

PETROLEUM PRODUCTION TAX

Presentations to the Senate
Resources Committee and to
the House Resources
Committee

February 23, 2006

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FISCAL SYSTEM OF ALASKA

The fiscal system applicable to oil and gas of Alaska consists primarily of four components:

- Royalties
- Production tax (severance tax, "ELF")
- Property tax
- State corporate income tax

Additionally, there is federal corporate income tax.

This presentation is about the international competitive aspects of the proposed petroleum production tax.

In international comparisons always the entire State and Federal package together is compared.

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PETROLEUM PRODUCTION TAX

The most recent proposal for the petroleum production tax is as follows:

Tax rate: 20%

Tax credit rate: 20%

Tax free allowance: Up to \$ 73 million

Capex clawback: 20% of capex over last 5 years

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PETROLEUM PRODUCTION TAX

The presentation is primarily aimed at the discussion of my PPT report. The preparation of the report started in July 2005 and continued until February 14th this month.

Until early January 2006, I recommended a system with a 20% tax and 15% tax credit based on the international competitiveness analysis.

As a result of the economic analysis done in DOR in January 2006, and input from various other consultants, I amended my recommendation to a 25% tax rate and 20% tax credit rate.

Therefore, the report contains chapters about 20/15 and 25/20. Sensitivity analysis was done on other combinations.

The 20/20 concept and the capex clawback were adopted after the finalization of this report. However, from an international perspective of competitiveness, all these options are rather close and therefore the general conclusions of the report remain valid for the 20/20 concept as well.

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PETROLEUM PRODUCTION TAX

The report contains the following chapters:

Executive Summary

1. Introduction
2. New international trends in government take
3. Economic analysis
4. Analysis of the 20/15 PPT
5. Analysis of alternative PPT's
6. International competitiveness of the 20/15 PPT
7. International rating of the 20/15 PPT
8. Competitiveness and PPT rate
9. International rating of the 25/20 PPT
10. Heavy Oil Incentives
11. Review of 25/20 PPT

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PETROLEUM PRODUCTION TAX

COST SCENARIOS		FIELD#1 FIELD#2 FIELD#3 FIELD#4 FIELD#5 FIELD#6						
Per barrel costs		DRY HOLE	50MM-LOW	150MM-LOW	500MM-LOW	50MM-HIGH	150MM-HIGH	500MM-HIGH
TOTAL OIL PRODUCTION (MMbbls)		0.0	50.0	150.0	500.0	50.0	150.0	500.0
HIGH COSTS:								
TOTAL CAPEX	Exploration (m\$)	45	45	45	45	45	45	45
	Development (\$/bbl)		7.50	6.00	5.25	6.00	4.50	3.00
TOTAL OPEX	(\$/bbl)		6.00	5.00	3.75	4.50	3.50	3.00
AVERAGE COSTS:								
TOTAL CAPEX	Exploration (m\$)	37.5	37.5	37.5	37.5	37.5	37.5	37.5
	Development (\$/bbl)		6.25	5.00	4.37	4.80	3.75	2.50
TOTAL OPEX	(\$/bbl)		5.00	4.17	3.12	3.75	2.92	2.50
LOW COSTS:								
TOTAL CAPEX	Exploration (m\$)	30	30	30	30	30	30	30
	Development (\$/bbl)		5.00	4.00	3.50	4.00	3.00	2.00
TOTAL OPEX	(\$/bbl)		4.00	3.33	2.50	3.00	2.33	2.00

The main focus of the economic work was on high cost fields of 50 million and 150 million barrels, since these field types represent North Slope conditions.

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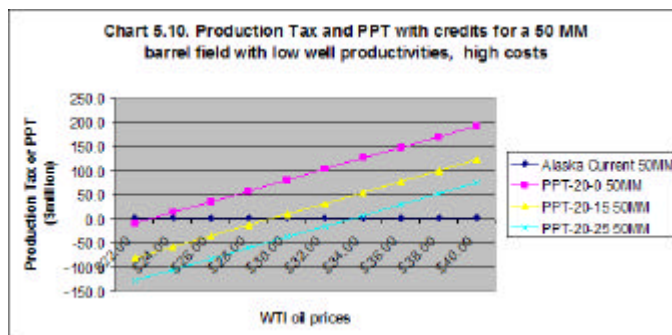
PETROLEUM PRODUCTION TAX

20/20 PPT \$ 40 CASE HIGH COSTS	DRY HOLE	50 MM	150 MM	500 MM
ROYALTIES	0.0	264.4	820.6	2827.5
PPT	-18.7	-110.1	180.6	1730.3
PROPERTY TAXES	0.0	28.3	86.3	292.3
STATE CIT	-2.6	100.6	318.1	1131.2
FEDERAL CIT	-8.9	340.3	1075.8	3825.5
ALASKA GOVERNMENT TAKE	45.6%	22.6%	31.4%	35.4%
FEDERAL GOVERNMENT TAKE	19.1%	27.2%	24.1%	22.7%
TOTAL	64.7%	49.8%	55.5%	58.1%

The 20/20 PPT provides for a progressive system for new investors, with a negative PPT on small fields to encourage investment.

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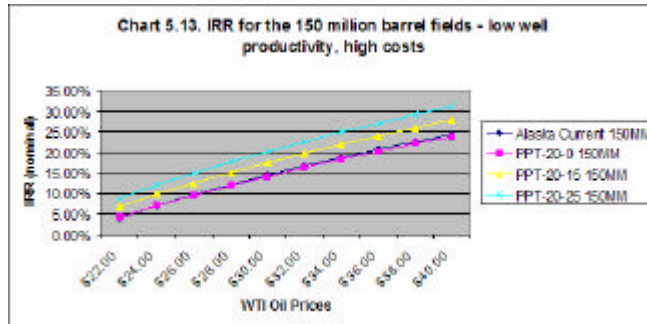
PETROLEUM PRODUCTION TAX



For small fields, the tax credits have a considerable impact on the break even point. Graph illustrates PPT for large producers

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PETROLEUM PRODUCTION TAX



The level of tax credit is the main determinant of the rate of return. The higher the tax credits the higher the rate of return.

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PPT AND COMPETITION

The competitive position of the Alaska system was analyzed using the same field sizes and applying international terms. Eight fiscal systems were analyzed. They all reflect areas in the world where currently considerable investment is taking place:

- Norway
- UK
- US Gulf Coast
- Alberta Oil Sands
- Nigeria
- Angola
- Russia-Sakhalin
- Azerbaijan

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PETROLEUM PRODUCTION TAX

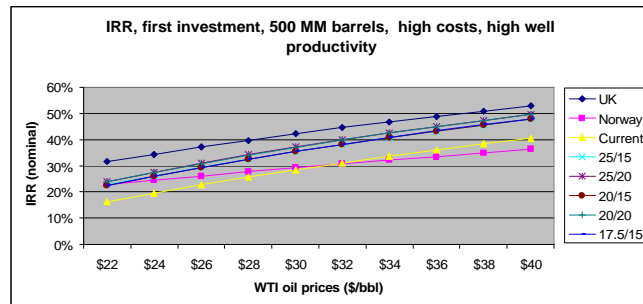
Jurisdiction	Net back differential (\$ per barrel)
Alaska-North Slope	\$ 7
Norway	\$ 1
UK	\$ 1
US Gulf of Mexico – Deep water	0
Nigeria – Deep Water	\$ 2
Alberta – oil sands	\$ 2
Angola	\$ 2
Russia-Sakhalin	\$ 1
Azerbaijan	\$ 6

The international comparison was corrected for the low net back of Alaska crude oil.

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PPT AND COMPETITION

First Investment in 500 MM barrel field

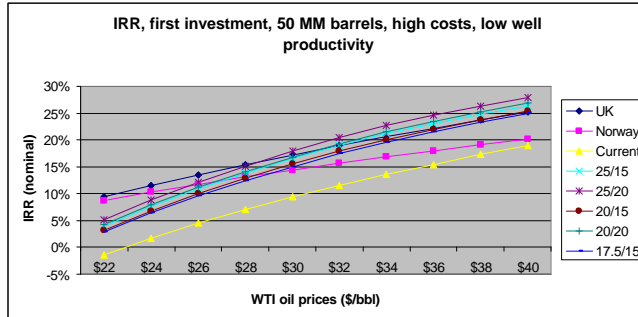


The PPT creates a very material improvement in IRR relative to Norway and UK, for a first investment in a large field.

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PPT AND COMPETITION

First Investment in 50 MM barrel field

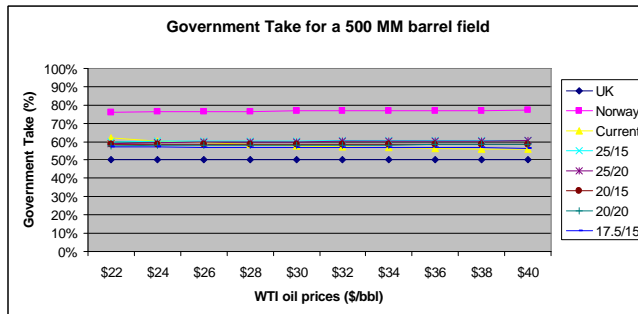


The PPT creates a very significant improvement in IRR relative to Norway and UK, for a first investment in a small field.

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PPT AND COMPETITION

First Investment in 500 MM barrel field

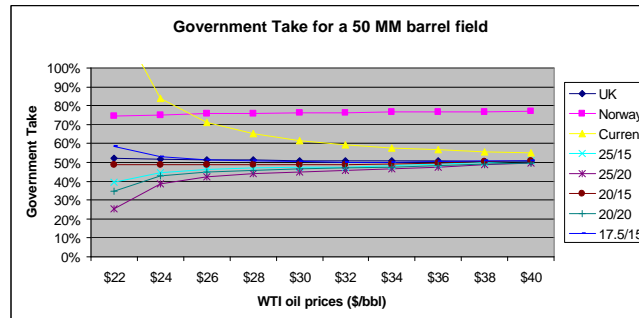


The PPT provides for a modest total government take for each of the five options, in order to compensate for the low net back prices and high costs.

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PPT AND COMPETITION

First Investment in 50 MM barrel field



For first investors or small producers there is a reduction of government take compared to the Current System. The regressive nature of the government take is removed for each of the five options.

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PPT and competition

A competitiveness index was prepared by evaluating 48 economic yardsticks for 10 fiscal terms.

If a fiscal system was the best in all of them the rating was 48. If the system was the worst in all of them the rating was 480

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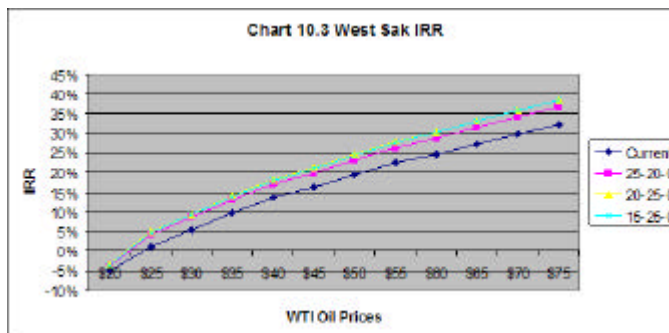
PPT and competition

RATING 20/15		RATING 25/20	
US GOM	52	US GOM	54
UK	135	UK	139
Alberta-Oil Sands	157	Alberta-Oil Sands	163
Nigeria	172	Nigeria	179
Alaska PPT	272	Alaska PPT	244
Angola	318	Angola	322
Azerbaijan	329	Azerbaijan	329
Alaska Current	364	Alaska Current	363
Norway	397	Norway	402
Russia-Sakhalin	444	Russia-Sakhalin	445

The rating of 25/20 was better than 20/15, because tax credits are very important in international rating. The system 20/20 would rate somewhat more attractive to investors than 25/20, but not significantly more

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PPT AND HEAVY OIL



The tax credit system will strongly enhance the rate of return on heavy oil projects, because the higher capital requirements will automatically result in more credits. The graph, however, also shows that it is not necessary to have very high credits of 25%.

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Conclusion

The 20/20 proposal results in very competitive terms from an international perspective for new investors as well as for existing petroleum companies.

The system will therefore result in more investment in Alaska, while at the same time creating much higher revenues, primarily from existing production and under average and high prices also from new production.