

**HB**

**20001**

**(10/31/07)**

ALASKA STATE LEGISLATURE  
House Resources Committee

**Carl Gatto, Co-Chair**

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**Wednesday, October 31<sup>st</sup>**  
**House Finance Committee Room 519**

**9:00 a.m.**

**HB 2001 Oil and Gas Tax Amendments**

**Presentation by the Stakeholders:**

**Claire Fitzpatrick, Commercial Senior Vice President,  
Bernard Hajny, Manager, Production Tax & Royalty, BP  
Kevin Mitchell, Vice President, Finance & Administration,  
Jim Taylor, Vice President, ConocoPhillips Alaska**

**Presentation by Division of Oil and Gas:**

**Kurt Gibson, Deputy Director, and Julie Houle, Chief of  
Resource Evaluation, Division of Oil & Gas, Department of  
Natural Resources**



BP Presentation on HB 2001  
House Resources Committee

Claire Fitzpatrick and Bernard Hajny  
October 31, 2007

# Key Messages

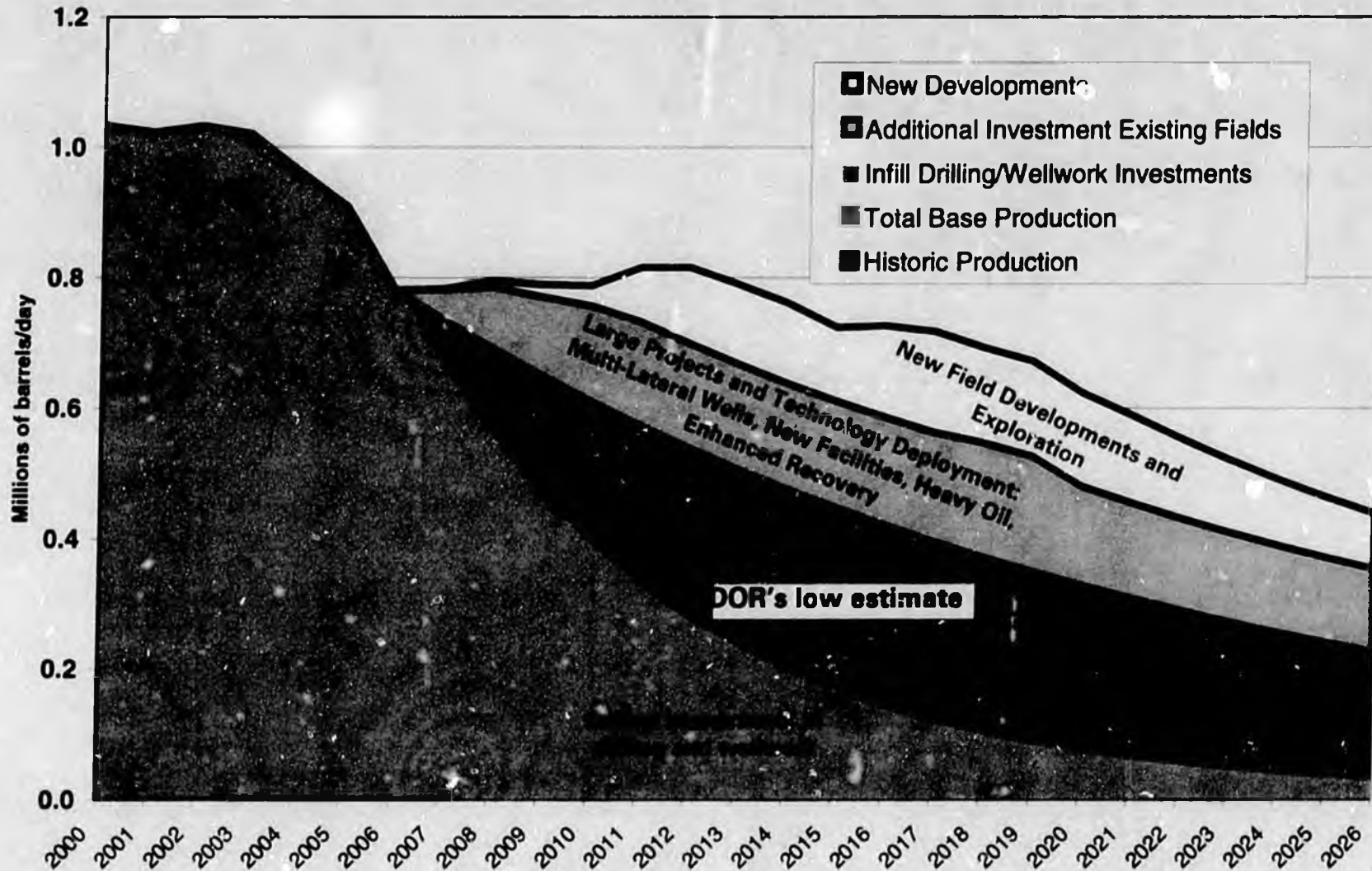


- **Production**, not tax rate, is the major factor in determining state revenue for the future years
- Delivering the production forecast will require tens of billions of **investment**
- Investment decisions are made on the combination of strategy, resource prospects, technology, economics, and risk, including fiscal terms and stability
- Higher prices and developing technology could give the Alaska fields a new lease on life, but huge **investments are needed**
- The proposed bill by the Administration significantly **deteriorates economics on 70%** of investment options in the next 20 years
- Committee substitute bill retain the portions of the original proposal that **increase investment risk**

Future of oil production is critically dependent on existing large fields, additional investments

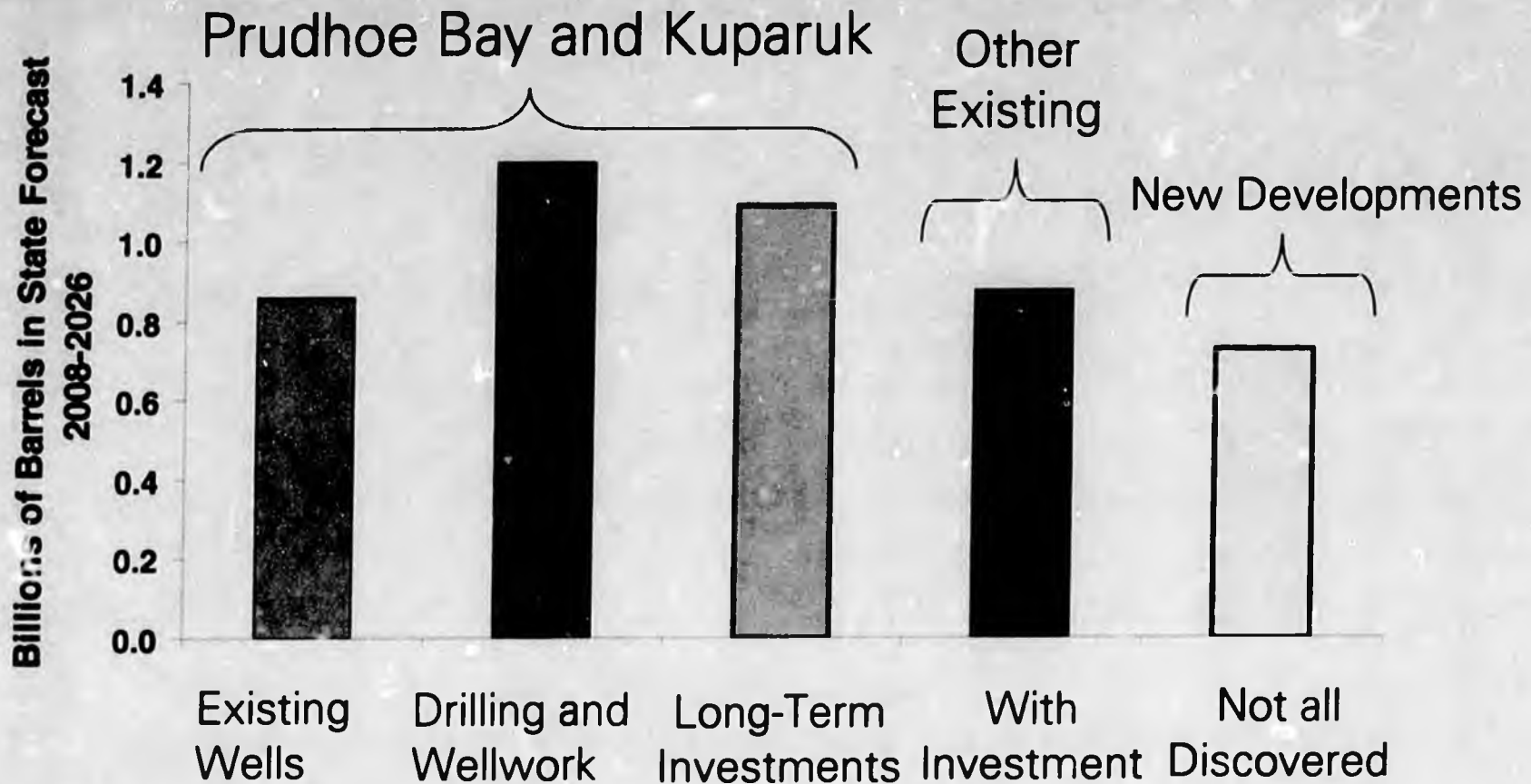


DOR Production History and Forecast





Alaska needs a world scale level of ALL types of investment to sustain the future of oil production



State Revenue, \$billion\*

13

18

16

11

9

\*assuming PPT terms and state revenue of \$15/bbl at \$60/bbl ANS

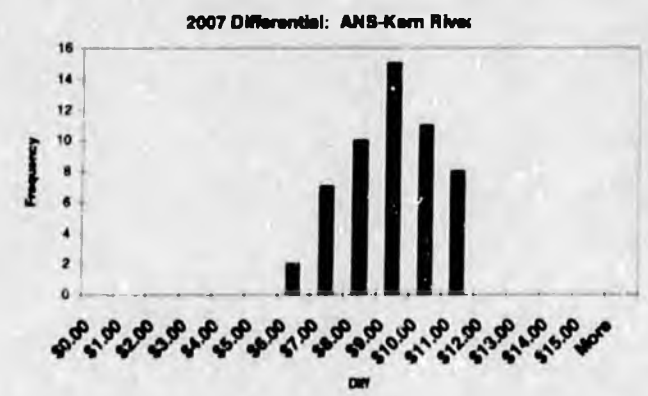
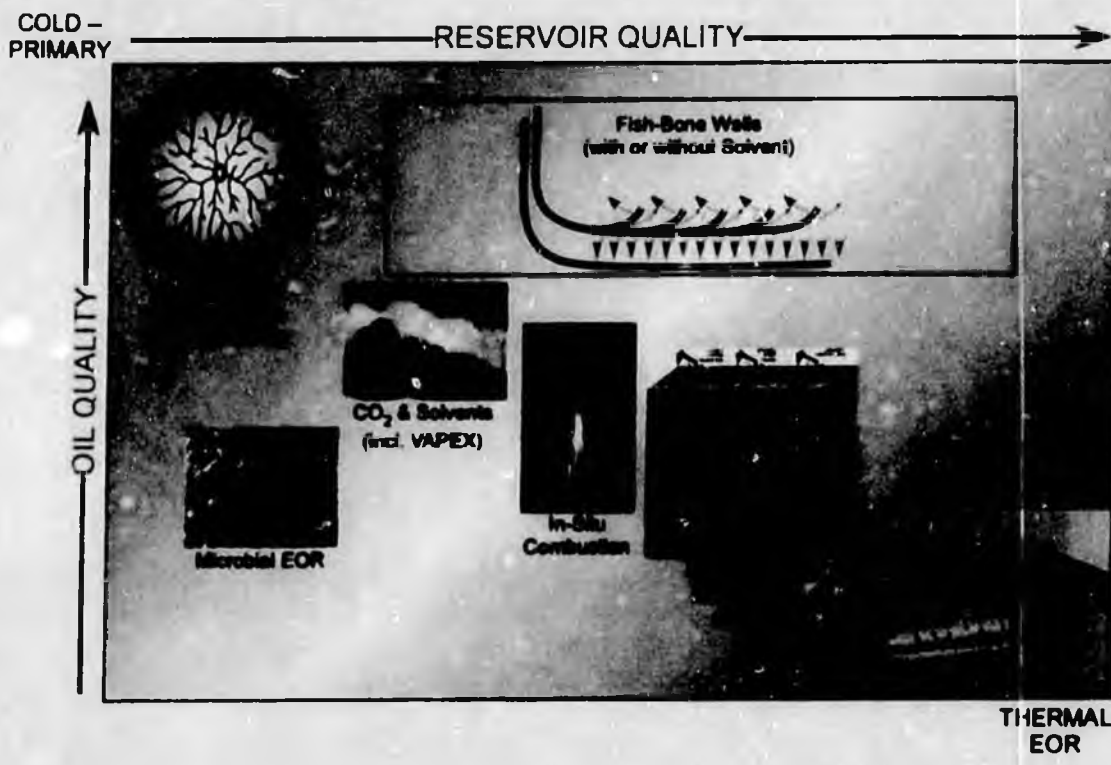


# Heavy Oil Challenges

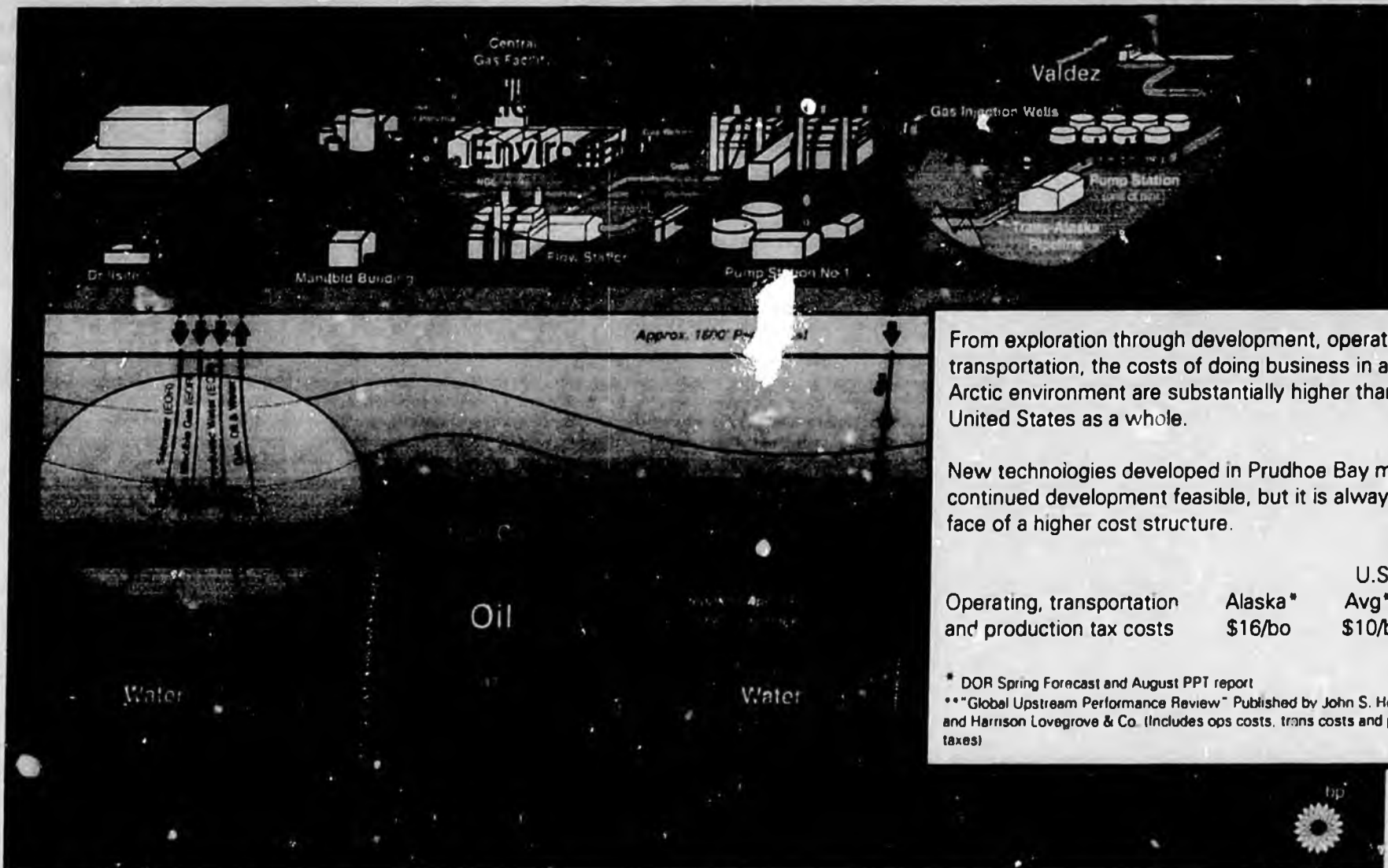
Heavy oil will always be disadvantaged relative to light oil on the basis of development cost, and commodity price



PROPERTIES	BUSINESS IMPACT
<ul style="list-style-type: none"> <li>• Chemical                             <ul style="list-style-type: none"> <li>- Hydrogen depleted relative to light oil</li> </ul> </li> <li>• Physical                             <ul style="list-style-type: none"> <li>- High viscosity</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Retool refineries</li> <li>• Take a lower price on market</li> <li>• High well density</li> <li>• Add heat to reservoir &amp; transit lines</li> <li>• Add diluent to major pipelines</li> <li>• Upgrading (partial refining)</li> <li>• Environmental Mitigation (e.g. CO<sub>2</sub> sequestration)</li> <li>• Water treatment</li> <li>• Sand Disposal</li> <li>• Wellwork</li> </ul>
	<p>Revenue</p> <p>Costs</p>



# Alaska vs. Average U.S. Cost Structure



From exploration through development, operating and transportation, the costs of doing business in a remote Arctic environment are substantially higher than the United States as a whole.

New technologies developed in Prudhoe Bay make continued development feasible, but it is always in the face of a higher cost structure.

	Alaska*	U.S. Avg**
Operating, transportation and production tax costs	\$16/bo	\$10/bo

\* DOR Spring Forecast and August PPT report

\*\* "Global Upstream Performance Review" Published by John S. Herold, Inc and Harrison Lovegrove & Co. (Includes ops costs, trans costs and production taxes)



# Sector inflation triggered by high oil prices is real and substantial – example measures



“The Upstream Capital Costs index, developed by Cambridge Energy Research Associates (CERA), shows that costs for oil and gas production equipment, facilities, construction, materials and personnel have increased 53% since 2005.” (Source: PPT Implementation Status Report, August 2007)

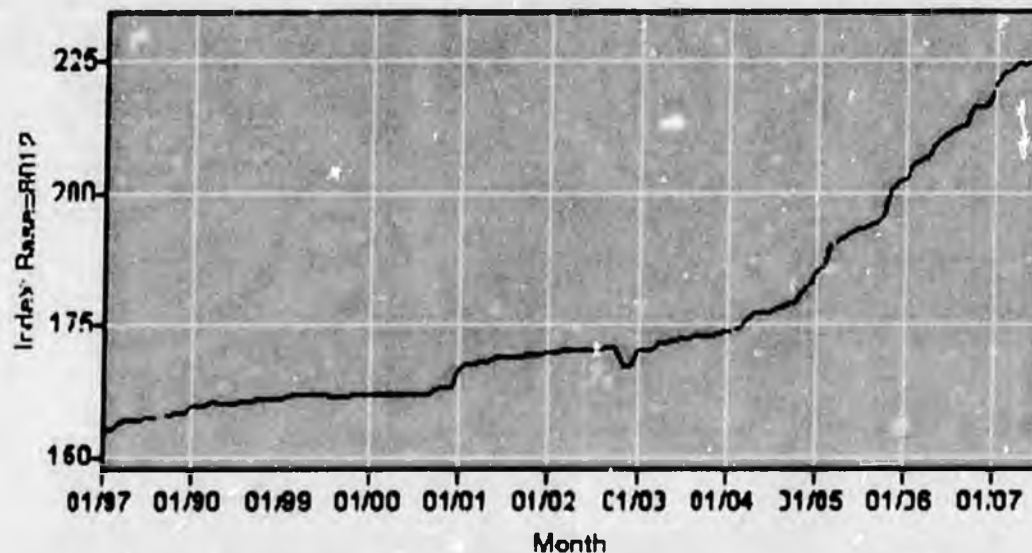
## 2004-2006 U.S. Average Cost Increases per barrel

- 153% on Finding and Development costs (Capital)
- 58% Lifting costs (Expense)

(Source: “Global Upstream Performance Review” published by: John S. Herold /Harrison Lovegrove)

## **Oil and Gas Field Machinery and Equipment PPI**

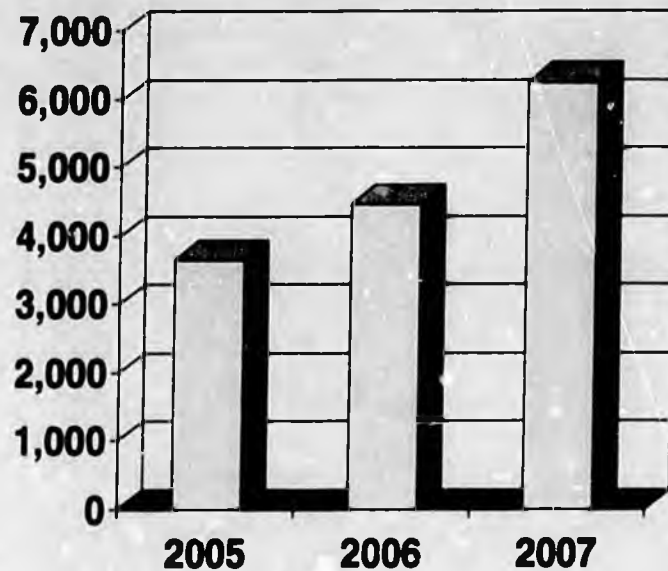
Source: U.S. Department of Labor



# Investment activity is also causing a large part of the increase



□ North Slope Contractor Jobs



- Since late 2004, BPXA staff has grown from 1300 to approaching 2000 employees
- Active drilling rig count on contract for BP has gone from 9 in 2004 to 10 in 2007
- BP commissioned a new camp this summer and rented 4 more, increasing our camp capacity by 30%
- Seismic acquisition activity brought in additional 100+ contractors to the Slope for the winter season
- Pickup truck rentals in support of NS operations has gone up approximately 60%
- Preventative maintenance and inspection programs on the 30-year old infrastructure are at an all-time high

# HB/SB 2001 Proposals



- Information Reporting
  - 30 years on one basis – should we be that surprised that both parties are working out how to make it work?
  - What information has been provided over the years
  - What information is needed to forecast
    - Audit rights enable full access to details on all expenditures
  - Business plans change: a forecast is **not a promise**
  - Statute of limitations
- Information Use
  - Sharing and confidentiality, public disclosure
  - Advisory bulletins

# HB/SB 2001 Proposals



- Lease Expenditure
  - Start with JV billing
  - Definitions
- Exclusions
  - Unscheduled interruption
    - Definition and unintended consequences
  - Topping plant : Safety and Environmental impact of alternative
  - DR&R
- Credit Adjustments
  - TIE credits
  - 2 years – v - 1 year

# Economic impact of proposed bill on new investments



- About 70% of future investment decisions are within Prudhoe Bay and Kuparuk.
- A significant number of investment opportunities in Prudhoe Bay and Kuparuk will cross into marginal or non-economic territory under minimum tax scenario, raising costs and lowering netbacks for the rest of the North slope production.
- Gross progressivity is not flexible for future changes. Net tax is self-adjusting to costs and revenues.

# Key Messages



- Production, not tax rate, is the major factor in determining state revenue for the future years
- Delivering the production forecast will require tens of billions of investment
- Investment decisions are made on the basis of strategy, resources, technology, economics, and risk, including fiscal stability
- Original SB/HB2001 significantly deteriorates economics on 70% of investment options in the next 20 years
- Higher prices and developing technology could give the Alaska fields a new lease on life, but huge investments are needed
- The focus of the tax policy should be on encouraging large investments in existing fields as well as exploration
- The proposed bill creates **uncertainty** for taxpayers and potentially distorts business decision making

# Backup Material



# Data Provided to State Agencies



- Special Requests:
  - Sept 2006 – Joint Company Upstream Accounting Review with example documents
  - Nov. 2006
    - 2001-2005 PBU Partnership Tax Trial Balance
    - 2004-2005 PBU Partnership Returns & Amendments
    - 2004-2005 PBU Gross Billable General Ledger Balances and accounting detail.
    - PBU Operating Agreement and Accounting Procedures with approved and pending amendments
    - 2001 to Present - Joint Venture Audit Status Reports

# 2006 PPT Filing Information



- BP PPT Template
  - Excel workbook w/ calculations
  - Monthly Volumes and GVPP
  - Lease Expenditures by field categorized by capital or expense and further detailed by: exploration, development, production, lifting, etc.
  - Annual Surcharge report by field
  - Schedule A: Qualified Capital Expenditures for each field. Included AFE #, AFE description, Account coding and amounts.
  - TIE credits
  - Tax credit summary form
  - May 2007 – BP met with DOR and presented a review of the 2006 filing process and numbers. From Trial Balance to filing and discussion of excluded items.

## 2007 Monthly Filings with DOR



- Taxpayer worksheet in DOR format for loading into DOR database
- Disposition Report – Special data extract for State Economists use
- Supplemental/Financial Month workbook (Netback calculation)
  - Production by field, Prevailing value, sales, TAPS deliveries, Marine transportation costs by account and amount
- PPT Conservation Surcharge: volumes and amounts by field
- PPT credits applied
- PPT Expenses by field, account type, expense type, expense activity
- PPT Month – Base Tax Report – includes GVPP, lease expense, base tax calcs, base tax credits and base tax installments.
- PPT Month – Index, PPT Actual Volumes, Tax Payment summary
- Contracts, invoices and netback reports

CSHB 2001 Testimony  
October 31, 2007

**ConocoPhillips Alaska**

**Kevin Mitchell**

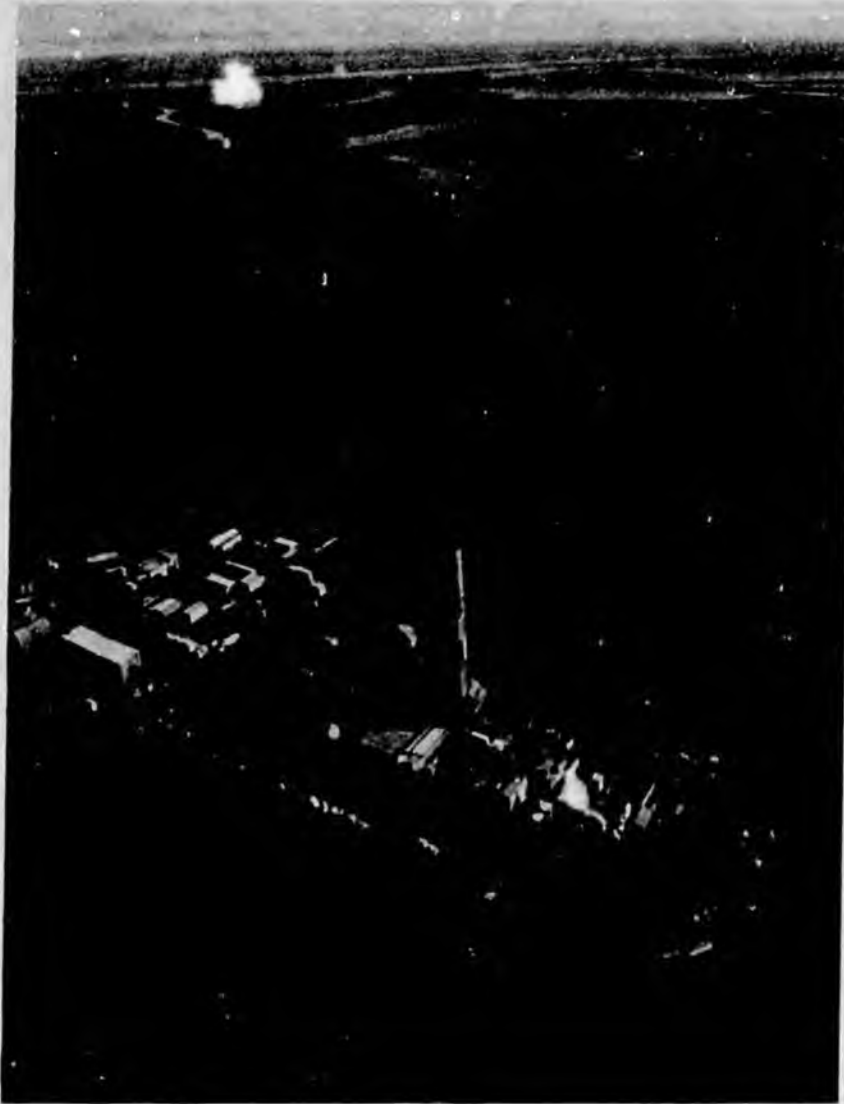
Vice President, Finance & Administration

**Jim Taylor**

Vice President, Commercial Assets

ConocoPhillips

# ConocoPhillips in Alaska Today



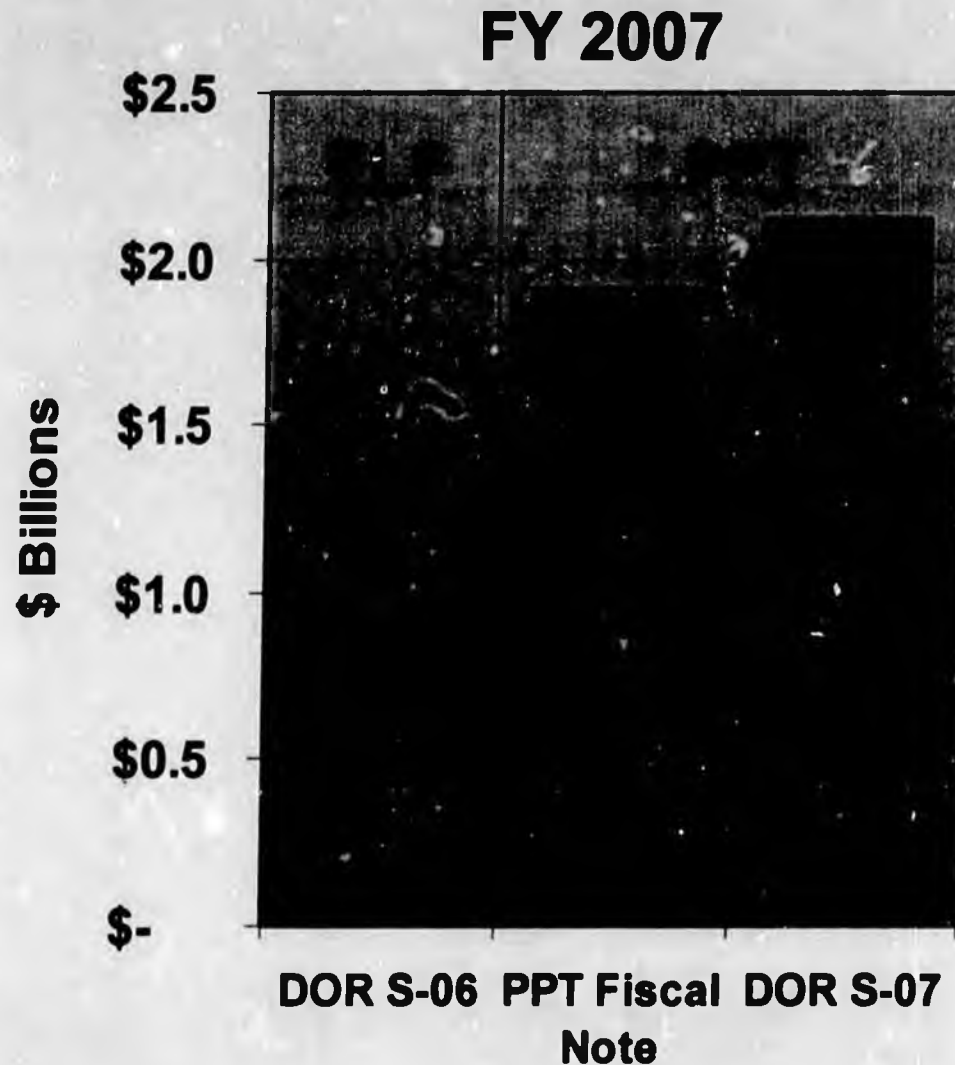
- **Alaska's Largest Producer**
  - 2006 oil production: 280,000 barrels of oil per day
  - 2006 gas production: 145 million cubic feet per day
- **Alaska's Largest Lease Holder**
  - Interest in 1.7 million gross (federal) acres in the NPRA
  - Nearly 2.6 million gross undeveloped acres in total outside of producing fields
- **Alaska's Leading Explorer**
  - 60 exploration wells since 1999, including 17 wells in NPRA
- **Alaska's Largest Industry Community Supporter**
  - 2006 > \$12 Million Contributions
  - 2007 > \$14 million (projected)
- **Alaska's Largest Royalty and Taxpayer**
  - 2006 taxes paid to government: \$2.3 billion
  - 2006 royalties: \$730 million

ConocoPhillips

# Summary Comment

- Interest between state and industry should be aligned
- Too early to change PPT
- Tax changes will impact investment
  - Increased tax take
  - Uncertainty with frequent tax changes
- Administrative provisions need careful thought

# Revenue Forecasts

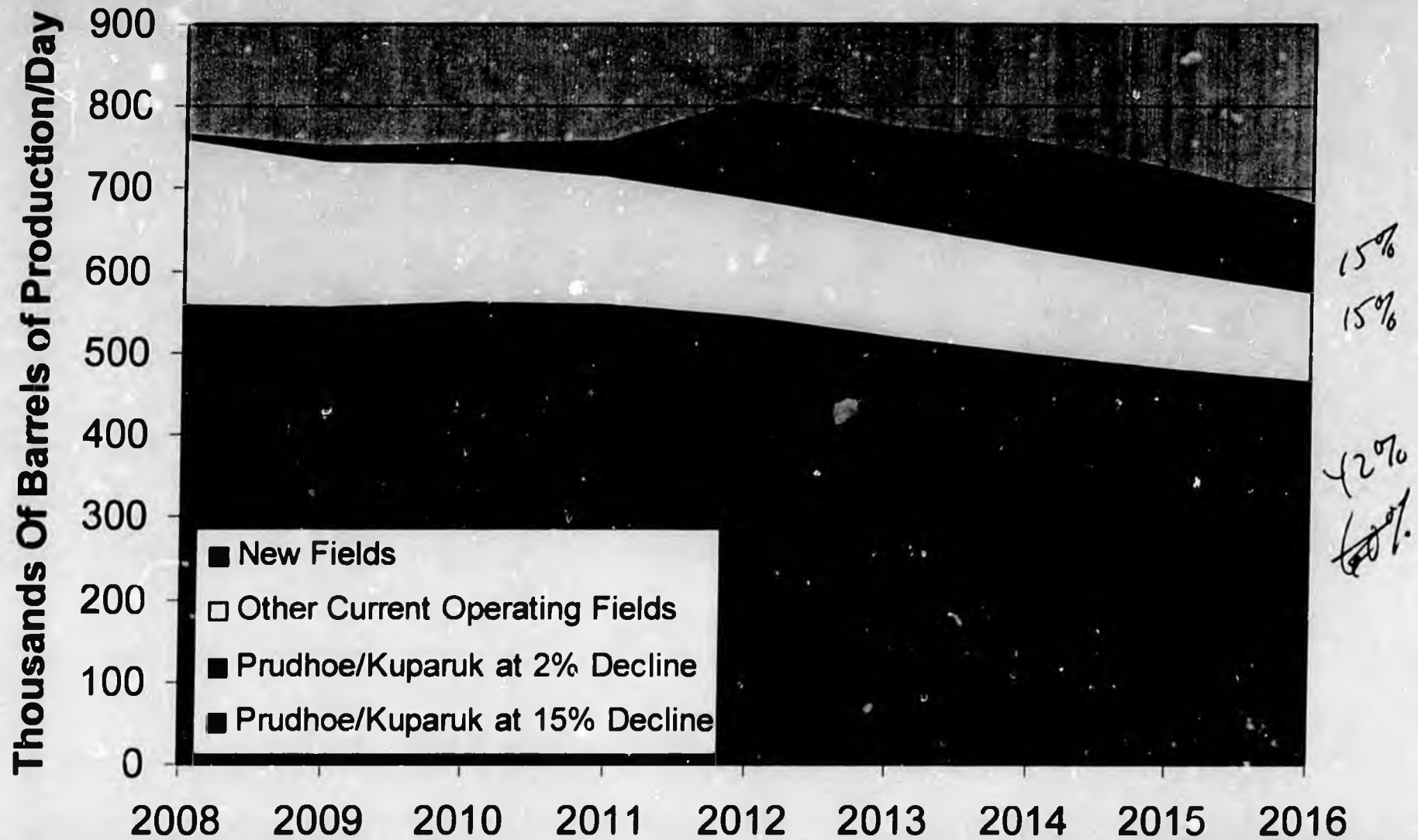


Revenues meeting targets despite forecasting uncertainty associated with:

- Price
- Production
- Operating costs
- Capital costs

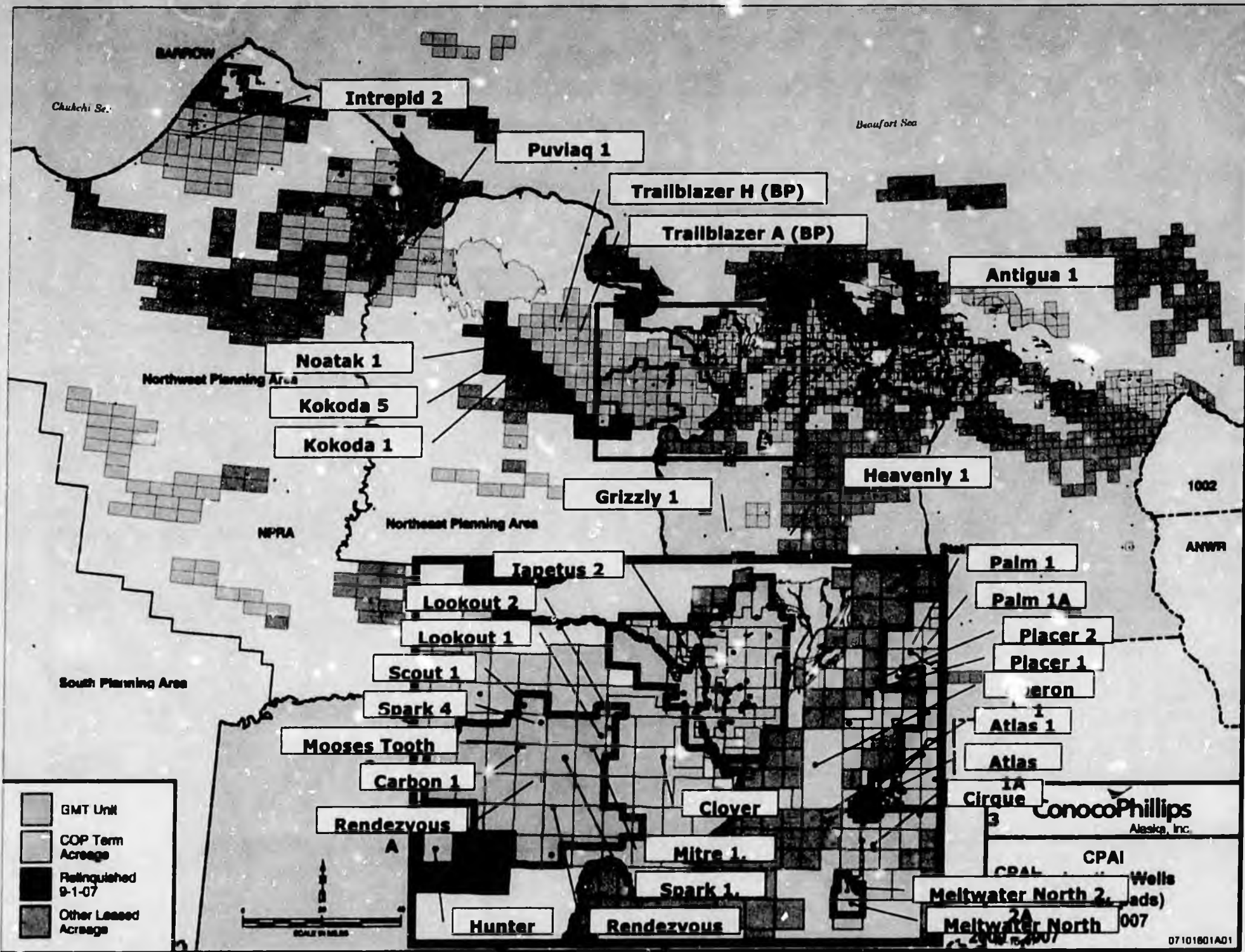
***Too early to change***

# Significance of Future Investment



Department of Revenue 2007 Spring Forecast

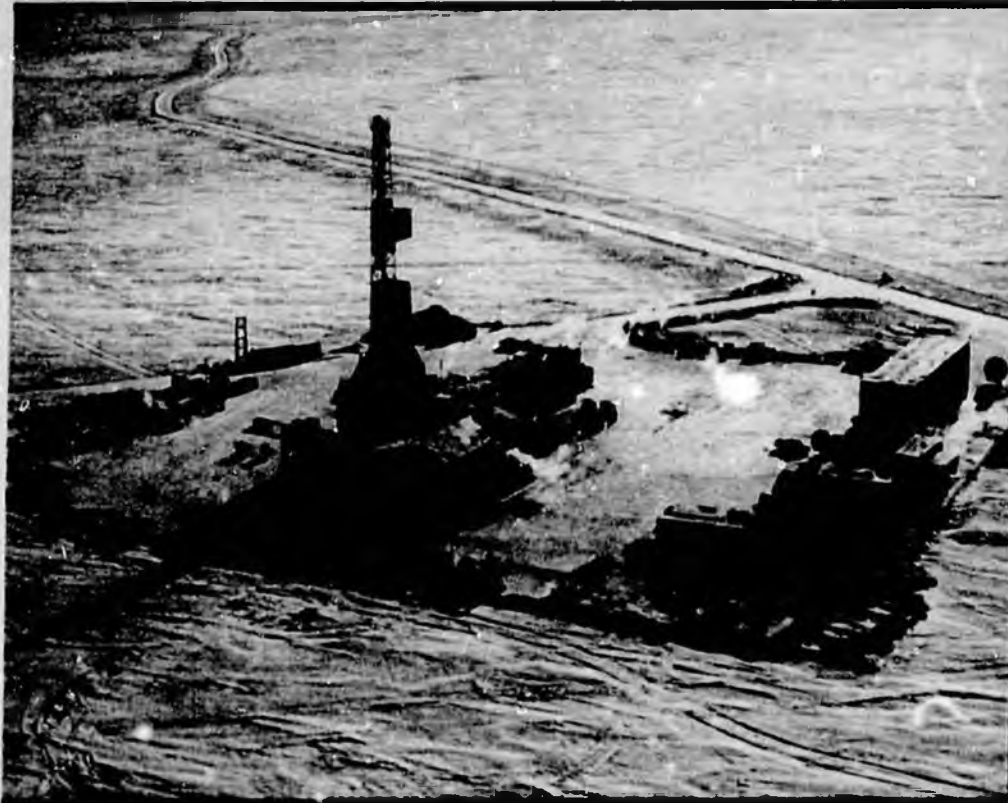
ConocoPhillips



- GMT Unit
- COP Term Acreage
- Relinquished 9-1-07
- Other Leased Acreage

**ConocoPhillips**  
 Alaska, Inc.  
 CPAI  
 Wells (ads)  
 007  
 07101801A01

# Alaska's Leading Explorer



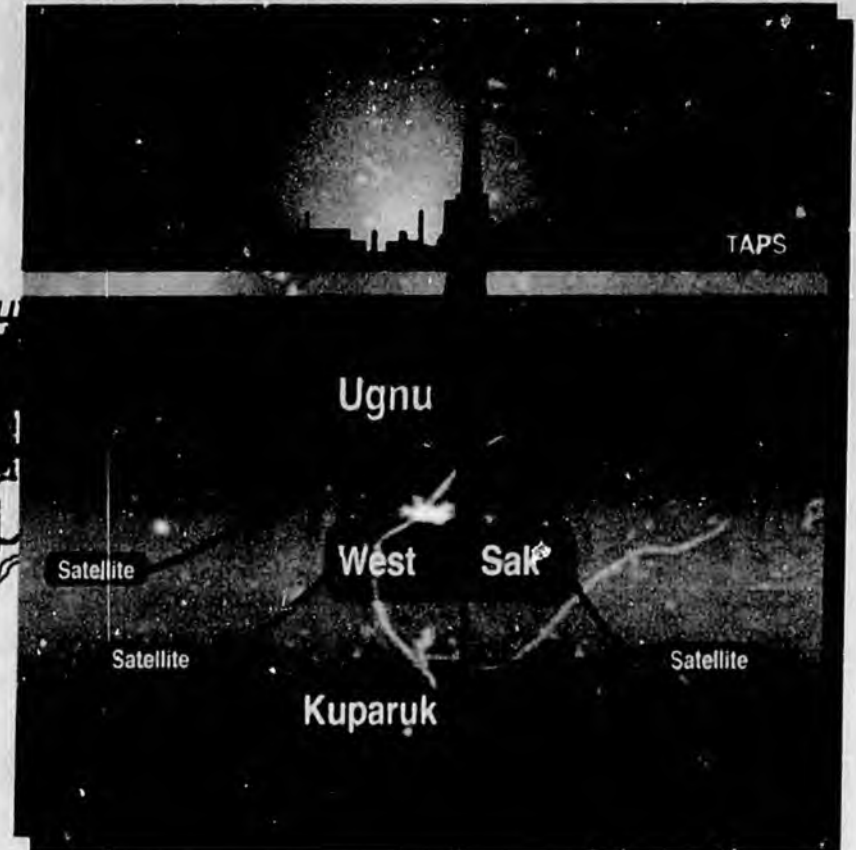
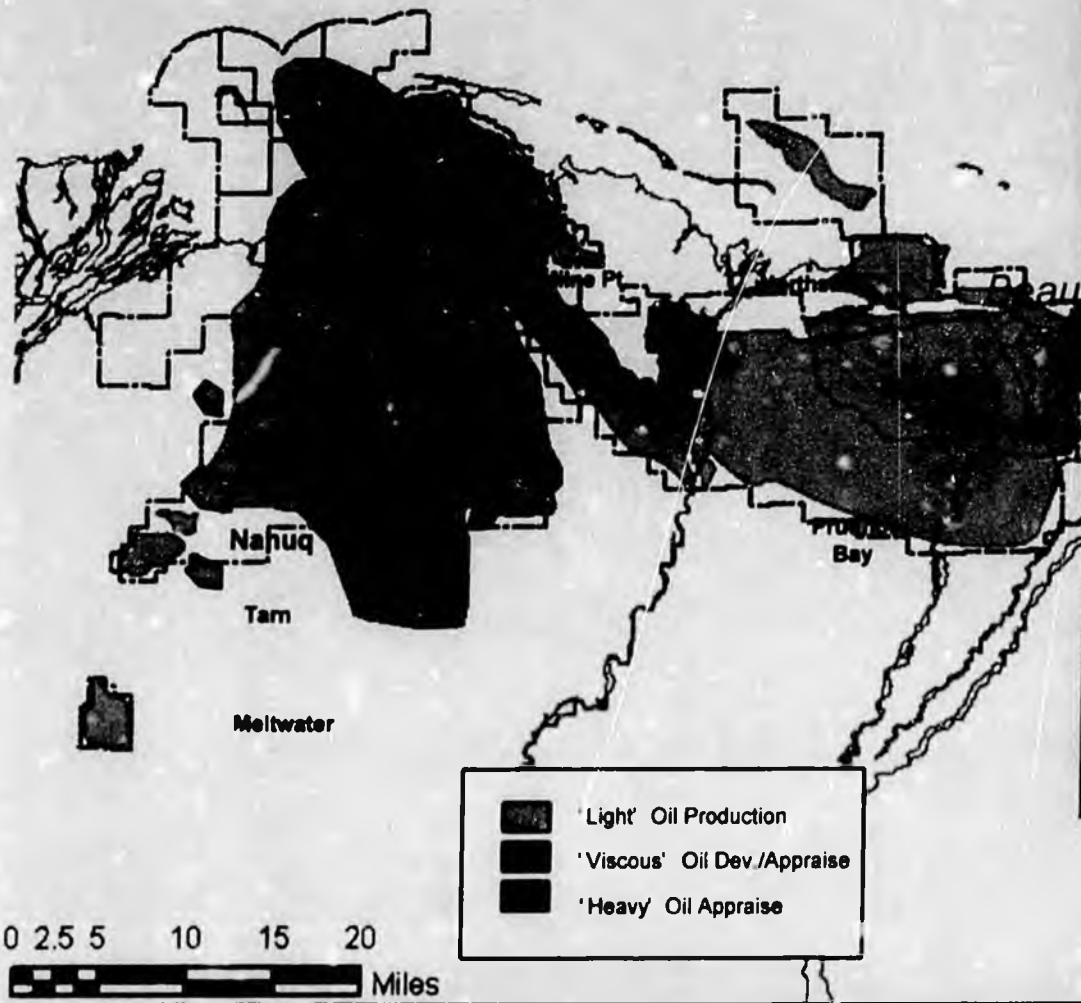
**Exploration Site – Winter  
Typically January - April**



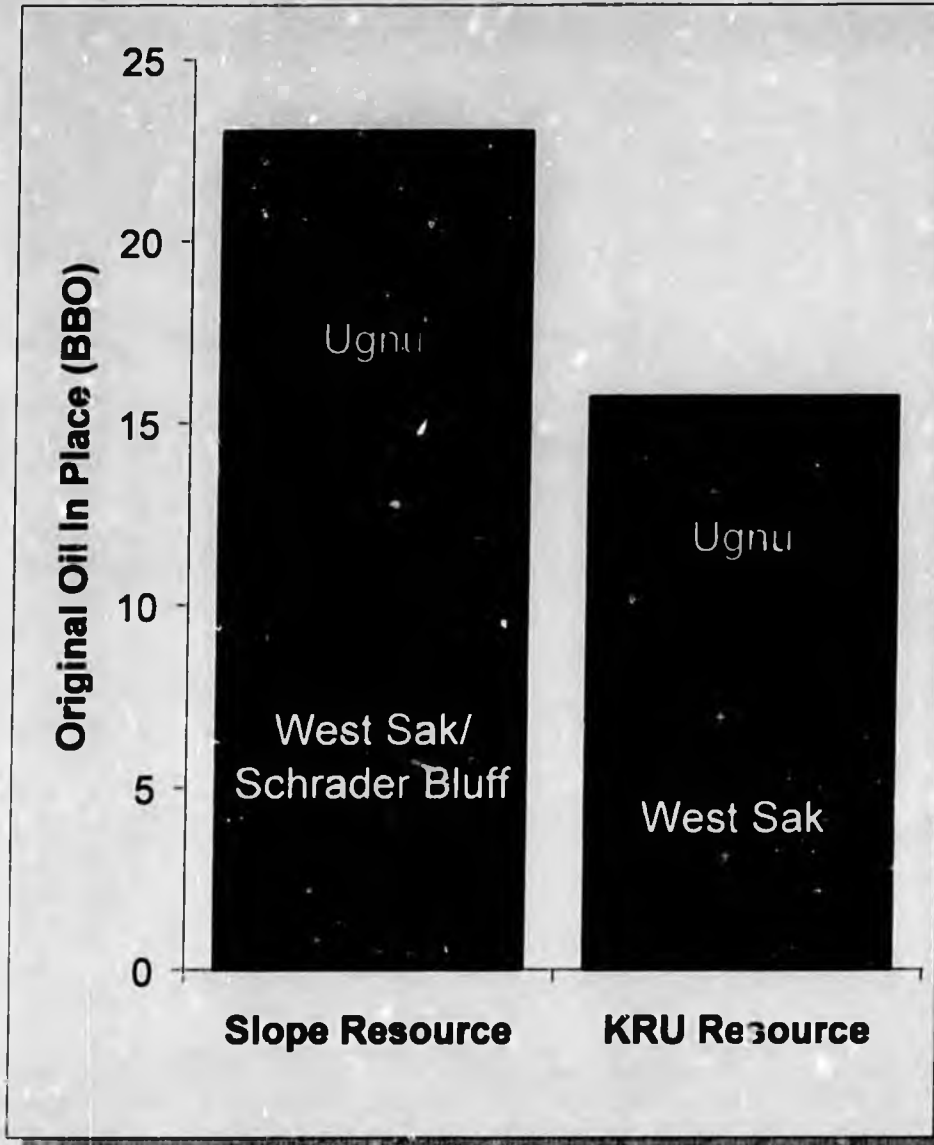
**Exploration Site - Summer**

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# North Slope Heavy Oil Fields



# North Slope Heavy Oil Resources



19 API Crude



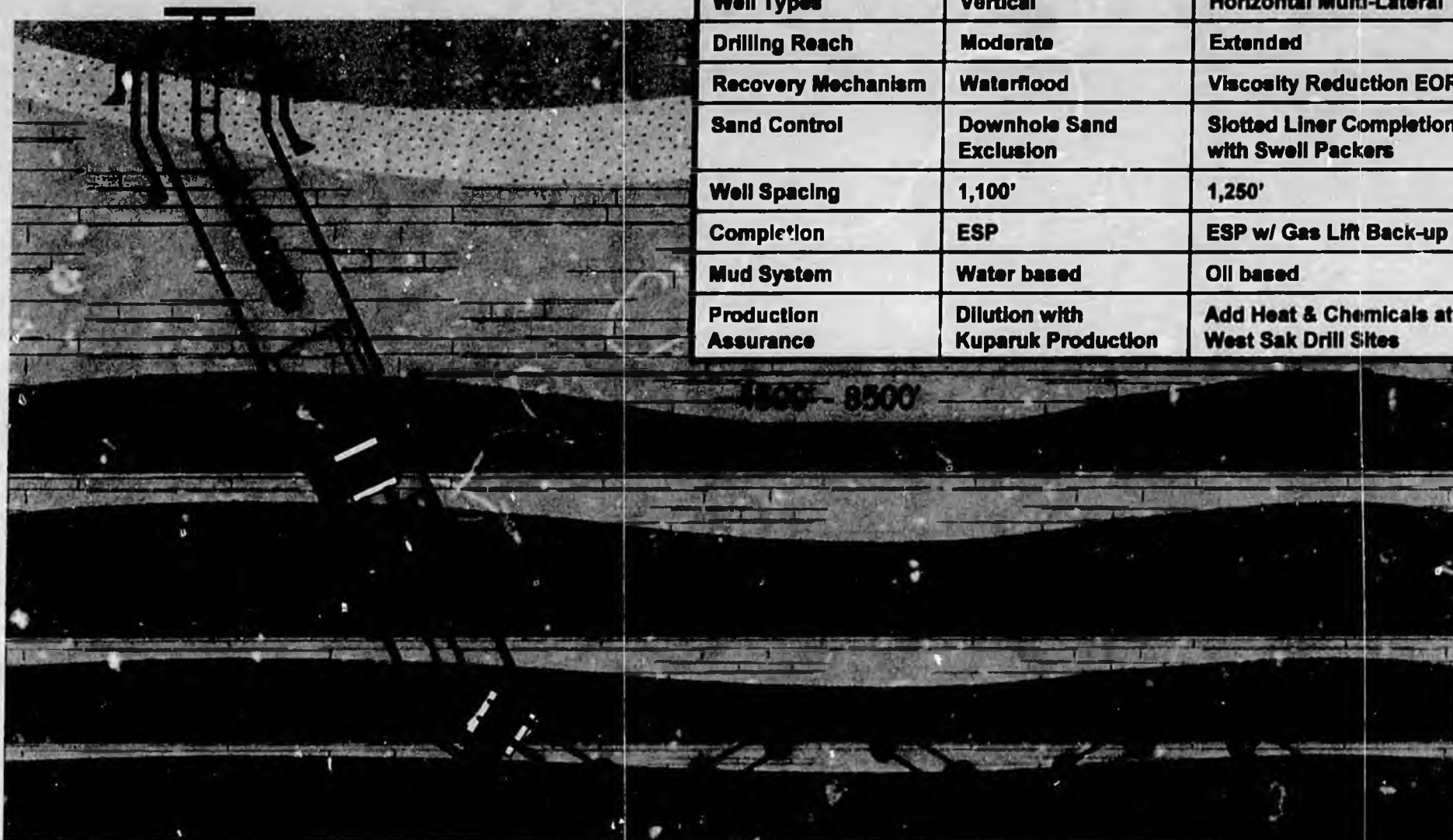
10 API Crude

- Shallow reservoirs (3,000 to 4,500')
- 1,800' of permafrost
- "Cold" Temperature (40° to 90° F)
- High viscosities for given API gravities (10's to 1000's cp)
- Low rates and recovery factors

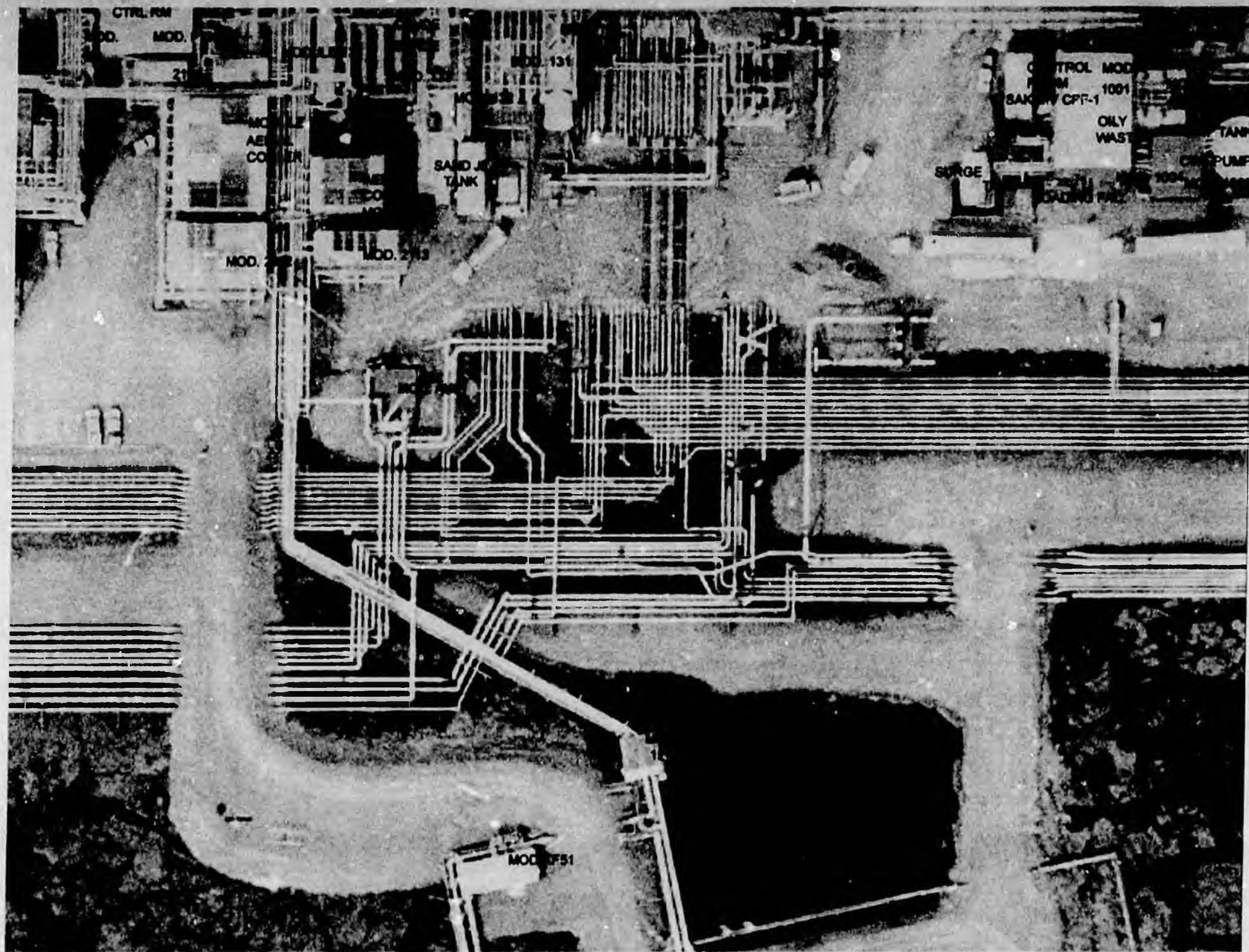
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# West Sak Tri-Lateral Producer

Component of Development Plan	1998	2004+
Well Types	Vertical	Horizontal Multi-Lateral
Drilling Reach	Moderate	Extended
Recovery Mechanism	Waterflood	Viscosity Reduction EOR
Sand Control	Downhole Sand Exclusion	Slotted Liner Completion with Swell Packers
Well Spacing	1,100'	1,250'
Completion	ESP	ESP w/ Gas Lift Back-up
Mud System	Water based	Oil based
Production Assurance	Dilution with Kuparuk Production	Add Heat & Chemicals at West Sak Drill Sites



ConocoPhillips



# Project Analysis

	Finniza's Field A	Prudhoe/Kuparuk Projects						Totals
		1	2	3	4	5	6	
Legacy Field	●	●	●	●	●	●	●	
Satellite	●			●	●	●	●	
Stand Alone								
Heavy Oil	●		●	●	●	●	●	
Reserves (MMB)	80	56	60	53	19	18	52	258 MMB
Ownership	Existing	Existing	Existing	Existing	Existing	Existing	Existing	
Capital (\$/B)	\$ 11	\$ 11	\$ 15	\$ 16	\$ 21	\$ 19	\$ 16	\$3.9 B
Expense (\$/B)	\$ 7	\$ 6	\$ 7	\$ 5	\$ 8	\$ 5	\$ 11	\$1.8 B
Production Start	hypothetical	2010	2010	2010	2012	2012	2013	

**Future investments are progressively more expensive to build and operate**

# Committee Substitute

- Gross on top of a Net
- Transitional Investment Expenditure (TIE) Credits
- Exclusion of legitimate costs
- Administrative Issues

# Progressivity

- When applied to Gross
  - Gross penalizes new projects at higher cost levels
  - Gross ignores impact of rising costs over time
  - Progressivity on gross could cause premature field shut in
  - Administration's consultants have testified that the net application of progressivity is most desirable

***Progressivity should be applied on a net basis***

# High Cost Projects' Economics Challenged under Gross Progressivity

Capital Cost = \$10/BBL



40% of Tax Paid  
Comes From Gross  
Progressivity

Capital Cost = \$30/BBL



100% of Tax Paid  
Comes From Gross  
Progressivity

Cases Run At \$60 WTI Flat Real, Gross Progressivity of .225% per \$1 above \$50/BBL Gross Wellhead Value

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# TIE Credits

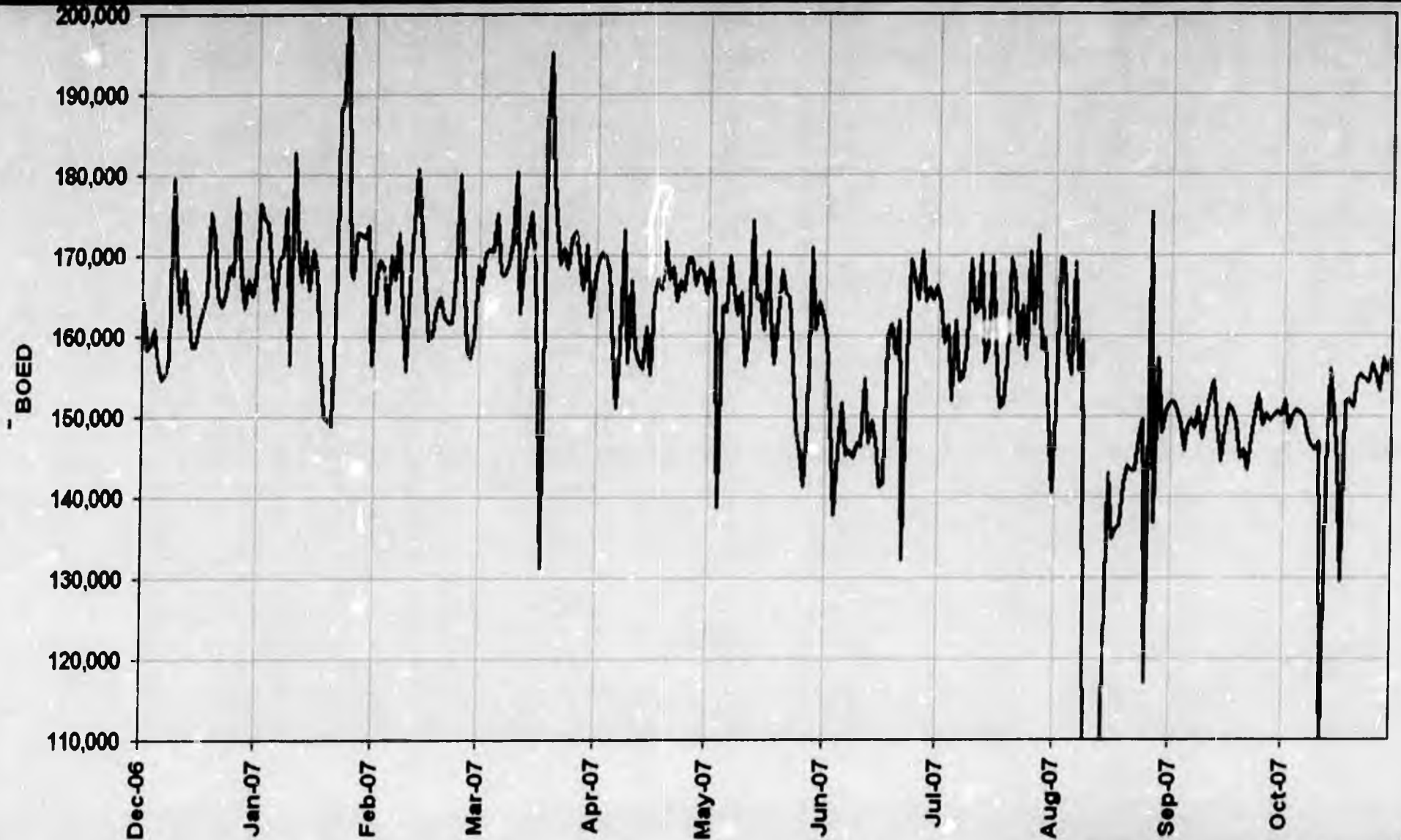
- An incentive to continue investment in Alaska
  - Producer has to spend twice the capital spent over the last five years to get the credit
- Use or Lose
  - PPT sunset clause erases all TIE credit remaining in 2013
- Soften the impact of tax changes

# Exclusions and Deductions

- Topping plant exclusion
- Driver for unscheduled maintenance exclusion was a specific event
  - Impractical and difficult to administer
  - Increases potential for dispute and litigation
  - Possible unintended consequences

*Exclusions and Deductions language needs careful and thorough consideration*

# Unplanned Maintenance



# “Other” Information

Section 27 (page 20) – **AS 43.55.030(f)** reads:

- “The department may require a producer, ....to file monthly reports, as applicable ..(8) other records and information the department considers necessary for administration of this chapter.”

## **Implications:**

- This statement is too broad, and
- Reporting data should be specified
- Could be compelled to give data that compromises our competitive position

# Statute of Limitations

Section 29 (Page 22) - **AS 43.55.075** reads:

- “...the amount of tax imposed by this chapter must be assessed within six years after the latest return was filed.”

## Implications:

- It's in the best interest of the state and the taxpayers to have audits completed in a timely manner
- Under proposed bill, first audit does not need to be completed before 2011 PPT review
- Amended returns due to decisions by regulatory agency, court, IRS or other body are compelled to be filed, however, the draft legislation **reopens the entire return** rather than just the items amended by these decisions

# Summary Comment

- Interest between state and industry should be aligned
- Too early to change PPT
- Tax changes will impact investment
  - Increased tax take
  - Uncertainty with frequent tax changes
- Administrative provisions need careful thought

# **Alternative Tax Credits for Oil and Gas Exploration**

## **ACES Amendments to AS 43.55.025**

**Kurt Gibson  
Julie Houle**  
Division of Oil and Gas

October 31, 2007



Alaska Department of

**NATURAL  
RESOURCES**

Division of Oil and Gas



- Before PPT, DOR offered credits for exploration wells and seismic surveys
  - AS 43.55.025 - Alternative tax credit for oil and gas exploration
- ACES original language intended to do the following
  - broaden this program by granting greater credit and extending timeline
  - Provide additional predictability to explorers by establishing a pre-approval process
  - Shore up data sharing requirements

# Broaden existing program



- Expands tax credit from 20% to 30% for some exploration wells
- Creates new 5% credits for old seismic surveys if the DNR commissioner determines that the acquisition is in the best interest of the state
- Extends the timeline allowed to drill wells from 150 to 540 days (POT - unintended - within 5 months)

# Enhances Predictability



Pre-approval process identifies up front whether or not activity qualifies for tax credit

- More fair to investors to inform them (going forward) whether or not they are credit eligible
- Predictability reduces the state's exposure to litigation by stripping out uncertainty
- Prudent practice for the state as a "working interest" owner to make forward looking investment decisions

# Data Sharing



State has a right to certain data stemming from its decision to invest in project

- Seismic
- Well data
- Fluid data
- Core data

New language provides clarity and consistency in what data must be shared

These data sharing requirements are consistent with those of other jurisdictions

By shoring up the data sharing language the state preserves its ability to pursue long-range exploration incentive goals



