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Date: 15/03/2006

To:

Senator Thomas Wagoner, Chair Senate Resources Committee
Representative Ralph Samuels, Co-Chair House Resources Committee
Representative Jay Ramras, Co-Chair House Resources Committee

Re: **Testimony of Mr Daniel Johnston on SB 305/HB 488 Production Profit Tax (PPT)**

Dear Senator Wagoner and Representatives Samuels and Ramras:

In his Testimony of 6th March 2006 to the House & Senate Resource Committees, Mr Johnston raised a number of issues related to BP's prior testimony to which I am compelled to respond. As well as setting the record straight I believe this response will be helpful to you and your committee's deliberations.

Our response relates to two issues raised by Mr Johnston:

- 1) The impact of 1993 tax cuts on investment in the UK North Sea.
- 2) The Marginal rate of taxation in the UKCS.

1) The impact of 1993 tax cuts on investment in the UK North Sea.

In BP's February 28th testimony, my colleague Ray Hall presented data from the UK North Sea, Gulf of Mexico and Alberta that illustrates the cause-and-effect relationship between fiscal policy and investment. With regard to the UK example, Mr Johnston contended that the data BP presented "is not a fair representation of what the result of lowering the tax rate in 1993 was". Clearly it is difficult to unequivocally attribute any outcome to the events that preceded it, and there will be many views of what might have happened without the tax change. However:-

For BP, the position is clear

- We increased capital investment in response to the 1993 changes
- We sanctioned 5 large projects in the matter of a few years (Andrew, Harding, Foinaven, Schiehallion and ETAP). These projects committed circa \$8 billion in capital and 2 billion boe in reserves.

For the UK Government the position is clear

- UKCS Exploration & Appraisal spend was the largest of any basin in the world between 1994-1999
- The number of development wells increased one and a half fold between 1993 and 1995
- Basin production rose following the reform
- Tax revenues increased following the reform

Mr Johnston himself is on record as saying:-

“Ordinary measures of Government take throughout the 1990’s made the United Kingdom government appear rather crazy and irresponsible. The “gross benefits” to the UK Government go way beyond direct tax revenues and royalties received from the upstream sector of the petroleum industry. **The economic impact of the industrial hyperactivity in the UK sector of the North Sea, a direct result of the “lenient” terms of the 1990’s, is difficult to measure.** Furthermore, the activity in the UK started in the late 1980’s and early 1990’s when the UK Government dropped the ring fence for the 75% PRT before Government take, as it is ordinarily measured, was drastically reduced. **The UK offshore became the most active offshore province in the world. Reducing the Government take in the following years managed to sustain that boom.** Activity and employment in the British petroleum sector is healthy and robust..” (*Source: Petroleum Tax Design page 6 by Daniel Johnston 23 Oct 2002, Washington DC*)

It is our sincere belief that there is a close relationship between fiscal policy and investment, a relationship acknowledged by Mr Johnston in earlier publications, and that the UK offers one of several notable examples where reducing taxes has stimulated investment. The attached slide pack provides additional detail.

2) The marginal rate of taxation in the UKCS

In BP’s testimony, Ray Hall compared the marginal government take under PPT 20/20 (61%) to that of the UK (50%). Mr Johnston challenged this figure, asking “why has nobody mentioned the 75% Government Take in the UK?” The 75% Government Take to which Mr Johnston is referring is that paid by the small number of the fields in the UK that are subject to Petroleum Revenue Tax (PRT). PRT is currently levied at 50% on fields given development consent prior to March 1993. Out of a total 208 fields in the UKCS, only 94 fields are liable to, and only 29 actually pay PRT (the rest are protected by volume and other allowances). These 29 fields contributed approximately 29% of the UK oil and gas production in 2005. In any event, the 50% marginal tax rate described by Mr Hall applies to all fields developed after 1993 and as such is a more appropriate comparator to future investments in Alaska.

I trust this letter is clear and would be happy to discuss any issues raised with you and your committees.

BP appreciates the opportunity to testify on this very important issue and intend to remain fully and constructively engaged in the process.

Sincerely yours,

Angus Walker

Commercial Vice President, BP Alaska

Attachments: 6 slides providing further context to the outcome of the UK 1983 and 1993 tax cuts