

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILE 8672
1649 SCOMM 62: SENATE SPEC. COMM. ON OIL & GAS, 1989-1990

OIL SPILL/DISCHARGE MATTERS - ANCHORAGE

State v. Block: Action in federal district court against U.S. Forest Service seeking cleanup of an oil spill from former cannery site on Evans Island in Chenega Bay.

State v. Tesoro Alaska Petroleum, et al.: Action in state superior court for cleanup, penalties and damages from underground oil spill at gasoline station in Peters Creek.

State v. Breeden: Action in superior court for damages (will be followed by action for cleanup and penalties) for gasoline contamination of water well at Independence Mine Visitor's Center at Hatcher Pass.

State v. Aoyagi Maru: Investigation proceeding and Complaint to be filed for damages and penalties for marine spill from grounded vessel at Lost Harbor near Dutch Harbor.

State v. M/T Thompson Pass: Investigation proceeding and Complaint to be filed for damages and penalties for oil spill from tanker while loading at Trans-Alaska Pipeline System (TAPS) terminal in Valdez.

State v. Chil Bo San: Investigation proceeding and Complaint for damages and penalties to be filed for marine spill from grounded vessel near Spray Cape, Unalaska Island.

AMOCO (Nikiski): Disposal of petroleum waste products and drilling muds to unlined pits. Compliance Order being negotiated for cleanup and groundwater assessment.

Texaco Station (Anchor Point): Extensive groundwater contamination has forced some residents to seek alternate water supply. Contamination resulted from leaking fuel delivery system; also, possible surface spill. Cost of cleanup may exceed \$500,000.00. Investigation proceeding.

Coastal Drilling (Soldotna): Unpermitted dumping site for drill muds, solvents, oils, equipment, etc. Investigation proceeding.

Ridgeway Service Station (Kenai): Leaking fuel delivery system polluted groundwater, wells, in residential subdivision. Several residents put in new wells. Compliance Order being negotiated for cleanup.

Tesoro Refinery (Nikiski): Tesoro estimates they have spilled and/or leaked 400,000 to 750,000 gallons of petroleum product

HAZARDOUS SUBSTANCE SPILL/DISCHARGE MATTERS - ANCHORAGE

Tesoro Refinery Hazardous Waste (Nikiski): Hazardous waste deposited in unlined pits at refinery in 1970's and possibly early 1980's. Waste has leached into the groundwater. Tesoro has applied to EPA for permit to leave the waste in the ground. Tesoro required to do groundwater monitoring, possibly groundwater remediation.

Union Chemical Fertilizer Plant: Soil and perhaps groundwater at plant contaminated with ammonia. UNOCAL has agreed to determine extent of contamination.

Norgetown Dry Cleaners (Anchorage): Substantial solvent discharge into sewer line resulting in major groundwater contamination. Investigation proceeding and Complaint to be filed.

McGahan Subdivision (Kenai): Tetrachloroethylene contamination in public water system. Investigation proceeding.

Alyeska Basin Subdivision: Tetrachloroethylene contamination of public water system. Complaint to be filed.

M & M Enterprises (Anchorage): Compliance Order under negotiation for PCB and lead contamination.

into the soil and water around the refinery. The contamination has migrated onto neighboring property, polluting neighboring wells. Cleanup is underway; will be ongoing for years to come.

Union Oil v. State -- DEC denied Union's permit application for six unlined pits for disposal of drill muds. DEC's decision was upheld by administrative hearing officer. DEC to undertake enforcement for proper disposal of the pit contents.

State v. Union Oil -- Litigation over a seventh unpermitted, unlined drill mud disposal site. Substantial site testing underway.

State v. All Alaska -- Investigation proceeding and Complaint to be filed for damages and penalties from oil spill from fish processing vessel at St. Paul Island.

State v. Glacier Bay -- Complaint for damages and penalties to be filed for marine oil spill from tanker in Kenai.

State v. M/V Swallow -- Investigation proceeding and Complaint for damages and penalties to be filed for marine spill from grounded vessel near Dutch Harbor.

State v. Cove Leader -- Investigation proceeding and complaint for damages and penalties to be filed for marine spill from tanker in Valdez.

Unocal Service Stations (Anchorage) -- Three sites are being investigated for oil contamination from leaking underground storage tanks. Compliance orders under negotiation for each site.

Kim's Service Station (Anchorage) -- Oil contamination from leaking underground storage tanks.

Topper's Service Stations (Anchorage) -- Four sites are being investigated for oil contamination from leaking underground storage tanks. Compliance orders under negotiation for each site.

Chevron Service Station (Anchorage) -- Oil contamination from leaking underground storage tanks. Compliance orders under negotiation.

7-Eleven Service Station (Eagle River) -- Oil contamination from leaking underground storage tanks. Compliance order signed and clean up proceeding.

Amoco Platform Anna -- Investigation proceeding and Complaint for damages and penalties to be filed for marine spill from off shore drilling pad.

Union Oil Gravel Pit (Kenai) -- Discharge of condensate and other oil waste. Compliance order under negotiation.

Ft. Richardson -- Investigation proceeding on leaking underground storage tanks.

Sterling Chevron Station -- Leaking underground storage tank. Criminal complaint filed. Complaint to be filed for cleanup and civil penalties.

Chevron Bulk Plant (Valdez) -- Soil and groundwater contamination from refined petroleum products. Investigation proceeding.



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

cc
HB68

January 9, 1989

The Honorable Sam Cotten
Speaker of the House
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Representative Cotten:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to liability for the release or threatened release of a hazardous substance and to recovery of State costs incurred in containing or cleaning up of an oil or hazardous substance spill.

This bill is necessary to clarify who is potentially liable for the damages that might occur, and the expenses that might be incurred, because of the release or threatened release of a hazardous substance. The bill is also necessary to provide the State with an added opportunity to recover the costs associated with responding to the release of oil or a hazardous substance.

Section 1 of the bill repeals and reenacts existing AS 46.03.822, which, in its current form, does not provide the specificity necessary to identify all the potential responsible persons who are liable for the release or threatened release of a hazardous substance. Reenacted AS 46.03.822(a) would identify those persons as follows:

(1) the owner and person controlling the substance at the time of the release or threatened release;

(2) the owner and operator of a facility or vessel from which the release occurred or was threatened; if a facility or vessel is abandoned, the owner, operator and any other person controlling activities on the facility or vessel just before abandonment;

(3) the owner or operator of a facility or vessel from which the release occurred or was threatened, at the time the substance was received by the facility or vessel;

(4) the owner of the substance who arranges for disposal, treatment, or transport for disposal or treatment by a third party, if a release occurs or was threatened at a facility or incineration vessel that contained the substance and was owned or operated by that third party; and

(5) a person who transported or accepted the substance for transport to the place from which the release occurred or was threatened, if in fact the person chose that place.

Reenacted AS 46.03.822(b) would provide relief from strict liability for a person who proves by clear and convincing evidence that an incident was caused by an act of war, by an act of God, or intentional or negligent conduct by certain third parties. The relief from strict liability for an act of God or for the intentional or negligent conduct of certain third parties must be premised upon the fact that the person, within a reasonable time, discovers the release or the threatened release and begins to contain and clean it up.

Reenacted AS 46.03.822(c) would clarify that the relief from strict liability for the intentional or negligent conduct of a third party is also limited by factors relating to the way a facility is acquired, including (1) that the person did not know and had no reason to know that the facility had a hazardous substance disposed on, in, or at it; (2) that a government entity acquired the facility by escheat, eminent domain, or another involuntary type of transfer; or (3) that the facility was acquired by inheritance or bequest.

Reenacted AS 46.03.822(d) would establish the standards by which a person can, under subsec. (c), be considered to have had "no reason to know."

Reenacted AS 46.03.822(e) would provide that the liability of a previous owner or operator of a facility is not lessened if that owner or operator is otherwise liable and if that owner or operator transfers ownership without disclosing the fact of a release or threatened release. Such a person may not obtain relief from strict liability under this section.

Reenacted AS 46.03.822(f) would clarify that the liability of a person who causes or contributes to a release or a threatened release is not affected by AS 46.03.822. Such a person is liable in any event.

Reenacted AS 46.03.822(g) would provide that a person otherwise liable may not transfer liability by agreement. However, this subsection makes clear that persons who are liable under AS 46.03.822 may be insured or indemnified, and may enforce such agreements against other persons.

Section 2 of the bill amends AS 46.03.826 by broadly defining the term "facility," and defines the terms "natural resources" and "vessel."

Section 3 of the bill is needed because of cases in which parties responsible for oil or hazardous substance spills have declared bankruptcy or left the state. The State could be left to remove the hazard with little hope of recovering the costs. The cleanup of such discharges can be enormously expensive.

Section 3 adds a new section to AS 46.08, the chapter on oil and hazardous substance releases. New AS 46.08.075(a) creates a lien in favor of the State whenever money from the oil and hazardous substance release response fund or any other State fund is used to respond to, contain, clean up, or mitigate an oil or hazardous substance spill, or is used to respond to a substantial threat of such a spill. The lien would be effective against all property of the persons liable for the spill.

New AS 46.08.075(b) would identify the method for enforcing the lien against real property, including a requirement of recording the certificate of lien and giving notice to the liable party and to anyone else with an interest in the property.

New AS 46.08.075(c) would require the commissioner of the Department of Environmental Conservation to certify that a lien has been reduced or satisfied if payments are made on the liable party's obligation.

New AS 46.08.075(d) would permit the owner of property against which such a lien has been asserted, to seek a court order removing it. The lien may be released by the court, to the extent of the person's ownership interest in it, if that person can show that he or she is not liable for the State's costs in an oil or hazardous substance cleanup or in responding to a threat of such a spill.

In an era when hazardous substances are an increasing part of our environment, and when the State must safeguard the money available to it for protecting the public health, I believe that this bill would give us important tools to respond to both. I urge your support of it.

Sincerely,



Steve Cowper
Governor

Anchorage Daily News Friday, November 4, 1988

It's time to clear the air about the effect of tort reform on the environment.

Trial lawyers opposed to Ballot Measure No. 2 would have you believe that this measure poses a threat to our environment. They maintain that if this measure passes, polluters will escape paying for the environmental damage they cause. That's simply not true.

According to the legislature's own independent lawyer, Ballot Measure No. 2 will have *no impact* on Alaska's environmental protection laws. Similarly, it will have *no impact* on federal environmental protection laws.

The truth of the matter is that since 1986, 39 states have passed

some form of tort reform. And on November 8th, it will be your turn to set the record straight.

Ballot Measure No. 2 will make Alaska's liability law more equitable. At the same time it will protect the right of the victim to receive compensation from those who are responsible.

These are the facts. Don't allow a lot of legal double-talk to cloud the issue.



Support tort reform.
Vote for Ballot Measure No. 2 on November 8th.

Paid for by Citizens' Coalition for Tort Reform, PO. Box 20164, Anchorage, Alaska 99522. David McGuire, M.D., Chairman.

ATTACHMENT — 1 —
PAGE — 1 — OF — 1 — PAGES.

SCOMM

62:28

THE COMMITTEE HAS ANALYZED THE IMPACTS OF SB 97 AND HB 118 REGARDING EFFECTS ON FIELD SIZE AND PRODUCTION INCENTIVES AND LOOKED AT HOW THE FORMULA IS STRUCTURED.

AN INVESTIGATION OF THE FORMULA IN BOTH BILLS HAS LED TO THE CONCLUSION THAT THERE IS NO REASONABLE WAY TO MODIFY THE FORMULA TO MEET THE NEEDS OF VARYING SIZE FIELDS.

AFTER OVER 12 HOURS OF HEARINGS I HAVE CONCLUDED THAT THE ADMINISTRATION HAS SOLELY DESIGNED THIS LEGISLATION TO RAISE REVENUES AND THAT ANY MODIFICATION MAY CREATE UNFORESEEN CONSEQUENCES IN THE FUTURE--JUST LIKE THE SITUATION WE ARE FACED WITH TODAY.

THE COMMITTEE HAS DRAFTED A SUBSTITUTE WHICH INCORPORATES THE FORMULA OF HB 118 WITH AN EFFECTIVE DATE OF JULY 1, 1989. THE FIRST PAYMENT OF INCREASED TAXES WOULD THEN OCCUR ON AUGUST 20, SINCE THE TAX IS DUE ON THE 20TH DAY OF EACH CALENDAR MONTH ON OIL AND GAS PRODUCED FROM EACH LEASE OR PROPERTY DURING THE PROCEEDING MONTH.

no new surcharge to Kuyper

WE HAVE LEFT THE CURRENT LAW STAND REGARDING WHETHER THE PRESUMPTION OF 300 BARRELS AS THE ECONOMIC LIMIT CAN BE REBUTTED DURING AN ADMINISTRATIVE HEARING. I THINK IT IS AN ISSUE OF FAIRNESS. IF A COMPANY CAN PROVE BY CLEAR AND CONVINCING EVIDENCE THAT ITS ECONOMIC LIMIT IS GREATER THAN 300 BARRELS, IT SHOULD HAVE THE OPPORTUNITY TO PROVE IT.

Alaska State Legislature

APR 5 1989



SENATOR JIM DUNCAN

P. O. Box V JUNEAU, ALASKA 99811-3100
(907) 465-4766

COMMITTEES:
FINANCE
VICE CHAIR -
HEALTH EDUCATION
& SOCIAL SERVICES
BUDGET & AUDIT
BANKING &
ECONOMIC
DEVELOPMENT

MEMORANDUM

April 5, 1989

TO: Senator Drue Pearce, Chairman
Senate Special Committee on Oil
and Gas

FROM: Jim Duncan
Senator

SUBJECT: Proposed Amendment to Elf Legislation to help finance
oil spill prevention and clean-up

The Prince William Sound oil spill dramatically illustrates the need for clearly identified and readily available funds for the prevention and clean-up of future spills.

The state's Oil and Hazardous Wastes Release Response Fund only had a balance of approximately \$1.5 million before the spill occurred. The costs of cleaning up the spill will be far higher than that, as the Governor and the Senate recognized in our approval of the \$20 million special appropriation. I believe it is safe to assume that the full costs to the state of the clean-up and restoration will far exceed that \$20 million figure.

The spill also points out the need for the state to increase its efforts at prevention of such disasters. We have seen that clean-up work after a spill is a particularly poor substitute to keeping the spill from happening in the first place.

I propose that the legislature address these needs by passing legislation to revise the Economic Limit Factor (ELF). This legislation made sense before. It makes more sense now.

We now know that there is clearly a connection between the industry; their activity, and the financial and environmental risk to Alaskans. The margin of profits to the Oil Industry can be a direct liability to us as we have seen this past week as the costs of doing business (risks) has been wrongfully placed on our shoulders.

Senator Drue Pearce
April 5, 1989
Page 2

The attached amendment would make the bill apply to all the oil produced this calendar year from Prudhoe Bay and Kuparuk. The amendment provides the following:

- 1.) An additional \$104 million more than the version reported out of the Senate Judiciary committee.
- 2.) Provide an immediate \$32 million dollars for the Oil and Hazardous Substance Release Response fund to deal with our immediate disaster. This also allows some immediate funding for prevention as well as clean-up and restoration as authorized in SB 261 which I introduced this morning.
- 3.) Provides that the Legislature will appropriate annually to the state's spill prevention and clean-up fund \$30 million or four percent of the severance tax revenues, whichever is greater.

As you are aware, Exxon has committed to paying for the costs of the clean-up, but the state needs to insure that the money is both adequate and timely. The state should spend the money as needed, and obtain reimbursement later through the courts if necessary. In the meantime we need to insure that adequate funding is available.

In addition to addressing the immediate need created by the Exxon Valdez spill, I believe if we are to see major production in the future, such as ANWR, it is necessary to demonstrate to the citizens of Alaska, and Congress that we will be prepared to prevent and respond quickly to future problems. I believe the building of a "super fund", such as this amendment provides for, would go a long way in providing those assurances.

I urge an early hearing of House Bill 118 and favorable consideration of both the legislation and my amendment.

A M E N D M E N T

OFFERED IN THE SENATE

BY DUNCAN

TO: SCS CSHB 118 (Judiciary)

Page 1, following line 24:

Insert a new bill section to read:

"* Sec. 3. AS 43.55.080 is amended by adding new subsections to read:

(b) The commissioner of administration shall separately account for all proceeds of the tax deposited into the general fund under (a) of this section.

(c) The legislature shall annually appropriate to the oil and hazardous substance release response fund established in AS 46.08.01 the greater of:

(1) \$30,000,000; or

(2) four percent of the amount estimated to be received from the tax levied and collected under this chapter during the fiscal year."

Renumber the following bill section accordingly.

Page 1, following line 25:

Insert new bill sections to read:

"* Sec. 5. Sections 1, 2, and 4 of this Act are retroactive to January 1, 1989, and apply to oil produced after December 31, 1988.

* Sec. 6. AUTHORIZATION FOR APPROPRIATION OF TAX REVENUE RECEIVED DURING FY 1989. The legislature shall appropriate to the oil and hazardous

substance release response fund 50 percent of the difference between taxpayer's tax liability on oil production under AS 43.55 for the period between the retroactive application date of this Act and May 31, 1989, determined under AS 43.55.013

(1) as that statute existed before the amendments to it made secs. 1, 2, and 4 of this Act; and

(2) as amended by secs. 1, 2, and 4 of this Act.

* Sec. 7. PAYMENT OF TAX DUE. The oil production tax payable as result of the retroactive application of this Act is due on the 20th day of the calendar month following the effective date of this Act. If the tax due and payable is not paid by the date specified in this section, the tax becomes delinquent and subject to payment of interest and the provisions of AS 43.10 relating to enforcement and collection of delinquent taxes.

* Sec. 8. OVERPAYMENT OF TAX UNDER REVISED FORMULA. The tax liability of a party that is reduced by the retroactive application of this Act shall be credited against the taxpayer's future tax liability. The provisions of AS 43.05.280(a) and 43.05.280(b)(1) do not apply to, and interest is not allowed on, the overpayment."

Figure 1. Production from a Field

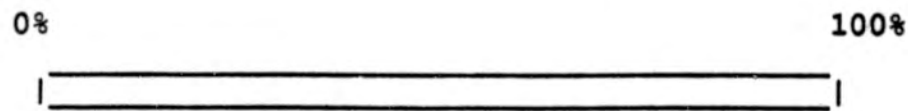


Figure 2. A Profitable Field

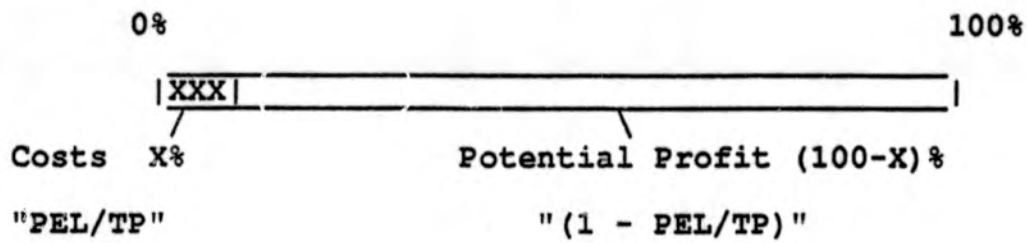
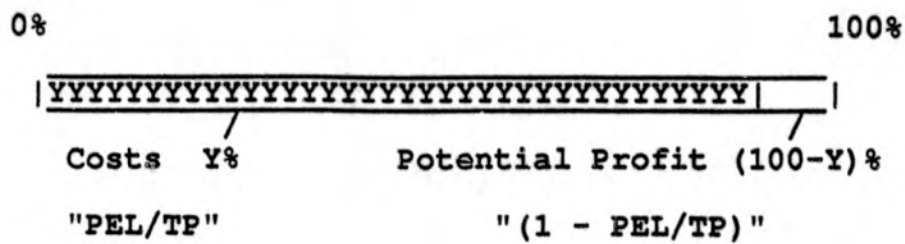


Figure 3. A Marginal Field

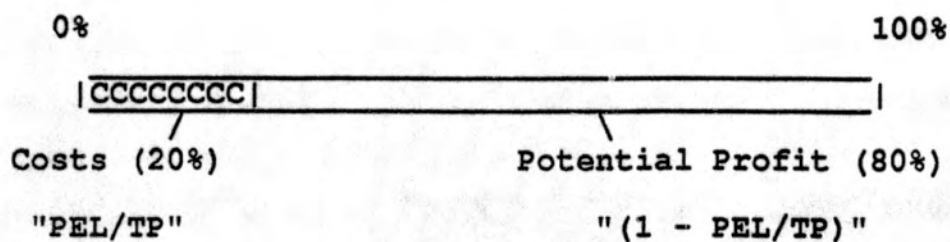


EXAMPLE 1. PRESENT ELF AND A SMALL FIELD

Production: 75,000 B/D

Wells: 50

Presumed Costs: $50 \times 300 = 15,000$ B/D equivalent



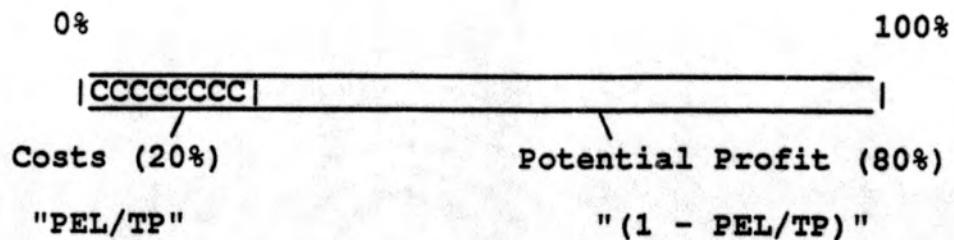
$$\begin{aligned}
 \text{ELF} &= (1 - \text{PEL/TP}) \frac{(460 \times \text{WD})}{\text{PEL}} \\
 &= (1 - 15,000/75,000) \frac{(460 \times \text{WD})}{(300 \times \text{WD})} \\
 &= (1 - 0.2) \frac{460}{300} \\
 &= 0.710239
 \end{aligned}$$

EXAMPLE 2. PRESENT ELF AND A LARGE FIELD

Production: 750,000 B/D

Wells: 500

Presumed Costs: $500 \times 300 = 150,000$ B/D equivalent



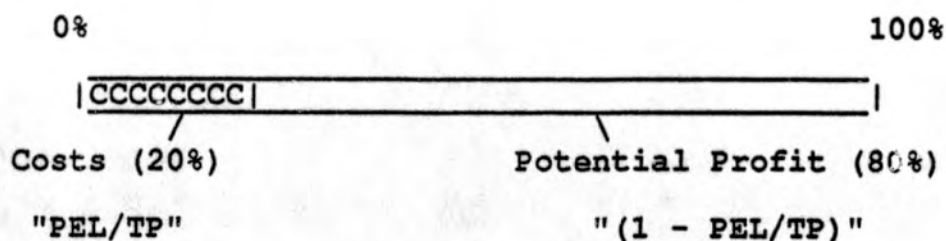
$$\begin{aligned}
 \text{ELF} &= (1 - \text{PEL/TP}) \frac{(460 \times \text{WD})}{\text{PEL}} \\
 &= (1 - 150,000/750,000) \frac{(460 \times \text{WD})}{(300 \times \text{WD})} \\
 &= (1 - 0.2) \frac{460}{300} \\
 &= 0.710239
 \end{aligned}$$

EXAMPLE 3. SCS CSHB 118'S ELF AND A SMALL FIELD

Production: 75,000 B/D

Wells: 50

Presumed Costs: $50 \times 300 = 15,000$ B/D equivalent



$$\begin{aligned}
 \text{New Exponent} &= (150,000/TP)^{(460 \times WD)/PEL} \\
 &= (150,000/75,000)^{460/300} \\
 &= 2 \\
 &= 2.894538
 \end{aligned}$$

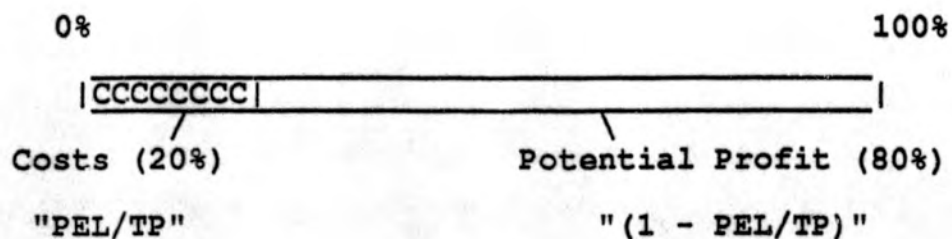
$$\begin{aligned}
 \text{New ELF} &= (1 - PEL/TP)^{\text{New Exponent}} \\
 &= (1 - 15,000/75,000)^{2.894538} \\
 &= (1 - 0.2)^{2.894538} \\
 &= 0.524192
 \end{aligned}$$

EXAMPLE 4. SCS CSHB 118'S ELF AND A LARGE FIELD

Production: 750,000 B/D

Wells: 500

Presumed Costs: $500 \times 300 = 150,000$ B/D equivalent



$$\text{New Exponent} = (150,000/\text{TP})^{(460 \times \text{WD})/\text{PEL}}$$

$$= (150,000/750,000)^{460/300}$$

$$= 0.2^{460/300}$$

$$= 0.084771$$

$$\text{New ELF} = (1 - \text{PEL}/\text{TP})^{\text{New Exponent}}$$

$$= (1 - 150,000/750,000)^{0.084771}$$

$$= (1 - 0.2)^{0.084771}$$

$$= 0.981262$$

EFFECTS OF CHANGING THE ELF ON DIFFERENT
SIZED FIELDS WITH THE SAME AMOUNT OF PROFIT

ASSUMPTIONS

Price per Barrel	\$7.36
Production Needed to Cover Operating Cost	300 B/D per well
Profit (\$ per day)	\$7,360
Profit (B/D)	1,000
State Royalty Share	12.50%

Total Production	Wells	Profit (\$/D)	SB 97 Tax (\$/D)	HB 118 Tax (\$/D)
31,000	100	\$7,360	\$0.0000453	\$0.00000000000006
61,000	200	7,360	0.25	0.0047
91,000	300	7,360	9.94	5.35
121,000	400	7,360	81.66	148.71
151,000	500	7,360	329.91	1,016.40
181,000	600	7,360	903.38	3,548.36
211,000	700	7,360	1,948.68	8,547.76
241,000	800	7,360	3,588.79	16,431.79
271,000	900	7,360	5,915.97	27,265.75
301,000	1000	7,360	8,992.83	40,889.43
331,000	1100	7,360	12,856.71	57,030.21
361,000	1200	7,360	17,525.00	75,377.76
391,000	1300	7,360	22,999.89	95,626.09
421,000	1400	7,360	29,272.53	117,494.13
451,000	1500	7,360	36,326.21	140,733.53
481,000	1600	7,360	44,138.91	165,129.88
511,000	1700	7,360	52,685.12	190,500.56
541,000	1800	7,360	61,937.30	216,691.27
571,000	1900	7,360	71,866.86	243,572.18
601,000	2000	7,360	82,444.92	271,034.33
751,000	2500	7,360	144,085.03	414,328.17
901,000	3000	7,360	218,012.58	563,165.99
1,051,000	3500	7,360	301,647.96	714,329.07
1,201,000	4000	7,360	393,030.40	866,360.07
1,351,000	4500	7,360	490,677.84	1,018,575.70
1,501,000	5000	7,360	593,460.96	1,170,652.32

FINDING THE "CROSS OVER" POINT - HB 118

The "cross over" point is the field size for which the ELF under HB 118 would be the same as the present ELF. Both formulas have $(1 - \text{PEL}/\text{TP})$ as their base, so the cross over point can be found by solving for the field size at which the two exponents have the same value. Let "X" be that field size.

$$\begin{aligned}\text{Present Exponent} &= (460 \cdot \text{WD}) / \text{PEL} \\ &= (460 \cdot \text{WD}) / (300 \cdot \text{WD}) \\ &= 460/300\end{aligned}$$

$$\begin{aligned}\text{HB 118 Exponent} &= (150,000/\text{X})^{(460 \cdot \text{WD}) / \text{PEL}} \\ &= (150,000/\text{X})^{460/300}\end{aligned}$$

Solution: HB 118 Exponent = Present Exponent

$$(150,000/\text{X})^{460/300} = 460/300$$

$$\{(150,000/\text{X})^{460/300}\}^{300/460} = (460/300)^{300/460}$$

$$(150,000/\text{X})^{(460/300) \cdot (300/460)} = (460/300)^{300/460}$$

$$150,000/\text{X} = (460/300)^{300/460}$$

$$\text{X} = \frac{150,000}{(460/300)^{300/460}}$$

$$= 113,507.3348 \text{ B/D}$$

FINDING THE "CROSS OVER" POINT - SB 97

The exponent in SB 97 can be simplified:

$$\begin{aligned}(55,000,000*WD)/(PEL*TP/Days) &= (55,000,000*WD)/((300*WD)*TP/Days) \\ &= 55,000,000/(300*TP/Days)\end{aligned}$$

When we are solving for the cross over point, "X" (the field size in barrels per day) equals TP/Days (i.e., total production in the month, divided by the number of days in the month), so the exponent in SB 97 can be further simplified to

$$55,000,000/(300*X)$$

The cross over point is the field size at which the new exponent equals the present one:

$$\begin{aligned}\text{SB 97 Exponent} &= \text{Present Exponent} \\ 55,000,000/(300*X) &= 460/300 \\ 55,000,000 &= (460/300)*(300*X) \\ &= 460*X \\ X &= 55,000,000/460 \\ &= 119,565.2174 \text{ B/D}\end{aligned}$$

TESTIMONY
OF
BP EXPLORATION (ALASKA) INC.
TO THE
SENATE SPECIAL OIL AND GAS COMMITTEE
REGARDING
SCS CSHB 118 (THE "ELF")

April 24, 1989

My name is Thomas K. Williams. I am Manager of Tax Planning at BP Exploration (Alaska). At the outset, I want to say that BP Exploration is saddened by the Exxon Valdez Incident. So is everyone I know at BP Exploration. We share in your desire to take steps to avoid further spills and to improve the ability to respond to any future spills, as already evidenced by actions announced to date.

However, my purpose in appearing before you today is to testify about the Economic Limit Factor, or ELF, and the legislation that proposes to change it, House Bill No. 118. My testimony today is in two parts. First, I have this prepared statement responding to certain testimony to the Committee last Thursday. Second, I have some comments about how the present ELF works and how it would be changed under HB 118.

Last Thursday there was a question about the nature and size of the return on investment which the owners of TAPS receive. Attached to my written statement are relevant pages from the Settlement Agreement between the State of Alaska and the pipeline owners. As Mr. Motley correctly stated on Thursday, the agreement provides for a 6.4% real rate of return from 1984 through 1989, and a return of 35 cents per barrel (adjusted for inflation) after that for the original investment. In signing the agreement, the State of Alaska endorsed this level of profitability for TAPS. Putting it another way, to increase the tax on production because of pipeline profits is counter to the intent and stated conclusion of the Agreement, which states on page 2 that "TAPS tariffs ... are both just and reasonable and non-discriminatory...." The tariff was structured in a way to increase capital recovery in earlier years so that there would be a lower tariff in later years. This in turn would mean that State revenues would be higher and new fields would have a lower transportation cost in those later years.

Also at Thursday's hearing, the Administration again showed a chart displaying the rate change in Prudhoe Bay in 1987. In explaining the chart, the Administration described how a change of this nature was not fully understood in 1981. The goal in 1981 was to ensure that the State continued to receive its fair share of not less than 30 percent. In fact, compared to 1981, the State's share has soared. BP's figures show that the State's share of production revenue went from 30% in 1981 to 49% in 1988.

	State Share of Production Revenue			
	1981	1986	1987	1988
BP	30%	72%	39%	49%

The same would be true for the other petroleum companies having production in Alaska given the substantial decline in crude oil prices that have occurred over this period. In short, over the last three years, the State of Alaska has received a share of the revenue "pie" far beyond what was contemplated in 1981. In our earlier testimony before this Committee regarding Senate Bill No. 97, BP emphasized that 1986 marked the beginning of an era of dramatically reduced profitability from oil production. As just shown, 1986 also marked the beginning of a period of a dramatically increased State's share of the net revenue from oil production.

We heard on Thursday that HB 118's ELF formula makes field size its dominant parameter because field size reflects how profitable a field is. Let us pass over the counter-example of the West Sak field -- a very large field that even the Administration concedes will be marginal at best. Instead, let me direct your attention to the case of Prudhoe Bay.

BP's figures show that the profitability of Prudhoe Bay has dropped by more than 65% from 1981 to 1988. House Bill No. 118 would match this 65% drop in profitability with a reduction in the tax rate from 15% to 14.9%. If all goes as the State predicts, the rate for Prudhoe will drop again in 1994 -- from 14.9% to 14.8 percent. So much for HB 118's sensitivity to profitability. The justification for setting the tax rate as high as Alaska does was and remains the fact that the ELF will scale the rate down as profitability drops. Under the formula in HB 118, this will no longer happen.

One last comment I have about last Thursday's hearing is not about something that was said, but about something that was not

said. At the beginning of this Session, the Administration's primary argument for amending the ELF was that the State needs the money to meet its budget needs. Since then, the change in the outlook for oil prices this year and next based on the State's Spring Forecast has increased State revenues by more than five times the amount that the ELF was supposed to bring in.

This concludes my prepared remarks. At this time, with your permission, I would like to distribute to the Committee a handout regarding the operation of the present ELF and the proposed one under HB 118.

FIGURE 1

ADMINISTRATION'S CRITIQUE

ARCO's CALCULATION OF AVERAGE KUPARUK PROFITS

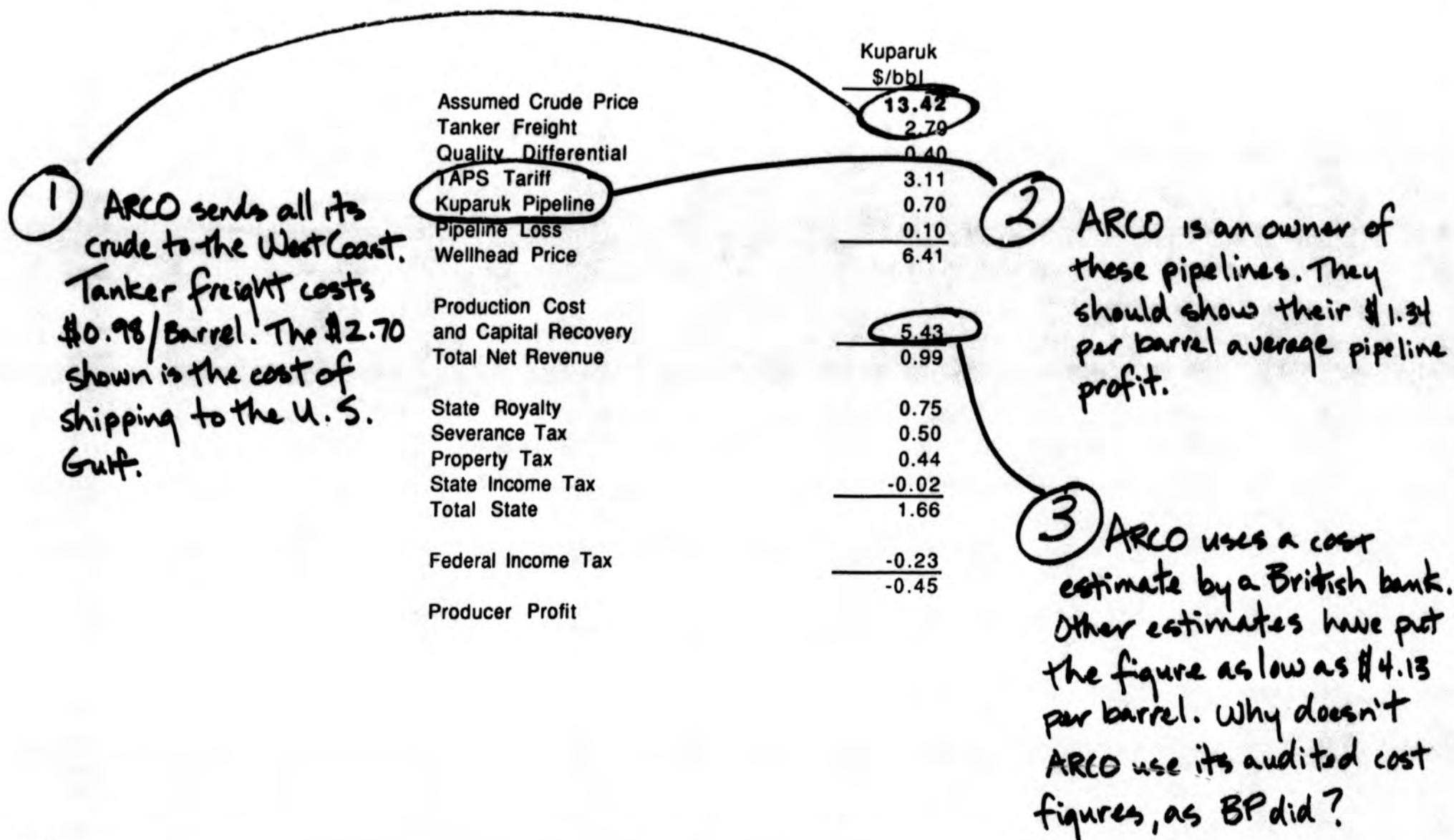


Figure 2

**ADMINISTRATION'S RECALCULATION OF
ARCO'S AVERAGE PER-BARREL PROFIT AT KUPARUK
\$ PER BARREL**

	<u>Under Existing Law</u>			<u>Under HB 118</u>		
Assumed U.S. Gulf Crude Price	13.42	16.41	18.96	13.42	16.41	18.96
West Coast market differential	1.09	1.09	1.09	1.09	1.09	1.09
West Coast tanker freight	0.98	0.98	0.98	0.98	0.98	0.98
Quality differential	0.40	0.40	0.40	0.40	0.40	0.40
 Kuparuk Pipeline & TAPS tariffs	 <u>3.81</u>	 <u>3.81</u>	 <u>3.81</u>	 <u>3.81</u>	 <u>3.81</u>	 <u>3.81</u>
Operating & capital costs (pipelines)	1.34	1.34	1.34	1.34	1.34	1.34
State & local property tax (pipelines)	0.22	0.22	0.22	0.22	0.22	0.22
State income tax (pipelines)	0.07	0.07	0.07	0.07	0.07	0.07
Federal income tax (pipelines)	0.84	0.84	0.84	0.84	0.84	0.84
Pipeline profits	1.34	1.34	1.34	1.34	1.34	1.34
Pipeline loss	<u>0.10</u>	<u>0.10</u>	<u>0.10</u>	<u>0.10</u>	<u>0.10</u>	<u>0.10</u>
Wellhead value	7.04	10.03	12.58	7.04	10.03	12.58
 Production cost	 <u>5.43</u>	 <u>5.43</u>	 <u>5.43</u>	 <u>5.43</u>	 <u>5.43</u>	 <u>5.43</u>
Total net revenue	1.61	4.60	7.15	1.61	4.60	7.15
 State royalty	 0.83	 1.20	 1.52	 0.83	 1.20	 1.52
Severance tax	0.55	0.78	0.98	0.83	1.18	1.47
State & local property tax (production)	0.18	0.18	0.18	0.18	0.18	0.18
State income tax (production)	0.00	0.11	0.21	-0.01	0.09	0.18
Federal income tax (production)	<u>0.02</u>	<u>0.79</u>	<u>1.45</u>	<u>-0.07</u>	<u>0.66</u>	<u>1.29</u>
 Total state (production & pipelines)	 1.85	 2.57	 3.18	 2.12	 2.94	 3.65
 Total federal (production & pipelines)	 <u>0.85</u>	 <u>1.63</u>	 <u>2.29</u>	 <u>0.76</u>	 <u>1.50</u>	 <u>2.13</u>
 Total profit (production & pipelines)	 1.37	 2.87	 4.15	 1.20	 2.62	 3.84

Sources:

ARCO spreadsheet handout, 4/20/89.
DOR Spring 1989 Revenue Forecast
TAPS settlement methodology

Figure 3

ADMINISTRATION'S CRITIQUE: ARCO KUPARUK "INCREMENTAL" CALCULATION

INCREMENTAL SEVERANCE TAX EXAMPLE

20-Apr-89

KUPARUK EXAMPLE

THE ADDITION OF 1 WELL PRODUCING AT THE AVERAGE RATE
ACTUAL DEC'88 FIGURES

	CURRENT LAW		HB-118	
	BASE	+1 WELL	BASE	+1 WELL
PRODUCTION MBPD	307.2	308.1	307.2	308.1
TOTAL PRODUCTION MBLMO	9,522.37	9,552.27	9,522.37	9,552.27
WELLS	318	319	318	319
BBI /DAY/WL	965	965	965	965
ELF	0.564894	0.564894	0.883291	0.883817
EFFECTIVE TAX RATE	8.4734%	8.4734%	13.2494%	13.2573%
TOTAL FIELD TAX M\$	4,165.46	4,178.55	6,513.28	6,537.63
TOTAL FIELD TAX \$/BBL	0.500	0.500	0.782	0.782
INCREASE IN TAX \$M		13.08		24.35
INCREASE IN MBBL\$		26.17		26.17
INCREMENTAL SEVERANCE TAX \$/BBL		0.500		0.930

① NEW WELLS AT KUPARUK
DON'T INCREASE PRODUCTION,
THEY MODERATE THE DECLINE.

② INCREMENTAL WELLS AT
KUPARUK PRODUCE ABOUT
300 BARRELS PER DAY,
NOT 965.

Figure 4

ANS Net Revenue

	Kuparuk \$/bbl	Kuparuk \$/bbl	Kuparuk \$/bbl
Assumed Crude Price	13.42	16.41	18.96
Tanker Freight	2.70	2.70	2.70
Quality Differential	0.40	0.40	0.40
TAPS Tariff	3.11	3.11	3.11
Kuparuk Pipeline	0.70	0.70	0.70
Pipeline Loss	0.10	0.10	0.10
Wellhead Price	6.41	9.40	11.95
Production Cost and Capital Recovery	5.43	5.43	5.43
Total Net Revenue	0.99	3.98	6.53
State Royalty	0.75	1.12	1.44
Severance Tax	0.50	0.73	0.92
Property Tax	0.44	0.44	0.44
State Income Tax	-0.02	0.05	0.11
Total State	1.66	2.34	2.91
Federal Income Tax	-0.23	0.56	1.23
Producer Profit	-0.45	1.08	2.38

ANS Net Revenue

Under HB-118

	Kuparuk \$/bbl	Kuparuk \$/bbl	Kuparuk \$/bbl
Assumed Crude Price	13.42	16.41	18.96
Tanker Freight	2.70	2.70	2.70
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Wellhead Price	6.41	9.40	11.95
Production Cost and Capital Recovery	5.43	5.43	5.43
Total Net Revenue	0.99	3.98	6.53
State Royalty	0.75	1.12	1.44
Severance Tax	0.75	1.10	1.40
Property Tax	0.44	0.44	0.44
State Income Tax	-0.03	0.04	0.10
Total State	1.91	2.70	3.37
Federal Income Tax	-0.31	0.43	1.07
Producer Profit	-0.61	0.84	2.08

Source:
 Barclays de Zoete Wedd, September 1988
 Alaska Department of Revenue October 1988
 State of Alaska Royalty and Severance Methodology

MEASURES OF ALASKA RESOURCE VALUES AND ESTIMATED STATE TAXES

1987 Values
Millions of Dollars

<u>Resource</u>	<u>Value At Point Of Production</u>	<u>Value At Point Of Export(a)</u>	<u>Value of Wages</u>	<u>Corporate Taxable Income</u>	<u>Book Income</u>	<u>State Taxes(b)</u>
Non-Petroleum Resources						60
Fisheries	937(c)		130(d)	24		56
Agriculture	29					<1
Timber		382(e)	103			<1
Minerals	202		26			2
Coal	42					1
Gold	105					<1
Petroleum	12,007	14,224	519	1,681	3,182	2,373

(a) Includes foreign and doestic destinations except as noted.

(b) FY 1988.

(c) Ex-vessel.

(d) Processing only.

(e) Foreign exports only.

Sources: The Alaska Economy Performance Report (DCED); House Research Report Report 89.303; Division of Policy memorandum to Rep. A. Hanley, 20 April 1989.

Division of Policy, 23 April 1989

INCREMENTAL SEVERANCE TAX EXAMPLE

20-Apr-89

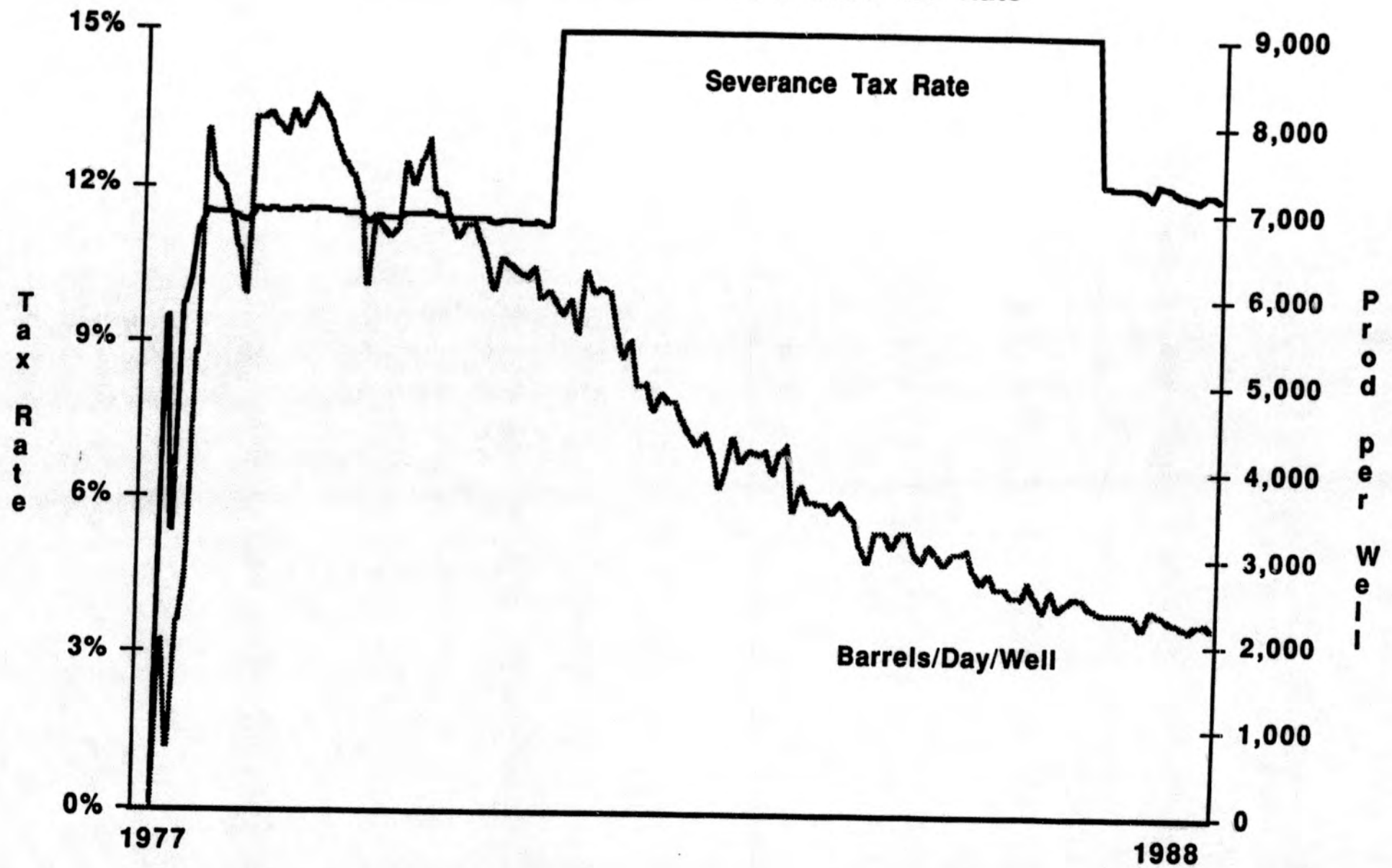
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ACTUAL DEC'88 FIGURES

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TOTAL FIELD TAX \$/BBL	0.500	0.500	0.782	0.782
INCREASE IN TAX \$M		13.08		24.35
INCREASE IN MBBLS		26.17		26.17
INCREMENTAL SEVERANCE TAX \$/BBL		0.500		0.930

Prudhoe Bay Per Well Production vs. Severance Tax Rate



ARCO Kuperuk Example

	<u>Current Law</u>	<u>Proposed Law</u>
Change in Annual Gross Revenue	\$981,000	\$981,000
Change in Annual Severance Tax	(\$37,846)	\$58,611
Tax Rate on Incremental Production	-3.9%	6.0%
Average Tax Rate Before Drilling	7.820%	10.944%
Average Tax Rate After Drilling	7.806%	10.938%
Percent Change in Average Tax Rate Due to Drilling	-0.180%	-0.055%

Excerpted from PricewaterhouseCoopers

CURRENT LAW

Field Rate = Wellhead Price = Severance Tax = ELF

90,168,000 BOPY = \$20.00 = 0.18 = 0.0018

= \$63,461,000/year

Addition of 1 well:

90,277,000 BOPY = \$20.00 = 0.18 = 0.0018

= \$63,423,300/year

A decrease of \$37,846/year

PROPOSED LAW

Field Rate = Wellhead Price = Severance Tax = ELF

90,168,000 BOPY = \$20.00 = 0.18 = 0.0018

= \$63,423,300/year

Addition of 1 well:

90,277,000 BOPY = \$20.00 = 0.18 = 0.0018

= \$63,470,100/year

An increase of \$58,611/year

[Copy of ARCO Handout, March 27, 1987]

"a \$38,000 tax break for the oil industry,
is that a good thing for Alaska?"

The Administration says, No.

For the citizens of Alaska, as Royalty Owners,
the answer is definitely, Yes!

The Rest of the Story on the ARCO Drilling Example

	<u>Without Royalty</u>	<u>Including Royalty</u>	<u>Royalty</u>
Original Kuperuk bbl / Yr.	90,168,000	103,049,143	12,881,143
With New Well	90,277,000	103,173,714	12,896,714
		Additional Royalty	15,571
		x \$9.00 / bbl	\$140,143
		+ Ad Valorem Tax	\$20,000
		- ELF Impact	(\$37,846)

Total State Revenue Impact

\$122,297

ANS Net Revenue

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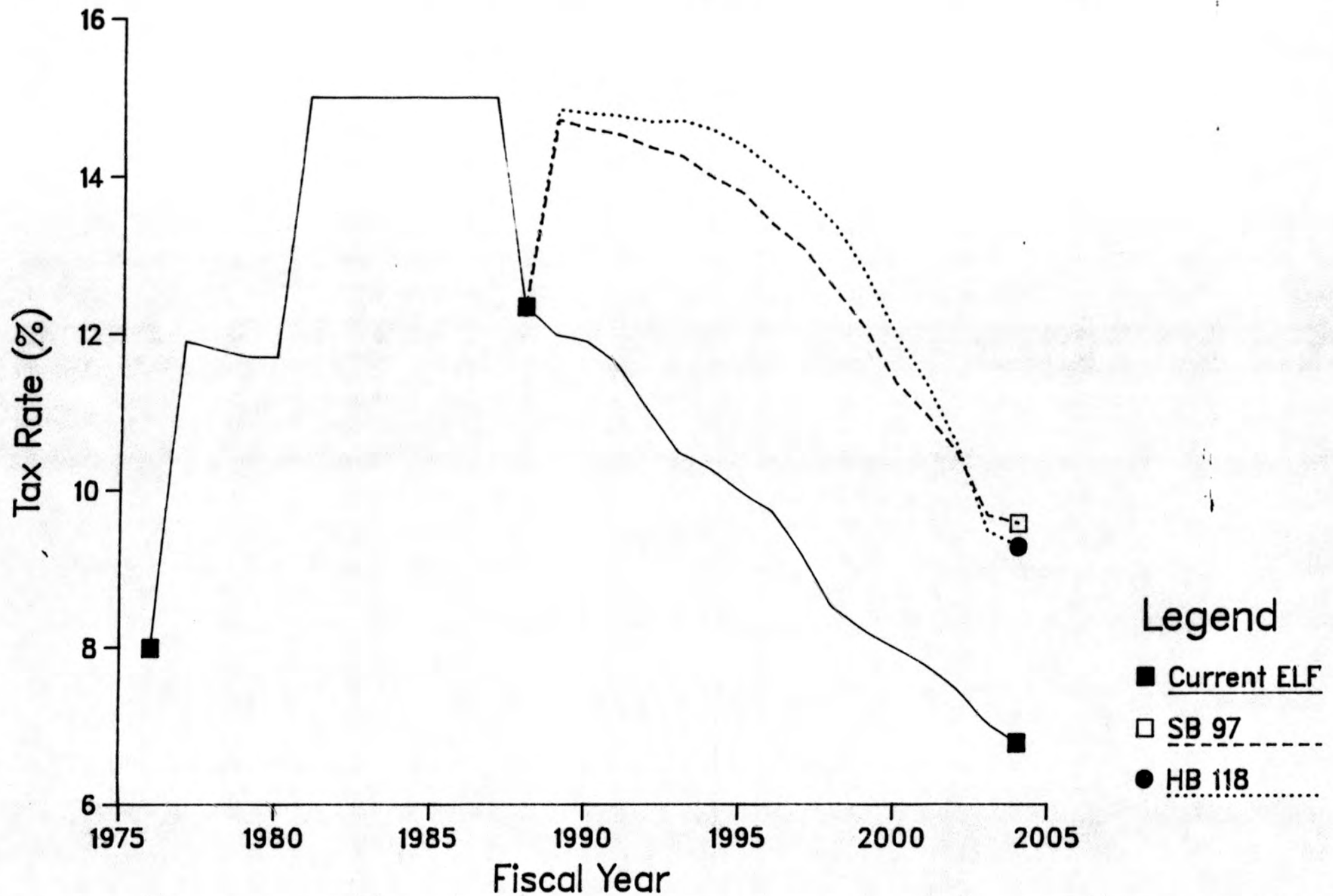
ANS Net Revenue

Under HB-118

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Producer Profit	-0.61	0.84	2.08

Source:
 Barclays de Zoete Wedd, Septer
 Alaska Department of Revenue
 State of Alaska Royalty and Seve

PBU Historical and Projected Tax Rate Includes SB 97 and HB 118 Impacts



Legend

- Current ELF
- SB 97
- HB 118

Introduced by: Mullen, Skogstad
Date: April 4, 1989
Vote: 12 Yes, 2 No
Action: Adopted

KENAI PENINSULA BOROUGH

RESOLUTION 89-33

(Local Affairs Comm. Amended)

IN SUPPORT OF MODIFICATION OF THE ECONOMIC LIMIT FACTOR BY THE
STATE OF ALASKA

WHEREAS, the Alaska legislature is considering modifications
to the Economic Limit Factor (ELF), and

WHEREAS, revenues available to local municipalities
including the Kenai Peninsula Borough in the form of funding for
education and municipal assistance and revenue sharing will be
directly impacted by action the legislature takes regarding the
ELF, and

WHEREAS, if the ELF were modified as proposed in HB 118,
additional revenues would be available to offset the budget
deficit, thereby decreasing the likelihood of dramatic cuts to
municipalities;

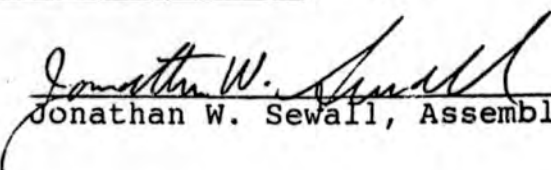
NOW THEREFORE, BE IT RESOLVED BY THE ASSEMBLY OF THE KENAI
PENINSULA BOROUGH:

Section 1. That the Kenai Peninsula Borough Assembly
supports HB 118.

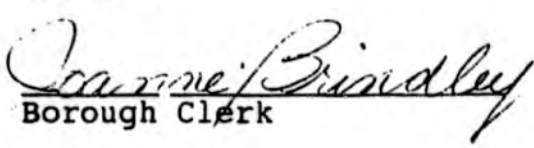
Section 2. That the Kenai Peninsula Borough Assembly urges
a Senate floor vote on the ELF prior to May 9, 1989.

Section 3. That copies of this resolution shall be sent to
all members of the legislature.

ADOPTED BY THE ASSEMBLY OF THE KENAI PENINSULA BOROUGH ON
THIS 18th DAY OF April, 1989.


Jonathan W. Sewall, Assembly President

ATTEST:


Borough Clerk

PROJECT PORTFOLIO

KUPARUK

<u>Project</u>	<u>Description</u>	<u>Timing</u>
<u>Drilling</u>		
• Peripheral Drillsite 2K	Selective peripheral DS development	1989 SU
• Peripheral Drillsite 3R	on 160 acre spacing. Total of 98	1989 SU
• Peripheral Drillsite 2M	additional wells	1990 SU
• Peripheral Drillsite 2L		1990 SU
• Peripheral Drillsite 3G		1990 SU
• Rem. Peripheral Dev.	14 drillsite expansions, 6 new drillsites, 180 additional wells 1 rig 1989, 2 rigs thereafter	1990==>
<u>Waterflood/EOR</u>		
• LIP-3 Expansion	Additional water handling capacity @ CPF-3	1990 SL
• Infill Drill @ DS 1Y/2Z	22 new wells. Improve EOR efficiency	1989==>
• Infill Drill @ DS 1A	16 wells. Seed for Phase I Infill	1989 SU
• Phase I Infill Drilling	160 + 80 acre accelerate reserves	1991 SU
• Fullfield EOR	19 drillsites staged over 4 years	1991 SU

figures last 3 years
 26% Area
 51% state
 15% Federal

Kuparuk River Field

	<u>Net Pay Feet</u>	<u>Gross Reserves MMBL</u>
Kuparuk Maximums	70 - 80	60.9
Current Kuparuk Developed Area Average	5.5	42.7
Remaining Drill Site Development Areas		
Drill Site 1 K	2.5	8.9
Drill Site 1 M	1.0	12.8
Drill Site 1 J	2.5	6.2
Drill Site 2 K	2.0	22.6
Drill Site 2 M	2.5	32.3
Drill Site 2 L	1.5	21.5
Drill Site 2 P	1.5	11.8
Drill Site 3 G	1.5	22.7
Drill Site 3 R	2.5	13.2
Drill Site 3 L	2.5	15.7
Total		167.6
Average		16.8

MEMORANDUM

State of Alaska
Office of the Governor
Division of Policy

TO: The Hon. Alyce Hanley DATE: April 20, 1989
FROM: Gregg Erickson
SUBJECT: Corporate Profits Earned Alaska

During the March hearings on the ELF legislation in the House you requested information on the net income earned by the fishing industry.

Based on tax data from the Department of Revenue, we estimate that 1987 taxable corporate net income in Alaska totaled \$2.010 billion. Of this, \$24 million (1.2 percent) was earned by corporations in fishing or fishing related fields.

Based on Dept. of Revenue data, we estimate taxable oil company income at \$1.681 billion, or 84 percent of the total.

Taxable income may differ substantially from the income shown on a company's books of account. This is especially true under the special taxation arrangements adopted for the oil industry by Alaska in 1981. The recent study by Professor Deakin found that 1987 oil industry net income totaled \$3.182 billion. Based on the Deakin analysis, it is likely that the oil industry accounts for more than 90 percent of total book income attributable to Alaska. The figure cannot be determined precisely, however, because comparable figures for non-petroleum book income are not available for the state.

cc: Senate Special Oil and Gas Committee

CASE 1

HOW THE ELF IS CALCULATED

$$\text{ELF} = (1 - [\text{PEL}/\text{TP}])\exp(460 \cdot \text{WD}/\text{PEL})$$

PEL = (Production at the Economic Limit) =
(300 barrels per day)*
(average number of operating wells during the month)*
(number of days of production for the month).

EXAMPLE

$$\text{PEL} = 300 \text{ barrels} * 541 \text{ wells} * 30 \text{ days} = 4,869,000 \text{ barrels per month}$$

TP = (Total Production for the field for the month) =
(average number of operating wells during the month)*
(number of days of production for the month)*
(average daily production per well).

EXAMPLE

$$\text{TP} = 541 \text{ wells} * 30 \text{ days} * 2477 \text{ barrels per well} = 40,201,710 \text{ barrels per month}$$

WD = (Well Days) =
(number of operating wells during the month)*
(number of days each well operates)

EXAMPLE

$$\text{WD} = 541 \text{ wells} * 30 \text{ days} = 16,230 \text{ well days}$$

CALCULATION EXAMPLE

$$\text{ELF} = (1 - [\text{PEL} / \text{TP}])\exp(460 \cdot \text{WD} / \text{PEL})$$

$$\text{ELF} = (1 - [4,869,000/40,201,710])\exp(460 \cdot 16,230/4,869,000)$$

$$\text{ELF} = (1 - .1211) \exp (1.533)$$

$$\text{ELF} = (.8789) \exp (1.533)$$

$$\text{ELF} = .82$$

MEMORANDUM

State of Alaska
Office of the Governor
Division of Policy

TO: Sen. Drue Pearce DATE: April 20, 1989

FROM: Gregg Erickson

SUBJECT: How Alaska Oil Income Is Shared

The attached table shows how the income from Alaska oil production and TAPs operations is divided between the state, the oil industry, and the federal government. This analysis shows that except at the very lowest oil prices the industry obtains a larger share of the income from Alaska operations than does the state. It also illustrates the great sensitivity of the shares to oil price levels. With average prices in the \$14 per barrel range in 1988, the state received approximately 32 percent. At the price prevailing today, however, the state's share drops to below 29 percent.

These figures use the audited production cost figures provided by BP America to the House Resources committee. Apart from the industry's desire to disregard pipeline income, we are not aware of any substantial disagreement with the substance of these figures.

The figures are calculated using costs and other parameter values for calendar 1988. The underlying spreadsheet is available from this office on request.

Attachments

**ALASKA OIL INCOME:
SHARES RESULTING UNDER VARIOUS OIL PRICES**

**AVERAGE LOWER 48
ANS VALUE**

 \$10 \$12 \$14 \$16 \$18 \$20

ANNUAL NET INCOME (BILLIONS)

Industry	\$1.143	\$1.909	\$2.654	\$3.399	\$4.144	\$4.889
State & local	\$1.298	\$1.615	\$1.964	\$2.312	\$2.661	\$3.010
Federal	\$0.678	\$1.073	\$1.457	\$1.841	\$2.224	\$2.608

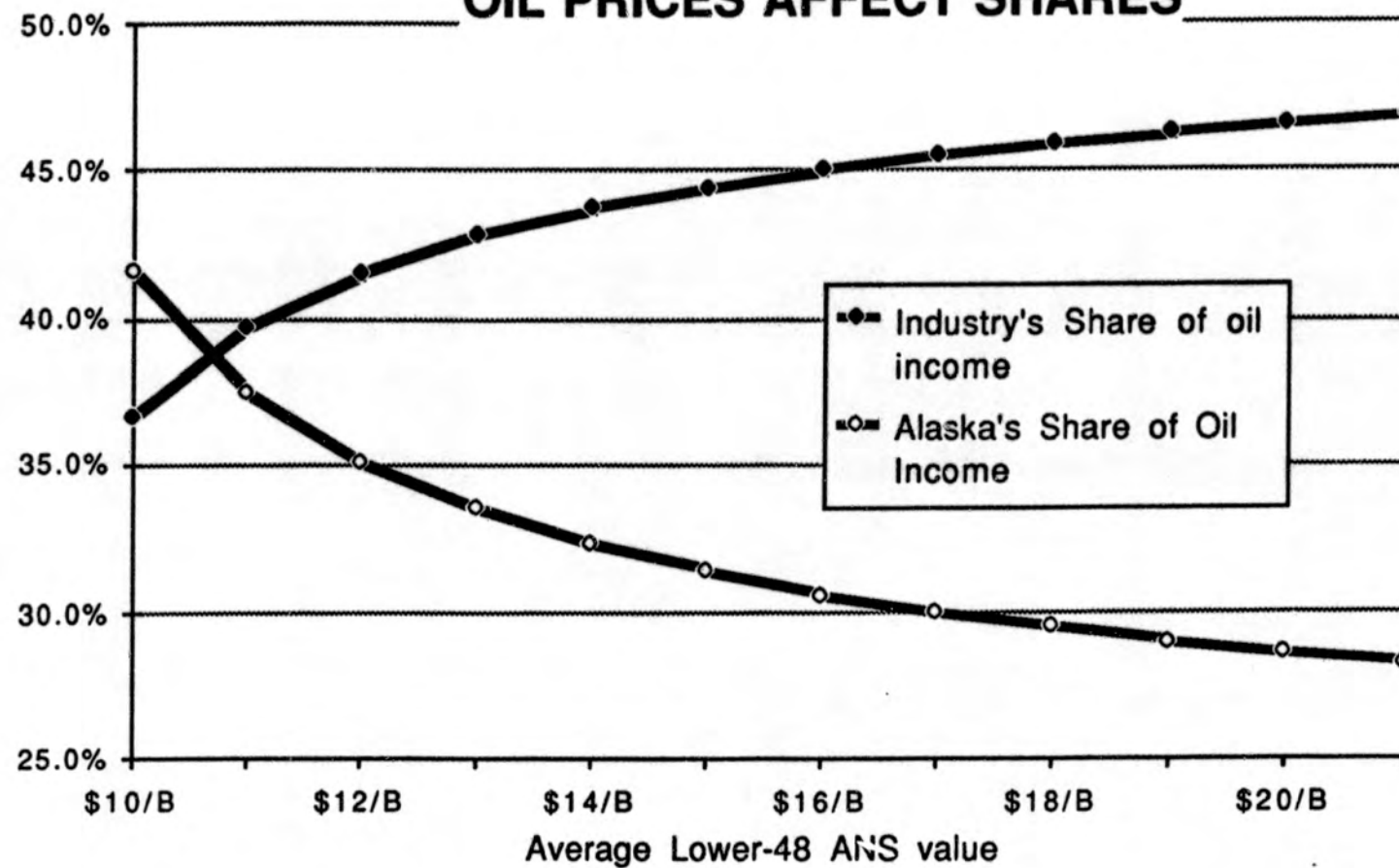
Memo: Industry cash flow	\$3.276	\$4.042	\$4.787	\$5.532	\$6.277	\$7.022
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PERCENTAGE SHARES OF NET INCOME

Industry	36.6%	41.5%	43.7%	45.0%	45.9%	46.5%
State & local	41.6%	35.1%	32.3%	30.6%	29.5%	28.6%
Federal	21.7%	23.3%	24.0%	24.4%	24.6%	24.8%

Division of Policy, 4/19/89

OIL PRICES AFFECT SHARES



**TESTIMONY OF
GERALD SERENA**

**FOR
EXXON COMPANY, U.S.A.**

**BEFORE THE
SENATE SPECIAL OIL AND GAS COMMITTEE**

SCS CSHB No. 118

APRIL 20, 1989

MY NAME IS GERALD SERENA AND I AM A TAX LAWYER FOR EXXON COMPANY, U.S.A. WE APPRECIATE THE OPPORTUNITY TO COMMENT ONCE AGAIN ON LEGISLATION PROPOSED TO MODIFY THE ECONOMIC LIMIT FACTOR. IN PREVIOUS HEARINGS BEFORE COMMITTEES OF THE HOUSE AND SENATE, EXXON HAS MADE CLEAR ITS OPPOSITION TO ANY PROPOSALS THAT WOULD EFFECTIVELY ELIMINATE THE BENEFIT OF ELF FOR THE PRUDHOE BAY AND KUPARUK FIELDS. OUR MESSAGE HAS NOT CHANGED.

THIS BILL WOULD SIGNIFICANTLY INCREASE PRODUCTION TAX ON 90% OF ALASKA'S OIL PRODUCTION. THIS INCREASED COST OF PRODUCTION WOULD ADVERSELY AFFECT INVESTMENT IN FUTURE PRUDHOE BAY DEVELOPMENT PROJECTS. THESE PROJECTS ARE ECONOMICALLY MARGINAL IN THE SAME SENSE THAT THE START-UP OF SOME SMALLER FIELDS ON THE NORTH SLOPE MIGHT BE MARGINAL. SUCH PROJECTS ARE NECESSARY TO OPTIMIZE PRODUCTION FROM PRUDHOE BAY, WHICH IS CRUCIAL TO ALASKA'S ECONOMIC FUTURE.

ALASKA'S PRODUCTION TAX LAW IS COMPREHENSIVE, WELL-REASONED, AND EFFECTIVE. IT COMBINES TWO ESSENTIAL ELEMENTS -- THE HIGHEST NOMINAL TAX RATE IN THE UNITED STATES, AND AN ECONOMIC LIMIT FACTOR WHICH REDUCES THIS RATE ON A FIELD-BY-FIELD BASIS AS MEASURED BY PRODUCTION RATE PER WELL IN THE FIELD.

IT HAS WORKED UP TO NOW AND IT WILL CONTINUE TO WORK AS DESIGNED AS PRUDHOE BAY PRODUCTION DECLINES.

THE PRODUCTION TAX ON OIL FROM PRUDHOE BAY IS HIGH ENOUGH BY ANY STANDARDS. WHEN COMBINED WITH THE OTHER STATE TAXES ON NORTH SLOPE PRODUCTION OPERATIONS, IT IS CLEAR THAT OUR INDUSTRY IS CONTRIBUTING ITS FAIR SHARE OF STATE TAX COLLECTIONS. WHEN YOU COMBINE TAXES AND ROYALTIES, OUR INDUSTRY ACCOUNTS FOR ABOUT 85% OF STATE REVENUES. FURTHERMORE, ROYALTIES AND OTHER LEASE PAYMENTS HAVE ESTABLISHED THE \$10 BILLION ALASKA PERMANENT FUND.

IN 1988, AVERAGE DAILY OIL PRODUCTION AT PRUDHOE BAY DECLINED TO 1,450,000 BARRELS FROM THE 1,500,000 AVERAGE ACHIEVED IN PRIOR YEARS, AND WE ANTICIPATE THAT THIS DECLINE WILL CONTINUE. THIS WAS INEVITABLE. IT WAS DELAYED UNTIL NOW BY AN EFFICIENT AND OPTIMAL DEVELOPMENT PLAN THAT CONTINUES TO BE IMPLEMENTED. SINCE INITIAL DEVELOPMENT, EXXON HAS EVALUATED AND SUPPORTED SEVERAL PROJECTS TO INCREASE RECOVERY AT PRUDHOE BAY. THE COST PER BARREL FOR THESE PROJECTS TO INCREASE RECOVERY WAS TWICE THE COST OF THE INITIAL DEVELOPMENT.

AFTER CURRENT DEVELOPMENT IS COMPLETED, IT IS ESTIMATED THAT 10 BILLION BARRELS OF OIL WILL BE LEFT IN FORMATION AT PRUDHOE BAY. H.B. 118 WOULD INCREASE THE COST OF PRODUCING THOSE BARRELS AND THEREBY REDUCE THE INCENTIVE TO UNDERTAKE SUCH PROJECTS. FUTURE PROJECTS TO MAINTAIN PRODUCTION AND INCREASE RECOVERABLE RESERVES AT PRUDHOE BAY WILL COST MORE THAN FIVE TIMES AS MUCH AS THE INITIAL DEVELOPMENT. IT IS CONCEIVABLE THAT UNDEVELOPED MARGINAL RESERVES AT PRUDHOE BAY MIGHT EXCEED THE POTENTIAL RESERVES OF ALL THE SMALLER FIELD PROSPECTS ON THE NORTH SLOPE IDENTIFIED TO DATE.

H.B. 118 IS BASED ON THE ASSUMPTION THAT LARGER OIL FIELDS SHOULD CONTRIBUTE PRODUCTION TAXES AT A HIGHER RATE THAN SMALLER FIELDS. TAX POLICY MAKERS SHOULD NOT CONFUSE THE PRODUCTION RATE OF A FIELD WITH ITS PROFITABILITY. THE PRUDHOE BAY FIELD IN DECLINE IS A PERFECT EXAMPLE.

OUR RECOMMENDATION TODAY IS THE SAME AS IT HAS BEEN AT ALL THE PRIOR HEARINGS ON THIS LEGISLATION. WE URGE YOU NOT TO SUPPORT H.B. 118. IT WILL ADVERSELY AFFECT FUTURE DEVELOPMENT INVESTMENT AT PRUDHOE BAY. SUCH INVESTMENT IS NEEDED TO MAXIMIZE OIL PRODUCTION, THEREBY INCREASING THE STATE'S ROYALTY AND PRODUCTION TAX BASE.

STATE OF ALASKA THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

MEMORANDUM

February 6, 1989

SUBJECT: Retrospective application of the economic
limit factor tax amendments, CSHB 118 ()

TO: Representative Cliff Davidson, Co-Chair
House Resources Committee

FROM: Jack Chenoweth
Legislative Counsel

The amendments requested are enclosed. The drafts differ only as to the date of retrospective application of each. The draft identified as 6-0652E applies the economic limit factor (ELF) retrospectively to oil produced after June 30, 1987; the draft identified as 6-0652H applies the economic limit factor retrospectively to oil produced after December 31, 1988. (A subsequent memo from your office specified different alternative dates. Mechanically changing a date in any of these drafts is not a significant drafting problem.)

It is my understanding that these provisions limit the applicability of the ELF to the state's major producing fields and that, as a consequence, the tax liability of some taxpayers subject to the severance tax, AS 43.55, would be increased, while the liability of others may decrease. 1/

1/ Under AS 43.55.020(a):

The gross production tax on oil or gas shall be paid monthly. The tax is due on the 20th day of each calendar month on oil or gas produced from each lease or property during the preceding month. If the tax is not paid before the end of the month in which it becomes due, the tax becomes delinquent.

Thus, tax liability is incurred and remitted on a monthly, not an annual basis. For oil production during December, 1988, the tax became due and payable January 20, 1989, and tax liability for oil production during January, 1989, becomes due and payable February 20, 1989.

A retroactive tax adjustment will apply if there is a valid public purpose served by giving retrospective effect to that adjustment. Here, the committee's deliberations may be critical. As a committee substitute for HB 118 is considered, it would, in my judgment, be important to develop a record on which a court, if called upon to consider an argument, would conclude that there was a public purpose served by giving the adjustment a retrospective effect.

A reasonable retrospective application will be sustained. The farther back the retroactive provision is given effect, the less likely a court would be to sustain the provision without a clear showing of public purpose. (To foreclose a claim altogether, this office has discouraged retrospective application of severance tax adjustments beyond the narrow period recognized under AS 43.55.020(a), that is, a change amending the economic limit factor to be made retroactive only to the beginning of the month in which the bill is to take effect. That approach should not create any problems of retrospective applications since the tax liability would not have become due on that date.)

I

RETROSPECTIVE APPLICATION OF THE AMENDMENTS:

Tax statutes may be made retroactive. 2/ The threshold

2/ This office has also recently considered proposed retrospective application of severance tax adjustments, specifically relying on the federal and state constitutional prohibitions against passage of ex post facto laws. There are two ex post facto law prohibitions of the federal constitution. Article I, section 9, clause 3 is a limitation on the federal government, while article I, section 10, clause 1 imposes a similar limitation on the states. Alaska's constitution also contains a limitation in section 15 of article I.

Our previous conclusion that federal and state constitutional prohibitions against enactment of ex post facto laws would support a challenge to the amendment's retrospective application was surely in error. Federal court decisions have limited the application of the limitations to criminal or penal consideration is that the retrospective application of the measure must not impair an obligation of contract.

February 6, 1989

The impairment of contract consideration appears to be inapplicable in this instance. Retrospective application of a newly-enacted statute may, in some instances, impair obligations of contract, in violation of article I, section 10 of the United States Constitution and article I, section 15 of the State Constitution. **However, the Alaska Supreme Court appears to have cut off an impairment of contract argument applicable to retrospective application of a tax amendment in Atlantic Richfield Co. v. State, 705 P.2d 418 (Alaska, 1985).** To the argument that the oil and gas corporate income tax then in litigation impaired the obligation of the state's underlying lease contracts, the court concluded that "[the] argument [was] without merit":

. . . No lease provision has been impaired. In entering into the leases the state could not, and did not, contract away its power as a sovereign to tax income earned in the state. Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 102 S.Ct. 894, 71 L.Ed.2d 21 (1982) disposes of this issue:

Contractual arrangements remain subject to subsequent legislation by the presiding sovereign. Even where the contract at issue requires payment of a royalty for a license or franchise issued by the government entity, the government's power to tax remains unless it "has been specifically surrendered in terms which admit of no other reasonable interpretation." St. Louis v. United R. Co., 210 U.S. 266, 280, 28 S.Ct. 630, 634, 52 L.Ed. 1054 (1908).

455 U.S. at 148, 102 S.Ct. at 907, 71 L.Ed.2d at 36 (citations omitted); see also Exxon v. Eagerton, 462

statutes, concluding that retrospective tax legislation is not prohibited by the ex post facto clause. Personal Finance Co. v. United States, 86 F. Supp. 779 (D.Del., 1949). See 16A Am. Jur. 2d secs. 636, 677. Decisions in other state courts have similarly concluded. Parlato v. McCarthy, 69 A.2d 648 (Ct., 1949), Walker v. Commonwealth, 130 S.W.2d 27 (Ky., 1939). The Alaska Supreme Court has not extended application of the state constitutional ex post facto prohibition beyond penal or criminal matters. Danks v. State, 619 P.2d 720 (Alaska, 1980); Creekpaum v. State, 753 P.2d 1139 (Alaska, 1988).

U.S. at 187-94, 103 S.Ct. at 2304 - 2307, 76 L.Ed.2d at 508-12.

705 P.2d 418, at 438.

*

If legislation acts retrospectively, the nature and duration of its retrospective application should be reasonable. The arguments favoring a reasonable retrospective operation arise out of the equal protection and due process clauses of the state and federal constitutions.

Federal equal protection considerations:

State legislation retroactively imposing a tax is not necessarily and certainly invalid under the equal protection clause of the Fourteenth Amendment to the federal constitution. The inquiry to be made is one of whether the retroactivity impairs substantial, vested rights, and is reasonable in the circumstances. As to retroactively imposed new taxes, the courts have been reluctant to find a violation because of the impairment of a vested right. Welch v. Henry, 305 U.S. 134, 83 L.Ed. 87, 59 S.Ct. 121 (1938), rehearing denied 305 U.S. 675, 83 L.Ed. 437, 59 S.Ct. 250 (1938). 3/ Several state courts have agreed. See Garrett

3/ In Welch, the United States Supreme Court concluded that a Wisconsin state statute, enacted in 1935 and operating retrospectively to tax corporate dividends earned in 1933 which, when received, were deductible from gross income, did not violate the equal protection clause. The tax rates applied to the dividends differed from the rates applicable to other types of taxable income. As to the retrospective application of the new tax to dividends that were, when earned, exempt from tax, the court noted that:

The equal protection clause does not preclude the legislature from changing its mind in making an otherwise permissible choice of subjects of taxation. The very fact that the dividends were relieved of tax [in 1933], when the need was less, is basis for the legislative judgment that they should bear some of the added burden when the need is greater.

Freight Lines v. State Tax Commission, 135 P.2d 523, at 526, 527 (Utah, 1943); Colonial Pipeline Co. v. Commonwealth, 145 S.E.2d 227 (Va., 1965), reh. den. (1966), app. dismissed, 384 U.S. 268, 16 L.Ed.2d 523, 86 S.Ct. 1476 (1966). 4/

Numerous retroactive revisions of the federal and Wisconsin revenue laws . . . have imposed taxes on subjects previously untaxed and shifted the burden of old taxes by changes in rates, exemptions, and deductions. It has never been thought that such changes involve a denial of equal protection if the new taxes could have been included in the earlier act when adopted. If some retroactive alteration in the scheme of a tax act is permissible, as is conceded, it seems plain that validity, so far as equal protection is concerned, must be determined, as in the case of any other tax, by ascertaining whether the thing taxed falls within a distinct class which may rationally be treated differently from other classes. If such changes are forbidden in the name of equal protection, legislatures in laying new taxes would be left powerless to rectify to any extent a previous distribution of tax burdens which experience had shown to be inequitable, even though constitutional.

83 L.Ed. 87, at 92.

4/ In Garrett Freight Lines v. State Tax Commission, 135 P.2d 523 (Utah, 1943), the Utah Supreme Court, called upon to determine whether an excise tax levied on the use of diesel motor fuel that was used prior to the date the legislative act became law, found no equal protection violation:

It is well settled that a tax does not necessarily violate the Federal Constitution merely because it contains retroactive features. Milliken v. United States, 283 U.S. 15, 21, 51 S.Ct. 324, 75 L.Ed. 809 [(U.S., 1931)]; Billings v. United States, 232 U.S. 261, 34 S.Ct. 421, 58 L.Ed. 596 [(U.S., 1914)]; Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 125, 83 L.Ed. 87 [(U.S., 1938)]

. . .

Neither the Federal Constitution nor the Utah

Federal due process considerations:

Retroactive imposition of a tax is not necessarily a violation of the due process clause of the Fourteenth Amendment to the federal constitution. The leading case is Welch, cited earlier, in which the United States Supreme Court determined:

The objection chiefly urged to the taxing statute is that it is a denial of due process of law because in 1935 it imposed a tax on income received in 1933. But a tax is not necessarily unconstitutional because retroactive. Milliken v. United States, 283 U.S. 15, 21, 75 L.Ed. 809, 814, 51 S.Ct. 324 [(1931)], and cases cited. Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process, and to challenge the present tax it is not enough to point out that the taxable event, the receipt of income, antedated the statute.

83 L.Ed. 87, at 93. But the assertion that due process is not violated is not absolute and, the court has said that

In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation.

Id.

Similarly, in Garrett Freight Lines, earlier cited, the Utah Supreme Court determined that the due process clause is not

Constitution has any provision in terms prohibiting retroactive legislation -- excepting that which forbids the enactment of ex post facto laws. [Citations omitted.] That clause relates to criminal and penal matters and does not affect legislation such as the statute here involved. Calder v. Bull, 3 Dall. 386, 390, 1 L.Ed. 648, 1 Kent Commentaries 409; 3 Story on Constitution 212; 18 C.J.S. Constitutional Law, sec. 435, p. 886.

a limitation on the state's ability to retrospectively impose a tax:

Although basing its case upon the due process clause, appellant does not show wherein the tax constitutes any arbitrary and oppressive discrimination except to assert that a tax based upon a transaction consummated prior to passage of the act amounts to a taking of property without due process. It has many times been questioned whether the due process clause constitutes any limitation upon the taxing power. In this connection we quote from Mr. Justice Sutherland of the United States Supreme Court in an opinion upholding the validity of a statute of the State of Washington levying a tax upon the sale of oleomargarine:

Except in rare and special instances, the due process of law clause contained in the Fifth Amendment is not a limitation upon the taxing power conferred upon Congress by the Constitution. * * * And no reason exists for applying a different rule against a state in the case of the Fourteenth Amendment. * * * That clause is applicable to a taxing statute such as the one here assailed only if the act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property. * * * Collateral purposes or motives of a Legislature in levying a tax of a kind within the reach of its lawful powers are matters beyond the scope of judicial inquiry. * * * Nor may a tax within the lawful power of a state be judicially stricken down under the due process clause simply because its enforcement may or will result in restricting or even destroying particular occupations or businesses, * * * unless, indeed, as already indicated, its necessary interpretation and effect be such as plainly to demonstrate that the form of taxation was adopted as a mere disguise, under which there was exercised, in reality, another and different power denied by the Federal Constitution to the state.

A. Magnano Co. v. Hamilton, 292 U.S. 40, 54 S.Ct. 599, 601, 78 L.Ed. 1109.

Garrett Freight Lines, 135 P.2d 523, at 527.

Courts have, however, considered retrospective tax legislation unconstitutional as a violation of the due process clause when, as Welch concludes, in light of "the nature of the tax and the circumstances in which it is laid," the legislation is "so harsh and oppressive as to transgress [that] constitutional limitation." Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87, at 93. The question is typically one of the degree of harshness, based upon consideration of factors such as (1) the effect of the retroactive application of legislation amending a tax on a taxpayer's voluntary act that was influenced by the taxpayer's understanding of tax incidence or consequence at the time of that act, especially if the tax to be imposed or amended is "novel," (2) the sufficient certainty of the taxpayer's expectation of money that is jeopardized by the retroactive legislation, (3) the length of the period of the legislation's retrospective application, and (4) the importance of the public purpose to be served by the action. The first three elements are, to some degree, based on the taxpayer's expectations, while the fourth involves a determination of a public interest that necessitated the actual enactment.

Computation and payment of the severance tax is not greatly determinative of taxpayers' taxable activities that generate the tax liability, nor does this proposed legislation seem to strike at activities of a taxpayer that reasonably relied on the current severance tax rates before this bill proposed amendment of that tax. It is the length of the period of the legislation's retrospective application and the importance of the public purpose to be served that need be most carefully considered.

The state's strongest case would be one that suggests that the purpose of the retroactive provision was remedial and that its impact was limited to the shortest period practicable. One benchmark date that might serve that purpose is July 1, 1988 (start of the current fiscal year, if, indeed, the principal purpose of the retroactive application is to meet revenue shortfalls in this fiscal year); a number of cases would sustain the argument that the legislation may be retrospective over the calendar or fiscal period of its enactment. An alternative--riskier because of the length of the period over which that retroactivity would reach back, but perhaps stronger from the point of view of public policy considerations--would be that date in 1987 when the ten-year exemption from the ELF's operation expired

and the economic limit factor became applicable to the state's major producing fields. But this would probably be justified only if the state could demonstrate that the conditions that suggested in 1981 that adoption of the ELF would benefit production are now shown to have been inaccurate or incorrect.

State due process and equal protection considerations:

Nothing in my quick research suggested that an analysis under the state's "due process" clause, article I, section 7, would reach a conclusion at variance with the decisions based on the comparable federal provision discussed above.

State "equal protection" analysis differs, though the conclusion reached under that analysis is consistent with the conclusions reached under the analysis applicable to the federal provisions. In State v. Erickson, 574 P.2d 1 (Alaska, 1976), the court established a "single test" approach for state-constitution based equal protection analysis, essentially requiring that the court (1) ascertain the purposes of the legislation to determine whether they are legitimate; (2) determine whether the means chosen to accomplish the objectives actually do so; and (3) balance the importance of the state's interest against the constitutional right involved. The state has plenary authority to tax. Assuming an adequate record--and the April, 1988, "ELF Policy Perspective" document may be sufficient--the ELF adjustments now proposed, adding to tax liability on the major producing fields that are most profitable but continuing or reducing rates on marginally producing fields, seems to bear a strong correlation to the state's efforts to impose a tax burden on an oil field's production that is consistent with the field's economics. By that analysis, if the retrospective application of the change is reasonable, the court should reject any state constitutional equal protection-based claim.

II

IS THERE A NEED FOR A SEVERABILITY CLAUSE?

A severability clause is not needed, and one has not been included in either draft. In the absence of a severability clause, you may rely on AS 01.10.030.

III

TO THE EXTENT THAT THE BILL MAKES A RETROACTIVE TAX REDUCTION, MAY THE LEGISLATURE PROVIDE FOR THAT TAX

REDUCTION BY A CREDIT AGAINST THE TAXPAYER'S FUTURE TAX LIABILITY, OR IS THE PAYMENT OF AN IMMEDIATE [CASH] REFUND REQUIRED?

If retrospective application of the ELF adjustment reduces the tax liability of any taxpayer, the revenue having been received and deposited into the general fund, the state would not be able to refund amounts that have been previously paid by the taxpayer to that taxpayer without an appropriation. However, article IX, section 6 of the state constitution provides that appropriations of public money may be made only for a public purpose. In states operating with a constitutional provision comparable to Alaska's in which there has been a proposed payment of a retroactive refund of a validly enacted tax, the appropriation has been held to violate those constitutional provisions. Japan Line, Ltd. v. MacCaffree, 558 P.2d 211 (Wash., 1977); City of Yakima v. Huza, 407 P.2d 815 (Wash., 1965); In re Estate of Skinner, 303 P.2d 745 (Cal., 1956); San Bernardino County v. Way, 117 P.2d 354 (Cal., 1941). These considerations then would favor the use of a credit due the taxpayer against the taxpayer's future tax liability, for the use of this approach would necessarily avoid a "public purpose" challenge under article IX, section 6.

IV

TO THE EXTENT THAT THE BILL MAKES A RETROACTIVE TAX REDUCTION, IS INTEREST PAYABLE ON THAT REDUCTION? IF SO, FROM WHAT DATE WOULD INTEREST ACCRUE?

Assuming the draft makes a retroactive tax reduction, I would treat the reduction as the equivalent of a refund of taxes legally collected. In a refund situation, the legislature may shape the conditions and limitations of that refund. While interest is generally recoverable on the amount of the refund, the few Alaska precedents suggest that payment of interest is discretionary and depends principally on whether or not the legislature, by statute, has authorized its payment.

By statute, interest is allowed on an overpayment of a tax levied and collected under AS 43. See AS 43.05.280. That statute is, of course, more generally applicable to instances involving tax payments made in regular fashion, and not to adjustments made by retrospective application of a change of the tax law. But it would seem to have applicability to the changes suggested under AS 43.55. Apart from the statute, I know of nothing that mandates

payment of interest on a tax refund due for a tax that, at the time of levy, was legally collectable, and suggest that the state may act with respect to interest on the tax refunds as it sees fit.

The committee should determine what it wants to do and give instructions, and the draft will be prepared accordingly.

V

TO THE EXTENT THAT THE BILL INCREASES A TAXPAYER'S LIABILITY, IS THE TAXPAYER OBLIGATED TO PAY INTEREST ON THE INCREASED LIABILITY? IF SO, FROM WHAT DATE WOULD INTEREST ACCRUE?

Assuming the committee substitute serves to establish a greater liability on the part of certain taxpayers for one or more "past due" months, that liability arises not under AS 43.55.020(a), but by operation of this law. The legislature has authority to determine whether interest should be paid, and from what date it should be paid.

The bill should not leave taxpayers subject to the assertion that they failed to remit taxes by the deadlines established in AS 43.55.020(a). In each measure, I have incorporated an additional provision that sets a date certain for reporting and paying the retroactive tax liability. Thereafter, if the amount due has not been timely remitted, provisions governing delinquency should apply.

*

Your January 30 memo asks other questions concerning retroactive application of the proposed ELF changes. Let me briefly respond.

As should be clear from the decision in Atlantic Richfield v. State, there is sound benefit in adhering to the requirements outlined in the Agency's drafting manual. The current manual, at pp. 27, 28, instructs that

The language providing for retroactive application of a bill or part of a bill should be set out in a separate section immediately preceding the effective date section. The retroactive section and the sections in the bill that are to be retroactive should have immediate effective date clauses.

I am bound to follow the drafting manual, and any draft version of legislation prepared for the committee's

Representative Cliff Davidson

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February 6, 1989

consideration that contained a retroactive provision would necessarily include an immediate effective date. All the drafts I would provide for the committee's consideration would contain the effective date clause. However, if, in a mark-up, the committee directs (on the record) deletion of the clause with the immediate effective date, I would provide the bill with that section omitted. But, before departing from the directive of the manual, I would want to have committee instruction, for I think it is important that the record show why there has been a departure from standard drafting procedure.

If one house or both houses fail to adopt an immediate effective date for legislation having a retroactive provision, the bill would still take effect. The effective date would be delayed 90 days, however, but the retroactive elements of the legislation would not be impaired by that delay.

JBC:kb
wkk1/109

Enclosure

STATE OF ALASKA THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL

JUNEAU ALASKA 99811

907 465 3800

MEMORANDUM

March 27, 1989

SUBJECT: Failure of effective date in CSHB 118
(Resources) and retroactivity

TO: Senator Jan Faiks, Chair
Senate Judiciary Committee
ATTN: Chris Christensen

FROM: Jack Chenoweth
Legislative Counsel

Late last week the House of Representatives narrowly passed CSHB 118 (Resources), amending the economic limit factor applicable to the state severance tax. At the same time, it failed to adopt the clause giving the act immediate effect by the requisite two-thirds vote.

The bill is before your committee as CSHB 118 (Resources) (eff. date failed).

Section 4 of CSHB 118 (Resources)(eff. date failed) makes the economic limit factor amendments retrospectively operative to January 1, 1989. If that date is tested and found constitutionally lacking, section 5 of the Act identifies an alternative retroactive application date, the first day of the month in which the Act takes effect.

In light of an Opinion of the Attorney General of March 31, 1988, you have asked whether the bill's passage, if coupled with the failure of the immediate effective date clause, would invalidate retrospective application of the legislation. The opinion in question examined House Bill 164 of the Fifteenth Legislature. The particular provision in the opinion that generates the question appears to be the concluding paragraph of the first section of the analysis, a paragraph that reads:

The language of sections 3 and 4 of [CSHB 164 (Finance)] is similar to the language approved by the [Alaska] Supreme Court in Atlantic Richfield v. State, 705 P.2d 418 (Alaska 1985)]. Ch. 110, SLA 1978. If

passed by the legislature with the requisite two-thirds vote on the effective date clause, the bill is certain to pass [the] first constitutional hurdle. Without passage of the effective date clause by a two-thirds vote, the retroactive application section will be void, and the bill will operate prospectively only.

Emphasis added.

In the Atlantic Richfield decision cited, the opinion notes:

Retroactive application [of separate accounting] was challenged by the oil companies. The Supreme Court held that the statute was "properly retroactive to January 1, 1978," because (1) the statute expressly stated it was to be retroactive, in accord with AS 01.10.090 and (2) the two-thirds vote requirement on the immediate effective date was met. The Court rejected oil company arguments that a separate two-thirds vote was required for retroactivity:

AS 01.10.090 states that "[n]o statute is retrospective unless expressly declared therein." A two-thirds vote requirement does not appear in that section, or elsewhere in Alaska law. The legislature, however, has recognized that where retroactive application of a portion or all of a bill is desired, an immediate effective date, which does require a two-thirds vote under article II, sec. 18 and AS 01.10.070(a), should be used in conjunction with the retroactivity section.

705 P.2d [418], at 438, citing Legislative Affairs Agency, Manual of Legislative Drafting 11 (1977 ed.) and Uniform Rules of the Alaska State Legislature, Rule 10 (May 3, 1977); accord, Legislative Affairs Agency, Manual of Legislative Drafting 28-29 (1987 ed.).

The interrelationship of the effective date clause and the retrospective application of the substantive statutory provisions in legislation is not governed by either the state constitution or statute. Each stands on its own and each can therefore have independent operational effect.

An effective date provision addresses when a particular bill, enacted into law, is to become effective. "Become[s] effective" is defined to mean "becomes applicable," AS 01.-

10.070(f)(3), and identifies the time from which the legislature intends that the substantive changes made in the particular bill are to be given legal application--the time when the bill's application as law is to begin. An effective date clause is essentially procedural.

A retroactive or retrospective applicability clause, on the other hand, is a provision that acts to "[give] to pre-enactment conduct a different legal effect from that which it would have had without the passage of the statute." Hochman, The Supreme Court and the Constitutionality of Retroactive Legislation, 73 Harv. L. Rev. 692 (1960). Retrospective application goes to the legal effect of conduct that had occurred prior to the enactment of the legislation in question, changing the legal consequences of an act after the act had occurred. Most commentators summarily characterize legislation applied retrospectively as affecting existing rights. It is because of this characteristic that courts will carefully scrutinize retrospective civil statutes under either the impairment of contract or due process clauses, but otherwise a statute given retroactive effect will operate by its terms.

Thus, retrospective applicability of legislation and effective date provisions giving validity to enacted legislation serve different ends. In the absence of a constitutional or statutory provision or case decision holding that the two are to be treated together, there is nothing to require linkage between them. The state constitution and state statute do not do so explicitly. Neither "due process" nor "impairment of contract" provisions so implicitly require. Nor, I suggest, does the court's decision in Atlantic Richfield that is relied on in the Attorney General's Opinion. Far from being conclusive on the point, the court's reference in that decision merely repeats the suggestion or directive of the Legislative Drafting Manual that when it is desired that portions of a bill are to have retroactive effect, an immediate effective date clause "should" be used in conjunction with it.

The Legislative Drafting Manual's recommended use of an immediate effective date provision in conjunction with a retrospective application section may be regarded as a matter of drafting policy and convenience rather than one of legal necessity. From the policy perspective, there is little sense, at least in theory, to delay the taking effect of those portions of a bill that are to have retroactive effect

Senator Jan Faiks
Page 4
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by 90 days when, to better accord with effectuating the legislature's intent that substantive relationships be changed retrospectively, the desired retroactive effect may be promptly obtained by giving the bill's provisions immediate effect.

Substantive constitutional questions concerning retrospective application of any legislation aside, the sole procedural requirement applicable to retrospective application of legislation is AS 01.10.090, with its directive that a statute is not retrospective unless it so expressly declares. CSHB 118 (Resources)(eff. date failed) meets that requirement.

There is nothing to indicate that article II, section 18, the state constitutional provision otherwise applicable to giving effect to legislation, should not operate in this instance. That section, as you well know, directs that laws passed by the legislature become effective ninety days after enactment unless, by a two-thirds vote of each house, a different effective date is provided. As to the bill's effective date, the suggestion or directive of the Drafting Manual ("... an immediate effective date ... should be used in conjunction with the retroactivity section") was met in the drafting of the initial versions of legislation. That clause was necessarily deleted by its failure to obtain 27 affirmative votes in the House.

The two provisions are not mutually dependent. They are independent provisions that operate, as I think they must do with respect to CSHB 118 (Resources) (eff. date failed), to delay the taking effect of the bill and making its changes retrospectively applicable to one of the dates identified in sections 4 and 5 of the bill.

In summary, I disagree with the language of the Attorney General's Opinion cited. The court's reference in Atlantic Richfield to a recommendation of the Legislative Drafting Manual is not, in my judgment, to compel the conclusion that "without passage of the effective date clause by a two-thirds vote, the retroactive application section will be void, and the bill will operate prospectively only." Article II, section 18 and AS 01.10.090 may operate independently and, when the requirements of AS 01.10.090 are met (as they are in the House-passed bill), the failure of the legislature to adopt an effective date clause is not fatal to a retroactive application of the legislation.

JBC:kb
wkk3/036

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F. Steven Mahoney
Senior Tax Attorney

March 29, 1989

Senator Jan Faiks
Chairman Judiciary Committee
P.O. Box V
Capitol Room #101
Juneau, Alaska 99811

Dear Senator Faiks:

This letter addresses the constitutionality of the retrospective application of CSHB 118. The question is posed because, as the bill is now drafted, Section 4 would make the Act retroactive to January 1, 1989. The retrospective application of this Act to Alaska's monthly Oil and Gas Properties Production Tax is fundamentally unfair and constitutes an arbitrary and unconscionable taking in violation of the 5th Amendment Due Process Clause of the Constitution of the United States, (as applied through the 14th Amendment Equal Protection Clause), and of Article I, Section 7 of the Constitution of the State of Alaska.

A provision that creates additional tax liabilities on tax periods that have already ended, places an unreasonable and unconstitutional additional tax burden on taxpayers. Those taxpayers are forced to pay added taxes on production long after it was produced, taxed, transported, marketed and sold. The original production taxes, properly paid in the affected earlier tax periods, are part of production costs. The sales price of the oil was in part determined in relation to the costs then attributable to production. The producers can not go back and adjust the prices they previously charged to customers for that oil. It is fundamentally unfair to come back after the sale, after the tax had been properly calculated, the return properly filed and the liability properly paid, and increase the tax cost of

producing the oil (as this bill does to oil produced by ARCO Alaska, Inc. at the Kuparuk River Unit).

The Supreme Court of Alaska summed up the general state policy in regard to retrospective application of statutes by stating "that people, in conducting their business, should be able to rely on existing laws with reasonable certainty." Norton v State, ABC Board, 695 P.2d. 1090, at 1093 (Alaska 1985).

This is the general policy of most states and the federal government because it is widely acknowledged that legislation applied retrospectively affects existing legal rights. When pre-existing legal rights are deemed at risk, courts have closely scrutinized retroactive provisions in determining whether due process has been violated.

"In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation." Welch v Henry, 305 U.S. 134, 83 L. Ed. 87, 59 S. Ct. 121 (1938) at 93. Because of the onerous additional tax liabilities created and that six separate tax return periods would be affected, retroactive application of this Act is so harsh and oppressive as to transgress constitutional due process limitations.

The Alaska Production Tax is a transactional tax on the production of each barrel of oil. It is not an income tax and therefore does not apply to any specific time period but instead relates directly to each barrel of oil produced. Each barrel severed subjects the producer to a tax on that barrel. The producer calculates, files and remits its taxes incurred in each month on the 20th day of the following month. Cases cited in recent state memorandum, asserting that due process is generally not violated by limited retrospective application of tax statutes, limit their findings specifically to income tax cases. United States v Darusmont, 449 U.S. 292, 66 L. Ed. 2d. 513, 101 S. Ct. 549 (1981), United States v Hudson, 299 U.S. 498, 81 L. Ed. 370, 57 S. Ct. 309 (1937), Welch v Henry, 305 U.S. 134, 83, L. Ed. 87, 59 S. Ct. 121 (1938), Brushaber v Union Pacific R.R., 240 U.S. 1, 60 L. Ed. 493, 36 S. Ct. 236 (1917). In each of these

cases provisions had been enacted during the taxable year which contained retroactive provisions to an earlier date in the same taxable year. In each case the tax acts were imposed before liabilities were fixed or the taxable period had ended. These cases are certainly distinguishable from the transactional Production Tax that will be affected by retroactive application of CSHB 118.

The retrospective application of tax statutes has in fact been found unconstitutional as violative of due process in transactional type taxes. Nichols v Collidge, 274 U.S. 531, 71 L. Ed. 1184 (1927), 47 S. Ct. 710, Blodgett v Holden, 275 U.S. 142, 72 L. Ed. 645, 48 S. Ct. 105 (1928), Untermeyer v Anderson, 276 U.S. 440, 72 L. Ed. 645, 48 S. Ct. 353 (1928). Justice Learned Hand, in addressing a retroactive provision of an income tax, recognized that "there is a valid distinction between the taxation of incomes and gifts or testamentary transfers." Cohan v Commissioner of Internal Revenue, 39 F. 2d. 540, at 545 (2nd CIR 1930). These cases dealing with gift and estate taxes are far more relevant to the present bill than income tax cases dealing with full year income tax periods.

Under either set of precedents the United State Supreme Court has determined that when reviewing retroactive tax questions a "totality of the circumstances" test must be applied. Various courts have used many different factors when making this inquiry but these factors can be summarized in four questions:

Keeping in mind the type of tax at issue, what is the extent of the retroactive effect of the tax?

In the current bill, the retroactive provision would apply to a transactional severance tax. The severance occurred months earlier than the Bill was proffered. Six separate and complete tax reporting periods will have ended between the earliest possible effective date and the retroactive application date. Funds generated through sales of the oil produced during that time frame have already been allocated, invested, or expended by the taxpayers. The affect is immediate, large and extraordinarily unfair to taxpayers.

What notice did the taxpayer enjoy and how should it have affected the certainty of his expectations?

That the ELF exists does not put a taxpayer on notice that a double exponent CSHB 118 would be drafted and include a retroactive provision. The taxpayer rightfully allocated, invested, and expended funds from production during this period believing that his production tax liabilities were fully satisfied. Notice was not necessarily adequate even on the date the bill was introduced (without a retroactive provision) because as the court has stated "[a taxpayer] cannot foresee and ought not be required to guess the outcome of pending measures." Untermeyer infra at 647. Therefore, the taxpayers have no clear notice of the Act until it is passed into law.

What is the public policy behind making the bill apply retroactively?

The legislature, in 1981, was aware that all oil produced in Alaska would eventually be subject to the unrestricted ELF formula. Therefore, the current ELF cannot be said to be adverse to public policy and the period over which it has been in effect should not be changed. If the legislature deems it necessary to change the ELF to cure its estimated budget shortfall it should do so prospectively only. No public policy is served by retroactively applying the bill.

Does the state's interest outweigh the harm done to the taxpayer because of the retroactive application of the bill?

The taxpayers are burdened by an onerous and unfair additional tax if the retroactive provision remains in the bill. The actions taken by the taxpayers during the period affected by the retroactivity can not be undone or changed in reaction to the additional tax burden. The state's interests in utilization, development, and conservation of its resources is neither enhanced nor harmed if the bill is not made retroactive. Therefore, the retroactivity provision serves no purpose except to add to the state's general fund.

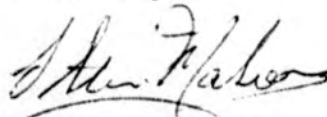
Senator Jan Faiks

March 29, 1989

Page 5

The conclusion is not that retroactive tax legislation is per se a violation of a taxpayer's due process rights; however when reviewing the "totality of the circumstances" and weighing the precedent of prior non-income tax cases, it appears certain that Section 4, Retroactive Application, of CSHB 118 would be found an unconscionable and unconstitutional violation of the due process rights of Alaska's oil producers.

Sincerely,

A handwritten signature in dark ink, appearing to read "F. Steven Mahoney", written in a cursive style.

F. Steven Mahoney
Senior Tax Attorney

MAY 1 1989

4/27/89

Pamela L. Rogers
10501 Stroganof Dr.
Anchorage, AK 99516

Senator Drue Pearce
P. O. Box V
Juneau, AK 99811

Dear Senator Pearce:

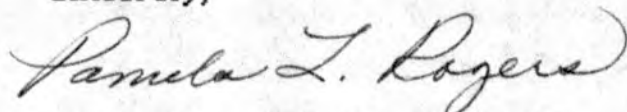
Thank you for passing the ELF bill out of your special Oil & Gas Committee. I believe this issue deserves a full Senate vote, although I doubt if it can make it through the remaining committees by adjournment on May 9.

Please don't take this personally. As a Republican, and unfortunately, a state employee, I hope the public doesn't fall for the committee's apparent strategy of hoping the ELF revision will die because the money will be available for more state spending...a public no-no. The state needs to spend some of that money.

As manager of the state's oil and gas leasing program, I have appeared before an often hostile public numerous times assuring that the oil and gas industry in Alaska has its environmental "act" together. Well, the Exxon Valdez proves that it didn't and it doesn't. I feel personally and professionally compromised. People who live in oil producing areas were well aware of monitoring and enforcement problems long before the Prince William Sound disaster. Unless the state spends money to monitor and enforce environmental terms related to oil and gas development, there is no guarantee that further disasters won't occur. And until we can assure the public of that, oil and gas development in Alaska could be in jeopardy. I don't say this idly. I've come to this conclusion from the letters I've received, from talks with local officials, and perhaps surprisingly, from editorials in the nationally-published Oil and Gas Journal.

Thus, I urge that you support modification of the ELF when it comes before the full Senate. And again, thank you for allowing the bill out of committee.

Sincerely,



cc: Senator Arliss Sturgelewski

Pamela L. Rogers
10501 Stroganof Dr.
Anchorage, AK 99516
4/27/89

Senator Arliss Sturgelewski
P. O. Box V
Juneau, AK 99811

Dear Arliss:

I am enclosing a letter I wrote tonight to Senator Drue Pearce.

I won't repeat my feelings as expressed in the letter to Drue - you can read those for yourself.

I did not support a revision in the ELF before the Exxon Valdez spill. Now I do. I realize the two are not related, but I am convinced the state must find extra money now to monitor and enforce the environmental terms we have developed for oil and gas exploration and development.

If the bill makes it to your committee before May 9 I hope that you, too, will pass it out. And I hope that you will support the bill when it reaches the Senate floor. This goes against my grain, too, as I also believe (despite my dislike of the phrase and its originator) that "a deal is a deal." But the oil industry has reneged on its deal with the citizens of Alaska to operate in an environmentally safe manner.

Sincerely,

Pam Rogers

cc: Senator Drue Pearce

SENATE COMMITTEE REPORT

FURTHER

RES
FIN

3/31/89

DATE TURNED INTO OFFICE _____

Mr. President:

OIL & GAS

Committee considered CSHB 118 (RES)(efd fld)

oil and gas properties production tax

and recommended

☒ replace with S CS HB 118 (OIL & GAS) ☐ same title
☐ or adopt _____ CS _____ ☒ new title
☐ attached amendment(s) and ☐ technical
title change
☐ _____ letter of intent adopted (HB only)

☐ do pass

☒ do not pass

☐ no recommendation

☐ individual recommendations

☐ further referral to _____

FISCAL NOTE(S) ☒ zero ☐ fiscal impact ☐ appropriation no FN
☐ new ☐ updated ☐ previous
☐ same as previous fiscal note(s) published _____

MEMBERS SIGNING DO PASS

OTHER RECOMMENDATIONS

Lee Adams - NEEDS Amendment

Paul Trieb (Do Not Pass)
Rick Halford (Do Not Pass)
Tim Kelly (Do Not Pass)

Irue Pearce - Do not pass
Chairman signature and recommendation

☐ Committee Backup attached

SENATE COMMITTEE REPORT

FURTHER

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☒ do not pass

☐ no recommendation

☐ individual recommendations

☐ further referral to _____

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Lee Adams - NEEDS Amendment

Paul Frick (Do Not Pass)
Rick Halford (NO REC)
Tim Kelly (Do Not Pass)

Irue Pearce - Do not pass
Chairman signature and recommendation

☐ Committee Backup attached

STATE OF ALASKA
1989 LEGISLATIVE SESSIONBill Version: CSHB 118 (RES)
Publish Date: HOUSE 3/20/89

FISCAL NOTE

REQUEST:

Revision Date: March 7, 1989
Title: Oil & gas properties production
tax - ELF; providing an effective date
Sponsor: House Finance Committee
Requestor: House ResourcesAgency Affected: Department of Revenue
BRU: Oil & Gas Audit Division

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	49,000	126,000	144,000	163,000	187,000	180,000

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: See attached page for analysis.

Prepared By: Roger MarksPhone: 277-5627Division: Dept. of Revenue, Oil & Gas Audit DivisionDate: March 7, 1989Approved by Commissioner: Hugh MaloneDate: 3/8/89Agency: Department of Revenue

Distribution (by preparer):

Legislative Finance

Legislative Sponsor

Requestor

Office of Management and Budget

Impacted Agency(ies)

Fiscal Analysis

This bill modifies the economic limit factor (ELF) formula used in computing the production (severance) tax on oil.

The bill (1) introduces the rate of field production into the exponent of the current ELF formula; (2) repeals the so-called "rounding rule," the provision of current law which states that for any month during the first 10 years of commercial oil production for which the computed ELF of a lease or property exceeds 0.7 the ELF shall be considered to be one; and (3) fixes the production at the economic limit (PEL) at 300 barrels times the number of well days in the month.

This bill is retroactive to January 1, 1989, and applies to oil produced after December 31, 1988. Because the severance tax on oil for a given month is due during the following month, a tax change which takes effect on January 1 would not affect revenues until February. Depending on the actual passage date of the bill, the FY 89 amounts may not be actually collected until FY 90.

This fiscal note was calculated using the oil price and production assumptions of the Department of Revenue's Fall 1988 Petroleum Production Revenue Forecast mid-case scenario updated for actual data through November of 1988. That forecast was predicated on Alaska North Slope crude prices at the U.S. Gulf of \$13.25 a barrel in FY 89 and \$12.89 a barrel in FY 90. 1/

Additional revenues for future years in millions of dollars are as follows:

1995	174
1996	169
1997	163
1998	153
1999	152
2000	144
2001	136
2002	129
2003	117
2004	110
2005	104
2006	91
2007	80
2008	60
2009	45
2010	19

1/ Had the fiscal note used the oil price and volume assumptions of the "Consensus Revenue Analysis" of January 24, 1989, the FY 89 fiscal impact would be \$56 million, and the FY 90 fiscal impact would be \$132 million. That analysis was predicated on Gulf ANS prices of \$14.07/bbl in FY 89 and \$14.30/bbl in FY 90.

Date: March 1, 1989

Price/Revenue Sensitivity Matrix for HB 118
(Millions of \$)

ANS @ US Gulf (\$/bbl)	Fiscal Year					
	1989	1990	1991	1992	1993	1994
10.35	28	89	89	97	100	96
12.70	42	113	114	123	135	129
15.00	56	149	149	159	170	160
17.35	70	185	186	196	208	196
19.70	84	216	218	230	243	216
22.00	98	251	254	278	273	239

Assumptions:

1. Production and well assumptions from Department of Revenue mid scenario Fall 1988 forecast.
2. HB 118 effective date January 1, 1989.
3. The variation in revenue between years is a function of a number of factors, including:
 - A. The changing relative tax rates under the current ELF and HB 118.
 - B. The effect of price on production levels. (e.g. West Sak economic at \$18/bbl.)
 - C. The effect of changing production and wells on ELF under either formula.

SENT BY: DTU OIL GAS

: 4-19-89 3:33PM ;

25344→

9075862754;# 1

DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL AND GAS
ROYALTY ACCOUNTING SECTION

PARTICIPATING PERCENTAGES -
KUPARUK RIVER UNIT

WORKING
INTEREST
OWNER

OWNER'S AREA
PARTICIPATION PERCENTAGE

ARCO	56.30096
BP	38.75643
UNOCAL	4.24961
MOBIL	.36600
EXXON	.21800
CHEVRON	.10900

100.00000

d:kprkpts
sms 4/11/89

KUPARUK

ADJUSTED FOR RSA AND
SECTION 37.110 - PRUDHOE

EXHIBIT 26A
AREA VALUES
OIL RIM AND GAS CAP PARTICIPATING AREAS

WORKING INTEREST OWNER	OWNER'S AREA PARTICIPATION PERCENTAGE		AREA INVESTMENT COST ALLO- CATION %
	OIL RIM	GAS CAP	
SAPC	50.6830966	13.8397816	49.8501784
ARCO	21.7799635	42.5649413	21.9509351
EXXON	21.7776490	42.5647901	21.9485818
MOBIL	1.8915771	0.2843666	2.1176717
PHILLIPS	1.8805235	0.2629370	2.1065745
CHEVRON	0.6717745	0.4830700	0.7106113
AMERADA HESS	0.5379191	-	0.5379191
TEXACO	0.5484215	-	0.5484215
LL&E	0.0397591	-	0.0397591
MARATHON	0.0499044	-	0.0499044
SHELL	0.1376744	-	0.1376744
BPAE	0.0017373	0.0001134	0.0017587

*LEGEND:

Amerada Hess	--Amerada Hess Corporation
Arco	--Arco Alaska, Inc.
BPAE	--BP Alaska Exploration Inc.
Chevron	--Chevron U.S.A., Inc.
Exxon	--Exxon Corporation
Texaco	--Texaco Producing Inc.
LL&E	--The Louisiana Land and Exploration Company
Marathon	--Marathon Oil Company
Mobil	--Mobil Oil Corporation
Shell	--Shell Western E & P Inc.
Phillips	--Phillips Petroleum Company
SAPC	--Standard Alaska Production Company

PRUDHOE
BAY

October 1987

Participating Percentages
Lisburne Participating Area
Prudhoe Bay Unit

<u>Working Interest Owner</u>	<u>Owner's Area Participating Percentage</u>
ARCO Alaska, Inc.	40.00
Exxon Corporation	40.00
BP Exploration	20.00

LISBURNE

Participating Percentages
Kuparuk Participating Area
Milne Point Unit

Working Interest Owner

Owner's Area
Participating Percentage

Conoco

72.14933

Chevron

17.37352

OXY

10.47715

3648A

MILNE POINT