MINUTES
SENATE FINANCE COMMITTEE
April 5, 2006
9:06 a.m.

CALL TO ORDER

Co-Chair Lyda Green convened the meeting at approximately 9:06:26 AM.

PRESENT

Senator Lyda Green, Co-Chair
Senator Gary Wilken, Co-Chair
Senator Con Bunde, Vice Chair
Senator Fred Dyson
Senator Bert Stedman
Senator Lyman Hoffman
Senator Donny Olson

Also Attending: JIM BOWLES, President, ConocoPhillips Alaska; DAVID BRAMLEY, Vice President, Charles River Associates International, Consultants to ConocoPhillips; MARIANNE KAH, Chief Economist, ConocoPhillips; AUDREY SEGAL, Elementary School Student, Camino Island, Washington

Attending via Teleconference: There were no teleconference participants.

SUMMARY INFORMATION

SB 305-OIL AND GAS PRODUCTION TAX

The Committee heard a presentation from ConocoPhillips Alaska and their consultant, Charles River Associated International. The bill was held in Committee.

Co-Chair Green introduced AUDREY SEGAL, a fifth grade student from Camino Island, Washington who was making a video about how legislatures conduct business, for a school project.

#sb305

CS FOR SENATE BILL NO. 305(RES)

"An Act providing for a production tax on oil and gas; repealing the oil and gas production (severance) tax; relating to the calculation of the gross value at the point of production of oil or gas and to the determination of the value of oil and gas for purposes of the production tax on oil and gas; providing for tax credits against the tax for certain expenditures and losses; relating to the relationship of the production tax on oil and gas to other taxes, to the dates those tax payments and surcharges are due, to interest on overpayments of the tax, and to the treatment of the tax in a producer's settlement with the royalty owners; relating to flared gas, and to oil and gas used in the operation of a lease or property under the production tax; relating to the prevailing value of oil or gas under the production tax; relating to surcharges on oil; relating to statements or other information required to be filed with or furnished to the Department of Revenue, to the penalty for failure to file certain reports for the tax, to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue as applicable to the administration of the tax; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the tax, and to the deposit of tax money collected by the Department of Revenue; amending the definitions of 'gas,' 'oil,' and certain other terms for purposes of the production tax, and as the definition of the term 'gas' applies in the Alaska Stranded Gas Development Act, and adding further definitions; making conforming amendments; and providing for an effective date."

This was the fifth hearing for this bill in the Senate Finance Committee.

JIM BOWLES, President, ConocoPhillips Alaska, introduced Marianne Kah, Chief Economist, ConocoPhillips/Houston who specialized in global economics and David Bramly with Charles River Associates (CRA) International, a consulting firm to ConocoPhillips which specializing in international oil and gas fiscal issues.

Mr. Bowles acknowledged the challenges facing the Legislature in its endeavor to revise the State's oil and gas fiscal policy.

The complexity of the issue has also been difficult for the industry "to take on".

Mr. Bowles stated that after attending several Legislative hearings on this issue, the company had gained a better understanding of the information required of them to answer Legislators questions and to provide further insight on the issue. Therefore, today's presentation would concentrate on how ConocoPhillips conducted its business and made its investment decisions. The intent would be for these "tools" to assist Legislators in the crafting of this petroleum production tax (PPT).

Mr. Bowles advised against Legislators taking the philosophy of increasing oil taxes to a point just short of "crippling the industry and then backing off just a little bit from that point". This would be likened to "not wanting to kill the golden goose but we'll take him as close to death as possible and then revive him". This presentation would include "a continuum on this. That as the golden goose gets weaker, investment and associated volumes respond accordingly".

Mr. Bowles also addressed the philosophical position that the State's tax rate should increase due to the recent high profits the oil industry has experienced by stating that the oil business is "a very very capital intensive business. During good times, we collect money and we have it ready to reinvest during bad times". Today's presentation would attest that the industry continued to make significant investments in the State during the good times.

Mr. Bowles addressed the question of what would be the appropriate percentage split of revenues, or "take", between the State, the federal government, and the industry. The notion of splitting the take into thirds "really has no basis in any type of international competitive market". This presentation would provide further insight to "how Alaska could be considered and looked at with respect to world markets". Such information could be utilized in the development of "a proper" tax structure.

9:11:32 AM

SB 305 (CS) Testimony
ConocoPhillips Alaska
April 5, 2006

[Note: The pages in this document are not numbered. For reference purposes, the Senate Finance Committee Secretary made a notation on each page of the corresponding timestamp in which that page was addressed in the hearing. General descriptive information of each page is provided in the body of these minutes when feasible. A copy of the handout can be obtained by contacting the Legislative Research Library at (907)465-3808.]

9:11:18 AM

[Note: The PPT bill introduced by Governor Frank Murkowski is SB 305. The version of the PPT bill being considered in the House of Representatives is CSHB 488(RES). The PPT bill being considered in the Senate is CSSB 305(RES). The House bill is referred to as CSHB 488 and the Senate bill is referred to as CSSB 305 in these minutes.]

Mr. Bowles referred the Committee to the "Projected Production Tax Revenues" graph in the presentation [copy on file]. The vertical scale represented "State Take (nominal 20-year sum)" in billions of dollars. The horizontal scale depicted the revenues the State would receive under the current production tax regime, the Economic Limit Factor (ELF) as compared to the revenues anticipated from SB 305, CSSB 305 and CSHB 488, as affected by a $40 and $60 Alaska North Slope (ANS) prices per barrel of oil.

Mr. Bowles explained that at $40 per barrel, ELF would generate approximately one billion dollars annually or a 20 year total of approximately $20 billion. SB 305 would essentially double the taxes currently paid to the State by the industry. While acceptance of this increase was difficult for the industry, it was made easier by the fact that the industry recognized, as did the Legislature, that "it was time to change" the ELF system. As a result, industry was "willing to support" the provisions in SB 305.

Mr. Bowles continued that at $60 per barrel, CSHB 488 would "effectively triple" the tax rate under ELF. CSSB 305 could, at current oil prices, quadruple the "total State Take in dollars from industry". Today's testimony would contend "that taking that amount of dollars from industry has to have some affect on our capacity to reinvest".

9:13:24 AM

Prudhoe Gross Capital Spend vs Severance Tax Rate

Mr. Bowles stated that this graph would depict the "Prudhoe Bay gross capital dollars spend over a five year period" from 2001 through 2006 as affected by ELF and the proposed severance tax rates. Even though there has been some production decline, the severance tax take percentage depicted by the blue line on the graph indicated that during this time period had remained fairly steady, ranging from ten to 12 percent. The increase reflected in 2006 indicated "the aggregation that occurred last year when the satellite fields were aggregated at Prudhoe Bay". The red line on the graph would indicate that ConocoPhillips had invested approximately $400 million dollars annually during this timeframe. Separate testimony had indicated that the overall annual industry investment on the North Slope was approximately one to 1.5 billion dollars. Investment in Prudhoe Bay would account for approximately one third of the total industry North Slope capital investment. Even with rising oil prices, this investment had been steady.

[NOTE: The labels of the graph lines on this chart had been inadvertently reversed. See Time Stamp 10:25:13 AM for further clarification].

9:15:02 AM

Kuparuk Gross Capital Spend vs. Severance Tax Rate

Mr. Bowles reviewed the industry's capital investment at the Kuparuk field during 2001 and 2006 as compared to that field's Severance Tax rate. The severance tax rate, depicted by the red line, showed the declining severance tax rate under the provisions of ELF. In 2001 the tax rate was approximately six percent, and in 2006 the rate was approximately zero. When comparing capital investments in Kuparuk to those in Prudhoe Bay, the record would indicate that as the tax rate decreased, investment increased. The size of the 2006 investment in Kuparuk was approximately equal to the investment at Prudhoe Bay, even though the Kuparuk field was approximately "2.5 times smaller in production capacity". The conclusion was that the activity occurring in Kuparuk was directly driven by the severance tax structure.

[NOTE: The labels of the graph lines on this chart were inadvertently reversed. See Time Stamp 10:25:13 AM for further clarification].

Mr. Bowles surmised that CSSB 305 "probably puts that effective severance tax rate anywhere between 16 and 22 percent … going forward". Consideration should be given to how a tax rate of 16 to 22 percent might affect a field that had been experiencing essentially a zero percent tax rate. "One would have to assume that there's going to be a direct correlation to what we see in that investment…"

9:16:57 AM

Senator Hoffman asked whether the numbers being presented were limited to ConocoPhillips' activity in these fields.

Mr. Bowles clarified that the capital investments being discussed "have been grossed up to reflect total field dollars spent".

Senator Hoffman understood therefore that the information reflected the total investment made by the major oil producers operating on the North Slope.

Mr. Bowles affirmed. The Prudhoe Bay and Kuparuk field investments would reflect total gross dollars spent. The investments made at these two fields would amount to $800 million or approximately two-thirds of the investments occurring today. This trend would be expected to continue in the near to mid term future.

9:17:46 AM

Senator Bunde asked regarding ConocoPhillips' calculations that the PPT would result in a severance tax rate of approximately 16 to 22 percent, as he understood the net tax under SB 305's 20 percent tax and 20 percent credit (20/20) PPT proposal would be approximately nine percent and approximately 12 percent under the 25/20 tax proposal in CSSB 305. Thus, his question was whether this calculation methodology matched that utilized by ConocoPhillips.

Mr. Bowles advised that the numbers could not be directly compared. The methodology utilized by ConocoPhillips indicated

that the provisions of SB 305 would result in an approximate 15 percent severance tax. The House and Senate committee substitutes would increase the tax beyond that.

Senator Bunde asked whether the 15 percent tax rate would be "a net tax after credits".

Mr. Bowles, affirming it would be, explained that the effort undertaken in the North Slope and Prudhoe Bay graphs "was to convert this into an apple to apple comparison" by presenting the numbers in terms of the present ELF tax system "which is really just a tax on gross revenues". The 16 to 22 percent tax rate estimation would be the result of the numbers under the provisions of SB 305 being adjusted to "an equivalent percent of gross revenue.

9:19:20 AM

Senator Stedman understood that the numbers in the PPT bill would "flux" as the bill developed; however, according to State calculations, a 15 percent severance tax under the 20/20 provisions of SB 305 would require a per barrel price of approximately $80; a $50 per barrel oil price would result in an approximate 12 percent severance tax rate. Tax rates would fluctuate as oil prices increased and decreased.

9:20:09 AM

Senator Stedman recalled that, in terms of industry aggregate numbers as opposed to individual company's numbers, the 2005 net to producers, at an average per barrel oil price of $43, was estimated to be approximately $4.7 billion. This was a "historically high" amount. Recent estimates, based on average oil price of $58.70 per barrel, would be that producers would net approximately $6.5 billion in 2006.

Senator Stedman asked whether "large net income gains" might influence the industry's capital decisions. In other words, would industry opt to make capital investments rather than to pay the federal government a significant amount of money. This issue has not been addressed.

9:21:20 AM

Mr. Bowles responded that ConocoPhillips, with "one of the most aggressive capital reinvestment programs" of any of the major producers, was dedicated to that effort and was undertaking numerous "significant projects" worldwide. The majority of ConocoPhillips' "allocation of profits now goes back into reinvestment, and to … established dividends", and retiring debt, which at the end of 2005, amounted to approximately $13 billion.

Mr. Bowles communicated that "during bad times we take on more debt" and during "good times", the effort was to reduce that debt. The goal was to keep the company "steady" through both good and bad times.

9:22:15 AM

Senator Stedman declared that efforts must be made to further clarify the information, as research conducted by Econ One Research, Inc., the economic research and consulting firm hired by the Legislature, indicated that "the costs statewide" were approximately $2.4 billion in 2005 and $2.3 billion in 2006. Econ One must assist in clarifying whether these capital investments were being compared in "an apple to apple" scenarios.

Mr. Bowles concluded his remarks.

9:23:02 AM

CRA International
Review of Alaskan Fiscal Proposals
April 5, 2006

DAVID BRAMLEY, Vice President, Charles River Associates (CRA) International, consultant firm to ConocoPhillips, explained that CRA was "a global firm specializing in business consultancy and economics". It served as oil and gas consultants to private and national companies as well as governments. He experience included working in the exploration and production (E&P) division of Shell International and as a petroleum economist, business planner and E&P consultant to oil companies and governments in more than 30 countries. "Understanding the applications of E&P fiscal systems and their business implications is fundamental" to his job.

Page 1

Overview of CRA Approach

Will the proposed changes in Alaska's fiscal system support new investment?

- Comparable group of mature OECD producers
- Economic potential
  * Maturity/Prospectivity
  * Cost base
- Fiscal Terms: Total Government Take

Mr. Bramley communicated that CRA had been retained by ConocoPhillips to analyze the State's PPT proposals. The analysis included comparing the PPT to "the fiscal environment of other" mature and significant oil and gas producing Organization for Economic Cooperation and Development regions (OECD). He acknowledged the "difficult tradeoff" the State was undertaking in deciding "between balancing the imperatively short-term revenues with those of incentivizing investment to arrest future production decline".

Mr. Bramley assured the Committee that CRA "did not approach" this fiscal analysis with the viewpoint "that lower taxes are an inherently good thing". Instead, "a comparable group of international of oil and gas areas", the OECDs, were identified and their fiscal systems compared "in the context of their underlying economic potential and current levels of investment. Through these comparisons we've sought to illustrate how well Alaska's existing fiscal system is aligned to the economic realities of the region and to infer what would be the consequences for investment of the proposed changes." CRA drew upon its experience "to generate working assumptions that we believe reflect the techno-economic realities of each of the comparison areas and applied methodologies". This would assist in projecting how investors "will assess the impact of fiscal terms in their investment decision making".

Mr. Bramley identified the question CRA strove to answer as being whether "the proposed changes to Alaska's fiscal system support new investment". The majority of the effort to answer this question was based on comparing the State's existing ELF tax system to the terms of SB 305, CSHB 488 and CSSB 305. He

would identify areas in which provisions in CSSB 305 would affect the analyses.

Mr. Bramley stated that the answer to the primary question was largely based on how the fiscal changes would affect investor decision making. Both large and small oil and gas industry investors operating in Alaska make their capital allocations decisions "in the context of a larger portfolio of choices about where to invest". There was "a huge range of competing options in different parts of the world and different parts of the oil and gas value chain". Like other sectors of today's economy, capital mobility levels in the oil and gas business "are very high".

Mr. Bramley declared that the OECD producers utilized in this comparison were appropriate. While these producers were comparable they were also different. "The underlying economic potential of each of them" was presented in terms of "relative maturity and remaining prospectivity on the cost base for accessing available opportunities in each area". Another comparison utilized was that of "the overall Total Government Take of the net cash flow from investing in a typical new opportunity in each area". This analysis was the "most fundamental" influence in the effort to attract investors. All applicable taxes including State and federal taxes were included. The end result of all of these factors provided "an effective high level view of the impact on investment of the current and proposed Alaska fiscal term".

9:28:09 AM

Mr. Bramley stated that the approach taken by CRA was different from other analyses in several fundamental respects. Further information on these differences and how they affected the conclusions of this report would be identified during the presentation.

Page 2

Comparing Alaska's fiscal proposals to other mature OECD producing areas is the basis for a realistic appraisal of their impact on investment

OECD Oil & Gas Peer Group	Common Investment Characteristics

Alaska Australia NW Shelf Canada Oil Sands Norway UK North Sea US GoM Deep Water US GoM Shallow Water	Similar strategic roles in overall investment portfolios *Large, established oil and gas producers *Similar political and business risks High level of comparability *Remaining potential and Costs are comparable from public data *Similar fiscal structures

Investor Capital Allocation Decisions

Mr. Bramley stated that in order to make "meaningful comparisons of investment attractiveness of the whole of the diverse range of options available to investors" was complicated by different corporate business strategies and different levels of risk and rewards attached to those opportunities. Instead of generalizing, the decision was made to focus on the comparisons and the E&D activities of a select group of "developed world economies". The investments made by this OECD group tended to have similar strategic roles in overall investment portfolios; they could "substitute for each other in terms of investor decisions" as they were all "large oil and gas provinces of global significant" with long production histories, existing infrastructure; stable commercial regulatory mechanisms, and had significant remaining reserves despite their maturity level. They each had "free competitive access" and were absent of barriers to capital investment. They also had similar levels of political, legal and commercial risks. Overall they were a group of investments with similar ranges of risk and reward.

Mr. Bramley also identified another commonality as being that "one could readily distinguish and characterize investment opportunities" in each area because they had similar fiscal structure: a royalty tax structure as opposed to production sharing. In addition, they tended to have "the tax ring fence drawn at the corporate level". In conclusion, the OECD grouping was "a good base" for CRA's analysis.

Mr. Bramley stated that had a different subset of opportunities such as the "higher prospectively regions" of Angola and former

Soviet Union regions been included in the comparison, "the results would have been fundamentally different". The comparison would have been more complex and would have spanned a wider range of risk and reward.

9:31:08 AM

Page 3

Alaska's production declined by 6% between 2000 and 2004: in the middle of the group

Total Hydrocarbon Production Change 2000-2004

Region	2004 Production (mboe/day)	Growth/decline since 2000
US GoM SW	738	-27%
Australia NWS	403	-27%
UK	2,144	-19%
Alaska	946	- 6%
Norway	3,180	8%
US GoM DW	1,037	26%
Canada Oil Sands	997	64%

Norway's production dropped by 10% between 2004 and 2005, the loss almost entirely through decline in oil production. Source: CRA Analysis of public sources of production history in each area

Mr. Bramley communicated that due to the extraction nature of the petroleum business, the total economic potential of an area would be a function of the types of its reserves "and the technical and operational costs required to bring the resource to market. A field's maturity should also be considered in regards "to its remaining prospectivity since the best and most economic hydrocarbon resources are typically discovered and developed early in a region's life". Following that there would be "a natural pattern of diminishing returns throughout the remainder" of the area's life cycle. Thus, the level of "maturity and remaining prospectivity of Alaska's fields relative to other OECD regions would be an important factor in defining the context for fiscal comparisons".

Mr. Bramley specified that the Alaska National Wildlife Refuge (ANWR) was purposefully excluded from the comparison scenario. In addition, the "currently uneconomic" heavy oil resources in the State would be addressed separately in the presentation.

Mr. Bramley concluded that the "overall oil and gas production from an area tends to rise to a peak" and then experience a long and steady decline. The United Kingdom (UK) was the exception to this characteristic. The information presented on page 3 was the total rate of oil and gas decline or increase experienced by the identified areas between 2000 and 2004; Alaska's production declined by six percent during that timeframe. The State experienced a similar six percent decline from 1980 to 2000. A steeper decline rate was projected over the long term.

Page 4

Alaska has 44% of its known conventional oil and gas reserves remaining

Total Hydrocarbons Produced/Remaining

[This bar depicts the amount of oil and gas produced to date and the estimated amount of oil and gas reserves remaining.]

Mr. Bramley advised that the State's remaining "oil and gas reserves and their size relative to past production from an area are another fundamental measure of maturity". The bar charts presented on this page depicted produced oil and gas volumes to date in green coloring and remaining reserves in blue. He noted however, that "definitive reserve figures" were difficult to determine. The numbers in red above Alaska's and other OECD regions depicted the percent of reserve potential relative to past production. The region with the lowest remaining reserve levels was the UK. Alaska with 44 percent of its reserves remaining was the second lowest of the comparison group.

9:33:59 AM

Page 5

Alaska and the UK are the only regions within the OECD group to show a decline in proven oil and gas reserves over the last decade

Change in Total Proved Reserves (1994-2004)

[This bar chart is a comparison of Alaska to other OECD regions based on the area's ability to replace used reserves with proven reserves.]

Mr. Bramley stated that another measure to be considered would be an areas' renewal ability. In other words, how successful an area might be in "replacing year by year production with proved petroleum reserves". Besides the UK which is just slightly below replacement production, only Alaska "failed to replace production on a proved reserve basis over the last ten years".

9:34:30 AM

Page 6

Alaska has had only eight new fields start production since 2001 and the average field size was the smallest of the group

Average New Field Size vs. Number of Starts

[This graph depicts the number of new fields and average field size for Alaska and other OECD regions between the years 2001 and 2005.]

Mr. Bramley cited the number of new field developments in an area as another measure used to depict "an area's potential to add to its producing base and to arrest long term production decline". Alaska had "the lowest number of new producing fields and the smallest average size" in the comparison group.

9:35:02 AM

Page 7

Alaska has the lowest exploration (wildcat) activity and success rate in the OECD comparison group

Exploration Activity (1995-2004)

[This bar graph compares the number of wells explored between 1995 and 1999 to those explored between 2000 and 2004 in OECD regions. The graph also indicates the number of successful exploration efforts an area experienced from 2000 and 2004.]

Mr. Bramley explained that this information depicted the number of exploration wells drilled in areas over the past ten years. The green portion of each area's bar indicated the number of wells drilled between 1995 and 1999 as compared to the activity for that area, as reflected by the blue portion of the bar chart, for the years 2000 to 2004. The numbers in red above an area's bar chart would reflect the percent of its exploration wells during the ten year period which held oil and gas in commercial quantities. Alaska lagged behind the other areas "both in terms of the number of exploration wells drilled and the number of those wells which were commercially successful".

9:35:48 AM

Page 8

Likely new developments in Alaska are relatively small and high cost

Typical New Development Size and Cost

[This graph compares the cost of new field developments in Alaska to other OECD regions in terms of estimated capital and operating expenses. NOTE: Alaska's total costs include an allowance for the incremental effects of TAPS transportation and Jones Act shipping requirement costs.]

Mr. Bramley stated that CRA developed profiles of a "typical field" in Alaska and other OECD regions based on "recent development history and an analysis of the available set of forthcoming opportunities". This information helped in "characterizing an area's economic potential and [was] a good basis for our later calculations of Government Take and economic terms".

Mr. Bramley explained that the bars on the chart depicted the typical size of a field in an area. The numbers in red at the end of each bar reflected the total "capital and operating costs of a barrel of oil equivalent to bring that oil and gas to

market". The Alaska, the UK, and the United States Gulf of Mexico Shallow Water fields were the smallest fields each with an average of 50 million barrels of oil equivalency [BOE]. Those three areas' costs were also the highest at $15, $11.50 and $9.50 per BOE, respectfully, for new developments.

9:36:53 AM

Page 9

Alaska emerges on a variety of measures as a relatively mature and high cost petroleum area

[This document provides a percentage comparison of production trends, reserves produced, proved reserves replacements, new field starts/field size, exploration wells, exploration success rates, and new field technical costs for Alaska and other OCED regions. The information is also color coded to indicate high, mid-range, and low remaining prospectivity levels.]

Mr. Bramley stated that this was a summary of the information presented on pages 3 through 8. The overall trends were depicted in colors: "red indicates low prospectivity levels and conversely high maturity and high unit costs", green signified high prospectivity levels and low costs, and yellow signified mid-range prospectivity levels. Alaska was "predominately in the red category". This should not be interpreted as Alaska having "little remaining economic" and resource potential, for it and the other OECD areas do. However, the meaning of this information "in relative terms" was that Alaska would rank "low in this group" for its "attractiveness to investment". The maturity analysis also raised concerns about the impact of the State's existing fiscal terms as this information would indicate that Alaska's current tax regime was not very competitive for new investment. Alaska ranked lowest in the OECD grouping "on measures closely related to production replacement activity; in other words, exploration drilling numbers and new field starts, even before looking at direct fiscal comparisons. That doesn't suggest a highly competitive climate for new investment."

9:38:35 AM

Page 10

The basic PPT 20/20 proposal gives Alaska the second highest level of total government take within the group

Total Government Take versus Total Technical Costs

[This graph illustrates how Alaska, were the SB 305 20/20 PPT proposal adopted, would be positioned in comparison to other OECD regions in terms of Total Government Take verses operating and capital expenses costs.]

Mr. Bramley stated this chart provided "direct" comparisons of Total Government Take throughout a producing field's life. "Calculating this involves modeling the way in which the relevant fiscal regime divides the available cash flow from a single additional new field between the government and the company investor." A $35 per barrel "real terms" price was used in this analysis "because we believe that this is close to the central planning assumption that most investors are currently using for the decision making. Investors will always look at the implication of higher and lower prices for their decisions as well. We've also modeled those and the conclusions we draw from that for Alaska competitiveness are rather similar to or stronger than the one's" depicted on this chart. Total Government Take, as represented "on the vertical axis of this chart … is a good measure of the share of the total available economic value of the field that's captured by a fiscal system. It takes full account of the affects of tax rate, tax credits, and all of the mechanisms inherent in each system. In calculating this figure for a typical field, you'll get something close to a like for like comparison of the kind that will emerge in investor portfolios when they review opportunities across this group."

Mr. Bramley stated the chart depicted the "total government take for each region on the vertical and on the horizontal the unit technical costs for our typical representative field for each area."

9:40:36 AM

Mr. Bramley noted that the State's total government take under ELF "is third highest" in the group. Under the provisions of SB 305, its overall take would increase eight percent. This "significant change" would place the State "second highest in the group". CSSB 305 with its 25/20 tax structure and

Progressivity feature would, at a $35 barrel price, increase government take an additional three percent for a total Government Take of 64 percent. The level of take would increase as barrel prices increased.

Mr. Bramley pointed out that Alaska's higher cost base was also illustrated on this graph. It might be expected that the overall relationship between "technical costs and tax take would be some kind of inverse correlation. With higher costs corresponding to lower levels of government take. All of the things being equal that would probably be the case, but in reality a more complex relationship exists. Prospectivity, field size, and growth potential also play a strong role, and tax take also depends on choices by the government on the tradeoff between short term revenue and investment incentivization."

9:42:07 AM

Page 11

High costs and lack of prospectivity compound the impact of Alaska's high overall government take

Total Government Take versus Total Technical Costs

[This chart illustrates the government take for various tax regimes, including Alaska's current ELF and the proposed SB 305 tax structure, as influenced by a field's maturity level and field costs.]

Mr. Bramley stated that this graph expanded the information on the graph on page 10 to include a field's maturity level. Alaska's current "positioning is "problematic" as it is a mature region "with a relatively high unit cost base but with a relatively high government take. The fact that levels of reinvestment in new exploration and development, even under the current system are also fairly low, adds to the concern around the potential impact of the new proposals."

Mr. Bramley pointed out that under the tax rates and credits proposed in the PPT legislation, the total government take for a new field "developed entirely by a group of new investors" would be similar to the take currently collected under ELF.

9:43:41 AM

Senator Bunde remarked that the State's long term forecast predicted a $40 barrel price. Other economists predicted higher prices. Thus, he asked how higher prices would affect this modeling.

9:44:00 AM

Mr. Bramley replied that the rankings would not change. However, under ELF and SB 305, there would be "some convergence" between the Norwegian and Alaskan rates. Were prices to decrease, Alaska would be number one is government take due to the regressive nature of the State's royalty provisions at lower oil prices.

9:44:56 AM

Mr. Bramley furthered his remarks about the regressive and progressive elements of the State's current and proposed SB 305 tax structures. The State's system was "regressive in a nature not duplicated in other OECD tax regimes", as its level of government take increased at lower prices and decreased at higher prices. "This in itself is not helpful in supporting investment decision making." The Progressivity components of the committee substitutes being furthered by both the House and the Senate would "produce a pattern of upside progressiveness and downside regressiveness, which is very very unusual," and, in his experience, "unique".

Mr. Bramley, reiterating that Alaska's total government take was only surpassed by that of Norway, reminded the Committee that Norway had "significantly more" economic potential than Alaska. The "exploration prospectiveness" of oil reserves off its coast could result in it becoming a major new oil and gas region. Norway's three largest oil and gas companies had substantial government ownership, thus there was "strategic commitment" to developing those offshore resources. Consequently attracting "international competitiveness is less of a central issue" to the Norwegian government than it would be for other regions. Of utmost significance was the fact that Norway had followed "a policy of measured development towards its oil and gas resources". As a result, "strategic control and maximization of government take tends to dominate over stimulation of high levels of new investment."

9:47:23 AM

Co-Chair Green asked the level of private investment in Norway's oil and gas industry.

Mr. Bramley estimated that 80 percent of the ownership interest in Norway's three largest oil and gas businesses was held by private entities.

9:47:49 AM

Senator Stedman was confused by Mr. Bramley's remarks that Alaska's current system was regressive in nature and that the PPT with its Progressivity element would introduce progressive taxes. This was contrary to the Department of Revenue's projections which indicated that the State's total government take under PPT, after the proposed severance tax, property tax, corporate income tax, and the federal income tax were factored in, would remain "fairly flat, with a very slight regressive nature to it". Therefore, he requested further definition of the term "progressive nature"; specifically in regards "to what level and then at what magnitude it would begin to affect their economic models".

9:49:08 AM

Mr. Bramley stated that the use of the terms regressive and progressive in CRA's modeling was used "in the context of the relationship of government take to overall economic value". The term progressive would be used to describe a scenario in which "the overall economic value of the underlying resource goes up and the fiscal system produces a higher government take at that higher level of economic potential". The term regressive would describe a situation in which government take decreased at higher prices. This term would also refer to a situation in which government take increased as prices decreased.

Mr. Bramley continued that CRA's "analysis is not fundamentally different directionally from the ones I've seen from the Administration" and other consultant's analyses.

9:49:59 AM

Mr. Bramley stated that "the net affect" of the State's royalties and other "fundamentally regressive" tax elements and the progressive element included in CSSB 305 would, in effect,

create a "u" shape: at low prices of $20 per barrel, for example, the State's government take would increase to approximately 80 percent under the PPT. The "point of inflection" under the provisions of CSSB 305 would be approximately $40 per barrel.

Mr. Bramley addressed investor behavior. They would first identify a range of prices around a current price in order to project what might happen in the future. The prospects at both the progressive end and the regressive end of that spectrum would be an important consideration; therefore the two scenarios "would be aggregated together" to provide the "bottom line … or expected value of an investment".

9:51:55 AM

Mr. Bramley pointed out that the regressive and progressive elements contained in the proposed PPT "is in itself, fundamentally unhelpful. It's very very unusual and it creates an additional pattern of uncertainty in decision making because of its unusualness".

In response to a question from Senator Stedman, Mr. Bramley affirmed that the OECD region in Australia being referenced in the comparisons was on Australia's northwest shelf.

Senator Stedman asked regarding the tax structure utilized in that region.

Mr. Bramley responded that its tax structure included a corporate income tax and a special royalty tax referred to as the petroleum resource rent tax. This tax structure was a "flat tax" rather than a rate of return tax.

9:53:06 AM

Senator Stedman communicated that the oil and gas industry tax system in Alaska had not, until recently, been compared to that of Australia. At some point, he hoped CRA would provide its perspective on the two oil fields being developed in northern central Russia, which had been discussed in a separate presentation by Daniel Johnston, the oil and gas consultant hired by the Legislature. Senator Stedman was particularly interested in CRA's viewpoint about "the suitability of those [tax] regimes".

9:54:11 AM

Mr. Bramley reiterated that the OECD comparison group utilized in this presentation by CRA were picked because they embodied "a range of risks and rewards to investors" that were similar to those found in Alaska. The two Russian fields were "fundamentally different from the opportunities" in any of the areas in the page 11 comparison as "they are much bigger". The fact that CRA had "taken the view that investors will look at economic potential in terms of prospectivity as a fundamental part of their decision making" is one of the reasons that CRA's analyses differed from others. CRA's position was that investors would be willing "to accept higher levels of government take for larger fields or lower costs or greater growth prospects … those things would have a fundamental impact". Therefore, CRA did not consider the two large Russian fields to "have the same economic potential on which to make fiscal comparisons".

Senator Stedman communicated he would further this discussion separately with Mr. Bramley, as he thought that the Russian fields he was referring to differed from those Mr. Bramley had in mind.

MARIANNE KAH, Chief Economist, ConocoPhillips agreed with Mr. Bramley's remarks about the Russian fields provided the two fields being discussed were located in Arctic Russia. ConocoPhillips was considering developing a 750 million barrel field in Arctic Russia, and, due to the immense size of that field, the company would be willing to accept higher tax rates. Alaska's field sizes were in the 30 to 50 million barrel range. The tax rate must be "commensurate with the prospectivity".

9:56:53 AM

Page 12

Alaska's largest potential is in its producing fields, heavy oil and gas resources: PPT 20/20 is a dis-incentive to investment in these

Alaska's Resource Potential

Resource Type	Comparable Size	Incentivized by PPT 20/20 proposal?

Producing Fields/	2 - 5 bn boe	Higher tax take is a direct disincentive
Known Undeveloped Resources: Conventional Oil	~0.5 bn boe	Only small and/or new players have some incentive
Known Undeveloped Resources: Conventional Gas	6 - 8 bn boe	Higher tax take is a direct disincentive Gas pipeline may Transform attractiveness
Known Undeveloped Resources: Heavy Oil	5 bn boe	Higher tax may cause Serious delay to heavy oil development
Exploration) Potential (YTF)	<1 bn bbl oil potential? Gas potential may be higher	Only small and/or new players have some incentive

Mr. Bramley stated that the discussion about how the PPT would impact future investment should consider where Alaska's future resource potential might be located. The table on page 12 would provide evidence that "Alaska is in a somewhat unusual position of having the majority … of its future resource potential in the form of known but undeveloped hydrocarbons". The known but undeveloped oil, heavy oil, and gas resources were "significantly larger than the resources likely to be available through new exploration and through undeveloped conventional oil. … The prospect of higher government take" as proposed under the PPT would directly impact the development of these resources. Reducing the level of government take on "new entrants for their early developments" would not assist in developing resources in "areas where the largest pots of Alaska's potential actually lies".

Mr. Bramley stated that CRA's conclusion from its analysis "about Alaska investment attractiveness, is that the new proposals will inevitability reduce future investment in oil and gas".

Mr. Bramley pointed out that even though the majority of CRA's study pertained to SB 305, their conclusion was that the House and Senate committee substitutes "with higher levels of government tax take, would reduce that attractiveness even further".

9:58:26 AM

Senator Bunde understood that ConocoPhillips had originally agreed to the 20/20 percent proposal presented in SB 305. To that point, he asked the reason the company had agreed to something which contained numerous "disincentives" to future investment.

Mr. Bowles communicated that the company has also pondered its decision in that regard. "In the broader context though …. one aspect of the 20/20 proposal" that was agreed upon by ConocoPhillips, Exxon, and BP, was that it would lay "the groundwork for proceeding to the next step with the gas contract". A gas pipeline would serve to "bring large investments in itself, but it will also spawn effectively a new exploration and development activity on the Slope with respect of exploring for both gas and oil combined". Thus, the combination of the benefits derived from the growth in investments, jobs and production volumes would outweigh "the downsides" of the 20/20 proposal.

Senator Bunde understood therefore that ConocoPhillips felt that a conventional gas pipeline would be attractive to investors.

Mr. Bowles concurred.

10:00:02 AM

Senator Dyson stated that in November 2006, the State's citizens would be voting on whether to adopt a ballot initiative to impose a gas reserves tax. While he thought it "would profoundly affect the attractiveness of Alaska", he understood that its affect on new resource exploration and development companies would differ from that on existing lease holders. Thus, he asked

ConocoPhillips to comment on how the adoption of this ballot measure would affect the company.

Mr. Bowles responded that the adoption of the gas reserve tax initiative "would definitely" affect new players differently than it would affect "the three that would be targeted … the biggest signal though that would go out" by the adoption of that initiative "would be the fact that we have a fiscal tax regime that could change in such short notice through a ballot process". Were it adopted, the industry could be subjected to an annual billion dollar tax increase. While it might "only directly affect three companies", it would communicate to newcomers in the State's resource industry "that they could be subject to some form of change of that magnitude once they had operations on the ground".

Senator Dyson asked how the adoption of the measure would affect existing lease holders in the Prudhoe Bay field; specifically "the investment propensity" of those who have "a big part of the gas cap".

Mr. Bowles communicated that a key element of the company's testimony today was how taking "dollars away from the industry" could affect investment. The adoption of the PPT could levy an annual one to two billion dollar tax increase on the industry. This would affect future investment as it would negatively impact the amount of capital available for investment. The adoption of the gas reserve tax could levy an additional tax which would further reduce the amount available to invest. It "would be another nail in the investment coffin".

Senator Dyson communicated that people in support of the gas reserve tax believe "it would be an incentive to get that gas to market". He asked Mr. Bowles' position on that line of thought.

Mr. Bowles responded that ConocoPhillips stated that "even if we started welding pipe the day before the ballot initiative came up, we would still be subject to that billion dollar a year tax, effectively until gas sales started possibly ten years later". A gas reserves tax could not be viewed as "an incentive to starting actual work on the pipeline".

10:03:37 AM

Senator Stedman identified this as being an area to which little discussion had occurred. Numerous competitive resource basins around the world included "relinquishment provisions in a lot of their leases". As a result, industry must develop a field within a particular timeframe or lose those leases. A lack of similar provisions in Alaska leases could place the State at "a competitive disadvantage for the flow of capital" because capital would be utilized in areas with development time limits. Rather than suggesting that similar provisions be included in Alaska law, he wished to point out that such action in other resource regions would influence "the flow of capital" on a worldwide basis. He asked the testifiers to address how others' relinquishment provisions might affect on Alaska.

10:04:53 AM

Mr. Bramley acknowledged that the OECD regions included in the comparisons do include relinquishment provisions in their leases; however, "they're generally not as aggressive in these areas as in areas which have production sharing type contract arrangements." He communicated that rather than being a "driver" of where investments occur relinquishment provisions would be a consideration in areas "at the margin". In other words, a competitive area "would attract capital".

10:05:41 AM

In response to a question from Co-Chair Wilken, Mr. Bramley affirmed that oil and gas reserves in ANWR and the National Petroleum Reserve-Alaska (NPR-A) were purposefully excluded from consideration in this presentation.

10:06:15 AM

Senator Dyson asked whether CRA had considered whether the investments "made on planning, permitting, and construction of the gas pipeline will be subject to credits or deductions" under the provisions of any of the PPT bills being discussed.

Mr. Bramley responded that this issue was not a consideration in this analysis. He agreed with Mr. Bowles "that it is self evident that it would transform attractiveness for investment simply because of the affect on incremental economic potential of opportunities here in Alaska". This presentation focused "on

the affect of the current PPT proposals" under current conditions.

10:07:51 AM

Senator Dyson asked whether any of the PPT bills would allow "the gas pipeline development costs to be a deduction or a credit on the PPT taxes".

Co-Chair Green assumed the bills were "silent" on that issue.

Senator Dyson identified this as an important consideration going forward; as such activities were "interwoven intrinsically". Further information in this regard could be sought from the Administration.

10:09:02 AM

Co-Chair Green communicated that this question could be added to the set of questions being developed by the Committee.

10:09:27 AM

> Page 13
>
> If Alaska wishes the new legislation to stimulate investment, a new system that reduces total tax take would be required
>
> Total Government Take versus Total Technical Costs
>
> [This chart compared remaining prospectivity levels for incremental fields of Alaska under the existing ELF and under a 20/20 PPT as compared to the remaining prospectivity levels of other OCED regions at a $35 per barrel price.]

Mr. Bramley expressed that CRA was not in a position to recommend "the appropriate level of government take" in Alaska; however, the information garnered from this study "led to an inescapable conclusion that the balance of the current proposals is slanted more towards short term revenue over stimulation of new investment to stem future production decline".

Mr. Bramley stressed that in order "to have reached a different conclusion … a system that yielded total Government Take lower than the existing ELF" tax structure would be required. While he was uncomfortable sharing this conclusion, he hoped that the evidence presented supported it.

10:10:14 AM

Senator Bunde puzzled about having to develop a taxation structure "less than" the existing ELF tax structure, as ELF was expected to generate zero tax revenue in the future.

10:10:38 AM

Mr. Bramley, hesitating to suggest a taxation level, voiced that the conclusion reached by CRA "is that the price the existing" ELF tax structure "sets on Alaska investments is already high". The price that would be required "to stimulate more investment" must be lower than that under ELF.

Senator Bunde reiterated that in the foreseeable future, the tax revenue generated by ELF would be zero. While a zero tax would encourage investment, "it would be an abrogation of our Constitutional requirement".

Mr. Bramley acknowledged. CRA's "analysis of the investment is analyzing only part of the economic equation, and it's certainly not analyzing any of the political equation." The intent of this study was "to provide an analysis of Alaska's positioning on a like for like basis". CRA's conclusions were based on that analysis.

10:11:52 AM

Senator Stedman remarked that "unlike the socialist regimes" which have oil and gas resources, Alaska does "not have the ability to nationalize our relationship and/or relinquish rights". Were that the case, the State could opt to re-bid current leases and "the open market would set those rates". However, "as a steward of the citizens' assets," determining the proper tax structure is difficult, particularly in consideration of recent years' global marketplace "adjustments and the splitting relationships between the industry and the governments". Other regimes have moved "toward more progressive systems where the splits stay more constant". The consideration

of whether to lower the State's taxes should not ignore such events. Numerous factors, including the control of and assess to a basin, influence the movement of free capital in and out of the North Slope. The process should be one of negotiation. As Senator Bunde stated, "we are stewards of this one time asset; this one time finite resource in the ground that citizens of Alaska own". The elements contained in ELF and the proposed PPT are "the mechanisms" through which the State could sell its resources. The process would entail "a sharing relationship with industry and the federal government".

Senator Stedman identified the PPT "trend" evolving from the Senate and House as being a tax rate ranging between 20 and 25 percent with some Progressivity level. Projections are that the government take under ELF would decline from the current 60 percent current to 52 percent over the next 15 years.

Senator Stedman concluded that "the buyer of the asset always feels that he's paying too much and the seller of the asset always thinks he's selling it" for too little.

Mr. Bowles deemed Senator Stedman's points to align with the intent of ConocoPhillips' presentation. "The geopolitical environment is one reason that we do believe strongly that the OECD countries probably are the best comparison … as far as competition out there for world wide capital". In response to Senator Bunde's concern, he declared that "by no means are we suggesting that taxes should be zero". One of the notable objectives of this discussion would be the realization "that it is not an elastic system; taxes do have a direct impact on investment and that at the end of the day it is your responsibility for finding that right balance". ConocoPhillips' effort revolved around trying "to communicate how we see the cause and effect of tax against investment in volume development".

10:16:03 AM

Page 14

Why is CRA more pessimistic about investment than previous testimony?

- Investors have choices, and more tax will drive some capital away

-CRA 'portfolio pricing model' rather than 'threshold model'

- Tax credits don't offset the impact of higher tax rates
  -CRAs 'typical Alaskan field' shows clearly the economic penalty of PPT 20/20
- Fiscal structure biased towards tax credits likely to be a dis-incentive for most investors
  - Tax credit bias erodes upside
  - High price environment means scale, efficient use of scarce human resource, is key factor

- Alaska's investment attractiveness low for current ELF levels of government take
  -PPT 20/20 is already a significant dis-incentive
  -Higher rates and/or progressivity will compound the impact on investment

Mr. Bramley reviewed the reasons CRA's conclusions differed from others. As with any increase in the price of something, some investors might accept the tax increase while others might not. Capital would migrate away from the State were the tax level to increase. Total government take would be "the primary fiscal driver" in influencing investor behavior. The effects of tax credits, deductibility of capital and other effects of the change were considered in the study. The determination was that tax credits would benefit investors but that benefit "is strongly outweighed by the proposed higher tax rates". Investors "would not view the tax credits and deductibility in isolation from those higher rates".

Mr. Bramley declared that fiscal structures were a complex issue. The question would be which tax structure an investor would prefer when considering any "two tax structures providing the same government take" where one is more dependent on tax credits than the other. Not all investors would make the same decision. CRA believed "that the majority of investors would prefer the system that's more generous in its tax rate and less generous in its tax credits", as tax credits would "erode upside and secure downside". The "main constraint that companies have is not their capital but their qualified people. Companies are pushed toward scale and larger projects … and a generous tax rate is more effective at giving that than tax credits are."

Mr. Bramley stated that the fundamental consideration of the State's "investment attractiveness is the context of its underlying economic potential". The conclusion of the effort to "rank Alaska's fiscal attractiveness within the OECD group" was that "the price is already high".

10:19:35 AM

Mr. Bramley stated that the important question left unanswered was "So what?" should the State worry that investment in the State would reduce were the PPT enacted. The answer to that question was uncertain. While the State would be responsible for balancing revenue, investment and growth, future activity was difficult to predict.

10:20:21 AM

Page 15

So what might the future look like? Some illustrative numbers

Tax Revenues to Alaska

[This graph compared tax revenues Alaska would receive under ELF system to the proposed 20/20 PPT with no production change as well as to the proposed 20/20 PPT with reduced production from the year 2007 through 2026.]

Mr. Bramley stated that, while no one could "confidently" predict whether higher taxes would reduce investment "and how that would in turn effect production decline", some possible outcomes were illustrated on this page.

Mr. Bramley explained that the vertical axis represented the total amount of taxes paid to the State. The horizontal axis reflected the timeline 2007 through 2026. The lower graph line indicated the projected tax revenue generated by ELF and the upper graph line reflected revenue projections of SB 305. Both of these revenue projections were based on a $35 per barrel oil price and the "base forecast of production", which projected that by the year 2014 production would decrease to approximately 690,000 barrels a day or an annual "decline rate" of approximately three percent. This decline rate was more optimistic than other forecasts.

Page 16

What could this mean for Alaska? Some illustrative numbers

Taxes: Gains and Losses	Investment Reduced	Jobs: Lower Activity
2007-2011 +$700m	20% reduction Means $2-3 bn lost over 10 years	Direct Loss 500-1000
2012-2016 -$700m	$1bn lost from Alaska GDP?	Indirect Loss 1500-3000

Mr. Bramley stated that, as depicted on this graph, the PPT would reduce investment and thereby cause production to decline faster than in the base case forecast. In the short term the State's revenue would increase; however over time the decrease in production would reduce tax revenue. Ongoing investment would decline by 20 percent as a result of the new taxes. Production decline would be two percent per year more than in the base forecast. The State would gain revenue until approximately 2012. After that the production decline would lower tax revenues under those generated by ELF.

Mr. Bramley attested that 500 to 1,000 industry jobs would be directly lost due to the decline in investment "based on current levels of employment and spending". Additional losses of up to 3,000 service industry jobs could transpire. Along with the 20 percent loss in capital spending, or $2 to $3 billion over a ten year period, "there would be a significant affect on the State's gross domestic products (GDP). A conservative estimate would be for a drop of a minimal one billion dollars over the next ten years.

Mr. Bramley stressed that a debate of these issues would be beneficial as others might have a different view. He would be surprised however were anyone to expect the overall level of investment to remain steady or increase as a result of the higher taxes.

Senator Hoffman asked how a $50 per barrel of oil price would affect revenue assumptions.

Mr. Bramley would not predict how a $50 per barrel price would affect the graph. However, "there is no reason to believe that the underlying effect on investment and production decline would be different". The relative positions would remain the same. "The fact of a tradeoff between declining production and the higher tax rates would be inescapable".

10:24:29 AM

Senator Bunde again questioned the reason a $35 per barrel price was utilized in the calculation, as the long range forecast was $40 a barrel.

Mr. Bramley expressed that CRA determined $35 to be in "the center of the range that investors are considering". Some investors might invest at a higher price and others might invest at a lower price.

10:25:13 AM

Senator Olson concluded from the Resource Potential table depicted on page 11 that a higher tax would "drive away" investment capital. However, this was contrary to the information presented in the Prudhoe Bay and Kuparuk "Gross Capital Spend vs. Severance Tax Rate" charts discussed earlier by Mr. Bowles. Those charts indicated that capital investment was declining under ELF.

Mr. Bowles stated that the graph lines on the two aforementioned graphs were incorrectly labeled. The correct scenario was that the capital investment in both those fields had increased as their ELF severance tax rate declined.

Senator Stedman pondered "the correlation between the escalating oil prices" during the last two years "and the drive for more capital expenditures". It seemed that at times of high prices, the industry would attempt to "expand their production and production capabilities to service that demand and capture those higher sales". To that point, he asked how much of that effect was reflected on the charts.

10:27:49 AM

Mr. Bowles responded that this element was one reason the comparison between the activity in Prudhoe Bay and Kuparuk was

provided. The effect of increasing prices would have applied to both fields; however, as reflected at the Kuparuk field, there was "a very direct correlation to reduction in tax and an even dramatic affect in investment increase". Senator Stedman was correct that in the overall scenario, more investment in the industry was going into oil and gas development around the world. "That capital would flow to where the best returns are". The Kuparuk chart provided evidence "that the tax structure has been creating a very favorable investment scenario and dollars are flowing to it as a result".

10:29:04 AM

Page 17

Increasing Alaska's oil and gas taxes will have a price

- We recognize the dilemma of balancing revenues and investment
- Alaska is mature, but has undeveloped potential
  - Low prospectivity and new field size
  - High cost base
  - BUT huge known resources, heavy oil especially
- Current fiscal proposals do not help competitiveness of OECD peer group
- Loss of Competitiveness will mean less investment and lower production.

Mr. Bramley acknowledged "the dilemma of balancing revenue, investment, and growth". CRA "has focused on the investment side of the equation". "Alaska is a mature province but one with an enormous remaining potential. The challenges of accessing that potential are also enormous, but because … the potential lies largely in known resources rather than in exploration, a competitive fiscal regime can provide effective support in turning speculative resources into real tax paying production. The current fiscal proposals do not help competitiveness verses your international peer group, and will make investment in Alaska less attractive than it is at the moment. Reduced investment will mean fewer jobs and will in time result in lower production and lower tax revenue. I belief that neither more analysis nor the passage of time will change that conclusion."

Mr. Bramley concluded his presentation.

10:30:08 AM

Senator Stedman brought up the prospect of there being a gas pipeline on the North Slope. He understood that the gasline would work in conjunction with an oil line. To that point, he asked whether an analysis had been conducted on where the deflection point would be for the two lines. He also recalled that 300,000 barrels of oil a day would be required to maintain a viable oil line. Therefore, his question was whether the PPT would result in a decline in oil which would jeopardize the oil line's operation. Loss of the oil line would negate the gas line's feasibility.

10:31:14 AM

Mr. Bowles qualified that a threat to the viability of the oil pipeline should not be garnered from this testimony. What should be derived from this discussion was that there was "clearly … a direct cause and effect between taxes and investment in barrels and whether or not the critical level on TAPS is 300,000 or some other number that's yet to be worked out and optimized." The overriding conclusion of this presentation should be that "it is strictly a policy call" as to what the State should do to balance "the income to the State from State resources against the continual investment of dollars in the State". The impact on short and long term tax revenues to Alaska which might result from the implementation of the PPT, as presented on page 15 of Mr. Bramley's presentation, were enlightening. He seconded Mr. Bramley's suggestion that other consultants should be asked "their view of what is the potential impact of the loss of investment in volumes".

Senator Hoffman pointed out that ConocoPhillips was one of the first companies to agree to the 20/20 tax structure proposed in SB 305. However, ConocoPhillips' television advertising touting "no new taxes or increased taxes" do not appear to reflect that support.

10:33:40 AM

Mr. Bowles stated that the intent of the advertising was to further the awareness of the correlation between taxes and investments in the State. The company would support "going forward with something that the industry can see as a balanced

tax structure; something that would allow not only a good strong continual investment in the State but also the investment in the gas line and what additional investment in jobs will come from the gas line development". The company's advertising was designed to place "investment in perspective of not only oil but what comes out of it in the way of gas development".

Senator Hoffman communicated that that was not the message he garnered from the television commercials.

10:34:39 AM

Mr. Bowles appreciated Senator Hoffman's and others feedback. Such input would be considered as the Company continued its effort "to develop a communication package" that would convey "the correct message to Alaskans".

10:35:16 AM

Senator Olson noted that the commercials appeared to have been filmed the previous summer. Were that the case, "the message was already there even before" the Legislature had been aware of "what the numbers were going to be" in the PPT proposal.

AT EASE 10:35:51 AM / 10:36:51 AM

Co-Chair Green informed the Committee that the plan would be for the Committee to reconvene after the 11:00 AM Senate Floor Session.

10:37:39 AM

MARIANNE KAH, Chief Economist, ConocoPhillips identified herself as representing "the corporate planning function of ConocoPhillips". Because she assisted the company's Board of Directors in developing its investment strategy, she could provide insight as to how the PPT tax being proposed might be viewed by investors and how it might change their investment behavior.

Ms. Kah stated that the primary focus of her remarks would be to counter consultant reports which have implied that the State's tax rate could be changed without having any impact on investment. She reviewed her written remarks (copy on file) as follows.

[NOTE: Ms. Kah's testimony was accompanied by a Power Point presentation. While a copy of the presentation was not provided, its contents were detailed in Ms. Kah's narrative.]

Investment Criteria: Let me start by showing you the general criteria we use at corporate headquarters to value upstream investment opportunities. The first factor we generally consider is the prospectivity of the country or opportunity. We would consider such elements as the maturity of the area, potential field size, remaining reserves and the quality of the reservoirs and crude oil. There are also a number of places around the world that have known reserves but they are difficult to develop. The larger the size of those reserves, the more feasible it will be to economically develop them.

The second factor we generally consider is the cost of the region or opportunity. This would include exploration, development and production costs as well as transportation costs to bring the crude to market.

The third criteria that is used to judge the value of opportunities is the cycle time or the amount of time it takes from exploration to first production. The value of the project is highly dependent upon whether it can be brought to the market quickly or whether it takes 7-8 years or longer before first production.

The fourth factor we consider is the attractiveness of the tax and fiscal terms and whether or not they are commensurate with the prospectivity and cost of the region or opportunity.

The fifth and last factor we consider is whether the country has a strong rule of law and efficient regulations for energy development. The stability of the political regime and the fiscal terms are also very important considerations in terms of the degree of risk that the value will turn out to be significantly lower than we anticipated.

With that said, let me show you how we would assess Alaska's competitiveness using these criteria. I will start

with an overview of all of these criteria and then provide more detail on a few of them.

Investment Criteria with Alaska Rating: Starting with prospectivity, CRA has already showed that Alaska has fewer and smaller field sizes than even the other mature areas in OECD countries. The crude quality is moderately high sulfur and getting heavier. These are negatives.

Alaska also has high exploration, development and production costs, and a long cycle time to get to markets given Arctic drilling conditions and limited drilling seasons.

The strong rule of law and political stability have been positive factors that explain why we have been investing in Alaska all these years. However, we are now concerned at the prospects of changing the tax regime after investments have been made without grandfathering these investments under the tax regime that was in effect when the investments were undertaken. The worst thing that you can do to an investor is to change the rules of the game after the investment is made. This significantly raises Alaska's risk profile and reduces the potential attractiveness of investing there.

10:41:28 AM

Global Average Commercial Discovery Size: Looking at prospectivity in greater detail, this slide compares the average commercial discovery size in Alaska with various countries around the world. Areas with high prospectivity can generally assess higher tax rates, while maintaining investment. The Alaska North Slope, however, has limited prospectivity as compared to many parts of the world. Tax rates need to reflect that.

But it is also important to acknowledge that although exploration will continue to play a role in halting Alaska's production decline, it will be a small one. Based on the State's forecast, exploration will account for about 3% of production over the next 10 years and about 8% over the next 20 years. Known discoveries which have yet to be developed or are economically challenged, also play a small part in Alaska's future.

The core legacy fields such as Prudhoe and Kuparuk will still produce over 80% of the total North Slope production in 2015, providing the base infrastructure on which these smaller fields smaller fields will depend. Significant capital will be required to maintain this infrastructure, as well as, in-field drilling and well work to mitigate decline. Discovered heavy oil resources would be included in this category. However, the State's consultants acknowledged that technology limitations and development costs will constrain heavy oil production in the near term, and it could be many years before this resource reaches its production potential. The technology required to develop this resource will require huge expenditures, which the long-term major producers, such as ConocoPhillips, are more likely to make than smaller companies.

Over the next 10 years, approximately 100% of the investment in existing fields, 100% of the investment in known discoveries, and probably about half of the exploration investment (or about 98.5% of the total investment over the next decade) will come from companies that are already here. If you are interested in Alaska's future, you are interested in seeing the major existing players continue to invest here.

10:42:26 AM

Senator Bunde asked whether NPR-A and ANWR oil and gas reserves were included in the company's future Alaska prospectivity considerations.

Ms. Kah understood those fields were not included in the company's prospectivity review. The information presented by the company was based on estimates provided by the State Department of Revenue.

10:42:45 AM

Increasing Production Costs: This slide compares the production costs (increases severance but no other taxes) of all of the major regions in ConocoPhillips' portfolio. Alaska is the highest cost region in our portfolio. And costs in Alaska are rising at a faster rate than in other regions, in part because of the aging infrastructure and

declining field size. Cost also needs to be taken into account when setting the tax take. The countries with the lowest costs can afford to have higher tax rates while remaining competitive. Similarly, higher cost countries need to offset these conditions with lower tax takes.

Alaska - High Cost, High Tax: My next slide shows total capital and operating costs as a function of government take for about 30 countries/stated in the world. This data, representing costs from 1994 to 2003, was taken from the Wood Mackenzie 2004 "Global Oil and Gas Risks and Reward Study" and was calculated at a $35 per barrel price. The study included more countries but we removed the ones where the government was carried through exploration in response to the Legislature's consultant, Daniel Johnston's, criticism of Wood Mackenzie for not accounting for this carried equity in their government take calculation.

As can be seen, there are four quadrants shown on this chart. The one on the bottom left shows countries that are trying to attract investment. They have low costs and still maintain low rates of government take. The quadrant on the top left contains low-cost countries that are then able to maintain high tax rates while remaining competitive. The quadrant on the bottom right contains high-cost countries but they compensate for their high costs by maintaining lower tax rates. The quadrant on the top right contains counties that have high costs and high taxes. Countries that position themselves in this quadrant may not get sufficient investment since their tax rates are not commensurate with their cost structure.

This plot also shows that there are inverse relationships between Government take and Total Costs. As previously mentioned, high-cost countries often lower their tax rates to remain competitive. The lower line tends to represent net crude-importing countries who want to minimize investment. The upper line tends to represent net oil-exporting countries.

Alaska under the ELF is shown as the Red Triangle. The PPT will move Alaska into the High-Cost, High-Tax Quadrant at the same time that costs are rising at a faster rate than in other locations.

This chart also shows with Green Triangles the OECD countries that CRA believes are more appropriate peers. Peer areas such as the Gulf of Mexico and the UK North Sea are still significantly more favorable investment regimes. The high cost in the Arctic and the types of fields that are likely to be found suggest that the proposed fiscal regime could detract, rather than encourage, significant additional investment.

Ms. Kah specified that the horizontal axis on the charts reflected total operating and capital costs. The vertical axis reflected development only government take and net present value. The purpose of this information would be "to show the relationship between cost and overall government take". OECD countries tend to fall into the lower left quadrant on the chart. The PPT under SB 305, and the additional provisions added by CSSB 305 would move Alaska into the high cost/high tax quadrant. This would likely result in "reduced investment".

Senator Stedman asked regarding the definition of government take in relation to the development only/government take percentages depicted on the chart. The State's analyses would indicate that Alaska's government take under CSSB 305 would be approximately 60 percent. Thus, he was interested in the reason the graph line depicted on the chart did not have "a more vertical" upward trend to it.

10:46:25 AM

Ms. Kah clarified that the vertical slope of the line would be more pronounced were cost increases excluded; however the chart was intended to demonstrate that costs would increase "at the same time". The slope of the line would also be elevated had such things as the tax credits and other incentives in the PPT been excluded from the calculations. In summary, the chart was developed to reflect how an investor such as ConocoPhillips would make development decisions on existing fields.

10:46:57 AM

Senator Stedman was puzzled that ConocoPhillips' chart depicted the government take under ELF to be approximately 60 percent. A 60 or 61 percent level of government take would be expected under CSSB 305. Therefore, he asked whether the industry was

anticipating "just a slight increase vertical" to result under CSSB 305.

Ms. Kah reminded Senator Stedman that the company's calculations did not exactly match those of the Legislature; such things as the starting rates even differed. Thus, rather that guessimate the differences, the entities should work together to identify the reasons that the numbers differ. "Clearly we are not comparing the exact same things."

10:48:08 AM

Mr. Bramley specified that the calculations on this chart had been calculated differently as they included "a discounted government take. In other words, in doing this analysis … a year by year discount rate, as an investor would do," was applied. That "would indeed have that effect of shifting all of the points upwards." The analysis included in his earlier presentation and the information in most other estimates had not been discounted.

10:48:58 AM

Senator Stedman asked whether the chart could be redone to reflect the provisions of CSSB 305 rather than SB 305.

Ms. Kah and Mr. Bramley replied in the affirmative.

10:49:21 AM

Senator Hoffman, noting that OECD countries were depicted on the chart, asked the goals of that organization.

Ms. Kah expressed that OECD countries were simply "the total of all the developed countries in the world", although recently Korea and Mexico, which were once considered developing countries, had joined the group. The OCED countries included in this analysis were those which had a similar "political risk" as Alaska. They were also chosen in terms of maturity and field sizes.

> Alaska - High Cost, High Tax (with prospectivity): Now I am showing you the same slide but adding in bubbles to indicate the prospectivity of some of these countries. You can see that a number of the countries that have high tax

takes also score high in prospectivity. That is why they can keep tax rates high and still be competitive.

The other point I wanted to make about this chart is that the Governor's consultant assessed the competitiveness of Alaska's tax rates by comparing tax rates of different regimes around the world applied to similar-sized fields in all locations. That is not the way investors look at it. When we compare investments in Russia versus Alaska, for example, we compare the prospects of accessing a very large field with very high tax rates in Russia versus finding a much smaller field with lower tax rates in Alaska. The greater prospectivity in Russia may compensate for the higher tax rates. Thus, it is not meaningful to compare the competitiveness of Alaskan tax terms with Russia's terms or those in Azerbaijan and Angola at the same field sizes.

Ms. Kah noted that this information was also based on the Woods Mackenzie study earlier referenced.

Higher Taxes Will Reduce Investment: I will now switch gears and talk about a concern I have with the testimony of all of the state's consultants. They would have you believe that you can raise tax rates without concern about substantially reducing investment or production in the state. This flies in the face of economic reality. To quote a phrase from Dr. Margo Thorning, the Chief Economist of the American Council on Capital Formation, "one of the axioms of public finance scholars is that if you tax something, you get less of it".

Ms. Kah was particularly concerned that other consultants had communicated there would be little impact from increased taxes. A substantial increase in taxes would impact investments.

10:51:27 AM

There are three reasons why higher tax rates will reduce investment. The first is that there will be less cash flow available to re-invest. Another less obvious reason is that you have changed the risk/reward balance. You will effectively increase the marginal cost of production and thereby lower the rewards, while at the same time increasing the perception of risk that the rules of investment will be changed after investments are made.

Making the tax rate too progressive in a higher price environment also negatively impacts the risk/reward balance by shaving off the benefits of better times disproportionately more than helping in a lower price environment. Our industry invests a tremendous amount of capital on projects with long lead times and significant exploration, technical, price and economic risk. We need the tax system to be stable and to allow us to keep enough upside that we can earn adequate returns for our shareholders on average over the long price cycles our industry experiences.

The third reason why higher taxes will reduce investment is that Alaska will be viewed as a less attractive place to invest and capital will migrate to countries that have tax regimes commensurate with their cost and prospectivity. The state may also receive less investment from long-time investors who believe they have been treated unfairly by the state in the transition to a new tax regime by not being given due consideration to recent investments made with different fiscal regime expectations.

There are a growing number of countries around the world who have increased their tax rates in this high price environment, which is probably making you thing that Alaska can still be competitive despite the proposed tax increases. However, private investors will shift from investing in conventional oil in all of these places with higher tax rates to investing in LNG, downstream and other energy projects that have more favorable tax terms. For example, our company is now more willing to invest in downstream and infrastructure projects than we were historically when we believed that upstream investments had higher and less risky returns. If current trends continue, conventional oil will end up being the domain of national oil companies who have lower return requirements than private investors.

And finally, capital will flow out of the energy industry if tax rates rise to the point that the energy industry looks less attractive than other industries.

10:53:16 AM

Senator Stedman asked the government take for oil and gas in Libya.

Mr. Bramley could not recall Libya's exact government take percentage; however, it was "at the high end" of government takes of countries having a "production sharing" tax regime. That type of tax regime was fundamentally "a different structure than the tax royalty regime" in Alaska and other areas. "In terms of economic potential", a like for like comparison between Alaska and Libya could not be drawn as Libya had a lower cost base and larger fields. In addition its fields were closer to the market than Alaska's. "The fundamentals are quite different."

Ms. Kah communicated that while ConocoPhillips would be resuming activities in Libya, its concentration would be on the assets it had before the Libyan government imposed new sanctions. Those assets, with a 200,000 barrel per day production, were not big fields.

10:54:58 AM

Senator Stedman stated that the Libyan field production in 2004 and 2005, as reflected on the chart, indicated that the average government take for Libya exceeded 90 percent. "That's a substantial government take number…"

Ms. Kah pointed out that that was "an exact example of why we're not investing as much in upstream, and we're investing in downstream and infrastructure". ConocoPhillips could not invest with those sorts of returns. She surmised that "the Independents can't either. They have a higher cost of capital than us; and therefore they should have higher return requirements. I believe that only like the Chinese national oil companies and other state oil companies would be able to invest in a sustained way at….those lack of returns."

Co-Chair Green stated that the Committee would recess until after the Senate floor session. Ms. Kah would continue her presentation at that time.

RECESS TO CALL OF THE CHAIR 10:56:01 AM / 12:31:00 PM

Ms. Kah continued reviewing the power point presentation slide titled "Why higher taxes would reduce investment". The

conclusion is that higher taxes would reduce industry's "after tax cash flow so we have less money to invest; it changes the risk/reward balance in Alaska; and also capital will go elsewhere." Capital would go to other countries in a company's portfolio and to other energy sources … because the company has determined that "with increased tax rates in some countries around the world that we can't invest profitably in them. And finally our entire industry is going to lose capital if tax rates were to price our industry out of the market and we don't get acceptable enough returns for our shareholders."

12:31:48 PM

Co-Chair Wilken agreed with the argument that "when you tax something you are going to get less of it". His question was whether "the general point" of ConocoPhillips's presentation was to the specific impact of the 25/20 tax structure proposed under CSSB 305 or whether it took into consideration other elements of the bill such as credits.

Ms. Kah qualified that she was speaking to the entire bill. "The tax credits definitely do not offset the much higher tax rate. The overall tax rate is far more important in terms of the economics, and certainly at this price level, it's a five to one ratio of being more important."

Co-Chair Wilken cited there having been "general agreement among the Governor and you folks at the 20 percent rate and then the other four or five major pieces. So what we are really talking about at this table is 25 or 20. So that difference is what your concern is …that that marginal difference is what's going to drive investment away."

Ms. Kah clarified that she had concerns about the 20/20 tax proposal in SB 305. Whether or not it was the right strategy, "companies reluctantly agreed to that just to get to the gas deal. But really it's on the outer edge of acceptability and won't encourage investment".

Senator Bunde recalled discussions in which the industry had urged for "certainty" in a tax structure. To that point, were the State's tax regime to include "a re-opener every five years, perhaps we'd approach it a different way." However, the tax proposal under consideration would not have a re-opener for

thirty years or more. "That has to factor into these discussions."

12:34:19 PM

Ms. Kah concurred. "There is certainly a value to certainty and I believe we are taking that into account when we view the overall fiscal package."

> COP Major Upstream Projects: While I believe there will likely be a long-term adverse impact on investment from rising tax takes around the world, let me bring the discussion back to corporate allocation decisions we face in the next 15 years.
>
> This slide represents the pipeline of upstream investments ConocoPhillips is pursuing in the next 5 years. We are planning on continuing investments in our base legacy OECD areas, such as Alaska. But we also are planning investments in global gas and other international areas. Investments in Alaska must be able to compete with investments in these other areas. The tax rate needs to be commensurate with Alaska's high cost and low prospectivity to ensure this state maintains its important place in our investment portfolio.

Ms. Kah stated that were the State's tax regime to change "in an unfavorable way", ConocoPhillips might be required "to make tough choices" about which of the projects in its portfolio "go forward, which get deferred".

12:35:25 PM

Senator Bunde stated that the "rhetorical question" is, were the State to guarantee a 15/20 tax rate, could ConocoPhillips "guarantee us a certain amount of investment in the next ten years. Certainty goes both ways."

Ms. Kah acknowledged the underlying message in the question.

> Portfolio Ranking: Another concern I have with the state consultants' assessment that Alaska can raise its tax rate without hurting investment is their implicit assumption that all projects with a positive net present value will be undertaken. That assumes that there is unlimited human and

financial capital. Our shareholders expect companies to exercise capital discipline and to avoid doing marginal projects. We also have limited manpower and focus on projects that have sufficient scale to make a difference to the company.

As indicated in this concept slide, when Alaska raises its tax rates, some projects, like Alaska project number one, will still be in the competitive range but it may be moved down to a lower ranking than other projects the company is planning on, such as upstream project number one and the downstream project shown here. Other projects, like Alaska project number two could slip from being competitive to being deferred. And finally, some projects, like Alaska project number three could slip into the uncompetitive range.

Ms. Kah stressed that, were taxes increased, not all projects having a net present value above zero would be undertaken; competition would exist within the Company's portfolio.

12:38:18 PM

In order to better understand the intent of this concept slide in relation to this bill, Co-Chair Wilken asked whether exchanging the words "'before tax increase' with 'before SB 305 and after SB 305'" would be "appropriate and correct".

Ms. Kah affirmed, but clarified that regardless of the tax levels proposed in these bills, any tax increase would cause projects to be re-evaluated.

What's Wrong With Windfall Profits Taxes: The proposed bill has a surcharge based on ANS West Coast oil prices over $40 per barrel. This is tantamount to a windfalls profit tax because it shaves off the upside without helping on the downside.

The U.S. federal government has recently debated the merits of a windfall profits tax on domestic production, and this concept drew great criticism from a broad range of economists and investors across many industries. I have provided two quotes that represent the criticism of such a tax. Daniel Yergin of Cambridge Energy Research Associates stated in an interview that "what a windfall profits tax

does is introduce a lot of distortion. It reduces investment, it increases a sense of political risk and it doesn't achieve the goal that is intended…it will really lead to decreased supply". A group of 250 economists from academic and other institutions across the nation, including Milton Friedman, the Nobel Laureate in Economics, recently sent a letter to the U.S. Congress stating their opposition to such a tax, indicating that it would reduce domestic production and expressing sadness that politicians hadn't learned any lessons from past experience with this type of tax.

The non-partisan U.S. Congressional Research Service (CRS) assessed the impacts of the federal windfall profits tax on domestic crude production that was in effect from 1980 to 1988. CRS concluded that the tax reduced industry gross revenues by $79 billion that could otherwise have been used for investment. As a result, the tax was estimated to have reduced domestic production by up to 1.6 billion barrels between 1980 and 1986, before the collapse in oil prices. It also increased oil imports by up to 16% during this period. The study also noted that the actual gross tax revenue collections were only 20% of what the federal government had expected. This was because prices did not remain at the very high levels of 1980 and domestic production ended up lower.

12:41:21 PM

Value Uncertainty in Balanced Government Take: Now I want to demonstrate how a windfall profits tax would impact our project economics and investment decisions. In evaluating investment opportunities, ConocoPhillips considers risk and opportunities associated with an investment. Assuming a stable fiscal environment, factors that most often impact our North Slope investments are:

- Oil price uncertainty, which accounts for the majority of NPV variance,
- Reserves and capital spending,
- Operating costs, and
- Schedule, which is particularly important in Alaska as construction windows are limited. Missing a key construction window (e.g. a sealift) can easily delay the project by a year

The impact of the sensitivities for these key variables are demonstrated in a chart called a Tornado Diagram. In a Tornado Diagram, the impact of a given variable on the project value is tested by holding all other key variables at their mean value and varying the variable being tested through the high and low end of its expected ranges. For example, in the tornado diagram pictured on the left, the price bar is truncated so that there is more downside than upside price risk. After running all the probabilistic simulations, this would shift the cumulative probability curve to the left so that the project loses money 53 percent of the time and has a positive net present value only 47 percent of the time. The expected value, reading across to the 50th percentile is now slightly negative. This decrease in project value is purely associated with reducing the upside potential associated with oil price. In other words, shaving off higher price risk creates greater risk that the project will not increase value. Thus, the project will probably not be approved.

Ms. Kah communicated that since the industry incorporated "conservative price assumptions" such as a $35 per barrel in its economic calculations, "people think" what would "be wrong with taking away the upside". However, no single price was the basis of the industry's economics. The tornado diagram depicted on this power point chart further explained how the industry "actually values investments". Typically, a price range of $20 to $80 per barrel would be considered and factors would be applied to that range to gauge their affects. "The price of oil by far" would create the biggest uncertainty for a project. 80 percent of the variances in projects were due to changes in the price of oil. "Probabilistic weightings" are applied to the various prices.

Ms. Kah explained that "the simplest distribution" would be "to assign a 50 percent weight to the mean price, 25 to the high price, and 25 to the low price". Similar probabilities would be applied to other economic factors such as reserves and capital operating costs. Thousands of multilayered simulations were applied in the effort to develop a cumulative probability curve which would "show you the probability that the project will have either a positive or negative net present value." The risk of having a positive or negative net value would be depicted

"across a range of prices and all these other variables". She reviewed the example depicted on the chart.

12:44:10 PM

Senator Stedman understood that the project exampled on the chart illustrated the concept of the process rather than a real scenario. Since, oil prices were the real issue of concern, a project's modeling would be affected by the proposed Progressivity factor since it "would shave off some of the upside". To that point, he asked whether the economic modeling of a project with a $20 to $80 price range would be treated as an "equally distributed price range".

Ms. Kah responded no, "the usual assumption we make about prices is that they're log-normally distributed and they're not normally distributed; they cut off at the bottom 'cause you start getting into shut-in costs quickly and they tend to spike up".

Senator Stedman understood therefore that the modeling would be "skewed to the right, substantially".

Ms. Kah affirmed. "That's what we're taking into account when we look at our upside. The upside is why our shareholders invest in energy stock."

Senator Stedman surmised that the presentation would also address "the impact of taking away the upside".

Ms. Kah confirmed.

Senator Stedman asked that "the magnitude" of that impact on the upside be discussed, "as clearly there's a impact, but what we're looking at is … a slight change" as the analysis conducted by the Administration indicated that the State's government take numbers would remain fairly constant going forward under CSSB 305.

12:46:17 PM

Ms. Kah expressed that, while the projects presented in her presentation were fictitious, the majority of ConocoPhillips' projects mirrored the examples. She reiterated that price accounted for 80 percent of the risk in a project. Capital,

reserves, operating costs, and schedules were also risks experienced in Alaskan projects.

> Balanced and Progressive Value Uncertainty Comparison: this slide summarizes how shaving off the upside price risk reduces the change that the project will be profitable and reduces the expected value. In this case, the project is far less likely to be undertaken without upside price risk.
>
> It is also important to understand that our shareholders invest in energy companies because they want to be exposed to upside price risk. We will have trouble attracting capital if we were no longer exposed to this risk. Being a high cost area, Alaska in particular, is a high-price play, and shaving off the upside will disproportionately impact investment in the state.

Ms. Kah reviewed the impact of "shaving off the price upside". It would remove real value and thus the expected value would decrease. The reason that a project could easily shift from being positive to negative is "that this was probably a marginal project to begin with". It would be likely "given the maturity, cost, and prospectivity issues in Alaska, that a lot of the projects" being considered "are marginal".

Ms. Kah compared the two graphs. "It looks like a very subtle shift but what has happened is that there is a greater chance of loosing money than there was before and you are less likely to do the project now than you would have before."

Ms. Kah stressed that "we do take account of the upside price risks. Our shareholders invest in our stock because they want to be exposed to the upside price risk and we do value it in our economics." Removal of the upside price risk would have an impact, "even if that isn't our mean belief of what we believe prices" would be in the future.

12:48:46 PM

Co-Chair Wilken furthered the position that as the price of ANS increased, industry costs would "only increase at an incremental amount". CSSB 305 would result in "a flat government take" out to a range of approximately $120 per barrel. The citizens of the State, who could be considered State shareholders, relied on Legislators "to make sure that we get our fair share, and our

fair share is that the government take at $40 is the same at $120." He also considered it "perfectly appropriate to have a progressivity factor". Where ConocoPhillips to benefit "by the market", the people who own the resource should also "benefit by the market"; that concept is what is embodied in the PPT. This is the concept he supported provided that the State's take remained constant rather than getting "exponential" as prices increased.

Ms. Kah argued that the State would benefit as prices increased. "Even if you held your percent the same" as revenues increased the State would get more rather than being "held flat".

Mr. Bowles emphasized ConocoPhillips's desire to continue to operate and invest in Alaska. "One of the key premises" stressed today "is that there are numerous locations" worldwide that companies operating in Alaska consider in their investment portfolio. "It's not so much of what's fair to the State or fair to the company" as much as it would be to "what you want to see developed in the State … It's your call at the end of the day of how much take that you want, but" companies might determine, "even it it's a flat take at higher prices", that other regions tax regimes were "more attractive", as expressed in Mr. Bramley's OECD presentation.

Co-Chair Wilken responded "that's fair".

> Finding, Developing & Production Costs: This last point I want to make about a windfalls profits tax is that some of what is being perceives as a windfall is actually higher reserve replacement costs. Let me explain.
>
> While price increases across all of our energy products have recently increased our industry's earnings to record levels, it is only temporary as we are also experiencing enormous cost inflation as the industry ramps up its investments to increase supplies. This chart shows that industry finding, developing and production costs have more than doubled since 1999, excluding government take. F&D and production costs are the components of replacement cost most quoted because they are the easiest to measure in the financial statements of oil companies. However, this chart is missing a number of the components of reserve replacement costs. It is missing all government take, which on average was probably about $20-25 per barrel in 2005. It

is also missing a cost-of-capital return and an adjustment reflecting compensation for the time value of money because you are spending money in year zero and getting production and revenues many years later. If replacement cost is being stated in terms of WTI prices, these numbers are also missing additional quality and transportation costs because most crudes are more remote and lower quality than WTI. When you add all these costs up, it is easy to see that replacement costs today are probably over $50 per barrel. In fact, several financial analysts (e.g., Goldman Sachs, Bernstein) who track the energy business believe that long-term reserve replacement costs today are over $50 per barrel when government take and the increased risk around cost uncertainty are included in the cost calculation.

While oil prices may have peaked, spending levels and costs are continuing to rise. Some of this inflation reflects temporary conditions such as service industry capacity not keeping pace with industry spending levels and the high cost of materials like steel due to particularly strong industrial growth in China. Some of the cost increase is structural, and more permanent, though, reflecting the fact that our industry is investing in prospects that are smaller, more complex or remote and higher cost.

We are concerned that some of what people perceive is a "windfall" today actually reflects the tremendous cost inflation that has taken place in the industry. In addition, the size of the major's earnings sounds large to most people but it reflects the scale of our business and required investment levels and enormous risk involved in replacing reserves.

This matters because if the alleged "windfall" is taxed at higher rates and reserve replacement costs really are between $50-60 per barrel, our industry will not be able to profitably re-invest even at today's prices.

Key Messages from Corporate Perspective: I will stop here and summarize my key messages.

- It is our opinion that the current tax regime isn’t competitive when compared with Alaska's prospectivity and cost versus the other opportunities we have to invest in around the world.

- Thus, we believe that increasing the tax rate will significantly reduce our investment and production in Alaska.

- We are also concerned about the windfall profits tax the CS would put in place as it would reduce the cash we have to invest, and it would adversely impact the risk/reward balance of investing in Alaska.

- The federal government has tried a windfall profits tax in the past and it reduced investment and production and failed to generate the expected revenues.

ConocoPhillips has been a long-term investor in Alaska. Including our heritage companies we have more than 50 years of business history in Alaska. We believe there can be a great future in this state, and although mature, there remains a lot of potential. We want to be part of this future.

12:55:55 PM

Senator Stedman recalled that the oil and gas industry experienced $12.75 billion in gross revenue in FY 2005. This netted producers approximately 37 percent or $4.7 billion. The government take of the industry share after costs was 45 percent. That would appear "to be a fairly profitable business regardless" of industry's position. This revenue was generated on an average oil price of $43 per barrel. Prices are currently considerably higher than that of FY 2006. This would result in more revenue to the producers and federal and state governments. While Alaska reaped substantial returns at the $43 per barrel price, a price of $20 per barrel would be harmful to all entities.

12:57:25 PM

Ms. Kah acknowledged that the oil and gas industry experienced record earnings in 2005. Their spending level could not keep pace with the swiftness of rising prices. "But what we quickly found was that when we tried to reinvest and look at new projects at today's cost levels, nothing looks economic. It's actually frightening to us"…. thus, the development of this

forward looking concept. The typical industry profit margin, even in the year 2007 would be 7.5 cents per unit of sales. Numerous other industries experience higher profit margins. "This is not a particularly attractive industry" even though 2005 was well above an average price cycle. "But we need years like that to offset years such as 1998 where the industry was well below the cycle. A decent return over a ten year cycle" would be desired.

Senator Stedman acknowledged.

Senator Stedman noted that barrel prices have escalated in recent years to the $60 range. Continuing, he asked how long the $20 to $80 range has been used in the industry forecasting modeling, as the forecast must have been adjusted to reflect changing times at some point.

Ms. Kah stated that price range was implemented in 2005. The price range might have included a high of $75 previously. The industry however, always included a spike on the price high side due to the log-normally distribution nature of the industry.

12:59:29 PM

Mr. Bowles summarized key points in the presentation. ConocoPhillips "fully supported the idea of a percent of government take that's competitive and that could be used as a yardstick as far as how you set the production tax rate that we're looking at today". ConocoPhillips asked the Committee to consider "one message" in the effort to determine an appropriate tax rate: that being that the OECD countries be considered as "the core competitors" for the capital that might be invested in Alaska.

Mr. Bowles also pointed out that there is "a direct connection" between increased taxes and investment and jobs. Increased taxes would reduce industry capital and would affect the industry's risk/reward economic decisions. The risk/weight economic modeling utilized by ConocoPhillips was a standard industry approach to considering whether a project would be undertaken.

Mr. Bowles professed there to be "a fine balance" in determining a correct tax level. A "tax increase that goes too far" could "take more value away from the State than what" it would generate in the short term. He encouraged the Committee to ask

other consultants to comment on some of the ideas being presented in this testimony.

Mr. Bowles noted that whether or not the 20/20 proposal presented in SB 305 would strike the right balance was difficult to predict. However, it would "be fair to say that it did strike a balance and it was something that the industry was prepared to go forward with". The addition of the Progressivity element in CSSB 305 "is something that does definitely take away the upside and is an item" that would affect any company's decision about whether or not to advance projects in Alaska.

1:02:26 PM

Mr. Bowles noted that, while the presentation had not addressed the bill's transition provisions, ConocoPhillips had reviewed the transition look-ahead provisions included in CSSB 305. The look-ahead provisions were evidence that the Senate recognized that investments made during the last five years, some of which had not yet produced any oil, were made under a previous "set of rules and tax forecasts". The look-ahead provisions which would allow a two dollar investment to receive one dollar in credits "would effectively offer an incentive" to a company which had made investments during the past five years. This was an example of many right balances that could be included in the bill.

Mr. Bowles favored SB 305's July 1, 2006 start date or a later date rather than the April 1, 2006 start date included in the committee substitutes. A start date later than July first would provide more time for companies to adjust to the changes in the tax regime.

Senator Stedman asked whether the industry considered the five year look-back and five-year look-ahead provision specified in the transition provisions of the bill to be sufficient time in which to conduct exploration and development activities in consideration of worldwide equipment and labor constraints.

Mr. Bowles appreciated the question. ConocoPhillips would consider a look-ahead recoupment period of seven or eight years on a five-year dollar look-back to be more appropriate. Rather than a company being unwilling to invest at a level in which their "expenses could be fully recouped", delays might be caused by other limitations such as equipment and labor constraints.

1:05:57 PM

Co-Chair Green reiterated that Members should notify her of any subjects they would like included in the set of questions being developed.

Senator Hoffman asked whether the Alaska Permanent Fund Corporation (APFC) had invested in ConocoPhillips.

Mr. Bowles understood that, while APFC wished that some investment had been made in companies investing in the State, no such investments had been made. This could be part of the "alignment" issue discussion.

Co-Chair Green stated that public testimony on the PPT bill was scheduled for Saturday, April 8th.

Co-Chair Green reminded the Committee that a joint hearing with the House Finance Committee would convene this afternoon. A presentation on the Alaska Gas Pipeline Project would be conducted by Econ One Research, Inc.

The bill was HELD in Committee.

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ADJOURNMENT

Co-Chair Lyda Green adjourned the meeting at 1:07:32 PM.