

ALASKA LEGISLATURE COMMITTEE FILES 2007-2008 SRF 1, 2, 7, 8



Chevron's Alaska Presence

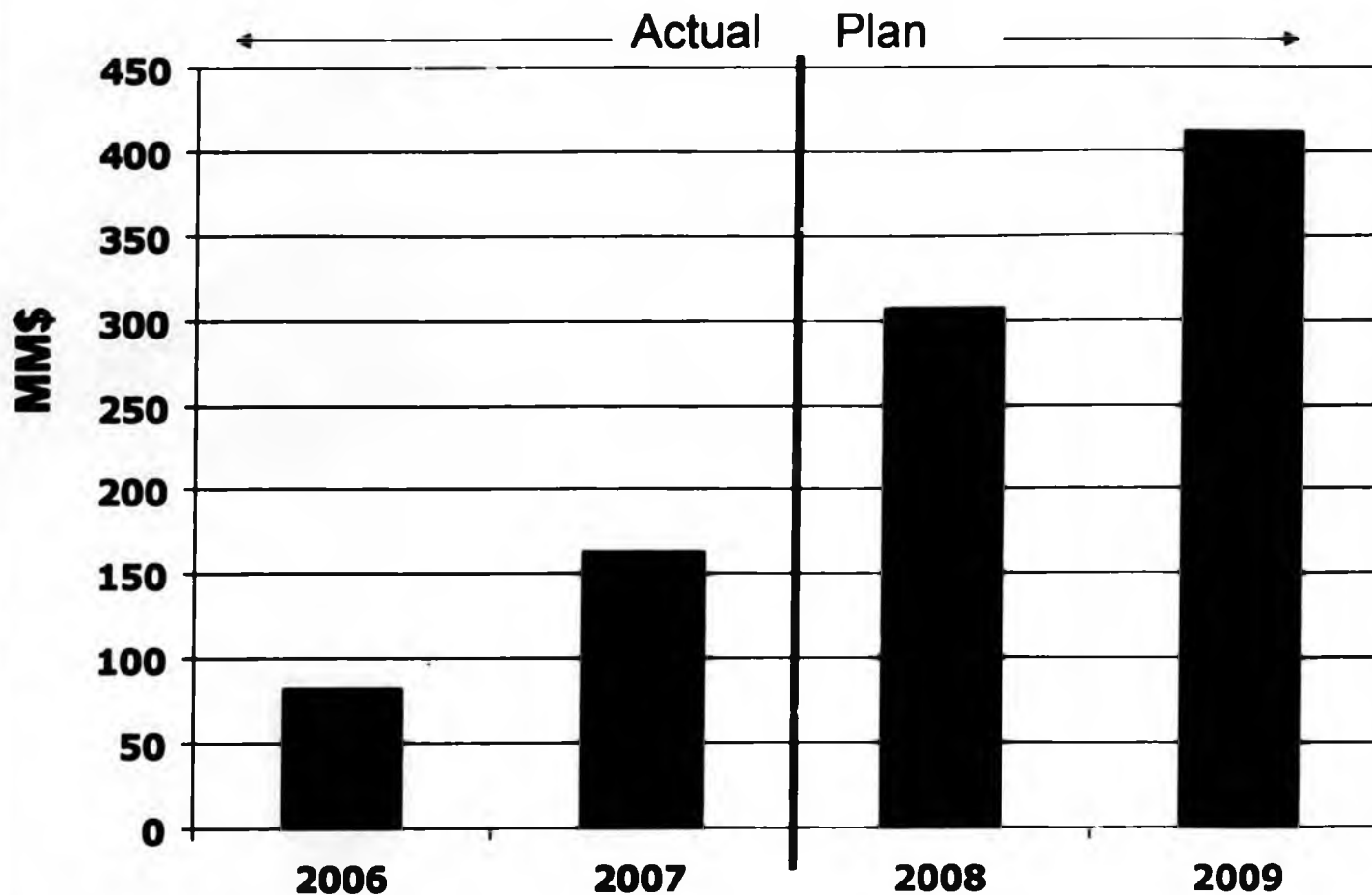
- 4th largest producer in state
- 3rd largest operator
- ~500 employees or full time contractors
 - >300 on the Kenai Peninsula
- Chevron is the only producer in the state with a relative balance of assets in the Cook Inlet and on the North Slope
 - Cook Inlet production – 23M BOPD
 - Old oil production, very high lifting cost
 - North Slope production – 15M BOPD
 - In early stages of increased capital program
 - Extend life of Cook Inlet O&G production
 - North Slope exploration on state lands
 - Investment decisions made under PPT

15/16 wells to drill

Chevron is increasing investment under PPT



Capital Investment





Introductory Comments

- We do have a common enemy – decline

- Disappointing to be back so soon after passage of PPT
 - Lack of actual PPT results to revise tax policy
 - Review scheduled for 2011
 - Too soon for a change

- Need to strike a balance between tax rate and investment climate

Factors that affect investment decisions



- Corporations have a responsibility to operate safely, seek returns, and increase shareholder value
- Corporate Cash Flow Management
 - Corporate uses of cash:
 - ▶ Operating Costs
 - ▶ Investment: upstream, downstream, technology, acquisitions
 - ▶ Pay down debt, build cash
 - ▶ Pay dividends to shareholders
 - ▶ Buy back stock

not Gov Take - not most important



Upstream Investment Decisions

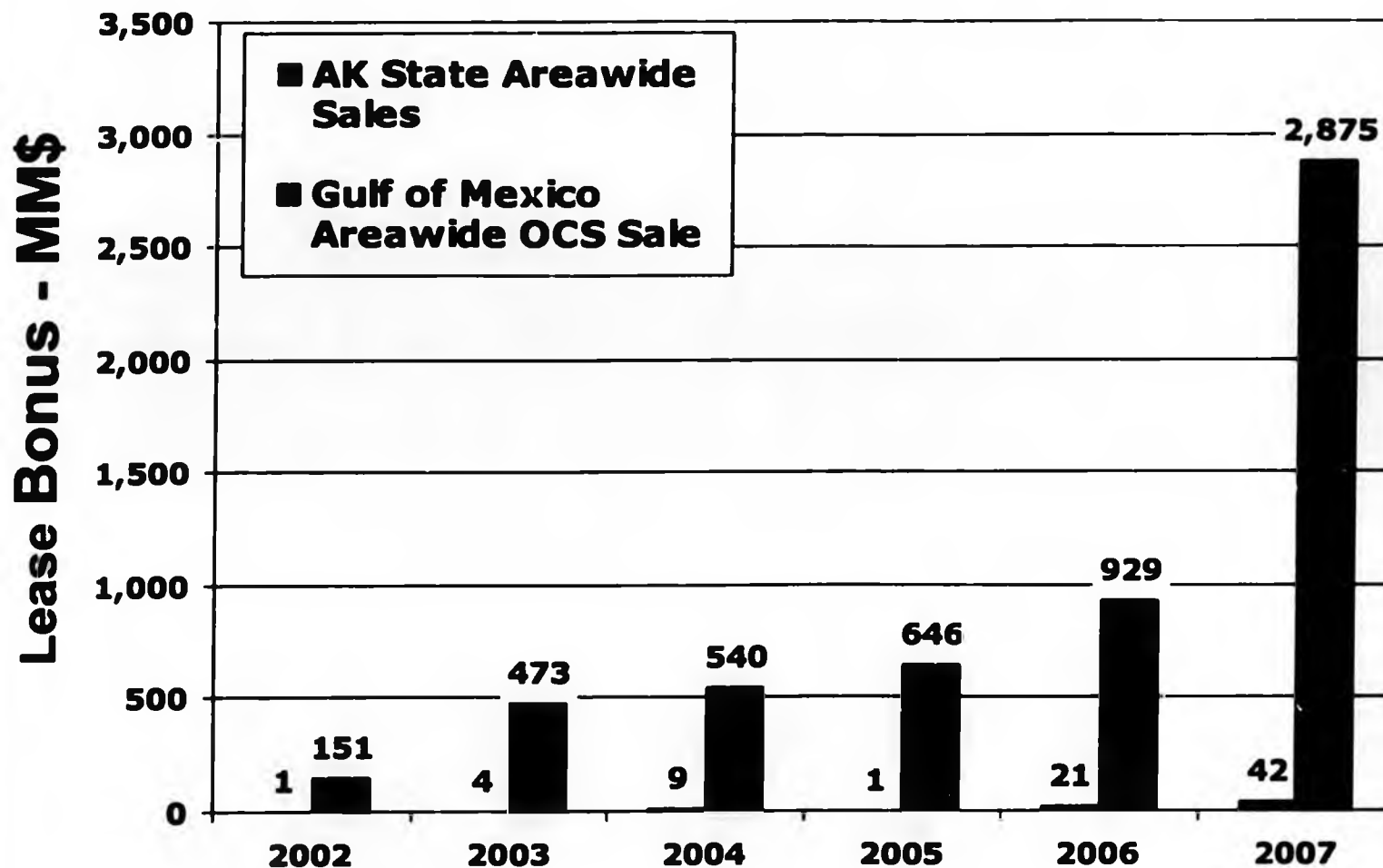
- Always more opportunities than can be funded or staffed
- Key Factors – How do Alaska state lands stack up?
 - Rocks – What is the reserve and production potential? – *Faint to Midway*
 - Cost – How much will it cost to find, develop, and produce? – *Fly in from Nova Scotia* – High End
 - Time – How long will it take to realize revenue?
 - Risk – What is the probability of success?
 - Fiscal regime – How much revenue does the investor get to keep? – *Don't care*
- Economic models are developed, opportunities ranked, and investment decisions are made on an After-Tax Net Present Value (NPV) basis
 - Does the investor get enough to justify the investment?
 - Great rocks can trump poor fiscal terms

How does Alaska stack up? Let's look at a real data point!

How attractive is Alaska as an investment?



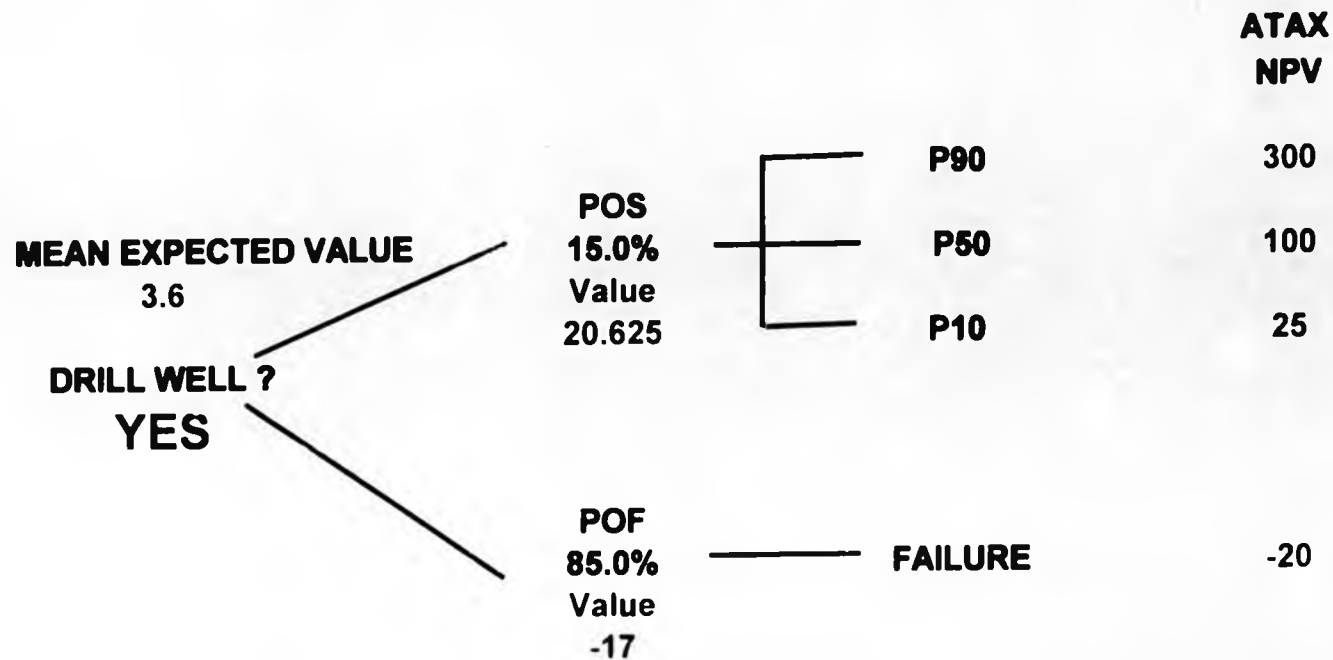
Let's look at results of recent lease sales as a scorecard: This is industry voting with their dollars



Exploration – How taxing the upside can deter investment decision



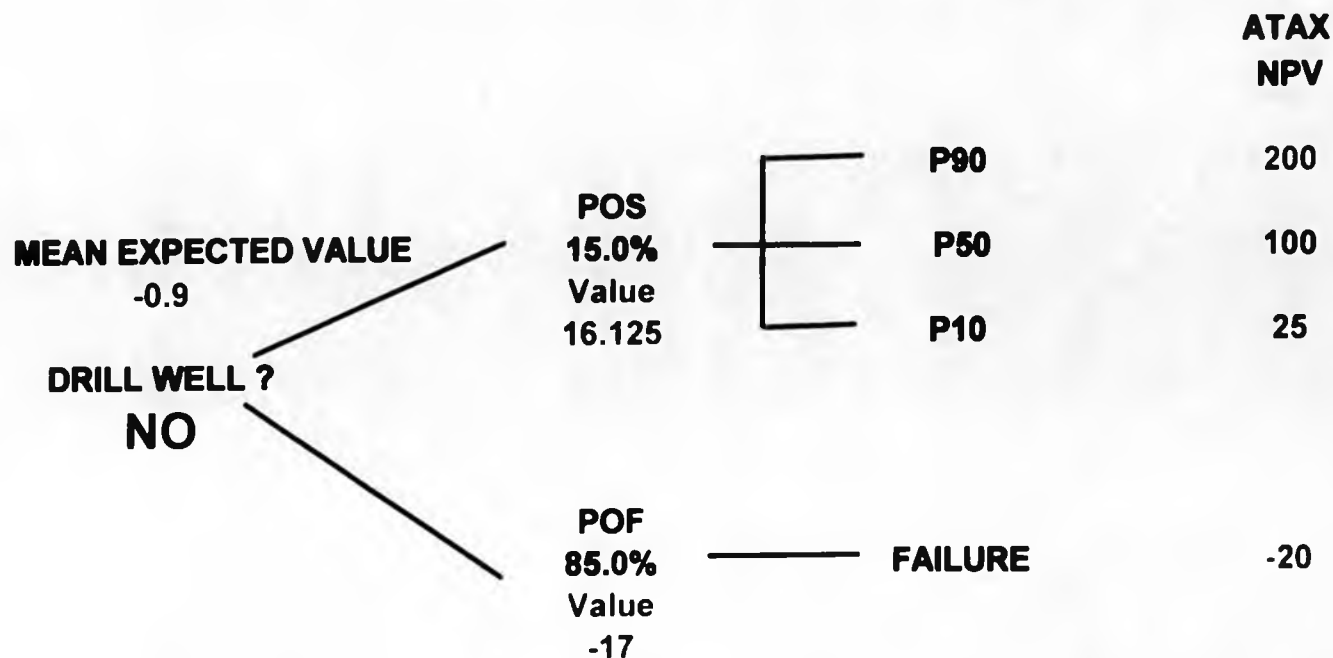
ACES EXAMPLE *RISKED ECONOMIC ANALYSIS, 4 pt Economic Model*



Exploration – How taxing the upside can deter investment decision



ACES EXAMPLE *RISKED ECONOMIC ANALYSIS, 4 pt Economic Model*



Investment is Needed to Maintain Production at Reasonable Levels



Alaska Production Forecast Estimate

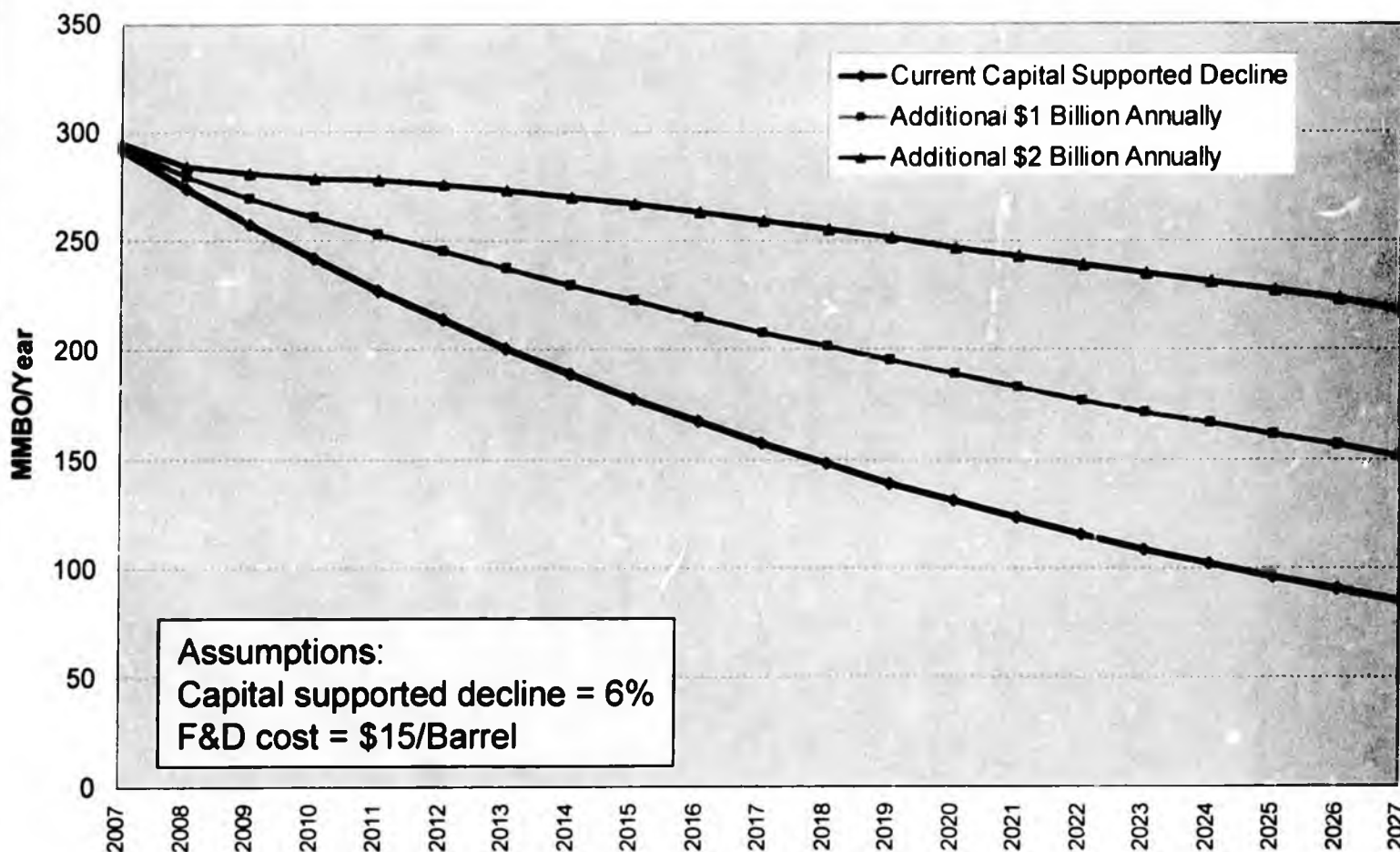
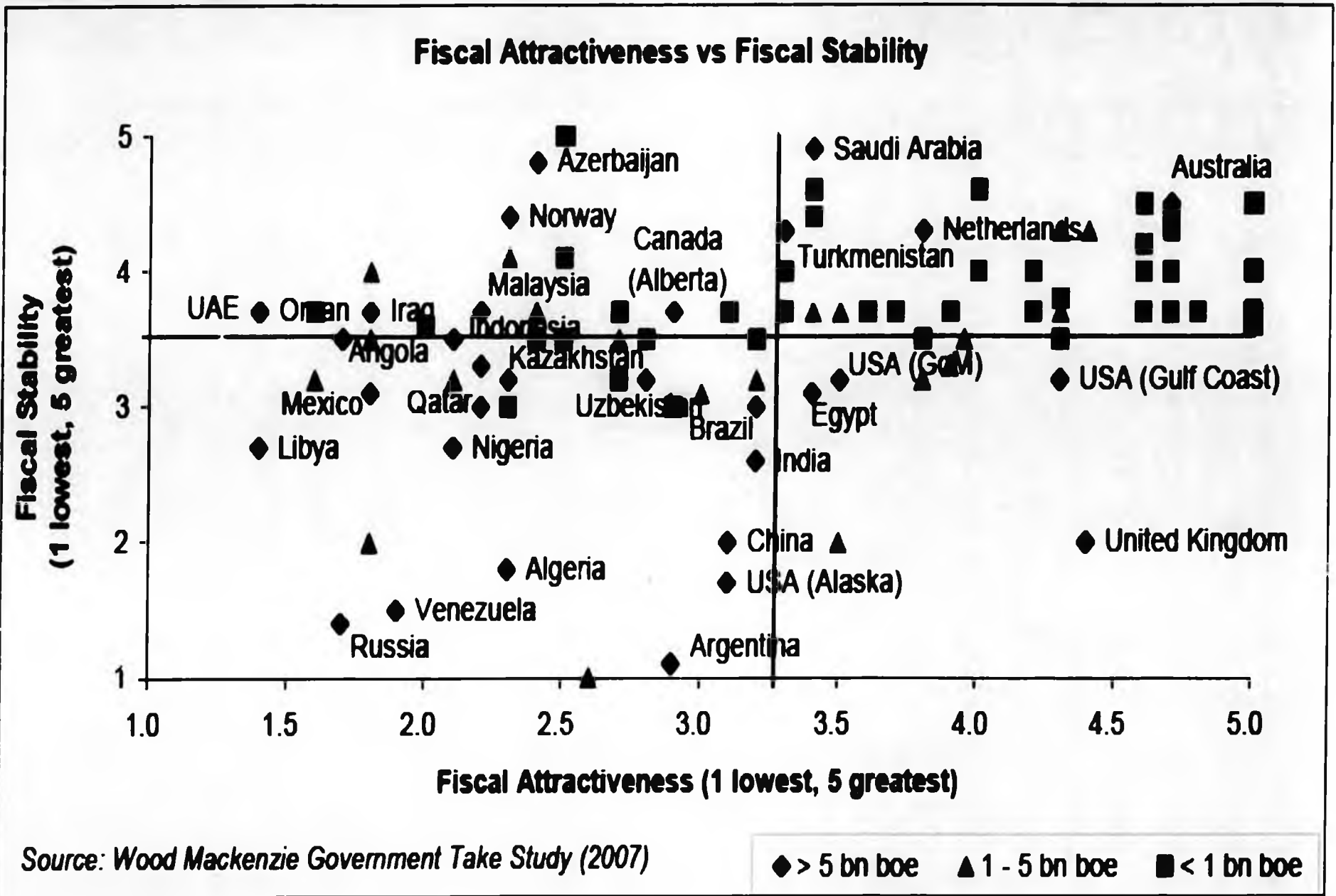


Chart 14 – Fiscal Attractiveness Rating versus Fiscal Stability Rating



Summary Comments



- You have the power to increase short term state revenue through raising taxes
- Energy companies have the responsibility to invest where they see the best risk/reward ratio
- The common enemy is decline,
- Investment is the only way to stem decline
- How do you price Alaska's product ?
 - Lowest possible taxes and stability will encourage investment
- Chevron intends to invest and grow in Alaska, but ACES makes investing in Alaska more difficult





PIONEER
ENERGY SERVICES

Pioneer's View of

Senate Resources Committee
House Oil and Gas Committee
October 23, 2007

NYSE: PXD
www.pxd.com



Presentation Outline



- Pioneer Profile
- Competition for Investment Capital
- Pioneer Projects & SOA Impact
- SOA "Fair Share" of Oooguruk
- Benefits of Current PPT Law
- ACES Proposal
- Conclusions



Pioneer Corporate Profile

- Large U.S. independent
- Operation Areas:
 - Alaska - *Syns*
 - Lower 48 - *Texas, KS*
 - South Africa - *Gas*
 - Tunisia - *oil*
- In 2006 Pioneer:
 - 1,600 employees
 - 36 mmboe production
 - \$1.6 billion in revenue



90% fuel & reserves in N. America

Pioneer Capital Investment Decisions

- **Global Investment Opportunities compete for capital**
 - Pioneer and most independents prefer U.S. L48 projects:
 - lower risk, cost
 - shorter cycle time
 - flexibility
 - **Portfolio selection drivers:**
 - Production Growth ** - Double Digit:*
 - Reserve Replacement
 - Finding & Development cost *\$15.00*
 - Economic & Financial metrics
 - **Project economics evaluated over a range**
 - probabilistic outcomes *75% - OK*
 - commodity price calls *- Super Others*

Competition for Pioneer Capital

- **Rising commodity prices have improved margins in L48** *(Lower AK)*
 - Budget dollars flowing to low risk resource plays
 - Tight sands, coal bed methane, shale gas
 - Less emphasis on high risk exploration
- **Pioneer Alaska's Competition for Capital**
 - Low risk, short cycle projects in Texas and Rockies
 - Low risk, high margin gas project in South Africa
 - High margin, short cycle oil drilling in Tunisia
 - New ventures in Resource Plays

AK competes with L48

Pioneer's Alaska Entry

Strengths

- Prolific petroleum system
- High impact opportunities
- Located in North America
- ELF and EIC's

Weaknesses

- High operations & transport cost
- Infrastructure challenged
- Long project cycle times
- Complex regulatory processes
- Limited season for access

Opportunities

- Business opportunities opening for Independents
- Improving regulatory process
- North Slope gas resources

Threats

- Higher taxes
- Regulatory delays or costs
- Project delays or cost overruns
- Return to lower oil prices

1. Reservoirs
2. Complex Regulatory
3. Cost much higher

4. Super later
Tax Policy 5
Still discussed

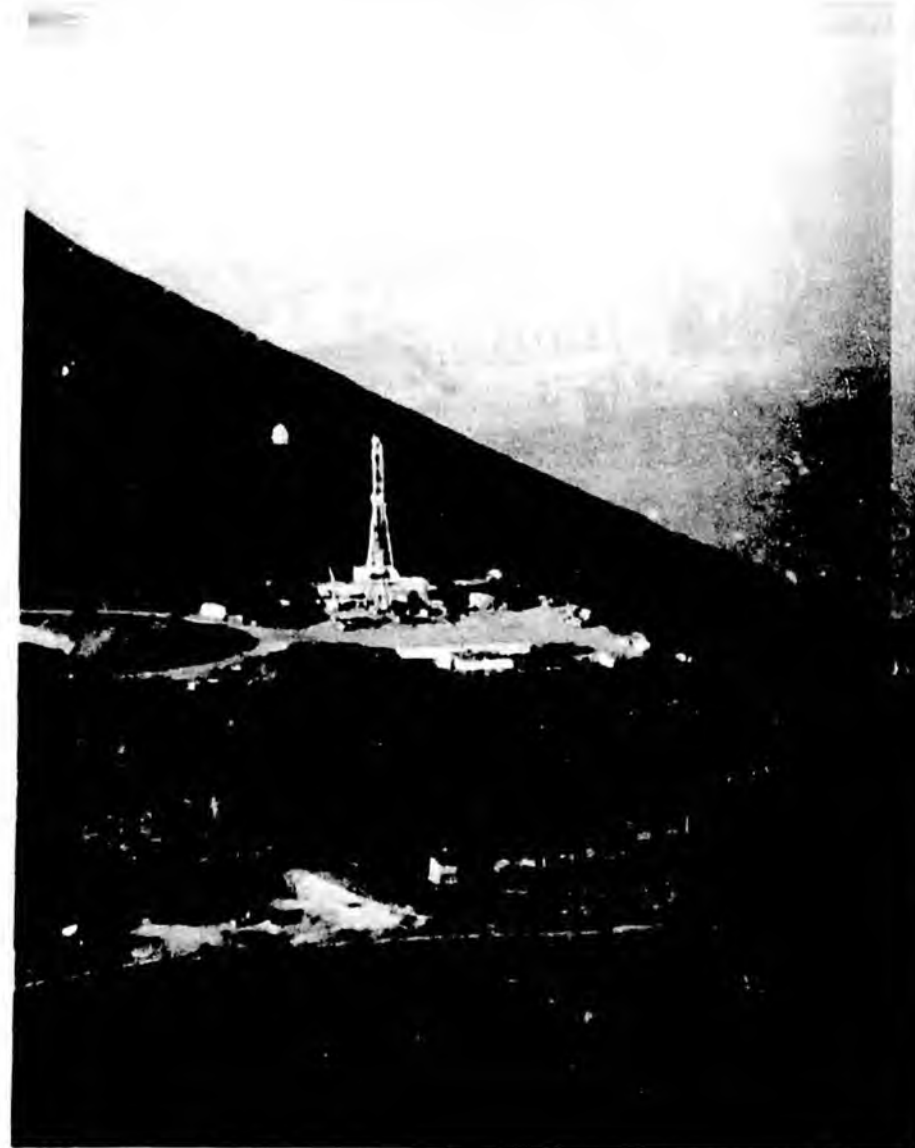
Pioneer Alaska Profile



Cosmopolitan

- Entered Alaska in late 2002
- Oooguruk Unit Operator
- 2005 ▪ Cosmopolitan Unit Operator
- ~1.5 million acre leasehold
- 11 NS exploration wells
- 35 local Alaska staff

over last 5 yrs - not much to show



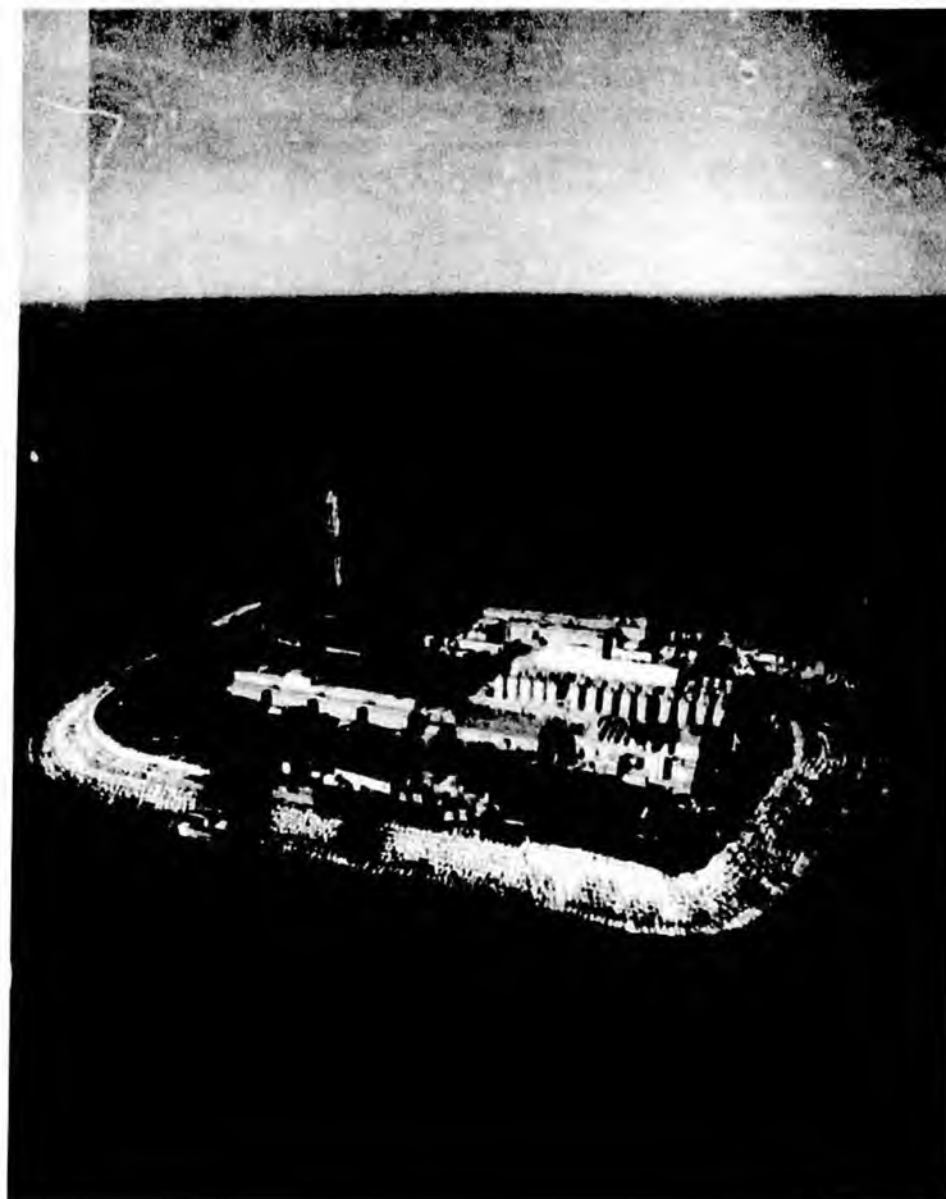
Ooguruk Project Summary



PIONEER

Future Operating Statistics

Field Life Cycle	Development
Project Type	Oil, EOR
Gross Acres	58,000
Working Interest	70% (Operator)
Partner	ENI (30%)
Gross Reserve Potential	70 - 90 MMBO
First Production	2008
Gross Peak Flow Rates	15 - 20 MBOPD
Productive Life	25+ Years
Development Wells	~40



Oooguruk Project Summary



PIONEER

- **Project sanction Feb 2006**
- **Constructed island drill site**
- **Fab/set ~ 120 modules**
- **Installed subsea flowline**
- **3 year development drilling**
- **600+ contractors at peak**
- **Total capex \$550+ MM**
- **First oil in 2008**

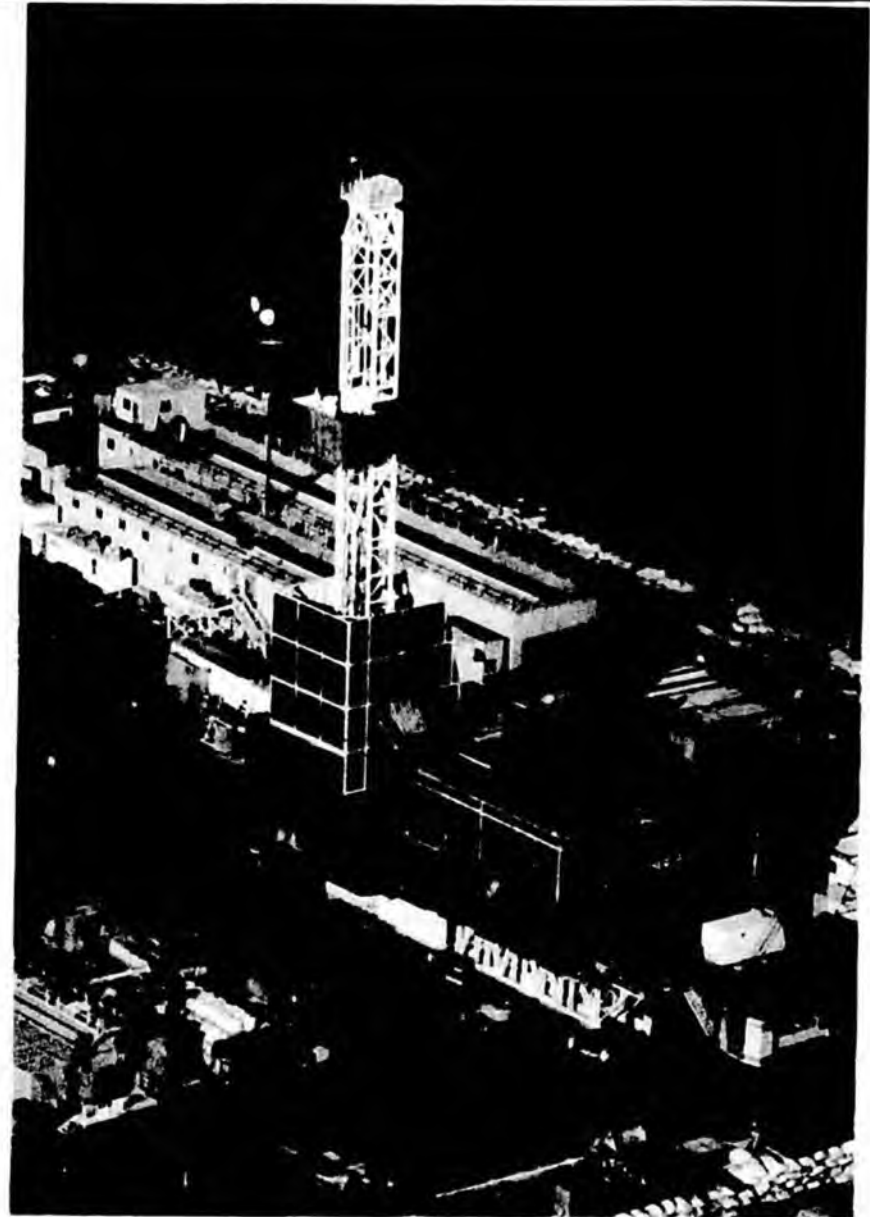


Oooguruk Project Benefits



PIONEER

- **First independent oil producer on the North Slope**
- **First third party facility access**
- **Other investors are watching for Pioneer success**
- **Royalty plus 30% net profits to SOA**
- **PPT revenues on Pioneer profits and KRU processing**
- **State income tax**
- **Property taxes to NSB**
- **Construction jobs and contractor profits**
- **Operating jobs and contractor profits**



Oooguruk Capital Expenditure Beneficiaries

Engineering	Fabrication	Transport	Installation	Drilling
ASRC/ Tri-Ocean	ASRC	Lynden	Nanuq	Nabors
Intec	ASRC/Omega	Carlisle	HC Price	Halliburton
Sandwell	Steel Fab	Tote	Veco	Baker Centrilift
Coastal Frontiers	Dowland-Bach	Penn Air	ASRC	
EEIS		Alaska Airlines	F&W	

Pioneer's View of PPT

- **PPT rolled out with no Pioneer consultation**
 - Huge investments and Oooguruk sanction prior to PPT
- **Balanced system - Investment credits offset high tax rate**
- **Modest incentive for investment**
 - Encourages development of abundant lower tier resources
 - Challenged by size, quality, viscosity or location
 - Encourages more aggressive exploration spending
- **Sustainable and fair across a broad range of investments**
- **PPT should grow the pie and give the State a bigger slice**

ACES Erodes Modest PPT Incentives

- **Changes are mostly negative for the investor**
 - Base Tax Rate Increase from 22.5% to 25%
 - Tax Rate Increase via more aggressive Progressivity Formula
 - Transitional Investment Expenditures Eliminated
 - Unfair to Pioneer - no recovery of \$100MM sunk investment
 - Spreads utilization of Earned Tax Credits over 2 years
 - Increased uncertainty for allowable deductions
- **Increased government take jeopardizes lower tier project funding**
 - Unfunded projects generate no state income
- **Oooguruk project returns reduced**
 - Oooguruk highest government take in the State (net profit)
- **Positive Elements**
 - Retains net tax framework for non-legacy fields
 - Allows credits to be monetized at face value (with time delay)

ACES Impact on New Projects

Project Net Present Value of Cash Flows (10% Discount Rate)

\$40 Test Price (\$-Millions)

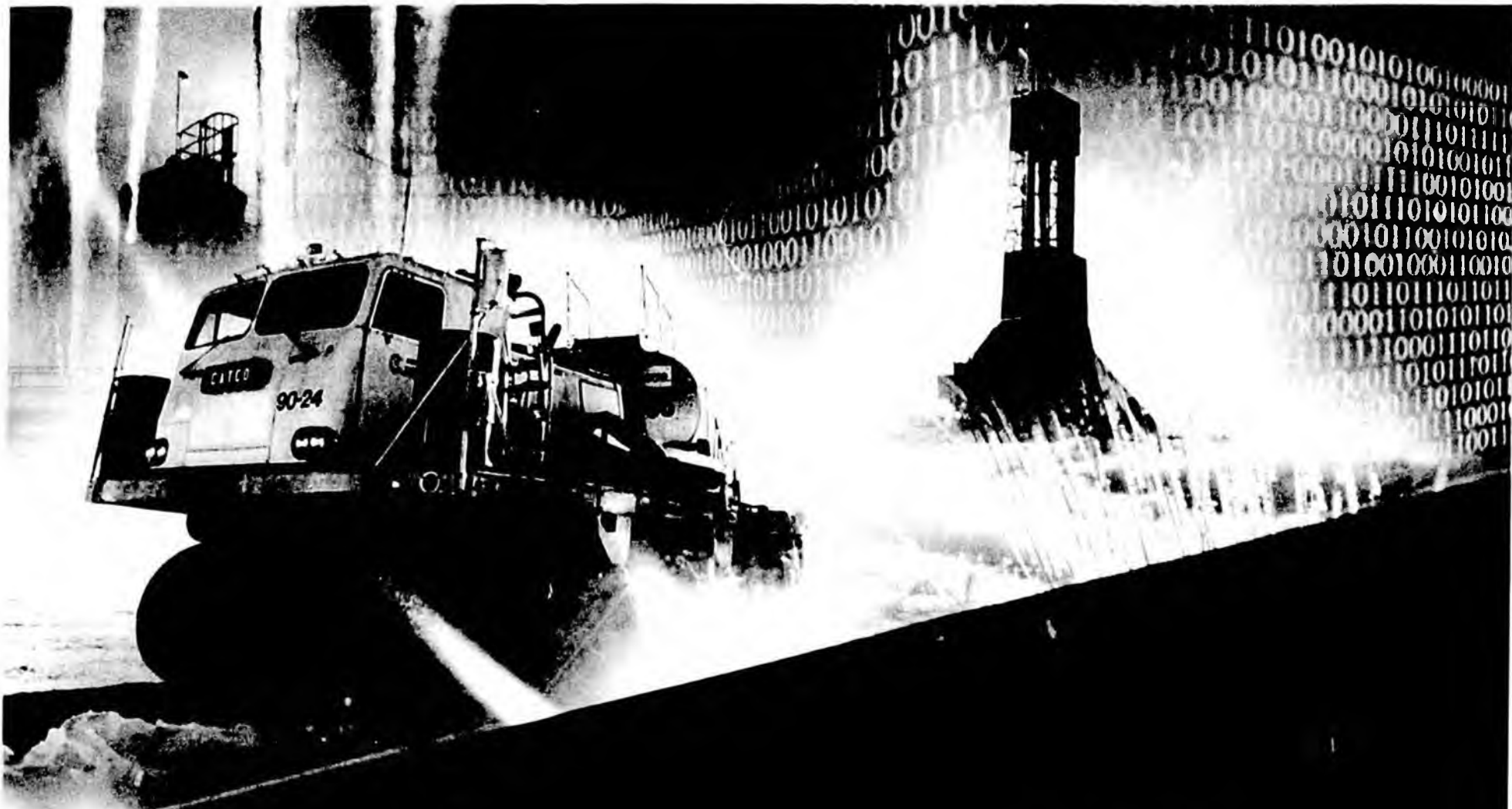
	Status Quo PPT	ACES Plan	16% Gross Tax No Capital Credits	19% Gross Tax With Capital Credits
Field/Project A	178	128	-35	27
Field/Project B	72	48	-22	9
Field/Project C	59	27	-53	-22
Field/Project D	-64	-90	-398	-282
Production Tax Revenues FY2008 @ \$60 oil price	\$1.3B	\$2.0B	\$2.1B	\$2.0B



Source: Alaska Department of Revenue

Conclusions

- **Pioneer AK's primary competition for capital is L48**
- **Pioneer has been an aggressive investor to date**
- **Fiscal stability needed to attract future Pioneer capital**
- **PPT provides balance/stability to grow our AK business**
- **ACES plan erodes modest PPT incentives**
- **Raising taxes jeopardizes lower tier project funding**
 - **Royalty, state income/property tax and jobs at risk**



ACES

Anadarko LLP
Petroleum Corporation

Senate Resources
October 23, 2007

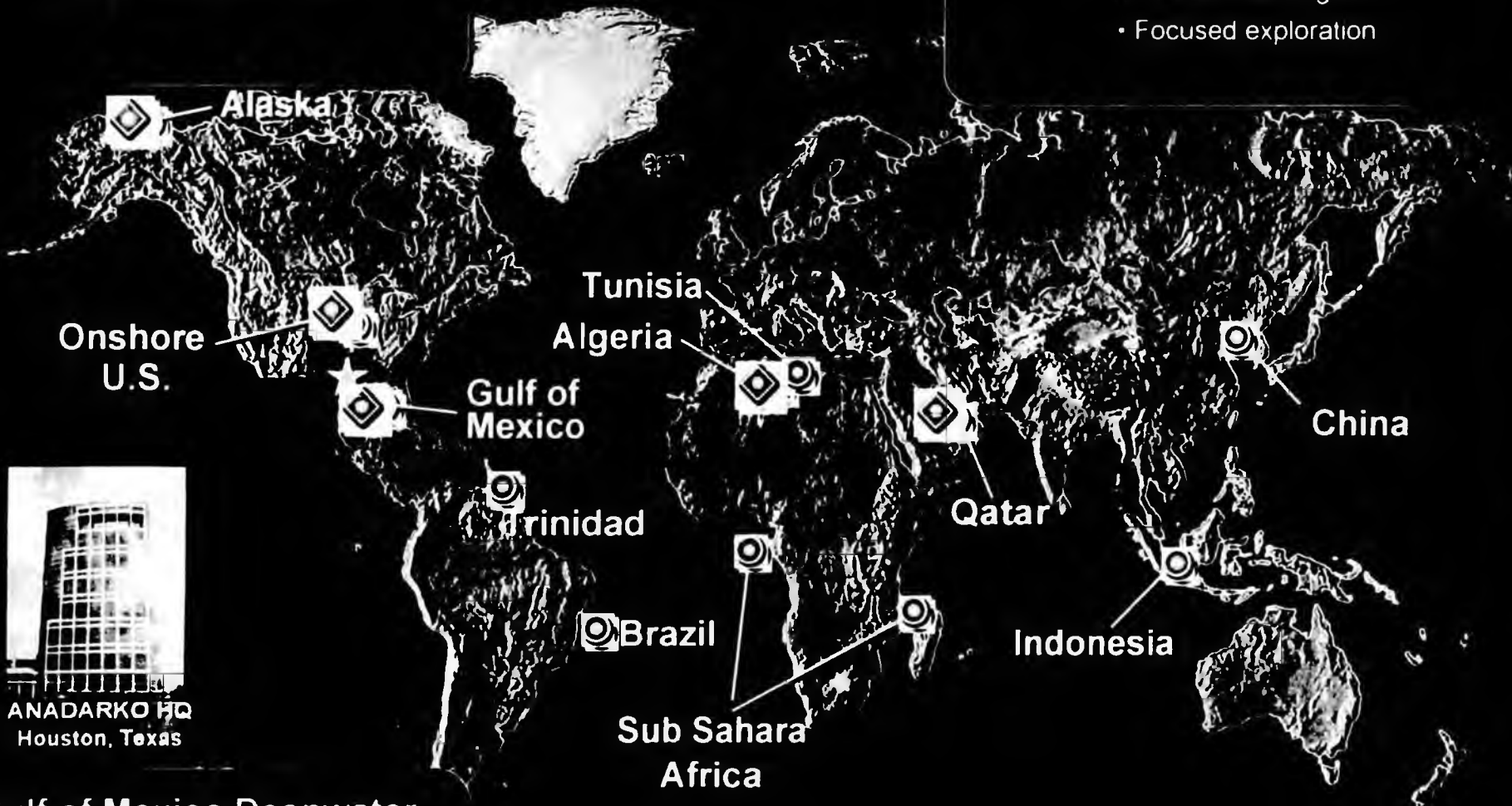
APC Operational Overview

Rockies

- Large acreage holdings

International

- World class targets
- Focused exploration



Gulf of Mexico Deepwater

- Significant Acreage position

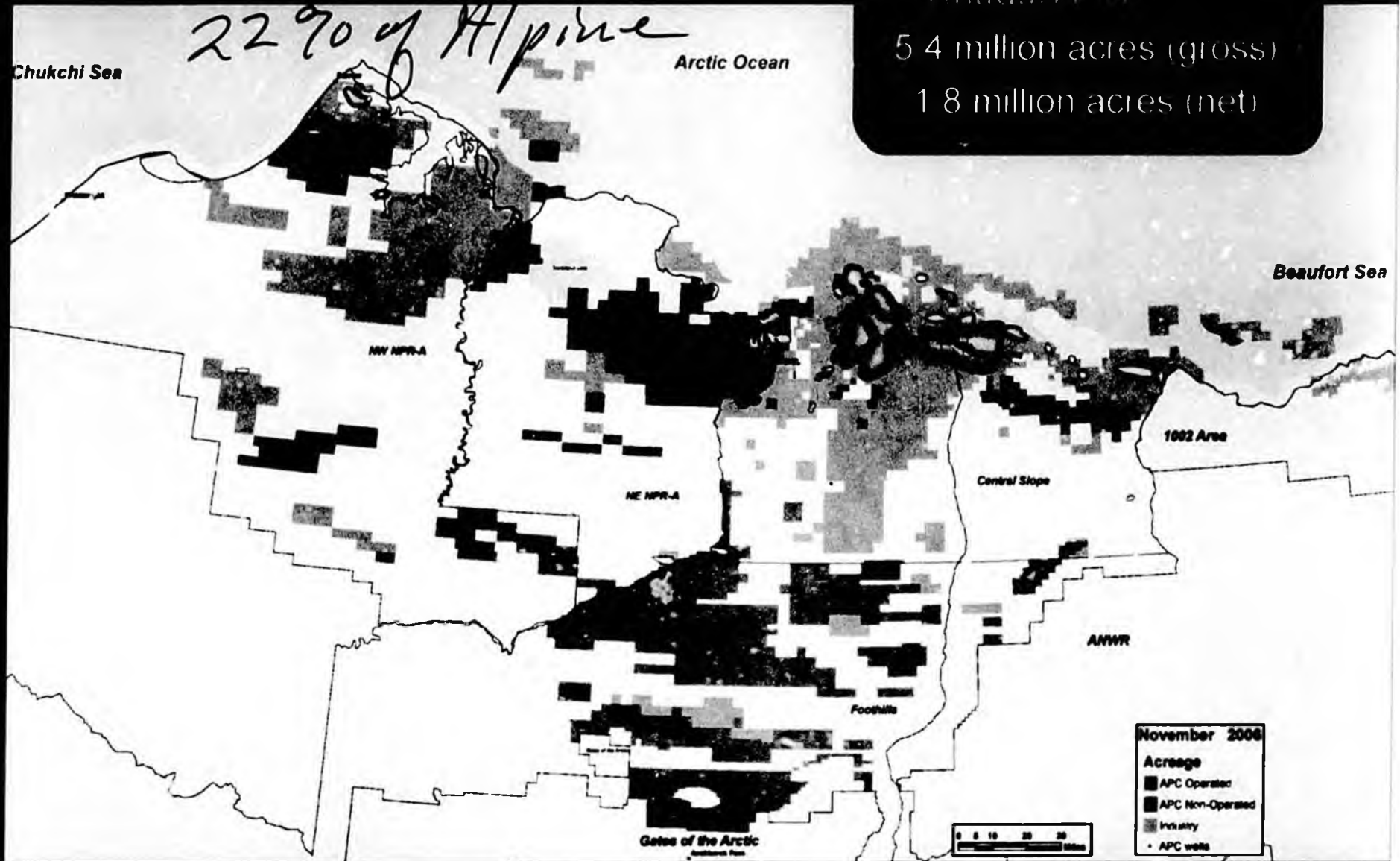
- Exploration Areas
- Producing Areas

Anadarko's Investment in Alaska-Land

Anadarko's

5.4 million acres (gross)

1.8 million acres (net)



Alaska Opportunities

- **World class petroleum basin**
- **Significant remaining resource potential**
- **Legacy type prospectivity (i.e. Anchor Fields)**
- **New entrants/partnering opportunities**
- **APC possesses tangible competitive advantages**

Alaska Challenges

- **Maturing basin/materiality/smaller prospects**
- **High costs**
- **Lack of infrastructure and competition**
- **Extremely long lead-time exploration**
- **Seasonal drilling, & regulatory timing requirements**
- **Distance from market**
- **Lack of gas transportation**

Our View of PPT & Recap of 2006 Testimony

- ▲ **Significant tax increase at existing fields**
 - *Can be offset by increased exploration & development investment*
- ▲ **Improvement in exploration economics versus elf system encourages new investment**
 - *Credits help reduce high costs & improve NPV*
 - *25 – 20 worse than old elf system*
- ▲ **On balance supportive of PPT system**

Support Net Profits Approach

- ▶ **Appreciate Administration work to evaluate gross vs. net and conclusion to stick with net**
- ▶ **Net considers varying economics & costs**
 - *Tax paid on net income after costs*
 - *Accounts for costs and levels playing field*
 - *Still doesn't account for risk*
- ▶ **Gross collects on income regardless of profit**
 - *Gross tax with proper incentives harder to develop equitably and still complicated to administer*
- ▶ **Royalty acts like a gross tax**

Our View of ACES- Negatives Outweigh Positives

• Support some parts of ACES

- *Expand time to qualify for Exploration Incentive Credits (offset by new exclusions and requirements)*
- *Modify Net Loss carry forward to create level playing field*
- *Goal of increased transparency & state auditor capability*

• Stability

- *Concern that PPT/ACES will be revisited again in next few years to deal with gas*
 - *Gas definitely needs to be addressed, but will reopen everything again*

• The significant tax increases would decrease exploration & development economics and far outweigh any positives in the bill

- *Tax rate increase*
- *Tax escalator changes increase costs*
- *Transition Investment Expenditure Credits Elimination*
 - *Fairness and Investment Impact*

Howardanko - Floor? (Regressive)

Administrative

Table below from Sept 4, 2007 Administration Presentation

Project Net Present Value of Cash Flows (10% Discount Rate)				
\$40 Test Price (\$ Millions)				
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<hr/>				
Production Tax Revenues FY2008 @ \$60 oil price	\$1.3B	\$2.0B	\$2.1B	\$2.0B

- Project Economics decrease by 33% to 54%
- What geologic & commercial risks were assigned?
- Where are dry holes & failed projects accounted for?

Summary

- ▲ **Significant tax increases outweigh any potential benefits**

**SENATE TESTIMONY
on SB 2001
October 23, 2007**

Thank you, Chairman Huggins. My name is Joe Mathis. My wife and I are the owner and operators of Montana Creek Campground located at mile 95.5 of Parks Highway. We own a 14 acre site with store and 66 sites. We have 7 employees all are Alaskans and employed from the local area providing jobs in an area of high unemployment. We also manage and operate for the state parks one of their campgrounds located nearby.

For me as a small business owner, I need to have certainty in my tax obligations for payroll, property, and sales taxes.

As a small business owner, we have struggled with the uncertainties of risk and disasters. Last year, we had floods that have done serious damage to our business but we were able to survive. We have faced high cost of fuel and seen huge declines in border crossing of RVs and travelers to Alaska coming up the Alcan Highway. These risks that we take in our small business are nothing compared to the risks that you are contemplating. Risk management should be part of your due diligence in this process. Can Alaska really afford to take the risk of discouraging future investment when 50 percent of our production ten years from now will come from 'new oil' generated by future investment?

If you are risking the long term health of our state's future without good foundation of information then you are making serious error in judgment. We need more factual information on how PPT is working. Making decisions based on emotion and rhetoric is poor decision making. The facts are:

- With the oil pipeline two-thirds empty and production continuing to decline, Alaska should be focused on doing whatever is necessary to increase oil production.
- Investments, which for Prudhoe Bay alone amount to about \$1 billion yearly, are aimed at keeping the decline rate at an average of about 6

percent yearly. If the investment rate is slowed the decline rates could increase to about 15 percent yearly before too long.

As others have said, we do not know what the right number is for the tax rate. However, we do know that increased taxation will not stimulate the industry or the economy. Increased taxation on the industry will not improve the business in our campground.

We need a change the dynamics of this process from one of negatives to one of positives. In past year we have had more than enough negatives that has consumed the public process as well as diverted our energies from those long term issues that will keep our economy from disaster in next 10 years.

I would prefer to be giving testimony on a long term fiscal plan or the POMV should be structured.

What has happen to long term planning? In this time of high oil prices we have a huge opportunity to encourage small independent oil companies to flock to our state. I am sure they now have a "wait and see attitude". If you start changing the rules again it will be a long, long wait.

As I stated before that my small business needs certainty in taxation so does the oil industry.

I have seen my business take two major floods. We were able to survive however I do not think that this state can take this third flood of taxes and survive. You need to give the PPT infrastructure put in place last year a chance to work.

Alaska Oil and Gas Association



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Anchorage, Alaska 99503-2035
Phone: (907) 272-1481 Fax: (907) 279-8114

TESTIMONY OF THE
ALASKA OIL AND GAS ASSOCIATION
TO THE SENATE RESOURCES COMMITTEE
ON SENATE BILL 2001

October 23, 2007

Mr. Chairman and Members of the Committee. Thank you for the opportunity to testify before you today on Senate Bill 2001.

My name is Marilyn Crockett and I am the Executive Director of the Alaska Oil and Gas Association ("AOGA"). AOGA is the trade association for the oil and gas industry in Alaska. Our 17 members account for the majority of oil and gas exploration, development, production, transportation, refining and marketing activities in the state. In addition to Alaska's instate refiners, Agrium and Alyeska, our membership includes companies new to Alaska hoping for the opportunity to explore, companies which are exploring today but do not yet have production (but hope to in the future) and those companies which are producing today.

One of the important functions the Association performs is to provide a forum for member companies to consider regulatory and legislative proposals, and to reach agreement on an industry position on those proposals. To establish an AOGA position, a 5/6 vote of the members is required. What this means, of course, is that when AOGA voices that position, regulators and legislators can be assured that that position is the position of the overwhelming majority of Alaska's oil and gas industry.

But on tax issues, AOGA members have taken this approval process to the highest level. AOGA positions on tax-related issues require 100% consensus of the AOGA Members. Let me be clear: my testimony today reflects the full consensus of the members of the AOGA Tax Committee, with no dissent.

The focus of our testimony today will be on the practical impact of declining production levels on industry operations and the State of Alaska. And while we are not in a position at this early date in this Special Session to provide you with a complete analysis of the many components of SB 2001, we will describe for you but a few of the troubling aspects of this legislation. The AOGA Tax Committee is in the midst of a comprehensive review of the legislation and will be in a position at a future date to characterize those concerns.

Here we are in Juneau for the fourth time in the past two years to deliberate whether one of the State's taxes on oil and gas should be changed, and if so, what it should be changed to.

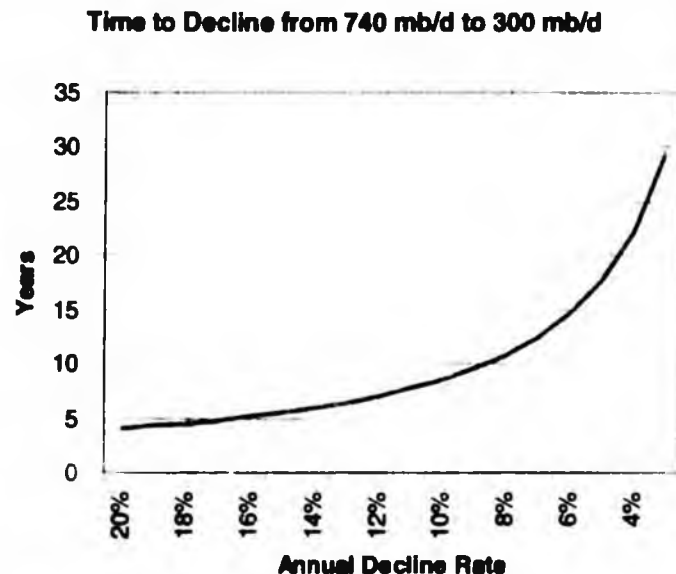
Last year the Legislature passed the Petroleum Production Tax, or PPT. Now, less than a year later, the Administration is telling you that the PPT is broken. They say it's too complicated to forecast, it isn't bringing in the revenue that was forecast last year, and they don't have enough capable auditors to enforce it.

In discussing the merits of SB 2001 versus PPT and the Administration's concerns, we must always keep in mind the real-world situation that Alaska faces. The greatest challenge that confronts this generation of Alaskans and the next is the ongoing decline of oil production, which has been, is today, and promises to remain the cornerstone of the finances of state government.

Production decline is eroding this cornerstone. It is a historical fact that even with the massive investments being made, North Slope production declined an average of 6.2% a year from FY 1997 to FY 2007, and Cook Inlet oil production declined at 8.0% a year.¹ Without those investments, decline would have been 15%.

With respect to the future of the North Slope, there is going to be a major challenge when ANS production gets down to about 300,000 barrels a day. According to Alyeska Pipeline Service Company, which operates the trans-Alaska oil pipeline (TAPS), the minimum mechanical capacity of the new electronic pumps that are being installed is about 300,000 barrels a day.

Here is a graph showing how long we have before ANS production reaches this 300,000 barrel-a-day mechanical threshold, depending on what the rate of decline is. If decline continues at the



Handwritten note:
Year 2022
300,000
BBL/D

historical rate of 6%, ANS will decline to 300,000 barrels a day in about 15 years, or FY 2022.

On the other hand, if decline can be held to 3% or less as DOR assumes, then we would have 30 years or so before we hit the mechanical threshold.

Let me stress that this graph is not a prediction. It merely plots the results of the mathematical calculations² of how long it would take to get to 300,000 barrels a day from the level of 740,000 barrels a day in FY 2007, depending on what decline rate you choose. What it does show is how important the rate of production decline is for Alaska's future. The difference between a 6% decline rate and 3% doesn't sound like much, but as you can see from the graph, that difference determines whether the 300,000 barrier is reached around FY 2022 or FY 2037. If you have a child in junior high school, this represents the difference between that child being able to grow up and have a career on the North Slope, and not having this opportunity.

Investment in new production is the only way to slow the decline enough to give the children of this state a future with the North Slope similar to what we have enjoyed. That's why new investment is such a crucial question facing the State, both in the context of the proposed tax proposal and in other areas that affect the business climate here.

There are three categories of investment that can slow the rate of decline on the North Slope, or at least keep it from getting any worse. These are, first, investment in exploration to discover new fields; second, investment in existing fields to prevent their decline from accelerating; and third, investment in innovation, technology, and new infrastructure to allow development of the vast but challenging resource of heavy and viscous oil that has already been discovered.

A great deal of the testimony to the Legislature, and a lot of the questions being asked, have focused on the fiscal terms of the "government take" for exploring in Alaska and the competitiveness of these terms relative to the terms in regimes elsewhere in the world. This kind of "who takes more" analysis is faulty for two fundamental reasons.

First, it assumes that the geologic prospects for making a commercial discovery in Alaska are comparable to those other regimes. This assumption is unsound. The North Slope has three major areas of significant oil and gas potential: the state lands in the central North Slope between the Colville and Canning rivers, the federal land in the National Petroleum Reserve - Alaska to the west of the state lands, and the coastal plain of ANWR to the east of the state lands. The exploration potential of the state lands is limited today primarily to the discovery of new satellite fields, as opposed to fields large enough to stand on their own economically. Exploration is still active in NPR-A and by no means over, but the courts have recently blocked federal leasing of the geologically promising lands around Teshekpuk Lake. And even if the Ninth Circuit decides to let that leasing go forward, the pro-leasing Bush Administration has less than 14 months left in office in which to hold the lease sale. Elsewhere in NPR-A, the relinquishment earlier this fall of some 300,000 acres of lands reflects disappointing results from leaseholder exploration efforts there. As for ANWR, despite Republican majorities in both houses of Congress and a pro-development president in the White House, the coastal plain is still closed.

And this brings me to the second reason why it is unwise to focus too much on investment in exploration as the solution to production decline. Exploration is a risky business, and there is no assurance that spending money to test a particular prospect will ever yield a dime of payback. Even when exploration succeeds in discovering a commercially viable field, it will take years from the time of its discovery until the time production from it begins. But the challenge of declining production confronts Alaska today — not eight, ten or a dozen years from now. By its nature, investing in exploration can make a significant contribution toward solving the challenge of declining production in the longer term, but not the shorter term when results are urgently needed.

Investment in heavy and viscous oil development is also a solution in the mid to long term. The first well ever drilled to test production from the Ugnu Formation was only drilled earlier this year in the Milne Point Unit, and it is still being tested and evaluated to gain a better understanding of the physical characteristics of the Ugnu oil. There are plans to use the results of these tests and evaluations to plan and develop a pilot project for producing Ugnu oil. Until then, West Sak will continue to be the only commercial heavy/viscous opportunity.

This gets us to investment in currently producing fields. Fortunately, there are investments that can be made, and are being made, in these fields to slow their decline. In the short term, this is in-fill drilling — that is, drilling new wells into the portions of a reservoir that are between the wells that have already been drilled. This accelerates the drainage of oil from the rock that currently lies in between existing wells. In-fill drilling last year contributed some 70,000 barrels a day to production from the Prudhoe Bay field. To put this into perspective, a 70,000 barrel per day field would be the 4th largest stand-alone field on the North Slope today.

There are also major investments being made, and yet to be made, in “renewal” of the surface facilities for existing fields. For instance, the gathering centers and flow stations for the Prudhoe Bay field have been in service for over 30 years now. For them the situation is not all that different from what yours would be if you bought a minivan van years ago when your children were young, and now that the kids are all grown up and it's just you and your spouse who are driving it, it's time to replace that minivan with a new vehicle that suits your needs better. If Prudhoe Bay and the other producing fields are to continue producing in the decades to come, their original production facilities will need to be overhauled or replaced. Also, as increasing amounts of heavy and viscous oil come into production, even relatively new facilities that were designed for comparatively light “conventional” oil will probably need to be modified, refitted or replaced in order to minimize operating problems in handling that heavy/viscous oil. Regardless of the stimulus or purpose for making them, renewal investments in production infrastructure present a very similar cash-flow pattern as there is for investments in the original infrastructure to develop a field. And consequently, an incentive that is effective for the initial development infrastructure is equally effective for renewal as well.

So, this is the harsh reality in which we — government, industry, the present generation of Alaskans, and the next one — find ourselves. For all of us, decline is the great challenge that

we must grapple with. It already threatens us now, and if unaddressed, will only get worse. Massive new investments for additional oil production are the only way to deal with this menace, and there are three areas of investment that can be made to deal with it: exploration, heavy and viscous oil development, and slowing decline of existing fields. The first two are of greatest benefit for the long term, and the other one is of great benefit for the near term. We need all three kinds of investment and don't have the luxury of ignoring one or two of them. I have explained our collective situation in such detail so we can each see for ourselves why declining production is the great issue of the day for Alaska.

Turning now to the relative merits of SB 2001 versus PPT, AOGA submits there are several self-evident principles of taxation that should be used to test those merits. First, a tax must be "fit for purpose" — that is, it must do the things it is intended to do, and it should do them well. Second, the administration and enforcement of a tax should be as efficient as possible, consistent with ensuring compliance by taxpayers. Third, for a taxpayer who wants to calculate and pay the correct amount of tax when it comes due, it must be possible to do so.

Regarding the first test — achieving what the tax is supposed to achieve — most new taxes have as their primary or only purpose the new revenues that they will bring in for the government. In the case of PPT, however, things were not so simple. In part its purpose certainly was revenue-related, because most legislators viewed the prior ELF-based production tax as outdated and unduly generous to producers in terms of the reduction in tax rate that the ELF caused. But, as Pedro van Meurs explained repeatedly in his testimony last year and again at the beginning of this special session, the PPT was also designed to provide incentives for investing in production and in that way answering the threat of declining production.

With respect to the revenue side, no one disputes that PPT has brought the State more tax revenue since April last year than ELF would have. According to DOR, the increase was more than \$800 million in the last nine months of 2006,³ and at that rate it would have been over a billion dollars in additional production tax revenue for a full year. DOR also said at the time that the March 31st payments were about \$137 million less than the \$950 million that it had estimated, and in due course I'll come back to the questions of forecasting the PPT and higher-than-forecasted lease expenditures. For now, my point is that PPT has certainly outperformed the old ELF tax, which is just what it is supposed to do.

As a consequence of the fact that field costs are higher than DOR predicted last year, this Administration criticizes PPT for failing to generate all the tax revenues that the fiscal note for HB 3001 predicted. It has even been suggested that Alaskans were somehow promised that PPT would generate \$800 million more this year than is now being projected, and that it is therefore necessary to raise the tax rate in order to make good on that promise.

That whole line of reasoning is flawed. First of all, DOR is complaining that they can't forecast PPT accurately because it has so many variables that affect the results. However, if they can't forecast it accurately, then why should so much reliance be placed on its current forecast

that shows the prior forecast was off by \$800 million? If the first forecast was poor, what has changed to make this latest one so good?

As I explained just a while ago, the purpose of PPT was more than just the tax revenues it would generate. It was to create incentives for attracting the massive new investments that will be needed in order to meet the threat posed by declining production. The system of tax credits under PPT provides significant incentives for investing in capital assets to explore for, develop, and produce more oil and gas.

- Current capital expenditures generate a 20% tax credit in addition to being immediately deductible as lease expenditures. For the kinds of economic analysis that reflect the time-value of money, these front-end benefits have the greatest possible positive effects on the results of the analysis.
- The incentive to invest sooner rather than later is materially increased by the fact that the "transitional investment expenditure" or "TIE" credit for pre-PPT capital investments can only be taken to the extent those prior expenditures are matched two for one by new capital expenditures, and taxpayers have only until the end of 2013 to use up their "TIE" credits.⁴
- The 20% tax credit for a carried-forward annual loss particularly benefits explorers and those who are bringing new fields into production for the first time in Alaska and don't have production yet that they can deduct their costs against.
- The "section 024(c) credit" of up to \$12 million a year for producers with less than 100,000 barrels a day of production is an incentive for independents and other smaller players to come to Alaska for oil and gas.
- The \$6 million annual credit under AS 43.55.024(c) is an incentive for exploration and development in the areas of Alaska outside the North Slope and Cook Inlet basin.

Have these incentives under PPT worked? The preliminary results so far say yes. DOR's August 3rd report on PPT states that capital investments for FY 2008 are 80% greater than previously estimated, despite the fact that operating expenditures are up by 101% over the prior projections.⁵ Of course, it will take time before companies can fully respond to these incentives, and it will take even more time to tell whether the new investments to increase oil production succeed in actually getting more production. But so far things appear to be moving in the right direction.

There is the question of whether the inability of explorers and almost-producers to sell their credit certificates near face value has been a material problem. As the Executive Director of AOGA, I can assure you there is no one among AOGA's membership who thinks any problem in selling the certificates has been serious enough to justify amending the PPT.

Now, moving on to SB 2001, how well does it stack up under the standard of being fit for purpose? Certainly, it would generate even more tax revenue than the PPT will, at least in the

short term. But it is premised on the totally mistaken notion that increasing what the government takes from the economic "pie" will encourage greater investment, or at least not decrease it from what it would be anyway. No one has ever taxed economic growth and development into existence. SB 2001 will not do so, either.

The second standard for evaluating SB 2001 versus PPT is that the administration and enforcement of the tax must be as efficient as possible, consistent with ensuring compliance by taxpayers. Here, the two chief objections to PPT have been, first, that it is all but impossible to forecast the revenues from it with the accuracy needed for state budget purposes, and second, that the audit challenges of PPT leave DOR's auditors hopelessly outgunned.⁶ So the questions that need to be answered are, how much merit do these criticisms have, and how would SB 2001 address these concerns?

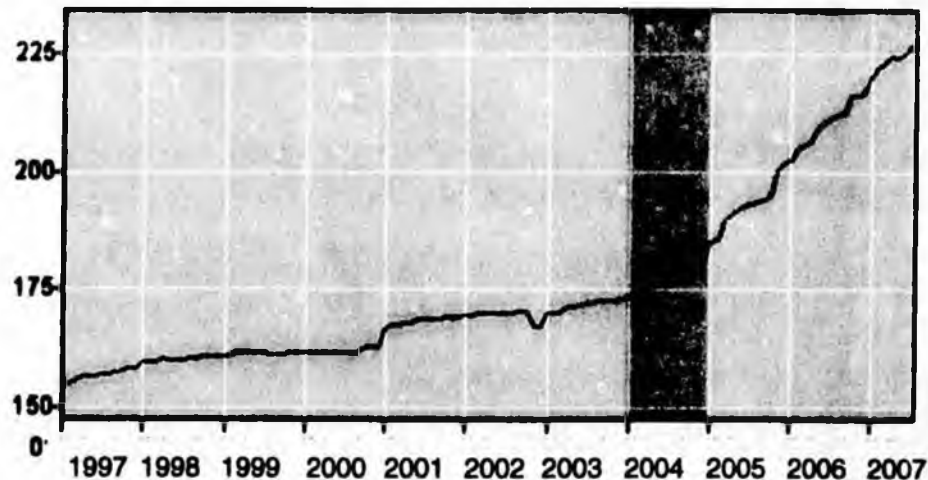
Regarding forecasts for PPT, DOR cites two major concerns about the forecasts. One is that, "[w]hile costs would be expected to increase, the dramatic difference between what was predicted [in the prior Administration's fiscal note for HB 3001] and what has actually been experienced brings into question whether the legislature made its decisions based upon appropriate information."⁷ The other is that DOR needs cost information about current and planned spending from the operators, producers and explorers, and this allegedly has not been forthcoming from them.

Let us consider this "dramatic difference" between the projected expenditures behind the fiscal note last year, and what those expenditures have actually been. When the DOR staff in the prior Administration sought information about expenditures, they chose not to rely on the representations about 2006 costs that individual companies gave the Legislature in public testimony at that time.⁸ Instead, they looked at what they believed to be more reliable information contained in the most recent partnership tax returns that had been filed with the IRS for fields on the North Slope.

Federal partnership returns are not due to be filed with the IRS until October of the following year, so even as late as August 2006 when the Legislature passed HB 3001, the most recent returns available were those for 2004. Here is a chart showing the Producer Price Index

Oil and Gas Field Machinery and Equipment PPI

Source: U.S. Department of Labor



for oil and gas field machinery and equipment during the last decade. The highlighted bar in the graph marks 2004, and you can see right away why a fiscal note based on the most recently filed federal tax returns, for 2004, would be way off the mark in predicting what the field costs would be in 2006 and '07.

There was nothing sinister about what that Administration did. The companies said the 2006 costs were high, but the latest tax returns at that time indicated the costs were significantly less, with a fairly lengthy track record of gradual increases. DOR went with the reported information on the tax returns. I suspect the DOR staff in the present Administration would do the same in those circumstances. In any event, this is not a reason for casting PPT aside.

The other criticism that DOR makes of PPT is that producers and other taxpayers are not providing DOR with the information it needs in order to be able to forecast PPT revenues with sufficient accuracy. Obviously, AOGA is not privy to what these taxpayers are reporting to DOR as they make their monthly installment payments and their annual true-up payment on March 31st.

DOR's second chief objection to the administrability and enforceability of PPT is that the audit challenges of PPT leave its auditors hopelessly outgunned. It is not for us to comment about the proposal to put auditors in the "exempt" service.

But there is a dimension to PPT audits, however, that we can and should address. This has to do with what the source or starting point for determining how much a producer's deductible lease expenditures are. The PPT statutes currently allow DOR a choice between starting from the joint-interest billings and invoices that operators bill to the other participants in