

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

1028 SCOMM 28: JOINT GAS PIPELINE COMMITTEE, 1981-82

1028

1 support for that, that I could risk if we were to take
2 this Committee meeting here at the last of the session
3 and go there and not have the votes to pass it, then
4 we are in a position to do nothing. Do nothing means
5 that the State of Alaska is out here with over \$2 billion
6 by the time we get back, in to revenue without any
7 backup position, and no escrow account or anything.
8 Fiscally, all of us are not going to let the State get
9 in that position. Those are problems you are very
10 well aware of, that we're up against it to the last
11 day. Thank you for your comments on it anyway.

12 MR. RAY: Well,

13 I see it just a little bit different than the Senator
14 here. As far as I'm concerned, if we don't do anything
15 this year, I'm sure that the Governor, as a prudent
16 man, will take \$400 million out of the capital budget
17 and the operating budget and have that sitting there
18 ready for us when we come back next year. It'll mean
19 a loss of revenue to individual legislators or to the
20 districts, but it will be a protection of the people
21 and it's one that, I suppose, anybody that is responsible
22 for the handling of other people's money that they take
23 the idea that they're going to have that backup there that's
24 going to be there, the money that we are generating now.
25 As far as your -- I don't like to call it a threat, although

1 that was plainly what it -- that was plainly what it was,
2 but I don't like to call it that. Nobody worries about
3 threats of other people unless they have reason to. /
4 I think that the oil companies have just as much reason
5 to be in Alaska as we have reason to have them here.
6 Of course, it just goes down to the point, if you don't
7 want to be reasonable then I suppose you will have to
8 be anyway you have to be, and the State will have to be
9 any way they have to be. As far as the implied threats,
10 or the -- whatever you were doing -- I don't think
11 that's going to make any difference because you are in
12 a position of representing stockholders also, and it's
13 your job to get the best return under the best conditions
14 that you can for your people. And that's what you are
15 going to do, whether it means a lawsuit or anything else.
16 If you can settle it thus, amiably and properly
17 with everything -- I think that's the best course.
18 But if you want to take the hard course, I'm certain
19 that the State will be prepared to meet any contingency.

20 MR. DANKWORTH:

21 Mr. Donaldson, thank you very much for your response on
22 that.

23 MR. RAY:

24 ... for his honest approach. Welcome, honesty is the
25 best thing to get -- smooth words and the rest of it

1 doesn't really come down until you actually see what's
2 facing you.

3 MR. DONALDSON:

4 Just in conclusion, please understand, for the next few days,
5 that - whatever you want to call it - compromise is on
6 the table and then it's gone. I happen to think it's a
7 reasonable approach; I happen to think it gives the state a
8 good deal of security for 95 percent of its revenue flow,
9 the glass is much more than half-full and part-empty - you
10 always talk about the empty part but there's a ton of money
11 flowing into your hands for wise management that you're taking
12 the cloud off of; we thought it was reasonable from that
13 standpoint. You know we have a long-term interest in Alaska,
14 that doesn't basically change. We will probably go on back
15 to court and ask these questions; we'll take that when it
16 comes. But the choice is yours, and we thought we were very
17 close to what the state wanted and what we thought we could do.
18 I hope you'll still give it a little further thought before
19 you make your final decision.

20 MR. RAY:

21 Well, you brought up another good point. Maybe we should
22 get this settled once and for all so you will know
23 where your limitations and what the State's limitations --
24 maybe you should go through with the lawsuit
25 and let you, whoever wins win and we'll know exactly what

1 happens. Then you won't have to apologize to anybody,
2 and we don't have to apologize to anybody. That's another
3 thought.

4 MR. DONALDSON:

5 We're perfectly prepared to do that as you know. As
6 Mr. Taylor said, each year that passes it gets extremely
7 difficult to forget an awful lot of past because those
8 dollars pile up. It almost gets to the place where
9 you have to call us, we can't come back.

10 MR. RAY:

11 We appreciate it.

12 MR. DONALDSON:

13 Thank you very much.

14 MR. RAY:

15 Thank you, sir.

16 MR. DANKWORTH:

17 Thank you, Mr. Donaldson. I have just one statement
18 along with the Chairman's, and that is I do think it
19 is important to settle this. I really wish we could.
20 I think it is going to be harder next year. But I don't
21 know, the Senator might want to -- I don't know
22 whether he wants to propose -- comment. But I have
23 tried. People will tell you. I have gone to these
24 Senators, and I've talked about a \$1.3 billion
25 reduction between now and 1985. Personally, I don't

1 think that is an option you can sell at least in the
2 Senate this year. We do have some time left. I don't
3 know whether he wants to comment, but I have
4 not found anybody in the Senate who is willing --
5 perhaps I'm talking to the wrong ones -- that felt
6 that that was an option. That's what forced me into
7 this position to stop the backstop.

8 MR. RAY:

9 I think -- just to respond, Senator -- You were, more
10 or less, given a direction by the leadership in the
11 Senate to do certain things. You did that. You came
12 back -- if there was anybody that you could have got
13 that would have presented your case more honestly, or
14 more forcefully, was Senator Dankworth. He did that.

15 MR. DONALDSON:

16 He did. No question about it.

17 MR. RAY:

18 He was told very politely, thank you for your work but
19 it isn't satisfactory to a majority of the Senate.
20 That's about what it comes down to. Politely. Nobody
21 blames you people for trying to do what you're doing
22 for your own stockholders. Nobody blames you for
23 trying to get the last dollar that you can get for your
24 stockholders. We all understand that. It's your job.
25 But you have to understand, conversely, it's our job to see

1 that our stockholders get value received for their
2 natural resource. It isn't something that should denigrate
3 down to a fist-shaking or anything else. It's something
4 that calm and study and see if we can't reach a compromise,
5 hopefully in our benefit - that's the way I see it, and
6 you see it, hopefully, in your benefit. It's just a
7 common ordinary occurrence in the business world. If I
8 thought this would be the last I would ever see you
9 people in court, hell, I'd sign right now. But you'll be
10 back tomorrow and once you settle this you'll be back
11 with something else. That again is your job to do that --
12 for every action there is a reaction. And that's what
13 we are doing.

14 MR. DONALDSON:

15 Since we're in good discussion here and going a long way
16 to try and understand each other. There are probably
17 two more things just to add to your record. And both
18 brief. One is that an industry, a company, doesn't
19 understand, when someone approaches it -- and I'm not
20 finding fault -- and says this is what it takes to settle.
21 And we said we'll settle. And then have the other
22 party, sort of, walk away, for whatever reasons.
23 It's very hard for business to understand that type of
24 negotiation. So there's a great deal of frustration
25 among our home offices, as you might expect. Second thing,

1 if you look at the net profit from a Prudhoe Bay oil
2 field. Today, under present federal law, the federal
3 government is taking about 45%. Today, under present
4 Alaskan law, the State of Alaska is taking something
5 over 30%. The companies who have taken all the risk,
6 done all the financing, are ground down to 23% or 24%.
7 Things seem out of balance. This is another factor
8 that may well be a driving force in our own analysis
9 of trying how to solve the problem. Those two things
10 may add a little bit to your perspective, but you
11 know basically where we have come from, and you're right -
12 we do have to represent our own shareholders.

13 MR. RAY:

14 Well, you shouldn't be disheartened, although it could
15 be frustrating. You have to understand that when you
16 are dealing with the legislature you are dealing
17 primarily with a committee. You are dealing with a
18 committee of 20 people in the Senate, and 40 in the
19 House. And sometimes those committees are not generally
20 in agreement. The whole thing is in any of our
21 relations, I think really -- what's the old saw --
22 reasonable men can certainly disagree but disagreeable
23 men can never reason. I hope that we always are
24 reasonable men.

25 MR. DONALDSON:

I appreciate that. Thank you, sir.

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

1 MR. RAY:

2 Thank you very much again. Mr. Showalter, did you
3 want to give testimony, sir? Is there anybody here
4 from ARCO? Dave? Excuse me, I'm sorry.

5 MR. HARBOUR:

6 Mr. Chairman, before I introduce myself, may I say
7 that my remarks were predicated on an assumption that
8 perhaps the Commissioner of Revenue would have given
9 a description of the material on the table. If it
10 pleases the Chair, I'd be happy to defer to the
11 Commissioner until I give my own testimony. Or I can
12 give it now - it's your pleasure.

13 MR. RAY:

14 Whatever your desire, sir. I'm sure -- we are here
15 to listen to you. You can pick and choose within the
16 limitations, and that's certainly within the limitations
17 as far as I can determine.

18 MR. HARBOUR:

19 ... you are agreeable to hear the Commissioner and then
20 my testimony?

21 MR. RAY:

22 We might be hearing him next year. That was just a
23 joke. Take it easy, David.

24 MR. HARBOUR:

25 I'm glad you identified it, Senator.

1 MR. RAY:

2 Just to allow the -- there is a request from some of
3 the people from the Cook Inlet Region Inc. that would
4 like to talk. Is there anybody here from Cook Inlet?

5 UNIDENTIFIED SPEAKER:

6 Cook Inlet Region has no testimony to give.

7 MR. RAY:

8 All right. Is there anybody else who would like to give
9 testimony previous to the time we again hear the Commissioner
10 of Revenue?

11 MR. BAUMAN:

12 Excuse me. I would like to speak briefly, if I could, on
13 behalf of Amerada Hess.

14
15 (Testimony not requested)

16
17
18
19
20
21
22
23
24
25

1 MR. RAY:

2 Commissioner, I don't want to rush you but if you could
3 keep to the specifics so -- because both houses have to
4 be back in at 5:00. We would like to get a considerable
5 amount of your testimony in here so that we can understand
6 it.

7 COMMISSIONER WILLIAMS:

8 Thank you, Mr. Chairman. I'll try to keep my remarks
9 brief. For the record, my name is Tom Williams. I'm
10 Commissioner of Revenue. A question of the Chairman
11 first - would you like me, at all, to respond to
12 Mr. Bauman's remarks that were just made here? Or would
13 you rather have me quickly describe this tax to lay
14 the foundation, the predicate, for Mr. Harbour's
15 testimony.

16 MR. RAY:

17 I would -- Senator: No, I would just as soon you would
18 get to the main point. We understand what Mr. Bauman's
19 problem is and we can address that in short order.
20 We understand that very well.

21 COMMISSIONER WILLIAMS:

22 The idea of the settlement is, has been fairly well
23 discussed already before. The ingredients are basically
24 as follows: first, that the companies would walk away --
25 these three companies anyway, who together account for over
90% of the tax payments under Chapter 21 -- that they

J&R Associates

P.O. BOX 29 • DUNSMUIR, ALASKA 99824

JUDY JONES
586-6846

page 55

1 would walk away from the taxes they have paid in the
2 past, and the taxes they will pay for the remainder of
3 this tax year. That is, for tax liability that accrues
4 through December 31, 1981. That money they would no
5 longer claim. They would dismiss their lawsuit with-
6 prejudice which would mean that, as far as they are
7 concerned, the legal doctrine of res judicata would apply.
8 They could not come back in and claim it. Even if
9 someone else subsequently came in and challenged Chapter
10 21 and proved to be successful - as to these 3 parties,
11 their claims are over with forever. That's one benefit
12 the State would receive from the settlement. Another
13 benefit that the State would receive is that the
14 severance tax would go to a nominal rate of 15% instead
15 of its rate of 12.25% at the present time. In exchange
16 for this, the State would give up the principle of
17 separate accounting starting with tax years beginning
18 next year 1982. We'd surrender separate accounting,
19 go back to the concept of apportionment, which is basically
20 looking at a worldwide pie of income and using a formula
21 to calculate how wide a slice the State is entitled to
22 take out of that and say that's Alaska income. Then we
23 tax it. The apportionment formula will not attribute to
24 Alaska as many dollars as the separate accounting
25 approach attributes to Alaska. The tax will have a

1 significant reduction. This reduction is only partly
2 offset in future years by the increase in the severance
3 tax. The net result has been calculated to be, between
4 now and 1985, about \$1.374 billion would be the total
5 amount of that difference. That is, between now and
6 1985 the State would receive \$1.3 billion, almost
7 \$1.4 billion, less under the settlement than it would
8 receive under Chapter 21, assuming, of course, that
9 Chapter 21 is ultimately upheld. The other ingredient
10 in the settlement is a 10% investment tax credit for
11 investments made in Alaska. This is a difficult one
12 to quantify because it is very hard to guess for sure
13 the precise timing of when investments will be brought
14 on stream. It's patterned after the federal investment
15 tax credit which says you don't get the credit until
16 you actually place your facility into operation. For
17 instance, when TAPS was being constructed, Trans-Alaska
18 Pipeline System, presumably the credits were accruing
19 until June 20, 1977 when oil started to be put into that
20 pipeline and it began operation. Until that time all
21 the expenditures in '76, '75, '74 and back to '69 or '70,
22 were piling up, but could not actually have been used.
23 The tax credit mechanism is a very difficult one for us
24 to forecast. It's hard to quantify. But it is possible
25 that we would see as much as \$5 billion of qualified

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586 6846

page 57

1 investment coming on stream in the State between now
2 and 1985. If that were so, then there would be \$500 million
3 of additional tax credits that would represent revenues
4 foregone, if you will, from the present course that the
5 State is on. That, in basic summary, is what the
6 settlement is. On the one hand, you gain the certainty
7 with respect to the revenues that have been collected,
8 at least 93% of them. You gain, not quite such a degree
9 of certainty with respect to future revenues under the
10 income tax because even though these 3 may not challenge
11 it, it is possible that others may. But I think they
12 will lose. So it's a question of how slight you think
13 the risk is that an apportionment formula will be upset
14 in the future. I think that is a very small risk, and
15 so there is very little likelihood that these companies
16 would stand to benefit if some third party came in and
17 litigated the apportionment formula in the settlement
18 bill. It's mostly a question of dollars and cents.
19 From our point of view in the administration, we go back
20 to the principles that were set out in the joint
21 statement in March of this year. Perhaps, it is worth
22 recalling exactly what those, what was said then. It
23 would have helped if I had it at the top. Well, I won't
24 take time searching for it. The basic idea that was
25 said then, I can't quote it verbatim, is that the

1 sentiment was expressed that the present level of
2 revenues being taken by the State from the oil and gas
3 industry was at an acceptable level - it was not
4 unreasonably onerous and it was not unreasonably light.
5 People felt comfortable with it. It was felt that any
6 increase in the level of taxation was inappropriate at
7 this particular time. By the same token, the statement
8 goes on and says it was felt that a decrease, a
9 significant decrease, is inappropriate at this time.
10 I think the phrase is unwarranted and unsupported by a
11 majority of Alaskans. This settlement -- if you divide
12 it out -- works out to an average of about \$400 million
13 a year, not counting the imponderable in the investment
14 tax credit. That is a lot of money. Whether that is a
15 material reduction in the State's revenues is a
16 different question. That's one that ...

17 MR. RAY:

18 What's the percentage?

19 COMMISSIONER WILLIAMS:

20 Overall it works out to a 5.2% reduction in the total
21 revenues that the State is contemplating to get from the
22 industry through 1985. In terms of this particular tax
23 and the amount that is at issue here, we are foregoing
24 27% of the tax in exchange for security on the 73%.
25 In our view it is an expensive price tag. However, the

1 mythical 30% figure has developed in conversations -- and
2 I believe over a longer time period, our present level
3 of 31.8 will, in fact, go down. So that if you look
4 at a period of a longer duration, say to the end of
5 the '90s, that you'll see we're right at the 30% number
6 This number was not just pulled out of a hat. As fields
7 age they become less profitable, hence the income tax
8 will be representing, in future years, a smaller and
9 smaller portion of the value of the production.
10 Similarly, the economic limit factor in the severance
11 tax will gradually begin to have an increasing effect
12 on the severance tax rate, drawing it down toward zero
13 as the economic limit is approached, and thus the
14 severance tax will also be declining over time. It will
15 represent a smaller and smaller proportion in those later
16 years. Looking at the long scale, I think we are at
17 30%. In the short term, we find we are at 31.8%. The
18 settlement agreement preserves the 30%.

19 MR. DANKWORTH:

20 I have one question, Tom. I don't want to interrupt your train of thought.
21 Also, is the \$1.8 billion -- I think it's about \$1.8 billion
22 that we would be collecting on the windfall profits
23 tax between now and 1985. Under the settlement
24 agreement, we would be losing 1.3. It depends
25 on where you're coming from. Some perceive that tax to

1 be unfair. Every state in the Union, except, I think,
2 Minnesota, and they don't have oil -- if we were to perceive
3 the windfall profits tax was unfair -- that was the
4 position of the State, \$1.8 billion, that would put us
5 truly back to about 30%. In fact, \$1.3 billion puts us
6 back at 30%. I suppose somewhere, maybe, a little below
7 30% -- if we said the windfall profits tax was not a --
8 we should give them the credit for the windfall profits tax.
9 I'm just kind of backing up your argument because I
10 think, probably, 30% didn't just come out of the air.
11 It depends on what you think is fair. Go ahead.

12 COMMISSIONER WILLIAMS:

13 Basically, the point I was reaching is, where does the
14 administration stand.

15 MR. RAY:

16 If you could contain yourself until tomorrow, Mr. Williams...

17 COMMISSIONER WILLIAMS:

18 Certainly. There's no suspense for me.

19 MR. RAY:

20 ... because there are some of us that haven't had the
21 benefit of looking at this for any length of time. I
22 think it would be fair to look at the suggestion by
23 Senator Dankworth in comparison with the, I believe it
24 is the H.C.S. for 524, and also look at the settlement,
25 and also look at the no settlement, look at the warts,

1 and look at the -- whatever else there is to look at.
2 Both houses are going back at 5:00. If it's agreeable
3 with the Committee, how about 2:00 tomorrow? Is that
4 convenient with everybody? Pat? Pardon? At what
5 time? Possibly we could ... Do you want to come back
6 at 3:00? 3:00 tomorrow? We have to do it sometime
7 tomorrow. We either turn it down entirely or to adopt
8 one of the suggestions. Sir?

9 UNIDENTIFIED SPEAKER:

10 How about if we just say right after the joint session?
11 Or is that not specific enough for everybody involved?

12 MR. RAY:

13 That's close enough. If it's 2:45 could we wait for
14 3:00? What I'm trying to do -- as far as the legislators,
15 we can meet in a telephone booth and cut the deal.
16 But we want to give you industry people the full operation
17 so that if you have anything you want to say -- we don't
18 believe it but we are going to listen. Ed believes it.
19 I want to say one more time, there's been a lot --
20 probably, some strange questions or remarks made about
21 Ed Dankworth, but I can tell you that the majority of them
22 are not true. We'll meet at 3:00.

23
24 (meeting adjourned at 4:45 p.m. June 22, 1981)
25

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 22, 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 62 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

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

2 FREE CONFERENCE COMMITTEE ON SENATE BILL 524

3
4
5
6 TRANSCRIPT OF PROCEEDINGS

7 JUNE 23, 1981

8
9
10
11
12
13
14
15
16 COMMITTEE PRESENT:

17 Representative Bill Ray, Chairman
18 Senator Ed Dankworth
19 Senator Don Bennett
20 Representative Terry Gardiner
21 Representative Rick Halford
22 Representative Patrick O'Connell
23
24
25

J&R Associates

P O BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

P R O C E E D I N G S

6/23/81

1
2
3 MR. RAY:

4 The Free Conference on Senate Bill 524 will please come
5 to order. Mr. Harbour? Please identify yourself for
6 the record, sir, and proceed with your testimony.

7 MR. HARBOUR:

8 Thank you, Mr. Chairman. For the record, my name is
9 Dave Harbour. I'm Director of Alaska Government Relations
10 for Atlantic Richfield Company. And I'm joined today
11 by Jim Egan who is with our Anchorage tax department.
12 Mr. Chairman, together we are grateful for the opportunity
13 to address this Free Conference Committee on the subject
14 of the various pieces of legislation before you. I will
15 present you at the end of this discussion with copies of
16 a formal position paper that our company has prepared.
17 But in the interest of time and also in the interest of a
18 little more dialogue, would like to be more informal
19 with my remarks and at the conclusion of them would value
20 the opportunity to answer any questions that may be
21 presented. There are three pieces of testimony, or three
22 pieces of legislation before the Committee today that
23 result from the Chapter 21 crisis. One is the backstop or
24 reserves tax version; another is a proposed compromise
25 or settlement position; another is an amended version of

1 that particular legislation but would not result in
2 settlement. First, I'd like to say that in testimony
3 that our company provided in May to the Joint Gas Pipeline
4 Committee -- at that time we expressed opposition to the
5 backstop or reserves tax approach, and I'd like to
6 reiterate our position that we believe that legislation is
7 not in the interest either of the companies involved or
8 the State itself for, indeed, it is not truly a backstop
9 tax that would stop back the revenues that the State is
10 achieving in a direct way but actually would be a real
11 tax increase resulting in the imposition of an even
12 higher tax burden on Alaska's oil industry. The proposed
13 legislation does not resolve the issues currently being
14 litigated in our constitutional challenge, but even
15 guarantees that that controversy will continue and be
16 expanded particularly through provisi of those activities
17 for determining the millage as well as the valuation on
18 the reserves or property. In fact, my attorneys have
19 instructed me that there are -- may very well be raised
20 new constitutional issues which could possibly place the
21 Alaska tax structure into controversy. Now secondly with
22 regard to the compromise or settlement bill produced by
23 Senator Dankworth, we feel that it is required that our
24 company and industry come the better part of the way to
25 reach that particular settlement understanding. The State

1 receives far more of the revenues at stake than does the
2 industry and retains all of the revenue collected as a
3 result of Chapter 21 payments since 1978,eliminating
4 the possibility that at some point in the future it may
5 be required to refund billions of dollars to the companies
6 involved along with attendant interest payments. Now,
7 in regard to this compromise or settlement concept that
8 has been developed,there are two questions that may be
9 asked. First, why should the companies involved - and
10 I believe, Mr. Chairman, you asked this question yourself -
11 be willing to settle on this basis when, as stated
12 above, the State receives the vast portion of the
13 settlement agreement. For one ,the legislature -- the
14 legislation would return to the companies at least a
15 portion of those revenues at risk. Secondly, it would
16 provide a more stable tax and investment climate for the
17 company to do business in. It would take the companies
18 as well as the State out of litigation - in our case
19 litigation with our largest royalty owner and put us
20 perhaps on a course of working more closely together
21 toward mutual goals. A second question that may be asked
22 is,what are the benefits that accrue to the State as a
23 result of that proposed settlement? Clearly,the State
24 would receive, Mr. Chairman, over 70% of the revenues
25 at stake. Furthermore, the State continues to receive

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

page 3

1 approximately 30% of the revenues from Prudhoe Bay as a
2 result of that agreement, a share which is greater than
3 that received by the industry which is producing the
4 resource. The State frees itself from the litigation. And
5 there's another aspect which is -- a number of State
6 leaders over a period of the last few months and years
7 have expressed dismay that as a result of this original
8 legislation, Chapter 21, the State is taking a tax on
9 the federal windfall profit tax paid to the federal
10 government as opposed to the income of the State.
11 Mr. Chairman, this settlement agreement, as negotiated,
12 would require the State to give up less than if it
13 provided the windfall profits tax deduction to the
14 companies involved. And lastly, it's becoming increasingly
15 apparent that the economy of the State as well as the
16 destiny of the State and the oil industry are becoming
17 absolutely linked. And this compromise, as we see it,
18 would demonstrate to those not only in my business but
19 also in other businesses that the State has a desire to
20 achieve a predictable, stable tax policy, thus adjusting
21 the atmosphere toward encouraging long term economic
22 development in our State. Yesterday morning Jim and I
23 learned of a third proposal before the Committee. It is
24 a mutation of the compromise bill which would not permit
25 settlement and which has a number of defects, although

1 somewhat less serious than those posed by the proposed
2 reserves backstop bill. First, it would act as a
3 disincentive to the discovery and production of new fields
4 not only by raising the effective severance tax rate from
5 12.5 to 15% after 5 years of commercial production, but
6 by eliminating the economic limit factor for the first 10
7 years of commercial production. Secondly, with regard
8 to new or marginal fields particularly, we would find
9 them less likely to achieve production since the
10 severance tax effective rate increases initially and also
11 after 5 years of production. Thirdly, it eliminates the
12 investment tax credit provision of the compromise bill
13 not only for my business but also for all Alaskan businesses,
14 thus removing the incentive for increased investment in
15 Alaska which ultimately produces more income for the
16 State. And fourthly, it is a rejection of the settlement
17 of current litigation. Mr. Chairman, the time has come,
18 in our opinion, to clear the air and to remove that
19 adversarial relationship which is -- has been shared by
20 the tax collecting and the tax producing entities of our
21 State for so many years. And although, as discussed,
22 the settlement reflected in the Dankworth compromise
23 heavily favors the State interest we agree to it, if it is
24 enacted in the present form. Atlantic Richfield Company
25 would immediately dismiss its lawsuit challenging the

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

page 5

1 constitutionalty of Chapter 21. It would relinquish its
2 claim on taxes paid under that authority since 1978.

3 Mr. Chairman, though it is not easy - an easy compromise
4 probably for any of the parties to contemplate, in our
5 opinion and after working with it for so long and hard,
6 it is a good faith and fair compromise - one that, we
7 think, will ultimately be supported by the respective
8 citizens and shareholders of those of us sitting around
9 the table. I appreciate the opportunity to be here.
10 And I'd be happy to answer any questions.

11 MR. RAY:

12 Thank you, Mr. Harbour. Did I understand you to say
13 that you believe that the settlement would be in the best
14 interest of the people of the State? And that they would
15 welcome that opportunity to have it settled?

16 MR. HARBOUR:

17 It's my experience in speaking with a number of citizens
18 of our State as well as organizations that there is a
19 feeling that the adversity that emanates from the current
20 legal activity should not exist, and thus the people
21 would support a dismissal of that suit. Yes, sir.

22 MR. RAY:

23 Would you support a Statewide referendum for that question?
24 To allow the people by their vote instead of just by
25 public relations returns; people themselves allow them a

1 vote to say we think that the settlement is just or we
2 don't think that the settlement is just.

3 MR. HARBOUR:

4 Senator Ray, if in 1978, prior to the passage, the last
5 days of the legislative session without public hearing,
6 you were to have asked me if Chapter 21, the proposed
7 Chapter 21, should have been put before the people at
8 that time, I probably would have been inclined to agree.
9 Now that, at that time, did not receive public hearing.
10 The legislature acted in its right to develop State policy
11 with respect to taxation, and it seems to me that the
12 legislature, having developed that policy, is in a position
13 now to correct that policy. Do I favor going to the
14 people? I wouldn't be against it, but I have to tell you
15 that I think that all of the ingredients are here for
16 the settlement -- all of those who know the case best in
17 the legislature and in the administration have worked long
18 and hard on it, and have far more material available to
19 it and resources available to them than the public has.

20 MR. RAY:

21 Well, I would think that you would advocate it. I don't know
22 if you are a part of the public relations campaign that is
23 being put out by some of the industry, but it appears that
24 they are putting out, and have been for a good set of
25 time -- our friend Mr. Taylor, there, has been very vocal

1 and put the little things in the paper - write in this and
2 send it in if you think that we are doing -- so I would think
3 that from your industry's initial petitioning of the
4 public through the media that you would welcome the
5 opportunity. Perhaps the legislature is wrong. Perhaps
6 it should be the people themselves who make the determination
7 on 6 or \$8 billions. I don't know. I'm just asking.

8 MR. HARBOUR:

9 You make a good point, Senator, but I will tell you that --
10 you know, no place else in the country does this kind
11 of a situation exist. That is, of year after year, a
12 state's major industry, the oil industry, facing tax
13 increases. And, in my opinion, my personal opinion, the
14 reason that we don't find that in other areas of the
15 country is because much of the production takes place on
16 private lands. And so there are a number of royalty
17 owners - in fact, just myriad of royalty owners. So
18 that if a state attempts to change policy that appears
19 not to be fair in the best interests of the citizens, a
20 vast constituency rises up. In our State, the entity
21 that owns the land is also the entity that has the power
22 to tax the land. And there is no direct constituency
23 in between. And therefore, I consider it a requirement
24 and a responsibility to communicate the problems that we
25 see developing with the constituencies that do exist.

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

page 8

1 And we do that. And I make speeches. And I talk with
2 people. And I find that the return on that is almost
3 universally supportive of a more stable investment climate
4 as reflected in the State's tax policy.

5 MR. RAY:

6 You are a nice fellow, and they don't like to hurt your
7 feelings.

8 MR. HARBOUR:

9 Thank you, sir.

10 MR. DANKWORTH:

11 Dave, go back over the four reasons on what I might call,
12 not the settlement agreement, but on what I proposed as
13 a possible amendment number 2 yesterday -- compromise.
14 You mentioned four reasons why you didn't think that that
15 was an acceptable agreement. I had one that you said
16 that it destroys the incentive after 5 years which -- I
17 understand what you mean by that. What was number 2?

18 MR. HARBOUR:

19 The second had to do, Senator, with marginal fields. That is,
20 that marginal fields might be expected to have a lower
21 likelihood of production since, when first coming under
22 commercial production they -- although at 12.25% rate --
23 they have that initial increase that's owing to the
24 elimination of the economic limit factor. And then after
25 5 years another increase which is the 15% severance tax rate.

1 MR. DANKWORTH:

2 If I could find a way to take care of that that would, at
3 least on the marginal fields, that would eliminate the
4 number 2 I'm going to assume, if that's what your problem
5 was there. Number 3 was the investment credit. That's
6 not in existence now, and while it was in the settlement
7 agreement, so was it in the settlement agreement that we
8 get out of court and that we do a whole lot of other
9 things, but I'm trying to confuse -- I don't want to
10 confuse what I offered there as not necessarily part of
11 the settlement agreement because that is not a settlement
12 agreement that I was offering as amendment number 2.
13 The first one was. So I didn't want the public to feel
14 that you were saying that my second amendment is part of
15 a settlement agreement, because I think you clearly say
16 it's not, even though you may prefer it to some others -
17 that's not an agreement. What was the fourth one? It
18 was -- and I didn't understand when you said it's a
19 rejection of current litigation.

20 MR. HARBOUR:

21 The fourth item, the fourth aspect of this second proposal,
22 Senator, is that it would not relieve the State of the
23 legal activity that now surrounds it.

24 MR. DANKWORTH:

25 But it would make moot our case in court, would it not

1 so far? It does do away with Title 21 and it does do
2 away with the windfall profits tax, and it does make moot
3 most of the things that you are in court for other than the
4 recovery of the \$1.4 or \$1.5 billion that we've already
5 used, and of course, which we -- that bill does not
6 require you to give up any rights to continue to pursue
7 that so -- I guess what I'm making sure we do, Dave, is
8 not -- for your sake as well as mine -- we're not
9 trying to -- I didn't propose that as a settlement
10 agreement because it is not one. And I was trying to --
11 and we'll get to that later -- finding that which was
12 least objectionable to you. Also under the agreement
13 that I'm going to propose, you don't lose money. You
14 make \$144 million between now and 1985 - there's no loss
15 to you. The industry's picking up \$144 million.

16 MR. HARBOUR:

17 Senator, everything is relative when compared with the
18 impact of Chapter 21, there is still a loss.

19 MR. DANKWORTH:

20 I understand, sir, and thank you.

21 MR. RAY:

22 Are there any other questions for Mr. Harbour?

23 Representative Gardiner?

24 MR. GARDINER:

25 Okay, one thing I'm not clear on the lawsuits here. If the

1 bill that Senator Dankworth is talking about that was
2 in Committee yesterday, if that's passed what would you
3 expect - is the industry going to litigate that?

4 MR. HARBOUR:

5 Representative Gardiner, I don't believe that the passage
6 of such legislation would change the litigation as it
7 affects Chapter 21 accruals to date. As to the future,
8 there are still defects in that bill which would probably
9 continue to be pursued in a legal arena. As to what form
10 that might take, we would have to analyze that with our
11 lawyers at the time of passage of the bill.

12 MR. GARDINER:

13 So you are saying that in respect to the current 43.21 suit, the
14 company would continue that suit in court even though
15 from here on out there's no revenue brought under it--
16 you'd continue it for the back -- what you have already
17 paid.

18 MR. HARBOUR:

19 I guess what I'm saying is that the conditions that gave
20 rise to the Chapter 21 suit in the first place would not
21 be eliminated in the past, all of them - neither would
22 they all be eliminated for the future. But -- and also
23 as of today, we've still been hearing about proposed
24 changes in this legislation. So I can't be that certain
25 with you until I see a final version and until it comes out.

1 But as soon as possible, I'd be happy to discuss that
2 with you.

3 MR. GARDINER:

4 Mr. Chairman, my concern here with -- one of the things
5 that we all think we'd like to do - at least I haven't
6 heard anybody disagree with is - is to get out of court.
7 If I understand what's being said here is, one, we are
8 still going to be in court over 43.21, although it may
9 only affect \$1.5 billion up to date, or whatever the
10 number is -- but then this new bill that's proposed for
11 us on the modified apportionment and other sections in
12 it may have legal problems, that may cause another suit.
13 So we have effectively, it's a possibility, ending up with
14 two different suits on two different taxes. You
15 know, unless the industry says they're not going to
16 litigate them - which I'd like to hear, if they are not.

17 MR. HARBOUR:

18 Mr. Chairman, I think perhaps that since I didn't prepare
19 this bill and didn't even see it until yesterday, that
20 actually the administration would be better qualified
21 to comment on that point, Representative Gardiner. But
22 as -- one point that you make with respect to the modified
23 apportionment also applies to the compromise package. And
24 I believe that there was some legislative staff suggestion
25 on that point of the modified apportionment change as it

1 applied to the compromise bill, is the point maybe you
2 are making now with respect to the fact that that might
3 cause future litigation. And as far as the settlement
4 agreement goes, that's not the case because the companies
5 would propose to drop suit in the event that passed. But
6 furthermore, the apportionment scheme that's outline under
7 the compromise and that is in some sense copied in the
8 second version, is demonstrably more acceptable to the
9 courts than is a direct accounting approach to taxation.

10 MR. RAY:

11 If there are no other questions I want to thank you very
12 much, Mr. Harbour.

13 MR. HARBOUR:

14 Thank you, Senator.

15 MR. RAY:

16 Bill Hickman, Vice President and Treasurer, Alaska Gas
17 and Service Company.

18 MR. HICKMAN:

19 Mr. Chairman, I'll be joined by Dick Barnes, Vice President of
20 Alaska Interstate Company. We are part of a consolidated
21 group of companies.

22 MR. RAY:

23 Okay.

24 MR. BARNES:

25 Mr. Chairman, the testimony issued so far in this hearing

1 by the industry has been mainly by the three...

2 MR. RAY:

3 Sir, you are Mr. Barnes?

4 MR. BARNES:

5 Yes, I am, sir.

6 MR. RAY:

7 Would you identify yourself for the record?

8 MR. BARNES:

9 Yes. For the record, my name is Richard F. Barnes,
10 Vice President of Alaska Interstate Company. The testimony
11 issued so far in this hearing by the industry has been
12 mainly by the three major producers. We understand that
13 there are currently 20 to 30 Chapter 21 taxpayers in the
14 State. We are among that group due to our natural gas
15 transmission line that is part of our Alaska Gas and
16 Service Company business. As part of the 20 to 30
17 taxpayers, we would like to share our perceptions on this
18 subject. Alaska Interstate Company currently has two
19 business interests in the State - Alaska Gas and Service
20 Company serves about 45,000 customers, and also the
21 State's largest electric utilities. Therefore, directly
22 or indirectly, we serve almost everyone from Halibut Cove
23 to Talkeetna in southcentral Alaska Gas' business
24 is regulated by the APUC, the Alaska Public Utilities
25 Commission. The rates that are allowed include operating

1 expenses such as income tax that would be perhaps increased
2 or decreased due to proceedings here today. Ultimately,
3 all the income taxes charged to the utility are passed
4 on as rates to the customers. The other business interest
5 that we have in the State at this time is part of the
6 Dow-Shell project where Alaska Interstate's role is studying
7 the southern section of the pipeline that would carry
8 natural gas liquids from the vicinity of Fairbanks to a
9 tidewater location. We believe that regulated utilities
10 should not necessarily be taxed in the same manner as
11 producers. They are very much different businesses.
12 Typically, utilities have very little upside opportunity
13 as in the case of the producers where they have seen broad
14 increases in the value of their oil. We would like to
15 discuss, for a minute, the effect that we see of the
16 three pieces of legislation before us. The settlement bill
17 as written would actually increase taxes to the utility
18 and to its customers. It would be acceptable if it were
19 amended to treat public utilities on a non-unitary or
20 separate basis. The same is true on the Free Conference
21 Committee Substitute as written would also negatively affect
22 Alaska Gas customers and increase the taxes markedly. I
23 would like to ask ...

24 MR. DANKWORTH;

25 Pardon me, just a moment. When you said Free Conference

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

page 16

1 Committee Substitute are you talking about 524 or 202?

2 MR. BARNES:

3 Free Conference Committee Substitute for 524.

4 MR. DANKWORTH:

5 Yes. Okay. That's the reserve tax, the one that we are
6 talking about here. I don't want to get confused when
7 you are saying - you are testifying now to, what, 524?
8 Senate Bill 524?

9 MR. BARNES:

10 Yes, sir.

11 MR. RAY:

12 We have two pieces of legislation that we are looking at
13 as a Free Conference -- first, I guess it would be
14 proper to say the House Committee Substitute for Senate
15 Bill 524, and we also have another proposal which is a
16 Free Conference Committee Substitute for Senate Bill 524.

17 MR. BARNES:

18 I believe that's one that I was speaking to that appears
19 to be an amendment to the settlement bill. Okay.

20 MR. RAY:

21 That's the one with the ELF's in it.

22 MR. BARNES:

23 Yes, sir. I would like to ask Mr. Hickman to discuss
24 the proposed change that we would offer to either of those
25 bills which would affect the utility. And then ask ...

1 MR. GARDINER:

2 Do you have copies of this so we could look at it?

3 MR. BARNES:

4 Yes, sir. After discussing that then we would like to
5 return to the third piece of legislation that has been
6 discussed previously, the backstop bill.

7 MR. HICKMAN:

8 We believe that under the allocation formula set forth
9 in either of the two bills mentioned, the settlement bill
10 or the substitute for the settlement bill - the effect
11 will be to allocate greater income into the utility
12 business in the State of Alaska so that a public utility
13 will pay a larger income tax and our rates will be
14 affected by that so that we will, in effect, pay a larger
15 tax than our tax would be if the utility were taxed on
16 a separate company basis. We would propose an amendment
17 to 43.20.065 which would add the following sentence: not
18 withstanding other provisions of this Act, the taxable
19 public utility income of a public utility regulated by
20 the APUC will be determined pursuant to Alaska Statute
21 43.19.010(18)(a) - that's the provision that provides for
22 separate accounting treatment of a company and tax on that
23 company's income based on its actual assets and activities
24 within the State.

25 MR. RAY:

Commissioner Williams, would you come up here, please?

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99624

JUDY JONES
586-6846

page 18

1 Continue, sir.

2 MR. HICKMAN:

3 If those -- if either of those bills were modified or if
4 this particular change were made, then either of the bills,
5 we believe, would be acceptable to the utility and its
6 customers since we would not be paying in excess of the
7 statutory rate, 9.4% times the income generated by our
8 activities in the State of Alaska as determined by the
9 Alaska Public Utilities Commission. We do believe that
10 the proposed substitute for the settlement bill has a
11 detrimental effect not only to our utility, but possibly
12 to other corporations in the State of Alaska - in that in
13 the original settlement bill there is a provision for
14 investment tax credit that goes beyond the provision
15 that is in the present law, so that all taxpayers in the
16 State, all corporate taxpayers, would receive an investment
17 tax credit in some instances substantially greater than
18 what they are presently entitled to. The proposed
19 substitute for the settlement bill, while it reduces the
20 effective tax rate in the lower brackets for a corporation
21 operating within the State, it does not provide the
22 investment tax credit that the settlement bill does.
23 And to some extent, it may represent a tax increase to
24 some corporations rather than a tax decrease to some
25 corporations. It's -- we've only looked at this particular

1 thing yesterday, and we're still uncertain as to all the
2 effects that the bill may have - not only on our corporation
3 but on other corporations in the State. However, our
4 interests have to be directed primarily to our utility
5 customers, and so from our standpoint if this amendment
6 takes place, then it would have to remove our objections
7 to those two bills.

8 MR. GARDINER:

9 Does this amendment, whether it is put in either bill,
10 create any legal problems for the State that is going to
11 make us vulnerable to anybody's attacks under equal
12 protection or discrimination?

13 MR. HICKMAN:

14 I'm not an attorney. My guess is that - Mr. Williams should
15 speak for himself, but - my guess is that some would say
16 that by restricting public utility to those regulated by
17 the Alaska Public Utilities Commission it may be that there
18 are other public utilities which should similarly qualify
19 and it might be discriminatory to that extent. If it was
20 only public utility -- if we said only public utility,
21 I don't know what the effect on State revenue would be,
22 and whether other accommodations would have to be made to
23 take care of that problem. That's -- again, I think
24 Mr. Williams could best advise in that regard.

25 MR. BARNES:

Mr. Chairman, if you will, I'd like to review the so-called

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

page 20

1 backstop bill as well, as to our interpretation how that
2 would affect us. Okay. We see the -- what we have titled
3 as the House Committee Substitute for Senate Bill 524
4 as allowing non-unitary treatment of a utility such as
5 Mr. Hickman has just spoken to. The effect being that the
6 statutory rate would be charged against the operations, the
7 income of the utility only, and we would not see allocation
8 of income from outside of the State against a utility.

9 MR. RAY:

10 If this amendment was in there, would that take care of
11 your problem? If your suggested amendment was incorporated
12 in that bill, would that take care of your problem?

13 MR. BARNES:

14 It would not be necessary, we don't believe, under the
15 House version of the backstop bill. The exemption of the
16 natural gas reserves was something that, of course, we
17 were glad to see added to the House version. We believe
18 that it benefits the Alaska Gas Service Company customers.
19 I think that it could benefit the ANCS (ph) line and
20 could benefit natural gas liquid-based petrochemical
21 development within the State. We recognize that it does
22 not settle industry claims against the State which we
23 would prefer to see settled in an amicable way. It does
24 give, from what we have seen, the lowest effective tax
25 rate to utility customers. This bill could use some other

1 technical amendments which we would like to suggest at
2 a later time if the Committee desires to move toward that
3 form of bill -- but we would not offer them at this time.

4 MR. RAY:

5 Thank you, sir. Are there any other questions from any
6 members of the Committee? My thanks, and ... Senator?

7 MR. DANKWORTH:

8 ... one quick question. Clarify on the proposed -- not the
9 settlement agreement but the proposed amendment to the
10 settlement agreement - did you say that you determined
11 you would take a loss? Or did you say that you are not
12 for sure whether you would lose or not on the bill?
13 You just haven't had time ...

14 MR. HICKMAN:

15 We would lose on the settlement bill -- not on the
16 settlement bill but on the proposed substitute for the
17 settlement. We are a very capital intensive business.
18 Our capital expenditures average, expansions to the
19 gas plant, average between \$5 and \$8 million per year
20 to serve that particular area. Under the proposed
21 settlement that has been discussed we believe, if we
22 interpret the bill correctly, we would have available
23 to us an investment tax credit of approximately \$800,000
24 which would reduce -- from \$500,000 to \$800,000 --
25 which would reduce our income tax expense to that extent.

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99624

JUDY JONES
586-6846

Page 22

1 That is an item that is also passed through to our
2 customers through the regulatory process. Under the
3 proposed substitute for that settlement bill, that
4 investment tax credit disappears. Now that's whether or
5 not the amendment goes in, Senator.

6 MR. DANKWORTH:

7 Were you here yesterday -- at the last meeting?

8 MR. HICKMAN:

9 Yes, sir, I was here yesterday afternoon from ...

10 MR. DANKWORTH:

11 Can you tell the Committee out of the options that are
12 before the Committee which one are you supporting?

13 We got to make a decision, you know, and I just want to
14 know what -- are you testifying against that particular
15 piece, or are you testifying for 200? Or are you
16 just making a statement and not testifying against any
17 of the options?

18 MR. HICKMAN:

19 In range, or in order of preference, the most costly bill
20 to us as a public utility in the State of Alaska, would
21 be the last bill that we have seen which would be the
22 Substitute -- proposed Substitute for the settlement,
23 which we have titled as Free Conference Committee Substitute
24 for Senate Bill 524. That would be the most costly to us.

25 MR. RAY:

That's the one you like least?

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

Page 23

JUDY JONES
586-6846

1 MR. HICKMAN:

2 That's the one we like least, yes, sir. The others are
3 probably about even in their application to our particular
4 situation. And I don't think that we could really
5 choose in tax effect between the others - it would depend
6 on any particular given year, with the amendment as
7 proposed.

8 MR. RAY:

9 With the amendment as proposed. The Free Conference
10 Committee Substitute with the amendment - that wouldn't
11 do you any good anyway right?

12 MR. HICKMAN:

13 It would be about 5 to \$800,000 more expensive than the
14 other.

15 MR. RAY:

16 All right. Are you finished, sir? Thank you very much.
17 I wonder if the Attorney General, the real Attorney
18 General now, and the Commissioner of Revenue would take
19 their places down at the end? This is a byword to the
20 Committee, we know he is really it now, so better cool off.
21 Sir? Did you have something, Senator, excuse me.

22 MR. DANKWORTH:

23 No, Mr. Chairman, other than to suggest -- and I had
24 forgotten where he left -- we cut him off yesterday an
25 his testimony -- and I can't remember where, at what bill

1 he was explaining in -- I thought ...

2 MR. RAY:

3 He hasn't started yet.

4 MR. DANKWORTH:

5 I don't know why, I thought he started yesterday.

6 MR. RAY:

7 No, he hasn't done anything really of any ... I think that
8 possibly in order to expedite the business of the
9 Committee that we get you both there and we'll start in
10 asking you the questions, or you can take us through some
11 of these proposals. I suppose that both of you speaking
12 for the Governor, you might have a preference as to
13 what the Governor wants. If you don't you shouldn't be
14 there.

15 COMMISSIONER WILLIAMS:

16 We have a communication.

17 MR. RAY:

18 All right. Perhaps we should hear that before we -- do you
19 have a communication from the Governor, Commissioner Williams?

20 MR. CONDON:

21 He does.

22 MR. RAY:

23 General?

24 COMMISSIONER WILLIAMS:

25 Thank you. We do indeed. We apologize that

1 the members have not had a chance to receive these yet.
2 They are in the process of being run off. Let me read
3 for the sake of the record the Governor's letter. It's
4 dated June 23, 1981. It says: "Let me make my position
5 clear on the oil tax issue. There are two criteria which
6 any legislation must meet to be acceptable. One, it must
7 not permit the State's share to fall beneath 30%. Two,
8 it must improve our legal position. Legislation which
9 fails to meet either objective would be subject to veto.
10 Additionally, it would be desireable to, three, extinguish
11 litigation. And four, reduce the likelihood that the oil
12 tax issue will continue to be a perennial political
13 liability for those in public office. Several options
14 could at least meet the first two criteria. These include:
15 one, passage of the backup tax as in House Bill 200.
16 However, while improving our legal position, this would
17 likely increase public responsiveness to the oil companies'
18 amplified charges of, quote, unfair treatment, unquote.
19 Certainly efforts would increase to secure an even larger
20 percentage of the State's current share than with the
21 companies' so-called settlement proposal. Two, pass the
22 settlement proposal. This could resolve the litigation.
23 However, I am advised it could reduce the State's share
24 below 30% should certain Reagan tax proposals be adopted
25 unless it is crafted so as to avoid that effect." I might add

1 parenthetically here that I believe the version of the
2 settlement bill that is before the Committee -- one of
3 the versions anyway -- does have provisions included in
4 there that would avoid those effects of the capital
5 recovery allowance which is super-accelerated depreciation.

6 MR. RAY:

7 Which one are you talking about, sir, so we can identify it?

8 COMMISSIONER WILLIAMS:

9 The one that I know is in there is in, I would call,
10 Dankworth 2. It's the modified settlement with the
11 ELF's in it. To continue on with the Governor's letter:
12 "The third option that would meet the basic two criteria
13 in order to avoid being vetoed. The third one: the
14 basic -- this would be the enactment of a basic settlement
15 proposal plus an adjusted ELF factor." Essentially this
16 is what I just referred to. "This approach would not
17 assure settlement but would reduce prospective State
18 revenue losses. Four, a public vote on House Bill 200
19 versus the settlement. This could be on the ballot in a
20 special election this fall. No matter what the public's
21 response, it could largely remove this issue from the
22 political arena. Approval of the industry's proposed
23 settlement or endorsement of House Bill 200 would place
24 the public stamp of approval on whichever approach were
25 selected by the voters."

1 MR. RAY:

2 I didn't get the first part of that. What did he say?

3 COMMISSIONER WILLIAMS:

4 Whichever way it went, it would have ...

5 MR. RAY:

6 He wants a vote? Is that what you are saying?

7 COMMISSIONER WILLIAMS:

8 That's the fourth option that would meet his two criteria
9 in order to avoid a veto. "It is doubtful that even massive
10 lobbying efforts from either side could easily persuade
11 future legislatures to fly in the face of that public
12 position. Since the latter approach is the only one which
13 meets all four objectives, it is my preference. Least
14 acceptable is do nothing. While this may seem the easiest
15 way to deal with this issue in the short term, it would
16 assure continuation of litigation, acceleration of the
17 industry's propaganda efforts designed to roll back the
18 State's share even further and thus continue this as a
19 major campaign issue." It would further necessitate --
20 I'm sorry -- "it would necessitate reduction of the proposed
21 fiscal year '82 budget by at least another \$350 million
22 for a rainy day should we lose in court. Accordingly,
23 let me urge you to pass any one of the above four
24 proposals for which there are the votes. As the only option
25 having already passed one house, the simplest, of course,

1 while not my first choice, would be for the Senate to
2 adopt House Bill 200. Thus, should other options not be
3 possible, at the very least, do that. Sincerely, Jay S.
4 Hammond, Governor."

5 MR. GARDINER:

6 Commissioner, there's one alternative I'm not sure that
7 I heard in there which was the alternative, I think,
8 originally suggested by the Attorney General, at least
9 that's the first time I remember hearing it although
10 people talked about it a lot -- and that would be a
11 piece of legislation that very simply passed the so-called
12 warts, granted the windfall profits tax exemption to the
13 producers which they have long told us that they desire to
14 have, and thirdly, to raise the severance tax in an
15 appropriate manner that would offset the revenue loss.
16 With that simple thing, the State would, as I understand it,
17 as argued previously by the Attorney General, improve its
18 position in the court because of, one, the warts and the
19 windfall profits tax argument would not longer exist in
20 court. And two, less revenue would be at risk because it
21 would now -- 40% of the revenue coming in, it would be
22 coming in under the severance tax rather than 43.21.
23 And thirdly, the industry would have a net tax relief of
24 something like \$150 million a year because of the offset
25 of the federal taxes. Even though the State would not lose

J&R Associates

P.O. BOX 29 • DOUGLAS ALASKA 99824

JUDY JONES
586 6846

Page 29

1 revenue, the industry would gain \$150 million a year. I
2 did not hear you refer to that alternative in there and
3 I wondered if there's any reason for objection to that, or
4 whether that alternative meets the criteria as described
5 in the letter.

6 COMMISSIONER WILLIAMS:

7 With respect to the two essential criteria, since it
8 preserves essentially the same amount of revenue, and the
9 present level of revenue is over 30%, it would meet the
10 first criterion, that is, the State's share would not fall
11 and - our revenue would be preserved. Second, it would
12 simplify the lawsuit, and to that extent improve our legal
13 position. The basic question of separate accounting versus
14 apportionment, of course, would remain. But I think probably
15 it -- on that second criterion, it marginally meets that
16 as well. It does not meet the third criterion of
17 extinguishing litigation. I don't think they will settle
18 the case. And fourthly -- well, people can make their
19 individual judgment about whether it reduces or continues
20 the likelihood that the oil tax will remain a perennial
21 political issue. Those are the four criteria. It does
22 meet the two that are essential to avoid a veto.

23 MR. RAY:

24 Commissioner, in the -- do you have a copy of all this
25 stuff? Free Conference Committee Report -- Committee

1 Substitute I guess you'd say. In there they have a
2 section 3 which is a -- it has to do with the income tax
3 rate. What would that do if that was incorporated into
4 the House Committee Substitute for 524?

5 COMMISSIONER WILLIAMS:

6 Sections 3 and 4 both provide for a graduated rate
7 schedule. And basically, it affects both oil companies
8 and non-oil companies since they would all come under
9 Chapter 20. For the non-oil companies it would probably
10 result in a reduction in the first year -- well, in FY '83 --
11 of perhaps \$5 million, \$6 million the next year, and
12 \$7 million the final year. That's the combined effect
13 between section 3 and section 4. In section 3 there's
14 provision for two brackets that are not present in
15 section 4, and so for fiscal year '82 which is when section 3
16 would primarily be in effect those different brackets
17 probably wipe out any cost that would result there. We
18 would assume that the fiscal impact would be zero there
19 as a result of 3. Fiscal impact in 1982 -- the same
20 fiscal impacts as I described before for '83, '84, and '85.

21 MR. RAY:

22 That would seem to be, at least, in my estimation, a
23 desirable inclusion in the Committee Substitute, speaking
24 for myself. Senator?

25 MR. DANKWORKTH:

Are we talking about -- maybe I didn't understand -- were

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

page 31

1 you talking then about the warts bill; including the warts
2 and raising the severance tax? What would that do, if
3 we were to do that and adopt that - what would be the
4 security of the State so far as -- our position on 21
5 would continue in court and we would continue to have
6 liabilities, wouldn't we? Or the amount of money at risk
7 would continue to grow, would it not?

8 MR. CONDON:

9 Yes. Under -- if I can refer to -- just make a comparison
10 between proposal number 5 -- it's not mentioned in the
11 Governor's letter but which Representative Gardiner
12 mentioned -- and Dankworth 2, for shorthand The switch
13 from -- at the time the switch from separate accounting
14 to apportionment takes place, there will be approximately
15 \$2 billion at risk as a result of taking the separate
16 accounting approach. And that will remain at risk throughout
17 the remainder of the litigation - there are some provisions
18 in this bill which would reduce that some, and I'll get
19 to them in a moment. If the switch is made that is
20 suggested by Representative Gardiner and the windfall profits
21 tax deduction is granted but separate accounting is
22 continued, then we would continue to pile up a risk as a
23 result of the separate accounting. And the numbers for
24 FY 82 would be approximately \$300 million, and then in
25 FY 83 would be \$698, FY 84 798, and FY 85 829. I mean,

1 those kinds of numbers are what we are looking at in
2 terms of the continued amount that would be collected
3 pursuant to the separate accounting approach during those
4 years.

5 MR. DANKWORTH:

6 Then basically, if we were to accept that approach then
7 we are going to have to reevaluate whether we have an
8 escrow account or a backstop or some kind of backup
9 position for the State.

10 MR. CONDON:

11 If you look at the numbers for FY 82, you would be
12 protecting about \$320 million worth of anticipated revenue
13 if you took proposal 5. And I discussed this matter with
14 the Governor and he does not believe that an escrow would
15 be required in FY 82, but thereafter, FY 83 and 84, the
16 Governor believes that an escrow should be established
17 until the litigation is resolved.

18 MR. GARDINER:

19 Yes, I don't -- I think I agree with that point, that the
20 objective of that bill is not that it eliminates all
21 risk, but on the other hand I haven't heard anybody say
22 that they are going to settle the 43.21 suit for the
23 \$2 billion in the back, or they are not going to attack
24 the modified apportionment because it is a unique thing -
25 nobody else has an apportionment formula like this one that's

1 being proposed, and there's the question of a whole new
2 tax structure that could be litigated. And, you know, if
3 people would tell me they aren't going to litigate this
4 new bill then maybe I wouldn't worry about that. One
5 of the arguments against the backstop that I heard people
6 say, well, we are going to have two court suits. And I
7 think that's what we are looking at here. And maybe
8 they're different types of tax structure, but I think one
9 of the answers from the industry is that, you know, they
10 might just litigate the whole tax structure of the
11 State if this continues on and there's not a reduction
12 there. I don't know what that means, but it has been
13 brought up at two different hearings. But, do you think
14 there's any risk with the modified apportionment? Is
15 the revenue that is brought under there at risk? Or is
16 there nothing to worry about?

17 MR. CONDON:

18 Of course there is some risk. It is a reduced risk, in
19 my opinion, from the separate accounting approach. So the
20 Dankworth 2 presents fewer risks than so-called option 5.

21 MR. RAY:

22 Mr. Condon, I'd like to go back to section 3 and 4, and
23 perhaps you can tell me, what harm or damage would this
24 do to any of our cases or any of our suits, or anything else,
25 if this was incorporated in the House Committee Substitute?

1 MR. CONDON:

2 Sections 3 and 4?

3 MR. RAY:

4 Yes.

5 MR. CONDON:

6 I do not think sections 3 and 4 increase the risk. They
7 are, I believe, an attempt to treat corporations even
8 handedly across the board, and I don't see any legal
9 problems with their adoption.

10 MR. RAY:

11 And you don't see any loss of revenues, Commissioner?
12 Appreciably.

13 COMMISSIONER WILLIAMS:

14 No appreciable loss. As I say, on the order of \$5 or
15 \$6 million a year after next fiscal year.

16 MR. RAY:

17 That looks very attractive to me in some form. I don't
18 know why we ... Senator?

19 MR. DANKWORTH:

20 Well, it certainly is. It's an option, but I did want to
21 bring up -- while that might solve Chapter 21, what would
22 be the effect of that on the native corporations in
23 Cook Inlet and other places? We would be, in effect,
24 raising the severance tax to 15. I just wondered if we
25 put the so-called warts package in this, have you had time

1 to evaluate what effect that would have? It may be an
2 unfair question if you ...

3 COMMISSIONER WILLIAMS:

4 Well, it's difficult to respond to the question, Senator,
5 because I'm not sure exactly what -- how comprehensive
6 the severance tax treatment Representative Gardiner
7 might be proposing. If he's proposing a simple raise
8 from 12.25 to 15% in the statute, then there's an effect.
9 But there are ways that that effect can be mitigated
10 for frontier areas or for marginal fields. And I'm not
11 sure how comprehensive his proposal is since the central
12 idea has only been set out and I haven't seen the detail.

13 MR. RAY:

14 And the warts, the warts deal would -- what's the final
15 analysis of -- give me a money figure and -- General
16 would you give us a legal opinion on what it would do?
17 First give us a money opinion or a money figure,
18 Commissioner?

19 COMMISSIONER WILLIAMS:

20 Of what Representative Gardiner is proposing?

21 MR. RAY:

22 On the warts, yes.

23 COMMISSIONER WILLIAMS:

24 Are we talking just the warts or the warts package? I'm
25 sorry, I don't mean to be evasive on this, but we don't ...

1 MR. RAY:

2 If we incorporated the warts into House Bill -- or Senate
3 Bill 524.

4 COMMISSIONER WILLIAMS:

5 Well, they are already there.

6 MR. RAY:

7 Yes, well, that's what I mean -- is it -- what is the
8 problem then?

9 COMMISSIONER WILLIAMS:

10 If it is only the warts by themselves in the first fiscal
11 year -- and a windfall profit tax - that will come to
12 \$494 million ...

13 MR. RAY:

14 That we would lose?

15 COMMISSIONER WILLIAMS:

16 That you would forego, that's correct.

17 MR. RAY:

18 And we don't pick up anything back with any of the other
19 taxes, right?

20 COMMISSIONER WILLIAMS:

21 You only asked me about warts - that's the cost of warts.
22 If you raise this production tax that could recover
23 \$501 million back.

24 MR. RAY:

25 We'd get it all back is what I'm saying.

1 COMMISSIONER WILLIAMS:

2 That's correct, if you do both.

3 MR. RAY:

4 And that's incorporated now in the House Committee
5 Substitute? Or is that Gardiner's proposal now? See,
6 we are getting so many different kites flying in the air
7 that it is hard to identify them.

8 MR. GARDINER:

9 Mr. Chairman, this, you know -- whatever you think is an
10 appropriate time, I would hand out copies of this proposal
11 which is pretty simple, and go through it and -- but
12 whenever you think that's appropriate so there's not so
13 much confusion.

14 MR. RAY:

15 It's appropriate anytime in this Committee to make any
16 suggestions that you want, and if you have something in
17 writing that makes it even more appreciative.

18 MR. GARDINER:

19 Well, I'll hand it out.

20 MR. RAY:

21 Yes, I've been waiting for a copy of the Governor's letter
22 there, Commissioner, if you could find it. If you can't
23 we'll get it -- somebody will get up and copy that for
24 us.

25 MR. GARDINER:

Mr. Chairman, I've put a star at the top just so you

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

page 38

1 could identify it, because they all say Free Conference.
2 Sorry, I only had 10 copies. Mr. Chairman, most of the
3 bill is the so-called warts which are the ones that were
4 modified in the House as per the recommendations of the
5 Commissioner of Revenue. What this actually proposes
6 is that the -- well, also on page 7 it has the same
7 proposals that appeared in other drafts of the bill
8 lately - the modified, from zero to 9.4% and 43.20 scale
9 on the income tax -- that's the same as appeared in
10 some of the other bills.

11 MR. RAY:

12 Might I suggest, Representative Gardiner, because we are
13 getting down to a time crunch here -- if you could just
14 delineate what your things are, and if we have a
15 problem with it we can pick up on them and then you
16 can argue at length. Okay?

17 MR. GARDINER:

18 Okay. What it basically does is set the severance at
19 13.5% and modifies the ELF in similar ways that Senator
20 Dankworth's bill and other proposals have modified the
21 ELF. Okay, that -- and it grants the windfall profits
22 tax exemption. And that's it in terms of what it really
23 does. Now, in terms of the financial effect, it basically
24 zeroes out the revenue exchange, although it has some
25 cash flow where the State loses some money in the early

1 years and then catches up. And that's because the windfall
2 profits tax exemption is retroactive and goes back and
3 picks up the time that the -- in which the industry has
4 been paying under that. I think that also helps the suit point
5 argument that a lot of people made that that's not the
6 strongest point in our case presently. So that removes
7 that issue as an argument. But the fact of it, because
8 we are increasing tax under the severance and it is
9 deductible up to 15%, that additional severance would
10 be deductible against federal taxes thereby reducing
11 the company's federal tax liability. So from my point
12 of view that has the beneficial effect of reducing the
13 company's liability while not reducing the State's
14 revenue, and that may seem appropriate since the federal
15 government is getting more than the State and the industry
16 anyway. So that's it, basically.

17 MR. RAY:

18 Could we have the reaction of both the Attorney General
19 and the Commissioner on this proposal? Or is it too
20 soon for you to make any statement?

21 MR. CONDON:

22 From a legal perspective I think the only reaction that I
23 can make at this point is just to remake the same point
24 I made earlier, and that is, that it reduces the risk but
25 it continues to allow the risk money that's at risk to pile

1 up in future years as far as the separate accounting issue
2 is concerned. By way of comparing it to so-called
3 Dankworth 2.

4 MR. RAY:

5 And what does that do as far as the Governor is concerned?

6 MR. CONDON:

7 Well, as far as the Governor is concerned, this -- without
8 knowing exactly what the revenue impacts of this are
9 going to be, but if they are close to the numbers that I
10 used on a different production tax, and anticipated
11 production tax rates, there would be no necessity for
12 an escrow this year; there would be a necessity for
13 escrows in future years.

14 MR. RAY:

15 Commissioner, what do you say? Do you know anything
16 about it?

17 COMMISSIONER WILLIAMS:

18 Well, this is the first I've seen of it but in terms of
19 your concern about marginal properties that might be
20 coming on stream, this has several positive features
21 which are worth emphasizing. First is the lower rate for
22 the first 5 years, which certainly helps. It starts
23 at 12.25, which is the present level. In addition, where
24 you are truly marginal, your ratio of PEL to TP in the
25 formula there - production at the economic limit to total

1 production - is going to tend to be small. And -- is
2 going to tend to be large, rather. And squaring that
3 is going to give you the relief that you are looking forward
4 to affording in the economic limit factor. The purpose
5 of the economic limit factor is to try to scale things
6 down as the economics deteriorate. If they start off
7 being weak, you want to have it scaled down. This is one
8 way. I believe this formula moves in that direction and
9 furthers that.

10 MR. RAY:

11 Is there a constitutional challenge to the ELF?

12 COMMISSIONER WILLIAMS:

13 Mr. Chairman, anybody with a filing fee can
14 bring a suit.

15 MR. RAY:

16 I didn't ask you that Commissioner. You know what I'm
17 asking you.

18 COMMISSIONER WILLIAMS:

19 Well, it's an important thing to remember, though, that
20 we talk about litigation and there are litigations that
21 are serious; there are those that have only a colorable
22 nature to them; and there are those that are frivolous.
23 I would think that this, in my own opinion -- they would
24 have a hard case, it would be a poor case. I wouldn't
25 want to take theirs on.

1 MR. RAY:

2 Okay. Senator Dankworth.

3 MR. DANKWORTH:

4 Well, we've probably discussed this -- unless somebody
5 else has some other questions -- you did say that
6 just so everyone knows that if we were to adopt this, we
7 will have to put somewhere between \$500 and \$1 billion
8 a year after next year into an escrow account, or
9 something; we are going to have set it in escrow until we
10 get this resolved. There will be that much less revenue,
11 if I am understanding this correctly.

12 MR. RAY:

13 Did you want somebody to respond, Senator?

14 MR. DANKWORTH:

15 No, I wanted to make sure everybody understood that was one
16 of the things that I think has already been said, that that
17 would be required. What I really want to say, if -- I
18 didn't know, maybe we were going to take number 5 and
19 put it ahead of the other proposals I had on the board,
20 but I would like to have him discuss, while we have the
21 time, my proposed amendment number 2.

22 MR. RAY:

23 I have no problem with that, Senator.

24 MR. DANKWORTH:

25 Unless there are any other questions on this one?

1 MR. GARDINER:

2 Mr. Chairman, just one little comment before we move on.
3 I don't want anybody to think that I dreamed up a new
4 brainstorm and suddenly slid this in. This is probably
5 the oldest proposal cruising around. And I promise not
6 to get the Attorney General in trouble, but this was
7 not originally thought up or suggested by myself - it
8 was suggested by the administration some months ago as a
9 simple approach because we were probably going to get
10 into all these convoluted other proposals, and this was
11 the simplest and easiest approach. I didn't agree with
12 that in February. But I do now. So it's not a new
13 proposal in that sense. It's merely that I brought it
14 up - that's the only thing that has changed.

15 MR. RAY:

16 Senator Dankworth, did you want to go back and try yours
17 again? Is that it?

18 MR. DANKWORTH:

19 No, I never have tried it, Mr. Chairman. It has never
20 been explained. That's why I wanted to start in now.
21 I have asked that - in my proposal - there be some
22 amendments made to cover some areas -- and I'd like to
23 throw that one out, and basically -- we'll pass these
24 out -- and then I want to explain.

25 MR. RAY:

Is this going to be a new one, is that it, sir? In place ...

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

page 44

1 MR. DANKWORTH:
2 ... number 2 ...
3 MR. RAY:
4 In place of the one that you have now, is what I'm saying.
5 MR. DANKWORTH:
6 That's right.
7 MR. RAY:
8 All right.
9 MR. DANKWORTH:
10 I'll mark it number 3 if that helps. Thank you.
11 MR. RAY:
12 I'll label this so we'll all have it together - this
13 is Dankworth 2.
14 MR. DANKWORTH:
15 No, it's Dankworth 3. The settlement was 1, Mr. Chairman.
16 Then there was an amendment .
17 MR. RAY:
18 But the settlement was not in the form. This is in the
19 form.
20 MR. DANKWORTH:
21 No, I had the settlement in the form, sir.
22 MR. RAY:
23 Did you?
24 MR. DANKWORTH:
25 I'm sorry if I didn't furnish you a copy ...

1 MR. RAY:

2 All right, Dankworth 3. Christians, nothing. Has everybody
3 got a copy that needs a copy? Speak, Senator.

4 MR. DANKWORTH:

5 If you would -- I don't have any preference who starts --
6 probably it would be good for Commissioner Williams
7 to -- since we all helped draft this thing from different
8 pieces of proposals that's come a long while -- they
9 may call this Dankworth number 3. And there's nothing
10 original about a lot of these proposals. They are all
11 just kind of brought together as I think probably an acceptable
12 solution to everything, but not real acceptable to
13 anybody. If it was acceptable to anybody and they were
14 very joyous about it, I'd want to go back and renegotiate
15 it. But at least this I would like for you to explain
16 if you would, Mr. Williams - go through what this bill
17 does.

18 COMMISSIONER WILLIAMS:

19 Okay. First of all, Mr. Chairman, let me explain where
20 this bill differs from Dankworth 2.

21 MR. RAY:

22 That's the main thing.

23 COMMISSIONER WILLIAMS:

24 It differs from it in section 13 which in Dankworth 3 starts
25 on page 14.

1 MR. DANKWORTH:

2 You'll have to remember that Dankworth number 2 has
3 never been explained. We've just referred to it.

4 COMMISSIONER WILLIAMS:

5 I understand that. But I want to first explain what the
6 difference is because I believe the concept of Dankworth 2
7 has been discussed. Section 13 modifies the economic
8 limit factor in the present law. Under Dankworth 2 it
9 simply was going to be made an economic limit factor of
10 1 for the first 10 years after a property came into
11 production. And then it would go back to the standard
12 formula. This one does much the same thing. It uses
13 the same formula as in the present law. It provides
14 that the economic limit factor will be 1 for the first
15 10 years if, and only if, the field is not so -- is not
16 a marginal field. And the criterion of whether it is a
17 marginal field or not is when you calculate what its
18 economic limit factor in the formula would be, if it
19 ends up being .7 or above it's not marginal. Therefore,
20 its economic limit factor is 1 for the first 10 years.
21 If it comes out that it is .7 or less then it is a marginal
22 field, and it should have the relief right from the
23 beginning that the economic limit factor is designed to
24 give. That's the break even point, then, as an indicator
25 of the economic strength of a field as it is coming on

1 stream. If its formula economic limit factor is below .7
2 then it gets its formula economic limit factor because it
3 needs that relief. If it's at .7 or higher -- I'm sorry,
4 if it's over .7, then for the first 10 years the economic
5 limit factor will be 1. That means that for the
6 stronger fields, for the first 5 years, they will be taxed
7 at a flat rate of 12.25% with no reduction, and then
8 for the next 5 years, they will be taxed at 15%, with no
9 reduction, and then finally, starting in the 11th year,
10 they'll go back to the standard formula. For the marginal
11 fields for the first 5 years there would be at 12.25% times
12 their ELF, whatever it is, that's less than .7. And
13 then it goes to 15% times the ELF, whatever it is, which
14 is .7 or less. And then it goes to the standard formula,
15 period, just as it has been. That's the difference
16 between Dankworth 3 and Dankworth 2. Now, Dankworth 2
17 sets out in section -- well, first of all, there are
18 three sections that deal with ordinary corporations.
19 The first one is a wart - this is in section 2 - and it's
20 the retroactive wart - it just simply makes the provisions
21 in 43.20 parallel to the provisions in Chapter 21 about
22 who is subject to which Chapter. Section 3 we've already
23 discussed - this introduces a new graduated, stair-step,
24 progressive rate schedule for corporations - the more they
25 make the higher their bracket becomes. This one would,

1 section 3 is made retroactive to the start of this year
2 and it applies only to this year. The tax rate can go
3 as high as 11% for taxpayers making over \$2 million.

4 MR. GARDINER:

5 Does that create any legal vulnerability, the fact
6 that you are retroactively putting in a higher rate
7 for just one year?

8 COMMISSIONER WILLIAMS:

9 We are in the middle of the year.

10 MR. GARDINER:

11 Yes, I know, but does that -- I might, as a taxpayer, if
12 you did that to me, say that wasn't the neatest idea in
13 the world. Why are you -- I would argue, well, why are
14 you coming in 11% this year if 9% is going to be good
15 enough for all the years to come? Maybe you just want
16 to gouge me now, and besides that you're making it
17 retroactive.

18 COMMISSIONER WILLIAMS:

19 On the other hand, you are also giving relief at the
20 lower end of the scale - it will depend on how much you
21 are making. Perhaps a simpler thing to do is to defer the
22 tax relief so that people don't see it until they file
23 their returns in April of 1983.

24 MR. GARDINER:

25 I'm just being argumentative as to whether it is legally

1 vulnerable.

2 COMMISSIONER WILLIAMS:

3 I understand, and that's the alternative.

4 MR. CONDON:

5 I don't think it is legally vulnerable. There have been
6 previous occasions, as you well know, when we've changed
7 the tax half way through the year and it has been
8 retroactive to the beginning of the year. As a matter
9 of fact that's how we got into Chapter 21.

10 MR. GARDINER:

11 And they didn't like that.

12 MR. CONDON:

13 Well.

14 MR. RAY:

15 Gentlemen, if I could ask you on the Dankworth 3 - does
16 this meet the first criteria, that it does not permit the
17 State's share to fall below 30%?

18 COMMISSIONER WILLIAMS:

19 That's correct.

20 MR. RAY:

21 Does it meet the second criteria, it must improve our
22 legal position?

23 COMMISSIONER WILLIAMS:

24 Yes, it does.

25 MR. RAY:

Does it do anything with litigation?

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

page 50

1 COMMISSIONER WILLIAMS:

2 Well, no. Probably not.

3 MR. DANKWORTH:

4 It doesn't get us -- what do you mean it doesn't improve
5 litigation? It does set moot the case in court, doesn't
6 it? It does involve the litigation to some extent, doesn't
7 it?

8 COMMISSIONER WILLIAMS:

9 I said it improved our legal position. And that's number 2.
10 But to extinguish litigation - I assume they will continue
11 to fight over the money that has been paid in under
12 Chapter 21.

13 MR. DANKWORTH:

14 Okay. I'm sorry. I didn't ...

15 MR. RAY:

16 Does the -- what does the Gardiner proposal -- does that
17 meet the first criteria?

18 COMMISSIONER WILLIAMS:

19 Yes.

20 MR. RAY:

21 Does it meet the second criteria?

22 COMMISSIONER WILLIAMS:

23 Yes.

24 MR. RAY:

25 How about the third? Do you extinguish the litigation?

1 COMMISSIONER WILLIAMS:

2 No.

3 MR. GARDINER:

4 I don't think anything except the industry settlement
5 would do that.

6 MR. RAY:

7 Maybe we ought to outlaw them.

8 COMMISSIONER WILLIAMS:

9 The election would also do that -- could do it.

10 MR. RAY:

11 It's too much trouble. The State should get out of the
12 oil business. They cause too much trouble.

13 COMMISSIONER WILLIAMS:

14 Mr. Chairman? May I continue on with the explanation of
15 the bill, or am I cutting off your ...

16 MR. RAY:

17 Do you really want to, Senator?

18 MR. DANKWORTH:

19 Well, it's pretty important, and I intend to move this
20 as an amendment to the bill. And if you'd like, if the
21 members are satisfied with it, I ...

22 MR. RAY:

23 Well, it's of no consequence to me whatever ...

24 MR. DANKWORTH:

25 I would like to pursue it, and as rapidly as possible.

1 I think what the Chairman is saying is let's don't repeat
2 old stuff.

3 MR. RAY:

4 What I'd really like to do is to have you make a
5 comparison between the Gardiner proposal and the Dankworth
6 proposal, if you could?

7 COMMISSIONER WILLIAMS:

8 The biggest difference, probably, is going to be the fact
9 that you continue to have the principle of separate
10 accounting be applied in the future, and therefore liability
11 under separate accounting, or exposure to liability under
12 separate accounting continues to pile up. Although that
13 means in fiscal year '82, perhaps, it's not necessary to
14 have an escrow, and strictly speaking it would be
15 necessary to have one of about \$35 million, but that's
16 small compared to the escrow that you are going to need
17 the next year which is several hundred million dollars,
18 and then several hundred million dollars more the following
19 year, to simply be prudent and have the money set aside
20 in the event that separate accounting is struck down.
21 Dankworth 3 goes to a different formula. It's no longer
22 the question of separate accounting. It goes to the
23 question of a formula. Lots of states have unique
24 formulas. Iowa has a unique formula and it was upheld
25 by the U.S. Supreme Court. Its formula looks only at sales.

1 New York has a unique formula. It has got the standard
2 three factors but it double counts sales. Florida, I
3 think, double counts property. The states have a great
4 deal of latitude to adjust their formulas. Now, it's true
5 our formula will also be unique. But I think there's a
6 reasonable basis for it when you are -- which will
7 sustain it when you are dealing with a depleting asset.
8 The standard three factors just don't apply to an
9 extractive industry. Payroll doesn't apply here because
10 this industry is highly capital intensive. Payroll
11 overstates the extent of their business activity here.
12 Sales -- by the oil companies' own accounting, two thirds
13 of their profits comes from their production, not from
14 their sales.

15 MR. RAY:

16 Stick to the 2, will you. Are you still talking
17 about the 2; comparison between Dankworth and Gardiner's?

18 COMMISSIONER WILLIAMS:

19 Yes.

20 MR. RAY:

21 All right.

22 COMMISSIONER WILLIAMS:

23 And finally, you know, land -- I'm just justifying the
24 formula, explaining why -- well, I can cut it short.

25 MR. GARDINER:

I think there's this issue of the escrow. I agree under what

J&R Associates

P.O. BOX 29 • DOUGLAS ALASKA 99824

JUDY JONES
585-6846

page 54

1 I propose, which was proposed by the administration,
2 there would be potentially a need for a future escrow.
3 Would we need an escrow if the modified apportionment
4 bill was seriously attacked by the producers in court?
5 Would you advocate an escrow then?

6 COMMISSIONER WILLIAMS:

7 My reaction would be, looking at it from the Department's
8 point of view, I would think that I would recommend an
9 escrow no more than I would in the case of the backstop
10 tax. That is, no, I would not recommend an escrow.

11 MR. CONDON:

12 Do you want my recommendation? My recommendation would
13 be no too.

14 MR. RAY:

15 In your judgment, which, from the position of the
16 administration, would you approve - the Dankworth 3 or
17 the Gardiner approach?

18 MR. CONDON:

19 From the position of the administration, we think the
20 Dankworth 3 is more desirable, assuming that it will
21 pass.

22 MR. RAY:

23 What do you think, Commissioner Williams?

24 COMMISSIONER WILLIAMS:

25 That's correct. I concur.

1 MR. RAY:

2 Are you back to doing nothing now, is that it?

3 COMMISSIONER WILLIAMS:

4 If Dankworth 3 will not pass.

5 MR. RAY:

6 That's the most desirable - or that's the least desirable,
7 and that's the end result it might be - is nothing.

8 MR. CONDON:

9 Well, if Dankworth 3 will not pass then pass Gardiner 1.

10 MR. DANKWORTH:

11 That one won't pass.

12 MR. HALFORD:

13 I've got a question with regard to Dankworth 3. There's
14 some indication that there would be an actual tax increase
15 on other non-oil businesses in the State, and on a
16 retroactive basis. If that increase is part of what
17 we're paying the bill with, how much is it? And what
18 happens if you take it out?

19 COMMISSIONER WILLIAMS:

20 You mean in section 3 there - that increase that goes up
21 to the 11%?

22 MR. HALFORD:

23 Right. 11%.

24 COMMISSIONER WILLIAMS:

25 It'll cost you \$140 million because the tables apply to all

1 corporations.

2 MR. HALFORD:

3 Right. If you don't make it retroactive, what is the cost?

4 COMMISSIONER WILLIAMS:

5 Half of that.

6 MR. HALFORD:

7 140 per year.

8 COMMISSIONER WILLIAMS:

9 In this fiscal year 1982, coming up.

10 MR. RAY:

11 Would you repeat that again? I didn't quite get that.

12 COMMISSIONER WILLIAMS:

13 Essentially, the question was if we only adopted section 4
14 instead of section 3 in Dankworth 3, what would the revenue
15 effect be coming up? There's a revenue effect that would occur
16 only in fiscal year '82, and that would be a reduction, by
17 not enacting section 3 -- a reduction of about \$140 million
18 in fiscal year '82. If you made it -- if you adopted
19 section 3 starting July 1, then you'd have half, roughly
20 half.

21 MR. HALFORD:

22 How does that \$140 million breakout in terms of what
23 industries, who pays the bill -- where does it breakout?

24 COMMISSIONER WILLIAMS:

25 90% of our revenue comes from the oil industry.

1 MR. DANKWORTH:

2 I wanted to -- did you have an opportunity, Commissioner
3 Williams, on the oil and gas service company, talked about
4 a proposed amendment which would probably fit in here --
5 did you have a chance at all to review that? Or would you
6 be able to comment on it at this time?

7 COMMISSIONER WILLIAMS:

8 Yes.

9 MR. DANKWORTH:

10 Would you?

11 COMMISSIONER WILLIAMS:

12 Yes, I would. First of all, the amendment as proposed
13 would cause a great deal of confusion because of the
14 consolidation of the Alaska Pipeline Commission with the
15 Alaska Public Utilities Commission. And this says that it's
16 a taxable public utility income of a public utility
17 regulated by the APUC will be determined pursuant to separate
18 accounting, essentially, is what it's saying. The
19 question will then be whether the, you know -- we've got
20 separate accounting on oil pipelines now. It's contemplated
21 that it's going to trans -- may transfer over if Dankworth 3
22 is adopted. This would be inconsistent with that transfer,
23 number 1. Number 2, I think that there may be a problem
24 when you are talking about only utilities that are regulated
25 by the State of Alaska. That's, by definition, in-state, and

1 you may have a challenge on its face of tax treatment
2 in-state versus out-of-state taxpayers. Number 3, the
3 relief that they are talking about - 43.19.010(18)(a)-
4 is really -- 43.19.010 article 4 section 18(a) -- and
5 that's power that the Commissioner already has, and that
6 they can already seek relief under in the statutes. It
7 says,"if the allocation and apportionment provisions of
8 this article do not fairly represent the extent of the tax-
9 payer's business activity in the State, the taxpayer may
10 petition for, or the tax administrator may require, in
11 respect to all or any part of the taxpayer's business
12 activity, if reasonable, (a) separate accounting." So it
13 can get the relief administratively. If they fail to get
14 the relief, or they are unsatisfied with the administrative
15 relief, there are provisions to take it to court. It's
16 not necessary to create all these legislative problems
17 with the bill, I don't think.

18 MR. GARDINER:

19 With this 10 year exemption business, what happens to the
20 State's revenues after Prudhoe Bay gets its 10 years in?
21 What's going to be the loss in State revenue during those
22 years?

23 COMMISSIONER WILLIAMS:

24 There will be a drop as there would be with any other field
25 that's discovered in the future whose initial economic limit

1 factor is robust, over .7, will be at 1 for those first
2 10 years, and then it will fall back. In the case of
3 Prudhoe Bay, I don't know -- probably, the economic limit
4 factor in 1987 will be .6 or .7, and maybe .8, and if that's
5 the case it would drop by 20% when the 10 years run out --
6 20 to 30%.

7 MR. RAY:

8 Commissioner, there's been a suggestion that the Dankworth --
9 both 2 and 3 -- that it would make a substantial increase
10 on the taxes on pulp mills, airlines, ALASCOM -- is this
11 true?

12 COMMISSIONER WILLIAMS:

13 Well, I certainly can't answer the question about ALASCOM,
14 since you mentioned them by name, but I can -- I don't
15 know what the net profits are of pulp mills. I know they
16 have high grosses, but they have small nets. And this is
17 net income - this is not gross income. So if there...

18 MR. RAY:

19 You can't answer that competently, at this time, right?

20 COMMISSIONER WILLIAMS:

21 I think that to get into specifics -- first of all, I don't
22 have the information with me. And second of all, I probably
23 would start verging on confidential information of individual
24 taxpayers.

25 MR. RAY:

Don't get too slippery, Commissioner.

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99824

JUDY JONES
586-6846

page 60

1 COMMISSIONER WILLIAMS:

2 I try not to.

3 MR. GARDINER:

4 Mr. Chairman, since yesterday was the first day we had to
5 start looking at this bill, I -- the reason I ask the
6 question was my information indicated that the -- when this
7 ELF thing kicks in in 1987, when Prudhoe Bay has got its
8 10 years in, that the revenue drop in the next 3 years
9 would be in the order of \$500 million a year. I don't know
10 whether that's correct or not. The Commissioner did say
11 there will be a drop - he said 20% - I don't know the
12 numbers well enough to know if that's the case or not. But
13 I would like to know the exact answer to that, and if my
14 numbers that I've got aren't correct, I would like to get
15 some numbers from the Commissioner in terms of what he
16 calculates the drop would be at that point.

17 COMMISSIONER WILLIAMS:

18 Mr. Chairman, I'm not in a position to dispute Representative
19 Gardiner's numbers. The point is no one knows how many
20 wells will be drilled in 1987. I can develop a drilling
21 scenario that would have the ELF at .5. If the point is that
22 you believe the revenues will fall in half, you can justify
23 that and I can't dispute it. The fact is, though, that they
24 will revert back then to the curve that we have under the
25 present law.

1 MR. GARDINER:

2 Maybe we won't have a 43.21.

3 COMMISSIONER WILLIAMS:

4 Oh, we probably could by then because we will have a decision.

5 MR. RAY:

6 Do you have your copy of Dankworth 3 there?

7 COMMISSIONER WILLIAMS:

8 Yes, I do.

9 MR. RAY:

10 On page 3, line 8 - if you would change the figures -- or
11 on line 9 - if you would change the \$2 million to \$4 million;
12 and on line 10, from \$2 million to \$4 million what
13 would that do, if anything?

14 COMMISSIONER WILLIAMS:

15 In the overall scheme of things, I don't think the effect
16 will be very large. I don't know off the top of my head
17 how many taxpayers there are who fall in that category but
18 there are probably, maybe, a few dozen, perhaps as many
19 as a hundred. And it's not going to be a major revenue
20 adjustment - several hundred thousand dollars, maybe a
21 million.

22 MR. RAY:

23 It is my hope -- of course, I just express it -- the body
24 is certainly open for motions at any time. I would think
25 that perhaps any proposal that might be forthcoming at this

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99624

JUDY JONES
586-6846

page 62

1 time could not garner the votes on either side, or, I mean,
2 on both sides. So if there are motions I will accept a
3 motion, but I would say that possibly we cannot finish
4 this until tomorrow. Senator Dankworth?

5 MR. DANKWORTH:

6 If I understand you, Mr. Chairman, you would entertain a --
7 if I cared to I could move an amendment that we -- you don't
8 want to vote on it until tomorrow.

9 MR. RAY:

10 Sir, it's not within my prerogative to tell the Committee
11 what to do. I appreciate your concern and consideration.
12 I would just as soon not vote on it. That does not preclude
13 you from offering it, and requesting a vote.

14 MR. DANKWORTH:

15 Well, sir, and I respect that, and I have no problem waiting
16 until tomorrow for the vote but for the purpose of discussion,
17 and so that we could offer some amendments, I would like
18 at least to make a statement to the Committee - that at the
19 next meeting, so we probably won't be able to take lengthy
20 testimony considering the work tomorrow, I would like to
21 tell the Committee that I intend to propose Dankworth number 3
22 as an amendment to 524 tomorrow. And I intend to try to
23 amend it to include, on page 3, raising that to \$4 million
24 on line 9; and raising the figure of \$2 million on line 10
25 to \$4 million. And those amendments I would make -- so with

1 that I won't make the motion -- defer it until tomorrow.

2 MR. RAY:

3 Senator, I would accept a motion -- as far as changing
4 the body of the bill, we can amend it anything after the
5 title and just substitute the Gardiner proposal, or the
6 Halford -- whatever, we could do that. It's just a matter
7 of semantics. It is not my intent to take any public
8 testimony tomorrow. I think we have heard from anybody
9 that has wanted to testify on this that wishes, and I think
10 it's time that, because of the shortness of the, expected
11 shortness of the session -- sir?

12 MR. DONALDSON:

13 I don't believe we have further testimony, but we would
14 be willing to answer questions should the Committee have
15 them tomorrow or ...

16 MR. RAY:

17 We'll try not to have any for you, sir. We stand -- how
18 about 2:00 tomorrow? Give you enough time to get this
19 thing done? 1:00 tomorrow? We stand adjourned until 1:00
20 tomorrow.

21
22 (meeting adjourned -- 4:45 p.m.)
23
24
25

- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10
- 11
- 12
- 13
- 14
- 15
- 16
- 17
- 18
- 19
- 20
- 21
- 22
- 23
- 24
- 25

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 23, 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 64 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

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE
2 FREE CONFERENCE COMMITTEE ON SENATE BILL 524
3
4
5
6

7 TRANSCRIPT OF PROCEEDINGS

8 JUNE 24, 1981
9
10
11
12
13
14
15
16

17 COMMITTEE PRESENT:

18 Senator Bill Ray, Chairman
19 Senator Ed Dankworth
20 Senator Don Bennett
21 Representative Terry Gardiner
22 Representative Patrick O'Connell
23 Representataive Richard Halford

24 OTHER LEGISLATORS PRESENT:

25 Representative Hugh Malone

J&R Associates

P.O. BOX 29 • DOUGLAS, ALASKA 99624

JUDY JONES
586-6846