

SB

305

(FILE 16)

Chevron



Chevron - Alaska Area
Testimony on SB 305

John P. Zager
General Manager

March 19, 2006



General Comments on CS

■ Previous Testimony by Chevron

- We will support the bill and the key terms as written with the following stipulations:
 - ▶ The bill must recognize the marginal nature of the Cook Inlet
- Do not pull all of the "levers" in the same direction
- We applaud the recognition in the current CS that the Cook Inlet oil cannot support an additional tax burden
- However, because of the substantive changes in many areas we can no longer support this bill in its entirety



Cook Inlet Provision – *One Size Does Not Fit All*

- I will not repeat previous testimony on Cook Inlet, which I believe demonstrated
 - the difficult financial position of the Cook Inlet oil
 - the unique value of the Cook Inlet oil and gas production to the economy of south central Alaska
 - co-dependent aspect of the Cook Inlet energy business
- Several Cook Inlet options were presented
 - Carving out current Cook Inlet oil production is the one adopted in the CS
 - Other options could work if they:
 - ▶ do not increase taxes
 - ▶ provide incentives for exploration and development



General Comments on CS

- Agree with many of the points that have already been made by other producers
 - Balance of the original bill is gone
 - Lever's pulled in the same direction
 - ▶ Tax rate at 25% is a disincentive
 - ▶ April 1, commencement date, not practical, punitive penalty and interest rate
 - ▶ Transition capital credit greatly diminished
 - ▶ Loss of "standard deduction"
 - ▶ Progressivity - taking away the "windfalls", no matter how you couch it, lowers expected value to investors
 - Other issues
 - ▶ WTI vs. ANS, oil marker for gas?
 - Makes Alaska less competitive



General Comments on CS

■ Debate between "get it now" and "grow the pie"

- "Get it now" option will balloon short term revenue creating a state windfall that must be well managed
- "Grow the pie" option will create long term opportunities for investors and for Alaska
- I am optimistic about the ingenuity and technology available in our industry and the people of Alaska to greatly extend oil production for the next generation

■ Consultants will one day leave and we will be left to deal with our decisions

- First you vote on behalf of the people of Alaska
- Then over the coming years investors vote with their dollars
 - ▶ Original industry support was quite astounding
 - ▶ However, Investors big and small, old and new, are now saying that the Senate CS structure will discourage investment in Alaska



Summary Comments on CS

- Chevron cannot support the Senate CS in its current form
- Urge return to original PPT terms, while retaining a Cook Inlet provision
- Chevron has been in Alaska for many years and intends to continue an active exploration and production operation in the state if a sound and stable fiscal regime can be offered

ALASKA STATE LEGISLATURE



Official Business

SENATE RESOURCES COMMITTEE

Senator Tom Wagoner, Chair

State Capitol, Room 427

Juneau, AK 99801-1182

Phone: (907) 465-4907 Fax: (907) 465-4779

Senator Ralph Seekins, Vice-Chair

Senator Ben Stevens

Senator Kim Elton

Senator Fred Dyson

Senator Bert Stedman

Senator Albert Kookesh

DATE: March 19, 2006

TO: Members, Senate Resources Committee

FROM: Senator Tom Wagoner, Chair *Tom*
Senate Resources Committee

RE: SB 305 Amendment procedures

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Administrative Amendments will be those suggestions, that I concur with, that were identified by either Mr. Dickerson or Ms. Wilson at their presentation on Saturday. They brought up a number of points, most of which had been previously identified as items of concern and are addressed as technical amendments. I note that there were two suggested "fixes" that they provided and they did not provide any written documentation of their testimony on Saturday.

Substantive Amendments that I have identified are three fold:

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- The second is the replacement for the \$73 million deduction (also noted as an issue that was expected to change) and I am attaching two options that I will be placing before the committee for your consideration. Please note that that "standards" have been identified as an issue and I was advised by Mr. Dickinson last Friday that he would provide some. I have yet to receive such standards.
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There are two other issues I am finalizing – abandonment and the Cook Inlet exemption.

**Replacing \$73 Million Per Producer Per Year Tax-Free Allowance
With 4,000 B/D Tax Exemption for 7 Years for New Fields
March 16, 2006**

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Delete Section 21(i) and (j).
Delete Section 36(d).

Insert the following as Section 21(i):

(i) Except as limited by this subsection, for each oil and gas unit in the state, and for each oil or gas field in the state but outside an oil and gas unit which first commences commercial production on or after July 1, 2006, the first 4,000 barrels of oil or oil equivalent produced each day during the first seven consecutive years of production shall be exempt from taxes levied under AS 43.55.011, and their value shall be excluded from the calculation of gross value at the point of production, except that to the extent that the gross value at the point of production for any one barrel of oil or oil equivalent exceeds \$40, then the excess above \$40 on that barrel of oil or oil equivalent is not exempt from taxes levied under AS 43.55.011 and shall be included in the calculation of gross value at the point of production. No producer may claim an exemption under this subsection to the extent that the exemption would result in a carried forward loss credit under AS 43.55.024. No single producer may claim further exemptions under this subsection once the total of all exemptions claimed on or after July 1, 2006 by the producer under this subsection equals or exceeds 10,220,000 barrels of oil or oil equivalent. The Alaska Oil and Gas Conservation Commission shall have jurisdiction to resolve any disputes about what constitutes an oil and gas field or oil and gas unit for purposes of this subsection. The Department of Revenue, after consultation with the Department of Natural Resources, shall resolve any dispute about the allocation of tax exemptions among multiple producers under this subsection.¹

¹ DOR is working on standards to support this option.

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Option #2

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Insert the following as Section 21(i):

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Two for One System

March 18, 2006

Pedro van Meurs

The "Two for One" concept is designed to reform the "claw back" into a feature that would reward companies that have been traditionally strong investors in Alaska and are now, as a result of the PPT law, be prepared to significantly increase the level of investment.

The past investments would be the investments made from January 1, 2001 to December 31, 2005.

It is suggested to establish a 7 year period from January 1, 2006 to December 31, 2012. During this period investors would be able to recover for every two new dollars invested, one dollar of previous capital. On this investment recovery companies would get the tax credit of 20% related to the capital cost deduction, but not the investment tax credit of 20%.

However, this recovery of capital can only be used in any month where the price is above the floor price of \$ 40 per barrel, escalated with CPI inflation.

Any past investment not recovered on December 31, 2012, "falls of the table" and can no longer be used.

The fixed period of 7 years seems reasonable since it can be anticipated that there will be one or more years where the price is below the floor price. Also companies would need one or two years to gear up for a higher level of investment.

The following table provides a comprehensive example of how the system would work.

It is assumed that in years 2009 and 2010 the actual price would be below the escalated floor price and therefore during these two years no investment recovery would take place. CPI escalation is assumed to be 2%.

Examples:

Company A has invested \$ 1800 million during the last five years. This company is prepared to significantly increase the level of investment. In fact, in total the company actually invests \$ 5400 during the 7 year period. Company A would fully recover the prior investment in 2012. During years 2006, 2007, 2008 and 2011 when prices are high the company receives a tax credit of 50%. Due to the two years of no recovery the tax credits are only 40%. The average tax credit rate is 46.7%.

Company B has invested only \$ 500 million during the prior five years. However, this company is also accelerating its investments in the future significantly. Total investments over the 7 year period are \$ 3700 million. This company recovers its past investment in the first three years and receives a tax credit of 50% in these years. Thereafter the company is no further eligible for past investment recovery. In years 4 – 7 the company therefore only receives the 40% tax credit. The company fully recovers its capital, but the average tax credit rate over the 7 year period is only 42.7%

Company C decides to reduce its rate of investment. Over the 7 year period the investments are \$ 1500 million, equal to the total incurred during the prior 5 years. In this case the company will get a tax credit of 50% in every year that the price is over the floor price. However, in total Company will only recover \$ 550 million of its \$ 1500 million prior investment. On December 31, 2012 \$ 950 million "falls of the table".

2 for 1 concept of Investment Recovery based on 20/20 system
(\$ million)

		2006	2007	2008	2009	2010	2011	2012	Total	Recovery percentage	Average Tax Credit
Price Floor		\$40.00	\$40.80	\$41.62	\$42.45	\$43.28	\$44.16	\$45.05			
Actual Price		\$60	\$55	\$52	\$39	\$41	\$46	\$49			
Company A											
Previous Investments	1800										
Investments		400	600	800	600	800	1000	1200	5400		
Investment Recovery		200	300	400	0	0	500	400	1800	100.0%	
Tax Credits		200	300	400	240	320	500	560	2520		46.1%
Net Investment		200	300	400	360	480	500	640	2880		
Company B											
Previous Investments	500										
Investments		200	400	600	600	700	600	600	3700		
Investment Recovery		100	200	200	0	0	0	0	500	100.0%	
Tax Credits		100	200	280	240	280	240	240	1580		42.7%
Net Investment		100	200	320	360	420	360	360	2120		
Company C											
Investments	1500										
Investments		200	300	200	200	200	200	200	1500		
Investment Recovery		100	150	100	0	0	100	100	550	36.7%	
Tax Credits		100	150	100	80	80	100	100	710		47.3%
Net Investment		100	150	100	120	120	100	100	790		

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