

HB

102

HB1022
SB 103

HB102
SB103

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MEMORANDUM

TO: Senator Kay Poland, Chairman
Senate Natural Resources Committee

FROM: Charles Naughton *Chas*
Assistant Director
Dept. of Natural Resources
Koniag, Inc.

DATE: April 16, 1975

RE: House Bill 102, and Senate Bill 103

For the purpose of clarification of my use of "potential" as it relates to the context of my testimony yesterday, I submit this comment:

To our Region, "proven reserve", and "potential" are synonymous. A reserve is just that; the benefits of which are not felt until the reserve is tapped.

We believe that a reserve has the capability of providing for use, a stored resource upon demand. When a reserve of known capacity is not drawn upon, its ability to provide is not reduced. Its contributing ability therefore still remains.

We recommend that an accurate definition of "proven reserve" be provided, so that in the future, it is not confused with "potential"; and also that the word "potential" in the context of my testimony not be equated with the word "speculation".

STATEMENT OF JACOB ADAMS, VICE-PRESIDENT-
LANDS, ARCTIC SLOPE REGIONAL CORPORATION
ON H.B. 102

My name is Jacob Adams. I am appearing before the Committee on behalf of the Arctic Slope Regional Corporation in my capacity as Vice-President in charge of Land Selection and Conveyance.

ASRC is strongly opposed to legislation which would impose a tax on proven oil and gas reserves. The proposed legislation would constitute an extremely damaging burden to ASRC and could very well bankrupt the corporation.

ASRC recognizes and appreciates the Legislature's concern over imminent near-term deficits in the State Treasury arising out of predictable imbalance between revenues and expenditures. Expenditures in recent years including revenue sharing with local governments has been a mainstay of supporting their local budget requirements especially in education.

While the Inupiat people of the Arctic Slope have benefited to some degree by State financial support, it has not been to the same extent that more urban areas have benefited.

At the present time, the present cash reserves and future anticipated revenues arising from the Alaska Native Claim Settlement Act, as well as programmed receipts

under various exploration and development agreements with major oil companies, have been heavily committed to produce a viable economy in the Arctic based on a profit motivated, free enterprise system. ASRC, without special assistance or subsidy from the State, is underwriting many commercial business ventures, which will ultimately provide revenues to the State in the form of income and business taxes. If prevented from developing on its own initiative because of a new tax burden on proven reserves, which ASRC shall shortly inherit under its mineral in-lieu selection entitlement, the economic future of the Arctic will be seriously impaired.

A tax on reserves is a regressive tax in that it is not gauged on the ability to pay. True, large oil companies can accommodate such taxes by passing on to consumers those costs, but not every corporation, organization or individual can pay. Contrary to the bulk of public opinion there are others in the State of Alaska, in addition to large oil companies, that have a stake in ownership of oil and gas reserves. This other category includes individual lessees, royalty owners, and independent companies.

As you are also aware, at least six native regional corporations have entered into oil and gas exploration agreements which, in addition to base royalties as a land owner, provide for other benefits including net profits provisions,

joint ventures or participations, carried working interests, or a combination of all three.

Although we are not here to argue the legal interpretation of Section 21(d) of the Alaskan Native Claim Settlement Act whereby a twenty year tax exemption applies to certain property interests of native corporations and individuals, there are those who believe that native interests in leases in the form of participations as well as royalty interests would be subject to a property tax in the same manner and to the same degree as oil company lessees.

We submit that the property tax being considered would depress the value of unleased native corporation lands as well as those that are presently leased or that shall be leased in the near future. The time of payout in order to receive benefits under a net profits interest would be much delayed. From the regional corporations' standpoint, paying taxes today with the uncertainties of developing a market and unknown future wellhead value of crude oil and natural gas, could create financial havoc if not bring upon the economic demise of the corporations.

A specific example will serve to illustrate our concern. ASRC previously filed in-lieu selections on approximately 18,000 acres within the boundary of the known geologic structure of the Kemik Unit. The Kemik Unit has one completed and shut-in gas well. A second exploratory well is currently drilling and a permit for a third exploratory well is pending. No development wells have been drilled;

however, the U.S. Geological Survey has indicated that the discovery probably is commercial based on the KGS classification. The Survey and the original operator, Forest Oil Company, indicates a probable produceable volume of 475 bcf of gas. This is certainly no "barn burner" or as we call it "igloo melter" in terms of North Slope operations.

ASRC filed selections within the Kemik Unit because it has over 1.2 million acres of in-lieu subsurface entitlement and the Board of Directors believes such selections should be made first in proven areas of production where fee ownership is not important in order to maximize the spread of its overall land ownership throughout the Arctic Slope.

ASRC's interest in the Kemik Unit upon transfer of the subsurface estate from the Department of the Interior ranges from 12-1/2% royalty under existing Federal leases to 100% mineral interest under unleased lands within the unit boundary.

Based on the reserves attributable to ASRC's interests derived from the operators volumetric calculations, the volume of produceable gas is 213 bcf. Assuming an arbitrary value at the time production commences of \$.50/MCF, the value of so-called proven reserves owned by ASRC is \$106MM. A 20 mil property tax levy would amount to \$2.1MM annually until production commenced.

Since ASRC will probably lease its 100% mineral interest lands reserving a 16-2/3% royalty thereby decreasing its royalty reserves to 64 bcf, the amount of ad valorem taxes paid in the first few years after the tax is imposed may never be recouped as a credit against production taxes. This would be true unless ASRC receives title to the subsurface estate and leases its interest prior to the effective date of the tax law. Actions which force ASRC to land management decisions in haste due to factors (the new tax) beyond its control are unreasonable and patently unfair.

Another problem that we consider likely to develop that would be harmful to ASRC relates to the contract provisions of our several oil and gas exploration agreements. The agreements provide for, among other things, a reasonable continuous drilling provision in the event of discovery on a lease. It is almost a certainty that we would have to waive the continuous drilling provision until the law expires (if ever) thereby extending the period of field development for many years which would not only affect our cash flow projections but deprive the State of production taxes from ASRC lands.

Although reserves could be assessed under a single discovery well, you would obviously be inviting litigation.

We believe that the Legislature should carefully explore all alternatives to raising sufficient revenues to offset near-term deficits and compare the impact against the obvious detrimental effects of the tax on reserves.

Several alternatives that have been advanced in recent weeks that should be thoroughly considered include the following:

1. Indirect borrowing against future oil and gas royalties through an "ABC" type transaction. Selling only a specified quantity of royalty reserves commits only that amount necessary to repay the loan. Royalty production thereafter is free from encumbrances. While further investigation of the applicability of "ABC" financing is needed, we believe it would avoid the question of constitutionality raised by opponents to funding through borrowing. Arlon Tussing, noted University of Alaska economist, has compared the cost effect of taxing reserves against borrowing at low interest rates and concluded that if the State wants to maximize the value of its oil revenues it would be far better off to issue revenue bonds rather than tax reserves in the ground.

2. Another alternative that should be considered is advance payment of severance taxes. Since the producers will be paying severance taxes based on gross wellhead price of oil or gas on a predictable declining basis, payment of advance severance taxes on production with a recapture provision after royalty revenues close the gap between receipts and expenditures should encourage

operators to produce a property beyond what would otherwise be its economic limit. The time of abandonment of marginal properties should be extended for a number of years which would benefit the State and promote good conservation practices.

3. A third alternative that should be considered is a purchase option on State royalty gas with the actual value to be determined at the time of transfer. An option of this nature could be made attractive to large gas utility companies who may be able to accommodate the option payment in their rate base. In any event, the State would not be committing its gas reserves at a fixed price in advance of what the actual value may be at the time production commences. It appears to ASRC that this alternative may be superior to all others.

4. Additional competitive lease sales should be programmed to coincide with calendar year budgets of major oil companies to maximize revenues. If the majority of the potential participants in a sale adopt a budget as of the first of a calendar year then it is unwise to schedule a sale for the fourth quarter of a year.

5. Another alternative that has been suggested is advance sale of royalty oil. This appears the least advisable at this time since the value would be heavily discounted by prospective purchasers. However, as an alternative it should be considered.

We wish to thank you for the opportunity to present our viewpoint on the proposed property tax on reserves. Although such a tax may be relatively easy to administer, it has gross inequities and applications. Therefore, if there are other means to raise revenues without inequities, they should be thoroughly investigated and only as a last resort should serious consideration of a tax on reserves be implemented.

One factor that begins to worry ASRC is that the anticipated revenues from Prudoe Bay may not cover rapidly escalating costs of State government at the time production begins. If this occurs, we believe that the tax on reserves will not be phased out as provided for in the various bills with the result that exploration and development on native lands will be further impaired.

BRISTOL BAY NATIVE CORPORATION

P.O. BOX 237
DILLINGHAM, ALASKA 99576
PHONE (907) 842-3070

February 18, 1975

Mr. Nels A. Anderson, Jr.
Pouch V
Juneau, Alaska 99801

Dear Nels:

You asked for our views on HB 102, the oil-in-place tax. In my opinion, the bill would slow oil exploration and production throughout the State and it would not produce any net gain in state revenues. It would cause severe problems for our Native regional corporations. In fact, it could easily push one or more of them under.

The tax is aimed at Prudhoe, but that is not where it will hit. HB 102 would not take effect until 1976. The Prudhoe fields will be paying gross production tax by 1977 if Alyeska stays on schedule, and those taxes will be in the neighborhood of a billion dollars a year by the end of the third year.

Five or eight years ago was the time to start taxing the field up there. Today is not.

Now, an oil-in-place tax will mainly hit the Native corporations, particularly the ones that have signed exploration and production contracts. Take BBNC, for example. Our contract provides:

- (1) Phillips Petroleum explores our land for oil. We do not get any direct payment for the exploration, and we cannot stop it at this time without breaching the whole contract.
- (2) Once oil is found, Phillips pays us a one-time bonus equal to 1% of the value of the field.
- (3) Phillips and BBNC will form a joint operating company to get the field into production and market the product. BBNC and Phillips will each own 50% of the JOC, and it will own the leases.

Mr. Nels A. Anderson, Jr.
February 19, 1975
Page 2

Getting a field into production might not take very long around Kenai, but in a remote area such as Bristol Bay it will take at least three years. In the NANA Region it might take even longer. It took nine years on the Arctic Slope.

Suppose Phillips finds a one hundred million barrel field. Our consultants tell us that this could be within the ball park. We get a one-time bonus of 1% of the value, which we can use to pay our 50% share of the 2% oil-in-place tax. We break even--the first year.

The second year, the tax would drain our bank account.

The third year, we would owe the State ten million dollars and we would not be able to pay.

I have not read the contracts entered by the other Native corporations, but I think that ours is at least typical and probably the best of the lot. In any case, what happens to any of the regional corporations affects them all, thanks to provisions such as 7(i) of the Land Claims Act.

I know that Doyon, which has enormous oil potential, has been thinking about going into an exploration contract. But if this bill passes, they would be crazy to get into one. That is why I say the bill will slow down oil and gas exploration and in the long run cost the State.


Obviously, we are not about to lay down and die while we wait for bankruptcy. I see that oil-in-place taxes have always meant lots of lawsuits in the States where they have been tried, and it wouldn't be any different here.

There are also good sound environmental conservation reasons for opposing such a tax. For instance, the fastest way of getting proven oil out of the ground might not always be the best way. But with this tax it would surely be the only way.

I hope these views will be of some help to you: in your deliberations on this bill.

Sincerely,

BRISTOL BAY NATIVE CORPORATION


Harvey Samuelson
President

HIS:ms

AGO 547310 +

BRISTOL BAY NATIVE CORPORATION

P.O. BOX 237
DILLINGHAM, ALASKA 99576
PHONE (907) 842-3070

February 4, 1975

Rep. Nels A. Anderson
Chairman, House Resource Committee
Pouch V
Juneau, Alaska

Dear Nels:

HB 102, that puts a tax on oil in place, is straight anti-Native legislation. It is going to cost every regional and village corporation shareholder untold sums of money, and at the same time it will force the corporations to tear up the land for mineral exploitation whether they want to do so or not.

Bottle it up in your committee forever.

How are you liking it down there in Juneau?

Sincerely,
BRISTOL BAY NATIVE CORPORATION


Harvey Samuelson

AGO 547311 +

ARCTIC SLOPE REGIONAL CORPORATION

File

PRESIDENT
JOSEPH UPICKSOUN
1ST VICE PRESIDENT
JOHN OKTALIK
2ND VICE PRESIDENT
EDWARD E. HOPSON, SR.
3RD VICE PRESIDENT
WYMAN PANIGEO

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SECRETARY
NELSON AHVAKANA
TREASURER
OLIVER LEAVITT
LAND SELECTION CHIEF
JACOB ADAMS
EXECUTIVE VICE PRESIDENT
LAWRENCE A. DINNEEN

March 13, 1975

The Honorable Nels A. Anderson, Jr.
Alaska State House of Representatives
Pouch V State Capitol Building
Juneau, Alaska 99811

Re: H.B. 102, 297 and S.B. 103

Dear Representative Anderson:

The captioned bills are of major concern to the Arctic Slope Regional Corporation and we believe to virtually all eleven other regions. It is our opinion that the language of the bills, as drafted, is extremely harmful to the interests of the native corporations and could bankrupt ASRC if enacted.

We are confident that you will remain open-minded on the issue of taxing oil and gas reserves at least until you have had the opportunity to hear our views presented. We would like to offer testimony before the House Resource Committee next week at the time to be scheduled by Chairman Anderson.

Sincerely,

ARCTIC SLOPE REGIONAL CORPORATION

By *Oliver Leavitt*
Oliver Leavitt
Treasurer

AGO 547312 +

BRISTOL BAY NATIVE CORPORATION

P.O. BOX 237
DILLINGHAM, ALASKA 99576
PHONE (907) 842-3070

March 6, 1975

HB102
file

Honorable Terry Gardiner
State Representative
Pouch V
Juneau, Alaska 99811

Dear Terry:

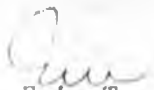
Regarding an oil-in-place tax, the critical years for us will come earlier than 1984. Fred Brown's new section 2(b)(1) is a step in the right direction, but I don't think it solves the problem. BENC will be protected, because of the particular way our contract is set up. But one Regional Corporation, to my own knowledge, could get zapped as early as 1978.

Wouldn't the tax really serve its purpose if it were only operative for two years? This gives the state two hundred million dollars a year during 1976 and 1977, and it does it without threatening the Native Corporations or unhinging orderly development. I enclose a copy of my letter to Fred Brown on the same subject.

On another subject, thank you for sending me Barry Jackson's letter. I agree with him that Native property should not be taxed while it is in its undeveloped state, even after 1991. At the very least, the policy makes the Native Corporations stop and think before rushing ahead with development schemes, and I believe that is to everyone's benefit.

Sincerely,

BRISTOL BAY NATIVE CORPORATION


Eric Treisman
General Counsel

ET:ms

AGO 547313 -1

BRISTOL BAY NATIVE CORPORATION

P.O. BOX 237
DILLINGHAM, ALASKA 99576
PHONE (907) 842-3070

March 6, 1975

Honorable Fred Brown
Alaska State Legislature
Pouch V
Juneau, Alaska 99801

Dear Fred:

Thank you for your letter of February 25th. I am very glad to learn that you are changing HB 102. I hope you will change it a little more, because I still do not think it is fair to make the bush pay for benefits that the urban centers voted themselves.

I am afraid the damage could all be done--the land devastated and the Native Corporations bankrupted--by 1984. I wonder whether you would consider a lapse on December 31, 1977. This would be adequate for the purpose of tiding over the state budget.

Please don't worry about my plain talk making your colleagues angry. Terry Gardiner is the only other legislator I wrote to. He won't be angry, because he is just a fisherman and sometimes he does not have any more tact than an atomic bomb either.

Sincerely,

BRISTOL BAY NATIVE CORPORATION


Eric Treisman
General Counsel

ET:ms

cc: Doyon Limited
Tanana Chiefs Conference
Fairbanks Environmental Center
Terry Gardiner

AGO 547314

BRISTOL BAY NATIVE CORPORATION

File
HB 102

P.O. BOX 237
DILLINGHAM, ALASKA 99576
PHONE (907) 842-3070

February 14, 1975

Honorable Fred Brown
Alaska House of Representatives
Pouch V
Juneau, Alaska 99811

Re: HB 102

Dear Fred:

I just received a copy of HB 102 and was surprised to see you listed as a sponsor.

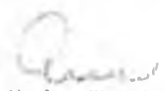
We are opposed to this bill for two reasons. First, it is anti-Native legislation. Under the terms of our contract with Phillips, such a law would begin to cost us money the day it is operative, and the mechanisms of Land Claims would pass this cost along to every Native in the State. What is more, by 1977 the Native corporations will be the main organizations in the State with oil-in-place interests not exempted under Section 3 of the bill or otherwise shielded. Since the benefits on which the State overspent during the past five years were not benefits to the bush, it is manifestly unfair now to make the bush pay for them.

Our second reason for opposing the bill is that it is anti-environmental and anti-planning legislation. It would force us to exploit our petroleum resources more hastily and less carefully, than Alaska's long range interests dictate.

I know that the State's need for money is great but HB 102 as presently written is ill considered. I know that such an anti-Native, anti-planning measure is opposed to your basic philosophy and I hope you will disassociate yourself from it at once.

Sincerely,

BRISTOL BAY NATIVE CORPORATION


Eric Treisman
General Counsel

cc: Doyon Limited
Tanana Chiefs Conference
Fairbanks Environmental Center

AGO 547315

BRISTOL BAY NATIVE CORPORATION

P.O. BOX 237
DILLINGHAM ALASKA 99576
PHONE (907) 842-3070

February 14, 1975

Mr. Sam Kito
Doyon, Ltd.
527 Third Avenue
Fairbanks, Alaska 99701

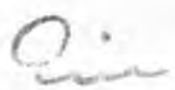
Dear Sam:

This is really a bad tax from our point of view. It means we will be paying one percent annually on the full and true value of anything Phillips finds during the five years or so between discovery and full production.

It's a bad tax from your point of view too, since the money will come off the top before anything goes in the 7(i) pool.

Sincerely,

BRISTOL BAY NATIVE CORPORATION


Eric Treisman
General Counsel

ET:ms

cc: Bill Timm

AGD 547316

BRISTOL BAY NATIVE CORPORATION

P.O. BOX 237
DILLINGHAM, ALASKA 99576
PHONE (907) 842-3670

February 14, 1975

Mr. Jim Kowalsky
Fairbanks Environmental Center
Box 1796
Fairbanks, Alaska 99701


Dear Jim:

I believe I already told you about HB 102, the bill to tax oil-in-place at the annual rate of 20 mills. Chancy Croft informs me that it stands a good chance of passing in the next three weeks.

I urge you to oppose the bill. From a Native point of view, it is unfair because it is designed to make Regional Corporations pay for the benefits on which the legislature overspent, benefits in which very few of our shareholders participated. From an environmentalists point of view, it is going to force the Native corporations to tear up land for mineral exploitation regardless whether or not it is in the long range interest to do so, and whether or not they want to do so.

Sincerely,

BRISTOL BAY NATIVE CORPORATION


Eric Treisman
General Counsel

AGO 547317

BRISTOL BAY NATIVE CORPORATION

P.O. BOX 237
DILLINGHAM, ALASKA 99576
PHONE (907) 842-3070

February 14, 1975

Honorable Terry Gardiner
Alaska House of Representatives
Pouch V
Juneau, Alaska 99811

Re: HB 102

Dear Terry:

I just received a copy of HB 102 and was surprised to see you listed as a sponsor.


We are opposed to this bill for two reasons. First, it is anti-Native legislation. Under the terms of our contract with Phillips, such a law would begin to cost us money the day it is operative, and the mechanisms of Land Claims would pass this cost along to every Native in the State. What is more, by 1977 the Native corporations will be the main organizations in the State with oil-in-place interests not exempted under Section 3 of the bill or otherwise shielded. Since the benefits on which the State overspent during the past five years were not benefits to the bush, it is manifestly unfair now to make the bush pay for them.

Our second reason for opposing this bill is that it is anti-environmental and anti-planning legislation. It would force us to exploit our petroleum resources more hastily and less carefully, than Alaska's long range interests dictate.

I know that the State's need for money is great, but HB 102 as presently written is ill considered. It will be difficult for me to convey the total depth of our opposition to this bill, and I hope you will withdraw your sponsorship.

Warm personal regards,

BRISTOL BAY NATIVE CORPORATION


Eric Treisman
General Counsel

ET:ms

AGO 547318