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TESTIMONY BY ARTIC SLOPE REGIONAL CORPORATION ON HOUSE BILL NO. 297
BEFORE HOUSE RESOURCES COMMITTEE

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.

As I testified before this Committee approximately three weeks ago, ASRC is strongly opposed to legislation which would impose a tax on proven oil and gas reserves. I am appearing before you again today to restate our continuing opposition to this type of tax for the reasons that I will state, and to ask that you attempt to satisfy the state's short-term cash needs by implementing any of the various alternatives that we and others have previously suggested.

Today, I would like to put my testimony in proper perspective by repeating what Oliver Leavitt, Treasurer, of ASRC, told the Senate Resources Committee at the conclusion of my recent testimony before that group regarding the proposed tax on oil and gas reserves. Arctic Slope Regional Corporation is a corporation "doing business for profit" in the State of Alaska. Like any corporation doing business in Alaska, we are and should be subject to taxation for the privileges and benefits afforded us by the Alaskan government. We will gladly pay taxes on any profits we realize - but we vigorously resist the enactment of a law that will require us to pay taxes on future revenue producing property years prior to the time that we will realize any cash return from the development and production of such properties. This is opressive taxation which would severely impede the growth and development of our corporation, and would

undoubtedly adversely affect the development and production of the oil and gas reserves on the North Slope of Alaska. Further, based on our evaluation of the possible cost that the proposed legislation could inflict upon us, we are seriously concerned as to whether or not we could continue to function as a viable corporation. I'm sure that it is not your intent to put us out of business or cripple our operations, but I'm also sure that you can appreciate our concern that we might be an unintended casualty of your efforts to ensure that the State's short term cash needs are satisfied.

Statements recently made before the legislature by Mr. Robert Paschall and Professor Griswold indicate that a tax on proven reserves would return annually to the State only \$100 - \$200 million. Since this will presumably be less than enough to meet the State's short-fall cash requirements, other avenues will have to be pursued. The various alternatives available in this regard were set forth in my earlier testimony, and have been stated and restated by others in their testimony. I suggest that it would be in the best interest of both the state, the Alaska business community and the Alaskan citizenry if the proposed oil in place tax legislation were abandoned and one of the following alternative courses of action were pursued:

- 1) Indirect borrowing against future oil and gas royalties though what is commonly known as an "ABC" type transaction. We understand that the Committee has already been provided with an explanatory memorandum and sample exhibits regarding this technique.

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- 2) Advance payment of severance taxes.
- 3) Sale of options to purchase state royalty gas and/or oil.
- 4) Issuance of revenue anticipation notes.
- 5) Sale of oil and gas leases.

Mr. Paschall, a California petroleum geologist, has testified that an ad valorem property tax has been used in his state for 60 years. He also predicted that such a tax applied to the Arctic Slope Regional Corporation's interest in the Kemik gas field would be approximately \$89,000 annually in contrast to the \$2.1 million tax which I previously estimated would be our liability.

Mr. Paschall is correct that California uses an ad valorem property tax approach to derive revenues from oil and gas interests. The tax is in lieu of severance tax. The net effect is approximately 7-8 percent of gross value which is comparable to the effect of severance tax in other oil producing states such as Texas or Oklahoma. 2
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The mechanics of assessment of reserves in California cannot be, in our opinion, equitably applied to Alaska, especially in areas where there is no production history, such as in the Arctic.

Because of the long history of production in California and knowledge of specific reservoir characteristics, a reasonably accurate estimate of reserves can be made. This is not so in Alaska.

The only reserve estimates that can be made on fields such as Kemik or Gubik (which we have also selected) is a simple volumetric estimate that may prove to be much in error. We believe that the error would be on the high side or not in our favor since a volumetric method of

calculating reserves is generally optimistic.

Paschall noted good conservation

The point to be made here is that an assessment of reserves based on estimates of recoverable oil and gas that are made from very little information and virtually no experience and will immediately invite challenge and litigation.

*✓
Nels*

Further, if the method of assessment (which is not spelled out in specific detail in this bill) provides only \$89,000 on an estimated value of \$106 MM, or \$100 MM tax on a \$5 MM assessed valuation of Prudhoe Bay, and the state will obviously still be cash deficient and will have to seek additional ways to raise revenues. This will only further complicate the states financing methodology.

*What about
revenue losses*

Finally, with all due respect to Mr. Paschall's expertise, I would like to point out that the determination of the fair market value of "proven" oil and gas reserves in Alaska will at best be a guessing game for some time to come. The very fact that the range of the possible annual tax cost upon Arctic Slope Regional Corporation could vary from \$89,000 to \$2.1 MM, depending on which assessment procedure you choose to employ, is as unsettling as it is uncertain and is clear evidence of the ambiguity and impracticality inherent in such a tax structure.

Nels

The legal morass that would undoubtedly evolve in administering its provisions prompt a suggestion that should you choose to enact such legislation, you might consider entitling it "The Attorneys Oil and Gas Annuity Bill."

*✓ Paschall's
et al
Constitutionally*

Professor Griswold states that there would be "no constitutional problem by exempting Native interests from a tax on oil and gas reserves". We recall similar claims about the legality of the right-of-way leasing

act which caused a special session at taxpayers expense and was ultimately repealed.

I understand that if any portion of a law is found unconstitutional under Alaska law, the other provisions of a statute are not necessarily invalid and may apply. Thus, if a court were to find that excepting only native interests is unconstitutional and thereby strike that provision, ASRC or any other regional corporation's interest would be subject ✓ to the remaining provisions of the law or, in this case, be subject to an ad valorem tax.

We are not so naive or gullible to be lead down a path of roses only to get hung on a thorn bush.

We want to emphasize the impact of this tax on a net profits interest which is one of the most important provisions of several exploration agreements between regional corporations and various oil companies.

A simple definition of a net profits interest is a share of gross production from a property, measured by the net profits from the operations of the property.

In the case of the North Slope, net profits are determined by ascertaining the cumulative gross proceeds from all oil, gas and other substances produced, saved and sold and deducting from such gross proceeds, the cumulative total of all chargeable costs and expenditures incurred by the lessee pursuant to the net profits agreement. Chargeable costs and expenditures are specifically defined and included any cash considerations paid or to be paid pursuant.

to an exploration agreement including lease bonuses and rentals, prouduction taxes and ad valorem taxes.

If a field is large and capable of reasonably rapid pay out, a 15 percent net profits interest is worth as much as a 45 percent working interest or perhaps even more.

A regressive tax - this ad valorem property tax - will prolong for years the time before our net profits become a reality. Moreover, a net profits interest is a property interest itself and therefore subject to an ad valorem tax, althou it is far beyond our knowledge as to ✓ how one would evaluate and as s the net profits interest before it actually materializes and produces income to ASRC.

As a fledgling corporation trying to provide financial benefits to thousands of native stockholders, we think this tax is very unfair and debilitating and therefore should not be enacted into law.

April 14, 1975

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