



Section 35 through 40 (cont.)

- ❑ Department may develop PPT implementing regulations immediately
- ❑ Conforming changes to statute captions (by Revisor)
- ❑ Sections enacting PPT take effect July 1, 2006
- ❑ Sections implementing other changes take effect immediately

ADDED INFO 2-24-06
Sen. Resources

SB 305 HB 488

The Rest of the PPT Story
House and Senate Resource
Committees of the Legislature

Dan E. Dickinson, CPA

Robert E. Mintz, DOL

February 24, 2006

Section 1 & 11

- Clarify AS 43.55.020 (f) to reflect consistent department interpretation, upheld in formal hearing decision in 1996
- Prevailing Value is used to set a taxable value for internally refined barrels
- May be moot for a taxpayer using "DNR" or formulaic valuation

Sections 2 & 3

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

Section 4 & 16

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

Section 5

- *Repeals and Reenacts AS 43.55.011(a)*
- *A tax for all oil and gas ... less any oil or gas...exempt from taxation. The tax is equal to 20 of the net value...*

Section 6

- *Amends AS 43.55.017 (a) to conform language to the IRC code to which it refers*

Section 7

- *Repeals and Reenacts AS 43.56.020 (a)*
- *Ninety percent...is due on the last day of each calendar month. The remaining portion is due on March 31...*

Section 8

Existing statute has a separate tax on oil and on gas, while the PPT has a common rate for oil and gas, so a bunch of "ors" need to be changed to "ands;" that is the only change in this section, and it is not noted when it occurs later.

Section 9 (part one)

- Amends AS 43.55.020 (d), which deals with private royalties.
- Note: State and federal royalty interests are tax free, so a producer pays tax typically on 7/8ths of its production from these leases.
- Private royalty interests are not tax free, so a producer pays tax on 8/8ths of its production from these leases
- However, law authorizes producer to pass severance taxes on to royalty owner.

Section 9 (part two)

- When tax was gross at the point of production, this was straightforward.
- However, net value tax is harder to define and apply to a specific lease: (i) statewide costs, and (ii) since royalty owners don't share in lease costs, it can be argued they ought not share in the resulting tax deduction or credit.
- New formula: $(TT / nR \text{ bbls}) * \text{private royalty bbls}$
- where
- TT= Total tax paid by producer
- nR bbls = non royalty barrels.

Section 9 (part three)

- Assume taxpayer produced 100 bbls from each of 2 leases, one with a 12.5% state royalty and the other with a 12.5% private royalty share
- Gross value at the point of production was \$10 per bbl, with lease expenditures of \$875
- Calculation of tax:
- $\$10 \times (100 + 87.5 \text{ bbls}) = \$1,875$
- $\$1,875 - \$875 \text{ lease expenditures} = \$1,000$
- $\$1,000 \times .20 = \200 Tax
- Amount passed on to private royalty owner:
- $\$200 / (87.5 + 87.5) = \1.14 per barrel
- $\$1.14 \times 12.5 \text{ barrels} = \14.29

Section 10

- Repeals and Reenacts AS 43.55.020 (e)
- Simplifies three tiered system where flared gas was either tax free, taxed, or subject to tax and a penalty.
- Now gas and oil are tax free if used for necessary lease operations. (If AOGCC determines they have been wasted, then they are taxed.)

Section 12

- *New AS 43.55.024: "Tax credits for certain losses and expenditures"*
- *(a) 20 % capital credit*
- *(b) 20 % loss carry forward*
- *(c) credits are non-refundable*
- *(d) certifying credits for transfer*
- *(e) limits on uses of credit certificates*
- *(f) audit adjustments of certificates*
- *(g) authority to write regulations*
- *(h) definitions including "qualified capital expenditure"*

Section 13, 14 and 15

- Conforming changes to 43.55.030(a)
- Gross/net, and/or, simplified reporting
- Repeals the \$25 a day filing penalty which predated the 43.05 civil penalties
- Requiring the March 31 true-up filing

Section 17

Amends AS 43.55.080

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

Section 18 and 19

- Conforming language and update style updates for AS 43.55.135 and .150 (a)

Section 20

- *Adds 43.55.150 (d)*
- *The department may allow a producer...to calculate the gross value at the point of production of oil or gas ...upon ... a royalty value...accepted by [DNR] or [US DOI] ...or another formula prescribed by ... [DOR]*

Section 21 (part one)

- *Adds AS 43.55.160 Determination of net value of oil and gas*
- *(a) gross value less lease expenditures and 1/2 of transitional investment expenditures*
- *(b) carry forward of lease expenditures that would cause a loss*
- *(c) definition of qualified lease expenditures*
- *(d) examples of and exclusions from direct costs*
- *(e) adjustments for amounts received by producer.*
- *(f) ability to annualize lease expenditures*

Section 21(part two)

- (g) *Transitional investment expenditures*
- (h) *inflation of \$40 floor for TIEs*
- (i) *\$73 million allowance*
- (j) *limitation on those qualified to use (i)*
- (k) *allocation between in-state and out-of-state expenditures*
- (l) *authority to write regulations*
- (m) *use of "producer" includes "explorer"*
- (n) *exploration and drilling of stratigraphic test wells*

Sections 22 through 29

- Amends AS 43.55.200 and 300
Concerning Conservation Surcharges
- 100% still due every month
- Now creditable against the PPT
- Oil used on lease does not incur the surcharge
- Conforming language changes (extend to AS 43.55.160)

Section 30 & 32

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

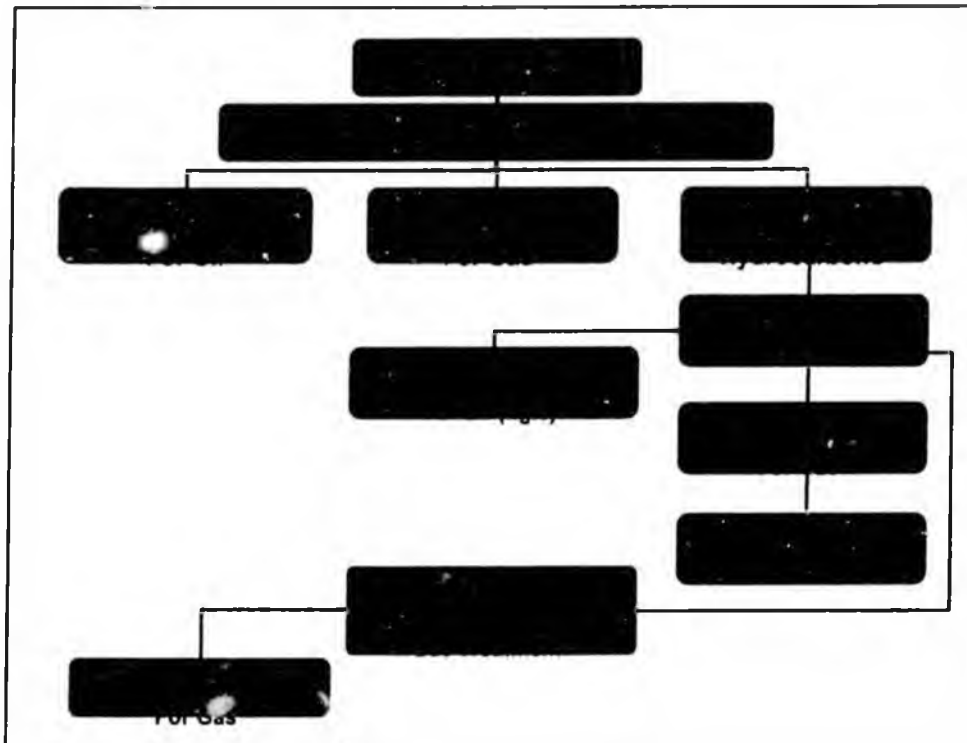
- New definition of "oil"
- Liquid hydrocarbons recovered by mechanical separation or gas processing

Section 31

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

Section 33

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



Title 34

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

Section 35 through 40

- Applicability: Sections pertinent to taxing oil and gas under the PPT apply to oil and gas produced starting July 1, 2006
- Applicability: Prevailing value clarification of existing law applies to all oil and gas
- Half-year conventions for 2006
- Note: no 2006 ELF based safe Harbor

Section 35 through 40 (cont.)

- Department may develop PPT implementing regulations immediately
- Conforming changes to statute captions (by Revisor)
- Sections enacting PPT take effect July 1, 2006
- Sections implementing other changes take effect immediately

SB

305

(FILE 4)



Alaska State Legislature

Please enter into the record my testimony to the Sen. Resource Cmte
committee name

Committee on HB488/SB305, dated 2-25-06
bill # / subject public hearing date

Signed: James Richert
Testifier

Representing (optional)
9201 Mountree Dr Anchorage 35290 Ken Salmon
Address 2071
(907) 727-2710 Funny River, AK
Phone number

2/24/2006

The Petroleum Production Tax (PPT) legislation currently under consideration by the State Legislature is part an agreement between the sponsor group (BP, ExxonMobil & ConocoPhillips) which covers fiscal terms for both oil and gas. The agreement represents a finely balanced package that will support the producers strategy to develop the massive oil and gas resources on the North Slope. It is a big milestone in delivering that strategy to the future of oil and gas in Alaska. Any further tax increase will jeopardize that future.

Points to consider -

- The Governor and producers have worked well over a year to reach this finely balanced agreement. Please don't mess this up.
- Alaska has abundant natural resources, but they are challenged by cost and geography
- The producers are working hard to apply innovative technologies to bring Alaska's oil and gas resources to energy consumers.
- These investments mean jobs for Alaskans and revenue for the state.
- But those investments won't happen if Alaska has a weak investment climate
- Alaska's fiscal policies should encourage investment and focus on growing the pie rather than taking an increased share of a shrinking pie.
- The rules of the game need to be clear and lasting. Big investments won't happen if taxes are too high, or if the rules can be changed once investments are made.
- We are on the brink of something very big: a fiscal contract that creates a healthy oil and gas business for generations to come.
- This delicately balanced legislation can help deliver that future, and I support this legislation as drafted because it enables a gas project to move ahead.
- New developments like the Ooguruk needed royalty relief to move forward, but also require infrastructure of the majors. The existing business must be healthy to provide this sort of development opportunity.
- Alaska's oil business must be healthy for gas to work.

Respectfully Yours,



James Gilbert
9201 Main Tree Dr.
Anchorage, AK. 99507

And

35280 King Salmon Ave.
Funny River, AK.

465 4779



ALASKA STATE LEGISLATURE

Please enter into the record my testimony to the Joint Resources
 Committee on Oil & Gas Production Tax Dated 2/25/06
Committee Name
Bill / Subject

please see attached

SIGNED:

Buzz Otis

Testifier

Representing

452-5617

Address / Phone Number

Take the time necessary to fully understand both the near & long term ramifications of this bill.

As you know the decisions made this legislative session will have huge impacts for our children as well as ^{our} grandchildren.

Whatever decisions are made please take a balanced approach where the oil industry is encouraged to explore & develop the oil and gas reserves of this state & that the financial needs of our state, based on fiscal responsibility, which the legislature must exercise, are met.

In short a

Long Term, Sustainable, & Balanced approach that is good for the state, good for the producers, & good for future generations is needed!

Buzz Otis Testimony
Read by Rhonda Boyles
2/25/06

Alaska Support Industry Alliance

360 W. Benson, Ste. 200
Anchorage, AK 99503
Phone: (907) 563-2226
Fax: (907) 561-8870

Alliance**Fax**

TO: SEN. TOM WAGONER

From: PAUL LAIRD

REP. RALPH SAMUELS

Pages: COVER + 1

REP. JAY RAMRAS

Date: 2/27/06

Paul Laird, General Manager; Hillary McIntosh, Communications Manager; Joanna Oldfield, Membership/Event Coordinator;
Shirley Nelson, Administrator

I ALSO SUBMITTED THIS AT THE
LIO IN ANCHORAGE ON SATURDAY.



THE ALLIANCE

... for responsible development of Alaska's Oil, Gas & Mineral Resources

HOUSE-SENATE RESOURCES TESTIMONY.1 On House Bill 488 - Senate Bill 305 February 25, 2006

Mr. Chairman, thank you for this opportunity to comment on Senate Bill 305 and House Bill 488. My name is Paul Laird, and I'm the general manager of the Alaska Support Industry Alliance.

As a trade organization representing companies and individuals that provide goods and services for Alaska's oil, gas and minerals industries, we know first-hand the critical role that investments in oil and gas exploration and development play in sustaining our members' businesses. As Alaskans, we also know the critical role they play in the future of our state's economy.

We're encouraged by the tax credits and annual allowance contained in these bills, because we believe they will achieve their goal of stimulating new investments both in developing known oil and gas resources and in finding new ones.

To the extent that this legislation could represent a critical step toward providing the fiscal stability and predictability investors will need in order to build a multibillion-dollar gas project, we're encouraged by that, too.

But the Alliance is also deeply concerned about the prospect of a \$1 billion annual tax increase on the industry that's already providing about 90% of Alaska's state revenues and the potential impacts on Alaska's competitiveness and its ability to attract the investments that are our state's lifeblood.

We're also concerned about extracting another \$1 billion a year from the private sector in order to provide even greater funding to a state government that's already projecting a \$1.2 billion budget surplus in the short term, that's growing at a disturbing rate and that still has no fiscal plan for managing excess funds during the good times or balancing the budget when times are lean.

This legislation is very complex, and it has historic implications not only for our industry, but for our state. We, like you, are still working to fully understand the implications to future investments, and thereby, to the economic future of Alaska.

As you consider how to ensure that Alaska gets its "fair share" of the profits from oil and gas production, which effectively means more money to grow the size of state government, the Alliance's 400 member organizations and the more than 30,000 employees who work for them in Alaska urge you to also consider what effect this legislation will have on growing Alaska's economy, and on Alaskans getting our fair share of the private sector jobs and business opportunities that will only come through new oil and gas investments.

ALASKA SUPPORT INDUSTRY ALLIANCE

360 W. Benson Blvd., Suite 200 • Anchorage, Alaska 99503 • Phone: (907) 563-2226 • Fax: (907) 561-8870 • www.alaskaalliance.com

Senator Wagoner,

Enclosed is my testimony on SB 305 Saturday.

For a small Independent Oil Company, it is critical that the \$73M deduction stays in the bill along with the tax credits and the ability to sell them.

Jim Weeks, a partner and the CEO of Ultrastar and Winstar may come to Juneau and testify as a stake holder. While there, he may stop in and see you. He is a former Arco executive with extensive experience on the slope.

John Winther

MR. CHAIRMAN, MEMEBERS OF THE COMMITTEE

THANK YOU FOR THE OFPORTUNITY TO TESTIFY ON SB 305.

FOR THE RECORD, MY NAME IS JOHN WINTHER AND I RESIDE IN PETERSBURG.

MY PRIMARY BUSINESS IS FISHING, BUT I AM ASLO AN OWNER OF TWO INDEPENDENT OIL COMPANIES THAT OWN ACREAGE ON THE NORTH SLOPE WITH HOPES OF BECOMING A PRODUCER.

IN 1997, DALE LINDSEY, MYSELF AND SEVERAL OTHERS FOUNDED WINSTAR PETROLEUM IN 1997. WE SUCESSFULLY BID ON LEASES TOTALING ABOUT 20,000 ACRES OVER THE NEXT SEVERAL YEARS.

IN 2002 DALE LINDSEY, JIM WEEKS AND I STARTED ANOTHER COMPANY CALLED UNLTRASTAR EXPLORATION. WE CURRENTLY HOLD 4700 ACRES NORTH SLOPE .

DALE AND I WERE INSTRUMENTAL IN GETTING THE PROVISIONS IN THE CHARTER FOR DEVELOPMENT THAT IS IN THE MERGER AGREEMENT BETWEEN BP AND ARCO. I CAN SAY WITH OUT THESE PROVISIONS IN THE CHARTER FOR DEVELOPMENT, THERE WOULDN' T BE ANY OPPORTUNITY FOR AN INDEPENDENT ON THE NORTH SLOPE TODAY. THE KEY PROVISIONS WERE ACCESS TO THEIR FACILITIES ON REASONABLE TERMS, THE MAJORS HAD TO PURCHASE UP 5000 BBL/DAY OF PRODUCTION, THEY WERE REQUIRED TO SELL SEISMIC TO AN INDEPENDENT, AND THERE WAS A BINDING ARBITRATION CLAUSE IN THE EVENT TERMS AND CONDITIONS CANNOT BE AGREED.

DALE AND I ALSO WENT TO WASHINGTON DC ON OUR OWN TO COMMENT ON THE MERGER AND PARTLY BECAUSE OF OUR EFFORTS, THE ARCO ASSETS IN ALASKA HAD TO BE SOLD OFF. THIS LED TO PHILLIPS COMING TO ALASKA. WE FELT THERE HAS TO BE THREE MAJORS ON THE SLOPE TO ENSURE COMPETITION.

WE ARE UNIQUE IN THAT I BELIEVE WE ARE THE ONLY ALASKAN OWNED INDEPENDENT OIL COMPANY TO EVER DRILL A WELL ON THE NORTH SLOPE. WE DID THIS IN 2003 ON A LEASE WE OWNED NORTH OF OLIKTOK POINT. WE CONTRACTED WITH CONOCCO TO DRILL AND IF WE WERE SUCESSFUL, TO DRILL ANOTHER WELL AND OPERATE THE WELLS. I WISH I COULD SAY WE STRUCK OIL, BUT ALL WE FOUND WAS WATER.

WHILE WE WERE DISAPPOINTED, WE WEREN'T DISCOURAGED AND BEGAN NEGOCIATING WITH BP TO DRILL A WELL FOR US AT PT MCINTIRE. WE

EXPECT TO COMPLETE THESE NEGOTIATIONS IN TIME TO DRILL A WELL LATER THIS YEAR.

I AM HERE TO SUPPORT SB305. WHILE THERE ARE MANY PARTS TO THIS BILL, I SUPPORT WHAT TO ME IS THE MAJOR PARTS OF THE BILL THAT IS THE 20% TAX LISTED IN SECTION 5 ON PAGE 2 OF THE BILL, THE \$73 M DEDUCTION AND THE TAX CREDIT PROVISIONS THAT ARE ALSO IN THE BILL.

I SEE THAT THERE IS SOME SUPPORT IN THIS LEGISLATURE FOR RAISING THE 20% TAX ON OIL AND GAS PRODUCTION. I URGE YOU TO LEAVE THIS AS NEGOTIATED BY GOVERNOR MURKOWSKI.

RAISING THIS TAX IS GOING TO DISCOURAGE EXPLORATION AND DEVELOPMENT BY THE MAJORS.

BEFORE BECOMING INVOLVED IN THE OIL INDUSTRY, I DIDN'T REALLY UNDERSTAND MUCH ABOUT BIG OIL, OTHER THAN THAT THEY MADE HUGE MONEY AND PUMPED A LOT OF OIL, AT LEAST THAT IS WHAT I THOUGHT.

AFTER DEALING WITH THEM, I HAVE A BETTER UNDERSTANDING ON HOW THEY WORK AND WHY THEY DO THINGS THE WAY THEY DO.

I THINK THE MOST IMPORTANT THING TO REMEMBER IS THEY HAVE MORE OPPORTUNITIES TO DRILL FOR OIL AROUND THE WORLD THAN THEY HAVE THE MONEY FOR SO THEY HAVE TO PICK AND CHOOSE THEIR PROJECTS. IT IS A WELL KNOWN FACT THAT ALASKA IS THE MOST COSTLY PLACE TO DO BUSINESS, BUT IT IS ALSO THE MOST POLITICALLY STABLE OIL SUPPLY FOR THE UNITED STATES IN THE WORLD. WHILE WE MAY THINK ALASKA IS A PLACE THEY MUST DO BUSINESS, I DOUBT THEY THINK THAT WAY. THIS 20% IS WHAT THEY HAVE AGREED TO AND I THINK IT SHOULD NOT BE RAISED.

WE WHO WERE IN ALASKA KNOW WHAT KIND OF ECONOMY WE HAD BEFORE OIL AND IT WASN'T WHAT YOU CALL ROBUST. I THINK THE STATE BUDGET IN 1967 OR 68 WAS \$98M.

OUR PRODUCTION IS DECLINING EVERY YEAR SO WHY DISCOURAGE DEVELOPMENT BY INCREASING THIS 20% TAX?

THE \$73M DEDUCTION IS SOMETHING THAT HEAVILY FAVORS THE INDEPENDENTS AND REALLY DOESN'T DO MUCH FOR THE MAJORS BECAUSE OF THEIR HIGH PROFITS SO, I URGE YOU TO KEEP THIS IN THE BILL ALONG WITH THE TAX CREDITS.

IN CLOSING, SOME OF MY REMARKS MAY SOUND LIKE I'M SPEAKING FOR THE MAJORS, BUT I'M NOT. HAVING NEGOTIATED WITH THEM TO DRILL A WELL FOR US, I LEARNED A LOT ABOUT THEM AND I RESPECT THE WAY THEY DO BUSINESS. AT 20% ALASKA, IS GOING TO DO VERY WELL AND TRYING TO GET MORE MAY WORK BUT YOU MAY HAVE DISGRUNTLED MAJORS WHICH IN THE LONG RUN ISN'T GOOD. AGAIN I URGE YOU TO SUPPORT AND APPROVE THE KEY PROVISIONS OF THIS BILL.

ALASKA LEGISLATURE - LEGISLATIVE AFFAIRS AGENCY - ONLINE TELECONFERENCE ORDER FORM

Note: All Fields Must Be Completed

New Meeting Update to an existing meeting Cancel Meeting

Sponsor and/or Committee Name:

Date of Teleconference:

Start Time: End Time:

Chairing Site: Juneau Room:

Testimony: Yes No Invitation Only N/A

Testimony Time Limit: 1 min 2 min 3 min 5 min no time limit other - see instructions

Will there be an Executive Session during this meeting? Yes No

Contact Person

Telephone Number

Email Address

LIO sites: Anchorage Barrow Bethel Cordova Delta Junction Dillingham Fairbanks Glennallen Homer Juneau Kenai Ketchikan Kodiak Kotzebue Matsu Nome

Other sites may add? Yes No

Offnet Name (s)

Please list all offnet callers

- Petersburg
- Seward
- Sitka
- Tok
- Valdez
- Wrangell
- No LIOs

Subject of meeting and/or Bills on Agenda

public hearing on SB 305

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RESOURCE DEVELOPMENT COUNCIL

Growing Alaska Through Responsible Resource Development

February 24, 2006

Senator Tom Wagoner
Chair, Senate Resources Committee
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182

Representative Ralph Samuels
Chair, House Resources Committee
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182

Re: Governor Murkowski's Proposed Petroleum Production Tax

Dear Senator Wagoner and Representative Samuels:

On behalf of the Resource Development Council for Alaska, Inc. (RDC), I am writing to provide our initial comments regarding Governor Murkowski's proposed petroleum production tax as articulated in House Bill 488 and Senate Bill 305.

RDC is a private, non-profit business association comprised of individuals and leading companies from Alaska's oil and gas, mining, forest products, fisheries and tourism industries. The association's membership also includes construction companies, local communities, Native corporations, organized labor and a wide range of industry-support firms. RDC works to grow Alaska's economy through the responsible development of the state's natural resources.

Having had only four days to review this complicated piece of legislation, RDC is not yet prepared to offer detailed feedback on its technical provisions. However, we intend to participate in the ongoing legislative process and to offer more thorough remarks upon further analysis and consultation with our most affected members. At this time, RDC has two major concerns regarding the legislation.

First, the Governor's proposal targets the one industry already responsible for providing nearly 90 percent of Alaska's general fund revenues. It would annually take an additional \$1 billion from the oil and gas industry at current prices. How will the Legislature manage this new windfall going forward? This industry-specific tax proposal comes at a time when the state is wrestling with the question of how best to manage an estimated \$1.5 billion revenue surplus under the current tax system.

RDC — in cooperation with a host of other business, community and social service organizations — has advocated the development of a long-term state fiscal plan for nearly a decade. During this period we have argued the state must do more to bring recurring revenues in line with expenditures in order to achieve tax stability and create a positive and predictable business climate. How the state manages surplus revenues is as important as managing deficits when it comes to accomplishing these policy goals.

- Founded 1975
- Executive Director**
- Thaddeus J. Owens
- 2005-2008 Executive Committee**
- John Shively, President
- Rick Rogers, Sr. Vice President
- Wendy Lindskoog, Vice President
- Thomas Maloney, Secretary
- Stephanie Madison, Treasurer
- Patty Belawski
- Allen Bingham
- Manilyn Crockett
- Sieve Denton
- Jeffrey Y. Foley
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- Richard J. Owen
- Thomas Panamatoff
- Jose M. Parker
- Keith Sanders
- Robert B. Stiles
- Scott L. Thurston
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- Lorna Shaw
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- Keith N. Silver
- Joseph Sprague
- Jeanine St. John
- Lee Stoops
- John L. Sturgeon
- Jim Taro
- Greg Thies
- Eric P. Yould
- Ex-Officio Members**
- Senator Ted Stevens
- Senator Lisa Murkowski
- Congressman Don Young
- Governor Frank Murkowski

It seems clear the proposed petroleum production tax will generate additional revenue at high oil prices. However, it does not necessarily make Alaska's revenue stream from oil more predictable or stable. In fact, under the proposed progressive system the state is assuming certain risks. Given these facts, how will the Legislature address periods of low prices without further penalizing the state's largest revenue-producing industry?

Secondly, how will this increased tax burden affect future investment and exploration in Alaska's oil patch? Maintaining significant production throughput in TAPS is paramount to the future health of both the industry and the state's general fund coffers. It is not clear to RDC at this stage that increasing the state's take by \$1 billion annually facilitates new investment in the Alaska economy.

If the Legislature moves forward with a new oil tax regime, it must focus on providing incentives for both new frontier exploration and increased investment in existing fields and known resources such as heavy oil. Without ongoing capital infusions, Alaska risks an accelerated decline in production flowing through TAPS. In addition to incorporating proper investment incentives, the Legislature must analyze whether a new tax regime places Alaska at a competitive disadvantage for capital investment. Ideally the Legislature will utilize the state's tax regime to create competitive advantages for investment.

RDC's membership is always concerned when new industry taxes are proposed. The petroleum production tax is a proposal with massive potential consequences to the long-term wellbeing of Alaska's largest industry and the health of the state's general fund. We urge the Legislature to carefully analyze House Bill 488 and Senate Bill 305 and we look forward to participating in the public dialogue on this issue. Thank you for your attention to the Governor's proposal and for your consideration of RDC's position on House Bill 488 and Senate Bill 305.

Sincerely,

RESOURCE DEVELOPMENT COUNCIL
For Alaska, Inc.



Tadd Owens
Executive Director



121 W. Fireweed Lane, Suite 207
Anchorage, Alaska 99503-2035
Phone: (907)272-1481 Fax: (907)279-8114
Email: brady@aoga.org
Judith Brady, Executive Director

TO: Senator Tom Wagoner
Senate Resources Chairman

Representative Ralph Samuels
House Resources Co-Chairman

Representative Jay Ramras
House Resources Co-Chairman

FROM: Judith Brady, AOGA Executive Director

DATE: February 24, 2006

RE: Written Testimony for Joint Resources Committee – February 25, 2006

Thank you for the opportunity to provide written testimony for the Joint Resources Committee, Saturday, February 25, 2006 regarding HB 488 and SB 305 – Governor Murkowski's proposal to create a new production tax on the net value of oil and gas.

The Governor's proposal is estimated to be a billion dollar annual tax increase on the Alaska oil and gas industry – doubling the severance tax collected from the current system. This is, by any standard, an unprecedented increase that is of significant concern to AOGA.

Any changes to the existing tax system should continue to maintain as well as improve Alaska's competitiveness in the world in order to attract new capital spending. Increased industry spending will result in greater oil and gas production, more revenue to the State and more jobs for Alaskans. Alaska should strive to be in the upper quartile of competitiveness to attract companies and grow the Alaska private sector economy.

As we all know, this bill is complex. Individual AOGA member companies will need time to fully evaluate the details contained in the 22-page proposal and determine how the provisions of the bill affects each of their operations.

We look forward to working with you.

Cc: Members of House & Senate Resources Committees

SB

305

(FILE 5)

Testimony Regarding HB 488 and SB 305, a
Petroleum Production Tax Bill

Brian Wenzel, Marianne Kah, Darren Jones
ConocoPhillips

Before the
House Resources Committee &
Senate Resources Committee
February 27, 2006

Mr. Chairman, members of the committee:

Good afternoon. My name is Brian Wenzel, and I am the Vice President, Finance and Administration, for ConocoPhillips Alaska. With me today are Marianne Kah, Chief Economist for ConocoPhillips globally, and Darren Jones, Vice President, Commercial Assets Alaska. Thank you for allowing ConocoPhillips the opportunity to present testimony on HB 488 / SB 305, a bill designed by the Administration to replace the current production tax system.

ConocoPhillips is proud of its 45 year long history (through ARCO and Phillips Petroleum) here in Alaska. We have been actively exploring and developing oil and gas since the early 50's and have been a producer for 49 years. ConocoPhillips is the State's leading oil producer, its leading explorer, and its leading champion for the gas pipeline. ConocoPhillips is also the leading investor in Alaska. We are committed to Alaska and this year alone we are reinvesting over \$700 million on Alaska capital projects, most in our core legacy fields but also in bringing on new developments.

Library
Senate Resources Committee

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

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State of Alaska

Testimony Regarding HB 488 and SB 305, a
Petroleum Production Tax Bill

Brian Wenzel, Marianne Kah, Darren Jones
ConocoPhillips

Before the
House Resources Committee &
Senate Resources Committee
February 27, 2006

Mr. Chairman, members of the committee:

Good afternoon. My name is Brian Wenzel, and I am the Vice President, Finance and Administration, for ConocoPhillips Alaska. With me today are Marianne Kah, Chief Economist for ConocoPhillips globally, and Darren Jones, Vice President, Commercial Assets Alaska. Thank you for allowing ConocoPhillips the opportunity to present testimony on HB 488 / SB 305, a bill designed by the Administration to replace the current production tax system.

ConocoPhillips is proud of its 45 year long history (through ARCO and Phillips Petroleum) here in Alaska. We have been actively exploring and developing oil and gas since the early 50's and have been a producer for 49 years. ConocoPhillips is the State's leading oil producer, its leading explorer, and its leading champion for the gas pipeline. ConocoPhillips is also the leading investor in Alaska. We are committed to Alaska and this year alone we are reinvesting over \$700 million on Alaska capital projects, most in our core legacy fields but also in bringing on new developments.

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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 SGDA 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

become part of a fair and durable fiscal regime for both oil and gas. But the Administration's position was clear: the new production tax had to stand on its own. In other words, it had to represent something the legislature itself would accept as wise tax policy even in the absence of a deal on the natural gas pipeline.

For our part, this oil tax increase—on average, \$1 billion per year for the industry at today's prices—is not something ConocoPhillips would have found acceptable if we didn't think it would result in progress—and, ultimately, an agreement to move forward—on the gas pipeline project.

So, once again, the proposed oil tax increase by the Administration is a balance. On the one hand, it provides a foundation for fiscal stability for the oil and gas-related businesses of the Producers in Alaska. This stability is essential to facilitate future investment, including investment in the development of a gas pipeline project. On the other hand, the Producers must pay substantially more taxes than they would under the current regime.

Future Oil Production: I would like to move on to talk briefly on the future of oil production in Alaska. Even with the proposed incentives, the State's consultant acknowledges that production resulting from wildcat exploration, will only play a small role in increasing revenues under the PPT. The core legacy fields such as Prudhoe and Kuparuk will still produce over 80% of the total North Slope production in 2015, providing the base infrastructure on which these smaller fields will depend.

The already discovered heavy oil resource will play a much more significant role in the future of the North Slope. However, the State's consultant acknowledged that technology limitations and development costs will constrain heavy oil production in the near term, and it could be many years before this resource reaches its production potential. Yet, this heavy oil resource base is huge; published data suggests that in-place volumes are greater than 20 billion barrels. This is a key resource for Alaska, and the legislature should consider a structure that will best enable its development. The technology required to develop this resource will require huge expenditures. Therefore, heavy oil should be given differential consideration in the form of a lower tax rate or additional credits to develop.

Impact on legacy production: The bill has been designed to encourage new investors to come to Alaska. We fully support the arrival of new players and believe they can be beneficial to both the State and the Industry. Indeed, we have already made partners of several of them. However, the terms that will attract new investors also come with a cost.

Under the Governor's proposal the tax increase mainly targets the large legacy production assets (Prudhoe and Kuparuk) and will result in one of the highest, if not the highest severance tax burden of anywhere in the United States. This is an unprecedented fiscal increase on those who invested tens of billions of dollars to develop the North Slope and stayed in Alaska through difficult times, including periods of very low oil prices. We believe such an increase could undermine investor confidence in Alaska.

As we have discussed, the huge rate increase reflected in this bill is

something that ConocoPhillips supports with great reluctance. We should acknowledge that the State is currently enjoying a budget surplus and if one were to consider moving to a profits tax that collected the same amount that is collected today under current law, the PPT rate would be approximately 13% vs the 20% in the proposed bill.

Nevertheless, the legislature has fielded many questions over the last week some of which suggest that a tax rate of 20% is too low and that 25% would be more appropriate. Anytime the government raises taxes it is taking away money from the private sector that could be used for reinvestment and continued job growth. While it is obvious that higher rates would negatively affect the oil and gas industry, we also believe that those higher rates would not be in the long-term best interest of the State.

New field sizes in Alaska are small and arctic operating and development costs are high. We therefore spend a lot of time and resources assessing the upside potential and the downside risk. When we invest, we fully understand that there is a chance that we may not get a return on the investment, but also acknowledge that results could exceed expectations; hopefully we are right more than we are wrong. As we bear the greatest risk, it is fair that we should be appropriately rewarded. We acknowledge that the presence of tax credits reduces the downside risk for investors, but conversely higher tax rates significantly reduce the upside potential.

To attract investors, the State needs to set an appropriate risk/reward balance. If the credits are too high, the state will take too much downside risk, if the tax rate is too high, investors see insufficient upside potential and

look for better opportunities elsewhere. As we have mentioned before, with the high field costs and limited exploration prospectivity, investors in Alaska need upside potential. Moving upwards from 20% will seriously disrupt this risk/reward balance.

Getting the right balance between the tax rate and the credits for reinvestment is critical to future resource development in Alaska. The balance provided in this bill, while incorporating a significant tax increase, reflects, as we've said, a balance we are willing to reluctantly accept. Changes, even small ones will impact this balance and will cause investors to re-evaluate potential investments. Twenty percent can be implemented; but, the question you have to wrestle with is, with a rate that high, are you really going to get the level of long-term investment you desire.

Transition Plan: Under the bill, a fraction of a producer's expenditures on exploration, appraisal, and development capital incurred over the past five years may be deducted for purposes of calculating the producer's monthly profit tax obligation. ConocoPhillips supports this plan as it provides an equitable transition to the new tax system and is an essential piece of the overall balance reflected in the bill.

The Fiord field was discovered in 1992 (prior to the discovery of the Alpine Field). It was not possible to develop this small field by itself and it is only with the expansion of the Alpine facilities in 2004 that it is now possible to develop this satellite.

The project kicked off in 2003 and when faced with ELF aggregation, was in

jeopardy of not moving forward. In 2005, the Department of Revenue provided ConocoPhillips with a letter ruling stating that Fiord would be treated as stand-alone satellite and not be aggregated with Alpine for severance tax purposes. As a small satellite, Fiord would have a low ELF and hence pay little severance tax. Once this decision was received from the DOR, ConocoPhillips and its partners sanctioned the project.

Fiord will be an 18 well, roadless satellite with first production in late third or fourth quarter this year. Drilling will continue in 2007 and 2008 and production will peak at around 17,000 bpd. Total capital costs are expected to be around \$300MM. While oil and gas prices have significantly increased over the past few years, we are also seeing dramatically increased labor and material costs. On this project alone, we expect the costs to be \$30MM more than originally sanctioned.

The majority of the costs associated with developing Fiord will have been expended prior to the bill becoming effective. Without the Transitional Investment Expenditure plan, only costs associated with the 2007 and 2008 winter drilling programs would be eligible for PPT deductions and credits. As previously discussed, the project was sanctioned (based on the letter ruling from the DOR) assuming that the field would pay full state corporate income tax, royalty and property tax, but little or no severance tax. However, under the new bill, the development would now be subject to the 20% PPT rate. Without the transition plan, the increase in fiscal terms will result in a reduction of over \$100MM in gross value and a 6% reduction in IRR at a \$40 ANS West Coast Price.

ConocoPhillips is currently working on two other satellites in addition to Fiord. These are Nanuq, due to start up in late 2006, and West Sak II, which came on line in late 2005. All of these projects will have similar value loss impacts without the transition plan. In addition there are several other projects undertaken over the last few years which are now almost fully developed and will have value eroded as a result of the PPT.

In order to ensure that these past investments are equitably treated, a transition plan is essential.

I would now like to ask Marianne Kah to spend a few moments discussing how this proposed tax change might impact Alaska's competitiveness from the perspective of a global investor.

Good afternoon. I am Marianne Kah, the Chief Economist for ConocoPhillips in Houston. Thank you for providing me the opportunity to discuss how this proposed tax change might impact Alaska's competitiveness from the perspective of a global investor.

First, let me say that I appreciate the difficulty of your position. Many factors have to be considered by a government in choosing an appropriate tax rate for an industry as complex as the oil and gas industry. Cost structure, prospectivity, potential field size, reservoir quality, regulatory constraints, and the desired level of investment are perhaps but a few of the factors that have to be considered. Moreover, how these factors interrelate is not always obvious or easy to predict. Nevertheless, I will discuss several of

these factors and try to give you information that I hope will be helpful and relevant to your deliberations.

With that said, let me turn to some things that may be important to your decision and that I can illustrate with some slides.

Global Total Cost per Barrel: This slide shows for Alaska and other locations average capital and operating costs on a per dollar per BOE basis over the last decade. You can see that Alaska has higher capital and operating costs than other regions. Cost needs to be taken into account when setting the tax take. The countries with the lowest costs can afford to have higher tax rates while remaining competitive. Similarly, higher cost countries need to offset these conditions with lower tax takes.

In addition, with higher taxes there is actually less of an incentive for companies to control costs so you can say that higher taxes lead to higher costs.

Alaska – High Cost, High Tax: My next slide, shows the total costs as a function of government take for about 50 countries/states in the world. This data was taken from the Wood Mackenzie 2004 “Global Oil and Gas Risks and Reward Study”. As can be seen, there are inverse relationships between Government take and Total Costs. Alaska under the ELF is shown as the Green Box and the peer companies referenced by the State’s consultant in his PPT report are annotated and shown as red data points. As can be seen, Alaska under ELF is on the same trend line as many of the countries used by the consultant for his competitive analysis in his PPT report and is in the

"High Cost-Low Tax" quadrant. Based on his analysis, Government Take under PPT will go up about 6%. Alaska's position on the charts under PPT is shown high-lighted with a circle in the upper right-hand quadrant. Using the new Government take figures estimated by the State's consultant, Alaska has now shifted from the original trend line and moved into the high cost-high tax quadrant.

It is interesting to note that peer areas (according to the consultant's competitive analysis) such as the Gulf of Mexico and UK North Sea (even adjusted for the recent tax increase) are still significantly more favorable investment regimes. The high cost in the Arctic and the types of fields that are likely to be found suggest that the proposed fiscal regime could detract, rather than encourage, significant additional investment.

Global Average Commercial Discovery Size: My next slide shows the average commercial discovery size in Alaska versus various countries around the world. Areas with high prospectivity can generally assess higher tax rates, while maintaining investment. The Alaska North Slope, however, has limited prospectivity as compared to many parts of the world that we are exploring. Tax rates need to reflect that.

The State's consultant assessed the competitiveness of Alaska's tax rates by comparing tax rates of different regimes around the world. He assessed the impact on investor net present value using similar sized fields in all locations. That is not the way investors look at it. When we compare investments in Russia versus Alaska, for example, we compare the prospects of finding a very large field with very high tax rates in Russia versus finding

a much smaller field with lower tax rates in Alaska. The greater prospectivity in Russia may compensate for the higher tax rates. Thus, it is not meaningful to compare the competitiveness of Alaskan tax terms with Russia's terms or those in Azerbaijan and Angola at the same field sizes.

Norwegian Crude Production: The State's consultant has stated that Norway is comparable to Alaska in its wealth of natural resources and should be an analogue for Alaska. I don't believe that it is a good analogue because Norway has a lower cost structure and better prospectivity than Alaska. However, Norway has significantly higher taxes than Alaska. I don't believe that the Norwegian tax model is a helpful comparison for Alaska because as shown in this slide, Norwegian crude production has declined by 17% since 2001 despite the high oil prices we have seen in recent years. Thus, I would assert that Norway is not getting sufficient investment since its tax regime isn't in line with its cost and prospectivity position.

Petroleum Industry Re-Investment Rates: Investors most need stable fiscal terms with tax rates that are commensurate with the cost structure and size of the opportunity. Alaska's tax regime has offered that in the past and that is why we have found Alaska to be an attractive place to invest.

With the recent tax increases we have seen in a few locations around the world, I have become concerned that global tax takes are reaching a point where private companies are finding it challenging to invest. I believe that is one of the main reasons why petroleum industry re-investment rates, including those of independents, have not completely followed the rise up in

crude prices.

Of course, there are several other reasons why we haven't seen a greater spending response thus far -- the expectation that prices will cycle down to more "normal" levels and a lag time in developing new projects to invest in. But I firmly believe that tax rates around the world are also playing a key role. I also believe that re-investment rates could be lagging due to fear that governments will change tax rates after investments are made. Longer term, I am concerned that private oil companies will not be able to invest in conventional oil under terms being offered and will be forced to invest in alternative energy supplies with more favorable tax terms.

Cost of Capital: Another concern from a major oil company's point of view is the bias in the proposed tax regime change in favor of new versus legacy investors. There is a common misperception that small and medium-sized petroleum companies have lower return requirements than the majors. I would like to point out that the independent petroleum companies as a group, for example, have a higher cost of capital than the supermajors, and they should therefore have higher return requirements. Companies of all sizes who have not maintained adequate returns for their shareholders are no longer with us today.

I would also imagine that independents will also be comparing Alaska's tax rates to those in the Gulf of Mexico, United Kingdom and Canadian oil sands, where they have been frequent investors. The State's consultant concludes that tax rates in these locations are more competitive than the existing and proposed tax rates in Alaska.

If countries have high tax rates, it is possible that only government-controlled oil companies with different objectives, like energy security, will be willing to invest.

There is another concern created by the bias in favor of new versus legacy investors. This bias creates the potential of having a large number of small players active in the environmentally sensitive North Slope. The costs associated with the environmental protections that companies like ConocoPhillips insist on and are demanded by federal, state, and local governments are significant. This level of environmental sensitivity may be new to many of these smaller players.

Majors Offer Important Benefits: ConocoPhillips has been a long-term investor in Alaska and we want to make the case for why our company, along with other majors, should continue to have a significant role in the state.

We have the size and financial strength to carry out projects of any size. We have the skills to manage large and complex projects and we have substantial experience in developing projects and operating in Arctic conditions. ConocoPhillips, in particular, has substantial experience in heavy oil production and has leading coking technology to process heavier crudes. We are also the second largest refiner in the United States so we have the ability to upgrade our numerous refineries to process additional heavy crude oil. We also have strong commercial acumen and access to markets, which allows us to design projects to maximize the value of the

resource. For example, ConocoPhillips is the second largest gas marketer in the United States. And we have strong risk management skills. Finally, we have a long-term investment horizon. That means that we invest year in and year out and won't leave when market conditions get rough.

Majors Have Great Spending Capability: The last point I wanted to make about why major oil companies should be viewed as desirable investors is our great investment capability. This chart shows the three-year average total upstream spending in billions of dollars of the majors versus various independent petroleum companies. We can and would like to bring a lot of investment dollars into this state provided the terms are competitive. The tax proposal as introduced is the upper bound of what we believe is reasonable given the totality of the deal.

Thank you for your attention.

Thank you Marianne

Bill Language:

Prior to some concluding remarks, I would like to note that we have identified some suggested changes in language to improve or clarify the intent of the bill. Among other things, these changes concern how eligible deductions and credits are identified and how the value at the point of production should be calculated. We are developing proposed language to reflect these changes and hope to offer this language to you shortly.

Finally, we would like to summarize several key messages.

One, the proposed tax results in a more than doubling of the effective tax rate over the current system. In isolation, we would not view this change as reasonable, fair or appropriate, particularly given the state's current budget surplus. However, as a foundation for oil and gas fiscal stability that facilitates future investment in Alaska, the balance proposed in this bill is something ConocoPhillips will reluctantly support.

Two, the North Slope has a huge heavy oil resource that is already significantly disadvantaged from a technology, quality and cost perspective; incentivizing this resource will be key to increasing production levels in Alaska.

Three, a transition plan from the current production tax system to the next is essential to ensure equitable treatment of our legacy investments. Many of these investments were associated with the development of marginal assets that were justified on the basis of ELF. Qualifying these legacy investments for deduction against PPT is an essential part of the balance reflected in the bill.

Four, the tax rate proposed in the bill pushes Alaska into a high cost/high tax bracket as compared to many regimes around the world. This will affect the risk/reward balance that companies will evaluate before deciding to invest here. Before you accept the rate reflected in the Governor's bill, you must be comfortable with the potential risks to future investment that such a high rate imposes.

I would like to reiterate that Alaska and ConocoPhillips are aligned as partners on many important goals:

- increasing investment in Alaska;
- increasing Alaska's oil and gas production,
- increasing Alaska's competitive position, and
- developing long-term relationships with proven partners for long-term, mutual benefit.

In closing, many factors have to be considered by a government in choosing an appropriate tax rate for an industry as complex as the oil and gas industry. Cost structure (including distance to market), prospectivity, potential field size, reservoir quality, regulatory constraints, and the desired level of investment are perhaps but a few of the factors that have to be considered. Today, Alaska is challenged in each of these areas and the fiscal regime needs to recognize this.

Thank you for considering our views.

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HB 488 / SB 305 Testimony

ConocoPhillips Alaska
February 27, 2006

Brian Wenzel
Vice President, Finance & Administration
ConocoPhillips Alaska

Marianne Kah
Chief Economist
ConocoPhillips

Darren Jones
Vice President, Commercial Assets
ConocoPhillips Alaska

ConocoPhillips Alaska



Alaska's No. 1 Oil Producer

2005 production: 314 MBOD

Alaska's No. 1 Gas Producer

2005 production: 170 MMCFD

Alaska's No. 1 Explorer

5 exploration wells in 2005

7 exploration wells 2006

Largest Owner of State & Federal Leases

605,755 acres developed '05

2.8 million acres undeveloped '05

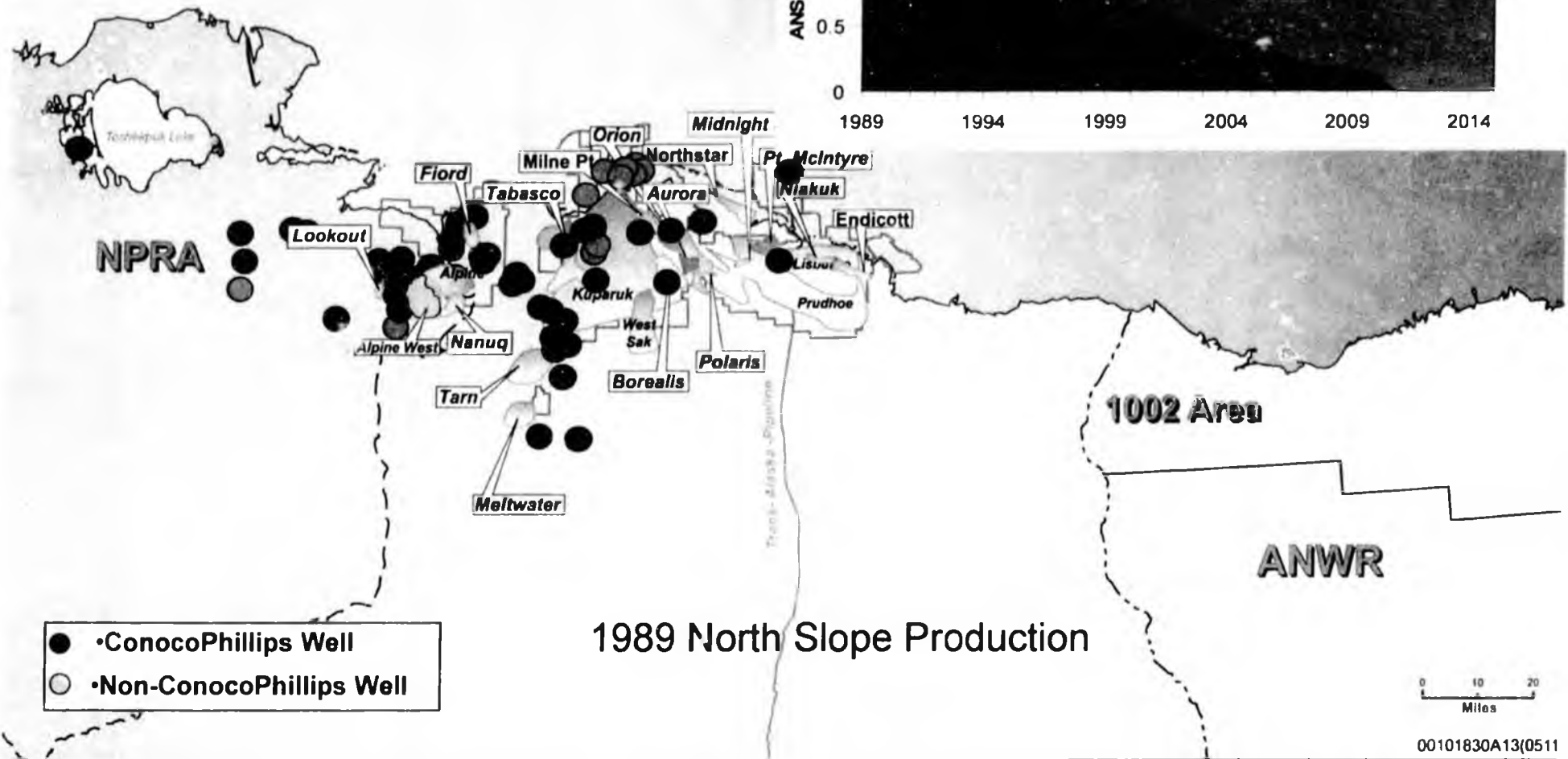
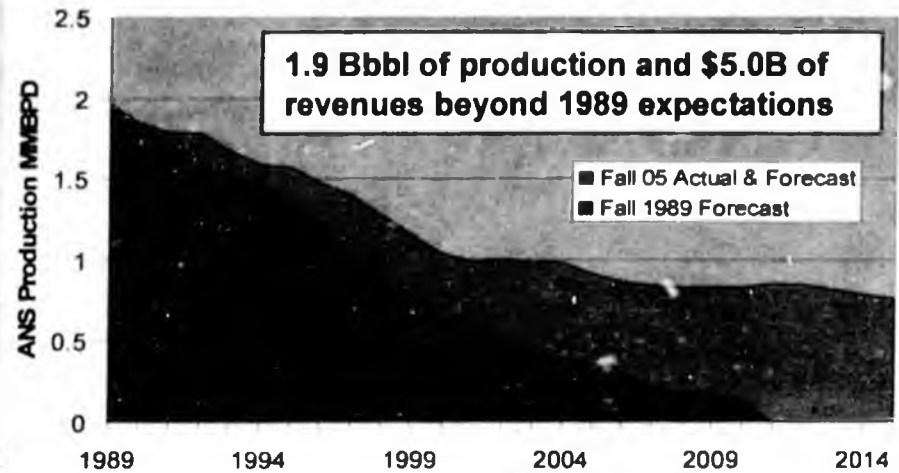
Largest Industry Community Supporter

2006 > \$12 Million Contributions

Largest Royalty and Tax Payer

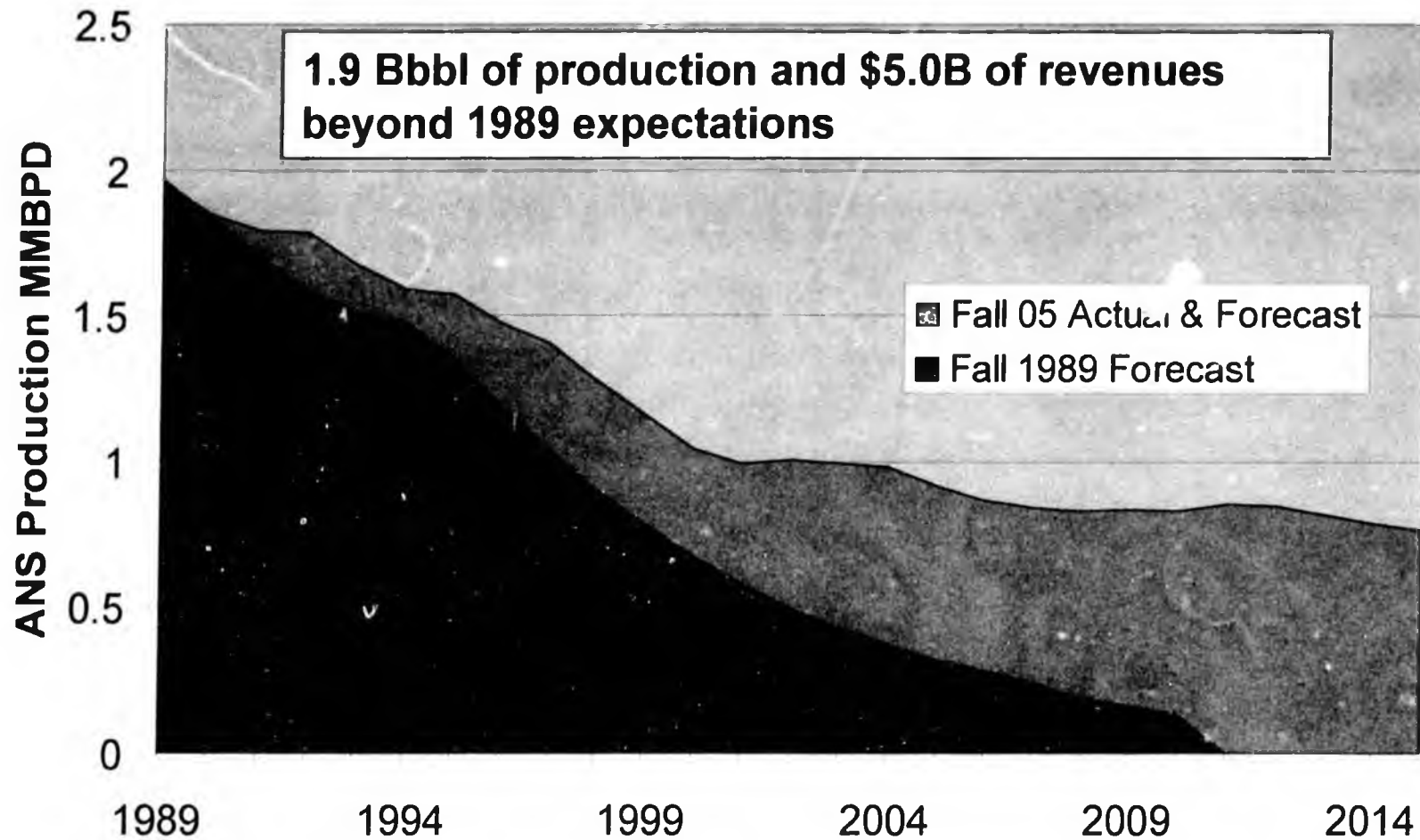
2005 Taxes and Royalties: \$1.6 Billion

Exploration Activity

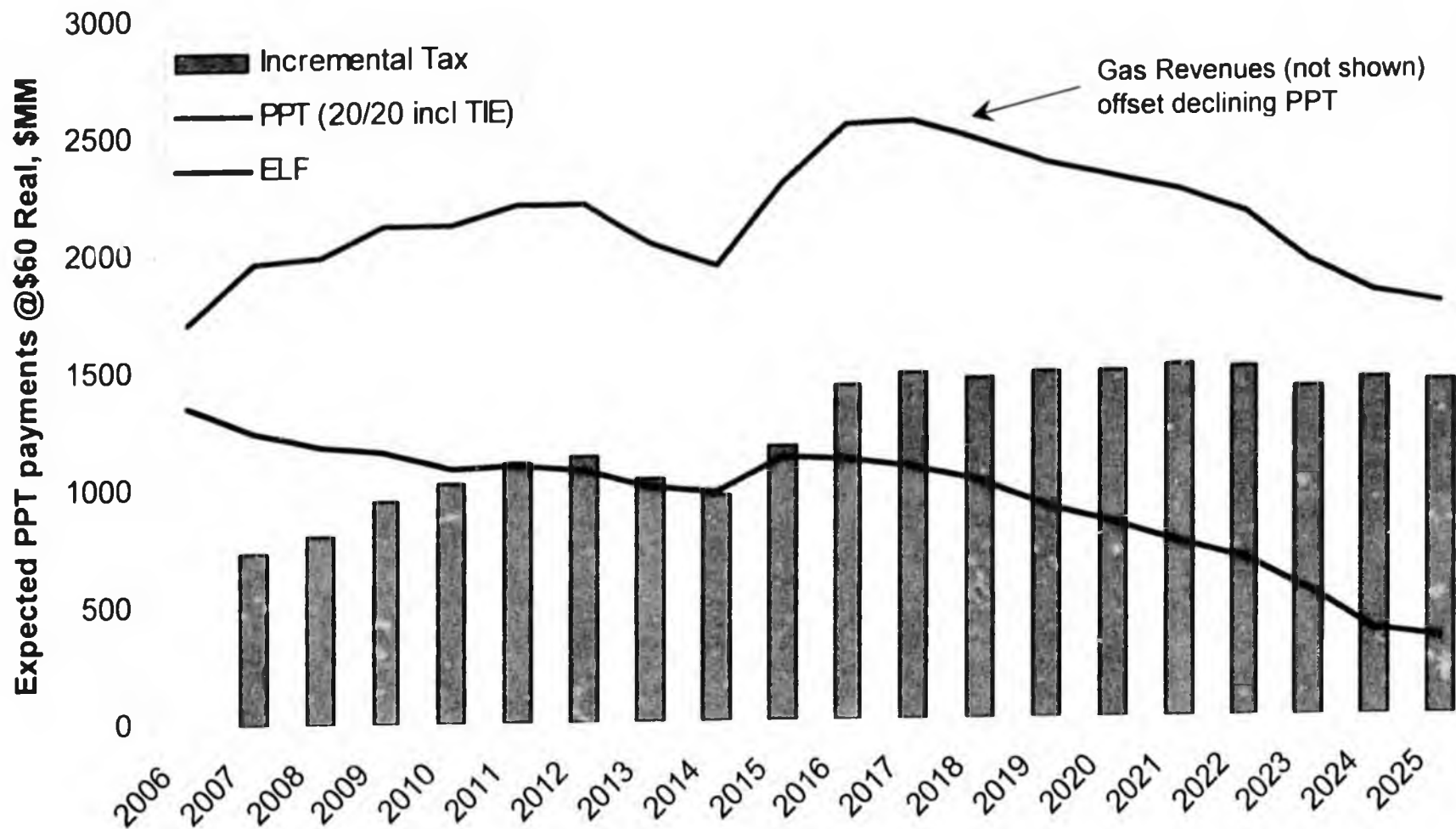


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North Slope Production



State of Alaska PPT Nominal Take @ \$60 Real



ConocoPhillips' Perspective

- Balanced fiscal structure critical for future O&G investment
- Future oil production in Alaska dependent on existing fields
- Bill differentially impacts legacy production
- Importance of Transitional Investment Expenditure plan
- Alaska's competitiveness on a global basis

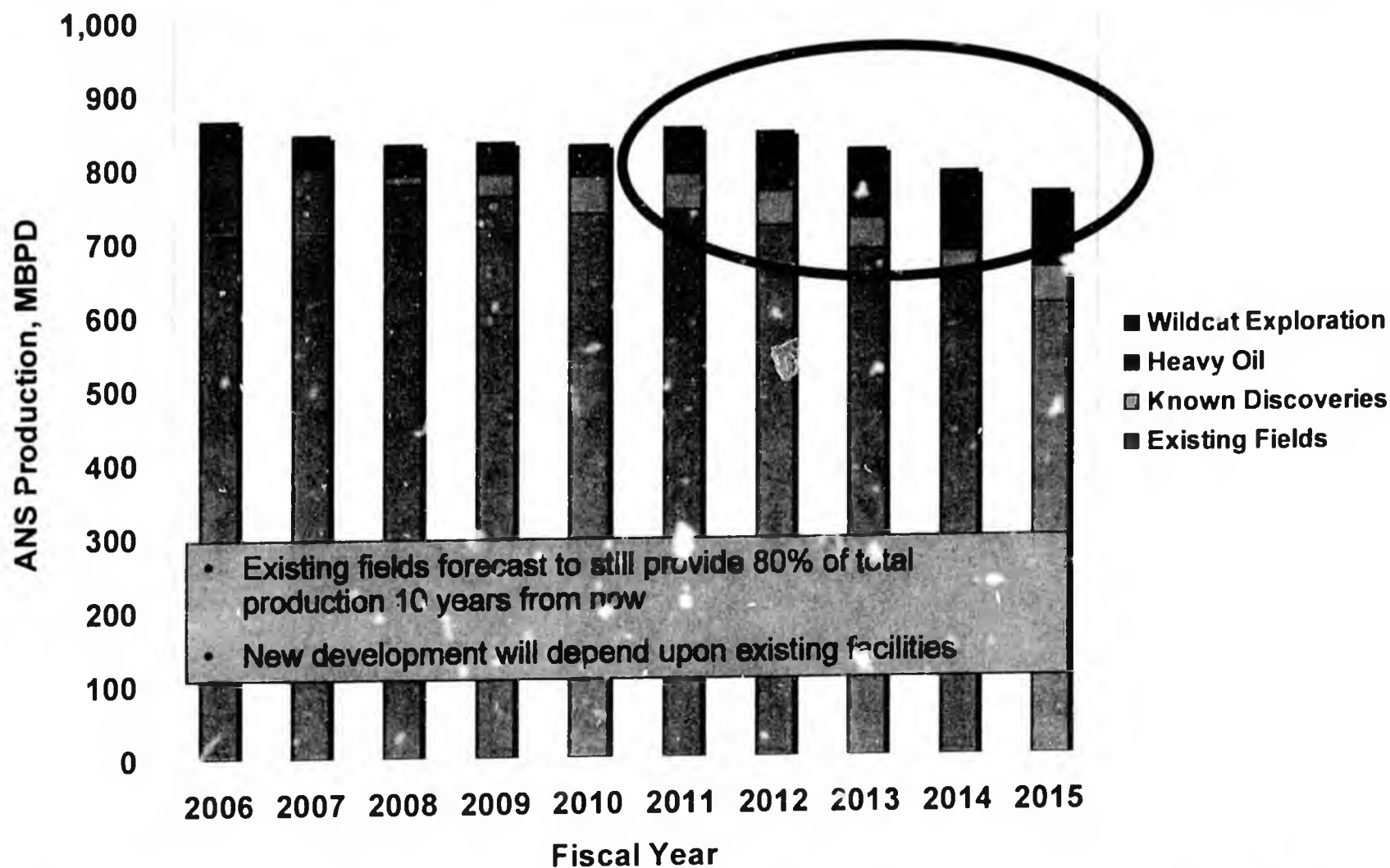
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Future North Slope Production Profile

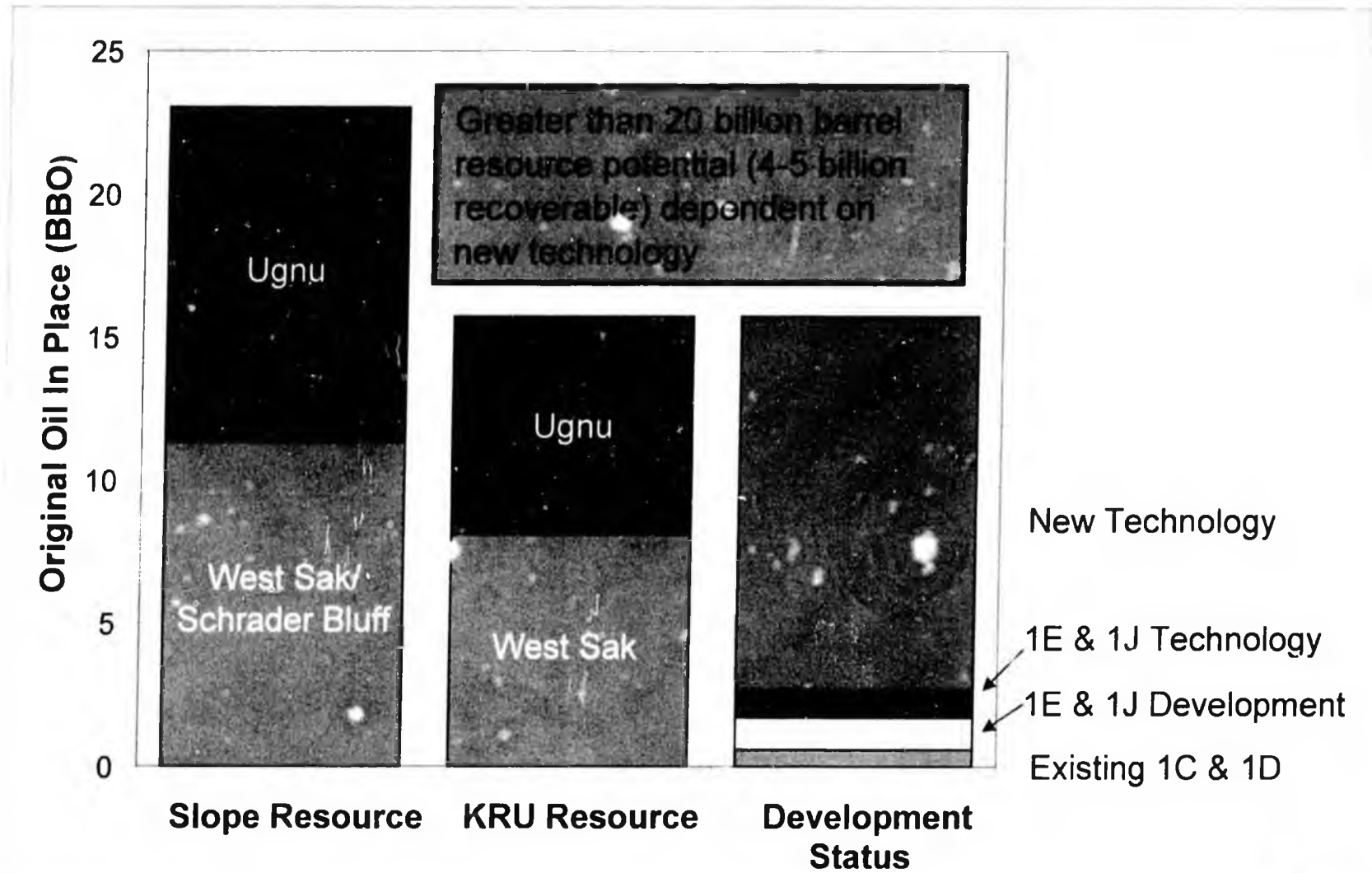


Source data: Alaska Dept Revenue Fall 2005 Revenue Sources Book

2/27/2006 - Slide 10

ConocoPhillips

Heavy Oil Resource Potential

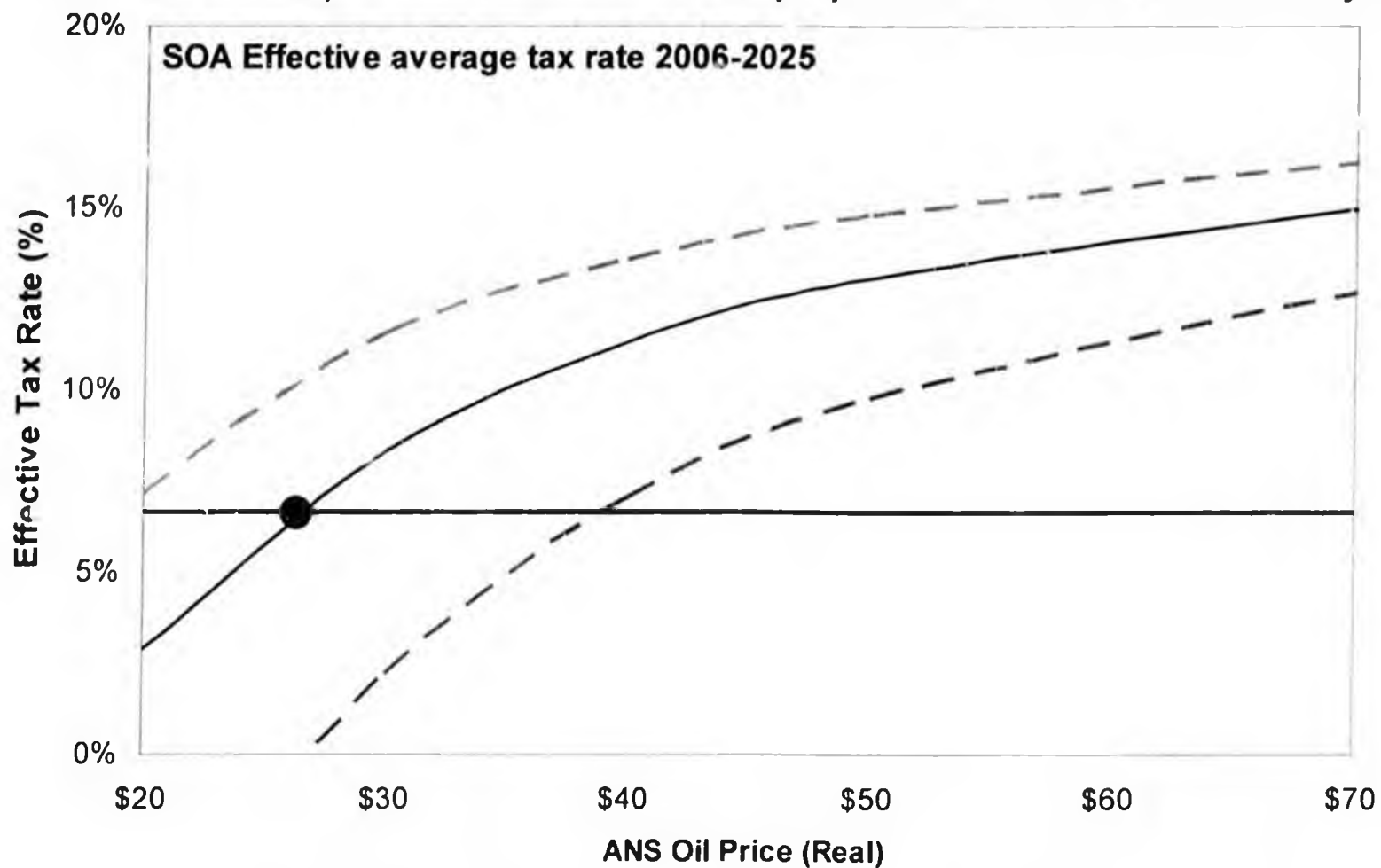


ConocoPhillips' Perspective

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SoA Effective Tax Rate: Core vs. Satellites/New

Core fields will provide 65% of North Slope production over the next 20 years



--- Core Assets PPT --- Satellites/New PPT ——— Total PPT ——— Total FLF

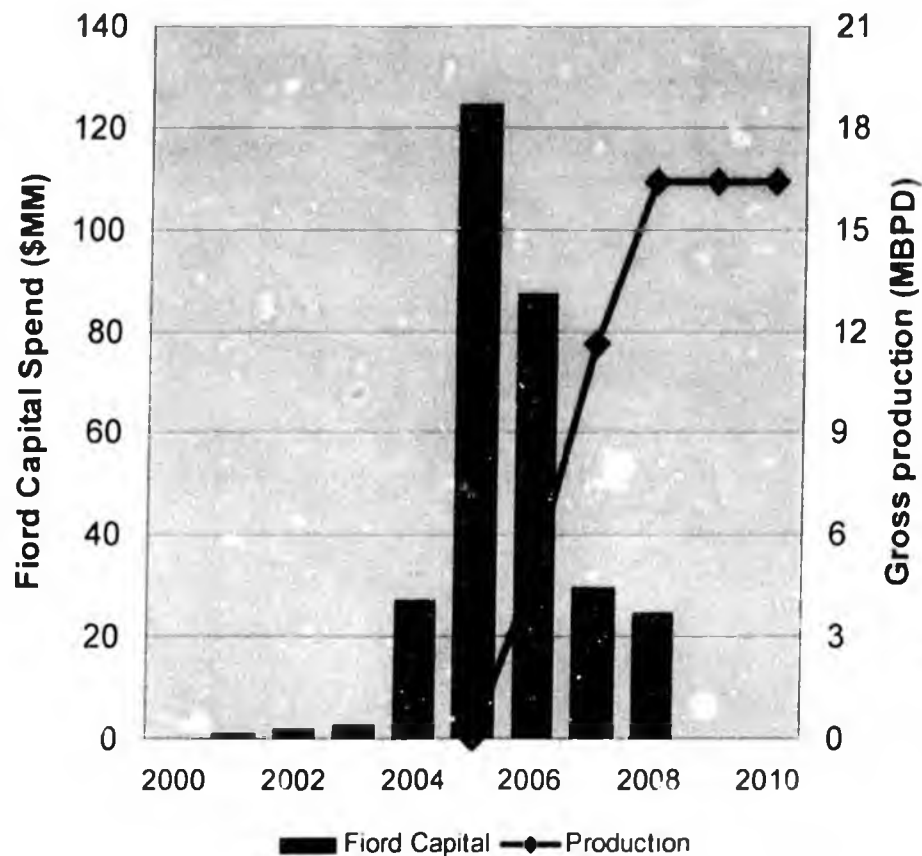
PPT assumptions: 20% tax rate, 20% credit rate, \$73MM corporate allowance, start date 7/1/2006, 5-yr TIE

ConocoPhillips' Perspective

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Importance of Transition Plan

Fiord Capital & Production



- PPT without transition reduces NPV₁₀ by \$100MM
- Increasing oil prices have impacted material and labor costs
 - Project costs have increase \$30MM since project sanctioned in 2005

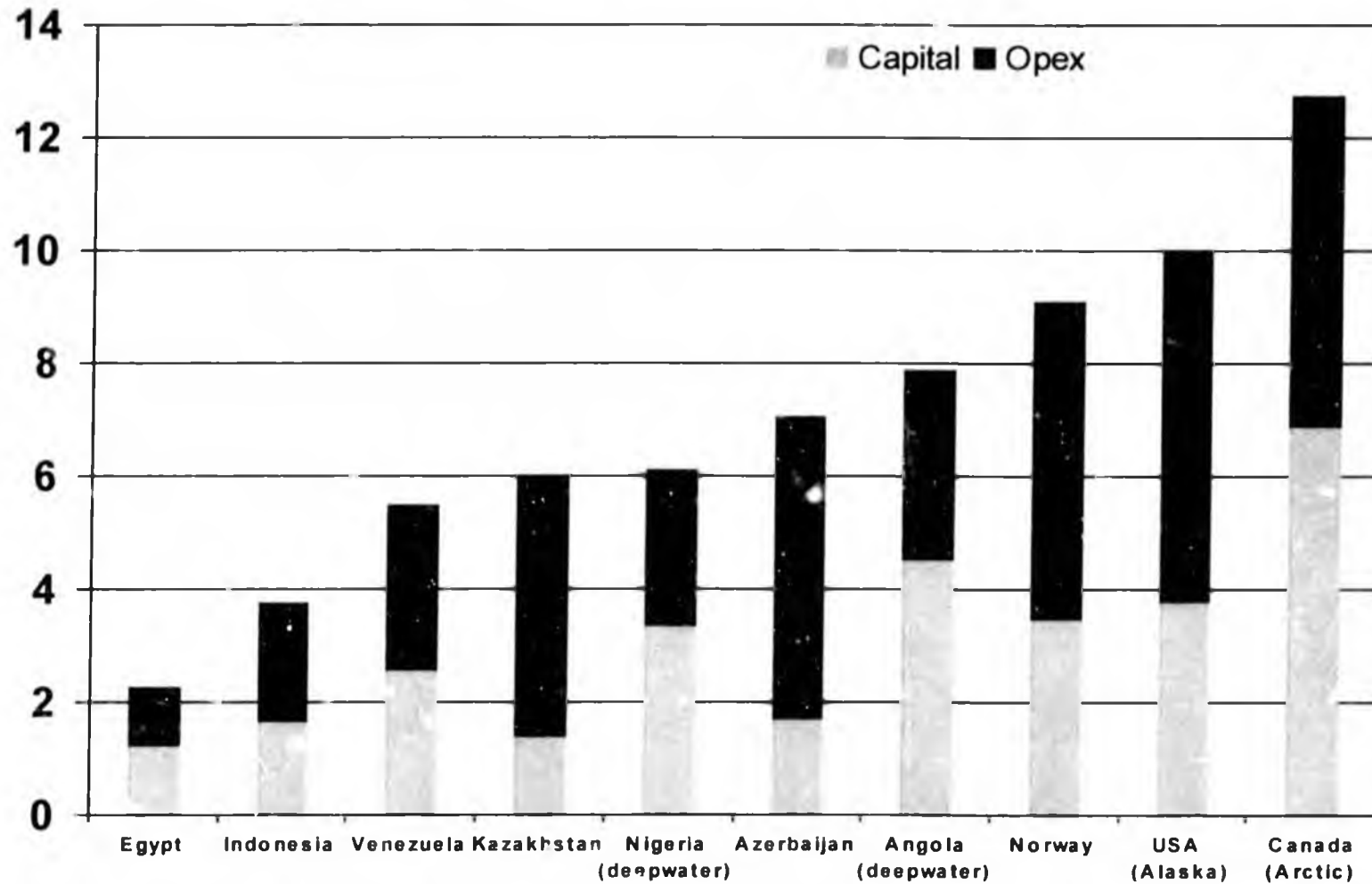
ConocoPhillips' Perspective

- Balanced fiscal structure critical for future O&G investment
- Future oil production in Alaska dependent on existing fields
- Bill differentially impacts legacy production
- Importance of Transitional Investment Expenditure plan
- Alaska's competitiveness on a global basis

Marianne Kah
ConocoPhillips Chief Economist

Global Total Cost Per Barrel

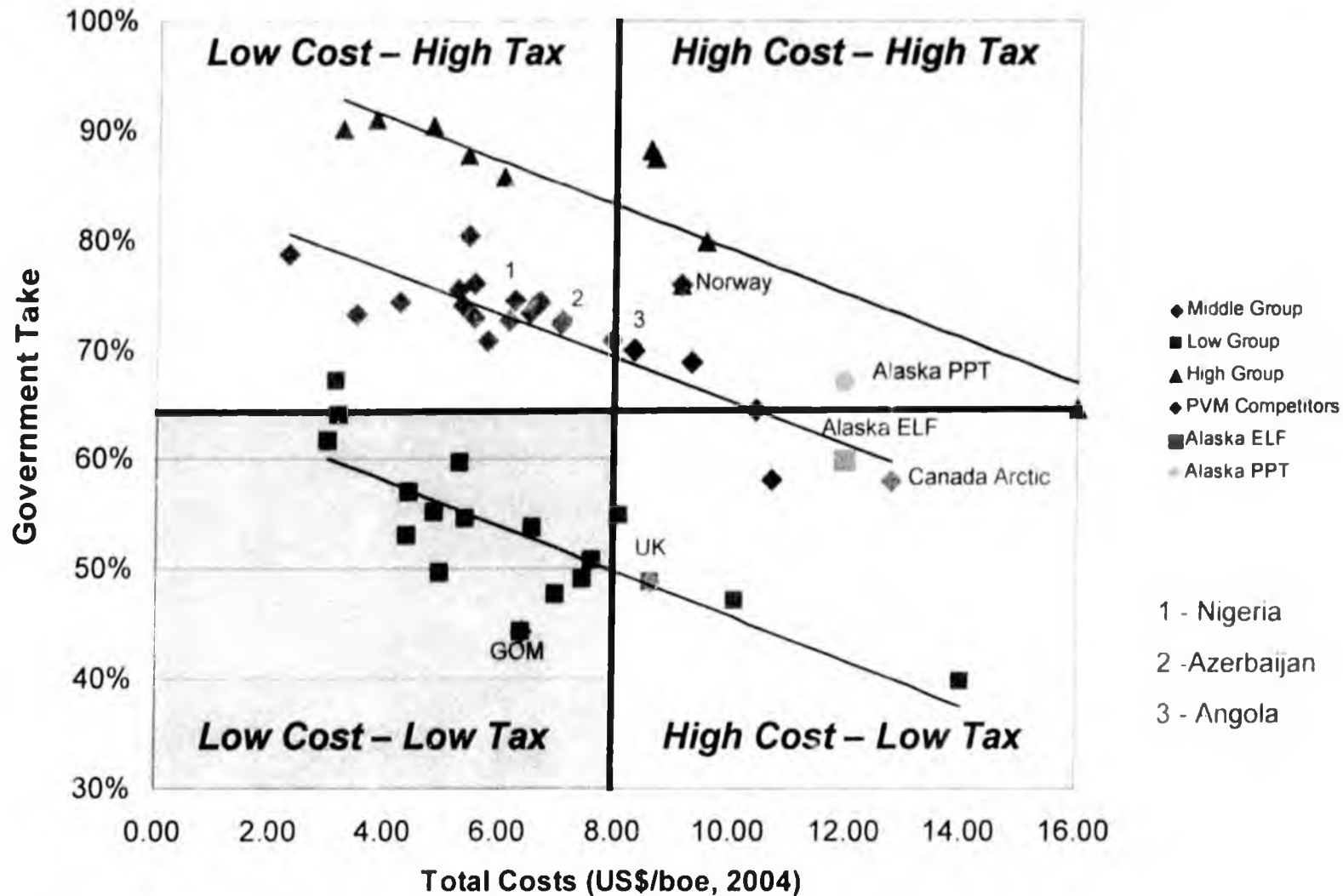
Total Cost per Barrel (\$/boe)^{1,2}



¹ Total cost includes capital and operating elements averaged over 10 year period (1994-2003).

² Source: Wood Mackenzie 2004 "Global Oil and Gas Risk and Reward Study".

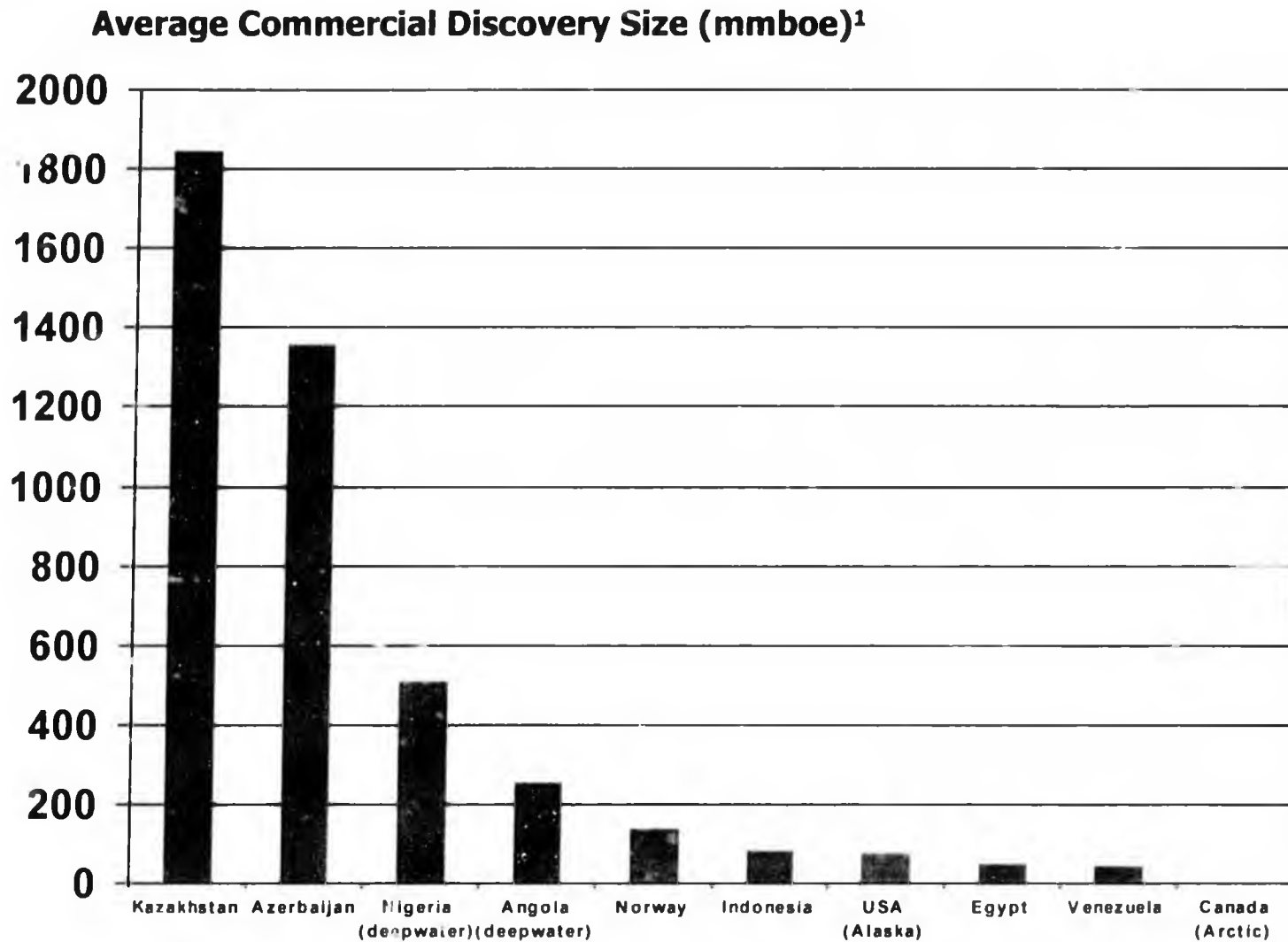
Alaska – High Cost High Tax?



1 Total cost includes capital and operating elements averaged over 10 year period (1994-2003)

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

Global Average Commercial Discovery Size

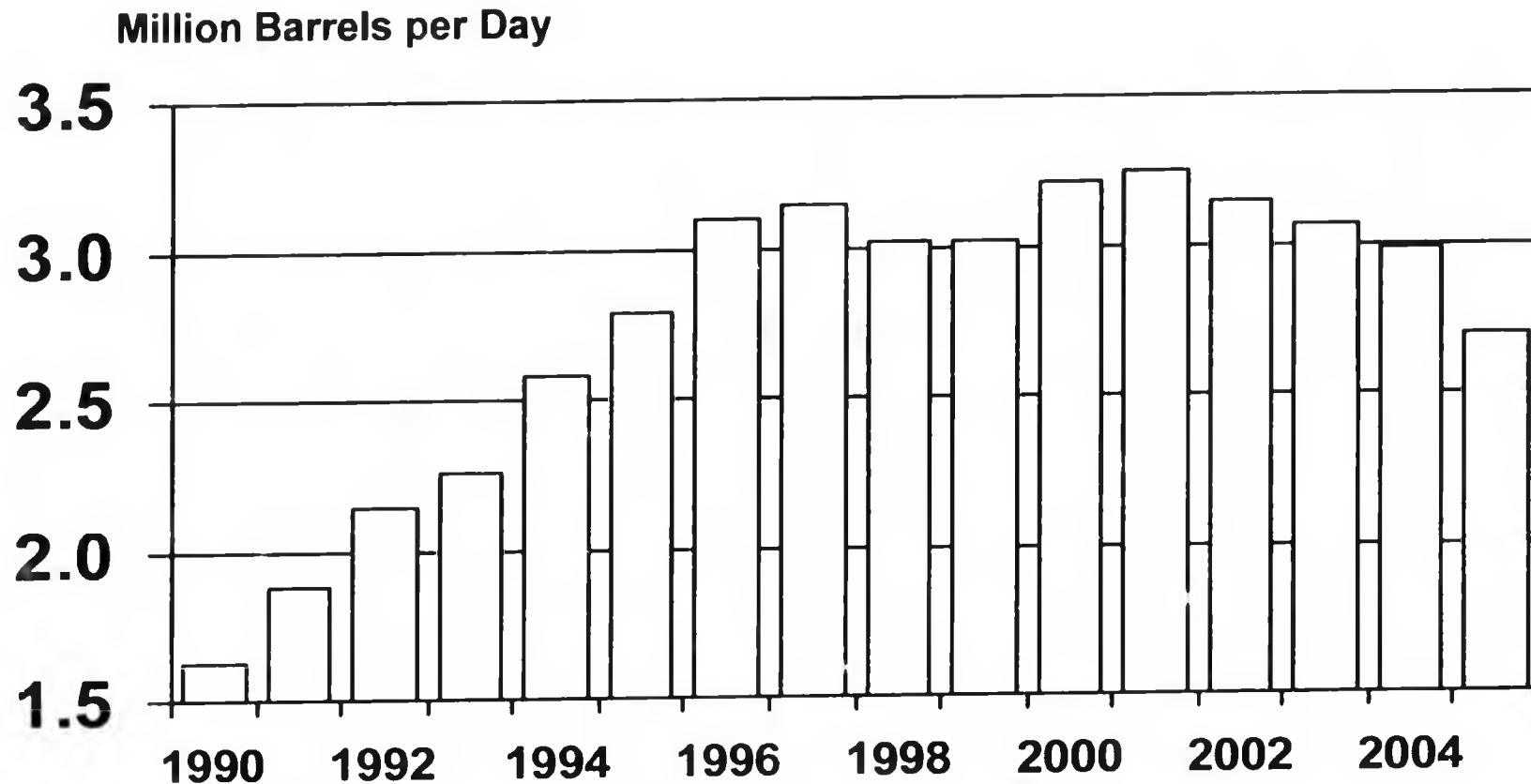


¹ Average commercial discovery size from 1994 to 2003.

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

Norwegian Crude Production

Decline Continues Despite Higher Prices



Source: Oil and Gas Journal
2005 is 11 month average

2/27/2006 - Slide 21

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