

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

433 SCOM11: INTERIM COMM. ON TAXATION & REVENUE 1975-76

Beaufort region irrespective of the immediate State revenue requirements. The Prudhoe field according to Mead likely extends north into the Beaufort Sea. When Prudhoe production starts, oil migrates from the "fingers" of the field. A unitization problem exists, and as Mead vividly explains it: "Someone has a straw into your oil. The immediate interest of Alaska is to hold a lease sale as soon as possible. The more delay, the more loss to the State of Alaska."⁴

Lipton and Mead are in agreement that the lease sale ranks as the highest alternative, particularly if the area includes the Beaufort which will bring in substantial revenues. Conversely, the advance sale of the State's royalty oil or options ranks as the least desirable of the alternatives available. Concerning the pre-sale of the State's royalty oil, Lipton emphasized the uncertainties involved in the future price of the oil which will influence the oil companies bids and work to the detriment of the State. Important points mentioned by Lipton included:

The oil companies are not in the position to say what the 1978-1980 market price means to them in terms of competitive positions. Market price is a very uncertain, ephemeral dubious sort of thing; and the recovery of the price you pay for oil from the North Slope depends on the price you can sell gasoline in Los Angeles. This is a tenuous uncertain relationship...

All the uncertainties get thrust back on to the State; none of the uncertainties work to the advantage of the State. In any case, no oil company is really in the position to commit themselves to the purchase of your oil, or an option on your oil, without assessing a relatively high interest rate against the funds they advance to the State compared to the time the oil is forthcoming. The interest rate the oil company is looking at is considerably higher than the cost of capital to the State of Alaska.

Finally, there is the presumed importance of the State's continuing access to royalty oil...for possible consumption within the State, e.g., to support the Fairbanks refinery. Most importantly, the movement of State royalty oil through the pipeline in interstate

⁴Walter Mead, testimony to House Resources Committee, April 15, 1975.

commerce is tremendously important to underpin the regulatory authority of the Alaska Pipeline Commission.⁵

These reasons for caution in considering pre-sale of Alaska royalty oil by Lipton were also emphasized by Pritchard. For the reasons of future uncertainty on price and other points noted by Lipton, Pritchard felt that any other alternative would be preferable. Mead was less adamant on the problems of sale of future oil and included it as one of the combination of solutions that the State should enact. Lipton and Mead see less of a problem in sale of future gas because the regulatory nature of gas pricing and transport removes some of the uncertainties. Advanced gas sales would not be as detrimental to the State.

Mead and Lipton both recommended that the State tighten its corporate income tax laws, as a much needed and integral part of the overall solution to the revenue shortfall problem.

Lipton testified that the property tax on oil reserves is intrinsically a bad tax.

It is our judgement that this tax as a tax measure is a bad tax...for two reasons: First, because there is no criteria available to the legislature or to the person being taxed as to what really the incidence of the taxation is. If you talk about income tax - you have the tax base which is identifiable - the profit is being taxed. Both the State, and the industry being taxed, has a basis of judgement of what the impact is, what the implications are. On the severance tax, you can make comparisons of what the tax base is in other producing areas. The bonuses are entered into by industry of their own free volition. But the ad valorem tax on oil in place is an estimate, its unknown...if you know what is in place, how much is recoverable? what is recoverable is not a technical estimate but an economic estimate...if you know how much can be recovered and if you know what it will be worth on the day it is produced or what it'll be worth on the last day the reservoir will be exploited.

⁵Milton Lipton, testimony to Senate Resources Committee, February 15, 1975.

So the fact of assessment itself, to assess the value of oil and gas in place is a different kind of animal than trying to assess other real property.

Secondly, insofar as it may involve the respective assessment of one company's oil and gas in place, and another company's you are confronted with the problem of equitable assessment -- it becomes a matter of equity and legal responsibility that the value of one person's oil and gas in place shall be assessed by the same criteria as the other persons oil and gas in place, and I submit to you that this is an impossible problem; because the assessment of the value of oil and gas in place is so different from every other aspect of ad valorem taxation that you have taken in this State, or that has been taken anywhere else.⁶

Although there is considerable disagreement on whether it is indeed an impossible problem, Lipton's testimony points out the difficulty involved. Conversely, Mead points out the advantage of the property tax:

The trouble with a royalty and a severance tax is that it leads to premature abandonment of a lease. A property tax does not have that disadvantage. A property tax is not a function of output. Royalty and severance is. A property tax does not raise costs. A property tax is paid whether you produce or not. That is a sizable advantage of the property tax compared to the royalty and severance which you now have.

In the long run you may wish to change this and change the disadvantage of the royalty if you like. By instituting what you have done for the severance (sliding scale), you can do that for the royalty too.⁷

The advantages of the ad valorem property tax can be gained through a different method, ie., a sliding scale royalty, similar to the system in Alberta, but with a lower bottom range. Also the sliding scale severance could be extended in the lower and higher range as mentioned earlier in this paper. The combination of the sliding scale royalty and a wider ranging sliding scale severance would then provide virtually all the benefits of the property tax.

⁶Ibid.

⁷Walter Mead, testimony to House Resources Committee, April 15, 1975.

Although Mead pointed out the advantage of the tax to insure maximum production of a field, he also testified that all future bids on lease sales would reflect the action taken on the property tax:

If you impose this property tax burden, hereafter, companies that bid bonuses to the State of Alaska will consider that piece of history and will reduce their bonus bids accordingly. You will pay for it in the future.⁸

Mead and Lipton emphasized the importance of minimizing the uncertainties when the leases are drawn. If uncertainties exist because of wording or arbitrary future events left unclear, the discount rate figured by the oil company will go up and the State of Alaska will pay the price.

Some capricious and morally questionable unilateral changes in lease agreements have been recently made by Arab leaders on Middle East oil, by the Norwegians on North Sea oil, and by the Canadians on Alberta oil. It is the opinion of this writer that the State, if nothing else, should stick by any lease agreements into which it has entered.

There are alternative means to raise revenue that are preferable to the property tax on reserves. The lease sale in the Beaufort Sea is the most logical alternative and can incorporate into each lease a sliding scale royalty as well as severance. This will have considerable benefit to the State of Alaska and treat the oil companies equally and fairly from the onset. Even with a portion of the bonus lease revenues placed in a permanent fund, these revenues provide an important part of a temporary solution to a temporary problem. Conventional revenue anticipation bonds can cover the remainder of the shortfall.

⁸Ibid.

SOURCES CONSULTED

I Personal Interviews and Direct Correspondence:

- Arnold, L.H. Supervisor, Severance Tax Section, State Tax Commission
State of Mississippi, Jackson, Mississippi
Correspondence: Description of oil taxes in Mississippi.
- Ashmore, G.W. Manager, Alaska Taxes, Accounting Department, SOHIO
Petroleum Company, Oklahoma City, Oklahoma
Correspondence: "Alaska taxes on oil are equal or higher
than other major oil producing states."
- Awalk, Charles. Property Tax Consultant, Pritchard & Abbott, Valuation
Engineers, Fort Worth, Texas
Personal Contact: "Property taxes on oil have a distinct
advantage over other forms of oil taxation, particularly in newly
developed fields."
- Berry, Randolph. Revisor of Statutes, Legislative Affairs Agency, State
of Alaska, Juneau, Alaska.
Personal Contact: Research on oil property taxes and
severance taxes of other states, 1973.
- Broberg, Roy S. Manager, Property Tax Division, Tax Department, UNION
Oil of California, Los Angeles, California
Correspondence: "An additional oil tax could bring the
level of tax burden above that of other states where Alaska crude
oil must compete - could affect future competitive oil lease sales."
- Bryant, E. Lee. Manager, Property Tax Department, MARATHON Oil Company,
Findlay, Ohio
Correspondence: An in-depth assessment of the various oil
taxes of major producing states - "Present Alaska taxes on Marathon
constitutes more than their 'fair share' - suggest no additional
property taxes on reserves."
- Calvert, Robert S. Comptroller of Public Accounts, State of Texas,
Austin, Texas
Correspondence: State of Texas is not on top of oil pro-
perty taxes on oil reserves, even though indirectly revenue does
accrue to the State of Texas - "contact the firm of Pritchard &
Abbott for answers."

Cooper, Robert H. Assistant Director, Property Tax Division, State Tax Commission of Utah, Salt Lake City, Utah

Correspondence: Description of oil taxes in Utah.

Cunningham, Milton. State Assessor, Ad Valorem Tax Division, State Comptroller, State of Texas, Austin, Texas

Personal Interview: "The Railroad Commission and the firm of Pritchard & Abbott know more than anyone about this subject, contact them."

De Bolt, Harold. Director, Ad Valorem Tax Division, Department of Revenue and Taxation, State of Wyoming, Cheyenne, Wyoming

Correspondence: Description of oil taxes in Wyoming.

Dunlop, W.W. Executive Secretary, State Board of Equalization, State of California, Sacramento, California

Correspondence & Telephone Interview: An advantage of the California oil property tax is that it prolongs the economic limit of a well where a comparable severance tax would encourage abandoning a well where marginally economic reserves could be removed.

Edgar, T.C. Director, Severance Tax Division, State Comptroller Office, State of Texas, Austin, Texas

Personal Interview: The Texas Severance tax is basically a gross receipts tax, or an occupation tax levied on the market value and is more equitable than the ad valorem tax.

Freeman, Roger A. Hoover Institution on War, Revolution and Peace, Stanford, California

Correspondence: "Oil companies are not rolling in 'gravy' and the popularly believed 'tax advantages' should continue in order to increase the vitally needed domestic production of oil and gas."

Freer, Richard A. Previous Commissioner of Alaska State Department of Administration, Juneau, Alaska

Personal Interview: Since property taxes in other states have historically benefited municipal-local government units, would Alaska State sponsored property tax, if dedicated to local revenue sharing, be advisable? "NO."

Hall, David M. Senior Revenue Agent, Statistics and Research Section, Department of Revenue, State of Colorado, Denver, Colorado

Correspondence: Description of oil taxes in Colorado.

- Heier, Gerald D. Director, Property Tax Division, Alaska Department of Revenue, Anchorage, Alaska
 Personal Interview: Key source of information, and head of Division under which a property tax on oil would be administered if enacted, "Sees no insurmountable administrative problems with oil reserves property tax."
- Hopkins, William W. Manager, Alaska Oil and Gas Association, Anchorage, Alaska
 Correspondence: "Not in favor of tax on oil reserves."
- Howell, Holland. Industrial Properties Appraisal Engineer, Pritchard & Abbott, Fort Worth, Texas
 Personal Contact: Experience in appraising Alaska petroleum industry production facilities.
- Humphries, J. Kenneth. Research Analyst, Legislative Affairs Agency, State of Alaska, Juneau, Alaska
 Personal Interview: Has conducted previous research on this subject, particularly California administration of oil reserve taxes, a provocative "free thinker."
- Kasline, Fred. Oil & Gas Conservation Department, State of California, Sacramento, California
 Telephone Interview: The severance taxes have more advantages to oil exporting states; property taxes tend to spread the tax revenues unevenly throughout the State of California.
- McElvany, W.L. Director, Gross Production Division, Oklahoma Tax Commission, State of Oklahoma, Oklahoma City, Oklahoma
 Correspondence: Description of Gross Production and Excise Tax of Oklahoma.
- McGrew, James W. Executive Director, Texas Research League, Austin, Texas
 Personal Interview: A creditable reliable source of pro-industry research information; strongly prefers severance tax over property tax because of the inequities in local administration.
- McLoed, W.D. Assistant Manager, Property Tax Division, Treasurer's Department, Standard Oil Company of California, San Francisco, California
 Correspondence: Subject is so complex that it would require an in-depth study which they are unwilling to conduct.
- Maguire, John R. Rax Counsel (State and Local) Taxation Division, American Petroleum Institute, Washington, D.C.
 Correspondence: A good source for severance and production taxes by state.

- Matthews, Guy. Railroad Commission, State of Texas, Austin, Texas
 Personal Interview: The Railroad Commission serves as the Texas oil and gas conservation agency; "Suggested that certain Texas counties benefit, others do not - Pritchard & Abbott have all the answers."
- Messenger, John R. Assistant Attorney General, Department of Law, State of Alaska, Juneau, Alaska
 Personal Interview: Most knowledgeable in Juneau on oil taxes particularly legal aspects of oil property taxes, and is concerned that oil majors pay insignificant Alaska income taxes.
- Morrison, K.K. Chief, Inter-County Property Bureau Property Valuation Division, Department of Revenue, State of Montana, Helena, Montana
 Correspondence: Description of oil taxes in Montana.
- Parker, D.M. Senior Tax Representative, Tax Division, SHELL Oil Company, Los Angeles, California
 Correspondence: "Alaska oil taxes are already high, a property tax would be difficult and costly to administer."
- Paschall, Robert H. Senior Petroleum & Mining Appraisal Engineer, Assessment Standards Division, State Board of Equalization, State of California, Sacramento, California
 Correspondence and Personal Interview: An exceptional source, very knowledgeable; strongly feels that the property tax in California is far superior to a severance tax.
- Pritchard, Edward S. Attorney at Law, Partner in firm, Pritchard & Abbott, Valuation Engineers, Fort Worth, Texas
 Correspondence and Personal Interview: Largest of three oil property appraisal firms in Texas (and the United States) has contract with Alaska State Department of Revenue and feels the property tax on oil has made the difference in developmental progress of the oil producing states.
- Roberts, H.A. Tax Representative, Property Tax Department, TEXACO Inc. Los Angeles, California
 Correspondence: "Alaska is already taxing oil at a rate as high as any state in the nation; either severance or property taxes should be levied, not both."
- Rosell, Earl P. Deputy Director, Ad Valorem Tax Division, Comptrollers Office, State of Texas, Austin, Texas
 Personal Interview: The ad valorem tax is basically an effective fair tax although there are some inequities in assessment rates applied by the local "county commissioners." The State of Texas received \$47 million last year; but less in future years because of declining rate; these funds dedicated to higher education.

Singletary, George F. Administrator, Railroad Commission, State of Texas, Austin, Texas

Telephone Interview: The administrator for the Texas oil conservation agency; "The State of Texas has no idea of the impact of ad valorem or severance taxes," referred all questions to the firm of Pritchard & Abbott.

Taylor, Robert L. Chief, Research and Management, Department of Revenue, State of Kansas, Topeka, Kansas

Correspondence: Description of oil taxes in Kansas.

Underwood, R.M. Manager, Alaska Taxes, Atlantic Richfield Company, Anchorage, Alaska

Correspondence and Personal Contact: "Against a property tax on oil reserves because the State has alternative better ways to cover the shortfall in State revenues and the property tax is the most difficult to administer and the most controversial form of oil and gas taxation."

Van Manning, Owen. Research/Legislation Specialist, Department of Revenue, State of Louisiana, Baton Rouge, Louisiana

Correspondence: Description of taxes on oil in Louisiana.

Williams, Thomas K. Assistant Attorney General, Department of Law, Anchorage, Alaska

Correspondence and Personal Interview: Probably the single best source of information on the broad subject of oil taxes of other states and the relation to current State taxes and potential Alaska oil development.

II Books and other Sources of Information -- Tax Related:

Advisory Commission on Intergovernmental Relations, The Property Tax in a Changing Environment, Selected State Studies, Washington, D.C.: U.S. Government Printing Office, 1974

A 33 state comparative analysis of property tax administration, exceptionally helpful background information.

Balk, Alfred. The Free List, Property without Taxes, New York: Russel Sage Foundation, 1971

A crusading type of treatment of the evils of real estate tax exemptions.

Bird, Richard and Oldman, Oliver, Readings on Taxation in Developing Countries, Maryland: The Johns Hopkins Press, 1964

A collection of 33 papers on fiscal policy and systems of a few nations and taxes by nation (analyzed according to effectiveness in administration).

Cameron, Helen A. and Henderson, William. Public Finance, Selected Readings, New York: Random House, 1966

Five papers dealing with budgeting, fiscal policy, evaluating state and local government finance (property tax evaluating standards).

Deran, Elizabeth. Earmarked State Taxes, New York: Tax Foundation, 1965

An 80 page booklet which lists and evaluates dedicated taxes by state.

Ecker-Racz, L.L. The Politics and Economics of State-Local Finance, New Jersey: Prentice-Hall, Inc. 1970

A historical analysis of state and local revenue sources, and an evaluation of problems and advantages of each type of tax.

Freeman, Roger A. Tax Loopholes, the Legend and the Reality.

Washington, D.C.: American Enterprise Institute - Hoover Policy Study #5, May 1973

A straightforward review of tax exemptions, exclusions, deductions and credits in federal taxes. A critical point on tax advantages to oil companies prompted a letter to Freeman, duplicating bibliographic entry in first section.

Harriss, C. Lowell. Handbook of State and Local Government Finance, New York: Tax Foundation, Inc. 1966

Basically a statistical handbook of state and local taxes on 15 selected states (Alaska not included).

Hirsch, Werner Z. The Economics of State and Local Government, Los Angeles: McGraw-Hill Book Company, 1970

Contemporary microeconomic approaches applied to an analysis of state and local government.

Keith, John A. Property Tax Assessment Practices, Highland Publishing Company, Monterey Park, California, 1966

The closest to a textbook approach of any publication available on property taxation (public finance, history, economics, and assessing).

Lindholm, Richard W. Property Taxation U.S.A., Madison: The University of Wisconsin Press, 1967

Fourteen individual papers on property taxation; of particular interest - Mesabi Iron-Ore taxation history outlined by Clarence Nelson, Head of Research Department of Minneapolis Federal Reserve Bank.

Lipton, Milton. Tax hearings before the Senate Resources Committee of February 12, 1975 and the House Resources Committee of April 14, 1975.

The proceedings revealed exceptional and diverse knowledge of this Walter Levy Company consultant.

Maxwell, James A. Financing State and Local Governments, Washington, D.C.: The Brookings Institution, Studies of Government Finance, 1969

A textbook type approach to state and local taxation trends and interaction with the federal tax system.

Mead, Walter. Taxed hearings before the House Resources Committee, April 15, 1975

Unencumbered by special interests, this consultant to the legislature provided some of the most outstanding far reaching testimony, with obviously strong impact on the conclusion of this paper.

Musgrave, Richard A. ed. Broad Based Taxes: New Options and Sources, Maryland: The Johns Hopkins University Press, 1973

Sources of government revenue analyzed in light of economic development, a collection of ten papers.

Musgrave, Richard A. Fiscal Systems, New Haven: Yale University Press, 1969

A comparison of tax structures in developed countries, an in-depth analysis.

Netzer, Dick. Economics of the Property Tax, Washington, D.C.: The Brookings Institution, Studies of Government Finance, 1966

A comprehensive analysis of property taxation, the nature of the tax, the incidence, distribution, and economic effects.

Pechman, Joseph A. Federal Tax Policy, Washington, D.C.: The Brookings Institution, 1971

A highly readable introduction of the field of taxation as a major instrument of public policy; it includes a section on the analysis of state and local taxes.

Reuss, Frederick G. Fiscal Policy for Growth Without Inflation, the German Experiment, Maryland: The Johns Hopkins Press, 1963.

A somewhat dated study of the effects of German fiscal policy, a system which allows a more equitable distribution of income than the U.S. system.

Ruskay, Joseph A. and Osserman, Richard A. Halfway to Tax Reform, Bloomington: Indiana University Press, 1970

A lucid examination of major areas of tax avoidance; the sale of oil property of particular interest.

Shannon, John. Business Taxes in State and Local Governments, Massachusetts: Lexington Books, 1970

A symposium report on state and local tax administration issues.

Statham, Robert R. and Lehmann, Cynthia P. A Review of the Property Tax and Its Impact on Business, Washington, D.C. Chamber of Commerce of the United States, 1973

This booklet highlights the negative aspects of property taxation in general, with strong reliance on U.S. Department of Commerce Census data.

State of Louisiana. 34th Annual Report, Louisiana Department of Revenue, Louisiana State Printing Office, 1974

State taxes listed by source for 1973; Severance tax collections itemized by product for each parish.

Tait, Alan A. The Taxation of Personal Wealth, Chicago: University of Illinois Press, 1967

Distribution of wealth in the U.S. and Britain is examined in the light of tax proposals for a "more equitable" distribution.

Texas Research League. The Texas Property Tax: Background for Revision, printed by the League for the Texas Advisory Commission on Intergovernmental Relations, 1973

A good analysis of the deficiencies of property taxes on oil properties which are administered at the local level.

U.S. Department of Commerce, Social and Economic Statistics Administration, Bureau of the Census, 1972 Census of Governments, Taxable Property Values and Assessment - Sales Price Ratios, Volume 2, Part 1 and Part 2, Washington, D.C., April 1974

Though somewhat dated when published, the best source of statistical data on property taxation of the 50 states.

_____, 1972 Census of Governments, Government Finances, Volume 4, Number 1, Finances of School Districts, Washington, D.C., April 1974

Statistical tables on school districts finances of 33 selected states in 1971-72, Alaska not included, most major oil producing states are included.

_____, Property Values Subject to Local General Property Taxation in the United States: 1973, Washington, D.C., December 1974.

White, Anthony G. Urban Property Taxation, Monticello, Illinois, Council of Planning Librarians, 1973

Two bibliographic lists of publications on urban property tax administration; of limited value.

III Books and other Printed Material -- Oil Related:

Adelman, M.A. ed. Alaskan Oil, Costs and Supply, New York Praeger Publishers, 1971

Economic analysis of the Prudhoe Bay field before oil price increases; excellent source but already somewhat dated.

_____, The World Petroleum Market, Maryland: Johns Hopkins Press, 1972

An excellent source on oil prices, reserves and international considerations.

Atlantic Richfield Company, Annual Report 1973.

_____, Supplement to the 1973 Annual Report.

Brown, R.D. The Crisis in Mining Taxation, CIM Bulletin, November 1974.

Campbell, Robert W. The Economics of Soviet Oil and Gas, Maryland: The Johns Hopkins Press, 1968

An historical sketch of Soviet energy development strategy and contemporary description of Soviet exploration, drilling, refining, transporting and marketing practices.

Exxon Corporation, 1973 Annual Report.

Forbes, January 1, 1975.

Hartshorn, J.E. Politics and World Oil Economics, New York: Frederick A. Praeger Publishing Company, 1962

This British author considers the international aspects of the oil industry and includes an arms-length evaluation of the "Oil Companies as Taxpayers."

Herbst, Robert L. Minnesota's Mineral Policy, Skillings Mining Review, October 12, 1974.

Marathon Oil Company, 86th Annual Report, 1973.

McCaslin, John C. ed. International Petroleum Encyclopedia, Tulsa, Oklahoma: Petroleum Publishing Company, 1973

An expansive volume presenting current statistical data on all aspects of petroleum production and reserves.

Mines and Minerals Act, Government of the Province of Alberta, 1973.

Mining Engineering, September 1974.

Mobil Oil Corporation, Annual Report 1973.

O' Dell, Peter R. Oil and World Power, New York, Taplinger Publishing Company, 1971

A lucid descriptive interesting work; an excellent introduction to the politics of international oil.

Oil and Gas Accounting Laws of New Mexico, State of New Mexico, 1972.

Oil Producing Industry in your State, The, Washington, D.C. Published
by the Independent Petroleum Association of America, 1973
Oil production statistics by state, a comprehensive list.

O'Neil, Thomas J. The Minerals Depletion Allowance (two articles) Mining Engineering, October & November, 1974.

Personal Property Assessment Manual, Oil and Gas 1974, by the Division
of Property Valuation, Department of Revenue, State of Kansas.

Phillips Petroleum Company, Annual Report 1973.

Standard Oil Company of California, 1973 Annual Report.

Standard Oil Company of Indiana, Annual Report 1973.

Standard Oil Company of Ohio, Annual Report 1973.

State of Oklahoma, Gross Production Tax Code and Petroleum Excise Tax Code,
published by Oklahoma Tax Commission, Oklahoma City, Oklahoma, 1965.

Shell Oil Company, Annual Report 1973.

State and Local Oil and Gas Severance and Production Taxes, a mimeographed
compilation of the American Petroleum Institute, Washington, D.C.
1974.

State of Alaska Hearings on Proposed Pipeline Legislation, Volumes I & II,
March 6 - 10, 1972, Alaska Department of Revenue
A transcript of testimony by State and oil industry officials
concerning ownership of pipeline, leasing of right of way, and oil
related taxes.

Texaco Inc. Annual Report 1973.

Union Oil Company of California, 1973 Annual Report.

Valuation of Oil & Gas Producing Properties, AH 566, published by the
Assessment Standards Division, Property Tax Department, California
State Board of Equalization, 1972.

Valuation of Oil and Mineral Rights, reprint from Institute of Public
Administration Symposium, Arizona State University, 1971.

SCOMM

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ALASKA
STATE LEGISLATURE

MEMORANDUM

May 14, 1975

Dear Mr. Mead,

It's been tough to pin Senator Huber down for very long--the session is getting into its fast and furious wind-up stage. Those handwritten memos you mentioned didn't seem to ring a bell at all, but if they are important we can make an all out search for them.

I thought I better go ahead and get these in the mail to you. Thanks a million. Your comments were apparently very valuable.

Have a nice day!

Kathie

AGO 513727 +

COMMENTS ON HB 297 AS IT PASSED THE HOUSE, TELEPHONED TO CHAIRMAN JOHN HUBER, SENATE SPECIAL COMMITTEE ON TAXATION & REVENUE, MAY 12 AT 11:00 a.m. BY WALTER J. MEAD

Page 1, Sec. 43.58.020 (2)

Beginning on line 24, it needs clarification. It lists three events leading to exemptions. If two or more of these events are at different points in time, then it will be unclear how the five year grace period is to be measured. As a correction, I would propose addition of the following words, "whichever comes first."

Page 2

The exemption provided in (4), lines 9 through 16, do not provide for termination of the exemption. I would suggest the addition of a phrase which provides that when the restrictions noted here are lifted, that the exemption be terminated.

Pages 7 and 9

Provision is made for accrual of the "early development incentive credit." In one of my previous memos to Senator Huber, I pointed out that this pay-back provision is the opposite of an early development incentive credit. By providing for pay-back of property taxes, it means that, in most cases, the property tax is simply a loan and the cost to the tax payer is limited to interest charges. It would be a greater incentive to eliminate this pay-back provision entirely, if the intent of the Legislature is to create an incentive for early development.

Page 8

Lines 15 and 16 are vague and will certainly lead to endless adjudication. The definition of "proven reserves" provided in SB 374 is far preferable. SB 374 language is standard language which the industry understands. HB 297 introduces new language, "if it is economically feasible to market," and "under reasonable foreseeable conditions." These terms are vague. I would recommend adoption of the SB 374 definition of proven reserves.

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Sec. 7 provides that if specified paragraphs are found to be invalid, the the act is voided in its entirety. This provision seems to me to introduce a high degree of uncertainty into the legislation. It is quite likely that the legal attack on these crucial paragraphs will be mounted after passage of HB 297 as a means of attacking and invalidating the entire legislation. In order to avoid this possibility, I would recommend removal of the provisions which may invalidate the entire legislation.

COMMENTS ON HB 297 AS IT PASSED THE HOUSE, TELEPHONED TO CHAIRMAN JOHN HUBER, SENATE SPECIAL COMMITTEE ON TAXATION & REVENUE, BY ROBERT PASCHALL ON MAY 12 AT 1:00 p.m.

EXEMPTION OF "PRODUCING OIL AND GAS LEASES" AND "VALUE OF INTANGIBLE DRILLING AND EXPLORATION EXPENSES" (Sec. 2. AS 43.55.010(b))

These exemptions are carried in the April 17 and later versions of HB 297. I strongly urge their deletion. They may well nullify all or part of Sec. 43.58.010, namely, the very proposal to levy an ad valorem tax on oil and gas reserves. Here is why I state that this may be the case.

(2) Producing oil and gas leases. A private party to the lease with a government agency is the very instrument that creates its leasehold interest in the mineral rights. Unless the intent of 43.58.010 is to confine the ad valorem tax to non-producing properties, 43.55.010(b)(2) creates an unintentional exemption from ad valorem taxation for all fields that now produce, but the very fact that 43.58.030 provides for a production tax credit against the ad valorem tax indicates that producing leases are not to be exempted.

INTANGIBLE EXPLORATION AND DRILLING COSTS

Exploration and development are necessary to establish the existence of a valuable oil or gas reserve. More precisely, the completion of a new well capable of production enhances the value of the reserves since the well is necessary to produce the reserves. One can maintain, then, that the cost of drilling is included in the value of the reserves developed by the drilling.

Now, intangible drilling costs (IDC) simply represent the portion of total drilling costs expended for wages, salaries and services and are identified separately from tangible drilling costs only because the Internal Revenue Service permits expensing IDC while it requires that tangibles be capitalized. The only reason that IDC's ever showed up in Alaska law is because the North Slope Borough Assessor insisted on attempting to assess these costs per se.

The best thing--the only thing--is to get the phrase out of the law. Otherwise, industry may claim that IDC's are automatically included in the value of the reserves and should be subtracted. You can bet that no prospective purchaser of an oil property would ever try to pull that on the owner of the property and that is the true test of the issue. IDC's were never raised in the entire history of oil property valuation until the North Slope Borough Assessor insisted upon assessing them as a specific item of property.

THE PERIOD OF GRACE

The period of grace refers to the particular period of time following discovery in which the new field would be exempt from ad valorem taxation. This subject is covered in Sec. 43.58.020 and in Sec. 7 at the end of HB 297. Sec. 7 says that the entire bill will be void if either of paragraphs (2), (3) or (4) of 43.58.020 are "for any reason held invalid or unenforceable." This very strong language of Sec. 7 adds great importance to the manner in which 43.58.020 is stated. In my own opinion, the language of SB 374 is infinitely clearer, more to the point and less subject to future controversy and possible litigation. In any event, if it is necessary to include the essence of paragraph (4), it should be required to have the exemption terminate if the injunction is lifted.

DEFINITION OF "PROVEN RESERVES" (Sec. 43.58.190 (7))

An excellent definition of this term was in HB 297 until the version of April 24 was written. That earlier version was almost exactly the one promulgated by the American Petroleum Institute and adopted throughout the industry. The definition in the latest version of HB 297 is awkward and ambiguous. The phrase, "if it is economically feasible to market it" is not necessary since the phrase "indicate to be recoverable" precedes it; no one will bother to recover it unless it is economically feasible. Also, the term "reasonably foreseeable conditions" is a monster and lawyers may have a field day defining "reasonable" as it applies to a given oil field. I recommend that the definition in the April 17 version be used. That definition is the same as that in SB 374.

THE AD VALOREM ASSESSMENT TIMETABLE

Four key dates are presented here: January 1, February 1, April 15 and June 15. I can see a major problem for the valuation engineer who would have an absolute maximum of 2½ months time in which to appraise the State's oil fields. In fact, it is likely that late returns would confine the time in which he could work from February 15 to April 15. Moreover, if the Department of Revenue must send a notice of assessed value by April 15, the valuation engineer would have to submit his values to the Department by about April 1 and this further restricts the time in which he could do his job. I would like to suggest that the date April 15 in Sec. 43.58.060 be changed to May 15.

WALTER J. MEAD
990 CAMINO MEDIO
SANTA BARBARA, CALIFORNIA 93105
PHONE: 805-9672295

April 26, 1975

Senator John Huber
Alaska State Senate
Pouch V
Juneau, Alaska 99811

Dear John:

Following the request in your April 22 letter which I received today I am providing the following comments on House Bill No. 297:

Chapter 58, Sec. 43.58.010, (b) and (c) do not specify the tax rate and therefore introduces an unnecessary degree of uncertainty into the operator's business. The Legislature may feel unconcerned about this problem, but ultimately the people of Alaska pay the bill due to increased uncertainty. Uncertainty in business dealings between the State and buyers of oil leases always leads to higher discount rates. This, in turn, leads to lower present values. But the bonus bids are based on present values. If the Legislature adds to the degree of uncertainty, its future bonus bid income will be lower than otherwise. In this respect, Senate Bill No. 374 is preferable because it specifies what the tax rate is to be.

Section 43.58.020 (3) specifies "the earlier of:" the items listed in A and B and is, therefore, superior in this respect to Senate Bill No. 374 which fails to specify "whichever comes earlier". See my letter to you dated April 22, 1975, paragraph No. 2.

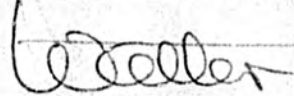
Section 43.58.170 provides a termination date of December 31, 1977 rather than 1978 as provided in Senate Bill No. 374. The authors of House Bill No. 297, in providing for only two years of tax liability, may have in mind an extension in the event that oil production does not begin in 1977, or begins but is of low volume and produces only minor severance tax payments. But a possible or probable one year extension again adds to business uncertainty. A terminal date of December 31, 1977 actually produces a final tax payment on June 30, 1977, covering the 1976 taxable year for property taxes. The 1977 terminal date does not appear to be realistic. Senate Bill No. 374 appears to be more forthright in this respect.

Section 43.58.180 provides for "accrual of early development incentive credit". The purpose of this section appears to be to provide for a subsequent recovery of up to 50% of property taxes paid. The wisdom of partial, or full, or no recovery is a value judgement that the Legislature must make. However, if the intent of the Legislature is to provide an incentive for early development as suggested in this section, the 50% repayment provision will not accomplish this objective as well as Senate Bill No. 374 which provides for no recovery of property taxes paid prior to production. Both bills provide that severance taxes are creditable against property taxes.

I have provided my comments on Senate Bill No. 374 separate_{ly}. See my letter dated April 22, 1975.

If I can be of further assistance, please feel free to let me know.

Sincerely yours,

A handwritten signature in dark ink, appearing to read 'Walter J. Mead', written over a horizontal line.

Walter J. Mead

WALTER J. MEAD
990 CAMINO MEDIO 10
SANTA BARBARA, CALIFORNIA 93105
PHONE: 805-9672295

April 22, 1975

Senator John Huber
Special Committee on Taxation and Revenue
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear John:

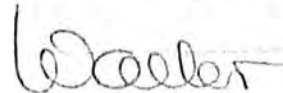
I have two additional comments on Senate Bill No. 374.

1. On page 1, line 27, you might want to add "whichever comes first.", in order to eliminate ambiguity that would arise in case that two or more of the events listed occurred on different days.

2. On page 1, line 24, you might consider adding the word "calendar" so the line reads as follows:

property during a five calendar-year period beginning with the date of the first ...

Sincerely yours,



WALTER J. MEAD

WJM:mr

WALTER J. MEAD
990 CAMINO MEDIO
SANTA BARBARA, CALIFORNIA 93103¹⁰
PHONE: 805-9672295

April 22, 1975

Senator John Huber
Special Committee on Taxation and Revenue
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear John:

This letter is in response to your request that I review Senate Bill No. 374 (4-15-75) to identify the economic consequences of enactment.

1. The effect of the five year grace period plus the December 31, 1978 termination date would be to exempt all leases issued on or after January 1, 1974. This follows from the fact that a lease issued on or after this date could not be placed on the tax roll until January 1, 1979, the day following expiration of the law. This point and other alternatives are illustrated in Figure 1 showing leases issued at three points in time. For the State leases sold in September 1969, property taxes would become due on June 30, 1976 for the 1976 taxable year. In the absence of production, property taxes would be due for three full years.¹ If the words are changed to read "five calendar years" on line 24, page 1, the three year maximum liability would remain unchanged for these leases.

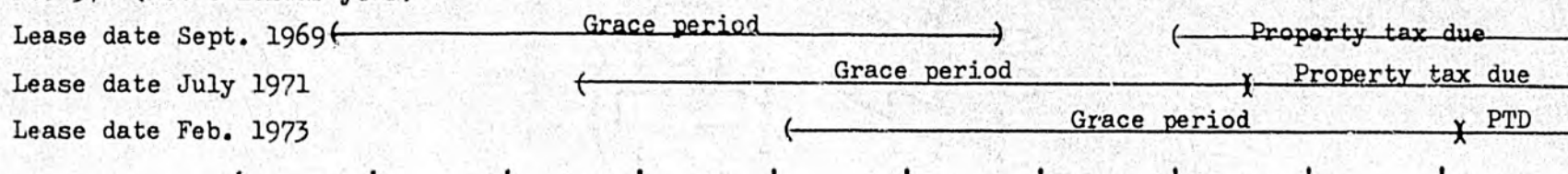
For a lease date effective July 1971, property taxes would be payable for the period July (lease day) 1976 through December 31, 1978. Property taxes for 1976 would require a partial year calculation. If the calendar year terminology is adopted, property taxes would be payable for two years beginning January 1, 1977 through December 31, 1978.

For a lease dated February 1973, property taxes would be payable for the period February (lease day) 1978 through December 31, 1978. If calendar year wording is adopted, this partial year property tax obligation would be eliminated.

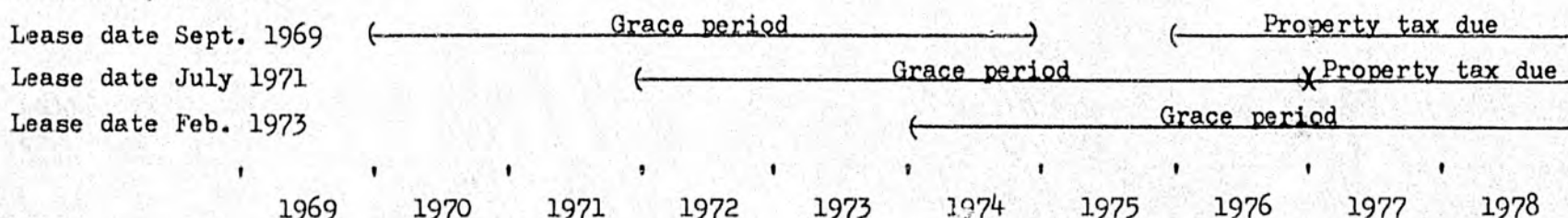
¹In all Figure 1 illustrations, the assumption is made that production is not initiated until after December 31, 1978.

Figure 1--. Illustration of property tax obligation in the absence of oil production from known oil reserves.

Wording in Senate Bill
No. 374 (Not calendar year)



Calendar year basis



*Assumes the absence of production or with production involving severance tax payments that average less than one-twelfth the amount of corresponding property tax liabilities.

2. The maximum number of years that any lease could be subject to the proposed property tax on reserves would be the three years 1976, 1977, 1978, the years encompassed by the initial effective date (January 1, 1976) and the termination date (December 31, 1978).

3. Firms might have property tax liabilities for less than the maximums because (1) leases were issued later than January 1, 1976, or (2) production commenced before June, 1978.

4. The timing of previous twelve month severance tax credits against property taxes due on June 30 of each taxable year raises a question of possible double taxation. The problem is illustrated graphically in Figure 2. If oil production begins in July, 1977, both severance and property taxes will be paid for the six months July through December of 1977. However, these severance taxes are creditable against the property tax liability, to the limit of the property tax liability. This timing situation involves pre-payment of property taxes, but not double taxation. The problem of double taxation arises in the final six month in the life of the property tax (July through December of 1978) when severance taxes are paid along with property taxes, but there is no offsetting credit. In this period, a double tax burden occurs. The extent of the double burden is less than that in one earlier version of the proposed legislation which provided that severance taxes in the preceding calendar year were creditable against property taxes on June 30 of any taxable year. In that case, the double tax burden would occur during the full 1978 calendar year.

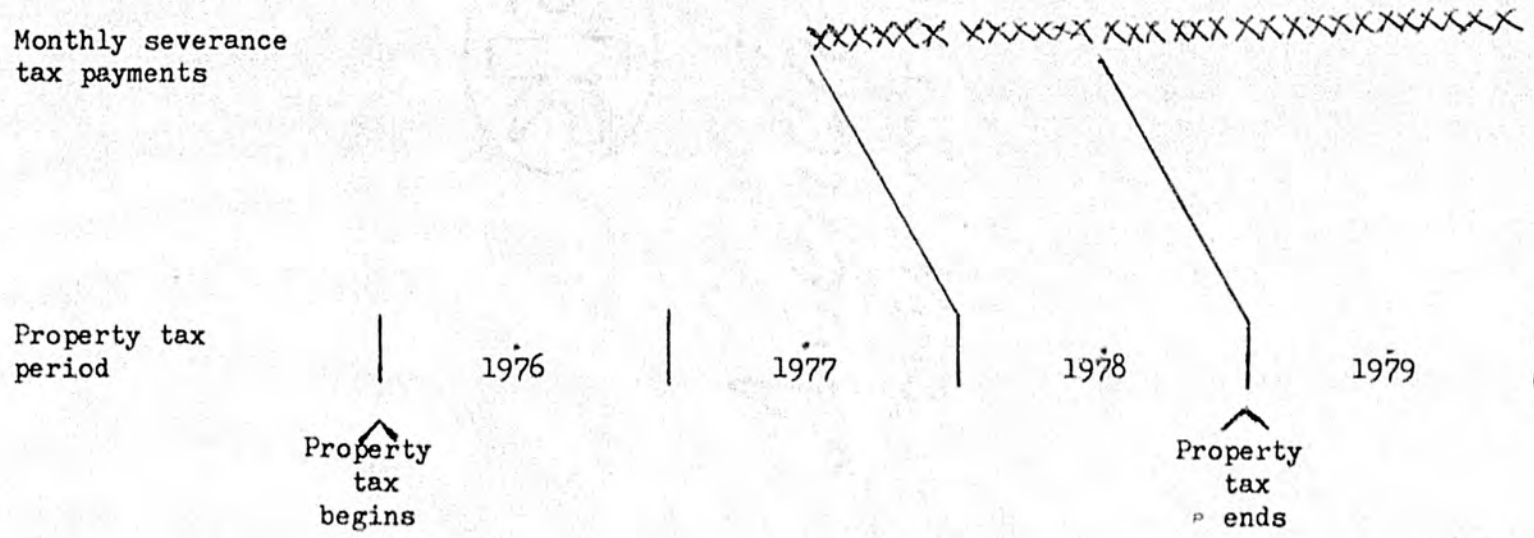
5. The five year grace period does not provide five years of exemption after discovery, but after lease issue date. Since discovery (if any) followed rather than preceded leasing for all leases issued prior to January 1, 1974, the grace period in all existing cases is less than five years after discovery.

6. The incidence of the property tax depends on the circumstances. Three statements can be made.

A. For all existing leases subject to property tax liabilities, the incidence is upon the leasee. Oil produced from the lease (if not in production in 1972) will be classified by the Federal Energy Administration as "new oil" and may be sold under free market conditions at the highest price that the market will allow. The imposition of this tax will not increase or reduce the supply of oil therefore the market price is unaffected by the tax. The lessee cannot pass the tax along to buyers of oil.

B. For all existing leases the lessee cannot pass the tax back to the lessor. The bonus has already been bid and paid. The lessee does not have the option of renegotiating the lease payment terms.

Figure 2--. Illustration of overlapping property and severance tax payments for a known oil reserve leased prior to January 1, 1971 and beginning production in July 1971.

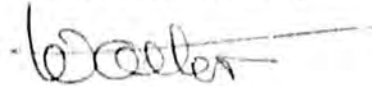


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C. For leases issued subsequent to the imposition of a property tax there is a potential property tax liability. Bidders will likely reason that if Alaska imposed a property tax once, in response to a critical budgetary need, it may do so again. In estimating costs, revenues and net income for future leases in order to arrive at a present value and a bonus bid, the probability of future property taxes will be included along with other contingent costs. This will reduce present value estimates and yield lower bonus payments to the state in the future.

7. As indicated in my testimony the most serious shortcoming of a property tax on oil reserves as proposed is the fact that such a tax is not based on an ability to pay. Income is not expected to flow from the Alaskan oil reserves dependent on the trans-Alaskan pipeline until 1977. From the date on which these bases were issued until the date oil is delivered to market, those reserves will generate no income. Payment of a property tax must come from other income available to the lessees, from borrowed funds or from new equity capital. The lessees have already borrowed on a large scale to finance construction of the pipeline. While this outlay has been greater than expected, income from other oil production has also been greater than expected due to the rapid increase in crude oil prices since 1973. A large property tax burden will place a great financial burden on SOHIO as the company holding the largest share of North Slope known crude oil reserves and to a lesser degree on ARCO. There is no corresponding ability to pay this tax.

Sincerely yours,



WALTER J. MEAD

WJM:mr

Biographical Data
Walter J. Mead
Professor of Economics
University of California, Santa Barbara

Personal Data:

Born May 6, 1921, Nehalem, Oregon
Married, Five Children

Education:

AB University of Oregon, June 1948
MA Columbia University, February 1950
Ph.D. University of Oregon, June 1952
(Carnegie Fellow, 1949-50, 1950-51)

Employment:

1951-1956, Department of Economics, Lewis and Clark College, Portland, Oregon
1956-1957, Asst. Field Director, Committee for Economic Development, New York City, on leave for one year from Lewis and Clark College
1957-to date, Department of Economics, University of California, Santa Barbara, Professor since 1966
1972-73, on leave with Ford Foundation, Energy Policy Project

Publications:

See attached list

Professional activities:

1. Chairman, Governor's Advisory Committee on Unemployment Compensation, 1954-55 (Advisory to Governor Patterson of Oregon).
2. Consultant to several corporations in the following industries: Pulp and Paper, Lumber, Plywood, Electronics.
3. Consultant to Committee for Economic Development, Stanford Research Institute, General Electric-TEMPO, U.S. Department of Agriculture (Forest Service), U.S. Department of Interior (Bureau of Land Management), U.S. Bureau of the Budget, and U.S. Federal Trade Commission.
4. Labor arbitrator since 1952.
5. Member of National Advisory Council of the Natural Resources Journal, 1968-to date.
6. Member, Editorial Board, Land Economics, 1969-to date.
7. Member, Editorial Board, Industrial Organization Review, 1973-to date.
8. President of the Western Economic Association for 1968-69.
9. Senior Economist, Ford Foundation, Energy Policy Project 1972-73.
10. Member, University of California Council on Energy and Resources, March 1974-to date.
11. Expert Witness, "The Advocates", January 1974.

Administrative Experience:

1. Acting Chairman, Department of Economics, UCSB, 1963-64.
2. Chairman of the Graduate Committee, Department of Economics, UCSB, 1965-1966.
3. Chairman of the Executive Committee of the College of Letters and Science, UCSB, 1964-1966 (elected).
4. Chairman of the Danforth Foundation Associates, Southwest Regional Conference 1963-64. Presently a Senior Associate of the Foundation.
5. Chairman of the Committee on Committees, UCSB, 1967-1968 (elected).

Administrative experience:

6. Chairman of a Committee to evaluate the goals of the Educational Opportunity Program, UCSB, 1969-to date.
7. Chairman of the Undergraduate Committee, Department of Economics, 1968-to date.
8. Chairman, Library Committee, UCSB, 1966-1967.
9. Member of the Regional Board of Directors, Omicron Delta Epsilon, the national honorary society in Economics.
10. See also Item #8 under Professional activities.
11. Chairman, Privilege and Tenure Committee, 1973-to date.

Research grants since 1965:

1. January 1965 - December 1968, \$45,000 grant from Resources for the Future for a study entitled "Price Determination in Natural Resource Oligopsonies." This study was concerned primarily with leasing policy for oil shale resources owned by the Federal Government.
2. January 1968 - June 1969, \$11,375 grant from the Haynes Foundation for a study entitled "Exploratory Economic Analysis of Ocean Mineral Resource Development." The objective of this project is to study the important externalities in marine development and to estimate the social rates of return for several marine minerals. This grant is jointly held by my colleague, Professor Philip Sorensen, and myself.
3. July 1969 - June 1971. The Haynes Foundation has made a follow-up grant of \$15,000 to continue the studies noted in item 2 above. This, in turn, has been matched 2 for 1 under the National Science Foundation, Sea Grant Program.

LIST OF PUBLICATIONS

Name: Walter J. Mead

<u>Year</u>	<u>Title</u>	<u>Journal, Vol., pages</u>	<u>Category</u>
1. 1953	"Some Recent Changes in the Concept of Fundamental Disequilibrium"	Proceedings of the Western Econ. Assn. Vol. 28, 5 pages	Article
2. 1954	Contributed to <u>The Forest Products Industry of Oregon, Part I</u>	Published by Reed College and Lewis and Clark College	Monograph
3. 1956	Contributed to <u>The Forest Products Industry of Oregon, Part II</u>	<u>Same</u>	Monograph
4. 1956	"The Forest Products Economy of the Pacific Northwest"	<u>Land Economics</u> Vol. 32, 7 pages	Article
5. 1958	"Non-Defense Government Purchases of Goods and Services"	GE TEMPO, RM 58TMP-45. 24 pages	Monograph
6. 1959	"The Impact of Capital Gains Taxes on Timberland Resource Utilization"	<u>Proceedings</u> of a conference on Timber Taxation U. of Ore., 14 pages	Paper
7. 1959	"Public Policy and Economic Development"	<u>Proceedings</u> Society of American Foresters, 3 pages	Article
	Reprinted	<u>Social Sciences in Forestry, A Book of Readings</u>	
8. 1960	"Long-Term Investment Planning for Forestry Development"	<u>Proceedings</u> Industrial Paper Forestry Seminar, Yale-UCB, 13 pages	
9. 1960	"Concepts and Cases in Economic Analysis"	<u>American Economic Review</u> , Vol. 50, 2 pages	Review
10. 1961	"Fundamentals of Forestry Economics"	<u>American Economic Review</u> , Vol. 51 2 pages	Review
11. 1961	"Changing Pattern of Cycles in Lumber Production"	<u>Journal of Forestry</u> Vol. 59, 6 pages	Article
12. 1962	"Some Political-Economic Issues Determining U.S. Tariff Policy"	<u>American Journal of Economics and Sociology</u> , Vol. 21, 14 pages	Article

LIST OF PUBLICATIONS

Name: Walter J. Mead

- | | | | | |
|-----|------|---|---|----------------------|
| 13. | 1962 | "The Changing Cyclical Character Residential Construction and its Impact on Lumber Production and Prices" | <u>Proceedings of the Western Economic Assn.</u> , Vol. 36, 8 pages | Article |
| 14. | 1964 | <u>Mergers and Economic Concentration in the Douglas-Fir Lumber Industry</u> | U.S. Forest Service Research Paper PNW-9 81 pages | Monograph |
| 15. | 1964 | "Seasonal Variation in Lumber Prices" | <u>Journal of Forestry</u> Vol. 62, 7 pages | Article |
| 16. | 1964 | "A Positive Proposal to Strengthen The Lumber Industry" | <u>Land Economics</u> Vol. XL, 12 pages | Article |
| 17. | 1964 | "Economics of the American Lumber Industry" | <u>Forest Science</u> Vol. 10, 2 pages | Review |
| 18. | 1965 | "A Positive Proposal to Strengthen The Lumber Industry": Rejoinder. | <u>Land Economics</u> Vol. XVI, 3 pages | Rejoinder to a reply |
| 19. | 1965 | "Economies of Scale in Lumber Production" | <u>Economic Concentration</u> Testimony Hearings before the Subcommittee on Anti-trust & Monopoly, U.S. Senate, Part 4, 20 pages | |
| 20. | 1966 | "The Workability of Competition in the Lumber Industry" | <u>Public Finance and Welfare</u> , Univ. of Ore. Press, 1966, 27 pages | Chapter in book |
| 21. | 1966 | "Effect of Capital Gains Taxation on Timber Resource Allocation" | National Tax Assoc. Proceedings, 1965, 17 pages | Article |
| 22. | 1966 | <u>Competition and Oligopsony in the Douglas-Fir Lumber Industry</u> | Univ. of California Press, 1966, 276 pages | Book |
| 23. | 1967 | "Some Economic Implication of Changes in the Federal Timber Supply" | <u>Proceedings</u> , Society of American Foresters, 1967, 6 pages | Article |
| 24. | 1967 | "Natural Resource Disposal Policy: Oral Auction vs. Sealed-Bidding" | <u>Natural Resources Journal</u> , Vol. 7, 30 pages | Article |
| 25. | 1967 | "The Use of Competitive Markets in Federal Oil Shale Lease Policy" | Hearings before the Subcommittee on Anti-trust and Monopoly, U.S. Senate, Part 1, 20 pages
<u>Congressional Record</u> , October 11, 1968, S-12564-12569 | Testimony |
| | | Reprinted | | |

LIST OF PUBLICATIONS

Name: Walter J. Mead

- | | | | | |
|-----|------|---|---|-----------------|
| 26. | 1967 | "The Competitive Significance of Joint Ventures" | <u>Antitrust Bulletin</u> ,
Fall 1967, XII, 30
pages | Article |
| 27. | 196 | "Resource Control as a Basis for Market Power: The Case of Timber" | <u>Extractive Resources and Taxation</u> , Mason Gaffney, ed.
Univ. of Wisconsin Press, 1967, 17 pages | Chapter in book |
| 28. | 1968 | "The Structure of the Buyer Market for Oil Shale Resources" | <u>Natural Resources Journal</u> , October, 1968, 27 pages | Article |
| | | Reprinted | <u>Rocky Mountain Mineral Law Journal</u> | |
| 29. | 1968 | "Economic Issues in Federal Oil Shale Leasing Policy Alternatives" | <u>Quarterly of the Colorado School of Mines</u> , 1968
19 pages | Article |
| 30. | 1968 | "The Workability of Competition in Federal Oil Shale Leasing" | <u>Public Land Policy</u> ,
Proceedings of the
Western Resources
Conference, 1968,
13 pages | Article |
| 31. | 1968 | With Philip E. Sorensen, "Externalities in Ocean Mineral Resource Development" | <u>Marine Technology Society, A Critical Look at Marine Technology</u> , July 1968
8 pages | Article |
| 32. | 1968 | With Philip E. Sorensen, "A Cost-Benefit Analysis of Ocean Mineral Resource Development: The Case of Manganese Nodules" | <u>American Journal of Agricultural Economics</u> ,
December 1968, 9 pages | Article |
| | | Reprinted | Hearings before the U.S. Senate Committee on Interior & Insular Affairs, Part 2, 1970 | |
| 33. | 1969 | "A Criticism of Mr. Bentley's Economic Model of Public Timber" | <u>Journal of Forestry</u>
June 1969, 3 pages | Comment |
| 34. | 1969 | <u>Competition for Federal Timber In the Pacific Northwest</u> , with Thomas E. Hamilton | U.S. Forest Service
63 pages | Monograph |

LIST OF PUBLICATIONS

Name: Walter J. Mead

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|-----|------|---|--|--|
| 35. | 1969 | "The System of Government
Subsidies to the Oil Industry" | Hearings before the
Subcommittee on Anti-
trust and Monopoly,
U.S. Senate, <u>Govern-
mental Intervention
In the Market Mechanism
the Petroleum Indus-
tries</u> , 25 pages | Testimony |
| | | Reprinted #1 | <u>Natural Resources Jour-
nal</u> , January 1970, 12
pages | |
| | | Reprinted #2 | <u>National Petroleum
Policy</u> , A.E. Utton
(ed.) U. of New Mexico
Press, 1970 | |
| | | Reprinted #3 | <u>Political Economy of
Federal Policy</u> , Robert
Haveman and Robert
Hamrin (eds.) Harper &
Row, 1973 | |
| 36. | 1969 | With Philip E. Sorensen,
"A New Economic Appraisal of
Marine Phosphorite Deposits" | Marine Technology
Society, <u>The Decade A-
head, 1970-1980</u> , 1969,
10 pages | Article |
| | | Reprinted | <u>Outer Continental Shelf</u> ,
Hearings Before the
Senate Committee on
Interior & Insular
Affairs, Part 2, 1970 | |
| 37. | 1969 | "Instantaneous Merger Profit
as a Conglomerate Merger
Motive" | <u>Western Economic
Journal</u> , Dec. 1969,
VII, 11 pages | Article
WEA Presidential
address |
| | | Reprinted | <u>The Journal of
Reprints for Anti-
trust Law and
Economics</u> | |
| 38. | 1969 | "Federal Public Lands Leasing
Policies" | <u>Quarterly of the Colo-
rado School of Mines</u> ,
Oct. 1969, Vol. 64,
33 pages | Article |
| 39. | 1970 | With Philip E. Sorensen,
"The Principal External Costs
and Benefits of Marine Mineral
Recovery" | <u>Proceedings</u> , Offshore
Technology Conference,
1970, Vol. I, 10 pages | Article |
| 40. | 1970 | With Philip E. Sorensen,
"Evaluation of Technological
Spillovers: The Case of the
Deep Sea Dredge" | <u>Proceedings</u> , Marine
Technology Society,
1970, Vol. 2, 9 pages | Article |

Name: Walter J. Moad

- | | | | |
|-----|------|--|--|
| 41. | 1970 | "The Potential Economic Value of Mineral Production from the Outer Continental Shelf" | <u>Outer Continental Shelf,</u> Testimony
Hearings before the U.S. Senate Committee on Interior and Insular Affairs, Part 2, 1970
35 pages |
| 42. | 1971 | "A National Defense Petroleum Reserve Alternative to Oil Import Quotas" (with Philip E. Sorensen)

Preprinted

Reprinted | <u>Land Economics,</u> Article
Vol. 47, August, 1971, 14 pages

U.S. Senate
<u>Congressional Record</u>
May 10, 1971

<u>Hearings</u> before the Committee on Interior and Insular Affairs, U.S. Senate, May 30, 1973 |
| 43. | 1971 | "Efficiency and National Security as Goals for Energy Policy" | <u>National Goals</u> Testimony
<u>Symposium,</u> Hearings before the Committee on Interior and Insular Affairs, U.S. Senate, 92nd Congress, first session, Part I, October 20, 1971, 23 pages |
| 44. | 1972 | "The Economic Cost of the Santa Barbara Oil Spill", with P.E. Sorensen | <u>Proceedings of the</u> Article
Oil Spill Symposium, U.S. Geological Survey, 43 pages |
| 45. | 1972 | "Public Land Policies and Natural Resources" | <u>America's Public Lands</u> Article
Institute of Governmental Studies, U.C. Berkeley, 30 pages |
| 46. | 1972 | "A Preliminary Estimate of the Economic Potential of Marine Placer Mining" (with Philip E. Sorensen and Sue Wilcox) | <u>Proceedings Marine</u> Article
Technology Society, 1972, 7 pages |
| 47. | 1973 | "Crude Oil Storage Costs" | <u>Hearings</u> before the Committee on Interior and Insular Affairs, U.S. Senate, May 30, 1973, pp. 19-58 Testimony |

Name: Walter J. Mead

48.	1973	"Joint Ventures in the Oil Industry"	<u>Hearings</u> before the Committee on Interior and Insular Affairs, U.S. Senate, December 12, 1973, pp. 999-104	Testimony
49.	1974	"The U.S. Energy Situation"	A New Look at Energy Sources, American Society of Agronomy, Special Publication No. 22	Article
50.	1974	"Comment" on papers by H. Houthakker & P. Verleger at joint session of AEA and AAEE annual meeting	Journal of the American Agricultural Economic Assn.	Comment
51.	1974	"Oil Energy and Environmental Concern"	<u>Economic Analysis of Pressing Social Problems</u> , Rand-McNally, Votey & Phillips, eds.	Chapter
52.	1974	Testimony on Senate Bills concerning OCS Development	<u>Hearings</u> before the Committee on Interior and Insular Affairs, U.S. Senate, May 7, 1974	Testimony

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11:19



JUNEAU, ALASKA

Alaska State Legislature

Senate

April 2, 1975

Senator Kay Poland, Chairman
Senate Resources Committee

Submitted herewith are the Preliminary Comments and supportive material of our analysis of the various options and implications involved in and surrounding the issue of Taxation of Leasehold Interests (SB 103 and SB 276).

The basic difference in the two Bills is that SB 276 offers a rebate of the monies paid, via future severance tax credits. As such, SB 276 must be regarded as mandatory lending. SB 103 does not offer a rebate and is a straight added tax on Industry. Both Bills adequately perform the purpose for which they were written, though SB 276 is the more flexible and can be adapted to either purpose.

Policy options discussed include:

- A. Imposition of an added tax
- B. Inclusion of other minerals
- C. Credit against future severance taxes paid, and the immediate amending of the existing severance tax
- D. Taxing vs borrowing
- E. Effect on overall cash availability
- F. Priority of action

We conclude with our recommendations as to priorities, as follows:

1. Pass SCR 27 urging a Beaufort Sea Lease Sale
2. Amend the Severance Tax (We include a proposed amendment)
3. Prepare a final version of SB 276 to be taken as a first order of business next session if lease sale bonuses and income from the amended severance tax do not suffice.

This report concludes the work to be performed under the limited directive given us. We would be pleased to continue this work on issues before the Legislature and your Committee, upon your request and authorization by the Legislative Council.

Very truly yours,



George C. Silides
Calliett and Silides Consultants

AGO 513747

PRELIMINARY COMMENTS
TAXING OF LEASEHOLD INTERESTS
SB 103, SB 276

SB 103 and SB 276 address the same issues, and it appears best to discuss the composition and implications of both bills simultaneously.

I. Background

The principle of taxing leasehold and ownership interests in land with proven mineral reserves is not new to the Legislature, but has been held in abeyance as an emergency measure.

During the Special Session of 1973, the Legislature kept the option alive by amending the severance tax laws to eliminate the language that the tax (severance) was "in lieu of all ad-valorem taxes that might be imposed upon property rights attached to or inherent in the right to produce oil or gas". During that session, the ad-valorem tax passed on production and transportation of unrefined oil and gas also left intact the option of taxing the property rights by the State, while at the same time foreclosing that option to local governments. Most of this action was formulated in the Senate and carried on through the Free Conference Committees.

II. Items Being Taxed

SB 103 and SB 276 both recognize this old option, but each

approaches it in a different manner.

SB 103 proposes to tax (a) oil and gas leases with proven resources, and (b) ownership interests in proven reserves.

Taxing of leases is possible if the Bill is clarified to mean any possessory right or interest in the lease. Obviously, the right to explore, develop, and produce is worth a great deal, depending upon the reserves contained therein.

Except on private lands, ownership interest in proven oil reserves are a different matter. Questions arise as to actual ownership of the oil until after production takes place.¹ The right to explore and produce is implicit, but the right to ownership is not. Obviously, the State cannot tax itself. The question was studied by the Attorney General's Office at our request. The Administration's Bill (276) recognizes this difficulty and is constructed to avoid it.

The purposes of SB 103 would be better served by taxing the possessory rights and deleting 015 (2) to help avoid challenge

¹ It has been argued for example, that for the producer's expenditure of time, money, and material, the State will give the producer seven-eighths of the oil produced in payment for those efforts, but retains ownership until the contract is fulfilled.

in the courts, and providing further that administrative procedures not spelled out in the Bill can be devised.

In 58.190, pages 7 and 8, SB 276 defines "interest" to be of wide variety and scope and clearly defines the property being taxed as "any interest" in the proven reserves of a lease or property". By so doing it avoids the issue of who owns the oil or gas prior to production. It should also be noted that every person's interests in the lease is taxed, not only the original leaseholder. The operator is primarily liable.

We must conclude that of the two Bills, the taxable property is more clearly defined in SB 276 and, as a consequence, appears more defensible.

III. Type of Tax

SB 103 imposes a straight additional tax with an offset against any severance tax paid during a particular ~~assessment~~ ^{assessment} year. There is no offset provided against any future tax to be paid. The tax begins five years after the date of the lease or when reserves are proven, whichever comes earlier. The tax continues indefinitely or until repealed.

The tax imposed by SB 276 also commences five years from initial entry and is an advance payment on the Gas and Oil

Production Tax (severance) imposed by AS 43.55.010 (a). The advance payments are credited against production taxes and are recovered through accrual and credit devices in 58.180 (page 6) and the new subsection 55.018 (page 8).

Under the terms of SB 276, as written, the advance tax payments may be recovered in two years of production. We suggest that if the Legislature adopts the taxing policy of SB 276, then the payback period should be not less than three years, preferably five years, in order to insure the State's liquidity.

SB 103 attempts to amend 43.56, which is the Ad-Valorem Tax passed by the 1973 Special Session, by including new taxable property described in a new subsection .015.

SB 276 writes a new Chapter 58 so as to clearly define intent of tax, property being taxed, and to keep away from the calculations needed to operate Chapter 56, which taxes exploration, production, and pipeline properties.

Chapter 55 (Severance Tax) is made subservient to the new Chapter 58 created by SB 276. AS 29.53.050 (b) (page 9) and AS 43.56.010 (c) are amended to maintain the status quo of the taxing powers of municipalities.

A special feature of SB 276 is that even if the Bill is passed no tax per se attains unless the Legislature imposes a levy by April 1 of each ensuing year. The tax is designed to self-destruct as soon as production tax equals the leasehold interest tax. A better triggering device would be an automatic one based on a dollar residue level of the General Fund.

IV. Policy Options

A. Additional Straight Tax Oil and Gas Leasehold Interests.

If the Legislature wishes a Bill that imposes a tax on oil or gas leases without additional inclusions or future offset considerations, SB 103 amended as above will impose that tax. However, SB 276 is a far better written Bill that could be adapted to the purposes of a straight additional tax by the simple removal of 43.58.180 (page 6) and 43.55.018 (page 8).

B. Inclusion of Other Minerals

The Legislature may wish to consider taxation of all mineral leases or mineral properties in fee simple. Thousands of acres are now held in a speculative non-production status.

More germane to the option of imposing a tax on leasehold interests is the history of the Union-Marathon gas holdings in the Kenai Gas Field.

There, Union-Marathon held six trillion cubic feet of proven gas reserves in a totally uncommitted status for ten years until West Coast purchasers were forced into settling for a premium price. Firstly, the State was deprived of its severance income and secondly, the prevailing higher market price forced on the West Coast is also being passed on to the people of the Anchorage-Cook Inlet area.

Other properties of interest are the Kennicott Copper holdings in the Kobuk area, the vast placer gold holdings of U - V Industries throughout the State, the Beluga Coal leases, the variously owned iron ore holdings, etc.

C. Credit Against Future Severance Taxes Paid

If the Legislature decides to offset the tax imposed by SB 276 against future severance taxes, consideration should be given to raising the severance tax at this time to a level that can be sustained without change during the payback period, for the following reasons:

1. To raise the severance tax during a payback period leaves the State open to the accusation that the raise was to offset the offset. This may raise the spectre of discriminatory taxation and possibly develop a bad faith aura.

2. Alaska's severance tax is now well below the national average of 7%, and is declining. (See attached computations.) Present yield is 5.7%)

3. Under the system now in use, Alaska's severance tax cannot reach the 8% implied in the current statute, and will decline. (See attached computations.)

4. If deregulation of oil prices occurs and the wind-fall profits tax goes into effect, severance taxes are expensable against that Federal Tax, to the benefit of the State if it is done now before the door is closed by the Federal government.

5. We estimate that a straight 8% severance tax effective immediately will raise an additional 41 million in the next three years. A tax of 9% effective immediately would bring in an additional 76 million

dollars. A tax of 10% would result in an additional 110 million dollars.

6. Severance tax should be high enough to equal the revenue we could derive by taking the tax in-kind, selling crude on the open market and investing the money.

A proposed severance tax Bill is attached for consideration.

D. Taxing Vs. Borrowing

As written, SB 103 is a straight tax. If severance tax offsets are involved as in SB 276, it is mandatory lending.

In either case, eventual profitability will be reduced and corporate taxes will also be reduced.

Mathematically it appears that a straight tax on leasehold interests without offsets results in a greater total eventual return to the State in terms of dollars when combined with a corporate tax on the remaining profitability. It is also simpler. It will also probably be described as onerous.)

Mathematically it appears that if an offset against future severance tax is given, the total eventual return

to the State in terms of dollars will be less than if the State borrowed the money on its own account - if such borrowing can be made constitutionally possible.

E. Effect on Cash Availability

Regardless of whether the Legislature passes a leasehold interest tax with or without a rebate provision, the effect on cash availability for other purposes, such as exploration and development will be immediate and, possibly, regressive.

We are advised by industry spokesmen that the delayed implementation device in SB 276 does not alter this condition because, if the Bill is passed, funds must be encumbered and set aside for the eventuality of implementation. Though industry adds lease bonus monies to their list of shortfalls, we do not believe they will be affected as bids on each parcel offered will be strictly on the merits of acquiring the parcel based on its production potential.

The need to secure and/or encumber monies for tax payments under either SB 103 or SB 276 affects all holders of possible reserves, including the Native and other cor-

porations or persons. Any attempts at exclusion of any group will open the door to a charge of discriminatory taxation.

F. Priority of Options

With regard to both the need of the State to secure additional revenues and of probable feeling that the oil and gas producer should also be accommodated when not inimical to the interests of the State, the following appears as a reasonable priority of action at this stage of discussion:

1. Pass SCR 27 urging a Beaufort Sea lease sale.
2. Amend the Severance Tax.
3. Prepare a final version of SB 276 so that it can be passed as a first order business at the next session.

1975 SEVERANCE TAXES

Cook Inlet	=	1036/day	@	5.8%, declining
Granite Point	=	523/day	@	5.4% declining
McArthur River	=	2069/day	@	6.9%, declining
Middle Ground	=	714/day	@	5.6%, declining
Swanson River	=	686/day	@	5.6%, declining
Trading Bay	=	457/day	@	5.3%, declining

NATIONAL AVERAGE IS 7%

Prudhoe = 10,000/day initially @ 7.77%
with a decline commencing the third year from
initial production

Other = 2000/day initially @ 6.85%
with a decline commencing the third year from
initial production.

EFFECTIVE YIELD OF PRODUCTION TAX AT VARIOUS LEVELS

$\frac{300}{700}$	x	5	=	$\frac{1500}{4200}$	$\frac{\text{Bbls}}{1000}$	@	$\frac{\text{Rate}}{5.7\%}$
$\frac{1000}{1500}$	x	6	=	$\frac{4000}{9700}$	1500	@	6.47%
$\frac{500}{1500}$	x	8	=	$\frac{4000}{9700}$	2000	@	6.85%
$\frac{500}{2000}$	x	8	=	$\frac{4000}{13,700}$	2500	@	7.08%
$\frac{500}{2500}$	x	8	=	$\frac{4,000}{17,700}$	3000	@	7.23%
$\frac{500}{3000}$	x	8	=	$\frac{4,000}{21,700}$	5000	@	7.54%
$\frac{2000}{5000}$	x	8	=	$\frac{16,000}{37,700}$	7500	@	7.69%
$\frac{2500}{7500}$	x	8	=	$\frac{20,000}{57,700}$	10000	@	7.77%
$\frac{2500}{10,000}$	x	8	=	$\frac{20,000}{77,700}$			

F.Y. 1976 and F.Y. 1977

$$\begin{array}{l}
 1) \quad 29 : 5.7 = x : 8.0 = 45.8-29 = +16.8 \\
 \quad \quad \quad \quad \quad \quad \quad 8.0 = 40.7-29 = +11.7 \\
 \quad \quad \quad \quad \quad \quad \quad 10.0 = 50.9-29 = +21.9
 \end{array}$$

F.Y. 1978

$$2) \quad 180 - 29 = 151$$

$$\begin{array}{l}
 151 : 7.7 = x : 8.0 = 156.9 \\
 \quad \quad \quad \quad \quad \quad \quad 9.0 = 176.5 \\
 \quad \quad \quad \quad \quad \quad \quad 10.0 = 196.1
 \end{array}$$

	PRUDHOE	C.I.	
e 8%	(157 - 151)	+11.7	= +17.7
9%	(176.5 - 151)	+16.8	= +42.3
10%	(196.1 - 151)	+21.9	= +67.0

Totals For F.Y. 76, 77, and 78

$$\begin{array}{l}
 3) \quad e \quad 8\% \quad 11.7 + 11.7 + 17.7 = \underline{41.1} \\
 \quad \quad e \quad 9\% \quad 16.8 + 16.8 + 42.3 = \underline{75.9} \\
 \quad \quad e \quad 10\% \quad 21.9 + 21.9 + 67.0 = \underline{110.8}
 \end{array}$$

C.I.	C.I.	(C.I.+P)
76	77	78

extra income if
 assistance is
 given

C.I. = Cook Inlet

P = Prudhoe

scomm

11:20

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Special Committee on Taxation & Revenue

John Huber, Chairman

February 14, 1975

SENATOR HUBER - We will come to order. We expect more members from the House Finance Sub-Committee. Brenda Itta is with us now. We also have sitting in with us Senator Rader, Senator Orsini, Senator Pat Rodey, and of course the man who will be talking to us, Milt Lipton. Milt, I think that you know where we left off on taxation and revenues the other day and maybe you want to start from scratch. But basically, the questions have to do mostly with how it refers to taxation and revenue, both against our immediate needs and our long-range needs and the infrastructures of our revenue system. So, we are just going to start out with you and let you go.

MILTON LIPTON - Thank you, Mr. Chairman. It was several sessions ago that I referred to the practice of my appearing before legislative committees as a kind of a floating crap game, but I notice that you violate the principle of a floating crap game. For reasons of security you should never reconvene in the same place twice, but here we are reconvened in a hearing room where I was yesterday. I would like to start out discussion with you on reserves tax, perhaps go over quickly some of the things we have covered together before and many of the things I have discussed with other committees. Looking at the bill before you for the enactment of a tax on reserves from two perspectives: First, as a revenue-raising measure per se, that is by itself is it a good means (or what is the effect of it) to increase the aggregate amount of revenue which the State can expect to get from oil and gas operations? And then secondarily, as one among various alternatives that the State might turn to, not to increase the sum total of oil and gas receipts, but to provide a flow of revenues during an interim period when the budgetary needs of the State may compel us to look at some form of taxation or some source of revenue which it might not consider simply from the standpoint of raising more money. That is to say, the urgency of the State's budgetary position at the present time. Let me repeat very, very briefly, at the risk that you identify me as one among many lobbyists, what our objection has been to the principle of reserve taxation in the past and at present: That we feel that among the various means of raising funds from an operating and profitable oil and gas industry, the reserves tax is not a good tax. It hits the oil industry at the wrong time. It is not well

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identified with the respective profitability of profits, or of producers, or with a lifetime of their exploitation of State resources. And it is not only extremely difficult to administer, but it raises the possibility of very serious inequities among the companies and producing firms who might, at least theoretically, be subject to the tax. Very quickly, the problems in the administration of the tax are that--as the Senate Bill provides and as the House Bill provides and as the bills of the last legislature provided--What you are doing in effect is assessing the value of property where you include in the value of the property an estimate of the value of oil or gas (or oil and gas) reserves underlying the property. The problem of assessment, and you provide that in effect the valuation shall be the commercial value of the property as it had been obtained between a willing buyer and a willing seller. If you look at an acre or two acres of undeveloped land, the valuation of such land can generally be determined by a tax assessor on the basis of other transactions; similar land, similar location, there have been purchases, there have been sales so that you can determine what it is. To try to assess the value of improved property you appreciate in assessment the value of the land either on the basis of the cost of the property that has been built upon the land or what it would cost to reproduce the property at some later date if it is an old house or an old factory, or the income-earning potential of a factory which is operating, which is manufacturing goods, which is selling them. The minute you move to the valuation of reserves in place, you have an entirely new order of problems of assessment. I think I discussed some of these with the Committee last time so I don't want to repeat them in great detail, but one that's very difficult to identify: What the magnitude of reserves in place are. I put to you that in the last fifteen, twenty years in the United States where we have statistics on recoverable reserves with gross additions to our recoverable reserves each year, the biggest change in our estimate of reserves is not on account of new discoveries, or not on account of the amount of oil that we have depleted these reserves through past production, but through changing circumstances which lead us to change our own estimate of what the volume of recoverable reserves are. Secondly, after you have estimated what the recoverable reserves are, you must determine what their value is in terms of how much oil will be produced from those reserves, over how many years in the future, at what price will they sell. So you have, from an administrative point of view, an extremely difficult problem of determining what the value of those reserves are for purposes of assessment, since in fact there is neither willing buyer nor willing seller of those reserves and you couldn't possibly have trans-

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actions on the scale that would parallel the underground resources whose value you are trying to determine. Then, if you look at--if all of these problems had somehow been resolved, there is still the problem for one large oil field there or gas field here, or an oil field there which may have already been discovered or which will be discovered while the tax is still in effect. How do you determine the relative value of those reserves? Because the contribution in the payment on the oil or gas reserve which a lease owner will have to make will depend not only on the State's estimate of the volume of oil, but the estimate of when it will be produced, what the value of these are. It becomes an extremely difficult problem in not only determining for an individual field what the assessed valuation is going to be, but when several producers in different areas of the state may be both affected by it and determine the relative valuation and therefore the relative contribution. So that if this tax is looked upon as a means of increasing the aggregate revenues which the State will get from a functioning oil and gas industry, it seems to me that it's a poor and ineffectual way of doing that. If you want to increase revenues, you have other tax means by which to do it. Which is through your leasing policy, through your severance tax policy, through your royalty policy, through your income tax policy. So then I come down really to a perspective on this proposed tax, not so much as a means by which the State will increase the total revenues which it obtains from "D day" when the first lease is put up for bid, until "Z day" when on any particular lease the oil had been fully produced and the State has gotten all these revenues, but as a device to obtain for the State over the next several years a flow of revenues, which otherwise the State might not even obtain, or might obtain later, but which is necessary to bridge the gap. In other words, it now becomes a special form of taxation which is looked at by the legislature under the circumstances of today because the State faces this budgetary deficit. Obviously I am in no position to talk to the State's budgetary deficit or to other alternatives for improving the State's revenue position. But if the legislature is prepared to look at this task, not as the means of increasing over the span of oil and gas operations--increasing the total revenues, but as an interim budgetary measure, then I think at the very least it must consider what we have, I suppose, first suggested in the last session: Namely that since the State is trying to accelerate the flow of revenue, that it look upon whatever payments have to be made through a reserves tax, a tax on oil and gas in place, in fact as a prepayment of the taxes which otherwise would have been paid to the State at a later date when the oil and gas in those

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reserves actually moves into production and when the severance tax payments are made by the leaseholders and the oil and gas producers. Which means in fact, that the payment to the State this year and next year becomes an anticipatory payment, that in a sense, offsets the severance tax that would be paid in the future. You exchange current revenues for future revenues. From the standpoint of the State, it would not in any sense increase their total flow of revenue, but bring them closer to the present. From the standpoint of the producing companies, it does increase their total tax burden: Because to the extent that they must pay the reserve tax before they begin production, they must pay either out of other sources of corporate income or by anticipatory borrowing, so that in effect they carry an interest cost for a year, two years, or three years, or four years--as long as is necessary before in effect they recover what they have paid in the reserve tax by the abatement of future severance tax liabilities.

Where the State would not feel a net increase in their income, it would be bringing forward to recent years income that would otherwise have been recovered, for the industry it represents a net increase in the cost of doing the oil and gas exploration development work within the state on their leases. And of course, it places an acute financial burden on the specific companies who are most heavily involved in the Prudhoe Bay area, but you are well aware of that. So in general, I think that we feel that it is not a good tax from the standpoint of raising revenue. It is not an attractive tax really, from the standpoint of even providing carry-over funds, but this is a choice among alternatives that you would have to make. Here or elsewhere we can talk about the alternatives such as the prior sale of future royalty oil and gas or other forms of taxation. But if it were to be done, then at least we would feel that the State would be best advised to provide that payments on the reserve tax should be credited by each company that makes those payments against what in the future will be their severance tax liability. So that for some period of time, a portion of the severance tax each year that might be paid to the State since in fact it had already been paid in advance by the reserve tax. One other aspect of the relationship between the State and the industry: If it commends itself to the legislature, that this tax is really not a tax that should be added to the arsenal of weapons that you use against the industry (that you have other forms of taxation much better to turn to if you want to increase your total revenue) and that it is, in a sense, an emergency tax which is enacted now because the alternatives are just now available, then I would strongly urge that

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in passage of the tax, and in the legislative debate and in the legislative history, that this be clearly understood. Whether there is a termination date on the tax, or whether there is a clear understanding that it is the intent of the legislature that this tax, as an interim tax, shall in a sense abate future severance tax; that this should be clear either in the language of this statute or at least in the legislative history. That is as far as I would want to go in terms of general remarks, and if you like I could turn to the specific language of the bill that is before you.

SENATOR HUBER - I think that might be a good idea if you did. The proposed bill on oil and gas taxes in place--He has a copy of both the House and Senate bill, and I believe he's been briefed on the Governor's bill. We have been joined by Representative Gruening and Representative Haugen, who are members of the House Committee on taxation and Revenue.

REPRESENTATIVE HAUGEN - Mr. Chairman, do we have a copy of this bill in our book so we can follow along with it?

SENATOR HUBER - You did have a copy in your books.

MILTON LIPTON - SB 103.

COMMITTEE MEMBERS LOCATED THEIR COPIES OF THE BILL.

SENATOR HUBER - Did anyone have any specific questions this far? Any members of either committee have any specific questions so far?

REPRESENTATIVE HAUGEN - Just one thing. I got in late, but putting it simply, what you are saying is that you are going to borrow against the future revenue, and what your caution was that that should be a credit against severance when the time came.

MILTON LIPTON - That is an alternative. That's not the alternative that's provided in SB 103.

REPRESENTATIVE HAUGEN - No. I know that, but I . . . Just to get . . . Putting it in simple form, that's what you said.

MILTON LIPTON - Yes. What I was saying was that if the purpose of this type of tax legislation is to provide a bridge between the time when the State faces an acute budgetary deficit and the time when its great expectations come to fruition, and not just to raise total revenue, then probably the best way to do it would be to say that all payments of the reserve tax (the tax on oil and gas in place) will, in due course become credits against future severance tax liability to that resource.

REPRESENTATIVE HAUGEN - I understand.

SENATOR HUBER - The difference between the intent of SB 103 was that it provide that same bridge, but with no payback provisions. It had a phase-in and phase-out provision, and it had no intent to pay it back out of future revenues. It was just an additional taxation policy.

MILTON LIPTON - This is very clear. I was going to call attention to this feature of SB 103. As it stands, I interpret SB 103 as an added burden of taxation upon the oil industry designed to increase the total payments which the industry will make to the State. If you look at section 3 of the Senate Bill, which is actually section 20 of AS 43, it says: Producing oil leases or properties which are paying the gross production tax (severance tax) during the assessment year in an amount which exceeds the tax that would otherwise be due under section 15 of this chapter (that is the reserve tax) are exempt from the reserve tax. Which means in effect you credit the severance tax against the reserve tax, but not the reserve tax against the severance tax, and there is a very distinct difference in what this means to the oil industry's liability. As this reads, and if this is your intention, what you are doing is you are not only increasing the flow of oil revenues during this interim period, but you are increasing the total tax burden on the oil-producing industry operating within the state. And my criticism is not that you are increasing the total tax burden of the oil industry, but that if it is your intention to increase the total tax burden of the oil industry, then it should not be through a reserve tax. It should be in due course, if it is on production, through the severance tax. If it is on the profitability of the industry, through your income tax. But not to say that the Legislature of Alaska in order to increase the total oil revenues for the State enacts this type of tax to increase the total.

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SENATOR HUBER - So we're clear on that now. You don't see any attempt there to double tax them after they are in production.

MILTON LIPTON - There is no double taxation. There is just an added taxation during an interim period which otherwise they would not pay, and no offset for that.

SENATOR HUBER - Yes, that is correct. Senator Rader.

SENATOR RADER - Doctor, are you prepared to make a recommendation to us if we made the assumption that all we wanted to do was to bridge our shortfall, as a matter of revenue, without adding significantly to the burdens of the oil industry? What mechanism would you suggest that we use?

MILTON LIPTON - There are many alternatives I presume, that the State might consider, that I'm not competent to talk about. If you are asking among all the alternatives that the State might consider which says that the oil industry is going to pay this deficiency for two or two and a half years, you see, then I suspect that probably among those alternatives, if one has to be selected, the reserve tax probably is the one that you will have to turn to. But if that's the case, then I would prefer that section 3 here reads not that the reserve tax becomes a credit against future severance taxes, but that all payment on the reserves up until such period of time as the lease goes into production shall, over a future period of time, be credited against the company's ongoing severance tax liability. Which means in effect, the aggregate payments of the company will not have been changed, but the time when they make the payments will have been advanced. It's the difference in whether the reserve tax is a credit against future tax liabilities, or if in effect you pay all this reserve tax, but then you simply stop paying it after the severance tax comes into being.

SENATOR RADER - Do I understand that you meant to say that you would not favor the preselling of royalty interests or anything of that nature?

MILTON LIPTON - Yes. Now we haven't really discussed that, and in a sense it is unfair to you for me just to say among all the alternatives which we haven't discussed--therefore the correct effort is this. But maybe we ought to hold off with this discussion on the presale of

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royalty oil and gas for a moment and concentrate on this thing. But I would certainly like to come back and tell you why it is in these fields that the sale in advance of what will be in the future royalty oil and gas is probably bad policy.

SENATOR HUBER - We have with us--there have been more people added--but we have the prime sponsor of the House version of the bill with us (Are you finished, Senator?), who would like to ask a question, Fred Brown.

SENATOR RADER - Yes.

REPRESENTATIVE BROWN - I have heard some of Mr. Lipton's presentation on some of these matters in House Resources this morning. I just had one short question right now. What other major oil jurisdictions have taxes that are either taxes on oil and gas in place or are somewhat similar to this one, something comparable to this one?

MILTON LIPTON - There is nothing quite comparable to what is being proposed in this legislature. There are in other oil-producing states ad valorem property taxes which involve the valuation of the reserves under the property. They're usually part and parcel of local jurisdictions in which first of all, there is already production, and secondly in which the valuation tends to be relatively mild. There was in the Province of Alberta, in special circumstances and enacted by the Province of Alberta, which set up a resource tax in which every producer in the state had the option of paying either a mill rate on the valuation of the oil resources or a higher royalty rate (which the Province was enacting) than they had previously been committed to. They could choose between the two. But the Province at that time established the valuation only on producing properties, not on oil and gas in place that was not subject to production. And they had, and provided to the industry in advance a clear schedule by formula as to how the valuation of the oil reserves would be determined by their own Department of Energy and Conservation. And what that involved was to use ongoing estimates of reserves which were already (since there was a history of production) the basis of the Province's own prorationing program. So production was established on the same basis of reserve estimates, as the valuation was, and where there was no attempt to make forward projections of what the value of the oil would be, there was a simple formula which says the price that was obtained in the last accounting period for the

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production applied to this agreed-upon volume of reserves in allowing for a given rate of decline in the reserve. So that it was, in effect, a mechanistic device. The one which was applied simultaneously to all producers in the province on the basis of reserves that they were already producing and on the basis of reserve estimates which were the basis of their allowables to produce. So, it was a somewhat considerably different tax device than the one that is being proposed here.

REPRESENTATIVE BROWN - You said it was a special case, and you had this in the past. That is, they don't have this anymore? When was this and why was this a special case?

MILTON LIPTON - Well, it was adopted by the Province several years ago when there was an appreciable increase in the value of Canadian oil. By way of background I must explain to you that the Province of Alberta, for example--No Canadian Province has the right to levy production taxes or severance taxes the way U. S. States do. This is a matter of constitutional delineation of taxing powers. The Province, if they taxed, could only tax really on the basis of income of value, but not on gross relative value. But the oil industry in Alberta has constantly taken exploration and production leases from the Province of Alberta on the basis not of a fixed contractual or legal royalty. The royalty has always been subject to change by the Province, at the will of the Province, excepting that some years earlier the then government of Alberta had entered in an Orders of Council in which they held it out to the industry that for ten years the royalty would not be changed. Then, before the ten years expired, the Province of Alberta wanted to change the royalty. They could on many, many of the leases, but they didn't want to violate what seemed to be a commitment on some of the outstanding leases. And so they went this route of setting up an alternative form of taxation and gave the companies the alternative of avoiding the taxation by voluntarily agreeing to an increase in the royalty.

REPRESENTATIVE BROWN - This would have been about when that this happened?

MILTON LIPTON - Several years ago. About two years ago this happened. But if the question, "Are there other instances by U. S. States . . ."

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REPRESENTATIVE BROWN - I meant basic jurisdiction. I meant anywhere in the world that has anything roughly comparable to the way we have in taxing. Particularly in English-speaking countries where . . .

MILTON LIPTON - Well, the English-speaking world has less problems with oil and gas than other parts of the world. Now, I don't mean to be facetious. There may be, but to my knowledge, I cannot think of a place where there is any substantial taxation of reserves before they enter into production.

SENATOR HUBER - Clark.

REPRESENTATIVE GRUENING - Mr. Chairman, I would like to ask . . . Doctor, doesn't your suggestion that credit be given against the severance tax kind of help alleviate some of the problems you have in evaluation of the reserves as well as the value of them? In other words, you don't have to be so exact because you are going to give them credit anyway.

MILTON LIPTON - Well, let me say that if you are looking just at the problems of one oil field and the producers in one oil field, whose respective interests may probably be defined anyway by unitization agreement, then really the problem of assessment and the problem of the mill rate becomes secondary to how much money the State wants to take from it. In effect, if the decision of the State is that in a fiscal year we need \$200 million and willy-nilly it is the leaseholders in Prudhoe Bay who have discovered oil who are going to have to carry us over, it doesn't make a hell of a lot of difference at what rate you assess the oil in place and what kind of a mill rate. One or the other will lead to \$200 million. It does make a difference, I have to be brutally frank, because to play around with an idea that there is somehow a principle of taxation involved here because it is part of your general property tax, you are now going to . . . You really haven't established a new tax at all. You have broadened the definition of taxable property where before you had exempted oil and gas in place and now you are going to include oil in place. But this is fooling around because in effect you are creating an entirely new tax and you're entering into a principle of valuation which you have never done before, which can't be done that way, but arbitrarily it's done. Yes, in that sense for those producers, the only thing that matters is the \$200 million. (I shouldn't use a number, because then it can be quoted as somehow it is significant and I have no idea of whether it is \$200 million, or \$100 million, or what. It will probably be more than that over the whole period that I'm talking about, but I'm using it for purposes of example.) Then what matters to them, the only thing

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that matters to them is how much the money is and how soon they are going to extinguish that by taking the credit against the severance tax. But if in fact this is a general--(You are not in fact saying here, at least in this bill, you may be in some other bills saying that this tax is levied against the leaseholders in Prudhoe Bay)--this is a general tax for the State, to what extent will this tax be applicable to other fields in the State that either have been found for which we may not have any clear estimate of the reserves yet?--But when you go to your Oil and Gas Division, they will have some information about successful wells which are not in the general domain and within some period of time, there may be enough knowledge to assess the tax against them. Then it becomes a matter of equity, you see. Then it becomes a matter of difference as to just how you begin to evaluate this field's reserves against that field's reserves. And even if you take two additional fields that may--on the North Slope--that may fall within the jurisdiction of this proposed tax, both of which have reserves of 150 million barrels and therefore presumably both paying the same tax: But one has relatively unfavorable producing conditions so to exploit 150 million barrels of oil will require twenty-five, thirty years of careful production. The other has a favorable producing reservoir and can produce in fifteen years. The different rates of production, the speed at which one field or another recovers its prepayment on the reserve tax, will differ. Which means that the net cost to the companies will be different. Is this an important consideration to you or not? I don't know. But certainly, if you are thinking in terms of principles of taxation, it is a very difficult tax to administer equitably. If the tax is not going to affect anybody but Prudhoe Bay, that's a different story. But even so, you talk about Prudhoe Bay. Who really are going to be the producers in Prudhoe Bay? By the time production starts, the unit may not quite be the same. The total amount of oil produced . . . may be oil coming from outside the unit and these reserves may be subject to tax. It is not an easy tax to administer equitably. It is for the legislature, an easy way to find the kind of money to bridge the gap. And the only thing that I can offer, is that if it were to be done, and this you must decide, then I think that the one principle you should follow is to allow the extinguishment of these reserve tax payments relatively quickly as an offset against future severance taxes. And then one other thought. If you enact this law and the companies look forward and ultimately start producing, their severance tax is going to start to go down, and then the successor of this legislature meeting in this room two years from now, takes a look at the severance tax and says that the severance tax is too low, it really

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ought to be higher. So in fact, there may not be any offset in the future, depending on what the legislature does with the severance tax. Now that in itself--now there is nothing wrong with that in itself, if the severance tax decision then is made legitimately in light of the circumstances at the time because your severance tax, nor your income tax, nor your property taxes are chiseled in stone. They are all susceptible to change from year to year according to changing circumstances and all taxation in particular is in a very volatile state because of the changes that are taking place in the world and in the United States and in the valuation, and the pricing, and the taxation. But I think it should be part and parcel of your legislative discussion here that the action by this legislature, if you have this right of offset against future severance tax, is done in good faith--that this does not imply that this legislature is trying to tie the hands of the future legislature--that in a sense they will be violating good faith if they legitimately review the severance tax in the future. Because you will surely hear three years from now in a debate when someone suggests raising the severance tax, that this is bad faith on the part of the Alaska legislature because when you adopted this tax you committed yourself to freezing the severance tax. Which is not what I am suggesting at all. You must have in the legislature the right to adopt whatever severance tax is appropriate to the time, but still have at this time a carry-forward credit.

SENATOR HUBER - Now if we'd go just a little further. If we could expand a little on the question--We had several versions of this bill that we were kicking around and we did ask some consideration for that aspect. In fact, we were thinking more in the line of, well if they are paying an ad valorem tax, maybe as much income tax wouldn't be levied or some other thing. We didn't know just what, but that's one reason we didn't have a phase-out on it. The other thing that we were thinking about is in the beginning, we were trying to figure a way to keep the tax from being a deterrent for new leases. Now, there is a difference between the House and Senate version on that. On the Senate version there is the five years that we put in there, and so you can see we were after an obvious time--five years would be enough to keep a new bidder so that he would never end up paying it. He would normally go into production. I would like you to touch on that and discuss it--Whether it is enough? How much of a deterrent it is? Whether it should stay in the final bill, or what?

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MILTON LIPTON - The bidders for leases on Prudhoe Bay in September of '69 would have bet that five years were enough for them at that time to have avoided any reserve tax that might have been on the books then. You know really, the tragedy (I should choose my words more carefully) --the problems of Prudhoe--there are no tragedies up there--but the problems are not only the delays but everything that has happened in the world while these delays were taking place: Inflation, and the run up of costs, and everything else. And it's very difficult to know in advance, and in particular for remote areas of the state which may be opening up to exploration in the future, what an adequate time is. This is paragraph (b), I guess, of section 15. The intent of it is very, very clear, but you see this also reads to the oil industry that this is not a temporary tax--that this reads as though it is an addition to the panoply of taxation which this State is going to impose upon the oil industry. And I really have one of the strongest objections to the idea that this is the kind of tax which by itself, standing on its own feet, is an appropriate form of taxation whereby the State of Alaska reaches out for the revenues which it is entitled to obtain from the oil industry. It's not a good principle of taxation. Anything which implies that it's part of your permanent tax package, I think, is counterproductive. I don't know whether you can go ahead and make this an emergency tax, or a tax with a direct termination date. This may raise special problems for you in terms of legislative practice, even constitutionality, and I am not competent to talk to that.

SENATOR HUBER - That was the next thing that I was going to raise. We will have to explore elsewhere for the constitutionality of it as a special tax which would be phased out.

MILTON LIPTON - Obviously, the tax can be passed by this legislature and repealed by another legislature. But whether this legislature can enact this particular form of tax with an expiration date, I don't know. But of course, it is of no help to those producers who are immediately subject to the tax to know that the tax is going to be repealed. But in terms of the interplay between the State and the industry, if we are correct, that this is really not a very effective or a commendable form of taxation, I would not like to see the legislature keep this as a piece of the permanent passage. And this has nothing to do . . . I'm not arguing here that the State already is taking too much money from the oil industry or anything else. What I am saying is that the appropriate relationship between the State and the industry in terms of taxation and revenue is best served by other

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vehicles other than this form of taxation.

SENATOR HUBER - I think you are basically telling us that it's an ends tax rather than a means tax. Fred.

REPRESENTATIVE BROWN - Mr. Chairman, I have another line of inquiry and then I have to go back to House Judiciary, next door. Some of the things you addressed yourself, some of the policy considerations (they aren't all there, I am sure) have been what the reasonable expectations of the oil industry are, of course depending on what those are--what affects what they would or would not bid in an oil lease sale for bonuses and that sort of thing. I know that you are in touch with the industry a lot more than many of us are and you talk to the people that they talk to and they fight with other countries and other states. I'm going to ask you a leading question, and maybe the answer is no, but isn't the industry already making business decisions based on the assumption that Alaska will almost certainly--just considering the political realities--almost certainly raise the severance tax after the oil goes on line and probably will either pass taxation of oil and gas in place this session, or keep it in the hopper and keep bringing it up and seriously considering it quite frequently?

MILTON LIPTON - The last thing I can do is to speak for the oil industry, which is . . . I give it to you as my personal opinion, that every prudent man who is in an executive position in an oil company in the oil industry is constantly anticipating tax increases in every jurisdiction where the oil company operates. Now, whether they look upon Alaska in some special light or different from other states, I suppose depends upon the whole flow of debate in the legislature and what their experience is and so on. I don't think that in any sense the oil industry has been poorly treated in Alaska. With all the jokes that may be made about the way in which Alaska operates, at least as I read it, all the legislation that has come out of the State of Alaska --including the taxation--the oil industry has not been treated poorly in the State of Alaska, and certainly not in comparison with the problems which they face in other jurisdictions, including other jurisdictions . . .

REPRESENTATIVE BROWN - My definition of other jurisdictions . . .

MILTON LIPTON - There is a very realistic problem of what the passage of this kind of legislation might do to the kind of bonuses that you could obtain in a lease sale. This is a very real question. The answer has to be in general, that it's going to have an adverse effect upon the way companies regard the bidding in a lease sale. But how adverse, I don't think anybody could really quantify. And whether in effect it would ever have a measurable distance really depends upon how attractive the acreage is that you put up for bid. Because if the acreage is very, very attractive, and the competition is very, very keen, then it is difficult for a company to say that I am going to penalize Alaska in my bid by so many dollars as the quid pro quo for the reserve tax to which I may be subject. Because if he does that he's made a very careful calculation and he comes out just as well in theory as if there hadn't been a reserve tax. Do you follow my argument? However, if not everybody does it, the difference may be that he doesn't get the lease. And so maybe you don't quite assess the full disadvantage of the reserve tax against the bonus bid, and the other guy doesn't quite do it to that extent so that you don't really know in the end. Yes, it has a discouraging effect. Yes, there will be a reevaluation and certainly if the acreage is not particularly attractive, it may make the difference between a company bidding at all, or how many companies even come in. But if it's attractive acreage, realistically it's very difficult to say with assurance that every dollar of revenue which a State may expect to get out of a reserve tax, they will have given up in advance by lower bonuses. They only example I can give you of how an industry will operate . . . Well, for example, up until several years ago there was computerized study after computerized study of rates of return to the oil industry on the oil exploration in the U. S. Gulf. There was hardly a one of them that didn't show the industry to date and projecting ahead of the basis of discoveries and price expectations, that the rates of return would be much better than 7 or 8%, or something like this. Which every firm knows is not the incentive for which one conducts exploration. These were industry calculations all the way through. So if you read the newspapers or follow, you know, the kinds of bids that have been made for offshore leases in the Gulf of Mexico. Which means that just as you in Alaska must be concerned by the depressing effect of adverse expectations, there is a kind of coefficient of euphoria, the hope upon the hope upon the hope that what you discover is really big oil, which leads to competitive bidding. And I don't think the world has changed in that respect: If anything, the higher values of which are beginning to emerge for U. S. oil and gas production I think are a spur to exploration and the deductions are here in Alaska and I would expect that if the acreage is attractive that you would get pretty good bids. But I am not prepared to assure you against failure.

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SENATOR HUBER - John.

SENATOR RADER - Dr. Lipton, what if we had not only a temporary bridge with the credit that you suggest, but perhaps an interest payment also, so there is not even a penalty of interest on the prepayment? What if we had one other factor in it that would trigger that the tax would not be imposed in the event that a lease sale held within let's say six months produced a given amount of money?

MILTON LIPTON - Well . . .

SENATOR RADER - In other words, you develop a sort of scale like this: If bonuses received from lease sales held for calendar year 1975 are \$100 million or less, than the tax will be "x". If it is \$200 million or less the tax will be "x". If it is \$300 million or less the tax will be "x". And really use this as an alternative triggered by the shortfall revenue from sales.

MILTON LIPTON - I am sure the industry people would appreciate any device in the act which minimizes their tax exposure. I don't respond instinctively, you know, to this formula approach. It seems to me that one alternative is that if there is not an urgency in terms of timing or present enactment, that perhaps you can defer enactment until such time as the results of a lease sale (if there is a lease sale) emerge. Or, alternatively, one can go ahead with the enactment and don't establish a single mill rate on the thing. In all your property taxation, mill rate varies according to various criteria from time to time, and this may be subject. I don't know. If the legislature concurs with our evaluation of this tax in principle, and if there is any leeway in time before the urgency of enactment, then perhaps that would be the device that one follows and not rush into passage. But this I can't judge, you see. I can't judge that. But, perhaps this is a time for me to address myself to the question that Senator Rader put before, which is: Are there other alternatives, and how do we assess those? Would that be in keeping with your own thinking, Mr. Chairman?

SENATOR HUBER - I think so. I was wanting to comment. I hope that if we adopt the system that Senator Rader just outlined that we can get him to draw up the constitutional opinion on it and so forth.

SENATOR RADER - Just toying with an idea is all.

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SENATOR HUBER - Before we get into this, I think Clark had a . . .

REPRESENTATIVE GRUENING - Mr. Chairman, this may dovetail into what you want to expand on in terms of other means, but I don't know if this has been asked in earlier sessions. But what effect will federal taxation have upon our taxing reserves in place, specifically the President's proposal that we put an excess profits tax on it? Isn't it a question of who pays it? Who the oil companies pay it to?

MILTON LIPTON - Not in this particular instance. As I see it, there are two variables again. One is, how will federal policy affect the valuation of reserves in place? And second, how will the tax payments on the valuation of reserves affect the company's federal tax liability? So you've kind of completed a circle. If the President's proposal for simultaneous decontrol of oil prices goes into effect (This of course, is irrelevant to crude oil because that oil would not be under price control under the present federal system), but at the same time that oil becomes subject to a federal windfall profits tax, that in effect would really diminish the value of Prudhoe reserves because of the fact if Prudhoe reserves today are completely not subject to control, whether they were being produced today they would have a relatively high value. The windfall profits tax goes into effect and if you have an honest assessment, then you would have to say that Prudhoe Bay's are less valuable because there is a windfall profits tax in effect. Realistically, if you were going to get the same amount of money from them by saying, "Well, if the value goes down, the mill rate goes up," doesn't make much difference. In any case, none of this is going to be in effect, I would expect, by 1978. No. I shouldn't say that. That implies a bad perspective on pipeline completion. None of this will be in effect in 1977, when the pipeline is completed. Now all of this, in effect, will represent a diminution or a potential diminution of the company's federal tax liability. Well, this is almost always the case, but that will vary from company to company, according to what their federal tax liability is, and that they are not in a positive tax paying position or in effect this is not an expensed item. This kind of State tax cannot be expensed against otherwise taxable income. It may not in any appreciable sense reduce their federal tax liability. I don't think there is much, one way or the other, that you really ought to concern yourself with respect to the proposed resources tax. There is something on the severance tax, but perhaps we can discuss that later in a different context.

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SENATOR HUBER - I think that we can go ahead now to Senator Rader's other questions.

MILTON LIPTON - I have been asked elsewhere on repeated occasions about the possibility of the State obtaining early revenue, not from taxation, but through the sale of royalty oil and gas to which the State will become entitled at some future date. Now you can regard that as two different ways. One, you can say that the State in effect is selling now what they otherwise would have sold later, or you can say that what the State is doing now is borrowing against the royalty income in the future. In one case you sell a good later or now, and the other perspective is that you are not selling anything, but what you really are doing is you are trying to get an anticipatory income against--because in the future you may take your royalty, well not as oil but as a cash payment. It has, for the industry, of course--it has two very keen attractions which I am sure they will quickly lay in front of you. One is that they're not paying taxes. They are spending money to buy something. And the second is that the incidence upon companies could be quite different. There is no question but that the reserve tax is going to hit most against Standard Oil of Ohio because of their proportionality of reserves (which happens to be a company this is already tremendously in tremendous cash pressure for the amount of capital they've got to put into the pipeline and the development of Prudhoe to go into production), then on to Atlantic Richfield and upon Exxon. And I don't mean to align these companies in order of magnitude, but there is a kind of continuity among these three companies. Whereas, if you sell royalty oil or an option on royalty oil, these companies may opt not to become buyers because they are already major producers and the more logical buyers could very well be other U. S. oil companies with major refining capacity who would not otherwise have direct access to Prudhoe Bay oil and would contemplate a look upon themselves as potential buyers in the future in any case. So why not try to buy from you now, instead of buying from you or from their own competitors later on. So, when it changes the total cash burden of the industry and it shifts it among companies within the industry, nonetheless I go back to what I said without explanation before, and now I'll try to give you that explanation. I think it is not an appropriate way or a good way for the State to approach a budgetary deficit. First of all, the worst time of all to be a seller of any kind is to be a seller under distress. If you have something to sell, you are in a much better position to choose the time and circumstances of sale than have to sell under distress, and

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especially when all buyers know that. Obvious. Secondly, what the State does not know is really how much oil it's going to be selling. Because what the State will sell is an option on its future royalty oil in return for a stipulated amount of money, whatever the State may need. A buyer is not going to give you \$10 a barrel or \$12 a barrel or \$9 a barrel or \$5 a barrel. No buyer can commit himself to pay a price today for oil he may not get until 1978, '79, and 1980. The price is too uncertain. It is completely uncertain. So what you may do is entertain the idea of taking competitive bids for your oil at some percentage of what is then the market price at the time delivery of the oil takes place. Are you with me? Now that percentage will be less than 100% of the value because the buyer, if he's not going to get the oil for two, three, four years, will put a discount factor on it. Under the reserve tax, the taxpaying companies carry the interest burden until they can extinguish it. Here, you carry the interest burden because they pay you in advance. So, it will be less than 100% of the value. But what you don't know is how much oil you'll be selling in the future to extinguish say, \$200 million worth of presell. If the oil is worth \$10 a barrel at that time, it'll take so many barrels to extinguish a prepayment of \$200 million. If the oil should be worth \$15, you are very fortunate because it will be less oil. But, if the price goes down, you may have in effect committed a hell of a lot more royalty oil in order to obtain this advance of funds than you had contemplated. And I know from past legislative hearings that this State has so often considered what the value of royalty oil or royalty gas will be to the State. Not in the dollar value of the royalty payment but the ability to take the oil as oil, not in the dollars and cents, and then dispose of that oil (the State itself) in ways which serve other purposes, other intentions of the State itself. There has been and there is, I'm sure, ongoing discussion of the extent to which that oil may be, for example, processed within the state. Or, what kind of petrochemical processing may be established within Alaska? Why the availability of oil and gas, at the disposal of the State, not under the control of leaseholding companies? You don't know for how long and to what extent. In a sense you hypothecate all of these possibilities to the immediate need for money if you go into this kind of a sale of royalty oil or gas. Then there is the further consideration that you have established an Alaska Pipeline Commission to exercise regulatory authority over the pipeline. None of us know the extent to which the tariff on the pipeline may be at issue. The importance--the significance of the pipeline tariff to the State itself is very, very clear. Because the higher the tariff, the lower will be the wellhead value of the oil. The lower the wellhead value, the lower the severance tax income, the

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lower the royalty income and so on. But if it was anticipation, among other things and not exclusively for that reason, but among other reasons, you established a Pipeline Commission with regulatory authority and jurisdiction over tariffs of that pipeline where the tariffs apply to the intrastate movement of oil. But for the jurisdiction of your Pipeline Commission to be enforced--to be reinforced--requires an intrastate movement. And it was always, I think, part of our thinking at least, that the State, so long as it had the access to royalty oil, was always in the position to take that oil in kind, to transport it through the pipeline and affect via buyer transportation services (and at the same time establish the fact of) intrastate business for the Alyeska Pipeline. Which then triggered the potential jurisdiction of your Pipeline Commission to review tariffs, to arrive at an agreement with the owners of Alyeska. What the appropriate tariff is and lack of agreement; to enforce a tariff; to fight the battle in the courts if it ever comes to pass. But in a sense to achieve sovereign powers in Alaska over a matter which is of very great concern to the State of Alaska. Now, if you have for temporary budgetary reasons in a sense given up control over very, very substantial volumes of royalty oil, my point is from unknown volumes of oil over an unknown period (because you can't anticipate how much oil you're selling for any given \$100 million of current income), then I think you have in a sense taken away from the State a flexibility of decision which the legislature has tried so hard for so long to establish. So between the uncertainties of the income and the fact that all of the uncertainties are more apt to have a depressing effect on the price you now get for your oil rather than an effect to increase the price, and because of depravity of control of the royalty oil which you may want to have in the future, I would think that this is not a very good way for the State to go about covering and expanding this prospective budgetary deficit.

SENATOR RADER - If you assumed that the price of oil the next ten years was going to be \$10 a barrel, what percentage (if we sold enough to raise \$600 million--\$200 million a year for say the next three years or something) . . . Playing with the figures, which I don't have a grasp of, what percentage of our oil would we be selling?

MILTON LIPTON - Senator Rader, that question is appropriate only if I'm the buyer of the oil. It doesn't matter what I assume the price of the oil to be. The real question that you face (and this is the tremendous problem) is what price the prospective buyers are going to assume for that oil. And I tell you as best as I can read the entrails of the hen, I don't think any executive is prepared today to make a

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hard and fast assumption as to what that price is going to be. Now, suppose everybody assumes that it's going to be \$10 (all right?) in the future. Then I would say, what rate of discount do you have to apply? If they're not going to get the oil for five years and they are going to assume a 10% discount for each of five years, and I won't even compound it, that's 50%. That means that they would be prepared to pay you \$5 a barrel today for what is \$10 oil five years from now. Now, if you want to ask yourself (if you want to do the arithmetic) if you're going to be paid \$5 a barrel--and mind you this is a purely hypothetical number, purely hypothetical--if you're being paid \$5 a barrel and you need \$100 million, then you're talking about 20 million barrels of oil. For every \$100 million, you multiply the 20 million barrels of oil. Now how much oil do you have? You have royalty oil as one-eighth of the production. If the production is 1.6 million barrels of oil a day, five, six, years from now, one-eighth of that is 200,000 barrels a day. 200,000 barrels a day times 365 days a year--You're talking about what is it--7 million barrels?--700 million barrels. How much of your royalty oil you are going to have to sell depends first of all on what the level of production is--how soon you get up to 1.6. Secondly, what kind of a price do you find are the buyers' expectations? Over what period of time are you prepared to tender to them? Can they claim all of it? Every buyer is going to have a limitation on how much oil he wants in one particular year. Chances are that he's going to want so much in one year, so much in the second--like a five-year contract. How many buyers are going to go for five-year contracts? I think that you have a tremendously difficult job, not only of estimating realistically how much income you could get out of this kind of an auction of options, how much revenue you'd get, but even after the fact is done--you've got your revenue--you will not really know how much oil you've committed. And you won't know for three, four, five years how much oil it's going to take to extinguish the cash payments that you have received.

SENATOR RADER - Now, we're talking about the sale price being the market price as of the date of delivery.

MILTON LIPTON - Yes, of course. Well, I would assume that nobody's going to commit himself to a--There is no oil company that today sells oil on a fixed basis so much as six months in advance, let alone five years in advance. And I'm sure they are not going to buy it on that basis, so I'd hate to be in a position to interpret what the market value is. But you can perhaps agree that the market value would be taken as the wellhead value. And the wellhead value is the basis for a severance tax royalty, and you'll probably be arguing about that

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anyway with the industry. It's not the technical problem. It's the conceptual problem of what the State is involved in. So if you start looking between the two and are forced to come back to what essentially is a bad tax which is ameliorated . . . Hopefully, by the offsetting clause which says in effect that it becomes an advance payment against the severance, and the net cost of the company is the interest cost in early payment of future severance taxes. And what that cost is, is a function of two things: What the interest rate is, and how long it takes them to offset it in the future. And if the effective interest rate is 10% a year and it takes them five years or six years or seven years to offset it, it is a very appreciable cost for the industry or for the select number of companies who are forced to bear that burden.

SENATOR RADER - Would . . .

SENATOR HUBER - Go ahead, John.

SENATOR RADER - Would that tax follow the companies equitably though, as between companies or not?

MILTON LIPTON - Well, it would fall . . . If for the moment you assume that the only producing area that is affected is Prudhoe Bay--which I would not assume if you have this kind of generalized tax system because we don't know--but if you assume it would fall upon them equitably . . . (If you define equitably in proportion to their lease ownership of reserves, since one of the things they are battling out among themselves now in unitization agreement is who has what among the Prudhoe Bay reserves . . . And I don't believe that just because they are subject to a reserves tax that one company is going to say to another company, "No, you take the reserves. I give it to you." I mean, it doesn't weigh that much in the balance.) But you notice that the taxes on oil and it's not on gas, the holdings of the companies with respect to gas reserves are very different from the ownership of the companies with respect to oil reserves. And your tax--although it is referred to in your section 15 that it is on the full and true value of oil and gas leases within the state under which there are proven reserves and ownership interest in proven oil and gas reserves--that the actual tax is levied only on oil reserves. Now, I don't know if this is deliberate. Do you mean to exempt from the tax the undeveloped gas reserves of the Cook Inlet area? And if you don't, then you really introduce the question of equity. Because then it is not a matter of indifference how you

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assess reserves, because you make it up in the mill rate. Then it makes a real difference how you assess the value of undeveloped gas reserves at Cook against undeveloped oil reserves or gas reserves on the North Slope. I don't want to confuse the picture by introducing extraneous arguments, but as the thing is now written, there is potential exposure of the regional corporations, in terms of their leasing arrangements with the private companies for the exploration and development of the native land selection areas.

SENATOR HUBER - They are obviously exempt for twenty years.

MILTON LIPTON - Why are they exempt?

SENATOR HUBER - The native corporations themselves are exempt from tax for the first twenty years of their existence by the . . .

MILTON LIPTON - I'm not talking about the native corporations. I'm talking about the private companies that take exploration leases from the native corporations. Are they exempt from this tax?

SENATOR HUBER - No, and you're getting back to another one of the basics of the tax.

MILTON LIPTON - Well, if they're not exempt from those taxes, then the nature of negotiations between the native corporations and the industry becomes affected by the existence of this tax.

SENATOR HUBER - There was another consideration in drafting the tax to begin with. It was drafted as an ad valorem tax with one favorable idea in it that is not in any other ad valorem tax. That is that when the production tax equals or exceeds it, it phases out, which doesn't happen to the farmer or the tree farmer or anybody else. So, it was realizing that the petroleum industry with its depletion problem is special. But we also were thinking in the future. The Pet. 4 is talked about now for leasing by the federal government to private concerns. Certainly once a private concern had a leasehold interest in Pet. 4, this tax would apply to their leasehold interest although we could not tax the federal government.

MILTON LIPTON - I don't think so. I'm not a lawyer and can't give you a legal opinion, but my feeling is that if the federal government goes to leasing of Pet. 4 (private leasing of Pet. 4), your income will come under the revenue-sharing aspects. You'll get 90% of the bonus

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in royalty income on that leasing. This is an aside, but I guess it comes within the purview of your particular committee: It makes a tremendous difference to the State of Alaska along what route the federal government chooses to go in the exploitations of Pet. 4. Because if it does it by virtue of direct federal activity, either directly by the federal government or contracting out without any leasing to private operations, then you have no claim upon any revenue from or any value of oil and gases. It's strictly federal property, not in your tax purview. But if they go the route of leasing, the State of Alaska, I would believe would have the same entitlement to revenue as you have from any federal leasing in the State of Alaska. That is to say, 90% of all the oil and gas revenue.

SENATOR HUBER - I can understand that, Milt. But if we didn't, part of the idea behind the bill in the Senate draft is that we would be able to tax an ad valorem tax. Some of the other ideas that have been put forth, such as the idea of phasing it out, paying it back, and using it for a loan didn't cover that. I'm not sure that we've covered enough of the aspects of the ad valorem tax and how it compares to others. I understand what you've told us so far about it. But I have trouble seeing how it is different than the ad valorem tax that we've placed upon the land that belongs to a tree farmer, for instance. And the tree farmer then also has a round log tax placed upon him by the State for the logs that he's taking out of the land. Our law here would be much the center of the bill we're referring to (the Senate bill)--would be much the same as saying, "Well, he pays his ad valorem tax every year and when he's in production he can credit his round log tax against it." But then if we put a phase out on it, or like shall we say his supposedly coming down to the Governor's Office, we say well, we're going to pay him back all his ad valorem taxes. I think those ad valorem taxes are unfair to begin with.

MILTON LIPTON - Don't forget that was ad valorem taxes. He's paying ad valorem taxes on a heck of a lot of property in this state. On all kinds of facilities and everything else. The only thing he's not paying the ad valorem tax on--and this has been a feature of your severance tax from the first year you adopted it--is on the value of oil and gas down below there. And if there is no other distinction I can think of between the tree farmer and the oil explorer it's that you can see the logs on top of his farm before he cuts the logs down. But you can't see it and it's awfully damn hard to estimate what the oil is.

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SENATOR HUBER - We were considering it from the farmer, too. Like the onion farmer and everything like that who seriously depletes his land by every crop that he raises. His resource in the ground (his minerals that he uses) is invisible too. I basically am not an ad valorem tax man. I hate it in my own business, my own home, and everything else. I don't think it's a good, equitable tax. But I do have trouble seeing why it is less equitable for the oil company to pay, especially when we give him a credit against his production back, which we don't anybody else. I can't see really the basic differences.

MILTON LIPTON - I can simply repeat what I said before, which is not an argument for less or more taxation in the relationship between the State and the industry. What I'm saying is that the tax on the reserves is a difficult tax to apply by standard of purpose that you want to adopt because of the difficulty of estimating what the reserves are in one field as compared to another. Because of the virtual impossibility of estimating what the value of the reserves are, since the value of the reserves at any one moment of time depends upon how much oil inflates, how much oil will be recovered, or how many years will it be produced--five, ten, fifteen, twenty, twenty-five. What will be the prices that that oil can command? And I think the last time we met I suggested to you that you can estimate. Reasonable men today can differ as to what will be the value of Prudhoe Bay oil in 1977 when it first starts flowing, which is two years, two and a half years from now. Reasonable men can differ between a price as low as \$4 a barrel to a price as high as \$12 a barrel, because of the two horrendous uncertainties that bear upon valuation. 1) What is the political price of foreign oil that we will obtain then? And 2) What will be the federal government's policy that says this will be the price of U. S. oil compared to the price of the foreign oil? These are two uncertainties.

SENATOR HUBER - There was one other question and then I'll go to someone else on it that is in the same area. We've been sitting back with an amendment to this that we thought of drafting into it to begin with and it's the proper time now to explore your ideas on it. I'll see if I can get the idea of the amendment out. It was realizing the problems that we've had in assessment and that the oil company would say that the oil is worth so much under this land and the State assessor would try to assess it differently. And we were toying with trying to put a provision (in fact we have a bit of drafting done on the amendment) so that if it is overestimated--overcharged on the part of the State, that the State eventually--and this would be clear up

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to when the field is depleted if necessary so you had final proof of what could be produced and would be adjustable all the way along the line--that if the State had overcharged, the State would have to rebate. If the company had underestimated and been allowed to pay the tax on that basis, then they would have to pay the difference. This was

MILTON LIPTON - This involves you, you know, not only in establishing --as under your present proposed bill you have to establish an assessed valuation as of January 1 every year. That in itself becomes kind of a difficult administrative thing. But then you would have to have a post mortem assessment as you go along in order to determine overage and underage, and I just wonder whether under any circumstances you want to involve the State in such a fantastic administrative burden. If in fact this thing rests--is designed as an interim measure under the pressure of necessity--that's one thing. And then the problem of assessment would be minimized at least if not too many producers are affected and the impact is somehow assuaged by having a carry-forward credit and an expected termination date, in a sense you've made the best of a bad job. But I wonder whether you can pretend to make a bad job good by complicating the task?

SENATOR HUBER - Joe.

SENATOR ORSINI - Further pursuing John's question which was what I was going to ask, are there other possibilities of raising revenue in this interim period that we have not considered other than leasing, other than the presale, other than this oil and gas in place? Is there something we haven't thought of?

MILTON LIPTON - These are the three obvious ones, and I must confess that I can't conjure up other than the obvious ones, if it is the oil and gas industry to whom you are pointing and saying that it's out of your assets that we must obtain these interim funds. Now, don't misunderstand me. When I say that this is a bad tax, and if I point to the fact that the oil industry is made in a sense the object of taxation out of necessity for the State, I don't think this is an unreasonable point. That is to say, a State, if in fact the State legislature in expressing the intent of its own constituents, has an expenditure program and a revenue program and the two don't match and therefore the legislature has to contemplate where else do we go, I presume that it contemplates all other avenues of taxation and among them there is the oil industry which in its particular circumstances is an industry which has a certain capability. Now, this is not

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without limits, obviously. But it has a certain capability and I suppose in a way it's inevitable that in Alaska you can't contemplate budgetary deficits without looking at the oil industry, which is a horrible thing for the oil industry to contemplate. But this is a fact of life and so you might do it. I would only hope that if you feel obliged to turn to a form of taxation upon an economic group such as the oil industry, that the capability of the oil industry is one thing, but the form of taxation and the duration of it is quite another. And I again urge upon you, avoid it if you can; don't chisel it into concrete. Because this you don't have to do. I think that as I said, to enact this as part of an ongoing tax package I think is bad taxation. It doesn't have the proper effect in terms of what the relationship between the State and the industry is in terms of revenue. In other words, how much revenue? This is the wrong way to go about doing it because of its impact on the company and defeating the object of the State.

SENATOR HUBER - Milt, you are--when we're comparing the three methods of raising the interim revenue, shall we say, we're really saying if we can make lease sales, that would be the best.

MILTON LIPTON - Again, I don't look upon the lease sale as a device to raise interim revenue. If, for all other reasons, the State were not going to lease land, then I wouldn't say we'll rush out and start leasing just to raise revenue. But in the context of certain State acreage, which is already under consideration for leasing (which I believe it's an appropriate time, it fits in with a lot of interests of the State and of the industry), then I would certainly feel that to go ahead with State leasing, say in the Beaufort Sea, with due diligence with regard to all the other things we're concerned about: The environmental impact, the way in which you select the areas for leasing with proper regard, you know, or how much acreage you put up or what you withhold, or what the circumstances are. If in all other respects it meets your criteria, then certainly the bonus revenue that you may get should be a primary input into the State's calculation as to what its budgetary position is. And if it were possible to defer action in other areas until you know what the results of such a sale are, then I think this is certain to be desired. But I can't judge really how much you need, what you expect from the lease sale, whether you dare defer or not. These are questions which are far beyond my comprehension.

SENATOR HUBER - I think we've been at it an hour and a half. I think

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we'd like to take a ten minute break and maybe come back and we can either finish on this subject or go ahead with subject trailers so we won't chop it off. I note that Representative Gruening would like to have another question, so we'll start at that point.

THE COMMITTEE RECESSED FOR TEN MINUTES.

SENATOR HUBER - We'll go back into session. Joe, if you'll excuse me, I promised Clark that he could ask his question. He was in line, so if you'll excuse me.

REPRESENTATIVE GRUENING - Mr. Chairman, I'd like to yield to Senator Rader's question because we have a line of thought going and Senator Rader asked his advice on how to apportion the tax between oil and gas on the reserves in place. I'd like to hear that.

SENATOR RADER - Mr. Chairman, I'm sorry. We just got to chatting here while we were waiting, and my question to him was to elaborate on the policy considerations as against taxing gas, or oil and gas and between the different fields. He touched on it very lightly awhile ago, and I'm just asking him to elaborate on that a little bit, and get his final advice as to how he would handle the problem, should we be compelled to go to this mechanism.

MILTON LIPTON - Senator Rader, just for the record, let me repeat what I have said, that the broader the application of the reserve tax, the more difficult and the more pertinent is the problem of reserve valuation, because it has to do with equity among taxpayers you expose to the tax, and the sharing of the tax burden among them, or the apportionment of the tax burden among them. Now, in reply to your question, "What is my recommendation?", I would really not like to answer that question or at least defer the answer until your Committee, or some committee, really gets the advice and counsel of your Oil and Gas Division, as to what the circumstances are within the State. I mean, what are we really talking about? Is there a problem? To what extent is there identified within the Oil and Gas Division on the basis of what they know about drilling equity? First of all, already definable reserves (that is, reserves proved up), to what extent have there been successful wells that are outside of the public domain? Or which, even if the success is known (very little about it is known, but they have a certain amount of information), whereby there is a known discovery but as yet no evaluation of a reserve, and how soon is it likely that the reserve can be evaluated? In other

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words, if it's oil on the North Slope, I would assume that there would be sufficient evaluation for the companies to know how fast it's going to be produced at the end of the pipeline. In the case of gas, it may not be apparent, depending on the circumstances, and really what you most need is a practical definition of the way you have proven reserves in place to which this would apply. But the circumstances of the State, I think, require that you all should know something more from the Oil and Gas Division, before I would say, well, good grief, try to go up there and try to narrow it. There I just don't feel that well informed.

SENATOR RADER - Mr. Chairman, did you plan to have Mr. Lipton back again? After today? So that perhaps as information could be supplied to us we could tie it in.

SENATOR HUBER - Well, not during--not before this Committee or committees during this trip that he's on. We do hope to have his further input at public hearings, probably during March on various bills. I believe he is scheduled back--what date is that?

MILTON LIPTON - I have no schedule, but as a prudent man, I anticipate being back in Juneau before you adjourn. As I said to the Committee this morning, before you adjourn on February 28, but . . . but on the basis of previous consultations I would think that the guts of the type of legislation, whether it's on leasing policy or on taxation, is more apt to be coming up in April than it is in February. But I certainly anticipate being back and in point of fact I look forward to it.

SENATOR HUBER - I do understand that Milt will be before the Resources Committee and our three members are all Resources members and we intend to be here at least part of the time tomorrow. I don't know the full contents of what will be covered, and I know that House Finance still has something on tonight, do they not?

MILTON LIPTON - Yes. My social calendar is well taken care of.

SENATOR HUBER - I do know that this trip, that Milt is here, is going to be most of the information that he's going to be able to give us that's going to go into the infrastructure of whatever we come up with in oil and gas taxation or at least the oil and gas end of the taxation bit during this session of the legislature. I think what comes later will be I suppose mainly for public consumption--or whatever it takes to get the bills passed. But I'm sure that what goes into them, the

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guts of them now is going to be the information that we're getting. Senator Orsini.

SENATOR ORSINI - Milton, just to . . . We've talked mostly this afternoon about two of the three methods of raising short-term funds, the third one being briefly discussed--the additional leases you mentioned in the Beaufort Sea. In the Resources Committee we started discussing Beaufort Sea on occasion, and apparently there are some problems with the leasing and developing oil resources in the Beaufort Sea. Namely, the particular type of the problems trying to drill in the ice packs, etc., there. So, really the question comes that completes this triad. Are you familiar enough to know that if in fact we did offer leases for sale, that we would raise funds in the order of the amount that the State needs in the next few years? And secondly, is the state of our technology such that we could develop maybe another lease there?

MILTON LIPTON - I wouldn't dare to guess what kind of income you could get from competitive leasing in that area. I'm not really terribly informed on the technical problems, but I do know a considerable amount of work has been done in areas like that and I do know that there are companies that are quite prepared and are quite interested in this State's having that kind of a sale. So I would assume that they feel reasonably competent about being able to operate in the area. Whether their own belief in their technical competence will prove to be justified or frustrated by events is something that you need not be concerned about at the moment of the lease sale. They feel competent, and if they are interested and they like the geology and they are prepared to bid, then presumably they will go ahead. But what they're prepared to bid competitively, I wouldn't have the foggiest notion. And obviously, no one company, or at least no one--there are groups of companies that are prepared to go together--no company or group of companies would have the foggiest notion of what their competitors are apt to do. So, it's very difficult for any of them to come up with an estimate of what that kind of a lease sale is really going to be in this state. I think one has to suspend judgment on that. But from the expression of interest on the part of companies in the industry, one gets the impression at least that this is highly attractive exploratory acreage.

SENATOR ORSINI - Of course that's a nice statement, but it didn't mean anything.

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MILTON LIPTON - What else can anyone say?

SENATOR ORSINI - Are there other areas of State-owned land that are possible leasing of the magnitude we are talking about?

MILTON LIPTON - This looks to be the area of prime interest. For many reasons, including the fact that it now becomes accessible to a pipeline which will be operating and probably can use their volumes of oil by the time such exploration comes to fruition. But I would suspect that over a good part of the North Slope there is probably State acreage which may be available. But this is a judgment that, as I said, one doesn't--but I don't think one makes that kind of a judgment from a revenue standpoint. This is something your own people in the State government would have to estimate in terms of what State leasing policy is. The only reason I would rank the revenue from a lease sale high among the alternatives is because the lease sale is already, for many reasons, looked upon as something that fits in with the State's scheme of things. I would certainly not suggest to the State that they turn everybody in the Bureau of Land Management and the Oil and Gas Division loose now and try to scrounge around and find what areas of the State can be thrown on the auction block in a hurry just to raise revenue. That I think would be a most inappropriate thing. But because Beaufort Sea is under active consideration--I think the Governor has an environmental impact statement he projected for the area, although it's not legally required. This has been the subject of consideration both by your Executive Department (or the professional people in the Executive Department) and by the industry which has looked at it, and I believe has indicated what their own preferences are. I mean, they've made certain selections for competitive bidding, and so on. So you have a latitude of moving in that direction. If it's a question of specific timing, again I wouldn't even suggest that the timing of such a lease sale be unduly accelerated just because you want to get in within a budgetary deadline. But if there are environmental concerns, if there are technical problems that the State should pursue, then I would pursue them with deliberate speed but no more than that. I wouldn't throw things precipitously into auction for revenue reasons. But if it's going to be done, and if you can withhold in other areas because it's going to be done, then I would consider the potential income as an important factor and I would rank it first in the array of alternatives for State revenue.

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SENATOR ORSINI - You mentioned the problems with presale of State's royalty, of selling under the stress of financial crush. Wouldn't the same problems exist in the case of a lease sale?

MILTON LIPTON - No. Entirely different. Entirely. Among other things, I'm saying that you should not lease under the pressure of a budgetary deficit, and for a very good reason. And secondly, the competitive urgency in bidding for very attractive leases is quite different from the competitive urgency on the part of oil companies to buy the State's royalty oil today with delivery in 1978, '79, '80, and '81. The uncertainties are of a different order of magnitude.

SENATOR HUBER - Milt, while you're on that subject, would you care to comment on the possible value changes, or whether it's practical on that lease sale now based upon the federal-State dispute over what boundaries might be, and so forth?

MILTON LIPTON - Well, I don't think that's particularly involved in the potential lease sale in Beaufort.

SENATOR HUBER - I believe it is, because I think that we're involved with the offshore islands in the Beaufort Sea and I think . . .

MILTON LIPTON - I don't know enough about the specifics.

SENATOR HUBER - You haven't looked into that yet?

MILTON LIPTON - No.

SENATOR HUBER - As I understand it, I believe that the federal government contends that the State's limits are within three miles of the shore, which doesn't mean very much, and that the State says, "Oh no, we've got a whole lot more because we own the offshore islands, and that means we own within three miles of them, too."

MILTON LIPTON - I don't know whether the acreage that may be under dispute is that vital to this particular sale. I just don't know. I mean, there's another part of Lower Cook Inlet which is also under dispute under different circumstances and I certainly feel that the proposals that have been made periodically for revenue-sharing or escrow in order to expedite lease sales would have made sense from

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both points of view.

SENATOR HUBER - Well, if there is a dispute (federal-State) there, then as far as being a money-raising measure, it would be in limbo like Lower Cook Inlet, wouldn't it?

MILTON LIPTON - Yes. At least to that extent. Any revenues obtained on a lease sale in disputed areas . . . I don't know what policy the federal government would--whether they would try to enjoin the lease sale or . . . I really don't know enough about the circumstances to speak of. I was under the impression just from what I have discussed with other people, both in the Administration and the industry, that there was very considerable interest in acreage which was not in dispute. So, I don't know. I may be completely misinterpreting what I've heard.

SENATOR HUBER - I have heard that raised and I think that . . .

MILTON LIPTON - It seems to me that one can get a very, very straightforward answer very, very quickly either from the Administration's office or from the Bureau of Land Management, where this thing has been going through the mill for some time. They must know the answer to that.

SENATOR HUBER - Our Division of Oil and Gas I'm sure would be able to answer that. You made reference already to some of the questions that have been asked here that we should be entertaining with that committee and we certainly will take your recommendations into account. I believe Clark wanted the floor next.

REPRESENTATIVE GRUENING - Senator Orsini asked the very question on the forced sale problems. I'm still troubled with it in that I don't see why the uncertainties are so much greater from the industry's point of view when you're dealing with sale of future oil and delivery sale for future delivery of oil and gas, when we all know that the United States is in a sort of, I think, a situation where gas is always going to be needed in greater and greater quantities. And I think that just the contract to have that at a certain time would be very marketable. In other words, they could take that, get the money they needed. From the financing point of view, they could raise the revenue.

sell reserves. What you sell is a claim on ongoing production for a year, two years, three years, or what have you. In the gas transactions, because of the interrelation between the owner of the gas and his participation in the pipeline and the financing, typically what is sold is not so many cubic feet of gas per year or three years or four years, but so much of the gas reserves. For example, I believe that Exxon announced that they have . . . What is it? . . . Their estimate is (if I remember the numbers correctly) 8 trillion cubic feet of reserves in Prudhoe and the announcement is that they've sold to (I believe) Northern Natural something on the order of 50% or less than 50% of the reserves. Which means that the buyer in effect has taken an economic interest in the reserves and will be the owner of that gas as it is produced, which is very different from selling a certain volume of oil on a short-term contract or a long-term contract. In a sense you're not only selling off royalty gas, but you're selling off the royalty portion of the reserves--of the gas reserves. There's a difference in the economic venture of the transactions in oil and gas that you'd have to consider very . . . I don't think you can sell gas, you see, so much gas for two years. You can sell so much oil production for two years, but you can't sell so much gas production for two years. The gas buyer has to have access to a continuous flow of gas which he then integrates into his entire system. So you sell gas reserves, but you sell oil production.

SENATOR HUBER - If we amplify that, then the obvious thing I'm sitting here wondering about . . . If we sold our royalty gas reserves to an organization that was part of Transarctic at this time, and they intended to move it in some other method than through Alaska to market, would we in effect have weakened our stand that we want access to the gas for petrochemical, that we want to have something to do with the routing?

MILTON LIPTON - Sure. If you've sold it without condition, of course you will have.

SENATOR HUBER - We'd just be a busybody then? If we sold it without condition?

MILTON LIPTON - And if you sell it with condition, it depends upon what condition. Because the conditions will always bear upon the price. One of the things you may want to do is to strip a certain