

ALASKA STATE LEGISLATURE
SENATE SPECIAL COMMITTEE ON TAPS THROUGHPUT

January 31, 2013

1:01 p.m.

MEMBERS PRESENT

Senator Mike Dunleavy, Co-Chair
Senator Peter Micciche, Co-Chair
Senator Anna Fairclough
Senator Lesil McGuire
Senator Berta Gardner

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Senator Cathy Giessel
Senator Hollis French

COMMITTEE CALENDAR

SENATE BILL NO. 21

"An Act relating to appropriations from taxes paid under the Alaska Net Income Tax Act; 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; relating to the determination of annual oil and gas production tax values including adjustments based on a percentage of gross value at the point of production from certain leases or properties; making conforming amendments; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 21

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

01/16/13	(S)	READ THE FIRST TIME - REFERRALS
01/16/13	(S)	TTP, RES, FIN
01/22/13	(S)	TTP AT 3:30 PM BELTZ 105 (TSBldg)
01/22/13	(S)	Heard & Held
01/22/13	(S)	MINUTE(TTP)
01/24/13	(S)	TTP AT 3:30 PM BUTROVICH 205
01/24/13	(S)	Heard & Held
01/24/13	(S)	MINUTE(TTP)
01/29/13	(S)	TTP AT 3:30 PM BELTZ 105 (TSBldg)
01/29/13	(S)	Heard & Held
01/29/13	(S)	MINUTE(TTP)
01/31/13	(S)	TTP AT 1:00 PM BUTROVICH 205

WITNESS REGISTER

JANAK MAYER, Manager, Upstream & Gas
PFC Energy
Washington, D.C.

POSITION STATEMENT: Presented information on Alaska Hydrocarbons Fiscal Systems.

TONY REINSCH, Senior Director, Upstream & Gas
PFC Energy
Parksville, British Columbia

POSITION STATEMENT: Presented information on Alaska Hydrocarbons Fiscal Systems.

TONY TENGS, representing himself
Juneau, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

PAM BRODIE, representing herself
Homer, Alaska

POSITION STATEMENT: Encouraged the legislature to protect the public's interest for the long term.

ROBERTA HIGHLAND, President,
Kachemak Bay Conservation Society
Homer, Alaska

POSITION STATEMENT: Testified in strong opposition to SB 21.

PATRICK SCHLICHTING, representing himself
Delta Junction, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

DAVID OTNESS, representing himself

Cordova, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

KELLY WALTERS, representing himself

Anchorage, Alaska

POSITION STATEMENT: Testified in strong opposition to SB 21.

RACHAEL PETRO, President and CEO

Alaska State Chamber of Commerce

Anchorage, Alaska

POSITION STATEMENT: Testified in support of revising the current oil tax policy.

WILLIAM WARREN, representing himself

Kenai, Alaska

POSITION STATEMENT: Said he had been active on instate gas for years and the governor and industry have let the citizens down.

RICHARD JACOB MAENPA, representing himself

Juneau, Alaska

POSITION STATEMENT: Testified in support of SB 21.

STEVE GIBSON, representing himself

Homer, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

GEORGE PIERCE, representing himself

Kasiloff, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

ERIC TREIDER, representing himself

Homer, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

DAVID TRANTHAM, representing himself

Bethel, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

MONIKA KUNAT, representing herself

Juneau, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

JAVEN OSE, representing himself

Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

AARON GRIFFIN, representing himself

Kodiak, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

ANDREW PETER, representing himself

Homer, Alaska

POSITION STATEMENT: Expressed concern about the direction things appear to be going in Alaska.

DELICE CALCOTE, representing herself

Sutton, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

KATHLEEN PEARSON, representing herself

Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

MICHAEL DZURSLIN, representing himself

Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

LYNETTE MORENO HINZ, representing herself

Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

ED NELSON, representing himself

Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

HARRY WALKER, representing himself

Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

DAVE DARRON, representing himself

Palmer, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

KATE VEH, representing herself

Soldotna, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

JIM BYRNES, representing himself

Eagle River, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

BEN CREASY, representing himself

Juneau, Alaska

POSITION STATEMENT: Testified in opposition to SB 21.

ACTION NARRATIVE

[1:01:03 PM](#)

CO-CHAIR PETER MICCICHE called the Senate Special Committee on TAPS Throughput meeting to order at 1:01 p.m. Present at the call to order were Senators Gardner, Fairclough, Co-Chair Dunleavy, and Co-Chair Micciche.

SB 21-OIL AND GAS PRODUCTION TAX

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CO-CHAIR MICCICHE stated that the purpose of today's meeting is to hear a presentation from PFC Energy and to hear public testimony on SB 21.

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SENATOR FAIRCLOUGH requested information about where the presentation can be found on line.

CO-CHAIR MICCICHE related that the information is on BASIS under the Senate Special TAPS Throughput Committee.

JANAK MAYER, Manager, Upstream & Gas, PFC Energy, introduced himself. He described his work with PFC Energy to provide advice and analysis to the legislature in the context of future Alaska production.

CO-CHAIR MICCICHE said he requested an independent evaluation, with a focus on increasing oil production through TAPS.

MR. MAYER introduced his partner, Mr. Reinsch. He listed the day's agenda.

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TONY REINSCH, Senior Director, Upstream & Gas, PFC Energy, explained that PFC Energy is an above ground risk group with a focus on issues beyond the oil reservoir which impact the success or failure of hydrocarbon exploration and development from global economics and geopolitics to above ground risk issues and fiscal systems. He described his focus within PFC is portfolio analysis and strategy and planning for the largest oil and gas companies globally. He said today's presentation will focus on BP, ExxonMobil, and Conoco Phillips.

CO-CHAIR MICCICHE noted the arrival of Senator McGuire.

MR. REINSCH turned to the first topic on how oil and gas company decision making is made in terms of capital allocation, budgeting, and long-range planning. He said the second part of the presentation would be a portfolio analysis of the three major oil companies and how Alaska fits into their global portfolios.

He began with a graph depicting a company's typical annual planning cycle. Oil and gas companies follow a standardized process aligning the annual budget cycle to the long range plan and corporate strategy. In the first quarter of the cycle, a company will look at its annual strategy review, operating environment, and long range plan, and prepare for a board meeting early in the second quarter of the year. In the third quarter a company focuses on the annual budget and in the fourth quarter the budget is approved.

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MR. REINSCH listed components of the first quarter analysis: strategy, planning and positioning. He discussed how companies analyze markets, new sources, and competition. Companies identify gaps in their planning. They apply their own filters that have to do with metrics and above ground risk, in order to produce strategic options.

He described the budget activity in the third quarter. Most companies are structured around business units. Corporate will provide those business units with their operating assumptions. Based on those assumptions, each unit will come up with a long range plan and a budget for next year's capital allocation. The budget is made during the first year of a five-year plan. Corporate evaluates the budget and sends it back to the unit with added constraints. Eventually, a budget request goes to the board for approval.

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MR. REINSCH related how companies attract capital - the project approval process. He listed stages of an oil and gas development or investment project; exploration, appraisal, development, and production. For each stage, companies have a project approval request form accompanied by an approval of expenditure.

SENATOR GARDNER asked for examples of what "stranded within the strategy of the company" looks like.

MR. REINSCH gave as an example ConocoPhillips' repositioning their global portfolio to focus their upstream more on

Organisation for Economic Cooperative and Development (OECD) basins in order to minimize above ground risk. In doing that, they sold their equity share in LUKOIL. He noted another example when BP sold out of entire portfolios in North America for lack of relevancy. Or, a developer may not have the focus to take on the enhanced recovery requirements of a particular asset, so they will sell it to a company for whom it is relevant.

MR. REINSCH continued to explain approval requests and approval for expenditures, both of which compete for limited capital. The board makes decisions at each stage of project development to amend, suspend, or divest.

MR. REINSCH turned to a graph depicting business control architecture of six years of cyclical planning. There are activities that extend well beyond a fiscal year. The capital budget in a given year consists of activities that have successfully competed for scarce resources and attracted capital to those activities.

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He addressed the question to what basis does a company allocate investment capital to opportunities, or how the projects compete for capital. He pointed out that a project will compete for capital within a basin, with like activities within a portfolio, and with all activities within a portfolio. For example, an enhanced recovery project in Alaska will compete for capital against other capital expenditure opportunities in Alaska, against enhanced recovery projects elsewhere, and against simple capital investment within those portfolios. It is also competing against alternative uses of capital, such as paying down debt or paying shareholders. He noted that ExxonMobil creates capital scarcity within their portfolio by allocating a significant share of their available funds to shareholder returns.

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CO-CHAIR MICCICHE asked if companies divide capital investment by business units and have areas of no investment because other projects are more attractive.

MR. REINSCH explained, if a business unit has received approval for an activity request, that capital is secure and is allocated. Competition is at the next stage.

CO-CHAIR MICCICHE understood that there could be business units that receive no capital.

MR. REINSCH said yes.

CO-CHAIR MICCICHE said even if a unit was a core interest of that company, the company can choose not to fund it.

MR. REINSCH said if the business is core to the operation, there is a level of production and on-going capital commitment and requirement. However, even within core business units, some are not competitive.

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MR. REINSCH listed the five elements of upstream financial metrics: growth, profitability, efficiency, cash flow, and risk. He described growth as managing the "top line." It involves compound average growth rate (CAGR) in production and reserves relative to the target, quality of growth, and plowback rates.

He explained profitability as the ability to manage the "bottom line," the upstream cash flow, net income, and production costs.

SENATOR GARDNER asked what CAGR is.

MR. REINSCH said it is compounded average growth rate.

He explained efficiency as the ability to manage capital, either from operations or from shareholders. The return on capital employed (ROCE) is one measure, as is finding costs.

He defined cash flow as the ability to manage investments and reinvestments in the portfolio. He said risk is the ability to manage a diversified portfolio.

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MR. REINSCH explained project selection and decision metrics such as the pay-out period and internal rate of return (IRR), a discount rate that equates costs and revenues. He related that net present value (NPV) is bringing the present values of the cost stream and the revenue stream together to occur at a point in time in order to measure net gain. If the NPV is greater than zero, it means the project is expected to deliver a return to the company that is greater than the cost of development. It includes a return on the capital invested.

CO-CHAIR MICCICHE asked about maximum negative cash flow exposure and capex/boe.

MR. REINSCH replied that maximum negative cash exposure is investing capital long before break even position. Is a companion to "pay-out period" and is particularly relevant to very large and long-life capex projects, such as major deep-water development, liquefied natural gas developments, or oil sands projects. A company may be putting capital out for four or five years before production.

CO-CHAIR MICCICHE suggested that might also be seen in shale or heavy oil production.

MR. REINSCH pointed out that shale projects return their investment very quickly. They are low cost wells and are characterized by very high initial flow rates, very steep declines, and very long plateau periods. They attract small investors who can test their theories and technological advances and get funds back quickly. He noted that Alaska has a mix of small investor projects and very large capex projects.

He said capex/boe, or cost per barrel of production capacity, is a measure of a project by accounting for the capital that was spent or burdened with shared facilities that it is benefitting from. It tends to favor developments that are less complex and less capital intensive.

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MR. REINSCH spoke of the advantages of NPV. One advantage is that time value can be incorporated. It can be calculated exactly. It can accommodate risk through discounting of costs and/or revenue flows. It can encompass opportunity cost of investment capital. The sole disadvantage with NPV is that it is difficult to rank projects. Significantly different capital and expenditure profiles can deliver the same NPV due to the effect of discounting.

MR. REINSCH defined internal rate of return (IRR). It is the discount rate that equates all future cash inflows to outflows at a point, usually the present. The value of an IRR is that it can be compared to a required minimum or hurdle rate. It helps companies allocate capital within a portfolio of competing opportunities.

MR. REINSCH showed charts that depict capital allocation and the IRR hurdle rate. The projects are ranked from highest IRR to lowest IRR. Eligibility for consideration for capital means that all projects are showing positive attributes. For example, they will all have a positive NPV, a positive return to the

investment dollar, and acceptable payback terms. Corporate will establish a hurdle rate for IRR. Projects with IRR's equal to or greater than the hurdle rate will be undertaken.

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MR. REINSCH spoke of issues with IRR hurdle rate. If there is an increase in cash flow from high oil prices, there is more available capex to spend on projects. In that case, companies may lower the hurdle rate and extend their risk horizon. The problem is that if the hurdle rate is lowered, the company may be taking on projects that are less lucrative and less competitive. This is reflected sometimes in "cycles of value destruction" and gaming the system. He explained problems with projects that are exposed and generate low rates of return.

CO-CHAIR MICCICHE asked if larger integrated companies have a higher IRR hurdle than smaller independents.

MR. REINSCH suggested it was the inverse; smaller companies tend to be risk companies. At the other end is ExxonMobil that has little interest in risk. Most companies fall somewhere in between.

MR. REINSCH related what "gaming the system" means. In a business that involves attracting capital, there is a real incentive for project managers to overstate the size of the prize or to understate the cost. There are standards in place that help to eliminate that behavior.

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MR. REINSCH discussed return on capital employed (ROCE). He said it is the net profit before interest and taxes, divided by gross capital employed, times 100. He talked about upstream and corporate, and compared independents.

He explained return on capital employed (ROCE) and issues with ROCE. He said ROCE is a measure of how successful and efficient a company is at investing the money that has been given to it. ROCE tends to increase with production and prices and it favors a mature portfolio. He featured charts that depict upstream and corporate ROCE amongst global players and amongst independents. The global players compete on efficiency so ROCE is extremely important. The independents compete on growth. There is a great difference between ROCE for larger global players, who in 2011 averaged 20 percent, and independents who averaged 11 percent.

MR. REINSCH spoke of issues with ROCE. Major capital projects, which increase the denominator in the equation, will weaken the ROCE performance. He said that ROCE favors mature assets.

SENATOR GARDNER asked why ROCE favors mature assets and at what point would a company consider stripping off assets. She wondered if Alaska is at that point.

MR. REINSCH said Alaska is an interesting mix of basin opportunities due to the variety of fields and situations. Field life is an economic concept. He related that Alaska has mature fields, enhanced recovery opportunities, new fields, offshore exploration, and stranded gas. There are also unique contractual structures. The big three play a part. All those are facts unique to Alaska.

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SENATOR GARDNER asked if Mr. Reinsch would talk more about the unique contractual structures.

MR. RAINSCH said that Mr. Mayer would address that issue.

CO-CHAIR MICCICHE questioned the idea that depreciation creates bias in favor of a mature portfolio. He asked if investment interest in a field were to be regenerated, if the bias would be eliminated.

MR. REINSCH said an enhanced recovery program of a mature field stands alone and does not receive the benefit of the maturity of the asset to which that capital is being deployed. The enhanced recovery activity is a brand new project. The company may or may not burden it with shared facility costs. It is an independent decision.

He used BP's 40's field that was sold to Apache as an example. That field today has produced out all of the reserves it was believed to have at purchase, and it still has more reserves. It was a tremendous success for Apache and BP would not have taken it on.

CO-CHAIR MICCICHE commented that with the right incentives, a field could still draw investment.

MR. REINSCH said the point is that the investment has to compete on its own.

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CO-CHAIR DUNLEAVY asked if BP left the field unaware of the reserves.

MR. REINSCH explained that BP recognized the field's possibilities, but it no longer had an interest due to opportunities or higher returns elsewhere. Apache, on the other hand, was in a capital spending phase.

CO-CHAIR MICCICHE asked if there were factors that could have been created to make the field competitive to BP.

MR. REINSCH replied that neither BP nor Apache foresaw the dramatic increase in crude oil prices over the life of that asset. High oil prices have saved a number of otherwise marginal investment decisions. Gas prices in North America currently are bringing into question what otherwise would have been good investments in on shore development. He could not say that Apache saw something BP did not. Apache had a different set of global opportunities they had captured and were looking to allocate capital towards.

CO-CHAIR DUNLEAVY asked if sometimes smaller companies are less risk adverse.

MR. REINSCH agreed, but for this example it was more a matter that the 40's field was an asset to Apache and the acquisition became the focus of their company. It was less of a risk issue and more of a capital focus issue.

SENATOR GARDNER asked if this is an example of natural progression in field development.

MR. REINSCH said yes, especially in North America. The industry has developed in this manner. He described a variety of ways consolidation takes place.

SENATOR GARDNER asked if there is a period of time between when assets mature and companies are ready to divest and move on.

MR. REINSCH called it "harvesting" when a field generates free cash flow that is being invested elsewhere. He used the UK North Sea as an example of a harvest portfolio within global players; however, for other companies the UK is considered a focus area for growth and development as they acquire UK North Sea assets.

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SENATOR GARDNER requested information about when the UK changed its tax regime and investment increased. She wondered if the investment increased for harvest producers or in the next generation of producers.

MR. REINSCH explained that the UK government uses its fiscal system for behavior modification to incentivize exploration and development. He termed that method "a risky game" because fiscal system changes have unforeseen consequences.

CO-CHAIR MICCICHE said a recent uptick in the UK was that it incentivized current players in order to increase production, similar to what Alaska is proposing to do. He said he thought that was what Senator Gardner was referring to.

MR. REINSCH said that was true. All production profiles of the major company portfolios in the North Sea have been trending downwards for a decade regardless of incentives. All companies have been generating cash flow to invest elsewhere. Offering incentives for small companies looking to grow portfolios in the UK has had a positive impact.

SENATOR GARDNER asked if SB 21 would cause that same effect - of the majors investing elsewhere.

MR. REINSCH stressed that the capital allocation decision is a relative decision. He said, "If you are augmenting the investment activity in a particular field or basin, all else being equal, you will improve the chances of that investment activity attracting capital within a global portfolio." He added that a good way to attract capital is by enhancing project economics; improving IRR and NPV.

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CO-CHAIR DUNLEAVY referred to a model where levers are used, such as in the UK and Alberta. He asked if Alaska is viewed similarly.

MR. MAYER responded that the UK is characterized as being very high in terms of sovereign risk due to constantly changing terms and in terms of regimes where governments pull levers at a micro-level, rather than simply setting broad and stable terms. He said Alaska is also characterized that way; it is characterized as a regime that is not competitive and not attractive. He gave an example of the use of a "lever" when the state proposed a tax credit for the best jack up rig in the Cook Inlet.

CO-CHAIR DUNLEAVY asked if the view of Alaska is that it likes to tinker.

MR. MAYER agreed.

CO-CHAIR DUNLEAVY asked if that enhances investment or not.

MR. MAYER explained when a company is making large capital investments that repay over decades, what is most important is stability in fiscal terms. He gave an example of Pioneer and Oooguruk with good economics under ELF, and then less so under PPT, followed by challenging economics under ACES.

CO-CHAIR DUNLEAVY stated that Alaska has plays such as those that are found elsewhere in the world. He inquired if the industry views Alaska as having a lot of potential.

MR. REINSCH said yes. For example, Alaska is core to ConocoPhillips. He added that Alaska has a lot of opportunity, but also has a challenging operating environment. Entry to Alaska is difficult because there is not a lot of asset sharing or opportunities for new players to position in mature assets. High potential growth opportunities, such as deepwater exploration, are very challenging, as is the Arctic paradigm.

He noted the technology of gas commercialization is giving new life to Alaska. He said there are many opportunities in Alaska. He agreed with Mr. Mayer that stability is key.

CO-CHAIR DUNLEAVY asked for an example of a place that does not tinker.

MR. MAYER said there were many examples. He used Australia's federalized system and U.S. federal offshore as examples of straightforward systems with well-designed tax systems. They shed risk from the government and put it on the private sector. He described the economics of a system that rewards for that risk with no micromanaging and has long-term stability.

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CO-CHAIR MICCICHE asked why Texas's conventional oil production has increased, while Alaska's has declined. Both states enjoy the increase in the price of oil. He questioned why the economics in Texas are more attractive than Alaska's.

MR. MAYER explained that two things make the production of conventional and unconventional oil more attractive in Texas: lower cost of drilling and lower government take.

MR. REINSCH began part 2 of the presentation, which addresses the global strategy and portfolio overview of major Alaska producers: BP, ConocoPhillips, and ExxonMobil. He said he would discuss portfolio composition and the growth/capex focus of the major companies. He said he would answer the question about where these companies are looking to grow and which plays and basins are attracting investment capital. He noted that the majors in Alaska are amongst the ten largest global international oil and gas companies. ExxonMobil is the largest of all companies and the largest privately traded entity in the world. Each of the major companies in the last three to four years, has hit a major strategic wall.

MR. REINSCH began with BP and its challenges. He said BP has taken the disaster in the Gulf of Mexico and turned it into an opportunity by repositioning its portfolio globally. They sold, and bought back, roughly \$30 billion in assets and changed their growth strategy: deepwater basins, global gas, and giant oil fields. On a performance basis, BP exposed a lot of capital to grow. It agreed to sell its Russian production and reinvest in Rosneft, focusing on the Arctic play.

He turned to a chart that shows BP's focus areas and a very large exit portfolio.

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CO-CHAIR MICCICHE asked why UK is considered only a harvest area in BP's portfolio.

MR. REINSCH showed a chart of regional trajectories, which shows a European decline in production for BP. The reality of the North Sea decline is because BP takes free cash flow from there and reinvests it in other areas, such as Africa or in the Middle East. He pointed out that BP's future growth will come from elsewhere.

SENATOR GARDNER asked, if Alaska is pulled out from the North American data, whether the profile would look the same as Europe or different.

MR. REINSCH replied that it would look a lot like Europe with a large decline.

SENATOR GARDNER pointed out that in Norway the government take is higher or comparable to Alaska's. In spite of the UK's recent reduction in government take, the profile shows a decline in production out to 2020.

MR. REINSCH agreed. He said this data consists of PFC Energy's modeling of each company's portfolio and does not include forward exploration success.

CO-CHAIR MICCICHE asked what is different about Alaska - so Alaska could expect greater fiscal certainty in a reduced government take. He inquired about the probability of Alaska not ending up looking like the UK.

MR. MAYER explained that the major differentiator is the enormous potential in Alaska, even with challenging access to the resources. He noted that there are many future unknowns, such as future of the shale resource.

CO-CHAIR MICCICHE asked if the investment world accepts that UK does not have the same potential.

MR. MAYER replied that the UK is not deemed to have similar resources.

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MR. REINSCH added that the UK/North Sea has reached a stage where the remaining resource basin and the field size distribution is material for smaller companies. Alaska has a very different reality.

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MR. REINSCH turned to global areas of upstream operations by BP. He reviewed the types of operations depicted: core, focus, harvest, or new venture.

He explained a graph that shows BP's production and how it compares to the competition. He pointed out that BP has been through a tremendous change. He said the impact of its Russian portfolio sale, TNK-BP, would yield a production floor of 2.3 to 2.4 million barrels a day (mmboe), a tremendous decrease. If they are successful in positioning within Rosneft, BP would receive that millions of barrels a day back by securing 20 percent equity stake in Rosneft.

He showed a chart called regional trajectories of BP's. It shows growing trends; where the company has been focused. The assumption is that BP would reposition in Rosneft. He related growth in various areas and said that BP is looking for a lot of capital investment, both in unconventional resources plays in the Lower 48 and in the oil sands development potential in Canada.

He highlighted BP's portfolio in Alaska.

He turned to BP Alaska activity and PFC Energy's assessment. He explained that Alaska is considered a harvest area. He suggested focusing on PFC Energy's assessment of BP, "Current production volumes are modest and declining. Significant potential lies in the long-term commercialization of Prudhoe and Point Thomson gas resources. Cancellation of the Denali gas pipeline proposal leaves BP as a potential supplier to an alternative pipeline/LNG export option, should one be approved and developed."

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He focused on BP's six challenges, as identified by PFC: bring a close to the portfolio rationalization process, reposition in Russia, develop a deepwater partnership in Brazil with Petrobras, develop the U.S. unconventional gas resource, and accelerate the development of oil sands leases in Western Canada.

MR. REINSCH moved on to discuss ConocoPhillips. He related that in 2010 ConocoPhillips committed to execute on a full portfolio repositioning plan that has resulted in a significant divestiture of assets. It included a departure from equity interest in LUKOIL, the entire proceeds which were put towards debt reduction and shareholder returns. This approach is very different from BP's approach.

He continued to say that in 2011 and executed in 2012, ConocoPhillips separated the company into two separate corporate entities. The net impact has been a significant decline in production. The company is looking to grow from global gas/LNG, oil sands, and unconventional resource development.

MR. REINSCH looked at ConocoPhillips' global portfolio, or areas of upstream operations. He said the company sees that deepening their position in relatively stable, above ground operating environments, separates them from their competitors. Their asset

divestitures have been largely focused on moving out of areas that did not fit that goal.

He looked at the total portfolio evolution for ConocoPhillips as a pure play independent versus their competition. He described a chart that shows rapid growth from 2001 until 2011 and a forecast of staying at 2011 production levels in 2016.

He presented a chart with regional trajectories for ConocoPhillips. He detailed seven focus areas: Asia-Pacific, Europe, Latin America, Middle East & North Africa, Russia & Central Asia, and Sub-Saharan Africa. He emphasized that activity in Alaska is core to ConocoPhillip's portfolio. The future of natural gas commercialization has a significant bearing to the success of their company.

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CO-CHAIR MICCICHE asked why BP and ConocoPhillips are in exit mode from Russia, whereas ExxonMobil is not.

MR. REINSCH replied that BP exited the TNK-BP joint venture in Russia, which was a monetization play, as much as anything. The TNK-BP portfolio was a very mature, onshore portfolio and made a lot of money. He explained that BP is not leaving Russia, but taking proceeds to buy a 20 percent equity interest in Rosneft.

He said that ConocoPhillips, however, is truly leaving. Its equity investment with LUKOIL did not bring expected returns. ExxonMobil is a single asset player in Russia. All of the majors are looking at the Arctic.

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MR. REINSCH looked at challenges ConocoPhillips is dealing with: competing as a "pure play" E & P company, effectively positioning in high value areas, defining operational strengths, effectively managing base production, and, their biggest challenge, delivering production growth.

CO-CHAIR MICCICHE welcomed Senator French.

MR. REINSCH provided an overview of ExxonMobil. He described difficult situations in global unconventional areas like Qatar, Brazil, and Venezuela. He related that ExxonMobil made a very aggressive move of a \$40 billion acquisition of XTO Energy. He concluded that ExxonMobil is a company that has had to redefine itself.

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He looked at ExxonMobil's portfolio, listing core, harvest, focus, and new ventures. The company is constantly churning its portfolio to move non-core, non-material assets out.

He said ExxonMobil is by far the largest producer. He described their total portfolio evolutions and compared them to the competition. He noted less emphasis on "return on capital employed - a little more emphasis on growth."

He looked at regional trajectories for ExxonMobil in seven regions of the world. He pointed out that ExxonMobil's Europe profile looks similar to BP and ConocoPhillips. Volume growth is focused on North America. There is growth in Asia Pacific due to LNG development ventures.

[3:10:36 PM](#)

He looked at ExxonMobil's Alaska activity and PFC Energy's assessment of that activity. Alaska is designated as a harvest designation. PFC's assessment reads, "As the largest holder of discovered gas resources on the North Slope and a co-operator of the Prudhoe Bay Western Region development, ExxonMobil holds a leading position in Alaska. Maintaining and growing upstream investment increasingly hinges on a gas commercialization/export scheme."

He showed a chart that summarized the three majors' share of U.S., Alaska, and global production.

[3:11:50 PM](#)

MR. MAYER began a presentation about Alaska's fiscal regime in a global competitive context and how ACES and SB 21 fit into the picture.

He showed a graph that depicts how fixed-royalty jurisdictions in the Lower 48 area are a key competitor to Alaska for investment dollars. It is now an exception not to be targeting unconventionals in North America as a major growth platform. He called them fixed royalty regimes and all have low government take that decreases as prices rise.

He showed how Alaska's days of "easy oil" are gone. High costs and high government take present challenges. Costs are significantly higher in Alaska than in the Lower 48 - even compared to unconventionals. Meanwhile, Alaska's government take has risen significantly over recent years. He suggested a

further look be taken at global economics in order to meet those challenges.

MR. MAYER defined divisible income as gross revenues less cost, including capex and transportation. Government take includes all payments the government mandates in its function as a sovereign including royalties, land rental fees, property taxes, production taxes, and income taxes. Relative government take is government take divided by divisible income.

MR. MAYER showed a graph that depicts fixed royalty versus profit based fiscal systems. He concluded that a high cost project in a given oil environment, or one single project as the oil price moves, is going to face a very different government take in those different circumstances. He pointed out that the chart on the left shows the incidence of a 30 percent fixed royalty for a single project, under five price environments. The chart on the right shows the incidence of a 50 percent profit-based tax on five different price environments.

[3:20:59 PM](#)

He noted that the fixed royalty system is inherently regressive. There are many benefits to the private investor on a low cost project or a high price environment. In a high cost project or low price environment the private investor does poorly. By contrast, the basic nature of the profit-based system in Alaska is one that tries to more evenly have a more stable government take.

He showed a chart that compares Alaska's government take under ACES with the take of global fiscal regimes at \$60/bbl. Alaska is shown in red. At \$60/bbl under ACES, government take looks moderate due to a fixed royalty at high costs. At \$100/bbl, both for a new producer and for an existing producer, Alaska has the highest government take of any OECD country other than Norway.

SENATOR GARDNER asked if the data includes lease costs.

MR. MAYER said lease costs are included in the overall economics, but are not done on an "unrisked basis."

SENATOR GARDNER said it was slightly distorted.

MR. MAYER agreed, as it applies to the Gulf of Mexico.

SENATOR GARDNER asked if it includes that Alaska is sharing in the risk under ACES through the credit system.

MR. MAYER replied that those credits are included in the analysis. He added that costs against existing production reduce government take. That benefit does not apply to a new entrant to Alaska. He noted that "these are stand-alone economics" for an existing producer based on their base portfolio or of a new producer. There is no incremental analysis for an existing producer.

[3:27:42 PM](#)

CO-CHAIR MICCICHE commented that a new entrant is disadvantaged under ACES until about \$140/bbl regarding government take.

MR. MAYER responded it relates to the economics of having higher costs.

He said at \$120/bbl, for new development under ACES, the government take is the highest of any area.

CO-CHAIR MICCICHE said at \$120 it is highest for new development and just below Norway for existing producers.

MR. MAYER agreed. He said at \$160/bbl, Alaska's government take is greater than Venezuela's.

MR. MAYER looked at the components of government take for existing production under ACES. The tables show the impact of credits. Credits are a way in which the state shares in the downside risk of all price environments, but takes a very large share of the benefit at high oil prices.

CO-CHAIR MICCICHE asked if at a low price environment - \$60/bbl to \$70/bbl - the state take is about half of that in a high price environment - \$110/bbl to \$120/bbl. He stated that the production tax dramatically declines in a lower price environment.

MR. MAYER drew attention to the wedge shape of the yellow bars on the graph that shows how progressivity affects government take. He compared how government take would look for a new investor under ACES.

He showed a cash flow analysis for new development at \$100 ANS West Coast under ACES. He said he is working with the same data Econ One used so that the models would align.

SENATOR GARDNER asked to see the chart as it would apply to legacy fields.

[3:36:58 PM](#)

MR. MAYER said such a chart would be less interesting, but he could provide that information. Existing production in Alaska is not as profitable as large mature assets in other parts of the world.

MR. MAYER discussed government take for existing production under SB 21. He noted the graph is nearly completely flat, but slightly regressive without progressivity. At \$100/bbl the government take is about \$60. It looks similar with new development. Under ACES there is limited ability to use profit based tax. He described the method of determining that amount. The best way to incentivize new development is to calculate production tax.

He explained a cash flow analysis on new development under SB 21 using \$100 bbl. He compared it to ACES with significant capital development but negative government take. Under SB 21 the project has better rates of return. In the early years there is no benefit from capital credit.

[3:45:53 PM](#)

MR. MAYER addressed regime competitiveness and average government take at \$60/bbl, and up to \$160/bbl. Under ACES at \$60/bbl for existing producers and for new development, government take is actually lower than under SB 21 because progressivity has yet to kick in. He said that SB 21 maintains an even take of 60 percent at about \$120, while the take gets continually higher.

CO-CHAIR MICCICHE requested the average for OECD at those prices.

MR. MAYER offered to provide that information.

CO-CHAIR MICCICHE said it would be useful for comparison.

MR. MAYER addressed making SB 21 more neutral at the 66 percent level of government take, such as if progressivity was introduced back into the regime. He showed a graph of government take for existing production if progressivity was reintroduced at the 0.1 percent level from \$30 PTV/bbl to a maximum of 35 percent.

He showed a graph that made the same comparison for new development and a graph depicting the cash flow analysis for new development with reintroduced progressivity.

MR. MAYER explained credits and deductions. The current credit system is necessary in ACES to offset high government take, but it introduces numerous distortions and unintended consequences. The best example of this relates to incentives for cost control, when one combines the progressive nature of ACES with the credits that exist. The best example is the 40 percent exploration credit.

In low price environments, or in the case of significant success attracting new producers to the North Slope, it poses significant cash flow risk to the state.

CO-CHAIR MICCICHE asked if "under the current system" means ACES and if it was part of an effort to control the downside risk to the state for credit payouts.

MR. MAYER agreed. He said that risk under ACES would be eliminated in SB 21.

He continued to say that eliminating the 20 percent capital credit may pose greater issues for small, more capital-constrained producers.

[3:54:07 PM](#)

CO-CHAIR MICCICHE questioned the statement, "If capital credit were to be retained in some form, it may be desirable to end the ability to claim directly from the state."

MR. MAYER explained there were a number of ways to do that. For example, a small producer could sell credits to a larger company. He said the next step would be to offer credits for future production.

He spoke of the benefits of differentiating between the various credits. He said credits could be targeting to specific development activity, but he cautioned against it. He said SB 21 is appealing in that it strips out the complexity of the tax regime. He maintained it is not always easy to distinguish between maintenance and development spending.

He discussed if current deductions should be allowed - for instance, in the case of the pipeline tariff, which is likely to be problematic and add complexity for little gain. He weighed

the advantages and disadvantages of allowing a credit. He opined that a simple regime has benefits.

[4:00:07 PM](#)

MR. MAYER concluded that Alaska's future petroleum revenues depend on sensitivities to oil price, production decline, and fiscal terms. He stated that the biggest sensitivity is crude oil price. It is the major determinant of Alaska's future petroleum revenues. He showed a graph with Alaska's crude oil production forecast.

CO-CHAIR DUNLEAVY asked if 2032 should be 2022.

MR. MAYER said yes.

He stated that the other major determinant regarding Alaska's future petroleum revenues is the rate of decline of North Slope production. He said fiscal terms changes have a smaller impact than oil prices and the decline rate. He emphasized that the state should work to stimulate new production by improving fiscal terms. If an improvement in fiscal terms can stimulate sufficient new investment to stem declines, it has the long run potential to increase revenue, despite the near-term cost of the change.

He said to maintain revenues to the state at a steady level in real terms, a reduction in government take such as that under SB 21 would need to spur sufficient investment to reduce the North Slope base decline from 6 percent, as currently forecast to 1 percent. Re-introducing 0.1 percent progressivity into SB 21 to a maximum of 35 percent production tax would require lower additional production post 2017 to be revenue neutral. To maintain revenues to the state at a steady level in real terms, a reduction in government take such as that under SB 21 with 1 percent progressivity would need to spur sufficient investment to reduce the North Slope base decline from 6 percent as currently forecast to 2 percent.

He showed graphs that depicted both scenarios under SB 21 and tables that show incremental production needed to be added every year with and without progressivity.

[4:06:50 PM](#)

CO-CHAIR MICCICHE thanked the presenters and asked committee members to submit further questions.

[4:07:17 PM](#)

At ease

[4:39:59 PM](#)

CO-CHAIR MICCICHE reconvened the meeting and opened public testimony. He reminded that the committee was looking at SB 21 with regard to how it affects TAPS throughput.

[4:42:28 PM](#)

TONY TENGS, representing himself, testified in opposition to SB 21. He said he was speaking in support of ACES. He quoted Governor Parnell who emphasized Alaska's healthy economy and is one of the best run governments in the nation. Mr. Tengs attributed that success to the benefits from ACES. He suggested that Alaska begin thinking like a country, such as Norway, which has a higher government take than Alaska's. He spoke in favor of letting Alaska continue to receive the benefits from ACES.

[4:46:02 PM](#)

PAM BRODIE, representing herself, encouraged the legislature to protect the public's interest for the long term. She said it seems unlikely that SB 21 is in the long-term interest of Alaskans.

[4:48:49 PM](#)

ROBERTA HIGHLAND, President, Kachemak Bay Conservation Society, testified in strong opposition to SB 21. She spoke in support of ACES and recommended that state use those funds wisely for renewable energy.

[4:50:46 PM](#)

PATRICK SCHLICHTING, representing himself, testified in opposition to SB 21. He said ACES gave Alaska a fair settlement and allowed the state to maintain its infrastructure. Governor Parnell introduced a bill several years ago and has been focused on it since. He stated that nothing is broken with ACES and nothing needs to be fixed.

[4:54:34 PM](#)

DAVID OTNESS, representing himself, testified in opposition to SB 21. He said the current direction is detrimental to the state. The Governor's bill will create a welfare state in Alaska. The producers are making the same claims in North Dakota as here. It is not in Alaska's best interest to pass SB 21.

[4:57:28 PM](#)

KELLY WALTERS, representing himself, testified in strong opposition to SB 21. He stated for the record that he took issue

with Senator Micciche's statement that he did not have a conflict of interest. He said that eliminating progressivity will rob Alaskans. Removing the capital credit will result in a harvest mode. Under ACES there has been record employment and numerous successes on the North Slope for three years.

[5:00:35 PM](#)

RACHAEL PETRO, President and CEO, Alaska State Chamber of Commerce, testified in support of revising the current oil tax policy. Alaska has a responsibility to be competitive and get a fair return for its citizens. This legislation is an investment in Alaska's long-term sustainability.

[5:03:27 PM](#)

WILLIAM WARREN, representing himself, said he had been active on instate gas for years. He said the Governor, the legislature, and industry have let the citizens down. The big boys left Cook Inlet and just the small ones are left. The chair is correct - we're all in the oil and gas business. He spoke in favor of getting the instate gas line in place and taking action this year or everyone will be looking for new jobs. He said the eyes of Alaska are upon you.

[5:06:27 PM](#)

RICHARD JACOB MAENPA, representing himself, said he was testifying in support of anything that would make it possible to work and stay in Alaska. He was worried about the declining throughput. He said at some point TAPS will fail. He said he supported taking action on SB 21 or any legislation that will increase throughput.

[5:08:30 PM](#)

STEVE GIBSON, representing himself, testified in opposition to SB 21. He said it appears that ACES is fairer than the proposal under SB 21. The long term effects of SB 21 are hopeful, nothing more.

[5:10:23 PM](#)

GEORGE PIERCE, representing himself, testified in opposition to SB 21. He said not to give the oil companies incentives unless they are given on a performance basis. If it weren't for the Senate last year, the citizen's resources would have been given away.

ERIC TREITER, representing himself, testified in opposition to SB 21. He said the oil companies are good at producing profits. Tax breaks are fine if they are tied to performance objectives.

He concluded that the oil is the people's resource and therefore he believes in the principle of progressivity.

[5:16:33 PM](#)

DAVID TRANTHAM, representing himself, testified in opposition to SB 21. He said he represents five generations of Alaskans and they are in survival mode. They pay more than \$7 a gallon for fuel and he didn't see that SB 21 would help. He said he supports ACES, although some minor tweaking may be necessary. He stated that the people need the legislature's help to protect all Alaskans.

[5:19:53 PM](#)

At ease

[5:44:50 PM](#)

CO-CHAIR MICCICHE reconvened the meeting.

[5:45:11 PM](#)

MONIKA KUNAT, representing herself, testified in opposition to SB 21. She said it wasn't good enough for future Alaskans.

[5:47:22 PM](#)

JAVEN OSE, representing himself, testified in opposition to SB 21. He said he didn't want to give his tax dollars away to the current scheme. He suggested if you give a tax break to make sure you get something for it.

[5:48:44 PM](#)

AARON GRIFFIN, representing himself, testified in opposition to SB 21. He urged the committee to tie tax breaks to production benchmarks.

[5:51:22 PM](#)

At ease

[6:12:57 PM](#)

CO-CHAIR MICCICHE reconvened the meeting.

[6:13:10 PM](#)

ANDREW PETER, representing himself, expressed concern about the direction things appear to be going in Alaska regarding corporate favoritism.

[6:15:53 PM](#)

DELICE CALCOTE, representing himself, testified in opposition to SB 21. She cited a 1970, 88 page article by the Stanford

Research Institute, regarding a plan for Alyeska. She said she was concerned that money is being given away. She did not support any tax break for the oil or mining companies that are making billion dollar profits.

CO-CHAIR MICCICHE asked what article she referenced.

MS. CALCOTE said she would send a link and reiterated that she wanted to see the document posted.

[6:20:13 PM](#)

SENATOR GARDNER requested her address.

CO-CHAIR MICCICHE asked her to send the link to the chair.

SENATOR FAIRCLOUGH inquired about future plans for the committee.

CO-CHAIR MICCICHE said the next meeting would be Tuesday, February 5, and the oil industry would testify on SB 21. February 7 would be the last meeting on the subject. He reminded the public that the committee was reviewing the bill solely from the perspective of declining throughput in TAPS. If there is a need for additional public testimony, arrangements will be made.

[6:23:32 PM](#)

At ease

[7:15:43 PM](#)

CO-CHAIR MICCICHE reconvened the meeting.

[7:15:56 PM](#)

KATHLEEN PEARSON, representing herself, said she didn't understand why the state should give its resources away to the oil companies.

[7:17:22 PM](#)

MICHAEL DZURSLIN, representing himself, said he thought the current tax system was fair. He testified in opposition to SB 21.

[7:19:36 PM](#)

LYNETTE MORENO HINZ, representing herself, testified in opposition to SB 21. She said the Governor should represent the people and not the oil companies. She said it is a conflict of interest.

[7:21:49 PM](#)

ED NELSON, representing himself, testified in opposition to SB 21. He said the Governor has been more a lobbyist for the oil companies than for the people of Alaska.

[7:23:27 PM](#)

HARRY WALKER, representing himself, testified in opposition to SB 21. He said the bill is not fair or good for Alaska.

[7:25:10 PM](#)

DAVE DARRON, representing himself, testified in opposition to SB 21. He said the fact that the Governor refused to debate Senator Wielechowski swayed him to oppose the legislation.

[7:28:00 PM](#)

KATE VEH, representing herself, said she submitted written testimony. She said ACES was working and she did not support SB 21.

[7:29:15 PM](#)

JIM BYRNES, representing himself, testified in opposition to SB 21. He said if the royalty rate is changed, it should be increased. Alaska is the safest place that the oil companies operate, but it should not be the most profitable.

[7:31:02 PM](#)

BEN CREASY, representing himself, testified in opposition to SB 21. He said he has a degree in economics and hasn't seen a good cost benefit analysis that demonstrates that the legislation is a good idea. He was a bit disappointed in the analysis that had gone into the bill thus far. He thought oil companies would continue to come to Alaska.

[7:34:28 PM](#)

CO-CHAIR MICCICHE closed public testimony. He said written testimony would be taken. He told committee members to have amendments to his office by 7:00 p.m. Wednesday. He reiterated that the committee was looking at SB 21 with the mission of how it might affect increasing throughput in TAPS.

[7:35:45 PM](#)

There being no further business to come before the committee, Co-Chair Micciche adjourned the meeting at 7:35 p.m.