

Addendum 2 to “Policy Options for Alaska Oil and Gas”

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Presentation

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COMMENTS ON DOR PRESENTATION OF FEBARY 13, 2012

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Re-investment by major oil companies

Slide 13 of the DOR presentation indicates that major oil companies reinvested \$ 1544 million in 2010 in capital expenditures. Comments:

- This is about \$ 8 per barrel produced
- DOR includes capital maintenance expenditures and work overs in these capital expenditures
- It is likely that about \$ 4 per barrel relates to these type of expenditures. These are non-discretionary. They have to be done to continue operations normally
- It seems that the remaining \$ 4 per barrel is largely infill drilling with the goal of accelerating cash flow
- This \$ 4 per barrel is about \$ 1 on an after tax basis.
- **It is therefore clear that the three major companies are “harvesting” at the maximum rate. During the last 5 years there was “near zero” interest in investments in new projects.**

Investor impact of high marginal rates related to higher prices

There may be some confusion as to the impact on investors of high marginal rates related to higher prices.

There is no direct impact of marginal rates on investment. Investments decisions are being made on the basis of the total average incremental NPV and IRR, not the marginal NPV or IRR.

For instance, Pakistan has in their production sharing contracts a price cap of \$ 100. Over \$ 100 all higher revenues go to government. So the marginal rate is 100%. Yet, investments are taking place because the take below \$ 100 is relatively modest and therefore the NPV and IRR are acceptable.

Investor impact of high marginal rates related to higher prices

There are two important impacts of very strong price progressivity:

- Strong price progressivity means that the average rates increase to higher levels under higher prices. In the case of Alaska this means that that Alaska will rapidly become less attractive than some of the main competitors with regressive systems, such as the Lower 48, Australia, Russia and Brazil.
- New investors, will look negatively on very strong price progressivity because it removes the “upside” of the possible outcome of investments. **This is a strong impediment for new investment.** Even if price progressivity is less strong for new production, new investors will still evaluate how current producers are being treated by Alaska since this is an indication of the fiscal policy of the jurisdiction.

For these reasons one would not recommend price progressivity that is too strong.

Fiscal design criteria for Alaska

From an international perspective a number of design criteria can be recommended in order to optimize fiscal terms for Alaska:

- **Price progressivity** should not be so strong that the price incentive index drops below \$ 0.10. For ACES this level is reached at a price of about \$ 190 per barrel
- **Cost progressivity** based on average blended costs should not be so strong that the cost savings index drops below \$ 0.20. For ACES this level is reached at a price of about \$ 180 per barrel (assuming \$ 25 per barrel costs)
- **Government take** should not be uncompetitive: For Alaska it should not be higher than 75%. For ACES this is reached at a price level of about \$ 90 per barrel.

Fiscal design criteria for Alaska

(continued):

- **Exploration support:** Government should not contribute more than 80% of the exploration costs through tax credits and tax deductions. For ACES this level is reached at \$ 60 per barrel.
- **Negative PPT:** Whenever tax credits or uplifts are being provided the tax income on a consolidated basis could become negative. Sensitivity analysis should be done to ensure that negative PPT only occurs under unlikely conditions. ACES is deficient under certain high cost – low price conditions.