

SENATE FINANCE COMMITTEE
March 21, 2012
1:10 p.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 1:10 p.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Lesil McGuire, Vice-Chair
Senator Johnny Ellis
Senator Dennis Egan
Senator Donny Olson
Senator Joe Thomas

MEMBERS ABSENT

None

ALSO PRESENT

Damian Bilbao, Head of Finance, Developments and Resources, British Petroleum (BP) Inc.; Dale Pittman, Vice President, Production, ExxonMobil Alaska, ExxonMobil Production Company.

SUMMARY

SB 192 OIL AND GAS PRODUCTION TAX RATES

SB 192 was HEARD and HELD in Committee for further consideration.

#SB192

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SENATE BILL NO. 192

"An Act relating to the oil and gas production tax; and providing for an effective date."

DAMIAN BILBAO, HEAD OF FINANCE, DEVELOPMENTS AND RESOURCES, BRITISH PETROLEUM (BP) INC., continued his PowerPoint presentation from the morning meeting: "BP Testimony to Senate Finance" (copy on file). He responded to an earlier question concerning Slide 3, which included both the operating and capital budgets. He clarified that the decline included a 4 percent inflation rate for both operating and capital.

Co-Chair Stedman observed that the growth could be modified under budgetary pressures. Mr. Bilbao replied that was correct. He pointed out that there could be opportunities to modify both budgets. He added that investment that resulted in increased production would be necessary in order to avoid the 6 percent decline depicted in the slide.

Senator Thomas referred to Slide 4. He recalled that Dr. Pedro Van Meurs had indicated that Alaska's Clear and Equitable Share (ACES) rendered Alaska non-competitive internationally. He referred to a letter from Bill Armstrong, President of Armstrong Oil & Gas, which indicated that producers were leaving the Gulf of Mexico and Alaska due to aging oil fields. He opined that given large amount of oil that still remained in the legacy fields; the reasoning was hard to accept. He pointed out that Cathy Foerster from the Alaska Oil and Gas Conservation Commission (AOGCC) and Kevin Banks from the Department of Natural Resources (DNR) had called the decrease of production in mature fields a natural transition. He pointed out that the decline in production had begun long before the passage of ACES, and wondered why it should currently be considered the only cause for the decline. He asked how it would cost to increase production.

Mr. Bilbao agreed with the previous testimony; that the major producers were leaving aging fields under ACES. He stated that globally, Alaska was still the third largest resource base for BP. He relayed that when the allocations for global projects were discussed it was beneficial that Alaska prove competitive. He stated that BP had three areas of focus in Alaska; the need to increase efficiencies, to develop technologies, and tax change. He noted that Prudhoe Bay had produced 44 percent more oil than originally estimated. He shared that BP had a deep hopper of opportunities being explored. He offered that BP could continue working in Alaska for another thirty years.

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Co-Chair Stedman stated that previous testifiers had indicated the three major producers in the state were operating under harvest mode; companies were extracting cash from Alaska as quickly as they could. He wondered if BP agreed. Mr. Bilbao responded that the company believed that more activity could be happening in Alaska. He stated that PFC Energy's statement that ACES did not encourage investment and growth was consistent with the view of BP. He asserted that the fiscal environment in Alaska's should reflect a desire to be competitive in the global market.

Senator Thomas appreciated that ACES presented challenges, but he highlighted that did not explain the lack of production 18 years prior to the passages of the legislation. He asserted that the state had a responsibility to ensure that changing the tax structure would result in more investment. Mr. Bilbao maintained that there had been significant activity during the years prior to ACES. He said that projects prior to ACES had required significant time and money, for example the drilling operation on Northstar Island. He stated that the environment of Alaska had once inspired investment, even at a high price, but no longer did under ACES. He concluded that due to ACES Alaska was no longer considered in conversations concerning new investments.

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Senator McGuire questioned what investment strategies were considered by producers when entering a high price oil environment. She furthermore queried how the company made investment decisions and how Alaskan projects stood up against other proposed projects. She likened the discussion in the boardroom to the consideration of retirement options of high-risk stock or safer bonds that families would consider when budgeting. She requested an overview of the investment changes that would occur as a result of changes in the tax structure.

Mr. Bilbao replied that fundamentally the question of ACES was about the allocation of investment dollars. He said that funds were not unlimited, and that BP had an obligation to its shareholders. He added that the opportunities to access new areas and develop new projects

globally were tremendous. He felt that the conversation would come down to how significant the changes in Alaska proved to be: was business more efficient, were there new technologies which had enabled new projects, and had the fiscal environment changed. He relayed that if none of the above had changed then the business would remain as before; if change could be calibrated then the investment picture would change. He maintained that little would change without an alteration to ACES. If the base business was healthy, heavy oil pilot programs and additional major projects would be easier to support. He concluded that the base business; the investment and renewal for the next 50 years, including investment in on-going activity, were the foundation for future projects.

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Senator McGuire asked what differentiated Alaska's fiscal terms from other countries in which the company was currently investing. Mr. Bilbao replied that the company examined the tax credits as part of a broad discussion. He said that there was a starting presumption, from a macro-view, of an understanding of which basins provided a more attractive investment in a high price environment. He noted that the Gulf of Mexico was a high price environment that was a more attractive investment destination when compared to Alaska. He asserted that BP had a responsibility to do what it could pertaining to business and technology, but needed help from the legislature to change the tax structure.

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Mr. Bilbao testified that, like ACES, SB 192 did not create meaningful tax change that would inspire future investment. He referred to Slide 5, which illustrated the similarities between ACES and SB 192.

Co-Chair Stedman requested further discussion of the slide. Mr. Bilbao explained that the bottom axis on the chart represented the production tax value per barrel (PTV/bbl.) and the vertical axis, the production tax rate per barrel. Mr. Bilbao explained that PTV/bbl. included the sales price of oil off of the North Slope, with a deduction for transportation as well as capital and allowable expenses, defined the production tax value per barrel on a yearly basis.

Co-Chair Stedman clarified that royalties were included in the equation. He offered that when the PTV/bbl. was at \$80 it indicated that the price of oil was at \$120 per barrel. He stated that one of the challenges for the committee during the SB 192 presentations was that the price of oil as understood by the general public was quite different than what was represented on industry charts. Some charts illustrated the Alaska North Slope (ANS) West coast price and others the PTV/bbl. For example the PTV/bbl. price would be \$130 per barrel and at the same time the ANS West coast would be \$170; a \$40 spread.

Mr. Bilbao agreed. He stated that some of the figures that had been seen during previous testimony had under-represented industry internal costs. He felt that Slide 5 gave a rough estimate of the difference between the sales price of the oil and the PTV/bbl.

Co-Chair Stedman concluded if the chart on Slide 5 were converted to ANS West coast, the figures would range from \$30 to \$105, which would truncate all projections north of \$105. He explained that there had been hypothetical discussions about, using for discussion \$150 ANS West coast, freezing the split of profit oil between the industry and the state. Under the hypothesis everything to the right hand side of the lower axis would become irrelevant.

Mr. Bilbao replied that BP had not considered that perspective and could not provide exact numbers. He relayed that the intent of the slide had been to give the committee a sense of the differences between SB 192, HB 110 and ACES.

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Co-Chair Stedman emphasized that for the sake of clarity, the price high of oil per barrel should remain at approximately \$150. He pointed out that it was natural for people to visually gravitate to the right-hand side of the chart and it would be more productive to truncate the price at the northern end of the axis. He shared that the committee would be working from \$150 and south, in an attempt to come up with a freezing of the split of profit oil.

Co-Chair Stedman reiterated that \$150 would be a safe number to end the charts. He offered that consultants had

testified that industry was profitable at \$100 per barrel oil and felt that the committee needed to concentrate on prices greater than \$100 per barrel. He noted that ACES became more difficult for industry as the price moved past \$100 per barrel.

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Mr. Bilbao disagreed with the previous testimony by PFC Energy, which used a flat per barrel cost. He asserted that costs tended to go up. He said that from a cash flow perspective, the base would be positively affected by tax change. He said that business was not as robust as the net income dollars that had been discussed. Capital expenditures overtime were treated different than cash flow. He stated that the \$70 dollar range given in earlier testimony by ConocoPhillips was closer to the view of BP than the figures given by PFC Energy.

Co-Chair Stedman asked whether the discussion concerned \$70 ANS West coast, or \$70 PTV/bbl. Mr. Bilbao believed that the figure used had been based on ANS.

Co-Chair Stedman informed the committee that moving forward there would be discussion based on less than \$100 per barrel. He reiterated that previous consultants had cautioned the committee from moving too much cash below \$100 ANS West coast per barrel. He thought that a constant x axis would clarify the discussion for the public.

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Co-Chair Stedman asked if the tax rate on the slide was the nominal rate after credits. Mr. Bilbao clarified that the nominal rate had been used. He said that the chart incorporated everything without distinguishing between individual elements.

Co-Chair Stedman asked which companies were represented by the numbers on the chart. Mr. Bilbao explained that the slide illustrated industry overall.

Co-Chair Stedman asserted that it was important that the committee clearly understand what they were looking at because when looking at homogenized fields, which brought in the non-taxpaying producers that consumed upwards of \$400 million in credits against the treasury, the tax rate

was shifted down. When only legacy field taxes were examined the rates increased leading to a misunderstanding between the state and the major producers. Mr. Bilbao said he would get back to the committee on the specifics.

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Mr. Bilbao referred to Slide 6, which implied that the individual elements of SB 192 did not provide meaningful tax relief.

Co-Chair Stedman probed the industry definitions of "meaningful" and "significant". He referred to earlier testimony by Senator Hoffman that the legislation would provide incentives of up to \$3 to \$4 billion, which the committee believed was both significant and meaningful. He requested further clarification of the elemental changes necessary in SB 192 in order to meet the industry's needs.

Mr. Bilbao replied that the state would know the definition of meaningful when the tax incentives resulted in increased investment and production. He believed that a change in the progressivity rate would be the number one element to shift the fiscal environment and encourage investment. The second element would be bracketing around the tax rates.

Co-Chair Stedman noted that progressivity was the number one issue and that bracketing was a possible solution.

Mr. Bilbao clarified that rate of the bracketing of the progressivity, in addition to progressivity, was too high. He testified that the 25 percent base rate was too high.

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Co-Chair Stedman emphasized that the difficulty faced by the committee lie in the testimony from consultants cautioning against dropping progressivity below \$100 per barrel. He agreed that there were problems with progressivity at higher rates.

Co-Chair Hoffman noted that support groups had indicated that there was no incentive for producers above \$100 because the state received too large a share. The issue was how far down the high end the state should go. He reiterated his morning question to ConocoPhillips regarding how lowering to \$130 per barrel would affect the high end.

He observed that billions would be saved at the high end. Oil companies had testified that there was no incentive at the high end and this was the problem the committee was attempting to address. He said if prices rise, the industry would see substantial return. He pointed out that international turmoil could increase the price per barrel to \$200, which would increase credits to nearly \$12 billion. He felt that the numbers were significant.

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Mr. Bilbao agreed that \$4 billion was significant, but that the high end was south of \$130 per barrel. He acknowledged that there were always opportunities for the price to go up, but stressed the need to consider both the low and the high end. He argued that the current base business was at \$100 and could go down just as easily as it went up.

Co-Chair Hoffman rebutted that the problem was that changes were being considered to a tax structure for a field that could be operational for 40 - 50 years. He recalled prices as low as \$9 per barrel, when no one thought oil would go to \$100 per barrel in a 25 year time frame, which it did. He asserted that, unless the discussion concerned the reduction of taxes for industry, the need for a stable tax structure was never mentioned by industry.

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Co-Chair Stedman agreed that progressivity was on the table for discussion along with new production. He observed that there could be one tax structure for new production and another for existing. He pointed out that SB 192 legislation contained a two-tier structure that considered both current and new production.

Mr. Bilbao spoke to the two-tier structure of new and existing production. He agreed that the health of legacy fields was primary. He warned that trying to differentiate between the two would create unintended consequences. He referred to testimony by Commissioner Cathy Foerster, AOGCC, before the Senate Resources, February 14, 2012:

"The health of all the fields on the North Slope depends, to a certain degree, on the health of Prudhoe Bay."

He argued that all production needed to be incentivized and should be separated. He suggested that the consultants reconsider the assumptions that were being used for cost projections. He said BP believed that the assumptions used were half of what they should be. He noted that the drilling rigs currently in the legacy fields delivered the largest discoveries year after year.

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Co-Chair Stedman wondered how new production would be incentivized without differentiation between new and existing fields.

Mr. Bilbao said that new production would be incentivized if the base business was healthy. Healthy light oil business would encourage viscous and heavy oil business, and would underpin a gas business. He asserted that everything started with the legacy fields.

Co-Chair Stedman noted that they would have more conversations with consultants on the issue. He understood that, in order of importance, separation of old and new production was second after progressivity. He solicited comments on minimum tax decoupling and the petroleum information system.

Mr. Bilbao reiterated that a tax increase would not be helpful in encouraging more investment. He added that an increase in the minimum tax would not increase additional investment.

Co-Chair Stedman inquired whether Mr. Bilbao could offer constructive suggestions concerning how the state could protect itself from exposure to a negative production tax value moving forward.

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Mr. Bilbao replied that the best thing that the state could do in the short term with meaningful tax change would be to look to increase drilling. He added that the state should incentivize drilling and well-work on the North Slope through meaningful tax change.

Co-Chair Stedman felt that the state and industry agreed on the need for increased production. He probed Mr. Bilbao's

thoughts concerning the state's exposure on the high end to capital credits and immediate write-offs for industry. Mr. Bilbao declared that he would be happy to continue with the presentation. He asserted that the more simple the plan for industry to incorporate into an economic model, the better.

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Senator McGuire spoke to bracketing. She understood that making the most profit possible was of the utmost importance to industry. She felt that bracketing was a fair concept because companies were not taxed at a higher marginal rate. She inquired of the nature of the conversation surrounding bracketing in the company boardroom.

Mr. Bilbao responded that if the price of oil was at \$60 dollars for the year and spiked to \$100 in December it would cause the company to go back to the beginning of the year to adjust the total tax payment. He said that bracketing provided the benefit of simplicity; if the company could plan for the year knowing that it would not have to pay back the difference in tax due to fluctuation oil prices. He reiterated that the company would be focusing on cash flow to establish how future business decisions were made.

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Senator Thomas felt that the subject of decoupling should be addressed and that the separate tax for oil and gas should be determined quickly. He expressed concern with the current amount of gas being used in the field and the amount of light oil being withdrawn which reduced the amount of heavier oil over time. Mr. Bilbao replied that decoupling was important, but not imperative. He furthered that the light oil business from the legacy fields remained the foundation for the company moving forward. He stressed that the conversations related to progressivity were more important to have at the current time.

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Senator Thomas understood that focusing on light oil was easy. He asserted that the focus should be on the heavy oil. He pointed out that BP had for some time had a plant in place in Prudhoe Bay that had experienced a degree of

success. He felt that there should be some focus on heavy oil and natural gas. Mr. Bilbao replied that the priority should be on light oil from the legacy fields because that was the majority of production generated by the company. He furthered that investment in light oil could contribute to the heavy oil business. He felt that there were remaining, significant light oil opportunities within the legacy fields. He remarked that there had been no oversight of heavy oil opportunities and with meaningful tax change those opportunities could be explored.

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Mr. Bilbao continued to Slide 7, which spoke to three key issues important to BP: ACES was not working, more investment was needed to increase production, and the policy crafted should focus on long-term solutions. He believed that industry could help provide long-term solutions through its control of efficiency and technology, but that the issue of tax change was wholly in the per-view of the legislature.

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Mr. Bilbao addressed Slide 8, which illustrated the drilling activity challenged by ACES. He believed the numbers on the slide could be improved through meaningful tax change.

Co-Chair Stedman noted that the slide depicted what was below ground. He asked if the companies processing facilities above ground were gas constrained. Mr. Bilbao replied that BP was constantly examining opportunities to ensure that facilities were producing as much as possible. He furthered that there was data that informed those efforts and that the project would be financially beneficial under ACES or not. He said that there were two ongoing efforts to ensure the facilities were optimized for production: the ongoing fine tuning of the kip and the expansion necessary to support major projects.

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Co-Chair Stedman surmised that the state faced challenges below ground and above ground related to the current tax structure. Mr. Bilbao responded that opportunity was waiting for both; under a different tax environment.

Mr. Bilbao presented Slide 9. The bar graph detailed the rise in operating and capital costs as depicted in the Department of Revenue (DOR) Source Book - Fall Forecasts. He relayed that the rise in costs was not solely activity led, but could also be contributed to inflation.

Co-Chair Stedman wondered if BP anticipated an increase in capital expenditures moving forward. Mr. Bilbao replied that he would provide the information to the committee.

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Co-Chair Stedman remarked that the slide showed the aggregate capital expenditures through 2.7 billion for all involved companies. He opined that the committee was challenged by its inability to break the numbers down by company. He furthered that it would be helpful to produce a capital expenditures graph that compared producing to non-producing legacy fields. He noted that industry has access to information that was unavailable to the committee. He was encouraged by the aggregate numbers into 2015, but the inability to examine the Prudhoe Bay numbers specifically, as they constitute 50 percent of production, was a challenge.

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Mr. Bilbao relayed that he could not provide data for Prudhoe Bay specifically, but believed that DOR could answer any questions.

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Senator Olson asked if the 50/50 split between capital and operating expenditures would remain unchanged by the production of heavy oil. Mr. Bilbao reminded the committee that the slide represented the gross number for industry and not BP specifically. He assumed that as the light oil business continued to decline the proportions would alter.

Senator Olson wondered if the numbers were significantly different would the industry expect the legislature to come back to the table to craft a different tax structure for companies solely developing heavy oil.

Mr. Bilbao replied that it would depend on how meaningful the any tax change crafted by the legislature proved to be; the challenge that surrounded heavy oil from a fiscal perspective remained unknown. He reiterated that industry could focus only on the efficiency and technological challenges, but that it was too early to give a definitive answer.

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Mr. Bilbao reviewed slide 10, which illustrated the base business challenges faced by industry. He testified that BP believed that the lifting cost figure used by PFC Energy was inaccurate by half.

Co-Chair Stedman assured Mr. Bilbao that PFC Energy would work with BP to make the necessary adjustments in the lifting cost figures.

Mr. Bilbao continued to Slide 11, which reiterated that more opportunities require efficiency, technology and tax change. He contended that as much as \$5 billion in growth would occur with meaningful tax change.

Co-Chair Stedman understood that it would take more than \$5 billion over a period of years for any meaningful change to the decline curve. He questioned the amount of capital costs it would take to reach the goal of additional production of 600,000 barrels a day, 50 percent of which would come out of Prudhoe Bay, regardless of the tax structure. Mr. Bilbao responded that increased production would not occur under ACES. He added that the increase in investment would bring new jobs to the industry. He furthered that there were additional opportunities being discussed by the company than those represented on the slide.

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Co-Chair Stedman noted that the committee had requested guidance from consultants on the magnitude of the capital expenditures that would be required to stem the 6 percent decline to 4, or even 0. He expressed concern for

diminishing marginal returns for the state. He understood that amount was significantly above \$5 billion. He wondered if the number dropped to \$3 to \$4 billion annually, would BP return to the committee with recommendations on how to stem the decline regardless of the tax structure. Mr. Bilbao responded that he could not give specifics, but stressed that Alaska had a potential for more projects in light and heavy oil, and gas. He reiterated that the fundamentals were in place but that what was needed was the financial support for the projects.

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Mr. Bilbao spoke to long-term policy issues cited on Slide 13. He repeated the testimony of Cathy Foerster, Commissioner, AOGCC, before the Senate Resources Committee, February 14, 2012 regarding the health of all the fields on the North Slope:

"The health of all the fields on the North Slope depend, to a certain degree, on the health of Prudhoe Bay. Prudhoe Bay is the central nervous system and the circulatory system (of the North Slope)."

Mr. Bilbao referred to statements by CERA, White Paper Industry Context, 1999:

"Companies evaluate exploration and development prospects in terms of the value (to shareholders) a prospect can generate. Government take, in the form of taxes, royalties, or other production-sharing or profit-sharing requirements, adds to upstream costs, and thus the level of government take is an important component of the investment decision."

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Mr. Bilbao informed the committee that regardless of which companies were doing the analysis; Alaska continued to stay at the bottom of the list of investment destinations. He continued to Slide 15, which reiterated:

- ACES was not working
 - Production adding activity remained flat

- More investment was needed

- Base business in legacy fields was the foundation for the future
- Focus on the long-term now
- Only the legislature could correct failed fiscal policy

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Senator Ellis asked what the ideal tax base rate would be for BP. Mr. Bilbao responded that the legislature should consider returning to a 20 percent base rate.

Senator Ellis understood that the next step for BP, if a bill similar to HB 110 were passed, would be a discussion surrounding the significant reduction of the base tax rate. Mr. Bilbao answered that HB 110 should go further in the quest for meaningful tax change. He maintained that a change of great magnitude was necessary for increased investment. He stated that BP would always encourage the state to be more competitive with other parts of the world.

Co-Chair Stedman interjected that it was unlikely that a 20 percent tax was responsible for past unlawful activities surrounding oil taxes. He said that some current lawmakers felt that 25 percent was reasonable and were extremely reluctant to enter into the base tax debate.

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Mr. Bilbao concluded that ACES was not serving the corporation. He reiterated that drilling on the North Slope was flat and that five out of every six jobs on the slope focused on renewing the kip and adding production. He added that the company would like to continue to make sure the infrastructure was healthy and renewed, but also to ensure that new oil was flowing. More investment was needed, which would start with the base business in the legacy fields. The company was not satisfied with a pipeline that was two-thirds empty.

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DALE PITTMAN, VICE PRESIDENT, PRODUCTION, EXXONMOBIL ALASKA, EXXONMOBIL PRODUCTION COMPANY, spoke first of the company's commitment to Alaska. He stated that Alaska had always been, and continued to be, a critical part of the

corporation's business. The corporation was the largest lease holder for discovered gas resources in the state, operated Point Thompson, and was the largest investor in Prudhoe Bay. He shared that the corporation's presence in the state dated back to the 1920s. ExxonMobil has had continuous business in Alaska for the last 50 years. The corporation expected to continue working in the state for years to come and remained committed to long-term responsible resource development.

Mr. Pittman addressed the testimony given by ConocoPhillips and BP regarding investment commitments. He assured the committee that the corporation supported ConocoPhillips at Kaparuk, and BP at Prudhoe Bay, and their continued commitment to invest in Alaska, and to pursue all additional opportunities and investment that would become viable through meaningful tax reform. He believed that there was a significant need for change in Alaska's oil tax structure. He said that oil production from existing fields would decline by approximately 40,000 barrels per day in 2012 alone, and had been declining at that rate for many years in the past. He challenged the state to stem the decline. He opined that the 40,000 barrel per day loss equaled nearly \$3 to \$5 billion. He warned that production under a new tax regime would take 5 to 10 years to implement. He cited the Nikaitchuq oilfield. He stated that Nikaitchuq field streamed in 2011 after 6 years in the planning and execution phase and cost approximately \$2 billion. The field was expected to reach peak capacity of 25,000 barrels per day by 2015. He emphasized that the addition of two projects, equivalent to Nikaitchuq, each year could stem the current decline in production.

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Mr. Pittman asserted that without meaningful change in oil taxes, investment would not be forthcoming. He testified that he was unaware of any new development streaming within the next 3 years. He felt that the state was "woefully" behind in attracting new investment. He stated that under the current tax structure, the taxes were too high to provide the doubling of annual investment necessary to effectively create change. He emphasized that with the current price of oil, Alaska should be at near record levels of activity.

Mr. Pittman related that investment decisions were akin to risk management decisions, particularly for long-term projects. The corporation assessed the broad based investment risk by examining the following aspects: commercial, technical, fiscal and regulatory. He testified that oil and gas companies depended on and expected upside potential to offset inherent downside risks of capital intensive investments. He asserted that the current tax regime took away the upside potential, leaving investors at a disproportionate risk on the low-side; leaving two choices: not to invest or invest in low-risk activities. Higher risk opportunities would be delayed. The tax reform as proposed by the administration would restore balance to the risk profile and favorably impact decision making for Alaska's investors. ExxonMobil firmly believed that meaningful change to ACES would attract additional significant investments, which would lead to greater development, increased production and reliable long-term revenue for the state. He declared that Alaska depended heavily on resource development but was currently burdened by a tax regime that did not support the resource development business. He said that the most onerous inhibition to investment was progressivity.

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Mr. Pittman acknowledged the magnitude of the challenge the committee faced in crafting sound policy. He allowed that under ACES the state had enjoyed strong, short-term revenue increases, but maintained that ACES had failed to sustain, or attract, investment that would ensure oil development into the future. He affirmed that SB 192 was a slight improvement over existing law, but not enough. The fiscal regime needed to encourage strong growth of both new and existing resources. He added that it was critically important that the state and industry become better aligned on the issue of development.

Mr. Pittman shared that time in the oil industry was measured in decades and generations, not business cycles. The current production rates were the product of government policies, technical work and investment decisions made years ago. The sound policies made in 2012 would directly affect the increase of production rates into the future. He furthered that the reform should result in a competitive, stable, and predictable fiscal environment that would encourage current and future development.

Mr. Pittman reiterated the legislature's careful examination of the issue was appreciated. He shared that it was critical to strike the right balance between the level on government take and insuring an active, healthy, long-term oil industry in the state.

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Co-Chair Stedman spoke to the corporation's concern for progressivity at high oil prices and the concept of freezing the split between the industry and the state at \$130 to \$150.

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Mr. Pittman shared that the corporation was mainly focused on the total government take. He stated that there were variables in the equation that would never be controlled. He agreed that progressivity was a lever for the state, as well as the base rate and the credits. He stressed that the corporation cared only about the total government take because that was what informed the total cash available for investment in the future. He offered that it made no difference if the credits were offered upfront and resulted in higher taxes later, or vice versa; viable future long-term investment opportunities ultimately depended on the level of government take.

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Co-Chair Stedman reminded the committee that prior testimony had indicated that at \$100 per barrel, existing fields were profitable for the industry, infield drilling was profitable, and that an adjustment north of \$100 dollars should be considered for current production. Additionally, there had been a request for incentives for new production which had been drafted into SB 192.

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Mr. Pittman responded that the corporation would continue to pursue low risk activities under ACES. He argued that the challenge lie in creating a broader pool of viable opportunities to choose from. He expressed concern that, even at \$100 dollars per barrel, not as much money was being spent by the industry in Alaska compared to other

areas of the world. He suggested that the committee visualize a broad opportunity pool for companies already working in the state and those that would be attracted in the future.

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Co-Chair Stedman understood that a two-tiered tax structure would not concern ExxonMobil, provided the legislature offered a form of credit incentive for new production outside of existing infrastructure.

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Mr. Pittman expressed concern with the definition of each tier in the two tier tax structure. He reiterated that there was considerable potential in Prudhoe Bay, Kaparuk and Alpine. He qualified that the potential was not currently viable because the projects were technically challenging and high risk. He warned that whatever new production meant to be incentivized in the bill should be fed by both tiers.

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Co-Chair Stedman mentioned decoupling, which was currently costing the state \$80 million per year.

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Mr. Pittman stated that he could not comment on the specifics of decoupling. He commented that the issue was not a concern to Exxon Mobil until the corporation began producing gas. He expressed concern about the administrative burdens that would accompany decoupling. He suggested that the issue should be addressed when the state moved forward with real gas development.

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Co-Chair Stedman stated that that the legislature had no knowledge of who made use of incentives in the Alaska Gasline Inducement Act (AGIA), that were available on the first day of the open season, or what it cost the state. He added that inducements existed that could of significant cost to the treasury. He opined that the legislature and

DOT could not gage the exposure to the treasury due to the confidentiality clauses in AGIA.

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Mr. Pittman replied that he had no knowledge about recent open seasons.

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Co-Chair Stedman noted that another problem was that the inducements were healthy, and were transferable, possibly to another project. Mr. Pittman replied that he had no knowledge about how the inducements would work in the future under the AGIA license.

Co-Chair Stedman stated that the committee was working with DOR to learn more on the issue, but that DOR was unaware of the details as well. He highlighted that there were potentially billions of dollars at stake for the state.

[3:09:53 PM](#)

Mr. Pittman stated that gas development was important to Exxon Mobile and hoped future conversations with the legislature surrounding the issue were fruitful.

[3:10:06 PM](#)

Co-Chair Stedman declared that there was language in the bill to implement a petroleum information system to ensure that the public had access to information. He reported that DOR had been working to clarify the language, but that the language would now need significant modification in light of new information the department had received from industry.

[3:11:03 PM](#)

Mr. Pittman expressed concern that the state could receive duplicate information. He reminded the committee that the corporation was not obligated to provide proprietary data. He referred further questions on the issue to Alaska Oil and Gas Association (AOGA).

[3:11:24 PM](#)

Co-Chair Stedman stated that the committee would work with the DOR to insure that there were no redundancies in the information.

[3:11:46 PM](#)

Senator Thomas felt that an arrangement that would result in more production should contain more specifics for the long-term. He thought that the exchange of information presently taking place would not result in an agreement that would equally satisfy both industry and the state. He asserted that the conversation should include more projects, the amount of production from those projects and the timeframe of the projects. He surmised that only then could an informed business model that would offset concerns that the state would simply spend money to flatten, and not reverse the decline in the long-term. He requested a thumbnail sketch of the projects that had not been put into place under ACES, and how much they would have produced.

[3:14:33 PM](#)

Mr. Pittman replied that the projects before the committee had been identified under the current fiscal regime. He assured the committee that as the financial viability for projects was increased, more projects would be added. He said that when the corporation put to task its specialists to search for more opportunities the projects would be found. He pointed out that the state may have given credits in the past, but the \$5 million dollar investment would generate considerable future income to the state.

[3:15:27 PM](#)

Senator Thomas expressed concern that the decline would offset any increase when using the numbers currently under discussion. He thought that more clear and specific language concerning what the projects would produce would be more productive for solidifying a fair business arrangement.

[3:16:12 PM](#)

Senator Olson understood that ExxonMobil was not currently interested in decoupling. He directed attention to the possibility that the governor could spend \$400 million on a gasline in the future, which boosted the eminence of gas

production becoming an issue for the corporation. He wondered how ExxonMobil could be indifferent to what the structure would be for gas taxes. He asked why the state should wait to tackle the decoupling issue.

[3:17:39 PM](#)

Mr. Pittman replied that in his previous comments he was referring to the trigger point for the system surrounding gas. He informed the committee that major discussions concerning fiscal policy pertaining to gas development were expected in the future. He stated that Exxon Mobile welcomed the discussion about decoupling. The corporation did not want to trigger additional costs, move cost, or change cost allocation before it was necessary.

Senator Olson pointed out that delaying the conversation increased the cost of devising and implementing a plan. He thought that inflation should be a consideration.

Mr. Pittman clarified that the point of discussion was the fiscal policy that would be in place to address gas production when it started. He contended that he did not see the correlation between the cost today and the cost in the future, unless the discussion was about cost allocation.

Senator Olson explained he wanted to settle the decoupling issue now so that the state would be aware of revenue that could be expected in the future.

[3:19:02 PM](#)

Co-Chair Stedman interjected that there were \$100s of millions being invested in Point Thomson and that the industry had required assurances that the state had not intended to block the ability of the deduction of gas expenditures to be carried forward to the time of an actual gas sale. Mr. Pittman acknowledged the concern.

#

ADJOURNMENT

[3:20:46 PM](#)

The meeting was adjourned at 3:20 PM.