ALASKA STATE LEGISLATURE

REPRESENTATIVE LES GARA

December 8, 2014

Mark Myers
Commissioner of Natural Resources

Marty Rutherford
Deputy Commissioner, Dept. of Natural Resources

Bill Barron
Director, Division of Oil and Gas

Revised Public Comment Seeking Dismissal And Timely New Analysis of Proposed Nuna Royalty Reduction

Dear Commissioner Myers, Deputy Commissioner Rutherford, and Director Barron:

I am writing with a more comprehensive comment on the proposed multi-million dollar reduction in royalties the prior administration has recommended on Nuna, an oil field that already enjoys exceptionally generous tax breaks, and a potentially unprecedented generous tax deduction system. In the end Alaskans deserve a fresh analysis to make sure we are not giving money away that, under Alaska law, is not prudent, or needed to produce oil from a lease the current owner purchased with no promises it would receive any royalty reduction. The current Administration should take the time it needs to make a proper determination.

<u>Nuna Will Already Produce a Negative or Near Zero Net Present Value for Alaskans in Production Taxes Under SB 21</u>

A fair, fresh analysis is needed for a few reasons which have been lost during the SB 21 debates.

Under SB 21, Nuna, like all oilfield "units" formed after 2002, receives such favorable tax reduction treatment that it will pay a tax rate so low that Scott Goldsmith concedes it produces a *<u>Negative or Near Zero Net Present Value for Alaskans</u>*. Attached is the Scott Goldsmith Net Present Value analysis, issued during the Ballot Measure One campaign this summer, and financed by SB 21 proponents.

That analysis concedes this field, which is technically considered a "Gross Value Reduction" field under the terms of SB 21, pays roughly 40-50% less in Production Taxes than fields like Kuparuk and other pre-2003 units. After the state pays Nuna's developer, Caelus, what will likely be tens of millions of dollars in up front exploration and development tax subsidies ("credits"), and after state

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revenue after development is reduced further through an especially high "tax deduction" formula, Goldsmith estimates the field will produce either a negative or near zero net present value for Alaskans.

SB 21's Exceptionally "Generous" Deduction Rules Further Reduce State Revenue From Nuna

The field, like all SB 21 fields, also benefits from an arguably unjustified, exceptionally generous tax deduction rule. It's a costly one most Americans, and most businesses do not enjoy. This will result in major Alaska revenue reductions for Alaskans, at a time of major budget deficits, from the Nuna and larger, producing, Ooogaruk fields.

Most Americans and companies receive a deduction for expenses that equals their tax rate. The Nuna field will get, under a special SB 21 provision, a 35% deduction from the state revenue they pay for their expenses, no matter how far below 35% their tax rate is. Under SB 21 the actual tax rate is far less than 35%. It would only hypothetically reach 35% at unprecedented prices of roughly $160/bbl. The tax rate is fully price dependent, not dependent on development activity, and is far lower than 35%.

Goldsmith estimates that at $110/bbl the effective rate is in the 20-25% range. At current prices it is likely below 15%. But Nuna will receive both tens of millions of dollars from the state in tax credits during the exploration and development stage that began under ACES in 2011, and a 35% deduction from any production tax payments to the state no matter how low the tax rate on this field. The only time this deduction disappears is when the tax rate becomes so low the 4% tax floor comes into effect.

Given these benefits, the state is likely not to break even, in inflation adjusted dollars, for many years, and possibly more than a decade, under the current proposal. That is, it may be a decade or more before the state receives revenue in inflation-adjusted dollars, to offset what the state has paid the owners of this lease in the up-front years.

Likely Overstated SB 21 Revenue Numbers By Parnell Administration and SB 21 Proponents

It is my belief that during the SB 21 debates (from listening to the consultants and officials the Parnell Administration used to present the bill and analyzing their testimony and presentations), that the information presented to legislators provided an unjustifiably slanted analysis of SB 21 and its comparison to the law it replaced, both in terms of anticipated revenue and production.

Curiously, in the fall of 2013, after the bill passed, and the SB 21 referendum was approaching, those numbers from the Department of Revenue changed vastly in what some believed to be an effort to defeat Ballot Measure One. I would hope the new Administration assesses this application under production cost numbers that are confirmed as accurate.

As you know royalty reductions are allowed on fields only if a company proves with "clear and convincing" evidence that the reduction is needed to make a field "economic" to produce.

A departing Governor should not set in motion a proposal decreasing the revenue we receive for our oil by potentially tens of millions of dollars, or more, in his last two weeks of office. I hope you will take the time needed for a fair review of this application, even if it requires the proposed royalty reduction to be rejected for lack of "clear and convincing evidence" as the new Administration engages in a timely, fresh analysis of this issue.

The October 28, 2014, proposal was reported to the general public on November 14, 2014 in the Alaska Dispatch, but thankfully the 30-day public comment period was extended past the tenure of the Parnell Administration because the original public notice was, as the Department concedes, deficient. http://www.adn.com/article/20141114/caelus-energy-slated-get-north-slope-royalty-reductions

Thank you for your consideration.

Sincerely,

Rep. Les Gara