



11590 MOUSE RESOURCES

Over the past 10 years we have invested over \$5.8 billion in capital and \$6.8 billion in expense dollars in the State. We are among the State's largest employers of Alaskans and we pay more to the state (\$1.6 B) than any other entity.

We can't talk about ConocoPhillips in Alaska without talking about our employees. We have approximately 1000 employees in the state and approximately 90% of them are Alaskan residents and proud of it. They are competent, motivated, and active in the communities. They care about Alaska, and they believe that the work they do makes Alaska a better place to live. They see themselves as playing an important part in building Alaska's future. And, through contractors, subcontractors and support industries, we directly and indirectly generate employment for thousands of additional Alaskans.

The past, present, and future for ConocoPhillips and the State of Alaska are inextricably linked. As we move forward as partners for perhaps the next 50-100 years, we believe there must be a mutual recognition of, and respect for, the interests of each. We have to try, together, to answer the question—how do we balance the factors that affect each of our interests in a way that makes us both successful—so that over time we are both better off than if we single-mindedly tried to pursue our individual short-term interests? That is the balance the Governor's bill tries to strike.

Unfortunately, the balance in the bill is decidedly in the favor of the State and at the expense of established investors. We believe the Governor's bill sets an aggressive level of State take, when that take is considered in conjunction with our corporate income tax obligations to the State, our

property tax obligations to the State, our property, sales and other tax obligations to the State's municipalities, our royalty obligations to the State, the various oil and gas tax surcharges imposed by the State, and the sundry additional fees and costs paid as part of the permitting process whenever we attempt to move forward with development. All of which, of course, is on top of our corporate income tax obligations to the Federal government attributable to our activities in the State. It is no surprise that this layer upon layer of governmental take inevitably has a negative impact on the level of investment here, and, commensurately, the level of job creation and job growth in the State. As taxes increase, it is difficult to see how investment in Alaska will not be effected.

On the other hand, we realize that the legislature cannot adopt a tax policy that is concerned exclusively with maximizing the robustness of the State's economy and the participants in that economy. The government is charged with providing certain essential services to its citizens and those essential services cost money. And, if the State cannot pay, or chooses not to pay, for those services from the proceeds of the sale of its resources—that is, the royalty proceeds from its oil and gas—then it must turn to its sovereign taxing power to obtain the revenues to pay for those services.

While we support passage of this bill, we do so reluctantly. The bill reflects a significant tax increase on our company, and on the industry, at a time when the government is enjoying a large budget surplus. We believe the tax rate set in the bill is too high to guarantee the State's goal of increasing investment over the long term, and it punishes companies that have made long term investments that are returning dividends to the State in the form of

jobs, royalties, corporate income taxes and property taxes. We would, in fact, oppose this bill except for the fact that it has enabled all parties to come together in support of a contract under the Stranded Gas Development Act that will move the gas pipeline project to the next phase of development. Advancing the gas pipeline project has been, and continues to be, one of ConocoPhillips' top priorities.

With that introduction, I would like to start off by discussing some of ConocoPhillips' long term investments in Alaska, the role they have played in minimizing North Slope production decline and the impact that ELF has had on these developments.

As I mentioned, ConocoPhillips is Alaska's leading producer and explorer. Since 1989, we have been involved with the exploration and development of fourteen satellites (six of these since 2001). These satellites were predominately marginal developments, the 50 to 150 million barrel type that the State is targeting with this legislation, that were able to be developed as a result of the favorable fiscal treatment given under ELF.

Development of these satellites played a significant role in reducing North Slope decline and enabling more than 1.9 billion barrels of additional oil to be produced compared to predictions back in 1989, when the Economic Limit Factor was first introduced. This is equivalent to discovering a Kuparuk-size field and has added more than \$5 billion in revenues to the State of Alaska. In addition to our active satellite developments, we continued to actively explore, drilling more than 40 exploration and appraisal wells in the last 5 years and are committed to continue exploring in the State

and developing future successes. As we look back, in general the ELF structure did what it was intended to do and enabled ConocoPhillips to continue exploration, pursue heavy oil, develop marginal satellite fields and maintain in-field drilling programs. It increased the barrels in the pipeline and the state government was able to collect the royalties, the corporate income taxes, the property taxes, and the various fees and surcharges that go along with these developments; the federal government collected its share; and most important, Alaska's economy was able to grow.

We understand the State's view on the limitations of the current ELF-based severance tax system, particularly at high prices. We also understand that there is no such thing as a perfect tax system. However, we believe that there can be such a thing as a wise and enduring tax policy. We believe a production tax, such as the one the Governor has proposed, that is intended to reflect profits from that production and includes incentives to encourage investment in the future and fair transition provisions that recognize the costs of the investments already made, is such a policy.

Nevertheless, HB 488 / SB 305 as proposed will result in an average of \$1 billion per year in additional State revenue at today's prices, even with significant industry investment levels. This unprecedented increase will more than double existing severance tax payments.

With that backdrop, Marianne and I would like to give you ConocoPhillips' perspective in several key areas:

- A balanced fiscal structure is critical for both oil and gas future investment,

- Future of oil production in Alaska is primarily dependent on existing fields
- HB 488 / SB 305 differentially and adversely impacts our legacy production from existing fields
- A significant transition plan is necessary to allow equitable conversion to a new production tax system
- The new PPT will impact Alaska's global competitiveness for investment

**Balanced Fiscal Structure:** There have been many questions about the relationship of the Governor's oil tax proposal to the fiscal contract negotiations under the Stranded Gas Development Act. As you know the fundamental purpose of the Stranded Gas Development Act was to encourage new investment to develop the State's stranded gas resources by establishing fiscal terms in advance with as much certainty as the Constitution of the State of Alaska allows.

Unfortunately, the line between "oil" and "gas" is not clear-cut. Oil and gas exist together in reservoirs; the wells we drill produce both; many of the investments necessary to develop gas will help develop oil as well. Ultimately, this means that the "fiscal certainty" provided by the State under the SGD.A. could be inadequate if it only applied to gas.

The Administration recognized the need for the Legislature to approve any agreement that included fiscal certainty for oil but was unwilling to consider fiscal certainty on oil under the terms of the current production tax statute. It was, however, willing to propose to the legislature a new oil tax that could

# ALASKA STATE LEGISLATURE



Official Business

## SENATE RESOURCES COMMITTEE

Senator Tom Wagoner, Chair  
State Capitol, Room 427  
Juneau, AK 99801-1182

## HOUSE RESOURCES COMMITTEE

Rep. Ralph Sanvels, Co-Chair  
State Capitol, Room 126  
Juneau, AK 99801-1182

Rep Jay R. Inras, Co-Chair  
State Capitol, Room 104  
Juneau, AK 99801-1182

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DATE: February 28, 2006  
TO: Commissioner Bill Corbus & Commissioner-Select Menge  
FROM: Senate & House Resources Committee  
RE: Questions on PPT Legislation

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We have listed the questions we have heard both during the committee process and also during subsequent discussions. Please provide your responses, at your very earliest convenience, in writing. We anticipate your appearance again before the committees perhaps as early as Wednesday, March 1.

To the extent that information requests are confidential information, please provide them as separate documents so we will be able to keep them distinguished from open, public information.

We understand that you are working on the first three questions, per the memo from R. Wilson on 2-27-06, and will also be providing tax calculations with the following assumptions: Gross value = 60.00; Opex = 15.00; and Capez = 10.00.

1. Identify values/amounts for the "look-back" or transitional section; per year according to the actual, by type (exploration, development, production), by company.
2. How are mob, demob, and platform abandonment costs treated - as tax credits or deductions?
3. Is there a "rating" for political stability - or one that reflects instability?
4. What loss of revenue is incurred by moving the effective date from Jan 1, 2006 to July 1, 2006 on both 20/20 and on 25/20?
5. Section 9 - what amount is involved in this section.
6. Was there consideration of phasing out the \$73 million deduction over a certain period of time?
7. Of the current 14 producers in Alaska, which would pay a severance tax after employing the proposed \$73 million standard deduction?

Committee Staff: Mary Jackson (907) 465-4907 telephone (907) 465-4779 fax

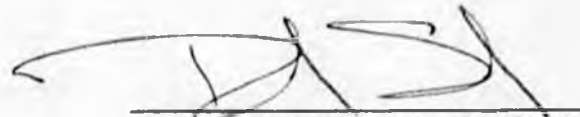
8. Which other tax regimes – worldwide - have a progressivity structure?
9. How many private royalty owners are there in Alaska – all areas, not just the North Slope (i.e., Nenana Basin, Kenai Peninsula, native corporation holdings, etc).
10. Provide a graph showing the status quo, the PPT, and the gas line contract terms.
11. Provide information on the effect of previous incentives – the costs.
12. What is the rationale for offering the same amount of credits for non-state lease lands where the state receives no royalty tax benefit – was there discussion of a reduction in the credit to offset this?
13. Why should Point Thomson be incentivised?
14. Can you provide better definitions for "point of production" and "oil" and "gas" and has the State litigated these terms?
15. What steps must be taken to make the tax credits refundable rather than transferable?
16. On Page 13, line 24 of the bill, what does "payment in lieu of" tie into for oil?
17. Does the limit on transferable tax credits in section 12 (subsection (e)) limit the amount of tax credits that a single taxpayer can take against their own production tax in a single year?
18. The State of Alaska has relied on the services and expertise of multiple outside law firms to handle disputes over oil and gas issues; have you conferred with such counsel in the drafting or review of this legislation? If so, have they assessed the impacts of the legislation on the State's legal position in past agreements, current disputes, or future disputes?
19. Have you asked the Department of Law to review this legislation in light of the 6<sup>th</sup> Circuit Court of Appeals' decision in Cuno v DaimlerChrysler that is now pending before the United States Supreme Court?
20. Please provide information regarding the expenditures that will qualify for the transition credits—including the depreciation method chosen under the federal and state income tax systems.
21. Have any of the definitions in sections 30-33 been the subject of disputes with tax and/or royalty payers in the past? To the extent they have, please provide the definitions the state asserted in those disputes.

22. Please provide an identification of the point of production at each unit in the state under existing statutes, regulations, agreements, and court decisions. Provide the same under the definition as proposed.
23. Please provide an identification of 'gas treatment' and 'gas processing' facilities in the state under the existing statutes, regulations, agreements, and court decisions. Provide the same under the definition as proposed.
24. What standard will be used to determine whether oil or gas is of 'pipeline quality' under the definition of 'gross value at the point of production'?
25. Provide a historical analysis of the results of valuation methodologies adopted by the Department of Revenue, Department of Natural Resources (under all agreements), and the Department of the Interior.
26. Will abandonment costs be eligible for deductions or credits under the legislation? If so, what estimates of the timing and costs of those activities does the Department project?
27. How will AS 43.55.160(j) protect the State from a proliferation of corporate entities and/or companies claiming the tax free allowance?
28. Provide the number of exploration and delineation wells estimated to be drilled over the first ten years of your economic models. Include the technical and economic success rates projected in the modeling.
29. Provide estimates for undiscovered resources in Alaska. Include the breakdown between technically recoverable and economically recoverable resources to the extent possible.
30. Provide a historical analysis of the effective tax rate on each field in production on the North Slope over the past twenty years.
31. How will Net Profit Share Leases be affected by this legislation? Will the gross costs of exploration and development go into the Development Account—or those costs net of the credits and deductions?

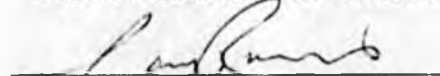
Thank you for your efforts in this regard.



Senator Tom Wagner, Chair  
Senate Resources Committee



Rep. Ralph Samuels, Co-Chair  
House Resources Committee

  
Rep. Jay Ramras, Co-Chair  
House Resources Committee

**MEMORANDUM****DEPARTMENT OF REVENUE****Tax Division**

**TO:** Senator Thomas Wagoner  
Chairman, Senate Resources Committee

**FROM:** Robynn J. Wilson *RW*  
Director, Tax Division

**RE:** Outstanding Questions on PPT (SB 305)

**DATE:** February 27, 2006

During the hearings on February 22—24, 2006, I have noted the following outstanding questions from your committee members. Please let me know if there are additional questions.

**Senate Resources**

1. Is it possible to revise Dr. Van M'uers' country rankings to include risk?
- 2.. Show tax calculation with the following assumptions:

gross value	\$60
opex	15
CAPEX	10
4. Which companies have made what investments on the North Slope in the last 5 years?  
(This question will be answered within the constraints of confidentiality requirements.)
5. Are costs to demobe wells a capital expenditure for purposes of the PPT?



SENATOR KIM ELTON

SB 305 Oil and Gas Severance Tax

1. It's been reported that the gas line contract will propose the state take its gas production tax share in the form of gas. How does that work in this bill?
2. Of the pre-PPT credit provisions (or claw back), what is the cost to the state for legacy fields and what is the cost to the state for frontier regimes?
3. Of the pre-PPT credit provisions (the claw back), how many investment credits were sold under SB 185 and how do we ensure the person who holds the credit, not the original recipient, gets the credit?
4. If we have a gas pipeline in 2015, what will the ELF tax "take" be on North Slope gas and what will the "take" be under the PPT? What will the "take" be under PPT if we take gas in lieu of the production tax (the take would, I assume be the day-to-day value of the gas less the state's cut in selling the gas on the marketplace)?

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ALASKA SENATE

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SENATOR\_KIM\_ELTON@LEGIS.STATE.AK.US

## SB305: Oil and Gas Severance Tax

Is current production tax deductible from corporate tax? If not, is this impact in the models presented by the Administration?

Referring to section five, what oil and gas is exempt from taxation – just what is discussed in section 10?

Referring to section six, will there be any impact to current state taxes or municipality taxes from this change?

Why was the payment for taxes and surcharges changed from the 20<sup>th</sup> day to the last day of the month? What is the economic impact of this change?

Do other nations with a net profit system have the 90 percent payment of taxes with the sure-up provision the following year? What is the economic impact of this change?

What are the penalties for under-payment when sure-up is more than ten percent of the taxes owed?

Referring to section 10, why does the AOGC role change from focusing on excess needed for safety reasons to whatever they determine to be waste. Does this provision provide more power to the AGOC on what is included/excluded for taxation?

Why does it seem the credits and incentive are on production along with exploration if our focus is to provide incentives for exploration?

Can the carry-forward amount be used for a credit for more than the first year after the loss?

Is it the case that any allowable expenses for the exploration, development, or production of gas can be deducted from oil revenues in determining net value? If so, could the expenses of a gas line be included in these deductible expenses?

Why not use GAP accounting rules versus set up our system of defining revenues and expenses?

Which credits can be applied to multiple years?

Can a tax credit be sold in any year or just the year after it was accrued?

What is the estimated economic impact to the state of the ability to sell tax credits?

Referring to section 16, what is current system and why do we need this change in confidentiality.

In what circumstances would oil and gas taxes go straight into the CBR?

Referring to section 18 and 19, why change from shall to is?

Why does the bill offer multiple methods to determine gross value? Who will choose a methodology?

Section 21, page 13, line 8 – why is this clause constrained by Dec 1, 2005

Section 21, provision (h), which US CPI does the Administration plan on using?

Are the current oil conservation surcharges deductible from any other taxation? If not, what is the policy reason to make them a credit in SB305 and what is the economic impact?

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TESTIMONY OF RICHARD OWEN  
HB 488 / SB 305 TO THE HOUSE SPECIAL COMMITTEE ON OIL AND GAS  
AND SENATE RESOURCE COMMITTEE

FEBRUARY 28, 2006

Mr. Chairman, members of the committee

Good afternoon. My name is Richard Owen and I am the Production Manager for ExxonMobil in Alaska and a vice president of ExxonMobil Alaska Production. Along side me, to assist in addressing any questions that you may have, are Marty Massey and Dan Seckers. Marty Massey is ExxonMobil's Joint Interest Manager for the U.S. and is leading our Alaska Gas Pipeline Project fiscal contract negotiations. Dan Seckers is our Tax Counsel responsible for Alaska.

I am here today, at your request, to offer ExxonMobil's thoughts and concerns about HB 488/SB 305. If this measure was simply a tax increase, ExxonMobil would actively oppose it. At current prices, we expect ExxonMobil's production tax payments would increase by \$50-\$100 million per year. However, we are prepared to move forward under the proposed system since it balances revenues to the State and producers across a range of oil prices, provides incentives for new investment, and includes a transition provision for recent investments. Most importantly for ExxonMobil, the PPT proposal provides a predictable and durable tax system which, along with the appropriate gas pipeline fiscal

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contract terms, will allow the Alaska Natural Gas Pipeline project to move forward to the next phase.

As far as specific concerns about this bill, they center around whether the high tax rate and resulting increase in taxes will hinder full development of the remaining oil resources on the North Slope. I'll expand on this concern during my testimony. Before I make further comment on the PPT bill, I would like to give a brief overview of ExxonMobil's presence in Alaska and review how the current ELF system has benefited both industry and the State of Alaska.

#### ExxonMobil in Alaska

ExxonMobil has had a presence in Alaska for over a half century, investing more than 11 billion dollars in the State's economy. Our activities date back to 1954 when we conducted a comprehensive study of the territory's oil and gas potential. Over the years, we explored most of the major hydrocarbon plays in Alaska including: the Gulf of Alaska; St. George and Navarin Basins; the Norton Sound; the Beaufort Sea; the Cook Inlet; and of course, the North Slope where we were a participant in the 1968 Prudhoe Bay State #1 discovery well. 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.

Currently, ExxonMobil has working interests in Prudhoe Bay, Kuparuk, Endicott and Granite Point. We are the operator of the Point Thomson Unit, and the largest interest

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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. Our production from Alaska represents approximately 4% of ExxonMobil's worldwide oil and gas production. Our Alaskan 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.

### Historical Context

One of ExxonMobil's objectives in both the gas pipeline fiscal contract negotiation and the debate 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. To that end, any change in the fiscal regime for oil has a direct impact on how we view the stability of the Alaskan fiscal environment, which in turn, impacts how we evaluate ongoing investment decisions.

We understand the State's desire to obtain additional tax revenue at higher prices. One of the most challenging tasks that the Legislature can undertake is how to change the oil tax system without damaging the industry. As Governor Murkowski has correctly stated on many occasions, the North Slope is one of the most expensive places in which our industry operates. Tax systems need to be carefully designed to ensure that the desired objectives are achieved and that any change does not result in unintended consequences, such as reduced investments and lower reserve recovery.

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One of the many questions that we are asked is, why are ExxonMobil and other Producers seeking durability and predictability for oil in parallel with negotiating a fiscal contract for a gas pipeline? The answer is fairly simple, the gas on the North Slope is contained in the same reservoirs as the oil and is produced through the same facilities. For a gas project to be viable, we need the fields that produce both oil and gas to be viable, underpinned by predictable and durable fiscal terms. A commitment of billions of dollars to build the natural gas pipeline requires confidence that the base oil business will remain healthy for the long-term.

#### Existing System – ELF

With that context in mind, I'd like to make a few comments about the current oil production severance tax system – the Economic Limit Factor or ELF and, in particular, how it has been effective at encouraging investment and mitigating production decline. The ELF was designed to allow the State to increase the production tax while not stifling investment in marginal fields. The ELF scaled down the production tax rate when a field became more marginal, reducing the economic limit to which a field could be produced and ultimately allowing more reserves to be recovered. The 1989 ELF amendment significantly increased the production tax on Prudhoe Bay and Kuparuk, while providing an incentive to encourage the development of smaller fields. That 1989 amendment worked as intended, with many small and marginal fields coming on stream over the past 17 years. The ELF lowered the tax rate on those fields, supporting their commercial viability.

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contribute substantial amounts to the State in royalties, property taxes and income taxes, and in jobs for Alaskans.

Over the past five years, we and other working interest owners have also extended the primary Prudhoe Bay enhanced oil recovery (EOR) technology to the some of these satellite fields. Since 1998, ExxonMobil has invested over \$30 million in tertiary recovery projects at Point McIntyre, Eileen West End, and Borealis which are expected to produce an additional 60 million barrels gross. While tertiary projects recover additional oil, the production profile results in a slower oil recovery and longer payout periods. These satellite EOR projects are in the early stages of development. The major investments have been made, but the oil production benefits will not be received until many years out. The ELF provision of the existing production severance tax made these economically challenged projects commercially viable.

Taken together, the recent Prudhoe Bay satellite and EOR development projects developed over 560 million barrels gross. While the resulting State's production tax under ELF was relatively minor, the State's royalty oil would total 70 million barrels, which at today's oil price is worth roughly \$4 billion. Bottom line, the ELF system has worked well for industry and the State of Alaska by encouraging significant new investment.

However, it is also recognized that ELF can be considered a somewhat regressive system in that it does not reflect "profitability" or "cost" in the division of gross revenue between

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the State and the producers as oil prices rise and fall. The assumption that a well is marginal at 300 BOPD does not necessarily hold in the current high oil price environment, yet this assumption typically contributes to a reduced ELF factor based on the current formula. As a global oil and gas producer, ExxonMobil operates across a wide array of fiscal systems. It is most important that the system recognize the quality of the resources so that the potential developments will be commercially viable and attract capital. When I say the 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 that are experiencing significant industry investment have achieved the proper balance in their fiscal regimes.

#### **Alaska Remaining Oil Resource Base**

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.

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Therefore, as stated earlier, we are concerned that the Administration's proposal is weighted towards a higher tax which may prevent some of Alaska's challenged resources from being developed.

### PPT Proposal - Overview

I would now like to make some comments on the Administration's PPT proposal. This proposal represents a tax based on profits which results in a sharing of the risks and the rewards across a range of prices. The State will receive a higher share of the revenues when prices are high and will accept lower taxes during periods of low prices. The proposal moves from the regressive ELF system to a progressive system. ExxonMobil affiliates have significant experience in profit-based progressive systems around the world and they work well, as long as they have properly taken into account the nature of resource base - which I mentioned earlier.

Let me discuss some of the key features of the PPT proposal:

### PPT System: Transition

This bill represents a major step-change in Alaska's current production tax system. The bill appropriately addresses this step-change by including a transition plan so that recent investment decisions are not adversely impacted. The bill provides a transition allowance over the next six years based on capital investments made in the last five years. We believe this transition plan is appropriate because the benefits from these recent investments have not yet been fully received. Oil and gas companies invest large sums of

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money years ahead of first production and are at risk for price, development cost, production rates and ultimate reserve recovery. In most cases it takes many years, often more than five years, for a return on oil or gas investment to occur.

For example, satellite and tertiary recovery investment decisions 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 that these challenged and costly projects would be commercially viable. It is not appropriate to suddenly increase taxes on these investments without providing some form of consideration. The transition provision recognizes that past investments were made under the ELF structure and somewhat reduces the increased tax treatment to which these projects will now be subjected. To avoid penalizing these recent investments, the transition provisions included in this bill are essential.

**PPT System: Tax Rate and Investment Tax Credits**

As I have said, we are concerned the 20% tax rate as proposed will not support the growth opportunities remaining on the North Slope which I've described as primarily: complex enhanced oil recovery projects; development of small oil accumulations; and innovative development of viscous and heavy oil resources – these opportunities have challenged economics. While the investment tax credits of 20% will enhance the present value economics of new investments, the 20% tax rate will result in lower overall cash flow. The impact on all economic parameters must be carefully weighed before a decision to progress an investment is made. The combination of a 20% credit along with

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a 20% tax rate may not be adequate to support development of all of the remaining opportunities.

It is with this in mind that we strongly recommend that the legislature not increase the proposed tax rate or reduce the proposed tax credits.

**PPT System: Valuation from Royalty Settlement Methodology**

This bill addresses many of the longstanding issues that have divided the State and the industry over the years. For example, 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. HB 488/SB 305 allows 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. This will provide certainty to a producer on the value on which to pay its royalty and production taxes and will reduce the administrative and audit costs to both the State and the industry.

**PPT Proposal - Conclusion**

Under current prices, ExxonMobil and industry will pay more in taxes as compared to the current production tax system. However, as I said in my opening comments we need predictably and durability under which to gauge investment decisions. No one wants to invest money in a project only to have the rules changed, reducing the attractiveness of

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the investment. The transition provision is an important feature of the bill necessary to provide relief for the abrupt change caused by the new PPT system.

The Administration decided to weight the proposal to a higher tax which may make it difficult to progress the remaining future development opportunities. It is most important that the quality of the resources be factored into the design of the tax system. Given our view of the resources, we would not support a higher tax rate or lower credits than proposed in the bill.

HB 488/SB 305 seeks to balance revenues to the State and the producers across a range of oil prices and provides incentives for new investments, which is a clear objective of the State of Alaska.

And most importantly for ExxonMobil, we believe the new system, coupled with appropriate gas pipeline fiscal contract terms, will lead to a predictable and durable tax system, which will enable the Alaska Gas Project to move forward to the next phase. Potential changes to the features of the PPT bill must be carefully considered to avoid upsetting the balance contained within the bill.

In conclusion, this bill is important for Alaska and the Producers. It is one part – a very important part – of a series of related issues that the legislature will need to address to ultimately provide the necessary fiscal environment to stimulate oil production and to progress the Alaska Gas Pipeline Project.

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The Fiscal Contract that is being finalized under the authority of the Stranded Gas Development Act will incorporate this PPT legislation by reference in order to provide fiscal stability. We are currently working with the Administration on how best to incorporate this bill into the fiscal contract.

The Fiscal Contract will soon be released for public and legislative comment. Following the regular session, we understand the Governor will call a special session so the Legislature can vote on the contract. For that reason it is important that HB 488/SB 305 be enacted in its present form prior to that special session.

ExxonMobil has been in Alaska for over 50 years. Our future business plans show our continued activity in Alaska for at least the next fifty years. We are on the verge of taking the next step to commercialize Alaska's North Slope gas and I ask you to support the Administration's efforts in this regard.

Thank you again Mister Chairman for the opportunity to testify today.

MR. PAT FOLEY  
PIONEER NATURAL RESOURCES

March 1, 2006

Representative Ralph Samuels and other members of the House Resources Committee

Thank you for the opportunity to share Pioneer's views regarding HB 488 eliminating the current severance tax system and replacing it with a Profit Sharing Production Tax.

Pioneer began its investment in Alaska in early 2003 with the drilling of 3 exploration wells in the shallow waters of the Beaufort Sea. Pioneer significantly expanded its Alaskan inventory at the October 2003 Alaska State Lease Sale where it was the largest participant and successful bidder on approximately 150,000 acres. We opened an office in Anchorage in early 2004 and now employ 26 persons in Alaska. In 2004, Pioneer concluded exploration agreements with ConocoPhillips and Anadarko across a vast portion of NPR-A. In 2005, Pioneer acquired a 10 percent working interest and the option to acquire up to an additional 40 percent working interest and possibly succeed ConocoPhillips as the operator of the Cosmopolitan Unit located in the Cook Inlet. Pioneer has significantly invested in the state and has assembled a substantial portfolio with an interest in approximately 1.6 million acres of leasehold.

On February 6, 2006, Pioneer announced that it approved and is commencing the development of the Ooguruk field on the North Slope of Alaska. Pioneer is the operator of the field, which is in the shallow waters of the Beaufort Sea approximately eight miles northwest of the Kuparuk River Unit. Pioneer has commenced operations to install an offshore gravel drilling and production site and we expect to complete gravel hauling activities by the end of winter. Following construction of the gravel drilling and production, a subsea flowline and facilities will be installed during 2007 to carry produced three-phase liquids to existing onshore processing facilities at the Kuparuk River Unit. Pioneer plans to drill approximately 40 horizontal wells to develop 50 million to 90 million barrels of estimated gross oil resources. Total gross capital to be invested in drilling and facilities is expected to range from \$450 million to \$525 million. The wells are expected to be brought on production as drilling progresses, with peak

rates of approximately 15,000 to 20,000 barrels of oil per day expected by 2010.

For independent companies like Pioneer, the challenges to building a business in Alaska are formidable. The remaining North Slope resources are nothing like the billion barrel fields that opened the Slope. The new wave of developers are working to commercialize: a) smaller, lower quality oil reservoirs, b) viscous oil resources, c) remote resources in NPRA, the foothills and offshore and d) natural gas resources, which will not have a market until the next decade. All of these resources are challenging to commercialize, but it is a challenge that must be met to insure new sources of supply for the state.

The North Slope is one of the highest cost areas in the world. Remote geography translates to some of the highest capital, lease operating and product transportation costs in the world. Additionally, North Slope projects have comparatively long cycle times. From buying a lease to selling oil takes 5 to 10 years depending upon drilling success and distance to existing infrastructure.

The largest challenge independents face on the North Slope is arguably uncertainty. To be successful, we must properly assess and make provision for a number of uncertainties related to exploration risk, future oil and gas prices, fiscal policy, regulatory processes and access to infrastructure.

The long cycle times for Alaska projects require that we make our investment decisions based upon a long term price projection. Although current prices exceed \$50 per barrel, the 10 year average price for North Slope crude is approximately \$25 per barrel. For Pioneer's Alaska projects, the price of oil in 2006 is irrelevant. The prevailing price in the next two decades will determine future cash flow for new projects.

Accurate assessment of risk is critical to the success of an exploration portfolio. Will the value of the fields we ultimately discover offset the cost of dry holes, land, seismic data and development costs? For many of the remote exploration areas in Alaska, it is difficult to project acceptable full cycle returns. In 2003, the state initiated exploration incentive credits for certain qualifying exploration expenditures. These incentives encouraged Pioneer to invest significantly in infrastructure challenged areas such as NPR-A.

When Pioneer was considering its first investments in Alaska, state officials were promoting the resource merits of Alaska basins. Alaska certainly contains world class petroleum systems. Additionally, the officials promoted the fiscal policy including the ELF formula and exploration incentives. Under the ELF formula, only very large new fields would pay severance tax and qualifying exploration expenditures in remote areas would receive exploration incentive credits at either a 20 or a 40% rate. With this fiscal system in place, Pioneer invested heavily in the state over the last several years. When we learned that a new severance tax policy was under development, we were quite concerned that any new system would be detrimental to our future investments and a departure from the fiscal system promoted to the independents by the state.

We recognize that the existing severance tax policy, as it applies to the large fields on the North Slope, is likely not sustainable and we are pleased that the proposed PPT taxes profits rather than revenues. Given that the state collects royalties right off the top, it makes sense that any additional government take should be assessed after costs have been recovered. This concept is important to the smaller, lower productivity and remote resources which are critical to future production growth. Although the proposed production tax rate of 20% is quite large when layered upon the other burdens of royalty, ad valorem tax, state income tax and federal income tax, the impact of the large tax rate is tempered by the allowance of cost recovery, investment tax credits and the proposed taxable income threshold.

Pioneer is pleased to see the provision included in the proposed legislation regarding the deductibility of transitional capital. The provision serves to compensate those companies, including Pioneer, who have made significant capital investments over the past five years based upon the fiscal terms in place at that time.

We have reviewed the testimony of the administration and agree that the PPT, as proposed, will provide incentives for new investment by all companies. Economic metrics for new investments will improve under the PPT versus existing tax law. This should encourage the development of marginal fields and will reduce the minimum economic size for exploration prospects, thus prompting more exploration and increasing the chances of finding commercial-sized fields. In addition, it should encourage re-investment in existing fields. We believe the PPT as proposed will entice

more companies to Alaska and increase competition. More companies and more ideas will lead to smarter field development methods, smarter drilling and production equipment, which will further reduce the minimum economic size of exploration prospects and grow the resource pie.

The tradable tax credits are a particularly effective incentive for the exploration and development of new resources. Under the proposed PPT, the higher risk, higher cost and long project cycle times associated with new resource exploration and development are partially offset by the ability to monetize these credits shortly after investment. In an exploration portfolio, the large majority of projects are not successful resulting in a total loss from all lease acquisition, seismic and drilling costs. The tradable tax credits would lessen the negative financial consequences of the inevitable dry holes explorers will drill.

A significant concern to Pioneer is the potential for a lack of liquidity for the tradable tax credits. Pioneer's outlook is to continue with very large capital expenditures in the state over the next several years. With only a handful of very large producers as potential buyers for the credits, and the proposed limit that a company may utilize purchased credits to offset no more than 20% of its tax, we are concerned that the market for the credits may not be competitive. New investors could face selling credits at a discount to tax payers who would in turn cash them in to the state at full value. We appreciate that a buyer of tax credits should recover its transaction costs, but we are concerned that the required discount might be substantially greater. We respectfully ask the legislature to consider implementing refundable credits with appropriate limitations to protect the state's cash flow in the event of low oil prices. The program could provide that credits be refunded at a modest discount to face value. This would allow the State, and not a third party producer, to benefit from any discount that a seller would be willing to accept.

We believe that the PPT as proposed improves Alaska's competitive position with respect to other investment opportunities around the world. Mr. Van Meurs' testimony indicated that the proposed PPT would improve Alaska's competitiveness versus a number of mostly large, international investment opportunities around the world. To attract companies of Pioneer's size and smaller, we believe that Alaska must effectively compete with U.S. lower 48 opportunities as well. With higher prevailing natural gas prices in the lower 48, gas resource plays (tight sands, shales and coalbed

methane) are attracting huge amounts of capital due to the relatively low risk, low cost and short project cycle time relative to exploration. The size of some of these resources is quite large resulting in increased competition in the U.S. for independent's capital. If Alaska wants to improve its competitive position and attract new investors, we believe that the legislature should take great care in making changes to the administration's proposal that would make it less competitive.

For new investors to Alaska, particularly smaller companies, exempting the first \$73 million of cash flow from taxation is a valuable feature of the PPT. The obstacles to new investors are high. Most new investment opportunities in Alaska are either small, infrastructure challenged, risky (exploration) or some combination of these factors. New investors are also handicapped by not owning the existing infrastructure and they lack the economies of scale enjoyed by the large operators. To be an effective operator in the state requires a huge commitment in highly compensated personnel to effectively navigate the regulatory and operational challenges that are unique to Alaska. Under existing law, it is unlikely that an explorer would pay significant production tax unless a huge field was discovered. A number of new companies were recruited to Alaska by the state and made substantial investments based on the existing tax law. Under the proposed PPT, exempting the first \$73MM of cash flow from taxation will help deliver an investment climate more consistent with the system that initially encouraged Pioneer to explore in Alaska and will help offset the high "start-up" costs.

In general, we believe the proposed PPT is a balanced program with appropriate incentives to encourage new investment in the state. We encourage the legislature to carefully evaluate the proposal and take care to insure that it results in fiscal policy that makes Alaska more competitive. We also respectfully request your consideration to make the tax credits in this bill refundable to allow the new investors the full intended advantage of the tax credit program. Thank you for this opportunity to express Pioneer Natural Resource's views on HB 488.

Pioneer Natural Resources Alaska, Inc.

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

**01 March, 2006**

Mr. Chairman, distinguished members of the House Resources Committee. My name is Jim Weeks, and I am here today representing UltraStar Exploration LLC, a very small all Alaskan owned independent explorer, with strategically located leases on the North Slope. UltraStar is based in Anchorage, with offices at 3111 C Street, Suite 500. The Company was formed in 2002 by me, John Winther, and Dale Lindsey, for the primary purpose of exploring and developing leases on the North Slope. UltraStar is 100% owned by Alaskans. I am Managing Member, and moved to Anchorage in 1984 with ARCO, and have had a presence here ever since. Dale, whom most of you know, was born and raised and still lives in Seward. John, whom most of you also know, was born in Fairbanks and raised in Juneau. He currently lives in Petersburg. Thanks for the invitation to testify on this important legislation.

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

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

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

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

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

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

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

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

Thanks for the opportunity to testify at this important proceeding.

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

**Chevron**



**Chevron**

**Testimony on SB 305 & HB 488**

**John P. Zager**

**General Manager – Alaska Area**

**Juneau, Alaska  
March 1, 2006**

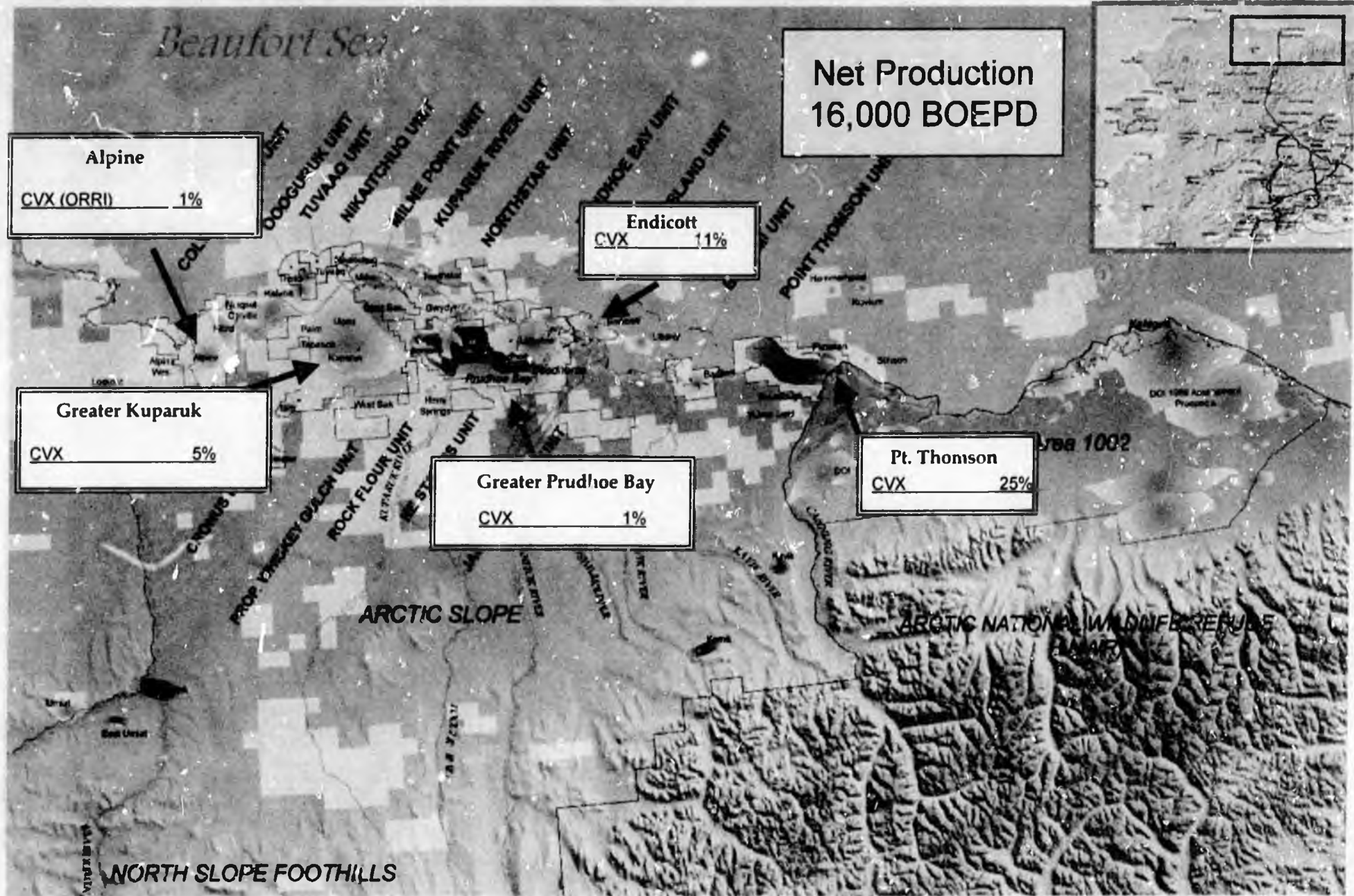


## Chevron's Alaska Presence

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

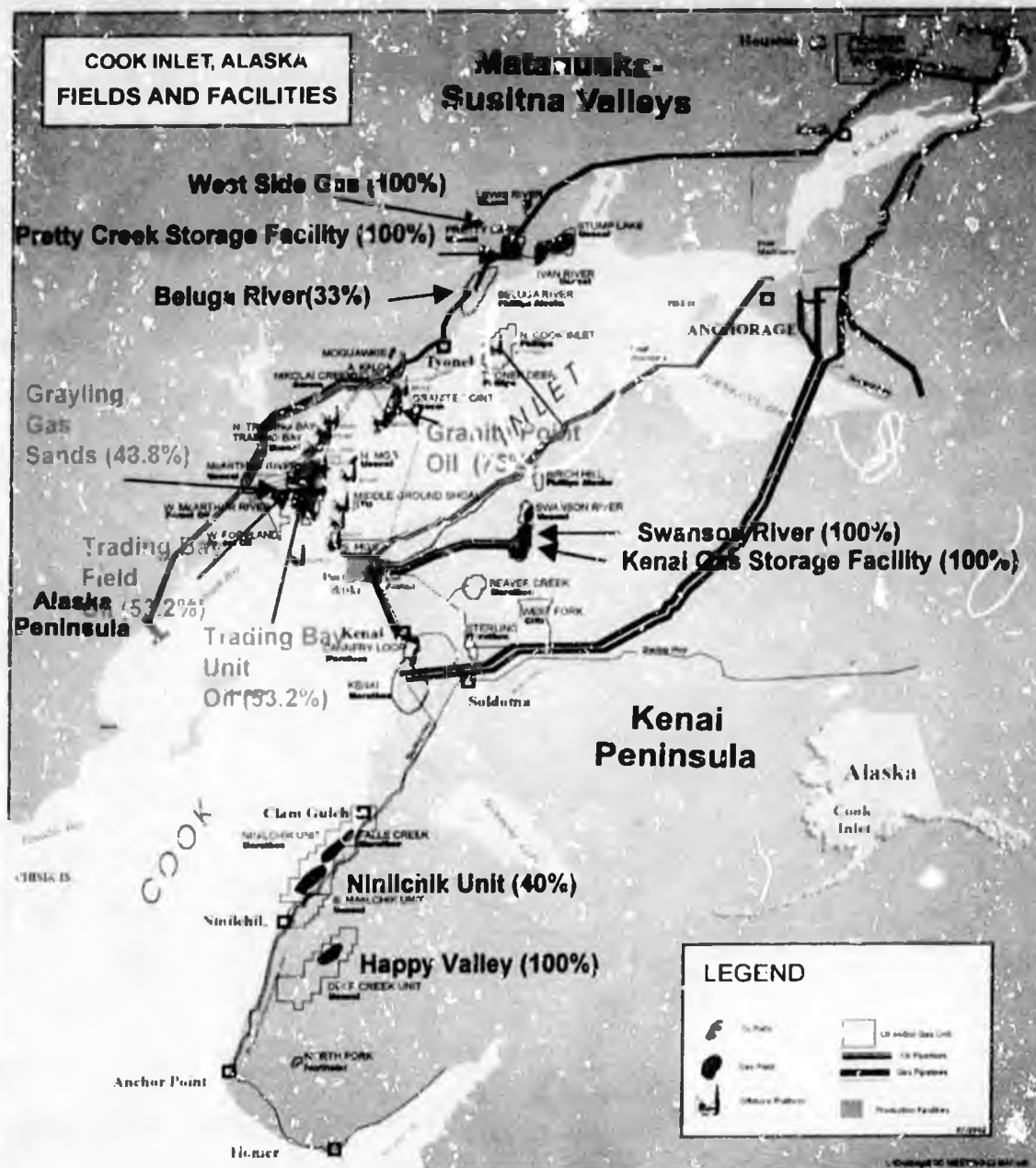


# Alaska North Slope Fields





# Cook Inlet - CVX Asset Description



## Cook Inlet Offshore :

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

## Cook Inlet Onshore :

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

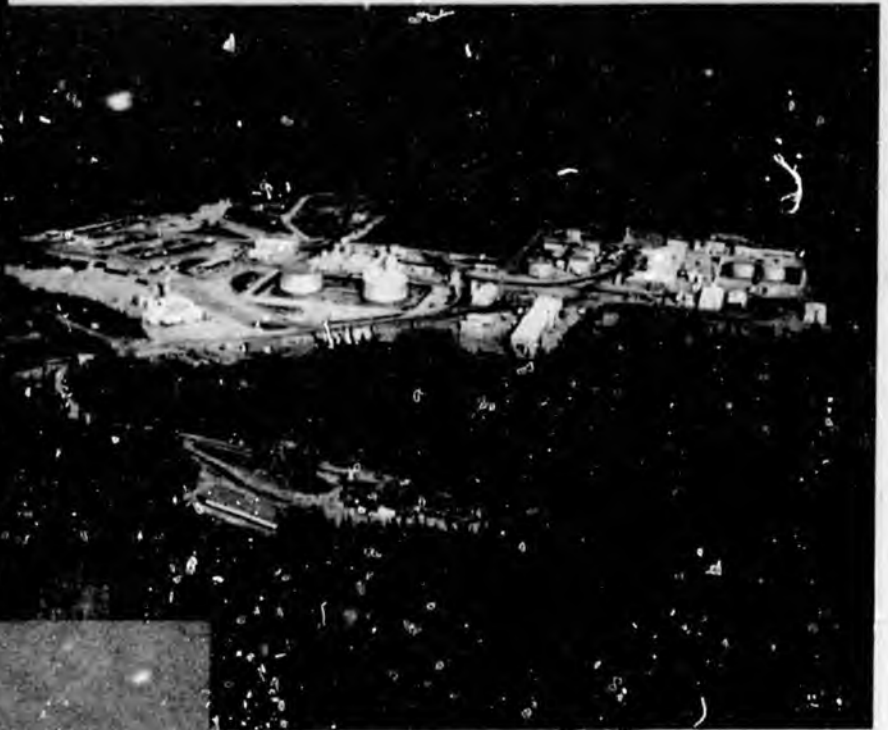
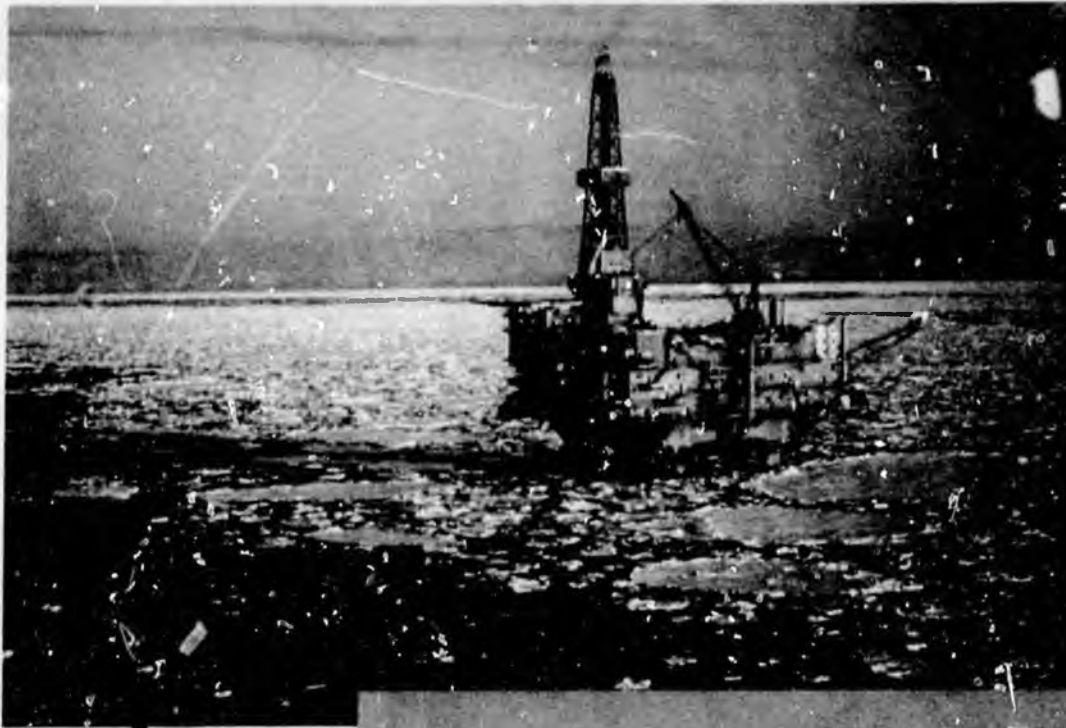
## Net Production

**Offshore Oil**  
**6,300 BOPD**

**Gas**  
**112 MMCFPD**

**25,000 BOEPD**

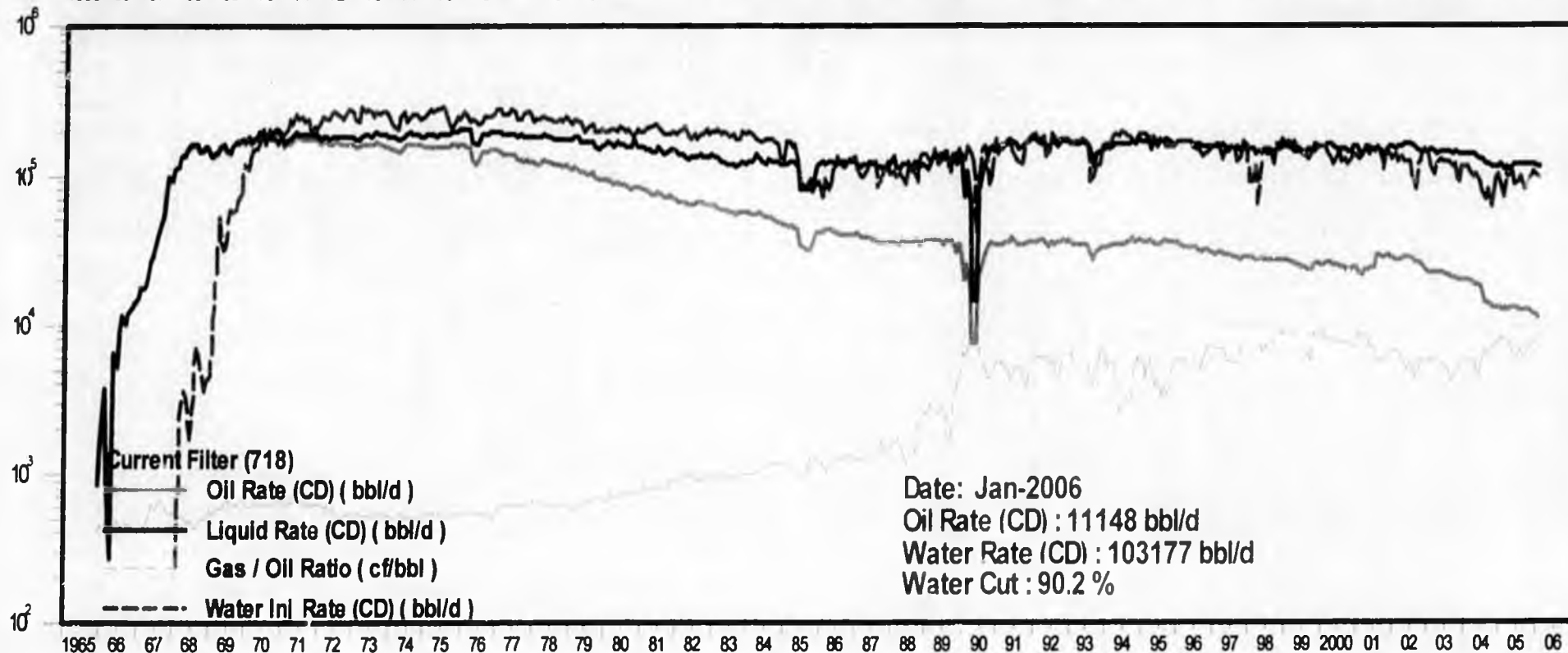
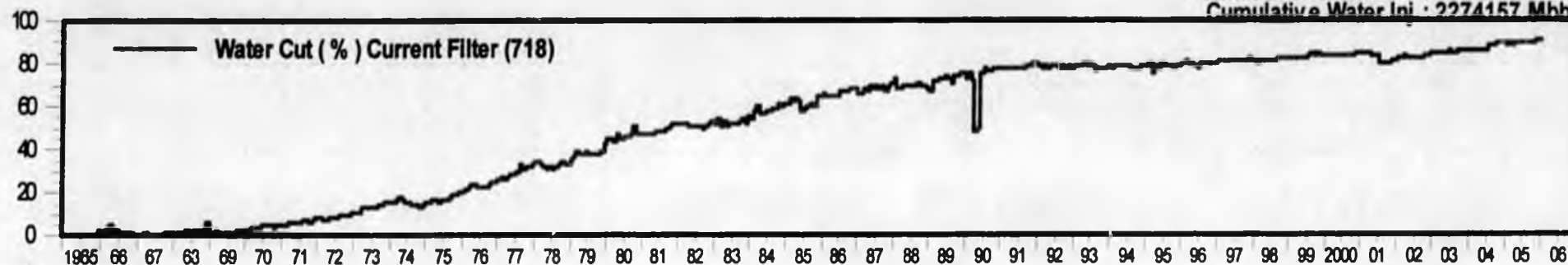
# Trading Bay Unit



# Cook Inlet Offshore



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

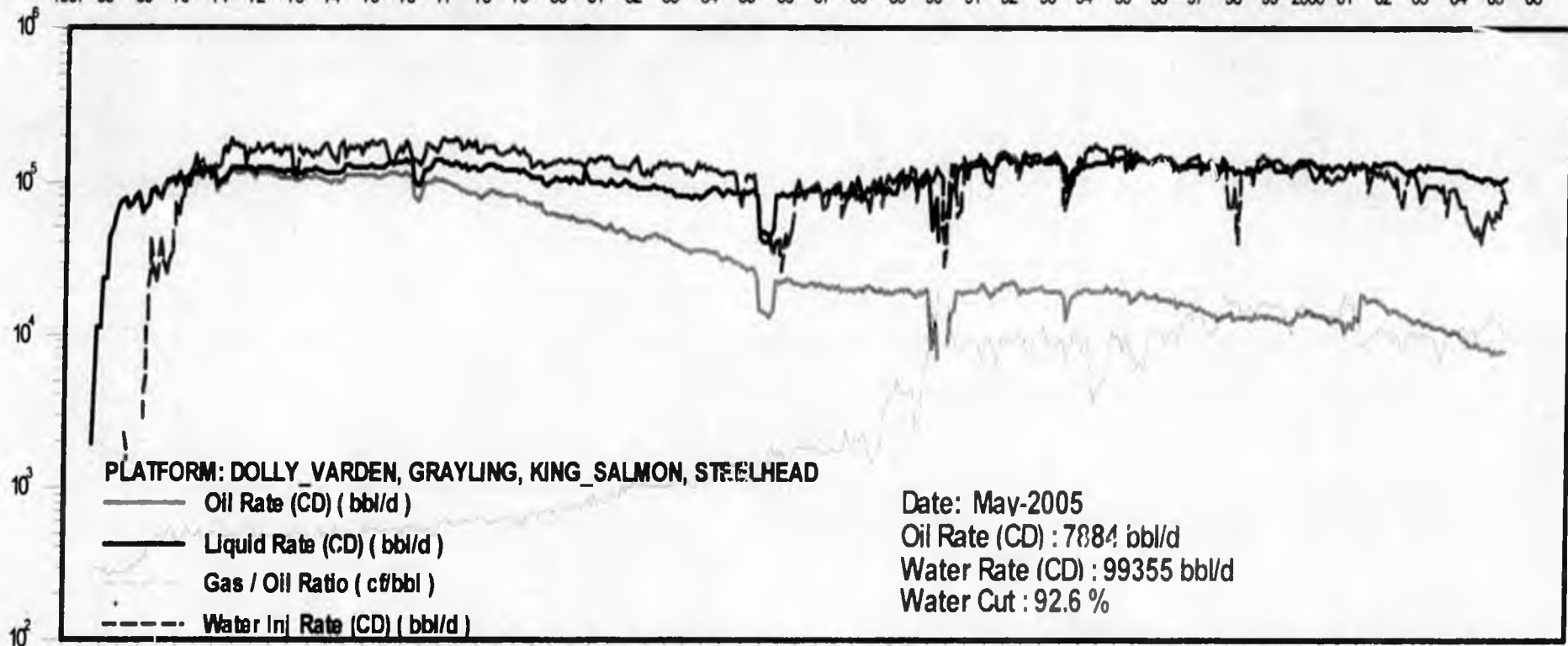
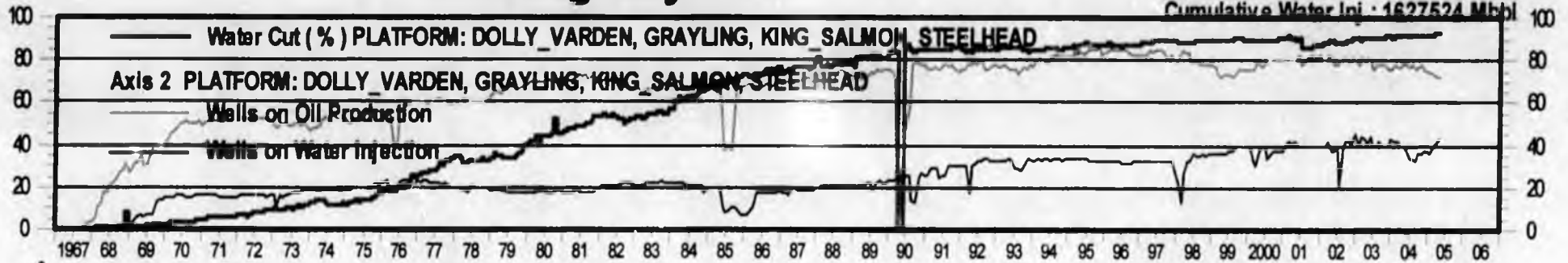


**Date: Jan-2006**  
**Oil Rate (CD) : 11148 bbl/d**  
**Water Rate (CD) : 103177 bbl/d**  
**Water Cut : 90.2 %**



# Trading Bay Unit

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



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

Date

07/18/2005 16:04:48



## Cook Inlet Offshore Oil

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



## Chevron Cook Inlet Strategic Study

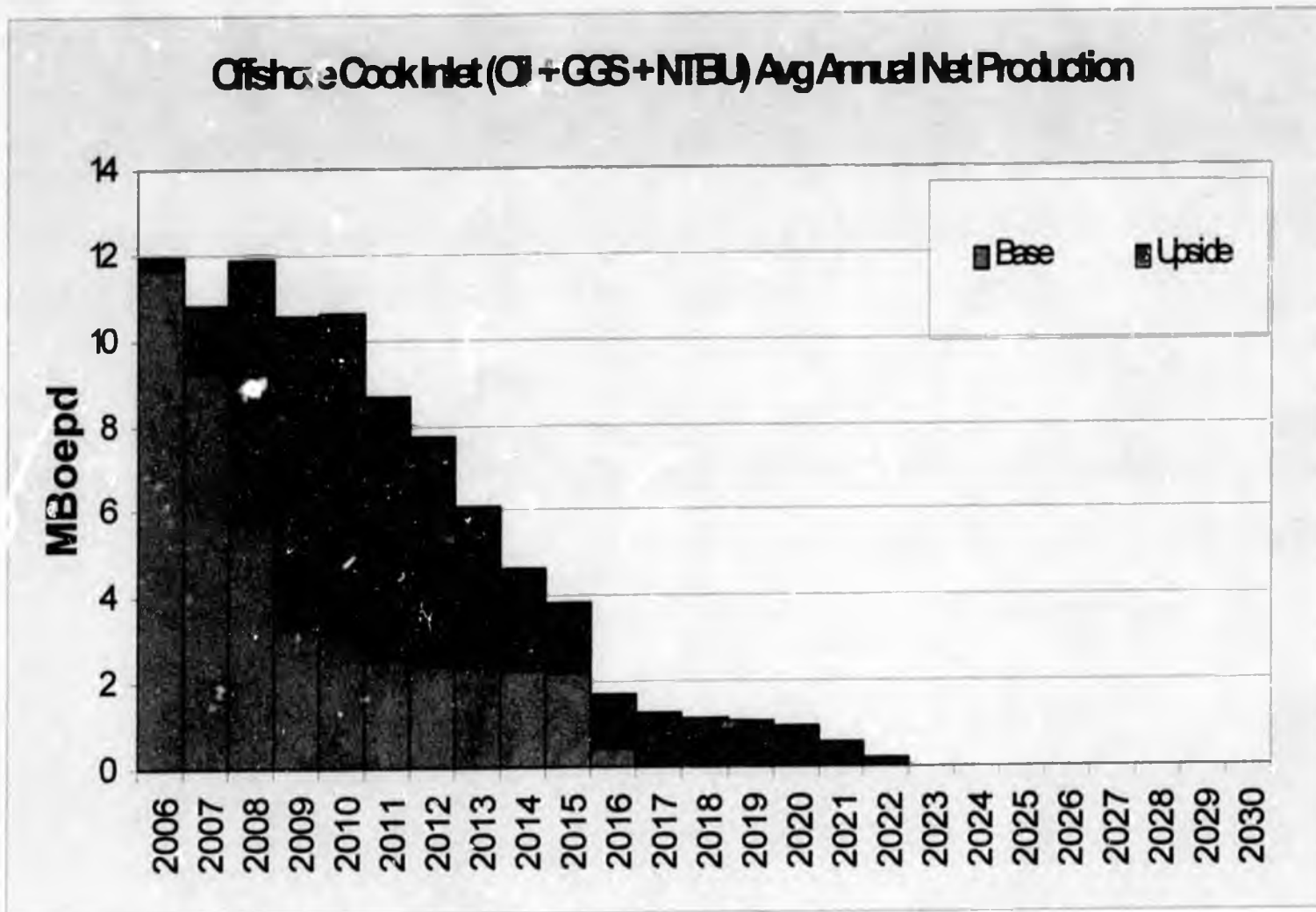
- August 10, 2005 Chevron acquires Unocal
  - Much speculation about Cook Inlet asset fit in Chevron Portfolio
- October 2005 – January 2006 – Strategy work completed
  - Determine that there are incremental investment opportunities in the Cook Inlet although they are in the lowest quartile of Chevron's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



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

- The Cook Inlet reinvestment program was evaluated using the current severance tax assumptions (zero severance tax)
- When modeled under the proposed PPT the economics on some projects are degraded, some projects are improved, overall poorer economics for the program
  - Will cause investment decision to be reconsidered
  - Enhanced PPT terms could significantly expand the list of economic projects in the investment program
  - Misalignment with joint venture properties

# Cook Inlet Production Forecast with Four Year Capital Plan





## Reasons to Spur Cook Inlet Investment

- Gas is running out
  - Home heating, electrical generation, industrial consumption
  - Additional gas supply is critical to state's economy
- Oil redevelopment will maintain and add new jobs and will extend field life
- New exploration efforts could add new fields
- Currently a lack of significant exploration
  - Last Cook Inlet lease sale was poorly attended



## Summary

- We will support the bill and the key terms as written with the following stipulations:
  - Cook Inlet must be treated differently
    - ▶ Re-apply \$73 million exemption
    - ▶ PPT rates – consider lowering the tax rate and/or increase the capital credit
- Recommend inclusion of an additional 5% capital credit (20/25) for heavy oil or tertiary recovery (CO<sub>2</sub>) projects statewide
- Need absolute clarity on terms and definitions
- Chevron has been in Alaska for many years and intends to continue an active exploration and production operation in the state if a sound and stable fiscal regime can be offered



# PPT Discussion

March 1, 2006

**Amadine**  
Petroleum Corporation

# Overview of Anadarko Petroleum

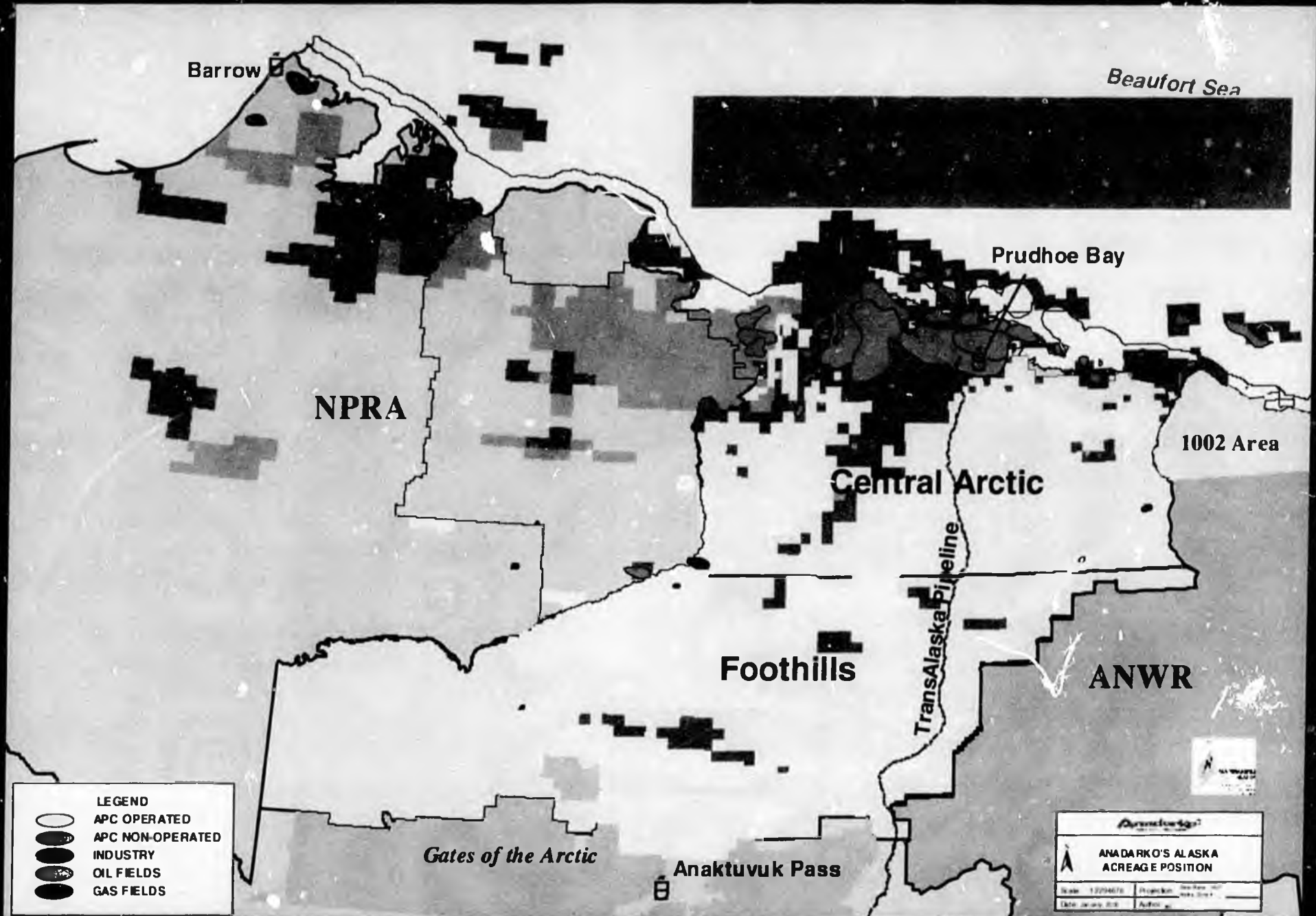


**ANADARKO HQ**  
Houston, Texas

○ Exploration Areas  
◻ Producing Areas

# Anadarko's Alaska Acreage Position

A  
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D  
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O



# **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**

# Alaska Challenges

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

## How about PPT?

**Administration did a good job  
balancing issues and priorities**

- *State vs. Companies*
- *Companies vs. State*
- *Companies vs. Companies*

# **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.**

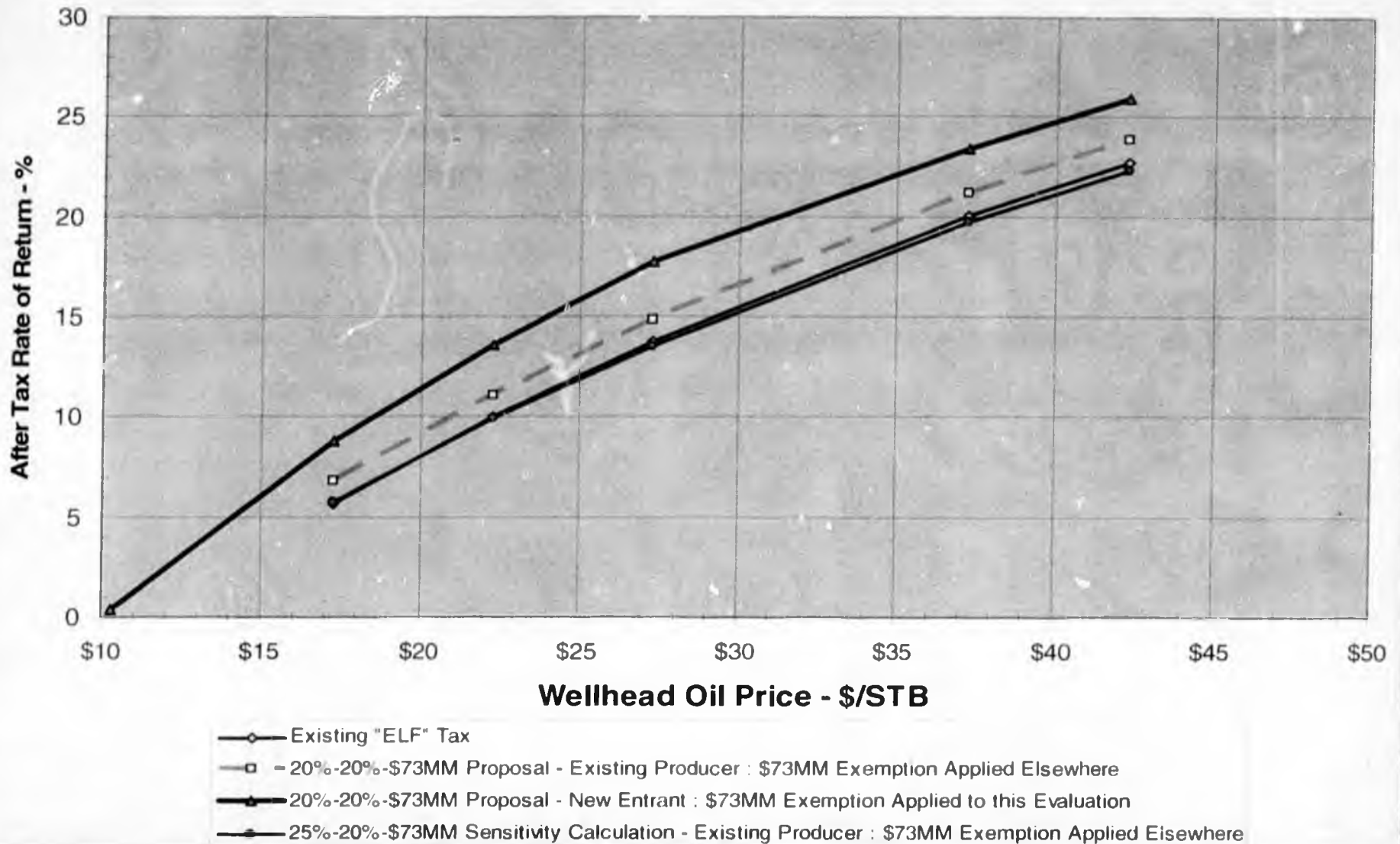
**The development concept is a satellite to an existing oil field. The satellite has a separate ELF calculation from the existing oil field.**

**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

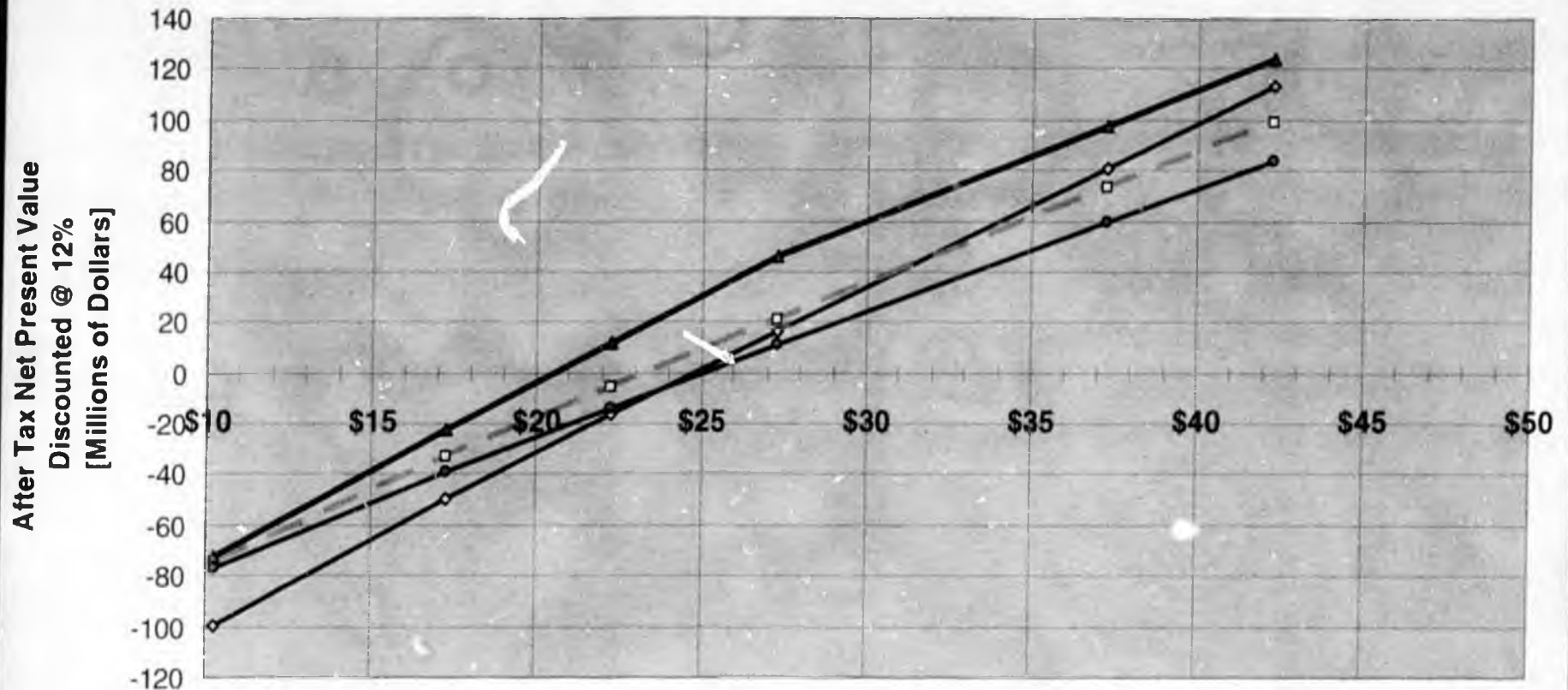
## After Tax Rate of Return as a function of Wellhead Oil Price Small Oil Development



A N A D A R K O

# 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
- 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

A N A D A R K D

# **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**

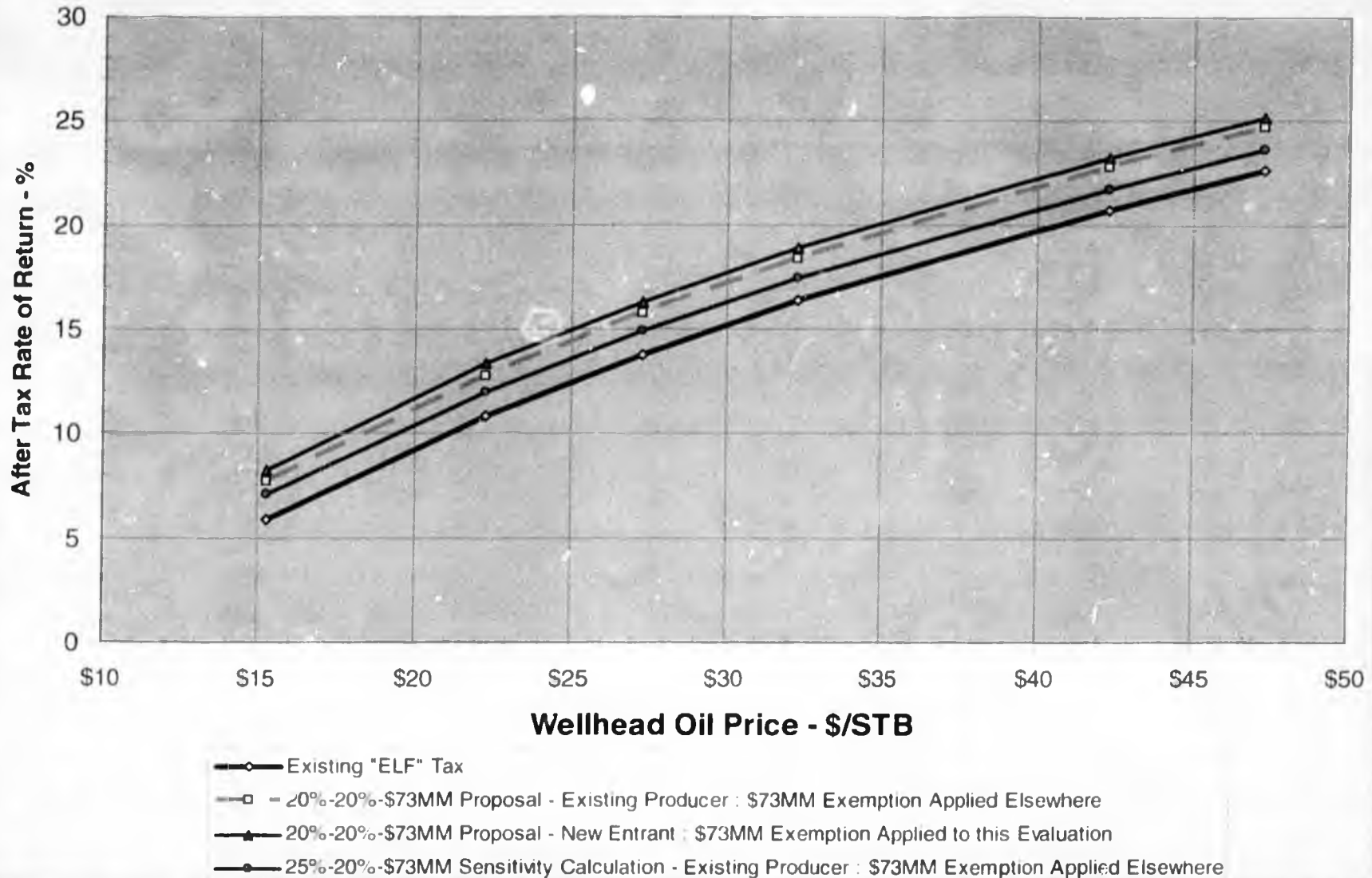
**Capital expenditure is 1.1 billion dollars**

**The peak production rate is 55,000 BOPD**

**Royalty is 12.5%**

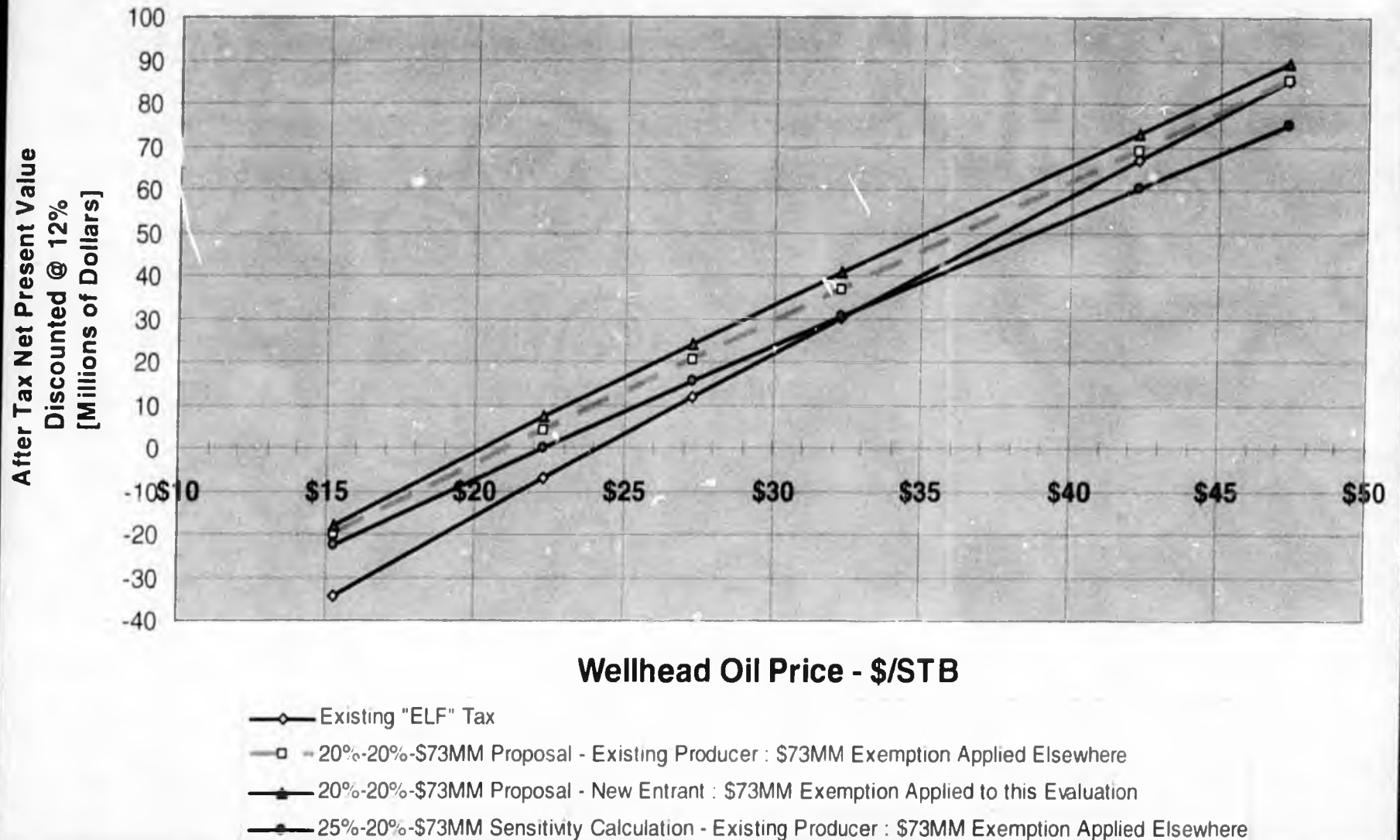
# Medium Oil Prospect- Risked Rate of Return

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



# Medium Oil Prospect- Risked Net Present Value

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



# Issues

Look back's looking bad

Price is King

Independents are sensitive

\$73 million is \$73 million right?

Credits that aren't

Be careful what you ask for

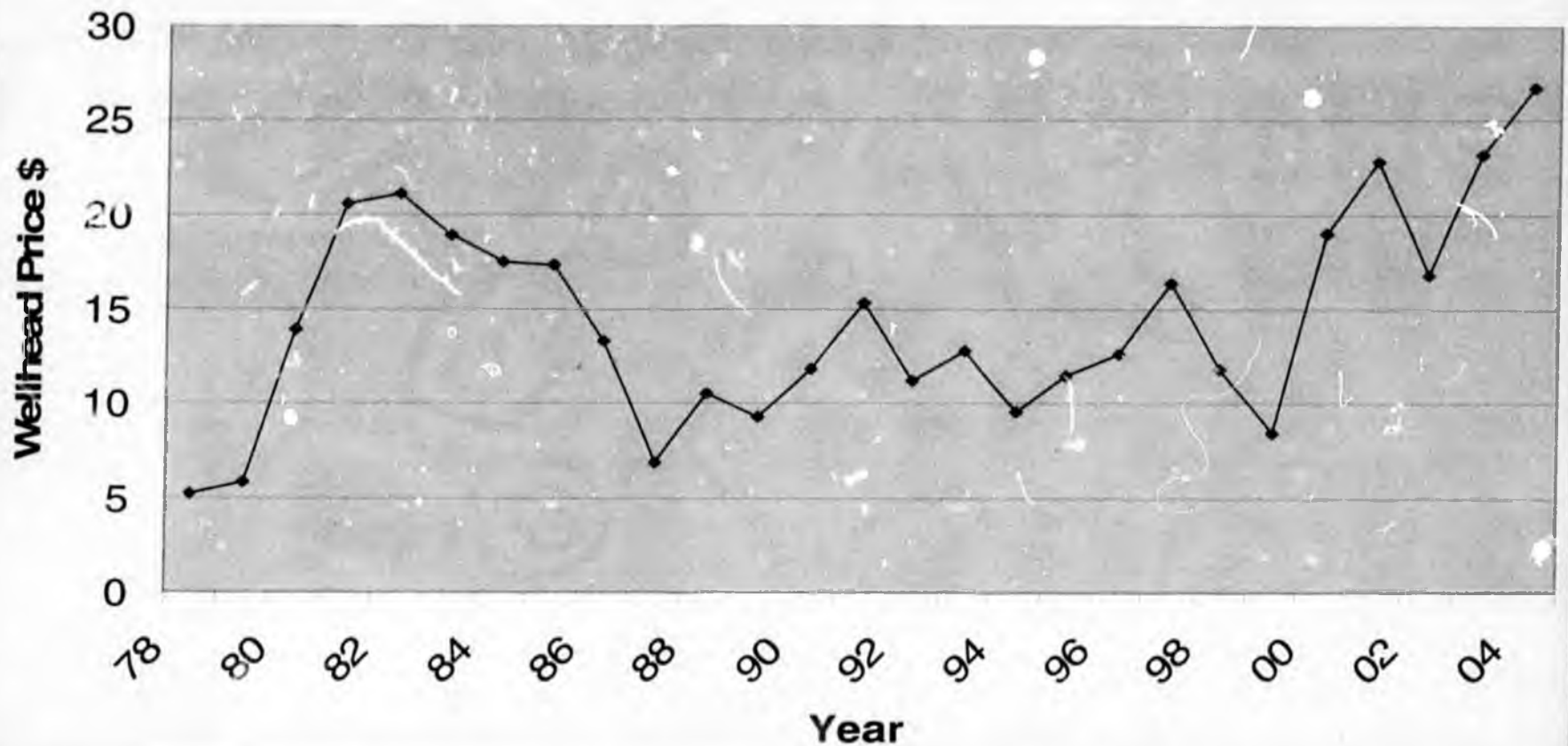
Should you know?

Let's talk

# Historic Alaska North Slope Crude Prices

## ANS Wellhead Crude Oil Price

From AK Dept. of Revenue, Tax Division



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

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

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

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

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

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

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

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

Thanks for the opportunity to testify at this important proceeding.

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



STATE OF ALASKA  
DEPARTMENT OF  
**REVENUE**

# **Responses to Committee Questions**

# Today's PPT Charts

- Comparisons to 20/20 PPT

- PPT 25/20

- PPT 30/20

- PPT 30/15

- ANS Crude Oil Prices

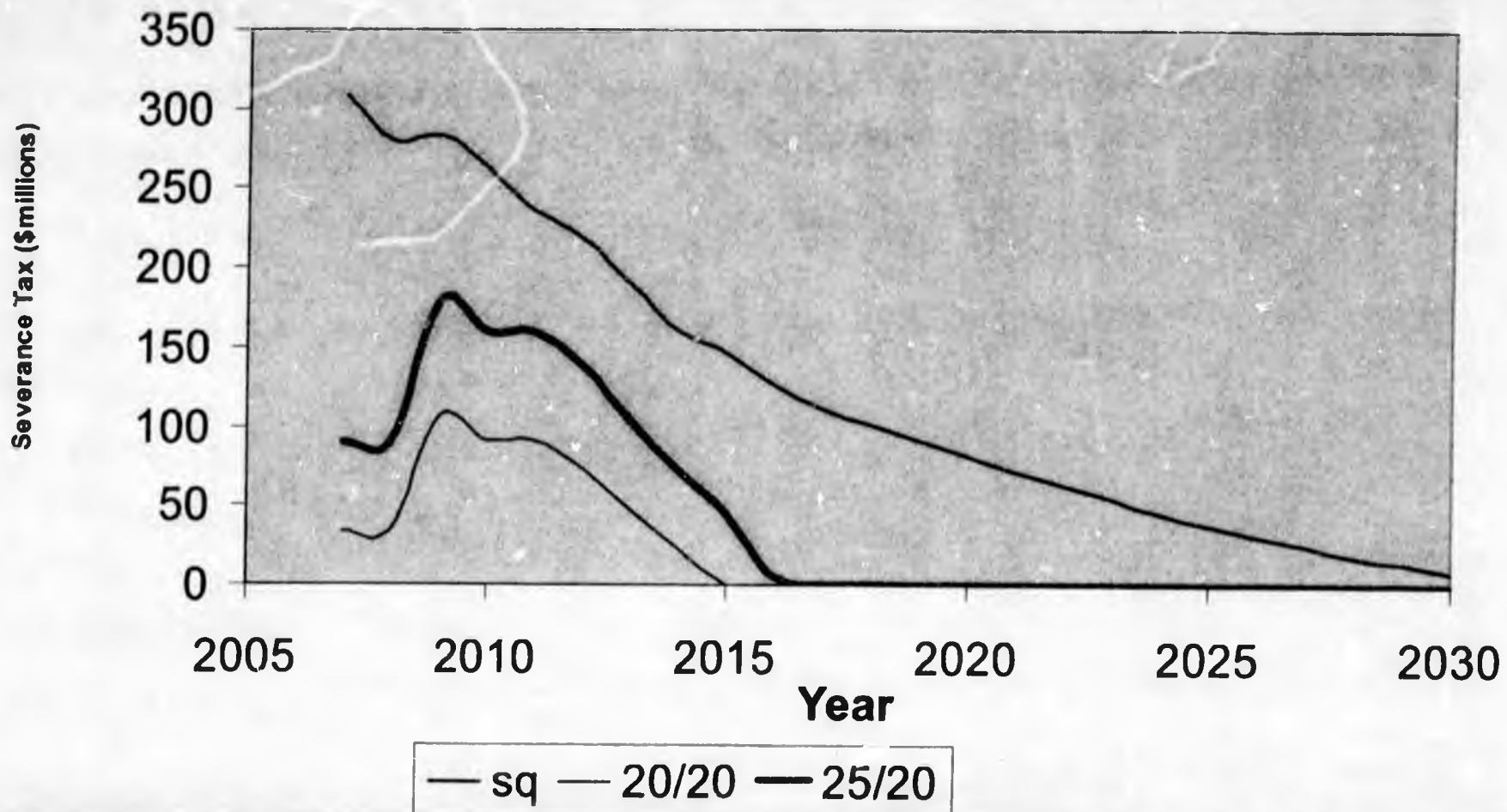
- \$20

- \$40

- \$60

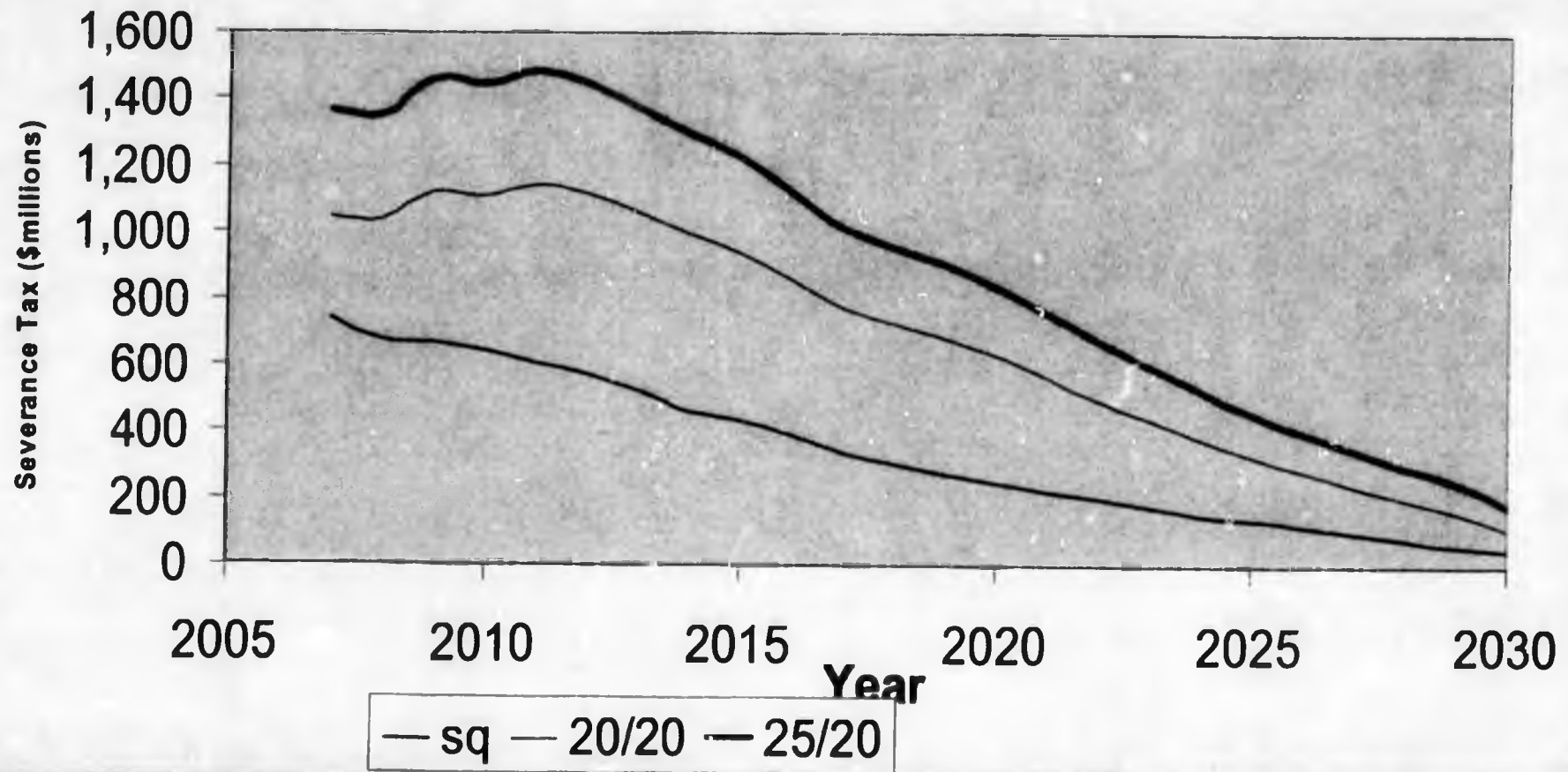


**Figure 4a**  
**Annual Oil Severance Tax (Millions of 2005 Dollars)**  
**Low Volume Scenario, No Gasline**  
**\$20**



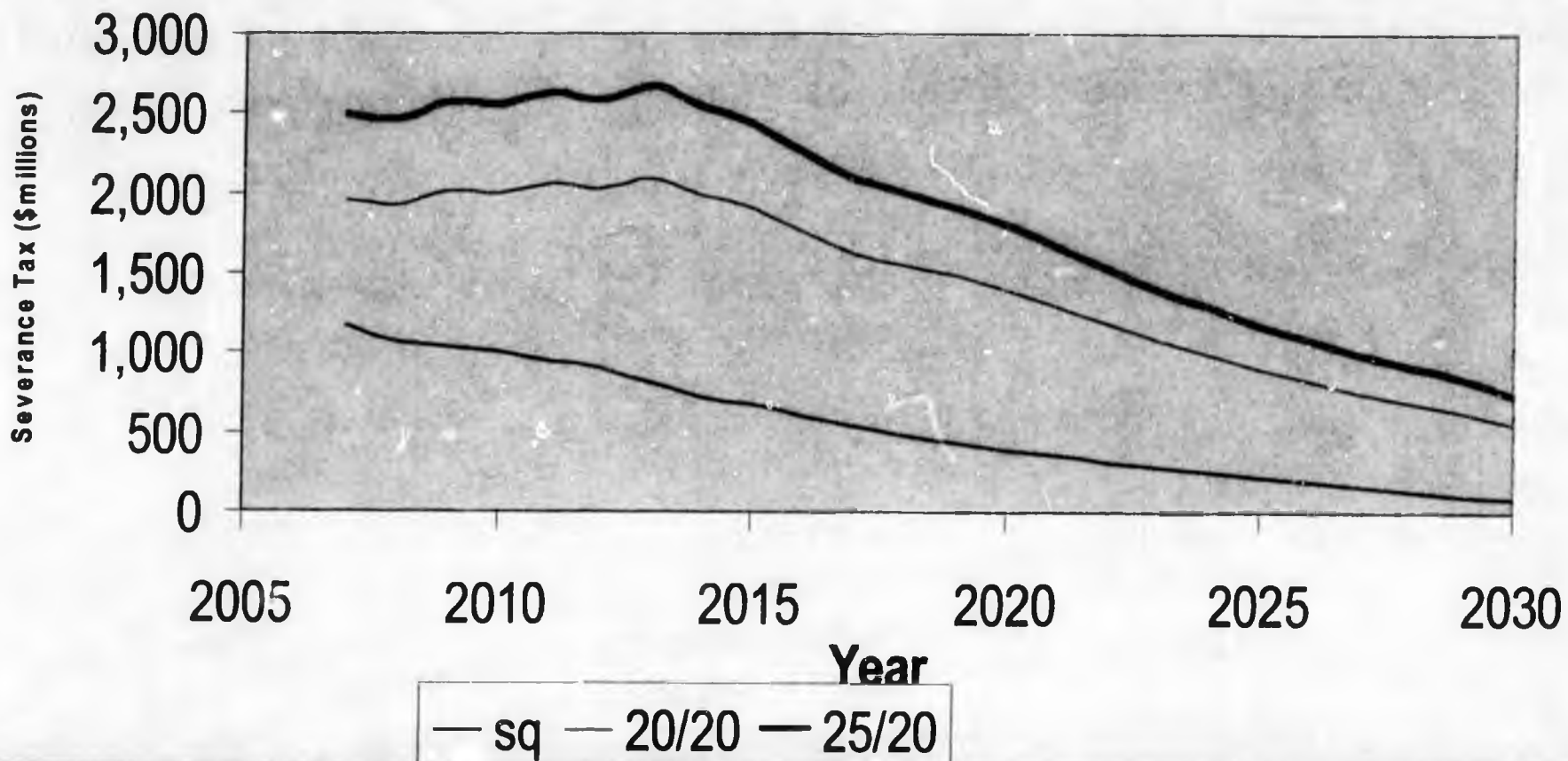
**PPT 25/20 - Average annual revenues \$80 million less than status quo & \$20 million more than 20/20**

**Figure 5a**  
**Annual Oil Severance Tax (Millions of 2005 Dollars)**  
**Low Volume Scenario, No Gasline**  
**\$40**



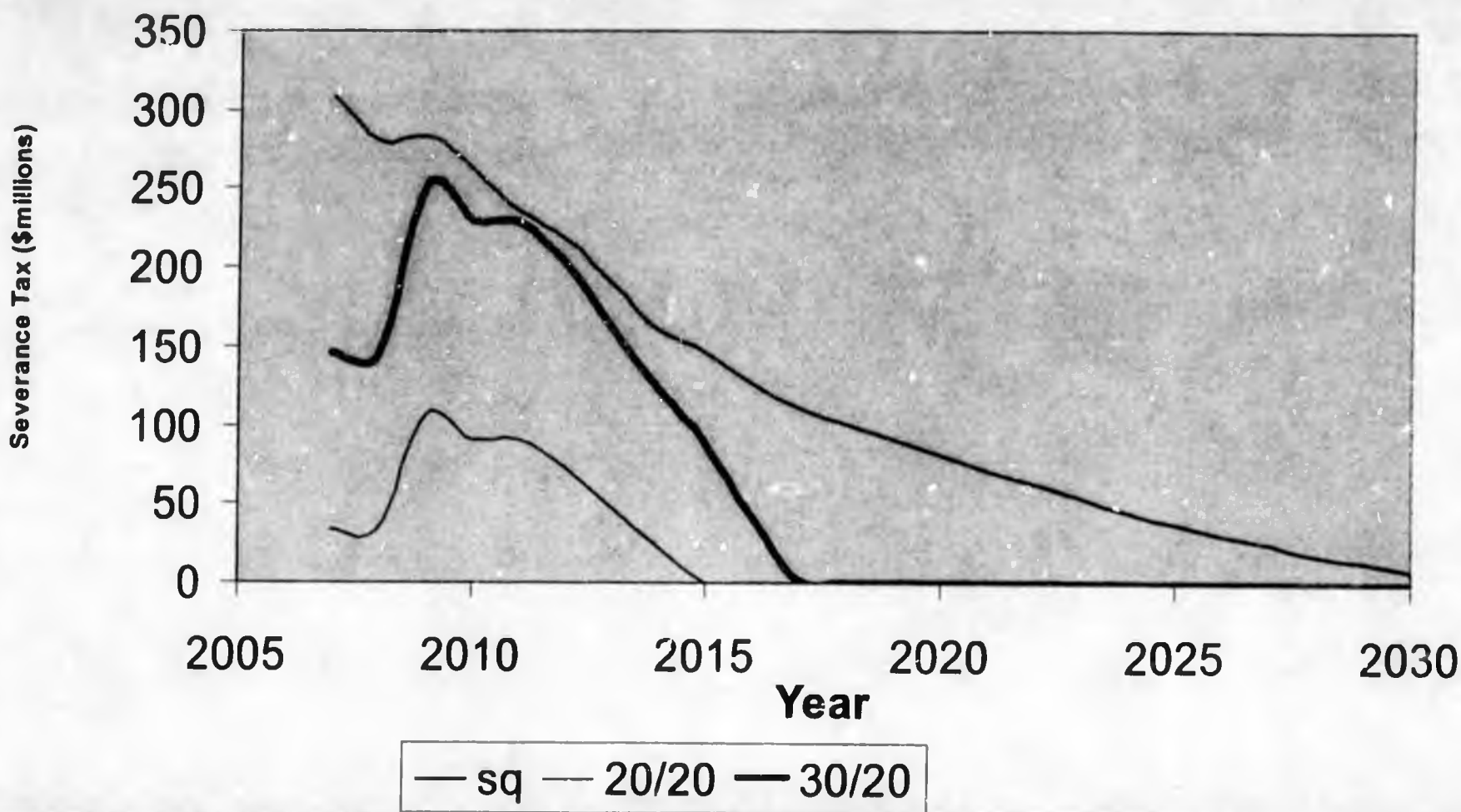
**PPT 25/20 - Average annual revenues \$565 million more than status quo and \$220 million more than 20/20**

**Figure 6a**  
**Annual Oil Severance Tax (Millions of 2005 Dollars)**  
**Low Volume Scenario, No Gasline**  
**\$60**



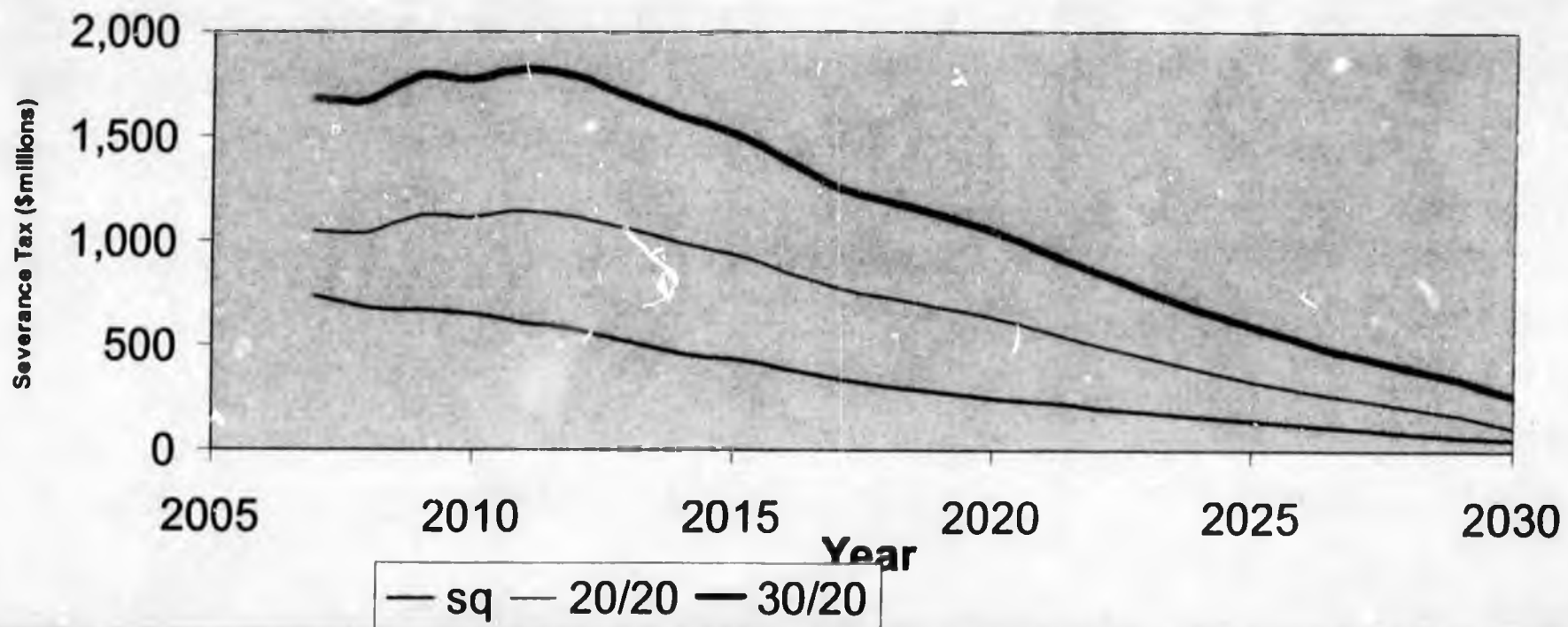
**PPT 25/20 - Average annual revenues \$1,300 million more than status quo & \$400 million more than 20/20.**

**Figure 4b**  
**Annual Oil Severance Tax (Millions of 2005 Dollars)**  
**Low Volume Scenario, No Gasline**  
**\$20**



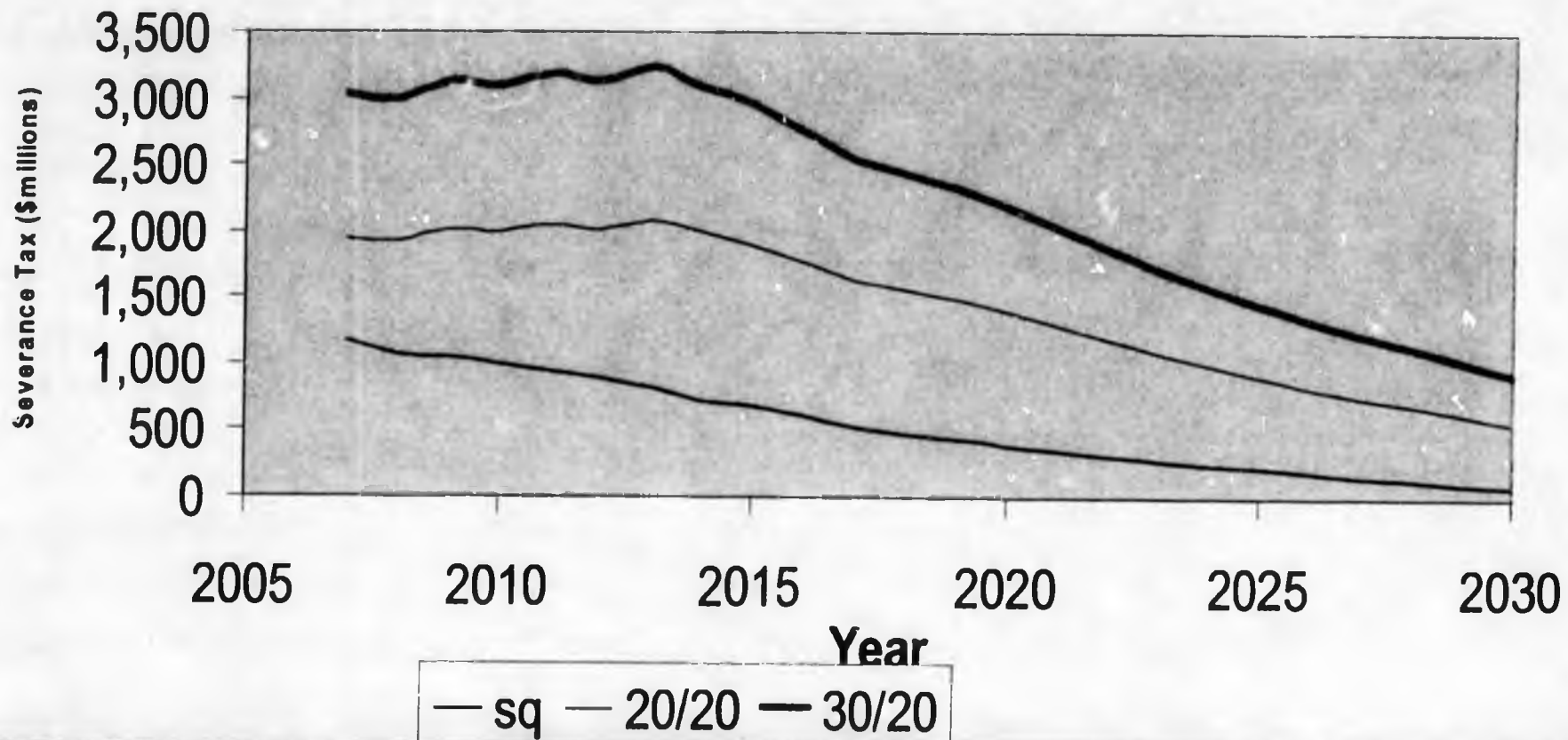
PPT 30/20 - Average annual revenues \$55 million less than status quo and \$45 million more than 20/20

**Figure 5b**  
**Annual Oil Severance Tax (Millions of 2005 Dollars)**  
**Low Volume Scenario, No Gasline**  
**\$40**



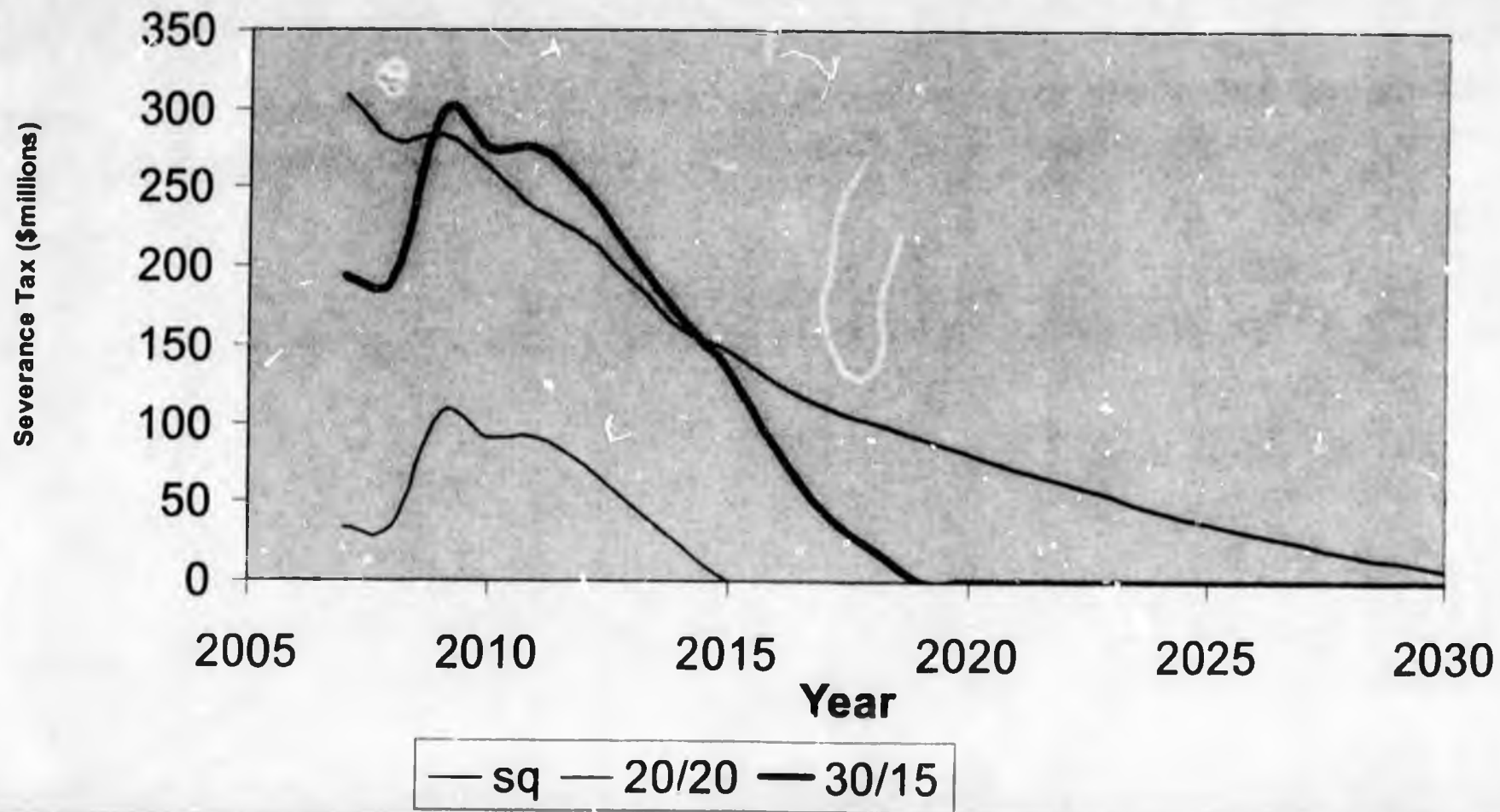
**PPT 30/20 - Average annual revenues \$790 million more than status quo and \$440 million more than 20/20**

**Figure 6b**  
**Annual Oil Severance Tax (Millions of 2005 Dollars)**  
**Low Volume Scenario, No Gasline**  
**\$60**



**PPT 30/20 - Average annual revenues \$1,730 million more than status quo and \$820 million more than 20/20**

**Figure 4c**  
**Annual Oil Severance Tax (Millions of 2005 Dollars)**  
**Low Volume Scenario, No Gasline**  
**\$20**



PPT 30/15 - Average annual revenues \$35 million less than status quo and \$70 million more than 20/20