

UltraStar Exploration

**Testimony of James D. Weeks
On SB 305
Oil and Gas Production Tax
Alaska State Senate Resources Committee**

01 March, 2006

Mr. Chairman, distinguished members of the Senate Resources Committee. My name is Jim Weeks, and I am here today representing UltraStar Exploration LLC, a very small all Alaskan owned independent explorer, with strategically located leases on the North Slope. UltraStar is based in Anchorage, with offices at 3111 C Street, Suite 500. The Company was formed in 2002 by me, John Winther, and Dale Lindsey, for the primary purpose of exploring and developing leases on the North Slope. UltraStar is 100% owned by Alaskans. I am Managing Member, and moved to Anchorage in 1984 with ARCO, and have had a presence here ever since. Dale, whom most of you know, was born and raised and still lives in Seward. John, whom most of you also know, was born in Fairbanks and raised in Juneau. He currently lives in Petersburg. Thanks for the invitation to testify on this important legislation.

First of all, I'd like to commend the Governor and members of the Administration for addressing this issue, and your Committee for the timely and thorough review it is being given. During the last several days, I've listened to a lot of testimony on the proposal. Some witnesses wanted the Committee to delay decisions on this issue. There should be no delay, nor should there be a rush. This is a very important piece of legislation, and you need to get it right, less it results in unexpected and/or un-desired outcomes. You are doing it right, giving the bill a thorough and fair hearing in a timely fashion.

I will now offer a few specific comments on the bill. You've heard lots of testimony supporting the 20-20 tax and exploration/development incentive split, and the arguments in favor of these provisions have been articulated very thoroughly and clearly, and I certainly cannot embellish on them, so I won't even attempt to. I'll just add UltraStar's strong support for the positions of the existing producers and independents and explorers on these issues.

John Winther testified to the Joint House and Senate Committee hearing last Saturday, echoing UltraStar's support for the 20/20 provisions, and the \$73 million deduction allowance in the bill. Since then, we've learned that the \$73 million allowance, granted to all companies in Alaska regardless of the size of their cash flow streams, may be a difficult pill for you and your colleagues to swallow. Thus, you may want to eliminate it from the bill. I encourage you not to jettison it entirely, but consider an alternative that will provide incentives for exploration and development of smaller fields.

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It's generally agreed that the big Prudhoe Bay and Kuparuk sized fields have been found. The big structures have been drilled, and what remains are 10-100 million barrel accumulations. These are modest by North Slope standards, but can add up to significant amounts of oil and related economic activity. The stock market rewards reserve replacement. The current producers are huge, publicly traded companies that have become so large that their reserve replacement needs cannot be met by chasing small satellites on the North Slope. For instance, ExxonMobil produces 20 million barrels in 10 days. We'd do jumping jacks in downtown Juneau if we found that much oil on our leases.

But smaller accumulations can be attractive to small independents like us, provided the right incentives. Rather than the \$73 million allowance for all companies, I suggest you consider establishing a ceiling above which larger companies would not get the \$73 million allowance, and below which smaller companies would . There is precedent for this in the "Charter for Development", a 1999 agreement between the State, BP and ConocoPhillips that made the combination of ARCO and BP possible. There are many provisions in the Charter, but one of them requires BP and ConocoPhillips to give preferential treatment to small producers, called "qualified producers". The Charter defines qualified producers as those with worldwide assets of less than \$1 billion dollars, and establishes 5000 barrels per day as a maximum amount of crude oil that a qualified producer can produce to receive the preferential treatment. I realize that the provisions of the Charter were developed for a different purpose, but certainly it distinguished between "little guys", and "big guys", and established a maximum production level for which the benefits apply. Whether \$1 billion dollars or 5000 barrels per day are the appropriate ceilings for the PPT is subject to more debate, but such a two-tiered approach will accomplish what I believe you want: to provide incentive for entry by small newcomers without giving an un-deserved windfall to the established players. Please don't throw the baby out with the bathwater by eliminating the \$73 million allowance altogether.

My last issue is pretty specific, but could be significant for small independents. It regards the exclusion of "amounts paid for purposes of indemnification." on line 15 of page 14 of the bill. Small independents like UltraStar will need to indemnify facility owners and operators who will process our oil through their facilities. We will need to purchase real, third party, arms length insurance to satisfy these requirements. We will also need insurance to meet the bonding and financial responsibility requirements of the Departments of Natural Resources and Environmental Conservation, and the Alaska Oil and Gas Conservation Commission. Depending upon the circumstances, membership in an oil spill clean up cooperative may also be required. All these costs can broadly be characterized as costs for the purposes of indemnification, and could arguably be excluded when direct costs are calculated, as defined at line 21 on page 13.

Nearly 15 percent of the cost of the Winstar exploration well at Oliktok Point in 2003 was for insurance premiums, so these indemnification costs can be

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significant for the little guy, and should clearly be deductible to determine direct costs. In his letter transmitting this legislation to this committee, the Governor said that a number of indirect costs are listed in the bill, and are to be excluded from the calculation of direct costs. Indemnification is one of the indirect costs listed. Trust me Mr. Chairman, there was nothing indirect about the \$370,000 check I wrote for the insurance premium on our last well. The money went directly from our bank account into theirs. I urge you to clarify your intent on this issue, and allow real, invoice supported, arms length indemnification costs to be included.

Thanks for the opportunity to testify at this important proceeding.

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