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ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

FREE CONFERENCE COMMITTEE ON SENATE BILL 524

TRANSCRIPT OF PROCEEDINGS

JUNE 11, 1981

Contains June 11-24, 1981

COMMITTEE PRESENT:

Representative Bill Ray, Chairman
Senator Ed Dankworth
Senator Don Bennett
Representative Terry Gardiner
Representative Anthony Vaska
Representative Patrick O'Connell

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MR. RAY:

... this is the Free Conference on House Committee Substitute for Senate Bill 524 Finance amended in the House. Members of the Committee from the Senate side: Senator Dankworth, Senator Bennett, Senator Ray. On the House side Representative Gardiner, Representative Vaska and Representative O'Connell. Sir?

MR. GARDINER:

I'd like to move and ask unanimous consent that Senator Ray serve as the Chairman of the Free Conference Committee.

MR. RAY:

Is there an objection? So ordered. The first order of business -- I've taken the privilege of asking Commissioner Williams,please,to come and identify yourself, sir, and give us more or less a sectional analysis of the House Committee Substitute for Senate Bill 524.

COMMISSIONER WILLIAMS:

For the record, my name is Tom Williams. I'm the Commissioner of Revenue. I'm here to testify on H.C.S.S.B. 524...

MR. RAY:

Commissioner, I might as well stop you right now. It is my feeling, as a Chairman, that I am going to allow any

member of the Committee to interrupt any witness at any time if they have a valid question pertaining to the information. Go ahead, sir.

COMMISSIONER WILLIAMS:

I think that is fine. I'd like to talk to you briefly about the context that this bill is in, namely, the litigation, and what the stakes are; describe in very brief form what the options seem to be; and then to go through with you how this bill works. At issue,of course, is the large majority of money that we are collecting under the oil and gas corporate income tax, which is Chapter 21 of Title 43. I'll often refer to it as Chapter 21. The risks are, that since this law was enacted in 1978,the United States Supreme Court has decided two cases: one is Exxon versus Wisconsin, and the other is Mobil Oil Corporation versus Vermont - which leave a question about the constitutional validity over the method of separate accounting, which is incorporated in Chapter 21. While we believe we will win the case, the stakes present in the case are very, very, high. Using our low case numbers, we find that they will be over $5.1 billion through 1985,which is the time period when we would expect to have the litigation finally adjudicated. In addition to that would be over $1.3 billion worth of interest, at 10%...

MR. RAY:

What was that figure, sir?

COMMISSIONER WILLIAMS:

$1.3 billion. So in a sense, this is a $6.4 billion question. The risks are that if we lose the case, we'll have to refund almost all that money. If I may, Mr. Chairman, I'd like to from time to time go up to the charts and flip them over and -- at this time I'd like to ...

MR. RAY:

As long as you stay pertinent to the subject, sir.

COMMISSIONER WILLIAMS:

Thank you. At this time I would like to briefly run through the basic types of options that we have available at this time. There are four basic approaches, as you can see there.

MR. RAY:

Excuse me, Senator Bennett?

MR. BENNETT:

Commissioner, before you proceed -- two questions if I might, real quick. You say that we would have to refund most of that money. What is most? And could you elaborate upon why it is just most instead of all that's involved?

COMMISSIONER WILLIAMS:

Well, it is conceivable that if the worst came about we'd have to refund everything. If the court ruled that Chapter 20 applied if 21 was struck down, then we'd have to refund

probably 85% of it.

MR. BENNETT:

My final question is, does this figure include the cost of litigation?

COMMISSIONER WILLIAMS:

No, it does not.

MR. BENNETT:

What would the cost of litigation be if it took the course that litigation takes?

COMMISSIONER WILLIAMS:

Well, compared to the billions of dollars, it would be small. In absolute terms, it would run several million dollars, I would expect.

MR. BENNETT:

Thank you.

MR. RAY:

Proceed, sir.

COMMISSIONER WILLIAMS;

Thank you. So we have four basic options, then, about types of action that can be taken at this time. First, is a backstop tax - the basic idea of a backstop tax would be to have some other tax that does not have the question that has been raised by the Mobil and Exxon cases decided by the Supreme Court. This tax would, instead, be a tax that

has secure legal precedent and would be much, much safer from the legal challenge. The second option would be a settlement package - legislation that would allow the companies to settle the case, walk away from it. And, of course, that would provide security, then, for not only the revenues that the companies have paid in, but would provide security for the revenues that they would continue to pay in in the future.

MR. RAY:

I know, sir, that you are not a practicing attorney - you're the Commissioner of Revenue. If there was a settlement, would it take 100% of the people on the Slope, or could a minority position come in and sue and then if they won the case it would obligate us to pay everbody at the same time?

COMMISSIONER WILLIAMS:

I think that while you cannot prevent the people who are not parties in the litigation from suing at a future time, I think you can bind the present parties to the litigation so that they would not get a refund regardless of what the outcome was of that lawsuit. Now, of course, if there was a fundamental change in federal law they preempt, really, passed legislation affecting our structure, well, that's the supreme law of the land under the federal constitution. There's nothing we can do about that. But we can bind the parties to the present lawsuit so that their amount, which represents over 90% of what's being

paid ...

MR. RAY:

What do they call that? Would they call that agreeing without prejudice? Is that ...

COMMISSIONER WILLIAMS:

They would be dismissing it with prejudice...

MR. RAY:

... with prejudice.

COMMISSIONER WILLIAMS:

... so that they could not raise the constitutional issues again.

MR. RAY:

You'll have to excuse -- I'm not an attorney, and so there are some of these things that I'm not too familiar with.

COMMISSIONER WILLIAMS:

I shouldn't profess to be one either. I haven't practiced in a long enough period of time. I'm familiar with the idea.

MR. RAY:

Continue, sir.

COMMISSIONER WILLIAMS:

Thank you. The third option would be to set the money aside. Obviously, if we don't set the money aside, we don't have a backstop tax, and we don't have a settlement,

then we have a real risk of having to come up with billions and billions of dollars around 1985 in the event that we lose. The important thing to remember - it doesn't matter what our odds are of winning or losing. We only get one shot. So if we lose, we lost. We can't come back multiple times on this issue and get to the expected value. If I think that we've got an 80% chance of winning, or someone else thinks it's a 60% chance of winning, it doesn't matter. If we've lost, we lost. And we have to come up with the money. To set the money aside over the interim and not spend it is one way to be able to afford to cover ourselves in the event that we should lose. Then we would be able to make the payments back that would be required by the court. Obviously, then, we would continue to litigate the present law. And there are certain strategic or technical amendments to -- some of which alleviate inadvertent inconsistencies in the law. Others would eliminate certain issues that are really peripheral issues in the case, and it's better just to clean them up and have the case go on its basic merits which is can you have separate accounting or can't you.

MR. DANKWORTH:

Commissioner Williams, you've said that regardless of what our chances are in court - whether they are good or bad - it's still a risk, that if we lose, if it's 80 to 20 and we

lose, we still have to pay it back. You get one shot. You still have to return this $6 billion.

COMMISSIONER WILLIAMS:

That's correct.

MR. DANKWORTH;

Then if we put in the backstop -- oh, for goodness sakes. I hope that jackhammer doesn't start right now. If the backstop tax is in place, now, are you absolutely sure that that statement is still true that we have 100% chance -- we know that there will be a suit filed against the backstop. Now, are you satisfied that we'll have 100% chance of winning that? Or will number 3 still be necessary to protect the fiscal integrity of the State by having some money in escrow in case we lose that one? Or do you think we should take that 20% chance that we might win?

COMMISSIONER WILLIAMS:

I don't think any lawsuit is 100% in any party's favor. So even with the backstop tax, there would be some risk. The basic risk is, is the 30% share that Alaska is taking too much under the federal constitution. That risk would remain regardless of what tax structure you have. If you had a lawsuit that risk would be present. The backstop tax, though, I think, does eliminate additional risk that has been introduced in the income tax area as a result of

the Exxon and Mobil cases. So to that extent, it cuts down significantly - at least in half, I would say - our chances of losing and having to make this massive refund. But there still would be the outside chance.

MR. DANKWORTH:

Well, that's the point that, I think, Commissioner, I wanted to make, is that -- to get your opinion on. If the backstop goes in, it may lessen our losses to some regard in the first case. But, I guess, the question is,is even with the backstop, now we would have two lawsuits instead of one, most likely. And I think I can reasonably predict that that probably will happen. But now we have two lawsuits. One probably makes us more comfortable with the first, the second does. But from a purely fiscal point of view, in looking after the State treasury, are we so sure, and are the odds so good, and would we normally in a good fiscal approach to things put the State in a position where we would continue to spend the money even though there is 5%, 10%, 20% chance of losing in that case? I guess I'm back to my question, when we are at risk is number 3 -- do you still see a need to put some of this in escrow, or are you satisfied the State would be in a sound fiscal position to continue on without any backup money?

COMMISSIONER WILLIAMS:

Well, the backstop tax is like having a pair of suspenders

instead of only one suspender. If you wanted to escrow as well as have a pair of suspenders that would be wearing suspenders and a belt. You could do it. I don't know that I would recommend that it's necessary to put the belt on when you have a pair of suspenders.

MR. RAY:

Commissioner, perhaps if we are faced with a loss of 6.4, maybe we should increase the tax and put that money into escrow to accommodate our 6.4 loss in case that we would lose it.

COMMISSIONER WILLIAMS:

Well, that's a possibility. In effect, as we'll see, that's in effect what the backstop tax does, except it doesn't make the companies cough up the money twice on a current basis.

MR. RAY:

And then they could sue us in 1985, and we could figure out something by 1990 when they come back again. Thank you, sir.

COMMISSIONER WILLIAMS:

The fourth option is to do nothing. Which is an option. Inaction is itself a choice. However, as you can see, I've put an X through it on the chart. That is the one clearly, absolutely, unacceptable option for us to take. That's the worst that we can do. That's going to a crap

shoot with over $6 billion of the public's money and rolling the dice. And I don't think that we can responsibly do that. Certainly we are absolutely opposed to a course of inaction at this time. I think that the other 3 are options that are viable. Doing nothing is the one option that we cannot take. Turning, then, to the basic idea of the present legislation ...

MR. RAY:

Just one question, sir. When you say the settlement -- the settlement you are referring to is the settlement only on this specific case and not on the royalty case and all the rest of them. You would just get the settlement of the one that they are -- in the particular area, and then it leaves the rest of them viable cases - right?

COMMISSIONER WILLIAMS:

That's correct.

MR. RAY:

Thank you.

COMMISSIONER WILLIAMS:

So now to the basic concept of this bill, again -- once again I'll have to flip the chart. I hope this picks me up. This tries to illustrate what the basic idea is in the backstop approach. This red area here, including the dotted lines, represents the income stream that we receive in any given year under Chapter 21, which is the

subject of the lawsuit, and is what we might have to refund if we lost. Among the changes that we propose in the bill is to allow a deduction for the windfall profit tax, and to make certain strategic or technical changes to remove what I called warts on the bill, that right now really raise extraneous issues, ancillary issues. And so to leave the lawsuit clean, in terms of can you have separate accounting or not. There's no point in having the case be decided on some finnarky issue off on the side and not on the basic merits of can you have separate accounting. So these two things would represent a change from the present level of tax down to some lower level that would be paid under Chapter 21. The backstop tax is a property tax on oil and gas reserves. It also produces, in gross, represents as much revenue as Chapter 21 would have represented before we took the warts off and before allowing the windfall profit tax. The payment under Chapter 21 gives rise dollar-for-dollar for a credit against the reserves tax. The excess of the reserves tax over the credit is a payment to the State. The combination is that you have this much being paid under Chapter 58, the reserves tax; this much being paid under Chapter 21, the income tax; and between the two, it adds up to the same size as what would be collected under Chapter 21, as it reads right now.

That's the basic concept of the reserves tax backstop. Now, if there's a change in the amount that is paid, either as a result of judicial decision or an audit or whatever - this goes up or down in the amount that is paid on the income tax. There's provision in the bill dollar-for-dollar for a change in the credit. So if this goes up, the credit goes up, and they owe less up here under the reserves tax. Similarly, if this goes way down, the credit goes way down, and the remaining reserves tax liability that has to be paid goes up. That's basically how the credit mechanism works. Now, we've done a fiscal note -- the bottom line, we've done two cases - a low price case and a high price case which are not particularly revenue forecasts in and of themselves. They are to illustrate whether the reserves tax works as a backstop for the income tax. Does it have the revenue generating potential to completely backstop over $1 billion a year of income tax payments? The answer is, yes. If we start at 30 mills for the first tax year, then go to 25 mills, which is the default rate right now - if the legislature fails to set the millage at a different level, it will be at 25. So if we are at 25 mills through these two years and then drop down to 20 mills in 1985, you'll see that we have all gained in the next fiscal year over Chapter 21 under the reserves tax. The reserves

tax would come out $7 million over. There would be small reductions in each of the next years which can be eliminated by fine tuning the millage rate. But if the millages stay at 25, 25 and then goes down to 20, you'll see that over the period we are looking at, while the lawsuit is pending, it would be a net failure to cover of only $164 million out of the $6.4 billion. So essentially over 95% of the revenue is backstopped under the low price.

MR. RAY:

Your figures are in millions then?

COMMISSIONER WILLIAMS:

Those figures are in millions, yes. Now looking at the high price case. This is more optimistic in terms of the assumptions about how oil prices will increase. You can see that, here, this time, it ends up being plus $483 million. Again, the same assumptions about millages - 30 mills in the first year, 25 the next two, and then dropping to 20 in 1985. That produces overall an increase in the tax liability of $483 million. These are the figures that are in the fiscal note. And I'd just like to show in the low price case some of the backup about how these are developed. This is what we project in the low price case would be collected under the present income tax. No warts, no windfall profit tax - just what we have on the

books now. $1,142 million in fiscal year '82. With the warts and the windfall profit tax, that would drop to $787 million in fiscal year '82. The new reserves tax would generate $601 million in that payment part - that top box that I showed in the first draft, $601 million. There'd be retroactive provision for the warts and for the past windfall profit taxes to clean those up - and the net change is $11.149 billion. The difference is a $7 million increase - that's the $7 million that I showed you earlier on the low price case.

MR. RAY:

Wait a minute. What was that first figure you just said? No, the bottom, the total figure. The next one up.

COMMISSIONER WILLIAMS:

This one is the new cash flow. That's the 787 plus the 601 minus 83 minus 156 - adds up to 1149. This is the revenue that we would see as the cash coming in under the low price case with this bill in this fiscal year. In this year, in 1983, this is the income stream you would see. There would be no more retroactivity because that has all been taken care of in the first year. So all you have now is the ongoing effects of the reserves tax and the ongoing effects of the amended version of Chapter 21. So here you have a total of $1.289 billion being collected. That's short of the $1.356 billion that would be collected

under the present tax, and is short by $67 million. Same thing here - it comes up short by $49 million. And over here it comes up short by $55 million. It does not necessarily, though, have to come up short. And I'd like to show you one graph here illustrating that point. Thank you. This is break even millage rates. One of the provisions is that the legislature may adjust the millage each year. If it fails to do it, it's 25 mills. But if it does do it, it can fine tune this tax so that the revenue effect is zero. In 1982 these are the assessed values that come up from the low price case for the reserves at Prudhoe Bay. These are all in millions of dollars. So this is $60.1 billion - would be the approximate assessed value based on the research and analysis we did. If you apply the millage, 29.65 mills, that's 2.965% of this assessed value - the gross reserves tax is $1.782 billion. The credit for income tax payments, for past income tax payments and for current income tax payments, comes to $1.188 billion - that's the sum of those two. So you subtract that from this, and you have the net reserves tax payment of $594 million. At present, Chapter 21 produces $1.142 billion. Taking the warts off would reduce that by 33. Taking the windfall profit tax deduction off, we would reduce it by another 308. And deduction for this reserves tax, since this will now

be an expense charged against their income - that reduces the reserves tax amount payment in the fiscal year by $14 million. So the new income tax that would be paid under Chapter 21 is $787 million. The combined revenue 787 plus 594 - right up here, the reserves tax and the income tax - comes to $1.381 billion. Applying - I don't know if you can see this - but applying the retroactive warts and the retroactive windfall profit tax credits that would be allowed, that knocks it down to $1.142 billion. That's exactly what we're trying to match - $1.142 billion. This is the income stream under the present law. So this is the net income stream we get under the new law if you apply this millage. And the revenue change is zero. The same calculations that are worked out for these (indisc.)--you can see that 29.65, 29.04, 23, and 20.72 work out to have no revenue effects given these assessed values. It neither raises nor lowers the tax. Now, the assessed values, of course, may vary as time goes by from year to year. They may well not come out at these particular levels. The point is to show that it need not result in either an increase or a decrease in the tax liability of the oil industry. But can, in fact, be fine tuned to eliminate any change in their liability.

MR. RAY:

Any questions from any members of the Committee? Senator?

MR. DANKWORTH:

Commissioner, when setting the mill rate on the assessed value of your reserve, 29.65, what do you use to -- how would you know whether to raise or lower that? Does that have anything to do with the rising or falling cost of oil or the price of oil in the nation?

COMMISSIONER WILLIAMS:

No. The assessed value has a relationship with the expected price of oil in the future because one of the ways that you'll look at, in evaluating one of a kind properties like reserves, is to say what's the income stream that this is likely to produce in the future? That income stream, of course, is going to depend on what the price of oil is. So it's this top line that depends on the price of oil. This one can be solved mathematically so that the numbers work out to zero at the bottom. And that's simply what was done. I went through this from front to back - if you were solving for this you would essentially, sort of, work through backwards and find out what millage it was you needed.

MR. DANKWORTH:

Does this take the risk out of the State being in the oil business at all? I mean, can we just use that each year to make sure that we get that amount which we want?

COMMISSIONER WILLIAMS:

You can use it to make sure you get the amount that you want. You can use it to make sure that you are covering what would have been collected under Chapter 21. It still, of course, leaves that residual risk about the 30% share - it's open to legal challenge. If there's a lawsuit, there's still is that chance in the lawsuit of losing. I'm not sure which risk you were ...

MR. RAY:

Are you finished, Senator?

MR. DANKWORTH:

Thank you.

MR. MALONE:

Thank you, Mr. Chairman. On these different presentations, Tom, you've been using high case, low case - which one is probably more likely?

COMMISSIONER WILLIAMS:

At the present time the low price case is much closer to where we are in our revenue forecast than the high price case. The high price case is the one that, on the pro forma fiscal note, ends up almost $500 million tax increase. That's less likely, considerably, than the low price case, although you can come up with reasonable situations where either one can come about.

MR. MALONE:

Thank you, Mr. Chairman.

MR. DANKWORTH:

Just to clarify that, Commissioner. If it's perceived that under 21 now that our income should be about 31 something, close to 32% - is that what it is presently, compared to those?

COMMISSIONER WILLIAMS:

Through the period to '85, it is about 31.8, I think.

MR. DANKWORTH:

All right, if it's 31.8% - to maintain that 31.8% of the revenue, we could annually, the legislature, could play with this millage rate to hold that 31.8%. Is that correct?

COMMISSIONER WILLIAMS:

That's correct. You do so by making these numbers down here at the bottom all equal to zero.

MR. RAY:

Just so long as your requirement doesn't exceed 30 mills though, right?

COMMISSIONER WILLIAMS:

You could set the millage at any level you wished. 30 mills is the limit that municipalities have on them.

MR. RAY:

I see.

COMMISSIONER WILLIAMS:

But this indicates you wouldn't have to go over 30 mills,

unless these assessed values were significantly lower.

MR. RAY:

Please continue.

COMMISSIONER WILLIAMS:

Thank you. I think I'd better sit back down. So having basically described that the fundamental idea of the backstop tax, having gone through the fiscal note that has been prepared for the tax, and showing how it can be tailored so that there is neither an increase nor a decrease in the percentage share, I'd now like to run through briefly, section by section, the provisions in the bill. And the first one involves, once again, getting to a chart. Section 1 -- the most confusing part about section 1 is the treatment of income that is required to be shared under the Native Claims Settlement Act. This chart illustrates what Congress created under the Native Claims Settlement Act. Now, for a moment let's talk about non-oil and gas so that we understand how it works for corporations that are under Chapter 20, and under the Internal Revenue Code which Chapter 20 follows. So let's say instead of oil and gas wells - now if you will imagine those are trees, and some one is cutting them down, there are trees that are granted to the regional corporation under the Native Claims Settlement Act. Under section 7(i) of that Act, the

revenue that comes in to the regional corporation owning that forest from those trees - 70% of the revenue must be shared under section 7(i). The regional corporation keeps 30%. 70% is shared under section 7(i), and it goes to all the regions in proportion to their shareholders. I've not drawn 12 regions here, but you can see there are 3 of them as well as the region that owns the timber. Under section 7(j) of the Act, each region in turn is required to distribute 50% of what it receives to its village corporations and/or its shareholders. But it has to break the second distribution out. So you see village corporations getting income from this region, these village corporations getting income from their region, and so on back -- including the original region. It has to turn back 50% of what it gets under 7(i) - has to go back to the villages. Now, under the Internal Revenue Code, and a letter ruling dated February 2, 1977 by the Internal Revenue Service - it's an informal letter ruling - the IRS took the position that the income is taxable to the recipient of it. So if 70% comes here, and 10% of that goes to this region, and then 5% goes to the villages. The villages are taxed on the 5% they received; this region is taxed on the 5% it keeps; this region is taxed on the 30% it kept originally, plus whatever it gets back; and these villages are taxed on what they

receive, and so on. Each one of these -- the recipient is taxed on the income. Neither this region nor its villages, nor any of the other regions and their villages, has an interest in the land for purposes of depreciation or depletion or anything else. They don't have an economic interest in the land under the Internal Revenue Code. So under Chapter 21, if this were a forest, the villages would be taxed on their income; this region would be taxed on what it nets; this region would be taxed on its net; and these villages would be taxed on their net. Now, what happens when it becomes Chapter 21 type income - these are oil wells now. Once again, they go in to section 7(i), 70% of the income. It's shared among the regions and in turn reshared among the villages. Some of it comes back to the original region, and half of that is shared with its village corporations. How should all of these corporations be taxed? If we follow the example of the Internal Revenue Code, you say that since none of these has an economic interest in the oil and gas, that it stays income under Chapter 20 for the non-owner region. This region is subject to Chapter 21 because it is getting income from oil and gas. So it is subject to 21. The income it gets back and keeps under revenue sharing would be subject to Chapter 21. But the income it shares out to its villages, since that is a

deduction from its income, and for the villages, since they don't have an economic interest in this land under the Internal Revenue Service, that's Chapter 20 income. Which makes sense - that it is exactly the same treatment. Everybody's getting the same tax rate, and the same parallel treatment under Chapter 21 as what they are getting under Chapter 20. That's what the underlying language in section 1, on page 1, at lines 16 to 21, does. It's a long explanation but it's probably simpler to go through the explanation and say what it does than to try to work with the language. So that's why I've prepared this. I'd be glad to answer any questions you have.

MR. RAY:

I think it is very well understood, and I'd like to thank you for the explanation.

COMMISSIONER WILLIAMS:

Thank you, Mr. Chairman. Continuing on, then, section by section -- the rest of them go much more quickly now. The second section just simply makes some technical changes. It does not change the substance, really. It just makes the language tidier. Section 3 relates to deductions from production income under Chapter 21. The addition of the language on line 10, "or incurred," allows for taxpayers who are using the accrual base of accounting

rather than cash base of accounting, to use accruals. They don't have to gin up a special set of books for our tax. In fact, we don't want specially ginned up books - we'll take the real books. So we'll look at their business the same way they look at their business themselves. So this allows accrual taxpayers to stay on the accrual basis. So the same thing is true on line 13 and again on page 3, line 4. The section on page 3 between lines 8 and 26 relates to the interest expense. Right now there is an absolute limit on the allowable interest that may be deducted. This limits the interest that may be deducted to interest incurred with respect to Alaskan investment instead of investment anywhere, and it allows the limitation -- there's a presumption about a limitation, but it allows it to be rebutted where the taxpayer can show that it's actually got more interest. It also allows the taxpayer to include interest expense where the parent, where the taxpayer is a subsidiary and where the parent actually did the borrowing on behalf of the subsidiary instead of the subsidiary doing it itself. It's a rather technical point. Again, on page 4, section 9 which starts on line 3 - it's a similar sort of item there. There's a limitation in the present law on general overhead or administrative expense that may be deducted. This replaces that absolute limitation with a presumption -

the presumption is provided for in new subsection (f) which comes in a few pages. The new deduction number 10 is for the deduction of the income that is shared under section 7(i), revenue sharing. That is to say, this 70% is a deduction from this gross income of this region which, of course, is consistent with the notion that this 70% is going to be taxable income to the recipient. That's all that number 10 does. Number 11 allows for a deduction for the actual reserves tax that is paid - reserves tax over and above the amount of the credit that is allowed against it. So actual payment of reserves tax is a cost and it is allowed as a deduction. Section 12 would allow the windfall profit tax.

MR. MALONE:

Mr. Chairman, on the windfall profits tax question, now that's incorporated in the bill but the legality of allowing or not allowing a federal excise tax, or whatever you call the windfall profits tax, is that a serious issue?

COMMISSIONER WILLIAMS:

I think it's a serious issue when the court looks to the equities of the tax.

MR. MALONE:

Mr. Chairman, if the information I have is correct, at least one state this year, one state legislature in Minnesota, in fact,

moved to eliminate that deduction from their tax code -- passed a bill on it.

COMMISSIONER WILLIAMS:

Mr. Chairman, I understand that to be correct. The point is, though, that Minnesota does not have a separate accounting tax. And our concern is, in looking at separate accounting, that the court may see this as a particularly unfair feature that separate accounting causes. And, once again, I think the important thing is to establish the precedent on the principle of separate accounting rather than lose that principle because there was a windfall profit tax associated with it. As I pointed out, the backstop has the capability to offset the revenue that's foregone under Chapter 21 - in effect, it gets shifted over to Chapter 58 because of the credit mechanism. It's not as though we suffer a diminution in cash flow by allowing this deduction, but it does definitely, I think, allow the issue of separate accounting to be presented on its own merits and not to be decided possibly on the extraneous issue of the windfall profit tax.

MR. MALONE:

Thank you, Mr. Chairman.

MR. DANKWORTH:

Then it's just semantics in the sense that we haven't given

them credit in anything - we changed the wording but we are still collecting. We've just found a new mechanism to collect the same amount of money.

COMMISSIONER WILLIAMS:

That's right. It preserves the revenue share. That's the purpose of the backstop -- is to protect the level of revenues that the State desires to continue to receive.

MR. DANKWORTH:

Thank you.

COMMISSIONER WILLIAMS:

Section 4 of the bill, which is at the top of page 5, allows for the taxpayer to rebut the presumptions as to allowable interest to be deducted or allowable administrative overhead -- general overhead or administrative expense that may be deducted. As I said earlier, those are specifically limited but it's a presumption. This provides how that presumption is to be rebutted by the taxpayer.

MR. DANKWORTH:

Before we get too far off my last question, if you don't mind, I'd like to return -- Commissioner, do you know offhand, or do you have the material with you -- if we gave the windfall profit tax, if we decided that was an unfair tax and we wanted not to charge that, do you know about what amount that would amount to between now and 1985?



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COMMISSIONER WILLIAMS:

I can quickly hunt it up here.

MR. DANKWORTH:

Just kind of roughly, Tom. If you could kind of give me an idea of what -- if we thought that was unfair and we didn't intend to do it in the first place, and we wanted not to charge that, how much would we lose in revenue between now and 1985?

COMMISSIONER WILLIAMS:

Through that period, the industry would pay approximately $18.75 billion of windfall profit tax. So that would be a deduction in that amount. It would reduce their income by that amount and our tax rate at 9.4% of that. So it would be about, I'd say $1.8 billion - plus or minus $20 or $30 million. But I'd say $1.8 billion is close.

MR. DANKWORTH:

If we had decided that that was an unfair tax and wasn't intended, and we didn't charge it, then we would, by setting that straight, we would have to give up about $1.8 billion.

COMMISSIONER WILLIAMS:

That's what you would reduce it by.

MR. DANKWORTH:

... if we continued to have Chapter 21.

COMMISSIONER WILLIAMS:

That's correct.

MR. DANKWORTH:

Thank you, Mr. Chairman.

MR. RAY:

However, couldn't we increase, or put another tax in to keep the same level of taxation? If we made an error in one place, we can correct it by doing the right thing in another place and collecting the same tax.

COMMISSIONER WILLIAMS:

If you didn't want to forego the $1.8 billion. In fact, that's what the backstop tax would recover.

MR. RAY:

Go ahead, sir.

COMMISSIONER WILLIAMS:

Thank you. Section 5 of the bill which starts on line 9 on page 5 allows for the non-production and non-pipeline income of a Chapter 21 taxpayer to be taxed on the basis of the federal taxable income. It's the same treatment as we give taxpayers now under Chapter 20. It refers to foreign subsidiaries and domestic subsidiaries, and it reflects the present practice of the Department - that where you have a domestic subsidiary that files or reports federal taxable income,that we use that federal taxable income in looking at the worldwide pie to be apportioned

to Alaska. Where there is a foreign subsidiary involved, we look at their book income usually. Ordinarily the taxpayer says,hey, it ought to be federal taxable income but then when it looks at the cost of redoing the books on the basis of federal taxable income they say it's close enough. So on lines 21 through 24 the option is there for the taxpayer to use book income if it's easier for it. But otherwise, if they can readily convert it over to federal taxable income, that's just as soon as what we'd have them do. Section 6 allows for administrative relief by the Department. This does not change what we believe the law to be at this time. Alaska is a member of the Multistate Tax Compact. It's enacted and codified as Chapter 19 of Title 43 of the Alaska Statutes. And under the Act, the Commissioner already may provide for modifications in the formula or in the separate accounting provisions where those are resulting in an inappropriate measure of the extent of the taxpayer's business in the State. Nevertheless, in the lawsuit, it is alleged and contended by the plaintiffs that the authority for our regulation does not exist, the regulation affording tax relief. This would make it clear that the authority does exist, that the Multistate Tax Compact is intended to apply to Chapter 21 just as it applies already to Chapter 20. On page 6 section 7 of the

bill allows for prepayments of the tax. Again, by regulation we have interpreted the present statute to allow for either payments on installments after the tax is due or for prepayments of estimated tax before the tax is due. The regulations require prepayments. The regulations are being challenged as lacking statutory authority. Once again, we don't believe that to be the case, but in an excess of caution and to simplify the lawsuit, this change would make it absolutely clear that the regulations do have that authority. Then comes section 8 which is the reserves tax - it enacts the reserves tax. One of the things that happens here is instead of using the existing provisions of AS 43.58, we are renumbering slightly off the original sequence. And the purpose of that is that the original Title 40 Chapter 58 had a provision saying that the tax expired. There's been some question raised about whether that expiration language means the tax was repealed. Rather than to have any question about whether the tax was repealed or not, we are repealing those sections and enacting new ones. The first one is Findings and Purposes which provide a statement of the intention of the reserves tax to be a backstop tax, a statement of the circumstances about why it is appropriate for the legislature to do so. The real substance of the tax starts on page 9. Page 9, first of all

on line 11 is the new 43.58.021 which imposes the reserves tax. It sets the rate at 25 mills each year unless a different rate is set for that tax year. The reason a deadline is imposed for changing the rate at the end of February, is because we send the tax bills out on March 15, and we need the two weeks in order to prepare the bills and we have to know what the millage rate is by that time. But the legislature would be free any time before the end of February to fine tune the rate if it wished to make the revenue consequence of the tax zero, as I illustrated before. Section 31 provides for exemptions. First one is fairly obvious. Property of the United States or the State is exempt from the tax - that's fairly clear. Property that we are preempted from taxing under the federal laws is also exempt - that's number 2. Under section 21(d) of the Native Claims Settlement Act, it seems quite clear that the intent there is that developed and undeveloped lands conveyed under the settlement act are exempt from State taxation, although they may be subject to municipal taxation once they are developed. But they are not subject to State taxation and consequently it's specifically referred to as being exempt here. The third exemption is for gas reserves. The major areas where gas reserves are found in Alaska are in the Cook Inlet area, and on the North Slope. The major developmental projects that are planned for both

areas are a gas liquification plant in Cook Inlet, and, of course, the gas pipeline on the North Slope. Both of those have marginal economic possibilities. And how many times we've been warned that the tax structure of Alaska can have a chilling effect on the decisions to develop or not develop. Consequently, since all gas in Alaska seems to be close to the margin of major development, it is appropriate at this time to exempt them from the reserves tax. And so the third exemption is in there. Gas reserves are exempted. If, however, you have exempt property of the United States or the State which is leased to a third party who is not tax exempt, that leasehold interest of that third party is taxable and that's provided for in subsection (b) starting at line 28 on page 9 and continuing on to the next page. Now, the next section .041 is the credits. This is one of two sections that form the heart of the reserves tax and the backstop concept. This allows for the credits for the income taxes that are paid. Subsection (a) is a credit for income taxes that are paid before July 1, 1981. Those credits may be carried forward from year to year. They are not exhausted just because there's not enough reserves tax to use them all up. They may be carried forward from one year's reserves tax to the next. Subsection (b) is for the current year's income tax payments. That is to say, income taxes paid starting

July 1, 1981. Those do not carry forward. That's why they are set out in a separate subsection. They are applied first against the reserves tax to make sure, in fact, they are all used up. They are taken first but they do not carry forward into subsequent years. That's the difference between the subsection (a) credits and the subsection (b) credits. Subsection (c) makes it clear the sequence that you use in applying the credits. You take the subsection (b) credits first, then you take the subsection (a) credits. And it provides a limitation -- subsection (d) provides for payment under Chapter 20 to give rise to a credit against the reserves tax where you have a taxpayer that's not a corporation, but is otherwise engaged in oil and gas. This is to give equal treatment for various interests in the State right now who will be subject to the reserves tax but who are not subject to Chapter 21 because they are not corporations - they're trusts, or individuals, and therefore exempt from income tax. Section .051 is the other critical part of the backstop concept. This says that where there's an adjustment in the income tax liability under Chapter 21 there's a dollar for dollar adjustment in the credit that is allowed against the reserves tax. In effect, this allows the reserves tax to serve as the escrow pool, as if we were collecting the tax under Chapter 43.58 - collecting it

and setting it aside in escrow. The credit mechanism accomplishes the same result but without making the companies pay twice as much on a current basis. Section .061 provides for the assessment of the reserves. Reserves are assessed in their full and true value as of the beginning of each tax year, and the tax date is July 1 of each tax year. It's the standard full and true value that you get in the open market. Fortunately you don't have lots of market sales of these types of properties. So one of the things that is specifically authorized, and,in fact, required that the Department look at is the discounted present value of the future income stream that we would expect reasonably to be generated from those reserves. Subsection (c) says you can't count property that's already taxed under Chapter 56. You can't double count it by hitting it again under 58 - well, that makes sense. Subsection (d) says what the discount rate shall be presumed to be. Discount rate is a very sensitive factor, and I think that it is better to create a presumption by law than to leave it to the individual assessor's judgment from year to year. This is one of the areas where, when I was director of the petroleum revenue and responsible for administering the first reserves tax, is one of the areas where we saw the biggest amount of problems with undue influence on the assessor's judgment.

And, rather than have that critical variable be subject to the assessor's judgment, we think it is best to create a presumption and the taxpayers can rebut it on an adequate showing that the presumption is inappropriate. Section .071 says we send out an assessment roll listing the properties - what its assessed value is and who the taxpayers are who own it. Section .081 provides that we mail the tax bill out -- a notice, rather, of what the assessed value is by October 15 of each year. Section .091 on page 12 gives the taxpayer 20 days after he gets the notice to make an appeal if he objects to the assessment. If he does object to the assessment, he has a formal hearing in conformance with the standard formal hearing procedures specified by law for the Department for other taxes. If he is still dissatisfied once the Department makes its decisi he has 30 days in which to appeal to the superior court. By February 1 we certify what the assessed values are. At that point -- actually we should have a pretty good idea of what the assessed values are before February 1 -- but by that point you'll have a clear handle what the assessed values will be and it will then be a straightforward matter to ascertain what the millage should be, if it should be changed at all. So that does give, I think, adequate lead time. Ordinarily, we would expect to beat that February deadline, but this is the

latest that it possibly can be. Section .111 on page 13 provides for picking up property that for one reason or another is not included on the original assessment roll - either it wasn't reported and we didn't know about it at the time, or it's new property coming into production after that time. If it's new property coming into production this section, in response to a comment made during the public hearings by the Joint Gas Pipeline Committees, it allows for prorating of the tax over the year - otherwise people would be hit for a double tax, once on the supplemental roll and then again the next July 1, and that's not really appropriate. That will tend to delay when people will start their properties up. So this prorating avoids that problem. Section .121 is the same language as was originally in the original reserves tax, saying that the Department can go out and, on its own, try to find taxable property so that we make sure, in fact, that people are -- everybody who has taxable property is reporting taxable property. It gives us the authority to conduct the investigation and find out where there's production. Section .131 talks about the statute of limitations and the time for when you make refunds of taxes. And it incorporates the standard provisions that are applicable to all taxes under Title 43. Section .141 requires the taxpayer to file a return reporting

what his taxable property is each year by the 1st of August. It also provides for who shall pay it and who is liable for the tax. Subsection (c) of that section says that we can require installment payments or authorize installment payments if it becomes appropriate to do so. Subsection (d) allows leases that have been unitized to be treated as a single property or other properties that are distinct can be combined if the Department authorizes it. Subsection (e) again is the standard provision from the other tax relating to payments and authorizes the person who makes the return to withhold the tax from anybody on whose behalf he is filing the report. And subsection (f) authorizes us to require additional information upon written notice. We can adopt regulations under section.151. And then.161 is just the list of definitions. And that's essentially the reserves tax in its basic form. Section 9 of the bill which appears on 17 makes it clear that the credit mechanism is essentially a subject of legislative grace. It's legislative grace in that we are not doubling up the amount of tax that has to be paid by the oil industry at this time. Credit mechanism allows them to pay the present amount of income that the State is receiving and provides for the backstop rather than doubling the amount that is collected and setting half of it aside in an escrow account. However, if that mechanism is

invalid then the credit is provided for to be struck down. And then it is doubled up. Section 10 is the severability feature for any of the exemptions from the reserves tax that were set out in the event that any of those should be declared to be invalid. Once again, it's out of an excess of caution - we don't expect that any of them will be struck down. Section 11 makes it clear that if separate accounting is declared to be unconstitutional, then it is at least intended that the taxpayers will be subject to Chapter 20. That's not a great deal of -- you know, we take a big fall from 21 back to 20, 85% of the revenue that under 21 would be shifted and only 15% of the amount of revenue would correspond to Chapter 21. Nevertheless, it's clear that that 15% is to be paid under Chapter 20 which is the approximate proportion it is (indisc.-cough) 15%. So if they are not under Chapter 21, they are not free from income tax - they are under Chapter 20. That's what Section 11 of the bill does. Section 12 provides for the special millage of 30 mills for the first year of the tax. Section 12(b) limits the amount of combined credits that may be taken against the reserves tax. But again there's a provision for the unused prior tax credits to be carried forward into subsequent years. So it really doesn't - it's just a question of the timing when those credits are recognized. It's a mechanism

there designed to preserve the cash flow so that we don't shift income from next year into 1984 and '85. It keeps it spread through the 4 years more or less evenly. And that's what section 12(b) does. Section 13 provides for a transition rule that 30 days after the effective date of the reserves tax the initial returns on the property reporting the taxable property are due. And that 60 days after the effective date of the reserves tax the Department's assessment notices are due to be issued. The rest of the schedule, or the rest of the timetable set out in the reserves tax we should be able to meet - the February 1 deadline for certifying the roll, the March 15 deadline for sending out the bills -- that we should be able to meet those without any problem. Section 14 repeals 2 sections in the Chapter 21 income tax. It's a technical change. It removes the warts, and it's to be consistent with changes that are made elsewhere in this law. And then Section 15 provides for repeal of certain provisions on the severance tax, and for the repeal of the existing sections of the reserves tax that are on the books. And that's it. Section 16 is for retroactive dates on certain sections.

MR. RAY:

Commissioner, it would appear - and you may correct me - it would appear that in this proposed legislation that the

State has the mechanism to protect its people or itself from a loss of revenue no matter what the court case says or does -- it has the mechanism either to make it up or to stabilize it so that there is a minimal loss of revenue. Is it safe to say, or is it a fair thing to say, that any change, any substantial reduction or increase in the revenues from the oil industry at this particular time would be a policy question and not one of strict need or desire -- it would be a policy question because we do have the mechanism to protect ourselves?

COMMISSIONER WILLIAMS:

That's correct. It's a policy question. The present level of the State's revenue from the oil industry is a policy question.

MR. RAY:

Thank you.

MR. DANKWORTH:

I'd like to -- you're through testifying on the bill, aren't you?

COMMISSIONER WILLIAMS:

I'm through testifying on this bill, yes.

MR. DANKWORTH:

I'd like to just touch on a couple of things that still bother me. And again we're back to policy questions, Tom, and that's,how much security do the people of Alaska have

in passing this bill -- if this bill were to pass -- certainly we have the ability to put in another bill to get the same amount of money, as Senator Ray just asked? We could even raise the taxes if we wanted to. There's no question about that's a policy decision. But the point is would you anticipate that we will have a lawsuit on this particular tax when we put it in?

COMMISSIONER WILLIAMS:

I'd be surprised if there was not a lawsuit.

MR. DANKWORTH:

Okay. I would to, and I've been told by a number of people there would be. But I guess I get back to worrying about, not so much how we got to 30% and stuff -- I'm one that believes that Alaska should have got her 30% and I don't mind seeing that we stay at 30%, and I'm going to insist on that even though we may now be talking at, in the tax we are in court on, I understand, at 31.8. But I just want to know for sure that if we try to hold on to the same thing we get in court on two cases, we should make a fiscal policy here as to whether we want to continue to spend this money on the statement that I think we'll win both cases. $6.5 billion is at stake, and I don't care if your chances, let's say they're 90% in favor of the State, and I don't know anybody that would go up on any case before any court and say you have a 90%

chance of winning. No lawyer would do that, I don't think, because of the way courts go. I'm concerned that if we take that 10% risk between now and 1985, that would almost bankrupt the State if we lose. That's the question that I'm asking sometimes, and I'm going to later on in these discussions, at least discuss the possibility of a settlement, and how it relates to that question. So I guess I'm not asking you a question so much as I am making a statement, Mr. Chairman, that concerns me. Well, that's permissible isn't it?

MR. RAY:

It's all right with me.

MR. DANKWORTH:

Thank you.

MR. RAY:

But I haven't heard from the rest of the Committee, though, there might be some ...

MR. DANKWORTH:

Well, ask them. Maybe they won't allow a statement.

MR. RAY:

Well, every action should have a reaction so I'll play your devil's advocate for you, if that's what you are desiring, sir.

MR. DANKWORTH:

I was reacting to yours, sir.

MR. RAY:

Oh. Well, I'll double the act to you then. If -- I don't think there is anybody here, except possibly the representatives of the oil companies, that can tell you whether the oil companies are going to -- when and at what point and at what issue that they are going to attack the State with a lawsuit. And I would imagine that they are well enough equipped and have the expertise, having been through it in many countries throughout the world, to continue a series of lawsuits on everything from taxes up through land or anything else. So I really -- that isn't a concern that I have of their threats or what they are going to do, and I don't think that they really mean that as a threat. I think that if what they -- when somebody sues me I think it's a promise from them that they are going to do what they want to do, and when they come around to make a settlement then it would seem to me that suddenly I've become very, very likeable in their eyes, and for some unknown reason. And I don't quite know what that reason is except perhaps through friendship or the respect for the State and the love of all of the people here. But I doubt that very much. I think that when they come around to make a settlement they have a reason. And as soon as we can uncover what the reason is that they want to make the settlement, and we can evaluate

what their answers are, then we'll know exactly where we're standing. As far as lawsuits, they are going to be suing us as long as there is oil coming out of the ground -- they're going to have a suit against the State. And the fear of a suit, or one down the road, or one tomorrow or the next day or the next day, it doesn't bother me that much. That's the end of the statement, sir.

MR. DANKWORTH:

You and I didn't come here to debate. But you did bring some good questions. And I don't mean my comments in the sense of debate. But I would like to say one thing - that I certainly view our duty here as legislators, and as responsible people here, not to use our powers to tax as any kind of a threat or to be unfair, or to bring people to their knees so that they can come and beg for mercy, you might say. That's not the purpose of that. And nor would we want -- I know in some of our consumer protection areas and other things, I see they get merchants down where they can hardly move and then sure they'll allow you to go ahead and do what you want to do. I just want to make the point that I think the question here is the sense of fairness, and I don't know which side it should fall on. And I'm not taking anyone's particular side even though I may appear to be. But, at least, I think our taxing policies should be based on a sense of



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fairness and not trying to push somebody to the wall to the extent that they have to give in that which is not fair. So that's what I'm looking for.

MR. RAY:

Well, Senator, I, for one, will stand with you and I will guarantee that no action that I take here will ever push the oil companies to the wall.

MR. GARDINER:

Mr. Chairman, a question. Commissioner, what risk does the State have in a settlement?

COMMISSIONER WILLIAMS:

Risks in a settlement?

MR. GARDINER:

Yes. Is the settlement risk free?

COMMISSIONER WILLIAMS:

Not 100%. But it does reduce the risk, I think. There are very few things that are totally risk free. We can make a settlement and the federal government next year can pass a law that none of us see or contemplate, and because it is the supreme law of the land it completely frustrates the intent of the parties in the settlement and the settlement is undone. So there is that sort of risk. For instance, if we settled with a severance tax increase and then Congress passed a law saying you can't have severance taxes that high and it's ultimately upheld

that Congress has the power to pass such a law. Obviously, the intent of the parties in the settlement agreement has been materially affected and frustrated by such a Congressional act. So you don't completely escape that sort of risk. In addition, the entire oil industry is not party to this lawsuit. You do have over 90% of the money being paid by the parties who are in this lawsuit. With respect to them, you have -- if you had a settlement, you would have security for past revenues and you would have security for future revenues subject to some sort of preemptive legislation by the federal government, or what have you. But they, for that 90 plus percent of the income, you could gain more stability even than you would have under a backstop tax.

MR. GARDINER:

But one of the things here is we are only talking about right now, that 90% of our income comes -- that most of our oil income comes from Prudhoe Bay and these three companies represent 90% of the income there, or whatever it is. But, you know, 10 years from now, it's going to be different. We're going to have other oil being produced by other companies -- these same companies may produce some of the oil but we don't know who will find what in upper Cook Inlet or other regions, or the Beaufort or other North Slope regions - so even though we can say it's 90%

today,it wouldn't necessarily be 90% in the future, would it?

COMMISSIONER WILLIAMS:

Well, it's hard to tell. I mean, that's pure speculation, ultimately, about who will find what and where. These particular three companies - ARCO, Exxon and SOHIO - did a good job in getting prime prospects for themselves in the Beaufort Sea lease sale. And one of them is going to be paying us almost 80% net profits in addition to a 20% royalty if they get production from block 76. But it's possible that block 76 may not come into production - it may not have commercial reserves. And so you never know until it is actually developed. But they -- it is true that as basins are explored elsewhere you have no assurance that these companies will always be the ones who are successful in acquiring the developmental rights to that acreage.

MR. DANKWORTH:

Commissioner, on the -- aside from that we do know that -- and we'll get to that later in this hearing about settlements and what their relationships are in answer to Representative Gardiner. Certainly we will always be open to suits- you and I are, and everybody is, and there is no security that anybody can offer on that -- but at least, we -- I believe you testified we pretty well admit that if

we pass the bill,Senate Bill 524,we are sure going to get sued. I mean, there's not the risk of that -- it's pretty obvious. You've said so yourself. But aside from that, I'd like to get to the question of, just out of my own curiosity, how many states presently do allow a deduction for windfall profits tax? Do you know? I know Minnesota and California have recently followed Alaska's lead, somewhat, or perhaps they didn't, maybe they weren't following our lead - but I believe now that they've said that they would not allow the deduction. Do you know if there is any other states that ...?

COMMISSIONER WILLIAMS:

I'm not sure whether California has actually passed it, or whether it has passed only one house there.

MR. DANKWORTH:

I don't know either, but -- is that all it's done is passed one house?

COMMISSIONER WILLIAMS:

In any event, the states that use apportionment, which is the other approach rather than separate accounting, and they start with federal taxable income that's -- the windfall profit tax is already going to be taken out of the pie that they then use the apportionment formula to figure the size of the slice they take out. And because the windfall profit tax is specifically allowed under the Internal Revenue Code

as a deduction in figuring federal taxable income. So if they start with federal taxable income, they are starting with the windfall profits tax having been allowed and it would take affirmative action on their part to add it back into the pie and then take their slice. As far as I know, it's only Minnesota and California who are doing it or are in the process of doing it.

MR. DANKWORTH:

All other states do allow that deduction, is that what you are saying?

COMMISSIONER WILLIAMS:

To my knowledge at this time.

MR. DANKWORTH:

Thank you.

MR. RAY:

That's hardly a fair assumption, though, because Alaska is unique in itself, and I don't think that there's another state that's producing oil in the same quantities and in the same manner as Alaska is. They welcome the oil companies to -- they've been with them for a long time and we welcome them and we hope we'll be with you for a long time too.

MR. DANKWORTH:

Well, Mr. Chairman, maybe you should clarify why we are unique in the sense of the windfall profits tax. The law

came along. We didn't intend to pass it. That just came about. I question whether we are unique in why we would charge and someone else wouldn't. We did, I agree, sort of get trapped into it in the sense that when that windfall profits tax hit we didn't have the provisions to allow the deduction. But we've never corrected it either. I don't believe that makes us necessarily unique. We just haven't done it.

MR. RAY:

Well, uniqueness is like beauty in the eye of the beholder.

MR. DANKWORTH:

All right.

MR. GARDINER:

Mr. Chairman, one thing on this, you know, over the windfall profits tax or anything, the basic question is still what share should the State be getting? That's why we passed the income tax bill in the first place. Everybody had expectations of what percentage it would bring in. And the passage of the windfall profits tax affected both the companies and the State adversely because what it did in that sense is raise the federal share of the pie. And at the time when we passed the income tax nobody thought they were going to pass it one way or the other -- I mean, I guess we could have guessed that they would do something if they ever deregulated -- but if they had

never passed the whole thing in the first place, then we might have had a higher percentage because they wouldn't have been taking that much of the total. Right now they are getting more than -- almost as much as the companies and the State put together.

MR. RAY:

Well, it seems to me I remember when we were first considering oil taxation and there were a lot of us at that time that wanted just to take the simplest procedure possible and eliminate all the transportation costs, and figuring this and figuring that, and just say every barrel of oil that popped out of the ground -- Alaska got so much and the oil companies could do with it what they wanted with the rest of it. But that wasn't satisfactory with the oil companies because they had a different way of going at it. And they won that by a very slim margin. And I just want to tell them, see if you had went with us on that we would have never been in this mess now. So really you have only yourselves to blame for being in this spot. I think that it's about 4:30. Truthfully, fellas, a lot of us have been here and have other ideas and other things that we have to work on, and I'm certainly -- want to give the oil representatives the complete time but in order -- but to start you out now, I wouldn't be fair to you. So if it is agreeable

with the Committee, I'll adjourn for today. And we'll meet again at 2:00 tomorrow? 2:00 p. m. tomorrow -- that'll give us plenty of time because we have some -- we want to hear your testimony, and we want to be fresher than we are at this time in order to evaluate it. I hope you will understand what I'm saying.

(meeting adjourned 4:30 p.m. June 11, 1981)

# C E R T I F I C A T E

STATE OF ALASKA )
: SS.
FIRST JUDICIAL DISTRICT )

I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing June 11, 1981 meeting of the Free Conference Committee on Senate Bill 524 was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 54 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this ____ day of July, 1981.

_____
Notary Public, State of Alaska
My Commission Expires: 11/30/84

ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

FREE CONFERENCE COMMITTEE ON SENATE BILL 524

TRANSCRIPT OF PROCEEDINGS

JUNE 22, 1981

COMMITTEE PRESENT:

Senator Bill Ray, Chairman
Senator Ed Dankworth
Senator Don Bennett
Representative Terry Gardiner
Representative Rick Halford

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MR. RAY:

Free Conference Committee on Senate Bill 524, come to order please. The discussion that we had, and I should apologize to the witnesses for keeping you so long, but the demands of the adjournment of the legislature in trying to get things going, I felt that you had as much interest as you needed in this or that you would be available when we took it up again. The discussion that we had during the last meeting - I think you were all here - we were discussing -- we have heard the testimony of Commissioner Williams and you people from the industry requested to give your testimony and so I would ask W. Monte Taylor, would you like to come forward, sir, and discuss whatever you would care to discuss about 524?

MR. TAYLOR:

Am I to understand that I'm supposed to just discuss the backstop bill?

MR. RAY:

You can discuss whatever you want, sir - if it concerns this bill or any other possible contingency.

MR. TAYLOR:

Mr. Chairman, members of the committee, my name is Monte Taylor, I'm Alaska Operations Manager for Exxon Company, U.S.A. With me today is Ken Reither, who is a tax attorney

for Alaska Operations. I appreciate the opportunity to present our views on this issue and I will develop, in this testimony, the fact that we have a limited opportunity to resolve - in an equitable manner - a major issue facing the state and the industry. Some days ago, I joined other oil company representatives, as well as a number of Alaska citizens not affiliated with the oil industry, in testifying before the Joint Gas Pipeline Committee against the adoption of SB 524, then identified as Sponsor Substitute for House Bill 200. At that time I commented that this bill did not solve the problem at hand and that it would only invite further litigation. I also noted that the bill would simply be a disguised tax increase, something most Alaskans do not favor, and would build instability into the tax system while assuring an annual confrontation between the State and the industry. Changing the number on the bill, to 524, has not changed its provisions or its effects. The bill is still not in the best long-term interests of the state, it's people, or the oil industry. Despite what some may say, the backstop bill is not risk free - not only does it carry the legal and the economic risks of additional lawsuits, but it endangers any future settlement of this issue. It certainly does not enhance the state's negotiating position. As time goes on, the amounts at risk in the Chapter 21 law-suits, grow at the rate of about one billion dollars per year,

according to state figures. While it might be possible now for Exxon and other companies to give up the 1.5 billion in taxes paid under protest so far, the larger the amount gets, the harder it becomes to write off past payments for potential future gain. And any future settlement would certainly require the state to make at least a partial refund of some of these past payments. In my earlier testimony before the Joint Gas Pipeline Committee, I commented that Exxon felt that somewhere between the extremes represented by this so-called backstop bill, and the simple repeal of AS 43.21, there must be a middle ground, which would stabilize the tax structure, solve the uncertainty of future state revenues, and permit the industry to plan with more certainty on future involvement in the state. We felt that this middle ground, or 50/50 settlement, was possible because of some preliminary discussions with a number of legislators. Since that time, we seriously discussed - with Ed Dankworth and certain other members of the legislature - the possibilities and details of compromise leglislation. These discussions resulted in a proposed compromise bill which, apparently, is not before you today, but which Ed Dankworth has ...

MR. DANKWORTH:

Mr. Chairman?

MR. RAY:

Senator?

MR. DANKWORTH:

May I interrupt at this point?

MR. TAYLOR:

Yes.

MR. DANKWORTH:

You -- he's brought up a modified portion of a bill - 524 - an amended version which he's discussing now, and I'd like the opportunity to pass those out to the members so you'll know what -- so everybody'll know what he's testifying to.

MR. RAY:

No objection.

MR. DANKWORTH:

Now that you all have a copy ...

MR. TAYLOR:

I'd like one.

MR. DANKWORTH:

This is the settlement ...

MR. TAYLOR:

Oh, okay.

MR. DANKWORTH:

In passing that out, Mr. Chairman, if I may proceed -- may I have just two minutes to comment about why I'm passing this out?

MR. RAY:

You're a member of the committee, sir.

MR. DANKWORTH:

Thank you. So that everyone will know what I have just passed out -- as the testimony's certainly correct - we've spent a lot of time working on proposals - it's been referred to a great deal as a settlement proposal, and with that, there was a lot of months of work that went in back and forth and working on this bill and I commend you fellows for all the time and effort you put into it. So at that, if you'd like to address this settlment proposal, Mr. Taylor, fine, but I wanted the committee to know how that came about, I didn't just pass this amendment out in the last few minutes.

MR. TAYLOR:

Okay.

MR. RAY:

Before you start, sir ...

MR. TAYLOR:

Yes, sir?

MR. RAY:

... if it's agreeable with the committee, it's my thought as chairman that during any testimony that any witness is giving, any member of the committee may halt the testimony at any time for a question ...

MR. TAYLOR:

Yes, sir.

MR. RAY:

... as long as it isn't dilatory. Go ahead, sir.

MR. TAYLOR:

Okay, the compromise that is now before you, we believe would, in fact, settle the current oil tax controversy. However, I might add that the compromise does not result in the 50/50 settlement we proposed, but rather as a better than 70/30 split for the state. The compromise, if I divert just a minute to talk about some of the characteristics of it, what it does is convert the income tax to modified apportionment effective January 1st, 1982, in lieu of chapter 21, if the industry has dropped, with prejudice, the lawsuit at -- before that date. It also has a compensating increase in the severance tax to 15 percent, also on January 1st, 1982, and also conditional on the dropping the law-suit. And includes a 10 percent tax credit for investments in Alaska against the income tax and that's not exclusive to the oil industry, it would be for any industry making investments -- any corporation making an investment in Alaska. As we view it, the compromise through this combination of apportionment formula, the increased severance tax, and the tax credit offers much to the State of Alaska. First, it would allow the state to keep the 1.5 billion dollars in income taxes it's collected so far under Chapter 21,

and the interest on that money that would undoubtedly be added to the state's liability under an adverse court decision. Second, based on figures supplied by the Department of Revenue, it would provide the state over a 30 percent share of the Prudhoe Bay net oil income. Third, it would result in only a very minor decrease in funds available for appropriation in fiscal year '82, and fourth, it would provide for increasing levels of state revenues in the years ahead, again based on the state's projections. Over all, the compromise would allow the state to recover 73 percent of the amount at risk by the time the courts are expected to resolve the current Chapter 21 lawsuit. The industry, on the other hand, would only receive 27 percent of the amount at risk. Nevertheless, we would be willing to settle for this amount, at this time, in order to obtain the promise of a more stable and predictable tax climate and the incentive for future Alaska investments through the investment tax credit. As with any compromise, neither side will get everything it wants, or feels that it deserves, but both must get enough to make the agreement mutually worthwhile. Believe me, we have worked long and hard to accomplish a settlement this year and have compromised on our side to the limit. Perhaps the major benefit to the state and the industry from this compromise would be that it would allow the state and the oil industry,

at long last, to put behind us the almost continual tax confrontations which have characterized our relationship since the discovery at Prudhoe Bay. It would allow us, instead, to use our energies to work together to promote future development and enhance the long-term benefits of that development for Alaska and its people. Mr. Chairman, Exxon had great difficulty coming to the point of agreeing to this compromise, however, if it is enacted into law in this form, Exxon would withdraw its lawsuit contesting the constitutionality of Chapter 21, and would relinquish its claim to those taxes already collected under that statute. This morning we were handed still another version of a bill that I would like to comment about, too, if it's going to be introduced to this committee.

MR. DANKWORTH:

Mr. Chairman. I would like for you to comment on it because it probably will also be offered as an amendment, so now would probably be an appropriate time, if you like, to comment on it.

MR. GARDINER:

Are we going to have copies of that, too?

MR. DANKWORTH:

They should be being made up now. I don't whether they're ready or not. Senator Ray, shall we hand them out?

MR. GARDINER:

Mr. Chairman? I had some questions on this proposal. Maybe it would be better to ask them before we go on to the next one.

MR. RAY:

Go ahead Representative Gardiner.

MR. GARDINER:

Okay. You made the argument now and in the past that the one thing that you didn't like about the backstop bill was the thought that industry would just file another suit against it and something, as it wouldn't get us out, and this proposal, because it's acceptable to the company, would get us out of litigation. There's a question about the other companies and stuff, but I have some questions about how safe this thing is in court, too - whether this is going to stand up. Because this doesn't really repeal 43.21, does it?

MR. TAYLOR:

It replaces, after the effective date that the other one comes in, it - in effect - replaces 43.21 with a modified apportionment.

MR. GARDINER:

But it would still be on the books for the other companies that aren't part of the suit.

MR. TAYLOR:

No, it would -- it would only be on the books for the time it's already been on the books and would be completely replaced by the modified apportionment, as of 1/1/82, assuming that the three companies that are in litigation had dropped their lawsuit with prejudice.

MR. GARDINER:

But how does that apply to the other -- it doesn't say that in here on page 3 -- is that the language that you say does that?

MR. REITHER:

Right. The intent of the bill is -- 43.21 just would not apply after 1/1/82.

MR. RAY:

Would you identify yourself, sir, for the record?

MR. REITHER:

Pardon?

MR. RAY:

Could you identify yourself for the record?

MR. REITHER:

Oh, it's Ken Reither, R-E-I-T-H-E-R.

MR. RAY:

Proceed, sir. Go ahead.

MR. TAYLOR:

The -- to get into that further, Terry, of course the past liability -- I mean the past other companies that are not

involved in the lawsuit would still have paid taxes under 43.21. They obviously have not joined the lawsuit now, in Tom's words I think the amount at issue there if they did sue would be minimal and we would have agreed not to - even if they sued and won - on the past liability for 43.21, we would have dropped with prejudice, so we wouldn't be able to take advantage of that. So, for the major revenues, it would be safe.

MR. GARDINER:

Okay. Do you think there is a delegation of powers problem with this section in the sense that three companies have basically the leverage or control, or the decision to effect other taxpayer's tax policy. Whether that's for better or for worse isn't one of my questions, but in effect, the state says look, all you companies out there, we'll change your tax policy if these three companies that are taking us to court do X, Y, and Z. I mean, is that a delegation of powers problem that would be a constitutional question?

MR. TAYLOR:

Well, I'm not a lawyer so I don't feel qualified to answer that. But another way to handle that, if you're worried about that, is not put that in the law, get letters from all three companies, which we're prepared to do, saying we will drop the lawsuit, signed by the appropriate

management, and then that potentially could solve that problem, if there's a problem; I don't really know.

MR. GARDINER:

Okay, this modified apportionment, of course, the companies have filed suit and say that there's all kinds of constitutional and legal problems with 43.21 -- I'm concerned about this modified apportionment doing the same thing. So you're sort of representing to us that you feel the modified apportionment is a legal and constitutional means as proposed here?

MR. REITHER:

Well, modified apportionment has been adopted, as I understand it, by 39 -- or apportionment formula taxation has been adopted by 39 states ...

MR. GARDINER:

But nobody has one quite like this.

MR. REITHER:

... and several of those states have modified apportionment of one kind or another. I agree, nobody has one exactly like this, but again, if we have settled a lawsuit on the income tax on this issue, I don't see where the risk is.

MR. GARDINER:

Well, the risk - seems to me - that you come in and you say well, this is fine with us, this modified apportionment, and then we settle out 43.21 some other company says well,

we don't like this extraction factor. It's unreasonable, it doesn't relate to our business activity -- in Alaska, they file suit and they win, you're not stipulating that if some future company beats this apportionment in that you won't take advantage of that, are you?

MR. TAYLOR:

No.

MR. GARDINER:

So how do we know you're not selling us something here that you think will be struck down in court? I mean, do you think this is vulnerable in court, on the bases -- on that basis?

MR. TAYLOR:

From the discussions I've had within our company, we do not think that it's near as vulnerable in court, and we've had discussions with your attorney general and people and I think it's generally accepted that the modified apportionment that since it's been adopted by most of the states, is a lot safer way to go about it.

MR. GARDINER:

Mr. Chairman -- that's what bothers me is what you say -- you don't think think this is near as vulnerable, right? And you stated other very carefully worded language in the previous testimony today that is very much like that. You're not saying that you think it is, you think it's better.

But I don't know if that's a dollar better, or a lot better, or whatever. So, it really is a big question in my mind, is whether we're making an improvement here or we're just opening up another court suit with this. I don't hear strong statements from you that - yes, we've checked this out with our legal people and it is a safe thing for the state to do.

MR. TAYLOR:

Do you want to say something?

MR. REITHER:

I don't think it's possible to write a law that absolutely guarantees the state that no one will challenge it. I think it's fair to say that Exxon wouldn't challenge that law, and I think, as to the merits of it, just how safe that law is -- I'd invite you to direct a question to Commissioner Williams.

MR. GARDINER:

Mr. Chairman, I'm not worried about the Commissioner suing over this thing, but I am worried about ...

MR. REITHER:

Well, you're worried about us suing?

MR. TAYLOR:

Well, we are proposing ...

MR. RAY:

Let him finish, please.

MR. GARDINER:

I'm worried about you and even if you say you won't, I'm worried about the reality of the legal problems with it. You might say we won't, but then run around and get one of your buddies to do it. I mean, I'm not saying you're going to do that, but that's conceivable that somebody would just do it on their own anyway, and I would like to know like, everybody's complaining about the one we got now, and I'd like to really know if this is any better and hear your legal people sit with their legal weight behind it and say it is okay.

MR. TAYLOR:

We think it's much better and we think if we settled the lawsuit, obviously, it's much better for the industry and the state. And we don't have some imagined scenario up our sleeve.

MR. GARDINER:

Thank you, Mr. Chairman.

MR. RAY:

Okay, any other questions for the witness? Thank you. Senator?

MR. DANKWORTH:

You know, Monte, we worked for an awful long time -- 2 months on this settlement, and I know you fellows have put in an awful lot of work and I think I have too and others of the Senate Committee and everyone trying to find that which we all think is

desirable and that's to get out, and this is the proposal and I really sincerely believe, when you tell me this is the bottom line. We went as far as we could go to get a settlement. Now, there was another amendment as I saw it, and I don't mean to make a speech, Mr. Chairman, but I do think the committee needs to know -- as we look at the different options this is one. Of course, the bill before us is 524 is one -- but we could have an amended, and I'm going to propose an amended thing to this settlement agreement and I'll explain that in a minute. and -- because I want you to address these things, the other one is I think that you will hear testimony later, is if we could take 1 and 2 which is the 200 and the settlement agreement and put it on a ballot and let the people decide - I think that will be testified to later. Of course, there's the other one, and that's the -- what we call the old warts bill and we just put that in and repeal the windfall profits tax and raise the severance tax and go from there. Then -- or we could do nothing. So with those options, I'd like to go back and while others will be addressed during this meeting, we've already talked about 200, I've passed out what I consider an amended version or settlement agreement - not a settlement agreement, I'd better not use the word settlement, but at least an amended version of what was originally the settlement agreement that is no longer a settlement agreement.

MR. TAYLOR:

Yes.

MR. DANKWORTH:

But an amended version that I made may propose as amendment before the committee and I may be unfair to you to ask you to comment on it in the short length of time you've had to see it, but if you could, and if you've had time, I think the Committee would like to hear your comments on that proposal.

MR. TAYLOR:

Yes, well we got a copy of that bill this morning and I'm not sure this is exactly what we were looking at, but assuming it is, that -- what that appears to us to be is pretty much a grab bag of various bills that have been floating around - as Ed says, including the compromise -- the proposed compromise, but also including some provisions from the backstop bill. In comparing it with the compromise, what it does is removes entirely the investment tax credit, which we considered a major -- an integral part of the compromise and the incentive for industry to agree to only a 27 percent recovery of the amount at risk. It also increases the severance tax on Prudhoe Bay by $2.2 billion over that proposed in the compromise, and it creates a major disincentive for future marginal fields in that it places a higher severance tax on all future fields for at least 10 years, considerably higher, it takes away the ELF

factor, and in our view does nothing to settle the lawsuit. So we view that as merely another attempt to substitute another tax for the Chapter 21 tax which we think is unconstitutional; it's another backstop tax, in our opinion.

MR. RAY:

Does it lessen the state's income from the oil production?

MR. TAYLOR;

What, sir, I couldn't hear you.

MR. RAY:

Does it lessen the states income from the 30 or 31.8 or whatever it's considered the state is getting now?

MR. TAYLOR:

I think it does reduce the state income somewhat over the 5 year period we're talking about. We looked at it as about a 95 percent recovery by the state of the amount of money risk, which, of course, is not even in the ballpark as a settlement.

MR. RAY:

But you don't believe it removes the challenge, or at least you say that it won't remove your court case challenge?

MR. TAYLOR:

No, sir.

MR. RAY:

Well, I think you're wise in that because if you win, you win - you know - and I think that you should proceed along those lines if you feel that strongly about it, I think --

once and for all you'll know exactly what the extent of the State's taxing abilities are. Senator?

MR. DANKWORTH:

Monte, on this -- and again I apologize for the lack of time you've had to look at this -- but on page, the bottom of 13 and the top of page 14, we talk about production of what any new oil production would cost. We allowed 5 years, the first 5 years to revert the -- we would go back to the 12.25 severance tax and the ELF factor would go back in for that first 5 years.

MR. TAYLOR:

On a new field?

MR. DANKWORTH:

On any new -- and I didn't know whether you had time to see that ...

MR. TAYLOR:

I didn't notice that the ELF factor was -- what happens in the second 5 years on a new field?

MR. DANKWORTH:

Then, of course, you have the problem of not having ten in and that there will be a 5 year problem there. But at least we have the first 5 years covered.

MR. RAY:

12.5 %

MR. DANKWORTH:

...get back to 12.5%, yes, sir.

MR. RAY:

After 5 years it goes to 15%. In other words, you get the first 5 years production at 12.5 and the next 5, or from then on, ...

MR. TAYLOR:

Well, that's how I read it - at 12.25, but without the ELF factor.

MR. DANKWORTH:

But it was my understanding, and we will hear the testimony in a moment from the Commissioner, but I thought it went back. I'll find out when he testifies as to whether that does.

MR. TAYLOR:

But in any case, if you have a marginal field, the ELF -- one of the good things about the severance tax in Alaska is the ELF factor because it takes into account marginal fields and makes them different from major fields. Any time you assume that 1.0 for some period of time, that's going to be very damaging to a marginal field, whether it's the second 5 years or the first 5 years.

MR. DANKWORTH:

I wanted to correct that because I think you're right. I think after the first 5 years you would go back to the

12.5 on the severance but you wouldn't continue for that next 5 years -- but I don't think the ELF factor comes out -- the ELF factor would still be 1.0 until you got the 10 years of production in. So you are correct in that.

MR. RAY:

That's in section 13. It takes care of the ELF factor. It tells you the first 10 years is 1.0, and then it goes on ...

MR. DANKWORTH:

Right.

MR. TAYLOR:

Yes.

MR. RAY:

... ELF factor. After the first 10 years ...

MR. TAYLOR:

... after the first 10 years. I understand.

MR. RAY:

... then you go to your monthly production rate, total production (indisc. -- noise). It's an easy formula that everyone can understand.

MR. TAYLOR:

Right.

MR. RAY:

It's not like the severance tax. This is much easier

than the severance tax where, you know, a barrel pops out of the ground and there's so much that the State gets, and so much that you get. That's very complicated. But this is easy.

MR. DANKWORTH:

Mr. Chairman. I would like, before you leave the witness chair there, to go on to the other options for just a moment because you commented on that one. And while you are here, if you'd like to, the other proposal was to take -- it will be proposed, I'll assume, because it's one of the Governor's proposals ...

MR. TAYLOR:

To take it to a vote?

MR. DANKWORTH:

To take the number 1 and 2 that you are here to testify in favor of, the settlement agreement, stand it alongside the backstop 200 or 524, whichever you prefer, and let the people decide what they -- you know, we're talking in terms of possibly, with the settlement agreement, of loss of revenue to the State -- and that again depends on how you want to do it -- there would be a reduction of revenue of about $400 million. There's a number of ways of calling that, whether it's a loss of revenue or correcting some inequities.

MR. TAYLOR:

We call our part loss of revenue -- that's a lot bigger, too.

MR. DANKWORTH:

I understand that. Putting that settlement agreement up against going into the backstop, that's one agreement that you might want to comment on as to how your company would view that proposal. And the next one would be to do nothing. Leave everything just as it is until next year. And the 6th one, of course, is the repeal of the windfall profits tax, raising the severance tax to 15, and, I believe, is that correct, we went back and put what we call the warts arrangement in. So if you'd like to comment on those three ...

MR. TAYLOR:

Okay. Well, I guess -- putting it to a public vote is -- I can't think of the proper terms -- is a cop-out, as far as I'm concerned. This is a representative government -- the representatives should take the action, as far as we're concerned.

MR. RAY:

Is that how you handle your stockholders meetings, sir? When you have a policy question, is that when you are copping out?

MR. TAYLOR:

It's according to what the question is. Some questions

are valid for the stockholders. Some questions are not. This is proposed as an advisory vote.

MR. RAY:

I see.

MR. TAYLOR:

In any case, if it was passed that way and subjected to a public vote, and I don't know what our company would do about that, I would say first off that our agreement to drop the lawsuit on that compromise would be up in the air, that it would not carry through to that. We would also not agree to necessarily work on the vote or to drop the lawsuit if we won. In some ways of thinking, if we won a public vote, you begin to wonder whether you ought to do a 73:27 compromise, if we had the public on our side in voting that way.

MR. DANKWORTH:

I take it then that you don't see that as one of your better options.

MR. TAYLOR:

No.

MR. DANKWORTH:

What about doing nothing. How do you feel about doing absolutely nothing. I know that's a tough question for all of us. How do you feel?

MR. TAYLOR:

We like that alternative better than some of the ones that are being considered right now because we still think a rational solution to this is some kind of a negotiated settlement. And doing nothing, at least, leaves us in a position possibly to do that. I don't think we can just go through the years and keep trying to settle the way we're doing it, and us picking up all the tab for past taxes paid. If we were to do nothing, at least there would be the possibility that this summer, with the right people, we could work out a compromise. I don't think it could be any better than the one we've offered. But maybe we could get more people convinced that we are offering a pretty good compromise. And maybe do it next year with the same effective dates. But, the do nothing option only has appeal if we are working on a settlement, it seems like to me.

MR. DANKWORTH:

Now the last one was the -- if you would like to comment while you're here on this -- the one where we would -- it was an original discussion when we first came down here talking about the possible solutions. I frankly don't know whether you were in on those discussions or not.

MR. TAYLOR:

Where you trade the windfall profits tax for an increased severance tax? That's no compromise. That's nothing. What are we to do? You can do that but not in exchange ...

MR. REITHER:

Could I add something there too? It also doesn't do anything to get rid of the lawsuit.

MR. DANKWORTH:

I agree. But I'm going to assume that number 1, the backstop, is not too good. 4, going to the voters, wasn't too good. 5 is do nothing which you could live with, if we could work on an agreement, but that's not too good - certainly not for the State because of the cash flow problems that would be involved. If we were to settle next year I think our settlement is going to be much harder, and secondly, the fiscal problems that are involved here if we allow the State to go any further without even an escrow account or some type of -- we are putting ourselves in a great deal of jeopardy. And the sixth one, of course, like you say, is do nothing. It gets us back to number 2 and 3, and that's the settlement agreement which you propose to get us out of court, and everybody shake hands and go away, with us with a little less cash and everybody happy. Or number 3, which is a little bit of

everything, and possibly -- we can discuss that later. You have already addressed that. Basically, as I see it, we are down to those 2 that make any sense.

MR. TAYLOR:

Well, one of those makes a lot of sense to us.

MR. RAY:

Are you finished,Senator?

MR. DANKWORTH:

I would like a few more ...

MR. RAY:

If time permits. Mr. Donaldson, Vice President for Government and Public Affairs, Standard Oil Company of Ohio.

MR. DONALDSON:

Thank you, sir. Mr. Chairman, members of the Committee. As you requested I will focus my testimony on the subject of this hearing. That is to say, what I understand is referred to now as Free Conference Committee Substitute for Senate Bill 524.

MR. RAY:

No, sir, that is not correct. This testimony ...

MR. DONALDSON:

How should I refer to that?

MR. RAY:

This testimony is opened for anything contingent upon

Senate Bill 524, or anything else. As I said at the first, if you have something that you want to say, we certainly don't want to cut you off, sir. We will give you a wide latitude as long as you don't get too far afield.

MR. DONALDSON:

I appreciate that, and thank you. What I'll do then is address that, the associated oil and gas tax policy of the State, and the effect on our pending litigation. A moment ago, Senator Dankworth mentioned that he thought the focus was down to two subjects: one was the possible settlement or compromise, and the other, I guess his third alternative, which was the, sort of, catch all of pieces...

MR. RAY:

Sir, that was -- the individual Senator was speaking for himself. All the options are open. It comes with the consensus of opinion of both the House and the Senate committee members, subject to the ratification by the body. So we are not limited to anything. If you've go some other thing that you want to talk about, you go right ahead.

MR. DONALDSON:

Let me go back just a couple of steps, then, to deal directly with the subject of this committee. The subject before the Free Conference Committee today, I think, is

really the third major effort by the State and our industry to try to settle or resolve our longstanding differences on the State's oil and gas tax policy. The first attempt at this occurred a year ago at the end of the last legislature. A lot of work was done to find a legislative settlement, and all concerned then agreed that the votes were there, in both the Senate and House, to pass a settlement bill. Unfortunately, the Speaker and the House leadership at that time would not permit a settlement bill to come to the floor. I told the Speaker that I did not understand his position and asked him what he really wanted. The Speaker said, and I quote, we'd like to rewrite the Prudhoe Bay leases. I'll tell you frankly, I was shocked by that answer. I'm still concerned that this thinking has been with us in all of the efforts to resolve the problem since that time. Last fall discussions began again between the State and the industry. Some progress was made. But on March 18th of this year a press conference was held here in Juneau. The timing and the content of that conference came as a surprise to us in view of our ongoing discussions. The State made it clear at the conference that it intended to maintain the State's revenue position and that it would not seek a settlement, notwithstanding the serious constitutional challenge on

the present oil and gas income tax facing them in the courts, and the financial risk to the State in such litigation. Five weeks ago Senator Dankworth initiated an effort to find some middle ground between the State and our industry to solve these difficult problems. While substantially protecting the State's revenues -- his intent was quite clear, I think, in that. He laid some very tough requirements for any settlement on us. My first reaction was that it just couldn't be done. The Senator is a hard negotiator and hard negotiations followed. Finally, and I might say reluctantly, two weeks ago, SOHIO, Exxon and ARCO agreed to the Senator's requirements. We had, and still have, nothing more in the drawer to add to that settlement. A one page summary of this settlement concept dated June 19th has been around for the last couple of days - it is a convenient summary reference for the longer document, and if you'd like I'd be happy to furnish extra copies to your Committee. I think it's a convenient reference to see the overall structure. What is does do is present that idea or concept in its basic terms. It spells out the impact on the State and, likewise, the impact on our industry. I would like to submit this for your record in this Committee but for settlement purposes only and the discussions attendant to that.

MR. RAY:

Sir, if I might -- just to identify this for everybody, for all of us -- is this the analysis of the House Committee Substitute for Senate Bill 524? Is that what you're talking about, sir?

MR. DONALDSON:

No, it's in Chapter 21, lawsuit analysis, summary of proposed compromise, dated June 19, 1981. It is a one page executive summary of the settlement compromise that we have been discussing for about 5 weeks. It's simply a convenient synopsis of it because there are a number of facets to it. I won't go through it. The points are obvious, but I thought you might like to have it as a reference. From SOHIO's standpoint, this proposal is still on your table. There comes a moment in time when a matter is capable of resolution. I think the moment on this matter is now. We certainly tried to find a way, and our best effort is before you. I believe it is a workable answer for all of us. But the choice, of course, is yours. You might ask what the alternate choice or choices are. There are a number of them but, perhaps, the principal one is this grab bag or catch-all of ideas that has been alluded to. Let me speak to that. We've waited from day to day for a couple of weeks and through a number of postponements, and we just had a

chance to look at this this morning, scrambled to see what it said and to prepare some testimony in response to it. There are a number of important last minute changes in it. It is quite different from, the settlement that that summary shows. A principal thrust of this appears to be another form of backstop legislation designed to maintain for the State virtually all of the revenues produced by the oil and gas income tax which is now in the courts. The principal thrust of this new draft continues to be directed at Prudhoe Bay, a single oil field. Its basic tax mechanism is to reduce, and hopefully legitimize, the present oil and gas income tax and recover the same revenue by substantially increasing the State's severance tax. In addition, this proposal puts new economic pressure on marginal oil fields that have been, or may be, found in Alaska, thus discouraging that part of the State's future as we would see it. This bill also drops, or omits,the idea of an investment tax credit that so many here in Alaska in the last couple of weeks have found quite attractive. A few words should also be said about the effect of this proposal on the settlement negotiations,such as they have been, and the pending litigation. First, I would have to tell you that our settlement proposal would be withdrawn for all purposes. It should not be considered, in any way, as a starting

point for next summer or for next year. Second, you shouldn't be surprised if we amend our complaint in the pending litigation. This was the question that you asked a few moments ago, Senator - I'd like to speak directly to that. This backstop legislation is so inextricably intertwined with the present tax law and the legislative history of this session, that virtually all of the same legal issues we have raised in that pending case will apply to this new backstop. Third, and perhaps even more importantly, the drift of this litigation that's in the courts now, and such a backstop tax, whether it's this grab bag that has been referred to, although I hate to characterize it as such, or former H.B. 200,the reserves tax type backstop, will put in issue, in my judgment, the whole of Alaska's oil and gas tax structure, not just its present income tax law, and not just a backstop bill. If you like I will give you the rest of the theory and then you can cross examine me, sir. The cumulative effect ...

MR. RAY:

Do you want to speak now, Representative?

MR. GARDINER:

No, I'll go with his ...

MR. RAY:

Go ahead, sir.

MR. DONALDSON:

I might shorten it a little bit. The cumulative effect of all the State's tax increases over the last 12 years capped by the State's decision that it is entitled to at least 30% of the net income from the Prudhoe Bay oil field as its fair share, and that it will act to maintain and protect this share through a backstop bill raises this new issue. In plain terms, the State has said, and is saying, that its backstop approach is not a genuine tax, but is simply a taking of a predetermined share of a property it sold over 12 years ago through its oil and gas tax leases.

MR. GARDINER:

Mr. Chairman. You brought up this issue before, or I should say threat that if we pass the backstop bill, which doesn't increase the State's take from what it is presently getting, that you would then litigate the total State taxation policy. My question to you is that if that is the case,why aren't you doing that now? If that is such a good thing to be doing, why aren't you doing that now?

MR. DONALDSON:

There are two reasons. First, our counsel are actually working on that as an amended complaint. Secondly, every time the subject of litigation comes up in one of

these hearings, the word goes out that somehow we are making a threat or we are being arrogant or we are being outrageous. Those are the terms that are applied. On the other hand, if we don't now tell you what we are really preparing at home, some day you may come as say why in the world didn't you tell us. I'm in a box. I hesitate to get into these subjects. That's the reason we haven't done so in the courts so far, Mr. Gardiner.

MR. GARDINER:

Well, my question is why didn't you do it last year? We haven't raised any new taxes last year, right? So the level of taxation that you had last year and the year before, and the year now, is the same level. Or is it suddenly because there's a proposed bill in the legi$lature, and the legislature and the Governor said in the statement that they intend to maintain the same level of revenue, not up, not down. Suddenly now the boogieman of - we're going to take on the whole tax structure comes up. If that was such a good legal idea why didn't you bring it up two years ago or last year or in January?

MR. DONALDSON:

Two things have happened since then. First is that the intent or purpose of the State in nailing down this predetermined come-to-30%,or whatever it is, share has been

etched pretty indelibly on the public record. You are manufacturing evidence for us right and left. And secondly, the direction of recent Supreme Court opinions, and cases now pending before us, give us substantial encouragement now to put this into the case. Both things are involved very much in our homework. I don't want to kid you about it. Those are the two key things. That really does explain the timing factor as we would see it.

MR. RAY:

I really don't find anything offensive as far as his job of threatening the State -- if he wants to threaten the State, it is certainly within his rights to threaten the State at any time he wants to. I don't see anything wrong with that, Representative.

MR. GARDINER:

Mr. Chairman, a couple of other questions on the settlement. The first question I have is the question I asked previously about whether, in the settlement bill that you propose, whether you feel that this modified apportionment formula is something that is legal, constitutional, that's going to stand up in court, whether it fairly represents your business activities in the State, since that's one basis it could be attacked on, that's what you are attacking us on now?

MR. DONALDSON:

From the standpoint of our own company, if we should settle this and dismiss with prejudice, we would not challenge it. Nor would we do something by indirection. Secondly, and going back on my own training as a lawyer, the Supreme Court has made it pretty clear that there must be some apportionment to be constitutional today. Chapter 21, today, has no apportionment. This modified apportionment approach goes a very long way to safe ground -- nothing, I guess, is 100% safe, but you are well within the area of an acceptable risk as government, in my judgment. No charge for the legal opinion. I might also point out, if you went back to a standard apportionment formula, you have no risk at all.

MR. GARDINER:

What about the issue of discrimination. That's, again, an issue that has been brought up in Chapter 21. Again, this formula is not going to apply to every taxpayer in the State. So do you think, you or someone else who might file suit against us would have a good legal case, in fact, that this is discriminatory?

MR. DONALDSON:

I can't speak with authority for any other company but my own. I can tell you that our company and the others associated in our present litigation have given this a

very thorough look. If we go to the settlement that we have put on the table, I don't think you have that problem. Almost any of the other alternatives that Senator Dankworth alluded to have the litigation potential that I have just addressed.

MR. RAY:

Could I identify just one more time -- the settlement that you are talking about, the original settlement not the -- what Senator Dankworth put out here as a Free Conference Committee Substitute.

MR. DONALDSON:

The settlement I have talked about is summarized on this one page, Senator Ray.

MR. RAY:

Okay. This whole -- we are getting so many papers here, it's hard to keep the identification factor.

MR. GARDINER:

Thank you.

MR. DANKWORTH:

Mr. Donaldson, speaking first to the first settlement agreement which you and I have spent a lot of time working on and tried to get to this point -- taking that aside, whether we think we've got the votes for it or do or don't -- at any rate, setting that aside, and let's speak to what I was going to put on the table as

a proposal amendment number 2 which is the -- what do you call it when you kind of throw everything in the same -- catch-all. I didn't really perceive it that way but, at least -- tell me where I'm wrong in my analysis in what I set out to do with this when I said that -- under that bill it would do away with Title 21. That seems to be one thing we wanted to do away with. These are the things that I thought the industry was interested in doing. It would give away -- it would take away Title 21 which we are in court on. It would repeal the windfall profits tax, which is considered unfair. It would hold -- you would gain approximately $300 million between now and 1985 on it. We would not have put into place a reserves tax which I personally have a great deal of problems with. I think, basically, it would get into a State property tax that I was wanting to avoid very much. But when you look at those alternatives, I can't help but think -- and, of course, also, that bill puts into place a proposed relief or tax, income tax, for smaller businesses or corporations which has not a great deal to do with 524, what we were talking about. But I thought, at least, it made it consistent that we didn't just give away the money - we put a sliding, graduated scale for taxes in there on all corporations or businesses. I don't know. It was

my intent when I proposed that, looking at all the options that were coming down here, at the end of the session, that that was the one that we probably could address as many concerns as everybody -- nobody got anything that they wanted, but at least it was as much and as close to trying to give everybody something that would hold the revenue then under $300 million -- the oil companies would at least pick up $300 million, and it would stop the reserves tax - that's what I was interested in doing. I realize that it creates some other problems. It's not a settlement agreement. We didn't agree to get out of court or anything like that. But that was the reason that I'm proposing this settlement agreement. So far, if I understand your testimony, and the one I believe I told you both here and in private, that the most desirable, of course, is the one that I am not convinced at all that is passable this year. And that's the settlement agreement that we worked on. Mr. Chairman, it's going to be worth just a minute for me to talk about, for the Committee's sake, to bring you up to date on the conversations that have transpired. Originally, all of us agreed -- we generally perceived, I think, that we did not want the State to lose any revenue. Then somewhere along the line we perceived that the fair share for Alaska is 30%.

That's what I ask you fellows to do. You go out and find a formula that will come up with 30% and you did that in the settlement agreement. I think what caused some of the problem is that, after we got into that, we found out that Alaska would get more than 30%. It was about 31.8%, which is about $1.3 billion or better. In the meantime, of course, we had all mutually agreed, in the statement that you referred to, that there would be no substantial reduction in the revenue. And politically, that's where we got into trouble. You fellows have certainly met your requirement and went out and brought back 30%. But then again that's what Ed Dankworth said, that I was going to get out and get 30% because that's the figure that's perceived to be the right one and you met your commitment. No one else agreed to the 30%. Most of them agreed that we would not take any substantial reduction in revenue. I just wanted to make it clear that there is a little bit of difference in what I perceived at the time to be 30%. I am not going to take all the blame for the 30%. I have heard the Commissioner of Revenue use it. I've heard the Governor use it. I've heard a lot of people -- because I think, we all perceive that 30% is what we were getting at. So, at least, so there won't be left in anyone's

mind any idea that there was, that we were trying to be deceitful about 30%. I hope you understand that. That was originally what I perceived to be Alaska's present share. At any rate, I did want to comment that I had proposed, right down to the wire if I knew that the settlement agreement is not going to pass -- 200 I can't stand. I don't like that one. I can't afford to do nothing. You can but Alaska can't. I thought that the middle ground that I proposed, while it has its faults so far as you're concerned, it certainly has its faults so far as the State's concerned - we would be losing another $300 million over the next 3 or 4 years and we are still in court. Nobody wins by that. I just wanted to make clear to the Committee that it took a lot of work to come to -- to even get this settlement.

MR. DONALDSON:

May I respond to your comment? Looking at this potluck of provisions in the bill that you have just described - there's some very good things in it.

MR. RAY:

Pardon, sir?

MR. DONALDSON:

I was just waiting for him to finish.

MR. DANKWORTH:

No, sir. You go ahead.

MR. DONALDSON:

I was going to say, in response to your comment about the bill, there's some very good things in it. You have mentioned the lower rates to small companies. I think it probably solves a 7(i) problem that the Commissioner has testified to. There is some treatment in there of the Cook Inlet gas problem, and those things make sense. When we were talking about the settlement, from within our own company's perspective, we are looking at a suit presently in court, as you know we think we have a much better than even chance of winning, and we said if you can find some middle ground, maybe split our differences down the middle, okay. As we ratcheted up the percentage of severance tax, we went from a 50:50 split to a 60:40 to a now something better than a 70:30 in the State's way. Your question is,doesn't this mix of ideas do it perhaps? It's not a 50:50, not a 60:40, not a 70:30 - it's about a 94:6 split. Obviously I think our management feel they can afford to litigate if that's the answer. It has the other two aspects that probably need further attention. And that is, it does raise taxes on marginal fields and wells in Alaska, whether it's us or a smaller company that is impacted by that. I'm not sure that's the wisest way to deal with that kind of a problem. And finally,

apart from the 94:6 division of the dollars at risk, it drops the investment tax credit idea which nobody could put a dollar to, but we thought was in the interest of almost everybody - the State, companies, and otherwise, up here, for the longer term. It's seed money for the future and obviously that's not a part of this provision. I understand the pieces. I don't see us settling the lawsuit. I see us going ahead on pretty much the grounds I sketched out for you. I'm glad to have the opportunity to tell you about it.

MR. DANKWORTH:

You are certainly right. I wouldn't dare propose this as a 94:6 settlement if I thought this was a settlement agreement. I'm not using the word settlement with this statement because we are long past the point where I think we can call it a settlement agreement. That we either adapt to your bottom line. I'm sincere when I think you went to that bottom line. It's not a 94:6. It's just another proposal for the present time retain -- we would be giving up somewhere between $300 million or perhaps more, I don't know. I suppose the tax credit is always a bargaining position that perhaps could be used in the future years, I don't know. But as I see it, it does make moot your case in court in the sense that we do get away with Title 21, we do

away with the tax. Those are things you, apparently, went to court on. Now you will continue in court to try to recover the $1.5 billion that is still on the table. That's the only reason to stay in court, unless you file another case. If you lose that, of course, that's another issue. It's not a settlement to get us out of court. But I think that there are -- in looking at all of these different proposals, at least, I want you to know it was my intent to stop what I considered some things that I didn't like and you didn't like. You can't have it all. I think, probably, when it comes down, everybody lost and gained a little bit. I'm offering this, not as a settlement agreement -- I understand very well that this is not a settlement and I knew when I was going to offer it that the oil industry is not going see this as good legislation. But, after all ,we do protect Alaska's interest too. This is an avenue that I think, probably before the meeting is over, I'm going to at least propose that as an amendment. I'm doing it in preference to 200 -- I don't believe that there is any chance that the difference between the $1.4 or $1.8 billion, whichever you want, between the 30% and the 31.8%. I'll let other Senators address this if they care to. I want to speak on the Senate side. I couldn't find enough

support for that, that I could risk if we were to take this Committee meeting here at the last of the session and go there and not have the votes to pass it, then we are in a position to do nothing. Do nothing means that the State of Alaska is out here with over $2 billion by the time we get back, in to revenue without any backup position, and no escrow account or anything. Fiscally, all of us are not going to let the State get in that position. Those are problems you are very well aware of, that we're up against it to the last day. Thank you for your comments on it anyway.

MR. RAY:

I see it just a little bit different than the Senator here. As far as I'm concerned, if we don't do anything this year, I'm sure that the Governor, as a prudent man, will take $400 million out of the capital budget and the operating budget and have that sitting there ready for us when we come back next year. It'll mean a loss of revenue to individual legislators or to the districts, but it will be a protection of the people and it's one that, I suppose, anybody that is responsible for the handling of other people's money that they take the idea that they're going to have that backup there that's going to be there, the money that we are generating now. As far as your -- I don't like to call it a threat, although

that was plainly what it -- that was plainly what it was, but I don't like to call it that. Nobody worries about threats of other people unless they have reason to. I think that the oil companies have just as much reason to be in Alaska as we have reason to have them here. Of course, it just goes down to the point, if you don't want to be reasonable then I suppose you will have to be anyway you have to be, and the State will have to be any way they have to be. As far as the implied threats, or the -- whatever you were doing -- I don't think that's going to make any difference because you are in a position of representing stockholders also, and it's your job to get the best return under the best conditions that you can for your people. And that's what you are going to do, whether it means a lawsuit or anything else. If you can settle it thus, amiably and properly with everything -- I think that's the best course. But if you want to take the hard course, I'm certain that the State will be prepared to meet any contingency.

MR. DANKWORTH:

Mr. Donaldson, thank you very much for your response on that.

MR. RAY:

... for his honest approach. Welcome, honesty is the best thing to get -- smooth words and the rest of it

doesn't really come down until you actually see what's facing you.

MR. DONALDSON:

Just in conclusion, please understand, for the next few days, that - whatever you want to call it - compromise is on the table and then it's gone. I happen to think it's a reasonable approach; I happen to think it gives the state a good deal of security for 95 percent of its revenue flow, the glass is much more than half-full and part-empty - you always talk about the empty part but there's a ton of money flowing into your hands for wise management that you're taking the cloud off of; we thought it was reasonable from that standpoint. You know we have a long-term interest in Alaska, that doesn't basically change. We will probably go on back to court and ask these questions; we'll take that when it comes. But the choice is yours, and we thought we were very close to what the state wanted and what we thought we could do. I hope you'll still give it a little further thought before you make your final decision.

MR. RAY:

Well, you brought up another good point. Maybe we should get this settled once and for all so you will know where your limitations and what the State's limitations -- maybe you should go through with the lawsuit and let you, whoever wins win and we'll know exactly what

happens. Then you won't have to apologize to anybody, and we don't have to apologize to anybody. That's another thought.

MR. DONALDSON:

We're perfectly prepared to do that as you know. As Mr. Taylor said, each year that passes it gets extremely difficult to forget an awful lot of past because those dollars pile up. It almost gets to the place where you have to call us, we can't come back.

MR. RAY:

We appreciate it.

MR. DONALDSON:

Thank you very much.

MR. RAY:

Thank you, sir.

MR. DANKWORTH:

Thank you, Mr. Donaldson. I have just one statement along with the Chairman's, and that is I do think it is important to settle this. I really wish we could. I think it is going to be harder next year. But I don't know, the Senator might want to -- I don't know whether he wants to propose -- comment. But I have tried. People will tell you. I have gone to these Senators, and I've talked about a $1.3 billion reduction between now and 1985. Personally, I don't

think that is an option you can sell at least in the Senate this year. We do have some time left. I don't know whether he wants to comment, but I have not found anybody in the Senate who is willing -- perhaps I'm talking to the wrong ones -- that felt that that was an option. That's what forced me into this position to stop the backstop.

MR. RAY:

I think -- just to respond, Senator -- You were, more or less, given a direction by the leadership in the Senate to do certain things. You did that. You came back -- if there was anybody that you could have got that would have presented your case more honestly, or more forcefully, was Senator Dankworth. He did that.

MR. DONALDSON:

He did. No question about it.

MR. RAY:

He was told very politely, thank you for your work but it isn't satisfactory to a majority of the Senate. That's about what it comes down to. Politely. Nobody blames you people for trying to do what you're doing for your own stockholders. Nobody blames you for trying to get the last dollar that you can get for your stockholders. We all understand that. It's your job. But you have to understand,conversely,it's our job to see

that our stockholders get value received for their natural resource. It isn't something that should denigrate down to a fist-shaking or anything else. It's something that calm and study and see if we can't reach a compromise, hopefully in our benefit - that's the way I see it, and you see it, hopefully, in your benefit. It's just a common ordinary occurrence in the business world. If I thought this would be the last I would ever see you people in court, hell, I'd sign right now. But you'll be back tomorrow and once you settle this you'll be back with something else. That again is your job to do that -- for every action there is a reaction. And that's what we are doing.

MR. DONALDSON:

Since we're in good discussion here and going a long way to try and understand each other. There are probably two more things just to add to your record. And both brief. One is that an industry, a company, doesn't understand, when someone approaches it -- and I'm not finding fault -- and says this is what it takes to settle. And we said we'll settle. And then have the other party, sort of, walk away, for whatever reasons. It's very hard for business to understand that type of negotiation. So there's a great deal of frustration among our home offices, as you might expect. Second thing,

if you look at the net profit from a Prudhoe Bay oil field. Today, under present federal law, the federal government is taking about 45%. Today, under present Alaskan law, the State of Alaska is taking something over 30%. The companies who have taken all the risk, done all the financing, are ground down to 23% or 24%. Things seem out of balance. This is another factor that may well be a driving force in our own analysis of trying how to solve the problem. Those two things may add a little bit to your perspective, but you know basically where we have come from, and you're right - we do have to represent our own shareholders.

MR. RAY:

Well, you shouldn't be disheartened, although it could be frustrating. You have to understand that when you are dealing with the legislature you are dealing primarily with a committee. You are dealing with a committee of 20 people in the Senate, and 40 in the House. And sometimes those committees are not generally in agreement. The whole thing is in any of our relations, I think really -- what's the old saw - reasonable men can certainly disagree but disagreeable men can never reason. I hope that we always are reasonable men.

MR. DONALDSON:

I appreciate that. Thank you, sir.

MR. RAY:

Thank you very much again. Mr. Showalter, did you want to give testimony, sir? Is there anybody here from ARCO? Dave? Excuse me, I'm sorry.

MR. HARBOUR:

Mr. Chairman, before I introduce myself, may I say that my remarks were predicated on an assumption that perhaps the Commissioner of Revenue would have given a description of the material on the table. If it pleases the Chair, I'd be happy to defer to the Commissioner until I give my own testimony. Or I can give it now - it's your pleasure.

MR. RAY:

Whatever your desire, sir. I'm sure -- we are here to listen to you. You can pick and choose within the limitations, and that's certainly within the limitations as far as I can determine.

MR. HARBOUR:

... you are agreeable to hear the Commissioner and then my testimony?

MR. RAY:

We might be hearing him next year. That was just a joke. Take it easy, David.

MR. HARBOUR:

I'm glad you identified it, Senator.

MR. RAY:

Just to allow the -- there is a request from some of the people from the Cook Inlet Region Inc. that would like to talk. Is there anybody here from Cook Inlet?

UNIDENTIFIED SPEAKER:

Cook Inlet Region has no testimony to give.

MR. RAY:

All right. Is there anybody else who would like to give testimony previous to the time we again hear the Commissioner of Revenue?

MR. BAUMAN:

Excuse me. I would like to speak briefly, if I could, on behalf of Amerada Hess.

(Testimony not requested)

MR. RAY:

Commissioner, I don't want to rush you but if you could keep to the specifics so -- because both houses have to be back in at 5:00. We would like to get a considerable amount of your testimony in here so that we can understand it.

COMMISSIONER WILLIAMS:

Thank you, Mr. Chairman. I'll try to keep my remarks brief. For the record, my name is Tom Williams. I'm Commissioner of Revenue. A question of the Chairman first - would you like me, at all, to respond to Mr. Bauman's remarks that were just made here? Or would you rather have me quickly describe this tax to lay the foundation, the predicate, for Mr. Harbour's testimony.

MR. RAY:

I would -- Senator: No, I would just as soon you would get to the main point. We understand what Mr. Bauman's problem is and we can address that in short order. We understand that very well.

COMMISSIONER WILLIAMS:

The idea of the settlement is, has been fairly well discussed already before. The ingredients are basically as follows: first, that the companies would walk away -- these three companies anyway, who together account for over 90% of the tax payments under Chapter 21 -- that they

would walk away from the taxes they have paid in the past, and the taxes they will pay for the remainder of this tax year. That is, for tax liability that accrues through December 31, 1981. That money they would no longer claim. They would dismiss their lawsuit with prejudice which would mean that, as far as they are concerned, the legal doctrine of res judicata would apply. They could not come back in and claim it. Even if someone else subsequently came in and challenged Chapter 21 and proved to be successful - as to these 3 parties, their claims are over with forever. That's one benefit the State would receive from the settlement. Another benefit that the State would receive is that the severance tax would go to a nominal rate of 15% instead of its rate of 12.25% at the present time. In exchange for this, the State would give up the principle of separate accounting starting with tax years beginning next year 1982. We'd surrender separate accounting, go back to the concept of apportionment, which is basically looking at a worldwide pie of income and using a formula to calculate how wide a slice the State is entitled to take out of that and say that's Alaska income. Then we tax it. The apportionment formula will not attribute to Alaska as many dollars as the separate accounting approach attributes to Alaska. The tax will have a

significant reduction. This reduction is only partly offset in future years by the increase in the severance tax. The net result has been calculated to be,between now and 1985, about $1.374 billion would be the total amount of that difference. That is, between now and 1985 the State would receive $1.3 billion, almost $1.4 billion, less under the settlement than it would receive under Chapter 21, assuming, of course, that Chapter 21 is ultimately upheld. The other ingredient in the settlement is a 10% investment tax credit for investments made in Alaska. This is a difficult one to quantify because it is very hard to guess for sure the precise timing of when investments will be brought on stream. It's patterned after the federal investment tax credit which says you don't get the credit until you actually place your facility into operation. For instance, when TAPS was being constructed, Trans-Alaska Pipeline System, presumably the credits were accruing until June 20, 1977 when oil started to be put into that pipeline and it began operation. Until that time all the expenditures in '76, '75, '74 and back to '69 or '70, were piling up, but could not actually have been used. The tax credit mechanism is a very difficult one for us to forecast. It's hard to quantify. But it is possible that we would see as much as $5 billion of qualified

investment coming on stream in the State between now and 1985. If that were so, then there would be $500 million of additional tax credits that would represent revenues foregone, if you will, from the present course that the State is on. That, in basic summary, is what the settlement is. On the one hand, you gain the certainty with respect to the revenues that have been collected, at least 93% of them. You gain, not quite such a degree of certainty with respect to future revenues under the income tax because even though these 3 may not challenge it, it is possible that others may. But I think they will lose. So it's a question of how slight you think the risk is that an apportionment formula will be upset in the future. I think that is a very small risk, and so there is very little likelihood that these companies would stand to benefit if some third party came in and litigated the apportionment formula in the settlement bill. It's mostly a question of dollars and cents. From our point of view in the administration, we go back to the principles that were set out in the joint statement in March of this year. Perhaps, it is worth recalling exactly what those, what was said then. It would have helped if I had it at the top. Well, I won't take time searching for it. The basic idea that was said then, I can't quote it verbatim, is that the

sentiment was expressed that the present level of revenues being taken by the State from the oil and gas industry was at an acceptable level - it was not unreasonably onerous and it was not unreasonably light. People felt comfortable with it. It was felt that any increase in the level of taxation was inappropriate at this particular time. By the same token, the statement goes on and says it was felt that a decrease, a significant decrease, is inappropriate at this time. I think the phrase is unwarranted and unsupported by a majority of Alaskans. This settlement -- if you divide it out -- works out to an average of about $400 million a year, not counting the imponderable in the investment tax credit. That is a lot of money. Whether that is a material reduction in the State's revenues is a different question. That's one that ...

MR. RAY:

What's the percentage?

COMMISSIONER WILLIAMS:

Overall it works out to a 5.2% reduction in the total revenues that the State is contemplating to get from the industry through 1985. In terms of this particular tax and the amount that is at issue here, we are foregoing 27% of the tax in exchange for security on the 73%. In our view it is an expensive price tag. However, the

mythical 30% figure has developed in conversations -- and I believe over a longer time period, our present level of 31.8 will, in fact, go down. So that if you look at a period of a longer duration, say to the end of the '90s, that you'll see we're right at the 30% number This number was not just pulled out of a hat. As fields age they become less profitable, hence the income tax will be representing, in future years, a smaller and smaller portion of the value of the production. Similarly, the economic limit factor in the severance tax will gradually begin to have an increasing effect on the severance tax rate, drawing it down toward zero as the economic limit is approached, and thus the severance tax will also be declining over time. It will represent a smaller and smaller proportion in those later years. Looking at the long scale, I think we are at 30%. In the short term, we find we are at 31.8%. The settlement agreement preserves the 30%.

MR. DANKWORTH:

I have one question, Tom. I don't want to interrupt your train of thought. Also, is the $1.8 billion -- I think it's about $1.8 billion that we would be collecting on the windfall profits tax between now and 1985. Under the settlement agreement, we would be losing 1.3. It depends on where you're coming from. Some perceive that tax to

be unfair. Every state in the Union, except, I think, Minnesota, and they don't have oil -- if we were to perceive the windfall profits tax was unfair -- that was the position of the State, $1.8 billion, that would put us truly back to about 30%. In fact, $1.3 billion puts us back at 30%. I suppose somewhere, maybe, a little below 30% -- if we said the windfall profits tax was not a -- we should give them the credit for the windfall profits tax. I'm just kind of backing up your argument because I think, probably, 30% didn't just come out of the air. It depends on what you think is fair. Go ahead.

COMMISSIONER WILLIAMS:

Basically, the point I was reaching is, where does the administration stand.

MR. RAY:

If you could contain yourself until tomorrow, Mr. Williams...

COMMISSIONER WILLIAMS:

Certainly. There's no suspense for me.

MR. RAY:

... because there are some of us that haven't had the benefit of looking at this for any length of time. I think it would be fair to look at the suggestion by Senator Dankworth in comparison with the, I believe it is the H.C.S. for 524, and also look at the settlement, and also look at the no settlement, look at the warts,

and look at the -- whatever else there is to look at. Both houses are going back at 5:00. If it's agreeable with the Committee, how about 2:00 tomorrow? Is that convenient with everybody? Pat? Pardon? At what time? Possibly we could ... Do you want to come back at 3:00? 3:00 tomorrow? We have to do it sometime tomorrow. We either turn it down entirely or to adopt one of the suggestions. Sir?

UNIDENTIFIED SPEAKER:

How about if we just say right after the joint session? Or is that not specific enough for everybody involved?

MR. RAY:

That's close enough. If it's 2:45 could we wait for 3:00? What I'm trying to do -- as far as the legislators, we can meet in a telephone booth and cut the deal. But we want to give you industry people the full operation so that if you have anything you want to say -- we don't believe it but we are going to listen. Ed believes it. I want to say one more time, there's been a lot -- probably, some strange questions or remarks made about Ed Dankworth, but I can tell you that the majority of them are not true. We'll meet at 3:00.

(meeting adjourned at 4:45 p.m. June 22, 1981)

# CERTIFICATE

STATE OF ALASKA )
: SS.
FIRST JUDICIAL DISTRICT )

I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing June 22, 1981 meeting of the Free Conference Committee on Senate Bill 524 was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 62 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this ____ day of July, 1981.

_____
Notary Public, State of Alaska
My Commission Expires: 11/30/84

ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

FREE CONFERENCE COMMITTEE ON SENATE BILL 524

TRANSCRIPT OF PROCEEDINGS

JUNE 23, 1981

COMMITTEE PRESENT:

Representative Bill Ray, Chairman
Senator Ed Dankworth
Senator Don Bennett
Representative Terry Gardiner
Representative Rick Halford
Representative Patrick O'Connell

J&R Associates

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586-6846

MR. RAY:

The Free Conference on Senate Bill 524 will please come to order. Mr. Harbour? Please identify yourself for the record, sir, and proceed with your testimony.

MR. HARBOUR:

Thank you, Mr. Chairman. For the record, my name is Dave Harbour. I'm Director of Alaska Government Relations for Atlantic Richfield Company. And I'm joined today by Jim Egan who is with our Anchorage tax department. Mr. Chairman, together we are grateful for the opportunity to address this Free Conference Committee on the subject of the various pieces of legislation before you. I will present you at the end of this discussion with copies of a formal position paper that our company has prepared. But in the interest of time and also in the interest of a little more dialogue, would like to be more informal with my remarks and at the conclusion of them would value the opportunity to answer any questions that may be presented. There are three pieces of testimony, or three pieces of legislation before the Committee today that result from the Chapter 21 crisis. One is the backstop or reserves tax version; another is a proposed compromise or settlement position; another is an amended version of

that particular legislation but would not result in settlement. First, I'd like to say that in testimony that our company provided in May to the Joint Gas Pipeline Committee -- at that time we expressed opposition to the backstop or reserves tax approach, and I'd like to reiterate our position that we believe that legislation is not in the interest either of the companies involved or the State itself for, indeed, it is not truly a backstop tax that would stop back the revenues that the State is achieving in a direct way but actually would be a real tax increase resulting in the imposition of an even higher tax burden on Alaska's oil industry. The proposed legislation does not resolve the issues currently being litigated in our constitutional challenge, but even guarantees that that controversy will continue and be expanded particularly through provisi of those activities for determining the millage as well as the valuation on the reserves or property. In fact, my attorneys have instructed me that there are -- may very well be raised new constitutional issues which could possibly place the Alaska tax structure into controversy. Now secondly with regard to the compromise or settlement bill produced by Senator Dankworth, we feel that it is required that our company and industry come the better part of the way to reach that particular settlement understanding. The State



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receives far more of the revenues at stake than does the industry and retains all of the revenue collected as a result of Chapter 21 payments since 1978,eliminating the possibility that at some point in the future it may be required to refund billions of dollars to the companies involved along with attendant interest payments. Now, in regard to this compromise or settlement concept that has been developed,there are two questions that may be asked. First, why should the companies involved - and I believe, Mr. Chairman, you asked this question yourself - be willing to settle on this basis when, as stated above, the State receives the vast portion of the settlement agreement. For one ,the legislature -- the legislation would return to the companies at least a portion of those revenues at risk. Secondly, it would provide a more stable tax and investment climate for the company to do business in. It would take the companies as well as the State out of litigation - in our case litigation with our largest royalty owner and put us perhaps on a course of working more closely together toward mutual goals. A second question that may be asked is,what are the benefits that accrue to the State as a result of that proposed settlement? Clearly,the State would receive, Mr. Chairman, over 70% of the revenues at stake. Furthermore, the State continues to receive

approximately 30% of the revenues from Prudhoe Bay as a result of that agreement, a share which is greater than that received by the industry which is producing the resource. The State frees itself from the litigation. And there's another aspect which is -- a number of State leaders over a period of the last few months and years have expressed dismay that as a result of this original legislation, Chapter 21, the State is taking a tax on the federal windfall profit tax paid to the federal government as opposed to the income of the State. Mr. Chairman, this settlement agreement,as negotiated, would require the State to give up less than if it provided the windfall profits tax deduction to the companies involved. And lastly, it's becoming increasingly apparent that the economy of the State as well as the destiny of the State and the oil industry are becoming absolutely linked. And this compromise, as we see it, would demonstrate to those not only in my business but also in other businesses that the State has a desire to achieve a predictable, stable tax policy, thus adjusting the atmosphere toward encouraging long term economic development in our State. Yesterday morning Jim and I learned of a third proposal before the Committee. It is a mutation of the compromise bill which would not permit settlement and which has a number of defects, although

somewhat less serious than those posed by the proposed reserves backstop bill. First, it would act as a disincentive to the discovery and production of new fields not only by raising the effective severance tax rate from 12.5 to 15% after 5 years of commercial production, but by eliminating the economic limit factor for the first 10 years of commercial production. Secondly, with regard to new or marginal fields particularly, we would find them less likely to achieve production since the severance tax effective rate increases initially and also after 5 years of production. Thirdly, it eliminates the investment tax credit provision of the compromise bill not only for my business but also for all Alaskan businesses, thus removing the incentive for increased investment in Alaska which ultimately produces more income for the State. And fourthly, it is a rejection of the settlement of current litigation. Mr. Chairman, the time has come, in our opinion, to clear the air and to remove that adversarial relationship which is -- has been shared by the tax collecting and the tax producing entities of our State for so many years. And although, as discussed, the settlement reflected in the Dankworth compromise heavily favors the State interest we agree to it, if it is enacted in the present form. Atlantic Richfield Company would immediately dismiss its lawsuit challenging the

constitutionality of Chapter 21. It would relinquish its claim on taxes paid under that authority since 1978. Mr. Chairman, though it is not easy - an easy compromise probably for any of the parties to contemplate, in our opinion and after working with it for so long and hard, it is a good faith and fair compromise - one that, we think, will ultimately be supported by the respective citizens and shareholders of those of us sitting around the table. I appreciate the opportunity to be here. And I'd be happy to answer any questions.

MR. RAY:

Thank you, Mr. Harbour. Did I understand you to say that you believe that the settlement would be in the best interest of the people of the State? And that they would welcome that opportunity to have it settled?

MR. HARBOUR:

It's my experience in speaking with a number of citizens of our State as well as organizations that there is a feeling that the adversity that emanates from the current legal activity should not exis , and thus the people would support a dismissal of that suit. Yes, sir.

MR. RAY:

Would you support a Statewide referendum for that question? To allow the people by their vote instead of just by public relations returns ; people themselves allow them a

vote to say we think that the settlement is just or we don't think that the settlement is just.

MR. HARBOUR:

Senator Ray, if in 1978, prior to the passage, the last days of the legislative session without public hearing, you were to have asked me if Chapter 21, the proposed Chapter 21, should have been put before the people at that time, I probably would have been inclined to agree. Now that, at that time, did not receive public hearing. The legislature acted in its right to develop State policy with respect to taxation, and it seems to me that the legislature, having developed that policy, is in a position now to correct that policy. Do I favor going to the people? I wouldn't be against it, but I have to tell you that I think that all of the ingredients are here for the settlement -- all of those who know the case best in the legislature and in the administration have worked long and hard on it, and have far more material available to it and resources available to them than the public has.

MR. RAY:

Well, I would think that you would advocate it. I don't know if you are a part of the public relations campaign that is being put out by some of the industry, but it appears that they are putting out, and have been for a good set of time -- our friend Mr. Taylor, there, has been very vocal

and put the little things in the paper - write in this and send it in if you think that we are doing -- so I would think that from your industry's initial petitioning of the public through the media that you would welcome the opportunity. Perhaps the legislature is wrong. Perhaps it should be the people themselves who make the determination on 6 or $8 billions. I don't know. I'm just asking.

MR. HARBOUR:

You make a good point, Senator, but I will tell you that -- you know, no place else in the country does this kind of a situation exist. That is, of year after year, a state's major industry, the oil industry, facing tax increases. And, in my opinion, my personal opinion, the reason that we don't find that in other areas of the country is because much of the production takes place on private lands. And so there are a number of royalty owners - in fact, just myriad of royalty owners. So that if a state attempts to change policy that appears not to be fair in the best interests of the citizens, a vast constituency rises up. In our State, the entity that owns the land is also the entity that has the power to tax the land. And there is no direct constituency in between. And therefore, I consider it a requirement and a responsibility to communicate the problems that we see developing with the constituencies that do exist.

And we do that. And I make speeches. And I talk with people. And I find that the return on that is almost universally supportive of a more stable investment climate as reflected in the State's tax policy.

MR. RAY:

You are a nice fellow, and they don't like to hurt your feelings.

MR. HARBOUR:

Thank you, sir.

MR. DANKWORTH:

Dave, go back over the four reasons on what I might call, not the settlement agreement,but on what I proposed as a possible amendment number 2 yesterday -- compromise. You mentioned four reasons why you didn't think that that was an acceptable agreement. I had one that you said that it destroys the incentive after 5 years which -- I understand what you mean by that. What was number 2?

MR. HARBOUR:

The second had to do, Senator, with marginal fields. That is, that marginal fields might be expected to have a lower likelihood of production since,when first coming under commercial production they -- although at 12.25% rate -- they have that initial increase that's owing to the elimination of the economic limit factor. And then after 5 years another increase which is the 15% severance tax rate.

MR. DANKWORTH:

If I could find a way to take care of that that would, at least on the marginal fields, that would eliminate the number 2 I'm going to assume, if that's what your problem was there. Number 3 was the investment credit. That's not in existence now, and while it was in the settlement agreement, so was it in the settlement agreement that we get out of court and that we do a whole lot of other things, but I'm trying to confuse -- I don't want to confuse what I offered there as not necessarily part of the settlement agreement because that is not a settlement agreement that I was offering as amendment number 2. The first one was. So I didn't want the public to feel that you were saying that my second amendment is part of a settlement agreement, because I think you clearly say it's not, even though you may prefer it to some others - that's not an agreement. What was the fourth one? It was -- and I didn't understand when you said it's a rejection of current litigation.

MR. HARBOUR:

The fourth item, the fourth aspect of this second proposal, Senator, is that it would not relieve the State of the legal activity that now surrounds it.

MR. DANKWORTH:

But it would make moot our case in court, would it not

so far? It does do away with Title 21 and it does do away with the windfall profits tax, and it does make moot most of the things that you are in court for other than the recovery of the $1.4 or $1.5 billion that we've already used, and of course, which we -- that bill does not require you to give up any rights to continue to pursue that so -- I guess what I'm making sure we do, Dave, is not -- for your sake as well as mine -- we're not trying to -- I didn't propose that as a settlement agreement because it is not one. And I was trying to -- and we'll get to that later -- finding that which was least objectionable to you. Also under the agreement that I'm going to propose, you don't lose money. You make $144 million between now and 1985 - there's no loss to you. The industry's picking up $144 million.

MR. HARBOUR:

Senator, everything is relative when compared with the impact of Chapter 21, there is still a loss.

MR. DANKWORTH:

I understand, sir, and thank you.

MR. RAY:

Are there any other questions for Mr. Harbour?

Representative Gardiner?

MR. GARDINER:

Okay, one thing I'm not clear on the lawsuits here. If the

bill that Senator Dankworth is talking about that was in Committee yesterday, if that's passed what would you expect - is the industry going to litigate that?

MR. HARBOUR:

Representative Gardiner, I don't believe that the passage of such legislation would change the litigation as it affects Chapter 21 accruals to date. As to the future, there are still defects in that bill which would probably continue to be pursued in a legal arena. As to what form that might take, we would have to analyze that with our lawyers at the time of passage of the bill.

MR. GARDINER:

So you are saying that in respect to the current 43.21 suit, the company would continue that suit in court even though from here on out there's no revenue brought under it -- you'd continue it for the back -- what you have already paid.

MR. HARBOUR:

I guess what I'm saying is that the conditions that gave rise to the Chapter 21 suit in the first place would not be eliminated in the past, all of them - neither would they all be eliminated for the future. But -- and also as of today, we've still been hearing about proposed changes in this legislation. So I can't be that certain with you until I see a final version and until it comes out.

But as soon as possible, I'd be happy to discuss that with you.

MR. GARDINER:

Mr. Chairman, my concern here with -- one of the things that we all think we'd like to do - at least I haven't heard anybody disagree with is - is to get out of court. If I understand what's being said here is, one, we are still going to be in court over 43.21, although it may only affect $1.5 billion up to date, or whatever the number is -- but then this new bill that's proposed for us on the modified apportionment and other sections in it may have legal problems, that may cause another suit. So we have effectively, it's a possibility, ending up with two different suits on two different taxes. You know, unless the industry says they're not going to litigate them - which I'd like to hear, if they are not.

MR. HARBOUR:

Mr. Chairman, I think perhaps that since I didn't prepare this bill and didn't even see it until yesterday, that actually the administration would be better qualified to comment on that point, Representative Gardiner. But as -- one point that you make with respect to the modified apportionment also applies to the compromise package. And I believe that there was some legislative staff suggestion on that point of the modified apportionment change as it

applied to the compromise bill, is the point maybe you are making now with respect to the fact that that might cause future litigation. And as far as the settlement agreement goes, that's not the case because the companies would propose to drop suit in the event that passed. But furthermore, the apportionment scheme that's outline under the compromise and that is in some sense copied in the second version, is demonstrably more acceptable to the courts than is a direct accounting approach to taxation.

MR. RAY:

If there are no other questions I want to thank you very much, Mr. Harbour.

MR. HARBOUR:

Thank you, Senator.

MR. RAY:

Bill Hickman, Vice President and Treasurer, Alaska Gas and Service Company.

MR. HICKMAN:

Mr. Chairman, I'll be joined by Dick Barnes, Vice President of Alaska Interstate Company. We are part of a consolidated group of companies.

MR. RAY:

Okay.

MR. BARNES:

Mr. Chairman, the testimony issued so far in this hearing

by the industry has been mainly by the three...

MR. RAY:

Sir, you are Mr. Barnes?

MR. BARNES:

Yes, I am, sir.

MR. RAY:

Would you identify yourself for the record?

MR. BARNES:

Yes. For the record, my name is Richard F. Barnes, Vice President of Alaska Interstate Company. The testimony issued so far in this hearing by the industry has been mainly by the three major producers. We understand that there are currently 20 to 30 Chapter 21 taxpayers in the State. We are among that group due to our natural gas transmission line that is part of our Alaska Gas and Service Company business. As part of the 20 to 30 taxpayers, we would like to share our perceptions on this subject. Alaska Interstate Company currently has two business interests in the State - Alaska Gas and Service Company serves about 45,000 customers, and also the State's largest electric utilities. Therefore, directly or indirectly, we serve almost everyone from Halibut Cove to Talkeetna in southcentral Alaska Gas' business is regulated by the APUC, the Alaska Public Utilities Commission. The rates that are allowed include operating

expenses such as income tax that would be perhaps increased or decreased due to proceedings here today. Ultimately, all the income taxes charged to the utility are passed on as rates to the customers. The other business interest that we have in the State at this time is part of the Dow-Shell project where Alaska Interstate's role is studying the southern section of the pipeline that would carry natural gas liquids from the vicinity of Fairbanks to a tidewater location. We believe that regulated utilities should not necessarily be taxed in the same manner as producers. They are very much different businesses. Typically, utilities have very little upside opportunity as in the case of the producers where they have seen broad increases in the value of their oil. We would like to discuss, for a minute, the effect that we see of the three pieces of legislation before us. The settlement bill as written would actually increase taxes to the utility and to its customers. It would be acceptable if it were amended to treat public utilities on a non-unitary or separate basis. The same is true on the Free Conference Committee Substitute as written would also negatively affect Alaska Gas customers and increase the taxes markedly. I would like to ask ...

MR. DANKWORTH:

Pardon me, just a moment. When you said Free Conference

Committee Substitute are you talking about 524 or 202?

MR. BARNES:

Free Conference Committee Substitute for 524.

MR. DANKWORTH:

Yes. Okay. That's the reserve tax, the one that we are talking about here. I don't want to get confused when you are saying - you are testifying now to, what, 524? Senate Bill 524?

MR. BARNES:

Yes, sir.

MR. RAY:

We have two pieces of legislation that we are looking at as a Free Conference -- first, I guess it would be proper to say the House Committee Substitute for Senate Bill 524, and we also have another proposal which is a Free Conference Committee Substitute for Senate Bill 524.

MR. BARNES:

I believe that's one that I was speaking to that appears to be an amendment to the settlement bill. Okay.

MR. RAY:

That's the one with the ELFs in it.

MR. BARNES:

Yes, sir. I would like to ask Mr. Hickman to discuss the proposed change that we would offer to either of those bills which would affect the utility. And then ask ...

MR. GARDINER:

Do you have copies of this so we could look at it?

MR. BARNES:

Yes, sir. After discussing that then we would like to return to the third piece of legislation that has been discussed previously, the backstop bill.

MR. HICKMAN:

We believe that under the allocation formula set forth in either of the two bills mentioned, the settlement bill or the substitute for the settlement bill - the effect will be to allocate greater income into the utility business in the State of Alaska so that a public utility will pay a larger income tax and our rates will be affected by that so that we will, in effect, pay a larger tax than our tax would be if the utility were taxed on a separate company basis. We would propose an amendment to 43.20.065 which would add the following sentence: not withstanding other provisions of this Act, the taxable public utility income of a public utility regulated by the APUC will be determined pursuant to Alaska Statute 43.19.010(18)(a) - that's the provision that provides for separate accounting treatment of a company and tax on that company's income based on its actual assets and activities within the State.

MR. RAY:

Commissioner Williams, would you come up here, please?

Continue, sir.

MR. HICKMAN:

If those -- if either of those bills were modified or if this particular change were made, then either of the bills, we believe, would be acceptable to the utility and its customers since we would not be paying in excess of the statutory rate, 9.4% times the income generated by our activities in the State of Alaska as determined by the Alaska Public Utilities Commission. We do believe that the proposed substitute for the settlement bill has a detrimental effect not only to our utility,but possibly to other corporations in the State of Alaska - in that in the original settlement bill there is a provision for investment tax credit that goes beyond the provision that is in the present law, so that all taxpayers in the State, all corporate taxpayers, would receive an investment tax credit in some instances substantially greater than what they are presently entitled to. The proposed substitute for the settlement bill,while it reduces the effective tax rate in the lower brackets for a corporation operating within the State, it does not provide the investment tax credit that the settlement bill does. And to some extent, it may represent a tax increase to some corporations rather than a tax decrease to some corporations. It's -- we've only looked at this particular

thing yesterday, and we're still uncertain as to all the effects that the bill may have - not only on our corporation but on other corporations in the State. However, our interests have to be directed primarily to our utility customers, and so from our standpoint if this amendment takes place,then it would have to remove our objections to those two bills.

MR. GARDINER:

Does this amendment, whether it is put in either bill, create any legal problems for the State that is going to make us vulnerable to anybody's attacks under equal protection or discrimination?

MR. HICKMAN:

I'm not an attorney. My guess is that - Mr. Williams should speak for himself, but - my guess is that some would say that by restricting public utility to those regulated by the Alaska Public Utilities Commission it may be that there are other public utilities which should similarly qualify and it might be discriminatory to that extent. If it was only public utility -- if we said only public utility, I don't know what the effect on State revenue would be, and whether other accommodations would have to be made to take care of that problem. That's -- again, I think Mr. Williams could best advise in that regard.

MR. BARNES:

Mr. Chairman, if you will, I'd like to review the so-called

backstop bill as well, as to our interpretation how that would affect us. Okay. We see the -- what we have titled as the House Committee Substitute for Senate Bill 524 as allowing non-unitary treatment of a utility such as Mr. Hickman has just spoken to. The effect being that the statutory rate would be charged against the operations, the income of the utility only, and we would not see allocation of income from outside of the State against a utility.

MR. RAY:

If this amendment was in there, would that take care of your problem? If your suggested amendment was incorporated in that bill,would that take care of your problem?

MR. BARNES:

It would not be necessary, we don't believe, under the House version of the backstop bill. The exemption of the natural gas reserves was something that, of course, we were glad to see added to the House version. We believe that it benefits the Alaska Gas Service Company customers. I think that it could benefit the ANCS (ph) line and could benefit natural gas liquid-based petrochemical development within the State. We recognize that it does not settle industry claims against the State which we would prefer to see settled in an amicable way. It does give, from what we have seen, the lowest effective tax rate to utility customers. This bill could use some other

technical amendments which we would like to suggest at a later time if the Committee desires to move toward that form of bill -- but we would not offer them at this time.

MR. RAY:

Thank you, sir. Are there any other questions from any members of the Committee? My thanks, and ... Senator?

MR. DANKWORTH:

... one quick question. Clarify on the proposed -- not the settlement agreement but the proposed amendment to the settlement agreement - did you say that you determined you would take a loss? Or did you say that you are not for sure whether you would lose or not on the bill? You just haven't had time ...

MR. HICKMAN:

We would lose on the settlement bill -- not on the settlement bill but on the proposed substitute for the settlement. We are a very capital intensive business. Our capital expenditures average, expansions to the gas plant, average between $5 and $8 million per year to serve that particular area. Under the proposed settlement that has been discussed we believe, if we interpret the bill correctly, we would have available to us an investment tax credit of approximately $800,000 which would reduce -- from $500,000 to $800,000 -- which would reduce our income tax expense to that extent.

That is an item that is also passed through to our customers through the regulatory process. Under the proposed substitute for that settlement bill, that investment tax credit disappears. Now that's whether or not the amendment goes in, Senator.

MR. DANKWORTH:

Were you here yesterday -- at the last meeting?

MR. HICKMAN:

Yes, sir, I was here yesterday afternoon from ...

MR. DANKWORTH:

Can you tell the Committee out of the options that are before the Committee which one are you supporting? We got to make a decision, you know, and I just want to know what -- are you testifying against that particular piece, or are you testifying for 200? Or are you just making a statement and not testifying against any of the options?

MR. HICKMAN:

In range, or in order of preference, the most costly bill to us as a public utility in the State of Alaska, would be the last bill that we have seen which would be the Substitute -- proposed Substitute for the settlement, which we have titled as Free Conference Committee Substitute for Senate Bill 524. That would be the most costly to us.

MR. RAY:

That's the one you like least?

MR. HICKMAN:

That's the one we like least, yes, sir. The others are probably about even in their application to our particular situation. And I don't think that we could really choose in tax effect between the others - it would depend on any particular given year, with the amendment as proposed.

MR. RAY:

With the amendment as proposed. The Free Conference Committee Substitute with the amendment - that wouldn't do you any good anyway right?

MR. HICKMAN:

It would be about 5 to $800,000 more expensive than the other.

MR. RAY:

All right. Are you finished, sir? Thank you very much. I wonder if the Attorney General, the real Attorney General now, and the Commissioner of Revenue would take their places down at the end? This is a byword to the Committee, we know he is really it now, so better cool off. Sir? Did you have something, Senator, excuse me.

MR. DANKWORTH:

No, Mr. Chairman, other than to suggest -- and I had forgotten where he left -- we cut him off yesterday an his testimony -- and I can't remember where, at what bill

he was explaining in -- I thought ...

MR. RAY:

He hasn't started yet.

MR. DANKWORTH:

I don't know why, I thought he started yesterday.

MR. RAY:

No, he hasn't done anything really of any ... I think that possibly in order to expedite the business of the Committee that we get you both there and we'll start in asking you the questions, or you can take us through some of these proposals. I suppose that both of you speaking for the Governor, you might have a preference as to what the Governor wants. If you don't you shouldn't be there.

COMMISSIONER WILLIAMS:

We have a communication.

MR. RAY:

All right. Perhaps we should hear that before we -- do you have a communication from the Governor, Commissioner Williams?

MR. CONDON:

He does.

MR. RAY:

General?

COMMISSIONER WILLIAMS:

Thank you. We do indeed. We apologize that



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JUDY JONES
586-6846

the members have not had a chance to receive these yet. They are in the process of being run off. Let me read for the sake of the record the Governor's letter. It's dated June 23, 1981. It says: "Let me make my position clear on the oil tax issue. There are two criteria which any legislation must meet to be acceptable. One, it must not permit the State's share to fall beneath 30%. Two, it must improve our legal position. Legislation which fails to meet either objective would be subject to veto. Additionally, it would be desireable to, three, extinguish litigation. And four, reduce the likelihood that the oil tax issue will continue to be a perennial political liability for those in public office. Several options could at least meet the first two criteria. These include: one, passage of the backup tax as in House Bill 200. However, while improving our legal position, this would likely increase public responsiveness to the oil companies' amplified charges of, quote, unfair treatment, unquote. Certainly efforts would increase to secure an even larger percentage of the State's current share than with the companies' so-called settlement proposal. Two, pass the settlement proposal. This could resolve the litigation. However, I am advised it could reduce the State's share below 30% should certain Reagan tax proposals be adopted unless it is crafted so as to avoid that effect." I might add

parenthetically here that I believe the version of the settlement bill that is before the Committee -- one of the versions anyway -- does have provisions included in there that would avoid those effects of the capital recovery allowance which is super-accelerated depreciation.

MR. RAY:

Which one are you talking about, sir, so we can identify it?

COMMISSIONER WILLIAMS:

The one that I know is in there is in, I would call, Dankworth 2. It's the modified settlement with the ELFs in it. To continue on with the Governor's letter: "The third option that would meet the basic two criteria in order to avoid being vetoed. The third one: the basic -- this would be the enactment of a basic settlement proposal plus an adjusted ELF factor." Essentially this is what I just referred to. "This approach would not assure settlement but would reduce prospective State revenue losses. Four, a public vote on House Bill 200 versus the settlement. This could be on the ballot in a special election this fall. No matter what the public's response, it could largely remove this issue from the political arena. Approval of the industry's proposed settlement or endorsement of House Bill 200 would place the public stamp of approval on whichever approach were selected by the voters."

MR. RAY:

I didn't get the first part of that. What did he say?

COMMISSIONER WILLIAMS:

Whichever way it went, it would have ...

MR. RAY:

He wants a vote? Is that what you are saying?

COMMISSIONER WILLIAMS:

That's the fourth option that would meet his two criteria in order to avoid a veto. "It is doubtful that even massive lobbying efforts from either side could easily persuade future legislatures to fly in the face of that public position. Since the latter approach is the only one which meets all four objectives, it is my preference. Least acceptable is do nothing. While this may seem the easiest way to deal with this issue in the short term, it would assure continuation of litigation, acceleration of the industry's propaganda efforts designed to roll back the State's share even further and thus continue this as a major campaign issue." It would further necessitate -- I'm sorry --"it would necessitate reduction of the proposed fiscal year '82 budget by at least another $350 million for a rainy day should we lose in court. Accordingly, let me urge you to pass any one of the above four proposals for which there are the votes. As the only option having already passed one house, the simplest, of course,

while not my first choice, would be for the Senate to adopt House Bill 200. Thus, should other options not be possible, at the very least, do that. Sincerely, Jay S. Hammond, Governor."

MR. GARDINER:

Commissioner, there's one alternative I'm not sure that I heard in there which was the alternative, I think, originally suggested by the Attorney General, at least that's the first time I remember hearing it although people talked about it a lot -- and that would be a piece of legislation that very simply passed the so-called warts, granted the windfall profits tax exemption to the producers which they have long told us that they desire to have, and thirdly, to raise the severance tax in an appropriate manner that would offset the revenue loss. With that simple thing, the State would, as I understand it, as argued previously by the Attorney General, improve its position in the court because of, one, the warts and the windfall profits tax argument would not longer exist in court. And two, less revenue would be at risk because it would now -- 40% of the revenue coming in, it would be coming in under the severance tax rather than 43.21. And thirdly, the industry would have a net tax relief of something like $150 million a year because of the offset of the federal taxes. Even though the State would not lose

revenue, the industry would gain $150 million a year. I did not hear you refer to that alternative in there and I wondered if there's any reason for objection to that, or whether that alternative meets the criteria as described in the letter.

COMMISSIONER WILLIAMS:

With respect to the two essential criteria, since it preserves essentially the same amount of revenue, and the present level of revenue is over 30%, it would meet the first criterion, that is, the State's share would not fall and - our revenue would be preserved. Second, it would simplify the lawsuit, and to that extent improve our legal position. The basic question of separate accounting versus apportionment, of course, would remain. But I think probably it -- on that second criterion, it marginally meets that as well. It does not meet the third criterion of extinguishing litigation. I don't think they will settle the case. And fourthly -- well, people can make their individual judgment about whether it reduces or continues the likelihood that the oil tax will remain a perennial political issue. Those are the four criteria. It does meet the two that are essential to avoid a veto.

MR. RAY:

Commissioner, in the -- do you have a copy of all this stuff? Free Conference Committee Report -- Committee

Substitute I guess you'd say. In there they have a section 3 which is a -- it has to do with the income tax rate. What would that do if that was incorporated into the House Committee Substitute for 524?

COMMISSIONER WILLIAMS:

Sections 3 and 4 both provide for a graduated rate schedule. And basically, it affects both oil companies and non-oil companies since they would all come under Chapter 20. For the non-oil companies it would probably result in a reduction in the first year -- well, in FY '83 -- of perhaps $5 million, $6 million the next year, and $7 million the final year. That's the combined effect between section 3 and section 4. In section 3 there's provision for two brackets that are not present in section 4, and so for fiscal year '82 which is when section 3 would primarily be in effect those different brackets probably wipe out any cost that would result there. We would assume that the fiscal impact would be zero there as a result of 3. Fiscal impact in 1982 -- the same fiscal impacts as I described before for '83, '84, and '85.

MR. RAY:

That would seem to be, at least, in my estimation, a desirable inclusion in the Committee Substitute, speaking for myself. Senator?

MR. DANKWORKTH:

Are we talking about -- maybe I didn't understand -- were

you talking then about the warts bill; including the warts and raising the severance tax? What would that do, if we were to do that and adopt that - what would be the security of the State so far as -- our position on 21 would continue in court and we would continue to have liabilities, wouldn't we? Or the amount of money at risk would continue to grow, would it not?

MR. CONDON:

Yes. Under -- if I can refer to -- just make a comparison between proposal number 5 -- it's not mentioned in the Governor's letter but which Representative Gardiner mentioned -- and Dankworth 2,for shorthand The switch from -- at the time the switch from separate accounting to apportionment takes place, there will be approximately $2 billion at risk as a result of taking the separate accounting approach. And that will remain at risk throughout the remainder of the litigation - there are some provisions in this bill which would reduce that some, and I'll get to them in a moment. If the switch is made that is suggested by Representative Gardiner and the windfall profits tax deduction is granted but separate accounting is continued,then we would continue to pile up a risk as a result of the separate accounting. And the numbers for FY 82 would be approximately $300 million, and then in FY 83 would be $698, FY 84 798, and FY 85 829. I mean,

those kinds of numbers are what we are looking at in terms of the continued amount that would be collected pursuant to the separate accounting approach during those years.

MR. DANKWORTH:

Then basically, if we were to accept that approach then we are going to have to reevaluate whether we have an escrow account or a backstop or some kind of backup position for the State.

MR. CONDON:

If you look at the numbers for FY 82, you would be protecting about $320 million worth of anticipated revenue if you took proposal 5. And I discussed this matter with the Governor and he does not believe that an escrow would be required in FY 82, but thereafter, FY 83 and 84, the Governor believes that an escrow should be established until the litigation is resolved.

MR. GARDINER:

Yes, I don't -- I think I agree with that point, that the objective of that bill is not that it eliminates all risk, but on the other hand I haven't heard anybody say that they are going to settle the 43.21 suit for the $2 billion in the back, or they are not going to attack the modified apportionment because it is a unique thing - nobody else has an apportionment formula like this one that's

being proposed, and there's the question of a whole new tax structure that could be litigated. And, you know, if people would tell me they aren't going to litigate this new bill then maybe I wouldn't worry about that. One of the arguments against the backstop that I heard people say, well, we are going to have two court suits. And I think that's what we are looking at here. And maybe they're different types of tax structure, but I think one of the answers from the industry is that, you know, they might just litigate the whole tax structure of the State if this continues on and there's not a reduction there. I don't know what that means, but it has been brought up at two different hearings. But, do you think there's any risk with the modified apportionment? Is the revenue that is brought under there at risk? Or is there nothing to worry about?

MR. CONDON:

Of course there is some risk. It is a reduced risk, in my opinion, from the separate accounting approach. So the Dankworth 2 presents fewer risks than so-called option 5.

MR. RAY:

Mr. Condon, I'd like to go back to section 3 and 4, and perhaps you can tell me, what harm or damage would this do to any of our cases or any of our suits, or anything else, if this was incorporated in the House Committee Substitute?

MR. CONDON:

Sections 3 and 4?

MR. RAY:

Yes.

MR. CONDON:

I do not think sections 3 and 4 increase the risk. They are, I believe, an attempt to treat corporations even handedly across the board, and I don't see any legal problems with their adoption.

MR. RAY:

And you don't see any loss of revenues, Commissioner? Appreciably.

COMMISSIONER WILLIAMS:

No appreciable loss. As I say, on the order of $5 or $6 million a year after next fiscal year.

MR. RAY:

That looks very attractive to me in some form. I don't know why we ... Senator?

MR. DANKWORTH:

Well, it certainly is. It's an option, but I did want to bring up -- while that might solve Chapter 21, what would be the effect of that on the native corporations in Cook Inlet and other places? We would be, in effect, raising the severance tax to 15. I just wondered if we put the so-called warts package in this, have you had time

to evaluate what effect that would have? It may be an unfair question if you ...

COMMISSIONER WILLIAMS:

Well, it's difficult to respond to the question, Senator, because I'm not sure exactly what -- how comprehensive the severance tax treatment Representative Gardiner might be proposing. If he's proposing a simple raise from 12.25 to 15% in the statute, then there's an effect. But there are ways that that effect can be mitigated for frontier areas or for marginal fields. And I'm not sure how comprehensive his proposal is since the central idea has only been set out and I haven't seen the detail.

MR. RAY:

And the warts, the warts deal would -- what's the final analysis of -- give me a money figure and -- General would you give us a legal opinion on what it would do? First give us a money opinion or a money figure, Commissioner?

COMMISSIONER WILLIAMS:

Of what Representative Gardiner is proposing?

MR. RAY:

On the warts, yes.

COMMISSIONER WILLIAMS:

Are we talking just the warts or the warts package? I'm sorry, I don't mean to be evasive on this, but we don't ...

MR. RAY:

If we incorporated the warts into House Bill -- or Senate Bill 524.

COMMISSIONER WILLIAMS:

Well, they are already there.

MR. RAY:

Yes, well, that's what I mean -- is it -- what is the problem then?

COMMISSIONER WILLIAMS:

If it is only the warts by themselves in the first fiscal year -- and a windfall profit tax - that will come to $494 million ...

MR. RAY:

That we would lose?

COMMISSIONER WILLIAMS:

That you would forego, that's correct.

MR. RAY:

And we don't pick up anything back with any of the other taxes, right?

COMMISSIONER WILLIAMS:

You only asked me about warts - that's the cost of warts. If you raise this production tax that could recover $501 million back.

MR. RAY:

We'd get it all back is what I'm saying.

COMMISSIONER WILLIAMS:

That's correct, if you do both.

MR. RAY:

And that's incorporated now in the House Committee Substitute? Or is that Gardiner's proposal now? See, we are getting so many different kites flying in the air that it is hard to identify them.

MR. GARDINER:

Mr. Chairman, this, you know -- whatever you think is an appropriate time, I would hand out copies of this proposal which is pretty simple, and go through it and -- but whenever you think that's appropriate so there's not so much confusion.

MR. RAY:

It's appropriate anytime in this Committee to make any suggestions that you want, and if you have something in writing that makes it even more appreciative.

MR. GARDINER:

Well, I'll hand it out.

MR. RAY:

Yes, I've been waiting for a copy of the Governor's letter there, Commissioner, if you could find it. If you can't we'll get it -- somebody will get up and copy that for us.

MR. GARDINER:

Mr. Chairman, I've put a star at the top just so you

could identify it, because they all say Free Conference. Sorry, I only had 10 copies. Mr. Chairman, most of the bill is the so-called warts which are the ones that were modified in the House as per the recommendations of the Commissioner of Revenue. What this actually proposes is that the -- well, also on page 7 it has the same proposals that appeared in other drafts of the bill lately - the modified, from zero to 9.4% and 43.20 scale on the income tax -- that's the same as appeared in some of the other bills.

MR. RAY:

Might I suggest, Representative Gardiner, because we are getting down to a time crunch here -- if you could just delineate what your things are, and if we have a problem with it we can pick up on them and then you can argue at length. Okay?

MR. GARDINER:

Okay. What it basically does is set the severance at 13.5% and modifies the ELF in similar ways that Senator Dankworth's bill and other proposals have modified the ELF. Okay, that -- and it grants the windfall profits tax exemption. And that's it in terms of what it really does. Now, in terms of the financial effect, it basically zeroes out the revenue exchange, although it has some cash flow where the State loses some money in the early

years and then catches up. And that's because the windfall profits tax exemption is retroactive and goes back and picks up the time that the -- in which the industry has been paying under that. I think that also helps the suit point argument that a lot of people made that that's not the strongest point in our case presently. So that removes that issue as an argument. But the fact of it, because we are increasing tax under the severance and it is deductible up to 15%, that additional severance would be deductible against federal taxes thereby reducing the company's federal tax liability. So from my point of view that has the beneficial effect of reducing the company's liability while not reducing the State's revenue, and that may seem appropriate since the federal government is getting more than the State and the industry anyway. So that's it, basically.

MR. RAY:

Could we have the reaction of both the Attorney General and the Commissioner on this proposal? Or is it too soon for you to make any statement?

MR. CONDON:

From a legal perspective I think the only reaction that I can make at this point is just to remake the same point I made earlier, and that is, that it reduces the risk but it continues to allow the risk money that's at risk to pile

up in future years as far as the separate accounting issue is concerned. By way of comparing it to so-called Dankworth 2.

MR. RAY:

And what does that do as far as the Governor is concerned?

MR. CONDON:

Well, as far as the Governor is concerned, this -- without knowing exactly what the revenue impacts of this are going to be, but if they are close to the numbers that I used on a different production tax, and anticipated production tax rates, there would be no necessity for an escrow this year; there would be a necessity for escrows in future years.

MR. RAY:

Commissioner, what do you say? Do you know anything about it?

COMMISSIONER WILLIAMS:

Well, this is the first I've seen of it but in terms of your concern about marginal properties that might be coming on stream, this has several positive features which are worth emphasizing. First is the lower rate for the first 5 years, which certainly helps. It starts at 12.25, which is the present level. In addition, where you are truly marginal, your ratio of PEL to TP in the formula there - production at the economic limit to total

production - is going to tend to be small. And -- is going to tend to be large, rather. And squaring that is going to give you the relief that you are looking forward to affording in the economic limit factor. The purpose of the economic limit factor is to try to scale things down as the economics deteriorate. If they start off being weak, you want to have it scaled down. This is one way. I believe this formula moves in that direction and furthers that.

MR. RAY:

Is there a constitutional challenge to the ELF?

COMMISSIONER WILLIAMS:

Mr. Chairman, anybody with a filing fee can bring a suit.

MR. RAY:

I didn't ask you that Commissioner. You know what I'm asking you.

COMMISSIONER WILLIAMS:

Well, it's an important thing to remember, though, that we talk about litigation and there are litigations that are serious; there are those that have only a colorable nature to them; and there are those that are frivolous. I would think that this, in my own opinion -- they would have a hard case, it would be a poor case. I wouldn't want to take theirs on.

MR. RAY:

Okay. Senator Dankworth.

MR. DANKWORTH:

Well, we've probably discussed this -- unless somebody else has some other questions -- you did say that just so everyone knows that if we were to adopt this, we will have to put somewhere between $500 and $1 billion a year after next year into an escrow account, or something; we are going to have set it in escrow until we get this resolved. There will be that much less revenue, if I am understanding this correctly.

MR. RAY:

Did you want somebody to respond, Senator?

MR. DANKWORTH:

No, I wanted to make sure everybody understood that was one of the things that I think has already been said, that that would be required. What I really want to say, if -- I didn't know, maybe we were going to take number 5 and put it ahead of the other proposals I had on the board, but I would like to have him discuss, while we have the time, my proposed amendment number 2.

MR. RAY:

I have no problem with that, Senator.

MR. DANKWORTH:

Unless there are any other questions on this one?

MR. GARDINER:

Mr. Chairman, just one little comment before we move on. I don't want anybody to think that I dreamed up a new brainstorm and suddenly slid this in. This is probably the oldest proposal cruising around. And I promise not to get the Attorney General in trouble, but this was not originally thought up or suggested by myself - it was suggested by the administration some months ago as a simple approach because we were probably going to get into all these convoluted other proposals, and this was the simples' and easiest approach. I didn't agree with that in Fe' uary. But I do now. So it's not a new proposal that sense. It's merely that I brought it up - that the only thing that has changed.

MR. RAY:

Senator Dankworth, did you want to go back and try yours again? Is that it?

MR. DANKWORTH:

No, I never have tried it, Mr. Chairman. It has never been explained. That's why I wanted to start in now. I have asked that - in my proposal - there be some amendments made to cover some areas -- and I'd like to throw that one out, and basically -- we'll pass these out -- and then I want to explain.

MR. RAY:

Is this going to be a new one, is that it, sir? In place ...

MR. DANKWORTH:

... number 2 ...

MR. RAY:

In place of the one that you have now, is what I'm saying.

MR. DANKWORTH:

That's right.

MR. RAY:

All right.

MR. DANKWORTH:

I'll mark it number 3 if that helps. Thank you.

MR. RAY:

I'll label this so we'll all have it together - this is Dankworth 2.

MR. DANKWORTH:

No, it's Dankworth 3. The settlement was 1, Mr. Chairman. Then there was an amendment .

MR. RAY:

But the settlement was not in the form. This is in the form.

MR. DANKWORTH:

No, I had the settlement in the form, sir.

MR. RAY:

Did you?

MR. DANKWORTH:

I'm sorry if I didn't furnish you a copy ...

MR. RAY:

All right, Dankworth 3. Christians, nothing. Has everybody got a copy that needs a copy? Speak, Senator.

MR. DANKWORTH:

If you would -- I don't have any preference who starts -- probably it would be good for Commissioner Williams to -- since we all helped draft this thing from different pieces of proposals that's come a long while -- they may call this Dankworth number 3. And there's nothing original about a lot of these proposals. They are all just kind of brought together as I think probably an acceptable solution to everything, but not real acceptable to anybody. If it was acceptable to anybody and they were very joyous about it, I'd want to go back and renegotiate it. But at least this I would like for you to explain if you would, Mr. Williams - go through what this bill does.

COMMISSIONER WILLIAMS:

Okay. First of all, Mr. Chairman, let me explain where this bill differs from Dankworth 2.

MR. RAY:

That's the main thing.

COMMISSIONER WILLIAMS:

It differs from it in section 13 which in Dankworth 3 starts on page 14.

MR. DANKWORTH:

You'll have to remember that Dankworth number 2 has never been explained. We've just referred to it.

COMMISSIONER WILLIAMS:

I understand that. But I want to first explain what the difference is because I believe the concept of Dankworth 2 has been discussed. Section 13 modifies the economic limit factor in the present law. Under Dankworth 2 it simply was going to be made an economic limit factor of 1 for the first 10 years after a property came into production. And then it would go back to the standard formula. This one does much the same thing. It uses the same formula as in the present law. It provides that the economic limit factor will be 1 for the first 10 years if, and only if, the field is not so -- is not a marginal field. And the criterion of whether it is a marginal field or not is when you calculate what its economic limit factor in the formula would be, if it ends up being .7 or above it's not marginal. Therefore, its economic limit factor is 1 for the first 10 years. If it comes out that it is .7 or less then it is a marginal field, and it should have the relief right from the beginning that the economic limit factor is designed to give. That's the break even point, then, as an indicator of the economic strength of a field as it is coming on

stream. If its formula economic limit factor is below .7 then it gets its formula economic limit factor because it needs that relief. If it's at .7 or higher -- I'm sorry, if it's over .7, then for the first 10 years the economic limit factor will be 1. That means that for the stronger fields, for the first 5 years, they will be taxed at a flat rate of 12.25% with no reduction, and then for the next 5 years, they will be taxed at 15%, with no reduction, and then finally, starting in the 11th year, they'll go back to the standard formula. For the marginal fields for the first 5 years there would be at 12.25% times their ELF, whatever it is, that's less than .7. And then it goes to 15% times the ELF, whatever it is, which is .7 or less. And then it goes to the standard formula, period, just as it has been. That's the difference between Dankworth 3 and Dankworth 2. Now, Dankworth 2 sets out in section -- well, first of all, there are three sections that deal with ordinary corporations. The first one is a wart - this is in section 2 - and it's the retroactive wart - it just simply makes the provisions in 43.20 parallel to the provisions in Chapter 21 about who is subject to which Chapter. Section 3 we've already discussed - this introduces a new graduated, stair-step, progressive rate schedule for corporations - the more they make the higher their bracket becomes. This one would,

section 3 is made retroactive to the start of this year and it applies only to this year. The tax rate can go as high as 11% for taxpayers making over $2 million.

MR. GARDINER:

Does that create any legal vulnerability, the fact that you are retroactively putting in a higher rate for just one year?

COMMISSIONER WILLIAMS:

We are in the middle of the year.

MR. GARDINER:

Yes, I know, but does that -- I might, as a taxpayer, if you did that to me, say that wasn't the neatest idea in the world. Why are you -- I would argue, well, why are you coming in 11% this year if 9% is going to be good enough for all the years to come? Maybe you just want to gouge me now, and besides that you're making it retroactive.

COMMISSIONER WILLIAMS:

On the other hand, you are also giving relief at the lower end of the scale - it will depend on how much you are making. Perhaps a simpler thing to do is to defer the tax relief so that people don't see it until they file their returns in April of 1983.

MR. GARDINER:

I'm just being argumentative as to whether it is legally

vulnerable.

COMMISSIONER WILLIAMS:

I understand, and that's the alternative.

MR. CONDON:

I don't think it is legally vulnerable. There have been previous occasions, as you well know, when we've changed the tax half way through the year and it has been retroactive to the beginning of the year. As a matter of fact that's how we got into Chapter 21.

MR. GARDINER:

And they didn't like that.

MR. CONDON:

Well.

MR. RAY:

Gentlemen, if I could ask you on the Dankworth 3 - does this meet the first criteria, that it does not permit the State's share to fall below 30%?

COMMISSIONER WILLIAMS:

That's correct.

MR. RAY:

Does it meet the second criteria, it must improve our legal position?

COMMISSIONER WILLIAMS:

Yes, it does.

MR. RAY:

Does it do anything with litigation?

COMMISSIONER WILLIAMS:

Well, no. Probably not.

MR. DANKWORTH:

It doesn't get us -- what do you mean it doesn't improve litigation? It does set moot the case in court, doesn't it? It does involve the litigation to some extent, doesn't it?

COMMISSIONER WILLIAMS:

I said it improved our legal position. And that's number 2. But to extinguish litigation - I assume they will continue to fight over the money that has been paid in under Chapter 21.

MR. DANKWORTH:

Okay. I'm sorry. I didn't ...

MR. RAY:

Does the -- what does the Gardiner proposal -- does that meet the first criteria?

COMMISSIONER WILLIAMS:

Yes.

MR. RAY:

Does it meet the second criteria?

COMMISSIONER WILLIAMS:

Yes.

MR. RAY:

How about the third? Do you extinguish the litigation?

COMMISSIONER WILLIAMS:

No.

MR. GARDINER:

I don't think anything except the industry settlement would do that.

MR. RAY:

Maybe we ought to outlaw them.

COMMISSIONER WILLIAMS:

The election would also do that -- could do it.

MR. RAY:

It's too much trouble. The State should get out of the oil business. They cause too much trouble.

COMMISSIONER WILLIAMS:

Mr. Chairman? May I continue on with the explanation of the bill, or am I cutting off your ...

MR. RAY:

Do you really want to, Senator?

MR. DANKWORTH:

Well, it's pretty important, and I intend to move this as an amendment to the bill. And if you'd like, if the members are satisfied with it, I ...

MR. RAY:

Well, it's of no consequence to me whatever ...

MR. DANKWORTH:

I would like to pursue it, and as rapidly as possible.

I think what the Chairman is saying is let's don't repeat old stuff.

MR. RAY:

What I'd really like to do is to have you make a comparison between the Gardiner proposal and the Dankworth proposal, if you could?

COMMISSIONER WILLIAMS:

The biggest difference, probably, is going to be the fact that you continue to have the principle of separate accounting be applied in the future, and therefore liability under separate accounting, or exposure to liability under separate accounting continues to pile up. Although that means in fiscal year '82, perhaps, it's not necessary to have an escrow, and strictly speaking it would be necessary to have one of about $35 million, but that's small compared to the escrow that you are going to need the next year which is several hundred million dollars, and then several hundred million dollars more the following year, to simply be prudent and have the money set aside in the event that separate accounting is struck down. Dankworth 3 goes to a different formula. It's no longer the question of separate accounting. It goes to the question of a formula. Lots of states have unique formulas. Iowa has a unique formula and it was upheld by the U.S. Supreme Court. Its formula looks only at sales.

New York has a unique formula. It has got the standard three factors but it double counts sales. Florida, I think, double counts property. The states have a great deal of latitude to adjust their formulas. Now, it's true our formula will also be unique. But I think there's a reasonable basis for it when you are -- which will sustain it when you are dealing with a depleting asset. The standard three factors just don't apply to an extractive industry. Payroll doesn't apply here because this industry is highly capital intensive. Payroll overstates the extent of their business activity here. Sales -- by the oil companies' own accounting, two thirds of their profits comes from their production, not from their sales.

MR. RAY:

Stick to the 2, will you. Are you still talking about the 2; comparison between Dankworth and Gardiner's?

COMMISSIONER WILLIAMS:

Yes.

MR. RAY:

All right.

COMMISSIONER WILLIAMS:

And finally, you know, land -- I'm just justifying the formula, explaining why -- well, I can cut it short.

MR. GARDINER:

I think there's this issue of the escrow. I agree under what

I propose, which was proposed by the administration, there would be potentially a need for a future escrow. Would we need an escrow if the modified apportionment bill was seriously attacked by the producers in court? Would you advocate an escrow then?

COMMISSIONER WILLIAMS:

My reaction would be, looking at it from the Department's point of view, I would think that I would recommend an escrow no more than I would in the case of the backstop tax. That is, no, I would not recommend an escrow.

MR. CONDON:

Do you want my recommendation? My recommendation would be no too.

MR. RAY:

In your judgment, which, from the position of the administration, would you approve - the Dankworth 3 or the Gardiner approach?

MR. CONDON:

From the position of the administration, we think the Dankworth 3 is more desirable, assuming that it will pass.

MR. RAY:

What do you think, Commissioner Williams?

COMMISSIONER WILLIAMS:

That's correct. I concur.

MR. RAY:

Are you back to doing nothing now, is that it?

COMMISSIONER WILLIAMS:

If Dankworth 3 will not pass.

MR. RAY:

That's the most desirable - or that's the least desirable, and that's the end result it might be - is nothing.

MR. CONDON:

Well, if Dankworth 3 will not pass then pass Gardiner 1.

MR. DANKWORTH:

That one won't pass.

MR. HALFORD:

I've got a question with regard to Dankworth 3. There's some indication that there would be an actual tax increase on other non-oil businesses in the State, and on a retroactive basis. If that increase is part of what we're paying the bill with, how much is it? And what happens if you take it out?

COMMISSIONER WILLIAMS:

You mean in section 3 there - that increase that goes up to the 11%?

MR. HALFORD:

Right. 11%.

COMMISSIONER WILLIAMS:

It'll cost you $140 million because the tables apply to all

corporations.

MR. HALFORD:

Right. If you don't make it retroactive, what is the cost?

COMMISSIONER WILLIAMS:

Half of that.

MR. HALFORD:

140 per year.

COMMISSIONER WILLIAMS:

In this fiscal year 1982, coming up.

MR. RAY:

Would you repeat that again? I didn't quite get that.

COMMISSIONER WILLIAMS:

Essentially, the question was if we only adopted section 4 instead of section 3 in Dankworth 3, what would the revenue effect be coming up? There's a revenue effect that would occur only in fiscal year '82, and that would be a reduction, by not enacting section 3 -- a reduction of about $140 million in fiscal year '82. If you made it -- if you adopted section 3 starting July 1, then you'd have half, roughly half.

MR. HALFORD:

How does that $140 million breakout in terms of what industries, who pays the bill -- where does it breakout?

COMMISSIONER WILLIAMS:

90% of our revenue comes from the oil industry.

MR. DANKWORTH:

I wanted to -- did you have an opportunity, Commissioner Williams, on the oil and gas service company, talked about a proposed amendment which would probably fit in here -- did you have a chance at all to review that? Or would you be able to comment on it at this time?

COMMISSIONER WILLIAMS:

Yes.

MR. DANKWORTH:

Would you?

COMMISSIONER WILLIAMS:

Yes, I would. First of all, the amendment as proposed would cause a great deal of confusion because of the consolidation of the Alaska Pipeline Commission with the Alaska Public Utilities Commission. And this says that it's a taxable public utility income of a public utility regulated by the APUC will be determined pursuant to separate accounting, essentially, is what it's saying. The question will then be whether the, you know -- we've got separate accounting on oil pipelines now. It's contemplated that it's going to trans -- may transfer over if Dankworth 3 is adopted. This would be inconsistent with that transfer, number 1. Number 2, I think that there may be a problem when you are talking about only utilities that are regulated by the State of Alaska. That's,by definition,in-state, and

you may have a challenge on its face of tax treatment in-state versus out-of-state taxpayers. Number 3, the relief that they are talking about - 43.19.010(18)(a)- is really -- 43.19.010 article 4 section 18(a) -- and that's power that the Commissioner already has, and that they can already seek relief under in the statutes. It says,"if the allocation and apportionment provisions of this article do not fairly represent the extent of the taxpayer's business activity in the State, the taxpayer may petition for, or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable, (a) separate accounting." So it can get the relief administratively. If they fail to get the relief, or they are unsatisfied with the administrative relief, there are provisions to take it to court. It's not necessary to create all these legislative problems with the bill, I don't think.

MR. GARDINER:

With this 10 year exemption business, what happens to the State's revenues after Prudhoe Bay gets its 10 years in? What's going to be the loss in State revenue during those years?

COMMISSIONER WILLIAMS:

There will be a drop as there would be with any other field that's discovered in the future whose initial economic limit

factor is robust, over .7, will be at 1 for those first 10 years, and then it will fall back. In the case of Prudhoe Bay, I don't know -- probably, the economic limit factor in 1987 will be .6 or .7, and maybe .8, and if that's the case it would drop by 20% when the 10 years run out -- 20 to 30%.

MR. RAY:

Commissioner, there's been a suggestion that the Dankworth -- both 2 and 3 -- that it would make a substantial increase on the taxes on pulp mills, airlines, ALASCOM -- is this true?

COMMISSIONER WILLIAMS:

Well, I certainly can't answer the question about ALASCOM, since you mentioned them by name, but I can -- I don't know what the net profits are of pulp mills. I know they have high grosses, but they have small nets. And this is net income - this is not gross income. So if there...

MR. RAY:

You can't answer that competently, at this time, right?

COMMISSIONER WILLIAMS:

I think that to get into specifics -- first of all, I don't have the information with me. And second of all, I probably would start verging on confidential information of individual taxpayers.

MR. RAY:

Don't get too slippery, Commissioner.

COMMISSIONER WILLIAMS:

I try not to.

MR. GARDINER:

Mr. Chairman, since yesterday was the first day we had to start looking at this bill, I -- the reason I ask the question was my information indicated that the -- when this ELF thing kicks in in 1987, when Prudhoe Bay has got its 10 years in, that the revenue drop in the next 3 years would be in the order of $500 million a year. I don't know whether that's correct or not. The Commissioner did say there will be a drop - he said 20% - I don't know the numbers well enough to know if that's the case or not. But I would like to know the exact answer to that, and if my numbers that I've got aren't correct, I would like to get some numbers from the Commissioner in terms of what he calculates the drop would be at that point.

COMMISSIONER WILLIAMS:

Mr. Chairman, I'm not in a position to dispute Representative Gardiner's numbers. The point is no one knows how many wells will be drilled in 1987. I can develop a drilling scenario that would have the ELF at .5. If the point is that you believe the revenues will fall in half, you can justify that and I can't dispute it. The fact is, though, that they will revert back then to the curve that we have under the present law.



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MR. GARDINER:

Maybe we won't have a 43.21.

COMMISSIONER WILLIAMS:

Oh, we probably could by then because we will have a decision.

MR. RAY:

Do you have your copy of Dankworth 3 there?

COMMISSIONER WILLIAMS:

Yes, I do.

MR. RAY:

On page 3, line 8 - if you would change the figures -- or on line 9 - if you would change the $2 million to $4 million; and on line 10, from $2 million to $4 million what would that do, if anything?

COMMISSIONER WILLIAMS:

In the overall scheme of things, I don't think the effect will be very large. I don't know off the top of my head how many taxpayers there are who fall in that category but there are probably, maybe, a few dozen, perhaps as many as a hundred. And it's not going to be a major revenue adjustment - several hundred thousand dollars, maybe a million.

MR. RAY:

It is my hope -- of course, I just express it -- the body is certainly open for motions at any time. I would think that perhaps any proposal that might be forthcoming at this

time could not garner the votes on either side, or, I mean, on both sides. So if there are motions I will accept a motion, but I would say that possibly we cannot finish this until tomorrow. Senator Dankworth?

MR. DANKWORTH:

If I understand you, Mr. Chairman, you would entertain a -- if I cared to I could move an amendment that we -- you don't want to vote on it until tomorrow.

MR. RAY:

Sir, it's not within my prerogative to tell the Committee what to do. I appreciate your concern and consideration. I would just as soon not vote on it. That does not preclude you from offering it, and requesting a vote.

MR. DANKWORTH:

Well, sir, and I respect that, and I have no problem waiting until tomorrow for the vote but for the purpose of discussion, and so that we could offer some amendments, I would like at least to make a statement to the Committee - that at the next meeting, so we probably won't be able to take lengthy testimony considering the work tomorrow, I would like to tell the Committee that I intend to propose Dankworth number 3 as an amendment to 524 tomorrow. And I intend to try to amend it to include, on page 3, raising that to $4 million on line 9; and raising the figure of $2 million on line 10 to $4 million. And those amendments I would make -- so with

that I won't make the motion -- defer it until tomorrow.

MR. RAY:

Senator, I would accept a motion -- as far as changing the body of the bill, we can amend it anything after the title and just substitute the Gardiner proposal, or the Halford -- whatever, we could do that. It's just a matter of semantics. It is not my intent to take any public testimony tomorrow. I think we have heard from anybody that has wanted to testify on this that wishes, and I think it's time that, because of the shortness of the, expected shortness of the session -- sir?

MR. DONALDSON:

I don't believe we have further testimony, but we would be willing to answer questions should the Committee have them tomorrow or ...

MR. RAY:

We'll try not to have any for you, sir. We stand -- how about 2:00 tomorrow? Give you enough time to get this thing done? 1:00 tomorrow? We stand adjourned until 1:00 tomorrow.

(meeting adjourned -- 4:45 p.m.)

# C E R T I F I C A T E

STATE OF ALASKA )
: SS.
FIRST JUDICIAL DISTRICT )

I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing June 23, 1981 meeting of the Free Conference Committee on Senate Bill 524 was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 64 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this ____ day of July, 1981.

_____
Notary Public, State of Alaska
My Commission Expires: 11/30/84

ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

FREE CONFERENCE COMMITTEE ON SENATE BILL 524

TRANSCRIPT OF PROCEEDINGS

JUNE 24, 1981

COMMITTEE PRESENT:

Senator Bill Ray, Chairman
Senator Ed Dankworth
Senator Don Bennett
Representative Terry Gardiner
Representative Patrick O'Connell
Representataive Richard Halford

OTHER LEGISLATORS PRESENT:

Representative Hugh Malone

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MR. RAY:

The Free Conference Committee on House Committee Substitute for Senate Bill 524 please come to order. Commissioner Williams? With the agreement of the Committee it's the request of the Commissioner to make a few remarks.

COMMISSIONER WILLIAMS:

Thank you, Mr. Chairman. What I'd like to do is very briefly explain the rationale for the 3 factors that are used in the formula for apportionment in the bill that was referred to yesterday as Dankworth 3. Under the Multistate Tax Compact the 3 standard factors that are used for measuring business income in a state are the ratio of property, payroll and sales in that state to the worldwide property, payroll and sales. And then you take the average of those 3 ratios, and that gives you your apportionment factor. With respect to an industry such as oil and gas, particualarly the oil and gas industry, those factors are not completely appropriate for the circumstances. That's why one of them is deleted in the version of the bill, and is replaced with an extraction factor. What happens is payroll is deleted so you have a property factor and a sales factor, but you do not have payroll - instead you have extraction. The reason for this

is simply -- well, first let me explain the deletion of the payroll factor. The reason for the deletion of the payroll factor is this is an enormously capital intensive industry. When you compare their capital investment per employee vis-a-vis other industrial corporations you find that the ratio is 4 to 5 times higher. And that's something that has held up over the last 5 years. That is to say, they have 4 or 5 times as much capital per employee as a steel mill or car manufacturer, something like that -- this is on average. The -- to give equal weight then to payroll -- well, before I get to that. They have this enormous capital intensiveness; they have very large sales, of course, yet their profitability per dollar of assets is about the same as the industry, as American industry all together. It's a few percent difference, but it's not grossly out of line. Similarly, their return on their sales volume as a percentage is not very different from their return on sales that industrial corporations in the United States generally have. When you look at return per number of employees, once again, you find that the factor is very, very much higher - by a factor of 4 or 5 dollars of profit per employee rather than you have dollars of profit per employee for industry as a whole. What this means, then, is that if you give equal weight to the payroll,which is essentially how many

employees you have in a state versus all the employees everywhere of the firm, you are overstating the amount of business income attributable to those employees. Thus, we believe that it is appropriate to delete the factor, and support its deletion. Now replacing it with an extraction factor is to remedy a defect that you have in the property factor. The property factor works fine when you have an ordinary business that is simply using land - you look at the value of land; you look at the value of the buildings on it; and that ratio is used. For a steel mill that works very fine. And after a hundred years or 50 years when the steel mill is all done producing steel, you still have the land behind. You haven't destroyed or consumed the land. It's a very big difference when you have an oil field. After 50 years the oil is gone. You still have the use of the land, and so when the production equipment is taken away you can put something else in. But something that was there is gone, and gone forever - or at least for 50 million years.

MR. RAY:

Could I interrupt you? Would you please close the door? There's a considerable amount of noise here and some of us can't hear too good. Thank you very much. I'm sorry, Commissioner.

COMMISSIONER WILLIAMS:

That's okay. Thank you. So the purpose of an extraction

factor, then, is to recognize the limitation of the traditional property factor. That property reflects the use of the property and the man-made things that are placed on the property. But it does not adequately reflect the fact that in an extractive industry you are removing something from the land that is no longer there. So it seems to us to be appropriate, again, to recognize that fact and incorporate an extraction factor. That's basically the gist of my comments today. Unless there are questions, that's all I have.

MR. RAY:

Are there any questions from members of the Committee? Thank you very much, Commissioner.

COMMISSIONER WILLIAMS:

Thank you, Mr. Chairman.

MR. RAY:

Gentlemen, we're in the position now -- sir?

MR. MALONE:

Thank you, Mr. Chairman. I do have a question on the proposal that the Commissioner is speaking to.

MR. RAY:

I'm sorry, Representative Malone. I ...

MR. MALONE:

Thank you, Mr. Chairman. Commissioner Williams, in the compromise proposal, I guess number 3 is being described,

if I've got the right lingo,
how would the new proposed tax law discriminate between companies that may be engaged in several types of businesses, including oil and gas, and those that are engaged in oil and gas? In other words, how would you know where to apply the apportionment formula to their income if you have a consolidated return, if a company has had some oil and gas business and then some other business activity that was not oil and gas - how would you break out the apportionment formula to concentrate that on their single tax return?

COMMISSIONER WILLIAMS:

The Department always has had the option of allowing the individual entities to report on their own return, and, in fact, for instance, in the split between those, under present law, those who are engaged in oil and gas are under Chapter 21. They file a return under Chapter 21 with all the calculations under that Chapter. If they are part of a consolidated business, and there are other corporate entities in the State who are also in that consolidated business that aren't engaged in Chapter 21 activities, they file separate returns under Chapter 20. The Department can require combined returns from those other taxpayers, or it can allow separate returns to be filed for each of those taxpayers. That rule would

presumably continue under this. There would be no reason for it not to.

MR. MALONE:

Okay, so if you had a company that was engaged in various types of businesses, and they were subject to apportionment, being, say, a company that had reason to use some apportionment for their income, then how would the extraction factor fit in? It would only fit in to that portion of their income that came from oil and gas? Or would it cover those portions of their income that came from other types of activities as well? Or would you use a standard 3 factor apportionment formula there? That's a question, again, how would you break that out?

COMMISSIONER WILLIAMS:

It would depend on the individual circumstances of a corporation. But if it was appropriate in a given set of circumstances you could look at -- let's say they were in a mercantile enterprise, selling curtains -- and it was appropriate in those circumstances to look at the curtain sales separately we could apply the 3 factors to the curtain business, and apply the other, the special factors here to the oil and gas business income. The Internal Revenue Code talks about unitary businesses, and although we are using the term here consolidated business, we are using that in a sense of who you can look

to gather to combine, in looking at that business. Typically, for instance, where you have an oil company and it owns a department store chain, the oil company is engaged in one unitary business - the department store chain is a different unitary business, and it would report separately. And that would probably continue. They would be different businesses.

MR. MALONE:

Well, what I'm getting at is that, you move away from the standard 3 factor apportionment and put in an extraction factor. And then you have a business that may be engaged in various lines -- which one applies? And if the extraction factor is carried over to the total income, where, in fact, it might not make sense to apply it there -- whether that puts anything other than the conventional 3 factor formula in sort of a dangerous position?

COMMISSIONER WILLIAMS:

The way we would resolve that is either on an individual case basis, or perhaps by regulation. I'll clarify it to make it clear that the intent is to look at the type of business. If you have an enterprise that's, as I say, engaged in a mercantile operation of some sort, and another one that's -- and part of its activity is as a wholly owned subsidiary -- yet it is primarily also engaged in oil and gas, you look at the type of business that it's

engaged in. You could, under the appropriate facts, say, the mercantile business, department store or whatever it was, was one unitary business, and the oil and gas was the other unitary business. You then look at the business income of the oil and gas unitary business and apply the 3 factors under this section 72 and come up with the oil and gas business income that was earned here. When you got over to the mercantile unitary business, you would apply the standard 3 factors, since the oil and gas factors aren't apposite there, and you look at the mercantile business income, apportion it according to the mercantile factors, the standard 3 factors, and that would be the taxable income from the mercantile business.

MR. MALONE:

Thank you, Mr. Chairman. I don't have any further questions along that line. I would say, though, that I think that that is a serious issue when moving to a apportionment factor that may not be applicable to all the types of business operations that a company is engaged in. I think that that at least raises a question in my mind as to how something like that would work.

MR. GARDINER:

Mr. Chairman, I don't have any more questions on ...

MR. RAY:

Were you trying to get my attention for some reason?

MR. GARDINER:

No. I will at some point when you are done here.

MR. RAY:

Well, then it would be within my prerogative to ask the Committee at this time if they have any considerations, or any proposals? Senator Dankworth?

MR. DANKWORTH:

Thank you, Mr. Chairman. As we discussed when I first started, when we first opened that Committee, that I had laid a couple of amendments of different types on the table for our discussion over the last few days. One was the settlement agreement. I think that's had pretty thorough discussion. The second one was a proposed settlement -- excuse me, I don't mean the word settlement. It's a compromise amendment taken from the settlement agreement. And the third one is the one that-- there were some corrections that were made, including the Halford amendment on page 3 -- that's before us now, and I was just laying on the table, if it's permissible from the Chair, that I'd like to offer that now as a Substitute for the Committee, to consider that as a Substitute for the Free Conference Substitute for Senate Bill 524.

MR. RAY:

Is that a motion, sir?

MR. DANKWORTH:

That's a motion.

MR. RAY:

Is there any objection?

MR. GARDINER:

Yes. Mr. Chairman, I'd like to offer -- if that's being offered as an amendment to -- the only way I can do it is offer an amendment to an amendment -- a couple other -- one bill that I offered yesterday to the Committee, and a variation of that bill. So if that's the way you'd like to conduct it.

MR. RAY:

Well, I suppose that it would be proper to move any proposal that you have as an amendment and it's the will of the body which one they pick or choose. I would imagine, then, that a majority of 2 from each side would make a determination as to which proposal would be considered. We have a proposal before the Committee at this time. I know that I am stepping outside of my authority, but if I could ask you, Representative Gardiner, does your amendment have any significant changes other than what we have discussed yesterday?

MR. GARDINER:

Yes. Mr. Chairman, I have a proposal I made yesterday and a variation of that that meets the third criteria of the Governor's letter that none of the other proposals that we've had before us do. That's why I would ...

MR. RAY:

And then it would be up to me to request that Senator Dankworth, or to ask his feelings if he wants to hold his motion in abeyance to give you opportunity to talk to the Committee or to make a presentation to the Committee. Otherwise, we have a motion pending. Senator?

MR. DANKWORTH:

Mr. Chairman, if Representative Gardiner would like to discuss another proposal, I'd be glad to withdraw my motion to adopt the position I have for the purposes of letting him discuss his amendment. If he wants to move his, then fine.

MR. RAY:

Then I would ask, because of the time constraints, and, of course, that to the will of the Committee that we address the portion that we have not addressed previously, if that's agreeable with the Committee.

MR. GARDINER:

Okay. There's a one page sheet that makes it real simple. It just compares what I offered yesterday, and what I'm offering today, and Senator Dankworth's bill, five of the Governor's criteria that he stated in his letter. Mr. Chairman, I think the difference -- the one criteria in the Governor's letter that is not met, I think, by both

the proposal that I made, which I'm calling compromise 1, there yesterday, is the protection of the revenues at risk. Under both the approach I offered yesterday and under Senator Dankworth's bill as offered, the existing money under 43.21, which the Attorney General said will be $2 billion -- we'll just have to litigate that and see what happens -- it puts a lid on it. But that $2 billion is still at risk. And we're not going to know for some years what happens to that $2 billion. It does have the benefit of, you know, cutting off increased risk. But we will have $2 billion at risk. What compromise 2 there does is it puts in a backstop, which is repealed in 1985, which is at the time people estimate the suit will be resolved -- but it has the effect of simply backstopping those revenues at risk under 43.21 that has no collection caused under it. It's at 17 mills, rather than at the 30 and 20 that was in the original backstop bill which the House passes. So that has the effect -- they credit everything that they pay under 43.21 against the reserve tax of 17 mills. It grants them the warts and the windfall profits deduction as in the other bill. But I think that's an important criteria. One of things that's not, again, backstopped beyond the $2 billion is any new suit generated over the bill that Ed has offered, over the new apportionment formula, whatever is litigated

over that will be at risk. We don't know whether that will be litigated because it isn't in law yet. And we won't know maybe for a while. But this second bill, I think, meets the original criteria - it protects the State's revenues in a better format than either of the bills. It improves our legal position by passing the warts and granting the windfall profits deduction. But it goes to a third criteria, and that is it totally protects the revenues at risk, that I don't think the other bills do.

MR. MALONE:

Thank you, Mr. Chairman. I'd like to speak to the proposal also. The -- as Representative Gardiner outlined, in the alternate proposal the revenues collected under 43.21, with the technical amendments and the windfall profits tax exemption provided, the remaining revenues would be protected under the proposal, at least to some degree. Not at 100%, but by the time that the tax expires -- that the reserves tax would expire -- there would be a very small amount of uncovered revenues. I think that that's an important question. Right now the liability that exists there is on the order of $1 billion and will climb rapidly. Or if it doesn't climb rapidly, then we face, because of a new apportionment formula, then I think that we face possible legal problem with the new apportionment formula. I think that the, basically the approach is to use the

severance tax to offset at least a portion of the revenues from the windfall profits tax deduction and the technical amendments. And then use a reserves tax to offset all but not -- a portion of but not all of the revenues collected under 43.21. That has the advantage of not raising any new issues, or giving any real potential for new issues arising because the basic parts of the law aren't being completely rewritten, they're just being cleaned up. And protects the State's income through a very traditional -- or most of the State's income collected under the remaining provisions of 43.21 -- under a very traditional form of state and local government taxation. I think that the approach has the certainty that would be needed, and I think if that approach were adopted by this Conference Committee, and adopted by the legislature, I think it would eliminate the need to address this question again in this legislature.

MR. RAY:

Commissioner Williams, have you had an opportunity to look at this proposal at all?

COMMISSIONER WILLIAMS:

Just now.

MR. RAY:

Is there any discussion on the proposal? Are there any questions by any of the members to the proposer? That's

the end of your presentation, sir?

MR. GARDINER:

Yes. I'd just say one thing. I think it covers that one criteria that the other bills we are looking at doesn't - that protects the State's revenues at risk. You know, people have talked about reserve accounts and what about that $2 billion hanging out there, and what about new suits -- and I think that that's where this bill goes farther than the other bills, and it still has the same financial impact on the producers that the other bills have. You know, we are basically not arguing over how much -- you know, the bills have about the same revenue effect. But the question is, how much it protects what's at risk. And I think this goes further.

MR. RAY:

Representative Malone,did you have something further?

MR. MALONE:

No, I think Representative Gardiner said -- I think the other thing is that no new issues would be introduced into possible litigation. That's another advantage of this bill.

MR. RAY:

That ends the discussion on the proposals. Is there any discussion from any of the members on any of the proposals? Are there any questions necessary to be answered? The

Chair is open for motions. Senator?

MR. DANKWORTH:

Mr. Chairman, I'd like at this time to -- after hearing that discussion -- I'd like to replace my motion that I just had prior to that discussion. And that we adopt that which has been passed out and better known, I suppose as Dankworth 3, and have that as the Committee Substitute for Senate Bill 524, I suppose, would be the motion, or let it be Free Conference Committee Substitute for Senate Bill 524.

MR. RAY:

For identification purposes, the proposal that is being suggested is this Dankworth 3.

MR. GARDINER:

Is that changed from yesterday?

MR. DANKWORTH:

Yes, it did. It had -- the only addition has been that -- and I think I spoke to it a moment ago -- is that it has the Rick Halford -- on here ...

MR. RAY:

The changes in this bill, to my knowledge, are on page 3. Lines 9 and 10 have been changed to 4 million -- from 2 million to 4 million.

MR. DANKWORTH:

With that, sir, I move the Committee Substitute.

MR. RAY:

The motion before the Committee is to adopt Dankworth 3 as Free Conference Committee Substitute for Senate Bill 524. Is there discussion? Are you ready to vote? Stand at ease. The Committee will come back to order. There is a technical change on page 15, line 5. A "b" should be "h". Line 15, I'm sorry. They haven't any "b". I thought it was pretty far down on the page to be 5, but I thought...

MR. GARDINER:

"H"?

MR. RAY:

"H". It should be "h" instead of "b". Is that change agreeable with the Committee? Is there an objection to that? We have the motion before us is for the adoption of Free Conference Committee Substitute for Senate Bill 524. And that Substitute is the Dankworth 3 amended. Are you ready for the vote? All those in favor do so by holding up your right hand. All those opposed. Let it show that the 3 Senate members were in favor. Representative Halford and Representative O'Connell were in favor. Representative Gardiner was opposed. Does anybody want to change their vote? Then the Free Conference Committee Substitute has been adopted. Yes.

(conversation between Mr. Ray and Mr. Dankworth)

MR. RAY:

Before I sign this I am going to take the privilege of the, as the Committee Chairman. I have a few words to say. I personally feel that, as a legislator and as a member of this legislature, that I owe an apology to the people of this State for the manner in which we have handled this entire oil taxation policy. I believe that until such time as we can establish in a competent court of jurisdiction, a firm taxing policy so that we know exactly what we are doing, we will never have any fiscal responsibility, we'll never have anything. That was one of my preferences as far as the settlement is concerned. I will be more than happy to go to a settlement in a court of law. That doesn't bother me a bit. In fact, I think it would assist us, as legislators, to make that determination so we'll know once and for all exactly where we stand and what we can do. 'Til that time any settlements and continual tinkering and fooling around with this thing, we'll never get anywhere. That's my own personal opinion. If I owe an apology to the Committee - you have it. 24th today? Copies of the Free Conference Committee report. The meeting is adjourned.

(meeting adjourned)

# C E R T I F I C A T E

STATE OF ALASKA )
: SS.
FIRST JUDICIAL DISTRICT )

I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing June 24, 1981 meeting of the Free Conference Committee on Senate Bill 524 was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 18 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this ____ day of July, 1981.

_____
Notary Public, State of Alaska
My Commission Expires: 11/30/84