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FACT & FANTASY

“Point/Counterpoint” Response to French/Gara Rig Manifesto

A picture may be worth a thousand words, as State Sen. Hollis French & Rep. Les Gara proclaimed in their news release and press conference regarding a pair of new drilling rigs headed for the North Slope, but the slightest amount of fact checking also would have alleviated the need for several hundred words of ranting and misrepresentation that characterized their outburst.

The two hailed a photo of two new North Slope rigs taken recently in Portland as evidence that ACES is working and used it to defend their indefensible claim that ACES is good for Alaska and attack the governor’s proposal to reform it in order to attract new investments.

It was typical of the don’t-worry-be-happy drivel that’s cost Alaska billions in oil industry investments and driven oil production down to less than one-third what it was at its peak.

CLAIM: “A picture is worth a thousand words. The governor is acting like the sky is falling, but these two rigs tell a very different story.”

TRUTH: BP signed the contract for two new rigs with Parker Drilling in 2007, long before ACES was adopted or even conceived. As part of the renewal project, they will replace two older rigs, not add to the number of active rigs.

While oil-producing states like Texas and North Dakota have hundreds of rigs active, there are currently seven active rotary rigs on the North Slope. Seven. Dozens more are stacked and out of service. Within two years of ACES’ adoption, drilled footage in mature fields on the North Slope had dropped by half.

CLAIM: “ConocoPhillips is making \$5 million in profits every day in Alaska, in a quarter when their global profits fell. Alaska is a cash cow for them.”

TRUTH: Really? Then why isn’t ConocoPhillips doing more to feed the cow? The company’s capital spending in the Lower 48 has nearly doubled this year because of strong oil prices, but it’s remained flat in Alaska. Once the crown jewel of the company’s global oil production portfolio, Alaska now attracts less than a quarter of its capital spending just for the U.S. For the first time in the past 45 years, ConocoPhillips has drilled no new exploratory wells on the North Slope the last two winters.

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Maybe it's because after risking tens of billions of dollars in Alaska in the past, ConocoPhillips' reward under ACES is to pay \$2 in state taxes and royalties for every \$1 it reaps in profits. During the second quarter, \$490 million in profits from its Alaskan activities were dwarfed by \$1.1 billion in tax and royalty payments to the state.

CLAIM: "For a small operator looking to get a sweet return on a moderate-sized pot of money, Alaska is like the El Dorado of oil and gas." (stock analyst Chris Mayer, quoted in French-Gara news release)

TRUTH: It's absolutely true that Alaska's tax and royalty structure is skewed to favor and even subsidize small explorers and developers (as long as they don't have the good fortune and temerity to become successful, in which case the state will tax them to their knees). But what's it yielded so far? Not a single molecule of new oil in the pipeline, not a single new molecule currently under development resulting from ACES and the lowest level of exploration resulting from ACES on the North Slope in decades. Where's the beef?

Leading international oil and gas research organizations give Alaska low marks for competitiveness and fiscal stability. Wood Mackenzie ranked Alaska #129 among 141 oil & gas regions worldwide in terms of fiscal stability. Fraser Institute found that Alaska's reputation among oil and gas executives as an attractive place for upstream investments ranked behind only California, New York and Florida among U.S. states. We also trailed nearly every Canadian province, and now rub shoulders with places like Peru, Turkey, Angola, Syria and Vietnam.

Alaska used to be the #1 state in oil production. Now we're a distant second to Texas, and if current trends continue, we'll be third behind California in the next few years. North Dakota is projected to surpass Alaska in less than 10 years, which would drop us to #4.

That may make us El Dorado to some, but at the rate we're sinking under ACES, we're starting to look a lot more like Atlantis.

CLAIM: "In addition to oil rigs heading north, companies that have announced or started work on the North Slope in the last year – without any additional tax breaks – include:

- *Spanish oil giant Repsol committed to spend \$768 million in new exploration over the next three years;*
- *Great Bear Petroleum announced plans for oil fracking development;*
- *Norway's Statoil opened offices in Anchorage last month;*

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- *Brooks Range Petroleum announced it will begin new development in Alaska;*
- *ConocoPhillips is still working to develop NPRA under current tax laws, which have only been delayed by a federal Army Corps of Engineers' decision most expect to be reversed."*

TRUTH:

- The company that forged the exploration venture with Repsol, Armstrong Oil & Gas, testified during the recent legislative debate on ACES that ACES reform would result in significant new development.
- Great Bear testified that the state's current fiscal terms are suppressing development and said ACES reform would help it to attract investment capital.
- Statoil's focus is on federal offshore leases from which production would not be subject to ACES.
- Brooks Range drilled the only two exploratory oil wells on the North Slope the past two winters. Legislative testimony by Ken Thompson, managing partner of Brooks Range's parent company: "If I were to rank the #1 reason (prospective partners) said no, it's the Alaska fiscal regime and the taxation is simply too high and complicated. Several have elected to put their money into North Dakota ... where there's a much more favorable severance tax rate." Brooks Range also testified that ACES is resulting in fewer and smaller developments.
- ConocoPhillips' efforts to develop CD5 in NPRA began more than a decade ago, long before ACES was enacted, and the company still has not secured necessary federal permits.

Exploration is vital to the long-term health and sustainability of Alaska's oil and gas industry. But it won't put new oil into the pipeline for another five or 10 years. Furthermore, exploration is no guarantee of development and new production ... it just means a company is willing to risk millions to *look* for new oil.

With the pipeline already experiencing technical problems due to low and ever-declining throughput – problems that will only grow worse with time – Alaska needs more oil NOW.

The only possible source of new oil in the short to medium terms is legacy fields like Prudhoe Bay and Kuparuk, and with the confiscatory taxation policies embraced by French and Gaara, that isn't happening. Not only is capital spending on the North Slope flat, but a disproportionate share is going toward maintenance work that produces no new oil.

Why *would* a major producer want to invest here? At current oil prices, taxes and royalties (state, federal and local) consume close to 90 cents out of every \$1 in profits. Would *you* invest here on those terms?

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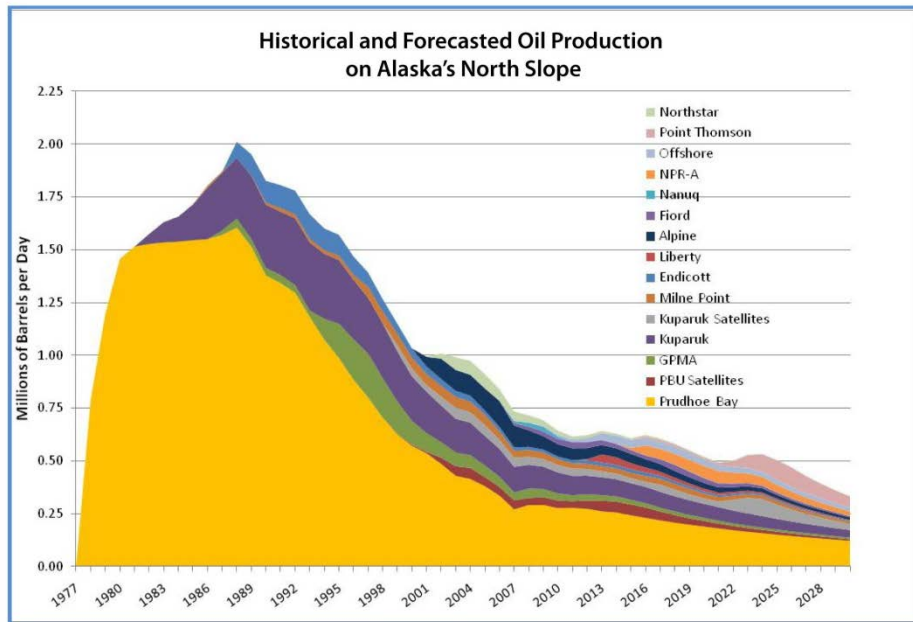


It's no coincidence that production is steady or growing in every other major oil-producing state while it continues to decline in Alaska.

CLAIM: "Our motto is going to be: 'No (tax) reduction without more production. Representative Gara and I are looking for ways to actually stimulate more Alaska investment."

TRUTH: If French and Gara are really serious about stimulating investment, they might try listening to the companies that would do the investing and change their motto to: "No more production without a (tax) reduction." Because that's what the evidence shows about the impacts of ACES: fewer jobs and business opportunities for Alaskans, steadily declining production and an uncertain future.

If the senator and representative want to see a picture that's really worth a thousand words ... and tens of billions of dollars ... and the economic future of our state, they might look at this one:



Source: Alaska Department of Revenue

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Here are some real facts for French and Gara to consider:

- North Slope oil production is less than a third what it was at its peak in the late '80s, and it continues to decline 6-7% (35,000-40,000 barrels a day) every year. That means we need four new fields every single year, each producing 10,000 barrels of oil per day, just to sustain production at its current historically low level.
- The pipeline is already experiencing problems with wax build-up and freezing due to low throughput at the current rate of about 600,000 barrels a day. Those problems will become more frequent and serious as throughput approaches 500,000 barrels a day over the next several years.
- Only new production from existing fields like Prudhoe can sustain production over the next several years.
- That can only happen with billions in new investments – investments that aren't happening because ACES has made Alaska a less attractive place to invest than the alternatives.

It's time they get *that* picture in focus.

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