

HOUSE FINANCE COMMITTEE  
April 8, 2013  
1:37 p.m.

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CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:37 p.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair  
Representative Bill Stoltze, Co-Chair  
Representative Mark Neuman, Vice-Chair  
Representative Mia Costello  
Representative Bryce Edgmon  
Representative Les Gara  
Representative Lindsey Holmes  
Representative Scott Kawasaki, Alternate  
Representative Cathy Munoz  
Representative Steve Thompson  
Representative Tammie Wilson

MEMBERS ABSENT

Representative David Guttenberg

ALSO PRESENT

Damian Bilbao, Head of Finance, British Petroleum; Scott Jepsen, Vice President, External Affairs, ConocoPhillips Alaska; Bob Heinrich, Vice President Finance, ConocoPhillips Alaska; Dan Seckers, Tax Counsel, ExxonMobil.

SUMMARY

CSSB 18(FIN) am  
BUDGET: CAPITAL

CSSB 18(FIN) am was SCHEDULED but not HEARD.

CSSB 21(FIN) am (efd fld)  
OIL AND GAS PRODUCTION TAX

CSSB 21(FIN) am (efd fld) was HEARD and HELD in committee for further consideration.

#sb21

CS FOR SENATE BILL NO. 21(FIN) am(efd fld)

"An Act relating to the interest rate applicable to certain amounts due for fees, taxes, and payments made and property delivered to the Department of Revenue; providing a tax credit against the corporation income tax for qualified oil and gas service industry expenditures; relating to the oil and gas production tax rate; relating to gas used in the state; relating to monthly installment payments of the oil and gas production tax; relating to oil and gas production tax credits for certain losses and expenditures; relating to oil and gas production tax credit certificates; relating to nontransferable tax credits based on production; relating to the oil and gas tax credit fund; relating to annual statements by producers and explorers; establishing the Oil and Gas Competitiveness Review Board; and making conforming amendments."

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DAMIAN BILBAO, HEAD OF FINANCE, BRITISH PETROLEUM (BP), provided an overview of his comments. He presented a PowerPoint presentation "Mr. Pulliam Testimony to House Finance on HCS CSSB 21(RES)."

Mr. Bilbao discussed slide 2: "Overview."

- BP in Alaska - working with the State over 50 years
- Alaska has great resource potential and people
- Under Alaska's Clear and Equitable Share (ACES), Alaska is at the back of the line in competition for investment
- HCS CSSB 21(RES) meets the Governor's four principles and will put Alaska back in the game of oil investments.

Mr. Bilbao detailed slide 3: "BP in Alaska - 54 years, and counting..."

BP presence in Alaska since 1959

- Operating area
  - 250 miles north of the Arctic Circle
  - 1200 sq. miles (approximately the size of Rhode Island)
  - Prudhoe Bay Unit, Endicott, Milne Point, Northstar
- People
  - 2,300 BP Alaska employees
  - 6,000 contract employees
- Facilities (start-up 1977)
  - 11 major production facilities
  - 2 major gas facilities
  - 3 water handling facilities
  - 2000 production/injection wells
- Prudhoe Bay
  - Original production estimate ~9.6 billion barrels
  - Cumulative production has exceeded 12 billion barrels
  - More than 2 billion barrels remaining
  - Largest field in North America - 35 years
  - COP ~36%, XOM ~36%, BP ~26%, CVX ~2%

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Mr. Bilbao discussed slide 4: "Estimated Capital Spending for Exploration and Development Alaska North Slope vs. U.S. and Worldwide Spending 2003-2012." The graph was prepared by Econ One Research. He noted that the price of oil increased steadily as illustrated by the graph's black line. He noted that the price of oil provided the greatest determinate for investment. From 2003 - 2008 the investments were consistent with investments tracking the price of oil. The graph's blue bar no longer increased with the price of oil beginning in 2007. The trend continued through 2012. The U.S. spending continued to increase. When the price of oil dropped to \$60 per barrel, investment followed. Following the decrease, global spending tracked the increasing price of oil with the exception of Alaska. The level of investment in Alaska was higher in 2007; however lost opportunities resulted from growth and investment occurring elsewhere.

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Mr. Bilbao discussed slide 5: "Crude Oil Production Alaska North Slope vs. United States and OECD Countries 2003-

2012." The graph depicted oil production. In Alaska production continued to decline. Globally new drilling and new pads led to increases in production following 2008. Unfortunately the increase in production seen in the Lower 48 did not occur in Alaska.

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Mr. Bilbao discussed slide 6: "Both conventional and unconventional oil production has grown in the Lower 48." He commented on the opinion that new production in the Lower 48 resulted from new technology from the shale oil revolution. He pointed out that Alaska production declined from year to year. He compared the onshore to the offshore production. The shale oil or "tight oil" increased significantly in production. He added that conventional oil production had increased as well. He concluded that Alaska did not benefit from the increase in investment as other jurisdictions had.

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Mr. Bilbao discussed slide 7: "Alaska does not compete for investment." The graph was constructed by PFC Energy. He explained that PFC Energy compared Alaska to other jurisdictions.

Co-Chair Stoltze asked about the logo and PFC Energy. Mr. Bilbao replied that the source of the graph was PFC Energy.

Representative Gara asked if PFC Energy was working for BP. Mr. Bilbao replied no. The material was generated by PFC Energy and then used by BP to simplify the conversation.

Mr. Bilbao noted that the red arrows showed how Alaska fell under ACES. Investment in Alaska moved to other jurisdictions where the investment climate was more attractive. He added that Alaska fell behind in competitiveness for investment. He noted the geographic and environmental challenges that made Alaska a fundamentally high-cost region of operation.

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Mr. Bilbao discussed slide 8: "Why doesn't ACES work?" The graph depicted a representation of the sharing of a barrel of oil between the state, the federal government and the

industry, when it sold for \$110 per barrel. The data was gathered from the Department of Revenue's (DOR) Fall Forecast, 2012. The top of the barrel depicted Alaska state revenue at \$36 per barrel. The federal government would benefit in the amount of \$12 per barrel. He added that the deductible costs amounted to approximately \$40 per barrel, which was used to support operations and investing for the future. Adding all of the costs together equaled \$88 per barrel leaving \$22 as the industry share. The \$22 must first cover BP's non-deductible expenses. Under ACES, the employees in Anchorage were considered non-deductible costs, which must first be covered by the industry share before the remaining amount was returned to the shareholders. A change in the tax structure would allow BP the opportunity to invest further in Alaska.

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Representative Wilson requested a graph similar to slide 8, utilizing HCS CSSB 21(RES) instead of ACES. Mr. Bilbao replied that under HCS CSSB 21(RES), the state share would be \$33, with \$13 as the deductible cost. The industry share increased to \$24 per barrel with HCS CSSB 21(RES).

Representative Gara asked about slide 4. He noted that the slide stopped at FY 12. He pointed out that the Revenue Source Book cited \$1.5 billion in capital expenditures in 2007 prior to ACES. He stated that the "Fall 2012 Revenue Source Book" stated the forecast as \$3.8 billion in capital expenditures or over 100 percent increase. He wondered if the slide could be extended past 2012.

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Mr. Bilbao stated that BP did not make any changes to the material provided by the consultants. He deferred the question to the consultants. He stated that BP did not expect their investments to change between 2012 and 2013.

Representative Gara asked for an investment forecast for next year. Mr. Bilbao offered to obtain the information for the committee.

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Vice-Chair Neuman asked about slide 8: The deductible cost under ACES at \$40 for capital and operating expenditures.

He understood that the operating cost remained the same under HCS CSSB 21(RES) and wondered if the amount included the 33 percent along with the \$45 slide. Mr. Bilbao responded that the overall representation of DOR data was presented, but the allowed costs were primarily the capital and operating expenditures. Included were the investments in new wells and facilities along with salary payments for North Slope employees. He stated that the impact linked to the production was reflected in the amount of revenue that the state derived.

Representative Gara stated that ConocoPhillips earned \$2.3 billion in profits on the North Slope in Alaska. He wondered if BP's earnings were comparable.

Mr. Bilbao replied that the slide represented cash flow rather than net income. In the oil and gas industry, a considerable amount of capital depreciated leading to a significant difference between net income and cash flow. He was not permitted to disclose the net income or financials for BP in Alaska.

Representative Gara replied that he had difficulty believing that BP was not earning enough money in Alaska, when the financial details were secret. He asked why it was fair to the legislators to be asked to modify the tax structure without full disclosure of financial information.

Mr. Bilbao replied that the evidence that business was going elsewhere indicated that Alaska was not competitive. He was not referencing BP's specific financial results, but rather the global data, which reinforced the fact that Alaska was not competing. He noted that the higher price of oil ought to summarize the issue effectively.

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Representative Gara testified that he questioned BP during HB 110 hearings two years ago, regarding BP's new production units and the answer he received was that new production would not be implemented by BP with the passing of HB 110. He asked if BP had plans for new exploration and units if HCS CSSB 21(RES) were to pass.

Mr. Bilbao replied no. He stated that BP would not embark on any new exploration with the passage of HCS CSSB 21(RES) because there was so much opportunity within the legacy

fields. Representative Gara asked how the comment that the legacy fields were full of opportunity squared with the statements that new production and new investment were tied and new exploration was the key to an increase in investment in Alaska.

Mr. Bilbao replied that if BP invested nothing, the fields would decline at 20 percent. He stated that BP saw more opportunities with the right fiscal environment. He wished to provide examples where a more positive fiscal environment led to more investment flowing to locations other than Alaska.

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Co-Chair Stoltze wished for a differentiation between exploration investment and production investment. Mr. Bilbao responded that exploration included the review of areas that had not yet been tested, drilled, explored or developed. If a company had an opportunity with basic seismic information, but had not yet drilled a well to prove that oil could be found, was considered exploration. The hope was that the risk would yield a higher reward. Development occurred in areas where the oil was proven to exist via exploration wells.

Co-Chair Stoltze imagined that different companies would provide a different emphasis regarding the company and the scope of their size and the nature of their business. Mr. Bilbao replied that different companies had different strategies for unique geographies. Each company could choose a different blend of investment for their company portfolios.

Co-Chair Stoltze wished to understand questions about exploration. He wished to understand why one company might have a greater emphasis on exploration than another.

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Mr. Bilbao appreciated the complexity of the topic. He clarified that the legacy fields presented a unique opportunity, but a large portion of the opportunities were not economically competitive. He repeated that BP did not need to drill leases outside of the legacy fields to find additional oil. The company strove to develop the existing resource in the most efficient way. He agreed that some

companies would seek new fields and pursue exploration as part of their strategy in Alaska.

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Representative Kawasaki asked if BP explored in other countries for new oil. Mr. Bilbao replied yes.

Representative Kawasaki asked which major countries BP chose to explore for new oil. Mr. Bilbao replied that BP explored in the United States, Indonesia, China and the Gulf of Mexico. He noted that a broad portfolio of opportunities existed throughout the world.

Representative Kawasaki revisited the statement regarding the 2 billion barrels currently existing under the legacy fields. He asked if the oil was considered new or old oil.

Mr. Bilbao replied that oil that had not yet been produced was considered new oil. He stated that timing of production might further define and classify oil as new or old.

Representative Kawasaki stated that the legislature and governor were striving for a production curve that increased rather than declined. He believed that policies incentivizing new oil would change the declining production curve. He wondered about new exploration and China and Indonesia. He asked if there was current production in the countries mentioned earlier, where exploration was considered. Mr. Bilbao replied that BP shared the desire to see increased production in Alaska because when the state benefitted, BP benefitted. He responded to the second question by stating that BP had Liquefied Natural Gas Production in Indonesia, and a non-operated producing area in China.

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Representative Kawasaki pointed to the barrel illustrated in slide 8 and he noticed that the Alaska state revenue represented a large portion of the barrel. He suggested that drawing the depiction to scale might provide a more fair assessment. Mr. Bilbao replied that the space between the royalties illustrated a graphic representation, but the intent was not to provide a disproportionate scale representation of the split of the barrel.

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Representative Thompson asked about slide 8 and the industry share. He requested a comparison of industry share in Alaska to that in North Dakota or West Texas. Mr. Bilbao replied that he did not have the information, but he suggested asking the state's consultants.

Representative Wilson asked about how many projects were analyzed at one time. She wondered how projects were prioritized for the company. Mr. Bilbao responded that BP had many opportunities. The economic nature of a project enabled it to gain higher priority. He noted that BP reviewed projects annually to determine whether circumstances had changed and whether new technology or new efficiencies had changed the economics of a project.

Mr. Bilbao noted that three things would alter the level of investment for BP: efficiency, new technology and fiscal policy. He explained that BP first reviewed whether the efficiency or technology changed. The conversations occurred locally and allowed the company to prioritize the opportunities locally. He pointed out that the large scale investment opportunities such as the additional rigs and new pads competed globally for investment. He added that the amount of global investment for BP was fixed and all projects competed for the investment.

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Representative Munoz recalled testimony from BP and ConocoPhillips in 2012 stating that \$5 billion in projects were potentially economic in Alaska with a change in the tax structure. She asked how HCS CSSB 21(RES) might affect the economic nature of projects in Alaska. Mr. Bilbao replied that without a final bill to model, BP could not recalibrate their economic model to provide the information. He stated that HCS CSSB 21(RES) made Alaska more competitive for investment, which would present the opportunity for new projects to move forward.

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Mr. Bilbao discussed slide 9: "HCS CSSB 21(RES) versus ACES."

ACES

- Progressivity discourages investors
- Links credits to spend
- Complex
- High base rate

HCS CSSB 21(RES)

- Eliminates progressivity
- Links credits to production
- Simpler
- Higher base rate balanced with credits

Mr. Bilbao determined that HCS CSSB 21(RES) had upside opportunity.

Co-Chair Stoltze asked if risk and reward should be viewed by the committee as antonyms. Mr. Bilbao concurred and stated that that the each investment opportunity presented a risk and reward decision creating a very important equation for BP's decision making process. He noted that HCS CSSB 21(RES) made a policy decision to shift the link from spend to production. He recognized that the shift placed the burden onto the producer to deliver the production in order to capture the benefit of the credit.

Mr. Bilbao stressed the complexity of ACES administration. He noted volatility in the price of oil from month to month could completely shift the cash flow profile. He claimed that ACES made the process of running a business very difficult. He noted that the higher base rate of HCS CSSB 21(RES) was balanced with the credits put in place.

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Mr. Bilbao discussed slide 10: "In Summary."

- TAPS is three quarters empty and ACES has not delivered increased production
- HCS CSSB 21(RES) is a game changer and a signal that Alaska is ready to compete for investment
- The HCS CSSB 21(RES) structure could work:
  - o Balances a high base rate with appropriate credits
  - o Requires production to earn credits
  - o Doesn't pick winners and losers
  - o Provides a foundation for future opportunities

Co-Chair Stoltze noted that the awareness of the public was skewed as seen by a recent poll. The public's opinion about oil flow through the pipeline was not consistent with the data provided to the legislature. He added that the public's opinion as communicated in the poll related to the amount of the state budget derived from petroleum revenue was also skewed. Mr. Bilbao did not receive the poll data yet he agreed that the public was often surprised about the impact of oil on the state's economy.

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Representative Gara asked about slide 4. He referred to the "Fall 2012 Revenue Sources Book," page 35, with projected capital expenditure figures of \$3.36 billion for FY 13 and \$3.8 billion for FY 14. The "Fall 2007 Revenue Sources Book," page 36 illustrated the FY07 historical figure of \$1.578 billion in FY 07 and a \$3.26 billion forecast for this year, which was a 100 percent increase. Next year's forecast was documented as \$3.8 billion for a 130 percent increase. He couldn't understand why DOR provided information displaying such an increase while the information provided in the presentation (slide 4) depicted flat capital expenditures.

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Mr. Bilbao stated that Econ One used slide 4 to illustrate a comparison between Alaska and other jurisdictions, providing an index of spend rather than an absolute. With the comparison provided, Alaska remained flat whereas other areas had increased.

Representative Gara asked if the bulk of the investment increase was related to fracking technology and investment. Mr. Bilbao answered that the technological progress regarding shale and fracking led to a significant increase in investment. He noted that conventional sources of oil had also benefitted from increased investment and production.

Representative Gara asked if the bulk of the increase in spending in the Lower 48 was due to fracking investment. Mr. Bilbao deferred the question to Econ One.

Representative Gara pointed out the elimination of the progressivity element of the bill. The industry would increase earnings with the elimination of progressivity and he wondered about reinvestment in Alaska and out of state.

Mr. Bilbao stated that as new opportunities became apparent, new investment would come to Alaska. He noted a general consensus that progressivity was not working. Progressivity limited the opportunities for Alaska to compete for investment. Investment would flow toward the best opportunities.

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Representative Gara asked if it was realistic to assume that most of what the company would receive due to progressivity's elimination would be spent in other areas globally. Mr. Bilbao responded that if the fiscal policy in Alaska became more attractive for investment, the company would spend more in the state.

Representative Gara referred to a statement by Mr. Bilbao on March 14 in the Senate Finance Committee. He wondered why the testimony was different today regarding progressivity. He quoted Mr. Bilbao as saying "we don't feel that it goes far enough to attract the type of meaningful investment that is required to make the future look different from the last six or seven years." Mr. Bilbao replied that HCS CSSB 21(RES) showed a different combination of base rates and credits than the bill before the Senate Finance Committee. He stated that the process through the various committees led to HCS CSSB 21(RES) and the new balance of base rates and credits was viewed as attractive by BP.

Mr. Bilbao recalled that the Senate Finance Committee version on the bill discussed on March 14th was a "35 percent and 5 fixed credit." Representative Gara concurred.

Mr. Bilbao pointed to a better balance of credits seen in HCS CSSB 21(RES). He furthered that the base rate was higher than it was under ACES, but BP had the opportunity to offset the base rate, otherwise the balance was lost and the bill would not provide the same incentive for investment.

Representative Wilson wondered how many years the state would wait to determine whether the bill would benefit production. Mr. Bilbao replied that producers would initially drill more with a more attractive investment climate. Sizable capital investments, such as new pads would follow and allow companies to drill more. He noted that if the legislature was not satisfied, the policy would be adjusted appropriately.

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Representative Wilson asked how many years until a shift in activity would occur under the bill. Mr. Bilbao responded that a shift should be seen in one to two years.

Representative Wilson asked about the credit shift. She didn't understand why BP would spend money that did not lead to production. She wondered how the current credits differed from those in HCS CSSB 21(RES).

Mr. Bilbao replied that "you get what you incentivize." He relayed that ACES provided a credit for spent. He mentioned a long list of projects that were planned for the North Slope. Many of the projects allowed for a 30 year plan, which would be extended for another 30. The money spent did not ensure new production, but instead ensured that the oil produced was done so safely and efficiently. The plan consumed billions of dollars of investment. He mentioned that if BP did not invest in new drilling and rigs, a decline of 20 percent would be expected in contrast to the current 6-8 percent decline. He noted that BP ran 10-11 rigs annually, prior to ACES, and 6 rigs with ACES.

Representative Wilson was interested to know what investment would occur with the new credits proposed in HCS CSSB 21(RES). Mr. Bilbao replied that shifting to the sliding scale of credits focused the analysis of incremental production.

Co-Chair Austerman asked about the \$8 sliding scale versus the \$5 fixed scale. He wondered if one was preferred. Mr. Bilbao replied that the sliding scale existed because the higher base rate claimed additional business below \$100 per barrel. Below \$100 per barrel, a fixed \$5 did not outweigh the impact of raising the base rate. The sliding scale would allow a credit to offset the impact of the base rate

below \$100 per-barrel. As prices of oil increased, the credit per-barrel decreased and made up the difference.

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Co-Chair Austerman discussed heavy oil. He wondered if a change in the tax changed the technological issue of drilling for heavy oil. Mr. Bilbao responded that the change in tax structure would not alter the technology, but would instead change BP's ability to hire people to work the technology required to drill for heavy oil and also allow enough light-oil to mix with the heavy oil for transport.

Co-Chair Austerman asked if BP did not have the technology available to drill for the heavy oil. Mr. Bilbao responded that the technology was not available to produce and transport the heavy oil down the pipeline in an economic manner.

Co-Chair Austerman asked if it was possible to extract the oil. Mr. Bilbao replied that BP had a successful pilot program to produce heavy oil, but the scale required for commercial quantities was unavailable.

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Representative Costello pointed to the life of a field. She asked for an expansion on the remark that it was up to the legislature to determine the speed of development. Mr. Bilbao replied that additional wells would efficiently extract oil from the ground. He noted that 100 well bores would only produce so much oil.

Representative Costello asked if the company was determining its decline rate. She understood that companies would intentionally buy-down their tax rate. She wondered about BP's focus on qualified capital expenditures with the goal of achieving the desired tax rate.

Mr. Bilbao replied that the decline rate was not chosen by BP. He stated that opportunities that were deemed economic were pursued and the decline rate was secondary. The typical decline rate was 6-8 percent.

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Representative Costello pointed to the presentation placing Alaska last in line. She asked where HCS CSSB 21(RES) would place Alaska. Mr. Bilbao responded that the bill would move the state somewhere in the middle of the chart. He explained that Alaska's operating costs presented challenges with ACES, but HCS CSSB 21(RES) placed Alaska in the middle for that category as well.

Representative Edgmon mentioned government-take and its importance in investment making decisions. He knew that government-take was not the only variable. He imagined that other constraints would potentially undercut the linkage between government-take and investment. He listed constraints such as other global investments, pipeline limitations and refiner capacity issues. Mr. Bilbao replied that there was not an unlimited amount of money available for global investment. He agreed that physical constraints existed regarding equipment, crew and projects.

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Representative Edgmon asked about rumors that BP planned to sell their Alaskan projects after the Deep Water Horizon accident. Mr. Bilbao answered that BP met its financial obligations related to the Deep Water Horizon accident without an impact to its operating budget.

Representative Gara asked about the base rate. He stated that the bill contained two base rates, one for new oil and one for existing oil. He asked about the 33 percent rate, which was the maximum rate at \$150 per-barrel, while the base rate was 25 percent. Mr. Bilbao disagreed. He understood that the base rate was 33 percent, which was then offset with a credit-per-barrel for the legacy fields, which was on a sliding scale and linked to the price of oil.

Representative Gara stated that 33 percent would not be achieved below \$150 per-barrel of oil. Mr. Bilbao answered that Representative Gara was referencing the credit per-barrel on the effective tax rate. He understood that the base rate was 33 percent with the credit linked to the amount of production. The legislature had the opportunity to position Alaska appropriately.

Representative Gara clarified that the effective tax rate increased first to 25 percent and then to 33 percent. Mr.

Bilbao answered that he could only read what the CS stated, which was a base rate of 33 percent.

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RECONVENED

SCOTT JEPSEN, VICE PRESIDENT, EXTERNAL AFFAIRS, CONOCOPHILLIPS ALASKA, introduced himself and his colleague. He outlined items he would address. He provided a PowerPoint presentation titled "House Finance Committee HCS SB 21" (copy on file). He began with slide 2: "Alaska Decline Continues While Lower 48 Continues to Increase." He explained the graph and noted that the black line on top depicted Lower 48 production vs. time. The productions corresponded to the Y axis on the left hand side of the chart. The colored lines represented Texas, Alaska North Slope, and North Dakota and they corresponded to the Y axis on the right side of the graph.

Co-Chair Stoltze asked if the graphs in Mr. Jepsen's presentation were a product of ConocoPhillips. Mr. Jepsen replied that the source of the graphs was the U.S. energy Information Administration.

Representative Kawasaki asked if the chart on slide 2 depicted ConocoPhillips' production. Mr. Jepsen replied no, the graph depicted all oil production for the entire North Slope, Texas, North Dakota and the entire Lower 48.

Mr. Jepsen stated that production had increased throughout the U.S. significantly over the last five or six years and was driven by technological advances. He pointed out Alaska's downward trend. He commented on the rich resources in the Lower 48 with the technology to produce both conventional and unconventional opportunities. With good oil prices investment was attractive. He noted that the Lower 48 had a favorable tax environment.

Mr. Jepsen credited Alaska for its rich resources. Technology was a key component to investment in Alaska. He stated that investment was hampered on the North Slope by the ACES tax environment.

Mr. Jepsen moved to slide 3: "Alaska Legacy Fields Still Provide Significant Opportunity." The data source was the Department of Revenue 2009 production forecast for the years 2010 through 2050. The older forecast was used because the department did not offer a similar type of production forecast. He noted that the vast majority of the remaining resource resided in the legacy fields.

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Mr. Jepsen turned to slide 4: "Easy Oil" In the Legacy Fields is Gone:"

Challenged oil remains

- Complex, high cost wells
- Smaller reserve targets
- Isolated fault blocks, flank oil
- Satellites and viscous oil
- Most new wells produce oil and water
- Facilities handling ~three times as much water as oil

A billion dollars does not go as far as it used to...

- 2000 alpine development: ~80,000 BOPD
- 2012 CD-5 Drillsite: ~18,000 BOPD

Mr. Jepsen explained that coil tubing drilling technology was progressing. The technology provided a cost-effective way to recover oil from isolated fault blocks. He explained that existing well bores were utilized to drill horizontal wells in an attempt to reach additional pockets of oil. He mentioned the drilling of an octolateral well, which had eight separate horizontal legs. The wells were complicated and expensive.

Mr. Jepsen mentioned the development of satellites in Kuparuk and Prudhoe Bay, which required vast new infrastructure. He noted that development of oil around the flanks of the field was another technological goal. Some circumstances required new pads. He noted the extension of the Kuparuk reservoir and the potential to further development of the field. The particular development was projected to take three years.

Mr. Jepsen mentioned that viscous oil was another opportunity for ConocoPhillips on the North Slope. He mentioned that multiple wells were producing both oil and

water as a function of the recovery techniques used. The challenge of extracting both oil and water added to the expense.

Mr. Jepsen informed the committee about cycle time. Cycle time included the amount of time required to drill and extract oil from a virgin site. He mentioned the CD-5 drill site for Alpine.

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Mr. Jepsen spoke to costs (slide 4). He mentioned \$1.4 billion spent on the initial Alpine development shown in the upper right hand picture of the slide, which produced approximately 80 thousand barrels per day. He pointed to costs related to CD-5 that would cost approximately \$1 billion to develop and yield 18 thousand barrels per day. He stressed that the environment was cost challenged.

BOB HEINRICH, VICE PRESIDENT FINANCE, CONOCOPHILLIPS ALASKA, addressed slide 5 related to the impact of ACES on the company's investment. The bottom axis of the chart related to the ANS West Coast oil prices and the vertical axis pertained to the industry's marginal share. He discussed the reason the state's share increased as price increased (represented by the black line) because of effective progressivity. He communicated that less than 20 percent of ConocoPhillips' earnings were retained by the business. He noted that marginal share had the ultimate impact on decisions made.

Mr. Heinrich moved to slide 6 titled "Earnings Per Barrel - ConocoPhillips Alaska and State of Alaska." During the period shown, earnings fluctuated between \$21 and \$25 per barrel of oil. Oil prices had moved from \$70 to about \$110. The company did not make much more as prices increased; however the state's share increased approximately 90 percent. He stated that if the share between the state and the industry was more evenly split, Alaska would be viewed as more attractive. He made remarks related to the company's earnings and discussed the taxes it had paid. He stated that for every dollar it earned over \$2 was paid in taxes.

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Mr. Heinrich turned to slide 7, "ConocoPhillips Capital Allocation" and discussed how the taxes impacted the company's investment in the state. He shared that ConocoPhillips had seen a flat budget over the past few years in Alaska, while the Lower 48 saw a three-fold increase in capital spending. He stated that the company's dollars were following investment opportunities in oil rich areas with attractive fiscal structures.

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Mr. Jepsen looked at slide 8: "Government Take Competitiveness." The slide had been presented by Mr. Bilbao earlier in the meeting and was generated by PFC Energy. He discussed government take competitiveness. He stated that the bill before the committee would result in change, but more competitiveness would make a larger shift.

Mr. Jepsen directed attention to slide 9 titled "Changes to ACES to Improve Alaska's Investment Climate." He stated that the elimination of progressivity was the bill's key objective. The company's objectives included the elimination of progressivity, the creation of a flatter tax rate over a broad range of prices and the establishment of a tax structure creating an attractive investment climate. He stated that the bill had a slightly progressive tax structure, but was a significant improvement over ACES. The bill addressed tax increases at lower prices relative to ACES and a hard minimum tax provided more revenue to Alaska at low prices. The 33 percent base rate was an improvement and the bill increased the likelihood that participating area (PA) expansions would receive the Gross Value Reduction (GVR).

Mr. Jepsen stated that ConocoPhillips believed that HCS CSSB 21(RES) created an environment that would lead to increased investment and additional production. He added that ConocoPhillips reviewed HCS CSSB 21(RES) and believed that investment decision making would change as a result of the bill, but until the final legislation was available, he could not commit to individual projects.

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Co-Chair Stoltze asked if Mr. Jepsen planned to communicate the changes in Alaska's tax structure to the company's board members. He asked how the legislation would wedge

more capital. He asked about the company's hopes and aspirations.

Mr. Jepsen relayed that geologists and engineers identified initial project opportunities. The next step included feedback from project engineers who would estimate the project cost. A multi-year analysis would then be conducted, analysts would look at cash flow and net income to analyze the cost, and depending on the cost the decision could either be made locally or at the highest company level (board of directors).

Mr. Heinrich expounded that the company redefined its focus on growing production and redefining margins at the corporate level. He elaborated that the margin would be increased through production growth and investment in liquid rich oil plays around the world. He stressed that Alaska was competitive for those higher margin opportunities.

Co-Chair Stoltze asked if the bill represented a battering ram or an Allen wrench. He wanted to understand the significance of the legislation to ConocoPhillips.

[3:31:45 PM](#)

Mr. Jepsen replied that the bill represented a significant change to the investment environment. He stated that ACES provided a large barrier to investment in Alaska. He pointed to slide 6 and noted that the data provided summarized the difficulties presented by Alaska.

Co-Chair Stoltze surmised that geology alone did not provide adequate incentive for industry investment. Mr. Jepsen affirmed.

Representative Gara discussed public reports of ConocoPhillips' profits in Alaska for multiple years. The reports depicted increases in profits that correlated with the price of oil. He asked how Mr. Jepsen could defend his statement that ConocoPhillips did not benefit from higher prices of oil in Alaska. Mr. Jepsen replied that while profit increased, the state share also increased. He opined that the ratio between state and industry share was disproportionate.

Representative Gara asked about the CD-5 unit and whether it was an Alpine satellite. Mr. Jepsen replied that the CD-5 unit was considered an Alpine drill site.

Representative Gara understood that the CD-5 project was initiated during the ACES regime.

[3:34:54 PM](#)

Mr. Jepsen replied that the decision regarding the CD-5 development was made prior to the ACES regime. ConocoPhillips remained optimistic that they would see ACES changed.

Representative Gara pointed out that ConocoPhillips proceeded with the CD-5 project despite the unknown fate of the ACES regime. Mr. Jepsen replied in the affirmative.

Representative Gara pointed to slide 2. He discussed the shale play in the Lower 48 and its place in the increases shown in the graph. He understood that conventional oil in North Dakota and in Texas remained relatively flat. He surmised that shale oil was the primary reason for increased investment in the Lower 48. Mr. Jepsen replied that maintenance of a flat production in conventional oil was an accomplishment. He agreed that the increases were largely seen in the conventional oil categories, but the investment made in conventional oil could not be trivialized.

Representative Gara referred to an article published in Petroleum News that paraphrased executive vice-president Matthew Fox stating that ConocoPhillips was committed to spending \$2.5 billion in Alaska over the next 5 years. He asked about the accuracy of the statement.

Mr. Jepsen replied that in the context the statement was accurate. He furthered that it was a continuation of the company's existing level of activity. He stated that there was a fairly long disclaimer that the company's investment plan could change if the environment changed. He appreciated the positive press for Alaska, but noted that the situation could be even better if the tax environment was altered.

[3:39:31 PM](#)

Representative Gara referenced a quote from an investor conference from Senior Vice-President, Greg Garland in 2011 stating that Alaska had strong cash margins and good rates of return. He wondered if the statements were accurate. Mr. Heinrich responded that it was a matter of describing the portfolio. With a portfolio that was predominately gas production, the 95 percent revenues and margins generated in Alaska did represent strong margins relative to a larger portfolio. He added that the Lower 48 saw 70 percent gas production, so the comparison with Alaska was not entirely accurate. He agreed that the earnings in 2011 were in excess of the corporate average.

Representative Gara spoke to the possibility of eliminating progressivity and the potential for the state to face an \$800 million loss as a result. He asked if ConocoPhillips would enter a contract costing \$500 million with another company that could not guarantee a response. Mr. Jepsen replied that his company would still pay a significant tax rate in Alaska. He clarified that his company could not guarantee production in specific projects. He did believe that the passage of HCS CSSB 21(RES) would lead to more investment.

Representative Gara asked how much investment. Mr. Jepsen replied that the investment decisions were outside of his authority.

Representative Gara provided a scenario in which ConocoPhillips handed over \$500 million to another company without commitment. He wondered if contracts of that nature were common in the oil industry.

[3:43:48 PM](#)

Mr. Jepsen believed the issue was related to public and tax policy. The right tax environment would yield more investment.

Representative Gara spoke to the CD-5 deadlock. He wondered if exploration would occur in additional units if the bill passed. Mr. Jepsen responded that ConocoPhillips was drilling an exploration-well in an attempt to maintain a lease. He stated that ConocoPhillips was an active explorer in Alaska. He mentioned federal land issues with the Alaska National Wildlife Refuge (ANWR) and the National Petroleum Reserve Alaska.

[3:45:47 PM](#)

Representative Costello noted that the company spent millions of dollars with no commitment from mother earth to yield oil. She wondered if the company could provide a sense of the top criteria used when making investment decisions.

Mr. Heinrich replied that there were multiple layers and parameters involved. He pointed to a timeline and spoke to a time when the company had spent capital dollars on gas acquisitions. The world had changed for oil producers due to the unconventional plays. The company was now focused on oil production, which was valued greatly by the market. He mentioned very high level strategies that companies would focus on. He discussed an array of opportunities of NPVs, Internal Rate of Return (IRR) and long-term cash flow as applied to Organization for Economic Co-operation and Development (OECD) countries. The type of activities in Alaska fit well with the current strategies.

Representative Costello asked about the cost of doing business in Alaska.

[3:50:04 PM](#)

Mr. Jepsen answered that costs were significant in Alaska. He pointed to a slide from PFC Energy related to average costs of investment in Alaska versus the Lower 48. He pointed to other environmental factors that made investment challenging in the state.

Mr. Heinrich added that costs and timelines ultimately comprised the metrics used. The types of items listed by Mr. Jepsen factored into the decision.

Mr. Jepsen expounded that cash flow also played a part. He noted that cash flow was compromised considerably under ACES.

Representative Costello asked if the company would be motivated to change its investment behavior if the legislation passed. Mr. Jepsen replied that the company did not "game" systems.

Representative Munoz asked about projects that had not occurred after ACES had been implemented. Mr. Jepsen pointed to a viscous oil project in North East West Sak that would have required 100-plus wells. He mentioned that BP also had a project that had not gone forward after ACES was implemented.

Representative Munoz asked if the bill provided sufficient incentive to increase investment. Mr. Heinrich answered that the comments had been made when the tax was at 35 percent compared to the current 33 percent proposed in HCS CSSB 21(RES).

Representative Kawasaki asked about the North East West Sak project. He wondered if a change in ACES might allow the project to proceed. Mr. Jepsen replied that technical problems existed in the project and would be prioritized by ConocoPhillips. He believed that a change in tax structure would position the project to compete more favorably, than if the change had not been made.

Representative Kawasaki asked about the company's international investment. Mr. Jepsen did not believe the company was invested in Sakhalin Russia, but he believed the company was invested in the other areas worldwide.

Representative Kawasaki asked about investment in Libya. Mr. Jepsen verified the company's investment in the country.

Representative Kawasaki asked about the company's involvement in extreme fiscal regimes. He expressed curiosity about the company's decision to work in those areas. Mr. Jepsen replied that there were many reasons the country invested in those countries and many times it was related to investment potential. Mr. Heinrich added that ConocoPhillips was prevented for a number of years from managing their assets in Libya, but had recently been allowed to seek developing opportunities. Mr. Jepsen added that Malaysia provided a high cash margin for the company.

[3:58:44 PM](#)

Representative Kawasaki pointed to slide 7 related to Conoco's capital allocation. He referenced a recent article related to investment and shale. He pointed to a different article where the company's CEO wanted to invest in

opportunities in the Lower 48. He stated that it was important for the legislators to see revenue come back to the state in the form of production. He asked about the company's strategy. Mr. Heinrich replied that cash margin returns were significant in the Lower 48. The fiscal environment for ConocoPhillips improved with those higher cash margins.

Representative Kawasaki clarified that the cash flow earned by ConocoPhillips in the Lower 48 was \$40 to \$50 while Alaska offered \$30. He asked if HCS CSSB 21(RES) would bring Alaska to similar cash flows. Mr. Jepsen replied that HCS CSSB 21(RES) would not provide Alaska the same cash flow as other states. He pointed to various items that impacted a company's investment decision. He stated that the North Slope had not been built with money made in Alaska. He believed there would be economic chaos if money had to be constrained in the place it was made.

[4:02:51 PM](#)

Representative Wilson asked what would happen if North Dakota chose to raise their taxes. Mr. Jepsen replied that it would have a negative impact on additional investment in North Dakota.

Representative Wilson asked how the company could ensure the state that Alaskan's would be put to work. Mr. Jepsen replied that the company's statistics pointed to 88 percent of Alaska workforce, and 70 percent of operators on the North Slope resided in Alaska. He believed the numbers were good in comparison to other industries in the state. One of the company's key objectives was to hire Alaskan workers.

Representative Wilson asked if a mandate was not needed to ensure Alaska hire in HCS CSSB 21(RES). Mr. Jepsen did not believe a mandate was necessary.

[4:05:19 PM](#)

Representative Wilson asked about slide 8. She wondered which arrows on the slide addressed ConocoPhillips, ExxonMobil and BP. He pointed to various arrows and how they pertained to the data.

Representative Wilson asked if the company would move to another arrow if classified as a new field. Mr. Jepsen answered in the affirmative.

Representative Wilson asked if the state was giving money to ConocoPhillips or taking less from them. Mr. Jepsen responded that the change in tax structure took less money from the company's earnings.

Representative Wilson encouraged the company to remember gas production and its importance in Alaska.

Co-Chair Stoltze made a remark about local hire.

Representative Gara pointed to slide 8. He noted that many other countries charged higher taxes than Alaska. Mr. Jepsen replied that there were not very many, but there were a handful.

Representative Gara asked about a premium the state should receive for its safe geopolitical environment. Mr. Heinrich replied that the political risk issue was difficult to quantify. He discussed investment in Venezuela during a period following nationalization in the country. He noted that ConocoPhillips interest was in new heavy oil projects. He explained that Venezuela had offered favorable royalty relief and favorable income tax rates that created attractive opportunities.

[4:10:23 PM](#)

Mr. Jepsen added that reserve replacement was a key element of the business. The company required large global opportunities to retain the key element. The issue was whether the company could increase investment in Alaska.

Representative Gara noted that Venezuela did not have a history of being a stable country. He stated that Alaska had a royalty relief statute, which states that if the tax rate prevented a new development, an application process was available to allow a company to prove that the tax rate deterred the development. He asked why the relief valve was not utilized by ConocoPhillips. Mr. Jepsen noted that royalty relief was not necessary to the company to increase investment. The company's agenda was to reposition Alaska to compete for capital.

Representative Gara appreciated that ConocoPhillips reported their Alaska profits.

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[4:33:21 PM](#)

RECONVENED

DAN SECKERS, TAX COUNSEL, EXXONMOBIL, discussed the "Testimony of ExxonMobil on Alaska's Investment Climate to the Alaska House Finance Committee on April 8, 2013"(copy on file).

[4:35:23 PM](#)

Mr. Seckers believed that HCS CSSB 21(RES) would make Alaska more competitive, which would result in more work for Alaska. He believed that the bill showed a strong improvement over the ACES structure. He believed that HCS CSSB 21(RES) improved Alaska's global investment climate. He anticipated that industry would reexamine the inventory of all North Slope investment opportunities once ACES was reformed. He discussed the attractiveness of Alaska in comparison to other opportunities. He expressed concern regarding the connection of the sliding scale to price aspect of HCS CSSB 21(RES). He believed that the base rate in HCS CSSB 21(RES) was too high.

Mr. Seckers informed the committee that Alaska remained a critical component to ExxonMobil's worldwide global portfolio. He was committed to working with the governor and the legislature to help Alaska reach its goal for more production. The need for Alaska to develop a competitive, attractive and stable fiscal regime was an important state issue. He noted that HCS CSSB 21(RES) was a tremendous improvement over ACES. He stressed the belief of ConocoPhillips that if the legislation was enacted, investment and activity would increase in the state.

[4:38:43 PM](#)

Co-Chair Stoltze recalled different tax regimes. He understood that a company's bottom line was primary for the company. He asked about ExxonMobil's unwillingness to pinpoint a rate.

4:39:55 PM

Co-Chair Stoltze noted that he wished to work toward tax reform. Mr. Seckers stressed that the rate established would not be perfect for everyone. He recommended that the committee rely on information from consultants who provide an independent and impartial view to the discussion. He was encouraged by HCS CSSB 21(RES) and believed that it provided a significant improvement over ACES.

4:40:55 PM

Representative Wilson asked about a lower base rate. She expressed curiosity about how far the state might need to drop to reach the level of a new oil field. Mr. Seckers replied that PFC energy and Econ One were the experts on the issue and he deferred the question to them.

Representative Wilson wished to know the presenter's opinion. She stressed the importance of Alaskan hire and asked how the company would address the issue. Mr. Seckers replied that ExxonMobil strived to hire locally. He noted that the Pt. Thompson activities required local hire as part of the corporate policy.

4:43:17 PM

Representative Gara asked about ExxonMobil's investment in shale plays in North Dakota. Mr. Seckers replied that ExxonMobil had a subsidiary known as XTO Energy that was active in the unconventional Lower 48 plays.

Representative Gara sensed that the tax rate could never be low enough. He pointed out that North Dakota was often portrayed as an ideal tax environment. He recalled a recent effort in North Dakota to lower taxes because the oil companies had deemed them uncompetitive. He asked if ExxonMobil supported the tax reduction in North Dakota. Mr. Seckers replied that he did not know.

Representative Gara understood that the company's profits would not be shared with the committee. Mr. Seckers replied that investment information was confidential.

Representative Gara requested profit information from ExxonMobil for Alaska. Mr. Seckers replied that his company provided information through DOR regarding activities and

investments in the state, but the information was taxpayer confidential.

Representative Gara asked how the legislature could evaluate claims that ExxonMobil was not earning enough profit in Alaska if the information regarding profit margins was confidential. Mr. Seckers replied that the consultants had demonstrated that Alaska was not competitive.

[4:46:17 PM](#)

Representative Gara recalled testimony from another representative of ExxonMobil that profits were comparable to those of ConocoPhillips. He asked if the information was applicable today. Mr. Seckers replied that he had no reason to doubt that the information would be applicable today.

Representative Gara asked about the effort to reduce taxes if the state wished to see new oil. He asked if ExxonMobil would embark on new exploration with new units in Alaska if HCS CSSB 21(RES) was passed.

[4:48:06 PM](#)

Mr. Seckers replied that a lease sale encouraged activity. He stated that ExxonMobil explored every opportunity for new oil extraction from the legacy fields. He suggested that "wildcatting" was not in the near-term plan, but an increase of activity was a priority.

Co-Chair Stoltze asked for a definition of wildcatting. Mr. Seckers replied that wildcatting referred to new entrant's exploration in remote areas.

Representative Gara requested commitment to new projects that HCS CSSB 21(RES) would encourage for ExxonMobil. Mr. Seckers replied that Pt. Thompson was progressing well and the company would pursue all competitive and attractive investments.

[4:50:42 PM](#)

Representative Gara asked if the investments were competitive and attractive, would ExxonMobil invest. He recalled Mr. Seckers' earlier statement that the fiscal

regime was not attractive enough as stated in HCS CSSB 21(RES).

Mr. Seckers clarified that ExxonMobil saw HCS CSSB 21(RES) as a tremendous improvement over ACES that would lead to investment increases in Alaska.

[4:51:32 PM](#)

Vice-Chair Neuman asked how industry viewed the risk assessment of the state. He had been advised that changing tax structures frequently was unwise for Alaska. He discussed the decline rate of approximately 40 thousand barrels per day and the impact that had on the state's budget. He noted that operating costs in Alaska would continue to increase despite the reduction in oil production.

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Mr. Seckers replied that ExxonMobil would view stability seriously. The more stable the environment, the easier it is to measure investments against it. He agreed that the decline scenario was a reality and that ExxonMobil hoped to help arrest. He stressed that stability was critical when making investment decisions.

Representative Wilson asked about the credit portion of the bill. She asked how the changes in HCS CSSB 21(RES) would change decisions. Mr. Seckers appreciated the balance sought by HCS CSSB 21(RES). He stated that tax credits had a different economic impact on investments. ExxonMobil reviewed the fiscal regime and other criteria when making investment decisions. Investments would be measured along with the credits to determine how competitive and attractive they could be.

[4:55:52 PM](#)

Representative Wilson asked if the credits were viewed as positive or negative by ExxonMobil. Mr. Seckers replied that HCS CSSB 21(RES) was simpler than ACES because of the uncertainties and variables. He expressed concern regarding a link between investment incentives to price. When the prices increased the dynamic of the evaluation would change.

Representative Wilson asked how he would incentivize the additional production in Alaska. Mr. Seckers replied that the answer was a difficult one because it was up to the state to determine their level of competitiveness. He recommended asking the unbiased state consultants.

[4:58:19 PM](#)

Representative Wilson stated that she wished to ask the question of the industry. She hoped to have the ideal development scenario presented for debate in the committee. Mr. Seckers observed that an adjustment of the base rate would aid in the state's competitiveness.

Co-Chair Stoltze appreciated the issue.

CSSB 21(FIN) am (efd fld) was HEARD and HELD in committee for further consideration.

#sb18

CS FOR SENATE BILL NO. 18(FIN) am

"An Act making, amending, and repealing appropriations, including capital appropriations, supplemental appropriations, reappropriations, and other appropriations; making appropriations to capitalize funds; and providing for an effective date."

CSSB 18 (FIN) am was SCHEDULED but not HEARD.

#

ADJOURNMENT

[4:59:27 PM](#)

The meeting was adjourned at 4:59 p.m.