

ALASKA LEGISLATION COMMITTEE FILES 2007-2008

12285 HOUSE RES

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 otherwise spend our revenue on to mitigate. If we can't muster the ethics to pursue a carbon tax for its environmental benefit, we should at least pursue a state and federal carbon tax to increase the value of our gas in an effort to make the gas pipeline economical. 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.

- Providing tax incentives to explore or produce 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. Granting these tax write-offs without careful consideration of what will/should be required of producers under existing leases could well reduce revenues from taxes to zero and the additional payment of credits could even require the state to pay the producers for exporting the oil. The least negative impact to exploration from any tax increase 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's no net increase in taxes on the oil co's. The increased income tax will also allow Alaska to extract a fairer share of income from production of oil on federal lands and even more so from the federal outer continental shelf, (i.e. the 90/10 vs 50/50 royalty split, justice w/o a court). The progressive sales tax will also capture additional revenue from federal OCS leases that is otherwise escaping sufficient state capture.
- 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 have recently discovered from RCA and FERC tariff proceedings that the state and consumers have been overcharged for TAPS costs by as much as \$3/bbl and a sales tax levied at the point of export must be imposed to insure the lowest overall transportation costs where a prior administration has illegitimately surrendered our right to challenge tariffs overcharges in the prior TAPS tariff settlement agreement. We would surely have a strong case for upholding the gross tax where it measures the oil value IN ALASKA. Both PPT and ACES are inviting fly by night 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 write-offs and credits and provide the needed oversight to exploration contractors we hire on a competitive bid? Existing lessees are already required to produce all hydrocarbons as is economically feasible and can apply for royalty relief if prices do not support optimal production rates.
- The discrepancies between projected revenues 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. Moreover, the complicated write-offs and credits would make it nearly impossible for ADNR/ADOG to properly assess appropriate plans for operation of leases/units if ADNR/ADOG was indeed inclined to properly implement their leases, statutes and regulations. Such an impairment of the lease contracts may well be interpreted as violating Article I Section 15 of the state constitution barring such impairment.

- 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 sales 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% gross government take up to about \$70/bbl and I would suggest lowering the base oil sales 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.

**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**

**Raw Oil/Gas Sales Taxes:** The gross tax on raw/unrefined hydrocarbons sold in/from Alaska shall be set at the value of the hydrocarbons at the Alaskan terminus of export or point of sale within Alaska in order to provide a market check on production costs and pipeline tariffs in furtherance of the relative competitiveness of Alaskan resources, (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). This tax system would also encourage export of value added petrochemical and refined products. The suggested tax rates for crude oil are as follows:

1. There shall be a minimum sales tax of 15% of gross value for oil prices between \$0 and \$20/bbl;
2. At \$21/bbl the sales tax 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 sales tax 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 sales tax shall be assessed at 36.1% of value and shall increase at a rate of 0.1% for each \$1 in value per barrel until a price of \$210/bbl at which point the sales 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 new 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 accessibility of lease holdings and the

relative BTU value of Alaskan hydrocarbons. The ADNR/ADOG shall provide a report to the legislature at the beginning of each general session all best interest findings relative to oil and gas development and suggest any additional statutory provisions necessary to advance the optimal development of the state's hydrocarbon resources from existing and proposed leases/lease sales.

**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, vessels 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 CO<sub>2</sub> 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.

## **Alaska Trucking Association, Inc.**

3443 Minnesota Drive · Anchorage, Alaska 99503 · Phone (907) 276-1149 · Fax (907) 274-1946  
[www.aktrucks.org](http://www.aktrucks.org)

Oil Tax Issues (PPT)

House Resources Committee

Aves D. Thompson

October 30, 2007

HB2001

Thank you. Mr. Chairman and members of the committee, I am Aves Thompson, Executive Director of the Alaska Trucking Association. The Alaska Trucking Association is a state wide organization representing trucking interests from Barrow to Ketchikan. In 2008, our association celebrates its 50<sup>th</sup> Anniversary of serving the interests of the trucking industry in Alaska. Our more than 200 members represent all of the diverse trucking operations in the state and many associate members who provide goods and services to our industry. It is important to note that, in Alaska, trucking employs over 20,000 people - 1 out of 14 workers. Trucking payrolls are over \$900 million annually and several thousand family-owned and corporate trucking businesses (most have less than 10 employees) operate in Alaska.

On behalf of ATA, I want to make several observations about PPT issues.

It has been said many times that, in developing our natural resources, our constitution requires that we seek maximum return to the citizens of Alaska. While it seems that the emphasis has been on raising taxes to increase tax revenue to the state, we believe that the better way to maximize benefits to Alaskans is to provide good paying, long term jobs for this and future generations.



*If you got it, a truck brought it...*

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The State needs to focus on how to slow the decline of production. To accomplish that objective, investments need to continue in existing fields, investments need to be made in heavy oil and investments need to be made to promote the development of new fields. Existing field development should be the first priority. Most of the new production, in recent years, has occurred in existing fields. Without this base production, heavy oil and other new field development will face major additional challenges.

The oil and gas business is capital intensive and it takes many years for return on investments to occur. Increases to taxes lengthen that recovery time and can negatively impact project economics and investment decisions.

We believe that it is important in setting tax policy to produce adequate revenues for the state but more importantly, encourage further investment in the development of our abundant resources.

We urge you keep the tax rate low and use incentives to encourage increased development investment. As stated earlier, we believe that the better way to maximize benefits to Alaskans is to provide good paying, long term jobs for this and future generations. Investment, not taxes, will provide the jobs we need to ensure our future.

Thank you for your attention. I will try to answer any questions.



*If you got it, a truck brought it...*



ANCHORAGE CHAMBER  
OF COMMERCE

1016 W. Sixth Avenue, Suite 303

Anchorage, AK 99501

October 22, 2007

Dear Governor Palin & Legislators:

The Anchorage Chamber of Commerce appreciates the Administration's desire to revisit the Petroleum Production Tax to ensure that the most vital component of our state's tax regimen was the result of sound public policy. Still, we have some significant concerns regarding this review.

First, we are concerned that there has been a headlong rush to prejudge the PPT as "unfair" to Alaskans. The illegal actions of some legislators and special interests have understandably cast a cloud of suspicion on this legislation. It should be kept in mind, however, that many supported the PPT who had no involvement in any improper activities. A large number of upstanding legislators and organizations, including the Anchorage Chamber, supported the passage of PPT as a sensible balance between increased state revenues and incentives for investment; therefore, we respectfully ask that you not start your analysis from the standpoint that the current law of the land is wrong or in any manner "unfair." Review the PPT thoroughly, for all our sakes, but have an open mind to the possibility that the PPT, in fact, is the best option for Alaska despite the unfortunate circumstances surrounding its original passage.

Second, we are concerned that there is insufficient evidence concerning the actual impact of the PPT. It is our understanding that the original PPT legislation contained a provision whereby it would be thoroughly reviewed at the end of five years. Thus, with less than a full-year's worth of data to analyze, a declaration that the PPT is not working would appear hasty and not fully informed. It should also be noted that during the past year the taxation landscape was significantly altered by the temporary shut-down of a significant component of the North Slope fields; therefore, the available data cannot be said to represent a typical year. From all review, the PPT brought in significantly more revenues to the State than the previous ELF system.

Third, we are very concerned about creating an impression that Alaska's tax platform is volatile and undependable. The Anchorage Chamber is not advocating that we need 30 years of certainty in our tax structure but we are concerned that we are faced with the possibility of three distinct methods of taxing petroleum within three years. Even though you will be debating a tax that directly deals only with a certain segment of the economy, it nonetheless, creates an unmistakable reputation that Alaska is a location that is more interested in *taxing* industry than in *growing* industry. Such a reputation is harmful to all business sectors and ultimately, to all Alaskans.

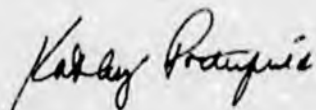
Fourth, we are concerned about the emphasis placed on increased revenues for the state. Without the political will to create a sensible economic plan for the State of Alaska, the Anchorage Chamber is concerned that we are behaving as if we are communally addicted to "oil money." As North Slope production invariably declines, we seem overly zealous to prop up our standard of living by simply increasing our take. What was a fair take 10 years ago is no longer "fair." What was fair last year now appears to be no longer "fair." History is devoid of instances in which a thriving economy has been built on the model of maximizing the government take. In contrast, history teaches us the important lesson that vibrant and flourishing economies spring from environments where the government encourages investment and entrepreneurship. It is ultimately self-defeating for Alaska to increase its short-term revenues at the expense of chilling long-term investment.

Finally, despite these significant concerns the Anchorage Chamber remains optimistic. As a State, we can prosper and we have the ability to make Alaska's future bright. The only question is whether we have the courage, the discipline and the will to resist the path of least resistance and instead focus our efforts on the hard, yet ultimately rewarding work of building a sound economic future. Toward this end, we respectfully ask that during this special session you do these four things:

1. **Review the PPT to ensure it is sound public policy but do not discard it simply because of the circumstances surrounding its passage; and**
2. **If there is legitimate doubt concerning the effect of the PPT, do not be afraid to allow the PPT to exist for sufficient time to allow reliable data to be generated, which is consistent with the original legislation that provided for a review at the conclusion of five years; and**
3. **Take all appropriate cautions to protect Alaska's reputation as a stable tax environment that encourages and promotes business opportunities and investment; and**
4. **Consider any revenue enhancements only in conjunction with actually developing a fiscal plan – a spending and savings plan - for the State of Alaska.**

Thank you for your service to our State and we wish you a very successful special session.

Sincerely,



Kathleen Porterfield  
Anchorage Chamber Board Chair



Stacy Schubert, IOM  
President

CC: Anchorage Chamber Board of Directors

**FAX FROM: Horace W Heffner**  
**Phone Number: 907-746-0820**  
**Fax Number: 907-746-0820**  
**Address: PO Box 325, Palmer, AK 99645**

**To: Alaska House Resource Committee**  
**Fax Number: 907-465-6813**  
**October 31, 2007**

**Subject: Tax deductions not investments**

**Number of pages including cover: 3**

In testimony before Alaska legislators it has been suggested Alaska should be happy to have current oil taxes reduced to zero by cost deductions because it will mean more taxes later, because it is an investment in Alaska. Incredible! It appears oil company lobbyists have, through repetition of the message, convinced many legislators and even voters that cost deductions to oil taxes represent an investment in Alaska resources. This is a gross distortion of the word investment. Investment in an enterprise implies increased future equity. Incremental investment implies incremental equity.

When we buy stock in a company we buy equity. Each dollar invested buys some portion of the company in perpetuity, or until that equity is sold in the marketplace or has no further value. Each dollar invested increases the investor's proportion of future profits. Further, equity typically implies voting rights. Equity holders as a whole control the board, and thus the company. An increment in investment typically means increased knowledge and control of a business, voting rights. Incremental investments are matched by an incremental percentage share in profits. Incremental investment implies an incremental share. Each dollar invested necessarily results in an increased share in future profits.

When we share the risk with a company we expect to obtain equity. Otherwise, if we don't share risk, return is guaranteed by the company up front and the investment is not an equity, it is a debt, a bond. Investments then result in either guaranteed debt or increased equity.

\* Tax write offs are not investments for the government. Tax deductions are not investments because they do not result in an incremental share, an incremental control, or a guaranteed future return. Tax write offs then represent payments to companies which

are not investments. They are incentive gifts. Each dollar of deduction does not result in an incremental percentage share in future profits. Each dollar of write off does not provide an incremental knowledge or control of a company, nor increased debt from the company. Each dollar of write off merely provides an increased probability of protracted auditing and litigation.

If the legislature truly wishes to invest in Alaska's oil resources, it should either buy a majority interest in exploration companies or create state owned exploration companies similar to the Alaska Railroad. Alaska should have every right to explore and even develop its own tracts, especially once those tracts have been put up for auction with no bid, or once the lease holder has made no effort at development for an extended period. This approach of true equity investment provides a true investment for Alaska, one controlled by and employing Alaskans. It further provides true incentives to oil companies to avoid land banking oil reserves and to get on with development.

The legislature has set out to fairly increase oil taxes in times of high prices. A haze of repetition and complexity appears to be mesmerizing many with the notion that an incentive gift is an investment, that a tax reduction is an investment. Cost deductions, if necessary, must have reliable predictable limits. It is easy to err in assumptions when setting tax rules. It is thus important to be conservative in assumptions. A tax set too high can readily be reduced, even retroactively, but this is not so for a tax set too low.

The legislature has a duty to maximize return on Alaska's resources. Hopefully it will not fail in that duty because the forest can not be seen for the trees and the haze.

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**To: Alaska House Resources Committee**  
**Fax Number: 907-465-6813**  
**October 31, 2007**

**Subject: Tax deductions not investments**

**Number of pages including cover: 1**

A gross tax plus floor is essential to prevent sudden massive oil company expenditures from drying up Alaska's tax revenue. Oil companies object to a fixed trigger point because inflation can drive up costs over the years. One approach to solving this problem is to automatically increase the trigger points annually based on the current price index (CPI).

**Chuck Logsdon Testimony to House Resources—October 30, 2007**

For the record my name is Chuck Logsdon. I am a petroleum economist currently working as a consultant to the Alaska Oil and Gas Association. Today I am testifying as a citizen from Palmer.

I like the PPT as it is currently structured. I believe it strikes a good balance between obtaining a fair share of the "economic rent" for the State from its production tax, while at the same time providing incentives to encourage reinvestment of industry profit. Reinvestment that will be crucial to keep oil flowing in the pipeline.

In particular, I like the use of net cash flow as the tax base. From an economist's perspective this is an efficient way of taxing business activity as it directly recognizes the ability to pay the tax in an industry with extremely high upfront capital costs. I also like the progressive rate schedule applied to the tax base because once again, it directly matches the tax to the ability of industry to pay the tax.

I also believe the tax credits in the PPT are set about right. Set too high, tax credits can create the incentive to gold plate and as a result high administrative costs to prevent this from happening. The combination of a tax based on net production value along with attractive tax credits is a solid step toward encouraging the investment needed to keep the TAPS flowing.

Obviously the choice of tax rate is a tough call and a lot of information and comparisons have been generated to try to help policy makers in making the decision as to where that rate should be set. I believe that the current PPT sets this rate about right both for base rate and progressivity.

As you may have gathered, I do not like resource production taxes that ignore the cost of extracting the resource in the tax base. Because resource deposits vary widely in their development costs, such taxes generally require complex tweaking to make adjustments to reflect these differences in the ability to pay the tax. We already have a royalty share that is based on the gross value at the point of production that is the same regardless of profitability or lease location. To encourage resource development it makes sense to go to the net for our production tax and apply it universally.

On efficiency grounds I also do not like fixed floor taxes. However, since government services are an important economic safety net a floor may be necessary but it should be kept low. As a result I like the tax floor mechanism in the PPT.

I would like to see these key provisions of the PPT remain as they are.

Thank you Mr. Chairman for the opportunity to testify.

**HB**

**20001**

**(10/31/07)**

ALASKA STATE LEGISLATURE  
House Resources Committee

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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

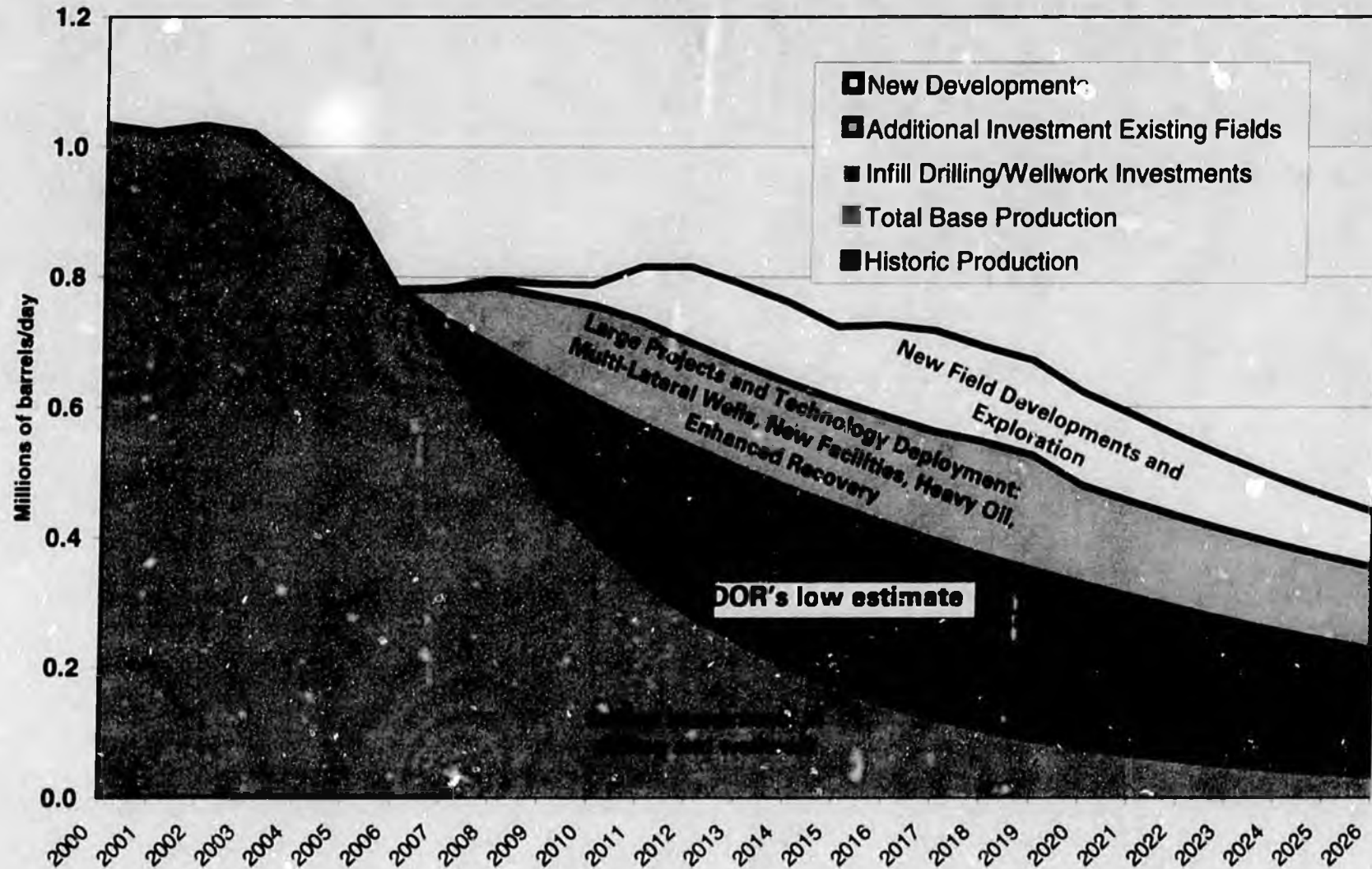


- **Production**, not tax rate, is the major factor in determining state revenue for the future years
- Delivering the production forecast will require tens of billions of **investment**
- Investment decisions are made on the combination of strategy, resource prospects, technology, economics, and risk, 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

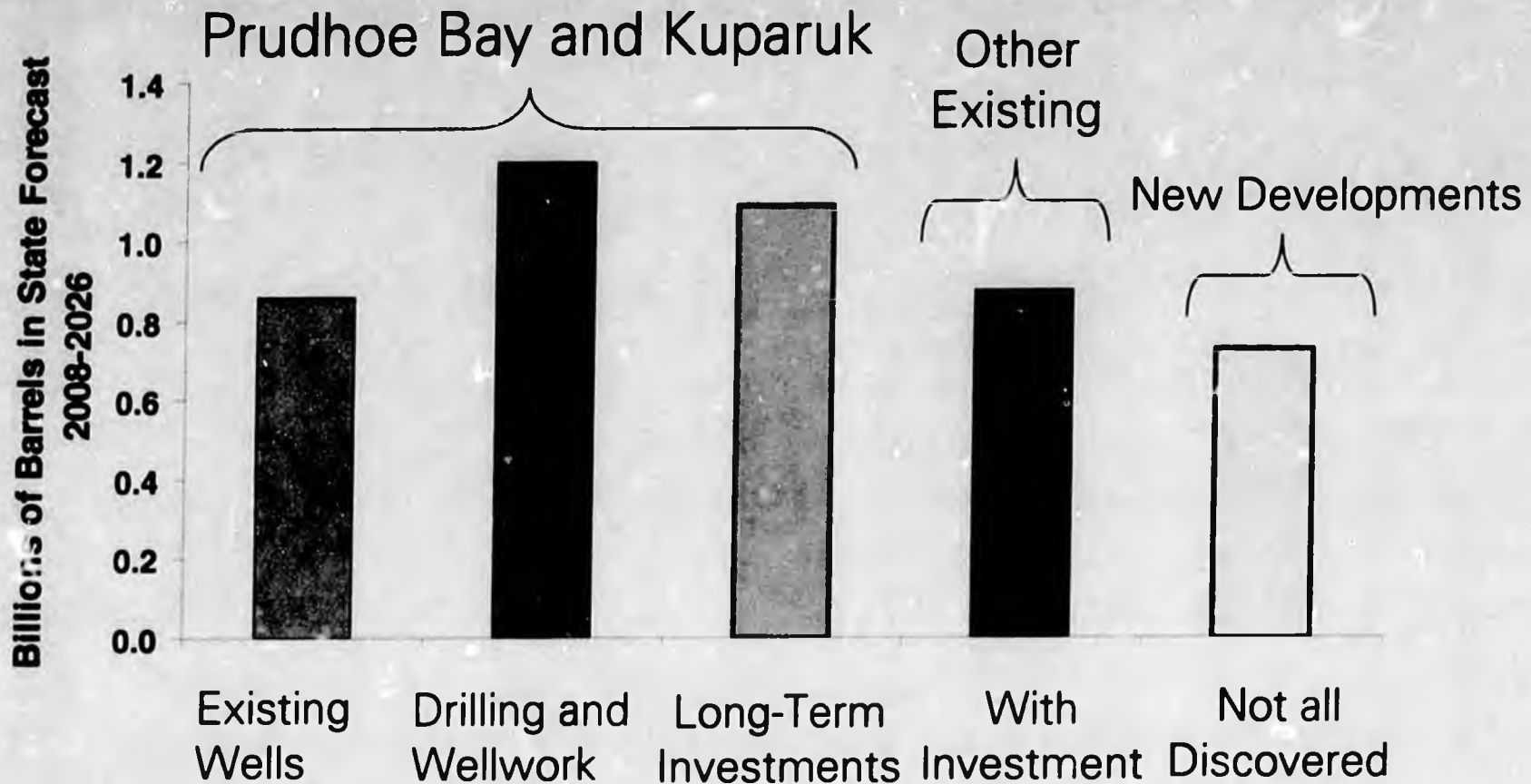


DOR Production History and Forecast





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

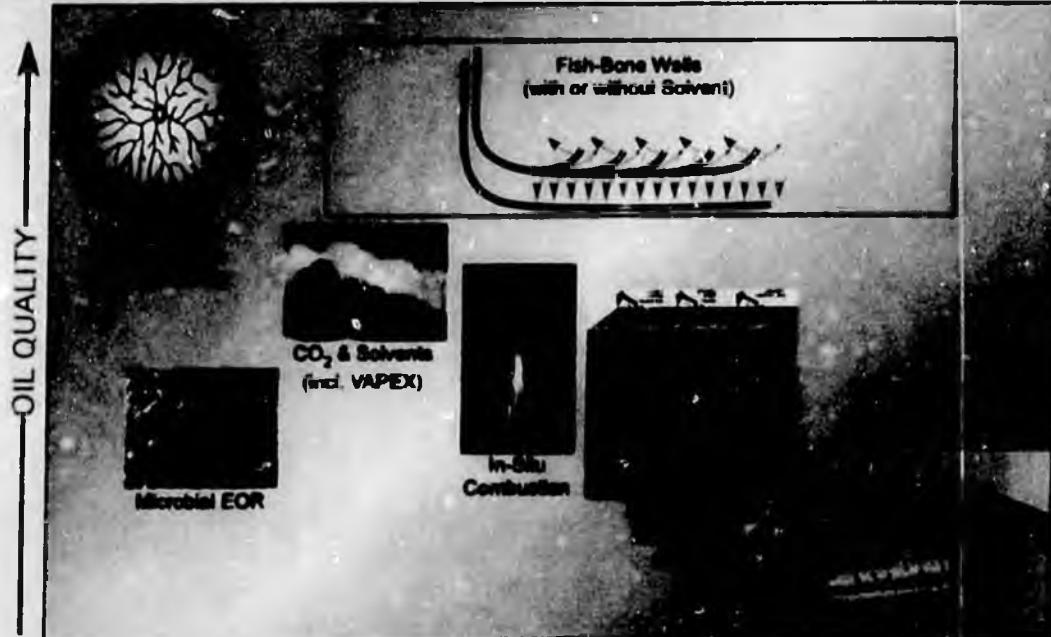
Heavy oil will always be disadvantaged relative to light oil on the basis of development cost, and commodity price



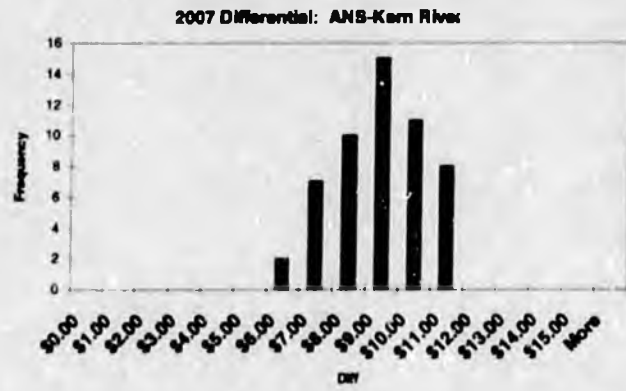
PROPERTIES	BUSINESS IMPACT
<ul style="list-style-type: none"> <li>• Chemical                             <ul style="list-style-type: none"> <li>- Hydrogen depleted relative to light oil</li> </ul> </li> <li>• Physical                             <ul style="list-style-type: none"> <li>- High viscosity</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>



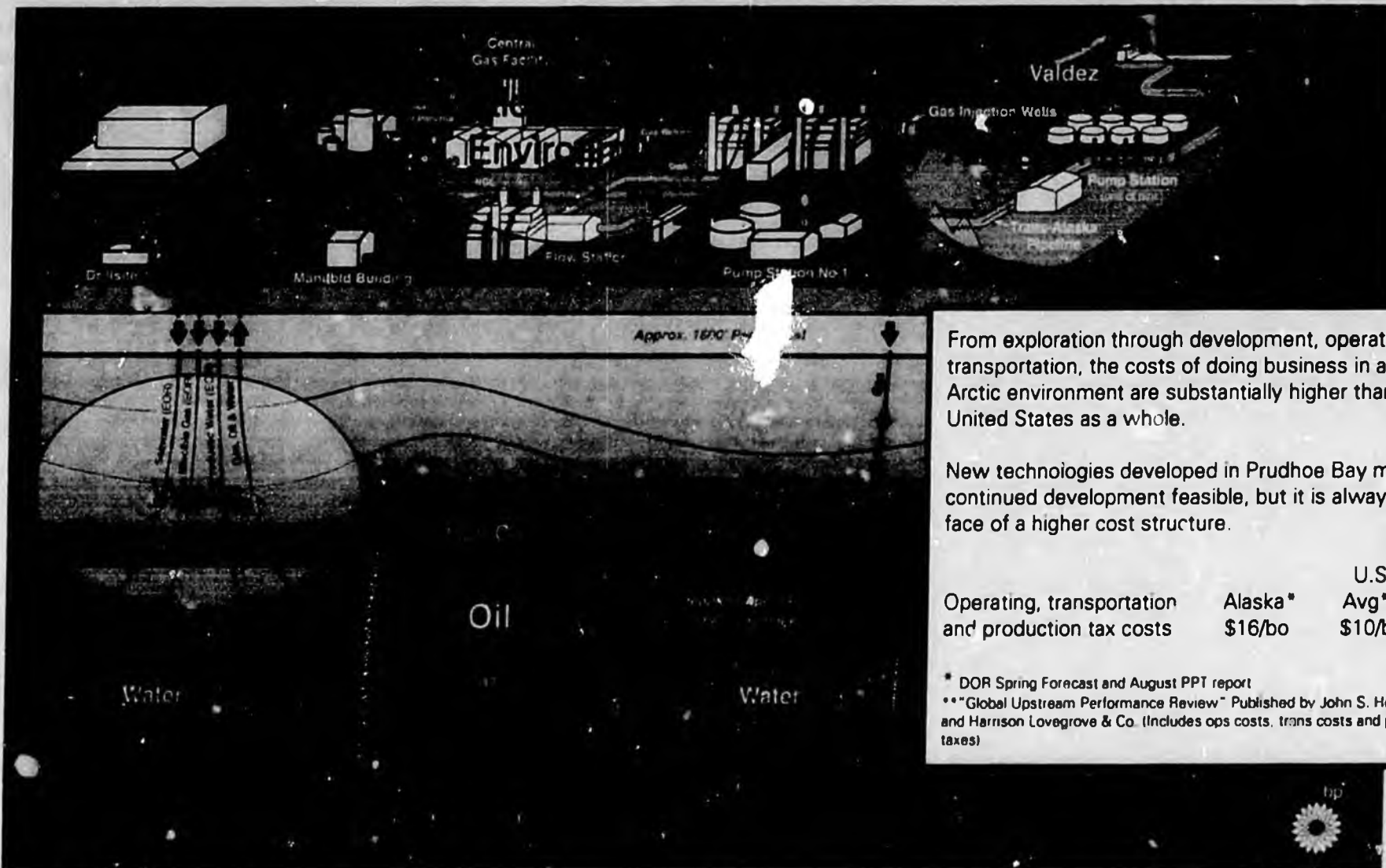
COLD - PRIMARY → RESERVOIR QUALITY →



THERMAL EOR



# 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)

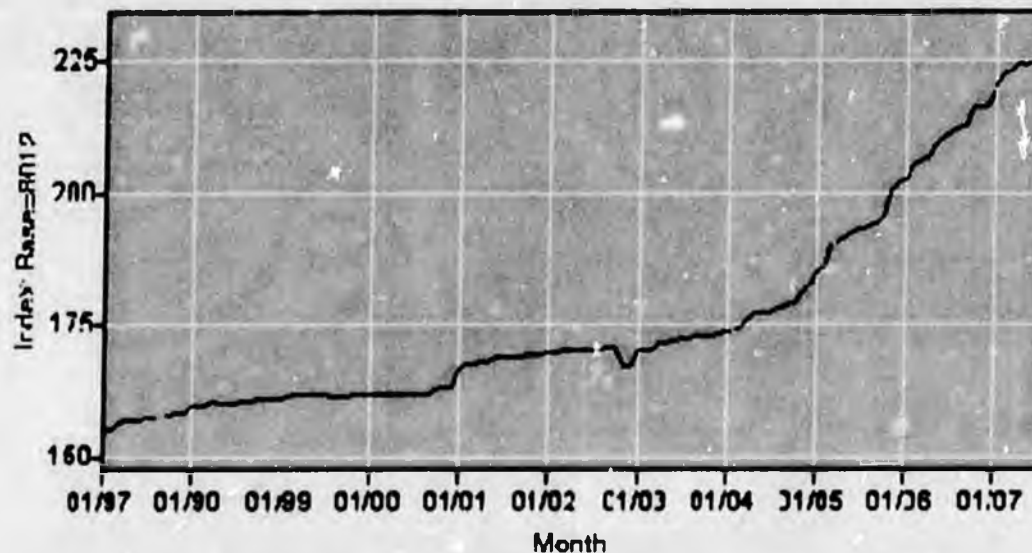
## 2004-2006 U.S. Average Cost Increases per barrel

- 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**

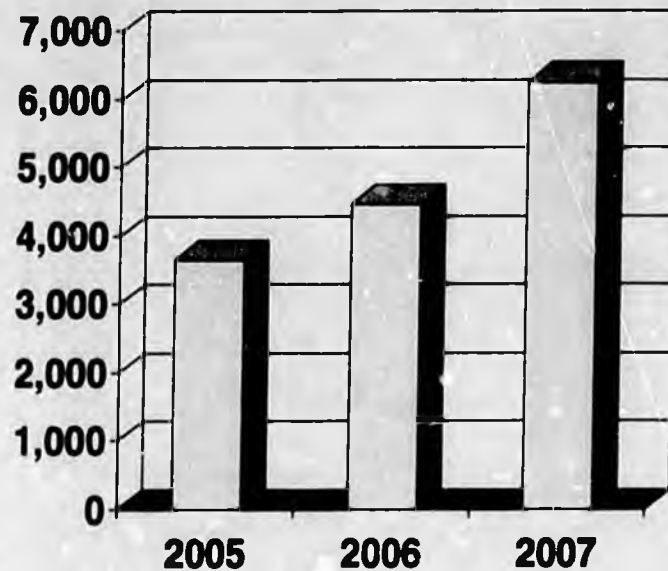
Source: U.S. Department of Labor



# 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**

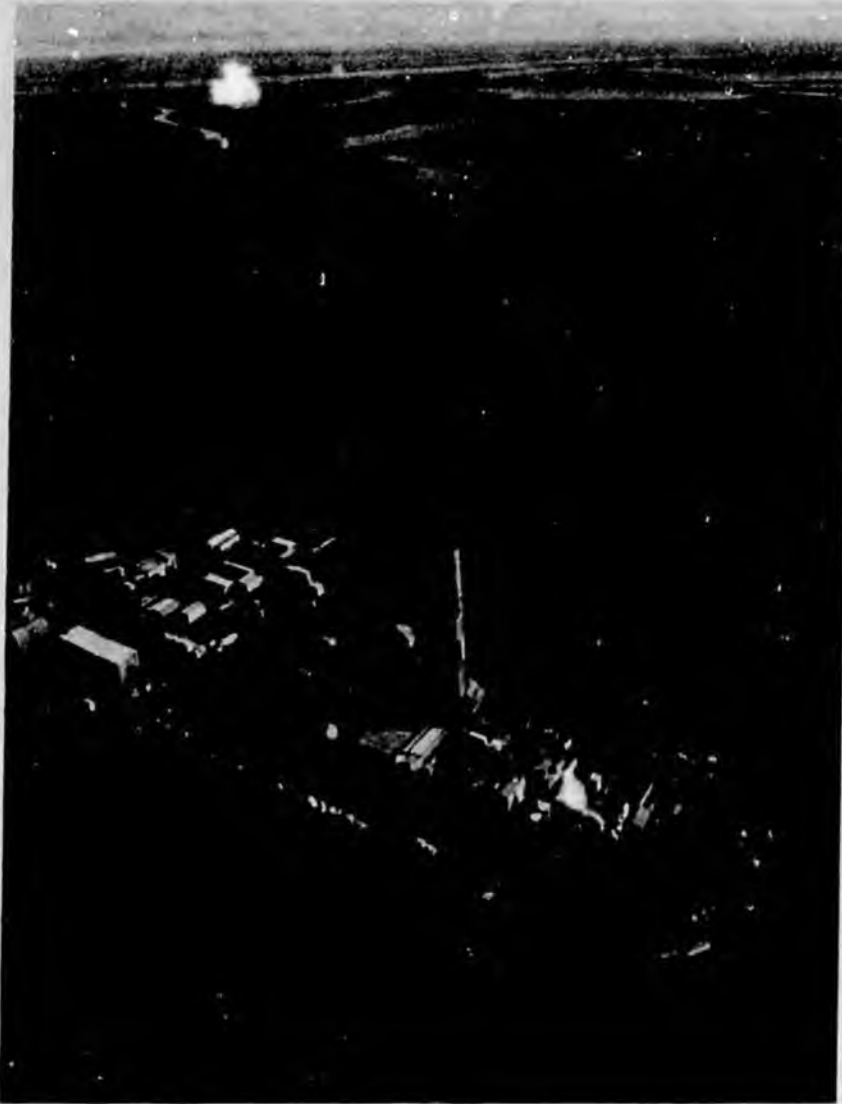
Vice President, Finance & Administration

**Jim Taylor**

Vice President, Commercial Assets

ConocoPhillips

# ConocoPhillips in Alaska Today



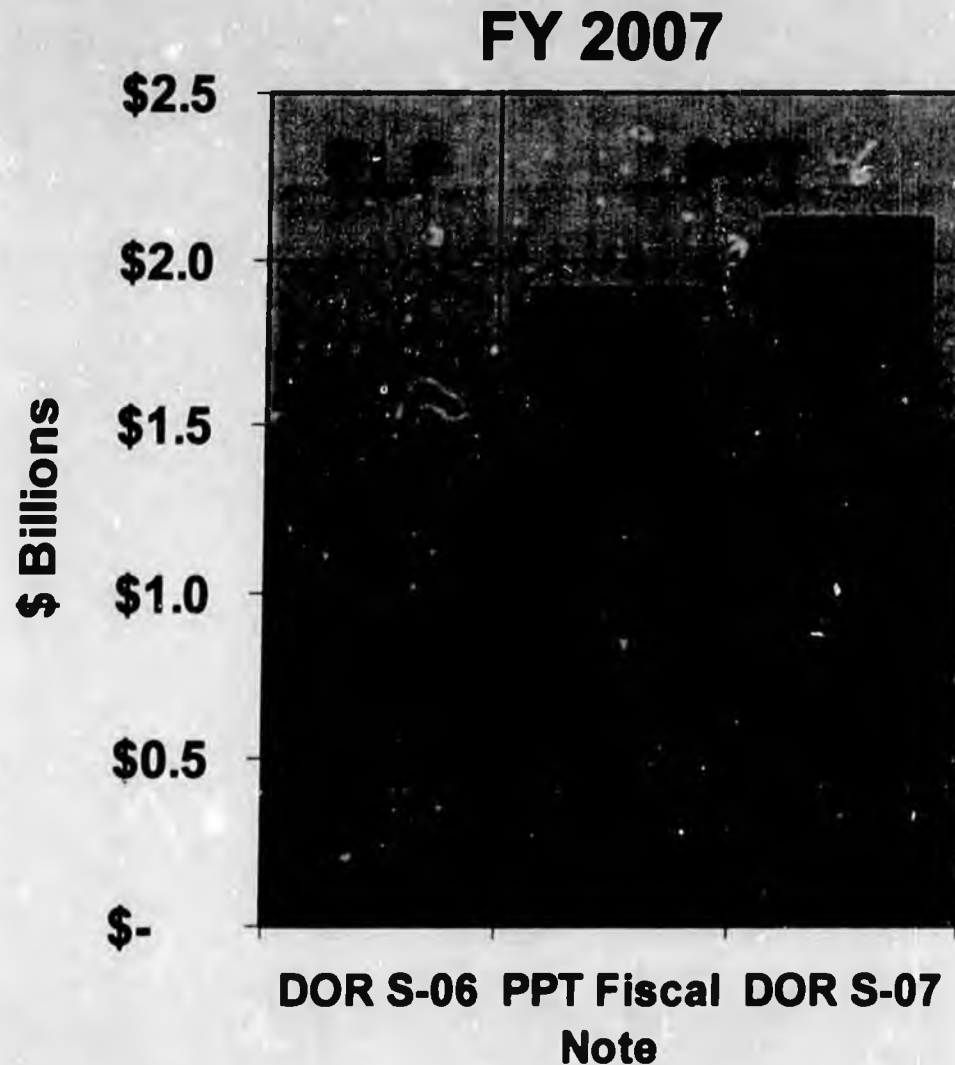
- **Alaska's Largest Producer**
  - 2006 oil production: 280,000 barrels of oil per day
  - 2006 gas production: 145 million cubic feet per day
- **Alaska's Largest Lease Holder**
  - Interest in 1.7 million gross (federal) acres in the NPRA
  - Nearly 2.6 million gross undeveloped acres in total outside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

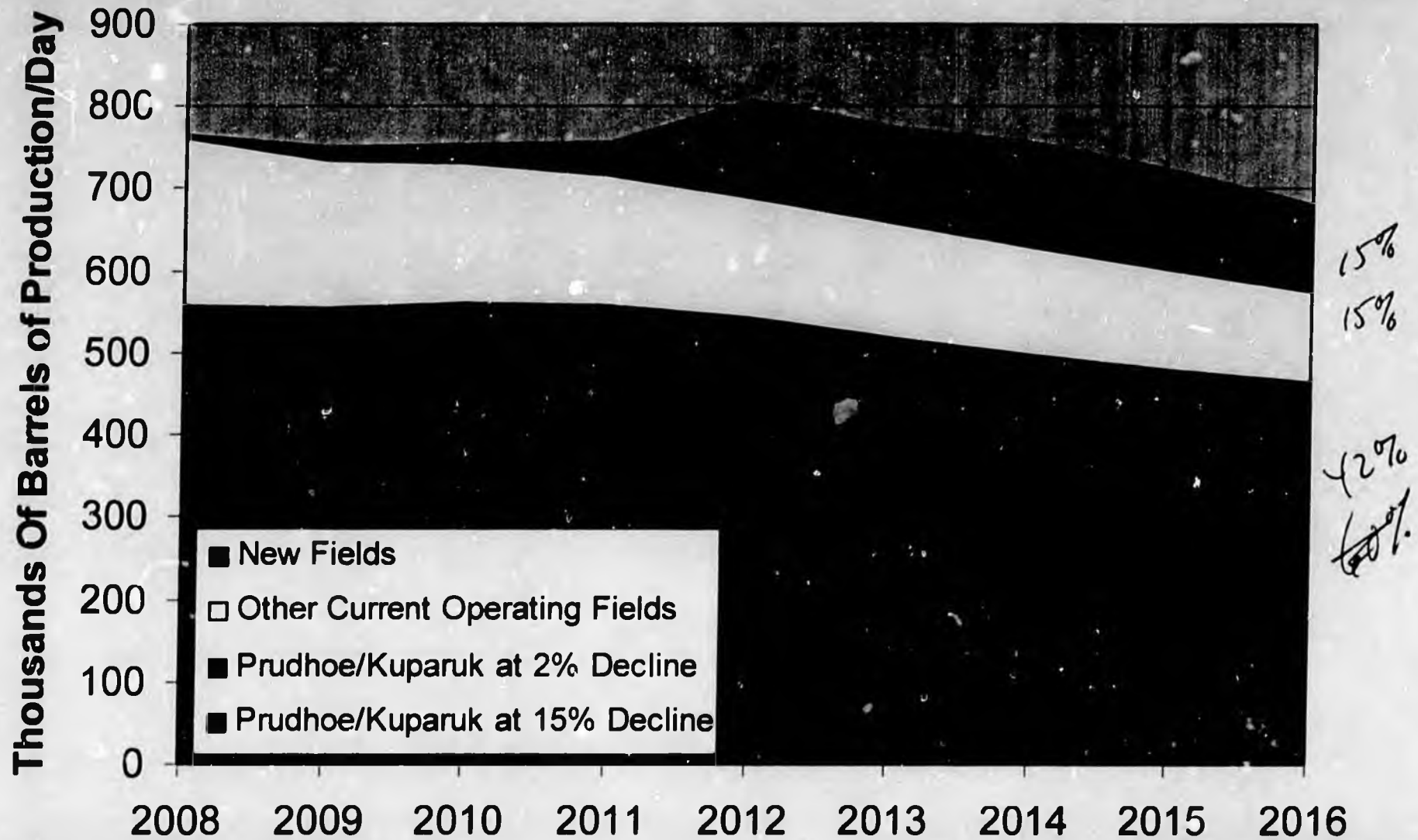


Revenues meeting targets despite forecasting uncertainty associated with:

- Price
- Production
- Operating costs
- Capital costs

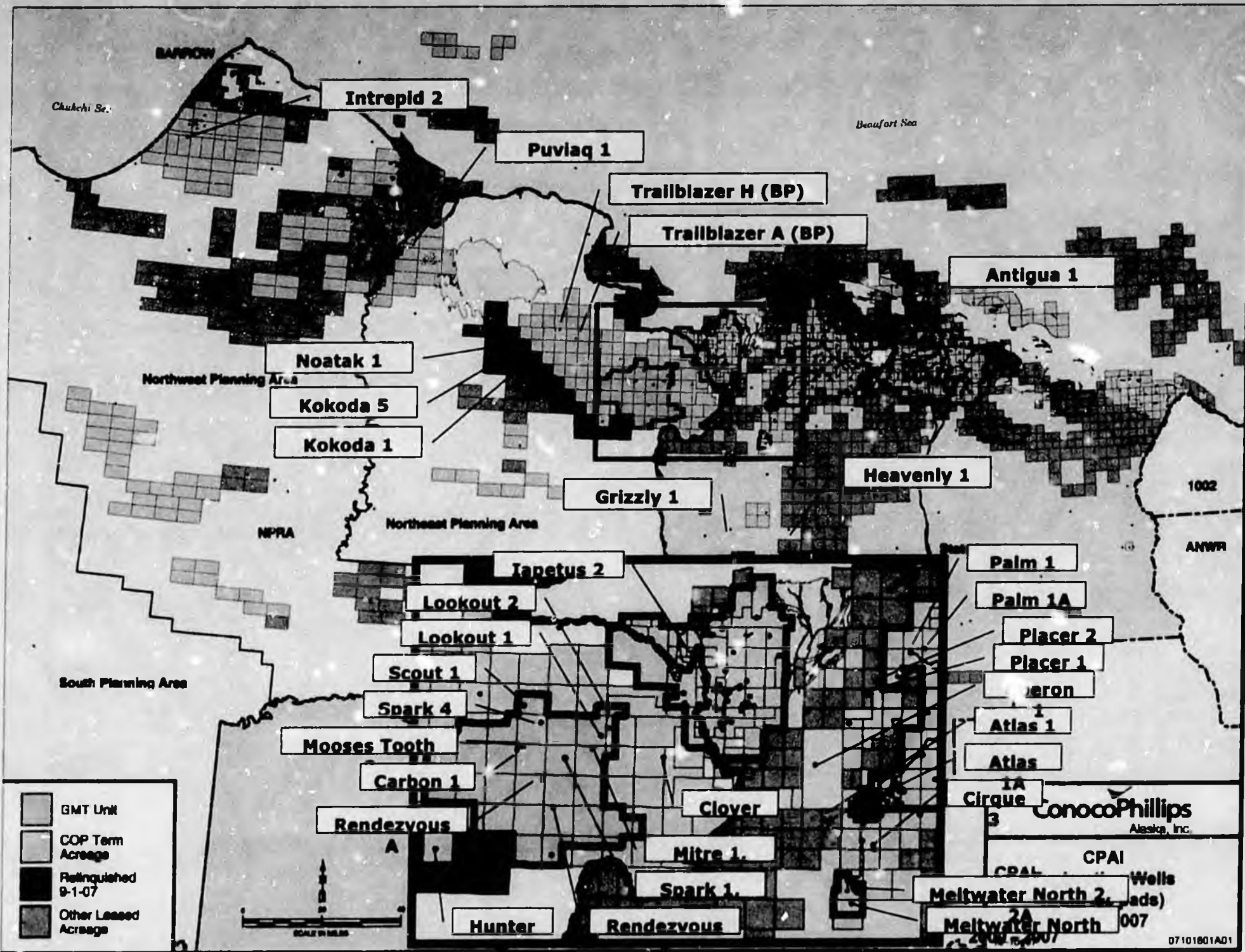
***Too early to change***

# Significance of Future Investment

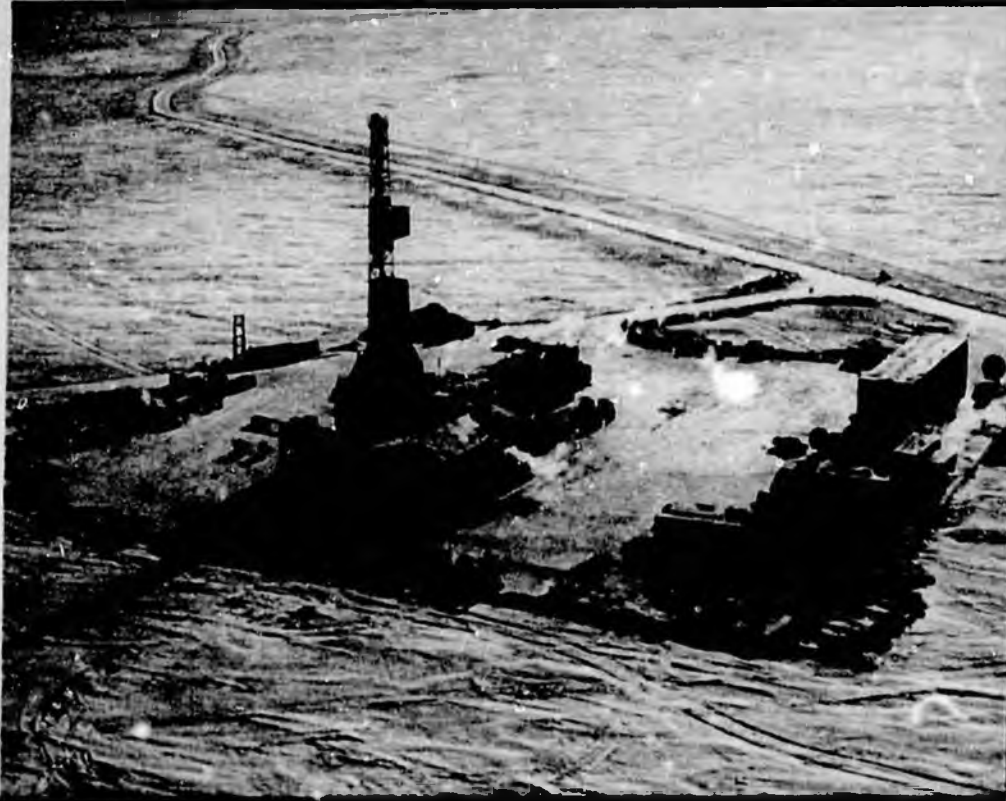


Department of Revenue 2007 Spring Forecast

ConocoPhillips



# Alaska's Leading Explorer



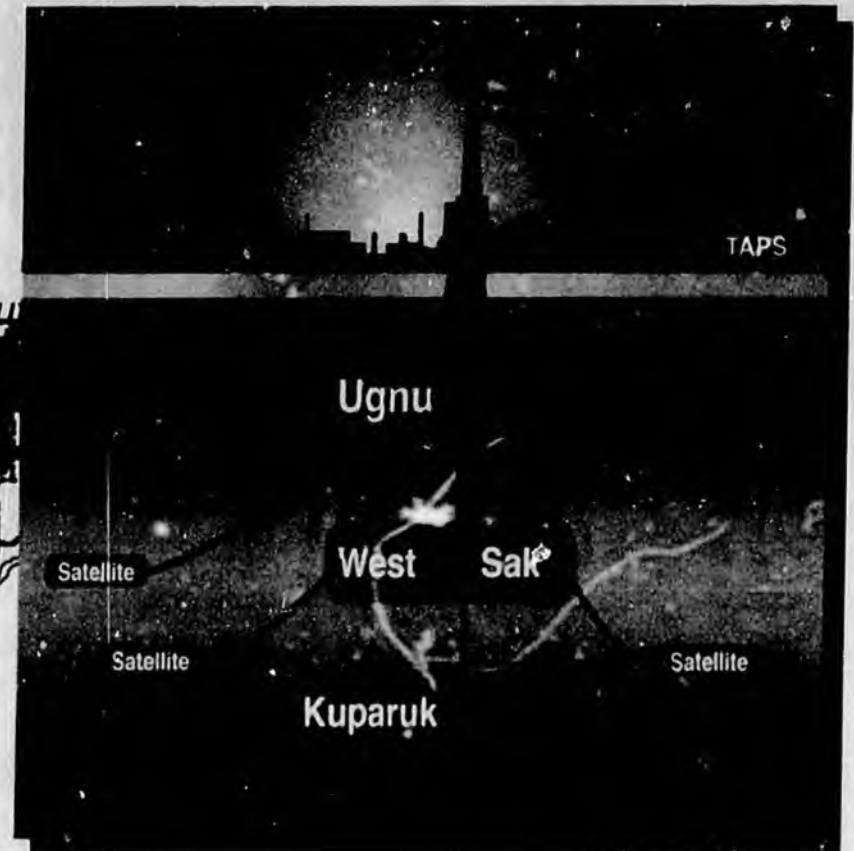
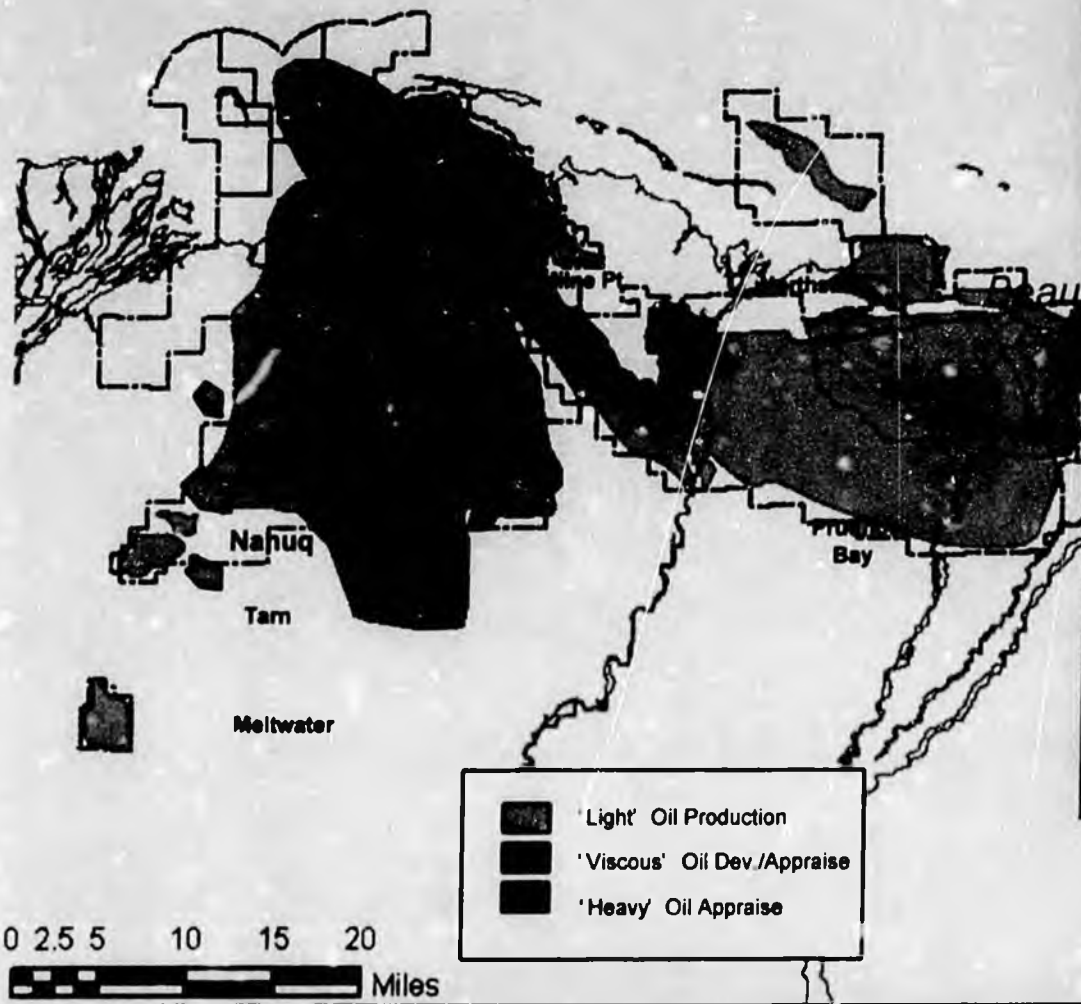
**Exploration Site – Winter  
Typically January - April**



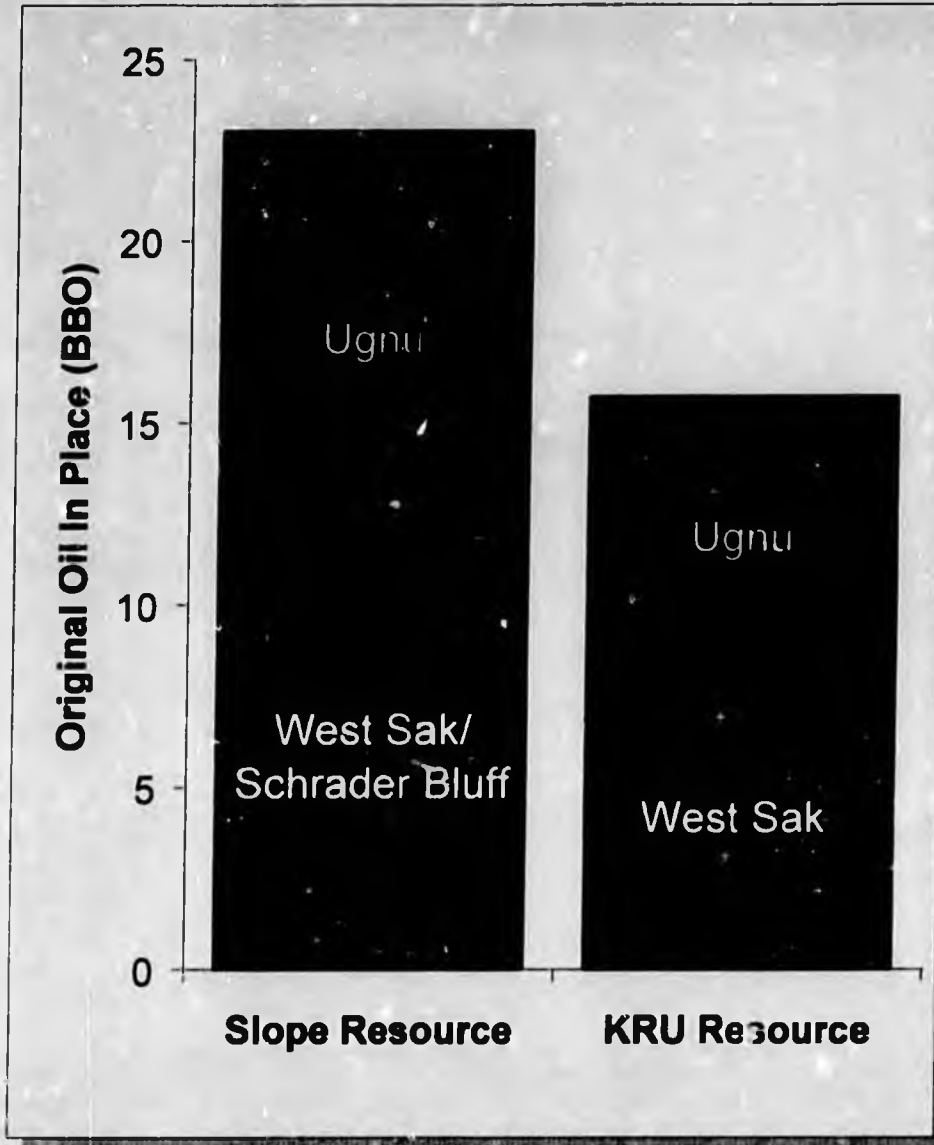
**Exploration Site - Summer**

ConocoPhillips

# North Slope Heavy Oil Fields



# North Slope Heavy Oil Resources



19 API Crude



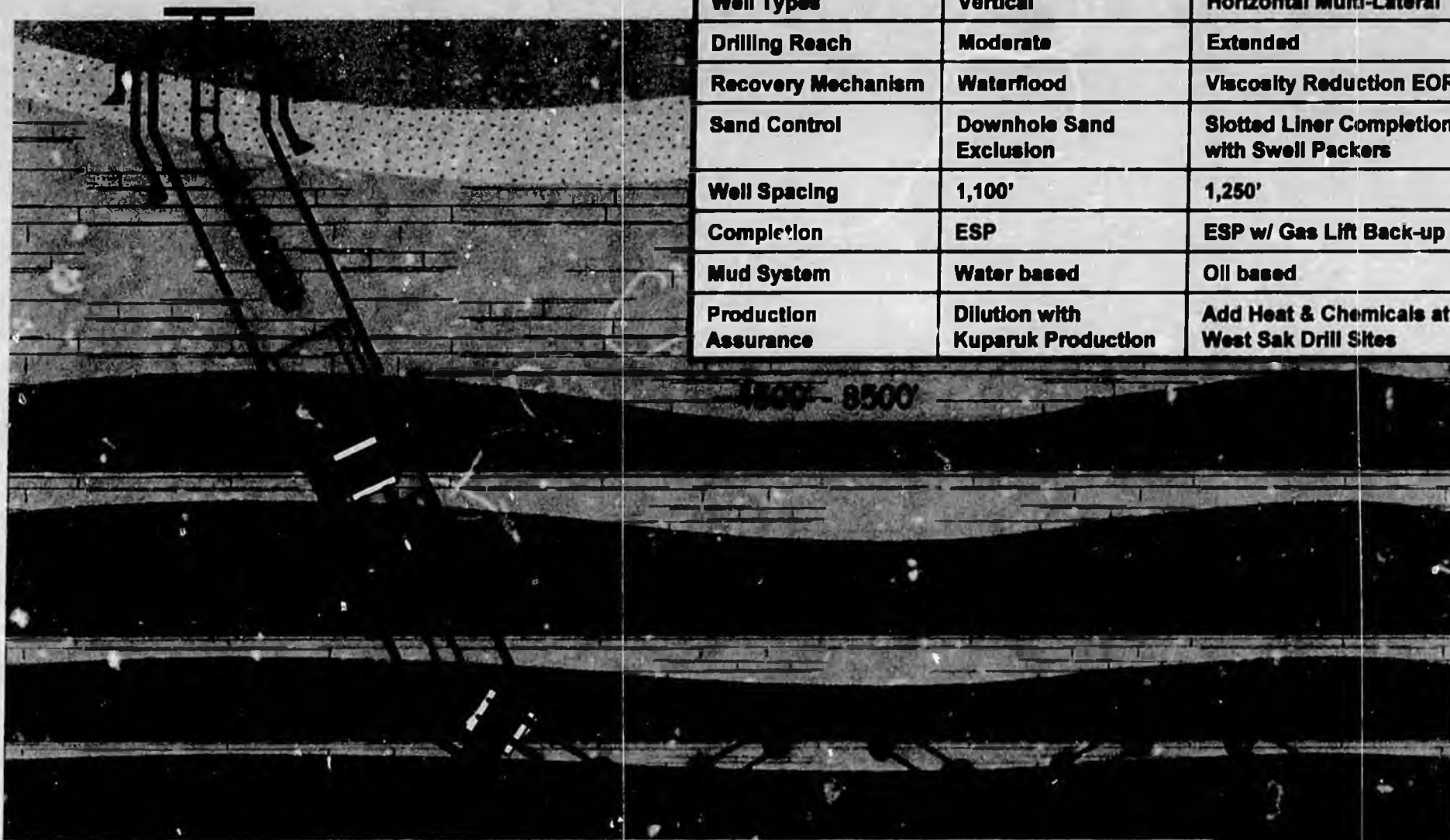
10 API Crude

- 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

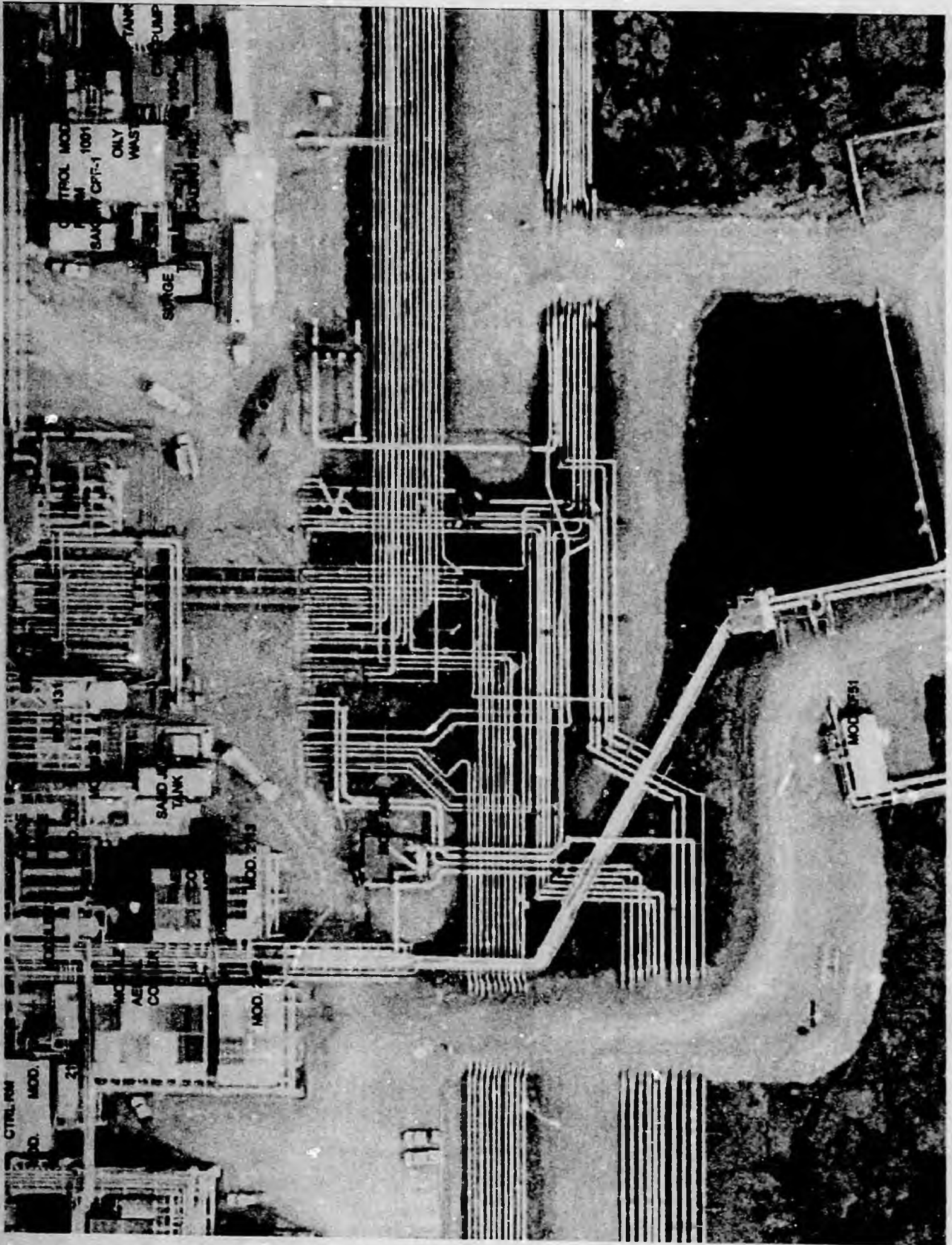
ConocoPhillips

# 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

ConocoPhillips

# TIE Credits

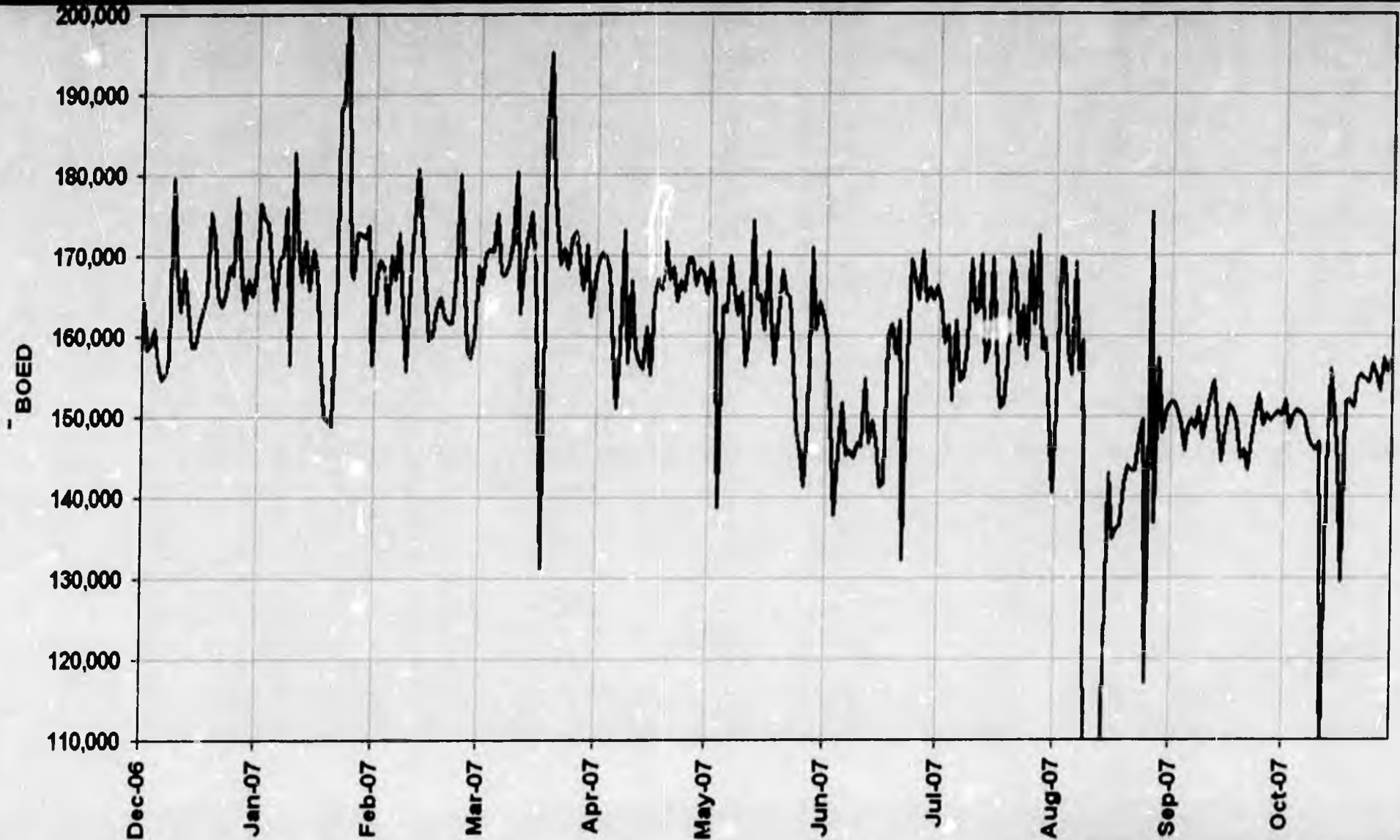
- An incentive to continue investment in Alaska
  - Producer has to spend twice the capital spent over the last five years to get the credit
- Use or Lose
  - PPT sunset clause erases all TIE credit remaining in 2013
- Soften the impact of tax changes

# 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





**HB**

**20001**

**(11/1/07)**

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**TESTIMONY OF CRAIG HAYMES  
ON PROPOSED HB 2001  
TO THE ALASKA HOUSE RESOURCES COMMITTEE  
NOVEMBER 1, 2007**

**EXECUTIVE SUMMARY**

ExxonMobil

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**ExxonMobil In Alaska**

- Over 50 year presence
- Spent and invested over \$20 Billion in Alaska
- Active with co-owners at Prudhoe Bay, Kuparuk, Duck Island, Granite Point, and Point Thomson
- Current working interest share of oil production ~150,000 barrels per day
- Largest owner of discovered Alaska gas resource
- Look forward to working with Alaska for many years to come

ExxonMobil

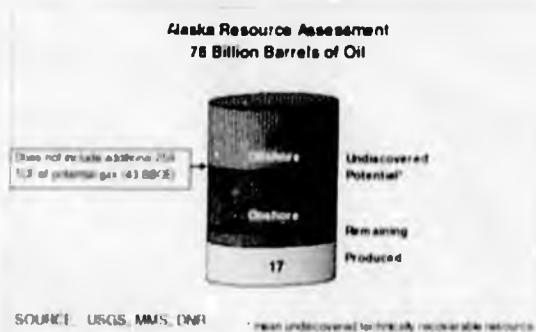
### Summary Points

- ExxonMobil believes the current tax and proposed increase will not result in the additional investment needed to maximize development of Alaska's resources
- ExxonMobil does not support the Administration's proposed tax increase
- Alaska has significant undiscovered resource potential - oil and gas
- Increasing investment required to mitigate production decline
- Government and industry need to work together
- ExxonMobil believes that Alaska needs a long term resource development policy that will encourage the full development of Alaska's oil and gas resources

ExxonMobil

### Alaska's Resource Potential Is Significant

- To date Alaska has produced one quarter of potential total oil resource
  - 17 Billion barrels produced (world class result)
- Future of Alaska not just gas, it is oil and gas
  - Undiscovered technically recoverable resources - 53 BB oil; 259 TCF gas
- Alaska's world ranking of proved reserves is declining
  - 14<sup>th</sup> in 1977 to 30<sup>th</sup> today



How can we commercialize Alaska's resource potential?

ExxonMobil

## Overcoming Alaska's High Cost Challenges

- Alaska's high cost environment challenges pace of exploration and development
- Alaska's mature fields have significant challenges with growing unit costs
- Many factors contribute to Alaska's higher costs
  - Severe arctic conditions, sensitive environment, remote location, restrictions for exploration opportunities
- Higher costs reduce attractiveness of opportunities
- Effective application of technology critical
  - Historical applications have proven successful
- Significant long term investment in research and technology required
  - Critical to the future pace of Alaska's resource exploration & development activity

ExxonMobil

## Alaska's Future Oil Production

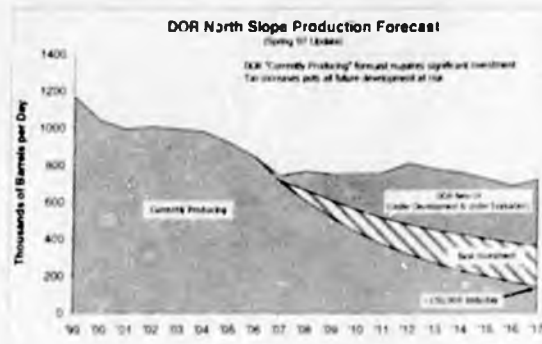
- Alaska currently producing one third of peak production and declining
- DOR forecast "base production" decline partially mitigated by "Under Development and Under Evaluation" production
- 50% of projected oil production in 10 years not developed or producing today
  - Most new projects take 5-7 years to bring to production
  - Near term investment decisions will be critical to future



ExxonMobil

## Alaska's Future Oil Production

- "Base production" includes current production enhancement investments
  - Same investment decisions as "Under Development and Under Evaluation"
  - Within 10 years, 75% of production projected to come from new investments
- At least \$30-40 billion of new investment required within 10 years to achieve DOR forecast
  - Excludes Billions of dollars of additional operating expenditures



## Alaska's Two Largest Oil Fields

- Prudhoe Bay and Kuparuk account for over 70% of North Slope oil production
  - Could remain at this level of contribution for next decade
  - Continuous investment essential to mitigate production decline
- Many exploration and development activities occurring in and around Prudhoe Bay and Kuparuk
- Development drilling in and around Prudhoe Bay and Kuparuk critical to Alaska's oil production
- Prudhoe Bay and Kuparuk have the potential to be key "hubs" for future developments

ExxonMobil

### **ExxonMobil's Position On Enacted PPT**

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- Did not support the PPT that was enacted last year
- Supported the concept of a net based tax
- Stated that proposed 20% tax rate would not encourage full development of resources
- Agreed with 20% tax rate in order to support progression of a gas pipeline project
- Current PPT tax rate reduces attractiveness of Alaska's resource developments
- Department of Revenue has not completed regulations or started any audit
- Willing to work with DOR and its auditors to improve understanding of joint interest billings

ExxonMobil

### **Proposed Tax Increase More Complicated**

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- **10% gross minimum tax on and ring-fencing of Legacy Fields**
  - Insulates State from price and cost risks, retains upside potential
  - Investors' economic risk increases
  - Revenues and expenses for Legacy Fields will be accounted for separately
- **Additional reporting requirements for exploration tax credits**
  - Credit qualification linked to release of proprietary information
- **Elimination of requirement for JI Billings as starting point for audits**
  - Joint Interest Billings are foundation of allowable business expenses
  - Significant co-owner audits undertaken
- **Information requests**
  - Information beyond tax filing submissions needs to be carefully considered
  - ExxonMobil willing to work with DOR

ExxonMobil

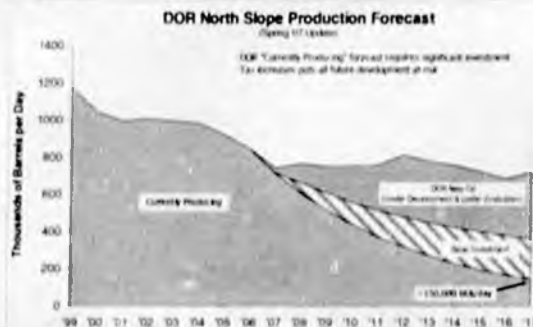
### Fiscal Predictability Is Important

- ExxonMobil, and we believe industry, values predictable fiscal environment
- Investments are capital intensive and typically evaluated over decades
- Change in fiscal regime has a direct impact on predictability of fiscal environment
- Changing fiscal environment for capital projects reduces attractiveness of investments
- For every well or project not progressed, production and State revenues are forgone
- Policies established today will impact attractiveness of potential future projects

ExxonMobil

### Alaska Needs a Long-Term Resource Development Policy

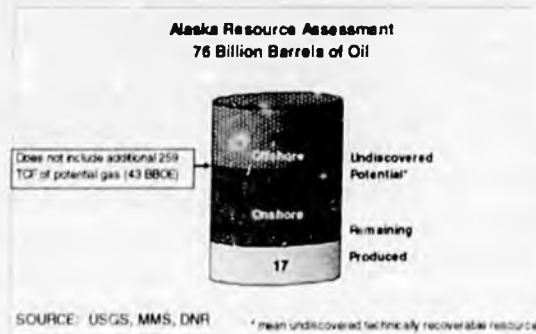
- Alaska has significant resource potential, but is a high cost environment
- Significant resources, technology, investment and teamwork required
- In 10 years, 75% of future oil production needs over \$30-40 Billion of new investments
- Alaska should consider what other regions are doing to encourage investment
- Alaska and industry collaboratively need to create a resource development policy



ExxonMobil

### **Alaska Needs a Long-Term Resource Development Policy**

- We propose collaborative approach to develop sustainable long term resource policy:
  - Characterization of state-wide resource potential
  - Identification of key issues challenging exploration and development
  - Key factors that impact resource value
  - Establishment of goals and measurement of progress
  - A fiscal policy that will encourage development of remaining resources
  - Regular meetings with industry and agency representatives
- ExxonMobil looks forward to working with the Administration, legislature, industry and people of Alaska



November 1, 2007

TESTIMONY OF CRAIG HAYMES  
ON PROPOSED HB 2001<sup>1</sup>  
TO THE ALASKA HOUSE RESOURCES COMMITTEE  
NOVEMBER 1, 2007

**INTRODUCTION**

Mr. Chairman, members of the committee:

Good morning. For the record, my name is Craig Haymes. I am the Alaska Production Manager for ExxonMobil, a position I commenced in January of this year. Prior to my current role, I was involved with oil and gas projects in Atlantic Canada and Australia. I reside in Anchorage with my family. In our short time in Anchorage we have found that Alaska has much to offer and we look forward to a rewarding experience.

I want to thank the committee for the opportunity to express ExxonMobil's views today regarding the Administration's proposed tax increase.

ExxonMobil has had a presence in Alaska for over 50 years and has been a key player in Alaska's oil industry development, spending and investing over \$20 billion dollars. We are currently active with our co-owners at Prudhoe Bay, Kuparuk, Duck Island, Granite Point and Point Thomson. Our current working interest share of oil production in the State is approximately 150,000 barrels per day and we are the largest owner of discovered Alaska gas resources. We look forward to working with Alaska for many years to come.

November 1, 2007

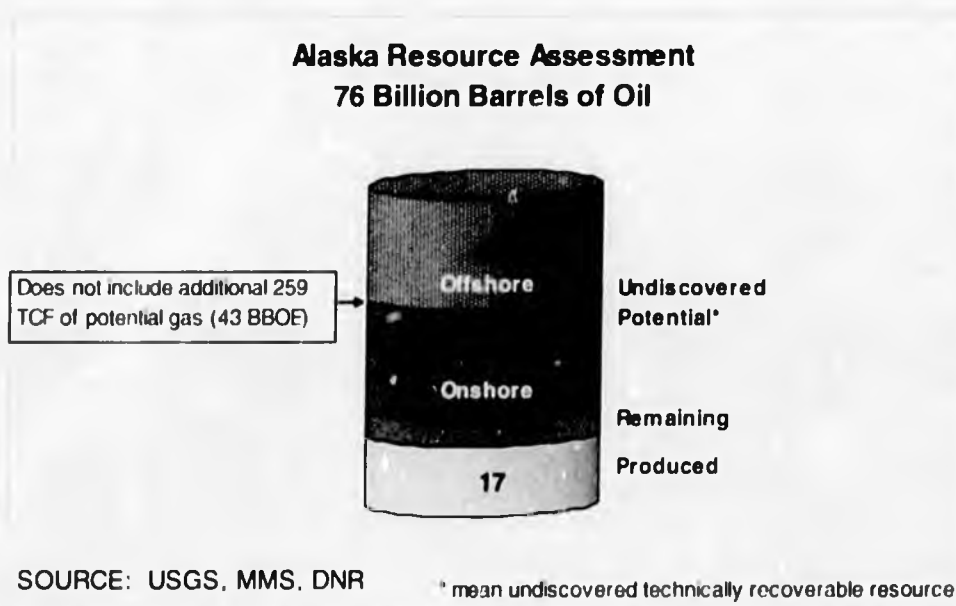
I would like to state upfront that ExxonMobil believes the current PPT tax rate and the increase proposed by the Administration will not result in the additional investment needed to maximize the development of Alaska's resources. When you consider Alaska's resource potential and the current production decline we do not support the proposed tax increase by the Administration.

Alaska has significant undiscovered resource potential in both oil and gas; but oil production is declining. As we all know, oil production today is one third of the peak of over 2 million barrels per day in 1988. Increasing investment in Alaska is needed to mitigate oil production decline - Government and industry have a common goal - to maximize economic resource development, both oil and gas

The full development of Alaska's resource potential will require extensive collaboration and focus from all parties. We need to work together, Government, the industry, and the people of Alaska to enhance the development of Alaska's resources. We believe that Alaska needs to create a long-term resource development policy, a policy that will encourage increasing investment needed to mitigate production decline, a policy that will encourage the full development of Alaska's oil and gas resources.

**ALASKA RESOURCE POTENTIAL IS SIGNIFICANT**

Alaska has significant oil and gas resources. To date Alaska has produced close to 17 billion barrels of oil - this is a world class result. According to the US Geological Survey and the US Minerals Management Service, Alaska still has undiscovered technically recoverable resources of over 53 billion barrels of oil. This is in addition to the Department of Natural Resources estimate for known remaining oil resources of 6 billion barrels. When you consider this resource potential, Alaska has only produced one quarter of its oil potential. Alaska still has the potential to produce another 59 billion barrels of oil. Expanding the resource assessment to include gas almost doubles this undiscovered potential on an oil equivalent basis. Alaska has significant oil and gas resources.



Whilst Alaska's resource potential is high, the Oil and Gas Journal and Energy Information Administration report that its world ranking of proved reserves has declined from 14<sup>th</sup> in 1977 to a position closer to 30<sup>th</sup> today. How can Alaska increase proved reserves; how can we commercialize Alaska's resource potential?

## **OVERCOMING ALASKA'S HIGH COST CHALLENGES**

Alaska is a high cost environment that challenges the pace of exploration and development of existing and new fields. Alaska's mature producing fields have significant challenges with growing unit costs.

Many factors contribute to Alaska's higher costs. Some examples include:

- Severe arctic conditions, placing limitations on when drilling and other operations can be undertaken
- A sensitive environment, requiring significant and due diligence measures to protect it
- Remote location of the resource and distance to market
- Current restrictions for exploration opportunities

All combine to create a unique and high cost environment for Alaska. For any investor, higher costs reduce attractiveness of opportunities. We need to work together to reduce these high costs. It will take significant effort including rigorous application of new technology.

November 1, 2007

Historically, the effective application of technology has proven to be successful in reducing costs for the exploration and development of new resources. ExxonMobil believes technology is the lifeblood of the industry and the key to unlocking Alaska's future resources. We have actively participated in the successful application of technology in Alaska, helping to contribute to the breadth of development that exists today. Some examples include:

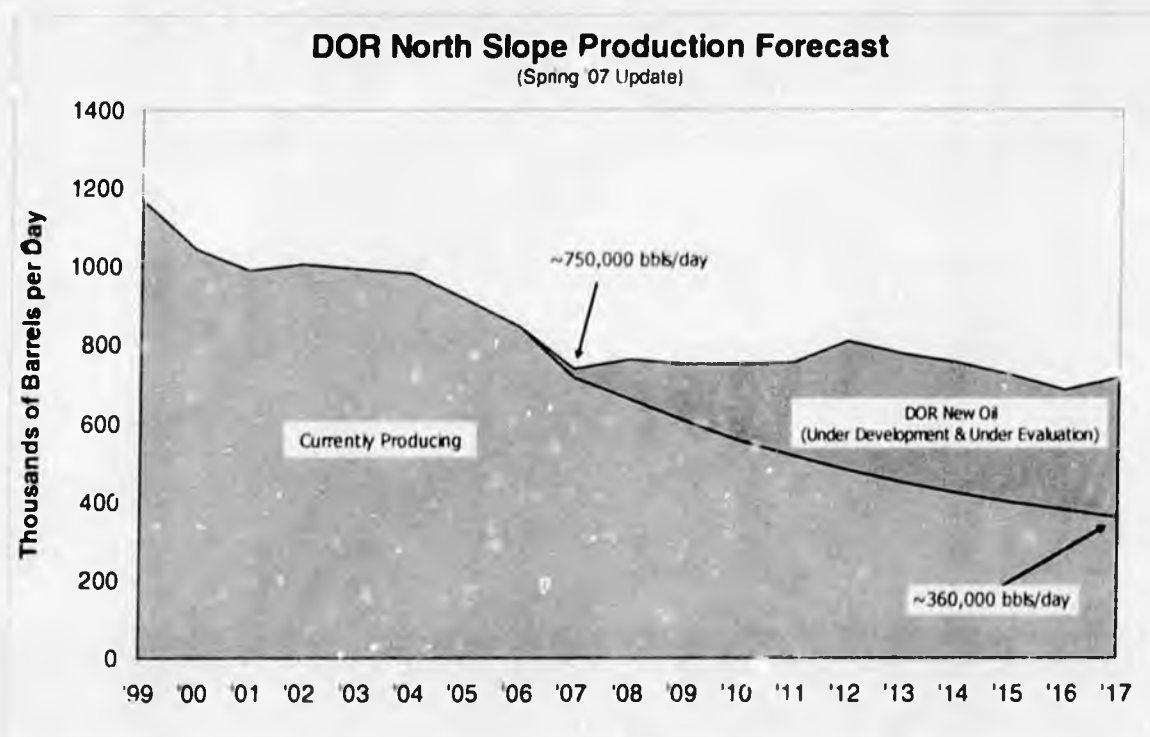
- Installation of ice resistant Granite Point platform in Cook Inlet
- Prudhoe Bay completion designs for permafrost
- First Concrete Island Drilling System (CIDS) to drill exploration wells in ice covered waters in the Alaska Beaufort Sea
- Prudhoe Bay full field 3-D simulation model, leading to many enhanced oil recovery and development drilling programs, many of which are still being pursued today

The application of technology will continue to be critical to the future pace of Alaska's resource exploration and development activity. There are significant cost challenges to overcome. It will require significant long term investment in the research and development of technology, now and in the future as we continue to pursue more challenging resource development opportunities in Alaska.

## ALASKA'S FUTURE OIL PRODUCTION

Alaska is currently producing approximately 750,000 barrels of oil per day from the North Slope, one third of its peak production. The Department of Revenue released a production forecast in their Spring Revenue Sources Book. The forecast consists of two main components, as shown in the chart below.

- Current base production (shown as green)
- Future "Under Development and Under Evaluation" production (shown as blue)



As the Department's forecast shows, the current base production is estimated to decline at 9% annually to approximately 360,000 barrels per day by 2017 with continued investment. That is a production level of less than half of today's. The Department's forecast also shows that this production decline will be partially mitigated by the "Under Development and Under Evaluation" production – which includes future investments in areas such as development drilling, satellite developments, and enhanced oil recovery from existing fields. Based on this forecast, 50% of future oil production in 10 years is

not even developed or producing today. Considering that most North Slope projects take at least 5-7 years to bring discovered resources to production, near term investment for these activities will be critical to underpin the future of Alaska's oil production.

As I mentioned earlier, the Department of Revenue's forecast is based on a 9% annual decline in Alaska's current base production. However, this decline includes current production enhancement investments at the core Prudhoe Bay, Kuparuk and Alpine areas. The Department's forecast does not highlight that this activity requires investment decisions that are no different from the "Under Development and Under Evaluation" categories. As such, a more accurate representation of the future investment levels required to achieve the Department's forecast is show in the chart below.

