

ALASKA LEGISLATURE

HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 3103

Alaska. Climate that Encouraged Pioneer



- **Emerging Business Opportunities**
 - Investment Opportunities Offered by the State
 - 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 oil and gas Resource Plays**

– Resource Plays (tight sands, coalbed methane shales) are attracting huge amounts of investment

- 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 Exploration**
- **Tradable Credits allow Quick Monetization**
- **Modest Incentives for Exploration, New Investment**
- **Reduces Minimum Economic Field Size**

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

PPT Tax Rate



- **20% Rate Reasonably Balanced with Credit**
- **If Rate is Higher it must be Balanced with Credit**
 - Credit must apply to both Exploration and Development
 - Rate / Credit Balance is Affected by PPT
- **Higher Tax Rate:**
 - Reduces Incentive to Invest
 - Raises Investment Threshold
 - Fewer Exploration Wells Drilled
 - Marginal Resources Left Undeveloped

Tax Rate Progressivity



- **Increasing Oil Prices Lead to Increasing Costs**
 - 2005 W. Texas Drilling Costs Increased 20%
 - Steel prices more than doubled in 2005
 - Costs for all Services Escalating Rapidly
- **Profits not Directly Proportional to Oil Prices**
- **If Enacted, Progressive Tax Rate**
 - Should be Profits Based
 - Fairness Issue
 - Different basis is un-necessarily complex
 - Trigger Price Should be:
 - At a level equal to today's price environment (\$60)
 - Based on ANS Posting (vs WTI)
 - Indexed for Inflation

5,000 BBL "Start-up" Exemption



- **New Entrant Challenges**
 - New Entrants do not hold Existing Infrastructure
 - Smaller Investors lack Operating Economies of Scale
 - Most New Investment Opportunities are Challenging
- **Exemption Mitigates High Alaska Start-up Costs**
 - Local, Highly Skilled Technical Employment
 - Requires Building an Expensive G&G Database
 - Companies w/ AK Employees Pay Income Tax
- **Exemption Sunset is not Fair or Practical**
 - Discovery to Production cycle time is 5 – 10 years
- **Phase out of Credit/Exemption is Discriminatory**

**We believe "Start-up" Exemptions are essential to attract
investors and give them a better return.**

Fair Value for Tradable Tax Credits



- **Tax Credit Value is Diminished to New Value**
 - Held Credits diminish through time
 - 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 Value**

- **Pioneer’s Investments Will Generate Substantial Cash Refunds**
 - Consider a State Cash Refund at Higher Oil Prices

Transitional Capital Recovery



- **Fairness Issue**
 - Investments were made under old tax system
 - Tax System is changing
 - Pioneer has recouped nothing from investments
- **Pioneer's Alaskan Investment Begins to Pay Off**
- **Pioneer's Cumulative Investment Over 10 Years**
- **Transition Capital Look-Back is Appropriate**
- **Look-Back w/ 2:1 Future Requirement is OK**

Pioneer Key Messages



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



PIONEER



SB 305 PPT

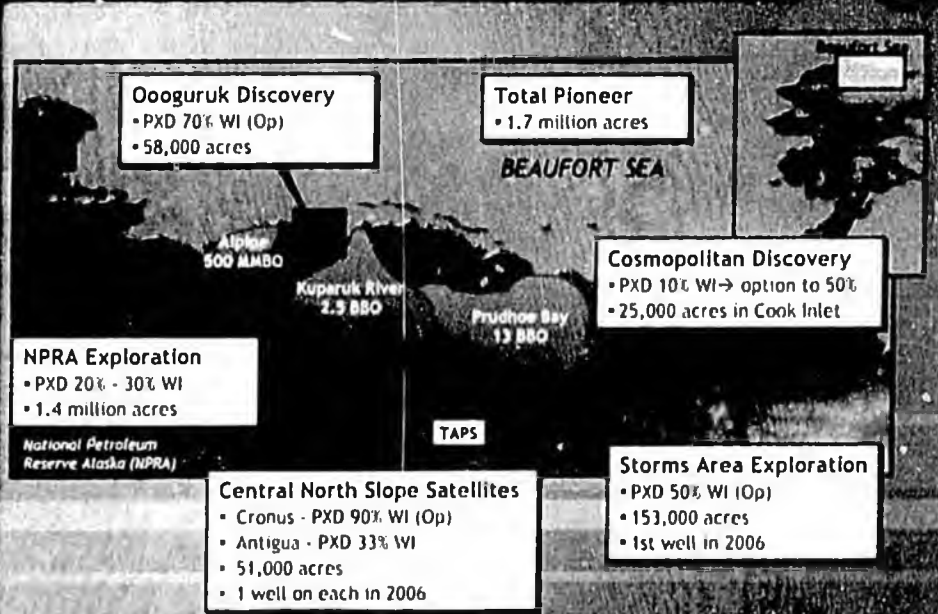
Senate Resources

Committee

Juneau, Alaska

April 7, 2006

Pioneer's Alaska Acreage



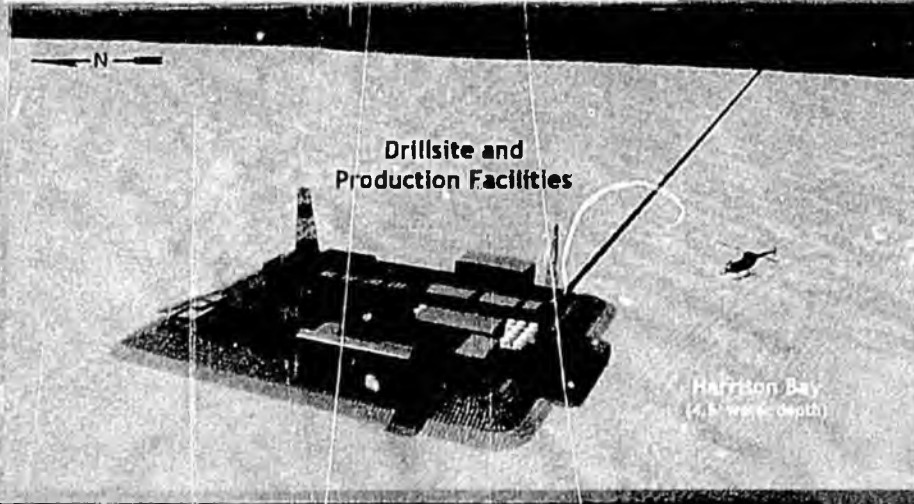
PIONEER NATURAL RESOURCES

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



PIONEER NATURAL RESOURCES

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



PIONEER NATURAL RESOURCES

Alaska's Challenges



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

PIONEER NATURAL RESOURCES

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MINNER NATURAL RESOURCES

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MINNER NATURAL RESOURCES

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- **Pioneer's Alaskan Investment Began In 2002**
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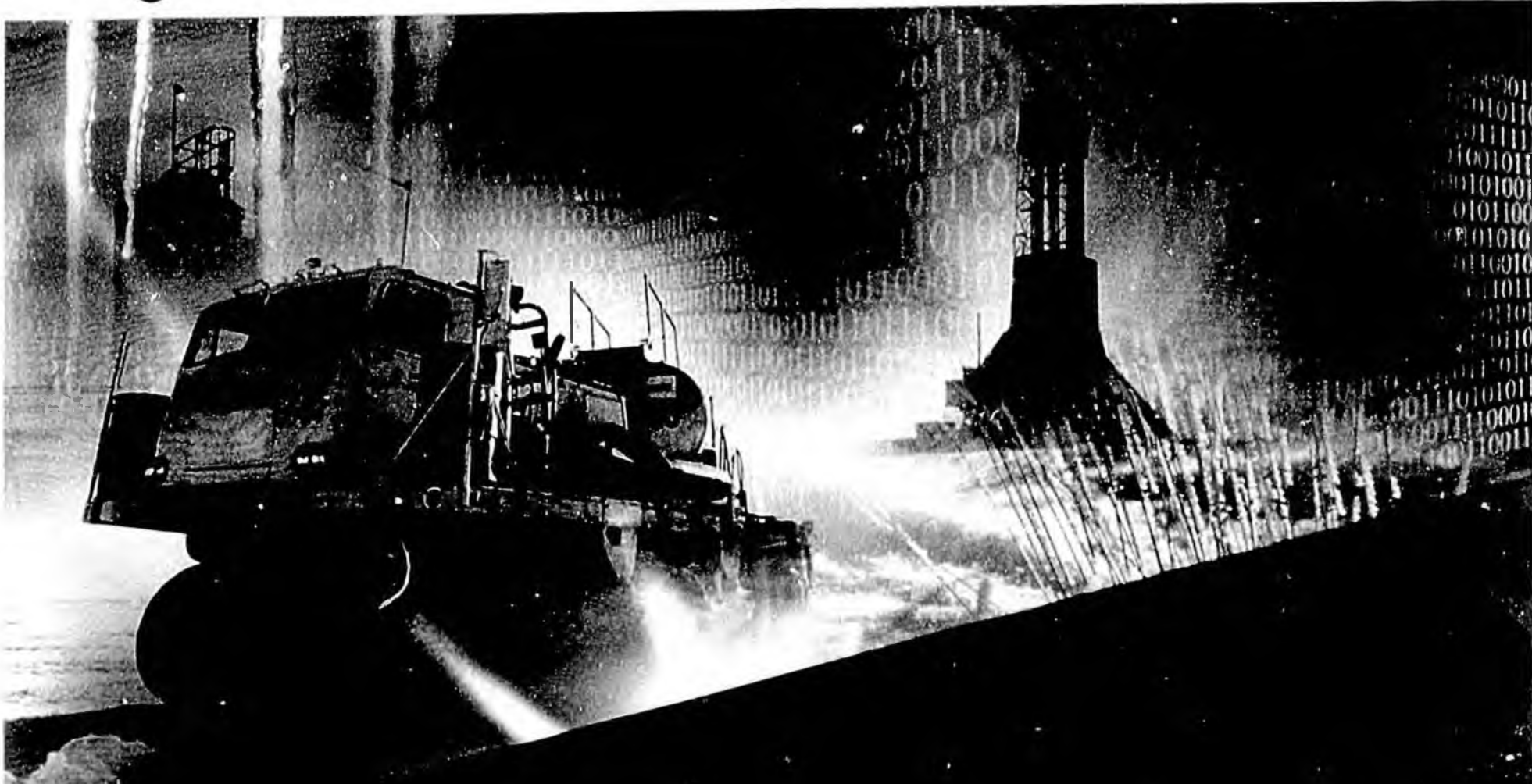
PIONEER NATURAL RESOURCES

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- **Pioneer Goal: Establish Alaska as Core Producing State**
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- **Administration's 20/20 Proposal is Balanced & Fair**
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PIONEER NATURAL RESOURCES



PPT Discussion

Anadarko[®]
Petroleum Corporation

April 7, 2006 Senate Finance Committee¹

4/7/06 Mark Hanley

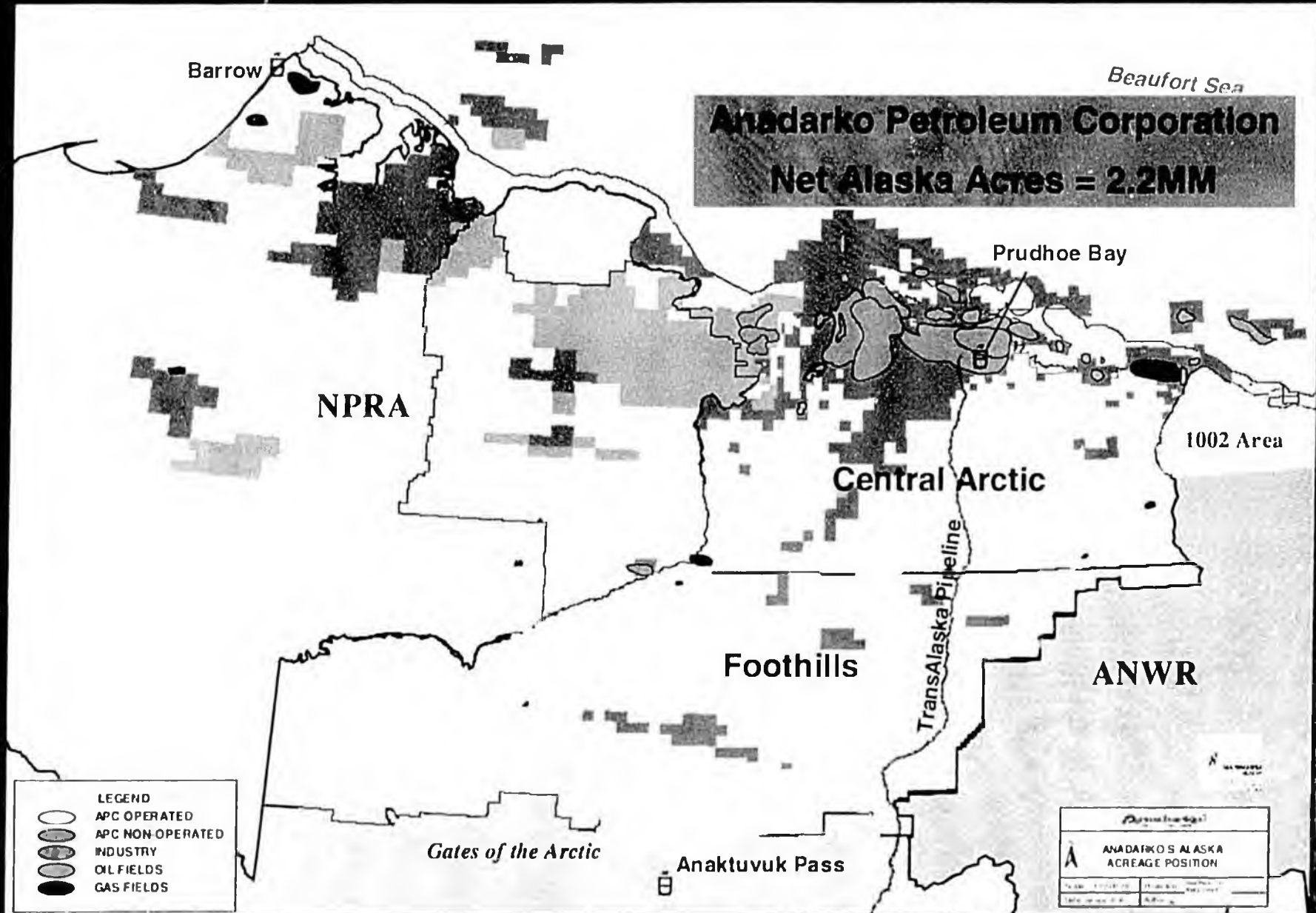
Overview of Anadarko Petroleum



ANADARKO HQ
Houston, Texas

○ Exploration Areas
◻ Producing Areas

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**
- ▶ **Extremely long lead-time exploration**
- ▶ **Seasonal drilling & regulatory timing requirements**
- ▶ **Lack of gas market**

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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

- 4 **Declining production is primary driver of lower state revenue**
- 4 **Increased investment (compared with today's levels) needed to increase production & stem decline**
- 4 **Original bill offset tax increase with credits & allowances**
 - *Our exploration economics generally improved*
- 4 **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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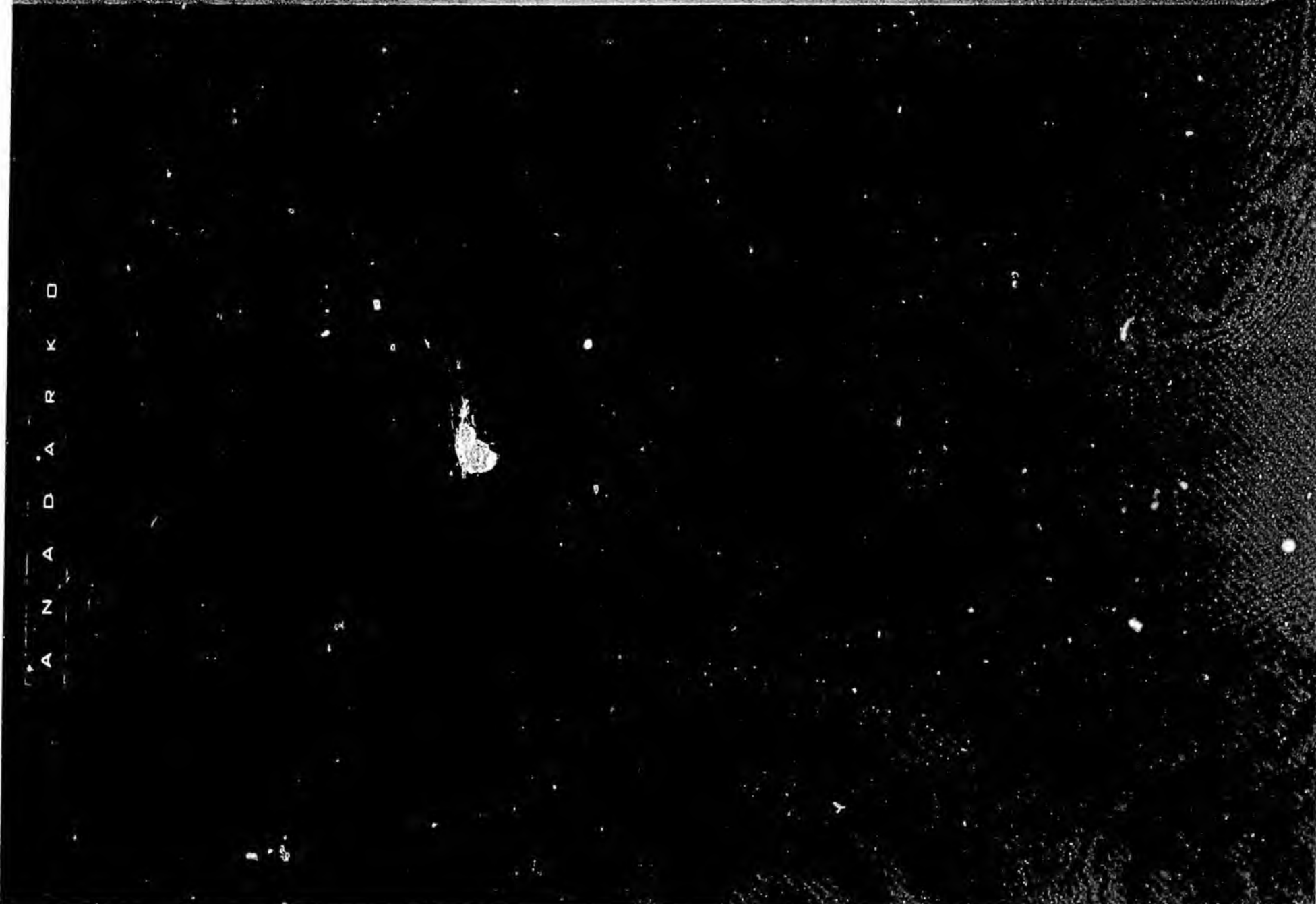
Key Issues

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

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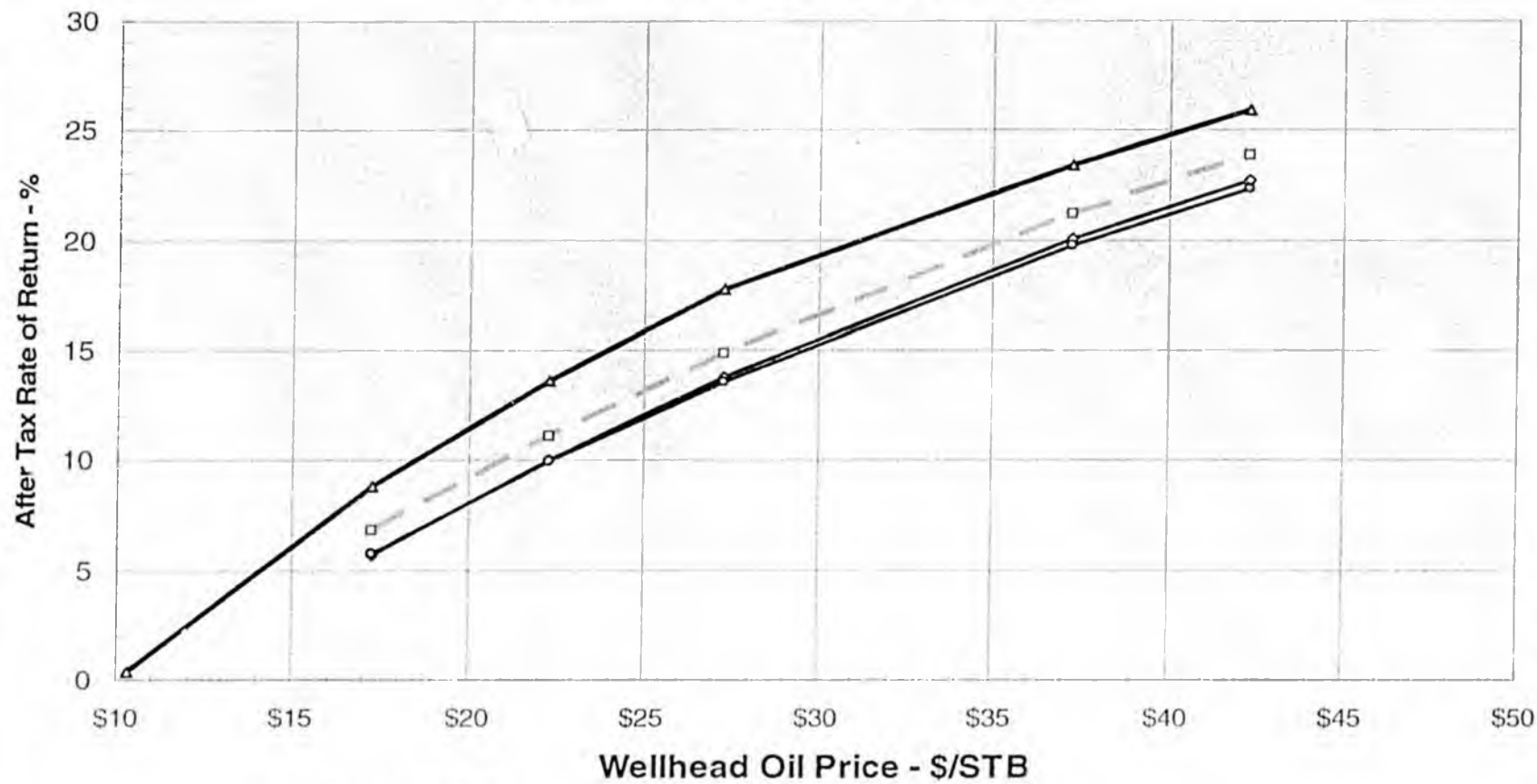


New Small Oil Development

- **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



- ◇— 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

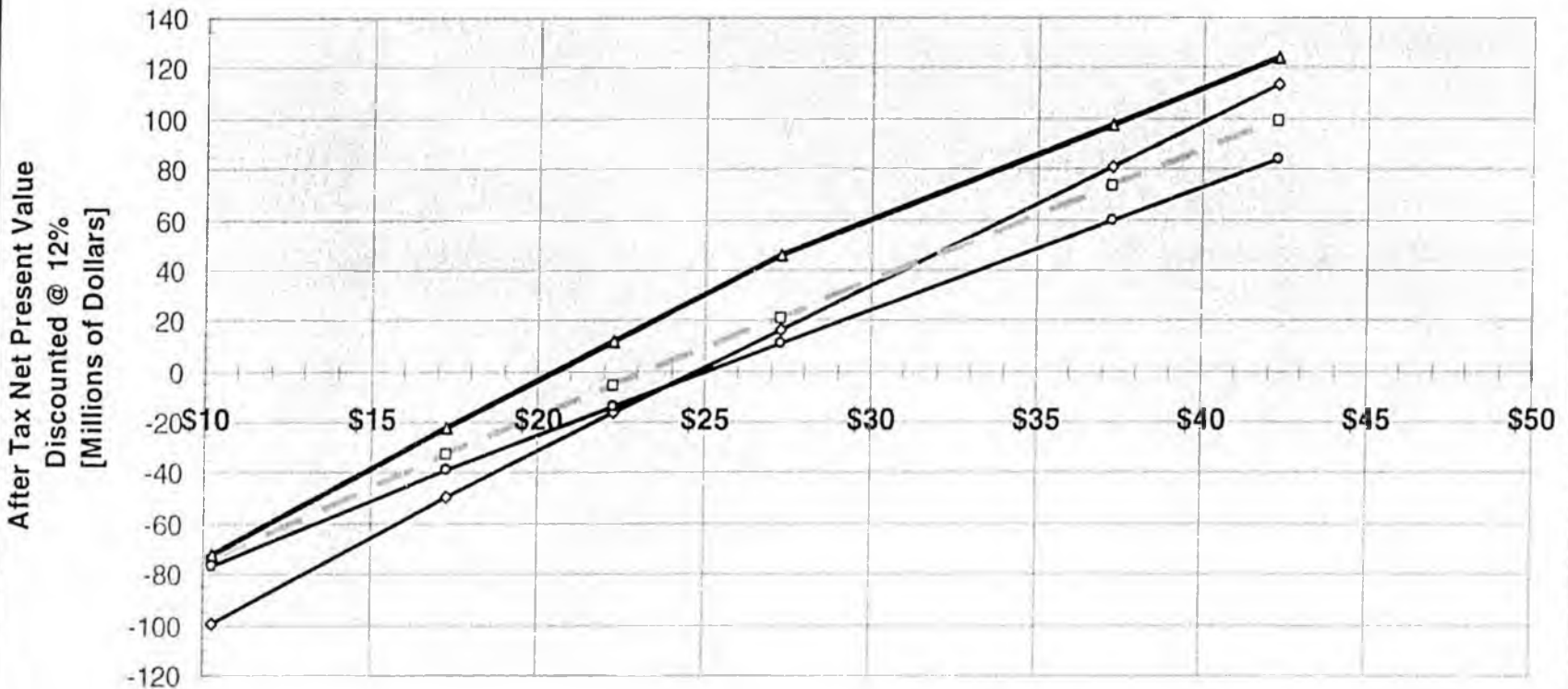
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Small Oil Development- Net Present Value

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

Small Oil Development



Wellhead Oil Price - \$/STB

- ◇— Existing "ELF" Tax
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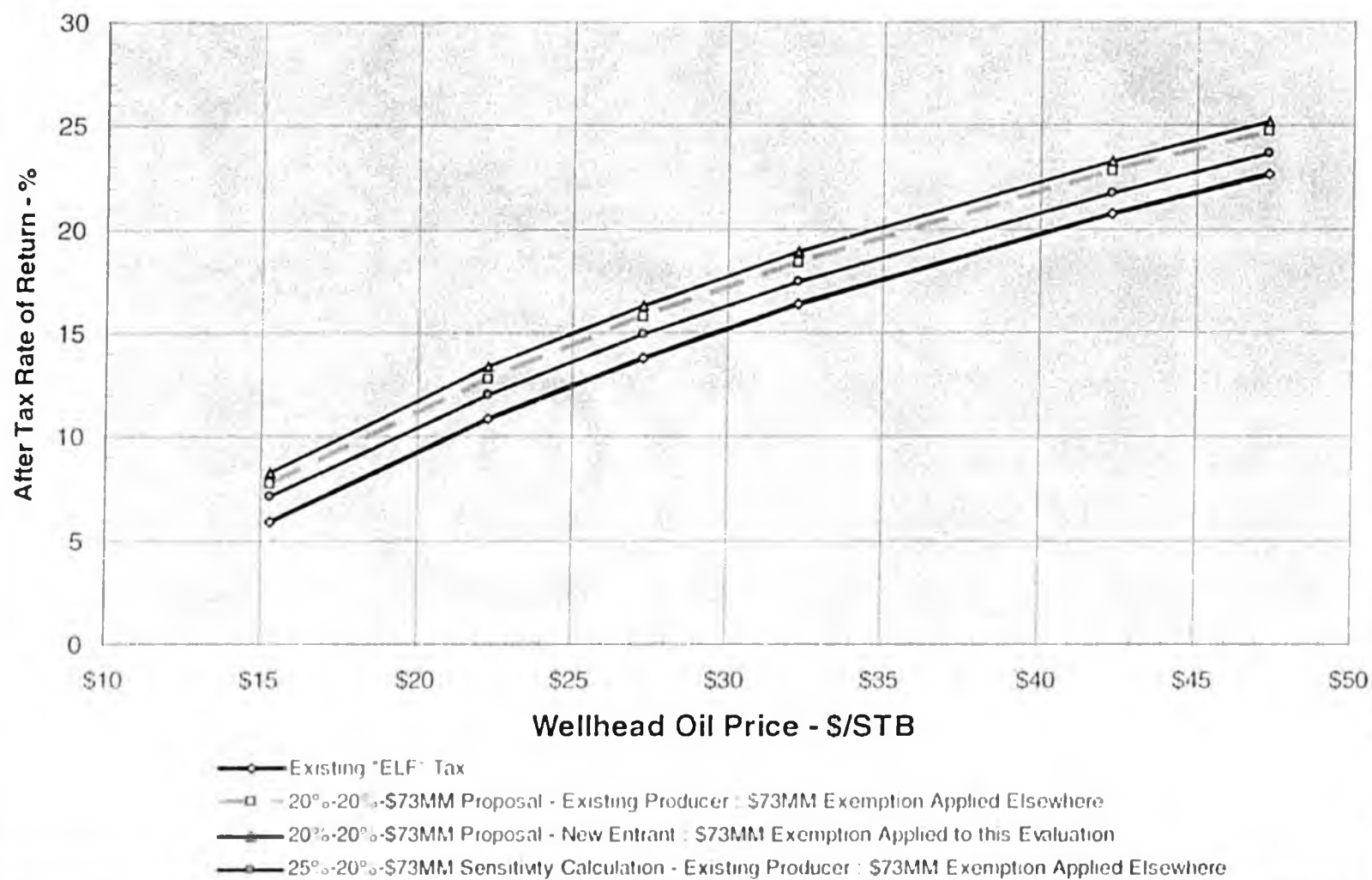
Risked Exploration Economics for Oil Prospect

- ▶ **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

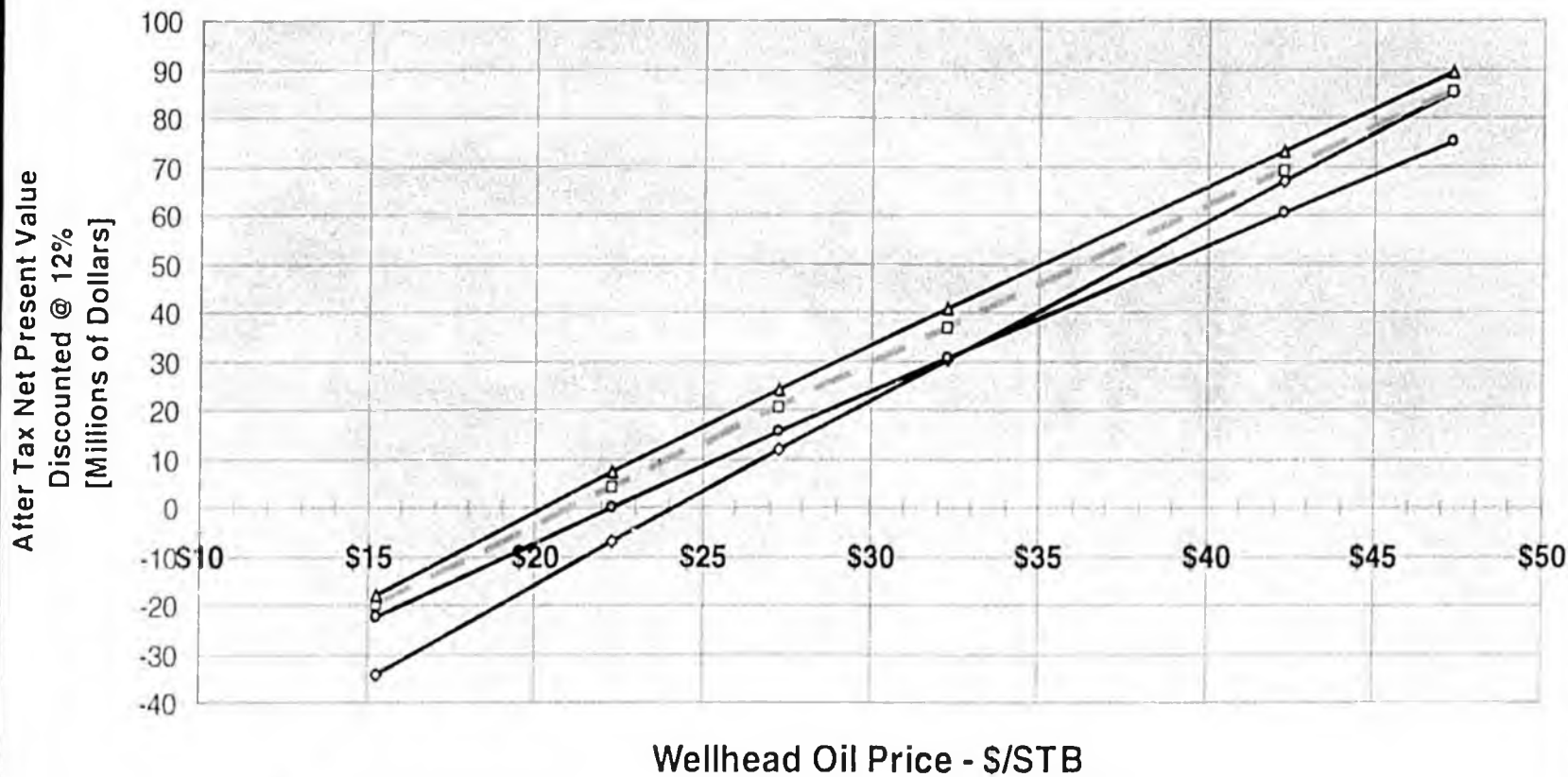
After Tax Rate of Return as a function of Wellhead Oil Price
 Risked Pre Drill 345 MMBO Prospect Exploration Economics



ANADARKO

Medium Oil Prospect- Risked Net Present Value

After Tax Net Present Value Discounted @ 12 % vs. Wellhead Oil Price
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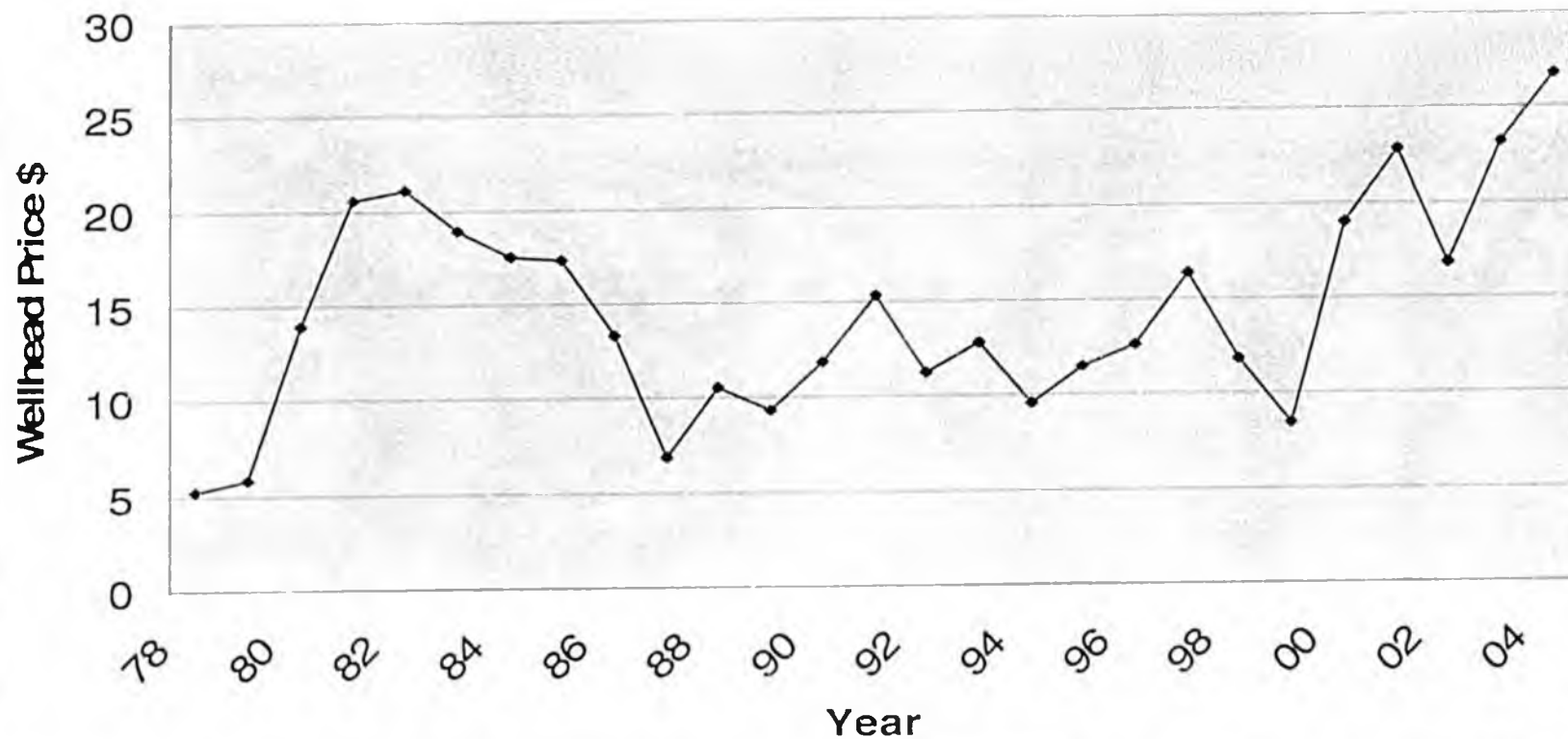
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Historic Alaska North Slope Crude Prices

ANS Wellhead Crude Oil Price

From AK Dept. of Revenue, Tax Division



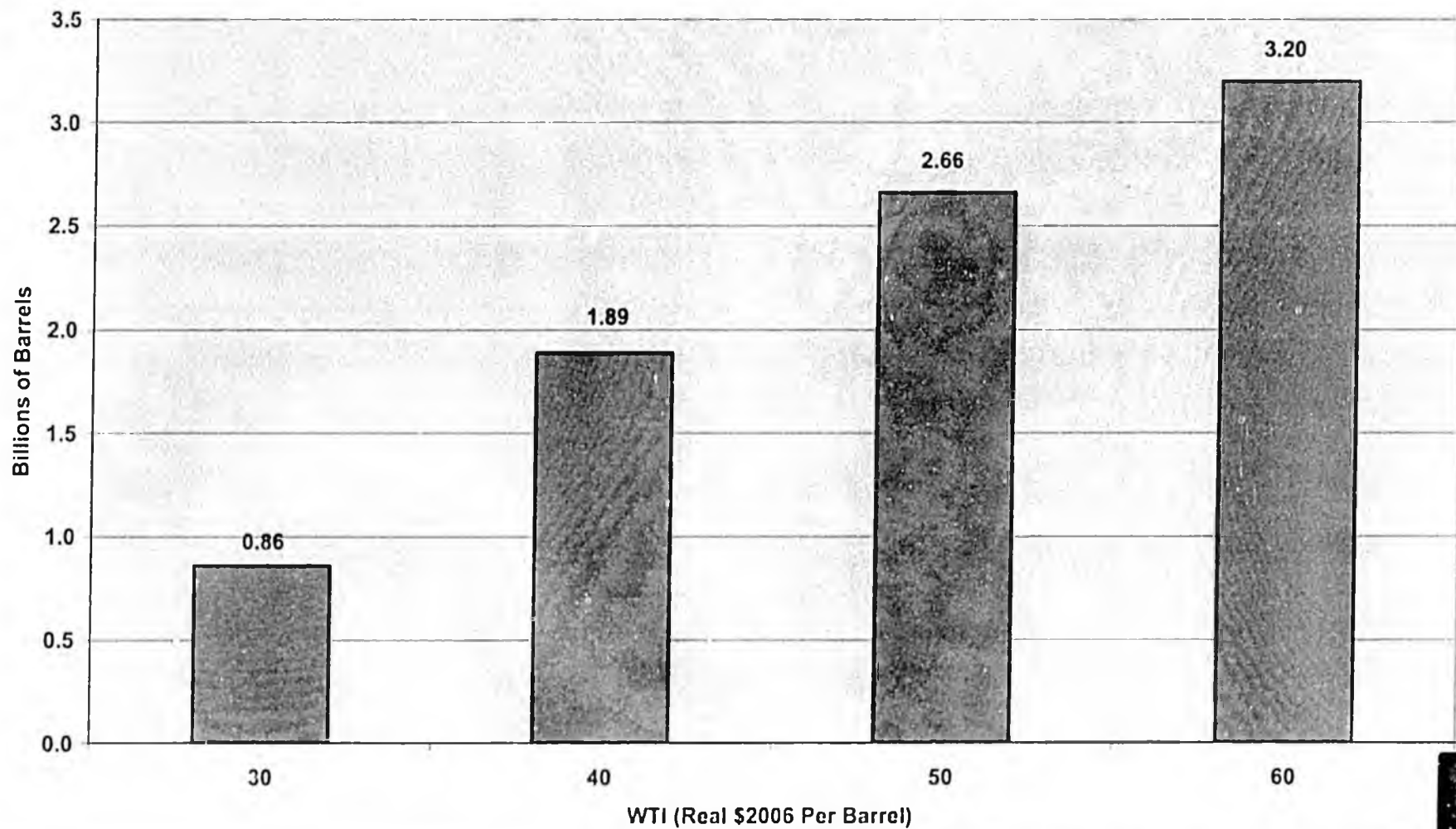
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This presentation contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934. Anadarko believes that its expectations are based on reasonable assumptions. 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.

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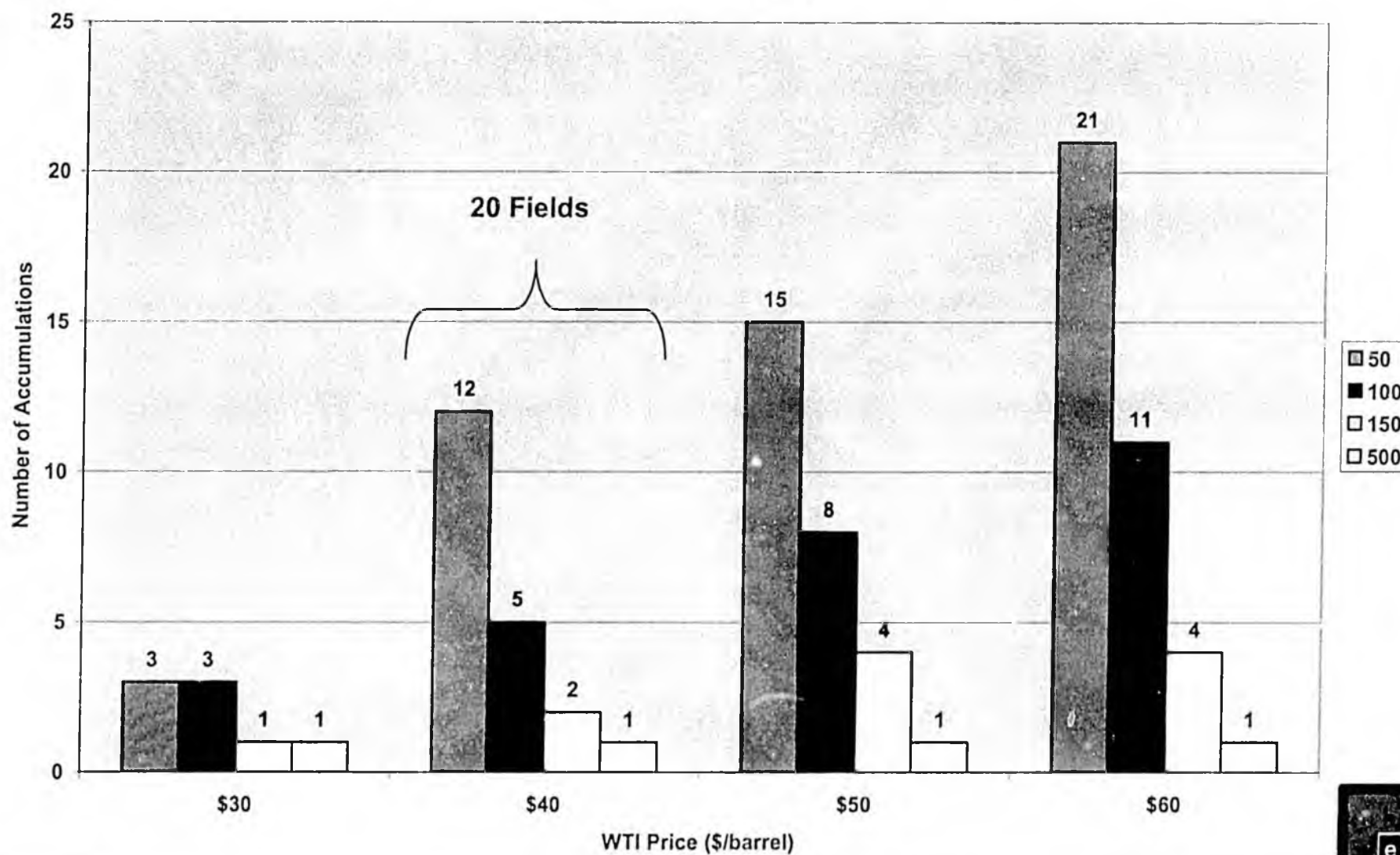
Economic Oil Reserves in Central North Slope Alaska At Alternative Prices

Economically Recoverable Reserves
Central North Slope
Mean Estimate
(No ANWR)



Expected Discoveries Under Alternative Prices

Expected Discoveries under Alternative WTI Prices
Central North Slope



Jim Weeks
4/7/06
testimony
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Testimony of James D. Weeks
On CS SB 305
Oil and Gas Production Tax
Alaska State Senate Resources Committee
FINANCE

06 April, 2006

Madam Chairman, distinguished members of the Senate Finance Committee. For the record, 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. The Company was formed in 2002 by John Winther, Dale Lindsey and me, for the purpose of exploring and developing leases on the North Slope. UltraStar is 100% owned by Alaskans. I am Managing Member, and moved to Anchorage in 1984 with ARCO, and have had a presence here ever since. Dale, whom most of you know, was born and raised and still lives in Seward. John, whom most of you also know, was born in Fairbanks and raised in Juneau. He currently lives in Petersburg. Thanks for the invitation to testify on what I believe to be a very bad bill.

During the last several weeks, I've listened to a lot of testimony on the Governor's original proposal, not only in this committee, but in the other committees in both houses of the legislature. I have witnessed an already complicated PPT proposal become so complicated that I sincerely doubt it can ever be fully and fairly administered, and the cost of such administration, for both the State and industry, will be huge. It will be even more overwhelming for small start-up guys like us, who don't have tax accountants and tax attorneys on staff, and will need to acquire these services at market prices outside of our organizations. This bill is so bad that if it were the only alternative, we'd be better off with what's now on the books. But that's not the only alternative. The proposal by the Administration was complicated, but one we supported, and still could, but we can't support this one. Gross simplification is needed. Some taxes are to be applied to net profits, others to gross revenues. Sometimes ANS prices at the North Slope are to be used. Other times ANS West Coast prices are to be used. This creates un-necessary complexity and opens the door to years of disputes and lawsuits. The Charter for Development may be a good example of how simple things can be made.

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 try. I'll just add UltraStar's strong support for the positions of the existing producers and independents and explorers on these issues.

Of more concern to me is the so called need for a progressive feature, where the State takes a higher percentage at higher oil prices. Wildcatters gamble for the upside. Upside reserves and upside prices. Taking away that upside will cause exploration investment to decrease. This smells to me like the federal windfall profits tax that so successfully drove industry from our shores in the early 1980's.

There needs to be a mechanism for the State to buy back or otherwise allow use of any un-used exploration credits. The market for these credits is very limited, and I expect any that we may have would be sold at a considerable discount. It would help if the State provide an option to buy them, or allow holders of the credits to use them for other oil and gas related expenditures, such as bonus bids, lease payments, permitting and filing fees.

The bill grants a 5000 barrel per day exemption to companies with less than 55,000 barrels/day production. This is a provision with which we can agree, but I don't think it goes far enough. If the Committee wants every company, large and small, current producer, or wannabes like us, to be looking for new oil then the 5000 barrels per day should apply to all new oil, regardless of the size of the company that drilled found it. I suggest the following:

When the PPT becomes effective, establish a "ring fence" around existing, producing units. If peripheral drilling outside of that ring fence confirms commercial hydrocarbons and justifies unit expansions, then production from those expanded areas should be eligible for the tax exemptions and exploration and development credits in the bill, regardless of the size of the company that drilled them. Deeper and shallower accumulations, drilled within existing units after the effective date of the bill, should also be eligible. If the big, current producing unit owners were to receive the 5000 barrel per day allowance for exploration credits on new pools within an existing or expanded unit, it would provide a more meaningful incentive for all the industry.

I question the need for a 7 year time limit after which the tax exemption will expire. UltraStar is a small, start-up company that is poking around the fringes of existing units and known reservoirs. Our leases are too small to stand alone, so access to existing facilities, owned mostly by the major producers, is the only way we can develop anything we might find. It took our sister company, Winstar, 6 years to negotiate access with the KRU to enable the drilling of the well they completed in 2003. UltraStar has been in negotiations with the PBU for over 3 1/2 years now to get seismic data and facility access to enable the drilling of our Dewline Prospect. It takes a long time for these things to get done, and I question why our investments should be put at risk with this relative short sunset provision, whereas the major producers demand a 30 year period of assured fiscal certainty.

Thanks for the opportunity to comment.

Jim Weeks
907-258-2969

PPT Issues for Discussion by the Question and Answer Panel
Senate Finance Committee
April 10, 2006

No.	Issue	Comment
1.	The impact on exploration, investment and production at various proposed tax rates and credit rates (15% - 30%)	Discuss the relationship between tax and credit to identify the best balance.
2.	WTI vs. ANS	
3.	\$73 million allowance vs. \$12 million credit vs. 5000 bbl plan	Discuss the different impact each option has on the state, the majors and the independents.
4.	Point of Production	Further explanation
5.	Credits and deductions applicable for capital investments in the gas pipeline	What is, what isn't
6.	Re-openers	Discuss 30 year commitments and suggest alternatives
7.	Incremental Cost/bbl by ANS Cost (Sensitivity)	Discuss the incremental costs of lifting a barrel of oil as ANS rises
8.	Acceptability of 2 for 1 provision and appropriateness of a sunset.	
9.	Progressivity on net vs. gross	Discuss options
10.	Cap on Progressivity	Discuss options
11.	Progressivity trigger	Discuss options
12.	Cook Inlet Provision	Should Cook Inlet be treated differently
13.	Transitional Capital Look-Back	Discuss options
14.	Impact of PPT on Facility Access Fees	
15.	Profit in Tankering/Pipeline	Should profit in transportation be included as a cost
16.	Effective Date	April 1, 2006 or July 1, 2006
17.	95% safe harbor and quarterly true-up	How the industry is treated by other tax collectors

1 meter or device through which the oil enters into the facilities of a carrier
 2 pipeline or other transportation carrier in a condition of pipeline quality; in the
 3 absence of an automatic custody transfer meter or device, "gross value at the
 4 point of production" means the value of the oil at the mechanism or device to
 5 measure the quantity of oil that has been approved by the department for that
 6 purpose, through which the oil is tendered and accepted in a condition of
 7 pipeline quality into the facilities of a carrier pipeline or other transportation
 8 carrier or into a field topping plant;

9 Point of Production (B) for gas, other than gas described in (C) of this paragraph,
 10 that is

11 (i) not subjected to or recovered by mechanical
 12 separation or gas processing, the value of the gas at the first point
 13 where the gas is accurately metered;

14 (ii) subjected to or recovered by mechanical separation
 15 but not gas processing, the value of the gas at the first point where the
 16 gas is accurately metered after completion of mechanical separation;

17 (iii) subjected to or recovered by gas processing, the
 18 value of the gas at the first point where the gas is accurately metered
 19 after completion of gas processing;

20 (C) for gas run through an integrated gas processing and gas
 21 treatment facility that does not accurately meter the gas after the gas
 22 processing and before the gas treatment, the value of the gas at the first point
 23 where gas processing is completed or where gas treatment begins, whichever is
 24 further upstream;

25 * Sec. 29. AS 43.55.900(10) is repealed and reenacted to read:

26 (10) "oil" means

27 (A) crude petroleum oil; and

28 (B) all liquid hydrocarbons that are recovered by mechanical
 29 separation of well fluids or by gas processing;

30 * Sec. 30. AS 43.55.900 is amended by adding new paragraphs to read:

31 (17) "Cook Inlet basin" means the area bounded by

1 (A) the north boundary of Township 18 North, Seward
2 Meridian;

3 (B) the Seward Meridian;

4 (C) the south boundary of Township 7 South, Seward
5 Meridian; and

6 (D) the west boundary of Range 19 West, Seward Meridian;

7 (18) "gas processing"

8 (A) means processing a gaseous mixture of hydrocarbons

9 (i) by means of absorption, adsorption, externally
10 applied refrigeration, artificial compression followed by adiabatic
11 expansion using the Joule-Thomson effect, or another physical process
12 that is not mechanical separation;

13 (ii) for the purpose of extracting and recovering liquid
14 hydrocarbons; and

15 (iii) upstream of any gas treatment and upstream of the
16 inlet of any gas pipeline system transporting gas to a market;

17 (B) does not include gas treatment;

18 (19) "gas treatment"

19 (A) means conditioning gas and removing from gas
20 nonhydrocarbon substances for the purpose of rendering the gas acceptable for
21 tender and acceptance into a gas pipeline system; and

22 (B) includes incidentally removing liquid hydrocarbons from
23 the gas.

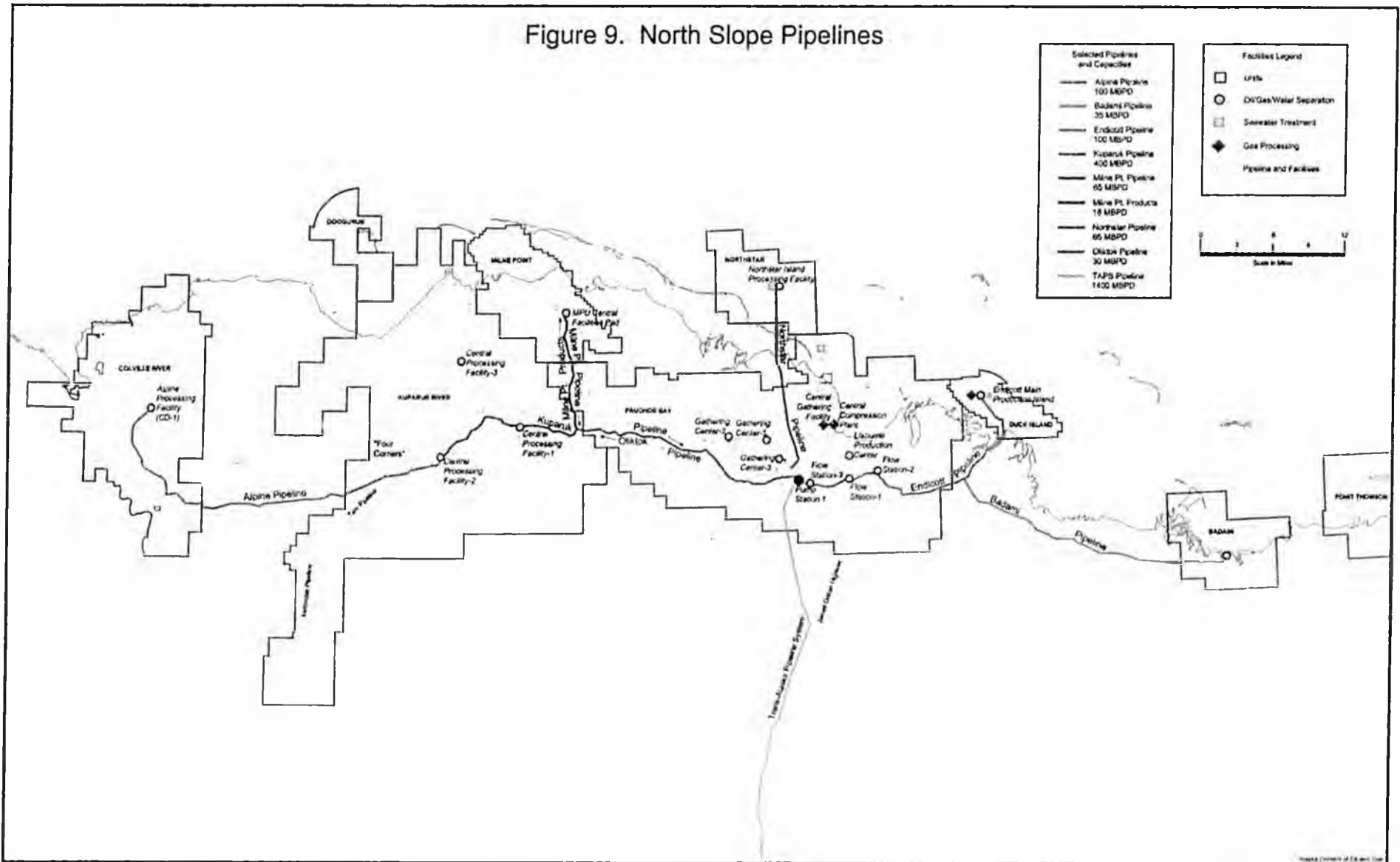
24 * Sec. 31. AS 43.55.011(a), 43.55.011(b), 43.55.011(c), 43.55.012, 43.55.013, 43.55.016,
25 43.55.900(1), 43.55.900(8), 43.55.900(11), 43.55.900(12), and 43.55.900(16) are repealed.

26 * Sec. 32. The uncodified law of the State of Alaska is amended by adding a new section to
27 read:

28 APPLICABILITY. (a) Sections 5, 7 - 10, 12 - 14, 16, and 20 - 31 of this Act apply to
29 oil and gas produced on or after April 1, 2006.

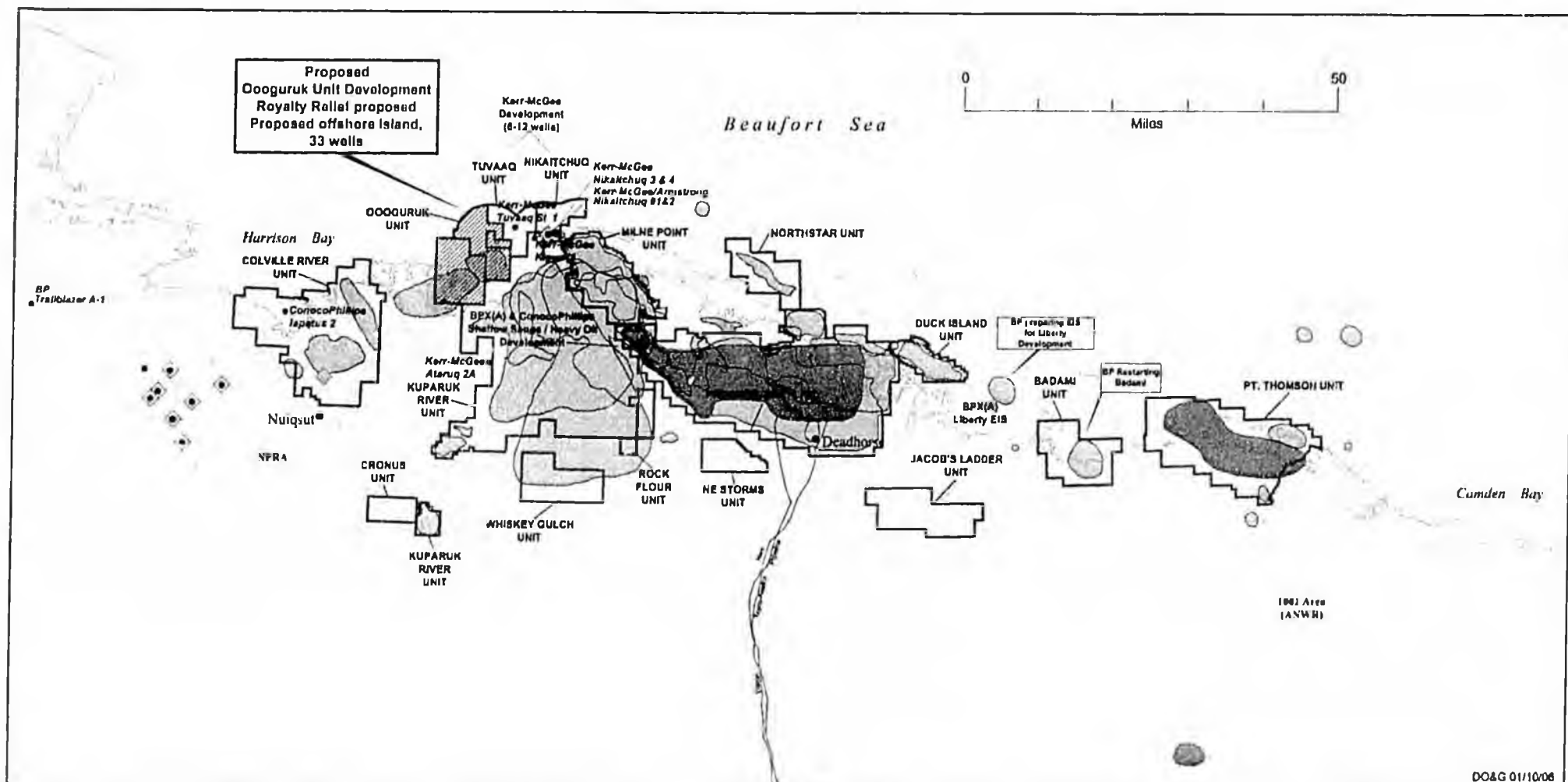
30 (b) Section 11 of this Act applies to oil and gas produced before, on, or after the
31 effective date of sec. 11 of this Act.

Figure 9. North Slope Pipelines

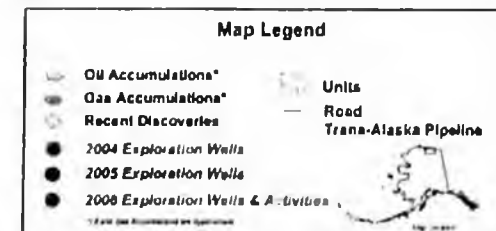


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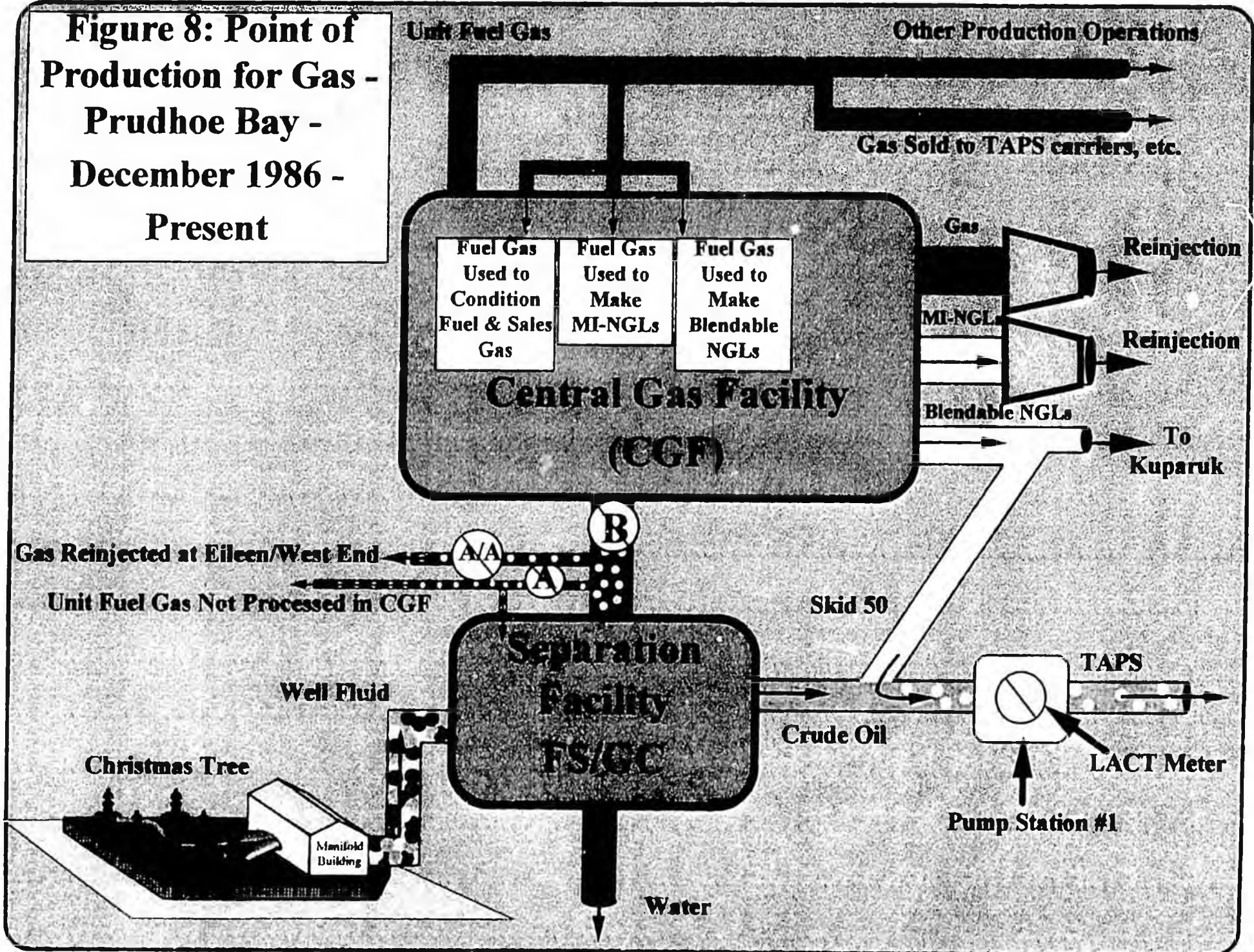
North Slope Oil & Gas Activity & Discoveries January 2006



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Provided by DAN Dickinson

Figure 8: Point of Production for Gas - Prudhoe Bay - December 1986 - Present



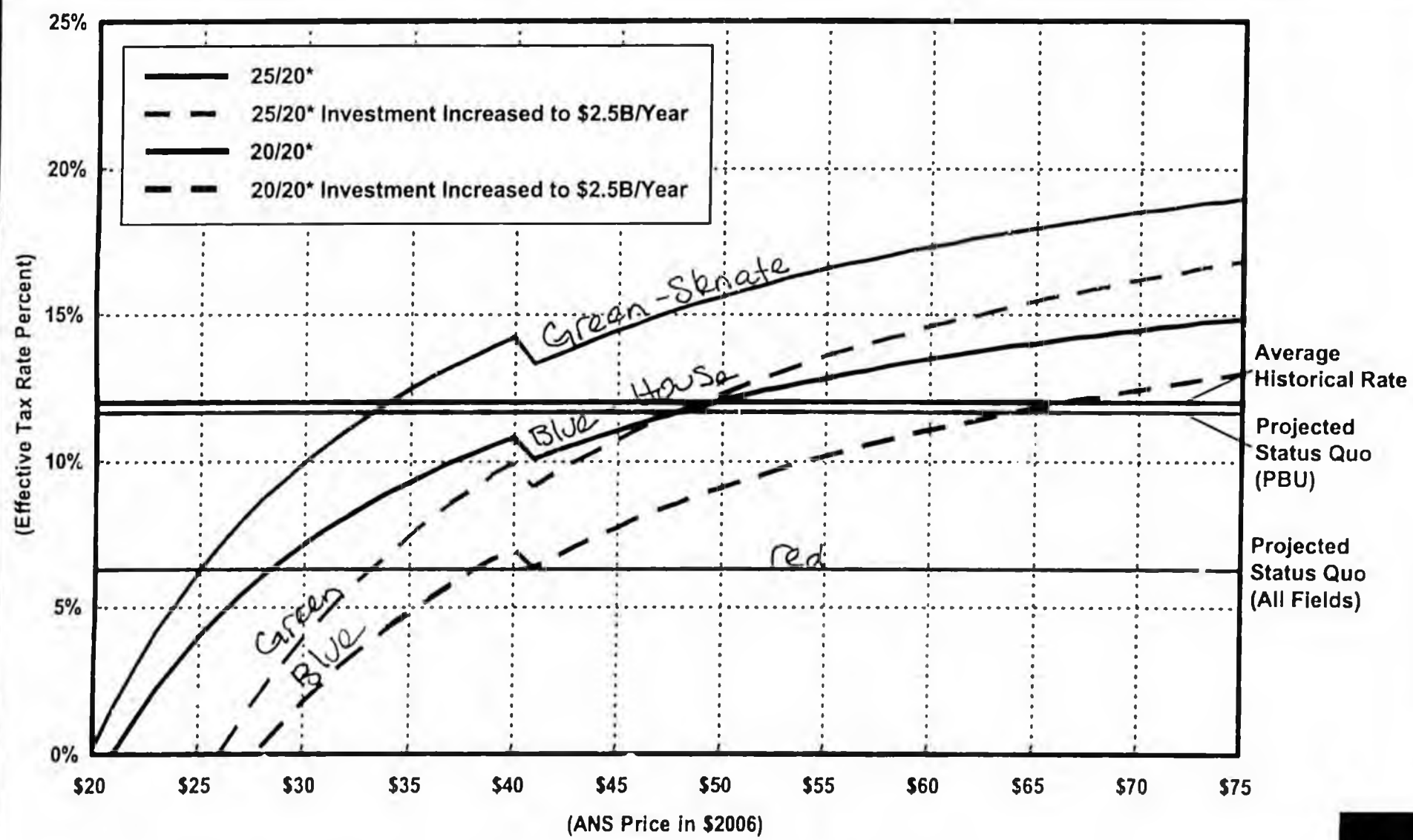
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12:24:14 PM Provided by Dan Dickison 4/10/06

Effective Average Tax Rates at Various Price Levels

Impact of Increased Investment

(FY 2007-2016)



* Calculated from July 2006. Includes 8-year transition (100% 2001-2005) and \$73 Million exemption over 7 companies volumes per DOR Fall 2005 Forecast with Oooguruk projection
 Source: Historical Alaska Department of Revenue



Hanley, Public Affairs Manager Alaska

MK
DD
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DB

Marianne Kah C.P.
Dan Dickinson Admin - Gov.'s Office
Angus Walker BP
John Zager Chevron
Mark ~~Hendley~~ Amudarko
Tony Finizza (teleconference) ~~FINNIZZA~~ LB+A Consultant
Daniel Johnston Leg. Cms. - LB+A Consultant
John Barnes Marathon
David Bramley, VP ERA International

Anthony Finizza

ELON ONP Consultants

4/10/2006

John David
Zagar Bramlay
Gm. chn

Marianne
Keh

Agnes
Walker

Daniel
Johnston

John
Barnes

Den Mark
Dickinson Hankey

ExxonMobil Production Company
P.O. Box 196601
Anchorage, Alaska 99519-6601
907 561 5331 Telephone

Richard J. Owen
Alaska Production Manager
Joint Interest U.S.

RECEIVED

APR 18 2006

ExxonMobil
Production

April 12, 2006

The Honorable Lyda Green
Co-Chair, Senate Finance Committee
State Capitol (MS 3101)
Juneau, Alaska 99801-1182

Dear Senator Green:

Thank you and the Senate Finance Committee for providing the opportunity on April 4, 2006 for ExxonMobil to testify regarding our thoughts and concerns with CSSB 305. Attached are ExxonMobil's responses to the questions from the Senate Finance Committee which were provided to us on Thursday, April 6.

Please let us know of any further questions that may arise from your deliberations.

Sincerely,



RJO:jpc
Attachment

cc. Senate Finance Co-Chair Gary Wilken
House Finance Co-Chair Mike Chenault
House Finance Co-Chair Kevin Meyer

Committee Questions on CSSB305

Questions	Response
<p>1. The PPT rate in the bill as introduced was 20%, while the rate in the Senate Resources CS is 25%. The consultants retained by the Legislature advise that the rate could be 25% without materially affecting the industry's investment in oil and gas development in Alaska.</p> <p>a. Do you agree with this statement?</p> <p>b. In your opinion, what should the PPT rate be in order to increase industry's investment here and why?</p> <p>c. Further more, if you think the PPT rate should be less than 20%, why did your company agree to a 20% rate?</p>	<p>a. It is not clear to us that all the consultants retained by the Legislature support a tax rate higher than 20%. Specifically, during the panel discussion before the House Finance Committee on April 6, the Econ One representatives stated that the PPT tax rate should not be increased beyond 20%. 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. 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. We are concerned that the higher base tax rate could prevent some of Alaska's remaining challenged resources from being developed.</p> <p>b. While higher taxes may bring in additional revenues in the short-term, any reduction in investment and subsequent production will significantly impact those</p>

Questions	Response
	<p>revenues in the longer term. We think that the focus of the tax bill should be to encourage investment and grow production. This is not accomplished with the higher tax rate and the proposal to further increase it as oil price increases.</p> <p>c. 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.</p>
<p>2. The Senate Resources CS proposes a tax in addition to the regular PPT in order to make the system more progressive when prices are high for oil. The House Resources CS proposes similar progressivity for gas as well as oil.</p> <p>a. If we include some kind of progressivity feature to deal with exceptionally high prices, will this have a material effect on industry investment in Alaska?</p> <p>b. Is, please explain why, and how material the effect would be.</p> <p>c. Is there any price level above which the effects of progressivity on new investments would become immaterial?</p>	<p>a/b. Higher tax rates will 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 that 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</p>

Questions	Response
	<p>negative impact on the state's economy.</p> <p>c. The PPT in the original SB305 is progressive. The effective PPT take percentage increases with oil and gas prices. We do not recommend any further progressive features.</p>
<p>3. We have been told there is a trade-off between the tax rate in the PPT and the percentage for tax credits against the PPT, and that an increase of five percentage points in the credit percentage will approximately offset the effects of an increase of the tax rate of one percentage point.</p> <p>a. Do you agree a trade-off exists, and if so, is the 5-to-1 ratio correct?</p> <p>b. Is there a law of diminishing returns at work here that decreases the effect of a credit after it gets to a certain percentage?</p>	<p>a. While there is a trade-off, it depends on a range of assumptions including level of income and investment. However, it is not a fixed ratio. This can be demonstrated in the following simplified cases:</p> <ul style="list-style-type: none"> - $(\\$1000 \times 20\%) - (\\$100 \times 20\%) = \\$180$ - $(\\$1000 \times 21\%) - (\\$100 \times 30\%) = \\$180$ - $(\\$1000 \times 20\%) - (\\$200 \times 20\%) = \\$160$ - $(\\$1000 \times 21\%) - (\\$200 \times 25\%) = \\$180$ - $(\\$1000 \times 20\%) - (\\$500 \times 20\%) = \\$100$ - $(\\$1000 \times 21\%) - (\\$500 \times 22\%) = \\$100$ <p>As you can see, the relationship between tax rate and credit rate is dependent on the income and investment rates which are highly variable and specific to the resource being developed.</p> <p>b. While the investment tax credits of 20% could enhance the present value economics of new investments, the 20% tax rate will result in lower overall cash flow. The combination of a 20% credit along with a 20% tax rate may not be adequate to support development of all the remaining ANS opportunities.</p>
<p>4. The original version of SB 305 provided three alternatives for determining the "gross value at the point of production" for taxable oil and gas: 1) using the royalty netback settlement determined under a royalty</p>	<p>a. The use of a producer's royalty settlement agreement to determine the value of oil and gas addresses a longstanding issue that has divided the State and the industry over the years. There is only one value in the</p>

Questions	Response
<p>settlement agreement with the State, 2) using a "formula" prescribed by the Department of Revenue (DOR) based on a netback value or netback methodology approved by the government, and 3) using "another formula" by DOR that reasonably estimates a value for the oil or gas at a specific geographic location. The Senate Resources CS deletes the first alternative, but keeps the latter two unchanged.</p> <p>a. What specific issues or problems do you foresee because of this deletion?</p>	<p>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 and the State on the value on which to calculate royalty and production taxes while reducing the administrative and audit costs to both the State and the industry.</p>
<p>5. What do you think the effective date should be for the PPT and why?</p>	<ul style="list-style-type: none"> ExxonMobil believes that tax increases should be prospective, so the effective date should be sometime after the date of enactment. A period should be provided to allow systems to be put into place and a true-up between estimated payments and actual obligations to occur.
<p>6. The Senate Resources CS allows a credit for investments made during the five years preceding the effective date of the PPT, but limits the credits so that new capital investments will have to be twice as much as the old ones in order for the credit to be fully used.</p> <p>a. How will this two-for-one transitional credit make a difference in your company's investment decision – making?</p> <p>b. Is this approach fair to both major and independent producers?</p>	<p>a/b. Investment decisions are based on the resource opportunity and are evaluated on a range of factors including geologic, technical, execution risks as well as risks associated with fiscal and political stability. The purpose of the transition provision is to address the sudden increase in taxes on recent 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 appropriate.</p>
<p>7. In committee, it was mentioned that the safe harbor provision in the Senate Resources CS, requiring</p>	<p>a/b. The monthly tax payments under the PPT are based on estimates of lease expenditures, production volumes</p>

Questions	Response
<p>taxpayers to calculate their monthly tax payments to a 95% accuracy, is a very difficult target to hit and unreasonable.</p> <p>a. Do you agree with this statement and if so, what do you consider reasonable?</p> <p>b. Do you feel the quarterly true-up provision is manageable or should it be an annual true-up as proposed in the original version of the bill?</p> <p>c. What is the traditional relationship in this regard between the oil and gas industry and tax collectors in other state?</p>	<p>and capital expenditures. As a production tax based on estimates of profit, we believe the PPT tax should follow the federal model – 90% “safe harbor” with a true-up after the close of the year. Provided the safe harbor is met, there is no interest or penalties assessed on any remaining balance.</p> <p>c. In our experience with state income tax, including Alaska, most jurisdictions generally follow the federal model for estimated payments, safe harbor and true-up.</p>
<p>8. Please take this opportunity to describe any other provisions of the Senate Resources CS to SB 305 that cause considerable concern for your company and deserve additional discussion by the Senate Finance Committee.</p>	<p>We would recommend the following changes to the CS:</p> <ul style="list-style-type: none"> • Return PPT tax rate to 20% • Eliminate additional progressive feature • Remove linkage of transition provision to future spending • Specifically allow Royalty Settlement Agreements for valuation • Make effective date the later of the enactment date or July 1, 2006. • Estimated payments should mimic federal model

bp

Steve Marshall
President, Alaska



BP Exploration (Alaska) Inc
900 East Benson Boulevard
P.O. Box 196612
Anchorage, Alaska 99519-6612
(907) 564-5422

April 11, 2006

The Honorable Lyda Green, Co-Chair
Finance Committee, Alaska State Senate
State Capitol, Mail Stop 3100
Juneau, AK 99801-1182

Re: Questions on SB 305

Dear Senator Green:

Thank you for the questions posed in your letter of April 5th. Attached, please find BP's response, which I hope you will find helpful.

Please advise if we can be of any further assistance in this matter.

Sincerely,

Steve Marshall



Provided 4/12/06



**BP's Response to
Senate Finance Committee Questions
on SB 305
April 11, 2006**

1. *The PPT rate in the bill as introduced was 20%, while the rate in the Senate Resources CS is 25%. The consultants retained by the legislature advise that the rate could be 25% without materially affecting the industry's investment in oil and gas development in Alaska.*
 - 1.1. *Do you agree with this statement?*
 - 1.2. *In your opinion, what should the PPT rate be in order to increase the industry's investment here and why?*
 - 1.3. *Furthermore, if you think the PPT rate should be less than 20%, why did your company agree to a 20% rate?*

Response

1.1: Do you agree with this statement?

BP strongly disagrees with this statement. We believe that increasing tax rates at this time will have a material impact on future investment. BP considers the PPT tax rate to be the most important feature in the bill and the single most important decision to be made by the legislature. Getting it wrong will have major impacts on the petroleum industry in Alaska for years to come.

We are acutely aware that investment decisions made here affect not only BP's shareholders, but our Alaskan employees & contractors, their families, the communities they live in, our suppliers, the local economy and of course the State itself. We all want to maximize the *potential* value of the resources in the ground and convert them into *real* value or wealth.

As the operator of Prudhoe Bay, Endicott, Northstar, GPMA, Milne Point, and Badami, as well as a major investor in Kuparuk our view of North Slope Production is as follows.

- North Slope production is declining at approximately 6% per year
- at this rate of decline production will be as low as 450 mboed in 10 years time.
- operating costs are increasing due to a worldwide shortage of petroleum industry resources
- fixed costs and declining production means that margins will continue to shrink
- the level of investment required to achieve the DOR's latest production forecast is double current levels
- oil price will change and that is something nobody has any control over
- the technical challenges involved in producing the remaining oil are getting more difficult, and will in many cases require new technologies that does not exist today

We believe that the recommendations of the State's and the Legislature's consultants have been crafted assuming that Alaska's oil production is declining more slowly than it is and that increasing taxes will have no impact on investment. We believe both these assumptions to be in error and dangerously misleading.



1.2: In your opinion, what should the PPT rate be in order to increase the industry's investment here and why?

In our opinion the PPT structure has real merit, but the tax rate should be significantly lower than the 20% proposed in order to attract the investment required to stem decline and to provide the Production, Revenues, Economy and Jobs which Alaska requires.

We believe the best thing the Legislature can do to maximize the value of the petroleum resources for Alaska is to create an environment that encourages investment. We believe the Gulf of Mexico, the UK, the Alberta Heavy Oil Province are good models to emulate. They show the impact of creating an unambiguous, attractive investment climate by adopting appropriate fiscal terms. The Alberta Heavy Oil Province, the Gulf of Mexico deep water and the UK of the 1980's and 1990's are wonderful illustrations of where attractive, *not tolerable*, tax rates encouraged huge investments that resulted in increased production and increased revenues for the government and significantly increased economic activity.

Production is declining faster than anyone has been predicting. The impact of production decline is being masked by the current high oil prices. This is not the time to raise taxes, but the time to adopt a fiscal policy which will attract investment.

We strongly urge the Legislature to adopt a tax rate significantly less than the 20% in the original bill (a 15/25 (15% tax and 25% credit) would be significantly better than the 20/20 originally proposed) and furthermore we urge the Legislature to look towards the UK, Gulf of Mexico and the Alberta Heavy Oil Province for inspiration from counties / states who have successfully attracted investment by adopting specific fiscal policies.

1.3: If you think the PPT rate should be less than 20%, why did your company agree to a 20% rate?

Very simply, we agreed not to oppose the 20% rate as part of a package deal which would enable us to proceed with gas. That package includes the other terms of the Governor's PPT bill, including the transition provisions among others.

It is important to remember the negotiating range defined by the Producers' first offer and the Governor's first offer was between 12.5% and 20%. At the end of the day, the Governor was successful in pulling the producers to the upper end of that range, a point which many in the legislature mistakenly interpret as a starting point.

The 20% should not be looked at in isolation but as part of the total package. We believe the 20% rate in conjunction with the rest of the provisions in the original bill created a *tolerable* climate for investment, not an *attractive* climate for investment. Alaska should be looking to create an attractive climate for investment in order to stem production decline, which is why we have consistently recommended that the Legislature adopt a tax rate less than the 20% proposed by the Governor.



2. *The Senate Resources CS proposes a tax in addition to the regular PPT in order to make the system more progressive when prices are high for oil. The House Resources CS proposes similar progressivity for gas as well as oil.*

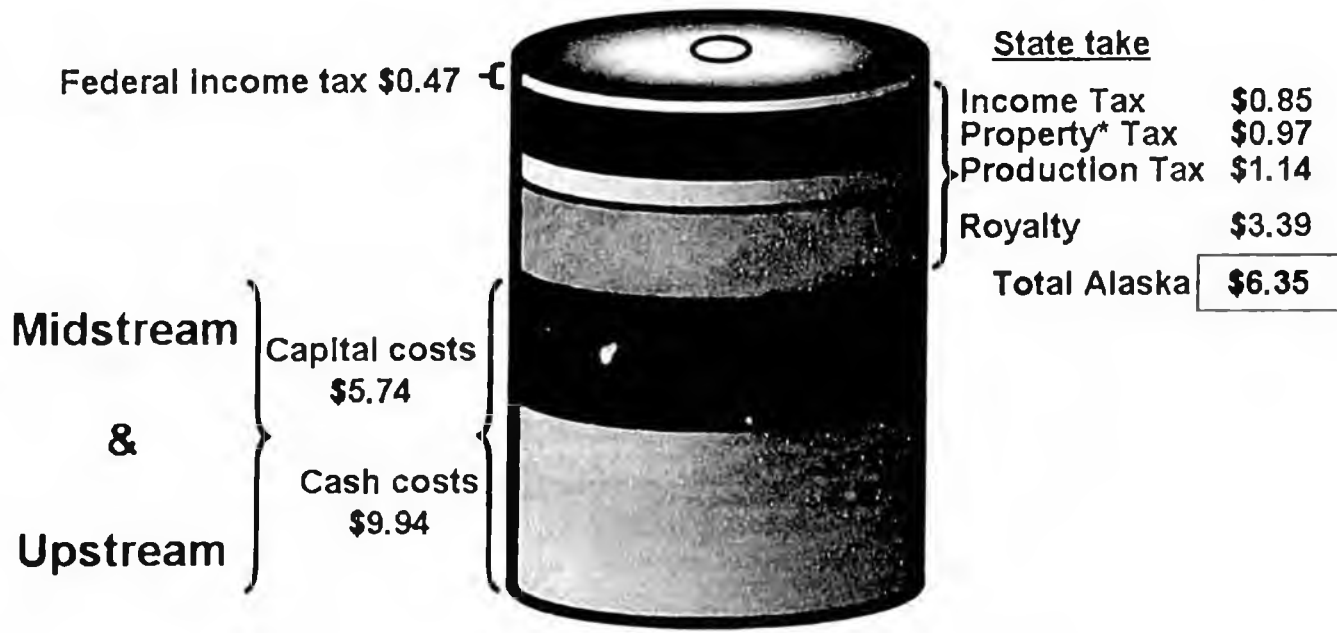
- 2.1. *If we include some kind of progressivity feature to deal with exceptionally high prices, will this have a material effect on industry investment in Alaska?*
- 2.2. *If so, please explain why, and how material the effect would be?*
- 2.3. *Is there any price level above which the effects of progressivity on new investments would become immaterial?*

Response

Reiterating the answer to question 1: **higher taxes generally result in less investment & lower taxes generally result in higher investment.**

As we have previously stated, at prices below \$22.50 ANS / barrel BP does not currently make a profit in Alaska. As ANS production declines our fixed costs will remain and the breakeven oil price will rise.

Breakeven Barrel \$22.50



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



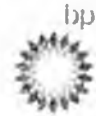
We should all share in the upside of high oil prices and we have agreed that it is appropriate for the State to take a higher share than that which they enjoy today based on the existing ELF system as part of a new fiscal regime.

In itself, the 20% PPT rate gives the State progressivity and significantly increases the State's share at high oil prices. Under the Governor's proposal DOR estimates that the State will receive an additional \$1bn / yr at current prices.

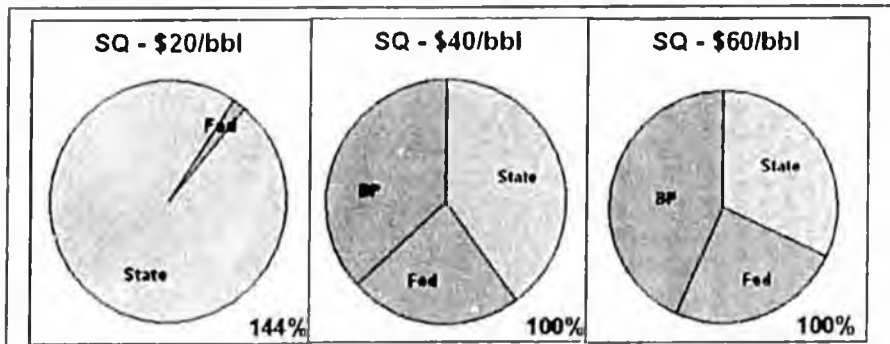
The pie charts below illustrate the split between State, Federal and BP take under the current regime and the original PPT 20/20 at low, medium and high prices. Under PPT 20/20, we would continue to make a loss at \$20. At \$40 the State gets a considerably higher share than BP. At \$60 under the original PPT 20/20, i.e. without any price surcharge, the State's and BP's take is balanced.

Introduction of progressivity squeezes our profit at higher prices even more than the original PPT and would create an extremely unbalanced system. Given the high government take in Alaska at low prices, this imbalance will make investments less attractive.

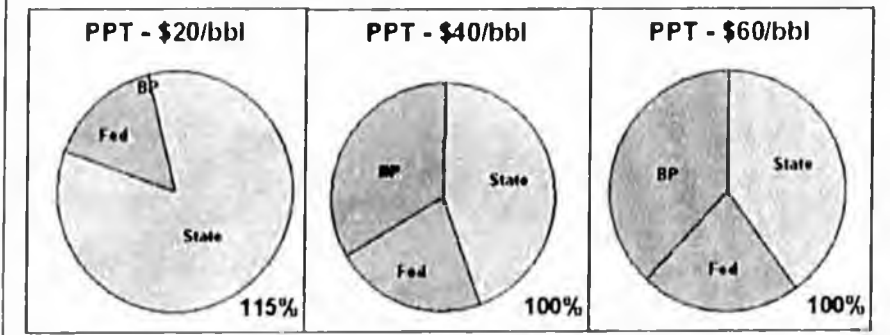
PPT Impacts
Government Take (%)



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 impact on investment will depend on the design of the system. If the Legislature is convinced that the ultimate solution must include progressivity we would encourage them to adopt the following principles:

Keep it simple. Alaska already has one of the most complex tax regimes in the world. Complexity breeds ambiguity and disputes and is a deterrent to investment.

Increase PPT tax rate with price rather than introduce an independent 'surcharge' based on gross revenue. PPT is a tax on net cash flow and thus it is appropriate that any incremental take at high prices or reduced take at low prices is based on net cash flow.

Create no more than 3 price bands with different tax rates:

- a low price band which provides real relief to industry at low prices when industry is struggling due to Alaska's very high costs and the regressive nature of royalties.
- a mid price band which spans the mid to high range of expected prices and at which the tax rate is reasonable (lower than 20%) and makes Alaska an attractive place to invest.
- a high price band over which a higher tax rate would not be a significant deterrent to investment.

In order that the system will endure and serve Alaska well it would be necessary to:

1) ensure price trigger points are based on the actual value of the product (i.e. Wellhead value is best, ANS is better than WTI)

& 2) ensure trigger points do not become outdated by inflation proofing them.

3. *We have been told there is a trade-off between the tax rate in the PPT and the percentage for tax credits against the PPT, and that an increase of five percentage points in the credit percentage will approximately offset the effects of an increase in the tax rate of one percentage point.*

3.1. *Do you agree a trade-off exists, and if so, is the 5-to-1 ratio correct?*

3.2. *Is there a law of diminishing returns at work here that decreases the effect of a credit after it gets to a certain percentage?*

Response

The most important driver in the PPT equation is the tax rate. The credits are, however, important and there is a trade-off between the PPT tax rate and the tax credit. The question of how much this trade-off is — whether it is 5-to-1, 6-to-1, or something else — does not have a simple answer. This is because other factors affect the balance point where a change of 1 percentage point in rate is balanced by a change of X percentage points in the credit. These other factors are the price of oil, the operating cost per barrel relative to the oil price, and the capital investment relative to the value of the oil currently being produced. We would be happy to illustrate this relationship with examples if that would be helpful to you or the committee.



4. *The original version of SB 305 provided three alternatives for determining the "gross value at the point of production" for taxable oil and gas:*
- *using the royalty netback determined under a royalty settlement agreement with the State*
 - *using a "formula" prescribed by the Department of Revenue (DOR) based on a netback value or netback methodology approved by the government, and*
 - *using "another formula" by DOR that reasonably estimates a value for the oil or gas at a specific geographical location."*

The Senate Resources CS deletes the first alternative, but keeps the latter two unchanged.

4.1. What specific issues or problems do you foresee because of this deletion?

Response

We believe that the deletion was a mistake.

The Royalty Settlement Agreement (RSA) netback not only has a methodology that reflects current market conditions, but it also includes a procedure for either side to "re-open" part or all of that methodology and adjust it as market conditions change.

This re-opener procedure has worked extremely well in the decade and a half since the *Amerada Hess* lawsuit over North Slope royalties was settled by the companies.

We believe using RSA netback values as much as possible in the PPT is a good idea.

Using RSA netbacks for PPT would minimize the need in DOR for an entire second group of administration, audit and enforcement, and dispute-resolution staff paralleling the existing one for royalty netbacks. The only need for DOR to have netback specialists for PPT would be to deal with producers that do not have an RSA with the State, but this need should be very small. When the other companies in the *Amerada Hess* case made their settlements with the State, they were given the option of patterning their RSA after ARCO's RSA (now ConocoPhillips' RSA), BP's RSA, or ExxonMobil's RSA. We see no reason why DNR would not extend a similar option to any new companies coming to the North Slope.

Although we advocate using existing RSA netbacks where possible for PPT, we recognize that an RSA developed for Cook Inlet production is inappropriate for the North Slope, and vice versa. We believe an RSA should be used only for the region or basin for which it was developed. Consequently, as oil and gas exploration and development occur in areas besides the North Slope and Cook Inlet, the PPT legislation should provide authority for DOR by regulation to designate other regions or basins within which the RSAs for them would be recognized and effective for PPT purposes as well.



5. *What do you think the effective date should be for the PPT and why?*

Response

The effective date should be no earlier than July 1, 2006. An April 1st effective date already involves retroactivity, and that retroactivity grows greater with each day that passes. Retroactivity in taxes is inherently unfair, and all the more so when such a major overhaul is being made to such a significant tax.

6. *The Senate Resources CS allows a credit for investments made during the five years preceding the effective date for the PPT, but limits the credit so that new capital investments will have to be twice as much as the old ones in order for the credit to be fully used.*

- 6.1. *How will this two-for-one transition credit make a difference in your company's investment decision-making?*
- 6.2. *Is this approach fair to both major and independent producers?*

Response

Keeping the transition provisions sends a very loud and clear message to existing and potential new investors that Alaska treats investors fairly, and that Alaska is open for business.

We believe that allowing a transitional credit is the right thing to do. These investments were made under the ELF-based severance tax, and now the tax is being changed in a very significant way. It is common for governments to provide such transitional relief when they make major tax changes. Alaska itself has allowed such transitions in the past when it has made major changes to its fiscal regime.

We believe the two-for-one investment proposal is an elegant solution and we could support it provided it is simplified to ensure that companies who make future investments get the benefit of the transition provisions.

To this end we would suggest that the \$40 test be removed and the 2013 sunset date be extended.



7. *In committee, it was mentioned that the safe harbor provision in the Senate Resources CS, requiring taxpayers to calculate their monthly tax payments to a 95% accuracy, is a very difficult target to hit and unreasonable.*

7.1. *Do you agree with this statement and if so, what do you consider reasonable?*

7.2. *Do you feel the quarterly true-up provision is manageable or should it be an annual true-up as proposed in the original version of the bill?*

7.3. *What is the traditional relationship in this regard between the oil and gas industry and tax collectors in other states?*

Response

The whole approach in the safe-harbour provisions is mistaken, not just the 95% figure.

The use of federal tax concepts and principles presents several important advantages.

First, the federal definitions are clear and well defined, both by statute and regulations and by administrative and judicial precedent.

Second, since the federal standards apply, producers can use the same accounting systems for these parts of the PPT that they use for the federal income tax.

Third, and of particular value for the State, the use of these federal tax concepts and rules means that the IRS, rather than DOR auditors, can do the heavy lifting in terms of auditing and enforcing these federal standards. As with federal principles adopted under the state income tax, the DOR auditors merely have to say "me too" on those matters once the IRS is done with its audit of a producer.

The federal system, however, is based on tax years rather than tax months. The whole notion of the PPT being a monthly tax is merely a carry-over from the present severance tax. There is nothing inherent in the severance tax, nor the PPT, that requires it to be a monthly tax instead of an annual one. The only reason for having PPT be paid monthly is to provide the State a more uniform stream of tax revenue from month to month, and this can be accommodated just as well under an annual PPT by having producers make monthly estimated payments with an annual true-up once the year is over.

The federal income tax uses a similar system of estimated payments for businesses. Once a quarter a business has to make an estimated tax payment, with a final payment due in March of the following year. To deter deliberate underpayment of the quarterly estimates, the Internal Revenue Code has an underpayment penalty if the total of those estimated payments is less than 90% of the actual amount of tax due for that year.

There are sound reasons behind the federal system of estimated payments with a true-up after the end of the year, and they apply equally well to the PPT system.

We recommend changing the tax period from a calendar month to calendar year, with monthly estimated payments that, on a cumulative basis each month, bring the total paid up to that point to at least 90% of the total PPT for that portion of the year based on the data available to the producer at the time it reports and makes its monthly estimated payment. At the end of March the following year, the full amount of the PPT for the year comes due, and anything not paid then not only accrues interest at the statutory rate, but is also subject to underpayment penalties if there is not sufficient cause to justify the underpayment.



Apart from being monthly instead of quarterly, our proposal is essentially the federal system. Two key elements of the PPT — namely, the “necessary and reasonable” nature of the expenses claimed as deductible lease expenditures, and the amount of such expenditures that are capital in nature instead of operating expense — are based on federal tax concepts and principles, and thus it is appropriate to follow the federal system for estimated payments.

8. *Please take this opportunity to describe any other provisions of the Senate Resources CS to SB 305 that cause considerable concern for your company and deserve additional discussion by the Senate Finance Committee.*

Response

It is our understanding that the tax committee of the Alaska Oil and Gas Association is working to finalize a half dozen or so technical amendments and recommendations regarding CSSB 305(RES). We expect they will be submitted very soon, along with a letter or written testimony explaining them. Some of those AOGA suggestions may cover material we have discussed here. Since AOGA takes positions on tax matters only by consensus without objection, the fact that AOGA will be presenting them to you will itself be evidence that BP endorses those proposals. In addition to the issues raised in this letter I would ask you to give full consideration to the issues raised by AOGA.

Presentation to
House Finance Committee
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:

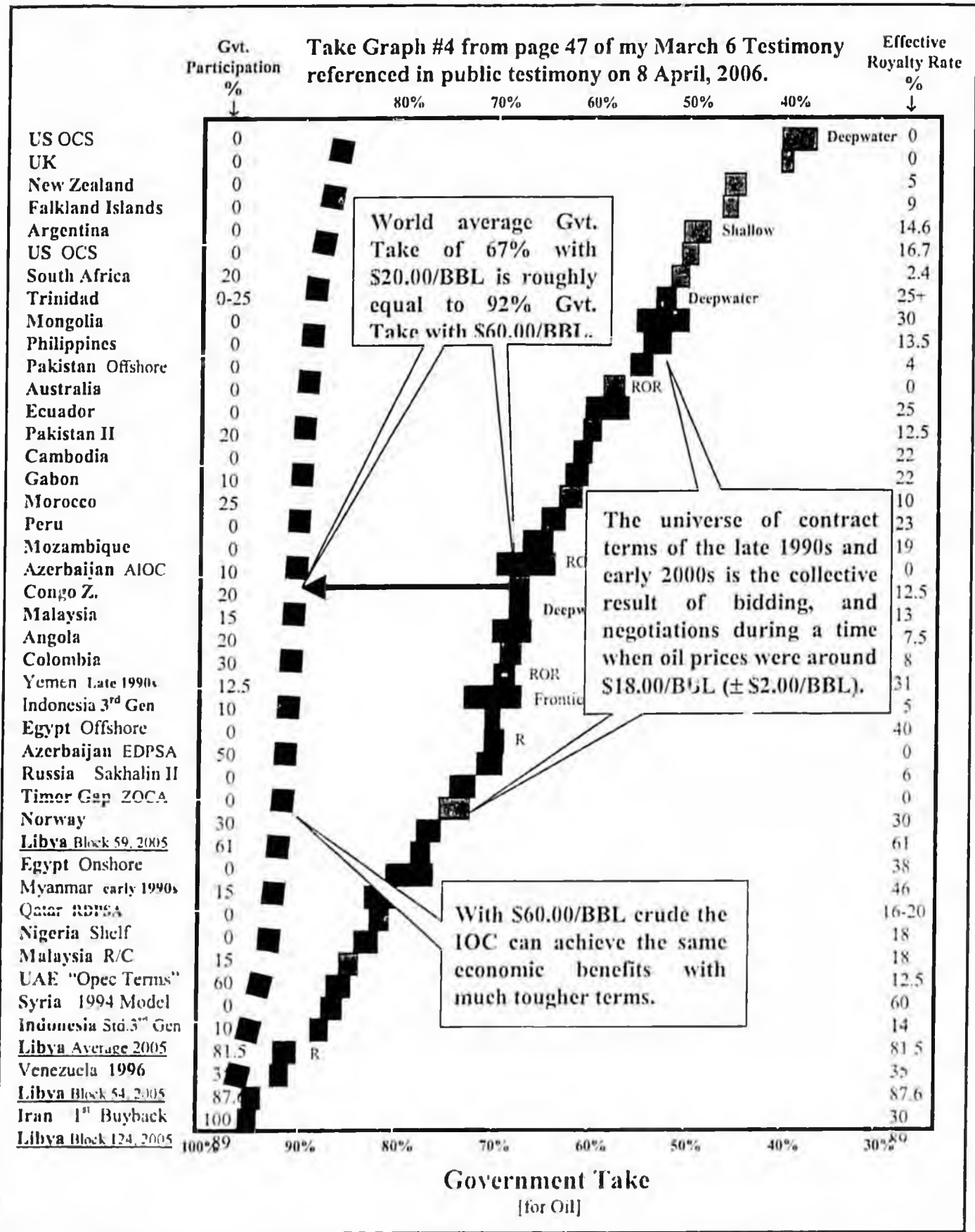
- (1) That Investment will dry up with the 25/20% proposal and a progressive feature.**
- (2) Alaska reputation will be seriously harmed**
- (3) There may be no Gas Pipeline**
- (4) Philanthropic donations are at risk (ConocoPhillips)**

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.

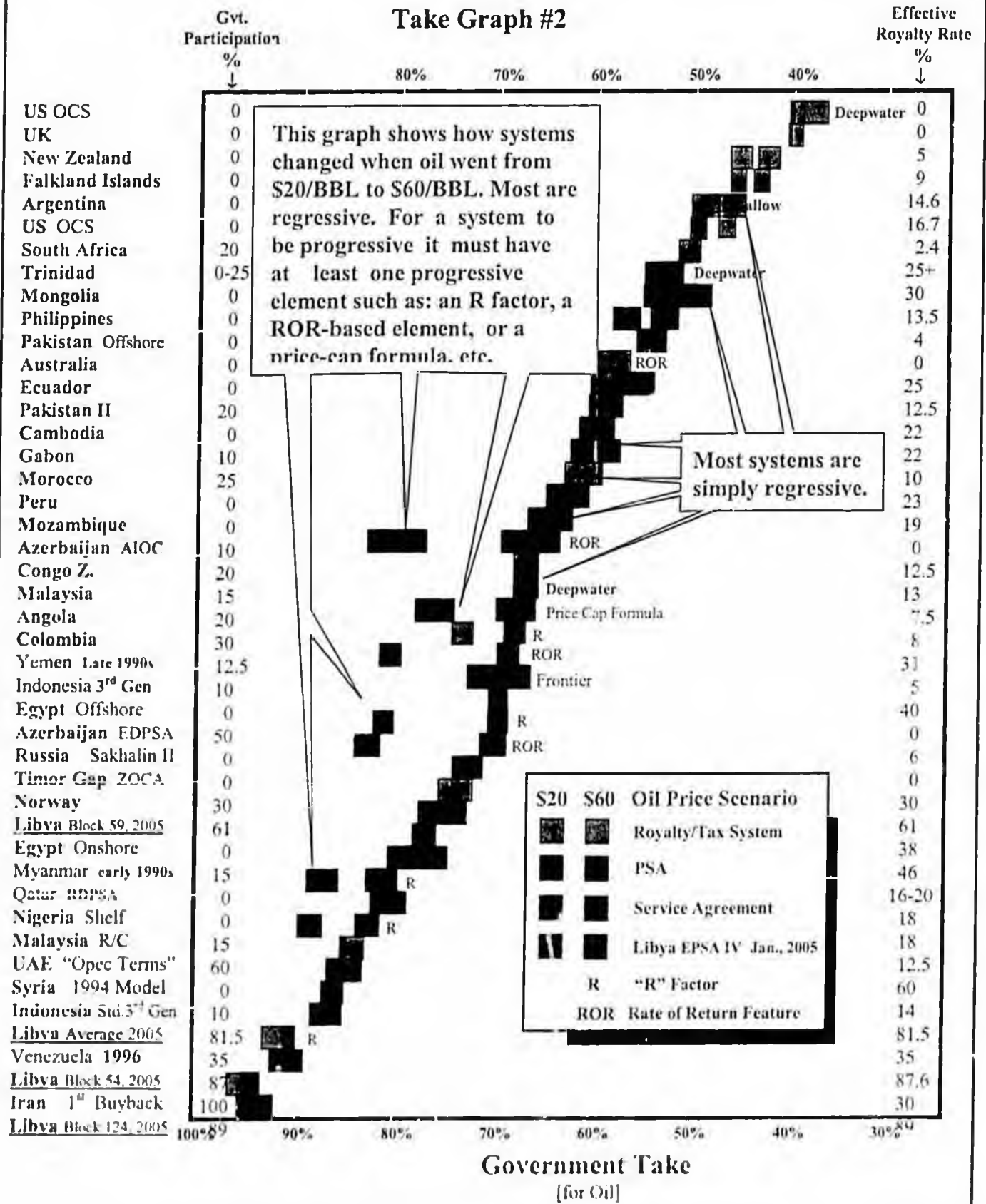
Who really thinks comparing Alaska to the likes of Kansas or Colorado is reasonable?

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?

Take Graph #2



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

<http://news.morningstar.com/news/DJ/M04/D04/200604040854DOW:JONESD:IONLINE000295.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

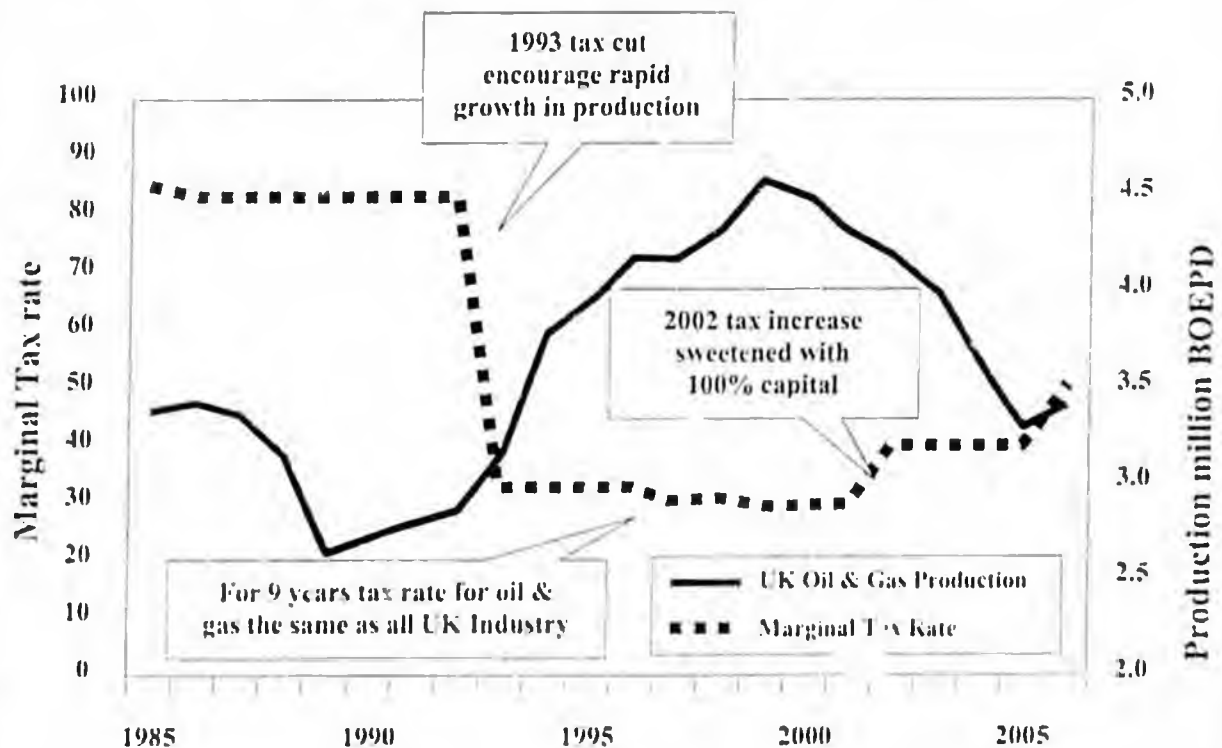
The graph below is not a fair representation of what the result of lowering the tax rate in 1993 was. In fact exploration expenditures went down significantly in 1994 and development expenditures did not go up (see following page). They went down but not as dramatically as exploration expenditures.

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)

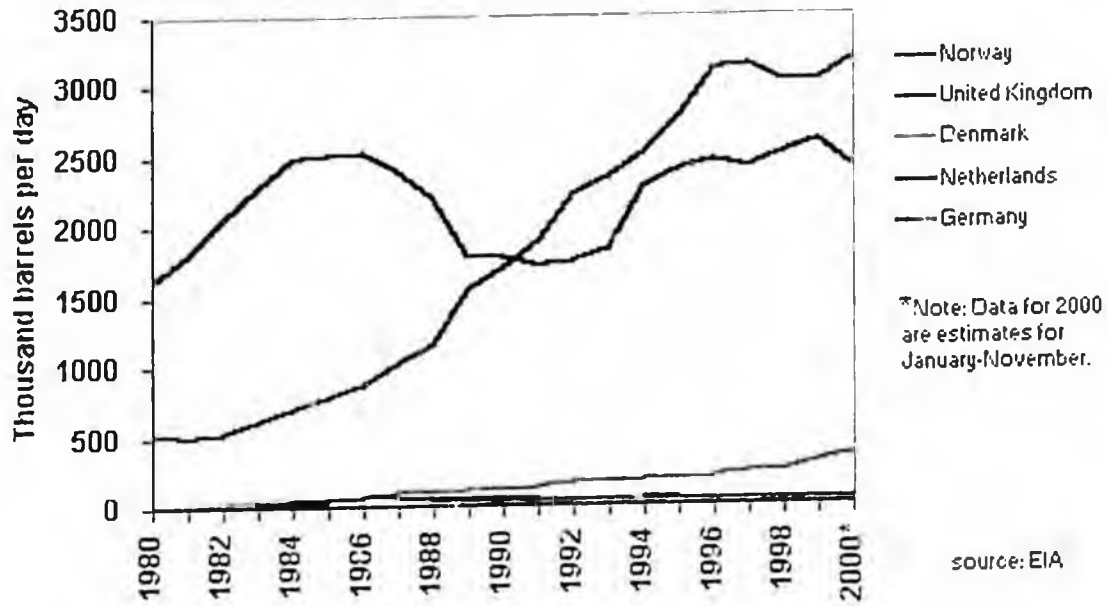
UK Drilling Activity History — Wells Drilled per year

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*



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 MBO/D	
	MMBBL S	TCF				
Andrew	160	0.25	6/1974	6/1996	50	
Harding	719	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)