SB

50

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: SB 50
() Publish Date:

Revision Date/Time (Note if correction):
Title: An Act relating to the oil and gas properties production (severance) tax
Sponsor: French
Requester: Senate Resources

Dept. Affected: Revenue
RDU: Revenue Operations
Component: Tax Division
Component No.

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Personal Services	20.3	20.3	20.3	20.3	20.3	20.3
Travel	2.0	2.0	2.0	2.0	2.0	2.0
Contractual	50.0	0.6	0.6	0.6	0.6	0.6
Supplies	0.3	0.3	0.3	0.3	0.3	0.3
Equipment	2.0					
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	**74.5**	**23.1**	**23.1**	**23.1**	**23.1**	**23.1**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	*	*	*	*	*	*

FUND SOURCE (Thousands of Dollars)

FUND SOURCE	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
1002 Federal Receipts						
1003 GF Match						
1004 GF	74.5	23.1	23.1	23.1	23.1	23.1
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	**74.5**	**23.1**	**23.1**	**23.1**	**23.1**	**23.1**

Estimate of any current year (FY2005) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal: [ ]

POSITIONS

POSITIONS						
Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This bill would amend the oil and gas production tax by changing the effective tax rate on North Slope oil production other than for heavy oil. With the exception of the tax rate for heavy oil, a minimum effective rate of 5% and a maximum effective rate of 25% would be established. To determine the effective tax rate, a price adjustment would be added to the current law that would increase the effective rate when prices are above $20 per barrel and lower the effective rate when oil prices are below $16 per barrel. The formula for the adjustment is Prevailing Value/20 for prices above $20 or Prevailing Value/16 for prices below $16. No price adjustment would be made for prices equal to $16 per barrel or equal to or less than $20 per barrel. The 20 or 16 would be annually revised to reflect inflation. Heavy oil production, defined here as oil that has an assay of 20 degrees API or less, would not be subject to either the 5% minimum or the price adjustment. There are adjustments for prices below $10 per barrel. Since monthly oil prices have only averaged less than $10 per barrel twice in the last 25 years we have not analyzed this provision.

Prepared by: Dan Dickinson, Michael Williams and Phyllis Rogers — Phone 269-1033
Division: Tax Division — Date/Time
Approved by: Tom Boutin, Deputy Commissioner — Date 3/17/2005
Agency: Department of Revenue

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

BILL NO. SB 50

ANALYSIS CONTINUATION

Properties, excluding those defined as heavy oil, with a current ELF above the minimum will have an increased effective tax rate when prices are above $20 per barrel. Properties, excluding those defined as heavy oil, whose current ELF is below the minimum will have an increased effective tax rate at all prices. The net effect of these changes is to raise the average effective tax rate at our forecast price.

This analysis does not tax production from West Sak or Tabasco because in 2004 both those fields had gravities below 20 degrees API. Other fields such as Schrader Bluff, Orion and Polaris have gravities close to 20 degrees API and as production increases may see their average gravities falling below 20 degrees API thus yielding tax free production.

This bill specifically limits its scope to North Slope production. This means that current taxpayers will pay the balance of the revenue change. We estimate a one time IT change will be required, which we have ball parked at $50,000, and one quarter FTE for additional audit work pertinent to North Slope fields that currently pay little or no tax.

The figures below result from simply changing the ELF mechanism in our production forecast model. The ELF was designed to affect taxpayers behavior, however this analysis does not account for any change in the taxpayer's production as a consequence of changes to the ELF.

A decade from now, one quarter of the oil in our forecast comes from fields not now producing. To bring those fields on line will require billions in additional investment. It appears to us that any tax increase that does not simultaneously involve the recognition of the need to make capital investments may well imperil that investment. Quantifying that peril, especially against the background of other aspect of the investment environment is difficult. Thus we have indicated an uncertain revenue effect, showing the figures below to offer insight into the mechanics of the bill.

Revenue Sensitivity for SB 50 Changes in Oil Production Tax
(millions of $)

	Status Quo		SB50 Minimum Elf		SB50 with Price Adj		Revenue Gain		
FY	Sev Tax	Avg Elf	Sev Tax	Avg Elf	Sev Tax	Effective Elf	Min ELF to Current	Price Adj Elf to Min ELF	Price Adj to Current
2006	715.1	0.5794	823.4	0.6698	1,420.1	1.1553	108.4	596.7	705.0
2007	616.2	0.5540	720.3	0.6532	1,108.1	1.0046	104.1	387.8	492.0
2008	485.6	0.5365	573.2	0.6441	721.2	0.8114	87.7	147.9	235.6
2009	448.7	0.5224	534.5	0.6341	672.2	0.7966	85.8	137.6	223.5
2010	422.1	0.4801	521.9	0.9012	653.7	1.1361	99.8	131.8	231.6
2011	422.3	0.4998	520.4	1.0014	653.1	1.2808	98.0	132.7	230.8
2012	375.9	0.4652	477.9	0.9644	599.8	1.2501	102.0	121.9	223.9
2013	334.8	0.4224	445.7	0.8703	561.9	1.1412	110.9	116.2	227.1
2014	295.1	0.3918	410.2	0.7444	518.2	0.9832	115.1	108.0	223.1
2015	259.9	0.3608	373.5	0.6979	472.7	0.9185	113.6	99.2	212.8
2016	228.2	0.3401	333.4	0.6622	421.8	0.8706	105.2	88.4	193.6
2017	196.5	0.3202	292.9	0.6273	372.0	0.8234	96.3	79.1	175.4
2018	174.3	0.3018	262.5	0.6015	333.9	0.7903	88.2	71.4	159.6
2019	152.7	0.2843	233.0	0.5778	296.9	0.7573	80.4	63.8	144.2
2020	133.7	0.2666	208.5	0.5566	265.4	0.7275	74.8	56.8	131.6
2021	136.3	0.2920	206.5	0.5770	263.3	0.7541	70.2	56.8	127.0
2022	122.1	0.2806	188.0	0.5624	239.7	0.7333	65.9	51.7	117.6
2023	107.0	0.2626	168.4	0.5410	214.7	0.7036	61.4	46.3	107.7
2024	91.9	0.2416	151.3	0.5215	193.0	0.6765	59.5	41.6	101.1
2025	82.6	0.2327	137.1	0.5054	174.8	0.6543	54.5	37.7	92.2
2026	75.3	0.2270	125.5	0.4926	160.0	0.6366	50.2	34.5	84.7
2027	67.1	0.2155	113.4	0.4745	144.6	0.6120	46.4	31.2	77.5
2028	59.4	0.2033	102.2	0.4558	130.3	0.5868	42.9	28.1	71.0
2029	52.6	0.1917	92.3	0.4379	117.7	0.5628	39.7	25.4	65.1
2030	46.4	0.1807	83.0	0.4204	105.8	0.5395	36.5	22.8	59.4

Forecasted Prices and Production Fall 2004 DOR Forecast
Updated for aggregate Elf and CY2005 Taps refiling

SPONSOR'S PRESENTATION
3-18-05

SB 50 The Fair Share Bill

March 18, 2005
Senate Resources Committee

The 'ELF' in Alaska's Oil Taxes

- There are four main taxes that the oil industry pays:
- Royalty – 12.5%
- Property – 20 mils per dollar, or 2%.
- Corporate income – 9.4% .
- Production – 15% before ELF.

The 'ELF' in Alaska's Oil Taxes

- The 15% production, or severance tax varies because of the ELF, or economic limit factor.
- At its simplest, the ELF is a number between zero and one. Multiplying the production tax by a field's ELF lowers that field's tax burden.

The 'ELF' in Alaska's Oil Taxes

- **Kuparuk's ELF is .054 for FY 2006**
- **.054 times 15 equals .081**
- **Thus, Kuparuk pays a 0.81% production tax.**
- **Prudhoe's ELF is .8435.**
- **Prudhoe pays a 12.65% production tax.**

The 'ELF' in Alaska's Oil Taxes

- **The formula is actually quite complex:**

AS 43.56.013. Economic Limit Factor.

(1-[PEL/TP]) exp ([150,000/(TP/Days)] exp [(460 X WD)/PEL])

where

PEL = the monthly production rate at the economic limit

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

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

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

exp = exponent

The 'ELF' in Alaska's Oil Taxes

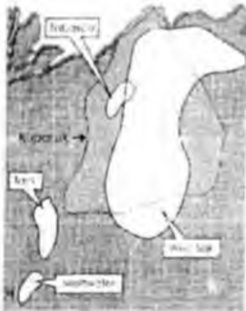
- **ELF was designed to encourage "small" field development.**
- **There are twenty fields now producing on the North Slope.**
- **Nine pay no production tax at all.**

Production Tax Revenue

- In 2003, the State took in $599 million in production taxes.
- The average price that year was $28 per barrel.
- The average ELF was .50, meaning the average production tax rate was 7.5%.

Kuparuk and its neighbors

Tarn,
Meltwater,
Tabasco,
and
West Sak



Kuparuk and its neighbors

- The Tarn field made 696,248 bbls in January 2005. Approx. 22,450 per day.
- The field has produced 65,000,000 bbls to date. It is one of the top thirty largest fields in the U.S.
- Tarn has a 0.013% ELF meaning it will pay a 0.2% production tax in 2005.
- Tarn's ELF will go to zero in 2007.

Kuparuk and its neighbors

- Tarn is produced via Kuparuk's facilities.

Kuparuk and its neighbors

- Tarn required two drill sites and three ten mile pipelines

Kuparuk and its neighbors

- The Meltwater field, also produced through Kuparuk's facilities, required only one drill site.
- In 2003, Meltwater produced 5800 bbls of oil per day and paid no production tax.
- This modest field will make the producers 2,000,000 bbls of oil this year.
- At $50 per barrel, that is $100 million.

How the "Fair Share" bill works

- Two principle reforms:
- The first simply establishes a minimum 5% production tax. All fields must pay the minimum 5%.
- In January 2004, the Dept. of Revenue estimated that this provision alone would raise $75 million at $22 per barrel.

How the "Fair Share" bill works

- The second major reform bases the ELF on the price of a barrel of oil.
- As the price rises, so does the ELF. As the price of oil falls, so does the ELF.
- The bill sets $16 to $20 oil as the norm, and allows this "range" to increase with inflation, to recognize that prices rise over time.

How the "Fair Share" bill works

- Example: At lower oil prices the production tax would be reduced. If oil goes to $12 per barrel, the formula would divide 12 by 16 to yield .75. Thus the production tax on an oil field would be reduced by 25%.

How the "Fair Share" bill works

- If oil prices fall below $10 per barrel, the bill would waive half the production tax and would defer the other half until prices rise above $16 per barrel.

How the "Fair Share" bill works

- Higher prices: At $30 oil, the new formula would divide 30 by 20 yielding 1.5.
- Thus, a field with a 10% production tax would pay an adjusted 15% production tax.
- The production tax cannot exceed 25% under the bill.

How the "Fair Share" bill works

- The bill exempts 'heavy oil' (less than 20 API gravity) from any of its measures. Heavy oil, like that contained in the West Sak reservoir, requires more expensive drilling and production measures.

How the "Fair Share" bill works

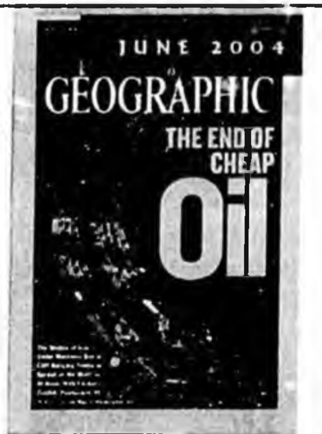
- Finally, the bill allows taxpayers "production tax relief." If the taxpayer can demonstrate that the field would be economical but for the production tax, the Department of Revenue has the power to waive the tax for that field.

Why Make a Change?

- "Despite its name of Economic Limit Factor, it ignores the biggest single economic determinant, which is price."

-- Dan Dickenson, Director, Tax Division quoted in The Petroleum News January 11 2004.

Why Make a Change?



LEADING THE NEWS

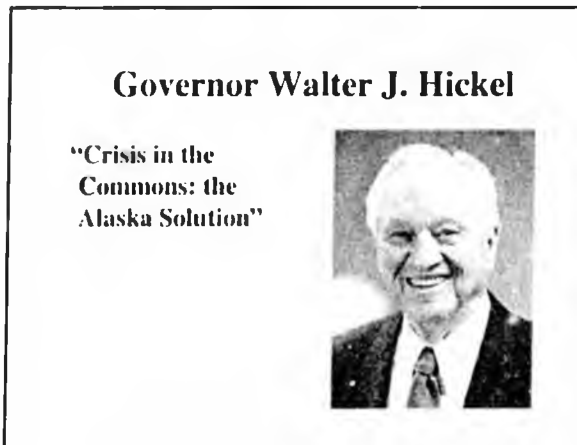
Spike in Oil Prices Is Likely in '05

As oil prices approached a new high yesterday, industry analysts said they are anticipating price increases to more than $60 a barrel this year. Some analysts are even beginning to talk of the possibility of greater increases—to $75 or $80 a barrel—in the event of a major supply disruption, unless red hot demand for crude cools in Asia and the U.S.

Wall Street Journal, March 5, 2005; p. A3

Oil Industry Profits

- ExxonMobil: Fourth quarter 2004 profits were $8.4 billion, the biggest quarterly profit ever for a U.S. company.
- BP: $4.4 billion
- ConocoPhillips: $2.4 billion
- Total quarterly profits: $15.2 billion in ninety days. $7 million per hour.



Governor Walter J. Hickel

"Crisis in the Commons: the Alaska Solution"

Governor Walter J. Hickel

- "Few world leaders are thinking about how we should care for and use the commons…for the benefit of the total."
- "Especially for the benefit of the local population…rather than for a political leader, a ruling family, an oligarch, or a group of multi-national corporations."

Governor Walter J. Hickel

- In 1909 President Roosevelt began the process of separating the ownership of land from the minerals below.
- "The Mineral Leasing Act of 1920 … recognized that the commons belonged to the public and required that income from the development of the commons must be paid to the public's government."

Governor Walter J. Hickel

- Alaska's Statehood Act was modeled on the 1920 Mineral Act. The subsurface energy resources were specifically designated to the new state.
- "We kept the resou[illegible] wealth in public hands…but we harnessed the free enterprise system to develop our wealth…all in the framework of a constitutional democracy."

Wood Mackenzie Study

- An international consulting firm says Alaska is a more profitable place to do business than the average of almost 60 oil and gas producing regions it surveyed worldwide.
- Higher than average costs, but lower than average government "take" at prices above $16 per barrel.

Wood Mackenzie Study

- At $35 per barrel, Alaska is 19th of 55, well above the median.
- At $35 per barrel, the total "take" is 58% compared to a global average of 73%.
- The difference between 58% and 73% -- 15% -- amounts to a subsidy of the oil industry.

Other Countries' Adjustments

- United Kingdom upped their minimum rate from 30 to 40 percent.
- Argentina introduced an export tax.
- Venezuela removed heavy oil royalty incentives.
- Nigeria increased its share of government profit.

Source: Petroleum News January 30, 2005

What Will the Industry Say?

- Won't discuss the fact the bill lowers taxes at low prices.
- Won't discuss the fact the bill raises the "normal range" each year to account for inflation.
- Won't discuss the fact the bill allows for production tax relief if it is justified.

ELF in 1989

"To the extent that production, net production, stays in the ground, the Permanent Fund is going to be a loser because the royalties that would have been collected won't be collected. The oil is still in the ground where it doesn't do anybody any good."

-- Tom Williams of British Petroleum on 2/22/89 before the House Resources Committee.

ELF in 1989

"My concern is that any additional taxes on the oil industry will have an adverse affect on the future drilling on the North Slope. This action will fundamentally impact not only the petroleum industry, but also the State's ability to encourage new economic development."

-- Morris Thompson, President, Doyon Drilling on 1/13/89 before the House Resources Committee.

ELF in 1989

"[This bill] would place an onerous additional tax burden on the oil industry that would remove to other states or countries funds that otherwise would be spent on additional investments in Alaska."

-- Ben Odom, Senior VP of Operations, ARCO Alaska, on 1/13/89 before the House Resources Committee.

Actual Development -- 1977

Actual Development -- 1989

Actual Development -- 1999

What Will the Industry Say?

- "A deal is a deal."

  Article IX, Section 1, Alaska State Constitution: "The power of taxation shall never be surrendered. This power shall not be suspended or contracted away, except as provided by this article."

What Will the Industry Say?

- "A deal is a deal."

  In conversations between Hugh Malone and industry leaders in 1981, when the original ELF was crafted, the idea was to allow industry and the State to have equal portions of the oil revenue.

  Testimony of Greg Erickson before the House Resources Committee, February 10, 1989 at pp 24-26.

MR. MALONE:

MR. TAYLOR:

30%. 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 - but that's all past history.

What Will the Industry Say?

MR. MALONE:

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.

Exchange between Rep. Hugh Malone and Monte Taylor, Alaska Operations Manager for Exxon

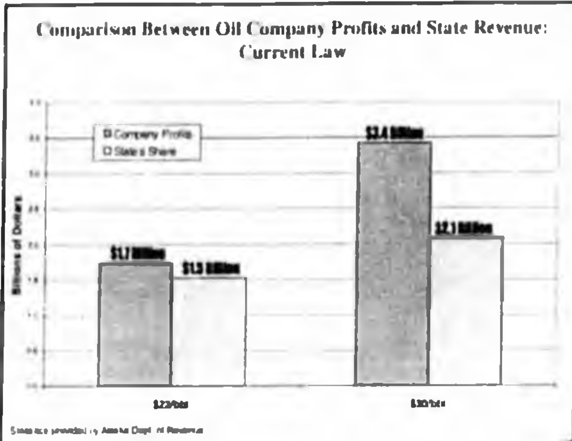
Industry and Alaska's Benefit from NS Petroleum Against Oil Prices (1987-2003)

Fiscal Year

State

Industry

NS Oil Wellhead Value



What Will the Industry Say?

- "Tax increases will kill development"

The real issue is the "net" effect. Increasing tax rates may decrease new investment and production, but it will also increase state revenues. The real analysis is to compare the increase in revenues with the decrease in investment.

What if we do nothing?

Production Tax Revenue

- By 2013, the average ELF will fall to .27, meaning the average production tax will fall to 4.05% (before aggregation).
- 2003: $599 million in production taxes.
- 2013: $180 million.

Production Tax Revenue

- Under this bill, the State would gain:
  an additional $90 million at $22/bbl.
  an additional $400 million at $30/bbl.
  an additional $886 million at $38/bbl.
  an additional $1.363 billion at $50/bbl.
  (with aggregation at Prudhoe).

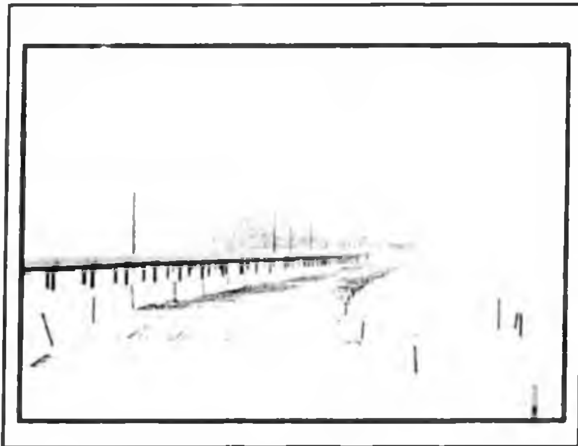
Conclusion

Fair Deal!

- The bill lowers taxes at low prices
- The bill all[illegible]s the [illegible] with inf[illegible]on
- Th[illegible] bil[illegible]s for production tax relief wh[illegible]re it is justified.

Conclusion

- It is better to address this issue now, when there is no immediate crisis.
- It is better to take an incremental approach, rather than a wholesale "shelf the ELF" approach.
- It is better to give the oil industry certainty during the planning and design phases of the gas pipeline.



(SB 50)

AOGA Presentation
3-18-05

Alaska's Current Oil and Gas Fiscal System

Oil & Gas: Vital to Alaska

FY05 Unrestricted Revenue

"Oil revenue will provide at least 75% of forecasted Unrestricted General Purpose Revenue through FY 2014. Two elements are critical to the oil revenue forecast: price and volume."

Present System's Four Elements

	To General Fund	To "Other"
Royalty	1,043.6	485.2
Production Tax	651.9	-
Property Tax	47.3	218.7
Oil & Gas Corp. Income Tax	298.8	- a
TOTAL	2,041.6	703.9
ALL OIL & GAS PAYMENTS	2,745.5	

Point No. 1

Even if ELF makes the production tax zero for a field, the field –

- **pays full royalty to the State**
- **pays full property taxes on its facilities**
- **contributes fully to the owners' income taxes**
- **increases the netback value by lowering tariffs**
- **creates Alaska jobs**

Production Tax

- A tax on the act of producing oil, gas
- Tax = ELF × Base Rate × Gross Resource Value
  - Gross Resource Value = Netback × Taxable Volume
  - Base Rate: gas 10%; oil 12¼% 1st 5 yr, then 15%
  - ELF: a field-specific number from zero to one

    Oil ELF is based on field size and well productivity; larger fields have larger ELFs and higher tax rates, as do fields with more productive wells; smaller fields and ones with low well productivity have smaller ELFs and lower tax rates. Gas ELF is based on well productivity only

Netback Methodology

West Coast Spot Price	$25.00
Marine Transportation	(1.61)
TAPS	(3.05)
Netback at Pump Stn. 1	$20.34

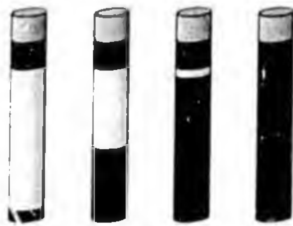
Why Have an ELF?

To allow a high-rate production tax early in a typical field's life, while avoiding the adverse consequences as the field is depleted

The Adverse Consequences of a High Rate

"As operating costs rise during the life of the field, the profit margin shrinks. At some point the total production costs overtake the value of the oil or gas produced, and production can then be continued only by operating at a loss. As one of the costs of doing business, the production tax contributes to the total costs and tends to hasten the time when this break-even point (called the economic limit) is reached."

The Adverse Consequences of a High Rate



Producers' Responses to the "Squeeze"

- "Do nothing" stage
- "Drive for efficiency" stage
- "Harvest" stage
- "Running in the red" stage

"[T]he Department of Revenue recommends an Economic Limit Factor (ELF), based on the ratio of the rate at the true economic limit to the current production, as a mechanism for scaling down the tax rate as the production declines toward the economic limit."

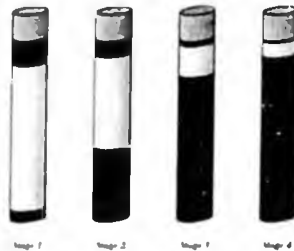
[illegible]

$$\left(1-\frac{PEL}{TP}\right)$$

PEL = Production at Economic Limit

TP = Total Production in tax period

How ELF Avoided the Adverse Consequences



Point No. 2

ELF was enacted in 1977 over industry's strenuous objections

- Why object? ELF allowed effective tax rate for Prudhoe Bay to be increased to ~11.7% from ~7.8%

March 18, 2005 13

How the Oil ELF was Changed in 1989

1977 formula was driven by "well productivity"

1989 added "field size" (total daily production) to the formula

- Larger fields have larger ELFs, higher tax rates
- Smaller fields have smaller ELFs, lower tax rates
- "Field size" is the dominant factor in the formula

March 18, 2005 14

Reasons Given in 1989 for the ELF Change

1. To get more revenue

March 18, 2005 15

Reasons Given in 1989 for the ELF Change

2. To give an incentive for small fields

"Marginal fields are fields with either relatively low per well productivity or <u>relatively low daily production</u>."

[illegible]

March 18, 2005 16 AOGA

Reasons Given in 1989 for the ELF Change

3. To give an incentive for West Sak viscous oil

"[T]he new ELF will increase drilling production and employment at the truly marginal fields … and, let's hope someday, West Sak …. In those fields the severance tax, under HB 118, will either be sharply reduced or eliminated entirely. That's a pro-development impact on those fields."

[illegible]

March 18, 2005 17 AOGA

Reasons Given in 1989 for the ELF Change

4. Prudhoe Bay & Kuparuk could afford it

March 18, 2005 18 AOGA

What legislators were told the change would do

1. Reduce rates for all fields except Prudhoe Bay & Kuparuk

"[For] marginal fields, …the severance tax, under HB 118, will either be <u>sharply reduced</u> or eliminated entirely."

"In Alaska the marginal fields are the six Cook Inlet fields … [and] Milne Point, Lisburne, Endicott, Niakuk, West Sak, Point Thomson, Seal Island, <u>and probably any other field that will be discovered in Alaska</u>."

March 18, 2005 19 AOGA

What legislators were told the change would do

2. Tax rates for some fields could go to zero under the new ELF that weren't zero under the old ELF

"[For] marginal fields, …the severance tax, under HB 118, will either be sharply reduced or <u>eliminated entirely</u>."

March 18, 2005 20 AOGA

What legislators were told the change would do

3. Smaller fields pay less tax even with the same well productivity as larger fields

March 18, 2005 21 AOGA

What legislators were told the change would do

4. State revenue gains from changing the ELF

- Projected cumulative effect through FY2010

Prudhoe Bay	$2.500 billion
Kuparuk	0.391 billion
All others	(0.200 billion)
Net	$2.691 billion

March 18, 2005 22 AOGA

Point No. 3

The 1989 ELF change has worked exactly the way legislators were told it would work

- Prudhoe & Kuparuk still have higher production tax
- Some fields don't pay production tax
- Small fields pay less even with same well productivity
- State already is over $2.7 billion ahead (net)

March 18, 2005 23 AOGA

Point No. 4

1989 ELF change was enacted over industry's strenuous objections

- Why? Major tax increase for Prudhoe Bay & Kuparuk

March 18, 2005 24 AOGA

Historical Effects on ANS Production from Different Kinds of Investment

- Wildcat Exploration
- Heavy Oil
- Satellite Fields
- New Investment to Slow Decline
- Declining Fields "Baseline"

ANS Production (mmb/d)

Fiscal Year

March 18, 2005 25 AOGA

Contributions of Different Kinds of Investments in Additional Oil Production

- Wildcat Exploration
- Heavy Oil
- Develop New Fields Already Discovered
- Satellite Fields
- New Investment to Slow Decline
- Declining Fields "Baseline"

ANS Production (000s of b/d)

Fiscal Year

March 18, 2005 26 AOGA

Point No. 5

More investment is <u>CRUCIAL</u>

Different kinds of oil investment have different economic profiles

A given tax change promises to impact different classes of oil investment differently

Any change must be carefully examined for "unintended consequences"

March 18, 2005 27 AOGA

What the Governor's ELF Decision Did

Lumped 6 smaller fields within the Prudhoe Bay Unit with the main Prudhoe Bay Field (aggregation)

Because of the "field size" component of the ELF formula, aggregating the fields increased the ELF and tax rate for all of them

Two of the 6 fields aggregated with the main Prudhoe Bay field are West Sak viscous oil

March 18, 2005 28 AOGA

Recent Legislative Proposals – HB63/SB50

AOGA Opposes Passage of HB63/SB50

- Industry views these proposals as a structural tax increase at all price levels except extremely low ones
- Imposes a 27.5% structural tax increase at DOR's expected $25.50 price
- Raises the maximum tax rate by 67% (from 15% to 25%)
- 5% minimum imposes a heavy burden on satellite development
- Fails to protect significant amounts of viscous oil (West Sak)
- Proposed without analysis of the consequences for investments
- Makes Alaska less competitive

March 18, 2005 29 AOGA

Senate Resources **March 18, 2005**

SB 50 Materials List

- Sponsor Statement – 2 pages
- Sectional Analysis – 2 pages
- SB 50 – 8 pages
- ***Power Point Presentation – 50 pages (not included in committee members materials packet - color version will be supplied Thursday afternoon).***
- Materials used with PPP – 32 pages

  NOTE: There is a hand-written number on these materials – it is the order in which the sponsor will refer to them during the PPP.
- Excerpts from Transcripts:
  - 1981: Oil & Gas Pipeline Committee: 32 pages
  - 2-10-89: House Resources Committee: 29 pages
  - 2-11-89: House Resources Committee: 30 pages

ALASKA STATE LEGISLATURE

SENATOR HOLLIS FRENCH

SPONSOR STATEMENT

SB 50– Alaska Fair Share Bill

Under the Alaska Constitution, the State is charged with ensuring that our natural resources are used "for the m ximum benefit of the people." In terms of dollar value, oil is indisputably our most valuable natural resource. It is imperative, therefore, that state government ensure that Alaskans receive a fair share of the revenue from this public resource. It is also important that a fair share of the resource be provided to the companies that have contracted with the State to produce and sell Alaska's oil.

The production tax, sometimes called a severance tax, is a major part of the State's oil and gas tax structure. The production tax, like most taxes, is calculated by using a complicated formula. In general, the tax rate is set at 15 percent of the net production value. Unfortunately, however, few producers are required to pay the full 15 percent, and revenue from the production tax is decreasing every year.

Producers are required to only pay a portion of the production tax because of the ELF (Economic Limit Factor). Under the ELF formula, smaller fields are partially or wholly exempt from the production tax, and larger fields see their production tax rate drop every year. Of the twenty producing fields on the North Slope, twelve pay no production tax at all. Several of the larger fields – including Kuparuk, which is producing over 100,000 barrels of oil per day -- pay less than 3 percent in production tax. Eleven of the last fourteen North Slope oilfields that have come into production since 1989 pay no production tax, or almost none (less than 1%).

That exemption applies whether oil is at $10/barrel, and profit margins are low, or at $30, $40, or $50/barrel, when corporate profit margins balloon. At $20/barrel, profit margins are high enough that BP announced last year it would use excess

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Senator_Hollis_French@legis.state.ak.us

profits at that price, and above, to send increased dividends to shareholders and to engage in a corporate stock buy-back program.

The Alaska Fair Share bill will make two adjustments to the state's production tax on oil. The first adjustment is simple: it would require all producing fields to pay a minimum 5 percent production tax. This provision alone would raise $75 million in state revenue at an oil price of $22 per barrel.

The second adjustment is more substantive. It would tie the production tax rate to the price of oil. The bill sets a 'normal' price range of $16 to $20 per barrel. Within that range, no adjustment would be made to the production tax rate. However, outside that range, the bill would allow the production tax rate to go up as prices go up and, to be fair, to go down as oil prices go down.

If no adjustments to the production tax structure are made, the State's return from this tax will diminish rapidly over time. For example, in 2003, the State earned $599 million in production taxes. Looking ahead, the Department of Revenue estimates that the State's production tax receipts will drop to $180 million in 2013.

The current severance tax law also gives the producers an unfair share of the state's oil wealth at average and high oil prices. As prices increase, the state's relative profit share falls. Conversely, state taxes are arguably too high at very low prices. The imbalance in favor of industry at high prices is much greater than the imbalance in favor of the state at low prices.

The Fair Share Bill is not a so-called "Shelf the ELF" proposal, which seeks to impose a flat 15 percent tax on all fields, at all prices. This bill recognizes that smaller and older fields should receive some tax relief under the ELF . However, it provides for a modestly higher production tax at higher oil prices, and a lower production tax at lower prices.

Please join me in making a revision to our production tax structure. Let's be sure that Alaska gets its fair share of our most valuable natural resource.

February 16, 2005

ALASKA STATE LEGISLATURE

SENATOR HOLLIS FRENCH

SECTIONAL ANALYSIS

SB 50 -- Alaska Fair Share Bill

Section 1 Amends definition sections regarding tax relief appeals filed with the Department of Revenue.

Sections 2-4 5% minimum production tax in most cases. This provision seeks to remove a current exemption that lets most new oil fields pay less than 1% in production taxes. While not all fields can pay Alaska's full 15% production tax, the state should at least set the minimum tax at 5% (to be reduced at low prices see below). Under provisions of Section 5, companies can apply for an exemption from this minimum tax if they can show it is necessary.

Taken together, these sections establish a minimum production tax rate. Currently the production tax is 15%, reduced by the ELF. In most recent cases, the ELF has reduced the production tax rate to 1% or less. Sections 2 - 4 set a field's production tax rate at the current rate, as determined by the ELF, but prevent the ELF-adjusted production tax from falling below 5%, except in certain circumstances when prices fall below $16/barrel.

Section 5 Increases to production tax when oil is above $20/barrel. Decreases to production tax when oil is between $16 and $10/barrel. Deferral and waiver of taxes when oil is below $10/barrel. This provision aims to make the current tax code more progressive, so that at low prices oil companies are protected from high taxes and at high prices the State of Alaska may share fairly in high oil company profits.

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Senator_Hollis_French@legis.state.ak.us

Enhanced tax factor above $20/barrel. Above $20/barrel, the severance tax rate is multiplied by the average monthly price of oil (West Coast price) divided by 20. Thus, at $20/barrel, the severance tax is multiplied by 20/20 -- "1" -- and is left unchanged. At $30/barrel, the severance tax is multiplied by 30/20 -- "1.5." In that case, a field with a 5% base production tax will pay 5% times 1.5, or 7.5%. The production tax will never exceed 25%.

Reduced tax factor below $16/barrel. Below $16/barrel, the production tax rate is reduced by the price divided by 16. Thus, at $12/barrel, the rate on a field with a 5% base production tax would be 12/16 -- ".75" -- times 5%, or 3.75 %.

Reduced taxes below $10/barrel. Below $10/barrel, one half of a field's production tax will be waived, and one half will be deferred until a month when prices average above $16/barrel.

Heavy oil exempted. "Heavy oil" is more expensive to produce than normal crude oil. Many believe the future of oil production will rely largely upon the production of heavy oil. The bill exempts heavy oil from the new enhanced tax provisions. It may be determined during hearings that a minimum tax should also be set for heavy oil, but that would have to be shown by testimony.

Reduction in tax. Provides a process for companies to seek a reduction in the production tax through an application to the Department of Revenue. The Alaska Fair Share Bill provides that any enhanced taxes under the bill may be waived if a company shows that tax relief is needed to make new or continued production at a field "economically feasible." This is modeled on Alaska's existing "royalty relief" law, and uses the same standards and process.

Section 6: This section provides a conforming amendment to existing law to include new provisions in this bill.

(1)

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Anchorage Daily News

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Oil producers profit more in Alaska

CONFIDENTIAL STUDY: Operating costs are high, but small tax bite makes up for it.

By LARRY PERSILY
Anchorage Daily News

(Published: February 2, 2005)

JUNEAU -- An international consulting firm says Alaska is a more profitable place to do business than the average of almost 60 oil and gas producing regions it surveyed worldwide.

The analysis, however, looks only at oil and gas fields where development started between 1994 and 2003, producing a limited view of overall North Slope costs and government tax bites compared with other projects started during that same period.

Legislators on Tuesday released two pages of data excerpted from the competitiveness study by Wood Mackenzie Ltd. The firm, based in Edinburgh, Scotland, late last year completed its report, "Global Oil and Gas: Risks and Rewards 2004."

The state paid $50,000 to subscribe to the report, but Wood Mackenzie's confidentiality requirements prevent the Legislature from releasing the entire 2-inch-thick document.

The numbers show Alaska oil and gas projects started during the 10-year period were among the costliest worldwide for development capital and operating expenses.

The oil and gas industry often makes the case that Alaska is an expensive place to do business because of its remoteness and Arctic conditions, and the Wood Mackenzie report appears to verify that claim. It shows Alaska ranked as the 52nd most expensive region out of 58 in the survey for development and operating costs.

Alaska averaged almost $10 per barrel in those costs, compared to the worldwide average of close to $6.

But Alaska producers fare much better when it comes to paying taxes and royalties, the report said. The total government tax bite in Alaska -- federal, state and municipal taxes and royalties -- is lower than two-thirds of the comparison regions.

Wood Mackenzie's analysis also shows the tax and royalty take in Alaska falls as a percentage of total net revenue when oil prices rise, verifying what proponents of higher oil taxes have long argued -- that the state is taking a smaller share of oil revenue at high prices.

The total government take after oil company expenses over the life of the field is about 71 percent on a worldwide average, the report said, regardless whether the price of a barrel of oil is $16, $22 or $35. In Alaska, however, the government share of the net is about 71 percent at $16 oil, 64 percent at $22 and 58 percent at $35, according to the survey.

Producer return on their investment in projects between 1994 and 2003 were three percentage points higher in Alaska than worldwide at $16 oil and six percentage points higher at $35 oil, Wood Mackenzie reported.

"This does not surprise me," said Dan Dickinson, director of the state Tax Division. "By definition, we are a regressive system," taking a smaller percentage of total revenue when prices are high.

Gov. Frank Murkowski has asked lawmakers to review the state's oil tax structure, particularly to look at the state's share when prices are high, but he has not committed himself to backing any specific change in tax law. The state did, however, raise the tax rate administratively on almost half of North Slope production as of [illegible]sday.

The information released Tuesday is limited and does not include all of the data that went into ranking the regions. Alaska is the only state surveyed for the report, which included federal leases in the Gulf of Mexico, two areas of Canada, and more than 50 foreign nations.

Although the company bars subscribers from publicly releasing the full report, the Legislative Budget and Audit Committee negotiated for release of some of the Alaska-specific numbers, said Committee Chairman Sen. Gene Therriault, R-North Pole.

Legislators are required to sign confidentiality agreements to read the entire report. As of Tuesday, six had signed agreements.

The committee, meanwhile, has contracted with Chuck Logsdon, who retired last fall after more than two decades as the state's chief petroleum economist, to review and verify the report and summarize its relevance for Alaska.

Logsdon's work likely will not be released to the public, Therriault said, under the s[illegible]ne rules that govern the report itself.

"This could be the one glimpse under the covers the public gets," Therriault said of the two pages released Tuesday.

"It's tough to start changing policies based on these six graphs," Rep. Ralph Samuels, R-Anchorage, said of the sh[illegible]rt summary. Samuels, vice chairman of the Legislative Budget and Audit Committee, said he wants to wait for [illegible]sdon's analysis before judging the state's oil and gas tax structure.

"Your best test for competitiveness is looking out the window," said Judy Brady, executive director of the Alaska Oil and Gas Association. The list of companies willing to invest big money in North Slope projects or the companies that have left the state is a good indication of Alaska's competitive position, she said.

The association, which also subscribed to the Wood Mackenzie report, will undertake its own analysis of the study, Brady said.

Reporter Larry Persily can be contacted at lpersily@adn.com or at 1-907-523-9306.

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2

Sen. Hollis French

From: Sen. Ben Stevens
Sent: Monday, March 07, 2005 3:26 PM
To: Sen. Hollis French
Subject: FW: *****SPAM*****

The article I referenced today.

Oil's Run Is Likely to Keep Fast Clip

**Price May Top $60 or More
If Supplies Are Disrupted
And Demand Fails to Cool**

By BHUSHAN BAHREE
Staff Reporter of THE WALL STREET JOURNAL
March 4, 2005; Page A3

The big oil-price spike of 2004 looks increasingly likely to get a sequel.

As oil prices approached a new high yesterday, industry analysts said they are anticipating price increases to more than $60 a barrel this year. Some analysts are even beginning to talk of the possibility of greater increases -- to $75 or $80 a barrel -- in the event of a major supply disruption, unless red-hot demand for crude cools in Asia and the U.S.

Unlike last year, when rising prices sparked protests in the U.S. and elsewhere, opposition to the increase ha become quieter as businesses and consumers have become accustomed to more expensive oil.

Yesterday, the acting secretary general of the Organization of Petroleum Exporting Countries, Adnan Shihab Eldin, acknowledged in remarks to journalists the possibility of prices rising to greater levels if supplies are disrupted, suggesting the cartel believes it has a limited ability to curb world oil prices. Talk of a renewal of la year's run-up in prices comes as OPEC's energy ministers prepare to meet in Iran on March 16. While they could raise production quotas, OPEC already is pumping close to capacity.

U.S. benchmark oil shot above the previous settlement high of $55.17 a barrel in intraday trading on the New York Mercantile Exchange yesterday before retreating. Futures for April delivery settled at $53.57 a barrel, up 52 cents, after hitting as high as $55.20. On an inflation-adjusted basis, oil is still well below highs of about $90 reached in the early 1980s.

Like last year, growing world demand -- particularly from the U.S. and China -- underlies much of the price increase. The continued weaknes of the dollar also has set the stage for increases, because oil is priced in dollars around the globe, and a weaker dollar means less revenue per barrel for oil producers.

The current surge in prices also comes amid realizations by OPEC nations and oil traders that higher prices have had a limited impact on world economic growth. While costlier energy has been a significant drag on relatively weak economies such as Japan and Germany, higher prices haven't been enough to derail recoveries in the U.S.,

Most major oil companies have been struggling with sluggish or declining production, faced with maturing oilfields in regions like the U.S. Gulf of Mexico and lack of access to regions that house some of the world's largest reserves.

An Exxon executive said on a conference call the company was not among the winners when Libya on Saturday awarded its first exploration contracts to U.S. companies in 18 years. U.S. oil majors are eager to reenter Libya after U.S. sanctions were eased last year.

ChevronTexaco Corp. (CVX.N), the No. 2 U.S. oil company, bid successfully on one onshore block in Libya. ChevronTexaco on Friday reported that quarterly profit nearly doubled, also on the back of record oil and gas prices.

Exxon shares were up 38 cents, or less than 1 percent, to $51.65 in afternoon trading on the New York Stock Exchange.

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(3)

North America's Source for Oil and Gas News
January 2004

Vol. 9, No. 2 Week of January 11, 2004

Alaska's tax formula an ongoing debate

State's average crude oil production tax rate continues to decline due to the Economic Limit Factor formula adopted in 1989

Larry Persily

Petroleum News Juneau Correspondent

The holiday season is over, but at least one ELF is still working in Alaska.

The ELF, or Economic Limit Factor, is a formula in state statute that reduces a field's oil and gas production tax rates based on the average daily total production and average per-well production from a reservoir.

The current formula, adopted by the Legislature in 1989, was intended as an incentive for producers to keep pumping — and investing — in older, declining fields. The 1989 amendment looked ahead to declining production at the giant Prudhoe Bay field and boosted short-term tax revenues to the state in exchange for cutting the rate in later years of the field's productive life.

Meanwhile, smaller and newer fields, even with their higher per-well productivity, benefit from the ELF formula, too, because their total daily production from all wells gives them a low tax rate — or no taxes at all in many cases.

No field in Alaska pays the full rate

Alaska's full production tax rate is 15 percent of the wellhead value of the oil, but there isn't a single field in Alaska paying the full rate. The ELF formula assigns each field a value between 0.0 and 1.0, which is then multiplied against the 15 percent rate to determine the field's actual tax rate. There is a separate ELF formula for natural gas production.

Prudhoe Bay's oil ELF in August 2003 was 0.857, for an effective tax rate of 12.86 percent.

The tax break for declining older fields and new, smaller fields — especially the satellite fields around Prudhoe Bay and Kuparuk — has been bringing down the North Slope's overall tax yield to the state for the past 10 years.

The average tax rate for all North Slope production in fiscal 1994 was 13.5 percent. The Department of Revenue estimates the average tax rate will be 7.6 percent in fiscal 2004, falling to about 6 percent in 2008 and under 5 percent by 2013.

Tax revenues falling faster than production

A department review in 2001 noted that North Slope production fell 34 percent between 1990 and 2000 yet, because of the ELF formula, production tax revenues dropped 53 percent when calculated at the same price for each year.

Production taxes will supply about one-third of the state's total take from oil and gas fields in fiscal 2004, with royalties, property and corporate income taxes providing the other two-thirds of the estimated $1.7 billion general fund revenue.

Supporters of the ELF formula say it's not the average tax rate or even the total dollars but the total production that counts, arguing that without the lower taxes there would be less oil coming off the slope. The ELF formula does not diminish the state's royalty share.

"ELF is working exactly as was planned, extending the life of older, mature fields like Kuparuk," said Dawn Patience, spokeswoman for ConocoPhillips in Anchorage. "ELF has also encouraged the development of several satellite fields surrounding Kuparuk over the past five years (Tarn, Tabasco and Meltwater), which account for more than a third of Kuparuk area production today."

BP is equal in its praise. "It is not a perfect system but has done what it was intended to do — support development that is burdened by low production rates at a high relative cost," said company spokesman Daren Beaudo of Anchorage.

"The North Slope is a high-cost, low-margin oil and gas basin characterized by a resource base of declining quality," Beaudo said. "High-cost, low-margin developments are beneficiaries of the current ELF formula."

He cited heavy oil as an example of North Slope production benefiting from ELF. Flow from the slope's heavy oil operations at West Sak and Schrader Bluff is estimated at a combined 31,000 barrels per day in fiscal 2004, up from 18,000 barrels a day in 2002. There is no production tax on either field.

ExxonMobil declined to comment on ELF.

No legislative action to change ELF

Proponents of changing ELF have debated for the past few years whether the state is seeing more production because of the lower tax rates but have never introduced legislation to amend the formula, other than a single bill that quickly disappeared during the past legislative session.

Rep. Beverly Masek, a five-term Republican, introduced a bill on May 6 to eliminate ELF, meaning all mature production in Alaska would have been charged the full 15 percent tax rate. Then, just 24 hours later, she withdrew the measure.

Not only did Masek fail to attract a single co-sponsor for her bill, but she managed to draw four committee assignments from the House speaker — a sure political sign that the measure likely would have died of old age before ever getting to the House floor for a vote.

Masek, from Willow, north of Anchorage, will serve as co-chair of the House Resources Committee this session. She did not return calls for this story.

Meanwhile, a freshman Democrat, Anchorage Rep. Les Gara, is working on his own bill to change the formula.

"It has been said within the Department of Revenue for a long time that many of the satellite fields are profitable enough to pay a production tax," Gara said, explaining he is looking at whether a price factor could be added to the ELF formula. The state could share the risk at low prices and, in return, earn a larger take at high prices.

Freshman legislator considers minimum tax rate

"I am considering whether it is responsible to set a minimum tax rate," he said.

And though Gara is working on his bill, he doesn't know when it might

be ready for introduction. "I want it to be responsible enough so that it doesn't slow down oil development."

Development of new fields has helped slow down the rate of decline on the North Slope, keeping total production around 1 million barrels a day since 2000. But the price to the state has been falling production tax revenues.

The state collects no oil production taxes or a very small fraction of a percent from several North Slope fields that averaged a total of 136,000 barrels a day in fiscal 2003, according to Department of Revenue numbers: Milne Point, 34,000 barrels; Endicott, 26,000; Schrader Bluff, 17,000; Niakuk, 14,000; Lisburne, 9,000; Aurora, 8,000; Meltwater, 8,000; Midnight Sun, 7,000; West Sak, 6,800; Tabasco, 3,600, and Polaris, 2,600.

"The ELF reduces the tax rate on smaller oil fields such that most fields producing less than 20,000 barrels per day will pay little or no production tax," the Department of Revenue said in its December 2003 state revenue forecast book.

Only seven fields pay more than a 1% tax rate

Unless it's a very large field or a very productive field, the tax rate will be zero or close to it, state Tax Division Director Dan Dickinson told a gathering of oil companies invited to Juneau to meet with the governor and other state officia last month.

And while some of the slope's smaller fields probably would not have been developed if they had to pay the full 15 percent tax rate, Dickinson said, it's also likely that some would have gone ahead at a rate higher than the zero they are charged.

"Did they need the magnitude of the incentive they got, that's a much tougher question," he said.

"Despite its name of Economic Limit Factor, it ignores the biggest single economic determinant, which is price," Dickinson said.

Other than Prudhoe Bay's almost 13 percent tax rate in August 2003, the only other North Slope fields with a double-digit tax rate are Northstar, at almost 12.5 percent that month and an estimated average daily production this year of 66,000 barrels, and Alpine, at about the same tax rate for its estimated 2004 production of 99,000 barrels per day.

Kuparuk, Borealis, Point McIntyre and Tarn pay between 1 percent and close to 3.5 percent, with everything else below 1 percent.

Kuparuk benefits from ELF formula

Perhaps just as controversial as the zero tax rate for new and satellite fields is the rapidly declining tax rate for Kuparuk, the second biggest oil field in the nation — Prudhoe is No. 1. The Department of Revenue expects Kuparuk will average 155,000 barrels a day this fiscal year, half its peak in 1993.

Kuparuk, which went online in 1981, is populated with less efficient wells, which, because of their lower per-well productivity, means a dropping tax rate for the entire field under the ELF formula. Kuparuk producers paid a 3.3 percent tax rate in September 2003, according to the Department of Revenue. ConocoPhillips, at 55 percent, and BP, at 39 percent, are the majority owners.

Department of Revenue projections in 2001 estimated that Kuparuk's oil flow will still be above 100,000 barrels a day in 2010, but its tax rate will be zero. "The field is forecast to keep producing 10 years beyond that. Is the ELF going to zero sooner than it needs to ensure maximum production?" the department asked in its December 2001 state revenue forecast book.

ELF is as old as the trans-Alaska oil pipeline itself, dating back to 1977 when the Legislature raised the top oil production tax rate from 8 percent to 12.25 percent while also adopting a formula to reduce the rate on less productive fields. Then, in 1981, while eliminating the personal income tax Alaskans had paid since 1949, lawmakers raised the top oil production tax rate to 15 percent.

The big battle came in 1989, when legislators voted to amend the ELF formula after realizing the state's take from Prudhoe Bay was slipping faster than many had envisioned. The intent was to boost the state's immediate share of Prudhoe Bay revenues, a politically popular move after the oil price crash of 1986-1987 and the Exxon Valdez oil spill in March 1989.

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Translate

4

BP plc

Prepared March 11, 2005

Balance Sheet Data

Source: MGFS

$ in Millions — *Fiscal Year End: Dec 31*

	2003	2002
Current Assets	54,465	45,066
Non-Current Assets	123,107	114,059
Total Assets	**177,572**	**159,125**
Current Liabilities	50,584	46,301
Non-Current Liabilities	51,050	43,415
Total Liabilities	**101,634**	**89,716**
Shareholder's Equity	75,938	69,409
Total Liab. & Equity	**177,572**	**159,125**
Debt / Equity	29%	32%
Curr. Liabilities / Curr. Assets	0.9	1.0

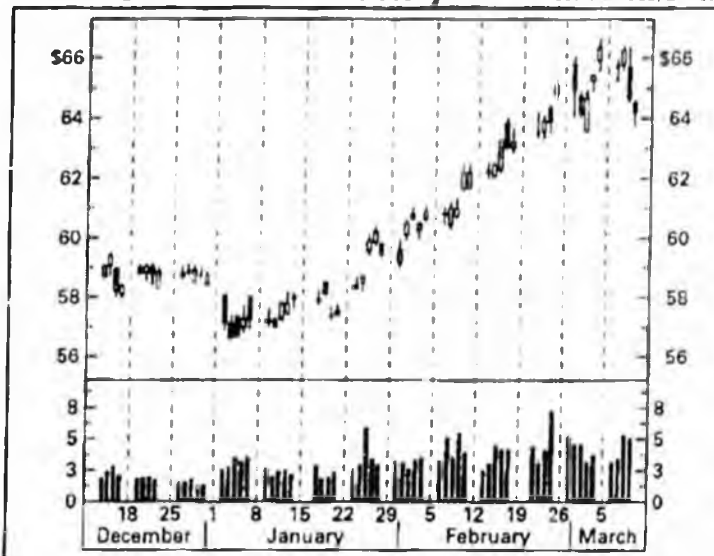
Quarterly Income Data

Source: MGFS

$ in Millions	Revenue	Net Inc.	Profit Margin	*$ Per Share* EPS	Div.	Payout (Div/EPS)
2004 Q3	70,885	4,483	6%	1.22	0.43	35%
2004 Q2	69,091	3,896	6%	1.05	0.43	41%
2004 Q1	67,602	4,818	7%	1.28	0.45	35%
2003 Q4	52,334	1,972	4%	0.52	0.43	83%

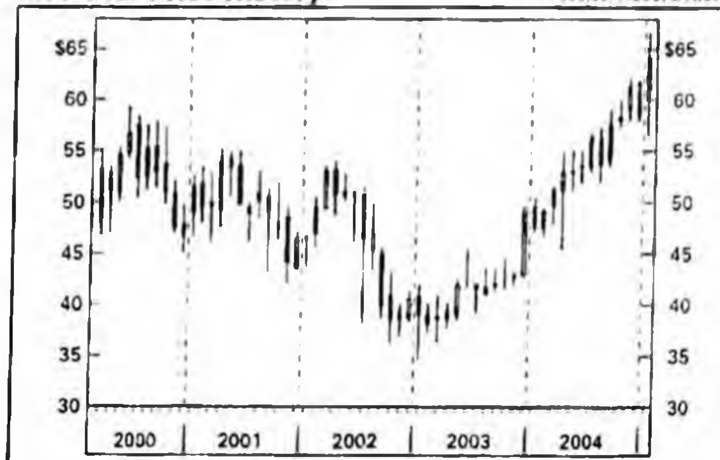
Last Three Months Price History

Source: WSOD, 3/10/2005



Five Year Price History

Source: WSOD, 3/10/2005



These charts show the stock's open, high, low, and closing price. They are called 'candlestick' charts because the area between the open and the close looks like a candlestick, and the trading range outside, the high and the low, look like the candle's wicks. If the candlestick is filled in black, the stock closed below its open. If the candlestick is white, the stock closed above its open.

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CONOCO INC

Prepared March 11, 2005

Balance Sheet Data

Source: MGFS

$ in Millions — *Fiscal Year End: Dec 31*

	2004	2003
Current Assets	15,021	11,192
Non-Current Assets	77,840	71,263
Total Assets	**92,861**	**82,455**
Current Liabilities	15,586	14,011
Non-Current Liabilities	34,552	34,078
Total Liabilities	**50,138**	**48,089**
Shareholder's Equity	42,723	34,366
Total Liab. & Equity	**92,861**	**82,455**
Debt / Equity	35%	52%
Curr. Liabilities / Curr. Assets	1.0	1.3

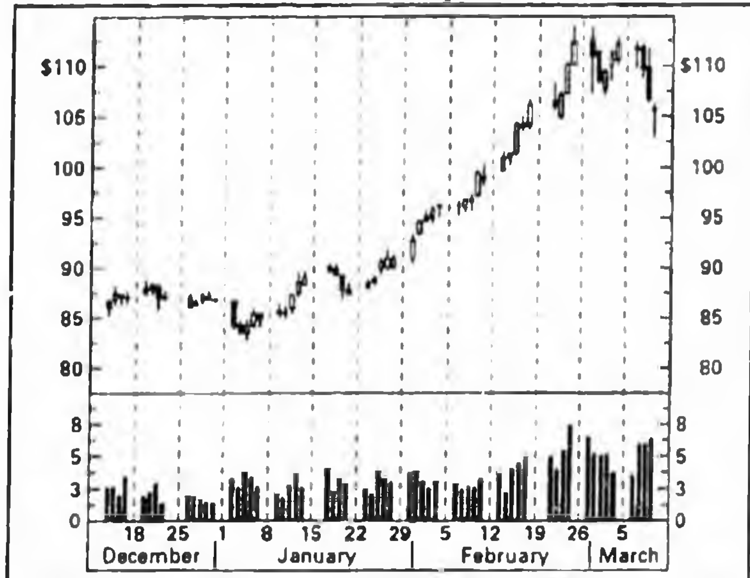
Quarterly Income Data

Source: MGFS

$ in Millions	Revenue	Net Inc.	Profit Margin	*$ Per Share* EPS	Div.	Payout (Div/EPS)
2004 Q4	35,140	2,432	7%	3.44	0.50	15%
2004 Q3	30,258	2,006	7%	2.86	0.43	15%
2004 Q2	27,343	2,075	8%	2.97	0.43	14%
2004 Q1	25,978	1,616	6%	2.33	0.43	18%

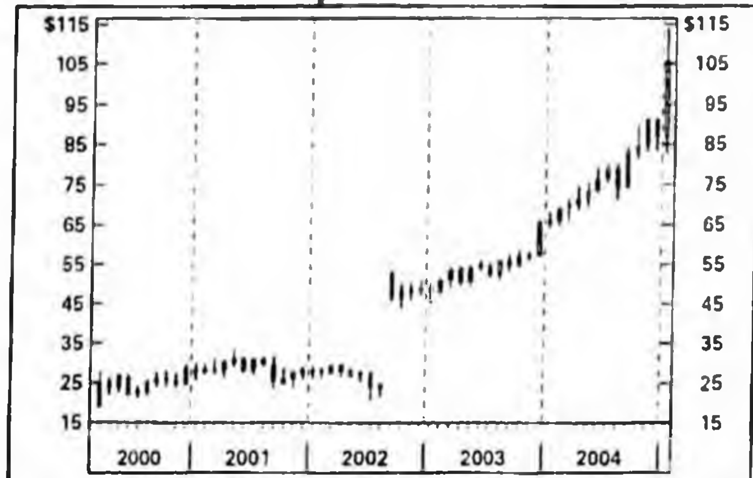
Last Three Months Price History

Source: WSOD, 3/10/2005



Five Year Price History

Source: WSOD, 3/10/2005



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EXXON MOBIL CORP

Prepared March 11, 2005

Balance Sheet Data

Source: MGFS

$ in Millions — Fiscal Year End: Dec 31

	200[illegible]	2003
Current Assets	60,377	45,960
Non-Current Assets	134,879	128,318
Total Assets	**196,26[illegible]**	**174,278**
Current Liabilities	42,[illegible]31	38,386
Non-Current Liabilities	50[illegible]19	45,977
Total Liabilities	**93,500**	**84,363**
Shareholder's Equity	10[illegible]756	89,915
Total Liab. & Equity	**195,256**	**174,278**
Debt / Equity	8%	11%
Curr. Liabilities / Curr. Assets	0.7	0.8

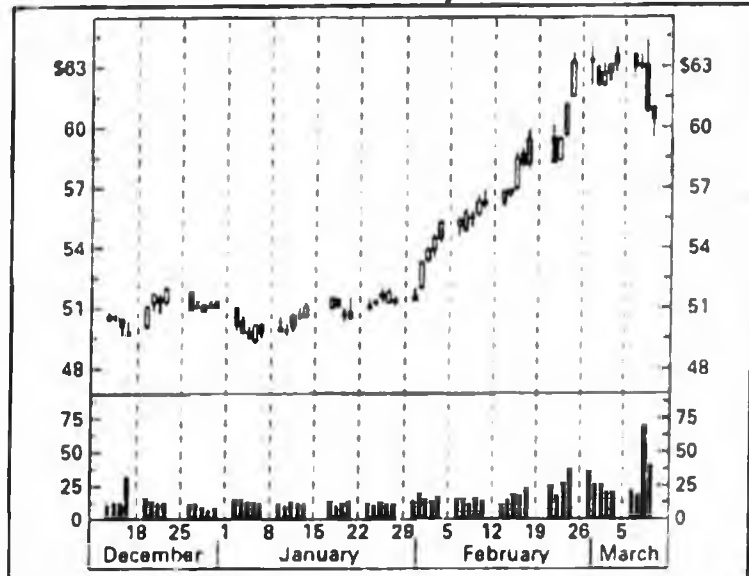
Quarterly Income Data

Source: MGFS

$ in Millions	Revenue	Net Inc.	Profit Margin	$ Per Share EPS	Div.	Payout (Div/EPS)
2004 Q4	73,830	8,420	11%	1.30	0.27	21%
2004 Q3	67,809	5,680	8%	0.88	0.27	31%
2004 Q2	62,706	5,790	9%	0.88	0.27	31%
2004 Q1	59,644	5,440	9%	0.83	0.25	30%

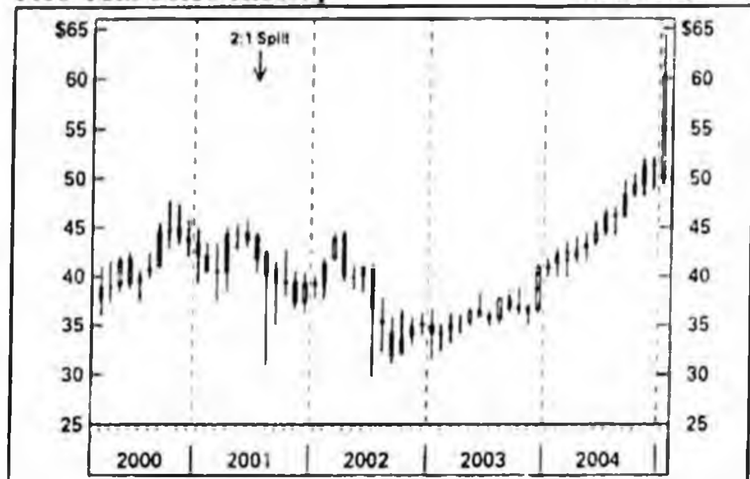
Last Three Months Price History

Source: WSOD, 3/9/2005



Five Year Price History

Source: WSOD, 3/9/2005



These charts show the stock's open, high, low, and closing price. They are called 'candlestick' charts because the area between the open and the close looks like a candlestick, and the trading range outside, the high and the low, look like the candle's wicks. If the candlestick is filled in black, the stock closed below its open. If the candlestick is white, the stock closed above its open.

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Summary by Pool: Oil Production January, 2005

Oil Field / Pool Name	Crude Oil (BBL)	Water (BBL)	Gas (MCF)	Producing Completions	Cum. Crude Oil (BBL)	Cum. Water (BBL)	Cum. Gas (MCF)
BADAMI							
BADAMI OIL					4,347,065	0	22,891,313
Field Total					4,347,065	0	22,891,313
BEAVER CREEK							
BEAVER CREEK OIL	4,130	1,090	1,923	2	5,730,067	66,292	2,043,792
Field Total	4,130	1,090	1,923	2	5,730,067	66,292	2,043,792
COLVILLE RIVER							
ALPINE OIL	3,700,977	153,702	4,248,724	43	141,339,541	1,372,330	166,607,645
NANUQ UNDF OIL					19,582	0	299,846
Field Total	3,700,977	153,702	4,248,724	43	141,359,123	1,372,330	166,907,491
ENDICOTT							
EIDER OIL	896	43,901	31,940	1	2,687,868	3,227,277	23,354,968
ENDICOTT OIL	640,689	7,313,131	12,402,009	56	427,877,328	741,075,473	1,837,003,923
IVISHAK OIL	436	14,122	274	1	7,948,341	31,258,795	6,507,845
Field Total	642,021	7,371,154	12,434,223	58	438,513,537	775,561,545	1,866,866,736
GRANITE PT							
HEMLOCK UNDEF OIL	4,469	2,126	3,964	2	1,968,697	128,303	2,004,469
MIDDLE KENAI OIL	105,128	20,862	99,422	26	139,885,726	16,678,641	124,485,390
Field Total	109,597	22,988	103,386	28	141,854,423	16,806,944	126,489,859
KATALLA							
KATALLA OIL					154,000	0	[illegible]
Field Total					154,000	0	0
KUPARUK RIVER							
CRETACEOUS UNDEF W					0	56,455,530	0
KUPARUK RIVER OIL	4,296,579	17,974,272	8,468,582	458	1,975,490,229	2,486,883,670	2,394,395,245
MELTWATER OIL	239,755	24,263	597,371	13	7,897,524	274,696	17,737,735
TABASCO OIL	157,055	673,175	43,756	8	9,892,529	26,862,881	1,372,736
TARN OIL	696,248	437,404	909,298	25	65,299,499	7,868,016	92,316,297
WEST SAK OIL	464,373	130,353	394,362	30	16,095,124	5,312,712	5,650,336
Field Total	5,854,010	19,239,467	10,413,369	534	2,074,674,[illegible]05	2,583,657,505	2,511,472,349
MCARTHUR RIVER							
HEMLOCK OIL	156,834	2,336,783	75,192	40	533,304,496	797,030,987	213,265,465
MIDDLE KENAI G OIL	79,153	486,058	31,565	31	61,647,023	64,546,154	33,788,443
UNDEFINED OIL					332,951	188,772	175,472
WEST FORELAND OIL	6,539	98,068	2,019	4	24,277,810	26,187,927	8,431,518
Field Total	242,526	2,920,909	108,776	75	619,562,280	887,953,840	255,660,898

Summary by Pool: Oil Production January, 2005

Oil Fields / Pool Name	Crude Oil (BBL)	Water (BBL)	Gas (MCF)	Producing Completions	Cum. Crude Oil (BBL)	Cum. Water (BBL)	Cum. Gas (MCF)
MIDDLE GROUND SHOAL							
A OIL					2,838,227	3,146,841	5,322,225
B C AND D OIL					12,010,325	5,509,414	8,797,239
E F AND G OIL	123,572	55,7[illegible]	40,856	27	177,020,864	99,320,781	78,028,416
Field Total	123,572	55,740	40,856	27	191,869,416	107,977,036	92,147,880
MILNE POINT							
KUPARUK RIVER OIL	903,213	1,370,315	531,923	82	181,18[illegible],610	138,662,224	92,023,892
SAG RIVER OIL	21,300	73,275	15,302	1	1,610,310	1,487,366	1,611,150
SCHRADER BLUFF OIL	607,517	570,794	440,444	46	38,733,774	15,468,341	24,354,739
TERTIARY UNDEF WTRS	0	1,094,106	0	4	0	186,961,697	0
UGNU UNDEF WTRSP	0	180,712	0	1	0	11,791,474	0
UGNU UNDEFINED OIL					16,746	0	3,370
Field Total	1,532,030	3,289,202	987,669	134	221,550,440	354,371,102	117,993,151
NORTHSTAR							
NORTHSTAR OIL	2,109,271	354,312	11,672,464	15	69,323,975	4,225,147	237,218,619
Field Total	2,109,271	354,312	11,672,464	15	69,323,975	4,225,147	237,218,619
OOOGURUK							
UNDEFINED OIL					3,828	0	0
Field Total					3,828	0	0
PRUDHOE BAY							
AURORA OIL	268,885	212,894	808,878	8	11,666,280	5,364,334	48,391,798
BOREALIS OIL	602,248	492,087	715,058	19	31,451,008	10,635,261	27,794,922
LISBURNE OIL	283,962	[illegible]7,563	5,158,844	30	139,995,06[illegible]	37,071,623	1,450,343,342
MIDNIGHT SUN OIL	176,702	75,143	948,241	2	11,518,936	1,705,250	41,040,900
N PRUDHOE BAY OIL					1,984,791	2,989,263	6,616,438
NIAK IVSH-SR UNDEF OIL					65,388	85,330	504,427
NIAKUK OIL	239,066	1,142,865	175,098	14	80,506,696	58,362,144	67,615,813
ORION SCHRADER BLUF	314,979	781	446,881	4	2,624,613	82,493	2,440,641
PM UNDEFINED OIL					33,480	13,127	30,008
POLARIS OIL	78,002	5,100	74,242	6	3,616,569	532,801	4,160,993
PRUDHOE OIL	10,968,778	37,458,455	259,726,871	692	10,709,487,609	7,351,952,168	48,447,026,751
PRUDHOE UNDEFINED W					0	1,112,346	0
PT MCINTYRE OIL	1,080,338	[illegible],154,452	5,642,237	47	377,152,322	33[illegible],331,073	644,406,875
UGNU UNDEFINED WTRS	0	579,448	0	1	0	1,626,294	0
W BEACH OIL					3,360,694	137,174	20,011,808
W BEACH TERTIARY UND					0	5,432,157	0

Summary by Pool: Oil Production January, 2005

Oil Fields / Pool Name	Crude Oil (BBL)	Water (BBL)	Gas (MCF)	Producing Completions	Cum. Crude Oil (BBL)	Cum. Water (BBL)	Cum. Gas (MCF)
Field Total	14,012,960	45,278,788	273,696,350	823	11,373,463,446	7,816,432,838	50,760,384,716
REDOUBT SHOAL							
UNDEFINED OIL	23,784	27,623	5,827	4	1,543,066	1,426,867	377,815
Field Total	23,784	27,623	5,827	4	1,543,066	1,426,867	377,815
SWANSON RIVER							
HEMLOCK OIL	17,412	176,065	115,147	20	228,637,369	117,735,483	2,858,679,556
UNDEFINED OIL					51,239	4,170	323,888
Field Total	17,412	176,065	115,147	20	228,688,608	117,739,653	2,859,003,444
TRADING BAY							
G-NE/HEMLOCK-NE OIL					23,630,100	30,468,431	6,484,662
HEMLOCK OIL	9,361	41,927	8,937	5	14,110,459	8,826,199	14,623,656
M.KENAI UNALLOCAT ZO					0	0	1,193,899
MIDDLE KENAI B OIL	7,532	3,012	1,185	4	4,010,431	821,270	3,384,887
MIDDLE KENAI C OIL	6,228	39,295	1,979	3	20,660,073	29,957,340	14,355,525
MIDDLE KENAI D OIL	11,287	48,123	3,975	6	29,269,147	24,250,381	24,021,231
MIDDLE KENAI E OIL	4,506	4,894	2,050	2	8,283,655	3,898,952	6,706,771
UNDEFINED OIL	1,953	3,538	1,673	1	1,391,661	933,776	649,941
W FORELAND OIL					61,120	9,611	28,517
Field Total	40,867	140,789	19,799	21	101,416,646	99,165,960	71,449,089
W MCARTHUR RIV							
W MCARTHUR RIV OIL	47,995	82,524	13,610	3	10,535,718	10,776,257	2,502,027
Field Total	47,995	82,524	13,610	3	10,535,718	10,776,257	2,502,027
Total Fields	28,461,152	79,114,353	313,862,123	1,787	15,624,590,543	12,777,533,316	59,093,409,179
Daily Average	918,102	2,552,076	10,124,585				

Condensate Total	3,321,094	*Condensate Totals apply to Crude Oil and Cum. Crude Oil totals for Prudhoe Oil Pool, Prudhoe Bay Oil Field only.
Condensate YTD Total	958,974,595	

Summary by Pool: Gas Production January, 2005

Gas Fields / Pool Name	Condensate (BBL)	Water (BBL)	Gas (MCF)	Producing Completions	Cum. Condensate (BBL)	Cum. Water (BBL)	Cum. Gas (MCF)
ALBERT KALOA							
UNDEFINED GAS	0	43	133,776	1	0	112	691,630
Field Total	0	43	133,776	1	0	112	691,630
BARROW							
EAST BARROW GAS	0	0	7,445	1	0	1,694	8,089,262
SOUTH BARROW GAS	0	0	3,146	1	0	1,040	22,485,647
Field Total	0	0	10,591	2	0	2,734	30,574,909
BEAVER CREEK							
BELUGA GAS	0	1,425	330,786	3	0	261,770	47,652,012
STERLING GAS					0	527,683	125,934,574
TYONEK UNDEF GAS	0	29	17,016	1	0	5,980	5,226,464
Field Total	0	1,454	347,802	4	0	795,433	178,813,050
BELUGA RIVER							
UNDEFINED GAS	0	621	5,152,974	14	0	32,223	909,933,184
Field Total	0	621	5,152,974	14	0	32,223	909,933,184
BIRCH HILL							
UNDEFINED GAS					0	0	65,331
Field Total					0	0	65,331
DEEP CREEK							
TYONEK UNDEF GAS	0	1,599	418,689	5	0	2,894	717,627
Field Total	0	1,599	418,689	5	0	2,894	717,627
GRANITE PT							
UNDEFINED GAS					0	0	844,378
Field Total					0	0	844,378
IVAN RIVER							
UNDEFINED GAS	0	15	157,203	3	0	12,500	75,876,032
Field Total	0	15	157,203	3	0	12,500	75,876,032
KENAI							
BELUGA UNDEFINED GA					0	0	120
STERLING 3 GAS	0	16	16,658	1	0	134,866	330,239,564
STERLING 4 GAS	0	312	304,487	6	0	150,725	447,381,881
STERLING 5.1 GAS					0	154,689	484,679,341
STERLING 5.2 GAS					0	12,700	44,031,635
STERLING 6 GAS	0	1,365	781,214	11	0	109,238	518,441,251
TYONEK GAS	0	21	92,267	1	8,994	72,508	184,644,174
UPPER TYONEK BELUGA	0	7,600	1,311,467	17	2,879	455,576	262,825,758
Field Total	0	9,314	2,506,093	36	11,873	1,090,302	2,272,243,724

Summary by Pool: Gas Production January, 2005

Gas Fields Pool Name	Condensate (BBL)	Water (BBL)	Gas (MCF)	Producing Completions	Cum. Condensate (BBL)	Cum. Water (BBL)	Cum. Gas (MCF)
KENAI C.L.U.							
BELUGA GAS	0	18,519	836,905	3	104	321,574	44,999,503
STERLING UNDEFINED G	0	102	273,624	1	0	664	13,128,160
TYONEK D GAS					0	9,410	1,399,385
UPPER TYONEK GAS	0	1,356	294,905	2	394	44,167	66,288,405
Field Total	0	19,977	1,405,434	6	498	375,815	125,815,453
LEWIS RIVER							
UNDEFINED GAS	0	0	43,311	1	0	1,895	11,294,940
Field Total	0	0	43,311	1	0	1,895	11,294,940
LONE CREEK							
UNDEFINED GAS	0	0	139,197	1	0	22	2,933,720
Field Total	0	0	139,197	1	0	22	2,933,720
MCARTHUR RIVER							
MIDDLE KENAI GAS	0	1,370	3,047,853	15	0	364,360	1,002,345,354
Field Total	0	1,370	3,047,853	15	0	364,360	1,002,345,354
MIDDLE GROUND SHOAL							
UNDEFINED GAS					0	131	16,383,183
Field Total					0	131	16,383,183
MOQUAWKIE							
UNDEFINED GAS	0	179	142,585	1	0	526	1,895,536
Field Total	0	179	142,585	1	0	526	1,895,536
NICOLAI CREEK							
UNDEFINED GAS	0	0	508	1	0	32,201	3,189,859
Field Total	0	0	508	1	0	32,201	3,189,859
NINILCHIK							
FC TYONEK UNDEFINED	0	401	386,289	3	0	7,276	6,365,354
GO TYONEK UNDEFINED	0	46	197,485	2	0	2,127	5,659,489
PAX TYONEK UNDEFINE	0	0	7,428	1	0	0	7,428
SD TYONEK UNDEFINED	0	260	308,320	1	0	12,381	4,296,789
Field Total	0	707	899,522	7	0	21,784	16,329,060
NORTH COOK INLET							
TERTIARY GAS	0	4,063	4,055,470	12	0	596,309	1,666,420,955
Field Total	0	4,063	4,055,470	12	0	596,309	1,666,420,955
NORTH FORK							
UNDEFINED GAS					0	0	104,595
Field Total					0	0	104,595
PIONEER							

The New York Times
nytimes.com

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January 31, 2005

Record Oil Prices Spur Exxon Mobil Profit

By REUTERS

Filed at 2:11 p.m. ET

NEW YORK (Reuters) - Exxon Mobil Corp. (XOM.N), the world's largest publicly traded oil company, on Monday posted the biggest quarterly profit ever for a U.S. company -- $8.42 billion -- driven by high crude oil and natural gas prices.

The blockbuster results easily topped Wall Street forecasts, capping an exceptional year for the Irving, Texas, behemoth. Exxon's revenue in 2004 was more than $298 billion, surpassing the gross domestic product of countries such as Austria and Indonesia.

Surging demand from fast-growing Asian giants India and China, coupled with fears of a disruption in supplies from countries such as Russia, Iraq and Nigeria, kept oil prices surging for much of last year. Crude prices topped $55 a barrel in late October.

Exxon's fourth-quarter profit was equal to $1.30 a share, up from $1.01 a share, or $6.65 billion, a year earlier. Analysts' average forecast was $1.05, according to Reuters Estimates.

``They're managing their business like a Swiss watch,'' said Oppenheimer & Co. analyst Fadel Gheit.

Revenue jumped to $83.36 billion from $65.95 billion a year earlier.

The results did not produce a surge in Exxon shares. One analyst said Wall Street has come to expect extraordinary results from the oil giant. Also, the shares have been climbing for much of the past year and were already near a 52-week high.

STRENGTH ACROSS THE BOARD

All three major business lines at Exxon posted a sharp rise in earnings.

The rise in prices drove earnings at its exploration and production unit to $4.89 billion, up from $3.27 billion a year earlier. Profit from refining and marketing operations tripled, to $2.34 billion from $736 million a year earlier, on strong refining margins.

Healthy worldwide demand pushed up earnings at its chemicals business to $1.25 billion from $476 million.

``This is a particularly impressive set of results given that every segment outperformed expectations,'' Credit Suisse First Boston analysts said in a research note.

Capital spending fell slightly, to $4.23 billion from $4.36 billion a year earlier.

Oil and gas production fell 2 percent in the quarter, hurt by divestments and the impact of higher prices on production-sharing agreements. Excluding the those items, production rose by 1 percent.

Most major oil companies have been struggling with sluggish or declining production, faced with maturing oilfields in regions like the U.S. Gulf of Mexico and lack of access to regions that house some of the world's largest reserves.

An Exxon executive said on a conference call the company was not among the winners when Libya on Saturday awarded its first exploration contracts to U.S. companies in 18 years. U.S. oil majors are eager to reenter Libya after U.S. sanctions were eased last year.

ChevronTexaco Corp. (CVX.N), the No. 2 U.S. oil company, bid successfully on one onshore block in Libya. ChevronTexaco on Friday reported that quarterly profit nearly doubled, also on the back of record oil and gas prices.

Exxon shares were up 38 cents, or less than 1 percent, to $51.65 in afternoon trading on the New York Stock Exchange.

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(1)

Announcement of Data Release

The Legislative Budget and Audit Committee sought and received permission to release information on Alaska's relative global ranking in three general areas:

1. Costs—both capital and operating
2. Government Take
3. Profitability

About the Study

Wood Mackenzie is a consulting firm headquartered in Edinburgh, Scotland that has been providing commercial analysis and strategic advice to the world's leading energy companies for 30 years. They have covered upstream oil and gas, oil refining and marketing, gas and power.

Global Oil and Gas—Risks and Rewards (GOGRR) was first published in 2002 and considered data from 1991 to 2000. It had two main objectives:

- To measure and rank the relative attractiveness of 60 areas (in 50 countries) for exploration
- To measure the relative attractiveness of the same areas for acquisitions of interest in existing commercial upstream oil and gas developments.

The 2004 study focuses on the period 1994 to 2003, adding more depth to some of the key areas.

Methodology Concerns

The Legislative Budget and Audit Committee has retained the services of Chuck Logsdon, former chief petroleum economist for the State of Alaska, to perform a review and evaluation of the study. The review will:

- Evaluate the cost assumptions for their appropriateness for Alaska;
- Evaluate the cost assumptions for any systematic bias for or against exploration and development economics in Alaska;
- Verify the accuracy of the modeling of the Alaska fiscal system;
- Establish whether the assumed field sizes, transportation, and location logistics are appropriate;
- Identify the effect that varying the cost assumptions would have on Alaska's competitive ranking;
- Review the appropriateness of the low, mid and high price projections;
- Identify other regions that might be appropriate to be included in a comparative analysis;
- Review the study for discussions of other intangible risk factors that might be more favorable in Alaska, including, but not limited to, physical security and political stability;

WOOD MACKENZIE

GLOBAL OIL AND GAS — RISKS AND REWARDS 2004

Alaska's Costs – Before Government Take

	Capital Costs	Operating Costs	Total Costs
Alaska's Ranking	45/58	56/58	52/58
Alaska's Cost	$3.75	$6.20	$9.94
Global Average Cost	$2.55	$3.34	$5.89

Full Cycle Government Take

Full Cycle Gov't Take (% Of Pre-Take Net Cash Flow, Undiscounted)

	Low Price ($16)	Base Price ($22)	High Price ($35)
Alaska's Ranking	33/54	24/54	[illegible]9/55
Take on AK Production	71.70%	63.63%	58.40%
Global Ave. Take	70.86%	70.26%	73.34%

Full Cycle Gov't Take (% Of Pre-Take NPV @10%)

	Low Price ($16)	Base Price ($22)	High Price ($35)
Alaska's Ranking	22/47	16/49	17/53
Take on AK Production	82.17%	72.09%	64.56%
Global Ave. Take	81.05%	74.16%	71.91%

Wood Mackenzie has authorized the public disclosure
of the information contained on this page.

WOOD MACKENZIE

GLOBAL OIL AND GAS — RISKS AND REWARDS 2004

Alaska's Profitability – Full Cycle, Post Government Take

Rate of Return (IRR – Nominal)

	Low Price ($16)	Base Price ($22)	High Price ($35)
Alaska's Ranking	15/49	14/52	14/53
Alaska's IRR	18.09%	23.57%	29.11%
Global Average IRR	15.20%	18.94%	23.07%

Net Present Value (NPV @10% in $/Bbl of Oil Equivalent)

	Low Price ($16)	Base Price ($22)	High Price ($35)
Alaska's Ranking	17/58	11/58	8/58
Alaska's NPV	$0.90	$2.14	$4.43
Global Average NPV	$0.65	$1.33	$2.35

Value Creation Ratio

	Low Price ($16)	Base Price ($22)	High Price ($35)
Alaska's Ranking	22/66	22/66	19/66
Alaska's VCR	1.98	3.33	5.82
Global Ave. VCR	1.90	2.84	4.26

Wood Mackenzie has authorized the public disclosure
of the information contained on this page.

(8)

Address by the Honorable Walter J. Hickel

The Woodrow Wilson Center, Washington, DC

May 22, 2002

Beyond Unbridled Capitalism and Failed Communism

It's a real pleasure to be back at the Woodrow Wilson Center and at this podium

Thank you Director Hamilton and Secretary Babbitt.

It's a special joy for me to have my long-time friend Senator Patrick Moynihan, a scholar in this Center, in attendance.

I respect the work that this Center does, and look forward to working with you on Arctic issues...

...especially in connection with your involvement in the new Russia

Woodrow Wilson was one of our most progressive and visionary presidents....

...whose passion to bring fairness and balance into our economic system...

...was second only to Teddy Roosevelt.

What prompts me to be here today relates to that passion.

I have written a book that I consider to be a guidebook for leadership...

...and a roadmap for those parts of the world...

... that are struggling with how to move towards democracy.

Mostly, my concern is for Alaska's neighbors to the West...the Russians...and the billion and a half Chinese.

Both of those great nations tried unbridled Capitalism. And it failed.

Neither had a Teddy Roosevelt or a Woodrow Wilson to balance the power of those who would monopolize the system.

Both had revolutions....Russia in 1917...and China in 1949.

Both adopted Communism. And it failed, too.

Now they are looking for something new...something that will not fail.

They are looking towards democracy, but they won't return to unbridled Capitalism, any more than they will return to failed Communism.

I believe there is as third way.

I also wrote this book for those countries elsewhere in the world that have been unable to win the war against poverty, the breeding ground of terrorism.

These are delicate and dangerous days in the world. And I hope this book can help.

Last month one of Alaska's newspapers called this book "A textbook for every Alaskan, every American, every world citizen. It lifts the spirit and gives hope to all ages."

I began this project in September of 1990 when I had breakfast in Anchorage with the late Terrence Armstrong of the Scott Polar Research Institute of Cambridge University.

He invited me to deliver a series of lectures at Cambridge that would be the core of a book.

Instead, I soon found myself re-elected governor of Alaska and back in Juneau, our state capital.

Then, in 1997, after leaving the governorship, I accepted that invitation to Cambridge University.

"We will help you."

Those discussions convinced me that the world could use a book that was about Alaska....but was bigger than Alaska.

A book that explained...not just in theory, but in practice....how to manage commonly owned lands and resources....for the benefit of the people.

This is an everyday challenge in the Arctic....but somewhat foreign to those here in the South 49 and Western Europe.

So we went to work.

I call it "Crisis in the Commons: the Alaska Solution" ---so let me begin by defining "the commons."

We, the people of the world, own most of this planet in common.

The oceans are ALL commons. They are not privately owned. No one will ever homestead in the ocean.

Alaska is 90 per cent commons.

It's commonly owned....one third by the people of Alaska and two thirds by all Americans.

Russia and China are nearly 100 per cent commons.

Canada is roughly 80 per cent. Australia is 85. And so on.

Including the oceans, nearly 90 percent of the earth's surface is owned in common or not owned at all.

It fascinates me that the human race lives in a World Commons and is not aware of it.

Few world leaders are thinking about how we should care for and use the commons...

...for the benefit of the total.

Especially for the benefit of the local population...rather than for a political leader, a ruling family, an oligarch, or a group of multi-national corporations.

And that's what this book is about.

It is about a growing crisis...and a solution to that crisis.

It's a crisis because the commons is easily exploited.

We in Alaska know all about exploitation.

Alaska was terribly exploited in territorial days.

And there are two kinds of exploiters.

Those who come, take and leave nothing.

And those who lock up and do nothing.

The canned salmon interests and the Alaska Steamship Company, both based in Seattle, and the Alaska Mining Syndicate were examples of those who monopolized and exploited us.

They used their political influence to control key committees in Congress to pass laws to protect their interests.

And for years they successfully opposed our efforts to become a state.

Finally, in 1959, we won statehood, winning control of nearly a third of our land and a third of our assets.

In our Statehood Compact with the federal government...which included an innovative State Constitution...

...we kept the resource wealth in public hands...

...but we harnessed the free enterprise system to develop our wealth...

...all in the framework of a constitutional democracy.

That's a unique combination...

...public ownership, private development, a democratic government.

We started as poor people on rich land...

.... and, using this formula, we've become a success...

......while protecting the beauty and the glory or our lands and seas.

But we had to face the so-called "Tragedy of the Commons."

Commercial fishing is a classic example.

The tragedy comes when each fisherman races all others to catch the last fish.

The result of this Wild West approach...that we used to call "enlightened self interest"....is that our God-give resources will eventually be extermina

All in the name of freedom!

Alaska saw this problem before the rest of the nation.

I helped fight for the 200-mile limit - the Magnuson-Stevens Act of 1976 – a great achievement of the late senator Warren Magnuson and Alaska's senior senator Ted Stevens.

This law helps protect the offshore commons.

And in the early 1990s, we established Community Development Quotas and Individual Fishing Quotas in the North Pacific.

Last September, national environmentalists and fisheries experts praised these programs as models for the nation...

...using the wealth of the commons....in ways that respect the environment...and protect the resource.

That is "the Alaska Solution."

Our generation didn't invent these ideas.

They are much older than we are. (Even older than I am!!)

It was Alaska's Native peoples.

The philosophy for successful living in the North was born when the first councils of elders sat down to solve problems of using and caring for the living resources upon which they depended.

They put the community first. They cared about the total.

When they caught a whale...it wasn't MY whale." It was OUR whale.

That was the natural way to survive on this harsh land.

Teddy Roosevelt took the next step in governing the commons.

Not only did this man, a blue blood of conservative heritage, save the free enterprise system by confronting and busting the great monopolies of his time....

....he also had a vision for the West.

He added enormously to the national forests, fostered great irrigation projects, and reserved lands for public use.

And he did something that would eventually affect Alaska more profoundly than any other state.

He separated the federal lands of America from the energy resources beneath them.

After his death and the Teapot Dome Scandal, his approach became law with the passage of the Mineral Leasing Act of 1920.

Signed by, who else but, President Wilson.

This law required that the revenues from energy resources on the federal commons shall forever remain with the government.

That's why I made it my personal crusade – as a 30-year old carpenter and builder – to fight for Alaska to have a sufficient land entitlement.

When the Alaska Statehood Act was written, it included 103 million acres for Alaska, and the identical terms of the Mineral Leasing Act.

The revenues from Alaska's subsurface energy resources were specifically designated to the new state.

Senator Taft and other leading senators understood that our population was too small. We couldn't build a state on taxes alone.

These resources were to be the engine to build our roads and public buildings, our state university and school systems...to fund our judiciary, our law enforcement,

...and to establish an economy that would free us from dependence on Outside interests.

We became the first Owner State.

As I describe in some detail in this book, an Owner State is an unusual combination of public and private, and it requires true leadership.

Public lands are easily exploited if politicians are afraid to stand up to special interests.

And their resources are left untouched and untapped, if politicians are afraid of controversy.

Our Owner State has prospered because of the oil found at the North Slope.

Instead of running out, Alaska's energy resources have only just begun to help our nation.

And energy is the key to our freedom as a nation.

I see Alaska today as a diamond, a brilliant star, a state with an outstanding quality of life, a glorious natural environment, and an economy with enormous potential.

What if the same could be said of Russia and the other great commons areas of the world?

What if the same could be said of Africa?

I have visited Africa many times where my son, Jack, served as a doctor and medical missionary.

Wherever I have visited on that continent, I have seen poor people living on rich land.

And I have come to believe that there is no legitimate reason for poverty.

The Alaskan solution could dramatically assist those parts of Africa that are ready to try a new approach...

...neither classical capitalism, nor socialism.

But something new coming out of the North.

A few days ago I received a letter from Maurice Strong, the Canadian who served as the Secretary General of the Earth Summit in 1992.....the largest gathering of Heads of State in the history of the world.

I had the honor of speaking at that event at Strong's invitation.

In his letter, he wrote that the world commons "is shaping up to be one of the world's major challenges in this new century...

... one which is fraught with a great potential for conflict as well as an imperative for cooperation..."

So, the message of this book...and the challenge I want to urge you to think about ...is the great opportunity before us.

In the Arctic, we have vast untapped resources.

ANWR is a perfect example.

When I look at America today, I ask myself where are today's pioneers? Where are the Roosevelts and the Wilsons?

Where is the courage and the guts and the vision?

I dream of a tunnel under the Bering Sea connecting Alaska to Russia.

I've talked for years about a railroad around the world, and this is the missing link.

We have vast supplies of fresh water in the North. It's time to build a transportation system to move that commodity...soon to be more valuable than oil...to help the parched and thirsty parts of the world.

To make such projects happen in the commons, government must take the lead.

Let's junk the idea that all government is the enemy.

Government in the commons has got to spend money to build a culture!

Our approach can be a model for the nations of the commons where poverty has become an endless cycle.

And make no mistake, "The War on Terrorism" will be a never-ending conflict unless we strike at its roots.

Those roots are complex, but they are fundamentally economic.

Learning to care for and use the commons responsibly for the benefit of the total – people, people's needs, and nature...that is "The Alaska Solution."

In a time of darkness worldwide, there is a light in the North.

And, in case you are wondering, I plan to be around for another 30 years to help make it happen!

Let's do it together.

Thank you.

(9)

Alaska's Constitution

A CITIZEN'S GUIDE

Fourth Edition

Alaska Legislative Affairs Agency • Gordon Harrison

Another important but familiar constitutional provision of Article IX is Section 12, which directs the governor to prepare an executive budget. This is a major executive responsibility that is not contained in Article III.

Two amendments to Article IX seek to curtail annual spending. In the summer of 1981, Governor Hammond called a special session of the legislature to consider a constitutional amendment to limit annual appropriations. A proposal was adopted, and it was ratified by the voters at the general election in the fall of 1982 as Section 16 of this article. The measure called for the voters to reconsider the section four years later, and it was upheld by a large margin at the general election of 1986. Section 16 has never effectively limited appropriations because the fiscal base was set comparatively high, there are numerous exceptions to the limit, and revenues available for appropriation have fallen short of what was forecast at the time the amendment was adopted.

Despite the failure of the appropriation limit, or perhaps because of it, interest continued in a mandatory device to curtail spending in the short term in order to set aside money to mitigate future fiscal crises foreseen from erratic oil prices and from declining production on the North Slope. In 1986, the legislature created in statute a budget reserve fund (AS 37.05.540). In 1990, the legislature adopted a constitutional budget reserve fund that was ratified by the voters at the general election the same year. The measure, Section 17 of this article, requires all income derived from the termination (by settlement or litigation) of disputes with oil companies over back taxes and royalties to be deposited to the fund.

Convention delegates surely gave little thought to the notion of a spending limit in the winter of 1956, in view of the lugubrious fiscal prospects for the new state, the delegates' determination to draft a concise constitution, and their confidence that a citizen legislature would act responsibly.

Section 1. Taxing Power

> **The power of taxation shall never be surrendered. This power shall not be suspended or contracted away, except as provided in this article.**

Legislatures frequently grant tax exemptions and other tax-related inducements to corporations to locate within the state. Courts have found that in some circumstances this special tax treatment amounts to a contractual relationship with the corporation that future legislatures may not abrogate. Consequently, the constitutions of many states provide that "the power to tax shall not be surrendered, suspended, or contracted away," to clarify that tax exemptions granted by the general laws of the legislature do not create contractual obligations. The *Model State Constitution* recommended such a provision (it was dropped in later editions). Presumably, the delegates adopted this version of the prohibition to emphasize that the state could legally grant tax exemptions under general law for public purposes, such as inducement for industrial development (see Section 4). The committee commentary

that accompanied the draft of this section said the following: "The power to tax is never to be surrendered, but under terms that may be established by the legislature, it may be suspended or temporarily contracted away. This could include industrial incentives, for example."

According to Article X, Section 2, the state can delegate its power to tax only to local government.

Section 2. Nondiscrimination

> **The lands and other property belonging to citizens of the United States residing without the State shall never be taxed at a higher rate than the lands and other property belonging to the residents of the State.**

The "equal protection" clauses of the Alaska Constitution (Article I, Section 1) and the U.S. Constitution (Fourteenth Amendment) both stand in the way of the state or a local government taxing property at different rates strictly on the basis of where the owner lives. Technically, therefore, this section is unnecessary. Symbolically, however, its inclusion was important to reassure nonresident commercial interests (who tended to oppose statehood) that their property would not be singled out for tax purposes. A similar provision was included for the same reason in the Territorial Organic Act of 1912: ". . . nor shall the lands or other property of nonresidents be taxed higher than the lands or other property of residents." Provisions of this kind are found in other constitutions of western states (see, for example, Article XXII of the South Dakota Constitution; a similar provision was deleted from the Hawaii Constitution by the convention in 1968).

Section 3. Assessment Standards

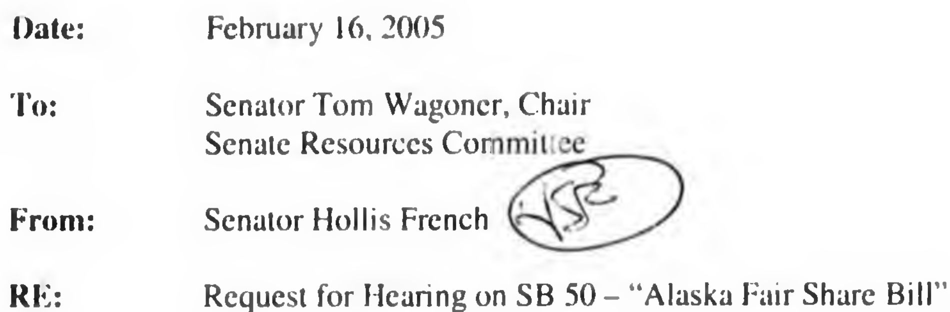
> **Standards for appraisal of all property assessed by the State or its political subdivisions shall be prescribed by law.**

Many state constitutions require taxes to be "uniform and equal." Section 9 of the Territorial Organic Act of 1912 contained a uniformity clause: ". . . all taxes shall be uniform upon the same class of subjects and shall be levied and collected under general laws, and the assessments shall be according to the actual value thereof." However, these provisions at times complicated the fiscal life of states when courts interpreted them to prohibit graduated income taxes, tax exemptions and other reasonable differences in the treatment of various tax resources. Because of the potential for these problems, Alaska's constitutional convention delegates decided against a uniform and equal clause. However, they included this language to accomplish a measure of statewide uniformity in local property taxation by requiring the legislature to establish a common set of standards for appraising property.

Senator Hollis French

Capitol Room 504
465-3892
465-6595 fax

MEMORANDUM



Date: February 16, 2005

To: Senator Tom Wagoner, Chair
Senate Resources Committee

From: Senator Hollis French

RE: Request for Hearing on SB 50 – "Alaska Fair Share Bill"

Per our discussion earlier today, this is an official request that you schedule a Resources Committee hearing on SB 50 – "Alaska Fair Share Bill" at the earliest possible time.

I have attached a copy of the bill, a sponsor statement, and a sectional analysis for your information. Additional materials will be made available to the committee aide prior to the hearing.

Attachments

Alaska State Legislature

Senator Hollis French

Sponsor Statement

SB 50– Alaska Fair Share Bill

Under the Alaska Constitution, the State is charged with ensuring that our natural resources are used "for the maximum benefit of the people." In terms of dollar value, oil is indisputably our most valuable natural resource. It is imperative, therefore, that state government ensure that Alaskans receive a fair share of the revenue from this public resource. It is also important that a fair share of the resource be provided to the companies that have contracted with the State to produce and sell Alaska's oil.

The production tax, sometimes called a severance tax, is a major part of the State's oil and gas tax structure. The production tax, like most taxes, is calculated by using a complicated formula. In general, the tax rate is set at 15 percent of the net production value. Unfortunately, however, few producers are required to pay the full 15 percent, and revenue from the production tax is decreasing every year.

Producers are required to only pay a portion of the production tax because of the ELF (Economic Limit Factor). Under the ELF formula, smaller fields are partially or wholly exempt from the production tax, and larger fields see their production tax rate drop every year. Of the twenty producing fields on the North Slope, twelve pay no production tax at all. Several of the larger fields – including Kuparuk, which is producing over 100,000 barrels of oil per day -- pay less than 3 percent in production tax. Eleven of the last fourteen North Slope oilfields that have come into production since 1989 pay no production tax, or almost none (less than 1%).

That exemption applies whether oil is at $10/barrel, and profit margins are low, or at $30, $40, or $50/barrel, when corporate profit margins balloon. At $20/barrel, profit margins are high enough that BP announced last year it would use excess

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Senator_Hollis_French@legis.state.ak.us

profits at that price, and above, to send increased dividends to shareholders and to engage in a corporate stock buy-back program.

The Alaska Fair Share bill will make two adjustments to the state's production tax on oil. The first adjustment is simple: it would require all producing fields to pay a minimum 5 percent production tax. This provision alone would raise $75 million in state revenue at an oil price of $22 per barrel.

The second adjustment is more substantive. It would tie the production tax rate to the price of oil. The bill sets a 'normal' price range of $16 to $20 per barrel. Within that range, no adjustment would be made to the production tax rate. However, outside that range, the bill would allow the production tax rate to go up as prices go up and, to be fair, to go down as oil prices go down.

If no adjustments to the production tax structure are made, the State's return from this tax will diminish rapidly over time. For example, in 2003, the State earned $599 million in production taxes. Looking ahead, the Department of Revenue estimates that the State's production tax receipts will drop to $180 million in 2013.

The current severance tax law also gives the producers an unfair share of the state's oil wealth at average and high oil prices. As prices increase, the state's relative profit share falls. Conversely, state taxes are arguably too high at very low prices. The imbalance in favor of industry at high prices is much greater than the imbalance in favor of the state at low prices.

The Fair Share Bill is not a so-called "Shelf the ELF" proposal, which seeks to impose a flat 15 percent tax on all fields, at all prices. This bill recognizes that smaller and older fields should receive some tax relief under the ELF . However, it provides for a modestly higher production tax at higher oil prices, and a lower production tax at lower prices.

Please join me in making a revision to our production tax structure. Let's be sure that Alaska gets its fair share of our most valuable natural resource.

February 16, 2005

Alaska State Legislature

Senator Hollis French

Sectional Analysis

SB 50 -- Alaska Fair Share Bill

Section 1 Amends definition sections regarding tax relief appeals filed with the Department of Revenue.

Sections 2-4 5% minimum production tax in most cases. This provision seeks to remove a current exemption that lets most new oil fields pay less than 1% in production taxes. While not all fields can pay Alaska's full 15% production tax, the state should at least set the minimum tax at 5% (to be reduced at low prices, see below). Under provisions of Section 5, companies can apply for an exemption from this minimum tax if they can show it is necessary.

Taken together, these sections establish a minimum production tax rate. Currently the production tax is 15%, reduced by the ELF. In most recent cases, the ELF has reduced the production tax rate to 1% or less. Sections 2 - 4 set a field's production tax rate at the current rate, as determined by the ELF, but prevent the ELF-adjusted production tax from falling below 5%, except in certain circumstances when prices fall below $16/barrel.

Section 5 Increases to production tax when oil is above $20/barrel. Decreases to production tax when oil is between $16 and $10/barrel. Deferral and waiver of taxes when oil is below $10/barrel. This provision aims to make the current tax code more progressive, so that at low prices oil companies are protected from high taxes and at high prices the State of Alaska may share fairly in high oil company profits.

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<u>Enhanced tax factor above $20/barrel</u>. Above $20/barrel, the severance tax rate is multiplied by the average monthly price of oil (West Coast price) divided by 20. Thus, at $20/barrel, the severance tax is multiplied by 20/20 -- "1" -- and is left unchanged. At $30/barrel, the severance tax is multiplied by 30/20 -- "1.5." In that case, a field with a 5% base production tax will pay 5% times 1.5, or 7.5%. The production tax will never exceed 25%.

<u>Reduced tax factor below $16/barrel</u>. Below $16/barrel, the production tax rate is reduced by the price divided by 16. Thus, at $12/barrel, the rate on a field with a 5% base production tax would be 12/16 -- ".75" -- times 5%, or 3.75 %.

<u>Reduced taxes below $10/barrel</u>. Below $10/barrel, one half of a field's production tax will be waived, and one half will be deferred until a month when prices average above $16/barrel.

<u>Heavy oil exempted</u>. "Heavy oil" is more expensive to produce than normal crude oil. Many believe the future of oil production will rely largely upon the production of heavy oil. The bill exempts heavy oil from the new enhanced tax provisions. It may be determined during hearings that a minimum tax should also be set for heavy oil, but that would have to be shown by testimony.

<u>Reduction in tax</u>. Provides a process for companies to seek a reduction in the production tax through an application to the Department of Revenue. The Alaska Fair Share Bill provides that any enhanced taxes under the bill may be waived if a company shows that tax relief is needed to make new or continued production at a field "economically feasible." This is modeled on Alaska's existing "royalty relief" law, and uses the same standards and process.

Section 6: This section provides a conforming amendment to existing law to include new provisions in this bill.

(1)

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Anchorage Daily News

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Oil producers profit more in Alaska

CONFIDENTIAL STUDY: Operating costs are high, but small tax bite makes up for it.

By LARRY PERSILY
Anchorage Daily News

(Published: February 2, 2005)

JUNEAU -- An international consulting firm says Alaska is a more profitable place to do business than the average of almost 60 oil and gas producing regions it surveyed worldwide.

The analysis, however, looks only at oil and gas fields where development started between 1994 and 2003, producing a limited view of overall North Slope costs and government tax bites compared with other projects started during that same period.

Legislators on Tuesday released two pages of data excerpted from the competitiveness study by Wood Mackenzie Ltd. The firm, based in Edinburgh, Scotland, late last year completed its report, "Global Oil and Gas: Risks and Rewards 2004."

The state paid $50,000 to subscribe to the report, but Wood Mackenzie's confidentiality requirements prevent the Legislature from releasing the entire 2-inch-thick document.

The numbers show Alaska oil and gas projects started during the 10-year period were among the costliest worldwide for development capital and operating expenses.

The oil and gas industry often makes the case that Alaska is an expensive place to do business because of its remoteness and Arctic conditions, and the Wood Mackenzie report appears to verify that claim. It shows Alaska ranked as the 52nd most expensive region out of 58 in the survey for development and operating costs.

Alaska averaged almost $10 per barrel in those costs, compared to the worldwide average of close to $6.

But Alaska producers fare much better when it comes to paying taxes and royalties, the report said. The total government tax bite in Alaska -- federal, state and municipal taxes and royalties -- is lower than two-thirds of the comparison regions.

Wood Mackenzie's analysis also shows the tax and royalty take in Alaska falls as a percentage of total net revenue when oil prices rise, verifying what proponents of higher oil taxes have long argued -- that the state is taking a smaller share of oil revenue at high prices.

The total government take after oil company expenses over the life of the field is about 71 percent on a worldwide average, the report said, regardless whether the price of a barrel of oil is $16, $22 or $35. In Alaska, however, the government share of the net is about 71 percent at $16 oil, 64 percent at $22 and 58 percent at $35, according to the survey.

Producer return on their investment in projects between 1994 and 2003 were three percentage points higher in Alaska than worldwide at $16 oil and six percentage points higher at $35 oil, Wood Mackenzie reported.

"This does not surprise me," said Dan Dickinson, director of the state Tax Division. "By definition, we are a regressive system," taking a smaller percentage of total revenue when prices are high.

Gov. Frank Murkowski has asked lawmakers to review the state's oil tax structure, particularly to look at the state's share when prices are high, but he has not committed himself to backing any specific change in tax law. The state did, however, raise the tax rate administratively on almost half of North Slope production as of Tuesday.

The information released Tuesday is limited and does not include all of the data that went into ranking the regions. Alaska is the only state surveyed for the report, which included federal leases in the Gulf of Mexico, two areas of Canada, and more than 50 foreign nations.

Although the company bars subscribers from publicly releasing the full report, the Legislative Budget and Audit Committee negotiated for release of some of the Alaska-specific numbers, said Committee Chairman Sen. Gene Therriault, R-North Pole.

Legislators are required to sign confidentiality agreements to read the entire report. As of Tuesday, six had signed agreements.

The committee, meanwhile, has contracted with Chuck Logsdon, who retired last fall after more than two decades as the state's chief petroleum economist, to review and verify the report and summarize its relevance for Alaska.

Logsdon's work likely will not be released to the public, Therriault said, under the same rules that govern the report itself.

"This could be the one glimpse under the covers the public gets," Therriault said of the two pages released Tuesday.

"It's tough to start changing policies based on these six graphs," Rep. Ralph Samuels, R-Anchorage, said of the short summary. Samuels, vice chairman of the Legislative Budget and Audit Committee, said he wants to wait for Logsdon's analysis before judging the state's oil and gas tax structure.

"Your best test for competitiveness is looking out the window," said Judy Brady, executive director of the Alaska Oil and Gas Association. The list of companies willing to invest big money in North Slope projects or the companies that have left the state is a good indication of Alaska's competitive position, she said.

The association, which also subscribed to the Wood Mackenzie report, will undertake its own analysis of the study, Brady said.

Reporter Larry Persily can be contacted at lpersily@adn.com or at 1-907-523-9306.

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2

Sen. Hollis French

From: Sen. Ben Stevens
Sent: Monc. y, March 07, 2005 3:26 PM
To: Sen Hollis French
Subject: FW: ***SPAM*****

The article I referenced today.

Oil's Run Is Likely to Keep Fast Clip

Price May Top $60 or More
If Supplies Are Disrupted
And Demand Fails to Cool

By BHUSHAN BAHREE
Staff Reporter of THE WALL STREET JOURNAL
March 4, 2005; Page A3

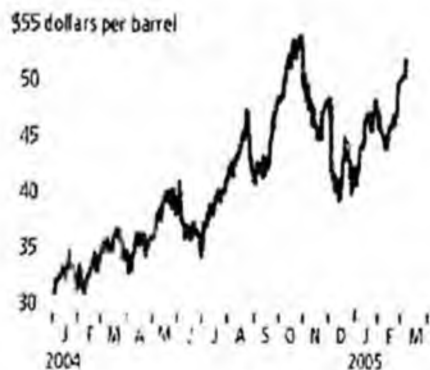
The big oil-price spike of 2004 looks increasingly likely to get a sequel.

As oil prices approached a new high yesterday, industry analysts said they are anticipating price increases to more than $60 a barrel this year. Some analysts are even beginning to talk of the possibility of greater increases -- to $75 or $80 a barrel -- in the event of a major supply disruption, unless red-hot demand for crude cools in Asia and the U.S.

Unlike last year, when rising prices sparked protests in the U.S. and elsewhere, opposition to the increase has become quieter as businesses and consumers have become accustomed to more expensive oil.

Yesterday, the acting secretary general of the Organization of Petroleum Exporting Countries, Adnan Shihab-Eldin, acknowledged in remarks to journalists the possibility of prices rising to greater levels if supplies are disrupted, suggesting the cartel believes it has a limited ability to curb world oil prices. Talk of a renewal of last year's run-up in prices comes as OPEC's energy ministers prepare to meet in Iran on March 16. While they could raise production quotas, OPEC already is pumping close to capacity.

Heading Up Again
Crude oil's settlement price on the continuous front month contract



Source: Thomson Datastream

U.S. benchmark oil shot above the previous settlement high of $55.17 a barrel in intraday trading on the New York Mercantile Exchange yesterday before retreating. Futures for April delivery settled at $53.57 a barrel, up 52 cents, after hitting as high as $55.20. On an inflation-adjusted basis, oil is still well below highs of about $90 reached in the early 1980s.

Like last year, growing world demand -- particularly from the U.S. and China -- underlies much of the price increase. The continued weakness of the dollar also has set the stage for increases, because oil is priced in dollars around the globe, and a weaker dollar means less revenue per barrel for oil producers.

The current surge in prices also comes amid realizations by OPEC nations and oil traders that higher prices have had a limited impact on world economic growth. While costlier energy has been a significant drag on relatively weak economies such as Japan and Germany, higher prices haven't been enough to derail recoveries in the U.S.,

China and other more-vigorous areas. With the world showing signs that it can withstand higher energy prices, there has been little evidence lately to suggest that either oil producers or big consumers are trying to cap the latest run-up.

"There is no fear of high oil prices," said Phil Flynn, an analyst at Alaron Trading Corp. in Chicago. "That's what scares me the most." He noted that Federal Reserve Chairman Alan Greenspan hadn't even brought up the issue of oil prices in Senate Budget Committee testimony on Wednesday.

Energy Secretary Samuel Bodman told a Senate panel yesterday that "the capability of any member of this government to influence the members of OPEC is limited." Mr. Bodman also suggested he had other priorities. "I have a lot on my plate," he told the Senate panel.

The current run-up still could further hurt those economically weak nations, as well as energy-sensitive industries such as airlines and auto makers. European Central Bank President Jean-Claude Trichet yesterday cited oil prices as one threat to economic growth.

The latest surge in prices was triggered by refinery shutdowns in the U.S. on Wednesday and a growing belie among many investors that OPEC isn't about to increase its production. Stockpiles of crude oil in the U.S. posted another increase this week, suggesting that OPEC wouldn't see a need to boost supplies when it meets this month. OPEC, led by Saudi Arabia, has made clear that its supply decisions are based in large part on making sure that inventories levels in major consuming countries don't rise.

As industry analysts pore over demand and supply numbers, they also realize that OPEC has very limited ability to intervene. This vulnerability in the global supply chain became evident last year, when OPEC was producing at nearly maximum capacity to meet demand. With demand continuing to rise this year, analysts reckon OPEC once again will be tested in the spring, as the U.S. driving season begins to use up large volumes of gasoline and as refiners struggle to keep up with demand for gasoline, diesel, jet fuel and other products elsewhere.

"I would not be surprised at all if prices spike past $60 [a barrel] in the third quarter, or in the next few weeks before the OPEC meeting," said Deborah White, an oil analyst at Société Générale in Paris.

Ms. White said the blow to consumers could be much heavier if there is a major crude-supply outage -- which she defined as two million barrels a day, about what Iraq produces on a good day -- or if 500,000 barrels a day of refinery capacity is lost. In such scenarios, "the sky is the limit," Ms. White said. "That means spikes to $75, $80 a barrel."

The world currently consumes more than 84 million barrels a day of oil. Rising overall demand and seasonal surges are expected to lead to global consumption of nearly 88 million barrels a day in the fourth quarter this year, a level of demand that refineries, making a whole slate of oil products, may be hard-pressed to meet. OPEC currently is producing 29 million barrels of oil every day, roughly a third of world supply.

Ms. White and other analysts figure OPEC has extra pumping capacity to replace only as much as one million to 1.5 million barrels a day of crude supply lost elsewhere because of accidents, strikes, wars or other reasons.

--Maya Jackson Randall and Ana Campoy of Dow Jones Newswires contributed to this article

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January 31, 2005

Record Oil Prices Spur Exxon Mobil Profit

By REUTERS

Filed at 2:11 p.m. ET

NEW YORK (Reuters) - Exxon Mobil Corp. (XOM.N), the world's largest publicly traded oil company, on Monday posted the biggest quarterly profit ever for a U.S. company -- $8.42 billion -- driven by high crude oil and natural gas prices.

The blockbuster results easily topped Wall Street forecasts, capping an exceptional year for the Irving, Texas, behemoth. Exxon's revenue in 2004 was more than $298 billion, surpassing the gross domestic product of countries such as Austria and Indonesia.

Surging demand from fast-growing Asian giants India and China, coupled with fears of a disruption in supplies from countries such as Russia, Iraq and Nigeria, kept oil prices surging for much of last year. Crude prices topped $55 a barrel in late October.

Exxon's fourth-quarter profit was equal to $1.30 a share, up from $1.01 a share, or $6.65 billion, a year earlier. Analysts' average forecast was $1.05, according to Reuters Estimates.

``They're managing their business like a Swiss watch,'' said Oppenheimer & Co. analyst Fadel Gheit.

Revenue jumped to $83.36 billion from $65.95 billion a year earlier.

The results did not produce a surge in Exxon shares. One analyst said Wall Street has come to expect extraordinary results from the oil giant. Also, the shares have been climbing for much of the past year and were already near a 52-week high.

STRENGTH ACROSS THE BOARD

All three major business lines at Exxon posted a sharp rise in earnings.

The rise in prices drove earnings at its exploration and production unit to $4.89 billion, up from $3.27 billion a year earlier. Profit from refining and marketing operations tripled, to $2.34 billion from $736 million a year earlier, on strong refining margins.

Healthy worldwide demand pushed up earnings at its chemicals business to $1.25 billion from $476 million.

``This is a particularly impressive set of results given that every segment outperformed expectations,'' Credit Suisse First Boston analysts said in a research note.

Capital spending fell slightly, to $4.23 billion from $4.36 billion a year earlier.

Oil and gas production fell 2 percent in the quarter, hurt by divestments and the impact of higher prices on production-sharing agreements. Excluding the those items, production rose by 1 percent.

Most major oil companies have been struggling with sluggish or declining production, faced with maturing oilfields in regions like the U.S. Gulf of Mexico and lack of access to regions that house some of the world's largest reserves.

An Exxon executive said on a conference call the company was not among the winners when Libya on Saturday awarded its first exploration contracts to U.S. companies in 18 years. U.S. oil majors are eager to reenter Libya after U.S. sanctions were eased last year.

ChevronTexaco Corp. (CVX.N), the No. 2 U.S. oil company, bid successfully on one onshore block in Libya. ChevronTexaco on Friday reported that quarterly profit nearly doubled, also on the back of record oil and gas prices.

Exxon shares were up 38 cents, or less than 1 percent, to $51.65 in afternoon trading on the New York Stock Exchange.

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Excerpt from Transcript
House Resources Committee
February 11, 1989

HB 118 -- ELF

have another handout that I have not quite completed yet, but I will get to you. These are the questions that I would like you to answer for the committee and with that, I thank you very much for your testimony and certainly appreciate your indulgence, or my indulgence, or anyway, thank you very much for your positions. I would like to have, please, Mr. Jerry Serena come to the table, and please state your name for the record, and who you represent, and could you give me please some idea about how much time you are going to need?

JERRY SERENA: Good afternoon, Chairman Davidson, Chairman Menard, members of the Committee and other Legislators in attendance. My name, for the record is Gerald Serena, and I'm a tax lawyer for EXXON Company, U.S.A., and I'm based in Anchorage. EXXON is a working interest owner in the Prudhoe Bay, Kuparuk, Lisburne and Endicott fields, and we appreciate the opportunity to present our views on HB 118 this afternoon. To digress from my prepared statement for a moment, it will take me less than fifteen minutes to read this into the record. I'd be pleased to try to answer some of your questions at any time, or after I read into the record, and I would also be happy to share with you some of my thoughts on some of the comparisons on Alaska and foreign nations that were presented to you yesterday.

CHAIR: And could you include in that please, some of the other states as well?

SERENA: I'm not sure I can do that today. We'll see how far we get.

CHAIR: Thank you very much, Mr. Serena. Would you please con-

tinue.

SERENA: 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 the 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 effective production tax rate for Prudhoe Bay and Kuparuk, resulting in immediate increases in tax rate in more than 20% of Prudhoe Bay, and about 60% in Kuparuk. Make no mistake about it, after we sit 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 to the production tax rate for more than 90% of Alaska's oil production.

It does not close a tax loophole, and it does not correct a tax giveaway. 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 being proposed now? Some would tell you that it's necessary to stabilize the 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 the discussion of the philosophy of State spending programs, or the abilities 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 and a quarter percent. But you 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 of 1981. In July, 1981, the basic rate was again increased from 12 and a quarter percent to 15%. And the ELF factor was fixed at one 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 on 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 million, 450 thousand barrels from the 1 million, 500 thousand 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 the decline was inevitable. The recurrence, however, was delayed until now by an efficient and (indiscernible) development plan implemented by the owners. That development plan continues to be implemented at Prudhoe Bay today through further development drilling, gas handling facilities, and extension of enhanced oil recovery on the drawing board. These investments will increase recoverable reserves at Prudhoe Bay and 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. They are similar to the projects to develop smaller fields on the North Slope in this regard. While HB 118 might lower the production 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 small 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 develop-

ment. This trend of less profitable projects will continue. Future projects which are being planned include wells, I mean closer spacing and (indiscernible) oil columns. Additional enhanced oil recovery, development of small reservoirs and new ideas such as horizontal drilling. The cost per barrel of 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 must be left if the current development is completed can be recovered eventually? No one knows for certain because the economics are marginal and a number of factors will have an impact on the limit to which 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 oil companies like EXXON endeavor to commit their capital and resources only to proven 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

tax. 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 a 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 of Prudhoe Bay require the approval of all three of the major owners. Each of the Prudhoe Bay owners evaluate the economics of the new proposed investment based on the needs of its company and the 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 project, this process includes the evaluation of various types of risk: geologic risk -- reservoir risk, drilling risk, and political and economic risk, including Prudhoe 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 it would be under current law. EXXON, obviously, has great interest in optimizing the recovery of oil at Prudhoe Bay in view of the enormous investment it has made to date; however, future development projects must stand on their own feet, and are evaluated primarily on the basis on the 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 on 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 where EXXON has little control -- crude oil price forecasts and Alaska taxation. With respect to crude oil prices, we try to forecast as accurately as possible based on economic, political and geologic intelligence from around the world. I don't have to tell you that this has been a less than precise science in more recent years. The vagaries of the world petroleum markets are surely one of the reasons that we are here today talking about this production tax increase. With respect to Alaska taxation, we make an assumption. We assume a stable tax policy based on fairness and uniform administration. State tax liability is a critical factor upon 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 product, investment activities will inevitably be trimmed back.

Tax policymakers 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 developments at Prudhoe Bay. The reduction of crude oil prices 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 impossible 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 work-over programs on existing wells. 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 stable tax policy which has encouraged enormous investment. To eliminate ELF now, at this historical time when it was intended to have its impact and benefit, would be a departure from the 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 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 with the lower risk projects elsewhere.

We have one final comment. HB 118 would repeal the proceeding under current law whereby taxpayers can rebut the statutory assumption 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 a 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. EXXON appreciates the opportunity to present our views this afternoon on this critical issue.

CHAIR: Thank you, Mr. Serena. We appreciate your remarks. Is your residence Alaska?

SERENA: Yes.

CHAIR: Thank you.

SERENA: I reside in Anchorage.

CHAIR: Thank you. Are there questions by members of the committee? Representative Navarre.

NAVARRE: Yeah, I have a question. On page 7, 8 and I guess 10, you refer to political risk, you investment scheme based on political risk, and I think what you're putting across here is if this legislature doesn't change the ELF that will give you some confidence that future legislatures won't change it? I mean that suggestion you're making, that doesn't seem like that's a good likelihood. I mean, I think each legislature has a responsibility to determine whether or not they think its a good idea, given the nature of the political arena how could it give you any real confidence?

SERENA: Where are you referring to?

NAVARRE: On page 7, you, about the fifth line down you were talking about the political and economic risks. On page 8, you assume a stable tax policy, and the backup page 10, you talked about the message that we're going to be sending to the industry and, I can't find it right now, but somewhere in your testimony...

SERENA: Six up.

NAVARRE: Page six?

SERENA: No, page 10, 6 up from the bottom.

NAVARRE: Page 10, 6 lines up from the bottom. No, that's, that's...

SERENA: I think I understand and I think I will move citations. There's two elements to this, this ELF business that we're concerned about. We're concerned when we review the economics of a particular project. We have to address what the current tax law is, and how that would impact our economics, and we also have to do some sensitivities to address cases of more, heavier tax burdens. The second element, and that fits into those sensitivities, is how practical and how likely do we think they might be. And I have to tell you that here in Alaska, there's a great concern because ELF legislation has been reviewed in the last two legislatures, that there is a certain instability to the tax climate here. I don't know that we would come to you and tell you you

shouldn't take these things under consideration to help that. We've found some legislators who do support our position, others who clearly are opposed to it, and in making our economic decisions and in committing our capital to investments in this State, that plays a role. Now its in the best interest, I believe, of Alaskans and of the State of Alaska, and of the State government here, to try to encourage continued investment and not to, to remove those question marks. You know, in a similar situation with the Governor's bill with unitary taxation, there are question marks in the minds of foreign investors. He's trying to remove those and trying to move stability in that income tax area with the foreign investors. Well, that impacts us. The dollars are significantly more than in the income tax area, and that's a concern and its a sensitivity we will always have to evaluate when we put a project together. Does that answer your question? I don't know if there's a remedy to it, and I'm not here today to tell you you can't do this anymore. I'm just telling you what the practical consequences are of a company like mine when we perceive legislative climate or a political climate that lacks this element that we would refer to as stability.

NAVARRE: Yeah, I guess my own comment would be that the, I mean, if this legislature doesn't change it, does that make it unstable? I mean do you think the next legislature would be less inclined?

SERENA: I think directionally that if we could look at three legislative sessions where ELF legislation did not succeed that directionally we would be moving toward a level of more stability than less stability. And what the measure of that

is I can't say. Again, we're just talking about what our perception of the overall economic, or if you want to call that political because that's economics that are imposed upon you as taxing authority, its our perception of what that environment is.

NAVARRE: Another question.

CHAIR: Go ahead, Representative Navarre.

NAVARRE: Could you provide us with where EXXON's other major investments are and what the relative stability, political taxing, whatever the climate is in those investment areas, and also, you mentioned earlier that you'd be happy to discuss the differences between some international developments and in Alaska, and how it compares and I'd be real interested in that.

SERENA: On the first part of your question, you don't expect that right now, do you?

NAVARRE: No.

SERENA: Mainly to talk about that a little further, so I'm sure I understand what it is you're after there. As far as commenting on international operations, I guess, Hugh Motley passed this to me a few moments ago. That's what happens when you had clean up in a situation like this. EXXON does have extensive overseas operations and I have been involved in them from time to time. But we operate in some of the countries that are listed here. I believe the United Kingdom and Indonesia -- not in some of the other countries

there listed. I just got this this morning and I'm referring to this. I think it was presented to you yesterday, so I can't conclusively give you our views, or critique it, but there's a few thoughts that I had that I've jotted down that I'd like to share with you.

END HRC 89-125, Side 1

BEGIN HRC 89-125, Side 2

SERENA: ...are being made between the State of Alaska, state of our republic and other sovereign nations. I understand that the oil fields might have some resemblance, so maybe that justified it, but when we talk about taxation in sovereign nations it represents the whole package of taxation that applies there. Now, when we talk about taxation in Alaska it doesn't necessarily represent the whole package. Its also a little unclear to me whether these charts include the federal tax burden or not. I, some people told me they do. Some people told me they don't. In any event, we would certainly like to run through these and verify the numbers. I see there's one, there is one clear error, I think, with respect to the United Kingdom where the Alaska revenue there jumps to 3.7 billion and its 3.1 on the other charts. The bar charts goes that high too. I assume that's a misprint, but in any event, I think these figures need to be reviewed a little more carefully.

Now, having said that, that'd be the easy way to get out of it, but you can't compare states to countries, but there are a few remarks that can be made. First off, and I guess I should tell you I've had some experience in EXXON's over-

seas operations. I spent five years in our affiliate that dealt with negotiating exploration contracts with foreign governments around the world. In most cases, almost without exception, the oil and gas and minerals in those countries belongs to the state. That's a little different than here in Alaska. Here in Alaska it belongs to the State because the State happens to own the land that's over it. There it doesn't matter who owns the land, the minerals belong to the state. You start with that proposition. There's no private ownership of minerals. So when you want to explore and develop and exploit those minerals you deal with the state, you deal with their state oil company.

CHAIR: Well, on that point then, Mr. Serena, then doesn't it make sense to make comparisons maybe between nations and the State of Alaska since the State of Alaska is the owner of the oil?

SERENA: Let me continue here. I'd like to address that ownership question just a little bit further, but...

CHAIR: Please continue.

SERENA: The political systems, the legal systems that are in those countries in some cases resemble some principles of Anglo-American law, in other cases they don't. They don't resemble our laws at all. The State owns all the oil. It still owns all the oil. The form of the contract under which the company explores and develops there is different. In general, and Mr. Ottom referred to this, the contract that we see more often than not, and this is in the case in Indonesia for sure, is a production sharing agreement, or

production sharing contract. Under the terms of that agreement, the foreign oil company puts up all the capital to explore and all the capital, usually, to develop a resource, but when the field comes on stream there's an accelerated recovery in that investment. It's called cost oil. Generally speaking, all the exploration costs come right off the top. In some cases, all of the development costs come right off the top as well. I think Mr. Ottom and Mr. Motley suggested that if we applied that principle to Alaska there would be $25 million that would come off the top. And I don't think any of you would be in favor of that kind of a program. So, the form of the oil contract is different, also, you have to look at each one of those countries because their physical environment is different. And in many of those cases they are much closer to market. They don't have to have a pipeline to get their oil to a port facility. So, that's different too. Now, I can tell you a little about Indonesia, and I don't want to get into it in great detail, but I know there was a quote in here, I think it was by an ARCO official about Indonesia and how they see Indonesia as being very stable political climate. I can tell you from EXXON's perspective that when we deal with a foreign nation in trying to explore and develop its national resources, taxability and our perception of taxability is a paramount important to us. About three years ago in Indonesia, they changed the form of the income tax law there and they extended it, all one income tax law to cover all kinds of taxpayers, and at that time the form of that production sharing contract was revised. I happened to have played a role with EXXON in negotiating some of the provisions of that new production sharing contract. It was the first one under the new tax law. Stability was of paramount concern

to us, and stability was what the government was able to deliver in that case. So, the lesson I think that teaches us is that stability is something that we look for in these foreign countries where we look for oil. It gets back to our discussion earlier, stability in Alaska. So, its the same in that regard, but other than that I'd like to reserve any other comments on that unless you have specific questions because I think its pretty dangerous to try to compare states with foreign governments.

CHAIR: You have an additional question, Representative Navarre.

NAVARRE: I had an additional comment with the $25 billion coming off the top. I think the assumptions are a little bit incorrect. We wouldn't owe $25 billion now. We'd go out and recalculate from the beginning when the investment was made and then split the shares of the profit after the $25 billion was taken off the top of that, recalculate and I don't think it would come out to $25 billion. I could be wrong.

SERENA: No, you're correct. If the point of focus was today to try to change things around, that's correct. But had we gotten into this type of foreign-type agreement back in the 1960's or the 1950's when these leases were first let on the North Slope, that wouldn't have been the case necessarily under the principles that apply to those agreements today.

NAVARRE: Right. If we took it from right now based on the infrastructure we wouldn't owe $25 billion off the top.

SERENA: Correct.

NAVARRE: If we went back and recalculated the $25 billion would come out of formula, I mean come right off the top of that profit that we split.

SERENA: The point here is that this is a snap shot. When we grab for a snap shot, and unless you know what happened before from the very day that the first agreement to explore for oil in that country was signed, you don't have the full picture and they'd bear further looking into.

NAVARRE: So you're saying that there are lots of variables that you cannot grab.

SERENA: There certainly are.

CHAIR: So, anyway that still leaves us with what is a fair, reasonable and appropriate public policy when it comes to oil taxation. One other question from you, Representative Navarre.

NAVARRE: Is there any parallel? I mean, can we get the information on, on the cost of production in Indonesia? Calculate the cost of production and the amount of profits in Alaska, and figure it out?

SERENA: Well, I have some concern as to what relativeness this adds to the present inquiry here. First off, there's got to be a natural reluctance on the part of a company like my, or any other company to give you more information than the law gives you access to. If there's a legitimate inquiry in the legislative committee, we certainly would try to cooperate

with it. I think, I can't answer the question across the table. I know that you've put some questions together and I saw those this morning, and we're certainly going to look those over and see if we can, what answers we can put together for them.

CHAIR: I just want to make this point. I think you referred to law and information. It might be worth mentioning here that perhaps more information would beget less law, whereas now we face a situation where less information is going to get more law. At least its one way of looking at it. Representative Navarre.

NAVARRE: Yeah, I, I just wanted to comment, I agree we can't take these charts and look at them and say, Alaska's getting screwed in this deal based on this chart. We don't have enough information, clearly. If we're going to use these charts for an example, and if, or if we're not going to use them, we need more information. We need to know all the production costs, who paid for them, and how much the profits were, who got what share of them if we're going to try to compare with Indonesia, for example, we could go back however long and get all the costs and calculate it out and then we could do a comparison. You're arguing that that may not be relevant to HB 118, but if we wanted to do a comparison, could we get that information.

SERENA: Subject to developing further what the precise information was and we had a starting point with your list of questions, we certainly would cooperate with you to try to do that.

CHAIR: We appreciate your cooperation. My question is a much

simpler one. It's on page 4. You mentioned that while HB 118 might lower the production tax for some smaller field, it would discourage marginal projects at Prudhoe Bay. Are you using smaller and marginal interchangeably here, or are you saying that Prudhoe Bay projects has marginal, that Prudhoe Bay has marginal projects within it, or that Prudhoe Bay is a marginal field? What are you saying there exactly?

SERENA: The comparison I'm trying to make here is between smaller fields that the State is (indiscernible)...

CHAIR: Milne Point, you mean?

SERENA: Yes. Along with several others. Fields that are smaller in comparison with Kuparuk and Prudhoe Bay, and the whole investment decision to move ahead to development of that entire field, at Milne Point that's already been undertaken, but there are smaller fields that the Department of Revenue has listed here in the last few days before you. The whole decision to move ahead with investments with respect to developing one of those fields, at the ground floor level, isn't a whole lot different than the decision to move ahead with further development in Prudhoe Bay. We can cut that kind of a project out, depending on what kind of a project it is, and maybe nothing more than a development drilling program.

CHAIR: What's a, what's an example of a marginal project at Prudhoe Bay?

SERENA: Development drilling.

CHAIR: Development drilling.

SERENA: As we continue, as our oil field continues to mature we have to put more development wells into it to maintain the production level. And usually, we look at those wells in groupings in terms that I, I think Mr. Ottom described some of them to you earlier with respect to Kuparuk. When we consider those projects each one of those wells has a cost on it, the group of wells has a cost as well. And we go through the process here that I've described here to determine whether the investment over a period of years in those wells is going to give us a return sufficient to justify it.

CHAIR: You indicated your clean up. I didn't get to ask this question to BP or ARCO. I'll just ask you and hopefully the others will respond. How fast would you like to extract the oil from Alaska?

SERENA: That's a decision that I think is driven by the physical characteristics of the reservoir. We, we want to follow an optimal and efficient program of developing that oil field. We don't want to slow it down and lose any oil. We don't want to speed it up and do anything reckless. The oil field characteristics dictate that. And I can't speak on it any more than that. I'd have to defer to one of our engineers or one of the other technical experts that's here today.

CHAIR: In your professional judgment, do you feel that the extraction, or at least the policy from your company will speed it up as a result of the ELF 20th of June 1987 date compared to whether it had not.

SERENA: June the 20th of 1987. Okay, this is when ELF became effective, right? At Prudhoe Bay.

CHAIR: Was there an effort by your company to speed up production after that?

SERENA: I think one of the earlier speakers today said that the decisions aren't necessarily the decisions that were made immediately after that date. They were decisions that were made after that date, and a year or two, three, four, before that date. We knew the tax rate was going to come down. That was part of our economics. That incurs, directionally, that incurred more investment, more active investment then, than would have otherwise have been the case. What the measure of that is I can't tell you right now. I, I don't know how succinctly we could identify that, but there is no question that incurrence, that investment and moved it ahead rather than backwards.

CHAIR: Thank you very much, Mr. Serena. Do we have questions from other members of the committee? Representative Furnace, and then Representative Hudson, and then Boucher.

FURNACE: Thank you, Mr. Chairman. I will be brief. Mr. Chairman, I appreciate your comments on the bar(?). Would you share with the committee to the best of your knowledge on the percentage basis, how much of EXXON's investment and operation is in Alaska versus other sectors of the United States?

SERENA: Well, I, I, it's hard to say. It depends on what your

yardstick is. I guess from a standpoint of production, a very significant of our production is in Alaska. I'm not certain but I think it approaches 50% of our production in the United States. From the standpoint of property, a significant amount of that is, you know, involved in the North Slope operations, but what percentages our real property, I just don't know. With respect to individual employees, as you all know, EXXON does not operate the oil fields on the North Slope. Our interests are, our ownership interest is roughly about the same as ARCO's interest is, but ARCO and BP are the operators so we don't have the same employee presence here in Alaska that those two companies do.

FURNACE: Thank you....

SERENA: I think that one yardstick of production is a very telling one. It's very important to us.

FURNACE: Can you just, in a thumbnail shape here, compare the political and taxing policy of Alaska that you operate versus other states within the United States that you're currently operating.

SERENA: Well, I want to proceed very carefully as I answer that question. Alaska is a very challenging political and taxing legislative environment. There are approximately 200 employees in the tax function of EXXON U.S.A., 199 of them live in Houston. Only one lives outside of Houston and that's me. So, that's what we think about Alaska's tax problems with respect to our manpower resources. We, we have challenges in our tax compliance area. We have chal-

lenges in the legislative area. We meet with you all the time. Year after year we talk about ELF and we talk about a lot of other things. We, you, and this legislature is very pro-active in the tax area and we are pleased with that in many cases. We're disappointed some time, particularly with respect to ELF, but it's a very challenging environment. We like things just the way they are. We've never come to you and asked you to reduce our taxes. We don't want you to increase them either.

FURNACE: Thank you, Mr. Chairman.

CHAIR: I can't help but comment here why you've been depressed, or curious about the employees such as yourself. I don't know whether to call you a citizen of Alaska or a citizen of EXXON. I think you guys have a very, very specialized lifestyle and I just had to say that. I probably won't get the opportunity again.

FURNACE: Excuse me, may I make a statement for the record. You have asked on many occasions, in fact, you made a comment a moment ago about the absence of information and the statement was, less information creates more loss. I think we need to be very sensitive here that the sharing of information, particularly within the industry, because of their competitive inferences within the industry has to be handled very carefully. As you well know there is a very quick inclination to charge price fixing if the industry does disclose too much information. And it is also the problem of being able to protect proprietary information. So, you know, we chastise them for information but we need to be sensitive of those two points.

CHAIR: Thank you, Representative Furnace. I think that's a point well taken, and perhaps now that you've mentioned the fact that perhaps the State of Alaska needs to develop a couple of tools that we do not have so we do not have to deal with the problems of proportional emotions that would be a marketing arm by the State government to determine exactly what the value of the oil would be as well as some method or tool that we could use to develop what those reserves actually are and not have to depend on the information we get from the industry. Thereby protecting both of us and perhaps coming out an information base that would be easy to develop sinful fact policy from. With that I would like to go on to Representative Boucher.

BOUCHER: I think it was Representative Hudson.

CHAIR: Oh, I'm sorry.

HUDSON: That's all right. Let Representative Boucher go.

BOUCHER: I want to go back to what really this is all about; maximizing our production for the longest period of time. There was, I date back to the beginning on this thing and it was our concern that indeed, they'd just drive (indiscernible) and move on. Well, for whatever reason that hasn't been the case. I would like to form a question. In 1988, this is on the bottom of page 3, sir, the production dropped from the hundred, 1.50 to 1.45, and of course, depending upon the figures that are available, that decline appears to have been, that decline appears to have been pushed out a period of time by the investment. Is that not true?

SERENA: I think that's clearly the case.

BOUCHER: I think, I think I'd like to know how much has been invested. This question probably was asked, and by that investment, how much more oil was produced? And obviously, the State of Alaska didn't have to invest in that. And how much revenue that resulted to the State in terms of severance tax by the additional investment. Does that question make sense to you?

SERENA: Beginning at what period. What time frame were you...

BOUCHER: You pretty well know. You know when you had to start doing, when you had to start adding to the natural function of the reservoir. I'd say from that time, in other words, there's two options you could take and they would have been no additional work, no water injection, etc. Just drain the field off. If that had happened what would be flowing through that pipeline today? I think considerably less than that. And I think that's one place that I would be very interested in, and I haven't unless I haven't retained that information, heard that story told. Never mind the amount, and these are important, the amount of money, but by applying technology to the field how much money do you spend? How much additional production? What was the return to the State? And I think you will find that to be a significant amount, but even more important I would like to find out, suppose nothing had been done, at what level of production would we be today? And would the world oil price be just the same is they were?

CHAIR: Would you like EXXON to get those answers to you, or are you (indiscernible)

BOUCHER: No, I think, if that question has been asked in the body of information that has come to you, Mr. Chairman, then it doesn't need to be repeated. But, I'm asking that question to the industry in general.

CHAIR: Thank you, Representative Boucher. On the the question of questions, I would just like to announce that the committee will develop additional questions, that is to say in additions to the ones handed out to you regards cost and other things, and a special question for Mr. Williams. On your handout you showed production costs of $3.39, and I would like for you to show, if you could, how you break those costs down. Now I would like a specific idea and if you could get that information to the committee we will be forwarding to the other companies who had expressed their positions on production costs, we will be forwarding other questions of that general nature to you. I am going to take one more Representative's questions and then, hopefully, we can bring this meeting to a close. Representative Collins, you have the last word.

REPRESENTATIVE VIRGINIA COLLINS (COLLINS): Women just love that. Thank you, Mr. Chairman. I have I guess a couple of comments and one question. It would seem that the information relevant to comparison between Alaska and other countries was generated by the Administration. It would seem appropriate that they provide the backup so that we can see what kind of information they were using at the time they come up with these comparisons and we could compare that with what-

ever we get from you, and that would be more helpful to me. I, the question I had is do you agree with Mr. Williams that the formula as identified in the HB 118 is in error?

SERENA: I agree with Mr. Williams that it points up a serious problem. The formula set out there works, it doesn't necessarily work the way the Administration has told you this bill is supposed to work. The problem and the complexity of this formula is such that we ask our legislators to review it and to reach an end result, and we don't necessarily have, it's not our place to expect you all to be experts in algebra, but things are so complex here. This formula has now become so complex that I had to read it five times before I could jot it down on paper, and there was some confusion in our office when we asked our analyst to run through it. I, I agree that the problem that the, that Tom brought to your attention before, I think is a problem and needs to be resolved. We've drawn up some curves that we think will go on these, and its not clear whether that's consistent with what the stories that you got from the proponents of the legislation or not.

COLLINS: Thank you. If I may followup. One of the other curves that I seem to hear as a result of the discussions of the questions that are being asked is really a question relevant to profitability degrees, and profitability among the industry or among I would say, maybe the private sector in general, are there some standards at which point, I mean a profit is a profit. You can have a profit of a dol... 1%, or you can have a profit of 50%. Is there some level out there that is kind of standard that people say, you're wasting your time if you're not making a profit of over 5% or 10% or

whatever?

SERENA: No, and as I mentioned earlier, those decisions are highly sensitive, proprietary, classified. ARCO and BP aren't going to tell us what their criteria are, and we don't tell them what ours is. Ours changes from time to time. If I could tell you, I'm not even sure what it is right now, but those decisions are made by management of our company to determine where our capital and our resources are going to be directed. And they change from time to time, the system of evaluating is the same, but it depends on what's perceived to be the price of crude oil, and just how good a particular investment is at a particular point in time.

COLLINS: Thank you, that's all I had, Mr. Chairman.

CHAIR: Thank you, Mr. Serena. I think we better close this off or I won't be able to afford to transcribe the notes. I'd like to thank all of you for coming today and if there is anyone left out there from the teleconference, thank you for hanging in there, and at 5:32 this meeting is adjourned.

I'd like to note that Representative Davis has been with us for a while up in Fairbanks. Thank you, Representative Davis. We'll probably see you on Monday.

Excerpt from Transcript
House Resources Committee
February 10, 1989

HB 118 - ELF

TRANSCRIPTION
OF
HOUSE RESOURCE COMMITTEE MEETING

HOUSE BILL NO. 118 - ELF

February 10, 1989

BEGIN TAPE HRC 89-121, Side 1

REPRESENTATIVE DAVIDSON (CHAIR): ...Committee to order on February 10, 1989 at 3:10 p.m. Members present: Representatives Vice Chairman Jacko, Representatives Navarre, Hudson, and Furnace, and on the teleconference network we have Co-chairman Menard in Mat-Su, as well as Representative Sharp in Fairbanks. Do you copy in our teleconference bridge please.

BRIDGE: Yes, Mr. Chairman. We copy you loud and clear and like I said earlier, we're smiling today. Over.

CHAIR: Thank you. Has Representative Sharp returned to the room yet in Fairbanks?

FAIRBANKS: Not yet.

CHAIR: Okay, please inform us or the moderator, rather the bridge operator when either Davis, Representative Davis or Sharp join us. Thank you very much. With that I would like to continue the hearing on House Bill 118, an Act relating to the Oil and Gas Property Production Tax, known by ELF by most of us I believe. First, I would like to make a couple of announcements. I would ask that the people who testify as well as our Representatives please speak into the mike. Yesterday we did have some difficulty, there was some difficulty hearing us out over the network. So, I ask you to speak up and into the microphones. And secondly, for every-

one who testified yesterday and all industry people who testify tomorrow, if you'd like to pick them up, the Committee has a list of questions that we would like all of you who testify who have an interest in this issue to please answer, and we would like a response to those in a timely manner, hopefully by Friday, February the 17th. There are two other very important announcements, actually the questions was one of them, the other one is that on Wednesday we will hopefully be offering time for short concise summary presentations and both the, for both the administration as well as the petroleum industries. Continuing on here today, I do have a couple of other comments that I would like to make before we get heavy into this proceeding. I hope that you will bear with me for a couple of minutes here.

Today we continue our discussion on this debate of House Bill 118. And before we move on for a continuation of the Administration's presentations I have a couple of questions that I would hope could be addressed in that presentation. Yesterday, there were two newspaper articles that caught my attention and one was an ad in the Juneau Empire that was about a three-quarters of a page ad and it said "What is ELF?" It was paid for by one of the oil companies. And I found it interesting because it is a question we are ourselves addressing here. So, when either Mr. Erickson or, well yes, Mr. Erickson, if you would please help to raise this in public debate, would you please address those questions and also the answer to that was presented and I would have a copy of those, of that newspaper ad for you shortly, I requested staff to get that for me.

The other thing I would like to add is that yesterday we heard extensive testimony indicating that House Bill 118 would more effectively accomplish what the current ELF was intended to do; and apparently is not doing. And that is to give a tax reduction in the marginal fields that require such a break.

The question before us then is not what if ELF? Rather, how does the ELF work? Is it doing its job? Should the ELF be modified to accomplish the stated goals? The other article that caught my eye was the article that was in the Anchorage Times, February the 8th, referring to our discussions here as "tampering with ELF." A major spokesman for the oil industry, E. John Brown, Vice President for BP Explorations, said, and I quote, "If Alaska goes ahead and changes the ELF for Prudhoe Bay we would have no choice but to cut back our planned developments here and elsewhere in the state." I am grateful to Mr. Brown for putting this question before us. This is an important statement that expresses major concerns about the public policy today before this Committee. And I would remind the committee that we, as publicly elected officials, are the ones responsible for setting that public policy, a policy that should be sensible, fair, reasonable and appropriate.

My question, which I hope, Mr. Erickson, you can address in your comments is, do you think the industry would cut back, even leave Alaska, if we modified the ELF as recommended in House Bill 118? And is the current activity of drilling and well reworking at Prudhoe Bay attributable to the ELF rate, or is this activity attributable to changes in the world price of oil? In these periods we are involved in a public

dialogue to establish the simple tax policy for our state. These are fascinating, complicated and important questions worthy of our most careful deliberations. I look forward to the testimony of the Administration today, and I look forward to the information from the oil industry tomorrow. And, indeed, I look forward to the public testimony next week. With those comments, I would ask then that the Administration please proceed with your presentation. Thank you.

COMMISSIONER HUGH MALONE (COMMISSIONER): Mr. Chairman, with leave of the Committee, one of the things I would like to do today is make a change in the order of presentation, the last part of the Administration's outline, and have sections six through eleven, those general topics covered first rather than the effect of the Economic Limit Factor on Alaska's revenues. In other words, reverse the order of presentation. Let Mr. Erickson go first and Mr. Logsdan take up the last part of the presentation, if that's agreeable.

CHAIR: That would be fine, thank you, Commissioner. I understand with that we are ready for Mr. Erickson.

COMMISSIONER: Yeah, Mr. Chairman, I would like to introduce Mr. Erickson to the Committee. Greg Erickson has been an economist for the State of Alaska for quite a number of years. I had the opportunity to work with him in the early '70's. I found these same issues. Mr. Erickson has followed them closely, the entire legislative history of the oil tax changes from the mid-seventies to today has, is the senior economist in the Governor's Office of Management and Budget Policy Division and has done extensive work on the Economic

Limit Factor issue over the past several years when it became apparent that this issue was going to need attention. And I think that you will find that Mr. Erickson's presentation is interesting, and I hope you find it enlightening. Greg.

CHAIR: Thank you, Commissioner, and Mr. Erickson, welcome to our committee. Will you please state your name and who your are representing for the record.

GREG ERICKSON: Thank you, Mr. Chairman. My name is Greg Erickson. I am Senior Economist with the Division of Policy in the Governor's Office. Mr. Malone did not mention in his very kind introduction that I also am an amateur opera singer, and in fact, tonight is opening night. And another fact is that I am losing my voice. So, if you would not mind, Mr. Chairman if I occasionally swig the fruit juice here as we go along, and perhaps I'll...

UNKNOWN: Is that home brew?

GREG ERICKSON: I wish maybe it was.

CHAIR: Mr. Erickson, the opera most certainly must go on and certainly, we have no objection. We have a few mechanical difficulties, arrangements out of the way here.

GREG ERICKSON: Mr. Chairman, I grew up in Anchorage. Maybe it will be helpful since I am going to be speaking to you for a rather lengthy period of time here, to give you just a little bit of my background and my bias, because I do have biases. I grew up in Anchorage in the 1950's, was educated

in Anchorage schools, went back east to college, studied economics and I returned to Alaska in the early 1960's, worked for the natural gas industry for a while, and then went back to school at the University of Alaska in Fairbanks, did graduate work in economics there, worked for the Institute for Social and Economic Research there. And have since 1966 been a professional economist engaged in Alaska fiscal and resource economic issues. 1972 to 1975 I worked for Resources for the Future, however, in Washington, D.C. on the National Energy Policy Project, and from 1975 to 1976 worked for the late Senator Henry M. "Scoop" Jackson as a staff economist on the what is now the Energy Committee, and what was then the Interior and Insular Affairs Committee, my duties then revolved around oil leasing policies for the federal government. I grew up in a political family in which Bob Bartlett and Ernest Gruening were visitors in our household. My father was a participant in the Statehood movement and I came to obtain values that are with me today. And those values say tnat when it comes to evaluating the kind of issues before you here today, the issue is not what's good for the oil companies. The issue is what is good for Alaska? And I think that's an important difference because we've heard a great deal said recently that purports to tell us that the, what's good for the oil companies is good for Alaska. Now, I wouldn't wish it all on the oil companies. We want to see them successful, but its wrong to say that what's good for the oil companies is necessarily good for Alaska. And that's my prejudice. I'm also very much prejudice towards the free-market and the kinds of capitalist institutions that we have developed here in the United States and Alaska.

This problem that we're facing is one that is not a new one for Alaskans. The question is how much of the return from a resource is going to go to those who supply the capital and the technology necessary to develop it, and how much is going tc stay with the people that provide the resource? Or the region, the source of that resource. That's an age old problem and I must tell you that the usual decision in that problem generally doesn't result in the resource owners getting too large a share. The fact of the matter is people who supply the capital and technology also generally have the wherewithal to influence political and institutional factors that govern how the benefit of that resource development gets shared. And they usually get a pretty good share for themselves. But it's not a new problem for Alaska, anymore than for other regions where its been developed. Resources have had to be developed with outside capital. And the photo that you see behind me indicates Ernest Gruening, forty-eight years ago, to the people of Alaska. He had just concluded a session o,f the 15th Territorial Legislature, in which his proposals for modest taxation for resources and incomes had been denied a hearing by the Territorial Senate. And the letter he wrote, the words he wrote that you see behind me, that were a response to that denial. The issue then, and as it is today, was whether Alaska shall be governed for an by outside interests whose sole concern is to take of Alaska as much as they can as fast as they can, and leave as little as possible.

Well, the ELF issue, as you heard yesterday, became a matter of significance again in 1987 when the time bomb, as Mr. Malone characterized, that placed in 1981, was set to go off. And our tax rates would effectively be reduced. The

oil industry knew that time bomb was ticking and the oil industry was concerned because the legislature and the State might take action to maintain the tax rate at the level it was prior to June of 1987, 15% rate on Prudhoe, or other changes that might adversly influence them and their profitability. Early in 1985 the industry began a campaign, a concerted campaign to oppose these kinds of changes and the keystone of their campaign, keynote of that campaign, was that changing the taxes would adversely influence the ability of Alaskans and Alaska oil companies to develop the marginal fields. George Nelson said, "We must have stable tax policies in order to make the risks associated with marginal fields worth taking." There were dozens of ads on the radio and the print media. Atlantic Richfield said, "The State must provide an investment climate that will encourage oil companies and other businesses to develop new ventures. Smaller fields already have been discovered on the North Slope, but they are marginal fields." The clear implication was that if tax laws were changed marginal fields wouldn't be developed. Companies were sophisticated enough to know that they couldn't claim Prudhoe Bay's economic would be adversely influenced, or to the point where development would cease. And, consequently, the kind of marginal changes in the severance tax that were being proposed because he doesn't want to make the argument that these marginal fields were at risk.

Well, the truth is that the tax system needs to take account of the differing profitability of differing resource development, and so it was in the summer of 1985, and the fall of 1985 we began to think about NRB(?), the Division, then called the Division of Strategic Planning, what might be

done to make the tax laws or changes in the ELF more appropriate to the kinds of needs that we were seeing, and the, specifically, to make it appropriate to encourage the marginal field development. And my colleagues at the Division of Strategic Planning came up with what was to be the first of several new ELF proposals. That proposal, I got all that are filed since, was designed to reduce taxes on the smaller fields and to raise taxes only on those larger fields like Kuparuk and Prudhoe Bay where it was clear that the profits were high. Notwithstanding this rhetoric the oil companies didn't support the so-called field ELF formula that was proposed. Producers refused to support the revised ELF, notwithstanding its admitted benefit to marginal field development. Why was that? Because they'd made such a production of their concern about marginal field development because when the amortizing hike is stripped away, there's only one bottom line for the industry, and it isn't developing marginal fields, and it isn't creating jobs, and it isn't even to get the most oil out of Alaska. The bottom line for the oil industry in Alaska, as elsewhere, is profits. Period. Now, it doesn't make the industry bad; it doesn't make them good. It makes them very predictable, however. And it's nothing we need to worry about. It's the way the system should work. But, if we forget that that's their motivation we're in for big trouble I think in this state. The ELF that we developed was designed to provide those incentives to the smaller marginal fields, but there's a lot said recently that indicates that, by the oil industry, that talk about the marginal projects within Kuparuk, and the marginal projects within Prudhoe Bay, the argument is that if this ELF is passed and higher taxes are imposed upon Prudhoe Bay and Kuparuk, these newer projects within

the profitable field- won't be developed. The industry's argument, like most good propaganda, starts with a grain of truth. Higher taxes on Prudhoe and Kuparuk could reduce investments in and production from those fields. But, our analysis suggests that if this reduction happens that it would be very small. On the order of a few tens of days worth of production from the North Slope over a period of the next twenty years or so. And what is conveniently overlooked by the oil industry are the countervailing factors that will tend to encourage development, not only on the large fields, but on the small fields if the new ELF is adopted And with these on balance major bill that's being proposed, the bill is before you today, a pro-development bill. A bill that will result in additional development, not less development. The bill that will result in additional jobs, not fewer jobs.

The reasons for that are as follows: Number one, the new ELF will increase drilling production and employment at the truly marginal fields, like Nyakuk, Endicott, Milne Point, and let's hope someday, Wetsack. In those fields the severance tax, under HB 118, will either be sharply reduced or eliminated entirely. That's a pro-development impact on those fields. These fields are likely to require more labor per unit of output because they're smaller fields. They tend to have more labor intensive development requirements. Focusing the benefits on those smaller fields, the ones that require more labor intensive development per unit of output is a way of maximizing the kind of jobs we're going to get out of this resource development.

Secondly, the new law encourages peripheral and in-field

drilling even in the big fields. Now and in the future, producers adding wells to maintain production or retard natural decline at Prudhoe or Kuparuk will be rewarded with lower marginal tax rates, and lower average tax rates. What is eliminated under the new ELF is the direct drilling subsidy the producers are exploiting under the current ELF. (Cliff, I'd like you to skip ahead to the Kuparuk, ARCO-Kuparuk example, it's near the back there. I think this thing's a little bit out of order here. That's right.) The drilling subsidy that exists under the current ELF is really something that came as quite a surprise to us. Now, I participated in the deliberations and served on the legislative staff in 1977 when the ELF was originally developed. We knew there was a potential in the ELF as it was written to provide some level of drilling subsidy, but we thought it more a theoretical exerc... problem, not a real one until 1987. ARCO came to testify before the House Finance Committee and they provided the example that you see up here. And they showed how the conditions that they postulated in this example, when the subsidy was actually occurring. Looking through ARCO's example, they said, suppose that we drill an additional well in the Kuparuk field, and suppose that as a consequence of that additional well we generate $981,000 of additional revenue in the fol-lowing year. Almost a million dollars worth of revenue from that well. Now, that would be the same under the current law, or the proposed law. The proposed law that we're looking at here is the Field ELF. It was proposed last year, but it's basically the same as the one we're talking about this year as well. The current law, of course is the same. They showed that that one well resulted in a give-back, a subsidy, in effect a payment from the State treasury to the producers of $37,000. In other

words, the producers paid a big fat zero of severence tax on that millions of dollars of additional oil produced, and not only did they pay zero taxes, they got a rebate on the severence tax they had already paid. That amounts to a subsidy from the treasury of the State to the drilling of that additional well. Now, you might say, well, gosh, isn't drilling wells a good idea for the state? And, of course, it is. We like to see lots of wells drilled, but not for their own sake. The oil companies like to drill wells because it generates profits. We like wells because it generates jobs and development, but it also because it develops profits too, both to the oil companies and to ourselves. Society is better off, not because it generates the jobs, but because it generates that wealth.

So, as you look down there you say, what was the incremental tax rate on that million dollars worth of new production? Answer-minus 3.9%, almost a minus 4% severance tax rate. The average tax rate, of course, was dramatically reduced here as well, and the average tax rate after drilling is reduced, and the percent change in average tax rate is reduced as well. Now, the difference is, it's almost as if you had an income tax in which the more money you made the less tax you pay. Instead of the bracket rates getting higher as your income goes up, the bracket rates get smaller and smaller. It's almost like when you reach a certain point you get a negative income tax for the really rich people that are making the most. Now that's how perverse the existing law has turned to be and that's one of the reasons that we need to change this law right now. But you notice we're not proposing to eliminate the incentives to drill additional wells. Under the proposed law, this mil-

lion dollars of additional production would pay a positive severance tax, 6%. That 6% is a lot less than the average rate. That means that by drilling that additional well and obtaining that additional (indiscernible) and the companies get a benefit -- a lower tax rate. Now, that may be a little hard to follow a technical argument, but that's a real important point as to the perversity of the existing law. When you talk to the oil companies you might ask them about this. Does it make sense to have a tax law that gives them a negative tax? You might ask the ARCO people when they come up to testify if they think it makes sense for us to pay them to drill additional wells and to produce additional oil. One of the other reasons, two reasons why the proposed ELF will produce more jobs.

The third reason is that any jobs forgone at Prudhoe Bay and Kuparuk has a consequence of the additional or the reduced profits in the near term will be made up later because this field is a tax reduction for all fields at some time in their lives. And what we would see, if, in fact, there was some deferral of oil production, that oil production would be regained later in the lives of those fields. For the law that we're proposing here is a tax reduction for fields that are producing less than 150,000 barrels a day, and in the tail end of its life, Prudhoe Bay will be producing less than 150,000 barrels a day. In fact, it won't be that long before it happens. So, anv loss in the short run is going to be made up in the long run. And there is a fourth reason.

The fourth reason that if, as our modeling studies last year suggested, that about five days of oil were to be left in

the ground as a consequence of this bill, and you know, that's a reasonable possibility, over the next twenty years or so. The benefits to the State of Alaska for each of those barrels of deferred production is likely to be between $50 and $300 worth of additional revenue. So, I realize the point of impact on the additional developments at Prudhoe Bay and Kuparuk is a very important one. I can assure you that impact is going to be marginal. I can assure you that impact is going to be very marginal. I can assure you that there will be accountability impacts, but we understand how important that is, and I think the Department of Revenue is going to undertake some more positional modeling studies to try to nail that number down more closely. But even those studies are not going to be able to answer with certainty the long run effect. That's something we're going to have to live with and make your choices of. I wish we could say, this is exactly what's going to happen. The truth is we can't. Neither can the oil companies because a lot depends on what happens to the oil prices. What the modeling studies have shown so far is that if prices stay about where they are or go up, there's going to be virtually no impact on production. No negative impact on production. But, if prices go down that's where we have the rub. If prices go down the higher tax, under this proposal, could result in, under very unusual circumstances, some less in investments. Well, I'm going to go on here and talk about profits. Mr. Chairman, I didn't put it in the packet but I'd like to introduce into the record a letter from my boss, Mary Halloran, to a Mr. John Navarre, of ARCO, who had questioned the source of some of these numbers and we provided them the answers as to how we derived them and offered to meet with them and discuss with them any suggestions they might have.

We have developed these numbers over a period of almost nine months now and we have worked very hard to make sure they are as accurate as possible. Naturally, we don't have the sources of information the oil companies have, and I must say, as you probably are aware, they don't share a lot of that information with us. The fact is they don't like to talk about profits. They don't like to talk about the numbers that relate to Prudhoe Bay. And, in general, they are not very helpful when it comes time to nail down what's correct and what's not. So, it may be as time goes on we'll find out better information, we'll have to make adjustments. Now, as things stand right now, we take this as a pretty good snapshot of what happens to the dollars of oil revenues that Alaska oil generates. In February of 1988, according to Petroleum Intelligence Weekly, which we took most of these numbers from, oil at Valdez was selling for, or was worth almost $12. Now, of that $12, $1.44 was all it took to actually operate the oil field and the pipeline and the Valdez terminal -- Maintenance, labor, fuel and all that sort of thing, including overhead. U.S. federal income taxes took about forty. Alaska severance tax, according to PIW, took about $1.99. Property taxes we show here as forty-six cents. PIW had, that's the Petroleum Intelligence Weekly, which is a fairly well-known industry publication, house industry publication. It supports some of these things and it's well respected. See, I got here a report at sixteen cents, fifteen cents, I can't remember the exact amount. A representative of Standard Oil pointed out to us that that was incorrect, that they had left out a low proportion of the property taxes, so we left that in. We also noted that pipeline operating expenses and some deferred return and the other categories of expense and expenditure

under the Taft-settlement methodology had not been properly factored in so we made those adjustments. These are PIW numbers adjusted for the property tax correction in the pipeline account. Royalty takes $1.10 and the State income tax takes twelve cents. Now you notice the State income tax there takes twelve cents. You also notice that the oil companies are collecting that $3.46 of profit. Now, the State income tax is assessed before federal income tax, if you add the $1.40 of income tax to the $3.46 you'd get what the tax base would be for State income tax assessment. For you folks running corporations in this state, and those make more than $100,000 a year, you know you have to pay a corporate income tax of 9.4% on that revenue. You notice the oil companies don't pay a 9.4% tax. They pay a considerably smaller tax because of the tax law changes that Mr. Malone and the other Department of Revenue representatives have described to you yesterday. You see after they've made up their expenses, and after they paid all their taxes, the oil companies have $3.46 of profit and $2.96 of depreciation. That's $6.42 of revenue. That's cash to the oil companies. That's cash that they can reinvest in Alaska. They can take somewhere else, they can pay to the stockholders, they can do whatever they want with it. We've been hearing a lot from the oil companies that, over the years, particularly in 1985, they said if we give large increase oil taxes that they would have that money to invest. Mr. Harold Heinz for the House Finance Committee, April 12, 1985, says, "As my profit decreases I have less money to invest." But what is a reality, and he's telling you something, shaking his finger as he's says this, "What I need you to understand is the amount of money I have to spend reflects the pace at which things happen. And the pace in which things happen in

terms of employment means the Alaska economy. If we" and that means ARCO, "slow down our investment pattern because of a lack of funds because of discouragement of investment in Alaska," now folks, that's a code word for raising taxes, "that has an effect on the economy of Alaska." The oil company was a little more straight forward than their ads that's in here. Quote, "If the state government increases our taxes we will have less cash to develop (indiscernible)." Well, what's the reality here? How much of that six dollars and forty some cents per barrel that was available to reinvest comprised of profit and depreciation, actually went into Alaska? Went back into Alaska. Well, we don't know exactly how much the oil companies reinvested in Alaska. But it's not that hard to figure out. This was a pretty public activity and they like to make big announcements about it, brag about the amount they are spending. We calculated last year that they spent about $750 million and divided that by the total amount of oil production and got ninety-six cents a barrel. I was interested to see that George Nelson spoke last week and said that in his estimation the industry would be investing about that same amount this year; $750 million. So, if it isn't that amount, or we think we're pretty close, it shows that of that almost $6.50 that the industry had to reinvest in Alaska, less than a dollar got sent back (indiscernible) ground here. Less than a dollar out of that $6.50. There's two million barrels a day going down that pipeline, ladies and gentlemen. Two million times $6.50 is about thirteen, fourteen million dollars a day. Less than two million dollars a day of that is sticking to Alaska in the form of new investment. The rest is gone. You're not going to see it again. It's gone. That points up what is a fact of the oil industry today.

Robert L. Anderson is really the founder of the modern Atlantic Richfield Company. He's the man that put the merger together that brought Atlantic and Richfield together and transformed it from the podunk oil companies to one of the major forces in the oil industry in the United States, and the world for that matter, today. In January of 1988 Mr. Anderson spoke about the very phenomenon that we're seeing here -- the liquidation of the oil industry's operation in Alaska, and he said, "U.S. oil companies are in the process of liquidating. U.S. oil reserves are leftovers of an enormous feast. Faced with a relentlessly declining reserve base, a good management is one that can intelligently liquidate its asset base." That is precisely what is happening in Alaska. The oil companies are liquidating their asset base in Alaska. They are taking more out than they are putting back in by a long shot. Now you might want to think about asking them when they come here to testify, why you folks should stand still for the remarkably low tax rates when the result is that the money they save as a consequence, the profits they make as a consequence, are virtually all going outside the state. You might want to think about asking them. But, of course, that isn't the only thing we have to look at. It may be that these oil company activities are producing a lot of jobs in Alaska. We certainly hear lots of advertisement to tell us that jobs depend on a healthy oil industry and if the oil industry isn't nurtured and taken care of that the jobs will disappear. Well, I think an interesting question to ask ourselves, how much of that $12 a barrel gets paid to Alaska workers? Well, it's an easy thing to calculate because we know how many workers there are working the Alaska oil industry, and we know from the Department of Labor statis-

tics how much they get paid. We divide that annual amount by the number of barrels and you can see that of all that $1.44 of investment, excuse me, $1.44 of cost of production of pipeline operations, and the ninety-six cents of investments, of that total only about seventy cents gets paid to workers in Alaska, and I said, Alaska workers. I didn't say Alaskan workers. Alaska workers, that's people who work in Alaska. The Department of Labor report that I just saw yesterday indicates that $55 million of that goes to people who are outside, or non-Alaskan Alaska workers. I'm sure you might want to ask the industry about that too.

Now one of the things the oil industry has said, and one of the great myths I think, is that the, when the ELF kicked in in 1987 on Prudhoe and Kuparuk, Prudhoe rather, that it caused a tremendous upsurge in activity. So, we asked the Department of Labor to calculate for us the monthly totals of employment resulting over the period of 1986 to 1988. Here's the picture of that. Here's 7/87, that's when the, that's when the ELF became effective. You see a feasible pattern there, C, D, it has a date, the year's along the bottom, and number of workers in thousands on the vertical axis here, and the black bars are oil extraction, and the cross-hatch bars are oil field services, and the top of the cross-hatch bars are total oil industry employment in Alaska. It is the total of the two. You see that oil extraction was the (indiscernible) category, it's more stable, and that oil field services tend to have a seasonal pattern to it. But, you know, you don't see a big leap upward in 1987 when ELF became effective. There is, true, a slightly higher number of people employed, maybe by a couple of hundred than there is back when the oil, when the ELF became

effective, but if you looked at twelve month intervals to avoid the seasonal pattern of demands, it's not possible to discern any impact as a consequence of the ELF becoming effective at Prudhoe Bay. But, you can see, however, what you can see that more as these numbers went back further, is how important the price of oil is to this kind of activity. You see here in '86, the oil industry was cranking down. If the figures went back to '85 you would see much higher levels of activity.

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GREGG ERICKSON: So, the point is, you might want to ask the industry, where was the activity that was purported to have taken place as a consequence of this tax break that the industry got in June of '87. But, of course, employment and reinvestment aren't the only things that matter when you look at whether this is fair to Alaska, if it makes sense to Alaska to have, give the oil companies this amount of recourse. Does it make sense for us to let them have that much? And, of course, those decisions get made on the basis of values and everybody has their own values, but the values are judged against facts, and we got a lot of facts about what other countries are doing in relation to what Alaska is doing. These are very crude comparisons. They are the sort of thing, though, that you might want to ask the oil companies. For instance, you might want to ask them why it is that Alaska with two million barrels a day of oil production is making $3.1 billion, and I should add that this is both Alaska's state revenue, Alaska local revenue, and Alaska

federal government revenue. In other words, revenue to all governments from Alaska oil production was in calendar '87 $3.1 billion dollars. We, we were using some smaller numbers in our earlier presentations and we went back to the drawing board and as a consequence of some suggestions from some of our oil company friends and we added in the back tax collections that we got, which probably should be counted in other years, but just to be conservative we added those in, so, even with taking account of those points, we only got $3.1 billion. You might ask them why it is that Nigeria, with 1.2 billion, million barrels of oil production a day, less than we have, got $6.2 billion from its oil resource in calendar '87. Maybe, maybe expenses are a lot less in Nigeria. Maybe the oil is a lot better. You might want to ask them. The next please. Incidentally, that's $14 a barrel Nigeria got whereas Alaska got $4.25 a barrel. Nobody asked the oil companies why Venezuela, that produced 1.3 million barrels a day got $9.2 billion. That's also for calendar '87. You may want, and don't for a moment think that this, these high profit shares are strictly a creature of countries where people have skins of different color. Not the case. Here's an English-speaking country with highly developed industrial society institutions. The United Kingdom produces more barrels of oil than we do, but they produce even much more revenue for their country. $8.8 billion on 3.2 million barrels a day of oil and oil equivalent. We weren't able to get numbers just for oil. We had to combine our natural gas numbers into that. That comes out to $7.53 a barrel for England compared to $4 and whatever it was for Alaska. You might ask them why. You might ask them why Indonesia, producing 1.3 million a day, substantially less than were producing, gets $4.5 billion of

revenue from its oil resource. Does that make sense? Is Indonesian production that much less expensive than ours? Is Indonesian oil that much, worth that much more at the market? It's a question you might ask them. You might also ask the ARCO people to explain the comments of their president, Robert Weycoff, when he went to the Indonesian Petroleum Associates in October 1987 and said, "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." You might want to ask the oil companies if it wouldn't make sense for Alaska to be an island of rationality and wisdom just like Indonesia was. We've already covered the ARCO Kuparuk example. You know, one of the things I think we have a hard time getting across is how tiny a share of these profits we're asking for when we suggest a change in the ELF. You know, you listen to these oil industry ads and you look at us and you say, my gosh, they're spending millions of dollars. This must be a state that's attempting to steal their britches and suspenders. Folks, it is not so. This chart shows the current shares of revenue between the oil companies and Alaska based on these PIW calculations. It shows that under current law the price is about $12 at Valdez, and Alaska gets $2.67 out of each barrel, about 35% of the available economic grants, if you want to look at it that way. And the oil companies get $3.46 a barrel. That's about 46%.

Now, is this ELF law going to make a big change in that? Well, take a look for yourself. Sure, it's going to increase Alaska's revenue -- by twenty cents. And it's going

to decrease the oil companies revenues by the same amount. And it's going to still leave them with substantially more revenue, per barrel, than we're going to get, because that's the price. Now, is prices go up they'll get even more. If prices go down we'll get even more, we'll do better. You might ask the oil companies, what's the fuss? Well, I'll tell you what the fuss is. The fuss is profits. That's twenty cents of profits that they think they need more than we do. And if I were in their shoes I would say the same thing. Profits is what the name of the game is about, and let's not forget it.

Now you know, I noticed that some of you have looked at that 35% and been talking about the so-called 30% criteria, the deal. Mr. Chairman, I have a memorandum here which, I'm not going to go into the 30%. I think we covered that earlier. Well, we'll talk about a deal, but we have a memorandum here that a colleague of mine has prepared today that may clarify the questions that were raised by the papers that Representative Furnace passed out last week, or yesterday. And you can put that in the record if you want. The question though is, did we make a deal? Did we make a deal in 1981, or in 1987? Well you can address that question in really three ways. The first way, the most important way is, was there legally a deal? Now, I'm not a lawyer. I'm an economist. But, I can read the Alaska Constitution, folks, and it just makes my blood boil when I hear people talk about a deal, because those people who talk about a deal, at least if they are talking about a legal deal, don't care about the Alaska Constitution. The power of taxation shall never be surrendered. Period. This power shall not be suspended or contracted away. Now the framers of our constitution didn't

put that in there just because they thought it would be cute. You know, folks, when you come to your session here, you can't contract away your freedom, your immunity from arrest or process on your way to the session. That's a right that isn't yours to give away. You can't give away your civil rights under most circumstances. Its not a right that you can give away because its a, the protection of that right is for our, all our benefits; not just yours. That's why the constitutional framers of this state and virtually every other state in the United States has said that the rights of the sovereignty that go with being a nation, or a country, or a state cannot be given away. You can't sell them. And thank God for that. Thank God for our children's future that you can't sell those rights to the future. So, there's no legal argument that there was a deal, and you know what? The folks that say there's a legal argument, they know this. They know this. But, okay, let's say (indiscernible) apart, what about, maybe there's a, maybe there's a moral argument. Maybe there's no legal argument that we made a deal, but maybe there's a moral understanding to it. That's possible.

So what happened in 1981? What did people say in 1981 about what they expected? Well, since its the oil companies saying they thought they had a deal, or their defenders and supporters saying they thought they had a deal, let's go back to what the oil companies said. May 21st, 1981. A coup has happened. It looks like the oil companies are going to get their, going to get some changes made in the law, but it's uncertain. There's a hearing of the joint Oil and Gas Pipeline Committee. A legislator, who happens to be the gentleman sitting right here, Mr. Hugh Malone, asked Mr.

Marty Taylor what he thought a fair deal would be. What percent do you think they, the State, should collect, Mr. Malone asked. Mr. Taylor said, something a little more 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 expenses and we made the investment. And he went on in that vein for quite a while, and then Mr. Malone came back and said, "So you think it should be brought down to the point where the State and you should get roughly equal shares in this? You like that better?" Mr. Taylor: Yes, sir.

In that same meeting Mr. Dick Donaldson was asked the followup questions (indiscernible) earlier between he and Malone and Mr. Taylor, he asked Mr. Dick Donaldson, who was the vice president for government and public affairs for Standard Oil Company of Ohio, was the main orchestrator of the oil industry's efforts to take care of their interests here in this legislature. He said, he asked him if he'd heard what Mr. Taylor had responded. And he said, did I hear you say that you would concur in 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." (Cliff, could I have back the shares graph again?) Rough parity was a stay. A pretty fair middle ground. (No, not that one. The bar chart that shows the comparative (indiscernible) is. That one. Rough parity. A pretty fair middle ground. Well, we're sort of approaching rough parity, but we're not there yet. With this new ELF we're not there yet, folks. We've got a ways to go yet. At least at

S12 a barrel at Valdez. So, anybody tells you that there's a moral deal, well, you know, I, and if anybody thinks, I know they come in and accuse of us of leaving off important words here with those (indiscernible), we've got the quotes. It's all in the record. If you want to see the original quote, the whole record, you can go and do it just the way we have. It's available.

So, you know, I could go on about the oil taxes a long time. Obviously, I feel strongly about them. It's not an easy decision that you have to make. I don't want to make it sound like (indiscernible) been working at this for twenty years, have this background that I think it's an easy decision. It's not. It's a hard decision. Resource interests are difficult ones to balance. And I sympathize with the difficult task you have before you. But, I hope that as you approach that task you'll be thinking of resources not just for current Alaskans, not just for, not just for the people who live here today, but for Alaskans next year and ten years from now, and in the same sense that Bob Bartlett was thinking of resources when he spoke to the Alaska Constitutional Convention when it convened in that cold November of 1955 in Constitutional Hall in Fairbanks, Founders Hall. He was concerned. He was concerned that the lobby that we'd seen development of the Kenicott Copper and the lobby that we'd seen to support the exportation of Alaska's canned salmon resources come to play too large an influence in Alaska. He was really concerned about that. He spoke to my father about that, and he spoke to the Alaska Constitutional Convention about that and he said, "Alaska is not unfamiliar with the activities of lobbyists, 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 Alaskan governmental services, and the use of all people of Alaska will mean a betrayal in the administration of the people's wealth."

Now we've got a lobby here, and the lobby is doing exactly what we'd expect it to do because it cares about profits. That lobby has spent lots of money to elect people who will support their interest, spent lots of money on campaign ads, and you know all this. So what it comes right down to it, you have to make the decision based on the facts as you know them. And I hope this information I've given you will help you make that decision more effectively. One of the things I think you might think about is that effective date clause, folks. You know, the oil industry said they were going to use the money from the, that didn't go into the state coffers to help develop Alaska's oil fields. We saw the ARCO ads to that effect. And they said they'd create more jobs if we let the ELF apply to Prudhoe Bay. I don't think either of those things have happened. Statistics don't show that there were that many jobs created and the numbers that we have surely don't indicate that any of that money that was made available to he companies as a consequence of the ELF applied to Prudhoe, ever found its way into a whole Alaska. I think that if there was ever a broken promise, that's the broken promise that you ought to think about. And you ought to make this bill retroactive to July 1, 1987. The chart that Mr. Malone's people showed you yesterday showed that big dip. Just build a bridge across that dip. Thank you.

CHAIR: Thank you, Mr. Erickson. I certainly have been impressed with your testimony. I think you've done a very thorough job for the Committee, and for the people of the State of Alaska, in presenting the facts as you see them. At this point, I would ask that the members of the committee who have any questions of Mr. Erickson. Mr. Hudson, please.

REPRESENTATIVE HUDSON: Thank you, Mr. Chairman. I just wanted to kind of separate, separate where I was coming from the other day when I talked about do we confer and negotiate with people on tax issues in the State of Alaska. And you made a very strong point of showing where the Constitution says, "...and we shall not surrender the powers of taxation." I don't think anybody has ever even, absolutely ever considered that we'd be surrendering that power. The very fact that we have the gentlemen right over here sitting down and negotiating, or talking with, or conferring with someone who is a business person who is going to be doing business in the State of Alaska, is, I think, probably what we normally would do. And that, I just wanted that to be straightened out because I senses that you were, you were almost flailing that thing when you came to that part of your speech. And since I brought the subject up it's been my feelings all along that if we're interested in encouraging development in the State of Alaska, we have to take these things into consideration. And when we're fashioning a first-ever tax policy in the State of Alaska, or something of that nature, I think we have to make certain, as I said, if we're trying to tax a fish company for example, or seafood processing, or encouraging them to situate themselves on our shores, you have to take into consideration there can't be profitability. I think you've shown in the rest of

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Oil and Gas Pipeline Committee

1981

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3 Other questions? Okay. Unless you have anything
4 further....
5 MR. BAUMAN:
6 I don't. Thank you very much.
7 MR. GARDINER:
8 Thank you very much. Monte Taylor.
9 MR. TAYLOR:
10 Ladies and gentleman, my name is Monte Taylor. I am
11 the Alaska Operations Manager for Exxon Company USA
12 I will briefly discuss the general issue of oil industry
13 taxation in Alaska, and why we oppose passage of the
14 backstop bill. I would like to start by reviewing
15 some past history in order to place my comments in
16 perspective. The oil and gas leases that provide most
17 of the present Prudhoe Bay production of just over
18 1.5 million barrels a day, were purchased from Alaska
19 in 1965 and 1967. From the producer's point of view
20 exploration in the Arctic was a bleak prospect at that
21 time. Climatic conditions were no more harsh than they
22 are today, but there were few airstrips on the North
23 Slope, no roads, no staging areas, and very little
24 infrastructure for logistical support. At the time the
25 leases were sold, the standard method of leasing was

competitive cash bonus bidding with one eighth retained royalty. Exploration on some of the new leases was begun in 1966. Some of the companies involved were SOHIO, ARCO, which was then Richfield, Chevron, Mobil, and Phillips. Exxon was involved as a 50% partner with Richfield. The early exploration results were less than promising - numerous dry holes had been drilled on the Slope when ARCO and Exxon decided to drill just one more well. As we all know, that final well discovered oil, what appeared to be at the time a large discovery, and was later confirmed to be the biggest oil field on the North American continent. If a way could be found to develop that field and get the oil to market then Alaska could look forward to sharing in the benefits of the find, one eighth of all the oil produced free and clear of all investment and operating risk. In 1969, Alaska held another lease sale near the area of the discovery, again retaining a one eighth royalty. A total of $900 million in bonus bids was received for 164 tracts or about $5.5 million per tract in that third sale. As we now know most of the acreage sold in that sale was outside of the productive limits of the Prudhoe Bay field. All of you know the trials and

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3 tribulations of the next decade after the discovery in
4 1968, with all the parties trying to solve what seemed
5 to be at the time insurmountable problems. But somehow the
6 government, the U.S. government, the state government,
7 the local government, the Alaska natives, and the producers
8 saw all that through with the passage of the Native Claims
9 Settlement Act granting the right of way for the pipeline,
10 construction of the pipeline, and the Prudhoe Bay facilities,
11 Valdez, and so forth. Then the oil began to flow through
12 the pipeline in June of 1977. From the time of the
13 discovery in 1968 to the time the oil began to flow, 10
14 tax increases were imposed on the oil industry. Each time
15 we heard the statement that the State had sold the leases
16 for too cheap a price, that the State had in effect given
17 away the oil. Perhaps I should emphasize here that the
18 sales were by competitive bid with the terms set by the
19 State. Those terms were one eighth royalty, plus whatever
20 cash bonus each company was willing to put up, with the
21 highest bonus receiving the bids only if the State believed
22 that the bonus was adequate. We don't think that changing
23 conditions justify changing that agreement any more than
24 we think drilling all dry holes in a sale area justifies a
25 refund of the bonuses. After all, those who bought the

off structure leases for $900 million in the Prudhoe Bay sale haven't asked the State for a refund. And those of us who participated in the Gulf of Alaska sale aren't too happy about the results; but we are abiding by the original agreement. As you know, the price of crude has risen dramatically over the past few years. The basic reason, of course, is the domestic and worldwide shortage of long-term oil supplies. These price increases have raised the revenues from oil fields all over the world. As a result, the revenue from Prudhoe Bay has exceeded the prior expectations of both the industry and the State. Perhaps it bears note in here, that the State has received the full benefit of those increases through royalties and taxes that automatically adjust to the increased wellhead values. For example, the State's royalty share in 1978, which was the first full year of production, was $200 million. In 1981 the State's royalty share is $1.46 billion , a 630% increase in the royalty share because of the increase wellhead values and most of that increase came from the increased wellhead values. Both the State and the industry have been very fortunate to share in the discovery and development of North America's largest oil field. The industry

has been involved in some unsuccessful ventures also and expects to repeat that pattern in the future. The replacement costs for a barrel of oil produced and sold have increased dramatically in the past few years, not only through inflation but through the increasing need to develop and explore in frontier areas and deeper horizons. There are obvious legal and equity reasons why states should not attempt to change an agreement through the powers of taxation. However, we do recognize that changing times and changing expectations can require some changes in the tax structure. In the case of Alaska we believe it is obvious that we have paid more than our fair share of taxes. We pay a 20 mill State property tax imposed only on the petroleum industry, a severance tax rate that is the second highest in the nation, and substantially higher than the rate imposed on other extractive industries in Alaska, and even a special tax to pay for the cost of regulating us. We were also subject for some time to the regular 9.4% income tax that has historically been imposed on all businesses in Alaska. After the 1978 special oil and gas income tax was passed, which taxes our income differently from all other Alaska businesses, a lawsuit was filed challenging

the constitutionality of the new special tax. What does all this have to do with the bill at hand? Simply that the bill at hand does not solve the problem at hand. It is merely an attempt to disguise another tax increase. The complexity of the bill will only invite further litigation which may possibly challenge the entire tax structure in Alaska. For example, the bill creates the illusion of allowing a windfall profits tax deduction on the State income tax. The bill says the deduction is granted. But then it turns around and sets a tax rate on the reserves tax which takes the money back again. A deduction without a benefit is hardly a legitimate deduction. Another severe problem with the bill is the provision allowing for, and indeed calling for, a revision of the millage rate each year. This provision builds instability into the tax system, and assures an annual confrontation between the State and the industry. The bill will also be still another warning to other industries who might venture to this State. It would say again, for example, to the coal industry, look at what happened to the oil industry after they bought the leases, after they did the exploration, after they made the discovery, after they built the $8 billion pipeline, and after they invested

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3 tremendous sums in Prudhoe Bay and in vessels to get the
4 oil to market. Ten tax increases occurred during the time
5 the investments were being made, and in 1978, after the
6 bulk of the initial effort had been invested, another major
7 tax increase. This last increase, in one single action,
8 raised the effective income tax rate to 6 times that of
9 other inter-state businesses in Alaska, and denied the oil
10 industry even the most obvious of tax incentives granted
11 to other businesses in the State, for example accelerated
12 depreciation. Now in 1981, the legislature is considering
13 still another tax increase on one industry to protect
14 the State against the possibility that the law passed in
15 1978 is unconstitutional. We also note from the findings
16 and purposes, and the transmittal letter, that the
17 legislation proposes to exclude gas from the reserves tax
18 because of a reluctance to adversely influence investment
19 decisions on gas development or the gas pipeline.
20 There is a strong implication that this might be changed
21 in the future after investment decisions are made.
22 Apparently the State will do the same thing on gas that
23 it has done on oil. We are glad, at least, to see a
24 recognition that tax rates do in fact influence investment
25 decisions. But we can hardly understand how a continuation

of that type of policy can improve the business climate or add to the stability that is so badly needed in Alaska. Our view is that passing this law would be an unconscionable action for the legislature to take against it's most productive industry. We further submit that such action would be counter productive to the best interest of the State because it will only reinforce the perception by the business community that this State has a very poor investment climate. I can think of no better shot in the arm for future development, not only by the oil industry, but by other potential investors, than for the State to repeal the special oil and gas income tax. And then to be able to point out to potential investors that the State does not have the highest taxes any more on the oil industry of any state, that all businesses are treated equally for income tax purposes at least, and that the State has taken positive steps to encourage development. There is no doubt in my mind that the State and the people would ultimately benefit from a dramatic and positive step like that. There is also no doubt in my mind that this State will not benefit by passing a backstop bill - it will only serve as a clear indication

that the legislature is not interested in seeking a resolution of the current litigation. We have here, it seems to me, two extreme positions - outright repeal, which in some legislators' view at least, would unreasonably reduce State revenues, and the backstop tax which by its statutory language is a tax increase over the four year period, and has the potential to be a further tax increase each year as the millage rate is reconsidered. We submit that somewhere between these two extreme positions, of repeal or backstop there must be a middle ground that will stabilize the tax structure, solve the uncertainty of future State revenues, and permit us to plan with more certainty on future involvement in the State of Alaska. Although we are confident of our legal grounds, Exxon would much prefer to see a legislative solution of this issue. As we see it, there are four basic elements to such a solution. First, maintenance of strong short and long term revenue bases for the State. Second, equitable treatment of corporations, including oil companies, doing business in Alaska. Third, elimination of the fiscal uncertainties which now hang over the heads of both the State and the oil industry with regard to the tax issue.

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3 And fourth, encouragement of future investments by the
4 industry in Alaska. Speaking for Exxon, I can tell you
5 that we are ready and willing to talk, to negotiate in
6 good faith and to agree to compromise where possible.
7 Our objection to the legislation before you is that it
8 will only make an unfair system worse. This legislation
9 would provide no new answers but would raise countless
10 new questions further adding to the uncertainty and
11 clouding the Alaska business climate. Rather than simply
12 rearrange the deck chairs on the Titanic, we think it is
13 a lot more reasonable for the legislature and the
14 administration to sit down with the oil industry and see if,
15 together, we cannot chart a new tax course which will
16 create a more equitable and stable tax climate that
17 avoids annual confrontations, and allows industry and
18 government to work together. We are convinced that a
19 middle ground is attainable, that would promote future
20 development and enhance Alaska's long-term future.
21 Thank you very much.
22 MR. GARDINER:
23 Representative Cotten.
24 MR. COTTEN:
25 Thank you for your testimony, Mr. Taylor. Noticing the

annual Exxon ad campaign, the newspaper ads and so forth, that say let's talk -- in one of those ads, you've talked abo here today too, that the State has changed the tax laws several times since 1969. One of the questions I have is, do you think any of those changes have been justified or, more specifically, do you think that tax that was in place in 1969 should never have been changed?

MR. TAYLOR:

No, I don't think that. It is obvious that the State of Alaska, that the petroleum industry is the major industry here -- we recognize that the-- for instance, the severance tax rate during the time of the sale was very low. We did not make the bids on the leases on the assumption that the severance tax rate would never change in the State of Alaska. Nor do we do that in Texas or any place else. Most states, we have some predictability as to what the tax changes might be as they come about because we can have some idea what the State might need. In the case of Alaska, we find it very difficult to predict.

MR. COTTEN:

I appreciate that. I think it is a pretty honest answer. I think one of the purposes of this bill is to

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3 maintain some stability. We think we are in a situation
4 where the revenues are predictable. I think that is
5 obviously the major thrust of this bill, to maintain a
6 revenue stream as is. Of course, we are in court - you
7 are suing the State, you and other companies are suing
8 the state over the constitutionality of another law that
was passed. This, as you know, attempts to maintain
10 that revenue stream.

11 MR. TAYLOR:

12 Well, we look at this as an increase in the taxes because --
13 just looking at the fiscal note.

14 MR. GARDINER:

15 Representative Rogers.

16 MR. ROGERS:

17 Mr. Taylor, you said that you think there is an equitable
18 level in there somewhere. You spoke in fairly general
19 terms in your four points -- I wonder if you could be a
20 little more specific as to what you see a compromise
21 could be, what would be the tax levels of the various
22 taxes, which ones -- in terms of a compromise, how would
23 you see that coming out.

24 MR. TAYLOR:

25 In terms of a compromise, we have a lawsuit going right

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3 now and there is a certain amoun . of dollars at issue.

4 We think a reasonable compromise, since it has been widely

5 circulated that we've said we have a 50-50 chance of

6 winning, the State said they have a 50-50 chance of winning -

7 it's somewhere in the 50-50 range between the chapter 21

8 and the chapter 20. We are willing to discuss

9 compromises that can put us in that range as a settlement

10 which would get rid of the lawsuit.

11 MR. ROGERS:

12 In terms of which tax ...

13 MR. TAYLOR:

14 In terms of the income tax only.

15 MR. ROGERS:

16 Okay, in terms of the income tax only. How about on the

17 other -- you are not, then, asking for any change in

18 the severance or property taxes. You feel that with

19 the existing other tax levels and split the difference between

20 AS 43.20 and 43.21, that that would be a fair tax

21 treatment.

22 MR. TAYLOR:

23 Yes, sir, I think so. I would have to -- I don't have

24 management committee approval to agree right here to that

25 compromise. If you would like to propose something we can

find out pretty quick.

MR. ROGERS:

I wasn't planning on proposing something. I did want to find out from you what level ...

MR. TAYLOR:

...compromise is a middle ground. As I tried to say in my testimony -- our ads were alluded to a while ago -- we have pointed out inequities that we consider in the taxation based on more things than just the income tax, but we have only proposed repeal of the income tax. I think compromise is related to that tax only. We don't like some of those other taxes but we realize we are going to be overtaxed here some and we are used to them, at least.

MR. ROGERS:

Essentially then, what I hear you saying, is that what we are talking about is bottom line number of dollars, not which tax you pay it in.

MR. TAYLOR:

Yes, it could be done other ways, but there just happens to be a lawsuit, which we think is a very valid lawsuit, on the income tax itself.

MR. ROGERS:

If my recollection is correct, right now we are collecting about $1.2 billion a year, total from the industry, from AS 43.21, as opposed to around $200 million for AS 43.20 so you are saying that a $700 million income tax treatment is the range you would consider a fair range.

MR. TAYLOR:

Did he do that math right?

MR. GARDINER:

They ask that up at the Finance Committee when he pulls those out too.

MR. TAYLOR:

That sounds right, doesn't it. There is $1 billion issue, and according to your assumption, and half of that $1 billion at issue is what we are talking about, which would by $500 million off, so a $700 million tax comes out of that, right? The numbers guys are over here.

MR. RANDOLPH:

Mr. Taylor, I have several questions for you. First, you alluded several times to the fact that you think this backstop legislation does, in fact, institute a tax increase. The information we were given yesterday, and the fiscal notes on it, indicate that it basically breaks

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3 cut even. What accounts for the discrepancy between
4 your attitude and the administration's attitude on this
5 matter?
6 MR. TAYLOR:
7 I think what you have to do is look at the assumptions
8 that went into the fiscal note. The statutory language
9 in the bill says that the millage rate will be 30 mills
10 for the first year, for 1982, and then 25 mills
11 thereafter. The fiscal note, in our opinion, makes an
12 unfounded assumption that a legislature in four years
13 from now will change the millage rate from the statutory
14 language of 25 mills and make it 20 mills. That is the
15 basis for the 1985 figures in the fiscal note. That
16 didn't make sense to me, so I ratioed the reserve tax
17 back up in '85 to make the fiscal note track the
18 statutory language. In that case, the total four year
19 effect, in the low case that is quoted in the fiscal
20 note, instead of being $164 million negative, is $218 million
21 positive. The high case effect, instead of being
22 $483 million positive, which we consider a big number,
23 becomes $964 million positive or almost $1 billion.
24 We have here a potential tax increase based on the
25 statutory language of $1 billion. I hardly think that

J&R Associates

justifies saying that the tax system remains essentially unchanged, or whatever the words were in the transmittal letter. Does that answer your question?

MR. RANDOLPH:

Yes, I think so. It seems to me that if you were to sit down and negotiate with the State and come out with some sort of agreement in this half-way area you were talking about, that still is an extremely tenuous position for the industry to be placed in - it is really not a -- if that was negotiated at this point, what would keep the State from coming back to the legislature 2, 3, 4 years from now and, through some vehicle or another, going right back to where we were. Or if we were to -- all we would have to do to correct that is to pass this so called backstop bill, cut the mill rate in half roughly, and we would be back in business. However, it would be a very small thing for the legislature to come back, in any kind of a future, and raise the mill rate and put you right back in the same position you are in. I guess my question is, how can he State at any point give the industry much assurance that our ten year history will not continue, regardless of the range on this particular issue?

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3 MR. TAYLOR:

4 We feel that is, to some extent, a risk we might have
5 to take. If we worked out an agreement, a settlement
6 so to speak, there might be some letter agreement that
7 says that we drop our suit and we do this and the State
8 agrees not to, or at least somebody agrees, not to
9 promote increased taxes. We realize this legislature
10 cannot bind a future legislature. There are ways out
11 on both sides of that, of course. We could decide at
12 some future time to sue on the severance tax, for
13 instance, although that doesn't seem like a very good
14 idea. I think that is just a risk we take, and we are
15 willing to take if we can get a rational settlement
16 that this legislature is committed to. Next year --
17 we've decided long ago that every year is a new ball-
18 game down here. We are going to have to be here and
19 play in it every once in a while.

20 MR. GARDINER:

21 It seems to me somewhat an answer to that question
22 is that there was this 10 year history where the
23 State and the industry went back and forth over -- there
24 even was one oil tax increase that the industry came in
25 and supported in 1973. The last time the legislature

acted was over the income tax bill and, probably, you could distinguish this bill -- I think there is some argument over numbers and that is something the Committee will want to get in over this bill as to exactly how much revenue it does raise, but, I think, the intent of the draft of the bill was to raise as close as possible, and I think the Commissioner went into this, to backstop the same amount of revenue. That is a lot different posture from the other 10 years of legislation, which, there was no doubt about it, each of those bills was intended to raise revenue. In the last couple of years I don't think the legislature has seriously considered any oil tax increases. In fact, I don't -- if you put the argument aside as to whether this does or doesn't, I don't think there has been a bill that has been seriously promoted - there may have been, I think there were some bills introduced, but I don't think they got hearings. To me it says that there was all this change, and not all of it was due to us or the industry, in terms of changing the value of oil, but I think, at least in my own mind, the process was concluded when the income tax bill was passed. Now other things have transpired, namely, the suit - and that's why we are here.

MR. TAYLOR:

It would be very diffcult to predict what's going to happen in the future though, with the annual requirement for setting the millage rate. The people have said, that's like your houses,that is set an annual requirement -- and, of course, that's true. But you've got a lot of houses around you and if they change it a little bit it doesn't change your personal property tax all that much. In our case, there would be an awful temptation, it seems to us, for the legislature to decide what they might want to spend that year and just set a millage rate that gets them that amount of money. We are out investing in hopefully new oil fields, not really being able to predict what the taxes will be. That's really a major problem in investment decisions, as you all know.

MR. RANDOLPH:

Just in response to your comments. We did have, in 1973 and then '75, a temporary reserves tax. Then in 1975 and '78 we had the income tax. And now we are in '81 and so it has been happening with fair rapidity.

MR. MALONE:

Thank you Mr. Chairman. Mr. Taylor, I suppose that you

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3 follow, at least to some degree, the progress of the
4 State budget and spending.
5 MR. TAYLOR:
6 Yes.
7 MR. MALONE:
8 Do you think that spending less in State government
9 is a feasible idea, and then again, do you think it would
10 be a good idea.
11 MR. TAYLOR:
12 Yes, sir, I do.
13 MR. MALONE:
14 Good. That's one thing we agree on. In your testimony to
15 the Committee, Mr. Taylor, you reviewed the Prudhoe Bay
16 development tax history there, and that the value of
17 crude oil has gone up - how much, approximately, was
18 crude oil worth in 1969 and what is it worth today?
19 MR. TAYLOR:
20 In 1969, I guess, it was worth something in the area of
21 $3 a barrel in the lower 48. I was in the lower 48 then,
22 and there wasn't any up here. It was $3. In '78 the net-
23 back price for Prudhoe Bay crude was $4. That's why the
24 big jump. It was $21 in '80. It has increased very
25 dramatically.

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3 MR. MALONE:
4 Roughly what percentage increase would you say that is?
5 MR. TAYLOR:
6 Well, $4 to $20 is 500% increase. Most of the increase
7 has been in that period of course.
8 MR. MALONE:
9 In your comments you said enactment of the reserves tax,
10 this backstop tax may lead to a challenge of the entire
11 tax structure of the State. What does that mean? Is it
12 a threat?
13 MR. TAYLOR:
14 What I think it means is that the -- we've contended
15 for some time that the 40% share that the State seems
16 to have decided it should have, based on a severance
17 tax higher than anybody else, any other extractive
18 industry, and a property tax that is only on us, and
19 an income tax which taxes, which redefines our income
20 and taxes higher, is discriminatory. What it means is
21 and I'm not saying that Exxon is planning to file a
22 lawsuit. I think it opens the door to a possible law-
23 suit challenging the entire tax structure rather than
24 just one given tax, which door is open anyway.
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3 MR. MALONE:

4 I guess it is open anyway. A person has some arguments
5 they want to have a legislature or court review, they can probably
6 have that done But what I am trying to understand is, what
7 that would mean is -- are you saying that the allocation
8 of the value of the resource that is produced in Alaska
9 right now among the State and the Federal government
10 and the producing companies is something that you regard
11 as unfortunate at the present time?

12 MR. TAYLOR:

13 Yes, I think it is discriminatory. The State gets about
14 a 30% or more share and the producers get about 25% share.
15 We are the ones that bought seven eighths of the oil and
16 found the oil field. I think it is a discriminatory tax
17 level.

18 MR. MALONE:

19 What -- for the last reporting period -- what's the net
20 income that your company produces after taxes in the
21 State of Alaska, production in the State of Alaska?

22 MR. TAYLOR:

23 Net income on production in the State of Alaska. I don't
24 know that figure. And if I did, it is confidential
25 information. It is part of our company you know. But it is

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3 fairly easy to figure. The wellhead value that the
4 State gets is something close to the wellhead value that
5 the producing department gets. We have to pay the
6 expenses out of that. The State doesn't have to pay the
7 expenses. It's something comparable -- the total industry
8 is something comparable to the State, less than the
9 State. And we have 20% of that.
10 MR. MALONE:
11 You don't think the State should collect approximately,
12 whatever it is, 30% -- what percent do you think they
13 should collect?
14 MR. TAYLOR:
15 Something a little lower than it is now. About half
16 the income taxes for instance. I don't know - 20, 27,
17 28%. I think it would be much more fair for the
18 industry and the State to get about the same share out
19 of Prudhoe Bay even though we are paying the expenses
20 and we made the investment - but that's all past history.
21 Like the personal income tax is pretty much limited to 50%
22 and I guess I've got my own personal philosophical thought
23 that when the taxes are higher than your take-home pay
24 that's pretty discriminatory.
25

MR. MALONE:

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. MALONE:

...an editorial comment. For me, I kind of look at it differently, of course, but - on the grounds that in any sort of transaction or deal, people try to get as much as they can on the grounds that if they don't somebody else gets it. I don't know -- one of the questions to come up here is that, and it has been alluded to, I think, in the public advertising by your company that we have a discouraging tax climate. Are there specific projects that your company is not investing in in Alaska based on the State's tax structure?

MR. TAYLOR:

I can't name one project. I can say that our exploration fairly clearly is not as expansive as it might be with a more moderate tax structure. We moved, we had an exploration office here in the same offices I have, we moved some of those people out, back to Texas, because

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3 they found better prospects elsewhere. That was partly
4 the land situation, partly this tax structure - the
5 exploration manager just decided he had a better place
6 to go. It is nearly always that way. What the effect of
7 an investment climate has, in my opinion, after a good
8 many years work in that problem, and making a lot of
9 investment decisions, is that what happens you don't go
10 look. If Exxon goes in to an area that looks promising,
11 from the standpoint of tax structure, the oil structure
12 that you might find, the logistics of the whole deal -
13 and it looks promising and drills a well and finds oil -
14 we might find more or less than we expected to find -
15 if we find an oil field, even that we feel is marginal,
16 as compared to what we look for, we will try our best
17 because we have already made a big investment to develop
18 that oil field. We might do it cheaper, we might do it
19 different, we might delay it 5 years, we might do lots of
20 things - but -- it's hard to find examples anywhere in
21 the world where you find a major oil field that you don't
22 eventually develop. There's no question in my mind that
23 there's a lot of major oil fields around the world that
24 nobody has ever found for various reasons, and some of them
25 is because you don't have land to go look at, or you just

don't go look because you think some government is going to take it away from you, in the case of some of the foreign operations. A positive investment climate, though, makes a tremerdous difference in the attitudes of the people making those decisions. We have not made investment decisions on -- we have discoveries, as you probably know, in the Duck Island area and the Point Thompson area. I can't say whether we will develop those yet or not. We will look at the economics after we get the fields better defined. We will put in all the taxes that we expect, that we know we are going to have to pay, and we will project, based on the history, probably, some increase in taxes in the State of Alaska. If it comes out and looks poor, we won't develop them. And if it looks good, we will. I don't know how that investment decision will come. The bigger problem is lack of exploration when the investment climate is poor. In my opinion - that is just my personal -- well, that's just how it works.

MR. MALONE:

...one last question. Investment climate, you know, is -- a simple statement might be that if the State had no oil taxes we would have a perfect investment climate as far

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3 the State's tax policy. In fact, that wouldn't be very
4 realistic because if we didn't have them, and you made
5 investment decisions based on that, any state government
6 or any government would probably have the taxes after
7 all.

8 MR. TAYLOR:

9 Oh, I agree. We would not go any place that did not
10 have any taxes, and assume for investment decisions,
11 there were never going to be any taxes.

12 MR. HAYES:

13 Thank you Mr. Chairman. I would like to follow up on one
14 of the questions that Representative Malone touched on,
15 which was the lawsuit. One of the concerns that I have
16 is that the backstop law that is proposed by this piece
17 of legislation would just add one more lawsuit on top
18 of the lawsuit we already have and, I believe would
19 result in just extending the time when we finally get
20 some conclusion in the courts. We've heard the
21 administration, I believe it was yesterday, indicate
22 that they felt the backstop approach was much more
23 legally secure than the present chapter 21 or the 1978
24 law. Either they said it was more secure now or more
25 secure than the perception they had at the time they enacted

the 1978 law. What is your opinion on that? Do you think that's true? If not, why note?

MR. TAYLOR:

I'm not a lawyer, and I can't really say or judge what Exxon might do with that. There is no question in my mind, from the discussions I've had with some of our lawyers, that the backstop bill would probably result in a lawsuit of some kind. The merits of one versus the other, I'm really not qualified to comment on.

MR. HAYES:

From a legislative point of view, one of the arguments that is being projected, is that this would be a more legally secure piece of legislation than that which we already have. I have some concerns about that. Perhaps when we have testimony from the oil and gas companies legal staff, they could perhaps get into that. But I just have concerns as to whether or not that is in fact true. We've heard that testimony two or three times before this Committee, but I have some questions as to whether that is in fact the case.

MR. TAYLOR:

In its simplistic terms, there are other areas that have reserve taxes, for instance. So maybe in that sense that's

more secure. The concept of separate accounting is not the accepted concept by most states right now - most are on modified apportionments. To that extent chapter 21 is, maybe more suspect. But you get into other things in this law about the setting of the millage rate and the retroactivity provisions and all sorts of complexities that -- is the reason I wouldn't comment because all those things might add up to a bigger deal than the separate accounting on the other side.

MR. GARDINER:

One thing. We've got some people who want to testify today who are leaving town today and I wanted to give them an opportunity. We do have at least a half dozen more questions for Mr. Taylor. I wanted to ask you if you are going to be available tomorrow?

MR. TAYLOR:

I will be here.

MR. GARDINER:

Would the Committee mind if we held over the questions? I will be sure that you get another opportunity. Then we can take some of the people that are leaving.

MR. TAYLOR:

That would be fine with me. I'll be here for these

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3 hearings.
4 MR. GARDINER:
5 I didn't mean to cut anybody off, but I'm just trying
6 to juggle all this. Jan Fakes please.
7 MS. FAKES:
8 Thank you, Mr. Chairman. I do have a plane to catch.
9 I do appreciate this. My name is Jan Fakes. I am a
10 member of the Board of Directors of the Anchorage Chamber
11 of Commerce so I reside in Anchorage. I serve with the
12 Board, with the Chamber as their legislative action
13 Chairman. I have been sent here by the Chamber to
14 express to you their strong desire to repeal 43.21, and
15 their strong opposition to the backstop tax. For the
16 sake of time, we have brought a member of the legislative
17 action committee with us today by the name of Dan Coffee
18 who is an attorney in town and he has been studying this
19 issue for the Chamber on a volunteer basis since January.
20 With your permission, Mr. Chairman, I'd like to turn the rest of the
21 testimony over to Dan.
22 MR. GARDINER:
23 That would be fine.
24 MR. COFFEE:
25 Mr. Chairman, members of the Committee. My name is

SB 50 The Fair Share Bill

March 18, 2005

Senate Resources Committee

The 'ELF' in Alaska's Oil Taxes

- There are four main taxes that the oil industry pays:
- Royalty – 12.5%
- Property – 20 mils per dollar, or 2%.
- Corporate income – 9.4% .
- Production – 15% before ELF.

The 'ELF' in Alaska's Oil Taxes

- The 15% production, or severance tax varies because of the ELF, or economic limit factor.
- At its simplest, the ELF is a number between zero and one. Multiplying the production tax by a field's ELF lowers that field's tax burden.

The 'ELF' in Alaska's Oil Taxes

- Kuparuk's ELF is..054 for FY 2006
- .054 times 15 equals .081
- Thus, Kuparuk pays a 0.81% production tax.
- Prudhoe's ELF is .8435.
- Prudhoe pays a 12.65% production tax.

The 'ELF' in Alaska's Oil Taxes

- **The formula is actually quite complex:**

AS 43.55.013: Economic Limit Factor.

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

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

where:

PEL = the monthly production rate at the economic limit;
TP = the total production during the month for which the tax is to be paid;
WD = the total number of well days in the month for which the tax is to be paid;
Days = the number of days in the month for which the tax is to be paid; and
exp = exponent.

The 'ELF' in Alaska's Oil Taxes

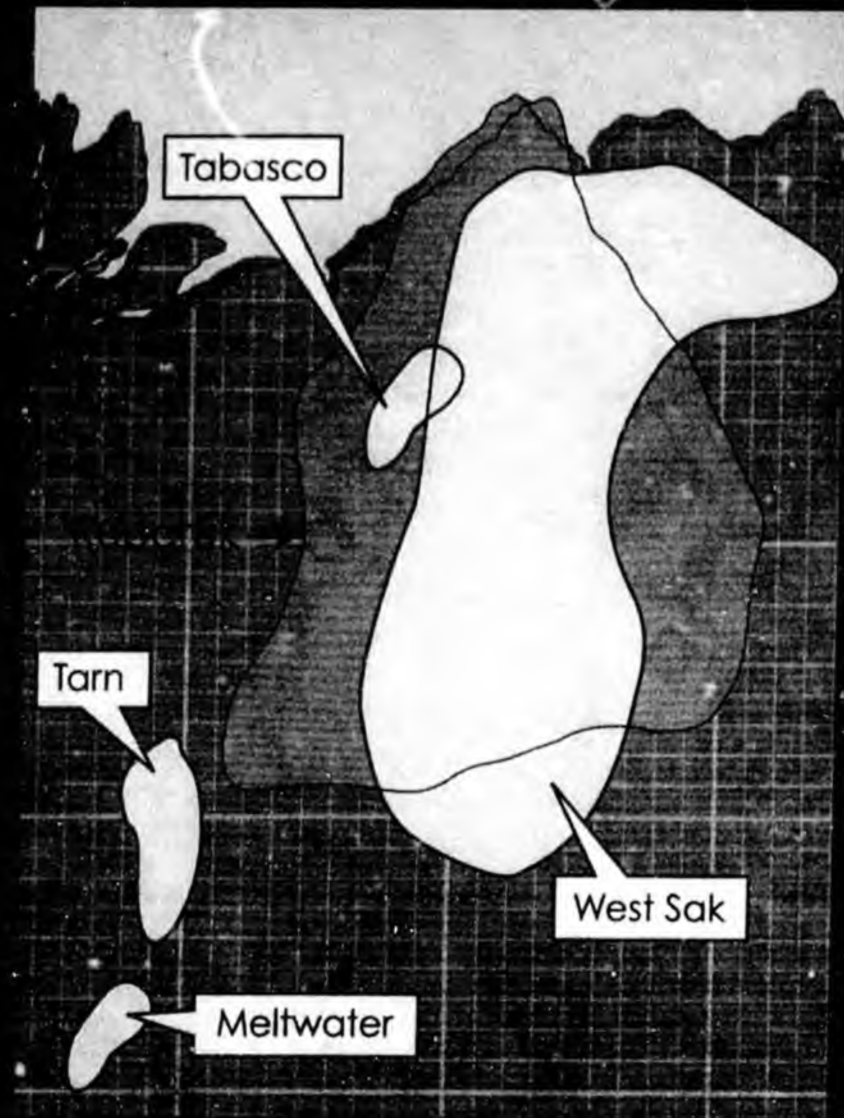
- ELF was designed to encourage "small" field development.
- There are twenty fields now producing on the North Slope.
- Nine pay no production tax at all.

Production Tax Revenue

- In 2003, the State took in $599 million in production taxes.
- The average price that year was $28 per barrel.
- The average ELF was .50, meaning the average production tax rate was 7.5%.

Kuparuk and its neighbors

Tarn,
Meltwater,
Tabasco,
and
West Sak



Kuparuk and its neighbors

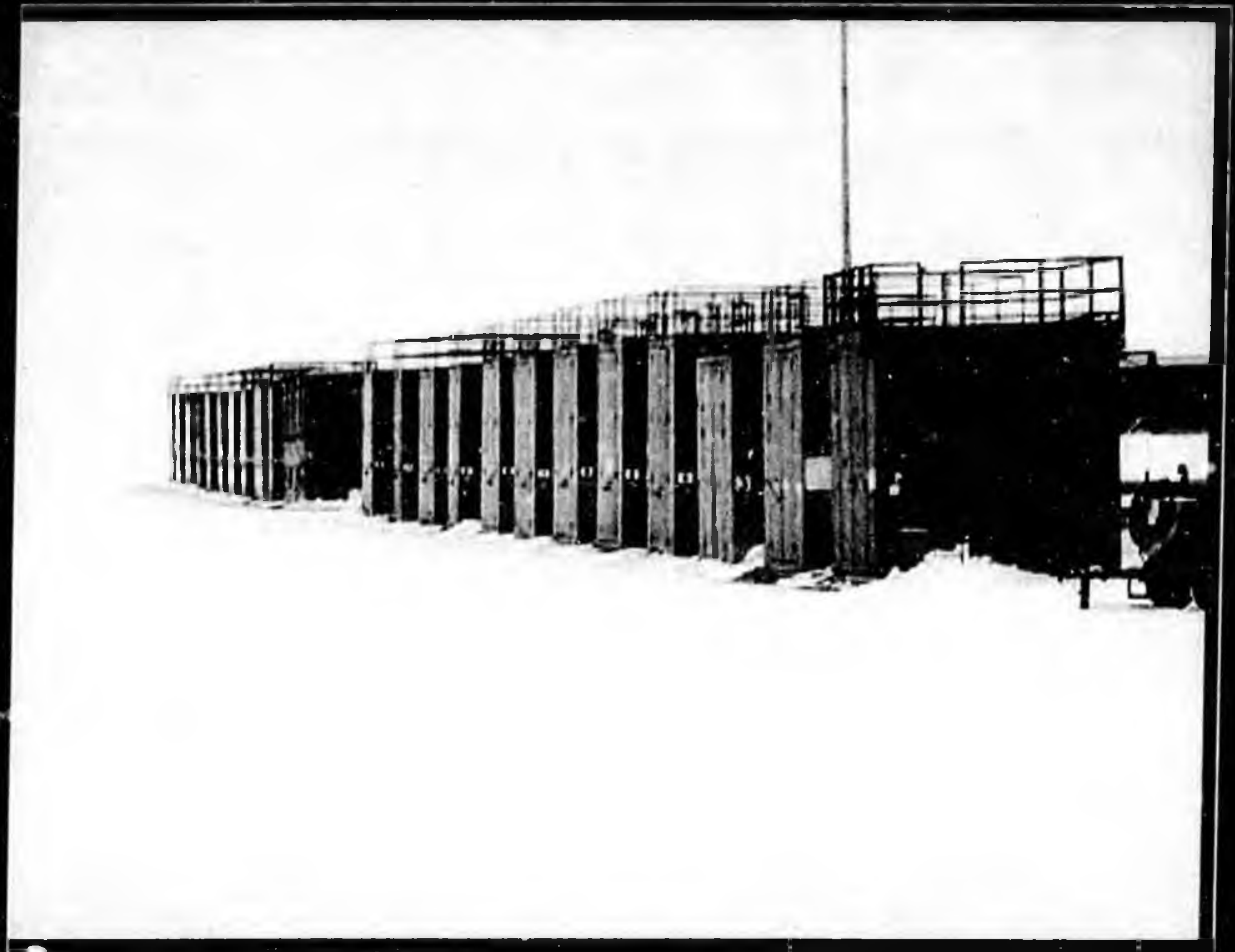
- The Tarn field made 696,248 bbls in January 2005. Approx. 22,450 per day.
- The field has produced 65,000,000 bbls to date. It is one of the top thirty largest fields in the U.S.
- Tarn has a 0.013% ELF meaning it will pay a 0.2% production tax in 2005.
- Tarn's ELF will go to zero in 2007.

Kuparuk and its neighbors

- Tarn is produced via Kuparuk's facilities.

Kuparuk and its neighbors

- Tarn required two drill sites and three ten mile pipelines



Kuparuk and its neighbors

- The Meltwater field, also produced through Kuparuk's facilities, required only one drill site.
- In 2003, Meltwater produced 5800 bbls of oil per day and paid no production tax.
- This modest field will make the producers 2,000,000 bbls of oil this year.
- At $50 per barrel, that is $100 million.

How the “Fair Share” bill works

- Two principle reforms:
- The first simply establishes a minimum 5% production tax. All fields must pay the minimum 5%.
- In January 2004, the Dept. of Revenue estimated that this provision alone would raise $75 million at $22 per barrel.

How the "Fair Share" bill works

- The second major reform bases the ELF on the price of a barrel of oil.
- As the price rises, so does the ELF. As the price of oil falls, so does the ELF.
- The bill sets $16 to $20 oil as the norm, and allows this "range" to increase with inflation, to recognize that prices rise over time.

How the "Fair Share" bill works

- Example: At lower oil prices the production tax would be reduced. If oil goes to $12 per barrel, the formula would divide 12 by 16 to yield .75. Thus the production tax on an oil field would be reduced by 25%.

How the "Fair Share" bill works

- If oil prices fall below $10 per barrel, the bill would waive half the production tax and would defer the other half until prices rise above $16 per barrel.

How the "Fair Share" bill works

- Higher prices: At $30 oil, the new formula would divide 30 by 20 yielding 1.5.
- Thus, a field with a 10% production tax would pay an adjusted 15% production tax.
- The production tax cannot exceed 25% under the bill.

How the "Fair Share" bill works

- The bill exempts 'heavy oil' (less than 20 API gravity) from any of its measures. Heavy oil, like that contained in the West Sak reservoir, requires more expensive drilling and production measures.

How the "Fair Share" bill works

- Finally, the bill allows taxpayers "production tax relief." If the taxpayer can demonstrate that the field would be economical but for the production tax, the Department of Revenue has the power to waive the tax for that field.

Why Make a Change?

- "Despite its name of Economic Limit Factor, it ignores the biggest single economic determinant, which is price."

-- Dan Dickenson, Director, Tax Division quoted in The Petroleum News January 11, 2004.

Why Make a Change?

JUNE 2004

GEOGRAPHIC

THE END OF CHEAP Oil

The Shiites of Iraq 2
Under Monterey Bay 36
Cliff-Hanging Tombs 56
[illegible]rawl on the Mall? 60
At Home With Flickers 72
ZipUSA: Pawtucket, RI 110
Tear-out Map of Washington, D.C.

THE WALL STREET

LEADING THE NEWS

Spike in Oil Prices Is Likely in '05

As oil prices approached a new high yesterday, industry analysts said they are anticipating price increases to more than $60 a barrel this year. Some analysts are even beginning to talk of the possibility of greater increases—to $75 or $80 a barrel—in the event of a major supply disruption, unless red-hot demand for crude cools in Asia and the U.S.

Wall Street Journal, March 5, 2005; p. A3

Oil Industry Profits

- ExxonMobil: Fourth quarter 2004 profits were $8.4 billion, the biggest quarterly profit ever for a U.S. company.
- BP: $4.4 billion
- ConocoPhillips: $2.4 billion
- Total quarterly profits: $15.2 billion in ninety days. $7 million per hour.

Governor Walter J. Hickel

"Crisis in the Commons: the Alaska Solution"

Governor Walter J. Hickel

- "Few world leaders are thinking about how we should care for and use the commons…for the benefit of the total."
- "Especially for the benefit of the local population…rather than for a political leader, a ruling family, an oligarch, or a group of multi-national corporations."

Governor Walter J. Hickel

- In 1909 President Roosevelt began the process of separating the ownership of land from the minerals below.
- “The Mineral Leasing Act of 1920 .... recognized that the commons belonged to the public and required that income from the development of the commons must be paid to the public’s government.”

Governor Walter J. Hickel

- Alaska's Statehood Act was modeled on the 1920 Mineral Act. The subsurface energy resources were specifically designated to the new state.
- "We kept the resource wealth in public hands…but we harnessed the free enterprise system to develop our wealth…all in the framework of a constitutional democracy."

Wood Mackenzie Study

- An international consulting firm says Alaska is a more profitable place to do business than the average of almost 60 oil and gas producing regions it surveyed worldwide.
- Higher than average costs, but lower than average government "take" at prices above $16 per barrel.

Wood Mackenzie Study

- At $35 per barrel, Alaska is 19th of 55, well above the median.
- At $35 per barrel, the total "take" is 58% compared to a global average of 73%.
- The difference between 58% and 73% -- 15% -- amounts to a subsidy of the oil industry.

Other Countries' Adjustments

- United Kingdom upped their minimum rate from 30 to 40 percent.
- Argentina introduced an export tax.
- Venezuela removed heavy oil royalty incentives.
- Nigeria increased its share of government profit.

Source: Petroleum News January 30, 2005

What Will the Industry Say?

- Won't discuss the fact the bill lowers taxes at low prices.
- Won't discuss the fact the bill raises the "normal range" each year to account for inflation.
- Won't discuss the fact the bill allows for production tax relief if it is justified.

ELF in 1989

"To the extent that production, net production, stays in the ground, the Permanent Fund is going to be a loser because the royalties that would have been collected won't be collected. The oil is still in the ground where it doesn't do anybody any good."

-- Tom Williams of British Petroleum on 2/22/89 before the House Resources Committee.

ELF in 1989

"My concern is that any additional taxes on the oil industry will have an adverse affect on the future drilling on the North Slope. This action will fundamentally impact not only the petroleum industry, but also the State's ability to encourage new economic development."

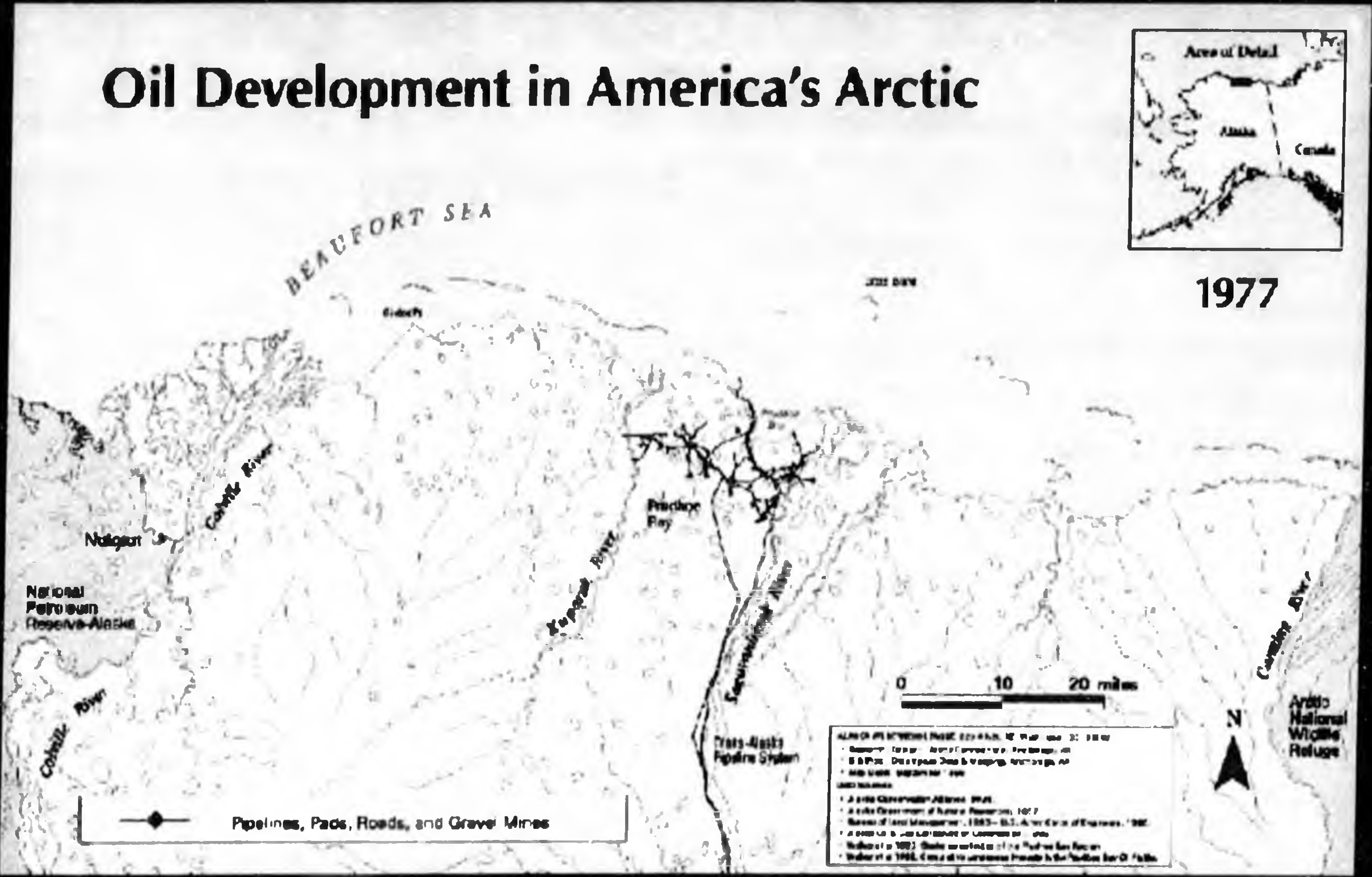
-- Morris Thompson, President, Doyon Drilling on 1/13/89 before the House Resources Committee.

ELF in 1989

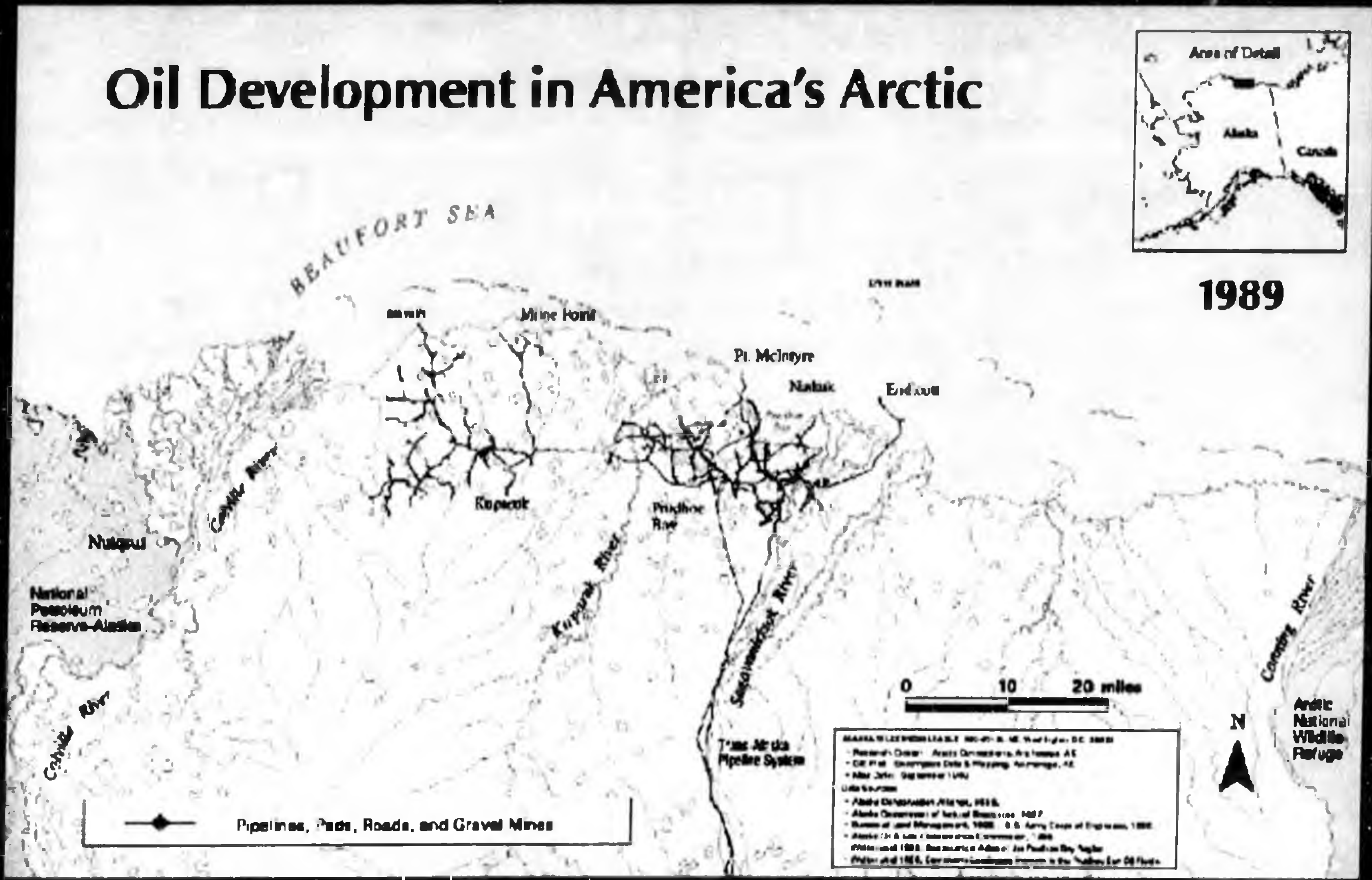
" [This bill] would place an onerous additional tax burden on the oil industry that would remove to other states or countries funds that otherwise would be spent on additional investments in Alaska."

-- Ben Odom, Senior VP of Operations, ARCO Alaska, on 1/13/89 before the House Resources Committee.

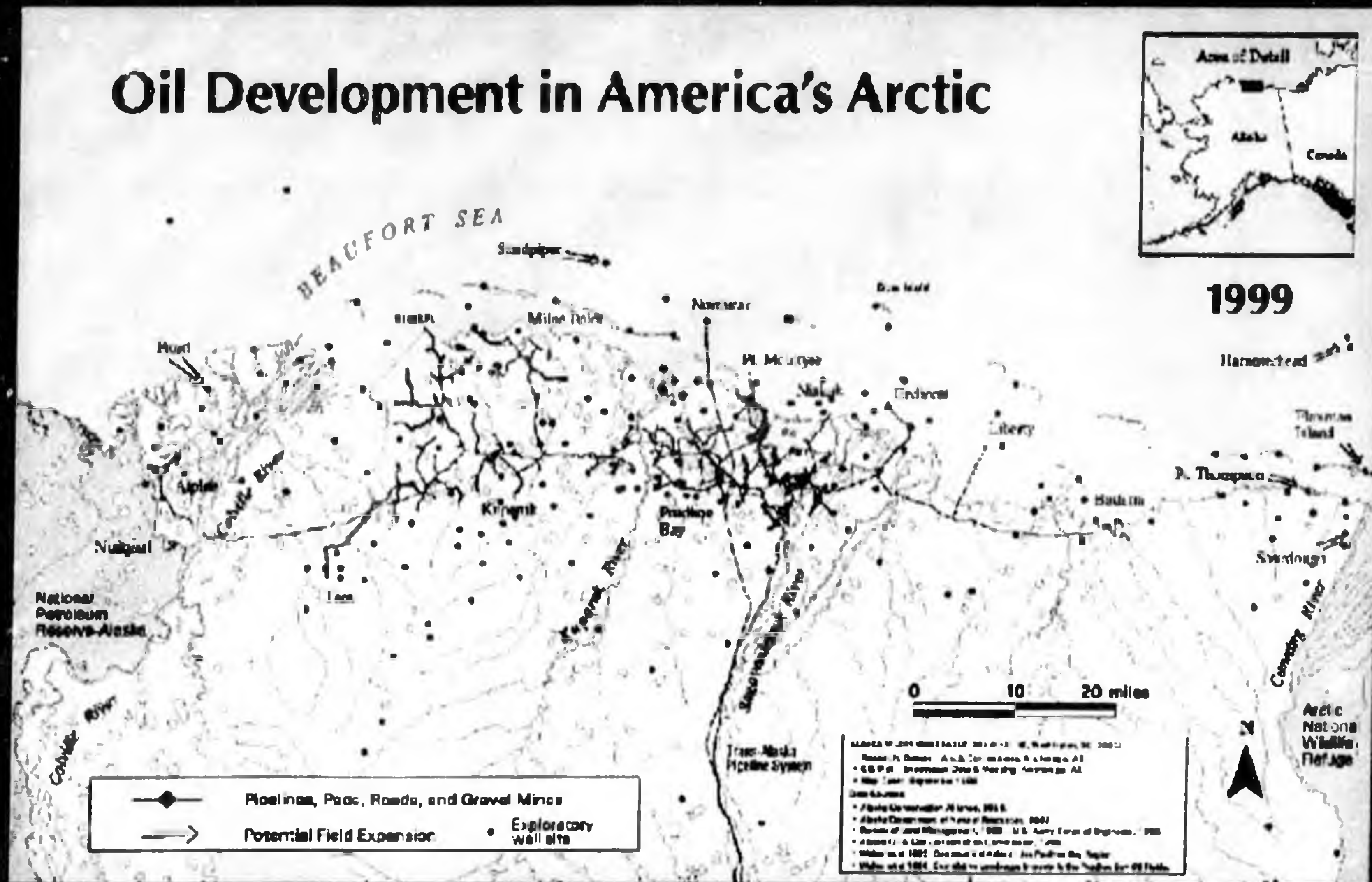
Actual Development -- 1977



Actual Development -- 1989



Actual Development -- 1999



What Will the Industry Say?

- "A deal is a deal."

Article IX, Section 1, Alaska State Constitution: "The power of taxation shall never be surrendered. This power shall not be suspended or contracted away, except as provided by this article."

What Will the Industry Say?

- "A deal is a deal."

In conversations between Hugh Malone and industry leaders in 1981, when the original ELF was crafted, the idea was to allow industry and the State to have equal portions of the oil revenue.

Testimony of Greg Erickson before the House Resources Committee, February 10, 1989 at pp 24-26.

10 MR. MALONE:

11 You don't think the State should collect approximately,

12 whatever it is, 30% -- what percent do you think they

13 should collect?

14 MR. TAYLOR:

15 Something a little lower than it is now. About half

16 the income taxes for instance. I don't know - 20, 27,

28%. 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 - but that's all past history.

23 that when the taxes are higher than your take-home pay

24 that's pretty discriminatory.

25

What Will the Industry Say?

2

3 MR. MALONE:

4 So you think it should be brought down to the point

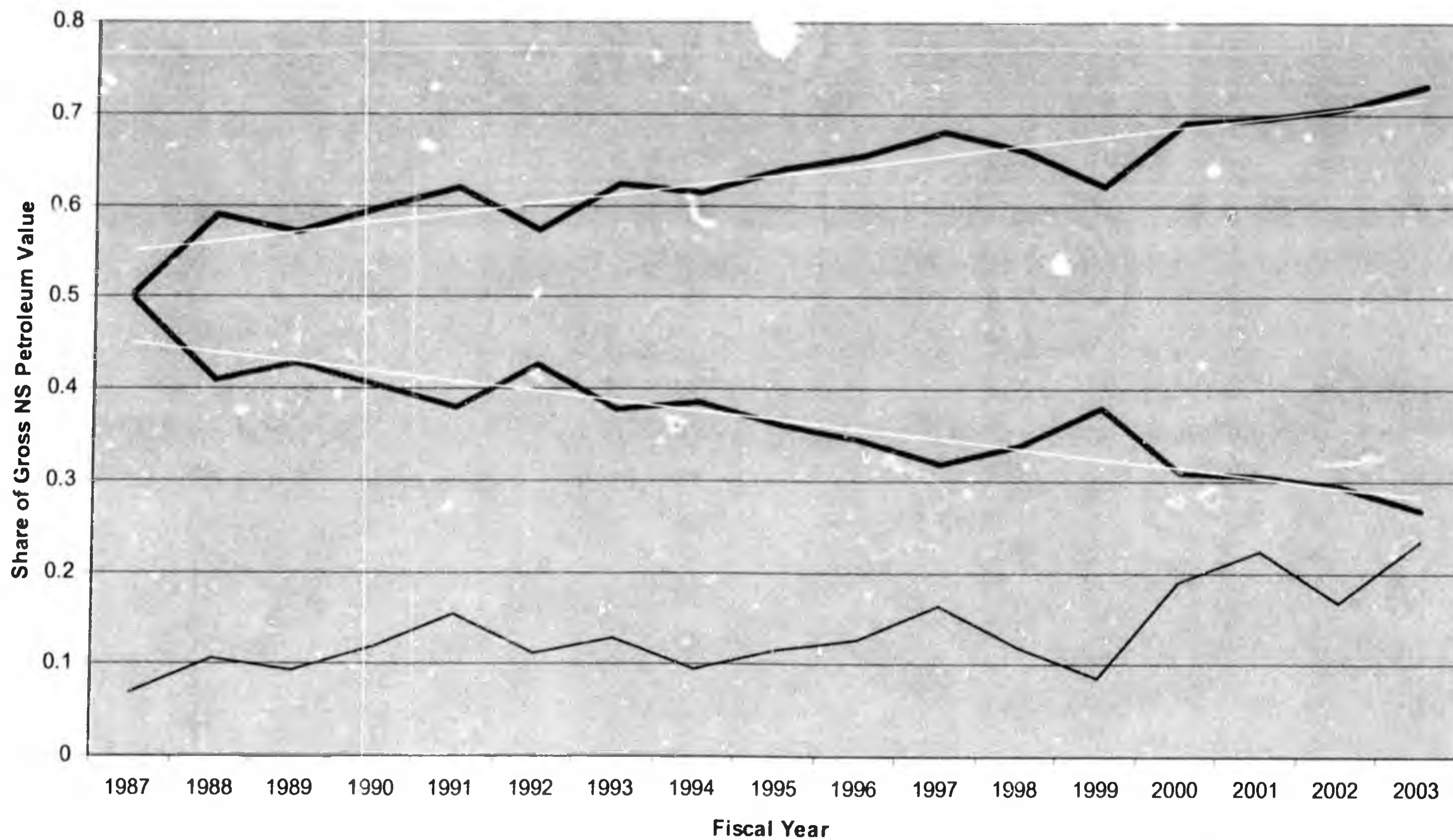
5 where the State and the industry get roughly equal

6 shares in this. You like that better?

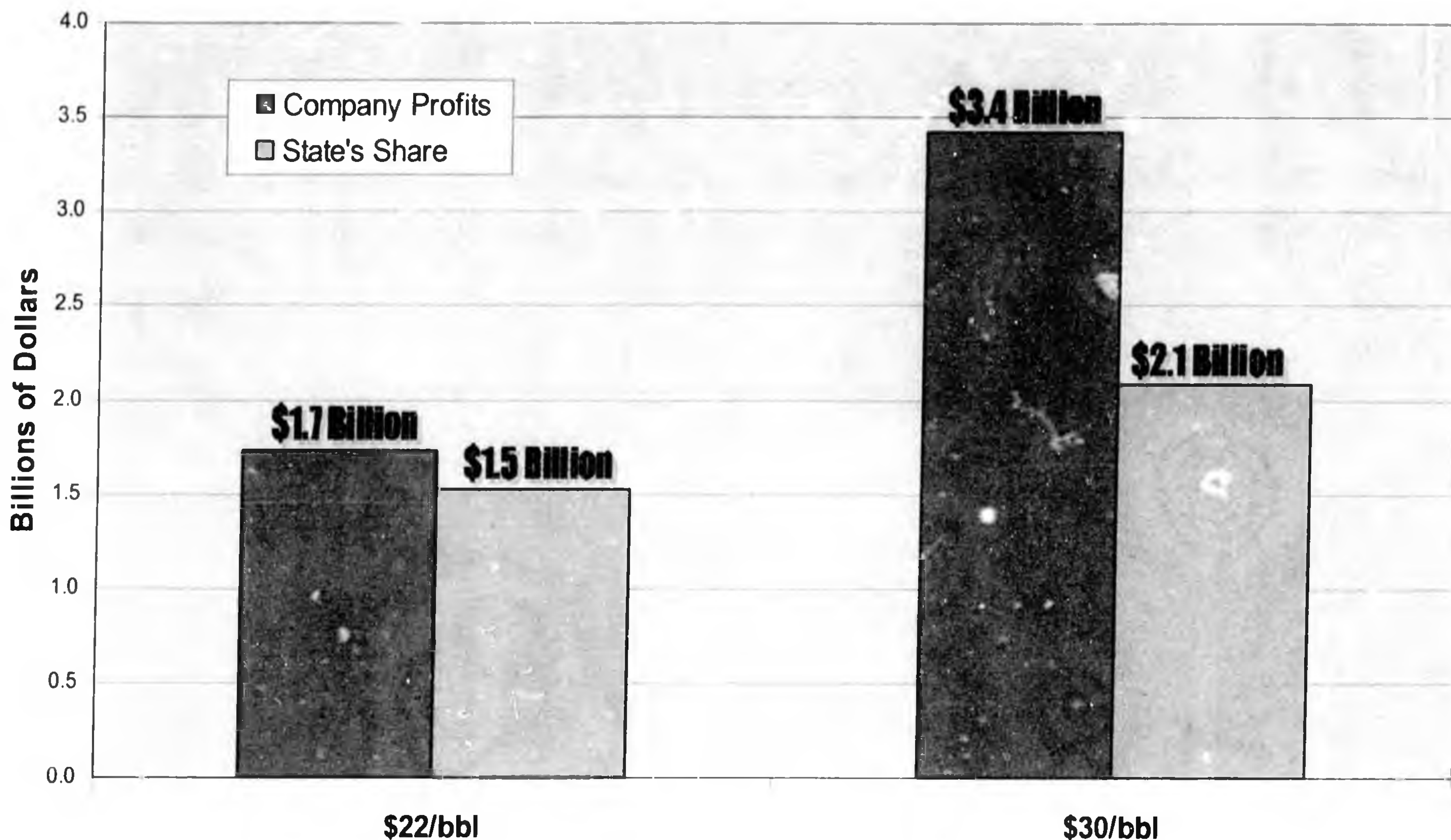
7 MR. TAYLOR:

8 Yes, sir.

Exchange between Rep. Hugh Malone and Monte Taylor, Alaska Operations Manager for Exxon


Industry and Alaska's Benefit from NS Petroleum Against Oil Prices (1987-2003)
Share of Gross NS Petroleum Value
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
Fiscal Year
State
Industry
NS Oil Wellhead Value

Comparison Between Oil Company Profits and State Revenue: Current Law



Statistics provided by Alaska Dept. of Revenue

What Will the Industry Say?

- "Tax increases will kill development"

The real issue is the "net" effect. Increasing tax rates may decrease new investment and production, but it will also increase state revenues. The real analysis is to compare the increase in revenues with the decrease in investment.

What if we do nothing?

Production Tax Revenue

- By 2013, the average ELF will fall to .27, meaning the average production tax will fall to 4.05% (before aggregation).
- 2003: $599 million in production taxes.
- 2013: $180 million.

Production Tax Revenue

- Under this bill, the State would gain:
  an additional $90 million at $22/bbl.
  an additional $400 million at $30/bbl.
  an additional $886 million at $38/bbl.
  an additional $1.363 billion at $50/bbl.
  (with aggregation at Prudhoe).

Conclusion

- The bill lowers taxes at low prices
- The bill allows the [illegible] with infl[illegible]on
- Th[illegible] bil[illegible] [illegible]ws for production tax relief wh[illegible]re it is justified.

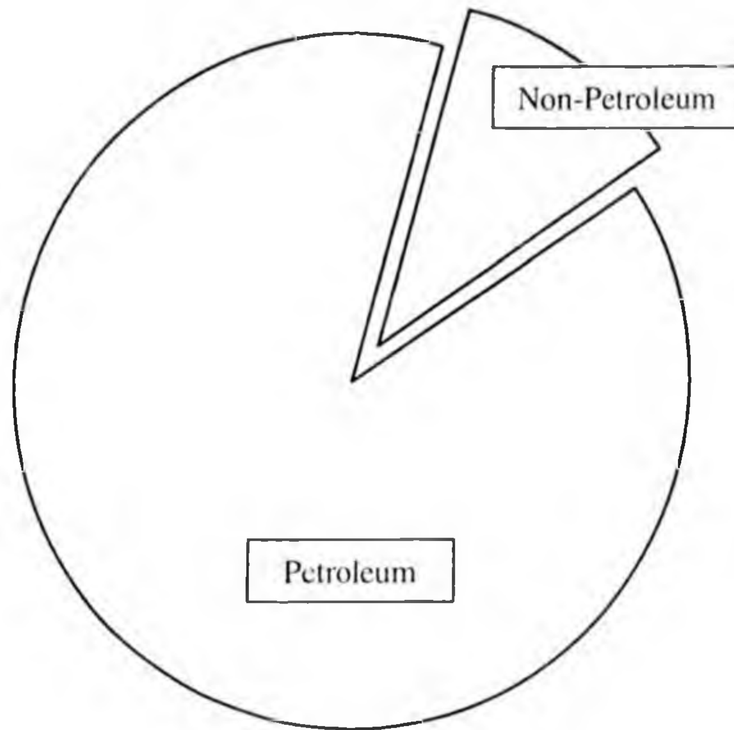
Conclusion

- It is better to address this issue now, when there is no immediate crisis.
- It is better to take an incremental approach, rather than a wholesale "shelf the ELF" approach.
- It is better to give the oil industry certainty during the planning and design phases of the gas pipeline.

Alaska's Current Oil and Gas Fiscal System

Oil & Gas: Vital to Alaska

FY05 Unrestricted Revenue



"Oil revenue will provide at least 75% of forecasted Unrestricted General Purpose Revenue through FY 2014. Two elements are critical to the oil revenue forecast: price and volume."

Fall 2004 Revenue Sources Book

Present System's Four Elements

	FY2004 Actuals ($millions)	
	To General Fund	To "Other"
Royalty	1,043.6	485.2
Production Tax	651.9	-
Property Tax	47.3	218.7
Oil & Gas Corp. Income Tax	298.8	- a
TOTAL	2,041.6	703.9

ALL OIL & GAS PAYMENTS 2,745.5

(Royalty "Other" is the Permanent Fund; property tax "Other" is municipalities taxing the same property.)

Point No. 1

Even if ELF makes the production tax zero for a field, the field –

- **pays full royalty to the State**
- **pays full property taxes on its facilities**
- **contributes fully to the owners' income taxes**
- **increases the netback value by lowering tariffs**
- **creates Alaska jobs**

Production Tax

- A tax on the act of producing oil, gas
- Tax = ELF × Base Rate × Gross Resource Value
  - Gross Resource Value = Netback × Taxable Volume
  - Base Rate: gas 10%; oil 12¼% 1st 5 yr, then 15%
  - ELF: a field-specific number from zero to one

    Oil ELF is based on field size and well productivity; larger fields have larger ELFs and higher tax rates, as do fields with more productive wells; smaller fields and ones with low well productivity have smaller ELFs and lower tax rates. Gas ELF is based on well productivity only

Netback Methodology

West Coast Spot Price	$25.00
Marine Transportation	(1.61)
TAPS	(3.05)
Netback at Pump Stn. 1	$20.34

AOGA

Why Have an ELF?

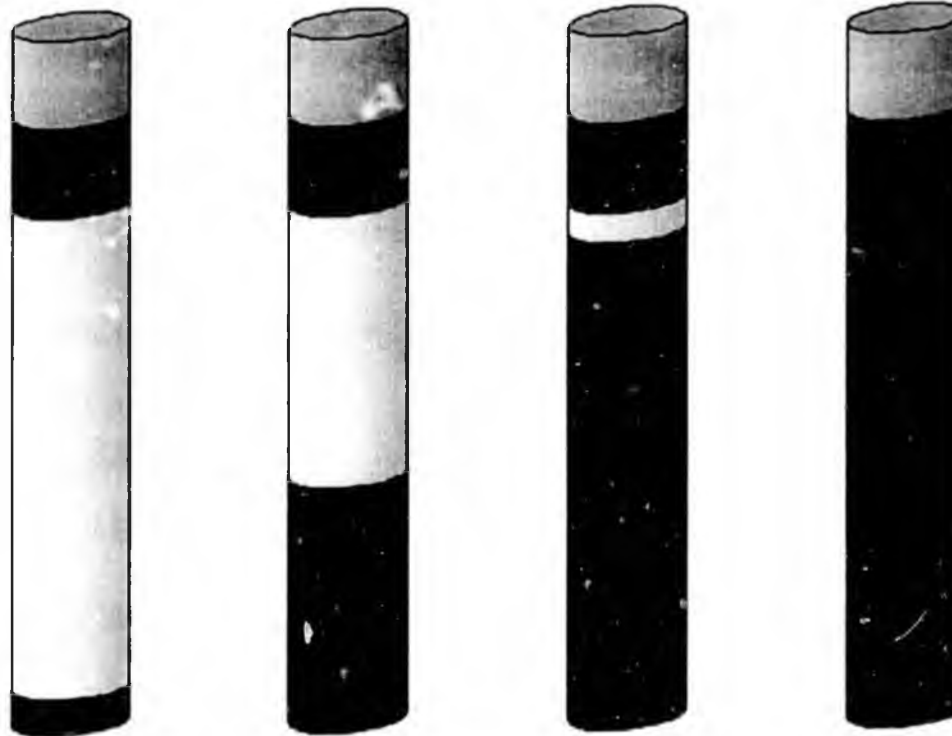
To allow a high-rate production tax early in a typical field's life, while avoiding the adverse consequences as the field is depleted

The Adverse Consequences of a High Rate

"As operating costs rise during the life of the field, the profit margin shrinks. At some point the total production costs overtake the value of the oil or gas produced, and production can then be continued only by operating at a loss. As one of the costs of doing business, the production tax contributes to the total costs and tends to hasten the time when this break-even point (called the economic limit) is reached."

DOR, *Alaska's Oil and Gas Tax Structure: A Study with Recommendations for Improvement* (Feb. 1977), p. V-21 (emphasis added)

The Adverse Consequences of a High Rate



Producers' Responses to the "Squeeze"

- "Do nothing" stage
- "Drive for efficiency" stage
- "Harvest" stage
- "Running in the red" stage

"[T]he Department of Revenue recommends an Economic Limit Factor (ELF), based on the ratio of the rate at the true economic limit to the current production, as a mechanism for scaling down the tax rate as the production declines toward the economic limit."

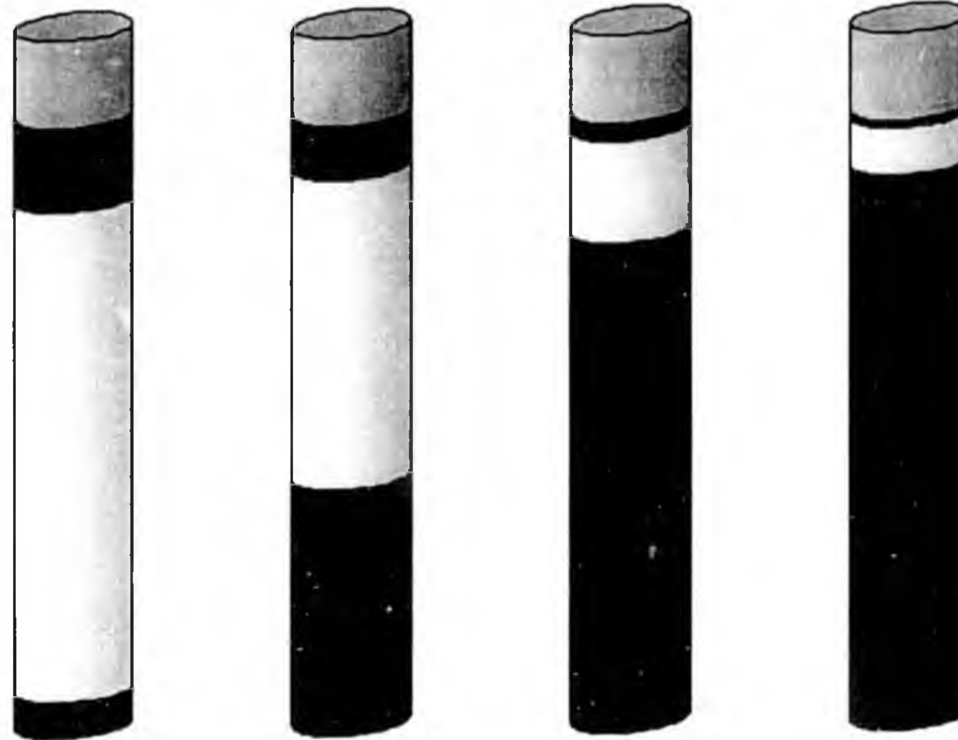
DOR, *Alaska's Oil and Gas Tax Structure: A Study with Recommendations for Improvement* (Feb. 1977), p. VI-17

$$\left(1 - \frac{PEL}{TP}\right)$$

PEL = Production at Economic Limit

TP = Total Production in tax period

How ELF Avoided the Adverse Consequences



Point No. 2

ELF was enacted in 1977 over industry's strenuous objections

- **Why object? ELF allowed effective tax rate for Prudhoe Bay to be increased to ~11.7% from ~7.8%**

How the Oil ELF was Changed in 1989

1977 formula was driven by "well productivity"

1989 added "field size" (total daily production) to the formula

- Larger fields have larger ELFs, higher tax rates
- Smaller fields have smaller ELFs, lower tax rates
- "Field size" is the dominant factor in the formula

Reasons Given in 1989 for the ELF Change

1. To get more revenue

Reasons Given in 1989 for the ELF Change

2. To give an incentive for small fields

"Marginal fields are fields with either relatively low per well productivity or relatively low daily production."

DOR, *Response to Questions from House Resources Committee – HB 118* (February 21, 1989), p. 1 (emphasis added)

Reasons Given in 1989 for the ELF Change

3. To give an incentive for West Sak viscous oil

"[T]he new ELF will increase drilling production and employment at the truly marginal fields ... and, let's hope someday, West Sak .... In those fields the severance tax, under HB 118, will either be sharply reduced or eliminated entirely. That's a pro-development impact on those fields."

Tape HRC 89-121, side 1 (February 10, 1989), testimony of Gregg Erickson, Senior Economist, Division of Policy, Office of the Governor (transcript), p. 10

Reasons Given in 1989 for the ELF Change

4. Prudhoe Bay & Kuparuk could afford it

What legislators were told the change would do

1. Reduce rates for all fields except Prudhoe Bay & Kuparuk

"[For] marginal fields, ...the severance tax, under HB 118, will either be <u>sharply reduced</u> or eliminated entirely."

Tape HRC 89-121, side 1 (February 10, 1989), testimony of Gregg Erickson, Senior Economist, Division of Policy, Office of the Governor (transcript), p. 10 (emphasis added)

"In Alaska the marginal fields are the six Cook Inlet fields ... [and] Milne Point, Lisburne, Endicott, Niakuk, West Sak, Point Thomson, Seal Island, <u>and probably any other field that will be discovered in Alaska</u>."

DOR, *Response to Questions from House Resources Committee – HB 118* (February 21, 1989), p. 1 (emphasis added)

What legislators were told the change would do

2. Tax rates for some fields could go to zero under the new ELF that weren't zero under the old ELF

"[For] marginal fields, ...the severance tax, under HB 118, will either be sharply reduced or eliminated entirely."

Tape HRC 89-121, side 1 (February 10, 1989), testimony of Gregg Erickson, Senior Economist, Division of Policy, Office of the Governor (transcript), p. 10 (emphasis added)

What legislators were told the change would do

3. Smaller fields pay less tax even with the same well productivity as larger fields

What legislators were told the change would do

4. State revenue gains from changing the ELF

- Projected cumulative effect through FY2010

Prudhoe Bay	$2.500 billion
Kuparuk	0.391 billion
All others	(0.200 billion)
Net	$2.691 billion

Point No. 3

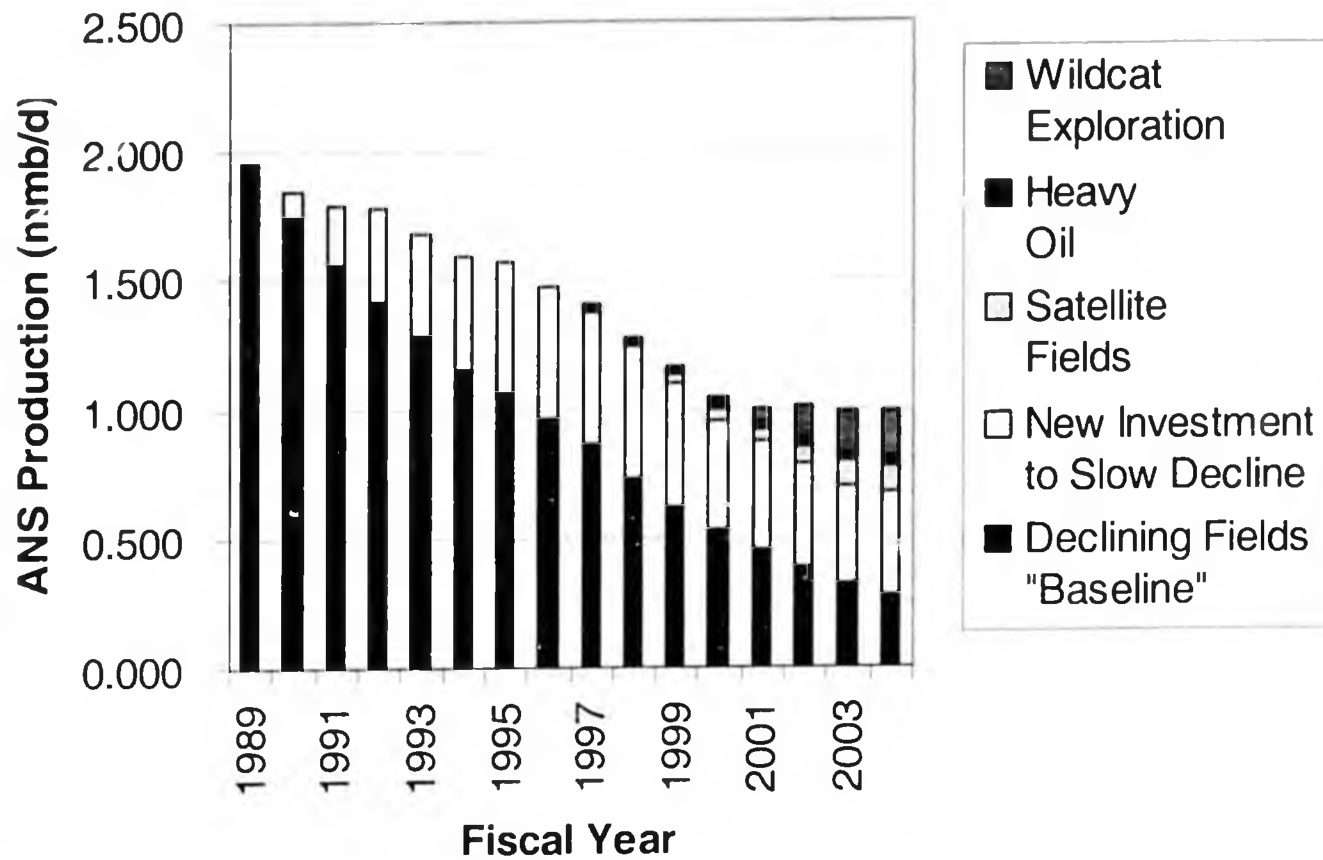
The 1989 ELF change has worked exactly the way legislators were told it would work

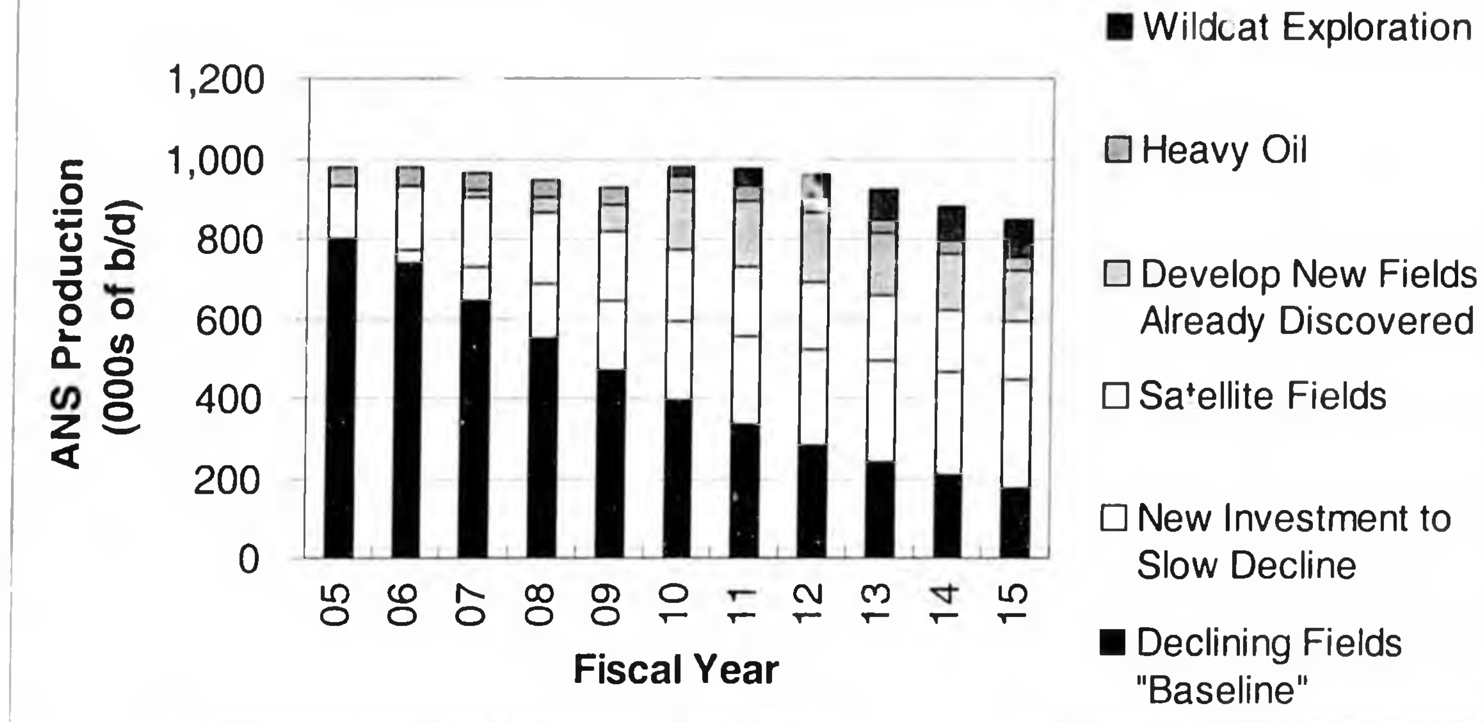
- **Prudhoe & Kuparuk still have higher production tax**
- **Some fields don't pay production tax**
- **Small fields pay less even with same well productivity**
- **State already is over $2.7 billion ahead (net)**

Point No. 4

1989 ELF change was enacted over industry's strenuous objections

- **Why? Major tax increase for Prudhoe Bay & Kuparuk**


Historical Effects on ANS Production from Different Kinds of Investment
2.500
2.000
1.500
1.000
0.500
0.000
ANS Production (mmb/d)
1989
1991
1993
1995
1997
1999
2001
2003
Fiscal Year
Wildcat Exploration
Heavy Oil
Satellite Fields
New Investment to Slow Decline
Declining Fields "Baseline"



SOURCE: DOR *Spring 2004 Revenue Source Book*, p. A5, "Historical and Projected Crude Oil Production".
Wildcat = "NPRA" production
Heavy Oil = "Milne Point" production (a simplifying assumption in the absence of published projections by DOR for West Sak production in other units)
New Fields Already Discovered = "Fiord" + "Point Thomson" + "Liberty" + "Nanuk" + "Known Onshore" + "Known Offshore" production
Satellites = "PBU-Satellite" + "KRU-Satellite" production
Declining Fields "Baseline" = "Prudhoe Bay" + "Kuparuk" + "Endicott" + "GPMA" production declining at 15%/yr starting in mid-2006, plus "Alpine" and "Northstar" production without adjustment from DOR's forecast
New Investment to Slow Decline = difference between Prudhoe/Kuparuk/Endicott/GPMA "baseline" above and DOR's forecasted production from them

Point No. 5

More investment is CRUCIAL

Different kinds of oil investment have different economic profiles

A given tax change promises to impact different classes of oil investment differently

Any change must be carefully examined for "unintended consequences"

What the Governor's ELF Decision Did

Lumped 6 smaller fields within the Prudhoe Bay Unit with the main Prudhoe Bay Field (aggregation)

Because of the "field size" component of the ELF formula, aggregating the fields increased the ELF and tax rate for all of them

Two of the 6 fields aggregated with the main Prudhoe Bay field are West Sak viscous oil

Recent Legislative Proposals – HB63/SB50

AOGA Opposes Passage of HB63/SB50

- Industry views these proposals as a structural tax increase at all price levels except extremely low ones
- Imposes a 27.5% structural tax increase at DOR's expected $25.50 price
- Raises the maximum tax rate by 67% (from 15% to 25%)
- 5% minimum imposes a heavy burden on satellite development
- Fails to protect significant amounts of viscous oil (West Sak)
- Proposed without analysis of the consequences for investments
- Makes Alaska less competitive