Alaska Oil and Gas Association

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AOGA Testimony on Committee Substitute for House Bill 247
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Good Morning Chairman Johnson and members of the Committee. For the record, my name is Kara Moriarty and I'm the President/CEO of the Alaska Oil and Gas Association, commonly referred to as "AOGA".

Thank you for the opportunity to testify on the Committee Substitute (CS) for HB 247. I do have unanimous consent of my diverse group of members to offer these brief thoughts today.

We recognize that many of you are looking for ways to fill the state's budget gap and see increasing taxes on the oil industry as part of the solution. However, to be completely candid, the CS in question will result in disastrous long-term economic consequences to our state that will far outweigh the temporary and modest short term gains.

Before I get into more detail about how this bill will unquestionably have a negative impact on Alaska, let me first lay the foundation for those comments. I begin by asking you, our state lawmakers, what is your vision for Alaska? With that in mind, how can this proposed legislation serve your ultimate endeavors? What will the bill do to production and how will state revenues be impacted by this bill next year or even five years from now? What will Alaska's economy look like following the adoption of this bill?

More to the point, is the CS likely to increase or even provide stable throughput in the Trans-Alaska Pipeline System, "TAPS"? Will the CS incentivize workovers and production from more mature fields, or encourage new companies to invest here? Will the CS increase the diversity of companies operating in Alaska? Perhaps your vision is a stampede of new activity on the North Slope, where companies compete fiercely for acreage and resources as they forge ahead with multi-million and even multi-billion dollar projects? Or perhaps you are focused on Cook Inlet and your CS is designed to provide energy security for South Central

Alaska by encouraging increased investment and production in Alaska's first oil basin? I would imagine that increased production and a healthy economy are the foundation of your long-term vision for Alaska, which is why it is paramount that I advise you that the CS will drastically undermine those goals and jeopardize Alaska's future.

As we read through this latest CS, it is unfortunate, but very clear that the CS does create new principles for Alaska. Those principles include eliminating refundable tax credits, which were the catalyst for several companies investing in Alaska. Those credits have provided, and continue to provide, a strong return for the state's investment. Another newfound principle appears to be to raise taxes on an industry that is already losing money in the state, regardless of the consequences to not only that industry but also the Alaskan economy. This CS is a flagrant money grab that will, **without question**, lead to less oil production, less investment, fewer Alaskans working, and ultimately, and somewhat ironically, less revenue for the State.

We understand the politics associated with this issue are challenging. We get it. And yet, to my member companies, the politics are largely irrelevant to the core of what drives decision-making, and that is economics. My member companies will not pursue projects that don't pencil out. They will not keep more Alaskans on the payroll when the State decides to take an even bigger bite out of the bottom line, which, at the moment, for some companies, is awash in red ink. The industry, recognized in the state's own data, does not have the current revenue to pay their daily bills, and it will be forced to constrict even more if a bill like this becomes law. This inevitable result will not be based on emotions or politics. It is simply a mathematical calculation. Numbers dictate investment, and a bill like this makes the numbers worse. End of story.

Ironically, with this CS, the State actually is setting the stage for an inevitable loss of revenue regardless of what credits it removes or taxes it raises. Getting back to the economics, the barrels of oil that remain in legacy and new fields, which we know are there for the taking, but require significant capital investment to recover, would lead to greater revenue to the State. And yet, instead of trying to facilitate the recovery of those volumes, this CS will raise the production tax, thus making those barrels less likely to be produced when oil prices inevitably come back up.

Again, here's the irony: Under this CS, the State will see lower oil and gas production, which will then drain State finances. For example, the owners of Prudhoe Bay just updated their plan of development and have estimated that production will decline 20,000 – 60,000 barrels per day due to the shut-down of 3 rigs and less well workovers being completed due to the low price environment. This lost drilling time could result in a 10-30% decline in Prudhoe Bay alone, which is in line with what industry has often said that the natural decline of is about 10-15% without increased investment. The tax increase proposed by this CS will not help turn this around.

Utilizing the Department of Revenue's Spring Forecast book, we have examined what production decline looks like over the next five years. (Show chart here). Using DOR's price and production estimates, production for this fiscal year should be about 520,000 barrels per day. If production estimates stay where they are, production in FY 2021 will be about 418,600, which is about 4% decline per year.

However, if the proposed legislation is enacted, the DOR's production estimates will invariably become far too optimistic. In reality, increased taxes and omitting tax credits will greatly exacerbate production decline. This chart highlights the possible ramifications. For example, a 10% decline in production will result in $793 million in lost royalties for the State. A 20% decline in production will result in a dramatic and terrifying loss of almost 2 billion in royalties alone.

Adding insult to injury in this scenario, the technical aspects of operating TAPS are made more challenging because of those lost barrels, and thus more expensive. Alyeska as stated that TAPS faces a significant operational obstacle at throughputs at around 300,000 barrels per day. Despite some of the best and most innovative people in the industry focused on this scenario, an operational solution has not yet been identified to sustain TAPS operation at this level.

The other unfortunate irony is that this resulting loss of production would come on the heels of the first year-over-year increase in oil production we've seen in 15 years. Under this CCS, Alaska throws out that progress with the bathwater.

So again, I ask all of you, what is your policy? In years past, focus was placed on several key components of a balanced oil and gas tax structure, including production, predictability, certainty, and competitiveness. From our view, this CS **negatively impacts every company in Alaska and violates every one of those tenets**. In addition, it has the dubious distinction of making a bad situation worse by bringing in even less long-term revenues to the state.

Alaska has been focused on increasing production on the North Slope and Cook Inlet and for good reason, because the state needs its economic engine to be successful. More production means more jobs and revenue for the state.

This CS is a dramatic shift in Alaska's policy as it essentially eliminates key tax credits within the next 2-3 years and adversely changes some of the key elements of the existing production tax system. After weeks and weeks of analysis and examination, this committee substitute makes yet again more drastic alterations. The rapid tax credit sunset will surely have major adverse impacts to projects currently under development, and discourage others from ever seriously considering investment in Alaska in the future. The change in the application of future potential net operating losses represents an immediate tax increase and devaluation of this essential element of a net based tax system.

Alaska is the only state in the nation considering increasing taxes or eliminating incentives at this time of low price. This CS will require an even higher oil price for companies to invest in Alaska, especially for companies that are looking to explore in Alaska's very high cost environment.

If Alaska wants to retain the strong benefits it receives from the industry that develops its resources and provides over 80% of the state's revenues, there needs to be confidence that the underlying tax structure is stable and predictable. This CS certainly does not promote the stability that will encourage industry to continue investing in Alaska. In fact, it sends a strong signal to the world that Alaska is constantly changing tax policies, regardless of oil price, and regardless of the economic condition of the industry.

As an example of instability, the CS creates a new policy regarding Alaska resident hire. Let me be clear, the industry strongly supports hiring as many Alaskans as we can. It makes economic sense for the industry to do so. The current language of this provision is unclear creates questions of retroactivity and questions of implementation, all of which creates additional uncertainty for industry.

In closing, the industry is not asking for a tax decrease or for tax or royalty relief while we struggle though extraordinarily low prices, and we have asked that you proceed with caution when changing tax policy.

It is my job to let you, our elected officials, know what impacts your decisions will have.

- The CS will not increase production from the Slope or Cook Inlet.
- It will not encourage new companies to invest in Alaska.
- It will not lead to more long-term revenues for the state.
- It will not increase the number of companies operating in Alaska, and will likely drive some companies out of the state.
- It will not lead to a stampede of new activity.
- It will not provide long-term energy security.

All this CS will do is provide a small amount of short-term revenue for the state, while significantly jeopardizing Alaska's long-term future.

Thank you for the opportunity to testify today, and I'm happy to take any questions you may have.