

SB

2001

(FILE 14)

10/24/07

ALASKA STATE LEGISLATURE

Sen. Charlie Huggins, Chair
Sen. Bert Stedman, Vice Chair
Sen. Lyda Green
Sen. Gary Stevens
Sen. Lesil McGuire
Sen. Bill Wielechowski
Sen. Thomas Wagoner



State Capitol, Room 119
Juneau AK 99801-1182
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Fax: 907-465-3265
800-862-3878

Senate Resources Committee

Butrovich Rm 205

Wednesday, October 24, 2007

10:00 a.m. – 5:00 p.m.

6:15 p.m.

AGENDA

SB 2001 - Oil and Gas Production Tax

Morning

BP Exploration

Claire Fitzpatrick - Commercial Senior Vice President

Mike Utsler - Senior Vice President – Prudhoe Bay

Afternoon

(continuation) BP Exploration testimony

ConocoPhillips

Kevin Mitchell - Vice President, Finance & Administration

Jim Taylor - Vice President, Commercial Assets

6:15 PM

Public Testimony

-Time Limit May Be Set -

1. Gavel In & Call to Order : Note time – members present

**I CALL THE SENATE RESOURCES COMMITTEE TO ORDER ON
WEDNESDAY, OCTOBER 24, 2007. LET THE RECORD REFLECT THAT IT
IS _____ A.M..**

PRESENT ARE:

**Vice-Chairman Senator Bert Stedman
Senator Gary Stevens
Senator Lyda Green
Senator Lesil McGuire
Senator Bill Wielechowski
Senator Tom Wagoner
& myself, Senator Charlie Huggins**

2. SB 2001 OIL & GAS TAX AMENDMENTS

Morning

BP Exploration

Claire Fitzpatrick - Commercial Senior Vice President

Mike Utsler - Senior Vice President – Prudhoe Bay

*******Lunch Break*******

Recess until _____ p.m.

Afternoon

**I CALL THE SENATE RESOURCES COMMITTEE MEETING OF TUESDAY,
OCTOBER 23, BACK TO ORDER**

(continuation) BP Exploration testimony
ConocoPhillips

Kevin Mitchell - Vice President, Finance & Administration
Jim Taylor - Vice President, Commercial Assets

*******Dinner Break*******

RECESS - afterwhich we'll return for public testimony @ 6:15 PM

6:15 PM

**Public Testimony
Time Limit May Be Set**

**I CALL THE SENATE RESOURCES COMMITTEE MEETING OF TUESDAY,
OCTOBER 23, BACK TO ORDER**

3. Announce: We'll be back tomorrow @ 10 AM, --[THIS IS A TIME CHANGE]-- when we'll hear from the Alaska State Chamber of Commerce; Brooks Range Petroleum and ExxonMobil with the added possibility of some call backs to look at some of the questions which have been raised here over the last week.

6. Meeting adjourned @ _____.

bp



BP Presentation on SB 2001
Senate Resource Committee

Claire Fitzpatrick and Mike Utsler - Sr VP *Production*
October 24, 2007

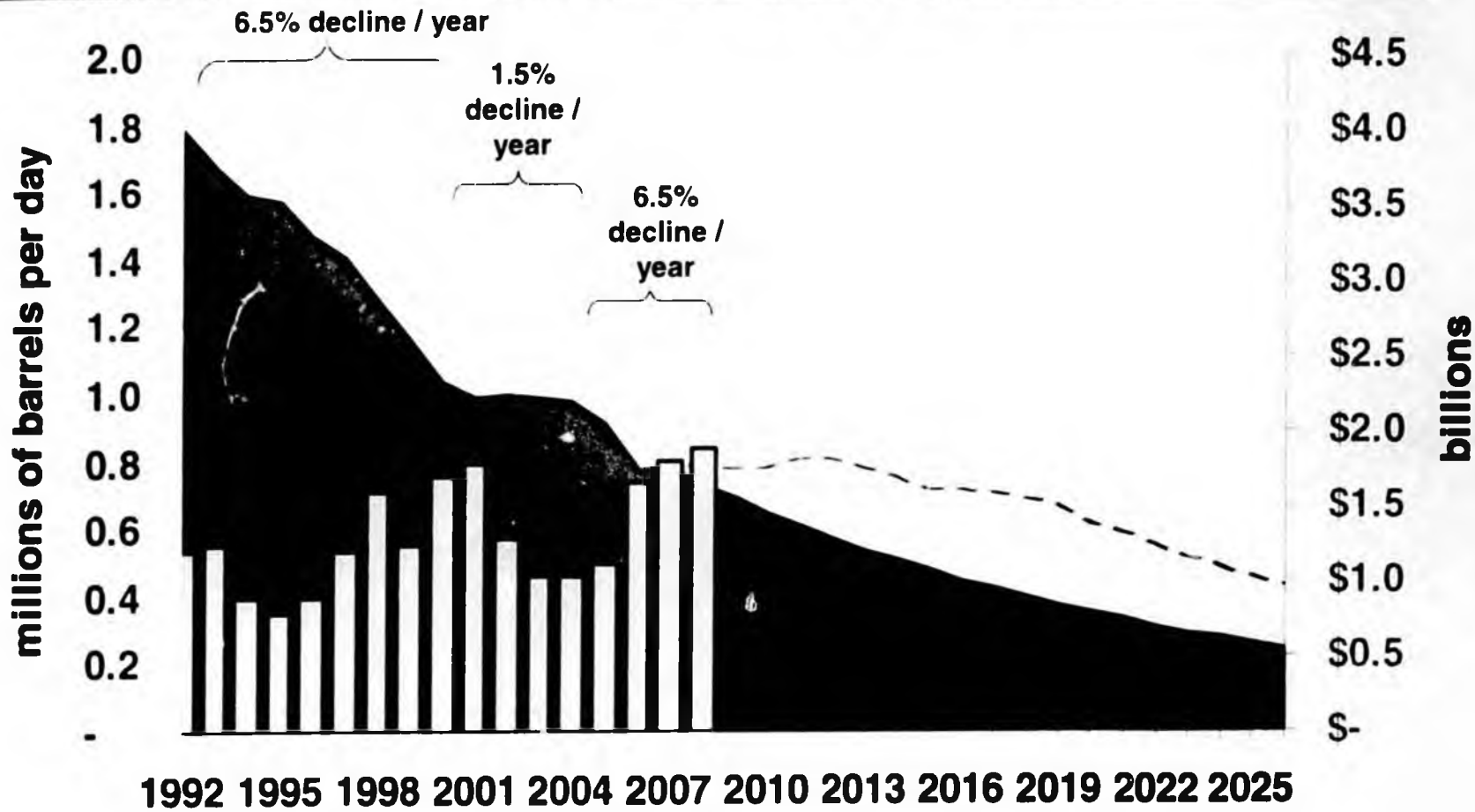
*Commercial
Sr. VP*

Key Messages



- **Production**, not tax rate, is the major factor in determining state revenue for the future years
- Delivering the State's production forecast will require tens of billions of **investment**
- **Investment decisions** are made on the **combination** of strategy, resource prospects, technology, economics including **fiscal policy**, and risk.
- The proposed bill 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 State's production and revenue forecast counts on higher than historical investment



□ Spring 2007 DOR Forecast

■ Actual Production

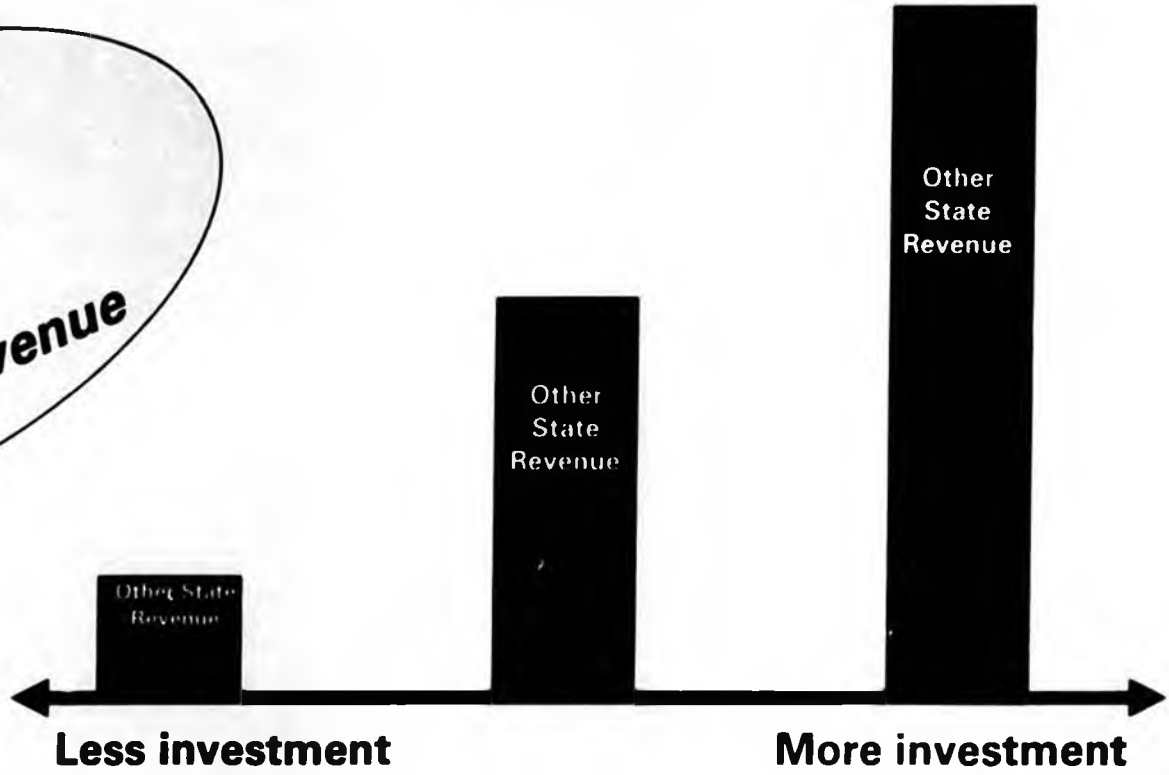
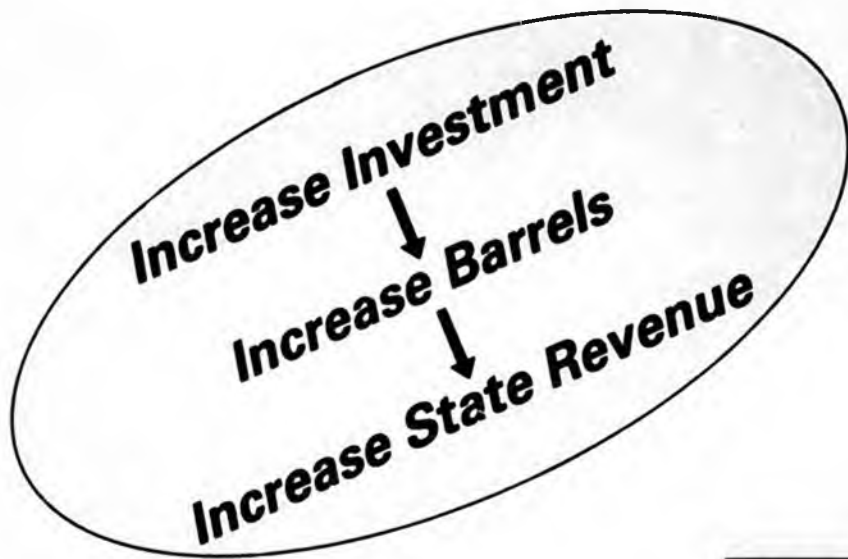
■ 6% Production Decline starting 2008

□ Capital Spend Estimate, \$billion

Production Drives Revenue



Decline Rate	15%	6%	3%
Produced Barrels	1.3 bn	3.9 bn	7.5 bn
Industry Investment	\$5 bn	\$25 bn	\$70 bn
		Status quo	



**ALASKA NORTH SLOPE
80 YEARS OF ONGOING DEVELOPMENT**

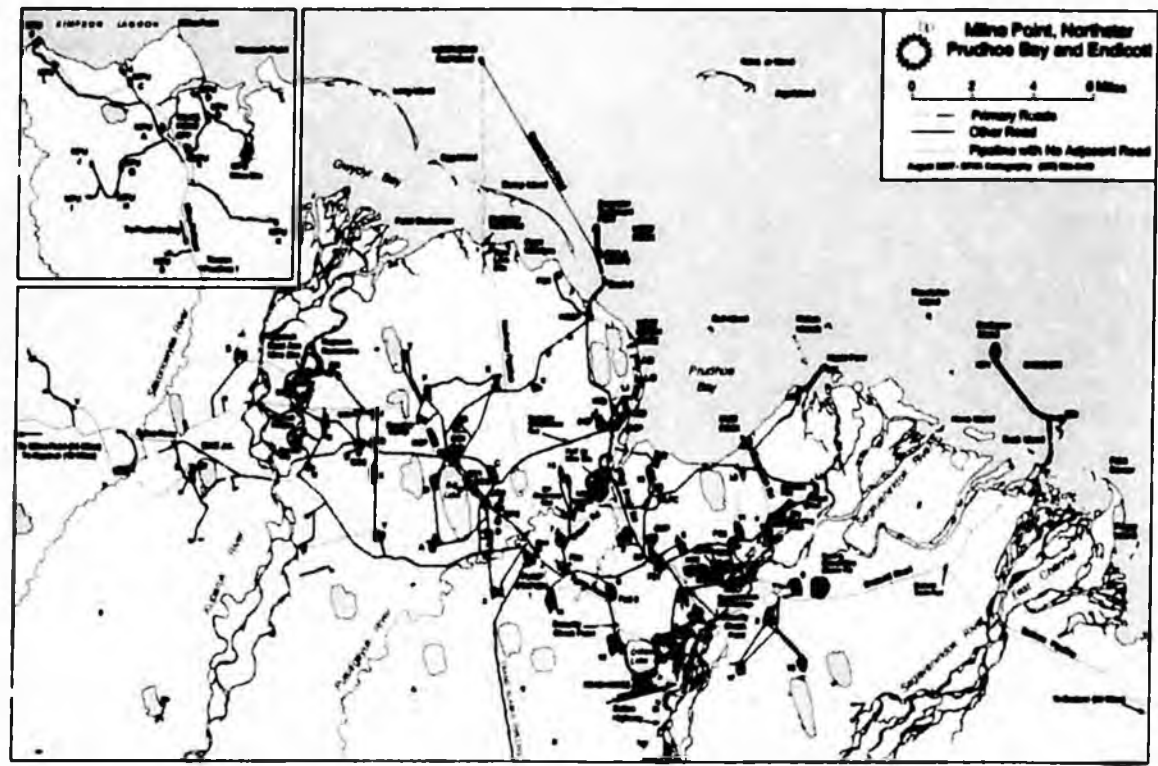


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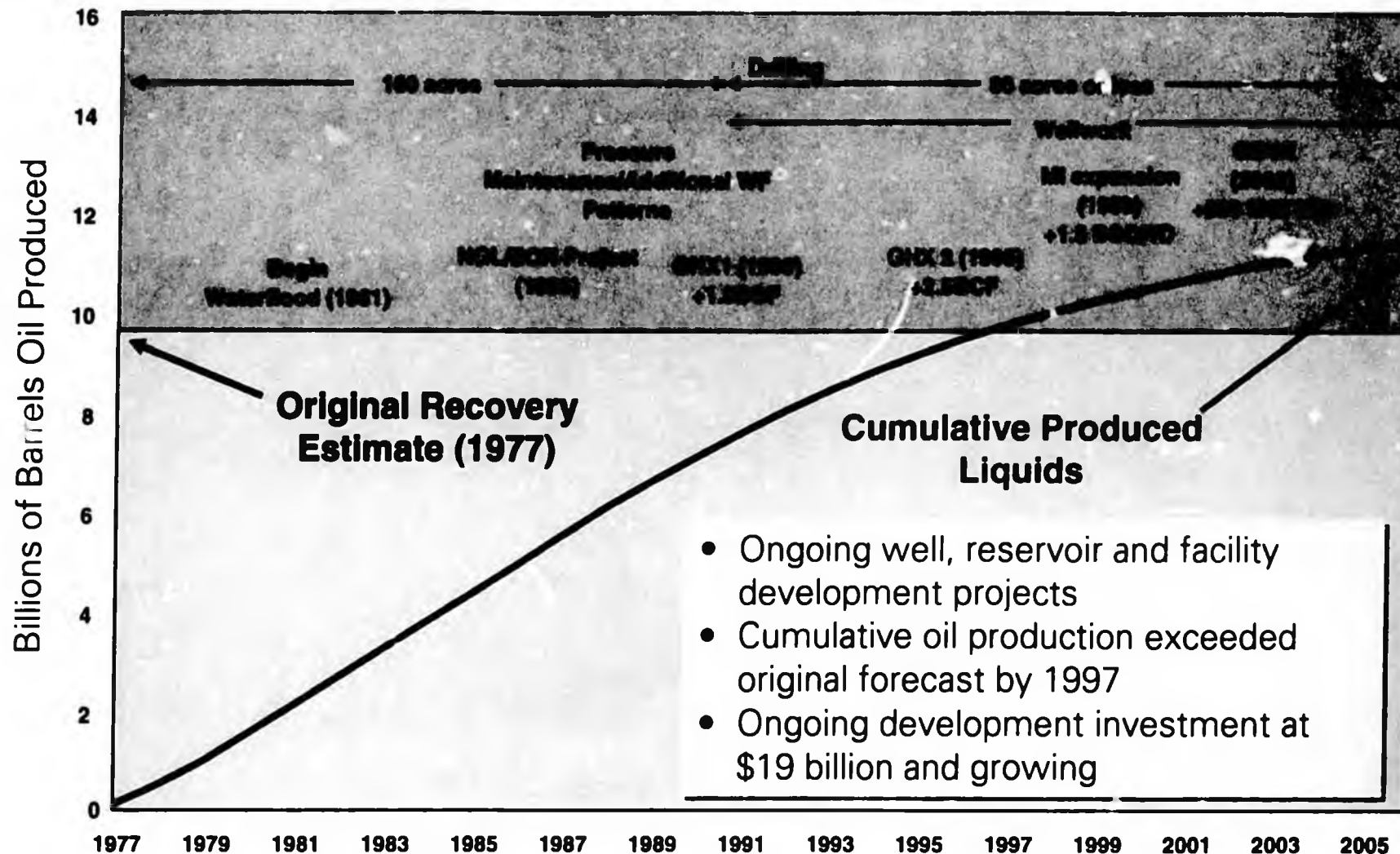
Prudhoe Bay



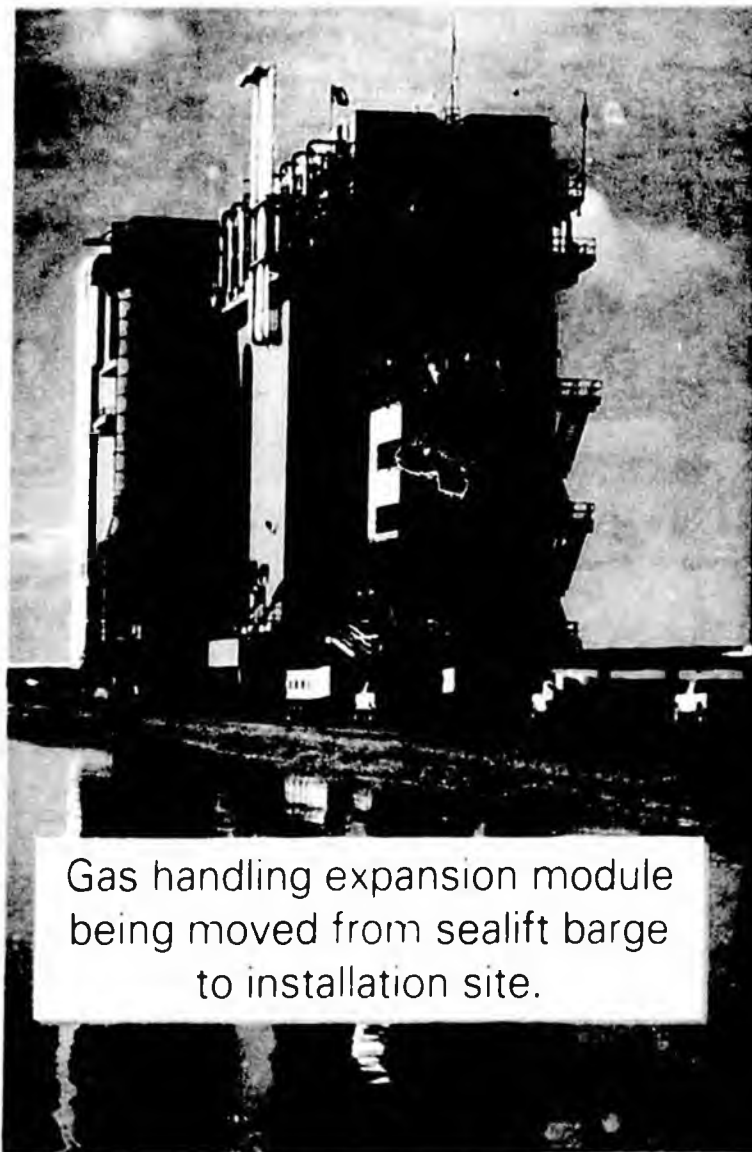
- Largest Oil Field in North America
- Extensive and successful development
 - 60 square miles
 - 11 major facility locations
 - 42 Drill sites
 - 1200 active wells
- Future challenges
 - Managing declining oil rate, and increasing water and gas rates
 - Ongoing developments, light and heavy oil, to offset steep natural decline
- Technology development and deployment is key
 - Arctic specific
 - Advanced reservoir processes
 - World class drilling and workover
 - Facility upgrades



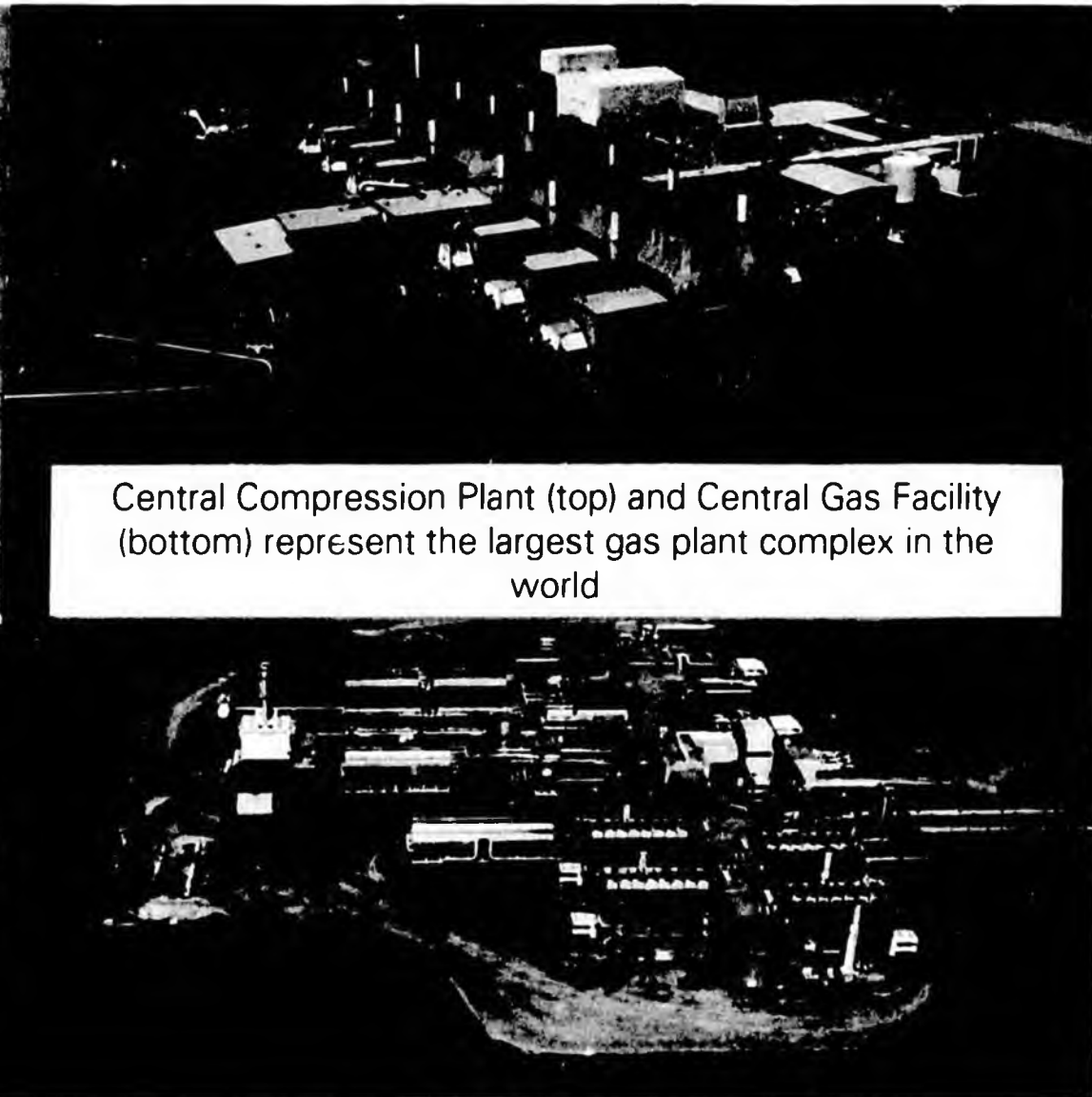
Prudhoe Bay Development History



Prudhoe Gas Facilities

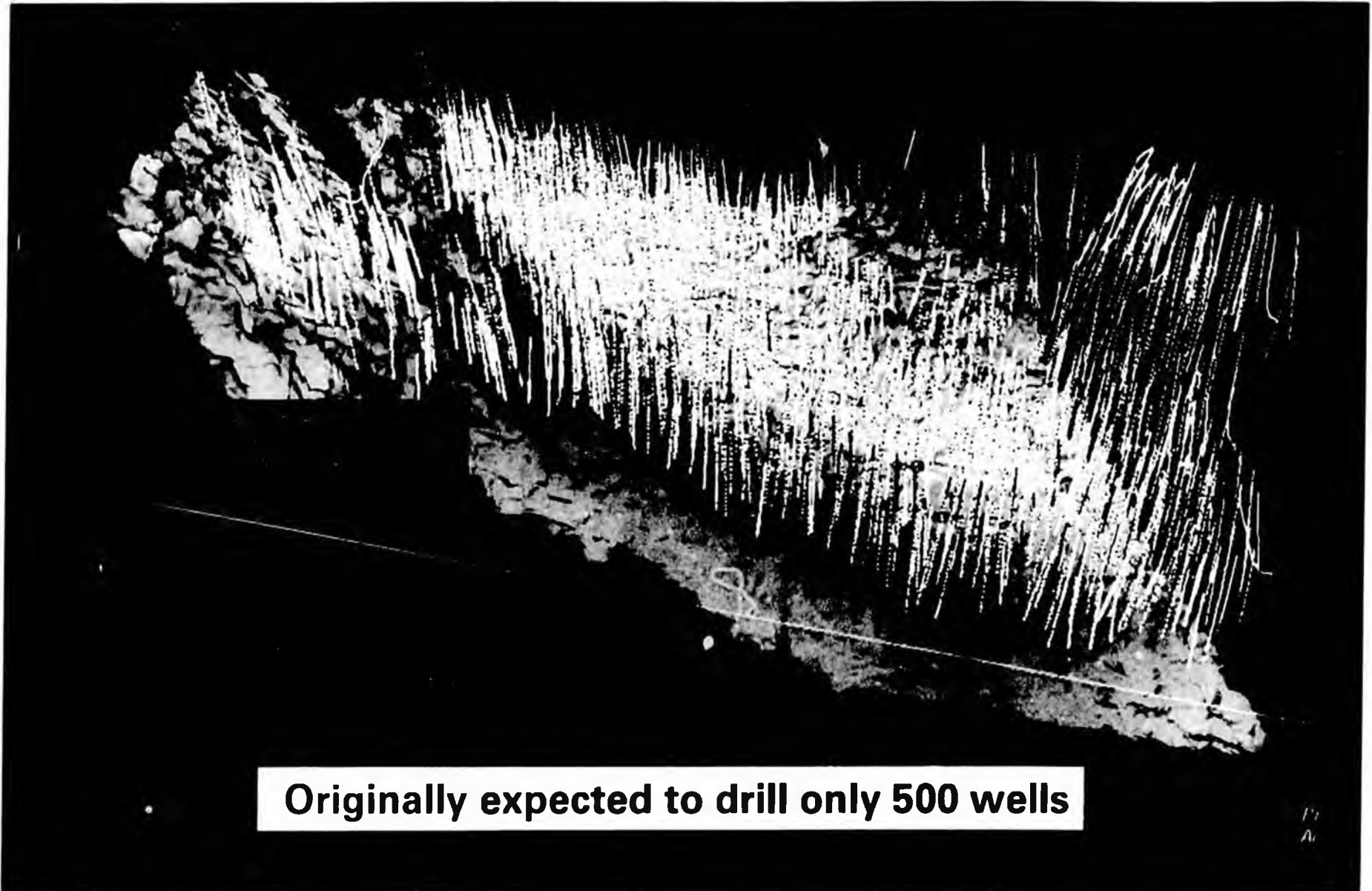


Gas handling expansion module being moved from sealift barge to installation site.



Central Compression Plant (top) and Central Gas Facility (bottom) represent the largest gas plant complex in the world

Drilled in Prudhoe Bay



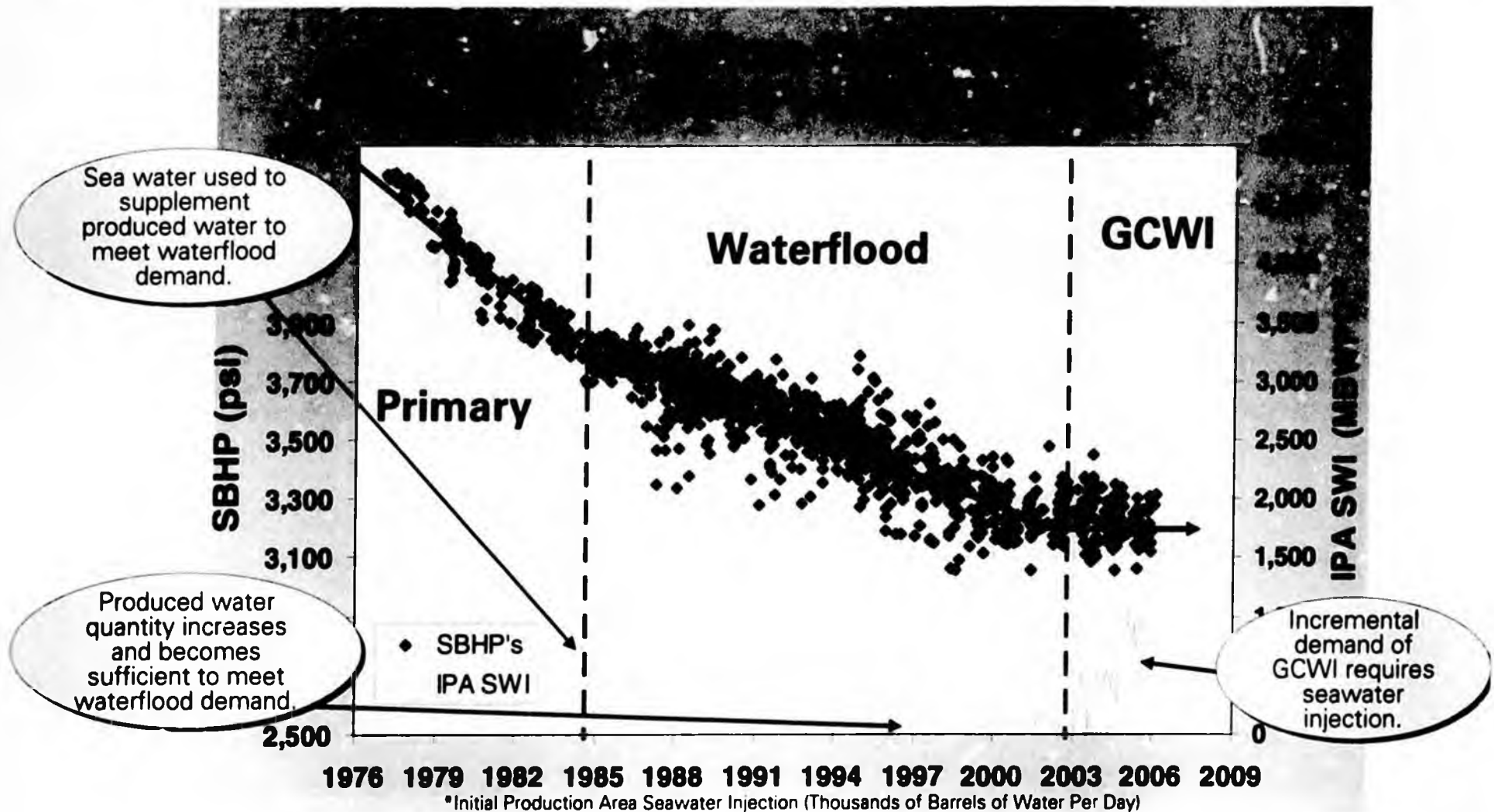
Originally expected to drill only 500 wells

17
A

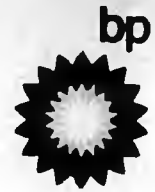
Water Injection Projects



Water injection into the oil reservoir (i.e., waterflood) to maintain field pressure followed by new Gas Cap Water Injection (GCWI) technology



Projects: Bright Water™



Objective

- Increase Oil recovery through improved sweep efficiency
- Reduce produced water

Concept:

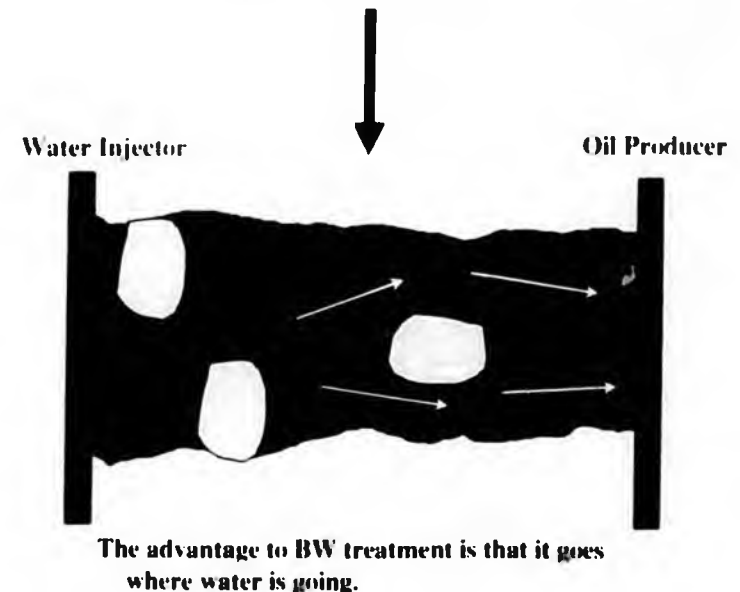
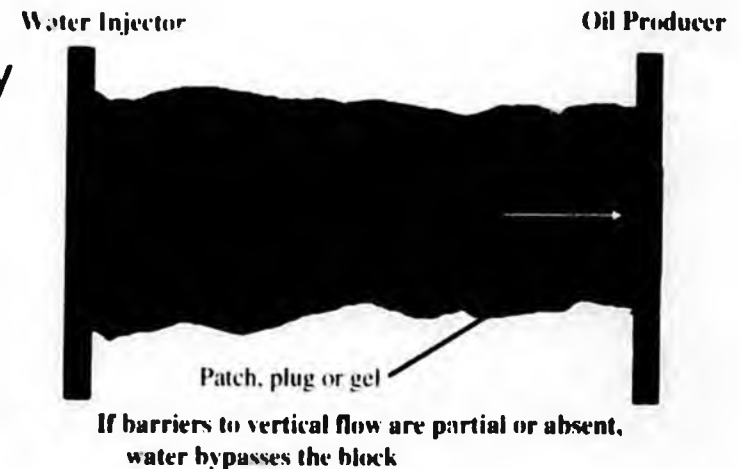
Polymer expands after deep penetration into reservoir, effectively blocking the swept zones and forcing the water into unswept oil zones. Timing for expansion and change in sweep is 9 months. Lab testing shows 2%-20% additional recovery.

2006 Highlights:

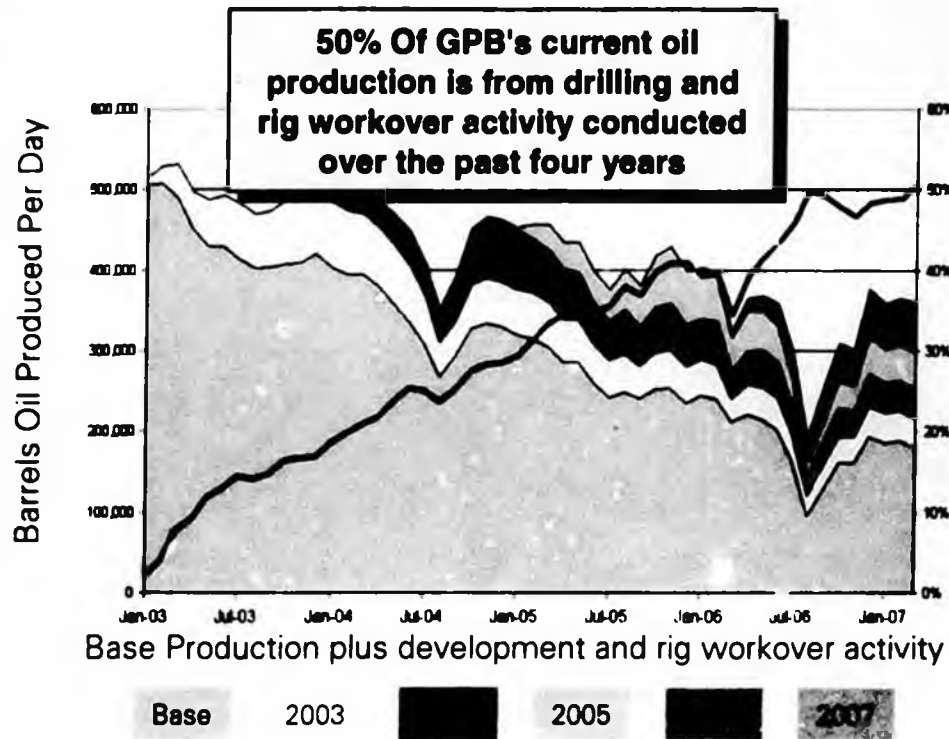
- NWFB Trial: limited response due to design and operational difficulties
- FS2 Trial: measurable response in 7 offsets

2007 Plan:

- Continued monitoring of FS2 and NWFB trials
- Pursuing additional treatments

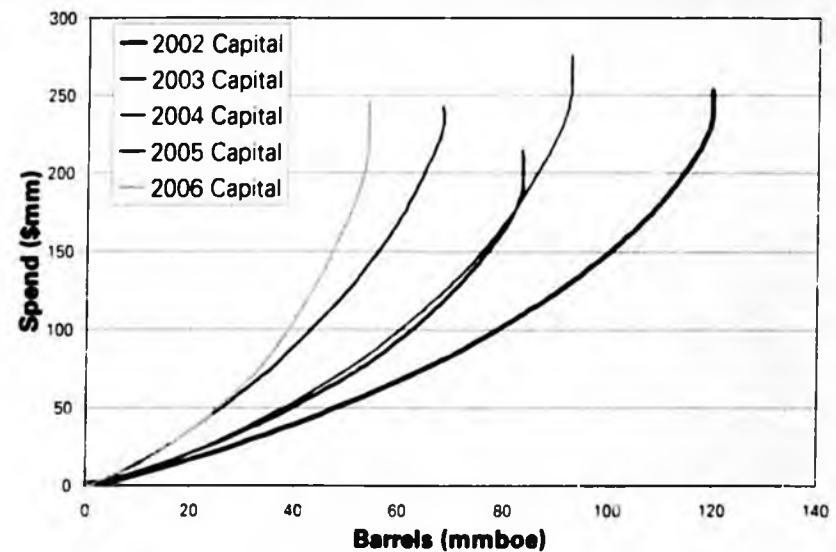


New Wells and Wellwork Deliver Barrels

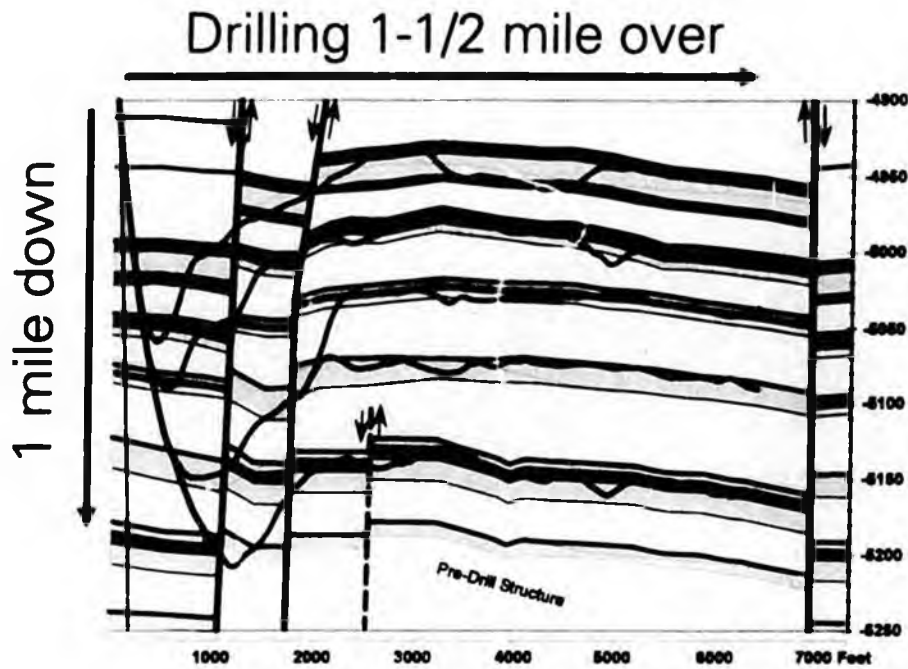


Each year, the challenge to delivering more barrels becomes greater

GPB Well Investments 2002-2006



Seismic Imaging and Directional Drilling Enable Development

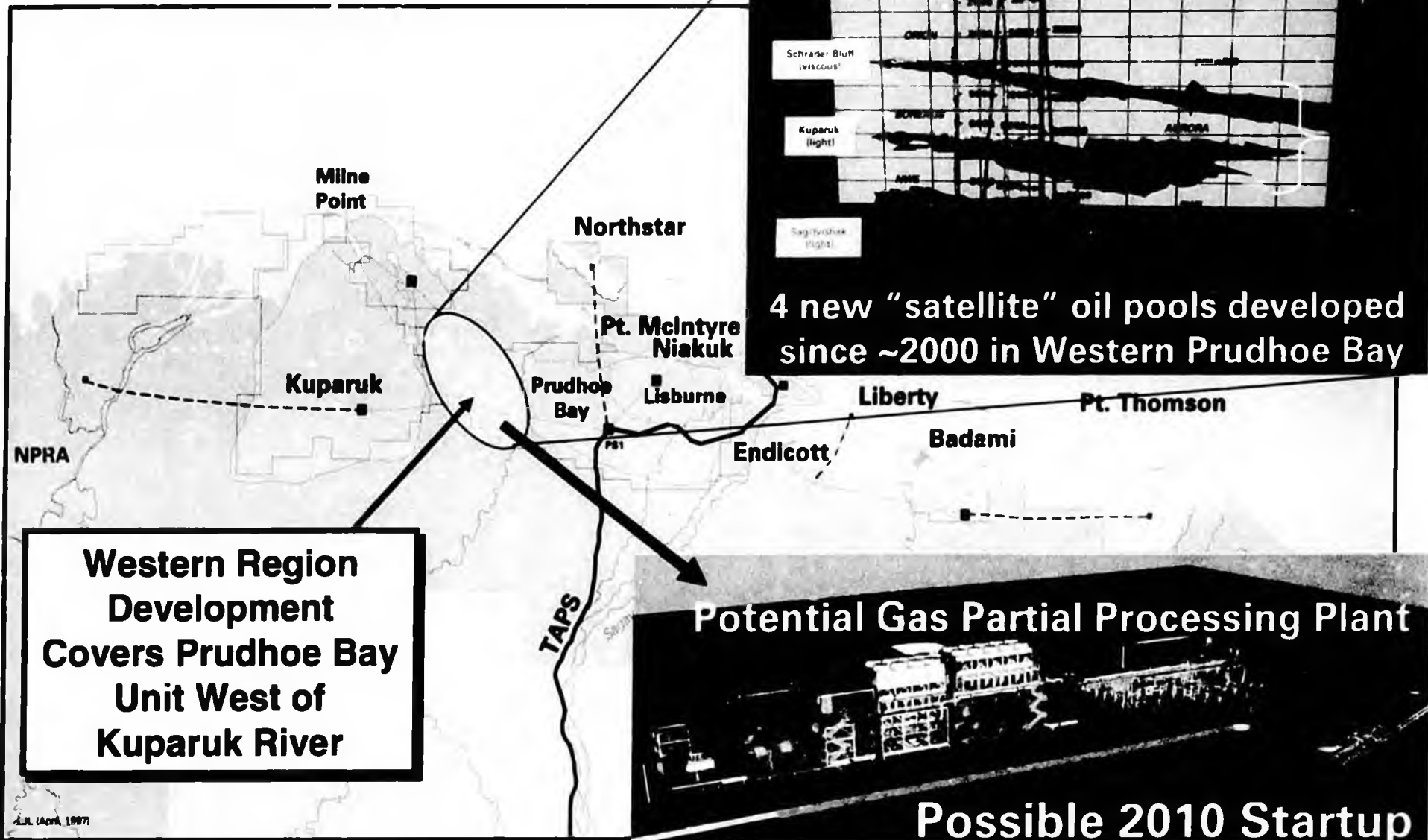


Now 15 are producing and over 20 more are planned, but not all are approved



Technologies required to drill and operate these multi-lateral well did not exist eight years ago

Western Region Prudhoe Bay



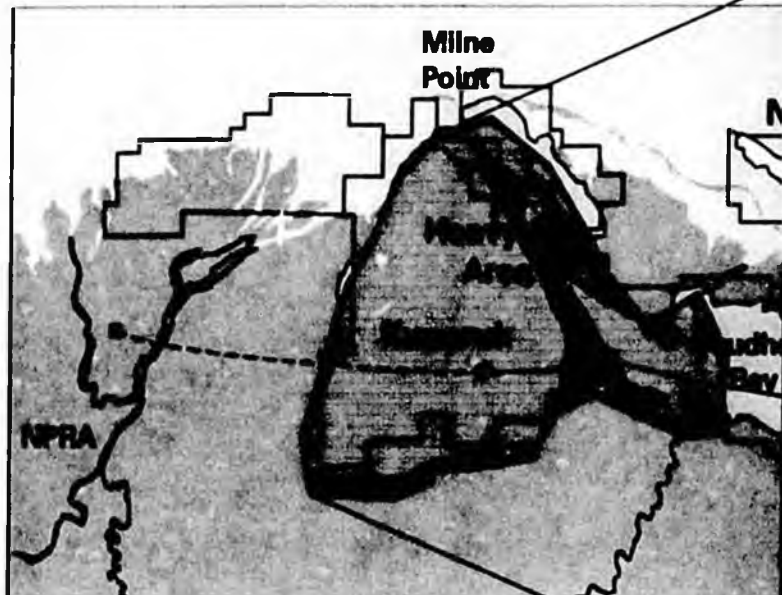
**Western Region
Development
Covers Prudhoe Bay
Unit West of
Kuparuk River**

**4 new "satellite" oil pools developed
since ~2000 in Western Prudhoe Bay**

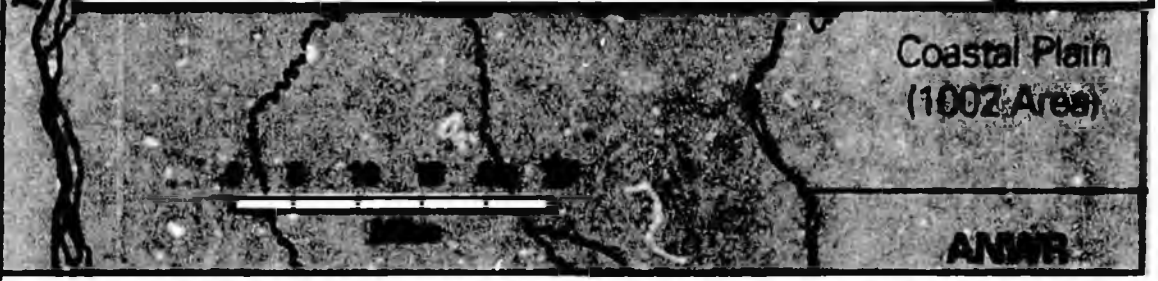
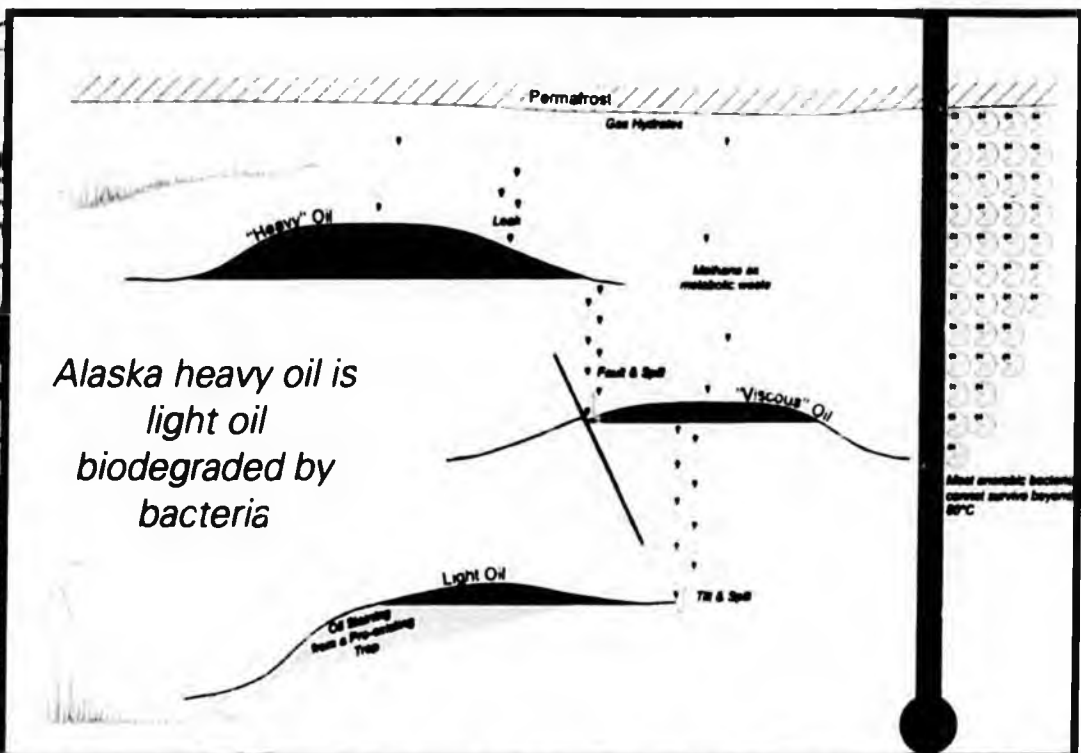
Potential Gas Partial Processing Plant

Possible 2010 Startup

North Slope Heavy Oil



- Alaska Heavy Oil: 25 – 30 billion barrels oil in place
- Creating new technologies to overcome challenges
- Pilot trials began decades ago
- Only 100 million barrels (0.4%) recovered to date
- Heavy Oil Fields are within the existing oil fields



Heavy Oil Challenges

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



PROPERTIES

- Chemical
 - Hydrogen depleted relative to light oil
- Physical
 - High viscosity

BUSINESS IMPACT

- Retool refineries
- Take a lower price on market
- High well density
- Add heat to reservoir: & transit lines
- Add diluent to major pipelines
- Upgrading (partial refining)
- Environmental Mitigation (e.g. CO₂ sequestration)
- Water treatment
- Sand Disposal
- Wellwork

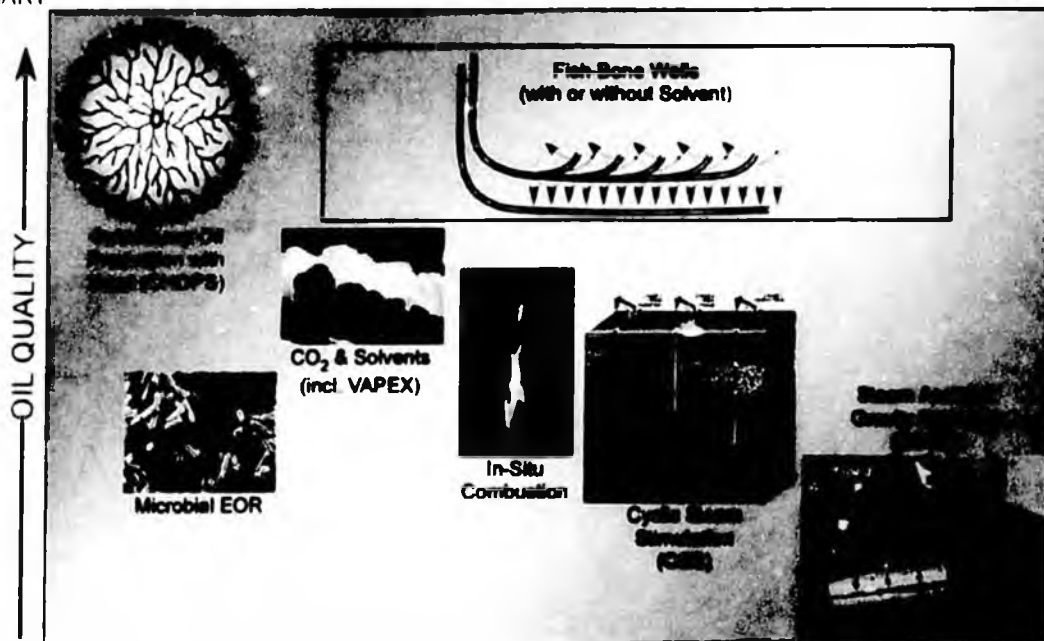
Revenue

Costs



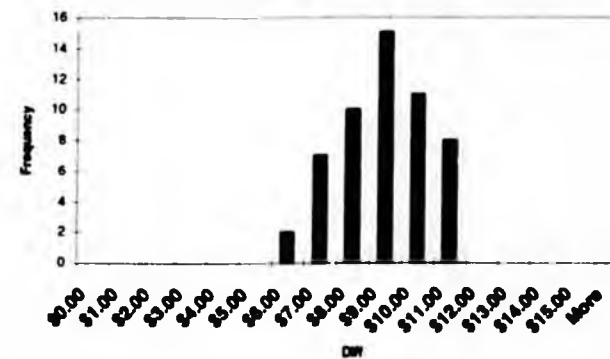
COLD - PRIMARY

RESERVOIR QUALITY



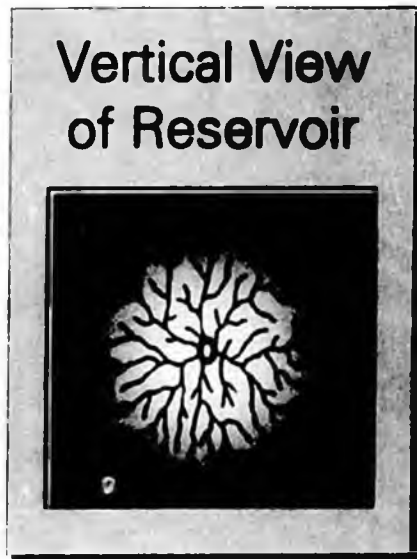
THERMAL EOR

2007 Differential: ANS-Kern River

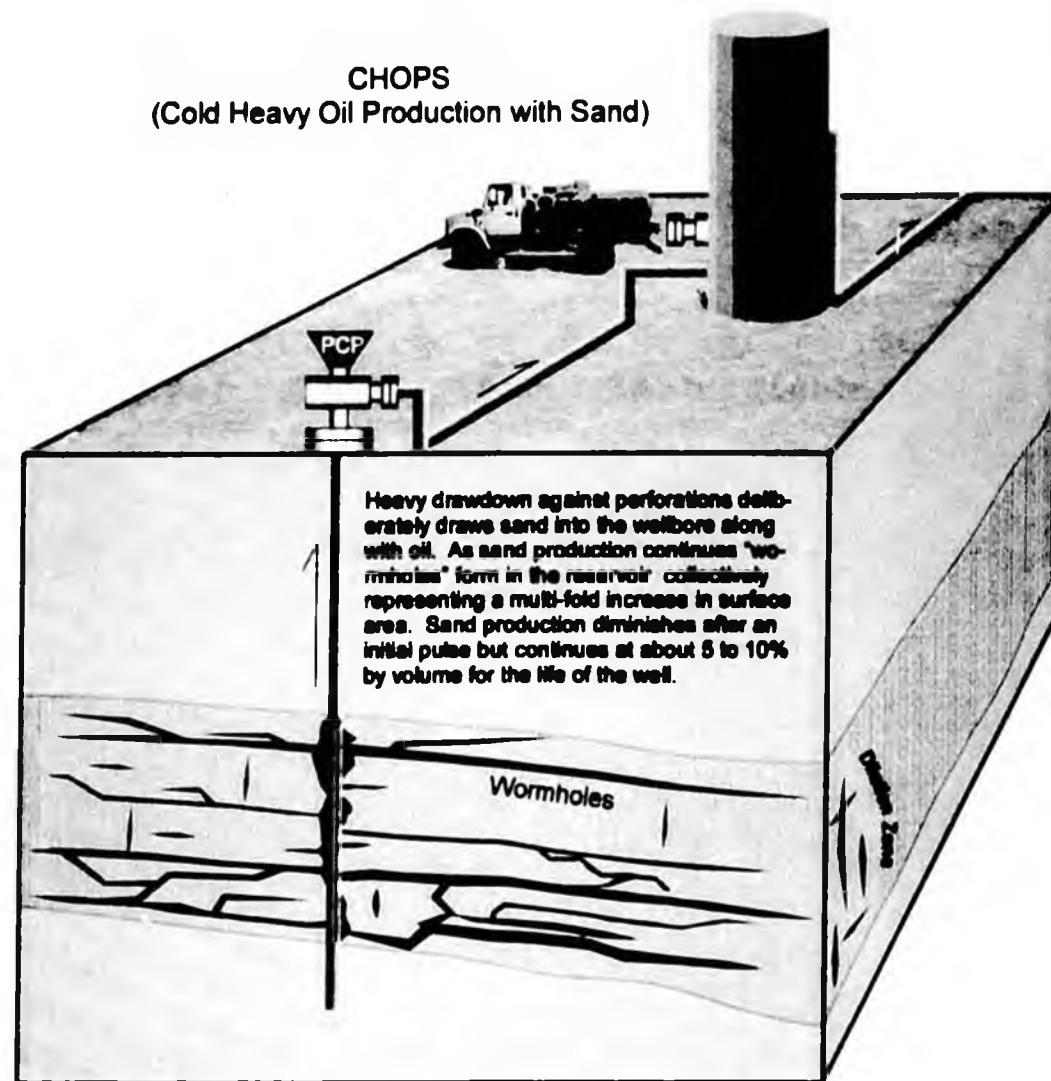


CHOPS

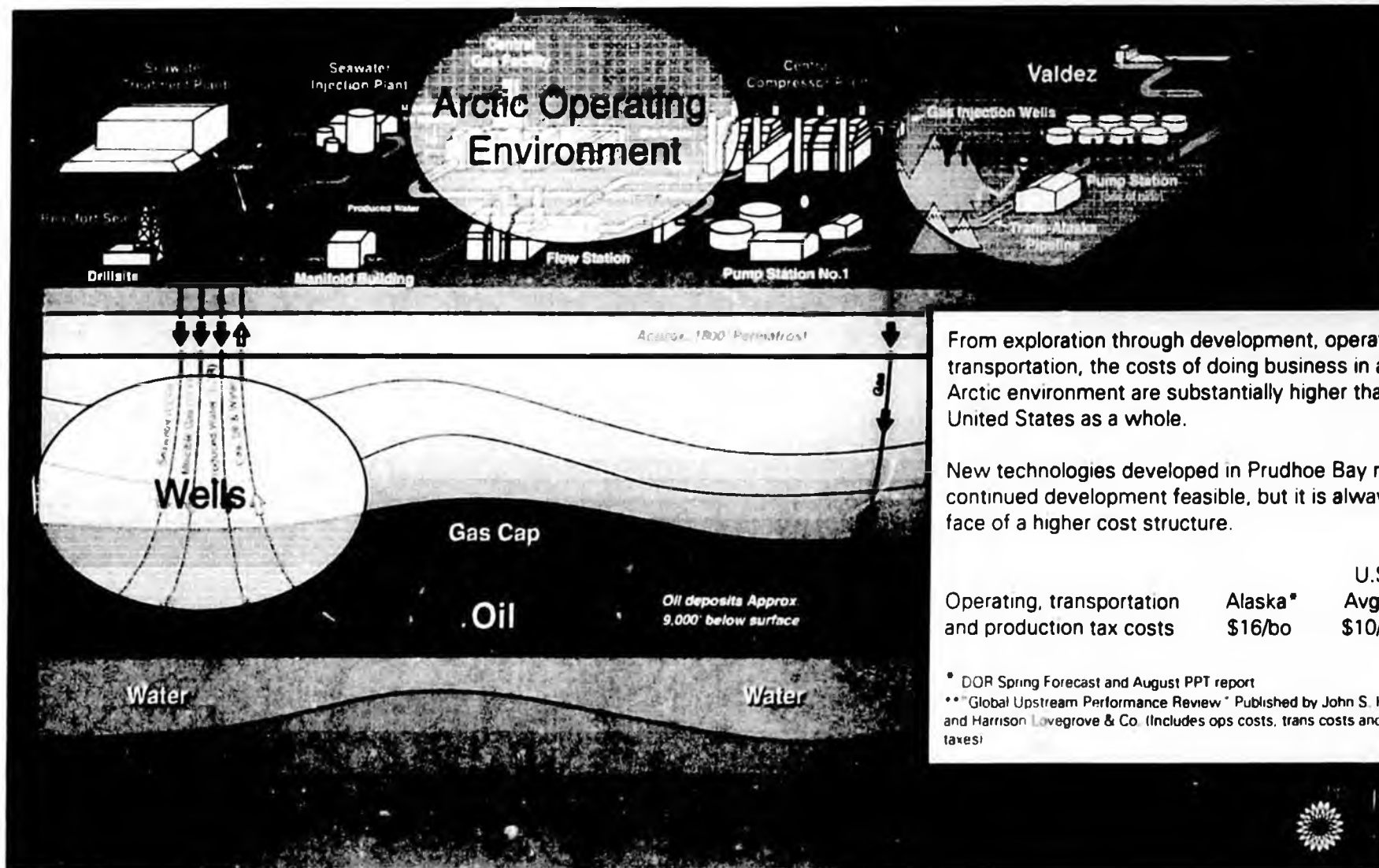
Cold Heavy Oil Production with Sand



CHOPS
(Cold Heavy Oil Production with Sand)



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)



Prudhoe Bay Development Summary

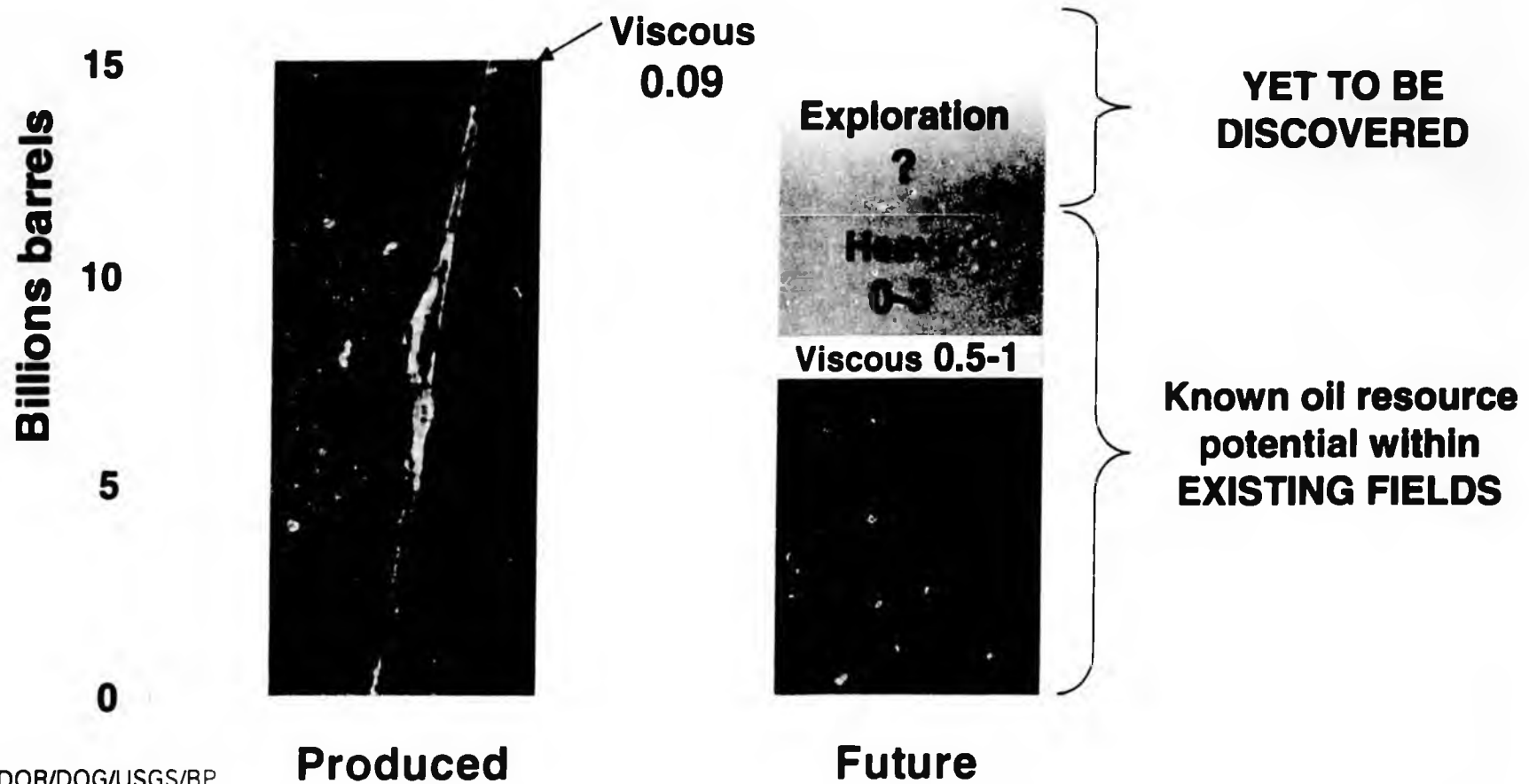


- Technology is Critical to Optimize Recovery:
 - Developing and applying new technology at scale
 - Arctic Technology
 - Major Facility Projects
 - Advanced Reservoir Processes Technology
 - Drilling/Workover Technology
- Development has been extensive and very successful
- Oil production is mature with over 11 billion barrels recovered
 - 1200 active wells
 - Declining oil rate and increasing water and gas rates
- Ongoing Projects Are Needed to Offset Steep Natural Decline
- Prudhoe Bay has a large part of Alaska's Future Opportunities

The future of North Slope oil still tied to existing fields



Sustained investment in light oil development is critical to developing heavy oil and new fields

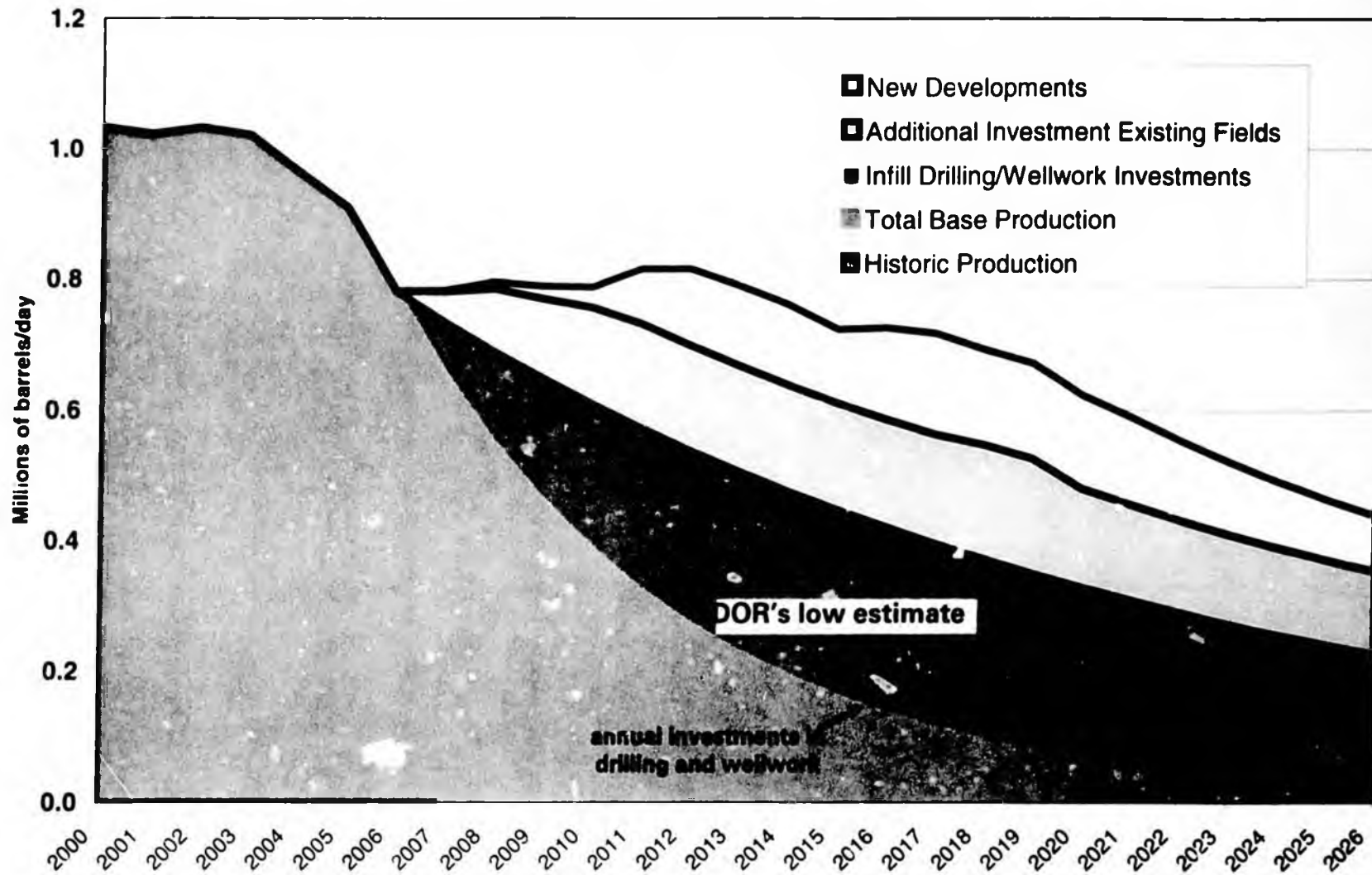


Source: DOR/DOG/USGS/BP

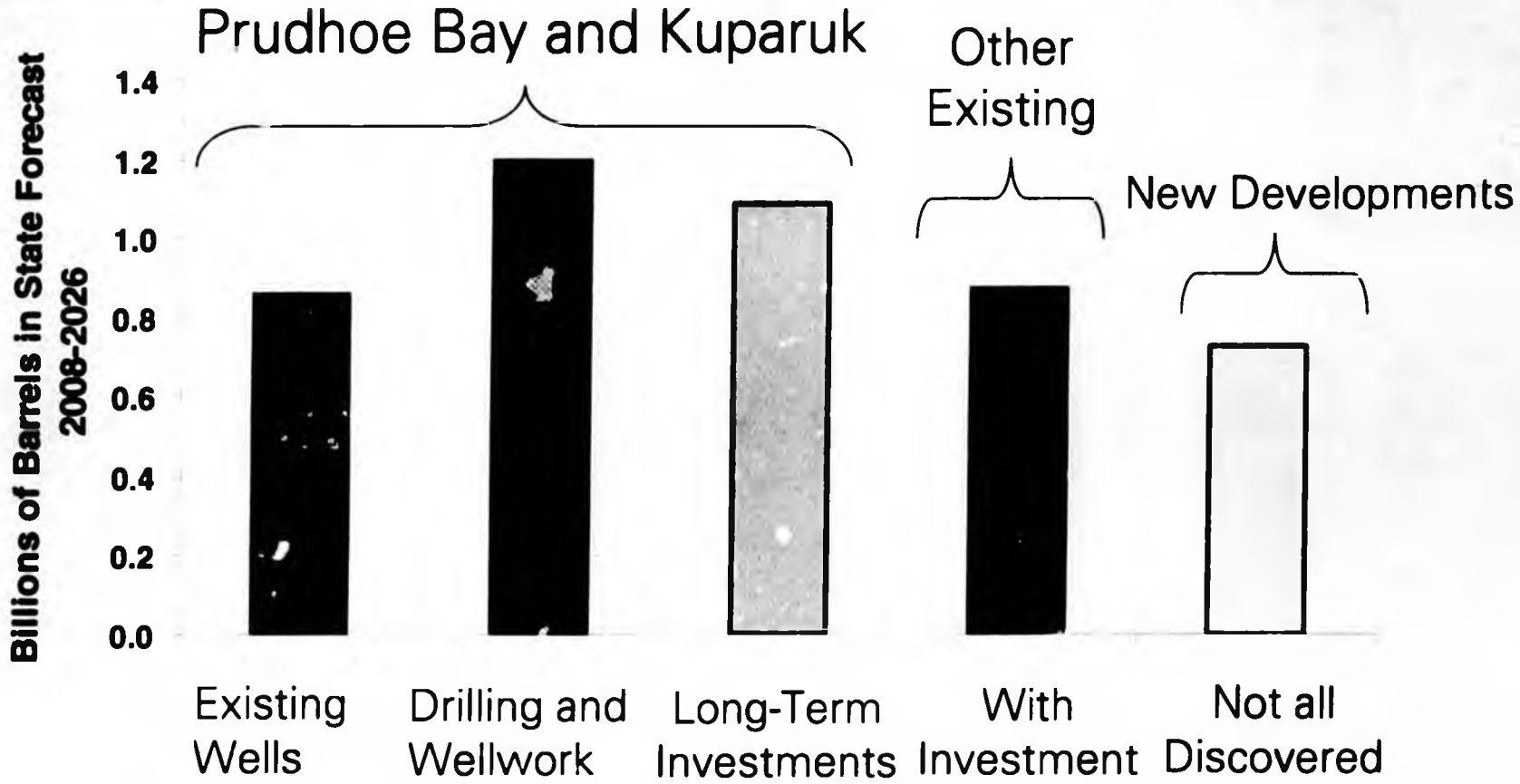
Future of oil production is critically dependent on existing large fields, additional investments



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

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)

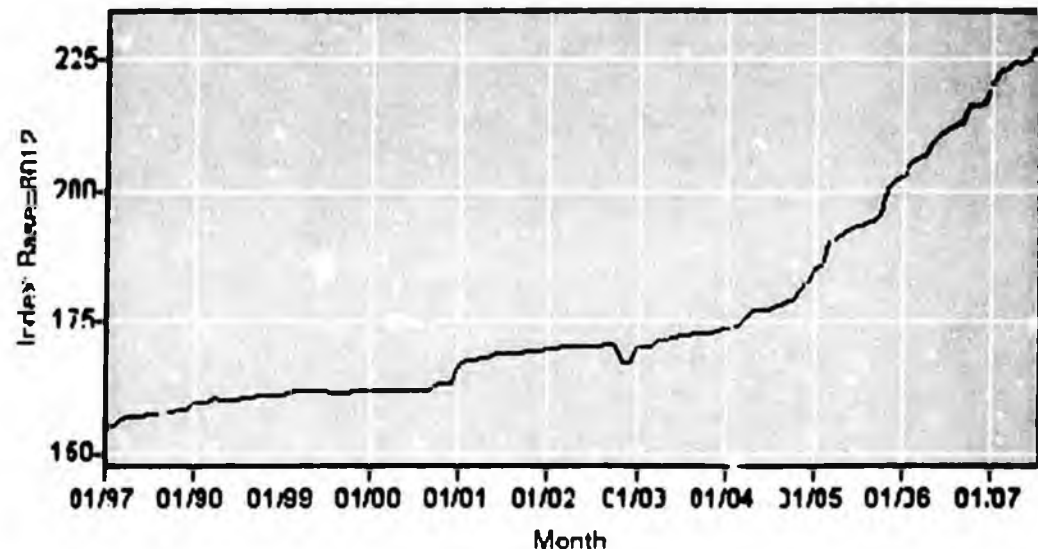
2004-2006 U.S. Average Cost Increases per barrel

- 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

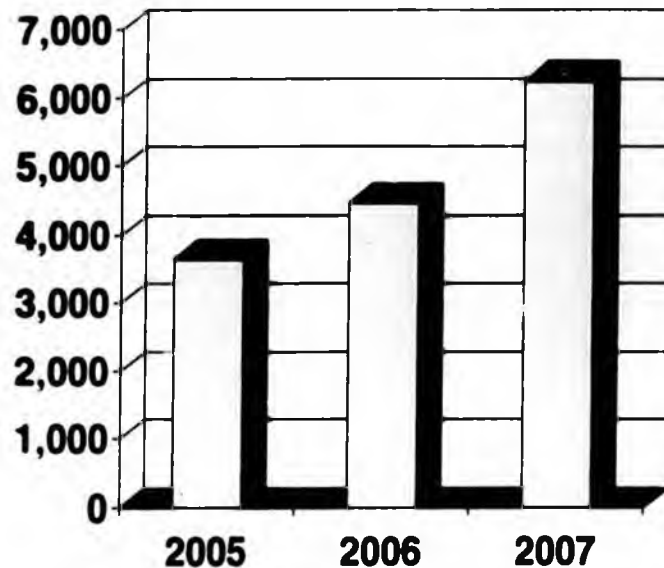
Source: U.S. Department of Labor



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

Economic impact of proposed bill on new investments



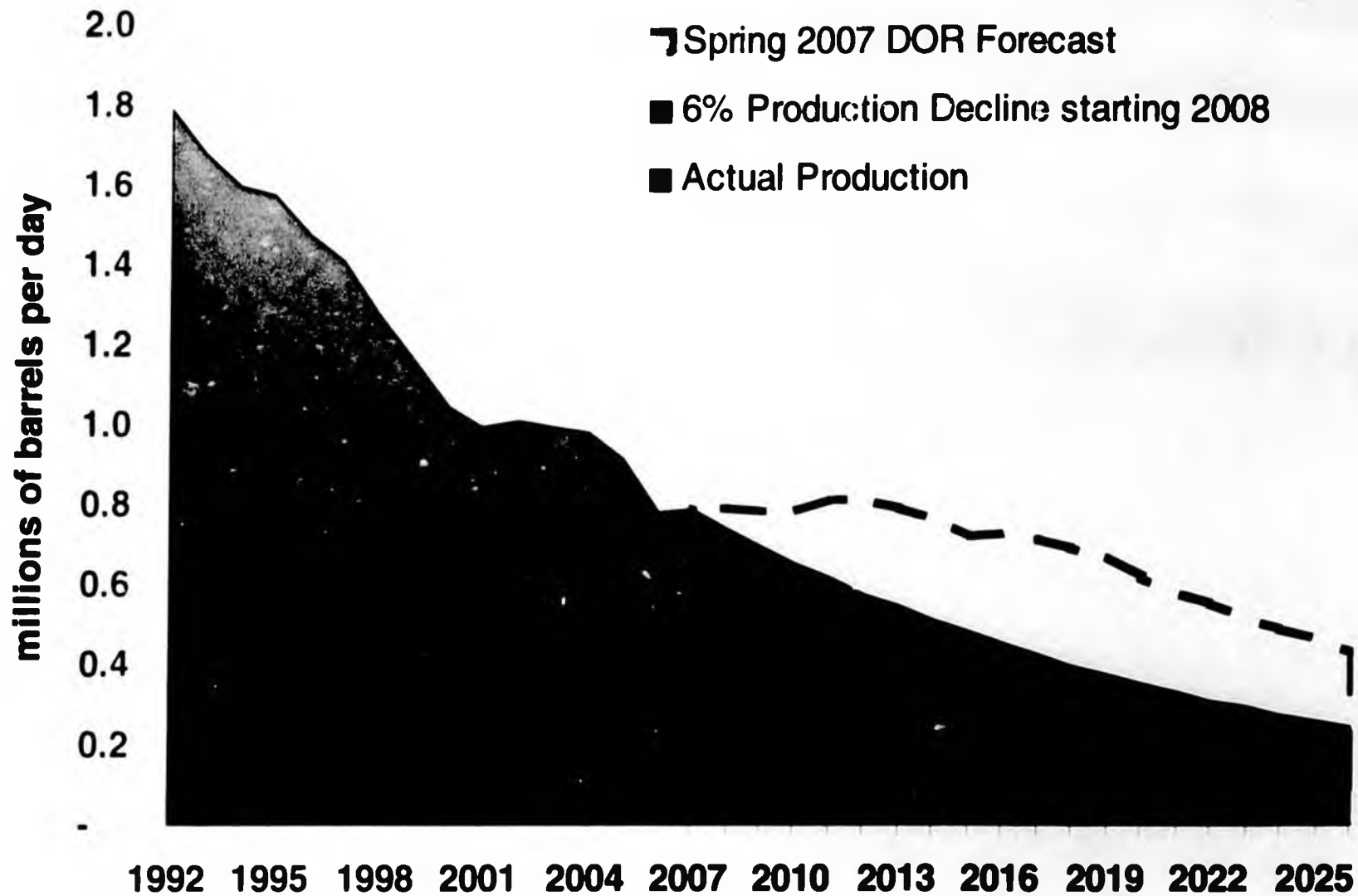
- About 70% of future investment decisions are within Prudhoe Bay and Kuparuk
- Minimum tax imposed on these fields causes a progressive deterioration of economics at medium to low prices
- A significant number of investment opportunities in Prudhoe Bay and Kuparuk will cross into marginal or non-economic territory, raising costs and lowering netbacks for the rest of the North slope production.

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
- 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

The time to influence the future outcome for the state is now



SB2001 Testimony

October 24, 2007

ConocoPhillips Alaska

Kevin Mitchell

Vice President, Finance & Administration

Jim Taylor

Vice President, Commercial Assets

ConocoPhillips in Alaska Today

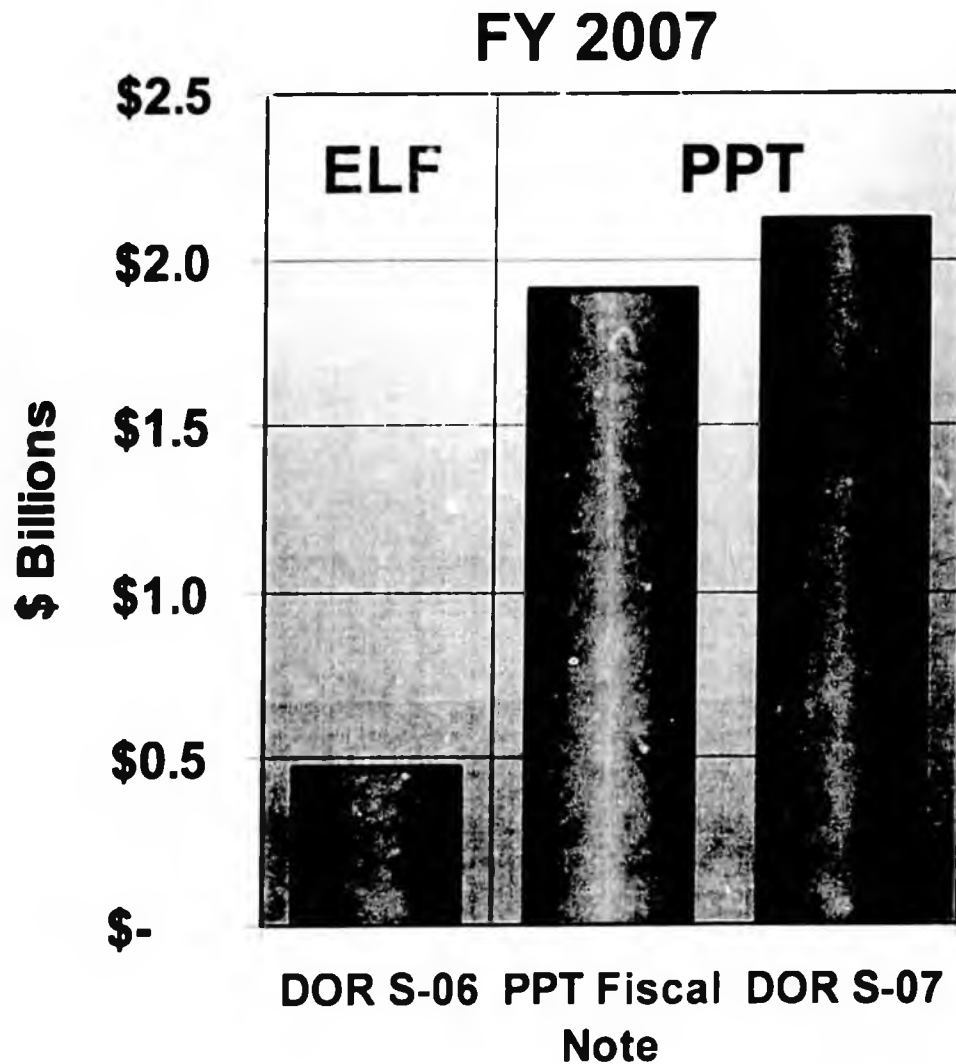


- **Alaska's Largest Producer**
 - 2006 oil production: 280,000 barrels of oil per day
 - 2006 gas production: 145 million cubic feet per day
- **Alaska's Largest Lease Holder**
 - Interest in 1.7 million gross (federal) acres in the NPRA
 - Nearly 2.6 million gross undeveloped acres in total outside 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

Summary Comment

- Interest between state and industry should be aligned
- Too early to change PPT
- Tax changes will impact investment
 - Increased tax take
 - Effect of 10% legacy floor
 - Uncertainty with frequent tax changes

Revenue Forecasts



Revenues meeting targets despite forecasting uncertainty associated with:

- Price
- Production
- Operating costs
- Capital costs

Too early to change

Impact of the 10% Legacy Floor

- The 10% minimum gross on the legacy fields can have a broader impact than simply downside price protection
- Minimum tax can be triggered by:
 - Low prices
 - Investment

Base Rate vs 10% Legacy Floor

Level of Investment

Low

Base Tax Calculations

Wellhead Revenue	\$ 50.00
- Opex	\$ (10.00)
- Capex	\$ (10.00)
<hr/>	
= Net Profit	\$ 30.00

25% Net Profit Tax	\$ 7.50	= 25% * \$30
- 20% Capital Credits	\$ (2.00)	= 20% * \$10
<hr/>		
= Net Tax After Credits	\$ 5.50	

Min Tax Calculations

Wellhead Revenue	\$ 50.00
x Gross Tax Rate	10%
<hr/>	
= Min Tax (\$)	\$ 5.00

Net Exceeds Min:

Tax Due = \$5.50

Investment Can Trigger Legacy Floor

	Level of Investment	
	Low	Potential
Base Tax Calculations		
Wellhead Revenue	\$ 50.00	\$ 50.00
- Opex	\$ (10.00)	\$ (10.00)
- Capex	\$ (10.00)	\$ (20.00)
= Net Profit	\$ 30.00	\$ 20.00
25% Net Profit Tax	\$ 7.50	\$ 5.00
- 20% Capital Credits	\$ (2.00)	\$ (4.00)
= Net Tax After Credits	\$ 5.50	\$ 1.00
Min Tax Calculations		
Wellhead Revenue	\$ 50.00	\$ 50.00
x Gross Tax Rate	10%	10%
= Min Tax (\$)	\$ 5.00	\$ 5.00

Min Exceeds Net:

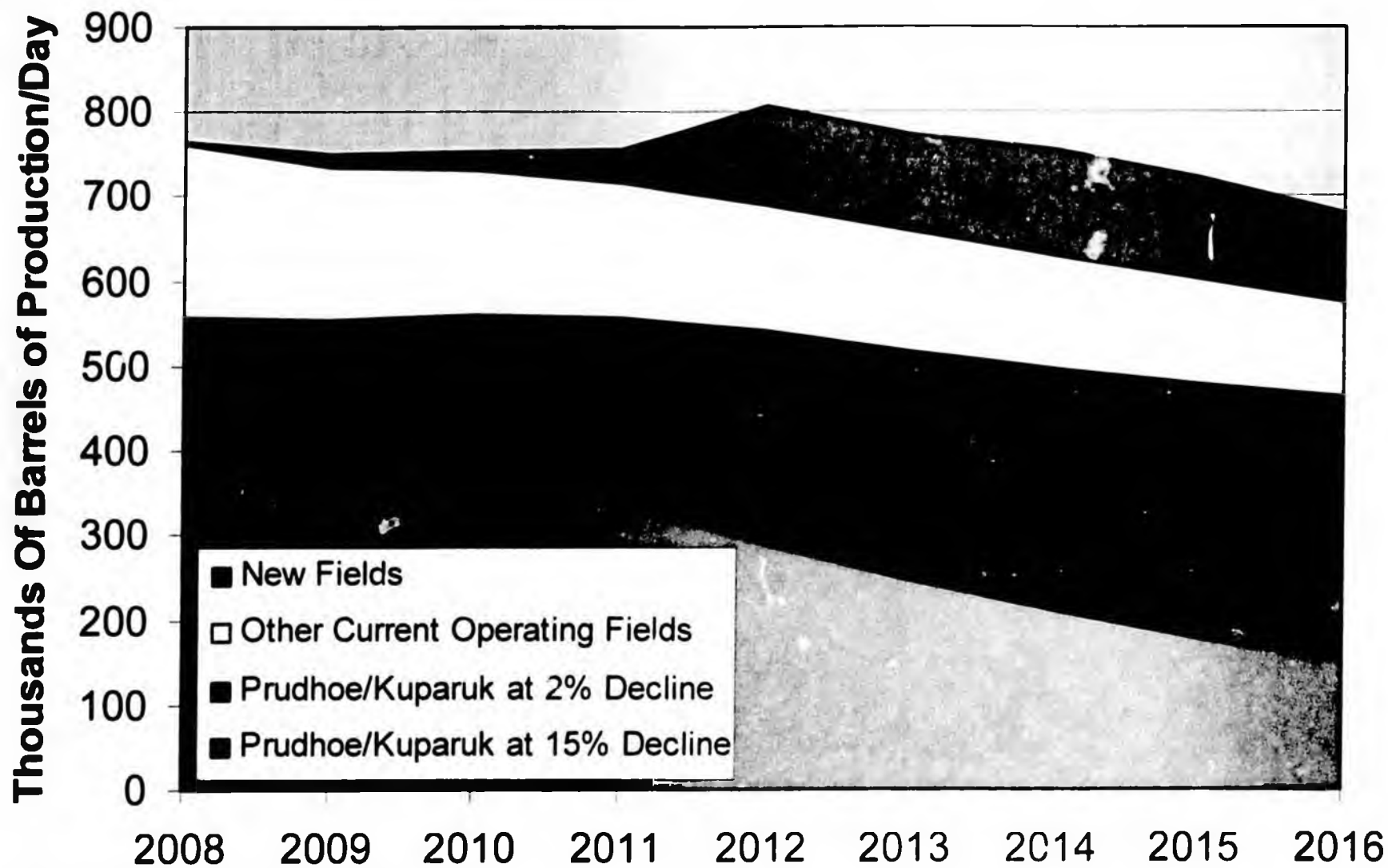
Tax Due = \$5.00

Potential Kuparuk Tax Calculation

	Level of Investment	
	DOR	Potential
Base Tax Calculations		
Wellhead Revenue	\$ 2,800 <i>bbl</i>	\$ 2,800 <i>bbl</i>
- Opex	\$ (450) <i>m.t</i>	\$ (450) <i>ml</i>
- Capex	\$ (400)	\$ (800)
= Net Profit	\$ 1,950	\$ 1,550
25% Net Profit Tax	\$ 488	\$ 388
- 20% Capital Credits	\$ (80)	\$ (160)
= Net Tax After Credits	\$ 408	\$ 228
Min Tax Calculations		
Wellhead Revenue	\$ 2,800	\$ 2,800
x Gross Tax Rate	10%	10%
= Min Tax (\$)	\$ 280	\$ 280

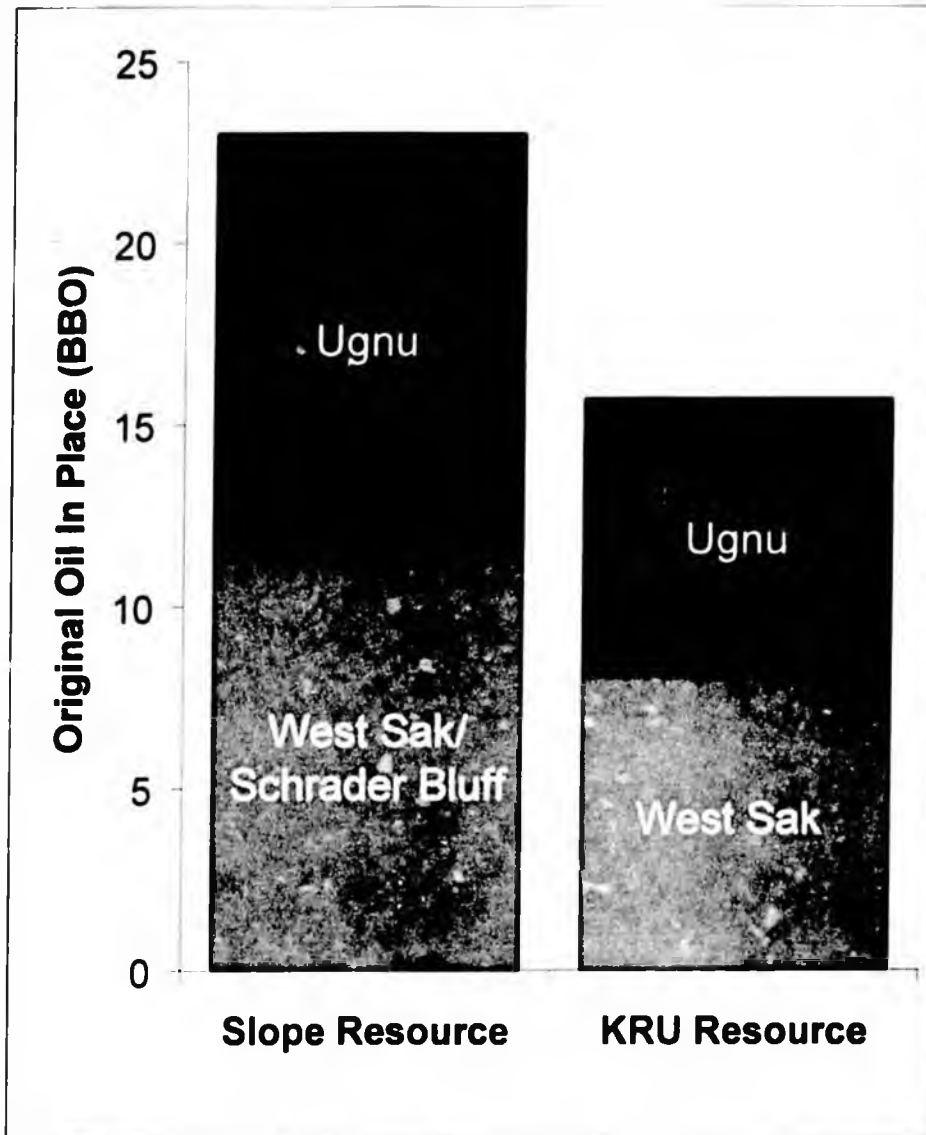
Data based on State DOR Spring Revenue Forecast 2007 for Kuparuk 2009 production and wellhead price Opex of \$7.75/bbl and capex of \$6.81/bbl based on Aug 3, 2007 PPT Status Report

Significance of Legacy Assets



Department of Revenue 2007 Spring Forecast

The Prize: North Slope Heavy Oil Resources



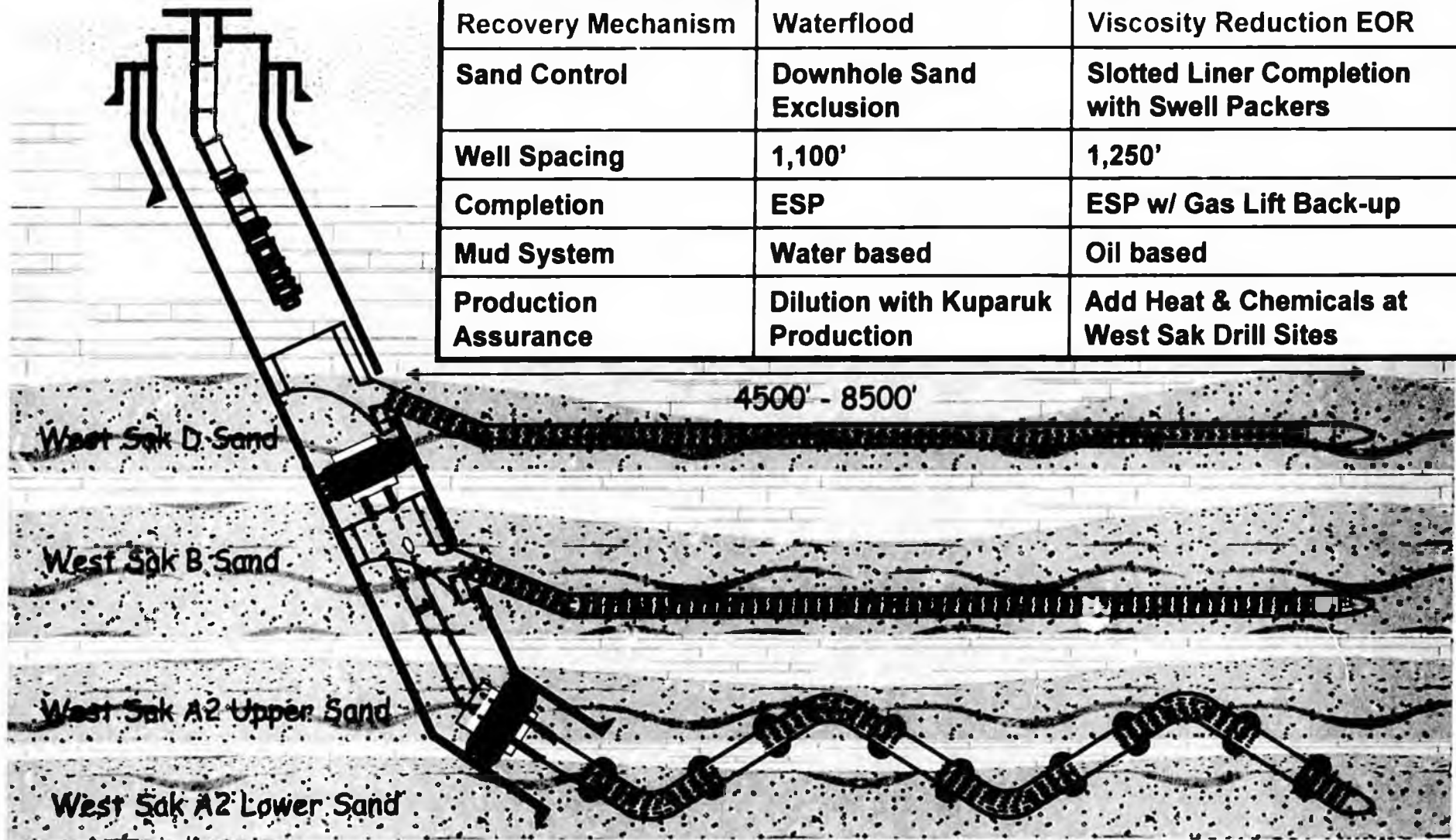
19 API Crude

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

West Sak Tri-Lateral Producer

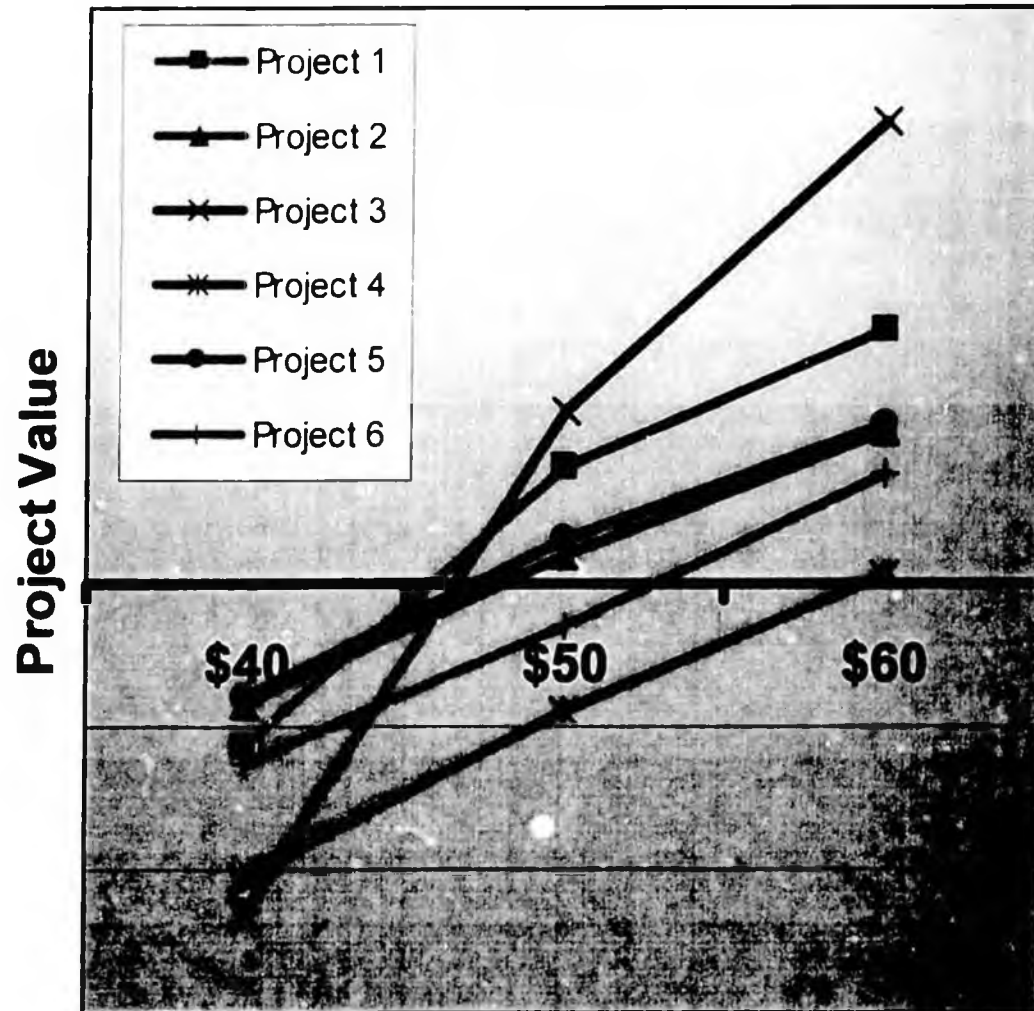
Component of Development Plan	1998	2004+
Well Types	Vertical	Horizontal Multi-Lateral
Drilling Reach	Moderate	Extended
Recovery Mechanism	Waterflood	Viscosity Reduction EOR
Sand Control	Downhole Sand Exclusion	Slotted Liner Completion with Swell Packers
Well Spacing	1,100'	1,250'
Completion	ESP	ESP w/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



Project Analysis

	Finniza's	Prudhoe/Kuparuk Projects						Totals
	Field A	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	

Project Economics Under Current PPT



- Projects challenged with higher development costs
- Higher price environment has enabled viability
- Tax change will erode economics

Impact on Investment

	PPT	Bill 25/20	Bill 10% Min
Project 1	Economic	Economic	Marginal
Project 2	Economic	Marginal	Marginal
Project 3	Economic	Economic	Marginal
Project 4	Marginal	Marginal	Not Economic
Project 5	Economic	Economic	Not Economic
Project 6	Marginal	Marginal	Not Economic

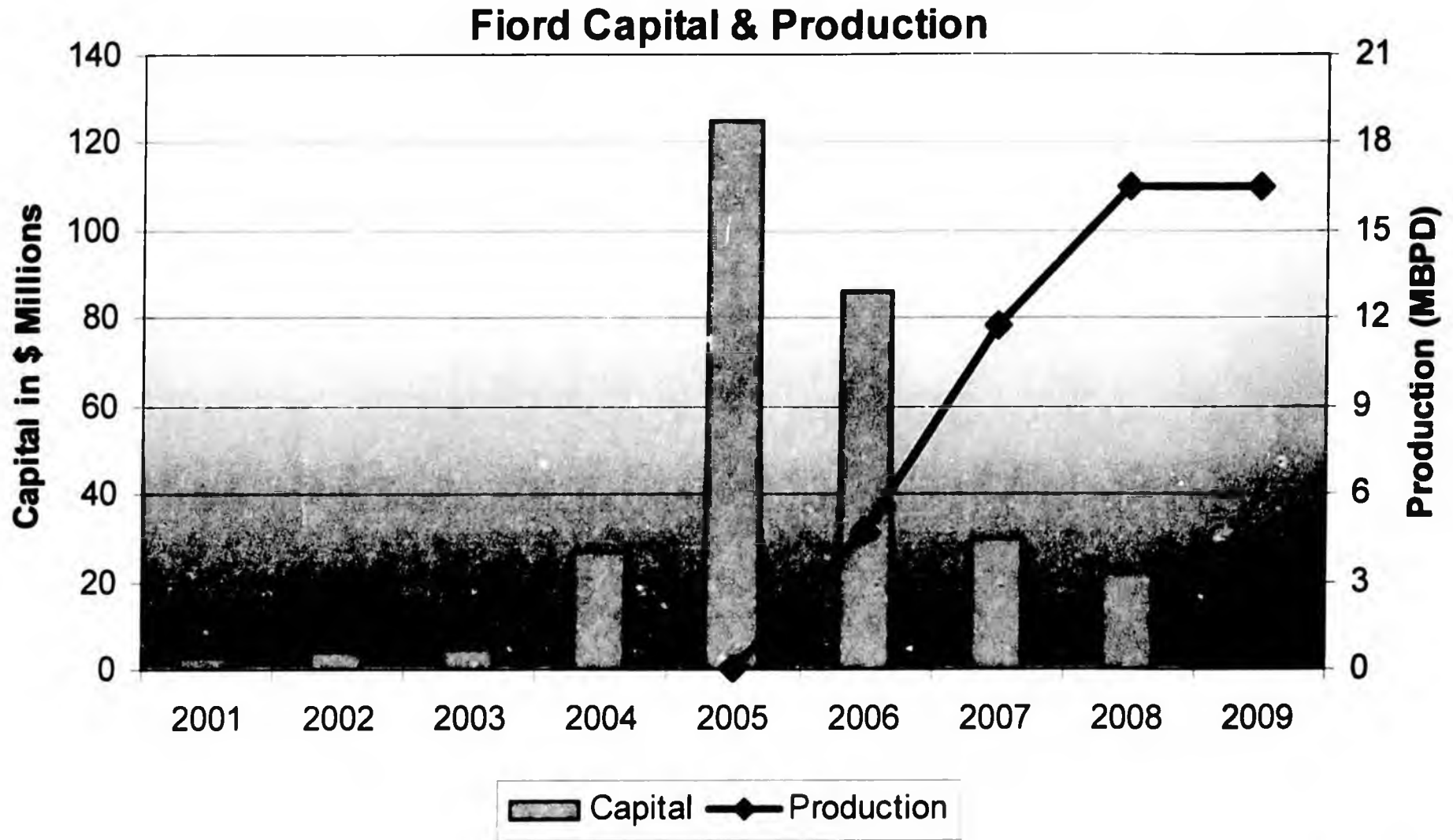
- Six real projects under evaluation
- \$3.5-\$4.0B gross capital spend
- Over \$6.0B revenue to state
- 250MM Bbls
- 1st production 2010-2013

TIE Credits

- Included in PPT legislation to recognize the impact of “changing rules” after investment decisions made
- Provides for equitable treatment of past expenditures
- TIE credits soften the impact of fiscal instability

—
2 for 1

Example of TIE Impact Fiord Development



Other Provisions

- Supportive of additional transparency in reporting
- But, certain areas of concern in bill:
 - Exploration confidentiality
 - Cost Deductions:
 - Statute should define lease expenditure deduction
 - Unscheduled maintenance exclusion
 - Exclusion of topping plant expenditures and investment
 - Exclusion of dismantlement costs

Summary Comment

- Interest between state and industry should be aligned
- Too early to change PPT
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 - Effect of 10% legacy floor
 - Uncertainty with frequent tax changes

Attached is response to Senate Resources Chairman, Sen. Huggins request for an illustration of ALL sources of revenue/income from the oil industry in Alaska, by category, showing actuals for years '05,'06,'07 and projected for 2008.

From DOR 10/23/07

Title: FY2005 to FY 2008 Petroleum Revenue

Data Sources: Alaska Department of Revenue, Tax Division
FY 2005 & FY 2006 from DOR historical database
FY 2007 Preliminary estimates
FY 2008 forecast from the Spring 2007 *Revenue Sources Book*

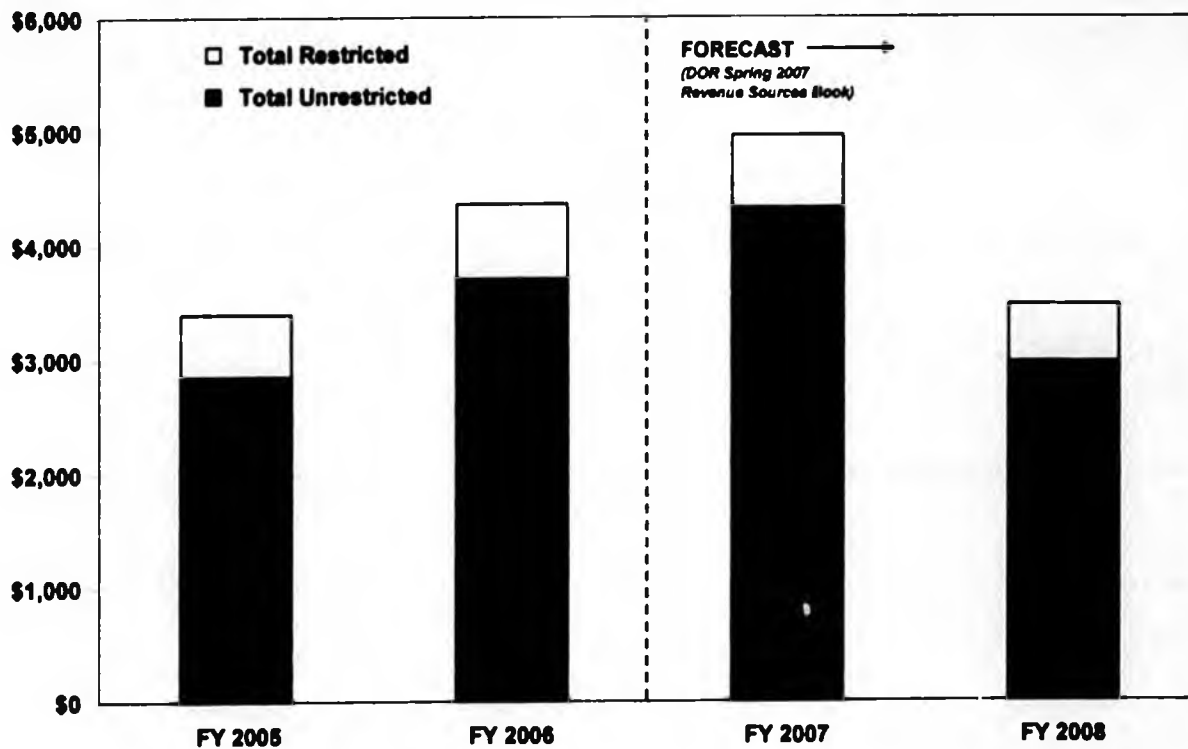
Prepared by: Jennifer Duval, Economist
jennifer.duval@alaska.gov

Date: October 23, 2007

Purpose: Request by Senator Huggins

Notes: Dollar amounts are millions of nominal dollars

Total Oil Revenue
in Millions of Dollars



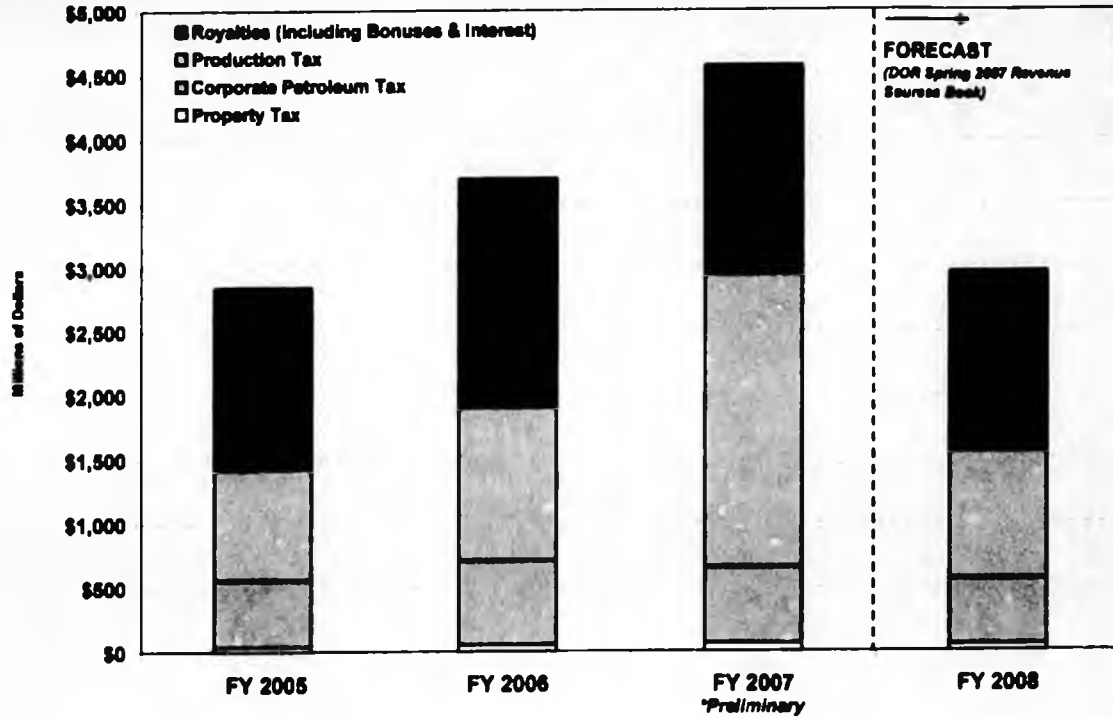
Historical and Forecast Oil Revenues FY 2005 - FY 2008

Source: DOR Spring 2007 Revenue Sources Book

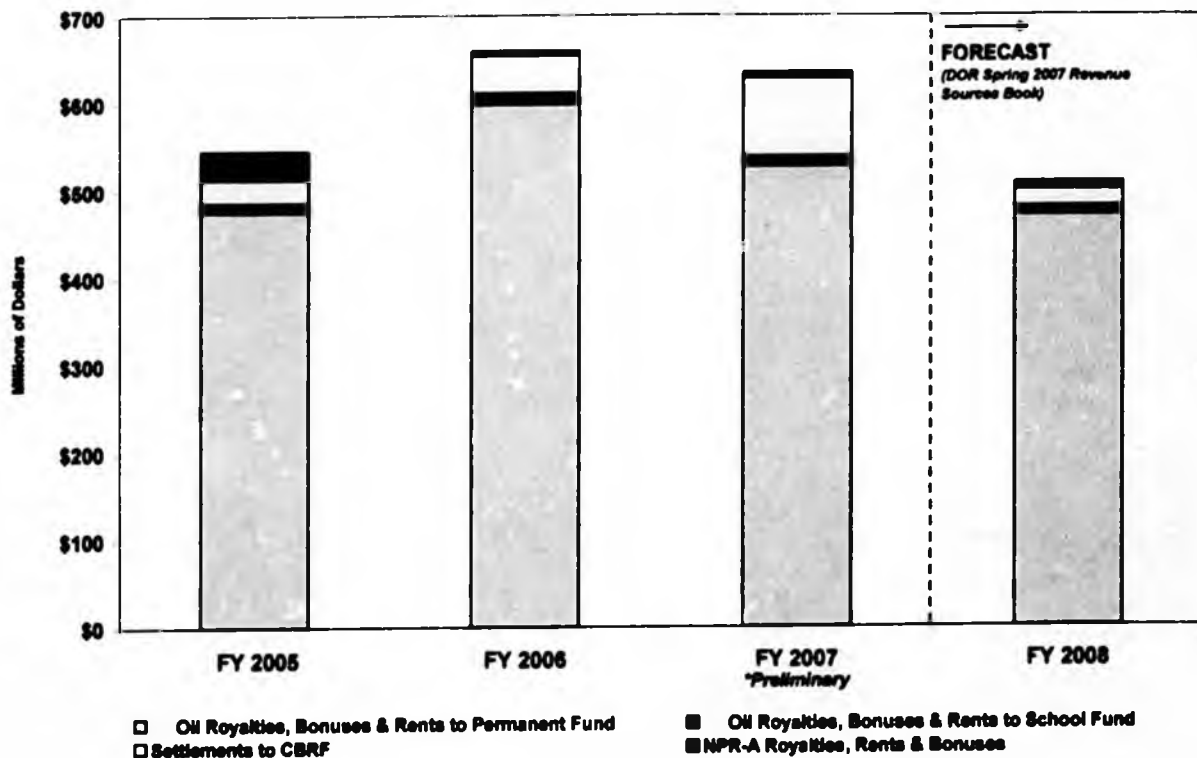
<i>in Millions of Dollars</i>	ACTUAL FY 2005	ACTUAL FY 2006	PRELIM ACTUAL FY 2007 (10/22/07)	SPR 07 FORECAST FY 2008
Unrestricted				
Property Tax	42.5	54.5	65.6	63.2
Corporate Petroleum Tax	524.0	661.1	594.4	612.1
Oil & Gas Production	854.9	1,191.7	2,282.2	983.1
Oil & Gas Hazardous Release	8.3	7.8	10.1	12.3
Production Tax	663.2	1,199.5	2,292.3	995.4
Mineral Bonuses & Rents	17.4	11.6	22.2	14.8
Oil and Gas Royalties	1401.1	1772.2	1,583.8	1,390.3
Interest	1.4	0.3	7.0	1.4
Royalties (including Bonuses & Interest)	1419.9	1784.1	1,613.0	1408.4
Total Unrestricted	2,849.6	3,698.2	4,565.3	2967.10
Year-over-Year change	795.5	849.6	869.1	-1,598.2
Year-over-Year % change	38.7%	29.8%	23.4%	-35.0%
Restricted				
Oil Royalties, Bonuses & Rents to Permanent Fund	476.9	599.5	535.0	471.5
Oil Royalties, Bonuses & Rents to School Fund	9.6	12	10.6	9.4
Royalties to Permanent Fund & School Fund + Bonuses & Interest	486.5	611.5	545.7	480.9
Settlements to CBRF	27.4	43.7	113.6	20
NPR-A Royalties, Rents & Bonuses	31.6	4.5	12.8	7.6
Total Restricted	645.5	690.7	672.1	598.5
Total Oil	3,395.1	4,358.9	5,237.4	3,475.6

Percent of Total Oil	FY 2005	FY 2006	FY 2007	FY 2008
Property Tax	1.3%	1.3%	1.3%	1.6%
Corporate Petroleum Tax	15.4%	15.2%	11.3%	14.7%
Oil & Gas Production	25.2%	27.3%	43.6%	28.3%
Oil & Gas Hazardous Release	0.2%	0.2%	0.2%	0.4%
Production Tax	25.4%	27.5%	43.8%	28.6%
Mineral Bonuses & Rents	0.5%	0.3%	0.4%	0.4%
Oil and Gas Royalties	41.3%	40.7%	30.2%	40.0%
Interest	0.0%	0.0%	0.1%	0.0%
Royalties (including Bonuses & Interest)	41.8%	40.9%	30.8%	40.5%
Total Unrestricted	83.9%	84.9%	87.2%	86.4%
Restricted				
Oil Royalties, Bonuses & Rents to Permanent Fund	14.0%	13.8%	10.2%	13.6%
Oil Royalties, Bonuses & Rents to School Fund	0.3%	0.3%	0.2%	0.3%
Royalties to Permanent Fund & School Fund + Bonuses & Interest	14.3%	14.0%	10.4%	13.8%
Settlements to CBRF	0.8%	1.0%	2.2%	0.6%
NPR-A Royalties, Rents & Bonuses	0.9%	0.1%	0.2%	0.2%
Total Restricted	16.1%	15.1%	12.8%	14.6%
Total Oil	100%	100%	100%	100%

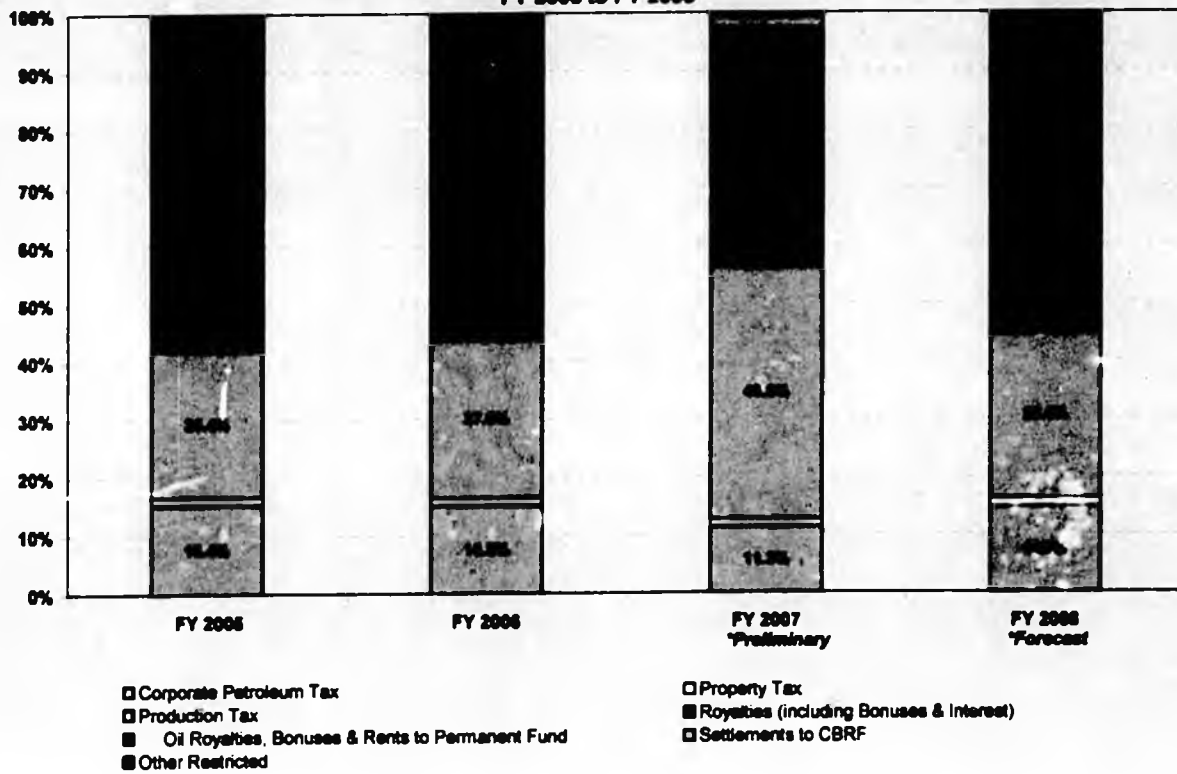
Unrestricted Oil Revenue by Category FY 2005 to FY 2008



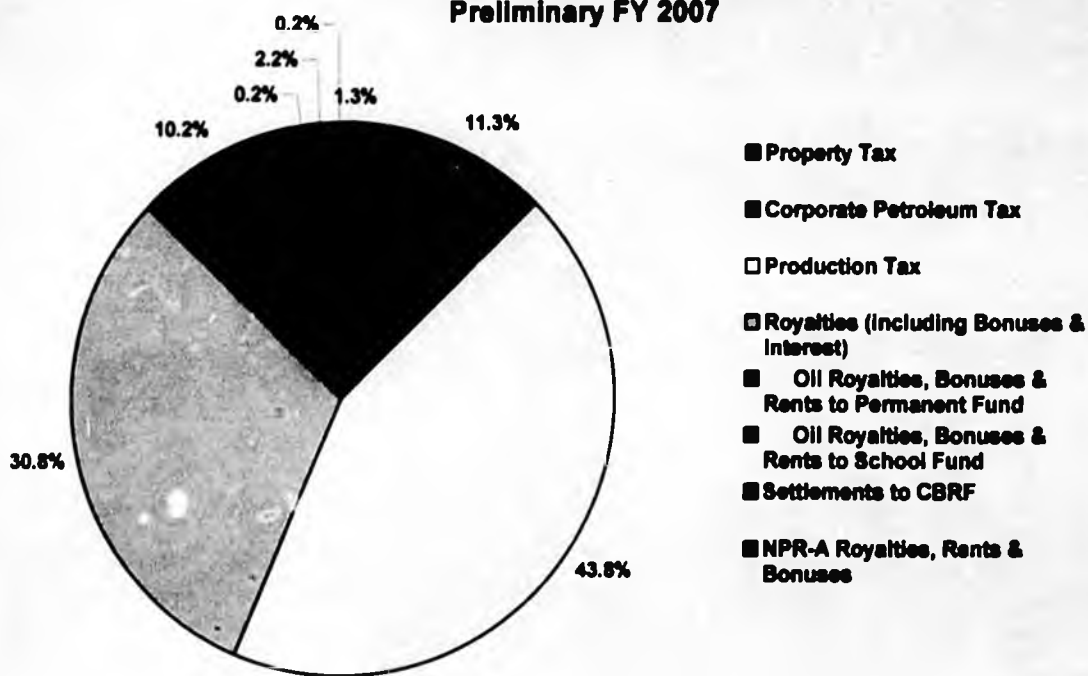
Restricted Oil Revenue FY 2005 to FY 2008



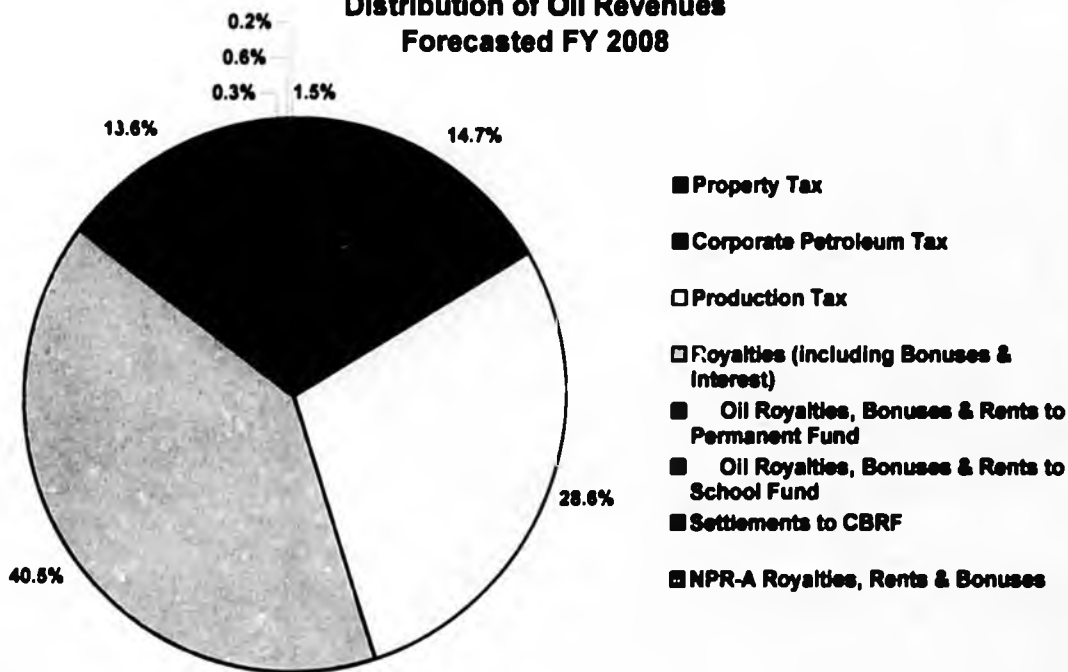
Percent Distribution of Total Oil Revenues by Year
FY 2005 to FY 2008



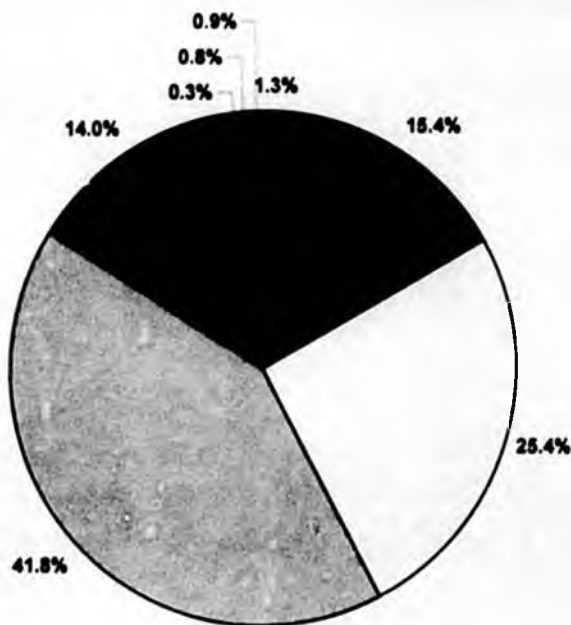
**Distribution of Oil Revenues
Preliminary FY 2007**



**Distribution of Oil Revenues
Forecasted FY 2008**

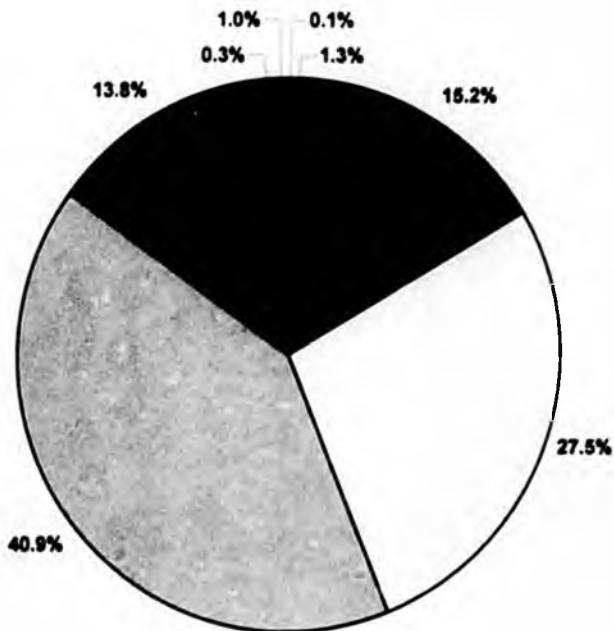


**Distribution of Oil Revenues
FY 2005**



- Property Tax
- Corporate Petroleum Tax
- Production Tax
- Royalties (including Bonuses & Interest)
- Oil Royalties, Bonuses & Rents to Permanent Fund
- Oil Royalties, Bonuses & Rents to School Fund
- Settlements to CBRF
- NPR-A Royalties, Rents & Bonuses

**Distribution of Oil Revenues
FY 2006**



- Property Tax
- Corporate Petroleum Tax
- Production Tax
- Royalties (including Bonuses & Interest)
- Oil Royalties, Bonuses & Rents to Permanent Fund
- Oil Royalties, Bonuses & Rents to School Fund
- Settlements to CBRF
- NPR-A Royalties, Rents & Bonuses

Deborah Grundmann

From: Sen. Charlie Huggins
Sent: Thursday, October 25, 2007 9:33 AM
To: Deborah Grundmann; Sharon Long
Subject: FW: Hearing testimony by ADNR and AOGCC

*Karen Sawyer
Staff to Senator Charlie Huggins*

907-376-4866
907-373-4724 Fax
600 E Railroad Avenue
Wasilla AK 99654
Karen.Sawyer@legis.state.ak.us

From: Tom Lakosh [mailto:lakosh@gci.net]
Sent: Thursday, October 25, 2007 7:49 AM
To: Rep. Kurt Olson; Sen. Charlie Huggins
Cc: jody.colombie@alaska.gov; tom.irwin@alaska.gov
Subject: Hearing testimony by ADNR and AOGCC

Dear Senator Huggins and Representative Olson;

Yesterday I provided testimony to your committees suggesting that ADNR and AOGCC be given the enhanced responsibility and tools to ensure the revenue maximizing administration of hydrocarbon leases. Would you please call the appropriate personnel from these agencies to testify on their roles in maximizing revenue and the potential for improved optimization if they were given new tools for incentivizing development?

While the ability to incentivize development with a broader range of royalty rates for new leases should be obvious, it may not be so obvious with regard to existing leases. ADNR already exhibited the ability to adjust the increased financial liability for existing leases by determining that satellite fields were indeed only extensions of the Prudhoe Units. I am only suggesting that, in cooperation with AOGCC and ADOR, that ADNR be mandated and permitted to evaluate the feasibility of proffering adjusted lease royalty rates where revenue optimization indicates that with projected oil prices, optimization would be infeasible given the cost of extraction of certain hydrocarbons on specific leased units. For example, if the long term revenue optimization requires concurrent development of heavy oils at West Sak and the

10/25/2007

projected price does not warrant extraction of the heavy oils with the most cost effective extraction technology, then ADNR would have the authority to offer lessees a lower royalty rate under an AOGCC conservation plan that requires the concurrent extraction of the optimal ratio of light and heavy oils.

My sense of the situation is however, that the current projected prices and existing agency mandates already support this type of concurrent extraction of heavy oil and light oils but the oversight of the responsible agencies is somewhat lacking and a renewal and enhancement of agency mandates is necessary to spur proper resource development/conservation policies.
Tom Lakosh

Testimony provided for the benefit of ADNR and AOGCC:

TOM LAKOSH P.O. BOX 100648 ANCHORAGE, AK 99510 Ph/Fax (907) 563-7380

October 24, 2007

TESTIMONY ON HB 2001 ACES

My alternative to ACES is called TRIPS, Taxes, Royalties and Infrastructure for the Petroleum Sector. There are some, albeit few, sections of ACES that would be useful but basic principles at work that require a wholesale reworking of the Bill are:

- Virtually all oil bearing structures on state lands have been explored so there's little reason to provide incentives to the industry to explore where they have already exploited everything they could. BP made this clear in their statement that 70% of their future investment would be in the greater Prudhoe area where they are obligated to wisely extract the hydrocarbons pursuant to the applicable leases and AOGCC guidelines. If producers don't provide full and efficient extraction, their leases are subject to revocation and "there's always other fish in the sea". We should not give existing producers kickbacks where they're obligated to do the job properly and within technological feasibility and economic limits under existing contracts and law. With the price of oil above \$80 there should be little left to recover in our legacy fields and we must demand heavy oil extraction now while we still have light oil to mix into TAPS shipments and the price is still high enough to warrant extraction without subsidy.
- Where extraction of heavy or viscous oils is necessarily tied to the availability of lighter oils, the ADNR and AOGCC must conduct the proper technology and economic analyses to insure the optimization of revenues from regulation of the rates heavy and light oils

are extracted. The ADNR and AOGCC must thereafter issue the necessary directives to lessees to insure that lessees are producing each type of hydrocarbon on their leases in manner that optimizes the total revenues to the state. There is no quantifiable correlation between the oil production rates or total state revenues and the tax rates so the proper mandates for our regulatory agencies must be codified in statute to insure that they regulate lessees to the optimal benefit of the state.

- If absolutely necessary, we can subsidize production of hydrocarbons that are difficult to develop by adjusting royalty rates instead of taxes. This would allow for lease by lease evaluation that is clearly more sensible than the broad subsidies to all operations. The royalty rates apply to gross production so the 19% range I've suggested has more than enough value available to provide incentive for development of heavy oils and remote gas should existing lessees submit, or new lessees sign on, to the new adjusted royalty rates that express the relative accessibility and marketability of specific lease types at specific distances from established infrastructure.
- The testimony clearly enforced the principle that "if you build it they will come". Angola got a \$1 billion for its leases and rabid global competition because the oil co's knew there was oil to develop. If there's oil/gas to be found, the state should find it and define the field before it puts out leases so it can garner the highest bids among many competitors. The state would also be better able to predict development, classify fields to establish proper royalty rates and determine appropriate deadlines for relinquishment. The more we improve information on prospective fields and insure access, the less we need speculators that demand high rates of return. When we eliminate the discovery and access impediments we essentially only need contractors to build the production facilities and pump the oil as regulated by ADNR and AOGCC.
- If we have to subsidize the industry we should do it in a way that benefits other businesses and public interests. Taking money from royalties to improve transportation to the fields/pipelines floats everybody's boat. The heavy lift helicopters and low impact transport would also reduce tundra impacts, allow a longer exploration season and year round deliveries to isolated drilling/production pads. They would also be extremely effective tools for getting spill response equipment to remote sites and help repair global warming damage in remote areas that is directly caused by the oil we peddle.
- Our economic future through 40 - 60 years depends on our ability to market gas and the gas will not be marketable until the relative BTU value of gas approaches the price of oil BTUs, (PVM said it was at 40% of oil because Northern Tier coal companies successfully

marketed their coal to power plants). The relative BTU value of gas can only be increased by de-valuing coal as a power plant fuel with a federal carbon tax. The carbon tax would also likely save us as much in damages to infrastructure from global warming as we would make on oil exports, billions and billions in prevented damage that we wouldn't have to spend our revenue on to mitigate.

- Providing tax incentives to explore on federal land will mostly provide returns for the federal gov't, leaving us with enormous development bills and not much revenue to show for it.
- The least impact to exploration on federal land/OCS can be accomplished by increasing the corporate income tax on hazardous operations because an increase in state corporate tax is used as a direct offset to federal income taxes so there' no net increase in taxes on the oil co's. This tax will affect new fields and existing fields that we've been getting a raw deal on, (i.e. the 90/10 vs 50/50 split, justice w/o a court).
- If we allow the oil co's to write off their Alaskan expenses it would tend to increase the price of our hydrocarbons and make them less competitive on the open market. Taxes do have an effect on corporate behavior and only taxing the gross at the point of export or in-state delivery will serve to keep a market check on expenditures in-state and therefore keep our hydrocarbons as cheap as possible in the market. We would surely have a strong case for upholding the gross tax where it measured value IN ALASKA. Both PPT and ACES are inviting fly by might wildcatters that will sell their credits and leave. The majors will be just as susceptible to the notion that spending controls are less of a priority given that they can sell the credits for marginal projects if they fail. Why not just take the money we'd spend on credits and provide the needed oversight to exploration contractors we hire on a competitive bid? The discrepancies between projected and collected revenues under PPT suggests that either the state is incapable of properly assessing tax provisions or that tax payers are withholding taxes. Both results suggest we must have a simple tax structure to avoid revenue shortfalls and costly litigation.
- The whole TRIPS scheme is designed to enhance certainty of development, (pre-defined leases and improved access), while alleviating risk due to low prices but eliminating any windfalls to industry, (the progressive production tax spanning a \$190 price range). Although I haven't done a precise analysis of the total government take, I strongly suspect that these rates would keep us below the Norwegian standard of 78% up to about \$70-\$90/bbl and I would suggest lowering the base production tax and/or raising the new class of corporate income tax until this parity was reached. I'm sure that the Norwegians never anticipated the blistering oil market we have today and so did not include progressivity. The gas problem can

only be rectified with a carbon tax and then all else will be controlled by the high, stable gas value generated by a proper valuation of this external cost of our hydrocarbon economy. More stringent particulate regulation would also likely help gas prices.

TRIPS beats ACES every day of the week and I would appreciate your feedback. Tom Lakosh phone 563 7380 in Anchorage

Proposed Principles and Rates for Design of an Oil Tax Bill:

Production and Corporate Income Taxes, Royalty Rates and Lease Provisions with

State Commitments to Exploration, Infrastructure and Carbon Conservation

Production Taxes: The gross tax on hydrocarbons produced in Alaska shall be set at the value of the hydrocarbons at the Alaskan terminus of export or point of sale within Alaska, (e.g. Valdez Marine Terminal for TAPS oil, Drift River or KPL Dock for Cook Inlet oil and gas, at the Canadian border in the case of gas transport by pipeline, at any in-state refinery or point of sale), in order to provide a market check on production costs and pipeline tariffs in furtherance of the relative competitiveness of Alaskan resources. This tax system would also encourage export of value added petrochemical and refined products. The tax rates for crude oil are as follows:

1. There shall be a minimum PT of 15% of gross value for oil prices between \$0 and \$20/bbl;
2. At \$21/bbl the PT increases to 15.5% and increases by a rate of 0.5% for each \$1/bbl increase in price to \$30 ;
3. At a price of \$31/bbl the PT shall be raised to 20.2% of gross value and shall increase at a rate of 0.2% for each \$1 in value per barrel until a price of \$110/bbl at which point the tax will have accumulated increases to provide a rate of 36% of value;
4. At a price of \$111/bbl the PT shall be assessed at 36.1% of value and shall increase at a rate of 0.2% for each \$1 in value per barrel until a price of \$210/bbl at which point the production tax will have reached its maximum rate of 46% of value.

Corporate Income Tax: A distinct class of Alaskan corporations shall include those operations that handle substantial quantities of hydrocarbons and other hazardous materials, as classified by the ADEC, and be subject to a corporate income tax of 14%. The safety and security issues presented by these operations require significant oversight, security and public safety assets

that warrant an enhanced level of corporate classification in such regard.

Royalty Rates: Lease bidders will proffer a signing bonus payment and a bid above an adjustable royalty floor/minimum established between 1% for the least marketable hydrocarbon, (e.g. inaccessible, undefined gas fields), to a maximum of 20% for the highest wellhead value hydrocarbon, (e.g. well defined, light and accessible liquids such as those at Point Thompson). Each lessee shall consent to an adjustment of its royalty rate every 5 years after production startup that reflects any increase or decrease in the market valuation of the BTU content of the hydrocarbon(s) under development and/or by a substantial improvement in accessibility of leased properties as generated by state efforts. Lessees shall provide all necessary information needed to assess the relative BTU values of Alaskan hydrocarbons.

Hydrocarbon Exploration, Production and Transport Lease Provisions: ADNR and AOGCC, shall in their administration of lessees operations, conduct the necessary analyses and issue appropriate directives to lessees to provide for the revenue optimizing extraction rates and use of technologies with respect to recovery of viscous and heavy oil recovery as such extraction may be tied to concurrent availability of lighter oils. All new leases shall have relinquishment provisions that reflect the realistic development timelines given the difficulty perfecting necessary permitting and development tasks. All lessees consent to regulation and assistance by the ADEC to effectively utilize and otherwise abate or sequester greenhouse gases released by exploration, production, transport, power generation and refinery operations associated with its leases. Lessees shall proportionately supply all necessary fuel for state aircraft and vehicles used to assist and administer lessees' operations.

Exploration Commitment: In order to exact the highest signing payments and royalty bids and to provide for a most efficient and predictable development of Alaska's hydrocarbon resources, the ADNR will commit to obtaining the services of exploration experts, whether contracted or employed, with the most advanced geologic mapping and analysis capability to define hydrocarbon resources to their greatest practicable extent prior to leasing of hydrocarbon fields to enhance "prospectivity".

Infrastructure Commitment: The ADOT in an MOU with DNR shall employ all due diligence in coordinating interested state and federal agencies to develop, subsidize or otherwise facilitate transportation of exploration and production materials to proposed leasing areas and for access of gas by Alaskan communities. A dedicated 4% portion of total royalty payments shall be set aside for this Safe Transport Development fund. The ADOT shall minimally provide heavy lift helicopters and other low impact vehicles to advance preservation of sensitive areas, enhance spill response, protect wildlife and maintain security in leasing areas as training for

their primary public safety and security duties that shall include repair and prevention of Global Warming impacts across Alaska. The ADOT shall also advance planning and construction of ports, port services, rail systems and pipelines necessary to promote efficient materials transport along established Alaskan transport corridors and extensions along the AGIA certified ROW(s).

Carbon Conservation Commitment: The state shall employ all due diligence with appropriate funding of legislative and regulatory efforts to establish in state and federal law establishing a transferable carbon tax and to additionally advance CO₂ sequestration and secondary utilization, methane capture and abatement, and Arctic-appropriate carbon-neutral energy generation technologies using a dedicated 4% portion of total royalty payments. The ADEC shall develop regulations establishing a carbon tax, appropriate emissions standards and/or other carbon limiting constraints upon hydrocarbon lessees. The ADEC shall conduct the necessary analyses to establish abatement technology standards and pursue advancement of the best available technologies with a bi-annual \$3 million grant funding that may accumulate beyond the \$3 million level to ensure appropriate funding of appreciably superior and effective technologies.

Sincerely, Tom Lakosh



NORTHWEST TECHNICAL SERVICES

Senate Testimony
Regarding HB 2001
October 24, 2007

Mr. Chairman and members of the committee:

Thank you for hearing my testimony, today, October 24, 2007.

As General Manager for Northwest Technical Services, a company which provides employees to a variety of industries, including the oil industry, I find it critical that I approach you and other members of the Legislature regarding this Bill. Needless to say, I am concerned its impact on the future employment for NWTS' 100+ employees and other Alaska workers may not be as obvious to you as it is to me.

This body spent considerable time in discussions and debate prior to passing the current tax on petroleum profits. The interchange of ideas, facts and beliefs used to arrive at what has become the 22.5% tax rate and current credits and escalator was thorough and a decision was reached – by 60 members of the Legislature. Then, to be entirely certain that it was the right decision for the long term, you established a provision to do a complete review of the system in 2011.

I ask that you give the system you have – after a great deal of public testimony – already established. Let us, at a minimum, get the first returns audited and the regulations for the Petroleum Production Tax promulgated before major changes are contemplated. You can't fix a system unless you know it is broken – and, we don't. If the State needs to hire additional auditors at a compensation rate consistent with their expertise in order to analyze these returns, a mechanism should be established to make that possible. Steps to make certain that data is timely can be put into place. I do, however, ask that you give considerable thought and consideration before making significant changes to the PPT that will again increase taxes and costs and which could easily result in a reduction of dollars available for investment in new and refurbished production facilities in Alaska.

It is those investment dollars that help provide jobs, not just for NWTS employees, and not just for employees who work directly in the oil and gas industry, but also for the individuals that work in the "fallout jobs" at grocery stores, hardware stores, educational facilities, the State of Alaska, - and the list goes on.

Senate Testimony
Regarding HB 2001
October 24, 2007
Page Two

I ask that as you deliberate over the next few days that you step back and consider all the ramifications of your decisions, particularly the impact on jobs, future development and the quality of life for this and the next generations of Alaskan citizens. The old saying that we can't tax ourselves into prosperity is still true.

Respectfully yours,



Mary E. Shields
General Manager

The testimony of Jerry McCutcheon

The taxes as proposed are FAR TOO LOW.

Increasing AK take will decrease the Fed's take, a good thing. The percent attributed to the Fed's take is much more than the oil companies actually pay.

Van Meurs pointed out that the State's take should be more and made that argument to Governor Murkowski in memo withheld from the legislature. Van Meurs also pointed out that PPT and Governor Palin's ACES' take, the percentage of the State of Alaska's take, actually declines with the increasing price of oil and they, Johnston also, thought that was stupid; the state percentage should increase with the increasing price of oil. Van Meurs quoted takes from 75% to 85% as usual and customary and takes of 90% to 95 % as not unusual and some takes were up to 98.5% and still the oil companies came. Johnston concurred.

Gross take on Alaska oil should approach 90%. See Shell oil's contract on North Star; it was over 90%, not the 80% that Johnston guessed for an example and that was when oil was \$18/barrel.

Also see the other lease about the same time, those were willing bids; nobody held a gun to their heads. Maybe AK should go back that system.

AS both van Meurs and Johnston pointed that having the oil companies threaten to leave Alaska or actually leaving Alaska is not a bad thing and it maybe in Alaska's best interest for the long term if some of the oil companies did leave. Alaska should not be magnet for every body.

However, considering the fact that the FBI and the grand jury have not completed their investigation and the fact the grand jury may bring a RICO Act indictment against not only the oil companies but also some legislators, not yet investigated, when the FBI begins to address the mechanics of passing legislation and what happed in the process. Remember the standards of proof are much lower under RICO and far broader in scope.

It would appear the legislature should adopt a clean tax on the gross pending the completion of the FBI and grand jury investigations. Then modify I, aft, to include any tax credits thought necessary.

Jerry McCutcheon susitnahydrnow@yahoo.com

Senate Resources Public Testimony 10-24-2007

October 24, 2007

Senator Charlie Huggins, Chair
Senate Resources Committee
State Capital Room 205
Juneau, AK 99801-1182

The Honorable Chair & Members of the Senate Resource Committee,

The Alaska State Chamber of Commerce is concerned about the legislation, Alaska's Clear and Equitable Share (ACES) and the changes proposed to the tax structure of the recently enacted Petroleum Production Tax (PPT). The State Chamber believes changing the tax structure so quickly will have long-term negative impacts on the future of Alaska's economy. We believe that the consequences of adoption of ACES have not been fully considered with regards to all businesses in Alaska.

The Alaska State Chamber of Commerce is a business advocacy organization whose mission is to drive positive change for Alaska's business environment and to improve our member organizations by providing leadership, advocacy, connectivity and support. The policy debate on everyone's mind these days is the special session. During our most recent Board meeting, we noted the following observations.

Renewing Public Faith in PPT

State Chamber members have a strong commitment to ethical business conduct and understand your commitment to ethical conduct among elected and public officials. Because you have heard from Alaskans that their faith in the current petroleum production tax (PPT) is shaken, we understand the desire to see the production tax debated again but believe this comes with great risk. We urge caution in the rush to find a fix for something that may not be broken.

The concern is that while the Governor and the Legislature work to restore public faith, outcomes based more on emotion than economics will further chill the oil investment climate. A second concern is the stated goal of generating more revenue for the treasury. The chamber does not agree with that goal, and our members fear that Alaskans will confuse the outcome of higher tax revenue with the goal of fair share.

Our membership believes tax debate creates unwelcome risk and stalls investment planning and decisions. Taxes are a key consideration in all business investment decisions, so any time tax law is debated, investments can be delayed. The wrong tax rate can end all consideration of investment.

Certainly working to induce investment such that the pipe is full of oil at \$80+/bbl would generate more revenue at the current tax rate than would a dwindling quantity of oil at a higher tax rate.

RAISING THE TAX RATE

Most of our members do not understand the finer details of petroleum exploration and production. However, they all understand two major trends in Alaska's oil patch:

- Taxes on the oil industry have increased at a rate no other business segment could survive; and,
- Despite billions of dollars invested by the oil industry on the North Slope and in Cook Inlet, production continues to decline at an alarming rate.

Many have repeatedly noted this decline. To propose a new increase to the production tax is a risky policy given the desire to encourage increased production. We have watched a decade-old production tax regime for Cook Inlet - essentially zero - encourage very limited investment. On the Slope, recent investments were committed under the significantly lower ELF tax and historically high oil prices, yet the exploration activity pales in comparison to that taking place in Canada and the Gulf of Mexico.

Raising production taxes in light of limited investment is counter intuitive. Instead of referring to fiscal notes and revenue projections, we urge you to set the policy outcomes you desire in the oil patch and then debate language to achieve those outcomes. We suggest the following statement can guide the debate:

- Adopt an oil tax regime that will generate reasonable revenue for state government, while encouraging maximum utilization of oil reserves.

FISCAL PLAN

The State Chamber has advocated for decades for a state fiscal plan. We applaud the identification of the fiscal dilemma our state faces, and the willingness of many to check spending. A clear plan, however, is not guiding spending or revenue collection, or the question of how the state can invest new revenue in projects that will render a return on investment. Given today's oil prices, the Alaska's Clear and Equitable Share (ACES) legislation proposes to collect surplus revenue for a fiscal system that results in increased spending but lacks a strategic business plan for the state. This policy outcome does not warrant worsening the investment environment.

ALASKA'S BUSINESS IMAGE

As stated earlier, State Chamber members have a strong commitment to ethical business conduct. This includes our many members from the oil and gas industry. Given the daily headlines and investigations, our concern is that many Alaskans now view "business" negatively.



This impression is further fueled by the implications that the oil and gas industry has slighted the state through its accounting practices.

We encourage our policy leaders in Juneau to consider this dynamic and avoid making unfair accusations that further fuels this distrust of our Alaska businesses big and small. At the end of the day, differences of opinions exist and reasonable people can disagree.

TAX AUDIT EXPERTISE

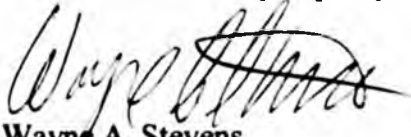
We offer assistance in boosting the state's tax audit capabilities. We are confident that if industry can acquire talent to administer a wide range of complex tax regimes throughout the world, Alaska can recruit the best and brightest to administer our single regime. This expertise will be found in a combination of state employees and private contractors.

TAX ON PROFITS IS GOOD FOR BUSINESS

Although we are concerned with a proposed minimum tax on certain fields, we would like to thank you for recognizing the wisdom of a profits tax. So many today illogically condemn petroleum industry profits. Alaskans should cheer since those profits will allow the same companies to make the world-class investments Alaska needs to monetize our oil and gas.

Thank you again for taking time to address these critical issues for Alaska's future. I would be delighted to meet with you to discuss the points above in further detail.

Yours in economic prosperity,



Wayne A. Stevens
President/CEO

