

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

1027 SCOMM 28: JOINT GAS PIPELINE COMMITTEE. 1981-82

1 be an expense charged against their income - that reduces
2 the reserves tax amount payment in the fiscal year by
3 \$14 million. So the new income tax that would be paid
4 under Chapter 21 is \$787 million. The combined revenue
5 787 plus 594 - right up here, the reserves tax and the
6 income tax - comes to \$1.381 billion. Applying - I don't
7 know if you can see this - but applying the retroactive
8 warts and the retroactive windfall profit tax credits
9 that would be allowed, that knocks it down to \$1.142 billion.
10 That's exactly what we're trying to match - \$1.142 billion.
11 This is the income stream under the present law. So this
12 is the net income stream we get under the new law if
13 you apply this millage. And the revenue change is zero.
14 The same calculations that are worked out for these
15 (indisc.)--you can see that 29.65, 29.04, 23, and 20.72
16 work out to have no revenue effects given these assessed
17 values. It neither raises nor lowers the tax. Now, the
18 assessed values, of course, may vary as time goes by
19 from year to year. They may well not come out at these
20 particular levels. The point is to show that it need not
21 result in either an increase or a decrease in the tax
22 liability of the oil industry. But can, in fact, be
23 fine tuned to eliminate any change in their liability.

24 MR. RAY:

25 Any questions from any members of the Committee? Senator?

1 MR. DANKWORTH:

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

7 COMMISSIONER WILLIAMS:

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

22 MR. DANKWORTH:

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

1 COMMISSIONER WILLIAMS:

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

9 MR. RAY:

10 Are you finished, Senator?

11 MR. DANKWORTH:

12 Thank you.

13 MR. MALONE:

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

17 COMMISSIONER WILLIAMS:

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

25 MR. MALONE:

Thank you, Mr. Chairman.

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1 MR. DANKWORTH:

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

6 COMMISSIONER WILLIAMS:

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

8 MR. DANKWORTH:

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

13 COMMISSIONER WILLIAMS:

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

16 MR. RAY:

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

19 COMMISSIONER WILLIAMS:

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

22 MR. RAY:

23 I see.

24 COMMISSIONER WILLIAMS:

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

1 unless these assessed values were significantly lower.

2 MR. RAY:

3 Please continue.

4 COMMISSIONER WILLIAMS:

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

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

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

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

14 MR. RAY:

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

17 COMMISSIONER WILLIAMS:

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

1 rather than cash base of accounting, to use accruals.
2 They don't have to gin up a special set of books for our
3 tax. In fact, we don't want specially ginned up books -
4 we'll take the real books. So we'll look at their
5 business the same way they look at their business themselves.
6 So this allows accrual taxpayers to stay on the accrual
7 basis. So the same thing is true on line 13 and
8 again on page 3, line 4. The section on page 3 between
9 lines 8 and 26 relates to the interest expense. Right
10 now there is an absolute limit on the allowable interest
11 that may be deducted. This limits the interest that may
12 be deducted to interest incurred with respect to
13 Alaskan investment instead of investment anywhere, and
14 it allows the limitation -- there's a presumption about
15 a limitation, but it allows it to be rebutted where the
16 taxpayer can show that it's actually got more interest.
17 It also allows the taxpayer to include interest expense
18 where the parent, where the taxpayer is a subsidiary and
19 where the parent actually did the borrowing on behalf of
20 the subsidiary instead of the subsidiary doing it itself.
21 It's a rather technical point. Again, on page 4, section
22 9 which starts on line 3 - it's a similar sort of item
23 there. There's a limitation in the present law on general
24 overhead or administrative expense that may be deducted.
25 This replaces that absolute limitation with a presumption -

1 the presumption is provided for in new subsection (f)
2 which comes in a few pages. The new deduction number 10
3 is for the deduction of the income that is shared under
4 section 7(i), revenue sharing. That is to say, this
5 70% is a deduction from this gross income of this region
6 which, of course, is consistent with the notion that this
7 70% is going to be taxable income to the recipient.
8 That's all that number 10 does. Number 11 allows for a
9 deduction for the actual reserves tax that is paid -
10 reserves tax over and above the amount of the credit that
11 is allowed against it. So actual payment of reserves tax
12 is a cost and it is allowed as a deduction. Section 12
13 would allow the windfall profit tax.

14 MR. MALONE:

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

20 COMMISSIONER WILLIAMS:

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

23 MR. MALONE:

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

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

3 COMMISSIONER WILLIAMS:

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

22 MR. MALONE:

23 Thank you, Mr. Chairman.

24 MR. DANKWORTH:

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

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

4 COMMISSIONER WILLIAMS:

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

8 MR. DANKWORTH:

9 Thank you.

10 COMMISSIONER WILLIAMS:

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

19 MR. DANKWORTH:

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

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1 COMMISSIONER WILLIAMS:

2 I can quickly hunt it up here.

3 MR. DANKWORTH:

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

9 COMMISSIONER WILLIAMS:

10 Through that period, the industry would pay approximately
11 \$18.75 billion of windfall profit tax. So that would
12 be a deduction in that amount. It would reduce their
13 income by that amount and our tax rate at 9.4% of that.
14 So it would be about, I'd say \$1.8 billion - plus or
15 minus \$20 or \$30 million. But I'd say \$1.8 billion is
16 close.

17 MR. DANKWORTH:

18 If we had decided that that was an unfair tax and wasn't
19 intended, and we didn't charge it, then we would, by
20 setting that straight, we would have to give up about
21 \$1.8 billion.

22 COMMISSIONER WILLIAMS:

23 That's what you would reduce it by.

24 MR. DANKWORTH:

25 ... if we continued to have Chapter 21.

1 COMMISSIONER WILLIAMS:

2 That's correct.

3 MR. DANKWORTH:

4 Thank you, Mr. Chairman.

5 MR. RAY:

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

10 COMMISSIONER WILLIAMS:

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

13 MR. RAY:

14 Go ahead, sir.

15 COMMISSIONER WILLIAMS:

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

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

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

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

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

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

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

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

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

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

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

1 there designed to preserve the cash flow so that we don't
2 shift income from next year into 1984 and '85. It keeps
3 it spread through the 4 years more or less evenly. And
4 that's what section 12(b) does. Section 13 provides
5 for a transition rule that 30 days after the effective
6 date of the reserves tax the initial returns on the
7 property reporting the taxable property are due. And that
8 60 days after the effective date of the reserves tax the
9 Department's assessment notices are due to be issued.
10 The rest of the schedule, or the rest of the timetable set
11 out in the reserves tax we should be able to meet - the
12 February 1 deadline for certifying the roll, the March 15
13 deadline for sending out the bills -- that we should be
14 able to meet those without any problem. Section 14
15 repeals 2 sections in the Chapter 21 income tax. It's
16 a technical change. It removes the warts, and it's to
17 be consistent with changes that are made elsewhere in this
18 law. And then Section 15 provides for repeal of certain
19 provisions on the severance tax, and for the repeal
20 of the existing sections of the reserves tax that are on
21 the books. And that's it. Section 16 is for retroactive
22 dates on certain sections.

23 MR. RAY:

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

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

11 COMMISSIONER WILLIAMS:

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

15 MR. RAY:

16 Thank you.

17 MR. DANKWORTH:

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

20 COMMISSIONER WILLIAMS:

21 I'm through testifying on this bill, yes.

22 MR. DANKWORTH:

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

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

8 COMMISSIONER WILLIAMS:

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

10 MR. DANKWORTH:

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

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

11 MR. RAY:

12 It's all right with me.

13 MR. DANKWORTH:

14 Thank you.

15 MR. RAY:

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

18 MR. DANKWORTH:

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

20 MR. RAY:

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

24 MR. DANKWORTH:

25 I was reacting to yours, sir.

1 MR. RAY:

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

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

8 MR. DANKWORTH:

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

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

4 MR. RAY:

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

8 MR. GARDINER:

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

11 COMMISSIONER WILLIAMS:

12 Risks in a settlement?

13 MR. GARDINER:

14 Yes. Is the settlement risk free?

15 COMMISSIONER WILLIAMS:

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

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

15 MR. GARDINER:

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

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

3 COMMISSIONER WILLIAMS:

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

18 MR. DANKWORTH:

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

1 we pass the bill, Senate Bill 524, we are sure going to
2 get sued. I mean, there's not the risk of that -- it's
3 pretty obvious. You've said so yourself. But aside from
4 that, I'd like to get to the question of, just out of my,
5 own curiosity, how many states presently do allow a
6 deduction for windfall profits tax? Do you know?

7 I know Minnesota and California have recently followed
8 Alaska's lead, somewhat, or perhaps they didn't, maybe
9 they weren't following our lead - but I believe now that
10 they've said that they would not allow the deduction.

11 Do you know if there is any other states that ...?

12 COMMISSIONER WILLIAMS:

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

15 MR. DANKWORTH:

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

18 COMMISSIONER WILLIAMS:

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

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

8 MR. DANKWORTH:

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

11 COMMISSIONER WILLIAMS:

12 To my knowledge at this time.

13 MR. DANKWORTH:

14 Thank you.

15 MR. RAY:

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

23 MR. DANKWORTH:

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

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

9 MR. RAY:

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

11 MR. DANKWORTH:

12 All right.

13 MR. GARDINER:

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

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

6 MR. RAY:

7 Well, it seems to me I remember when we were first
8 considering oil taxation and there were a lot of us at
9 that time that wanted just to take the simplest procedure
10 possible and eliminate all the transportation costs,
11 and figuring this and figuring that, and just say every
12 barrel of oil that popped out of the ground -- Alaska
13 got so much and the oil companies could do with it what
14 they wanted with the rest of it. But that wasn't
15 satisfactory with the oil companies because they had a
16 different way of going at it. And they won that by a
17 very slim margin. And I just want to tell them, see if
18 you had went with us on that we would have never been in
19 this mess now. So really you have only yourselves to
20 blame for being in this spot. I think that it's about
21 4:30. Truthfully, fellas, a lot of us have been here and
22 have other ideas and other things that we have to work on,
23 and I'm certainly -- want to give the oil representatives
24 the complete time but in order -- but to start you
25 out now, I wouldn't be fair to you. So if it is agreeable

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

7
8 (meeting adjourned 4:30 p.m. June 11, 1981)
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C E R T I F I C A T E

STATE OF ALASKA)
: SS.
FIRST JUDICIAL DISTRICT)

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

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

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

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

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

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1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE
2 FREE CONFERENCE COMMITTEE ON SENATE BILL 524
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6 TRANSCRIPT OF PROCEEDINGS

7 JUNE 22, 1981
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16 COMMITTEE PRESENT:

17 Senator Bill Ray, Chairman
18 Senator Ed Dankworth
19 Senator Don Bennett
20 Representative Terry Gardiner
21 Representative Rick Halford
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23
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P R O C E E D I N G S

6/22/81

1
2 MR. RAY:

3 Free Conference Committee on Senate Bill 524, come to order
4 please. The discussion that we had, and I should apologize
5 to the witnesses for keeping you so long, but the demands of
6 the adjournment of the legislature in trying to get things
7 going, I felt that you had as much interest as you needed
8 in this or that you would be available when we took it up
9 again. The discussion that we had during the last meeting -
10 I think you were all here - we were discussing -- we have
11 heard the testimony of Commissioner Williams and you people
12 from the industry requested to give your testimony and so
13 I would ask W. Monte Taylor, would you like to come forward,
14 sir, and discuss whatever you would care to discuss about
15 524?

16 MR. TAYLOR:

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

19 MR. RAY:

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

22 MR. TAYLOR:

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

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1 for Alaska Operations. I appreciate the opportunity to
2 present our views on this issue and I will develop, in this
3 testimony, the fact that we have a limited opportunity to
4 resolve -- in an equitable manner -- a major issue facing the
5 state and the industry. Some days ago, I joined other oil
6 company representatives, as well as a number of Alaska
7 citizens not affiliated with the oil industry, in testifying
8 before the Joint Gas Pipeline Committee against the adoption
9 of SB 524, then identified as sponsor Substitute for House
10 Bill 200. At that time I commented that this bill did not
11 solve the problem at hand and that it would only invite
12 further litigation. I also noted that the bill would
13 simply be a disguised tax increase, something most Alaskans
14 do not favor, and would build instability into the tax
15 system while assuring an annual confrontation between the State
16 and the industry. Changing the number on the bill, to
17 524, has not changed its provisions or its effects. The bill
18 is still not in the best long-term interests of the state,
19 it's people, or the oil industry. Despite what some may say,
20 the backstop bill is not risk free -- not only does it carry
21 the legal and the economic risks of additional lawsuits,
22 but it endangers any future settlement of this issue. It
23 certainly does not enhance the state's negotiating position.
24 As time goes on, the amounts at risk in the Chapter 21 law-
25 suits, grow at the rate of about one billion dollars per year,

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

23 MR. DANKWORTH:

24 Mr. Chairman?

25 MR. RAY:

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1 Senator?
2 MR. DANKWORTH:
3 May I interrupt at this point?
4 MR. TAYLOR:
5 Yes.
6 MR. DANKWORTH:
7 You -- he's brought up a modified portion of a bill - 524 -
8 an amended version which he's discussing now, and I'd like
9 the opportunity to pass those out to the members so you'll
10 know what -- so everybody'll know what he's testifying to.
11 MR. RAY:
12 No objection.
13 MR. DANKWORTH:
14 Now that you all have a copy ...
15 MR. TAYLOR:
16 I'd like one.
17 MR. DANKWORTH:
18 This is the settlement ...
19 MR. TAYLOR:
20 Oh, okay.
21 MR. DANKWORTH:
22 In passing that out, Mr. Chairman, if I may proceed -- may
23 I have just two minutes to comment about why I'm passing
24 this out?
25 MR. RAY:

1 You're a member of the committee, sir.

2 MR. DANKWORTH:

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

14 MR. TAYLOR:

15 Okay.

16 MR. RAY:

17 Before you start, sir ...

18 MR. TAYLOR:

19 Yes, sir?

20 MR. RAY:

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

25 MR. TAYLOR:

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1 Yes, sir.

2 MR. RAY:

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

4 MR. TAYLOR:

5 Okay, the compromise that is now before you, we believe
6 would, in fact, settle the current oil tax controversy.
7 However, I might add that the compromise does not result
8 in the 50/50 settlement we proposed, but rather as a better
9 than 70/30 split for the state. The compromise, if I divert
10 just a minute to talk about some of the characteristics
11 of it, what it does is convert the income tax to modified
12 apportionment effective January 1st, 1982, in lieu of
13 chapter 21, if the industry has dropped, with prejudice, the
14 lawsuit at -- before that date. It also has a compensating
15 increase in the severance tax to 15 percent, also on January
16 1st, 1982, and also conditional on the dropping the law -
17 suit. And includes a 10 percent tax credit for investments
18 in Alaska against the income tax and that's not exclusive
19 to the oil industry, it would be for any industry making
20 investments -- any corporation making an investment in
21 Alaska. As we view it, the compromise through this
22 combination of apportionment formula, the increased severance
23 tax, and the tax credit offers much to the State of Alaska.
24 First, it would allow the state to keep the 1.5 billion
25 dollars in income taxes it's collected so far under Chapter 21,

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1 and the interest on that money that would undoubtedly be
2 added to the state's liability under an adverse court
3 decision. Second, based on figures supplied by the
4 Department of Revenue, it would provide the state over a
5 30 percent share of the Prudhoe Bay net oil income. Third,
6 it would result in only a very minor decrease in funds
7 available for appropriation in fiscal year '82, and fourth,
8 it would provide for increasing levels of state revenues
9 in the years ahead, again based on the state's projections.
10 Over all, the compromise would allow the state to recover
11 73 percent of the amount at risk by the time the courts are
12 expected to resolve the current chapter 21 lawsuit. The
13 industry, on the other hand, would only receive 27 percent
14 of the amount at risk. Nevertheless, we would be willing
15 to settle for this amount, at this time, in order to obtain
16 the promise of a more stable and predictable tax climate
17 and the incentive for future Alaska investments through the
18 investment tax credit. As with any compromise, neither
19 side will get everything it wants, or feels that it
20 deserves, but both must get enough to make the agreement
21 mutually worthwhile. Believe me, we have worked long and
22 hard to accomplish a settlement this year and have
23 compromised on our side to the limit. Perhaps the major
24 benefit to the state and the industry from this compromise
25 would be that it would allow the state and the oil industry,

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

15 MR. DANKWORTH:

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

20
21
22 MR. GARDINER:

23 Are we going to have copies of that, too?

24 MR. DANKWORTH:

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

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1
2
3 MR. GARDINER:

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

7 MR. RAY:

8 Go ahead Representative Gardiner.

9 MR. GARDINER:

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

19 MR. TAYLOR:

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

23 MR. GARDINER:

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

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1 MR. TAYLOR:

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

7 MR. GARDINER:

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

10 MR. REITHER:

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

13 MR. RAY:

14 Would you identify yourself, sir, for the record?

15 MR. REITHER:

16 Pardon?

17 MR. RAY:

18 Could you identify yourself for the record?

19 MR. REITHER:

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

21 MR. RAY:

22 Proceed, sir. Go ahead.

23 MR. TAYLOR:

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

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1 involved in the lawsuit would still have paid taxes under
2 43.21. They obviously have not joined the lawsuit now, in
3 Tom's words I think the amount at issue there if they did sue
4 would be minimal and we would have agreed not to - even if
5 they sued and won - on the past liability for 43.21, we would
6 have dropped with prejudice, so we wouldn't be able to take
7 advantage of that. So, for the major revenues, it would be
8 safe.

9 MR. GARDINER:

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

20 MR. TAYLOR:

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

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

3 MR. GARDINER:

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

11 MR. REITHER:

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

15 MR. GARDINER:

16 But nobody has one quite like this.

17 MR. REITHER:

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

22 MR. GARDINER:

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

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

6 MR. TAYLOR:

7 No.

8 MR. GARDINER:

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

13 MR. TAYLOR:

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

20 MR. GARDINER:

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

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

8 MR. TAYLOR:

9 Do you want to say something?

10 MR. REITHER:

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

17 MR. GARDINER:

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

20 MR. REITHER:

21 Well, you're worried about us suing?

22 MR. TAYLOR:

23 Well, we are proposing ...

24 MR. RAY:

25 Let him finish, please.

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1 MR. GARDINER:

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

12 MR. TAYLOR:

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

17 MR. GARDINER:

18 Thank you, Mr. Chairman.

19 MR. RAY:

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

22 MR. DANKWORTH:

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

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1 desirable and that's to get out, and this is the proposal
2 and I really sincerely believe, when you tell me this is the bottom
3 line. We went as far as we could go to get a settlement.
4 Now, there was another amendment as I saw it, and I don't
5 mean to make a speech, Mr. Chairman, but I do think the
6 committee needs to know -- as we look at the different
7 options this is one. Of course, the bill before
8 us is 524 is one -- but we could have an amended,
9 and I'm going to propose an amended thing to this
10 settlement agreement and I'll explain that in a minute. and --
11 because I want you to address these things, the other one is I think
12 that you will hear testimony later, is if we could take 1 and
13 2 which is the 200 and the settlement agreement and put it
14 on a ballot and let the people decide. - I think that will be
15 testified to later. Of course, there's the other one,
16 and that's the -- what we call the old warts bill and we
17 just put that in and repeal the windfall profits tax and
18 raise the severance tax and go from there. Then -- or we
19 could do nothing. So with those options, I'd like to go
20 back and while others will be addressed during this meeting,
21 we've already talked about 200, I've passed out what I
22 consider an amended version or settlement agreement - not a
23 settlement agreement, I'd better not use the word settlement,
24 but at least an amended version of what was originally the
25 settlement agreement that is no longer a settlement agreement.

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1 MR. TAYLOR:

2 Yes.

3 MR. DANKWORTH:

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

9 MR. TAYLOR:

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

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

5 MR. RAY:

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

7 MR. TAYLOR:

8 What, sir, I couldn't hear you.

9 MR. RAY:

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

12 MR. TAYLOR:

13 I think it does reduce the state income somewhat over the
14 5 year period we're talking about. We looked at it as about
15 a 95 percent recovery by the state of the amount of
16 money risk, which, of course, is not even in the ballpark as
17 a settlement.

18 MR. RAY:

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

21 MR. TAYLOR:

22 No, sir.

23 MR. RAY:

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

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

3 MR. DANKWORTH:

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

11 MR. TAYLOR:

12 On a new field?

13 MR. DANKWORTH:

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

16 MR. TAYLOR:

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

19 MR. DANKWORTH:

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

24 MR. RAY:

25 12.5 %

1 MR. DANKWORTH:

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

3 MR. RAY:

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

7 MR. TAYLOR:

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

10 MR. DANKWORTH:

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

15 MR. TAYLOR:

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

23 MR. DANKWORTH:

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

1 12.5 on the severance but you wouldn't continue for that
2 next 5 years -- but I
3 don't think the ELF factor comes out -- the ELF factor
4 would still be 1.0 until you got the 10 years of
5 production in. So you are correct in that.

6 MR. RAY:

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

10 MR. DANKWORTH:

11 Right.

12 MR. TAYLOR:

13 Yes.

14 MR. RAY:

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

16 MR. TAYLOR:

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

18 MR. RAY:

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

22 MR. TAYLOR:

23 Right.

24 MR. RAY:

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

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

5 MR. DANKWORTH:

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

12 MR. TAYLOR:

13 To take it to a vote?

14 MR. DANKWORTH:

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

25

1 MR. TAYLOR:

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

3 MR. DANKWORTH:

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

14 MR. TAYLOR:

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

20 MR. RAY:

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

24 MR. TAYLOR:

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

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

3 MR. RAY:

4 I see.

5 MR. TAYLOR:

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

16 MR. DANKWORTH:

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

19 MR. TAYLOR:

20 No.

21 MR. DANKWORTH:

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

25

1 MR. TAYLOR:

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

19 MR. DANKWORTH:

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

1 MR. TAYLOR:

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

5 MR. REITHER:

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

8 MR. DANKWORTH:

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

1 everything, and possibly -- we can discuss that later.

2 You have already addressed that. Basically, as I see it,
3 we are down to those 2 that make any sense.

4 MR. TAYLOR:

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

6 MR. RAY:

7 Are you finished, Senator?

8 MR. DANKWORTH:

9 I would like a few more ...

10 MR. RAY:

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

14 MR. DONALDSON:

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

20 MR. RAY:

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

22 MR. DONALDSON:

23 How should I refer to that?

24 MR. RAY:

25 This testimony is opened for anything contingent upon

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

5 MR. DONALDSON:

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

14 MR. RAY:

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

22 MR. DONALDSON:

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

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

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

1 MR. RAY:

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

6 MR. DONALDSON:

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

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

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

20 MR. RAY:

21 Do you want to speak now, Representative?

22 MR. GARDINER:

23 No, I'll go with his ...

24 MR. RAY:

25 Go ahead, sir.

1 MR. DONALDSON:

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

13 MR. GARDINER:

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

22 MR. DONALDSON:

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

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

9 MR. GARDINER:

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

22 MR. DONALDSON:

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

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

10 MR. RAY:

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

16 MR. GARDINER:

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

1 MR. DONALDSON:

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

15 MR. GARDINER:

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

22 MR. DONALDSON:

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

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

6 MR. RAY:

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

11 MR. DONALDSON:

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

14 MR. RAY:

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

17 MR. GARDINER:

18 Thank you.

19 MR. DANKWORTH:

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

1 a proposal amendment number 2 which is the -- what do
2 you call it when you kind of throw everything in the
3 same -- catch-all. I didn't really perceive it that
4 way but, at least -- tell me where I'm wrong in my
5 analysis in what I set out to do with this when I said
6 that -- under that bill it would do away with Title 21.
7 That seems to be one thing we wanted to do away with.
8 These are the things that I thought the industry was
9 interested in doing. It would give away -- it would
10 take away Title 21 which we are in court on. It would
11 repeal the windfall profits tax, which is considered
12 unfair. It would hold -- you would gain approximately
13 \$300 million between now and 1985 on it. We would
14 not have put into place a reserves tax which I personally
15 have a great deal of problems with. I think, basically,
16 it would get into a State property tax that I was
17 wanting to avoid very much. But when you look at those
18 alternatives, I can't help but think -- and, of course,
19 also, that bill puts into place a proposed relief or
20 tax, income tax, for smaller businesses or corporations
21 which has not a great deal to do with 524, what we
22 were talking about. But I thought, at least, it made
23 it consistent that we didn't just give away the money -
24 we put a sliding, graduated scale for taxes in there
25 on all corporations or businesses. I don't know. It was

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

1 That's what I ask you fellows to do. You go out and
2 find a formula that will come up with 30% and you did
3 that in the settlement agreement. I think what
4 caused some of the problem is that, after we got into
5 that, we found out that Alaska would get more than
6 30%. It was about 31.8%, which is about \$1.3 billion
7 or better. In the meantime, of course, we had all
8 mutually agreed, in the statement that you referred
9 to, that there would be no substantial reduction
10 in the revenue. And politically, that's where we got
11 into trouble. You fellows have certainly met your
12 requirement and went out and brought back 30%.
13 But then again that's what Ed Dankworth said, that
14 I was going to get out and get 30% because that's the
15 figure that's perceived to be the right one and you
16 met your commitment. No one else agreed to the
17 30%. Most of them agreed that we would not take any
18 substantial reduction in revenue. I just wanted to
19 make it clear that there is a little bit of difference
20 in what I perceived at the time to be 30%. I am not
21 going to take all the blame for the 30%. I have heard
22 the Commissioner of Revenue use it. I've heard the
23 Governor use it. I've heard a lot of people -- because
24 I think, we all perceive that 30% is what we were
25 getting at. So, at least, so there won't be left in anyone's

1 mind any idea that there was, that we were trying to
2 be deceitful about 30%. I hope you understand that.
3 That was originally what I perceived to be Alaska's
4 present share. At any rate, I did want to comment
5 that I had proposed, right down to the wire if I knew
6 that the settlement agreement is not going to pass --
7 200 I can't stand. I don't like that one. I can't
8 afford to do nothing. You can but Alaska can't.
9 I thought that the middle ground that I proposed,
10 while it has its faults so far as you're concerned, it
11 certainly has its faults so far as the State's concerned -
12 we would be losing another \$300 million over the next
13 3 or 4 years and we are still in court. Nobody wins
14 by that. I just wanted to make clear to the Committee
15 that it took a lot of work to come to -- to even get
16 this settlement.

17 MR. DONALDSON:

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

21 MR. RAY:

22 Pardon, sir?

23 MR. DONALDSON:

24 I was just waiting for him to finish.

25 MR. DANKWORTH:

No, sir. You go ahead.

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JUDY JONES
586-6846

1 MR. DONALDSON:

2 I was going to say, in response to your comment about
3 the bill, there's some very good things in it. You have
4 mentioned the lower rates to small companies. I think
5 it probably solves a 7(i) problem that the Commissioner
6 has testified to. There is some treatment in there
7 of the Cook Inlet gas problem, and those things make
8 sense. When we were talking about the settlement, from within
9 our own company's perspective, we are looking at a
10 suit presently in court, as you know we think we have
11 a much better than even chance of winning, and we said
12 if you can find some middle ground, maybe split our
13 differences down the middle, okay. As we ratcheted up
14 the percentage of severance tax, we went from a 50:50
15 split to a 60:40 to a now something better than a
16 70:30 in the State's way. Your question is, doesn't this
17 mix of ideas do it perhaps? It's not a 50:50, not a
18 60:40, not a 70:30 - it's about a 94:6 split. Obviously
19 I think our management feel they can afford to litigate
20 if that's the answer. It has the other two aspects
21 that probably need further attention. And that is, it
22 does raise taxes on marginal fields and wells in
23 Alaska, whether it's us or a smaller company that is
24 impacted by that. I'm not sure that's the wisest
25 way to deal with that kind of a problem. And finally,

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

11 MR. DANKWORTH:

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

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