SCOMM

#11:9

STATEMENT OF JOHN A. CARVER, JR., PROFESSOR OF LAW AT THE UNIVERSITY OF DENVER COLLEGE OF LAW, TO COMMITTEES OF THE ALASKA LEGISLATURE CONSIDERING BILLS TO AMEND ALASKA STATUTES, RESPECTING TAXATION OF OIL AND GAS, JUNEAU, ALASKA, APRIL 15, 1975.

AGO 529855

My name is John A. Carver, Jr., and I appear on behalf of BP Alaska, Inc. I am a law professor at the University of Denver College of Law, and reside at 5639 Montview Boulevard, Denver, Colorado, 80207. My professional background relevant to the Committee's inquiry today derives principally from my governmental service as Assistant Secretary and Under Secretary in the Department of the Interior (1961-1966) and as a member of the Federal Power Commission (1966-1972).

It is not my purpose to discuss the pending legislation in terms of the power of the Alaska legislature constitutionally to tax reserves in place on an ad valorem basis. I will point out flaws in the legislation proposed, not with the idea that these flaws are incapable of being remedied, but rather for the purpose of laying a foundation for discussion of the policy implication in national energy supply terms.

As the Committee well knows, section 6(b) of the Statehood Act gave Alaska the right to select lands already leased by the United States for oil and gas development, the state selection being made subject to the federal leases. Upon patent, Alaska takes the right, title and interest of the United States under the lease. Under the final proviso of section 6(h), which provides, "that nothing herein contained shall affect the continued validity of any such lease, permit, license, or contract or any rights arising thereunder," the rights of lessees cannot be diminished by the selection process. (Emphasis added.)

AGO 529856

On their face the proposed measures seem to tax reserves underlying all Alaska-administered leases on the same basis, that is, without distinction based on whether the base fee interest was acquired under section 6(h) or under other selection procedures. The question I suggest is that a lessee from the federal government, when he acquired his lease with the federal government, acquired a "right" not to have the reserves taxed by the State of Alaska.

Should such a contention be sustained, Alaska, if it enacts one of these measures, would at best have a tax anomaly. The two classes of lessees being not substantially different, effort ought to be made not to adopt a scheme of taxation which has to be inequitably applied.

A roughly comparable dilemma, although not in the same direct legal terms, is presented when the State's right to select lands valuable for oil and gas not under lease or development contract by the United States is considered in the light of the provisions of section 28(b) of the Statehood Act, which amended 30 U.S.C. §191 to provide that 90% of the proceeds of federal oil and gas (and other) leases should be remitted to the State.

Alaska is the beneficiary of a 90% share of rentals, bonuses and royalties of federally leased public domain lands; it does not presently have a materially higher stake in the revenue derived from equivalent operations on the lands it selects. But

the clear and specific exemption of federal interests in the pending bill from an ad valorem reserve tax will result in differential treatment of the companies owning reserves.

The point is not that the State may not extend its tax this far and no further, but rather that the State should consider the policy consequences, and ask whether it wants business operations of its citizens, corporate or individual, taxed in this differential fashion, if other methods are available.

There is at least the potential of legal as well as policy problems in terms of what the Courts in the future may determine the Congress to have intended with respect to the Statehood Act's provision of 90% sharing and the right of state selection of already leased areas.

The interests of Alaska and the rest of the United States in these resources may require adjudication at some time in the future.

I was in the employ of the U. S. Senate as assistant to one of the Statehood Bill's chief sponsors, when the Statehood bill was enacted. I was closely involved with Alaska officials in working out the kinks and eliminating the frictions of implementing the provisions of the Statehood Act on a wide range of issues in the early 1960's. As I recall the problems we faced and the attitudes which prevailed in those days, much of Alaska was regarded as continuing to be peculiarly national, even after statehood. This was particularly true with respect to public land

AGO 529858

wildlife policies. I confess that I do not recall that anyone in those days had the prescience to see how vital the vast oil and gas reserves of the North Slope might become to relieve our country from the stranglehold of a more than 40% dependence on foreign oil under cartelized prices. On the contrary, at about that time the big struggle on oil policy was between the consuming states which wanted access to "cheap" foreign oil, even at the expense of loss of much of our domestic productive capability.

Courts frequently take advantage of the hindsight available to them, and they perhaps would listen to the argument that the allocation of 90% of the proceeds of federal leases and 100% of the proceeds of federal leases taken over by the state should represent the outer limit of what Congress intended should be the division of the benefits of these resources between Alaska and the consuming areas of the country or between Alaska and the federal government.

A test of this proposition might be far off in judicial terms; nevertheless, it ought to be considered by the Alaska legislature in the process of determining whether to pass the reserve value tax measure initially.

It is demonstrable that a tax on reserves in advance of their production adds to the fixed costs of the recovery operation. In more "normal" times we might have dealt with this circumstance purely in terms of the cut-off point of economic feasibility of the particular project. Today, however, we must

AGO 529859

see it more accurately in terms of a further charge upon the energy consumers, in this case the energy consumers of the rest of the United States. Given the high leverage of energy prices as additive to inflationary pressures, the question for the legislature is whether it should pioneer a program for this kind of tax on a nationally vital resource. When the oil finally moves, its cost and price will be augmented to the extent of this tax and the cost of carrying it. The potential of Alaska oil to put pressure on the OPEC cartel will be pro tanto reduced.

Bear in mind that I am not attacking the power or right of Alaska to tax. But taxes in advance of the stream of revenue from which they must be paid are like borrowings, equivalent to the sale of bonds secured by the stream of revenue. In exercising the policy choice to use the "pay-as-we-go" approach of these bills, rather than the "pay-as-you-go" approach of taxing only when the flow of revenue begins, the State is doing two things: It is shifting the cost of the "borrowing" to the lenders; and it is setting a precedent for financing governmental needs in resource-rich areas which if widely emulated would become nationally intolerable.

The first point becomes more clear if we think of how the cost of natural gas developments are treated. To the extent that gas reserves are owned by companies which market their gas under regulation by the FPC or by state regulatory

AGO 529860

commissions or both, a tax on reserves might well be capitalized and added in to the company's rate base, upon which it would be permitted to earn a return in its rates as soon as such treatment was approved. This is a way of transferring the cost from investors or lenders to customers which is being increasingly utilized as the capital funds available in the money markets become scarcer and more expensive.

The company in such situations becomes a conduit between ratepayers in the Lower Forty-Eight and the State Treasury of Alaska. Consumers, already hard-pressed by rising energy costs, could be expected to question such a development, particularly if it showed signs of spreading to other producing states. The objectionable features of such a program would be emphasized: the potential for taxing the same reserves over and over again, the absence of theoretical limit on the amount of the tax burden, the transfer of risk to consumers, and the saddling of costs of government unfairly on this particular nationally-needed resource.

It would be only rank legal speculation to specify the possible legal arguments, but I should perhaps list one. What is the difference between this kind of ad valorem tax and those efforts, notably and universally unsuccessful, of producing states to use their police power to assure a preference to their own citizens of resources physically in their states? Is interstate commerce burdened less by a taxing measure of this kind than it is by a regulatory scheme?

AGO 529861

I have no doubt whatever about this Committee and the Alaska legislature being fully aware of the problems presented by these pending measures, and I am sure this thicket would not even be approached, much less entered, in the absence of extremely pressing circumstances.

It is the purpose of my presentation, in summary, to suggest that you take into account in your deliberations the fact that the whole country is in serious straits for lack of petroleum from domestic sources, and of natural gas generally, and that it would be folly to divide ourselves into producing and consuming blocs on the model of the international scene. In addition, serious thought must be given to internal inequities, as among lessees similarly situated except as to the identity of their lessors or the time of their leases, and to the possibility that the program might be found to be at odds with the revenue-sharing and state selection pattern of the Statehood Act.

The adoption by Alaska of a resource managing pattern similar in all important respects to that of the federal government--bonus leasing, size of royalty, and life-of-field terms --is in the spirit of constructive uniformity. It should not be lightly abandoned.

AGO 529862