Should Alaska Voters Repeal Senate Bill 21?

March 13, 2014
Senator Bill Wielechowski
Southeast Conference
Considerations

• How much will SB 21 cost the State?
• Was ACES really broken?
  – Investment under ACES
  – Jobs under ACES
  – Exploration under ACES
  – Oil companies coming & going under ACES
  – Oil Company profits under ACES
  – Was Alaska “competitive” under ACES
• Will SB 21 lead to more oil production and revenue?
How Much Will SB 21 Cost?

Last year, the Parnell Administration estimated SB 21 would cost Alaskans $4.5 billion in the first five years alone. After that billions more.

If oil prices increase, the loss to Alaskans will grow ever steeper, up to $2 to $3 billion per year.
If SB 21 had been in effect since 2007, Alaska would have lost $8.5 billion
Alaskans will give away billions. What will we get in return?

- No guarantees of new investment.
- No guarantees of more jobs.
- No guarantees of increased production.
Safeguarding our Savings

ACES enabled us to save more than $16 billion in two “rainy day” accounts, giving Alaskans the biggest state savings accounts in the nation.
Perennial Deficits

This year’s deficit is $2.3 billion. Continued cash flow deficits of $2+ billion a year are expected in the foreseeable future, assuming state spending continues along its current trajectory.

House Republicans recently announced they were discussing using the Permanent Fund to meet shortfalls in the future.
Myth #1 for SB 21

“ACES caused oil companies to stop investing in Alaska.”
Spending by Industry Grew to All-Time Highs
Oil Company Investment Surged Under ACES

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Spending</th>
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<tbody>
<tr>
<td>FY2007</td>
<td>$3.7 billion</td>
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<td>FY2008</td>
<td>$3.8 billion</td>
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<tr>
<td>FY2009</td>
<td>$4.3 billion</td>
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<tr>
<td>FY2010</td>
<td>$4.7 billion</td>
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<tr>
<td>FY2011</td>
<td>$4.9 billion</td>
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<tr>
<td>FY2012</td>
<td>$5.4 billion</td>
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<tr>
<td>FY2013</td>
<td>$6.3 billion</td>
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</tbody>
</table>

Investment increased by 70% in 7 years.
Source: Alaska Department of Revenue.
FY 2013 is a forecast.
As One Oil Exec Said

"One of the big things is to let independent oil and gas companies know is that Alaska is open for business and a big incentive is the ACES legislation," Vigil said.

Source: Article, Alaska Business Monthly, December 2009
Myth #2 for SB 21

“Oil companies were not exploring in Alaska under ACES.”
There was Fierce Competition For New Oil Leases

In 2011, 19 oil companies competed for 616,000 acres of new petroleum-rich lands, paying the state nearly $21 million.

The bidding generated the 6th largest amount ever for tracts on the North Slope.
Big Investors, Big Interest

The large Spanish oil giant Repsol began exploring in Alaska in 2012.

The company hopes to spend at least $768 million under a "broad-reaching exploration and development program."
New Exploration was Underway

“The good news is we are seeing a lot of increase in oil exploration.”

— Karen Rehfeld, Director of the Governor’s Office of Management and Budget, January 19, 2011
Myth #3 for SB 21

“Oil companies were leaving under ACES.”
The Number of Companies Under ACES

- In 2008, the first year after ACES passed, 18 tax returns were filed by oil and gas companies.
- In 2009, it grew to 26 and, in 2010, to 47.
- In 2011, 69 returns were filed: a 383% increase under ACES.
Myth #4 for SB 21

“Alaska was not a profitable place to do business under ACES.”
BP: Alaska Net Income

(Billions)

‘07: $2.5
‘08: $2.0
‘09: $1.9
‘10: $2.3
‘11: $1.4
‘12: $2.0 (estimate based on average)
‘13: $2.0 (estimate based on average)

(minus $1.5 billion in ‘10 deducted for non-Alaska costs, such as the Gulf spill)

$14.4 billion in profit under ACES

Source: BP Annual Report
ConocoPhillips Net Income
From Alaska in Billions

‘07: $2.3
‘08: $2.3
‘09: $1.5
‘10: $1.7
‘11: $2.0
‘12: $2.3
‘13: $2.3

$14.4 billion in profit under ACES

Source: ConocoPhillips Annual Report
Alaska Profits vs. World Profits

In 2012, O&G production in Alaska made up 13% of ConocoPhillips’ worldwide output.

Yet, Alaska contributed 34% of its worldwide production income.
### Alaska Profits Compared with Elsewhere

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<tbody>
<tr>
<td>Alaska</td>
<td>$1.7 Billion</td>
<td>$2 billion</td>
<td>$2.3 billion</td>
<td>$2.3 billion</td>
</tr>
<tr>
<td>Lower 48</td>
<td>$1 billion</td>
<td>$1.3 billion*</td>
<td>$1.0 billion*</td>
<td>$1.0 billion</td>
</tr>
</tbody>
</table>

* Includes earnings from Latin America

From ConocoPhillips Income Statements
Alaska Earnings Per Barrel Much Greater than Elsewhere

Table 2: ConocoPhillips Exploration and Production Net Income per Barrel of Oil Equivalent by Selected Jurisdictions
(Nominal Dollars)

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</thead>
<tbody>
<tr>
<td>Alaska</td>
<td>$8.97</td>
<td>$6.01</td>
<td>$6.19</td>
<td>$10.43</td>
<td>$14.36</td>
<td>$20.38</td>
<td>$21.08</td>
<td>$20.66</td>
<td>$22.84</td>
<td>$15.73</td>
<td>$19.47</td>
<td>$24.16</td>
<td>$29.20</td>
<td>$31.15</td>
<td>$17.90</td>
</tr>
<tr>
<td>Lower 48/Latin</td>
<td>$9.13</td>
<td>$8.02</td>
<td>$3.77</td>
<td>$8.42</td>
<td>$10.56</td>
<td>$15.96</td>
<td>$10.63</td>
<td>$9.80</td>
<td>$14.39</td>
<td>$(0.20)</td>
<td>$6.26</td>
<td>$8.24</td>
<td>$6.15</td>
<td>$6.03</td>
<td>$8.37</td>
</tr>
<tr>
<td>Latin America</td>
<td>$5.35</td>
<td>$3.60</td>
<td>$2.74</td>
<td>$5.57</td>
<td>$7.64</td>
<td>$11.55</td>
<td>$12.70</td>
<td>$11.43</td>
<td>$18.57</td>
<td>$5.63</td>
<td>$19.56</td>
<td>$11.82</td>
<td>$21.12</td>
<td>$24.49</td>
<td>$11.55</td>
</tr>
<tr>
<td>International</td>
<td>$7.54</td>
<td>$5.62</td>
<td>$4.43</td>
<td>$7.32</td>
<td>$9.88</td>
<td>$13.85</td>
<td>$13.05</td>
<td>$7.58</td>
<td>$8.61</td>
<td>$5.88</td>
<td>$15.75</td>
<td>$12.62</td>
<td>$12.95</td>
<td>$16.24</td>
<td>$10.10</td>
</tr>
</tbody>
</table>

Notes: Global Total includes results from "equity affiliates," which are companies that ConocoPhillips owns or in which it holds an equity interest. It is our understanding that the company conducts operations through these affiliates in order to comply with regulatory requirements. These entities exist across a number of geographic jurisdictions and vary in location from year to year. Global Totals further include claimed corporate losses spanning operations. "Barrel of oil equivalent" expresses the amount of a given fuel required to equal the amount of energy contained in one standard U.S. barrel of crude oil (42 gallons). For instance, a generally accepted BOE approximation for natural gas is 5,800 cubic feet (5.8 Mcf). Please note, however, that the amount of energy provided by a given amount of crude oil (or any fuel) varies by production location or, more precisely, the grade of oil produced. Therefore, BOE figures should be viewed as estimates. The figures in this table are the results of dividing net income by the aggregate BOE production of oil, natural gas, and natural gas liquids. Figures are imprecise due to the impact of round production figures to the nearest 1,000 barrels.

Healthy Rates of Return

ConocoPhillips executives acknowledge that Alaska has “strong cash margins” and “very good rates of return.”

(3/23/11 investor conference call)
BP Says Alaska Generates “Excess Cash Flow”

Alaska “generates significant excess free cash flow ... Rather than using this cash to reduce debt ... we are committed to return .... 100% of this excess cash flow to our investors for as long as oil prices remain above $20 a barrel ....”

Lord John Brown, Chief Executive, BP: Address to shareholders on 4/15/04
We “Fuel Growth Elsewhere”

“Alaska role in BP’s portfolio is to provide a stable production base and cash flow to fuel growth elsewhere in the business while improving margins and returns.”

(2004 BP Memo)
Rates of Return Under ACES

In 2007, consultants hired by the Legislature estimated the rate of return an oil company would receive from new investments in Prudhoe Bay – a **123% rate of return** when oil sells at $80 a barrel.
Senate CS – Forecast Mode, $80 oil

- IRR = 123%, NPV10 = $5.375 billion

Modeling the Prudhoe Success contained in AOGA/BP Testimony

Drilling Program Year
- 2002
- 2003
- 2004
- 2005
- 2006

Capex Multiplier: 300%
Opex Multiplier: 100%
Production Multiplier: 100%
Discount Rate: 10%
Royalty: 12.5%
Net Tax Rate: 25.0%
Progressivity: 0.40%
Price: $80

CAPEX for Drilling Program

Incremental Production

Oil Company Net Present Value

Alaska Royalty And Taxes

NPV = $7957
Parnell’s consultants confirmed this just last year. These slides were prepared by them.
Alaska Yields Extremely High Rates of Return compared with Norway
Alaska Yields Extremely High Rates of Return compared with Canada
Alaska Yields High Rates of Return Compared with North Dakota
Myth #5 for SB 21

“Oil industry lobs declined under ACES”
Under ACES, North Slope oil jobs reached an all-time high.
Oil Tax Revenue Fueled Job Growth

More than 124,000 private-sector jobs were created from state capital investments since ACES passed.
Myth #6 for SB 21

“Alaska’s tax rates were not competitive under ACES.”
Alaska WAS Competitive Under ACES

The following slide, developed by Chevron, shows the government take in various countries.

As this slide illustrates, governments have generally been increasing their taxes to ensure that their citizens are fairly reimbursed for selling their non-renewable oil resources.
Capturing "Fair Share"

Assessment of Oil and Gas Jurisdictions is Complex and Continuous

Changes in Government Take 2002 to 2006

Source: CERA: 2002 vs. 2007

Conclusions from the Analysis

In general, the information does not indicate that changes in the tax system have had a direct negative impact on industry activity in the state.

In fact, the data would indicate that the investment incentive provisions of ACES are contributing to increased levels of expenditure.
Myth #7 for SB 21

“ACES is the reason oil production declined.”
North Slope production declines started decades before ACES.
National Research Results

“Severance tax rate cuts substantially reduce tax revenue collected, but yield moderate to little change in oil drilling and production activity.”

Effectiveness of Severance Tax Incentives in the U.S. Oil Industry, Professor Mitch Kunce, International Tax and Public Finance, 2003
“States should be wary of arguments asserting that large swings in oil field activity can be obtained from changes in severance tax rates.”

Professor Mitch Kunce, Department of Economics and Finance, University of Wyoming
“Oil production is quite insensitive to the tax structure”

Figure 9.1. Oil production is quite insensitive to the tax structure in the U.S. case.

State Tax Policy and Oil Production

Dr. Shelby Gerking Testimony before Senate Resources Committee, 2/1/12
New Technology Spurred the Boom in North Dakota

“The recent growth in exploration and production was spawned by technological advancements in horizontal well drilling and hydraulic fracturing (fracking) techniques ...”*

* March 11, 2011, report from the non-partisan Legislative Research Services
Lower Taxes Are Not the Cause

“Claims that petroleum investment in North Dakota, at the expense of such investment in Alaska, is occurring primarily due to difference in tax structure appear to be problematic. To the contrary, it is clear that the rapid expansion of oil and gas production in North Dakota was initiated by advances in oil recovery techniques.”

* March 11, 2011, report from the non-partisan Legislative Research Services
Under our old system of extremely low taxes (ELF), production declined dramatically at Kuparuk & elsewhere.
In Cook Inlet, production declined 99% from 1970-2013 with 0% production tax.

During this period, the production tax rate for Cook Inlet has been 0%.
Fundamental Question

Are the billions in tax cuts in SB 21 leading to more production now when low taxes failed to achieve this historically?
What the Governor Promised

“Governor Sets Million Barrel Daily Goal for TAPS within Ten Years”

March 30, 2011, Anchorage, Alaska –

“Governor Parnell said that his administration’s proposal to reduce oil taxes to spur investment and create jobs was vital to arresting the oil production decline and achieving the new throughput goal.”
How much oil production is Governor Parnell now projecting?

### Table C-2b: Annual Forecasts of Daily Averaged Crude Oil Production

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<tbody>
<tr>
<td>Prudhoe Bay</td>
<td>230.6</td>
<td>237.9</td>
<td>230.3</td>
<td>220.7</td>
<td>212.1</td>
<td>202.4</td>
<td>192.0</td>
<td>179.3</td>
<td>166.1</td>
<td>153.5</td>
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<tr>
<td>PBU Satellites&lt;sup&gt;(1)&lt;/sup&gt;</td>
<td>45.1</td>
<td>41.9</td>
<td>41.3</td>
<td>38.2</td>
<td>36.8</td>
<td>35.0</td>
<td>31.1</td>
<td>28.0</td>
<td>25.5</td>
<td>23.1</td>
</tr>
<tr>
<td>GPMA&lt;sup&gt;(2)&lt;/sup&gt;</td>
<td>26.5</td>
<td>22.8</td>
<td>21.1</td>
<td>19.4</td>
<td>17.8</td>
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<td>15.4</td>
<td>14.3</td>
<td>13.4</td>
<td>12.5</td>
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<tr>
<td>Kuparuk</td>
<td>83.3</td>
<td>77.0</td>
<td>78.1</td>
<td>79.0</td>
<td>72.7</td>
<td>67.5</td>
<td>62.9</td>
<td>58.4</td>
<td>53.9</td>
<td>48.8</td>
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<tr>
<td>Kuparuk Satellites&lt;sup&gt;(3)&lt;/sup&gt;</td>
<td>24.1</td>
<td>25.3</td>
<td>25.8</td>
<td>24.1</td>
<td>24.6</td>
<td>22.4</td>
<td>20.0</td>
<td>18.1</td>
<td>16.3</td>
<td>14.5</td>
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<tr>
<td>Endicott&lt;sup&gt;(4)&lt;/sup&gt;</td>
<td>11.0</td>
<td>10.4</td>
<td>9.2</td>
<td>8.3</td>
<td>7.6</td>
<td>7.0</td>
<td>5.8</td>
<td>5.0</td>
<td>4.3</td>
<td>3.8</td>
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<tr>
<td>Alpine&lt;sup&gt;(5)&lt;/sup&gt;</td>
<td>56.8</td>
<td>50.6</td>
<td>49.1</td>
<td>54.7</td>
<td>49.7</td>
<td>41.9</td>
<td>35.8</td>
<td>30.4</td>
<td>26.0</td>
<td>22.4</td>
</tr>
<tr>
<td>Offshore&lt;sup&gt;(6)&lt;/sup&gt;</td>
<td>30.8</td>
<td>32.4</td>
<td>31.2</td>
<td>29.6</td>
<td>27.5</td>
<td>24.8</td>
<td>22.4</td>
<td>20.4</td>
<td>18.7</td>
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<td>NPR-A</td>
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<td>2.6</td>
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<td>2.5</td>
<td>4.4</td>
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<td>Point Thomson</td>
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<td>-</td>
<td>1.6</td>
<td>8.7</td>
<td>8.0</td>
<td>7.4</td>
<td>10.8</td>
<td>12.5</td>
<td>11.8</td>
<td>12.7</td>
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<tr>
<td><strong>Total Alaska North Slope</strong></td>
<td>508.2</td>
<td>498.4</td>
<td>487.6</td>
<td>482.7</td>
<td>459.5</td>
<td>429.1</td>
<td>399.6</td>
<td>368.8</td>
<td>340.1</td>
<td>312.9</td>
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<td><strong>Cook Inlet</strong></td>
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<tr>
<td><strong>Total Alaska</strong></td>
<td>521.7</td>
<td>510.0</td>
<td>498.1</td>
<td>492.2</td>
<td>468.3</td>
<td>437.2</td>
<td>407.2</td>
<td>375.9</td>
<td>346.8</td>
<td>319.1</td>
</tr>
</tbody>
</table>
How much revenue is the Governor now projecting?

The Governor in his Revenue Forecast projects a 47% drop in O&G revenue over the next 10 years.

Table 2-4: Ten-Year Forecast of Total Unrestricted General Fund Revenue

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>History</th>
<th>Forecast</th>
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<tbody>
<tr>
<td>Unrestricted Petroleum Revenue</td>
<td>6,352.0</td>
<td>4,359.5</td>
</tr>
<tr>
<td>Unrestricted Non-petroleum Revenue</td>
<td>548.4</td>
<td>484.1</td>
</tr>
<tr>
<td>Unrestricted Investment Revenue</td>
<td>28.1</td>
<td>86.4</td>
</tr>
<tr>
<td>Total Unrestricted Revenue</td>
<td>6,928.5</td>
<td>4,930.0</td>
</tr>
<tr>
<td>Percent from Oil</td>
<td>92%</td>
<td>88%</td>
</tr>
</tbody>
</table>
Conoco: Increased Production Everywhere Else. Except Alaska
Conclusion

ACES led to all-time highs in investment, jobs, oil company profits and number of oil companies doing business in Alaska.

SB 21 will cost billions in lost revenue and is not leading to increased production.
Our Future is at Stake

We deserve a tax system that provides a sound business deal for Alaskans and the oil industry. We should not trade our savings for promises or risk our future for hopes.
What Can You Do

This is our future.
It’s our oil.
Get involved.