

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

February 1, 2017

1:07 p.m.

MEMBERS PRESENT

Representative Andy Josephson, Co-Chair
Representative Geran Tarr, Co-Chair
Representative Dean Westlake, Vice Chair
Representative Harriet Drummond
Representative Justin Parish
Representative Chris Birch
Representative DeLena Johnson
Representative George Rauscher
Representative David Talerico

MEMBERS ABSENT

Representative Chris Tuck (alternate)

COMMITTEE CALENDAR

PRESENTATION(S): UPDATE: STATUS OF THE OIL AND GAS TAX REGIME
IN ALASKA

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

KARA MORIARTY, President/CEO
Alaska Oil and Gas Association
Anchorage, Alaska

POSITION STATEMENT: Provided a PowerPoint presentation
entitled, "House Resources Committee," dated 2/1/17, and
answered questions.

SCOTT JEPSEN, Vice President
External Affairs
ConocoPhillips Alaska, Inc.
Anchorage, Alaska

POSITION STATEMENT: Provided a PowerPoint presentation entitled, "House Resources Committee," dated 2/1/17, and answered questions.

DAMIAN BILBAO, Vice President
Commercial Ventures
BP Alaska
Anchorage, Alaska

POSITION STATEMENT: Provided a PowerPoint presentation entitled, "Prudhoe Bay & Alaska Policy Enabling the next 40 years," and answered questions.

DAN SECKERS, Tax Counsel
ExxonMobil Corporation
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing of the status of the oil and gas tax regime in Alaska, and answered questions.

PAT FOLEY, Senior Vice President
Caelus Energy
Anchorage, Alaska

POSITION STATEMENT: Provided a PowerPoint presentation entitled, "Caelus Activity Update," dated 2/1/17, and answered questions.

ACTION NARRATIVE

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CO-CHAIR GERAN TARR called the House Resources Standing Committee meeting to order at 1:07 p.m. Representatives Tarr, Birch, Parish, Rauscher, Johnson, Westlake, and Josephson were present at the call to order. Representatives Talerico and Drummond arrived as the meeting was in progress.

PRESENTATION(S): UPDATE: STATUS OF THE OIL AND GAS TAX REGIME IN ALASKA

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CO-CHAIR TARR announced that the only order of business would be an update on the status of the oil and gas tax regime in Alaska.

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KARA MORIARTY, President/CEO, Alaska Oil and Gas Association (AOGA), provided a PowerPoint presentation entitled, "House

Resources Committee," dated 2/1/17. Ms. Moriarty informed the committee AOGA is a private, professional trade association representing the majority of the companies in the oil and gas industry in Cook Inlet and on the North Slope [slide 2]. She said a review of the changes in Alaska's tax system over the past ten years revealed five guiding principles found in common: production, investment, competitiveness, revenue, and "fair share" [slide 3]. Production from fiscal year 2015 (FY 15) to FY 16 increased 3 percent, and she pointed out that the present production increase is the first since 2001-2002, after the [Alpine oil development owned by ConocoPhillips Inc.] came online [slides 4 and 5]. Slide 5 illustrated oil production from 2002 through 2016, record high and record low oil prices, and changes in the oil and gas tax system. Ms. Moriarty provided a chart that illustrated that production increased in excess of what was forecast; the 2013 fall forecast was for 487.6 thousand barrels per day and the actual production in 2016 was 514.9 thousand barrels per day, even as oil prices dropped [slide 6]. In Cook Inlet, after passage of the Cook Inlet Recovery Act [passed in the 26th Alaska State Legislature], oil production went up 84 percent from its lowest point in 2009. She noted that all of the oil produced in Cook Inlet is utilized at the Tesoro Alaska Company Refinery in Nikiski [slide 7]. The next guiding principle is investment, without which there is not production. In 2003 as prices went up, U.S. and worldwide spending followed, but investment by the industry in Alaska "remained relatively flat" under the tax system of Alaska's Clear and Equitable Share (ACES) [passed in the 25th Alaska State Legislature]. She said the lack of investment was the impetus for Senate Bill 21 [passed in the 28th Alaska State Legislature] [slide 9]. Slide 10 was a chart previously provided by the Department of Revenue (DOR) - with an added column for average oil price - which illustrated that from 2007 to 2012, investment levels are about the same. She concluded that investment in Alaska did not increase with rising oil prices and investment in the Lower 48, because the ACES tax structure included high progressivity. However, in 2013 as oil prices begin to decline, the level of investment shown is higher and more stable because current tax policy is predictable and geared toward production.

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MS. MORIARTY stated that increased investment has led to higher production and major new discoveries, even though low oil prices have led to layoffs and job losses [slide 11]. She questioned whether Alaska's tax policy will allow the new discoveries to

reach production and increase the flow of oil into the Trans-Alaska Pipeline System (TAPS) [slide 12]. Ms. Moriarty provided a DOR slide entitled, "North Slope Repurchased Credits," and pointed out the slide should be updated to reflect the potential ultimate recovery from repurchased tax credits [slide 13]. She opined credits have been a very worthwhile investment for the state. The next guiding principle is competitiveness, because to attract investment the state needs to be competitive; however, the question is how the industry can remain competitive if the state is constantly changing tax policy. The state has changed tax policy in the past ten years - and an additional change was proposed - and all six changes except one have been tax increases [slide 15]. She elaborated that Senate Bill 21 was both a tax increase and a tax decrease under certain conditions. Ms. Moriarty disagreed with DOR that the Petroleum Production Tax (PPT) [passed in the 24th Alaska State Legislature] was neutral and that PPT doubled production tax [slide 16]. Slide 16 was corrected as follows: FY 2016 to FY 2006; FY 2017 to FY 2007. She opined that during debate in 2007, no one disputed that PPT brought the state more in tax revenue than the Economic Limit Factor (ELF) [passed in the 12th Alaska State Legislature and modified by executive order in 2005], and that a correct fiscal note attached to the PPT bill would have indicated PPT was almost a 200 percent increase in taxes over ELF.

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MS. MORIARTY turned to the challenge of remaining competitive in Alaska's high cost environment due to factors - such as remote locations and Arctic environments - which restrict drilling to a short period of time. Further, costs don't decrease as quickly as oil prices, and remain the same at lower production. For calendar year 2016, the average oil price was approximately \$43 per barrel, and the average deductible cost per barrel was approximately \$41. However, according to page 29, DOR Revenue Sources Book (RSB) Fall 2016, total costs are over \$48 per barrel. This discrepancy explains why companies are cash-negative in Alaska, and she emphasized that the \$48 per barrel cost is before taxes or royalty are paid, and only includes transportation, operating, and capital expenditures [slide 17]. Alaska has a hybrid tax of a net tax at higher prices and a gross tax at low prices, demonstrated by a chart that showed at an oil price of \$40 per barrel, production tax value (PTV) is a negative number, thus taxing "phantom income" even when companies are losing money [slide 18]. Finally, she presented a graph that compared Alaska's 2013 development costs to that of

competitors in the Lower 48 [slide 19]. The next principle is revenue and she advised that since statehood, oil has provided 85 percent of the state's unrestricted general funds (UGF) that support government and a strong economy [slide 21]. Senate Bill 21 generates more revenue to the state at low prices than ACES, as reaffirmed during testimony before the committee on 1/30/17 [slide 22]. She then clarified that the industry pays more in government revenue than it receives in credits: total FY 16 revenue paid was over \$2 billion; cashable credits or credits used against tax liability were \$598 million. Ms. Moriarty stressed that the total tax credit liability after FY 20, for cashable credits, is about \$150 million per year after the reforms of House Bill 247 [passed in the 29th Alaska State Legislature] [slide 23].

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CO-CHAIR JOSEPHSON expressed his understanding that the total number of cashable and tax liability credits for FY 16 is over \$900 million.

MS. MORIARTY responded that the credits shown on slide 23 are those that were generated in FY 16 only; a higher number could include some of the credits that were vetoed. Ms. Moriarty recalled there are questions about whether earned credits need to be paid, and she pointed out that the administration has stated that the credits are obligations the state needs to pay. She advised that if the governor had not vetoed certain credits, the state's liability for FY 18 would be near \$400 million, instead of over \$1 billion; in fact, the vetoes have inflated the actual liability [slide 24]. Turning attention to net operating loss credits, she explained that a net tax is a tax on the difference between a taxpayer's gross revenue and the cost of producing revenue, and to demonstrate the impacts of a net tax versus a gross tax, she gave the example of the costs and profits of a restaurant business [slide 25]. Ms. Moriarty concluded that taxes on net allow net operating loss from the loss year to carry forward to the following year, and observed that her organization could not find a net-based oil tax system without some type of mechanism, such as an NOL credit, to carry forward losses.

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MS. MORIARTY addressed the last principle of fair share, which is the most subjective of the five guiding principles discussed. She provided a chart that illustrated what is received by the

industry and state and federal governments from a barrel of oil at various prices. At under \$40 per barrel, the industry receives nothing, and government receives more revenue than industry at any price [slide 27]. She summarized as follows:

- production: there is more production
- investment: there is more investment than under the ACES regime
- competitiveness: industry is attracted to Alaska, leading to major discoveries
- revenue: the current system is bringing in more revenue
- fair share: government receives the most at any price scenario

MS. MORIARTY suggested that proposed changes to the tax system should be weighed against the foregoing principles.

REPRESENTATIVE BIRCH returned attention to slide 10 and observed that the capital credits for 2016 are 6 percent of the total spend, which is a relatively small percentage.

MS. MORIARTY agreed that the credits have spurred investment even though average oil prices are low.

REPRESENTATIVE BIRCH recalled that Shell spent \$7 billion and left Alaska; investments carry a significant risk.

CO-CHAIR TARR advised that the spending shown on slide 10 does not reflect deductions for operating and capital expenditures.

REPRESENTATIVE PARISH surmised that spending also includes support of ongoing operations. He asked what cashable tax credit certificates sell for.

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MS. MORIARTY responded that the amount for which a company sells its cash certificate is proprietary data. In further response to Representative Parish, she said a company is at liberty to disclose this information if it chooses to do so.

REPRESENTATIVE PARISH asked the industry to share this information with the committee in order to better inform its decisions.

MS. MORIARTY, addressing an earlier statement, clarified that deductions are costs that have previously been paid by industry.

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SCOTT JEPSEN, Vice President, External Affairs, ConocoPhillips Alaska, Inc., provided a PowerPoint presentation entitled, "House Resources Committee," and dated 2/1/17. He informed the committee he would address three basic aspects of Alaska's tax framework: Senate Bill 21 has achieved the state's goals of achieving a flatter tax rate over a broad range of oil prices and certainty of revenue at lower oil prices; there has been increased investment resulting in jobs, production and revenue; there is competition from the unconventional plays in the Lower 48, and Alaska should ensure it does not create a disadvantage for additional investment by changes in its cost structure [slide 2]. He provided a graph that illustrated net cash flow from negative -\$4 billion to \$12 billion, Alaska North Slope (ANS) West Coast (WC) price of a barrel of oil from \$30 to \$100, and bars representing investor, federal, and state shares of a barrel of oil at various prices [slide 3].

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MR. JEPSEN, directing attention to slide 3, pointed out that at any price, state share is the largest and is a positive share when industry share is negative. The state share includes royalty, production tax, state income tax, and property tax. From the investor share is subtracted transportation, capital expenditures (CAPEX), operating expenditures (OPEX), royalty, production tax, property tax, state income tax, and federal income tax. The federal share consists of federal income tax. Mr. Jepsen recalled that debate surrounding Senate Bill 21 raised the issue of revenue divided into equal thirds for the state, federal government, and producers. In fact, about two-thirds does go to government, and the present system provides the state the larger share of revenue, even when oil prices are low. He acknowledged that the graph did not reflect cashable credits, small producer credits, or exploration credits, because ConocoPhillips Alaska, Inc. is a large producer and does not consider the credit incentive system to be part of the basic tax structure; the basic tax structure is the net tax the state imposes on those who produce and make a profit. The per barrel credit is included in slide 3 as it is an integral component of the overall tax system, and he recalled that the per barrel credit was implemented to create a leveled tax rate over a broad range of prices. Mr. Jepsen said ConocoPhillips Alaska, Inc.

considers the tax framework in Alaska each time projects are proposed, and increases do not create a good climate for investment. Since the passage of Senate Bill 21, ConocoPhillips Alaska, Inc., added several rigs to the Kuparuk River Unit rig fleet; two new rigs were delivered in 2016. Through the last quarter of 2016, five rigs were running between Kuparuk and Alpine, and through 2017 three rigs will be running in Kuparuk; higher oil prices may lead to more investment. An extended reach drilling (ERD) rig was sanctioned that means 125 square miles can be reached from an individual drill site. In addition, work was restarted on the Northeast West Sak (NEWS) 1H drill site at Kuparuk. Also sanctioned was drill site 2S in Kuparuk, and Greater Mooses Tooth 1 in 2015, and the company began the process of permitting Greater Mooses Tooth 2. ConocoPhillips Alaska, Inc. recently announced its Willow discovery which may hold 300 million barrels of recoverable resource. At the December 2016 lease sale, ConocoPhillips Alaska, Inc. bought leases over 400,000 acres of federal land and over 200,000 acres of state land. He recalled that during the ACES tax system from 2007 through 2012, the average investment by ConocoPhillips Alaska, Inc. was \$800 million per year; beginning in 2013 there was a "step-up" in investment, and the percentage of the corporation's spend increased - even while keeping its expenditures level - to an average investment of \$1 billion per year through 2016 [slide 4]. He opined that in calendar year 2016, the first growth in production in 14 years was a function of the positive investment climate as a result of Senate Bill 21. Mr. Jepsen recalled his previous testimony stating that if there is a positive investment climate, the state should expect the industry to react rationally and increase investment, and it has done so. He turned to the topic of competition, and advised that there is opportunity in unconventional plays in the Lower 48 which is due to "all the massive investment," that is attracted by nearby infrastructure, a shorter time from investment to production, less regulation, and a nearer market. Also, wells are cheaper to drill and operate; in Alaska, after the industry does its part to manage OPEX costs, the role of the state in competition is that an increase in taxes is an increase in cost, which will send investment to other places than Alaska. Mr. Jepsen urged the committee to consider how Alaska can remain competitive with the Lower 48 and worldwide [slide 5].

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CO-CHAIR TARR questioned whether Mr. Jepsen would provide updated information related to the timelines on slide 4. The

committee has heard that although most projects take years to plan, "quick decisions" were made following the passage of Senate Bill 21, and she requested the dates that the foregoing projects listed on slide 4 were sanctioned.

MR. JEPSEN responded that all of the investment decisions illustrated on slide 4 were sanctioned after Senate Bill 21 was passed.

REPRESENTATIVE TALERICO asked whether the ERD rig is in association with Doyon.

MR. JEPSEN said yes.

REPRESENTATIVE BIRCH questioned whether the use of ERD rigs will reduce the cost of producing oil in Alaska.

MR. JEPSEN was unsure about the amount of savings, but ERD rigs will enable his company to develop certain resources; for example, ERD rigs will allow the company to access resources in areas for which permits probably would not be secured, and also to reach areas that do not economically justify drilling a new rig, thus reducing the total number of drill sites.

REPRESENTATIVE PARISH inquired as to the 50 percent difference in the growth of North Slope production that was projected by AOGA and ConocoPhillips Alaska, Inc.

MR. JEPSEN explained the ConocoPhillips Alaska, Inc. projection was based on a calendar year, and AOGA's was based on a fiscal year.

REPRESENTATIVE PARISH asked how much revenue was foregone by the state in providing the per barrel credit.

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MR. JEPSEN said none. Per barrel credits are part of the tax rate put in place in order to have a reasonable tax on producers; unlike other credits, a per barrel credit is not reimbursable and cannot be carried forward, but is a mechanism agreed to in Senate Bill 21 legislation. In further response to Representative Parish, he said the state determines a fair tax rate to achieve revenue, more jobs, a healthy economy, investment, and oil in the Trans-Alaska Pipeline System; he opined incentives for investment create a healthy economy and encourage new investment.

[2:02:52 PM](#)

DAMIAN BILBAO, Vice President, Commercial Ventures, BP Alaska, provided a PowerPoint presentation entitled, "Prudhoe Bay & Alaska Policy Enabling the next 40 years." Mr. Bilbao said he supported the testimony of the previous speakers, Ms. Moriarty and Mr. Jepsen. He directed attention to graphs labeled "Investment trends by region" and "Production trends by region" that illustrated global, U.S., and Alaska trends, and explained that both graphs were indexed to a common starting point to show how each region moved relative to each other. He pointed out that from 2008-2009, investment in the Lower 48 was much higher - relative to global investment - due to new technology and developments, and although globally there was an increase, in Alaska investment was "flat" until about 2013 when the Alaska profile began to increase; in fact, investment globally and in the Lower 48 began to decline as prices fell in 2014, but investment in Alaska continued to climb. Looking at the production graph, increased investment in the Lower 48 resulted in dramatic increases in production in the Lower 48, global production increased, and in Alaska production continued to decline by an average of 4 percent to 6 percent until 2013-2014, when the production trend in Alaska flattened out. Mr. Bilbao advised that in 2014, there was a material shift that brought investment into Alaska, and with that an associated impact to production [slide 2].

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MR. BILBAO presented an example of the distribution of one barrel of oil in Alaska priced at \$43 per barrel: in 2016, of \$43, royalty and state taxes were \$7, and OPEX, CAPEX and transportation were \$48, which resulted in a loss to industry of \$12 per barrel; despite the industry's loss, the state was still receiving revenue [slide 3]. From the perspective of BP, losses were over \$1 million per day, prompting improved efficiencies to its operations. To illustrate how Senate Bill 21 attracted investment and activity, Mr. Bilbao provided a graph that showed that investment in Prudhoe Bay drilling from 2010 to 2012 was "a broadly flat level." In response to Senate Bill 21, the industry quickly increased drilling activity and spending in Prudhoe Bay beginning in 2013 through 2015, even though oil prices continued to decline [slide 4]. He acknowledged that spending in 2016 has decreased as a result of low oil price, concluding that policy has its limitations. Overall, however, Senate Bill 21 has resulted in increased activity, production,

new discoveries, and more revenue to the state than under the ACES system; further, he opined that Senate Bill 21 is not complicated to administer and drives behavior in the best interest of the state. Regarding policy, BP measures policy against the following set of principles [slide 5]:

- encourages more North Slope oil down TAPS
- extends the life of the backbone fields which provide the bulk of production
- encourages more independents to look for oil and gas
- does not pick winners and losers, but remains neutral

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CO-CHAIR TARR asked whether BP has used any of the credits that are currently available.

MR. BILBAO said since 2006, no. He referred to an opinion letter recently issued by the Department of Revenue which he said, "certainly discourages the opportunity" [document not provided].

MR. BILBAO, in response to Representative Parish, clarified that BP has not acquired any credits to offset tax liability.

REPRESENTATIVE PARISH surmised BP has used tax credits, but has not purchased them from smaller companies.

MR. BILBAO said BP uses per barrel offsets to reduce its tax liability. Senate Bill 21 increased the tax rate from 25 percent to 35 percent; however, in order to encourage a focus on more production, the legislation also created the per barrel credits, and for every barrel produced, BP uses per barrel credits to offset its tax liability.

REPRESENTATIVE PARISH asked what BP would pay to purchase transferrable tax credits from a small independent producer.

MR. BILBAO said he would not speculate.

REPRESENTATIVE TALERICO asked how much BP reduced its workforce.

MR. BILBAO answered that BP has reduced its workforce approximately 17 percent over the last several years to 1,700 employees.

REPRESENTATIVE BIRCH asked whether the existing infrastructure is accessible to others in the industry that may have a new discovery.

MR. BILBAO suggested the question should be asked of the independents. He opined BP has made progress in creating standard third-party facility terms that can be leveraged; currently, at Prudhoe Bay water management is an issue, however, commercial terms are managed more efficiently than in the past.

CO-CHAIR TARR passed the gavel to Co-Chair Josephson.

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MR. DAN SECKERS, Tax Counsel, ExxonMobil Corporation, informed the committee ExxonMobil Corporation is committed to Alaska and has been a key player in the development of Alaska's oil and gas resources, spending over \$20 billion dollars in the state over many years. Alaska remains an important component in ExxonMobil Corporation's worldwide portfolio; however, for Alaska to maximize the benefits of its resource potential, the state must remain globally competitive and needs a long-term and stable fiscal environment that attracts industry and provides the state and industry a fair share of revenue. He opined that Senate Bill 21, [also known as the More Alaska Production Act (MAPA)] has made Alaska more globally competitive and has led to industry investment and increased oil production. He stated his support of the previous testimony offered by Ms. Moriarty, Mr. Jepsen, and Mr. Bilbao, and added that MAPA has simplified Alaska's production tax regime, thereby providing more confidence to industry and investors. The policy goals of MAPA are being achieved such as providing a more predictable and competitive tax regime and attracting additional investment, more production, and corresponding benefits to Alaskans. Mr. Seckers recalled that in 2013 at the time MAPA was proposed, he stated that MAPA would make significant progress in making Alaska more globally competitive, and has done so by providing a more balanced tax production tax structure by offsetting aspects of the ACES tax regime; for example, eliminating the punitive progressivity feature of ACES. In addition to being an excessive tax, the progressivity feature was calculated monthly, so projects could not be evaluated, and the elimination of progressivity simplified the production tax regime; on the other hand, MAPA increased the tax rate to 35 percent, compared to 12.25 percent in Louisiana. Although high, the tax rate is predictable, so industry can make easier investment decisions; MAPA also removed a 20 percent tax credit on capital expenses

tied to investment - not necessarily to production - which was replaced by the per barrel credit that helped incent production at legacy and economically-challenged new fields. Importantly, MAPA preserved the critical net-based tax structure of PPT and ACES which allows the recovery of ordinary and allowable expenses. Mr. Seckers stressed that in Alaska deductions and credits are necessary to offset a 35 percent gross tax rate; furthermore, MAPA preserved a net operating loss feature that allows a balancing of revenue and expenses: a cornerstone feature of all net-based tax systems. He concluded that MAPA has resulted in the first overall production increase since 2002, a more competitive investment climate, and more predictable production taxes; therefore, ExxonMobil Corporation believes allowing the reforms brought by MAPA to continue will lead to more increased investment and production, and more benefits to Alaskans.

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[Although not stated on the audio recording, Co-Chair Josephson returned the gavel to Co-Chair Tarr.]

REPRESENTATIVE PARISH asked what percent of gross value at the point of production ExxonMobil Corporation paid to the state last year.

MR. SECKERS answered he did not know and taxpayer information is confidential. In further response to Representative Parish, he said he did know they have paid their fair share.

REPRESENTATIVE BIRCH asked for an update on Point Thomson.

MR. SECKERS said Point Thomson is on schedule and is producing. Point Thomson has unique economics and pressures, and he added that under the ACES tax system ExxonMobil Corporation would have paid less tax, however, the current regime is more stable and favorable.

CO-CHAIR TARR inquired as to whether ExxonMobil Corporation has used any credits that are currently available.

MR. SECKERS stated that ExxonMobil Corporation has used credits to the extent they were available.

CO-CHAIR TARR clarified that net operating losses are a feature of every net tax system - as related to corporate income tax - but not as a feature of a severance tax. She pointed out that

net operating losses as a feature of a severance tax, in addition to a corporate income tax, are unique to Alaska.

MR. SECKERS reminded the committee that the state's tax system is a combination of a gross and a net system, which is predominately a net system, and thus has an essential net operating loss feature to allow balancing of revenues and expenses, and to allow companies to recover costs of investments in the future, "otherwise, some investments won't get made, and you'll start causing a different dynamic approach to the analysis of investments in the state."

CO-CHAIR JOSEPHSON surmised that ExxonMobil Corporation has invested \$3 billion in the Point Thomson Unit with the hope of supplying a natural gas pipeline in the future.

MR. SECKERS agreed that Point Thomson is primarily a gas field to anchor a gas pipeline, but it is also important for delineating the reservoir and possibly other uses on the North Slope.

CO-CHAIR JOSEPHSON noted Point Thomson has the advantage of being closest to the Arctic National Wildlife Refuge (ANWR).

MR. SECKERS was unsure as to Point Thomson's application to ANWR or other areas.

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PAT FOLEY, Senior Vice President, Caelus Energy Alaska (Caelus), provided a PowerPoint presentation entitled, "Caelus Activity Update," dated 2/1/17. Mr. Foley stated Caelus is a company that is in Alaska because of the fiscal climate created by Senate Bill 21; in fact, Caelus has earned several tax credits and his presentation would show how the state also benefits from tax credits as a co-investor. Caelus is a privately-held company and he provided brief background information on its president and on prior company activities. Three factors in Alaska that attracted Caelus to purchase Pioneer Alaska assets are: the petroleum system and opportunities for discovery; the contractor community of services; the investment climate [slide 2]. He directed attention to the company's portfolio, noting that Caelus operates Ooguruk River Unit as its 70-percent owner, producing approximately 15,000 barrels per day. Onshore, the Nuna project was sanctioned after the passage of Senate Bill 21; Nuna is a project of approximately 25,000 barrels at peak production after a future investment of approximately \$1

billion, and Caelus will drill 30 wells during phase 1. Caelus has purchased eastern exploration leases totaling 350,000 acres and anticipates drilling two projects "in the next winter or two." The Caelus Smith Bay discovery is approximately 125 miles outside of the Colville River Unit and 70 miles from Barrow/Utqiagvik, located in a very sensitive waterfowl habitat area [slide 3]. Mr. Foley provided Caelus' major milestones: in 2013, Senate Bill 21 passed; in 2014, Caelus purchased Pioneer Alaska assets and acquired 320,000 acres in leases; in 2015, sanctioned Nuna project; in 2016, idled drilling rig in Ooguruk, reduced workforce, and announced discovery at Smith Bay [slide 4]. An overview of the Nuna project revealed that peak production would be about 25,000 barrels per day, and that the project is now idled due to low oil prices and concern about the fiscal policy in the state. The project is searching for investment dollars and he expressed his hope that pipelines will be installed this winter with first oil late in 2018. Within the terms of House Bill 247, the project will acquire and earn \$150 million in cashable tax credit certificates from the state in exchange for \$2.2 billion in revenue from royalty, net profit share lease payments, production tax, and ad valorem, which equates to a 15.8 times over return on investment [slide 5].

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CO-CHAIR JOSEPHSON inquired as to how the outlay of \$151 million in state tax credits was calculated.

MR. FOLEY explained that Caelus' projections come from economic models; the values are generated at \$70 per barrel of oil and estimate a net operating loss credit of 35 percent of a negative cash flow stream before becoming cash flow positive. He remarked:

All of these are estimates, all of these are wrong, but directionally, it's going to give you the right ballpark of what a project like this can, can contribute to the state of Alaska.

MR. FOLEY stated two exploration wells were drilled at Smith Bay last year that discovered a resource with a thickness of about 1,000 to 1,500 feet, and a gross sand thickness of about 200 feet. He characterized the discovery as a tight reservoir; however, the oil sample extracted was 43 degree gravity oil, which is a very low viscosity of twice the quality of most North Slope oil production, and which indicates that Smith Bay is a commercial project. The goal next winter is to drill another

appraisal well with additional testing, at a cost of \$140 million [slide 5]. Thus, oil in place on Caelus leases is six billion barrels and, if estimating recoverable oil at between 20 percent and 30 percent, the project could deliver 1.8 billion to 2.5 billion barrels of oil. He placed Smith Bay field on par with Kuparuk River Unit, supplying 200,000 barrels of oil per day and supported by 2,000 direct jobs at peak production. The total cash contribution to the state would be \$28 billion from royalty, production tax, and ad valorem. He acknowledged first oil is not expected until 2022 or later, and the project will only progress under a tolerable oil price and a durable fiscal system [slides 6 and 7]. Mr. Foley restated that in [2000] TAPS had almost 1 million barrels flowing through, and currently about one-half of that flows through: at around 300,000 barrels per day TAPS becomes challenged [slide 8]. He provided a chart that illustrated increased oil production projected from all new projects except [ConocoPhillips Alaska, Inc. Willow discovery] [slide 9]. Turning to recent and proposed tax changes, Mr. Foley provided a project model that illustrated how fiscal regime changes and proposed changes affect the value of the Nuna project; due to changes made by House Bill 247, the Nuna project is now worth \$0.62 on the dollar to Caelus, and under changes proposed in Senate Bill 5005 the project would never happen [slide 10]. He offered key drivers that are important to the state and industry [slide 11].

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CO-CHAIR JOSEPHSON directed attention to slide 10 and inquired as to what royalty relief Caelus had already received for Nuna.

MR. FOLEY said Caelus received royalty relief; Nuna is a project with a combination of leases: one-sixth royalty leases and one-eighth royalty leases, plus a 30 percent net profit component. He remarked:

So, the royalty modification that was granted took all of those base royalties and rolled them down to a flat 5 percent until we received a multiple of our total investment. ... One of the conditions of that royalty modification said first oil had to commence by X date. We will not make that date, so that royalty modification will expire without having any activity done.

CO-CHAIR JOSEPHSON surmised that Caelus will not receive any benefit from the contracted royalty relief due to its expiration.

MR. FOLEY advised that the Division of Oil and Gas, Department of Natural Resources, will receive a renewed application to extend the aforementioned royalty modification.

REPRESENTATIVE BIRCH asked how sanctioning is defined.

MR. FOLEY explained that after a company completes a rigorous economic evaluation of a project, it seeks financing, thus sanctioning is a culmination of the financing request and the commitment to the project.

REPRESENTATIVE BIRCH inquired how Caelus plans to access privately-owned existing infrastructure on the North Slope.

MR. FOLEY recalled that at the Ooguruk River Unit, Caelus contracted with owners for third-party processing. He said the details of the contract are confidential, however, Caelus avoided capital expenditures and in exchange, rented capacity in the existing system by paying fees.

REPRESENTATIVE RAUSCHER asked for Caelus' policy on Alaska-hire and for the number of Caelus employees who are local.

MR. FOLEY answered that Caelus has 70 employees in Anchorage and on the North Slope; he estimated that 80-85 percent are local.

[3:02:19 PM](#)

The House Resources Standing Committee meeting was recessed at 3:02 p.m. to be continued at 6:00 p.m. [The meeting never reconvened.]