

SB

238

COMMITTEE REPORT

3/11/77

SENATE **Finance

5/2/77

Date

Mr. President:

The Committee on Resources has had SB 238
oil & gas properties production tax
under consideration. A majority of the members of the Committee

- recommends it do pass
- recommends it do not pass
- recommends it do pass with attached amendment(s)
- recommends it be replaced with CS for SB 238 and that
CS for SB 238 do ~~pass~~.
- (and) recommends it be referred to the _____
committee
- reports it back without recommendation
- AND attaches a report of its intent
- (other) INDIVIDUAL RECOMMENDATIONS

MEMBERS SIGNING THE MAJORITY REPORT:

<u>Trillion</u>	<u>Do Pass</u>	_____
<u>Harvey H.</u>	<u>No Rec</u>	_____
<u>John D. ...</u>	<u>NO REC</u>	_____
<u>Tom ...</u>	<u>...</u>	_____

MEMBERS NOT CONCURRING IN THE MAJORITY REPORT:

_____ recommends: _____

_____ recommends: _____

_____ recommends: _____

R. Paland
Chairman

AMENDMENT

OFFERED IN THE SENATE:

By: _____

To: _____ SENATE BILL No. 238

HOUSE BILL No. _____

PAGE: 2

LINE: 27-29

Delete everything after the word "equals", and substitute the following:

":

$(1 - [PEL/TP]) \exp ([300 \times WD]/PEL)$

Where: PEL = The production rate at the economic limit;

TP = Total production during the month for which the tax is to be paid;

WD = The total number of well days in the month for which the tax is to be paid; and

Where "exp" indicates that the expression following it is an exponent."

AMENDMENT

OFFERED IN THE SENATE:

By: _____

To: _____ SENATE BILL No. 238

HOUSE BILL No. _____

PAGE: 3

LINE: 1-5

Delete the first sentence

Page 3, Line 7:

Delete everything after the word "during", and substitute the following material:

"the month for which the tax is to be paid,"

EFFECTIVE SEVERANCE TAX RATES IN PERCENT
 FOR PRESENT LAW, HB 144/SB 103, HB 321, AND PROPOSED CHANGE, BY UNITS
 FISCAL YEAR 1978

<u>Field Units</u>	<u>Present Law</u>	<u>HB 144/SB 103</u>	<u>HB 321/SB 238</u>	<u>Proposed</u>
Beaver Creek	8.3	5.6	10.2	5.2
Granite Point				
280001	7.7	5.8	10.5	6.7
280002	7.5	5.1	9.3	4.3
280012	7.0	0	0	0
280022	8.0	6.8	10.9	5.5
McArthur River				
520001	10.5	11.7	14.8	12.7
520002	9.0	7.5	13.3	7.5
520003	8.8	7.4	13.1	9.0
Middle Ground Shoal				
524001	5.6	4.2	7.7	3.9
524002	6.0	5.3	8.7	5.0
524003	5.8	4.9	8.5	5.5
524013	5.6	4.4	8.2	4.8
Swanson River				
772001	10.4	7.7	10.5	4.1
772002	0	0	0	0
Trading Bay				
800001	7.6	5.3	12.0	4.3
800002	7.2	0	0	0
800003	0	0	0	0
800004	8.5	5.7	11.4	2.1
800005	7.1	2.2	3.5	0
PRODUCTION WEIGHTED COOK INLET COMPOSITE	8.9	8.3	12.3	8.7
PRUDHOE BAY	7.7	12.3	9.6*	10.3*

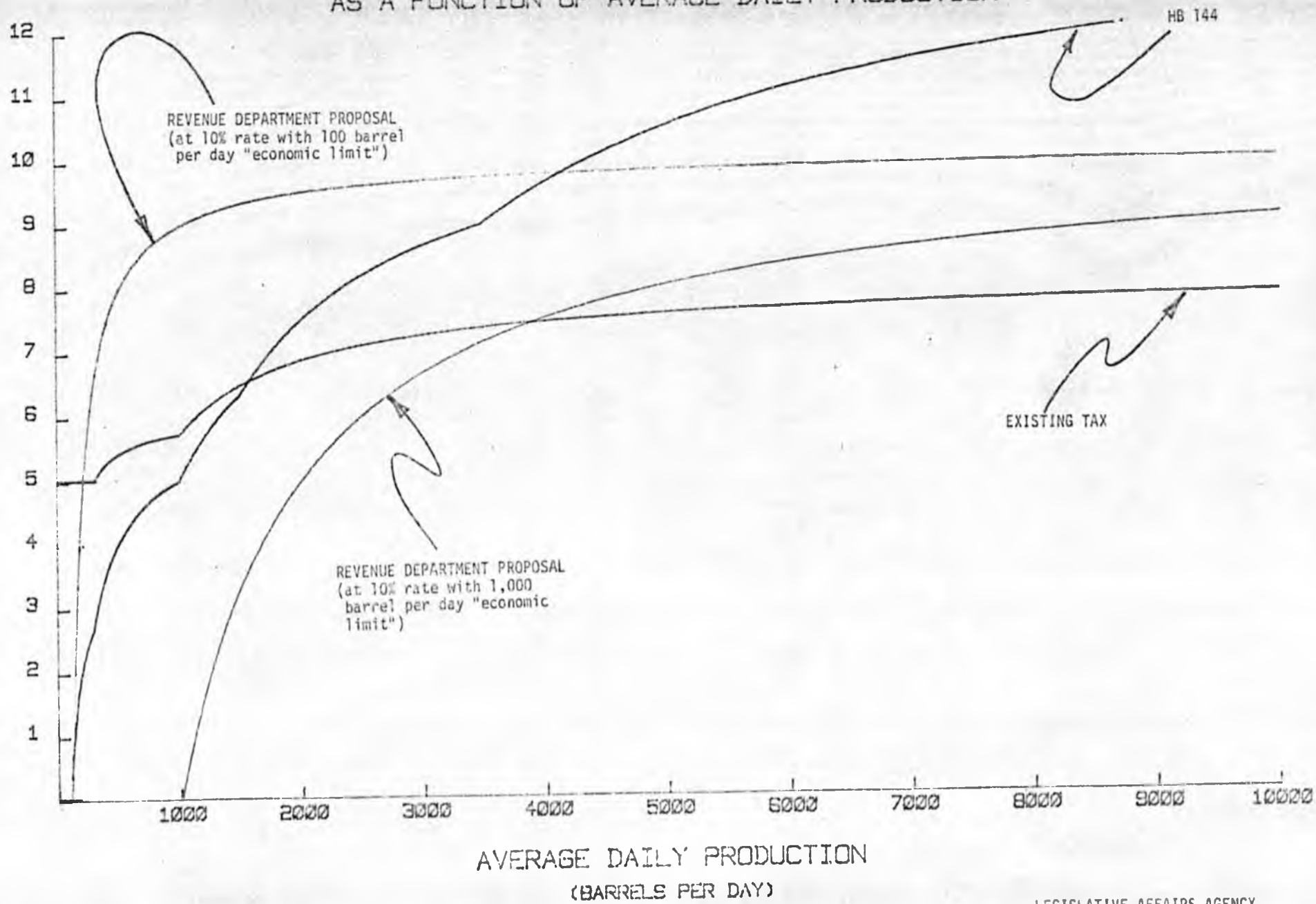
* Assuming an economic limit of 750 bbl/day

Prepared for Senator Poland by:
 Legislative Affairs Agency
 Research Division
 13 April 1977

20.2

EFFECTIVE SEVERANCE TAX RATE AS A FUNCTION OF AVERAGE DAILY PRODUCTION

EFFECTIVE SEVERANCE TAX RATE
(PERCENT)



AVERAGE DAILY PRODUCTION
(BARRELS PER DAY)

FOR $Y=12 \cdot (X-100)/X$: INTEGRAL $F(X)=6X \ln(X) - 6X + 1200$

FOR $Y=10 \cdot (X-1000)/X$: INTEGRAL $F(X)=57566.60$

LEGISLATIVE AFFAIRS AGENCY
RESEARCH DIVISION
15 February 1977

AGO 547811



Alaska State Legislature

POUCH Y, STATE CAPITOL
JUNEAU, ALASKA 99811
907 465-3800

SENATE RESOURCES COMMITTEE

KAY POLAND CHAIRMAN

2/ed.

~~TUESDAY~~, APRIL 13

ROOM 126, CAPITOL

3:00 P.M.

DISCUSSION AND WORK SESSION ON COMPOSITE COMMITTEE SUBSTITUTE FOR

SB 103 - OIL & GAS PROPERTIES PRODUCTION TAX

SB 238 - OIL & GAS PROPERTIES PRODUCTION TAX

SB 306 - CABINS WITHIN STATE PARKS & GAME REFUGES

HB 195 - DRILLING OF DEEP WELLS

HJR 15 - OFFSHORE AREAS, GEOLOGICAL & GEOGRAPHICAL DATA

THE FOLLOWING PAGES WERE TREATED AS
A UNIT IN THE ORIGINAL FILE.

RICHARD KILGORE - Okay, I would then like to turn to the severance tax. As I said in my general remarks, if you're interested in raising the severance tax, both of these bills that we're going to consider seem to in general follow our guidelines, and has to do with more the specifics of how each one of them works. We'll start with HB 144, SB 103. This bill does several things. One is it moves to lease averaging rather than wells in the calculation, and we think that makes an awful lot of sense from the administrative standpoint, and probably should be done even if you don't raise the severance tax, probably even amending your present severance tax would do that, and would make sense. Page 1, line 11 of the bill moves the point of tax from the wellhead to a new point of production which is later defined.

SENATOR HUBER - How is this defined?

RICHARD KILGORE - It's defined back on Page 4, line 9, gross value at the point of production means for oil, the value of the oil at the point where it is metered or measured in a condition of pipeline quality on the premises of the lease or property from which it is recovered. So in some cases it would change the point of taxation from the wellhead to somewhere beyond up to a point where it was meter measured and made put in pipeline conditions, so it clearly, and this is pointed out by someone else, moves the point of taxation

and in a sense in certain situations it would tend to tax the transportation and upgrading of the crude oil. That's clearly the case.

SENATOR HUBER - I think it had another reason for being in there. I think it was on account of that Kenai deal to where if they transferred our royalty share portion that went into resale that they were subject to the APUC, and doing it this way, while they pushed their royalty share through our line, they were not subject to our APUC. There was quite a problem on that in Kenai, it happens to be in gas, but we're talking jointly here and I think this was done for the company's benefit.

RICHARD KILGORE - Well, I think also in Cook Inlet, as I understand it, there have been continuing disputes about questions of wellhead and where one taxes, and I think this is all intended to straighten this matter out by legislation. This is where it is, and we don't have to argue about backing out transportation or whatever, this is what they're talking about. This makes administration of it easier, clearly, I think that some of the testimony yesterday it was complained that there would be a cost to the companies in a sense that they wouldn't be taxed on transporting and upgrading. I think that if it's administratively easier and there is a cost, perhaps what you should do here is get a better idea of what you're really talking about in terms of cost and dollars and

cents. What is really the extra costs that companies would bear by doing this, or some idea. I think that's how you would have to assess that. Now lets look at the tax rates in this bill. I think you are all familiar with the fact that it adds higher well brackets and puts in these higher brackets at higher tax rates than exist in the present legislation, and it also lowers the tax rates, both the cents per barrel tax and the percentage tax for lower productivity wells. Now, just to give you a rough idea of what this does, and I'd like to just give you some numbers on how it would seem to us to effect, say, Prudhoe Bay, and then look at the Cook Inlet situation under this bill. All the numbers I'm going to use are ease of comperability for 27 gravity crude oil. Now, in Prudhoe Bay, and I'm assuming for purposes of this calculation that the wellhead value on Prudhoe Bay is say \$7.50 per barrel just as illustriative. Under the present tax for a 5,000 barrel a day well in Prudhoe Bay, and these figures are cents per barrel of gross production not of taxable production, but you still get an idea of the relative increase in the tax. The present tax for 5,000 barrel a day well at \$7.50 is 49 and 1/2 cents per barrel of gross production. This tax for the same well, a 5,000 barrel a day well would raise the tax to 68.9 cents. That's about a 37% increase in taxation of a 5,000 barrel a day well in Prudhoe Bay. If you went to a 10,000 barrel a day well, the percentage increase and the tax is greater. As against

about 51 cents at the present time, this tax would raise it to about 80 cents, so on a very productive 10,000 barrel a day well at Prudhoe Bay, the increase there would be about 58%, increased through this tax over what you have today. The effective rate on gross barrels produced would go from about 7.8% on a 10,000 barrel a day well to about 12.2% under the new tax, so this is what it does to Prudhoe Bay, very significant increases. And the percentage as I gave you were really the effective rate on taxable barrels going from 7.8 to 12.2. So you are ending up on the very productive well, you end up with an average effective rate on taxable barrels of just under 12 and 1/2 percent in Louisiana. I think that's what was intended. So that's the impact it has on Cook Inlet, I mean on Prudhoe Bay. Now, let's look at Cook Inlet, and particularly the old oil because we've always been worried about effective taxation of old oil. Now, this bill does retain the cents per barrel feature that exists in the present bill, and it retains the cents per barrel feature with basically the same floor price as you have today. It works out for 27 gravity crude to about \$6.10 today. So it retains that, but what it does at the same time is that it does lower the rates of taxation both percentage and the cents per barrel taxes in the lower well brackets, so despite the cents per barrel feature still being in there, it does lower taxes on low productivity wells below what they are today. I'll again give you some examples, and they'll

again be on the same basis as before. 27 gravity crude, and these are figures on a gross barrel basis. At the present time a 100 barrel a day well in Cook Inlet would be on the cents per barrel tax and it would pay 26.6 cents per barrel. This bill on a 100 barrel a day well would eliminate the tax. It would go to zero, and a very substantial gain for a 100 barrel per day well. For a 300 barrel a day well, would also pay under the present tax, 26.6 cents. Under this bill, under our calculations, it would drop that 26.6 to 14.2 cents per barrel. So you have about a 12 and 1/2 cent reduction for a 300 barrel a day well, and if you move up to a 500 barrel a day well, you still get a reduction. Under the present tax it would be 28.7 cents. Under SB 103 it would be 21.2. So even for a 500 barrel per day well, you're going down by about 7 and 1/2 cents per barrel, and in fact this new tax as compared with the present lowers the tax up to somewhere wells in the range of 1,000 to 2,000 barrels a day. Somewhere in that range, the new tax gets higher than the old tax, so it does provide very significant relief for low productivity wells.

SENATOR HUBER - Madam Chairman - the figures which we have in the committee they are open to him now, I think, I just wonder when he finishes there. If you have any dispute with those, I think that they confirmed his testimony.

RICHARD KILGORE - Yes Senator, we did do our own homework on this obviously, and we have had a chance to look at what legislative affairs has, and they coincide with what I'm testifying here.

SENATOR HUBER - I was wondering. It would help us a lot to know that they do or don't or if there are differences.

RICHARD KILGORE - No they don't they calculate the same way we do.

Now, so this bill does, I think, meet our objections really to the present taxation of old oil at Cook Inlet which has the high effective rates because of the cents per barrel feature. At least its present operation would reduce the tax substantially for low productivity wells, and we think that's a good feature of this bill. I should point out though, this bill does retain cents per barrel and it does retain escalation of that cents per barrel, so it is possible that under this bill we would again be back in the same problem that we have today. If the escalation manages to raise the cents per barrel tax high enough, we could be back in this problem again of taxing old oil in Cook Inlet at high prices, it's possible. The potential is still in this bill.

SENATOR HUBER - This evades it from present time, and we might have to look at it again in future years if we don't do something with cents per barrel.

RICHARD KILGORE - Yes, it may be back again.

SENATOR HUBER - Well, I'd sure look at it again, Madam Chairman, than I would to have Tom Fink for Governor.

RICHARD KILGORE - I think I was on record the first time I testified as saying that if you do retain a cents per barrel that perhaps what you do is at least consider no further escalation in cents per barrel, and perhaps that could be in this bill too. I don't know. I want to only point out that it could happen again. So that's basically what this tax does. It raises fairly significantly, the tax in Fudhoe Bay, but it does lower the tax considerably on low productivity old oil priced wells in Cook Inlet. It also has a severance tax for gas that is flaired, and a very substantial one, five times the rate. I think before you do this kind of thing and add such a tax, you ought to look very carefully at where gas is being flaired and why. There has been testimony yesterday about safety flairs and so on. I think you ought to look very carefully at what it is that you would be taxing and why the flairing is going on at the present time. Now, if what you're really trying to do is tell companies to find a use for this flaired

gas and find markets for it, I think that at the very least if there is gas being flaired now which you think you could find markets for, therefore you're going to try to compel people through this tax, somebody used the word incentive the other day, but you're compelling them through this tax that at least you ought to provide somebody with a grace period before they would pay this tax. That is, you wouldn't start right away. You would make it clear to them that they had certain time within which to find markets for this. You wouldn't penalize them in the meantime, but if you don't find gas for which it's logical to find markets, that you would say at some point in the future you're going to start paying a tax on this, so you had better get busy and look for markets. I don't think I.....

SENATOR HUBER - I think, Madam Chairman, that we should make sure in there. I think we should find out the required safety flair of no more than a certain amount except during an emergency blowout or something like that. The idea was, as long as it's economically unfeasible to take small amounts of gas and reinject them, the State loses its royalty share on it, and the nation loses the energy strictly because at a given space in time, using if you will excuse me, a cash discounting flow and everything else, that we determine its value and we say it's nothing, and what's nothing is moving down the pike another twenty or thirty years may be all we have, and Prudhoe Bay, in spite of an absolute no

flair restriction has been allowed to flair and everybody knows it. Somehow or other, it does have to be stopped, and if you make it so it isn't economically feasible to flair, then it becomes economically feasible to build a small compressor system for saving.

GEORGE SILIDES - Madam Chairman, I know that the flairing _____ as Huber pointed out, _____ that the flairing of course, and the word allowed is important, they get permission from the State, and we have to do something about the bill, that we don't have competition between the taxing department and the Department of Oil and Gas Conservation. They are the ones that give the permission, and you have to apply and you have to point out that it's being done with safety and so on. I don't think that the bill intended to penalize somebody for entering into a safety feature, and so am I correct Mr. Kilgore?

RICHARD KILGORE - I would assume that that's the intent. You'r not really interested in taxing gas.....

SENATOR HUBER - But that board still has the power and makes the exemptions and has been constantly making the exemptions, and it's a matter of record, both at Prudhoe Bay and elsewhere, they make the exemptions, they're legally made, but the product is gone, the resource is gone, it is flaired, and so at least putting in a fairly stiff recovery there, does at

least give us something off of our severance tax that went up in flair too.

GEORGE SILIDES - Madam Chairman, I might make another comment. I think that in view of the comments being made, we're going to have to look into the legality of being able to tax a safety feature.

SENATOR HUBER - No, we don't tax the safety feature. Let's not get crossways on that. We should put an exemption in here for the safety flair only, and somewhere we need to come up with a figure of what is the amount that may be flaired to date per well or per safety flair. We definitely shouldn't tax them on what is a safety requirement. But there isn't a provision. The gas that's being burned in significant, is not being burned in so called legal actual safety flairs. It's being flaired otherwise by legal permits by the board.

CHAIRMAN POLAND - I think we have to check with the Board as to why they are giving the tax.

SENATOR HUBER - That's why the Governor's bills has it in it. That's why committee's bills has had this for two years, and we should certainly, like Dick says, make sure that we don't tax the necessary safety flairs. I asked yesterday what

was, and they said a million cubic feet. That's a thousand MCF's a day. I'm not sure that that isn't considerably over what's needed to burn there in case, I need a good definition of a safety flair.

RICHARD KILGORE - I think also you might consider if you really feel the gas is being flaired that you don't want to be flaired other than as safety purposes or whatever, that's something you might consider as an alternative just tightening up your regulatory bill and your regulations rather than do it through a taxing approach.

SENATOR HUBER - We've done everything but tar and feather the board.

REPRESENTATIVE OSTERBACK - Madam Chairman, could anybody tell us how much gas they will be flairing at Prudhoe Bay? Anything that burns is energy. We're talking about we're running short of energy. Somebody talked about the railroad. If they took it in there, they could take out about a hundred tanks of gas a day, and they didn't think it would be enough to pack that out with flairing, and that would be an awful lot of energy, but most of us don't really know what this gas is with the flairing, but I know anything that burns is energy, and we're talking we're running out of energy. So I think there should be something done about it. Anything

that you can save as energy, you can sell. There's no problem in that.

RICHARD KILGORE - Well, I agree with you, if what we're really talking about is waste, then I think we should eliminate that. It is energy, and you're absolutely right, and I think you should look very carefully at what's going to happen at Prudhoe Bay, and how your regulatory people will handle it.

SENATOR HUBER - Might we, Madam Chairman, Al brought it up and it's very important. I think that it's understood that they have stopped flaring or are to stop flaring. It was only for that refinery that they flaired at Prudhoe Bay, and they didn't pump it back down the gas well even though they were drawing gas out to run the refinery because it would have cost more money than the gas was worth, so naturally the gas was worth nothing, so it wouldn't cost money to pump it back down into the ground. If it had a value of 20 cents an MCF, it would have been a lot cheaper to pump it back down into the ground, but just so that the record is straight, we aren't really looking for flaring at Prudhoe Bay, but if you will take a look at the Valdez terminal, you will find that we don't flair no more, but we've got three huge oxidizers there, and there's going to be a tremendous amount of energy unless the LPG's that are in that gas and the vapors that are in the gas at Valdez,

unless there's a plant built to recover those and use them which is not in the plan, it is going to effectively flair trillions of BTU's before Valdez is over with. That's because the plant and the tanks will not stand the pressure in the storage.

GEORGE SILIDES - Madam Chairman, I think the point is well made that something's got to be done about defining what is meant by safety gas, what is being wasted, and I think also that the bill had intended to address the bottom of the possible wasting of carbon dioxide. There was a considerable amount in this particular natural gas, and I suppose what we're getting to is that we have to do something about those things, either by definition or by amending the bill. I think this is a point that we're going to have to look into. I don't think we're going to get it solved right here.

SENATOR HUBER - I think they're willing, George, not to flair the carbon dioxide, but I'm not sure if they will get rid of it.

GEORGE SILIDES - It doesn't burn anyway, Senator.

CHAIRMAN POLAND - We'll be checking on this flaring part.

SENATOR HUBER - Well, it's important on both ends. I think that the bill needs to not penalize them, but by all means

should be retained in the bill, and we may of course have to put it in in some other places. I don't think this is going to effect it when it comes to the flairs in Valdez.

RICHARD KILGORE - I'd like to move on the the second severance tax bill, and that's HB 321, SB 233. Now, basically this tax changes the tax rate to 10%, but it also has a cents per barrel feature of 75 cents per barrel, so it has an effective floor price of \$7.50, and it also has what _____ for an economic limit factor built into it, and I think Mr. Wilson yesterday did quite a good job explaining how the mechanics of this worked, and he also provided an example for you that I think was probably quite useful. Basically what the bill does is give you the first hundred barrels a day as an allowance for operating costs is what it amounts to, and wells producing more than 100 barrels a day, they pay then an increasing fraction of the 10% for the 75 cent tax is the way it works, and it's a continually increasing thing as well productivity moves above average well productivity moves above 100 barrels a day. Very roughly, a 100 barrel a day well would pay no tax under this bill. A 200 barrel a day well would pay about 43% of the tax. It isn't 50% because as you might think by taking 100 to 200 because it's taxable barrels only that count. That is the 200 barrel a day doesn't produce 200 barrels that are entirely income to the company. Twelve and a half percent of those go to the State.

GEORGE SILIDES - Mr. Kilgore, it's 43%.

RICHARD KILGORE - It's 43%, 200 is 43% of either 10% of value or 75 cents a barrel depending on which it is.

GEORGE SILIDES - That's what I wanted you to say.

RICHARD KILGORE - For a 300 barrel a day well it would be 62% of these basic rates and on a 4,000 barrel a day well, it would be up to 89% of this. This is the way it works, and it amounts to a continuous function as against the step schedule that you have in your present legislation. As I said, it amounts to a continuous function and in principal we find it as kind of an appealing concept as against the step schedule. Now the other feature of it is that one can't apply for an economic limit factor greater than 100 barrels per day well average if you can prove it, and what you basically have to prove is that your operating costs that you require, out of pocket operating costs are greater than what you would get with 100 barrels of production per well. You would need more than this to recover your operating costs. Now, there appear to us to be a couple problems with how this actually works. First of all on Page 3 Line.....

SENATOR HUBER - Madam Chairman, I would note that we've got John Messenger here, too. This is the same problem that came

up yesterday in talking with the industries. We might want John to answer some of these.

RICHARD KILGORE - It has to do first of all with how costs are defined, and that starts on Page 3, Line 16, subsection C here, and as was pointed out in testimony yesterday, it is not clear that the cost category specifically allowed here really provide for all the kind of out of pocket expenses that a producer might have, and basically that's the concept that you're trying to get at, whatever is out of pocket expenses, and it's not clear to us that that is the case and some questions were raised yesterday and I think you ought to consider those too, but what I think is more important is that after calculating the costs here, you then have to determine how many barrels are necessary to recover, that is if more than the hundred that you are allowed anyway. Now the problem with it is that the way that the bill was written, you don't take your costs and divide through by the price of oil that you as a producer receive. That is your actual price, if you're an old oil producer and getting \$5.00 per barrel, you don't divide through by \$5.00 to see how many barrels you need to recover your costs, but you use another deemed price to do this, and the deemed price is acquisition, this is Page 3, Line 29, its acquisition costs CIF at westcoast refineries for imported oil of like quality and then you net this back to Alaska, so you're not doing it on the price you actually

receive, you're doing it on a deemed price that you may not be receiving, and it seems to us this causes problems.

SENATOR HUBER - Could we at this point if it's convenient, I wonder, Sterling isn't here, but John is and this was the question yesterday, I understood from the testimony by the State that as of starting in December or sometime like that that these wells that were in economic trouble shall we say, that these figures that you have put in here talking about _____ price are actually what's happened. They are now being allowed, these higher prices on the producer's share, but not upon the State's royalty share. The argument yesterday, and I think we're right into it again today, is whether we're just talking about a possible deemed price working it back from San Francisco or whether we're truly talking about what they're going to get, and the industry said no this was unfair that wasn't what they were going to get, so we're right at the nitty gritty, and I think you can help us John.

RICHARD KILGORE - Perhaps, Senator, I'm going to give an example, maybe I ought to do this and then we can talk about it.

SENATOR HUBER - Okay, just so that John, he wasn't here yesterday, so he's alerted. My stand was or what I saw was that you fellows put this in here because that's actually

what the oil companies are getting, and so you were getting right to the nitty gritty, and they said no this is what they might give them, but I understood Sterling to say that this had actually started in December, and I don't think this was in testimony, I believe this was talking in the afterwards that it actually had started in December and the State had been denied that increase, but the producer's share had been allowed, so if that predicates it and as he goes on if you can straighten this out, it will help me a lot.

RICHARD KILGORE - I'd like to just give a little example of what we're talking about here. If we had an operating cost for a well or wells whatever the unit or something, and say \$2,800 a day, and these were direct operating expenses defined properly however, and if you didn't get these revenue enough to do this, you would shut down. Now, if one looked at the foreign price and then netted back to Alaska, let's say you came up with \$14 just to make the arithmetic easy, you came up with \$14. Now in calculating your economic limit factor here, you would divide through by that, and that would give you \$2,800 divided by \$14 is 200 barrels a day. You're economic limit you could then justify is 200, rather than the 100 which you had presumed. That means you're getting more, but let's say that the producer only gets \$5 a barrel for oil because he's receiving the old oil price in Cook Inlet. He doesn't get \$14, he gets \$5. Well for him to actually recover the

\$2,800 his total expenses at \$5 he's actually receiving for his oil, his real economic limit factor is \$2,800 divided by \$5 or 560 barrels, so that in fact, his limit factor, that is the number of barrels he needs before he's got to shut down, because he doesn't make it out of pocket cost of 560 under this bill it appears to me, he would only get 200. I don't think it really gives you the results that you intend. The result that you intend is to provide relief for marginal wells. It doesn't appear to really serve the intended purpose.

SENATOR HUBER - That's at \$5.61?

RICHARD KILGORE - That's at \$5.00 even.

SENATOR HUBER - But doesn't this other deal work to raise that?

RICHARD KILGORE - Well, the other thing we're talking about is price relief under FEA regulations. I think that's really something different here. I'm addressing.....

SENATOR HUBER - That's not five dollar oil. You know, if we're talking about his economical limit on the well then we assume it to be \$5 00 oil, but he is actually receiving \$10.95 for it because it's below a certain economic limit

already established, then we're dealing with something that doesn't exist, and that's what I'm trying to get into this, and I thought that that was why the State had drafted it.

RICHARD KILGORE - Because it assumes that the Federal government will always bail out people, is what you're saying, other than royalty owners.

SENATOR HUBER - My information was, it didn't only assume, it was based on what was happening. Can you clarify that John?

JOHN MESSENGER - Let me just make a couple comments. I guess it's true that one position that we've taken on this bill that our taxes should not be based on the artificial price set by the Federal government, and the Federal government set a price of \$5.00. Our position is that we shouldn't be content with the tax based on that artificial price, and that's why, one, we've set the cents per barrel floor, likewise when you're figuring the economic limit factor, again, we say the true economic limit is not how many barrel are produced at the artificial price, but the amount of barrels they would produce using the true value of that oil, pre-market oil. We should insure ourselves that so many cents to so many percent of that pre-market oil because that is our resource and we should get at least that percent out of it. Secondly, is that producers are

reaching their break even point which they will stop producing. There is a procedure by which they can make application to the FEA and get price relief and with that higher price they can produce longer, but the FEA has said that they will give price relief only to the producers, and not to royalty owners, so if a company is reaching its economic limit in Cook Inlet, and they go in for price relief, they are given that price relief. They will raise their price, but they will not raise that price in the terms of the amount of royalties which _____.

So, it's two things, one is the tax rate and the economic limit factor should be based upon the true value of the oil, and secondly that producers are protected through FEA regulations, but the State is not.

SENATOR HUBER - Then I guess what he's saying is that if someone's going to shut down the production there, by it being below economic limit on \$5.00 oil, the State is advocating that we put the monkey on the fed's back and say you did it, you set an artificial price, we're going to set our tax based on free market price, and if you want to save that resource, save that company, you can turn around and do likewise what's reasonable. I'd say it's what I call putting the monkey on the Fed's back. They caused the problem. I happen to be strongly in agreement with the State's stand on that, and compliment them for it because why should we throw away our royalty share and our

taxing ability because somebody forced an artificial price down our throat, and is forcing that same artificial price down the throat of the oil companies.

RICHARD KILGORE - Look, I'm going to address myself to the question of the artificial price, that's part of what I'm doing here, and I think the Commissioner took issue with earlier testimony I made when I said I thought this was a flaw in the thing, and it certainly was, I thought, a flaw in terms of its purpose of providing relief, and now I do understand why they do this which is another objective, than what appeared to be the intent of the bill and I'm going to come back to the whole question of the artificial price. It's very clear they did this by design. I'd like to again, as you asked, talk about just very roughly what it does to Prudhoe Bay and then to Cook Inlet, and then discuss the consequences of that. Again, for Prudhoe Bay, looking at 5,000 and 10,000 barrel a day wells at Prudhoe Bay, this bill also raises taxes significantly on those wells as does the other bill, as does HB 321 that we looked at before, excuse me HB 144, that we looked at before, but it does not raise them as sharply as the other tax. If we take a 5,000 barrel a day well, I said that, and I'm not going to run through all the numbers here, I think but that the other tax for a 5,000 barrel a day well raised the tax about 39% on a 5,000 barrel a day well. This tax would raise it about 29% it appears to us using the presumed hundred

barrel figure. The discrepancy between the two gets larger at very productive wells because of the steep rates near the end of the schedule in the other bill, and for a 10,000 barrel a day well, HB 144 raised it 58%, this would raise it about 27% on the very productive wells, so if it both increased taxes on Prudhoe Bay, clearly the one, HB 144 would increase them significantly.

SENATOR HUBER - That would be effective of what of 5 and 10.

RICHARD KILGORE - Okay, the effective rate would be very close to, on taxable barrels it would be very close to 10%. On 5,000, it would be 9.8% and 9.9% on the 10,000. It approaches 10%.

SENATOR HUBER - Just slightly under ten percent for a total maximum. Or fully 2 and 1/2 percent, a little over 2 and 1/2 percent below Louisiana. Using the Administration's bill.

RICHARD KILGORE - That's correct.

SENATOR HUBER - And it would be right at Louisiana with the other bill.

RICHARD KILGORE - Close to it. That's correct.

Now, let's look at what happens to the Cook Inlet old oil price here. This bill as the other one for a 100 barrel a day well eliminates the tax altogether. It does exactly the same thing, but what we find troublesome is that is you go to 300 barrel a day wells, these are the wells that we're concerned with because of their productivity and the old oil price they have to bare, they get the tax there doesn't go down, but it increases. It goes up from 26.6 cents on gross barrels to 40.6 cents. It goes up by 14 cents a barrel. This tax raises it that much. On a 500 barrel a day well, it raises it by about 13 and 1/2 cents, and on a 1,000 barrel a day well. I'm sorry 14 cents increase on a 300 barrel a day well, 22 cents on a five hundred barrel a day well, and 28 cents on a 1,000 barrel a day well. What I think are particularly disturbing are the increases on the lower productivity wells. A well as low as 300 barrels a day which we already have some concern for because of the effective rate on the old oil thing has actually a fairly substantial increase in its tax burden. As Commissioner Gallagher stated correctly, you get this result because of raising the floor price essentially. You are raising the floor price from \$6.10 to \$7.50 and you have higher tax rates at the same time, and it's deliberately designed to do this. Now, we really feel that this kind of goes against what we feel are good principals of severance taxation. What you're saying is the producer in Cook Inlet he received a relatively low old oil price established by

the Federal government. This in turn restricts his own profitability, but then the State adds to his burden by taxing him as if he received \$7.50, and it seems to us that rather than help his producing situation, this only makes the situation worse. One of the reasons given for doing this is that the Federal government is following an unwise, or I think it was described as a foolish price policy. Now, this may or may not be the case. I'm not willing to pass a judgement on that, but they're, you should know that the Federal government does have reasons for doing this. It's not capricious, they do have reasons. They have concern over the effect. What they're concerned with is this, we've had a fantastic increase in the oil prices outside the United States by the OPEC nations and if one frees the oil, the old oil price, it will go up very, very sharply. It will, perhaps in some cases, close to triple in price, and the people are concerned about the consequences of this. Rightly or wrongly, they are concerned about the inflationary impact on consumers. They're concerned about when _____ producers, because these are on old oil wells, wells production which is established at old costs and so on and therefore you have to question whether you want to give them huge increases in the price and windfalls. There is concern over that. So there are reasons, and you can argue one way or another, but there are reasons for this.

SENATOR HUBER - Would it be fair to say that those reasons are exactly on a par with the same reasons for having controlled gas prices as would be in inter-state commerce as well as setting a free-market price. It's the same principal in both cases.

RICHARD KILGORE - As deregulation of natural gas prices. Yes.

SENATOR HUBER - Deregulation of natural gas. Deregulation of petroleum would do the same thing, it would increase the price at the burner or the price at the gas tank as it comes in out of the nozzle, but all of the other factors of pro and con are the same.

RICHARD KILGORE - Yes, that's right, and the concern is that if you let it go up to, and I really object to the word free-market price because we're not talking about free-market price, what we're talking about is it goes to a price administered by OPEC. That's what we're talking about going from price administered by the Federal government to a price administered by OPEC. This is by no means a free-market price. It's a market price, but one set by OPEC, and set by political reasons as much as for economic reasons.

SENATOR HUBER - Some of us are referring to free-market price though as to this free-market price that exists that we talk

about what the price would be if OPEC were not controlling it. Some of us are talking about a true free-market price

RICHARD KILGORE - Senator, I don't know what the price would be if OPEC were not controlling it.

SENATOR HUBER - We don't know. We have projections just like we do on what Prudhoe Bay is going to cost.

RICHARD KILGORE - One the one hand, if OPEC did not exist one would certainly expect over time that the price would rise at some point in time to the level of alternative energy sources which are quite high in the \$20 - \$25 range. On the other hand, in the short run, you do have an overhang of surplus productive capacity in the world, and if there were no OPEC, and it were perfectly free market, there's no reason why the price couldn't drop to less than \$1.00 per barrel, because that's what costs are in their surplus capacity. If there were truly competitive free market, one would have \$1.00 a barrel oil or less because that's what the costs are in the middle east, less than that so but as time went on, and this surplus which overhangs the market now, and which would push it down, gets eaten up and it will, one would then have prices moving off in the other direction. I don't know what the price would be. But anyway, we're talking about not letting the price, the U.S.

government as a matter of policy, not letting it go to a price set outside its own borders by an organization of petroleum exporting companies, and that's what we're talking about. It's the intent apparently of the Congress not to do this because basically the idea is concerned with price impacts, concerned with windfalls, and also that there's no way of assuring that the price that would be set by OPEC is an appropriate price for our internal markets for our own costs and so forth. There's no way of knowing whether they will set a price appropriate to our cost circumstances in the United States or a price that may be very much higher than people think it is now or maybe even a price lower. Not good enough for development of our domestic resources. So this is a matter of national policy and people can quarrel.

SENATOR HUBER - Feable minded or otherwise.....

RICHARD KILGORE - Well, I don't want to characterize it. I'm trying to give you a few of the reasons for doing this, and this is a matter of federal policy. Now, but even if it is a foolish policy, or at least if Alaska views it as one, or the people who did this legislation think it is, I think that you have to ask, if that is the case, still, why do you want to then punish producers for this price policy basically. They already suffer enough from it in terms of the revenues they receive, why do you want to go an

added step and raise their taxes because of this. I don't think it's reasonable to assume that if you do this you will force national policy to change by what you do in the way of taxation here in Alaska. That seems to be reasonable.

GEORGE SILIDES - Madam Chairman, may I ask a question?

In addition to your comment of being unable to force national policy, would you think that this kind of tax is counter-productive?

RICHARD KILGORE - I suppose it's possible, I don't really know the answer to that, but I suppose there are reasons that might want to lead one to that result, and if the FEA has procedures for relief of these kinds of situations, then it sees the State of Alaska in fact imposing higher and higher taxes on such low productivity wells. I don't know. It's not inconceivable that it would enter into their thinking in this matter. Rather than providing relief, it seems that the State of Alaska goes in the other direction in this situation.

SENATOR HUBER - George brought something up here. Isn't this the fact that it effects these 300 barrel wells just because of the total tax maximum that we pay and then how we apply the mechanics of the formula. They could for instance, modify, and the mathematics of it I would have

to find out from somebody else how, so that that point would hit, maybe, more on a five or six hundred barrel a day well and maybe give as much as 10.3% or 10.4% out of Prudhoe Bay instead of an even 10%, and the formula diddled with enough to change that point to where it would be correct. Couldn't that be done?

RICHARD KILGORE - Yes it could be. If you like the basic approach of the continuous formula

SENATOR HUBER - Apparently you do, and I do too, and we might consider, and George's question pointed up that we might consider something from being John Messenger is here, that they might give us an alternative is that reasonable Madam Chairman?

CHAIRMAN POLAND - Well yes, except today we have Mr. Kilgore with us. He's leaving on a plane and we want to take advantage of this. We can bring this up.

SENATOR HUBER - I have considered this, Madam Chairman, to be a work session with him, and it's more valuable to me, the way we've been conducting it here today, than anything that we've had.

CHAIRMAN POLAND - Well fine. Let's give him a chance to get with it.

RICHARD KILGORE - Okay, we really are concerned with how this aspect works. There are two parts where Alaska is attempting to impose its own view of what the proper price policy should be, that is if they want the OPEC price. It comes on the floor, and it also comes as I said before in this calculation of the economic limit factor again. It enters in two places, and we have serious questions about this and what you really want to do. If the basic intent of the legislation is to provide relief that you don't go off in the other direction simply because you're unhappy with the prices because this throws all the burden on the producer, and then you're going exactly against what you really want to do, and you could have economic consequences to this.

I understand your concern with the prices that you get for your oil, and you'd rather get higher prices than lower prices, and that's fine, but the question is if the price is not set at a level that you think is appropriate then what do you do about it, and I guess, it's just bothersome to us that what you do about it is throw a burden back on a producer here. That's what you're doing about it, and that then goes against what we feel is an appropriate kind of severance tax because then you run into all the kind of economic problems with this gross tax and that's our concern, and we appreciate why you think in terms of floors and why you want to get an adequate value for your oil, and so forth,

and we understand why you do it, it's the consequences.

This tax also raises the tax on natural gas. If you'll recall our testimony before, we were always pointing out to you that if you did this you would have an impact on Alaskan consumers, that would flow through to Alaskan consumers. I noticed that there is another bill which is HB 329, SB 239 which is a residential fuel credit, and I presume that the intent of this is to mitigate to some extent the impact that raising the gas tax would have on Alaska. Consumers - we're not really in a position to know how adequately it does this because this has to do with what fuel bills really are in Anchorage and so on. We really don't have the information to calculate how adequately that does that, but obviously, you are concerned with that aspect to it, and the balance of the increase of course would be assessed against exports. I think that the other thing I should point out is that here you have in this not only an increase in the tax rate from 4% to 10%, but also introduce a floor price here, that is a minimum 6.4% per MCF, which is an effective floor price of 64 cents per MCF, and I think we have the same reservations here about this as you do on the oil side. If you have oil flowing, producers getting less than 64 cents, someone mentioned 42 cents the other day, but less than 64 cents, then you start to raise the effective rate of it, and I think we have the same problems with it here as we would anywhere else, and this

also has a gas flaired feature taxation, but it's only double, not five times, and all my comments on that go for this too.

SENATOR HUBER - That is in the equalization deal?

RICHARD KILGORE - No, it's in the severance tax, itself. There's a provision.

In the end, I'd like to talk a little bit about this whole question of the overall tax burden and how you assess it, the kind of questions that Senator Rader has been talking about, but I would first just like to make a few comments on the property tax bill, unless there are some other questions here on the severance tax.

CHAIRMAN POLAND - No. I was going to suggest that when you are finished on the bill, and before you kind of wrap up, that we take a five minute break.

RICHARD KILGORE - Okay, shall I just say a few things about the property tax. I have relatively limited comments here. HB 323, SB 237, now, this extends the property tax to some other areas as you know to refineries, gas plants, and also to marine transportation, and L. & G. Liquefaction facilities, and so forth. So it extends the kinds of things that you would tax with your property tax. Now, the only real comments

that we have here are that for each of these areas that you're thinking of proposing a property tax on, you think carefully about where that tax will actually be borne. You're talking about taxing properties for crude oil production that largely obviously is borne by producers. They realize prices in the lower '48 that are set for them, and the tax you impose is a tax which they have to bare in terms of their own profitability, but that's not necessarily the case with each of these other areas that you are extending, and what I think you ought to think about what you are doing, because if you're looking at property taxes on refining in Alaska, we would expect that most of the refining capacity in Alaska for some time to come would be basically capacity oriented to supplying low markets so that the tax that you impose on those refineries presumably would over the long run be borne by Alaskan consumers. You're assessing a tax which goes to the treasury, but eventually that tax would have to be borne by consumers if the refineries are to operate properly. So you have to worry about the incidence of the tax. If you're looking at L & G facilities you have to worry again about the consequences of this and what will happen, and who will actually bare this. Will it be a cost that will simply be passed along because the facilities under an FPC jurisdiction will be passed along as probably may be the case. It's not clear that if it's L & G or export to foreign countries whether this would be the case. Who would bare it, it's not entirely clear.

GEORGE SILIDES - Would it not also have an effect on a decision as to whether to locate in Alaska.

RICHARD KILGORE - Yes, it could under certain circumstances. If it's a cost which basically the person thinking of putting in the facility has to bare himself because he hasn't got an automatic pass along or he can't pass along to Alaskan consumers, or he can't through his regulatory process, pass it along, then surely, it would be one of those tax entering into his decision as to whether to locate in Alaska. Noone can say whether this is the thing that would swing it in the balance, but obviously, it's part of the package of doing business, if it's a higher cost, it could have some effect, yes.

The last one is marine transportation, and there, well there's a question of legality, I guess, but we can't address ourselves to those, but it seems to me you might have some concern about this one too, because you already face a problem where you are concerned with the fact that your oil may have to move to quite distant markets, for example the U. S. gulf and the eastcoast, and you're very much rightly concerned about that long haul and those high transportation costs and what it may do to your wellhead value, and if you go this route of taxing marine transportation, you obviously add to the cost of transportation, I don't know how much would be thrown up by this tax, but you are in principal anyway

adding to the cost of transporting your oil which certainly works in the direction of lowering the value of your oil, so I think that you ought to consider this as well, as I say, in each case consider the consequences, but here you're putting an added cost on transportation and it may be small, but it certainly works in the direction of lowering your wellhead value. Basically that concludes my remarks on the specifics of the bill.

I would like to conclude with a few remarks about this old question of the total tax burden in Alaska. What fair share is, and at what point do you destroy incentives, undermine profitability and the like, and of course Senator Rader has been pressing a number of people for answers to this, but as he himself in asking the question admits, there obviously is no easy answer to this question. If there were, somebody would have given it, and I can't give you an easy answer. A number of things have been suggested, all of which make a certain amount of sense. What kind of activity is there in the State has been suggested. A number of people have suggested looking at the total tax burden in Alaska, relative to other states. I have a few comments on that aspect too. It clearly is important what the total tax burden is on the oil and gas industry, there's just no doubt about that and how it compares with other states. It certainly is not just the absolute amount of dollars being paid or dollars per

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