ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2635 SCOMM 117: JOINT SPECIAL COMMITTEE ON MERGERS, 1999-2000

Both those negotiations were suspended pending the resolution of the larger merger issue. Both reopener processes are subject to binding arbitration in the event that the parties are unable to reach agreement, and both incorporate retroactive revisions back to the time of the reopener. Thus, any comparison between Arco and BP wellhead values since 1999 is a comparison of interim figures, representing two ways of approximating royalty value, both of which will be retroactively revised -- and neither of which currently represents a meeting of the minds between industry and the state. Over the long term, state royalty cost deductions will be what the state and the industry can negotiate and, if those negotiations fail, whatever an arbitrator finds fair. In either case, they will closely track the company's or companies "actual costs."

## E. Production (Severance) Tax (AS 43.55)

The state has imposed a tax on oil production in the State of Alaska. For most oil the rate is 15 percent of the 87.5 percent left over after the royalty has been withdrawn, times the Economic Limit Factor (ELF). The ELF currently averages about 80 percent, so the effective tax on all barrels is about 10 percent. The State raised $395 million in severance taxes from the oil industry in FY 1999.[15] Production taxes are essentially levied on the same netted-back wellhead value as royalties.

Based on preliminary evaluations, the acquisition should have no effect on production taxes. As long as the oil is delivered to the same market, and the assets used to ship it are the same, there will be little, if any, change.

## F. Income Taxes on Oil and Gas Producers and Pipelines (AS 43.20.072)

The state has an income tax of 9.4 percent with special rules that apply only to companies that have pipelines or oil production in the State of Alaska. In FY 1999, the State realized $165 million in income tax from the petroleum industry.[16] This tax is the hardest to analyze, both for our forecast and in terms of merger-related effects. As a result, we did not modify our standard forecasting process in the Department of Revenue's fall forecast to account for the effects of the merger. The merger may reduce state revenue, or it may increase state revenue. The available information is insufficient to support a change from our standard procedure.

Alaska's oil income tax uses a modified apportionment system. To build a bottom-up forecast of income tax revenue, the department first needs to know or project the total unitary income: how much the BPs, Arcos, Exxons, Mobils, and Amocos of the world make worldwide.[17] This tells us how big the pie is. The larger and more diversified the business entity, the harder that projection becomes.

15 Of this $371 million was unrestricted. The rest came from settled disputes and went into the CBRF.

16 Of this, $145 was unrestricted and the rest came from settled disputes and went into the CBRF.

17 No annual returns from recently merged companies have yet been filed. The BP Amoco combination was effective in 1999, and the first full returns covering that period have not yet been filed.

Then, for modified apportionment, a forecaster needs to know, or project, each of three apportionment factors: the firm's extraction (or production), sales, and assets, for Alaska alone and for the rest of the world. The three factors are then averaged to arrive at an apportionment factor, which tells us how big a slice of the pie is taxable as Alaska income. The unitary income is then multiplied by the apportionment factor, and the result is taxable Alaska income. Needless to say, any bottom-up prediction of revenue from this tax is difficult, especially with reference to the post-merger period.

There are other difficulties associated with predicting this source of revenue. The income tax is a tax on what is left over after subtracting expenses from revenues. The three mechanisms already discussed -- property taxes, production or severance taxes, and royalties -- are all deductible expenses. First-order changes in those revenues will create second-order effects in the eventual income tax revenues. In addition, huge swings in unitary income can result from events outside Alaska, or changes in either the federal tax code or the tax code of some other jurisdiction in which oil companies are doing business.

Department of Revenue analysts do not apply a bottom-up analysis in forecasting incomes, but use three different techniques. First, they look at past and current quarterly estimated payments and analyze carry-forwards and refunds due to figure out the amount of tax expected in the next year. Second, they run a regression model that uses production times price to give a general forecast of income tax, assuming that the relationship between those factors will be the same in the future as in the past. A merger of two large entities such as BP and Arco is the classic example of a situation in which a regression developed from separate entities is not likely to be appropriate for the merged entities. Finally, for the more distant years, analysts step down from current year figures. The roundness of the projections suggests the accuracy of the forecast. The best that can be done is to estimate the general level of tax.

Alaska's taxable income can increase because either there is a bigger slice of smaller pie, a bigger slice of a bigger pie, or a smaller slice of a bigger pie. Alaska taxable income can decrease because either there is a smaller piece of a bigger pie, a smaller piece of a smaller pie, or a larger piece of a smaller pie. Neither a bigger slice or a bigger pie automatically means more revenue.

Auditors from the Division of Income and Excise Audit have analyzed prior income tax returns for the five companies involved in the completed or proposed mergers. In each of several years, analysts combined older returns of companies that had proposed merging. They compared the tax that would have been due from the combined returns with the sum of the taxes shown on the individual returns. Some of the combined returns generated less income tax than the sum of the individual returns. Other times the combined returns generated more income tax than the returns showed individually. The net effect of all the combining activity was a decrease in tax compared to the returns filed individually. Specifically when the five returns of merging firms were considered individually and then combined into pertinent groups of two and three, resulting income taxes fell by an average of $20 million a year. That means the tax fell, not because unitary income fell, but because the State of Alaska took a smaller slice of the same sized pie. Although this may seem like a significant sum, it should not be considered a forecast of falling revenue. Combining companies is a very different proposition from combining the historical returns of separate companies. Companies merge to use the same assets to create more income. In a simplified world, more income would mean more income tax. However, in the real world, total tax can fall even when net income stays the same. Because the merger will rearrange how assets, production, and sales are divided between Alaska and the rest of the world, we cannot predict how much of that income would be attributable to Alaska, and thus taxable by Alaska.

On the other hand, **even though much of the potential merger-related cost savings will not result in increased wellhead values for the State of Alaska, it will result in increased unitary income**. In fact, the whole billion dollars that BP hopes to achieve in cost-savings from its acquisition of Arco would feed into unitary income. However, if those cost savings resulted in a larger decrease in Alaskan assets than in worldwide assets, Alaska's return through the income tax would be smaller.

In conclusion, analysis of past returns suggests a merger might result in lower income tax revenues. The common-sense notion that the purpose of the merger is to increase income suggests that a merger might increase taxable income. These two effects are laid over the inherent difficulties associated with projecting modified apportionment income. The result is that we believe our current income tax projection is the best estimate of revenue, whether the merger occurs or not.

## V. SUMMARY

Our analysis demonstrates that the state's revenues are determined not so much by who owns the barrels, but how many of them are produced. Consequently, for the short to medium term, we have tentatively projected no material change in state oil revenue resulting from the merger. I say tentatively because the FTC certainly might compel changes in the marketplace as a consequence of the merger that would reduce state revenue.

The goal of the Charter for Development of the Alaskan North Slope was to keep North Slope competition alive in the long term and create replacement barrels for the fields that drive our current production. It will be many years before our forecasts will begin to reflect whether that attempt was successful or not.

SCOMM

117:5

JOINT SPECIAL COMMITTEE ON MERGERS
FEBRUARY 8, 2000

Motion adopted with unanimous consent:

"The Joint Special Committee on Mergers oppose(s) the original merger and the merger configuration of BP Amoco and ARCO as embodied in the current version of the amended Charter, dated December 2, 1999, for the reasons enumerated in the consultant's report, dated January 24, 2000, as not in the best interests of Alaska."

# SCOMM

# 117:6

# ALASKA STATE LEGISLATURE

## Joint Special Committee on Mergers

Official Business

State Capitol
Juneau, AK 99801

Chairman: Senator Rick Halford
Vice Chair: Rep. Joe Green
Senator Drue Pearce
Senator Johnny Ellis
Rep. Brian Porter
Rep. Beth Kerttula
Rep. Jim Whitaker

**AGENDA**
Thursday, February 24, 2000
1:00 - 3:00 pm
Butrovich Room 205

Update by Committee Consultants
William MacLeod, Collier, Shannon, Rill & Scott

Update by the Administration
Jack Griffin, Assistant Attorney General

Collier, Shannon, Rill & Scott, PLLC
Attorneys-at-Law
3050 K Street, N.W.
Suite 400
Washington, D.C. 20007
(202) 342-8811
Tel.: (202) 342-8400
Fax: (202) 342-8451

**MEMORANDUM**

**February 24, 2000**

**TO:** JOINT SPECIAL COMMITTEE ON MERGERS OF THE ALASKA STATE LEGISLATURE

**FROM:** WILLIAM C. MACLEOD, ESQ.

**RE:** BP AMOCO/ARCO MERGER - PRELIMINARY INJUNCTION STATUS REPORT

---

The Federal Trade Commission ("FTC") filed its motion for a preliminary injunction to enjoin BP Amoco from merging with ARCO in the U.S. District Court for the Northern District of California, San Francisco Division. The case was assigned to Judge Susan Illston.

## RECENT DEVELOPMENTS

- Earlier this month the parties participated in a scheduling conference in which they submitted their witness lists and set a schedule for submission of pleadings and a hearing on the motion for preliminary injunction. Judge Illston also entered an order for a protective order. A few parties (primarily journalists) reportedly threatened to file motions challenging the protective order, but, none have done so as of this date.

- On Tuesday, February 23, 2000, Judge Illston granted the Alaska Attorney General's motion to intervene in the proceedings. As an intervener, the Alaska Attorney General will have the ability to call witnesses, introduce evidence and cross-examine FTC witnesses. Judge Illston also ruled that she would consolidate the complaints of Washington, California and Oregon with the FTC's case. The parties have indicated in their pleadings and in court that intervention will not delay or prolong the preliminary injunction hearing.

- The parties have been negotiating a discovery schedule but have not settled on particular terms and dates. The parties have exchanged witness lists. The FTC has submitted some plaintiff's exhibits to BP Amoco. Since the outcome of the February 23, hearing was only recently determined, the FTC has not received or attempted to obtain any documents from Alaska.

- The discovery time frame for this matter is going to be extremely compressed and fast paced as the parties will need to complete discovery within about a six week period. Since the FTC has already received substantial documentation from BP Amoco and ARCO pursuant to the Second Request, discovery is likely to focus on depositions and discovery of documents of third parties (i.e. customers). The last two weeks before the hearing is usually reserved for depositions of experts.

**UPCOMING KEY DATES**

| DATE | PROCEEDING |
|---|---|
| **February 24** | Telephone conference with parties and Judge Illston to discuss various discovery issues, including: whether parties can depose more than 10 witnesses (since BP Amoco listed more than 10 potential witnesses on their witness list); and, finalizing specific dates for document delivery. |
| **February 25** | Exchange of experts documents including economists' reports. |
| **Week of February 28** | Depositions scheduled to begin. |
| **March 1** | BP Amoco and ARCO opposition to motion for a preliminary injunction due. Alaska Attorney General might also file a separate opposition. |
| **March 6** | FTC rebuttal to BP Amoco and ARCO opposition to motion for a preliminary injunction due. |
| **March 20 - 31** | Hearing on motion for a preliminary injunction. Each side will have 3 ½ days to present their case. This time limit includes introducing evidence and witnesses as well as cross-examination of opposing witnesses and an opportunity for rebuttal questions. During the week of March 20, the court will be in session Monday through Thursday. During the week of March 27, the court will be in session on Tuesday through Thursday. |

*Please note that the above schedule is tentative and it is not uncommon for events such as these to be postponed due to any number of factors. We will of course update you as further developments arise.*

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Competition

Phillip L. Broyles
Assistant Director

Direct Dial
202-326-2805

February 11, 2000

Frank Cicero Jr., Esquire
Kirkland & Ellis
200 East Randolph
Chicago, IL 60601

Re: *FTC v. BP Amoco/ARCO*

Dear Frank,

Please find enclosed plaintiff's witness list for the above referenced matter. I do not have an address or telephone number for Wally Hickle, but I will forward that information when I get it.

1. W. Scott Lovejoy
   Paramount Petroleum
   14700 Downey Avenue
   Paramount, CA 90723
   562 531-2060

2. Ken Fidyck
   C/o Lynda Irvine, Esq
   Equiva Services LLC
   910 Louisiana
   Houston, TX 77002
   713 241 9586

3. Suzanne Hahn
   C/o Lynda Irvine, Esq
   Equiva Services LLC
   910 Louisiana
   Houston, TX 77002
   713 241 9586

4. Greg Nady
Shell E&P Co.
C/o Charles Cowdry, Esq.
Shell Oil Company
910 Louisiana Street
Room 4814
Houston, TX 77002
(713) 241-1150

5. Drue Pearce
716 West 4th Avenue
Suite 500
Anchorage, AK 99501

6. Walter Hickle

7. R. Preston MacAfee
Department of Economics
University of Texas at Austin
Austin, TX 78712

8. Steanson Parks
Greene & Associates, Inc.
Consulting Engineers
1130 One Energy Square
4925 Greenville Avenue
Dallas, Texas 75206
(214) 691-3500

9. S. Craig Pirrong
Assistant Professor of Finance
Olin School of Business
Washington University
St. Louis, MO
314-935-5924

10. Robert J. Aicher
BP Amoco

11. David Campbell
BP Amoco

If you have any questions, please feel free to call.

Sincerely,

Phillip L. Broyles

cc: Matthew Heartney

# STATE OF ALASKA

TONY KNOWLES, GOVERNOR

## DEPARTMENT OF LAW

*OFFICE OF THE ATTORNEY GENERAL*

P.O. BOX 110300
JUNEAU, ALASKA 99811-0300
PHONE: (907) 465-3600
FAX: (907) 465-2075


February 18, 2000

FEB 18 2000

The Honorable Rick Halford
Alaska State Senate
State Capitol, Room 121
Juneau, AK 99811

Dear Senator Halford:

This is in response to your letter of February 14 concerning the BP Amoco – Arco merger.

You requested clarification of the Administration's position on the fiscal effects of BP Amoco's proposed acquisition of ARCO. A fiscal note will be provided under separate cover early next week by Wilson Condon, Commissioner of Revenue.

You also requested copies of the reports prepared by consultants hired by the Department of Law to assist in its antitrust investigation. You indicated that you are particularly interested in the economic model discussed by Dr. Warren-Bolton at the Special Committee's January 19 meeting.

We will provide you with Dr. Warren-Bolton's entire work product that has been provided to the FTC to date. This work product includes all of the data and variables used by Dr. Warren-Bolton to reach the conclusions he expressed at the January 19 committee meeting. We will provide this information to you no later than the end of next week.

Unfortunately, we are not in a position to waive any of the privileges that apply to information developed by Dr. Warren-Bolton, or other consultants hired to assist in the State's antitrust investigation, that we have not yet disclosed to the FTC. As you know, we are currently preparing for litigation and we cannot release information at a time or in a manner that might prejudice the State's chances of success. Nevertheless, once additional disclosures have been made to adverse parties in thc litigation, or the litigation has reached its conclusion, we will revisit the question of whether it is appropriate to waive the privileges that otherwise apply to this information.

Sincerely,

Bruce M. Botelho
Attorney General

BMB:kh

STATE OF ALASKA

**DEPARTMENT OF LAW**

*OFFICE OF THE ATTORNEY GENERAL*

*TONY KNOWLES, GOVERNOR*

FEB 24 2000

*P.O. BOX 110300*
*JUNEAU, ALASKA 99811-0300*
*PHONE: (907) 465-3600*
*FAX: (907) 465-2075*


HAND DELIVERED

February 24, 2000

The Honorable Rick Halford
Alaska State Senate
State Capitol, Room 121
Juneau, AK 99811

Dear Senator Halford:

Attached to this letter is the "fiscal note on the merger," which was prepared by the Department of Revenue in accordance with the request of the Joint Special Committee on Mergers. Enclosed with this letter is a CD rom containing the data from our expert, Rick Warren-Bolton, that the Attorney General agreed to provide you in his letter of February 18, 2000. Most of the data is in SAS ("Statistical Analysis System") format, which I understand is the software used by most economists doing significant data analysis.

Please call me if you have questions.

Sincerely,

BRUCE M. BOTELHO
ATTORNEY GENERAL

By: John P. Griffin
Assistant Attorney General

JPG:kh

Attachment: Fiscal Note

# FISCAL NOTE

**STATE OF ALASKA**
**2000 LEGISLATIVE SESSION**

**BILL NO.** ______________

Revision Date/Time (Note if correction) ______________

Dept. Affected Revenue/Natural Resources

Title BP Amoco/ARCO Acquisition

BRU N/A

Component N/A

Sponsor N/A

Requester N/A

Component No. N/A

**Expenditures/Revenues** (Thousands of Dollars)

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

| OPERATING EXPENDITURES | FY 2001 | FY 2002 | FY 2003 | FY 2004 | FY 2005 | FY 2006 |
|---|---|---|---|---|---|---|
| Personal Services | | | | | | |
| Travel | | | | | | |
| Contractual | | | | | | |
| Supplies | | | | | | |
| Equipment | | | | | | |
| Land & Structures | | | | | | |
| Grants & Claims | | | | | | |
| Miscellaneous | | | | | | |
| **TOTAL OPERATING** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **CAPITAL EXPENDITURES** | | | | | | |
| **CHANGE IN REVENUES ( )** | 0.0 | 0.0 | $0-80,000 | $0-80,000 | $0-80,000 | $0-80,000 |

**FUND SOURCE** (Thousands of Dollars)

| | | | | | | |
|---|---|---|---|---|---|---|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | | | | | | |
| 1005 GF/Program Receipts | | | | | | |
| 1037 GF/Mental Health | | | | | | |
| Other (Specify Type) | | | | | | |
| **TOTAL** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

**Estimate of any current year (FY2000) cost:** ______

**POSITIONS**

| | | | | | | |
|---|---|---|---|---|---|---|
| Full-time | | | | | | |
| Part-time | | | | | | |
| Temporary | | | | | | |

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

We currently believe that the proposed BP/ARCO transaction will most likely not affect the State's projected revenue over the next five years. However, there is a small chance the proposed transaction could lead to a substantial increase in North Slope investment in the near term and a consequent increase in State revenue.

The "detailed analysis" of the revenue effect that the Administration anticipates will occur as a result of the BP Amoco/ARCO merger, which the Joint Special Committee on Mergers requests in Senator Halford's February 14 letter to Attorney General Botelho, is contained in the January 13 report of Dan

Prepared by: Dan D. Dickinson, Director

Phone 269-1033

Division Oil and Gas Audit Division

Date/Time 2/24/00, 11:46 AM

Approved by Commissioner Wilson L. Condon, Commissioner

Date 02/24/2000

Agency Department of Revenue

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**ANALYSIS CONTINUATION**

Dickinson, Director of the Oil and Gas Audit Division. That analysis was based on the assumption that there would be no additional production attributable to the merger. Mr. Dickinson's analysis identified "production" as the driving force behind any major effect of the merger on State revenues.

According to BP, their merger with ARCO would create synergies and efficiencies on the North Slope that would result in significant reductions in the cost of North Slope oil production operations. BP announced that it would use these cost savings to increase its planned investment in North Slope development. BP claimed this additional investment would, within two year's time, increase North Slope oil production 150,000 barrels a day above the level forecast by the Department of Revenue's Fall Revenue Forecast. If the average wellhead value of ANS over the first five years of increased production is $10 per barrel and the State's combined royalty and tax share is approximately 20 percent, the additional State revenue attributable to the merger over those five years would be approximately $400 million.

Under the Charter, BP and ARCO were required to make substantial divestitures of interests in producing fields, exploration acreage, and infrastructure to secure the benefits of robust competition in future North Slope lease sales and development. Nevertheless, the Charter was also crafted to permit the North Slope producers to capture most of the important synergies and efficiencies contemplated by the merger. Thus, we believe that if the Charter were implemented, the operators on the North Slope would be able to achieve most of the synergies and efficiencies BP originally anticipated. If these cost savings resulted in increased investment of the magnitude suggested by BP, it would be reasonable to anticipate receiving a maximum of $400 million in additional state revenue over the five year period after increased production commences.

Given the concerns raised by the Federal Trade Commission about the proposed merger and the resulting litigation, the likelihood of the increased investment level on the North Slope has been significantly reduced. As a consequence, it is possible the proposed merger transaction will neither increase nor decrease the revenue we have forecast. This fiscal note, therefore, reflects a range of possible outcomes attributable to the merger.

SCOMM

117:7

Backbone

# Standing Up For **Alaska's** Future

MAY 28 1999

Christy McGraw, Director

May 26, 1999

Thanks for your attention & your help on this!

Honorable Rick Halford
Senator, Alaska State Legislature
P.O. Box 670190
Chugiak, AK 99587

Dear Rick Halford, Rick!

BACKBONE - Standing up for Alaska's Future is a newly formed and growing ad hoc group of Alaskans representing many organizations, interest groups, political viewpoints and individuals from across the state. We have come together because we are gravely concerned about the long-term implications of the pending takeover of ARCO by BP Amoco.

C-

This takeover is perhaps the most important economic event since the construction of the Trans Alaska Pipeline System, and when viewed in all aspects, may be Alaska's single most momentous event since statehood. Our over arching concern is the unprecedented concentration of economic and political power and control this takeover will create over our state's vital oil and gas resources, and our future economic viability as an independent state.

Because this moment is so critical to Alaska's future, we ask that you do everything within your power to ensure the widest possible public education and meaningful participation. Additionally, we ask that you create the most thorough public examination of a merger that is humanly and governmentally possible.

The impact of this transaction on Alaska, if it is not significantly conditioned, will be vastly different, negative, and unprecedented by orders of magnitude, than its effect on any other state or country where ARCO has business interests. For this reason, we firmly encourage and are supportive of the Legislature's efforts to date, but ask you to augment your personal efforts for maximum public input. ***In short, it is not the takeover of ARCO that lies at the heart of our concern; it is the takeover of Alaska.***

5412 West Dimond #4 Anchorage, AK 99515 ◆ 243-4816 ◆ Fax 243-5555 ◆ backbone@alaska.net

We are counting on you to help. We are encouraged by the hearings conducted by Representative Barnes and hope these efforts continue. However, we are concerned that funding for the efforts to be undertaken by the Administration be adequate to the task. We expect the Legislature and the Governor will put aside politics and work on this problem together to provide the funds necessary for a thorough review.

We are encouraged by the decisions that the Governor has made since this takeover was first announced and look forward to learning more about his plans. In a separate letter, we praised his actions. We commended his pro-active approach and believe his task force, if allowed to proceed independently, will conclude that what has been proposed by BP Amoco and ARCO requires immediate and aggressive action on a number of fronts. These range from absolute restrictions on the economic and competitive consequences of the takeover to severe limitations on the tremendous influence that comes with the overwhelming financial dominance of Alaska implicit in this transaction. Simply put, BP Amoco - and their willing entree, ARCO - have arrogantly proposed nothing less than the conversion of Alaska to a company state. BACKBONE, <u>and we believe most Alaskans</u>, will have none of it.

All Alaskans need a complete understanding of the six critical areas of concern you and the administration have identified thus far. As BACKBONE views them, these are:

- Ensure that Alaskans get maximum value for North Slope crude oil.

- Optimize marine transportation with emphasis on responsibility, safety and economic return to Alaskans.

- Optimize operation of the Trans Alaska Pipeline System (TAPS) with emphasis on providing the open, commercial access to potential producers that is essential to ensuring competition that will produce the greatest return to Alaskans.

- Maximize competition, environmental protection and return to Alaskans in the development of current and new North Slope facilities and fields by ensuring fair access to all potential producers.

- Ensure access to, and production and marketing of North Slope natural gas under terms that will provide a substantial source of revenue for the state's budget for years to come.

- Ensure that the leasing of acreage for oil and gas development including leases currently held and those offered for future sales provides for maximum return to Alaskans on a timely, state dictated, basis.

In addition to considering these six points in their total context, there are three other matters, which should immediately be added to this list. The first is the non-existent TAPS DR&R fund. BACKBONE would like to see you encourage the Governor to use merger discussions to correct industry's over-collection of these funds and require escrow of the necessary amounts in an account that benefits Alaskans. This and other problems associated with TAPS tariffs that must be carefully reviewed during takeover deliberations.

The second concern is the impact of the now-overshadowed Exxon/Mobil merger. BACKBONE asks that you, again, encourage the Governor to intervene and demand access, production, and marketing of North Slope natural gas as a condition of this merger approval.

Additionally, BACKBONE thinks you must conduct a thorough examination of the impacts of the takeover on the social, cultural, economic, political, and environmental foundations for Alaskans' quality of life. All Alaskans should be aware of the ramifications of the political and economic power British Petroleum will have if this takeover is allowed to proceed in its present state.

While BACKBONE is encouraged by your actions thus far, we are hopeful that you will appropriate the funds necessary to add knowledgeable parties to the review team who can provide much needed independent analysis, that you will continue to hold public hearings throughout the entire process, and that you will take special measures to place as much information as possible on the public record.

We think that the simplest solution to this problem is to pass legislation that requires BP Amoco and ARCO to pay for the Necessary State review of the takeover. In all other aspects of regulatory process in Alaska, the applicant pays the expenses for State agencies to conduct reviews. Why not require it here? This would be helpful legislation and we urge you to adopt it quickly in special session.

We look forward to the opportunity to work with you, the administration and your advisors. In the meantime, we will use every available forum to advance our concerns and to help determine the outcome. We are working to alert and mobilize Alaskans to publicly endorse efforts such as those you have undertaken and to aggressively fight any secretly negotiated settlement, which falls short of the best possible outcome for Alaska.

Thank you for placing the best interests of Alaskans first.

Sincerely,

Christy McGraw

Christy McGraw, Director
BACKBONE – Standing Up for Alaska's Future
5412 W. Dimond #4
Anchorage, AK 99515
907-243-4816
907-243-5555 FAX
backbone@alaska.net

Backbone

# Standing Up For **Alaska's** Future

*Christy McGraw, Director*

## STATEMENT OF PURPOSE

BACKBONE formed to provide a statewide forum for all citizens of Alaska to:

- Express concerns and opinions;
- Share information;
- Examine and gain a complete understanding of the implications and consequences; and,
- Develop common strategies and goals,

in connection with the impending takeover of ARCO by British Petroleum.

BACKBONE seeks to represent, assert, and advance the interests, traditions, rights, and expectations of all the people of Alaska in connection with the pending takeover of ARCO by British Petroleum.

BACKBONE seeks to preserve, defend, and assure an independent and thriving economic, social, environmental and political climate in Alaska.

BACKBONE seeks to actively, aggressively, and positively influence the future and fate of Alaska.

5412 West Dimond #4 Anchorage, AK 99515 ◆ 243-4816 ◆ Fax 243-5555 ◆ backbone@alaska.net

**PRESS RELEASE**

# BACKBONE – STANDING UP FOR ALASKA'S FUTURE

**FOR IMMEDIATE RELEASE**
July 2, 1999

**CONTACT:**
Christy McGraw, BACKBONE
243-4816
backbone@alaska.net

## 83% of Alaskans' Favor Placing Conditions on Pending BP/ARCO merger.

In the wake of the pending BP-Arco merger, **BACKBONE – Standing Up for Alaska's Future** announces the results of a recent poll that shows that Alaskans have a low level of trust in multi-national oil companies and therefore are demanding that conditions be placed on the merger to safeguard Alaska's interests.

The poll, conducted by Ivan Moore Research of Anchorage for the **Kay Brown and Alaska Conservation Alliance,** asked a random sample of 300 Alaskans to rate who they trust for information from various agencies, groups, politicians, and industries. In a field of eleven, oil companies scored 11th. On a scale of 1-4 (1 being no trust and 4 being great trust), multi-national oil companies scored last with a score of 1.98. The top three groups whom Alaskans trust the most are scientists (3.24), Alaska Native Tribal Councils (2.93), and local conservation groups (2.83). Governor Tony Knowles has slipped to 4th.

Additionally, when asked if certain conditions should be placed on the BP-Arco merger to protect Alaska's interests, an overwhelming 83% answered they would support such a move. 8.9% oppose conditions. This result is across the political spectrum of Democrats, Republicans and non-affiliated voters.

"Obviously Alaskans do not trust the oil companies and they want our elected and appointed officials to guarantee that their rights will be protected and their future will be secure," said Christy McGraw, executive director of the citizens' group BACKBONE. "BP's propaganda machine has been cranking out promise after promise, but it's gratifying to know that Alaskans aren't buying it."

McGraw states that with so much at stake for Alaska – North Slope oil and gas, the Trans-Alaska pipeline, and indeed the state's economic future – we cannot afford to simply take Sir John Browne at his word. "Governor Knowles and the state legislature need to obtain guarantees that the needs of Alaskans will take precedence over the needs of BP's shareholders."

**Clarity and action that involves all Alaskans is BACKBONE's primary mission. BACKBONE wants all Alaskans to be able to understand and evaluate the efforts of the Governor's task force, the Legislature's task force, and the work of the Attorney General. BACKBONE wants Alaskans to be able to evaluate and understand whether we are getting the best deal we can for Alaska. For more information, or to join us call 243-4816, e-mail at backbone@alaska.net or check out the website at www.alaskabackbone.com.**

**Alaska Conservation Alliance is a coalition of 33 organizations and business throughout Alaska representing over 19,000 voters.**

# DISCUSSION GUIDE
# FOR
# JOINT SPECIAL COMMITTEE ON MERGERS
# ALASKA STATE LEGISLATURE

## BY
## BACKBONE – STANDING UP FOR ALASKA'S FUTURE

**AUGUST 24, 1999**
**9:00 – 12:00**
**ANCHORAGE LIO**
**5TH FLOOR CONFERENCE ROOM**

The purpose of this meeting is to provide the Joint Special Committee On Mergers with an opportunity to talk with the members of Backbone – Standing up for Alaska's Future on the significant areas of interest resulting from the impending merger of BP Amoco and Arco, Inc.

Follows a guide for purposes of discussion that covers 4 broad areas:

- Access and Transportation
- Competition and the State's Interest
- Gas Development
- Environment

We are also including a paper on state ownership, by Nick Begich dated August 1999, and one on TAPS DR&R analysis performed by Richard Fineberg in June of 1999.

**Backbone** members collectively possess hundreds of years of experience in oil and gas development in Alaska. We look for this to be an open and frank conversation. We present the following as a guide only, and do not represent it as an exhaustive investigation. We hope that you will bring with you any and all questions you might have on these issues. And we thank you for the opportunity to be of service.

## ACCESS AND TRANSPORTATION

- With the completion of the merger in its present form, BP will control virtually all North Slope facilities, including a majority share of TAPS. Will other potential oil developers have fair access to these facilities necessary to bring their oil to market?

  No. Any potential oil developer will be forced to use BP-owned facilities, and thus, the crude oil would either have to be sold to BP at the wellhead or be subject to a potentially high "process" fee. Without competition, BP's incentive is to justify tariffs as high as possible and effectively squeeze out any and all producers. Indeed, past history bears this out. In 1993, Conoco was forced to trade off their holdings at Milne Point. Their president explained that "all the value of that property was taken away from us in the pipeline [Kuparik and TAPS] tariffs." Additionally, there exist allegations in APUC docket P-97-4 that excessive TAPS tariffs handicap the operations of non-TAPS owners.

  The state is subject to the same conditions as any third party oil developer and would wind up paying the higher rate.

  TSM (TAPS Settlement Methodology) should be reviewed and changed with respect to the collection of dismantling, removal and restoration funds, amortization of capital investment, etc. to assure that the state is getting it's fair share.

- Where Arco and BP tariff rates differ on TAPS, which will be used by the new company? Who will decide?

- BP stands to gain Arco's share of TAPS, which would bring their holdings to 72% ownership. This monopoly share would lead to the access problems stated above. Is this transfer of pipeline ownership legal without review and a finding that it is in the State's best interest?

  The newly created Regulatory Commission of Alaska (RCA) has been charged with monitoring all pipeline sales and transfers so that their decisions "shall be based on the best interests of the public" (AS 42.06.305 (b)). Clearly, if BP is allowed monopoly control of the pipeline and if that control represents a detrimental situation for the public (i.e. lack of competition leading to decreased state revenue) then the RCA must not approve the transfer.

- Huge process fees and high tariff rates reduce the value of new oil leases to potential bidders, thus giving BP a decided advantage. If there is effectively only one bidder for state oil and gas leases because there is no, or limited, access to lines and facilities on the North Slope, can the state legitimately hold an auction?

- How might the issue of fair access be resolved?

  The State of Alaska could acquire TAPS, the manner of which is spelled out in "State Ownership of TAPS: Why It Should Be Considered and How It Would Work," by Richard Fineberg. The state would run the pipeline without the huge profit motive currently employed by BP, and thus fair access would again be guaranteed. The state should own a minimum of 12.5% to protect its royalty in-kind interest.

  Additionally, the state should be wary of "attempts" by BP to divest the pipeline to other oil companies. BP may agree to such a divestiture as a condition of the merger, then, after a lengthy process of bidding and negotiating, announce that there are no qualified buyers. At that time the merger will have been long since approved and the state may be stuck with BP and its 72% control. A similar situation transpired in Lima, Ohio, where BP, feeling that they had excess capacity in the region, placed its refinery up for sale only to close it after claiming they received no acceptable bids. The townspeople of Lima, including the mayor, feel that BP did not act in good faith, documented that qualified buyers did exist but intended to close the refinery all along.

- How would the sale of BP's combined share of TAPS to another outside buyer affect the tariff collected on the transportation of the state's 12.5% share and the tariff collected from any other producer?

- How might BP's majority control of TAPS impede state efforts to monitor the safety of the pipeline?

  The state would find itself in a much weaker negotiating position in terms of such oversight. Simply put, the state has a vested interest in the continuation of oil production. BP (i.e. an independent audit of TAPS) repeatedly threatens to scale back production in Alaska on a number of fronts if they don't get their way on taxes, royalties and environmental protection. The limits which the merger puts on competition caused the Alaska Department of Environmental Conservation to state in a briefing paper (4/15/99): "[I]f BP won't develop an area...there won't be another company to come in and do it correctly, so the state would either have to relent or the project wouldn't happen."

- What effect might the merger have on marine transportation at Port Valdez?

  The Oil Pollution Act of 1990 mandated that all tankers in U.S. waters have double hulls by the year 2015. While BP has publicly stated that they plan to abide by this law, they have in fact terminated negotiations to build three double-hulled tankers (that termination coming immediately after the merger's public announcement) and have steadfastly resisted the congressional mandate. Again, the state would be in a weak negotiating position for these double-hulled tankers for the same reasons as above.

  Additionally, BP plans to sell Arco's fleet of tankers to Alaska Tanker Company, a newly-formed shipping enterprise that is 25% owned by BP.

## COMPETITION AND THE STATE'S INTEREST

- In terms of state anti-trust law, is this merger legal?

  It may not be under the following sections of the law:

| | |
|---|---|
| Section 45.50.562 | Combinations in restraint of trade are unlawful. |
| Section 45.50.564 | Monopolies and attempted monopolies are unlawful. |
| Section 45.50-568 | Mergers and acquisitions unlawful when competition is lessened. |

  If in fact it is not legal, the state should be initiating action now.

- What are the primary Arco assets that represent a threat to an open market if transferred to BP without significant divestiture?

  Trans Alaska Pipeline
  North Slope Gathering and Feeder Lines
  North Slope Facilities
  North Slope Leases

- The BP acquisition of Arco's assets without significant divestiture will create a monopoly even though BP claims that the pipeline is a common carrier and therefore regulated to prevent monopoly. Why is this not the case when the shipper is also the owner?

  Royalties and Severance Vs Capacity

- If approved, the BP/Arco merger will produce one primary owner of facilities and gathering and feeder lines on the North Slope. In addition, BP will become the only operator of all producing wells and control 100% of the infrastructure that supports oil and gas development and production on the Slope. With this monopoly on existing infrastructure, is it possible for an independent to operate on the North Slope?

  No. Abnormally high construction costs on the North Slope typically preclude the construction of stand-alone facilities for small oil fields. As a consequence, independents realistically must move crude oil through existing infrastructure owned by BP through TAPS to Valdez and on to the West Coast. In addition, while independents can sell their production to BP at the wellhead, without competition for that production, BP will be able to dictate the wellhead price, processing fees, usage rates, and tariffs potentially rendering independent production uneconomical.

- In the past, the state's regulatory regime has been based on competition. How will the state's regime have to change in order to deal with a monopoly such as is presented by the BP/Arco merger?

- Because of the tremendous contribution that oil revenues - lease sales, taxes and royalties - make to the state's treasury, there is a significant threat posed to that income stream from "warehousing" of Alaska's gas resources. If BP is not required to divest of Arco's Alaska holdings, how will the state deal with reduced treasury income when BP decides to develop it's other, competing, world-wide, interests before it develops Alaska's?

- One significant source of income to the state's treasury is lease sales. How will the monopoly created by BP's acquisition of Arco's share of leases, facilities, and lines affect lease prices?

  Lease prices will be driven down if independent producers are deterred from bidding on leases. Since both the state and federal government benefit directly from the competitive lease of oil and gas tracts by receiving sales proceeds this monopoly would prevent them and the people of Alaska from realizing maximum value for their resources.

- With the advent of worldwide accounting in the mid 1980's, the effective tax rate on oil development in Alaska slipped to 3%. The corporate tax rate for Alaska owned business is 9%. With the monopoly that will be created once the takeover is complete, is there a plan to rebalance the revenue stream from oil development and make it more equitable to Alaska business?

- In anticipation of this merger we have already seen a tightening in the North Slope oil economy that depends on competition. Only 2 rigs are currently operating where there were 14 prior to the announcement. What are some of the specific areas of Alaska's economic future that will be affected?

    - Support industry is already subject to squeezing on work contracts.
    - Individual income levels may drop.
    - Lease sale prices may drop.
    - There may be less technological innovation.
    - There may be less investment in environmental protection.
    - There may be less regulation on taxes, safety, and the environment.
    - There will be less income to the state's budget.
    - Alaska will not benefit from competition in the timely development of its resources.
    - Because of the overall lid on competition and personal income, Alaska's currently health business environment will suffer.

## GAS DEVELOPMENT

- Over the past year there have been three major efforts to develop a gas project that will market Alaska North Slope Gas as LNG or GTL. What are these?

    Representative Whitaker introduced HB 170 that would form the Alaska Gas Corporation.

    An Arco led "sponsor group" continues investigation of a pipeline route to Cook Inlet.

    A group of pipeline mayors began development of a port authority to build a pipeline from Prudhoe Bay to Valdez.

    In addition, there is an effort on the part of BP to develop GTL technology that would utilize TAPS.

- Which of these are the most promising projects and why?

    Alaska Gas Corporation
    Port Authority

- What is a port authority and how will it function?

- What is the expected long-term revenue from the project?
- How will that be distributed?
- What will be the method of financing this project?

  The port authority project will be financed by revenue bonds generated based on the contracts for sale of the gas. Professional investment managers will market the bonds to institutional investors after a stringent process of due diligence. There is no investment of the Permanent Fund planned or required.

- Since BP will own the majority of the gas once the merger is complete, how will the port authority secure the gas needed to make the port authority's project economically viable?

  Contracts to buy conditioned gas must be secured from BP and Exxon.

- What alternatives does the state have if the gas is not made available to the project?

  Reserve taxes that would charge for non-development.

  New legislation that makes the gas available to any viable project on a non-exclusive basis at fair market value or makes it subject to a tax.

- How is this proposal different from a "private sector" proposal?

## ENVIRONMENT

- What is Dismantling, Removal, and Restoration (DR&R) and why is it important in the context of the merger?

  The DR&R, simply put, is a plan to set aside oil revenues in order to have a source of funding to take down oil facilities and reclaim the environment when the oil runs out and production stops. In 1985, a settlement approved by the Federal Energy Regulatory Commission allowed the pipeline owners to pre-collect the DR&R funds. Present value of DR&R is approximately $4.5 to $4.9 billion, yet these funds are not currently available for the purpose for which they were intended. Because the funds were not escrowed they remain as a liability on the balance sheets of the companies, have been invested in other projects and do not actually exist. These funds have been over-collected through the years affecting wellhead pricing, taxes and royalties due the state. This collection should stop and these funds should be escrowed immediately.

- How will the merger affect cleanup of toxic waste sites on the North Slope?

  Arco's legal settlement with Natural Resources Defense Council has a definite schedule for closeout of reserve pits. BP has been asked, but has made no firm commitments, to clean up their respective sites. This is an example of poor environmental citizenship. With the significant increase in control over activities on the North Slope, it behooves the state to take action to secure agreements for clean-up.

- How will the merger affect the oil industry's plans (or lack thereof) for double-hulled tankers?

  The overall pace and extent of conversion to double-hulled tankers in the TAPS fleet may be slashed. Last year, Arco announced its plans to construct state-of-the-art double-hulled tankers for shipping crude oil from Valdez. Arco ordered three "Millennium Class" tankers, with an option to purchase two more. At the same time, BP announced its intention to build three double-hulled tankers. However, since BP announced its plans to acquire Arco, construction negotiations for these three tankers were abruptly terminated. *Although BP has recently stated its intent to complete construction of the three Millennium Class tankers ordered by Arco, instead of six-and possibly eight-new double-hulled tankers, it appears there will only be three.* No new tankers have been added to the fleet since the Exxon Valdez oil spill. There may also be less corporate liability from future oil spills due to a new pattern of tanker ownership. This creates a disincentive for maintaining current standards of marine safety and oil spill prevention. The state should insist on the enforcement of OPA 90 now.

- What are the foreseeable problems in terms of industry self-monitoring?

  Regulatory agencies increasingly rely on the oil industry to monitor its own compliance with state and federal environmental laws due to budget constraints. Within this system, multiple operations have been key to disclosure of environmental problems. We are very concerned that downsizing of industry will result in the loss of this traditional safeguard of corporate accountability. Accountability concerns on the North Slope include the clean-up of toxic sites, ensuring compliance with health, air and water quality laws and assuring maximum preservation of wilderness and wildlife habitat values.

- Will the merger allow for citizens' oversight of TAPS?

  It remains to be seen how the consolidation of ownership in the Trans-Alaska Pipeline System (TAPS) will affect the environment. Among other reasons, we are concerned because of the very real impact one dominant owner-company would have on the level of environmental and safety monitoring of TAPS. Members of the environmental community have expressed interest in establishing a citizen's advisory council for the TAPS corridor and oil fields similar to the Regional Citizens' Advisory Council (RCAC) established for the Valdez Marine Terminal, but industry has opposed the idea. Whether or not there is divestiture of the TAPS pipeline, there should be instituted a Citizens Advisory Council to oversee the operation of the line.

- Will one company have the same oil spill response capabilities as two?

  With the personnel cuts that will follow from a merger of this size, the ability of BP to develop and maintain oil spill prevention and response capabilities throughout the oil fields and transportation system is called into question. This is particularly troublesome given BP's development of the Northstar oil field offshore of Prudhoe Bay. This is an area for which no effective spill response technology currently exists, particularly during broken ice conditions.

## Divestiture – What About State Acquisition of Arco Alaska, Inc.?

**Prepared by Nick Begich**
**August 19, 1999**

## Executive Summary

This concept paper has been put forward to stimulate public debate of this important issue. The impact of the issues surrounding the acquisition of Arco by BP must include an analysis of the option of state ownership. It is in the public interest that this analysis is carried out and the results presented to the public. We have an opportunity to change the course of our state from one worried about declining revenues at the mercy of a foreign corporation or to create a new vision capable of meeting the challenges we face in the next century. We are one of the richest regions in the world and are being exploited like a third world colony at a time when we have the resources, talent and capability of rising above the current circumstances and once again gaining control of our state's destiny.

## The Concern

BP Amoco's acquisition of Arco, Inc. places Alaskans at a turning point in the evolution of the oil and gas industry in Alaska. Should Alaska allow a single foreign corporation to control 72% of the states oil and gas development, a resource so important to Alaska's future economic viability?

The regional development of oil worldwide has resulted in the creation of two types of producers - multinational corporations and government owned oil companies. In the course of the last several years I have considered the possibility of what would happen if Alaska, like many third world countries, began to produce its own oil. The third world reached a point in their oil development where they began to cost out the value of owning and controlling oil production resulting in new marketing alliances with the industry while retaining the bulk of the wealth produced through oil and gas production within their boundaries.

It became clear to them that the industry's strategies were primarily vested in serving their stockholders interests regardless of the advertising campaigns conducted to the contrary. Perhaps it is time to consider the economic consequences of a state acquisition of Arco verses a BP oil monopoly on the states greatest income producing assets - our oil and gas.

Our relationship with the oil and gas industry has provided Alaska a 12.5% in kind share of North Slope oil production. Other regions of the world have been able to obtain substantially greater shares of their production (in many cases over 50%) while at the same time gaining significant capital investment commitments for producing the oil. What Alaska receives for its oil is less than a sharecropper would receive for working the land of another in the southern part of the United States.

## Who owns the Oil?

Alaska owns the oil on state land and is entitled to 90% of the revenues generated from oil on federal land in Alaska according to the Statehood Act. Each person in Alaska has a vested interest in the development of the state's resources not just by virtue of the existence of the Permanent Fund but because fundamentally the citizens are the state of Alaska. Alaskans own the oil as the lessor, as the owner with the industry being our tenant. Yet as owner we are receiving the smallest benefit from the resource.

Our state constitution mandates that our resources be developed in a manner that offers the greatest benefit to all Alaskans. At the time that North Slope oil leases were being sold, Alaska was not in a position to produce its own oil. The best use of the resource at that time was to enter into production leases and create a right-of-way for the transportation of oil from the North Slope to Valdez.

Alaska is in a much different position now in that we have the economic base to reevaluate our role in oil and gas development in the region. We are in a position, a crossroad, where we can choose to be dominated by the stockholder interests of a foreign corporation - British Petroleum - or we can begin to chart our own course through control of our energy resources.

## Buying ARCO - The Price

At the present time British Petroleum (BP) has set a value on all of the worldwide assets of Atlantic Richfield Corporation (Arco). The Alaska portion of this value could be easily separated from the value of the rest of Arco's assets. The prorata share of the assets could be valued based on either their income producing history, their depreciated book value or, perhaps, something in between. The value of Alaskan Arco owned assets would likely range between $7 and $11 billion.

## The Assets

Arco owns about 40% of the oil and gas on the North Slope with a corresponding ownership interest in the Trans Alaska Pipeline. The pipeline produces about $2.1 billion a year in revenues of which 40% of the profit belongs to Arco.

Assuming Arco is selling 500,000 barrels of oil a day at $20.00 a barrel over $3.65 billion per year is being produced.

The natural gas Arco owns is in excess of 4 trillion cubic feet and at present is not being marketed at all.

Most importantly Arco has already established a complete staff; office complexes and corporate infrastructures needed to operate in Alaska.

## The Advantages of Acquisition

Alaska's share of oil and gas moving through TAPS would increase from 12.5% to 52.5%. Permanent Fund contributions would increase over 400% above present levels resulting in significant increases in dividends in the short and long run.

The problem then facing Alaskans would change from worrying about the dividends being capped, if at all, to avoiding an increasing influx of people from other states.

Funds available for the State Operating Budget and the Capital Budget would increase also by over 400%. These funds could be used for a number of things including building water, sewer, road, railroad, ports and other improvements needed in the long term in Alaska.

The State would receive Arco's share of all oil transportation costs from the operation of the oil pipeline, which over time could repay the States initial cost of buying the asset in the first place.

Another advantage is that as a state owned enterprise the Arco assets would be exempt from federal corporate taxes, which would further increase the profitability of state ownership. In fact, if the state chose to, as part of its acquisition plan, it could divert these funds to Municipal Revenue Sharing in order to replace property taxes in Alaska cities and boroughs.

At present a movement towards the formation of a Port Authority has begun. This initiative would place ownership of the gas line in the hands of some municipalities and boroughs while it should be more rightly placed in ownership by a state if public ownership is being considered at all. By adding this to the asset mix acquired from Arco, together with the states existing oil and gas interest in development, an incredible set of possibilities emerge.

The economic possibilities would position Alaskans to accomplish almost any future vision put forward. The added income to the state from the resources already in production would also change the rate of development of future resources. The pressure to give tax concessions to the industry in exchange for development considerations would end, the pressure to develop risky off-shore oil and gas fields would diminish or disappear altogether in the short run and the need to tax citizens would be avoided. Alaskan hire and in-state contracting issues would be resolved.

## Taxes

The idea that Alaskans "pay no taxes" is not true. State revenues are generated by either a direct tax of money from business or individuals or through the sale of Alaskan resources, which already belong to the people who reside here by virtue of their state citizenship. The industry-favorable leases and terms of exploitation negotiated with the oil industry has allowed us the opportunity of avoiding state taxation of private persons in favor of a policy of generating revenue from our resource base. This taxing method is being managed in a way, which is fundamentally unfair to all Alaskans. Acquisition offers us the opportunity of maximizing our income from our resources perhaps putting off the question of direct taxes forever.

Several years ago under the Hickel Administration we settled a number of oil tax disputes with our oil "partners". Those settlements resulted in billions of dollars in savings to the oil industry. The following administration, the Knowles Administration, then entered into tax agreements which gave the industry "marginal" oil fields virtually royalty free generating nothing for the state but the promise of a few jobs. Every oil and gas field in Alaska has been underestimated in terms of size after initial drilling programs. Field size is delineated over time. What incentive is there to delineate a field's size when there is a counter incentive to keep it small?

In the coming years addition tax questions will arise for Alaskans. Particularly, the issue of property taxes will begin to affect Native Corporations, which are land based and currently exempt from property taxes. In addition, with the anticipated decreases and perhaps elimination of state municipal revenue sharing we will be faced with either significant decreases in public services or significant increases in property taxes. The revenue stream produced from the ownership of Arco could in part be used to eliminate property taxes in Alaska allowing people to one day truly own their land free off all encumbrances.

## Industry Trust

The interests of the oil industry are counter to the formation of good public policy in that the industry is accountable first to their stockholders. The interests of an owner state such as Alaska where its citizens own the resources are secondary. The Alaska based oil industry has been a less than model corporate citizen. The pipeline was built on a cost-plus basis with all the costs being assessed against future oil coming through the line. The value of the transportation was based on an underestimated oil reserve thereby subjecting the state to an unfair transportation price for its 12.5% in kind share.
The industry then moved on to take advantage of the tax laws in order to avoid paying the state its fair entitlement resulting in multi-billion dollar losses for the state. The industry then captures new tax concessions resulting in increased profits for them and nothing for the state or its citizens.

What many Alaskans do not consider is that the oil revenue the state gets from its oil is not just effected by the price per barrel but also by the quantity of oil shipped through the pipeline and out of Valdez. The pipeline was designed to ship up to 2 million barrels a day. At present we are shipping 1.3 million barrels per day. The industry cannot control the world price of oil but by controlling the shipping and refining they can control the state's income. When BP put its offer for Arco forward, it canceled a number of tanker contracts which in the long term limit the carrying capacity available for Alaskan crude oil. The ability of a single oil company to constrict the flow of oil and thus the income to the state must be avoided by proper state policing of the industry.

## Competition

Competition between BP and an Alaska owned company could take place. Arco - Alaska really would represent a partnership with Alaskans and it would be free to compete for the opportunities to develop all of Alaska's oil and gas resources available in the future. It would be a company operated by Alaskans for the interests of Alaskans.

The idea the industry has put forward in the past is "if you tax us or change the rules we will go elsewhere." This has been the cry of the oil industry everywhere in the world. Competition between multi-national corporations and a state owned oil company would yield the greatest benefits to all Alaskans.

## Method of Acquisition

The acquisition could take place through a number of possibilities:

- ARCO-Alaska could be purchased through the use of Alaska Industrial Development Bonds which could be repaid out of the transportation fees collected by 40% ownership in the oil line and 100% ownership of the gasoline in addition to part of the profits from the oil itself.

- ARCO-Alaska could be purchased by the Permanent Fund.

## Summary

This concept paper has been put forward to stimulate public debate of this important issue. The impact of the issues surrounding the acquisition of Arco by BP must include an analysis of the option of state ownership. It is in the public interest that this analysis is carried out and the results presented to the public. We have an opportunity to change the course of our state from one worried about declining revenues at the mercy of a foreign corporation or to create a new vision capable of meeting the challenges we face in the next century. We are one of the richest regions in the world and are being exploited like a third world colony at a time when we have the resources, talent and capability of rising above the current circumstances and once again gaining control of our state's destiny.

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## Overcollection and Failure to Escrow TAPS DR&R Funds

## Imputed Present and Future After-Tax Value to TAPS Owners of Excess DR&R Collections Under TSM

By Richard A. Fineberg

June 24, 1999

### Executive Summary

The owners of the Trans-Alaska Pipeline System (TAPS) collect payments from shippers for the eventual dismantling and removal of pipeline facilities and restoration of the pipeline corridor (DR&R). The worksheets presented here show that if TAPS shuts down in 2011, industry's tax-paid profit from DR&R collections — over and above the costs of DR&R itself — is likely to be somewhere between $12.5 to $16.0 billion, with outlier estimates ranging from approximately $4.3 to $20.5 billion (all estimates in 1999 dollars). If TAPS operates past 2011 and the earnings of the owners exceed inflation, gains to the TAPS owners from this obscure provision of the 1985 TAPS Settlement Agreement will be even greater; few expect the line to shut down in 2011 and average earnings of the TAPS owners beat inflation in each of the first 21 years of pipeline operations.

Through 1998 the TAPS owners collected $1.535 billion for DR&R. The imputed value of those collections at the end of 1998 was approximately $4.5 billion to $4.9 billion. The lower estimate values DR&R collections at 1% below the rate of the weighted average return on all TAPS owner equity during this period; the higher estimate assumes that DR&R earnings equaled TAPS owner return to equity.

These estimates assume that the TAPS owners paid nominal state and federal income tax rates; they do not include gains to the TAPS owners (and loss to the state) from reduced state royalty and severance income. Including estimates to recognize either factor would increase the present value and the future gain to the TAPS

owners on a pipeline tariff item that was portrayed as revenue neutral during 1985 settlement reviews.

## Chapter 1: The Bases for TAPS DR&R Collections

### A. Background: The TSM DR&R Provision

The Trans-Alaska Pipeline (TAPS) Settlement Agreement of 1985[1] ended eight years of litigation between the State of Alaska and prospective shippers, on the one hand, and the pipeline owners, on the other. The settlement established the methodology for calculating the TAPS tariff (shipping charge). The tariff framework, known as the TAPS Settlement Methodology (TSM), consists of seven major tariff elements:

- Operating expenses — the cash Alyeska Pipeline Service Co. draws from the TAPS owners for TAPS operations and maintenance;
- Capital costs — recovery of original investment;
- State and local property taxes;
- State and federal income tax;
- After-tax margin — profit;
- Recovery of deferred return — an allowance representing deferred income the owners collect in recognition of earlier capital costs (a conventional allowance for funds used during construction and deferred payments representing the inflation component of return on rate base); and
- DR&R allowance — funds for the future dismantling of the pipeline, its removal and restoration of the 800-mile right-of-way.[2]

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[1] *Settlement Agreement between The State of Alaska and ARCO Pipe Line Co., BP Pipelines Inc., Exxon Pipeline Co., Mobil Alaska Pipeline Co., Union Alaska Pipeline Co. with Respect to the Trans Alaska Pipeline System* (Federal Energy Regulatory Commission Docket OR 78-1), *June* 28, 1985.

[2] TSM includes property taxes with operating expenses and therefore identifies only six tariff elements. See: State of Alaska and U.S. Department of Justice, *Explanatory Statement of the State of Alaska and the United States Department of Justice in Support of Settlement Offer*, June 28, 1985 (Federal Energy Regulatory Commission Docket No. OR 78-1), pp. 29-53.

Each element of the tariff is calculated in accordance with terms spelled out in the 1985 settlement agreement. The TAPS owners levy the required revenues on each barrel of oil shipped through TAPS through a tariff submitted annually to and approved by the Federal Energy Regulatory Commission.

The DR&R obligation originates in the pipeline consortium's lease agreements with the state and federal governments.[3] Section II-4 of the 1985 agreement establishes the basis for funding this tariff element in this statement:

> The DR&R Allowance to be included in the Total Revenue Requirement for each year to provide for the eventual dismantling, removal and restoration of TAPS is given in Exhibit E.[4]

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[3] The lease states that during "construction . . . , operation, maintenance. . . and termination of the Pipeline System," the companies are required to "employ all practicable means . . . to preserve and protect the environment." *Agreement and Grant of Right-of-Way for Trans-Alaska Pipeline between the United States of America and Amerada Hess Corporation, ARCO Pipeline Company, Exxon Pipeline Company, Mobil Alaska Pipeline Company, Phillips Petroleum Company, Sohio Pipe Line Company [succeeded by BP], and Union Alaska Pipeline Company,* Jan. 23, 1974, p. 1. Essentially identical language appears in Right-*of-Way Lease for the Trans-Alaska Pipeline between the State of Alaska and Amerada Hess, (et al.),* p. 1. The agreements further require the TAPS operators to "abate. . . completely, or as completely as possible using their best efforts, any . . . condition . . . arising out of construction, operation, maintenance or termination of all or any part of the Pipeline System . . . that causes or threatens to cause . . . serious and irreparable harm to the environment." [*Agreement,* p. 17; *Lease,* pp. 16-17.] Stipulations attached to the agreement specify that:

> Upon completion of the use of all, or a very substantial part, of the Right-of-Way or other portion of the Pipeline System, Permittees shall promptly remove all improvements and equipment, except as otherwise approved in writing by the Authorized Officer [State Pipeline Coordinator on state lands], and shall restore the land to a condition that is satisfactory to the Authorized Officer [or State Pipeline Coordinator] or at the option of Permittees pay the cost of such removal and restoration. The satisfaction of the Authorized Officer [or State Pipeline Coordinator] shall be stated in writing. Where approved in writing by the Authorized Officer, buried pipe may be left in place, provided all oil and residue are removed from the pipe and the ends are suitably capped. (*Stipulations for the Agreement and Grant of Right-of-Way for the Trans-Alaska Pipeline,* Exhibit D of Agreement, Par. 1.10.1. Again essentially identical language appears in the state lease stipulations [Par. 1.10.1.].)

[4] *Settlement Agreement between the State of Alaska and ARCO Pipe Line Co.,* June 28, 1985, p. 14.

In a settlement that marked the finale to a proceeding the Alaska Department of Law frequently described as "the largest utility rate case ever presented,"[5] the provisions of TSM that delineate DR&R collections are remarkable in their brevity. Settlement Exhibit E consists of a single column of numbers listing the amount the TAPS owners may collect for DR&R during each the life of the settlement, starting with $110.377 Million in 1984 and ending with $0.796 million in 2011. As to how these figures are derived, Exhibit E of the settlement is silent.[6]

The explanatory statement of the State of Alaska and the U.S. Department of Justice submitted to FERC with the settlement is almost as brief as the settlement phrasing itself. That statement, which is 111 pages long, discusses DR&R in one paragraph that states:

> The schedule for the DR&R Allowance is found in Exhibit E of the Agreement. See Section II-4. As with the depreciation schedule described below, the DR&R schedule was accelerated in order to further Protestant's [State's] objective of ensuring a declining tariff profile. The annual amounts were calculated so that when they are accumulated at a rate equal to the after-tax yield on Moody's AA bonds, the balance will be sufficient to meet the expected costs of dismantling, removal and restoration of TAPS, stipulated for purposes of the TSM [TAPS Settlement Methodology for tariff calculation] at $872 million in 1977 dollars *[emphasis added]*.[7]

## B. Unusual Aspects of the TAPS DR&R Mechanism

The numbers embodied in the DR&R provision have three salient characteristics:

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[5] The Alaska Department of Law described the case as "the largest" case of its kind in budget and other legislative presentations Oct. 20, 1983, Feb. 6, 1984 and January 24, 1985.

[6] The dollar amounts in settlement Exhibit E can be found in column (L) of Table 1, below (and in each of the other tables estimating the value of DR&R collections to the TAPS owners).

[7] *Explanatory Statement*, pp. 30-31.

• The DR&R collection schedule is accelerated, or "front-loaded;"

• The amounts to be collected for DR&R are cast in concrete; and

• The funds are not escrowed or placed in a special reserve account).[8]

These attributes of the TAPS DR&R component of the complex settlement deserve further discussion, for each appears to run directly counter to standard ratemaking practices, and to common sense. The following paragraphs summarize the principal reasons these three characteristics of TSM's treatment of DR&R function together to create an enormous financial gift to the owners of TAPS.

• Accelerated recovery of DR&R. As noted in the explanatory brief, payments to reimburse the Owners for future DR&R outlays are collected under TSM on an accelerated or "front-loaded" schedule. The reason for collecting DR&R in advance of actual outlays is to match those costs with barrels shipped during the existence of the pipeline; that makes good sense. But the decision to accelerate those advance collections is a different matter altogether. There are clear public policy reasons for allowing a pipeline owner to recoup capital investment on an accelerated depreciation schedule — for example, to make capital available more rapidly for further development. Indeed, front-loaded return of *prior* expenditures is one of the primary bases for the 1985 settlement. But allowing accelerated collections in advance for *future* cash outlays is a gift to the pipeline owners that does not, on its face, make sense.

• Terms cast in concrete. Unlike the settlement methodology as a whole — which consists of formulae for determining the maximum amount the TAPS Owners may collect each year for each element of the tariff — the DR&R numbers are stated in hard dollars.

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8 This section borrows extensively from *Prefiled Testimony of Rudolph L. Bertschi* (Alaska Public Utilities Commission Docket No. P-86-2), December 17, 1986, pp. 63-70. For additional discussion, see: Richard A. Fineberg, *Hidden Billions: The TAPS DR&R Provision* (prepared for Stan Stephens), August 1992; and Antony Gordon Scott, The *Trans-Alaska Pipeline System: The Consequences and Causes of Regulatory Failure* (Master of Science Thesis, University of Wisconsin - Madison, 1996), pp. 59-68.

In 1985 it was virtually impossible to estimate the correct amounts to pre-collect for DR&R. Even if the year of pipeline shutdown could have been known with certainty, three other estimating factors necessary to calculating the correct pre-collection of DR&R through the tariff were uncertain or unknown at that time: Specifically, the annual amounts listed in Exhibit E of the Settlement Agreement were based on assumptions regarding (1) the return the Owners would realize from the pre-collected funds during the years between collection and expenditure and (2) the rate of inflation during those years. Since the DR&R collections constituted income until the funds were expended, the pre-collected funds would be taxable; the DR&R collections were therefore "grossed up" by (3) the estimated income tax. Finally, (4) nobody knew in 1985 — and nobody knows today — when TAPS will actually be dismantled. Under normal utility rate-making principles, elements that are difficult to forecast are typically recalculated periodically; not so with TAPS DR&R. The almost inevitable errors in all four 1985 estimates has caused DR&R over-collections that will be quantified in Chapter 2.

• Collections not escrowed. The settlement might have required that TAPS DR&R collections be held in escrow, or even placed in a special internal account. In a subsequent North Slope pipeline tariff proceeding, a FERC Administrative Law Judge ruled that because the amount necessary for DR&R was so difficult to estimate, DR&R funds should be placed in escrow to ensure refunds to the rate-payers (shippers) in the event of over-collection.[9] Another policy problem results from the failure to escrow DR&R collections. At some point in the future, as TAPS shutdown nears, the North Slope producers may claim that the need to expend funds for DR&R will deprive them of capital that might otherwise be invested in efforts to extend production. Under these circumstances, the State may be forced to choose between requiring DR&R funds be used for the

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[9] Paul J. Fitzgerald, Presiding Administrative Law Judge, "Initial Decision (October 26, 1988)," in: Kuparuk Transportation Co., Docket Nos. IS85-9-000 and OR85-1-000, pp. 77-83. (That decision was rendered moot in 1991 by a settlement between the state and the Kuparuk pipeline owners.)

purpose for which they were collected or continuing North Slope production.

## C. How TAPS DR&R Entries Were Calculated

The DR&R numbers in Exhibit E of the TAPS Settlement Agreement cannot be derived from the terse statements in the settlement itself, or from the explanatory statement. In his 1996 University of Wisconsin master's thesis, Antony G. Scott observes that "TSM is quite opaque in this regard . . . . only by locating a copy of a consultant's brief *pertaining to a different case* can one locate the (parameters necessary to understand how the yearly DR&R allowances specified by the TSM were determined)" *[emphasis in original].* [10]

The worksheet that the state and the TAPS owners used to establish DR&R collections set up an accelerated collection schedule under which the preponderance of the money deemed necessary to pay for DR&R at the end of the life of the pipeline would be collected in the early years of operation. The amount needed was a compromise between an Army Corps of Engineers estimate of $0.602 billion proposed by the state, which would benefit from a lower tariff, and an industry estimate of $1.049 billion favored by the TAPS owners, who sought a higher tariff. Collections to cover the stipulated figure of $872.1 million were "grossed up" to cover income tax on money received for DR&R, then converted into inflated dollars that would be used at the time of dismantling, when the owners would also receive a tax deduction for decommissioning expenditures. Four of the particularly noteworthy assumptions in this calculation — unstated in the settlement or the explanatory statement — were:

- Assumed inflation of 6% between 1986 and 2015;
- Federal income tax of 46% between 1979 and 2015;
- Assumed past pre-tax income on DR&R collections earned at the rate of AA bonds; future earnings estimated at 12% (pre-tax); and

[10] *Consequences and Causes of Regulatory Failure*, p. 60.

- Assumed dismantling of TAPS between 2011 and 2015.[11]

Tables and calculations available at the meeting.

[11] See: *Prefiled Testimony of Rudolph L. Bertschi and The Consequences and Causes of Regulatory Failure.*

Backbone

# Standing Up For Alaska's Future

*Christy McGraw, Director*

August 25, 1999

Senator Rick Halford
Alaska State Legislature
P.O. Box 670190
Chugiak, AK 99567

Dear Senator Halford:

On behalf of Backbone, I would like to thank you, other members of the Joint Special Committee on Mergers, and other interested legislators, for devoting an entire morning to discussing BP's takeover of Arco with us. We very much appreciate the time and attention your Committee has taken to hear from Alaskans on this issue.

Alaska should benefit from any upside that BP realizes as a result of the buyout. You mentioned $1 billion. At one point, BP claimed the transaction would realize savings of $5 billion. Alaska's treasury should benefit proportionately, directly, and independently of any University endowments or charitable giving. We also strongly agree, Senator Halford, with your no-net-loss position, regarding the huge differential between the value of oil produced by Arco and the value of oil produced by BP. Indeed, the discrepancy is so large it begs investigation. The Committee should insist that any state merger approval incorporate rectification of these issues.

We agree with Speaker Porter that the legislature should have been involved from the get-go in any negotiations between the state and BP. Matters of confidentiality notwithstanding, the Administration will get a better deal with the legislature's participation.

As the time for deals to be made draws near, we believe even more strongly that the Knowles Administration should file an anti-trust lawsuit. There are at least three good reasons. First, the proposed takeover clearly violates both the letter and spirit of state law. Second, a lawsuit will improve our bargaining position. Finally, a lawsuit is the

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best way to demonstrate to FTC the depth of the state's concerns.

We also believe a lawsuit will slow the process and delay will work to Alaska's advantage. The closer we get to the March 31, 2000 drop-dead date, the more nervous the shareholders, officers, and the financial community will become. The more willing BP and Arco will be to negotiate.

Certainly, the issues raised by Mr. Lakosh warrant investigation and may be part of a anti-trust law suit. BP's refusal thus far to build its own double-hulled tankers appears to us to contradict its claim in the Daily News ad of August 25 that its entire fleet will be double-hulled by 2006. Several weeks ago, BP explained to the environmental community it's unwillingness to commit to constructing additional tankers. I'v asked them to forward their notes from those discussions to you.

Although Mr. Opstad cited others who have been victims of BP's anti-competitive activities on the North Slope, Petersburg Energy has also. Dale Lindsay gave testimony to this during hearings held by Senator Murkowski and Eric is preparing a list of questions and answers on this issue, which will be put on our website when prepared.

The Committee asked Mr. Lewis if there was evidence of anti-trust activities in the Prudhoe Bay Unit Agreement. Language in the Prudhoe Bay Issues Resolution Agreement prohibiting a major gas sale prior to 2005 absent approval by 90% of the unit owners might fall into this category.

In acknowledging that the tariff has been unfair and excessive, the Governor essentially said that TAPS owners have been engaged in anti-competitive practices. This is a huge admission and, assuming the Governor knew what he was saying, is a major sea-change. Heretofore, the state has always defended the tariff. The Committee should ask the administration how it intends to collect the approximately $6-9 billion in revenues lost to the state since 1985.

Like Mr. Fineberg, we're skeptical that the Governor's solution will rectify the problem of producer/shipper ownership of TAPS. For starters, we'd like the Committee to ask the Governor to condition approval of the buyout on restoration to the state of any and all revenues lost as a result of excessive tariffs. According to filings by Tesoro before the Regulatory Commission of Alaska (RCA), the overcharges have cost Alaska's treasury $3 to $4 billion. Needless to say, recovering these funds would go along way to addressing the state's current revenue shortfalls--without imposing any new taxes.

For all of these reasons, we urge to the Committee to ask the Governor to file an anti-trust suit. It sends a strong message to the Governor and a strong message to the public that the BP-Arco deal is illegal and threatens Alaska's sovereignty. If the legislature lacks standing, the Committee should explain that to the public and explain why the Governor is obliged to file suit on behalf of all Alaskans.

We agree with Mr. Conn that Alaska should be working with other states when it is mutually advantageous rather than engage the BP colossus single-handedly as the Governor proposes.

Mr. Fineberg has suggested that producer ownership of TAPS may be inherently flawed and anti-competitive. If true, then the Governor's proposed divestiture is doomed to fail. State ownership may be the best solution. Therefore, it's essential that the Administration look seriously at this issue before negotiating a solution. Furthermore, although there are undoubtedly documents that by law must be kept confidential, we suspect that many documents are not deserving of this confidentiality privilege. In any case, the prohibition need not necessarily extend to the state's analyses of those documents and the conclusions based on those analyses. The Administration's logic and interpretations must be available to the public and legislators.

Exploring the producer-ownership issue is critical for another reason. The Governor has decreed that BP must divest enough assets to induce another major oil company to open up shop on the North Slope. Mr. Croft (Chancy) and many others believe that BP will never agree to such terms as it recreates the very duplication and competition that the buyout eliminates. But even if BP agrees to significant divestitures, then what? Any buyout approval involving divestiture must contain terms that fully and completely protect the state prior to the merger.

We agree with Mr. Parker that the Legislature should ask U.S. Energy Secretary to immediately initiate an investigation of the chaos now extant in Petroleum Allocation District (PAD) 5 and the likely impact of BP's acquisition of Arco.

We have made a formal request to the RCA to examine this matter. We would like the Committee, as well, to ask the RCA take up, on an expedited basis, the issues related to the merger now on its docket.

Once again, Senator Halford and ladies and gentlemen of the Committee, thank you. We are grateful for your concern and efforts. We are impressed by your grasp of the issues, many of which are exceedingly complex. We are convinced that you are and intend to continue doing what's right on the issue. If any of our statements engender any questions or if we can assist your deliberations in any way, please don't hesitate to call.

Sincerely,

Christy McGraw
Director.

Backbone

# Standing Up For **Alaska's** Future

*Christy McGraw, Director*

SEP 0 [illegible] 1999

September 3, 1999

Senator Rick Halford
Alaska State Legislature
P.O. Box 670190
Chugiak, AK 99567

Dear Rick: Rich!

The attached is a letter from the Backbone Group on the meeting we had with you on the 23rd. I know things have progressed further since then and want to lend my support for your pursuit of an anti-trust action. This week's ad in the Anchorage Daily News will feature a prominent plea to Governor for this as well. Next week's will be even firmer with the anticipated BP meeting on the 13th.

I also understand that you all are contemplating an amended call during the special session on subsistence. I hope that eventuality takes place as well. If there is anything we can do to assist in this endeavor, please let us know.

Again, thanks for the opportunity to talk with you all, although the session did not turn out as I had desired or planned. It's kind of hard to talk strategy with the opposition and the press in the room.

Heard you were great in the debate, by the way.

Best regards,

Christy

Christy McGraw

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Backbone

# Standing Up For **Alaska's** Future

*Christy McGraw, Director*

September 22, 1999

Rick!
thanks + call on us for help!

Honorable Rick Halford
Alaska State Legislature
Room 121 State Capitol
Juneau, AK 99801

Dear Rick:

A recent poll by UAA showed that Alaskans are very concerned about the implications of the proposed acquisition of ARCO, Inc. by BP AMOCO. We believe these concerns are well founded. As you know, Backbone was formed in April 1999 as a public interest organization with a broad-based and diverse membership to advocate for Alaska's interests in the merger.

We feel it is appropriate for the Governor and the Legislature to develop a set of strong standards and conditions that will protect Alaska's future. These conditions should be used by the Legislature to review BP's response to the demands made by the Governor. If these standards are not met, Alaska should file state and federal antitrust lawsuits immediately.

The following comprise a list of our recommendations. There may be other issues you feel need to be addressed, but we think that these are critical. We hope the Joint Special Committee on Mergers and the Legislature will use these and establish their own list of conditions which can be presented to Alaskans, the Governor, the FTC and British Petroleum over the next few weeks. We encourage you to be as specific as possible in these conditions so that they will be enforceable and measurable in years to come.

Thank you in advance for your attention to this matter. Members of Backbone will be present in Juneau for the session so that we can be available for meetings and to present information. If you would like further information on any of the points we have made here, please do not hesitate to call me, either at 907-243-4816 or at the Goldbelt Hotel as of Thursday, September 23, 1999.

Best regards in your deliberations.

Christy

Christy McGraw
Director

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# A Partial List of
# Proposed Conditions for the BP Amoco/Arco, Inc. Merger
# Backbone – Standing Up for Alaska's Future
September 22, 1999

## Wellhead Value

BP and ARCO have negotiated different wellhead values for their oil in the past. At present there is a difference of up to \$3 dollars per barrel. This affects the royalties and severance taxes paid to the state treasury.

- *As a condition of the merger, the state should demand all production from BP Amoco/Arco, Inc. be subject to the Arco, Inc. settlement terms and method of valuation.*

Due to "world-wide" accounting, foreign oil companies effective tax rate to between 3% and 6% for profits in Alaska. Other Alaska businesses pay 9%.

- *As a condition of the merger, BP should agree to pay the same tax rate as other Alaskan businesses.*

BP's acquisition of Arco's refineries may leave room for arbitrary determination of profit centers and the landed oil price. If BP charges itself a lower wellhead price, the state gets less taxes and royalties.

- *As a condition of the merger, the state should demand independent valuation of the wellhead values.*

## Competition

- *As a condition of the merger, BP should be required to divest itself of sufficient North Slope acreage and producing wells to facilitate a viable "market" for another major producer.*

## Access to TAPS and Tariffs

Owners of TAPS have a significant economic advantage over independent producers because of the pipeline tariff which owners pay to themselves.

- *As a condition of the merger, the state should demand that pipeline tariffs be lowered to ensure reasonable access to all producers in order to assure competition and full production of marginal fields.*

The TAPS settlement methodology that provides the formula for figuring the tariff on the pipeline states that the owners were to collect a fee per barrel to dismantle, remove, and restore the pipeline corridor once TAPS is no longer in use. This was based on the original estimate of 9 billion barrels of oil. So far there have been nearly 13 billion shipped. The oil companies are still collecting and this over collection now amounts to somewhere between \$4.5 - \$5 billion.

- *As a condition of the merger, the state should demand that the companies discontinue collection of DR&R funds and escrow the already collected amount in an account for the benefit of Alaskans. This \$4.5 billion would produce about \$250 million to the treasury in interest at 5% per year.*

## Access to Facilities and Infrastructure on the North Slope

On Alaska's North Slope independent producers cannot economically operate if they have to replicate facilities, roads, and gathering and feeder lines (not currently common carriers).

- *A condition of the merger should be a guarantee that independents will have unrestricted access to this infrastructure on an allocated basis at published fair prices.*

## Natural Gas

Oil and gas producers have never offered Alaska's gas for sale on the world market. If another entity can market the gas it must be made available to them.

- *A condition of the merger should be an agreement to sell sufficient gas for an LNG project. This should include a commitment to sell to projects such as the Mayor's group port authority project (They have already made an offer to purchase the gas.) and others that produce* ***maximum*** *return to Alaska's treasury.*

According to state law and oil and gas leases the state is to get a 1/8 share of produced hydrocarbons as royalty. Although the oil companies have placed an economic value on Prudhoe Bay gas, Alaska cannot get access to its royalty share until it leaves the production unit.

- *A condition of the merger must be that Alaska can take its gas as it leaves the ground as a percentage of total wellhead gas production. This would allow the state to commit its gas to an LNG project such as the Mayor's proposal, which could provide significant revenue to the State, and a clean fuel to the communities.*

If the gas producers pursue a Gas-to-Liquids (GTL) project, this project will consume a large portion of the unit gas as fuel and losses during production. In this process, the royalty gas does not leave the unit and therefore the state gets no revenue.

*The state needs to determine the valuation of the state's gas and royalty either as the total feed to the GTL process or as the oil product leaving the GTL process. This has not to date been addressed by the state and could be settled as a part of the merger.*

September 22, 1999

Governor Tony Knowles
240 Main Street, Suite 300
Court Plaza Building
Juneau, AK 99801

**An Open Letter**
**To**
**Governor Tony Knowles**

Alaska cannot and will not be beholden to a Board of Directors in London or anywhere else. You have recognized that Alaska's citizens have a right to comprehend any agreement with British Petroleum before it is finalized. It is fitting that we, as the people's elected representatives, have an equal opportunity to determine if the principles necessary to protect Alaska's interests have been met. We request that you also submit any tentative agreement to the Legislature with reasonable time for our review, inquiry and comment, collectively if appropriate, before you finally agree to it.

Backbone

# Standing Up For **Alaska's** Future

Christy McGraw, Director

Senator Rick Halford
P.O. Box 670190
Chugiak, AK 99567

SEP 22 1999

September 16, 1999

Dear Senator Halford:

BACKBONE strongly encourages you to call yourselves in for a special session to address the BP's purchase of Arco and the future of Alaska's oil industry.

Additionally, we believe the first item on your agenda should be consideration of an anti-trust lawsuit to protect Alaska's interests. We feel that protection of our state's interests requires more than good faith bargaining sessions with BP's high-powered negotiators. An anti-trust lawsuit does not have to be a contentious, mean-spirited affair. It is simply the best way to slow this process down and ensure that irrevocable decisions are made carefully.

The Arco acquisition would give BP unprecedented control of Alaska's oil. BP would monopolize the Trans-Alaska Pipeline and leases and production facilities on the North Slope. This virtual monopoly will allow BP to indirectly control our state's budget, our employment levels, our real estate market – indeed our entire state.

In light of the enormous consequences implicit in this issue, we urge you to call yourselves in for a special session as soon as possible, pass a resolution urging the Governor to file an anti-trust suit, and then appropriate the requisite funds.

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The suit will be a wise investment in our future financial stability. We cannot afford to find ourselves years hence asking what we could have done differently in 1999 to protect Alaska's interests. We must do it now. Alaska's financial future and political independence are at stake.

Sincerely,

Christy McGraw, Director

Dear Legislator:

This is a critical time for action on the BP/Arco merger and a critical time to secure Alaska's future. Backbone is looking forward to the hearings of this week and to the report that will be issued by the Committee.

Members of Backbone including myself will be joining you for the testimony and opinions given by your consultants. We feel as does the FTC and members of your own body that there are too many questions that must be answered before you should feel confident in giving your approval of the Governor's Charter and endorsing the merger.

I am attaching two documents produced by Backbone this past week. 1) a letter to the FTC, and 2) the letter written by three past governors - Hickel, Hammond and Miller.

Both contain excellent perspective and may be of use to you.

Looking forward to seeing you on Tuesday. If there are any questions I can answer in the meantime, please feel free to call me at 907-243-4816.

Thank you for your time and attention to this matter.

Christy McGraw, Director

BACKBONE

# Standing Up For **Alaska's** Future

*Christy McGraw, Director*

January 16, 1999

Mr. Robert Pitofsky, Chairman
Ms. Shiela Anthony, Commissioner
Mr. Orson Swindle, Commissioner
Mr. Mozelle Thompson, Commissioner
Mr. Thomas Leary, Commissioner
Federal Trade Commission
600 Pennsylvania Avenue
Washington, DC

RE: BP Amoco Takeover of Arco, Inc.

Gentlemen and Ms. Anthony:

First of all, I would like to thank you and your excellent staff for the tremendous effort you have expended on the BP Amoco/Arco, Inc. merger. We appreciate all the time you have taken to talk with the many of us from Alaska who have journeyed to see you. Secondly, we appreciate your continued vigilance in securing merger conditions that will help to protect the future of Alaska. If this cannot be accomplished, we ask that you deny your approval and seek to enjoin the merger.

It seems apparent that Arco, Inc. now much stronger, will not need to merge with BP Amoco to survive, and **BACKBONE** believes that if the merger does not occur, the situation may present new opportunities for a stronger, more competitive oil and gas industry here in Alaska. Arco Alaska Inc. has always been a strong and competitive company with interests more closely aligned with the State of Alaska.

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In news articles of this past week, many are making reference to the fact that "Alaska approved the merger." I'd like to correct that mis-statement. Alaska did not approve the merger. Governor Tony Knowles did. **BACKBONE** polls during the merger process and after the public hearings show that Alaskans are opposed to this deal because it may make Alaska a "company state" controlled through a BP Amoco monopoly on its lifeblood - North Slope oil and gas revenues. This event comes at a time when Prudhoe Bay, once an "elephant," is on the decline. A monopoly that "warehouses" our assets and that does not fully develop Alaska's remaining oil and gas reserves will cripple our state in years to come.

**BACKBONE - Standing up for Alaska's Future,** a group of concerned Alaskans, has carefully reviewed Alaska Governor Tony Knowles' final merger agreement ("Charter for Development of Alaska's North Slope") with BP Amoco and finds it to be seriously lacking provisions and language that would assure that Alaska's interests are protected. As written, the Knowles Charter is insufficient, ambiguous and unenforceable.

Additionally, the Knowles Charter may in fact be illegal according to Alaska's constitution. One of our group has filed suit in state court alleging that the agreement confers powers that are not within the purview of the Governor, but reside with the legislature which was not a party to the agreement. In addition, **BACKBONE** thinks the time and process prescribed by the Governor for public scrutiny and input on this merger was unacceptably short and one-sided.

As you may know, Alaska is a unique state where its natural resources are owned by each of us. This deal, which will affect Alaska for many years to come, is much too important to be rushed through without understanding its impact. The Governor has so far failed to produce an understandable fiscal note to accompany his Charter that might give Alaskans an idea of the long term effects on the State's budget which is funded more than 70% through oil and gas revenues. Conversely, you can be sure that BP Amoco knows exactly what each acquisition or concession will cost.

**BACKBONE** has been a vocal critic of the Knowles Charter and the resulting monopoly of Alaska's oil industry. Since April it had done public education on six main areas of concern that reflect the diversity of the coalition of Alaskans that see this latest agreement as troublesome:

- ✓ Access to facilities and infrastructure on the Alaska's North Slope in order to assure an open and viable market for Alaska's independent oil producers.
- ✓ Access to the Trans Alaska Pipeline System that will ensure all producers a way to get their product to market.
- ✓ Competition in leasing and production that will assure maximum return on Alaska's resources and the continued development of best available technology.
- ✓ Commercialization of Alaska's vast natural gas resources, the most significant new source of revenue for State and community budgets.

- ✓ Environmental Impacts.

- ✓ Alaska jobs and social contributions.

While I realize that not all of our concerns are within the purview of the Federal Trade Commission, those issues that relate to monopoly power over our state are within your area of law enforcement. **BACKBONE** and its members have completed analyses and made recommendations in these areas. We have addressed some of the more intricate details of the merger including worldwide accounting and the TAPS Settlement Agreement. Elements of these have so far cost Alaska in excess of $5 billion. Copies of our reports have been delivered and discussed with Molly Boast and Joe Brownman of your staff and with Commissioner Swindle, his staff and staff of Commissioner Anthony.

Major points of disagreement with the Knowles Charter are:

- ✓ The Knowles Charter, as it stands, provides for divestiture that does not eliminate BP's monopoly position on production, facilities, or the TAPS pipeline.

- ✓ Even though Knowles called for a reduction in tariffs on TAPS, there is no provision of this Charter that deals with it. This is a barrier to future competition and has implications for the State's income on royalties and taxes that may be in excess of $20 million per year.

- ✓ The conditions for natural gas as established in the Charter allow BP Amoco to maintain control of the direction and schedule of gas development activities and therefore the delay of Alaska gas into the world market. This makes the Charter anti-competitive.

- ✓ This Charter does not deal with BP's previously stated commitment to invest in Alaska. A highly publicized $5 billion investment commitment along with an increase in production of 150,000 barrels per day, and a $40 million contribution to the University that were used as incentives at the outset have disappeared from the deal.

As a result, **BACKBONE** asked Governor Knowles to reopen negotiations and bring back a binding contract that assures Alaska's future – not a "Charter for Development" that only benefits BP Amoco. Instead, Alaska's Governor secured only minor changes to the Charter. As previously stated, **BACKBONE** conducted a statewide poll (copies forwarded to FTC staff) showing that a majority of Alaskans were not in favor or did not understand the terms of the agreement. We brought these results to the attention of the Governor, but to no avail.

As you may know, even though we have been successful in communicating our message to Alaskans, we have faced strong opposition from BP Amoco here in the state. We estimate they have outspent us about $65:1 in the media. Last week BPXA's Director of Governmental Affairs and the Director of the Support Industry Alliance were in Juneau aggressively lobbying for legislators to sign a letter in support of the deal at the behest of the Governor. This is in spite of two separate opinions from outside counsel hired by the Legislature's Joint Special Committee on Mergers stating that the merger should not proceed.

Lastly, BP Amoco has not increased production or exploration activity on the North Slope commensurate with the dramatic increase in oil price over the last 12 months. An independent observer might even deduce that, like so many kings of mideval times, BP Amoco laid siege to Alaska in order to secure our support. BP Amoco has stated that they cannot infuse capital into Alaska until the merger is completed. We might ask why this is the case, especially since oil prices are at their highest level since 1991. The effect of BP Amoco's self-imposed restrictions has been to reduce revenue to oil related industries and the State of Alaska. The Knowles administration, oil industry alliances and BP Amoco are using this as a means to push the merger through as quickly as possible and to demand state legislative support. Many Alaskans not tied to the oil industry view this as a classic symptom of monopolistic control and worry about how much more complete this control will be if the merger is allowed to continue.

With members of all political affiliations and socio-economic backgrounds including Democrats and Republicans, liberals and conservatives, environmentalists and development advocates, oil industry workers, investment managers, businessmen, lawyers, 5 former legislators and 3 former Governors, **BACKBONE** is currently Alaska's most politically diverse group since the struggle for statehood in 1959. And even though the merger was not covered in depth before August, Alaska newsmen and women voted the BP Amoco takeover of Arco, Inc. the most important issue for 1999. Alaskans are paying attention.

Gentlemen and Ms. Anthony, the people of Alaska are not unanimously in favor of the merger. The Governor, BP Amoco, Arco management, BP contractors and employees, and so far only 13 legislators, representing a small minority of the 617,000 Alaskans, have expressed support for the merger. The rest of us believe that the effective monopoly posed by BP's takeover of Arco, and in particular its Alaska assets as negotiated by Governor Knowles, presents a grave risk to Alaska's future.

We appreciate the long hours of intense work this merger has already taken and your willingness to pursue a just and equitable resolution. If we can be of further service, or provide additional information, please do not hesitate to call on me at any time.

Sincerely,

Christy McGraw, Director

**Walter J. Hickel Keith H. Miller Jay S. Hammond**
P.O. Box 101700, Anchorage, AK 99510

January 13, 2000

Mr. Robert Pitofsky, Chairman
and Members of the Federal Trade Commission
600 Pennsylvania Av. NW
Washington, D.C. 20580

Dear Chairman Pitofsky and Commission Members:

As former Governors of Alaska, this letter reflects our concern over the proposed BP-ARCO merger. All of us are keenly aware how hard Alaskans fought for Statehood and control over our own resources. With the ARCO buyout, Alaska stands to lose control of its most important resource and source of state revenues. Therefore, we urge you to amend or reject the takeover of ARCO by BP.

Alaska chose the path of competition as the way to ensure fair return in leasing, production, and transportation of our oil. By eliminating competition, the ARCO buyout jeopardizes Alaska's petroleum industry and funding for vital government services. Unlike other states where most petroleum resources are privately owned, Alaska's oil is on state lands and therefore Alaskans own our natural resources in common. The legislature and Governor have constitutional responsibilities to ensure that Alaskans receive maximum benefits from the development of our natural resources.

The crown jewel of the assets being acquired by BP through the takeover of ARCO is control over virtually all of Alaska's North Slope oil, which represents one fifth of America's domestic oil production. Competition for this oil and gas is critical for Alaska and for consumers in the Western U.S.

After decades being steamrolled by Outside corporate influences, Alaskans finally gained statehood in 1959. Framers of the Alaska Constitution were acutely aware of the importance of ensuring that Alaska's natural resource wealth could <u>never</u> be monopolized. The proposed ARCO acquisition is precisely the scenario foreseen by Congressional Delegate E.L. "Bob" Bartlett when he warned the Alaska Constitutional Convention in 1955. Today his words ring true and clear:

**"Development must not be confused with exploitation at this time. The financial welfare of the future state and the well-being of its present and unborn citizens depend upon the wise administration and oversight of these developmental activities. Two very real dangers are present. The first, and most obvious danger, is that of exploitation under the thin disguise of development. The taking of Alaska's mineral resources without leaving some reasonable return for the support of Alaska governmental services and the use of all the people in Alaska will mean a betrayal in the administration of the people's wealth. The second danger is that outside interests, determined to stifle any development in Alaska which might compete with their activities elsewhere, will attempt to acquire great areas of Alaska's public lands in order NOT to develop them until such time as, in the omnipotence and the pursuance of their own interests, they see fit. If large areas of Alaska's patrimony are turned over to such corporations, the people of Alaska may be even more the losers than if the lands had been exploited."**

Delivered 45 years ago, Bartlett's speech is prophetic. The elimination of competition through the BP merger will put the state in the exact situation that Bartlett, and the constitutional framers who took his advice, sought to avoid.

BP has been an outstanding corporate citizen in Alaska. It took leadership in the formation of the trans-Alaskan pipeline, and at the North Slope it has helped pioneer the most environmentally responsible oil field anywhere worldwide. But BP, like all companies, needs healthy competition. The FTC has received evidence demonstrating that the only real competition during the recent federal oil lease sale in May 1999 was between ARCO and BP. Without meaningful competition, BP can occupy and control the North Slope to the detriment of all potential competitors, the state treasury, and downstream consumers.

The Alaska Joint Legislative Committee on the merger released two independent legal opinions December 1, 1999, both indicating that the merger should be rejected. Much of the language contained within the proposed charter is not enforceable and there are no penalties.

The complete vertical integration achieved by the proposed merger cannot be matched or even challenged by another company, because the only serious competitor with similar vertical integration (ARCO) will be dissembled like a junked car. Since BP can choose its future "competitor," odds are that the new entrant will lack vertical integration possibilities. As a result, the merger virtually assures BP control over the pace of oil and gas exploration and development for three to five decades through operations, ownership, facilities sharing agreements, and leasing.

Increased monopoly share of the Trans-Alaska Pipeline and marine shipment of oil pose effective choke points against potential competitors. In summary, the takeover of ARCO by BP assures it such a dominant position that no other oil company could compete on anything resembling equal footing.

Please consider viable alternatives to the merger that benefit the State of Alaska, consumers on the West Coast and oilfield support services. These include the continuation of ARCO alone, the purchase of ARCO by some other company that does not eliminate competition for Alaska's oil and gas, or the purchase of ARCO's leases by the State of Alaska for re-sale to a viable competitor when the market is most favorable.

We rarely express our concerns jointly, but Alaska's future is too important to remain silent. Therefore, we three former Governors urge you to reject or amend this merger as it is presently framed. If you have any questions, or would like further information or clarification, please contact us. Thank you for your consideration.

Sincerely,


| | | |
|---|---|---|
| Walter J. Hickel | Keith H. Miller | Jay S. Hammond |
| 1966-1969, 1990-94 | 1969-1970 | 1974-82 |
| (907-343-2400) | (541-997-8318) | (907-781-2235) |

Subject: BP/Arco Merger
Date: Sun, 23 Jan 2000 18:03:06 -0900
From: "Christine A. McGraw" <backbone@alaska.net>

Dear Legislator:

Thank you for your attention to the BP Amoco / Arco, Inc. merger in last week's hearings. I appreciate being able to be with you and hear the analysis from all sides. It became even more clear that the decisions you make now regarding the merger are all-important to Alaska's future.

I hope you will encourage the Joint Special Committee on Mergers to issue a report and opinion that highlights its expert team's conclusion that a merger is not required to achieve the results claimed to be beneficial to Alaska. In addition, I made note of a few points that I would like you to consider as a legislator and the body responsible for maximizing return on Alaska's natural resources. They are as follows:

A. We heard a lot about the $140 million in potential savings from efficiencies gained in the merger. Along with that assertion is an implication that if we go for the merger and these savings, BP will be disposed to "re-invest" those savings - taken from Alaska in jobs, goods and services reductions - somewhere down the line in exploration and production in Alaska. There is no direct connection here. The Governor has secured nothing in terms of exploration or production investment in the Charter. Even when pressed by Senator Pearce, BP would not commit to any investment or production targets. Without commitments from BP, why should Alaska commit to endorse the merger? As pointed out in the hearings, these savings can be achieved without the merger and its resulting monopoly over Alaska's oil and gas.

B. There should be serious concern by the legislature that Governor's Charter will produce a net revenue loss to Alaska. The administration's "fiscal note" predicting no net loss as a result of the merger, is dependent on an increase in production. That increase in production is not assured in the Charter. If, for whatever reason, there is no increase in production, the State estimates a loss of $20 million per year in tax revenues. This may be the least of the losses and Alaskans are not protected from this or any others through the Charter.

C. No matter what the window dressing, the Charter still produces a monopoly over Alaska's oil and gas and therefore over Alaska's budget. The Governor apparently believes a monopoly is fine. Do you, as a legislator, want BP, in their monopoly control over state revenues, to dictate future public policy for Alaska?

D. In consideration for divesting certain Arco assets which brings BP's monopoly position to about 58% rather than the current 72%, the Governor's team have given up all rights to pursue BP under our own anti-trust laws. In addition, because the form of agreement is a "charter" and not a "consent decree" as is generally used in these cases, the burden of proof for any wrong doing or violation of the agreement is on the State of Alaska. This is another expensive concession to BP that impacts the rights of Alaskans and the fiscal integrity of the State.

This is by no means an exhaustive list of my concerns, merely the highlights. It seems clear that the Charter, in its final form, gives BP a monopoly and valuable concessions in exchange for little or no commitment to Alaska. Please support a strong stand against the Charter and vocalize your concerns to FTC at this critical time. They are listening and value your input.

Christy McGraw, Director
Backbone

FOR IMMEDIATE RELEASE: February 22, 2000
CONTACT: Christy McGraw - 907-243-4816 backbone@alaska.net

Alaskans not in favor of State's intervention in FTC suit to stop BP Amoco-Arco merger.

Anchorage: BACKBONE - Standing up for Alaska's Future, a group of Alaskans formed in response to British Petroleum's takeover of Arco, Inc., is today releasing its latest poll revealing that an increasing majority of Alaskans (64%) believe that the takeover Arco by BP Amoco will be bad for Alaska.

A significant majority (60%) of those polled (250 sample size +/-6%) oppose the State of Alaska taking BP's side in the anti-trust action mounted by the Federal Trade Commission, believe there will be less jobs for Alaskans (57%), less competition on Alaska's North Slope (79.6%) and less income to the State (43%) if the takeover goes ahead.

FTC's motion to oppose Alaska's intervention in this case is being heard today by Judge Susan Illston in the Northern District Court in California.

In their motion to oppose Alaska's intervention, FTC cites several points that include the following:

"Alaska found that the proposed merger, left unchecked, would violate the state's antitrust laws."

"Together the putative buyers would own substantially fewer assets than does Arco today."

Backbone's Analysis: In its motion to intervene, Alaska admits that the merger is against state law. Because the new buyers of formerly Arco North Slope assets would own "substantially fewer assets than does Arco today" the merger would increase BP Amoco's monopoly and serve to even further lessen competition.

FTC states "Alaska's motion broadly asserts three grounds for intervention: 1) it has a contractual interest in its settlement agreement; 2) it has a substantial economic interest in petroleum production; and 3) it has information and expertise"

"An antitrust plaintiff or potential plaintiff that reaches a settlement with a defendant has not antitrust standing or other legally protectable interest in opposing the efforts of another antitrust plaintiff."

"Alaska's settlement is by its terms a compromise and like all settlements, indicates nothing save the relative bargaining skills of the settling parties."

"Alaska's settlement cannot dictate the outcome of this proceeding. [This proceeding does not] review, set aside, or vindicate the Alaska settlement. It does not call upon the Court to decide whether Alaska has entered into a good deal, or a very bad deal."

"But no matter how great those benefits are, they do not trump the federal antitrust laws or otherwise justify an anticompetitive merger."

"Alaska could have maintained its own action as a plaintiff to protect that interest. Alaska, however, chose not to litigate, but to compromise its claims."

Backbone's Analysis: Contrary to the media spin on the charter, FTC asserts that Knowles contractually gave up all rights to participate in the proceedings. Alaska's settlement can have no bearing on the outcome of FTC's action. Even though there are unenforceable provisions in the charter that may benefit environmental and social issues in Alaska, these provisions do not change the fact that it may be an unlawful merger. The Knowles administration chose to compromise our claims and settle rather than litigate to uphold state laws.

"Alaska's interests in this proceeding are fully represented by defendants."

"[Alaska] admittedly has the same objective as the defendants in this proceeding nor could it [show any adversity of interests between it and the defendants] given the provisions in the Charter by which the defendants have agreed to pay for Alaska's legal expenses."

"By settling with the defendants, [Alaska] has forgone any possibility of asserting any claim in this action."

"Count II of the Commission's complaint in this proceeding asserts that "BP and Arco are the two most important competitors in bidding for exploration leases for oil and gas on lands owned by the State of Alaska; and that The effect of the proposed merger, if consummated, may be substantially to lessen competition in bidding for leases on state and federal properties on the Alaska North Slope. The proposed merger will also raise the already formidable barriers to entry in the North Slope bidding market and enhance the incentive and capability of BP to reduce the pace of exploration and development and ultimately the amount of crude oil produced."***

Backbone's Analysis: FTC asserts that the Knowles administration, through compromising its objective status by taking legal fees from BP, and through settling its claims by signing an agreement with the defendants, has allied its interests strictly with BP Amoco and therefore has no other interest in these proceedings.

FTC's complaint clearly recognizes the potential for BP Amoco's increased monopoly to "warehouse" Alaska's resources. One has only to note the lack of mention of Alaska in a speech last week by Sir John Browne to his shareholders to realize where Alaska sits in the hierarchy of resources important to BP Amoco.

Three former Governors of Alaska and three former Senate Presidents expressed their concerns in January with letters to FTC Chairman Robert Pitofsky. They cited the "inevitable restraint of trade" that will result from this combination and the effects of monopoly ownership of Alaska's oil and gas as well as effects on downstream competition including California consumers as imperatives for stopping the merger.

BACKBONE has been a vocal critic of BP Amoco's pending takeover of Arco, Inc. and the resulting monopoly of Alaska's oil industry and remains opposed to a merger agreement that establishes a monopoly over production, facilities, pipelines, natural gas, and tanker shipping and remains concerned about the following points:

A. The highly touted $140 million in potential savings to BP Amoco from "efficiencies" gained in the merger - taken from Alaska in jobs, goods and services reductions - has no direct connection to commitments to Alaska. BP has not committed to any investment or production targets that would assure a healthy oil and gas industry in the future. With a once again healthy Arco, Inc., these savings can be achieved without the merger and its resulting monopoly over Alaska's oil and gas.

B. Governor Knowles'Charter agreement with BP Amoco may in fact produce a net revenue loss to Alaska. The Knowles administration's "fiscal note" predicting no net loss as a result of the merger, is dependent on an increase in production. That increase in production is not assured in the Charter. If, for whatever reason, there is no increase in production, this sketchy analysis estimates a loss of $20 million per year in tax revenues.

C. No matter what the window dressing, the Knowles Charter still produces a monopoly over Alaska's oil and gas and therefore over Alaska's budget. Even though Governor Knowles apparently believes a BP Amoco monopoly is good for Alaska, BP, in their monopoly control over state revenues, must not be allowed to dictate future fiscal, and thereby public policy for Alaska.

D. State and FTC negotiations with BP Amoco have centered on divestiture of Alaska's oil production and operation facilities, but no mention has been made of divestiture of Alaska's natural gas resources. Arco's share of natural gas must be divested along with the other Arco Alaska Incorporated assets in order to eliminate the pending monopoly and preserve competition.

With members of all political affiliations and socio-economic backgrounds including Democrats and Republicans, liberals and conservatives, environmentalists and development advocates, oil industry workers, investment managers, businessmen, lawyers, and former legislators and Governors, BACKBONE is currently Alaska's most politically diverse group since the struggle for statehood in 1959. It believes that the effective monopoly posed by BP's takeover of Arco presents a grave risk to Alaska's future. BACKBONE has lobbied the Alaska State legislature, the Federal Trade Commission, the Alaska delegation, and the Knowles Administration to take action to protect Alaska's interests since the announcement of the merger in early April.

THE FOLLOWING PAGES MAY NOT FILM LEGIBLY BECAUSE OF THE POOR QUALITY OF THE ORIGINAL

# Alaska Public Information about the BP Amoco and ARCO Merger Introduction

## Purpose of this Web Site

This internet site provides the public with information regarding the proposed merger of BP Amoco and ARCO. The purpose is to counterbalance a one-sided media campaign both companies are pitching to Alaskans. BP and ARCO's expensive ads only tout the positive impacts of their merger. These ads often present misleading information and do not disclose the many negative consequences for Alaska. This internet site contains research results and analysis of historical data relating to BP Amoco and ARCO operations in Alaska. All information contained here is available from public records that BP and ARCO prefer the public did not see.

Recent survey results show only 22% of Alaskans favor the proposed merger. Forty-two percent oppose the merger and 36% have no opinion. With such a large group having no opinion, this implies people simply do not understand the true impacts of this merger on Alaska. This internet site provides information to help educate Alaskans about the real issues pertaining to the pending merger of these two oil giants and its likely impacts.

## Introduction

The pending purchase of ARCO by BP Amoco for $26.7 billion has caused a great deal of concern within the State of Alaska. The decision by ARCO to sell itself to BP Amoco will certainly have major economic, social and political consequences for Alaskans. The merged company will pay taxes totaling almost 75% of Alaska's general state budget. No other state will be tied so intimately to a single company for their primary source of revenues. No other company will have the potential to control a state's revenues the way BP Amoco can control Alaska's if this merger is approved. Citizens and state lawmakers have begun to voice their concerns about the merger's impact on state revenues. One Alaska legislator said, "We are in nothing less than an epic battle to control our own economic destiny."

The primary reason for concern is the fact a combined BP Amoco-ARCO company will own an overwhelming majority of Alaska's petroleum resources. They will become the sole operator of all oil fields on the North Slope of Alaska. BP Amoco will have a 72% ownership in the trans-Alaska pipeline. They will own controlling interests in every pipeline that feeds oil into the trans-Alaska pipeline. The merged company will own 50% or more of every producing oil field on the North Slope. They will own mineral rights to 870,000 acres covering some of Alaska's best prospects for future oil fields. British Petroleum will, quite literally, control the current and economic future of Alaska's oil.

Alaska Governor Tony Knowles has appointed a team of his top officials including Attorney General Bruce Botelho, Revenue Commissioner Wilson Condon, Natural Resources Commissioner John Shively, and the head of his Washington, D.C. office, John Katz to review implications of the purchase. Davis Boies, one of the U.S. Justice Department's leading antitrust lawyers, has been hired by Botehlo to evaluate the takeover and advise the state on how best to protect its interests. Alaska Senator Frank Murkowski held hearings before his U.S. Senate Energy and Natural Resources Committee to study impacts from this buyout and implications beyond Alaska. Hopefully, he will plan more hearings to get straight answers about the mergers true impacts. The Attorney Generals and antitrust officials from California, Oregon and Washington state will also review the sale.

The Alaska Legislature hired two law firms to help them study antitrust laws this merger may violate. Legislative hearings have already been held to discuss the impacts on Alaska from this proposed merger and more are scheduled. Unfortunately, these hearings are not scheduled to occur until the Legislative Session in 2000. BP Amoco plans to close the ARCO deal before Alaskans and their elected officials have an opportunity to fully review impacts of this merger. BP Amoco's eagerness to close the deal quickly is primarily driven by corporate greed. In the most likely event, Alaska lawmakers will not be given a chance to voice their official concerns until after the merger has likely closed.

Several former Alaska Governors and Attorney Generals are calling on a special legislative session to review the deal. They have helped organize a citizen panel named Backbone: Standing Up for Alaska's Future" to help Alaskans speak up with their questions. Many Alaskans worry, with good reason, about criticizing the deal publicly because they might not be given the opportunity to work for British Petroleum in the future. Perhaps that is the reason few Alaskans and even fewer elected officials are standing up for Alaska's future.

Other civic action, consumer protection, and environmental groups have expressed concern and are encouraging the public and elected officials to take a critical look at the merger. Some of these groups include:

- Ralph Naders' Center of Study of Responsive Laws
- Consumer Project on Technology Group
- Alaska Conservation Alliance, a coalition of 33 groups and businesses.
- Alaska Public Interest Research Group
- Alaska Forum for Environmental Responsibility
- Alaska Conservation Foundation
- Alaska Injured Workers Alliance
- Oil Watch Alaska
- Greenpeace

ARCO's sellout to BP Amoco is presently under review by the Federal Trade Commission who can block part or all of the merger. However, the FTC is allowing Alaska to take the lead in identifying concerns the state may have.

# *Background Information*

## Background

The North Slope of Alaska is a large expanse of almost treeless tundra north of the Brooks Range Mountains and above the Arctic Circle. This broad plain dips gently to the north and hence the name North Slope.

**View of the North Slope of Alaska**

The North Slope of Alaska is one of the most prolific petroleum producing areas in the world. It contains 30% of U.S. oil reserves, 21% of gas reserves, and accounts for 22% of all the oil produced in the U.S. every day. Prudhoe Bay and Kuparuk are the two largest oil fields in North America and four out of the top ten producing fields in the U.S. are located on Alaska's North Slope. The map in Figure 1 shows the location for most of the North Slope oil fields.

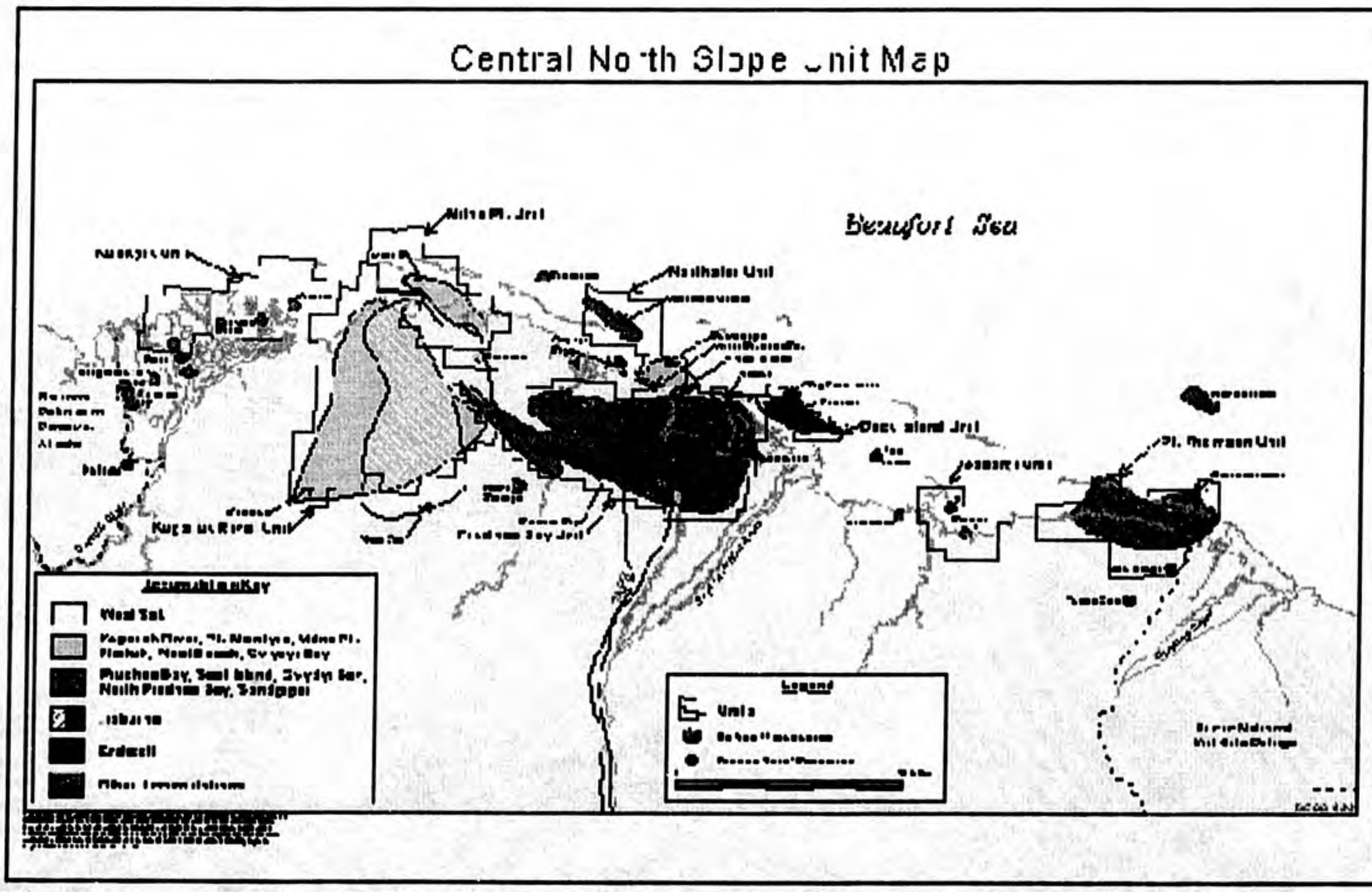


**Figure 1**. Alaska Dept. of Natural Resources map showing major North Slope oil fields.

The merger of Alaska's two largest oil producers will create a "supermajor" oil company. The combined BP Amoco-ARCO company will possess the largest oil reserves of any non-state owned oil company in the world. As shown in Figure 2, they will become the world's largest producer of oil and second largest producer of natural gas.

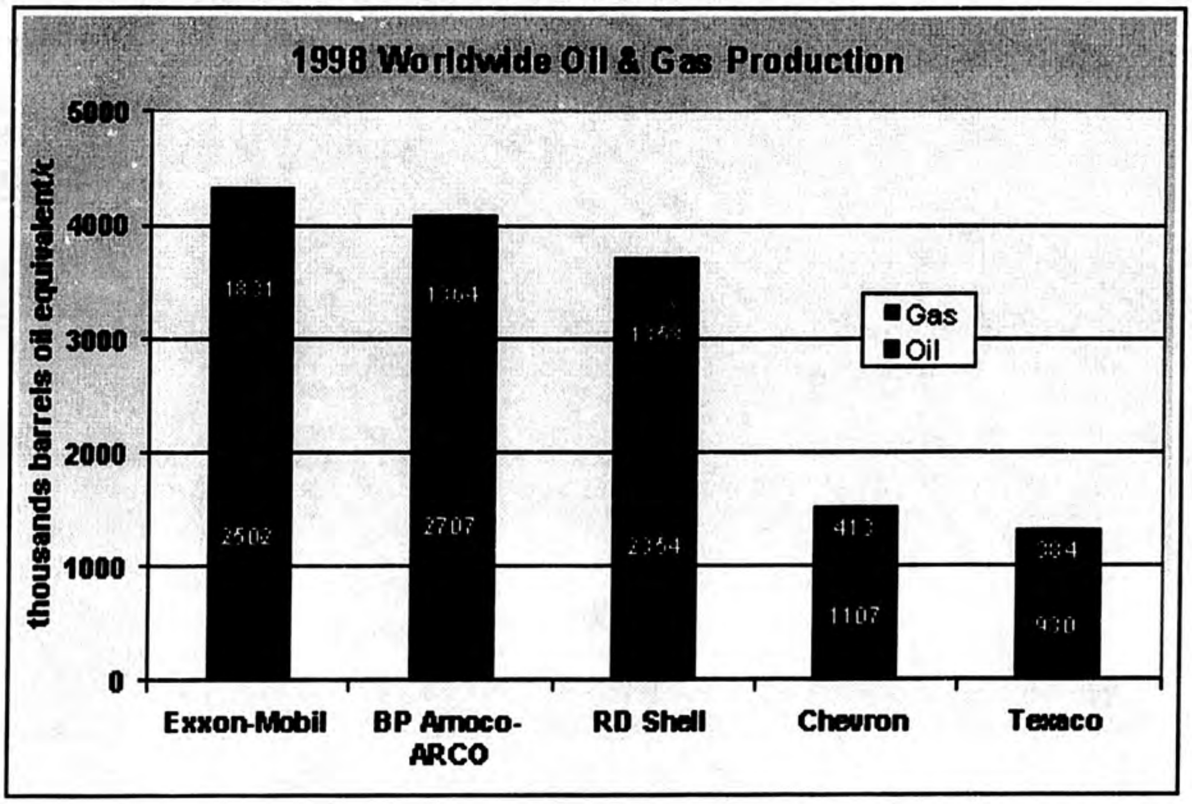


**Figure 2.** The combined BP Amoco- ARCO daily hydrocarbon production position.

Figure 3 shows BP Amoco-ARCO will be the largest oil producer in the United States supplying over 30% of the daily domestic production. This foreign owned company will become the dominant U.S. oil producer. They will be roughly three times larger than their nearest competitors with the exception of Exxon. Once BP Amoco buys ARCO, they will produce 35% more oil than Exxon.

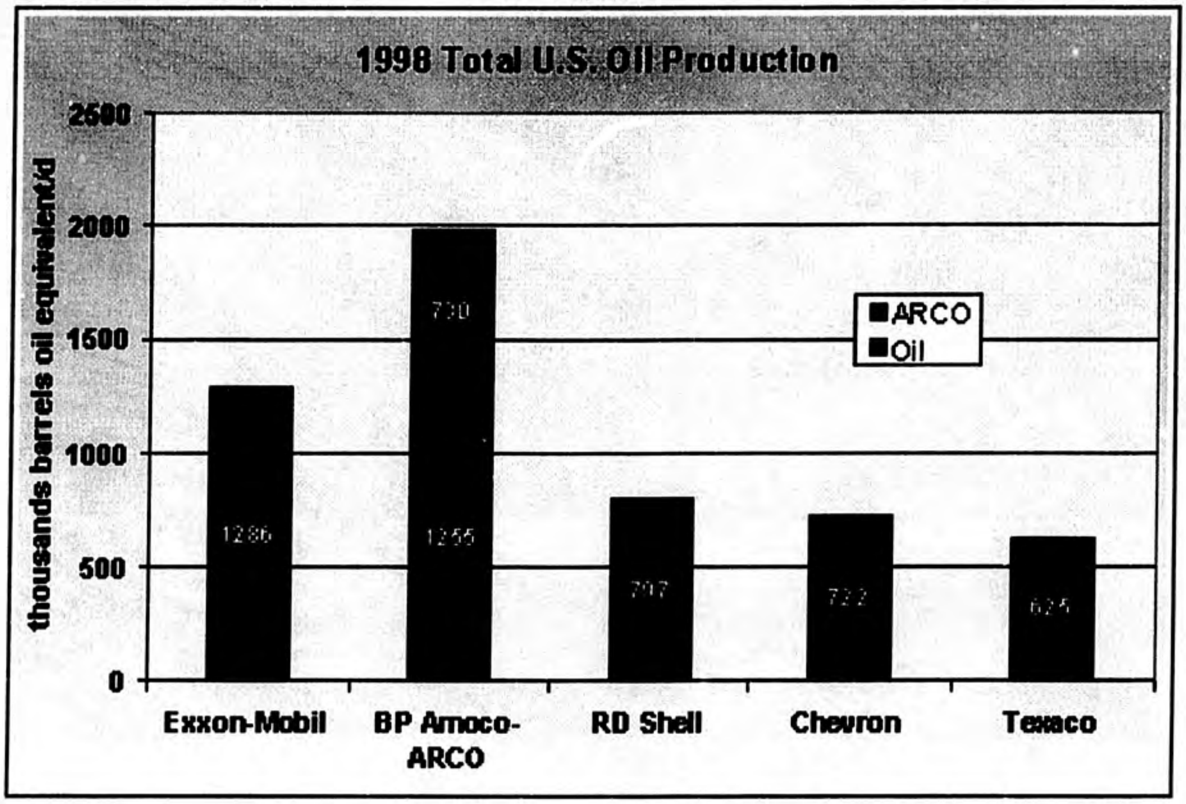


**Figure 3.** Major oil company daily U.S. production.

## *Relevant Facts*

The following listing contains facts about the Alaska oil industry and what impacts this merger will have.

- The U.S. Geological Survey estimates Alaska contains 30% of the nation's proven oil reserves, 21% of the proven gas reserves, 57% of the nation's undiscovered oil reserves, and 37% of the nation's undiscovered gas reserves.
- The U.S. Energy Information Administration reports that Alaska produces 22% of all oil in the United States.
- If the buyout is approved, BP Amoco will own approximately 75% of all the oil fields in Alaska as is shown in Figure 5 below.

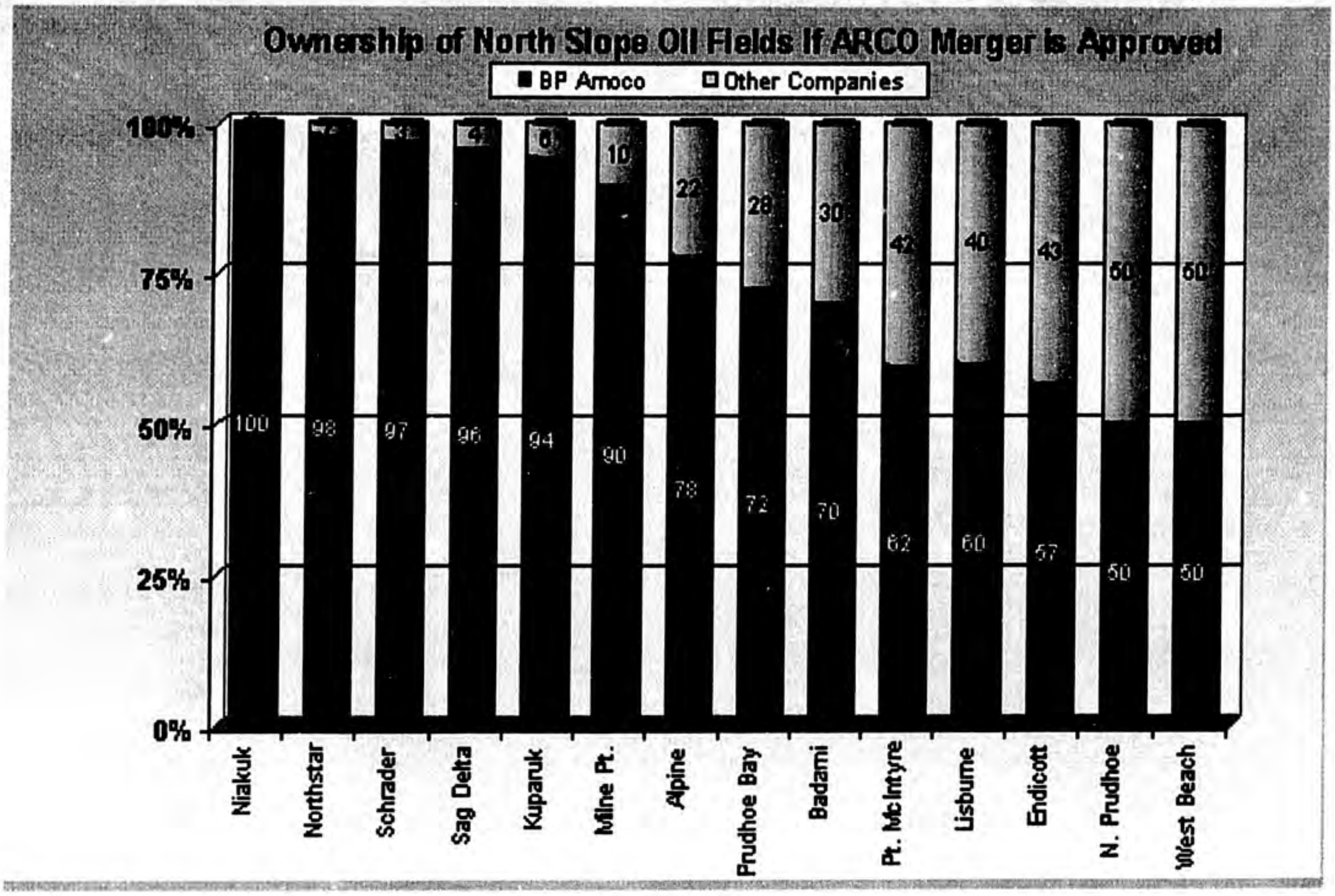


**Figure 5.** The BP Amoco-ARCO merged ownership of Alaska oil fields.

- BP Amoco will be the sole operator of all producing oil fields on the North Slope.
- BP Amoco will dominate and control Alaska's pipelines used for transporting oil to the U. S. market.

  BP will own 72% of the Trans-Alaska Pipeline.

  BP will own 92% of the Kuparuk Pipeline.

  BP will own 91% of the Milne Point Pipeline.

  BP will own 100% of the Alpine and Oliktuk pipelines.

  BP will own 60% of the Lisburne and Pt. McIntyre pipelines.

  BP will own 100% of the Niakuk pipeline.
- BP Amoco will own and control 73% of the North Slope oil tanker fleet capacity.
- BP Amoco will supply 34% of the crude oil to the U.S. West Coast market. This market share is large enough that BP has the ability and potential to influence gas prices.
- BP Amoco will own 870,000 acres of mineral leases which violates Alaska state regulations prohibiting a single company from owning leases on more than 500,000 acres.
- BP Amoco, a foreign company, will own interest in 87% of oil leases in the National Petroleum Reserve-Alaska. NPR-A was established by Congress for national security purposes.

- Since 1992, the combined expenditures of BP and ARCO have accounted for 70% of the total dollars spent at North Slope lease sales held by the State of Alaska.
- During the last seven years ARCO and BP have operated over 90% of the exploration wells that were drilled on the North Slope.
- Over the last seven years, ARCO has operated approximately twice as many exploratory wells as BP.
- Since 1992 ARCO and its partners have spent almost 350% more at State of Alaska lease sales than BP and its partners have spent.

## *Can BP and ARCO be Trusted to Equitably ManageAlaska Petroleum Resources?*

The combined BP Amoco and ARCO company is expected to have revenues of over $100 billion and make $10 billion in profit every year beginning in the early parts of the next century. BP Amoco expects this merger will save over $200 million each year just in Alaska. These companies primary business goal in Alaska right now is to prevent changes to the proposed merger terms and minimize any concessions so they can protect these huge profits. They have already begun a major public relations campaign in Alaska touting the benefits of their merger. Both companies have refused to disclose how much they expect to spend on advertising dollars in Alaska to try and sway public opinion.

Most public information provided by these companies is biased toward what is in the best interests of their company. They have provided no information, or entered into any meaningful dialogue regarding the negative consequences to Alaska and U.S. consumers if this merger is approved. It is important everyone has access to all information as they try to understand the consequences of this merger. We can not rely only on the judgement of these oil executives to do what is right for Alaska or consumers. Indeed, the oil business is so complex even oil executives have difficulty forecasting the wisdom of their decisions. This is easily demonstrated with the following three examples.

**Example 1**. Earlier this year when oil was selling for $9/barrel, Richard Campbell, president of BP Exploration predicted oil prices would remain depressed for another two or three years. Campbell said, "The issue from my perspective is that low price is not something we're going to see an end to in the short-term." This pessimistic price forecast led BP Amoco to severely reduce their budget by 43%, layoff 600 employees in Alaska, and idle over half the drilling rigs on the North Slope. Yet, Figure 4 shows BP's own posted average price for Alaska North Slope crude has been below $10/barrel for a total of only three months since 1983 and has never sold for less than $14/barrel for longer than nine consecutive months.

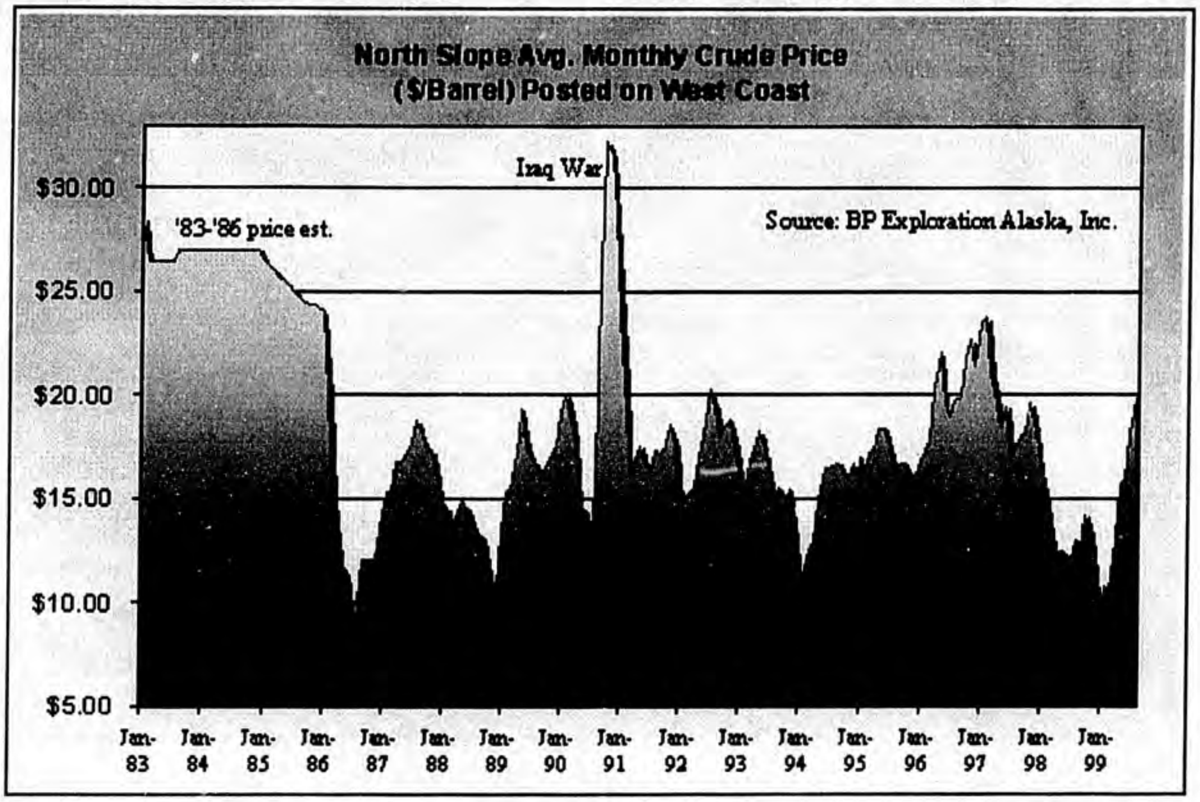


**Figure 4**. BP's monthly average crude oil prices on the U.S. West Coast.

After BP Alaska's president made his prediction in March the price of oil has more than doubled to over $20/barrel today (click here for current price). Figure 4 shows there was no factual basis for Mr. Campbell to predict oil prices would remain at historic lows for two or three years. BP Amoco and other major oil companies have used these temporary low oil prices as an excuse for consolidating and cutting costs so they can make huge profits. Figure 4 also illustrates the dramatic oil price decline since early 1997 to its near record low at the beginning of 1999. This period of low oil prices placed unprecedented pressure on oil companies to improve their efficiency in order to remain highly profitable. The continual pressure by stockholders to increase profits, become more efficient, and cut costs has contributed to rapid consolidation among oil companies. This may be good for stockholders but it has not yet been proven this is good for Alaska or consumers.

**Example 2**. When ARCO bought Union Texas Petroleum, they claimed it was a good deal for stockholders. Now ARCO claims their merger with BP is good deal for Alaska. But, did the UTP deal turn out to be a good one? In June 1998, ARCO's CEO Mike Bowlin completed a deal to purchase UTP for over $3.4 billion. The $29/share price was a 41% premium over UTP's closing price on May 1, 1998. Since UTP had about 577 million barrels of hydrocarbon reserves, simple math reveals ARCO paid $5.89/barrel for UTP's reserves. Nine months later Bowlin agreed to sell ARCO and UTP's combined 4.7 billion barrels of reserves for $26.7 billion, or $5.68/barrel.

If Bowlin had sold ARCO's reserves for the same price he was willing to pay for UTP's, the sale would have netted nearly $1 billion more for ARCO shareholders. In any case, the $5.68/barrel selling price to BP Amoco represents a loss to ARCO shareholders on the UTP reserves of over $120 million in just 7 months. This is not a trivial loss when compared to ARCO's 1999 first quarter earnings of $165 million. Either Mr. Bowlin values his own company's hydrocarbons less than he does UTP's or he failed third grade math.

When Bowlin approached BP Amoco about selling out ARCO, the price of oil was about $10/barrel. With the current price of oil around $23/barrel, Bowlin's decision to sell ARCO when oil prices were near record lows, will go down in history as one of the worst decisions by any executive of a major