

ALASKA LEGISLATURE

HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 3095

"grace period" to come into complete compliance. I'm not suggesting that any taxes not be paid, or be paid late, but rather that companies be allowed to get their act together within 6 months before the stiff penalties and interest provisions apply. During this period, any adjustments can be made for under and/or over payments. This bill requires a complex calculation of the appropriate amount of tax, and conforming to it will take some time, even for the current producers with tax accountants and attorneys on staff. UltraStar hopes to have production in the future, and we will be glad to pay our fair share of taxes, but we will need to contract for tax accounting and legal services on the street at market rates, and frankly, I don't know whether or not we can even find them. Anyone we hire will need to get familiar with the law and regulations, and develop the algorithms needed to comply with them. This will take some time, and I think that 6 month grace period is the minimum amount of time necessary to assure compliance before the penalties and interest starts. Obviously, to accommodate production not yet on stream, the 6 month grace period should begin when taxes under the PPT are due, and not necessarily July 1, 2006.

Lastly, Mr. Chairman, I'd like to comment on the 20/20 provisions and the so called progressivity feature of the bill, and their relationship to the gas pipeline. I graduated from the University of Wyoming with a Petroleum Engineering degree in 1969. In the fall of 1968, nearly 40 years ago, as a class project, we designed a gas pipeline from Prudhoe Bay to Chicago. After graduation, I joined ARCO, and in the early 70's, spent several years working in project engineering and construction, based in Dallas, headquarters of ARCO's North American operations. I spent hours talking to the real life engineers who spent nights and weekends at the office, sleeping on cots, designing a gas pipeline from Prudhoe Bay to Chicago. For seven years in the late 80's and early 90's, I was in charge of all of ARCO's Prudhoe Bay interests, including the commercialization of natural gas. Except perhaps for Governor Hickel, I've probably worried longer than anyone in the State about getting North Slope Gas to market.

The legislature is to be commended for the fair and full hearing the PPT has been given. Many thankless hours of hearings, reviewing complicated drafts, and debate have been spent by you and your colleagues in both houses and in my mind you all deserve a medal. During the process, I've heard more than once that there is no linkage between PPT and the gas line project. But as the Governor said this week, there is indeed linkage between the two. I think we all know that.

Also of concern to me as an Alaskan who hopes to build a business here that my kids and their kids can carry on, is the "so what" attitude I've heard from several legislators. They say "so what" if the big guys walk from the gas line deal over disgust with the PPT. Causing them to walk from the gas line as a result of the PPT would be a huge dis-service to the State of Alaska. To forego the long term benefits of the gas line in favor of short term higher taxes in the PPT would be a very mistaken, short sighted approach. Therefore, I encourage you to adopt the

Governor's 20/20 proposal, with no progressivity. Twenty percent of the net profits on seventy dollar oil is progressive enough. Oil companies compete worldwide. The governments of China, Russia and the Middle East don't put their domestic oil companies at a competitive disadvantage with windfall revenue or profits taxes. Why should the State of Alaska? However, if you feel compelled to take a bigger share at higher prices, then that bigger share should be on net profits, not gross revenue. Be careful, though, lest they walk. Enough has always been enough.

Thanks for the opportunity to comment.

Jim Weeks
907-258-2969



PIONEER

NATURAL RESOURCES AGENCY

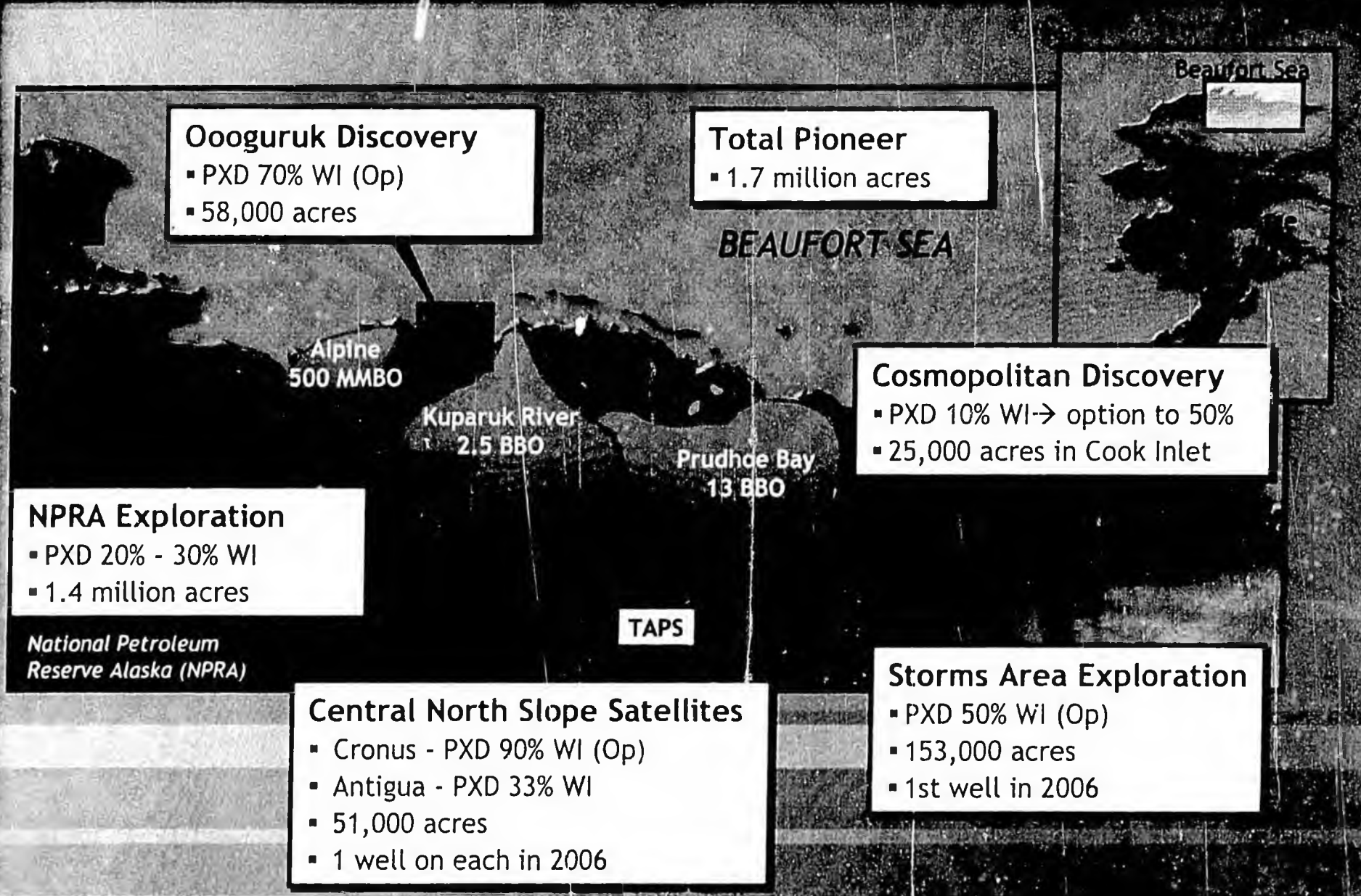
HB 488 PPT

Juneau, Alaska

April 3, 2006

4/3/06

Pioneer's Alaska Acreage

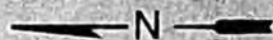


Oooguruk Development Project

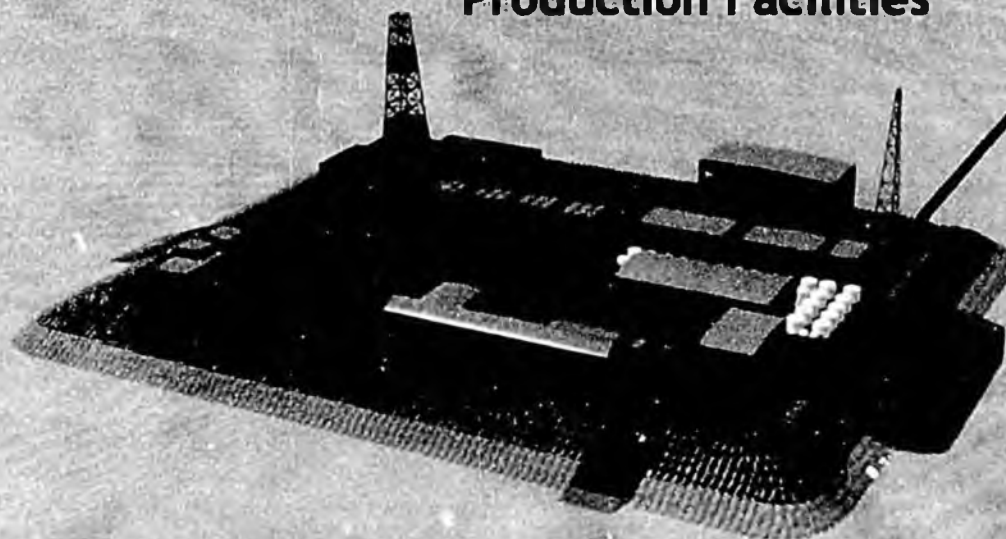


- Development Cost: \$450 – 525 million
- Reserve Potential: 50 – 90 million bbls
- Peak Flow Rates: 15 – 20,000 bbls per day in 2010

Tie-in to COP
Kuparuk River Facilities



**Drillsite and
Production Facilities**



Harrison Bay
(4.5' water depth)

Oooguruk Major Project Construction Components



▪ Winter 2006

- Gravel Mining
- Gravel Placement - Drillsite & Onshore Pad

▪ Winter 2007

- Flowline Installation
- Facility & Equipment Installation

▪ 2008 – 2011

- 38 Well Drilling Program



Alaska's Challenges



- **Some of the Highest Costs in the World**
 - Large Minimum Economic Field Size
- **Future Exploration & Development Uncertainty**
 - Smaller Reservoirs
 - Remote Resources
 - Viscous Oil Resources
 - Gas
- **Long Cycle Times (5 to 10 years)**
- **Investment Uncertainty**
 - Exploration & Reservoir Risk
 - Price Risk
 - Fiscal Certainty

Alaska Climate that Encouraged Pioneer



- **Emerging Business Opportunities**
 - Investment Opportunities Offered by Major
 - Cooperation re: Facility Access

- **Attractive Fiscal Policy**
 - Reasonable Lease Terms & Availability
 - ELF Formula: Low Taxes on all but Largest Fields
 - Exploration Incentive Credits

Alaska's Competitiveness



- **To Attract Most Independents, Alaska must effectively compete with onshore North America Resource Plays**
 - Resource Plays (tight sands, coalbed methane, shales) are attracting huge amounts of capital
 - Lower Risk
 - Lower Cost
 - Shorter Project Cycle Time
 - Lower State Tax

Benefits of Administration's PPT Proposal



- **Balanced Tax/Credit Rate of 20/20**
- **Fair Principles**
 - Tax Based Upon Profits
 - Compensation for Transition Capital
- **\$73MM Exemption Mitigates New Economic Burden**
- **Tradable Credits allow Quick Monetization**
- **Modest Incentives for Exploration, New Investors**
- **Reduces Minimum Economic Field Size**

We believe the proposal would encourage new investment in Alaska, grow the resource pie and increase revenues to the State

PPT Tax Rate



- **20% Rate Reasonably Balanced with**
- **Higher Tax Rate:**
 - Reduces Incentive to Invest
 - Raises Investment Threshold
 - Fewer Exploration Wells Drilled
 - Marginal Resources Left Undeveloped

Tax Rate Progressivity



- **Increasing Oil Prices = Increasing Costs**
 - 2005 W. Texas Drilling Costs Increased
 - Steel prices more than doubled in 2 years
 - Costs for all Services Escalating Rapidly
- **Profits not Directly Proportional to Oil Price Increase**
- **If Enacted, Progressive Tax Rate**
 - Should be Profits Based
 - Fairness Issue
 - Different basis is un-necessarily complex
 - Trigger Price Should be:
 - Based on ANS Posting (vs WTI)
 - Indexed for Inflation

\$12MM "Start-up" Credits Encourage New Entrants



- **New Entrant Challenges**
 - Smaller Investors lack Operating Experience
 - New Entrants do not hold Existing Investment
 - Most New Investment Opportunities are Challenging
- **High Alaska Start-up Costs**
 - Local, Highly Skilled Technical Employees Required
 - Engineers, Geoscientists, Land & Reg. Experts
 - Requires Building an Expensive G&G Database
- **Start-up Credits Mitigate Changes to ELF Based System**

We believe this will bring in new investors and give them a better chance to succeed.

Fair Value for Tradable Tax Credits



- **Tax Credit Value is Diminished to New Investor**
 - Held Credits diminish through time value of money
 - Sold Credits would likely sell at a discount
 - Discount value captured by purchaser
 - Credit Cost to State remains 100%

- **“Refundable” Credits Increase Value to New Investor**

- **Pioneer’s Investments Will Generate Substantial Credits**
 - HB 488: State to Refund \$10 million per year per company
 - Consider Increasing at Higher Oil Prices

Transitional Capital Recovery



- **Fairness Issue**
 - Investments were made under ELF system
 - Tax System is changing
 - Pioneer has recouped nothing from production
- **Pioneer's Alaskan Investment Began in 2003**
- **Pioneer's Cumulative Investment Over \$100mm**
- **Transition Capital Look-Back is Appropriate**

Pioneer Key Messages



- **Pioneer Goal: Establish Alaska as Core Production State**
- **Priorities for State of Alaska:**
 - Provide Incentives to Convert Resources to Production
 - Attract New Investment
 - Effectively Compete w/ North American Countries
- **Administration's 20/20 Proposal is Balanced & Fair**
- **Higher Tax Rates will Discourage Needed Investment**
- **Progressivity, if Enacted, Should be Structured Fairly**
- **"Start Up" Credits will Encourage New Entrants**
- **Refundable Credits are an Incentive to New Entrants**
- **Transition Capital Look-Back is Appropriate**

4/3

Alaska Venture Capital Group

April 3, 2006, Comments To Alaska House Finance Committee
CS For HB 488 – Petroleum Production Tax
By Ken Thompson

Introduction

For the record, my name is Ken Thompson. I reside in Anchorage. I am the Managing Director of Alaska Venture Capital Group, or AVCG, an independent oil exploration company with a focus on the North Slope of Alaska. AVCG is a consortium of 15 independent oil and gas companies and individuals from Kansas and me as an owner/investor from Alaska. AVCG has a technical and operational services' subsidiary company called Brooks Range Petroleum, with offices in Anchorage. Many of you know me as the former President of ARCO Alaska, Inc.

AVCG has been very active in the past six North Slope (NS) areawide lease sales and we have acquired over 160,000 acres of exploration leases in five exploration prospect areas, including new acreage we acquired in the recent March 1, 2006, NS lease sale. Our exploration strategy is to explore in the central part of the North Slope for fields in the 25-150+ million barrels range, fields that may be too small for the giant producers but fields that can be produced profitably by smaller companies like ours. We believe there are hundreds of millions if not billions of barrels of oil left on the North Slope in smaller fields of this size and these fields near infrastructure can be brought on more quickly. Our first exploration well in partnership with Pioneer Natural Resources – the Cronus #1 about 10 miles southwest of the large Kuparuk Field – completed drilling last week but results remain confidential.

Let me focus my comments on the CS for House Bill 488. I reluctantly supported the Governor's proposed 20/20 PPT and I supported many elements of the original draft of HB 488 as fair to the State and fair to industry. But, somehow, things are beginning to derail and the CS HB 488 with its revisions from the original draft has evolved into a complex bill that is no longer a win-win for the State and industry, in my opinion. I don't fully understand how things began to derail...perhaps it was due to anger at the Big 3 producers and the Governor for not revealing the natural gas contract details before demanding a new oil tax fiscal structure. Perhaps its anger at the Big 3 companies who are demanding certainty for 30 years when asking for certainty for three full decades truly is an unreasonable demand.

I don't understand all the dynamics of the past three weeks in the legislature, but this I do know. The CS for HB 488 needs to be greatly simplified and it needs to move back closer to the Governor's proposal and the original HB 488 draft if a win-win solution is to be re-developed.

I am an optimist and always have been. I personally think there is still time to avoid a train wreck in this complicated business of a major restructuring of Alaska's

petroleum taxation system...if the House Finance Committee acts quickly. I, for one, have not given up hope that there is a version – easier to understand and to implement - that can be a win-win for both the State and industry. I repeat that the current draft of CS HB 488 is not a win-win. There is a simpler and better way, in my opinion, for the State to improve government take while not dampening exploration and development investment. Let me outline my suggestions for a win-win and my suggestions for simplification.

AVCG Owners' Perspectives

First, however, let me say that while I am Managing Director of AVCG, our other owners disagree strongly that any change should be made to the 20/20 PPT formula proposed by the Governor. The 20% PPT tax rate and the 20% credit originally presented in the Governor's bill should be the tax rate and credit enacted. The AVCG owners representing 15 new exploration investors in Alaska are concerned enough that the current system is being revised after they have made almost \$10 million investment in North Slope leases and other costs and are planning a 3-year \$46 million exploration program with our first well recently drilled. With reasonable discovery success over the next 3 years in any of our upcoming prospects, we could see development capital spending at \$500 million to \$1 billion.

Quite honestly, the AVCG owners listened in disbelief when I told them the production profits tax rate being considered in the current CS to HB 488 draft could add a "progressive surcharge" that could place an additional 37.5% taxation of wellhead value by the state at high oil prices on to the base PPT, the State's 12.5-16.7% royalty, the ad valorem property tax, the 3-9% corporate income tax, lease bonus bid amounts, the ongoing annual lease rental amounts, and the Federal income tax rates averaging 20-35% of taxable income. It all adds up, and AVCG Owners are saying, "enough is enough."

Interestingly – and this is important – when I was communicating the latest CS to HB 488 details to the AVCG owners by teleconference and email recently, I felt two overwhelming emotions. The first emotion was discouragement. Under the original 20/20 proposal, I was recommending to our owners that considering the value of the tax credits, we could add a sixth exploration well for every fifth well drilled essentially at no cost to our company...this could lead to additional discoveries and production for all of us. This is good policy. However, in discussing the CS to HB 488 with its much higher taxation at high oil prices, I recommended to our owners that, in order to pay potentially higher production taxes under the surcharge concept, we sell our credits to other companies and save the cash to literally offset our higher taxes later. I suggested we not consider the additional sixth exploration well any longer...the AVCG owners concurred. This will result in potentially a new oil field that will never be drilled and lower production for all of us. This is bad policy. And this is discouraging.

But I also found interesting another strong emotion during that teleconference which surprised me a great deal. I felt embarrassment for the State of Alaska, and I felt embarrassment as an Alaskan. Here I was, telling a group of outside investors that recently put all of their focus and personal exploration budgets on the North Slope of Alaska, and now I was telling them that Alaska was creating the most complex, confusing production tax bill ever created since the disastrous Federal windfall profits tax. And I was telling them that Alaska was levying the highest tax rate and government take in North America, much higher than the other U.S. states where they invest. I was embarrassed that the anger – or the mistrust – of the Big 3 producers and the Governor has resulted in the State crossing the line between balancing State revenues and attracting outside investment.

Currently, the total Alaska and Federal governments' take is just over 50%. The Governor's proposal moved this to 53% or so then the original HB 488 moved the government take closer to 55%. Then the CS to HB 488 boosted the government take close to 60% with its "Progressivity Surcharge." This compares to total government take in the U.S. Gulf of Mexico of 45% or so, 50% or so in the U.K., and 39-56% in Canada. Including the U.S. government take share, this compares to a total government take of 51% in Colorado, 52% in Wyoming, 53% in Kansas (where AVCG investors are located), 53% in Texas, 53% in New Mexico, 53% in Oklahoma, 53% in California, and 57% in Louisiana. At least the State should not exceed a threshold of 55% total government take, 45% producer take...after all it is the producer who is taking the capital spending risks.

I'm excited about what's happening in Alaska's oil patch right now, and let's not dampen the spirit. When I first came to Alaska in 1994 as President and CEO of ARCO Alaska, there were a handful of companies leasing acreage on the North Slope. Today, there are 25 companies and individuals holding North Slope leases. In all oil and gas areas of Alaska including the North Slope and Cook Inlet, in 1994 there were 24 companies with leases; today in all basins there are 100 companies or individuals holding leases. Let's not dampen this activity. Activity with new discoveries is how the state will achieve the most in revenues. Let's have a new tax bill that encourages, not discourages new entrants.

My Personal Perspective

Now let me shift gears in my comments to you. Because I could not get buy-in for any alternatives from the AVCG owners except the 20/20 case, I have decided to speak out alone. As an Alaskan, I am concerned and feel I must try to share a personal perspective trying to balance what is best for my continued involvement on the North Slope in balance with how the State must change its system to be competitive in the world and realize more government share at high prices.

I realize by stepping out like this, I could jeopardize my management status with AVCG and perhaps even jeopardize how I am viewed by the major oil companies and my friends in the independent company sector. But I have taken such personal

risks in the past, and I don't mind doing so again today to simply do what I think is the right thing to do regardless of others' opinions.

So, let me turn my attention to what key changes I would make to the CS of HB 488. Again, my views are not supported by AVCG owners or others in industry; rather they are my personal views.

1) Make Tax Rate Progressive But Greatly Simplify The Taxation Formula

When the Governor's office first announced a 25% tax rate then amended that to 20%, I could see the move by legislators to somehow bridge the gap from 20% to 25%. However, the approach used by the House Resources Committee based on their outside consultants' work is simply too complex and will be arduous to implement. I think – and perhaps all of you think – the Federal tax code is too complex....the changes to HB488 are also too complex and will lead to different interpretation, "gamesmanship" possibly by some companies because of the unwieldy progressive tax structure formula, and future costly lawsuits when the State disagrees with a company's calculations. And the number of accountants to keep track of these complexities on both sides will balloon! I urge you to simplify, simplify, simplify...yet still have some progression that legislators seem set on.

For my company which drills the smaller oil traps that may add up, we do not have a lot of upside potential in seeing these smaller fields grow much larger in reserves over time in contrast to the giant Prudhoe Bay and Kuparuk fields. So our main upside is in oil price escalation to offset exploration risks and to offset the cycles of oil prices downward, a reality over time for any commodity. I find it disturbing – and personally unfair – that the House Resources Committee recommended a windfall profits tax, or "Progressivity Surcharge", as high as an additional 37.5% of value in addition to the base PPT.

I found it so interesting to see the Econ1 consultants and consultant Daniel Johnston saying the government should take more and more at high prices when not one member of the Resources Committee asked them a very important question they should have been asked: "how much are you investing in Alaska?" I was shocked to see that these consultants, when calculating the future revenues to the State at various escalating rates, used the same oil production curves. In reality, less capital will be spent by industry at exorbitant production profits tax rates (tax rates above 25% when coupled with all other payments such as royalty, corporate income tax, ad valorem tax, lease costs and rentals, etc.). With less capital spending, the production curve will be lower...an increasingly higher tax rate may not in the end yield the forecasted revenues for the State.

On a related note, our company plans to go into the private or public equity markets to raise funds and capital for any future development. Such equity investors invest in the oil markets to be fully exposed to crude price upside. When they look at investments all over the world, and see that Alaska could tax at much higher crude

prices with a "Progressivity Surcharge", they will place their capital elsewhere to continue their exposure to higher crude prices in investments without alternative taxing structures such as the Lower 48 states, the Gulf of Mexico deep water with royalty relief, the Canadian oil sands or other countries. The consultants did not address this issue that I face month in and month out...the private and public equity markets and the desire for such investors to fully benefit from upside commodity price swings without hedging or excessive, escalated taxation at high prices.

I could not believe the consultants did not show capital spending elasticity graphs from different countries. They did the legislature a disservice by not doing so. Their work showed a biased perspective in my opinion; by getting the House Resources Committee to adopt a complex progressive tax rate structure, or windfall profits tax, the consultants may feel they have been successful...but not one of these consultants will be around to defend their views in the future when capital spending does decline at exorbitantly high and unfair tax rates above the 25% level.

So, what is a simpler alternative? What is an alternative to yield more revenues to the State with a balance to attract increased investment? I have followed the progression of the PPT and noted when respected global consultant Pedro van Meurs recommended a 25/20 formula, i.e. a 25% tax rate and a 20% investment tax credit. Yet the Governor recommended a 20/20 formula with a 20% tax rate. Since that controversial time a few weeks ago, it appears the House Resources Committee and the Senate Resources Committee have spent a lot of time trying to recapture the perceived "lost revenue" from the Governor not taxing at the 25% level. On the other hand, the Governor does make a good case about increased cash flow to producers and resultant increased capital investment at the lower 20% tax rate level. But consultants Econ1 and Daniel Johnston did get things way off track by proposing too complex a solution to bridge this gap and get even more...the complex "Progressivity Surcharge." Having the PPT at higher prices being a mixture of taxation of profits and a separate incremental tax on incremental revenues is unwieldy and an accounting nightmare.

Let me address a way to transition from the 20% tax rate to the 25% tax rate without getting too complicated.

I suggest that the Finance Committee revise the bill to keep the production profits tax simply that...a tax on production profits, and not an underhanded way to further burden gross revenues with a surcharge. A simpler way getting the progressive rate from 20% to 25% without the surcharge treatment complexity is to adopt a graduated PPT that does accomplish a higher State take at higher prices, yet leaves a reasonable producer take.

I recommend the following production profits tax schedule as a suggested one to "simulate" revenue results somewhere between the Governor's proposal and the CS to HB 488 proposal. It is one that everyone could easily understand

and implement with the State realizing upside at higher oil prices yet not too much upside is taken away from explorers/producers for re-investment:

Up to monthly average wellhead price of \$50/barrel for a company: PPT rate of 20%

When monthly average wellhead price is between \$50-75/barrel: PPT rate of 22.5%

When monthly average wellhead price exceeds \$75/barrel: PPT rate of 25%

By the way, if the State were to pass a complex, unwieldy windfall profits tax like that one proposed by Econ1 and favored by some on the Resources Committee with escalating production profits tax rates or surcharges, I predict Alaska will make the cover of the industry-wide influential magazine "The Oil and Gas Journal" and perhaps even a cover spot in the "Wall Street Journal." And I don't mean this media coverage in a positive way...I think all in industry will say the State is taking advantage of industry at high prices. Whether or not industry makes money or not and makes good, solid returns is not the issue with such extremes...the perceived fairness of taxation in a high cost, remote area like Alaska is the issue. This will discourage new entrants, in my opinion.

I highly respect industry consultant Daniel Yergin who has an excellent reputation among industry personnel and government officials alike. In November, 2005, Mr. Yergin said this about a windfall profits tax: "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."

I urge the Finance Committee to seriously consider this simpler approach, and ask that you have the Department of Revenue run the above case to compare the State revenues to the Governor's proposal, to the current CS to HB 488 proposal, and to the existing ELF severance tax program. Please do away with the complex "Progressivity Surcharge" and simplify, simplify, simplify.

2) "Trigger Points" For Escalating PPT Should Not be WTI But Wellhead Value

I do not think the "trigger point" that increases the PPT tax rate from 20% should be based on West Texas Intermediate (WTI) oil price as suggested by Econ 1 and Daniel Johnston and by the House Resources Committee. The "trigger point" should be when a company's average realized wellhead price in Alaska exceeds \$50 per barrel. Some say lower, but I do think there is strong merit that those who have invested and taken exploration risk and exposure to low prices should be able to benefit from increased profits at higher prices..."share the pain, share the gain"...to this \$50/barrel wellhead level. However, I personally am fine with the State increasing the PPT tax rate eventually to a cap of 25% when wellhead prices exceed \$50/ barrel. Having said this, you need to know that I do not know anyone else in industry who thinks this; everyone I know continues to press the 20/20 formula.

Why should the State tie the PPT calculation to a company's realized wellhead price instead of to West Texas Intermediate (WTI) price? In reality on the North Slope, not one company sees WTI prices. Every crude oil in Alaska is different in quality with viscous crude receiving less and oil produced from wells farther away from infrastructure receiving less wellhead value due to higher shipping costs. Conversely, oil in the Cook Inlet is close to actual refining or on the water to ship out of state and thus realizes on average much higher wellhead value than most North Slope crude oils, a substantial plus to Cook Inlet operators who face higher operating costs with maturing fields. Our company's crude when discovered on the North Slope will be farther west, and when we have to transport the oil via the major producers' gathering system lines to TAPS pump station #1, we will pay the majors a certain tariff of \$0.50-1.00/barrel or more, and a facility processing fee of \$3.00/barrel or more, giving us a lower wellhead value for our crude while the major producers make an additional profit on shipping in their crude lines and processing. The majors further make profits from tariffs for shipping down TAPS and in their marine tankers.

So I ask, why should the tax rate increase with WTI price when there is such a variance in crude oil pricing factors on the Slope at the wellhead affecting each field's economics and economic limit differently? The production profits tax rate should not go up at the same time for those who produce viscous crude or oil from a farther distance as compared to those who have good quality oil right next to the TAPS line. If there is a "trigger point", it should be one based on a company's average monthly realized wellhead price for production.

I recommend that the "trigger point" for PPT tax rate escalation be \$50 per barrel realized wellhead price based on a company monthly average and not be based on \$50 WTI, thus allowing explorers and producers to share in the upside profits at prices to this level with no higher burden than the 20% PPT tax rate (plus burden of royalty, corporate income tax, ad valorem tax, Federal tax, etc.).

3) Reinstate The Transitional Deductible Allowance

Jumping immediately from the prior ELF severance tax to the PPT formula overnight wreaks havoc with a company's budgeting and their forecast of available cash flow for near-term capital investment. While this does not have a major impact on AVCG, I do greatly empathize with ConocoPhillips, who is the largest investor and most active explorer in Alaska, about having "look back" investment credits. Part of the current oil production bringing in much higher revenues to the State is due to investment over the past few years. Interestingly, the PPT will have the largest negative impact on ConocoPhillips, particularly on their production from the Kuparuk Field. ARCO used to own the ConocoPhillips properties on the North Slope, and I am concerned with the impact on Alaska's largest investor and most successful explorer. A transition adjustment of some sort is appropriate and is fair.

I recommend the Finance Committee re-institute the original HB 488 compromise to a three-year staged and tiered "look back"; while not as substantial as the Governor's proposal, the House Resources Committee's staged "look back" is fair and should be re-instated in the bill. The cost recovery allowed should be 75% of 2005 expenditures, 50% of 2004 expenditures, and 25% of 2003 expenditures to be deductible as costs for near-term PPT calculations as originally in HB 488.

4) The \$12 Million Tax Credit Standard Allowance

The Governor proposed a \$73,000,000 annual allowance of production profits that would not be taxed by the PPT, essentially giving a \$14.6 million tax credit per company. The House Resources Committee revised this downward to a \$50,000,000 annual allowance as a reasonable compromise, or a \$10,000,000 tax credit. The CS to HB 488 further proposed that this be changed to a simple \$12,000,000 annual "standard tax credit allowance" as a reasonable compromise.

This "standard deduction" is very important to a startup company like AVCG/Brooks Range Petroleum trying to establish a foothold in Alaska and someday contribute substantial oil revenues to the State.

I recommend the Finance Committee endorse the \$12,000,000 tax credit allowance per company.

5) Tax Credit Repurchase Program

As protection for explorers and new entrants to Alaska, the CS to HB 488 devised a tax credit repurchasing program for those credits a company earns on expenditures up to \$10,000,000 per year for investments in exploration and/or lease purchases in Alaska.

This is important to explorers like AVCG who does not yet have production revenues. Without such a repurchase program, our company might be able to sell our annual tax credits to one of the major producers but have to accept only 90-95% on the dollar or less. On the other hand, the State would not be giving up anything to repurchase the credits at 100% of value because the major producers would otherwise use the credits to reduce their tax bill and reduce revenue to the State. But using the State repurchase approach, the small explorer could turn around and re-invest the State-refunded credit into new leases, seismic or exploration drilling.

I recommend the Finance Committee support the tax credit repurchase program outlined in the CS to HB 488.

6) Remote Exploration Tax Credit Extension

I thank the House Resources Committee for their proposal in extending the SB 185 exploration tax credits for the next 10 years.

I recommend that the Finance Committee also endorse this proposal that will extend the 40% tax credit for remote wildcat exploration wells more than 25 miles from existing facilities.

7) Effective Date

The State has made far more money at high prices than anyone ever dreamed. The State has, in a way, already received a rich windfall at high oil prices. The change in the production profits tax is controversial in its own right. I would not dare "pour salt in the wound" by making the tax effective on April 1, 2006, but allow the transition as originally planned to a July 1, 2006, date. This will also give all of us time to hire additional accountants to do the monthly, complex filings!

I recommend that the Finance Committee amend the effective date to July 1, 2006.

Concluding Remarks

The above comments are my personal views offered with a hope that there can be an eventual win-win solution to this complex subject of the State realizing more revenues at higher prices while attracting exploration and development investors who can also realize upside at higher prices. I do believe the House Finance Committee can get things "back on track" and better balanced.

Importantly, many – if not most – in industry would disagree with some – if not all – my personal views expressed above. But I do feel compelled to "tell it like it is" from my perspective as an Alaskan who has worked the Cook Inlet and the North Slope oil and gas fields for over 12 years.

I sincerely thank the Committee for the opportunity to present my comments.

Respectfully submitted by:

Ken Thompson

**State of Alaska Petroleum Production Tax
Testimony to House Finance Committee
(HB 488)
John A Barnes**



April 3, 2006

Marathon



4/3

Marathon Testimony – Alaska PPT Impact of HB 488 (RES) on Alaska Natural Gas

- ◆ Cook Inlet Natural Gas Summary: Pre PPT
- ◆ Financial Impacts of PPT
- ◆ Consequences of PPT
- ◆ What Is Needed



Cook Inlet Natural Gas Summary: Pre PPT

- ◆ Declining reserves and production rate.
- ◆ High operating and capital costs as compared to lower 48 natural gas provinces.
- ◆ Difficult permitting and regulatory arena.
- ◆ Need for additional exploration and development to moderate price increase to consumers and to continue to provide industrial feedstock.
- ◆ Historical price differential to Henry Hub.



Cook Inlet Gas Supply and Demand

May 9, 2005

State of Alaska
Department of Natural Resources
Division of Oil and Gas



Alaska Department of
Natural
Resources

http://www.dnr.state.ak.us/divisions/dog/pressrel/050905.htm

Cook Inlet Areawide Lease Sale Results

	Number Bids Rec'd	Number Tracts Sold	Multiple Bid Tracts	Total Acreage Sold	Total Bonus Rec'd	Avg Winning Bid	Max Bid Rec'd
				Acres	\$	\$/ Acre	\$/ Acre
2000	27	27	0	69,928	\$609,358	\$8.72	\$36.01
2001	31	29	2	102,523	\$928,085	\$9.05	\$22.18
2002	24	21	3	64,923	\$421,840	\$6.50	\$27.03
2003	28	27	1	103,680	\$887,059	\$8.56	\$33.28
2004	77	72	5	363,520	\$2,629,820	\$7.23	\$40.25
TOTAL	187	176		704,574	\$5,476,162		
AVERAGE	37	35	2	140,915	\$1,095,232	\$8.01	\$31.75

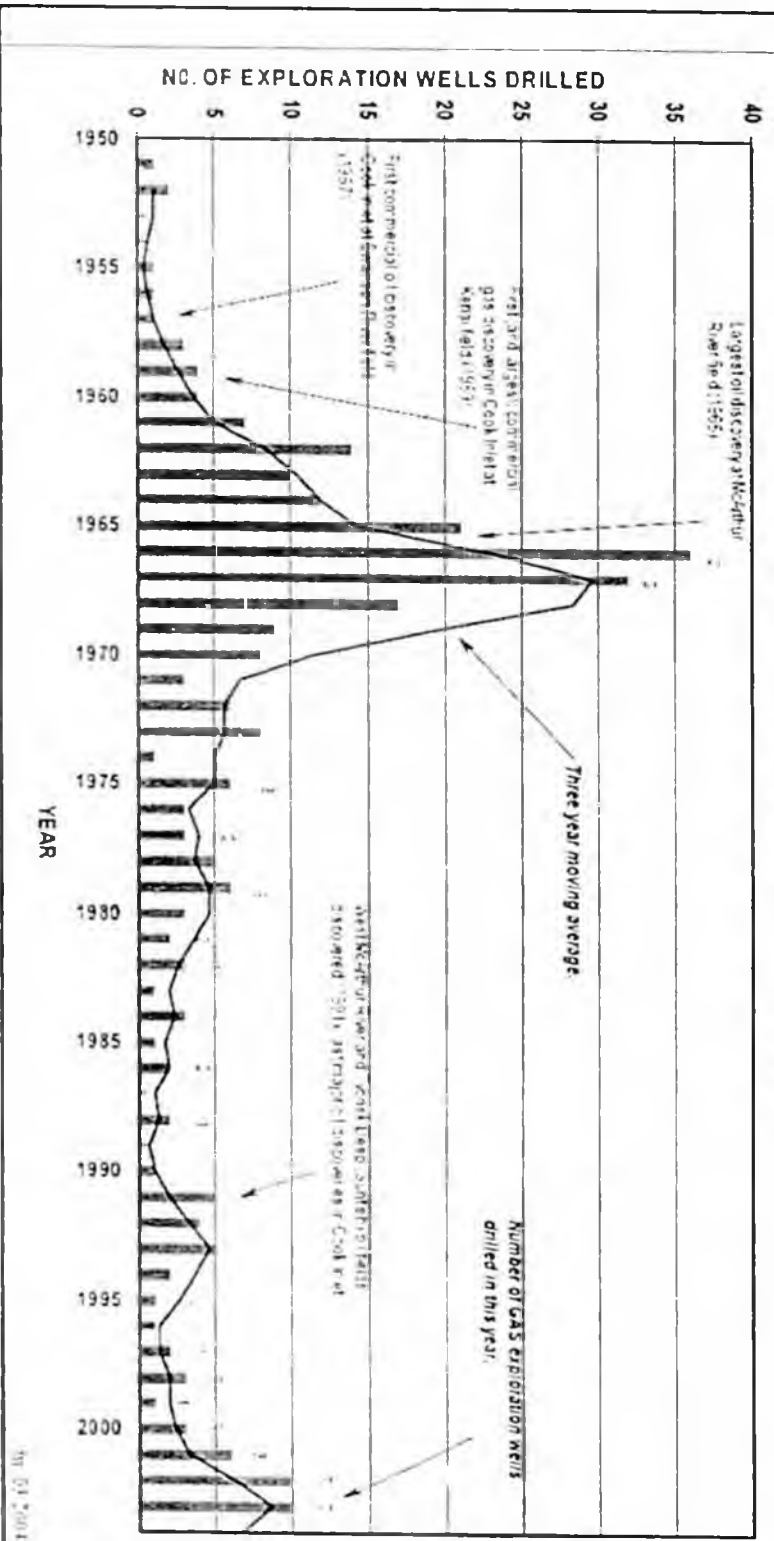
pg. 61 2005

RICHFIELD HITS OIL
PRODUCTION OF COOK INLET



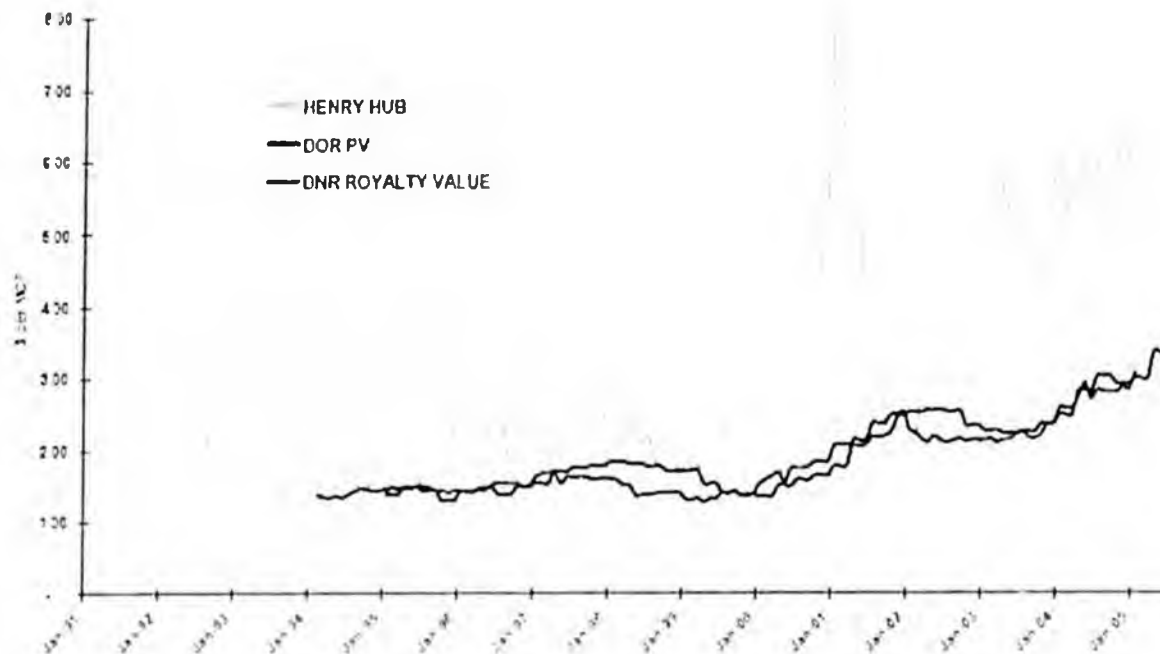
Timeline of Cook Inlet Exploration

COOK INLET EXPLORATION WELL DATA AND IMPORTANT EVENTS



Rev. 03/2004

Historic HH, DOR PV and DNR Royalty Value



Future of Supply

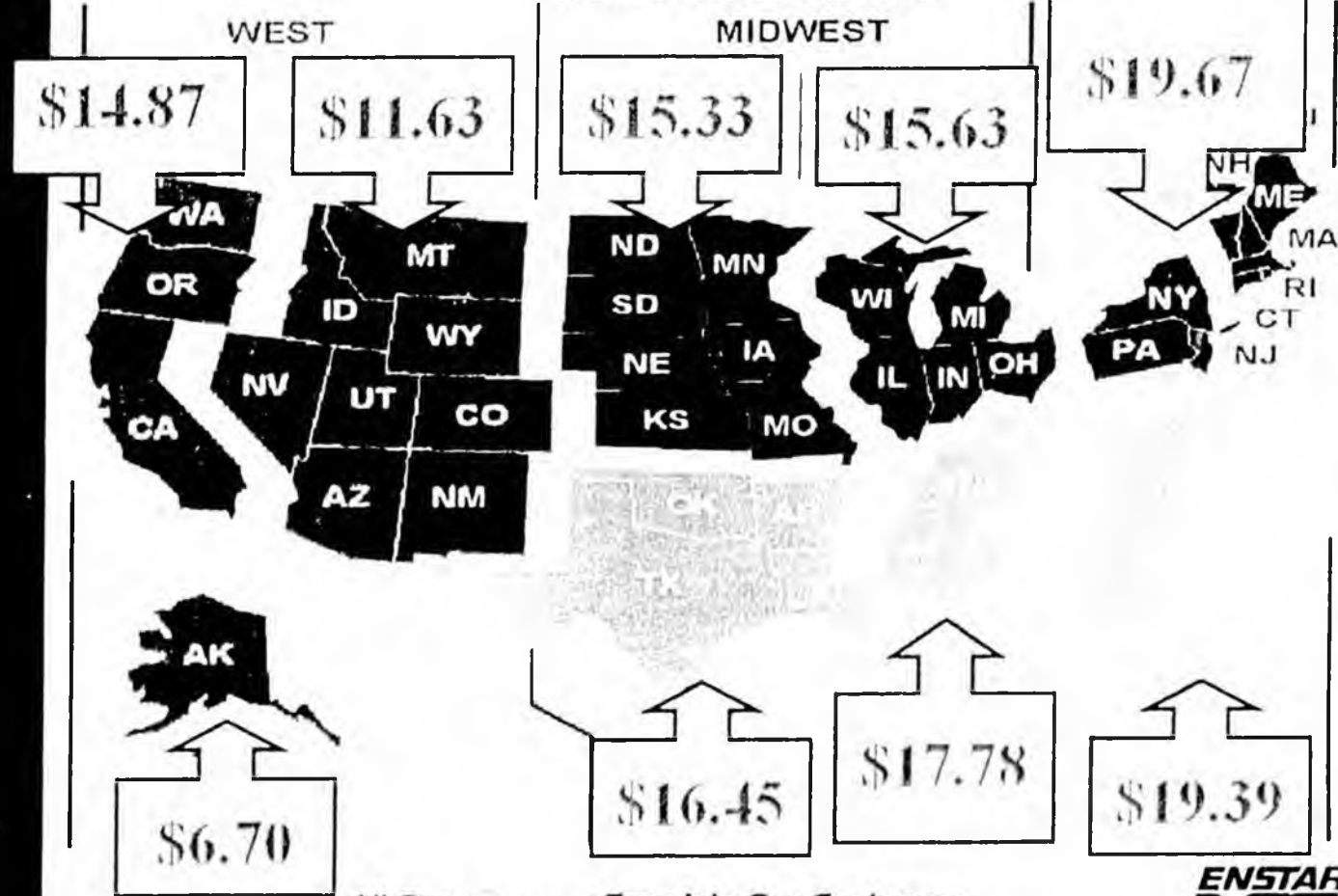
- We have moved from an “Excess Supply” market to a “Supply & Demand” market
 - Cost of Natural Gas will go up
 - More supply contracts are needed and will likely be for smaller volumes
 - Supply contracts will likely be more complicated
 - Pipeline system will be more complicated to operate
- We are working to identify and evaluate options to meet future demand
 - LNG Imports may be economic at some point
 - Storage options are being explored for peaking purposes
 - We have achieved Federal support for an in-depth DOE study of In-State demand and for conceptual engineering of a spur pipeline to Nenana Basin / Fairbanks

All Our  Goes Into Our Customers

ENSTAR
Natural Gas Company

Residential Costs-By Region

Natural Gas Cost (\$/Mcf)



All Our *Quality* Goes Into Our Customers

ENSTAR
Natural Gas Company

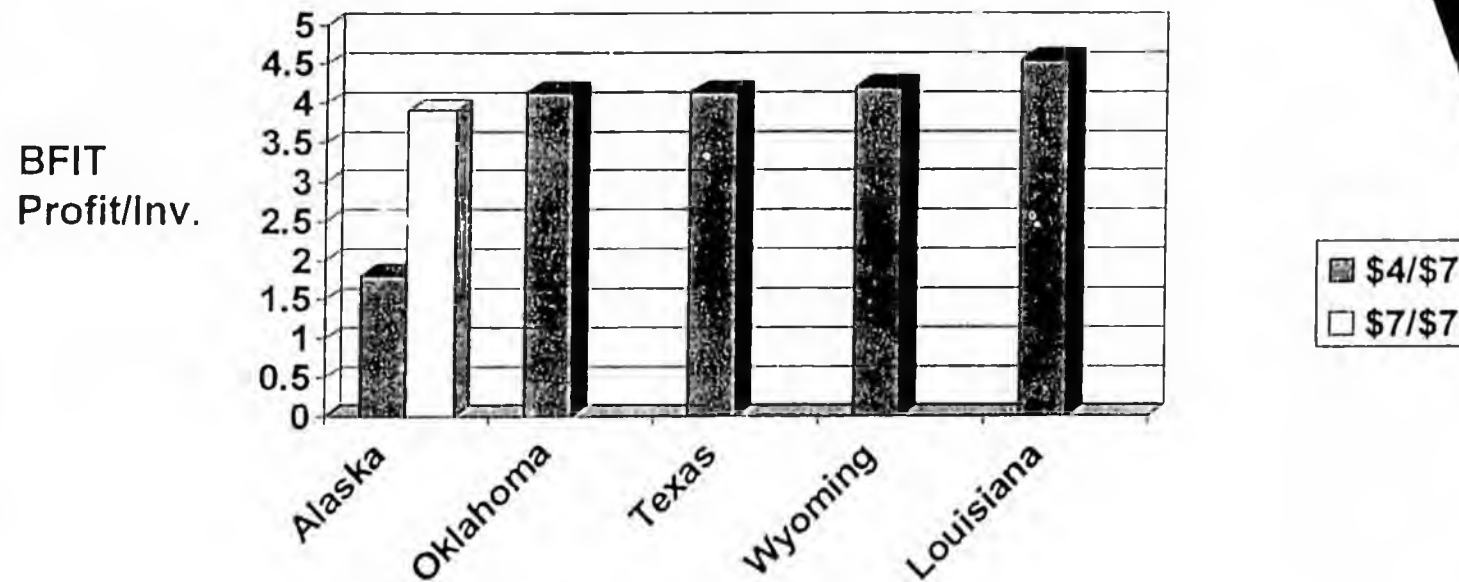
Conceptual Competitive Comparison Common Input – Per Well Analysis

Recoverable Reserves	5 BCF
Development Cost (Capital)	\$5 million
Operating Cost	\$0.50/mcf
Royalty	1/8

Based on House PPT (HB 488, RES) and domestic severance tax rates



Competitiveness Comparison: Cook Inlet Natural Gas Investments Disadvantaged Against Competition



Based on House PPT (HB 488, RES) and domestic severance tax rates



Cook Inlet Competitive Analysis

- ♦ Must compare Cook Inlet to N American gas opportunities
 - Cook Inlet does not have world class exploration opportunities
 - However, viable smaller exploration opportunities exist
- ♦ Good access to lands
- ♦ Disadvantaged by high costs
- ♦ Disadvantaged by permitting and regulatory burden
- ♦ Disadvantaged by price and closed market
- ♦ Disadvantaged or incentivized by fiscal regime?????



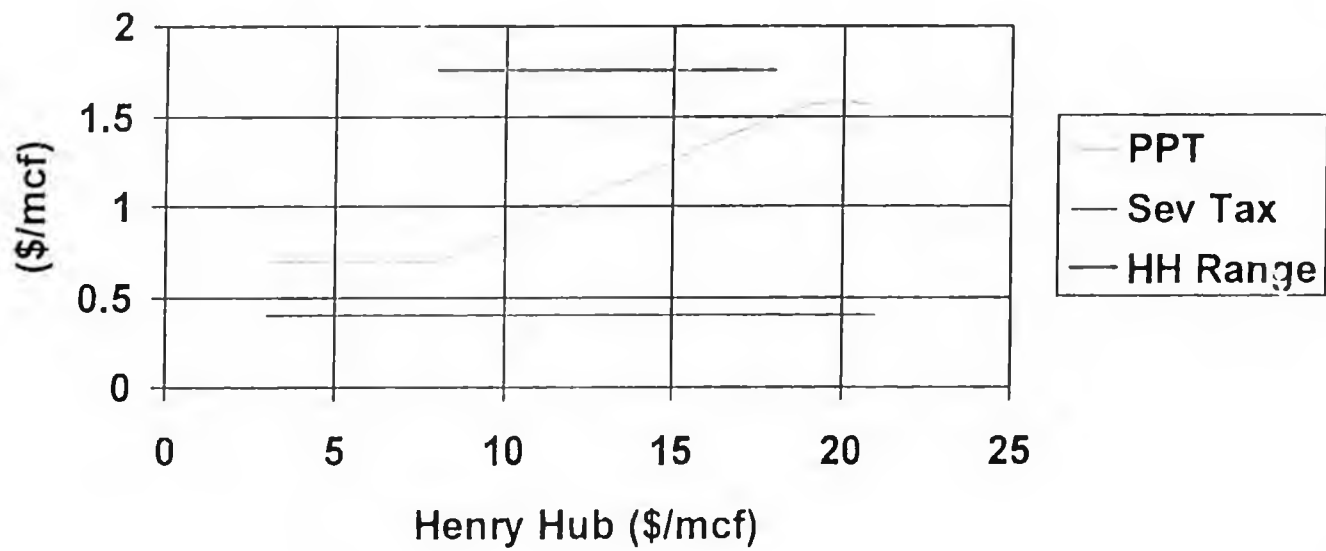
Consequences of HB 488 (RES) – Cook Inlet Gas

- ♦ Existing Fields
 - Nothing wrong with ELF for Cook Inlet natural gas
 - Loss of ELF and higher tax rate in low gas price environment will result in
 - Higher rate required to pay for costs (economic limit)
 - Fields will be shut in at higher production rates
 - Reserves will be lost.
- ♦ New Exploration and Development
 - Higher taxes will result in:
 - Less competitive opportunities compared to N American gas provinces
 - Renewed decline in Cook Inlet exploration and development
 - Cancelled projects
 - **NO NEW RESERVES DEVELOPED**
- ♦ Loss of industrials and jobs
- ♦ **Higher and volatile costs to utility consumers**



Impact of Link to HH for Gas Consumers

PPT for \$4.00 Cook Inlet Gas



Cook Inlet – What is Needed

- ◆ Must not link Cook Inlet PPT to volatile Henry Hub Price
 - Link to Cook Inlet Department of Revenue Prevailing Value
- ◆ Must include provision for marginal low rate fields
 - 5/20 Plan for Cook Inlet
- ◆ Prioritize efforts to incentivize, not hinder exploration and development
 - Include some form of transitional investments credit
- ◆ Actions by this Legislature will have immediate and measurable impact on Cook Inlet oil and gas industry



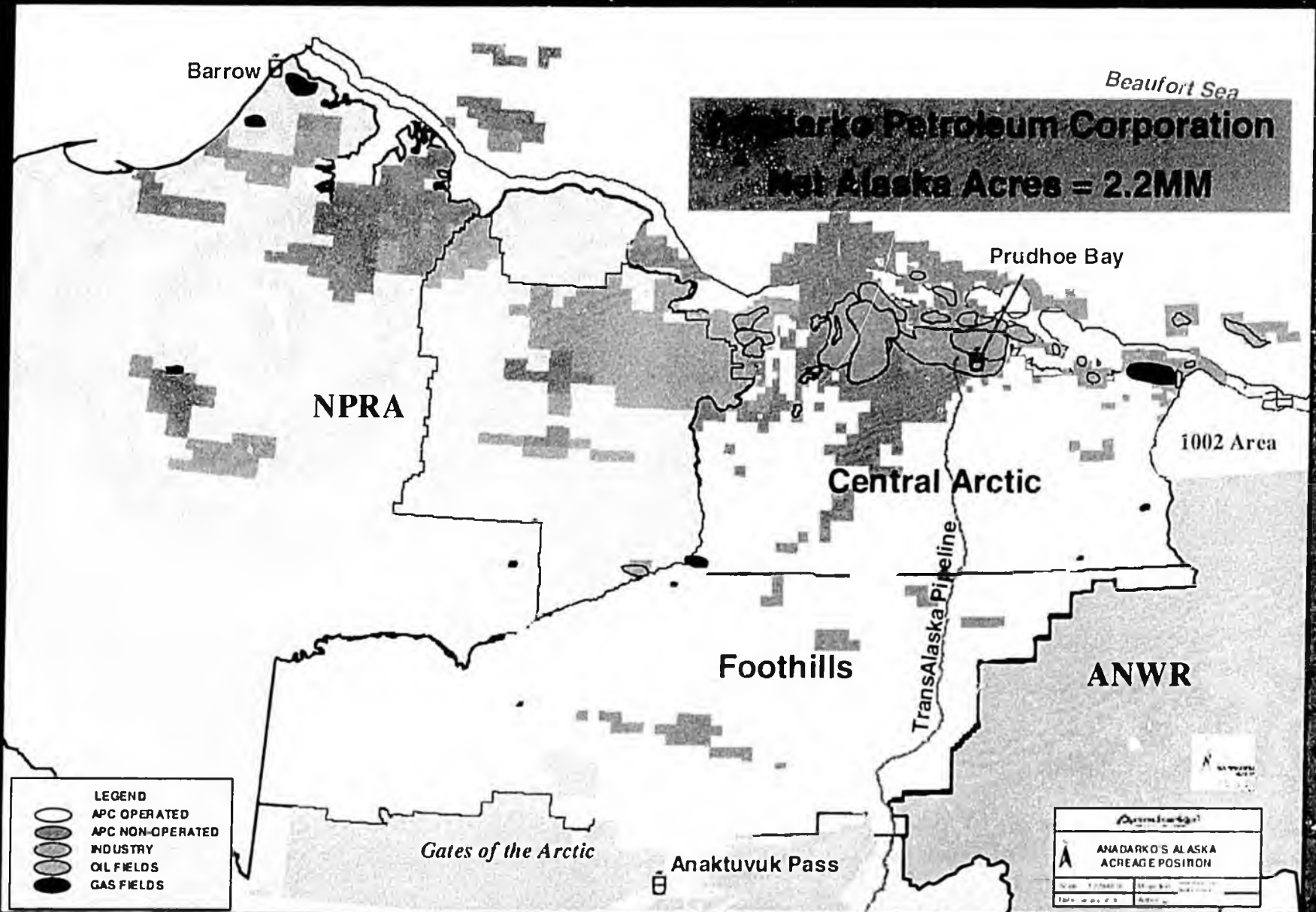


PPT Discussion

March 31, 2006 House Finance Committee

Anadarko 
Petroleum Corporation

Anadarko's Alaska Acreage Position



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Alaska Opportunities

- ▶ **World class petroleum basin**
- ▶ **Significant remaining resource potential**
- ▶ **Legacy type prospectivity (i.e. Anchor Fields)**
- ▶ **Favorable political environment**
- ▶ **Abundant new entrants/partnering opportunities**

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Alaska Challenges

- ▶ **Maturing basin/materiality**
- ▶ **High costs**
- ▶ **Lack of infrastructure and competition**
- ▶ **Limited access to facilities and pipelines**
- ▶ **Extremely long lead-time exploration**
- ▶ **Seasonal drilling & regulatory timing requirements**
- ▶ **Lack of gas market**

How about PPT?

- ▶ **We support original bill**
- ▶ **Administration did a good job balancing issues & priorities**
 - *We pay more in taxes, but our exploration economics improve and there is some downside price protection- should increase exploration investment*
 - *State receives substantially more revenue than under current system*

More production needed

- Declining production is primary driver of lower state revenue
- Increased investment (compared with today's levels) needed to increase production & stem decline
- Original bill offset tax increase with credits & allowances
 - *Our exploration economics generally improved*
- Tax rate increases and allowance decreases (with no credit offsets) reduce our economics
 - *Minimum economic field size increases*
 - *Amount of economically recoverable oil & gas decreases*

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Key Issues

- ▶ Tax Rate
- ▶ Tax Escalator
- ▶ \$73 million allowance
- ▶ Transition allowance
- ▶ Point of production
- ▶ Gas economics
- ▶ Credit additions

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Backup

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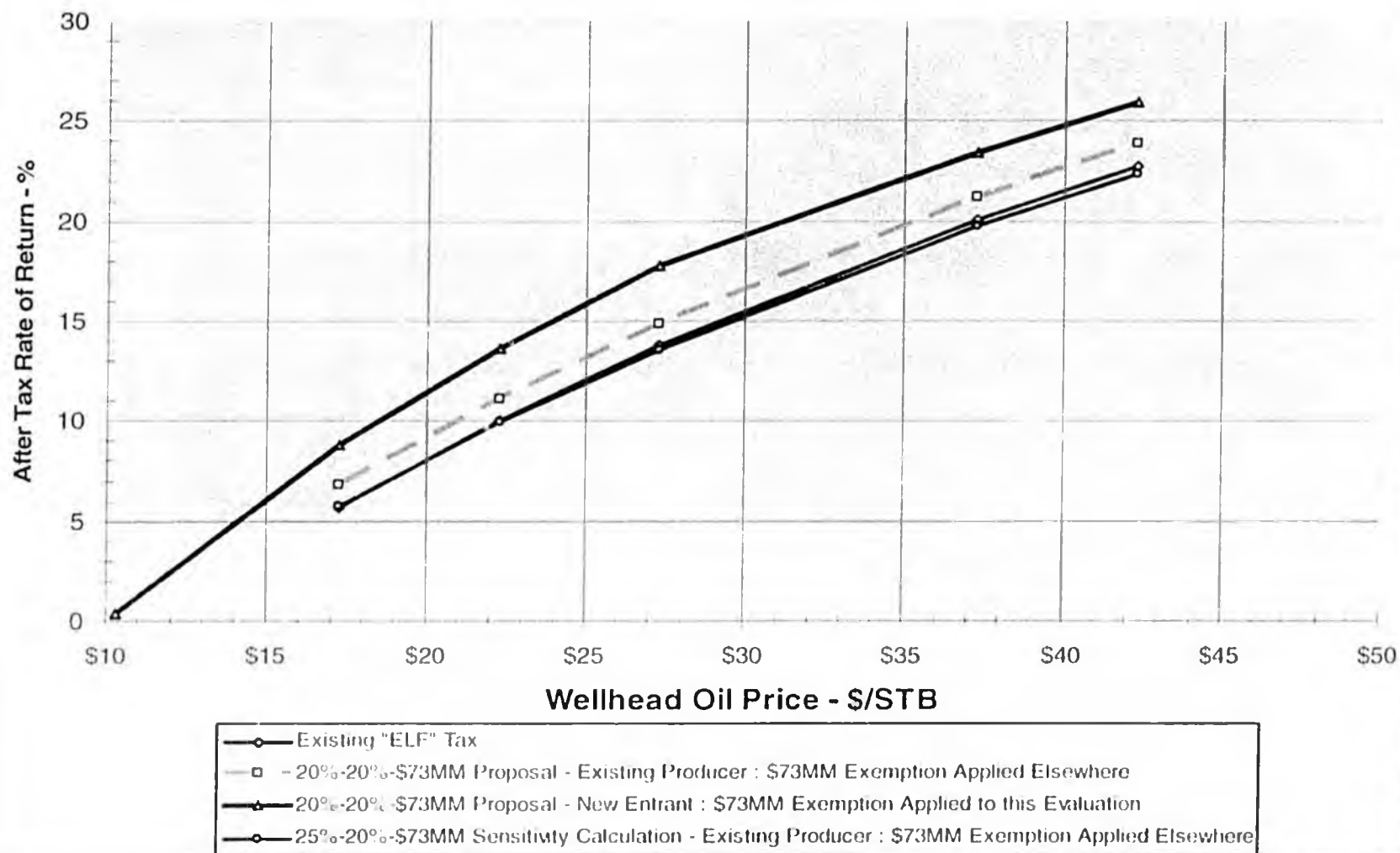
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New Small Oil Development

- ▶ **Ultimate recovery is 47 million barrels.**
- ▶ **Peak oil production rate is 15,000 BOPD.**
- ▶ **Capital expenditure is 316 million dollars.**
- ▶ **Timing from discovery to first production is 6 years.**
- ▶ **The development concept is a satellite to an existing oil field. The satellite has a separate ELF calculation from the existing oil field.**
- ▶ **The satellite field pays an oil processing charge to the existing facility of \$5.00 per barrel. This is treated as a deduction to the wellhead price.**
- ▶ **The royalty is 12.5%.**

Small Oil Development- Rate of Return

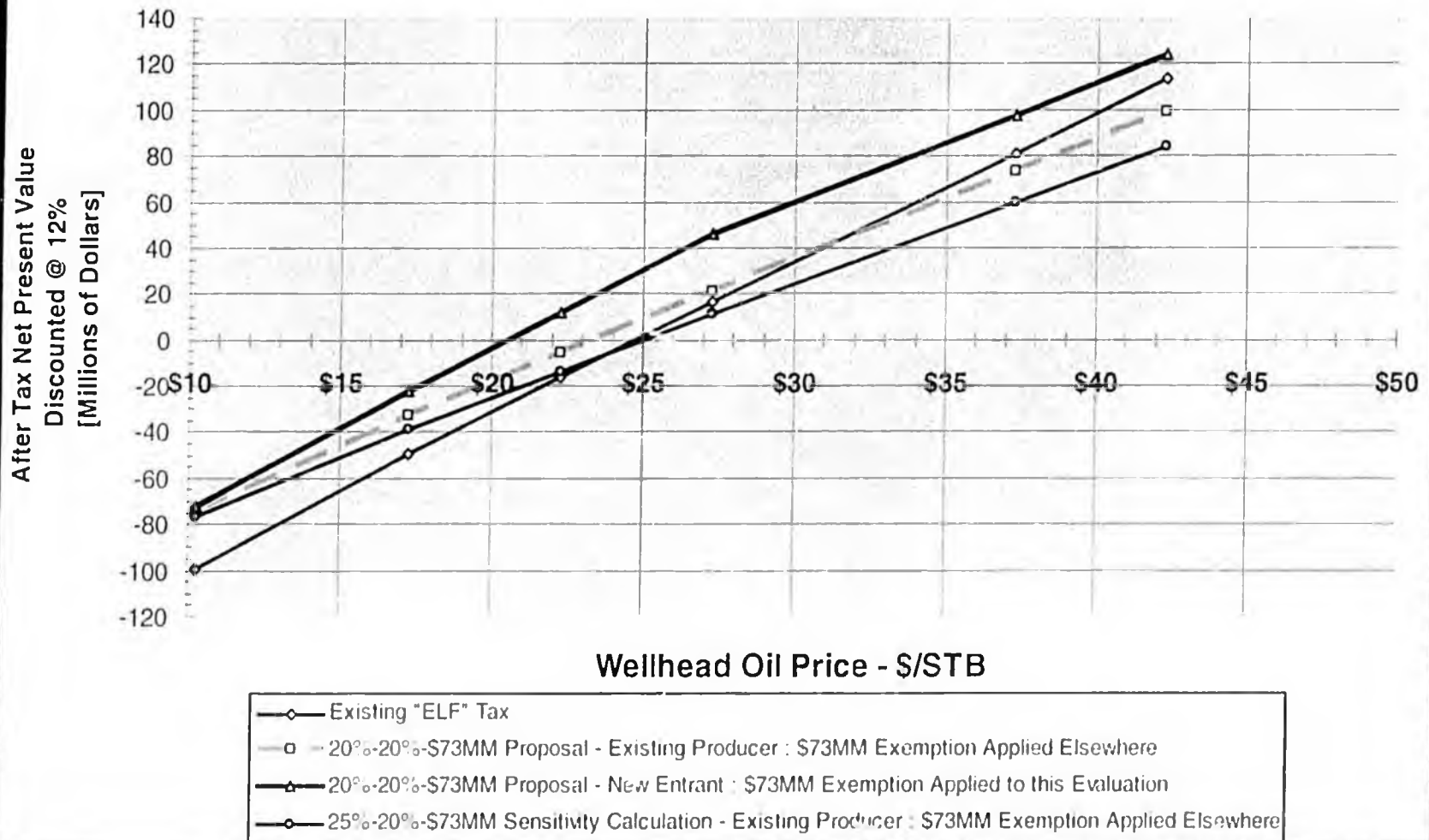
After Tax Rate of Return as a function of Wellhead Oil Price
Small Oil Development



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Small Oil Development- Net Present Value

After Tax Net Present Value Discounted @ 12 % vs. Wellhead Oil Price
Small Oil Development



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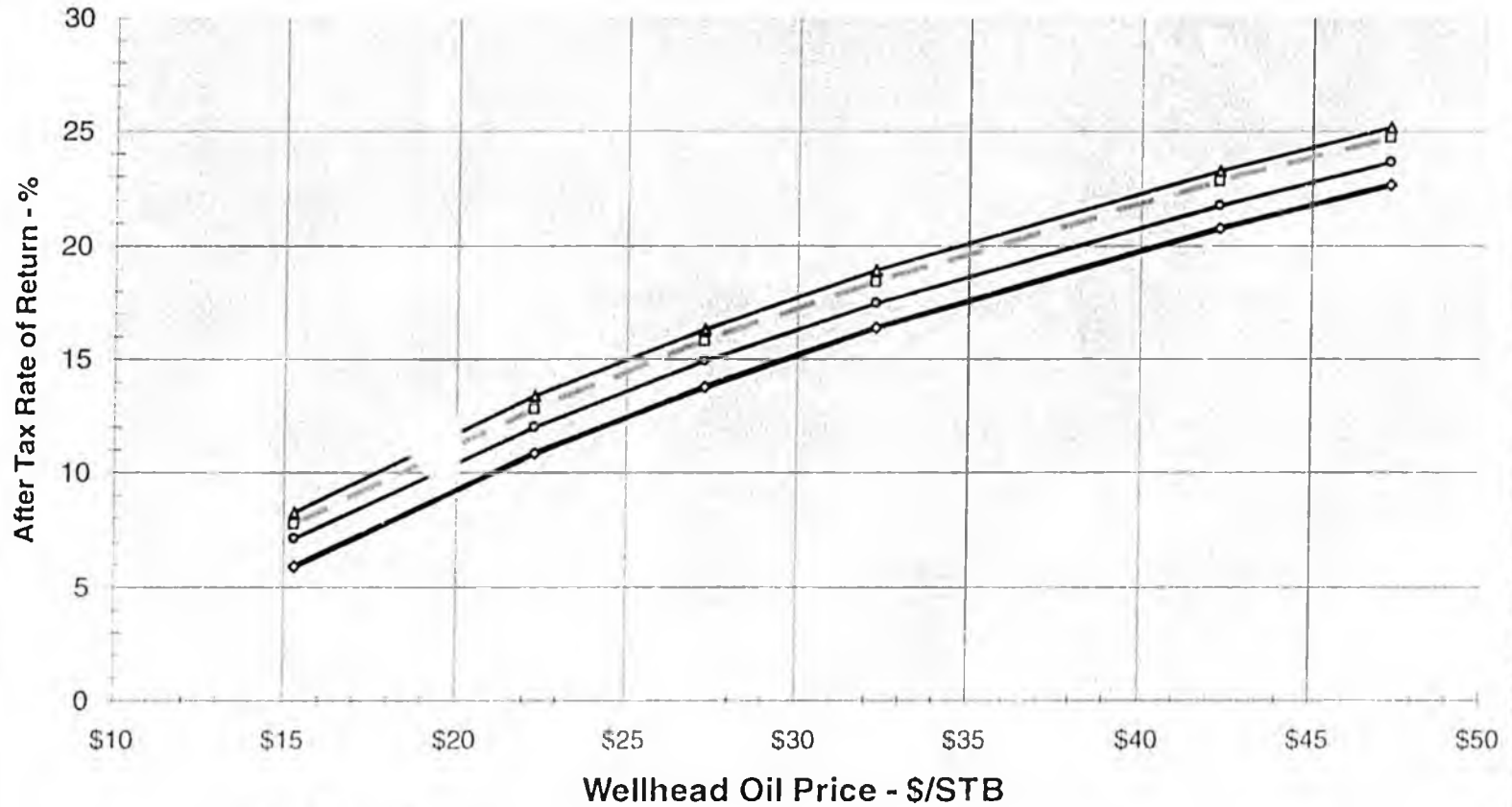
Risked Exploration Economics for Oil Prospect

- ▶ **Commercial chance of success is 15% at a \$32/Bbl wellhead oil price**
- ▶ **Mean commercial prospect size is 345 million barrels**
- ▶ **Capital expenditure is 1.1 billion dollars**
- ▶ **The peak production rate is 55,000 BOPD**
- ▶ **Royalty is 12.5%**

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Medium Oil Prospect- Risked Rate of Return

After Tax Rate of Return as a function of Wellhead Oil Price
 Risked Pre Drill 345 MMBO Prospect Exploration Economics

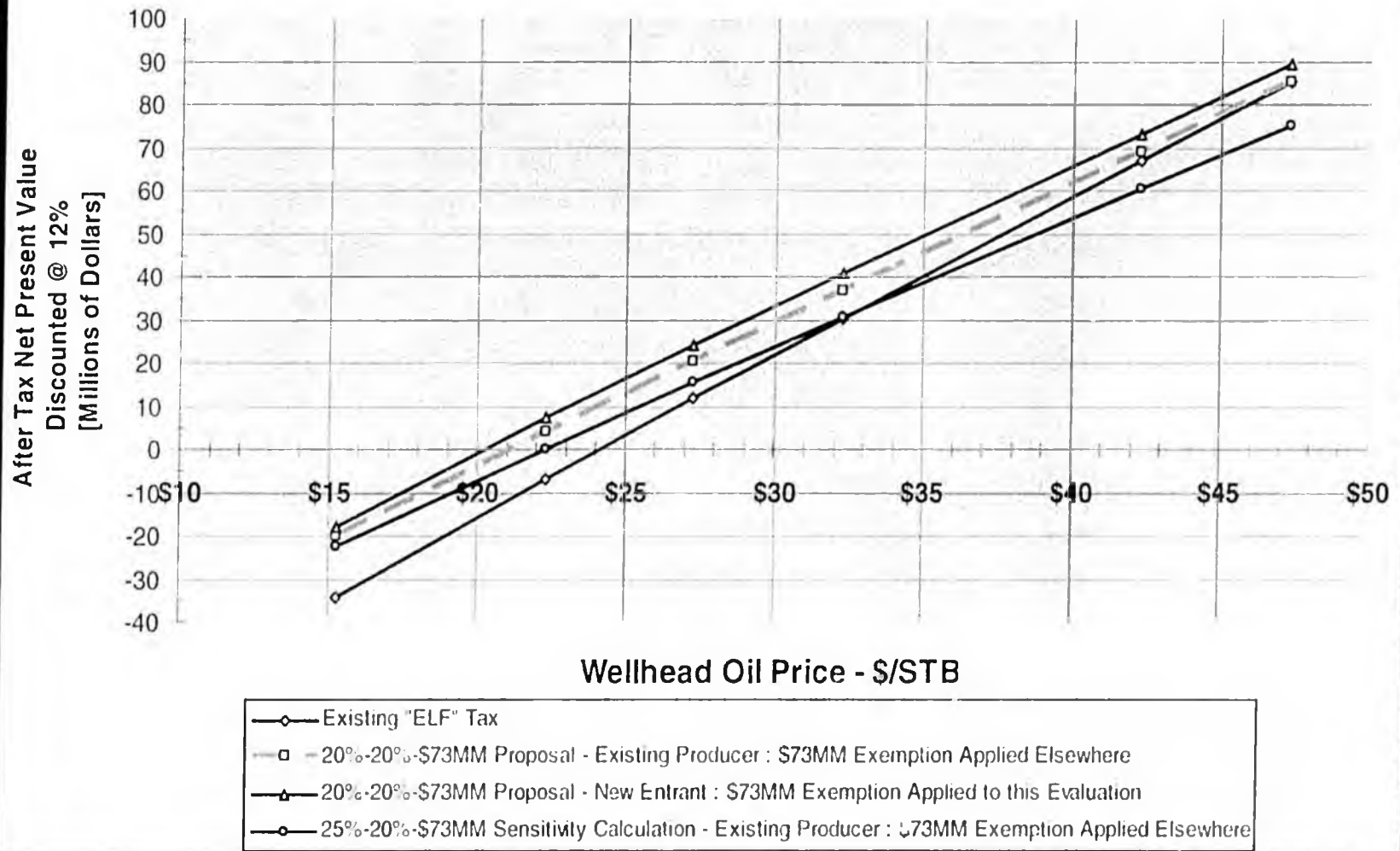


- Existing "ELF" Tax
- 20%-20%-\$73MM Proposal - Existing Producer : \$73MM Exemption Applied Elsewhere
- △— 20%-20%-\$73MM Proposal - New Entrant : \$73MM Exemption Applied to this Evaluation
- ◇— 25%-20%-\$73MM Sensitivity Calculation - Existing Producer : \$73MM Exemption Applied Elsewhere

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Medium Oil Prospect- Risked Net Present Value

After Tax Net Present Value Discounted @ 12 % vs. Wellhead Oil Price
 Risked Pre Drill 345 MMBO Prospect Exploration Economics

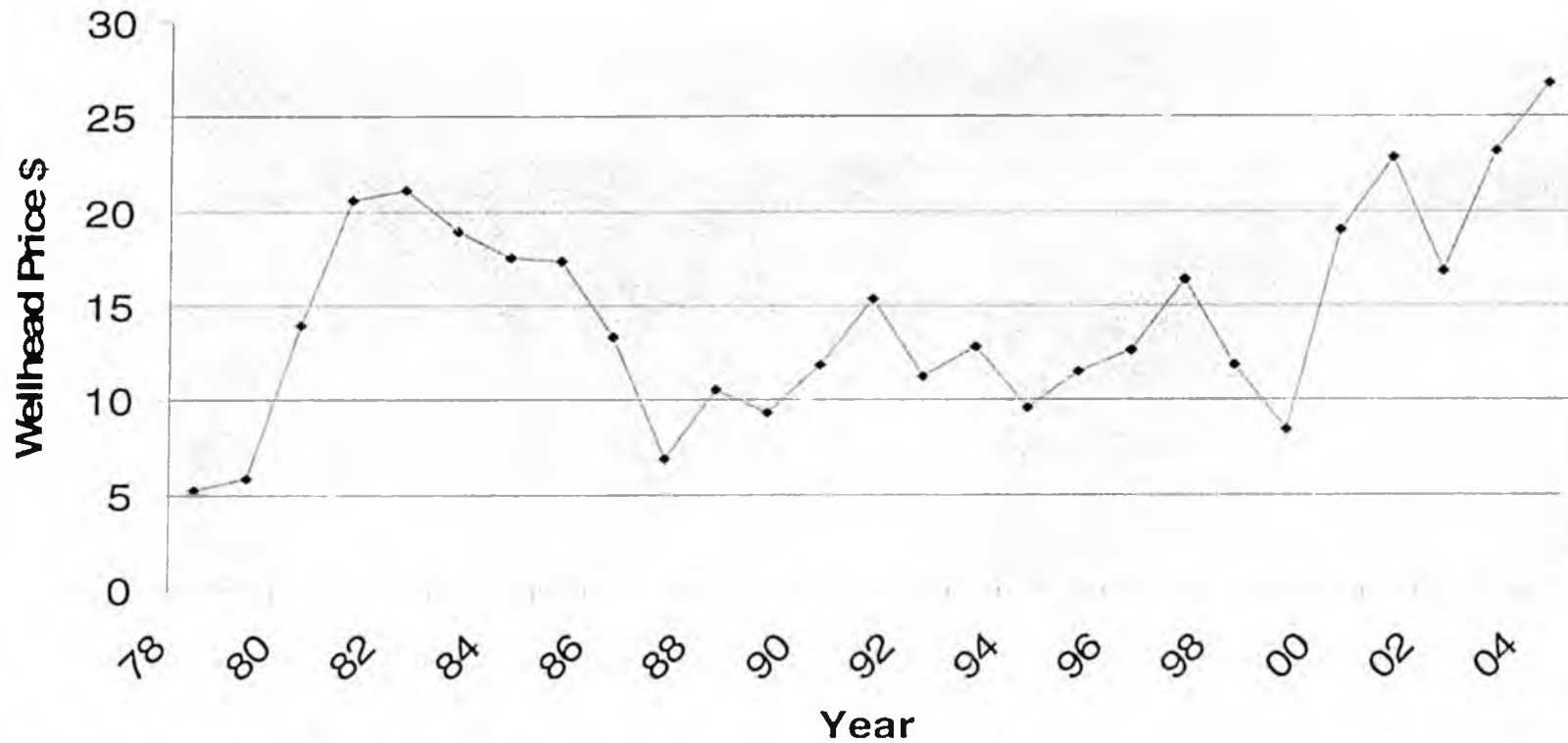


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Historic Alaska North Slope Crude Prices

ANS Wellhead Crude Oil Price

From AK Dept. of Revenue, Tax Division



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This presentation contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934. Anadarko believes that its expectations are based on reasonable assumptions. No assurance, however, can be given that its goals will be achieved. A number of factors could cause actual results to differ materially from the projections, anticipated results or other expectations expressed in this release. While Anadarko makes these forward-looking statements in good faith, neither Anadarko nor its management can guarantee that the anticipated future results will be achieved. Anadarko discloses proved reserves that comply with the SEC's definitions. Additionally, Anadarko may disclose estimated reserves, which the SEC guidelines do not allow us to include in filings with the SEC. See Additional Factors Affecting Business in the Management's Discussion and Analysis (MD&A) included in the company's Annual Report on Form 10-K.

**Testimony of James D. Weeks
On HB 488
Oil and Gas Production Tax
Alaska State House Resources Committee**

01 March, 2006

Mr. Chairman, distinguished members of the House Resources Committee. My name is Jim Weeks, and I am here today representing UltraStar Exploration LLC, a very small all Alaskan owned independent explorer, with strategically located leases on the North Slope. UltraStar is based in Anchorage, with offices at 3111 C Street, Suite 500. The Company was formed in 2002 by me, John Winther, and Dale Lindsey, for the primary 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 invitation to testify on this important legislation.

First of all, I'd like to commend the Governor and members of the Administration for addressing this issue, and your Committee for the timely and thorough review it is being given. During the last several days, I've listened to a lot of testimony on the proposal. Some witnesses wanted the Committee to delay decisions on this issue. There should be no delay, nor should there be a rush. This is a very important piece of legislation, and you need to get it right, less it results in unexpected and/or un-desired outcomes. You are doing it right, giving the bill a thorough and fair hearing in a timely fashion.

I will now offer a few specific comments on the bill. You've heard lots of testimony supporting the 20-20 tax and exploration/development incentive split, and the arguments in favor of these provisions have been articulated very thoroughly and clearly, and I certainly cannot embellish on them, so I won't even attempt to. I'll just add UltraStar's strong support for the positions of the existing producers and independents and explorers on these issues.

John Winther testified to the Joint House and Senate Committee hearing last Saturday, echoing UltraStar's support for the 20/20 provisions, and the \$73 million deduction allowance in the bill. Since then, we've learned that the \$73 million allowance, granted to all companies in Alaska regardless of the size of their cash flow streams, may be a difficult pill for you and your colleagues to swallow. Thus, you may want to eliminate it from the bill. I encourage you not to jettison it entirely, but consider an alternative that will provide incentives for exploration and development of smaller fields.

It's generally agreed that the big Prudhoe Bay and Kuparuk sized fields have been found. The big structures have been drilled, and what remains are 10-100 million barrel accumulations. These are modest by North Slope standards, but can add up to significant amounts of oil and related economic activity. The stock market rewards reserve replacement. The current producers are huge, publicly traded companies that have become so large that their reserve replacement needs cannot be met by chasing small satellites on the North Slope. For instance, ExxonMobil produces 20 million barrels in 10 days. We'd do jumping jacks in downtown Juneau if we found that much oil on our leases.

But smaller accumulations can be attractive to small independents like us, provided the right incentives. Rather than the \$73 million allowance for all companies, I suggest you consider establishing a ceiling above which larger companies would not get the \$73 million allowance, and below which smaller companies would. There is precedent for this in the "Charter for Development", a 1999 agreement between the State, BP and ConocoPhillips that made the combination of ARCO and BP possible. There are many provisions in the Charter, but one of them requires BP and ConocoPhillips to give preferential treatment to small producers, called "qualified producers". The Charter defines qualified producers as those with worldwide assets of less than \$1 billion dollars, and establishes 5000 barrels per day as a maximum amount of crude oil that a qualified producer can produce to receive the preferential treatment. I realize that the provisions of the Charter were developed for a different purpose, but certainly it distinguished between "little guys", and "big guys", and established a maximum production level for which the benefits apply. Whether \$1 billion dollars or 5000 barrels per day are the appropriate ceilings for the PPT is subject to more debate, but such a two-tiered approach will accomplish what I believe you want: to provide incentive for entry by small newcomers without giving a subsidy to the established players. Please don't throw the baby out with the bathwater by eliminating the \$73 million allowance altogether.

My last issue is pretty specific, but could be significant for small independents. It regards the exclusion of "amounts paid for purposes of indemnification." on line 15 of page 14 of the bill. Small independents like UltraStar will need to indemnify facility owners and operators who will process our oil through their facilities. We will need to purchase real, third party, arms length insurance to satisfy these requirements. We will also need insurance to meet the bonding and financial responsibility requirements of the Departments of Natural Resources and Environmental Conservation, and the Alaska Oil and Gas Conservation Commission. Depending upon the circumstances, membership in an oil spill clean up cooperative may also be required. All these costs can broadly be characterized as costs for the purposes of indemnification, and could arguably be excluded when direct costs are calculated, as defined at line 21 on page 13.

Nearly 15 percent of the cost of the Winstar exploration well at Oliktok Point in 2003 was for insurance premiums, so these indemnification costs can be

significant for the little guy, and should clearly be deductible to determine direct costs. In his letter transmitting this legislation to this committee, the Governor said that a number of indirect costs are listed in the bill, and are to be excluded from the calculation of direct costs. Indemnification is one of the indirect costs listed. Trust me, Mr. Chairman, there was nothing indirect about the \$370,000 check I wrote for the insurance premium on our last well. The money went directly from our bank account into theirs. I urge you to clarify your intent on this issue, and allow real, invoice supported, arms length indemnification costs to be included.

Thanks for the opportunity to testify at this important proceeding.

James D. Weeks
Managing Member
UltraStar Exploration LLC
907-258-2969

**Testimony of James D. Weeks
On CS for SB 305
Oil and Gas Production Tax
Alaska State Senate Resources Committee**

20 March, 2006

Mr. Chairman, distinguished members of the Senate Resources Committee. My name is Jim Weeks, and I am here today representing UltraStar Exploration LLC, based in Anchorage, with offices at 3111 C Street, Suite 500. Thanks for the opportunity to testify on this important legislation again.

I want to make a few brief comments on the Committee Substitute: I've seen two options being proposed to replace the \$73 million allowance. UltraStar prefers Option 2, which eliminates the \$40/barrel oil price ceiling above which the exemption would not apply. It seems that if the legislature is willing to grant a 10,220,000 barrel per new field exemption, then it shouldn't matter how fast that exemption is recovered, and sooner is better than later for industry. I also hear that the Committee may be considering an increase of the 4000 barrels per day to 5000, and lifting the total of the exemptions to a corresponding 12,775,000 barrels. This is more consistent with the Administration's initial proposal, and is a change I encourage you to make.

I question the need for a 7 year time limit after which the tax exemption will expire. Again, it seems if you're willing to grant a 10 or 13 million barrel exemption, then there is no need for a time limit, and we recommend that it be deleted. Industry will do everything economically feasible to use up the exemption as soon as possible, but well productivity and conservation issues may not allow for that to be the case in all instances.

Both options to replace the \$73 million allowance name the Alaska Oil and Gas Conservation Commission (AOGCC) as being the "referee" to resolve disputes about what constitutes an oil and gas field or unit. We agree with the selection of the AOGCC for this role, but recommend you clarify your intent regarding eligibility for the 4000 barrels per day exemption described in the first three lines of Section 21(i). In addition to providing incentives and tax exemptions for the drilling of new field wildcats, if the Committee wants every company, large and small, current producer, or wannabes like us, to be poking around the fringes of existing reservoirs, as well as looking deeper and shallower within the boundaries of existing units; then I suggest the following:

When the PPT becomes effective, establish a "ring fence" around existing, producing units. Current production from these units would not receive the 4000 barrel per day exemption. If peripheral drilling outside of that ring fence confirms commercial hydrocarbons and justifies unit expansions, then those expanded

areas should be eligible for the tax exemptions and exploration and development credits contemplated in CSSB 305. Deeper and shallower accumulations, drilled within existing units after July 1, 2006, should also be eligible. If the current producing unit owners receive a 4000 barrel per day exemption on current production, which means very little to them, they have will no additional incentive to push the envelope. If however, the exemption applies only to new production within an existing or expanded unit, it provides a meaningful incentive.

Lastly, I'd like to register my support of Dr. Van Meurs "Two for One System" that he summarized on March 18.

Thanks for the opportunity to testify at this important proceeding.

James D. Weeks
Managing Member
UltraStar Exploration LLC
907-258-2969

LEG. / GOV.
CONSULTANTS

4-9-06

**Further Discussion
of
Senate Bill 305 and House Bill 488**

Daniel Johnstons Testimony

**Juneau, Alaska
9 April, 2006**

**Daniel Johnston & Co., Inc.
www.danieljohnston.com
60 Shady Lane
Hancock, NH 03449**

Where do we stand today?

Oil Industry threatens:

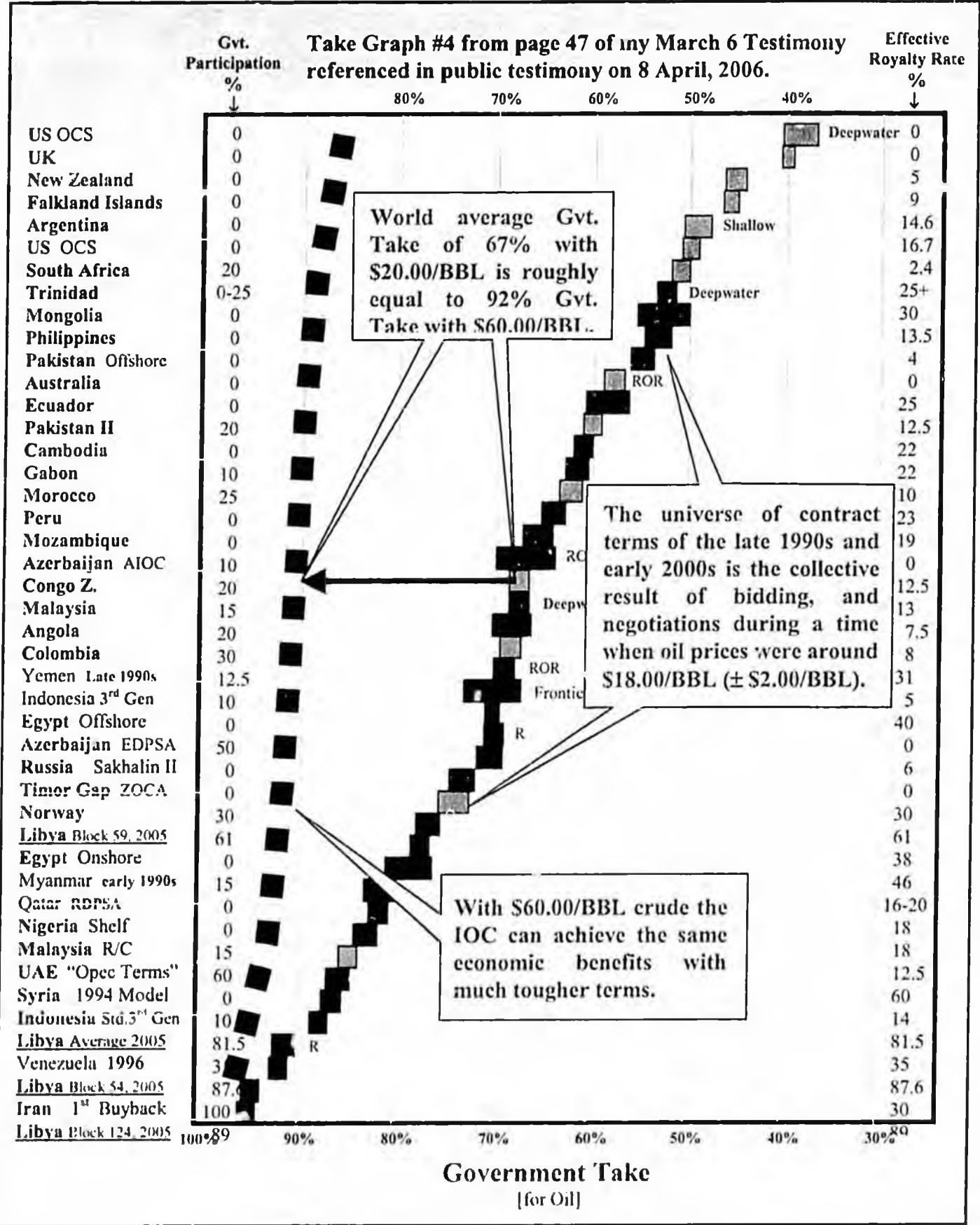
- (1) That Investment will dry up with the 25/20% proposal and a progressive feature.**
- (2) Alaska reputation will be seriously harmed**
- (3) There may be no Gas Pipeline**
- (4) Philanthropic donations are at risk (ConocoPhillips)**

Oil Industry has lobbied hard with every means available
(Can't blame them, but . . .)

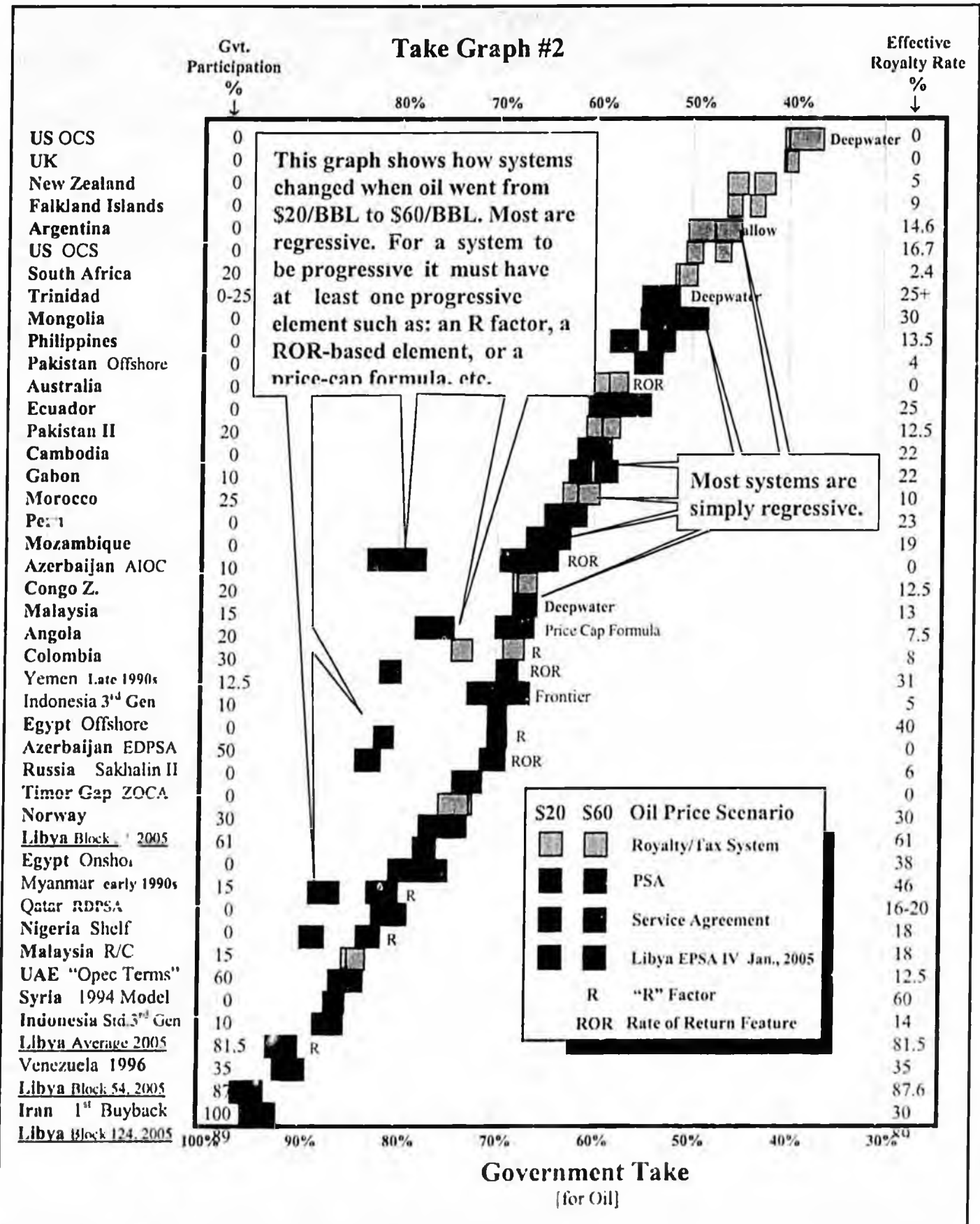
I still have problems with some of the Peer Groups we keep getting compared to.

Who really thinks comparing Alaska to the likes of Kansas or Colorado is reasonable?

Russia provides some good analogs: both with PSAs as well as the Royalty/Tax arrangements there: very tough terms.



What terms would yield the same economic benefit at \$60/BBL?



Difference between \$20/BBL and \$60/BBL.

<http://news.morningstar.com/news/DJ/M04/D04/200604040854DOWJONESD.JONLINE000295.html?Cat=Energy>

04-04-06 08:45 AM EST

Beijing -(Dow Jones)- China's Ministry of Finance Tuesday issued rates for a newly implemented windfall profit tax on crude oil that is sold above US\$40 a barrel in the country.

"(The tax is aimed at) pushing forward the reform on oil price mechanism and promoting continuous, healthy and coordinated development of the national economy," the ministry said on its Web site.

In late-March, the National Development and Reform Commission, China's top economic planning agency, said it was immediately implementing a windfall profit tax on domestic crude oil sales, but didn't disclose the tax rate.

The tax took effect on March 26 and the tax rate ranges from 20% to 40% of the amount that companies get above US\$40.

The tax applies to enterprises and joint-venture companies that produce and sell oil onshore and offshore China, the ministry said.

Income generated from the windfall tax will be included in the central government's budget management, and taxes will be collected by the MOF.

The tax will be calculated monthly and should be paid quarterly, the ministry said, adding that since the tax is regarded as a company cost, it can be deducted before income tax.

Below is a table of the tax rates

<u>Crude Oil Selling Price (US\$ per Barrel)</u>	<u>Tax Rate On Portion Of Price Above US\$40</u>
40-45 inclusive	20%
45-50 inclusive	25%
50-55 inclusive	30%
55-60 inclusive	35%
above 60	40%

-Zheng Kiaolu contributed to this story. Dow Jones Newswires; 8610 6588-5848;
tracy.zheng@dowjones.com

Edited by Tracy Gan

Comments of Dr. Juan Carlos Boué

The following selected quotes come from Chapter 11 of an upcoming book by Dr. Juan Carlos Boué of Oxford University in the UK. I sincerely appreciate the insights from Dr. Boué and his permission to quote him as extensively as I have here. My commentary is confined to sections within brackets [such as these] to preface or expand on quotes from Dr. Boué's work. I would like to take this opportunity to publicly thank Dr. Boué for his concern and for his insights. DJ

The following quotes are from:

A QUESTION OF RIGS, OF RULES, OR OF RIGGING THE RULES? UNDERSTANDING THE PROFITABILITY AND PROSPECTS OF UPSTREAM OIL ACTIVITIES IN THE OFFSHORE US GULF OF MEXICO.

Copyright Oxford Institute for Energy Studies 2006. Juan Carlos Boué

11 CONCLUSIONS: WHAT SHOULD THE WORLD LEARN FROM THE SUCCESS STORY OF THE DEEPWATER GOM?

[The first of Dr. Boué's quotes regarding "basin masters" comes from a McKinsey Company study by; Conn, C., and White D., 1994, Revolution in Upstream Oil and Gas - Strategies for growth beyond 2000; McKinsey & Company, Australia. DJ]

"11.1 Basin Mastery: Adding Value in Global E&P Activities

McKinsey gave the name "basin masters" to those companies that managed to build dominant acreage and logistical positions in difficult new plays, partly because of their skills at resource development, technology and integrated project management but chiefly by virtue of their stealing a march on competitors in remote areas where scale and infrastructure were of paramount importance. [pg 334-335]

The cornerstone of this type of control [as basin master] is their dominant position in early infrastructure corridors (often over-built, with a view towards future discoveries), which allows the basin masters to extract rents from other players through access charges to this infrastructure. Frequently, this is bolstered by cosy relationships with governments, licensing agencies and NOC partners (the latter in provinces where PSA's [production sharing agreements] prevail), all of which tend to complicate the lives of potential competitors (through the appearance of bureaucratic and other, less wholesome, type of barriers) while simplifying the lives of incumbents (cast as they are in the enviable role of 'operator of choice' for licensing agencies). In this way, basin masters can ensure that they will be able to capture the majority of the value in a given province, including that generated from operations in fields not discovered by themselves. [pg 336]

Basin mastery may translate into very comfortable lives for a few bureaucrats and politicians in key positions in the governments of certain countries. However, for these governments as a whole (and even more so for the populations they represent), basin mastery effectively means stunted competition for acreage and consequently lower acreage process, higher upstream entry barriers, a high degree of fiscal dependence on very few operators . . . [pg 339]

“Furthermore, during subsequent years [subsequent to 1998], the magnitude of oil company [share] buybacks [around \$20 Billion per year or so] and cash holdings has made it painfully clear that these companies always had far more funds available for investment than attractive prospects to plough them into. The way in which domestic Russian firms succeeded in ensconcing themselves in the driving seat in their country, largely marginalizing international oil companies from Western Siberia, has made the dearth of attractive investment opportunities for the latter even more conspicuous.” [pg 346]

11.3 The Issue of Tax Breaks

A landmark study commissioned by the Wyoming legislature (prompted in large part by a fiscal crunch in that US state, whose fiscal dependence towards oil income is second only to Alaska's) found that, *over a forty year period*, a once-and-for-all drop of 2 per cent in the state's severance tax rate would increase total oil recovery by less than one percent (50 MMBOE) and employment by 300 persons (i.e. 7.5 jobs *per year*), while causing a 17 percent reduction in the present value of severance tax collections. In contrast a doubling of the state severance tax (from 4 to 8 per cent) was found to reduce ultimate recovery by around 6 per cent, while increasing tax revenue, in present value terms, by over ninety per cent.³⁵ [pg 347]

[Footnote 35 is as follows: “Gerking *et al.* 2000. These conclusions had been foreshadowed by GAO 1990. This study found that some petroleum production incentives actually “provided incentives to make petroleum production investments that have pretax returns below those of investments in other industries” (p. 5). An even earlier GAO study 1985b: 32) had found that a 40 per cent reduction in Windfall Profit Tax for EOR projects had led to only one GOM project.”]

[The UK]

Likewise, the resurgence of UK North Sea output after what is seen to be its production peak in the mid-1980s is often put forward as a prime example of the power of more flexible taxation schemes to coax higher output from maturing fields.³⁶ A study focusing on this issue concluded that, out of a total production of 2,676 MMBD in 1995, only about 355 MBD would not have been produced without the modifications to the British fiscal regime introduced from 1983 onwards.³⁷ [pg 347]

[Footnotes 36 and 37 are as follows: “36 Production of liquid hydrocarbons in the UK peaked (for a second time) in 1999 at 2.82 MMBD, after having languished at 1.88 MMBD during 1988-89. 37 Martin 1997: ii-iv”]

BP Graph of Production vs. Tax Rate

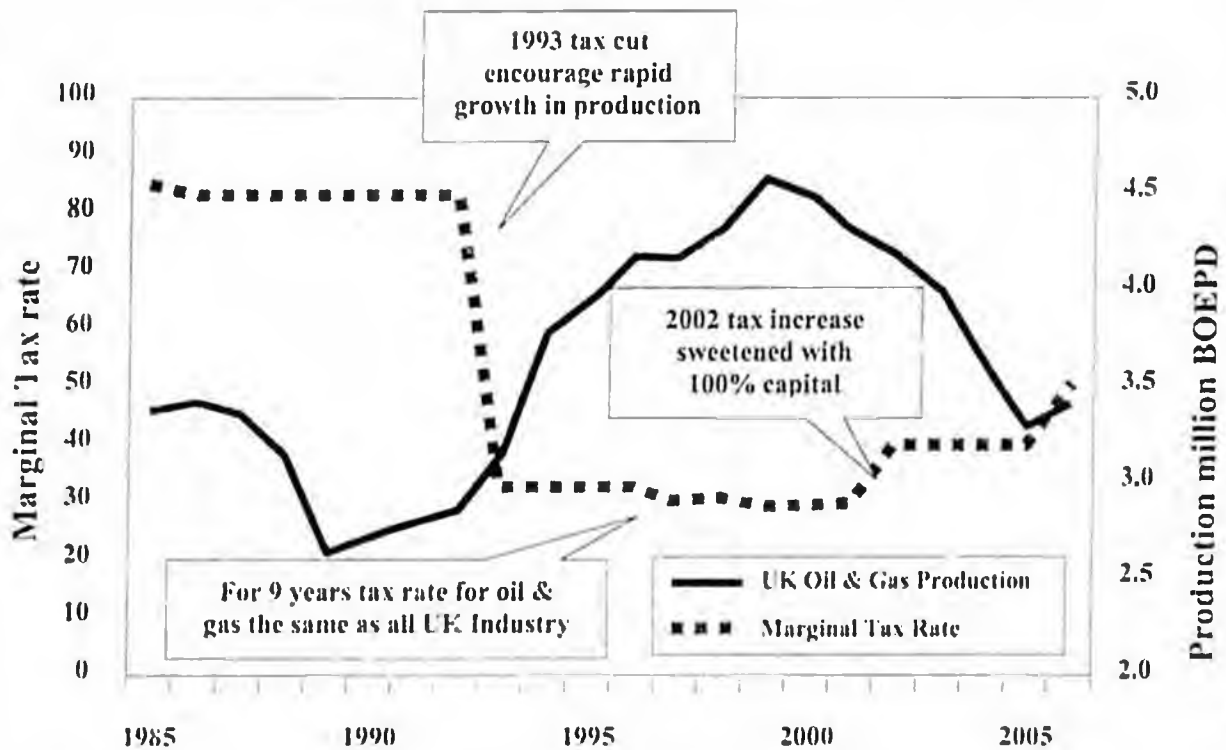
The graph below is not a fair representation of what the result of lowering the tax rate in 1993 was. In fact exploration expenditures went down significantly in 1994 and development expenditures did not go up (see following page). They went down but not as dramatically as exploration expenditures.

I think every Alaskan should consider this carefully and compare it to the data on the following page.

I experienced the "boom" in the mid-1980s in the UK sector of the North Sea that resulted from incentives provided that were very similar to the "credits" proposed here in Alaska. The increase in production was the result of exploration that occurred years before the 1993 reduction in taxes as one would expect. I do not see how it could be possible for industry to gear up and respond as quickly as this graph would suggest.

Please consider my work on the following page with caution. I had very little time to respond to this graph on such short notice with the busy schedule here in Juneau. With a bit more work we can verify — it is so important.

... But lowering tax rates will encourage investment



Source: BP presentation to Alaska Legislature 28 February, 2006 (page 8)

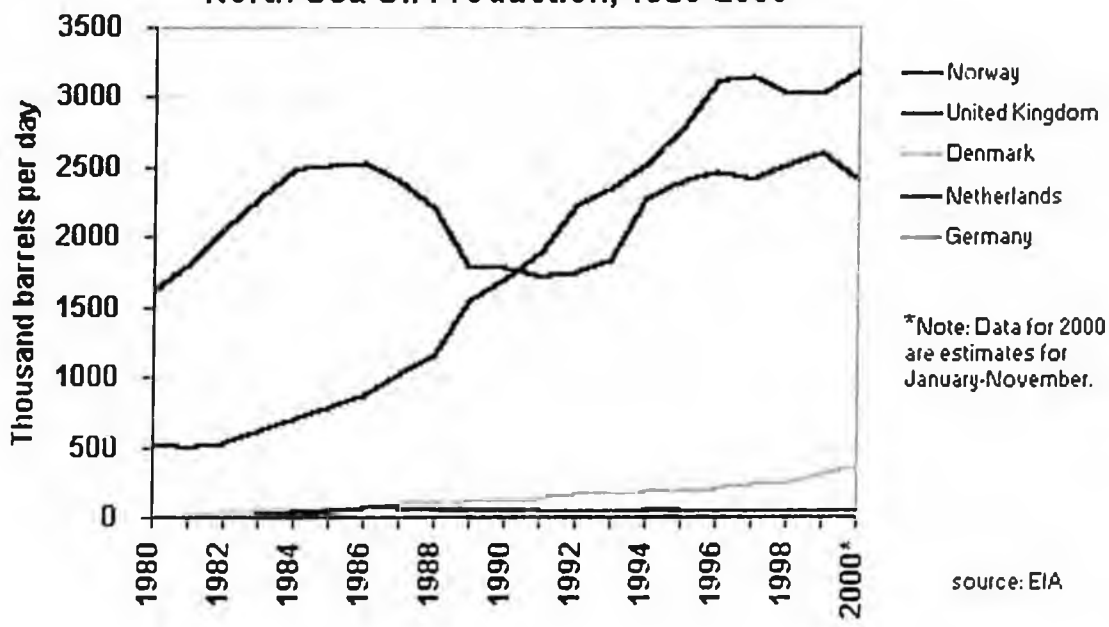
UK Drilling Activity History — Wells Drilled per year

This data was “reduced” from a graph from another UKOOC document and generated at 1:AM March 6, 2006. It begs verification and “real data” but I believe it confirms the fallacy of the claim that the reduction of Government take from around 85% to 33% enhanced investment activity in the UK in 1993.

More work needs to be done but it is clear to me that something is wrong with the conclusions drawn by BP regarding the 1993 fiscal event.

Year	Exploration	Appraisal	Development	Total
1974	67	33	19	119
1975	81	38	19	138
1976	58	28	52	138
1977	67	39	92	198
1978	38	25	92	155
1979	34	16	97	147
1980	31	22	117	170
1982	48	27	131	206
1983	69	44	111	223
1981	78	52	92	222
1984	108	78	102	288
1985	94	66	128	288
1986	73	41	81	195
1987	70	64	123	258
1988	94	86	159	339
1989	95	91	150	336
1990	163	66	122	350
1991	108	81	142	331
1992	75	58	161	294
1993	52	59	158	269
1994	63	38	197	297
1995	61	38	239	338
1996	72	41	256	369
1997	63	34	253	350
1998	47	33	272	352
1999	16	19	222	256
2000	27	33	213	272
2001	25	36	275	336
2002	16	31	258	305

North Sea Oil Production, 1980-2000*



*Note: Data for 2000 are estimates for January-November.

source: EIA

BP Fields Brought on-stream after 1993

Andrew, Harding, Foinaven, Schiehallion, and ETAP (Eastern Trough Area Project includes 7 fields in the Central North Sea).

BP fields brought on-stream after 1993						
	Recoverable Reserves		Discovery Date	Start-up Date	Production 2000 MBOPD	
	MMBBL S	TCF				
Andrew	160	0.25	6/1974	6/1996	50	
Harding	219	0.27	1/1988	4/1996	87	
Foinaven	362	0.22	10/1992	1/1997	92	
Schiehallion	±300		10/1993	1/1998	100	
ETAP	450	1.1				

Norwegian Development Activity

Development Activity Investment

5 years <u>Before</u> 1993 (1988-1992 inclusive)	NKr 134,251 MM	\$ 20,340 MM	
5 years <u>After</u> 1993 (1994-1998 inclusive)	NKr 205,730 MM	\$ 31,170 MM	+ 53%

Norwegian Exploration Activity

Exploration Activity Investment

5 years <u>Before</u> 1993 (1988-1992 inclusive)	NKr 30,112 MM	\$ 4,560 MM	
5 years <u>After</u> 1993 (1994-1998 inclusive)	NKr 30,978 MM	\$ 4,694 MM	+ 3%

(Assumed exchange rate = NKr 6.6/US\$ 1)