

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672
1495 SCOMM 55: JNT. SPEC. COMM. ON STATE TAX POLICY, 1986-1987

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3 a competitive interest rate that was determined to be
4 competitive by outside experts. Most of -- I won't say
5 all because it may not be entirely all -- but most of the
6 remaining 98.5% of the pipeline was financed through
7 borrowings from third parties. What that results in is
8 that the interest that the other pipeline companies pay
9 for the debt that they obtained on the Trans-Alaska
10 pipeline is deductible under your present form of the
11 oil and gas corporate income tax. Amerada Hess is in
12 a different situation because it obtained its loan from
13 its parent corporation and the interest that the
14 pipeline company pays is therefore not deductible.
15 You have a basic unfairness here with respect to the
16 pipeline transportation context. At the time that
17 Amerada Hess Pipeline Corporation took its loan in
18 1977 from its parent, the Federal laws at that time
19 and the State laws at that time, both allowed the
20 interest deduction. It was only subsequent to that,
21 when you enacted in 1978 the special oil and gas
22 corporate income tax, that you indicated with respect
23 to production tax that interest on inter-company
24 transactions would not be allowed. That was not
25 addressed in the statutes with respect to the pipeline

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3 transportation income context. You left that to the
4 Department of Revenue to enact and promulgate
5 regulations on. They perceived that it was your
6 intent that those be disallowed. They have accordingly
7 disallowed them. The primary impact of that is only
8 with respect to one corporation, and that is Amerada
9 Hess Pipeline Corporation. The other 98.5% of the
10 equity ownership in the pipeline is not impacted by
11 this. I've proposed, on behalf of Amerada Hess, a
12 very simple, straightforward amendment to the statute
13 that would allow this particular deduction, that would
14 bring Amerada Hess back in line and treat them the same
15 as the other companies. It seems to me that it is just
16 a question of fundamental fairness -- and we did
17 mention this to the Commissioner's Department before we
18 came before you today. I can't, you know officially
19 relate what their position is because they didn't have
20 time to form an official position, but -- in essence,
21 this is not a matter of major financial impact to the
22 State of Alaska. We are talking something here of very
23 minor concern in relation to the reserves tax that you
24 have before you. But it is a significant matter to
25 Amerada Hess Corporation in its competitive stance with

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3 the other companies on the pipeline. The other companies
4 get to deduct their interest - Amerada Hess does not.
5 I could go on but I won't because I think the reserves
6 tax is probably an overriding interest and there are
7 other people from out of town. I have prepared some
8 written comments that are relatively brief, and a
9 proposed amendment to the statute, and I would offer
10 that to you.

11 MR. GARDINER:

12 If you have enough copies we could distribute that now.

13 MR. BAUMAN:

14 I do.

15 MR. GARDINER:

16 One thing -- I wasn't clear on. Do you -- the request
17 for the deduction would both apply to the corporate
18 income tax and also the ad valorem tax that exist now -
19 is that correct? One by law and one by administrative
20 interpretation?

21 MR. BAUMAN:

22 What we are proposing is just to change the law and make
23 it very clear with respect to pipeline transportation
24 that the interest deduction should be allowed. You have
25 in the bill before you some language with respect to the

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3 production income context that relaxes the present
4 rules with respect to inter-company interest transactions.
5 The amendment that we are proposing is slightly
6 different - it is more straightforward and it simply
7 provides that the Department allow this deduction in
8 its regulations which it presently does not.

9 MR. SACKETT:

10 Was the deduction -- was the law silent on the
11 non-allowance?

12 MR. BAUMAN:

13 The law was silent on the non-allowance but the
14 Department ...

15 MR. SACKETT:

16 ... regulation, if amended, a non-allowance.

17 MR. BAUNMAN:

18 That's correct.

19 MR. SACKETT:

20 Thank you.

21 MR. GARDINER:

22 Representative Cotten.

23 MR. COTTEN:

24 The other companies that have an interest in the
25 pipeline borrowed money from banks or other financial

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3 institution, and as a result, the interest payments
4 they make are deductible. But since Amerada Hess
5 borrowed from the parent company, yours aren't -
6 is that correct?

7 MR. BAUMAN:

8 That's exactly right.

9 MR. COTTEN:

10 Who is the parent company that Amerada Hess borrowed
11 from?

12 MR. BAUMAN:

13 Well, the company that did the borrowing, the corporate
14 entity that has the present equity interest in the
15 TAPS is Amerada Hess Pipeline Corporation. It borrowed
16 from Amerada Hess Corporation. The only distinction is
17 that one corporation has pipeline in its name. They are
18 separate and distinct corporations. But they are within
19 a consolidated business.

20 MR. COTTEN:

21 I can see why there is, perhaps, a reason for the
22 distinction then, and that it is considered, at least
23 by some, and apparently by the administration, that
24 it is an in-house transaction. As a result, it isn't
25 quite the same as if you had to borrow money from a bank.

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3 You are being considered different for that reason, I
4 assume.

5 MR. BAUMAN:

6 I think that is the reason, but I think the fundamental
7 premise of that is incorrect and unfair because capital
8 and money is a fungible asset. The managers of a large
9 corporation can structure things in a number of ways. What you
10 are doing is going back now and penalizing a management
11 decision that was made in 1977 at the time when the tax
12 laws allowed that deduction, both for Federal income
13 tax purposes and for State income tax purposes. It was
14 allowed then. After the loan was made and the interest
15 rate, again, which I'll point out is competitive with the
16 interest that is being paid by the other companies for
17 their debt, now, subsequent to the time that the
18 transaction was entered the deduction is being disallowed.

19 MR. COTTEN:

20 Are you saying 42.20 allowed it, and 43.21 didn't.

21 MR. BAUMAN:

22 That's correct. In 1977.

23 MR. COTTEN:

24 Thank you Mr. Chairman.

25 MR. GARDINER:

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3 Other questions? Okay. Unless you have anything
4 further....

5 MR. BAUMAN:

6 I don't. Thank you very much.

7 MR. GARDINER:

8 Thank you very much. Monte Taylor.

9 MR. TAYLOR:

10 Ladies and gentleman, my name is Monte Taylor. I am
11 the Alaska Operations Manager for Exxon Company USA.
12 I will briefly discuss the general issue of oil industry
13 taxation in Alaska, and why we oppose passage of the
14 backstop bill. I would like to start by reviewing
15 some past history in order to place my comments in
16 perspective. The oil and gas leases that provide most
17 of the present Prudhoe Bay production of just over
18 1.5 million barrels a day, were purchased from Alaska
19 in 1965 and 1967. From the producer's point of view
20 exploration in the Arctic was a bleak prospect at that
21 time. Climatic conditions were no more harsh than they
22 are today, but there were few airstrips on the North
23 Slope, no roads, no staging areas, and very little
24 infrastructure for logistical support. At the time the
25 leases were sold, the standard method of leasing was

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3 competitive cash bonus bidding with one eighth retained
4 royalty. Exploration on some of the new leases was
5 begun in 1966. Some of the companies involved were
6 SOHIO, ARCO, which was then Richfield, Chevron, Mobil,
7 and Phillips. Exxon was involved as a 50% partner with
8 Richfield. The early exploration results were less
9 than promising - numerous dry holes had been drilled
10 on the Slope when ARCO and Exxon decided to drill just
11 one more well. As we all know, that final well
12 discovered oil, what appeared to be at the time a large
13 discovery, and was later confirmed to be the biggest
14 oil field on the North American continent. If a way
15 could be found to develop that field and get the oil to
16 market then Alaska could look forward to sharing in the
17 benefits of the find, one eighth of all the oil produced
18 free and clear of all investment and operating risk.
19 In 1969, Alaska held another lease sale near the area
20 of the discovery, again retaining a one eighth royalty.
21 A total of \$900 million in bonus bids was received for
22 164 tracts or about \$5.5 million per tract in that
23 third sale. As we now know most of the acreage sold
24 in that sale was outside of the productive limits of the
25 Prudhoe Bay field. All of you know the trials and

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

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

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

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

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

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

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

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

21 Thank you very much.

22 MR. GARDINER:

23 Representative Cotten.

24 MR. COTTEN:

25 Thank you for your testimony, Mr. Taylor. Noticing the

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

10 MR. TAYLOR:

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

23 MR. COTTEN:

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

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

11 MR. TAYLOR:

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

14 MR. GARDINER:

15 Representative Rogers.

16 MR. ROGERS:

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

24 MR. TAYLOR:

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

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3 now and there is a certain amount of dollars at issue.
4 We think a reasonable compromise, since it has been widely
5 circulated that we've said we have a 50-50 chance of
6 winning, the State said they have a 50-50 chance of winning -
7 it's somewhere in the 50-50 range between the chapter 21
8 and the chapter 20. We are willing to discuss
9 compromises that can put us in that range as a settlement
10 which would get rid of the lawsuit.

11 MR. ROGERS:

12 In terms of which tax ...

13 MR. TAYLOR:

14 In terms of the income tax only.

15 MR. ROGERS:

16 Okay, in terms of the income tax only. How about on the
17 other -- you are not, then, asking for any change in
18 the severance or property taxes. You feel that with
19 the existing other tax levels and split the difference between
20 AS 43.20 and 43.21, that that would be a fair tax
21 treatment.

22 MR. TAYLOR:

23 Yes, sir, I think so. I would have to -- I don't have
24 management committee approval to agree right here to that
25 compromise. If you would like to propose something we can

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3 find out pretty quick.

4 MR. ROGERS:

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

7 MR. TAYLOR:

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

17 MR. ROGERS:

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

21 MR. TAYLOR:

22 Yes, it could be done other ways, but there just happens
23 to be a lawsuit, which we think is a very valid law-
24 suit, on the income tax itself.
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3 MR. ROGERS:

4 If my recollection is correct, right now we are collecting
5 about \$1.2 billion a year, total from the industry, from AS
6 43.21, as opposed to around \$200 million for AS 43.20
7 so you are saying that a \$700 million income tax treatment
8 is the range you would consider a fair range.

9 MR. TAYLOR:

10 Did he do that math right?

11 MR. GARDINER:

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

14 MR. TAYLOR:

15 That sounds right, doesn't it. There is \$1 billion at
16 issue, and according to your assumption, and half of that
17 \$1 billion at issue is what we are talking about, which
18 would be \$500 million off, so a \$700 million tax comes
19 out of that, right? The numbers guys are over here.

20 MR. RANDOLPH:

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

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3 out even. What accounts for the discrepancy between
4 your attitude and the administration's attitude on this
5 matter?

6 MR. TAYLOR:

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

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

6 MR. RANDOLPH:

7 Yes, I think so. It seems to me that if you were to
8 sit down and negotiate with the State and come out with
9 some sort of agreement in this half-way area you were
10 talking about, that still is an extremely tenuous
11 position for the industry to be placed in - it is really
12 not a -- if that was negotiated at this point, what
13 -- would keep the State from coming back to the legislature --
14 2, 3, 4 years from now and, through some vehicle or
15 another, going right back to where we were. Or if we
16 were to -- all we would have to do to correct that is
17 to pass this so called backstop bill, cut the mill
18 rate in half roughly, and we would be back in
19 business. However, it would be a very small thing for
20 the legislature to come back, in any kind of a future,
21 and raise the mill rate and put you right back in the
22 same position you are in. I guess my question is, how
23 can the State at any point give the industry much
24 assurance that our ten year history will not continue,
25 regardless of the range on this particular issue?

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3 MR. TAYLOR:

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

20 MR. GARDINER:

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

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

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3 MR. TAYLOR:

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

19 MR. RANDOLPH:

20 Just in response to your comments. We did have, in 1973
21 and then '75, a temporary reserves tax. Then in 1975 and
22 '78 we had the income tax. And now we are in '81 and so
23 it has been happening with fair rapidity.

24 MR. MALONE:

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

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follow, at least to some degree, the progress of the State budget and spending.

MR. TAYLOR:

Yes.

MR. MALONE:

Do you think that spending less in State government is a feasible idea, and then again, do you think it would be a good idea.

MR. TAYLOR:

Yes, sir, I do.

MR. MALONE:

Good. That's one thing we agree on. In your testimony to the Committee, Mr. Taylor, you reviewed the Prudhoe Bay development tax history there, and that the value of crude oil has gone up - how much, approximately, was crude oil worth in 1969 and what is it worth today?

MR. TAYLOR:

In 1969, I guess, it was worth something in the area of \$3 a barrel in the lower 48. I was in the lower 48 then, and there wasn't any up here. It was \$3. In '78 the net-back price for Prudhoe Bay crude was \$4. That's why the big jump. It was \$21 in '80. It has increased very dramatically.

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3 MR. MALONE:

4 Roughly what percentage increase would you say that is?

5 MR. TAYLOR:

6 Well, \$4 to \$20 is 500% increase. Most of the increase
7 has been in that period of course.

8 MR. MALONE:

9 In your comments you said enactment of the reserves tax,
10 this backstop tax may lead to a challenge of the entire
11 tax structure of the State. What does that mean? Is it
12 a threat?

13 MR. TAYLOR:

14 What I think it means is that the -- we've contended
15 for some time that the 40% share that the State seems
16 to have decided it should have, based on a severance
17 tax higher than anybody else, any other extractive
18 industry, and a property tax that is only on us, and
19 an income tax which taxes, which redefines our income
20 and taxes higher, is discriminatory. What it means is
21 and I'm not saying that Exxon is planning to file a
22 lawsuit. I think it opens the door to a possible law-
23 suit challenging the entire tax structure rather than
24 just one given tax, which door is open anyway.
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3 MR. MALONE:

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

12 MR. TAYLOR:

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

18 MR. MALONE:

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

22 MR. TAYLOR:

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

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3 fairly easy to figure. The wellhead value that the
4 State gets is something close to the wellhead value that
5 the producing department gets. We have to pay the
6 expenses out of that. The State doesn't have to pay the
7 expenses. It's something comparable -- the total industry
8 is something comparable to the State, less than the
9 State. And we have 20% of that.

10 MR. MALONE:

11 You don't think the State should collect approximately,
12 whatever it is, 30% -- what percent do you think they
13 should collect?

14 MR. TAYLOR:

15 Something a little lower than it is now. About half
16 the income taxes for instance. I don't know - 20, 27,
17 28%. I think it would be much more fair for the
18 industry and the State to get about the same share out
19 of Prudhoe Bay even though we are paying the expenses
20 and we made the investment - but that's all past history.
21 Like the personal income tax is pretty much limited to 50%
22 and I guess I've got my own personal philosophical thought
23 that when the taxes are higher than your take-home pay
24 that's pretty discriminatory.

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3 MR. MALONE:

4 So you think it should be brought down to the point
5 where the State and the industry get roughly equal
6 shares in this. You like that better?

7 MR. TAYLOR:

8 Yes, sir.

9 MR. MALONE:

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

20 MR. TAYLOR:

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

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

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

22 MR. MALONE:

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

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

8 MR. TAYLOR:

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

12 MR. HAYES:

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

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

5 MR. TAYLOR:

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

12 MR. HAYES:

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

23 MR. TAYLOR:

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

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

12 MR. GARDINER:

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

18 MR. TAYLOR:

19 I will be here.

20 MR. GARDINER:

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

24 MR. TAYLOR:

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

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3 hearings.

4 MR. GARDINER:

5 I didn't mean to cut anybody off, but I'm just trying
6 to juggle all this. Jan Fakes please.

7 MS. FAKES:

8 Thank you, Mr. Chairman. I do have a plane to catch.

9 I do appreciate this. My name is Jan Fakes. I am a

10 member of the Board of Directors of the Anchorage Chamber

11 of Commerce so I reside in Anchorage. I serve with the

12 Board, with the Chamber as their legislative action

13 Chairman. I have been sent here by the Chamber to ---

14 express to you their strong desire to repeal 43.21, and

15 their strong opposition to the backstop tax. For the

16 sake of time, we have brought a member of the legislative

17 action committee with us today by the name of Dan Coffee

18 who is an attorney in town and he has been studying this

19 issue for the Chamber on a volunteer basis since January.

20 With your permission, Mr. Chairman, I'd like to turn the rest of the
21 testimony over to Dan.

22 MR. GARDINER:

23 That would be fine.

24 MR. COFFEE:

25 Mr. Chairman, members of the Committee. My name is

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3 Dan Coffee. As Jan said, I am on the Chamber of
4 Commerce committee that has looked at this business
5 of oil taxes. The Chamber's concern for the business
6 climate in Alaska led the Chamber to consider the taxing
7 practices and policies of the State of Alaska. That
8 inquiry led us into consideration of the oil and gas
9 taxes. As a result of this examination, the Chamber
10 has reached certain conclusions, and formed certain
11 opinions which the Chamber believes the legislature
12 should be aware of. These conclusions were contained in
13 a resolution which the Chamber passed back in March.
14 We have copies of that resolution which I'll be happy to
15 make available to you. In reaching its conclusions and
16 formulating its opinions, the Chamber relied on our
17 committee, and our committee in turn obtained information
18 from various sources. For example, we examined
19 statistics and interviewed employees from the
20 Department of Revenue. We examined the Merrill-Lynch
21 report which was prepared at the legislature's request
22 concerning the relationship between the State and the
23 oil companies. We reviewed the pleadings in the current
24 lawsuit with regard to chapter 21, so we would have some
25 feel for what was going on there. We contacted and

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3 discussed the tax problems and the problems associated
4 with the lawsuit with representatives of the oil industry.
5 We contacted the Attorney General's Office. We also
6 consulted other civic organizations such as the State
7 Chamber of Commerce, PASIT(ph), the Alaska
8 Support Industry, and there were others that we also
9 consulted with. Of course, the purpose of this was to
10 get as much information as we possibly could so when we
11 formulated our position and made our statements as to our
12 opinions with regard to this chapter 21 and now with
13 regard to this present bill, we would have -- it will be firmly
14 founded upon facts which we had developed and we could
15 that way properly fulfill our functions speaking out on
16 behalf of the business community. The Chamber of Commerce,
17 like other organizations, has a philosophical basis.
18 And I think that can best be stated as a belief in the free
19 enterprise system. A natural corollary of that philosophy
20 is that the private sector has a vital place to play and
21 a vital role to play in our society. This philosophy
22 also entails a belief that the government is best which
23 governs least. To the extent that government becomes
24 the sole, or at least the overwhelming predominant force
25 in our society, the quality of our society is diminished.

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3 It is the Chamber's position that our State is rapidly
4 becoming dominated by government. It is our further
5 opinion that their tremendous revenues earned from the
6 oil industry, which are as you know by far the highest
7 of any state, and the dampening effect that this has on
8 both the oil industry and other industries is the prime
9 cause of the dominance of State government in our daily
10 lives. You are all familiar with the history of the
11 oil and gas taxes in Alaska. I will just remind you that
12 there have been 13 increases in tax rates since 1970,
13 resulting in a 900% plus increase in taxes on this
14 industry. We all want to share in the oil wealth that
15 is part of Alaska's richness, and also our history is
16 replete with stories of industries from outside which
17 have come up here "rape, ruin, and run". We've had the
18 fur industry, we've had the gold industry, and we've had the
19 fishing industry. I remember hearing from my father, who
20 served in this legislature, both in the House and the
21 Senate during territorial days, stories with the salmon
22 industry. When the salmon processors were controlled by
23 Seattle, and they had fish traps, and there were no jobs
24 for fisherman, and they finally got those laws, and they
25 got laws on the books prohibiting fish traps. That made

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3 jobs for our fishermen. But I would suggest to you that
4 current facts indicate that the oil industry is not like
5 the Seattle based processors, and not like those who came
6 up here and took gold and left the State, and so on.
7 I think the oil companies have demonstrated a tremendous and
8 permanent interest in Alaska. They have tremendous
9 capital investments here in Alaska. They create jobs.
10 They pay taxes. I think, in many respects, they receive
11 much more, excuse me -- they contribute much more to the
12 State than they receive back in benefits. As you are well
13 aware, the oil companies receive less than 10% from
14 every deregulated dollar that they earn on the sale of
15 oil. The rest of it goes in taxes and royalties. I would
16 suggest to us that we not be imprisoned in part by our
17 past when the present facts demonstrate that we have an
18 industry which is substantially different than that which
19 faced Alaska in the past. It is our belief that the
20 tax policy of the State has created a climate that is not
21 conducive to further oil and gas development. Nor is it
22 conducive to other extractive industries and the support
23 businesses which necessarily grow up around them. I attended
24 the coal conference in Anchorage this past winter. It was
25 conducted at the Anchorage Westward. A major concern at

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3 planning investment in Alaska. If the history of the
4 oil and gas taxation is any indication, once a new
5 industry, coal or otherwise, is successfull, it can
6 expect to be clobbered by higher and ever increasing
7 taxes. Alaska is rich in natural resources - we all
8 know this. It is a real plus for us that it is.
9 At the same time Alaska suffers from a harsh climate,
10 remote geography and is far from any markets. These
11 are factors over which we don't have any control
12 whatsoever. But we do have control over the taxing
13 policies of our State. I think we can engage in a
14 taxing policy in such a manner that would generate
15 tremendous revenues for the State. For example, even
16 without chapter 21 and House Bill 200, the State would
17 have income for fiscal year 1981 of \$3.2 billion -
18 this is from Department of Revenue figures - and \$4.4 billion
19 in 1982. This is in excess of the operating budget
20 and would provide substantial funds for capital
21 improvements throughout the State. At the same time,
22 it is the Chamber's opinion that by eliminating
23 chapter 21 of Title 43 and by not imposing the present
24 bill the State would signal a return to, what we consider
25 to be, rational taxing policies. This could not help

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3 but encourage development of the private sector. It is
4 the Anchorage Chamber of Commerce's firm belief that the
5 growth and development of the private sector, which we
6 believe is the only truly productive sector in our
7 economy, that Alaska will be able to achieve long term
8 economic stability, create an economy where all of its
9 citizens can find full and meaningful employment, where
10 there exists opportunities in business and commerce, for
11 those willing to take risks, and where the State will
12 be able to meet the legitimate needs of its citizens.
13 We believe that the present policy of the State, with
14 regard to oil and gas taxation, while it raises tremendous
15 revenues in the short run, is detrimental to the
16 long term interests of the State and its citizens.
17 Therefore, the Anchorage Chamber of Commerce would strongly
18 urge the legislature to repeal chapter 21 and defeat
19 the present bill which is before you. We think that to
20 do otherwise would foster development of the public
21 sector at the expense of the private sector and will be
22 detrimental to Alaska.

23 MR. PARR:

24 I would like to make one quick comment if I might. First,
25 if I understood this gentleman correctly, the Chamber

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3 believes that the government that governs best is the
4 one that governs least. I would like to remind him,
5 and other people who hold that viewpoint, that also
6 includes sweatshops, child labor, air and water
7 pollution, social and sexual and racial discrimination,
8 monopolies - all those good things, by the governments
9 that governs least. I would like to come back to the
10 main question to make sure I understood it correctly.
11 It is my understanding that the Chamber has backed the
12 capital projects being asked for by the Anchorage
13 community, which amount to a great deal of money.

14 MR. COFFEE:

15 That's correct.

16 MR. PARR:

17 It is my understanding that the Chamber feels those can
18 be afforded even if we repeal chapter 21.

19 MR. COFFEE:

20 That is also correct.

21 MR. PARR.

22 Do these two assumptions include putting any money at all
23 into the Permanent Fund?

24 MR. COFFEE:

25 I don't know. I can't answer that question, sir.

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3 MR. PARR:

4 Do they include the capital projects in other parts
5 of the State when you make those assumptions?

6 MR. COFFEE:

7 Well, sir, I guess the only way I can really answer
8 that question would be to take a list of the capital
9 projects which the Chamber has either endorsed or has
10 supported in some manner in their entirety, total up
11 the cost, estimated or actual, determine the cost of
12 all the other projects to which you may be referring,
13 look at what contributions you would like to make to
14 the Permanent Fund, and make a decision based on that.

15 MR. PARR:

16 That's exactly the point I'm trying to get to. Just what
17 did the Anchorage Chamber consider? The impression
18 that has been given us, that this was a very well
19 thought out, well considered, careful approach to the
20 subject. Now what I would like to know, if the Chamber
21 is prepared to justify those statements. Considering
22 our capital needs in the State, \$300 or \$400 million to put
23 the highways back in shape, educational needs, the
24 University and public school system, lack of water
25 facilities in many villages, lack of sewer facilities in

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3 many villages - just take the whole gamut, and then I
4 would like to know what the Chamber, after really making
5 a careful consideration of all this, and the need for
6 these things, including the Anchorage projects, and
7 including the rest of the projects in the State, still
8 believes that repealing Title 21, or chapter 21, will
9 leave us enough money to do it. If you aren't prepared to do
10 that, sir, then I don't think the Chamber has done its
11 homework.

12 MR. COFFEE:

13 To answer your question if I may. For example, if chapter 21
14 were repealed in fiscal year '81, there would be \$3.2 billion
15 approximately, from the Department of Revenue. Obviously,
16 there are many, many projects which exist in the State
17 of Alaska due to the fact that we are not a fully
18 developed State which might very well need to be done
19 at some time. Obviously, we have to prioritize to some
20 extent - which is more important, which is least
21 important. Further, obviously, if our revenues are
22 reduced by \$839 million in this year, it will not be
23 possible to do everything that would be possible if that
24 money were in the State treasury. That would require
25 consideration by the legislature as to which is more

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3 important. It may very well be that some of the projects which
4 are suggested by the Chamber of Commerce are not viewed
5 as important by the legislature as some other projects
6 which may be suggested. I think the only way I can
7 answer your question is to put it back on the legislature
8 that it is their obligation to take revenues that they
9 have and put them in a priority basis for spending.
10 We can't have everything we want.

11 MR. PARR:

12 I understand that. The point I was trying to make is,
13 if the Chamber of Commerce, as a responsible body, is
14 going to come to us and make that recommendation, it
15 should be prepared to support it with specifics.
16 If you don't want \$1.8 billion in the Permanent Fund,
17 then say, No, we would rather have the oil tax repealed,
18 chapter 21 repealed. If you don't want all those
19 programs in the Anchorage area that the Anchorage
20 community seems to want, come back and say, No, we
21 don't want this \$25 million sports facility, we would
22 rather have the oil company get its money back. But come
23 to us with some specifics which show that the problem
24 has been clearly thought out and fairly addressed.
25 It would be a big help.

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3 MR. ROGERS:

4 Senator Parr has addressed some of the same points I
5 was going to make. We have received a number of
6 resolutions from the Chamber and individual members of
7 the Chamber have spoken to me about some projects -
8 I know the Knik Arm Crossing, which is about \$460 million
9 has been a priority of the Chamber. Some members
10 have talked about the Alaska Housing Finance Corporation's
11 home loan program, somewhere near \$900 million, or if
12 we just talk about the subsidies \$300 or \$400 million.
13 There have been expressions of support for \$400 million
14 in capital projects through the per capita Senate Bill 168.
15 The Chamber and the Association of General Contractors
16 have pointed out that it would take about \$700 million just
17 to bring our roads up to safe standards, it was in the
18 newspaper just this last week. We have been asked for
19 funding mining loans, tourism loans, small business
20 loans; asked for a reduction in the AS 43.20, on exemption
21 for the first \$150,000 or \$200,000 for corporate
22 taxes. Then there is the Susitna hydroelectric project
23 \$3 billion, maybe \$4 billion. There is the rest of the
24 hydroelectric package for other parts of the State, maybe
25 another \$1 billion or \$2 billion -- I guess what my

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1 question is, which ones of those should we eliminate
2 in order to meet your request to eliminate 43.21?

3 MR. COFFEE:

4 In the first instance, I don't think I or the Chamber
5 is in a position to suggest to you on a statewide basis
6 what projects are or are not appropriate on a statewide
7 basis. We don't have the resources nor the capabilities
8 to do all the things that you do.

9 MR. ROGERS:

10 But you have suggested that the State be involved in a
11 number of these items. And then you suggested that we
12 repeal one of the sources of income that is paying for
13 those projects. You are asking us to do two things
14 that are incompatible. Which is a higher priority?
15 Is State construction of the Susitna project a higher
16 or a lower priority than repeal of 43.21?

17 MR. COFFEE:

18 First of all I don't accept your premise that they are
19 necessarily inconsistent. For example, you gave me a
20 figure of \$400 million with regard to S.B. 168. My
21 understanding is that it would be, at least as far as
22 Anchorage is concerned, \$173 million. There is a
23 substantial difference in your figures.

24 MR. ROGERS:

25 Would you just do the \$173 million for Anchorage and not

1 do the rest for the rest of the State?

2 MR. COFFEE:

3 Of course not. But this is the Anchorage Chamber of
4 Commerce speaking. We don't have the capability that the
5 legislature does to address every issue that arises on a
6 statewide basis.

7 MR. ROGERS:

8 43.21 is a statewide basis.

9 MR. COFFEE:

10 Yes, but, the issue before us is not only how much
11 revenue is generated by it, but whether or not there are
12 other considerations which we have dealt with. For example,
13 whether or not ~~the bill is conducive to a good~~
14 investment climate. What would be created in the private
15 sector, for example, with coal development or other
16 extractive industry development which may or may not be
17 taking place as a result of your taxing policy.

18 MR. ROGERS:

19 You have asked for both the projects and certain State
20 spending, and you have also asked for repeal of 43.21.
21 Construction is the biggest item on here. Construction
22 of the Susitna hydroelectric project - is it a higher
23 or a lower priority than repeal of 43.21?

24 MR. COFFEE:

25 I can't answer that question, sir. I don't know whether

1 it's a higher or a lower priority. It is something which,
2 I think, the Chamber of Commerce is suggesting is certainly
3 worthy of consideration by the legislature who has got to
4 appropriate the money necessary to do it. I also think
5 the Chamber has suggested that everything doesn't have to
6 be done in one year. Things like this should be considered
7 by the legislature. I think we are providing -- fulfilling
8 a civic duty by saying these are things of concern to
9 the business community in Anchorage. We are presenting
10 these items to you for your consideration. For me to come
11 down here and attempt to establish some sort of priority
12 exceeds what I, what we are capable of doing in the
13 Chamber.

14 MR. ROGERS:

15 But the Chamber is asking the legislature to reduce the
16 amount of money for State spending, but you are also
17 asking for more than enough to spend every penny that
18 we would get without it. I think that is a very
19 inconsistent position.

20 MR. COFFEE:

21 I don't know that that is a fact in terms of the total
22 dollars you are talking about. I don't know that to be
23 true.

24 MR. RANDOLPH:

25 Mr. Chairman, I am going to take advantage of the

1 same quality as the last two questioners have and make
2 a statement. I think, as well, to pose a question.
3 I think what we are talking about is whether or not
4 we are going to take a bigger and bigger piece of an
5 ever restricting pie because of governmental policy, or
6 whether we are going to be in a position to get as much
7 revenue through an expanding economy and not necessarily
8 increase taxes. That is what I fear from the policies
9 of this legislature and this administration more than
10 anything else. I'm sorry Senator Parr left because his
11 comments talking about pollution, monopolies, sweat-
12 shops, and somehow relating that to the issue is pure
13 nonsense. Most of the pollution that has taken place in
14 this country has been either government created or
15 government allowed. Our water system has been under
16 government control forever. Our highway system is what
17 creates most of the air pollution, which has been
18 government controlled forever. The sweatshops we had
19 in this country were a hell of a lot better than what
20 the people had in the place they came from. So that's
21 just nonsense. I wouldn't have done this if he had not.
22 Now getting to my question. There are a good many programs
23 that other speakers or questioners have brought up.
24 But they have purposely left out others. We passed the other
25 day a socialized medicine bill that will cost us \$800 million.

1 We have on the calender today a bill which allows day
2 care centers to anyone who wants to go out and try to find
3 a job. The abuses of that can be immense. We have in this
4 budget almost 1000 new employees, most of them for social
5 problems, not for doing anything creative in the capital
6 projects that you alluded to. My question to you is,
7 much along the same line as the question Representative
8 Rogers was asking, that the Chamber -- and I think you
9 have answered it -- is certainly willing or appears to
10 be willing at least, to try to get along on the State
11 support that is created by an ever expanding economy
12 rather than trying to take a bigger and bigger chunk of a
13 restricting economy. Do you want to comment on that?

14 MR. COFFEE:

15 I think that is correct because it is the belief that
16 if the investment climate is conducive to further investment,
17 and we believe the taxing policies are not so conducive,
18 then there will be expansion in the industry. There will
19 be availability to spread the tax burden, as it were,
20 from the one industry to others and perhaps lower it as to
21 all of them. I don't represent any oil companies in my
22 business, but I do represent a lot of small businessmen.
23 They are the type of people that are in the Chamber. They
24 get a lot of their business as second and third level
25 supports to the oil companies because the oil companies are

1 the biggest business in Alaska. They have the belief that
2 the taxing policies are not conducive to the types of
3 industries that we are talking about. Whether it is
4 absolutely true or not, and whether or not anyone can point
5 to a particular project that has or has not gone, begs
6 the point. The point is that that is what is in people's
7 minds, that we are taxing them too much, way too much.
8 It is unfair and it is discriminatory. The other people
9 are not going to come in here and develop the resources of
10 Alaska when they are not sure what they are going to be
11 facing over the next 10 years in terms of taxes. No
12 rational businessman is going to make those types of
13 decisions. It is going to -- it may not stop the big
14 project, you know, the one that is really good. But it
15 very well may stop the one that is a little bit on the
16 margin. It may not have any effect for 10 years or 5 years -
17 but in the long term it is our belief that it will have a
18 substantially detrimental effect.

19 MR. COTTEN:

20 How are you doing Dan, nice to see you.

21 MR. COFFEE:

22 Thank you, Sam.

23 MR. COTTEN:

24 How is business in Anchorage these days? How would you
25 describe the Anchorage business climate right now.

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1 MR. COFFEE:

2 Business for lawyers is always good. If it's bad, it's
3 good for lawyers...

4 MR. COTTEN:

5 You are representing the Chamber. I suppose -- you made a
6 lot of comments that are pertinent to why the Chamber
7 is interested in this tax. It appears that you assume
8 that a change in the tax will help the business climate
9 in Anchorage. I just wonder how would you describe it
10 right now?

11 MR. COFFEE:

12 Well, Sam, Alaska from my experience, what I have learned
13 from my father, has been a boom and bust. It always has
14 been. It is good years and bad years. Right now I would
15 say we are going into a good year. We are going into
16 some good times. We've got a lot of money going through
17 the economy and so on. Whether that will result in a bust,
18 as has been the past history, I don't know. But right now
19 business is better. And certainly some of the programs
20 that the legislature has passed have helped. Obviously
21 the housing industry is very good based on the fact that
22 we've got cheap mortgages.

23 MR. COTTEN:

24 I see ARCO is planning on building a big new complex
25 downtown. The rumor is that there are several hundred new

1 families that are going to move out to Eagle River. That's
2 a rumor I've been hearing ... I could spend a half hour
3 debating some of the things Representative Randolph used in
4 his opening statements that were, I suppose, close to being
5 accurate, but I won't do that. I was interested in your
6 view of the Anchorage business climate - it appears that it
7 is looking real good ...

8 MR. COFFEE:

9 The building is 21 stories ...

10 (new tape)

11 MR. COLLETTA:

12 ... on the hot seat as to which area the Chamber supports.
13 I could rationalize they paid their own way to come and
14 talk and suggest that we consider looking at Chapter 21.
15 Have any of you paid your own way to come down on the
16 projects you have supported, or have they just come through
17 the mail?

18 MR. COFFEE:

19 I don't know that. I haven't paid my way on a project.

20 MR. COLLETTA:

21 Thank you.

22 MR. VASKA:

23 How much interest do you think the oil companies will have
24 after the oil is all gone, in Alaska?
25

1 MR. COFFEE:

2 After the oil is all gone in Alaska, I would imagine an
3 oil company would have very little interest in Alaska, once
4 the oil is gone.

5 MR. VASKA:

6 Thank you very much.

7 MR. COFFEE:

8 The question, I would say, is then how long is it going
9 to take that to happen. That is something that we think
10 the present taxing policies are stopping from determining,
11 because they are not -- they are curtailing the development,
12 they are curtailing the exploration. This bill taxes,
13 the bill 200, taxes when they produce. So that is an
14 incentive not to produce. If they find oil, they have got
15 a good incentive to leave it right in the ground, which
16 doesn't do any good for the country, in terms of energy.
17 I doesn't do any good for the revenue of the State. Keep
18 it in there for 10, 20, 30 years and hope that the taxing
19 policies of the State of Alaska change. The bill is
20 counter productive in that respect.

21 MR. GARDINER:

22 Thank you very much. I do appreciate your coming down here.
23 Dick Donaldson.

24 MR. DONALDSON:

25 Thank you Mr. Chairman. I'm Dick Donaldson. I work for

1 SOHIO. In the early seventies, my job was as General
2 Counsel. Since then my job has been Vice President for
3 Government/Public Affairs. I suddenly realized this
4 morning that this is my 75th trip to my home away from
5 home. Some of the issues and questions seem to be very
6 familiar. I would like to give you some comments on
7 S.S.H.B. 200 and related matters. I'm also pleased that
8 a number of the questions that your Committee has been
9 asking have been a little bit anticipated in my testimony.
10 If you something further afterwards I would be happy to
11 try to answer any question.

12 MR. GARDINER:

13 Mr. Donaldson, I should have asked you this earlier-- if
14 you have any written testimony that goes along with your
15 verbal testimony, other people and the Committee would
16 like to receive that.

17 MR. DONALDSON:

18 I have a copy but I can give you a Xerox copy when we
19 finish if you would like it. In fact, you may find some
20 of the points might prove useful for reference if you
21 think about any of these things. I'm glad you laughed.
22 The purpose of H.B. 200, as I understand it, is to achieve
23 stability for Alaska after 12 years of change in its tax
24 laws applicable to its principal industry - oil and gas.
25 I understand that through H.B. 200 you are seeking legal

1 stability, fiscal stability, investment stability, and
2 even political stability. I would like to reflect on
3 each of those four things briefly. First legal stability.
4 Over the last 12 years we have had a number of legal
5 confrontations on tax and other matters. SOHIO does not
6 like to have to go to court with any government. We've
7 done so only when the issues warranted it and no other
8 alternative was available. Head-to-head litigation
9 often leaves hard feelings on both sides and can impair
10 both side's future opportunities. I start with that
11 because I think it important that you know a little bit
12 philosophically where I and my company come from on this
13 question of litigation. I start from this because some
14 questions that you have asked and some of the issues
15 involved in the bill that you are considering, have that
16 potential and I think you should know that we, somehow
17 reluctantly, take that step to the courthouse. Today,
18 we are in court with the State of Alaska again, this time
19 on the constitutionality of Chapter 21, the oil and gas
20 income tax. I've no desire to argue that case here today.
21 The legal issues of discrimination, burden on interstate
22 commerce, non-apportionment of the income taxed, the
23 absence of any reasonable relationship between the huge
24 revenues we pay the State and the services we receive back
25 from it, and more broadly, the persistent pattern of the

1 State's efforts to increase its share of the Prudhoe Bay
2 oil field, are all issues this legislature has been familiar
3 with for some time. During the last year, however, there
4 have been four important developments bearing on this case
5 that I would like to mention and identify. First, the
6 Governor and the Attorney General, separately and publicly,
7 have acknowledged what we have known for some time that
8 the State has at least a 50% chance of losing the Chapter 21
9 litigation. Second, U.S. Supreme Court litigation, both
10 decided and now pending, have enhanced and could further
11 enhance the industry's Chapter 21 case. Third, almost
12 everything this legislature has done in the last couple of
13 years or is now considering regarding taxes on our industry,
14 including S.S.H.B. 200, or on other taxpayers in Alaska, has
15 manufactured "evidence" which will be useful in our
16 Chapter 21 case. Make no mistake about it. I certainly
17 don't begrudge the tax relief you've afforded others in
18 Alaska, but it does etch out the disproportionate burden
19 you've imposed on one industry, most of which falls on a
20 few companies in that industry. Fourth, there has been a
21 growing awareness by all concerned that the Chapter 21
22 litigation could take 5 or 6 years to resolve, and that if
23 the State loses, that the State could be faced with some
24 substantial financial problems. An \$8 billion judgment,
25 give or take a few dollars, is a whopper by any standard,

1 particularly if most of the money has already been spent.
2 Today, your Committee is considering S.S.H.B. 200 in search
3 of some legal stability for the State's oil and gas tax
4 structure. May I give you some specific comments about
5 this bill. First, the legislature's counsel, former
6 Senator Floyd Haskell, of the firm Herrick and Smith, has
7 observed that any such new law would probably be
8 challenged by the industry. My comment is, I think he is
9 probably right. Second, why? Why is he right? The law
10 does not usually permit someone to do indirectly what he
11 cannot legally do directly. The Chapter 21 oil and gas
12 income tax and the S.S.H.B. 200 reserves tax now proposed
13 are inextricably intertwined, and you should be aware that
14 virtually the same legal issues we have raised in the
15 Chapter 21 litigation will apply to S.S.H.B. 200. Third,
16 S.S.H.B. 200 raises a new issue. The practical retroactive
17 effect of this bill is 'so transparent that that issue would
18 have to be questioned too. And fourth, the drift of the
19 Chapter 21 litigation and the prospect of S.S.H.B. 200 will
20 put in issue in my judgment the whole of Alaska's oil and gas
21 tax structure, not just Chapter 21, and not just S.S.H.B. 200.
22 The cumulative effect of all your tax increases over the
23 last 12 years, capped by your March 18th press conference
24 and confirmed by yesterday's hearing on S.S.H.B. 200, is that
25 State government, using its own words, has "settled on",

1 has "decided" that it is entitled to the 30% of the
2 Prudhoe Bay oil field as its fair share, and that it will
3 act to maintain and protect this share through S.S.H.B. 200.
4 In plain terms the State has said that this is not a
5 genuine tax measure but a taking of a predetermined share
6 of a property it sold over 12 years ago through its oil
7 and gas leases. The Commissioner of Revenue expressed
8 an appropriate caution to the legislature yesterday when
9 he noted the risk to the State in the size of that 30%
10 share. From a legal standpoint, my own footnote is,
11 yesterday's hearing was absolutely fascinating. To
12 summarize, the legal stability which S.S.H.B. 200 might
13 give the State is probably no more than it has now under
14 Chapter 21, all by itself, and may be less. S.S.H.B. 200
15 is a brilliant piece of work on the mechanics of tax
16 collection, but from a litigation standpoint, it's a legal
17 charade. Second area, fiscal stability. The second
18 purpose of the H.B. 200 is to achieve fiscal stability
19 for the State. Much was said in the March 18th press
20 conference and in the hearing yesterday about not
21 increasing the State's revenue share from Prudhoe Bay,
22 but only just maintaining it. Our public opinion
23 research here in Alaska clearly confirms that a large
24 majority of Alaskans do not favor any further oil and
25 gas tax increases. My comment is that S.S.H.B. 200 is not

1 just a backstop to maintain the State's revenues, but
2 would probably increase the State's taxes on oil
3 substantially. Why do I say that? Consider several things.
4 Although the Commissioner of Revenue presented a low case
5 and a high case, and suggested to your Committee that the
6 legislature might want to use the low case to be
7 conservative, the present and continuing uncertainties in the
8 Middle East and the probable improvement of the U.S.
9 economy during the next 4 or 5 years could separately or
10 collectively push the real numbers to the high case and
11 a substantial tax increase. I also observed in the
12 Commissioner's numbers that the change of one factor or
13 figure in his study produced a half billion dollar increase
14 in one year. The Commissioner also properly noted the
15 "broad range of subjectivity in the assessment by the
16 assessor" under this bill. This subjectivity has been
17 characterized in the past by Milton Lipton as an
18 inherent uncertainty. When you consider the variables
19 and unknowns, you can see why. How much oil is in a
20 reserve? How much is recoverable, and when? What will
21 it be worth then, and where? What will the circumstances
22 of world oil prices be at any particular time in the
23 future? What is the appropriate discount rate to apply,
24 to get back to a present valuation on this reserve. There
25 are no real criteria for any such measurements. Every such

1 reservoir is different from every other one. Even a good
2 faith effort, by any assessor, produces an assessment that
3 is inaccurate at best and highly speculative at worst.
4 Milton Lipton observed back in 1975 when you were considering
5 a reserves tax then - that with any such tax, the State
6 would need to develop a "highly specialized administrative
7 program to monitor the oil industry," that it was likely to
8 be an administrative nightmare, and that it was probably
9 impossible to provide an equitable assessment for all
10 producers. Yesterday, during the hearing, the Commissioner
11 of Revenue noted that any assessor "can see that any
12 increase in assessment increases State revenues, and there
13 is pressure there" to do so. Increases, not maintenance,
14 in my judgment, would be inevitable. The Commissioner
15 also noted yesterday, and he was pretty sanguine about
16 this, that under S.S.H.B. 200 the legislature would set
17 the millage annually. The question was asked, would
18 future legislatures use Chapter 21 as a yardstick and just
19 maintain those revenues? The answer was that they, of
20 course, would not be bound to do so. The plain English
21 translation of that situation is this - that the legislature
22 would be in a position to decide how much new money it needed
23 each year, set the necessary millage rate to get it, and
24 send the tax bill to everybody in the State with any
25 interest in any proven oil reserve. That's a lot of people,

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1 and a lot of interest, and an open checkbook. Now you
2 might say, what's another couple of billion dollars
3 between friends? Frankly, that's not my idea of fiscal
4 stability. It would simply turn loose more chapters in
5 Alaska's history of tax increase after tax increase.
6 Needless to say, the sums involved would be well worth
7 litigating. The third purpose is investment stability.
8 My comments today have already raised a number of
9 questions bearing on this purpose, investment stability.
10 I won't repeat but two other aspects probably should be
11 mentioned. In April 1979, the Alaska Legislative Affairs
12 Agency produced a document entitled an "Historical
13 Review of Alaska Petroleum Taxes 1955-1978". In this
14 paper the 1975 reserves tax was described as an
15 undesirable tax from the beginning that was designed to
16 meet a very special and temporary revenue problem facing the
17 State of Alaska in the mid 70's. It noted that most of
18 the parties at that time agreed that a reserves tax was
19 discouraging to exploration, and could weigh heavily
20 on marginal fuels. That, of course, is the practical
21 problem of any reserves tax and a key factor bearing on
22 this investment stability that you seek. The second aspect
23 concerning investment stability is Alaska's extensive
24 resource base other than oil and gas. Companies engaged
25 in renewable and non-renewable resources are watching

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1 how Alaska has treated and continues to treat its principal
2 industry. Their investment decisions, and the Alaska jobs
3 and commerce that flow from them, are not made in a
4 vacuum. These companies continually take a close look
5 at the real world where their investments might be made.
6 They know that if the State thinks it is short of money,
7 they are not exempt from the tax bill to cover it. I might
8 add parenthetically today, as distinguished from 5 years
9 ago or 10 years ago, we are taking a look at some of
10 Alaska's coal potential, and this whole picture is a very good
11 one to us in those assessments. Assuming our Kennicott
12 merger goes through, we do have some copper prospects
13 in Alaska and other minerals. I will be frank to tell you
14 that these things bear on all of that. Fourthly, the
15 purpose of political stability. While most of my comments
16 so far also relate to that matter, again there are two
17 additional aspects I would like to note. Although I
18 summarized the difficulties of assessing reserves under a
19 reserves tax and the problem of the annual millage
20 determination, that whole process also portends an annual
21 confrontation between the legislature on the one hand and
22 our industry and all others having interest in the
23 reserves on the other. I don't relish that and I doubt
24 that anyone who thinks about it would. The second aspect
25 on political stability is this, you are well aware of the

1 present search for revenues by the federal government and
2 most state governments in the lower 48. Last December,
3 the Governor's Growth Policy Council had an all-day
4 symposium on this subject in Anchorage, and I was pleased
5 to be a member of the panel. I'd judge that passing
6 S.S.H.B. 200 would be waiving a red flag in the faces of
7 the federal and many state governments. You can judge
8 that as well as I can, but I do think it deserves some very
9 careful consideration. In summary, S.S.H.B. 200 is not a
10 wise tax, but comes across as a matter of litigation
11 expediency, and a device that is not likely to solve
12 the State's problem in that dimension. You might ask,
13 what would you suggest? I've thought about that. One of
14 the things that came to mind was a marvelous line by
15 Abba Eban, the former ambassador from Israel. He was
16 supposedly to have said that men and governments behave
17 wisely, after exhausting all the other alternatives.
18 I think that the State and our industry have about
19 exhausted them, and that it would be wise for both of us
20 to find some middle ground - I'll borrow Monte's word -
21 on our present tax differences. I know that the nature of
22 government here in Alaska is such that it is absolutely
23 not politic for our industry to suggest a middle ground.
24 I know, however, that we are usually willing to listen
25 to a responsible proposal by government. Such a middle

1 ground, if honored over time, can provide the legal,
2 fiscal, investment and political stability you say you
3 seek. In plain terms, and in my own words, some fairness
4 and some stability go hand in hand. After looking at
5 Alaska's projected revenues from all probable sources -
6 not pie in the sky, but probable sources - I'd judge that
7 Alaska can clearly afford to solve its stability problems
8 now, and can do so. Consider these three points, and
9 can do so: without reducing State services; can do so
10 without reducing the basic funds you project as necessary
11 for your operating and capital budgets during the next
12 few years; and can do so without affecting the tax relief
13 you have afforded other Alaskans and Alaskan companies.
14 You might say, why would I pick those three points? There is
15 a very special reason. The practical politics in any
16 setting says you look to see what the people think. Our
17 public opinion research here in Alaska says that if the
18 Alaska public understands those three things are covered,
19 then it's high time to be a little bit fair to your
20 principal industry. In looking at probable revenues, and
21 your potential, I don't see any absence of funds to do the
22 things you really need. I lay out on the table the pragmatic
23 consideration of where we see the people of Alaska are
24 all of them, or a substantial majority, the criteria that would
25 probably have to be met in some middle ground that we would

1 both feel comfortable standing on. I think you can afford
2 it. But only you can afford to decide whether you can
3 afford not to. Thanks. If you have some questions I would
4 be happy to answer them.

5 MR. GARDINER:

6 I had one question. You made a lot of comments about the
7 undesirable natures of a property tax on reserves. What
8 is your view of the advisability of tax form, in terms of an
9 income tax or a reserves tax. Do you feel one is a better
10 taxing mechanism than another?

11 MR. DONALDSON:

12 I don't think a reserves tax is a very easy tax to
13 administer. It's just fraught with all the problems I
14 just tried to summarize. There are volumes on this
15 subject. It's something that I would stand away from.
16 I think an income tax is probably the basic fair tax of
17 all taxes because it, in effect, says you share the cost
18 of government based on your success. Therefore, I look
19 to that as a partial answer. One of the questions you
20 asked Monte Taylor was, what specifically would you do.
21 I think it is inpolitic to say, here is a package, here
22 is a draft bill. I think the middle ground idea that he
23 expressed makes a good deal of sense. We have studied it
24 independently and come basically to the same general
25 feeling. The mechanics of that have to do a couple of things

1 if you are interested in this as a State and as a
2 legislature. The resulting tax structure that you end up
3 with has to be basically free from legal challenge. It may
4 take a combination of several of your tax vehicles that
5 you now have on the books, adjusted to produce the middle
6 ground rate, but also to put them on a basis where you sort of
7 found the middle between your widely different points of
8 views. Maybe I am anticipating a question, but I thought
9 it was a very good question. This is my response to it.

10 MR. GARDINER:

11 I appreciate your answer very much.

12 MR. HAYES:

13 Thank you Mr. Chairman. —You addressed the question that
14 I asked Monte Taylor about what security he felt, in his
15 opinion, that we had in the backstop tax as opposed to the
16 Chapter 21 that ... There has been some testimony by the
17 administration that we would be more legally secure if we
18 adopted the House Bill that is before us in lieu of the
19 present tax law which we are, to some extent, trying to amend or
20 change. I think that it is fairly clear, as I have heard
21 it, that you've indicated that we are not very secure.
22 In fact, we may be as insecure, if not more insecure,
23 with this proposed bill as we are, and have been, with
24 Chapter 21. Which brings to mind how we came around to
25 Title 21, which many of us here remember, occurred near

1 the end of the session in 1978. Much the same way that
2 this particular bill is being handled - it was dealt with
3 in a very short period of time and passed into law
4 resulting in the litigation that we are now trying to
5 resolve with another piece of litigation that precipitated
6 the question that I asked about how secure are we with
7 this new proposed law. It seems to me that, from where
8 I am sitting as a legislator, that perhaps we ought to
9 stop a minute and ask ourselves, are we moving too fast
10 on this piece of legislation, and are we moving towards
11 the piece of legislation that will ultimately be in the
12 best interest of the State. I've got some concerns,
13 because now I've conflicting opinion from those opinions --
14 that I have heard from the administration. Which brings
15 up another question.

16 MR. DONALDSON:

17 Could I comment on your implied question, sir? In
18 preparing testimony today, I tried to state the essence
19 of a good deal of work we have been doing with inside
20 and outside counsel on this question. I thought that,
21 based on our past relationships, some candor on the realities
22 of that problem, as we see it, wouldn't be inappropriate
23 at all. I did not come to offend anybody. We can all
24 make serious mistakes, sometimes in good faith, but they can
25 still be very serious. I have asked our counsel to begin to

1 prepare this case for trial. Whether it is Chapter 21
2 or Chapter 21 and whatever comes out as H.B. 200, if it
3 does - on the basis of the whole tax structure - I think
4 we have gone that far. I do not want to elaborate on the
5 detail of that. I have given you the tip of the iceberg
6 so that you see the structure. If you would like a copy
7 of my testimony which shows a good deal more of that
8 detail, I would be happy to give that to any of you.
9 At the same time, I don't hesitate to sit down with
10 this Committee or this legislature or the Alaskan
11 government, and say, you know we have been at each other
12 for 12 years. Isn't it time we hit a little peace treaty
13 that lets you do the things you basically want to do.
14 It takes a little bit of the burden off our back, creates
15 the kind of stability you have mentioned you want to find,
16 and puts you on a basis where you don't have to worry
17 day in and day out that we've dreamt up another lawsuit.
18 It's an honest question I am asking you. I can't suggest
19 an answer but simply underline triple again that we are
20 listening. We are happy to go either way, the courthouse
21 or caucus. This is really where we are.

22 MR. HAYES:

23 Mr. Chairman, just to follow up on my final question.
24 We have discussed in the legislature to a great extent,
25 inhouse and publicly, what Alaska's fair share for the oil

1 ought to be. How, in your opinion, should we decide what
2 that share is - what is our fair share? We are talking now
3 the federal government gets so much, the oil industry gets
4 so much, the State gets so much. It looks like it's an
5 even cut. I've heard that type of rationale used. We talk
6 about the great profitability of the oil industry and
7 the windfall situation they found themselves in. How,
8 in your opinion, do we decide what the fair share is from
9 the State's point of view, or from anybody, or from our
10 collective point of view?

11 MR. DONALDSON:

12 Can I speak just for myself? This is not off the ceiling,
13 but I really speak for myself on this.. You start first
14 from the fact that the federal government -- we have some
15 problems with their taxes and we are looking at that --
16 taking a share in the 40% range. They had no risk. Just
17 a revenue take. The State of Alaska takes a percentage
18 in the low 30's right now, and you have no risk. Our
19 share under present law is someplace in the 20's, and we
20 have all the risk. What Monte Taylor said struck me as
21 a reasonable note, although we had not discussed it.
22 Some kind of equilibrium, at least, between the State and
23 the industry. That is a beginning point I would at least
24 think about if I were trying to find an answer. Secondly,
25 many times the questions we throw at each other are so in

1 the extreme. When I'm in litigation - I've been in it for
2 20 years - I don't expect a 100% win all the time. I don't
3 expect a 100% loss. I think we make a mistake when we start
4 from either end of the extreme. It would be a rotten policy
5 by the State of Alaska to assume that its taxes were fair
6 as long as nobody packed up and left. You can't prove
7 business decisions not made. That's not the point of
8 departure either. Thirdly, Alaska has a great deal of
9 potential. I'm fascinated by it. In the oil area alone,
10 you probably have found only about 20 or 25% of the
11 potential that is conservatively estimated in your State, by
12 U.S.G.S., by National Petroleum Council, by the most able
13 and responsible studies that exist. - I think, sometimes, as
14 you grapple for new tax you have forgotten your own
15 potential. Some of those fields are marginal on economics
16 today, technology tax and other things. But it is there,
17 it will be needed in our lifetimes. You do not want to
18 spoil that by trying to catch up your State, and it does
19 have needs, please do not misunderstand, by sending the
20 entire bill for the catch-up to one field, a few companies,
21 in a very short span. I think if you lay your answer
22 over a little bit longer perspective, it has a lot more
23 wisdom and the public will understand. Third thing, or
24 fourth thing, whatever the number is at this point -- I
25 don't know what the exact point of middle ground is. I think

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1 that if the State has some serious desire to find it, try us
2 out. If we think it's not quite right, and I don't mean
3 haggling now, I mean listening and responding promptly.
4 But try us out. There may be some people in this
5 legislature that begin to get their own ideas, we'll listen
6 to all of you. But you at least have to take that first
7 step. I think that is probably the best I can do for you
8 on these - but those are the principal considerations.
9 We just have a lot of high hopes for this place. It's
10 fantastic. Yet it's not fun to walk when you are hobbled.

11 MR. ROGERS:

12 I'd like to thank you for your testimony today. I think it
13 ~~is a different attitude brought to the hearing than in~~
14 past years. I think it is important, though, to note that --
15 you talked about the federal search for revenue -- the major
16 change in the allocation of the profit pie from Prudhoe Bay
17 in the last three years has not been one that the industry
18 or the State has caused, but, in effect, semi-nationalization
19 of Alaskan and everybody else's oil resources. If you
20 look at the split of the profits now, outside of the
21 original ownership share, the original 12.5% the State has
22 retained, almost 50% of the remaining amount is being
23 taken by the federal government. That is what has caused
24 the most instability. I would like to point out a couple
25 of errors in your testimony ...

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1 MR. DONALDSON:

2 Do you want me to comment on that, please?

3 MR. ROGERS:

4 If you wish, sure.

5 MR. DONALDSON:

6 There is a question there, at least implied again. We
7 understand that. We don't like that either. But just
8 because someone is wailing over here doesn't mean that
9 it is right to get spanked twice. We are trying to deal
10 with both and not just passing one off against the other.
11 One analogy that might be helpful to you -- one of our
12 lawyers observed a little bit wryly - he says, you know
13 it's almost like you bought a house for \$20,000 from the
14 State of Alaska 12 years ago, and now they decided it was
15 a bad deal and they want to sell it to you again by taking
16 most of the \$100,000 that it is now worth. If somebody
17 had that happen to their house they would feel outraged.
18 I said, I hear you, but we need to find some answer,
19 again, that is in the middle that we both have some comfort
20 in and both of us can go ahead.

21 MR. ROGERS:

22 A couple of errors, and I think they were probably inadvertent.
23 One was on the difficulty of setting a discount rate, in
24 terms of the reserves tax. That is set by law in the bill.
25 So that is not a difficult administrative decision, because

1 it is in the bill.

2 MR. DONALDSON:

3 On that point, suppose it is wrong.. The change of 1%
4 in the discount rate is millions and millions and millions
5 of dollars.

6 MR. ROGERS:

7 But you said it is administratively difficult. I think
8 your point may be that it could be wrong, and I'll accept
9 that point. But not that it is administratively
10 difficult.

11 MR. DONALDSON:

12 I stand corrected.

13 MR. ROGERS:

14 The second one - you discussed the discouragement on
15 proven reserves. There is a fundamental difference
16 between the '75 tax and this one. Which is that this one
17 is on producing and not proven reserves, at least
18 as I read it. That is a substantial difference from the
19 '75 tax and, as I recall Mr. Lipton's comment about the
20 '75 tax, more primarily the difficulties of assessing it
21 on proven but unproducing reserves.

22 MR. DONALDSON:

23 When you've had some production it is a little easier to
24 estimate. My point, however, was. if we found something --
25 Beaufort Sea, western Alaska, what have you -- and we know

1 What we start producing commercially - suddenly the reserves
2 tax is laid on, that is a burden you can look at and worry
3 about before you ever start. It is that inhibition that
4 applies, whether it is '75 is a year, or '85 is a year, or
5 '90 is a year.

6 MR. ROGERS:

7 So on Beaufort where some of your best, what may be your
8 best tracts are net profits, the tax is not as important
9 in determining whether or not you produce. Is that
10 correct?

11 MR. DONALDSON:

12 Yes and no. You look at all the factors, Brian, and some
13 things you just can't talk about up here yet.

14 MR. ROGERS:

15 Right. There has been a lot of discussion about how
16 Alaska's oil tax has discouraged investment, not only in
17 the oil industry but in other industries. Do you think
18 it has discouraged investment in the copper industry in Alaska?

19 MR. DONALDSON:

20 I don't know enough about the copper industry yet. I will
21 maybe by this time next year.

22 MR. ROGERS:

23 There was an article in Business Week that quoted a high
24 ranking official at SOHIO, saying that SOHIO's making so
25 much money from Alaska oil that it can't begin to invest it

1 intelligently.

2 MR. DONALDSON:

3 Whoever he may be, I haven't met him. The answer to that
4 is an important point. We caught some flak about this
5 acquisition. It is a natural resources thing, though,
6 and an extension of a business that we understand. What
7 most of the working business press missed was the comment
8 by our Chairman, and indeed our press release, that this
9 is a major investment for us. It is a long term potential
10 that has base in many geographic areas that are attractive.
11 But it is only a small fraction of our potential. We
12 announced at the same time that, even though this was a
13 \$1.8 billion purchase, we would be spending and investing
14 about \$16.5 billion in energy development between now and
15 the end of 1985. Energy is still our business. We are
16 looking in lots of places, from the North Slope to the
17 Gulf coast and beyond, and we think it still has a great
18 deal of potential. But where we put that money depends
19 a lot on questions just like this, Brian.

20 MR. ROGERS:

21 ... getting into a couple of more details...

22 MR. DONALDSON:

23 I can stop any time.

24 MR. ROGERS:

25 Your comments have centered around section 3 of the Sponsor

1 Substitute, the reserves tax portion of the Sponsor
2 Substitute. Would you care to comment on other sections of
3 the bill, in terms of -- most of them address the issues
4 you have raised in the lawsuit. That's the purpose of those
5 sections. In fact, the other sections, by themselves,
6 when they were originally introduced in H.B. 200, would
7 represent a decrease in State revenues ...

8 MR. DONALDSON:

9 The technical amendments are what you are referring to are
10 things that would not surprise me to see the State pass in any
11 event this session. I would if I were you. It takes away
12 some legal arguments from us. That is the purpose of it.
13 It is house cleaning and it is important. : ..

14 MR. ROGERS:

15 Do you support those?

16 MR. DONALDSON:

17 I think so on the whole. Because it tends to bring your
18 law more into a comparable position that Chapter 20 is.
19 It does not take away the main issues in the lawsuit,
20 but it clears the air a little bit. It certainly is a
21 step in the right direction.

22 MR. ROGERS:

23 One difference I see in this year's, is that the State
24 has said that a fair share is on the order of 30%.
25 In previous years, the State was saying a fair share is

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1 more. And that is a pretty key difference with this year's
2 tax as with the previous. Perhaps for the first time, the
3 industry has said what, at least one member believes might
4 be a fair share - on the order of 27% or 28%. Did I hear
5 you say you would concur on that?

6 MR. DONALDSON:

7 I think that if you get in rough parity with the State,
8 and that is probably in the range where that happens, we
9 would have to think a long time as an industry, as a
10 company, before we said that is not a pretty fair piece
11 of middle ground.

12 MR. ROGERS:

13 One problem, of course, is that almost of all -- when we
14 look at taxation we look at Prudhoe Bay. But Prudhoe Bay
15 happens to be one that was originally State owned and the
16 State had received the royalty share. On a hypothetical
17 other field where someone else owned the royalty share, are
18 you saying the State's fair share is 27% or 28% minus the
19 royalty, or 15% would be the ...

20 MR. DONALDSON:

21 Those kinds of questions that you want to look at as you
22 sort things out. Let me point out, and again I don't want
23 to be argumentative, the State did not always own Prudhoe Bay.
24 They acquired it from the federal government, as a part
25 of a settlement - Statehood. The federal government assumed

1 that you would lease it and lease it properly. I think
2 the federal government might have been terribly surprised
3 if they knew back then what you have done since. Because
4 there is an element of trust of the total public of the
5 country, not just of Alaska. While your focus has to be
6 Alaska, and I think there is a broader scope that you might
7 sometimes want to consider. It's that kind of federal
8 interest that a federal government can seize on and come in
9 and help you run your own affairs. My suggestion for middle
10 ground is not intended to be a threat at all, but there
11 are other considerations that just have to be addressed by
12 the State. If I were running the State, and I am sure not,
13 they are things I would want to think about. Thank you.
14 very much for letting me testify.

15 MR. GARDINER:

16 Thank you, and we will continue the hearings tomorrow.
17
18

19 (meeting adjourned 3:00 p.m., May 21, 1981)
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C E R T I F I C A T E

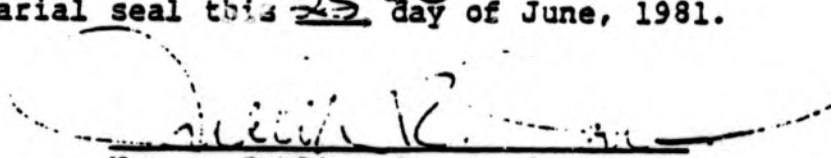
STATE OF ALASKA)
: SS.
FIRST JUDICIAL DISTRICT)

I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing May 21, 1981 meeting of the Joint Gas Pipeline Financing Committee was recorded by me and thereafter transcribed by me or someone under my direction.

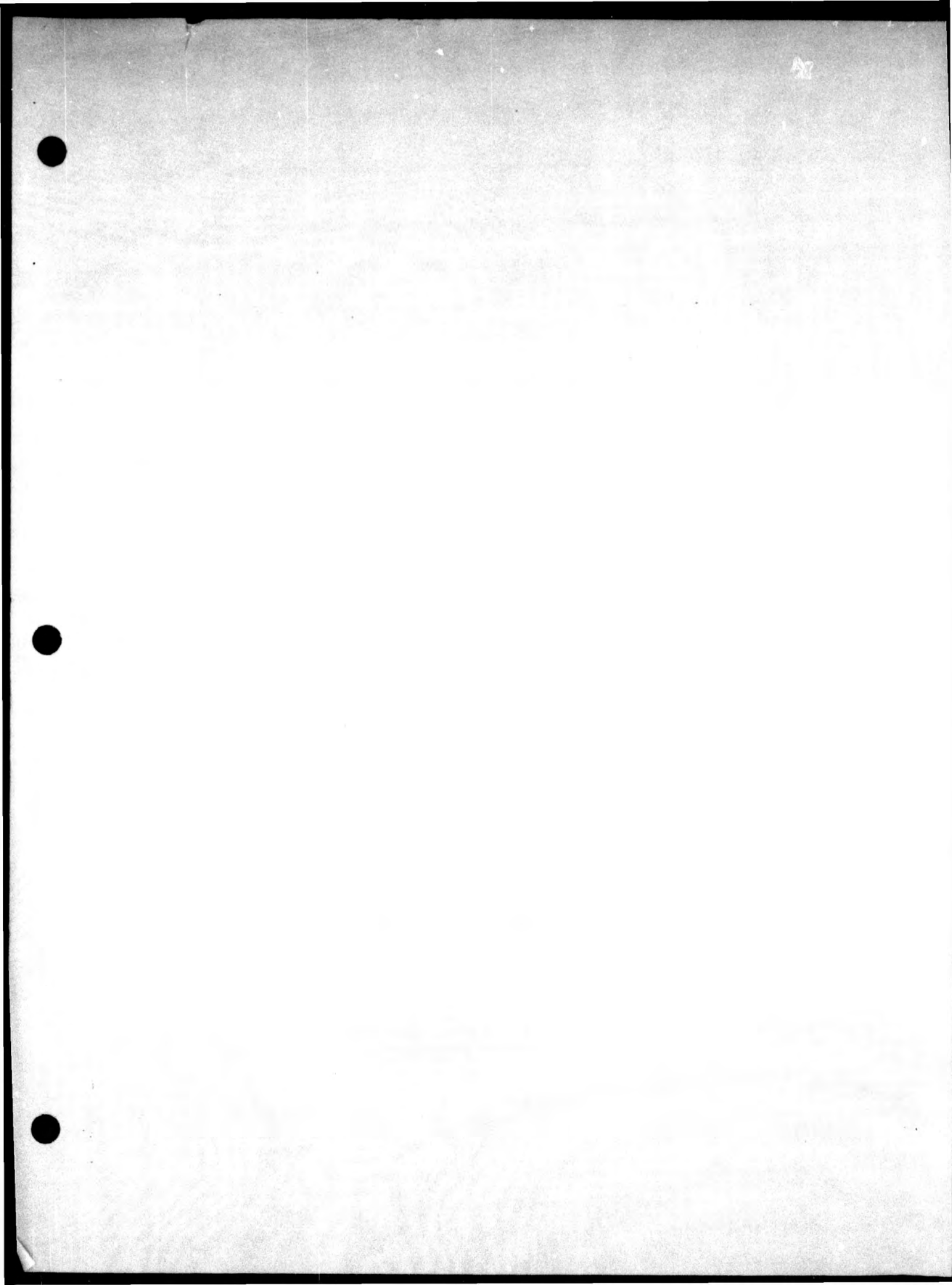
I further certify that the transcript, consisting of 97 pages, is a full, true and correct transcript of the proceedings.

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 25th day of June, 1981.


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

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1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE
2 JOINT GAS PIPELINE ~~FINANCING~~ COMMITTEE
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6 TRANSCRIPT OF PROCEEDINGS

7 MAY 22, 1981
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16 COMMITTEE PRESENT:

17 Representative Terry Gardiner, Chairman
18 Senator Michael Colletta
19 Senator Bettye Fahrenkamp
20 Senator Charles Parr
21 Senator John Sackett
22 Senator Jalmar Kerttula
23 Representative Hugh Malone
24 Representative Anthony Vaska
25 Representative Brian Rogers
Representative Richard Randolph
Representative Sam Cotten
Representative Richard Halford

P R O C E E D I N G S

5/22/81

1
2
3 MR. GARDINER:

4 Call the meeting to order. Continuing testimony on
5 House Bill 200, the first person to testify today is
6 Paul Harding. Paul Harding?

7 MR. HARDING:

8 Good afternoon. My name is Paul Harding, from Anchorage,
9 Alaska. I am here to testify on behalf of the Alaska
10 Support Industry Alliance. The Alliance is made of more
11 than 200 companies and corporations, most of them involved in
12 the oil, mining and construction industries. Our group
13 was organized in the summer of 1979 when the Beaufort Sea
14 lease sale was threatened with cancellation. When one
15 examines the list of Alliance members, it is surprising
16 to discover the diversity of businesses which felt that
17 the availability of exploration lands on the North Slope
18 would pertain to their interests. Laundry companies,
19 hardware stores and travel agencies joined with drilling
20 companies and oil field caterers to organize support for
21 the lease sale which did occur as scheduled. The support
22 industry is a maze of businesses providing the hundreds of
23 goods and services a primary industry, such as oil,
24 requires. Investment decisions made by the primary
25 industries have a critical effect on the economic health

1 of the support industry. Political policies affecting
2 those decisions inevitably affect us. So naturally they
3 demand our attention. One such policy is the oil and gas
4 corporate income tax. This tax on the earned income of
5 oil companies doing business in Alaska provides
6 approximately 19% of State revenues. It represents a
7 substantial increase in the cost of Alaskan oil operations,
8 thereby diminishing Alaska's competitive position with
9 other U.S. exploration areas. It denies the right of
10 substantial reward that high risk ventures must offer
11 if they are to be undertaken. Such denial can only be
12 perceived as indifference on the part of the State toward
13 continued exploration and development. That indifference
14 ignores our interests and condemns the future that many
15 of us are trying to build here in Alaska. Ironically,
16 it is our condition of affluence that helps foster this
17 indifference. The overzealous determination of some
18 legislators and officials of the administration to
19 maximize State interests in their dealings with the oil
20 industry blind them to the fact that the interest of the
21 citizens are not singularly aligned with the State.
22 There is a point at which maximizing State interests
23 diminishes opportunity in the private sector, thereby
24 infringing on the welfare of the citizenry and increasing
25 their dependence on the State. Chapter 21 is a case in point.

1 While a resolution of the problem now appears possible
2 with the negotiation of an affordable revenue reduction,
3 we instead find ourselves pursuing a course of non-
4 resolution that will undoubtedly lead to still more
5 legal entanglements. This course, marked by the assumption
6 that no relationship exists between tax policies and
7 investment decisions, ignores the interests of all other
8 private sector parties. According to World Book
9 Encyclopedia, the fundamental problem of a tax system is
10 to produce enough money to pay government expenses.
11 Obviously, we have succeeded in overcoming that fundamental
12 problem. Not only have we raised enough money to
13 provide for government services, we have established a
14 billion dollar savings account and enjoyed the assurance
15 of billion dollar surpluses throughout this century.
16 Given these fiscal conditions, it would seem that a
17 straightforward resolution of Chapter 21 through a
18 negotiated revenue reduction is affordable and advisable.
19 While the legislature and the administration have an
20 obligation to protect and promote the interests of the
21 State, they also have an obligation to protect and
22 promote the interests of the citizenry. The continued growth
23 of exploration activity in the State is within those
24 interests and can be assured by positive action on
25 Chapter 21 rather than the course you consider here today.

1 Evidence of public support for a resolution of this problem
2 is impressive. Organizations supporting a resolution
3 by reduction of revenues include the Alaska Support
4 Industry Alliance, PASIT (ph), the Alaska Black Caucus,
5 the Alaska State Chamber of Commerce, Cook Inlet Regional
6 Corporation, Chugach Regional Corporation, Bering Straits
7 Regional Corporation, and the Chambers of Commerce in
8 the following cities: Petersburg, Valdez, Homer, Kenai,
9 Palmer, Wasilla, Fairbanks, and Anchorage. Also in
10 support is the Kenai Borough Assembly, The Kachemak
11 Board of Realtors and the Resource Development Council.
12 That concludes my remarks. I'd be glad to answer any
13 questions.

14 MR. ROGERS:

15 Could you discuss the --what you felt was the positive
16 impact of repeal of AS 43.21 on drilling activity.
17 Isn't it true that exploration activity in Alaska hit a
18 new high last year, a record high, after -- this came
19 after passage of AS 43.21.

20 MR. HARDING:

21 There has been a moderate increase, but I don't think --
22 if you compare the drilling activity, the increase of
23 activity in the State of Alaska, with the increase that
24 has occurred in all other regions of the country, I
25 think that it is relatively unimpressive.