Alaska Oil and Gas Association

AOGA

121 W. Fireweed Lane, Suite 207
Anchorage, Alaska 99503-2035
Phone: (907) 272-1481 Fax: (907) 279-8114

November 1, 2011

Honorable Paul Seaton
Co-Chairman, House Resources Committee
State Capitol Building, Rm. 102
Juneau, AK 99801

RE: Written Comments for House Resources Hearing, November 1, 2011

Dear Representative Seaton:

Thank you for the opportunity to provide written comments for your committee hearing on the impediments to filling the Trans-Alaska Pipeline System (TAPS). The Alaska Oil and Gas Association (AOGA) is a nonprofit trade association that represents the majority of oil and gas exploration, production, transportation, refining and marketing activities in Alaska. Our member companies who currently produce oil on state land include BP, ExxonMobil, Pioneer, Chevron, Anadarko, XTO, Marathon and eni petroleum.

Our mission at AOGA is to foster the long-term viability of the oil and gas industry in Alaska. TAPS is the cornerstone of the long-term viability of Alaska's oil and gas industry. For this current fiscal year (FY 2012), the Department of Revenue (DOR) is forecasting production of 610,000 bpd, just over a 100,000 bpd decline in the last three years. In fact, in the last three years, the pipeline has operated at less capacity every day since its original startup in 1977. Additionally, according to the DOR forecast, crude throughput could decline to approximately 255,000 bpd by 2020 unless significant investment is made in projects currently under development and evaluation.

These production statistics are staggering so the topic of your hearing is incredibly important and relevant to the future of the industry and for Alaska's economy. Unfortunately, the single, largest obstacle in filling TAPS, a change in Alaska's production tax structure, is missing as a discussion topic for the November 1 hearing.

By evaluating estimates of resource potential for state land development, especially onshore, existing North Slope fields are believed to contain another 5 billion barrels of oil (bbo). And heavy/viscous oil has been estimated to reach gigantic proportions of potentially 50 bbo, almost three times larger than the almost 17 bbo produced from the North Slope to date. Development in existing fields and stimulating production from high cost development areas such as heavy oil should be one of the most important priorities for state policy makers as production from these fields can occur in the shortest amount of time. Although the 2012 exploration season for brand new fields is encouraging, it takes at least 5-7 years to bring a new field into production, assuming the season was successful.

Changing Alaska's production tax structure, commonly referred to as "ACES", will increase the competitiveness for investment dollars in Alaska, especially for existing fields. While investment, development and production are increasing in nearly every other major oil region in the world, they continue to fall here in Alaska. To increase production in existing fields, companies need to be utilizing capital spending on activities that produce more oil, such as drilling, pad extensions, debottlenecking, etc. Lowering the tax burden for companies through HB 110 or another similar vehicle will result in increased job opportunities and will spur the development necessary in the short-term to stem the decline in oil production currently facing Alaska.

Alaska has the highest production tax in the nation. AOGA has repeatedly testified that the not only is the base rate too high, but when coupled with the windfall provision of the tax structure (progressivity), Alaska has extremely high marginal tax rates and the tax system creates an imbalance in the risk-reward investment environment in Alaska. The competition for investment dollars is real. Reforming our production tax will move Alaska to a more competitive position and make the corporate arguments to invest in Alaska more palatable and possible. Investment goes where it has the opportunity to make the best return, and since ACES, that's been somewhere other than Alaska.

One of the most onerous features of ACES is the lack of bracketing for progressivity. Each time the Production Tax Value (PTV) per barrel increases beyond $30, all prior dollars are taxed at the higher rate instead of just that further increase. Removing the upside to the degree the progressivity feature does makes it much more difficult to compete for investment dollars with other areas that are not as fiscally challenged as investments here in Alaska. Bracketing sets tax rates for the different levels of PTV so that each level is taxed only once and at a specific rate for that bracket, moderating the impact of ACES' high rate of tax.

In addition, capping progressivity and the base tax at a 50 percent combined rate as proposed by HB 110, rather than the current 75%, also provides the impetus needed to motivate companies to undertake the high risk projects on which the future economic health of Alaska will depend.

Another important aspect of HB 110 is expanding the existing 40 percent well lease expenditure tax credit currently available to properties south of the North Slope. Extending these qualified capital expenditures to all developments in Alaska will provide incentive for investment in much needed in-field drilling. These expenditures will include labor costs resulting in increased job creation. These additional credits could potentially jump-start production sorely needed to stem the production decline in the near-term.

These proposed production tax changes would create a competitive business climate in Alaska where the reward is commensurate with the risk while keeping the needs of the State and the producers in a more appropriate balance.

There clearly is a sense of urgency with regard to the need for investment and stemming the decline in production. The most efficient and effective way to address one of the largest impediments to getting more oil into TAPS is reducing Alaska's high production tax rate.

Sincerely,

Marilyn Crockett

MARILYN CROCKETT
Executive Director

Cc: Members of House Resources Committee