

HB

118 (FILE 2)

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1 IN THE HOUSE

BY THE FINANCE COMMITTEE

2

HOUSE BILL NO. 118

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6 For an Act entitled: "An Act relating to the oil and gas properties pro-
7 duction tax."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 43.55.013(b) is repealed and reenacted to read:

10 (b) The economic limit factor for oil production of a lease or
11 property shall be computed according to the following formula:

12 $(1 - [PEL/TP]) \exp ([150,000/(TP/Days)] \exp [(460 \times WD)/PEL])$

13 where: PEL = the monthly production rate at the economic limit;

14 TP = the total production during the month for which the
15 tax is to be paid;

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

18 Days = the number of days in the month for which the tax is
19 to be paid; and

20 exp = exponent.

21 * Sec. 2. AS 43.55.013(d) is repealed and reenacted to read:

22 (d) The monthly production rate at the economic limit for a
23 lease or property is 300 barrels times the number of well days for the
24 lease or property during the month for which the tax is to be paid.

25 * Sec. 3. AS 43.55.013(e) and 43.55.013(f) are repealed.

DEPARTMENT OF REVENUE
February 9, 1989

SECTIONAL ANALYSIS OF HB 118: LEGISLATION REVISING
THE ECONOMIC LIMIT FACTOR

Section 1. This section modifies the severance tax's Economic Limit Factor (ELF) as it relates to oil production.

Under current law and under this section, the ELF statute reduces the effective severance tax rate on oil production by applying a formula which considers productivity. The ELF formula always produces a fraction between zero and one. That fraction is multiplied with the nominal tax rate to get the effective tax rate. This means that the higher the ELF, the higher the actual tax paid; the lower the ELF, the lower the actual tax paid. This also means that if the ELF is zero, the severance tax rate is zero.

This section changes the ELF statute in two ways.

First, this section modifies the formula for calculating the "economic limit" of oil production. The current law considers only average per-well productivity of the field. The formula here adds consideration of total field productivity to the current ELF formula.

← new element

The rounding

Second, this section repeals the provision of current law which states that for any month during the first 10 years of commercial oil production for which a lease or property's computed ELF exceeds 0.7, the ELF shall be considered to be one. This section's repeal of this "rounding" rule of current law would result in initial lower taxes for any field in this situation.

Compared to current law, these two changes raise taxes on fields producing on average more than 150,000 barrels a day and reduce taxes on fields producing on average less than 150,000 barrels a day.

Section 2. This section fixes the monthly production at the economic limit (PEL) at 300 barrels per well per day. The PEL is a rough approximation of the number of barrels a well must produce to cover costs.

Under current law, the PEL is presumed to be 300 barrels a day, and the taxpayer may rebut this presumption at a hearing. This section repeals the provisions for rebutting the 300 barrel per day presumption.

Section 3. This section repeals two provisions of current law which are only necessary for setting a PEL in a hearing.

Needs an effective date, not later than the beg of calendar year

FISCAL NOTE

REQUEST:

Revision Date: _____ Agency Affected: Department of Revenue
 Title: Act relating to the oil and gas BRU: Oil & Gas Audit Division
properties production tax
 Sponsor: House Finance Committee Components: _____
 Requestor: House R sources

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL						
CAPITAL	0	0	0	0	0	0
REVENUE						
REVENUE	0	96,000	144,000	163,000	187,000	180,000

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: See attached page for analysis.

Prepared By: Roger Marks
 Division: Dept. of Revenue, Oil & Gas Audit Division

Phone: 277-5627
 Date: January 31, 1989

Approved by Commissioner: [Signature]
 Agency: Department of Revenue

Date: 2/3/89

Distribution (by preparer):
 Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

Fiscal Analysis of HB 118

This bill modifies the economic limit factor (ELF) formula used in computing the production (severance) tax on oil.

The bill (1) introduces the rate of field production into the exponent of the current ELF formula; (2) repeals the so-called "rounding rule," the provision of current law which states that for any month during the first 10 years of commercial oil production for which the computed ELF of a lease or property exceeds 0.7 the ELF shall be considered to be one; and (3) fixes the production at the economic limit (PEL) at 300 barrels times the number of well days in the month.

Since the bill does not carry an effective date, this analysis has assumed that the bill will be enacted June 1, 1989 and go into effect September 1, 1989 and will apply to oil produced after August 31, 1989. (Because the severance tax on oil for a given month is due during the following month, a tax change which takes effect on September 1 would not affect revenues until October.)

This fiscal note was calculated using the oil price and production assumptions of the Department of Revenue's Fall 1988 Petroleum Production Revenue Forecast mid-case scenario updated for actual data through November of 1988. ^{1/}

Additional revenues for future years in millions of dollars are as follows:

1995	174
1996	169
1997	163
1998	153
1999	152
2000	144
2001	136
2002	129
2003	117
2004	110
2005	104
2006	91
2007	80
2008	60
2009	45
2020	19

^{1/} Had the fiscal note used the oil price and volume assumptions of the "Consensus Revenue Analysis" of January 24, 1989, the FY 90 fiscal impact would be \$99 million.

6-06521 ✓
Chenoweth
2/22/89

Original sponsor: Finance Committee

1 IN THE HOUSE

2 CS FOR HOUSE BILL NO. 118 ()
3 IN THE LEGISLATURE OF THE STATE OF ALASKA
4 SIXTEENTH LEGISLATURE - FIRST SESSION
5 A BILL

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7 duction tax; and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

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11 property shall be computed according to the following formula:

12 $(1 - \frac{PEL}{TP}) \exp \left(\frac{150,000}{TP/Days} \right) \exp \left(\frac{460 \times WD}{PEL} \right)$

13 where: PEL = the monthly production rate at the economic limit;

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15 tax is to be paid;

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17 the tax is to be paid;

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19 to be paid; and

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21 * Sec. 2. AS 43.55.013(d) is repealed and reenacted to read:

22 (d) The monthly production rate at the economic limit for a
23 lease or property is 300 barrels times the number of well days for the
24 lease or property during the month for which the tax is to be paid.

25 * Sec. 3. AS 43.55.013(e) and 43.55.013(f) are repealed.

26 * Sec. 4. RETROACTIVE APPLICATION. This Act is retroactive to
27 January 1, 1989, and applies to oil produced after December 31, 1988.

28 * Sec. 5. ALTERNATIVE RETROACTIVE APPLICATION DATES. (a) If a court
29 makes a final determination that retroactive application under sec. 4 of

1 this Act is invalid, this Act is retroactive to the first day of the month
 2 in which it takes effect, and applies to oil produced on or after that day.

3 (b) If a court makes a final determination that retroactive applica-
 4 tion under (a) of this section is invalid, this Act applies to oil produced
 5 on or after the effective date of this Act.

6 * Sec. 6. PAYMENT OF TAX DUE. The oil production tax payable as a
 7 result of the retroactive application of this Act is due on the 20th day of
 8 the calendar month following the effective date of this Act. If the tax
 9 due and payable is not paid by the date specified in this section, the tax
 10 becomes delinquent and subject to payment of interest and the provisions of
 11 AS 43.10 relating to enforcement and collection of delinquent taxes.

12 * Sec. 7. OVERPAYMENT OF TAX UNDER REVISED FORMULA. The tax liability
 13 of a party that is reduced by the retroactive application of this Act shall
 14 be credited against the taxpayer's future tax liability. The provisions of
 15 AS 43.05.280(a) and 43.05.280(b)(1) do not apply to, and interest is not
 16 allowed on, the overpayment.

17 * Sec. 8. This Act takes effect immediately under AS 01.10.070(c).
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6-0652D ✓
Chenoweth
2/17/89

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27 1987, and applies to oil produced after June 30, 1987.

28 * Sec. 5. ALTERNATIVE RETROACTIVE APPLICATION DATES. (a) If a court
29 makes a final determination that retroactive application under sec. 4 of

1 this Act is invalid, this Act is retroactive to July 1, 1988, and applies
2 to oil produced after June 30, 1988.

3 (b) If a court makes a final determination that retroactive applica-
4 tion under (a) of this section is invalid, this Act is retroactive to
5 January 1, 1989, and applies to oil produced after December 31, 1988.

6 (c) If a court makes a final determination that retroactive applica-
7 tion under (b) of this section is invalid, this Act is retroactive to the
8 first day of the month in which it takes effect, and applies to oil pro-
9 duced on or after that day.

10 (d) If a court makes a final determination that retroactive applica-
11 tion under (c) of this section is invalid, this Act applies to oil produced
12 on or after the effective date of this Act.

13 * Sec. 6. PAYMENT OF TAX DUE. The oil production tax payable as a
14 result of the retroactive application of this Act is due on the 20th day of
15 the calendar month following the effective date of this Act. If the tax
16 due and payable is not paid by the date specified in this section, the tax
17 becomes delinquent and subject to payment of interest and the provisions of
18 AS 43.10 relating to enforcement and collection of delinquent taxes.

19 * Sec. 7. OVERPAYMENT OF TAX UNDER REVISED FORMULA. The tax liability
20 of a party that is reduced by the retroactive application of this Act shall
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6-0652S.
Chenoweth
2/22/89

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24 lease or property during the month for which the tax is to be paid.

25 * Sec. 3. AS 43.55.013(e) and 43.55.013(f) are repealed.

26 * Sec. 4. APPLICABILITY. This Act applies to oil produced on or after
27 the effective date of this Act.

28 * Sec. 5. PAYMENT OF TAX DUE. The first monthly oil production tax
29 payable as a result of the amendments made by this Act is due on the 20th

1 day of the calendar month following the effective date of this Act. If the
2 tax due and payable is not paid by the date specified in this section, the
3 tax becomes delinquent and subject to payment of interest and the provi-
4 sions of AS 43.10 relating to enforcement and collection of delinquent
5 taxes.

6 * Sec. 6. This Act takes effect immediately under AS 01.10.070(c).
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Alaska State Legislature

HOUSE OF REPRESENTATIVES
COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 468-3718

TO: Resources Committee Members

FROM: Representative Cliff Davidson, Co-Chair *Cliff Davidson*
Representative Curt Menard, Co-Chair *Curt Menard*
House Resources Committee

DATE: February 27, 1989

SUBJECT: HB 118; ELF Application Date Issues

ELF APPLICATION DATE ISSUES

Two legal memos (one by Legislative Legal and one by the Attorney General's Office) have been done on the constitutionality of retroactive dates. Both conclude that a reasonable retroactive date, supported by public policy reasons in the record, will be found constitutional.

In summary, the law requires that, to be retrospective, a statute must specify that it is retrospective, and there must be a two-thirds vote for an immediate effective date. There is precedent in Alaska and federal law for retroactive application of a statute back from the date of enactment to the beginning of the calendar year. Retroactivity has also been allowed during the year of the preceding session. In one federal case, a court upheld a tax passed in 1935 applicable to tax years 1933 and 1934. In the present case, the modification of the ELF would result in retroactive application back two years. While the present case is somewhat different from the 1935 case, that case supports the likelihood that the two-year application in this case will be upheld.

The federal rule of law is based on "reasonable notice" whether the nature or the amount of the tax could not have reasonably anticipated by the taxpayer at the time the application date would begin. Changes to tax rates are presumed to be foreseeable. In one case, the court flatly rejected a taxpayer's argument that retroactivity was barred by due process because the proposed rate increase had been under public discussion before Congress for about a year and concluded that this had provided ample notice of the increase. In the present case, the taxpayers have been on notice that

the ELF may be modified since January 1987, when HB 164 was introduced. In fact, the taxpayers were on notice even back in 1981 that the legislature might reassess the tax structure in 1987.

While it is unlikely that the retroactive date back to July 1, 1987 would be found unconstitutional if challenged, to ensure that there won't be a problem, alternative application dates are also added to the bill in the Committee substitute. Alternative dates include July 1, 1988 (the beginning of the fiscal year), January 1, 1989 (the beginning of the calendar year), and immediately on the effective date of the Act.

The following questions and answers establish for the record the reasonableness of the retroactive date back to July 1, 1987.

(1) Is the modification of the ELF and the retroactive application date remedial?

The answer is: Yes, the ELF modification and the retroactive application date are remedial. The modification of the ELF is designed to close up a loophole that allowed profitable Prudhoe Bay and Kuparuk oil fields a tax cut that was designed for marginal fields. The modification of the ELF allows the ELF to function the way it was meant to function. The retroactive date of July 1, 1987, enables the state to receive from the oil companies all the revenue lost as a result of the loophole going into effect at the end of June 1987.

(2) What important public policy does the modification of the ELF and the retroactive application date further?

The answer is: The modification of the ELF and the retroactive application date reflects important public policy relating both to state revenues and to use of state resources. The severance tax serves to raise revenue for the state, which allows the state to provide needed services for all the people. Aside from merely raising revenue, the severance tax serves to obtain for all the people of the state benefits from the oil resources of the state, in accordance with constitutional mandate. The Alaska Constitution requires the legislature to provide for the utilization, development, and conservation of all natural resources belonging to the state for the maximum benefit of the people. Thus, an appropriate severance tax is constitutionally necessary, regardless of the state's fiscal needs.

(3) Will the modification of the ELF and its retroactive application date accomplish the objective of the legislation?

The answer is: Yes. The modification of the ELF and its retroactive application date does accomplish its objectives. They will serve to raise revenue and to fulfill the

constitutional mandate to ensure that all Alaskans benefit fully from Alaska's resources. If the ELF were not to be modified, or if the application date was not made retroactive to July 1987, the people of Alaska would not be fully benefiting from Alaska's resources and revenue would be lost because of this loophole.

(4) Why is the retroactive application date reasonable in its nature, circumstances, and effect?

(A) Did the oil companies have reason to believe that the ELF might be modified and the loophole removed and the change applicable back to July 1, 1987?

The answer is: The retroactive date of July 1, 1987 is reasonable because it is retroactive only two years and because HB 164, a similar bill modifying the ELF, was introduced in January 1987, prior to this retroactive date, so the affected oil companies were on notice prior to this date that the ELF could be changed. In addition, even prior to 1987, the oil companies were on notice that the ELF could be modified and the loophole eliminated. In 1981, when the loophole was created, public officials indicated their expectation that the loophole would be reassessed and possibly changed by 1987, so the oil companies could not have reasonably expected the ELF not to be modified and to not have a change applicable to July 1987, preventing the oil companies from benefiting from the loophole.

(B) Will the retroactive application have an unduly harsh effect on the oil companies required to pay the retroactive tax?

The answer is: No. While the modification of the ELF and the retroactive date serves to raise the amount paid for the severance tax for Prudhoe Bay and Kuparuk oil fields beginning July 1987, it does not raise the amount paid above the 15% statutory nominal rate for the severance tax. Neither does it raise the amount that will be paid above the amount that had been paid by the affected oil companies for Prudhoe Bay oil fields prior to July 1987. The modification and the retroactive date is thus reasonable.

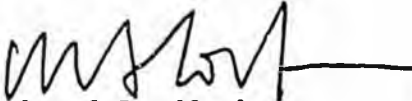
The Committee substitute also provides for payment of the tax on the 20th day of the calendar month following the effective date of the Act. It indicates that delinquent taxes are subject to payment of interest and to the provisions in AS 43.10, which relate to enforcement and collection of delinquent taxes, and also indicates that tax overpayments will be credited against the taxpayer's future tax liability.

MEMORANDUM

State of Alaska
Department of Law

TO: Mary Halloran
Director
Division of Policy
Office of Management and Budget
Office of the Governor

DATE: March 31, 1988
FILE NO: 663-88-0432
TEL. NO: 465-3600
SUBJECT: Retroactivity of HB 164


FROM: Richard D. Monkman
Assistant Attorney General

You requested our opinion as to whether CSHB 164(Fin) am ("HB 164"), which would retroactively apply changes to the economic limit factor in the Oil and Gas Properties Production Tax (AS 43.55), would be likely to be held constitutionally permissible. If not, you ask our advice on "the maximum degree of retroactive application that would likely be held permissible."

The short answer is that the sections which would make HB 164 retroactive to June 1, 1987, would likely be held constitutional. If the law was retroactive to January 1, 1988, it would certainly be held constitutional.

1. Article II. The first step in analysis is the Alaska Constitution, article II, section 18:

Laws passed by the legislature become effective ninety days after enactment. The legislature may, by concurrence of two-thirds of the membership of each house, provide for another effective date.

This section was designed to give the public three months notice of a new law before it is applied to them - unless the legislature, by a two-thirds vote, provides otherwise. State v. A.L.I.V.E. Voluntary, 606 P.2d 769 (Alaska 1980). In line with this provision, the general state policy is against retroactive statutes, based on the philosophy that people "should be able to rely on existing laws with reasonable certainty." Norton v. State, ABC Board, 695 P.2d 1090, 1093 (Alaska 1985). Retroactive application of new laws requires an express statement in the statute itself:

No statute is retrospective unless expressly declared therein.

AS 01.10.090.

The leading case on point is Atlantic Richfield v. State, 705 P.2d 418, 438 (Alaska 1985). In this challenge to Alaska's former "separate accounting" oil tax statute, the Supreme Court upheld retroactive application of the statute back from the date of enactment to the beginning of the calendar year. The bill in question was signed into law on July 8, 1978. It provided:

* Sec. 4. This Act applies to taxable income earned or received after December 31, 1977.

* Sec. 5. The Act takes effect immediately in accordance with AS 01.10.070(c).

Ch. 110 SLA 1978.

Retroactive application was challenged by the oil companies. The Supreme Court held that the statute was "properly retroactive to January 1, 1978," because (1) the statute expressly stated it was to be retroactive, in accord with AS 01.10.090 and (2) the two-thirds vote requirement on the immediate effective date clause was met. The Court rejected oil company arguments that a separate two-thirds vote was required for retroactivity:

AS 01.10.090 states that "[n]o statute is retrospective unless expressly declared therein." A two-thirds vote requirement does not appear in that section, or elsewhere in Alaska law. The legislature, however, has recognized that where retroactive application of a portion or all of a bill is desired, an immediate effective date, which does require a two-thirds vote under article II, sec. 18 and AS 01.10.070(a), should be used in conjunction with the retroactivity section.

705 P.2d at 438, citing Legislative Affairs Agency, Manual of Legislative Drafting 11 (1977 ed.) and Uniform Rules of the Alaska State Legislature, Rule 10 (May 3, 1977); accord, Legislative Affairs Agency, Manual of Legislative Drafting 28-29 (1987 ed.).

The language of sections 3 and 4 of HB 164 is similar to the language approved by the Supreme Court in Atlantic Richfield. Ch. 110 SLA 1978. If passed by the legislature with the requisite two-thirds vote on the effective date clause, the bill is certain to pass this first constitutional hurdle. Without passage of the effective date clause by a two-thirds vote, the retroactive application section will be void, and the bill will operate prospectively only.

2. Due Process. The next constitutional question is whether the bill would offend guarantees of due process of law. Generally speaking, there is no vested right in any particular rate of taxation. Cohan v. Commissioner, 39 F.2d 540, 545 (2d Cir. 1930) (Learned Hand, J.). Both Congress and state legislatures can change tax statutes and apply the changes retroactively:

Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process, and to challenge the present tax it is not enough to point out that the taxable event, the receipt of income, antedated the statute.

Welch v. Henry, 305 U.S. 134, 146-147 (1935).

The federal rule on retroactivity is that "the application of an income tax statute to the entire calendar year in which enactment took place does not per se violate the Due Process Clause of the Fifth Amendment." United States v. Darusmont, 449 U.S. 292, 297 (1980). A tax rate "may be retroactively changed at the will of Congress at least for periods of less than twelve months; Congress has done so from the outset..." Cohan, 39 F.2d at 545, quoted in Darusmont, 449 U.S. at 298. The rule is based in large part on Congressional history:

For more than seventy-five years it has been the familiar legislative practice of Congress in the enactment of revenue laws to tax retroactively income or profits received during the year of the session in which the taxing statute is enacted, and in some instances during the year of the preceding session.

Welch, 305 U.S. at 148.

Welch upheld a Wisconsin tax on dividends passed in 1935, and made retroactive to tax years 1933 and 1934. The Court noted that the Wisconsin legislature meets every other year, and thus the 1935 session was "the first opportunity after the tax year in which the income was received" at which the tax could be changed. Reaching back twelve months (1933 taxes were due in

1934) did not "exceed" the "limit of permissible retroactivity."
Welch, 305 U.S. at 151.

The federal rule is based largely on questions of "fair notice", whether "the nature or amount of the tax could not have reasonably been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event." Welch, 305 U.S. at 147. Changes to tax rates are presumed to be foreseeable. In Darusmont, for example, the Court flatly rejected a taxpayer's argument that retroactivity of an income tax change was barred by due process concerns. The Court stated that the proposed rate increase had been under public discussion in the form of bills before Congress for about a year, and therefore, the taxpayer "had ample advance notice of the increase." 449 U.S. at 299. -/

State courts generally follow the federal rule, noting that "[t]ax provisions, as key components in a system designed to fairly apportion the costs of government, seldom remain static. Rather, we expect them to change in response to changing conditions." Martin v. Board of Assessment Appeals, 707 P.2d 348, 354 (Colo. 1985). The Alaska Supreme Court, as noted above, approved retroactive application of the Oil Tax Act to the full year in which it was enacted. Atlantic Richfield. In another case, the Alaska court had "no doubt" that a license fee increase could have been retroactive to the start of the year of enactment, if the legislature had followed AS 01.10.090 and "stated expressly that it intended the revised fee schedule to be retroactive." State, ABC Board v. Odom, 671 P.2d 375, 377 (Alaska 1983), quoting United States v. Hudson, 299 U.S. 498, 500 (1937) ("it has been the practice of Congress to make [income tax statutes] retroactive for relatively short periods ... and repeated

* The Court also rejected the taxpayer's argument, based on gift tax cases, that he "could have altered his behavior to avoid the tax if it could have been anticipated by him at the time the transaction was effected." Darusmont, 449 U.S. at 299. Gift taxes seem to be the only tax area where the Court has been receptive to arguments against retroactivity. The Court has refused to consider income in the same light as the "one time transaction" of a gift. "[A] tax on the receipt of income is not comparable to a gift tax. We cannot assume that stockholders would refuse to receive corporate dividends even if they knew that their receipt would later be subjected to a new tax or an increase of an old one." Welch v. Henry, 305 U.S. at 148-149.

Mary Halloran, Director
Division of Policy
663-88-0432

March 31, 1988
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decisions of this court have recognized the practice and sustained it as consistent with the due process clause of the Constitution.").

Because HB 164, as written, goes back beyond the start of the calendar year in which it will be passed, we cannot absolutely assure you that the retroactivity section will be held constitutional. By contrast, there is "no doubt" that the bill could be retroactive to January 1, 1988. Odom, Atlantic Richfield. However, going back further is not an insurmountable problem by any means. The proposed effective date of May 31, 1987 is less than twelve months prior to the presumed date HB 164 will be enacted. Twelve months is a "short period," approved by the United States Supreme Court in Welch and again, albeit implicitly, in Darusmont. The bill proposes to change tax rates, an area which is presumed to be subject to legislative change on a regular basis. In this particular case, the taxpayers have been on actual notice that the tax rate might be changed since HB 164 was introduced in January, 1987. Thus, it can be argued that the May 31, 1987 effective date does not violate due process. We believe these arguments to be very strong, although, given the widespread adherence to the "calendar year" approach by the courts, not absolutely certain of success.

RDM:nb

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RECEIVED
Department of Law

MAY - 1 1986

MEMORANDUM

AM 7, 9, 10, 11, 12, 1, 2, 3, 4, 5, 6 PM

TO: Deborah Vogt
FROM: Joseph K. Donohue
DATE: April 28, 1986
RE: Retroactive Amendments to ELF Factor

You have requested an opinion concerning the constitutionality of enacting a bill which would retroactively either repeal, or amend the methodology for calculating, the economic limit factor under AS 43.55.013. Specifically, you have asked whether a bill enacted in February 1987 and made retroactive to January 1, 1987 would present any due process problem under the Fifth Amendment to the United States Constitution or under Article I, Section 7 of the Alaska Constitution.

The gross production tax on oil or gas is payable monthly. The tax is due on the 20th day of each month for oil or gas production which occurred during the preceding month. The tax is delinquent if not paid before the end of the month following the month of production. AS 43.55.020(a). Thus, the tax on January production is due on February 20 and is delinquent if not paid on or before February 28.

The economic limit factor is defined in AS 43.55.013 and the Department of Revenue has promulgated a number of regulations which interpret and implement of the provision. See 15 AAC 55.010-.040 and .090. The economic limit factor (ELF) is a concept which is designed to reduce the effective rate of taxation on a producing field as production from that field becomes increasingly marginal. The ELF is multiplied by the percentage-of-value amount set forth in AS 43.55.011(b) or the cents-per-barrel amount calculated under (c) to determine the tax due. AS 43.55.013(b) (2) and (3) provide that during the first 10 years of commercial production from a lease or property, an economic limit factor which is greater than .7 is deemed to be one for purposes of the calculation of tax liability. For example, for the period since 1981 when the .7 threshold was enacted as part of Ch. 116 SLA 1981, the ELF at Prudhoe Bay has been greater than .7 and, therefore, one. This, in turn, means that the ELF does not have any operative effect unless it is found to be less than .7 during the initial 10-year period. For Prudhoe Bay, the 10-year period expires in June 1987.

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The ELF is derived by the use of a rather complicated mathematical formula which in turn is based on certain simplifying assumptions. For oil, the monthly production rate at the economic limit is presumed to be 300 barrels times the number of well days for the lease or property during the month for which the tax is to be paid. AS 43.55.013(d).

The taxpayer may rebut this presumption at a formal hearing by providing clear and convincing evidence of a different monthly production rate. The determination of the monthly production rate at the economic limit is made by dividing the value at the point of production under AS 43.55.013(f) into the average monthly direct operating costs calculated under subsection (e). The hearing must be held before February 15 of a year or within 6 months after commencement of oil production from a lease or property. The results of the hearing "shall be used for all oil production during that calendar year from the lease or property." AS 43.55.013(d). Therefore, the statute expressly calls for an annual determination with some retroactive effect on the monthly tax period preceding the hearing on the appropriate monthly production rate. This procedural approach makes administrative sense since it is more efficient to have this potentially difficult issue decided on an annual basis rather than on a monthly basis.

Perhaps the leading case on the question of whether a tax statute can apply retroactively to previous tax periods is Welch v. Henry, 305 U.S. 134 (1938). There, the United States Supreme Court upheld a corporate income tax amendment enacted by Wisconsin in March 1935 which was applicable to receipt of corporate dividends in 1933. The court held that, except for a narrow category of gift taxation cases, the legislature had broad authority to adjust or amend tax liability retrospectively.

The exception to this rule mentioned by the court pertained primarily to instances where voluntary irrevocable actions of taxpayers (e.g., making a bequest) were impacted by the retroactive imposition of a tax. The Supreme Court stated that the critical part of the constitutional test was whether "the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event." 305 U.S. at 147. The cases cited by the court, e.g. Nichols v. Coollidge, 274 U.S. 531 (1927), and Untermeyer v. Anderson, 276 U.S. 440 (1928), were instances where the donor might well not have acted as he did had he anticipated the tax. The court said that the facts of each case and the nature of the tax would have to be examined to determine if retroactivity gives rise to such harsh and oppressive results that it offends the Constitution. The court stated "there are other forms of taxation whose retroactive imposition cannot be said to be similarly offensive, because their incidence

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is not on the voluntary act of the taxpayer." 305 U.S. at 147. The court specifically listed property taxes, income taxes and benefit assessments. 305 U.S. at 147-148. The Supreme Court also noted that it was historically the practice of Congress and the Wisconsin Legislature to enact revenue or tax legislation in a given year and to give it effect to the entire calendar year.

The United States Supreme Court more recently upheld the retroactive increase in the minimum tax on preferences in United States v. Darusmont, 449 U.S. 292 (1981). There, an amendment to the Internal Revenue Code enacted in October 1976 was applied to the entire 1976 tax year. In addition to relying on Welch v. Henry, *supra*, the Supreme Court cited its earlier decision in Cooper v. United States, 280 U.S. 409, 411 (1930), which upheld the taxation of gains from "prior but recent transactions." The Supreme Court also relied on the analysis of Judge Learned Hand in Cohan v. Commissioners, 39 F.2d 540, 545 (2d Cir. 1930). Judge Hand, in resolving a similar issue involving retroactivity of a tax, held that nobody had a vested right in the rate of taxation. In responding to the question of whether the tax law change was foreseeable, Judge Hand stated that once a system of taxation is already in place, a taxpayer "must be prepared for such possibilities" 39 F.2d at 545.

Other decisions which uphold tax law changes with arguably retroactive impacts in the face of due process challenges include Buttke v. Commissioner, 625 F.2d 262 (8th Cir. 1980) (involving the same minimum tax amendments subsequently upheld by the U.S. Supreme Court in United States v. Darusmont, *supra*) and Neild v. District of Columbia, 110 F.2d 146, 153 (D.C. Cir. 1940) (involving the constitutionality of the application of a new gross receipts tax measured by the prior year's receipts).

Sometimes retroactive tax laws are challenged under state constitutional provisions barring retrospective laws per se or interference with vested rights. The analytical approach taken by the courts is substantially similar. Under the first line of cases, tax bills which are applied to the entire calendar year in which they are enacted are generally found not to be retrospective in operation. See, e.g., Martin v. Board of Assessment Appeals, 707 F.2d 348 (Colo. 1985). In the Martin case, a law changing the factors to be considered in appraising condominiums which took effect in May 1982 and which was used to assess property values as of January 1, 1982 was upheld. The court held that to find an unconstitutional retrospective effect required a showing of an impairment of a vested right. The court concluded:

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... [P]roperty owners have no vested right to have their taxable property assessed by particular methods employed in prior years. ... Since the statute only alters the factors which may be considered in determining actual value, it does not impair the taxpayers' vested rights, and therefore is not unconstitutionally retrospective in its operation. 707 P.2d at 352.

A "vested rights" challenge in the context of a severance tax increase led to an identical conclusion. In Belco Petroleum v. State Board of Equalization, 587 P.2d 204 (Wyo. 1978), a 1975 amendment to the state severance tax increased the amount of tax due for the previous year. Under the Wyoming severance tax, a taxpayer paid his 1974 tax in July 1975 computed on the value of gross production for previous year. In upholding the application of the 1975 increase to the July assessment, the court ruled that such an increase was not retrospective but merely called for a tax measured by or computed on the basis of antecedent facts or transactions. The court also found that there was no vested right in a specific tax rate.

On the basis of the foregoing state and federal cases, one can conclude that there is no vested right in a particular tax rate or in a particular method of determining a tax liability. The U.S. Supreme Court cases focus on whether the transaction was taxable during the period of retroactive coverage and whether said period is reasonable, whether the transactions were "prior but recent" in time with respect to the tax law change, whether the change was reasonably foreseeable and whether or not the taxpayer might have voluntarily acted as he did had he but known of the change.

The question before us involves the proposed repeal or modification of the ELF factor in February 1987, effective January 1, 1987. The retroactive period is at most two months. It would adjust a factor which is determined on an annualized calendar basis under present law. The affected taxpayers are those whose decision to invest and produce oil or gas has already been made and whose production is already subject to taxation. In the State of Alaska, amendments to the oil and gas production tax must certainly be viewed as foreseeable. In fact, the Legislature has discussed and debated changes to the ELF factor during the 1986 legislative session. Under these circumstances, I conclude that neither state nor federal due process limitations would be abrogated by the repeal or amendment of the ELF factor under consideration here. Furthermore, under the analyses set forth in Martin and Belco Petroleum above, a change in the tax rate or ELF methodology prior to February 20, 1987 might not even be viewed as having "retrospective" operation.

STATE OF ALASKA
THE LEGISLATURE

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LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

February 6, 1989

SUBJECT: Retrospective application of the economic
limit factor tax amendments, CSHB 118 ()

TO: Representative Cliff Davidson, Co-Chair
House Resources Committee

FROM: Jack Chenoweth
Legislative Counsel

The amendments requested are enclosed. The drafts differ only as to the date of retrospective application of each. The draft identified as 6-0652E applies the economic limit factor (ELF) retrospectively to oil produced after June 30, 1987; the draft identified as 6-0652H applies the economic limit factor retrospectively to oil produced after December 31, 1988. (A subsequent memo from your office specified different alternative dates. Mechanically changing a date in any of these drafts is not a significant drafting problem.)

It is my understanding that these provisions limit the applicability of the ELF to the state's major producing fields and that, as a consequence, the tax liability of some taxpayers subject to the severance tax, AS 43.55, would be increased, while the liability of others may decrease. 1/

1/ Under AS 43.55.020(a):

The gross production tax on oil or gas shall be paid monthly. The tax is due on the 20th day of each calendar month on oil or gas produced from each lease or property during the preceding month. If the tax is not paid before the end of the month in which it becomes due, the tax becomes delinquent.

Thus, tax liability is incurred and remitted on a monthly, not an annual basis. For oil production during December, 1988, the tax became due and payable January 20, 1989, and tax liability for oil production during January, 1989, becomes due and payable February 20, 1989.

A retroactive tax adjustment will apply if there is a valid public purpose served by giving retrospective effect to that adjustment. Here, the committee's deliberations may be critical. As a committee substitute for HB 118 is considered, it would, in my judgment, be important to develop a record on which a court, if called upon to consider an argument, would conclude that there was a public purpose served by giving the adjustment a retrospective effect.

A reasonable retrospective application will be sustained. The farther back the retroactive provision is given effect, the less likely a court would be to sustain the provision without a clear showing of public purpose. (To foreclose a claim altogether, this office has discouraged retrospective application of severance tax adjustments beyond the narrow period recognized under AS 43.55.020(a), that is, a change amending the economic limit factor to be made retroactive only to the beginning of the month in which the bill is to take effect. That approach should not create any problems of retrospective applications since the tax liability would not have become due on that date.)

I

RETROSPECTIVE APPLICATION OF THE AMENDMENTS:

Tax statutes may be made retroactive. 2/ The threshold

2/ This office has also recently considered proposed retrospective application of severance tax adjustments, specifically relying on the federal and state constitutional prohibitions against passage of ex post facto laws. There are two ex post facto law prohibitions of the federal constitution. Article I, section 9, clause 3 is a limitation on the federal government, while article I, section 10, clause 1 imposes a similar limitation on the states. Alaska's constitution also contains a limitation in section 15 of article I.

Our previous conclusion that federal and state constitutional prohibitions against enactment of ex post facto laws would support a challenge to the amendment's retrospective application was surely in error. Federal court decisions have limited the application of the limitations to criminal or penal consideration is that the retrospective application of the measure must not impair an obligation of contract.

The impairment of contract consideration appears to be inapplicable in this instance. Retrospective application of a newly-enacted statute may, in some instances, impair obligations of contract, in violation of article I, section 10 of the United States Constitution and article I, section 15 of the State Constitution. However, the Alaska Supreme Court appears to have cut off an impairment of contract argument applicable to retrospective application of a tax amendment in Atlantic Richfield Co. v. State, 705 P.2d 418 (Alaska, 1985). To the argument that the oil and gas corporate income tax then in litigation impaired the obligation of the state's underlying lease contracts, the court concluded that "[the] argument [was] without merit":

. . . No lease provision has been impaired. In entering into the leases the state could not, and did not, contract away its power as a sovereign to tax income earned in the state. Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 102 S.Ct. 894, 71 L.Ed.2d 21 (1982) disposes of this issue:

Contractual arrangements remain subject to subsequent legislation by the presiding sovereign. Even where the contract at issue requires payment of a royalty for a license or franchise issued by the government entity, the government's power to tax remains unless it "has been specifically surrendered in terms which admit of no other reasonable interpretation." St. Louis v. United R. Co., 210 U.S. 266, 280, 28 S.Ct. 630, 634, 52 L.Ed. 1054 (1908).

455 U.S. at 148, 102 S.Ct. at 907, 71 L.Ed.2d at 36 (citations omitted); see also Exxon v. Eagerton, 462

statutes, concluding that retrospective tax legislation is not prohibited by the ex post facto clause. Personal Finance Co. v. United States, 86 F. Supp. 779 (D.Del., 1949). See 16A Am. Jur. 2d secs. 636, 677. Decisions in other state courts have similarly concluded. Parlato v. McCarthy, 69 A.2d 648 (Ct., 1949), Walker v. Commonwealth, 130 S.W.2d 27 (Ky., 1939). The Alaska Supreme Court has not extended application of the state constitutional ex post facto prohibition beyond penal or criminal matters. Danks v. State, 619 P.2d 720 (Alaska, 1980); Creekpaum v. State, 753 P.2d 1139 (Alaska, 1988).

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U.S. at-187-94, 103 S.Ct. at 2304 - 2307, 76 L.Ed.2d at 508-12.

705 P.2d 418, at 438.

*

If legislation acts retrospectively, the nature and duration of its retrospective application should be reasonable. The arguments favoring a reasonable retrospective operation arise out of the equal protection and due process clauses of the state and federal constitutions.

Federal equal protection considerations:

State legislation retroactively imposing a tax is not necessarily and certainly invalid under the equal protection clause of the Fourteenth Amendment to the federal constitution. The inquiry to be made is one of whether the retroactivity impairs substantial, vested rights, and is reasonable in the circumstances. As to retroactively imposed new taxes, the courts have been reluctant to find a violation because of the impairment of a vested right. Welch v. Henry, 305 U.S. 134, 83 L.Ed. 87, 59 S.Ct. 121 (1938), rehearing denied 305 U.S. 675, 83 L.Ed. 437, 59 S.Ct. 250 (1938). 3/ Several state courts have agreed. See Garrett

3/ In Welch, the United States Supreme Court concluded that a Wisconsin state statute, enacted in 1935 and operating retrospectively to tax corporate dividends earned in 1933 which, when received, were deductible from gross income, did not violate the equal protection clause. The tax rates applied to the dividends differed from the rates applicable to other types of taxable income. As to the retrospective application of the new tax to dividends that were, when earned, exempt from tax, the court noted that:

The equal protection clause does not preclude the legislature from changing its mind in making an otherwise permissible choice of subjects of taxation. The very fact that the dividends were relieved of tax [in 1933], when the need was less, is basis for the legislative judgment that they should bear some of the added burden when the need is greater.

Freight Lines v. State Tax Commission, 135 P.2d 523, at 526, 527 (Utah, 1943); Colonial Pipeline Co. v. Commonwealth, 145 S.E.2d 227 (Va., 1965), reh. den. (1966), app. dismissed, 384 U.S. 268, 16 L.Ed.2d 523, 86 S.Ct. 1476 (1966). 4/

Numerous retroactive revisions of the federal and Wisconsin revenue laws . . . have imposed taxes on subjects previously untaxed and shifted the burden of old taxes by changes in rates, exemptions, and deductions. It has never been thought that such changes involve a denial of equal protection if the new taxes could have been included in the earlier act when adopted. If some retroactive alteration in the scheme of a tax act is permissible, as is conceded, it seems plain that validity, so far as equal protection is concerned, must be determined, as in the case of any other tax, by ascertaining whether the thing taxed falls within a distinct class which may rationally be treated differently from other classes. If such changes are forbidden in the name of equal protection, legislatures in laying new taxes would be left powerless to rectify to any extent a previous distribution of tax burdens which experience had shown to be inequitable, even though constitutional.

83 L.Ed. 87, at 92.

4/ In Garrett Freight Lines v. State Tax Commission, 135 P.2d 523 (Utah, 1943), the Utah Supreme Court, called upon to determine whether an excise tax levied on the use of diesel motor fuel that was used prior to the date the legislative act became law, found no equal protection violation:

It is well settled that a tax does not necessarily violate the Federal Constitution merely because it contains retroactive features. Milliken v. United States, 283 U.S. 15, 21, 51 S.Ct. 324, 75 L.Ed. 809 [(U.S., 1931)]; Billings v. United States, 232 U.S. 261, 34 S.Ct. 421, 58 L.Ed. 596 [(U.S., 1914)]; Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 125, 83 L.Ed. 87 [(U.S., 1938)]

Neither the Federal Constitution nor the Utah

Federal due process considerations:

Retroactive imposition of a tax is not necessarily a violation of the due process clause of the Fourteenth Amendment to the federal constitution. The leading case is Welch, cited earlier, in which the United States Supreme Court determined:

The objection chiefly urged to the taxing statute is that it is a denial of due process of law because in 1935 it imposed a tax on income received in 1933. But a tax is not necessarily unconstitutional because retroactive. Milliken v. United States, 283 U.S. 15, 21, 75 L.Ed. 809, 814, 51 S.Ct. 324 [(1931)], and cases cited. Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process, and to challenge the present tax it is not enough to point out that the taxable event, the receipt of income, antedated the statute.

83 L.Ed. 87, at 93. But the assertion that due process is not violated is not absolute and, the court has said that

In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation.

Id.

Similarly, in Garrett Freight Lines, earlier cited, the Utah Supreme Court determined that the due process clause is not

Constitution has any provision in terms prohibiting retroactive legislation -- excepting that which forbids the enactment of ex post facto laws. [Citations omitted.] That clause relates to criminal and penal matters and does not affect legislation such as the statute here involved. Calder v. Bull, 3 Dall. 386, 390, 1 L.Ed. 648, 1 Kent Commentaries 409; 3 Story on Constitution 212; 18 C.J.S. Constitutional Law, sec. 435, p. 886.

a limitation on the state's ability to retrospectively impose a tax:

Although basing its case upon the due process clause, appellant does not show wherein the tax constitutes any arbitrary and oppressive discrimination except to assert that a tax based upon a transaction consummated prior to passage of the act amounts to a taking of property without due process. It has many times been questioned whether the due process clause constitutes any limitation upon the taxing power. In this connection we quote from Mr. Justice Sutherland of the United States Supreme Court in an opinion upholding the validity of a statute of the State of Washington levying a tax upon the sale of oleomargarine:

Except in rare and special instances, the due process of law clause contained in the Fifth Amendment is not a limitation upon the taxing power conferred upon Congress by the Constitution. * * * And no reason exists for applying a different rule against a state in the case of the Fourteenth Amendment. * * * That clause is applicable to a taxing statute such as the one here assailed only if the act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property. * * * Collateral purposes or motives of a Legislature in levying a tax of a kind within the reach of its lawful powers are matters beyond the scope of judicial inquiry. * * * Nor may a tax within the lawful power of a state be judicially stricken down under the due process clause simply because its enforcement may or will result in restricting or even destroying particular occupations or businesses, * * * unless, indeed, as already indicated, its necessary interpretation and effect be such as plainly to demonstrate that the form of taxation was adopted as a mere disguise, under which there was exercised, in reality, another and different power denied by the Federal Constitution to the state.

Garrett Freight Lines, 135 P.2d 523, at 527.

Courts have, however, considered retrospective tax legislation unconstitutional as a violation of the due process clause when, as Welch concludes, in light of "the nature of the tax and the circumstances in which it is laid," the legislation is "so harsh and oppressive as to transgress [that] constitutional limitation." Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87, at 93. The question is typically one of the degree of harshness, based upon consideration of factors such as (1) the effect of the retroactive application of legislation amending a tax on a taxpayer's voluntary act that was influenced by the taxpayer's understanding of tax incidence or consequence at the time of that act, especially if the tax to be imposed or amended is "novel," (2) the sufficient certainty of the taxpayer's expectation of money that is jeopardized by the retroactive legislation, (3) the length of the period of the legislation's retrospective application, and (4) the importance of the public purpose to be served by the action. The first three elements are, to some degree, based on the taxpayer's expectations, while the fourth involves a determination of a public interest that necessitated the actual enactment.

Computation and payment of the severance tax is not greatly determinative of taxpayers' taxable activities that generate the tax liability, nor does this proposed legislation seem to strike at activities of a taxpayer that reasonably relied on the current severance tax rates before this bill proposed amendment of that tax. It is the length of the period of the legislation's retrospective application and the importance of the public purpose to be served that need be most carefully considered.

The state's strongest case would be one that suggests that the purpose of the retroactive provision was remedial and that its impact was limited to the shortest period practicable. One benchmark date that might serve that purpose is July 1, 1988 (start of the current fiscal year, if, indeed, the principal purpose of the retroactive application is to meet revenue shortfalls in this fiscal year); a number of cases would sustain the argument that the legislation may be retrospective over the calendar or fiscal period of its enactment. An alternative--riskier because of the length of the period over which that retroactivity would reach back, but perhaps stronger from the point of view of public policy considerations--would be that date in 1987 when the ten-year exemption from the ELF's operation expired

and the economic limit factor became applicable to the state's major producing fields. But this would probably be justified only if the state could demonstrate that the conditions that suggested in 1981 that adoption of the ELF would benefit production are now shown to have been inaccurate or incorrect.

State due process and equal protection considerations:

Nothing in my quick research suggested that an analysis under the state's "due process" clause, article I, section 7, would reach a conclusion at variance with the decisions based on the comparable federal provision discussed above.

State "equal protection" analysis differs, though the conclusion reached under that analysis is consistent with the conclusions reached under the analysis applicable to the federal provisions. In State v. Erickson, 574 P.2d 1 (Alaska, 1976), the court established a "single test" approach for state-constitution based equal protection analysis, essentially requiring that the court (1) ascertain the purposes of the legislation to determine whether they are legitimate; (2) determine whether the means chosen to accomplish the objectives actually do so; and (3) balance the importance of the state's interest against the constitutional right involved. The state has plenary authority to tax. Assuming an adequate record--and the April, 1988, "ELF Policy Perspective" document may be sufficient--the ELF adjustments now proposed, adding to tax liability on the major producing fields that are most profitable but continuing or reducing rates on marginally producing fields, seems to bear a strong correlation to the state's efforts to impose a tax burden on an oil field's production that is consistent with the field's economics. By that analysis, if the retrospective application of the change is reasonable, the court should reject any state constitutional equal protection-based claim.

II

IS THERE A NEED FOR A SEVERABILITY CLAUSE?

A severability clause is not needed, and one has not been included in either draft. In the absence of a severability clause, you may rely on AS 01.10.030.

III

TO THE EXTENT THAT THE BILL MAKES A RETROACTIVE TAX REDUCTION, MAY THE LEGISLATURE PROVIDE FOR THAT TAX

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REDUCTION BY-A CREDIT AGAINST THE TAXPAYER'S FUTURE TAX LIABILITY, OR IS THE PAYMENT OF AN IMMEDIATE [CASH] REFUND REQUIRED?

If retrospective application of the ELF adjustment reduces the tax liability of any taxpayer, the revenue having been received and deposited into the general fund, the state would not be able to refund amounts that have been previously paid by the taxpayer to that taxpayer without an appropriation. However, article IX, section 6 of the state constitution provides that appropriations of public money may be made only for a public purpose. In states operating with a constitutional provision comparable to Alaska's in which there has been a proposed payment of a retroactive refund of a validly enacted tax, the appropriation has been held to violate those constitutional provisions. Japan Line, Ltd. v. MacCaffree, 558 P.2d 211 (Wash., 1977); City of Yakima v. Huza, 407 P.2d 815 (Wash., 1965); In re Estate of Skinner, 303 P.2d 745 (Cal., 1956); San Bernardino County v. Way, 117 P.2d 354 (Cal., 1941). These considerations then would favor the use of a credit due the taxpayer against the taxpayer's future tax liability, for the use of this approach would necessarily avoid a "public purpose" challenge under article IX, section 6.

IV

TO THE EXTENT THAT THE BILL MAKES A RETROACTIVE TAX REDUCTION, IS INTEREST PAYABLE ON THAT REDUCTION? IF SO, FROM WHAT DATE WOULD INTEREST ACCRUE?

Assuming the draft makes a retroactive tax reduction, I would treat the reduction as the equivalent of a refund of taxes legally collected. In a refund situation, the legislature may shape the conditions and limitations of that refund. While interest is generally recoverable on the amount of the refund, the few Alaska precedents suggest that payment of interest is discretionary and depends principally on whether or not the legislature, by statute, has authorized its payment.

By statute, interest is allowed on an overpayment of a tax levied and collected under AS 43. See AS 43.05.280. That statute is, of course, more generally applicable to instances involving tax payments made in regular fashion, and not to adjustments made by retrospective application of a change of the tax law. But it would seem to have applicability to the changes suggested under AS 43.55. Apart from the statute, I know of nothing that mandates

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February 6, 1989

payment of interest on a tax refund due for a tax that, at the time of levy, was legally collectable, and suggest that the state may act with respect to interest on the tax refunds as it sees fit.

The committee should determine what it wants to do and give instructions, and the draft will be prepared accordingly.

V

TO THE EXTENT THAT THE BILL INCREASES A TAXPAYER'S LIABILITY, IS THE TAXPAYER OBLIGATED TO PAY INTEREST ON THE INCREASED LIABILITY? IF SO, FROM WHAT DATE WOULD INTEREST ACCRUE?

Assuming the committee substitute serves to establish a greater liability on the part of certain taxpayers for one or more "past due" months, that liability arises not under AS 43.55.020(a), but by operation of this law. The legislature has authority to determine whether interest should be paid, and from what date it should be paid.

The bill should not leave taxpayers subject to the assertion that they failed to remit taxes by the deadlines established in AS 43.55.020(a). In each measure, I have incorporated an additional provision that sets a date certain for reporting and paying the retroactive tax liability. Thereafter, if the amount due has not been timely remitted, provisions governing delinquency should apply.

*

Your January 30 memo asks other questions concerning retroactive application of the proposed ELF changes. Let me briefly respond.

As should be clear from the decision in Atlantic Richfield v. State, there is sound benefit in adhering to the requirements outlined in the Agency's drafting manual. The current manual, at pp. 27, 28, instructs that

The language providing for retroactive application of a bill or part of a bill should be set out in a separate section immediately preceding the effective date section. The retroactive section and the sections in the bill that are to be retroactive should have immediate effective date clauses.

I am bound to follow the drafting manual, and any draft version of legislation prepared for the committee's

Representative Cliff Davidson
Page 12
February 6, 1989

consideration that contained a retroactive provision would necessarily include an immediate effective date. All the drafts I would provide for the committee's consideration would contain the effective date clause. However, if, in a mark-up, the committee directs (on the record) deletion of the clause with the immediate effective date, I would provide the bill with that section omitted. But, before departing from the directive of the manual, I would want to have committee instruction, for I think it is important that the record show why there has been a departure from standard drafting procedure.

If one house or both houses fail to adopt an immediate effective date for legislation having a retroactive provision, the bill would still take effect. The effective date would be delayed 90 days, however, but the retroactive elements of the legislation would not be impaired by that delay.

JBC:kb
wkk1/109

Enclosure

STATE OF ALASKA
THE LEGISLATURE

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

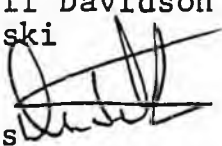
LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

February 23, 1989

SUBJECT: Dedication of ELF Proceeds to Permanent Fund (HB 118)

TO: Representative Cliff Davidson
Attn: Lourene Miovski

FROM: David R. Dierdorff 
Revisor of Statutes

This morning I discussed with Lourene Miovski your desire to provide that 30 percent of the additional revenue received under the oil and gas properties production tax by reason of the ELF amendments go into the permanent fund. As I told Lourene, the state constitution (Art. IX, sec. 7) prohibits the dedication of state revenue to a specific fund or purpose. However, the legislature could enact a provision that embodies the present intent that certain revenue be appropriated for certain purposes. The provision would not be legally binding on future legislatures.

Enclosed are two amendments that provide alternative means of enacting the legislature's intent. I drafted them as amendments to the original bill rather than for one of the draft CS's prepared for you. Amending the draft CS's would require several technical amendments in the sections after sec. 3, and the exact nature of those amendments will vary from version to version. Consequently, I determined that the simplest way to provide you with the language in amendment form was to amend the bill as introduced.

DRD:gc
WKG7/046

Enclosures(2)

A M E N D M E N T

OFFERED IN THE HOUSE

BY DAVIDSON

TO: HB 118

Page 1, following line 8:

Insert a new bill section to read:

"* Section 1. LEGISLATIVE INTENT. It is the intent of the legislature that 30 percent of any additional revenue received by the state under AS 43.55 as a result of the amendments made by this Act be appropriated annually to the principal of the permanent fund."

Page 1, line 9:

Delete "Section 1."

Insert "Sec. 2."

Renumber remaining bill sections accordingly.

A M E N D M E N T

OFFERED IN THE HOUSE

BY DAVIDSON

TO: HB 118

Page 1, following line 24:

Insert a new bill section to read:

"* Sec. 3. AS 43.55.013 is amended by adding a new subsection to read:

(1) The commissioner of administration shall separately account for 30 percent of any additional revenue received by the state under this chapter as a result of the 1989 amendments to this section that the department deposits in the general fund. The annual estimated balance in the account may be used by the legislature to make appropriations to the principal of the permanent fund."

Renumber remaining bill section accordingly.



Alaska State Legislature

HOUSE OF REPRESENTATIVES
COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 485-3715

MEMORANDUM

TO: The Majority Caucus

FROM: Representative Cliff Davidson *CD*
Representative Curt Menard *CPM*
Co-Chairs, House Resources Committee

DATE: February 3, 1989

SUBJECT: House Bill 118 - The ELF Bill

Our staff has prepared the attached paper on the ELF and the history and issues surrounding it, which we think will be helpful in understanding the bill. We would be happy to talk to you about this bill if you have any questions.

WHAT IS THE SEVERANCE TAX?

The Severance (production) tax is a tax that the state imposes on the extraction of oil, gas, and other nonrenewable resources. The severance tax is a mechanism designed to give the people a share in the nonrenewable resource wealth of a state. In Alaska, this tax is one of the largest sources of oil revenue to the state. Other oil revenue derives from the corporate income tax and the property tax, but these taxes are a small source of state revenue by comparison. These taxes are different from a royalty, which is the amount that a company contractually agrees to pay the owner (which in this case is the state) in the oil lease for the extraction of the oil from the owner's land.

The statutory nominal rate of severance tax on oil production in Alaska is 15%. (The "nominal rate" refers to the amount of the tax prior to the application of the ELF formula. The amount of tax after the application of the ELF formula is called the "effective rate".)

WHAT IS THE ELF?

"ELF" means "economic limit factor". In simple terms, the ELF is a tax formula that serves to reduce the severance tax by variable amounts, depending on per-well production at individual fields. The ELF was designed to lower the tax rate for the less profitable oil fields to encourage continued production as the productivity of the well declined and to encourage development of the less profitable oil fields. As an oil field's production declines, the ELF reduces the tax burden. As the field's oil production reaches the point at which it would be forced to shut down further oil development, the severance tax would be reduced to zero. Thus, it was designed to provide a substantial tax cut for less profitable oil fields.

The original ELF was created by the legislature in 1977. In 1981, as a result of lawsuits by oil companies challenging the constitutionality of Alaska's separate accounting method of computing corporate income taxes (which was later found to be constitutional), the oil and gas taxation statutes were revised to provide for another accounting method. This tax package provided Alaska's oil producers a large reduction in their corporate income taxes on the assumption that most of the revenue lost from the income tax would be offset by the gains from a modification of the ELF that would raise the effective rate of the severance tax. This was devised as a temporary fix.

In this legislation, for all oil fields in their first ten years of commercial production, the ELF was fixed at 1.0 if the oil field's calculated ELF exceeded 0.7. (This has been called the "ten-year rounding rule".) At the time the 1981 legislation was passed, several policy makers, including then Governor Hammond, stated that the legislature could reassess Alaska's oil tax structure, after the courts determined the constitutionality of Alaska's method of separate accounting.

For Prudhoe Bay, the most productive and most profitable oil field, the ten-year rounding rule resulted in the severance tax being temporarily raised back up to the statutory nominal rate of 15%. Prudhoe Bay's ten-year anniversary was on June 20, 1987. On June 20, 1987, the rounded ELF of 1.0 expired, resulting in an effective tax cut from 15% to 12.5% for Prudhoe Bay.

Because oil revenues account for more than 84% of state revenues, much of it from Prudhoe Bay, state revenues were immediately reduced by more than 5% as a result of the expiration of the rounded ELF for Prudhoe Bay that occurred in 1987 -- more than \$100 million per year. The state's budget crisis is partially attributable to this loss of revenue.

A change to make the ELF work as it was supposed to work, and to reverse the tax cut for Prudhoe Bay, was proposed in 1987 and passed the House but was never considered in the Senate. Changes to the ELF were recently proposed in HB 118, now under consideration in the House. HB 118 is similar to the bill that passed the House in 1987, but would raise taxes on Prudhoe Bay and Kuparuk more, and cut taxes on all other oil fields more, than the 1987 proposal.

WHAT DOES THE ELF BILL DO?

The ELF bill provides a greater tax relief for all oil fields in Alaska except Prudhoe Bay and Kuparuk, the two most productive oil fields in Alaska (and the United States), and are two of the most profitable. Under the revised ELF, the taxes for these two oil fields will increase but will still remain below the nominal statutory rate of 15%. The only oil fields besides Prudhoe Bay and Kuparuk whose severance taxes are not reduced by the ELF bill are those fields which have a zero tax rate under current law.

WHAT DATE SHOULD THE ELF'S APPLICATION BEGIN?

There is currently no beginning application date specified in the ELF bill. If passed as is, the ELF rate change would apply to all oil produced beginning 90 days after the bill is signed by the Governor. Amendments have been drafted to provide other choices of dates for beginning application of the ELF rate change.

The other choices of dates for beginning application of the ELF rate change are June 20, 1987 (when the ten-year rounded ELF expired for Prudhoe Bay, reducing the effective tax rate from 15% to 12.45%), January 1, 1989 (the beginning of this calendar year), or immediately upon being signed by the Governor.

The earliest choice will recapture the entire \$397 million revenue lost from the period from June 20, 1987 through to the end of the 1990 fiscal year. The later the application date, the more the revenues that will be lost. If a January 1, 1989 beginning date is used, \$222 million of revenue would be lost. If a June 1, 1989 beginning date is used, \$271 million of revenue would be lost. If a September 1, 1989 beginning date is used, \$301 million would be lost.



Alaska State Legislature

HOUSE OF REPRESENTATIVES
COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3715

MEMORANDUM

TO: All Resource Committee members

FROM: Representative Cliff Davidson
Representative Curt Menard
Co-Chairman, House Resources Committee

DATE: February 21, 1989

SUBJECT: ELF hearing, Wednesday, February 22

The Resources Committee will be having an evening hearing on HB 118, Oil and Gas Properties Production Tax. The purpose of the hearing is to allow the industry and the administration to answer questions while side by side.

We will have Greg Erickson from OMB presenting the administration's position and Tom Williams from BP Exploration presenting the oil industry's position. It is our intention to keep the format fairly structured and to allow the participants to make their best case without interruptions. During their exchange, spontaneous questions will not be allowed. However, we have scheduled a work session on Thursday at which all interested parties will be available to answer any questions from Committee members.

Under this hearing format, each side will first be allowed seven minutes to summarize their position on the question of the ELF legislation. A question from the Committee will follow the opening statements. The first witness will be allowed three minutes to outline their organization's position. The second witness will then be allowed to outline the opposing position. Finally, the first witness will be allowed one additional minute for a summary. For the next Committee question, the witness order will be reversed. Responses and counter-responses will be timed so that both witnesses stay within their allotted time.

Each Committee member will be allowed to ask two questions during the presentation. Our staff has prepared a list of 20 sample questions from which you may select your two questions, or you may draft your own questions. However, you must provide copies of your questions to the Committee staff by our Wednesday 3 p.m. Committee meeting so that any overlap in questions can be resolved. The witnesses will be given a copy of the questions prior to the evening meeting.

If you have any questions or comments about the structure of the hearing, please contact the Committee staff at 3715.

POSSIBLE DEBATE QUESTIONS

- 1) The ELF is designed to provide incentives for wells in marginal oil fields. Which oil fields are considered marginal in Alaska and why are they considered marginal.
- 2) How do Alaska's taxes and royalties compare with those of other oil-producing states?
- 3) Describe the function of the current ELF and give your assessment of how well it is functioning.
- 4) What effect do you think the new ELF (HB-118) will have on oil production in Alaska?
- 5) In June of 1987 the Economic Limit Factor kicked into operation at the Prudhoe Bay oil field. As a result the oil companies have been paying less severance tax. What have the oil companies done with their extra revenue?
- 6) How much revenue is being generated from the Prudhoe Bay by the oil companies? How much revenue is being generated for the State of Alaska? Please compare their respective shares of the oil wealth.
- 7) What oil prices are industry using to evaluate whether or not to proceed with development of projects?
- 8) At current prices, how much per barrel is this expected to cost the industry (your company) and how does this cost compare with a drop in oil prices.
- 9) How do profits from operation of the Trans Alaska Pipeline affect oil company decisions as to profitability?
- 10) How much profit does your company (or "do the companies") make currently on North Slope operations. Please include TAPS profits.
- 11) Compare the profitability of oil industry operations in Alaska with the profitability of the refining of that oil.
- 12) How many additional jobs have been created at Prudhoe Bay since the ELF became effective in June of 1987?
- 13) What effect will the ELF in HB-118 have on employment at the large oil fields? At the small oil fields?
- 14) How much will the oil industry reduce or modify operations in Alaska if this ELF legislation passes? How sensitive is this to oil price considerations?

- 15) Is it true that oil field size, in addition to well productivity, is an indicator of profitability.
- 16) What rate of return does the oil industry require when deciding on oil development projects?
- 17) What is your company's (or "the oil industry's) record on local hire. Is local hire improving among the oil industry?
- 18) Please compare and contrast Alaska's oil tax policies with the oil tax policies used in other countries.
- 19) Please explain the difference between severance tax and royalties and how they affect the oil companies and the state.
- 20) In his (your) testimony earlier, Mr. Williams (you) stated that the ELF formula in HB-118 does not work. Please provide your analysis of the ELF formula in this legislation and why it does or does not work.
- 21) Compare the oil industry and oil production in Alaska with that of other states.
- 22) Explain what happened to Alaska's oil tax laws in 1981.
- 23) Are there mechanisms to encourage production from marginal oil fields that are not being used in Alaska? Give some examples.

Please select two questions or write two questions for the House Resources Committee ELF hearing. We would like a copy of your questions by the Resources meeting this afternoon.



Official Business

Alaska State Legislature

HOUSE OF REPRESENTATIVES

P.O. Box V
State Capitol
Juneau, Alaska 99811

Sent in
BP Alaska
Exxon, Inc
ARC Alaska Revenue
Dept. MEMORANDUM

TO: Industry

FROM: Representative Bert Sharp *Bert Sharp*

DATE: February 21, 1989

SUBJECT: FLF

1. What is the average investment cost of each production well drilled since 1978 in the Prudhoe Bay field?
2. Other than the additional production wells, what is the approximate total cost of Prudhoe Bay investment in production enhancements facilities in the period 1978 through 1988 (by major projects if available)?
3. What is the projected industry Prudhoe Capital Expenditure Budget for the next 5 years; 10 years?

TO: Representative Bert Sharp
FROM: Department of Revenue
DATE: February 21, 1989
SUBJECT: ELF

By Mark

1. A. Prudhoe Bay produced 1.090 million barrels a day in 1978 and 1.528 million in 1988.
B. The average well count was 148 in 1978 and 751 in 1988.
C. Average production per well was 7,365 barrels per day in 1978 and 2,035 barrels per day in 1988.
2. Total state revenue from oil production from 1978 through 1988 has been approximately \$28 billion.



Alaska State Legislature

HOUSE OF REPRESENTATIVES
COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3715

February 5, 1989

!TITLE! !FNAME! !LNAME!
!COMPANY!
!ADDRESS!
!CITY!, !STATE! !ZIP!

Dear !TITLE! !LNAME!:

As you were previously notified, the House Resources Committee will be holding public hearings on HB-118, "An Act relating to the oil and gas properties production tax", from February 9 to 13.

We have scheduled time for your testimony, 1:00-4:00 p.m. on Saturday, February 11. You may testify in person or from any site on the teleconference network.

Our staff will be preparing briefing books for the Resources Committee. We would like to invite you to forward to us a summary of your position totaling not more than three (3) pages of text and four (4) pages of graphics for inclusion in the briefing book. Please provide this material to the Committee staff at least 24 hours before your testimony to allow time for copying and assembly of the materials.

There is no limit to the amount of additional material that may be given the Committee prior to or during the hearing, although we would request that you provide at least 25 copies of any materials.

We look forward to hearing from you.

Sincerely,

Representative Cliff Davidson
Co-Chairman
House Resources Committee

Representative Curt Menard
Co-Chairman
House Resources Committee

January 31, 1989

!TITLE! !FNAME! !LNAME!
!COMPANY!
!ADDRESS!
!CITY!, !STATE! !ZIP!

Dear !TITLE! !LNAME!

The House Resources Committee will be holding public hearings on HB-118, "An Act relating to the oil and gas properties production tax", between February 9 and 14.

This measure, introduced by the House Finance Committee, will modify the computation of the economic limit factor, commonly known as ELF. The House Resources Committee would like to invite a representative of your company to testify on this measure and how it would affect your operations in Alaska.

As currently envisioned, we will be having two days of testimony by the State of Alaska from 3:00-5:00 p.m. on Thursday and Friday, February 9 and 10. These hearings will be listen only on the Alaska teleconference network.

We have scheduled time for oil industry testimony for 1:00-4:00 p.m. on Saturday, February 11. For your convenience, we have reserved the teleconference network so that testimony may be taken from Anchorage and other locations.

Finally, the Resources Committee will hear public testimony on Monday February 13 from 3:00-5:00 p.m. and again from 7:00-9:00 p.m..

We would appreciate hearing from you as to your availability to testify during this period.

Sincerely,

Representative Cliff Davidson
Co-Chairman
House Resources Committee

Representative Curt Menard
Co-Chairman
House Resources Committee

1	M O.	Adamson	Amerada Hess Corporation	Box 2040	Tulsa	OK
2	Beverly	Ward	ARCO Alaska Inc.	134 N Franklin	Juneau	AK
3	J.B.	Rigg	Amoco Production Company	Box 800	Denver	CO
4	Tom	Gallagher	Chevron USA Inc.	Box 107839	Anchorage	AK
5	Al	Hastings	Conoco Inc.	3201 C Street #200	Anchorage	AK
6	Dave	Parrish	Exxon Co. USA	421 Judy Lane	Juneau	AK
7	Thomas	Cirigliano	Exxon Co. USA	Box 196601	Anchorage	AK
8	C.E.	Schwobel	Marathon Oil Company	Box 3128	Houston	TX
9	Waco	Shelley	Mobil Oil Corporation	310 2nd Street	Juneau	AK
10	B.A.	Stallsworth	Phillips Petroleum Company	8055 E. Tufts Avenue Parkway	Denver	CO
11	C.	Waddington	NW Alaska Pipeline Company.	295 Chipeta Way	Salt Lake City	UT
12	Gorden	Evans	Shell Western E & P Inc.	318 4th Street	Juneau	AK
13	Jim	Palmer	Standard Alaska Production Co.	Box 196612	Anchorage	AK
14	E.H.	Nelson	Texaco Incorporated	550 W 7th #1325	Anchorage	AK
15	Norman	Gorsuch	UNOCAL	Box 240504	Douglas	AK
16	Rick	Neal	MAPCO	1800 S. Baltimore A.	Tulsa	OK
17	Debra	Reinwand	Resource Development Council	Box 100516	Anchorage	AK
18	Morris	Thompson	Doyon, Ltd.	201 1st Street	Fairbanks	AK
19	Roy	Hundoí	Cook Inlet Regional Corp.	2525 C Street	Anchorage	AK
20	L.A.(Ardie)	Merbs	Alaska Oil & Gas Association	121 W Fireweed Lane Suite 207	Anchorage	AK
21	Willie	Hensley	NANA Regional Corporation	Box 49	Kotzebue	AK

PHILLIPS PETROLEUM COMPANY

8055 East Tufts Avenue Parkway, Phone: 303 850-4383
DENVER, COLORADO 80237-2898

Corporate Affairs

BRUCE A. STALLSWORTH
Director
Government Relations and Public Affairs
Western States

RECEIVED FEB 20 1988

February 10, 1989

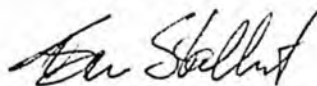
The Honorable Cliff Davidson
and Curt Menard
Co-Chairman
House Resources Committee
House of Representatives
State of Alaska
State Capitol Building
Juneau, AK 99811

Dear Representatives Davidson and Menard:

I am in receipt of your letter dated February 5, 1989, concerning H.B. 118. Thank you for providing Phillips Petroleum Company the opportunity to provide material for the briefing books being prepared for the Resources Committee. Although we are opposed to the legislation, we, unfortunately, were not able to have our tax specialists put the information together within your timeframe.

Again, we appreciate your interest and regret we were not able to provide material for the briefing books.

Sincerely,



Bruce A. Stallsworth

BAS/cyk



Chevron U.S.A. Inc.
3001 C Street, Anchorage, AK 99503 • Phone (907) 563-2556

RECEIVED FEB 9 1989

T. P. Gallagher
Public Affairs Manager

February 6, 1989

Representative Cliff Davidson
Representative Curt Menard
Alaska State Legislature
House Resources Committee
Pouch V
Juneau, Alaska 99811

Dear Representatives Davidson and Menard:

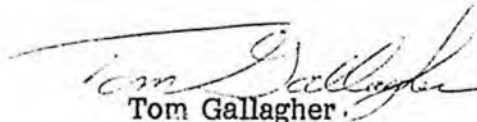
Thank you for your letter of January 31st inviting Chevron to testify on HB-118.

Chevron's comments on subject bill will be incorporated into testimony provided by the Alaska Oil & Gas Association - Tax Committee.

As a result of the hearings scheduled on February 9-14, Chevron may wish to comment further at a later date.

I appreciate your contacting Chevron and look forward to continue working with you and your staff.

Sincerely,


Tom Gallagher

TPG:mw

AMERADA HESS CORPORATION

February 7, 1989

P. O. BOX 2040
TULSA, OKLAHOMA 74102
918-599-4200

Representative ~~Cliff Davidson~~
Co-Chairman
House Resource Committee
Pouch V
Juneau, Alaska 99811

RECEIVED FEB 10 1989

Representative Curt Menard
Co-Chairman
House Resources Committee
Pouch V
Juneau, Alaska 99811

Re: Alaska HB118
Public Hearings

Dear Sirs:

Amerada Hess Corporation thanks you for the opportunity to provide testimony on the potential effect of HB118 on its present and future Alaska oil and gas operations. Certainly, Amerada Hess has some very serious concerns about the referenced proposal and its effect on our outlook for future operations in Alaska. We are active members of the Alaska Oil and Gas Association which plans to provide comments and/or testimony to the House Finance Committee; however, our discussions with AOGA personnel on this matter indicates that AOGA will encompass most of the points we would raise. For this reason, and in the interest of time and efficiency, Amerada Hess will not burden the record with individual testimony.

Thank you again for this opportunity, and be assured of our continued interest.

Very truly yours,



Marilyn O. Bernhardt
General Attorney

MOB:sgb

xc: L. A. (Ardie) Merbs
Alaska Oil and Gas Association
121 W. Fireweed Lane, Suite 207
Anchorage, Alaska 99503-2035



Alaska State Legislature

HOUSE OF REPRESENTATIVES
COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3718

TO: Whom it may concern

FROM: Representative Cliff Davidson, Co-Chair ^{CD}
Representative Curt Menard, Co-Chair ^{CM}
House Resources Committee

DATE: February 10, 1989

SUBJECT: Questions

The Committee appreciates the efforts you have made in informing the Committee of the facts and issues concerning HB 118. In order to get a better perspective, questions have been prepared on this bill. The Committee would appreciate answers to the attached questions by the administration and each participating oil company. Answers are requested to be received by Friday, February 17, so that they can be distributed to the Committee for discussion prior to a vote on any legislation.

ELF QUESTIONS

I AMOUNT OF OIL EXTRACTED

(1) The ELF is designed to provide production incentives for wells in "marginal" oil fields. Which oil fields are considered "marginal" in Alaska?

(2) How many barrels per day are extracted from the most productive oil field in Alaska that will be allowed tax cuts under this ELF bill?

(3) How many barrels per day are extracted from Prudhoe Bay? from Kuparuk?

(4) How many barrels per day are extracted from wells in the most productive oil fields in the various lower 48 states? What is the greatest barrels-per-day extraction considered marginal and provided tax cuts for production incentive in the various lower 48 states?

(5) Which oil companies have the greatest lease interests in Prudhoe Bay and Kuparuk oil fields and what is the percentage of their lease interests?

(6) Oil Companies: How much oil did you extract world wide in 1976? How much of that was from Alaska? (Prudhoe Bay?)

(7) Oil Companies: How much oil did you extract world wide in 1988? How much of that was from Alaska? (Prudhoe Bay?)

II TAXES PAID

(8) Which oil fields will receive tax breaks from this ELF Bill? Which oil fields will receive tax increases from this ELF bill?

(9) Can the ELF raise the amount that would be paid for severance taxes above the statutory nominal rate of 15% for any oil field or any oil company? So this ELF bill can't do this either, right?

(10) Will this ELF bill raise the rate that would be paid for severance taxes for Prudhoe Bay above the rate that was paid by oil companies at Prudhoe Bay prior to June 20, 1987?

(11) How much is being paid to the State of Alaska in severance taxes each year?

(12) How does the amount that Alaska receives in severance taxes compares to the amount that other oil-producing states and nations receive? How much would the

fields in the lower 48 pay if they were placed under the Alaska tax structure?

(13) Oil Companies: Do you have North Sea productions? If so, what percent of the total economic rent do you realize from your Alaska production and what percent do you realize from your North Sea production?

III PROFITS

(14) Oil Companies: How much profit is being made off of the most productive oil fields in the lower 48 states?

(15) Oil Companies: How much profit is being made off of the most productive oil fields in other oil-producing countries?

(16) How much profit is being made off of Prudhoe Bay and Kuparuk oil fields each day?

(17) Does this include TAPS? If not, what is the profit on TAPS?

(18) What public sources corroborate this? Would you provide materials proving this? Would you provide a detailed list of your revenues and expenses?

(19) How much profit is made from refined products from Alaskan oil?

(20) What did the oil companies of Prudhoe Bay do with the savings made as a result of the tax break occurring on June 20, 1987?

(21) What percent of money grossed by Alaska's oil in Prudhoe Bay and Kuparuk is reinvested in Alaska? How much money is sent outside?

IV IMPACTS ON ALASKANS

(22) How many jobs are involved in starting up a small oil field? How many jobs are involved in maintaining a small field?

(23) How many Alaskans were employed by the oil companies of Prudhoe Bay prior to June 20, 1987 when the tax cut kicked in? How many Alaskans are employed by the oil companies of Prudhoe Bay now?

(24) What is the long-term effect on Alaskan jobs in Prudhoe Bay and Kuparuk oil fields as a result of this ELF bill?

(25) How many Alaskans are employed by the oil companies of the marginal oil fields now? How many Alaskans are likely

to be employed by the oil companies of existing marginal oil fields and in developing other oil fields as a result of this ELF bill?

(26) What is the long-term effect on Alaskan jobs in the smaller oil fields as a result of this ELF bill?

ALASKA DEPARTMENT OF REVENUE

POSITION PAPER

QUESTIONS AND ANSWERS ON

HOUSE BILL 118

Why should the Legislature modify the ELF?

This legislation promotes economic development, creates jobs, raises revenue, and protects the interests of the people of Alaska in their resources.

What tax does the Economic Limit Factor formula affect?

The Economic Limit Factor (ELF) formula affects the severance tax on oil. The severance tax -- also called the production tax -- is a tax on oil removed from the ground. The tax compensates for the depletion of the state's non-renewable resources. The severance tax has provided more than a third of the state's unrestricted General Fund revenue in the past decade.

What is the Economic Limit Factor?

The ELF is a formula which reduces the severance tax actually paid on oil. The ELF formula produces a fraction which reduces severance taxes as the productivity of a well declines. This reduced severance tax rate is the "effective" severance tax rate -- that is, it is the rate the producer actually pays. The effective severance tax rate is the "nominal" severance tax rate (the one set out, or "named" in statute, which is normally 15 percent for mature fields) multiplied by the ELF. Here's an example:

15% nominal tax rate

multiplied times ELF of 0.66

equals an effective severance tax
rate of 9.9%

The higher the ELF, the higher the actual tax paid. The lower the ELF, the lower the actual tax paid. A low ELF provides a large tax break.

Why do we have the ELF?

The ELF was originally created in 1977 to encourage oil companies to develop marginal oil fields, and to extend the life of producing fields when production at those fields became marginal.

How did we get to where we are today?

In 1981, the Legislature sharply reduced the state's corporate income tax on oil and gas producers by abandoning separate accounting. (The changes were made because the separate accounting law had been challenged in court, but the state later won the lawsuit.) In an attempt to compensate for the expected loss of revenues from the changes made in the corporate income tax, the Legislature raised the severance tax rate from 12.25% to 15%. Because the ELF formula would have cut into this needed revenue, the Legislature as a stopgap measure -- suspended the ELF at Prudhoe Bay until 1987.

Even at the outset, this attempt to compensate failed. The 1981 changes in the income tax and severance tax had the net effect of costing the state more than \$1 billion in lost revenues between fiscal years 1982 and 1987.

In 1987, the impact of the 1981 tax changes became even more negative for the state. When the stopgap provision ended in 1987, this additional tax break caused the effective severance tax rate at Prudhoe Bay to drop sharply. (Graphic #1 shows this sharp drop for Prudhoe Bay.) This sharp drop immediately cut Alaska's total revenue by \$135,000,000 in FY88.

Why do people want to change the ELF now?

The current ELF is not giving Alaska an attractive enough tax climate to encourage development of marginal oil fields. Instead of helping marginal fields, the ELF formula now mostly provides a massive and unnecessary tax break to two fields which are not marginal at all -- Prudhoe Bay and Kuparuk. These are the largest oil fields in the United States, and two of the most profitable as well.

House Bill 118 would target tax breaks toward marginal fields and away from these two large, high-profit fields. The bill would give tax breaks to currently producing marginal fields such as Endicott and Lisburne and to prospective marginal fields at Niakuk, Point Thomson, Milne Point, and Seal Island. It would leave taxes at zero at West Sak and all the Cook Inlet fields. (See Graphic #2.)

In fact, HB 118 would cut -- or leave at zero -- the taxes on every oil field in Alaska except Prudhoe Bay and Kuparuk.

HB 118 would reduce the tax breaks given to Prudhoe Bay and Kuparuk. The current ELF gives a 20 percent tax break to Prudhoe Bay, and more than a 40 percent tax break to Kuparuk. HB 118 would reduce -- but not eliminate -- the tax breaks given to these two large fields.

Graphic #3 shows the tax savings provided by HB 118 for producers at all other fields except Prudhoe Bay and Kuparuk. Graphic #4 shows the increased revenues generated from Prudhoe Bay and Kuparuk by HB 118. The legislation on balance raises substantial revenues.

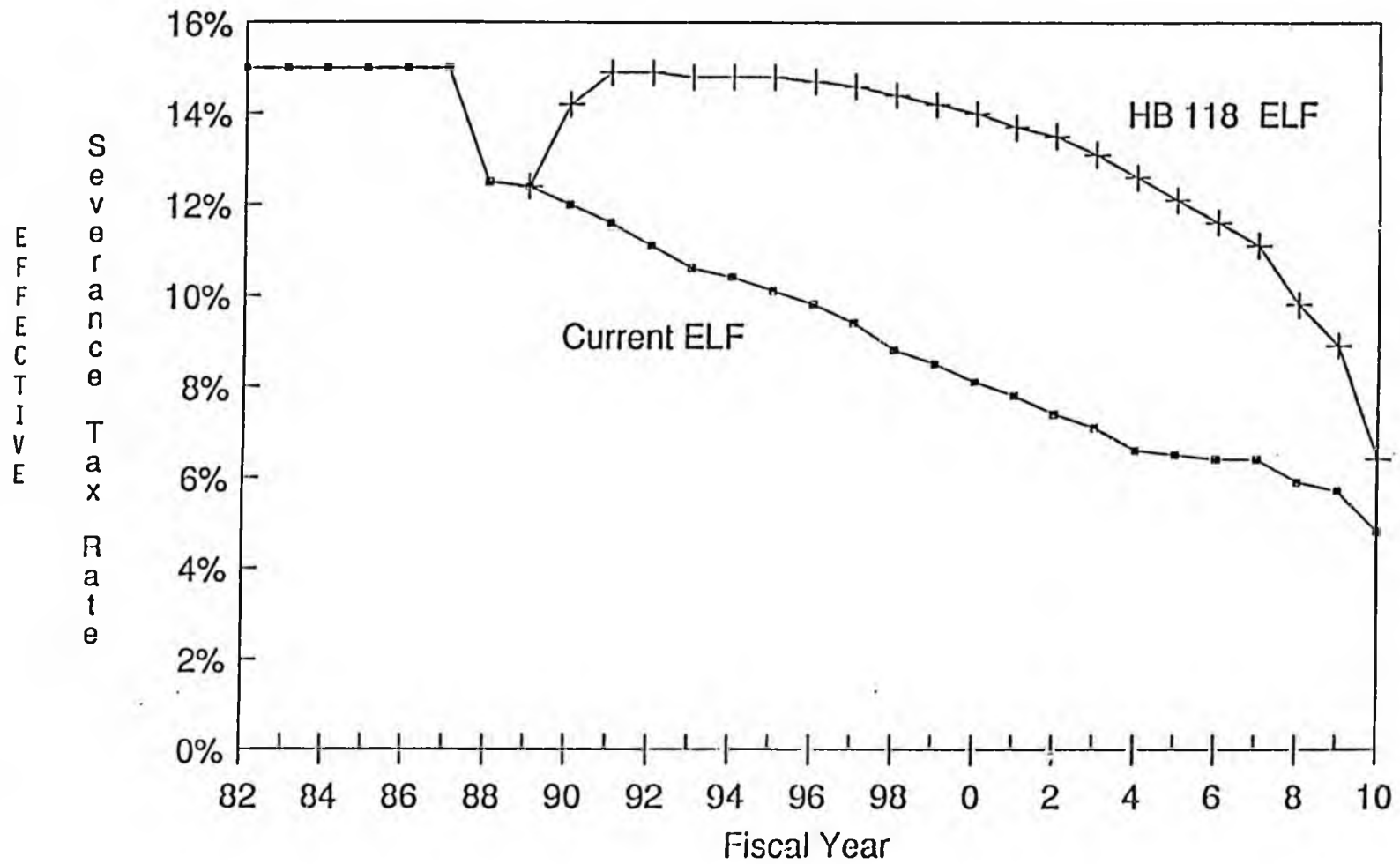
How much revenue would HB 118 raise?

HB 118 does not provide for an effective date, nor does it specify when it begins to apply. Assuming that the bill went into effect September 1, 1989 and applied to oil produced after August 31, 1989 -- and assuming the mid-case scenario projections of the Fall, 1988 Department of Revenue forecast -- the bill will raise \$96 million in Fiscal Year 1990.

The legislation would raise much more money if it were retroactive. If the bill applied to oil produced after December 31, 1988, it would generate \$175 million for FY89 and FY90. If the bill applied to oil produced after June 30, 1987, it would generate \$397 million in FY89 and FY90.

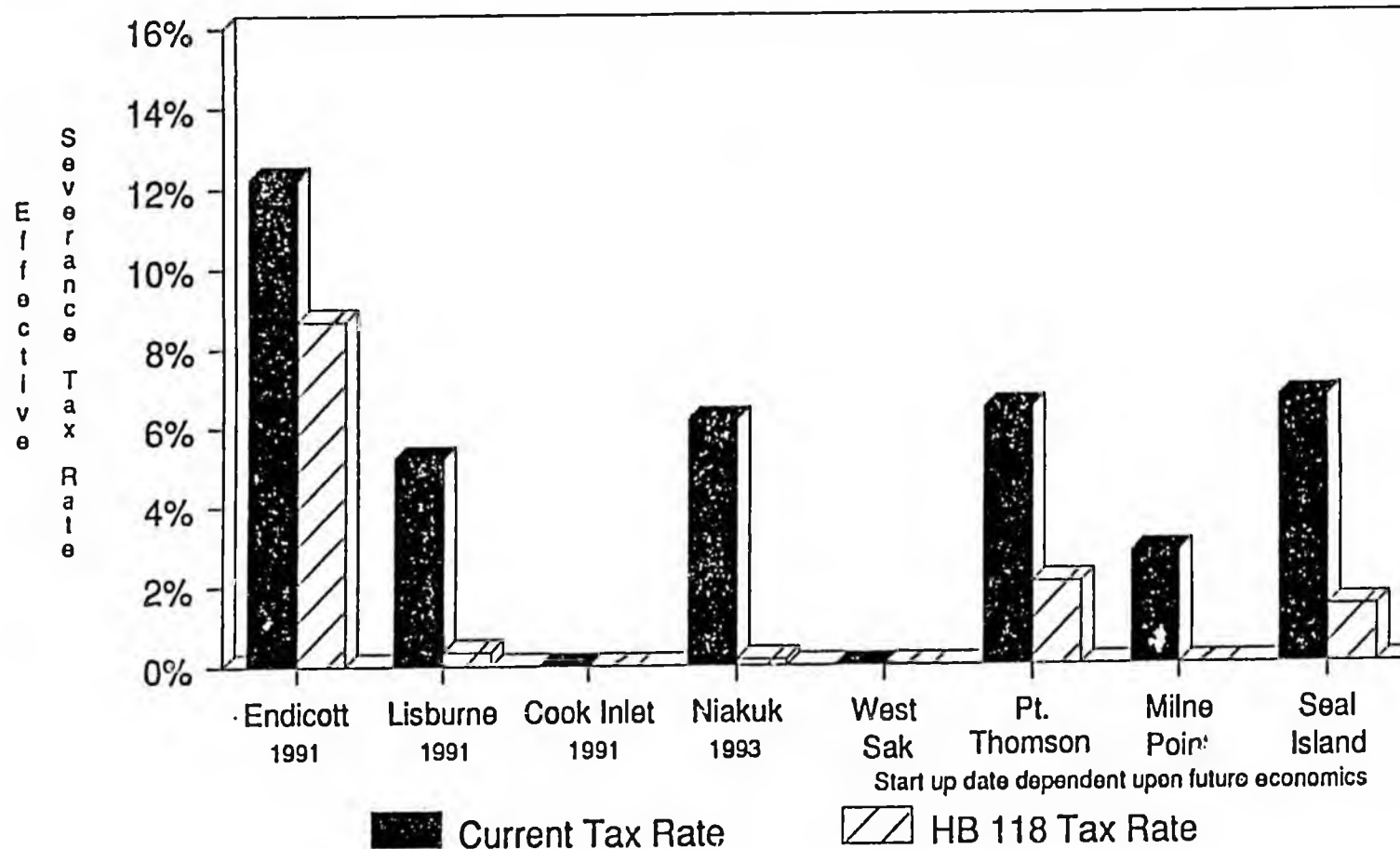
The long-term fiscal impact is substantial as well. For the FY91-FY95 period, the legislation would raise \$848 million.

GRAPH #1
The Tax Rate on Prudhoe Bay
Has Dropped Sharply



GRAPH #2

Fields Where Taxes Would Decrease Under HB 118 (For Representative Years)

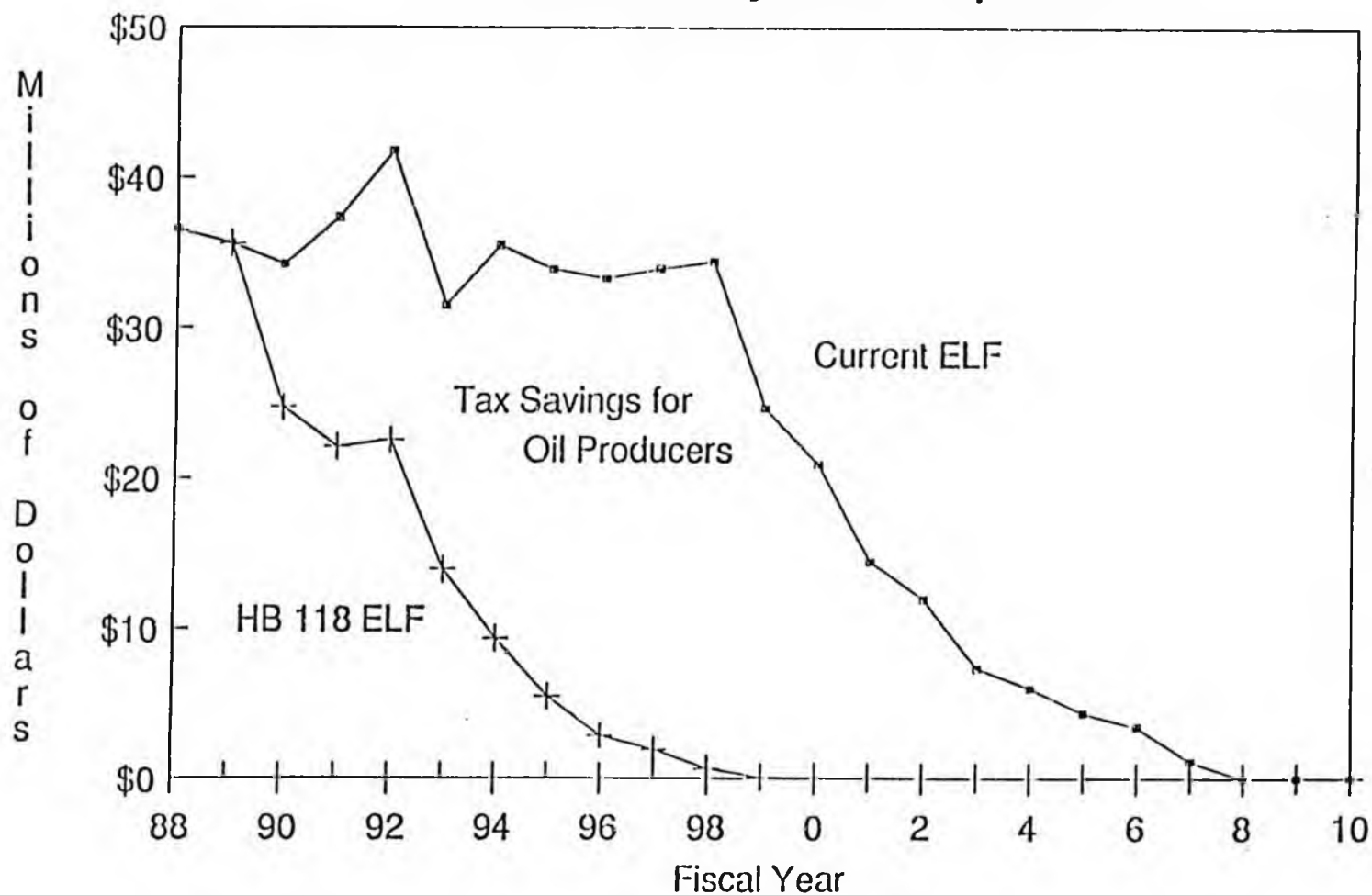


Source: Department of Revenue

Date: February 7, 1989

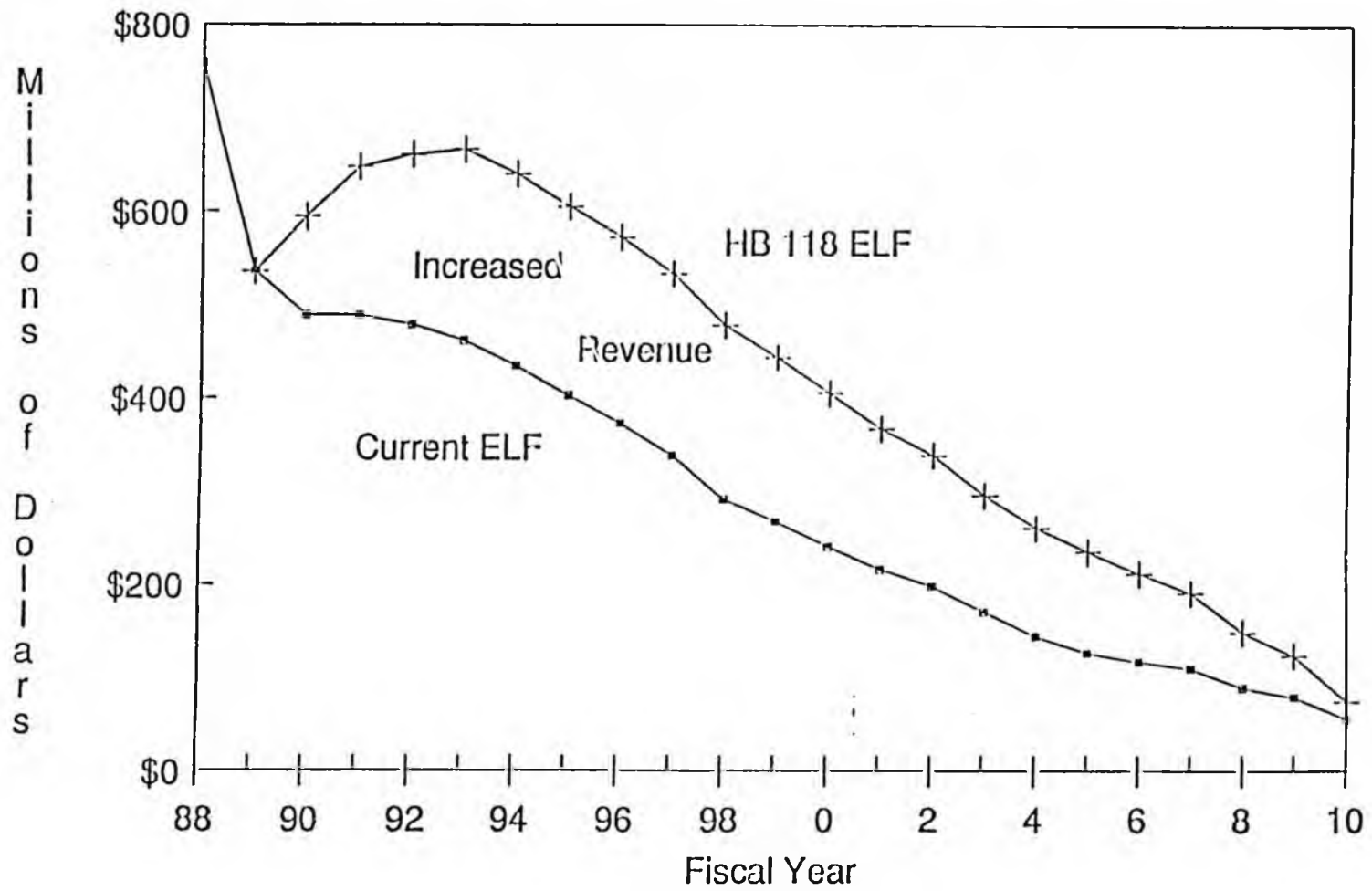
GRAPH #3

HB 118 Gives a Tax Savings for Producers at Oil Fields Other than Prudhoe Bay and Kuparuk



GRAPH #4

HB 118 Raises More Severance Tax Revenue from Prudhoe Bay and Kuparuk



BP EXPLORATION (ALASKA) INC.

POSITION PAPER

QUESTIONS AND ANSWERS ABOUT THE "ELF"

Q. What is the ELF?

A. The Economic Limit Factor (ELF) is just a number ranging from zero to one (1.00) that is multiplied times the base tax rate to figure out the actual tax rate on oil and gas production. The ELF is computed according to a formula set out in the production tax statute.

Q. Why have the ELF?

A. It allows oil and gas to be produced that would stay in the ground without it. This gives the State of Alaska additional royalties and gives the State and municipalities a higher property tax base because the tangible field investment is depreciated over a longer economic life.

A production tax is based on the gross value of the production, not the profit from it. Operating costs rise as time passes. Eventually they reach the total value of the production, leaving nothing for profit. Since the tax does not change when profits are shrinking, it squeezes profits even further and hastens the time when there is no profit left at all. The field then gets shut down even though more oil and gas could be economically produced if there were no tax.

The ELF avoids this by lowering the actual tax rate as the field becomes less profitable. However, the ELF formula is carefully designed so that the tax rate is not reduced very much until the field is very close to closing down. Then the ELF falls rapidly to zero and so does the tax.

Q. Last year the state House of Representatives passed a change to the ELF formula that they say would lower tax rates for small fields like Endicott. Wouldn't this change be better for marginal fields than the present ELF formula?

A. Don't confuse smallness with being marginal. A field in Cook Inlet about 1/20 the size of Prudhoe Bay has had a higher internal rate of return than Prudhoe. On the other hand, West Sak has as much or even more oil in place than Prudhoe, but it will be so difficult and expensive to produce that it is only a marginal field economically.

All small fields would get a tax break under the House bill, whether they need it or not.

The House bill would calculate the ELF using field-wide production, instead of production per well. Under the House

bill, drilling new wells to increase production would actually raise the tax burden per barrel for the field. This would be a disincentive to full development. The present ELF provides an incentive.

Q. Isn't the ELF just a give-away that was made in 1981?

A. No, the present ELF formula was enacted in 1977. Our present governor, Steve Cowper, was the House Finance Committee chairman then and endorsed the ELF concept:

"Given the tax relief that the [ELF] proposal will afford the economically marginal oil and gas fields and the relatively modest increase in taxation the proposal places on the highly productive and profitable oil and gas fields, House Finance Committee Substitute for CS for SB 238 represents a balanced and reasonable adjustment to the present tax law."

Source: 1977 House Journal, Supp. 60 (May 7, 1977), p. 8.

The 1981 legislation raised the actual tax rate for Prudhoe Bay to 15% by increasing the base rate from 12.25% to 15% and by "rounding off" the ELF to 1.00 until June 1987, the 10th anniversary of Prudhoe production. The actual tax rate with the ELF today is 12.1% -- higher than the 11.7% it was prior to the legislation in 1981.

Q. When Governor Hammond signed the 1981 legislation, he said he had full confidence in the ability of the Legislature to deal with the situation when the ELF would start up again for Prudhoe Bay in mid 1987. Didn't he mean that the ELF would have to be fixed or changed then?

A. No. Governor Hammond's most important concern was that the State's share should remain at or above 30%. He was told that the bill would keep the State's share just over this 30% minimum until the ELF started working again in mid 1987 for Prudhoe Bay. Everyone agreed the ELF would reduce the State's share, but no one in 1981 was prepared to predict whether the reduction would drop the State's share below 30%. If it did drop below that minimum level, Governor Hammond had full confidence in the Legislature's ability to remedy the situation.

Q. Has the State been getting its 30% share? If so, is it still getting it now that the ELF has kicked in again for Prudhoe Bay?

A. Yes to both questions. The following table shows the State's actual share through FY 87 and its projected share for FY 88 through FY 91.

	Actual State Share	
FY 82		35.02%
FY 83		33.80%
FY 84		36.53%
FY 85		36.89%
FY 86		37.40%
FY 87		52.35%
	Projected State Share	
	\$9 Oil at Wellhead (\$13-14 at market)	\$11 Oil at Wellhead (\$15-16 at market)
FY 88	79%	57%
FY 89	92%	61%
FY 90	96%	63%
FY 91	103%	67%

Sources: For FY 82-85 actuals, Alaska Department of Revenue (Research Section), "ANALYSIS OF HB 353" (October 31, 1985), Mean Case Summary Tables, Table 2a ("Calculation of State Petroleum Revenues as a Percent of Adjusted Production Income"), column 12 ("State / Net Rev %"); for FY 86-87 actuals, Petroleum Intelligence Weekly; for FY 88-91 projections, Alaska Department of Revenue (Larson, Logsdon and Marks), "SENSITIVITY ANALYSIS OF PROJECTED REVENUE COLLECTIONS" (December 1986), pp. 82 (for \$11 wellhead figures) and 93 (for \$9 wellhead figures).

Q. How much is the impact of the ELF? Last year in June the State was saying it would be \$200 million for FY 88 and 89 together. This past February the Department of Revenue said it will be \$300 million, and the Speaker of the House recently said \$400 million.

A. As a percentage of the State's petroleum revenues, the ELF represents a reduction of slightly less than 7%. The dollar amount depends on the price levels you assume. The higher your prices are, the greater the impact in dollar terms.

Both the Speaker and the Department of Revenue tell only part of the story when they focus only on the extra "cost" of the ELF due to their higher price assumptions. Despite the ELF, higher prices mean higher production tax and royal-

ty collections. While Revenue bemoaned the "loss" of another \$100 million because of the ELF, its higher price assumptions indicate an increase of \$189 million in production tax from Prudhoe Bay alone, plus another \$260 million in royalties.

Less than 1/6 of the Department of Revenue's latest \$300 million figure is due to an increased number of producing wells.

Q. Prudhoe Bay isn't a marginal field. Why should it get a tax break like the ELF?

A. Prudhoe Bay is a lot more marginal these days than people think. A major indicator of field profitability is daily production per well. Ten years ago Prudhoe was producing 1.2 million barrels a day from only 120 wells -- an average of 10,000 barrels a day per well. Today it produces 1.55 million barrels a day from 669 wells. While total production for the field has increased, the average production per well has declined by 76.8% to a little over 2300 barrels per day. Yet the ELF has declined by only 15.3%, from 0.954370 to 0.808459.

Q. Isn't the ELF providing a tax incentive for oil companies to drill extra wells at Prudhoe Bay that aren't really needed?

A. No unnecessary wells are being drilled just for the tax benefit of the ELF. Based on the Department of Revenue's price forecast for FY 89 (\$10.43 at the wellhead), the difference in production tax in FY 89 due to having 715 wells in the ELF calculation (as Revenue has in its forecast this past February) instead of 590 (as it had in its forecast last June) is \$26.8 million. For the extra 125 wells, the average tax benefit per well is only \$0.21 million -- not enough to justify the \$2 million that each well costs.

CONOCO INC.

POSITION PAPER



Tom Painter
Division Manager

Conoco Inc.
3201 C Street
Suite 200
Anchorage, AK 99503

February 7, 1989

RECEIVED FEB 9 1989

Representative Cliff Davidson
Co-Chairman
House Resources Committee
Pouch V
Juneau, AK 99811

Representative Curt Menard
Co-Chairman
House Resources Committee
Pouch V
Juneau, AK 99811

Gentlemen:

I have received your letter of January 31 inviting a representative of Conoco to testify on HB-118. Conoco appreciates this invitation to present our views on HB-118; however, the most appropriate person to testify, Conoco's Division Manager Tom Painter, will be out of town during the hearings. Conoco's position favoring a modification of the ELF to make the production tax structure a progressive tax based on field size as well as well productivity remains unchanged from our prior testimony in the hearings on CSHB-164 in 1987. We continue to believe such change would offer a positive first step in encouraging the development of Alaska's small, marginal fields.

Oil field development in remote areas of Alaska, such as the North Slope, offshore, or interior, requires high fixed cost components of investment and operation. All fields, regardless of size, must possess living quarters, roads, pipelines, and personnel transportation infrastructure in addition to the normal production handling facilities. In Alaska's high cost environment, these factors result in significant diseconomies of scale for smaller fields. For smaller fields to be economically developed, we believe some adjustments must be made in the tax or royalty structure.

Conoco remains desirous on becoming a more active participant in the Alaskan economy. For Milne Point, the North Slope's smallest field, a change in the production tax structure would help. The economics of resuming development and production at Milne Point would be more enhanced by a change in our royalty rate, which, at 20%, is the largest fixed royalty for any field in the state. HB-128, which has recently been introduced by Representative Brown, has the potential to provide royalty relief. For Milne Point to be a success, a sufficient differential between crude price and costs, including taxes and royalty, must exist to generate a profit. While oil price continues to be the controlling factor, any incremental improvement in taxes and royalty would have the same effect as an increase in price.

We must caution that our position on modifying the ELF to provide an incentive for small field development should not be misconstrued as support for increasing taxes on any currently producing field in Alaska. Alaska's sustainable economic growth has and will continue to come from private sector investment to develop Alaska's natural resources. From our observations, the tax reductions initiated

Representatives Cliff Davidson and Curt Menard
February 7, 1989
Page 2

at Prudhoe Bay are benefitting both the State and the Prudhoe Bay owners as additional production and reserves are being developed, investments are being made, and new jobs are being added to the Alaska economy.

It is possible to provide both an incentive for small field development and to maintain continued investment in the state's larger fields by adopting the modified ELF proposed in HB-118 and simultaneously reducing the production tax rate, resulting in a "tax neutral" position.

I hope this information will suffice to adequately define Conoco's position on HB-118. If you so choose, you may submit this letter as testimony at the hearing.

Very truly yours,



A. E. Hastings
Sr. Staff Engineer

AEH/(jah)

COMMITTEE TO REPEAL THE ELF

POSITION PAPER

Committee to Repeal the ELF

P.O. Box 1114 • Fairbanks, AK 99707 • (907) 452-3360

POSITION PAPER ON HB118
February 6, 1989

Based upon our research, the Committee to Repeal the Elf maintains it's stated position of being committed to the total repeal of this flawed and complex formula.

We support HB118 as a step in the right direction until such time as a repeal is effected, particularly as it is retroactive to July 1, 1987. But only a step because the bill deals with the application and not the formula itself.

Our information indicates that the built-in subsidy which provides the first 300 barrels, per well, per day, on the average in a "field" to be totally tax free was:

1. based upon 1975 - 76 Cook Inlet data, which has absolutely nothing to do with fields such as Prudhoe Bay and Kuparek and at best is unintelligible to all but geologists and engineers,
2. a massive, unwarranted and unnecessary incentive to the industry giants,
3. if appropriate at all, more logically done on a National, rather than State, level,
4. so illogical that by simply punching another hole in the ground, and by producing more over-all oil, the "average" production can be "decreased", thereby decreasing total taxes,

POSITION PAPER ON HB118
FEBRUARY 6, 1989
PAGE TWO

5. a blanket concession methodology not used by any other state, and

6. in a phrase, simply too complex, open to possible abuse, interpretation and litigation.


Some of the greatest service the Resources Committee could provide to Alaska and it's future would be to:

1. Pass through this bill, with a clear, concise definition of "field", as a temporary halt to the raid.

2. Fund an independent study by a third party of impeccable reputation, to determine, among other things:

- how to break the monopoly enjoyed by the major producers and assure real competition in lease bidding
- what we could and should be doing to guarantee now and into the future a fair share of the proceeds for our non-renewable resources.


JEAN MANNING
CAMPAIGN CHAIR


DON LOWELL
COMMITTEE CHAIR

Committee to Repeal the Elf

RESOURCE DEVELOPMENT COUNCIL FOR ALASKA INC.

POSITION PAPER



Resource Development Council

for Alaska, Inc.

807 "B" Street, Suite 200, Anchorage, Alaska 99501-3440
 Box 100518, Anchorage, Alaska 99510-0518 - 707/270-0700

RDC Position Paper on HB 118

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Senator Ted Stevens
 Senator Frank Murkowski
 Congressman Don Young

The Resource Development Council appreciates the opportunity to submit its comments for the record on HB 118. A non-profit membership organization, RDC supports responsible resource development. RDC's membership consists of resource developers from all sectors, small and big businesses, communities across the state, and individuals.

Our broad-based membership strongly supports a stable tax policy in the 49th state - a policy that fosters new investment and development, but provides a return to the state.

Gov. Steve Cowper in his combined state of the state and budget speech in mid-January said that Alaska owns the fields at Prudhoe Bay and Kuparuk. Let us not forget that the oil companies obtained the right to extract that oil by paying for it, and provide the state with a royalty as well.

As in any sound business arrangement, both sides have something to gain - the state sees its resource developed and profits from that production, while the oil industry provides infrastructure and achieves its profit through the sale of the commodity it paid for.

Like most business ventures, the arrangement between the state and the oil industry involved some bargaining, a long list of ground rules and some give-and-take during the development process.

One of the agreements forged during this stage was the ELF.

As most involved in the ongoing tax debate know, ELF was proposed in 1977 as a way to encourage the industry to drill additional wells in all fields. Once a mature field begins to decline, there is an incentive for new investments that will extend the life of the field. This incentive is accomplished through the ELF formula.

State officials, as well as elected leaders, have heard many times that Alaska's current tax structure compels the oil industry to pay higher taxes here than in any other state. Yet it seems that message has not penetrated, because the oil industry is confronted with yet another proposed increase through the ELF legislation before you. The industry in question already pumps 85 percent of the state's revenue into the treasury.

All Alaskans understand state government is facing a fiscal crunch. Without perpetuating the finger-pointing syndrome, RDC respectfully suggests that while massive

RDC comments, HB 118

Pg. 2

cuts are not the answer, neither are increased taxes, particularly on the one industry which fuels so much of Alaska's budget. When all the smoke and mirrors fade, the reality is that Alaska needs a healthy, productive oil industry, and the best way to foster that is through a stable tax structure.

Alaska needs to stop thinking about the short-term quick-fixes, such as increasing the money flow into the treasury through HB 118, and start thinking of the long-term ramifications of such a move. Those include the job losses associated with higher taxes, projects being stalled or shelved completely, the loss of long-term state revenue from marginally economic projects as well as the loss of oil and gas reserves due to early abandonment, and delays in technological advances that could extend the lifespan and productivity of all Alaska fields.

The oil companies are no different than state government when it comes to cash flow - when more money is taken out of an entity, cuts must occur somewhere else. Right now, state government has more expenses than the sum of its expected income. If state government truly wants to increase its income, the most sound way to do just that is by providing a good business climate and stable tax policy. By encouraging the industries that currently fuel the state's operations and continuing its current tax policy, the state has a better chance of achieving a long-term payoff in the end, when oil companies are able to explore, develop and bring new fields on line, thus increasing the state's future income.

In closing, RDC hearkens back to a statement made by Gov. Cowper in his January speech. He said that in order to retain the benefits and services of government, people have to pay for "what you get."

RDC would submit that the oil industry has not only paid its own way, but picked up a good share of the load for the rest of the state through the years.

ALASKA OIL AND GAS ASSOCIATION

POSITION PAPER

Testimony of the
Alaska Oil and Gas Association
before the
Alaska State House of Representatives
Resources Committee
on
HB 118, An Act Relating to the
Oil and Gas Properties Production Tax

February 13, 1989

My name is Gerald Serena and I am a tax lawyer with Exxon Company, U.S.A. I am here today to present testimony of the Alaska Oil and Gas Association (AOGA). AOGA is a trade association whose member companies account for the majority of oil and gas exploration, production and transportation activities in Alaska.

AOGA believes that it is in Alaska's best interest to encourage responsible exploration and development of its hydrocarbon resources. We oppose the tax increases included in HB 118 since its passage would act to discourage continued development in Alaska's larger fields. In general, marginal developments in these fields that are already at risk due to soft crude price forecasts would be further burdened by the proposed tax increases. Increasing taxes on existing fields, after significant investment decisions have been made under the existing tax structure, is counterproductive to the complete development of these vast resources. In general, changes in the tax structure will require different risk analysis techniques, which could be a hindrance to future exploration and development.

Alaska's current tax structure has our industry paying higher taxes in this state than in any other. As you are probably aware, the production tax rate is the highest in the country, peaking at 15 per cent on gross production value. Taxes and royalties have provided 80 to 90 per cent of the state's unrestricted revenues in recent years and created the \$10 billion Permanent Fund. Surely oil and gas is paying its fair share by any measure.

Turning to the oil industry for more tax revenues would not be an effective approach to solving revenue problems brought on by crude price volatility, and which will be exacerbated in the near future with production declines from the major fields. This would only increase the State's enormous dependence on oil revenues while not addressing the long term problem of state spending levels.

In conclusion, AOGA strongly opposes the increased taxes in HB 118. Passage would unreasonably increase an already high tax burden, and would increase the state's dependence on volatile crude price swings.

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Oil Revenue Update

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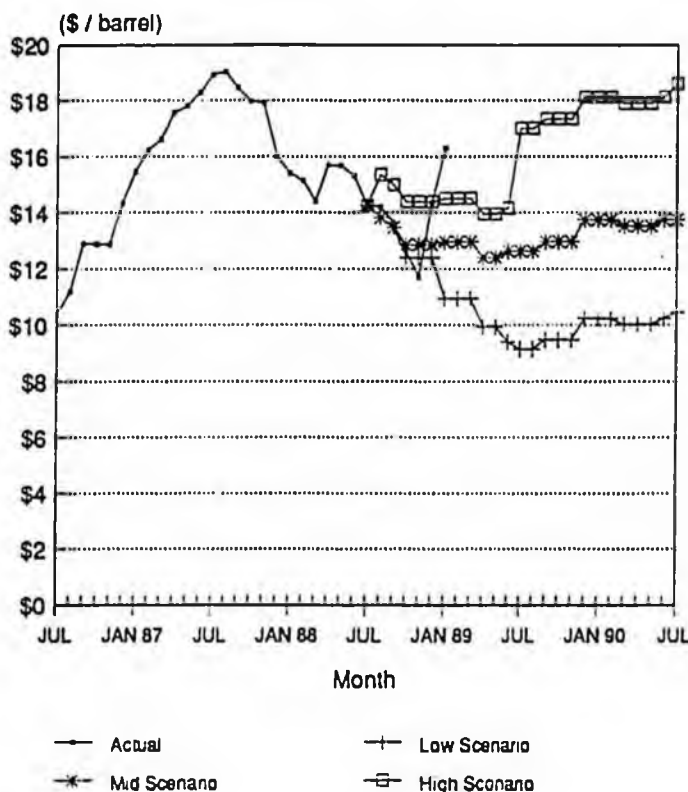
March 1989

The purpose of this note is to briefly update the oil revenue situation to reflect events which have occurred since our last revenue forecast released November 1988.

Oil Prices

World oil prices have remained strong through December and January in response to the November OPEC production agreement. It appears that OPEC production has averaged 19.5 million bbl/day through January. Although this is 1 million bbl/day over the agreed upon quota, strong demand and supply disruptions in the North Sea have kept Saudi Light oil prices near \$15.00/bbl on the spot market. BP Exploration, the largest producer of Alaska North Slope (ANS) crude oil, recently announced a February price for ANS of \$16.30/bbl for Gulf Coast delivery. The figure below illustrates the current Department of Revenue scenarios and actual ANS Gulf Coast prices.

ANS at the U. S. Gulf
(Nominal data)



The TAPS tariff filing for calendar 1989 sets the average tariff for the pipeline at \$3.01/bbl. This is \$0.04/barrel higher than assumed in the Fall Forecast.

Oil Production

Production from Alaska's North Slope held firm through year end at well over 2.0 million bbl/day. It is still not clear if the production slide at Prudhoe Bay of 50,000 bbl/day, which ARCO envisions, can be avoided in calendar 1989. Based on preliminary information from Conoco, it looks like Milne Pt. may recommence production sometime this Spring barring another price drop.

Oil Revenues

Higher prices, and higher than expected production through year-end result in a slightly improved outlook for the remainder of the fiscal 1989. The high scenario we developed last Fall outlined a revenue stream predicated on a successful OPEC production agreement. So far events outlined in the high scenario continue to unfold with the result being oil prices which correspond roughly to those characterizing this scenario. For example, under the high scenario the world economy was expected to increase at 3.5% in both 1989 and 1990. OECD growth appears to have been 4 percent for 1988. World oil consumption growth for 1988 has been revised upward by Energy Security Analysis, Inc. to an estimated 3.6%, or about 1.8 million barrels/day. The high scenario assumes a growth in demand of 1.5 million barrels/day for 1989 and 1990. In the November OPEC meeting Iran and Iraq were given a quota of 2.6 million barrels/day, about 14% higher than the 2.3 million barrels/day of production from these countries assumed by the high scenario. The high scenario was based on a total OPEC quota of 18.7 million barrels/day, with continued cheating by the member countries. The current OPEC quota is 18.5 million barrels/day. Over production by member countries has resulted in an estimated production in January of 19.5 million barrels/day.

There is, however, no guarantee that conditions within OPEC will remain the same. In particular the seasonal drop in oil consumption during the second quarter may present serious problems to cartel cohesiveness.

Table 1 outlines the price/revenue sensitivity for the remainder of FY 1989 and FY 1990. The FY 1989 outlook incorporates our most recent data on actual revenue collections through December and substitutes current spot market price data for January 1989. A summary of the current mid case assumptions, as well as actual collections through December production month and corresponding January revenue month, is shown on Table 2.

Table 1

PRICE/REVENUE SENSIVITY SCHEDULE
 Unrestricted State Revenue¹
 (Millions \$)

ANS Price Lower 48 ²	FY 1989	FY 1990
\$10 /bbl	1724	1139
11	1769	1238
12	1827	1373
13	1885	1507
14	1943	1641
15	2001	1775
16	2060	1909
17	2117	2043
18	2176	2178
19	2240	2312
20	2292	2446

¹ Based on Department of Revenue mid scenario assumptions Fall 1988 Forecast updated for actual marketing and production data through December 1988, new 1989 TAPS tariff filing, and spot price information for January 1989.

² The average ANS price for all lower 48 sales is approximately \$0.80/bbl less than the U. S. Gulf price.

Table 2

Updated with actual data thru DEC/JAN FY 1989 and calendar year 1989 TAPS filing		Spot prices added for JAN/FEB										Assumptions based on October 1988 forecast by DOR - Mid section					14 Feb 89		
PRODUCTION/REVENUE MONTHLY	1988	JUNE/JUL	JULY/AUG	AUG/SEP	SEP/OCT	OCT/NOV	NOV/DEC	DEC/JAN	JAN/FEB	FEB/MAR	MAR/APR	APR/MAY	MAY/JUN	1989	90 Q1	90 Q2	90 Q3	90 Q4	1990
14 OPEC MARKER - \$/bbl	18.2900	14.3100	13.3200	13.3100	11.8100	10.4600	10.6100	12.6800	14.3667	12.5000	12.5000	12.0000	12.0000	12.4889	11.5300	11.8300	12.5100	12.3100	12.0550
15 TRANS & MARKET DIFFERENTIAL	0.5389	1.0700	0.9700	0.8900	1.8200	2.1900	1.1000	0.1079	1.9333	0.4470	0.4470	0.3880	0.3880	0.9793	0.8580	0.7830	0.8776	0.8306	0.8373
16 AVG. ANS OIL PRICE @ U.S. GULF \$/bbl	18.0209	15.3000	14.2900	14.2000	13.6300	12.6500	11.7100	12.7879	16.3000	12.9170	12.9470	12.3800	12.3800	13.4682	12.3880	12.6130	13.4076	13.1606	12.8923
17 AVG. ANS OIL PRODUCTION MMbbls/day	1.8940	1.9399	1.9160	1.9654	1.9748	1.9674	1.9833	1.9510	1.9270	1.9270	1.9270	1.9270	1.9270	1.9444	1.8310	1.8290	1.8290	1.8290	1.8295
18 AVERAGE ANS WEST/GULF MARKET DIFFER	2.4796	-0.4878	-0.8756	-0.5250	-0.6687	-0.5837	-0.7966	-0.7438	-0.5230	-0.5330	-0.5430	-0.5390	-0.5490	-0.6140	-0.5810	-0.6190	-0.6640	-0.6800	-0.6360
19 TRANSPORTATION TO U.S. GULF	2.7820	3.1640	2.7186	3.0014	3.0527	2.8004	2.7399	3.1730	3.1830	3.1930	3.1890	3.1990	3.0163	3.2310	3.2690	3.3140	3.3380	3.2880	
20 AVG. TAPS TARIFF \$/bbl	3.6827	3.1860	3.1770	3.1700	3.1640	3.1610	3.1660	3.1611	3.0100	3.0100	3.0100	3.0100	3.0100	3.1029	3.0100	3.0100	3.1310	3.1440	3.0738
21 AVG. NON PRUDHOE TCOST/QUAL/MKTDIF	0.1984	0.1984	0.1984	0.1984	0.1870	0.1870	0.1870	0.1872	0.1872	0.1872	0.1871	0.1871	0.1899	0.1866	0.1866	0.1866	0.1866	0.1866	0.1866
22 WT. AVG. ANS OIL ROY WHV \$/bbl	10.4682	9.7012	8.6262	8.6380	7.9463	6.8330	6.3532	7.4435	10.4528	7.0998	7.0999	6.5409	6.5409	7.7730	6.5414	6.7664	7.4400	7.1800	6.9820
23 AVG. CGF NGL MM bbl/DAY	0.0457	0.0587	0.0547	0.0555	0.0604	0.0597	0.0612	0.0607	0.0550	0.0550	0.0550	0.0550	0.0550	0.0572	0.0543	0.0540	0.0540	0.0593	0.0554
24 AVG. PROCESS COST NGL	5.5200	5.5200	5.6200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200	5.5200
25 DAYS IN PRODUCTION MONTH/YEAR	368	30	31	31	30	31	30	31	31	29	31	30	31	365	92	92	90	92	365
26 AVG. PIET REV ELF	0.7950	0.7963	0.7938	0.7930	0.7906	0.7876	0.7863	0.7835	0.7898	0.7896	0.7894	0.7892	0.7890	0.7899	0.7807	0.7609	0.7644	0.7637	0.7674
27 SEVERANCE RATE ADJ. FACTOR	0.9939	0.9707	1.0010	0.9772	0.9651	0.9942	1.0282	1.0046	0.9894	0.9862	0.9850	0.9914	0.9912	0.9981	0.9831	1.0143	1.0261	1.0058	1.0073
28 AVG. EFFECT FLOOR ADJ. ELF	0.7902	0.7730	0.7946	0.7749	0.7630	0.7830	0.8085	0.7871	0.7815	0.7787	0.7776	0.7825	0.7821	0.7822	0.7675	0.7718	0.7843	0.7882	0.7729
29 WT. AVG. NOMINAL SEV TAX RATE	0.1496	0.1480	0.1480	0.1481	0.1481	0.1481	0.1431	0.1481	0.1479	0.1479	0.1479	0.1479	0.1479	0.1480	0.1477	0.1477	0.1477	0.1477	0.1477
30 ANS OIL SEVERANCE TAX MM \$	789.8297	56.4826	52.6900	52.7948	46.5105	42.2525	39.5738	45.8803	63.1047	39.9555	42.6497	38.2626	39.5202	55.6773	109.1890	113.4763	124.0300	119.8400	166.5354
31 ANS NGL SEVERANCE TAX MM \$	7.2386	0.6438	0.4604	0.4692	0.3845	0.2124	0.1339	0.3164	0.7353	0.2203	0.2355	0.1473	0.1522	4.1111	0.4462	0.5412	0.8155	0.7920	2.5949
32 ANS TOTAL OIL & NGL SEVERANCE TAX MM	797.0683	57.1263	53.1504	53.2640	46.8949	42.4649	39.7077	46.1968	63.8401	40.1758	42.8852	38.4099	39.6724	563.7884	109.6352	114.0175	124.8455	120.6320	169.1302
33 ANS OIL CONSERVATION TAX MM \$	2.4319	0.2036	0.2078	0.2132	0.2073	0.2147	0.2082	0.2110	0.2100	0.2000	0.2100	0.2000	0.2100	2.4959	0.5800	0.5800	0.5800	0.5900	2.3200
34 AVG. ANS OIL ROYALTY RATE	0.1254	0.1257	0.1257	0.1257	0.1257	0.1257	0.1257	0.1257	0.1257	0.1257	0.1257	0.1257	0.1257	0.1257	0.1260	0.1260	0.1260	0.1260	0.1260
35 ROYALTY RATE ADJ. FACTOR	0.9918	1.0332	1.0303	0.9504	0.9649	0.9510	0.9536	0.8547	0.9963	0.9928	0.9918	0.9936	0.9938	1.0132	1.0111	1.0224	1.0356	1.0149	1.0210
36 EFFECTIVE ROYALTY RATE	0.1244	0.1299	0.1305	0.1195	0.1213	0.1195	0.1189	0.1074	0.1252	0.1248	0.1247	0.1249	0.1249	0.1227	0.1274	0.1288	0.1305	0.1279	0.1286
37 AVG. ROY FIELD COST DEDUCT \$/bbl	0.5790	0.6500	0.6500	0.6500	0.6500	0.6500	0.6500	0.6500	0.6521	0.6543	0.6564	0.6586	0.6607	0.6527	0.6591	0.6656	0.6722	0.6788	0.6689
38 ANS OIL ROYALTY B4 PF&PSF CONTRIB	897.6531	68.4139	61.8312	58.1441	52.4285	45.0786	40.6759	44.1424	73.3201	44.9522	47.9849	42.4723	43.8791	623.3232	126.2430	132.2397	145.3700	139.8900	543.7427
39 ANS NGL ROYALTY B4 PF CONTRIB	10.3787	0.9255	0.6620	0.6746	0.5527	0.3054	0.1024	0.4550	1.0572	0.3167	0.3386	0.2117	0.2188	5.9107	0.6433	0.7802	1.1757	1.1417	3.7410
40 TOTAL ANS OIL & NGL ROYALTY B4 PF M	908.0318	69.3394	62.4932	58.8187	52.9812	45.3839	40.8684	44.5973	74.3773	45.2690	48.3235	42.6840	44.0979	629.2339	126.8863	133.0199	146.5457	141.0317	517.4937
41 ANS OIL ROY PF&PSF GF ADJ. FACTOR	0.7450	0.7398	0.7398	0.7398	0.7398	0.7398	0.7398	0.7398	0.7398	0.7398	0.7398	0.7398	0.7398	0.7398	0.7395	0.7395	0.7395	0.7395	0.7395
42 ANS OIL ROYALTY NET GF MM \$	676.4837	51.2973	46.2325	43.3141	39.1955	33.5750	30.2344	32.9931	55.0243	33.4900	35.7497	31.5777	32.6236	465.5072	93.8324	98.3682	108.3706	104.2930	404.8642
43 TOTAL GF ANS OIL PRODUCT REVS MM \$	1475.9838	108.6273	99.5908	96.9913	86.2977	76.2546	70.1503	79.4009	119.0744	73.8658	78.8449	70.1875	72.5060	1031.7915	204.0477	212.9657	233.7961	225.5049	876.3144
44																			
45 ANS OIL PROD. REV. CURRENT FY MOLY CASI	FLOW ANALYSIS AND COMPARISON WITH OFFICIAL DOR FORECAST																		
46 GF ANS OIL PROD. REV. ACT COIL	1475.9838	108.6273	99.5908	96.9913	86.2977	76.2546	70.1503	79.4009											
47 LAST DOR REVENUE FORECAST (OCT88)	1475.9838	108.2807	98.2827	87.5195	78.8616	77.9302	75.3884	77.8827	79.7896	74.3863	79.3770	70.6931	73.0164	983.4183	205.3520	214.1787	233.7961	225.5049	878.8326
48 UPDATED DOR ANS REVENUE FORECAST	1475.9838	108.6273	99.5908	96.9913	86.2977	76.2546	70.1503	79.4009	119.0744	73.8658	78.8449	70.1875	72.5060	1031.7915	204.0477	212.9657	233.7961	225.5049	876.3144
49																			
50 UPDATED REVENUE FORECAST DIFFERENCE	0.0000	0.3466	1.3081	8.4717	6.4361	-1.6756	-5.2381	1.5082	39.2848	-0.5205	-0.5321	-0.5055	-0.5104	48.3733	-1.3052	-1.2131	0.0000	0.0000	-2.5182
51 YTD CUM. UPDATED FORECAST DIFFERENCE	0.0000	0.3466	1.6547	10.1264	15.5625	14.8869	9.6488	11.1570	50.4418	-0.9213	-0.3892	-0.8837	-0.3733	48.3733	-1.3052	-2.5182	2.5182	2.5182	2.5182

C.MIGHSORTDECS;ORT WK1

Actual Data

**ADMINISTRATION PRESENTATION ON HOUSE BILL 118--
LEGISLATION REVISING THE ECONOMIC LIMIT FACTOR (ELF)
HOUSE RESOURCES COMMITTEE
FEBRUARY 9-10, 1989**

Thursday, February 9, 1989

**I. INTRODUCTION TO ALASKA'S OIL REVENUES
AND TAXATION**

A. Overview

B. Alaska's Oil Revenues

1. Severance Tax
2. Income Tax
3. Property Tax
4. Royalties

C. The Severance Tax and the ELF

1. Importance of Severance
Tax to Alaska's Revenues
2. Definition of ELF
3. Application of ELF to Produce
Effective Tax Rate

II. HISTORY OF ELF

A. 1977 Creation

B. 1981 Oil Tax Changes

1. Income Tax
2. Severance Tax
3. Comments of Policymakers

C. 1987 --End of suspension on Prudhoe Bay

III. HB 118

IV. ELF'S EFFECTS ON ALASKA FIELDS

A. Fields Where ELF Will Increase Under HB 118

1. Prudhoe Bay
2. Kuparuk

B. Marginal Fields -- Fields Where ELF Will Decrease
Or Remain at Zero Under HB 118

1. Endicott
2. Lisburne
3. Cook Inlet
4. West Sak
5. Niakuk
6. Milne Point
7. Point Thomson
8. Seal Island

V. THE ELF AND ALASKA'S REVENUES

A. Marginal Fields -- Tax Savings for Oil Producers

B. Large, High-Profit Fields of Prudhoe Bay and Kuparuk --
Increased Revenues for the State

Friday, February 10, 1989

VI. PROFITS AND RE-INVESTMENT OF
THE OIL INDUSTRY IN ALASKA

VII. COMPARISON OF GOVERNMENT REVENUE
FROM OIL PRODUCTION BETWEEN ALASKA
AND OTHER OIL-PRODUCING AREAS

VIII. EFFECTS OF CHANGING ELF ON JOBS FOR
ALASKANS

IX. EFFECTS ON CHANGING ELF ON PRODUCTION

X. WAS THERE A DEAL IN 1981?

XI. WAS THERE A DEAL IN 1987?

ADMINISTRATION TESTIMONY ON HB 118

BRIEFING MATERIALS

HB 118
Modifying the ELF

Briefing materials provided to the:

Alaska State House of Representatives
Resources Committee
Rep. Cliff Davidson, Co-Chairman

Office of the Governor
Division of Policy
February 10, 1989

"The session of the 15th Territorial Legislature just concluded brings out more clearly than ever the basic issue that confronts the people of Alaska. That issue is whether Alaska shall be built up for Alaskans..., or whether it shall continue to be governed for and by outside interests whose sole concern is to take out of Alaska as much as they can, as fast as they can, and leave as little as possible."

*Governor Ernest Gruening
Message to the people of Alaska
March 28, 1941*

"We must have stable tax policies in order to make the risks associated with marginal fields worth taking."

Mr. George Nelson
Sohio Alaska Petroleum Company
as quoted in the Alaska Journal of Commerce and Pacific Rim Reporter
March 11, 1985

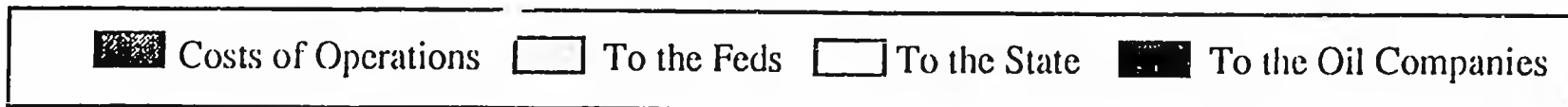
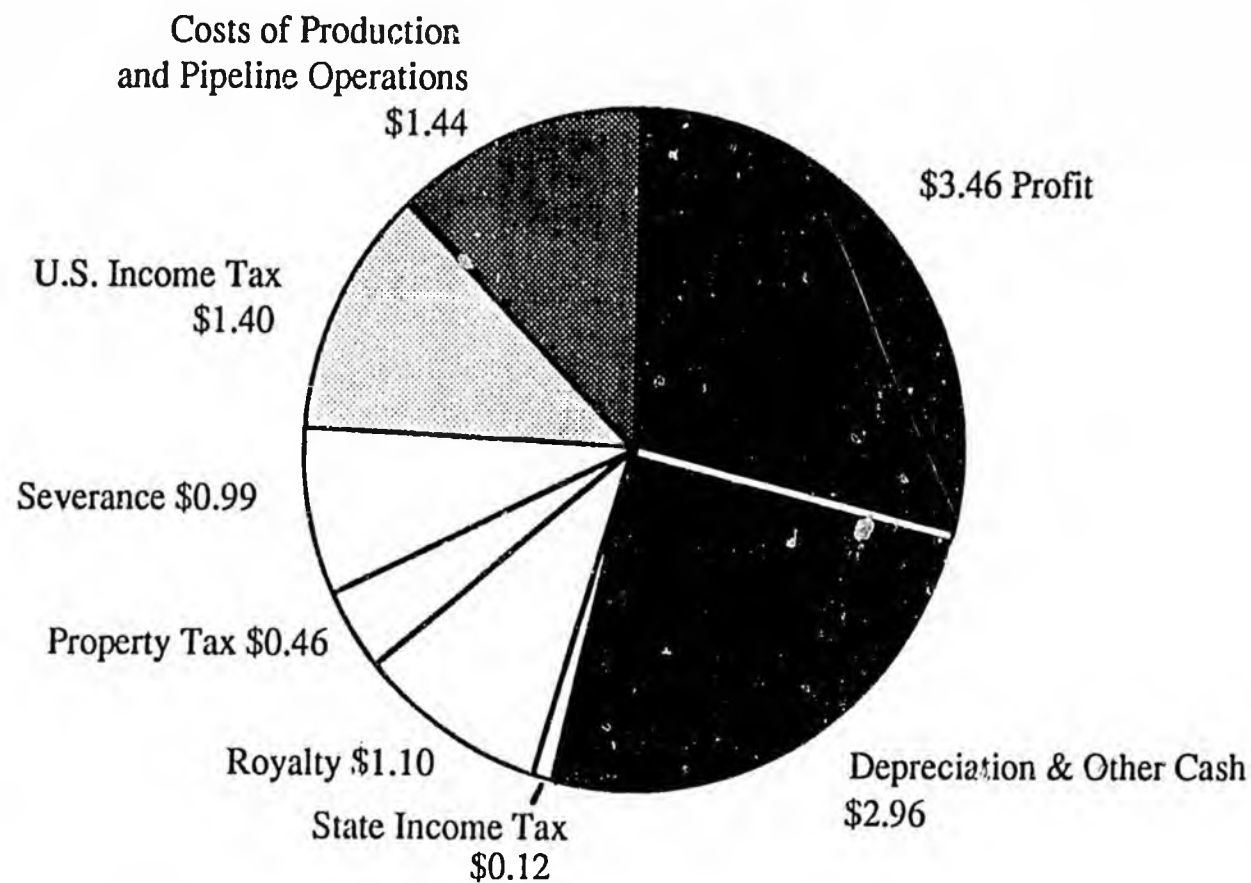
"The state must provide an investment climate that will encourage oil companies and other businesses to develop new ventures....[S]maller fields already have been discovered on the North Slope. But they are marginal fields...."

ARCO Alaska Inc.
newspaper advertisement
Alaska Journal of Commerce and Pacific Rim Reporter
October 14, 1985

Chart 1

In February 1988, A Barrel of Oil at Valdez Was Worth \$11.93.

This is how the \$11.93 Was Divided:



"[A]s my profit decreases I have less money to invest....But what is a reality and what you need to understand is that the amount of money I have to spend affects the pace at which things happen. And the pace at which things happen, in terms of employment, means the Alaskan economy. If we slow down our investment pattern because of a lack of funds, because of discouragement of investment in Alaska...that has an effect on the economy of Alaska."

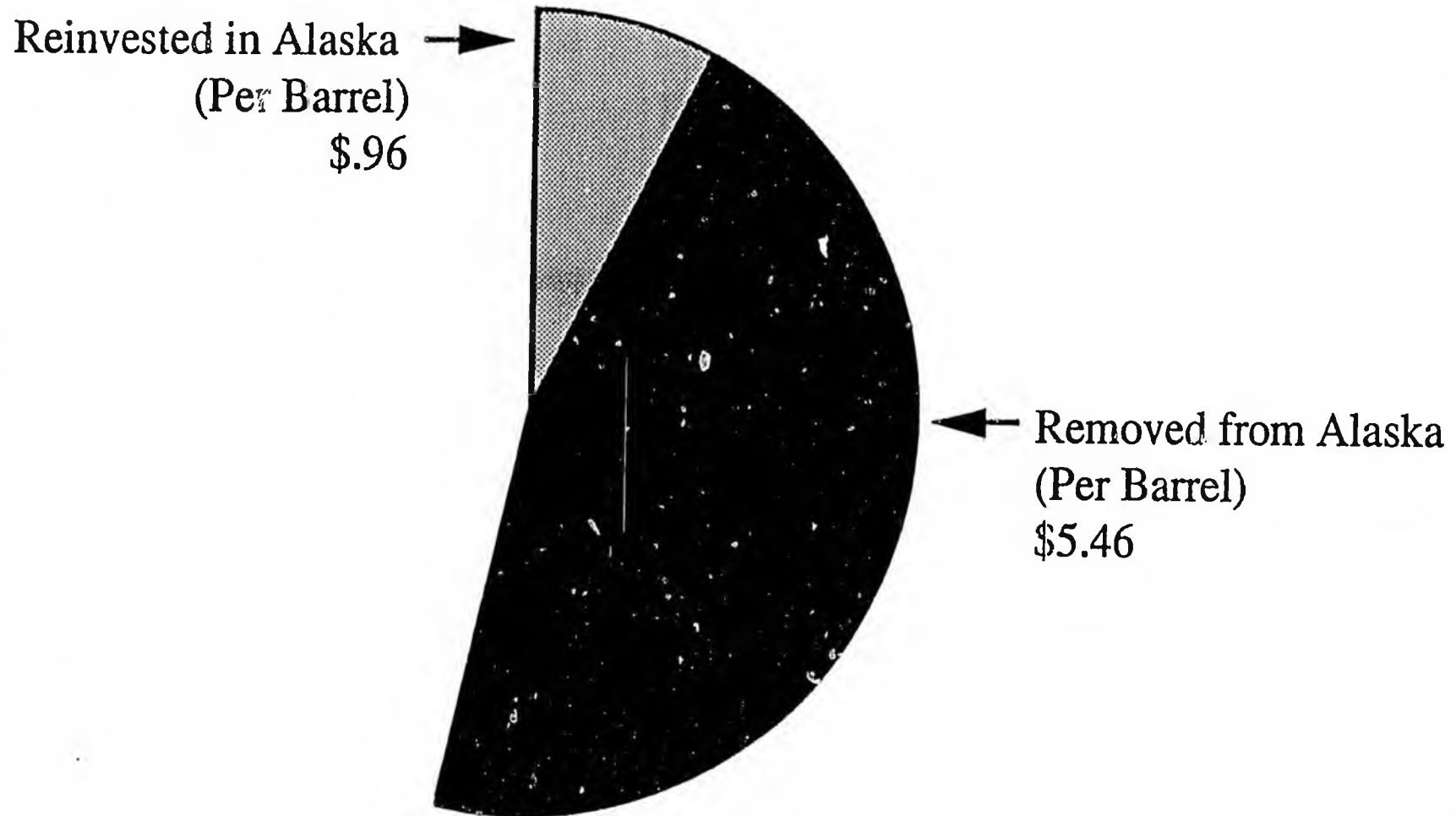
*Mr. Harold Heinze
ARCO Alaska Inc.
Testimony to the House finance Committee
April 12, 1985*

"If the state government increases our taxes we will have less cash to develop new fields."

*ARCO Alaska Inc.
newspaper advertisement
Alaska Journal of Commerce and Pacific Rim Reporter
October 7, 1985*

Chart 3

How Much Money Do The Oil Companies Reinvest in Alaska?

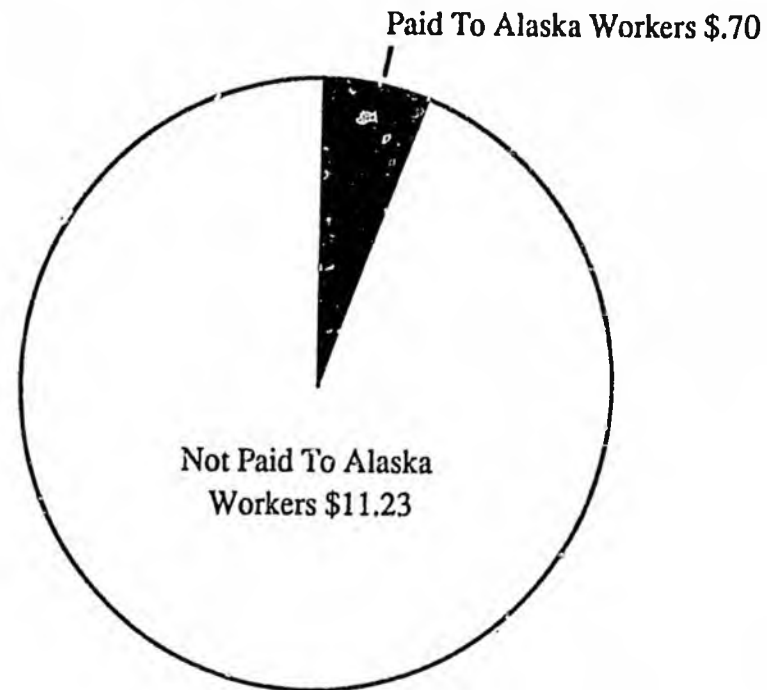


U.S. oil companies are in the process of liquidating. U.S. oil reserves are the leftovers of an enormous feast. Faced with a relentlessly declining reserves base, a good management is one that can intelligently liquidate its asset base.

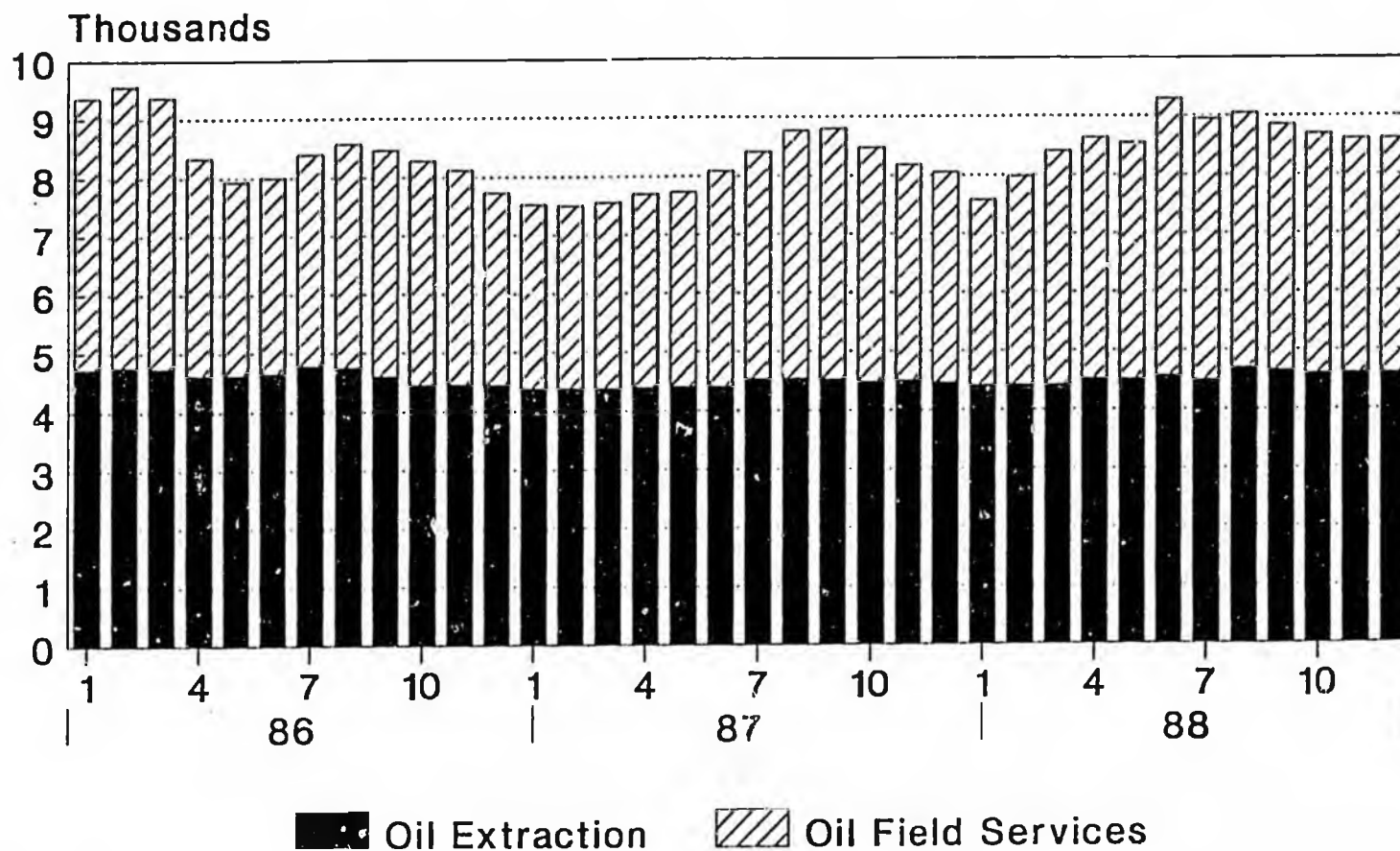
*Robert O. Anderson
former chairman and CEO
Atlantic-Richfield Co.
January 14, 1988*

Chart 4

How Much of The \$11.93 Revenue Per Barrel Gets Paid To Alaska Workers?
(\$/Barrel)



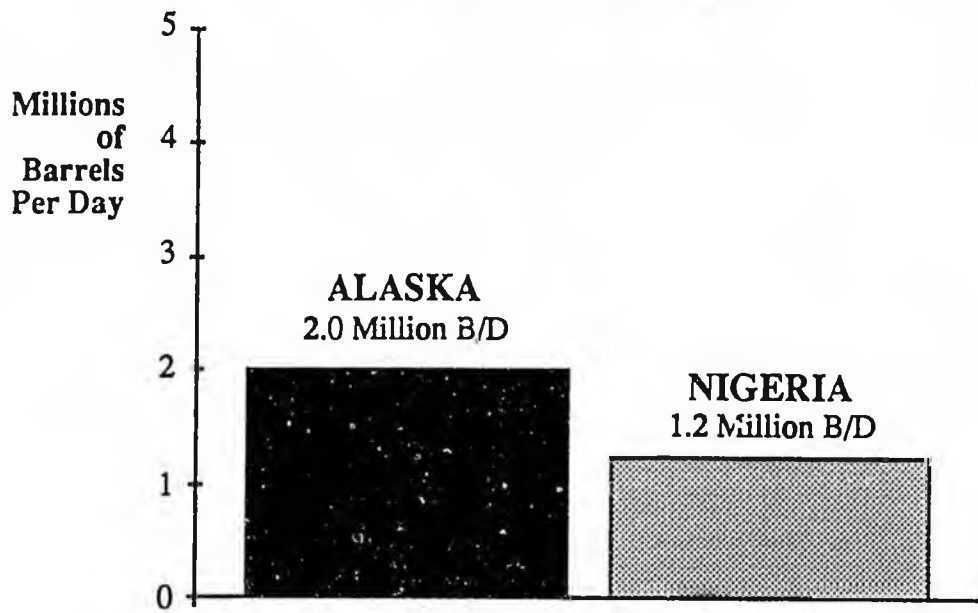
Alaska Oil Industry Employment 1986-1988



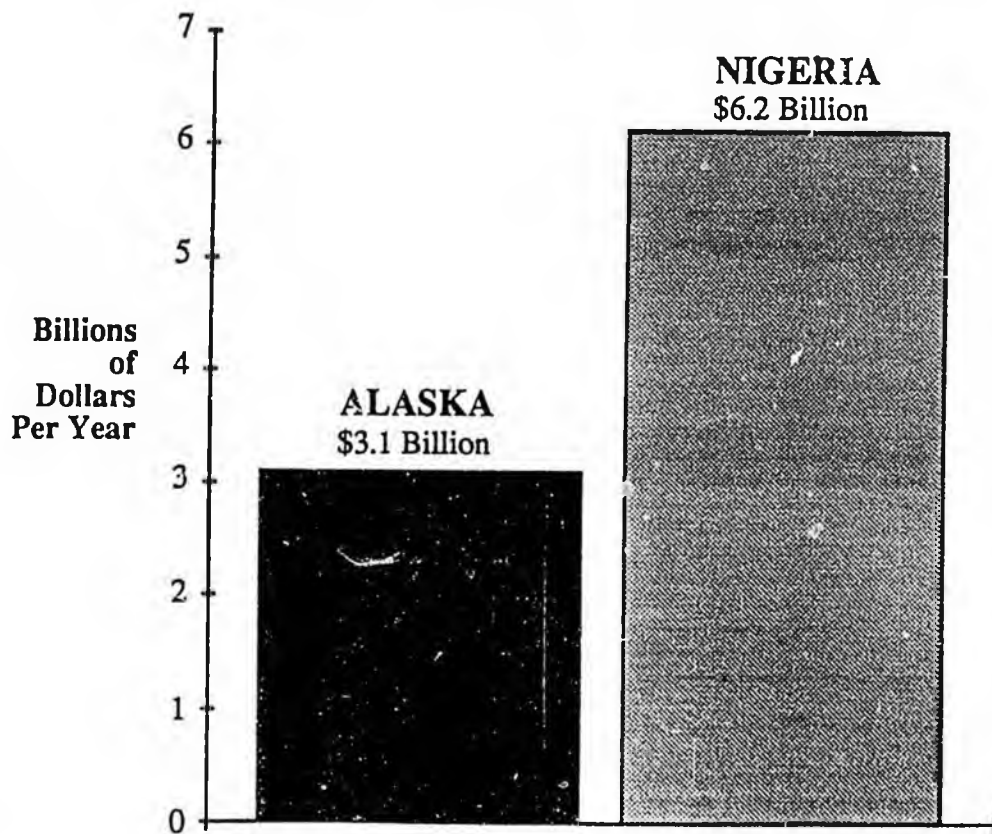
Source: Alaska Dept. of Labor
BLS 790 Survey

PRODUCTION

(Calendar Year 1987)

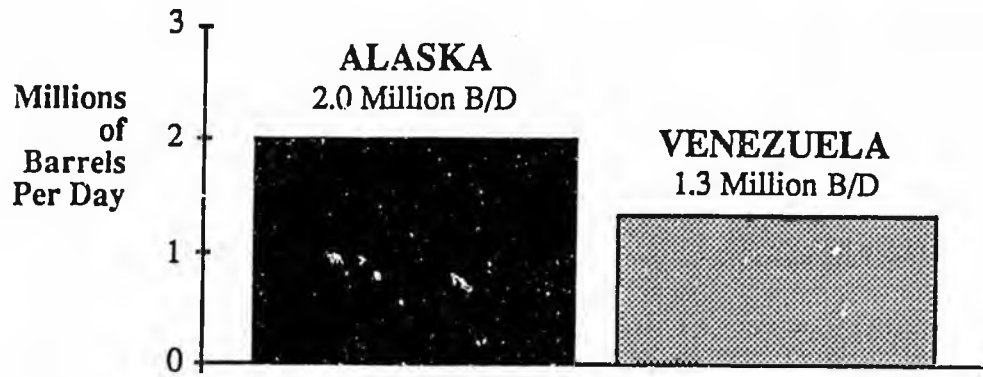


GOVERNMENT REVENUE

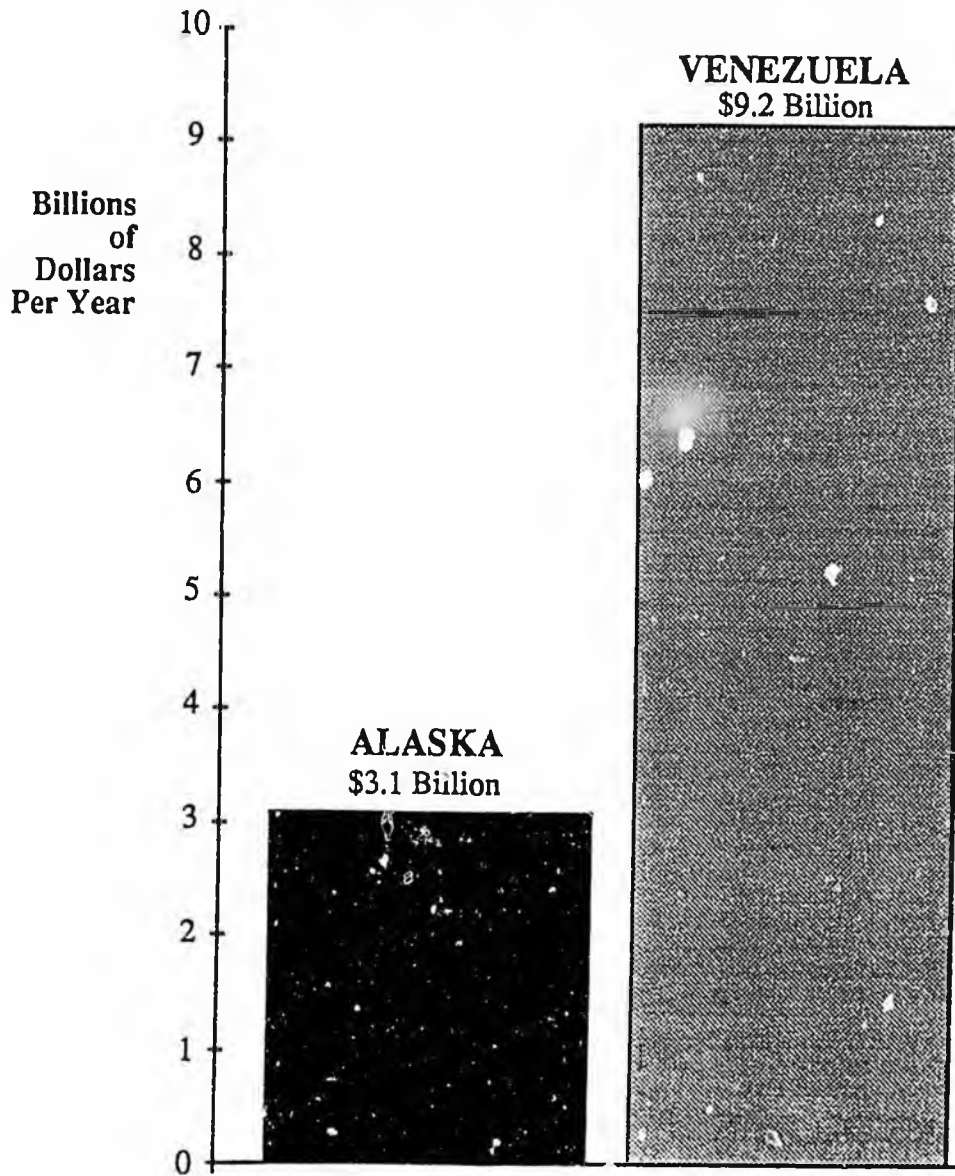


PRODUCTION

(Calendar Year 1987)

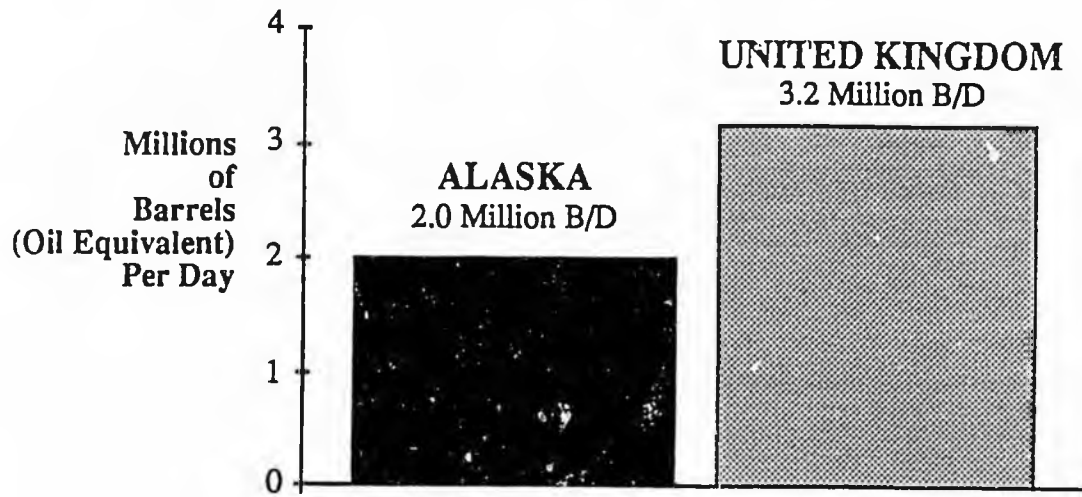


GOVERNMENT REVENUE

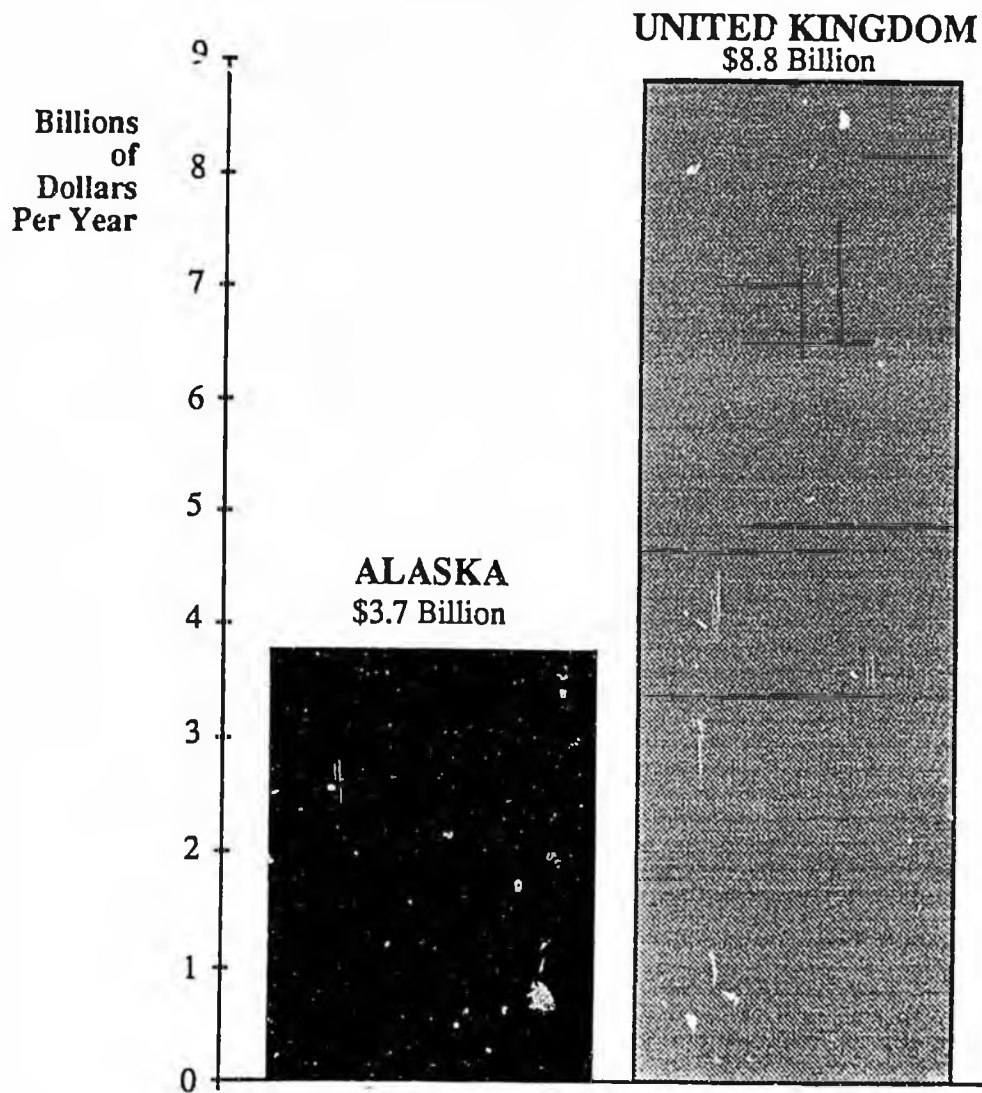


PRODUCTION

(Fiscal Year 1987)

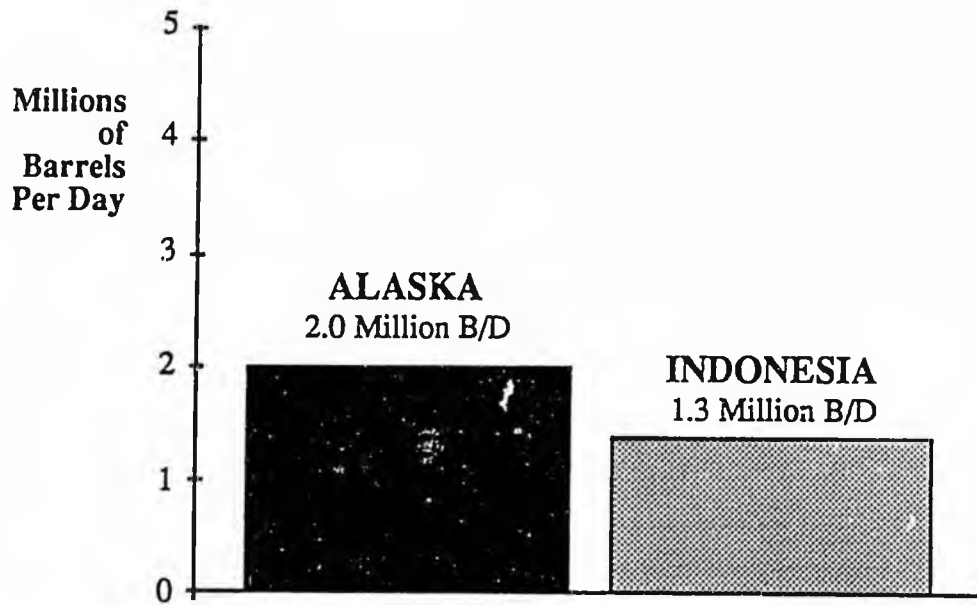


GOVERNMENT REVENUE

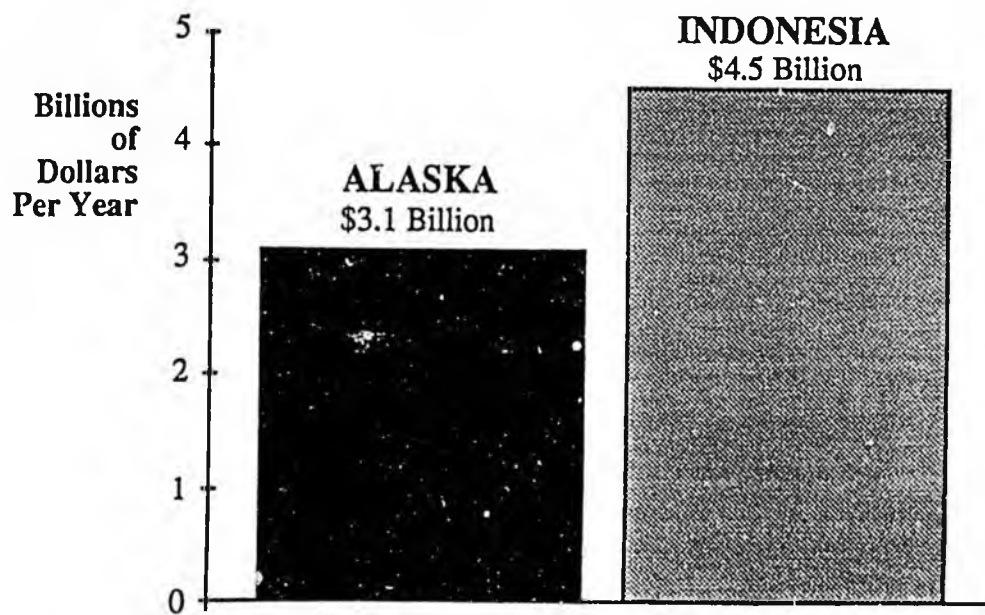


PRODUCTION

(Calendar Year 1987)



GOVERNMENT REVENUE



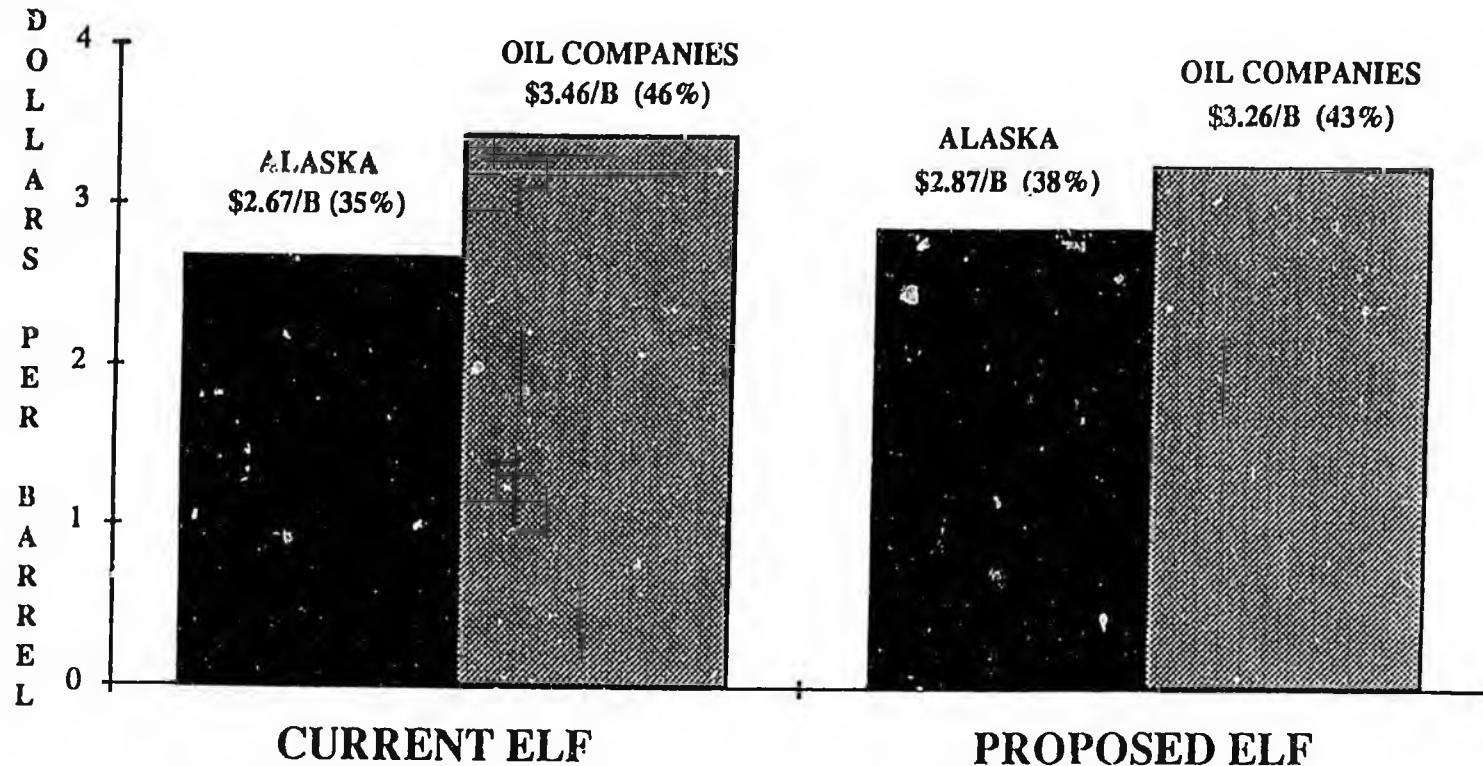
"We have also found [in Indonesia] to an almost unprecedented degree the very desirable and somewhat uncommon qualities of stability, honor, and fair dealing. In the turbulence of the international oil business, Indonesia has been an island of rationality and wisdom."

Robert E. Wycoff
President, Atlantic-Richfield Co.
address to the Indonesian Petroleum Association
October 20, 1987

ARCO Kuparuk Example

	<u>Current Law</u>	<u>Proposed Law</u>
Change in Annual Gross Revenue	\$981,000	\$981,000
Change in Annual Severance Tax	(\$37,846)	\$58,611
Tax Rate on Incremental Production	-3.9%	6.0%
Average Tax Rate Before Drilling	7.820%	10.944%
Average Tax Rate After Drilling	7.806%	10.938%
Percent Change in Average Tax Rate Due to Drilling	-0.180%	-0.055%

How Would The New ELF Affect Profits And Shares ?



"The power of taxation shall never be surrendered. This power shall not be suspended or contracted away...."

The Alaska Constitution

Legislator: "...[W]hat percent do you think they [the state] should collect?"

Mr. Taylor: "Something a little lower than it is now. About half the income tax for instance.... I think it would be much more fair for the industry and the state to get about the same share out of Prudhoe Bay even though we are paying the expenses and we made the investment...."

Legislator: "So you think it should be brought down to the point where the state and the industry get roughly equal shares in this. You like that better?"

Mr Taylor: "Yes, sir."

*Mr. Monte Taylor
Exxon USA Alaska Operations Manager
Joint Gas Pipeline Committee, May 21, 1981*

Legislator: "Did I hear you say you would concur on that?"

Mr. Donaldson: "I think that if you get rough parity with the state...we would have to think a long time as an industry, as a company, before we said that is not a pretty fair piece of middle ground."

*Mr. Richard Donaldson
SOHIO vice-president for government/public affairs
expressing agreement with Mr. Taylor,
Joint Gas Pipeline Committee, May 21, 1981*

"Alaska is not unfamiliar with the activities and importance of lobbies. But it is important to bear in mind that lobbying activity on a scale never before seen will take place in the capital when Alaska becomes a state....

"The taking of Alaska's mineral resources without leaving some reasonable return for the support of Alaska governmental services and the use of all the people of Alaska will mean a betrayal in the administration of the people's wealth."

*Congressional Delegate E.L. "Bob" Bartlett
Address to the Alaska Constitutional Convention
November 8, 1955*

MEMORANDUM

DEPARTMENT OF REVENUE ANALYSIS

MEMORANDUM

State of Alaska

DEPARTMENT OF REVENUE

TO: Cliff Groh
Special Assistant to the
Commissioner

DATE: February 9, 1989
2962A

FILE NO:

TELEPHONE NO:

THRU:

SUBJECT: APPLICABILITY DATE OF
HB 118

FROM: Roger Marks *RM*
Petroleum Economist

If the ELF formula contained in HB 118 applied to oil produced after the following dates, the amount of additional revenue (relative to current law) raised through the end of FY 1990 would be as follows. This is based on the assumptions in the Department of Revenue's Fall 1988 Petroleum Production Revenue Forecast mid-case scenario, updated for actual data through November 1988:

June 30, 1987	\$397mm
December 31, 1988	\$175mm
May 31, 1989	\$126mm
August 31, 1989	\$ 96mm

The August 31, 1989 figure was the basis of the fiscal note on the bill.

Assuming the "Consensus Revenue Analysis" of January 24, 1989, the revenues would be as follows:

June 30, 1987	\$410mm
December 31, 1988	\$188mm
May 31, 1989	\$132mm
August 31, 1989	\$ 99mm

Synopsis of Alaska Fields

<u>Field</u>	<u>Volume (bbls/day)</u>	<u>Wells</u>	<u>Daily Volume p/well</u>	<u>Effctv Sev Tax Rate Under Current Law</u>	<u>Effctv Sev Tax Rate Under HB118</u>
<u>Current Fields</u>					
<u>North Slope</u>					
Prudhoe Bay	1,526,932	691	2210	11.59%	14.91%
Kuparuk	320,685	337	952	8.36%	13.18%
Lisburne	38,293	51	751	5.22%	0.36%
Endicott	98,099	35	2803	12.25%	8.68%
<u>Cook Inlet</u>					
Beaver Creek	263	2	132	0.00%	0.00%
Granite Pt.	7,454	29	257	0.00%	0.00%
McArthur River	19,053	76	251	0.00%	0.00%
Middle Ground Shoals	7,913	44	180	0.00%	0.00%
Swanson River	5,684	27	211	0.00%	0.00%
Trading Bay	2,310	34	68	0.00%	0.00%
<u>Prospective Fields</u>					
Milne Pt.	30,000	40	750	4.67%	0.00%
West Sak	250,000	4000	65	0.00%	0.00%
Pt. Thomson	50,000	45	1111	7.62%	2.43%
Seal Island	100,000	112	893	6.57%	5.75%
Niakuk	20,000	12	1657	12.25%	0.01%

For current fields: actual November 1988 data. For prospective fields the expected values at peak production.

IF LOWER 48 FIELDS WERE IN ALASKA THEY WOULD PAY
NO SEVERANCE TAX UNDER EITHER CURRENT LAW OR HB 118

<u>Top 10 Lower 48 Fields</u>	<u>Daily Production</u>	<u>Average Daily Per Well Production</u>	<u>ELF (Current or Proposed)</u>	<u>Severance Tax Under Alaska Law</u>
1. Belridge South (CA)	165,981	28	0	0
2. Midway-Sunset (CA)	157,526	19	0	0
3. Kern River (CA)	128,491	17	0	0
4. East Texas (TX)	111,225	12	0	0
5. Elk Hills (CA)	107,244	98	0	0
6. Yates (TX)	91,890	80	0	0
7. Wilmington (CA)	81,975	40	0	0
8. Wasson (TX)	78,510	36	0	0
9. Spraberry Trench (TX)	60,585	8	0	0
10. Slaughter (TX)	55,792	19	0	0

Source: Oil and Gas Journal

U.S. fields with reserves exceeding 100 million bbl

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89	Est. rem. reserves	Est. No. wells
ALABAMA						
	Citronelle, 1955		1,827	147,861	7,000	435
ALASKA						
	Endicott, 1978		36,098	43,098	324,902	37
	Granite Point, 1965		2,787	109,535	16,213	29
	Kuparuk River, 1969		112,055	503,357	994,945	328
	Lisburne, 1957		14,500	35,600	175,689	49
	McArthur River, 1965		7,040	529,040	34,950	76
	Middle Ground Snaal, 1962		2,737	155,869	5,263	42
	Prudhoe Bay, 1967		576,335*	6,053,018*	3,533,665	691
	Swanson River, 1957		2,154	209,450	8,846	29
*Includes about 30.66 million bbl of condensate. †Includes about 138.66 million bbl of condensate.						
ARKANSAS						
	Smackover, 1922		2,654	556,907	9,097	2,100
CALIFORNIA						
San Joaquin Valley						
	Bainbridge South, 1911		60,583	677,063	435,295	6,000
	Buena Vista, 1909		1,574	647,274	39,271	895
	Coalinga, 1890		10,212	753,845	161,098	2,174
	Coalinga Nose, 1933		1,285	498,665	17,370	78
	Colas Lavee North, 1938		442	160,432	2,748	85
	Cuyama South, 1949		469	218,191	6,938	105
	Cymric, 1909		8,479	199,308	40,000	1,013
	Edison, 1928		1,470	134,391	25,670	674
	Elk Hills, 1911		39,144	693,374	579,776	1,099
	Fruitvale, 1925		577	115,553	13,709	274
	Greeley, 1936		237	112,547	1,763	27
	Kern Front, 1912		1,500	173,056	55,230	950
	Kern River, 1909		46,899	1,204,479	743,000	6,709
	Kettleman North Dome, 1929		172	456,648	1,298	44
	Lost Hills, 1910		5,627	173,293	61,203	1,634
	McKittinck, 1935		2,551	266,522	90,919	931
	Midway-Sunset, 1994		57,497	1,879,347	373,963	9,180
	Mount Poso, 1925		6,620	263,250	79,230	411
	Rio Bravo, 1937		151	115,051	1,319	15
	Yowumne, 1974		6,570	81,363	27,015	65
Coastal Area						
	Carpintera, 1965		2,650	88,101	29,289	114
	Cat Canyon E. & W., 1908		2,735	298,236	46,930	512
	Des Cuadras, 1969		4,371	212,804	54,140	140
	Elwood, 1923		317	105,725	2,283	7
	Hanco, 1959		9,952	89,621	112,223	20
	Orcutt, 1901		906	165,874	10,238	136
	Point Pescadero, 1982†		6,515	11,715	331,544	10
	Rincon, 1927		1,118	148,759	14,832	240
	San Arco, 1947		4,641	408,351	122,903	600
	Santa Maria Valley, 1934		1,751	198,131	40,408	172
	South Mountain, 1916		727	145,934	12,035	352
	Ventura, 1919		7,072	894,742	97,026	570
Los Angeles Basin						
	Beta, 1976		6,013	40,423	173,825	60
	Beverly Hills, 1900		2,034	122,616	42,356	116
	Brea Clinda, 1920		2,143	383,894	54,787	720
	Coyote East, 1909		584	108,653	13,212	103
	Coyote West, 1909		808	249,359	7,481	113
	Domnguez, 1923		607	269,266	7,448	113
	Huntington Beach, 1920		5,816	1,066,268	72,044	990
	Inglewood, 1924		2,790	345,433	54,149	366
	Long Beach, 1921		2,466	909,757	17,216	410
	Montebello, 1917		525	192,337	10,267	155
	Richfield, 1919		1,494	189,165	27,412	203
	Santa Fe Springs, 1919		587	613,077	9,035	151
	Seal Beach, 1924		876	203,118	14,113	168
	Torrance, 1922		1,693	212,023	35,847	365
	Wilmington, 1932		23,921	2,292,229	495,633	2,050
COLORADO						
	Rangely, 1933		12,492	739,418	35,000	488

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89	Est. rem. reserves	Est. No. wells
FLORIDA						
	Jay, 1970		4,676	360,612	55,944	121
ILLINOIS						
	Clay City, 1938		2,448	393,960	6,000	2,600
	Lawrence, 1905		2,919	394,521	5,300	2,700
	Louden, 1936		1,345	389,237	3,555	1,340
	Main, 1905		2,066	233,273	5,000	3,356
	New Harmony, 1939		1,072	153,545	4,000	1,140
	Salem, 1938		2,167	386,983	4,500	1,325
KANSAS						
	Bemis-Shotts, 1928		1,169	244,247	4,405	973
	Chase-Siica, 1930		1,019	301,003	4,499	1,103
	El Corado, 1915		839	256,734	2,515	822
	Hall-Gurnay, 1931		1,032	145,677	4,051	1,130
	Trapp, 1929		1,200	225,958	4,643	1,000
LOUISIANA						
Offshore						
	Say Marchand Blk. 2, 1949		5,547	596,972	53,759	120
	Eugene Island Blk. 330, 1930		7,859	269,080	55,920	169
	Grance Isle Blk. 16, 1948		1,659	263,729	95,645	44
	Grande Isle Blk. 43, 1955		4,312	272,256	85,688	126
	Mississippi Canyon Blk. 194, 1920		4,929	116,958	76,311	44
	Main Pass Blk. 41, 1957		2,985	237,854	23,384	112
	Main Pass Blk. 306, 1969		1,776	201,869	78,335	94
	South Pass Blk. 27, 1954		1,659	125,317	75,198	119
	South Pass Blk. E1, 1968		9,140	152,151	45,000	156
	South Pass Blk. 62, 1965		3,331	106,364	91,594	73
	South Pass Blk. 55, 1969		4,032	100,875	89,252	61
	Ship Shoal Blk. 204, 1968		1,591	66,070	38,930	40
	Ship Shoal Blk. 207, 1967		1,023	87,818	38,000	25
	Ship Shoal Blk. 208, 1962		4,117	160,169	65,274	67
	South Timbalier Blk. 21, 1939		1,324	216,239	47,133	45
	South Timbalier Blk. 135, 1956		1,390	139,337	25,663	37
	West Delta Blk. 30, 1949		6,754	446,683	47,375	153
	West Delta Blk. 73, 1952		4,469	188,700	86,291	73
Onshore South						
	Bay de Chené, 1941		390	96,382	17,952	24
	Bay St. Eraine, 1928		321	164,503	25,292	18
	Bayou Sole, 1941		769	161,369	3,417	20
	Black Bay West, 1953		1,971	144,799	10,432	94
	Cattico Island, 1930		2,308	602,231	74,020	136
	Cote Blanche Bay West, 1940		741	181,594	46,374	86
	Delta Farms, 1944		293	115,351	7,019	13
	Garden Island Bay, 1934		1,406	221,261	31,954	144
	Golden Meadow, 1938		894	135,439	4,290	176
	Grand Bay, 1938		454	170,514	3,750	41
	Hackberry, East, 1927		777	109,087	7,603	60
	Hackberry, West, 1928		1,771	141,995	6,492	107
	Iowa, 1931		134	99,303	697	25
	Jennings, 1901		315	116,409	700	181
	Lafitte, 1935		1,665	255,304	9,550	111
	Lake Barre, 1929		941	204,023	20,051	31
	Lake Pierre, 1929		477	117,000	17,415	23
	Lake Washington, 1931		2,353	242,390	16,376	93
	Leeville, 1931		447	141,646	7,221	37
	Paradise, 1939		725	126,650	8,600	31

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466
747
664

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. res. reserves	Est. No. wells
	Quarantine Bay, 1937...		761	172.672	1,654	71
	Timbalier Bay, 1938					
	Venice, 1937.....		858	181.878	7,590	59
	Vinton, 1910.....		287	161.001	900	96
	Weeks Island, 1945.....		816	225.939	21,556	33
	West Bay, 1940.....		1,349	228.246	16,355	79
North						
	Caddo-Pine Island 1905		3,310	360.299	12,888	10,688
	Deihi, 1944.....		675	211.707	34,651	59
	Haynesville, 1921.....		761	168.237	2,373	166
	Homer, 1919.....		434	98.375	1,908	199
	Rodessa, 1935.....		331	105.027	1,506	67

MISSISSIPPI

	Baxterville, 1944.....		2,509	239.164	10,391	316
	Heiderberg, 1944.....		2,829	174.809	12,171	316
	Tinsley, 1939.....		834	29.677	3,197	173

MONTANA

	Bell Creek, 1957.....		958	128.836	22,984	91
	Cut Bank, 1925.....		994	162.459	37,159	575
	Pine, 1951.....		1,302	105.145	5,657	96

NEW MEXICO

	Denton, 1949.....		652	138.693	3,000	179
	Empire-Abo, 1957.....		1,424	219.983	50,017	405
	Eunice-Monument, 1929		2,500	125.414	10,854	879
	Hocos, 1928.....		8,480	297.482	20,000	613
	Majamar, 1926.....		1,859	144.961	5,070	851
	Vacuum, 1929.....		12,359	432.242	40,000	1,556

NORTH DAKOTA

	Beaver Lodge, 1951.....		1,704	111.574	16,684	102
	Billings Nose, 1978.....		2,550	61.659	51,744	102
	Little Knife, 1977.....		3,392	51.437	57,924	131
	Mondak, 1976.....		439	13.165	82,837	96

OKLAHOMA

	Burbank, 1920.....		1,135	536.746	8,377	1,105
	Eola-Reeberson, 1920.....		746	103.124	8,210	603
	Fitts, 1934.....		2,963	199.894	12,000	589
	Glenn Pool, 1925.....		1,170	327.265	5,000	714
	Golden Trend, 1945.....		4,333	474.100	28,000	1,396
	Healton, 1913.....		1,938	334.645	9,563	1,000
	Hewitt, 1919.....		3,152	266.371	13,615	923
	Oklahoma City, 1928....		902	816.170	5,966	174
	Poste, 1958.....		1,216	106.393	14,921	226
	She-Vel-Tum, 1905.....		18,398	1,167.379	60,000	7,616
	Sooner Trend, 1945.....		4,147	255.544	20,000	4,746

TEXAS

District 2						
	Greta, 1933.....		746	147.570	12,530	100
	Lake Pasture, 1953.....		2,194	87.784	12,644	143
	Tom O'Connor, 1934.....		10,380	747.848	55,000	646
	West Ranch, 1938.....		2,640	350.034	8,504	307
District 3						
	Ananias, 1935.....		1,068	284.888	15,112	106
	Carroe, 1951.....		3,864	727.215	33,728	278
	Giddings, 1971.....		8,656	278.570	148,032	2,281
	Hartogs, 1934.....		3,084	697.237	72,764	206
	Magnet Withers, 1936....		1,834	110.950	5,030	150
	Oyster Bayou, 1941.....		864	160.204	18,096	39
	Thompson, 1931.....		3,972	472.540	27,360	262
	Tomcat, 1933.....		400	121.055	9,858	85
	Webster, 1937.....		5,304	573.192	20,000	243
District 4						
	Agua Dulce-Stratton, 1926.....		360	146.623	24,751	94
	Bonegas, 1943.....		192	114.021	20,186	40
	Kelsey, 1938.....		200	114.359	36,247	60

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. res. reserves	Est. No. wells
	Plymouth, 1925.....		400	122.823	3,300	60
	Seeligson, 1925.....		156	271.483	55,544	42
	TCB, 1944.....		456	112.700	52,358	30
	White Point E, 1938.....		60	104.034	6,340	21
District 5						
	Alabama Ferry, 1983....		3,600	14.600	86,400	253
	Van, 1928.....		3,056	521.960	15,000	366
District 6						
	East Texas, 1930.....		40,597	5,008,747	988,759	9,363
	Fairway, 1950.....		2,424	192.591	17,777	100
	Hawkins, 1940.....		8,244	821,644	42,372	442
	Neches, 1953.....		1,416	103,980	6,036	163
	Quitman, 1948.....		1,680	121,346	8,440	208
District 8						
	Andacter, 1946.....		1,500	181,888	6,500	28
	Block 31, 1945.....		3,555	220,068	12,000	325
	Cowden, N., 1930.....		13,596	488,092	40,000	1,210
	Cowden, S. Foster, Johnson, 1932.....		9,696	509,796	40,000	1,593
	Dollarhide, 1945.....		2,568	153,780	11,448	202
	Dune, 1938.....		2,928	183,000	18,704	771
	Fullerton, 1942.....		7,452	348,200	22,000	870
	Goldsmith, 1934.....		7,246	755,516	33,752	2,036
	Howard Glasscock, 1925		5,844	404,508	26,000	2,239
	Iatan, E., 1925.....		3,372	142,556	12,000	1,304
	Jordan, 1937.....		480	128,975	2,520	135
	Keystone, 1920.....		1,872	313,080	9,374	812
	McElroy, 1926.....		7,884	465,549	56,800	1,600
	Means, 1934.....		7,020	228,594	20,000	713
	Midland Farms, 1944....		4,609	241,990	18,615	415
	Sand Hills, 1931.....		2,760	248,207	21,500	1,312
	TXL, 1944.....		2,004	263,515	6,500	600
	Wadell, 1927.....		709	100,712	3,792	169
	Ward Estes, N., 1929....		3,408	364,177	76,435	1,562
	Westbrook, 1923.....		2,000	88,000	16,000	718
	Yates, 1925.....		33,540	1,171,820	782,695	1,146

District 8-A						
	Anton-Irish, 1944.....		3,554	175,910	24,150	239
	Cogdell Area, 1949.....		1,556	252,219	41,204	103
	Diamond M., 1948.....		1,903	239,415	16,053	474
	Kelly-Snyder, 1948.....		11,552	1,234,962	115,038	805
	Leveland, 1938.....		17,329	464,144	50,000	3,012
	Prentice, 1951.....		6,216	161,036	20,000	437
	Salt Creek, 1950.....		10,404	247,340	12,552	173
	Seminole, 1935.....		17,004	524,765	35,000	624
	Slaughter, 1936.....		20,354	1,029,800	50,000	3,001
	Spracery Trend, 1951..		22,212	653,388	50,000	7,321
	Wasson, 1925.....		28,656	1,711,998	60,000	2,152
	Welch, 1942.....		3,324	144,228	14,000	651
District 10						
	Pannagie, 1921.....		7,812	1,423,286	41,240	11,643

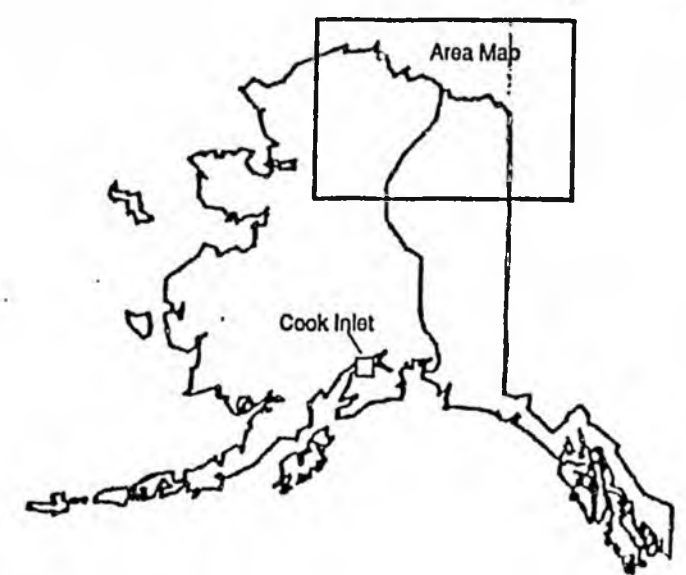
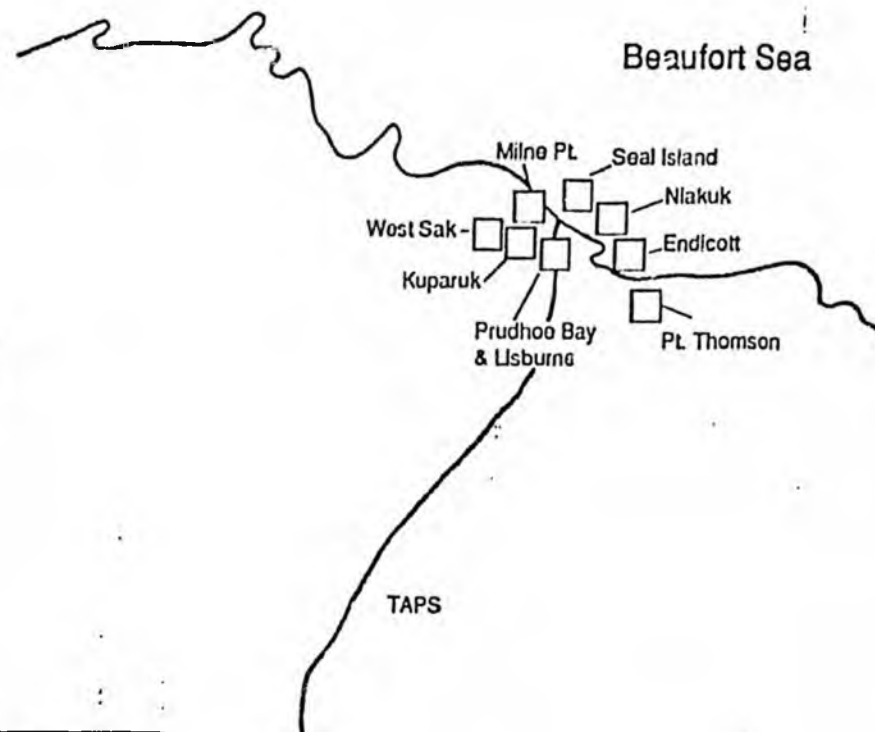
UTAH

	Altamont, 1955.....		3,047	89,493	231,216	227
	Aneth, 1956.....		5,340	354,004	30,000	461
	East Anschutz Ranch, 1979.....		12,755	80,365	727,799	29
	Red Wash, 1951.....		1,075	77,511	13,377	146

WYOMING

	Brady, 1960.....		2,438	54,537	49,251	22
	Byron, 1918.....		1,119	120,639	7,656	67
	Elk Basin, 1915.....		2,968	446,695	25,750	170
	Frannie, 1928.....		1,122	116,020	5,000	63
	Garrison, 1906.....		2,625	154,885	6,000	225
	Grass Creek, 1914.....		2,414	185,120	9,000	288
	Hamilton Dome, 1918....		2,853	268,103	6,000	239
	Hartzog Draw, 1976.....		6,647	66,722	293,739	157
	White, 1955.....		541	75,416	55,885	93
	Lance Creek, 1918.....		163	107,805	400	24
Little Buffalo Basin, 1914.....						
	Lost Soldier, 1916.....		2,666	118,653	9,389	154
	Oregon Basin, 1912.....		2,308	192,073	6,000	71
	Painter Reservoir, 1979		8,669	388,180	30,000	500
	Salt Creek, 1906.....		1,739	31,674	80,674	31
	Salt Creek, 1906.....		5,210	629,689	25,000	1,217
	Wertz, 1920.....		3,500	99,695	15,000	65
	Whitney Canyon, 1980..		1,652	10,379	105,435	29

State of Alaska
Approximate Field Locations
(Current and Prospective Fields)



Date: February 7, 1989

HOW REVENUE NEUTRAL WERE THE 1981 CHANGES?
(\$mm)

	<u>What collections would have been under pre 1982 Law</u>			<u>Actual Collections</u>			<u>Loss from change in law</u>
	<u>Petro. Corp. Income Tax</u>	<u>Sev. Tax</u>	<u>Total</u>	<u>Petro. Corp. Income Tax</u>	<u>Sev. Tax</u>	<u>Total</u>	
1982	980	1219	2199	669	1582	2251	52
1983	915	1099	2014	236	1494	1730	(284)
1984	836	1033	1869	265	1393	1658	(211)
1985	812	1014	1826	169	1389	1558	(268)
1986	658	805	1463	134	1108	1242	(221)
1987	<u>375</u>	<u>464</u>	<u>839</u>	<u>120</u>	<u>649</u>	<u>769</u>	<u>(70)</u>
Total	4575	5634	10210	1593	7615	9208	(1002)*

*Had the Legislature authorized deduction of the Federal Windfall Profits Tax the total loss over the period would have been \$670 mm

Severance Tax Receipts as Percentage of Gross Wellhead Value -
Prudhoe Bay

<u>Year</u>	<u>Wellhead Price (\$/bbl)</u>	<u>Volume (mmbbl)</u>	<u>Gross Value (\$mm)</u>	<u>Sev Tax (\$mm)</u>	<u>Sev Tax as % of Gross Value</u>	<u>Loss from ELF (\$mm)</u>
1982	24.45	557	13619	1787	13.1%	NA
1983	20.27	560	11351	1499	13.1%	NA
1984	19.73	562	11088	1455	13.1%	NA
1985	18.48	564	10423	1368	13.1%	NA
1986	12.74	563	7173	941	13.1%	NA
1987	11.08	567	4581	601	13.1%	NA
		(Suspension of ELF on Prudhoe Bay ends)				
1988	10.68	565	6034	657	10.9%	135
1989	7.36	540	3974	430	10.8%	92
1990	7.00	502	3514	368	10.5%	93
1991	7.56	466	3523	357	10.1%	105

DEFINITIONS

The Economic Limit Factor or ELF is a fraction which reduces severance taxes as well productivity declines.

Date: February 7, 1989

SEVERANCE TAX, also called production tax, is a tax on oil removed from the ground. The tax compensates for the depletion of the state's non-renewable resources.

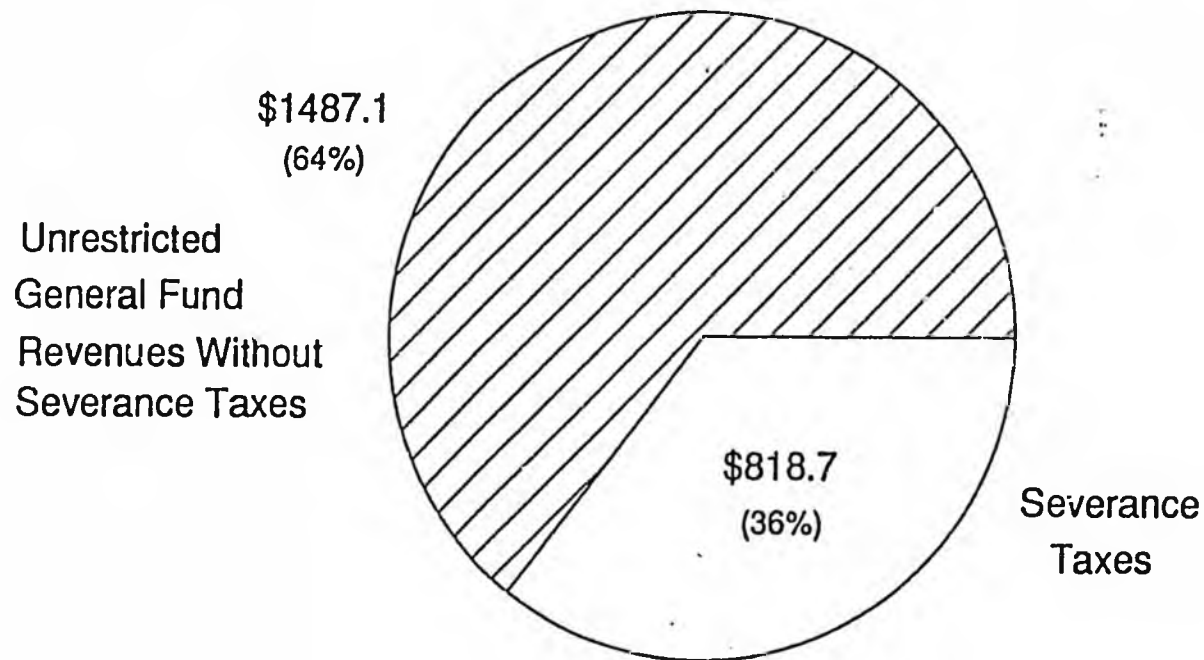
Date: February 7, 1989

EFFECTIVE SEVERANCE TAX RATE
equals nominal severance tax rate times ELF.

For example, 15.00% times 0.66 equals
an effective severance tax rate of 9.90 %

Date: February 7, 1989

Severance Taxes are an Important Part of Alaska's Revenues



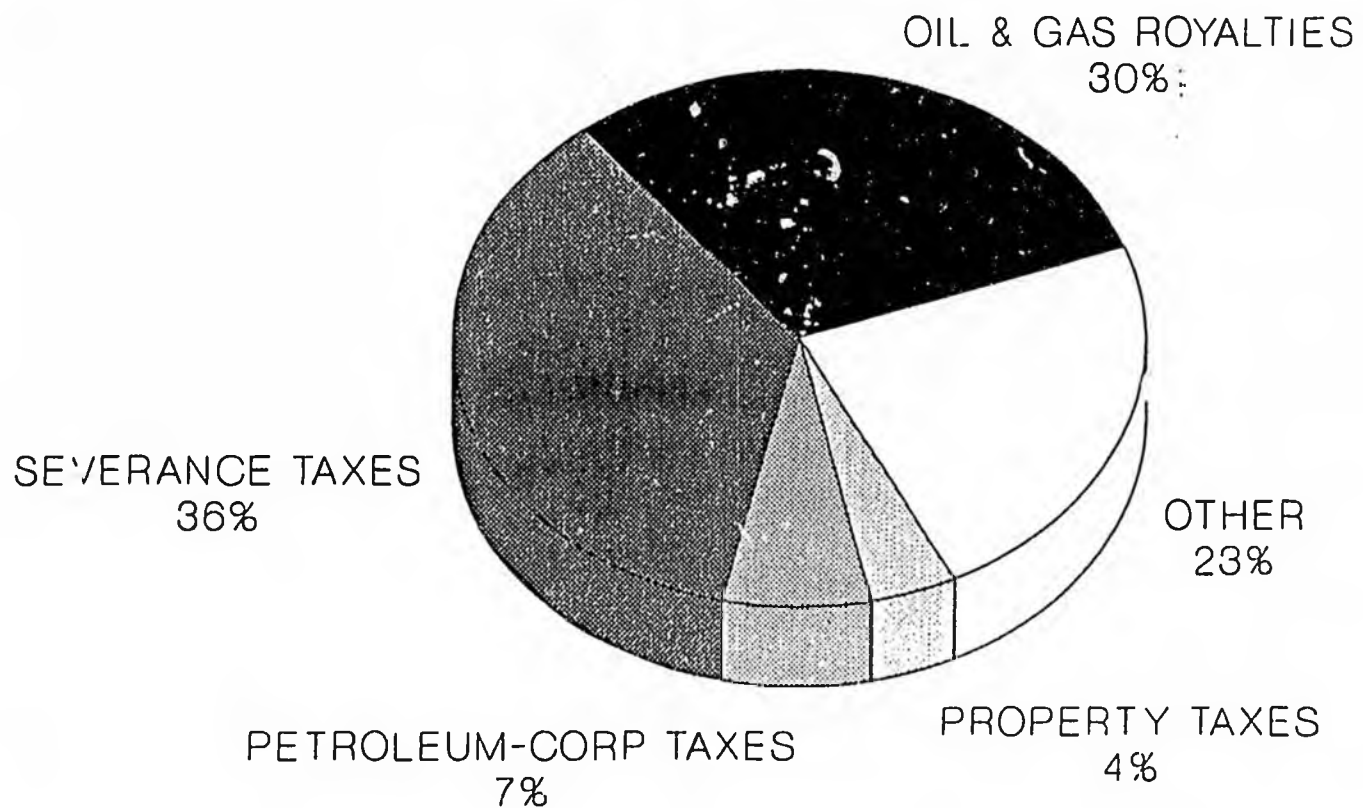
Unrestricted
General Fund
Revenues Without
Severance Taxes

Severance
Taxes

\$2305.8
Total Unrestricted General Fund
Revenues For Fiscal Year 1988

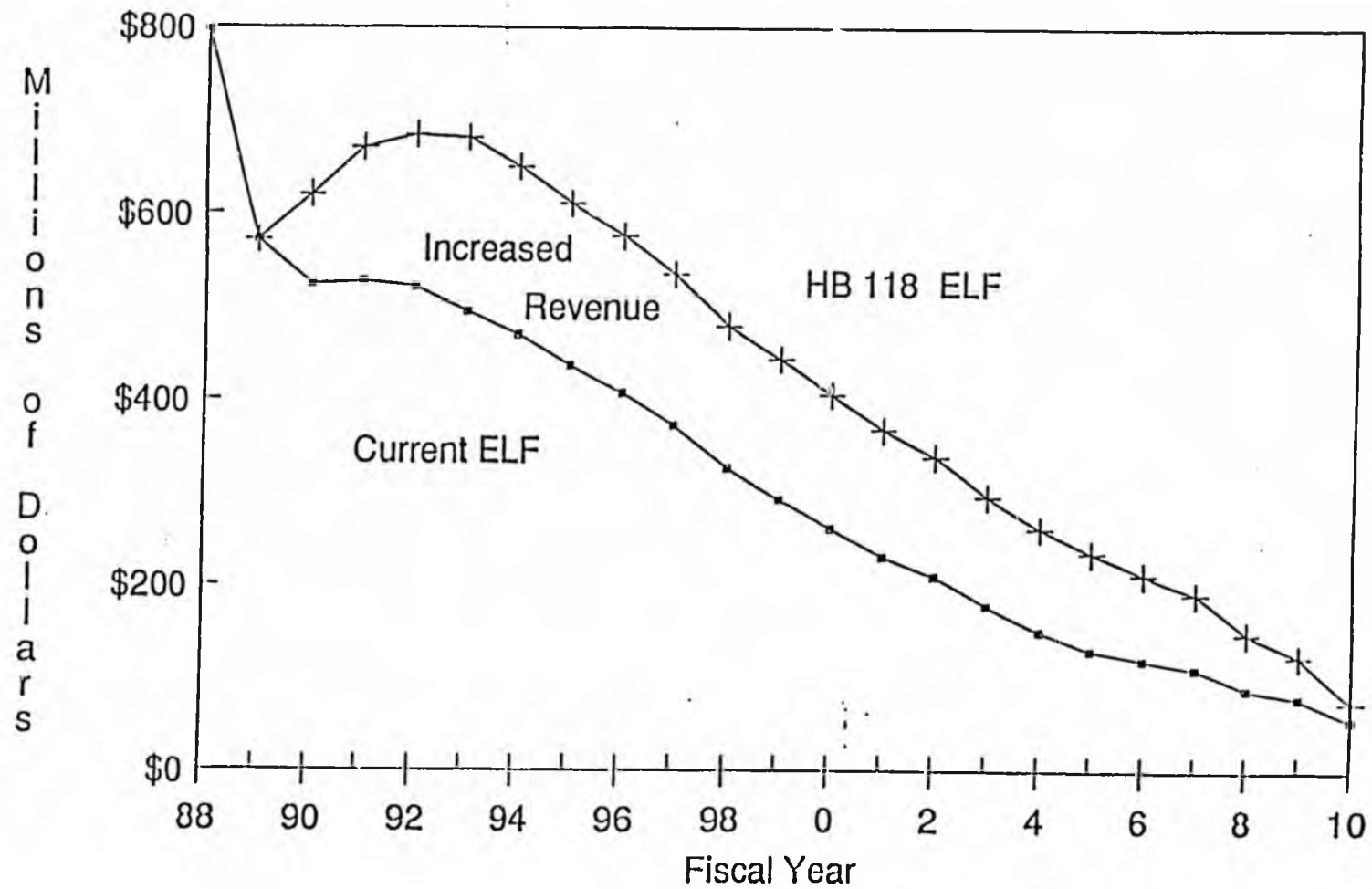
Date: February 7, 1989

GENERAL FUND UNRESTRICTED REVENUES (FY 1988)



(Alaska Department of Revenue-Research)

HB 118 Raises Net Revenue From Severance Taxes on Oil Production



OFFICE OF MANAGEMENT & BUDGET

MEMORANDUMS

OFFICE OF THE GOVERNOR
DIVISION OF POLICY

Box AD, Juneau, Alaska 99811-0164
Phone (907) 465-3568

Mary Halloran
Director

. 16 January 1988

Mr. John Havard
Planning and Evaluation
ARCO Alaska, Inc.
P.O. Box 100360
Anchorage, AK 99510-0360

Dear Mr. Havard:

In your presentation to the Bartlett Democratic Club you questioned the accuracy of the calculations of per barrel Alaska oil profits, depreciation, etc. presented by Mr. Gregg Erickson of my staff.

The figures we presented are based on the calculations published in the *Petroleum Intelligence Weekly* of February 1, 1988. We earlier summarized those calculations in Appendix B of *The ELF, A Policy Perspective*, a copy of which you will find enclosed.

After *Perspective* was published Mr. Tom Williams, an official of Standard Alaska Production Co., pointed out that the calculations failed to include property tax payments to local governments. We also noted that the *PIW* calculations did not reflect the allocations of pipeline tariff revenue provided for under the TAPS Settlement Methodology agreed to by the owner companies, the state, and the Federal Energy Regulatory Commission. After discussing the matter with Mr. Williams, James Palmer, and other Standard officials, and *PIW*, we appropriately recalculated the numbers with the adjustments (shown below) for property tax and TAPS.

<u>Purpose of Adjustment</u>	<u>(\$ per barrel)</u>	
	Original	Adjusted
	PIW	PIW
	<u>Allocation</u>	<u>Allocation</u>
Correct property tax	0.15	0.46
Add TAPS depreciation, DR&R	2.25	2.96
Add recovery of TAPS deferred return	0.43	1.15
Add TAPS operating expense	0.85	1.44

Mr. John Havard, January 15, 1989, page 2

This administration stands by the estimates presented by Mr. Erickson. Naturally, we would be happy to work with your company -- as we did in this case with Standard -- in our ongoing effort to insure that our information on the economics of Alaska oil operations is as accurate as possible.

Please contact Mr. Erickson directly if you have information to add, or further questions concerning the derivation of our estimates.

Yours truly,

Mary Halloran

enc: *The ELF, A Policy Perspective*

cc: John Levy, program chair
Bartlett Democratic Club

MEMORANDUM

Division of Policy
Office of the Governor

To: Gregg Erickson
Senior Economist
Division of Policy

Date: February 10, 1989

From: R.A. Fineberg
Senior Analyst, Oil & Gas
Division of Policy



Subject: Data on Shares of Profit from the Alaska Operations
of North Slope Producers

This memorandum discusses the undated, one-page flyer from Senator Rick Halford, "Background of the Economic Limit Factor (ELF),"¹ which was provided to the House Resources Committee yesterday. The flyer contains data on the "state share" of North Slope income from two separate sources. Review of the two source documents indicates:

1. The flyer data are derived from two separate sources using different assumptions. The reported results are therefore inaccurate.

2. Data from both sources were reported on the flyer in a manner that understates industry revenue from Alaska operations.

For these reasons, the data in the one-page flyer cannot be taken as an accurate portrayal of "state share" of North Slope revenue. The following sections discuss these conclusions are discussed in greater detail.

1. The flyer data are derived from two separate sources using different assumptions. The reported results are therefore inaccurate.

The first set of numbers, from 1985 to "1988 (to date)," is taken from a Petroleum Intelligence Weekly of Feb. 2, 1988; the figures for 1988 through 1991 are projections taken from a December 1986 report by the

¹ These data were originally circulated to all legislators Mar. 23, 1988 by Senator Mitch Abood.

Department of Revenue.² These calculations require assumptions about corporate activities that the North Slope producers decline to make public. The assumptions used by PIW (based on the best industry information the PIW analysts could get in 1988) are very different from those the Department of Revenue used in 1986.

A March 1987 memorandum by one of the authors³ of the 1986 study warned specifically that to isolate industry shares of profit from the 1986 tables may be "somewhat misleading" if taken out of context. This is precisely what occurred in the hand-out you were given yesterday.

The Department of Revenue reports that the 1986 study over-estimated production costs, capitalization and other factors. To get actual results for 1988 and results comparable to the PIW data for future years, one would have to revise the 1986 study. In that process, the Department reports, the state share of North Slope income would be significantly reduced.

2. Data from both sources were reported on the flyer in a manner that understates industry revenue from Alaska operations.

The North Slope producers own the trans-Alaska pipeline. Both sets of income data exclude the enormous profits from the trans-Alaska pipeline operations. From examination of the PIW table, it is evident that the "state share" for each of the six periods listed in the memorandum between 1985 and 1988 excluded pipeline profits. These profits increase profits from Alaska oil operations for the six periods listed from 20% to 300%. At the same time, pipeline taxes were already counted with the state property and income taxes in the PIW totals. **This omission results in a significant under-statement of producers' revenue from the North Slope and a corresponding over-statement of the state's share of production revenue.**⁴

² The Petroleum Intelligence Weekly table is reprinted in its entirety in ELF: A Policy Perspective (distributed in the House Resources Committee workbook). The Department of Revenue tables are taken from Larson, Logsdon and Marks, "Sensitivity Analysis of Projected Revenue Collections," December 1986, pages 82 and 93.

³ Memorandum from John Larson, Economist, to Vince Wright, Chief of Research, March 23, 1987.

⁴ Additionally, after discussing the Petroleum Intelligence Weekly table extensively with its authors, the Division of Policy concluded that the Petroleum Intelligence Weekly totals under-stated the

Finally, it should be noted that nothing in the 1981 dictum that the state should maintain tax and royalties "above 30 percent" indicates that policy-makers intended to exclude the profits from the trans-Alaska pipeline from this calculation. For that matter, I am aware of nothing in the 1981 record to indicate that the policy-makers considered the tremendous profit potential of the trans-Alaska pipeline to the North Slope operators who own that pipeline.

property taxes paid. However, this error was more than balanced by significant understatements of other items in the table.

SUBJECT: Background of the Economic Limit Factor (ELF)

Attached is a press release issued when Governor Hammond signed legislation in 1981 which related to the state's oil and gas taxation system. One effect of the 1981 legislation was to raise the tax rate for Prudhoe Bay from 11.7% to 15% by rounding the ELF to 1.00.

As stated in the third paragraph of the press release, one of Governor Hammond's essential conditions for signing the bill was that it "maintain the state's combined royalty and tax 'share' from its one-time resource at above 30 percent."

Also attached is an analysis from "Petroleum Intelligence Weekly". According to this analysis, the State of Alaska's share of net revenue has been the following:

<u>Year</u>	<u>State of Alaska's share</u>
1985	33.0%
1st half of 1986	41.8%
2nd half of 1986	63.7%
1st half of 1987	39.0%
2nd half of 1987	35.5%
1988 (to date)	36.3%

Additionally, here are figures as forecast by the Department of Revenue:

<u>FY</u>	<u>State's share with \$9 wellhead value (\$13-14 market price)</u>	<u>State's share with \$11 wellhead value (\$15-16 market price)</u>
88	79%	57%
89	92%	61%
90	96%	63%
91	103%	67%

Source: Department of Revenue (Larson, Logsdon, and Marks), "Sensitivity Analysis of Projected Revenue Collections" (December, 1986), page 82 (for \$11 wellhead figures) and page 93 (for \$9 wellhead figures).

HB 118 MEMORANDUM

OIL FIELD SIZE VS. TAX REVENUE

Size of Field Where Taxes Will Increase or Decrease Under HB118

HB118 modifies the ELF statute in two ways which affect the relationship of field size to the tax rate for the field: (1) by modifying the formula; and (2) by repealing the "rounding rule." (Under current law if a field has an ELF of greater than 0.7 for the first ten years of the field, the ELF is elevated to 1.0. This is called the "rounding rule.") The combined effect of these two changes will increase the severance tax on fields producing an average of more than approximately 150,000 barrels per day, and will reduce the severance tax on fields producing an average of less than approximately 150,000 barrels per day. An analysis of these two changes and the underlying assumptions follows.

The change in the formula would raise taxes on fields which produce more than approximately 115,000 barrels per day and for which the rounding rule does not apply. (Only Prudhoe Bay and Kuparuk fit this description. The rounding rule does not apply to them now because Prudhoe Bay is older than ten years, and Kuparuk's current ELF is less than 0.7.) The Bill would cut taxes -- or leave them at zero -- for any field producing less than approximately 115,000 barrels per day. If a field produces an average of less than 300 barrels per well per day, their taxes are zero under current law and the new Bill.

The Bill also initially decreases the ELF for new higher productivity (where average well productivity is greater than 1500 barrels per day) large fields (over the 115,000 barrel per day level). Under current law, fields producing more than an average of 1500 barrels per well per day will have an ELF of greater than 0.7, and would have an initial effective ELF of 1.0 because of the rounding rule. Since the first ten years of the field is when the greatest proportion of oil is produced (upwards of 75 percent), these large fields could have reduced weighted average severance taxes over the entire life of the field under the Bill since it eliminates the rounding rule. The exact size of field that will benefit over the entire life of the field will depend on its well productivity, decline profile, and the discount rate. We estimate that a field with the same well productivity and decline characteristics as Endicott, for example, (which produces 100,000 barrels per day and produces 2800 barrels per well per day average), but with peak production of 280,000 barrels per day, would have the same discounted (8%) weighted average effective ELF over the life of the field under the Bill as it would under current law. Fields producing less than that amount would have a lower ELF than under current law.

A weighted average of all field sizes and average per well productivities from all Alaska fields indicates that on average fields which produce less than approximately 150,000 barrels per day will have a reduced severance tax under HB 118.

GOVERNOR COWPER'S LETTER TO EDITORS

STEVE COWPER
GOVERNOR



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

February 8, 1989

Dear Editor:

During the next several days the public will have the chance to talk to their legislators about an issue that will make a big difference in Alaska's economic stability.

The so-called ELF - or Economic Limit Factor - went into effect last June on the tenth anniversary of the pipeline. The ELF gives a major tax break to Prudhoe Bay, the largest and most profitable oil field in North America. I believe tax breaks should be reserved for those fields that really need it.

My administration strongly supports a measure that encourages further economic development and more jobs by expanding the tax break for the truly marginal fields. The legislation, House Bill 118, would correct the loophole that permits the most profitable oil field in the country to be classified as a marginal field.

The ELF adjustment we're proposing will be a tax break for eight of the ten oil fields immediately affected. Even Prudhoe and Kuparuk, North America's two biggest oil fields, will pay less than before the loophole took effect 18 months ago. We think that by plugging the loophole and giving a bigger break to smaller fields will mean that more oil company investment and jobs can be kept in Alaska in the long run.

I want a system of taxation that's fair and stable and fosters development. Adjusting the Economic Limit Factor is an important and necessary step. Citizens who support that effort can participate in a public hearing with the House Resources Committee, Monday, February 13, from 3 to 5 in the afternoon and from 7 to 9 in the evening. Just go to your local Legislative Information Office if you'd like to have your say.

Sincerely,

Steve Cowper
Governor

THE ELF: A POLICY PERSPECTIVE

The ELF
A Policy Perspective

April 1988

Division of Policy
Office of the Governor

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Preface

Since statehood, oil taxes have been a continuing and difficult policy issue for Alaskans. The current debate centers on the state severance tax and the economic limit factor or "ELF." Put simply, the ELF is a tax reduction formula meant to encourage marginal oil field development. The Governor proposed ELF legislation last year, and a bill to make a change in the ELF formula passed the House.¹ The oil companies, with one notable exception, oppose the change, and the bill has now stalled in the state Senate, where the leaders have said they oppose allowing the bill to come to a vote.

In the Alaska legislature oil tax issues have traditionally received intense scrutiny. Each side has had the opportunity to challenge the assertions of the other, bring its experts forward, and present its case. This process has not been perfect, but the legislators and the public have been able to get the facts to make informed decisions. Nothing will substitute for the give and take of a public hearing, but in the face of the Senate's refusal to allow this major policy issue the open debate it deserves, the state administration has a responsibility to make its perspective known.

We believe passage of the new ELF will help stabilize the Alaska economy at a time when it needs the reassurance of stable state spending. More stable revenues from the new ELF will help guarantee that local governments receive the money they need for roads, public safety and other services, and explains why the Alaska Conference of Mayors, among others, supports the ELF bill. Most importantly, passage of the new ELF

¹ House Finance Committee Substitute for House Bill 164, amended [CSHB 164 (Fin.) am].

will provide a more reliable incentive for marginal field development — the ELF's original purpose — by lowering tax rates on Alaska's smaller fields, such as Milne Point, Endicott, and Lisburne.

This paper attempts to fully discuss the reasons behind our perspective. We have tried to include all the relevant facts. We also have tried to avoid unnecessary complication. If others have additional information and perspectives, we welcome hearing from them.

Mary Halloran
Director, Division of Policy
Office of the Governor

Executive Summary

- The immediate revenue loss from the current ELF is about 8 percent of Alaska's oil revenues, or about \$150 million this year. This percentage loss will increase over the next six years to about 14 percent and will erode Alaska's fiscal strength.
- The 1987 application of the ELF to Prudhoe Bay was adopted within 72 hours in the closing days of the 1981 legislative session. Legislators and the Governor were assured the tax changes were revenue neutral — incorrectly as it turned out. In fact, the revenue loss has been over \$1 billion from FY82-FY87.
- Neither the Railbelt Energy Fund nor the Permanent Fund earnings reserve provides a long-term response to the on-going loss of 8 percent to 14 percent of Alaska's oil revenues and the erosion of Alaska's fiscal strength. The new ELF does.
- Prudhoe Bay and Kuparuk are extraordinarily profitable oil fields. Industry journals indicate oil companies make \$6.2 million per day in profits from North Slope operations. Currently, the oil industry is taking \$8 Outside for every \$2 it reinvests in Alaska. Without their Alaska holdings, neither ARCO nor Standard would be as strongly positioned against their industry competitors as they are today.

- The oil industry has one of the poorest resident hire records in the state, with major drilling, exploration and service companies employing about 28 percent non-residents.
- The written record of the 1981 legislative deliberations on oil taxes provides no evidence of any legal, moral, or political commitment by state officials regarding any limit on the state's appropriate share of future oil income. In fact, the legislature and the governor explicitly recognized that today's legislature would have to grapple with the revenue problems caused by the reimposition of the ELF.
- At Prudhoe Bay, at a profit of \$3 per barrel, wells that average over 2,000 barrels per day — more than 100 times greater than the national average of 14 barrels per day — are receiving the benefit of an ELF reduction designed for fields whose economics are marginal.
- The new ELF's consideration of total field productivity, as well as per-well productivity, provides a better incentive for marginal field development than the current ELF and better reflects field profitability.
- By adding total field productivity to the ELF calculation, most Alaska fields will receive a larger tax break under the new ELF than under the current ELF. Only the two giant fields, Prudhoe Bay and Kuparuk, will not receive increased tax breaks. Fields with Alaska corporation ownership, such as Endicott, will benefit more under the new ELF than the current ELF.

- The current ELF provides a substantial state subsidy to oil company drilling operations in the nation's two largest and very profitable oil fields by lowering the effective tax rate on an entire field every time a below-average producing additional well is brought on line.

Introduction

The major issue in the current debate over the ELF (economic limit factor) is whether this tax reduction to the oil industry makes sense for Alaska at this time. Among the different perspectives against which Alaskans judge the issue are the ELF's effects on the rate of oil development and jobs, and its impact on state revenue, budget stability and the economy. The purpose of this paper is to fill in as much as possible of the factual background. The following issues are therefore addressed in detail:

(1) ELF AND OIL DEVELOPMENT: Does the current ELF tax subsidy work to increase marginal field development? Are Prudhoe Bay and Kuparuk marginal fields? Do ARCO, Standard and Exxon, the major North Slope producers, need a substantial tax break now to continue production from Prudhoe Bay and Kuparuk? How does Alaska's tax structure compare with that of other states?

(2) ELF AND ALASKA'S ECONOMY: How much does the current ELF contribute to industry drilling activity? What will be the effect of the new ELF on drilling activity? Are oil company development dollars spent in Alaska or Outside? How many jobs does ELF create? Who gets those jobs?

(3) ELF AND ALASKA'S REVENUES: What is the difference in revenues between the current ELF and the new ELF? How does ELF affect revenue stability? What is the long-term impact of ELF on the state's fiscal strength? What roles do revenue stability and a balanced budget play in creating a stable Alaska economy?

(4) ELF AND THE PAST: What happened in 1981? Why was the ELF suspended for Prudhoe Bay? What were the commitments?

Background

The roots of the current tax debate go back to the early days of North Slope oil production. In 1979 several major oil companies sued the state, arguing that the separate accounting form of corporate income tax adopted by Alaska in 1978 was unconstitutional. The state won that lawsuit in 1986, but in 1981, in an attempt to limit the fiscal effects of possibly losing the case, the legislature changed the method for assessing oil and gas corporate income tax from separate accounting to modified apportionment.² That legislation also dealt with the ELF.

The 1981 tax package gave Alaska's oil producers a big reduction in their corporate income taxes, but legislators were assured by then-Revenue

² To tax corporate income, separate accounting focuses on the income a corporation actually produces in the taxing jurisdiction. In contrast, the apportionment formula looks at all the income produced worldwide by the corporation and attempts to attribute a portion of that income to the taxing jurisdiction. Alaska now uses a modified version of the standard apportionment method in assessing corporate tax liability.

Commissioner Tom Williams — incorrectly as it turned out — that most of the state revenue lost from the income tax would be offset by gains from a severance tax increase adopted at the same time. The bill also suspended the applicability of the ELF to Prudhoe Bay "for the first ten years following the commencement of commercial production."

The tenth anniversary came in June of 1987, triggering reinstatement of the ELF to Prudhoe Bay. Since the ELF is a formula that reduces severance tax rates, it gave the oil companies a tax cut in addition to the net tax reduction they won in 1981. The 1987 cut was substantial — worth over \$15,000 per hour to the Prudhoe Bay producers or about 8% of Alaska's revenues from oil operations.

The ELF Formula: Well Productivity & Field Productivity

The ELF bill, CSHB 164 (Fin) am, substitutes a new formula for calculating the "economic limit" — the point at which production is no longer profitable. The new formula will reduce the tax reduction provided to Prudhoe Bay and Kuparuk, and increase the tax reduction afforded to smaller fields, such as Endicott, Lisburne or Milne Point.

The ELF is a number between one and zero that is multiplied by the nominal tax rate, producing the effective tax rate. The nominal severance tax rate at Prudhoe Bay is 15 percent. With the average FY 88 Prudhoe Bay ELF at .82, the field's effective tax rate is 12.3 percent ($.15 \times .82 = .123$).

The current ELF is determined by *per-well productivity* in the field, measured by the number of barrels produced by an average well in an

average day. If well productivity is high, the ELF is relatively close to 1 (.9 for example), and the field gets a small tax reduction. Fields with low per-well productivity have a smaller ELF (.5 for example), and get a larger tax break. Most fields in Cook Inlet are currently paying no severance tax because their very low per-well production gives them an ELF of zero.

(Zero times the nominal tax rate gives an effective tax rate of 0.0 percent.)

In Cook Inlet, the current ELF works properly, encouraging production of marginal fields.

But the super-giant Prudhoe Bay field³ is a different story. At Prudhoe Bay, wells that average over 2,000 barrels per day — more than 14 times greater than the Texas average and more than 100 times greater than the national average — are receiving the benefit of an ELF reduction designed for fields whose economics are marginal.

This inappropriate ELF break results from the fact that the current ELF takes account only of productivity *per well* and not overall *field* productivity. By giving a profitable field a larger tax break than a marginal field, the current ELF distorts the purpose of this tax subsidy.

Consider, for example, the case of Milne Point, a small field near Prudhoe Bay. Soon after the Milne Point field opened in late 1985, revenue officials, state economists and the management team at Conoco, the oil company operating the Milne Point field, discovered that per-well productivity, if used by itself, can be an inadequate measure of a field's ability to pay severance tax.

³ Production from Prudhoe Bay, the largest field in the United States, is five times that of the nation's second largest field (Kuparuk). Industry publications consistently refer to Prudhoe Bay as "super-giant."

The average well in the Milne Point field initially produced 950 barrels per day, giving it an ELF very nearly the same as the Kuparuk field, where the average well produced 1,000 barrels per day. Total Kuparuk production was then 250,000 barrels per day, while Milne Point produced less than one-tenth of that amount.

But due to its smaller size, operators at Milne Point had far fewer barrels of production over which to spread operating costs than the Kuparuk field. Although the two fields had almost identical per-well productivity, the smaller Milne Point field was less profitable, and in January 1987 the owners elected to shut down production. This experience illustrates the deficiency of an ELF formula based solely on per-well productivity.⁴

The new formula incorporated in the ELF bill will correct this perverse and unintended effect *by adding total field productivity to the ELF calculation*. Fields producing less than 120,000 barrels per day, such as Milne Point and Endicott, will have a lower ELF (bigger tax break) than under current law, while fields producing more than that amount will have a higher ELF (smaller tax break). This change will affect estimated FY 89 severance tax rates as follows:

⁴ Under provisions of the current severance tax law, Milne Point producers requested and received additional tax reductions after showing that the field would be uneconomic to operate without the reductions. The administrative uncertainties of this avenue would be eliminated for smaller fields by the automatic reduction provided by the new ELF. Large fields facing similar problems could still apply for and receive the special "hardship" reductions.

EFFECTIVE FY 89 SEVERANCE RATES

	<u>Existing Law</u>	<u>New ELF</u>	<u>Percent Change</u>
Prudhoe Bay	11.9 %	14.8 %	23 %
Kuparuk River	6.9 %	11.3 %	65 %
Endicott	12.3 %	8.9 %	-27 %
Lisburne	6.8 %	3.6 %	-47 %
Cook Inlet Fields	0.0 %	0.0 %	0 %

That this approach benefits producers in smaller fields is reflected in the March, 1987 testimony of Conoco supporting the new ELF: "This legislation is a positive first step in encouraging the development of marginal fields in Alaska."⁵

ELF Subsidy Effect

In the summer of 1987 oil producers increased the rate at which they were drilling additional wells at Prudhoe Bay and Kuparuk. Since total North Slope production is limited by pipeline capacity to just over 2 million barrels per day, more producing wells means that average production per well is being reduced. Lower per-well production, in turn, means a bigger tax break for producers under the current ELF.

⁵ Tom Painter, Conoco Anchorage Division Manager, Transcript of Joint House Finance and House Resources Committees Hearing on House Bill 164, March 19, 1987, pp. 49-54.

Because the drilling increase started about the same time as ELF's application to Prudhoe Bay, state officials investigated the possibility of a cause-and-effect relationship between the two. The ELF's role could not be precisely determined. At the same time, because of the current ELF's sensitivity to per-well productivity changes, the investigation found that the current ELF provides a substantial — and unintended — state subsidy to oil company drilling operations in the nation's two largest and very profitable oil fields.

An example of how this subsidy works was provided by ARCO official James Weeks, during 1987 testimony before the House Finance Committee.⁶ Weeks' example showed how a new Kuparuk well, so long as it produced below the Kuparuk per-well average, would result in a lower severance tax payment on the now-higher total Kuparuk production than the severance tax would have been on the lower total Kuparuk production without the well. In Weeks' example, the result was an overall tax savings or subsidy to the producer of \$37,846 yearly from drilling that single additional well.

Weeks' example showed that the per-well emphasis of the current ELF formula will cause the effective tax rate on an entire field to drop when a below-average producing well is brought on line. Despite the increase in total production, the state will receive less tax revenue than if the well and its production had never occurred. This would be a perverse effect even in a marginal field.

Because this subsidy takes the form of a tax reduction rather than a payment from the state's treasury, the subsidy is restricted to fields paying

⁶ A copy of the ARCO handout and the state's analysis of it are in Appendix D.

severance tax. In short, the subsidy is not available to fields like Cook Inlet, where no severance tax is currently paid.

While Weeks' example was restricted to one hypothetical new well at Kuparuk, and may or may not reflect what is currently happening at Kuparuk or Prudhoe Bay, recent econometric modeling studies by the Department of Revenue estimate the Prudhoe Bay drilling subsidy in the range of \$19 million in FY 88, and about \$40 million in FY 89. The model indicates that a tax break that would have totalled about \$240 million during FY88-89 has been increased to approximately \$300 million by the additional drilling.

Not only is this subsidy going to be costly to Alaska, it is an extraordinarily inefficient way to create jobs or additional oil production.⁷ The overall effect of this subsidy may be that, by accelerating drilling that would have occurred later anyway, it robs jobs and economic stability from the future for the sake of higher production and profits in the short term.

ELF and Jobs

Alaskans are concerned about the effects a change in the ELF may have on jobs. Oil industry proponents have said that the recent increase in drilling has created 2,400 new jobs — 800 drilling jobs and 1,600 additional jobs. They implied that those jobs would be lost if the proposed new ELF is adopted.

⁷ A March 1988 analysis by the Dept. of Revenue implies that each barrel gained through the subsidy through the year 2000 costs the state \$175 in foregone revenue.

The figure of 2,400 new jobs (or even 800) bears no resemblance to the reality reflected in Department of Labor employment figures taken from employer records. Total oil and gas employment on the North Slope during the fourth quarter of 1987 was 3,994 jobs, down by 122 jobs from a year earlier. Drilling employment at the end of 1987 was actually about 50 jobs less than at the end of 1986. Some modest employment increase may occur this spring, but nothing on the scale of 800 new jobs is conceivable, given that 1987 year-end North Slope drilling employment was only around 500 with 12 rigs operating.⁸ The Department of Natural Resources estimates the rig count will climb to 14 on the North Slope this spring. The resulting rise in employment might be 80 to 100. Each rig employs an estimated 40 to 50 workers, depending on the type of drilling.

In total, the oil industry generates about 8,500 jobs in Alaska, about 4 percent of Alaska's work force — and only about 6 percent of the entire private sector work force. Unfortunately, many of those employed by the oil industry are not Alaska residents.

The drilling companies now operating on the North Slope employ about 28 percent non-Alaskans. The hiring record of the major drilling firms ranges from 57 percent non-residents to 15.4 percent non-residents. The hiring of non-residents by other oil industry segments (exploration and services) also runs about 28 percent , with the exception of the production/management sector, which has trimmed its non-Alaskan hiring to about 11 percent.⁹ These statistics make for one of the poorest resident hire

⁸ Statewide oil industry employment, however, was up by about 200 jobs over this period. For more detail on recent employment trends, see Alaska Economic Trends, Alaska Department of Labor, October 1987.

⁹ The Department of Labor developed the statistics by cross-checking employment records with Permanent Fund dividend records.

records in the state, according to the Department of Labor.

Industry-wide, these non-Alaskans have total earnings of about \$80 million, which is the highest amount of wages paid by any industry to non-residents. Much of this non-resident income, of course, does not circulate in or benefit the Alaska economy.

As oil fields mature, labor required to produce a given amount of oil tends to increase. Over the long run, oil and gas employment is likely to increase in Alaska due to these technical factors, regardless of the state's action on the ELF bill. A huge tax increase might discourage additional field development, but economic studies by the state and others indicate that the economic effects of the ELF change will be marginal.¹⁰ Also, correcting the misapplication of the current ELF to Prudhoe Bay and Kuparuk, while improving incentives for smaller fields, is not likely to adversely affect future field developments. From an Alaskan perspective, given the record of the oil industry to date, a real concern will continue to be whether the jobs generated by additional oil development will be filled by residents or non-residents.

¹⁰ "[T]he economic limit factor in Alaska's severance tax...has limited ability and high revenue cost for conserving oil and gas from producing fields," according to University of Alaska researchers led by Mathew Berman in Alaska Petroleum Revenues: The Influence of Federal Policy. Institute of Social and Economic Research, October 1984, pp. xxvii. See also, "Severance Tax Impact Often Misinterpreted," by John Lohrenz, in Oil and Gas Journal, June 18, 1984, pp. 133-137; "Analysis of ELF Alternatives," by Charles Logsdon, Alaska Dept. of Revenue, October 14, 1986; and "A Model to Assess Economic Feasibility and Optimum Production Volume for North Slope Fields," by R. Marks and J. W. Moore (both with the Alaska Dept. of Revenue) in Journal of Petroleum Technology, August 1987, pp. 943-54.

Profitability

Does the oil industry in Alaska need a tax break now to continue production at Prudhoe Bay and Kuparuk? This question is at the heart of the current oil tax discussions.

Companies with major oil interests in Alaska are all publicly traded on the stock market. Alaska industry operations have attracted the interest of numerous trade publications, investment advisory services, and occasionally academic and government researchers. All the studies indicate that Prudhoe Bay and Kuparuk are extraordinarily profitable oil fields.¹¹

According to a recent study, published February 1, 1988, in *Petroleum Intelligence Weekly (PIW)*, a respected trade journal, oil companies are currently making after-tax profits of \$6.2 million per day from North Slope operations. State and local revenue from North Slope oil, by comparison, is estimated by *PIW* at \$4.7 million per day. (The *PIW* article and the state's analysis of the *PIW* figures are found in Appendix B.)

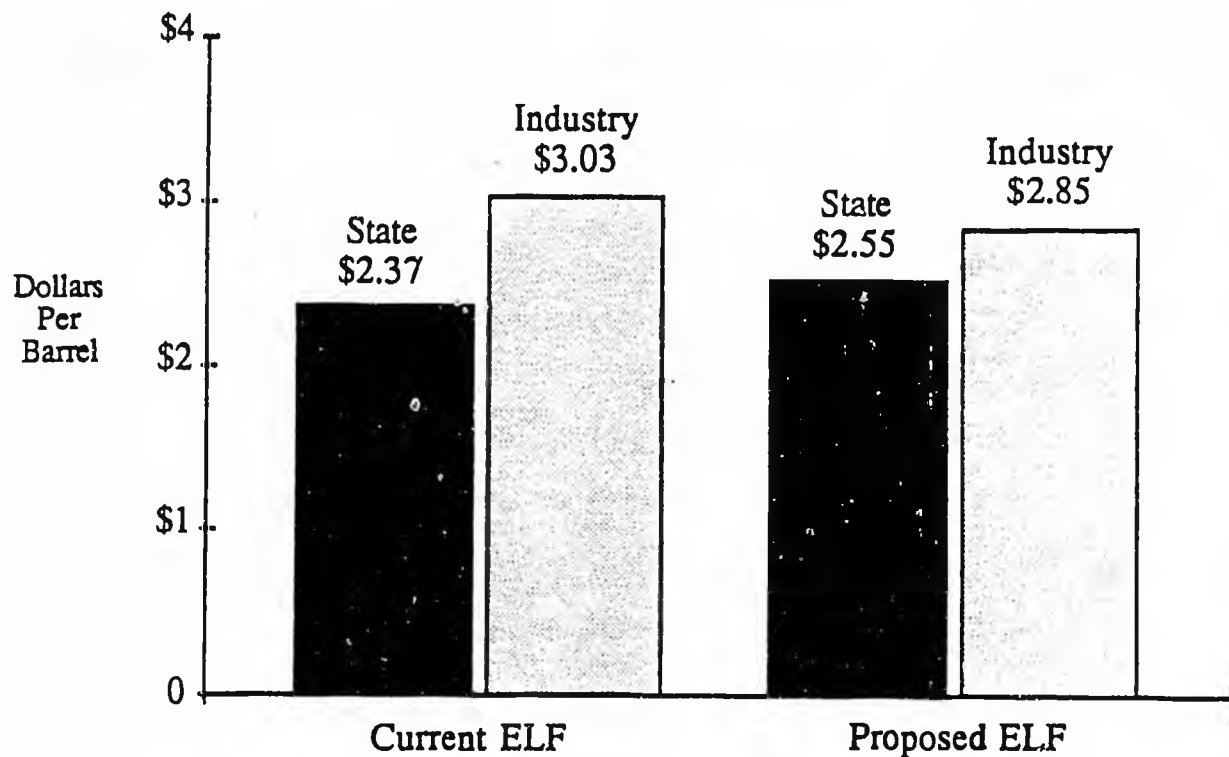
Under the new ELF, oil companies' profits would continue to be larger than state revenue, though not by as big a margin. Industry profits would decline to \$5.6 million daily, after all expenses, taxes and royalties are paid. As Figure 1 shows, the ELF will have only a small impact on the relative shares of revenue going to the state and the producers.

¹¹ In addition to the *PIW* analysis described below, the following studies have been released in 1988: "Alaska's Oil Promise Remains Strong," in *International Petroleum Finance*, March 18, 1988, p. 8; "Alaskan Resource Wealth -- The Inestimable Bounty" in *Atlantic Richfield Company -- Restructured and Resourceful, Part II*, by Salomon Brothers (Bernard Picchi, author), March 31, 1988, p. 3-4; "\$30 a Barrel Profits in an \$18 World," in *Forbes*, March 21, 1988, pp. 110-114; and "Income and Investment Flows From Alaska Oil and Gas Producing Activities," by Edward Deakin, in *Joint Special Committee on Tax Policy, Final Report*, Alaska State Legislature, January 1988.

Figure 1

State and Industry Shares

(Dollars Per Barrel)



Shares under current ELF are from *Petroleum Intelligence Weekly* Feb. 1, 1988; shares under the proposed ELF are by the Division of Policy, April 11, 1987.

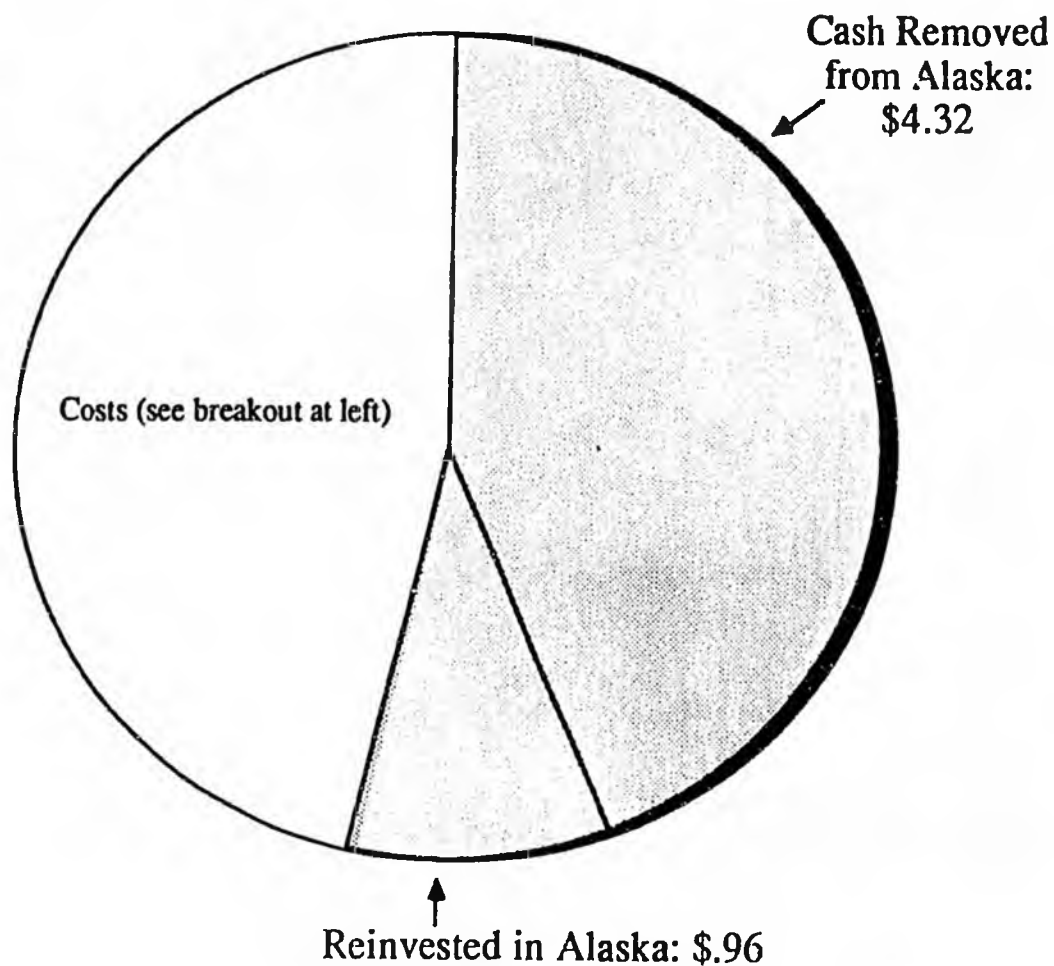
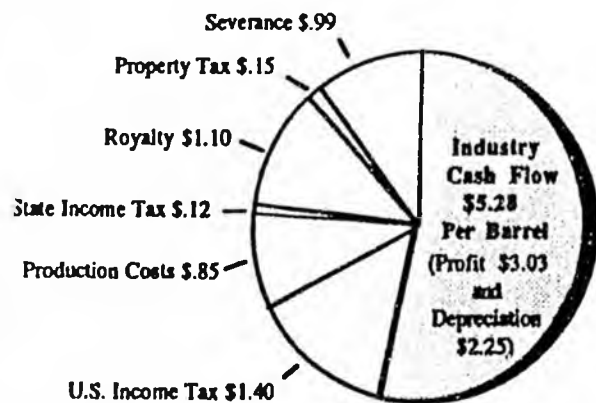
Data on the cash flowing to and from North Slope operations suggest that since 1978 in Alaska, only a fraction of the funds generated by North Slope oil have been reinvested in Alaska. According to the *PIW* figures, the companies' current cash flow (profits and depreciation) from the North Slope comes to \$10.6 million per day.¹² The Division of Policy estimates that the rate of oil industry reinvestment in Alaska is \$1.9 million per day. Thus, as shown in Figure 2, the oil industry today is taking \$8 Outside for every \$2 it reinvests in Alaska.

This "takeout" from Alaska's North Slope production has made the major producers in Alaska uniquely successful companies. A March 21,

¹² The *PIW* figures do not include depreciation on the pipeline, so the cash flow to producers from North Slope operations is understated.

The Economics of North Slope Oil

(Dollars Per Barrel)



Source: Division of Policy, based on *Petroleum Intelligence Weekly* February 1, 1988.

Office of the Governor
Division of Policy
4/12/88

1988 *Forbes* article examined ARCO's phenomenal success: "...a return on equity of 23 percent, just about the best in the industry and roughly twice the industry average." Astute corporate management, company restructuring, and its Alaska resources let ARCO "claim the highest per-barrel profit of any marketer on the West Coast." Key to ARCO's current strength, said *Forbes*, "is its commanding position in the U.S. largest oil reserve, the Alaskan North Slope, from which it derived 68 percent of its production last year." With \$3 billion in cash reserves, ARCO is actively investing its Alaskan profits elsewhere.

A report by Salomon Brothers, March 31, 1988, similarly calls ARCO "the premier equity investment in the domestic oil industry." The report goes on to say, "Arco's Alaskan resource base is without parallel in the industry in terms of its size alone. Arco's net share of the original oil in place in its Alaskan oil fields, 20 billion barrels, is equal to 75 percent of the proved oil reserves of the rest of the country." Top ARCO management also cited its Alaska holdings as key to the company's profitability: "ARCO Alaska's low-cost producing ability provides the base for ARCO's West Coast downstream infrastructure: its integrated transportation and refining and marketing assets." ¹³

Production

Oil development patterns are not easily predictable so forecasts of future production should be interpreted cautiously. Department of Revenue modeling studies nevertheless suggest that while the new ELF

¹³ "Alaska Operations," Harold Heinze, President, ARCO Alaska, Inc., Oil Industry Analysts Meeting, March 31, 1987.

could initially cause lower production, any impact would be small. The probabilities are that the new ELF will decrease North Slope output by a cumulative 1 million barrels during the FY 1988-93 period — equal to about 12 hours of flow through the TAPS pipeline. The cumulative production loss through 2005 is estimated at about 21 million barrels, or about 10 days of North Slope production. Losses taper off in later years but become gains sometime after 2020, when the new ELF increases incentives for production in the later stages of oil field life.

The ELF is a minor factor in industry decisions to pursue Prudhoe Bay development. What matters most is oil prices. For example, a spokesperson for ARCO, commenting on that company's plans to drill five Prudhoe Bay development wells in September, 1987, stated, "resuming production drilling in Prudhoe is good news and strictly the result of higher oil prices."¹⁴ A March 31, 1988, stock research report notes, "West Sak field production could start in 1992, because the field is profitable at oil prices of \$15-20 per barrel."¹⁵

How does increased production benefit Alaska? Nearly all manufacturing and assembly of equipment used in the oil industry is done outside Alaska so economic impacts from that sector are small, according to Department of Labor economists. The ARCO newsletter of January 1, 1988, states, "Between 1980 and 1986, North Slope development accounted for approximately \$10.5 billion in hard goods alone, according to ARCO Alaska, Inc., Standard Alaska Production Company and Conoco." The newsletter indicates one-eighth of that amount (\$1.35 billion) was spent in

¹⁴ Alaska Report, p. 1, 7/22/87.

¹⁵ Atlantic Richfield Company---Restructured and Resourceful, Part II, by Salomon Brothers, March 31, 1988, p 1.

Alaska, with the remainder going Outside, with Texas and California the largest beneficiaries.¹⁶ Employment opportunities, however limited, and revenues to the state, are the most readily discernible benefits to Alaska.

Comparing Taxes

Though the existing tax at Prudhoe Bay is 12.3 percent, the *nominal* rate at Prudhoe Bay, without the ELF, is 15 percent. But no field in Alaska pays the full tax rate. Furthermore, the severance tax rate contrasts with the low corporate income tax rate.¹⁷

Each state designs its severance tax structure for its particular conditions in that jurisdiction. The range of profitability among fields in Alaska is very different from any other state. In none of the other states is there an oil field even close to the size of Prudhoe Bay. But because the fields in other states are much nearer to oil markets, the wellhead price of a barrel is much lower in Alaska. Unlike other states, Alaska gains little

¹⁶ On Top of ANWR, ARCO Alaska, Inc., January 1, 1988.

¹⁷ Here is how Alaska's effective severance tax rate compares to other major oil-producing states on a percentage basis:

<u>State</u>	<u>Severance Tax as a Percent of Value</u>
Alaska (<i>Prudhoe proposed</i>)	14.8 %
Wyoming (state & average local)	13.0 %
Louisiana	12.5 %
Alaska (<i>Prudhoe existing</i>)	12.3 %
Alaska (<i>Kuparuk proposed</i>)	11.9 %
Alaska (<i>Kuparuk existing</i>)	8.0 %
Oklahoma	7.0 %
Texas	4.6 %
New Mexico	3.8 %

This chart is based on average effective severance tax rates in FY 1988. Under current law the Prudhoe Bay rate will decline to 11.9 percent in FY 1989.

from the manufacturing and retail sales of most of its petroleum resources — although the producers realize additional profits from transporting, refining, and selling North Slope oil. Differences like these make simplistic comparisons regarding which state has the "highest" or "lowest" severance tax of limited use.

On a dollars-per-barrel basis, for example, Alaska's tax rate is among the lowest of all the producing states.¹⁸ If the oil fields in these states were somehow transported to Alaska, all would find their severance taxes reduced or eliminated. The reason for this apparent paradox is that all are so much smaller than Prudhoe Bay or Kuparuk. Prudhoe Bay wells, according to Standard Alaska, are producing an average 2,300 barrels per day. The average oil well in Texas, in contrast, produces 145 barrels per day. A well producing at that rate in Alaska, like most oil wells in Cook Inlet, would pay no severance tax whatever under either the existing or proposed ELF. Similarly, virtually all the fields Outside that would pay tax under the current ELF would pay less tax under the new ELF.

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<u>State</u>	<u>Approximate Severance Tax Per Barrel</u>
Wyoming (state & average local)	\$2.02
Louisiana	\$1.94
Alaska (Prudhoe proposed)	\$1.26
Oklahoma	\$1.08
Alaska (Prudhoe existing)	\$1.05
Alaska (Kuparuk proposed)	\$1.04
Texas	\$0.71
Alaska (Kuparuk existing)	\$0.62
Alaska (Cook Inlet)	\$0.00

Estimates for other states are derived from the effective tax rates of other states at a well-head price of \$15.50 (Gulf Coast).

The "Commitment"

The ELF issue in 1988 is the legacy of a 1981 tax bill that passed in an extraordinary hurry. The issue of how to respond to the North Slope oil producers' legal challenge to separate accounting was the focus of attention for much of the 1981 legislative session. However, the proposal that modified the ELF was first unveiled to a free conference committee on June 22, 1981. Two days later, it passed both houses and was on its way to the governor. There was little time to study the bill; moreover, the fiscal note prepared by then-Commissioner Williams included no projections beyond FY 1985. The confusion concerning what legislators and Governor Hammond meant when they adopted the 1981 legislation is not surprising.

A 1981 post-session analysis by the Legislative Finance Division showed that the ELF provision would cause state revenue to fall sharply in FY 1988. When Governor Hammond reluctantly signed the bill, he expressed "full confidence in the ability of the legislature to deal at that time" with any adverse revenue consequences.

Governor Hammond insisted that the oil tax changes adopted in 1981 not reduce the state's share below the 30 percent that was thought to be the rough percentage level of the state's share *at that time*. Hammond sought to insure that the tax changes would be "revenue neutral;" i.e., that the changes would leave state oil revenue largely unaffected. It is now clear that the changes adopted in that bill were far from neutral as to state revenue: between fiscal 1982-87 total tax collections were reduced by over \$1 billion compared with what would have been collected had the changes not been made.

As shown in Appendix C, the 1981 record contains statements by Hammond, then-Rep. Rick Halford, Commissioner Williams and others addressing the future need to revise the 1981 scheme by 1987 or 1988. But the written record of the 1981 deliberations provides no evidence of any legal, moral, or political commitment by state officials to limit the state's appropriate share of future oil income. Additionally, company officials testified to the Legislature that the state's share should equal the industry share.

Revenue Effects

As originally introduced by the Governor in 1987, the ELF legislation would have kept the ELF from applying to Prudhoe Bay for an additional five years. The measure that passed the House and now awaits action in the Senate takes a more comprehensive approach: the new ELF applies at Prudhoe Bay, but the formula for calculating the new ELF includes consideration of field productivity in addition to well productivity. The new formula gives Prudhoe Bay a much smaller tax break now, but a larger tax break later when the giant field finally reaches its marginal years of production. Tax revenue from nearby Kuparuk, the second largest producing field in the United States, would also increase. All other producing fields would either pay no tax at all or receive a bigger tax break than they get under the current ELF.

The net effect of the new ELF, using the Department of Revenue's March, 1988 "mid-case" assumptions, would be \$150 million in additional state revenue in FY 1988, and \$152 million in FY 1989. To put this amount

in perspective, \$150 million is about the amount of the combined annual general fund budgets of the departments of Fish and Game, Labor, Commerce, Natural Resources, Revenue and Environmental Conservation, and about one-quarter of the amount the state spends each year on elementary and secondary education. As the table below shows, the revenue gain from the new ELF depends, in part, on the level of oil prices.¹⁹

<u>Average Oil Prices</u> ²⁰	<u>Incremental FY 89 Revenue From the ELF Bill, CSHB 164 (Fin) am</u>
\$11.00/B	\$114 million
\$12.00/B	\$125 million
\$13.00/B	\$136 million
\$14.00/B	\$146 million
\$15.00/B	\$157 million
\$16.00/B	\$167 million

According to Department of Revenue projections, the dollar gain from the new formula would peak in FY 91 at \$223 million, and then gradually diminish as Prudhoe Bay production declines. The yearly dollar gain from the new ELF will vary with oil prices and total oil production. Over the next six years, the percentage loss to the state's oil revenue from

¹⁹ Other factors would also affect the fiscal effect of the proposed legislation. The table is based on the "mid-case" assumptions in the current Department of Revenue forecast.

²⁰ Weighted average of U.S. West Coast and Gulf Coast selling prices for Alaska North Slope crude.

the current ELF will increase from approximately 8 percent this year to nearly 14 percent in fiscal year 1993. (Complete long-run projections are contained in the ELF legislation fiscal note, in Appendix A .)

Budget Stability and the Economy

In opposing the ELF legislation, one senator argues that "the solution to Alaska's economic problems is not increasing taxes to fuel more government spending," but instead to just cut state spending.

How big a cut would be required to balance the budget? With only weeks to go in the legislative session, Alaska faces a revenue shortfall of about \$150 million to \$400 million, depending on the optimism of the forecaster. Theoretically, the budget could be balanced by cutting hundreds of millions of dollars from spending, but this approach is hard to take seriously in light of the vital impact of state spending on a recovering economy. In fact, the legislature has already recognized the role of state spending in the economy's health in its early passage of the "jobs" bill.

Budget cuts over the last three years have brought per capita real spending down — dramatically. The deepest recession the state has ever experienced was one consequence. Now — as that recession is ending — is not the time for extracting hundreds of millions of dollars from Alaska's economy.

With state spending now well below its 1979 level and the economy starting its recovery, Governor Cowper has proposed a maintenance level budget. The House and Senate can reduce the budget shortfall by eliminating proposed expenditures. But, close to half the budget is pass-

through entitlement programs to local governments, schools, and individuals, politically difficult areas to cut. It appears the majority of Senators and Representatives do not believe this is the time for inflicting the stress of another multi-million dollar spending cut on the Alaska economy. Although reductions and reallocations will certainly occur, deep cuts are not a realistic possibility.

So what options are left? The use of the Railbelt Energy Fund has been proposed. But many Railbelt voters rebel against "their" money being spent to solve a statewide problem, and the construction industry opposes any non-construction use of the money.

Another option is to use the cash reserves (earnings reserve account) of the Permanent Fund. Using the reserves would reduce future dividends. However, the necessary appropriation could be a "loan" with a promised but problematical payback in the future. Combined, the Railbelt Energy Fund and the Permanent Fund earnings reserves are the state's cash reserves since last year the Budget Reserve Fund was emptied to help meet last year's revenue shortfall. Without these funds as backstops, Alaska is left with no emergency monies to meet another precipitous drop in oil prices.

Leaving aside the obvious difficulties inherent in the use of either the Railbelt Energy Fund or Permanent Fund earnings to fill the budget shortfall this year, there remains the issue of revenue stability. This issue deserves very serious consideration for two reasons. First, Alaskans desire and need public services. Second, there clearly exists a now-demonstrated tie between Alaska's revenue stability and Alaska's economic stability.²¹

²¹ For evidence of the relationship of state budget stability to economic activity in Alaska, see "Can State Spending Speed Alaska's Recovery," by Professor Scott Goldsmith and Lee Gorsuch, Institute of Social and Economic Research, University of Alaska, December 8, 1987.

Both reserve sources are only stop-gap measures, providing one or two years of fiscal relief, at most. Neither fund provides an answer to the ongoing loss of more than 8 percent of Alaska's oil revenues and the erosion of Alaska's fiscal strength year after year. The new ELF does. It's a long-term solution to what will otherwise be a long-term loss.

Finally, the legislature simply could pretend that there is no problem. Led by the Senate, the legislature gambled last year that oil price increases would cover the shortfall in the budget with extra revenue. It worked then, due in part to the unexpected receipt of some monies owed the state by the federal government.²² The legislature could roll the dice again. The risk is that the extra revenue will not materialize and that the state will be unable to pay its bills. If oil prices don't rise, current cash flow projections show that the risk could become reality as early as February or March 1989.

Division of Policy

April, 1988

²² The funds received were \$160 million which had been held in escrow by the federal government pending resolution of the Dinkum Sands boundary dispute.

Appendix A

STATE OF ALASKA
1988 LEGISLATIVE SESSION

BILL VERSION: CSHB164 (fin) am
PUBLISH DATE: _____

FISCAL NOTE

REQUEST:

Revision Date: April 4, 1988
Title: An Act Relating to the Oil and Gas Properties Production Tax & Effective Date
Sponsor: Rules/Governor
Requestor: _____

Agency Affected: _____
BRU: _____
Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING						
CAPITAL						
REVENUE	150,150	152,330	203,450	222,850	213,940	207,490

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

See Attached

Prepared by: Charles L. Logsdon
Division: Oil and Gas Audit

Phone: 277-5627
Date: April 4, 1988

Approved by Commissioner: [Signature]
Agency: Revenue

Date: 4/4/1988

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

This bill would effectively increase the severance tax rate on fields producing greater than approximately 120,000 barrels per day. At the same time, fields producing less than this amount would be taxed at a lower rate. The relative increase or decrease would depend on the relative per well productivity of the field. The estimates contained in this fiscal note are based on the Department of Revenue March 1988 mid scenario assumptions about production, wells, and oil prices.

The attached tables illustrate the revenue and tax rate impact of the bill by North Slope oil field. The sensitivity of the tax revenues to change in oil prices is also illustrated.

FY 1989 PRICE/REVENUE SENSITIVITY OF CSHB164(fin) am
(Millions \$)

	\$16.00/bbl	11.00	12.00	13.00	14.00	15.00	16.00	17.00
Prudhoe	93.16	102.47	111.79	121.10	130.42	139.73	149.05	158.36
Kuparuk	21.54	23.69	25.84	28.00	30.15	32.30	34.46	36.61
Milne	0	0	0	0	0	0	0	0
Endicott	-6.49	-7.14	-7.79	-8.43	-9.08	-9.73	-10.38	-11.03
Lisburne	-3.72	-4.10	-4.47	-4.84	-5.21	-5.59	-5.96	-6.33
TOTAL	104.48	114.93	125.37	135.82	146.27	156.72	167.17	177.61

CHANGE IN REVENUE CSHB164
(Millions \$)

YEAR	PRUDHOE	KUPARUK	MILNE	ENDI	LISB	W SAK	PT THOM	SEAL IS	NIAKUK	TOTAL
1988	130.03	30.30	0.00	-4.27	-5.93	0.00	0.00	0.00	0.00	150.15
1989	125.82	31.40	0.00	-9.46	-5.43	0.00	0.00	0.00	0.00	152.33
1990	172.12	39.56	0.00	-2.04	-5.19	0.00	0.00	0.00	0.00	203.45
1991	150.27	40.37	0.00	-2.25	-5.53	0.00	0.00	0.00	0.00	222.85
1992	182.74	39.51	0.00	-2.40	-7.01	0.00	0.00	0.00	0.00	213.94
1993	180.62	38.38	0.00	-5.24	-6.27	0.00	0.00	0.00	0.00	207.49
1994	176.59	35.55	0.00	-5.65	-5.74	0.00	0.00	0.00	0.00	199.74
1995	171.39	30.60	0.00	-7.41	-7.18	0.00	0.00	0.00	0.00	187.40
1996	162.93	22.19	0.00	-7.50	-7.83	0.00	0.00	0.00	0.00	169.69
1997	164.10	14.09	0.00	-7.22	-8.17	0.00	0.00	0.00	0.00	162.70
1998	157.08	6.98	0.00	-5.84	-8.44	0.00	0.00	0.00	0.00	148.78
1999	144.16	2.76	0.00	-4.22	-8.30	0.00	0.00	0.00	0.00	134.33
2000	137.86	1.22	0.00	-2.29	-8.44	0.00	0.00	0.00	0.00	129.25
2001	127.38	0.46	0.00	-0.61	-9.22	0.00	0.00	0.00	0.00	117.94
2002	118.80	0.08	0.00	0.00	-9.79	0.00	0.00	0.00	0.00	109.09
2003	122.08	0.06	0.00	0.00	-9.43	0.00	0.00	0.00	0.00	112.71
2004	116.55	0.04	0.00	0.00	-9.28	0.00	0.00	0.00	0.00	107.32
2005	103.90	0.03	0.00	0.00	-8.50	0.00	0.00	0.00	0.00	95.03
2006	91.47	0.00	0.00	0.00	-9.26	0.00	0.00	0.00	0.00	82.11
2007	80.13	0.00	0.00	0.00	-7.52	0.00	0.00	0.00	0.00	72.67
2008	69.43	0.00	0.00	0.00	-5.12	0.00	0.00	0.00	0.00	62.31
2009	61.76	0.00	0.00	0.00	-4.73	0.00	0.00	0.00	0.00	57.03
2010	55.85	0.00	0.00	0.00	-2.28	0.00	0.00	0.00	0.00	52.48

CHANGE IN SEVERANCE TAX RATE PERCENT OF VALUE CSHB164

YEAR	PRUDHOE	KUPARUK	MILNE	ENDI	LISB	W SAK	PT THOM	SEAL IS	NIAKUK
1988	0.0249	0.0391	0.0000	-0.0259	-0.0382	0.0000	0.0000	0.0000	0.0000
1989	0.0281	0.0448	0.0000	-0.0322	-0.0321	0.0000	0.0000	0.0000	0.0000
1990	0.0323	0.0481	0.0000	-0.0340	-0.0324	0.0000	0.0000	0.0000	0.0000
1991	0.0373	0.0513	0.0000	-0.0223	-0.0291	0.0000	0.0000	0.0000	0.0000
1992	0.0394	0.0539	0.0000	-0.0023	-0.0277	0.0000	0.0000	0.0000	0.0000
1993	0.0421	0.0550	0.0000	-0.0098	-0.0270	0.0000	0.0000	0.0000	0.0000
1994	0.0450	0.0545	0.0000	-0.0194	-0.0282	0.0000	0.0000	0.0000	0.0000
1995	0.0488	0.0491	0.0000	-0.0251	-0.0282	0.0000	0.0000	0.0000	0.0000
1996	0.0548	0.0405	0.0000	-0.0315	-0.0289	0.0000	0.0000	0.0000	0.0000
1997	0.0548	0.0234	0.0000	-0.0353	-0.0314	0.0000	0.0000	0.0000	0.0000
1998	0.0574	0.0171	0.0000	-0.0375	-0.0345	0.0000	0.0000	0.0000	0.0000
1999	0.0593	0.0083	0.0000	-0.0320	-0.0368	0.0000	0.0000	0.0000	0.0000
2000	0.0597	0.0042	0.0000	-0.0231	-0.0373	0.0000	0.0000	0.0000	0.0000
2001	0.0595	0.0017	0.0000	-0.0102	-0.0391	0.0000	0.0000	0.0000	0.0000
2002	0.0585	0.0001	0.0000	0.0000	-0.0413	0.0000	0.0000	0.0000	0.0000
2003	0.0559	0.0000	0.0000	0.0000	-0.0426	0.0000	0.0000	0.0000	0.0000
2004	0.0553	0.0000	0.0000	0.0000	-0.0433	0.0000	0.0000	0.0000	0.0000
2005	0.0509	0.0000	0.0000	0.0000	-0.0440	0.0000	0.0000	0.0000	0.0000
2006	0.0452	0.0000	0.0000	0.0000	-0.0475	0.0000	0.0000	0.0000	0.0000
2007	0.0409	0.0000	0.0000	0.0000	-0.0434	0.0000	0.0000	0.0000	0.0000
2008	0.0344	0.0000	0.0000	0.0000	-0.0411	0.0000	0.0000	0.0000	0.0000
2009	0.0229	0.0000	0.0000	0.0000	-0.0257	0.0000	0.0000	0.0000	0.0000
2010	0.0209	0.0000	0.0000	0.0000	-0.0214	0.0000	0.0000	0.0000	0.0000

APPENDIX B
ALASKA NORTH SLOPE ECONOMICS *
Weighted Average of West and Gulf Coast Sales as Reported in PIW

<u>REVENUE, COSTS & INCOME PER BARREL</u>				
	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Wellhead price/barrel	\$16.72	\$10.17	\$7.54	\$9.47
LESS:				
Royalty/barrel	\$2.01	\$0.73	\$0.86	\$1.10
Severance/barrel	\$2.21	\$0.87	\$1.00	\$0.99
Property tax/barrel	\$0.21	\$0.18	\$0.16	\$0.15
Producing cost/barrel	\$0.90	\$0.75	\$0.80	\$0.85
Depreciation/barrel	\$1.53	\$2.17	\$2.21	\$2.25
State income tax/barrel	\$0.29	\$0.06	\$0.08	\$0.12
US income tax/barrel	\$4.54	\$0.84	\$0.89	\$1.40
PLUS:				
Pipeline profit/barrel	\$2.18	\$0.64	\$0.58	\$0.43
EQUALS:				
Industry profit/barrel	\$7.22	\$1.56	\$2.13	\$3.03
<u>NET INCOME SHARES</u>				
<u>Shares in dollars per barrel</u>				
Industry profits/barrel	\$7.22	\$1.56	\$2.13	\$3.03
State & local rev./barrel	\$4.71	\$1.84	\$2.10	\$2.37
Federal rev./barrel	\$4.54	\$0.84	\$0.89	\$1.40
<u>Shares in billions of \$ per year</u>				
Industry profits/year	\$5.004	\$1.102	\$1.530	\$2.211
State & local revenue/year	\$3.269	\$1.294	\$1.512	\$1.728
Federal revenue/year	\$3.148	\$0.592	\$0.640	\$1.022
<u>Shares in percent of total</u>				
Industry profits	43.8%	36.9%	41.6%	44.6%
State & local revenue	28.6%	43.3%	41.1%	34.8%
Federal revenue	27.6%	19.8%	17.4%	20.6%
<u>ALASKA REINVESTMENT PERFORMANCE</u>				
<u>Reinvestment in billions \$/year</u>				
Cash flow (billions \$/year)	\$6.065	\$2.630	\$3.119	\$3.853
Reinvestment (billions \$/year)*	\$0.860	\$1.322	\$0.650	\$0.700
<u>Reinvestment in \$/barrel</u>				
Cash flow per barrel	\$8.75	\$3.73	\$4.34	\$5.28
Reinvestment per barrel*	\$1.24	\$1.88	\$0.90	\$0.96
Percentage reinvested in Alaska	14%	50%	21%	18%

* Revenue, costs and income data from Petroleum Intelligence Weekly (attached); reinvestment performance estimated by the Division of Policy. See the following page for additional notes.

Division of Policy, 4/11/88

Notes to analysis of *PIW* data on North Slope economics:

1. *PIW* data for the first and second half of 1986 and 1987 were averaged using equal weights to produce the average annual values shown on the preceding page.
2. *PIW* values stated separately for U.S. West and Gulf coasts were combined to provide weighted average figures; the following weighting factors were used (West/Gulf): 1985-50%/50%; 1986-52.5%/47.5%; 1987-56.66%/46.67%; 1988-60%/40%.
3. Annual revenue figures assume production levels of 1.90 MMB/D, 1.93 MMB/D, 1.96 MMB/D, and 2.00 MMB/D in 1985-88 respectively.
4. Data for 1988 are extrapolated assuming costs and revenues continue at the per barrel levels reported in *PIW* for the first two months of 1988.
5. Reinvestment estimates for 1985-6 are from Income and Investment Flows From Alaska Oil and Gas Producing Activities, by Edward Deakin, May, 1987. Estimates for 1987-8 are Division of Policy estimates based on industry statements of current and planned project activity.
6. Cash flow is understated by an estimated \$2.00 per barrel because depreciation on pipeline investments are not accounted for separately in the *PIW* data. (Pipeline tariffs are deducted before determining the wellhead price per barrel.)

Division of Policy
11 April 1988

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• Living With \$15 Oil p.5 • Shift In Tanker War..... p.7

Short-Haul Sales By Saudis Key To Overseas Stockbuild

Oil markets should be very careful in drawing grand conclusions about Saudi Arabia's oil policies on the basis of its latest foray to charter ships for moving crude oil into its overseas stockpile. The fact is that Saudi Arabia is in the process of placing a large chunk of stockpile crude with several of the Aramco partners on a delivered basis, and it chartered the tankers almost entirely to replenish those supplies, according to well informed PIW sources in shipping circles. The stockpile moves say more about Riyadh's wish to retain a basic presence as a short-haul crude supplier in the Caribbean and Europe (p5) than about its long-term goals or role within Opec (PIW Jan.25,p1). PIW confirms that the Saudis have lined up five ships to move 10-million barrels of oil into overseas storage in the coming weeks, plus at least one other vessel to supply non-Aramco clients like Ashland and Marathon. In the past, the Saudis have used the Western Hemisphere stockpile for occasional spot sales, and more routinely to supply term customers on a prompt basis.

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By taking nearby crude from the stockpile now, the Aramco partners get the benefit of the oil in the heart of the winter season, rather than in late March or early April when oil loaded today in Saudi Arabia would arrive at Atlantic Basin destination. The stockpile barrels are within the overall 1.4-million b/d oil crude the partners obtained from the Saudis in January, and are expected to take in February. They do not represent any extra supply. Overall Saudi output volume is still below Opec quota in the 3.8- to 4-million b/d range (excluding the Neutral Zone). This suggests Riyadh is willing to cautiously and temporarily stick with other Opec producers in sharing some of the burden of

(continued on p.4)

Alaskan Oil Profits Staying Buoyant Amid Volatile Prices

With oil markets again threatening a possible sharp drop in prices, US Alaskan production looks surprisingly well positioned to cope with a repeat of the collapse of 1986. Despite high transport costs that would appear to make Alaskan North Slope output highly vulnerable to lower prices, it is currently making good profits at \$14.50-\$15.50 delivered prices, and has shown it can break even at \$10 a barrel. Profits also bounce back quickly as prices recover, according to a PIW analysis of Alaskan North Slope economics (see table). Producers briefly suffered losses of a few pennies a barrel in mid-1986 when the delivered price at the Gulf Coast fell to \$10. But profits rebounded to an average \$3.50 in 1987, and even managed to average over \$1 a barrel in disastrous 1986. ANS crude — which is one-fourth of US production — realizes a healthy \$2.60-\$3.20 a barrel now, depending on sales destination.

Even if prices dropped below \$10, very little North Slope production would be shut in, mainly because of the large amounts already invested in current output and its importance to US supply. What's more, the oil is primarily absorbed into the refining and marketing systems of producing companies, and low crude prices usually provide

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offsetting improvements in the profitability of downstream refining. Meanwhile, the long-term outlook for Alaskan North Slope crude is encouraging a continuing buildup of production capacity, in sharp contrast to plunging production in other US areas. ANS output surged over 2-million b/d in late 1987 as Alaska displaced Texas for the first time as the largest source of US crude. The North Slope is still regarded as holding the best potential for finding big new fields. But discoveries have to be large to offset growing development and operating costs, already apparent at the Kuparuk River and Endicott fields, and for enhanced recovery in super-giant Prudhoe Bay (PIW Jan.25,p10).

Since the 1986 price collapse, the economics for Alaskan North Slope crude sold on the West Coast have become relatively more profitable than the longer shipments to the Gulf and East Coasts, which used to earn almost as much. As a result, more North Slope crude is moving to the California market, with the West Coast absorbing 60% of last year's higher production versus 50% in 1985. Profits on West Coast sales are now about 65¢ a barrel higher than those to Atlantic ports, compared to a gap of 10¢ in 1985. This mainly reflects the much larger \$11.66 a barrel drop in ANS prices to Gulf and East Coast destinations in the last two years compared to a drop of just under \$10 on the West Coast. The bigger decline in the east is hard to explain but is probably only partly due to the highly competitive Atlantic Basin crude oil market.

THE COMPARATIVE ECONOMICS OF ALASKAN NORTH SLOPE PRODUCTION (in dollars per barrel)

	Sales To US East Coast						Sales To US West Coast					
	1985	1987		1988		1985	1987		1988		1985	
Delivered Price	Current	2nd H	1st H	2nd H	1st H	Year	Current	2nd H	1st H	2nd H	1st H	Year
Sohio Price	\$15.50	\$18.45	\$17.00	\$12.00	\$16.80	\$27.00	\$14.50	\$17.45	\$16.00	\$11.00	\$15.80	\$25.00
Average Price(a)	15.25	18.62	13.99	12.31	16.72	26.97	14.28	18.48	13.56	10.78	14.54	24.23
Less:												
Shipping Cost	3.35	3.21	3.19	3.38	3.72	4.21	0.99	0.96	0.94	0.94	1.14	1.29
Valdez l.o.b.	11.90	13.61	13.80	8.93	12.00	22.70	13.26	14.52	14.62	9.81	13.40	22.94
Less:												
Pipeline Loss	0.05	0.10	0.05	0.05	0.05	0.10	0.05	0.10	0.05	0.05	0.05	0.10
Pipeline Tariff	3.20	3.95	3.95	4.50	4.50	6.00	3.20	3.95	3.95	4.50	4.50	6.00
Wellhead Price(b)	8.86	9.56	9.88	4.38	7.48	16.88	18.01	18.47	16.82	5.28	8.85	16.84
Less:												
Royalty(c)	1.00	1.11	1.14	0.47	0.85	1.99	1.17	1.23	1.24	0.58	1.02	2.02
Severance(d)	0.91	1.00	1.30	0.59	0.99	2.19	1.05	1.09	1.40	0.70	1.17	2.22
Property Tax	0.15	0.15	0.15	0.18	0.18	0.21	0.15	0.15	0.15	0.18	0.18	0.21
Producing Cost	0.85	0.85	0.85	0.75	0.75	0.90	0.85	0.85	0.85	0.75	0.75	0.90
Depreciation(e)	2.25	2.25	2.25	2.17	2.17	1.53	2.25	2.25	2.25	2.17	2.17	1.53
Pre-Tax Profit	3.49	4.20	4.11	0.23	2.51	9.78	4.54	4.90	4.72	0.88	3.56	9.96
Less:												
State Income Tax(f)	0.10	0.13	0.12	0.01	0.08	0.29	0.14	0.15	0.14	0.03	0.11	0.30
US Windfall Tax(g)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
US Income Tax(h)	1.19	1.43	1.40	0.11	1.16	4.50	1.54	1.67	1.61	0.41	1.64	4.58
Oil Profit	2.29	2.64	2.59	0.12	1.28	4.03	2.86	3.08	2.98	0.45	1.81	5.88
Pipeline Profit	0.43	0.53	0.53	0.64	0.64	2.18	0.43	0.53	0.53	0.64	0.64	2.18
Overall Profit	2.63	3.17	3.12	0.76	1.82	7.17	3.29	3.62	3.51	1.89	2.45	7.28

a) Average of all producers. b) Price at Pump Station #1. c) Royalty 12.5% after deduction of gathering costs (63¢ 1988, 66¢ 1987 & 1986, 65¢ 1985). d) Severance Tax based on wellhead price after deduction of royalty (11.94% from 2nd Half 1987 to present, 14.96% 1985 to 1st Half 1987. e) Includes depletion. f) Average state income tax rate of 3% for all producers. g) Windfall profits tax not applicable at lower wellhead prices. h) US income tax rate 34% 1987 to present and 46% previously, after deduction of costs, state taxes.

Another big change in the last few years is the more even split between producing company profits and the tax take of federal and state governments. With Alaskan wellhead prices well below the floor level of US "windfall" taxation, the tax burden has shrunk to an estimated \$3.35 a barrel currently. Reduced corporate income tax rates from 46% to 34% starting in 1987 has also helped producers. However, Washington claims that the companies may owe \$200-million in "windfall" profits taxes for 1984 and 1985 due to disparities in pricing and pipeline charges among the various Alaskan oil producers (PIW June 13, '83,p3).

The settlement of a 7-year legal dispute over Alaskan pipeline tariffs has also put an extra squeeze on profits since 1986, with the Trans-Alaskan Pipeline providing 15% of North Slope profits now compared to 30% in 1985. Aimed at fostering greater competition for North Slope leases, the resolution with the seven owners (BP 50%, Exxon and Arco

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20% each, and the rest split between Mobil, Phillips, Union and Amerada Hess) sharply reduced tariffs, settled back claims of overcharges and put the pipeline on a real-rate-of-return basis starting in 1986 (PIW Nov. 4, '85, p8).

The existence of a semi-secret and unofficial "mini-Brent" North Sea market might help London's International Petroleum Exchange win a central role in the globalization of oil futures dealing. Mini-Brent could provide a model for the IPE as it prepares another relaunch for its failed Brent futures contract following the New York Mercantile Exchange's refusal to trade US crude futures in London as a joint venture (PIW Jan. 25, p8). Shocked and disappointed by Nymex's rejection of joint trading of West Texas Intermediate futures, the IPE is considering a number of alternative options, with a restyled 1,000-barrel Brent contract based on cash settlement rather than physical delivery at the top of the list (PIW Jan. 25, p8). Other possibilities include a London-based West Texas Intermediate contract administered independently of Nymex, and a link to another US exchange such as the Chicago Board of Trade, which dabbled with oil futures several years ago.

Steady but largely unpublicized trade in the unregulated mini-Brent market leaves little doubt that demand exists for a financial tool of this type geared to European crude. Also known as the Brent partial market, and only reluctantly revealed to PIW by major players, mini-Brent is the brainchild of US investment banks. But its future is now in doubt due to new UK laws which may leave room for the IPE to take over instead. Mini-Brent works because the investment banks are willing to buy and sell futures contracts for part-cargoes of Brent in 50,000 barrel increments under their own set terms, normally closing out at an agreed cash-settlement price as 600,000-barrel forward Brent cargoes begin to trade in the physical market. However, this trading could fall foul of the forthcoming UK Financial Services Act (PIW Jan. 11, p2). The IPE, as a recognized futures exchange, might win approval of a similar standard contract, using well-established procedures of exchange-of-futures-for-physicals for participants wanting to take delivery. The IPE is now seeking industry advice on how to tailor a new contract, but there's virtually universal agreement that simply restyling the existing 1,000-barrel contract won't work.

Even with its poor track record in marketing and planning, the London futures exchange is still eager to launch its own crude contract that will spark trade both locally and from Mideast and Far East time zones, largely out of New York's normal reach. It plans "some form of significant trading incentive scheme to encourage initial participation" and scope for broader membership, aimed at attracting more active floor traders. While Nymex boasts almost 800 members and last year traded an average 40-million b/d, there are currently just 57 authorized IPE dealers. There's general dismay in European trading circles over the Nymex's "parochial" decision not to come to London, coupled with the recognition that Eastern Hemisphere traders increasingly want to use crude futures (PIW Dec. 7, p6). The IPE has already been approached by the Singapore International Monetary Exchange on possible broad cooperation.

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Like the big Mideast exporters, Opec's key African members are moving fast to cushion themselves against rapid swings in output even in a weak market. But they are using very different means to achieve the same ends. Resisting straight market-related pricing, the Africans are looking to product sales, processing deals of various kinds and enhanced margins for foreign equity producers to sustain volumes. Though techniques differ, almost all Opec exporters are adapting to an oil market in which some price volatility is seen as inevitable, making maintenance of sales to key customers in ways that cause the least market disruption a top priority (PIW Jan. 25, p1). The various methods reflect marketing strengths of individual producers and preferences of traditional customers, among other factors.

Among African producers, Libya appears to have significantly reduced its vulnerability to short-term market swings. Though volume has fallen somewhat, Tripoli seems to be offsetting much of the recent loss of up to 200,000 b/d in third-party crude sales to traders without flooding the Mediterranean with discounted crude. "They

APPENDIX C -- EXPLANATION OF 1981 OIL TAX LAW CHANGES

I. Introduction

The 1981 oil tax legislation (ch. 116, SLA 1981) replaced the separate accounting oil and gas corporate income tax, enacted in 1978, with a modified apportionment-based corporate income tax. To make up the substantial loss in revenues caused by this shift, the legislation also raised the severance tax rate on Prudhoe Bay from an effective rate of just over 11% (with the ELF) to 15%. This increase was accomplished by raising the nominal rate from 12.25% to 15% and effectively suspending the ELF until the tenth anniversary of Prudhoe Bay production in 1987. (For fields beginning production after June 1981, the nominal rate was set at 12.25% for the first five years of production.) Taken together, the two changes were intended to be revenue neutral.

In addition to the two primary changes -- eliminating separate accounting and increasing the severance tax -- the 1981 law also:

(a) made retroactive technical amendments (known as the "warts" amendments) to state tax laws in order to improve the retrospective constitutionality of separate accounting;

(b) corrected tax problems posed by the sharing of oil and gas revenues among Native corporations under §7(i) of the Alaska Native Claims Settlement Act;

(c) allowed for the retroactive deduction of federal windfall profit tax payments; and

(d) instituted a graduated, stair stepped rate, beginning at 1%, for the taxation of corporate income under \$100,000, and raised the top rate from 9.4% to 11% for one year.

Tax "stability" was not the issue in 1981. The 1981 law was passed solely in response to litigation filed by the oil industry challenging the 1978 separate accounting corporate income tax. Unlike the separate accounting law, which was passed after nearly a decade of study, discussion, and debate, the 1981 oil tax changes were not designed to make the state's tax system fair and predictable, or to encourage future exploration and production. Instead, the 1981 law was designed to limit the state's potential liability as a result of the oil companies' legal challenge to the 1978 separate accounting law. Because the oil industry benefitted from the 1981 law, it did not object to the changes in the state's oil tax structure.

At the time the 1981 law passed, many assumed that the oil tax issue would be revisited, after a decision on the 1978 law was made, and before the June 1987 reimposition of the ELF. The state won the separate accounting litigation in the trial court in May 1983 and on appeal to the Alaska Supreme Court in August 1985. The statute's constitutionality was affirmed by the U.S. Supreme Court in January 1986.

II. How It Happened

A. Activity Before 1981

The 1977-78 Alaska Legislature and Hammond Administration, confronted with the prospect of the first commercial production from Prudhoe Bay, instituted a comprehensive revision of the state's oil and gas tax structure. In 1977, the legislature, with the active support of the governor, increased the maximum severance tax rate from 8% (first put in effect in 1970) to 12.25%. An economic limit factor [ELF] formula replaced the statutorily-reduced rates for well production less than one thousand barrels per day (from 1973-1977, a well's first 300 barrels were taxed at 5%, and the next 700 barrels at 6%). The ELF was designed to give the severance tax a curved or sliding scale, instead of stair stepped, rate.

In 1978, the separate accounting oil and gas corporate income tax was enacted. The law was developed and passed in response to detailed analyses, prepared for the legislature and administration from 1970-78, showing that the state's existing apportionment-based corporate income tax would result in Prudhoe Bay oil producers paying less than a third of the statutory rate of 9.4% of net income. The apportionment tax also had the inequitable effect of imposing different tax levels on producers with the same profits in Alaska, in effect penalizing producers with a larger degree of investment and employment in Alaska.

In early 1979, the major Prudhoe Bay oil producers filed suits challenging the constitutionality of the 1978 separate accounting law. Concerned over the amount of revenues at risk in the litigation, in the fall of 1980 the Hammond Administration engaged in substantive settlement discussions with those companies. The options proposed would have required the sacrifice of several hundred million dollars of state revenue in order to settle the litigation.

B. The 1981 Session -- Policy Background

At the beginning of the 1981 session, House and Senate leaders urged the Administration to pursue solutions to the problems posed by the oil industry suit that would not require revenue losses to the state. On March 18, 1981, the leadership of

both chambers, including Senate President Kerttula and Finance Chairmen Dankworth and Bennett, House Speaker Duncan and Finance Chairman Cotten, and Governor Hammond, Attorney General Condon, and Revenue Commissioner Tom Williams, joined in a statement declaring that "any significant decreases in state oil and gas revenues appear both unwarranted and unsupported by a majority of Alaskans. . . . All agree that any changes which would give large sums of money to the oil industry at the expense of the people of Alaska are unacceptable."

House leaders did not agree with the Administration's view that existing law needed to be changed. They were more optimistic that the separate accounting statute would be upheld, as it was in 1986. They believed that the tax structure put in place in 1977-78 was sound, and preferable to the alternatives of a higher severance tax or an apportionment-based income tax. They also believed any changes to state tax laws should be made after, not prior to, any unfavorable court decision, and that the potential problem of having to refund money to the oil industry was better left to the future, if and when it was more than a hypothetical possibility.

C. The 1981 Legislation

Because the Administration felt that some action was required to limit the risk posed by the separate accounting lawsuit, the House developed a "backstop" bill (in conjunction with the Administration), which set an oil and gas reserves tax in place to take effect and preserve state revenues if the 1978 separate accounting law were to be found unconstitutional.

Governor Hammond introduced the backstop bill in May 1981 (as SSHB 200). It passed the House (as SB 524) in early June. A free conference committee, consisting of Senators Ray, Bennett, and Dankworth, and Reps. Gardiner, Vaska, and O'Connell, first met on June 11.

During the latter half of the session, Senator Dankworth had attempted to develop a bill that would succeed in settling the separate accounting litigation while preserving, in substantial part, past and future state oil revenues. He was unsuccessful, and gave up the idea of ending the existing separate accounting litigation. He then attempted to craft a bill that would repeal the separate accounting law prospectively and maintain future state oil revenues at a level roughly comparable to those collected under the separate accounting law.

On June 17, following the reorganization of the House, Rep. Halford replaced Rep. Vaska on the conference committee and became the House chair. At that time, the oil industry circulated a settlement proposal which repealed separate accounting, increased severance taxes, and instituted a 10% investment tax credit. The oil

industry estimated the proposal's revenue loss to the state for FY 82-85 at \$1.37 billion; legislative staff estimates of revenue losses ranged from \$1.5 to \$2.1 billion.

Senator Dankworth prepared a draft bill embodying the settlement proposal, and distributed it to the conference committee on June 22. At a later point in the June 22 meeting, he also distributed a draft bill that modified the settlement proposal in two important ways, in order to make the bill as revenue neutral as possible. He abandoned the 10% investment credit and suspended the application of the ELF during a field's first ten years of production in order to achieve a 15% effective severance tax rate at Prudhoe Bay. As a result of these changes, the oil industry was not willing to settle the litigation, and stated in testimony that they would continue the separate accounting litigation even if the modified proposal were enacted.

Prior to the next meeting of the conference committee on June 23, Governor Hammond wrote a letter to all legislators clarifying his position on the oil tax issue. He stated his preference was for a public vote on the backstop bill versus the oil industry settlement proposal. Alternatively, he urged the Senate to pass the backstop bill, and stated he preferred passage of any proposal to doing nothing. He noted that legislative action should "[r]educ[e] the likelihood that the oil tax issue will continue to be a perennial political liability for those in public office."

On June 23, Senator Dankworth submitted to the conference committee the legislation ultimately signed by Governor Hammond, described on the first page of this appendix. The June 23 bill, known as "Dankworth 3," retained the basic characteristics of Senator Dankworth's earlier proposal, but suspended the application of the ELF during the first ten years of production only if the ELF was greater than .7. The change did not affect Prudhoe Bay, but did provide a tax break for Kuparuk.

The June 23 legislation received only cursory examination in the free conference committee and on the floor of the House and Senate before its passage on June 24. No committee report or written analysis was provided by either the bill's sponsor, Senator Dankworth, or the Administration. A bare bones fiscal note, which projected total revenue losses from FY 82-85 of \$141 million, did accompany the bill during the legislature's deliberations. Specifically, the note showed revenue losses of \$21 million in FY 82, \$117 million in FY 83, \$18 million in FY 84, and a gain of \$15 million in FY 85. No figures for the effect of the reimposition of the ELF on Prudhoe Bay in 1987 were provided. Revenue Commissioner Williams personally prepared the fiscal note and provided no supporting documentation for it, other than stating the estimates were based on confidential figures provided by the oil industry.

Speaker Hayes refused to allow a minority report opposing the legislation,

authored by Rep. Gardiner, to be published in the House Journal. At pages 2-3 of the minority report, after questioning the validity of the \$141 million estimate, Rep. Gardiner stated the fiscal note "failed to point out an even more significant revenue loss which will occur in the latter half of this decade, due to the sharp decline in severance tax collections from Prudhoe Bay after the reimposition of the economic limit factor in 1987. This loss is on the order of two billion dollars." (The two billion dollar estimate was based on the optimistic oil price assumptions prevailing at the time.) The bill passed over the strenuous objections of the former House majority.

At the time he signed the 1981 law, Governor Hammond noted that the new law would only reduce state income by .6%, relying on the figures in the fiscal note.

The key arguments made in opposition to the 1981 law were:

(a) It was not revenue neutral, because the estimates for the amounts to be collected by the new apportionment formula were overstated and speculative.

(b) A future legislature and administration would be saddled with a huge drop in revenues by the reimposition of the ELF in 1987.

Other arguments concerned the harmful effects of a shift from a net income-based separate accounting tax to a gross revenue severance tax.

Both Commissioner Williams and Governor Hammond explicitly recognized that a future legislature would have to deal with the post-1987 revenue effects from reimposition of the ELF. In the press statement issued on July 21, 1981, at the time he signed the oil tax bill, Governor Hammond declared, "As for the possible revenue effects in 1988 and beyond, I have full confidence in the ability of the Legislature to deal at that time with whatever is required to retain the state's 'fair share' of our oil wealth."

In responding to a question about the post-1987 ELF revenue loss at the June 23 conference committee meeting, Commissioner Williams noted that a future legislature would have the option of reimposing separate accounting if it proved constitutional. A newspaper account of the meeting reported that "If the projected revenue loss proves true, Williams said the Legislature would have the option of hiking taxes." (*Anchorage Daily News*, June 25, 1981, p. A4, "Lawmakers Pass Revision of Oil Tax Law.")

During the June 24 House floor debate on the 1981 bill, Rep. Gardiner noted the ELF factor would cause multi-hundred million dollar losses after 1987. Rep. Halford responded that "by that time [1987], if the companies continue to challenge the portion of funds that are in the state's hands under chapter 21 [separate accounting], we should have an answer to that lawsuit. And with that answer, we should be able to develop possibly a more consistent taxing policy at that time. That's

pretty far in the future, but we'll have more information available to us at that time."

III. Postscript

The revenue losses resulting from the shift to the modified apportionment method have exceeded considerably the \$141 million estimate for FY 82-85 made in 1981 by Commissioner Williams. Analyses by the Department of Revenue shows the FY 82-85 revenue loss of the 1981 law at over seven hundred million dollars. Through FY 87, the state lost over one billion dollars in revenue as a result of passage of the 1981 law.

The problems arising from the reimposition of the ELF are the subject of the main body of this report.

Appendix D

DRILLING/WORKOVER DISINCENTIVE COMMITTEE SUBSTITUTE HB 164

SEVERANCE TAX CALCULATION

CURRENT LAW

Field Rate x Wellhead Price x Severance Tax x ELF

90,168,000 BOPY x \$9/BO x 0.15 x 0.52134

= \$63,461,050/year

Addition of 1 well:

90,277,000 BOPY x \$9/BO x 0.15 x 0.5204

=\$63,423,203/year

A decrease of \$37,846 year

PROPOSED LAW

Field Rate x Wellhead Price x Severance Tax x ELF

90,168,000 BOPY x \$9/BO x 0.16 x 0.7296

=\$88,811,873/year

Addition of 1 well:

90,277,000 BOPY x \$9/BO x 0.15 x 0.7292

=\$88,870,484/year

An increase of \$58,611 year

[Copy of ARCO Handout, March 27, 1987]

TECHNICAL NOTE ON ARCO'S KUPARUK EXAMPLE

Tax Effects of Drilling an Additional Well Under Current Law

Mr. James Weeks, Kuparuk Unit Manger for ARCO, provided testimony to the House Finance Committee on March 27, 1987. Examples of severance tax effects (see preceding page) accompanied his testimony. The examples compare the severance tax effects of adding one additional well in the Kuparuk field under the current ELF and under the proposed ELF. The examples show that the addition of one well producing just under 300 barrels per day would increase output from 90,168,000 barrels of oil per year (BOPY) to 90,277,000 BOPY. At the \$9.00 per barrel price assumed in ARCO's example, annual gross revenue to the owners increases by \$981,000.

$$(90,277,000 \text{ BOPY} - 90,168,000 \text{ BOPY}) * (\$9/\text{barrel}) =$$

$$(109,000 \text{ BOPY}) * (\$9/\text{barrel}) = \$981,000$$

The first of ARCO's two examples shows how under current law the owners would collect an annual severance tax *rebate* of \$37,846 on this additional revenue. The effective severance tax rate on the new production is thus -3.9 percent. The effect is analagous to a personal income tax where the effective tax rates become lower as increasing income moves the taxpayer into a higher bracket.

The second ARCO example illustrates how this will be changed under the proposed law. Instead of giving the owners a \$37,846 windfall, the proposed law will collect \$58,611 (6.0 percent) of the incremental \$981,000 for the state in severance tax. The table below summarizes the effects under the current and proposed severance tax laws, as shown in the ARCO examples.

TAX EFFECTS OF DRILLING ONE ADDITIONAL WELL (ARCO Kuparuk Example)

	Change In Annual Gross Revenue	Change In Annual Severance Tax	Tax Rate On Incremental Production	Average Tax Rate Before Drilling	Average Tax Rate After Drilling	Percent Change In Average Tax Rate Due To Drilling
Current Law	\$981,000	(\$37,846)	-3.9%	7.820%	7.806%	-0.180%
Proposed Law	\$981,000	\$58,611	6.0%	10.944%	10.938%	-0.055%

Prepared by Division of Policy, April 1987.

Oil Revenue Update

March 1989

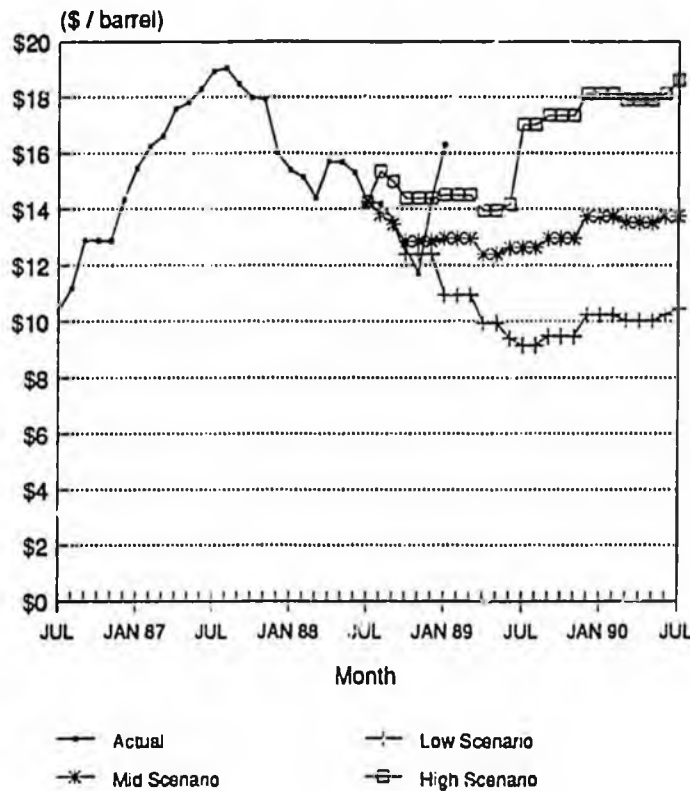
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The purpose of this note is to briefly update the oil revenue situation to reflect events which have occurred since our last revenue forecast released November 1988.

Oil Prices

World oil prices have remained strong through December and January in response to the November OPEC production agreement. It appears that OPEC production has averaged 19.5 million bbl/day through January. Although this is 1 million bbl/day over the agreed upon quota, strong demand and supply disruptions in the North Sea have kept Saudi Light oil prices near \$15.00/bbl on the spot market. BP Exploration, the largest producer of Alaska North Slope (ANS) crude oil, recently announced a February price for ANS of \$16.30/bbl for Gulf Coast delivery. The figure below illustrates the current Department of Revenue scenarios and actual ANS Gulf Coast prices.

ANS at the U. S. Gulf
(Nominal data)



The TAPS tariff filing for calendar 1989 sets the average tariff for the pipeline at \$3.01/bbl. This is \$0.04/barrel higher than assumed in the Fall Forecast.

Oil Production

Production from Alaska's North Slope held firm through year end at well over 2.0 million bbl/day. It is still not clear if the production slide at Prudhoe Bay of 50,000 bbl/day, which ARCO envisions, can be avoided in calendar 1989. Based on preliminary information from Conoco, it looks like Milne Pt. may recommence production sometime this Spring barring another price drop.

Oil Revenues

Higher prices, and higher than expected production through year-end result in a slightly improved outlook for the remainder of the fiscal 1989. The high scenario we developed last Fall outlined a revenue stream predicated on a successful OPEC production agreement. So far events outlined in the high scenario continue to unfold with the result being oil prices which correspond roughly to those characterizing this scenario. For example, under the high scenario the world economy was expected to increase at 3.5% in both 1989 and 1990. OECD growth appears to have been 4 percent for 1988. World oil consumption growth for 1988 has been revised upward by Energy Security Analysis, Inc. to an estimated 3.6%, or about 1.8 million barrels/day. The high scenario assumes a growth in demand of 1.5 million barrels/day for 1989 and 1990. In the November OPEC meeting Iran and Iraq were given a quota of 2.6 million barrels/day, about 14% higher than the 2.3 million barrels/day of production from these countries assumed by the high scenario. The high scenario was based on a total OPEC quota of 18.7 million barrels/day, with continued cheating by the member countries. The current OPEC quota is 18.5 million barrels/day. Over production by member countries has resulted in an estimated production in January of 19.5 million barrels/day.

There is, however, no guarantee that conditions within OPEC will remain the same. In particular the seasonal drop in oil consumption during the second quarter may present serious problems to cartel cohesiveness.

Table 1 outlines the price/revenue sensitivity for the remainder of FY 1989 and FY 1990. The FY 1989 outlook incorporates our most recent data on actual revenue collections through December and substitutes current spot market price data for January 1989. A summary of the current mid case assumptions, as well as actual collections through December production month and corresponding January revenue month, is shown on Table 2.

Table 1

PRICE/REVENUE SENSIVITY SCHEDULE
 Unrestricted State Revenue¹
 (Millions \$)

ANS Price Lower 48 ²	FY 1989	FY 1990
\$10 /bbl	1724	1139
11	1769	1238
12	1827	1373
13	1885	1507
14	1943	1641
15	2001	1775
16	2060	1909
17	2117	2043
18	2176	2178
19	2240	2312
20	2292	2446

¹ Based on Department of Revenue mid scenario assumptions Fall 1988 Forecast updated for actual marketing and production data through December 1988, new 1989 TAPS tariff filing, and spot price information for January 1989.

² The average ANS price for all lower 48 sales is approximately \$0.80/bbl less than the U. S. Gulf price.

Table 2

Updated with actual data thru DEC/JAN FY 1989 and calendar year 1989 TAPS filing

Spot prices added for JAN/FEB

Assumptions based on October 1988 forecast by DOR - Mid scenario

14 Feb 89

PRODUCT/REVENUE MONTH/YEAR	1988	JUNE	JULY	AUG	AUG/SEP	SEP/OCT	OCT/NOV	NOV/DEC	DEC/JAN	JAN/FEB	FEB/MAR	MAR/APR	APR/MAY	MAY/JUN	1989	90 Q1	90 Q2	90 Q3	90 Q4	1990
14 OPEC MARKER - \$/bbl	18 2900	14.3100	13.3200	13.3100	11 8100	10 4600	10 6100	12 6800	14 3667	12 5000	12 5000	12 0000	12 0000	12 4889	11 5300	11 8300	12 5300	12 3300	12 0550	
15 TRANS & MARKET DIFFERENTIAL	0 5389	1 0700	0 9700	0 8900	1 8200	2 1900	1 1000	0 1079	1 9333	0 4470	0 4470	0 3800	0 3800	0 9703	0 8500	0 7800	0 8776	0 8306	0 8373	
16 AVG. ANS OIL PRICE @ U.S. GULF \$/bbl	16 8289	15 3800	14 2900	14 2000	13 6300	12 6500	11 7100	12 7879	16 3000	12 9470	12 9470	12 3880	12 3880	13 4662	12 3880	12 6130	13 4076	13 1606	12 8923	
17 AVG. ANS OIL PRODUCTION MMbbls/day	1 8940	1 8399	1 9160	1 9654	1 9748	1 9674	1 9833	1 9510	1 9270	1 9270	1 9270	1 9270	1 9270	1 9414	1 8310	1 8290	1 8250	1 8290	1 8295	
18 AVERAGE ANS WEST/GULF MARKET DIFFER	2 4796	-0 4878	-0 8756	-0 5250	-0 6687	-0 5837	-0 7866	-0 7438	-0 5230	-0 5330	-0 5430	-0 5390	-0 5400	-0 6140	-0 5810	-0 6190	0 6640	0 6880	0 6300	
19 TRANSPORTATION TO U.S. GULF		2 7820	3 1640	2 7186	3 0014	3 0527	2 8004	2 7399	3 1730	3 1830	3 1930	3 1890	3 1990	3 0163	3 2310	3 2690	3 3140	3 3380	3 2800	
20 AVG. TAPS TARIFF \$/bbl	3 6827	3 1860	3 1770	3 1700	3 1640	3 1610	3 1660	3 1811	3 0100	3 0100	3 0100	3 0100	3 0100	3 1029	3 0100	3 0100	3 1310	3 1440	3 0730	
21 AVG. NON PRUDHOE COST/QUAL/AMTDIF	0 1984	0 1984	0 1984	0 1984	0 1870	0 1670	0 1870	0 1872	0 1872	0 1872	0 1871	0 1871	0 1871	0 1899	0 1866	0 1866	0 1866	0 1866	0 1866	
22 WT. AVG. ANS OIL ROY WHV \$/bbl	10 4682	9 7012	8 6262	8 6330	7 9463	6 8330	6 3522	7 4435	10 4528	7 0998	7 0999	6 5409	6 5409	7 7730	6 5414	6 7664	7 4300	7 1800	6 9820	
23 AVG. CGF NGL MM bbl/DAY	0 0457	0 0587	0 0547	0 0555	0 0604	0 0597	0 0612	0 0607	0 0550	0 0550	0 0550	0 0550	0 0550	0 0572	0 0543	0 0540	0 0540	0 0593	0 0554	
24 AVG. PROCESS COST NGL	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	
25 DAYS IN PRODUCTION MONTH/YEAR	368	30	31	31	30	31	30	31	31	29	31	30	31	365	92	92	90	92	365	
26 AVG. PET REV ELF	0 7950	0 7963	0 7918	0 7930	0 7906	0 7876	0 7863	0 7835	0 7898	0 7896	0 7894	0 7892	0 7890	0 7899	0 7807	0 7609	0 7644	0 7637	0 7674	
27 SEVERANCE RATE ADJ. FACTOR	0 9939	0 9707	1 0000	0 9772	0 9651	0 9942	1 0282	1 0046	0 9894	0 9862	0 9850	0 9914	0 9912	0 9991	0 9831	1 0143	1 0261	1 0058	1 0073	
28 AVG. EFFECT FLOOR ADJ. ELF	0 7902	0 7730	0 7946	0 7749	0 7630	0 7830	0 8085	0 7871	0 7815	0 7787	0 7776	0 7825	0 7821	0 7822	0 7675	0 7718	0 7843	0 7682	0 7729	
29 WT. AVG. NOMINAL SEV TAX RATE	0 1496	0 1480	0 1480	0 1481	0 1481	0 1481	0 1481	0 1481	0 1479	0 1479	0 1479	0 1479	0 1479	0 1480	0 1477	0 1477	0 1477	0 1477	0 1477	
30 ANS OIL SEVERANCE TAX MM\$	789 8297	56 4826	52 6900	52 7948	46 5105	42 2525	39 5738	45 8803	63 1047	39 9555	42 6497	38 2626	39 5202	559 6773	109 1890	113 4763	124 0300	119 8400	466 5353	
31 ANS NGL SEVERANCE TAX MM\$	7 2386	0 6438	0 4604	0 4692	0 3845	0 2124	0 1339	0 3164	0 7353	0 2203	0 2355	0 1473	0 1522	4 1111	0 4462	0 5412	0 8155	0 7920	2 5919	
32 ANS TOTAL OIL & NGL SEVERANCE TAX MM	797 0683	57 1263	53 1504	53 2640	46 8949	42 4649	39 7077	46 1968	63 8401	40 1758	42 8852	38 4099	39 6724	563 7884	109 6352	114 0175	124 8155	120 6320	469 1302	
33 ANS OIL CONSERVATION TAX MM\$	2 4319	0 2036	0 2078	0 2132	0 2073	0 2147	0 2082	0 2110	0 2100	0 2000	0 2100	0 2000	0 2100	2 4959	0 5800	0 5800	0 5800	0 5800	2 3200	
34 AVG. ANS OIL ROYALTY RATE	0 1254	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1260	0 1260	0 1260	0 1260	0 1260	
35 ROYALTY RATE ADJ. FACTOR	0 9918	1 0332	1 0383	0 9504	0 9649	0 9510	0 9536	0 8547	0 9963	0 9928	0 9918	0 9936	0 9938	1 0111	0 1111	1 0224	1 0356	1 0149	1 0210	
36 EFFECTIVE ROYALTY RATE	0 1244	0 1299	0 1305	0 1195	0 1213	0 1195	0 1199	0 1074	0 1252	0 1248	0 1247	0 1249	0 1249	0 1274	0 1288	0 1305	0 1279	0 1286	0 1286	
37 AVG. ROY FIELD COST DEDUCT \$/bbl	0 5790	0 6500	0 6500	0 6500	0 6500	0 6500	0 6500	0 6500	0 6521	0 6543	0 6564	0 6586	0 6607	0 6591	0 6566	0 6722	0 6788	0 6689	0 6689	
38 ANS OIL ROYALTIES B4 PF&PSF CONTRIB	897 6531	68 4139	61 8312	58 1441	52 4285	45 0786	40 6759	44 1424	73 3201	44 9522	47 9849	42 4723	43 8791	623 3232	126 2430	132 2397	145 3700	139 8900	543 7427	
39 ANS NGL ROYALTIES B4 PF CONTRIB	10 3787	0 9255	0 6620	0 6746	0 5527	0 3054	0 1924	0 4550	1 0572	0 3167	0 3386	0 2117	0 2188	5 9107	0 6433	0 7802	1 1757	1 1417	3 7410	
40 TOTAL ANS OIL & NGL ROYALTIES B4 PF M	908 0318	69 3394	62 4932	58 8187	52 0812	45 3839	40 8684	44 5973	74 3773	45 2690	48 3235	42 6840	43 0979	629 2339	126 8863	133 0199	146 5457	141 0317	547 4037	
41 ANS OIL ROY PF&PSF GF ADJ FACTOR	0 7450	0 7223	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7395	0 7395	0 7395	0 7395	0 7395	
42 ANS OIL ROYALTIES NET GF MM\$	676 4337	51 2973	46 2325	43 5141	39 1955	33 5750	30 2344	32 9931	55 0243	33 4900	35 7497	31 5777	32 6236	465 5072	93 8324	98 3682	108 3706	104 2930	404 8642	
43 TOTAL GF ANS OIL PRODUCT REVS MM\$	1475 9838	108 6273	99 5908	96 9913	86 2977	76 2546	70 1503	79 4009	119 0744	73 8658	78 8449	70 1875	72 5060	1031 7915	204 0477	212 9657	233 7961	225 5049	876 3144	
44																				
45 ANS OIL FRODN REV' CURRENT FY MOLY CASI	FLOW ANALYSIS AND COMPARISON WITH OFFICIAL DOR FORECAST																			
46 GF ANS OIL PROD REV ACT COLL	1475 9838	108 6273	99 5908	96 9913	86 2977	76 2546	70 1503	79 4009	79 7896	74 3863	79 3770	70 6931	73 0164	983 4183	205 3528	214 1707	233 7961	225 5049	878 8326	
47 LAST DOR REVENUE FORECAST (OCT88)	1475 9838	108 2807	98 2827	88 5195	79 8616	77 9302	75 3984	77 8927	119 0744	73 8658	78 8449	70 1875	72 5060	1031 7915	204 0477	212 9657	233 7961	225 5049	876 3144	
48 UPDATED DOR ANS REVENUE FORECAST	1475 9838	108 6273	99 5908	96 9913	86 2977	76 2546	70 1503	79 4009	119 0744	73 8658	78 8449	70 1875	72 5060	1031 7915	204 0477	212 9657	233 7961	225 5049	876 3144	
49																				
50 UPDATED REVENUE FORECAST DIFFERENCE	0 0000	0 3466	1 3081	8 4717	6 4361	-1 6756	-5 2381	1 5082	39 2848	-0 5205	-0 5321	-0 5055	-0 5104	48 3733	-1 3052	-1 2131	0 0000	0 0000	-2 5182	
51 YTD CUM UPDATED FORECAST DIFFERENCE	0 0000	0 3466	1 6547	10 1264	15 5625	14 8869	9 6488	11 1570	50 4418	-49 9213	-49 3892	-48 8837	-48 3733	48 3733	-1 3052	-2 5182	2 5182	2 5182	2 5182	

CMBIGSHORTDEC SHORT WK1

Actual Data

King
Tallman
Cote
Chenhall
Bartholomew

Voting "No" Westfall
Absent: None
4 votes required for passage
Effective Date: 1/16/89

K E T C H I K A N G A T E W A Y B O R O U G H

RESOLUTION NO. 821

A RESOLUTION OF THE ASSEMBLY OF THE KETCHIKAN GATEWAY BOROUGH, ALASKA, SUPPORTING LEGISLATION ADJUSTING THE ECONOMIC LIMIT FACTOR; AND ESTABLISHING AN EFFECTIVE DATE.

R E C I T A L S

A. The State of Alaska will lose approximately \$200 million this fiscal year from the application of the Economic Limit Factor (ELF) to Prudhoe Bay.

B. Revenue losses to the State due to the tax break allowed by the ELF are projected to total more than \$1 billion during the next five years.

C. The Alaska economy is beginning to emerge from the deepest recession in 30 years. Yet, without additional sources of revenue, public spending this year and next likely will be severely reduced.

D. Cuts of this magnitude would have a devastating effect on the entire economy and on Alaska's local governments.

E. The ELF was originally intended to serve as a tax break to encourage oil production in marginal fields. Prudhoe Bay and Kuparek are respectively the largest and second largest oil fields in North America and are in no sense marginal fields.

F. While oil prices have dropped, oil company profits continue to climb.

Section 1. The Assembly of the Ketchikan Gateway Borough urges the State of Alaska Legislature to enact legislation that would adjust the Economic Limit Factor to make it work as originally intended so as to encourage oil production at marginal fields and not give an unneeded tax break to the largest fields on the continent.

Section 2. The Borough Clerk is directed to send copies of this resolution to the Governor and District Legislators.

Section 3. Effective Date. This resolution is effective upon adoption.

ADOPTED this 16th day of January, 1989.



BOROUGH MAYOR

City council endorses

Cordova Times 1/2/88

The Cordova City Council met in a special session Saturday morning to debate the Economic Limit Factor (ELF). For the past two years, the Cowper Administration has been seeking to adjust ELF. Opponents to adjusting ELF say it would not promote economic development. The Cowper Administration believes differently and is currently soliciting support from cities around the state.

The fiscal crisis the state finds itself in now may bring the results Cowper seeks. Oil

revenues comprise close to 85 percent of the government's revenues, according to the revenue commissioner's office.

For an hour, councilmembers debated whether to approve a resolution endorsed by the Cowper Administration requesting the legislature to enact legislation adjusting ELF to encourage oil production at marginal fields and remove the tax break to the two largest and profitable oil fields on the continent. In essence the adjustment

will remove Prudhoe Bay and Kuparek from ELF tax breaks.

Mayor Erling Johansen circulated copies of a letter and model resolution he received from Gov. Cowper's office. The administration says the State of Alaska will lose approximately \$200 million this fiscal year from the application of ELF to Prudhoe Bay, according to the letter.

"Essentially the legislature is split," Johansen told the council. "Democrats are for revising it

ELF tax changes

and Republicans are against that."

Johansen informed the council he needed to know the city's stance on ELF prior to his attendance at the Annual Conference of Mayors Jan. 12 and 13 where the Governor, Lieutenant Governor, and Commissioner of the Department of Community and Regional Affairs will be in attendance. The council unanimously passed the resolution. Councilmembers Dave Rawlins and Doug Lape were absent.

According to Cliff Groh, special

assistant to Revenue Commissioner, Hugh Malone, an adjustment in ELF would enhance economic development and raise more revenues for the state. "It's (been) a bitter and controversial fight," Groh said. "The nominal tax rate is 15 percent. In some cases, ELF reduces that to zero. Prudhoe Bay sometimes pays 12 percent. By adjusting ELF, we would raise the effective rate closer to 15 percent. Higher oil prices would bring in more state revenues and if prices drop the state's loss is less."



CITY OF KOTZEBUE
P.O. BOX 48 • KOTZEBUE, ALASKA 99752

RECEIVED
JAN 30 1989

January 25, 1989

GOVERNOR'S OFFICE

City Hall
442-3401
Police Dept.
442-3351
Fire Department
442-3404
Public Works
Dept.
442-3435
Day Care Center
442-3157
Planning Dept.
442-3465
Building Inspector
442-2623
George Francis
Memorial Library
442-3816
Recreation Center
442-3065
Teen Center
442-3379
Regional Fire
Training Center
442-3921

The Honorable Steve Cowper
Governor
State of Alaska
P.O. Box A
Juneau, Alaska 99811-0101

Dear Governor Cowper;

Enclosed please find Resolution No. 89-3; A Resolution supporting adjustment of the Economic Limit Factor (ELF) which was unanimously passed by the Kotzebue City Council at it's January 19th, 1989 meeting.

The City Council feels the State's municipalities support could be generated if municipal assistance and revenue sharing funding was tied to the ELF repeal.

Sincerely,

Michael Scott
City Manager

MS/zkl

Enclosure

cc: City Council

CITY OF KOTZEBUE

RESOLUTION NO. 89-3

A RESOLUTION SUPPORTING ADJUSTMENT OF THE ECONOMIC LIMIT FACTOR (ELF).

WHEREAS; the State of Alaska will loose approximately \$200 million this fiscal year from the application of the Economic Limit Factor (ELF) to Prudhoe Bay, and;

WHEREAS; revenue losses to the State due to the tax break allowed by the ELF are projected to total more than \$1 billion during the next five years, and;

WHEREAS; the Alaska economy is beginning to emerge from the deepest recession in 30 years. Yet, without additional sources of revenue, public spending this year and next likely will be severely reduced or in the red; and

WHEREAS; cuts of this magnitude would have a devastating effect on the entire economy and on Alaska's local governments, and;

WHEREAS; the ELF was originally intended to serve as a tax break to encourage oil production in marginal fields. Prudhoe Bay and Kaparek are the largest and second largest oil fields in North America and are in no sense marginal fields, and;

WHEREAS; the application of ELF in its current form actually discourages oil production at some truly marginal fields; and

WHEREAS; while oil prices have dropped, oil company profits continue to climb.

BE IT RESOLVED that the City of Kotzebue support adjustment of the Economic Limit Factor (ELF) to make it work as originally intended so as to encourage oil production at marginal fields and not give an unneeded tax break to the largest fields on the continent.

Alaska Conference of Mayors
March 24, 1988
Juneau, Alaska

ALASKA CONFERENCE OF MAYORS

RESOLUTION NO. 88- 20

A RESOLUTION OF THE ALASKA CONFERENCE OF MAYORS
SUPPORTING ADJUSTMENT OF THE ECONOMIC
LIMIT FACTOR (ELF).

WHEREAS, the State of Alaska will lose approximately \$200 million in the next fiscal year from the application of the Economic Limit Factor (ELF) to Prudhoe Bay; and,

WHEREAS, the revenue losses to the State are projected to total more than \$1 billion over the next five years; and,

WHEREAS, the Alaska economy is only now beginning to emerge from the deepest recession it has suffered in 30 years; and,

WHEREAS, without the additional revenue the state budget for FY 89 will be almost \$400 million in the red; and,

WHEREAS, cuts of this size would have a devastating effect on the economy and on Alaska's local governments; and,

WHEREAS, the economic limit factor (ELF) was originally intended to serve as a tax break to encourage oil production in marginal fields; and,

WHEREAS, the Prudhoe Bay oil field is in no sense a marginal field, but is instead the largest oil field in North America, and appears to be one of the most profitable oil fields in the world; and,

WHEREAS, the application of the Economic Limit Factor to the Prudhoe Bay oil field is thus wasteful and unnecessary; and,

WHEREAS, the application of the Economic Limit Factor actually discourages oil production at a truly marginal field such as Milne Point;

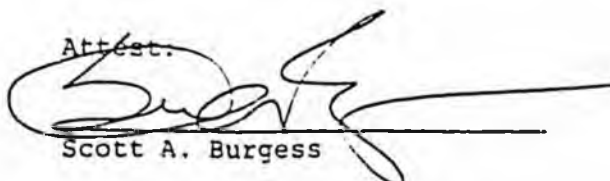
NOW, THEREFORE, BE IT RESOLVED that the Alaska Conference of Mayors urges the Alaska Legislature to enact legislation that would adjust the Economic Limit Factor to make it work as originally intended so as to encourage oil production at marginal fields and not give an unneeded tax break to the Prudhoe Bay field, the largest and most valuable field in North America.

ADOPTED this 24th day of March 1988.



Erling Johansen, President
Alaska Conference of Mayors

Attest.



Scott A. Burgess

By: Jeff Weltzin
Valerie Therrien
Introduced: 03/26/07
Advanced: 03/26/07
Amended: 04/09/07
Adopted: 04/09/07
Reconsideration
Filed: 04/10/07
Reconsidered: 04/23/07
Substituted by Phil
Yunker: 04/23/07
Adopted: 04/23/07

10 6 1987
RESOLUTION NO. 87-043

A RESOLUTION ADDRESSING THE STATE OF ALASKA'S
ECONOMIC LIMIT FACTOR

WHEREAS, the Economic Limit Factor enacted by the legislature in 1981 was intended to promote marginal oil field development; and

WHEREAS, the fields currently producing oil in Alaska differ from one another with regard to production costs and profitability; and

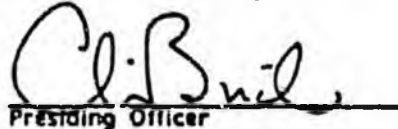
WHEREAS, it is good public policy to encourage commercial production at marginal fields and avoid premature shut-downs in production; and

WHEREAS, a fair and equitable form of oil taxation is beneficial to the residents of the state and the industry; and

WHEREAS, the existing statute dealing with the Economic Limit Factor is faulty in a number of technical aspects and does not fulfill its intended purpose.

NOW, THEREFORE, BE IT RESOLVED that the Fairbanks North Star Borough Assembly urges the Governor and the Legislature to examine each oil field individually, evaluate the economic characteristics of each field, and set taxes accordingly.

PASSED AND APPROVED THIS 23RD DAY OF APRIL, 1987


Presiding Officer

ATTEST:


Clerk of the Assembly



City and Borough of Sitka

304 LAKE STREET. SITKA, ALASKA. 99835

RECEIVED

JAN 12 1989

sc copy
return to me

GOVERNOR'S OFFICE

January 9, 1989

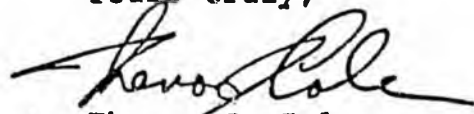
The Honorable Steve Cowper
Governor of the State of Alaska
P.O. Box A
Juneau, Alaska 99811-0101

Dear Governor Cooper:

The Assembly of the City & Borough of Sitka requested that I write to you expressing their support of your position on the Economic Limit Factor (ELF). They are also concerned with the future funding of education and wish to study the matter further before expressing a position on that matter. The Assembly appreciates your giving them the opportunity to respond to these issues.

Thank you for your consideration.

Yours truly,


Theron J. Cole
Municipal Attorney

TJC:COOPER:klw

Mutual opportunities

WE MUST listen carefully to precisely what Bill Wade said. Not to do so could mean a misinterpretation of the message delivered by Mr. Wade, the president of Arco Alaska, Inc.

His was an exciting speech, to be sure, as he addressed yesterday's luncheon forum of the Anchorage Chamber of Commerce.

He used clear and simple words.

Arco, he said, is prepared to invest more than \$7 billion in Alaska over the next 10 years.

That's more than \$700 million a year.

Considering Alaska's down economy, the announcement should have evoked cheers.

But listen carefully.

He didn't say Arco *would* spend \$7 billion between now and 1998.

He said the company was *prepared* to spend that much money, if . . .

Unfortunately, it's a big if.

TO MAKE the vitally important decisions that will justify such investments, Mr. Wade said, Arco "will require reasonable oil prices and a stable tax policy."

And that's totally understandable.

Reasonable oil prices, obviously, are not something the State of Alaska can deliver. Whether we like it or not, Alaskans — and all Americans, for that matter — are at the mercy of the ministers of the Organization of the Petroleum Exporting Countries. When it comes to global oil prices, OPEC calls the tune.

But Alaska is in control of its destiny on the second aspect of Mr. Wade's short list of requirements.

Stable tax policy is com-

pletely in the hands of the administration and the legislature at Juneau.

With wisdom and reasonable attention to reality, we won't go after the neck of the goose that lays our golden eggs.

If the legislature and the administration would lock long term — 10 years in this case, as Arco is looking — it will be obvious that it is in the state's best interest to keep oil taxes steady, if for no other reason than to permit the industry to plan with certainty.

ABSENT THAT, we can anticipate a long and gloomy period of attempting to recover from the deep depression that now engulfs Alaska.

But by adopting an attitude of cooperation with the industry, mutual success can be achieved.

According to Mr. Wade, Arco is ready to put \$3 billion in development of known reserves in the Prudhoe Bay and Kuparuk fields — where he says more than 1,000 additional wells should be drilled.

Another major commitment, he said, is planned — assuming things can move forward — in the initial development of the West Sak field, an area with 20 billion barrels of oil in place. But it's an area requiring the development of difficult and expensive technology to make production possible.

The 10-year program, he emphasized, now represents plans on the drawing board.

But, he said, "our goal is to make them a reality."

Alaska should share that goal, and help make it achievable by not doing something stupid through the regulatory and/or legislative process.

Walking on thin ice

Sunday, March 13, 1988, The Anchorage Times

WE'RE GOING to be in trouble again unless the ladies and gentlemen of the Alaska House quit messing around with a tax system that's working — one that's providing jobs and helping to sustain and expand the state's oil industry in a down economy.

But instead, beating an old drum and proclaiming that white is black, Democratic House Speaker Ben Grussendorf of Sitka and some of his colleagues once again are hell-bent on changing the rules at the expense of the oil companies.

Forget the golden eggs. Attack the goose that lays them.

Raise the cry of "giveaway." Call out that Big Dirty Oil is taking our heritage and our money and throwing only scraps to us Alaskan peons. Lay on more taxes so that the government in Juneau will have more money and the legislators will have more dollars to scatter hither and yon among their individual districts, thus helping ensure their return to office at the next election.

THIS TIME — as it was a year ago — the target is the Economic Limit Factor, the so-called ELF tax formula designed and put into place some three years ago to encourage oil companies to keep drilling, to keep looking for new fields to replenish those in decline or soon to face decline.

On the basis of the complex formulas of ELF, the oil companies operating in Alaska — and employing huge numbers of people and providing the state with virtually its entire revenue source — have made their long-term plans, mapped their budgets, set up drilling and production schedules.

And ELF is paying off.

Alaska is the beneficiary of the results.

But Mr. Grussendorf, a Sitka teacher, knows better. As a populist, he raises the shout that the oil companies have received a "tax break" that is costing Alaskans millions of dollars a year.

If he had his way, and if he and his Democratic colleagues prevail, Alaska will lay yet another tax increase on the oil industry.

And that's precisely what a change in the ELF statute would be — a tax increase.

Pure and simple that and nothing more.

THE EFFECT would be to impair the oil companies — the big employers of the state — to continue some drilling programs and very likely force them to delay, or even abandon, others.

The state government — and Mr. Grussendorf and the legislators — would get more money.

But Alaskans would lose jobs and opportunities.

The economy, struggling to recover from a depression that has been devastating to thousands of Alaskans (if not to some legislators), would take another blow to the midsection.

And action repealing or significantly amending ELF would send yet another negative — terribly negative — signal to domestic and foreign business and industry leaders whose capital investment in Alaska are so desperately needed. We would be telling them, in a loud and clear voice, that they can't trust Alaska to keep its word, can't trust the state to keep the playing field level, can't trust Alaska as a place for the investment of venture capital and dollars.

And that's shockingly the reverse of what we should be doing.

ARCO head: ELF repeal would deter industry

The Associated Press

FAIRBANKS

The head of ARCO Alaska Inc. came to Fairbanks with a promise of economic hope and a warning.

"Don't call it a threat," ARCO President Bill Wade said Tuesday. "It isn't that."

The promise of hope was ARCO's plan to spend more than \$7 billion on oil-related work in Alaska during the next 10 years, with industry-wide expenditures estimated at \$20 billion to \$25 billion during that time.

The warning was that an increase in oil taxes might make ARCO and other oil comp-

anies think twice about making such a large investment in Alaska.

Wade made his comments in an address to about 250 people attending the Fairbanks Chamber of Commerce luncheon Tuesday.

He said tax increases in Alaska, such as repeal of the economic limitation factor, or ELF, would send the wrong signal to the oil industry, particularly while it is going through such turbulent times.

Despite fluctuating oil prices on the world market, ARCO believes it has a bright future in the state. "ARCO is bullish on Alaska," Wade said.

The key to further ARCO investments in Alaska, Wade said, is whether Atlantic Richfield Co.'s board of directors feel the company is working in a stable tax and regulatory climate. Atlantic Richfield is ARCO Alaska's parent company.

Wade said ARCO's \$7 billion plan was submitted to Atlantic Richfield directors last January. "Clearly, my objective as president



William Wade

of ARCO is to make this plan become a reality. We still have so much to do in this state," he said. That includes work on existing oil fields, more exploration, and bringing other known oil reservoirs, such as West Sak, into production, he said.

"We see tremendous exploration opportunities waiting here," Wade said. "But tax stability is the key, that's why you hear us talking so much about it and about the ELF."

Wade was referring to legislation put forward by the state House of Representatives to remove the ELF from application to Prudhoe Bay.

A form of oil-production tax, the ELF was initiated in 1977 and revised in 1981. As written, it lowers the taxes paid by the industry on oil production from Prudhoe Bay to encourage industry investment of the money in other Alaska oil exploration, development and production activities. Sponsors of

the law envisioned new job opportunities for Alaskans and new revenues for the state.

However, the ELF isn't working the way its sponsors planned, according to Rep. Mark Boyer, a Fairbanks Democrat who has been pushing hard for partial repeal of the ELF incentive.

Boyer cited testimony from Conoco that the proposed ELF revision would provide the incentive the company needs to develop the Milne Point oilfield, a marginal oil field on state land.

"If we don't do something, we leave oil in the ground in marginal fields and we continue to give a tax break to some of the largest companies in the world," Boyer said.

He said the House proposal, if enacted, would bring \$179 million additional dollars to the state in its first year, and \$1.4 billion over the next five years.

But the oil industry says House Democrats want to revise the ELF to bring more money into state coffers so they can appropriate it for projects in their districts in an election year.

In an interview Tuesday, Wade said the

effort to repeal the ELF seems "hypocritical" because legislators aren't trying to increase taxes on any other state industry to make up for the state's revenue shortfall.

Because the Prudhoe Bay oil field, the largest in North America, is on state land, the oil industry pays a royalty in addition to state severance taxes on its Prudhoe operations.

ARCO Alaska, he said, paid the state \$300 million in severance taxes and \$300 million in royalties to the state in 1987. The oil industry accounted for 94 percent of all the taxes paid to the state last year, Wade said.

State taxes in 1987, he said, made up ARCO's largest expenditure. He also said the company spent \$457 million in Fairbanks between 1982 and 86.

At the luncheon, Wade said the industry invested in state oil fields other than Prudhoe Bay — fields more expensive to develop — because the state's stable tax climate encouraged it to do so.

"Now times get a little tough, on our industry particularly, and they want to change the rules. That doesn't seem fair," he said. "How would you feel if it were your company and your industry?"

Arco's plans unaffected by lower oil prices

By Ray Tyson
Times Business Editor

Oil prices would have to slip further and remain depressed for six to nine months before investment plans by Arco Alaska Inc. were seriously threatened, company president Bill Wade said.

However, Wade said Tuesday after a speech to the Society of Petroleum Engineers, he doesn't expect oil prices to continue their slide.

In fact, Wade said he expects prices to rise and hold at about \$20 a barrel into the 1990s and then rapidly increase.

Arco fashioned its \$7 billion, 10-year capital budget for Alaska based on \$20-a-barrel oil.

About \$3 billion of Arco's budget is earmarked to develop known oil reserves, including West Sak, a field on the North Slope believed to contain as much oil as the giant Prudhoe Bay reserve.

Since last fall, however, the price

of North Slope crude has declined steadily to \$12.75 a barrel on the West Coast and \$13.75 on the Gulf Coast.

Arco based its 10-year budget on the West Texas Intermediate benchmark, which has been hovering in recent weeks at about \$15-to-\$16 a barrel.

Wade said the oil industry as a whole will spend \$20-\$25 billion on projects in Alaska over the next 10 years, if oil prices are steady and the tax climate is favorable.

"If we go to \$10 a barrel and stay there, obviously we are not going to have \$7 billion to spend," Wade told the gathering of petroleum engineers at the Anchorage Hilton Hotel.

"The message is that Arco is very bullish on the state . . . there is a lot of investment opportunity . . . and we are hoping oil prices will be good," he said.

Wade said oil prices will remain "volatile," but he said price-to-production ratios, in the short term, will

be controlled by OPEC, depending on what is in the cartel's best interest at the time.

OPEC has indicated a desire to eventually increase prices to \$20 a barrel, Wade said.

"We try not to get caught up in the day-to-day, seasonal movements of oil prices," he said. "Short-term things are not what we base long-term decisions on."

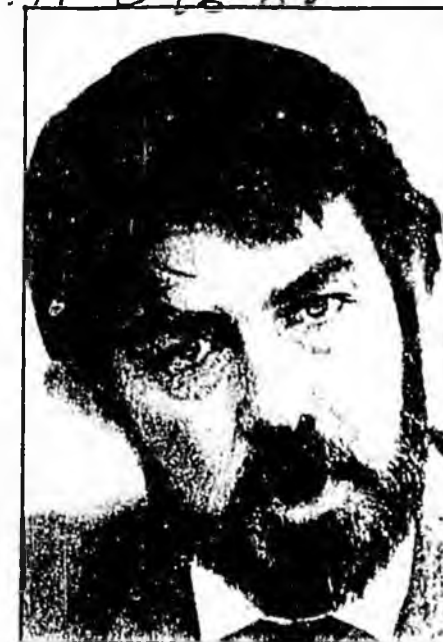
Wade also suggested any tax increases on the oil industry may disrupt investment plans for Alaska.

He said the roughly \$300 million in taxes the state collects from Arco each year is more than the company spends on payroll, supplies and materials in Alaska.

"This state has a pretty unhealthy tax structure," Wade said.

"We (industry) are paying 95 percent of the tax receipts — that's a really unhealthy dependence on one industry. We have been the golden goose that has run the state."

AT 3-16-88



Bill Wade
... planning on \$20 oil

ELF repeal question continues to capture writers' fancy

Issue bigger than one tax break

In recent communications Jan Faiks and others have demonstrated commendable loyalty to ARCO and BP. Nonetheless, it seems unlikely that revoking the ELF tax cut on our immensely profitable Prudhoe Bay field will alter oil company expenditures in Alaska. Nor should we fear the effects of leaving less accessible oil underground until the price is right, even if that only benefits our children.

I certainly favor continued investments in Alaska by large foreign corporations like BP and "Outside" companies like ARCO, and agree that we must avoid taxing them "for all they are worth" while they remain. But I also resent the way Fink, Faiks, Halford, Abood, Paul Fischer and many others turn limp whenever the discussion comes around to taxes on the oil industry. For if our politicians can be bought and sold like potato chips, who is there to negotiate on our behalf?

The real issue is far greater than a single unnecessary ELF tax break. Alaska's biggest problem is the continuing corruption of our representative form of government by all those Big Oil dollars, while advertisements promise future jobs and good times galore as long as we don't challenge their rule. Fortunately, we still have regular elections.

— Arndt Von Hippel

What did industry do to state?

Let's look at some facts. When we pay our income taxes, we complain but we pay the taxes. No one comes up and says he since he doesn't like the law he doesn't have to pay taxes. Why should it be any different for any industry? Alaska has fair oil taxes so leave the law alone.

As for our legislators, I sincerely believe that all or almost all of the ones from Anchorage should be excused from any bills concerning the oil industry because of conflicts of interest. This is if any members of their family are working for any oil firms,

or if more than a thousand dollars' contribution was made to them in any form from the oil industry they are under too much pressure to make a fair decision after selling their vote.

Let's stop saying, "What did the oil industry do for Alaska," and put it in a true form and say, "What did the oil industry do to Alaska?" It is time to start thinking what is best for Alaska and do it.

— E.A. Endicott

Article might give wrong idea

Shame on Hal Spencer for his article on Alaska's ELF tax break for the oil companies and their donation of bucks to Sen. Jan Faiks. People may get the idea that Sen. Faiks is the finest that oil companies can buy.

— Bob Caughey

A subsidy is a subsidy

A subsidy is a subsidy regardless if it is the old-timers' \$250 a month or ELF. The first test of any subsidy is need; the second test is that need is so great that the subsidy funds must be raised by another segment of our social economic structure. Then if in the public's mind that the subsidy is needed and affordable then and only then should any subsidy be enacted by the legislature or Congress.

In my opinion, based on public information, the Forbes article on March 21, 1988, and U.S.A. report and annual corporate reports of the North Slope companies, it is apparent that the ELF subsidy is *neither needed or affordable* at this time.

— Bruce Kendall Sr.
former Speaker of the House

Let's pay Faiks \$45,000

Rarely is such honesty so forthcoming from the power brokers as it is today from our own politicians in Juneau. Senate president Jan Faiks, an "oil industry" ally

who received almost \$40,000 in oil industry campaign donations in 1986" (Daily News, March 15) is blatantly up front about where her loyalty lies. If this is going to cost the state, and thereby all Alaskans, \$1.4 billion over the next four years, perhaps we the people should offer her \$45,000 and call the oil industry's bluff. This is serious econo-

I call on all Alaskans to either donate to the Faiks for Alaskans fund or call their senators and ask them to repeal the latest oil industry "tax break."

— Paul Kroenung

ELF repeal threatens projects

Prudhoe Bay may not be considered a marginal field, but some major industry activities there are marginal. The easy oil has already been produced, and "marginal projects" aimed at squeezing out more oil from beneath the tundra will hold the key to additional production and state oil revenues.

There is much more drilling and development work to do in the aging Prudhoe Bay field, but repeal of the economic limit factor will only dampen the economics of marginal projects. These investments, which cost industry hundreds of millions of dollars and justified with ELF in mind, mean more jobs, more exploration, more development and more revenue. But all this could be threatened if taxes under ELF are increased.

Any negative effect of the ELF formula is currently offset by increased revenue to Alaska from additional drilling and production. Yet the state claims that because ELF has created an incentive for operators to drill more wells, tax revenue "losses" will be greater than anticipated. As a result, the state wants to repeal ELF, in effect penalizing industry for increasing production and generating new revenues for Juneau.

With or without ELF, the tax rate at Prudhoe Bay will still exceed that of any other state. If government opts for even higher taxes on industry, a few years of higher government revenues and larger state budgets might be purchased, but only at the cost of future prosperity and private sector jobs.

— Carl Portman, public relations director
Resource Development Council

Senate honors a commitment that never existed

JUNEAU — As the chief justice spoke, the president of the Senate and the speaker of the House exchanged notes one morning in early March. Ben Grussendorf offered a deal to Jan Falks, but with another quotation bound for glory she declined.

"...The ELF is an organizational matter and has my word of honor," the Senate president wrote. "It is a matter of grave personal commitment on my part."

Using that line like a live grenade, Grussendorf accused Falks in a "Dear Alaskans" letter, reprinted in the Daily News Friday, of selling out to the oil industry over a tax loophole that's "a pickpocket, purse-snatcher and thief of jobs."

Those are heavy words to describe a small part of state law re-born in obscurity during one of the most tumultuous months in Alaska politics. It was June, 1981, when the economic limit factor was repealed and re-enacted by a legislature turned upside down in an overthrow of the House leadership.

Flush with money that year, the legislature was trying to reach a settlement with the oil industry over a lawsuit filed against the state's oil and gas income tax. The ELF was not at issue then, but an estimated \$7.3 billion was at stake in the court battle, and the state — unsure of winning — wanted to hedge its bets.

The House and the governor pushed for a back-up tax on producing oil reserves that would kick in if the state lost the income tax case. The Senate wanted to settle with the industry by taking the offending law off the books. A chain of events that June gave the Senate a victory:



john greely

- On June 9, the House passed its back-up tax over the objections of GOP leader Joe Hayes (who would become speaker in six days) that "the way to solve the problem is not with this bill, but to reach a settlement with the oil industry."

- On June 10, the Senate rejected the House bill and appointed Republicans Ed Dankworth and Don Bennett to a three-man negotiating team. The House team was led by Democrats Terry Gardiner and Tony Vaska.

- On June 15, the House leadership was replaced by a Hayes-headed coalition.

- On June 17, Hayes replaced Gardiner and Vaska on the negotiating committee with Republicans Rick Halford and Pat O'Connell.

- On June 24, the free conference committee issued a bill patterned after the Senate's approach to income taxes. It was adopted 17-2 by the Senate and 21-17 by the House just before the legislature adjourned.

Gov. Hammond signed the law, but the litigating oil companies rejected this settlement offer and chose to take the case to the

U.S. Supreme Court, where five years later they lost a 5-to-3 decision. While it won in court, then, Alaska lost several hundred million dollars in removing from the books a corporate income tax whose legal foundation was to be proved solid.

That's 20-20 hindsight of course.

What's far more topical is the fact that the 1981 legislature stuck the state with a tax loophole through which the industry is now driving a truck loaded with even more profits from Prudhoe Bay.

Enacted originally in 1977, the ELF was a feature of law giving oil producers a break on state severance taxes as individual wells reached their "economic limit." Aimed primarily at Cook Inlet, where producers were squeezing out mere hundreds of barrels daily, the ELF was never to apply to the most prolific wells on the North Slope until well into the next century, if then.

But a funny thing happened on the way to the millennium. During those two weeks in 1981, the legislature altered the ELF in such a way that starting in 1987, the biggest oil field in North America was declared to be at its "economic limit." That timed a tax break with the peak production years of Prudhoe Bay, hardly the intent of state law.

Hammond could have vetoed the ELF alterations seven years ago, but that would have meant tubing an overall tax settlement before the industry had a chance to reject it. Instead, he demurred, saying that "as for the possible revenue effects in 1988 and beyond, I have full confidence in the ability of the legislature to deal at that time with whatever is required to

retain the state's 'fair share' of our oil wealth."

Perhaps Hammond never figured on Falks making a "grave personal commitment." Of course, the Anchorage Republican wasn't in office then and it would be a few years yet before she would disclose that "Waikiki is no picnic" and "the rich deserve representation, too."

Falks was quick to cover her tracks last week by saying her personal commitment was actually a government commitment to the industry not to raise taxes. The public is getting its fair share of Prudhoe Bay, she said.

But that bit of back-tracking not only is wrong, it's also beside the point, as legislators sweating blood over the state budget shortfall are seeing in grim reality. Under pressure to raid the permanent fund, cut state services, or both, legislators are being bound by a "personal commitment" to preserve a tax loophole that was never intended to exist, or at best is premature, but through which an estimated \$1.2 billion will flee the state treasury in the next five years.

So, to borrow Grussendorf's canine analogy of last week, the House speaker may be just a wild dog howling at the moon, but when it comes to the ELF issue, the Senate president and her colleagues are riding a hound that just won't hunt.

□ John Greely, a Juneau radio reporter, covered the legislature for a variety of news organizations from 1972-82. He was Gov. Bill Sheffield's deputy press secretary and press secretary from 1982-1988.

Oil industry runs ads to keep tax break

Association chief says campaign designed to counter moves to cut exemption

By HAL SPENCER *ADN 4/1/88*
Daily News reporter

In one television advertisement, children are shown enjoying the Loussac Library in Anchorage, a facility, the ad says, "made possible by oil and gas development in Alaska."

In another, happy teens play with computers and basketballs in the gleaming new North Pole High School "built with pride by the people of North Pole and made possible by oil and gas development in Alaska."

A third ad shows colorful Eskimo dancers performing at the Arctic Museum in Kotzebue, a facility also brought by oil and gas development, the ad says.

The television ads, sponsored by the Alaska Oil and

Gas Association, never mention the word taxes. But the ads are a direct response to legislative moves to suspend a controversial oil severance tax reduction for Prudhoe Bay producers, said the association's executive director, Bill Hopkins on Thursday.

Prepared by Mystrom Advertising Inc. of Anchorage for use in television markets all over the state, the ads have drawn fire from House Speaker Ben Grussendorf, who calls them misleading.

Hopkins, on the other hand, said the ads, and four newspaper ads on the same subject, are a legitimate and reasonable response to a push by Grussendorf and other legislative Democrats, as well as by Gov. Steve Cowper, to suspend or revise the Economic Limit Factor, or ELF, a

severance tax formula used to encourage development of marginal fields.

The ads are intended "to raise awareness of the public of where these things (facilities) have come from. What we are saying is the benefits we have in Alaska are many and varied, but they all come from the same source, oil and gas development," Hopkins said.

Grussendorf, D-Sitka, contended the television ads are misleading because they suggest that the oil and gas industry brought Alaskans fine new facilities, when, in fact, it was petrodollars from state-owned oil leases that paid for the facilities. In other words, Grussendorf said, the state allowed the industry to make huge profits developing the state's oil. The indus-

try did not do "the state" favor by doing so, as the ads seem to imply, he said.

Grussendorf said he sees one good result of the ads: "They're an economic stimulation for the media to get them through until election ads start," he said.

Actually, Hopkins asserted, the ads suggest a partnership between the state and the oil industry. True, the state owns the oil production leases, but it was the industry that discovered and then developed the oil, he said.

Mystrom account executive Cheryl Tatom, who helped create the television ads, said "We're not saying the oil industry did all this. We're saying it couldn't have taken place if the oil industr

and by Bradley Advertising Inc., are more direct in linking state tax loads to oil activity. One quotes a Doyon Drilling official as saying "There's a new sense of optimism" and increased drilling activity since the ELF "kicked in" last summer.

AOGA is the trade association of Alaska oil and gas producers, and is funded by producers ranging from ARCO Alaska to Standard Alas-

ka Production Co. Hopkins declined to divulge the cost of the ad campaign.

The ELF, state revenue officials contend, will cost the Alaska treasury more than \$1 billion in taxes over the next five years. Gov. Steve Cowper and House Democrats argue that the ELF should be suspended or revised so that it does not apply to Prudhoe Bay, the richest oil field in North America pumping 1.5

million barrels of oil a day.

Oil industry officials, including the presidents of Standard Alaska Production Co. and ARCO Alaska, Inc., say Prudhoe is wearing out. They say it has reached its economic limit at current oil prices and tax rates, and needs the severance tax reduction.

The officials say further oil and gas development at Prudhoe and elsewhere on the

North Slope could be retarded or halted if the industry is forced to shoulder a heavier tax burden.

Grussendorf and other lawmakers worry that revenue lost to the ELF may be made up in a budget crunch with earnings reserves of the Alaska Permanent Fund.

Hopkins and other industry officials say state government should employ another solution — reduce state spending to match revenue.

hadn't been in Alaska. I guess we were just trying to make people realize how important the industry is to Alaska."

But Grussendorf said the ads seem to say quite clearly that if it were not for the oil and gas producers, libraries, schools and museums would not exist in Alaska.

Some of AOGA's newspaper ads, prepared by Mystrom

ELF dealing a critical blow to state's budget

By HUGH MALONE

The Economic Limit Factor is a tax break for oil companies that has gone awry. The ELF has helped throw the state into a fiscal crisis, and is also inhibiting oil development at marginal fields.

The ELF formula reduces the state's severance tax on oil depending on the productivity of a particular well. When the ELF was originally created in 1977, the intent was to keep taxes low at marginal oil fields — such as those in Cook Inlet — so as to encourage production. At highly profitable fields — such as Prudhoe Bay — the ELF was supposed to match a field's tax rate with its productivity, and thus tax rates would fall as a field's production began declining.

The ELF is not working as intended. The tax law does not operate to encourage production at marginal fields. In fact, the ELF provides an

insufficient tax break to bring fields like Milne Point into production.

Meanwhile, the ELF provides a massive and unnecessary tax break to fields like Prudhoe Bay, which need no help at all. The ELF reduces the effective severance tax rate by 20 percent on the Prudhoe Bay field. Prudhoe Bay is the largest oil field in North America, and probably the most profitable "supergiant" field in the world. Data in Petroleum Intelligence Weekly show that after paying all expenses and taxes, the oil companies are making profits of \$6 million a day from the North Slope.

The application of the ELF formula to highly profitable fields such as Prudhoe Bay and Kuparuk is causing the state to lose substantial revenues. Unless the legislature modifies the ELF as proposed — assuming that oil prices are at \$15 to \$16 a barrel over the

next 16 months — the Department of Revenue estimates that the state will lose \$150 million to this fiscal year and \$152 million in the next.

The loss of revenue caused by the current ELF is a major reason the state faces more than a \$400 million shortfall in the budget. This shortfall is 20 percent of the total budget. Simply cutting the budget by 20 percent in one year — such as some have suggested — would devastate the Alaska economy just as it begins to climb out of a deep recession. The University of Alaska's Institute of Social and Economic Research has stated that across-the-board cuts of \$400 million would ripple across the economy and ultimately cause more than 9,500 Alaskans to lose their jobs.

A better approach is to alter the ELF by passing proposed legislation called House Bill 164. The bill would modi-

The tax law does not operate to encourage production at marginal fields. In fact, the ELF provides an insufficient tax break to bring fields like Milne Point into production.

fy the ELF to shift tax breaks to marginal fields that really need them. The net effect of these changes is also to collect \$1 billion in additional revenue over the next five years that would otherwise be lost.

Two additional reasons make it critical that we change the ELF now. The first reason is that changes made in 1981 in the state income tax that oil companies pay have cost the state more than \$1 billion.

According to Petroleum In-

telligence Weekly oil companies in Alaska pay an effective state income tax of only 3 percent. This rate is only a third of the 9.4 percent rate paid by other Alaska businesses. This loss of "fiscal horsepower" from the state income tax on oil companies makes it even more important to ensure that our severance tax and its ELF work properly.

The second reason making it critical to change oil taxes now is that North Slope oil is

a one-time bonanza of non-renewable wealth. The resource is leaving the state at a rapid rate. More than half of the oil ever discovered in Alaska has already been produced. Once this oil leaves Alaska, the revenue is lost. The state needs to change its oil tax laws now before it is too late.

□ Hugh Malone is Commissioner of Revenue. He served in the Alaska House of Representatives from 1973 through 1984.

Oil company reports don't support need for tax break

On Sept. 21, 1986, I warned readers of this page that a little-known provision of state law called the Economic Limit Factor, or ELF, could put a multi-million dollar dent in Alaska's oil revenue.

That column was the midwife to the birth of the ELF as a public issue, and it has certainly grown since then.

The ELF is supposed to be a tax break to encourage development of the poorer oil fields in Alaska. It was rewritten in 1981, at the same time the Legislature voted to abandon the separate accounting method of oil industry income tax.

The severance tax was raised slightly in 1981 to make up for the income we would lose without a full tax on oil industry profits here, but the ELF was rewritten to insert a loophole in those higher taxes. We were told ELF was needed to keep the severance tax from being a burden on smaller oil fields.

At that time, then-Gov. Jay Hammond repeatedly swore the measure was "revenue neutral," that it would not reduce oil income. In fact, we now know that his measure as cost us hundreds of millions of dollars.

As a sidelight, the man who wrote the ELF formula and crafted the rest of Hammond's package was Tom Williams, Hammond's commissioner of Revenue. Williams is now employed by Standard Alaska Petroleum Co., owner of half the oil in Prudhoe Bay.

As my earlier column warned, the ELF was to go into effect for the



**Fred
Pratt**

Prudhoe Bay field in June, 1987. The most recent Department of Revenue estimates I've received say the ELF will cost the state \$1.2 billion over the next five years.

Revenue officials argue that Prudhoe Bay is obviously not a marginal oil field, and they are urging the Legislature to exempt it from the ELF tax deduction.

This all comes to mind since the president of ARCO Alaska, Bill Wade, was in town two weeks ago crying and moaning about his company's taxes. This self-serving lamentation from the oil companies has become so common in Alaskan public affairs that we all tend to tune it out, a matter that Wade acknowledged even before he began.

Wade sang the usual tune of how the oil companies would like to do a lot of work in Alaska, but they need a stable tax climate with no tax increases in order to plan their capital projects.

Now most Alaskans know why we don't lose lots of sleep over the poor oil industry's taxes, but for Wade and other newcomers, it's probably good to expend a few paragraphs in explanation.

First, let's dispose of this face-

tious "stable tax climate" argument.

Alaska has changed oil company taxes only once in the last decade, and that was 1981 when we lowered them. This year we're due to lower them again if the ELF formula goes into effect. How many of your businesses face that kind of tax situation? Why should the oil companies be any different?

ARCO is the only public corporation left among the oil companies that have their major dealings here. The other, Standard Oil Co., is a subsidiary of British Petroleum and its results are buried deep within that company's finances. Exxon Corp. is the third-largest Prudhoe Bay owner, but Alaska plays a small part in Exxon's overall operations.

ARCO owns about one-third of the Prudhoe Bay field, and it's the largest owner of the Kuparuk field. Alaska North Slope production is 70 percent of ARCO's total, so its financial reports are the best reading we have on the profitability of our oil industry.

So how has ARCO been doing? According to ARCO's own reports, the company has been doing quite well despite the 1986 plunge in oil prices.

In the first quarter of 1987 ARCO was producing 472,000 barrels per day of oil from the North Slope, up from 427,600 in the first quarter of the previous year. This helped offset the lower oil prices it was receiving.

In the second quarter of 1987

ARCO reported its profits had more than doubled from the previous year. Its net income was \$330 million, or \$1.80 per share, up from \$150 million, or 83 cents a share, on only a 15 percent increase in gross revenue.

This wasn't due to downstream profits, but from the Alaskan crude oil end. ARCO's profit from refining and marketing operations plunged 63 percent to \$45 million from \$121 million the year earlier.

The dramatic doubling in profits came from crude oil earnings and some relatively minor accounting changes and contract settlements, and it was posted when ARCO was still getting only a relatively modest \$12.76 per barrel for its crude oil.

For the first half of 1987, ARCO's profits increased 27 percent to \$569 million while its revenue was \$7.85 billion, nearly identical to the same period of the previous year.

The trend continued. ARCO ended 1987 with the highest per-share profits of its history, \$6.68, with \$1.22 billion earned on revenue of \$16.83 billion. Its fourth quarter profits were more than four times what it earned the year before.

In the second half of 1987 ARCO went shopping. The company had amassed cash and securities of \$3.5 billion, up from \$2.4 billion the year before, and Wall Street analysts estimated its flow of funds from continuing operations exceeded \$3

billion in 1987, up from \$1.3 billion in 1986.

ARCO set out on a plan to triple its operations outside the U.S. It entered a bidding contest with BP for Britoil PLC, a Scottish North Sea company. When BP bought out ARCO's 24 percent share of Britoil, ARCO made a tidy after-tax profit of \$110 million for the first quarter of this year.

ARCO used this money to buy Tricentrol PLC, a smaller North Sea firm, for \$331 million. ARCO estimates it got Tricentrol's oil reserves for about \$4 per barrel.

A story in the Wall Street Journal earlier this year called ARCO "one of the nation's most profitable oil companies" and said its per-share profits in 1987 were actually higher than what it was earning in the days of \$30-per-barrel oil.

On March 30, ARCO president Lodwick Cook told a meeting of New York security analysts that ARCO will earn more than \$2 a share just in the first quarter, which is well ahead of 1987's record-setting performance. This can't happen when North Slope oil prices were running \$3 a barrel lower than the year before.

Is this an industry that needs a tax cut just to stay in business?

Free-lance journalist Fred Pratt has been covering Alaska business and politics for the past 15 years.

4-11-88 FANM

ELF: from myth to reality and back

ADN Editorial 4-20-88
Tom Williams is the man who claims credit for writing the controversial oil tax law known as the ELF, or economic limit factor. The Hammond administration revenue commissioner defended his creation at Monday's Anchorage Chamber of Commerce lunch. His theme was ELF: the myth vs. the reality.

Mr. Williams, now a tax planner for Standard Alaska Production Co., took his audience from myth to reality, but he then led them back to myth again.

He did debunk the myth that the ELF was a tax change born of the billion-dollar oil tax cut passed by lawmakers in 1981. The ELF first took effect in 1977.

Mr. Williams also debunked the myth that ELF never applied to Prudhoe Bay until last year. It applied to Prudhoe Bay when it passed in 1977, but the 1981 tax law suspended the ELF on Prudhoe until last summer.

As Mr. Williams also pointed out, the original ELF was not strictly a Republican creation. Gov. Steve Cowper spoke in favor of the ELF when he served in the state House in 1977.

But then Mr. Williams proceeded to leave his listeners with a few myths of his own.

First is his claim that the ELF is doing exactly what it's supposed to do: reduce taxes on fields as they approach their economic limit — the point at which production becomes so costly, the field is shut down.

No one, except an oil executive defending a lucrative tax break, could argue that Prudhoe Bay is near its economic limit. The average oil well at Prudhoe produces 2300 barrels a day; nationwide, the average is about 15 barrels. The investment firm Solomon Brothers estimated that ARCO made an operating profit of \$7 a barrel at Prudhoe Bay in 1987. Yet the ELF has cut severance taxes at Prudhoe Bay by nearly 20 percent.

Mr. Williams also says ELF is not a tax break. Whenever the ELF came up, he says, it was in conjunction with a tax increase: first in 1977, again in 1981.

Mr. Williams' point is a half-truth. Oil severance tax rates were indeed increased in 1977, and again in 1981. But Mr. Williams neglects to mention that the 1981 law, pushed by Republicans, also repealed the oil income tax called separate accounting. That move has already cost the state \$1 billion. Mr. Williams, who as revenue commissioner helped write those changes, said at the time they would cost only \$130 million.

It's important to remember that Gov. Steve Cowper and the House do not want to do away with the ELF. They have proposed a new ELF formula that does the same job — encourage production from fields that really need tax help — at less cost to Alaskans.

Beneficiaries of today's ELF, like Mr. Williams' employer Standard Alaska, object to any change. But Conoco, which owns a truly marginal field at Milne Point, has expressed support of the House formula. So, when industry officials sing the praises of today's ELF, don't be fooled by self-serving myths.

Marked recovery for most in 1987

The oil industry's story in 1987, as presented in recent annual reports, was decidedly brighter than in 1986. There was a widespread recovery in profits, cash flows were higher, and long-term debt was reduced in most cases. However, operating figures changed relatively little, with only three leading companies reporting a significant rise in oil product sales. Natural gas and chemicals were more buoyant. The changing fortunes of the seven majors put Royal Dutch/Shell into equal first-place with Exxon on most criteria, while BP jumped into third position.

FOLLOWING what was for most of them a turbulent and difficult year in 1986, the major integrated oil companies made the best of a partial recovery in prices during 1987. Omitting Texaco as a special case, (see below), the other four US-based majors reported profits ranging from \$1.0bn for Chevron to \$4.8bn for Exxon. With substantial increases for Amoco and Chevron outweighing declines by Exxon and Mobil, their combined total was 3% better at nearly \$8.5bn; while the Europe-based Royal Dutch/Shell and BP groups both scored very considerable gains. The earnings recovery, stimulated by the rally in crude oil prices since the lows of 1986, has already been reviewed in our March issue (see page 101). Basically, it involved an upsurge in exploration/production profits despite generally lower volumes. Downstream profits were depressed until the fourth quarter, but have since rebounded strongly in the first quarter of 1988 (see page 203). Last year, cash flow improved for all except Texaco and Royal Dutch/Shell, but capital investments were held in check below 1986 levels, while asset sales helped to reduce long-term debt in most cases. Operating data for the five US groups registered little change in oil reserves and production, refinery runs and product sales; but natural gas sales rose by 5% on average, and there was a widespread boost for chemicals. The emphasis in some of the reports is on opportunities for expansion upstream through reserve additions at relatively modest prices, while the stress downstream is on upgrading and to some extent on joint ventures with others — including OPEC state companies seeking integrated status through commitments inside the main consuming areas. Finally, the relative position of the seven majors under review has changed, with Royal Dutch/Shell pulling broadly level with Exxon and BP leaping into third place.

Amoco Although still the smallest of the five US majors in terms of asset values and product sales, Amoco last year was perhaps the outstanding performer of them all with its 41% increase in cash flow and 82% rise in net income (see Table). While retaining its position as one of the USA's leading crude oil and natural gas producers and fifth largest refiner with 5% of the domestic market, its policy in recent years has been to emulate the larger internationals by expanding overseas, where it is now active in some forty countries and has 35% of its proven crude reserves. Emphasis on upstream activities at home and abroad led to the replacement of 130% of production during the year through a combination of exploration successes, improved recovery, and acquisitions. That was probably the best result for any major company, and represented a significant turnaround from

1986 when reserves had declined sharply. The improvement featured major additions to reserves in the US onshore, Egypt, China, and the North Sea. It will be followed this year by the addition of 121 million barrels of oil and gas liquids and 3 trillion cubic feet of natural gas from the \$4bn (C\$5.5bn) acquisition of Canada's Dome Petroleum, agreement on which formed the highlight of Amoco's 1987 report. This will make the company the biggest natural gas producer and reserve holder in North America, not to mention Dome's crude oil production and undeveloped heavy oil properties. The continuing drive to expand internationally has been underlined by a recent decision to direct over 50% of exploration and production spending to foreign operations over the next five years, up from around 34% during the past twenty years. Downstream activities last year featured a continued rise in sales of lead-free gasoline, where Amoco is the market leader, and a dynamic performance for chemicals with profits up 64%.

Chevron Despite its healthy rise in cash flow and net income* and its better than average increase in product sales, Chevron's report does not enthuse over what it saw as an "uncertain" year — in some ways "even more demanding than 1986". Operating earnings failed to reach the levels desired, although new programmes are expected to result in significant improvements during 1988. Obviously, there is cause for satisfaction in the continued reduction of long-term debt, with the burden cut by over half since the \$13.3bn acquisition of Gulf Oil in 1984 and the debt ratio down from 51% to 31%; but the board's attention is currently directed to the need for continued streamlining. Chevron is selling smaller, inefficient fields and consolidating operations by trading properties with other companies where feasible; concentrating its marketing efforts on the growing Sun Belt area of the southern states; looking at joint ventures such as last year's agreement with Nippon Oil on US drilling; and exploiting new "niche businesses" within the scope of its present operations. Upstream consolidation has meant accepting some reduction in output (Chevron's US production was 7% down last year and the worldwide total down by 3%), but the report notes that new production has begun offshore California while secondary and enhanced recovery are providing good returns onshore. Production is rising in Canada, and overseas operations have stayed profitable. West Africa

* Since the annual report appeared, Chevron has restated earnings for the past two years to meet new accounting standards. To reflect deferred taxes arising from the 1984 acquisition of Gulf, 1986 has been restated to show a \$1.41bn loss, while net income for 1987 has been increased to \$1.25bn.

despite the recent enforced sale of 20% of its Angolan offshore interests) and Indonesia continue as major sources of crude production, along with the North Sea; and Chevron is looking ahead to the start-up next year of the Australian LNG 'megaproject' in which it has a one-sixth share. Downstream, the company retains its position as the USA's largest seller of refined products in general and second largest in gasoline sales, with important positions too in Canada, the UK (through Gulf Oil Great Britain), and the eastern hemisphere — where it markets in over fifty countries through 50%-owned Caltex. Chemical earnings more than doubled to a record high last year.

Exxon In contrast to Amoco and Chevron, the largest of the US majors might almost be said to have 'marked time' during 1987. Exxon's production rose by only 2%, refinery runs were nearly 2% down, and the product sales were unchanged at 4 043 000 barrels/day — still way ahead of its US competitors but lower than the Royal Dutch/Shell Group's 4.9 mb/d. The recovery in the upstream business on the bases of higher prices and lower operating costs (along with improved earnings from chemicals) was not enough to offset the squeeze on margins downstream, and net income overall fell by 10% to \$4.84bn — only \$100m ahead of the Shell Group's figure expressed in dollars. However, Exxon continued to expand its asset base, unlike most of its competitors, as the value of fixed assets rose by 8% to \$53.4bn and total identifiable assets by 6% to \$74bn. Exxon's upstream strength was enhanced by liquid reserve additions equal to 114% of its production during the year, due in part to purchases of 450m barrels of oil equivalent for

about \$1.3bn. Much of this came from properties in the USA, Canada and Australia acquired with Celeron Oil & Gas, SLIpetro and Delhi Petroleum respectively. Reflecting the current emphasis on selectivity, the number of exploration wells drilled was down, but rising production is expected in future on the basis of, for example, last year's start-ups at Endicott in the Arctic and Clyde in the North Sea, the commencement last December of shipments from North Yemen, and the continuing development of new fields in Australia, Malaysia and elsewhere. If 1986 was the year of restructuring (see PE 6/87 page 214), last year was a time for testing the new structure which grouped international oil and gas activities outside North America under Exxon Co International and similarly consolidated coal and minerals operations under Exxon Coal & Minerals Co. Altogether, Exxon claims that its new organisational efficiency added \$375m to net income last year alone. Meanwhile, it sought to offset the drop in net income and the rate of return by making a two-for-one stock split, raising the dividend, and repurchasing 58 million Exxon shares.

Mobil As with Exxon, Mobil's upstream gains failed to offset its earnings decline downstream, and net income was 11% down on balance. Yet it rated the year a positive one for its competitive position, noting in particular the continued upgrading of refineries at home and abroad, impressive results for the natural gas business, and the return of the Montgomery Ward unit to profitability. (Subsequently, however, Mobil decided to wind up its previously diversified strategy by selling MW for \$1.5bn, see PE 4/88

MAJOR OIL COMPANIES: ANNUAL RESULTS

Financial data in million dollars (except BP and R/D Shell). Operating statistics in thousand b/d (except where otherwise indicated).

	Net income (a)	Depreciation & depletion (b)	Cash flow from operations (c)	Cash dividends (d)	Capital & exploration expenditures (e)	Long-term debt (f)	Value of fixed assets (g)	% return on equity (h)	Oil reserves (i)	Oil production (j)	Refinery runs (k)	Product sales (l)	Natural gas sales (m)
US-based groups													
Amoco													
1986	747	2 418	2 842r)	849	3 181	2 993	18 169	6.5	2 424	810	914	1 032	2 819
1987	1 360	2 295	4 012	847	2 979	2 773	18 129	11.6	2 580	802	895	1 021	3 001
% change	+82	-5	+41	—	-6	-7	—	—	+6	-1	-2	-1	+6
Chevron													
1986	715	2 787	3 920	818	3 018	7 310	22 746	4.6	3 513	1 389r)	1 800	2 264r)	2 329
1987	1 007	2 514	4 416	818	2 841	5 885	21 736	6.4	3 348	1 338	1 878	2 335	2 402
% change	+41	-10	+13	—	-6	-19	-4	—	-5	-3	+4	+3	+3
Exxon													
1986	5 360	4 415	9 048	2 603	7 200	4 294	49 289	17.5	6 512	1 796	3 032	4 043	5 329
1987	4 840	4 239	9 826	2 686	7 100	5 021	53 434	14.7	6 634	1 835	2 981	4 043	5 227
% change	-10	-4	+9	+3	-1	+17	+8	—	+2	+2	-2	—	-2
Mobil													
1986	1 407	2 471r)	3 771	898	3 003r)	7 885	24 304	9.6	3 018r)	727r)	1 545	2 274	3 434r)
1987	1 258	2 546	3 974	903	2 942	7 064	24 946	7.9	2 953	709	1 563	2 362	4 052
% change	-11	+3	+5	+1	-2	-10	+3	—	-2	-2	+1	+4	+18
Texaco													
1986	725	2 732	3 683	722	2 369	6 857	21 661	5.3	3 225	1 146	1 934	2 740	2 705
1987	(-4 407)	2 552	2 984	181	2 234	5 917	18 722	—	3 089	1 065	1 892	2 734	2 767
% change	—	-7	-19	-75	-6	-14	-14	—	-4	-7	-2	—	+2
Five US majors													
1986	8 954	14 823	23 264	5 890	18 771	29 339	136 169	—	18 692	5 868	9 225	12 353	16 616
1987	4 058	14 146	25 212	5 435	18 096	26 660	136 967	—	18 604	5 749	9 209	12 495	17 449
% change	-55	-5	+8	-8	-4	-9	+1	—	—	-2	—	+1	+5

Europe-based groups

Financial data in £m

British Petroleum													
1986	499	3 202r)	4 461	623	3 303	3 290	15 418	8.2	4 658	1 434r)	1 895	2 740	637
1987	1 391	2 173	5 217	670	2 762	3 107	15 302	13.4	5 005	1 514	1 822	2 622	680
% change	+179	-32	+17	+8	-16	-6	-1	—	+7	+6	-4	-4	+7
Royal Dutch/Shell													
1986	2 540	3 160	7 145r)	1 340	4 678r)	4 218	30 548	10.5k)	7 263r)	1 803r)	3 220	4 395	6 205
1987	2 383	2 959	5 023	1 529	4 380	3 169	27 148	12.0k)	7 914	1 766	3 244	4 900	6 538
% change	-14	-6	-30	+14	-6	-25	-11	—	-9	-2	-1	+11	-5

a. After write-downs and extraordinary gains or losses. b. Excluding proceeds from sales of assets. c. Excluding cost of major acquisitions. d. At year-end. e. Net income as percentage of average stockbrokers' equity. f. In million barrels including natural gas liquids. g. Production of crude oil and gas liquids. Purchases are excluded where possible. h. In some cases processing agreements with other companies are included. i. Billion cubic feet/day. j. Rate of net production. k. Net income as % of average net assets. l. Restated or revised.

page 140). Another positive feature was the 10% reduction in long-term debt, due in part to continued asset sales. The debt-to-capitalisation ratio is now down to 34% from the uncomfortably high level of 49% reached three years ago after the \$5.7bn acquisition of Superior Oil in 1984. Crude oil production and reserves were both marginally lower than before, but exploration and development continued apace with a discovery rate of 40% in wildcat drilling — including major finds in the USA, North Sea and Nigeria. A resumed rise in production is expected before long. Downstream, Mobil's product sales were up by an above-average 4% in volume, the best result for any of the US majors. Motor gasoline sales grew at twice the industry rate in the USA and boosted the company's market share for the third successive year, from 5.6% in 1984 to 7% in 1987. Mobil also claims a 10% share in the lubricants business in areas where it operates. In common with most of the majors, it reported a steep rise in chemicals earnings, especially in the USA and Saudi Arabia.

Texaco For the greater part of 1987 Texaco was in something like a state of siege, following its resort to the protection of the bankruptcy code in April, but its prolonged trials and tribulations finally ended in the closing days of the year with the agreement to settle Pennzoil's litigation for a payment of \$3bn. Backed by shareholder and court approval of its restructuring plan (see *PE* 5/88 page 180), it now hopes to resume its former role in the industry — albeit in a slimmer form after asset sales likely to total \$5bn. Proceeds will be used to reduce debt and fund high potential capital projects. It seems likely that the future emphasis will be on the upstream, including joint ventures with others such as those already made with Nippon Oil and Petrobras for the Gulf of Mexico. Downstream commitments will be reduced at home and abroad through the partial sale of some refineries and marketing assets, in addition to the already announced intention to sell Deutsche Texaco outright. Reverting to 1987, the financial figures were mostly adverse and consequently depressed the overall totals shown for the five US majors in our table. Including a \$2.8bn charge associated with the Pennzoil settlement, Texaco showed a massive net loss of \$4.4bn compared with 1986 profits of \$725m; cash flow was down by 19% to under \$3bn; and dividend payments were of necessity suspended after the first quarter (but will be resumed this month). Although only 70% of production was replaced by reserves additions, this was better than in 1986; and operating results were otherwise satisfactory. There were declines in crude production in North and South America, but gas sales rose and oil product sales were level at 2.7mb/d.

British Petroleum The year was especially momentous for BP, dominated as it was by the acquisition of the 45% minority shareholding in Standard Oil for £4.7bn, the UK government's sale of its remaining holding in BP, and the first moves in the take-over for Britoil. Merging Standard fully into BP (it was previously only 55%-owned) provided access to the full potential of the US market and established BP as one of the world's three largest oil companies*. The government share sale, though disappointing at the time due to the stock market crash, effectively doubled the

number of shareholders while the associated issue of £1.45bn in new equity helped to offset the cost of the Standard acquisition. (The emergence of the Kuwait Investment Office as a major shareholder is seen as a problem for the UK government rather than BP itself). Finally, the offer for Britoil, which later became unconditional and closes this month, will result in a major expansion of BP's already considerable North Sea production base. To strengthen the group's key interests, some of the smaller businesses were merged into larger ones last year (e.g. upstream gas into BP Exploration) and US operations were restructured under the newly-formed BP America, comprising Standard Oil plus the former BP North America. BP America is the group's largest overseas holding and source of profit — and it ranks as the twelfth largest US company in its own right. In common with others, BP had difficulty in recovering higher crude oil costs in the marketplace last year, but E & P profits doubled and minerals earnings trebled. The end result was a rise of 70% in net income before extraordinary items, and as much as 179% after allowing for these in the 1986 figures. Cash flow was up by 17% — relatively more than for any other company apart from Amoco — to £5.2bn. Although refinery runs and product sales were both 4% down in volume, BP's crude production was 7% up at 5.0 mb/d and natural gas sales likewise increased by 7%. Capital spending proper fell by a sixth in sterling terms, reflecting in part the weakness of the dollar, but the group's business portfolio was enlarged by increased spending on acquisitions, up from £484m to £794m.

Royal Dutch/Shell Group Highlights of 1987 for the Anglo-Dutch group, by now vying with Exxon for the first place in the oil industry league table, demonstrate the wide range of its interests in such features as its continued leadership in the US motor gasoline market, a return to the Italian market, acquisition of several companies in the chemicals and other fields, the commissioning of new downstream ventures in China, and start-up of a new gold mine in Australia. In the oil sector it showed the best increase of any company in product sales (up 11% to 4.9 mb/d), the biggest increase in oil reserves (up 9% to over 7.9bn barrels), and an improved rate of refinery utilisation at 88% of distillation capacity. Against the trend elsewhere, refinery runs increased marginally. The financial data show that it outpaced most of its competitors with a 14% improvement in net income and an equivalent boost in dividend payments. The latter followed increases of 26% in 1986 and 20% in 1985. Meanwhile, long-term debt was reduced by a remarkable 25% to £3.2bn, thus further demonstrating the group's financial strength — which has since been underlined by record first-quarter 1988 profits, putting it ahead of Exxon (see Company Information). As regards the balance of its activities, the group is already widely spread with interests including coal and metals as well as oil, gas and chemicals; so there are no plans for major new diversification, although acquisitions within the scope of existing businesses will doubtless continue. With equity production representing only 54% of refinery runs last year (compared with 83% in the case of BP), upstream expansion through discoveries of new fields and enhanced recovery from others must be top priorities. At the same time, the report notes, "new products will be developed to meet the needs of consumers, operations will be made even more efficient, and new markets will be developed." □

* See Companies in the News, *PE* 5/87 page 160, for a detailed account of the background to the bid and the advantages of full merger.

State policy in perspective

An historical look at the "ELF"

Almost from the discovery of Prudhoe Bay in 1969, Alaska lawmakers have faced a dilemma in oil-tax policy:

The problem was how to levy an "appropriate" (whatever that might be) state severance tax on the Prudhoe Bay field without putting the same tax on smaller, mature oilfields in Cook Inlet that would soon be approaching their economic limits.

It was no particular good-will gesture toward Cook Inlet producers, however, the policy goal was to save jobs and local community tax-base in Cook Inlet, while also collecting severance taxes at the full rate from Prudhoe Bay.

The solution, designed in 1970 by oil consultants Walter J. Levy and Milton Lipton (then under contract to the legislature) was a "progressive" severance tax that would levy higher taxes on high-producing wells, like those at Prudhoe Bay, but then lower the tax on wells producing fewer barrels, such as the Cook Inlet. It involved the same concept as the graduated federal income tax — the greater the income, the greater the tax.

There have been structural changes in the severance tax since 1970 — including major revisions in 1977 and 1981 — but the policy has been consistent. Today, state leaders not only want to keep Cook Inlet running as long as possible, but also encourage development of "marginal fields" on the North Slope, oil deposits near Prudhoe that, while large, are barely economic in the high-cost North Slope environment.

This spring, Alaska legislators are considering more changes to the severance tax. In doing so, they are looking closely not only at how much more revenue a tax change might bring, but how it would affect development of new, marginal fields as well as the ongoing development work in Prudhoe Bay.

Changes In The Tax

From 1970 to 1977, Alaska had a "stair-step" graduated severance tax with rates that increased from five to eight percent of the wellhead value of oil depending on how much the well produced. This was the formula devised by Walter Levy and Milton Lipton.

In 1977, the tax was changed to a flat 12.5% tax on wellhead value for all production, but with the "Economic Limit Factor," a formula that reduced the effective rate of tax as the well production fell and it approached the economic limit. In adopting such a change, legislators attempted to build more flexibility into the Economic Limit Factor (it could then be different for each field, fitting more closely to its economics, rather than locked into specific brackets), while also increasing the amount of tax on Prudhoe.

In 1981, there were other changes: As part of the legislative package that also repealed Alaska's controversial separate accounting income tax on oil, legislators increased the severance tax to 15%. In addition, a number of other complex changes were made.

• New fields coming into production after mid-1981 were to enjoy a lower 12.5% tax for the first five years. After that, the

tax would increase to 15%. Since Prudhoe Bay was already in production, it bore the full 15%.

• The Economic Limit Factor would not apply to Prudhoe until 1987. After that, the declining Prudhoe Bay wells would get the same benefit of the "ELF" as wells in other oilfields, such as Kuparuk, Milne Point and Cook Inlet.

" . . . companies think that an additional 1.5 billion barrels could be coaxed out of the reservoir through enhanced oil recovery projects or more intensive drilling or waterflood."

In practical terms, the effective tax on Kuparuk and Milne Point are in the range of five to six percent compared to 15% on Prudhoe, the Department of Revenue says. When the new Endicott field goes into production, the tax will be in the three percent range, the department says. If the West Sak heavy oil deposits are ever developed, the effective rate of tax could be almost zero, because of razor-thin economics.

One of the options being considered in Juneau this spring is to continue the exclusion of the Economic Limit Factor on Prudhoe, so that Prudhoe would continue to carry the whole tax, while other fields enjoyed lower tax rates.

But complications arise, as they usually do when governments attempt to design complex and intricate tax systems.

New Prudhoe Development

If the Economic Limit Factor is designated to encourage development of new "marginal" fields, what about marginal areas of the big Prudhoe field? Only 40 percent of Prudhoe's oil will be recovered through primary and secondary (mainly waterflood) production. The companies think that an additional 1.5 billion barrels of oil could be coaxed out of the reservoir through enhanced oil recovery projects or more intensive drilling or waterflood. But it will be marginal, "high cost" oil. A high tax could discourage development of these added reserves, just as it would a brand new, "marginal" field.

If major new commercial oil production in the near future will be from Prudhoe itself, the same tax policy that applies to smaller fields should also apply to Prudhoe, to encourage development of these reserves.

Strategic Shift ^{10/13}

Restructured Oil Firms Suffer Little Hardship As Crude Prices Plunge

Profits Soar, Reflecting Years Of Severe Cost Cutting And Efforts to Diversify

Plastic Bags and Pesticides

By ALLANNA SULLIVAN

Staff Reporter of THE WALL STREET JOURNAL

NEW YORK — On Friday, a selling panic gripped global oil markets. OPEC was in disarray. Saudi Arabia had opened the floodgates. From Brussels to New York, oil prices crashed to their lowest level in more than two years.

Yet through it all, on the floor of the New York Stock Exchange, Robin Stonehill was leaning ho-hum against the post where he trades shares of Atlantic Richfield Co. "The stock is stable," he nonchalantly said. "The investment community isn't paying any attention to the price of oil today."

Why should it? Despite plunging prices, ARCO's profit is surging. So, in fact, are the profits of Exxon Corp., Mobil Corp., and nearly every multinational oil company. Despite the continuing collapse of oil prices, profits of the nation's 18 biggest oil companies will leap by about one-third this year, to nearly \$20 billion—far exceeding the profits of every major airline and auto maker combined.

A New Look

Through a radical restructuring spanning less than a decade, Big Oil has abandoned the days when profits moved in lock-step with oil prices. Indeed, for the first time in its 129-year history, the oil industry has positioned itself to make money—big money in some cases—even when oil prices fall out of bed. (For an article on the drop in oil prices, see page A3.)

"It is one of the most sweeping and most dramatic restructurings of any industry," says Philip Verjeer, visiting fellow at the Institute for International Economics in Washington.

The turnaround is due partly to cost-cutting on a scale that has hit few industries. Almost 300,000 oil-patch employees have lost their jobs—20 times the number of financial-industry workers idled since last year's stock-market crash.

Exxon alone cut about \$375 million in costs just last year. (Only two years ago and Exxon employees occupied 13 floors of the

Oil: Profits and Prices

	PROFITS OF 18 INTEGRATED COS. (In billions)	MIDEAST LIGHT CRUDE (Per barrel)
1987 First Qtr.	\$2.936	\$17.25
1987 Second Qtr.	3.507	17.38
1987 Third Qtr.	3.429	17.65
1987 Fourth Qtr.	3.600	17.02
1988 First Qtr.	4.398	15.05
1988 Second Qtr.	4.257	14.68

Source: Energy Performance Review, Arthur Andersen & Co.

oil giant's New York skyscraper. Today, after layoffs and transfers, only 300 workers remain on seven floors. And the building, part of the legacy of Exxon founder John D. Rockefeller, has been sold to a Japanese group.

But Draconian cost cutting alone doesn't account for the surge in profits. By radically overhauling the process by which it refines and distributes oil, the industry has managed to keep consumer prices high, even as crude-oil costs plunge. Big Oil, long adept at exploring and pumping, has also finally learned the art of selling—by going after market niches with new grades of gasoline, for instance, and by manufacturing such high-value petrochemical products as Mobil's Hefty Storage Bags. In recent years, all large oil companies have slashed the number of gasoline stations through which they move their products, eliminating any unprofitable or even marginal operations.

There isn't any evidence that major oil companies have conspired to keep retail oil prices high. But consumer groups complain that regulators have been inattentive to the issue. Three times during the Reagan Administration, the Citizen-Labor Energy Coalition, based in Washington, D.C., has approached the Justice Department with claims that consumer prices were too high relative to the falling price of crude. Two years ago, in response to such a complaint, the coalition received only a thank-you note in return, said Edwin Rothschild, assistant director of the group.

The Cost of Sales

Behind the turnaround is a fundamental reshaping of the internal structure of the major oil companies. For more than a century, oil companies have consisted of two halves. There was an exploration or production division that drilled wildcat wells and kept the oil flowing—the so-called upstream business. The oil companies pumped crude furiously and "sold" it to themselves at market prices, which, in nearly every year until the price crash of 1986, were sufficient to guarantee huge profits.

Then there was the "downstream" side—all the refineries and filling stations that "bought" the oil, poor stepchildren of the romantic and profitable wildcatting and oil-pumping business. "Service stations were just a way to move oil," says Thomas Manning, vice president of Purvin & Gertz Inc., a refining-consulting firm in Houston. Money-losing retail operations were a global phenomenon. Total Compag-

nie Francaise des Petroles of France once chose where to sell products according to a guidebook called "Losses at Posted Prices."

Such losses were practically guaranteed because there were simply too many refineries and gasoline outlets. By the late 1970s, the industry was operating more than 300 refineries, many of them among the world's largest factories. Service stations grew ubiquitous, often four to an intersection, with price wars erupting regularly.

Then the industry began awakening to a painful truth: The crude-oil gravy train was screeching to a halt. The U.S., it became clear, was rapidly running out of oil. Governments in Asia, Africa and the Middle East nationalized their oil fields. "Now that [the companies] don't own the oil, they must run the rest of their business to make money," Mr. Manning says.

The answer lay largely in marketing. No longer could oil companies blindly push products with broad national advertising, as Texaco once did with its "Texaco Star Theater." The industry began choosing geographical markets carefully, cannily introducing new products and pricing shrewdly.

"It wasn't until this decade that big oil companies focused on ensuring that the refining and marketing businesses operate profitably," said Robert Stobaugh, a business professor with the Harvard Business School.

Headhunters have noticed the change. "Our clients want marketing people who understand the concept of 'positioning' a product, even if he comes from the fast-food or soft-drink industry," says Joseph Collard, an oil and gas specialist at Spencer, Stuart & Associates, an executive-search firm. In the past, he said, oil companies generally wanted people with technical backgrounds.

The industry also eliminated excess refining capacity, mothballing in this decade more than a third of its refineries. The resulting tight supplies now force the oil industry to import not just crude oil but also gasoline.

And as supplies of gasoline tighten, the industry is doing all it can to get consumers to buy more. High-tech gasoline stations decked out in eye-catching colors dot the landscape, replacing the mom and pop operations that had become part of American folklore. In addition to the old standby products—tires, batteries and accessories—gasoline stations now sell bread, milk, beer and Playboy magazine.

Computerized pumps at these designer stations have more than tripled the speed at which gasoline moves to the customer. The "smart pumps" can handle the credit-card payment, log the sale for inventory purposes and then reset themselves in a flash for the next patron—at huge cost savings to the oil companies.

A New Flavor

Like cereal and soap makers, the oil industry is rapidly introducing new products, further segmenting a market that once consisted solely of "regular" and "high-test." Most of the majors have introduced, at least in some regions, a medium-octane gasoline that most cars don't need but that consumers are buying in droves, largely because of advertising. Exxon, for instance, just introduced its Exxon Plus medium grade in six states.

Although the medium-grade gasoline costs very little extra to produce, it fetches several cents a gallon more than regular unleaded gasoline. In some cases, profit margins are two times higher. And best of all, clever marketing of the new grades generally causes consumers to "buy up" from the less expensive gasoline, rather than "buy down" from the premium grade.

The companies have also become very fussy about where they sell their gasoline, withdrawing from the most competitive areas and building a presence in locations where they can dominate. Tenneco Inc., a big gasoline retailer in the South, even quit selling gasoline in its hometown of Houston because it didn't have a big enough share of the market to make it worth the company's while.

Atlantic Richfield pulled out of the Atlantic states. Amoco Corp. makes gasoline in Texas but recently quit selling it there, except at the lone outlet where refinery employees can fill up. Exxon and Texaco Inc. recently swapped dozens of gasoline stations, mostly in California and Nevada to consolidate their hold on markets that are closest to their respective refineries. All told, the industry has closed 26,514 service stations since 1982, nearly a quarter of the total.

Tough Times for Independents

As the big companies cut costs, they can also cut prices, sometimes driving independent distributors out of the business altogether. Steven Riggins, whose family runs 16 gasoline stations in New Jersey, says the number of independent gasoline suppliers in his market has shrunk by one-half in only the past year. They have abandoned their businesses because of slim profits. As a result, Mr. Riggins is stuck buying from the majors. "There definitely isn't the pick anymore," he says.

As the majors achieve market dominance, they naturally can charge more. An ARCO station in Boulder City, Nev., which competes with only one independent retailer, has charged 10 cents more for a gallon of gasoline than ARCO stations in Las Vegas, only 15 miles away, where at least four major oil companies compete.

Gasoline is far from the only product producing huge profits these days. The petrochemicals business, for years a dumping ground for the by-products of gasoline refining, has become the diamond in Big Oil's hydrocarbon crown.

In fact, the oil industry has nudged the petrochemical industry out as the top player in its own business. Oil firms now produce three of every five pounds of building-block petrochemicals—ethylene, propylene, butadiene, benzene and paraxylene—from which up to 85% of petrochemicals in the U.S. are made.

Petrochemicals also are going into an increasing proportion of high-value consumer packaging and products—no longer just the bowling ball, for instance, but also

OGJ group profits jump 74.4% in first 9 months

Downstream operations are lifting profits for most of the 23 U.S. oil firms in the Oil & Gas Journal group.

During the first 3 quarters of 1988, the group's net income jumped 74.4% from a year ago to \$16.647 billion. Group third quarter net profits climbed 34.1% from last year to \$4.552 billion. Profits totaled \$6.039 billion in the second quarter and \$6.027 billion in the first quarter.

Falling crude oil prices helped boost refining and petrochemical earnings but cut upstream income.

Thirteen of the companies in the group reported capital and exploration expenditures of \$19.824 billion for the first 9 months of 1988, up 29.7% from the same 1987 period.

Downstream gains. Companies scored downstream earnings gains in the U.S. and worldwide.

Refining margins widened as crude prices fell and product prices held steady on the strength of rising demand, which also lifted volumes.

According to the Energy Information Administration (EIA), demand for petroleum products for the first 3 quarters of 1988 averaged 16.884 million b/d, up 303,000 b/d from the same period of 1987.

International Energy Agency estimated non-Communist product demand at 49.23 million b/d, up 2% from the first 3 quarters of 1987.

U.S. refinery crude acquisition costs fell 15.3% to an average of \$15.13/bbl during the period. Meanwhile, the U.S. average pump price for all types of motor gasoline climbed to 96.24¢/gal from 94.83¢/gal a year ago. The average price of residential heating oil moved up to 80.27¢/gal from 78.37¢/gal in 1987.

An increase in the average refinery utilization rate to 84.8% from 83.2% helped reduce operating costs and further improved margins.

Here's a sample of company refining and marketing results for the first 9 months of the year:

- Exxon Corp. reported profits of \$414 million in the U.S., compared to a \$50 million loss a year earlier, and \$835 million outside the U.S., up from \$185 million in 1987.

- Mobil Oil Corp. had income of \$333 million in the U.S., up \$263 million, and \$368 million outside the U.S., up \$197 million.

- Chevron Corp. earned \$411 million in the U.S. vs. \$2 million a year earlier, \$154 million outside the U.S. vs. \$26 million in 1987.

- Texaco Inc. earnings totaled \$402 million in the U.S., compared to a

Breakout of the OGJ group's profits and revenues

	First 9 months				Third quarter			
	Net profits*		Revenues		Net profits*		Revenues	
	1988	change	1988	change	1988	change	1988	change
	Million \$	from 1987	Million \$	from 1987	Million \$	from 1987	Million \$	from 1987
Exxon	3,880	18.1	65,522	6.5	1,225	15.0	21,888	-0.2
Shell	1,851	134.1	15,923	3.8	352	-16.2	5,445	-3.7
Amoco	1,688	71.7	17,878	7.3	552	34.0	5,948	3.4
Mobil	1,625	85.9	40,987	10.4	557	68.8	13,116	-0.2
Chevron	1,593	56.8	21,998	1.1	420	41.4	7,156	-6.9
Pennzoil	1,439	5,357.5	1,649	23.3	39	745.1	617	37.2
ARCO	1,192	34.8	13,776	11.5	391	24.1	4,592	3.4
Texaco	1,008	183.9	26,799	3.3	239	121.3	8,689	-3.0
Phillips	515	25,650.0	8,630	8.1	215	593.5	2,850	1.7
USX [†]	363	-21.8	7,594	3.7	168	40.0	2,504	0.6
Unocal	339	123.0	7,432	5.3	97	234.5	2,581	0.2
Conoco	320	64.1	8,502	5.3	71	-6.6	2,790	-2.0
Occidental	295	46.0	14,133	11.2	103	139.5	4,913	16.4
Ashland/	224	68.4	8,200	17.1	66	0.0	2,200	4.8
Tenneco	224	-	9,634	10.7	7	-	3,025	9.0
Coastal	86	10.5	6,169	13.4	9	-21.4	1,921	8.3
Kerr-McGee	77	15.7	2,054	4.4	30	62.4	660	-4.9
Amerada Hess	58	-81.3	3,070	-12.5	16	-59.1	925	-17.6
Murphy	13	-27.2	1,110	-1.7	10	29.5	382	-10.6
Quaker State	9	-	613	-6.1	4	-35.1	192	-5.5
Louisiana Land & Exploration	(34)	-292.7	574	-4.9	(55)	-1,048.3	182	-14.1
Maxus	(59)	-	446	-11.3	(36)	-	131	-22.5
Sun	(69)	-126.0	7,280	1.0	72	-47.4	2,460	-2.4
Total	16,647	74.4	289,973	6.6	4,552	34.1	95,167	0.2

*As reported. May include nonrecurring gains and losses. †Reflects 1.7 billion extraordinary gain due to settlement with Texaco. ‡Oil and gas segment only. §Operating income before interest and taxes. ¶After-tax operating income. ††Fiscal year and fourth quarter.

How profits and spending compare

	Net profits		Capital & exploration expenditures			
	1988	1987	1988	1987	% change from 1987	% of net income 1988
	Million \$	Million \$	Million \$	Million \$		
Exxon	3,880	3,285	5,091	4,205	21.1	131.2
Shell	1,861	795	2,714	1,841	47.4	145.8
Amoco	1,688	983	2,341	1,788	30.9	138.7
Mobil	1,625	874	2,228	2,010	10.8	137.1
Chevron	1,593	1,016	2,245	1,808	24.2	140.9
Texaco	1,008	355	1,722	1,240	38.9	170.8
Phillips	515	2	550	486	13.2	106.8
USX*	363	464	651	525	24.0	179.3
Unocal	339	152	779	529	47.3	229.8
Occidental	295	202	599	337	77.7	203.1
Kerr-McGee	77	66	215	152	41.7	280.4
Amerada Hess	58	309	594	230	158.0	1,025.5
Maxus	(59)	(485)	95	136	-30.1	-
Total	13,243	8,018	19,824	15,287	29.7	149.7

*Oil and gas segment only.

loss of \$63 million in 1987. Outside the U.S. earnings were \$291 million, up from \$118 million.

- Shell Oil Co.'s oil products segment earned \$480 million, up from \$272 million.

- Amoco Corp.'s earnings from worldwide refining, marketing, and transport operations climbed to \$631 million from \$147 million in 1987.

Chemical, upstream results. Lower crude costs also boosted earnings from chemical operations.

Examples of 9 month company chemical performances: Phillips Pe-

troleum Co. \$690 million vs. \$333 million for the same period of 1987; Mobil \$482 million, more than twice the year-earlier net; ARCO \$670 million vs. \$280 million; Amoco \$539 million, up 77%; Shell \$480 million vs. \$272 million; Texaco \$135 million vs. \$50 million; Chevron \$283 million, up 56.4%; and Exxon \$966 million, up \$403 million.

Almost all OGJ group companies had lower exploration/production earnings. An exception was Phillips, which posted a gain to \$443 million from \$234 million a year earlier.

Wall Street Journal

Arco's Earnings Set a Record; Amoco Net Falls

By **FREDERICK ROSE**
Staff Reporter of THE WALL STREET JOURNAL
Atlantic Richfield Co., boosting its quarterly dividend, reported record fourth-quarter profit and announced an indefinite extension of a stock-purchase program.

Separately, Amoco Corp. said its fourth-quarter net income declined less than 1%, to \$375 million, or \$1.45 a share, as increased profit from refining and marketing operations was offset by declining results from crude oil and natural gas production.

Los Angeles-based Arco's quarterly dividend increase, to \$1.125 a share from \$1, is

the company's first boost since 1985, when it undertook a massive recapitalization and cost-cutting program that trimmed its common stock by more than 25%, slashed costs and boosted the dividend at that time to \$1 from 75 cents.

The latest increase had been expected but came earlier and at the high end of analysts' forecasts. Analysts said yesterday's announcements underscore the effectiveness of Arco's 1985 recapitalization, which was widely questioned when it was announced. "They have been vindicated," said Eugene Nowak, an analyst at Dean Witter Reynolds Inc.

The increased dividend will be paid March 30 to stock of record Feb. 17. Arco and Amoco shares both fell yesterday amid a broad slide of oil stocks on news of declining oil prices. Arco was off 12.5 cents, at \$85 a share. Amoco dropped \$3, to \$75.625 a share. The shares of both companies are quoted on the New York Stock Exchange.

Arco's fourth-quarter net income rose

1/27/89

15%, to \$391 million, or \$2.22 a share, from \$340 million, or \$1.86 a share, a year earlier. The latest quarter was Arco's highest ever. Revenue declined 1.6%, to \$4.54 billion from \$4.62 billion. The average shares outstanding declined 3%, to 176.9 million from 183.5 million a year earlier.

Contributing to the earnings increase, after-tax profit from Arco's refining and marketing operations jumped 76%, to \$88 million from \$50 million. Profit at the company's Lyondell Petrochemical Co. unit, currently the subject of an initial public offering that will reduce Arco's stake to just under 50%, was nearly trebled at \$151 million compared with \$56 million a year earlier. These increases and others were countered in part by a 38% drop in the company's after-tax profit from crude oil and natural gas production, to \$95 million from \$154 million in the year-earlier quarter.

Arco's indefinite extension of its stock buy-back continues a program started in 1985, under which the company purchased 62.6 million shares—or about 35% of the

amount previously outstanding—at an average price of \$63.47 a share. Analysts said they expect the company to continue the purchases at about the recent rate of its buy-back, which, since November 1987, has brought in 7.6 million shares at an average of \$77.01 a share.

Arco's net income for the year rose 29%, to \$1.58 billion, or \$8.78 a share, from \$1.22 billion, or \$6.68 a share, a year earlier. Revenue increased 7.9%, to \$18.32 billion from \$16.98 billion. The average number of shares outstanding declined 1.6%, to 180.4 million from 183.3 million.

Separately, Chicago-based Amoco reported fourth-quarter net income of \$375 million, or \$1.45 a share, compared with \$377 million, or \$1.47 a share, a year earlier. Revenue climbed 4.3% to \$6.19 billion from \$5.94 billion.

Amoco's net income for 1988 totaled \$2.06 billion, or \$8.01 a share, a 52% increase from \$1.36 billion, or \$5.31 a share, a year earlier. Revenue increased 6.6%, to \$23.93 billion from \$22.46 billion.

Anchorage June 2/8/89 C2

BP chief threatens cutbacks

Attacks tampering with ELF

By RAY TYSON
Times Business Editor

A top executive for BP America said Tuesday the company will be forced to cut back on projects in Alaska if the state tampers with the Economic Limit Factor, a tax incentive designed to encourage drilling in marginal oil fields.

E. John P. Browne, executive vice president of BP America, also told members of Commonwealth North the state must learn to live with lower oil prices, just as oil companies have done.

"If Alaska goes ahead and changes the ELF for Prudhoe Bay, we will have no choice but to cut back our planned developments there and elsewhere in the state," Browne said. "Our own budgets were built on real costs and our estimated price of oil."

Gov. Steve Cowper and House Democrats want to change the ELF to help raise more tax revenue to boost an ailing state treasury.

Browne said BP Exploration, formerly Standard Alaska Production Co., had planned to have four rigs working at Prudhoe Bay this year.

"Without ELF, we will have to consider fewer rigs," he said. "That's at least 125 fewer jobs for every rig not working, lower production, and the loss of revenues which will no longer be economic. A change in ELF will be a

short-term solution with longer-term damage."

While oil executives have criticized Cowper's plan to change the ELF, Browne's message was particularly hard-hitting.

"Not even Keynesian economists deny, anymore, that the best way to gain more state income from taxes and royalties is to encourage more development to tax," Browne said. "You plant the seeds, you don't eat your seed corn. But knowing and doing aren't the same, alas."

Like BP did, Browne said, the state must put its "house in order . . . to compete on an international footing."

"In a world with ample supplies of oil, costs must be reduced and taxes stabilized here to allow new sources of oil to be produced," he said. "Otherwise the investment will simply go to the countries or states where better opportunities exist."

Browne said the "glory days" of abundant oil money in Alaska are over.

"No matter how many excuses we give ourselves, the fact remains that Alaska has chosen high-cost government which can no longer be financed from high-cost oil," he said.

"Calling the situation a money problem is like saying the Hindenberg has gas trouble, the Titanic had an ice problem or that Noah had water woes. This is reality, Alaska is in danger of losing its way."

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PRICE

Changes in oil company tax break

By LARRY PERSILY *ADN 2/10/89*
The Associated Press

JUNEAU — Changes in state oil taxes proposed by the Cowper administration would generate an estimated \$3 billion in extra revenue by 2010, more than \$5,500 for every person in the state.

Despite the large amount of money at stake, the issue is not the cash, said Rep. Cliff Davidson, D-Kodiak. The question

facing legislators is establishment of a fair oil tax policy, said Davidson, co-chairman of the House Resources Committee.

The committee Thursday started four days of hearings on the state's Economic Limit Factor, also known as ELF, a tax break for marginally profitable oil fields.

The oil industry opposes a change in the ELF formula, but Gov. Steve Cowper is trying again this session to win legislative

could generate \$3 billion by 2010

approval for his proposal.

Not only does the administration want the ELF formula changed, but it would prefer that lawmakers make the changes retroactive to July 1987, when the tax break took effect for Prudhoe Bay.

"It can go backwards in time," said Revenue Commissioner Hugh Malone.

If the changes were retroactive to 1987, as proposed by Malone, the measure

would add almost \$400 million to the state treasury in fiscal year 1990 for three years of taxes.

Changes in ELF passed the Democratic-controlled House in 1987, but died in the Republican-led Senate last year. The House Finance Committee introduced legislation again this session.

House Resource hearings will continue today, Saturday and Monday.

House panel starts oil tax hearings

By LARRY PERSILY

THE ASSOCIATED PRESS

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The committee Thursday started four days of hearings on the state's Economic Limit Factor, also known as ELF, a tax break for marginal oil fields.

"What's fair to the industry, what's reasonable, what's appropriate?" Davidson asked.

"Are we getting maximum benefits from it (oil) for the people of the state," without discouraging oil companies from working in Alaska?

The oil industry opposes a change in the ELF formula, but Gov. Steve Cowper is trying again this session to win legislative approval for his proposal.

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'89

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Changes in ELF passed the Democratic-controlled House in 1987, but died in the Republican-led Senate last year. The House Finance Committee introduced legislation again this session, with House Bill 118 before the resources committee for its first hearings.

Changes are needed in ELF to correct problems that go back more than 10 years, Malone said.

The tax-break formula was adopted in 1977 to encourage oil companies to develop marginal fields, he said.

In 1981 lawmakers suspended the tax advantages of ELF at Prudhoe Bay until 1987.

ELF affects the severance or production tax paid by companies on the oil they pump out of the ground. The severance tax, which is separate from corporate income taxes, produced about one-third of the state's general fund revenues in the past 10 years, Malone said.

In 1987 the suspension of the ELF tax savings was lifted and the oil companies cut more than \$100 million a year from their severance tax bills at Prudhoe Bay, Malone said.

"Instead of helping marginal fields, the ELF formula now mostly provides a massive and unnecessary tax break to two fields which are not marginal at all, Prudhoe Bay and Kuparuk," the revenue commissioner said.

The administration wants ELF changed to reduce the tax break for the state's largest oil fields at Prudhoe and Kuparuk. The legislation also would increase the tax break for marginal fields.

For every dollar in new tax savings on smaller fields, oil companies would pay about \$10 more in higher severance taxes at Prudhoe and Kuparuk, Malone explained at a press conference Thursday.

"We should have done it in 1987, it would have been better to do it in 1988," and the legislature should not miss its chance to change ELF in 1989, Malone said.

The House Finance Committee bill would generate about \$96 million in additional revenue in fiscal 1990, unless the changes are retroactive, according to Revenue Department estimates.

Annual revenues would climb to \$187 million in fiscal 1993 and then gradually fall until they run out in 2010.

By 2010, the proposed changes in ELF would have earned the state almost \$3 billion in additional severance taxes, the department said.

House Resource hearings were to continue today, Saturday and Monday, with administration officials, oil company representatives, elected officials and public testimony scheduled for the hearings.

What is ELF?

- The ELF is one factor in calculating severance tax rates, but does not affect oil royalties.
- The ELF encourages additional development as oil fields mature.
- The ELF prevents oil fields from being shut in prematurely.

ANSWER: All three are correct. The ELF, which stands for Economic Limit Factor, was created by the Legislature, recognizing that oil would become more expensive to develop as fields mature. It encourages additional development in existing fields by a formula which charges higher taxes to more productive wells and lower taxes to less productive wells.



Wanted: A business of his own

By Jim Henderson
USA TODAY

1-30-89
P. 4B



By Barb Kinney

CAPITAL HOLIDAY: Mark Nelson and Tina Jensen on vacation last month in Washington, D.C.

Nelson's finances

Assets		Annual income	
Checking accounts	\$1,350	Salary	\$64,000
Money market fund	82,000	Plumbing work	3,000
Municipal bonds	8,900		
Real estate	146,000		
401(k) retirement plan	14,000		
Individual retirement account	21,700		
Mortgage note	18,000		
Furnishings	2,000		
Misc. (coin collection, guns, tools)	14,000		
Pickup truck and car	7,500		
Total	\$325,450		
Liabilities		Annual expenses	
Real estate loan	\$79,000	Food	1,200
Net worth	\$246,450	Clothes	600
		Telephone	1,800
		Cleaners	120
		Auto expenses	900
		Car insurance	240
		Entertainment	1,800
		Vacations	2,400
		Donations to church and charity	300
		Medical expenses	240
		Gifts	900
		Misc. personal expenses	240
		Federal income taxes	13,800
		Social Security	3,605
		Available for savings	45,505
		Total	\$72,850

Source: USA TODAY research

Mark Nelson is ready to begin Stage 2 of his life's dream of owning and running his own business.

Stage 1 was to make as much money as quickly as possible so he could buy a business. Stage 2 is finding and buying one.

At 28, Nelson has a net worth of nearly a quarter of a million dollars, and it's getting fatter by the day.

After graduating in 1983 from the University of Idaho with a degree in accounting and finance, he headed to Alaska from his hometown of Lewiston, Idaho, to make big bucks in the oil boom. He spent a year in the offices of an oil firm in Anchorage and then transferred in Prudhoe Bay, north of the Arctic Circle.

He's an administration manager for Alaska Petroleum Contractors Inc. His work schedule: three weeks on — 12 hours a day, seven days a week — then three weeks off. His salary: \$64,000 a year.

"The beauty of my job is that I'm not only paid a good salary, but for the six months a year I'm up there, all my living expenses are paid for." Back in Lewiston, he lives with his mother and stepfather and works as a plumber. His stepfather owns a plumbing business.

He has invested in three rental properties in the Lewiston area: a duplex, a commercial building that houses a real estate office and a sign-making company, and a condominium that he owns in partnership with his mother, a Realtor.

"Real estate values haven't gone through the roof in Lewiston like they have in California and the East Coast, but they're pretty stable and have gone up a little each year," he says.

The properties are worth about \$146,000. He paid a total of \$127,000 for them and owes \$79,000 on mortgages.

During the past two years, Mark has been spending more of his time off traveling. He also has fallen in love. He met Tina Jensen, 26, of Copenhagen, Denmark, in 1981 when he spent a summer backpacking in Europe. They plan to get married next spring. Tina will move to the USA. They plan to work together in Alaska while they research a business to buy, then work in it together.

Mark has been to the Soviet Union, China, Hong Kong, Japan, and Africa. "But I try to do it as cheaply as possible," he says. "Backpacks and youth hostels." His company-paid plane flights to Prudhoe Bay qualify him for frequent-flyer mileage.

Besides real estate, most of his money is invested in a money market mutual fund and tax-free municipal bonds, bought through his father, a broker for D.A. Davidson & Co., a regional brokerage based in Great Falls, Mont.

Mark is "wide open" about what kind of business he wants. "I want to go about it the right way and take my time searching for the right business. I don't mind working hard, and I figure if things don't work out I'll still be young enough for a comeback." His only criteria at this point: "Some place warmer than Alaska, and no rat-race cities like L.A. or New York."



By John Sherlock, USA TODAY

Hearing on ELF set to consider cut in tax break

JUNEAU (AP) ^{2/3/89 AT} More than \$115 million in fiscal 1990 taxes will be at stake when the House Resources Committee next week opens this session's hearings on legislation to amend the state's oil tax structure.

The committee has scheduled four days of hearings on House Bill 118 to amend Alaska's Economic Limit Factor, known as ELF, a tax break intended to provide incentives for the development of marginal oil fields.

The House Finance Committee proposal would cut the tax break on the state's larger oil fields such as Prudhoe Bay and in return offer a bigger tax break on smaller fields.

The Revenue Department estimates the House bill would generate \$115 million in extra revenue next year and more than \$2 billion over the next 16 years.

"We intend to give this legislation a fair and complete hearing," said Rep. Cliff Davidson, D-Kodiak, co-chairman of House Resources.

A similar bill passed the Democrat-led House last session, but died in the Republican-controlled Senate without a single committee hearing.

Opposition to the bill comes primarily from the oil industry, Davidson said.

House Resources will meet the afternoon of Feb. 9 and 10 to hear from Cowper administration officials.

Oil industry testimony is scheduled for the afternoon of Feb. 11, and a statewide teleconference is set for the afternoon and evening of Feb. 13 to hear from the public, Davidson said.

T U E S D A Y

SECTION E Feb. 14, 1989

Public tells House about ELF

By LARRY PERSILY
The Associated Press

JUNEAU — House Resource Committee members listened to public testimony on state oil tax policies Monday and heard the same arguments as were presented by oil industry and administration officials last week.

Some members of the public said oil taxes are too low and should be raised to earn a fair share of the state's one-time resource at Prudhoe Bay.

Others said state government should be cut instead of going to the oil companies for higher taxes to pay the bills.

The committee is considering House Bill 118, which would change the state's oil production tax schedule and could boost state revenues by more than \$2 billion over the next two decades.

"The state of Alaska has a non-renewable resource that is leaving the state, and I believe we have to take full advantage of it," said James Barton, a Fairbanks truck driver and former North Slope construction worker who testified Monday in favor of raising oil taxes.

"The state is sending the wrong message to potential investors," said Bill Bivin, of the Bethel Chamber of Commerce and Native corporation.

Gov. Steve Cowper and many lawmakers want to change the Economic Limit Factor, known as ELF, a 12-year-old tax savings intended to encourage development of marginal oil fields.

The bill before the Resources Committee would raise taxes on the state's largest fields at Prudhoe Bay and Kuparuk, and would offer a larger tax break for smaller fields.

The result would be millions of dollars more each year for the state treasury.

ELF never was intended to provide such a huge tax savings for Prudhoe Bay during its profitable years, Cowper said. Oil companies deny that ELF gives them unfair tax savings at Prudhoe Bay.

The committee spent two days last week listening to Cowper administration officials testify in support of changing ELF, and then the oil industry had its turn at the table Saturday and spoke against the bill.

Monday's hearing was devoted to public testimony, and another public hearing is planned for Wednesday, said Rep. Cliff Davidson, D-Kodiak and co-chairman of the committee.

Juneau fisherman and teacher Alan Stein said the social ills caused by oil development are high, but taxes are too low.

"The oil industry should pay its fair share of those inflictions and wounds," he said in favor of changing ELF.

The problem is not oil taxes, but "the bloated level of government services and bureaucracy," said Ken Flynn, the owner of an Anchorage advertising agency.

Alaska needs a stable tax policy that does not change with political and fiscal tides, said Martin King of Fairbanks, who owns a trucking company that serves oil fields.

Robert B. Atwood
President and Publisher

Elaine Atwood
Assistant Publisher

William J. Tobin
Vice-President, Editor-in-Chief

Shabby government

A LOT OF monkey business is going on as the Democrats in the legislature and Gov. Steve Cowper and his troops try to drum up support for raising taxes on the oil industry. They are trying to do so by jiggering with the Economic Limit Factor, the formula by which the state assesses levies on petroleum production.

The effort is turning into a big flop, and that's just as well. But meanwhile the public is being subjected to a lot of governmental hooey, and a lot of legislative and administrative time is being wasted that should be devoted to doing something positive for the people of the state.

The facts are simple. The state, in a rare show of wisdom a dozen years ago, created a graduated severance tax on oil production. Wells producing the most oil paid the higher taxes. Wells in declining stages of production paid less. The idea was to encourage oil companies to utilize revenue that otherwise would have been paid in taxes on declining wells in the search for new production, that would keep dollars flowing into the state treasury.

And the plan has worked marvelously well.

THE INDUSTRY has reinvested millions of dollars in the task of enhanced recovery from marginal fields, creating thousands of jobs over the years, keeping support industries viable and enlarging the state's share of oil revenues.

As a result of ELF, as the formula is called, new exploration has moved ahead and hundreds of millions of dollars in new drilling has been accomplished or scheduled.

Gov. Cowper, however, in seeking more dollars to keep the government bureaucracy fat and growing, wants to extract more money instantly from the oil companies. With the help of House

Democrats, he's trying to do it by labeling the ELF as a "tax break" for the industry.

What his effort obviously is, however, is a proposed enormous tax increase on an industry employing thousands of Alaskans who need tax stability to solidify their employment. According to industry figures, the governor's proposed changes in the ELF formula would result in an increase of more than 100 percent in taxes against Kuparuk and an increase of more than 40 percent against Prudhoe Bay over the next 10 years.

Those proposals are unconscionable.

BUT CONSIDER the shenanigans that have been used to try to put this scheme across.

Democratic Rep. Cliff Davidson of Kodiak, chairman of the House committee holding the ELF hearings, scheduled testimony by the administration and the anti-oil environmentalists on Thursday and Friday, a week ago, in Juneau, when the ELF-change advocates would get prime time media coverage. He scheduled the oil industry's chance to respond last Saturday afternoon, when nobody was around.

In teleconference followups, those on hand here were polled to see whether they were for or against ELF changes before they were called upon to express their views — and guess which group got the most committee attention.

Then the governor wrote letters urging people favoring changes in the ELF to appear at two other hearings, which were called without notice for Monday — and sponsors let it be known that a body count of numbers would carry the most weight with the committee, rather than the substance of anyone's views.

The whole business is a sorry charade.

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Tye Lake lawsuit

Contractor agrees to pay state \$6 million

A.M.
SATURDAY

The Anchorage Times



STATE OF ALASKA

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February 27, 1989

William J. Tobin, Editor
The Anchorage Times
P.O. Box 40
Anchorage, Alaska 99510

Dear Mr. Tobin,

Enclosed is a letter to the editor in response to your editorial entitled "Shabby government," which appeared on Saturday, February 18, 1989.

I trust that you will print this response in fairness to me and the other members of the House Resources Committee. The Committee has worked very hard on the ELF legislation to ensure a fair hearing.

Thank you for allowing me the opportunity to tell my side.

Sincerely,

A handwritten signature in cursive script that reads "Cliff Davidson".

Representative Cliff Davidson
Co-Chair, House Resources Committee

CD/jn



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ELF: A QUESTION OF FAIRNESS

Dear Editor,

Recently (February 18), The Anchorage Times editorialized on the ELF legislation currently before the House Resources Committee. In your comments on HB 118, you attacked both the legislation and the process by which the Committee is reviewing the issue.

The debate on ELF should lead to the determination of an appropriate, reasonable, justifiable and equitable state tax policy for gas and oil produced on state owned property. What taxes should the oil industry be paying? And, at what rate? What tax incentives should be offered? Which numbers -- on costs, profitability, recoverable reserves, etc. should be used?

Oil has made Alaska a wealthy state. But that should not obscure the fact that Prudhoe Bay, the only supergiant oil field in North America, has also provided phenomenal profits for the North Slope oil producers, as well as a reliable and plentiful supply of "cheap Alaska reserves" for additional transportation and refinery profits. How much, then, the oil companies are taxed is not the only question.

Equally important is what share of Alaska's oil wealth should go to maximize benefits to the people of the state. This is the resource policy imbedded in our State Constitution which all elected officials are sworn to uphold: "The legislature shall provide for the utilization, development and conservation of all natural resources belonging to the state for the maximum benefit of its people." (Article 8, Section 2).

These are the questions with which the House Resources Committee has been grappling during its extensive hearings on ELF. The Committee is working hard toward developing a tax policy that encourages investment by the oil industry. And everyone wants a tax policy that captures for Alaskans a fair and equitable share of the non-renewable, irreplaceable oil wealth that belongs to us all.

I believe that the intent and effect of HB 118 is laudable and would help future oil production in Alaska. It would reduce oil taxes on small oil fields and encourage additional exploration.

- more -

Your attack on my handling of the ELF hearings was wildly inaccurate. I have conducted extensive hearings to bring out the facts concerning ELF and what constitutes a fair share of the oil wealth for all Alaskans. We have had over 20 hours of testimony, including six from the Administration, six and a half from the oil industry and six from the public.

Contrary to your assertion that we held public hearings without notice, the ELF public hearings were scheduled and announced more than a week in advance. In fact, your paper printed our hearing schedule on February 3, and specifically mentioned the hearing that your editorial accused us of holding "without notice." Your suggestion that we would hold public hearings and then attempt to exclude the public is sloppy journalism and ludicrous.

My main concern is the development of a reasonable and responsible tax policy for Alaska. It needs to be fair to the oil companies, and it needs to be fair to the people of Alaska. The issue of ELF is only a part of that policy, but it deserves close examination.

Cliff Davidson

Representative Cliff Davidson
Co-Chairman, House Resources Committee

Anchorage Times
February 3, 1989

Hearing on ELF set to consider cut in tax break

JUNEAU (AP) ^{2/3/89 AT} — More than \$115 million in fiscal 1990 taxes will be at stake when the House Resources Committee next week opens this session's hearings on legislation to amend the state's oil tax structure.

The committee has scheduled four days of hearings on House Bill 118 to amend Alaska's Economic Limit Factor, known as ELF, a tax break intended to provide incentives for the development of marginal oil fields.

The House Finance Committee proposal would cut the tax break on the state's larger oil fields such as Prudhoe Bay and in return offer a bigger tax break on smaller fields.

The Revenue Department estimates the House bill would generate \$115 million in extra revenue next year and more than \$2 billion over the next 16 years.

"We intend to give this legislation a fair and complete hearing," said Rep. Cliff Davidson, D-Kodiak, co-chairman of House Resources.

A similar bill passed the Democrat-led House last session, but died in the Republican-controlled Senate without a single committee hearing.

Opposition to the bill comes primarily from the oil industry, Davidson said.

House Resources will meet the afternoon of Feb. 9 and 10 to hear from Cowper administration officials.

Oil industry testimony is scheduled for the afternoon of Feb. 11, and a statewide teleconference is set for the afternoon and evening of Feb. 13 to hear from the public, Davidson said.



It's getting to be a zoo

It's getting to be a zoo around here.

This is great, but keeping up with it all is driving us crazy.

Take this week, for example.

The President's coming to town. So are more than 90 Soviets from Moscow to Siberia, tagging along on Dixie Belcher's Juneau music ambassadorship of many years. A big annual resources conference opens, following on the heels of a big oil forecast conference. The construction industry has another large meeting, rural Alaskans are gathering in Southeastern, seminars and business functions are proliferating, noise levels have increased in Congress on arctic oil development and Southeastern timber's future, the state House and Administration are turning up the heat on new oil taxes, and that's just for starters.

There are so many opportunities jumping around this state that we're falling all over ourselves trying to keep up. (All the while guarding our pockets from the gummint).

Guess how we know that the level of activity and opportunity has increased significantly, so as to justify commentary.

It's the mail and the calendar. In recent weeks, with the volume of great mail we receive, we could fill

a 60-page newspaper with interesting information. And pretty photos. And clear charts and graphs. With the news scoops we stumble on everywhere, we could fill another 20 pages. With all the events we can't all attend at once, we could fill still more pages.

Alas, we are shackled by the old limitations of ink on paper, we can only print all the news that fits.

Judging by active weeks such as those in recent months, we can say with some confidence that the recovery certainly has begun. Until all of this economic chumming yields the fish, we're repackaging parts of the Journal to cram in more information.

Have fun reading it all. And keep up the good mail and phone calls.

Short ELF editorial

To cram more information, we need shorter editorials around here. Here's a short one on the ELF:

Tinkering with oil taxes is not only greedy and goofball, it is dirty pool.

We also think the House Resources Committee last week engaged in some dirty pool of its own making. Over hearings extending more than four days, guess where the industry most impacted by this tax increase was scheduled for giving

testimony? On a Saturday morning at 8 a.m.

For those of us who aren't in oil or don't pour over legislative production as our daily bread, guess how the House labelled the hearings? "Hearings on the ELF," perhaps, something we might all readily understand? Nope. "HB 118, Oil & Gas Properties Production Tax" is what the hearings were called.

We checked out the hearings a few times, and, as our Gene Rutledge puts it, "The ELF bill will never see daylight in the Senate."

That is good. But it would have been better if people all over the state didn't have to invest the hours to say No one more time. ELF modifications are bad business. Let's stop beating the dead horse.

Underdog winners

Last week Thursday as these words went into type, the doberman had just won best of show at the Westminster Kennel Club in Madison Square Garden (judging by the description of the new champion, we'll likely see it in Sports Illustrated soon).

One of these years, Roxy's going to win the Rondo. And the North American and the Race of Champions.

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February 27, 1989

Sally J. Suddock, Editor
Alaska Journal of Commerce
900 West 5th Avenue, Suite 410
Anchorage, Alaska 99501

Dear Ms. Suddock,

This letter is in response to your "short ELF editorial" of February 20th. Any tax policy is an on-going process of review and re-examination. Alaska's tax policy on oil and gas produced on state property should be no exception.

Who's to know which changes are in order to ensure public policies, over time, are doing their job? Certainly public policy that "never sees the light of day" is policy doomed to darkness. I think more highly of and expect more from those fine Alaskans serving as our Senators, those dedicated men and women who are constantly working for the public's interest and our state's welfare.

To set the record straight, by my recollection, during my three years of serving on the House Resources Committee, there has never been an 8:00 a.m. Saturday hearing -- and there certainly wasn't one on Saturday, February 11, as you erroneously report.

I trust that you will print this response in fairness to me and the other members of the House Resources Committee. The Committee has worked very hard on the ELF legislation and on giving HB 118 a fair hearing.

Thank you for allowing me the opportunity for telling my side.

Sincerely,

A handwritten signature in cursive script that reads "Cliff Davidson".

Representative Cliff Davidson
Co-Chair, House Resources Committee

CD/eed

cc: All Alaska State Senators

Davidson ran hearing poorly

This is to voice my outrage at the way the statewide teleconference on House Bill 118 (on modifying the Economic Limit Factor, or ELF) was handled from Juneau Feb. 13 by Rep. Cliff Davidson (D-Kodiak) co-chairman of the House Resources Committee.

I, along with 60 others in Anchorage, were "polled" on whether we were "for" or "against" the legislation. Instead of allowing us to testify in the order in which we registered, Davidson "bumped" us to hear others in favor of the bill; in other words, those with views coinciding with his. This resulted in considerable delay for those wishing to testify against the bill.

Davidson's snappy, often rude behavior toward people testifying against HB 118 was unprofessional and completely out of line. A public hearing is for the public, and if Mr. Davidson doesn't like the views of the majority of Alaskans — who believe in private enterprise rather than a government-run economy — then perhaps he should reassess why he became an elected official.

To end on a positive note, I would like to commend the folks at the State Legislative Affairs office in Anchorage for doing a great job on the teleconference despite the lack of protocol on the part of Rep. Davidson.

— Frank Baker
Chugiak



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February 27, 1989

"Letters from the people"
Anchorage Daily News
P.O. Box 14-9001
Anchorage, Alaska 99514-9001

Dear Editor,

This letter is in response to Frank Baker's letter appearing in your February 25 "Letters from the people." In his letter Mr. Baker criticizes my handling of a statewide teleconference on HB 118, the ELF, which is being heard before the House Resources Committee.

It is always good to receive criticism, whether constructive or otherwise, after conducting a statewide teleconference. Any tax policy is a complex issue. Alaskan oil and gas production tax policy on state properties is especially complex, because it is historically difficult to "puzzle" together. That is why we are having extensive hearings on HB 118 -- to fully cover the many and varied perspectives and components of this complex issue.

In my first statewide teleconference, I did take testimony from four people out of the order in which they had signed in (two in Anchorage and two in Fairbanks). Due to the large number of persons who had signed in to testify, thus knowing beforehand that not everyone who signed up would get the opportunity to testify, it was my judgement call that a balance of views, for and against and from different geographic areas, all be heard. Additional public testimony was taken after the dinner hour on Monday, as well as on the following Wednesday. All individuals who "stuck it out" were able to be heard.

I truly appreciate and respect all publicly offered testimony. I have tried hard to be fair in all hearings on HB 118, whether testimony came from the public, oil company representatives or the Administration. You will find in the public record that members of the committee stated that they believed the hearings had been fair. Further, I have been complimented for my fairness in the hearings by oil industry lobbyists, most of whom I hold in high regard, as well as oil executives from within Alaska and several who came to the hearings from "Outside."

Thank you for allowing me the opportunity to tell my side of the issue.

Sincerely,

A handwritten signature in cursive that reads "Cliff Davidson".

Representative Cliff Davidson
District 27

ELF hearing process was unfair

The public testimony before the House Resources Committee regarding HB118 (ELF revisions) was grossly mismanaged. In his letter to the editor printed in the Daily News Feb. 13, Gov. Cowper indicated that "citizens who support that effort (passage of HB118) can participate in a public hearing with the House Resources Committee Monday, Feb. 13."

Apparently, the House Resources Committee took the governor's words literally!

Although normal procedure is that those wishing to testify sign in on arrival and speak in order of arrival, the committee decided to bypass this procedure and allow those testifying in favor of HB118 priority over those opposed. Rep. Davidson ignored the signed and posted speaking order. He insisted that speakers opposed to HB118 be alternated with those in support of HB118, regardless of arrival time or place on the roster. Rep. Davidson claimed this would give equal time to both sides.

What he actually did was rob citizens opposed to the bill their chance to testify. In addition, priority was given to elected and former officials, further reducing time available to those wishing to testify. Furthermore, in an attempt to discredit the testimony of those opposed to HB118, the committee requested that persons testifying indicate whether or not they derived their livelihood from the oil industry.

This was patently unfair and extremely frustrating for those of us who took time off from our jobs to testify on an issue that affects all Alaskans. Public testimony should be a time for all concerned citizens to voice their opinions on an issue, regardless of their stance on that issue or their place of employment.

— Jennifer Reed

Debate on ELF clouded

The Anchorage Daily News devotes tremendous editorial space to its version of open and honest government, while brutalizing politicians who don't meet the ADN's standards.

Yet, when Rep. Cliff Davidson, D-Kodiak, limited testimony at a recent ELF hearing primarily to those who support changing the ELF (raising oil severance taxes), not a peep was uttered by the self-righteous ADN.

The Associated Press story the ADN ran on the ELF hearings gave no indication of how the public testimony ran. Moreover, the opposition would have been higher if all those who attended had been allowed to testify. Someone in Anchorage finally protested the hearing, claiming that of the 60 people wanting to testify, all but two were opposed to ELF changes.

The ADN published a letter by Gov. Steve Cowper the day of the ELF hearings in which he said, "Kuparuk ... will pay less than before the loophole took effect 18 months ago." This is a lie! Cowper's ELF changes will increase Kuparuk's severance tax from 8.3 percent to 13.2 percent — higher than in any other state.

Lies and denial of the public process are being used to cloud the ELF debate.

— Jerry Foster

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nam equates to the U.S.S.R.'s presence in Afghanistan. Into self-flagellation who better such nonsense need only keep track of the number of Afghan refugees who, after the fall of Kabul, head across the Hindu Kush for sanctuary in the Soviet Union and compare them with the millions of Indochinese boat people who continue to risk their lives in hopes of building a new life in the United States.

Then there is the matter of the troop withdrawals. You wouldn't know from most current accounts that the U.S. withdrew from Vietnam of its own accord on a timetable of its own making. In the summer and fall of 1969 (almost six years before the fall of Saigon) the U.S. 9th Infantry Division and 3rd Marine Division left Vietnam. In 1970, the 1st Infantry Division was

...of the Daily News-Miner

withdrawn, as were the 4th and 25th Infantry Divisions. The 1st Cavalry Division and the 1st Marine Division departed in early 1971, and in the winter of 1971 (still over three years before the end of the war) the last U.S. divisional-sized units—the Americal Division and the 101st Airborne Division—were withdrawn.

When the United States signed the Paris "Peace" Accords in January 1973, its ground combat forces had long since left Vietnam. By comparison, when the Soviet Union signed the "Afghanistan Settlement" in Geneva on May 15, 1988, its forces were still actively engaged in combat with the Afghan guerrillas. Where all U.S. military forces were withdrawn from Vietnam within 60 days of the signing of the Paris Accords, it has taken the

...with their ill-conceived...
...no bones about the fact that for the following seven years (i.e., for a period longer than World War II) the war became primarily a matter for the regular forces of the North Vietnamese Army rather than for the Viet Cong.

In 1972, the NVA also made a disastrous miscalculation. With almost all U.S. ground combat forces withdrawn, they thought the South Vietnamese Army would be easy pickings, so they launched their multi-division cross-border Easterly invasion. But, to their surprise this attack was turned back with terrible losses by a determined South Vietnamese Army backed up by the massive application of U.S. air power.

Thus, in 1973, when the U.S. de-

...all the roads were open to travel, the markets were over-loaded with food, and refugees continued to vote with their feet and flock into the government-controlled areas.

The Soviets must wish they had it so good. Kabul, in 1989, finds itself in almost exactly the opposite situation as Saigon in 1973. In Afghanistan, it is the guerrillas that dominate the battlefield. The mujahedeen rebels control the countryside and interdict the roads whenever they choose to do so. Kabul is a city under siege, and reports are that foodstuffs are becoming scarce. Abandoned by the majority of the Afghan people, there are serious doubts that the Najibullah regime can survive.

Having said all this, there may yet be a valid comparison between Vietnam and Afghanistan, a comparison that grows out of the fact

thing, not only refusing to honor its guarantees under the Vietnamese government that it would reenter if the accords were violated. Improving relations with the Soviet Union was deemed more important than the survival of an erstwhile ally.

Now, even as the last Soviet soldier leaves Afghanistan, objections are beginning to be raised to the propriety of sending arms and equipment through Pakistan. Once again, there are those who argue that improving relations with the Soviet Union is far more important than honoring guarantees to a rag-tag ally. And, if it persists in such pusillanimity, once again the United States may find itself snatching defeat from the jaws of victory.

Harry G. Summers Jr. is a former colonel in the U.S. Army. His column is distributed by the Los Angeles Times Syndicate.

Gadd also said that he billed...
...\$392,000 for constructing an airstrip in Costa Rica that designed to help supply the Com on the Southern Front in Nicaragua.

Gadd said North enlisted his help build the airstrip for an military supply missions to Nicaraguan Contras while

Soldier pleads guilty to spying

WASHINGTON (AP)—An Air Force warrant officer admitted at opening of his court-martial that he was involved in a five-year conspiracy to provide classified military information to War Pact nations.

Warrant Officer James W. III, 30, of New York City, pled guilty to all 10 counts of espionage attempted espionage and failure to obey Army regulations that lodged against him after his arrest last December in Georgia.

Col. Howard C. Eggers, the military judge presiding at the court-martial at Fort McNair here, did not immediately accept Hall's guilty plea. Under Army regulations he will hear the prosecution's case against Hall and defense witnesses before deciding Hall's guilt punishment.

Court officials said Eggers' verdict and sentence probably not come before Friday.

Under a defense-initiated trial agreement disclosed by the court martial today, Hall pleaded guilty to all charges against him in exchange for government agreeing not to seek the death penalty.

The rest of the government agreement on a sentence for Hall was not disclosed.

Letters to the Editor

The Daily News-Miner welcomes letters to the editor, P.O. Box 710, Fairbanks, AK 99707. Each letter must carry the name and address of the writer, which will be published. Letters that are libelous or in poor taste will be rejected. Thank-you letters will be published in the "Applause" column. Because of space limitations, the following rules generally apply: A letter may not be longer than 350 words. Copies of letters from one person to another will not be published. No one may publish more than one letter per month. Political endorsement letters from outside our readership area will not be published. The Daily News-Miner reserves the right to edit or reject any letter submitted.

Butt out

March 1, 1989
4743 Da Niece St.
North Pole, AK 99705

To the editor:
In Sunday's News-Miner I read another letter by pro-lifer Donna Holbrook condemning an abortion which quite likely gave the mother a better chance of surviving the coma she is in.

Her letter was an example of the bigoted, radical beliefs of pro-lifers, and others who are against abortion for any reason. I have no time or patience with anyone who

would presume to know what's best for a pregnant woman. That is such a serious, personal condition that it should be discussed and decided upon only by the lady and the father and/or close relatives, and all other big-nosed, busybodies should butt out.

Michael Allen

Close a loophole

March 1, 1989
P.O. Box 82679
Fairbanks, AK 99708

To the editor:
I found it interesting that Mr.

Corbet was kind enough to advise the public who were unable to attend hearings on HB 118 with the "real facts." Particularly since he was only present on Monday evening; not during the "more than four hour" afternoon session he alludes to.

His statement regarding the way House Resources Chair Cliff Davidson conducted the hearings is not factual. After some early attempt to allow a balance of views, the forum was abandoned and testimony was taken in order of sign-in. At least in Fairbanks. Reports

from Anchorage, the source of most opposition, indicated that the oil industry had stacked the hearing with employees and that a number of citizens left without testifying.

It really shouldn't surprise anyone that those testifying in favor of eliminating an oil company tax loophole would be working (or non-working) people, citizens who care about Alaska, public officials who have a responsibility to protect the resources and public interest groups. Or that those opposing any changes in oil taxation are industry employees and contractors. The chambers are run by oil executives, no surprise there either.

Clearly there is a great "silent majority" who didn't take part in these public hearings. When any one industry dominates an economy or state, the tentacles become long and deep. The brutal truth is that Alaskans are as en-

slaved to Big Oil as any drug junkie is to the source of the next fix. I fear it may take more courage than we have to break the addiction.

A starting point would be to express justifiable outrage at the farce hearings on SB 97 promises to be. The Senate Special Committee on Oil and Gas, chaired by Drue Pearce, will "hear" public testimony on this bill March 18. Other committee members are: Paul Fischer, Rick Halford and Tim Kelly. Can we really expect an impartial hearing from senators who are either openly employed by the industry or receiving most campaign funds from it? Or that the bill won't die in committee?

This group needs to be pressed hard to put the bill out on the floor for a vote. Alaskans deserve to know exactly who their elected representatives really serve.

Tom Favero

FDNM 3/6/89



BP EXPLORATION

TESTIMONY
OF
BP EXPLORATION
ON
HOUSE BILL NO. 118

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(February 11, 1989)

Mr. Chairman, Members of the Committee: Good afternoon. My name is Thomas K. Williams, and I am here to testify on behalf of BP Exploration (formerly known as Standard Alaska Production Company) and its parent, BP America, regarding the changes to the Economic Limit Factor (ELF) proposed in House Bill No. 118. We believe the proposed changes are unnecessary, ill-advised, unfair and ill-conceived, and should not be adopted.

Unnecessary Changes. The changes are unnecessary because the present ELF formula is working perfectly well and as intended. Without an ELF, the production tax is a regressive tax. That is, the tax is the same regardless of how easily a field can afford to pay it. The ELF makes the tax progressive by assessing more profitable fields at a higher rate of tax, while allowing a lower tax rate for less profitable ones. Every field during its life makes a transition from a profitable phase to an increasingly less profitable one, until there eventually is no profit left at all and production ceases.

The present ELF formula reflects this transition as and when it occurs. It does so by asking what fraction of a field's current production is needed to cover the direct costs of getting that production out of the ground. When the fraction is small,

it means the field has a large operating margin that can be tapped for higher taxes. When the fraction is close to one, it means almost all the production is needed to cover costs, and the field cannot afford to pay a lot of tax. The ELF has been the key that has allowed Alaska to impose a tax with the highest rate in the nation (15%), without suffering any loss of production or development as the result of doing so.

The present ELF works perfectly fine for marginal fields. Milne Point is often cited as an example where the present ELF failed to work. The fact is, the ELF had reduced the tax rate to zero for Milne Point during the last half of the time it was in production. That is the ultimate in tax relief, and the proposed ELF formula in HB 118 cannot and will not provide any further relief for Milne Point than that.

Ill-advised Changes. The proposed changes to the ELF formula in HB 118 are ill-advised because the ELF would no longer depend on a field's relative profitability in setting the actual rate of tax. The changes being proposed appear to be intended to lower tax rates for fields with less than 150,000 barrels a day of production, while increasing them for fields with more.

This would place emphasis on a wholly inappropriate factor, field size. A field's size has, at best, only a loose relationship with how profitable it is and how much tax it can reasonably afford to pay. For example, in terms of dollars returned for each dollar invested, the most profitable field in Alaska's history is the McArthur River field, which never reached

the 150,000 barrel-a-day level. Yet this field would have been given tax relief as a "marginal" field under HB 118, even at its heyday.

The proposed changes are also ill-advised because the State stands to gain more from additional investment and development of Prudhoe Bay and Kuparuk than it will from any of the "marginal" fields on the North slope. The Eileen (West End) Project at Prudhoe Bay, for instance, will add over 100,000,000 barrels of new reserves. This single project is larger than either Milne Point or Niakuk. Yet the proposed new ELF formula would make it even more difficult to justify economically the investment in these large but increasingly marginal projects at Prudhoe Bay.

Testimony yesterday by the Cowper Administration endorsing changes to the ELF formula suggested that there are marginal fields just waiting for the ELF to be changed and then they will start producing. You were told, for example, that HB 118 could let Niakuk start up four years earlier. Well, you have been told wrong. What is holding Niakuk up is a permit for the causeway that it needs. And Milne Point already had a tax rate of zero under the present ELF, so I don't see how HB 118 could make a real difference there. The fact is, there are no commitments to develop any other new fields, no announced plans, not even any serious discussions. No one is saying that they will start up a new marginal field if you change the ELF formula for them. So don't let yourselves be misled into thinking there is a lot of marginal production to be gained by changing the ELF.

What you are hearing, and what you undoubtedly will continue to hear, are warnings about what changing the ELF will mean for marginal projects in the large fields. Such warnings, cautions,

caveats, or whatever you want to call them, are NOT intended to be threats. The industry is not going to pick up its marbles and go home if you change the ELF. But changing it will make some projects too expensive for us to afford. HB 118 will adversely affect the economics for developing the periphery of the two large fields and for continued in-fill drilling on closer well spacing to maximize recoverable reserves and keeps production as high as possible.

UNFAIR CHANGES. The proposed changes are unfair in at least three fundamental respects. First, fields in similar economic situations would be taxed at very dissimilar rates. For example, when Prudhoe Bay is averaging 500 barrels a day per well, its tax rate under this formula would still be approximately 11.95 percent, while Lisburne's rate at 500 barrels a day per well would be nearly a thousand times smaller -- only 0.016 of one percent. I have attached a worksheet to my written testimony, which shows how these numbers have been calculated.

Second, HB 118 is unfair because the oil industry is already being disproportionately taxed relative to other industries in Alaska. In the January 1989 edition of Alaska Business Monthly, economist Andrew Safir writes that oil and gas contributed 33.3 percent of Alaska's "gross state product" in 1986, the latest year for which figures are available. But although petroleum represents only one third of the economy, it accounts for 90 percent of

the money the State of Alaska collects each year. It is unfair to demand more taxes from the oil industry when all other industries enjoy such smaller burdens.

Third, the proposed changes to the ELF are unfair because the State is already receiving a fair share (or more) from North Slope oil production. In 1981 there was a political consensus that the wealth of the petroleum resource should be shared roughly equally among the three interests sharing in it -- the State of Alaska, the oil industry and the IRS. As far as Alaska was concerned, it would be content that it was receiving its fair share as long as that share did not go below 30 percent. Figures published by the Department of Revenue in 1985 and 1986 show that the State has stayed above this 30 percent minimum for each fiscal year since 1981. In fact, the 1986 analysis, which was published by the Cowper Administration before the ELF debate flared up, shows that the State's share of net production and pipeline revenues this fiscal year would be 69.4 percent at \$7.00 wellhead prices, and 55.4 percent at \$9.00 wellhead prices. The latest revenue forecast, from last October, predicts an average wellhead price this fiscal year of \$7.36 (mid case), which means the State is likely to be closer to the 69% figure instead of the 55% one. In the future, as operating costs continue to go up and production starts to go down, the trend will be for the State's share of the net revenue to increase rather than decrease.

Ill-conceived Changes. If the intent of HB 118 is to have the same tax rate for a 150,000 barrel-a-day field as under

the present tax, with lowered rates for smaller fields and increased rates for larger ones, then the formula in the bill is wrong. The math simply does not work. This is because the bill takes the exponents in the wrong order.

The sequence in which exponents are taken makes a big difference. For example, take

$$4^{3^2}$$

This may be easier to think about (and certainly easier to type!) if we use a caret ("^") to indicate that an expression is an exponent. The expression above would then look like this: 4^{3^2} .

Without any parentheses to indicate a different order, the correct sequence in a compound exponent is to start at the top and work down or, when using carets to indicate exponents, to start at the right and work left. Thus, we first raise three to the second power: three squared is nine.

$$\begin{aligned}4^{(3^2)} &= 4^{(3 \times 3)} \\ &= 4^{(9)}\end{aligned}$$

Then we raise four to the ninth power. Four times itself nine times is 262,144.

$$\begin{aligned}4^9 &= 4 \times 4 \times 4 \times 4 \times 4 \times 4 \times 4 \times 4 \times 4 \\ &= 262,144\end{aligned}$$

If we went the other way, starting with four and working our way to two, then four cubed is 64, and 64 squared is 4,096.

$$\begin{aligned}
(4^3)^2 &= (4 \times 4 \times 4)^2 \\
&= (64)^2 \\
&= 64 \times 64 \\
&= 4,096
\end{aligned}$$

As you can see, this produces a very different result from the first. The order in which compound exponents are applied is crucial in determining the outcome.

The formula in HB 118 takes the exponents in the wrong sequence from what seems to be intended. In the present ELF formula there are two components: a "base" and an exponent. If we use "A" to represent the base and "B" to represent the exponent, the present formula is A^B . HB 118 introduces a new component, a second exponent, into the formula between "A" and "B;" "A" and "B" are the same in the proposed formula as they are in the present one, so the difference between the two formulas is this new, second exponent. If we call this new exponent "C," then the new formula is $A^C{}^B$. But is this $(A^C)^B$ or $A^{(C^B)}$? As HB 118 is written, the formula is $A^{(C^B)}$.

"C" is defined in the bill to be $[150,000/(TP/WD)]$. In other words, "C" equals 150,000 divided by the average daily production from the field during the tax period. It is plain that "C" is intended to equal 1.0 for a 150,000 barrel-a-day field, because then "C" equals 150,000 divided by 150,000. But if the number one is raised to any power, the result is still one. For a 150,000 barrel-a-day field, $A^{(C^B)}$ will be $A^{(1^B)}$, or A^1 . Any number raised to the first power is the same

number, so $A^{(1)}$ is the same as "A." Hence the ELF for a 150,000 barrel-a-day field will be "A" under HB 118, instead of A^B . The ELF will not be the same, and in fact the tax will be higher for a 150,000 barrel-a-day field under HB 118 than it is under the present law (assuming in the present law the 300 B/D/well presumption for the field has not been rebutted and shown to be 460 B/D/well or more).

In conclusion, then, the proposed changes to the ELF formula are unnecessary because the present formula is not broken and does not need to be fixed. The proposed changes are ill-advised because field size is not a reliable indicator of a field's economic health and ability to withstand a high rate of tax. They are also ill-advised because they over-emphasize the importance of so-called "marginal" fields at the expense of marginal projects in the large fields: marginal projects in large fields can have greater overall benefits for Alaska and Alaskans than the development of small fields. The proposed changes to the ELF are unfair, first, because of the wildly different treatment that will occur between comparably profitable fields; second, because of the disparity between the present level of taxation on the oil industry and the burden on any other resource industry; and third, because the State is already receiving more than a fair share of the value of the resource. The proposed changes to the ELF are ill-conceived because the formula in the bill is mathematically deficient and fails to achieve the

apparent objective of keeping the tax rate the same for fields producing 150,000 barrels a day.

Thank you for this opportunity to testify to you today. I would be pleased to answer any questions the Committee may have.

Prudhoe Bay

Average Production Rate per Well = 500 B/D
Number of Wells (projected) = 745
Fieldwide Production = 372,500 B/D

$$\begin{aligned} \text{"A"} &= (1 - [\text{PEL}/\text{TP}]) \\ &= (1 - [(300 \times 745) / 372,500]) \\ &= 0.400000 \end{aligned}$$

$$\begin{aligned} \text{"B"} &= [150,000 / (\text{TP}/\text{Days})] \\ &= [150,000 / 372,500] \\ &= 0.402685 \end{aligned}$$

$$\begin{aligned} \text{"C"} &= [(460 \times \text{WD}) / \text{PEL}] \\ &= [(460 \times \text{WD}) / (300 \times \text{WD})] \\ &= [460 / 300] \\ &= 1.533333 \end{aligned}$$

$$\begin{aligned} \text{Tax Rate} &= \text{ELF} * 15\% \\ &= [A^{(B^C)}] * 15\% \\ &= [0.400000^{(0.402685^{1.533333})}] * 15\% \\ &= [0.400000^{0.247902}] * 15\% \\ &= [0.796801] * 15\% \\ &= 11.95202\% \end{aligned}$$

Lisburne

Average Production Rate per Well = 500 B/D
Number of Wells (projected) = 81
Fieldwide Production = 40,500 B/D

$$\begin{aligned} \text{"A"} &= (1 - [\text{PEL}/\text{TP}]) \\ &= (1 - [(300 \times 81) / 40,500]) \\ &= 0.400000 \end{aligned}$$

$$\begin{aligned} \text{"B"} &= [150,000 / (\text{TP}/\text{Days})] \\ &= [150,000 / 40,500] \\ &= 3.703704 \end{aligned}$$

$$\begin{aligned} \text{"C"} &= [(460 \times \text{WD}) / \text{PEL}] \\ &= [(460 \times \text{WD}) / (300 \times \text{WD})] \\ &= [460 / 300] \\ &= 1.533333 \end{aligned}$$

$$\begin{aligned} \text{Tax Rate} &= \text{ELF} * 15\% \\ &= [A^{(B^C)}] * 15\% \\ &= [0.400000^{(3.703704^{1.533333})}] * 15\% \\ &= [0.400000^{7.445755}] * 15\% \\ &= [0.001089] * 15\% \\ &= 0.01634\% \end{aligned}$$

HOUSE RESOURCES COMMITTEE
HEARING FEB 11 1989

BP EXPLORATION FIGURES
WHERE THE PRODUCTION REVENUE GOES

FY 89

	\$ MILLIONS	\$/BBL	
TOTAL REVENUE	5,300	7.36	
PRODUCTION COSTS	2,440	(3.39)	
NET REVENUE (THE "PIE")	2,860	3.97	100%
TO ALASKA GOVERNMENT			
ROYALTY	627	0.87	
PRODUCTION TAX	547	0.76	
PROPERTY TAX	214	0.30	
INCOME TAX	130	0.18	
TOTAL	1,518	2.11	53%
TO FEDERAL GOVERNMENT	455	0.63	16%
TO INDUSTRY	887	1.23	31%

TAPS Tariff (\$/bbl)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 89	3.22	3.09	3.09
FY 90	3.36	3.05	3.07
FY 91	2.90	3.08	3.05

Wellhead Value (\$/bbl)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 89	6.49	7.36	8.82
FY 90	3.63	7.00	10.94
FY 91	5.79	11.02	18.28

Total Alaska Production Volume (mmbbs/day)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 89	1.92	1.97	1.97
FY 90	1.82	1.86	1.88
FY 91	1.71	1.76	1.81

Inflation (%)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 89	3.36	4.19	5.19
FY 90	3.15	4.15	5.55
FY 91	3.00	4.15	5.80

(Utilized to generate nominal dollar value of the revenue projections.)

GENERAL FUND UNRESTRICTED REVENUES

(Millions of Dollars)

TAXES	FY 1988	FY 1989 ESTIMATES			FY 1990 ESTIMATES			FY 1991 ESTIMATES		
	<u>Actuals</u>	<u>Low</u>	<u>Mid</u>	<u>High</u>	<u>Low</u>	<u>Mid</u>	<u>High</u>	<u>Low</u>	<u>Mid</u>	<u>High</u>
<u>Income</u>										
Corporate General	23.4	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0
Corporate - Petroleum (1)	<u>158.0</u>	<u>122.0</u>	<u>130.0</u>	<u>138.0</u>	<u>115.0</u>	<u>125.0</u>	<u>138.0</u>	<u>109.0</u>	<u>120.0</u>	<u>144.0</u>
Total	<u>181.4</u>	<u>136.0</u>	<u>144.0</u>	<u>152.0</u>	<u>129.0</u>	<u>139.0</u>	<u>152.0</u>	<u>123.0</u>	<u>134.0</u>	<u>158.0</u>
<u>Gross Receipts</u>										
Alaska Business License	1.4	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Fish - Canned/Shorebased (2)	13.8	13.2	13.2	13.2	12.0	12.0	12.0	14.0	14.0	14.0
Fish - Floating	8.7	11.3	11.3	11.3	9.0	9.0	9.0	9.0	9.0	9.0
Salmon Enhancement (3)	5.8	8.9	8.9	8.9	7.0	7.0	7.0	7.0	7.0	7.0
Seafood Marketing (4)	2.7	3.3	3.3	3.3	2.5	2.5	2.5	2.5	2.5	2.5
Insurance Companies	23.7	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0
Electric & Telephone Coops	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Mining License Tax	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>
Total	<u>58.5</u>	<u>62.5</u>	<u>62.5</u>	<u>62.5</u>	<u>56.3</u>	<u>56.3</u>	<u>56.3</u>	<u>58.3</u>	<u>58.3</u>	<u>58.3</u>
<u>Severance</u>										
Oil & Gas Production	816.4	489.0	544.9	641.7	357.5	482.2	730.5	330.7	483.3	726.6
Oil & Gas Conservation	<u>2.3</u>	<u>2.5</u>	<u>2.5</u>	<u>2.5</u>	<u>2.3</u>	<u>2.3</u>	<u>2.3</u>	<u>2.1</u>	<u>2.2</u>	<u>2.2</u>
Total	<u>818.7</u>	<u>491.5</u>	<u>547.4</u>	<u>644.2</u>	<u>359.8</u>	<u>484.5</u>	<u>732.8</u>	<u>332.8</u>	<u>485.5</u>	<u>728.8</u>
<u>Property</u>										
Oil & Gas	<u>96.2</u>	<u>90.1</u>	<u>90.1</u>	<u>90.1</u>	<u>86.0</u>	<u>86.0</u>	<u>86.0</u>	<u>82.3</u>	<u>82.3</u>	<u>82.3</u>
<u>Sale/Use</u>										
Alcoholic Beverages	12.1	11.6	11.6	11.6	11.5	11.5	11.5	11.5	11.5	11.5
Fuel Taxes - Aviation	9.0	9.0	9.0	9.0	9.1	9.1	9.1	9.1	9.1	9.1
Fuel Taxes - Highway	19.3	19.5	19.5	19.5	19.6	19.6	19.6	19.6	19.6	19.6
Fuel Taxes - Marine	5.3	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4
Tobacco Products	<u>6.1</u>	<u>6.2</u>	<u>6.2</u>	<u>6.2</u>	<u>6.1</u>	<u>6.1</u>	<u>6.1</u>	<u>5.9</u>	<u>5.9</u>	<u>5.9</u>
Total	<u>51.8</u>	<u>51.7</u>	<u>51.7</u>	<u>51.7</u>	<u>51.7</u>	<u>51.7</u>	<u>51.7</u>	<u>51.5</u>	<u>51.5</u>	<u>51.5</u>
<u>Other</u>										
Estate	<u>0.3</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>
TOTAL TAXES	<u>1206.9</u>	<u>832.5</u>	<u>826.4</u>	<u>1001.2</u>	<u>683.5</u>	<u>818.2</u>	<u>1079.5</u>	<u>648.6</u>	<u>812.3</u>	<u>1079.6</u>

	<u>Actuals</u>	<u>Low</u>	<u>Mid</u>	<u>High</u>	<u>Low</u>	<u>Mid</u>	<u>High</u>	<u>Low</u>	<u>Mid</u>	<u>High</u>
<u>LICENSES & PERMITS</u>										
Business (5)	8.6	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Non-Business	19.7	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5
Total	28.3	27.0	27.0	27.0	27.0	27.0	27.0	27.0	27.0	27.0
<u>INTERGOVERNMENTAL RECEIPTS</u>										
Federal Shared Revenues (6)	8.9	8.5	8.5	8.5	8.0	8.0	8.0	7.5	7.5	7.5
<u>STATE RESOURCE REVENUE</u>										
<u>Sale/Use</u>										
Bonus Sales (6)(7)(8)	5.6	10.1	10.1	10.1	0.0	0.0	0.0	0.0	0.0	0.0
Investment Earnings (9)	132.6	105.8	109.0	113.4	19.6	29.1	67.2	15.4	15.4	29.9
Rents (6)(7)(8)	6.0	6.3	6.3	6.3	6.5	6.5	6.5	6.5	6.5	6.5
Royalties (6)	694.8	393.8	469.8	563.4	194.1	470.8	680.3	223.4	450.5	711.1
Sale of State Property (5)	3.8	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Gravel, Timber, etc.	1.1	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Total	843.9	521.0	600.2	698.2	225.2	471.4	759.0	250.3	477.4	752.5
<u>Facilities Related Charges</u>										
Airports	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Ferry System—SE	26.0	30.5	30.5	30.5	31.9	31.9	31.9	33.5	33.5	33.5
Ferry System—SW	3.8	4.3	4.3	4.3	4.5	4.5	4.5	4.6	4.6	4.6
Other (5)	0.7	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Total	32.3	37.6	37.6	37.6	39.2	39.2	39.2	40.9	40.9	40.9
<u>Services Related Charges</u>										
Court System	5.5	5.5	5.5	5.5	5.6	5.6	5.6	5.7	5.7	5.7
Other (5)	2.0	2.6	2.6	2.6	3.0	3.0	3.0	3.2	3.2	3.2
Total	7.5	8.1	8.1	8.1	8.6	8.6	8.6	8.9	8.9	8.9
TOTAL RESOURCE REVENUE	883.7	566.7	645.9	743.9	273.0	519.2	806.8	300.1	527.2	802.3
<u>MISCELLANEOUS REVENUE</u>	16.1	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
<u>SPECIAL SETTLEMENTS (10)(11)</u>	161.9	221.2	221.2	221.2	0.0	0.0	0.0	0.0	0.0	0.0
<u>TOTAL UNRESTRICTED REVENUE (12)</u>	2305.8	1670.9	1814.0	2016.8	1006.5	1387.4	1936.3	998.2	1389.0	1931.4
MENTAL HEALTH TRUST INCOME ACCOUNT (13)	0.0	83.6	90.7	100.8	50.3	69.4	96.8	49.9	69.5	96.6

* Footnotes on the following page.

ARCO

Position Paper

Testimony, ELF
Resources Committee, House of Representatives
Juneau, Alaska
February 11, 1989

On February 11, 1989, Mr. Ben L. Odom, Senior Vice President of Operations of ARCO Alaska, Inc. will offer testimony concerning House Bill 118 to the Resources Committee of the Alaska State House of Representatives. Mr. Odom will express ARCO Alaska's opposition to any changes to the Economic Limit Factor (ELF) and specifically the modifications dictated by H.B. 118. The effects on the oil industry of H.B. 118 will be discussed and specific examples will be provided showing the Kuparuk River Unit of which Arco Alaska is both the operator and a Major investor. Discussion will revolve around how operations and future plans related to Kuparuk can and will be negatively impacted by H.B. 118. Economic evaluations and various exhibits will be used to illustrate how the Bill would function to deter oil industry exploration and production in Alaska.

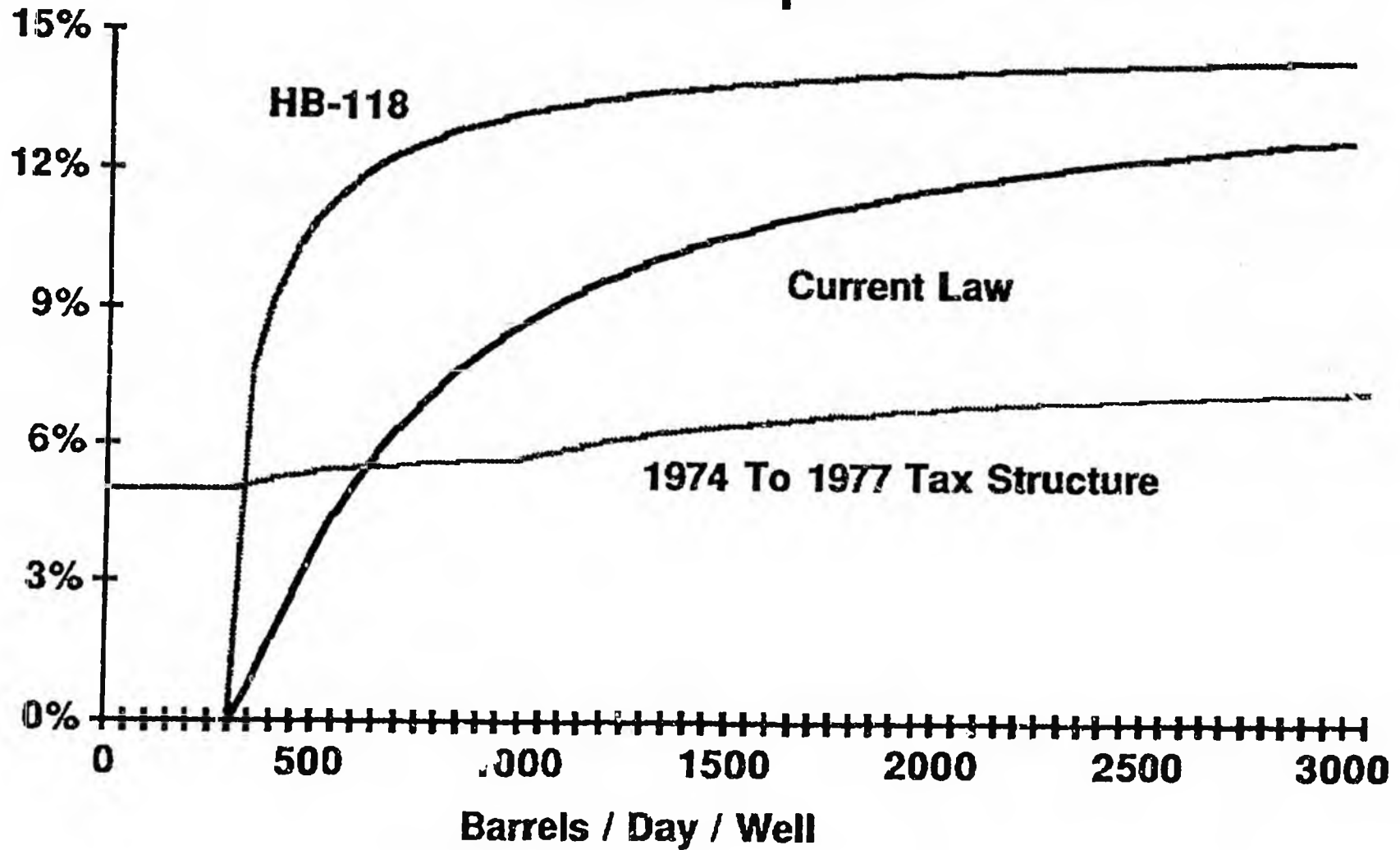
The near and long term economic welfare of the State of Alaska and the oil industry are extraordinarily intertwined. House Bill 118 is a change in fundamental tax policy that is detrimental to the oil industry. Any change in the ELF Oil and Gas Properties Production Tax laws that adversely effects the ability of the industry to develop the state's oil and gas resources, is detrimental both to the state and to the industry.

PROJECT PORTFOLIO

KUPARUK

<u>Project</u>	<u>Description</u>	<u>Timing</u>
<u>Drilling</u>		
• Peripheral Drillsite 2K	Selective peripheral DS development on 160 acre spacing. Total of 98 additional wells	1989 SU
• Peripheral Drillsite 3R		1989 SU
• Peripheral Drillsite 2M		1990 SU
• Peripheral Drillsite 2L		1990 SU
• Peripheral Drillsite 3G		1990 SU
• Rem. Peripheral Dev.	14 drillsite expansions, 6 new drillsites, 180 additional wells 1 rig 1989, 2 rigs thereafter	1990====>
<u>Waterflood/EOR</u>		
• LIP-3 Expansion	Additional water handling capacity @ CPF-3 22 new wells. Improve EOR efficiency 16 wells. Seed for Phase I infill 160 + 80 acre accelerate reserves 19 drillsites staged over 4 years	1990 SL
• Infill Drill @ DS 1Y/2Z		1989====>
• Infill Drill @ DS 1A		1989 SU
• Phase I Infill Drilling		1991 SU
• Fullfield EOR		1991 SU

Effective Severance Tax Rates For Kuparuk



Testimony, ELF
Resources Committee, House of Representatives
Juneau, AK
February 11, 1989

Good afternoon. My name is Ben Odom. I am Senior Vice President of Operations of ARCO Alaska, Inc. I appreciate the opportunity to offer testimony today concerning yet another proposed modification to the Economic Limit Factor of the Alaska Oil and Gas Properties Production Tax.

I feel certain that it will come as no surprise to you that ARCO Alaska opposes any changes to the Economic Limit Factor (ELF) which would have the effect of increasing the oil and gas industry's tax burden. We certainly identify with your problems concerning the potential budget deficit generated by the drop in crude oil prices. We have had to make a number of difficult decisions because of lower crude prices, including organizational restructuring and substantial reductions in costs, because our revenues, like yours, were and are, tied to the price of crude oil.

Our economics for making investment decisions contain two principal components. Estimated prices and estimated costs. We know we can't control prices, and we have learned we don't have the ability to predict them very well either. That leaves only cost. Other than the actual costs of transporting the crude oil, the largest single cost we have in Alaska is not the result of the remoteness of the fields or even the cold. The largest single item of cost we face in Alaska is taxes. Higher costs or lower prices result in exactly the same thing -- more oil left in the ground -- more oil that could be recovered becomes uneconomic to recover. That oil which is left in the ground because it is uneconomic will not return any royalties to the State, and it's from these royalties that the contributions are made to the Permanent Fund. It will not result in the payment of any production tax nor generate any income tax. Oil left in the ground will not create jobs. It will not utilize the facilities already available for its production, therefore, those facilities will generate less ad valorem tax revenues. The ELF helps to reduce the regressive effect of a gross production tax and prevent the premature cessation of oil production. Short-term fixes resulting in higher costs today have the result of removing jobs today and revenue from the future.

High crude prices have meant more tax and more royalty for the state. Those high prices have also equated to more crude oil reserves and more jobs to produce those reserves. However, reserves are not the equivalent of the total amount of crude oil in a reservoir. There is also an economic consideration. Reserves are instead only equal to the amount of crude oil that can be economically produced. Added crude reserves come when prices have been high enough to provide the economic incentive to pay for the technology specific to each reservoir and to pay for workers and equipment to implement that technology in each reservoir. Low prices mean reduced crude reserves; high costs likewise mean reduced crude reserves.

I want to show you this afternoon some information about the Kuparuk River Unit which should give you cause to move carefully in considering changes to the ELF. It is my understanding that the administration has prepared the 1990 budget based on a \$14 Gulf Coast North Slope crude price. I would like to call your attention to Exhibit I, which indicates the impact on the Kuparuk River Unit of a \$14.01 crude oil price. Kuparuk is the second largest oil field in North America with a current daily production rate of around 300,000 barrels. Our studies indicate nearly a billion barrels of oil can be produced with the existing wells and facilities. Half as much again is recoverable with additional capital spending. One might suppose that this field is an extremely profitable investment. But contrary to what you read in the papers or see on television, at \$14 a barrel, Kuparuk is anything but profitable. As the exhibit so clearly shows, the State already, with the current ELF, receives more than 100% of the available net revenue on each incremental barrel of crude.

Even at its current peak production rate, only the State of Alaska, not the Kuparuk investors, receives a profit. These numbers paint a rather bleak picture at \$14 a barrel. How can increasing the production tax burden by 160% over the next ten years, as HB-118 would do, be justified when you look at the economics? The State would certainly appear to be receiving a great deal more than a fair share of the available revenue.

The producer's return on each incremental barrel of oil will determine whether additional investments are made to produce more oil. Kuparuk has no natural

gas cap to force the oil from the ground. From the day the first barrel was lifted, pressure has been decreasing, and production on a per-well basis would decline without extensive additional investment in enhanced recovery projects. These new investments are very costly and can only provide for a slower decline in production than would otherwise occur. The loss per barrel that you see is the amount that must support the economic decision of whether we continue to create additional crude oil reserves in the Kuparuk River Unit. Do we operate a drilling rig to do well workovers to produce more barrels when we lose \$.14 on each barrel? Does it look better to double the production tax and increase the loss to \$.32? There is not a multiplier or an exponent which will convert this loss to an economic incentive to spend more money, to generate more barrels at a loss. What is at issue is the one half billion barrels in the ground that require additional wells and investment to produce.

We are currently looking at a long-range plan for Kuparuk involving what we hope to be a continuing development package. As attached Exhibit II shows, there are many development projects left to be done at Kuparuk, and they would require additional capital of almost \$1.6 billion and would create additional Alaskan jobs amounting to nearly 4000 man years of construction. Many of those projects will stay on the drawing board unless we have higher crude oil prices or lower costs -- or both. We can't do it without your help. The industry can't live with low prices and higher taxes. Among these projects, for example, is a drill site on the periphery of the Kuparuk field. Our plans call for a project consisting of 12 wells to be drilled on the site, providing an additional 12 million barrels of new oil reserves. Under the State's price forecasts and the present tax laws, this project is only marginally economic. If HB-118 is enacted, this project won't happen. Twelve million barrels of oil and effectively \$35 million in State revenue will be left in the ground. Of the \$35 million, \$14 million would go into the Permanent Fund.

The importance of tax burden in a project evaluation cannot be overstated. The ELF plays a pivotal role in mitigating the regressive nature of the Alaska production tax by taking into account the economic realities of oil field operations. Those realities are that it doesn't matter how large or small the field is, what does matter is that each new project must stand on its own by showing a positive net present worth. Although prices are still very low, the current ELF

provides a small but measurable incentive to help reduce some of the costs associated with producing more oil.

When I initially came to Alaska in 1968, the severance tax rate was 1%. A step production tax was introduced in 1974 to help mitigate the production tax burden on wells whose production was at certain low levels. This step methodology was modified in 1977 with the introduction of the ELF, and the maximum statutory rate was increased to 12.25%. Again in 1981 the statutory rate was increased to 15%, the highest production or severance tax rate in the nation. In addition, the application of the ELF was limited during the first ten years of production. As the curves in Exhibit III indicate for the Kuparuk Field, the burden on the production tax has not only changed by calculation method, but it has continually increased. Kuparuk would clearly be paying less production tax under prior laws than it would be paying under HB-118. As the top line of the graph plainly shows, HB-118 does not provide a slowly declining tax rate, or even a step decline, as production drops off. HB-118 is more on the nature of a cliff, where the production of the wells in the field must be so low before any reduction in tax is realized that under North Slope economic realities, the wells could not be operated at these production levels. This can be restated by saying that the Kuparuk Field will shut down before the ELF in HB-118 mitigates anything but an insignificant amount of the production tax.

An increase in taxes also has the direct effect of reducing the amount of capital available for exploration and production in the state. The modification of the ELF embodied in HB-118 is an increase in taxes. This bill provides only a short term revenue boost to cover excessive current government spending. It will not solve the fiscal difficulties the state now faces, and if it is enacted, it will be at the expense of long-term stability and growth. Too much of the oil industry's resources are being drained out of resource development and into government. It is time for the Legislature to set the pace for Alaska by putting into place policies that attract new investment and provide incentives to increase current investments. The current ELF formula does help to provide incentives to increase production, while HB-118 severely limits those incentives and effectively reinstates the regressive inequities of the gross production tax.

In closing, I would like to state that ARCO Alaska believes that HB-118 will not be advantageous to the economy or the citizens of Alaska. Its enactment would place an onerous additional tax burden on the oil industry that would remove to other states or countries funds that could otherwise be spent on additional investment in Alaska. HB-118 would create a disincentive to future Alaska exploration and development and will not maximize the recovery of Alaska's oil resources. ARCO Alaska strongly opposes House Bill 118.

ARCO

**ANS Net Revenue
Kuparuk River Field**

	<u>Current Law</u> \$/bbl	<u>HB-118</u> \$/bbl
Assumed Crude Price	14.01	14.01
Tanker Freight	2.70	2.70
Quality Differential	0.40	0.40
TAPS Tariff	3.11	3.11
Kuparuk Pipeline	0.70	0.70
Pipeline Loss	0.10	0.10
Wellhead Price	<u>7.00</u>	<u>7.00</u>
Production Cost and Capital Recovery	<u>5.43</u>	<u>5.43</u>
Total Net Revenue	1.58	1.58
State Royalty	0.82	0.82
Severance Tax	0.54	0.82
Property Tax	0.44	0.44
State Income Tax	-0.01	-0.02
Total State	<u>1.79</u>	<u>2.06</u>
Federal Income Tax	<u>-0.07</u>	<u>-0.17</u>
Producer Profit	-0.14	-0.32

Source: .
 Barclays de Zoete Wedd, September 1988
 Alaska Department of Revenue October 1988
 State of Alaska Royalty and Severance Methodology

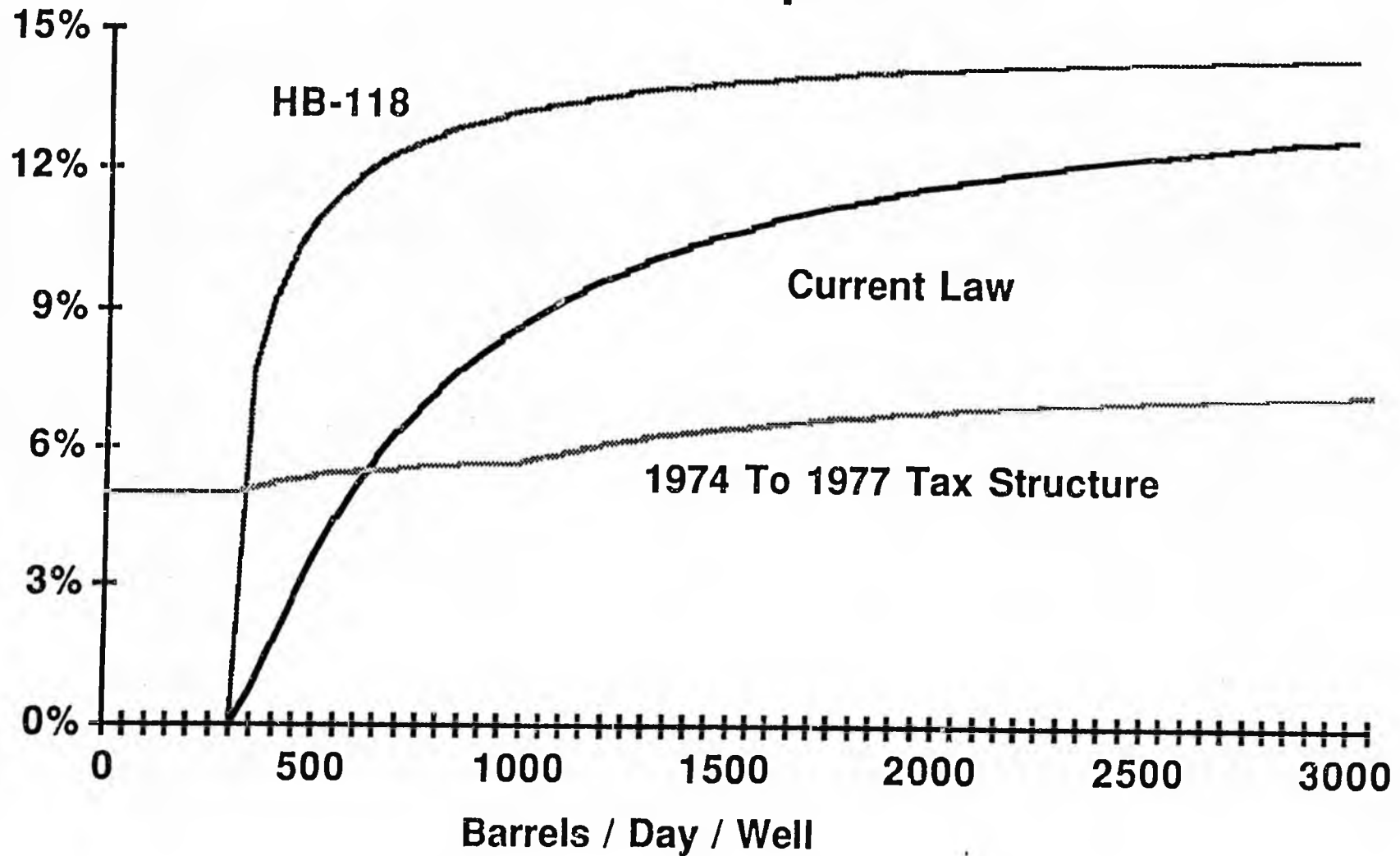
PROJECT PORTFOLIO

KUPARUK

<u>Project</u>	<u>Description</u>	<u>Timing</u>
<u>Drilling</u>		
• Peripheral Drillsite 2K	Selective peripheral DS development on 160 acre spacing. Total of 98 additional wells	1989 SU
• Peripheral Drillsite 3R		1989 SU
• Peripheral Drillsite 2M		1990 SU
• Peripheral Drillsite 2L		1990 SU
• Peripheral Drillsite 3G		1990 SU
• Rem. Peripheral Dev.		14 drillsite expansions, 6 new drillsites, 180 additional wells 1 rig 1989, 2 rigs thereafter
<u>Waterflood/EOR</u>		
• LIP-3 Expansion	Additional water handling capacity @ CPF-3 22 new wells. Improve EOR efficiency 16 wells. Seed for Phase I Infill 160 + 80 acre accelerate reserves 19 drillsites staged over 4 years	1990 SL
• Infill Drill @ DS 1Y/2Z		1989====>
• Infill Drill @ DS 1A		1989 SU
• Phase I Infill Drilling		1991 SU
• Fullfield EOR		1991 SU

II

Effective Severance Tax Rates For Kuparuk



TESTIMONY OF

GERALD SERENA

FOR

EXXON COMPANY, U.S.A.

BEFORE THE

HOUSE RESOURCES COMMITTEE

HB No. 118

FEBRUARY 11, 1989

MY NAME IS GERALD SERENA AND I AM A TAX LAWYER FOR EXXON COMPANY, U.S.A. EXXON IS A WORKING INTEREST OWNER IN THE PRUDHOE BAY, KUPARUK, LISBURNE, AND ENDICOTT FIELDS. WE APPRECIATE THE OPPORTUNITY TO PRESENT OUR VIEWS ON HB 118 THIS AFTERNOON.

HB 118 IS ONLY 25 LINES LONG, BUT NONETHELESS IT WOULD RESULT IN A MAJOR CHANGE IN LONG-STANDING OIL PRODUCTION TAX POLICY IN ALASKA THAT COULD SERIOUSLY IMPACT CONTINUED DEVELOPMENT OF THE TWO LARGEST OIL FIELDS IN THE UNITED STATES, WITHOUT ADDING ANY MEANINGFUL OFFSETTING BENEFIT TO DEVELOPMENT OF OTHER SMALLER FIELDS IN ALASKA. IT WOULD DO THIS BY REVISING THE ECONOMIC LIMIT FACTOR ("ELF"), USED IN CALCULATING THE EFFECTIVE PRODUCTION TAX RATE FOR PRUDHOE BAY AND KUPARUK, RESULTING IN IMMEDIATE INCREASES IN TAX RATE OF MORE THAN 20% AT PRUDHOE BAY AND ABOUT 60% AT KUPARUK. MAKE NO MISTAKE ABOUT IT. HB 118 DOES NOT CLOSE A "TAX LOOPHOLE"; IT DOES NOT CORRECT A "TAX GIVEAWAY". AFTER WE SIFT THROUGH ALL THE POLITICAL RHETORIC, AFTER WE REDUCE THE COMPLEXITY OF THE NEW DOUBLE EXPONENTIAL FORMULA TO UNDERSTANDABLE TERMS, HB 118 IS NOTHING MORE THAN AN INCREASE IN THE PRODUCTION TAX RATE FOR MORE THAN 90% OF ALASKA'S OIL PRODUCTION. IT EFFECTIVELY ELIMINATES THE BENEFIT OF ELF, A PROVISION OF THE PRODUCTION TAX LAW THAT WAS DESIGNED TO REDUCE THE PRODUCTION TAX BURDEN ON A FIELD AS IT MATURES AND THE AVERAGE WELL RATE DROPS, A

PROVISION THAT HAS BEEN AN ESSENTIAL PART OF ALASKA'S PRODUCTION TAX POLICY SINCE 1977.

WHY IS THIS TAX RATE INCREASE BEING PROPOSED NOW? SOME WOULD TELL YOU IT'S NECESSARY TO STABILIZE DECLINING STATE REVENUES. THEY IGNORE THE CAUSE AND EFFECT RELATIONSHIP BETWEEN HB 118 AND FURTHER NORTH SLOPE DEVELOPMENT. SOME WOULD HAVE YOU BELIEVE THAT THE OIL COMPANIES CAN ANTE UP A LITTLE MORE TO HELP BALANCE THE BUDGET OVER THE NEXT TWO YEARS, THAT THEIR PROFITS ARE MORE THAN ENOUGH TO ALLOW THIS. THEY IGNORE THE ECONOMIC REALITY THAT PROJECTS IN ALASKA COMPETE WITH OTHER PROJECTS THROUGHOUT THE WORLD FOR LIMITED INVESTMENT DOLLARS. I WON'T TAKE UP YOUR TIME TODAY WITH A DISCUSSION OF THE PHILOSOPHY OF STATE SPENDING PROGRAMS OR THE ABILITY OF CERTAIN TAXPAYERS TO SUPPLEMENT REVENUE SOURCES TO MEET THEM. INSTEAD, MY REMARKS WILL FOCUS ON HOW THE TAX INCREASE WHICH WOULD BE BROUGHT ABOUT BY HB 118 WOULD JEOPARDIZE THE RECOVERY OF ADDITIONAL OIL AT PRUDHOE BAY.

FIRST, AS BACKGROUND, LET'S TAKE A BRIEF LOOK AT THE HISTORY OF ELF. ELF WAS FIRST ADOPTED IN A MAJOR REVISION OF ALASKA'S PRODUCTION TAX LAWS IN 1977, AT THE TIME WHEN PRUDHOE BAY PRODUCTION BEGAN. PRIOR TO THAT TIME, THE MAXIMUM OIL TAX RATE WAS 8%. THE 1977 CHANGE IN THE LAW SIGNIFICANTLY

INCREASED THE BASIC RATE TO 12.25%, BUT ALSO INCORPORATED THE ELF IN RECOGNITION THAT THE BASIC RATE SHOULD BE SCALED DOWN IN APPROPRIATE CASES. ELF RESULTED IN AN EFFECTIVE OIL TAX RATE FOR THE PRUDHOE BAY FIELD OF APPROXIMATELY 11.3% AS OF JUNE 1981.

IN JULY 1981, THE BASIC RATE WAS AGAIN INCREASED, FROM 12.25% TO 15%, AND THE ELF FACTOR WAS FIXED AT 1.0 FOR THE FIRST TEN YEARS OF PRODUCTION FROM THE PRUDHOE BAY FIELD. THIS SUSPENDED THE APPLICATION OF THE ELF FACTOR AT PRUDHOE BAY FOR SIX YEARS UNTIL THE SUMMER OF 1987, TEN YEARS AFTER PRUDHOE BAY PRODUCTION BEGAN. DURING THAT WHOLE TIME WE PAID PRODUCTION TAX AT A 15% RATE -- THE HIGHEST IN THE NATION. IN THE CASE OF THE PRUDHOE BAY FIELD TODAY, THE ELF FACTOR REDUCES THE BASIC TAX RATE OF 15% TO APPROXIMATELY 12.3%.

IN 1988, AVERAGE DAILY OIL PRODUCTION AT PRUDHOE BAY DECLINED TO 1.45MB FROM THE 1.50MB AVERAGE ACHIEVED IN PRIOR YEARS, AND WE ANTICIPATE THAT THIS DECLINE WILL CONTINUE. THIS IS A NORMAL PHYSICAL OCCURRENCE FOR AN OIL FIELD, WHICH IS A DEPLETING NON-RENEWABLE DEPOSIT OF PETROLEUM. THE FACT OF DECLINE WAS INEVITABLE; THE OCCURRENCE, HOWEVER, WAS DELAYED UNTIL NOW BY AN EFFICIENT AND OPTIMAL DEVELOPMENT PLAN IMPLEMENTED BY THE OWNERS. THAT DEVELOPMENT PLAN CONTINUES TO BE IMPLEMENTED AT PRUDHOE BAY

TODAY, WITH FURTHER DEVELOPMENT DRILLING, GAS HANDLING FACILITIES, AND EXPANSION OF ENHANCED OIL RECOVERY ON THE DRAWING BOARD. THESE INVESTMENTS WILL INCREASE RECOVERABLE RESERVES AT PRUDHOE BAY AND WILL MAINTAIN HIGHER LEVELS OF PRODUCTION. THE TYPES OF PROJECTS THAT CONTRIBUTE TO THIS EFFORT ARE BOUNDED ONLY BY TECHNOLOGICAL INNOVATION AND ECONOMIC FEASIBILITY.

MANY FUTURE PROJECTS TO MAINTAIN PRODUCTION AND INCREASE RECOVERABLE RESERVES AT PRUDHOE BAY ARE MARGINAL INVESTMENTS, SIMILAR TO THE PROJECTS TO DEVELOP SMALLER FIELDS ON THE NORTH SLOPE. WHILE HB 118 MIGHT LOWER THE PRODUCTION TAX FOR SOME SMALLER FIELDS, IT WOULD DISCOURAGE MARGINAL PROJECTS AT PRUDHOE BAY. SUCH A TAX POLICY IS HARD TO UNDERSTAND, SINCE IT IS CONCEIVABLE THAT THE UNDEVELOPED MARGINAL RESERVES AT PRUDHOE BAY MIGHT EXCEED THE POTENTIAL RESERVES OF ALL THE SMALLER FIELD PROSPECTS IDENTIFIED TO DATE. THE RESULT WOULD BE LESS TOTAL OIL RECOVERY FROM PRUDHOE BAY AND CONSEQUENTLY LESS ROYALTY AND TAXES FOR THE STATE OF ALASKA AND FEWER JOBS FOR ALASKANS.

SINCE THE INITIAL DEVELOPMENT, EXXON HAS EVALUATED AND SUPPORTED SEVERAL PROJECTS TO INCREASE RECOVERY AT PRUDHOE BAY. THESE PROJECTS HAVE INCLUDED WELLS ON CLOSER SPACING, ENLARGEMENT OF FLUID HANDLING

FACILITIES, ARTIFICIAL LIFT, AND WATER INJECTION. THE COST PER BARREL FOR THESE PROJECTS TO INCREASE RECOVERY WAS TWICE THE COST OF THE INITIAL DEVELOPMENT.

THIS TREND TOWARD LESS PROFITABLE PROJECTS WILL CONTINUE. FUTURE PROJECTS WHICH ARE BEING PLANNED INCLUDE WELLS ON EVEN CLOSER SPACING AND IN THINNER OIL COLUMNS, ADDITIONAL ENHANCED OIL RECOVERY, DEVELOPMENT OF SMALLER RESERVOIRS, AND NEW IDEAS SUCH AS HORIZONTAL DRILLING. THE COST PER BARREL FOR THESE PROJECTS WILL BE MORE THAN FIVE TIMES AS MUCH AS THE INITIAL DEVELOPMENT. IN THE FUTURE, OTHER MARGINAL PROJECTS WILL BE DEFINED AS RESEARCH CONTINUES.

JUST HOW MANY OF THESE MARGINAL PROJECTS WILL BE JUSTIFIED AT PRUDHOE BAY? HOW MANY OF THE MORE THAN 10 BILLION BARRELS TO BE LEFT AFTER CURRENT DEVELOPMENT IS COMPLETED CAN BE RECOVERED? NO ONE KNOWS FOR CERTAIN BECAUSE THE ECONOMICS ARE MARGINAL AND A NUMBER OF FACTORS WILL HAVE AN IMPACT ON THE LIMIT TO WHICH SUCH PROJECTS CAN BE JUSTIFIED.

BUT ONE THING IS CERTAIN, HB 118 WOULD PLACE FUTURE MARGINAL PROJECTS AT PRUDHOE BAY IN JEOPARDY. THE PRODUCTION TAX INCREASE PROPOSED BY HB 118 SIGNIFICANTLY REDUCES THE INCENTIVE TO PRODUCE THESE MARGINAL BARRELS.

LOSS OF MARGINAL PROJECTS AT PRUDHOE BAY WILL REDUCE THE RATE OF PRODUCTION AND ULTIMATE OIL RECOVERY, THEREBY REDUCING JOBS, STATE ROYALTY AND TAX COLLECTIONS.

IT IS AN ECONOMIC FACT OF LIFE THAT COMPANIES LIKE EXXON ENDEAVOR TO COMMIT THEIR CAPITAL AND RESOURCES ONLY TO PRUDENT INVESTMENTS THAT PROVIDE THEIR SHAREHOLDERS WITH A REASONABLE RETURN. THEY ARE MOST SELECTIVE IN THIS PROCESS. TWO DECADES AGO THE QUALITY OF NORTH SLOPE INVESTMENT OPPORTUNITIES CAUSED EXXON TO COMMIT BILLIONS OF DOLLARS IN THE INITIAL DEVELOPMENT OF PRUDHOE BAY AND CONSTRUCTION OF TAPS. AS A RESULT, PETROLEUM DEVELOPMENT IN ALASKA HAS ACCOUNTED FOR ABOUT 85% OF STATE REVENUES DURING THE PAST 12 YEARS AND IN ADDITION HAS ESTABLISHED THE NEARLY \$10 BILLION ALASKA PERMANENT FUND. HOWEVER, EACH SUCCEEDING DEVELOPMENT PROJECT MUST STAND ON ITS OWN FEET AND THE METHODOLOGY FOR EVALUATING THE QUALITY OF THESE PROJECTS TODAY IS THE SAME AS THAT APPLIED AT THE TIME THE INITIAL INVESTMENT WAS MADE.

MAJOR DEVELOPMENT PROJECTS AT PRUDHOE BAY REQUIRE THE APPROVAL OF ALL THREE OF THE MAJOR OWNERS. EACH OF THE PRUDHOE BAY OWNERS EVALUATES THE ECONOMICS OF A NEW PROPOSED INVESTMENT BASED ON THE NEEDS OF ITS COMPANY, UNDER CRITERIA ESTABLISHED BY ITS MANAGEMENT. EXXON IS NOT PRIVY TO THE

DECISION-MAKING PROCESS AT ARCO OR BP, SINCE OUR COMPANIES ARE IN KEEN COMPETITION, AND I CANNOT COMMENT ON THEIR PROCEDURES. I CAN HOWEVER TELL YOU SOMETHING ABOUT HOW EXXON EVALUATES FUTURE DEVELOPMENT PROJECTS AT PRUDHOE BAY. THIS PROCESS INCLUDES THE EVALUATION OF VARIOUS TYPES OF RISK - GEOLOGIC RISK, RESERVOIR RISK, DRILLING RISK, AND POLITICAL/ECONOMIC RISK INCLUDING CRUDE OIL PRICES AND TAXES. THE INTRODUCTION OF HB 118 ADDS TO THE OVERALL RISK BY AFFECTING OUR PERCEPTION OF FUTURE TAX STABILITY IN ALASKA. UNDER HB 118, THE PRODUCTION TAX RATE AT PRUDHOE BAY DURING THE MID-1990'S IS PROJECTED TO BE ALMOST THREE TIMES HIGHER THAN UNDER CURRENT LAW.

EXXON OBVIOUSLY HAS GREAT INTEREST IN OPTIMIZING RECOVERY OF OIL AT PRUDHOE BAY IN VIEW OF THE ENORMOUS INVESTMENTS IT HAS MADE TO DATE. HOWEVER, FUTURE DEVELOPMENT PROJECTS MUST STAND ON THEIR OWN FEET AND ARE EVALUATED PRIMARILY ON THE BASIS OF RETURN ON THE FUNDS INVESTED. WE DO A DISCOUNTED CASH FLOW ANALYSIS WHICH OFFSETS ALL PROJECT EXPENDITURES REQUIRED AGAINST ADDITIONAL REVENUES PROJECTED, BASED ON THE ADDITIONAL OIL RECOVERY OUR ENGINEERS PREDICT AND THE PRICE WE ANTICIPATE THAT OIL WILL BRING IN THE MARKET WHEN PRODUCED. IF THE ECONOMICS ARE ATTRACTIVE, THE PROJECT WILL BE APPROVED; IF NOT, THE PROJECT WILL LIKELY NOT PROCEED.

THERE ARE TWO ELEMENTS OF THIS FORMULA OVER WHICH EXXON HAS LITTLE CONTROL - CRUDE OIL PRICE FORECAST AND ALASKA TAXATION. WITH RESPECT TO CRUDE OIL PRICES, WE TRY TO FORECAST AS ACCURATELY AS POSSIBLE BASED ON ECONOMIC, POLITICAL, AND GEOLOGICAL INTELLIGENCE FROM AROUND THE WORLD. I DON'T HAVE TO TELL YOU THAT THIS HAS BEEN A LESS THAN PRECISE SCIENCE IN RECENT YEARS. THE VAGARIES OF THE WORLD PETROLEUM MARKETS ARE SURELY ONE OF THE REASONS WE ARE HERE TODAY TALKING ABOUT THIS PRODUCTION TAX INCREASE. WITH RESPECT TO ALASKA TAXATION, WE ASSUME A STABLE TAX POLICY BASED ON FAIRNESS AND UNIFORM ADMINISTRATION.

STATE TAX LIABILITY IS A CRITICAL FACTOR IN APPLYING THE ECONOMIC EVALUATION FORMULA I HAVE DESCRIBED. PRODUCTION TAXES ARE ESPECIALLY SIGNIFICANT SINCE THEY ARE BASED ON GROSS VALUE OF OIL PRODUCED IRRESPECTIVE OF THE PROFITABILITY OF THE PRODUCER. HB 118 SEEMS TO BE BASED ON THE PREMISE THAT PRODUCTION TAXES ARE, IN EFFECT, TAXES ON THE OIL FIELD, NOT ON THE OIL COMPANY, AND THAT LARGER OIL FIELDS SHOULD CONTRIBUTE AT A HIGHER RATE THAN SMALLER FIELDS. LET ME MAKE IT CLEAR - OIL FIELDS DON'T PAY TAXES; OIL COMPANIES PAY TAXES. OIL COMPANIES, LIKE ALL OTHER COMMERCIAL ENTERPRISES, ARE IN BUSINESS TO MAKE A PROFIT. WHEN TAXES ARE INCREASED SO AS TO CUT TOO DEEPLY INTO THAT PROFIT, INVESTMENT ACTIVITY WILL INEVITABLY BE TRIMMED BACK.

TAX POLICY MAKERS SHOULD NOT CONFUSE THE PRODUCTION RATE OF A FIELD WITH ITS PROFITABILITY. HB 118 IMPOSES A HIGHER PRODUCTION TAX RATE ON LARGER FIELDS. THE AVERAGE PRODUCTION RATE PER WELL AT PRUDHOE BAY DURING THE MID-1990'S IS PROJECTED TO BE THE SAME AS AT LISBURNE TODAY. HOWEVER, HB 118 WOULD IMPOSE A PRODUCTION TAX RATE ON PRUDHOE BAY AT THAT POINT IN TIME WHICH WOULD BE SIX TIMES HIGHER THAN ON LISBURNE TODAY. THIS DOESN'T MAKE SENSE.

PROJECTS UNDER CONSIDERATION TODAY TO INCREASE RECOVERABLE RESERVES AT PRUDHOE BAY REPRESENT STATE-OF-THE ART TECHNOLOGY, WITH COST PER BARREL SEVERAL TIMES HIGHER THAN THE INITIAL DEVELOPMENT PROJECTS AT PRUDHOE BAY. THE REDUCTION IN CRUDE OIL PRICES OVER THE LAST FEW YEARS HAS ALREADY CUT THE GO-AHEAD MARGIN SHORT. AN INCREASE IN PRODUCTION TAX AT THIS TIME WOULD ONLY FURTHER COMPOUND THE PROBLEM.

IT IS ESTIMATED THAT OVER 10 BILLION BARRELS OF OIL WILL BE LEFT IN THE PRUDHOE BAY RESERVOIR AFTER CURRENTLY PLANNED DEVELOPMENT HAS BEEN COMPLETED. TO OBTAIN THE MAXIMUM RECOVERY, MORE AND MORE marginally PROFITABLE PROJECTS MUST BE IMPLEMENTED. FUTURE PROJECTS MAY INCLUDE:

DRILLING ON CLOSER SPACING,

DRILLING IN THINNER OIL COLUMNS,
EXPANDING ENHANCED OIL RECOVERY PROJECTS,
DEVELOPING SMALLER RESERVOIRS, AND
EXPANDING WORKOVER PROGRAMS.

IMPLEMENTING SUCH MARGINAL PROJECTS WILL ALLOW FOR PARTIAL RECOVERY OF THIS 10 BILLION BARRELS. HOW MUCH ADDITIONAL RECOVERY WE MAY EXPECT IS UNCERTAIN. HOWEVER, THESE PROJECTS HAVE TO BE JUSTIFIED BASED ON A SIMILAR RISK ASSESSMENT APPLIED TO EARLIER PRUDHOE BAY PROJECTS. THIS INCLUDES THE RISK OF A CHANGE IN THE TAX STRUCTURE.

WHILE THE CURRENT PRODUCTION TAX RATE IS HIGH COMPARED WITH OTHER STATES, IT HAS REPRESENTED A STABLE PRODUCTION TAX POLICY, WHICH HAS ENCOURAGED ENORMOUS INVESTMENT. TO ELIMINATE ELF NOW, AT THE HISTORICAL TIME WHEN IT WAS INTENDED TO HAVE ITS IMPACT AND BENEFIT, WOULD BE A DEPARTURE FROM THIS STABLE TAX POLICY SO RADICAL AS TO SEND A CLEAR MESSAGE TO OIL COMPANIES, AND OTHER INVESTORS, THAT STABILITY AND FAIRNESS ARE NOT NECESSARILY CHARACTERISTICS OF ALASKA'S TAX POLICY. YOU MUST CONSIDER THE REPERCUSSIONS CAREFULLY BEFORE YOU SEND THAT MESSAGE. ELIMINATION OF ELF WILL MEAN THAT INVESTMENT DOLLARS AND JOBS SLATED FOR MARGINAL NORTH SLOPE PROJECTS ARE MORE LIKELY TO GO TO LOWER RISK PROJECTS ELSEWHERE.

WE HAVE ONE FINAL COMMENT. HB 118 WOULD REPEAL THE PROCEEDING UNDER CURRENT LAW WHEREBY A TAXPAYER CAN REBUT THE STATUTORY PRESUMPTION OF 300 BARRELS PER DAY AS PRODUCTION AT THE ECONOMIC LIMIT. THE TAXPAYER CAN DO THIS UNDER CURRENT LAW BY INTRODUCING EVIDENCE ON THE ECONOMICS OF THE PARTICULAR FIELD. HB 118 WOULD ARBITRARILY FIX THIS RATE AT 300 BARRELS PER DAY FOR ALL FIELDS. THE PROVISION IN CURRENT LAW WAS DESIGNED TO PROVIDE TAX RELIEF FOR MARGINAL FIELDS SO THAT THE PRODUCTION TAX BURDEN WOULD NOT BE A FACTOR IN SHUTTING DOWN THE FIELD. IT WORKS! THE OWNERS OF THE MILNE POINT FIELD APPLIED FOR RELIEF BEFORE THE DEPARTMENT OF REVENUE UNDER THIS PROVISION SUCCESSFULLY IN 1986. IN VIEW OF THE ADMINISTRATION'S DESIRE TO ENCOURAGE DEVELOPMENT OF MARGINAL FIELDS, IT MAKES NO SENSE TO REPEAL THIS PROVISION.

TO SUMMARIZE, EXXON URGES YOU NOT TO SUPPORT HB 118. IT COULD HAVE A PROFOUND EFFECT ON FUTURE DEVELOPMENT INVESTMENT AT PRUDHOE BAY, COMPOUNDING THE ALREADY SERIOUS SITUATION BROUGHT ABOUT BY LOWER CRUDE PRICES. ANY BENEFITS TO ALASKA FROM MARGINAL FIELD DEVELOPMENT PROVIDED BY HB 118 WOULD BE MORE THAN OFFSET BY THE IMPACT ON ROYALTY AND TAX COLLECTIONS AT PRUDHOE BAY AND KUPARUK. TO PASS HB 118 INTO LAW WOULD BE ILL-ADVISED AND SHORT-SIGHTED. CONTINUED STABILITY IN PRODUCTION TAX POLICY WILL STRIKE THE BEST BALANCE BETWEEN FUTURE DEVELOPMENT AND STATE

REVENUE COLLECTION. ABOVE ALL, ALASKA MUST REMAIN COMPETITIVE IN THE
QUEST FOR FUTURE INVESTMENT DOLLARS.

THIS CONCLUDES MY TESTIMONY. WE APPRECIATE THE OPPORTUNITY TO PRESENT OUR
VIEWS THIS AFTERNOON ON THIS CRITICAL ISSUE.

GHS/cjs/117

02/10/89

D R A F T

TESTIMONY OF E. H. PETE NELSON
TEXACO USA
BEFORE THE HOUSE RESOURCES COMMITTEE
CONCERNING ELF MODIFICATIONS (HB 118)

FEBRUARY 11, 1989

GOOD AFTERNOON. MY NAME IS ETHEL H. "PETE" NELSON. I AM THE SENIOR LAND REPRESENTATIVE FOR TEXACO USA.

TEXACO APPRECIATES THE OPPORTUNITY TO COMMENT TODAY ON HB 118 WHICH WOULD REVISE THE ECONOMIC LIMIT FACTOR WHICH WOULD IN EFFECT SUBSTANTIALLY INCREASE TAXES ON THE PETROLEUM INDUSTRY.

WHILE WE CAN APPRECIATE THE FACT THAT STATE GOVERNMENT HAS BEEN HIT HARD BY THE DECLINE IN OIL PRICES OVER THE PAST THREE YEARS, THE INDUSTRY WAS HIT EVEN HARDER. THE DIFFERENCE IS, INDUSTRY HAS TAKEN THE NECESSARY STEPS TO COUNTER THE ADVERSE AFFECTS OF LOW OIL PRICES. WE HAVE RESTRUCTURED AND STREAMLINED OUR OPERATION TO REDUCE OPERATING COSTS.

THE OIL INDUSTRY IS NOT THE ONLY SEGMENT OF THE ECONOMY AFFECTED BY DECLINING OIL PRICES. ALASKAN BUSINESSES SUCH AS CONSTRUCTION COMPANIES, GROCERY STORES, RESTAURANTS, HOTELS AND SCORES OF OTHERS HAVE HAD TO BITE THE BULLET AND SCALE DOWN OPERATING COSTS IN ORDER TO SURVIVE.

THIS IS NOT THE TIME TO FURTHER BURDEN INDUSTRY WITH INCREASED TAXES. THE PRICE OF OIL HAS INCREASED SLIGHTLY IN THE PAST FEW MONTHS, SHAKY AS IT IS. AS A RESULT, WE HAVE SEEN A SLIGHT INCREASE IN EXPLORATION AND DEVELOPMENT THIS WINTER, WHICH HAS INCREASED THE NUMBER OF JOBS AVAILABLE, WHICH HAS

INCREASED THE AMOUNT OF PRIVATE SECTOR SPENDING, WHICH HAS IMPROVED THE GENERAL ECONOMY OF THE STATE.

THE PASSAGE OF HB 118 WOULD SIGNIFICANTLY INCREASE INDUSTRY'S OIL AND GAS TAX BURDEN AND CAUSE A DECLINE IN EXPLORATION AND DEVELOPMENT ACTIVITIES IN ALASKA.

INDUSTRY'S MANAGEMENT SIMPLY IS NOT GOING TO LOOK FAVORABLY AT REQUESTS FOR EXPLORATION DOLLARS FOR ALASKA WHEN THEY ARE ALSO CONSIDERING REQUESTS FOR EXPLORATION DOLLARS FOR STATES WHICH ARE OFFERING INCENTIVES RATHER THAN DETERRENTS TO OIL AND GAS EXPLORATION (WYOMING & LOUISIANA).

IN CONCLUSION, TEXACO OPPOSES THE PROPOSED MODIFICATIONS TO THE ECONOMIC LIMIT FACTOR AND URGES YOU TO NOT PASS HB 118.

AGAIN, WE THANK YOU FOR THE OPPORTUNITY TO SHARE THESE VIEWS WITH YOU TODAY.

P7/118

TESTIMONY BEFORE HOUSE RESOURCES COMMITTEE
ON OIL AND GAS TAXATION -- HB-118
FEBRUARY 15, 1989
KENNETH W. GRIFFIN

I am here today to speak out in opposition to the proposed changes in oil and gas taxation, and to encourage limiting the size and extent of state government and restraint in state spending. Lately much has been made by administration officials that the state owns Alaskan oil reserves and the oil industry is simply a contractor to the state. This distinction is an oversimplified half-truth which distracts attention from the true issues of today. The fact is, the industry has made and is making enormous investments in Alaska based on the existing tax environment. The industry has shouldered the entire financial risk -- and the cost -- of finding and developing extremely remote resources. And yes, the proceeds from those investments and risks are large. But the state's share of the proceeds is also already high, and it is essentially "off the top". However, out of their share of the proceeds, the industry pays back their capital, they pay all the operating costs on the oil fields, they pay salaries and wages to Alaskans, they pay a return to those outsiders whose money has been invested in Alaska, and they make the investments for future expansions of existing fields and for the chance of finding more. Prudhoe Bay presently operates under one of the highest tax burdens of any oil field in the country. And Alaska's nominal severance tax rate is the highest in the nation. Personally, I find further increases in such high tax rates unconscionable; particularly during a depressed economy when the economics of future projects are already marginal. Industry spokesmen, I'm sure, have already described those figures. As a private citizen whose livelihood is wrapped up in the success of Alaskan business, I am extremely concerned with several impacts which I see the proposed tax changes causing:

- 1) further depressing the existing Alaskan oil industry and support industries -- the source of 85% of state revenues,
- 2) lowering the level of future investments which would maintain and increase recoveries from existing oil fields,

- 3) cutting industry resources and incentives with which to make large capital investments in undeveloped marginal oil fields,
- 4) reducing the willingness of other businesses to invest in an Alaska with a continually changing tax policy,
- 5) and causing a long term ripple-down effect, further depressing the entire Alaskan economy -- both in the cities and in the Bush.

I believe these tax changes will exacerbate and prolong for the foreseeable future the slowdown in the Alaskan economy.

I am extremely frustrated with the pro-business/anti-business rhetoric emanating from Juneau and other parts of the state. A responsible pro-business tax and governmental policy is pro-Alaskan, pro-jobs, pro-family. Stable, reasonable taxes are a critical part of such a governmental policy.

All businesses have a limited pool of money for investment. This money is invested carefully based on the expected return from that money. Alaska competes with many parts of our nation and of the world for those investment dollars -- both from the oil industry and from other existing and potential industries. High tax burdens reduce Alaska's ability to compete for these investment funds. Changing tax policies increase the risk that industries may not get the return on their money that they expect -- again encouraging business to go elsewhere with their investments. In both cases, the loss of investment dollars in Alaska translates to losses in jobs and income for Alaskan workers and their families.

The profits from these businesses represent investments, spending, salaries, and wages in Alaska. Even the money going to out-of-state corporations is a return to the outside investors who have committed their money to the development and growth of the Alaskan economy. This growth in the Alaskan economy represents jobs and higher standards of living for us and our families -- and future jobs which will provide opportunities for our children in this great state.

I urge each of you to meet the challenge of preparing for the future by endorsing stable tax policies, by encouraging business to invest in Alaska, and by paring down the existing state government to a responsible level which is sustainable by the private sector. Entitlements across the state which, in the past, were funded by ample proceeds from Alaskan resources can no longer be sustained at current levels without industry tax increases and personal taxes transferred from those of us who work and pay the bills to subsidize both an overgrown state government and the chosen subsistence lifestyles of some.

The major problem, as I see it, concerning severance taxes and the economic limit factor is that there is a very limited constituency in this state which actually understands these issues, their impact upon the major industry in the state, their eventual impact upon the state itself, and their ultimate impact on our families and our futures. I urge you to look past the shortsighted goals, biased perspectives, and limited understanding presented by a few vocal voices and defend the economic future and wellbeing of our state and of all Alaskans.

ADDRESS: 121 W FIREWEEED, STE 207
ANCHORAGE, AK 99503

Testimony of the
Alaska Oil and Gas Association
before the
Alaska State House of Representatives
Resources Committee
on
HB 118, An Act Relating to the
Oil and Gas Properties Production Tax

February 13, 1989

My name is Gerald Serena and I am a tax lawyer with Exxon Company, U.S.A. I am here today to present testimony of the Alaska Oil and Gas Association (AOGA). AOGA is a trade association whose member companies account for the majority of oil and gas exploration, production and transportation activities in Alaska.

AOGA believes that it is in Alaska's best interest to encourage responsible exploration and development of its hydrocarbon resources. We oppose the tax increases included in HB 118 since its passage would act to discourage continued development in Alaska's larger fields. In general, marginal developments in these fields that are already at risk due to soft crude price forecasts would be further burdened by the proposed tax increases. Increasing taxes on existing fields, after significant investment decisions have been made under the existing tax structure, is counterproductive to the complete development of these vast resources. In general, changes in the tax structure will require different risk analysis techniques, which could be a hindrance to future exploration and development.

Alaska's current tax structure has our industry paying higher taxes in this state than in any other. As you are probably aware, the production tax rate is the highest in the country, peaking at 15 per cent on gross production value. Taxes and royalties have provided 80 to 90 per cent of the state's unrestricted revenues in recent years and created the \$10 billion Permanent Fund. Surely oil and gas is paying its fair share by any measure.

Turning to the oil industry for more tax revenues would not be an effective approach to solving revenue problems brought on by crude price volatility, and which will be exacerbated in the near future with production declines from the major fields. This would only increase the State's enormous dependence on oil revenues while not addressing the long term problem of state spending levels.

In conclusion, AOGA strongly opposes the increased taxes in HB 118. Passage would unreasonably increase an already high tax burden, and would increase the state's dependence on volatile crude price swings.

ds:26

2072

HB 118 testimony

THANK YOU MR. CHAIRMAN AND COMMITTEE MEMBERS:

MY NAME IS NORMA JOHNSON. I'M THE EXECUTIVE DIRECTOR OF COMMON SENSE FOR ALASKA. I AM A LIFELONG RESIDENT OF ALASKA, BORN AND RAISED IN CORDOVA.

COMMON SENSE FOR ALASKA RECOMMENDS THAT NO NEW OR INCREASED TAX MEASURES BE ENACTED UNTIL STATE GOVERNMENT SIZE AND SPENDING ARE REDUCED TO A REASONABLE AND SUSTAINABLE LEVEL. OPERATIONAL STATE SPENDING HAS INCREASED AT A NECK-BREAKING SPEED SINCE COMMON SENSE ISSUED ITS 1986 STUDY, WHICH THEN SHOWED TOTAL CAPITAL AND OPERATING PER-CAPITA STATE SPENDING AT 5 TIMES THAT OF THE NATIONAL AVERAGE.

INDIVIDUAL ALASKANS AND ALASKA'S BUSINESSES DESIRE AND NEED A STABLE TAX SYSTEM. INCREASING THE STATE REVENUES THROUGH REIMPOSING THE STATE PERSONAL INCOME TAX, ENACTING A STATE SALES TAX, USE OF THE PERMANENT FUND, INCREASING THE STATE'S GASOLINE TAX, OR INCREASING THE TAX BURDEN ON THE OIL INDUSTRY SHOULD NOT RECEIVE THE ATTENTION, NOR DISCUSSION, IT IS CURRENTLY GETTING. THE STATE DOES NOT HAVE A REVENUE PROBLEM AT ALL, IT HAS A SPENDING PROBLEM.

USING 500 THOUSAND RESIDENTS, CURRENT ALASKA PER-CAPITA STATE SPENDING IS OVER \$4,600.00 IN JUST OPERATING GENERAL FUND EXPENDITURES ALONE. WHEN FEDERAL FUNDS AND CAPITAL DOLLARS ARE ADDED, TOTAL STATE SPENDING IN ALASKA COMES TO \$6,480.00 PER-CAPITA. THE STATE OF WASHINGTON, WITH A TOTAL ANNUAL BUDGET OF \$5.1 BILLION AND A POPULATION OF 4.3 MILLION, REPRESENTS \$1,173.00 IN TOTAL PER-CAPITA STATE SPENDING. IF WASHINGTON STATE GOVERNMENT WERE TO SPEND WHAT ALASKA DOES ON A PER-CAPITA BASIS, WASHINGTON WOULD HAVE TO SPEND \$28 BILLION ANNUALLY. CALIFORNIA SPENDS \$2,246.00 ANNUALLY, PER-CAPITA----WERE THEY TO TAX AND SPEND WHAT OUR STATE DOES, CALIFORNIA'S BUDGET WOULD HAVE TO BE \$181 BILLION ANNUALLY, WHICH WOULD MEAN A REVENUE INCREASE OF \$118 BILLION.

ACCORDING TO THE STATE DEPT. OF LABOR, ALASKA'S PER-CAPITA INCOME WAS \$18,489.00 IN 1985, AND \$17,969.00 IN 1986, A SHARP DROP OF \$520.00 IN JUST THAT ONE YEAR ALONE. THE DEPARTMENT DOES NOT HAVE MORE CURRENT PER-CAPITA INCOME THAN WHAT IS RECORDED FOR 1986; HOWEVER, IN DISCUSSION WITH ONE OF THE DEPARTMENT'S ANALYSTS, THE 1986 FIGURE OF \$17,969.00 IS EXPECTED TO SHOW FURTHER DECLINES. COMPARATIVELY, THE STATE OF WASHINGTON'S PER-CAPITA INCOME FOR 1986 IS \$14,979.00. WHILE ALASKA STATE GOVERNMENT SPENDS UPWARDS OF 5 AND A HALF TIMES THAT OF WASHINGTON STATE GOVERNMENT, PERSONAL INCOME IN ALASKA IS ONLY 1 AND A FIFTH TIMES THAT OF THE WASHINGTON PER CAPITA WAGE EARNER.

COMPOUNDING THIS SPENDING PROBLEM IS THE INCREASED RATE OF INDEBTEDNESS THAT STATE GOVERNMENT HAS INCURRED OVER THE PAST FEW YEARS. THE STATE'S PER-CAPITA DEBT IS NOW SOMEWHERE IN THE AREA OF 12 AND A QUARTER TIMES THE NATIONAL AVERAGE. ALASKA STATE GOVERNMENT IS THE NATION'S HIGHEST PER-CAPITA STATE SPENDER AND, EXCLUDING LOCAL GOV'T DEBT, ALASKA TAKES FIRST PLACE IN THE NATION IN STATE PER-CAPITA INDEBTEDNESS.

ACCORDING TO A RECENT ANALYSIS BY A LOCAL ECONOMIST, IN FY'86, COLUMN ONE IS THE PERCENT OF TOTAL STATE EXPEDITURES IN CAPITAL OUTLAY. COLUMN TWO IS THE PERCENT OF TOTAL STATE .PENDITURES IN COMBINED CAPITAL OUTLAY AND DEBT PAYMENTS.

1.	2.
AK 11%	28%
OK 10%	15%
TX 12%	14%
WY 15%	20%
US. AVG. 8%	12 TO 13%

ALASKA HAS FOUR TIMES THE NATIONAL AVERAGE IN STATE EMPLOYMENT. THE U.S. AVERAGE IS 120 STATE GOVERNMENT JOBS PER A POPULATION OF 10,000. IN ALASKA, STATE GOVERNMENT JOBS RUN 400 PER A POPULATION OF 10,000. WHEN STATE AND LOCAL EMPLOYMENT ARE COMBINED, THE U.S. AVERAGE IS 435 GOVERNMENT POSITIONS PER POPULATION OF 10,000. ALASKA'S COMBINED STATE AND LOCAL GOVERNMENT POSITIONS ARE OVER 900 PER POPULATION OF

10,000. BEAR IN MIND THAT REVENUE SHARING AND MUNICIPAL ASSISTANCE AND GRANTS PAY FOR MUCH OF ALASKA'S LOCAL GOVERNMENT WORK FORCE.

IN PAYING FOR THIS WORK FORCE, NOT ONLY ARE STATE SALARIES MUCH HIGHER THAN WILL BE FOUND IN COMPARABLE PRIVATE SECTOR POSITIONS BUT, IN ADDITION, THE HOURS WORKED WEEKLY ARE LESS, AND THE TOTAL PAID TIME OFF, SICK DAYS, AND BENEFITS ARE MUCH HIGHER THAN WILL BE FOUND IN THE PRIVATE SECTOR.

AS AN EXAMPLE, MEDICAL COVERAGE AT 100% AVERAGES \$435.00 PER EMPLOYEE, PER MONTH, OR APPROXIMATELY \$105 MILLION FOR THIS FISCAL YEAR ALONE. THIS SMALL PORTION OF THE OVERALL BENEFITS PACKAGE IS RESPONSIBLE FOR BETWEEN 17 AND 22 MILLION DOLLARS OF THE TOTAL BUDGET SHORTFALL FOR THIS CURRENT FISCAL YEAR. THIS BUDGET SHORTFALL REPRESENTS APPROXIMATELY HALF OF WHAT WILL BE NEEDED TO SUPPLEMENTALLY FUND OUR CURRENT FISCAL YEAR. THE SHEER NUMBER OF POSITIONS, EXORBITANT SALARIES, AND LUCRATIVE BENEFITS FOR ALASKA'S GOVERNMENT WORKFORCE ONLY SERVES TO INFLATE THE COST OF LIVING IN THE 49TH STATE.

NEW AND INCREASED LEVELS OF TAXATION ONLY SERVE TO RETARD ECONOMIC GROWTH, AND SERVE TO DISCOURAGE CURRENT AND FUTURE INVESTMENT. HOUSE BILL 118 IS NO EXCEPTION.

ENSR

RECEIVED FEB 20 1988

Formerly ERT

February 17, 1989

ENSR Consulting
and Engineering

Representative Cliff Davidson
Chairman, Resources Committee
House of Representatives
P.O. Box V
Juneau, Alaska 99811

750 West Second Avenue
Suite 100
Anchorage, AK 99501
(907) 276-4302

Re: HB-118

Dear Representative Davidson:

I appeared before your committee on February 13, 1989 and presented a brief statement concerning my opposition to HB-118. I was unable to present my full prepared statement due to the time constraints which you imposed. I have attached a copy of the testimony I had intended to present and formally request that it be included in the hearing record.

I also want to go on record as protesting the manner in which the hearing was conducted. By your conduct you were clearly biased toward those who favor HB-118. The time constraints you imposed on testimony were more stringent on those who opposed the bill. You really watched the clock in our case but became quite lax on time when a proponent was testifying. In addition, your blatant attempt to equalize testimony during the early stages of the hearing was a total disregard of the purpose of a public hearing.

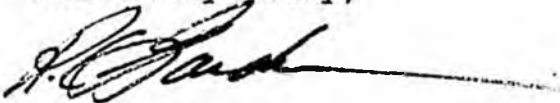
You personally paid little or no attention to the testimony being presented and in several instances distracted the proceedings by conversing audibly with your staff. Fortunately, several members of the committee did pay close attention to the testimony, and I thank them for their interest and consideration.

ENSR

Representative Cliff Davidson
February 17, 1989
Page 2

I came to Juneau rather than teleconference my testimony from Anchorage because I thought an appearance before the Resources Committee was justified by the magnitude of the issue. While it is certainly your right not to agree with my position, I do believe that I have the right as a private citizen to present my testimony to committee members who 1) are in attendance and 2) have the common courtesy to listen.

Yours very truly,



R. C. Gardner
Manager, Alaska Operations

RCG/rm

Attachment

cc: Governor Steve Cowper
Representative Sam Cotton
Representative Curt Menard
Representative George Jacko
Representative Mike Davis
Representative Richard Foster
Representative Mike Navarre
Representative Walt Furnace
Representative Bill Hudson
Representative Bert Sharp

Feb. 13, 1989

House Resources Committee

Testimony of Robert C. Gardner in opposition to House Bill 118. "An Act Relating to the Oil and Gas Properties Production Tax."

Members of the Committee, Ladies and Gentlemen:

My name is Robert C. Gardner. I am employed by ENSR Consulting and Engineering in Anchorage in the capacity of Alaska Operations Manager. ENSR may be an unfamiliar name to some of you and perhaps you are better acquainted with our previous name, NORTEC/ERT. The ENSR name change reflects both an internal reorganization as well as the acquisition of NORTEC by a national company. As an operating group, the key staff here in Alaska have worked together as engineering and environmental consultants to the natural resources industries since 1977. Our Alaska office presently employs 30 people, which is an increase of 5 over 1986 when our firm felt the maximum impact from the collapse of oil prices. In 1988, 85% of our gross revenue was derived from work for oil and gas companies.

I am appearing before you today to voice my strong opposition to House Bill 118 which, if enacted, would alter the way in which the Economic Limit Factor (ELF) is calculated. This proposed modification of the ELF would have two almost immediate effects:

- 1) An additional approximately 130 million dollars would flow into the State Treasury during the next fiscal year alone from the collection of increased production taxes, principally from Prudhoe Bay and Kuparuk fields. This figure could be much greater if the change in the ELF is made retroactive as proposed by the Governor's office. While the prospect of this increase in revenue brings smiles to the faces of many state bureaucrats, a much more important and negative effect needs to be considered;
- 2) There will be a major change in the way that oil companies do business in this state, particularly by BP, ARCO and Exxon, who hold majority working interests in Prudhoe Bay and Kuparuk. These operators will definitely reduce future investments in Alaska, as well as reduce their present commitments to current projects. This will obviously further erode job opportunities for those of us in the private sector who have chosen to live and work in this marvelous state.

In addition to these two immediate effects, the long term or downstream effects are perhaps even more thought provoking:

- 1) HB-118 will remove the main incentive to extend production further into the decline curve. Wells will reach their economic limit sooner under the proposed legislation, and therefore we can expect to see earlier plugging and abandonments of declining wells. This translates into more oil left in the ground and the commensurate long term loss of royalty and production tax revenue to the state.

- 2) Also, the additional tax burden imposed by House Bill 118 will severely diminish future secondary and enhanced oil recovery projects in Prudhoe Bay and Kuparuk fields. These kinds of projects are expensive and require a stable tax climate in order to be economically justifiable. Obviously, secondary and enhanced oil recovery projects mean more long term royalty and tax income to the state, and more jobs for Alaska citizens. In other words, a better return to both the public and private sectors from the extraction of our oil and gas resources.

The method that HB-118 uses to calculate the ELF appears flawed to me. It looks like the authors of this bill, no doubt coached by the Department of Revenue, decided how much of an impact they wanted to have on Prudhoe Bay and Kuparuk and then "backed into" the exponent used to calculate the ELF. In addition, HB 118 changes the application of the ELF from lease or property specific to field specific; all the more damaging to Prudhoe Bay and Kuparuk. All wells decline no matter what field they are located in, and this attempt to penalize two large fields by assuming they are each one large reservoir is without economic or engineering justification.

There seems to be a prevailing opinion among certain legislators, the Department of Revenue, and the Governor's office that the oil industry in Alaska can absorb whatever tax burden the State wants to impose with little or no trickle-down effect felt by the remainder of the private sector. This philosophy says get everything we can now, maintain state spending at the current unreasonable levels and build an ever larger state bureaucracy. This may look like long term job security to a state bureaucrat, but to me in a private sector oil industry support role it looks like disaster. Our employees also need job security, professional challenge and a good quality of life. We have endured salary cuts, loss of jobs and a less than exciting business climate as a direct result of the collapse in oil prices a few years ago. Our firm, and many others like us, have made the necessary adjustments to

continue our operations in a down economy. In other words we have learned how to live within our means. We welcome the return of some stability, albeit at lower oil prices, within the petroleum industry.

House Bill 118 will only serve to undermine what progress the oil companies as well as the support industries have made since the catastrophic drop in oil prices. More specifically, it will result in fewer work opportunities for firms such as ours. I can assure you of at least 30 angry voters if the legislature makes the wrong choice between supporting and improving the business climate in the private sector or maintaining the present bloated State operating budget.

I suggest that this committee focus its attention on another perspective. Like it or not this is pretty much a one-industry state. The only reason we have been able to sustain State government at the existing level has been because of revenues derived from the oil industry. Instead of continually harassing our main source of State revenue through unstable tax policies I think it would be in all of our best interests to explore ways to encourage them to make even greater commitments in Alaska. Further investment in exploration and development projects within the present tax framework will ultimately produce more revenue to the State through royalties, production taxes, lease bonuses, etc. than can ever be realized by modifying the ELF. For example, I suggest

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we consider the long term beneficial effects to both the public and private sectors by re-enacting the discovery royalty. Our state lands contain some excellent exploration targets, and of course there is ANWR somewhere in the future. Much oil remains to be recovered in Prudhoe Bay and Kuparuk through secondary and enhanced oil recovery projects if the tax climate will support these investments. Let us therefore send a positive statement to the oil industry; We want you here, we encourage your investment through stable tax policies and we want others like you.

The oil and gas operators, and those businesses which support them, have been consistently among Alaska's best corporate citizens. In addition to funding 85% of State government, this industry supports numerous community programs including the United Way, Boys and Girls Clubs and many more. Oil industry individual employee as well as corporate commitments to the arts are unexcelled. I challenge State employees to demonstrate a similar level of civic commitment. Do you, as elected officials, want to jeopardize this community commitment for the short term gain HB-118 provides? In short, if I don't have a job I can hardly contribute to community programs.

This State does not have a revenue problem, it has a government spending problem. Modification of the ELF through HB-118 solves nothing. It only provides a temporary revenue band aid over a wound that requires major sutures. In the interests of the greater good for the State of Alaska, and specifically the health of our private sector economy I urge you to give HB-118 a deep burial.

Thank You.



Alaska State Legislature

Please enter into the record my testimony to the House Resources
 committee name
 committee on Oil & Gas Properties + Prod. Tax, dated 2/13/89
 bill/subject

I am sorry I am unable to speak to you through the teleconference.

I believe it is very important to have an effective tax rate which will be fair to all and not give an advantage to the oil companies.

Oil has become too powerful a tool in this state - dictating policy & controlling legislation to the detriment of all Alaskans.

I support HB 118 & hope our representatives in Juneau will do likewise.

Signed: Marian Kawanan
 Testifier

Representing (Optional)
35985 Pioneer Dr - Soldotna, AK 99669
 Address

262-5993
 Phone No.

(1)

FAX MESSAGE TO: House Resources Committee

DATE: 2/13/89 TIME: 4:50 PM

FAX NUMBER: 463-2718

NUMBER OF SHEETS ON MESSAGE: 2
(INCLUDING COVER SHEET)

FROM: STP - Sam Kelly / Halford

FAX NUMBER: 6940509

Attn: Rep Davidson

HB118 Teleconference 2/3/89

Follow up testimony of Donnette Rupprecht,
who could not wait ~~part~~ part 4:00 o'clock to
testify.

HB118 Revis.

2/13/89

Donnette Rupprecht, chair, (Barnes) Council
(Testify as individual - NOT FOR COUNCIL)

Want to amend HB 118 - so that
it may also be passed by as
any of the same time period same tax
given to the committee (including fees)



Alaska State Legislature

Please enter into the record my testimony to the House Resources
 committee name
 committee on HB 118 Oil & Gas, dated 2-13-89
 bill/subject

Our natural resources should benefit all Alaskans. HB 118 would benefit Alaskans and not harm the Oil companies as they claim. I would hope that our representatives in Juneau would support the Governor in this bill and help Alaska through this time of economic hard times.

Signed: Richard Waisanen
 Testifier

Representing (Optional)
35985 Pioneer Drive, Soldotna
 Address
2625983
 Phone No.

(2)

February 13, 1989

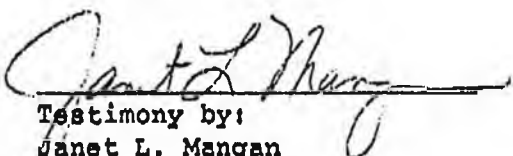
I have been an Alaska resident since 1980. Upon moving to Alaska, I found a job in the oil industry. I have been through four company re-organizations and reductions in force. In addition, I know a number of people in the service companies, and a number of people who have lost their jobs in reorganizations due to the drop in the price per barrel of oil.

As a research analyst, I have read a great deal, pro and con about the Economic Limit Factor. I do not believe that changing the ELF should even be an issue before our State. A well-considered contract was made between the State and the PBU and that contract should be honored. I believe the State Government's credibility will suffer a great deal if a decision is made to change the ELF. The oil industry had to make major cuts and reorganizations in order to live within their reduced budgets - the State of Alaska is going to have to do the same.

The State of Alaska already collects more than half of all the revenues generated from oil. Some people have the perception that there is no bottom to the pocket of the oil industry. That is unrealistic, perhaps wishful thinking. If Alaska changes the ELF, industry will have to cut back its development. That will cost current jobs, future projects, and in the long run, it will cost the State of Alaska.

There are some logical solutions to the State Government's money problems. They include more creative things such as working with Congress to lift the ban on the sale of North Slope oil in foreign commerce, which would in turn increase the State's income. Alaskans need to be realistic about personal taxation and the Permanent Fund - in turn, the public would probably be more open to those options if they believed that the State Government spending level was justified.

The issue around changing the ELF should not be taking the State's time and money. The State should be working on more logical and long term efforts to strengthen Alaska.


Testimony by:
Janet L. Mangan
1512 Kepner Drive
Anchorage AK 99504
(907) 337-3655



Greater Fairbanks

Chamber

of Commerce

P.O. Box 74446

709 Second Avenue

(907) 452-1105

Fairbanks, Alaska 99707

February 13, 1989

RECEIVED FEB 16 1988

The Honorable Cliff Davidson
House of Representatives
Co-Chairman, Resources Committee
P.O. Box V
Juneau, AK 99811

Dear Representative Davidson:


The Greater Fairbanks Chamber of Commerce has consistently opposed any legislative initiative to unduly increase taxes on individuals or businesses. Specifically, we have opposed modification of the Economic Limit Factor to increase the severance tax oil producers pay since that strategy has emerged.

With increasing frequency, we see demonstrations that ELF is fulfilling its intended purpose. Oil company investment is stimulated. Jobs are on the increase. Enhanced recovery methods are employed to maximize production. Planned capital programs are moving forward. All this because ELF is working.

When oil prices decline; when significant growth in administration staffing occurs; when new social programs are proffered or existing programs expanded; when the basis of revenues to support the budget is not sufficiently diversified; mature government must prevail. Tough decisions are required. Demand efficient cost effective operation. Vigorously negotiate expiring labor contracts. Implement a reduction in force. Courses of action to reduce cost of government are many, with services still provided.

Responsible and mature government recognizes that to retain or attract industry a stable tax philosophy must prevail. Industry should be able to expect that. We oppose House Bill No. 118 and any other legislation which would modify the current structure of the economic limit factor.

Sincerely,


W.R. Cox
President and CEO

WRC:ldm

Gary E. Light
8211 Summerset Dr.
Anchorage, AK 99518

February 14, 1989

RECEIVED... 20 1988

House of Representatives
Resources Committee
P. O. Box V
Juneau, AK 99811

RE: HB 118 - The ELF Bill

Dear Chairmen Davidson and Menard:

I would like to first thank your committee for holding public hearings on the subject proposed bill. I believe that it is important to hear from as many knowledgeable people on this topic as possible. Unfortunately, it can be a challenge to determine who the knowledgeable people are versus the merely emotional people. Any time money is involved, especially when it's tight, emotions can run high. Whether it's personal, municipal, state, or federal money we are talking about, money, by itself, seems to raise the level of emotions. Thus, I will attempt to be as factual as possible with the balance of my discussion.

While I applaud your efforts to hear all of the facts surrounding this issue, I am concerned about statements made by the chairmen of this committee regarding HB 118 in a memorandum dated February 3, before any testimony had even begun, addressing the question, "Why should the legislature pass the ELF bill?" Without attacking individuals or personalities, I would like to present objective facts regarding each of the statements made in the memorandum that I trust will be considered objectively before decisions are made regarding this bill.

STATEMENT (1): The oil industry is making substantial profits on Alaska's oil -- as of February, 1988, oil companies were making more than \$6 million each day in profits on North Slope oil.

FACT: We all know that the major oil fields on the North Slope are the two largest in the nation and, as a result, generate large revenues and profits, but these revenues are shared with the state and, to a lesser extent, the federal governments. As oil companies' profits increase, so do the state's. Oil companies' profits stimulate our overall state economy by providing additional capital for new investments, jobs, and taxes.

Additionally, the amount of profit is not as good a measure of

prosperity as is the return on investment. If I put \$5 in my bank account and my bank pays me \$100 per day, I am doing quite well. If, however, I have to put \$5 billion in the bank to get \$100 per day, that return is noncompetitive. If companies doing business in Alaska cannot get a competitive return on their investment here, they will invest elsewhere. By reducing return on investment, you reduce investment in the state and, thus, the state's economy.

STATEMENT (2): The oil resource is Alaska's resource, not the oil companies. The only way for Alaskans to benefit from the resource is to make the oil companies pay for the resource.

FACT: From 1980 through 1986 alone, the oil companies had already paid the state in excess of \$26 billion and annually fund 80% - 90% of the state's general budget. When the current ELF provisions were written in 1981, then Governor Hammond stated as a state policy objective to collect 30% of the net value of the oil as state revenue. According to Alaska Department of Revenue reports, for Fiscal Years 82 - 87, the state has collected from 33.8% up to 52.35% of the profits. And for FY 88 - 91, the DOR projects to collect 57% to 67% at \$15 to \$16 oil prices and 79% to 103% at \$13 to \$14 oil prices with the current version of ELF. Those projections average more than twice the state's stated "fair share" of 30% and the 103% projection means that the state would make money while the oil companies lost money.

STATEMENT (3): Since 1987, the oil companies have been able to avoid paying the full amount of the statutory nominal tax rate for the resource because of loopholes in the tax laws

FACT: Actually, the oil companies have not paid the full statutory tax rate (currently highest in the nation) since the ELF was instituted and applied in 1977. However, the ELF provision is not a loophole, it is a provision of tax code that offsets the regressive nature of a gross production tax to prevent the premature cessation of oil production as oil company margins decline. When the maximum IRS personal income tax rates were 50%, did any of you on this committee pay this rate of your total taxable income? No, neither did anyone else. This is because of the progressive structure of the tax rates. The ELF provides for the same thing in severance tax rates.

STATEMENT (4): Alaska receives less in oil tax revenue than virtually every other oil-producing nation in the world.

FACT: Alaska is not a nation. Rather, we are one of fifty states, and we are the state with the highest statutory nominal severance tax rate of 15%. According to the U. S. Department of Energy Technical Report titled "Energy Severance Taxes 1972 - 1987", the total of all states' severance collections averaged less than 5% of value. Actual severance tax collections

per barrel produced in 1987 were \$0.88 in Alaska (second highest) versus a US average of \$0.53 and for the five years 1983 - 1987 they were \$1.81 in Alaska (the highest) versus a US average of \$0.87.

STATEMENT (5): In order to balance the budget and provide vital services to all Alaskans, Alaska must raise millions of dollars in revenue. Alaska must choose between either taxing the most profitable oil fields or taxing struggling Alaskans to balance the budget

FACT: There is another side of a balanced budget equation; it's called reducing the spending. When the "struggling Alaskans" run out of money, they quit spending. When the oil companies run out of money, they quit spending. Alaska's per capita spending currently exceeds more than twice the number two state in per capita spending and it is more than four times the national average. We do have a cost of living differential here, but it is not 100% or more. State government needs to learn to do as the private sector has already done, tighten your belts and do more with less.

STATEMENT (6): . . . If the modified ELF were to be first applied back on June 20, 1987, when the 10-year rounding rule expired for Prudhoe Bay, this bill would raise, through fiscal year 1990, over \$397 million more than would be raised under the current ELF. In the long term, this bill would raise more than \$2 billion

FACT: The more money government extracts from the private sector, the less the private sector can, or is willing to, spend in that economy. Given that the private sector spends dollars more efficiently than the public sector, the transfer of additional money from the private to the public sector is a negative for the economy. In reference to even the consideration of a retroactive date for a tax increase, how would any of you on the committee feel if the IRS decided this year to raise personal tax brackets effective two years ago? This is the same situation and it's definitely not good business practice.

STATEMENT (7): There will be no jobs lost to Alaskans as a result of this ELF bill being adopted. . . . Because the savings from the ELF tax cut was not spent to create jobs, elimination of the tax cuts will have no impact on Alaskans' jobs.

FACT: Following the June, 1987, application of the ELF at Prudhoe Bay, several additional drilling rigs were added there, resulting in several hundred positions being employed. Jobs are funded by money. The more money the government takes from the private sector, the less is available to be spent on jobs.

STATEMENT (8): The oil companies that will have an increase in taxes from the ELF bill have poor records in local hire and for purchase of Alaska materials, contributing to the outflow of money from the state. . . .

FACT: ARCO is the largest private employer in the state. Virtually 100% of ARCO's employees that work in the state of Alaska are Alaskan residents. The oil companies' business does not result in an outflow of money from the state, just the opposite. The oil is exported from the state and sold to consumers outside for dollars that are imported to the state and used to pay wages, operating costs, taxes, and capital investment; thus, stimulating the economy. This is called a positive balance of trade. For the state's economy to have a negative cash flow, we would have to be a net importer of products. This is not the case, we are a net exporter of products and a net importer of cash.

STATEMENT (9): The ELF bill only raises taxes on the two most productive oil fields, Prudhoe Bay and Kuparuk, which are making substantial profits. All the smaller oil fields are actually given tax cuts by this bill. . . . These tax cuts are designed to encourage continued or additional production, which will promote economic development and create jobs.

FACT: See the first FACT regarding profits versus rate of return. Also, it should be pointed out that field size and production levels are not indicators of field profitability. The Kuparuk River field (not only the second largest in Alaska, but also the second largest in the US) has a negative profit, or loss, at \$14 market prices with the current ELF and severance tax structure. Higher taxes on this field will mean greater losses. How can this be an economic stimulus?

In addition, this ELF bill will not accomplish the stated objective to "encourage continued or additional production" for two reasons. First, by taking more money away from the investors in the two largest fields, these investors have less money available to develop other fields, even with tax reductions at the other fields because, as is stated in STATEMENT (6), this bill will cost the oil industry more than \$2 billion over the next 20 years, net of any savings in smaller fields. Secondly, there are projects within the Prudhoe Bay and Kuparuk fields that are marginal, but that could actually contain more oil for sales, royalties, taxes, and jobs than all of the smaller fields combined. Raising the "economic limit" for our state's two largest fields will leave marginal projects in these fields undone and oil unproduced; the opposite effect of economic development and creation of jobs.

STATEMENT (10): The ELF tax cut was only intended to be applied to the smaller, less profitable oil fields. Thus, Prudhoe Bay and Kuparuk should never have been allowed these tax cuts in the first place.

FACT: When the stair-step severance tax rates were replaced with the flat nominal rate of 12.25% in 1977, the original ELF was implemented and Prudhoe Bay was producing oil. Prudhoe Bay was not only not specifically excluded from the ELF provisions, but it was not intended to be

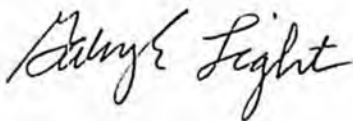
excluded either. In 1981, when the nominal severance tax rate was raised to 15%, the ELF provisions were modified and the 10-year rounding rule was implemented for ELF's greater than .7. This rule was intended to cover Prudhoe Bay specifically. Other changes were intended to cover Kuparuk specifically. Given that the current ELF provisions include specific coverage for both Prudhoe Bay and Kuparuk, the statement that the ELF was never intended for Prudhoe Bay and Kuparuk is false.

STATEMENT (11): The 1981 ELF was not intended to last forever. It was designed to expire because it was assumed that the legislature would step in prior to its expiration to reassess the ELF and make appropriate changes. Governor Hammond clearly indicated that when he signed the bill into law in 1981.

FACT: The current ELF law has no expiration provisions. If it had been intended to expire, it would have so stated. The above statement is false, including the reference to Governor Hammond's intent. The former governor has recently stated that he is being misquoted with this statement (public radio program February 13 and other forums) and that the current level of taxation on the oil industry in Alaska is at least what was intended in 1981.

I do hope that these facts will be objectively considered and that they will alleviate the bias, intended or not, of your committee's statements presented to other Alaskan representatives and the Alaskan public. While I have attempted to be factual, I have also been as brief as possible. I would be happy to expound upon any or all of these facts and the answers to your questions. I would welcome the opportunity to discuss these with you individually or as a committee. My office telephone number is 265-6044. Please call to discuss or to schedule meeting time.

Again, I appreciate your attempts to gather all of the facts and I trust that they will all be considered before this bill is voted on.



Gary E. Light

xc: Representative Larson, Cochair, House Finance Committee
Representative Hoffman, Cochair, House Finance Committee
Senator Binkley, Cochair, Senate Finance Committee
Senator Uehling, Cochair, Senate Finance Committee
Senator Pearce, Chair, Senate Oil & Gas Committee
Governor Cowper

RECEIVED FEB 20 1988

To: Rep. Sam Cotten - Speaker of the House
Rep. Cliff Davidson - Cochairman House Resources Committee
Rep. Curt Menard - Cochairman House Resources Committee
Rep. George Jacko - House Resources Committee
Rep. Mike Davis - House Resources Committee
Rep. Richard Foster - House Resources Committee
Rep. Mike Navarre - House Resources Committee
Rep. Walt Furnace - House Resources Committee
Rep. Bill Hudson - House Resources Committee
Rep. Bert Sharp - House Resources Committee
Rep. Alyce Hanley - House Resources Committee
Rep. Loren Leman - House Resources Committee
Sen. Drue Pearce - Chairman Senate Oil and Gas Subcommittee
Sen. Pat Rodey

From: Kenneth W. Griffin
8231 Summerset Dr.
Anchorage, AK 99518
(907) 349-7259

Date: February 15, 1989

Re: The Conduct by Rep. Cliff Davidson
of the February 13 Public Hearings on HB-118.

I am protesting the manner in which the above hearing was conducted by Rep. Davidson. I was in attendance at the afternoon meeting until 5 PM, at which time family obligations required that I leave. Several actions by Rep. Davidson while conducting those hearings were designed to deny a large portion of the public the opportunity to speak to an issue which will eventually affect us all. First, Rep. Davidson refused to take speakers from the Anchorage LIO in the order in which they were signed up. All of those signed up were opposed to oil and gas tax law changes. After two speakers, Rep. Davidson stated that he would not allow subsequent speakers from Anchorage unless they were speaking on the side he personally supports -- ie. favoring the tax law changes. In doing so he skipped over at least 30 signed up speakers and took a speaker that was not even signed up at all. After asking for someone from Anchorage to please testify on his side, Rep. Davidson allowed a total of two speakers -- while ignoring a total of 60 persons now in the room wishing to speak against the tax law change. Regardless of perspectives on this issue, Rep. Davidson's actions were blatant efforts to deny Anchorage residents the right to speak to issues of critical importance to our futures. These are reprehensible actions coming from an elected representative sworn to uphold the constitutional rights which protect us all. Rep. Davidson has demonstrated a total disregard for these rights.

Further concerns about the conduct of this meeting:

The afternoon public testimony period was advertised as running from 3-5 PM. Rep. Davidson cut this period in half, dedicating the second hour to elected officials. I checked with the LIO both before and after the hearing. They were not aware this change would occur. Obviously, in his letter on the hearing, neither was the governor. I submit that this appears as yet another attempt to reduce the opportunity for the public to provide testimony which heavily opposed Rep. Davidson's preference. That became more apparent when he allowed the elected officials to ramble on at length with unprepared, non-substantial statements, while large public crowds sat around the state expecting to be allowed to speak to both sides of the issue.

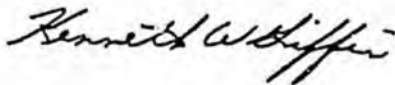
I further resent Rep. Davidson's accusations that testimony from Anchorage was due to an organized campaign by big oil. The people who finally were able to speak against the tax changes identified themselves variously as a private accountant, an advertiser, small business owners, personnel/ placement worker, trucker, construction company manager, support industry employees, oil industry employees, and others. All of these people realize that the proposed tax law changes will indeed affect their opportunities and economic future in Alaska. Again, I resent my perspective being discounted so readily.

A final concern is the propriety of holding such hearings, ostensibly for the purpose of gauging public opinion and gathering input prior to making a decision, when, in fact, the Chairman and the committee have already clearly stated that they have a position and do not intend to change. It is obvious that Rep. Davidson does not clearly understand the impact of oil and gas taxation changes on not only the industry but on the future of the state as a whole. Nevertheless he clearly communicates the message that he does not care to understand nor is he willing to listen to the arguments from those of us who are going to have to carry the burdens he lays upon this state.

The issue aside, Rep. Davidson has demonstrated extreme disregard for the public he has sworn to serve. I call on Speaker Cotten and the entire House of Representatives to communicate clearly to Rep. Davidson, and others if need be, that such high-handed actions as those taken this week are unacceptable and will not be tolerated within this body.

Thank you for your attention to this and your willingness to serve the interests of Alaskans.

Sincerely,



Kenneth W. Griffin



STATE OF ALASKA

HOUSE OF REPRESENTATIVES

Box V, Juneau, Alaska 99811

(907) 465-2487 • 465-2498

REPRESENTATIVE CLIFF DAVIDSON • DISTRICT 27 • Box 746, Kodiak, Alaska 99615 • (907) 486-8250

February 24, 1989

Ken W. Griffin
8231 Summerset Drive
Anchorage, Alaska 99518

Dear Mr. Griffin,

Thank you for your memo of February 15, 1989. It is always good to receive criticism, whether constructive or otherwise, after conducting a statewide teleconference. Any tax policy is a complex issue. Alaskan oil and gas production tax policy on state properties is especially complex, because it is historically difficult to "puzzle" together.

The key phrase is "tax policy." Policy, to my mind, implies a process and this in turn means "ongoing." So, while you may profess to know my innermost thoughts and understanding of this difficult state policy process, I myself would not presume to decide the issue until after it is examined and re-examined in the light of new numbers (world oil prices, costs of production, profitability, ownership share, etc.); determination as to whether the public policy objectives were met as intended or anticipated; and other considerations too numerous to list in this letter. That is why we are having extensive hearings -- to fully cover the many and varied perspectives on this complex issue.

Your memo is accurate on one point, and for that I extend my apologies: in my first statewide teleconference, I did take testimony from four people out of the order in which they had signed in (two in Anchorage and two in Fairbanks). Due to the large number of persons who had signed in to testify, thus knowing beforehand that not everyone who signed up would get the opportunity to testify, it was my judgement call that a balance of views, for and against and from different geographic areas, all be heard. Additional public testimony was taken after the dinner hour on Monday, as well as on the following Wednesday. All individuals who "stuck it out" were able to be heard.

As in many such events, the first hour was the most hectic, and that is, unfortunately, where most of your criticism is directed and I accept that. However, on all your other negative points, I must respectfully disagree.

As regards the "lengthy testimony" I allowed elected officials and past-elected officials who were speaking on behalf of large constituencies, only seven such individuals (six

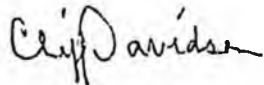
for and one against) chose to testify on HB118. None spoke for the measure for over five minutes and the individual who spoke against chose to use less than two minutes. A maximum of 32 minutes was reserved for elected officials out of a total of 440 minutes of public testimony. By over two to one, the number of persons testifying against the bill out-numbered those who favored the bill.

I truly appreciate and respect all publicly offered testimony, including that offered by elected officials. Additionally, I have a high regard for any individual who offers to serve the public as an elected official in any office, regardless of partisan or philosophical stripe.

You will find in the public record that members of the committee stated that they felt I had tried to hold the hearings fairly. Further, I have been complimented for my fairness in the hearings by oil industry lobbyists, most of whom I hold in high regard, as well as oil executives from within Alaska and several who came to the hearings from "Outside."

Again, thanks for your memo. Your comments are always welcome.

Sincerely,



Representative Cliff Davidson

CD/eed

cc: House Resources Committee members
Representative Sam Cotten
Representative Alyce Hanley
Representative Loren Lemman
Senator Drue Pearce
Senator Pat Rodey

Feb 17 1989

Rolan Ruoss
Box 1371
Kodiak, AK 99615

Rep. Cliff Davidson
Juneau, Alaska

RECEIVED FEB 27 1989

Dear Cliff,

I found this curious piece of public education in the newspaper this evening. My gut feeling is that the people at ARCO are trying to sway public opinion with an emotional appeal, maybe presenting the facts to shed favorable light on their position.

Do they have their facts right? Can you print a reply to their facts in the paper to help us keep a clear view of the situation?

Personally, I'm not convinced that ARCO is motivated by civic spirit; the oil industry is heavily invested in the profitable Alaskan fields and will likely spend considerable money on lobbyists, lawyers, and advertising to maintain their profits.

Based on what I know, I support HB 118.
Please don't let us be buffeted by specially tailored "facts".

Sincerely,
Rolan Ruoss



ARCO Alaska, Inc.

External Affairs Dept.
P.O. Box 100360
Anchorage, AK 99510

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: EMILY MCALISTER
 TITLE:
 ADDRESS: 3504 WILLOW ST.
 CITY: ANCHORAGE
 PHONE: 248-5494

ZIP: 99517

BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF
 MESSAGE: I STRONGLY SUPPORT REPEALING ELF. LOCAL OIL COMPANIES ARE AGAIN MAKING RECORD PROFITS WHICH ARE PASSED ON TO OUT OF STATE STOCKHOLDERS. OIL COMPANIES FOOLED STATE IN 70'S: INSTEAD OF WHINING AND THREATENING JOBS, THEY SHOULD CUT SPENDING, IMPROVE MANAGEMENT JUST LIKE THEY URGE STATE TO DO.

POMID: 03143856

DATE: 02/14/89

TIME: 14:38:56

LIONAME: ANCHORAGE LIO

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DAVIS, M.	DONLEY	ELIASON
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FURNACE	GOLL	FAIKS
GRUENBERG	GRUSSENDORF	FISCHER
HANLEY	HOFFMAN	FRANK
HUDSON	JACKO	HALFORD
KOPONEN	LARSON	JONES
LEMAN	MACLEAN	KELLY
MARTIN	MENARD	KERTTULA
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RIEGER	SHARP	RODEY
SHULTZ	SPOHNHOLZ	STURGULEWSKI
SWACKHAMMER	TAYLOR	SZYMANSKI
ULMER	WALLIS	UEHLING
ZAHACXI		ZHAROFF

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: GARY E. LIGHT
 TITLE:
 ADDRESS: 8211 SUMMERSET DRIVE
 CITY: ANCHORAGE
 PHONE: 344-2218

ZIP: 99518

BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF
 MESSAGE: AS WAS POINTED OUT IN THE PUBLIC TESTIMONY REGARDING HB 118, THE ANCHORAGE TURNOUT FOR THIS HEARING WAS 60+ AGAINST HB 118 AND 2 FOR. DID YOU CONSIDER "BALANCED" TESTIMONY WHEN YOU HEARD FROM THE ADMINISTRATION ON THURSDAY AND FRIDAY? DID YOU CONSIDER THAT TESTIMONY BALANCED WHEN YOU HEARD FROM THE OIL INDUSTRY ON SATURDAY?

POMID: 03155222

DATE: 02/13/89

TIME: 15:52:22

LIONAME: ANCHORAGE LIO

COPIES: REPRESENTATIVES

MENARD
 JACKO
 FOSTER
 NAVARRE
 FURNACE
 SHARP
 HUDSON
 DAVIS, M.

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: ROB AUSTIN

TITLE:

ADDRESS: P.O. BOX 425

CITY: JUNEAU

ZIP: 99802

PHONE: 780-6058

BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF

MESSAGE: I SUPPORT THE ELF LEGISLATION BECAUSE THE GOVERNOR SAYS "IT WILL BE GOOD FOR THE ECONOMY AND IT WILL CREATE JOBS."

POMID: 00145949

DATE: 02/14/89

TIME: 14:59:49

LOCATION: JUNEAU LIO

COPIES: REPRESENTATIVES

MENARD
JACKO
FOSTER
NAVARRE
FURNACE
SHARP
HUDSON
DAVIS, M.

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: TOM KANE

TITLE:

ADDRESS: BOX 520989

CITY: BIG LAKE

ZIP: 99652

PHONE: 892-7289

BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF

MESSAGE: I'M AGAINST HB 118. LEAVE ELF ALONE, CUT GOVERNMENT SERVICES AND BUREAUCRACY.

POMID: 03082106

DATE: 02/14/89

TIME: 08:21:06

LOCATION: ANCHORAGE LIO

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MENARD
JACKO
FOSTER
NAVARRE
FURNACE
SHARP
HUDSON
DAVIS, M.

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: KEN HIGGINS

TITLE:

ADDRESS: 1730 RIERIE

CITY: ANCHORAGE

ZIP: 99507

PHONE: 562-0760

BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF

MESSAGE: I WORKED IN PRUDHOE FROM 1975 TO 1985, I FIND A LARGE PROPORTION 60
70 PERCENT NON RESIDENT HIRE BY ARCO AND SOHIO SUBCONTRACTORS. I SUPPORT
MOVING THE ELF, THEY DON'T HIRE ALASKAN RESIDENTS. I WOULD EVEN SUPPORT A
GHER TAX ON THE OIL COMPANIES. PLEASE DON'T SELL OUT YOUR VOTE LIKE JAN
IKS.

POMID: 03091321

DATE: 02/14/89

TIME: 09:13:21

LOCATION: ANCHORAGE LIO

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FURNACE	GOLL	FAIKS
GRUENBERG	GRUSSENDORF	FISCHER
HANLEY	HOFFMAN	FRANK
HUDSON	JACKO	HALFORD
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MILLER	NAVARRE	PEARCE
PETTYJOHN	PHILLIPS	POURCHOT
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SHULTZ	SPOHNHOLZ	STURGULEWSKI
SWACKHAMMER	TAYLOR	SZYMANSKI
ULMER	WALLIS	UEHLING
ZAWACKI		ZHAROFF

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: THOMAS WOOD

TITLE:

ADDRESS: BOX 0014

CITY: EAGLE RIVER

ZIP: 99577

PHONE: 694-9430

BILL NO:

SUBJECT: ELF

MESSAGE: INTELLIGENCE NOT PAMDERING IDIOCY. DO NOT TINKER WITH ELF, CUT THE
INCOMPETENCE AND DROANS FROM THE BLOATED STATE BUREAUCRACY.

POMID: 03150612

DATE: 02/14/89

TIME: 15:06:12

LOCATION: ANCHORAGE LIO

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SHULTZ	SPOHNHOLZ	STURGULEWSKI
SWACKHAMMER	TAYLOR	SZYMANSKI
ULMER	WALLIS	UEHLING
ZAWACKI		ZHAROFF

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: BOB MITCHELL
 TITLE:
 ADDRESS: 212 W 9TH STREET
 CITY: JUNEAU ZIP: 99801
 PHONE: 465-4803
 BILL NO:
 SUBJECT: ELF REPEAL
 MESSAGE: REPEAL ELF? OF COURSE!

POMID: 00080310
 DATE: 02/14/89
 TIME: 08:03:10
 LIONAME: JUNEAU LIO

COPIES: REPRESENTATIVES REPRESENTATIVES SENATORS

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DAVIS, M.	DONLEY	ELIASON
ELLIS	FOSTER	FAHRENKAMP
FURNACE	GOLL	FAIKS
GRUENBERG	GRUSSENDORF	FISCHER
HANLEY	HOFFMAN	FRANK
HUDSON	JACKO	HALFORD
KOPONEN	LARSON	JONES
LEMAN	MACLEAN	KELLY
MARTIN	MENARD	KERTTULA
MILLER	NAVARRE	PEARCE
PETTYJOHN	PHILLIPS	POURCHOT
RIEGER	SHARP	RODEY
SHULTZ	SPOHNHOLZ	STURGULEWSKI
SWACKHAMMER	TAYLOR	SZYMANSKI
ULMER	WALLIS	UEHLING
ZAWACKI		ZHAROFF

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: DALLAM MASTERSON
 TITLE:
 ADDRESS: 13001 GALVESTON CIRCLE
 CITY: ANCHORAGE ZIP: 99516
 PHONE: 345-4699
 BILL NO:

SUBJECT: ELF AND OTHER TAXES
 MESSAGE: IT'S OUTRAGEOUS THAT GOVERNOR COWPER PROPOSES TO INCREASE TAXES WITHOUT FIRST CUTTING STATE SPENDING. HERE IN ANCHORAGE, A STATE EMPLOYEE TELLS ME THAT A NEW HIRE IN HIS GROUP DOESN'T HAVE ENOUGH TO DO! DO SOME HOUSE CLEANING, AND STOP TRYING TO SQUEEZE MORE BLOOD OUT OF THE TAXPAYERS TURNIP!

POMID: 03162003
 DATE: 02/13/89
 TIME: 16:20:03
 LIONAME: ANCHORAGE LIO

COPIES: REPRESENTATIVES REPRESENTATIVES SENATORS

BARNES	BOUCHER	HALFORD
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ELLIS	FURNACE	KELLY
GRUENBERG	HANLEY	KERTTULA
LEMAN	MARTIN	RODEY
PETTYJOHN	PHILLIPS	STURGULEWSKI
ZAWACKI	MENARD	SZYMANSKI
JACKO	FOSTER	UEHLING
NAVARRE	SHARP	FAIKS
HUDSON	DAVIS, M.	

CURTIS W. FOSTER
9621 SPRING HILL DRIVE
ANCHORAGE, AK. 99507-4374

RECEIVED FEB 13 1988

February 10, 1989

Representative Cliff Davidson
Co-Chairman: House Resources Committee
Pouch V
Juneau, AK. 99811

Representative Curt Menard
Co-Chairman: House Resources Committee
Pouch V
Juneau, AK. 99811

Dear Representatives Davidson and Menard:

In regard to the current hearings in your House Resources Committee regarding modifications to the Economic Limit Factor (ELF), I am opposed to any modification to the ELF. The proposed changes, as put forth by the administration, are a tax increase in simple terms and are totally un-justified.

To further tax the one industry that fuels the state's economy as a trade-off for short-term infusions for increased state spending is a course for fiscal disaster. Where would the money have come from for establishment of a sound economic base which has lasted for decades, if States such as Texas, Oklahoma and Louisiana had practiced the current administration's philosophies. In those States, after finding the large fields that became the catalyst for infra-structure and capital, a momentum developed whereby new fields were developed with the support of tax policy and agency assistance-not an adversarial relationship!

In fact, in several of the Lower 48 producing states, production taxes are being lowered, not raised, to more appropriately reflect the current economic climate of the oil markets. Perhaps Alaska should be considering this versus raising taxes. As stated by several oil industry executives, Prudhoe Bay is in decline and future development is dependent on marginal economics; no different than Niakuk or other marginal projects.

KEEP TAXES STABLE, the in-efficient state spending and bloated budget must be addressed before any taxes are added.

I look forward to hearing from you on this subject.

Sincerely,



Curtis W. Foster

cc: Governor Steve Cowper
House Resource Committee members
Representative Steve Rieger
Representative Fritz Pettyjohn



Alaska State Legislature

Please enter into the record my testimony to the HOUSE RESOURCES
 committee name
 committee on HB 118, dated 2-13-89
 bill/subject

The oil belongs to the people, I feel
 we get the best deal by keeping
 it REALLY marginal fields operational
 but the others should pay the full
 tax -

I support the Governor's position.

Signed: Wm P Christenson
 Testifier
For the Love in ELR
 Representing (Optional)
PO Box 799
 Address Sitka AK 99835
 Phone No. 907-747-8682 or 742-5833

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: JOY PRICE
 TITLE:
 ADDRESS: PO BOX 1948
 CITY: FAIRBANKS ZIP: 99707
 PHONE: 451-0484
 BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF
 MESSAGE: THIS IS IN ADDITION TO MY LETTER OF 2/8/89 IN SUPPORT OF HB 118.
 WE FEEL HB 118 IS A BEGINNING TO A WAY TO PROVIDE MORE OPTIONS FOR OUR
 CHILDREN AND ALL OTHER INDIVIDUALS IN ALASKA. AGAIN, I BELIEVE WE SHOULD
 NOT WASTE OUR VERY VALUABLE RESOURCES. AFTER ALL OUR CHILDREN AND OUR
 PEOPLE ARE OUR VERY VALUABLE RESOURCE. EOM/MJO

POHID: 07082259
 DATE: 02/23/89
 TIME: 08:22:59
 LIONAME: FAIRBANKS LIO

COPIES: REPRESENTATIVES SENATORS

BOYER	FAHRENKAMP
DAVIS, M.	FRANK
KOPONEN	COGHILL
MILLER	
SHARP	
MENARD	
JACKO	
FOSTER	
NAVARRE	
FURNACE	
HUDSON	

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: DENNIS REIMERS
 TITLE:
 ADDRESS: PO BOX 875571
 CITY: WASILLA ZIP: 99687
 PHONE: 376-0184
 BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF
 MESSAGE: I SUPPORT THE CURRENT ELF FACTOR. THE PUBLIC OPINION POLLS HAVE
 REPEATEDLY SHOWN THAT MOST ALASKANS ARE IN FAVOR OF REDUCING STATE SPENDING.
 BEFORE ADDITIONAL TAX REVENUES ARE GENERATED THE STATE SHOULD CONTROL THEIR
 SPENDING. THE ELF WOULD DEFINITELY RECOVER MORE MARGINAL OIL FROM ANY OF THE
 LARGER ALASKA FIELDS.

POHID: 03111330
 DATE: 02/23/89
 TIME: 11:13:30
 LIONAME: ANCHORAGE LIO

COPIES: REPRESENTATIVES

MENARD
 JACKO
 FOSTER
 NAVARRE
 FURNACE
 SHARP
 HUDSON
 DAVIS, M.

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: KEN HIGGINS

TITLE:

ADDRESS: 1730 RIERIE DRIVE

CITY: ANCHORAGE

PHONE: 562-0760

ZIP: 99507

BILL NO:

SUBJECT: ELF

MESSAGE: I SUPPORT REPEAL OF THE ELF. MY REASON IS ARCO'S FAILURE TO ENCOURAGE LOCAL HIRE ON THEIR SUBCONTRACTING. I WOULD SUPPORT THE STATE OF ALASKA IN PUTTING ON TV COMMERCIALS IN OPPOSITION OF ARCO'S ADS.

POMID: 03095236

DATE: 02/17/89

TIME: 09:52:36

LIONAME: ANCHORAGE LIO

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ELLIS	FOSTER	FAHRENKAMP
FURNACE	GOLL	FAIKS
GRUENBERG	GRUSSENDORF	FISCHER
HANLEY	HOFFMAN	FRANK
HUDSON	JACKO	HALFORD
KOPONEN	LARSON	JONES
LEMAN	MACLEAN	KELLY
MARTIN	MEHARD	KERTTULA
MILLER	NAVARRE	PEARCE
PETTYJOHN	PHILLIPS	POURCHOT
RIEGER	SHARP	RODEY
SHULTZ	SCHNOLZ	STURGULEWSKI
SHACKHAMMER	TAYLOR	SZYMANSKI
ULMER	WALLIS	UEHLING
ZAWACKI		ZHAROFF

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: LUCILLE JOHNSTON

TITLE:

ADDRESS: 7815 JEWEL LAKE ROAD

CITY: ANCHORAGE

PHONE: 243-3621

ZIP: 99502

BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF

MESSAGE: I AM OPPOSED TO THIS BILL.

POMID: 03093150

DATE: 02/23/89

TIME: 09:31:50

LIONAME: ANCHORAGE LIO

COPIES: REPRESENTATIVES

MEHARD
JACKO
FOSTER
NAVARRE
FURNACE
SHARP
HUDSON
DAVIS, M.

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: WILLIE LEWIS, PRESIDENT
 TITLE: LABORERS' LOCAL 942
 ADDRESS: 315 BARNETTE STREET
 CITY: FAIRBANKS
 PHONE: 456-4584
 BILL NO: HB 118

ZIP: 99701

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF
 MESSAGE: THANK YOU FOR HOLDING THE PUBLIC HEARING. HOWEVER, IT APPEARS ONLY THOSE COACHED BY THE OIL COMPANIES UNDERSTOOD THE BILL. THE COMMITTEE NEEDS TO MAIL OUT INFORMATION EXPLAINING THE FORMULA, THE 300 BARRELS AND THE COST TO ALASKANS BEFORE ANOTHER HEARING IS HELD. LOCAL 942 IS BEHIND YOU ALL THE WAY.

POMID: 07094920
 DATE: 02/15/89
 TIME: 09:49:20
 LIONAME: FAIRBANKS LIO

COPIES: REPRESENTATIVES SENATORS

DAVIS, M.	COGHILL
BOYER	FAHRENKAMP
SHARP	FRANK
MILLER	
KOPONEN	

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: CAROLYN & RICHARD REICHMANN
 TITLE:
 ADDRESS: P.O.BOX 2633
 CITY: FAIRBANKS
 PHONE: 451-7467
 BILL NO: HB 118
 SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF
 MESSAGE: WE STRONGLY URGE YOU REPEAL THE ELF.

ZIP: 99707

POMID: 07100618
 DATE: 02/15/89
 TIME: 10:06:18
 LIONAME: FAIRBANKS LIO

COPIES: REPRESENTATIVES

MENARD
 JACKO
 FOSTER
 NAVARRE
 FURNACE
 SHARP
 HUDSON
 DAVIS, M.

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: RICHARD CLAUSEN
 TITLE:
 ADDRESS: 5520 OLD STEESE
 CITY: FAIRBANKS ZIP: 99712
 PHONE: 474-5580
 BILL NO: HB 118
 SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF
 MESSAGE: I SUPPORT REVISION OF ELF THAT WILL BRING IT MORE IN LINE WITH ITS ORIGINAL INTENT. I RELY ON YOUR EXPERTISE TO DETERMINE IF HB118 OR SB97 IS THE BETTER APPROACH TO A FAIR TAXATION THAT ELF WAS ORIGINALLY MEANT TO PROVIDE. ELF SHOULD ONLY APPLY TO MARGINAL FIELDS.

POMID: 07095855
 DATE: 02/15/89
 TIME: 09:58:55
 LIONAME: FAIRBANKS LIO

COPIES: REPRESENTATIVES SENATORS

MENARD	PEARCE
JACKO	ADAMS
FOSTER	FISCHER
NAVARRE	HALFORD
FURNACE	KELLY
SHARP	
HUDSON	
DAVIS, M.	

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: MRS. WALTER STEPHEN
 TITLE:
 ADDRESS: P.OB.OX 112114
 CITY: ANCHORAGE ZIP: 99511
 PHONE: N/R-
 BILL NO:
 SUBJECT:
 MESSAGE: 1. PLEASE, PLEASE, PLEASE KEEP ELF THE WAY IT IS. GOVERNOR IS OUT OF TOUCH WITH MAINLINE ALASKANS. THE OIL COMPANIES MADE US, KEEP THEM HEALTHY.
 2. DON'T RAISE ANY TAXES OR MAKE ANY NEW ONES, INSTEAD CUT STATE GOVERNMENT.
 3. DON'T USE THE PERMANENT FUND FOR EDUCATION. 4. DON'T FUND WOMENS COMMISSION. 5. DON'T PASS THE SEAT BELT LAW.

POMID: 03104514
 DATE: 02/15/89
 TIME: 10:45:14
 LIONAME: ANCHORAGE LIO

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DAVIS, M.	DONLEY	ELIASON
ELLIS	FOSTER	FAHRENKAMP
FURNACE	GOLL	FAIKS
GRUENBERG	GRUSSENDORF	FISCHER
HANLEY	HOFFMAN	FRANK
HUDSON	JACKO	HALFORD
KOPONEN	LARSON	JONES
LEMAN	MACLEAN	KELLY
MARTIN	MENARD	KERTTULA
MILLER	NAVARRE	PEARCE
PETTYJOHN	PHILLIPS	POURCHOT
RIEGER	SHARP	RODEY
SHULTZ	SPOHNHOLZ	STURGULEWSKI
SHACKHAMMER	TAYLOR	SZYMAWSKI
ULMER	WALLIS	UEHLING
ZAWACKI		ZHAROFF

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: DON BURLEY
 TITLE:
 ADDRESS: PO BOX 876151
 CITY: WASILLA ZIP: 99687
 PHONE: N/R-
 BILL NO: HB 124

SUBJECT: INCREASE SPORT FISHING/HUNTING LIC. FEES
 MESSAGE: I STRONGLY DISAGREE WITH HB124 THAT RAISES THE SPORT, HUNTING AND TRAP
 FISHING LICENSE FEES. WE NEED TO INSTITUTE OTHER MEANS OF INCOME, SUCH AS ZAPPING
 IT TO COMMERCIAL LICENSES. ALASKA STATUTES FISH AND GAME SEC. 16.43.160 SECTION
 3 IS A GOOD PLACE TO START.REPLY REQUESTED.

POHID: 14112827
 DATE: 02/21/89
 TIME: 11:28:27
 LIONAME: MAT-SJ LIO

COPIES: REPRESENTATIVES REPRESENTATIVES SENATORS

LARSON	MENARD	KERTTULA
HOFFMAN	SWACKHAMMER	SZYMANSKI
WALLIS	KOPONEN	
ULMER	BROWN	
SHULTZ	RIEGER	
PHILLIPS	BARNES	
JACKO	FOSTER	
NAVARRÉ	FURNACE	
SHARP	HUDSON	
DAVIS, M.	GRUSSENDORF	
CATO	COTTEN	
DONLEY	MARTIN	
TAYLOR		

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: JOHN D. RILEY
 TITLE:
 ADDRESS: P.O.BOX 110512
 CITY: ANCHORAGE ZIP: 99511
 PHONE: 345-1719
 BILL NO:

SUBJECT: BUDGET REVENUES AND COSTS
 MESSAGE: OPPOSED TO ANY CHANGE IN ELF, ANY TAMPERING WITH RAILBELT ENERGY
 FUND, OR PERMANENT FUND EARNS DISTRIBUTION. SUGGEST, INSTEAD, DRASTIC
 CUTS IN STATE BUREAUCRACY.

POHID: 03104753
 DATE: 02/21/89
 TIME: 10:47:53
 LIONAME: ANCHORAGE LIO

COPIES: REPRESENTATIVES REPRESENTATIVES SENATORS

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DAVIS, M.	DONLEY	ELIASON
ELLIS	FOSTER	FAHRENKAMP
FURNACE	GOLL	FAIKS
GRUENBERG	GRUSSENDORF	FISCHER
HANLEY	HOFFMAN	FRANK
HUDSON	JACKO	HALFORD
KOPONEN	LARSON	JONES
LEMAN	MACLEAN	KELLY
MARTIN	MENARD	KERTTULA
MILLER	NAVARRÉ	PEARCE
PETTYJOHN	PHILLIPS	POURCHOT
RIEGER	SHARP	RODEY
SHULTZ	SPOHNHOLZ	STURGUŁEWSKI
SWACKHAMMER	TAYLOR	SZYMANSKI
ULMER	WALLIS	UEHLING
ZANACKI		ZHAROFF

NO RESPONSE REQUIRED

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: KEN GRIFFIN

TITLE:

ADDRESS: 8231 SUMMERSET

CITY: ANCHORAGE

ZIP: 99518

PHONE: 349-7259

BILL NO:

SUBJECT: TAXATION

MESSAGE: I HEARTILY SUPPORT GOVERNOR COMPER'S RECOMMENDATION TO THE GOVERNORS OF FEDERAL TAX CREDITS FOR OIL EXPLORATION AS A MECHANISM TO HELP REDUCE OUR INCREASING DEPENDENCE ON FOREIGN OIL. OF COURSE, THE SAME LOGIC WOULD SUGGEST NOT CHANGING THE ELF FORMULA - WHICH ITSELF IS NOTHING MORE THAN ANOTHER TAX INCREASE.

POMID: 03145026

DATE: 03/03/89

TIME: 14:50:26

LIONAME: ANCHORAGE LIO

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CATO	COLLINS	COGHILL
COTTEN	DAVIS, C.	DUNCAN
DAVIS, M.	DONLEY	ELIASON
ELLIS	FOSTER	FAHRENKAMP
FURNACE	GOLL	FAIKS
GRUENBERG	GRUSSENDORF	FISCHER
HANLEY	HOFFMAN	FRANK
HUDSON	JACKO	HALFORD
KOPONEN	LARSON	JONES
LEMAN	MACLEAN	KELLY
MARTIN	MENARD	KERTTULA
MILLER	NAVARRE	PEARCE
PETTYJOHN	PHILLIPS	POURCHOT
RIEGER	SHARP	RODEY
SHULTZ	SPOHNHOLZ	STURGULEWSKI
SWACKHAMMER	TAYLOR	SZYMANSKI
ULMER	WALLIS	UEHLING
ZAHACKI		ZHAROFF

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: PHILLIP GUY

TITLE:

ADDRESS: BOX 80

CITY: KWETHLUK, ALASKA

ZIP: 99621

PHONE: 757-6613

BILL NO: HB 99

SUBJECT: MINING CLAIMS, LEASES, RENTS & ROYALTIES

MESSAGE: THE LANGUAGE IN THIS BILL IS VERY BRIEF AND THE RECLAMATION LANGUAGE NEEDS TO BE INCLUDED. WE DO NOT WANT TO SEE ANOTHER SITUATION, LIKE THE ONE TULUKSAK EXPERIENCED, HAPPEN AGAIN. RECLAMATION LANGUAGE WILL MAKE IT VERY CLEAR TO ALL MINERS. THANK YOU.

POMID: 05091020

DATE: 02/21/89

TIME: 09:10:20

LIONAME: BETHEL LIO

COPIES: REPRESENTATIVES SENATOR

HOFFMAN	BINKLEY
MENARD	
JACKO	
FOSTER	
NAVARRE	
FURNACE	
SHARP	
HUDSON	
DAVIS, M.	

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: DON CHANCEY

TITLE:

ADDRESS: 12840 SUMMER DRIVE

CITY: ANCHORAGE

PHONE: 345-3659

ZIP: 99516

BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF

MESSAGE: I OPPOSE PASSAGE OF HB 118. THIS BILL WOULD INCREASE THE SEVERANCE TAX WHICH IS ALREADY THE HIGHEST TAX IN THE COUNTRY. TAXES ARE ALSO THE HIGHEST EXPENSE OF OPERATING AN OILFIELD IN ALASKA. IT IS TIME TO CUT STATE EXPENSE BUDGET.

POMID: 03160656

DATE: 02/24/89

TIME: 16:06:56

LIONAME: ANCHORAGE LIO

COPIES: REPRESENTATIVES

PETTYJOHN
MENARD

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: JOHN STALLONE

TITLE:

ADDRESS: PO BOX 201172

CITY: ANCHORAGE

PHONE: 243-2192

ZIP: 99520

BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF

MESSAGE: THE ELF TAX SHOULD BE LEFT ALONE. IT WAS A GOOD PLAN WHEN ENACTED AND STILL IS. ECONOMICALLY, I SEE THE BENEFITS DAILY. TAXATION SHOULD BE FAIR AND STABLE. WHY NOT LOOK AT OTHER REVENUE SOURCES BESIDES TAXES LIKE LEGALIZING GAMBLING OR ENHANCING OUR FISHERIES FOR THE SPORTSMAN.

POMID: 03100219

DATE: 02/28/89

TIME: 10:02:19

LIONAME: ANCHORAGE LIO

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DAVIS, M.	DONLEY	ELIASON
ELLIS	FOSTER	FAHRENKAMP
FURNACE	GOLL	FAIKS
GRUENBERG	GRUSSENDORF	FISCHER
HANLEY	HOFFMAN	FRANK
HUDSON	JACKO	HALFORD
KOPONEN	LARSON	JONES
LEMAN	MACLEAN	KELLY
MARTIN	MEHARD	KERTTULA
MILLER	NAVARRE	PEARCE
PETTYJOHN	PHILLIPS	POURCHOT
RIEGER	SHARP	RODEY
SHULTZ	SPOHNHOLZ	STURGULEWSKI
SWACKHAMMER	TAYLOR	SZYMANSKI
ULMER	WALLIS	UEHLING
ZAWACKI		ZHAROFF

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: DANA LINDQUIST

TITLE:

ADDRESS: 9140 CATHEDRAL PLACE

CITY: ANCHORAGE

ZIP: 99507

PHONE: 349-2590

BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF

MESSAGE: I'M OPPOSED TO HB 118 BECAUSE IT PROVIDES ONLY A SHORT-TERM REVENUE BOOST TO COVER OUT OF CONTROL GOVERNMENT SPENDING AT THE EXPENSE OF LONGTERM OIL INDUSTRY GROWTH AND DEVELOPMENT. I SUGGEST WE WORK AT REDUCING SPENDING BEFORE WE INCREASE TAXES ON AN INDUSTRY WHICH GENERATES 80% OF STATE REVENUES.

POMID: 03092139

DATE: 02/24/89

TIME: 09:21:39

LIONAME: ANCHORAGE LIO

COPIES: REPRESENTATIVE

MENARD

PUBLIC OPINION MESSAGE

DEAR: REPRESENTATIVE DAVIDSON

NAME: SCOTT WILSON

TITLE:

ADDRESS: 11240 STROGOMOF DR

CITY: ANCHORAGE

ZIP: 99516

PHONE: 346-2679

BILL NO: HB 118

SUBJECT: OIL & GAS PROPERTIES PRODUCTION TAX -ELF

MESSAGE: HB188 IS UNFAIR TO ALASKANS. IT TELLS INDUSTRY THAT THE STATE OF ALASKA WILL TAKE WHATEVER IT WANTS WITHOUT HELPING SHOULD THE BURDEN ITSELF. WHY HAS STATE FUNDING INCREASED WHILE THE PRIVATE SECTOR HAS BEEN CUT TO THE BONE. HB118 IS SETTING UP ALASKANS FOR A BIG FALL.

POMID: 03135809

DATE: 02/24/89

TIME: 13:58:09

LIONAME: ANCHORAGE LIO

COPIES: REPRESENTATIVES REPRESENTATIVES

BARNES	BOUCHER
BOYER	BROWN
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DAVIS, M.	DONLEY
ELLIS	FOSTER
FURNACE	GOLL
GRUENBERG	GRUSSENDORF
HANLEY	HOFFMAN
HUDSON	JACKO
KOPGREN	LARSON
LEMAN	MACLEAN
MARTIN	MENARD
MILLER	NAVARRE
PETTYJOHN	PHILLIPS
RIEGER	SHARP
SHULTZ	SPOHNHOLZ
SWACKHAMMER	TAYLOR
ULMER	WALLIS
ZAWACKI	

Full story on ELF

Feb. 17, 1989
1358 Carat Loop
North Pole, AK 99705

To the editor:

It was a mere 10 months ago that the liberal press, liberal politics, state and local government workers and the government worker's union leaders from the Laborers, Teamsters, Operators, and the IBEW were literally screaming for a public hearing on the ELF.

Well, finally a statewide hearing on the ELF took place on Monday, February 13, for more than four hours. Given the fevered "Public Hearing! Public Hearing!" chant of last spring and the importance of the ELF issue to the future of Alaska I believe the public unable to attend the hearing's deserved more than the very short Page 2 story "Old ELF arguments recited" run in the Feb. 14 News-Miner.

For their benefit, then:

1. The count was two to one against ELF modification, 50 persons spoke against HB118, 25 spoke in favor.
2. Those speaking against HB118

were predominantly private sector—oil industry employees, Chamber of Commerce members and staff, businessmen, and businesswomen. Those speaking in favor of HB118 were predominantly public sector—state and local government employees and their spouses, government employee union leaders, union members, local government elected officials, and AKPIRG. It became quite clear the ELF is a public sector vs. private sector issue.

3. House Resources Chair, Cliff Davidson (D-Kodiak), in an unprecedented maneuver, required people to declare whether they were either for or against HB118, before they were called to testify. Davidson's stated intention was to hold a "balanced hearing" by calling to testify an equal number "for" or "against." As noted above, even with the chair's maneuver, the count was two to one against ELF modification.

Kenneth D. Corbet

*From the Fairbanks
Daily News-Miner
2/26/89*

February 13, 1989

To: Members of the House Resources Committee

From: Kristine Funk
PO Box 940
Sitka, AK 99835

My name is Kristine Funk and I have been a resident of Sitka and Alaska for 10 years.

I believe that increased taxation of the oil industry should be considered only if you believe that there should be no limits on state spending and if you believe that our state government has the right to spend every dime of revenue and demand more when that runs out.

It is my opinion that the oil industry is paying its fair share of taxes and I do not support changes to the ELF equation. Our state government made a commitment to the oil industry when an agreement on the Economic Limit Factor was enacted. It is my position that a deal is a deal and state government has no business trying to renege on the agreement now which would send a signal to other industries and foreign corporations to beware of Alaska because they make deals and don't honor them.

We see the same thing happening to the timber industry in Southeast Alaska. Deals made between the federal government and the industry with government not honoring the deal. Deals broken will cost Alaskans jobs.

I oppose changes to the ELF.

Thanks for your consideration on this matter of grave importance to all of us in Alaska.

cc: Senator Dick Eliason
Representative Ben Grussendorf

RECEIVED FEB 17 1988

Opposition testimony to House Bill 118

February 13, 1989

My Name is Megan Woods. I represent Norgasco, Inc. of 8740 Hartzell Road, Anchorage, AK 99507. We are a natural gas utility serving the Deadhorse area.

Passage of House Bill 118 will guarantee price increases for Norgasco and therefore prices for their customers will likewise rise. I estimate each customer will pay an additional \$16,000 a year (on average) as result of increased severance tax alone.

\$16,000 seems rather a small pot of coffee in light of the current deficit situation. Multiplied by 30 customers over 10 years it boils up to over 5 million dollars that the bill will suck out of our customers. Such increases are translated into higher operating costs.

These increase can only cripple industry's efforts at recovery. Norgasco, too will suffer more directly from these high rates as our customers may decrease their use of gas.

This is not the basis for economic recovery. Norgasco does not consider increased taxes an alternative to the State's revenue deficiencies until its operating budget is reduced to realistic and sustainable levels.



Alaska State Legislature

HOUSE OF REPRESENTATIVES
COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3718

MEMORANDUM

TO: House Resources Committee members

FROM: Representative Cliff Davidson
Representative Curt Menard
Co-Chairs, House Resources Committee

DATE: February 27, 1989

SUBJECT: ELF Questions

Attached are answers to 26 questions concerning HB 118 (ELF) that have been provided to the Committee by the following:

- 1) Department of Revenue
- 2) BP Exploration (Alaska), Inc.
- 3) Exxon Company USA
- 4) ARCO Alaska, Inc.

ELF QUESTIONS

I AMOUNT OF OIL EXTRACTED

(1) The ELF is designed to provide production incentives for wells in "marginal" oil fields. Which oil fields are considered "marginal" in Alaska?

(2) How many barrels per day are extracted from the most productive oil field in Alaska that will be allowed tax cuts under this ELF bill?

(3) How many barrels per day are extracted from Prudhoe Bay? from Kuparuk?

(4) How many barrels per day are extracted from wells in the most productive oil fields in the various lower 48 states? What is the greatest barrels-per-day extraction considered marginal and provided tax cuts for production incentive in the various lower 48 states?

(5) Which oil companies have the greatest lease interests in Prudhoe Bay and Kuparuk oil fields and what is the percentage of their lease interests?

(6) Oil Companies: How much oil did you extract world wide in 1976? How much of that was from Alaska? (Prudhoe Bay?)

(7) Oil Companies: How much oil did you extract world wide in 1988? How much of that was from Alaska? (Prudhoe Bay?)

II TAXES PAID

(8) Which oil fields will receive tax breaks from this ELF Bill? Which oil fields will receive tax increases from this ELF bill?

(9) Can the ELF raise the amount that would be paid for severance taxes above the statutory nominal rate of 15% for any oil field or any oil company? So this ELF bill can't do this either, right?

(10) Will this ELF bill raise the rate that would be paid for severance taxes for Prudhoe Bay above the rate that was paid by oil companies at Prudhoe Bay prior to June 20, 1987?

(11) How much is being paid to the State of Alaska in severance taxes each year?

(12) How does the amount that Alaska receives in severance taxes compares to the amount that other oil-producing states and nations receive? How much would the

fields in the lower 48 pay if they were placed under the Alaska tax structure?

(13) Oil Companies: Do you have North Sea productions? If so, what percent of the total economic rent do you realize from your Alaska production and what percent do you realize from your North Sea production?

III PROFITS

(14) Oil Companies: How much profit is being made off of the most productive oil fields in the lower 48 states?

(15) Oil Companies: How much profit is being made off of the most productive oil fields in other oil-producing countries?

(16) How much profit is being made off of Prudhoe Bay and Kuparuk oil fields each day?

(17) Does this include TAPS? If not, what is the profit on TAPS?

(18) What public sources corroborate this? Would you provide materials proving this? Would you provide a detailed list of your revenues and expenses?

(19) How much profit is made from refined products from Alaskan oil?

(20) What did the oil companies of Prudhoe Bay do with the savings made as a result of the tax break occurring on June 20, 1987?

(21) What percent of money grossed by Alaska's oil in Prudhoe Bay and Kuparuk is reinvested in Alaska? How much money is sent outside?

IV IMPACTS ON ALASKANS

(22) How many jobs are involved in starting up a small oil field? How many jobs are involved in maintaining a small field?

(23) How many Alaskans were employed by the oil companies of Prudhoe Bay prior to June 20, 1987 when the tax cut kicked in? How many Alaskans are employed by the oil companies of Prudhoe Bay now?

(24) What is the long-term effect on Alaskan jobs in Prudhoe Bay and Kuparuk oil fields as a result of this ELF bill?

(25) How many Alaskans are employed by the oil companies of the marginal oil fields now? How many Alaskans are likely

to be employed by the oil companies of existing marginal oil fields and in developing other oil fields as a result of this ELF bill?

(26) What is the long-term effect on Alaskan jobs in the smaller oil fields as a result of this ELF bill?

ANSWERS TO QUESTIONS

DEPARTMENT OF REVENUE

Department of Revenue

February 21, 1989

Response to Questions from House Resources Committee - HB 118

I. Amount of Oil Extracted

1. Marginal fields are fields with either relatively low per well productivity or relatively low daily production. These are indicative of the economic well being of the field. Production is significant because of the considerable economies of scale that accompany large fields. For example, the consultants report for the U.S. Minerals Management Service estimated the production platform capital cost per barrel for a 300,000 barrel per day field to be approximately 60% of that of a 100,000 barrel a day field. Attachment 1 displays economies of scale for production platform costs. There are numerous precedents for taxing on the basis of field size. For example, see Attachment 2, which shows higher royalties for larger fields in Norway. In Alaska the marginal fields are the six Cook Inlet fields (Beaver Creek, Middle Ground Shoals, Granite Point, McArthur River, Swanson River, and Trading Bay), Milne Point, Lisburne, Endicott, Niakuk, West Sak, Point Thomson, Seal Island, and probably any other field that will be discovered in Alaska.

2. There are two factors that will affect the size of field that will have reduced taxes under the bill. The first factor is the change in the formula itself. Because of this fields that produce less than approximately 115,000 barrels per day will have reduced taxes under the bill. The second factor is the elimination of the "rounding rule." Under current law fields whose ELF is greater than 0.7 must raise the ELF up to 1.0 for the first ten years of the field, making the severance tax rate equal to that set in the law (12.25% for the first 5 years, then going to 15%). This provision is eliminated under the bill. Thus fields that produce more than 115,000 barrels per day could benefit from the bill by eliminating the rounding provision. The most productive oil field in Alaska that will have reduced taxes under the bill is currently Endicott, which produces approximately 100,000 barrels per day.

3. Prudhoe Bay produces approximately 1,500,000 barrels per day. Kuparuk produces about 320,000 barrels per day.

4. The most productive fields in the lower 48 produce less than

100 barrels per well per day. (Prudhoe Bay produces over 20 times that much.) Alabama, for example, gives tax relief for wells producing less than 25 barrels per day.

5. BP owns approximately half of Prudhoe Bay with the remainder split approximately in half between ARCO and EXXON. There are eight other minor owners. ARCO/BP have an approximate 60/40 split of Kuparuk. There are four other minor owners.

II. Taxes Paid

8. Milne Point, Lisburne, Endicott, Niakuk, Point Thomson, and Seal Island would receive tax breaks under the proposal. Cook Inlet and West Sak pay no severance tax under current law and would not pay any under the proposal. Prudhoe Bay and Kuparuk would have increased taxes under the proposal.

9. Neither the current nor the proposed ELF could raise the effective severance tax rate over the statutory nominal rate.

10. This ELF bill would result in a lower effective severance tax rate for Prudhoe Bay than was in effect on June 20, 1987.

11. The State received \$819 million from severance taxes in FY 88. Attached is a table for other prior years.

12. For 1987, the last year where we have comparable data, Alaska ranked 8 out of the top 10 producing states in severance tax payments per barrel (where 1 would be the highest payment). (See Attachment 3.) Texas received \$529 million more in severance taxes (55%) than Alaska, whereas its production was only six percent higher. (Texas got \$1.55 per barrel, Alaska got 91 cents per barrel). Virtually every field in the lower 48 (except one) would pay no severance tax if put under either Alaska's present or the proposed severance tax structure under HB118.

III. Profits

16. The Administration testimony of February 10, 1989 showed that producers made \$3.46 per barrel in profit from Alaska North Slope operations in February 1988. This is \$7 million a day. TAPS accounted for \$1.15 of this. The remainder (\$2.31) is attributable to production. Also according to PIW (see Attachment 4), average production profits worldwide were \$0.87 per barrel. This is derived by dividing total production profits by oil production.

17. See #16 above.

18. See #16 above. Also the State is currently developing an

extensive analysis of the profitability of North Slope fields.

19. Because the refining segment is more concentrated than the producing segment, and thus less competitive, when crude prices (upon which State revenues are based) are low, refining profits are high since the lower price does not have to be passed on directly to consumers, and because demand increases. In the third and fourth quarters of 1988, for example, petroleum earnings were very high because of this. For example, ARCO's fourth quarter 1988 earnings set a record of a 15 percent increase. Their refining and marketing segments were up 76 percent. (See Attachment 5.)

20. Well drilling was only increased slightly. The average well count at Prudhoe Bay increased by 60 in 1986 and by 67 in 1987. See #21 below.

21. Based on the PIW data and the announced spending figures of the producers (\$750 million), it is estimated that approximately 15% of cash flows (profit plus depreciation - this is discretionary income) are reinvested in Alaska. (See Attachment 6.) The other 85% leaves the State. Note, however, that even the investment that stays in Alaska does not create income indigenous to Alaska. For instance, the amount invested in a gas plant is invested where the plant is manufactured. e.g., Texas), not where it is erected. (See Attachment 7.)

IV. Impacts on Alaskans

22. The start-up and maintenance of small fields, that might otherwise not occur without HB 118, could create in excess of 1,000 jobs. (See Attachment 8.)

23. Department of Labor data suggests that employment on the North Slope has not increased over the period. (See Attachment 9.)

24. #23 above suggests that HB 118 would not affect employment at Prudhoe Bay and Kuparuk. Also note that the bill will result in lower severance tax rates than current law even on those fields in the long run.

25. It is difficult for the State to get a field by field breakout of employment. This bill could cause fields to come on line that otherwise might not. Since the bill reduces severance taxes on the marginal fields, the Department of Revenue estimates that the bill would reduce the threshold start-up price on the marginal fields by approximately \$2 a barrel. As stated above, each new field that comes on line could create in excess of 1,000 jobs.

26. See #25 above.

Attachment 1

TABLE 4.2-5

PRODUCTION PLATFORM TOPSIDES CAPITAL COST - ARTIFICIAL ISLAND

	<u>Cost. MMS</u>		
	<u>100,000 BPD</u>	<u>200,000 BPD</u>	<u>300,000 BPD</u>
Management and Engineering	34	40	41
Drilling Equipment	17	34	34
Production and Other Equipment	99	156	210
Module Fabrication	95	165	180
Transport and Installation	130	200	260
Certification and Insurance	<u>5</u>	<u>5</u>	<u>5</u>
Total Cost	400	600	730

TABLE 4.2-6

PRODUCTION PLATFORM TOPSIDES CAPITAL COST - BOTTOM FOUNDED

	<u>Cost. MMS</u>		
	<u>100,000 BPD</u>	<u>200,000 BPD</u>	<u>300,000 BPD</u>
Management and Engineering	34	40	41
Drilling Equipment	17	34	34
Production and Other Equipment	99	156	210
Below Deck Equipment	10	10	10
Module Fabrication	115	165	180
Transport and Installation	20	35	40
Certification and Insurance	<u>5</u>	<u>5</u>	<u>5</u>
Total Cost	300	445	520

Source: Han-Padron Assoc., Beaufort Sea Petroleum Technology Assessment
 Technical Report No. 112, prepared for Minerals Management Service, Alaska
 Outer Continental Shelf Region, Leasing and Environment Office, Social and
 Economic Studies Unit, March 1985.

an oil purchaser and trader to the until 1985, when the corporation is Agency was set up to maintain oil but these rights are not being by no government participation is

tionary fiscal power which it can marginal fields. The Department here it is convinced that the couraging the development of a onment to be considered. The 'PRT and corporation tax (i.e., no s payable, even though royalties these two taxes). To date several es have been made, but none has

offshore petroleum in Norway is t of 1963, the Royal Decree of n Activities Law of 1985. In t the Crown. Licensing is done by including technical and financial vegian economy (in particular the ial growth and development), overnment participation offered. i petroleum exploitation, namely,

royalty is part of the licence. The s at the production-area point of ore December 1972, the rate is 10 e December 1972, a progressive s shown in Table 3.4. The rates ield. The tax is thus applied on a

The rules also state that when e royalty rate will fall as well, t it may not fall below 12 per cent. t per cent. Section 26 of the Royal government the power to fix lower ty per well, or other conditions so no reductions in royalty rates. yable by all companies operating at the rate of 27.8 per cent; and cent. With regard to petroleum,

the Municipal Tax is collected and utilized not by the local governments but centrally. In 1975 the Norwegian government introduced a tax package on North Sea operations which maintained the royalty provisions described above but substantially changed income taxation.

Table 3.4
Royalty Rates on Oil Production in Norway

Average Field Production (barrels per day)	Rate of Royalty (%)
Under 40,000	8
40,000 and under 100,000	10
100,000 and under 225,000	12
225,000 and under 350,000	14
350,000 and above	16

The 1975 act introduced allowances which apply equally to both income taxes. Deficits accumulated over the previous 25 years are deductible as losses, although there is a restriction on the rate at which such losses can be deducted. The deduction in any one year is limited to one third of the total deficit in the previous 15 years, so that the total deductions have to be distributed over a minimum of 3 years. Eligible costs include exploration costs, various licence fees, and royalties. Only 50 per cent of losses incurred from other (non-Continental Shelf) activities in Norway may be deducted from Shelf income. Had the 1975 act not stipulated this restriction, companies would have an incentive to invest in non-Shelf activities, and tax revenues from North Sea oil exploitation would be postponed. The provision means, in effect, that 50 per cent of non-Shelf operating losses may be set against Shelf income, as can 50 per cent of the costs of investing in, say, a refinery or marketing facilities. On the other hand there is no restriction on the ability to set losses incurred in Shelf operations against income from other activities in Norway. Thus, there are still advantages to be obtained from integrated operations in Norway. However, losses or deficits incurred abroad are not allowed as deductions against North Sea income in Norway.

The 1975 act also introduced special depreciation provisions for North Sea operations. The normal depreciation allowances were considered too restrictive for the size of the investments and risks

Source: Kemp, Alexander, Petroleum Rent Collection Around the World, The Institute for Research and Public Policy, Halifax, 1987

Table 3
HISTORICAL PETROLEUM REVENUES
(Millions of Dollars)

FY	Corporate		Oil/Gas	Property Tax	Reserve Tax	Fed. Min.		Rents (1)	Royalties (1)	Oil/Gas	Total	Total G.F.	% of Total	
	Non-Petroleum	Petroleum	Severance Tax			Rents & Royalties (1)	Bonus Sales			Special Settlements	Petroleum Revenues	Unrestricted Revenues	Unrestricted Revenues	
59	1.4						3.1				3.1	25.4	12	
60	1.7						5.8	4.0	.1		9.9	48.0	21	
61	1.4						2.4	1.6	.2		4.2	40.5	10	
62	1.8		.2				4.5	20.3	1.0		26.0	68.9	38	
63	2.2		.3				8.6	17.9	1.0		27.8	71.6	39	
64	1.8		.3				8.7	4.7	1.2		14.9	67.0	22	
65	1.9		.3				8.3	5.9	1.9	.1	16.5	83.0	20	
66	4.1		.3				7.7	10.8	2.5	.3	21.6	86.5	25	
67	3.5		.5				7.7	8.6	2.8	1.9	21.5	86.6	25	
68	3.8	.1	1.2				7.5	21.8	2.9	9.5	43.0	112.7	38	
69	4.2	.1	5.6				7.8	.8	3.3	16.9	34.5	112.4	31	
70	4.9	.4	7.9				8.2	900.0	3.1	19.3	938.9	1067.3	88	
71	5.2	.9	10.5				8.6	.2	2.9	23.9	47.0	220.4	21	
72	5.3	1.2	11.4				7.9	.3	3.0	24.6	48.4	219.2	22	
73	5.9	.9	12.0				6.7	3.8	3.4	23.5	50.3	208.2	24	
74	7.0	1.2	14.8				7.1	24.8	3.6	28.7	80.2	254.9	31	
75	14.8	2.5	26.6	6.6			9.8	1.0	3.9	40.0	90.4	333.4	27	
76	26.2	4.9	28.0	83.4	223.1		5.1		3.7	43.3	391.5	709.8	55	
77	30.8	5.0	23.8	139.1	270.6		2.0*		2.8*	34.3*	477.6*	874.3	55	
78	25.1	8.4	107.7	173.0			1.0*		1.8*	149.6*	441.5*	764.9	58	
79	24.8	232.6	173.3	163.4			1.0*		1.6*	249.2*	821.6*	1133.0	73	
80	17.9	547.5	506.5	168.9			1.2*	342.4*	1.8*	688.2*	2256.5*	2501.2	90	
81	34.8	860.1	1170.2	143.0			1.2*	7.6*	3.7*	1118.5*	3304.3*	3718.2	89	
82	34.8	668.9	1581.7	142.7			17.1*	5.0*	2.1*	1157.3*	3574.8*	4108.4	87	
83	30.1	236.0	1493.7	152.6			27.2*	36.2*	2.5*	1078.4*	3026.6*	3631.0	83	
84	39.5	265.1	1393.1	131.0			11.0*	10.1*	3.8*	1047.5*	2861.6*	3390.1	84	
85	36.0	168.6	1389.4	128.4			8.2*	11.5*	3.4*	1034.0*	2743.5*	3260.0	84	
86	11.2	133.9	1108.4	113.5			14.3*	34.7*	4.2*	856.1*	392.8*	2657.9*	3075.5	86
87	20.5	120.4	648.5	102.5			11.0*	.5*	3.8*	439.3*	68.5*	1394.5*	1799.4	77
88	23.4	158.0	818.7	96.2			8.7*	5.6*	5.7*	694.8*	161.9*	1949.6*	2305.8	85

* Net of Permanent Fund contribution.

(1) These categories are primarily composed of oil/gas revenues; however, includes some additional revenues from other minerals (mostly coal).

Attachment 3

Comparative Severance Tax Payments
1987 Production and Collections
10 Top Oil Producing States

	Production ¹ (1000's of bbls)	Severance Tax ² (1000's of \$)	\$/Bbl	Severance Tax Rank
Texas	760,145	1,178,052	1.55	6
ALASKA	715,855	648,500	0.91	8
California	364,572	14,600	0.04	10
Louisiana	173,409	439,237	2.53	4
Oklahoma	132,970	372,883	2.80	2
Wyoming	112,597	138,915	1.23	7
New Mexico	71,533	262,290	3.67	1
Kansas	59,120	159,952	2.71	3
North Dakota	41,351	90,665	2.19	5
Utah	35,477	22,781	0.64	9

¹ Source: Department of Energy

² Source: Petroleum Independent, September 1988

Chart 1

In February 1988, A Barrel of Oil at Valdez Was Worth \$11.93.

This is how the \$11.93 Was Divided:

Costs of Production
and Pipeline Operations
\$1.44

36%

\$3.46 Profit

U.S. Income Tax
\$1.40
~31%

Severance \$0.99

Property Tax \$0.46

Royalty \$1.10

State Income Tax
\$0.12 34%

Depreciation & Other Cash
\$2.96

 Costs of Operations  To the Feds  To the State  To the Oil Companies

Photocopied by permission of Petroleum and Energy Intelligence Weekly.

WHAT'S NEW AROUND THE WORLD

GENERAL

OPEC — The first meeting of the ministerial-level monitoring committee is scheduled for March 29-30 in Vienna. Ministers from Saudi Arabia, Kuwait, Nigeria, Algeria, Indonesia, Venezuela, Iran and Iraq will gather as agreed at the full ministerial meeting last November. The panel's official brief includes review of progress toward the group's \$18 price target, quota compliance, and longer-term issues, such as permanent output quotas for members.

TANKERS — A shortage of available tonnage sent spot freight costs soaring in December despite a drop in single-voyage chartering. Following extremely high levels of listings in October and November, average spot rates in December for all vessel sizes rose by over 40% from the previous month, according to London tanker brokers Howard Houlder. Overall, spot chartering in December fell over 10-million tons to 44.3-million tons.

Reflecting higher volumes of oil afloat, tonnage employed as floating storage rose almost 2-million tons in December to 13.5-million tons, mostly in the US Gulf. Tankers in lay-up in December fell to a rock-bottom level of 2.5-million tons, with

most of the remaining vessels probably only suitable for scrap. Following are per-bbl freight costs for specific voyages.

Spot Freight Costs for Key Cruises (\$/bbl):

Voyage	1,000 dwt	Dec.	Nov.
Arab Lt.-N. Europe	250	\$1.31	\$1.40
Arab Lt.-Singapore	220	0.77	0.53
Nigeria-US Gulf	125	1.22	0.90
UK Brent-US Gulf	80	1.25	0.98
Venezuela-US Gulf	50	1.17	0.69
Libya-Italy	80	0.64	0.36
Indonesia-Singapore	80	0.23	0.19

INDUSTRY RESTRUCTURING — In what may be the last step of a major restructuring plan, Texaco has agreed to sell its 78% interest in Texaco Canada to Imperial Oil, Exxon's Canadian subsidiary, in a deal valued at \$4.15-billion. The acquisition solidifies Imperial's position as Canada's biggest oil company, though the deal is subject to regulatory approval. Imperial may be forced to sell some marketing assets, as the combined companies would have 36% of total oil sales in Canada.

Gas pipeline firm Texas Eastern is fighting Coastal's \$2.5-billion tender and may seek another suitor, make a leveraged buyout or undertake a major asset sale. Securing a toehold in the expanding Spanish market, British Petroleum has an option to

buy 8%-15% of refiner Petromed, which operates a 120,000 b/d refinery at Castellon de Plana. BP also plans to sell another \$1-billion in non-US assets as part of its plans to reduce debt. Conoco has purchased a 31.25% interest in the undeveloped UK Anglia gas field from Lasmo for an undisclosed amount. Arco realized \$1.22-billion from the stock sale of roughly half its interest in Lyondell.

COUNTRIES

AUSTRALIA — Lukewarm oil company reaction to Canberra's latest excise tax proposal minimizes chances for a significant production increase in Australia's largest oil field. The country's two largest oil producers, BHP and Exxon, reacted unenthusiastically to a newly drafted sliding-scale excise tax. The companies contend that the latest government proposal still does not provide adequate tax relief for operating older, marginal fields discovered in the Bass Strait before 1979.

Shut-ins by the two companies have trimmed production by more than 65,000 b/d (PIW Nov.21,p7).

BRUNEI — Reflecting the sharp upturn in the spot market, the sultanate retroactively boosted crude oil export prices

Record Refining And Chemical Earnings Boost Company Profits In 1988

Record refining and chemical earnings for many oil companies more than offset steep declines in upstream profits and pushed total 1988 profits for seven major US companies up sharply. Total profits for the seven companies of \$15.3-billion during 1988 were almost 30% above earnings in 1987, after excluding extraordinary charges of nearly

\$5-billion by Texaco in 1987 to settle litigation and for restructuring.

Total profits for the group in the fourth quarter of \$3.3-billion declined by 8% from a year earlier, despite huge downstream earnings for many companies. Combined refining and marketing earnings of \$1.3-billion were almost 120% above like 1987 results, while

chemical earnings of \$1.2-billion showed an increase of 35% and exceeded upstream profits. Exploration and production profits fell 68% to just under \$780-million in the fourth quarter.

Annual 1988 profits are shown in million dollars, with percent changes from 1987. Oil volumes are in 1,000 b/d, and gas is in million cu ft/d.

	Exxon		Mobil		Chevron		Texaco		Amoco		US Shell		Arco	
	1988	% Chg.	1988	% Chg.	1988	% Chg.	1988	% Chg.	1988	% Chg.	1988	% Chg.	1988	% Chg.
Profits: Oil & Gas	2,508	-30.8	894	-42.7	655	-38.3	814	-40.8	631	-21.1	326	-55.5	542	-35.1
Production	829	-37.1	95	-20.4	16	-95.8	151	-32.5	383	+0.8				
United States	1,779	-27.3	799	-25.8	639	-7.3	463	-43.1	248	-41.0				
Foreign	1,304	+254.4	996	+329.3	622	+225.7	1,116	+758.5	897	+315.3	519	+131.7	368	+145.3
Refining & Mktg.	669	+1,990.6	554	+350.4	571	+288.0	651							
United States	1,125	+137.9	442	+305.5	51	+31.1	465	+180.1						
Foreign	4,412	+3.2	1,890	+5.4	1,277	+1.3	1,730	+48.2	1,528	+50.4	845	-11.7	910	-7.6
Total Petroleum	1,209	+74.5	631	+110.3	391	+62.9	245	+214.1	684	+60.2	553	+32.9	-929	+73.3
Chemicals	-461		-427		100		-671		-149		-194		-256	
Other	5,260	+8.7	2,094	+55.3	1,768	+41.3	1,304		2,063	+51.7	1,239	+0.7	1,583	+29.3
Total Profits														
OPERATING STATISTICS														
Oil Production	1,919	+4.6	855	+4.0	1,309	-2.2	990	-6.3	809	+0.9	595	-2.3	738	+1.4
Refinery Runs	3,041	+2.0	1,653	+5.8	1,907	+1.5	1,977	-0.8	944	+5.5	999	-2.0	704	+5.1
Product Sales	4,206	+4.0	2,281	+4.9	2,422	+3.7	2,787	+1.9	1,133	+11.0	1,314	-2.5	669	-1.6
Natural Gas Prod.	5,192	-0.7	4,747	+3.5	2,732	+2.4	2,235	+10.2	3,151	+5.0	1,613	-11.4	1,543	+7.5
Crude Per Barrel	\$3.42	+4.3	\$2.51	+47.8	\$2.09		\$1.58		\$4.97	+36.2	\$2.58	+3.6	\$6.47	+31.2

* Not meaningful. † Includes \$225-million profit from 1988. ‡ Includes \$2.796-billion for the Pennzoil settlement and \$2.056-billion in restructuring.

Wall Street
Journal

Arco's Earnings Set a Record; Amoco Net Falls

By FREDERICK ROSE

Staff Reporter of THE WALL STREET JOURNAL
Atlantic Richfield Co., boosting its quarterly dividend, reported record fourth-quarter profit and announced an indefinite extension of a stock-purchase program.

Separately, Amoco Corp. said its fourth-quarter net income declined less than 1% to \$375 million, or \$1.45 a share, as increased profit from refining and marketing operations was offset by declining results from crude oil and natural gas production.

Los Angeles-based Arco's quarterly dividend increase, to \$1.125 a share from \$1, is

the company's first boost since 1955, when it undertook a massive recapitalization and cost-cutting program that trimmed its common stock by more than 25%, slashed costs and boosted the dividend at that time to \$1 from 75 cents.

The latest increase had been expected but came earlier and at the high end of analysts' forecasts. Analysis said yesterday's announcements underscore the effectiveness of Arco's 1955 recapitalization, which was widely questioned when it was announced. "They have been vindicated," said Eugene Nowak, an analyst at Dean Witter Reynolds Inc.

The increased dividend will be paid March 30 to stock of record Feb. 17. Arco and Amoco shares both fell yesterday amid a broad slide of oil stocks on news of declining oil prices. Arco was off 12.7 cents, at \$85 a share. Amoco dropped \$3, to \$75.625 a share. The shares of both companies are quoted on the New York Stock Exchange.

Arco's fourth-quarter net income rose

15%, to \$391 million, or \$2.22 a share, from \$340 million, or \$1.86 a share, a year earlier. The latest quarter was Arco's highest ever. Revenue declined 1.6%, to \$4.54 billion from \$4.62 billion. The average shares outstanding declined 3.6%, to 176.9 million from 183.5 million a year earlier.

Contributing to the earnings increase, after-tax profit from Arco's refining and marketing operations jumped 76%, to \$88 million from \$50 million. Profit at the company's Lyondell Petrochemical Co. unit, currently the subject of an initial public offering that will reduce Arco's stake to just under 50%, was nearly trebled at \$151 million compared with \$56 million a year earlier. These increases and others were countered in part by a 38% drop in the company's after-tax profit from crude oil and natural gas production, to \$95 million from \$154 million in the year-earlier quarter.

Arco's indefinite extension of its stock buy-back continues a program started in 1985, under which the company purchased 62.6 million shares—or about 26% of the

amount previously outstanding—at an average price of \$63.47 a share. Analysts said they expect the company to continue the purchases at about the recent rate of its buy-back, which, since November 1987, has brought in 7.6 million shares at an average of \$77.01 a share.

Arco's net income for the year rose 29%, to \$1.58 billion, or \$8.78 a share, from \$1.22 billion, or \$6.68 a share, a year earlier. Revenue increased 7.9%, to \$18.32 billion from \$16.98 billion. The average number of shares outstanding declined 1.6%, to 180.4 million from 183.3 million.

Separately, Chicago-based Amoco reported fourth-quarter net income of \$375 million, or \$1.45 a share, compared with \$377 million, or \$1.47 a share, a year earlier. Revenue climbed 4.3% to \$6.19 billion from \$5.94 billion.

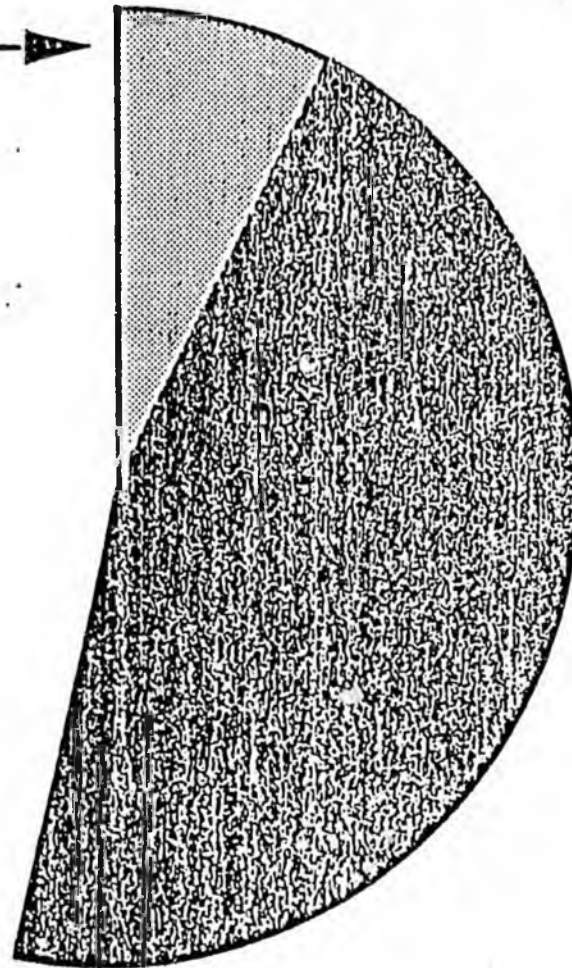
Amoco's net income for 1988 totaled \$2.06 billion, or \$8.01 a share, a 52% increase from \$1.36 billion, or \$5.31 a share, a year earlier. Revenue increased 6.6%, to \$23.93 billion from \$22.46 billion.

1/24/89

Chart 3

How Much Money Do The Oil Companies Reinvest in Alaska?

Reinvested in Alaska
(Per Barrel)
\$.96



Removed from Alaska
(Per Barrel)
\$5.46

Attachment 7

ALASKAN OIL IS VITAL TO NORTHWEST

Oil from Alaska is vital to the Pacific Northwest's economy.

Between 1980 and 1986, over \$10 billion was spent nationwide on oil activities for Alaska's North Slope. Of that, more than one billion dollars was spent in the Seattle, Tacoma and Portland areas.

From 1970 to 1975, the volume of cargo passing through the ports in Washington bound for Alaska tripled.

Virtually all members of Washington's congressional delegation are undecided about their position on oil exploration of the Coastal Plain of Alaska's Arctic National Wildlife Refuge (ANWR).

Congress is expected to decide this year whether to open ANWR to oil exploration and development or designate it a wilderness area.

OIL DEVELOPMENT IN ALASKA BENEFITS EVERY STATE IN U.S.

Oil development on the Coastal Plain of Alaska's Arctic National Wildlife Refuge (ANWR) could provide economic benefits to all 50 states.

Since 1974, companies operating in Alaska's North Slope oil fields have pumped more than \$36 billion into oil development which has impacted every state.

Between 1980 and 1986, North Slope development accounted for approximately \$10.5 billion in hard goods alone, according to North Slope producers ARCO Alaska, Inc., Standard Alaska Production Company and Conoco. An additional \$7 billion was spent on labor and engineering and design services.

ANWR development is expected to generate tens of thousands of new jobs

across the nation, according to Resource Development Council president Joseph Henri. As many as 250,000 jobs could be created by the year 2005, producing over \$6 billion in annual salaries. Development of the Coastal Plain has the potential to enable the North Slope to continue providing an alternative to imported oil.

On the eve of the 1973 Arab oil embargo, the U.S. was importing 35 percent of its oil. Today, imports represent 45.6 percent of the nation's total consumption.

However, imports are expected to reach 52 to 53 percent of the country's total oil supply by the year 2000, according to the American Legislative Exchange Council.

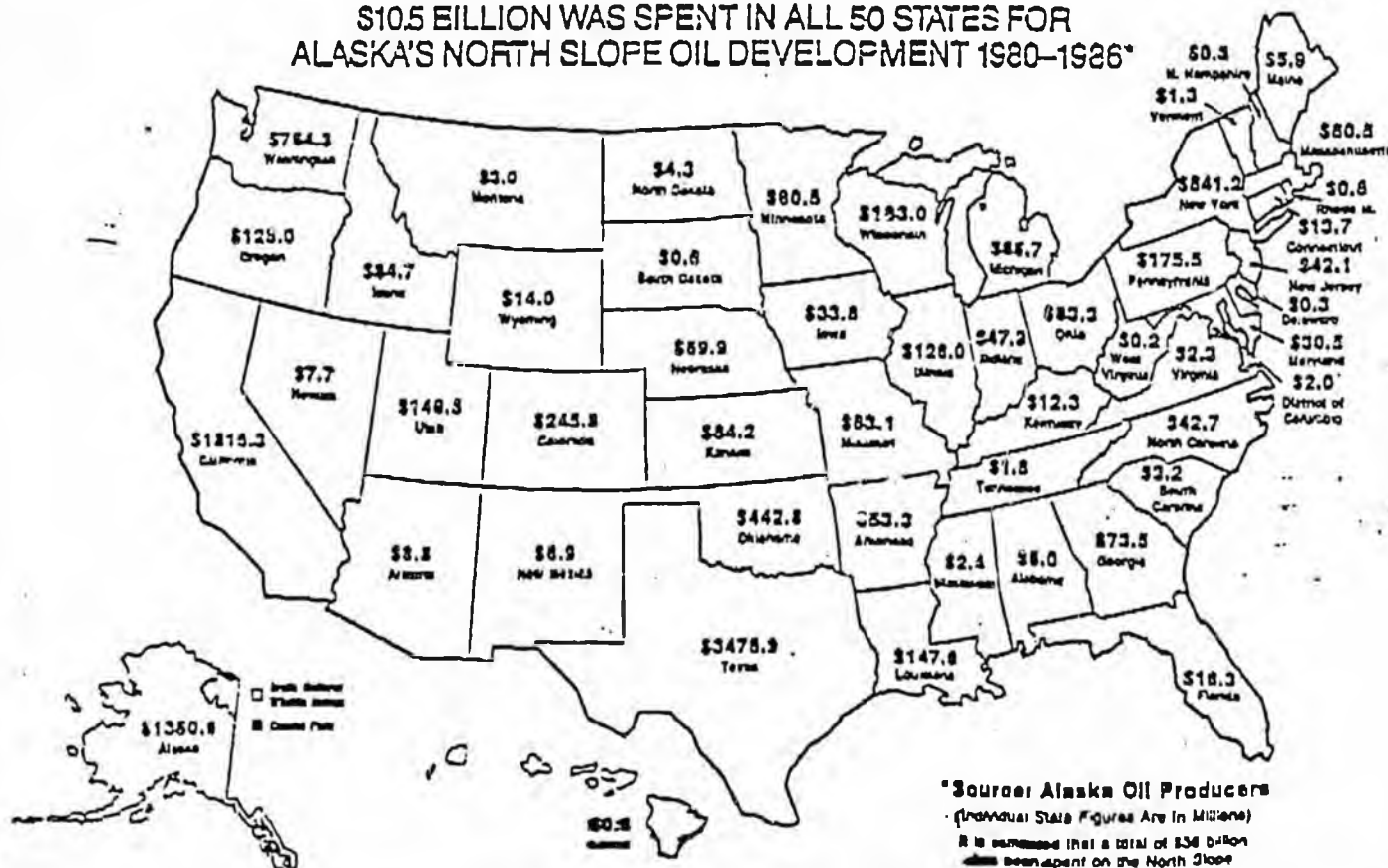
Even exploration of

ANWR's Coastal Plain were to begin immediately, actual oil production on the Coastal Plain could not take place until close to the year 2000. Such long lead times are dictated by the remoteness of the area, arctic weather conditions, regulatory requirements and insuring that development is compatible with the natural environment.

Even while oil exploration and development declined in the U.S. in 1986, consumer demand for oil has increased. This situation has resulted in a rise in imported oil of one million barrels a day.

U.S. domestic production fell by more than nine percent in 1986, while consumer demand increased by three percent, says the American Legislative Exchange Council.

\$10.5 BILLION WAS SPENT IN ALL 50 STATES FOR ALASKA'S NORTH SLOPE OIL DEVELOPMENT 1980-1986*



Attachment 9

Jobs from a Small Offshore Oilfield

I. Exploration

Drilling	285
Island Construction	480
Transportation Support	150
Base Camp	<u>150</u>
Total	1065

II. Development

Drilling	300
Island Construction	480
Transportation Support	75
Base Camp	<u>240</u>
Total	1095

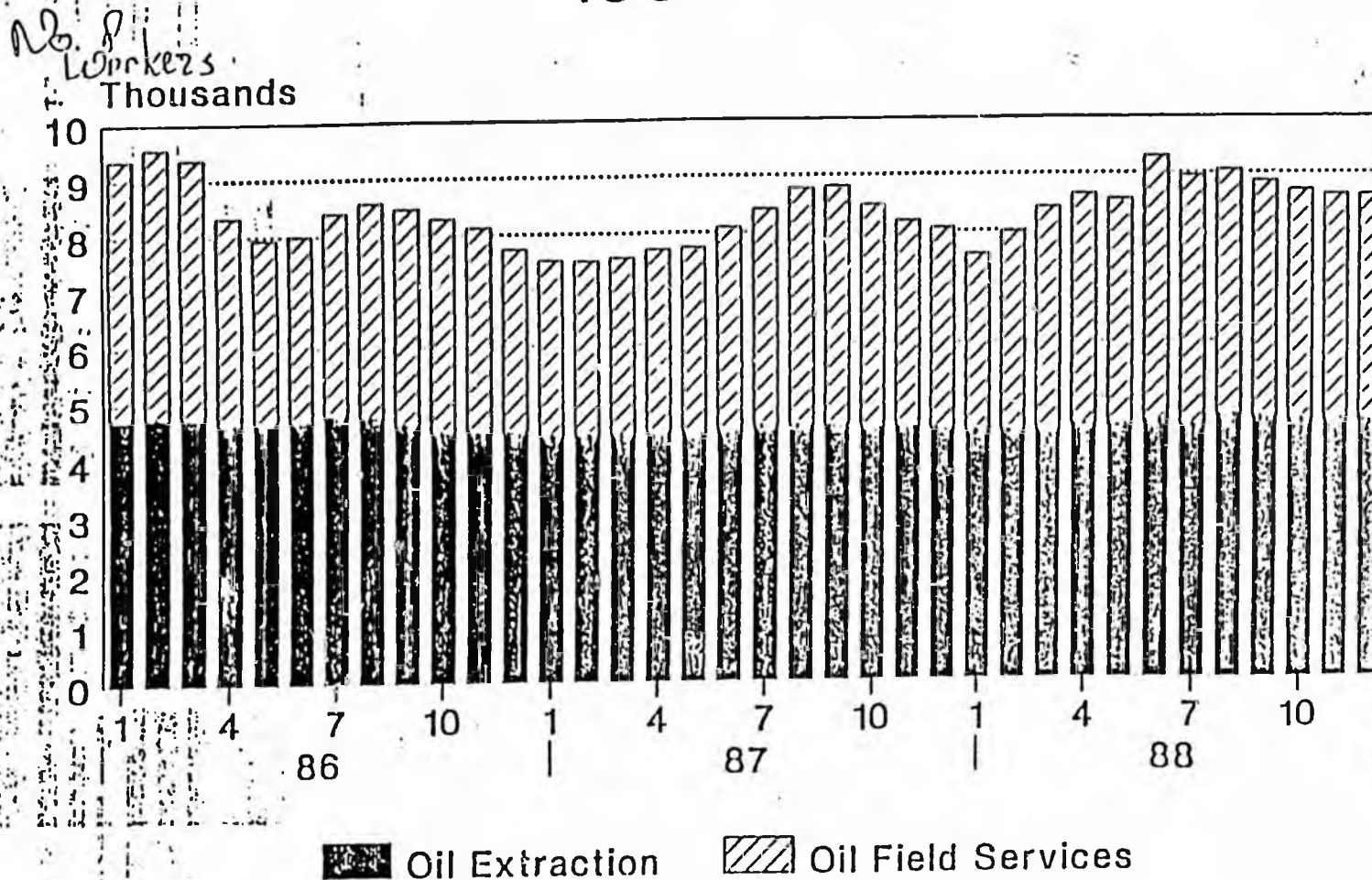
III. Production

Production	450
Island Maintenance	330
Transportation Support	75
Base Camp	240
Pipeline Maintenance	<u>75</u>
Total	1170

Assumes two twelve hour shifts with a two week on / one week off rotation.

Source: Abstracted from Han-Padron Associates, Beaufort Sea Petroleum Technology Assessment, Technical Report No. 112, prepared for Minerals Management Service, Alaska Outer Continental Shelf Region, Leasing and Environment Office, Social and Economic Studies Unit, March 1985.

Alaska Oil Industry Employment 1986-1988



Source: Alaska Dept. of Labor
BLS 790 Survey

ANSWERS TO QUESTIONS

BP EXPLORATION (ALASKA), INC.



BP EXPLORATION

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February 22, 1989

Representative Cliff Davidson, Co-Chair
Representative Curt Menard, Co-Chair
House Resources Committee
Alaska State Legislature
Pouch V
Juneau, AK 99811

Re: Your "ELF Questions"

Dear Representatives Davidson and Menard:

Set out below are the 26 questions regarding the ELF that you distributed at your Committee's hearing on House Bill No. 118 on February 10, 1989. Following each question is BP Exploration's answer.

(1) The ELF is designed to provide production incentives for wells in "marginal" oil fields. Which oil fields are considered "marginal" in Alaska?

Answer: The question misstates the purpose and function of the ELF. The ELF was designed to provide incentives for the full development of all fields. It does this by adjusting the tax rate for each field so that it is based on that field's own degree of profitability. As a profitable field starts becoming marginal, the ELF automatically responds by lowering the tax rate; but while the field is very profitable, the ELF keeps the tax rate high.

The idea behind the ELF is simple -- the more profitable a field is, the more tax it can afford to pay. Although it looks complicated, the ELF formula simply asks what percentage of the current production from a field is needed to cover the basic costs of getting that production out of the ground. The rest of the production is treated as representing profit. The larger the percentage of profit, the more tax the field can afford to pay. Thus, the larger the percentage of production that is deemed to represent profit, the higher the ELF is. In fact, for gas the ELF is precisely equal to this percentage of deemed profit. The

oil ELF formula is similar, except that the percentage is modified somewhat by the present exponent.

Every field eventually becomes marginal. Usually this is a very gradual process, instead of one that happens over night. There is no identifiable point at which a field suddenly becomes "marginal." Thus, to the extent one sees the ELF to be "designed to provide production incentives for wells in 'marginal' fields," the ELF provides such incentives for every field in Alaska.

(2) How many barrels per day are extracted from the most productive oil field in Alaska that will be allowed tax cuts under this ELF bill?

Answer: By "this ELF bill" in this and other questions you have posed, we assume you mean House Bill No. 118. As you have been told, the present formula in HB 118 is flawed and does not work the way it has been described as working. However, it appears that the formula in HB 118 -- whether it stays as written or whether it is corrected to work as intended -- would reduce the rate of production tax for the Endicott field because the ELF for Endicott is currently being "rounded" to one. According to data provided by the Administration to your Committee, Endicott produced an average of 98,099 barrels a day during November 1988.

(3) How many barrels per day are extracted from Prudhoe Bay? from Kuparuk?

Answer: According to the same data provided by the Administration for November 1988, Prudhoe Bay produced 1,526,932 barrels a day that month and Kuparuk River produced 320,685 barrels a day.

(4) How many barrels per day are extracted from wells in the most productive oil fields in the various lower 48 states? What is the greatest barrels-per-day extraction considered marginal and provided tax cuts for production incentive in the various lower 48 states?

Answer: BP does not have extensive holdings in the Lower 48 states and therefore does not have direct, first hand information available to answer these questions.

(5. Which oil companies have the greatest lease interests in Prudhoe Bay and Kuparuk oil fields and what is the percentage of their lease interests?

Answer: Both Prudhoe Bay and Kuparuk River have been unitized, and hence each company's working interest in either field is

determined under the unit agreement for that field. The following shows each company's present working interest in each field.

	<u>Prudhoe Bay</u>		<u>Kuparuk River</u>
	<u>Oil Rim</u>	<u>Gas Cap</u>	
BP Exploration	50.6848339%	13.8398950%	38.756%
ARCO	21.7799635	42.5649413	56.301
Exxon	21.7776490	42.5647901	0.218
Mobil	1.8915771	0.2843666	0.366
Phillips	1.8805235	0.2629370	--
Chevron	0.6717745	0.4830700	0.109
Texaco	0.5484215	--	--
Amerada Hess	0.5379191	--	--
Shell	0.1375744	--	--
Marathon	0.0499044	--	--
Louisiana Land	0.0397591	--	--
Unocal	--	--	4.250

(6) Oil Companies: How much oil did you extract world wide in 1976? How much of that was from Alaska? (Prudhoe Bay?)

Answer: BP had worldwide oil production of 3.5 million barrels a day in 1976. The Standard Oil Company (SOHIO) produced 41,927 barrels a day worldwide in 1976. BP and SOHIO had no commercial production in Alaska in 1976. The Prudhoe Bay field came into production in June 1977.

(7) Oil Companies: How much oil did you extract world wide in 1988? How much of that was from Alaska? (Prudhoe Bay?)

Answer: BP had worldwide oil production of 1.45 million barrels a day in 1988, of which 0.86 million barrels a day was from Alaska.

(8) Which oil fields will receive tax breaks from this ELF bill? Which oil fields will receive tax increases from this ELF bill?

Answer: It appears that HB 118 is intended to reduce taxes for the Endicott and Lisburne fields. It also appears that the bill is intended to increase substantially the production tax for the Prudhoe Bay and Kuparuk River fields. Intended or not, HB 118 would increase the tax for Milne Point, which was zero when the field was shut in. The rate for Milne Point would be low under HB 118, but it would not be zero. No other producing oil fields

would be affected because the present ELF already reduces their effective tax rate to zero.

(9) Can the ELF raise the amount that would be paid for severance taxes above the statutory nominal rate of 15% for any oil field or any oil company? So this ELF bill can't do this either, right?

Answer: Wrong. HB 118 would increase the tax rate for fields as they get larger. So if a 1,000 barrel-a-day well were drilled in a 100,000 barrel-a-day field, that well would increase the rate of tax on the first 100,000 barrels a day as well as increase it for its own additional production. The effective rate of tax on the new production from this well could easily exceed the nominal statutory rate of 15 percent.

The following example illustrates this negative effect of HB 118. Suppose a field produces 100,000 barrels a day from 100 wells, and the wellhead price of the oil is \$7.00 a barrel. The State has a one-eighth royalty in the production. Suppose a new well can be drilled, and it will produce 1,000 barrels a day. Under the ELF formula in HB 118, the tax on the present production of 100,000 barrels a day would be \$1,418,644 a month (30 days). If the 101st well were drilled and produced 1,000 barrels a day, the value of the additional taxable production would be \$183,750 a month. The tax on 101,000 barrels a day would be \$1,447,312 for the month. This is an increase of \$28,668 in tax for an extra \$183,750 worth of taxable production, giving an effective tax rate of 15.60 percent. Here are the details of these calculations.

TAX ON EXISTING PRODUCTION (100 wells)

$$\begin{aligned} \text{"A"} &= (1 - [\text{PEL}/\text{TP}]) & \text{"B"} &= [150,000 / (\text{TP}/\text{Days})] \\ &= (1 - [(300 \times 100) / 100,000]) & &= [150,000 / (100,000)] \\ &= 0.700000 & &= 1.500000 \end{aligned}$$

$$\begin{aligned} \text{"C"} &= [(460 \times \text{WD}) / \text{PEL}] \\ &= [(460 \times \text{WD}) / (300 \times \text{WD})] \\ &= [460 / 300] \\ &= 1.533333 \end{aligned}$$

$$\begin{aligned} \text{ELF} &= \text{A}^{\text{B}^{\text{C}}} \\ &= 0.700000^{(1.500000^{1.533333})} \\ &= 0.700000^{(1.862115)} \\ &= 0.514701 \end{aligned}$$

$$\begin{aligned}\text{Tax} &= (7/8) * (100,000 \text{ B/D}) * (30 \text{ days}) * (\$7.00) * (\text{ELF}) * (15\%) \\ &= \$1,418,644\end{aligned}$$

TAX WITH 101 WELLS PRODUCING

$$\begin{aligned}\text{"A"} &= (1 - [\text{PEL}/\text{TP}]) & \text{"B"} &= [150,000 / (\text{TP}/\text{Days})] \\ &= (1 - [(300 * 101) / 101,000]) & &= [150,000 / (101,000)] \\ &= 0.700000 & &= 1.485149\end{aligned}$$

$$\begin{aligned}\text{"C"} &= [(460 * \text{WD}) / \text{PEL}] \\ &= [(460 * \text{WD}) / (300 * \text{WD})] \\ &= [460 / 300] \\ &= 1.533333\end{aligned}$$

$$\begin{aligned}\text{ELF} &= \text{A}^{(\text{B} * \text{C})} \\ &= 0.700000^{(1.485149 * 1.533333)} \\ &= 0.700000^{(1.833920)} \\ &= 0.519903\end{aligned}$$

$$\begin{aligned}\text{Tax} &= (7/8) * (101,000 \text{ B/D}) * (30 \text{ days}) * (\$7.00) * (\text{ELF}) * (15\%) \\ &= \$1,447,312\end{aligned}$$

EFFECTIVE TAX RATE ON THE ADDITIONAL 1,000 B/D PRODUCTION

$$\begin{aligned}\text{Rate} &= (\text{Change in Tax}) / (\text{Value of Additional Taxable Production}) \\ &= (\$1,447,312 - \$1,418,644) / [(7/8) * (\$7.00) * (1,000) * (30)] \\ &= (\$28,668) / (\$183,750) \\ &= 15.60\%\end{aligned}$$

(10) Will this ELF bill raise the rate that would be paid for severance taxes for Prudhoe Bay above the rate that was paid by oil companies at Prudhoe Bay prior to June 20, 1987?

Answer: Yes, for new production that is added by further development of the field, the effective rate of tax under HB 118 could exceed the 15% rate that was in effect prior to June 20, 1987. The answer to the preceding question applies here. The following hypothetical case illustrates how, for example, the effective tax rate could be 15.04% on additional production from Prudhoe Bay.

Suppose it is some time in the future and Prudhoe Bay is in its decline, producing 1,400,000 barrels a day from 700 wells. To offset the decline partially, another well could be drilled that would produce 2,000 barrels a day. The wellhead price is \$7.00 a barrel, and the State has a 1/8 royalty.

TAX ON PRODUCTION WITHOUT THE 701st WELL (1.4 MMB/D)

$$\begin{aligned} \text{"A"} &= (1 - [\text{PEL}/\text{TP}]) & \text{"B"} &= [150,000 / (\text{TP}/\text{Days})] \\ &= (1 - [300 \cdot 700 / 1,400,000]) & &= [150,000 / 1,400,000] \\ &= 0.850000 & &= 0.107142 \end{aligned}$$

$$\begin{aligned} \text{"C"} &= [(460 \cdot \text{WD}) / \text{PEL}] \\ &= [(460 \cdot \text{WD}) / (300 \cdot \text{WD})] \\ &= [460 / 300] \\ &= 1.533333 \end{aligned}$$

$$\begin{aligned} \text{ELF} &= \text{A}^{\text{B}^{\text{C}}} \\ &= 0.850000^{(0.107142^{1.533333})} \\ &= 0.850000^{(0.032554)} \\ &= 0.994723 \end{aligned}$$

$$\begin{aligned} \text{Tax} &= (7/8) \cdot (\$7.00) \cdot (1,400,000 \text{ B/D}) \cdot (30 \text{ days}) \cdot (\text{ELF}) \cdot (15\%) \\ &= \$38,383,884 \text{ per month} \end{aligned}$$

TAX WITH 701 WELLS PRODUCING (1.402 MMB/D)

$$\begin{aligned} \text{"A"} &= (1 - [\text{PEL}/\text{TP}]) & \text{"B"} &= [150,000 / (\text{TP}/\text{Days})] \\ &= (1 - [300 \cdot 701 / 1,402,000]) & &= [150,000 / 1,402,000] \\ &= 0.850000 & &= 0.106990 \end{aligned}$$

$$\begin{aligned} \text{"C"} &= [(460 \cdot \text{WD}) / \text{PEL}] \\ &= [(460 \cdot \text{WD}) / (300 \cdot \text{WD})] \\ &= [460 / 300] \\ &= 1.533333 \end{aligned}$$

$$\begin{aligned} \text{ELF} &= \text{A}^{\text{B}^{\text{C}}} \\ &= 0.850000^{(0.106990^{1.533333})} \\ &= 0.850000^{(0.032483)} \\ &= 0.994735 \end{aligned}$$

$$\begin{aligned} \text{Tax} &= (7/8) \cdot (\$7.00) \cdot (1,420,000 \text{ B/D}) \cdot (30 \text{ days}) \cdot (\text{ELF}) \cdot (15\%) \\ &= \$38,439,163 \text{ per month} \end{aligned}$$

EFFECTIVE TAX RATE ON PRODUCTION FROM THE 701st WELL

$$\begin{aligned} \text{Rate} &= (\text{Change in Tax}) / (\text{Value of Additional Taxable Production}) \\ &= (\$38,439,163 - \$38,383,884) / ((7/8) \cdot \$7.00 \cdot 2,000 \cdot 30) \\ &= (\$55,279) / (\$367,500) \\ &= 15.04\% \end{aligned}$$

(11) How much is being paid to the State of Alaska in severance taxes each year?

Answer: According to the Alaska Department of Revenue's latest revenue forecast, the following severance taxes have been paid to the State of Alaska since FY 82 (in millions of dollars):

FY82	\$1,581.7
FY83	1,493.7
FY84	1,393.1
FY85	1,389.4
FY86	1,108.4
FY87	648.5
FY88	818.7

Under the "Mid Case Scenario" in that forecast, severance taxes this fiscal year (FY 89) will be \$547.35 million, and next year will be \$484.47 million.

(12) How does the amount that Alaska receives in severance taxes compare to the amount that other oil-producing states and nations receive? How much would the fields in the lower 48 pay if they were placed under the Alaska tax structure?

Answer: Among oil-producing states, only Louisiana has a severance tax rate approaching Alaska's base rates of 12.25 and 15 percent.

Comparisons between Alaska and oil-producing nations are inappropriate for several reasons. First, foreign nations have greater sovereign powers than Alaska has, and their institutions regarding the ownership of property and natural resources often vary considerably from those in the United States and Alaska.

Second, foreign nations often grant concessions to large areas of land, instead of making it available in much smaller, leased parcels as Alaska does.

Third, the regime in many foreign nations allows the oil company to recover its exploration costs and some or all of its development costs before the host government starts taking its share. This is very different from leasing on a bonus-bid basis, which has been the method primarily used by Alaska.

Fourth, the lifting costs for Alaskan oil, particularly on the North Slope, are significantly higher than for large fields in many other countries. In addition, in none of the foreign countries does the oil have to be transported over 800 miles by pipeline to an ocean port. Moreover, unlike foreign oil, Alaskan North Slope production must go only to U.S. ports, which means more expensive Jones Act tankers have to be used instead of low-

cost foreign-flag ships. This combination of greater costs of producing and transporting the oil to market makes it extremely difficult to draw any meaningful comparisons between Alaskan oil and that of the foreign nations you seem to be referring to.

(13) Oil Companies: Do you have North Sea production? If so, what percent of the total economic rent to you realize from your Alaska production and what percent do you realize from your North Sea production?

Answer: To compare Alaska with the North Sea at any given moment is like taking a single frame from Gone with the Wind and a frame from Star Wars and asking which is the better movie. You have to know the whole story before any meaningful comparison can be made.

In the North Sea, the oil company gets to recover its costs of exploring and developing the resource, before the high tax rate begins. Depending on whether these costs have been recovered or not, the government's share of the "economic rent" is either very small or very large.

The most nearly comparable situation in Alaska is its net profits share leases. Under those leases, the State's net profits share does not start to be paid until the lessee has recovered its developments costs, plus a reasonable rate of return on its investment. The rate of return was specified by the State when it put the lease up for bid. For one lease at Endicott, SOHIO and three Alaska Native Regional Corporations bid a net profits share of over 79% for the State. Once the development costs and return are recovered, the State's share of the "economic rent" from this lease will be very comparable to that of the United Kingdom for properties in the North Sea that have similarly paid off their investments.

(14) Oil Companies: How much profit is being made off of the most productive oil fields in the lower 48 states?

Answer: Because BP's interests in the Lower 48 are somewhat limited, we are unable to answer this question.

(15) Oil Companies: How much profit is being made off of the most productive oil fields in other oil-producing countries?

Answer: Either BP does not have access to this information, or if it does, the information is proprietary.

(16) - (18) - How much profit is being made off of Prudhoe Bay and Kuparuk oil fields each day?

Does this include TAPS? If not, what is the profit on TAPS?

What public sources corroborate this? Would you provide materials proving this? Would you provide a detailed list of your revenues and expenses?

Answers: The State of Alaska's most recent revenue forecast is the Department of Revenue's Revenue Sources - Fall 1988 dated December 16, 1988 (hereinafter cited as Revenue Sources). The "Mid Case Scenario" in that forecast assumes an average wellhead value of \$7.36 a barrel on the North Slope during FY 89 (Revenue Sources, p. 21). It also assumes production will average 1.97 million barrels a day (id.), or 719.05 million barrels during the year. The following table shows the potential production profits from the North Slope based on an average wellhead price of \$7.36 a barrel.

	<u>\$ millions</u>	<u>\$/barrel</u>	
Total Revenue	5,292.2	7.36	
Production Costs	(2,158.0)	(3.00)*	
Net Revenue	<u>3,134.2</u>	<u>4.36</u>	100%
To Alaskan Government			
Royalty - Unrestricted	469.8	0.65	
Royalty - Perm. Fund	178.7	0.25	
Production Tax	547.4	0.76	
Property Tax	214.0	0.30	
Income Tax	<u>111.8</u>	<u>0.16</u>	
TOTAL	1,521.7	2.12	49%
To Federal Government	548.2	0.76	17%
To Industry	1,064.2	1.48	34%

* See the discussion in the first two full paragraphs on the next page.

This is how the numbers in the table have been calculated. In the first line, the \$7.36 figure is taken from Revenue Sources, page 21 ("Wellhead Value" - "Mid" case). The yearly figure of

\$5,292.2 million equals \$7.36 a barrel times the annual production of 719.05 million barrels.

The information in the second line is based on BP Exploration's audited financial statements for 1988. The composite production cost is for depreciation and lifting expenses; it was \$3.43 a barrel for our working-interest oil on the North Slope. (The figure of \$3.39 that was previously given to your Committee represented our actual cost experience through only the first 11 months of 1988.) We are enclosing a copy of a letter from our independent auditors, Ernst & Whinney, confirming the \$3.43 figure in our financial statements for these costs during 1988.

These production costs are not borne by the State's royalty interest; hence, in grossing up to the annual production cost figure in the table above, we have multiplied \$3.43 a barrel times 7/8 of 719.05 million barrels. When these costs are averaged over 8/8 of production, the average cost is \$3.00 per barrel (\$2,158.0 million divided by 719.05 million barrels). The table previously provided to your Committee erroneously deducted a per-barrel cost of \$3.39 for the working-interest barrels, as if it had been the cost per barrel for 100% of the production.

The data in the third line (Net Revenue) are obtained by combining lines one and two.

The figure of \$469.8 million for unrestricted royalty revenue is taken from Revenue Sources, p. 24 ("Mid" case). The per-barrel amount is found by dividing by the annual production of 719.05 million barrels.

The figure of \$178.7 million for royalties contributed to the Permanent Fund is taken from Revenue Sources, p. 39, column 18 ("Perm Fund Contri"). Again, the per-barrel amount is found by dividing by the annual production figure.

The figure of \$547.4 million for production tax is taken from Revenue Sources, p. 24 ("Mid" case for "Severance Tax"). Dividing by 719.05 million barrels yields the per-barrel amount in our table.

The figure of \$214.0 million for property tax equals 20 mills times our estimate for the 1989 assessed value of property taxed under AS 43.56 within the North Slope Borough, excluding the Trans Alaska Pipeline System (TAPS). The actual assessment roll will not be issued by the assessor until March 1, 1989. Dividing by 719.05 million barrels equals the per-barrel amount.

Next is the corporate income tax on the industry. Taxable Alaskan income is determined by a modified three-factor formula under AS 43.02.072, based on the ratios of Alaskan property, sales and production to worldwide property, sales and production. We have compared our apportioned Alaskan income under the modified formula, using first the factors including our interest in TAPS, and then without TAPS. Based on this analysis and on public information about Arco and Exxon, we estimate that about 14%, or nearly one seventh, of the taxable Alaskan income is attributable to the inclusion of TAPS in the companies' apportionment factors. This reflects the heavy emphasis on production under the modified apportionment formula in AS 43.20.072.

The Department of Revenue predicts a total of \$130.0 million in petroleum income tax for this fiscal year; Revenue Sources, p. 24 ("Mid" case for "Corporate Petroleum" tax). Deducting 14% of this, or \$18.2 million, as income tax due to TAPS leaves us with \$111.8 million as the portion of the petroleum income tax attributable to production. This \$111.8 million figure is the one in our table above. Dividing it by 719.05 million barrels equals the per-barrel amount.

The data for the total paid to Alaskan government are the totals for the data for unrestricted royalty, royalty contributed to the Permanent Fund, production tax, property tax and income tax.

The federal income tax of \$542.0 million is computed by applying the tax rate of 34 percent to the difference between the net production revenue of \$3,134.2 million and the total payments to the State of Alaska of \$1,539.9 million. The per-barrel amount is found by dividing by the amount of annual production.

The difference between net revenue and the total paid to the State of Alaska and the federal government equals the amount that goes to the industry and its shareholders.

The figures in the table above do not include TAPS. HB 118 is a production tax proposal. The figures above represent production revenues and costs.

Income attributable to Alaskan pipeline activity is already being taxed under the corporate income tax, using a specially modified two-factor or three-factor apportionment formula under AS 43.20.-072. The number of factors in the formula depends on whether the pipeline company or any of its affiliates produces oil or gas in Alaska. We might add that TAPS profits are limited by the TAPS tariff settlement.

(19) How much profit is made from refined products from Alaskan oil?

Answer: BP refines a relatively small percentage of its Alaska North Slope (ANS) oil because most of its refining capacity in the United States cannot accommodate large amounts of ANS. The rest is either sold outright to third parties or is exchanged for other crude, which may then be refined or further exchanged for crude that can be run in the refineries.

BP has no refineries in Alaska, yet part of its refining profit is apportioned to Alaska and taxed under the modified apportionment formula in AS 43.20.072.

(20) What did the oil companies of Prudhoe Bay do with the savings made as a result of the tax break occurring on June 20, 1987?

Answer: We do not agree that the expiration of the 10-year rounding rule for Prudhoe Bay was a "tax break."

Substantial amounts of new capital were invested in Alaska both before the rounding rule expired for Prudhoe Bay and afterwards. Within the space of 12 months in 1986 and 1987, approximately \$3 billion worth of new facilities were installed at Endicott, Lisburne and the central gas facility at Prudhoe Bay. Those investments were justified in part because of the anticipation that the State would not change the rules of the game and the "rounding" rule would expire as scheduled.

Since 1987 the industry has continued to make major expenditures for the continued drilling and development of the North Slope. Without the drilling of new wells and the workovers of existing ones, production from Prudhoe Bay would already be in serious decline. If these activities were to be discontinued today, the repercussions could start being felt in as little as 60 to 90 days. The decline would not only set in sooner than it needs to, but it would also be faster than it would be if drilling and workover work can continue unabated.

(21) What percent of money grossed by Alaska's oil in Prudhoe Bay and Kuparuk is reinvested in Alaska? How much is sent outside?

Answer: As stated in the answer to the preceding question, major new investments in the development of the North Slope have continued to be made. Some \$3 billion dollars of investment came on line within a single 12 month period ended in late 1987. This

was despite the fact that SOHIO's entire "upstream" net operating income (before interest, income tax and extraordinary item) reported to its shareholders for 1986 was only \$13 million -- a figure that included both the North Slope and Lower 48 operations. These continued investments have added a billion barrels to the reserves that can be recovered, and have increased production by some 200,000 barrels a day, allowing Alaska to overtake Texas for first place as the nation's largest oil-producing state. All other major oil-producing states were reporting significant declines in production during the same time as Alaska's was increasing.

Your question seems to suggest that there is something wrong if profits from Alaskan operations are not all reinvested back into Alaska. It is worth remembering that the industry's investment in Alaska -- which exceeds \$25 billion to date -- came primarily from "outside" funds.

(22) How many jobs are involved in starting up a small oil field? How many jobs are involved in maintaining a small field?

Answer: That depends partly on what you mean by "small." For the Endicott field, employment on the North Slope during construction peaked at approximately 725 jobs, not including indirect support positions in Anchorage or Fairbanks. Of these construction jobs, 95% went to Alaskans.

The number of people operating the Endicott field varies seasonally from a low of about 205 in winter to a high of about 235 in summer. The winter figure includes 103 employees of BP Exploration, 39 employees of contractors, and 63 in the drilling rig crew. All of these positions are on the North Slope, and do not include any support personnel in Anchorage.

(23) How many Alaskans were employed by the oil companies of Prudhoe Bay prior to June 20, 1987 when the tax cut kicked in? How many Alaskans are employed by the oil companies of Prudhoe Bay now?

Answer: As of June 15, 1987 (the last payroll date before June 20, 1987) Standard Alaska Production Company had 1,333 full-time people and 16 part-time people on its payroll. Contract employees at that time totaled 259.

As of January 31, 1989 BP Exploration had 1,380 full-time and two part-time employees, plus 350 contract employees.

(24) What is the long-term effect on Alaskan jobs in Prudhoe Bay and Kuparuk oil fields as a result of this ELF bill?

Answer: The long-term effect will probably be a reduction in the number of Alaskan jobs, as the ELF bill will make various development projects at Prudhoe Bay and Kuparuk River too expensive for the companies to afford. The number of missed opportunities at Prudhoe and Kuparuk because of HB 118 is likely to be greater than any opportunities in "marginal" fields elsewhere that HB 118 might stimulate. Frankly, we doubt that HB 118 will stimulate any new development of "marginal" fields -- the Administration's statement that HB 118 will lower the threshold oil price for a new "marginal" field by \$2 a barrel is exceedingly doubtful. On the one hand the Administration says that HB 118 will not affect development of the large fields, but on the other hand it says HB 118 will significantly encourage the development of small ones. They can't have it both ways -- either HB 118 will affect development, or it will not. If it does affect development, it will adversely affect those fields where the tax would increase. The Committee should request the Administration to provide the back-up for its figure, because of the inconsistency in the Administration's position on the face of it.

(25) How many Alaskans are employed by the oil companies of the marginal oil fields now? How many Alaskans are likely to be employed by the oil companies of existing marginal oil fields and in developing other oil fields as a result of this ELF bill?

Answer: As stated in response to Question 22, BP Exploration employs about 205 to 235 people at Endicott.

The Eileen (West End) Project in Prudhoe Bay is nominally slated to have 72 oil production wells and four gas injection wells. Two rigs (Alaska United Drilling's rig #2 and rig #3) began drilling 36 of these wells in 1988. This project was a pioneer in the "mini-module" approach to North Slope production facilities. While Eileen's mini-modules were fabricated Outside and trucked to Alaska, the success of this design has led to the in-state fabrication of mini-modules for the Hurl State Project, also at Prudhoe. Contracts were let to Alaskan contractors in Anchorage and Fairbanks for over 180,000 man-hours of work, creating more than 350 temporary construction jobs. Some 16 oil production wells and four water injection wells are planned for Hurl State, with drilling currently planned to begin in the third quarter of 1989 and be completed late next year.

Plans for Niakuk have not been finalized, and we do not at this time have estimates of the likely workforce that would be involved.

With respect to the effects of this ELF bill on planned projects that BP is involved in, we foresee no additional Alaskan jobs being created as the result of HB 118. Instead, we believe it is likely that jobs that would have been created for Alaskans will not come into existence because of HB 118.

(26) What is the long-term effect on Alaskan jobs in the smaller oil fields as a result of this ELF bill?

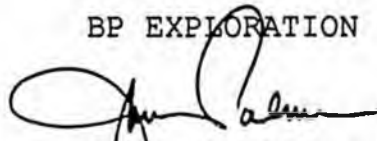
Answer: HB 118 is unlikely to cause any measurable long-term increase in the number of Alaskan jobs in smaller oil fields. As noted above, we do not believe the Administration's statement that HB 118 would lower the threshold price for developing a small field by \$2 a barrel. By relying on fieldwide production as its dominant parameter, HB 118 provides an incentive to keep small fields small. When drilling another well is going to increase the tax rate for all the oil already in production, why should the producer of even a small field want to increase production any more than necessary?

HB 118 provides a disincentive to the full development of even the small fields it purports to help, as was illustrated by the example in our answer to Question 9. This disincentive will tend to offset any incentive that HB 118 would provide through lowering the effective tax rate for small fields.

Thank you very much for this opportunity to respond to your questions. The ELF is still working the way it was intended to work. There is no need to fix it. We believe HB 118 is not necessary and is likely to prove counterproductive in terms of the public interests it seeks to advance.

Very truly yours,

BP EXPLORATION (ALASKA) INC.



James A. Palmer
Director of Government Affairs

Enclosure



Suite 601
301 W. Northern Lights Boulevard
Anchorage, Alaska 99503
907/279-1411

February 17, 1989

Representative Cliff Davidson
Co-Chairman, House Resources Committee
Representative Curt Menard
Co-Chairman, House Resources Committee
Pouch V
Interdepartmental Mail Stop 3100
Juneau, Alaska 99811

Dear Sirs:

HB 118 - ELF CHANGE LEGISLATION

We have audited, in accordance with generally accepted auditing standards, the consolidated financial statements of the BP America Inc. and subsidiaries for the year ended December 31, 1988 and will issue our report dated February 10, 1989.

The aforementioned financial statements included on a consolidated basis, the accounts of BP Exploration (Alaska) Inc., a subsidiary of BP America. Time spent by our Anchorage office on the 1988 audit of BP Exploration (Alaska) Inc. totaled some 3,000 hours.

The financial statements of BP Exploration (Alaska) Inc. included Alaskan lifting costs and field depreciation which totaled \$1042.8 million. This amount divided by BP America's share of production (delivered to Pump

Station #1) of 303.5 MMBOE results in a cost per barrel of \$3.43. These costs include BP America's share of both BP America operated fields and fields operated by others. Costs within these categories associated with the State of Alaska's royalty share are borne by the working interest parties and BP America's share is included in the \$3.43 per barrel rate.

Not included in the above costs are:

- (i) property taxes
- (ii) insurance
- (iii) severance taxes
- (iv) corporate overhead
- (v) depreciation on non-unit assets
- (vi) environmental studies

Very truly yours,

Ernst & Whinney

Delivered To: R. W. VanHook
Director of Taxes
BP Exploration (Alaska) Inc.

ANSWERS TO QUESTIONS

EXXON COMPANY USA

Exxon Company U.S.A
Response to Request for HB 118 Information

The following are provided in response to the questions posed by the House Resources Committee on February 10, 1989:

Question 1

The ELF was designed to encourage investment in "marginal" oil projects. The definition of "marginal" should relate to the profitability of a field, or projects within a field, and not to the total production from a field. Recently, some people have erroneously confused profitability with productivity. Profitability is not directly related to productivity. Crude prices, operating expenses including taxes and investments are variables that affect field profitability. As an example, although Prudhoe Bay is a profitable oil field overall, there are marginal projects within the field that cannot be pursued if HB 118 becomes law.

Question 2

HB 118 will reduce taxes for only two producing oil fields in the entire state of Alaska. The two fields that will incur a tax reduction are Endicott and Lisburne, with Endicott being the largest, averaging approximately 100 thousand barrels of oil per day in 1988. HB 118 imposes a higher production tax rate on larger fields. The average production rate per well at Prudhoe Bay during the mid-1990's is projected to be the same as at Lisburne today. However, HB 118 would impose a production tax rate on Prudhoe Bay at that point in time, which would be six times higher than on Lisburne today.

Question 3

The 1988 annual average oil production for Prudhoe Bay was 1.45 million barrels of oil per day. The January 1988 average oil production for Kuparuk was 318 thousand barrels per day.

Question 4

We do not have a readily available list of average well productions, but expect it to be highly variable, especially if offshore properties are included. Several states offer incentives for new development, tertiary projects and stripper wells. As an example, Alabama provides tax incentives for all new wells regardless of rate.

Question 5

The three major working interest owners at Prudhoe Bay are BP Exploration with 50.7% of the oil production, and ARCO and Exxon who both have 21.8%. The major Kuparuk owners are ARCO and BP Exploration with 56.3% and 38.8%, respectively.

Question 6 & 7

Exxon's 1976 worldwide net production of crude oil and natural gas liquids was 2.285 million barrels per day with virtually none of it being produced from Alaska. Exxon's 1988 worldwide net production of crude oil and natural gas liquids was 1.919 million barrels of oil per day with 356 thousand barrels extracted from our Alaska properties. Exxon's 1988 Prudhoe Bay net liquids production averaged 322 thousand barrels per day.

Question 8

HB 118 will only affect four oil fields in the entire state of Alaska that are currently producing. None of the Cook Inlet fields will be affected since

they currently pay no severance taxes. The taxes at Lisburne and Endicott will be reduced, while the taxes at PBU and Kuparuk will increase by more than 20% and 60%, respectively, during the first year. Under HB 118, the production tax rate at Prudhoe Bay during the mid-1990's is projected to be almost three times higher than under current law. Overall, HB 118 will result in a tax increase on over 90% of Alaska's oil production.

Question 9

Under current state law, the maximum tax rate that can be applied is 15% when ELF is one.

Question 10

Since mid-1981 until the end of the first ten years of production, the top rate at PBU was 15%. Under the proposed HB 118, the severance tax rate will be increased from the current 12.3% to 14.9%.

Question 11

Exxon's severance tax records are not public information and, therefore, cannot be released. However, according to the Petroleum Revenue Forecast published by the Alaska State Department of Revenue, severance tax revenue of \$818.7 million was collected in FY 1988 from petroleum operations.

Question 12 & 13

According to the Division of Policy's April 1988 Report entitled "The ELF - A Policy Perspective", only Louisiana with a tax rate of 12.5% has a higher severance tax rate than the effective tax rate at PBU under current law. If HB 118 becomes law, Alaska's taxes will increase from 12.3% to 14.9%, which will be the highest severance tax rate in the United States.

As a note, however, that a direct comparison of Alaska's severance taxes to other individual states may not be valid since each state's total tax structure can vary considerably. Similarly, attempting to compare different countries' tax structure to Alaska is not valid since you must consider the timing of the recoupment of investment and expenses, and the leasing schemes.

Section III - Profits

Certain profit information is considered confidential and, therefore, is not released. Additionally, we would refrain from releasing this information due to ongoing litigation with the state over royalty and tax dispute resolution.

The oil companies' basic purpose for being in Alaska is to earn a profit on invested funds. The profits from Alaska oil are partially reinvested in Alaska, but are also invested in other projects throughout the world. Due to this diversity of sources and uses of funds, it is not possible to say exactly where profits from one area are eventually employed. However, bear in mind that if the oil companies had not used the profits from "Outside" investments, PBU would not have been discovered or developed, FPS would not have been built, and Alaska would not have enjoyed the benefits it has derived from North Slope oil interests over the past 20 years.

Section IV - Impact on Alaskans

Since Exxon has no oil production operations in the state of Alaska, we have limited information to answer these questions. However, if the current tax structure remains, it will encourage development of future marginal projects, which will maintain jobs on the North Slope.

ANSWERS TO QUESTIONS

ARCO ALASKA, INC.

ARCO Alaska, Inc.
Tax Department
Post Office Box 100360
Anchorage, Alaska 99510
Telephone 907 265 6556



Hugh R. Motley
Vice President
General Tax Officer

February 22, 1989

Representative Curt Menard, Co-Chair
Representative Cliff Davidson, Co-Chair
House Resources Committee

Gentlemen:

In response to your request of February 10, 1989 please find attached answers to the 26 questions requested of members of the oil industry concerning House Bill 118. ARCO Alaska appreciates the opportunity to provide information to the committee and would be more than happy to assist in any way possible in the future.

Sincerely,

Hugh R. Motley
Vice President and
General Tax Officer

Attachment

February 22, 1989

Responses to House Resources Committee
ELF Questions - HB-118

Question 1: The Elf is designed to provide production incentives for wells in "marginal" oil fields. Which oil fields are considered "marginal" in Alaska?

Answer: The ELF was originally designed to provide incentives to obtain the maximum ultimate recovery from all fields in the state. It is not and was never intended to assist only projects in "marginal" fields. It works to lower the production tax rate as the daily production per well in a field declines. The less profitable the field (measured by the average production per well), the more incentive the producer receives, and therefore presumably, the more likely that new investments would be made to increase ultimate production.

In most instances, a field declines throughout its producing life and becomes "marginal" only when its profitability is very low. The reservoir must be carefully managed long before this time or parts of the reservoir will deteriorate to the point where no additional recovery will ever be economically viable. Ongoing development provides the field with a longer life and produces far more crude. But incremental recovery projects decrease in economic attractiveness as an oil field ages. The attractiveness (or marginality) of an incremental investment is the primary consideration in the decisions affecting additional development and the recovery of associated oil reserves in any oil field. If incentives were provided only near the end of a field's life, (when it is already "marginal"), it is entirely likely that enhanced recovery projects could never be undertaken.

Question 2: How many barrels per day are extracted from the most productive oil field in Alaska that will be allowed tax cuts under this ELF bill?

Answer: The most productive field in Alaska as of the end of 1988 was the Endicott field with a per well per day production of 3000 barrels. This would be one of the small fields (97 thousand barrels per day production) whose production tax burden would be decreased upon the enactment of HB-118. But a field like Kuparuk can also be only marginally profitable or as Attachment I shows might even operate at a loss. The Kuparuk field produces only 1000 barrels per

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well per day, one third that of Endicott, and yet, under HB-118, Endicott will get a reduction in its production tax and Kuparuk will get an immediate 60% increase.

Question 3: How many barrels per day are extracted from Prudhoe Bay and Kuparuk?

Answer: During December, 1988 Prudhoe Bay production was 1508.3 thousand barrels per day. Kuparuk averaged 307.2 thousand barrels per day during that same time period. This level of production, however, is only the result of significant incremental investment which included in its economic justification the application of the ELF. The incentives provided by the current ELF will allow the industry to maintain production at the highest possible rates through additional incremental investment in the future.

Question 4: How many barrels per day are extracted from wells in the most productive oil fields in the various lower 48 states? What is the greatest barrels per day extraction considered marginal and provided tax cuts for production incentive in the various lower 48 states?

Answer: The average production from any well in the lower-48 fields is significantly lower than is the average in Alaska as indicated by the figures provided by the Administration. At production levels presented, with or without a production tax burden, not one of these fields could be economically produced in Alaska. Whether any of these fields are marginal or not is dictated by many variables including operating costs, transportation costs, and eventually wellhead value. However, any well becomes more marginal as its production and therefore its relative profitability declines. None of these fields would survive a \$7.00 per barrel transportation cost.

Question 5: Which oil companies have the greatest lease interests in Prudhoe Bay and Kuparuk oil fields and what is the percentage of their lease interests?

Answer: Attachment II details ownership of Prudhoe Bay, Kuparuk and several other fields in the state. Please note that the companies which own significant pieces of Prudhoe and Kuparuk are the same companies which own substantial interests in other smaller fields.

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Question 6: Oil companies: how much did you extract world wide in 1976? How much of that was from Alaska? (Prudhoe Bay?)

Answer: ARCO production in 1976, world wide was 511.2 MBPD. ARCO's Alaska production in 1976 was 27.7 MBPD, all of which came from fields in the Cook Inlet.

Question 7: Oil Companies: How much oil did you extract world wide in 1988? How much of that was from Alaska? (Prudhoe Bay?)

Answer: In 1988, after ARCO Alaska Inc.'s investment totaled \$7.6 Billion in the State of Alaska, ARCO's production from the state was 470 MBPD with 305 MBPD of that production coming from Prudhoe Bay. ARCO's total world wide production in 1988 was 679.7 MBPD.

Question 8: Which oil fields will receive tax breaks from this ELF Bill? Which oil fields will receive tax increases from this ELF bill?

Answer: The only fields currently in operation which will have their taxes reduced are Endicott and Lisburne whose combined total production is only 135 MBPD. Prudhoe Bay and Kuparuk fields which produce 1,815 MBPD, will have their taxes increased by 40% and 160% respectively over the next ten years. Over 90% of the state's production and nearly all of the state's reserves will be burdened with additional production tax under HB-118. When the two fields that hold the vast majority of the states known reserves are burdened by more production tax, there can only be a negative impact on the ultimate recovery of the state's oil and gas resources. Almost one-half billion barrels of additional Kuparuk oil can be recovered if economics allow.

Question 9: Can the ELF raise the amount that would be paid for severance taxes above the statutory nominal rate of 15% for any oil field or any oil company? So this ELF bill can't do this either, right?

Answer: House Bill 118 would not subject the total production of a field to more than the nominal statutory rate of 15%. It could, however, subject an incremental barrel of oil produced to a

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production tax rate in excess of 15%. This result would place an onerous burden on any investment that would act to produce additional barrels of oil and can only be perceived as an incentive to keep small fields small and make big fields smaller.

Question 10: Will this ELF bill raise the rate that would be paid for severance taxes for Prudhoe Bay above the rate that was paid by oil companies at Prudhoe Bay prior to June 20, 1987?

Answer: Again, it is possible for the rate on an additional barrel produced at Prudhoe Bay to be burdened with a production tax in excess of the 15% rate. From 1981 through June 20, 1987, the "rounding rule" was applied to production at Prudhoe Bay that set its ELF at 1.0 and its production tax rate therefore at 15%. House Bill 118 would raise the rate to 14.9%. Kuparuk's rate would go from 8.4% to 13.2%.

Question 11: How much is being paid to the State of Alaska in severance taxes each year?

Answer: The fiscal year 1988 severance tax collections, based on the Alaska Department of Revenue's October, 1988 Revenue figures, were \$816.4MM.

Question 12: How does the amount that Alaska receives in severance taxes compares to the amount that other oil-producing states and nations receive? How much would the fields in the lower 48 pay if they were placed under the Alaska tax structure?

Answer: A definitive study of severance tax rates throughout the nation would be a complex task, however, based strictly on statutory rates Alaska still maintains the highest rate in the nation at 15%. ARCO's lower-48 production company, which owns and operates fields in many of the significant petroleum producing areas utilizes an average severance tax rate of 5% in its financial planning. At the production per well rates quoted by the administration in its earlier testimony none of the fields producing in other states would be economically viable in Alaska so no taxes would be paid in any case.

As the charts used by the Administration in their testimony so clearly point out, snap shot comparisons between Alaska and other

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states or oil producing nations are of questionable use. The comparisons can easily mislead and are dependent on so many variables that they are difficult to accurately quantify. For example: When the administration's bar chart comparing Alaska and Indonesia is reformatted to show percent of revenue as well as gross revenue (Attachment III), it becomes quickly evident that the State of Alaska receives a larger percentage of the available revenue from crude oil production than Indonesia receives. But this bar chart too ignores the differences in capital commitments, concessions by sovereigns, lifting costs, trade restrictions, and many other factors.

It appears that the Administration's Division of Policy best described the usefulness of the nation and state tax comparisons in 1988 in their ELF Policy Perspective when they stated "Differences like these make simplistic comparisons regarding which state has the highest or lowest severance tax of limited use".

Question 13: Oil Companies: Do you have North Sea production? If so, what percent of the total economic rent do you realize from your Alaska production and what percent do you realize from your North Sea production?

Answer: ARCO has no significant North Sea oil production and is therefore unable to adequately respond to this question.

Question 14: Oil Companies: How much profit is being made off of the most productive oil fields in the lower 48 states?

Answer: The profitability of many fields in the lower-48 is unknown to ARCO since we do not have interest in every lower-48 field. Specific profitability data of any particular field in which we have an interest is considered company confidential data and we regret that we cannot share this with you. However, no Lower-48 oil field must cope with a \$7.00 per barrel transportation burden.

Question 15: Oil Companies: How much profit is being made off of the most productive oil fields in other oil-producing countries?

Answer: ARCO Alaska Inc. does not have adequate data for international operations to provide any meaningful insights into this

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issue. We can say however, that the states documentation concerning Indonesia is very misleading because of major differences in wellhead price due to transportation and export restrictions.

Question 16: How much profit is being made off of Prudhoe Bay and Kuparuk oil fields each day?

Answer: Current public data available on the profitability of both the Prudhoe Bay and Kuparuk fields is from Barclays de Zoete Wedd, an independent London Investment House. These figures are provided on Attachment I.

Question 17: Does this include TAPS? If not, what is the profit on TAPS?

Answer: For a look at TAPS profits we would refer you to the TAPS settlement methodology to which the State of Alaska is signatory. The question of TAPS profits is, we submit, irrelevant to the issue of HB-118. The issue of taxes on transportation, which is being discussed here, is an issue that was settled in the development of the TAPS settlement. In any event, since ARCO Alaska's current North Slope production exceeds ARCO Pipeline Company's TAPS capacity, any incremental project oil is shipped through another owners pipeline capacity.

Question 18: What public sources corroborate this? Would you provide materials proving this? Would you provide a detailed list of your revenues and expenses?

Answer: These figures in Barclays de Zoete Wedd are public information and are utilized because they are public information. The public investment community are ultimately the owners of the companies in our industry and their perception as to profitability and/or the value of investments is of paramount concern to our companies. Additional detailed breakdowns of costs and revenues cannot be provided in this public forum because they are considered company confidential for competitive reasons as well as for SEC disclosure purposes.

Question 19: How much profit is made from refined products from Alaskan oil?

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Answer: Profits generated on the refining and marketing of Alaskan source oil are no more or less than those generated on similar quality crude from other sources. Crude oil, whether from an Alaskan or other source, is a commodity which is valued and traded based on quality, location and market conditions. At the same locale, any source crude oil has the same value or cost as any other source similar quality crude oil. No more refining or marketing profit is made on products refined from Alaskan source crude oil than is made on products refined from any other source similar quality crude oil.

Question 20: What did the oil companies of Prudhoe Bay do with the savings made as a result of the tax break occurring on June 20, 1987?

Answer: First as we have previously discussed, the ELF is not a tax break, it is an incentive provided to increase the ultimate amount of crude oil produced in the state. The cumulative reduction in production taxes, relative to a flat 15% rate that accrued from June, 1987 to December, 1988 was \$43MM strictly to ARCO. During that same time frame ARCO has invested \$77MM in capital at Prudhoe. This question does not address the \$3 Billion of investment that was made by the oil industry in the state during 1986 and early 1987 which was in part justified and funded in contemplation of the expiration of the "rounding rule" on Prudhoe Bay in June of 1987.

Question 21: What percent of money grossed by Alaska's oil in Prudhoe Bay and Kuparuk is reinvested in Alaska? How much money is sent outside?

Answer: More than 100% of the last three years net profits of ARCO Alaska Inc. have been reinvested in new fixed assets and exploration in Alaska (i.e. none has gone south).

Question 22: How many jobs are involved in starting up a small oil field? How many jobs are involved in maintaining a small field?

Answer: The marginal projects now being planned for the Kuparuk field over the next five years will require \$1.6 billion and 4000 man years of construction labor to complete. These new wells and facilities will require at least 40 additional operating staff, nearly as many as it takes to operate the entire Lisburne oil field.

February 22, 1989

Question 23: How many Alaskans were employed by the oil companies of Prudhoe Bay prior to June 20, 1987 when the tax cut kicked in? How many Alaskans are employed by the oil companies of Prudhoe Bay now?

Answer: As of June 20, 1987 ARCO Alaska had 2,578 employees. At the end of 1988 ARCO Alaska employed over 2,800. These figures however only show half of the picture. The number of employees has increased since the June 20, 1987 date, but of more significance is the fact that 142 of these permanent operating jobs have been created solely due to projects such as the Central Gas Facility and the Kuparuk CPF-3. (This figure does not consider the millions of man hours of construction labor that was created in establishing the facilities). These projects were intended to increase the ultimate production of Alaskan oil and gas and are exactly the type of projects the ELF was intended to stimulate. The majority of Alaskan jobs created through the operation of enhanced recovery projects are attributable to activities at Kuparuk and Prudhoe Bay, the two fields that would be most adversely impacted by the passage of HB-118.

Question 24: What is the long-term effect on Alaskan jobs in Prudhoe Bay and Kuparuk oil fields as a result of this ELF bill?

Answer: The long term impact of passage of HB-118 will be that there will be fewer jobs in Alaska. As question 23 so vividly points out, investment dollars are spent and jobs are created in the fields where the greatest likelihood of additional recovery is found. Those same investment dollars are spent and jobs created not on the basis of a fields profitability, but on the basis of the value of producing the next barrel of oil. At Prudhoe and Kuparuk, HB-118 will only make the next barrel of oil more expensive to produce and therefore it will be less likely to ever be produced. That means there will be more oil left in the ground, fewer oil industry jobs and fewer support industry jobs because there will be fewer facilities to operate.

Question 25: How many Alaskans are employed by the oil companies of the marginal oil fields now? How many Alaskans are likely to be employed by the oil companies of existing marginal oil fields and in developing other oil fields as a result of this ELF bill?

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Answer: Every Alaskan who works in the oil industry works for an oil company that owns an interest in a field where there are marginal projects that would be detrimentally effected by HB-118. The question that needs to be asked is how many jobs will be created under the current ELF that will not be created under HB-118? Enhanced recovery projects at Prudhoe and Kuparuk can provide access to additional recoverable reserves of about twice the recoverable reserves of all the other oil fields in Alaska combined. These additional projects could contribute over 400MM barrels of oil to Alaska's royalty share and would help maintain or create many Alaskan jobs. HB-118 creates an additional roadblock to justifying any of these projects.

Question 26: What is the long-term effect on Alaskan jobs in the smaller oil fields as a result of this ELF bill?

Answer: HB-118 would provide few or no new jobs anywhere in the Alaskan oil industry. More jobs exist at Prudhoe and Kuparuk than at all the other fields in Alaska combined. The negative impact of HB-118 would act to decrease activities at these fields. The long term effect would also be to decrease the number of Alaskan jobs. ARCO Alaska is a major interest owner in both large and small fields in Alaska (as defined by the Administration). These interests places us in an excellent position to assess the effects of HB-118 on jobs. **ARCO Alaska believes this bill will act to decrease the ultimate recovery of Alaskan oil and reduce the number of jobs in Alaska.**

ANS Net Revenue

	<u>Prudhoe</u> \$/bbl	<u>Kuparuk</u> \$/bbl
Assumed Crude Price	14.01	14.01
Tanker Freight	2.70	2.70
Quality Differential	0.00	0.40
TAPS Tariff	3.11	3.11
Kuparuk Pipeline	0.00	0.70
Pipeline Loss	0.10	0.10
Wellhead Price	<u>8.10</u>	<u>7.00</u>
Production Cost and Capital Recovery	<u>2.80</u>	<u>5.43</u>
Total Net Revenue	5.30	1.58
State Royalty	0.93	0.82
Severance Tax	0.89	0.54
Property Tax	0.26	0.44
State Income Tax	0.10	-0.01
Total State	<u>2.17</u>	<u>1.79</u>
Federal Income Tax	<u>1.06</u>	<u>-0.07</u>
Producer Profit	2.06	-0.14

Source:

Barclays de Zoete Wedd, September 1988

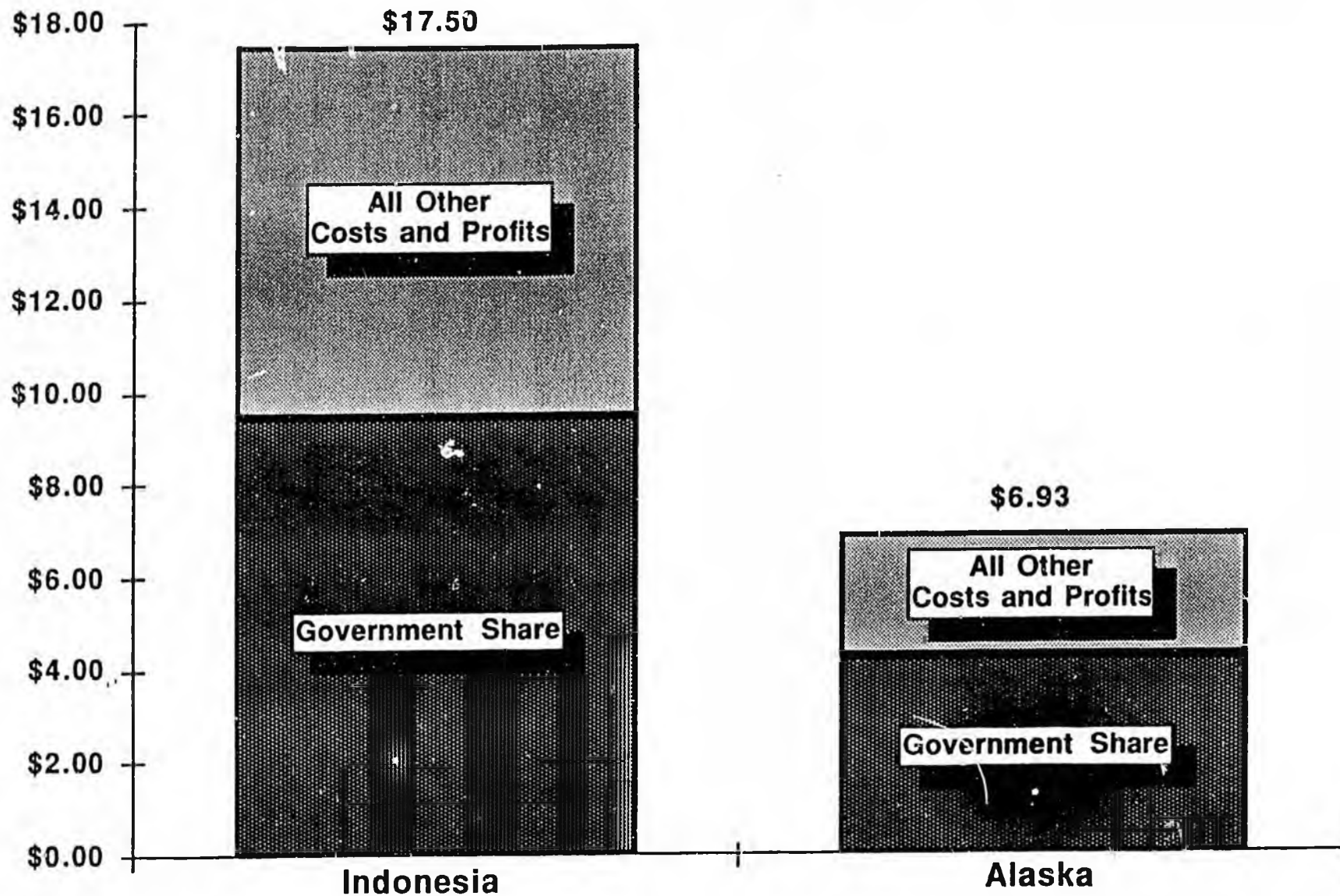
Alaska Department of Revenue October 1988

State of Alaska Royalty and Severance Methodology

APPROXIMATE WORKING INTEREST SUMMARY

Field	State Royalty	ARCO	Exxon	BP	Union	Mobil	Phillips	Chevron	Cities Service	Conoco	Other
Prudhoe (Oil)	.125000	.217800	.217776	.506848		.018916	.018805	.006718			.013137
Prudhoe (Gas)	.125000	.425649	.425648	.138399		.002844	.002629	.004831			
Kuparuk	.125000	.563010	.002180	.387560	.042500	.003660		.001090			
Lisburne	.125000	.400000	.400000	.200000							
Endicott	.140000	.000234	.210206	.567825	.105174				.104840		
Niakuk	.125000			1.000000							
Mine Point	.178250							.180000	.110000	.710000	
Pt. Thompson	.125000	.033400	.393400	.194000		.117000	.103500	.089000		.069700	
Swanson River	.161913	.484864			.015136			.484864		.015136	

Administration's Indonesia Comparison On a Dollar per Barrel Basis



Note: Refer to Administration's testimony; (\$3.1 Billion+2.0 MMBPD, compared to the ADOR wellhead value)

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REPRESENTATIVE WALT FURNACE

MEMORANDUM

TO: Representative Cliff Davidson, Co-Chairman
Representative Curt Menard, Co-Chairman
House Resources Committee

FR: Representative Walt Furnace 

DATE: Feb. 28, 1989

RE: Minority Report on HB 118

Please include with the Resource Committee's report on HB 118 the following minority report, which more fully and completely reflects my concerns about the changes to the Economic Limit Factor (ELF) under this bill.

MINORITY REPORT ON HOUSE BILL NO. 118

This bill proposes to change the statutory formula for the Economic Limit Factor (ELF) in the oil and gas properties production tax. The present ELF formula is based on a field's profitability as measured by its average production per well. The higher the profitability is, the higher the tax becomes under the present ELF. In the proposed formula, the dominant factor will be field size instead of profitability. Despite the many hours of testimony that the Committee heard on this bill, I am still concerned that a

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number of basic questions have not been answered regarding the proposed change.

Should Alaska Rely on Field Size in Computing the Tax Rate?

I am concerned that the proposed bill would create a tax incentive to keep small fields small and to make large fields smaller than they should be. The new ELF formula would make field size a factor in the exponent, where it becomes the most important factor in the formula. With this formula, if new production is added to an existing field, there will be an increase in the tax rate not only on the additional new production, but on all of the existing production as well.

In BP Exploration's letter of February 22, 1989, we were given an example of how this would occur. For a 100,000 barrel-a-day field with 100 wells, the ELF would be 0.514701 and the tax rate would be 7.72%. If another well were added with the same average daily production (1,000 barrels a day), the new ELF would be 0.519903, making the tax rate 7.80%. This does not sound like a big increase, but because the higher rate applies to all 100,000 barrels a day of the existing production as well as the additional 1,000 from the new well, the increase in tax represents 15.60% of the value of the new production. Thus, the effective tax rate on the extra production would be *twice* the rate prevailing before the well is drilled. A person does not have to understand all the intricacies of the ELF in order to understand that such a tax scheme will frustrate people's development plans and leave valuable oil in the ground that could otherwise be produced.

Will HB 118 Help Truly Marginal Fields?

The Committee received uncontradicted testimony that, in terms of the dollars paid out per dollar invested, the most profitable field in Alaska's history has been a field in Cook Inlet that never reached 120,000 barrels a day at its peak. Yet for all of this field's life, HB 118 would have reduced its tax rates from what they would be with the present ELF. This seems to be leaving something on the table that the State should not be leaving for fields that are highly profitable but which happen to be small.

The Committee was also told that the new ELF in HB 118 would help Milne Point. Again, we received uncontradicted testimony that for the last half of the time Milne Point was in production, the present ELF laws had allowed the tax rate to be reduced to zero. HB 118 would repeal the rebuttable presumption that allowed this to happen. Instead, with HB 118,

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Milne Point will always have *some* tax to pay until its average production falls below 300 barrels a day per well. Based on the \$7.36 wellhead price in the Administration's Revenue Forecast, Milne Point will pay almost \$20,000 a year in production tax under HB 118.

Are the Administration's Numbers Reliable?

I am highly disturbed by the apparent misinformation that the Administration has advanced in support of HB 118. The following examples illustrate the type of thing I mean:

1. On the first day of testimony, the Commissioner of Revenue handed out several packets of materials. One of these had as its first page a graph with the title, "The Tax Rate on Prudhoe Bay Has Dropped Sharply." The third page of that packet gives the production tax as 13.1% during the 1982-1987 period, despite the fact that it was actually 15%. You can get to a 13.1% rate only by including the State's own one-eighth royalty share of the production, but State royalty is exempt from the tax.
2. During the "debate" last Wednesday evening, Mr. Erickson said HB 118 would only cost 15 cents out of a \$15 value of the oil in Valdez. First, the tax will be more like 30 cents than 15. More serious, however, was the sudden increase in oil prices that Mr. Erickson made up for the occasion. The weighted average North Slope oil price in the Administration's Revenue Forecast (at page 20) is only \$12.45, and that's for Alaskan oil *delivered* to the West and Gulf Coasts. Netted back to Valdez this is about \$11. If oil prices went up \$4 a barrel over the forecast and stayed there, the State would have the revenue it needs to balance the budget and we probably wouldn't be talking about the ELF at this time.
3. The Administration testified that HB 118 would lower the threshold oil price by \$2 a barrel for bringing marginal fields into production. In other words, they said a marginal field would be profitable under HB 118 at a price \$2 lower than they would need with the present ELF. This was contradicted by industry testimony. In light of the fact that there will be a substantial delay between the time a commitment must be made to develop a marginal field and the time that field comes into production, plain common sense suggests that it would be unlikely for the tax change to have such a large impact on the price needed for the project to go forward. The Administration has not shared any details of its calculation. It has also failed to present any information about how large a field would have to be in ANWR, for example, before it would be economic to build the transportation

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infrastructure necessary to tie that field into TAPS so the oil can get to market.

4. The Administration said that the cumulative impact of the 1981 legislation has been a reduction of one billion dollars. It has failed to make clear that a third of this figure is based on the assumption that the federal windfall profits tax did not have to be allowed as a deduction under the old separate accounting income tax. The legal opinion at the time in 1981 was that such a deduction was necessary in order to preserve separate accounting against the constitutional challenge that had been brought against it.

5. The Administration said that the new ELF formula in the bill is the formula they meant. However, they said that the effect of the bill would be a benefit for fields under 150,000 barrels a day in size. There has been no explanation to reconcile this 150,000 figure with the effects of HB 118. The repeal of the "rounding" rule would benefit fields of any size -- even as big as Prudhoe Bay. The new formula will lower taxes for small fields producing less than 113,507 barrels a day. How does either effect tie in to the 150,000 figure? The explanation offered by industry -- that the parentheses are in the wrong place in the formula -- is more plausible at this point than the Administration's explanation. Can it be we are being asked to adopt the wrong formula simply because the Administration is embarrassed to admit there was a mistake in it?

Conclusion.

Because of these and other questions which still have not been answered to my satisfaction, I have serious misgivings about House Bill No. 118 and the formula it contains. Therefore, I recommend "DO NOT PASS" to you and my other colleagues in the Legislature regarding the original version of this bill and the draft Committee Substitute for it that is being considered by the Resources Committee.