Written testimony for House Resources HB 247

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The Honorable Benjamin Nageak
Co-Chair of House Resources
Alaska State Capitol, Room 126
Juneau, Alaska 99811-1182

My name is Sarah Obed, and I am the Vice President of External Affairs for Doyon, Limited ("Doyon"). Doyon is the state chartered Alaska Native Claims Settlement Act Regional Corporation for Interior Alaska. Doyon has over 19,300 shareholders, most of whom reside within the State of Alaska. Doyon is the largest private land owner in the State, and one of our highest priorities is the continued exploration for oil and gas resources on State owned lands in the Minto Flats/Nenana Basin, as well as on Doyon-owned lands near Steven's Village.

HB 247: An Inequitable Result for Middle Earth Exploration and Development

The structure of the Alaska oil and gas production tax is vital to the exploration and development of areas of the state sometimes referred to as "Middle Earth," which encompasses all areas of the state south of the North Slope and outside of Cook Inlet. These areas are uniquely situated and the opportunities and challenges for economic development and oil and gas exploration and development are dramatically different than the opportunities and challenges on the North Slope and in Cook Inlet.[1]

HB 247/SB 130 ("the Bill") leaves intact certain elements of the oil and gas production tax that are very important for Middle Earth exploration and development, in recognition of the lack of commercial discoveries and infrastructure. For instance, Middle Earth production will benefit from a ceiling tax rate of 4% of the gross value at the point of production for 7 years after the start of commercial production. This ceiling was clearly intended to help "jump-start" Middle Earth production. The Bill also does not change the alternative credit for exploration under AS 43.55.025, which benefits seismic exploration and exploration drilling, and sunsets January 1, 2022 for Middle Earth projects (July 1, 2016 everywhere else). The Bill has left these provisions untouched and thus available for future use for Middle Earth projects.

However, the Bill would result in inequitable treatment of Middle Earth projects. The Bill would repeal the tax credits that have been vital to exploration and development in Middle Earth and Cook Inlet, specifically: the 20% qualified capital expenditure credit under AS 43.55.023(a) (QCE) and the 40% well lease expenditure credit under AS 43.55.023(*l*) (WLE). Further, this repeal would be effective July 1, 2016 — in the middle of Doyon's planned drilling season. Doyon decided to drill a well this summer based on the reasonable expectation of receiving these credits,

[1] A summary of Middle Earth exploration and development has been included as an appendix.

and a repeal at that time would catch the project in mid-stride. The repeal of these credits, which are based upon capital expenditures, will also hamper Middle Earth development and production. In addition, assuming that production commences and continues after the 7-year sunset date of the Middle Earth tax ceiling, oil production will bear the 35% tax rate, yet Middle Earth only has a 25% loss credit under AS 43.55.023(b) (Loss Credit), compared to the North Slope where the tax rate and Loss Credit are both 35%.

It is also important to recognize that Middle Earth has not benefitted from certain tax credits and other incentives that have benefitted other areas of the state. Because Middle Earth development is still in its early stages and has not yet reached production, Middle Earth has not availed of credits that can only be applied against production tax liability and that are due to sunset. For example, Middle Earth projects will never be able to use the small producer credit due to the 2016 sunset date. Certain other incentives have never been available to Middle Earth projects, such as the $5/bbl credit and gross value reduction on the North Slope, and the favorable tax treatment for Cook Inlet production and gas produced and used in the state.

The following table demonstrates: i) what Middle Earth would lose under the Bill; (ii) what opportunities Middle Earth is losing due to sunset dates and the early stages of exploration and development; (iii) what Middle Earth never had compared to other areas; and (iv) what would remain if the Bill passes.

Name	**Statute**	**Description**	**Status**
Qualified capital expenditure credit	AS 43.55.023(a)	20% credit for qualified capital costs	Would be repealed for Middle Earth and Cook Inlet by the Bill
Well lease expenditure credit	AS 43.55.023(*l*)	40% credit for seismic in a unit and intangible drilling and development costs	Would be repealed for Middle Earth and Cook Inlet by the Bill
Small producer credit	AS 43.55.024(c)	Up to $12 million credit against tax liability	Sunsets in 2016 - no Middle Earth production, so never used
Middle Earth (a.k.a "new area") development credit	AS 43.55.024(a)	$6 million credit against tax liability for Middle Earth production	Sunsets in 2016 - no Middle Earth production, so never used
Middle Earth "frontier basin" credits	AS 43.55.025(a)(6) and (7)	Lesser of 80% or $25 million for four wells and lesser of $7.5 million or 75 percent for four seismic projects	Sunsets July 1, 2016 - very limited use
Gross value reductions	AS 43.55.160(f), AS 43.55.160(g)	20% - 30% reduction in gross value	Not available to Middle Earth

$5/bbl credit	AS 43.55.024(i)	$5/bbl credit applied against tax liability for new oil production	Not available to Middle Earth
Ceiling tax rates for Cook Inlet oil and gas production	AS 43.55.011(j) and (k)	For new production, oil tax rate is 0% and gas tax is capped at $.177/Mcf.	Not available to Middle Earth
Ceiling tax rate for gas produced and used in the state	AS 43.55.011(o)	Tax on gas used in state is capped at $.177/Mcf	Not available to Middle Earth due to 2022 sunset - gas under Middle Earth ceiling rate is ineligible
Ceiling tax rates for Middle Earth oil and gas production	AS 43.55.011(p)	4% of gross value for first 7 years of oil and gas production	Available, but sunsets 7 years after start of production
Carried-forward annual loss credit	AS 43.55.023(b)	25% credit for expenditures that were not deductible due to insufficient revenue	Available, but at 25% rate (compared to 35% for North Slope)
Alternative credit for exploration	AS 43.55.025(a)(1)-(4)	30%-40% credit for exploration wells, 40% for seismic outside a unit	Available, but sunsets January 1, 2022

In sum, the Bill would repeal the most valuable credits for Middle Earth exploration and development and would result in inequitable taxation of Middle Earth projects due to the lack of mitigating measures available in other areas of the state. Repealing the QCE and WLE credits and leaving the Loss Credit at 25% not only impacts exploration, but also development activities that are essential for bringing fields into production; the alternative credit for exploration does not cover development activities and in any event sunsets in 2022. This would put Middle Earth on unequal footing for development and production — after 7 years of production, oil will be taxed at the 35% tax rate and the only relief would be a 25% Loss Credit. The net result unduly impacts Middle Earth projects.

There are several potential solutions that would help level the playing field for Middle Earth projects. These solutions can stand alone or be combined, and can be tailored to apply only to Middle Earth, or to Middle Earth and other areas of the state. Options include:

- (i) Do not repeal the QCE and WLE credits;
- (ii) Move the effective date of any repeal to at least January 1, 2017, if not later to allow for effective planning;
- (iii) Increase the rate for the Loss Credit to 35%;

(iv) Extend the sunset date for the small producer credit;
(v) Extend the sunset date for the Middle Earth ("new area") development credit - and increase it to $12 million per year;
(vi) Allow Middle Earth the North Slope gross value reductions; and
(vii) Allow Middle Earth the $5/bbl North Slope tax credit.

We would be happy to provide draft legislation if it would be helpful.

Appendix: Middle Earth Exploration and Development

Middle Earth includes the Nenana Basin and Yukon Flats in central Alaska where Doyon holds oil and gas interests, including over 400,000 acres of state leases. Middle Earth also includes Kotzebue, Copper River, Bristol Bay, and the Aleutians.

There is no oil and gas production in Middle Earth and the prospective basins are unexplored or underexplored, with no commercial discoveries. Federal and state studies indicate that many of the basins in Middle Earth are highly prospective areas for oil and gas. Some areas are near infrastructure and could be quickly developed to bring oil and gas into production in the near future. There are great opportunities for major oil and gas discoveries that could accelerate economic development and provide jobs, local sources of gas to communities, revenues from royalties, lease rentals, and taxes, and also valuable well and seismic data.

There are several Middle Earth projects that are moving forward and production tax rates and credits impact these projects and the appetite for investment in them. Doyon has been drilling wells and shooting seismic in the Nenana Basin and Yukon Flats for the last several years, is currently building a road and pad for one additional well, is currently shooting seismic, and has moved forward with permitting and contracts for services and equipment. Doyon has advanced its projects from unknown to the demonstration of an active hydrocarbon system and has methodically de-risked the Nenana Basin prospect to a 1-in-2 chance of success for gas. These prospects are roughly 40-60 miles from the Trans-Alaska Pipeline and the likely route of a major gas line, and can provide gas to Fairbanks. These projects are already spurring economic development and providing revenue to the state and localities — Doyon pays the state over $1.2 million in lease rentals annually.

The oil and gas production tax credits are vital to Middle Earth exploration and development, but the amount of credits associated with Middle Earth activity is miniscule compared to the total amount of credits in the state. Total rebates to Doyon for 2005-2016 are estimated to be only $62-65 million. However, if there is an oil discovery in 2016, a simple royalty calculation for Doyon's mean production estimate would be: 70 million barrels x $60/bbl = $525,000,000 in oil royalties alone. Further, that estimate is for just one of several similar traps identified in Doyon's most recent 3-D seismic survey, which covered less than 10% of the area Doyon is actively exploring. Success with one of these traps strongly suggests that there will be success with many others. There are also significant opportunities for gas production, estimated to yield enough gas to supply Fairbanks for over 20 years. In addition, over 30 local groups will provide services for Doyon's 2016 programs and over 150 people will be directly employed. Such opportunities are repeatable throughout the basin.