Alaska Oil and Gas Association

AOGA

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ALASKA OIL AND GAS ASSOCIATION STATEMENT
ON SENATE BILL 21
FOR SENATE SPECIAL COMMITTEE ON TAPS THROUGHPUT

February 5, 2013

Good Afternoon. For the record, my name is Kara Moriarty and I am the Executive Director of the Alaska Oil and Gas Association, commonly referred to as "AOGA". AOGA is the professional trade association that represents 16 member companies who account for the majority of oil and gas exploration, development, production, transportation and refining of oil and gas onshore and offshore in Alaska. These comments regarding SB 21 have been reviewed by all members and were approved unanimously.

Senate President, Senator Charlie Huggins, outlined the Senate's priorities in an opinion piece published in the *Anchorage Daily News* on January 31. In it he stated "the most pressing issue facing Alaska is the downturn in oil production on Alaska's North Slope." We couldn't agree more. In fact, that is why this committee has been formed; to investigate the causes of oil production decline and make recommendations to turn the tide. We applaud Senator Huggins, you and Governor Parnell for recognizing this as a serious issue.

You have seen this chart over and over, but I think it's important to reflect on this decline. When I was legislative staff in 2000, the first year of this chart, no one was talking about production decline. Instead, everyone was focusing on price, because even though we had a million barrels per day of production, prices hovered between $8-10 that year. The state was facing a $1 billion shortfall, at a time when the budget was significantly less than it is today.

This is the updated forecast from the Department of Revenue (DOR) and you will see that they have employed a new risk modeling into their forecast. In the past, DOR projected that 10 years from now 50% of our oil production would be from new oil. While we applaud DOR for providing a more likely and realistic projection, it is important to note that their forecast for currently producing fields assumes that the current level of investment in producing fields will continue, which is by no means guaranteed.

Regardless, the fact is Alaska's production decline rate has remained at around 6% per year for the last decade, or at least 40,000 barrels a day per year. While we have never said that oil production will return to historic levels of 2 million barrels per day, we continue to argue that this accelerated decline is unacceptable, especially at a time of record and sustaining high oil prices over the last five years.

And just how is our competition reacting to high oil prices? This slide shows the oil price in the green dotted line and production from other regions, including mature basins like ours. Production in Texas started to level off as prices increased, and this was before the shale explosion. And of course, I don't need to remind you about North Dakota on the bottom of the graph that has caught up and surpassed us in production.

But another state that is about to surpass us is California. As this slide says, we are headed out of medal contention. We barely have the bronze and are about to slip to the fourth largest producing state in the United States. In fact, we now supply only 8% of the nation's oil production. I shared similar statistics with you at our legislative luncheon, but I think they bear repeating. In November 2012, the most recent month of statistics on the U.S. Energy Information Agency's website, production in Texas was 2.1 million barrels per day, North Dakota was 731,000 bpd, Alaska was 553,000 and California was nipping at our heels at 533,000. This at a time when we still have world class resources.

As you know, I represent a diverse membership, ranging from companies exploring and operating in Cook Inlet and on the North Slope, to companies hoping to develop Arctic Outer Continental Shelf resources, to three in-state refineries and our lifeline, the Trans-Alaska Pipeline System – or TAPS.

Current production is over 100,000 bpd less than when production from the North Slope began in 1977, so one company in particular that would love to see more oil through TAPS is Alyeska Pipeline Service Company. Because of the dedication and efficiency of their employees, we don’t hear about the increasing day to day demands and challenges Alyeska faces in providing safe and reliable transportation of our resources to market, but you are going to hear about them in detail from the president of Alyeska following my presentation.

But it’s not just Alyeska. Every single one of my members shares your concern about the decline in TAPS, and for good reason. Two of the three in-state refineries rely solely on North Slope crude, delivered through TAPS, for their refineries. And it is no secret the challenges our refiners face. Low throughput has increased the costs of refining, especially in Interior Alaska. For example, about 20 years ago, the oil when it reached North Pole refineries was about 110 degrees Fahrenheit. Now, it comes in in the mid 30 degree range. So in the refining process of heating oil to over 600 degrees F, the Interior refineries are expending considerably more energy to heat the oil an extra 70 degrees or so due to the drop in throughput, and it is no secret the cost of energy is extremely high in the Interior.

And even though my members in Cook Inlet may seem far removed from this issue, successful operations on the North Slope affect their businesses as well. As skilled workers, especially those with drilling experience have left Alaska for areas that are booming, now that Cook Inlet is starting to experience a boom again, it has been challenging to get drilling equipment and workers back to the Inlet.

As we look to the next generation of oil and gas development, the Arctic OCS is believed to have an estimated 27 billion barrels of oil and 130+ tcf of natural gas. But, even if we have a successful exploration season in 2013, it will be 12-15 years before we see production from the Chukchi Sea. Our pipeline needs to be healthy and viable then, as well as today and the time in between.

My remaining member companies are exploring, producing and operating on the North Slope. These producers of the existing non-legacy fields on the Slope, and the developers of any new fields that may be discovered, need as much production as possible flowing from the legacy fields through TAPS in order to keep the costs affordable to ship their oil from the Slope to its refinery destinations. Unaffordable high transportation costs could cripple the economics of any new fields that might be found, as well as economics of non-legacy fields currently in production.

We have used this analogy before, but it still rings true. The North Slope oil province is like a tree, with the two great legacy fields being its trunk, and with the other fields being branches rising out of the trunk. If one peels the bark off all the way around the trunk and make it unhealthy, all the other branches will become unhealthy too, no matter how robust they might have been if the trunk stayed strong.

Governor Parnell recognizes that as a state, we need increased oil production from all fields because the current throughput is unacceptable. He has identified four "core principles" that "any tax reform proposal must adhere to":

- "First, tax reform must be fair to Alaskans."
- "Second, it must encourage new production."
- "Third, it must be simple, so it restores balance to the system."
- "Fourth, it must be durable for the long term."

AOGA endorses these principles. As you work through this bill and throughout the session, we also encourage you to ask yourselves:

- What is the state's goal and desired outcome?
- Does the state's policy reflect the constitutional mandate of developing the natural resources here for the maximum benefit of Alaskans, both today and tomorrow?
- Is the policy short, mid or long term?
- Will it encourage additional investment across a wide spectrum of projects/companies?
- Will it encourage development through a fair and predictable regulatory environment?
- Will it encourage development through land sales and competitive lease terms?

The challenge facing Alaska is not in having too many companies pursuing the opportunities that they see here, but in having too few. To be effective, any reform measure needs to avoid tax changes that artificially create "winners" and "losers".

Senate Bill 21 takes some positive steps towards the goal of more production; such as the Gross Revenue Exclusion concept and eliminating progressivity, which has led to Alaska being uncompetitive. There are some other provisions that need further consideration in order to fully achieve the goals set out in this legislation.

We support the proposed elimination of progressivity. We have reservations with what the Bill proposes for tax credits – most importantly with the proposed repeal of tax credits for qualified capital expenditures (QCE). The trade-off between repealing progressivity and losing the QCE credit is not beneficial to industry with a rising cost structure and low oil price environment, although it would be helpful with high prices.

We strongly support the GRE (gross revenue exclusions) concept but have concerns over its limited applicability to new fields, only, which is further compounded by the loss of QCE credits as a driver for additional investment. We believe the GRE and tax credit restructuring proposed in the Bill could and should be expanded and better tailored to fit the majority of projects for "legacy" fields that would increase the amount of oil and gas from them.

We also believe the reasons that led the State to create the small-producer tax credit under AS 43.55.024 are still valid, and we are pleased the Bill will extend this credit from 2016 to 2022. But the reasons for creating the exploration tax credits under AS 43.55.025 are also still valid today, and the Bill would be improved by extending these tax credits or making them permanent. Similarly, the Bill would also be improved by addressing the upcoming end of the tax caps for Cook Inlet production and non-Cook Inlet gas sold for in-state use, which will otherwise occur at the end of 2021. Addressing these known issues now, before they become imminent, would strengthen the durability of the reformed tax.

The members of AOGA desire the same outcome that the Governor and the People of Alaska want – more oil in the pipeline providing a solid future for our industry and continued revenues to the State for the benefit of all Alaskans.

Our member companies want to do business in Alaska. Some have been exploring and producing in Alaska for decades, while others have arrived more recently. Both groups have a strong desire to be able to remain in Alaska long-term for their own and the State's mutual benefit.

Overall, the Bill as introduced represents a cornerstone for significant and crucial tax reform. It will take a monumental effort just to replace oil from declining fields with a mixture of new production and new stimulation to legacy fields, and bring the decline to a stop. AOGA stands ready and willing to help Alaskans, the Governor and this Legislature in the remaining work to achieve the four "core principles". We all need to work together to make this happen.