

ALASKA LEGISLATURE

HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 3101

Sections 2 & 17

- 1 Amends current statute (AS 43.05.230 and 43.55.040) to clarify rules for using one taxpayer's information to determine another taxpayers tax
- 1 Generally limited to Prevailing value calculation, which may be moot for taxpayer electing alternative valuation formula
- 1 Taxpayer recipients of information are brought under confidentiality provisions of AS 43.05.230

Sections 3 & 4

- Clarify state income tax code that production tax is not a tax “based on or measured by net income”
- Ensures that the PPT is deductible for state income tax purposes.

Section 6

- Amends AS 43.55.017 (a) to conform language to the Internal Revenue Code provision to which it refers

Sections 9, 19, 20

Conforming amendments for language consistency and modernization.

Sections 10, 24, 26

- Repeals and Reenacts AS 43.55.020 (e)
- Simplifies three tiered system where flared gas was either tax free, taxed, or subject to tax and a penalty.
- Now gas and oil are not taxed or subject to conservation surcharges if used for necessary lease operations. (If AOGCC determines they have been wasted, then they are taxed.)

Section 14 and 15

- ▮ Conforming changes to 43.55.030(a)
(dealing with tax returns)
- ▮ Gross/net, and/or, simplified reporting
- ▮ Repeals the \$25 a day filing penalty which predated the 43.05 civil penalties

Section 18

Amends AS 43.55.080

- 1 Conforms statute to constitution
- 1 Namely: recognizes that money from resolved disputes goes into Budget Reserve Fund and not into the general fund

Sections 27, 29

- New definition of “gas”
- Point of production moved downstream
- Gas processing now included in Upstream

- New definition of “oil”
- Liquid hydrocarbons recovered by mechanical separation or gas processing

Section 28

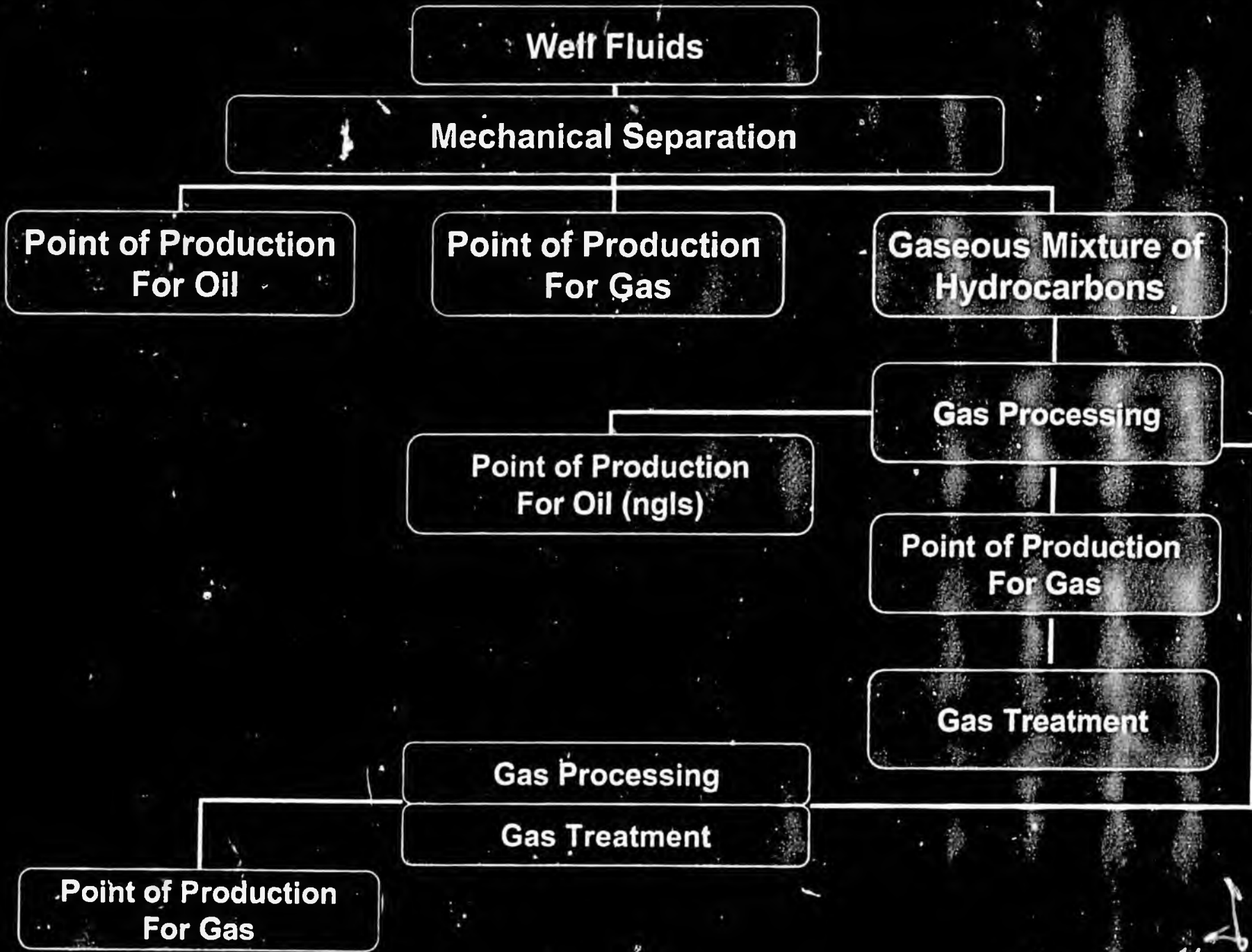
- 1 Redefine “gross value at the point of production”
- 1 Oil pt.-of-prod. definition essentially unchanged (but if there is gas processing, the pt.-of-prod. for extracted liquids is downstream of processing)
- 1 Gas pt.-of-prod. is downstream of any gas processing
- 1 If there is a combined processing/ treatment plant facility, pt.-of-prod. is further upstream point where processing ends or treatment begins

Section 30 (part 1)

- New definition of "Cook Inlet Basin"
- For purposes of the 1.5 percent tax on lessor's royalty share (outside of Cook Inlet Basin the tax is 5 percent)

Section 30 (cont.)

- 1 Define “gas processing” and define “gas treatment”
- 1 Gas processing: physical processes that extract liquid hydrocarbons, upstream of a sales line or gas treatment plant
- 1 Gas Treatment: removing non-hydrocarbon substances and conditioning gas for sales line



Section 31

Repeal of superseded provisions,
including individual gas and oil taxes,
ELF, and some definitions

Sections 32, 33

- ▮ Applicability: Sections pertinent to taxing oil and gas under the PPT apply to oil and gas produced starting April 1, 2006
- ▮ Applicability: Prevailing value clarification of existing law applies to all oil and gas
- ▮ Part-year conventions for 2006
- ▮ ELF based safe harbor for 6 months

Section 34

- 1 Transition provisions --
- 1 Department may develop PPT implementing regulations immediately
- 1 Implementing regulations may have retroactive effect to April 1, 2006

Section 35

Conform headings of statutory provisions

Sections 36, 37, 38

- Effective dates –
- PPT provisions take effect April 1, 2006
 - but if they take effect after April 1, they are retroactive to April 1
- Other provisions take effect immediately

Greenberg Traurig

Memorandum

TO: Senator Gene Therriault, Joe Balash
FROM: Donald C. Shepler
DATE: March 19, 2006
RE: Regulatory treatment of proposed net profits tax credits and deductions associated with investment in North Slope Gas Treatment Plant

fact = gas pipeline

Yesterday you asked whether proposed net profits tax credits and deductions associated with investments in a North Slope Gas Treatment Plant ("GTP") would be flowed-through to customers who ship gas through the Plant. As discussed more fully below, I have found no binding FERC precedent on whether state tax incentives would, in all instances, have the effect of reducing rates. However, there are strong arguments to support that result in the context of investment in the GTP. At the same time, however, arguments could be advanced by the Project Sponsors in support of their right to "retain" the value of the credits and deductions that are presently being considered by the Legislature in the context of SB-305.

BACKGROUND

Under SB-305 the Alaska Legislature is considering a net profits tax program to be applied to oil and gas produced in the State. In conjunction with that program certain credits are proposed that would be based upon investment in oil and gas infrastructure. Further, certain tax deductions are also being considered that would also be based upon investment in infrastructure. Investment by Project Sponsors in a multi-billion dollar GTP as well as the related, upstream "feeder lines"

*distributed by Senator Green
4/3/06
- 9:33 AM -*

that will be necessary to move natural gas from the point of production to the GTP might qualify for such credits and deductions.

Based upon those facts, the question has arisen as to whether the FERC would require that rates for the GTP reflect the Alaska state tax benefits that the Sponsors received if such investments qualify for the deductions and credits. If the value of the tax credits and deductions is reflected in the tariff rates for the GTP (and upstream feeder lines), those rates will be lower than would otherwise be the case. In this context the tax benefits would be said to "flow through" to ratepayers. The alternative ratemaking approach would not reflect the tax benefits received by the Project Sponsors who would therefore be allowed to "keep" or "retain" those tax benefits.

DISCUSSION

As noted at the outset, I have been unable to find any binding FERC precedent that would categorically dictate whether Project Sponsors would be required to flow through the value of state tax benefits and deductions that arose through the Sponsors' construction of FERC-jurisdictional facilities. Consequently, I have attempted to analyze the question by analogy to other comparable circumstances

As you know, the FERC utilizes a cost of service methodology for setting pipeline rates and it is unlikely that this approach will change in the context of an Alaskan pipeline/GTP. Consequently, the ultimate question that the FERC asks is, "What did the facility cost?" Once the cost is determined, then rates can be derived. Application of this simple concept should result in the value of tax credits and deductions that are made possible as a result of the investment in the facility being flowed-through to ratepayers. The logic is simple--by spending the money to build the plant the Sponsors will have obtained quantifiable tax benefits. As a result, the net cost of the

facilities to the Sponsors will be reduced by those amounts. Since reflecting this reduced cost in rates would have the effect of reducing the tariff rates and thus benefiting ratepayers there is a compelling basis for FERC to require flow through.¹

In somewhat analogous circumstances the FERC recently issued a policy statement on the inclusion of an income tax allowance in rates for jurisdictional entities.² There the Commission concluded that it should permit an income tax allowance for all entities or individuals owning public utility assets, "*provided that an entity or individual has an actual or potential income tax liability to be paid on that income from those assets.*" (111 FERC ¶ 61,139 at P 32). The Commission required that any pass-through entity (such as a limited partnership or an LLC) that owns jurisdictional facilities and seeks an income tax allowance in a specific rate proceeding must establish that its partners or members have an actual or potential income tax obligation on the entity's public utility income. To the extent that any of the partners or members do not have such an actual or potential income tax obligation, the amount of any income tax allowance will be reduced to reflect the weighted income tax liability of the entity's partners or members.

This Policy Statement suggests that the FERC is very mindful of whether costs to be included in rates were or were not actually incurred by the jurisdictional entity. Applying that policy by analogy to the tax credits and deductions that Sponsors would receive for investing in the GTP under SB-305 suggests that the benefits would be flowed through to ratepayers whose gas is treated at the plant.

¹ It also bears noting that the FERC is generally opposed to requiring the bundling of services (and related costs). This means that one would expect that there will be a tariff for the GTP (and presumably the feeder lines) that is separate from the tariff for the pipeline facility. This allows shippers whose gas does not need treatment to bypass the plant and avoid the costs of that plant. In such case, obviously, those shippers who did not use the plant would not receive any of the tax benefits since they would not be paying the unbundled rates for the use of the GTP.

² *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 (2005).

Unfortunately, the Commission (with court approval) has not always subscribed to an "actual costs incurred" standard. In *City of Charlottesville, Virginia v. FERC*, 661 F.2d 945 (D.C. Cir. 1981)) the court noted that while ascertaining "actual" expenses is a desirable goal in ratemaking, "the complexities of accounting, business organization and tax laws often preclude finding any one 'actual' cost." (661 F. 2d at 953, n. 38).

The court noted that regulated entities typically use accelerated depreciation for tax purposes but use straight-line depreciation for rate purposes. This results in a higher tax for ratemaking purposes than is actually paid. This deviation from "actual taxes paid," the court noted, has been upheld on appeal (*Id.*).

In *City of Charlottesville* the court rejected on evidentiary grounds FERC's then-effective policy of allowing pipeline rates to reflect tax costs (at the subsidiary level) that were never actually paid because, at the parent company level, profits from the pipeline subsidiary were offset by losses from exploration and production subsidiaries. This policy had been defended on the ground that the shortage of natural gas supported ratepayers paying tax costs that were never actually incurred.³

Thus, one cannot rely entirely on the simple logic that FERC will always require tax benefits to be flowed through to ratepayers. Moreover, additional arguments could be advanced by the Project Sponsors that would allow them to retain the tax benefits. For example, the Sponsors could argue that the tax benefits that they received under SB-305 related to their tax liability as oil and gas producers—not as owners/operators of the GTP. I have not had the opportunity to research

³ Technically, FERC had allowed pipeline rates to reflect the computed tax liability associated with the profits of the jurisdictional pipeline subsidiary even though taxes were actually paid on a corporate-wide (so-called "consolidated") basis and the parent company was able to use losses and tax deductions attributed to the exploration and production subsidiaries to reduce or eliminate millions of dollars of tax liabilities that were computed on the so-called "stand-alone" basis.

the merits of this claim but it would appear to have some validity insofar as FERC's jurisdiction over the owners as gas producers is extremely limited.

In addition, the Sponsors could argue that the tax credits and deductions that they received were provided in order to encourage investment in infrastructure projects in Alaska. As such, the argument could be made that flowing through those benefits would defeat the policy of encouraging investment by giving all the benefits to the ratepayers rather than the investors.

In this context it is notable that in 1971 Congress enacted tax legislation that made investment tax credits available to many industries, including gas pipelines. In that legislation Congress established ratemaking guidelines that allowed taxpayers in certain industries to retain the tax credits so long as certain findings of supply shortages could be made by regulators. The Federal Power Commission made such a "short supply" finding with respect to natural gas in 1972.⁴ This finding allowed gas pipeline companies to retain 100% of the investment tax credits. The short supply finding was ultimately rescinded by the FERC in 1985 (*Order No. 440, FERC Statutes and Regulations, Regulations Preambles—1982-85* ¶ 30,674 (1985)).

While the treatment of federal investment tax credits pursuant to the 1971 legislation is clearly not binding precedent in the context of Alaskan net profits tax credits and deductions, it does lend support to the argument that flow-through of such benefits could thwart public policy encouraging investment in new projects.

This argument is somewhat strengthened by the fact that it arises in the context of an Alaskan pipeline project. FERC has evidenced a willingness to adopt policies and practices with

⁴ Order No 448, 47 FPC 141 (1972)

respect to an Alaskan pipeline that differ from those they would apply to Lower-48 pipelines.⁵ As such, Project Sponsors might be able to persuade the FERC that the unique importance of the Alaskan pipeline project requires that FERC depart from policies that might be thought to discourage the development of the project. If sustained by the FERC such argument would allow the Project Sponsors to retain the value of the State tax credits and deductions.

CONCLUSION

I have not found any clearly binding precedent that answers the question you posed. However, since FERC bases rates on the costs incurred to provide the services, the fact that Project Sponsors received quantifiable state tax credits and deductions as a direct result of investing in a GTP suggests that FERC would be inclined to require that those benefits be flowed through to shippers who make use of the GTP. This would be the result I would expect.

However, as noted above, in the absence of binding precedent on the issue, there are arguments that Sponsors could make that might allow them to retain any net profits tax benefits that result from their investment in the GTP. The fact that the GTP is an essential element of the unique Alaskan pipeline project makes it particularly difficult to predict FERC's final action.

Under the circumstances, I am unable to give you a categorical answer to your question. While I believe FERC would be most likely to require flow-through of state tax benefits, I have to state that the result is simply uncertain.

Please feel free to contact me if you have further questions on this issue or want me to pursue it in more depth than has been possible given the present time constraints.

⁵ For instance, in Order Nos. 2005 and 2005-A the FERC departed from its generally applicable policy requiring incremental pricing on pipeline expansions that would raise the cost for existing shippers and adopted a policy favoring rolled-in treatment of voluntary expansions of an Alaskan pipeline.



Official Business

Alaska State Senate

Senate Finance Committee

Mail Stop 3100
State Capitol
Juneau, Alaska 99801-1182

AGENDA

Tuesday, April 4, 2006

9:00 a.m.

SB 305-OIL AND GAS PRODUCTION TAX

Bills previously heard/scheduled

Angus Aja Walker, ^{Commercial} VP
Tom Williams, Sen Tax Counsel

Sen. G Stevens

TESTIMONY OF RICHARD OWEN
ON PROPOSED CSSB305 TO THE SENATE FINANCE COMMITTEE

April 4, 2006

Madam Chair, Members of the Committee:

Good afternoon. My name is Richard Owen, and I am the Production Manager for ExxonMobil in Alaska and Vice President of ExxonMobil Alaska Production.

I am here today to discuss ExxonMobil's concerns with the Committee Substitute to SB 305. Before I go into our specific concerns, I would like to take a few minutes to describe ExxonMobil's history in Alaska, how tax systems impact investments, and our assessment of the remaining resource potential on Alaska's North Slope.

ExxonMobil has had a presence in Alaska for over a half century, investing more than 11 billion dollars in the State's economy. Currently, ExxonMobil has working interests in Prudhoe Bay, Kuparuk, Erdicott, and Granite Point. We are the operator of the Point Thomson Unit, and we are the largest interest holder in the Prudhoe Bay field. Our current working interest oil production is approximately 180,000 B/D (*Note: EMWI 159,000 EMNI*), and we are the largest owner of discovered gas resource. We are proud of the role our company has played in Alaska through: exploration; initial field developments; construction of TAPS; development of new technology; and the promotion of efficient reservoir management practices. Today, our production from Alaska represents approximately 4% of ExxonMobil's worldwide oil and gas production.

Our Alaska production is primarily from Prudhoe Bay and near-by satellite fields. Prudhoe Bay, along with Point Thomson, has significant remaining potential, but it comes at higher cost and risk.

One of ExxonMobil's objectives – in both the gas pipeline fiscal contract negotiation and the discussion on oil taxes – has been to reduce the risk associated with fiscal changes by working with the State of Alaska to establish a predictable and durable fiscal environment in which to make long term investment decisions. Changes in the fiscal regime for oil directly impact how we view the stability of the Alaska fiscal environment, which in turn, impacts how we evaluate ongoing investment decisions. Tax systems need to be carefully designed to ensure the desired objective of resource development is achieved. To that end, it is critical to take into account the quality of the remaining resource otherwise a change may result in unintended consequences, such as reduced investments and lower reserve recovery.

When I say quality of resource, I mean: the size and nature of the oil and gas reservoirs; the cost and technology required to develop those reservoirs; the distance to market; as well as the tax and royalty system that applies, including the long-term stability of that system. Countries experiencing significant industry investment have achieved the proper balance in their fiscal regimes. ExxonMobil's assessment of the remaining oil resource suggests future growth opportunities will come from: complex enhanced oil recovery (EOR) projects; development of smaller, more marginal oil accumulations; and the innovative development of viscous and heavy oil resources. These opportunities will require the development and application of new technology, higher unit development

costs, and more complex operations to deliver a given production rate. These resources are much lower in quality as compared to Prudhoe Bay and Kuparuk, though they face the similar challenges associated with arctic conditions and distance to market.

Therefore, we are concerned the Administration's original proposal is weighted towards a higher tax which could prevent some of Alaska's challenged resources from being developed. The Committee Substitute contains even higher tax rates, which may prevent more of these challenged resources from being developed.

On February 28, I testified before the Senate Resources Committee about our key concerns with SB 305 as originally proposed. On March 18, I testified again before the Senate Resources Committee about how the proposed changes incorporated in the Committee Substitute bill exacerbate our concerns. I do not intend to cover all of my previous testimony, but I will provide comments on these areas: the increase of the base tax rate and addition of a progressive tax rate component; the Committee Substitute's transition provisions; and the elimination of royalty settlement agreements as a determination of market value.

SB 305, as originally proposed, would represent a significant tax increase on the industry. And as I just outlined, we are concerned the higher tax rate could prevent some of Alaska's remaining challenged resources from being developed. The Committee Substitute bill increases the already high base tax rate to 25% and then further increases it as oil prices increase.

Higher tax rates discourage investment. Companies are willing to accept the risks of long-term, capital intensive investments when there is a corresponding opportunity for upside potential through a variety of factors, such as increased production or higher prices. When you limit or reduce the benefit Companies can achieve from the upside factors, you reduce the attractiveness of those investment opportunities. The proposal to increase the already high base tax rate and then further increase it as oil prices increase, reduces or limits the upside potential which will result in Companies recalibrating investment decisions. Reduced investment will result in reduced resource recovery, diminished state revenues, and fewer employment opportunities, with a resultant negative impact on the state's economy. Again, let me reemphasize this point. While higher taxes may bring in additional revenues in the short-term, any reduction in investment and subsequent production will significantly impact those revenues in the longer term. We think the focus of the tax bill should be encouraging investment and growing production, which is not accomplished with the higher tax rate and increasing the tax rate with oil price.

I would now like to discuss the Committee Substitute's transition provisions. The benefits from a typical oil and gas investment take many years to be realized. Satellite and tertiary recovery investment decisions by our Company during the last five years were made under the ELF structure, anticipating a lower tax relative to that proposed under the PPT bill. The State appropriately provided this incentive so these challenged and costly projects could be commercially viable. SB 305, as originally proposed, recognized it is not appropriate to suddenly increase taxes on these prior investments without providing some form of consideration. The Senate Resources Committee

included transition provisions in the Committee Substitute bill, but proposed a deduction based on recent investments with the pace of the deductions linked to future spending. As I stated, the purpose of the transition provision is to address the sudden increase in taxes on recent historical investments. Future investment decisions will be made under the new tax system based on the balance between the new tax rate and the credit rate. For this reason, we think the Administration's proposal of providing a deduction based on recent investments, not linked to future spending, is more appropriate.

Finally, I would like to express our disappointment that the provision allowing the use of a producer's royalty settlement agreement to determine the value of oil and gas has been removed from the Committee Substitute bill. That provision addressed a longstanding issue that has divided the State and the industry over the years. Too many years and too much money have been spent in disputes over how to value a single barrel of crude oil or a single molecule of gas. It made little sense in the past and it makes little sense today for the State to have separate divisions determining the value of oil and gas – one for royalty and one for taxes. There is only one value in the market place. SB 305, as originally proposed, allowed the State to value a producer's oil and gas using the producer's royalty settlement agreement, which was negotiated with, and approved by, the Department of Natural Resources. That provision was important to industry as it provided certainty to a producer on the value on which to pay its royalty and production taxes while reducing the administrative and audit costs to both the State and the industry. We urge this committee to reinstate that provision.

In summary, the quality of the resources, the risks undertaken by a producer, and the impact on the State's overall investment climate must be factored into the design of the tax system. While industry needs predictably and durability under which to gauge investment decisions, the attractiveness of that predictably and durability is lost if it comes at too high a cost.

Despite our concerns with the original SB 305, we are prepared to move forward under that system as originally proposed, since it sought to provide a balance of revenues to the state and producers across a range of oil prices, provided sufficient incentive for producers to undertake exploration and development risks, and included reasonable transition provisions for past investments. And, most importantly for ExxonMobil, oil fiscal contract terms consistent with the Administration's proposal would provide the predictability and durability necessary to advance the gas project to the next phase. Potential changes to the Administration's PPT bill should be carefully considered to avoid upsetting the balance contained in the bill – changes would require a reexamination to ensure the underlying health and stability of the oil business is sufficient for a gas pipeline project.

As I mentioned, the proposed Committee Substitute exacerbates our key concerns regarding both tax rates and certainty. For these reasons and the need to move ahead with the review of the Gas Pipeline Fiscal Contract, we urge this Committee to support SB 305 as originally proposed.

Thank you again Madam Chair for the opportunity to testify today.

BP Presentation on CSSB 305 (PPT)

**Alaska State Legislature
Senate Finance Committee
4th April 2006**

For the record, I am Steve Marshall, President of BP Exploration Alaska. I appreciate the opportunity to provide my point of view regarding SB305.

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 CSSB 305 (PPT)

Alaska State Legislature
Senate Finance Committee
4th April 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 Senate Bill 305.

I will summarize the key issues raised in previous testimony and provide our view of the substantive changes made by the Senate Resources Committee to SB 305.

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
	Produced	15
	Known Remaining	17.5
	Developed	
	- Light	3.5
	- Viscous	0.3
	Undeveloped	
	- Light	4
	- Viscous	0.7
	- Heavy	3
	- Gas	6
	Yet to Find (Exploration)	5

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.

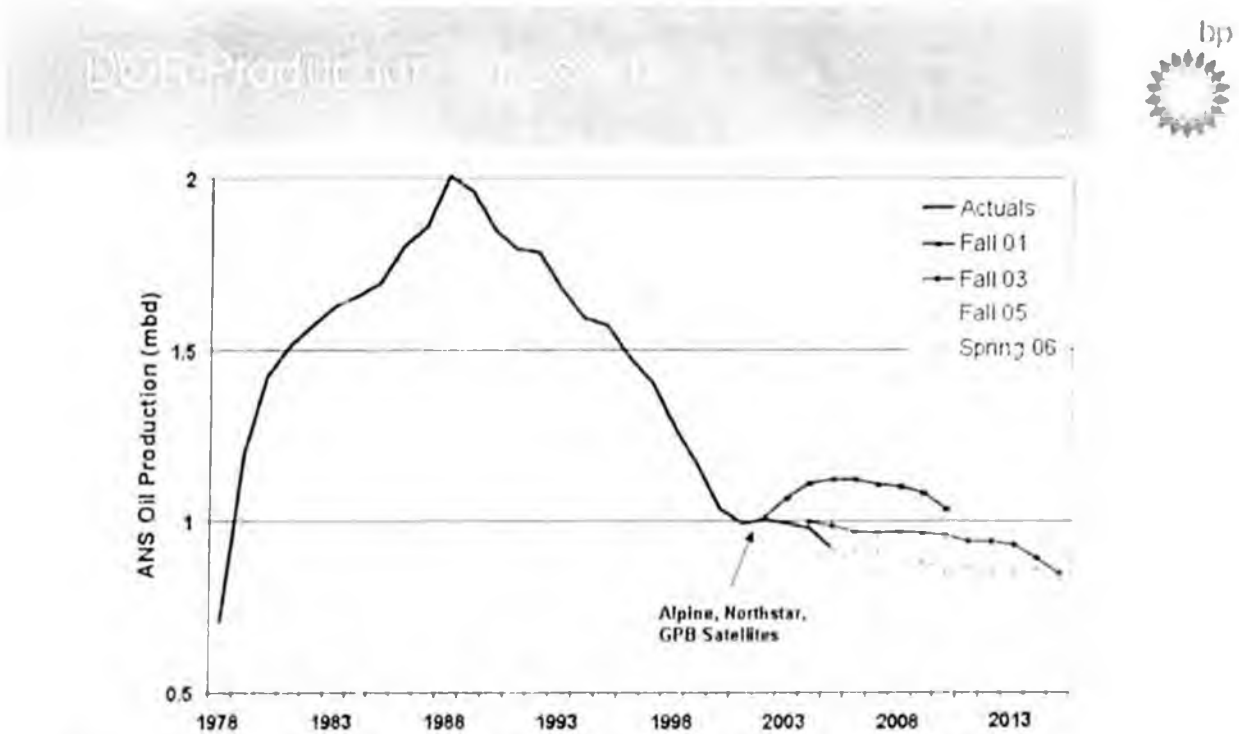
One example is that we're spending in excess of \$100 million implementing innovative technology to increase recovery at Endicott. If we are successful at Endicott it could add hundreds of millions of barrels of production across the North Slope. (Another Alpine?)

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.

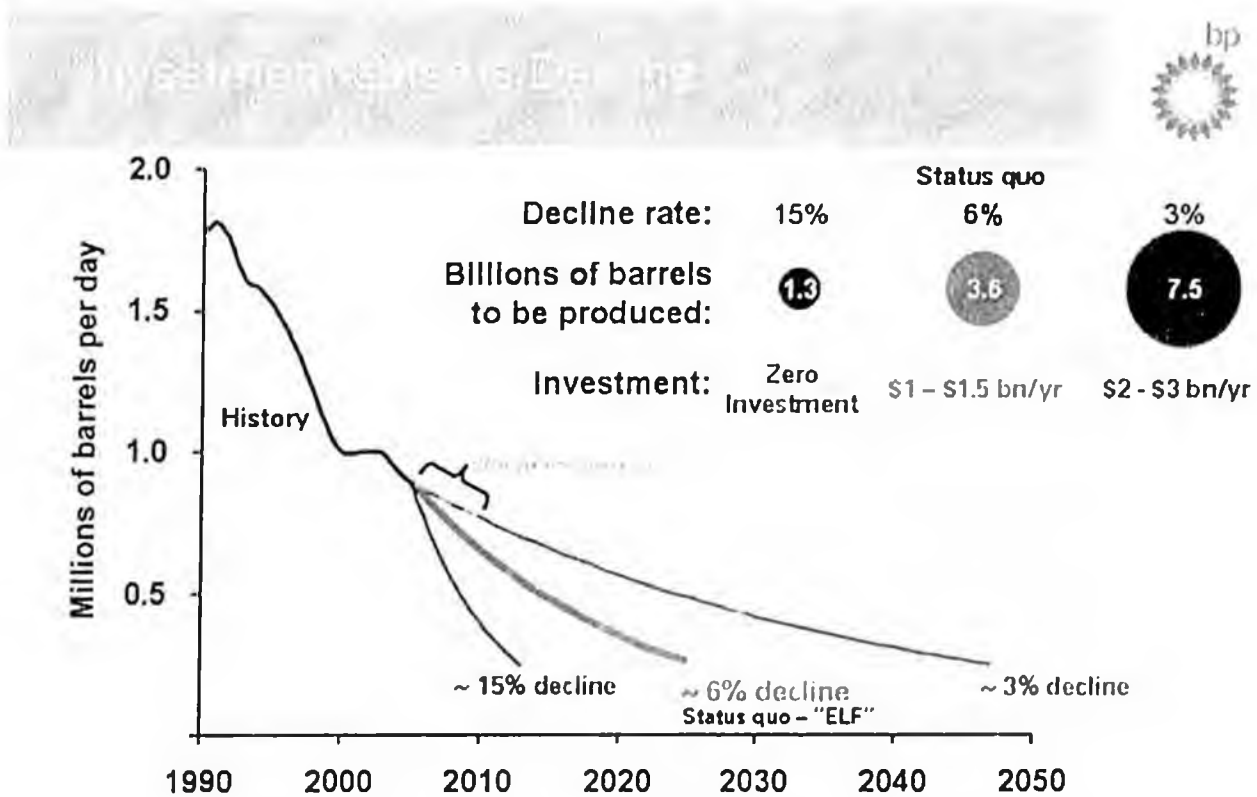


- Historical basin decline has been around 6%
- Flattening of production from 2002-2004 due to Alpine & Northstar
- Decline since 2004 has mirrored historical basin decline

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.

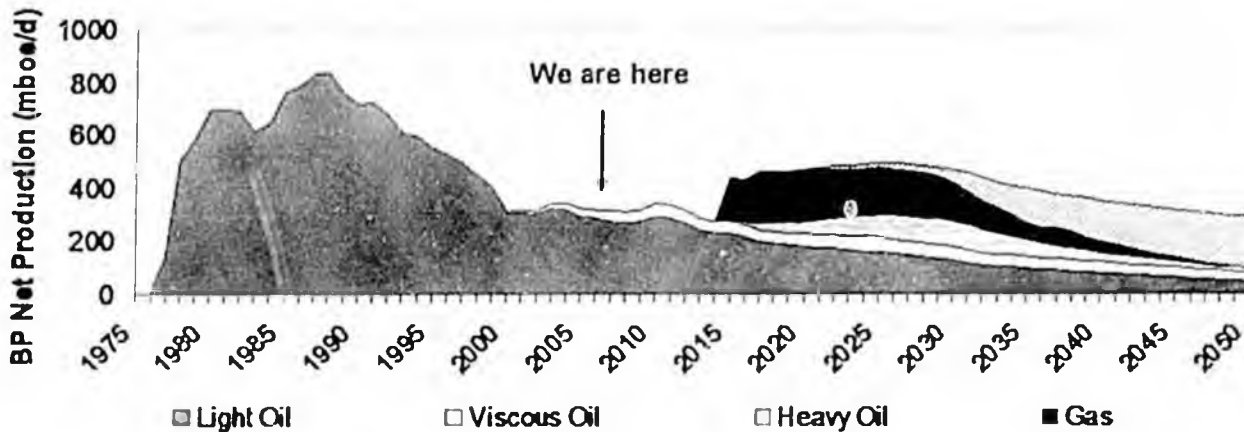
However, the 3% decline cannot be met without significant additional investment, in the order of 2 to 3 billion dollars per year. Unless those investments are made, history will repeat itself, decline will continue at the current rate, and the DOR will be revising its production forecast down yet again.

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.

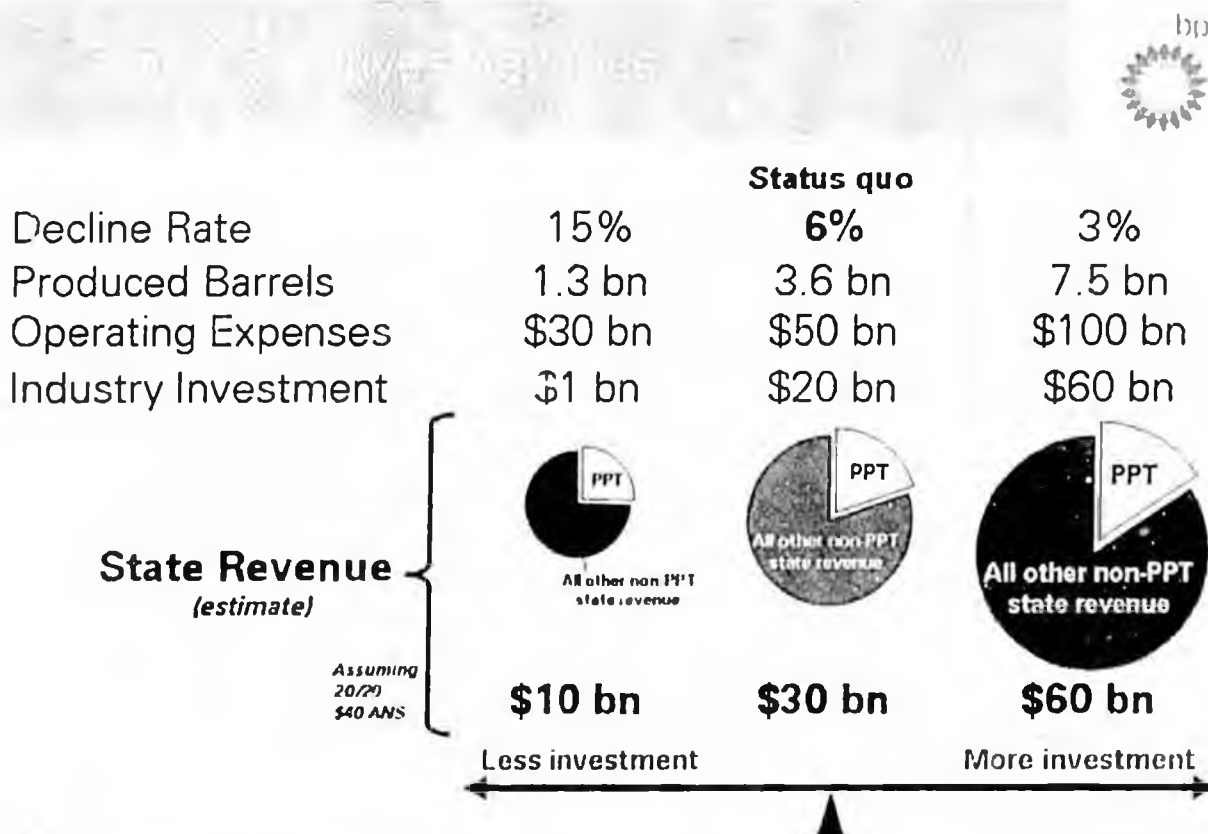
We have plans to invest \$14 billion over the next 10 years in our Alaska business.

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

Maximizing Production will maximize State Revenue

The tax regime you approve will directly impact how attractive Alaska is for investment and that will translate into what the future decline will be. It is in the interest of all (industry and Alaska) that we focus on growing the pie rather than increasing state take from a declining pie.

The following shows how growing the pie by incentivizing investment is in the best interest of the state over the long term.



Maximizing State Revenue means maximizing Production

The highest state revenue is derived from the scenario which delivers the greatest production regardless of what severance tax (PPT) you collect. You could collect zero severance tax (PPT) and this would be a better outcome for the State than one where you collect a high severance tax (PPT) and have less resource development.

It should also be noted that this analysis does not attempt to quantify the ripple effect on the state economy of a vibrant oil and gas business. Needless to say if the total impact on Alaska's economy, including direct & indirect employment, wages etc., were taken into account the impact of getting it right would be staggering. This is a matter of the utmost importance for Alaska's future.

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!

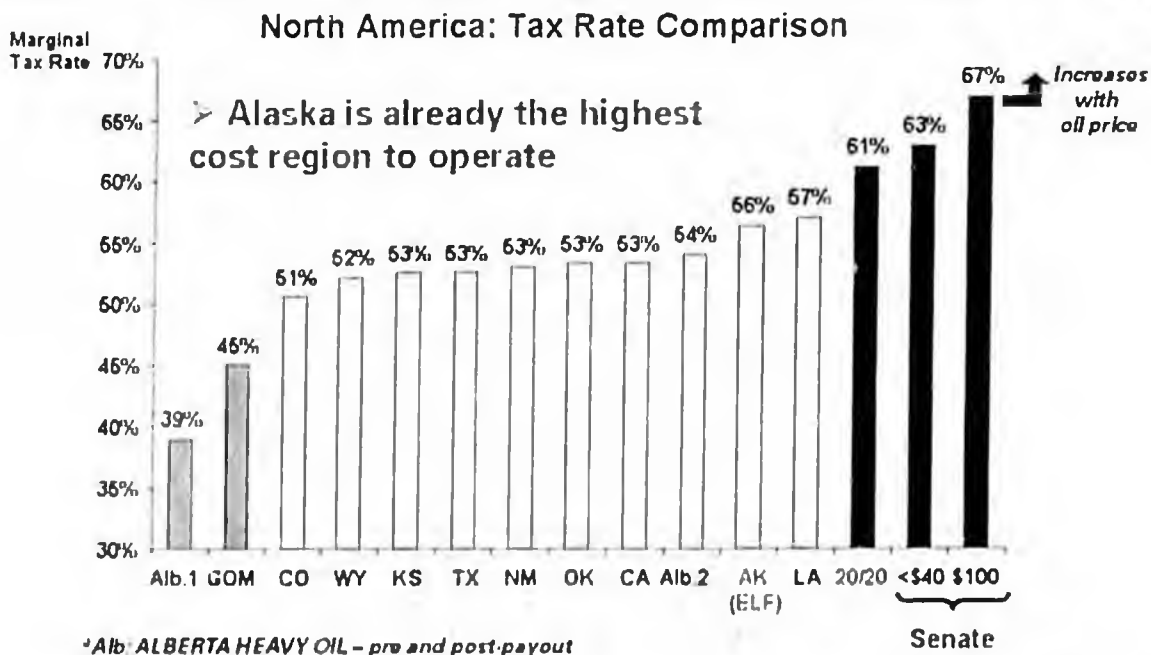
The good news for Alaska is that there is a huge known resource base on the North Slope.

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 25/20 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 Senate Resources CS.



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:—



“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% FRT 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%

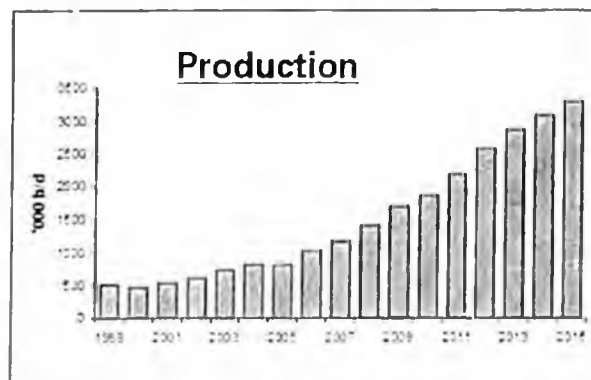
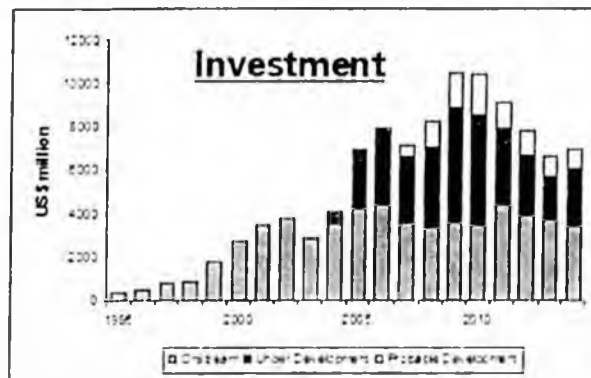
Marginal tax rates

- 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.

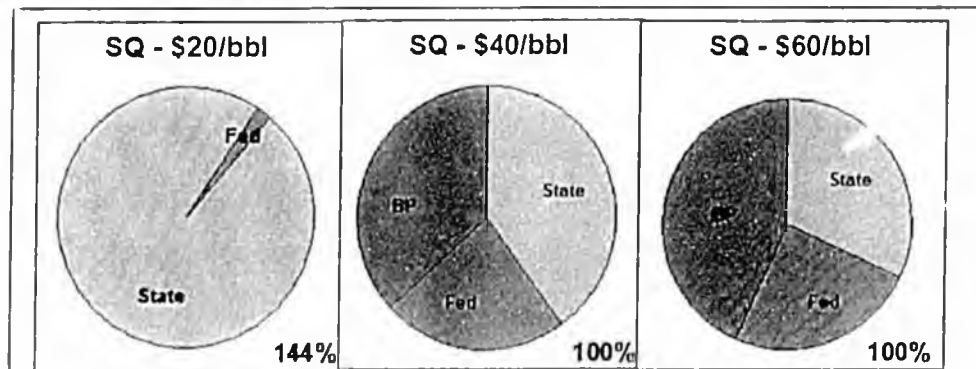
PPT Impacts & Government Take

This chart shows the total Government take at different oil prices for the current Elf based system and PPT.

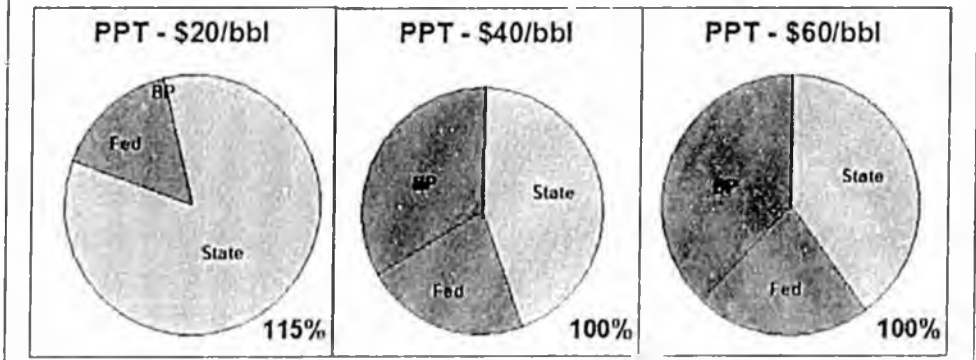
Also note that BP does not make a profit at low oil prices under either regime but the state still receives revenues from the oil industry.



Status Quo



PPT
(20-20)



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

The current version of SB 305 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 increase of the base tax rate to 25% will be a serious barrier to investment
2. The proposed progressivity in the tax rate combined with the significant base rate increase in moving from EIT to PPT (25/20) 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
3. 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. There is no recognition of inflation and thus tax rates will effectively increase with time making the system unsustainable
4. Transition provisions demonstrate to investors that they do not have to bear the full risk of retroactive tax increases. Failure to provide for the full transition without the two-for-one condition will harm the State's reputation with investors.
5. 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.
6. 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.



- 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(25% is even worse!)
- 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 SB 305, 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.

SB 305 (CS) Testimony

ConocoPhillips Alaska
April 5, 2006

Slide 1

ConocoPhillips

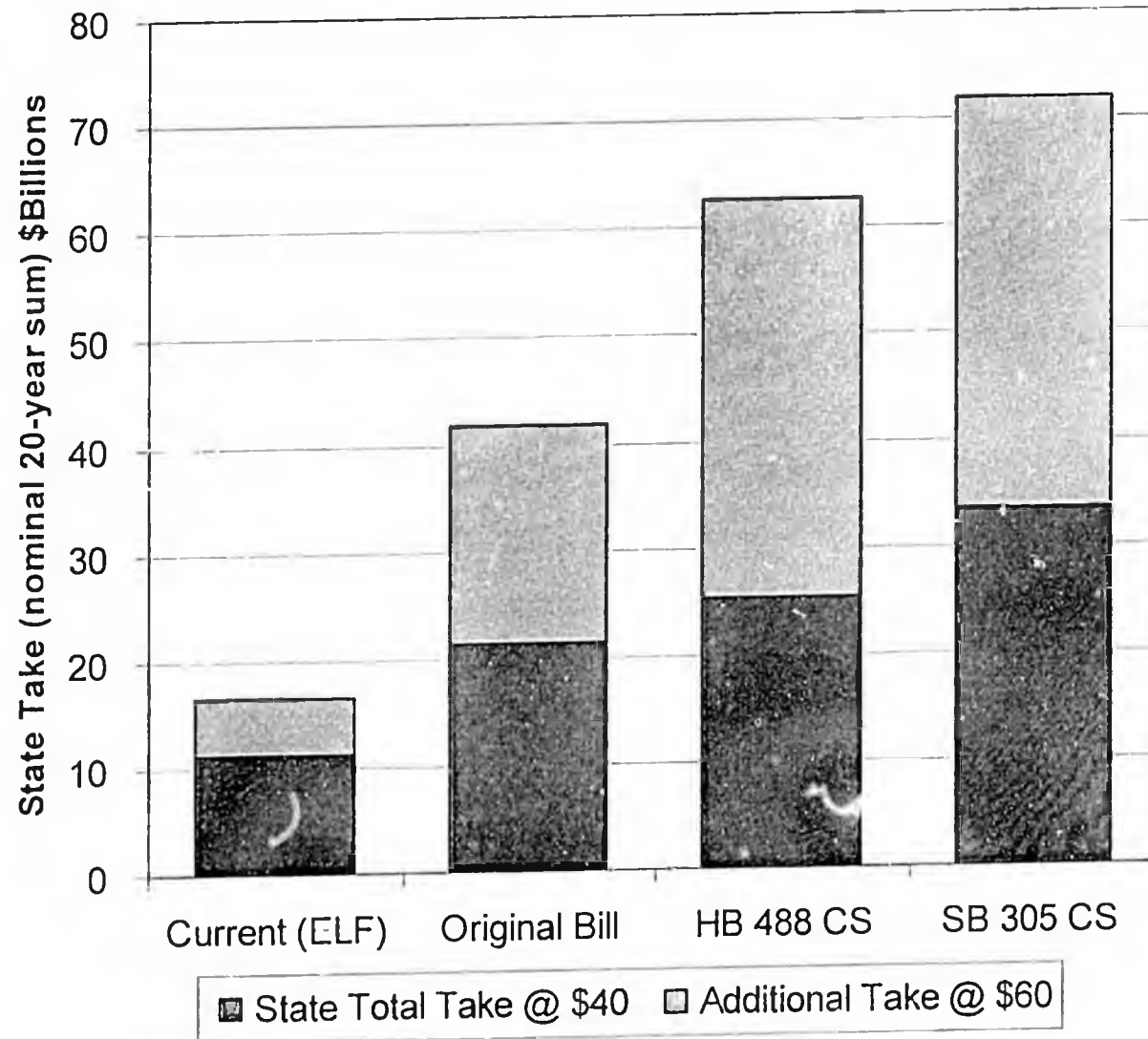
4/5/06

Jim Bowles
President
ConocoPhillips Alaska

Marianne Kah
Chief Economist
ConocoPhillips

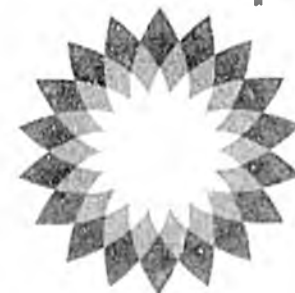
David Bramley
CRA International

Projected Production Tax Revenues



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9:11:18 AM

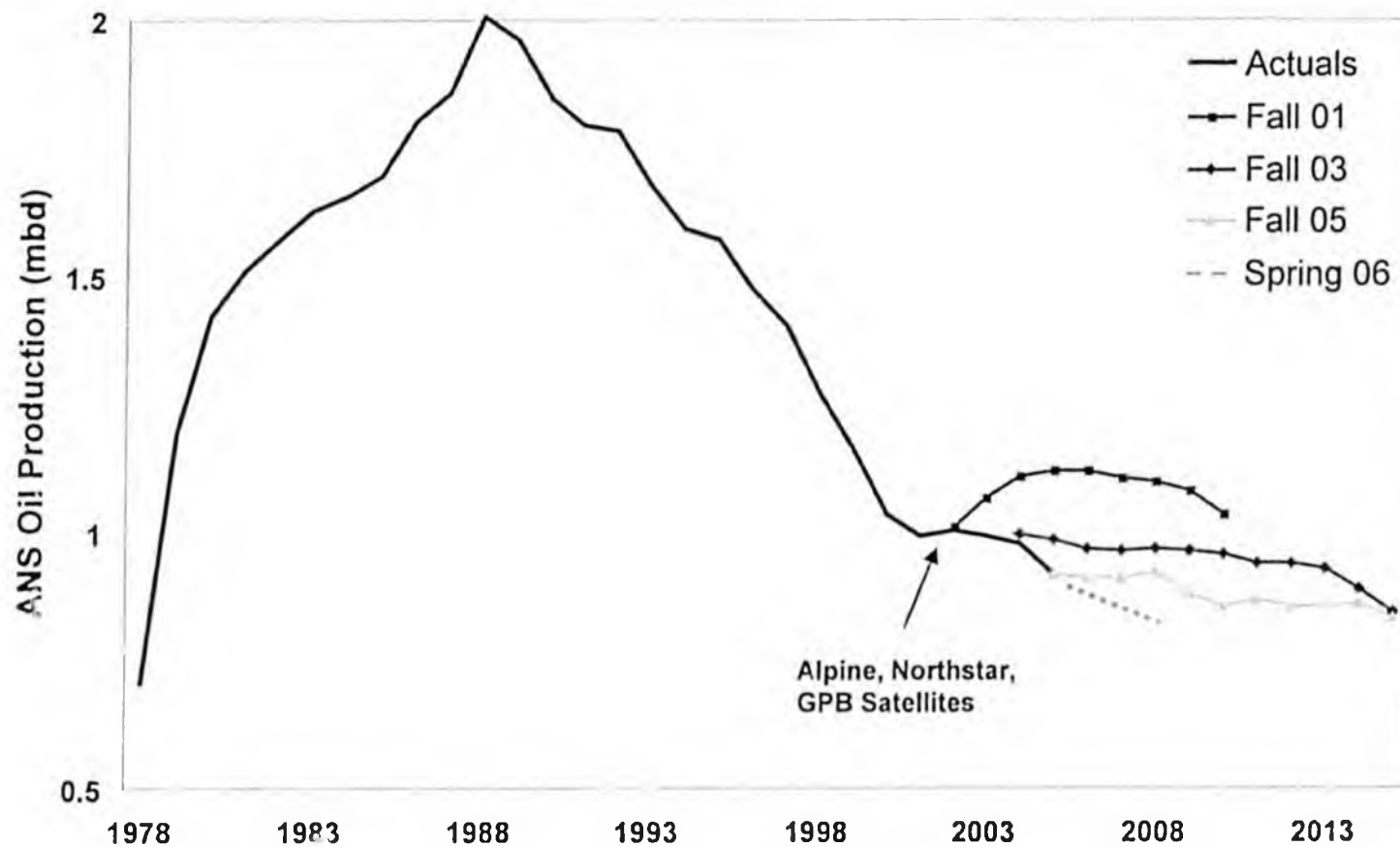
bp



Juneau

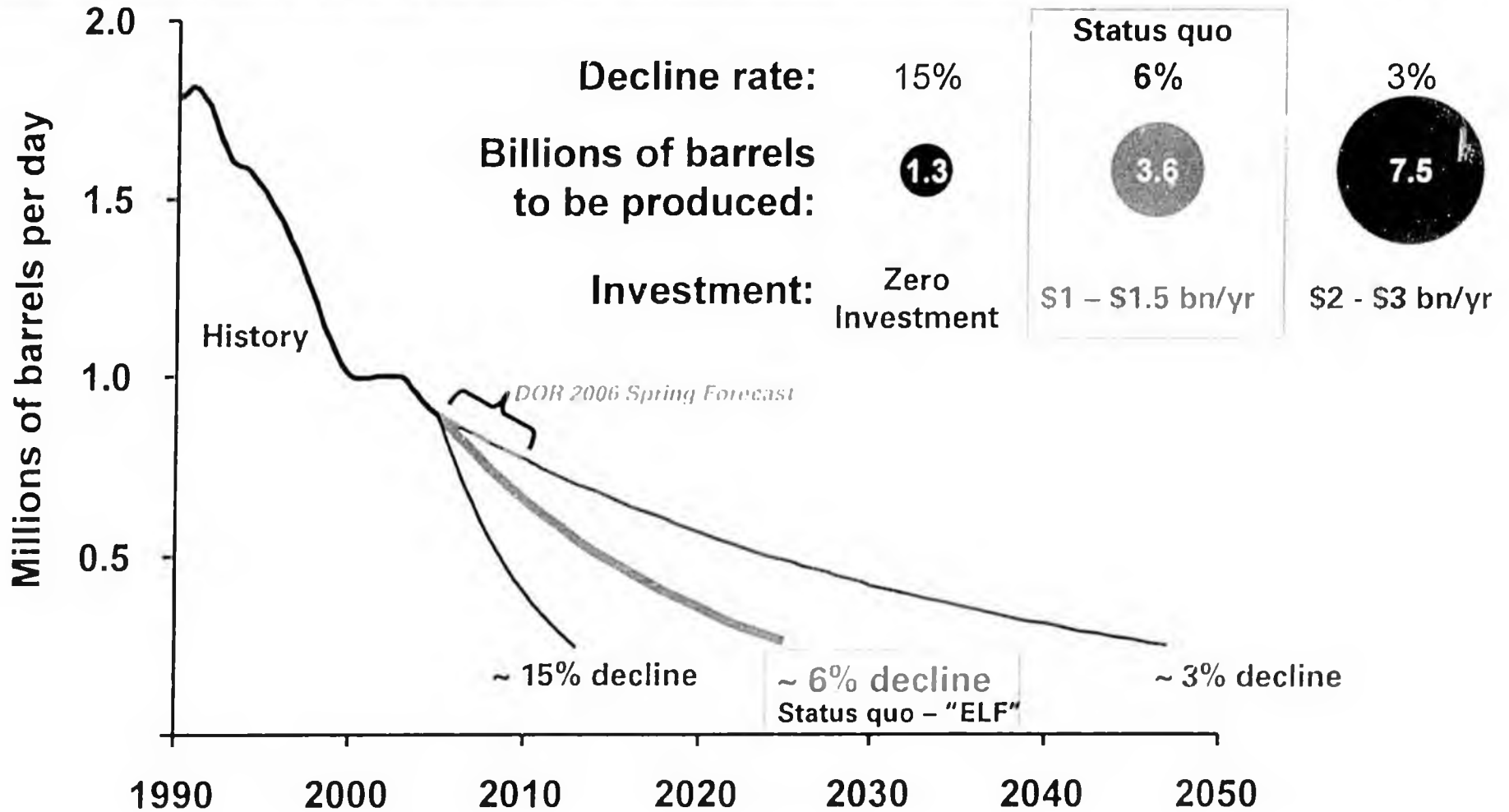
04 April 2006

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

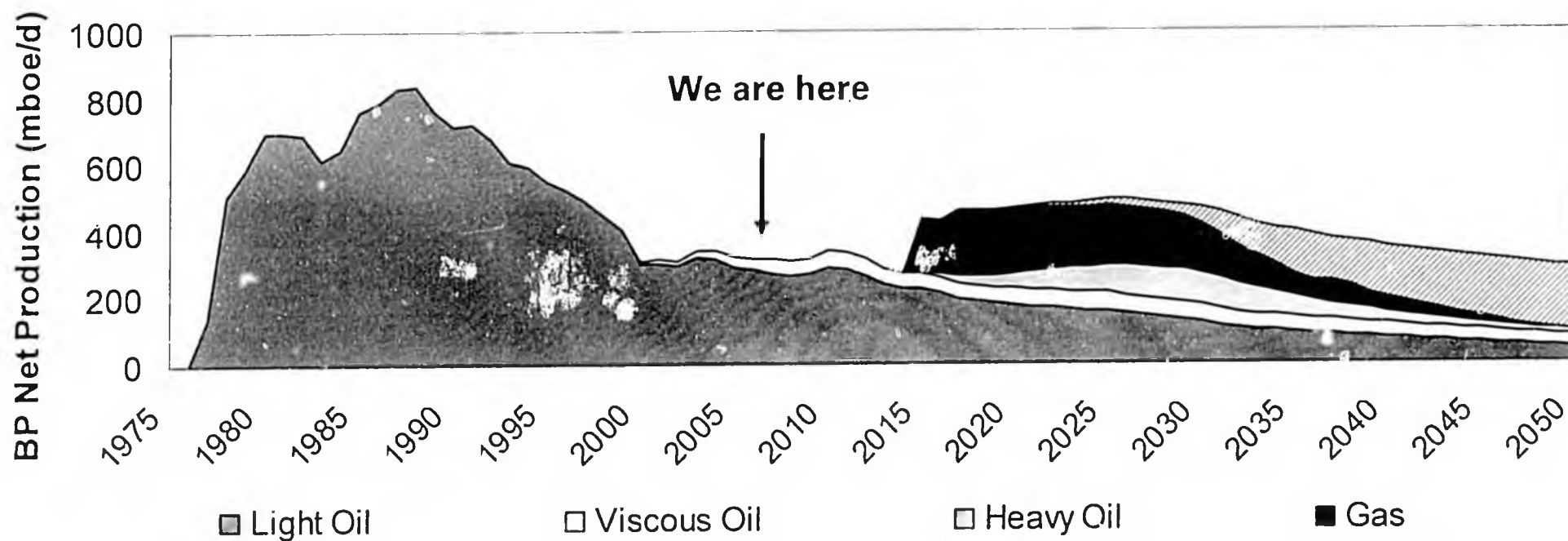
Investment Offsets Decline



***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%	Status quo 6%	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

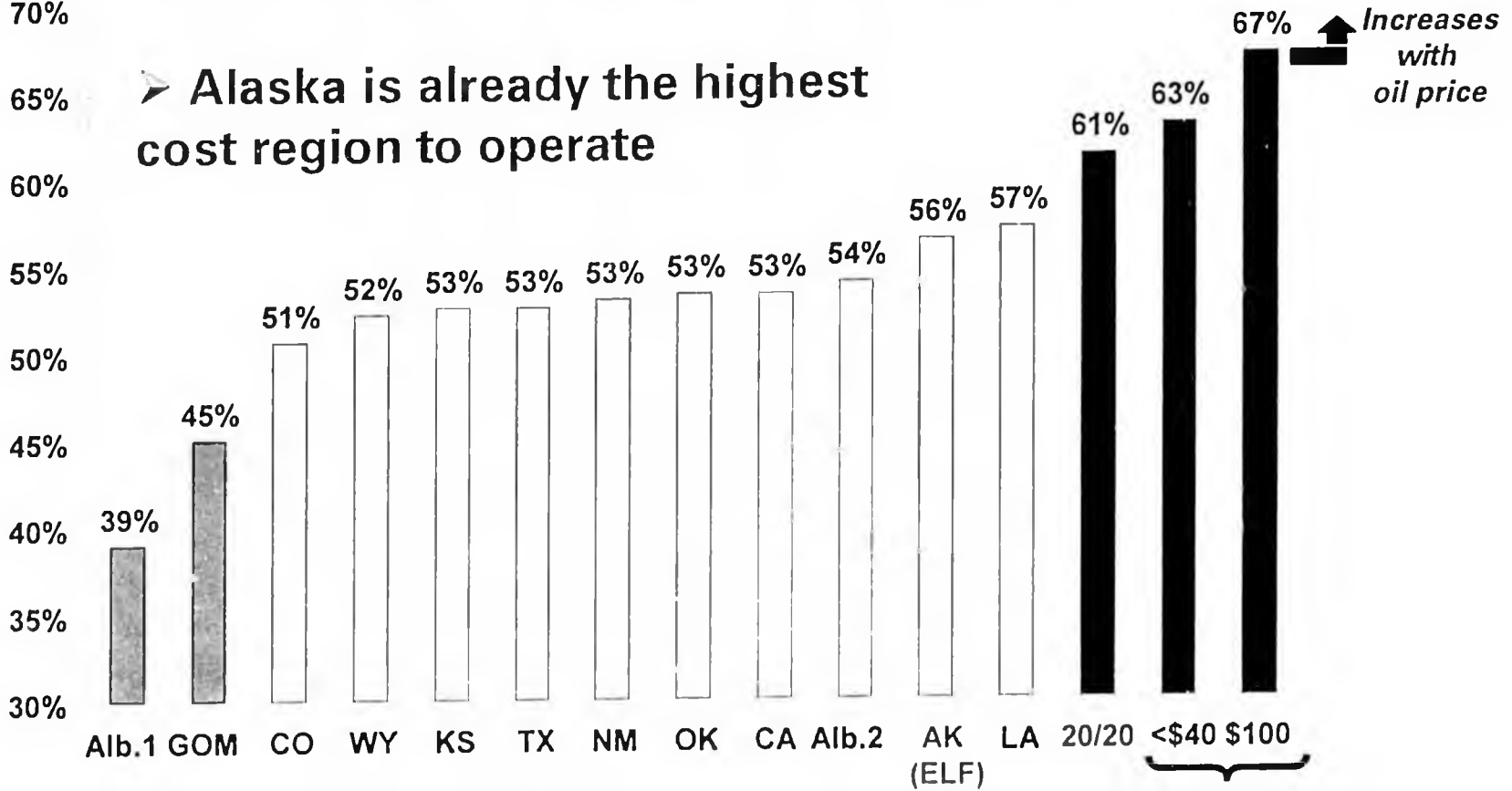
Maximizing State Revenue means maximizing Production

US Marginal Tax Rates



North America: Tax Rate Comparison

Marginal Tax Rate 70%



➤ Alaska is already the highest cost region to operate

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

BP data

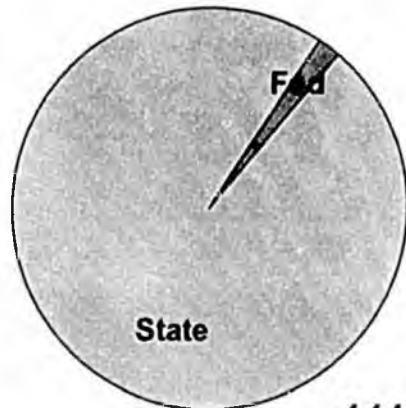
Alaska will have the highest marginal tax rate

PPT Impacts Government Take (%)



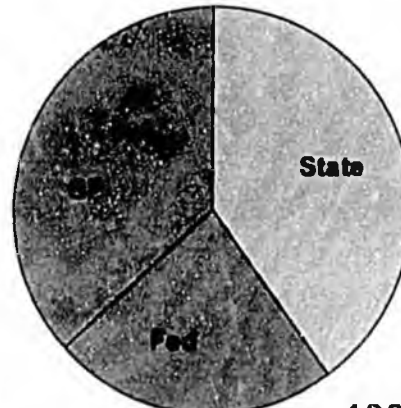
Status Quo

SQ - \$20/bbl



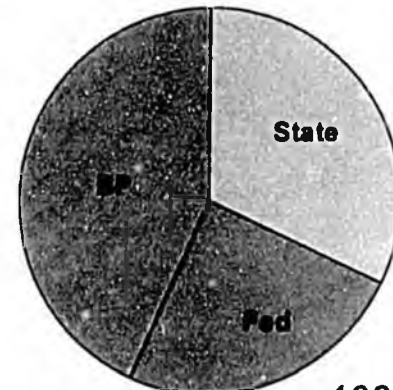
144%

SQ - \$40/bbl



100%

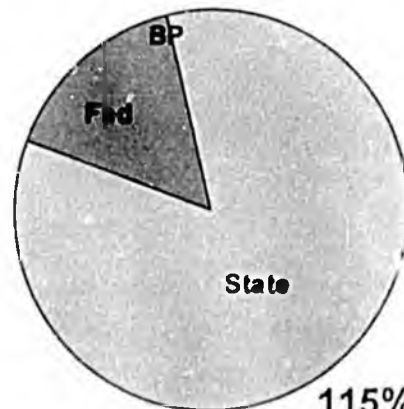
SQ - \$60/bbl



100%

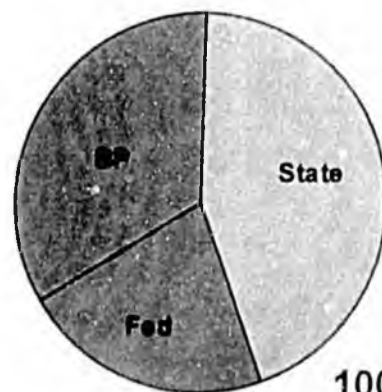
PPT
(20-20)

PPT - \$20/bbl



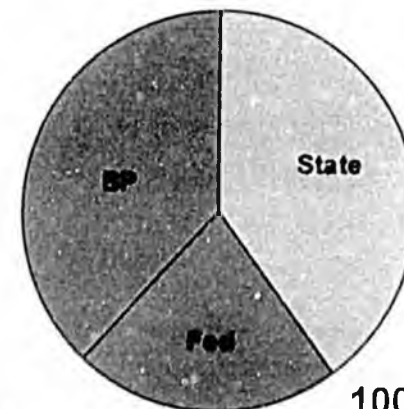
115%

PPT - \$40/bbl



100%

PPT - \$60/bbl



100%

CSSB 305: Key Issues



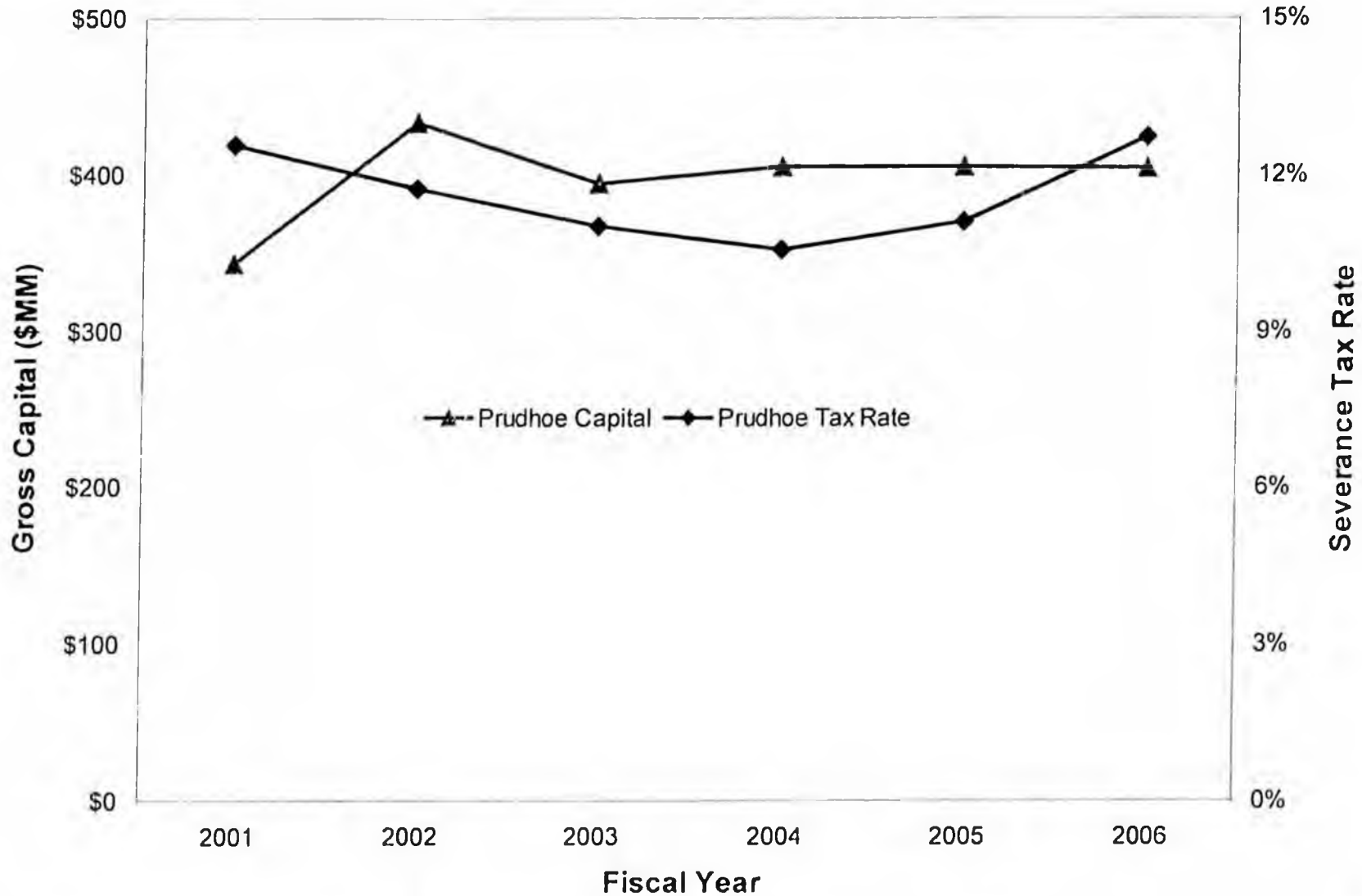
- The increase of the base tax rate to 25% will be a serious barrier to investment
- The proposed progressivity in the tax rate combined with the significant base rate increase in moving from Elf to PPT (25/20) is inappropriate given Alaska's circumstances
- Several of the newly introduced terms are unbalanced and will cause problems
- Failure to provide for the full transition will harm the State's reputation with investors
- The current version of the Bill adds significant complexity to one of the most complex fiscal regimes in the world
- We do not believe this Bill as drafted achieves the mutual goal of increasing investment & stemming decline

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(25% is even worse!)
- 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

Prudhoe Gross Capital Spend vs. Severance Tax Rate

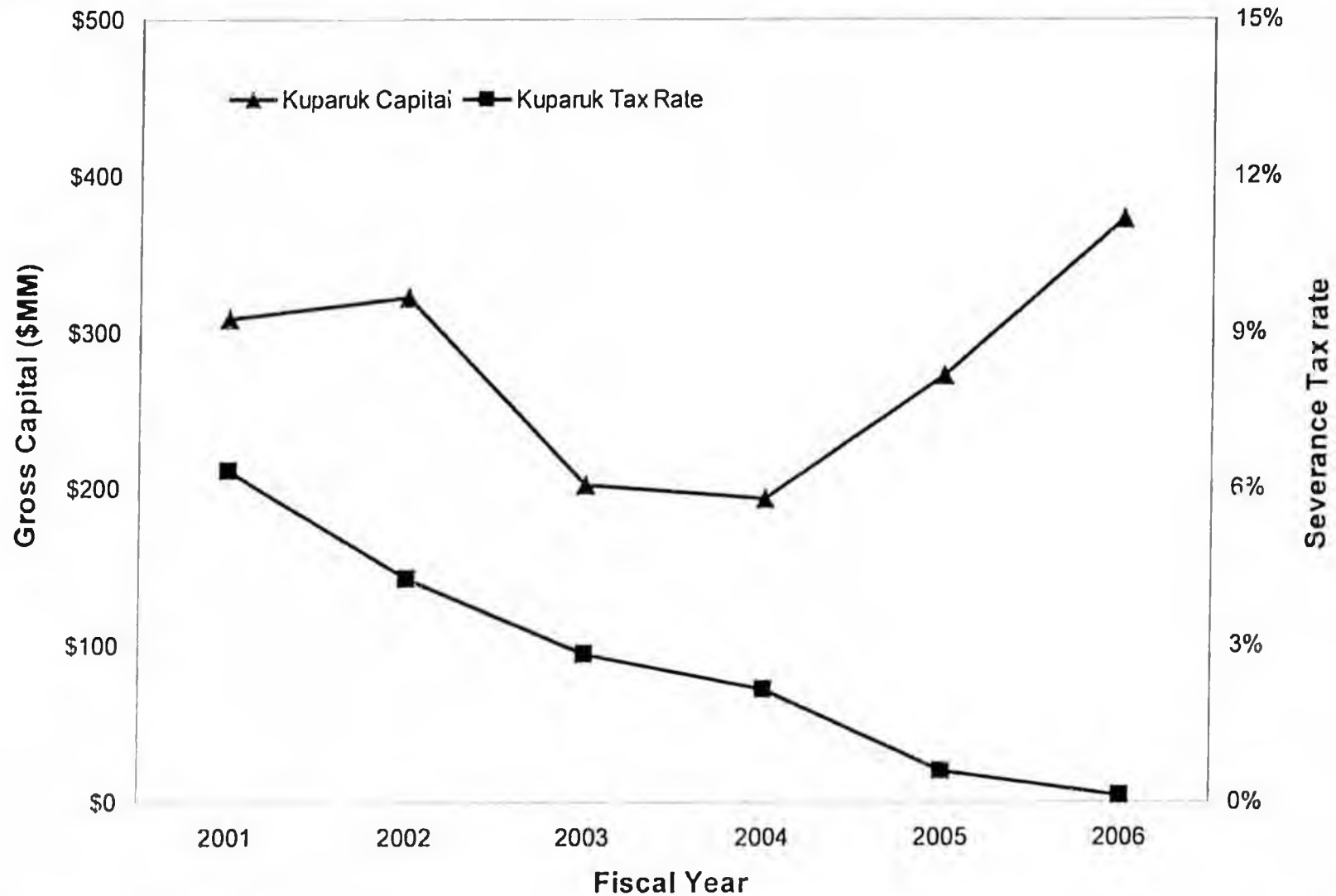


Note: Capital converted from calendar to fiscal year assuming capital spend equal in each half of year

(Note: the graph lines on this chart were inadvertently reversed. See S.T. 10:24 AM)

4/5/06
9:13:24 AM
2 10:24 AM

Kuparuk Gross Capital Spend vs. Severance Tax Rate



Note: Capital converted from calendar to fiscal year assuming capital spend equal in each half of year

9:15:02AM
4/5/06

ConocoPhillips Alaska



Alaska's No. 1 Oil Producer

Alaska's No. 1 Gas Producer

Alaska's No. 1 Explorer

Largest Owner of State & Federal Leases

Largest Industry Community Supporter

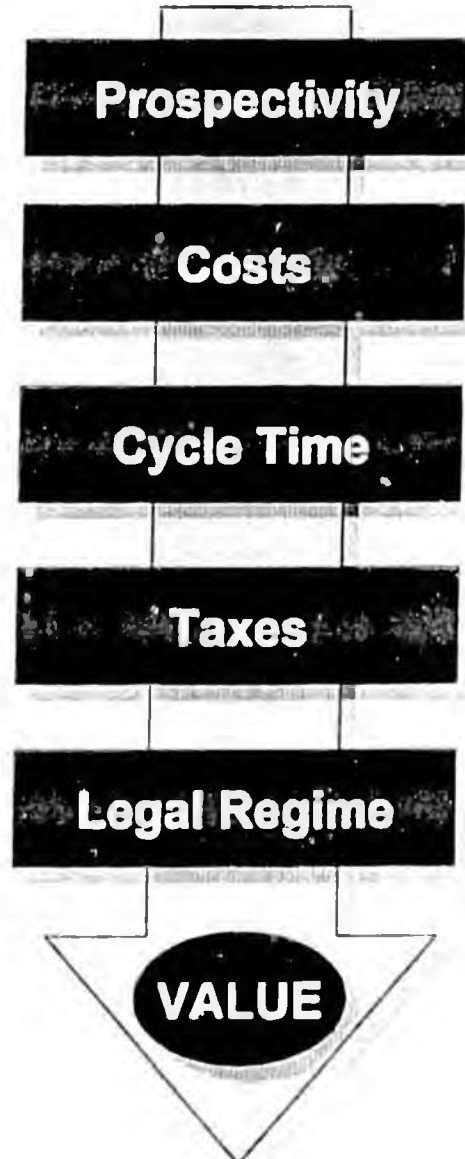
Largest Royalty and Tax Payer

Key Employer

David Bramley
CRA International

Marianne Kah
ConocoPhillips Chief Economist

Investment Criteria



Prospectivity

- Expected field size / maturity
- Crude quality

Costs

- Exploration, development & production cost
- Transportation costs to market

Cycle Time

- Time to production

Taxes

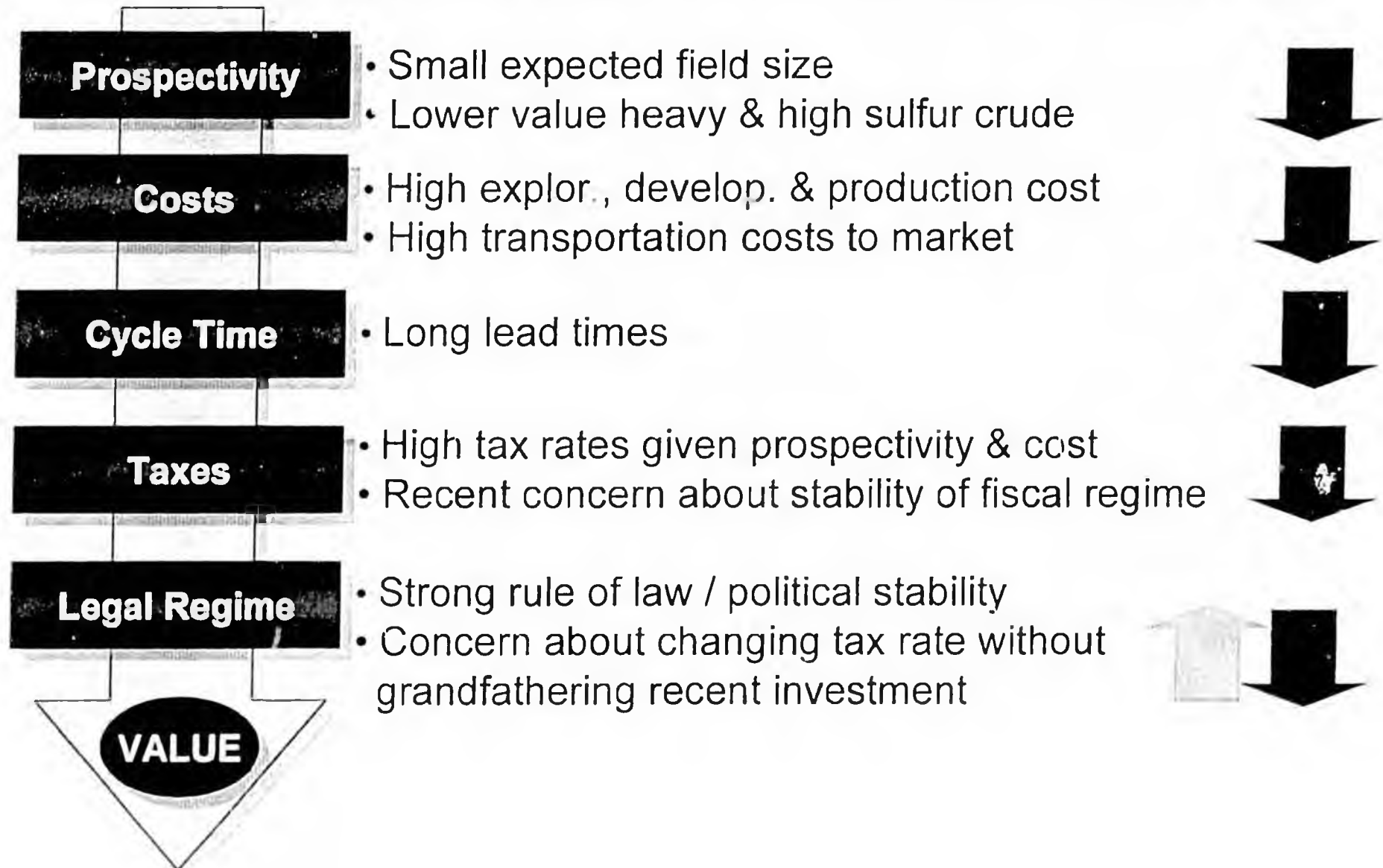
- Tax rates given prospectivity & cost
- Stability of fiscal regime

Legal Regime

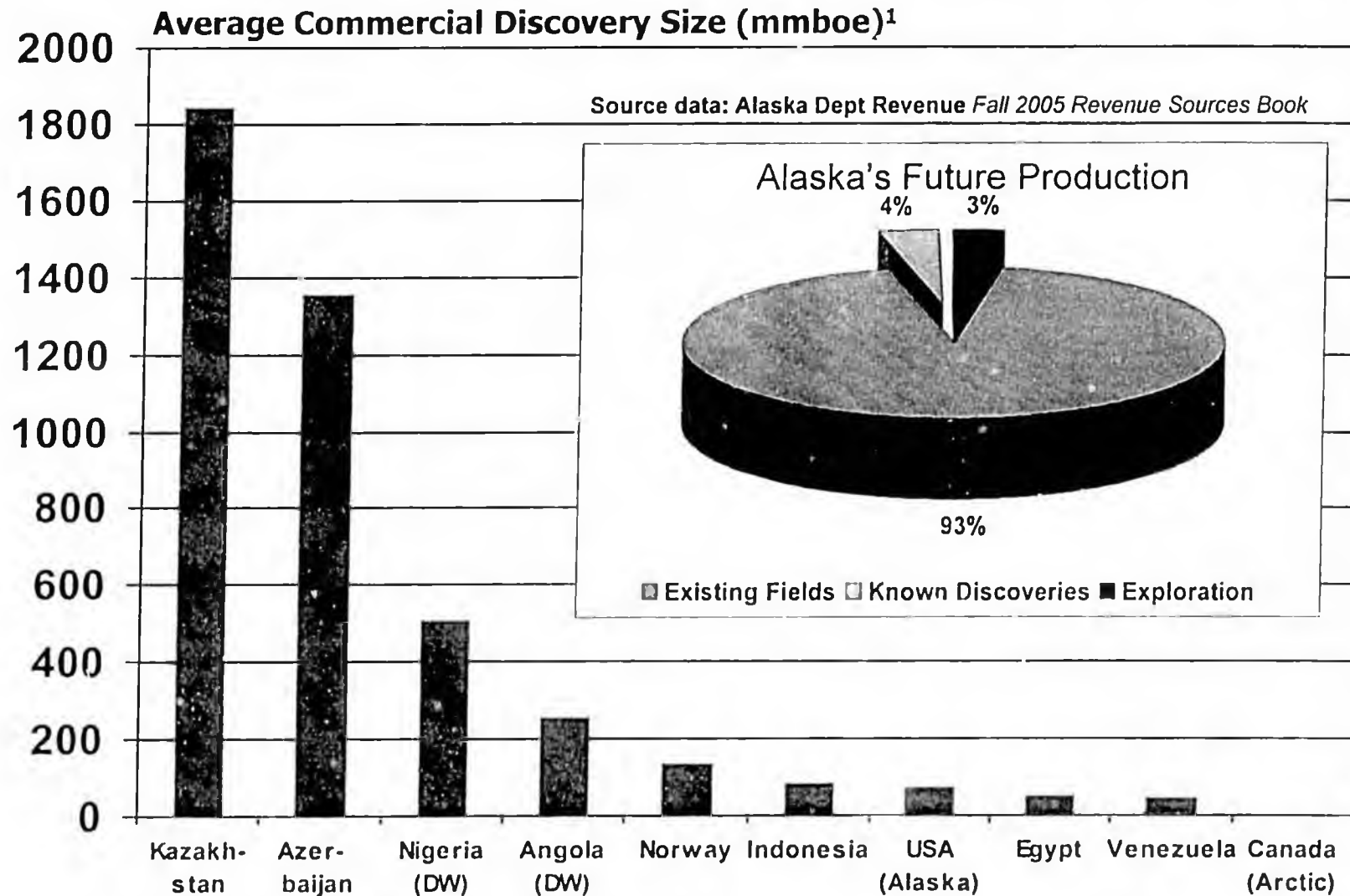
- Strong rule of law / political stability

VALUE

Investment Criteria - Alaska Rating



Global Average Commercial Discovery Size

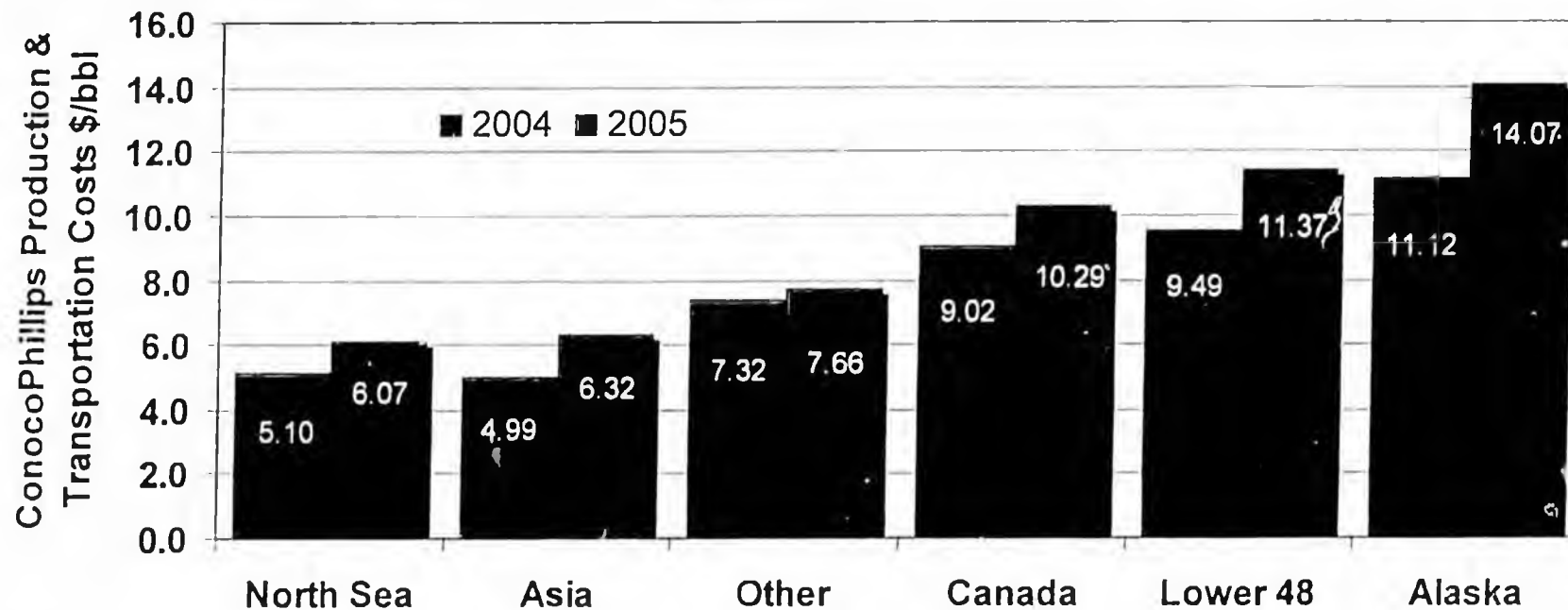


¹ Average commercial discovery size from 1994 to 2003.

² The average discovery size is calculated as: total commercial reserves discovered (1994-2003) / total commercial discoveries (1994-2003)

Increasing Production Costs

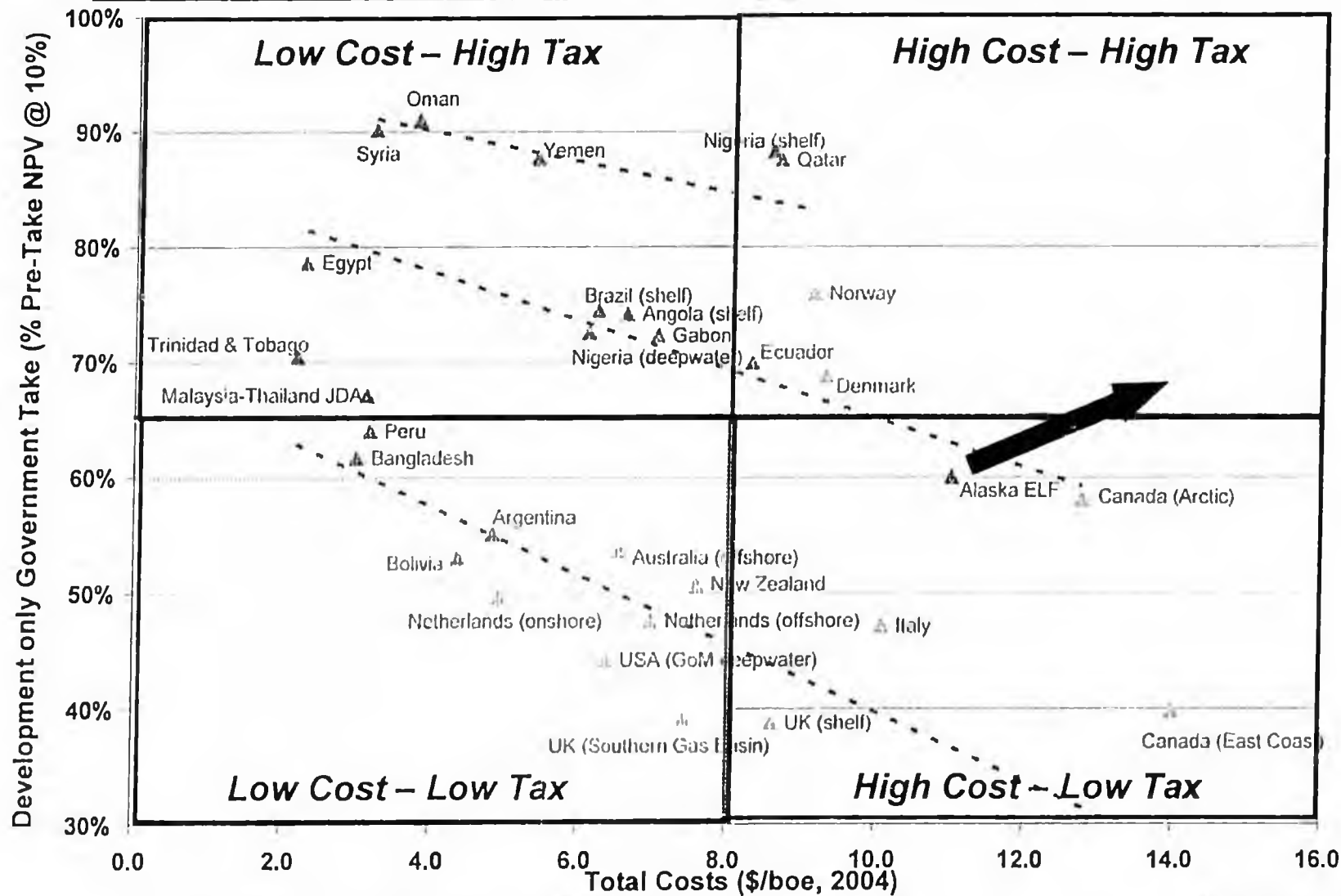
Source: ConocoPhillips 2004 Annual report and 2005 10-K



- Alaska has the highest cost structure in ConocoPhillips Portfolio
- Alaska costs are increasing at greater rate than other areas
 - Aging infrastructure concerns and increasing well work
 - Market Forces
 - Regulations
 - Smaller, more complex field developments

Alaska – High Cost, High Tax?

Countries with no equity participation or not carried

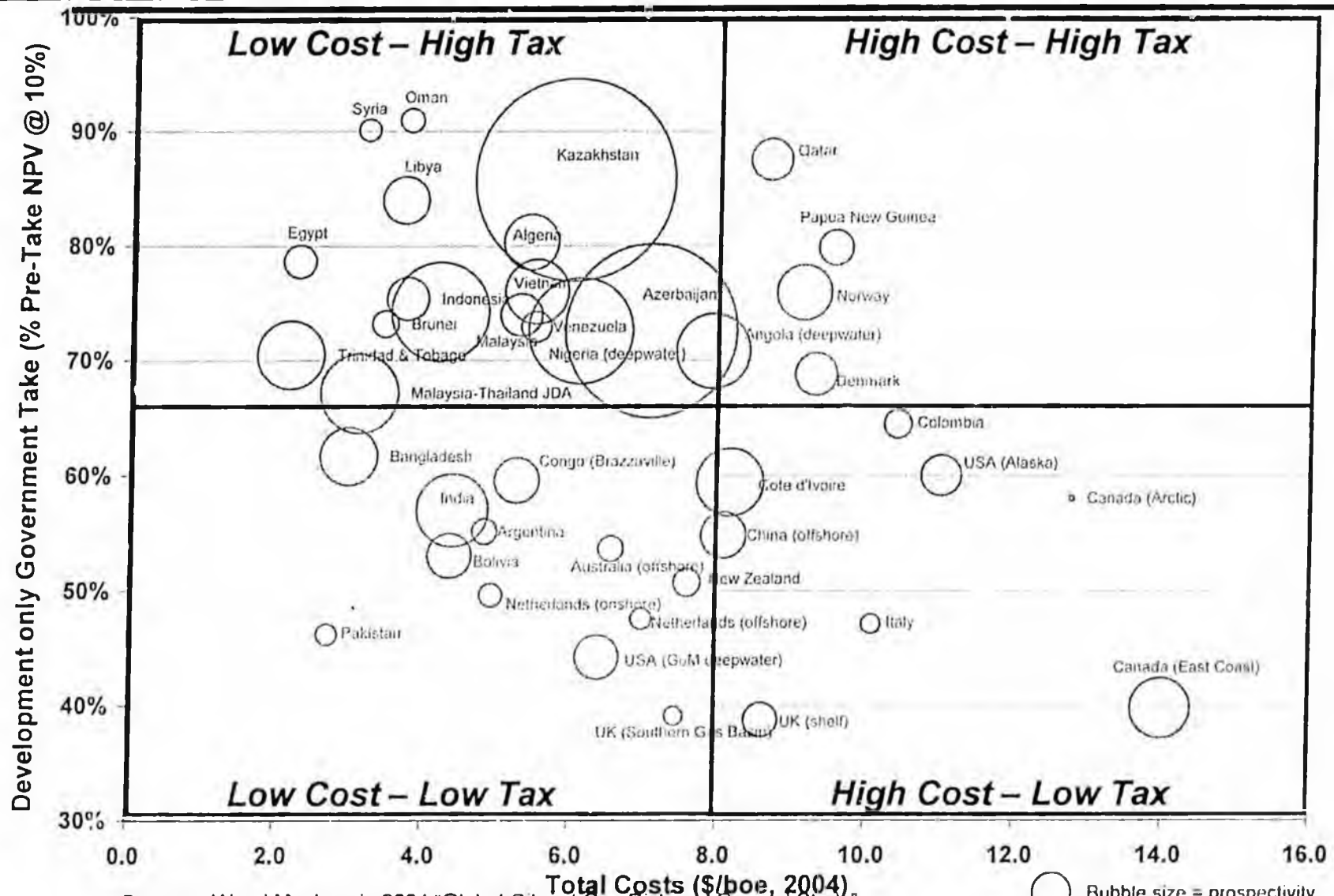


Source: Wood Mackenzie 2004 "Global Oil and Gas Risk and Reward Study".

▲ OECD Countries

Total cost includes capital and operating elements averaged over 10 year period (1994-2003), Economics were run at \$35/bbl long term real Brent price

Alaska – High Cost, High Tax & Low Prospectivity



Source: Wood Mackenzie 2004 "Global Oil and Gas Risk and Reward Study".

Total cost includes capital and operating elements averaged over 10 year period (1994-2003), Economics were run at \$35/bbl long term real Brent price

Prospectivity = Average commercial discovery size (1994-2003)

Higher Taxes Will Reduce Investment

- Reduces after-tax cash flow available for investment
- Adversely changes risk / reward balance
- Capital goes elsewhere to:
 - Other countries
 - Other energy sources
 - Other industries

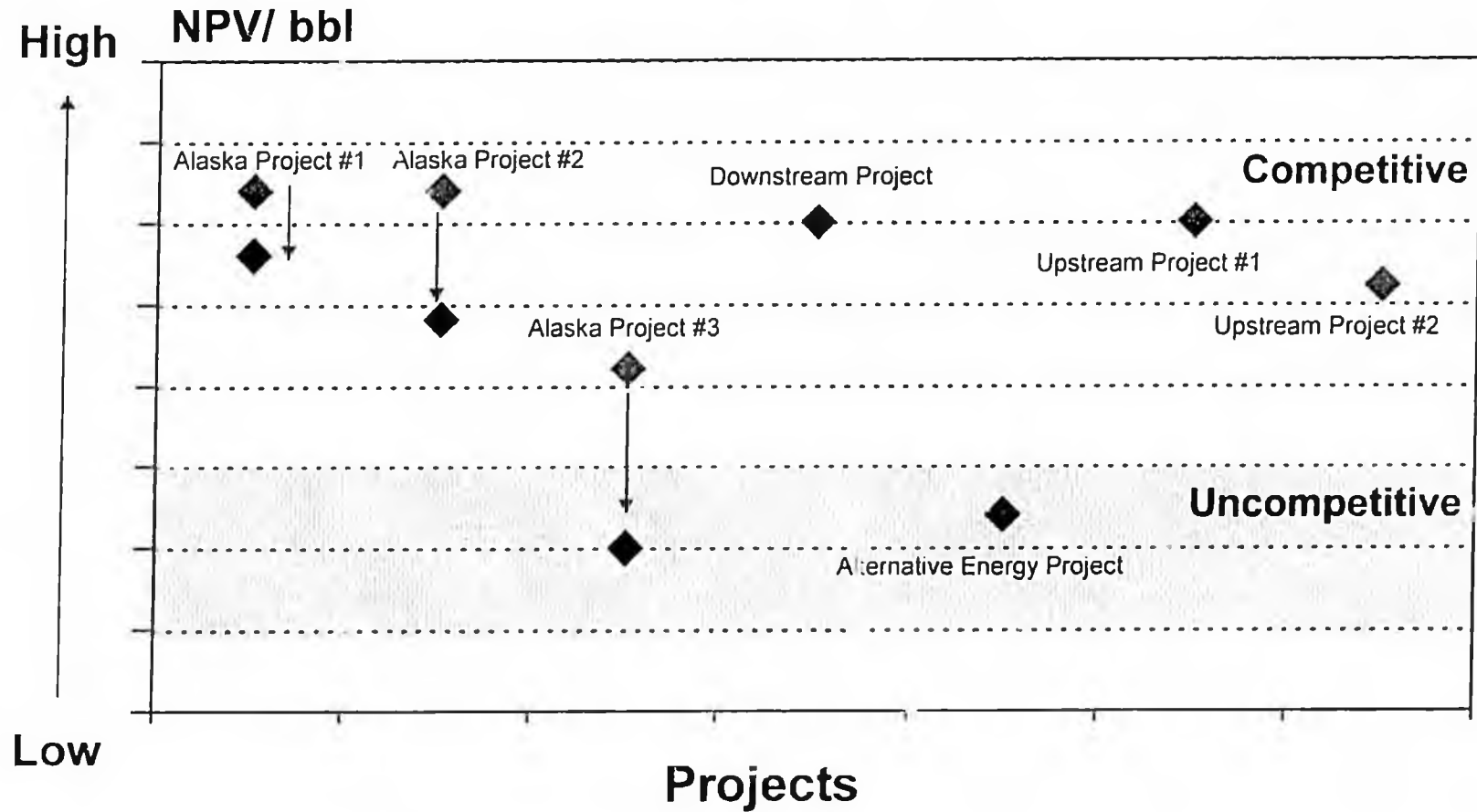
“If You Tax Something, You Will Get Less of It”

ConocoPhillips' Major Upstream Projects



¹ Negotiations are under way.

Portfolio Comparison



- ◆ Before tax increase
- ◆ After tax increase

What's Wrong With Windfall Profits Taxes

- “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”.

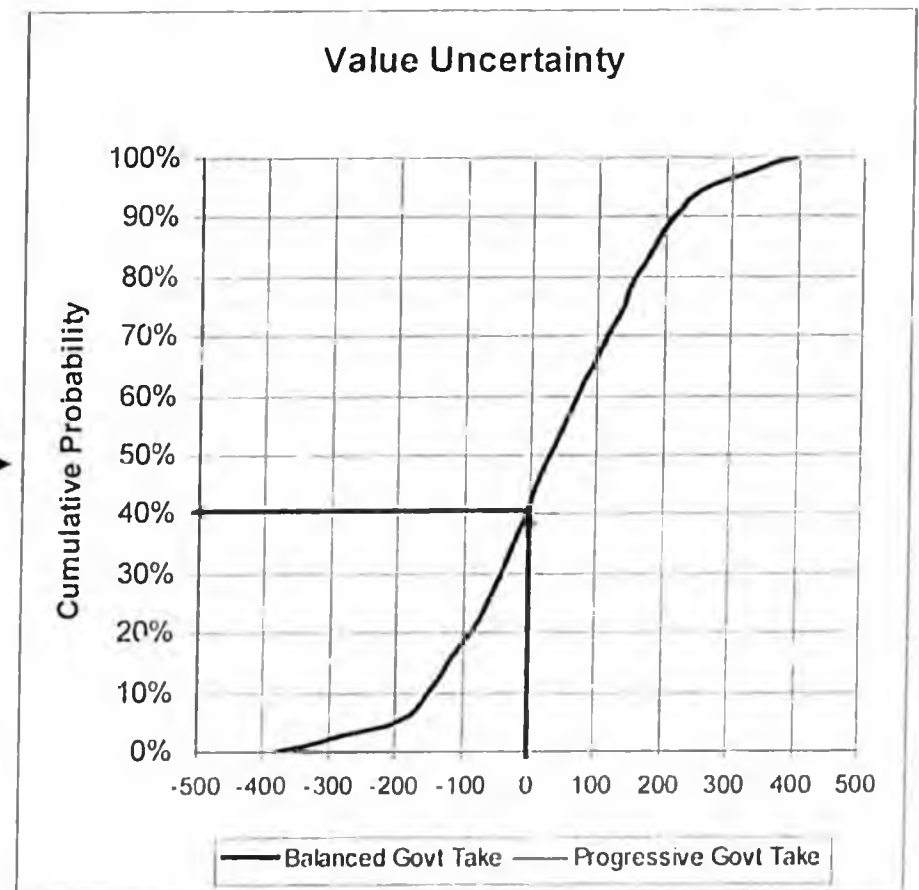
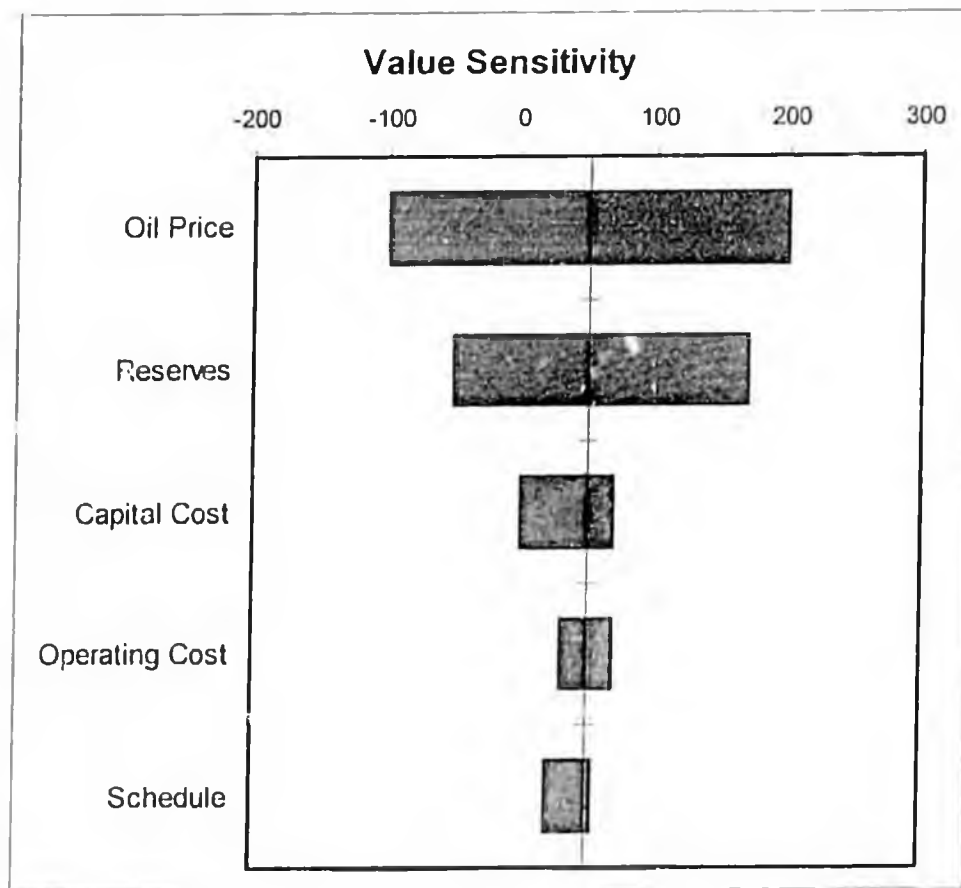
Daniel Yergin interview, Capitalism Magazine, November 11, 2005

- “If it is again enacted, a windfall profits tax can be predicted to result in a diminution of domestic energy production... Sadly, the recent clamoring by some for new energy taxes indicates that the lessons of the 1970s were not learned.” *Open Letter to America's Elected Officials, 250 economists, October 25, 2005*

Non-partisan Congressional Research Service assessment of 1980 Windfall Profits tax on domestic crude oil:

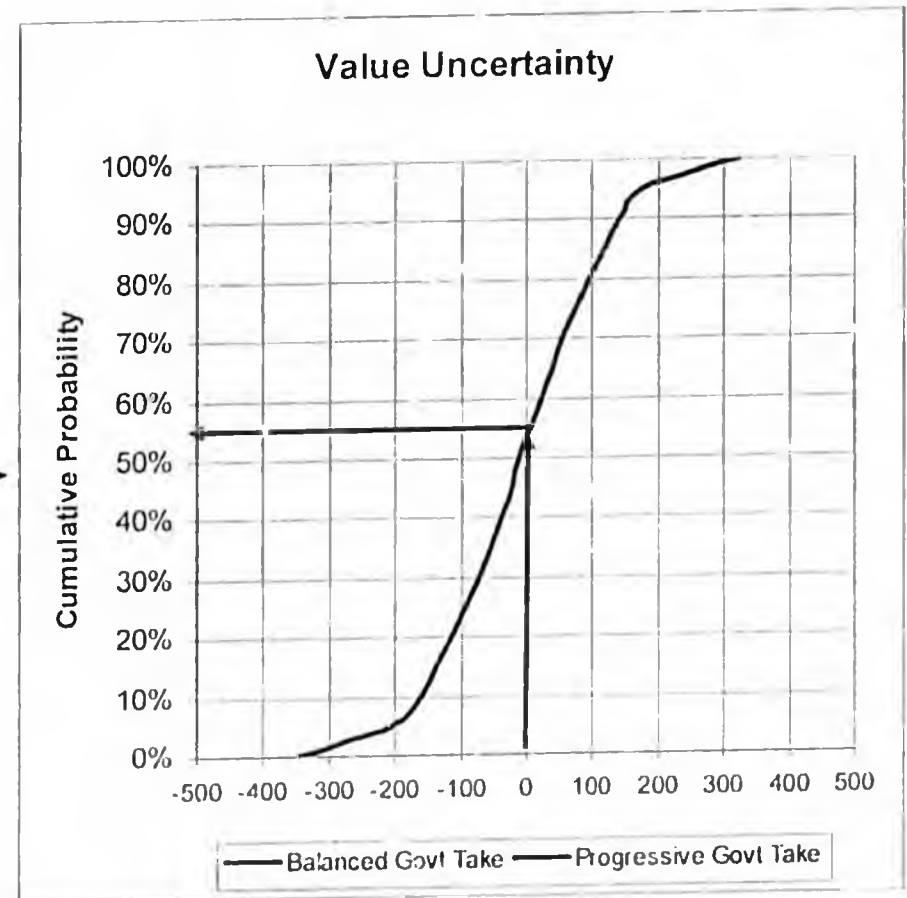
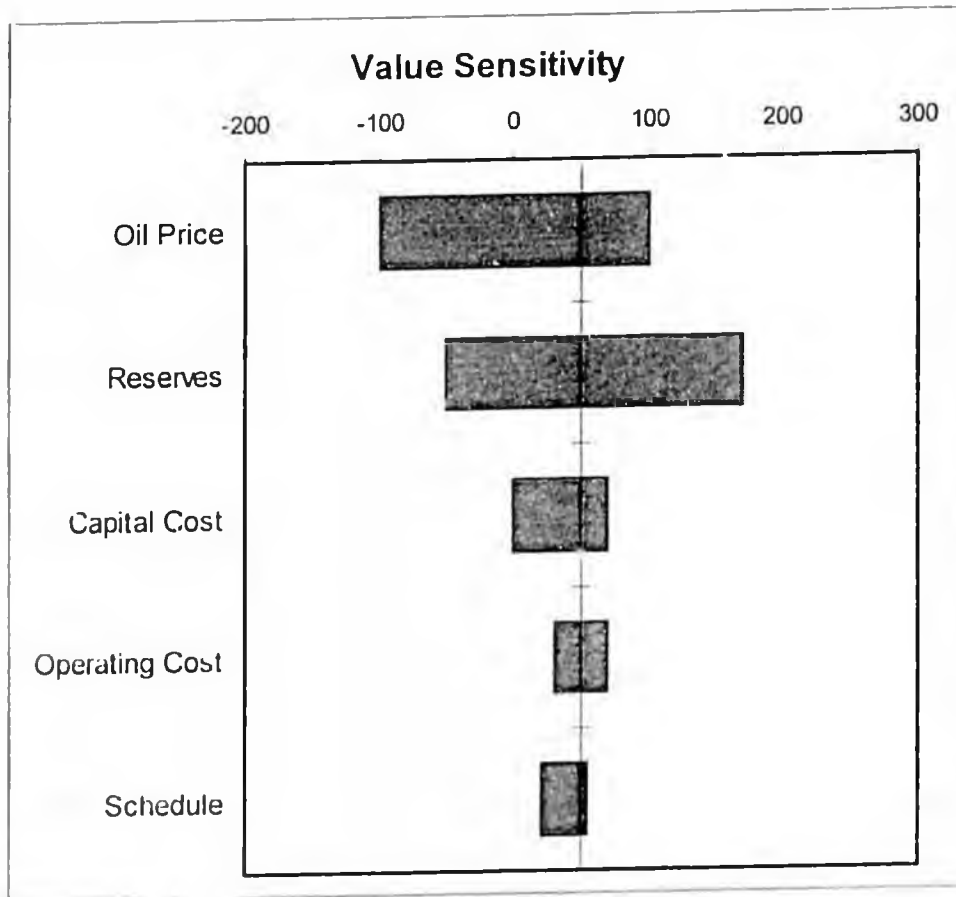
- Removed \$79 billion in gross revenues from industry that could otherwise have been invested
- Reduced domestic oil production by up to 1.6 billion barrels between 1980 - 1986
- Generated only 20% of expected gross revenues

Value Uncertainty in Balanced Government Take



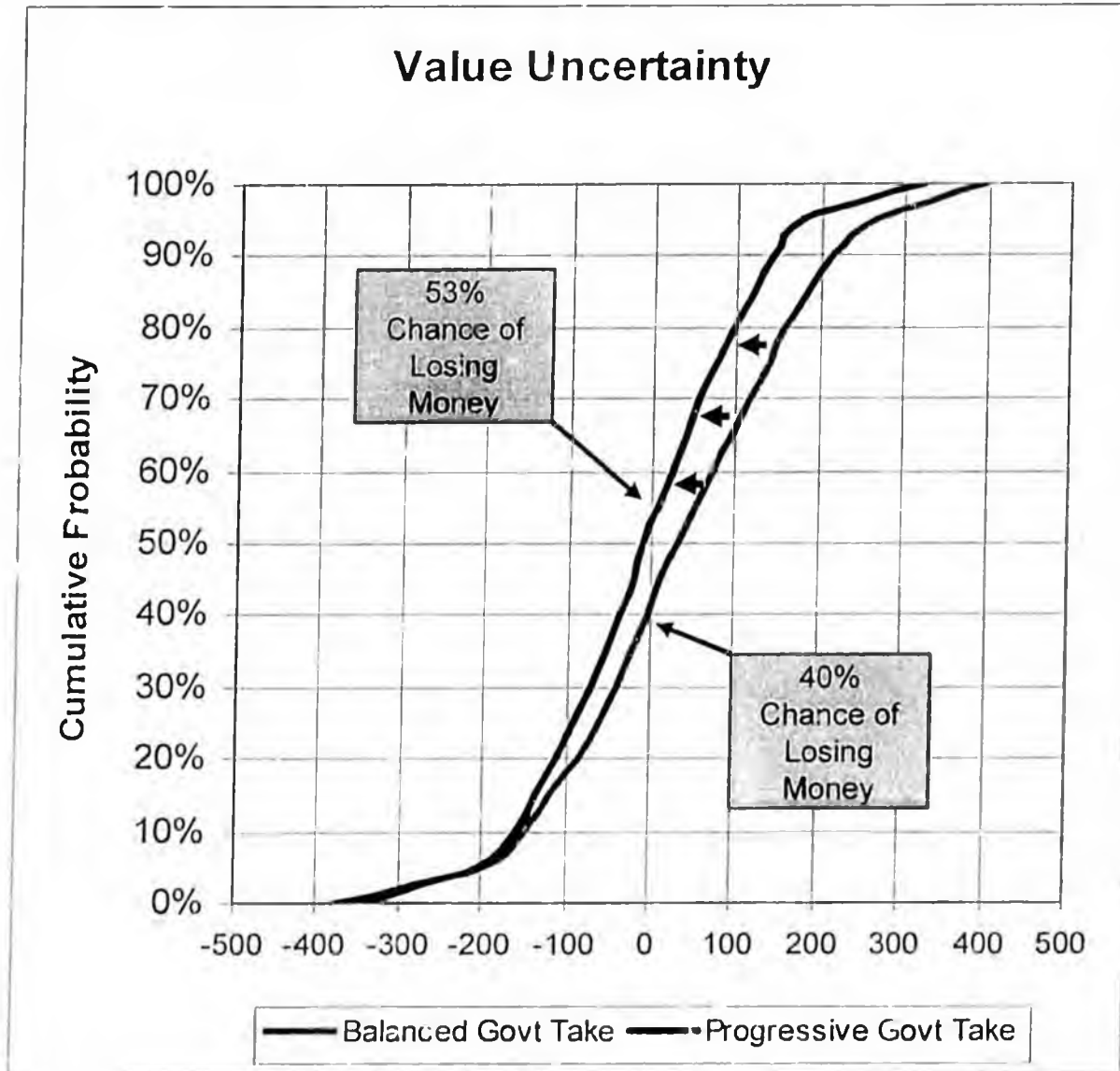
60% of the time, the project adds value (40% of the time it loses value)

Value Uncertainty in Progressive Government Take



47% of the time, the project adds value (53% of the time it loses value)

Balanced and Progressive Value Uncertainty Comparison



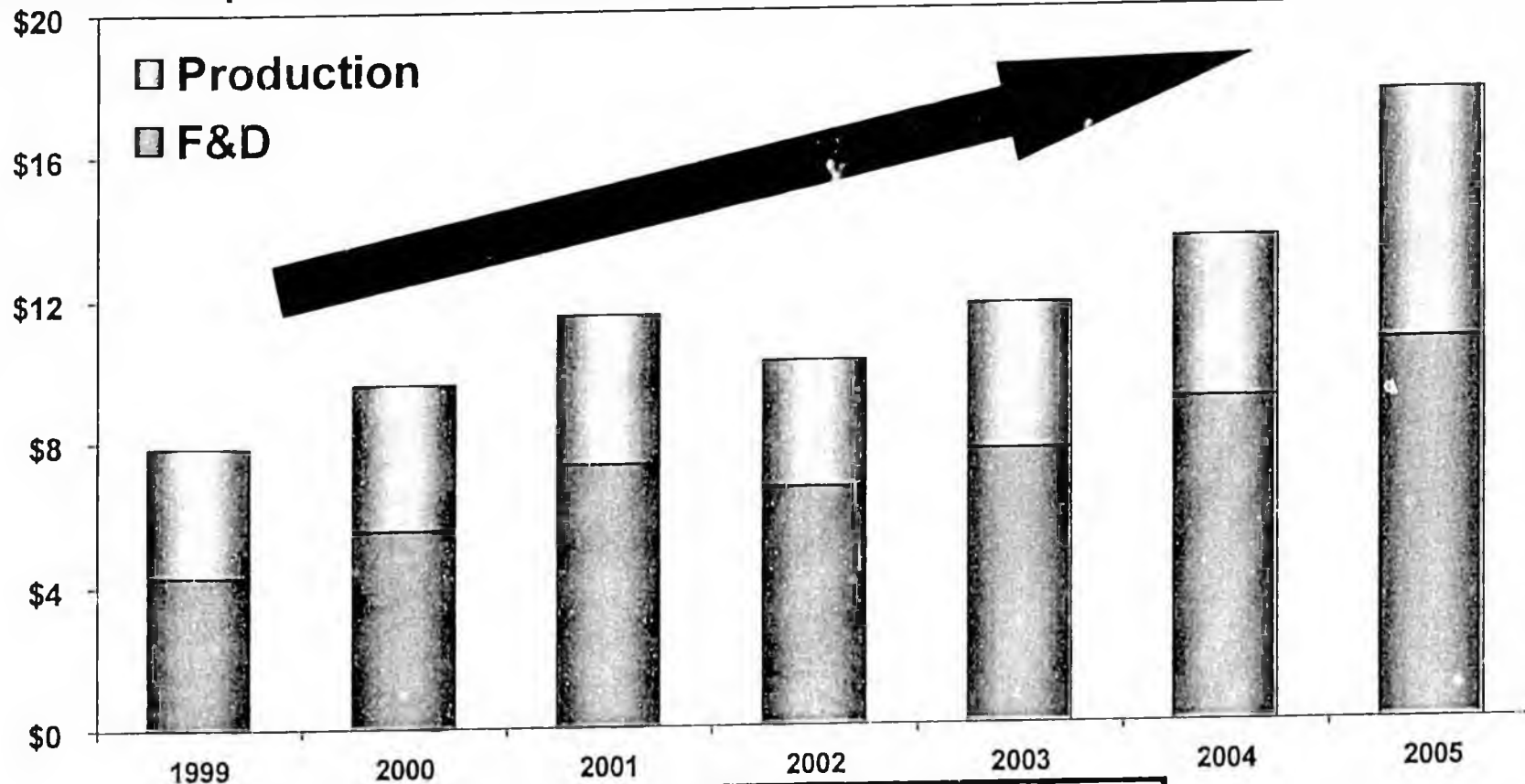
In this example:

- Under a balanced government take the project would be developed
- Under the progressive government take the project would not go forward.

Finding, Development & Production Costs

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