

HB

386

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FILE

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSHB 386(O&G)
(H) Publish Date: 3/17/06

Revision Date/Time (Note if correction): _____ Dept. Affected: Natural Resources
Title: Extend North Slope Severance Tax Credit RDU: Resource Development
Component: Oil and Gas Development
Sponsor: Rep. Kohring
Requester: House Oil and Gas Component No.: 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2006) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill does not have any fiscal impact to the Department of Natural Resources.

Prepared by: William Van Dyke, Acting Director Phone: 269-8800
Division: Oil and Gas Date/Time: 2/17/2006
Approved by: Michael Menge, Commissioner Date: 2/17/2006
Agency: Natural Resources

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: CSHB 386(O&G)
(H) Publish Date: 3/17/06

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
Title: Extending North Slope Severance Tax Credits RDU: Revenue Operations
Component: Tax Division
Sponsor: Rep. Kohring
Requester: House Committee on Oil and Gas Component No.: 2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()	See Analysis
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type-Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2006) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)
This bill extends the existing credit for hydrocarbon exploration, including seismic and exploratory wells, north of 68 degrees, 15 minutes North latitude. The only change made to existing law is to extend the credit cutoff date from July 1, 2007 until July 1, 2010. All other portions of existing law remained unchanged under this bill including:

1. Credit up to 40 percent of total qualifying exploration expenditures with the possibility of an additional 20 percent credit for distance exploratory well drilling.
2. The credit may be used against production taxes.
3. The credits are transferable and saleable.

Prepared by: Dick Tremaine Phone: 269-1021
Division: Tax Division Date/Time: 2/22/06 11 a m
Approved by: Jerry Burnett Date: _____
Agency: Department of Revenue

FISCAL NOTE #2

STATE OF ALASKA
2006 LEGISLATIVE SESSION

BILL NO. CSHB 386(O&G)

ANALYSIS CONTINUATION

The effect of this provision is that the State pays up to 40 percent of eligible exploration expenses with no maximum limit on such cumulative credits. This occurs whether or not the State owns the surface or mineral rights to the area explored. This credit is likely to induce additional exploration in marginal fields. Exploration encouraged by this legislation will result in economic activity within the State and should increase the probabilities of hydrocarbon discovery and, ultimately, production. Such production may result in increased corporate income tax and property tax to the State. Royalties and severance taxes to the State might also increase.

To date, 95.5 million dollars in expenditures have been claimed representing 11 exploration projects on both the north slope and within Cook Inlet. Credits totaling 14.8 million dollars have been issued and an additional 15.1 million dollars in credits are under consideration.

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REPRESENTATIVE VIC KOHRING
DISTRICT 14

House Bill 386 Sponsor Statement

House Bill 386 provides a production tax credit for certain oil and gas exploration expenses from a leasehold or property owned in the state. It also establishes a deadline for using credits from certain exploration expenditures against production tax on oil and gas produced.

HB 386 would extend the exploration credit incentives to 2010 and encourage exploration in Alaska and in particular the North Slope. HB 386 would make AS 43.55.025 uniform thorough out the state, allowing oil producers to credit exploration expenditures against production tax on oil and gas produced after July 1, 2004.

In order to qualify for the production tax credit under existing statute, exploration expenditures must be incurred on or after July 1, 2003, and before July 1, 2007. It has become apparent that the July 1, 2007, deadline will arrive too soon for some smaller independent oil companies that are now planning their exploration dollars for the future. Given this timetable, it is likely that exploration expenditures on these leases would occur after July 1, 2007, in which case they could not be credited against future production taxes.



PIONEER

April 25, 2006

Representative Vic Kohring
Chairman
House Oil and Gas Committee

Thank you for the opportunity to share Pioneer's views regarding HB 386 extending the deadline for certain exploration expenditures used as credits against Alaska production taxes.

Pioneer Natural Resources Alaska, Inc. fully supports this legislation and urges the Legislature to enact its provisions.

Pioneer began its investment in Alaska in early 2003 with the drilling of 3 exploration wells in the shallow waters of the Beaufort Sea. Pioneer significantly expanded its Alaskan inventory at the October 2003 Alaska State Lease Sale where it was the largest participant and successful bidder on approximately 150,000 acres. We opened an office in Anchorage in early 2004 and we now employ 26 persons in Alaska. In 2004, Pioneer concluded exploration agreements with ConocoPhillips and Anadarko across a vast portion of NPR-A. Pioneer has assembled a substantial portfolio with an interest in approximately 1.7 million acres on the North Slope of Alaska. More recently, Pioneer acquired a 10 percent working interest and the option to acquire up to an additional 40 percent working interest and possibly succeed ConocoPhillips as the operator of the Cosmopolitan unit located in the Cook Inlet.

For independent companies like Pioneer, the challenges to building a business in Alaska are formidable. Firstly, the remaining North Slope resources are nothing like the billion barrel fields that opened the Slope. Independents are working to commercialize: a) smaller, lower quality oil reservoirs, b) viscous oil resources, c) remote resources in NPR-A, the foothills and offshore and d) natural gas resources, which will not have a market until the next decade. All of these resources are challenging to commercialize, but it is a challenge that must be met to insure new sources of supply for the state. Secondly, the North Slope is one of the highest cost areas in the world. Remote geography translates to some of the highest capital, lease operating and product transportation costs in the world. Thirdly, North Slope projects have comparatively long

cycles times. From buying a lease to selling oil takes 5 to 10 years depending upon drilling success and distance to existing infrastructure.

The largest challenge independents face on the North Slope is arguably uncertainty. To be successful, we must properly assess and make provision for a number of uncertainties related to exploration risk, future oil and gas prices, fiscal policy, regulatory processes and access to infrastructure. With the long cycle times for Alaska projects, we must make our investments against a long term view for prices. Although current prices exceed \$70 per barrel, the 10 year average price for North Slope crude is less than \$30 per barrel. For Pioneer's Alaska projects, the price of oil in 2006 is irrelevant. The prevailing price in the next decade and beyond will determine future cash flow for new projects.

For explorers, properly assessing exploration risk is critical to the success of an exploration portfolio. Will the value of the fields we ultimately discover offset the cost of dry holes, land, seismic data and development costs? For many of the remote exploration areas on the North Slope, it is difficult to project acceptable full cycle returns due to the cumulative effect of all costs, the long time between investment and cash flow and the relatively long odds of finding a large enough discovery to justify new infrastructure. In 2003, the state initiated exploration incentive credits for certain qualifying exploration expenditures. These incentives encouraged Pioneer to invest more significantly in infrastructure challenged areas such as NPR-A. We believe the state has and is benefiting from this existing program and support the extension of the credits beyond the current expiration in 2007. The program has worked.

Thank you for this opportunity to express Pioneer Natural Resource's views on HB 386. We urge your support for this measure.



Ken Sheffield

President

Pioneer Natural Resources Alaska, Inc.

Oil and Gas Incentives

Exploration Incentive Credits

AS 38.05.180(i)

- This program authorizes the DNR Commissioner to establish an EIC system under which a lessee drilling an exploratory well on state-owned land may earn credits based upon the footage drilled and the region in which the well is located. The program also provides for an EIC for geophysical work on state land if that work is performed during the two seasons immediately preceding an announced lease sale and is on land included within the sale area and the geophysical information is made public following the sale.
- EIC provisions are set by the DNR Commissioner as a lease sale term at the time of each lease sale.
- The credits may not exceed 50 percent of the cost of the drilling or geophysical work and may be applied against royalties, rentals, or taxes under AS 43.55. The credit may not exceed 50 percent of the payment to which it is being applied.
- EICs totaling \$54,692,614.64 have been approved since 1983 for 20 wells. No applications have been filed seeking this EIC since 1994. Several applications for seismic EICs were withdrawn possibly due to public disclosure requirement.

AS 41.09.010 (Implemented 1994)

- This exploration incentive credit program was enacted in 1994. Under this program, EICs may be granted for exploratory drilling, the drilling of stratigraphic test wells, and for geophysical work on unleased state, private, or federal lands. Credits are applied against oil and gas royalties, rentals, taxes, and bonus bids payable to the state. Credits may be as high as 50 percent of eligible costs if performed on state land and as high as 25 percent if performed on private or federal land. However, in order to qualify for the credit, the work must have been performed after August 7, 1994, and before July 1, 2007.
- The intent of this EIC program was to encourage the acquisition of oil and gas geophysical and well data for oil and gas exploration in remote areas of the state on unleased state acreage and provide a means for the state to obtain exploration data from federal lands and private lands.
- No applications pursued as of this date, possibly because of prohibition of extended confidentiality for well information and limited disclosure of geophysical data to approved third parties.

Exploration Tax Credits

AS 43.55.025 Department of Revenue Oil and Gas Exploration Tax Credit

AS 43.020.043 Department of Revenue Capital Investment and Operating Cost Tax Credit.

Royalty Reduction

AS 38.05.180(j) (Amended most recently in 2003)

- This program provides a mechanism to modify oil and gas royalties to allow for production that would not otherwise be economically feasible. Royalties may be reduced to as low as 5 percent if there is new production; 3 percent if producing or shut-in.
- Goal is to encourage otherwise uneconomic production of oil and gas.
- Two companies applied in the past but later withdrew their applications. We believe two companies may soon make application under this provision, but no final applications have been received.

AS 38.05.180(f)(5) (Implemented 2003)

- This incentive program allows payments of royalties as low as 5 percent (rather than the usual 12.5 percent) for oil production from Cook Inlet platforms if production falls below specified levels.
- The goal was to prevent certain Cook Inlet platforms from being shut down and "mothballed" prematurely.
- Thus far, one platform has qualified for the incentive.

Discovery Royalty

AS 38.05.180(f)(4) Cook Inlet Discovery Royalty (Implemented 1996)

- Awarded to the first to have drilled a well discovering oil or gas in a previously undiscovered oil or gas pool and certified by the DNR commissioner within one year of completion of that discovery well. The pool must be capable of producing in paying quantities.
- Five percent royalty (rather than the usual 12.5 percent) on all production of oil or gas from that pool attributable to that lease for a period of ten years following the date of discovery.
- Intent was to encourage additional exploration in the mature Cook Inlet area.
- No applications have been received.

AS 38.05.180(f)(5) Cook Inlet Royalty Relief for small shut-in fields. (Implemented 1998)

- Reduces the royalty to five percent on the first 25,000,000 barrels and first 35,000,000,000 cubic feet for ten years (following the date on which the production for sale commences) on six specific units. The field must have been producing by January 1, 2004.
- The intent was to encourage production from six Cook Inlet oil or gas fields that were either undeveloped or shut in.
- Numerous projects qualified for royalty relief under this provision: Falls Creek Unit (now Ninilchik Unit) Nicolai Creek, Point Starichkof Unit (now Cosmopolitan Unit), Redoubt Shoal Unit, and the West Foreland Unit have all

qualified for the incentive. Only the North Fork Unit did not meet the January 1, 2004 deadline. Falls Creek, Nicolai Creek, Redoubt Shoal, and West Foreland are currently producing units.

Value of state's royalty gas used for agriculture products - AS 38.05.180(ee)
(Implemented 2003)

- Allows the DNR Commissioner to establish the value of the state's royalty share for gas that is sold under contracts entered into on or after the effective date between an oil and gas lessee and a manufacturer of agricultural chemicals. The royalty value may not be less than the price used in contracts (floor) but may not exceed the amount that would otherwise be due under the lease (ceiling).
- This incentive may have slowed the shut-down of the Agrium plant.

Nonconventional Gas Incentive – AS 38.05.180(n)(2) (Implemented 2004)

- Lessee of a gas only lease must demonstrate to the DNR commissioner that potential resources are estimated to be only nonconventional gas.
- Rental payment is \$1 per acre. If the nonconventional gas is not indirect competition with gas which a royalty rate of at least 12.5 percent is payable, then the royalty share is set at 6.25 percent.
- This incentive may have encouraged both the Healy and Holitna Exploration License Applications.

Exploration Licensing – AS 38.05.132 - .133 (Implemented 1994)

- Exclusive right to explore an area between 10,000 and 500,000 acres in size for a term of up to 10 years. Pays a one-time \$1 per acre license fee, no bonus bid, and no annual rental. Has the sole right to convert to an oil and gas lease.
- Goal was to encourage oil and gas exploration within remote areas of the state outside of known oil and gas provinces.
- So far four Exploration Licenses have been issued (Copper River Basin, Nenana, and two in Susitna, Bristol Bay Basin has been awarded, and Healy and Holitna Basins have been proposed).

<u>CURRENT INCENTIVES</u>	<u>CONVENTIONAL LEASES</u>	<u>UNLEASED STATE LAND</u>	<u>LICENSED LAND</u>	<u>SNG LEASES</u>	<u>FEDERAL & PRIVATE LAND</u>
Exploration Incentive Credits (EIC)					
AS38.05.180(l)	up to 50% of drilling costs	up to 50% of seismic costs	N/A	up to 50% of drilling costs	N/A
AS41.09.010 – expires 7-1-2007	N/A	up to 50% of drilling & seismic costs	up to 50% of drilling & seismic costs	N/A	up to 25% of drilling & seismic costs
Exploration Tax Credit					
AS43.55.025 – expires 7-1-2007 (03.185)	20% of drilling costs or 40% of drilling costs if >25 mi of a unit plus 40% of seismic costs	20% of drilling costs or 40% of drilling costs if >25 mi of a unit plus 40% of seismic costs	20% of drilling costs or 40% of drilling costs if >25 mi of a unit plus 40% of seismic costs	20% of drilling costs or N/A	20% of drilling costs or 40% of drilling costs if >25 mi of a unit plus 40% of seismic costs
AS43.20.043 – expires 1-1-2013 (03.61) for below 68° latitude *** (see note at bottom)	10% of capital investment 10% of annual cost	10% of capital investment 10% of annual cost	10% of capital investment 10% of annual cost	10% of capital investment 10% of annual cost	10% of capital investment 10% of annual cost
Royalty Reduction					
AS38.05.180(j) (03.28)	as low as 5% if new production as low as 3% if producing or shut-in	N/A	(Applies after conversion to Lease) (Applies after conversion to lease)	as low as 5% if new production as low as 3% if producing or shut-in	N/A
AS38.05.180(f)(5) (03.185)	As low as 5% for oil production from CI platforms if production falls below specified levels	N/A	N/A	N/A	N/A
Discovery Royalty					
AS38.05.180(f)(4) for Cook Inlet only for pre-1969 leases only, statewide	5% royalty for 10 yrs 5% royalty for 10 yrs	N/A N/A	(In limited area after conversion: T18N) N/A	(Applies to limited area: T18N) N/A	N/A N/A
AS38.05.180(f)(5) for following fields only: Falls Creek, Nicolai Creek, Stanchkof, Nor Fork, Redoubt Shoals, & West Foreland field must be in production by 1-1-2004	5% on 1st 25 MM bbls for 10 yrs 5% on 1st 35 BCF for 10 yrs	N/A	N/A	N/A	N/A
Economic Limit Factor – AS43.55.013	Yes	N/A	(Applies after conversion to Lease)	Yes	Yes
Contract Gas Price With a Utility vs Royalty Value – AS38.05.180(aa)	Value of state's royalty share equals gas contract price	N/A	(Applies after conversion to Lease)	Value of state's royalty share equals gas contract price	Value of state's royalty share equals gas contract price
Value of state's royalty gas used for ag products – AS38.05.180(aa) (03.57)	Negotiated Value	N/A	(Applies after conversion to Lease)	Negotiated Value	Negotiated Value
*** If requesting this credit, not eligible for any other tax credits or royalty modifications					
INCENTIVES AS PART OF A PROGRAM	CONVENTIONAL LEASES	UNLEASED STATE LAND	LICENSED LAND	SNG LEASES	FEDERAL & PRIVATE LAND

Exploration Licensing	AS38.05.132	N/A	N/A	Up to 500,000 acres per license One-time \$1/acre license fee No bonus bid No annual rental sole right to convert to O & G leases	N/A	N/A
Nonconventional Gas Incentive—		reduced rental	N/A	(Applies after conversion to Lease)	N/A	
AS 38.05.180(n)(2)	(04.531)	6.25% royalty if no competition with 12.5% leasee				

Exploration Incentive Credit Summary (a layman's explanation)

AS 43.55.025 provides

<u>Section</u>	<u>tax credit rate</u>	<u>must satisfy (see below)</u>
(a)(1)	20% credit	(b) and (c)
(a)(2)	20 % credit	(b) and (d)
(a)(3)	40% credit	(b), (c) and (d)
(a)(4)	40% credit	(b), and (e)

Section (b)

- (1) must be seismic or geophysical work
- (2) must be a well not included in a unit POD or POE on 5/13/03

Section (c)

- (1) well must be greater than 3 miles from pre existing well except in Cook Inlet where well can be less than 3 miles from pre existing well if it is drilled for a separate exploration target.

Section (d)

- (1) well must be greater than 25 miles from a preexisting unit except for Cook Inlet where the well must be greater than 10 miles from a pre existing unit

Section (e)

- (1) seismic program must be outside of unit area

Cook Inlet Results

1. Seismic and geophysical can get a 40% credit anywhere outside unit areas
2. A well can get a 20% tax credit as long as it is drilled for a separate exploration target even if it is closer than 3 miles from a pre existing well.
3. A well can get a 40% tax credit if it greater than 10 miles from a unit that is under a plan of development. Again, the 3 mile limit from pre existing wells can be waived if it is drilled for a separate exploration target. The 10 mile limit can not be waived.

WVD 3/20/06

February 23, 2006

Representative Vic Kohring
Chairman, House Special Committee on Oil & Gas
Alaska State Legislature
State Capitol
Juneau, AK 99801

Dear Chairman Kohring:

We would like to express our thanks to you and your Committee for sponsoring House Bills 372 and 386.

While it may seem basic, in order to increase future North Slope oil production, more exploration wells must be drilled. Even with modern technology, the commercial chance of success of frontier exploration projects in Alaska is still under 10%. When compared with many other exploration opportunities worldwide, it takes longer in Alaska to begin generating revenue from investments. By reducing early expenditures, exploration tax credits provide great incentives to invest and drill more wells.

The companies listed below strongly support extending the North Slope exploration incentive credits because we believe they are effective in encouraging additional investment in oil and gas exploration, as well as in attracting new players to Alaska.

Anadarko Petroleum Corporation
Arctic Slope Regional Corporation
BG Alaska E&P, Inc.
Brooks Range Petroleum Corporation/AVCG LLC
Devon Energy Corporation
FEX L.P.
Petro-Canada (Alaska) Inc.
Pioneer Natural Resources Alaska, Inc.
Ultrastar LLC

Support

22 February 2006

Representative Vic Kohring
Chairman, House Special Committee on Oil & Gas
Alaska State Legislature
State Capitol
Juneau, AK 99801

Dear Chairman Kohring:

BG Group plc is new to Alaska, having just announced our partnership with Anadarko Petroleum and Petro-Canada to explore for oil and gas along the North Slope. We are convinced there is potential in Alaska for the continued development of gas and oil reserves. However, there are also considerable risks and we along with the other independents would like to express our thanks to you and your Committee for sponsoring House Bills 372 and 386.

When making investment decisions BG looks at opportunities on a world wide basis and one of the key reasons we chose to enter Alaska and explore along the North Slope was because of the tax credits. As you know, in order to increase North Slope gas and oil production, more exploration wells must be drilled. Even with modern technology, the commercial chance of success of frontier exploration projects in Alaska is still under 10%. When compared with many other exploration opportunities worldwide, it takes longer in Alaska to begin generating revenue from investments. By reducing early expenditures, exploration tax credits provide great incentives to invest and drill more wells.

BG strongly supports extending the North Slope exploration incentive tax credits because they are effective in encouraging additional investment in gas and oil exploration, as well as in attracting new players, such as BG, to Alaska.

Sincerely,



David N. Keane

BP NORTH AMERICA LLC
David N. Keane
Vice President
Policy & Corporate Affairs
528 Westheimer
Suite 1000
Houston, Texas 77056

Tel: (281) 201-1000
Fax: (713) 599-4291

Alaska Oil and Gas Association



121 W. Fireweed Lane, Suite 207
Anchorage, Alaska 99503-2035
Phone: (907)272-1481 Fax: (907)279-8114
Judith Brady, Executive Director

Date: March 2, 2006

To: House Special Committee on Oil & Gas

The Alaska Oil & Gas Association (AOGA) supports House Bill 386 extending to July 1, 2010, the deadline for oil and gas exploration tax credits under Title 43 of the Alaska Statutes for both Cook Inlet and the North Slope, thereby making the deadline uniform throughout the state.

AOGA is a non-profit trade association whose 17 member companies represent the majority of oil and gas exploration, production, transportation, refining and marketing activities in Alaska.

The Oil and Gas Exploration Tax Credit, adopted in 2003, now applies to wells drilled between July 1, 2003 and July 1, 2007. HB 386 would extend the deadline to July 1, 2010. This tax credit has been successfully used to encourage exploration investment and should be continued as one of the tools the State has available to encourage interest in both Cook Inlet and the North Slope.

The program allows for a production tax credit of 20 percent of the cost of an exploratory well if the bottom hole location is three or more miles from the bottom hole location of a pre-existing well that was spud more than 150 days, but less than 35 years, prior to the spud date of the eligible exploration well.

The program also allows for a production tax credit of 40 percent of the cost of an exploratory well if the bottom hole location is 25 miles or more from the boundary of any unit under a plan of development as of July 1, 2003. The program also offers seismic exploration tax credits of 40 percent of eligible costs for those portions of activities outside of a unit that is under a plan of development or plan of exploration. Seismic data qualifying for this credit will be held confidential for 10 years and 30 days. This tax credit is transferable.

Thank you for the opportunity to comment on this proposed legislation.

Sincerely

JUDITH M. BRADY
Executive Director

cc: Commissioner Michael Menge, DNR
Ms. Robynn Wilson, DOR - Tax Division
Mr. Pat Galvin, DNR



PIONEER
NATURAL RESOURCES ALASKA, INC.

February 21, 2006

Representative Vic Kohring
Chairman
House Oil and Gas Committee

Thank you for the opportunity to share Pioneer's views regarding HB 386 extending the deadline for certain exploration expenditures used as credits against Alaska production taxes.

Pioneer Natural Resources Alaska, Inc. fully supports this legislation and urges the Legislature to enact its provisions.

Pioneer began its investment in Alaska in early 2003 with the drilling of 3 exploration wells in the shallow waters of the Beaufort Sea. Pioneer significantly expanded its Alaskan inventory at the October 2003 Alaska State Lease Sale where it was the largest participant and successful bidder on approximately 150,000 acres. We opened an office in Anchorage in early 2004 and we now employ 26 persons in Alaska. In 2004, Pioneer concluded exploration agreements with ConocoPhillips and Anadarko across a vast portion of NPR-A. Pioneer has assembled a substantial portfolio with an interest in approximately 1.6 million acres on the North Slope of Alaska. More recently, Pioneer acquired a 10 percent working interest and the option to acquire up to an additional 40 percent working interest and possibly succeed ConocoPhillips as the operator of the Cosmopolitan unit located in the Cook Inlet.

For independent companies like Pioneer, the challenges to building a business in Alaska are formidable. Firstly, the remaining North Slope resources are nothing like the billion barrel fields that opened the Slope. Independents are working to commercialize: a) smaller, lower quality oil reservoirs, b) viscous oil resources, c) remote resources in NPRA, the foothills and offshore and d) natural gas resources, which will not have a market until the next decade. All of these resources are challenging to commercialize, but it is a challenge that must be met to insure new

sources of supply for the state. Secondly, the North Slope is one of the highest cost areas in the world. Remote geography translates to some of the highest capital, lease operating and product transportation costs in the world. Thirdly, North Slope projects have comparatively long cycle times. From buying a lease to selling oil takes 5 to 10 years depending upon drilling success and distance to existing infrastructure.

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For explorers, properly assessing exploration risk is critical to the success of an exploration portfolio. Will the value of the fields we ultimately discover offset the cost of dry holes, land, seismic data and development costs? For many of the remote exploration areas on the North Slope, it is difficult to project acceptable full cycle returns due to the cumulative effect of all costs, the long time between investment and cash flow and the relatively long odds of finding a large enough discovery to justify new infrastructure. In 2003, the state initiated exploration incentive credits for certain qualifying exploration expenditures. These incentives encouraged Pioneer to invest more significantly in infrastructure challenged areas such as NPR-A. We believe the state has and is benefiting from this existing program and support the extension of the credits beyond the current expiration in 2007. The program has worked.

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Ken Sheffield
President
Pioneer Natural Resources Alaska, Inc.