

MR. REINSCH acknowledged the absolute number is important, but the fact that ConocoPhillips is liquids-focused in the current market environment makes it even more important. He suggested that comparing the numbers three or four years ago might have changed the opinion - when Henry Hub was \$8-9 per barrel, heading to \$12 per barrel and in a high gas future forever. He pointed out the industry responded by producing a lot of gas while consumers have been using a lot less, too. He predicted a time will come in which crude oil prices are in the \$40-60 per barrel range and "much hand wringing" will be made of the fact that this is a liquids-rich environment where companies should be producing gas. He characterized this as a reality of market movement; however, certainly the crude oil intensive nature of production to date in Alaska is absolutely a "checkmark" for the importance of these assets within the ConocoPhillips portfolio. He said, "There's no question about it."

[3:19:15 PM](#)

MR. REINSCH turned to a slide titled, "ConocoPhillips Global Production Portfolio - 2010" [side 37], which indicates the magnitude of the portfolio and the asset types within the portfolio. He said what jumps out immediately is the size of the circles or bubbles in Canada, the U.S., UK, and Norway. Clearly, this represents the strength of the ConocoPhillips

portfolio, which is strengthened even further by ConocoPhillips's decision to divest its equity interest in LUKOIL Oil Company - the Russian oil and gas company . This has reduced its remaining exposure to the Russian upstream to about three percent of its total portfolio in 2011, versus over 20 percent just two years prior. He characterized ConocoPhillips today as a much smaller player with much less exposure.

[3:20:20 PM](#)

REPRESENTATIVE FEIGE asked what happened with LUKOIL and ConocoPhillips.

MR. REINSCH explained the relationship was an equity ownership as opposed to a joint venture. The value proposition behind their initial positioning was that by combining these portfolios, ConocoPhillips would be exposed to new developments in Russia and LUKOIL would be exposed to new developments outside Russia through its affiliation with ConocoPhillips. However, in 2010, the value proposition had not yet been realized. ConocoPhillips had better places to put its funds and LUKOIL had not really made any inroads in the international arena and more importantly, the areas they wanted to go weren't necessarily areas in which ConocoPhillips was active. The decision to divest the equity position was part of a larger portfolio rationalization activity.

[3:22:21 PM](#)

MR. REINSCH discussed the "Total Portfolio Evolution: ConocoPhillips vis-à-vis the Competition" [slide 38]. He projected ConocoPhillips's production in 2015 was below the 2010 production. He pointed out the Burlington acquisition was important as was the 20 percent stake in LUKOIL. The restructuring and significant divestment in assets and joint venture exposure was expanded from \$15 billion to \$20-25 billion, which has shrunk the ConocoPhillips portfolio to a much smaller level than in 2010. He highlighted that selling assets and giving dividends to shareholders is not a long-term strategy. The industry and analysts are keenly awaiting the direction the new executive management team and board of the newly created independent exploration and production (E&P).

[3:24:15 PM](#)

MR. REINSCH discussed the slide titled "How the Portfolio is Financed: Sources and Uses of Cash" [slide 39]. He stated that

unlike the equivalent chart for BP, this slide illustrates how much longer a number of the ConocoPhillips operating areas were in cash deficit positions. He highlighted that the improvement in crude prices has definitely helped this portfolio move into a cash surplus situation. He related that the U.S. and Canada, in particular, have been contributing cash flow in 2009-2010, after spending most of the decade in a deficit situation. ConocoPhillips has been using its UK and North Sea portfolio position as a "cash cow" for financing operations and capital investments elsewhere.

[3:25:32 PM](#)

REPRESENTATIVE TUCK noted the values are different than the BP chart. He related the angle between cash deficit and cash surplus seem to be 1:1 ratio. He asked whether the money ConocoPhillips invests has been a better return on investment.

MR. REINSCH answered no, that the scales on the two charts are different since the capital expenditure on the BP chart peaks at \$12 billion and this chart peaks at \$20 billion since ConocoPhillips had the big acquisition of Burlington Resources in 2006. Thus the capital is skewed and was accommodated by the value changes on the vertical axis. He pointed out the zero line is still 1:1 ratio. In further response to Representative Tuck, Mr. Reinsch said it's deceptive.

[3:27:37 PM](#)

MR. REINSCH provided the evolution of the portfolio [slide 40]. He recalled that this underscores the dominance of North America and the important role of the OECD's basins in ConocoPhillips's portfolio. He pointed out that Sub-Saharan Africa, Russia and Central Asia, and Latin America have almost nothing in the way of material production in any of the jurisdictions. He concluded ConocoPhillips is still a global player, but has a much more consolidated or narrowly-focused global portfolio and growth portfolio than BP's portfolio.

[3:29:43 PM](#)

MR. REINSCH explained the country growth project analysis [slide 41]. He referred to the red single project in Qatar. He explained that ConocoPhillips has been involved in an LNG development in Qatar - the last project that country will develop under its current and ongoing moratorium on gas development. He predicted the project will reach peak

production in 2012. He referred to slide 40, to the Middle East and North Africa region, noting the orange bar represents that project. He highlighted this as ConocoPhillips's one major gas development, which is more of a manufacturing development, while the majority of its other large-scale projects are very oily. He pointed out that the shale gas and liquids production in the Eagle Ford basin is largely an oil or liquids play, as opposed to a gas play.

[3:30:53 PM](#)

MR. REINSCH projected that the ConocoPhillips Asia-Pacific deepwater projects will be a significant producer. He related the oil sands joint venture with Canadian Cenovus Energy, Inc. - the spinoff company from EnCana Corporation - when they separated those two companies from a gas play and oil sands entity. He shifted to the Alaska-North Slope slide [slide 42]. He described the portfolio as a somewhat larger portfolio - arguably a more exploration-oriented portfolio - with large lease holdings in the Chukchi Sea and the National Petroleum Reserve - Alaska (NPRA), as well as the core assets. Interestingly, ConocoPhillips executed some creative asset swapping with Statoil - Norwegian oil company - to introduce its deepwater expertise into Alaska in exchange for further positioning ConocoPhillips in the Gulf of Mexico deepwater. He suggested that marrying these two companies will strengthen their interests. Additionally, ConocoPhillips has both operated and non-operated assets in the Cook Inlet area [slide 43].

[3:32:05 PM](#)

MR. REINSCH discussed the "ConocoPhillips Alaska Activity & PFC Energy Assessment" [slide 44]. ConocoPhillips's largest producing area has been the greater Prudhoe Bay area. ConocoPhillips and BP had been proposing the Alaska Gas Pipeline or Denali Pipeline for commercialization of the Prudhoe Bay gas resources, but that proposal has officially been withdrawn. This places uncertainty around the gas portfolio, but releases the resource for consideration in competing or alternate commercialization prospects.

[3:33:04 PM](#)

REPRESENTATIVE GARDNER read from the discussion page, which read, "Production from material mature Alaska portfolio has been in slow decline since 2004." She asked why the date was

selected since the field has been in decline longer than that date.

MR. REINSCH offered to provide a clarification at a later date.

[3:34:04 PM](#)

MR. REINSCH turned to the slide, titled, "PFC - Identified Challenges" [slide 46]. He outlined the challenges for ConocoPhillips. First, ConocoPhillips needs to compete as a "pure play" upstream exploration and production company as rather than being an integrated major. He was uncertain as to whether ConocoPhillips would return to a competitor space in the mid-2000s and if it is not successful, whether it would survive. He pointed out that \$93 billion is still a big company, but questions remain about ConocoPhillips's future. Second, ConocoPhillips must re-establish a value proposition through this fairly significant change in strategy direction and restructuring - one that can compete with peer group members in light of continuing challenges of production costs, operating costs. The flipside of this is the OECD intensive portfolio consists of a lot of mature basin operations and the impact that will have on their costs. Third, ConocoPhillips must improve their operational performance. ConocoPhillips has shown improvements in funding development costs, but continues to rank near the bottom of its peer group in some pretty key areas such as net income for BOE, production costs for BOE, and upstream return on capital employed. He highlighted that ConocoPhillips has a reasonable portfolio of major capital projects that it is currently executing on. As those projects move to commercialization and begin to generate production, volumes should boost their operational metrics and return on capital employed figures. He reiterated that one of the challenges ConocoPhillips currently faces is it is in transition, which means all aspects of their operation are in transition, including the performance metrics. Finally, this company must show it can deliver volume growth on a consistent basis, relative to its peers - arguably a smaller set of aggressively-growing independents - such as Apache Corporation and Anadarko Petroleum Corporation. Certainly, ConocoPhillips appears to have a portfolio of significant assets to develop. It boasts 10 billion barrels of oil equivalent (BOE) resource to move from resource to reserves and reserves to production through further appraisal and project development. Again, ConocoPhillips has been promising strong organic growth and the question is whether it can deliver. He suggested that ConocoPhillips's performance in Eagle Ford basin will be a good indicator; however,

ConocoPhillips needs to be growing production to continue to please their investors and analysts that the company is moving forward.

[3:38:13 PM](#)

REPRESENTATIVE HERRON stated that ConocoPhillips has a rich history in Alaska and has provided many things, including a cancer center. He asked him to grade their road map forward. In response to a question, he clarified that if the snapshot is an A, B, or C. He asked whether this is a good plan or an okay plan.

MR. REINSCH responded he is suggesting that if Alaska wants to be part of the solution the state must understand that what ConocoPhillips wants is growth. The more Alaska and the Alaska portfolio can deliver in near-term and long-term production gains, the greater Alaska's role will grow in ConocoPhillips's portfolio in terms of significant relevance and materiality relative to its peers. He said if someone had asked that question 24 months ago, he would have given ConocoPhillips a grade of troubled; however, today the assessment would be that ConocoPhillips's position has significantly improved. One significant weakness in the ConocoPhillips's portfolio has been that it divested in companies; however, this has become their strength due to the portfolio churn previously mentioned. It has left ConocoPhillips with a narrower, better focused, and arguably stronger portfolio to deliver growth moving forward. He emphasized the question of whether ConocoPhillips can deliver a two-percent production growth number. This would be a pretty good performance relative to the integrated majors and be benchmarked against them or ConocoPhillips will be asked to deliver five to seven percent growth and be benchmarked against a smaller more agile set of independents such as Anadarko Petroleum Corporation - which has been moving towards a 1 million barrel per day mark - at a time when ConocoPhillips has been dropping back and is now repositioning to grow again. These are the great uncertainties that the company faces and investors will determine.

[3:42:58 PM](#)

CO-CHAIR SEATON asked whether the challenges, such as reliance on profit generation from Alaska, includes the ability to further concentrate the company's profitability in Alaska or if ConocoPhillips would have a liability - structurally - with too much focus in one region. He said he's trying to figure out the

relationships of the three players and whether massive reinvestment would happen with a major tax regime change.

MR. REINSCH offered his belief that Alaska and the Alaska portfolio is the heart of the wheelhouse for ConocoPhillips. It is branding itself as a company with substantial material assets, in safe haven operating environments, close to major markets. He said, "That's Alaska." He stated that if the question is whether the company is overexposed to shutdown, that question is a technical issue he would expect any board conversation to discuss how to ensure that doesn't happen and keep the pipeline operating. Similarly, he would expect more attention will be focused on how to grow more production in Alaska because of materiality and the core nature of this portfolio to ConocoPhillips. He said if the question is whether ConocoPhillips is too heavily leveraged in Alaska and ConocoPhillips should be looking elsewhere he would answer that would appear to be counter to the company's strategy.

CO-CHAIR SEATON queried whether there is anything in the ConocoPhillips's structure that would give Alaska pause in terms of ConocoPhillips's perspective on massive reinvestment in the Prudhoe Bay and Kuparuk reservoirs that is different from the other two companies.

MR. REINSCH reiterated that the Alaskan assets are of more importance to ConocoPhillips's global portfolio and would attract more attention and if necessary, some type of strategic premium within the overall portfolio that isn't seen within the other two.

[3:47:52 PM](#)

The committee recessed from 3:47 p.m. to 4:05 p.m.

[4:09:34 PM](#)

CO-CHAIR SEATON reconvened the meeting. He recognized Representatives Johnson, Doogan, and Fairclough in the audience.

[4:10:06 PM](#)

MR. REINSCH turned to the final company to be reviewed, ExxonMobil Corporation (ExxonMobil). He said he previously mentioned all three companies have been in a state of transition and crossroads in terms of their strategies, which is certainly true for ExxonMobil. He pointed out that most people find it

difficult to fathom a company of this size could ever be in trouble or have a strategy crisis. However, that was the case for ExxonMobil 12-18 months ago. ExxonMobil is the largest global, integrated oil and gas company outside of the national oil companies. ExxonMobil's average production in 2011 was 4.5 million barrels per day oil equivalent (mmbode/d). Its gross strategy has been based on scale - basin dominance and execution excellence. He related that ExxonMobil moves in a large way, dominates the area and prides themselves on their ability to develop and produce assets. The flip side is that ExxonMobil must continually look for and secure opportunities of significant materiality. The company had been driving its global volume growth through the commissioning of a series of large scale liquefied natural gas (LNG) projects in Qatar exploiting the North field - a gas field offshore in shallow water that is the largest single gas field on the face of the earth. However, in the middle of the last decade, Qatar placed a moratorium on the project since it struggled with what to do with the revenue the field generated. That moratorium exists today and Qatar represents ExxonMobil's growth engine. In 2010-2011 ExxonMobil commissioned the last pieces of that portfolio so while production continues from Qatar new source production does not.

[4:13:23 PM](#)

MR. REINSCH said at the same time its European and Asia Pacific portfolios were drifting away as the mature assets moved into decline. The company was also positioned to venture into the extra heavy oil development in Venezuela, but unilateral terms by the government as well as the requirement that PDVSA - the national oil company - take a 60-percent ownership were terms that were not acceptable to ExxonMobil. Other areas of interest to ExxonMobil Corporation include Brazil pre-salts development of significant scale, but with Petrobras receiving a legislated requirement to operate all pre-salts development, ExxonMobil questioned its role in the venture. He summarized that ExxonMobil doesn't want to invest a lot of capital in a basin in which it won't be the operator. Additionally, ExxonMobil tried to position itself in the offshore West Africa Equatorial Margin Côte d'Ivoire-Ghana, but was rebuffed by the government.

[4:15:31 PM](#)

REPRESENTATIVE SADDLER asked about the use of the term "materiality."

MR. REINSCH answered that "materiality" is defined as a significant absolute volume volumetric - a meaningful percentage of resource base or a meaningful percentage of total production.

[4:15:57 PM](#)

REPRESENTATIVE FEIGE queried about the term "pre-salt."

MR. REINSCH described "pre-salts." He explained that in Brazil they found significant accumulations of high quality oils positioned below very thick salt depositions. In order to access the resource, the drilling occurs in deepwater depths of 3,000-5,000 feet, but requires drilling through a thick salt layer to get into the producing horizons. He pointed out that drilling through the salt layers makes it very difficult to image what is below. Thus standard seismic techniques do not happen as efficiently and if anything untoward happens - such as a blowout or a leak - it can represent a difficult and unique environment. Some companies produce through salt formations in the Gulf of Mexico, but nothing on the scale and magnitude of the multi-billion barrel fields discovered in Brazil. He described the deepwater sites as technically challenging, big investment, and big production volumes, which are tailor made for ExxonMobil. He speculated if PDVSA had not been granted operatorship over the developments that ExxonMobil would have been one of two or three companies Brazil would have turned to in developing its resource.

MR. REINSCH continued to explain how ExxonMobil emerged from the problems it had been facing, which involved taking an aggressive move into unconventional shale gas exploitation. ExxonMobil made two commitments. First, ExxonMobil made a commitment to immediate growth, which happened with the acquisition of XTO Energy, Inc. (XTO) - a multi-billion dollar acquisition - that brought ExxonMobil into shale gas and coal bed methane it had not previously had exposure to. He characterized this as the materiality move ExxonMobil is known for, but the surprise was that ExxonMobil moved into unconventional resources. He highlighted that ExxonMobil is known for big field, major capital project developments. He related that XTO has been a separate company within ExxonMobil, which is absolutely unique in the history of the company. This means ExxonMobil not only envisions a U.S. onshore resource play, but a global resource play. It could mean ExxonMobil will be leading the charge to access hundreds of trillion cubic feet (TCF) of gas on a global basis. Another recent move was a joint venture with Rosneft in Russian Kara Sea in the Russian Arctic. He described this as a

place-holder in the emerging Arctic region portfolio in which Alaska clearly has a role to play. He predicted this is where Alaska fits into ExxonMobil. He reported the 2011 reserves production market capital figures are over the \$400 billion mark, whereas ConocoPhillips is at \$93 billion. He characterized ExxonMobil as a company of a different scale and magnitude. He also reported ExxonMobil's corporate revenue at \$343 billion.

[4:22:16 PM](#)

MR. REINSCH provided a map to indicate ExxonMobil's global areas of upstream operations [slide 48]. The corporation has global reach with operations in 41 countries and production from 21 countries. The core projects are in the U.S., Canada, the Netherlands, Norway, Nigeria, and Qatar. He reviewed the global portfolio in terms of the relative size of production and asset type [slide 49]. He pointed out the very large bubbles for the U.S. and Qatar. The U.S. bubble has grown with the XTO acquisition. He highlighted that three small scale unconventional acquisitions have occurred since XTO, which represent the cornerstone for growth for ExxonMobil. He pointed out that Qatar represents 20 percent of global output in 2010 and while the commissioning of new liquefied natural gas (LNG) capacity has come to a temporary end due to the moratorium, the level of production will continue for some years into the future delivering significant cash flow to the company as it moves forward. The UK and North Sea represent a mature declining asset portfolio. He related that ExxonMobil divested a significant number of its UK assets to Apache recently. In Russia, ExxonMobil has been primarily an east coast player with the LNG natural gas developments in Sakhalin; however, ExxonMobil is also positioned to consider development in the northern Arctic region.

[4:24:43 PM](#)

MR. REINSCH viewed the chart on production growth and said ExxonMobil Corporation is the leader [slide 50]. He stated that BP was poised to take the lead, but fell back with the Macondo event and divestiture. ExxonMobil has not been in a growth stance, but its dominant metrics have been shareholder return through dividends and buyback programs and return on capital employed. ExxonMobil continues to lead its peer group by a significant margin. However, in 2011 the return on capital employed figures slipped back for ExxonMobil as the XTO business model begins to take a more prominent position within the global

portfolio, which will bring a new mix. He highlighted modest growth projections of \$4.5 mboe/d in 2015, which is not much different from 2010; however, the company has been guarded as to how quickly it plans to grow the XTO portfolio. He related it is U.S. gas market dominated and while it can focus on liquids rich shale gas clays, ExxonMobil has the option to slow down the development of that resource base given the other assets and elements within its global portfolio. The PFC Energy predicts fairly slow growth in the XTO portfolio, but if ExxonMobil changes its plan the growth figures could move very quickly.

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REPRESENTATIVE PETERSEN asked whether part of the slow growth is due to the abundance of shale gas which has caused the cost of gas falling below the cost of production.

MR. REINSCH responded that all companies involved in Lower 48 gas production are considering the situation and strategizing. Some companies are diverting upstream capital programs to the liquids rich shale gas developments. Further, a number of companies are involved in "cash and carry" joint ventures, in which a total has been brought in as a partner, and the company has been paying \$.50 on the dollar for subsequent drilling and activity until the remainder of the purchase price is worked off. He said these ventures are still in place and allow companies to be less sensitive to the gas prices. He reported that the majority of the deals are unwound this year, and next year and he anticipated another ratcheting down of upstream activity if low prices continue. He concluded that ExxonMobil has the ability to slow down and wait for market prices to correct.

4:29:56 PM

MR. REINSCH discussed the slide "How the Portfolio is Financed: Sources and Uses of Cash" [slide 51]. He acknowledged that the chart could have been adjusted from \$10 billion to \$60 billion, but that would have flattened out the dotted line. He stated that the U.S. capital expenditure (U.S. Capex) was \$60 billion in 2010, mostly related to the XTO acquisition. He highlighted that virtually all of the areas except for the U.S. in 2010 have been in cash surplus situations, in particular, the Africa and Europe portfolios, which have been generating significant cash flow volumes for an extended period of time. He noted that ExxonMobil was one of the first to venture into the West Africa deepwater projects. He stated that Canada/South America is

really Canada and reflects the significant investment in Canadian oil sands development, in particular, and the Kearn integrated sands or Syncrude Canada, Ltd. (Syncrude) capital expenditures. He pointed out that as this project comes into production it will represent a significant and long-standing cash flow generator for the company.

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MR. REINSCH reviewed the ExxonMobil "Global Production: Evolution of the Portfolio" [slide 52]. He noted that ExxonMobil is not present in Latin America. It is unclear how ExxonMobil will move forward, but Latin America plays a minimal role. He pointed out the emerging shale gas play in Argentina and it is not clear whether ExxonMobil will decide to proceed there. The Middle East and Africa will be ramping up in 2011-2012 and represent the Qatar LNG portfolio - 1 mboe/d which will generate cash flow for years. In North America the significant impact that XTO has had on ExxonMobil's portfolio represents a shift in materiality.

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MR. REINSCH turned to new source production, "Global Production: Country Growth Project Analysis" [slide 53]. He said that 2011 will be the last year ExxonMobil will show new source growth out of Qatar, with a large number of discrete projects being developed in the U.S. for growth into 2015, as well as a large number of smaller - 100-150 mboe/d - oily projects in Iraq, Angola, Nigeria, and Canada.

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MR. REINSCH reviewed "ExxonMobil in Alaska - North Slope" [slide 54]. He suggested ExxonMobil's portfolio is similar to BP's portfolio on the North Slope, including greater Kuparuk, Greater Point McIntyre, Greater Prudhoe Bay, and the Point Thomson development, which forms the heart of ExxonMobil's portfolio. ExxonMobil has been the largest holder of discovered gas resources on the North Slope, and long-term potential for ExxonMobil in Alaska which also fits their global strategy - in terms of a potential for a material development in an area of LNG [slide 55]. He emphasized that gas development is an area of ExxonMobil's competence and leadership on a global basis.

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MR. REINSCH moved to the final presentation slide, the challenges faced by ExxonMobil [slide 56]. First, ExxonMobil has made a significant bet on unconventional resource plays on shale gas and oil development in the U.S. and globally. ExxonMobil's move to unconventional resource goes counter to ExxonMobil's historic growth through organic development. It was formulated on a major acquisition of a company that ExxonMobil has been allowing to operate essentially outside of itself - looking to leverage what it does well - to the benefit of the larger company. However, with the continued weak gas environment in the U.S. and substantive concerns over shale gas exploitation outside of the U.S. and with moratoriums in France in South Africa, delivering on this is far from a sure thing. Second, the company has been involved in a suite of significant Asia-Pacific LNG projects - the largest is Gorgon LNG operated by Chevron, and Papua New Guinea (PNG) LNG and the potential Scarborough field in the Carnarvon Basin. All of these projects sell gas into the energy hungry Asia markets of China, Japan, and Korea. He pointed out with Qatar at a standstill, ExxonMobil needs to move forward on the LNG portfolio. Third, ExxonMobil must maintain leadership in share buy-back and dividend performance. The company has spent just under \$115 billion on share repurchase during 2006 to 2010. However, the question has been raised whether ExxonMobil can maintain its leadership position given its emphasis on unconventional resource play, which has been a different type of model from the large Capex and cash flow projects that the company has been involved in. Finally, ExxonMobil must replace volume growth from Qatar North Field in commercialization within its portfolio. He stated Qatar contains significant captured gas resource that remains stranded. The Mackenzie Valley gas pipeline project was finally approved in 2011, after 24 years of constant regulatory processes, at a time when it isn't desirable to move the gas to the Lower 48. He characterized this as a lesson in how not to conduct business and a lesson the Canadian government is taking to heart as it looks to other developments such as the Gateway oil pipeline to the West Coast.

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MR. REINSCH pointed out that the stranded aspect of these various gas resources has rekindled interest in Alaska's LNG expansion. He reiterated that Alaska is the only jurisdiction for whom recovery and Henry Hub gas prices would not have any impact on a LNG development moving volumes to the Asia gas market. He characterized it as an absolute decision as opposed to a relevant one. ExxonMobil has significant reserves in the

Caspian region that it has attempted to move forward to development, but has faced aboveground risks and resource nationalism challenges. While ExxonMobil was successful in securing the West Qurna-1 development project in Iraq, it is also having challenges in moving the project forward due to obstacles in terms of takeaway infrastructure capacity and the development of a project of that size in Iraq. He pointed out that ExxonMobil made an aggressive move into Kurdistan, securing six exploration blocks in late 2011, which appears to have cost them a spot in Iraq's fourth licensing round. He characterized this as a volatile area and it is not clear this is the position ExxonMobil thought it would have at the onset of the Iraq war.

[4:42:35 PM](#)

MR. REINSCH summarized ExxonMobil by referring to slide 47, titled "ExxonMobil: Company Overview." He suggested that two stories are similar for ExxonMobil and BP, in terms of placing Alaska within global portfolios. He related that ConocoPhillips, is very different. He explained that in reviewing the portfolios and the trends, all else being equal, production from Alaska will become less material for BP and ExxonMobil, and could become more important for ConocoPhillips, depending on how successful the company is in restarting its growth engine after two years of asset sales, divestitures, and shrinkage in their upstream.

[4:43:42 PM](#)

CO-CHAIR SEATON asked, given the challenges and structural differences for ExxonMobil in the declining legacy fields, whether a change in the tax regime would affect ExxonMobil in other ways than it would BP and ConocoPhillips.

MR. REINSCH said that addressing the decline in the legacy fields of Alaska is a competition for capital within ExxonMobil Corporation as everywhere else. However, ExxonMobil has the greatest strategic interest in gas commercialization - through LNG - of these three companies. He suggested that it should be of more interest to ExxonMobil than building a pipeline to the Lower 48. With the pipeline set aside, this project could be a "dial turner" for them. He said one of ExxonMobil's unique operating practices is that once a project or resource has been approved and sanctioned for development one team of workers takes over from the other and it is efficient in that way. Additionally, ExxonMobil Corporation may be the most disciplined

corporations to avoid capital destruction since every monetary aspect is considered for its highest value use.

4:48:26 PM

REPRESENTATIVE GARDNER indicated that other consultants have expressed surprise at the limited information Alaska has available about the industry, in terms of confidential information. She described the difficulties in obtaining information, besides financial information, which companies are not required to furnish to the legislature. She asked him to speak to this.

MR. REINSCH answered that the sophistication on behalf of the government doesn't necessarily guarantee smart decisions. He pointed out the UK sometimes stumbles and they are the most interventionist, fiscal policy player in the energy matrix. He characterized the UK as trying to fine tune projects. He said the Alberta government engages the industry, still, they have stumbled and the speed of policy decisions is often overtaken by events. Having said that, he related there is a time in the life of a basin development, particularly one of Prudhoe Bay's magnitude - whose largess was almost unimaginable and the flow and return to the government was so substantial - that there was less of a need early on for a true, sophisticated dialogue with the companies. He suggested this is a different time now, and while it does not mean that what happened earlier was faulty or incorrect, these discussions have brought into focus that the Alaska upstream is getting increasingly complicated. The mix of assets should not be treated or examined as single-basin, single-asset decisions. The dialogue has been changing and is becoming more sophisticated so the dialogue with companies must get more sophisticated. He stressed that Alaska will need tools to engage in that dialogue. He suggested using models with the same output and assumptions helps, as does a continually improving understanding of the technical aspects of the industry that the companies must confront. Thus when one hears that a company is not an oil-producing company, but is a water-handling company, it could improve the conversation if the legislature understands the terminology. He summarized by stating that better data, better integrated-data, and more sophisticated technical-analysis modeling will improve the dialogue and the decision-making. He emphasized the expertise needed is internalized expertise rather than external expertise.

4:54:15 PM

REPRESENTATIVE FEIGE said the state is trying to extend out the years that the state can enjoy revenue from oil. He asked what factors will be the most significant ones for the state to focus on to try to improve oil production.

MR. REINSCH responded that there are three issues on the table. First, how does Alaska extend the asset life of its producing legacy fields and stem the decline or reverse it through aggressive exploitation of the fields. The second issue would be explore for and or commercialize new field developments. The third issue would be natural gas commercialization. He focused on the first, and said Alaska needs to address the decline rate and improve production. The target for that in many jurisdictions is to negotiate a decline and incentivize incremental production. He said it is not unusual and many companies deal with this using a tried and true method; however, it is necessary to incentivize the incremental production. At the end of the day it is critical how a government is perceived to have secured a fair deal for the people of the state, but it is equally or more important that the flow continue. He emphasized that he would focus the attention on this issue. He emphasized the need for a balance which must be struck in order to make this decision.

[4:57:43 PM](#)

REPRESENTATIVE FEIGE asked whether he could cite examples by any other countries where a negotiation on a decline rate and incentives to spur production have occurred.

MR. REINSCH referred to Shell's Mukhaizna field, which was a field that produced 15-20,000 barrels per day. Occidental through negotiations on the decline rate agreed to increase production to 150,000 barrels per day within a three-year period, which they did. He pointed out a long list of these types of projects exist, but they are project specific and not basin development projects.

[5:00:06 PM](#)

REPRESENTATIVE FEIGE asked whether the negotiations for the decline rate were contentious.

MR. REINSCH responded that the nice thing about the negotiations is the history, so looking at the last three to five years to determine the rate. The argument by the company has to be that all capital they have been investing is commercial capital.

Companies don't willingly engage in value destruction so whatever the company has invested to impact the decline has been invested in competition with global portfolio opportunities. That process would provide the state with historic data and evidence. He stated that it appears to be a situation in which an avenues exists. He concluded by stating that companies will know.

[5:01:27 PM](#)

CO-CHAIR SEATON related that Alaska's tax regime is based on individual companies. He asked whether a basin or project decline rate would be external to the existing tax.

MR. REINSCH answered that the mechanics would involve isolating the fields in question and carving them out to create a separate set of arrangements, similar to how the state currently is incentivizing exploration activity separate from other activity in the basin. He suggested that a special set of criteria and fiscal terms for the legacy fields would need to be defined in this context. He deferred to his colleague to answer in more detail.

CO-CHAIR SEATON asked for a response in writing of any examples, which would be helpful to the committee.

[5:03:12 PM](#)

REPRESENTATIVE SADDLER asked for an opinion on the bill that is before the committee and whether it is an effective tool.

MR. REINSCH deferred to his colleague. He did not think this was his area of expertise.

[5:04:15 PM](#)

REPRESENTATIVE DICK suggested Mr. Reinsch has a sense of the pulse of the companies. He related his understanding that currently a window of opportunity exists. He asked whether Mr. Reinsch could estimate and quantify the window of opportunity and if it is two to three years.

MR. REINSCH related that he has heard a number of opinions on the state of the Trans-Alaska Pipeline System (TAPS) and its ability to manage lower flows. He stated that he is an economist and is not qualified to assess which opinion is correct; however, he offered his belief that the window is the

length of time that reliable production can flow through the pipeline and at what volume. He viewed the decision as a set of developments and not just one. He said there is not any end to the dialogue since the considerations consist of short, medium, and long-range considerations, which will develop over time. He suggested that the legislature will not likely make a decision and see what happens, that it is more likely to be incremental. Clearly, the focus needs to be on the one to three year time frame. He cautioned against fixing something that will take another two to three years to assess the impact. He also stated that if the decline is irreversible, decisions on the size of government can be made.

[5:08:30 PM](#)

REPRESENTATIVE PETERSEN returned to the point of negotiating the decline, and asked how it works.

MR. REINSCH explained how the decline rate can be projected into the future. He said that the negotiation is around a decline rate. The historical data is present and can be projected into the future. That volume of production would be taxed at one rate while every barrel incremental to the decline would be taxed differently - in a lighter manner. The incentive would be to increase the production as far as possible. He suggested avoiding negotiating something different in the future than has not historically been seen since the discussion can unravel and lead to reservoir mechanics and rock fluid properties. He predicted that the state is interested in more production.

REPRESENTATIVE PETERSEN stated that since there are different companies with different leases for each field, the negotiations will need to occur with each company separately; however, one tax rate could apply to all current production. Another rate could apply to production past a certain level of cumulative volumes, which is the structure and formulation or the art of putting the policy together.

MR. REINSCH answered that the mechanics would apply the same to each company. The structure and formulation approach would not change. He related that different negotiations would occur for new fields or exploratory areas, a different negotiation would occur.

[5:13:08 PM](#)

REPRESENTATIVE P. WILSON questioned whether it is appropriate to increase taxes if the decline continues.

MR. REINSCH emphasized it does not make any economic sense for a company to withhold capital that would create value for the company. Therefore to penalize companies for doing that would not make any sense. He said the state wants to incentivize them to drive costs down or change the field development metrics for the incremental barrels in a way that will attract capital. He apologized to keep returning to this, but this is how business is conducted. He predicted if a company is left on its own to decide there will be a pay set in which production will continue given the current fiscal system. He sensed the committee is reluctant to give oil companies more money and hope something happens. However, if the state could change the economics to change the commercial comparisons of the investment activity in this activity versus somewhere else in the portfolio it should elicit a response, and if it doesn't then nothing existed. He suggested that this would lead to a different set of conversations.

[5:15:57 PM](#)

REPRESENTATIVE PRUITT related his understanding that a company would not withhold profit. He asked whether there any reason why the three companies on the North Slope would not produce the resource that exists.

MR. REINSCH responded that a more likely scenario would be the company would decide there was nothing more for them to do for the legacy fields since the company did not have the capability, management focus, or technical teams to bring to bear relative to other opportunities in its portfolio. The logical next step would be to consider divesting the assets. He said, "These assets have value. I mean, there's lots of resource left." The only reason to not to produce it would be if the company reached a decision that it would be worth much more if it were monetized today or else a company thinks it could obtain a reasonable share of the net present value through divestiture. He pointed out what is tricky with this particular arrangement is the unanimity issue and to make this an interesting acquisition from an enhanced oil recovery specialist viewpoint. He suggested that due to the infrastructure, it would be hard to unwind and could become a complicated and messy situation. However, he has never heard of any company who was willing to leave value in the ground. At the end of the day, companies must answer to the shareholders and board of directors. They cannot destroy value

and capital since they have a fiduciary responsibility. He concluded that his answer would be no.

CO-CHAIR SEATON summarized this goes back to an earlier conversation, which recognizes that different companies have hurdle rates and may make different decisions, but the companies will not destroy value. He highlighted that companies may have strategic reasons for their decisions. He did not want to suggest that companies are destroying value when they make economic decisions. He said the state may decide to make changes to the tax system to make it more economical for companies, which, in turn, could affect their decisions. He concluded by stating that is what we are all talking about here today.

[HB 3001 was held over.]

[5:19:20 PM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 5:20 p.m.