

TESTIMONY OF RICHARD OWEN
ON PROPOSED CSSB305 TO THE SENATE FINANCE COMMITTEE

April 4, 2006

Madam Chair, Members of the Committee:

Good afternoon. My name is Richard Owen, and I am the Production Manager for ExxonMobil in Alaska and Vice President of ExxonMobil Alaska Production.

I am here today to discuss ExxonMobil's concerns with the Committee Substitute to SB 305. Before I go into our specific concerns, I would like to take a few minutes to describe ExxonMobil's history in Alaska, how tax systems impact investments, and our assessment of the remaining resource potential on Alaska's North Slope.

ExxonMobil has had a presence in Alaska for over a half century, investing more than 11 billion dollars in the State's economy. Currently, ExxonMobil has working interests in Prudhoe Bay, Kuparuk, Endicott, and Granite Point. We are the operator of the Point Thomson Unit, and we are the largest interest holder in the Prudhoe Bay field. Our current working interest oil production is approximately 180,000 B/D (*Note: EMWI 159,000 EMNI*), and we are the largest owner of discovered gas resource. We are proud of the role our company has played in Alaska through: exploration; initial field developments; construction of TAPS; development of new technology; and the promotion of efficient reservoir management practices. Today, our production from Alaska represents approximately 4% of ExxonMobil's worldwide oil and gas production.

Our Alaska production is primarily from Prudhoe Bay and near-by satellite fields. Prudhoe Bay, along with Point Thomson, has significant remaining potential, but it comes at higher cost and risk.

One of ExxonMobil's objectives – in both the gas pipeline fiscal contract negotiation and the discussion on oil taxes – has been to reduce the risk associated with fiscal changes by working with the State of Alaska to establish a predictable and durable fiscal environment in which to make long term investment decisions. Changes in the fiscal regime for oil directly impact how we view the stability of the Alaska fiscal environment, which in turn, impacts how we evaluate ongoing investment decisions. Tax systems need to be carefully designed to ensure the desired objective of resource development is achieved. To that end, it is critical to take into account the quality of the remaining resource otherwise a change may result in unintended consequences, such as reduced investments and lower reserve recovery.

When I say quality of resource, I mean: the size and nature of the oil and gas reservoirs; the cost and technology required to develop those reservoirs; the distance to market; as well as the tax and royalty system that applies including the long-term stability of that system. Countries experiencing significant industry investment have achieved the proper balance in their fiscal regimes. ExxonMobil's assessment of the remaining oil resource suggests future growth opportunities will come from: complex enhanced oil recovery (EOR) projects; development of smaller, more marginal oil accumulations; and the innovative development of viscous and heavy oil resources. These opportunities will require the development and application of new technology, higher unit development

costs, and more complex operations to deliver a given production rate. These resources are much lower in quality as compared to Prudhoe Bay and Kuparuk, though they face the similar challenges associated with arctic conditions and distance to market.

Therefore, we are concerned the Administration's original proposal is weighted towards a higher tax which could prevent some of Alaska's challenged resources from being developed. The Committee Substitute contains even higher tax rates, which may prevent more of these challenged resources from being developed.

On February 28, I testified before the Senate Resources Committee about our key concerns with SB 305 as originally proposed. On March 18, I testified again before the Senate Resources Committee about how the proposed changes incorporated in the Committee Substitute bill exacerbate our concerns. I do not intend to cover all of my previous testimony, but I will provide comments on these areas: the increase of the base tax rate and addition of a progressive tax rate component; the Committee Substitute's transition provisions; and the elimination of royalty settlement agreements as a determination of market value.

SB 305, as originally proposed, would represent a significant tax increase on the industry. And as I just outlined, we are concerned the higher tax rate could prevent some of Alaska's remaining challenged resources from being developed. The Committee Substitute bill increases the already high base tax rate to 25% and then further increases it as oil prices increase.

Higher tax rates discourage investment. Companies are willing to accept the risks of long-term, capital intensive investments when there is a corresponding opportunity for upside potential through a variety of factors, such as increased production or higher prices. When you limit or reduce the benefit Companies can achieve from the upside factors, you reduce the attractiveness of those investment opportunities. The proposal to increase the already high base tax rate and then further increase it as oil prices increase, reduces or limits the upside potential which will result in Companies recalibrating investment decisions. Reduced investment will result in reduced resource recovery, diminished state revenues, and fewer employment opportunities, with a resultant negative impact on the state's economy. Again, let me reemphasize this point. While higher taxes may bring in additional revenues in the short-term, any reduction in investment and subsequent production will significantly impact those revenues in the longer term. We think the focus of the tax bill should be encouraging investment and growing production, which is not accomplished with the higher tax rate and increasing the tax rate with oil price.

I would now like to discuss the Committee Substitute's transition provisions. The benefits from a typical oil and gas investment take many years to be realized. Satellite and tertiary recovery investment decisions by our Company during the last five years were made under the ELF structure, anticipating a lower tax relative to that proposed under the PPT bill. The State appropriately provided this incentive so these challenged and costly projects could be commercially viable. SB 305, as originally proposed, recognized it is not appropriate to suddenly increase taxes on these prior investments without providing some form of consideration. The Senate Resources Committee

included transition provisions in the Committee Substitute bill, but proposed a deduction based on recent investments with the pace of the deductions linked to future spending. As I stated, the purpose of the transition provision is to address the sudden increase in taxes on recent historical investments. Future investment decisions will be made under the new tax system based on the balance between the new tax rate and the credit rate. For this reason, we think the Administration's proposal of providing a deduction based on recent investments, not linked to future spending, is more appropriate.

Finally, I would like to express our disappointment that the provision allowing the use of a producer's royalty settlement agreement to determine the value of oil and gas has been removed from the Committee Substitute bill. That provision addressed a longstanding issue that has divided the State and the industry over the years. Too many years and too much money have been spent in disputes over how to value a single barrel of crude oil or a single molecule of gas. It made little sense in the past and it makes little sense today for the State to have separate divisions determining the value of oil and gas – one for royalty and one for taxes. There is only one value in the market place. SB 305, as originally proposed, allowed the State to value a producer's oil and gas using the producer's royalty settlement agreement, which was negotiated with, and approved by, the Department of Natural Resources. That provision was important to industry as it provided certainty to a producer on the value on which to pay its royalty and production taxes while reducing the administrative and audit costs to both the State and the industry. We urge this committee to reinstate that provision.

In summary, the quality of the resources, the risks undertaken by a producer, and the impact on the State's overall investment climate must be factored into the design of the tax system. While industry needs predictably and durability under which to gauge investment decisions, the attractiveness of that predictably and durability is lost if it comes at too high a cost.

Despite our concerns with the original SB 305, we are prepared to move forward under that system as originally proposed, since it sought to provide a balance of revenues to the state and producers across a range of oil prices, provided sufficient incentive for producers to undertake exploration and development risks, and included reasonable transition provisions for past investments. And, most importantly for ExxonMobil, oil fiscal contract terms consistent with the Administration's proposal would provide the predictability and durability necessary to advance the gas project to the next phase. Potential changes to the Administration's PPT bill should be carefully considered to avoid upsetting the balance contained in the bill – changes would require a reexamination to ensure the underlying health and stability of the oil business is sufficient for a gas pipeline project.

As I mentioned, the proposed Committee substitute exacerbates our key concerns regarding both tax rates and certainty. For these reasons and the need to move ahead with the review of the Gas Pipeline Fiscal Contract, we urge this Committee to support SB 305 as originally proposed.

Thank you again Madam Chair for the opportunity to testify today.