

ALASKA LEGISLATURE

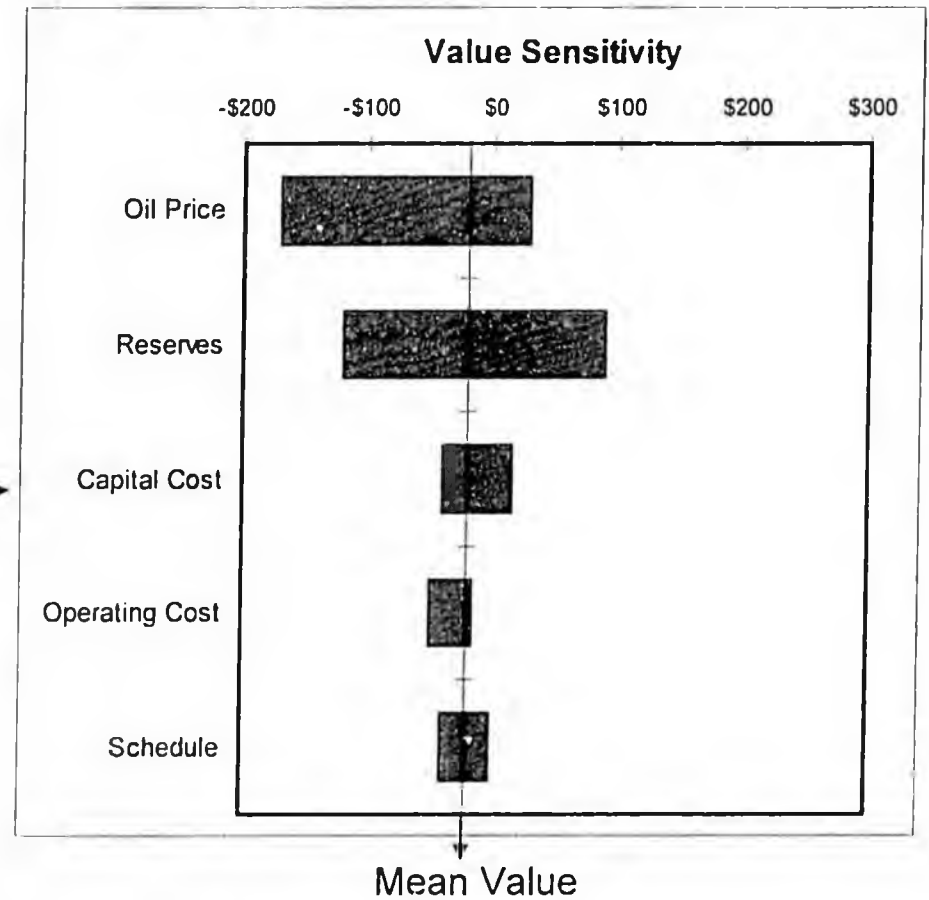
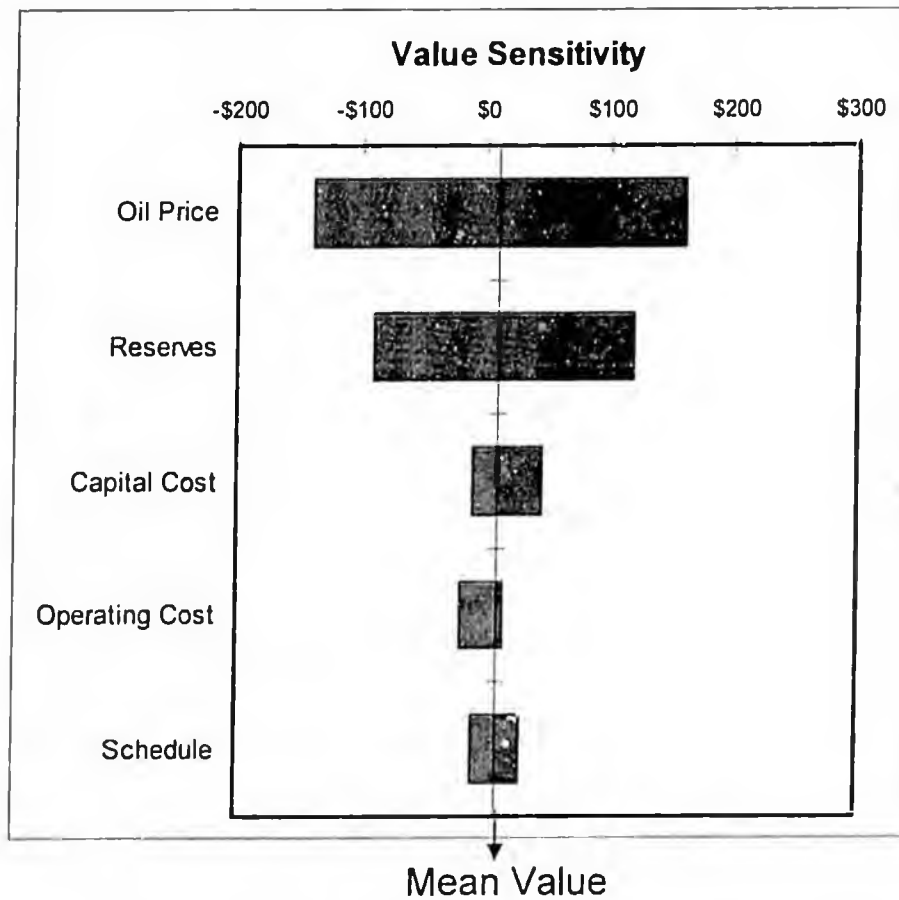
HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 3094

# Impact of Progressivity on Risk/Reward Balance

#10

Positive Value –  
Project Accepted

Negative Value –  
Project Rejected



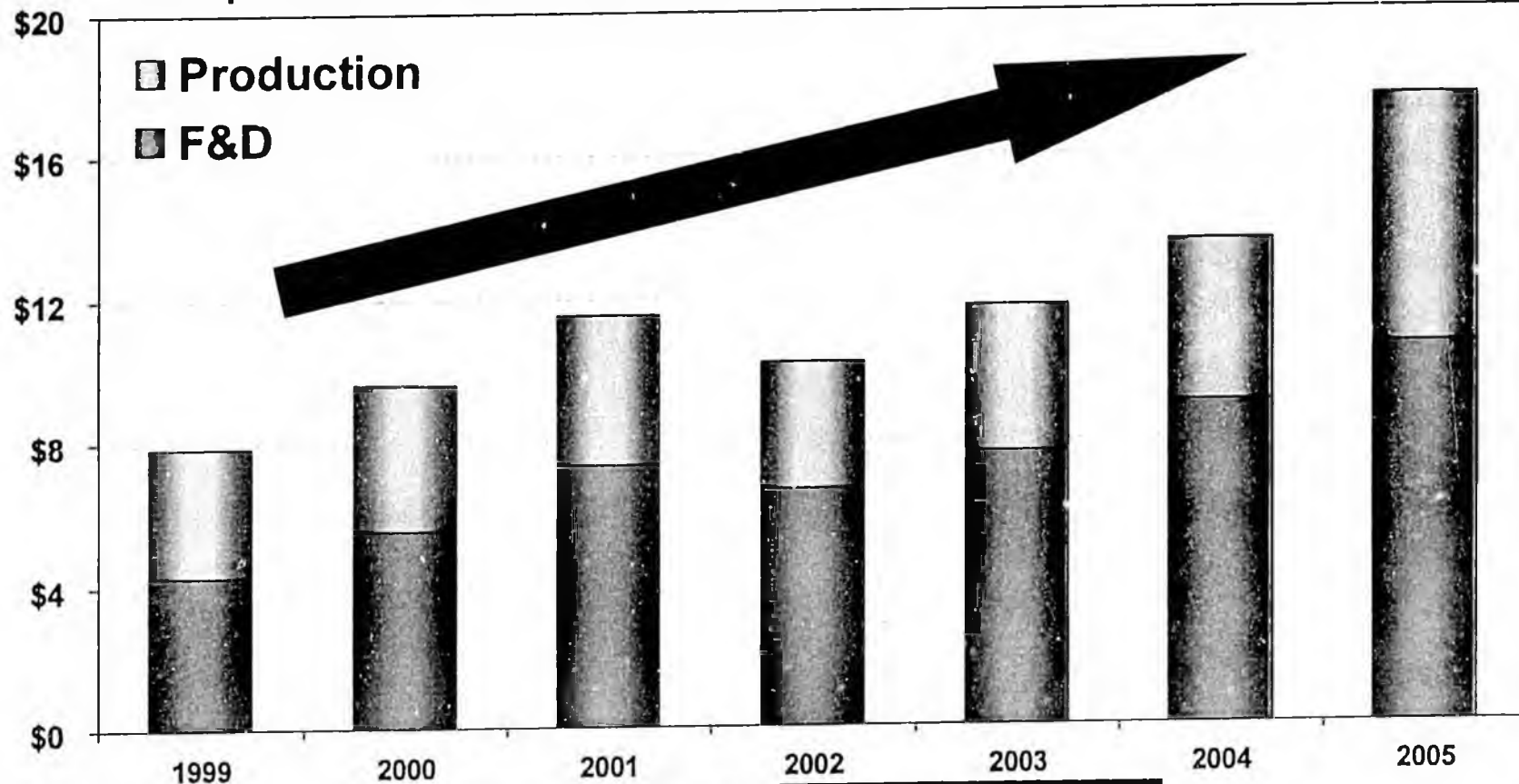
Project value is decreased when price upside is removed

# Finding, Development & Production Costs

# 11

## More than Doubled Since 1999

2006 Dollars per Barrel of Oil Equivalent



Excludes all government take (\$20-25/bbl),  
adjustment for the time value of money &  
a cost of capital return

Source: J.S. Herold

## Key Messages from Corporate Perspective

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#12

- Current tax rate already uncompetitive given cost & prospectivity
- Proposed tax increases will reduce investment & production in Alaska
- U.S. federal windfall profits taxes lowered production and failed to produce expected revenues

From TAPS Production Model

March 30, 2006

Dept. Revenue

Div. Tax

Share of Oil in Pipeline		Yesterday's Gross Revenue	
Exxon:	20.34%	\$	10,263,503.90
BP:	46.93%	\$	23,680,739.32
CP:	28.29%	\$	14,275,050.40
Chevron:	1.36%	\$	686,251.98
COCH:	3.08%	\$	1,554,158.90
	<u>100.00%</u>		

Yesterday's Production: 782,321 bbls

YTD Average: 854,740 bbls/day

Yesterdays' Price ANS: \$64.50 /bbl

# Summary

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- Higher taxes will reduce investments
  - 20% strikes the right balance
  - Windfall profits surcharge increases project risk
- Recognition of transition investments is fair
- Reasonable start date

## BP Presentation on CSHB 488 (PPT)

Alaska State Legislature  
House Finance Committee  
29<sup>th</sup> March 2006

For the record, I am Steve Marshall, President of BP Exploration Alaska. I appreciate the opportunity to provide my point of view regarding HB488.

I have watched the oil tax proceedings over the course of the last few weeks with great interest. As the discussion has evolved, I've become increasingly concerned. My concerns center on both the direction of changes and the focus of the discussion itself. I believe the current bill is moving in the wrong direction and will hurt Alaskans. And, while we have many common goals upon which to align our conversation, we have clearly not been successful so far.

It seems to me that while a lot of energy has been brought to bear, we are having the wrong conversation. So what is the right conversation?

We cannot afford an "us and them" conversation. We are all in the boat together. We all benefit from increased production and we all suffer from production decline. As our business faces its middle-age challenge, the day-to-day business is really about battling decline. I know that this doesn't have quite the same sizzle as a big project or new discovery, but this is our shared reality.

So the real issue before us is one of finding a suitable tax structure and rates that will encourage additional investment, stimulate development, get additional barrels in the pipeline; and yes, also give Alaskans a fair share of oil price upside when we all have such good fortune.

So the question is, what tax policy and plan will achieve this? This is the key point of discussion.

While the current high price is of great benefit, it has the tendency at the same time to mask the seriousness of the underlying production decline. We cannot afford to be distracted by the price environment. Instead, we need to recognize the underlying performance of the business, focus on our mutual goal of increasing production and avoid any outcome that creates undue burden across the whole of the business cycle. If we don't work together and get this right, decline will continue unabated and no tax rate will be high enough to generate the level of revenues Alaska needs to remain robust. We will all lose.

I wish I shared the confidence of your consultants that increasing taxes will not reduce investment. As an investor who has spent considerable effort to make Alaska more competitive so that we can successfully compete for increased investment, I have a different view. As I consider this bill, I recognize that my job is going to be much more difficult.

I feel a real personal stake in this today. To some degree, this is a result of my participation in the work over the last several years. An effort by the Alaska organization to develop a tangible plan that extends more than 50 years into the future. But, to a larger degree, it is because I am accountable to over 5,000 employees and contractors who have worked so diligently to develop the plans that underpin this future.

I'm privileged to have led this organization for the last five years. Through that time, the people of BP Alaska have faced many challenges and continued the progress to where we have now turned a corner and see new growth and opportunity. And their efforts and passion have had an impact on me. I have been affected by their commitment to this future, by their commitment to their local communities, by their dreams for their children and by their passion for the richness and unique qualities of living in Alaska.

With this in mind, I remain hopeful that we can return to a common dialog. In this discussion we will align behind the mutual goal of growing the pie and stand firm against the common enemy - production decline. I remain confident that this Committee will re-direct the conversation and the bill in such a way that we all end up with a tax policy that works for the people of Alaska and for investors like BP.

BP remains committed to this legislative process. We will continue to do our part in providing testimony and support with the goal of together creating a balanced structure that results in an infusion of capital, reduces decline, creates growth in state revenue, provides a better balance at high oil price and secures a healthy oil business that bridges us to gas and beyond.

You will hear Angus describe why:

- Production is declining
- Significant additional investment is vital to stem decline
- Production is paramount in maximizing State revenue and benefit to Alaskans
- The current bill is not in the best interest of Alaska.

Thank you for the opportunity to address the members of this committee.

Steve Marshall

## BP Presentation on CSHB 488 (PPT)

Alaska State Legislature  
House Finance Committee  
29<sup>th</sup> March 2006

For the record, my name is Angus Walker and I am the Commercial Vice President of BP Alaska.

I would like to start by thanking this Committee for the opportunity to provide testimony on Committee Substitute for House Bill 488.

I will summarize the key issues raised in previous testimony and provide our view of the substantive changes made by the House Resources Committee to HB 488.

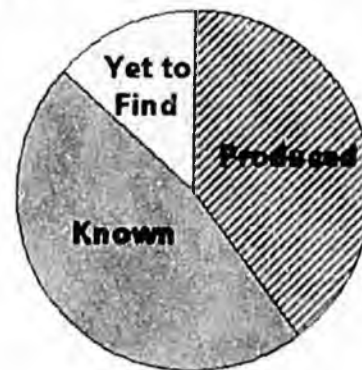
### Alaska has lots of Oil and Gas!

The good news for Alaska is that you have a huge known resource base, enough resources for the next 40 years and beyond.



		Billion barrels equivalent
	<b>Produced</b>	<b>15</b>
	<b>Known Remaining</b>	<b>17.5</b>
	Developed - Light	3.5
	- Viscous	0.3
	Undeveloped - Light	4
	- Viscous	0.7
	- Heavy	3
	- Gas	6
	<b>Yet to Find (Exploration)</b>	<b>5</b>

### Recoverable Resource



Source: DOR/USGS/BP

To date we have produced 15 billion barrels, but there are 17.5 billion barrels remaining that we already know about, 3.8 billion barrels of which have been developed to date.

Of the 13.7 billion barrels that are yet to be developed, there are:-

- 4 billion bbls of light oil remaining in the existing reservoirs
- 0.7 billion bbls of viscous oil, similar to that which we have started to produce
- 3 billion bbls of heavy oil lying in shallow formations below the permafrost
- 6 billion bbls of gas which we are working so hard to get to market

**The scale of this known resource greatly exceeds that expected from future exploration.** Future discoveries are expected to be of the order of 50-150 million barrels. It's not to say you should stop exploring, but you cannot rely on exploration to stem the decline of the North Slope.

While BP isn't exploring in the conventional sense, we are adding barrels. We're not only looking to develop our share of the 17.5 billion barrels, but we're looking to make it even bigger.

To put that in perspective, every time we increase the recovery efficiency by just 1% we access an additional 600 million barrels (400 mmbbls light oil and an additional 200 mmbbls heavy oil)..... Every 1% is equivalent to another Alpine!

It is for this reason we are investing in technology. We are exploring within our existing fields.

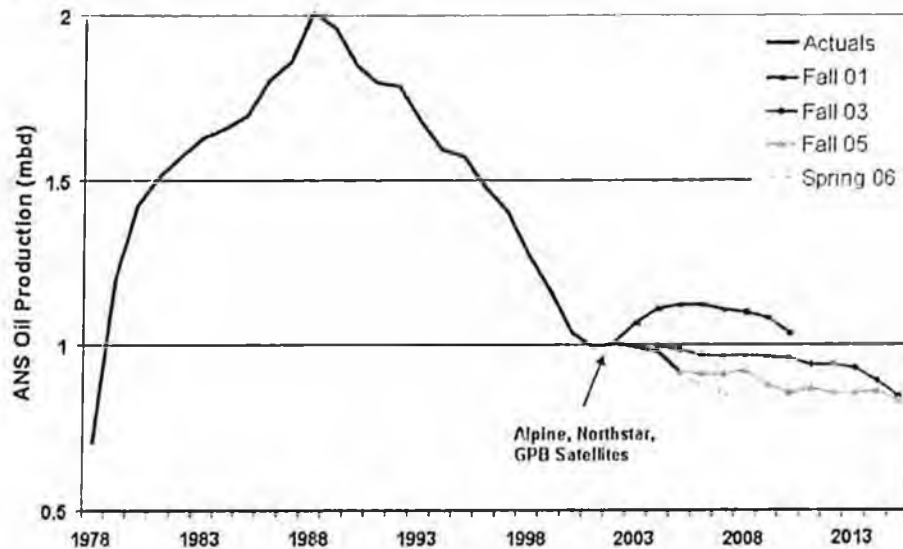
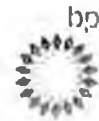
One example is that we're spending in excess of \$100 million implementing innovative technology to increase recovery at Endicott. If we are successful at Endicott it could add hundreds of millions of barrels of production across the North Slope. (Another Alpine?)

**To develop the 14 billion barrels we know about would require well in excess of \$100 billion. And that kind of investment can only come from the Major oil companies of the world.**

Encouraging new exploration is good but it is a fact, acknowledged by all who have testified, that the resources expected to be discovered through exploration will likely be significantly less than the resources we already know about. **It is investment in the known resources that offers the greatest chance of stemming the decline of ANS production. As you look at incentives for exploration please do not overlook incentives for the investments in known fields, which are more likely to succeed.**

## Production is declining:

Since 1999, both Industry and DOR have consistently overestimated production and have annually revised production forecasts down significantly. This is of great concern to us as it should be to you. A one hundred thousand barrel per day drop in production represents a drop in state revenue of around \$500 million per year at current prices.

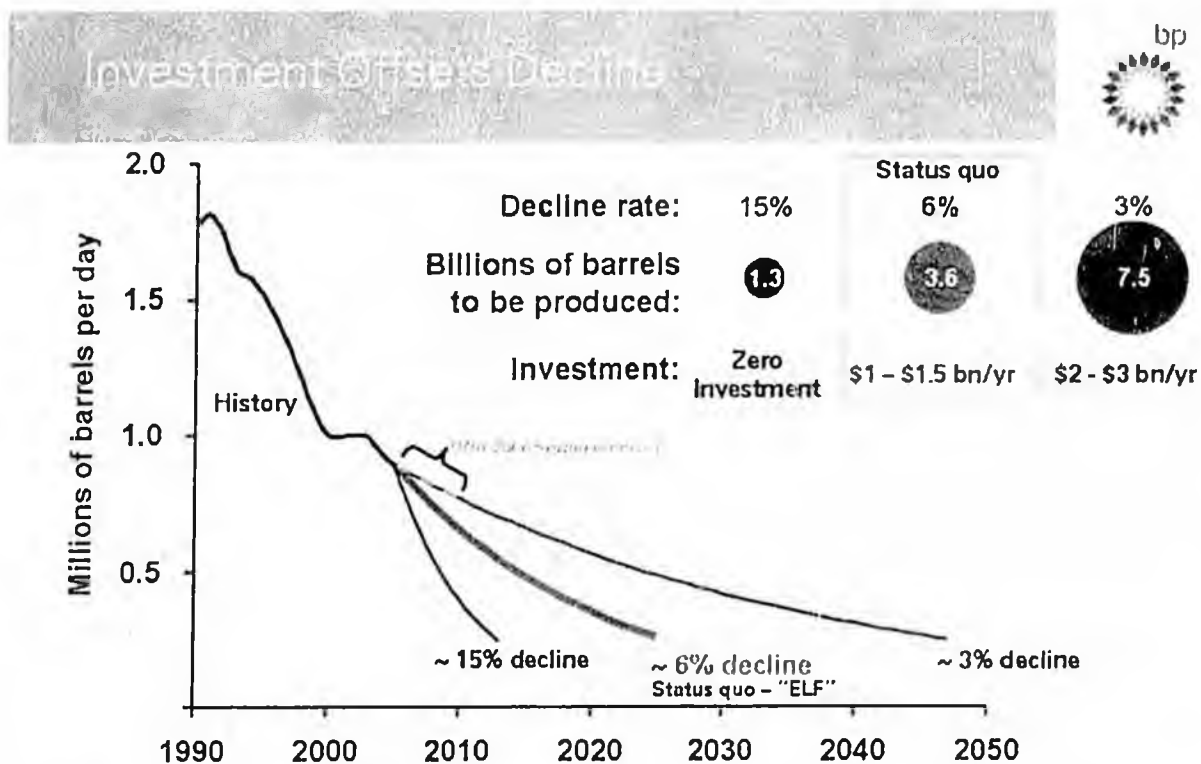


- Historical basin decline has been around 6%
- Flattening of production from 2002-2004 due to Alpine & Northstar
- Decline since 2004 has mirrored historical basin decline

This chart shows a subset of the DOR forecasts from 2001, 2003, 2005, along with the latest view of the Spring 2006 forecast, against actual production in red.

Whilst development of Alpine, Northstar, and the Prudhoe Bay Satellites between 2000 and 2002 successfully flattened North Slope production for a number of years, 2005 saw decline return to the 6% rate that has characterized this basin in the past. Unfortunately for all of us, there are no more fields of Alpine or Northstar's magnitude waiting to be developed.

**Significant additional investment is required to offset decline**



***DOR Spring Forecast cannot be met without significant additional investment  
The vast majority of that investment must be made in existing fields***

With no investment the natural decline of the fields would be the lower red line. At the current levels of investment (\$1-1.5 bn/year) that decline will be around six percent per year. The latest DOR 2006 Spring forecast translates into an approximate 3% decline which you can see is above the current status quo.

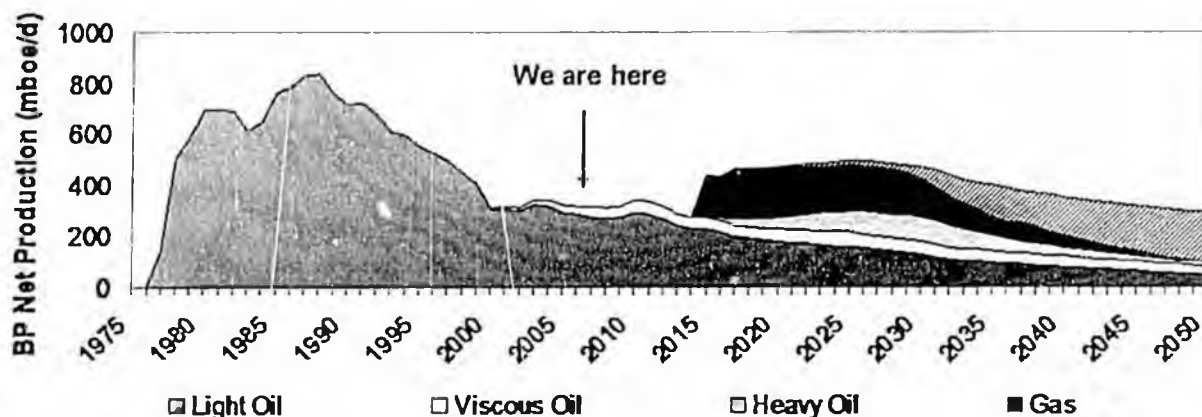
However, the 3% decline cannot be met without significant additional investment, in the order of 2 to 3 billion dollars per year. Unless those investments are made, history will repeat itself, decline will continue at the current rate, and the DOR will be revising its production forecast down yet again.

The real question for you to be asking industry and the consultants is 'what would it take to double investment in the Alaska North Slope?'

So what is BP doing to address the issue of decline?



## A 50 year vision



For several years now we have been pursuing our vision of a fifty year future for our business in Alaska. This future will be based on the development of the known resources on the North Slope (conventional light oil, viscous oil and gas).

Creating this future has many challenges and will not be easy to deliver, but we are already in action laying the foundations for the next 50 years.

We are pursuing technology to unlock the difficult oil.

We have been investing in infrastructure to get it ready for the decades to come (including \$1 bn by BP on four new tankers and \$400 million by the TAPS owners to update the pipeline). Each of these investments is designed to reduce costs and increase the wellhead value of Alaska's oil, to the benefit of the industry and the State.

We are hiring people, 200 people this year alone.

We have plans to invest \$14 billion over the next 10 years in our Alaska business.

We have great hopes for our Alaskan business, but are seriously concerned that without an appropriate fiscal policy that future will not transpire.



The size of the pie is the most important consideration. Maximizing the value of resources for Alaskans means maximizing state revenue by maximizing production. Resources left in the ground are simply a wasted opportunity.

This should be the focus of our deliberations. Alaska needs more investment, more jobs, more production, not higher taxes.

### Alaska will have the highest tax rates in the United States!

The good news for Alaska is that there is a huge known resource base on the North Slope.

The bad news is that it going to be technically difficult to extract that resource out of the ground. Every barrel gets more difficult.

Alaska is already one of the most expensive places in the world to produce oil and gas.

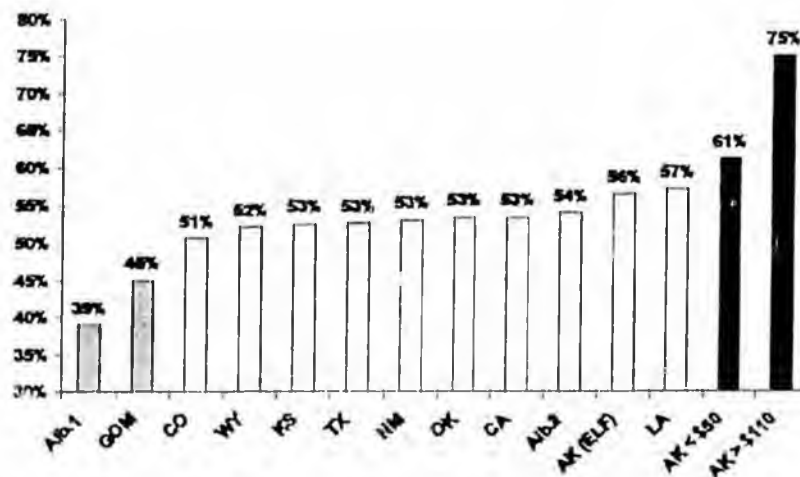
Assuming the new 20/20 PPT is put in place, Alaska would also become the area with the highest marginal tax rate in the US. Needless to say this introduces one more barrier to attracting investment. The incorporation of yet higher tax rates at higher prices creates a bizarre fiscal regime, being regressive at low prices and progressive at high prices, thus reducing space for industry and creating yet more barriers to attracting investment.

The following graph shows how Alaska compares to other North American regimes both under 20/20 PPT and the scenario outlined in the House Resources CS.



Marginal Tax Rate

North America: Tax Rate Comparison



➤ Alaska is already the highest cost region to operate

\*Alb: ALBERTA HEAVY OIL - pro and post-payout

BP data

## Alaska will have the highest marginal tax rate

To maximize the value of the resources in the ground, we should be focussed on maximizing North Slope production by attracting investment. The priority for the state of Alaska should be to encourage investments to help industry develop those known resources, not to make it more difficult and risky than it already is.

**Other countries have proven that reducing taxation increases investment:–**

UK – a role model for attracting investment



"Ordinary measures of Government take throughout the 1990's made the United Kingdom government appear rather crazy and irresponsible. . . . **The "gross benefits" to the UK Government go way beyond direct tax revenues and royalties received from the upstream sector of the petroleum industry. The economic impact of the industrial hyperactivity in the UK sector of the North Sea, a direct result of the "lenient" terms of the 1990's, is difficult to measure** Furthermore, the activity in the UK started in the late 1980's and early 1990's when the UK Government dropped the ring fence for the 75% PRT before Government take, as it is ordinarily measured, was drastically reduced **The UK offshore became the most active offshore province in the world. Reducing the Government take in the following years managed to sustain that boom. Activity and employment in the British petroleum sector is healthy and robust.**"

***Daniel Johnston***

*23 Oct 2002, Washington DC  
Petroleum Tax Design*

There was much discussion over recent weeks about the impacts of reducing taxes in the UK. The UKCS has been our backyard for many years and we couldn't agree more with Daniel Johnston that reducing taxes firstly created and subsequently sustained an economic boom. The UK's decision to reduce Government Take led to a significant increase in activity in the North Sea, more production, higher revenues for the Government and a ripple effect throughout the whole economy.

**The actions of the UK during the 1980's and 1990's provide an excellent role model for any Government hoping to attract investment.**

# Alberta Heavy oil



## Investment boom underway

- Capex increasing up to \$10 billion p.a
- Alaska flat circa \$1 billion p.a

## Enabling fiscal regime

- Key reform in 1995
  - 1% Royalty until project payout
  - 25% after payout
  - Federal and State tax of 39%

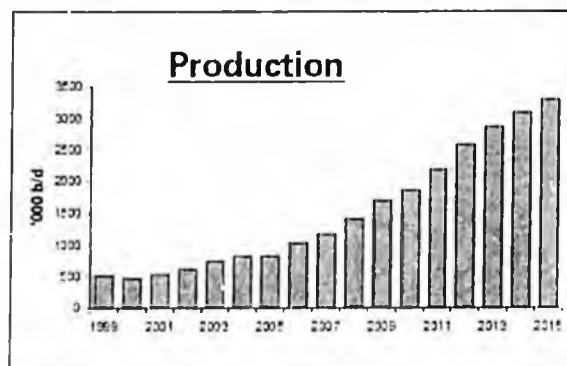
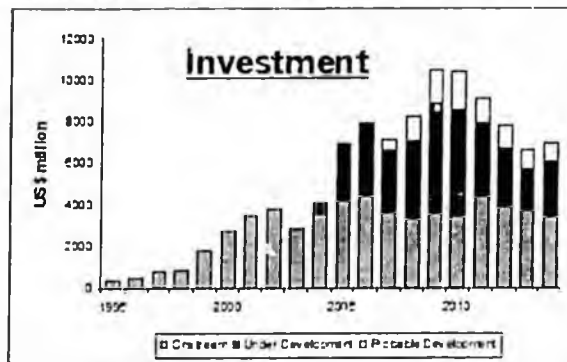
## Marginal tax rates

- 39% pre payout
- 54% post payout

Above rates will decline by 4% through 2007

- via phased reduction in Federal tax rates

Source: Wood MacKenzie



If we just take a relatively short trip across the border into Canada and look at what is happening in the heavy oil province of Alberta we find another great example of where cutting taxes has increased investment & state revenues.

**The current version of HB 488 is not good for Alaska and will not help stem decline of the North Slope and we encourage you to address the following key issues:**

1. The proposed progressivity in the tax rate combined with the significant base rate increase in moving from Elf to PPT (20/20) is inappropriate given Alaska's circumstances:
  - a. Challenged resource base
  - b. High cost environment
  - c. Distance to market
  - d. Regressive nature of the rest of the fiscal regime
  - e. Urgent need to attract very large amounts of capital to stem decline
  
2. Several of the newly introduced terms are unbalanced and will cause problems:
  - a. It contemplates only an increase in tax with no reduction in tax at medium and low prices
  - b. The tax rate is dictated by the price of WTI which is not representative of the realized value for ANS crude
  - c. There is no recognition of inflation and thus tax rates will effectively increase with time making the system unsustainable
  - d. The proposal contains a large step function in taxation at a single price point which could have bizarre consequences
  
3. Transition provisions demonstrate to investors that they do not have to bear the full risk of retroactive tax increases. Failure to provide for transition will harm the State's reputation with investors.
  
4. The change in the effective date to April 1 means this tax will be implemented before it is enacted by the Legislature. Retroactive application of taxation policy should be avoided.
  
5. Simplicity should be a key objective in setting fiscal policy and the current version of the Bill adds significant complexity to one of the most complex fiscal regimes in the world. This will be a further disincentive to investors.

At the highest level we do not believe this Bill as drafted achieves the mutual goal of increasing investment & stemming decline.

## Key Messages

I would like to leave you with the key messages from this testimony.

### Key Messages



- Alaska has lots of oil & gas but production is declining!  
Decline is our common enemy!
- Significant additional investment is required to stem decline
- Maximizing production will maximize State revenues and benefits to Alaska
- With a 20% tax rate Alaska will have the highest tax rate & the highest cost structure in the US
- The bill as drafted will not maximize benefits to Alaskans
- The UK and Alberta have successfully attracted significant investment and increased production by reducing taxes and are thus great role models

We believe that the changes made to HB 488, if enacted, would be a serious mistake for Alaska and we urge you not to adopt them but to return instead to a bill close in structure to the original Bill.

In order to maximize the value of Alaska's resources we believe you should be adopting tax rates lower than those proposed by the Governor. In so doing you would maximize investment, maximize production and maximize jobs for Alaskans. You would also take an important step towards creating a healthy oil business which will be the foundation for gas.

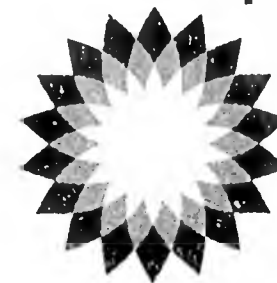
We recognize the burden on your shoulders in making these decisions. There are many people advising you to increase taxes, which will indeed increase state revenue, but for how long? One year? Two years? ....and at what cost to future production?

This is a matter of urgency. All Alaskans should be concerned. Short sighted increases in tax will jeopardize future oil investments, future oil production and the gas pipeline project itself.

We will continue to participate fully in the legislative process and will be available to assist this committee in whatever way we can.

On behalf of BP I would like to thank you for this opportunity to testify.

bp



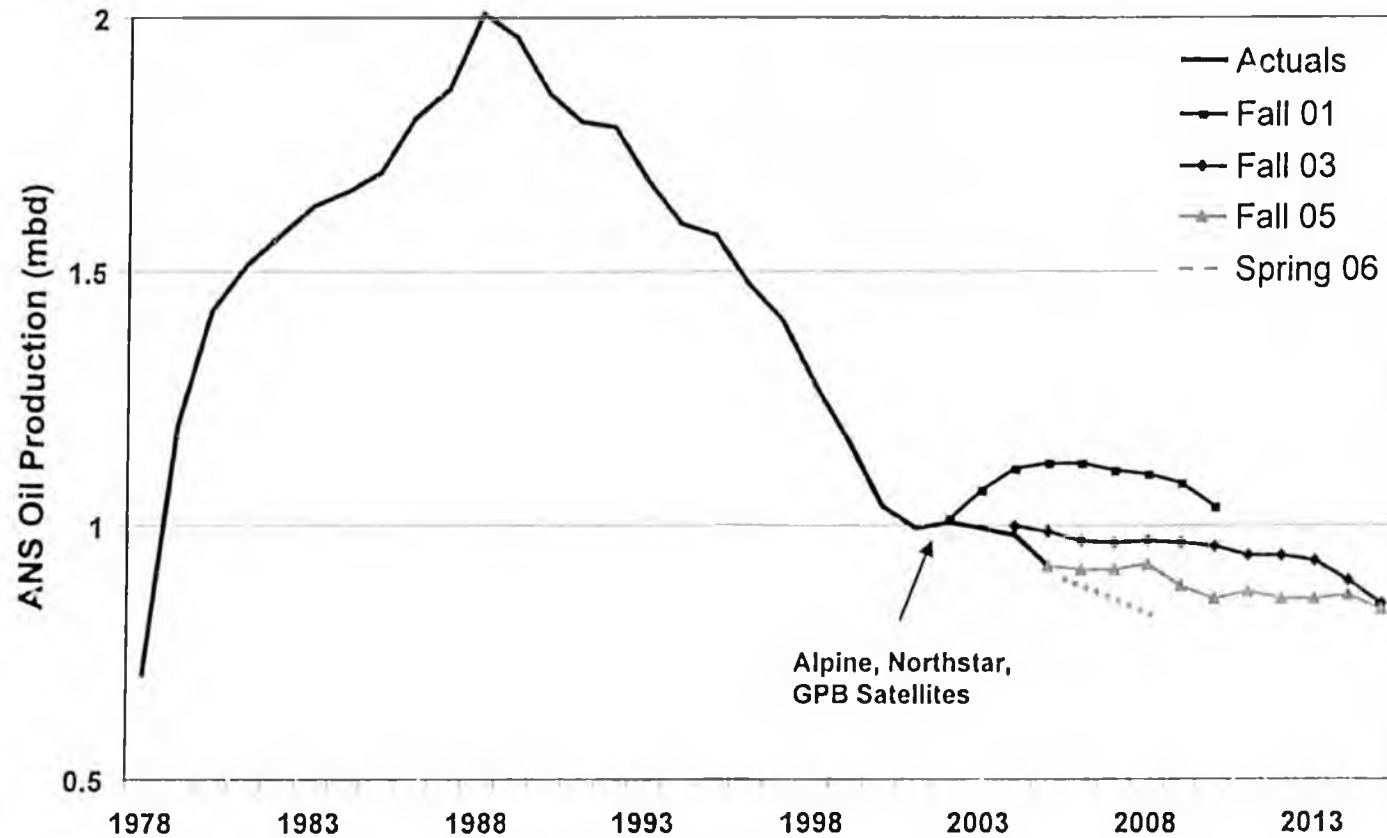
BP Presentation to the House Finance  
Committee  
RE: HCS House Bill 3281

**Juneau**

**29 March 2006**

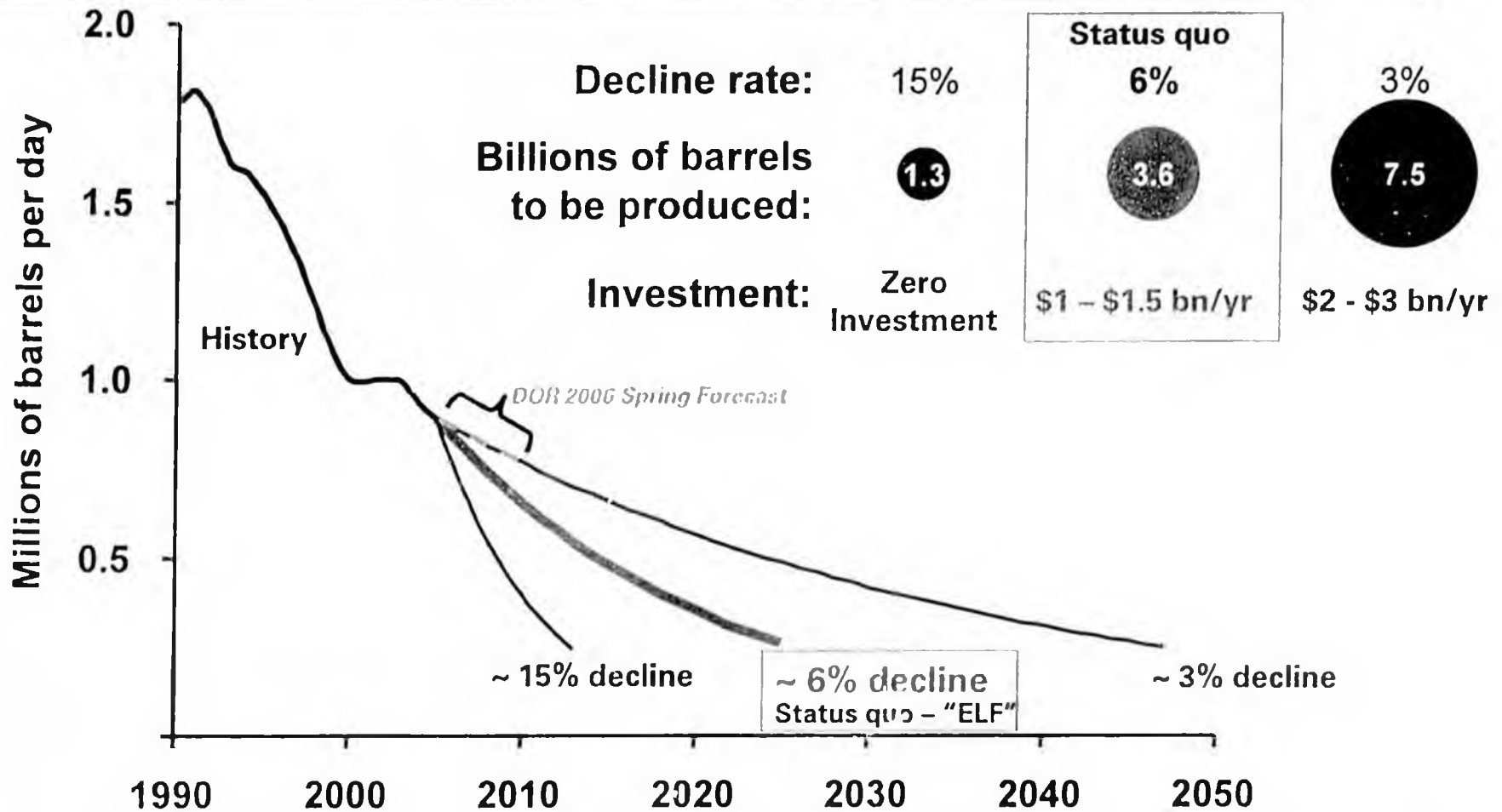
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# DOR Production Forecasts



- Historical basin decline has been around 6%
- Flattening of production from 2002-2004 due to Alpine & Northstar
- Decline since 2004 has mirrored historical basin decline

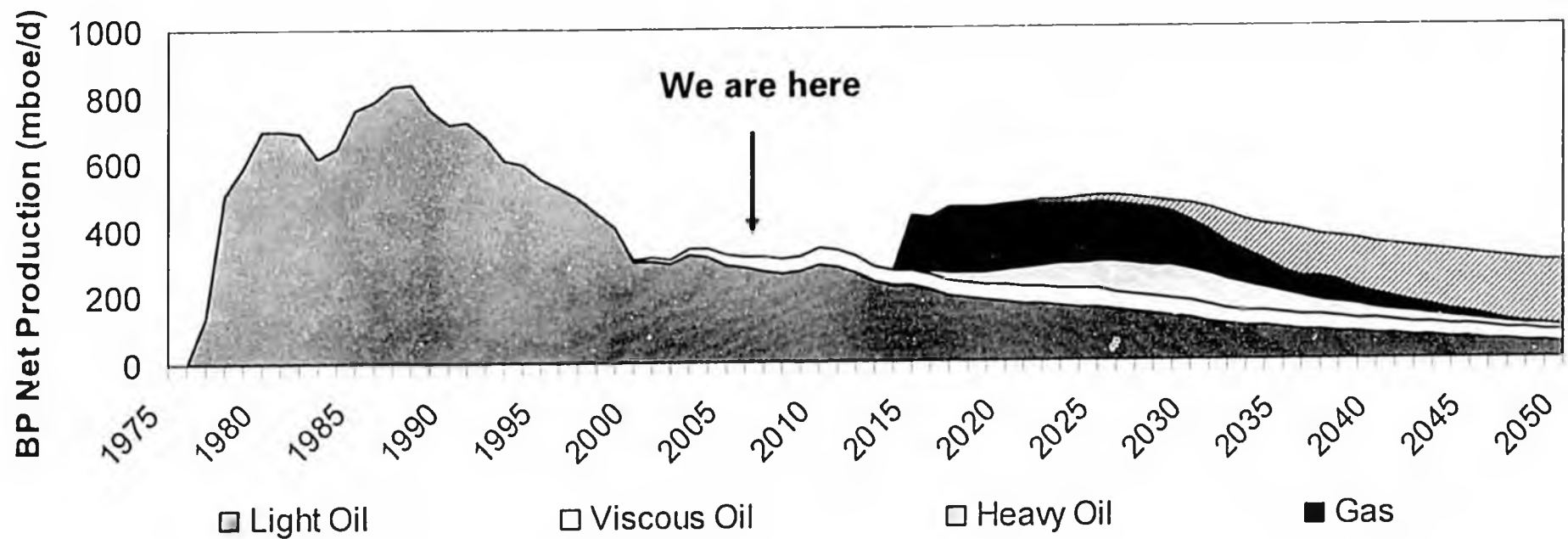
# Investment Offsets Decline



***DOR Spring Forecast cannot be met without significant additional investment  
The vast majority of that investment must be made in existing fields***



# A 50 year vision



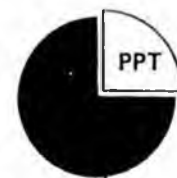
# Production Drives Revenue



Decline Rate	15%	<b>Status quo</b> <b>6%</b>	3%
Produced Barrels	1.3 bn	3.6 bn	7.5 bn
Operating Expenses	\$30 bn	\$50 bn	\$100 bn
Industry Investment	\$1 bn	\$20 bn	\$60 bn

**State Revenue**  
*(estimate)*

*Assuming  
20/20  
\$40 ANS*



All other non-PPT  
state revenue

**\$10 bn**



All other non-PPT  
state revenue

**\$30 bn**



All other non-PPT  
state revenue

**\$60 bn**

Less investment

More investment

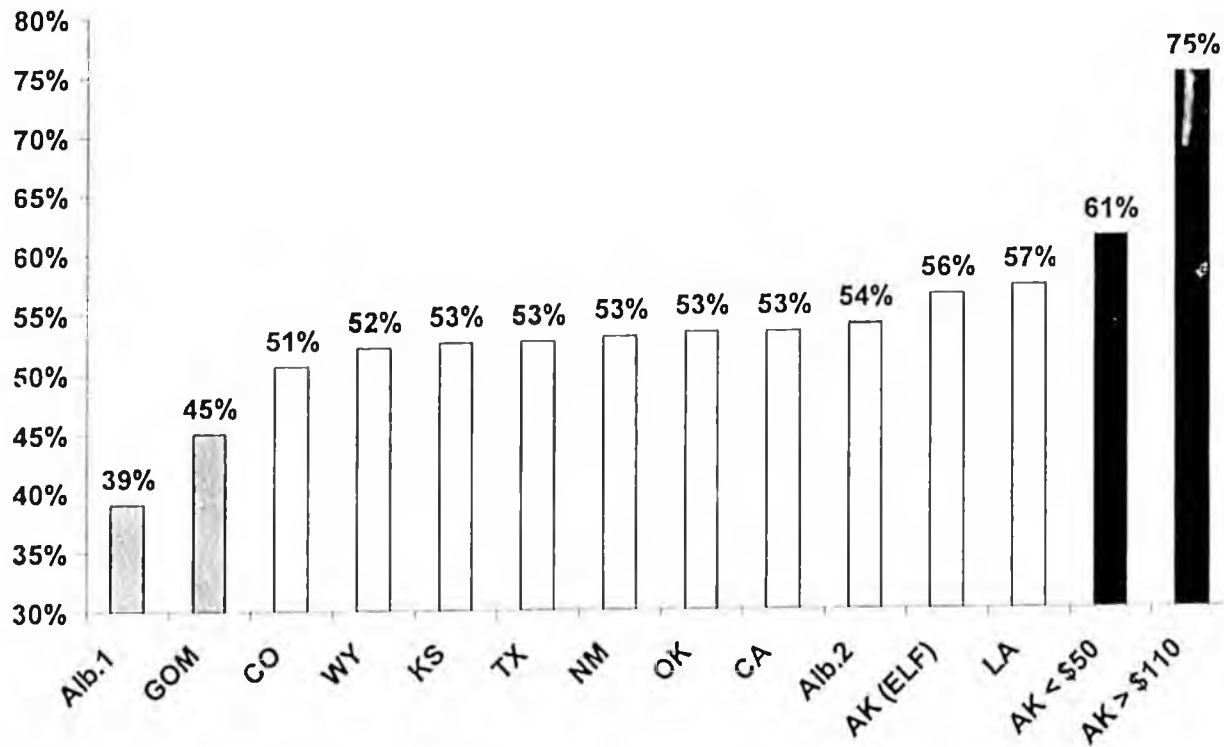
***Maximizing State Revenue means maximizing Production***

# US Marginal Tax Rates



Marginal Tax Rate

## North America: Tax Rate Comparison



➤ Alaska is already the highest cost region to operate

\*Alb: ALBERTA HEAVY OIL – pre and post-payout

BP data

## Alaska will have the highest marginal tax rate

## Key Messages



- Alaska has lots of oil & gas but production is declining!  
Decline is our common enemy!
- Significant additional investment is required to stem decline
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- With a 20% tax rate Alaska will have the highest tax rate & the highest cost structure in the US
- The bill as drafted will not maximize benefits to Alaskans
- The UK and Alberta have successfully attracted significant investment and increased production by reducing taxes and are thus great role models

**Chevron**



**Chevron - Alaska Area  
Testimony on HB 488  
Finance Committee**

**John P. Zager  
General Manager**

**March 29, 2006**

3-29-06



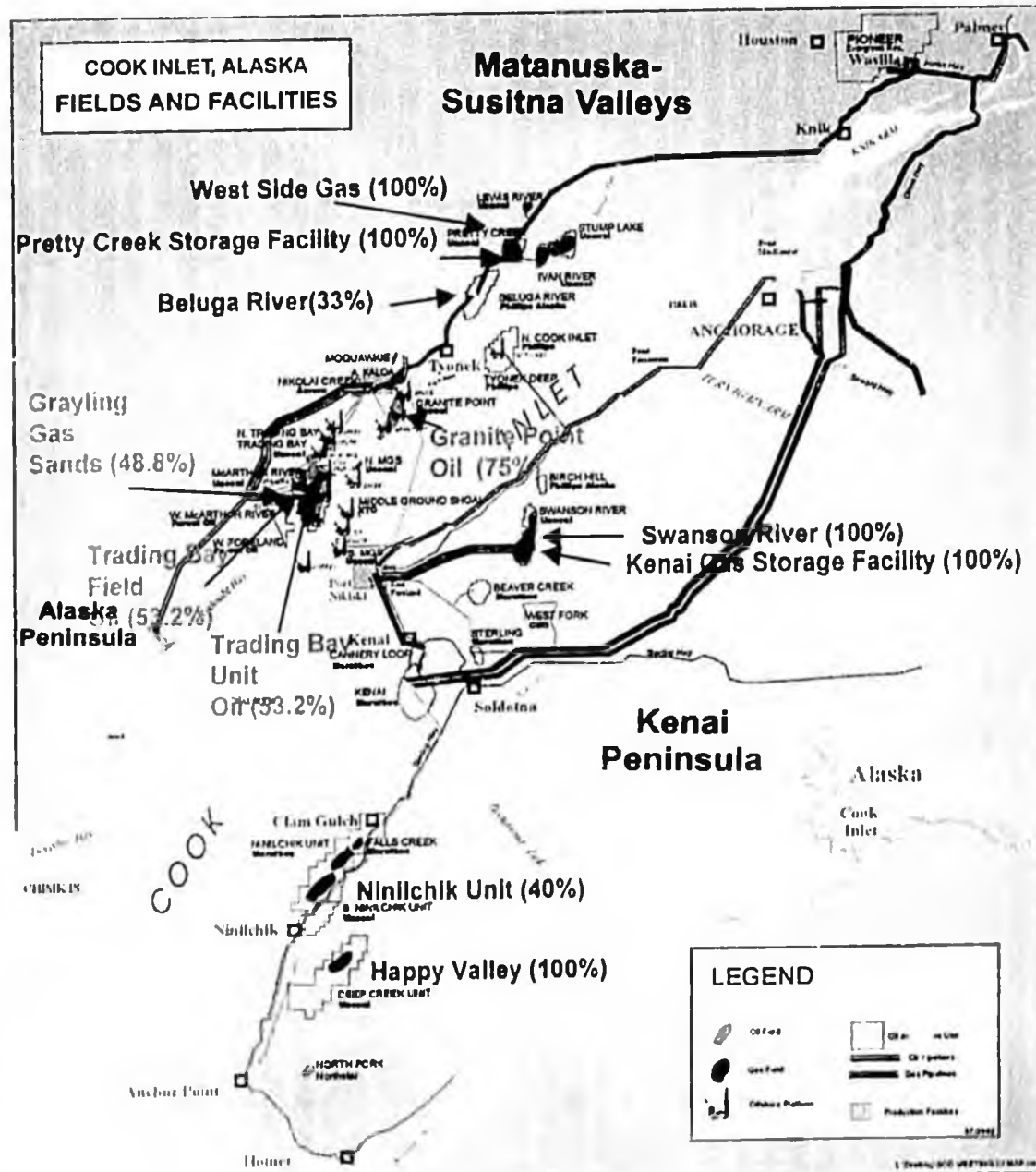
## Chevron's Alaska Presence

- Current Asset base is formed by combination of heritage Chevron and Unocal assets
  - Both companies have been active in Alaska for many years
- 4<sup>th</sup> largest producer in state
- 3<sup>rd</sup> largest operator
- 382 employees or full time contractors
  - 272 on the Kenai Peninsula
  - Payroll of >\$45 million
- Key customers: Tesoro, Enstar, Chugach Electric, Agrium, Aurora
- Chevron is the only producer in the state with a relative balance of assets in the Cook Inlet and on the North Slope
  - Both production streams are large enough to trigger PPT
- Chevron's Cook Inlet offshore assets are uniquely positioned to suffer from the proposed PPT





# Cook Inlet - CVX Asset Description



## Cook Inlet Offshore :

- 3 fields ( all op. )
- 10 Platforms
- 145 wells
- 2 onshore plants
- 42 mile PL
- 10,900 BOEPD

## Cook Inlet Onshore :

- 8 fields ( 6 op. )
- 60 wells
- 2 gas storage fields
- WI% in 4 PLs
- 14,100 BOEPD

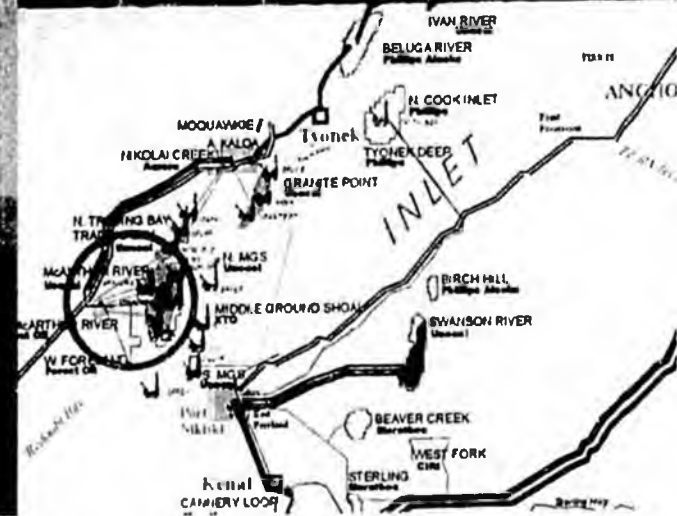
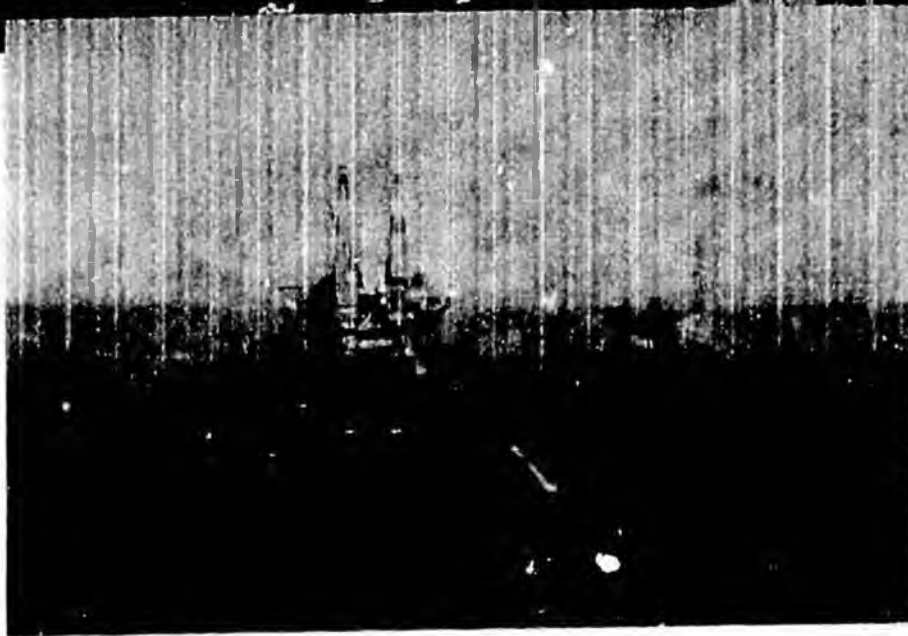
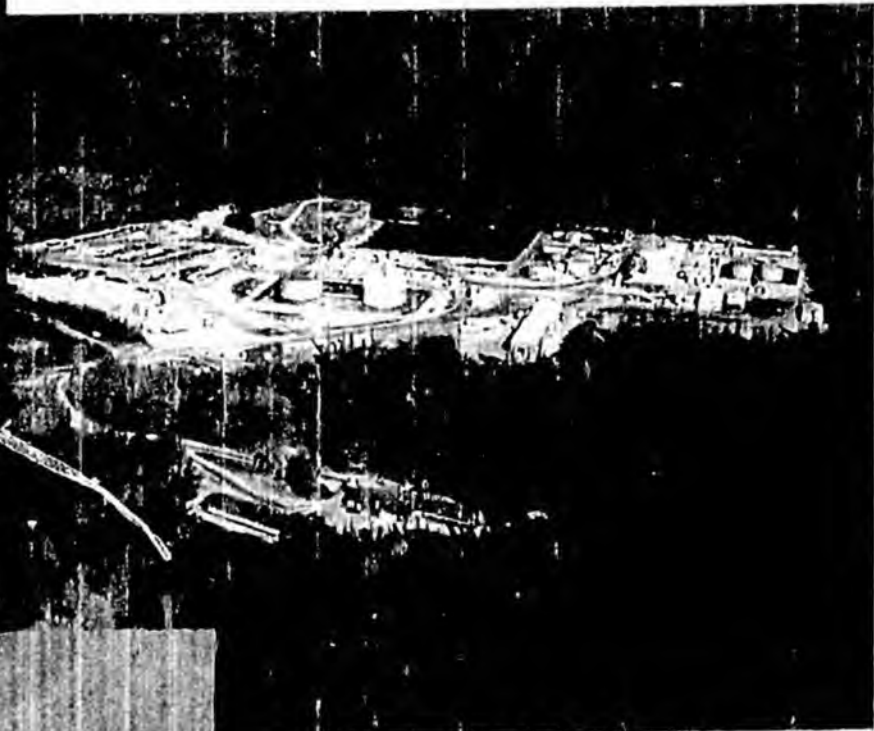
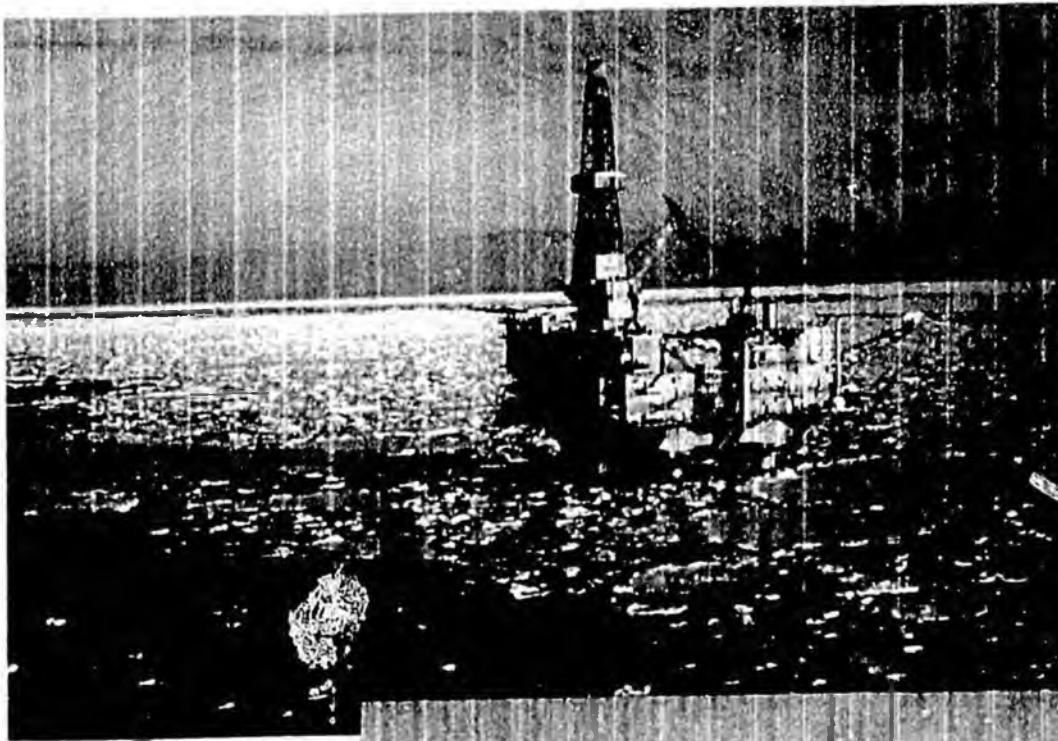
## Net Production

**Offshore Oil  
6,300 BOPD**

**Gas  
112 MMCFPD**

**25,000 BOEPD**

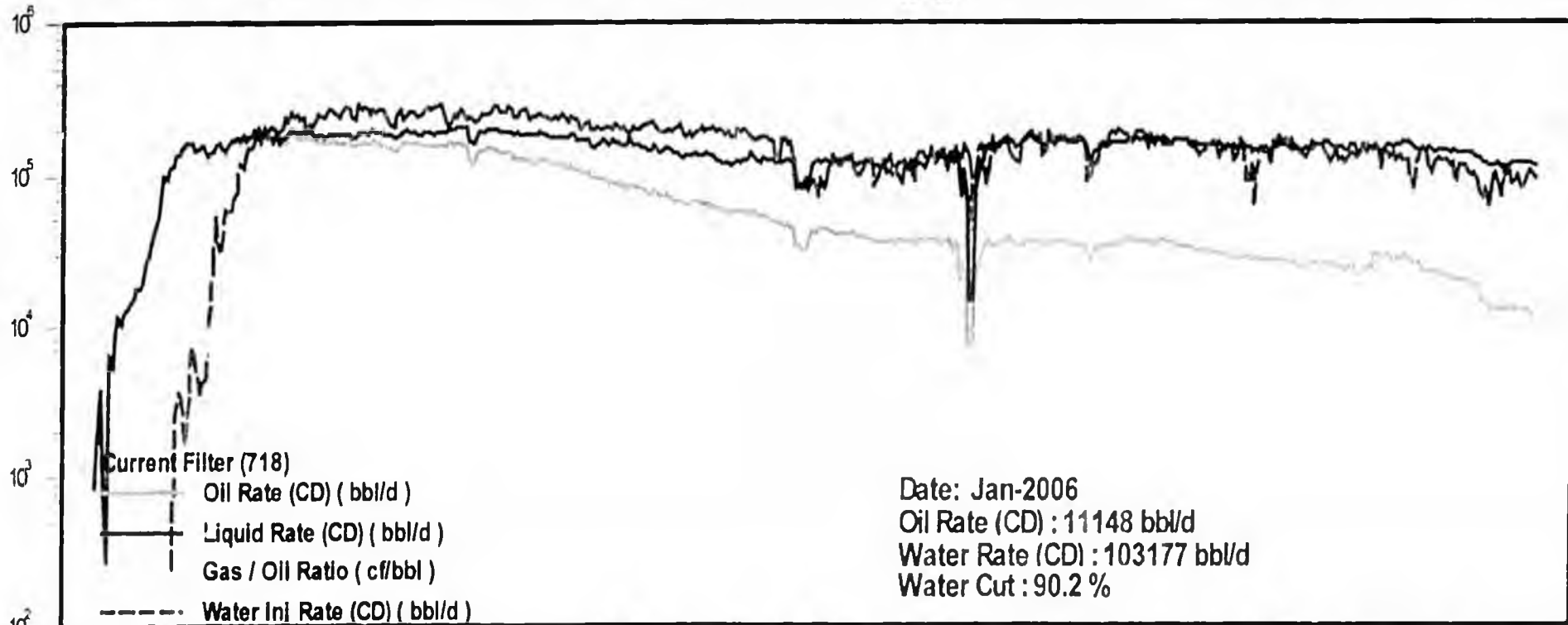
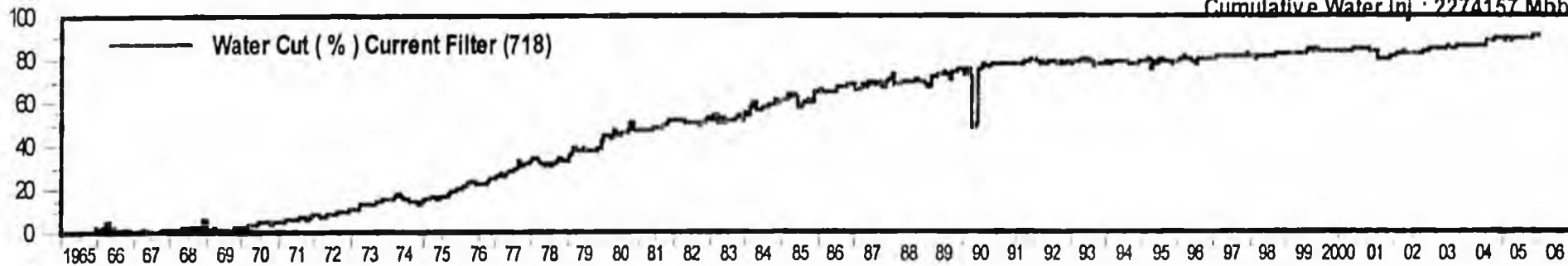
# Trading Bay Unit



# Cook Inlet Offshore



Cumulative Oil Prod : 1030570 Mbbbl  
 Cumulative Gas Prod : 1587463 MMcf  
 Cumulative Water Prod : 1117781 Mbbbl  
 Cumulative Water Inj : 2274157 Mbbbl

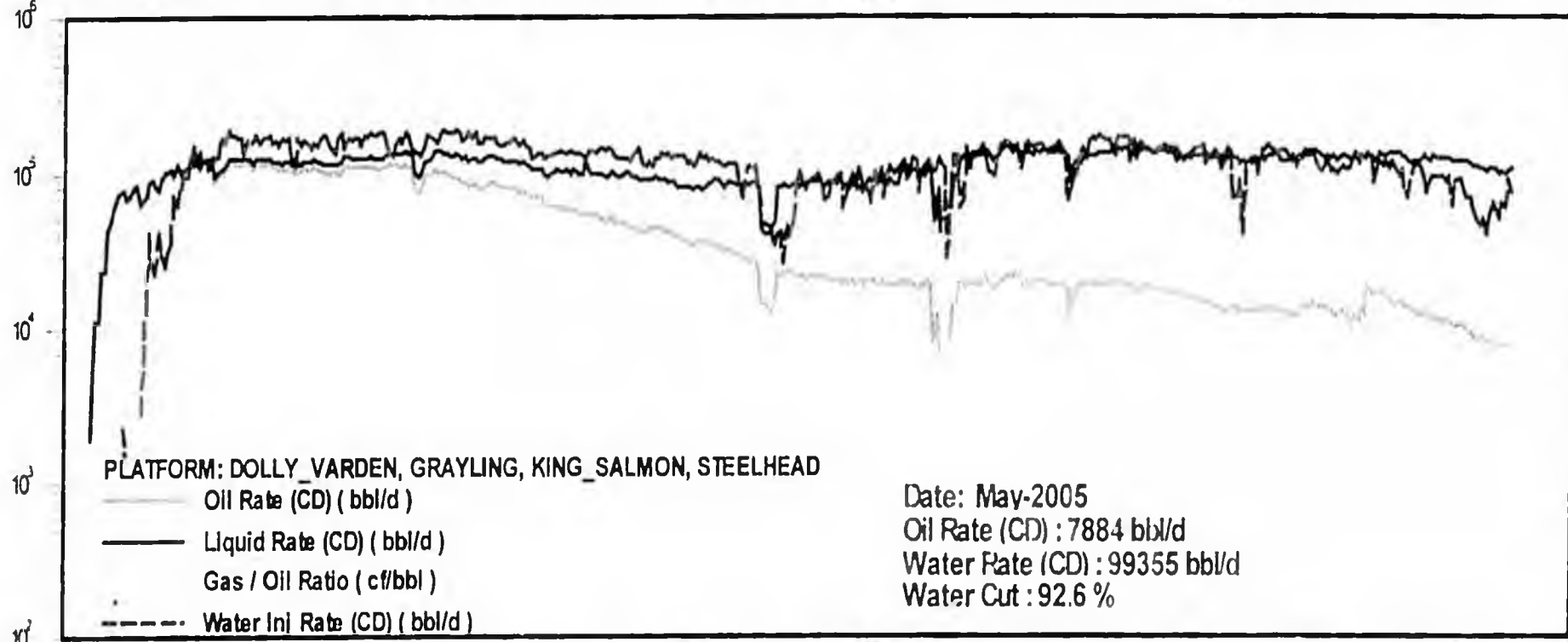
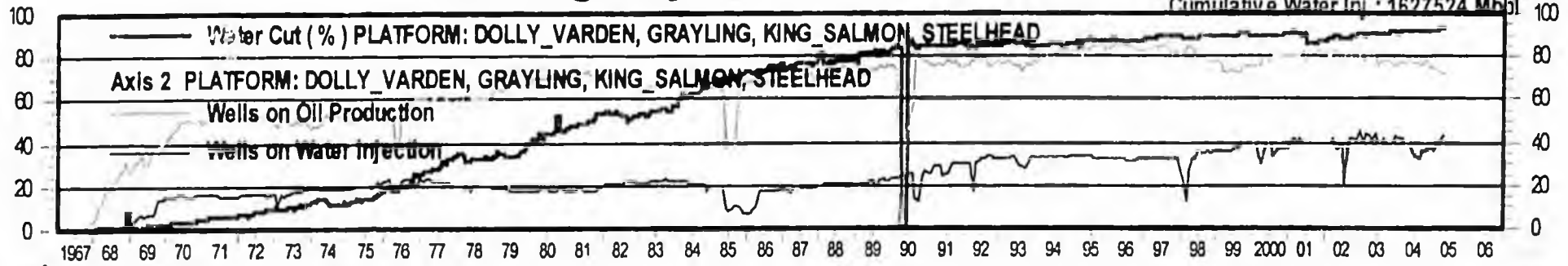


Date: Jan-2006  
 Oil Rate (CD) : 11148 bbl/d  
 Water Rate (CD) : 103177 bbl/d  
 Water Cut : 90.2 %



# Trading Bay Unit

Cumulative Oil Prod : 618928 Mbbbl  
Cumulative Gas Prod : 1266687 MMcf  
Cumulative Water Prod : 897435 Mbbbl  
Cumulative Water Inj : 1627524 Mbbbl



PLATFORM: DOLLY\_VARDEN, GRAYLING, KING\_SALMON, STEELHEAD

Date: May-2005  
Oil Rate (CD) : 7884 bbl/d  
Water Rate (CD) : 99355 bbl/d  
Water Cut : 92.6 %

1967 68 69 70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 2000 01 02 03 04 05 06

Date

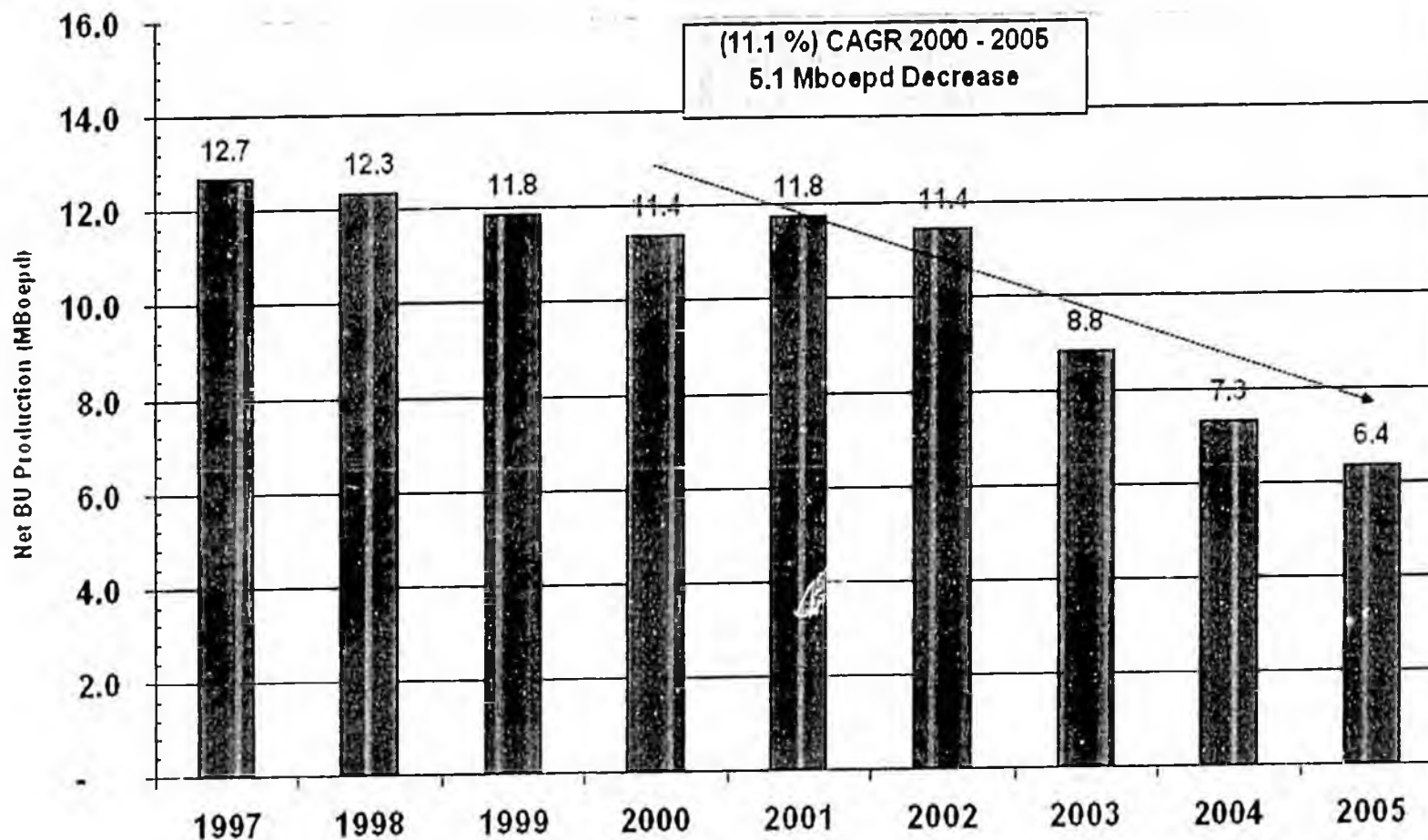
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7



# Cook Inlet Oil Production History

Cook Inlet Oil Business Segment Production History  
(Avg Annual Net MBoepd)





## Cook Inlet Offshore Oil

- Cook Inlet Oil is very high cost
  - Direct lift cost \$20 - \$25 per BOE
  - Currently breakeven on Cash Flow @ ~ \$30/BOE
  - Currently breakeven on Earnings @ ~ \$40 - \$45/BOE
  - Further production declines will raise breakeven prices
- Significant operational risks
  - Two platforms are currently shut-in
  - Must maintain critical mass of operations
- Cook Inlet Offshore cannot afford an additional tax burden



## Chevron Cook Inlet Strategic Study

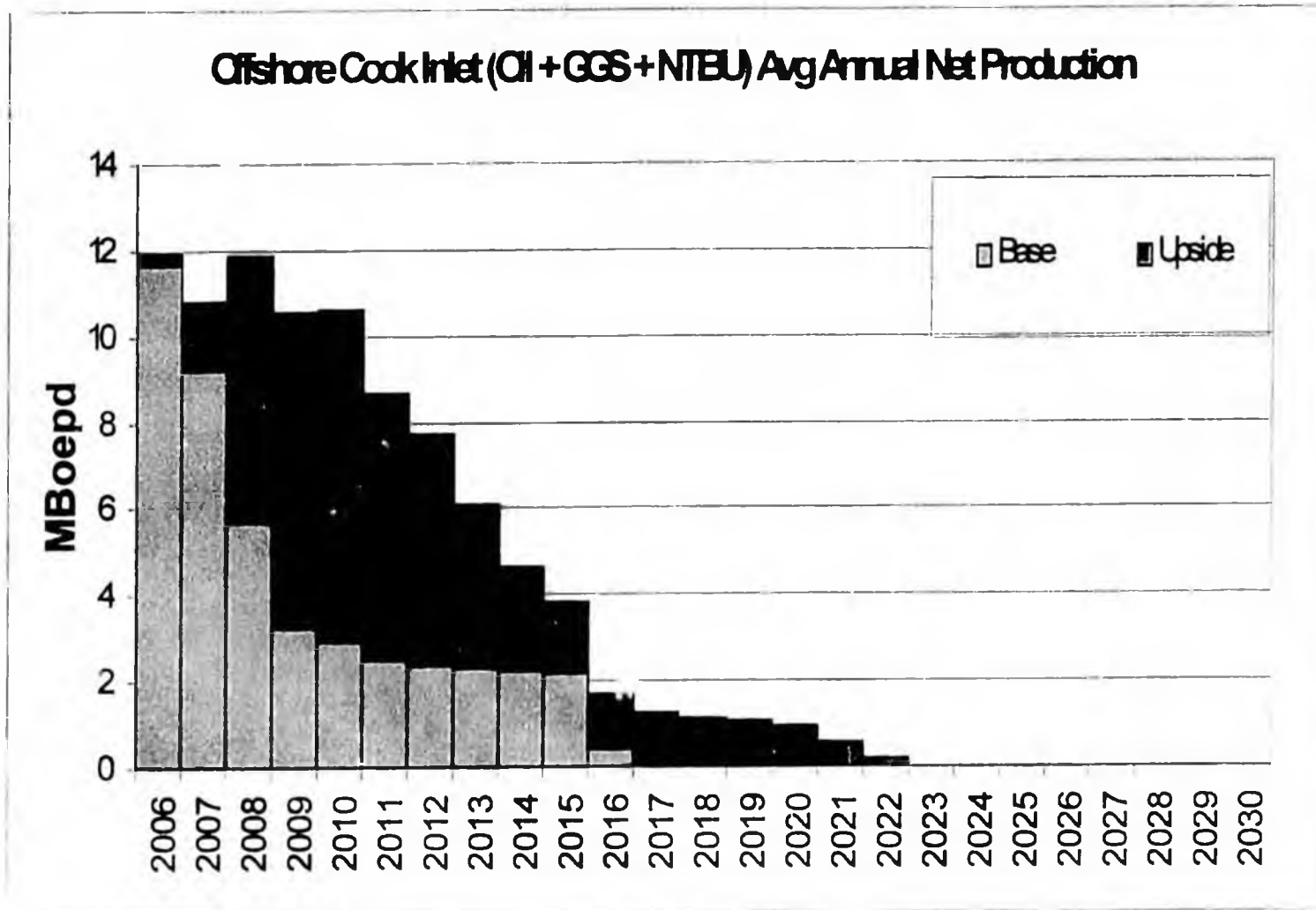
- August 10, 2005 Chevron acquires Unocal
  - Much speculation about Cook Inlet asset fit in Chevron Portfolio
- October 2005 – January 2006 – Strategy work completed
  - Determined that there are incremental investment opportunities in the Cook Inlet although they are in the lowest quartile of Chevron's investment portfolio, many projects did not make the cut
- February 2006 – Great news - announce decision that Chevron will retain all Cook Inlet assets with the intent to begin a multiyear investment program
  - Chevron will retain the current office locations



## Great news, so what's the problem?

- The Cook Inlet reinvestment program was evaluated using the current severance tax assumptions (zero severance tax)
- When modeled under the proposed 20/20 PPT the economics on some projects are degraded, some projects are improved, overall poorer economics for the program
  - Oil production taxes will go up dramatically
  - Will cause investment decision to be reconsidered
  - Higher taxes will cause less capital to be spent
  - Enhanced PPT terms could significantly expand the list of economic projects in the investment program and significantly extend the life of offshore oil production

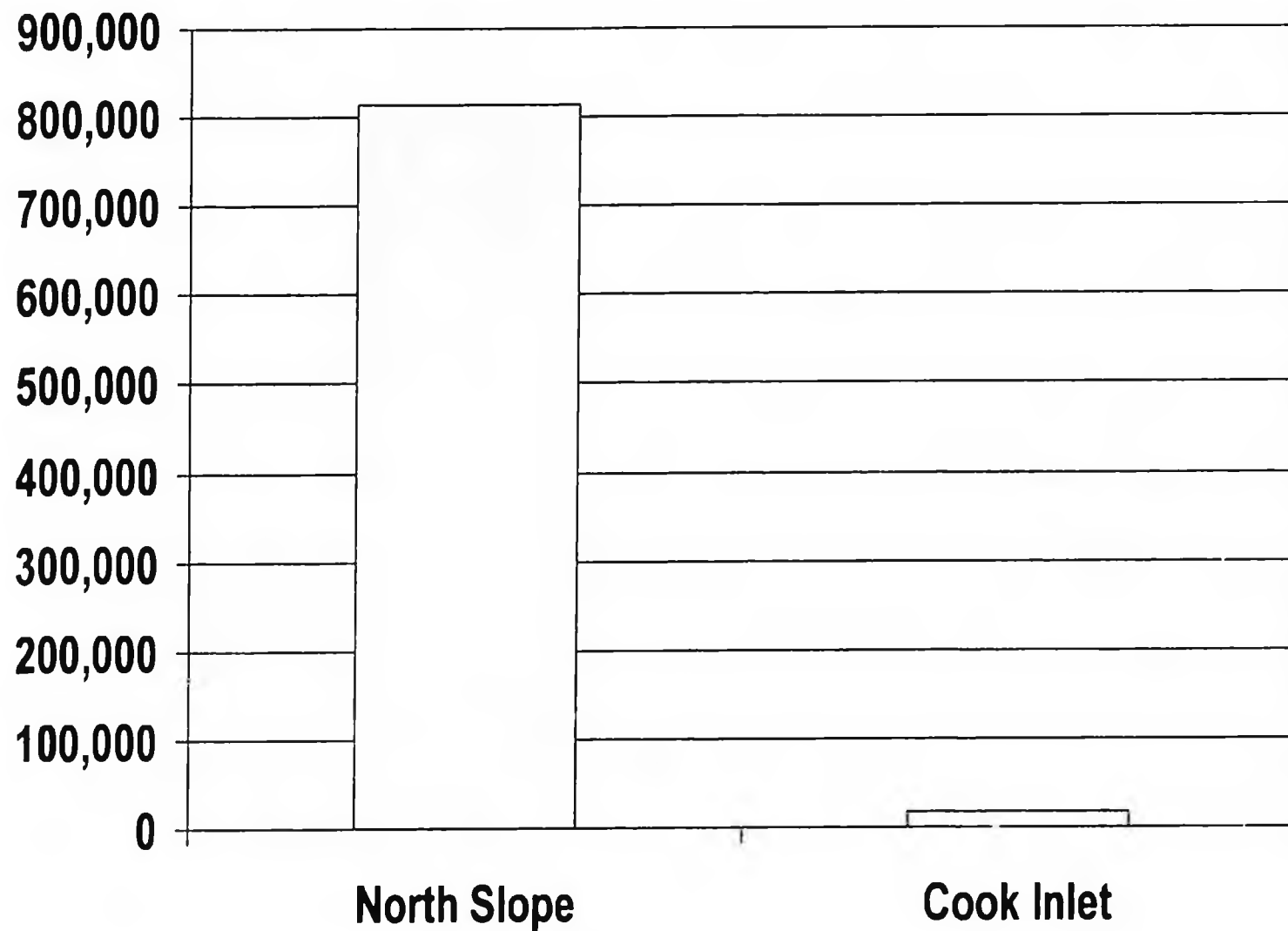
# Cook Inlet Production Forecast with Four Year Capital Plan



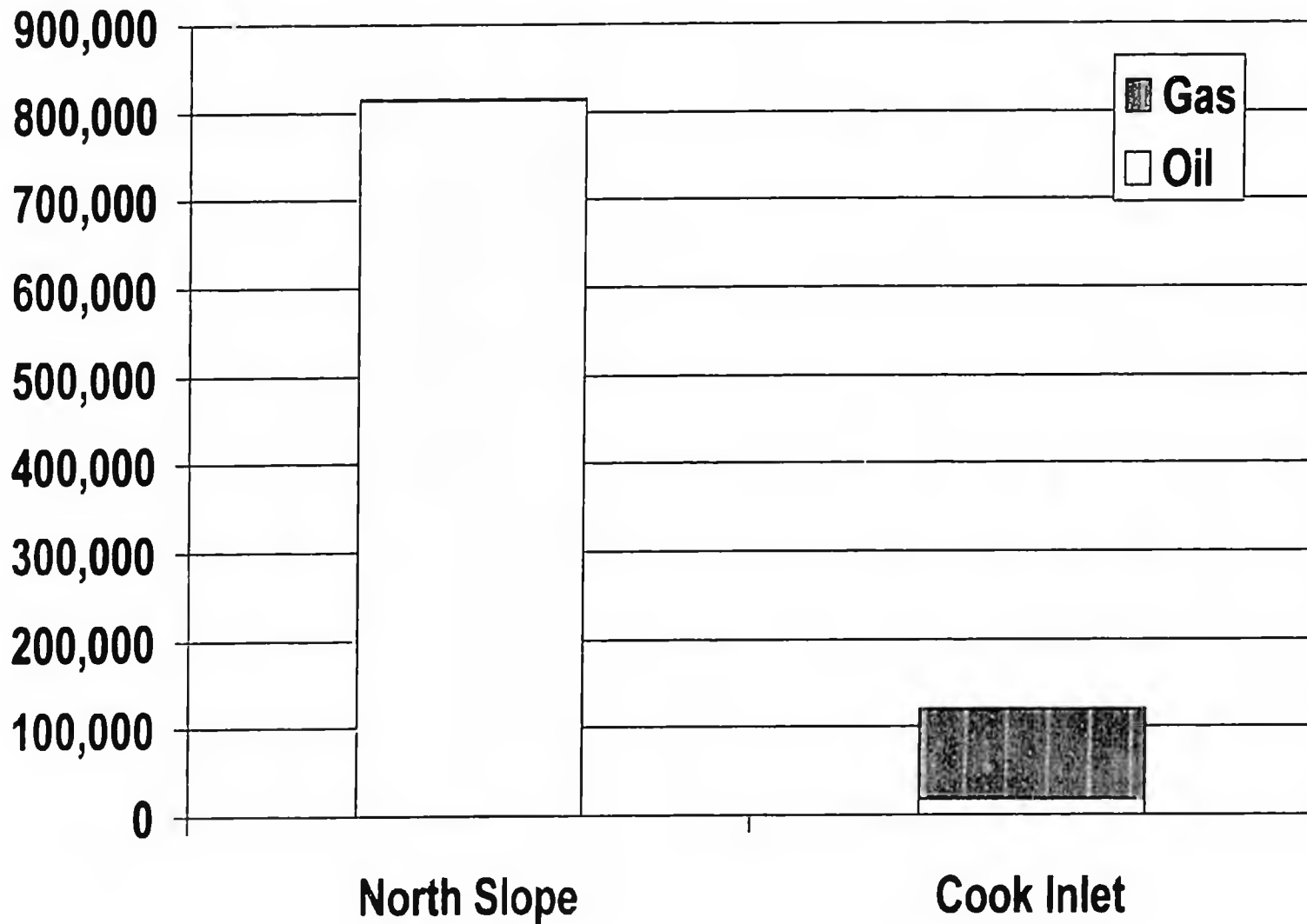
12



# Alaska Oil Production January 2006 BOPD



# Alaska Oil Production January 2006 BOEPD



14



## Reasons to Lower Taxes and Provide Incentives for Additional Cook Inlet Investment

- Gas is running out
  - Home heating, electrical generation, industrial consumption
  - Additional gas supply is critical to state's economy
  - Other options are much more expensive
  
- Currently a lack of significant exploration
  - Last Cook Inlet lease sale was poorly attended
  - New exploration efforts could add new fields
  
- Production tax is a pass through on most utility contracts
  - Tax increase represents increase in gas price to consumers
  
- Oil redevelopment will maintain and add new jobs and will extend field life
  
- Cook Inlet competes for capital with other areas in North America, does not compete for global capital
  - Under PPT Alaska will have the worst fiscal terms in the U.S.

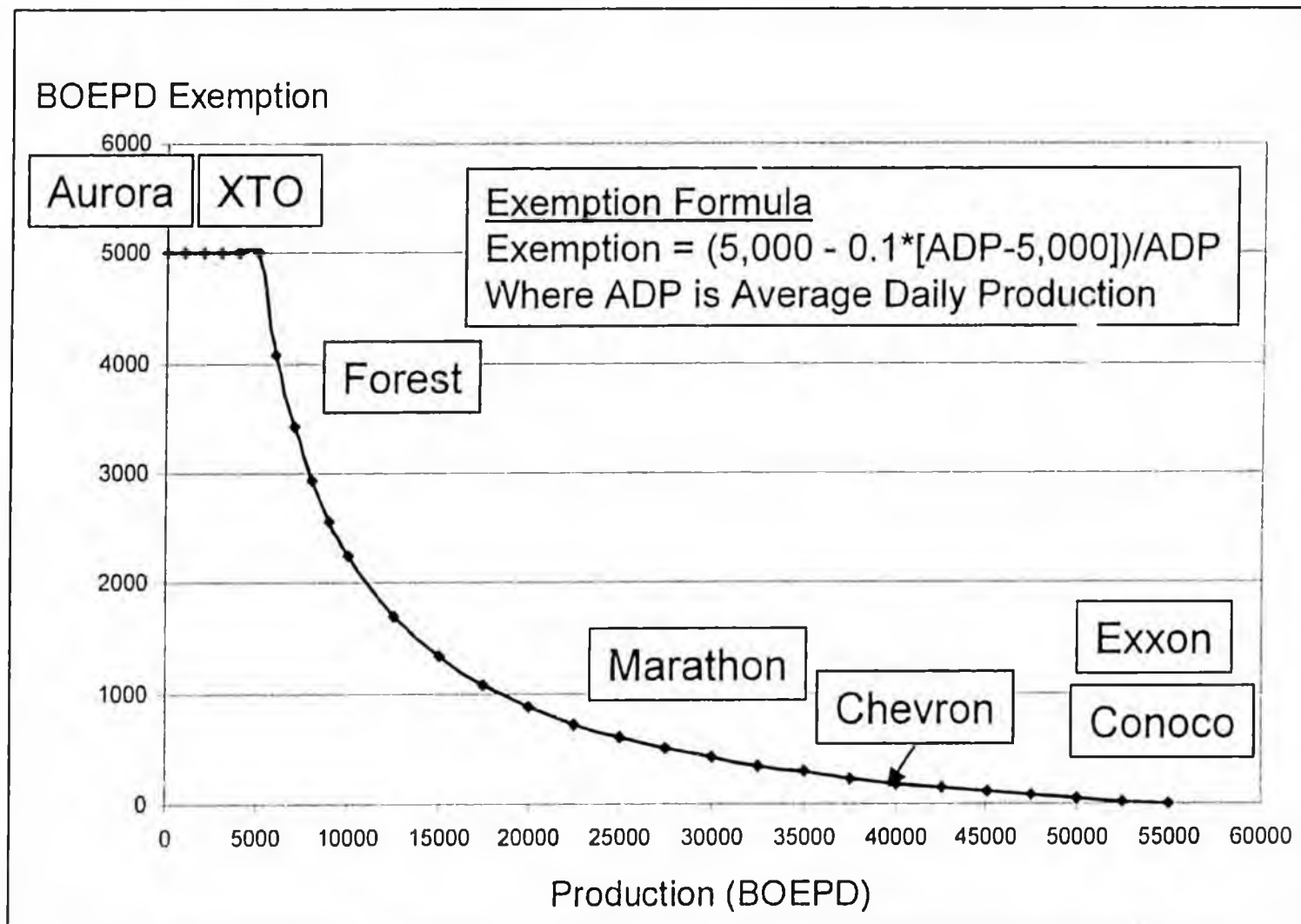


## Cook Inlet Provisions to Date

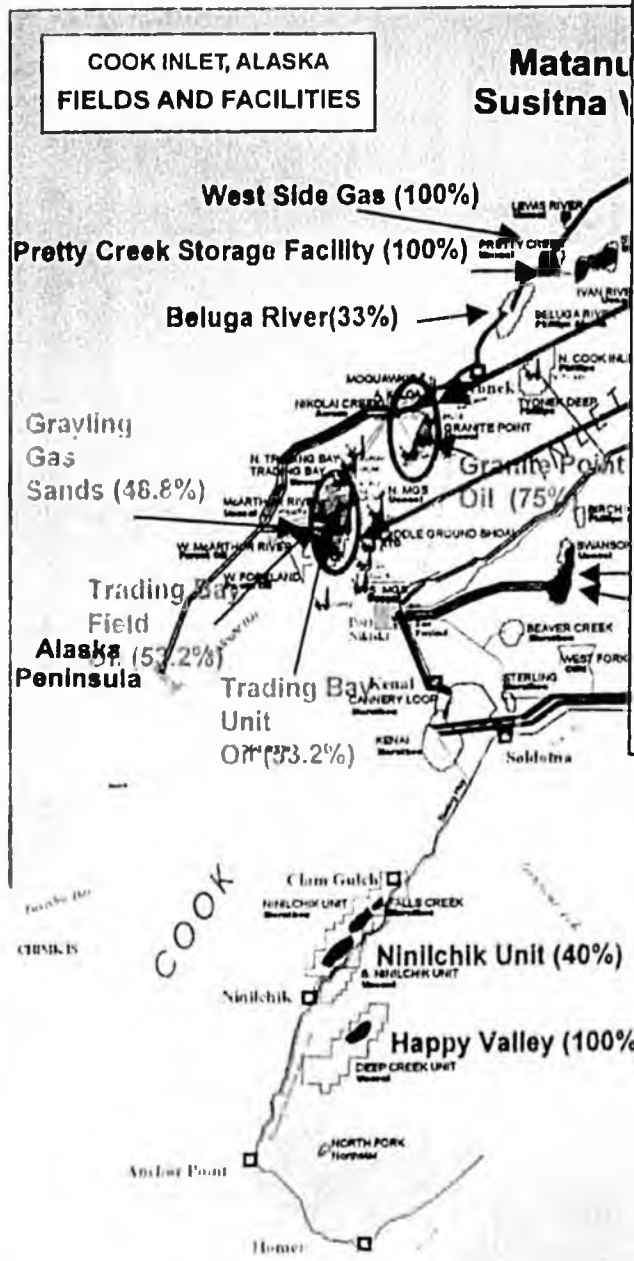
- House Resources – None
- Senate Resources – “5,000 BOPD exemption”
  - Fails to provide any real help to Cook Inlet
- Reasons given not to consider Cook Inlet provision
  - Adds complication
    - ▶ Some additional complication to help Cook Inlet is justified
  - System must be uniform over entire state
    - ▶ We already have statutes that distinguish geographic areas



# Impact of Senate 5,000 BOPD Exemption



# Any "Cook Inlet" provision should be specific to the Cook Inlet



It has been said that the 5,000 BOPD provision protects the Cook Inlet, but it does not help Chevron (or other major producers), Chevron operates 75% of the inlet's oil production

Why does it "not help" Chevron?

- Cook Inlet is the incremental asset
- These are incremental investments
- Therefore we run incremental economics
- Anything above 5,000 BOPD will be hit by PPT
- No effect on "end of life" decision
- Chevron is at ~40,000 BOPD
- Cook Inlet's aging oil fields can not afford additional tax
- Any "Cook Inlet" provision should be specific to the Cook Inlet (or areas outside of the North Slope)

## Net Production

Offshore Oil  
6,300 BOPD

Gas  
112 MMCFPD

25,000 BOEPD

18

# Biggest Disappointment of House Resources CS



- The unique value and challenged position of the Cook Inlet is not recognized
- Revisions as proposed lowers the economics of capital investments in the Cook Inlet
  - Puts Chevron's four year capital program in jeopardy
  - Without capital McArthur River Field is gone in ~4 years
  - Critical mass for Cook Inlet oil industry is gone



# Recommendation on Cook Inlet

Consider the following options:

- Carve out Cook Inlet
  - Leave under current system
  
- Special exemption for Cook Inlet
  
- Apply PPT to keep taxes at current levels
  - Retain overall incentive rates
  - Adjust tax rates lower



# General Comments on CS

- Balance of the original bill is gone
  - Applaud holding tax rate at 20%
  - Tax credit of \$12 million is okay as replacement for \$73 million standard deduction
- Lever's pulled in the same direction
  - Transition capital credit is gone
  - Progressivity - taking away the "windfalls", no matter how you couch it, lowers expected value to investors
    - + WTI vs. ANS
    - + If retained, base price must be inflated
  - April 1, commencement date, not practical, punitive penalty and interest rate



# General Comments on CS

## ■ Debate between "get it now" and "grow the pie"

- "Get it now" option will balloon short term revenue creating a state windfall that must be well managed
- "Grow the pie" option will create long term opportunities for investors and for Alaska
- I am optimistic about the ingenuity and technology available in our industry and the people of Alaska to greatly extend oil production for the next generation

## ■ Consultants will one day leave and we will be left to deal with our decisions

- First you vote on behalf of the people of Alaska
- Then over the coming years investors vote with their dollars
  - ▶ Original industry support was astounding
  - ▶ However, Investors big and small, old and new, are now saying that the House Resources CS structure will discourage investment in Alaska



# Summary Comments on CS

- Chevron cannot support the House Resources CS in its current form
- Urge return to original PPT terms, while inserting a Cook Inlet provision
- Recommend inclusion of an additional 5% capital credit (20/25) for heavy oil or tertiary recovery (CO<sub>2</sub>) projects statewide
- Chevron has been in Alaska for many years and intends to continue an active exploration and production operation in the state if a sound and stable fiscal regime can be offered

23

# INDUSTRY RESPONSES

bp

3-30-06



BP Exploration (Alaska) Inc.  
900 East Benson Boulevard  
P.O. Box 196612  
Anchorage, Alaska 99519 6612  
(907) 561-5111

Date: March 30, 2006

To: House Finance Co-Chair Mike Chenault  
House Finance Co-Chair Kevin Meyer

Re: Follow Up Information to 3-29-06 Testimony – Per Request

Dear Representatives Chenault and Meyer:

During BP's March 29 presentation to the House Finance Committee, I agreed to provide additional information which I am pleased to attach as follows:

- 1) Copy of my March 15 letter and attachment to the House and Senate Resource Chairs providing details of the UK experience where lenient fiscal policy was successful in attracting significant investment to the UK oil and gas sector.
- 2) Answers to various questions relating to government and industry take previously shared with the House and Senate Resource Committees.

We are happy to discuss these issues further with the committee or individual members of it.

Sincerely,

A handwritten signature in black ink, appearing to read "Angus Walker", is written over the "Sincerely," text.

Angus Walker

## Follow-up to BP Presentation on CSHB 488 (PPT)

Alaska State Legislature  
House Finance Committee  
29th March 2006

Attached are answers to questions originally provided to House & Senate Resource Committees. The answers to these questions are relevant to questions raised during BP's presentation to the House Finance Committee on 29<sup>th</sup> March 2006.

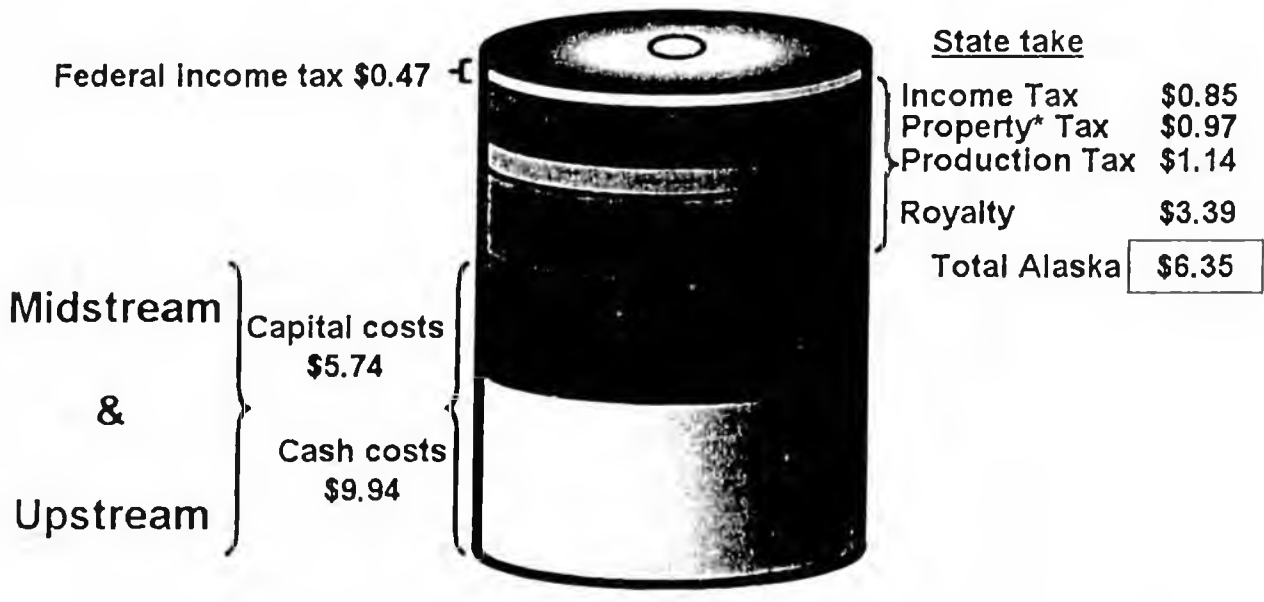
- Please explain why your analysis shows that BP makes a loss while the DOR shows that you still make money at oil prices below \$20/bbl?
- What is the effective tax rate under PPT vs under the Status Quo for BP?
- What is the relative profit share between the State, Federal Government and BP at different oil prices under the existing system and the proposed PPT.

BP is pleased to provide responses as follows:

**Please explain why your analysis show that BP makes a loss while the DOR shows that you still make money at oil prices below \$20/bbl?**

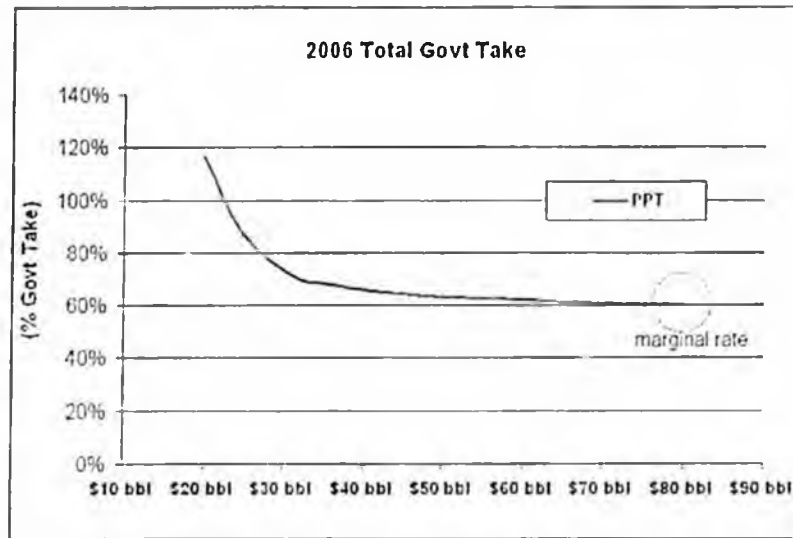
We have reviewed the DOR calculations and while we have some differences we get close to replicating DOR's revenue calculations. The key difference between the two approaches is that the DOR calculates revenue, and BP calculates profit. In the calculation of profit we include the non-cash costs (depreciation of capital investment). The capital component is shown in the breakeven barrel below. At our current breakeven price of \$22.50 / bbl the State receives \$6.35 / bbl and the federal government receives \$0.47 / bbl. It is only at prices above \$22.50 that BP starts to make a profit.

Breakeven Barrel \$22.50



Upward pressure created by inflation (driven by high oil price) and production decline

The following shows the government take at different oil prices applicable to BP's business in Alaska calculated for the PPT (20/20) system (i.e. without any price surcharge). It should be noted that at all but the current high oil prices the actual government take is substantially higher than the marginal rate.



Based upon BP net

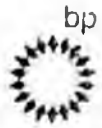
## What is the effective tax rate under PPT vs under the Status Quo for BP?

The effective tax rate is a useful way of comparing PPT to the current severance tax which is calculated on gross revenue. The effective tax rate is the tax rate which would have to be applied to gross revenue to achieve the same outcome as under PPT (20/20) which is calculated on net revenue (gross revenue less expenditures).

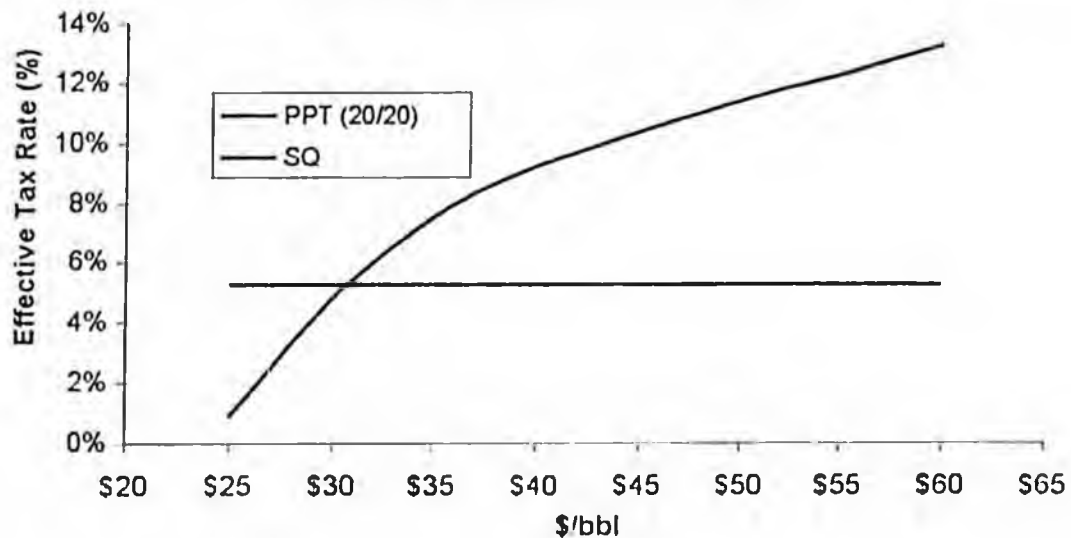
The effective tax rate under PPT is a function of oil price and costs. As such it will vary slightly by company depending on their assumptions re expenditure.

The effective tax rate under the Status Quo (SQ) will vary from company to company depending on their ownership in high and low Elf fields.

(The following example does not include transitions arrangements which are temporary by nature)



BP Alaska Effective PPT Rate

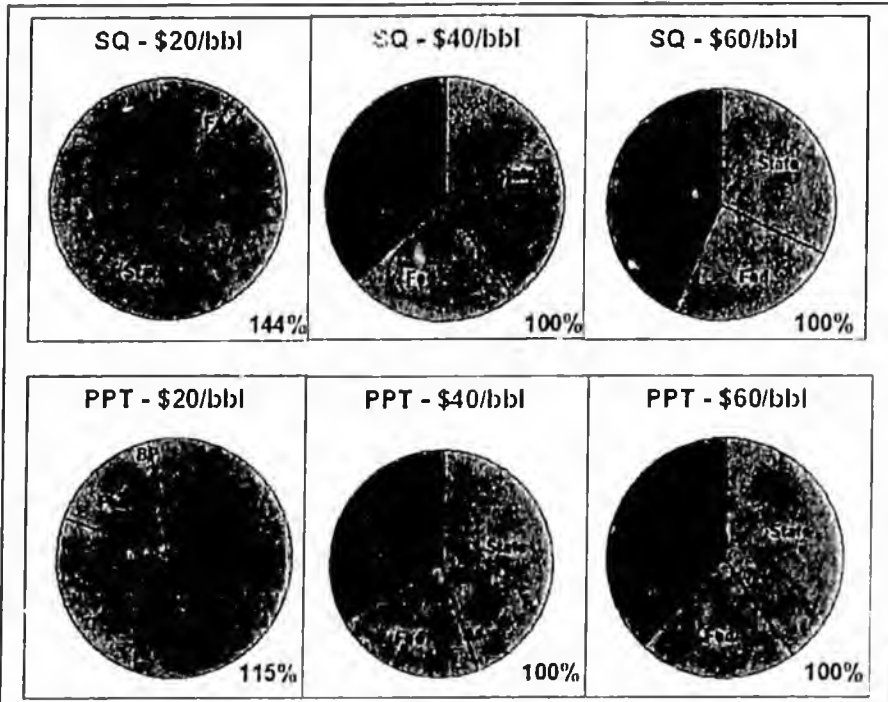


# What is the relative profit share between the State, Federal Government and BP at different oil prices under the existing system and the proposed PPT.

The pie charts below illustrate the split between State, Federal and BP take under the current regime and the original PPT 20/20 at low, medium and high prices.



Status Quo



PPT  
(20-20)

	\$20		\$40		\$60	
	SQ	PPT	SQ	PPT	SQ	PPT
<b>State</b>	143%	97%	40%	44%	32%	40%
<b>Federal</b>	1%	18%	23%	22%	25%	22%
<b>BP</b>	0%	0%	37%	34%	43%	38%

The left hand pies show the problem for industry at low prices. BP makes a loss when oil prices are less than \$20.50/bbl.

At \$60/bbl the current system provides a higher % to the industry than to the State, but that is not new news. Alaska's fiscal system was designed to protect the state at low prices and compensate the industry at high prices. That is the nature of a regressive tax regime.

Under PPT 20/20, we would continue to make a loss at \$20. At \$40 the State gets a considerably higher share than BP. At \$60 under under PPT 20/20, (i.e. without any price surcharge), the State's take is greater than BP's take.

*(Please note that the pie charts and percentages shown above have been updated since the presentation made on 28<sup>th</sup> February to the House Resource Committee to properly incorporate some costs associated with running the BP Alaska business, which had been omitted in error from the original analysis.)*



**Angus J. Walker**  
Commercial Vice President

BP Exploration (Alaska) Inc.  
P.O. Box 196612  
900 East Benson Boulevard  
Anchorage, Alaska 99519-6612  
(907) 564-4761  
(907) 561-5111  
Fax (907) 564-5598  
WalkerA4@BP.com

Date: 15/03/2006

**To:**

Senator Thomas Wagoner, Chair Senate Resources Committee  
Representative Ralph Samuels, Co-Chair House Resources Committee  
Representative Jay Ramras, Co-Chair House Resources Committee

**Re: Testimony of Mr Daniel Johnston on SB 305/HB 488 Production Profit Tax (PPT)**

Dear Senator Wagoner and Representatives Samuels and Ramras:

In his Testimony of 6th March 2006 to the House & Senate Resource Committees, Mr Johnston raised a number of issues related to BP's prior testimony to which I am compelled to respond. As well as setting the record straight I believe this response will be helpful to you and your committee's deliberations.

Our response relates to two issues raised by Mr Johnston:

- 1) The impact of 1993 tax cuts on investment in the UK North Sea.
- 2) The Marginal rate of taxation in the UKCS.

**1) The impact of 1993 tax cuts on investment in the UK North Sea.**

In BP's February 28<sup>th</sup> testimony, my colleague Ray Hall presented data from the UK North Sea, Gulf of Mexico and Alberta that illustrates the cause-and-effect relationship between fiscal policy and investment. With regard to the UK example, Mr Johnston contended that the data BP presented "is not a fair representation of what the result of lowering the tax rate in 1993 was". Clearly it is difficult to unequivocally attribute any outcome to the events that preceded it, and there will be many views of what might have happened without the tax change. However:-

**For BP, the position is clear**

- We increased capital investment in response to the 1993 changes
- We sanctioned 5 large projects in the matter of a few years (Andrew, Harding, Foinaven, Schiehallion and ETAP). These projects committed circa \$8 billion in capital and 2 billion boe in reserves.

**For the UK Government the position is clear**

- UKCS Exploration & Appraisal spend was the largest of any basin in the world between 1994-1999
- The number of development wells increased one and a half fold between 1993 and 1995
- Basin production rose following the reform
- Tax revenues increased following the reform

Mr Johnston himself is on record as saying:-

"Ordinary measures of Government take through out the 1990's made the United Kingdom government appear rather crazy and irresponsible. .... The "gross benefits" to the UK Government go way beyond direct tax revenues and royalties received from the upstream sector of the petroleum industry. **The economic impact of the industrial hyperactivity in the UK sector of the North Sea, a direct result of the "lenient" terms of the 1990's, is difficult to measure.** Furthermore, the activity in the UK started in the late 1980's and early 1990's when the UK Government dropped the ring fence for the 75% PRT before Government take, as it is ordinarily measured, was drastically reduced. **The UK offshore became the most active offshore province in the world. Reducing the Government take in the following years managed to sustain that boom.** Activity and employment in the British petroleum sector is healthy and robust.." (Source: *Petroleum Tax Design page 6 by Daniel Johnston 23 Oct 2002, Washington DC*)

It is our sincere belief that there is a close relationship between fiscal policy and investment, a relationship acknowledged by Mr Johnston in earlier publications, and that the UK offers one of several notable examples where reducing taxes has stimulated investment. The attached slide pack provides additional detail.

## 2) The marginal rate of taxation in the UKCS

In BP's testimony, Ray Hall compared the marginal government take under PPT 20/20 (61%) to that of the UK (50%). Mr Johnston challenged this figure, asking "why has nobody mentioned the 75% Government Take in the UK?" The 75% Government Take to which Mr Johnston is referring is that paid by the small number of the fields in the UK that are subject to Petroleum Revenue Tax (PRT). PRT is currently levied at 50% on fields given development consent prior to March 1993. Out of a total 208 fields in the UKCS, only 94 fields are liable to, and only 29 actually pay PRT (the rest are protected by volume and other allowances). These 29 fields contributed approximately 29% of the UK oil and gas production in 2005. In any event, the 50% marginal tax rate described by Mr Hall applies to all fields developed after 1993 and as such is a more appropriate comparator to future investments in Alaska.

I trust this letter is clear and would be happy to discuss any issues raised with you and your committees.

BP appreciates the opportunity to testify on this very important issue and intend to remain fully and constructively engaged in the process.

Sincerely yours,



Angus Walker

Commercial Vice President, BP Alaska

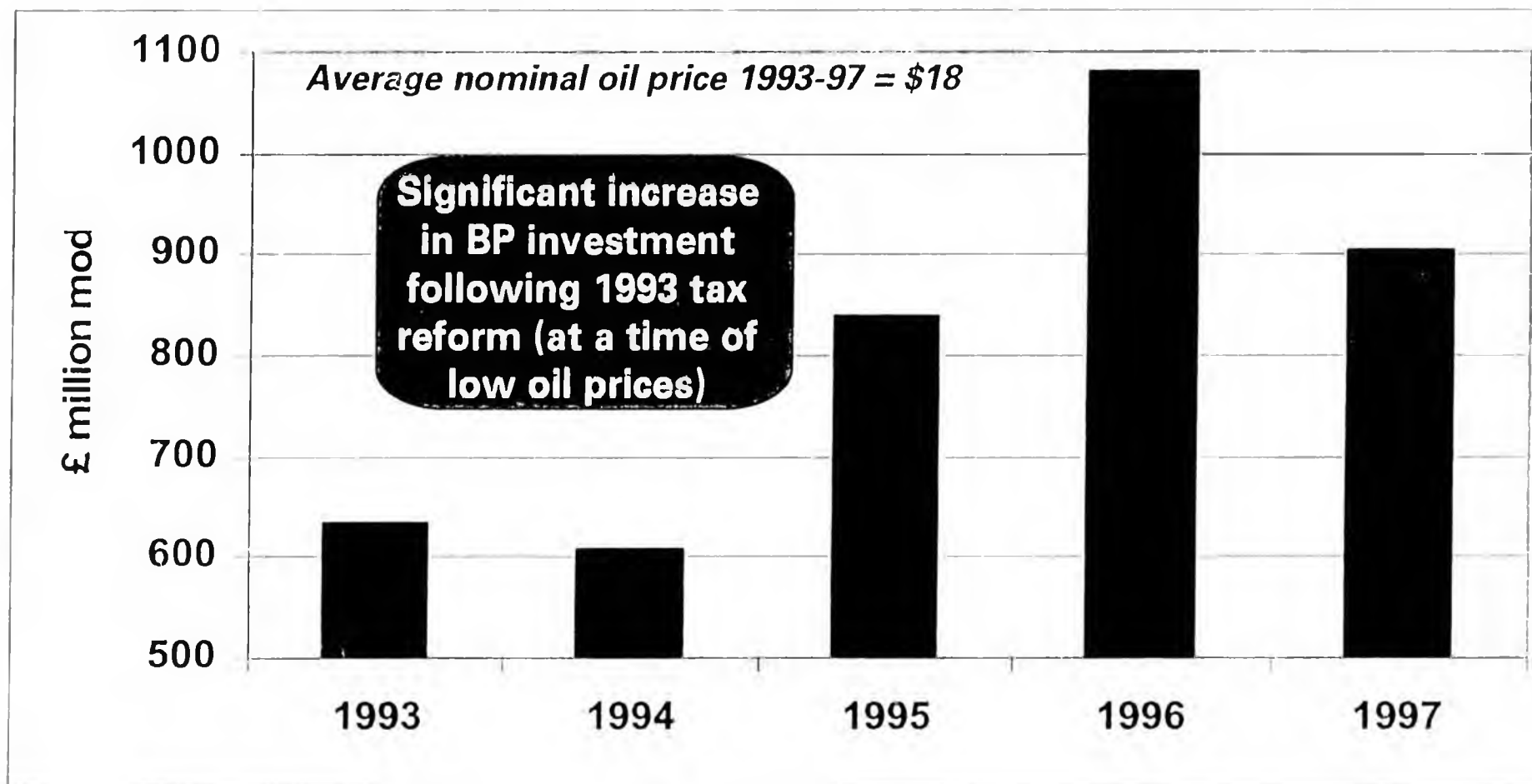
Attachments: 6 slides providing further context to the outcome of the UK 1983 and 1993 tax cuts

bp



15<sup>th</sup> March 2006

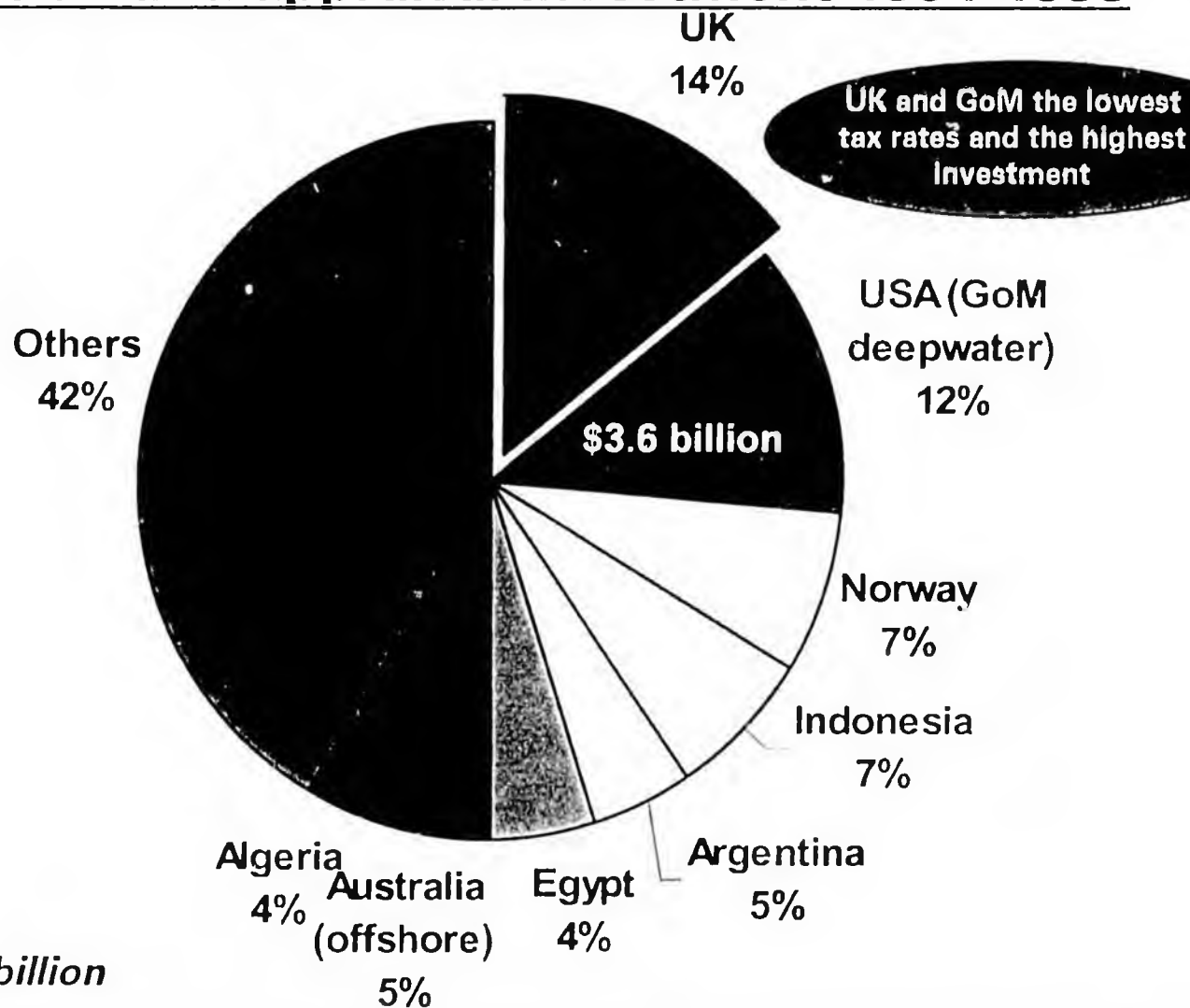
# Investment in UKCS



Source : BP Financial and Operating information

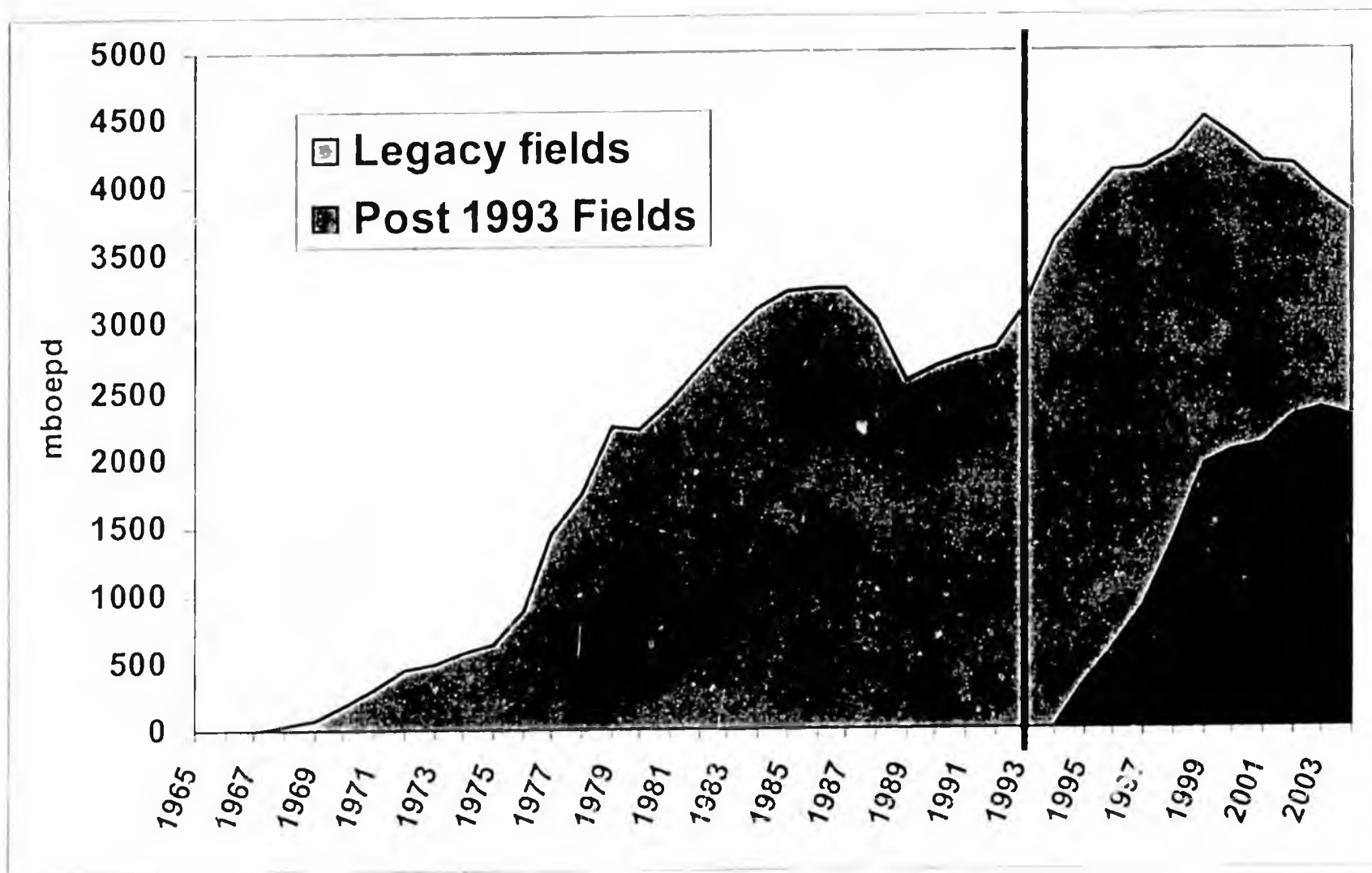


## Exploration and appraisal investment 1994-1999

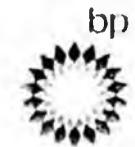


Source : Wood MacKenzie ' Global oil & gas risks and rewards study'

Oil production is clear



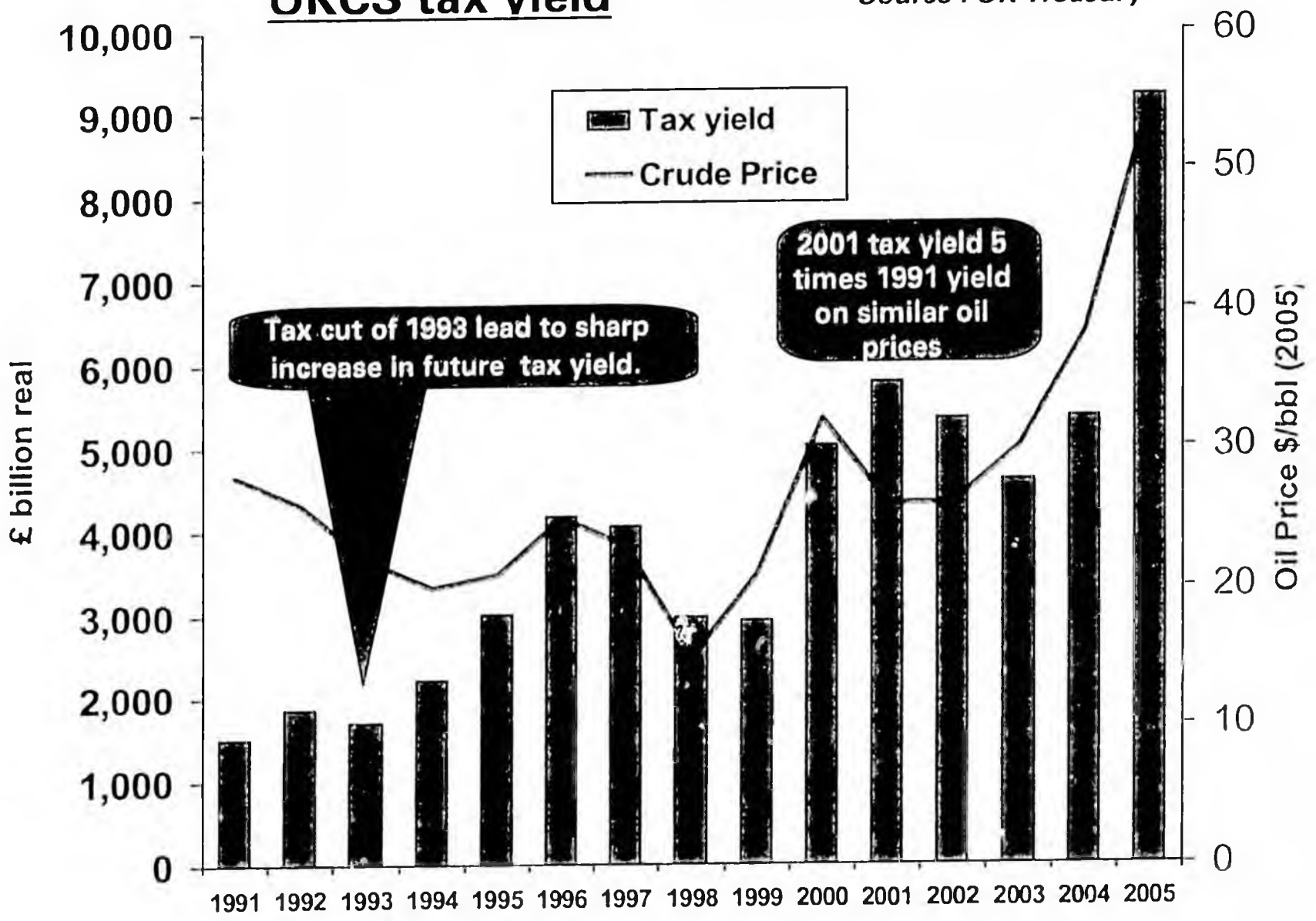
Source: Wood Mackenzie



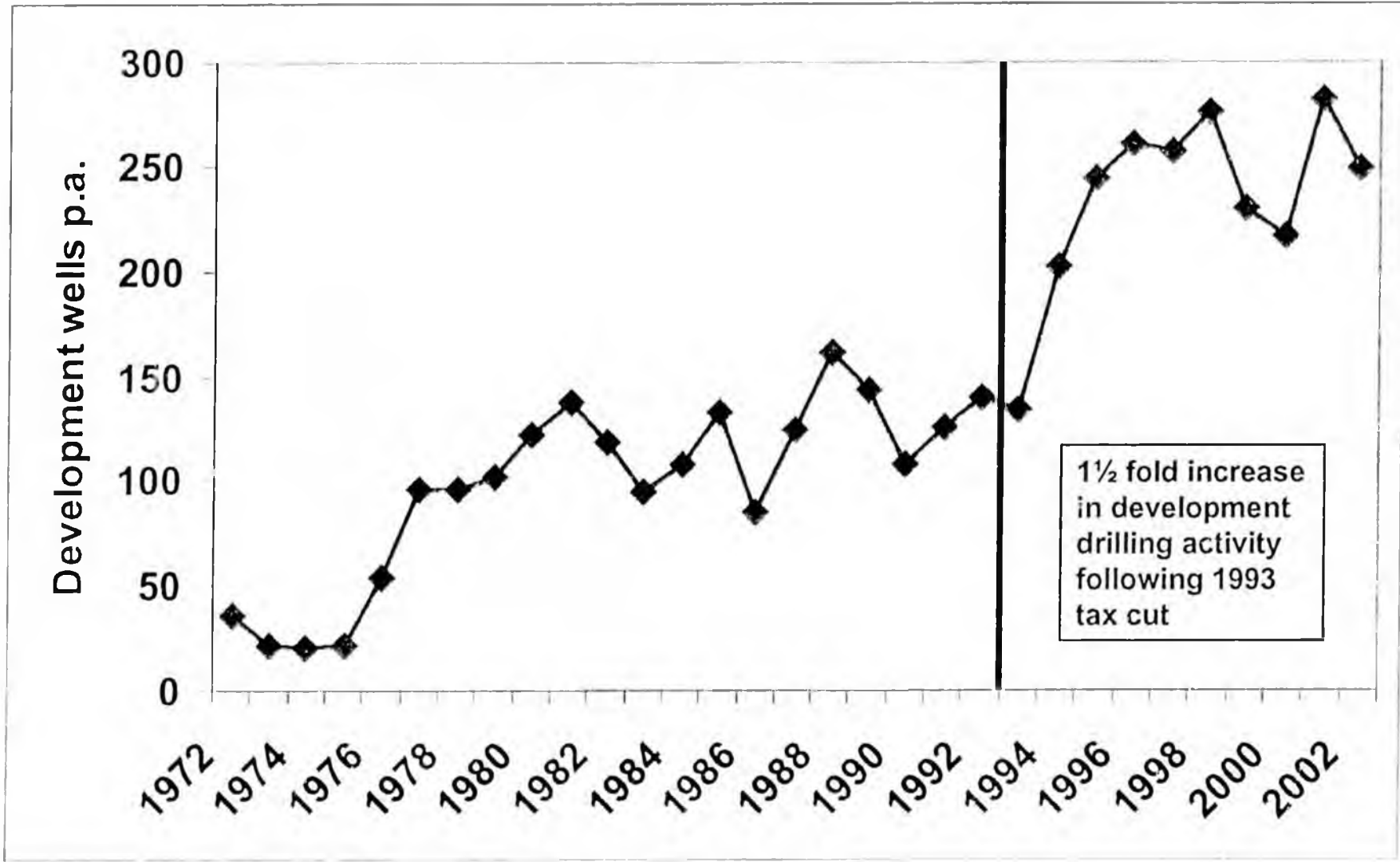
tax yield increase in response to 1993 reform

# UKCS tax yield

Source : UK Treasury



# Onshore Drilling Activity



Source of data: UK Department of Trade & Industry



"Ordinary measures of Government take throughout the 1990's made the United Kingdom government appear rather crazy and irresponsible. .... The "gross benefits" to the UK Government go way beyond direct tax revenues and royalties received from the upstream sector of the petroleum industry. The economic impact of the industrial hyperactivity in the UK sector of the North Sea, a direct result of the "lenient" terms of the 1990's, is difficult to measure. Furthermore, the activity in the UK started in the late 1980's and early 1990's when the UK Government dropped the ring fence for the 75% PRT before Government take, as it is ordinarily measured, was drastically reduced. The UK offshore became the most active offshore province in the world. Reducing the Government take in the following years managed to sustain that boom. Activity and employment in the British petroleum sector is healthy and robust.."

***Daniel Johnston***

***23 Oct 2002, Washington DC  
Petroleum Tax Design***

MINOR

PRODUCERS

**Chevron**



**Chevron - Alaska Area**

**Testimony on HB 488**

**Finance Committee**

**John P. Zager**

**General Manager**

**April 28, 2006**



# We Standby Our Previous Testimony on the PPT

- Overall tax/credit rate - believe that 20/20 is in the best interest of the state
- Cook Inlet - believe that 5% tax rate is appropriate
- Standard deduction - support either \$12 million credit or current 5,000 BOEPD exemption
- Transition capital - accept that it must be earned again on 2:1 basis, suggest extending time period to 10 years
- Effective date - April 1, is the earliest reasonable date
- Challenged Oil - additional credit is warranted
- Abandonment expense - Believe that it should be prorated and that it should be a qualifying expense
- Gas Storage Costs - *New item* - Gas storage costs should be explicitly recognized as qualifying costs
- Progressivity - do not support - lowers expected value to investors and will lower overall investments



## Progressivity Provision

- Reason for the state to want progressivity
  - To get a fair share when there is a price run up accompanied by large profits
  - NOT to raise taxes if the price increase is gradual over time and is accompanied by increases in costs and thus not accompanied by increased profits – NOT a creeping tax increase
- Problems with progressivity as currently proposed
  - “Trigger” price tied to ANS is not inflated
    - Over time costs will rise
  - “High cost” oil will be produced in increasing quantities
  - Over the long term a fixed trigger price will not work as intended and is grossly unfair

**House Finance Committee**  
**Testimony of Ken Sheffield, President**  
**Pioneer Natural Resources Alaska, Inc.**  
**April 28, 2006**

**Key Messages Regarding SB 305 – Oil & Gas Production Tax**

- **Governor's Bill**
  - Modest incentive for Pioneer to invest more aggressively
  - Struck a delicate balance between incentives/taxes
  
- **Tax Rate**
  - Oil – recommend 20% rate
  - Gas – support SB 305 (7.5% rate)
  - Cook Inlet – support SB 305 (5% rate)
    - Could affect Pioneer's decision regarding Cosmopolitan project
  
- **Base Allowance - 5000 BOPD equivalent credit capped at \$14 million**
  - Value deterioration due to:
    - Calculation methodology
      - More investment yields less tax credit in some cases
    - 10 year sunset provision
      - Long cycle time for exploration projects
  - Recommend House Resources CS methodology
    - Simpler, flat tax credit – currently \$12 million
    - Requested Changes
      - \$14 million vs \$12 million
      - Eliminate annual investment requirement
      - Eliminate sunset provision
        - If sunset required, 10 years following first utilization
  
- **Refundable Credits – House Resources CS: \$10 million annually**
  - Significant incentive to explorers (no current production)
    - Thin market for credits – few buyers
    - Allows explorers to receive full value for some credits
    - No extra cost to State of Alaska
  - Request increase to \$30 million annually
  - Request allowing credits to apply to lease bonus and rentals
  
- **Transition Capital – Sunset Provision**
  - Unable to utilize capital credits "earned" with 2:1 in 7 years
  - Disincentive to invest beyond 2:1
  - Request no sunset after credits are "earned"
  - If sunset required, allow 7 years following first utilization

- **Progressivity Surcharge**
  - If required, base upon net profits consistent with PPT structure
  - Recommend \$45/barrel net profit trigger in SB 305 draft version
  
- **Point of Production for Gas**
  - Gas treatment facilities should qualify for credits
  - Facility is required for marketable gas
  - Equal treatment for gas vs oil



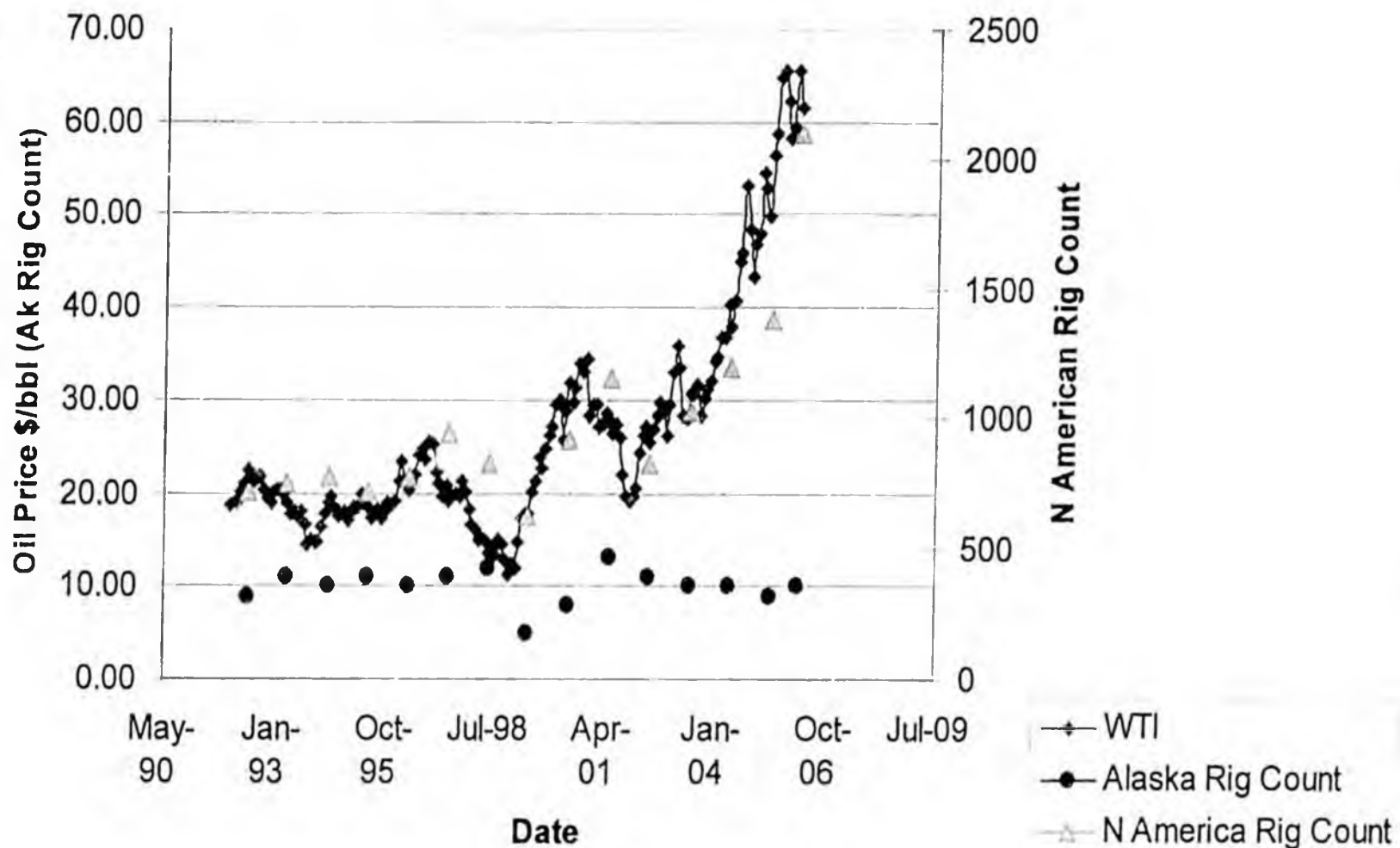
**State of Alaska  
Petroleum Production Tax (SB305 CS)  
John A Barnes**

**House Finance**  
*April 28, 2006*

**Marathon**



## High Oil Price and Alaska Response



# PPT – A World Class Tax Structure

- ▶ One “World Class Opportunity in Alaska”
  - North Slope Gas Line tied to PPT
  - Negotiated Settlement with “Producers”
  - Clearly Tied to Overall North Slope Oil and Gas Integrated Development
  - Strong North Slope Industry Benefits State of Alaska as well as Cook Inlet Industry
  
- ▶ But, the Cook Inlet is not the North Slope...
  - Previous testimony and recognition of need for Cook Inlet incentivization



# Cook Inlet PPT Concerns

- ▶ Cook Inlet Gas is not Cook Inlet Oil
  - CI Gas does not receive world market prices.
- ▶ Cook Inlet Gas Competes with N American Gas for Investment
  - Reduction to 7.5% or 5% would increase attractiveness of investment
- ▶ Gas Progressivity places volatility and risk on Alaska consumers and industry. If progressivity then...
  - Base on net and not gross
  - Base on actual value, not Henry Hub



**Testimony of James D. Weeks  
On SB 305/CS HB488  
Oil and Gas Production Tax  
Alaska State House Finance Committee**

**28 April, 2006**

Co-Chairmen Chenault and Meyer, distinguished members of the House Finance Committee. For the record, my name is Jim Weeks, and I am here today representing UltraStar Exploration LLC, a very small independent explorer. The Company was formed in 2002 by John Winther, Dale Lindsey and me, for the purpose of exploring and developing leases on the North Slope. UltraStar is 100% owned by Alaskans. I am Managing Member, and moved to Anchorage in 1984 with ARCO, and have had a presence here ever since. Dale, whom most of you know, was born and raised and still lives in Seward. John, whom most of you also know, was born in Fairbanks and raised in Juneau. He currently lives in Petersburg. Thanks for the opportunity to testify today.

During the last two months, I've testified and listened to a lot of testimony on the Governor's original proposal, not only to this committee, but to the other committees in both houses of the legislature. The bill seems to get more complicated with every iteration, but is still a program we can support, given a few modest changes. I'll go into details about them.

The Administration's original proposal was for a \$73 million base allowance for net profits below which there would be no PPT, with no sunset provision. The Senate, rightfully so in my view, changed that to 5000 barrels of oil per day, but established a sunset date of 2016, after which the allowance will expire. I question the need for a 10 year time limit after which the tax exemption will expire. UltraStar is a small, start-up company that is poking around the fringes of existing units and known reservoirs. Our leases are too small to stand alone, so access to existing facilities, owned mostly by the major producers, is the only way we can develop anything we might find. It took our sister company, Winstar, 6 years to negotiate access with the KRU to enable the drilling of the well that was completed in 2003. UltraStar has been in negotiations with the PBU for over 3 1/2 years now to get seismic data and facility access to enable the drilling of our Dewline Prospect. It takes a long time for these things to get done, and I question why our investments should be put at risk with this relative short sunset provision, whereas current producers can use the allowance immediately after the effective date of the bill, and receive the full ten years benefit. During this debate, I've heard more than once about the need for a "level playing field". No sunset provision does indeed level the playing field.

Next is the issue of the effective date for the PPT. We agree that July 1, 2006 is an appropriate date, but also suggest that taxpayers should be given a 6 month