2/1/06 OVERVIEW: PROFIT SHARING PRODUC-TION TAX ANALYSIS

SFIN

FILE

PPT, new investments and international competition

February 1,2006

Presentation to the Joint Senate House Finance Committee

INTERNATIONAL TRENDS

The high oil prices have had an important impact on the international government take.

Progressive countries:

- "One Way" adjustment

  NWT, Angola, Russia, Azerbaijan, Libya

- "Two way" adjustment

  Alberta, Norway, Indonesia

Regressive-Neutral countries:

US, UK, Egypt, Argentina

INTERNATIONAL TRENDS

The high oil prices create a possibility for the regressive-neutral countries to increase their government take. Several countries have already done so:

- UK
- Trinidad & Tobago
- Kazakhstan
- Bolivia
- Venezuela

PPT AND CURRENT TERMS

The PPT on new investments depend on the costs, field size and well productivity assumptions.

Six field cases were analyzed under high cost and low cost scenarios:

50 MM	– low well productivity
150 MM	- low well productivity
500 MM	- low well productivity
50 MM	- high well productivity
150 MM	- high well productivity
500 MM	- high well productivity

Because of special support for small producers, two scenarios will be evaluated:

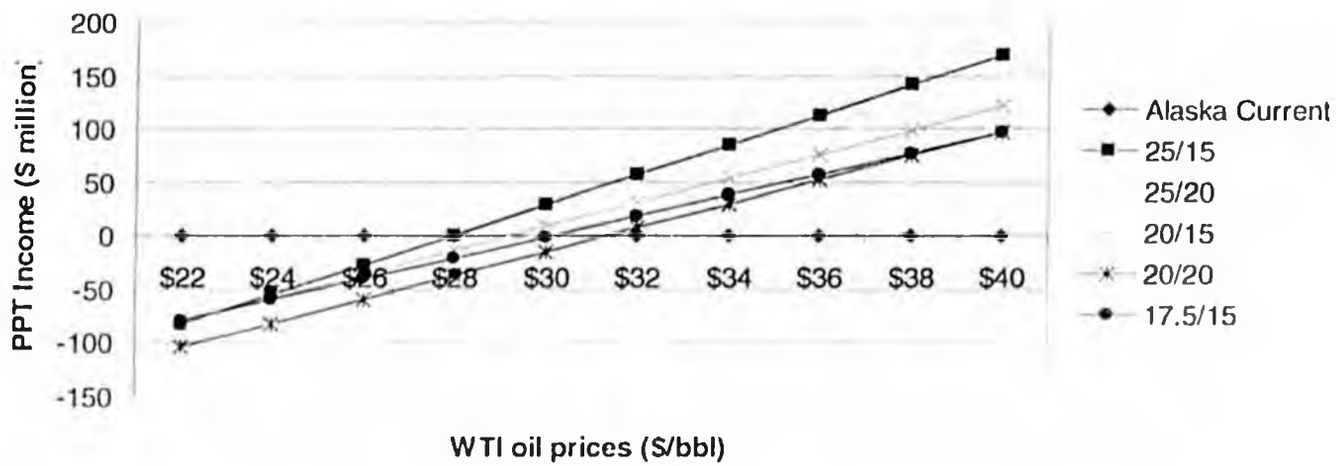
First Investment

Re-investment

PPT AND CURRENT TERMS

Re-investment in a 50 MM barrel field

PPT income, re-investment, 50 MM bbls, high costs, low well productivities

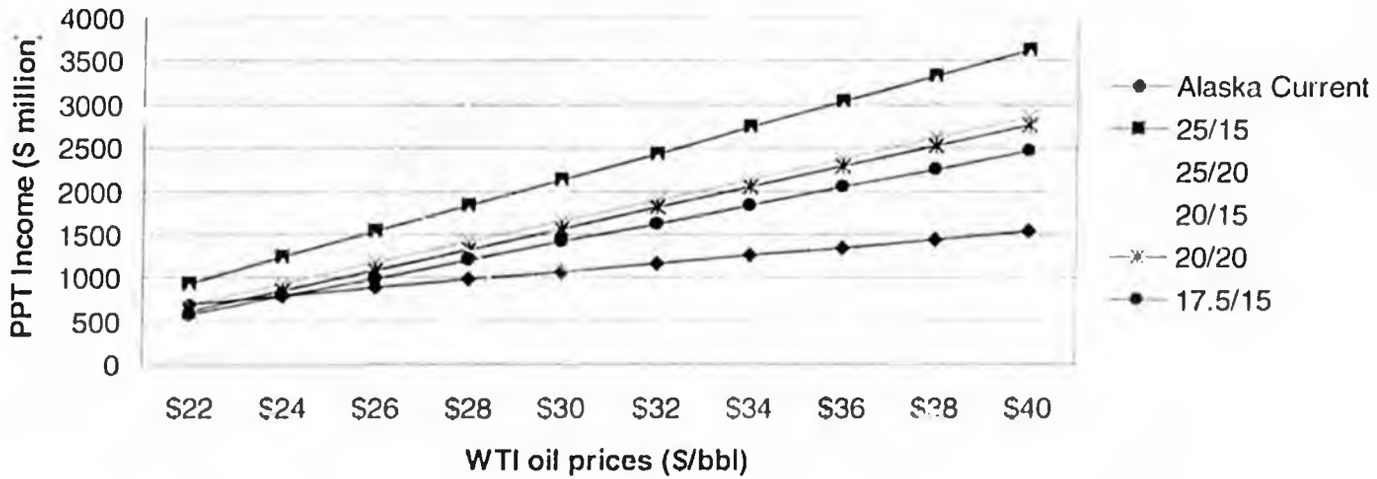


Alaska will collect more production tax under high oil prices even on a small 50 million barrel field.

PPT AND CURRENT TERMS

Re-investment in a 500 million barrel field

PPT income, re-investment, 500 MMbbls, high costs, high well productivities

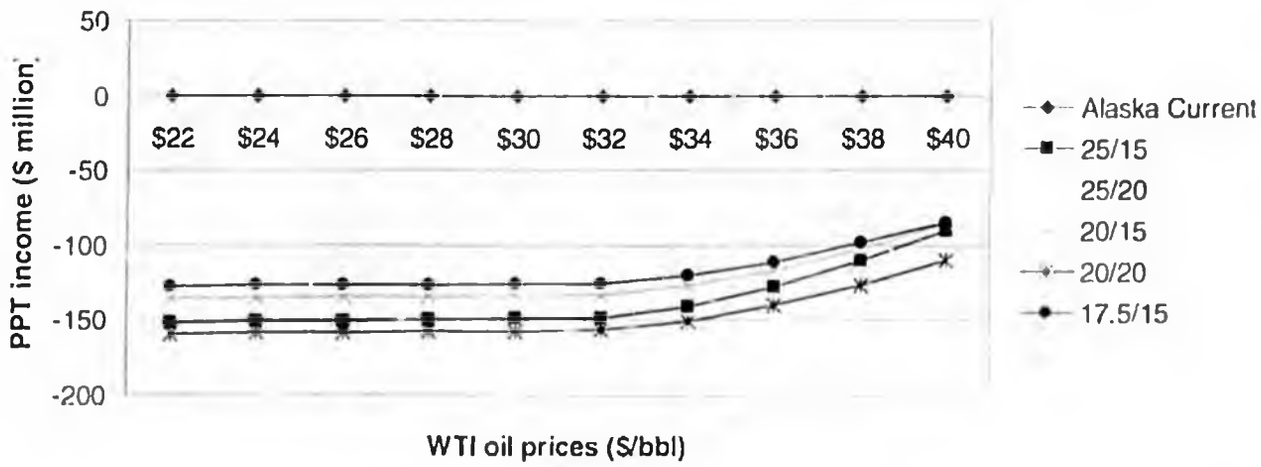


On large fields, Alaska will collect more production tax under average and high oil prices

PPT AND CURRENT TERMS

First investment in a 50 million barrel field

PPT income, first investment, 50 MM bbls, high costs, low well productivities

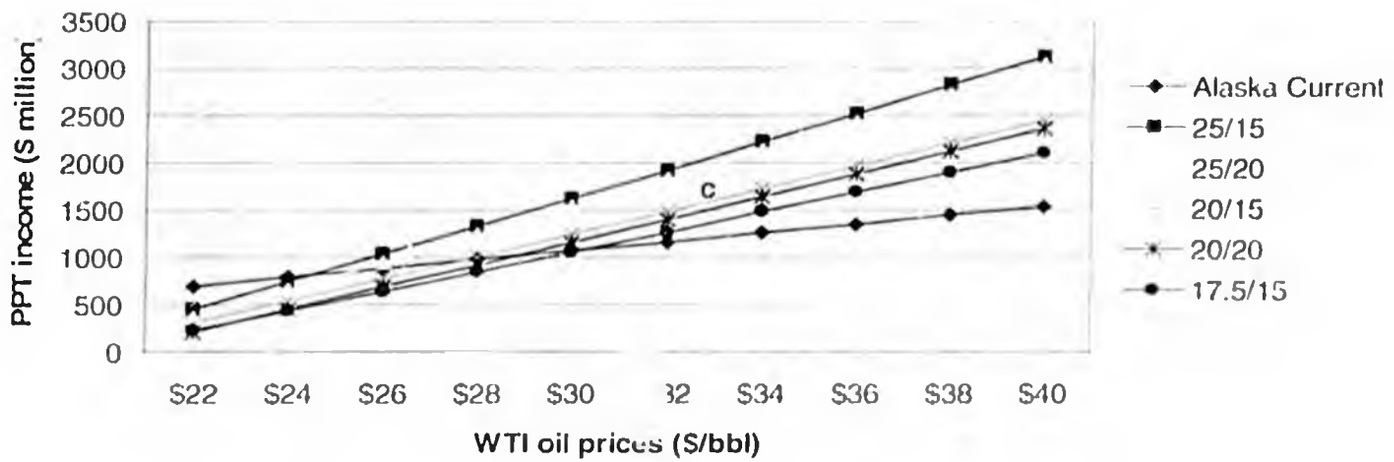


A small producer will not pay PPT and therefore on a small field, such producer will only earn tax credits, which can be traded.

PPT AND CURRENT TERMS

First investment in a 500 million barrel field

PPT income, first investment, 500 MM bbls, high cost, high well productivities

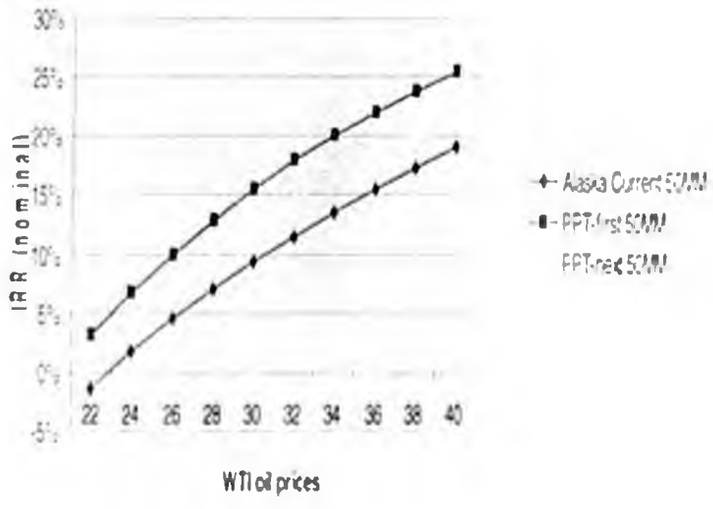


A first investment in a large field will result in considerable PPT under high prices, but less than under a re-investment scenario.

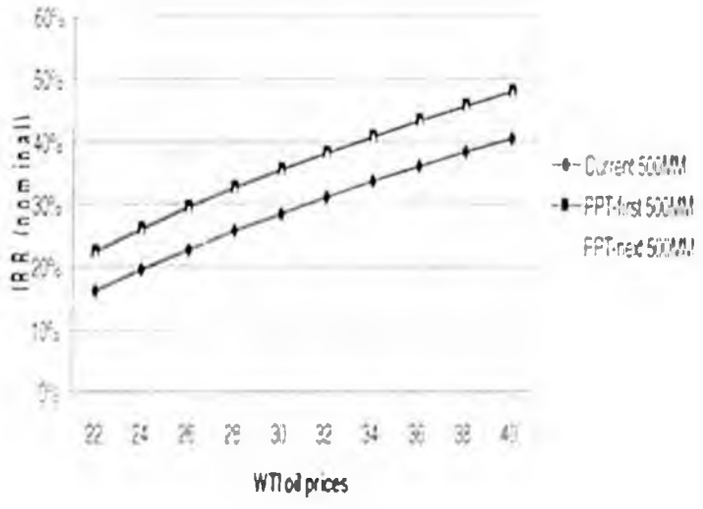
PPT AND CURRENT TERMS

Impact on investors: 50 and 500 MM barrel fields

IRR for 50 million barrel - low productivity case, high costs



IRR of 500 million barrel - high productivity case, high costs



The tax credits under the PPT improve the IRR for first investment or re-investment, regardless of field size and cost conditions (20/15 case was used for illustration)

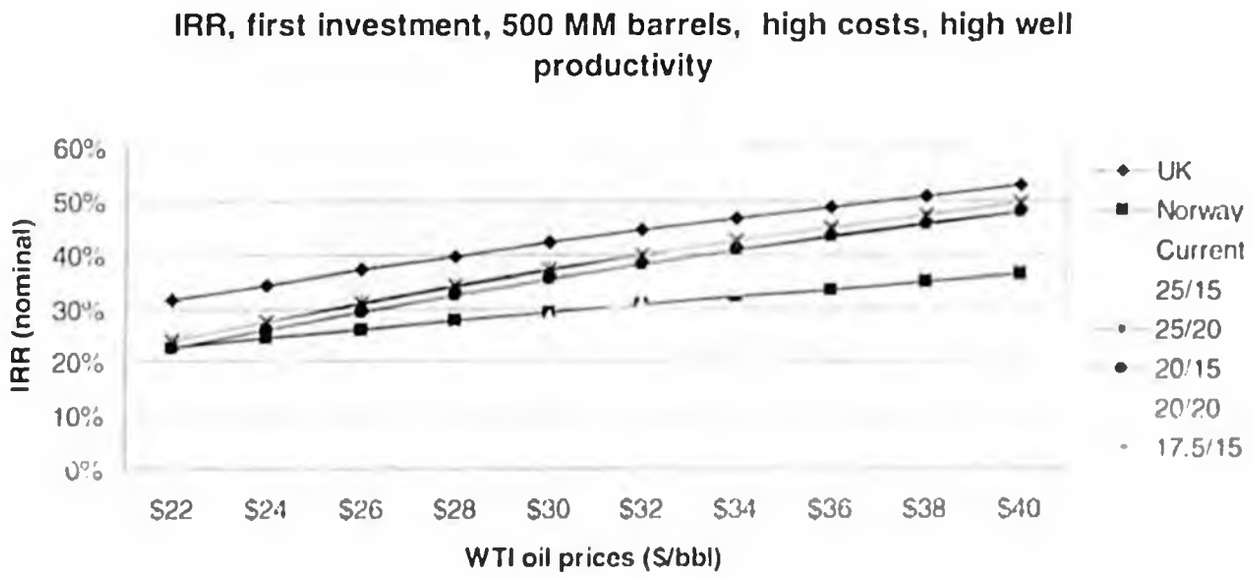
PPT AND COMPETITION

The competitive position of the Alaska system was analyzed using the same field sizes and applying international terms. Eight fiscal systems were analyzed. They all reflect areas in the world where currently considerable investment is taking place:

- Norway
- UK
- US Gulf Coast
- Alberta Oil Sands
- Nigeria
- Angola
- Russia-Sakhalin
- Azerbaijan

PPT AND COMPETITION

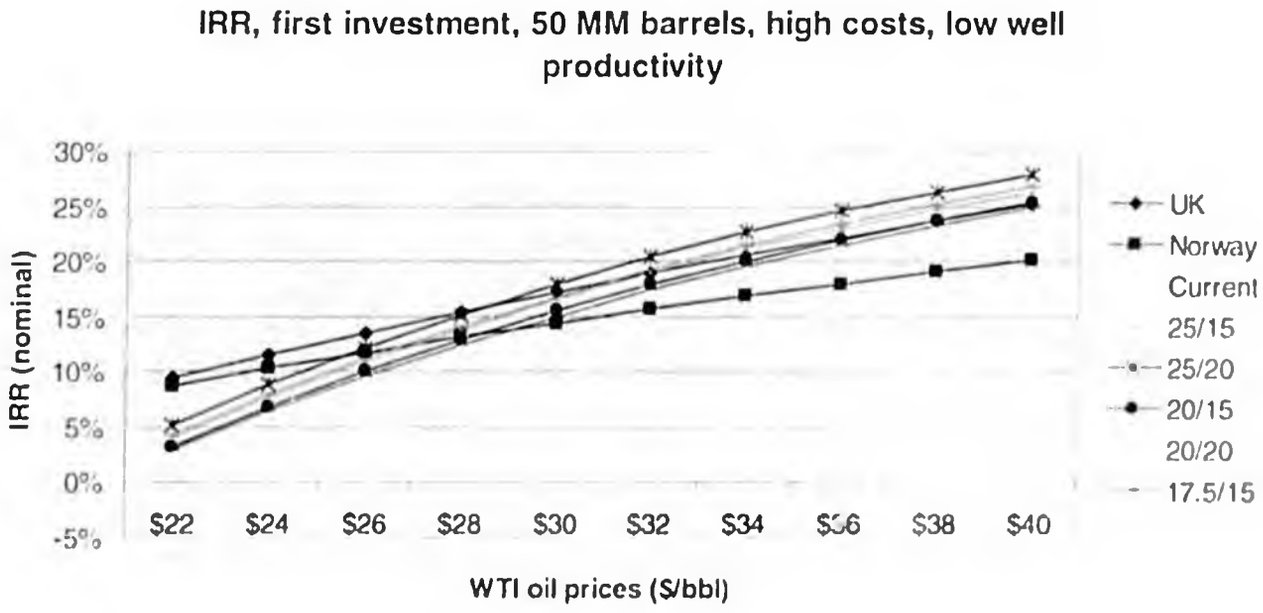
First Investment in 500 MM barrel field



The PPT creates a very material improvement in IRR relative to Norway and UK, for a first investment in a large field.

PPT AND COMPETITION

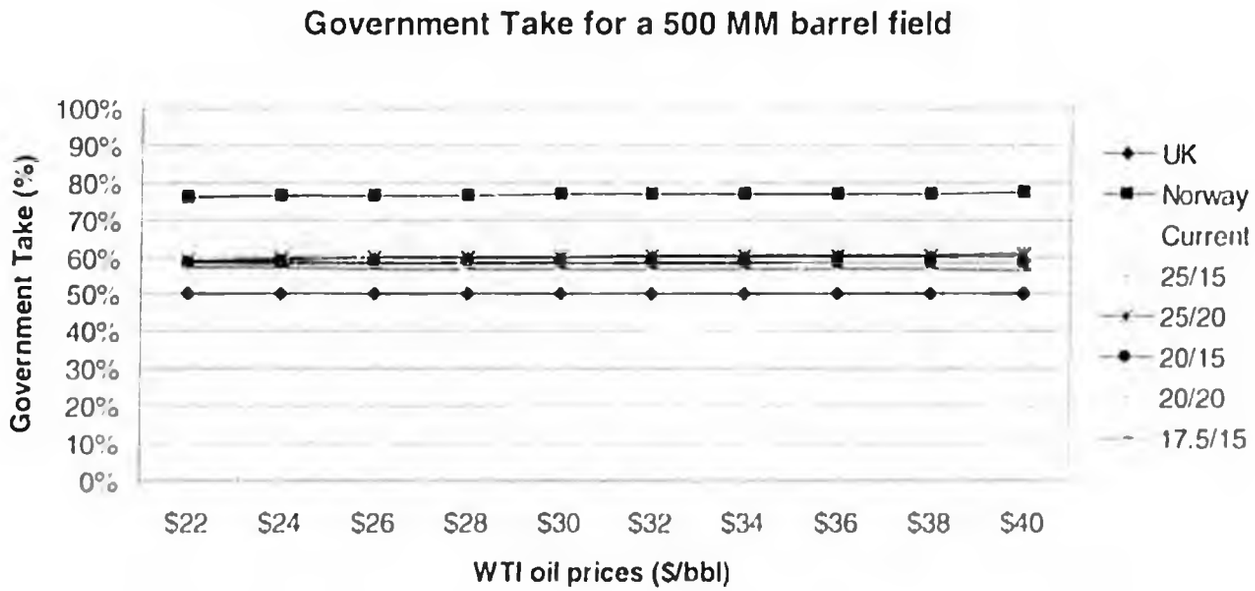
First Investment in 50 MM barrel field



The PPT creates a very significant improvement in IRR relative to Norway and UK, for a first investment in a small field.

PPT AND COMPETITION

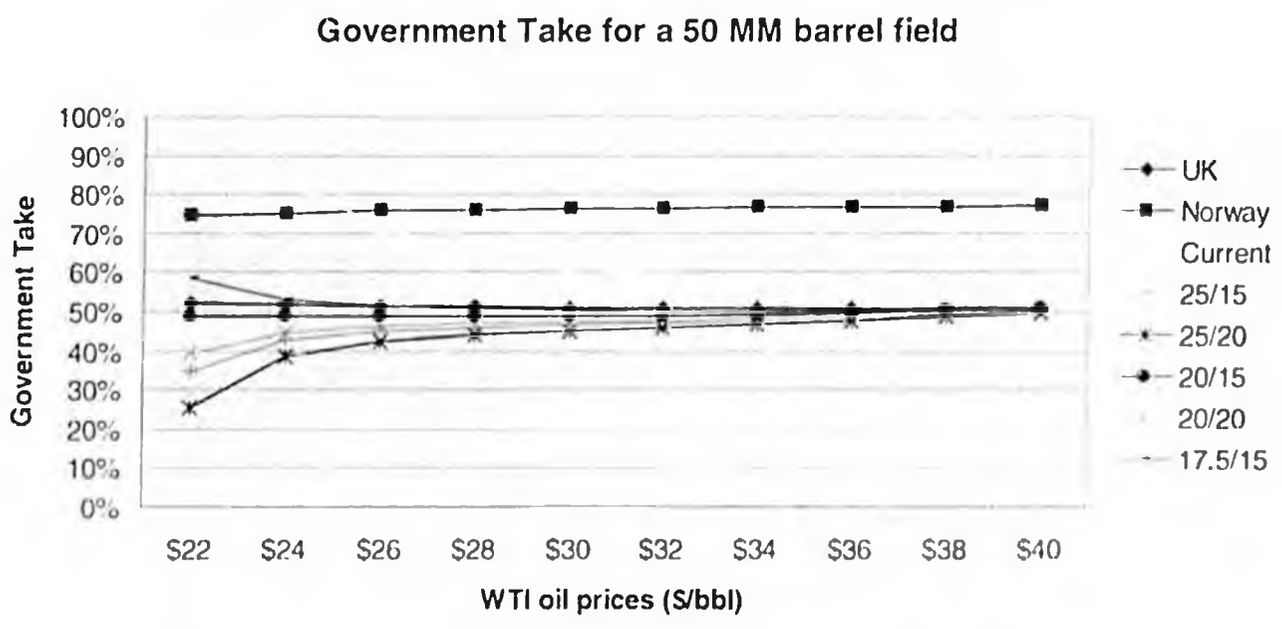
First Investment in 500 MM barrel field



The PPT provides for a modest total government take for each of the five options, in order to compensate for the low net back prices and high costs.

PPT AND COMPETITION

First Investment in 50 MM barrel field



For first investors or small producers there is a reduction of government take compared to the Current System. The regressive nature of the government take is removed for each of the five options.

PPT AND COMPETITION

First Investment

COMPETITIVENESS INDEX

Hypothetical best	**48**	
US GOM	**52**	**#1**
UK	**135**	**#2**
Alberta-Oil Sands	**157**	**#3**
Nigeria	**172**	**#4**
Alaska PPT	**272**	**#5**
Angola	**318**	**#6**
Azerbaijan	**329**	**#7**
Alaska Current	**364**	**#8**
Norway	**397**	**#9**
Russia-Sakhalin	**444**	**#10**
Hypothetical worst	**480**	

The lower the number the better the rating. The table shows a considerable improvement in overall competitiveness for the PPT for **new investors** (20/15 options was used)

PPT AND COMPETITION

Next Investment

COMPETITIVENESS INDEX

Hypothetical best	**48**	
US GOM	**51**	**#1**
UK	**131**	**#2**
Alberta-Oil Sands	**153**	**#3**
Nigeria	**169**	**#4**
Angola	**307**	**#5**
Alaska PPT	**322**	**#6**
Azerbaijan	**323**	**#7**
Alaska Current	**353**	**#8**
Norway	**391**	**#9**
Russia-Sakhalin	**440**	**#10**
Hypothetical worst	**480**	

The lower the number the better the rating. The table shows a modest improvement in overall competitiveness for the PPT for **investors who do not benefit from the small producer incentive** (20/15 option was used).

PPT STUDIES

Alaska Department of Revenue

February 1, 2006

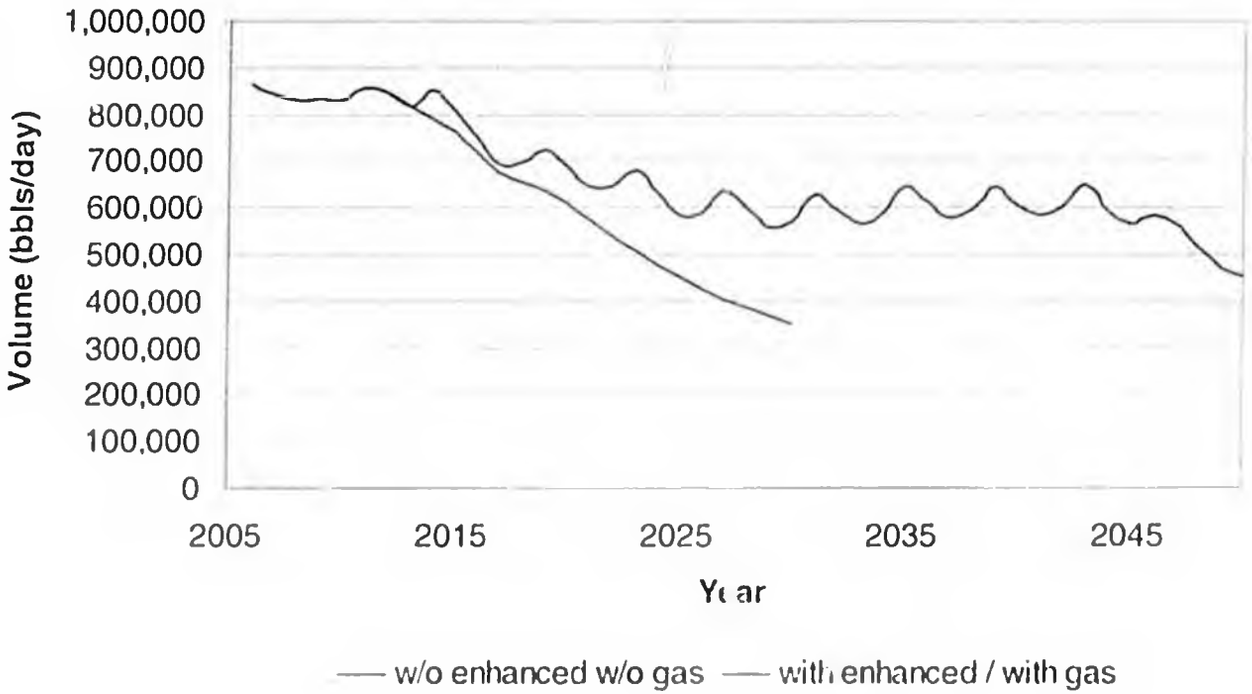
PPT

- Wellhead Value less:
  - Operating cost
  - Property tax
  - Royalty
  - Capital cost
- *x* tax rate
- *y* credit on capital costs

Volume Scenarios

- No enhanced volumes / No gasline
- Gasline and enhanced volumes

Figure 1
Volume Scenarios



Costs and Prices

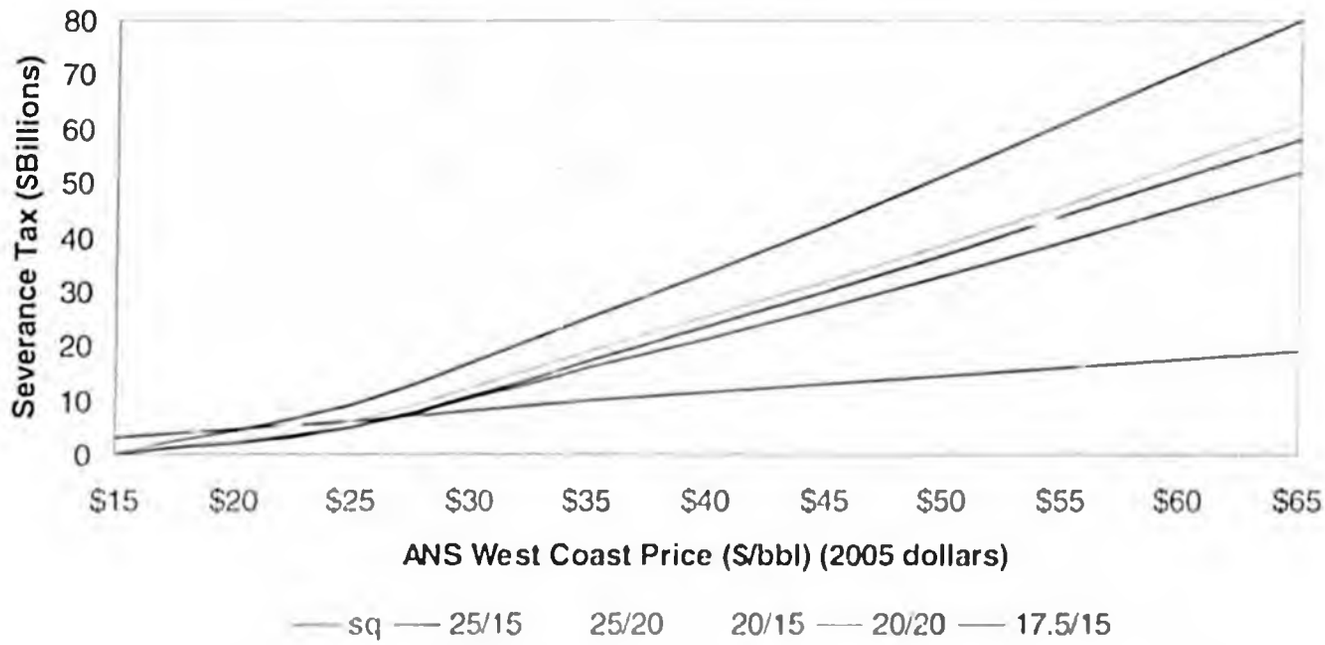
- Costs
  - $100 mm/yr exploration
  - $1/bbl on-going capital
  - $4/bbl developmental capital on 2/3 of oil on existing fields
  - $4/bbl developmental capital on new fields
  - $4/bbl operating costs

Costs and prices are real $2005 dollars escalating at 2%/year

Cumulative Revenues

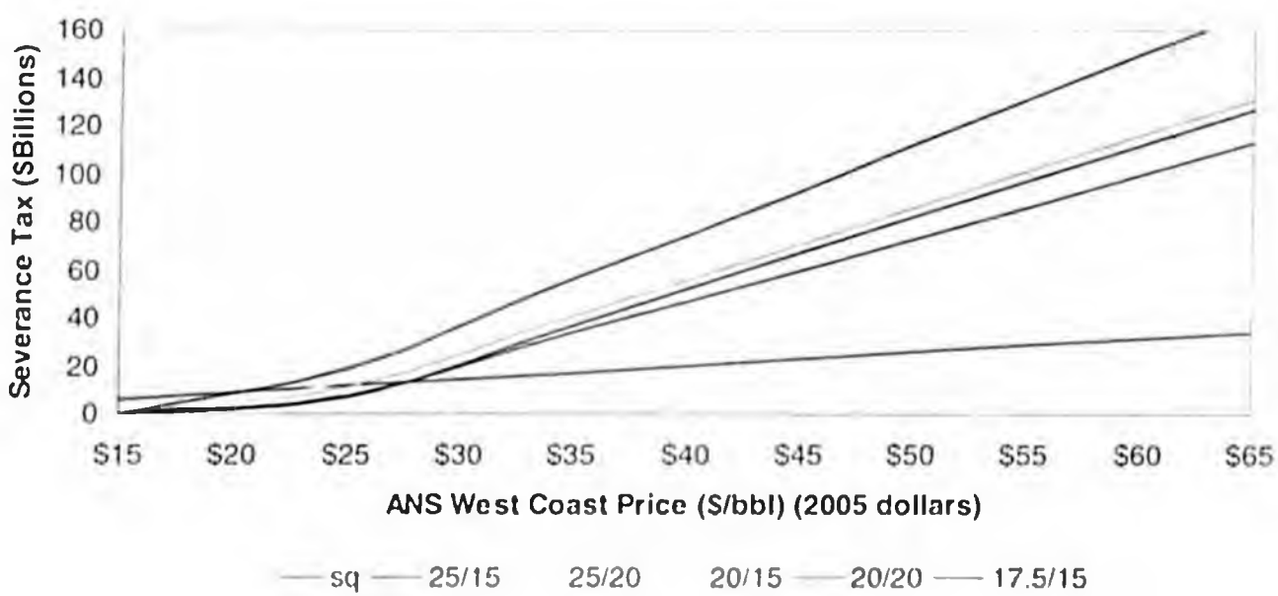
- Without enhanced volumes / without gasline (through 2030)
- With enhanced volumes / with gasline (through 2050)

Figure 2
Cumulative Oil Severance Taxes 2006-2030 ($)
Without Gasline / Without Enhanced Volumes



Total revenues $3 billion less to $61 billion more than status quo

Figure 3
Cumulative Oil Severance Taxes 2006-2050 ($B)
With Gasline / With Enhanced Volumes

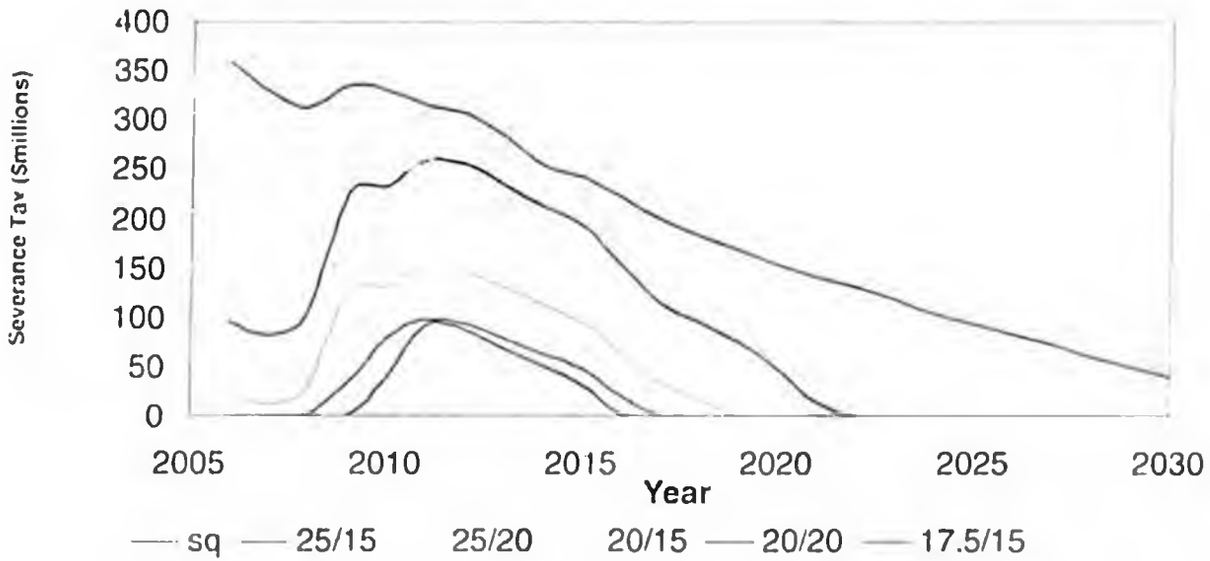


Total revenues $6 billion less to $134 billion more than status quo

Annual Revenues

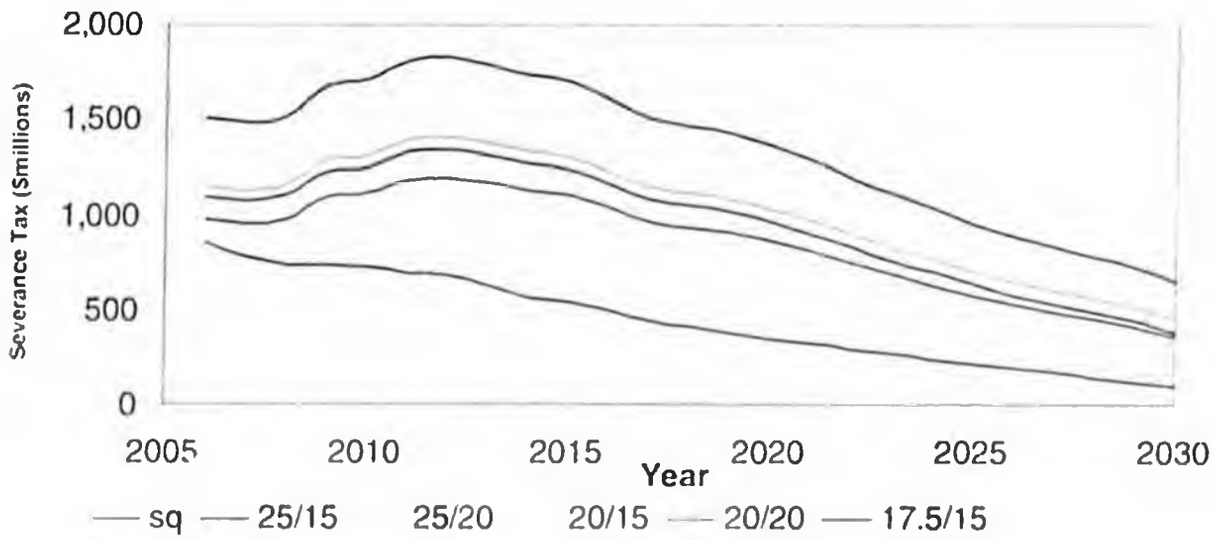
- Without enhanced volumes / without gasline (through 2030)
  - $20
  - $40
  - $60
- With gasline / with enhanced volumes (through 2050)
  - $20
  - $40
  - $60

Figure 4
Annual Oil Severance Tax ($mm)
No Gasline / No Enhanced Volumes
$20



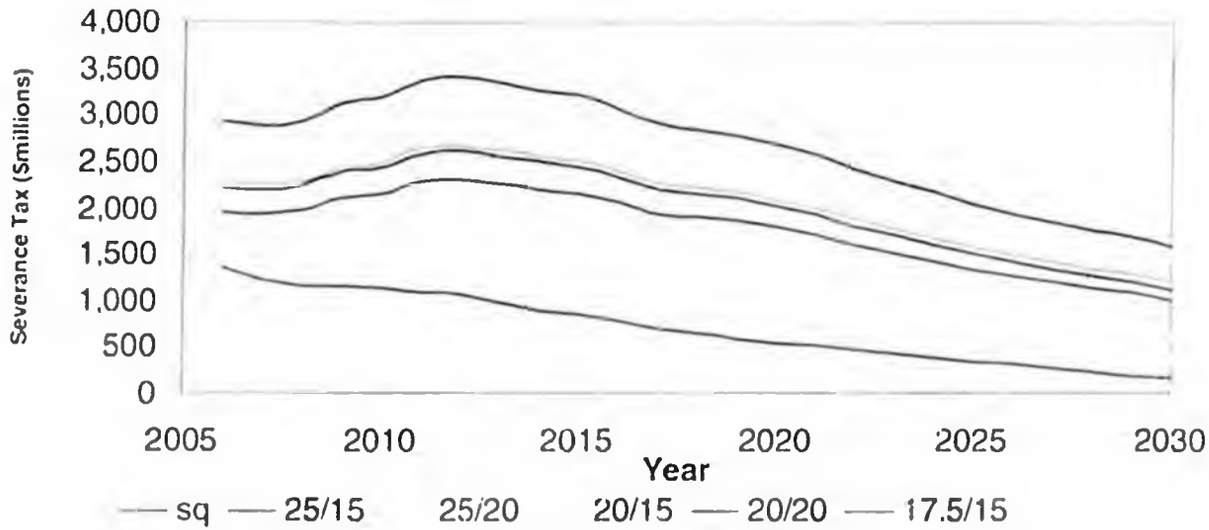
Average annual revenues $100 - $180 million less than status quo

Figure 5
Annual Oil Severance Tax ($mm)
No Gasline / No Enhanced Volumes
$40



Average annual revenues $400 - $900 million more than status quo

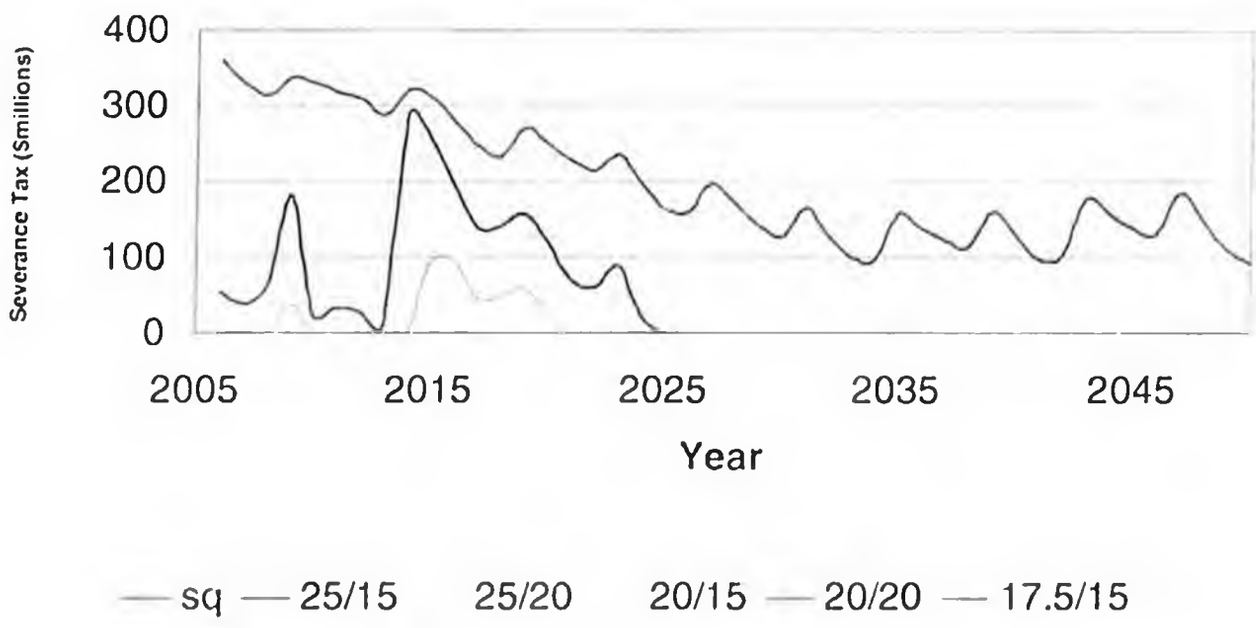
Figure 6
Annual Oil Severance Tax ($mm)
No Gasline / No Enhanced Volumes
$60



Average annual revenues $1.1 - $2.0 billion more than status quo

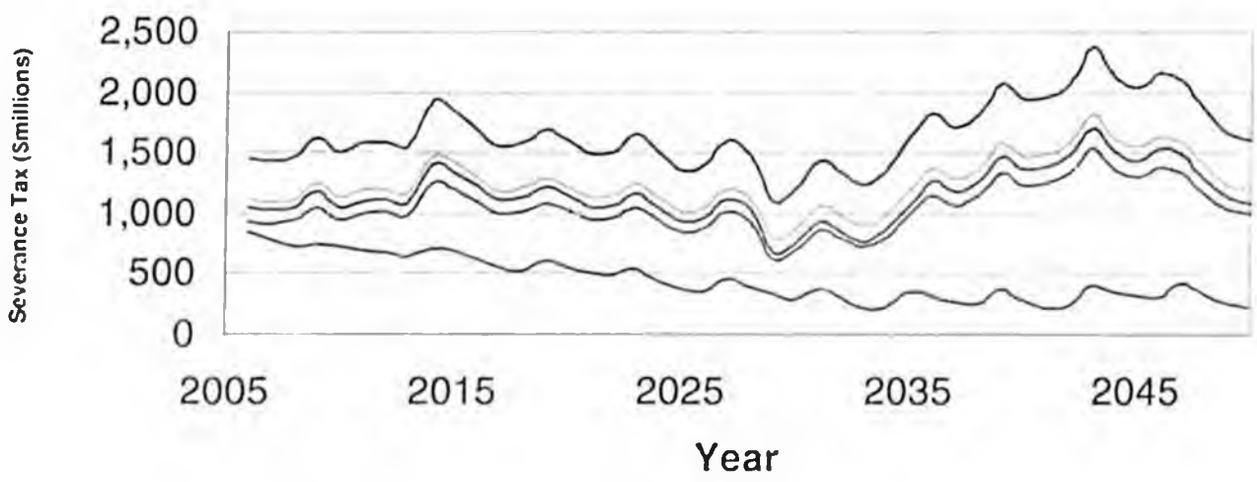
This is equivalent to total State Gasline revenues at a $5/mmbtu market price

Figure 7
Annual Oil Severance Tax Revenues ($mm)
With Gasline & Enhanced Volumes
$20



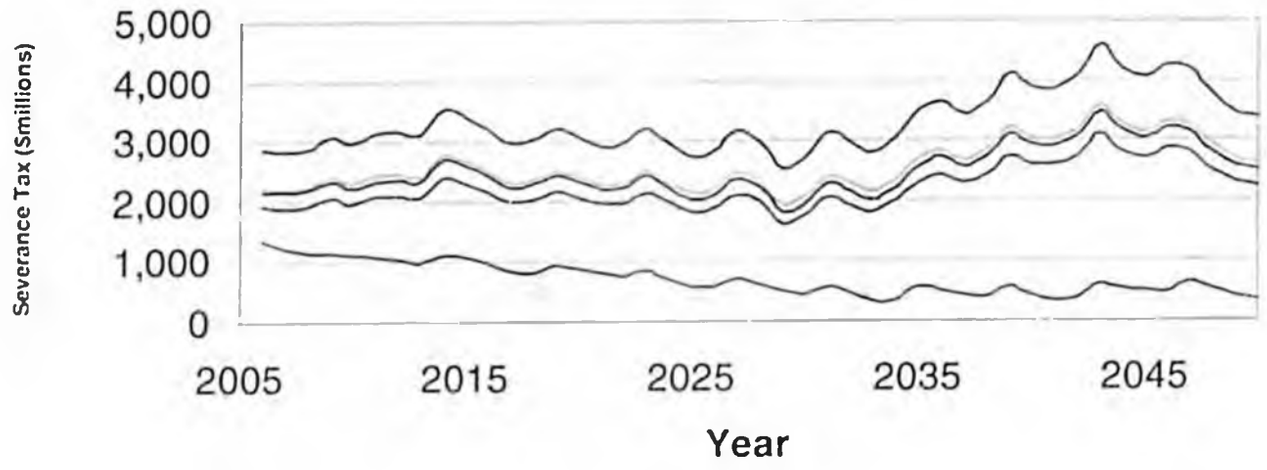
Average annual revenues $150 - $200 million less than status quo

Figure 8
Annual Oil Severance Tax Revenues ($mm)
With Gasline & Enhanced Volumes
$40



Average annual revenues $0.6 - $1.2 billion more than status quo

Figure 9
Annual Oil Severance Tax Revenues ($mm)
With Gasline & Enhanced Volumes
$60



Average annual revenues $1.5 - $2.6 billion more than status quo

Effective Tax Rate

- Without enhanced volumes / without gasline

With enhanced volumes / with gasline

Figure 10
Effective Oil Severance Tax Rate
Without Gasline / Without Enhanced Volumes

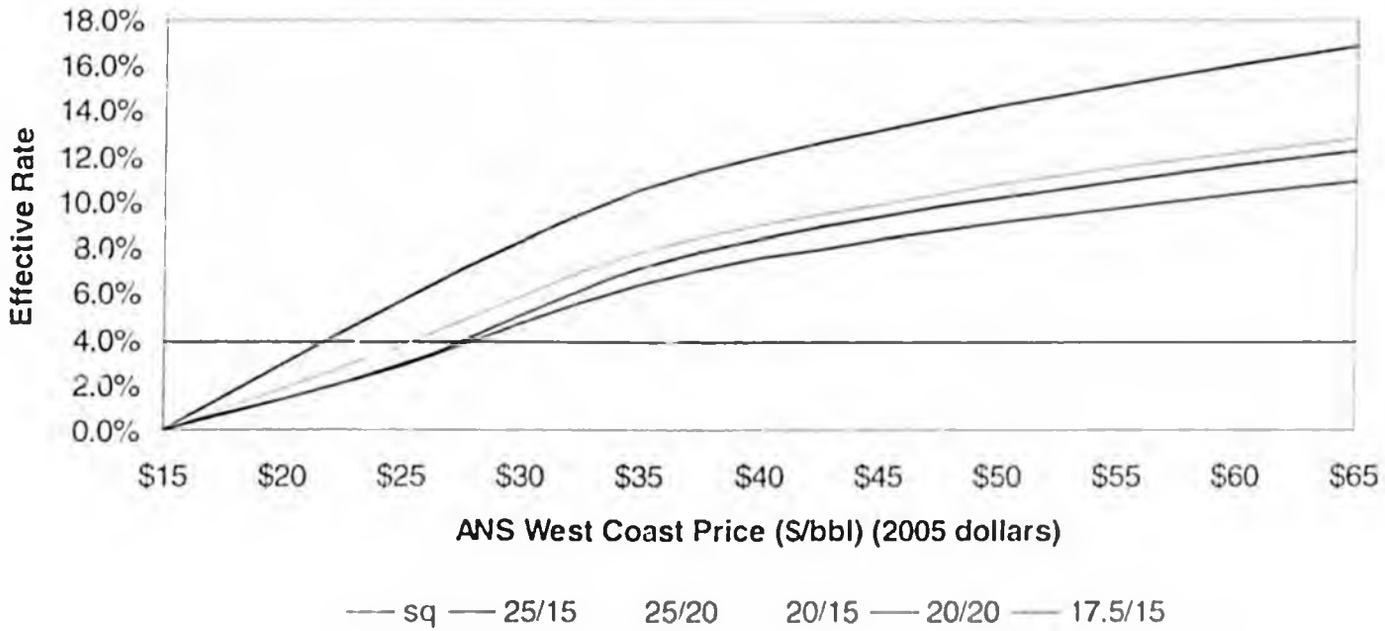
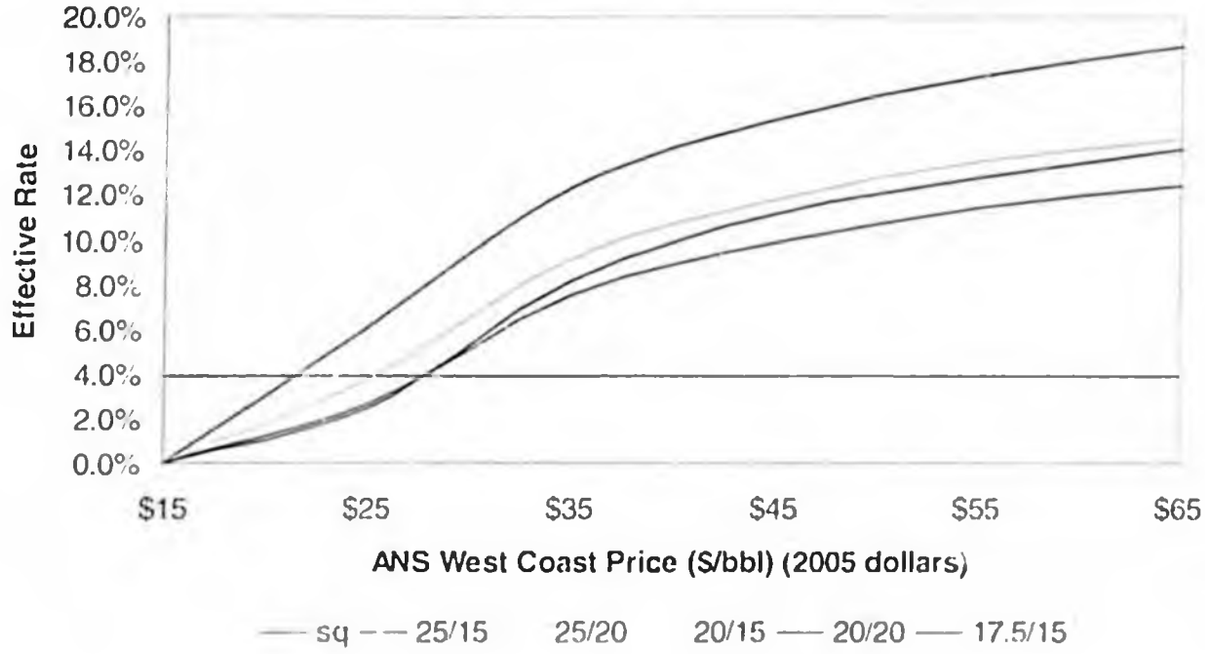
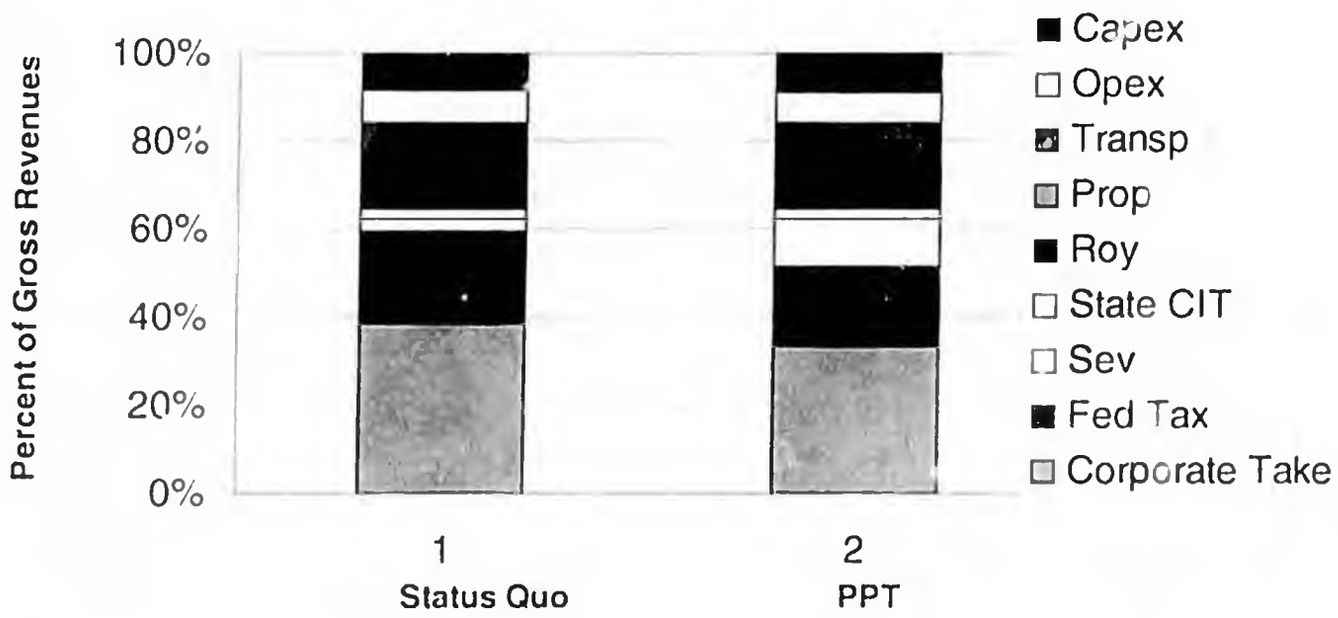


Figure 11
Effective Oil Severance Tax Rate
With Gasline & Enhanced Volumes



Conclusion:
Corporate Take

Figure 12
Corporate Take at EIA Forecast Price ($58)
20% Tax/15% Credit
With Gasline & Enhanced Volumes



Corporate take goes from 39% to 33% of gross revenues,
or from 51% to 44% of the economic rent

PROFIT SHARING PRODUCTION TAX

Presentation to the Senate and House Finance Committee

February 1, 2006

FISCAL SYSTEM OF ALASKA

The fiscal system applicable to oil and gas of Alaska consists primarily of four components:

- Royalties
- Production tax (severance tax, "ELF")
- Property tax
- State corporate income tax

Additionally, there is federal corporate income tax.

This presentation is about proposed changes in the production tax.

CURRENT PRODUCTION TAX

The current production tax for oil is 12.25% net of royalty for the first five years of production and 15% thereafter. These percentages are multiplied by the Economic Limit Factor (between 0 and 1). The ELF lowers the production tax rate for smaller fields and fields with low productivity wells.

CURRENT PRODUCTION TAX

The current version of the production tax ("ELF") was introduced in 1989. The formula reflects economic conditions in 1989 when oil prices were in the $ 14 - $ 17 per barrel range and the values of 300 bopd for well productivity and 150,000 bopd for field productivity represented reasonable economic benchmarks.

Also the formula did not contemplate the subsequent development of a variety of satellite fields.

While the production tax stimulated the development of a variety of marginal fields, the benchmarks are now outdated.

Therefore, an overhaul of the production tax is in the interest of the State.

CURRENT PRODUCTION TAX

The production tax has serious deficiencies:

- ELF is no longer rational in relation to well productivity and field production.
- ELF is not responding reasonably in case of field production decline
- ELF does not provide a reasonable balance under a range of oil prices
- ELF does not provide a sufficient incentive for re-investment

CURRENT PRODUCTION TAX

$$ELF = \left[1 - \frac{(300 \times wells)}{volume}\right]^{\left[\left(\frac{150{,}000}{volume}\right)^{1.53333}\right]}$$

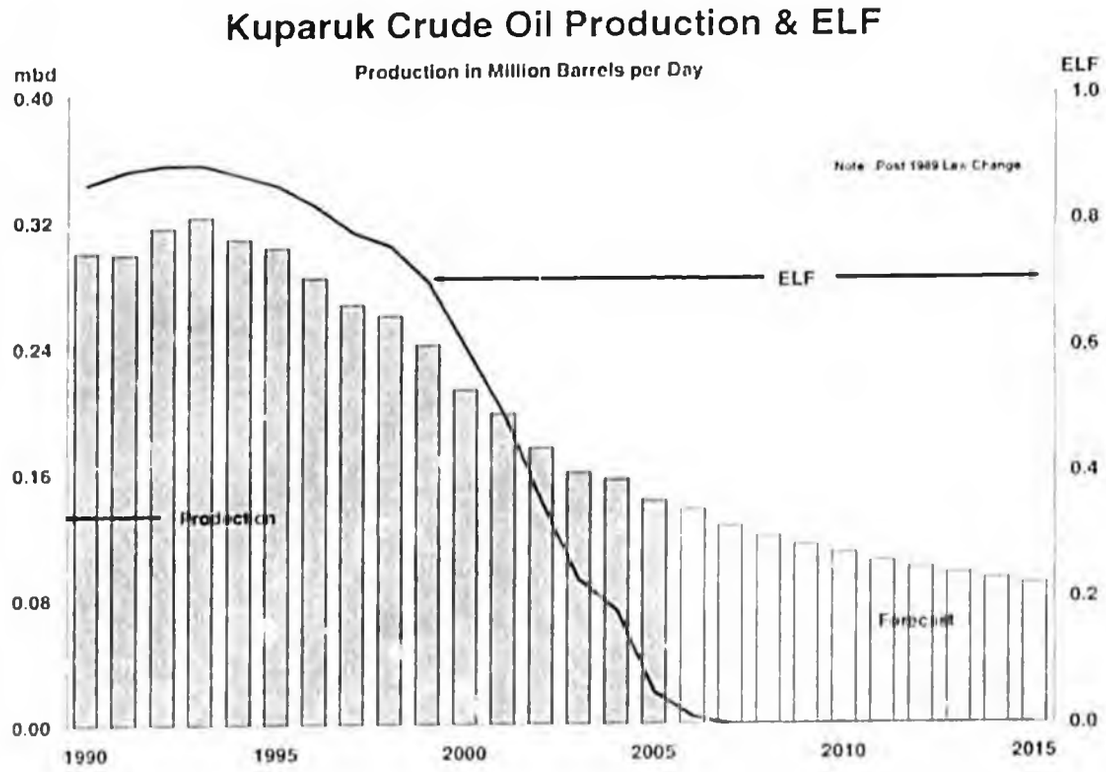
"wells" is the number of producing wells in the field, "volume" is the total daily production for the field

Well Prod bopd	Wells	Volume bopd	ELF
300	2000	600000	0.00
300	500	150000	0.00
1500	100	150000	0.80
1500	20	30000	0.07
6000	5	30000	0.55

An ELF of 0.00 means that the production tax is zero. However, royalties, property tax and corporate income tax remain payable.

CURRENT PRODUCTION TAX

ELF is declining faster than production in some fields.



CURRENT PRODUCTION TAX

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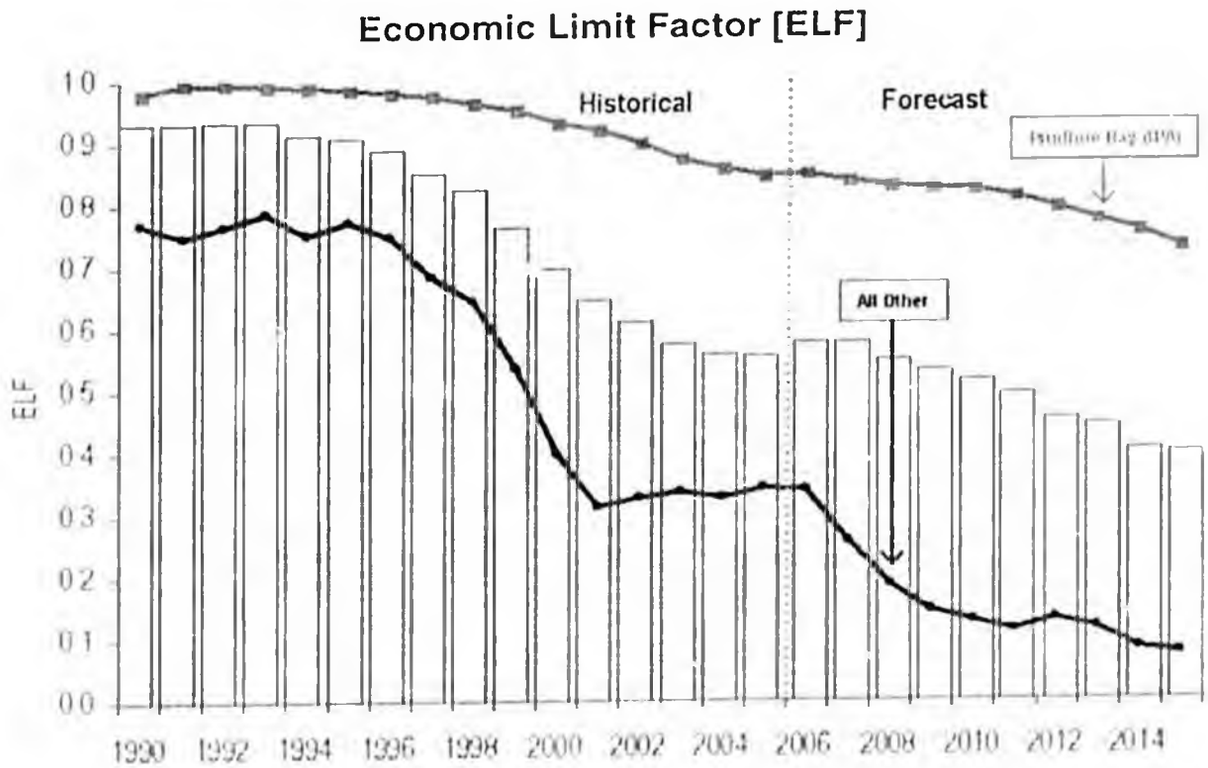

PROFIT SHARE CONCEPT

The Governor proposes a profit sharing production tax ("PPT") which is a complete replacement of the current ELF based version of the production tax on oil and gas.

The PPT will be a law of general application.

PPT

The PPT is calculated as a tax rate multiplied by the corporate cash flow from production in Alaska from oil and gas, with tax credits to encourage investments.

It is a consolidated tax at the corporate level.

The cash flow is calculated as:

Gross production revenues (net of royalties) based on wellhead prices, less the producer's lease expenditures.

PPT

There will be tax credits to encourage investment based on a percentage of the amount of the investment

Losses in any year can be converted to tax credits by multiplying the amount of the loss with the tax rate.

Tax credits can be transferred and traded

Explorers and independents will be able to monetize part of their investments immediately, thereby strongly encouraging exploration.

PPT

The tax rate and tax credit rate are currently being discussed in the context of negotiations.

The Joint Senate/House Finance requested data around five specific scenarios,

Tax Rate	Tax Credit Rate on Capital Expenditures
25%	15%
25%	20%
20%	15%
20%	20%
17.5%	15%

These requested cases are not necessarily reflective of what may ultimately be decided.

PPT

Small Producers

There will be features to ensure that there is no tax on a low level of production per company in order to encourage explorers and independents. Several alternatives are being considered:

- The tax rate on the first 5000 barrel of oil equivalent per day per company is 0%, or
- There will be a tax free allowance equal the lower of an agreed level per company or the actual profits per company. This allowance could be in the range of $ 50 to $ 100 million per year.

PPT

Heavy Oil

The State is also considering the possibility for having a somewhat higher tax credit on capital investments in the development of heavy oil

Increased development of heavy oil will add to the level of North Slope production. It represents an important possible future development that is clearly high cost.

PPT and Resource Development

The enhanced incentives to invest in exploration and development through the PPT as well as the gas line investment will create a new environment whereby Alaska will be considered by many petroleum companies a new core area for petroleum investment and increased oil and gas production.

Conclusion

The current ELF based production tax is completely outdated, is a regressive tax and is no longer in the interest of Alaska.

Therefore the Governor proposes that Alaska adopts a profits based system that will provide on average for a higher government take for Alaska. It is a progressive tax with a strong incentives for investment and exploration. It will attract new entrants to Alaska.