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TESTIMONIES

BEFORE JT

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HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
REVENUE TO ALASKA AND OTHER STATES IF OIL SELLS FOR \$10.00/BBL. IN CALIFORNIA

TABLE 1-A

(All Amounts in Millions of 1976 Dollars)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Alaskan State Income Tax Paid By:										
A-California Marketing and Refining Company	\$ 2.4	\$ 15.3	\$ 21.0	\$ 21.6	\$ 21.3	\$ 21.7	\$ 22.8	\$ 23.7	\$ 24.4	\$ 23.3
B-Large Integrated Domestic Company	7.9	14.9	17.9	18.4	18.5	18.9	19.8	20.7	21.2	20.6
C-Major International Company	11.4	16.7	18.9	19.4	19.7	20.1	20.9	21.8	22.4	21.9
Alaskan State Income Tax Revenue	<u>\$ 21.7</u>	<u>\$ 46.9</u>	<u>\$ 57.8</u>	<u>\$ 59.4</u>	<u>\$ 59.5</u>	<u>\$ 60.7</u>	<u>\$ 63.5</u>	<u>\$ 66.2</u>	<u>\$ 68.0</u>	<u>\$ 65.8</u>
Alaskan State Revenue Other Than Income Tax*										
Royalty to State of Alaska	\$ 66.7	\$ 237.1	\$ 344.2	\$ 351.1	\$ 357.9	\$ 364.8	\$ 349.0	\$ 338.1	\$ 342.9	\$ 308.5
Alaskan State Severance Tax	82.5	219.4	274.8	274.8	274.8	274.8	274.8	274.8	274.8	256.5
Alaskan State Reserves Tax-- Paid	235.0	---	---	---	---	---	---	---	---	---
Severance Tax Credit	(41.2)	(109.9)	(137.4)	(137.4)	(31.5)	---	---	---	---	---
Alaskan State Ad Valorem Tax	190.0	208.2	219.5	215.6	211.4	206.8	203.6	202.9	196.1	184.0
Non-Income Tax Subtotal	<u>\$533.0</u>	<u>\$555.3</u>	<u>\$701.1</u>	<u>\$704.1</u>	<u>\$812.6</u>	<u>\$846.4</u>	<u>\$827.4</u>	<u>\$815.8</u>	<u>\$813.8</u>	<u>\$749.0</u>
Total Alaskan State Revenue	<u>\$554.7</u>	<u>\$602.2</u>	<u>\$758.9</u>	<u>\$763.5</u>	<u>\$872.1</u>	<u>\$907.1</u>	<u>\$890.9</u>	<u>\$882.0</u>	<u>\$881.8</u>	<u>\$814.8</u>
Income Tax Paid to All States By:										
A-California Marketing and Refining Company	\$ 9.7	\$ 60.7	\$ 82.4	\$ 84.0	\$ 82.4	\$ 83.1	\$ 86.6	\$ 89.2	\$ 91.1	\$ 87.1
B-Large Integrated Domestic Company	50.3	88.9	105.6	106.8	105.7	106.3	109.1	111.2	112.8	109.6
C-Major International Company	58.2	80.6	90.4	91.2	90.8	91.3	93.1	94.5	95.5	93.6
Total Income Tax Paid to All States	<u>\$118.2</u>	<u>\$230.2</u>	<u>\$278.4</u>	<u>\$282.0</u>	<u>\$278.9</u>	<u>\$280.7</u>	<u>\$288.8</u>	<u>\$294.9</u>	<u>\$299.4</u>	<u>\$290.3</u>
Effective Composite State Income Tax Rate on Total Taxable Earnings	4.8%	5.5%	5.7%	5.7%	5.7%	5.7%	5.7%	5.8%	5.8%	5.8%
Alaskan Income Tax Payments as Percent of Income Tax Payments to All States	18.4%	20.4%	20.8%	21.1%	21.3%	21.6%	22.0%	22.4%	22.7%	22.7%

* Each owner company would pay one-third of the figures shown in this section.

HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
 STATE REVENUE DISTRIBUTION FROM 1977 THROUGH 1986 IF OIL SELLS FOR \$10.00/BBL. IN CALIFORNIA
 (All Amounts in Millions of 1976 Dollars)

Type of Revenue	Company A California Refiner		Company B Large Domestic		Company C Major International		Three Company Total	
	Alaskan Revenue	As Percent To All States	Alaskan Revenue	As Percent To All States	Alaskan Revenue	As Percent To All States	Alaskan Revenue	As Percent To All States
Prudhoe Bay Royalty	\$1,020.1	100.0%	\$1,020.1	100.0%	\$1,020.1	100.0%	\$3,060.3	100.0%
Prudhoe Bay Severance Tax	827.5	100.0%	827.5	100.0%	827.5	100.0%	2,482.5	100.0%
Prudhoe Bay Reserves Tax--								
Paid	78.3	100.0%	78.3	100.0%	78.4	100.0%	235.0	100.0%
Severance Tax Credit	(152.4)	100.0%	(152.4)	100.0%	(152.5)	100.0%	(457.3)*	100.0%
Prudhoe Bay and TAPS Ad Valorem Tax	679.4	100.0%	679.4	100.0%	679.4	100.0%	2,038.2	100.0%
State Income Tax on <u>All</u> of Company's Operations	197.5	26.1%	178.8	17.8%	193.2	22.0%	569.5	21.6%
Total Revenue to State of Alaska	<u>\$2,650.4</u>	77.8%	<u>\$2,631.7</u>	72.3%	<u>\$2,646.1</u>	75.1%	<u>\$7,928.2</u>	75.0%

* Includes credit for the \$222.3 million reserves tax paid during 1976.

HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
 REVENUE TO ALASKA AND OTHER STATES IF OIL SELLS FOR \$13.00/BBL. IN CALIFORNIA
 (All Amounts in Millions of 1976 Dollars)

TABLE 2-A

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Alaskan State Income Tax Paid By:										
A-California Marketing and Refining Company	\$ 5.5	\$ 24.1	\$ 31.9	\$ 32.5	\$ 32.0	\$ 32.6	\$ 33.9	\$ 35.0	\$ 35.7	\$ 33.9
B-Large Integrated Domestic Company	9.5	19.2	23.4	24.0	23.9	24.6	25.6	26.6	27.2	26.3
C-Major International Company	12.4	19.6	22.6	23.2	23.4	24.0	24.9	26.0	26.6	25.9
Alaskan State Income Tax Revenue	<u>\$ 27.4</u>	<u>\$ 62.9</u>	<u>\$ 77.9</u>	<u>\$ 79.7</u>	<u>\$ 79.3</u>	<u>\$ 81.2</u>	<u>\$ 84.4</u>	<u>\$ 87.6</u>	<u>\$ 89.5</u>	<u>\$ 86.1</u>
Alaskan State Revenue Other Than Income Tax^A										
Royalty to State of Alaska	\$128.3	\$401.6	\$549.6	\$556.4	\$563.2	\$570.1	\$554.3	\$543.4	\$548.2	\$500.1
Alaskan State Severance Tax	82.5	220.7	298.9	302.6	306.3	310.1	301.1	295.6	298.2	272.0
Alaskan State Reserves Tax-- Paid	235.0	---	---	---	---	---	---	---	---	---
Severance Tax Credit	(41.2)	(110.3)	(149.4)	(151.3)	(4.9)	---	---	---	---	---
Alaskan State Ad Valorem Tax	190.0	208.2	219.5	215.6	211.4	206.8	203.6	202.9	196.1	184.0
Non-Income Tax Subtotal	<u>\$594.6</u>	<u>\$720.2</u>	<u>\$918.6</u>	<u>\$923.3</u>	<u>\$1076.0</u>	<u>\$1087.0</u>	<u>\$1059.0</u>	<u>\$1041.9</u>	<u>\$1042.5</u>	<u>\$956.1</u>
Total Alaskan State Revenue	<u>\$622.0</u>	<u>\$783.1</u>	<u>\$996.5</u>	<u>\$1003.0</u>	<u>\$1155.3</u>	<u>\$1168.2</u>	<u>\$1143.4</u>	<u>\$1129.5</u>	<u>\$1132.0</u>	<u>\$1042.2</u>
Income Tax Paid to All States By:										
A-California Marketing and Refining Company	\$ 22.8	\$ 95.1	\$124.7	\$126.2	\$123.3	\$124.7	\$128.4	\$131.2	\$133.0	\$126.5
B-Large Integrated Domestic Company	60.1	114.8	137.7	138.9	136.8	138.0	141.0	143.3	144.9	139.7
C-Major International Company	63.5	95.4	109.0	109.9	109.0	109.8	111.7	113.3	114.3	111.2
Total Income Tax Paid to All States	<u>\$146.4</u>	<u>\$305.3</u>	<u>\$371.4</u>	<u>\$375.0</u>	<u>\$369.1</u>	<u>\$372.5</u>	<u>\$381.1</u>	<u>\$387.8</u>	<u>\$392.2</u>	<u>\$377.4</u>
Effective Composite State Income Tax Rate on Total Taxable Earnings	5.1%	5.8%	5.9%	5.9%	5.9%	5.9%	5.9%	5.9%	5.9%	5.9%
Alaskan Income Tax Payments as Percent of Income Tax Payments to All States	16.7%	20.6%	21.0%	21.3%	21.5%	21.8%	22.1%	22.6%	22.8%	22.8%

^A Each owner company would pay one-third of the figures shown in this section.

**HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
STATE REVENUE DISTRIBUTION FROM 1977 THROUGH 1986 IF OIL SELLS FOR \$13.00/BDL. IN CALIFORNIA**
(All Amounts in Millions of 1976 Dollars)

Type of Revenue	Company A California Refiner		Company B Large Domestic		Company C Major International		Three Company Total	
	Alaskan Revenue	As Percent To All States	Alaskan Revenue	As Percent To All States	Alaskan Revenue	As Percent To All States	Alaskan Revenue	As Percent To All States
Prudhoe Bay Royalty	\$1,638.4	100.0%	\$1,638.4	100.0%	\$1,638.4	100.0%	\$4,915.2	100.0%
Prudhoe Bay Severance Tax	896.0	100.0%	896.0	100.0%	896.0	100.0%	2,688.0	100.0%
Prudhoe Bay Reserves Tax--								
Paid	78.3	100.0%	78.3	100.0%	78.4	100.0%	235.0	100.0%
Severance Tax Credit	(152.4)	100.0%	(152.4)	100.0%	(152.5)	100.0%	(457.3)*	100.0%
Prudhoe Bay and TAPS Ad Valorem Tax	679.4	100.0%	679.4	100.0%	679.4	100.0%	2,038.2	100.0%
State Income Tax on <u>All</u> of Company's Operations	297.1	26.2%	230.3	17.8%	228.6	21.8%	756.0	21.7%
Total Revenue to State of Alaska	<u>\$3,436.8</u>	75.2%	<u>\$3,370.0</u>	72.2%	<u>\$3,368.3</u>	76.3%	<u>\$10,175.1</u>	74.5%

* Includes credit for the \$222.3 million reserves tax paid during 1976.

HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
 REVENUE TO ALASKA AND OTHER STATES IF OIL SELLS FOR \$16.00/BBL. IN CALIFORNIA
 (All Amounts in Millions of 1976 Dollars)

TABLE 3-A

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Alaskan State Income Tax Paid By:										
A-California Marketing and Refining Company	\$ 8.6	\$ 32.4	\$ 42.4	\$ 41.9	\$ 42.2	\$ 42.9	\$ 44.3	\$ 45.5	\$ 46.3	\$ 43.7
B-Large Integrated Domestic Company	10.9	23.4	28.7	28.7	29.2	29.9	31.0	32.2	32.9	31.5
C-Major International Company	<u>13.4</u>	<u>22.5</u>	<u>26.3</u>	<u>26.5</u>	<u>27.0</u>	<u>27.7</u>	<u>28.7</u>	<u>29.9</u>	<u>30.5</u>	<u>29.6</u>
Alaskan State Income Tax Revenue	<u>\$ 32.9</u>	<u>\$ 78.3</u>	<u>\$ 97.4</u>	<u>\$ 97.1</u>	<u>\$ 98.4</u>	<u>\$100.5</u>	<u>\$104.0</u>	<u>\$107.6</u>	<u>\$109.6</u>	<u>\$104.8</u>
Alaskan State Revenue Other Than Income Tax*										
Royalty to State of Alaska	\$189.9	\$565.6	\$754.9	\$761.7	\$768.6	\$775.4	\$759.7	\$748.7	\$753.5	\$691.8
Alaskan State Severance Tax	103.3	307.6	410.6	414.3	418.0	421.7	413.2	407.2	409.8	376.2
Alaskan State Reserve Tax-- Paid	235.0	---	---	---	---	---	---	---	---	---
Severance Tax Credit	(51.7)	(153.8)	(205.3)	(46.6)	---	---	---	---	---	---
Alaskan State Ad Valorem Tax	<u>190.0</u>	<u>208.2</u>	<u>219.5</u>	<u>215.6</u>	<u>211.4</u>	<u>206.8</u>	<u>203.6</u>	<u>202.9</u>	<u>196.1</u>	<u>184.0</u>
Non-Income Tax Subtotal	<u>\$666.5</u>	<u>\$927.6</u>	<u>\$1179.7</u>	<u>\$1345.0</u>	<u>\$1398.0</u>	<u>\$1403.9</u>	<u>\$1376.5</u>	<u>\$1358.8</u>	<u>\$1359.4</u>	<u>\$1252.0</u>
Total Alaskan State Revenue	<u>\$699.4</u>	<u>\$1005.9</u>	<u>\$1277.1</u>	<u>\$1442.1</u>	<u>\$1496.4</u>	<u>\$1504.4</u>	<u>\$1480.5</u>	<u>\$1466.4</u>	<u>\$1469.0</u>	<u>\$1356.8</u>
Income Tax Paid to All States By:										
A-California Marketing and Refining Company	\$ 35.5	\$128.0	\$165.5	\$162.2	\$162.3	\$163.8	\$167.5	\$170.3	\$172.2	\$163.2
B-Large Integrated Domestic Company	69.5	139.7	168.9	166.5	166.7	168.0	171.0	173.4	174.9	167.8
C-Major International Company	<u>68.9</u>	<u>109.9</u>	<u>127.3</u>	<u>126.2</u>	<u>126.5</u>	<u>127.5</u>	<u>129.4</u>	<u>131.1</u>	<u>132.2</u>	<u>127.8</u>
Total Income Tax Paid to All States	<u>\$173.9</u>	<u>\$377.6</u>	<u>\$461.7</u>	<u>\$454.9</u>	<u>\$455.5</u>	<u>\$459.3</u>	<u>\$467.9</u>	<u>\$474.8</u>	<u>\$479.3</u>	<u>\$458.7</u>
Effective Composite State Income Tax Rate on Total Taxable Earnings	5.3%	5.9%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.1%	6.0%
Alaskan Income Tax Payments as Percent of Income Tax Payments to All States	18.9%	20.7%	21.1%	21.3%	21.6%	21.9%	22.2%	22.7%	22.9%	22.8%

* Each owner company would pay one-third of the figures shown in this section.

**HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
STATE REVENUE DISTRIBUTION FROM 1977 THROUGH 1986 IF OIL SELLS FOR \$16.00/BBL. IN CALIFORNIA
(All Amounts in Millions of 1976 Dollars)**

Type of Revenue	Company A California Refiner		Company B Large Domestic		Company C Major International		Three Company Total	
	Alaskan Revenue	As Percent To All States	Alaskan Revenue	As Percent To All States	Alaskan Revenue	As Percent To All States	Alaskan Revenue	As Percent To All States
Prudhoe Bay Royalty	\$2,256.6	100.0%	\$2,256.5	100.0%	\$2,256.6	100.0%	\$6,769.8	100.0%
Prudhoe Bay Severance Tax	1,227.3	100.0%	1,227.3	100.0%	1,227.3	100.0%	3,681.9	100.0%
Prudhoe Bay Reserves Tax--								
Paid	78.3	100.0%	78.3	100.0%	78.4	100.0%	235.0	100.0%
Severance Tax Credit	(152.4)	100.0%	(152.4)	100.0%	(152.5)	100.0%	(457.3)*	100.0%
Prudhoe Bay and TAPS Ad Valorem Tax	679.4	100.0%	679.4	100.0%	679.4	100.0%	2,038.2	100.0%
State Income Tax on <u>All</u> of Company's Operations	390.2	26.2%	278.4	17.8%	262.1	21.7%	930.7	21.3%
Total Revenue to State of Alaska	<u>\$4,479.4</u>	75.0%	<u>\$4,367.6</u>	73.6%	<u>\$4,351.3</u>	78.3%	<u>\$13,198.3</u>	75.6%

* Includes credit for the \$222.3 million reserves tax paid during 1976.

January 21, 1977

SOHIO SUBMISSION TWO

This is the second paper submitted by Sohio for consideration by the Alaskan Administration and the Alaskan Legislature in the studies each has been conducting concerning the long term oil taxation and leasing policy for the State. The first paper, entitled Sohio Submission One, was provided to the Alaskan Administration and Legislature on October 28, 1976.

By way of background, that paper examined the state income tax of Alaska under the allocation method of the Multistate Tax Compact and made illustrative projections of the substantial revenue that Alaska would receive as a result of the first ten years of operation of the Prudhoe Bay Field and the Trans Alaska Pipeline System (TAPS). Those projections of revenue included estimates of the State's royalty income and tax receipts resulting from Alaska's severance tax, reserves tax, ad valorem tax and state income tax.

In order to develop those hypothetical projections for the future operations of Prudhoe Bay and TAPS, it was assumed that equal one-third shares of that field and pipeline would be owned by three typical companies, none of which were intended to represent any company actually involved in that project. The assumed characteristics of the three typical companies which were used in Sohio Submission One were as follows:

Company A - A California based marketing and refining company with no crude oil production.

Company B - A large, integrated domestic company with significant petroleum production and transportation operations.

Company C - A major international company with substantial foreign operations.

Due to the degree of uncertainty surrounding both the future price of North Slope oil and future rates of inflation, the projections of Alaskan revenue contained in Sohio Submission One were calculated in terms of constant 1976 dollars, assuming three different California market prices: \$10.00/barrel, \$13.00/barrel, and \$16.00/barrel.

Among the significant findings of Sohio Submission One was that at the \$10.00 per barrel price, Alaska would receive average revenues of almost \$800 million per year from Prudhoe Bay and TAPS during the next ten years. At the \$13.00 per barrel and \$16.00 per barrel prices, Alaska's average annual revenues from this project would exceed \$1.0 billion and \$1.3 billion, respectively. These tax and royalty revenues to Alaska would represent approximately 75 percent of such revenue paid to all states, including Alaska, resulting either wholly or in part from the Prudhoe Bay Field and the Trans Alaska Pipeline. If some factor for inflation were applied to these projections rather than using constant 1976 dollars, the average annual revenues would increase accordingly, but Alaska's 75 percent share of such revenue to all states resulting from this project would not change.

The purpose of Sohio Submission Two is not to further examine either the "fair share" aspects of Alaska's taxation policy or the revenues the

State might expect as a result of Prudhoe Bay and TAPS. Sohio Submission Two takes the next step and compares the tax burden of such Alaskan tax laws currently on the books with the tax burden of the comparable tax laws of the other three largest oil producing states--Texas, Louisiana, and California. In the development of this comparison of tax burdens, exactly the same basic economic assumptions regarding the Prudhoe Bay Field and TAPS are used that were the basis for Sohio Submission One. Additionally, it is assumed again for this hypothetical case that one-third of this field and pipeline is owned by each of the three typical companies previously mentioned. In other words, the tax payments for each other producing state have been calculated by simply assuming that Alaska adopted the tax laws of that other state in lieu of the existing Alaskan tax laws. For comparison purposes, only the constant \$13.00 per barrel selling price in California is used. This is the midpoint of the assumed price levels which were used in Sohio Submission One. As in the previous paper, no attempt has been made to forecast future rates of inflation, and again, all the calculations and results are expressed in constant 1976 dollars.

Since this paper analyzes only the taxes of these oil producing states, the \$4.9 billion in royalty payments that Alaska would receive if oil sells for \$13.00 per barrel in California has been eliminated from the comparison. To simplify the comparison, Alaska's 1976-1977 reserves tax and future credit against severance tax payments have been deleted from this analysis. Since the reserves tax was enacted to alleviate Alaska's short term financial difficulties prior to initial production from Prudhoe Bay and since the reserves tax payments will be completely offset by future credits against severance tax obligations, it is not a

part of Alaska's permanent ongoing taxes, and it is the comparison of these states' ongoing tax laws that is the most informative.

The results of this analysis are displayed on the attached Tables 1, 2, and 3. Each of these Tables lists the principal Alaskan taxes which currently apply to petroleum activities in the state. These include the state income tax, the severance tax, and the petroleum property ad valorem tax. The payments which would be made to the State of Alaska over the 1977 through 1986 ten year period have been calculated and listed on each Table, along with the basis of calculation for each tax. The tax payments resulting from the comparable taxes of Texas, Louisiana, and California and their bases are listed on Tables 1, 2, and 3, respectively. Finally, each Table compares the total payment to Alaska for each tax as a percent of the total payment which would result under the comparable tax of the other leading oil production state.

Table 1, for example, is a comparison of the tax burden under the Alaskan tax laws with the tax burden under such tax laws of Texas, currently the largest oil production state in the U.S. As indicated on Table 1, the Alaskan state income tax payments of the three hypothetical companies owning Prudhoe Bay and TAPS would total more than \$750 million over the 1977-1985 ten year period. Texas, on the other hand, does not have a state income tax so, if the three companies were subject to Texas tax laws instead of the Alaska tax laws, the state income tax payments by the three companies would be zero.

The second section of Table 1 compares the payments which would be made from 1977 through 1986 by the three companies under the Alaskan

severance tax and ad valorem tax to those payments which they would have to make if they were subject to similar taxes in Texas. Since it is assumed that one-third of Prudhoe Bay and TAPS would be owned by each of the three typical companies, each company's tax payments would simply be one-third of the figures shown in this section. Alaska's severance tax would average 7.8 percent of the net wellhead value of the oil, i.e., the wellhead value after royalty payments are deducted. This results in total Alaska severance tax payments of almost \$2.7 billion over the ten year period. Since the Texas severance tax rate is only 4.6 percent of the net wellhead value, the total severance tax payments would be slightly more than \$1.6 billion over the same period. Therefore, the severance tax payments resulting under Alaska's current severance tax would be 163 percent of those resulting under Texas's current severance tax.

The present ad valorem tax rate of Alaska is equal to 20 mills and is applied to the valuation of all petroleum hardware. This would result in Alaskan ad valorem tax payments by the three companies of more than \$2.0 billion from 1977 through 1986. The ad valorem tax on production properties in Texas is equivalent to 2.5 percent of the net wellhead value of the oil produced. For pipeline facilities, the Texas ad valorem tax averages slightly less than 8 mills times the hardware valuation. Therefore, the total ad valorem tax payments which the three companies would have to pay if they were subject to these Texas tax laws would total \$1.46 billion from 1977 through 1986. As indicated on Table 1, the Alaskan

ad valorem tax payments over this ten year period would be 140 percent of those in Texas.

The sum of all these Alaskan tax payments made by the three companies from 1977 through 1986 would be almost \$5.5 billion. The comparable figures under the Texas tax laws would be only slightly more than \$3.1 billion. In summary, the Alaska tax burden would be 176 percent of that for Texas.

Table 2 compares in the same way Alaska's taxes with those of Louisiana, currently the second largest oil production state. Several significant factors concerning Louisiana's taxes are demonstrated by this Table. First of all, while the Louisiana state income tax rate is 4.0 percent, Louisiana has an oil depletion allowance equal to the lesser of 38 percent of the net wellhead value, or 50 percent of oil production taxable income. Furthermore, the state allows the deduction of Federal income tax payments prior to the determination of the state income tax liability. Therefore, income tax payments to Louisiana by the three companies would amount to \$382 million over the 1977 to 1986 period. The income tax payments under Alaska's state income tax over this same period would be 197 percent of this amount.

Another significant item highlighted by Table 2 is the total payments by the three companies of almost \$4.5 billion resulting from Louisiana's 12.5 percent severance tax rate, which is the highest oil severance tax in the U.S. As indicated on Table 2, the corresponding payments under Alaska's severance tax are 60 percent of those under Louisiana's severance tax. However, this difference in tax receipts

is almost completely offset by the fact that Alaska's ad valorem taxes are substantially higher than those in Louisiana, that is, 298 percent of such Louisiana taxes. When the total of these tax payments by the three companies is considered, the payments to Alaska of almost \$5.5 billion over the ten year period are 99 percent of the tax payments which would be made to Louisiana.

Table 3 compares the tax laws of Alaska to those of California, the third largest oil producing state. California's income tax rate of 9.0 percent is almost as high as that of Alaska, and the total tax payments by the three companies under either state's income tax law would be within \$25 million of each other for the ten year period.

As indicated on Table 3, the ad valorem tax payments under California's tax law would be about twice those paid to the State of Alaska. On the other hand, California levies no severance tax on oil production. When the total payments by the three companies resulting from these two taxes are compared for each state, the payments to Alaska would be 112 percent of those under California's method of taxation. Including the projected state income tax payments in these totals, the \$5.5 billion total ten year tax burden in Alaska would be 111 percent of the \$4.9 billion total which would result under California's tax laws.

Sohio Submission Two confirms the testimony by Sohio before the joint hearing of the Alaskan Senate and House Resources Committees that the burden of these tax laws already on the books in Alaska equals or exceeds the corresponding tax burdens of the other leading

oil production states. Using the hypothetical three company ownership of the Prudhoe Bay Field and the Trans Alaska Pipeline to illustrate the point, Sohio Submission Two affirms in a more precise manner that Alaska's current tax laws are 176 percent of those of Texas; 99 percent of Louisiana's; and 111 percent of California's.

It is respectfully suggested that Alaska's comparative tax position is one factor deserving careful attention if the State considers further changes in its tax laws, since such changes will affect the revenues flowing to the State government and the health of the State's economy, both of which will principally depend on reasonable resource development.

The Standard Oil Company (Ohio)
1780 Guildhall
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January 21, 1977

HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
COMPARISON OF THE TAX BURDEN UNDER THE LAWS OF ALASKA AND THE LAWS OF TEXAS - 1977 THROUGH 1986
(This hypothetical case assumes oil sells for a constant \$13.00/BBL. price in California. All figures in millions of constant 1978 dollars.)

	ALASKA TAXES		TEXAS TAXES		Payments Under Alaskan Tax Structure As A Percent of That Under Texas Tax Structure
	Basis	\$Millions	Basis	\$Millions	
State Income Tax Paid By:					
Company A - California Marketing and Refining Company	9.4% of Income Taxable by the State	\$ 295.2	0% of Income Taxable by the State	\$ 0.0	∞
Company B - Large Integrated Domestic Company	9.4% of Income Taxable by the State	229.4	0% of Income Taxable by the State	0.0	∞
Company C - Major International Company	9.4% of Income Taxable by the State	220.2	0% of Income Taxable by the State	0.0	∞
State Income Tax Subtotal		<u>\$ 752.8</u>		<u>\$ 0.0</u>	∞
Other Taxes:^a					
Severance Tax	7.8% of Wellhead Value after Royalty Payments	\$2,688.0	4.6% of Wellhead Value after Royalty Payments	\$1,648.9	163%
Ad Valorem Tax	Field and Pipeline - 2.0% of Hardware Valuation	2,038.2	Field - 2.5% of Wellhead Value after Royalty Payments Pipeline - 0.78% of Hardware Valuation	1,459.0	140%
Severance and Ad Valorem Tax Subtotal		<u>\$4,726.2</u>		<u>\$3,107.9</u>	152%
Total Tax Payments		<u>\$5,479.0</u>		<u>\$3,107.9</u>	176%

^a Company A, Company B, and Company C would each pay one-third of the figures shown in this section.

HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
 COMPARISON OF THE TAX BURDEN UNDER THE LAWS OF ALASKA AND THE LAWS OF LOUISIANA - 1977 THROUGH 1986
 (This hypothetical case assumes oil sells for a constant \$13.00/BBL. price
 in California. All figures in millions of constant 1978 Dollars.)

	ALASKA TAXES		LOUISIANA TAXES		Payments Under Alaskan Tax Structure As A Percent of That Under Louisiana Tax Structure
	Basis	\$Millions	Basis ^a	\$Millions	
State Income Tax Paid By:					
Company A - California Marketing and Refining Company	9.4% of Income Taxable by the State	\$ 295.2	4.0% of Income Taxable by the State	\$ 127.4	232%
Company B - Large Integrated Domestic Company	9.4% of Income Taxable by the State	229.4	4.0% of Income Taxable by the State	127.4	180%
Company C - Major International Company	9.4% of Income Taxable by the State	228.2	4.0% of Income Taxable by the State	127.4	179%
State Income Tax Subtotal		<u>\$ 752.8</u>		<u>\$ 382.2</u>	197%
Other Taxes:^b					
Severance Tax	7.8% of Wellhead Value after Royalty Payments	\$2,688.0	12.5% of Wellhead Value after Royalty Payments	\$4,465.6	60%
Ad Valorem Tax	Field and Pipeline - 2.0% of Hard- ware Value	2,038.2	Field - 0.4% of Wellhead Value after Royalty Payments Pipeline - 0.75% of Hardware Valuation	604.0	298%
Severance and Ad Valorem Tax Subtotal		<u>\$4,726.2</u>		<u>\$5,149.6</u>	92%
Total Tax Payments		<u>\$5,479.0</u>		<u>\$5,531.8</u>	99%

^a Even though Louisiana's corporate income tax rate is 4.0%, the State has a 38% depletion allowance and allows deduction of Federal Income tax payments prior to the determination of state income tax payments.

^b Company A, Company B, and Company C would each pay one-third of the figures shown in this section.

HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
 COMPARISON OF THE TAX BURDEN UNDER THE LAWS OF ALASKA AND THE LAWS OF CALIFORNIA - 1977 THROUGH 1985
 (This hypothetical case assumes oil sells for a constant \$13.00/BBL. prices
 in California. All figures in millions of constant 1976 dollars.)

	ALASKA TAXES		CALIFORNIA TAXES		Payments Under Alaskan Tax Structure As A Percent of That Under California Tax Structure
	Basis	\$Millions	Basis	\$Millions	
<u>State Income Tax Paid By:</u>					
Company A - California Marketing and Refining Company	9.4% of Income Taxable by the State	\$ 295.2	9.0% of Income Taxable by the State	\$ 286.6	103%
Company B - Large Integrated Domestic Company	9.4% of Income Taxable by the State	229.4	9.0% of Income Taxable by the State	221.6	104%
Company C - Major International Company	9.4% of Income Taxable by the State	<u>228.2</u>	9.0% of Income Taxable by the State	<u>219.7</u>	104%
State Income Tax Subtotal		<u>\$ 752.8</u>		<u>\$ 727.9</u>	103%
<u>Other Taxes:^a</u>					
Severance Tax	7.8% of Wellhead Value after Royalty Payments	\$2,688.0	None	\$ 0.0	"
Ad Valorem Tax	Field and Pipeline - 2.0% of Hard- ware Valuation	2,038.2	Field - 7.7% of Wellhead Value after Royalty Payments Pipeline - 2.2% of Hardware Valuation	4,201.6	49%
Severance and Ad Valorem Tax Subtotal		<u>\$4,726.2</u>		<u>\$4,201.6</u>	112%
Total Tax Payments		<u>\$5,479.0</u>		<u>\$4,929.5</u>	111%

^a Company A, Company B, and Company C would each pay one-third of the figures shown in this section.

March 22, 1977

SOHIO SUBMISSION THREE

In recent months Sohio has provided the Alaskan Administration and Legislature with two writings entitled "Sohio Submission One" and "Sohio Submission Two". Sohio Submission One sets out the revenues the State of Alaska might receive under its existing tax laws during the next decade. These figures were based on taxes that might be paid by three hypothetical companies, which were described in Submission One, under the assumption that in addition to its present operations each company would own a one-third interest in the Prudhoe Bay field and a one-third interest in the Trans-Alaskan Pipeline.

Sohio Submission Two compared the revenues Alaska might receive under its existing laws, as set out in the first writing, with the revenues Alaska would receive if it had the tax structure of either of three other leading oil producing states, namely, Texas, Louisiana, and California.

The purpose of Sohio Submission Three is to set out the taxes these three hypothetical companies would pay under two sets of assumptions; first, that the Administration's tax proposals became law, and second, that the Legislature's tax proposals became law.

This Sohio Submission Three consists of two parts. The first part describes our understanding of the existing laws and of the provisions of the proposed laws as we have used them in our work. The second part, commencing on page 8, provides comments on the results of our calculations as

HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
 COMPARISON OF THE TAX BURDEN UNDER THE LAWS OF ALASKA AND THE LAWS OF CALIFORNIA - 1977 THROUGH 1986
 (This hypothetical case assumes oil sells for a constant \$13.00/BBL. price
 in California. All figures in millions of constant 1976 dollars.)

	ALASKA TAXES		CALIFORNIA TAXES		Payments Under Alaskan Tax Structure As A Percent of That Under California Tax Structure
	Basis	\$Millions	Basis	\$Millions	
State Income Tax Paid By:					
Company A - California Marketing and Refining Company	9.4% of Income Taxable by the State	\$ 295.2	9.0% of Income Taxable by the State	\$ 286.6	103%
Company B - Large Integrated Domestic Company	9.4% of Income Taxable by the State	229.4	9.0% of Income Taxable by the State	221.6	104%
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State Income Tax Subtotal		<u>\$ 752.8</u>		<u>\$ 727.9</u>	103%
Other Taxes:^a					
Severance Tax	7.8% of Wellhead Value after Royalty Payments	\$2,688.0	None	\$ 0.0	∞
Ad Valorem Tax	Field and Pipeline - 2.0% of Hard- ware Valuation	2,038.2	Field - 7.7% of Wellhead Value after Royalty Payments Pipeline - 2.2% of Hardware Valuation	4,201.6	49%
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Total Tax Payments		<u>\$5,479.0</u>		<u>\$4,929.5</u>	111%

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March 22, 1977

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Sohio Submission Two compared the revenues Alaska might receive under its existing laws, as set out in the first writing, with the revenues Alaska would receive if it had the tax structure of either of three other leading oil producing states, namely, Texas, Louisiana, and California.

The purpose of Sohio Submission Three is to set out the taxes these three hypothetical companies would pay under two sets of assumptions; first, that the Administration's tax proposals became law, and second, that the Legislature's tax proposals became law.

This Sohio Submission Three consists of two parts. The first part describes our understanding of the existing laws and of the provisions of the proposed laws as we have used them in our work. The second part, commencing on page 8, provides comments on the results of our calculations as

they appear in the attached tables.

Part 1 - Comments on Existing Laws and Proposed Bills

The bills we considered in the case of the Administration proposals pertain to the franchise tax and property taxes and production taxes. In the case of the Legislature's proposals, we considered the bills relating to severance tax and income tax and a bill pertaining to net proceeds tax.

The salient provisions of the bills compared to the existing laws are as follows:

SEVERANCE TAX

Existing Law

The present law provides for payment of the higher of a percent of value or a cents per barrel in the case of oil. In the case of gas the tax is a straight 4 percent of value. The tax on oil is on a graduated scale as follows: For the first 300 barrels per day produced by a well during a month, the rate of 5 percent of value or 16.875¢ per barrel; for the next 700 barrels, the tax is 6 percent of value or 20.25¢ per barrel; and for all production over 1,000 barrels the tax is 8 percent of value or 27¢ per barrel. If a well produces 10,000 barrels per day the tax would be 7.77 percent of value or 26.22¢ per barrel, at the rate provided in the law. The cents per barrel figures escalate based on the wholesale price index for crude oil.

Administration's Proposal

The tax would be the greater of 10 percent of value or 75¢ per barrel, with the cents per barrel figure adjusted for changes in the Gross National Product deflator from and after the first quarter of 1977. The greater tax

rate is further adjusted by multiplying it by an "economic limit factor" for the purpose of reducing taxes on wells on properties which are approaching their economic limit. This economic limit factor is defined as one less the monthly rate of production at the economic limit of the property, divided by the current production from the property. The factor will be presumed to be one minus 100 barrels per day divided by total production per day, unless the owner can prove that this factor is not representative of the true economic limit. The economic limit factor will be changed if the operator can prove that his operating cost divided by the wellhead price would result in a lesser factor. A wellhead price for this purpose is determined by taking the landed price of imported oil on the West Coast and subtracting reasonable transportation costs from the field to the West Coast. The operating costs to be considered are set out in the proposed law.

With respect to gas, the tax would be the higher of 10 percent of value or 6.4¢ per MCF, providing that the cents per MCF will be adjusted by the GNP deflator from and after the first quarter 1977. These rates are subject to an economic limit factor, calculated in a manner similar to that described above for oil.

Legislature's Proposal

The legislative proposal provides for payment of the higher of a percent of value or cents per barrel of oil. In the case of gas the tax is a straight 4 percent of value. The tax on oil is on a graduated scale as follows: For the first 300 barrels per day produced by a well in a month, no tax; for the next 200 barrels, 4 percent of value or 13.5¢ per barrel;

the next 700, 6 percent or 20.25¢; the next 500, 9 percent or 30.38¢; the next 2,000, 11 percent or 37.13¢; over 3,500, 14 percent or 47.25¢. The cents per barrel figures escalate based on changes in the wholesale price index for crude oil from and after December 1973. If a well produces 10,000 barrels per day in a month, the composite rate would be 12.25 percent and the cents per barrel would be 41.346¢.

PROPERTY TAX

Existing Law

The present law provides for a 20-mill tax based on an assessed value equal to full and true value of the property. With respect to production facilities, the fair and true value is defined as actual cost during construction and thereafter as replacement cost less depreciation based on the economic life of proven reserves.

Full and true value of the pipeline is defined as cost during construction and then shall be determined with due regard to the economic value based on the estimated life of the proven reserves deliverable to the pipeline. However, if such reserves indicate an economic life materially shorter than the physical life of the pipeline, the full and true value is the actual cost reduced by straight-line depreciation over the life of the reserves. Under the law, the terms "actual cost" and "replacement cost" do not include capitalized interest or intangible drilling costs.

Administration's Proposal

The Administration proposes no basic change in the law with respect to production facilities. With respect to pipelines, the provision cited in the second to the last sentence above has been deleted. The law would

simply now say that the assessed value shall be "determined with due regard to the economic life of the property based on the estimated life of the reserves deliverable to the pipeline."

The property tax would apply to refineries and gas plants not now subject to tax. The basis would be replacement cost less depreciation based on the useful life of the property. It would also apply the tax to the tankers coming in to pick up oil at Valdez. This would be based on replacement cost less depreciation based on the useful life of the property. And based on the number of days the tankers spent in Alaskan ports compared to the total number of days the tankers spent in ports everywhere.

Legislature's Proposal

To our knowledge the Legislature has made no proposal with respect to property tax.

INCOME TAX

Existing Law

Practically speaking, under the existing law of Alaska, the income tax rate is applied to a portion of federal taxable income allocated to the State of Alaska under a three-part formula involving sales, payroll, and property.

Administration's Proposal

The Administration's proposal would apply to any company whose gross receipts exceed \$250 million, 50 percent or more of which comes from one or more aspects of the oil and gas business. The taxable income of a company, part of which would be allocated to Alaska, would be the greater of taxable income as now computed or financial income before deduction of

any taxes based on income. The portion attributable to Alaska would be again determined by a three-part formula involving factors for property, payroll and extraction with extraction replacing the sales factor which is now used. The extraction factor would be the ratio, in terms of BTU's, of the oil and gas production of a company within the State of Alaska to such production everywhere.

Legislature's Proposal

The Legislature proposes separate accounting with respect to income tax. With respect to most oil companies operating in Alaska, their total taxable income in Alaska would consist of a combination of taxable income from oil and gas production, from oil and gas pipelining operations, and from other operations. The taxable income from oil and gas production would consist of the wellhead value of such production reduced by royalty, severance tax, property tax, operating costs, depreciation, interest, and exploration expenses.

Under this formula, depreciation would include a write-off of capitalized interest, less acquisition payments and property taxes which were incurred prior to the commencement of production. The interest would be interest not capitalized, allocated to the property based on the following formula: total interest times a fraction, the numerator of which is the book value of the field's fixed assets, defined by the book value of the fixed assets in the entire company.

The taxable income from oil pipeline operations would be calculated at 8 percent of the ICC valuation. In the case of gas pipelines the taxable income would be determined in accordance with FPC procedures as far as

interstate pipelines are concerned, and in accordance with the Alaska Public Utility Commission as far as intrastate lines are concerned.

The taxable income from all other activities would be the corporation's consolidated taxable income, minus the taxable income for oil and gas production and for oil and gas pipelines as outlined above, allocated to Alaska on the three-part formula.

NET PROCEEDS TAX

Existing Law

No such tax.

Administration's Proposal

None proposed.

Legislature's Proposal

There has been proposed an ad valorem tax based on income at income tax rates. The basis for the tax would be gross value minus certain deductions specified in the law. The gross value would be computed either at the wellhead or at some other point chosen by the Department of Revenue. There would be deducted from gross value royalties, transportation costs (if the valuation point is beyond the wellhead), operating costs incurred in the State, operating costs incurred outside the State or in lieu thereof 5 percent of expenses incurred in the State, taxes, depreciation, and geological and geophysical costs in areas outside the area of production. This latter item could be carried forward for ten years and may be included as an expense at no more than 20 percent per year. Income from operations other than production would continue to be taxed under the existing income tax law.

Part 2 - Results of Calculations

The results of our calculations are shown on attached Tables A through E. Tables A, B, and C show the amounts of each type of tax that will be paid each year from 1977 through 1986, under existing laws, the Administration's proposals and the Legislature's proposals, respectively. All of the figures are based on an oil price of \$13 00/barrel in California and are in constant dollars. We have not shown the reserves tax to be collected in 1977 nor the impact of the future credits against severance taxes, because our purpose here was to show the impact of on-going taxes. As a consequence of this, it will be noted that the figures for the existing laws shown in Table A are slightly different from those on Table 2-A of Sohio Submission One, which covered basically the same tax situation.

Tables D, E, and F compare the total of taxes estimated to be received by Alaska during 1977 through 1986 with those that would be received if Alaska had the tax structure of Texas, Louisiana, or California, respectively. They are, therefore, somewhat similar to the tables appended to Sohio Submission Three but in addition include comparisons of the total taxes under existing laws, the Administration's proposals and the Legislature's proposals.

Of particular note on Tables A, B, and C is the second line of numbers from the bottom entitled "Effective Composite State Income Tax Rate on Total Taxable Earnings." This is the composite income tax rate paid to all states by the three companies. It ranges from 6 percent under existing laws to 12 percent under the Administration's proposal and 15 percent under the Legislature's proposals. We found that calculating this composite rate was a difficult and imprecise task. But in any event, the 6 percent,

12 percent, and 15 percent were all calculated using similar procedures with respect to all states with the exception of Alaska. Therefore, the increase in these rates highlights the impact of the Administration's and the Legislature's proposals. If Alaska should move away from the three-factor formula now provided for in its law and in the laws of most states the duplication of taxes becomes obvious.

Tables D, E, and F indicate that, as a consequence of the Prudhoe Bay field and TAPS, Alaska will collect \$5.5 billion from 1977 - 1986 under its present tax laws from the three hypothetical companies. This is 176 percent of what it would collect under the tax structure of Texas; about the same as it would collect under the structure of Louisiana; and a little more (111 percent) of what it would receive under the tax structure of California. Figures in millions of dollars are:

	<u>If Alaska had the taxes of:</u>			
	<u>(Millions)</u>			
	<u>Alaska</u>	<u>Texas</u>	<u>Louisiana</u>	<u>California</u>
Severance Tax	\$2,688	\$1,649	\$4,466	\$ 0
Ad Valorem Tax	2,038	1,459	684	4,202
Income Tax	<u>753</u>	<u>0</u>	<u>382</u>	<u>728</u>
Total	\$5,479	\$3,108	\$5,532	\$4,930
Alaska as a percent of the other states		176%	99%	111%

If we assume the Administration's tax proposals are enacted, we note from the following table that the tax income of Alaska will increase about \$2 billion over what it would be under the existing tax structure for a

total of \$7.5 billion. We note further Alaska's tax income would be from 1-1/3 to almost 2-1/2 of what it would be under the laws of the other three states.

	<u>If Alaska had the taxes of:</u> (Millions)			
	<u>Alaska</u>	<u>Texas</u>	<u>Louisiana</u>	<u>California</u>
Severance Tax	\$3,283	\$1,649	\$4,466	\$ 0
Ad Valorem Tax	2,582	1,459	684	4,202
Income Tax	<u>1,591</u>	<u>0</u>	<u>382</u>	<u>728</u>
Total	\$7,456	\$3,108	\$5,532	\$4,930
Alaska as a percent of the other states		240%	135%	151%

If the Legislature's proposed tax bills are enacted, we note that the tax income will go to \$9 billion for 1977 to 1986. This would be three times as much as Alaska would collect under Texas law, over 1-1/2 times as much as under Louisiana law, or almost twice as much as under California law. Furthermore, we note that if the Net Proceeds bill were passed, the State would collect another \$90 million during this time.

	<u>If Alaska had the taxes of:</u> (Millions)			
	<u>Alaska</u>	<u>Texas</u>	<u>Louisiana</u>	<u>California</u>
Severance Tax	\$4,219	\$1,649	\$4,466	\$ 0
Ad Valorem Tax	2,038	1,459	684	4,202
Income Tax	<u>2,774</u>	<u>0</u>	<u>382</u>	<u>728</u>
Total	\$9,031	\$3,108	\$5,532	\$4,930
Alaska as a percent of the other states		291%	163%	183%

It should be noted again that all of these figures assume a constant price of \$13.00 for oil. We believe that in making some of its estimates of income, outgo, and fund balances the State of Alaska assumed some increase in the price of oil over the years. Comparisons of numbers should be made with this point in mind.

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March 22, 1977

**HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
REVENUE TO ALASKA AND OTHER STATES IF OIL SELLS FOR \$13.00/BBL. IN CALIFORNIA UNDER EXISTING TAX LAWS
(All Amounts in Millions of Constant 1976 Dollars)**

TABLE A

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
<u>Alaskan State Income Tax Paid By:</u>										
A-California Marketing and Refining Company	\$ 6.9	\$ 23.2	\$ 30.8	\$ 31.4	\$ 32.0	\$ 32.6	\$ 33.9	\$ 35.0	\$ 35.7	\$ 33.9
B-Large Integrated Domestic Company	10.1	18.8	22.8	23.4	23.9	24.6	25.6	26.6	27.2	26.3
C-Major International Company	12.9	19.4	22.2	22.8	23.4	24.0	24.9	26.0	26.6	25.9
Alaskan State Income Tax Revenue	<u>\$ 29.9</u>	<u>\$ 61.4</u>	<u>\$ 75.8</u>	<u>\$ 77.6</u>	<u>\$ 79.3</u>	<u>\$ 81.2</u>	<u>\$ 84.4</u>	<u>\$ 87.6</u>	<u>\$ 89.5</u>	<u>\$ 86.1</u>
<u>Alaskan State Revenue Other Than Income Tax*</u>										
Royalty to State of Alaska	\$ 128.3	\$ 401.6	\$ 549.6	\$ 556.4	\$ 563.2	\$ 570.1	\$ 554.3	\$ 543.4	\$ 548.2	\$ 500.1
Alaskan State Severance Tax	82.5	220.7	298.9	302.6	306.3	310.1	301.1	295.6	298.2	272.0
Alaskan State Ad Valorem Tax	190.0	208.2	219.5	215.6	211.4	206.8	203.6	202.9	196.1	184.0
Non-Income Tax Subtotal	<u>\$ 400.8</u>	<u>\$ 830.5</u>	<u>\$ 1,068.0</u>	<u>\$ 1,074.6</u>	<u>\$ 1,080.9</u>	<u>\$ 1,087.0</u>	<u>\$ 1,059.0</u>	<u>\$ 1,041.9</u>	<u>\$ 1,042.5</u>	<u>\$ 956.1</u>
<u>Total Alaskan State Revenue</u>	<u>\$ 430.7</u>	<u>\$ 891.9</u>	<u>\$ 1,143.8</u>	<u>\$ 1,152.2</u>	<u>\$ 1,160.2</u>	<u>\$ 1,168.2</u>	<u>\$ 1,143.4</u>	<u>\$ 1,129.5</u>	<u>\$ 1,132.0</u>	<u>\$ 1,042.2</u>
<u>Income Tax Paid to All States By:</u>										
A-California Marketing and Refining Company	\$ 28.7	\$ 91.8	\$ 120.2	\$ 121.6	\$ 123.1	\$ 124.7	\$ 128.4	\$ 131.2	\$ 133.0	\$ 126.5
B-Large Integrated Domestic Company	64.4	112.3	134.3	135.5	136.8	138.0	141.0	143.3	144.9	139.7
C-Major International Company	65.9	94.1	107.1	108.0	109.0	109.8	111.7	113.3	114.3	111.2
Total Income Tax Paid to All States	<u>\$ 159.0</u>	<u>\$ 298.2</u>	<u>\$ 361.6</u>	<u>\$ 365.1</u>	<u>\$ 368.9</u>	<u>\$ 372.5</u>	<u>\$ 381.1</u>	<u>\$ 387.8</u>	<u>\$ 392.2</u>	<u>\$ 377.4</u>
Effective Composite State Income Tax Rate on Total Taxable Earnings	5.2%	5.7%	5.9%	5.9%	5.9%	5.9%	5.9%	5.9%	5.9%	5.9%
Alaskan Income Tax Payments as Percent of Income Tax Payments to All States	18.8%	20.6%	21.0%	21.3%	21.5%	21.8%	22.1%	22.6%	22.8%	22.8%

*Company A, Company B and Company C would each pay one-third of the figures shown in this section.

HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
REVENUE TO ALASKA AND OTHER STATES IF OIL SELLS FOR \$13.00/BBL. IN CALIFORNIA UNDER THE ADMINISTRATION'S TAX PROPOSALS
(All Amounts in Millions of Constant 1976 Dollars)

TABLE B

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Alaskan State Income Tax Paid By:										
A-California Marketing and Refining Company	\$ 31.3	\$ 67.6	\$ 84.5	\$ 84.6	\$ 84.2	\$ 83.9	\$ 84.3	\$ 83.6	\$ 82.1	\$ 76.0
B-Large Integrated Domestic Company	10.3	38.6	48.6	48.9	49.1	49.3	49.8	50.1	49.6	46.1
C-Major International Company	<u>19.3</u>	<u>33.9</u>	<u>40.9</u>	<u>41.4</u>	<u>41.6</u>	<u>42.0</u>	<u>42.6</u>	<u>43.2</u>	<u>43.1</u>	<u>40.7</u>
Alaskan State Income Tax Revenue	<u>\$ 60.9</u>	<u>\$ 140.1</u>	<u>\$ 174.0</u>	<u>\$ 174.9</u>	<u>\$ 174.9</u>	<u>\$ 175.2</u>	<u>\$ 176.7</u>	<u>\$ 176.9</u>	<u>\$ 174.8</u>	<u>\$ 162.8</u>
Alaskan State Revenue Other Than Income Tax*										
Royalty to State of Alaska	\$ 123.4	\$ 395.3	\$ 542.7	\$ 549.6	\$ 556.4	\$ 563.2	\$ 547.5	\$ 536.6	\$ 541.3	\$ 493.1
Alaskan State Severance Tax	99.0	275.1	365.1	370.1	374.7	378.9	369.5	362.1	361.9	326.9
Alaskan State Ad Valorem Tax	<u>254.4</u>	<u>255.5</u>	<u>273.2</u>	<u>269.3</u>	<u>265.1</u>	<u>260.5</u>	<u>257.6</u>	<u>257.1</u>	<u>250.6</u>	<u>239.0</u>
Non-Income Tax Subtotal	<u>\$ 476.8</u>	<u>\$ 925.9</u>	<u>\$ 1,181.0</u>	<u>\$ 1,189.0</u>	<u>\$ 1,196.2</u>	<u>\$ 1,202.6</u>	<u>\$ 1,174.6</u>	<u>\$ 1,155.8</u>	<u>\$ 1,153.8</u>	<u>\$ 1,059.0</u>
Total Alaskan State Revenue	<u>\$ 537.7</u>	<u>\$ 1,066.0</u>	<u>\$ 1,355.0</u>	<u>\$ 1,363.9</u>	<u>\$ 1,371.1</u>	<u>\$ 1,377.8</u>	<u>\$ 1,351.3</u>	<u>\$ 1,332.7</u>	<u>\$ 1,328.6</u>	<u>\$ 1,221.8</u>
Income Tax Paid to All States By:										
A-California Marketing and Refining Company	\$ 51.8	\$ 134.0	\$ 171.4	\$ 172.4	\$ 172.8	\$ 173.4	\$ 176.3	\$ 177.3	\$ 177.1	\$ 166.4
B-Large Integrated Domestic Company	63.6	130.3	158.0	158.8	159.7	160.6	163.1	164.7	165.2	157.6
C-Major International Company	<u>71.8</u>	<u>107.7</u>	<u>124.6</u>	<u>125.4</u>	<u>125.9</u>	<u>126.6</u>	<u>128.2</u>	<u>129.4</u>	<u>129.8</u>	<u>125.0</u>
Total Income Tax Paid to All States	<u>\$ 187.2</u>	<u>\$ 372.0</u>	<u>\$ 454.0</u>	<u>\$ 456.6</u>	<u>\$ 458.4</u>	<u>\$ 460.6</u>	<u>\$ 467.6</u>	<u>\$ 471.4</u>	<u>\$ 472.1</u>	<u>\$ 449.0</u>
Effective Composite State Income Tax Rate on Total Taxable Earnings	6.6%	10.5%	11.8%	11.8%	11.8%	11.8%	11.8%	11.8%	11.8%	11.4%
Alaskan Income Tax Payments as Percent of Income Tax Payments to All States	32.5%	37.7%	38.3%	38.3%	38.2%	38.0%	37.8%	37.5%	37.0%	36.3%

*Company A, Company B and Company C would each pay one-third of the figures shown in this section.

**HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
REVENUE TO ALASKA AND OTHER STATES IF OIL SELLS FOR \$13.00/BBL. IN CALIFORNIA UNDER THE LEGISLATURE'S TAX PROPOSALS
(All Amounts in Millions of Constant 1976 Dollars)**

TABLE C

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
<u>Alaskan State Income Tax Paid By:</u>										
A-California Marketing and Refining Company	\$ 22.3	\$ 76.5	\$ 104.3	\$ 104.5	\$ 104.9	\$ 105.4	\$ 102.9	\$ 100.5	\$ 101.2	\$ 93.7
B-Large Integrated Domestic Company	22.9	78.0	105.8	105.9	106.3	106.7	104.1	101.7	102.2	94.5
C-Major International Company	22.8	78.3	106.1	106.2	106.5	106.9	104.2	101.7	102.3	94.5
Alaskan State Income Tax Revenue	<u>\$ 68.0</u>	<u>\$ 232.8</u>	<u>\$ 316.2</u>	<u>\$ 316.6</u>	<u>\$ 317.7</u>	<u>\$ 319.0</u>	<u>\$ 311.2</u>	<u>\$ 303.9</u>	<u>\$ 305.7</u>	<u>\$ 282.7</u>
<u>Alaskan State Revenue Other Than Income Tax*</u>										
Royalty to State of Alaska	\$ 128.3	\$ 401.6	\$ 549.6	\$ 556.4	\$ 563.2	\$ 570.1	\$ 554.3	\$ 543.4	\$ 548.2	\$ 500.1
Alaskan State Severance Tax	113.9	344.4	471.2	477.1	483.0	488.8	475.4	465.0	470.1	428.9
Alaskan State Ad Valorem Tax	190.0	208.2	219.5	215.6	211.4	206.9	203.6	202.9	196.1	184.0
Non-Income Tax Subtotal	<u>\$ 432.2</u>	<u>\$ 954.2</u>	<u>\$ 1,240.3</u>	<u>\$ 1,249.1</u>	<u>\$ 1,257.6</u>	<u>\$ 1,265.7</u>	<u>\$ 1,233.3</u>	<u>\$ 1,211.3</u>	<u>\$ 1,214.4</u>	<u>\$ 1,113.0</u>
Total Alaskan State Revenue	<u>\$ 500.2</u>	<u>\$ 1,187.0</u>	<u>\$ 1,556.5</u>	<u>\$ 1,565.7</u>	<u>\$ 1,575.3</u>	<u>\$ 1,584.7</u>	<u>\$ 1,544.5</u>	<u>\$ 1,515.2</u>	<u>\$ 1,520.1</u>	<u>\$ 1,395.7</u>
<u>Income Tax Paid to All States By:</u>										
A-California Marketing and Refining Company	\$ 43.3	\$ 142.3	\$ 189.9	\$ 190.9	\$ 192.2	\$ 193.5	\$ 193.6	\$ 193.0	\$ 194.8	\$ 183.0
B-Large Integrated Domestic Company	76.5	169.2	214.1	214.7	215.8	216.8	216.3	215.3	216.7	205.1
C-Major International Company	75.5	151.8	189.3	189.6	190.2	190.9	189.2	187.3	188.4	178.3
Total Income Tax Paid to All States	<u>\$ 195.3</u>	<u>\$ 463.3</u>	<u>\$ 593.3</u>	<u>\$ 595.2</u>	<u>\$ 598.2</u>	<u>\$ 601.2</u>	<u>\$ 599.1</u>	<u>\$ 595.6</u>	<u>\$ 599.9</u>	<u>\$ 566.4</u>
Effective Composite State Income Tax Rate on Total Taxable Earnings	6.8%	13.1%	15.5%	15.5%	15.5%	15.5%	15.3%	15.0%	15.1%	14.5%
Alaskan Income Tax Payments as Percent of Income Tax Payments to All States	34.8%	50.2%	53.3%	53.2%	53.1%	53.1%	51.9%	51.0%	51.0%	49.9%

*Company A, Company B and Company C would each pay one-third of the figures shown in this section.

TABLE D

HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDICE BAY FIELD AND TAPS
 TAX BURDEN UNDER EXISTING AND PROPOSED LAWS OF ALASKA AND THE LAWS OF TEXAS - 1977 THROUGH 1986

*(This hypothetical case assumes oil sells for a constant \$13.00 DBL price
 in California. All figures in millions of constant 1976 dollars.)*

	ALASKA TAXES			TEXAS TAXES	ALASKA TAXES AS PERCENT OF TEXAS TAXES		
	Existing Laws	Administration's Proposals	Legislature's Proposals		Existing Laws	Administration's Proposals	Legislature's Proposals
State Income Tax Paid By:							
Company A - California Marketing and Refining Company	\$ 295.2	\$ 762.1	\$ 916.2	0.0	∞	∞	∞
Company B - Large Integrated Domestic Company	229.4	440.4	928.1	0.0	∞	∞	∞
Company C - Major International Company	220.2	388.7	929.5	0.0	∞	∞	∞
State Income Tax Subtotal	<u>752.0</u>	<u>1,591.2</u>	<u>2,773.8^b</u>	<u>0.0</u>	∞	∞	∞
Other Taxes:^a							
Severance Tax	\$2,688.0	\$3,203.3	\$4,218.8	\$1,648.9	163%	199%	256%
Ad Valorem Tax	<u>2,038.2</u>	<u>2,582.3</u>	<u>2,038.2</u>	<u>1,459.0</u>	140%	177%	140%
Severance and Ad Valorem Tax Subtotal	<u>4,726.2</u>	<u>5,865.6</u>	<u>6,257.0</u>	<u>3,107.9</u>	152%	189%	201%
Total Tax Payments	<u>\$5,479.0</u>	<u>\$7,456.8</u>	<u>\$9,030.8</u>	<u>\$3,107.9</u>	176%	240%	291%

^a Company A, Company B, and Company C would each pay one-third of the figures shown in this section.

^b If the Net Proceeds Tax Bill were passed this amount would increase by \$90 million.

TABLE E

**HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDICE BAY FIELD AND TAPS
TAX BURDEN UNDER EXISTING AND PROPOSED LAWS OF ALASKA AND THE LAWS OF LOUISIANA - 1977 THROUGH 1986**
(This hypothetical case assumes oil sells for a constant \$13.00/BBL. price
in California. All figures in millions of constant 1976 dollars.)

	ALASKA TAXES			LOUISIANA TAXES	ALASKA TAXES AS A PERCENT OF LOUISIANA TAXES		
	Existing Laws	Administration's Proposals	Legislature's Proposals		Existing Laws	Administration's Proposals	Legislature's Proposals
State Income Tax Paid By:							
Company A - California Marketing and Refining Company	\$ 295.2	\$ 762.1	\$ 916.2	\$ 127.4 ^a	232%	598%	719%
Company B - Large Integrated Domestic Company	229.4	440.4	928.1	127.4 ^a	180%	346%	728%
Company C - Major International Company	228.2	388.7	929.5	127.4 ^a	179%	305%	730%
State Income Tax Subtotal	<u>\$ 752.8</u>	<u>\$1,591.2</u>	<u>\$2,773.8^a</u>	<u>\$ 382.2^a</u>	197%	416%	726%
Other Taxes:^b							
Severance Tax	\$2,688.0	\$3,203.3	\$4,218.8	\$4,465.6	60%	74%	94%
Ad Valorem Tax	2,038.2	2,582.3	2,038.2	684.0	290%	378%	298%
Severance and Ad Valorem Tax Subtotal	<u>\$4,726.2</u>	<u>\$5,865.6</u>	<u>\$6,257.0</u>	<u>\$5,149.6</u>	92%	114%	122%
Total Tax Payments	<u>\$5,479.0</u>	<u>\$7,456.8</u>	<u>\$9,030.8</u>	<u>\$5,531.8</u>	99%	135%	163%

^a Even though Louisiana's corporate income tax rate is 4.0%, the State has a 30% depletion allowance and allows deduction of Federal income tax payments prior to the determination of state income tax payments.

^b Company A, Company B, and Company C would each pay one-third of the figures shown in this section.

^c If the Net Proceeds Tax Bill were passed this amount would increase by \$90 million.

TABLE F

HYPOTHETICAL THREE COMPANY OWNERSHIP OF PRUDHOE BAY FIELD AND TAPS
 TAX BURDEN UNDER EXISTING AND PROPOSED LAWS OF ALASKA AND THE LAWS OF CALIFORNIA - 1977 THROUGH 1986
 (This hypothetical case assumes oil sells for a constant \$13.00/BBL. price
 in California. All figures in millions of constant 1976 dollars.)

	ALASKA TAXES			CALIFORNIA TAXES	ALASKA TAXES AS A PERCENT OF CALIFORNIA TAXES		
	Existing Laws	Administration's Proposals	Legislature's Proposals		Existing Laws	Administration's Proposals	Legislature's Proposals
State Income Tax Paid By:							
Company A - California Marketing and Refining Company	\$ 295.2	\$ 762.1	\$ 916.2	\$ 286.6	103%	266%	320%
Company B - Large Integrated Domestic Company	229.4	440.4	928.1	221.6	104%	199%	419%
Company C - Major International Company	228.2	388.7	929.5	219.7	104%	177%	423%
State Income Tax Subtotal	<u>\$ 752.8</u>	<u>\$1,591.2</u>	<u>\$2,773.8^b</u>	<u>\$ 727.9</u>	103%	219%	381%
Other Taxes:^a							
Severance Tax	\$2,688.0	\$3,283.3	\$4,218.8	\$ 0.0	∞	∞	∞
Ad Valorem Tax	<u>2,038.2</u>	<u>2,582.3</u>	<u>2,038.2</u>	<u>4,201.6</u>	49%	61%	49%
Severance and Ad Valorem Tax Subtotal	<u>\$4,726.2</u>	<u>\$5,865.6</u>	<u>\$6,257.0</u>	<u>\$4,201.6</u>	112%	140%	149%
Total Tax Payments	<u>\$5,479.0</u>	<u>\$7,456.8</u>	<u>\$9,030.8</u>	<u>\$4,929.5</u>	111%	151%	183%

^a Company A, Company B, and Company C would each pay one-third of the figures shown in this section.

^b If the Net Proceeds Tax Bill were passed this amount would increase by \$90 million.

HEARINGS ON ALASKAN NORTH SLOPE PRICING AND ENTITLEMENT ISSUES

BEFORE THE FEDERAL ENERGY ADMINISTRATION

Monday, March 21, 1977

Statement of David P. Goodman, Managing Director of
Morgan Stanley & Co. Incorporated

My name is David P. Goodman. I am a Managing Director of Morgan Stanley & Co. Incorporated, investment bankers in New York City. I am a member of the Energy Financial Advisory Committee to the Federal Energy Administration.

In Morgan Stanley's capacity as investment bankers to the Standard Oil Company (Ohio), Exxon Corporation, Mobil Oil Corporation and the British Petroleum Company, Limited, our Firm has arranged during the last two and one-half years over \$5.5 billion of financing for the development of the Prudhoe Bay Field and the Trans Alaska Pipeline System. I have had personal responsibility for over \$5 billion of this financing in a series of ten public offerings and two private placements of \$1,750 million and \$500 million. In the course of these financings, particularly the two private placements which were to finance a portion of Sohio and BP's interests in TAPS (the Trans Alaska Pipeline), I have had in-depth discussions with many major institutional investors regarding the financing of major energy projects.

As a result of these discussions, I have concluded that if the Administration establishes price control or entitlements treatment for Alaskan North Slope crude which does other than allow it to compete in

price with world oil in the United States market, this action will have a serious detrimental impact on investors' willingness to provide financing for the development of future major energy projects, both for petroleum and other energy sources.

I realize that this is a strong statement, but I would like to review with you some of the problems we faced and overcame in financing the North Slope project.

The companies which own the Prudhoe Bay reserves will likely spend \$14 to \$15 billion to develop the 9.6 billion barrels of oil reserves and transportation facilities needed to bring the oil to market. Expenditures of similar magnitude will be required to bring Prudhoe Bay gas reserves to market. Probably in excess of \$9 billion of financing for the oil project has been arranged since the Pipeline Right of Way Act was passed in January 1974, almost \$7 billion through the sale of securities, principally debt, and the balance through bank loans. Although all of the major Prudhoe reserve holders have done extensive financing, I will focus my remarks on Sohio and BP.

Sohio has about 53% of the Prudhoe oil reserves, and Sohio and BP will spend almost \$7.5 billion on the project, of which Sohio's share is \$6 billion. Since Sohio's non-North Slope assets are only about one-third of this amount, the bulk of these funds have been raised externally.

The most important financing steps for Sohio and BP were two

private placements for their TAPS affiliates, one of \$1,750 million arranged in the spring and summer of 1975 and one of \$500 million arranged in the summer of 1976. Seventy-seven institutional investors, including almost all of the major life insurance companies and public pension funds, savings banks and many private pension funds administered by trust banks, participated in these transactions. The loans represent the largest single investment for many of these investors.

In selling a private placement of this type, Morgan Stanley, as agent, prepares an extensive offering memorandum and sits down with the institutional investors to explain the project in great detail and answers any questions they have. It was through these discussions that we became aware of the concerns of investors which led to my previous conclusion. There were a number of risks that lenders sought assurance on: that the oil was there, that the pipeline and terminal would work, that there would be a ready market for the oil. The lenders obviously required a detailed economic analysis of the project, particularly since costs continued to escalate at an alarming rate during the construction period. We were able to demonstrate the continued financial viability of the project because during the same period world oil prices also increased dramatically. But Prudhoe oil is expensive oil, with development costs on the order of magnitude of \$12,500 per barrel per day.

Obviously, we were able to answer most questions these investors had since the Sohio/BP financings were by far the largest ever accomplished.

But there was one risk which we were unable to eliminate in the minds of certain major, sophisticated investors, and they declined to participate in the financing partly because of it. That risk was that the government would not permit Alaskan North Slope crude oil to compete with world oil in the market place, but would place restrictions on its price such as are currently under consideration. We cited the language of, and the legislative history behind, Section 8(g) of the EPAA which clearly contemplated that the President should consider special treatment for Alaskan North Slope crude to assure that its well-head price was high enough to provide incentive for future North Slope development. We pointed out the words of the law directing the President to exclude Alaskan North Slope crude from the composite price if the inclusion of high-priced Alaskan North Slope crude would lower the price for other upper-tier crude in the United States. Clearly the entitlements program was, in the words of the FEA, "designed to approximately equalize the cost of crude oil purchases" among refiners, and was never conceived of as a price control mechanism for crude oil. Yet the uncertainty of the prospect of these very proceedings here today was enough to cause important lenders not to participate in the most important energy project this country has ever seen. That is why my Firm feels strongly that unfavorable treatment for Alaskan North Slope crude will adversely affect the ability of industry to finance future energy projects. The prospect of a political decision in these hearings caused major investors to

eschew TAPS. Alaskan North Slope crude is new oil -- treat it as no worse than upper-tier oil at the well-head. Alaskan North Slope crude is very high-cost oil. Allow it to compete with world oil in the market place on the same basis as stripper oil, without detriment from the entitlements program.

These hearings are also investigating the risk elements of North Slope development and the appropriate rate of return for this project. Both of these subjects were obviously matters of great interest to investors. This project is one of the riskiest ever undertaken by industry. The important risks aren't those cited in the Mortada study. The cost of exploration before the Prudhoe Bay discovery well is ^{compared} insignificant with the risk undertaken by the industry in going ahead with the project under the Pipeline Right of Way Act. The participants were committed to complete the project no matter what the cost in the face of absolute federal and state controls over construction. Remember that this project had been delayed over four years by court intervention and government redesign. Compliance with these actions had already more than doubled costs. Yet the industry was forced to accept a set of stipulations far more exacting than any ever applied to such construction before, stipulations that many in the industry were concerned about being physically able to comply with, and to proceed with absolute authority vested in one man to halt construction or require design changes that could cause costs to sky-rocket with no accountability for cost effectiveness. The industry undertook these absolute obligations, and cost did

rise to the point where, if Alaskan North Slope crude is allowed to compete against world oil, the Mortada study and industry figures indicate that the project will earn a discounted return in the area of 14% to 16%.

Mortada states that a return of 12% should be equitable. There may be some analogy to the returns allowed to regulated industries in Mortada's thinking, although even higher returns are allowed in risky start-up ventures there. But regulated returns involve an exclusive franchise wherein subsequent rate regulation assures such a return. No one is assuring the price of Alaskan or world oil.

If we had projected a 12% return from the outset, I'm not sure that the project could have been financed. It is our experience that oil companies will not undertake a project involving any significant risk for a projected return of under 15%. The industry will earn returns of approximately 22% in the British North Sea, where they have experienced retroactive majority participation by British government. Financial institutions which invest in the equity of the leased tankers for the Valdez trade will earn a discounted after-tax return in excess of 15%, even though these financings are backed by "hell-or-high water," all-events charters from the oil companies. Based on these facts, I cannot accept that a 12% return is equitable for a project of the magnitude and riskiness of the North Slope project.

Gentlemen. The aggregate earnings from the North Slope will be

very large. It is one of, if not the largest oil field ever found outside of the Middle East. But the costs are high and the rate of return will be modest, particularly bearing in mind the risk. If you want industry to be able to finance the development of major energy discoveries this country so sorely needs, particularly the smaller companies you want to favor in your CCS leasing policies, do not make the wrong decision in pricing Alaskan North Slope crude oil. It is critical with regard to establishing an over-all energy policy, of which the issue of pricing Alaskan North Slope crude oil can be looked on as an important first step, to retaining the willingness of the private sector to provide financing of future energy projects.

Thank you.

QUESTIONS AND ANSWERS
RICHARD DONALDSON - SOHIO
March 24, 1977

SENATOR COLLETTA - Dick, referring to Page 30, your statement on utterly inconsistent factor of the State urging major economic incentives before FEA in these taxing proposals before us gets subjective opinion to how damaging those would be in decision by FEA?

RICHARD DONALDSON - There are several parts, I guess, in answer to that Senator Colletta. We have been working the FEA question in Washington for about two months, calling on various members of the staff, talking with Mr. O'Leary himself, _____ we've talked with James Schlessinger on several occasions. We have called on members of Congress, chairmen of committees and their staff, generally trying to lay the foundation on kinds of things you think they ought to be talking about, focusing on this maximum incentive. The first part of the answer, I guess, is you begin to get a feel of where the balance is, and what additional help can mean in striking a balance so that the answer hopefully comes out of the maximum price possible under law for Alaskan crude. In the course of this work, we have encouraged others, not just in our industry, but who rely on energy in various ways to study it, reach their own conclusions and express their opinions to the government on this. They are doing so. I was just delighted to see Alaska as a State government:

beginning to participate in this. You don't know how important it is to have not just another oil company coming in in a sovereign state, representing people. It puts a different element into the balance for which there is no substitute, and quality of advocacy that Alaska has been bringing to this, I felt it very good. My testimony reflected that. We have not yet gotten into the conference where the political questions of consumerism, a something for nothing kind of price will be raised. A pretty good record has been made so far in hearings in Washington, San Francisco, and in Anchorage, and I'm very concerned that we lose the essence of Alaskan advocacy that is an important thing in this bounds. It could be lost if, for example, the State appeared disinterested. It could be substantially reduced if somebody in Washington said "hay, you guys are down here arguing for the best price, but you're taking away at home". If you want to put it bluntly, why should the rest of the consumers in the lower '48 simply raise prices so you can raise taxes. The inconsistency of the position undermines the position as an advocate _____ State brings to this right now. I'm probably remiss in not reporting to you the fact that, and I don't mean this in a critical way, that there is a feeling in Washington that Alaska always wants some special treatment, and anything that doesn't stimulate that reaction that can temper judgement the wrong way ought to be avoided. So when you boil it all down, Senator Colletta, I think we need as an industry, and the State needs

in its own interests, as many positive advocates down there right now as we can. The FEA is going to make its decision, the President may make his recommendations toward the end of May or the early part of June that seems to be where they're pointing, so the next couple of months are pretty critical. I can't guarantee that I'm right. We're in the trenches on this and following it very very closely, and we need all the help we can. In this one, our interests simply are not enough. My suggestions in this testimony is intended as a friendly one. The State of Alaska gives up nothing in its sovereignty by deferring judgement on major tax questions now. I think some of them deserve more study, but I don't think you lose anything by saying we will come back to it next year and we will be cross-examining you, and we expect you to be responsive SOHIO, but I think it's a bad choice of tactics to ignore what is the big issues now for all of us, FEA pricing, and run down this, what is an important trail, but a side trail a long way from the main issue. That's a long response and I guess I'm only communicating feeling. For whatever it's worth I believe that's where we are.

SENATOR COLLETTA - During the gas hearings, Judge Litts decision came to the floor by a gentleman who gave extensive comprehensive testimony on interpretation of what that man was saying, and the _____ of what he was saying in this one

interpretation was that the credibility of Alaska is so laced with greed that whatever we do is just suspect, and what I want you to tell me is that I can gather from what you're saying on Page 30 here, if you perceive this attitude as far as oil is concerned why these people are going to make a decision is Alaska projecting an image of total greed?

RICHARD DONALDSON - I don't think dealing with issues like this at the National level, the State should feel apologetic. Obviously, someone who is a cynic can give it a translation of greed, but you could present the same position in a much more acceptable way which I think is much more honest in the responsibility of State government, and I'm not trying to pretend I'm the State Governor, but let me express it this way. The State of Alaska is made up of people who live here, who are doing many things. Some of them work for the Governor. Most of them, maybe 75% of them work in the private sector so called of businesses or maybe they're just employed there. Almost all of those in the private sector one way or another directly or indirectly have the success of their business in part, maybe a large part, and the success of their remaining employed dependent on the resource development here, because it is your biggest industry and we're proud to be a part of it. Now what you're saying in Washington to me doesn't come across as greed. What you're saying is "look, in terms of the interests of the people in our State, we want to keep

our businesses relatively profitable. We want to do it over many years, and we recognize that a key thing in that is having a continued resource development, not tearing up the State, but in a planned way that goes forward on a continuing basis that keeps things humming, so men here of the FEA, we've come to Washington to tell you that we're concerned about people in Alaska who need to be employed, and we know that to do that, you have to have some incentive on oil and gas prices in the _____ that will permit this activity to move forward. The second thing you can say without any apologies, if you look at the resource potential in Alaska, and what it contributes potentially is the whole country's needs in terms of energy, but we have a very responsible part to play, and that can't be done unless you have a fairly high incentive in the terms of the price decision which you have to make. So yes, there's an element of self interest, but it's all of our self-interests for people in the lower '48, people in the private sector who incidentally over the long haul bringing revenues into a state government provide the services that people need. I don't think you have to make any apologies for that. That is kind of how I would do it if I were representing the State, and that's the essence of what the Governor, the Commissioner of Revenue, Senator Stevens has been saying. I think that they would be a little more persuasive even though they have been good, if they talked a little more

about the private sector, and the concern for that here in Alaska. Most of you have lived or worked in the private sector before you put on your legislative hats. This is so, and I think arguing that and urging that, and saying it's important leaves you nothing to apologize for.

REPRESENTATIVE ELIASON - Dick, somewhere earlier in your presentation, you were tying in the surplusses and the needs of revenue relationship to extraction taxes. Now, I can relate the need for on-going programs to cover the services of the people in a relationship to income taxes and property taxes, but would you elaborate how surplusses or the need of income relates to a one time non-renewable resource and extraction tax?

RICHARD DONALDSON - Right now, I'm working on a committee that is a part of the National Petroleum Council in Washington. It's an interesting committee to work on because it's made up of members of our industry, members of organized labor, environmentalists, consumers, professors from academia, people in government. To try to get all those people around one table and agree on something like a national energy policy is what the committee is supposed to be doing, and we've made some interesting progress, and one of the things that we had been wrestling with at first, and it's responsive to your question,

is how do you treat something that seems finite. In other words shouldn't you take more because it is finite. That's really your question _____, and to pull two things out of all those weeks of discussion might be of interest to you and will help. The first is our ability to underestimate our energy reserves of all kinds has always been infinite, and what has happened is we have looked harder, brought better technology, new horizons on-shore, off-shore. We have kept pushing out the finite of what we know exists in energy supplies. I have a 1916 article from a magazine in my files, kind of a collectors piece that absolutely predicted that in 1925 we were going to run out of oil and gas, and no question about it, it had the figures, it had dates, it had a projection. You know, you can read that same article today, and all you've got to do is change the dates, and numbers and a couple names. Now, in a sense, fossil fuels have a finite quality, but I have to tell you that what we know may be very limited, our horizons are in close. The history of our industry is keeping and pushing those horizons out, so part of the answer to your question is let's don't assume today to know everything that's there because the history of our whole industry _____.

The second thing that's important to it, there is a dual responsibility of government, if you don't mind putting it that way. On the one hand, you have to raise sufficient revenues from businesses and citizens where you are responsible to pay for the services they need, and you can bank some ahead,

and you are fortunate today if you can do it, but you have another responsibility and it's not to be so over-reaching, if you will, in the running of a government that you put a total chill, or a substantial chill, on the private sector because most people out there are in it for a living, and paying the taxes too, and so what you have is a very tough problem in government, and I don't envy you for a minute, of trying to hit some kind of a balance between government, taxes, and stimulation of the private sector so that it runs on its own, and that's exactly what we've got here. What I was trying to reach here, and probably didn't do it too well was saying you've done a good job in covering your future revenue needs. You're bills are paid for a couple of decades, there's no question about it, and I think there's time here needed to say what about the other side? What about the private sector? Where is the bounds? And, it's suggesting that you think about this policy and how it effects the private sector. I'm saying it kind of meshes in with the two problems that we have here in Alaska today that are the big ones. The FEA pricing decision is one, and this policy balance is the other. My whole testimony, when you boil it down simply says one thing, let's all work on the pricing problem with FEA this year, if you will until that's solved, and meanwhile so we don't prejudice that, let's take this policy question head on and try to answer that. Then you see how the two blend and you can go forward on both simultaneously

without prejudicing either one.

REPRESENTATIVE ELIASON - I guess what you're really saying then is that we're morally right in charging an increased tax upon a non-renewable resource, and extraction tax compared to an ordinary property tax or income tax approach?

RICHARD DONALDSON - All I'm suggesting is, and I don't know what the right numbers are, the laws help somewhat, the economics help sort it out somewhat, but the real point of focus, if you're going to do a good job, is to remember you've got a public sector and a private sector in the State, and overhanging the whole thing right now is this Federal Energy Administration question.

I have come today to be as frank as I can because we're trying to work on both, and I can't do anything less than tell you where we are and what we're worried about.

REPRESENTATIVE ELIASON - Of course, we really don't know what our future incomes are going to be either, and you're saying we have our bills paid for a number of years down the road, but we really don't know that particular point until the FEA makes that determination.

RICHARD DONALDSON - I don't either, and yet every study that I have seen shows very substantial surplusses in your treasury in the mid '80's, and the only question is how big they are, not whether they will be there. So directionally what you're saying is we've got a great piece of life insurance out there ahead of us. Maybe we should take a few months, or most of the year and sort out these other questions so we don't lose anything by taking the time.

SENATOR RADER - Madam Chairman, following along the same line as Representative Eliason, and in fact, I think it's exactly the same point, the Governor in his State of the State message to the legislature, and I think also in his budget message, spoke of a general policy which would involve the argument that the State has in trust these non-renewable resources such as oil, and that all of the revenue, at least 25% which is our permanent fund referendum, but he urges that 100% of the revenue which comes from royalty be saved and set aside and not used for the ongoing purposes of government, and that we impose taxes to handle which you consider to be our normal ongoing needs. You're a lawyer, I'm a lawyer, so lawyers would say we have the trust and he's arguing that the corpus of the trust, the body of the trust to be preserved, and that for the State to carry on its day to day activities, it must have the tax proposals that he has suggested in order to balance his budget. Now, if you adopt the Governor's argument

I suspect that the tax proposals that he's suggested may be correct that you'd have to have those to balance the budget. I don't know that that's the case, but at least he's said that that's the case. Do you, and I think this is exactly the same question as Mr. Eliason is addressing himself to, to what extent do we have an obligation to not invade the the corpus, so to speak? To what extent do you think we should raise taxes if we are going to completely keep the corpus in trust? How do you meet that argument?

RICHARD DONALDSON - Let me give you an example. Let me take myself and the way the finances of my family run. Some of the income on our family comes from my salary, some of it comes from investments, not too many that I have made, dividends, maybe a little appreciation on it, some comes from interest on my savings account, but it comes in at an overall flow, so to speak, in the family treasury. Now, I haven't made any decisions that I can stand with very long for the whole future of the rest of my life, I'm only going to bank my interest in dividends and not spend it if there's some other need. Sometimes, I have to dip into that where there's situations in the family. Sometimes I can put a little of the salary away too, and I stay flexible on that. Now, let's translate that into the State if it is translatable. The State has income strains from several sources. Many sources actually, but we will say basically to the tax and royalty. In a sense it's nice to put some by for problems that you can't foresee

now that the State will have. The idea of having a kind of permanent fund, particularly if it's used as a development type fund for sources and capital that wouldn't otherwise be available. It's a very good thing. Let me digress just a moment as an example. Suppose there had been a big copper strike somewhere up in the center part of the State, and it's a commercial load, and there's no transportation there and there's no town, but industry said, we'd like to come in and develop that, but put stipulations and requirements on. It would be a nice thing to have a fund that would say, well, industry normally puts in the mines, the processing facilities, and if they can get at the tide water they'd have to come up with the ships and take it from there, but maybe a fund that could establish a town and transportation systems and maybe even port facilities, the kind of thing that this permanent fund, just like you have some reserved in your own savings account can take up. On the other hand, if I draw too much out of my business and destroy the business or make it less profitable, I'm hurting my family too, aren't I? So the State has a balancing job at the other side. If it tries to draw too much into the savings account and destroys the general flow of income from oil and gas, maybe it hasn't made the best decision in managing those funds. So in a sense, the state's no different from my family. You've got to check the flow coming in and the flow going out, and be able to

adjust somewhat from time to time if you're going to run it intelligently. In answer to your question specifically, the idea of some kind of a permanent fund is a development resource for the State, not to help us necessarily, but other Alaskan's participating in that. I have no idea personally what the right size is, except that I would want to stay flexible if I were running it for my own family. On the other side, I don't want to prejudice the income. You see, that's the other question. If you set it all aside to the permanent fund, you may be very comfortable about those fat balances, but if there's no future out there, in ten years or fifteen because it's been discouraged, has it been the right decision? This is why I think, John, that we need to take a look at it.

SENATOR RADER - Alright, then that brings us to the next question. Should we, I note that Mr. Tanzer for example, compares our situation with tax loads that have been imposed by other governments, places where the oil industry has been nationalized in some places and so on and so forth. Your comparisons are primarily to other states. You did mention the North Sea situation, I think, a little bit, but in thinking of our own terms in terms of the future of an oil industry in Alaska, to what extent should we consider the international method of taxation or exappropriation or whatever might be the situation?

RICHARD DONALDSON - Well, I guess there are three questions that you have rolled into one. First we have considered Alaska versus other states because all states are subject to the same federal body of tax law that simply simplifies the presentation. There's no intention to mis-lead. Secondly, when you compare other country's situations what you are really doing is comparing the total tax burden in other countries, and sometimes they have only one government, not several levels, and you add up whatever they have, and if you compare that, and compare it with what we have which is the sum of federal, State and local, in doing that kind of comparison, we've done some work on that and Ken Schowlater can get it for the committee if you'd like to have it, what you find is that the total tax burden in the United States of Federal tax law, Alaskan tax law, and local tax law is very comparable to the burdens that you find in these other countries that Dr. Tanzer likes to refer to. The third thing, you can look at any kind of tax mechanism to raise revenue, and the ingenuity on that, you know it's really only limited by the time that somebody has thought of that you can research, but the key question is less the mechanics than the total burden, and if the burden becomes such that you tone down the economic activity that you also want, obviously, it's the burden that's the key to watch, not the mechanics. There's an interesting article as an editorial in the Anchorage paper last night talking about Indonesia. They over-reached, the industry shutdown. They tried to come back, and I guess those negotiations have fallen

off again. There isn't anything magic in saying well this is what they're doing someplace else in the world. What you really have to look at is the economics of the situation, and does it stimulate the activity you want? I don't know what's right or wrong, but I know the economics is worth it where it's all sorted out. You might say we'd have one tax in Alaska, not fifteen or three or four, and one tax generates the revenue and provides the economic activity, fine. What is the problem though in most state activity is that there is the need in other states, a terrible need for revenue. They don't have enough to run schools and things. You're fortunate here, so they keep looking for different kinds of taxes, and playing the game because it's a different tax, maybe nobody will mind, but here when you're doing planning of an economic nature for the state's longrun, I think it's incumbent upon you to look at the whole scene, all the taxes and the burden, and do the kind of comparative stuff that we try to do for you. If you do your own, you won't come out with any different numbers, though maybe you'll accept it.

SENATOR RADER - Just one more question if I might, Madam Chairman. One of the goals of the Governor's package was to capture some of the impact and activity from the Outer-continental Shelf development, the franchise tax is, I think, what he called it. Address yourself to that problem. I suppose you wouldn't care if you had a franchise tax that didn't change the total burden, and also include the Outer-continental Shelf.

As again, you're saying it's not the mechanics, it's the burden that you're worried about.

RICHARD DONALDSON - It's kind of a hard question to answer. You get into kind of a speculative area that you're just not sure where you are. Let me try this Senator. When you go into an area for resource development, as a company what you're looking at is the potential there for development, the costs and investments you have to throw at it, and you look at tax burdens and whatever it's called charges, franchise tax, or whatever, you do look at that. You also look at how many winners and losers you might expect in drilling holes here and there. You make some judgment, probably imperfect because there's much you still don't know whether it's worth the risk against other places. In this area of OCS development of what burdens should be assumed for impact for example on the coastal lands you tend to support this. You get some very tough questions, at least three that come to mind that you ought to sort out. Whatever it is, I suspect any industry that goes in there, they expect to pay a share of that impact cost. Maybe a little more than a fair share, that also seems to be the pattern, but they also have the option of not to go, and how that gets traded out many times is a matter of negotiation. I think there is a problem however of asking somebody to come in. You say, we want you to pay on day 1 what we will guess the total impact cost to be over the whole

life of your project. In the first place, that's not discounted for the time in the future when the impact will occur. There's no _____ economically in that advance payment. The second point is, suppose you're calculation of the advance is wrong. You don't find anything. You don't have any large development. You have a large string of dry holes. You've put a premium or a penalty if you will going in that would discourage a lot of people, and I think the answer, and this is only personal, not our company view, what you need is a system to say you've got a fair business cost, just like you pay your fuel bill or hire a guy to run a cat for this type of impact. I'd say it would be difficult for a company to say well, that's not right, that's fair, that is a business cost. But then you come to the second phase that says what's fair, and you say well, we had so many people coming in, we need so much land, we will pay these taxes, and then you have other service industries come in to support that. They too have a share of that impact cost, so you need a system that kind of allocates that over the whole thing. We've got a lot to learn in this area, and I suspect all of us will spend a good deal of time, but again you run the risk of making a mistake of trying to do something well and guessing wrong, and deterring other things that you really want to happen. I hope that's helpful.

SENATOR COLLETTA - On page 2, you were excited about the Governor's policy objectives on any new tax, Dick, and you enumerated the

five points that he made. Would it be fair to ask in the proposals that are before us, how many of these points do they fall short of?

RICHARD DONALDSON - You don't have any easier questions, you'd rather I'd answer do you? Alright lets take a flier at it. I think it's a fair question. Item one, sufficient revenues to compensate the State for additional service costs pending such development. Let me pause right here, I'll come to the dividend part in just a moment. If any of the forecasts of future revenues from lets say Prudhoe Bay or the pipeline are valid, over the next three years we will be paying from 75% to 120% of the State's total budget. It seems to me that that first standard is well covered just by one project. I'm not saying that you don't want more, but at least in terms of covering your costs, we're probably more on payment, and I'm not saying that to be argumentative. In terms of dividends, I don't know what the Governor had in mind, what he's saying is we'd like to bank a little bit for the future. What you do say is if you have that surplus, maybe it's eight and a half million dollars in the mid 80's I don't know. There's at least a suggestion that the dividend is being paid. Maybe it's not enough, but this is one of the areas that you would have to discuss. I can't say it's short, but there's at least a good down payment on it and maybe some area for discussion. That's really the hardest part of the answer. Point two - I'm not sure that any consideration has been given to the

profits to investors to keep them _____, and back later on in the paper where I was quoting the stuff from Morgan Stanley and the cost of business here, there is at least a first offering on the subject, not enough consideration has been given to that. Perhaps we ought to have some discussion and we are all interested in having that go forward. Point three - We must be reasonably responsive to the National and world economic trends of the time. Things that come to mind when you read that is the cost of energy on a BTU basis that is going up all over the world, and the need to generate supplies of energy of all kinds, particularly domestically here in the United States to try to meet more of those here at home so that we're not at the mercy of the foreign cartel. I think Alaska at least at the moment is responsive to this because it is just about to contribute to the United States energy supply, the oil flow from Prudhoe Bay, and nobody can say that that's small. On the other hand, as far as future participation, there hasn't really been much movement in the State in the last three years to significantly encourage future contributions, and you know the lead time is long. We hope for a Beaufort Sea lease, we hope for a Gulf of Alaska, and I think that needs to be dusted off and you would probably comply with that, if compliance is the question, by moving ahead on those things. The FEA question, you see, your participation in that, I think is being responsive to National need because if you get a higher price and stimulate this development, you see, you've got a part of that and

that's another place that I've tried to encourage you to do it. Nondiscrimination on the basis of ownership - well here I guess our industry feels like that wonderful line from Fiddler on the Roof. Remember when Tevia the father was standing out on the road, he looked up at the heavens and said "Lord, it's nice to be the chosen people, but do you have to do this every time"? I'm sorry about that, sometimes a joke is better than _____.

I must reduce uncertainty and encourage stable expectations about future resource tax and management policies. One of the problems, here and many places in the country, not just here has been the instability of governments relations with industry in energy, and as this testimony started and finished, it was really almost begging you again, say let's sit down and look at this policy to find some stability. We've done pretty well on some of these, Senator Colletta. Others I think, needs more work.

GEORGE SILIDES - Mr. Donaldson, I've been invited to ask you a couple of questions as counsel to the committee, and I notice, and I almost hesitate to ask you this question, but I do think that there is a table missing which would have made a rather fine report, or perhaps even better, but I notice that in the report in your comparison between taxes paid among the states, that is the percentages, your comparisons, of course, are in

actual dollars paid, and I don't see a table which includes the factor of doing business. Now, you indicated, of course, you made a very excellent point about how much more it costs your company to do business in Alaska. The corollary, of course is that it costs the State of Alaska to do business here also including the municipalities and everyone else. Have you a table which takes that into consideration? If I might give an example of what I'm speaking of, we'll use the State of Louisiana because it makes the numbers come out even, if for example, it costs 50% more to do business in the State of Alaska than it did in a third of Louisiana, then it could be argued that our taxes are not 99% of Louisiana's but only 66% of Louisiana's. Have you made that type of table in comparison?

RICHARD DONALDSON - This is the area that I have said that we hadn't completed, and what we're trying to do is to get comparative data, which is very hard to get, that would compare cost of findings and producing and transporting oil to different regions of the country. You remember about a year ago, we gave you a couple of maps and showed you some things. We've been trying to develop this comparative cost data in public figures. You can get pieces of it, but we haven't been able to get something that you could put all together. The pieces that we have, and this is sort of a preliminary report, if you will accept it that way, tend to show that there is a premium, a higher cost for doing business in the Arctic and off-shore

than in other states, and when you are looking at a company making your business decisions, what you do is tend to add two basic factors. You say, okay, there is a potential here that we would like to explore that we would guess going in would have two billion barrels of oil, just to take a number off the ceiling, and we know that the cost of that if we carry it through would be X and X is probably twice what it is in some other place. We also know what the tax burden would be. Let's say that's Y, now we add up X and Y versus the return. We say now that's a good risk investment, or no, we just don't want to touch it, even if the oil is there. The cost is not there, so we approach it from this standpoint, why this comparative data, we think would be helpful if we could get together. I'm not sure we can yet, we've worked on it for about six months, so we have some of the pieces but not all. You could say alright, let's consider how Alaska stands up with an oil well in west Texas or some off-shore work in California or something off the East Coast. Let's just see how we compare as a risk potential, risk reward type from other places in the country, and what I think this will show is that Alaska has a high development potential, but that it has to have better potential in resources than other places in the country because the costs are higher, and what that comes down to is this, you begin to see the margin of profitability shrink as you go farther off-shore or further into the arctic today. What that means to me for purposes

of bills that you have here, is that everytime you push that thing closer together by additional taxes.

We were told a few weeks ago that, how does it feel to work for an industry that has no risk, and I said how did you derive that? The man said, well, if you look at the earnings they are very stable. I couldn't wait to get back to Cleveland and talk to Charlie Plumb who is our Vice-President for Accounting who has worked very hard to spread out these peaks and valleys of income and whatever so that you have some of these finance reportings that are consistent. Charlie, I said, you did a swell job on accounting, but you've made me real proud _____, and this is one of the little _____ that I just couldn't get over. On the pipeline itself, you find the oil and you know the market is there, and you think you have the technology to connect to, so in a sense you say a lot of the risk is taken away, and in a sense that's so because that's what project financing is all about, but when you get into the building and the design, the financing, the calculations of how to engineer something like this, it's sort of like going past the first grade and thinking you know how to add and subtract and suddenly you realize that out there is something called analytical geometry and calculus, and there's a whole string more of things you don't know. What we've had to do is to work through all of that the first time out in a project like this in the Arctic where there's no precedence for it in the whole world. Now, we've had a lot of experience building pipelines, and we've brought that to the table, but there's

a lot that we didn't know, and what is really happening, if you will recall is that through delay, the inflation involved in it, stipulations laid on by government for things that will be done in this line, increasing labor costs which you can anticipate _____ the actual cost of this pipeline, the things that are almost beyond our control has gone up 400% during the time of this project. Fortunately the cost of the oil in the world market has gone up 400% approximately too. What has happened in this is that probably more of my grace than anything else, the increase in price for oil has covered the increase in cost of the project. This is proved out, and I think we reported this to you in testimony a year ago that are going in anticipated return on a DCF basis in 1970 was about a 14 to 16% range. In 1974, we ran it again. A whole lot of things have changed and all these prices have gone up, but they are still all in about a 14 to 16% range. When we calculated for you a year ago, it was still in that range, not by anything more than chance frankly, so while we've had to invest four more dollars for each one we anticipated, the return in the market will be about four, but the profitability dollar per dollar hasn't changed, and you know who's been the real recipient for this windfall in products? Happily, it's the State of Alaska because you don't have any investment money in it. Your tax rates are still there on the books and you get a same percentage from a larger income plus. I think it's great that you do. I don't begrudge it, it's just a factor.

GEORGE SILIDES - Madam Chairman, if I might just one more time. Dick, that's a very complex subject, and I know that everytime we talk about it, we can go on for hours and I'll let it go for now, but there's something coming up that we're going to have to face in taxation, here, now, we've all heard a lot about the surplus of Alaskan crude on the west coast, and what to do with it whether it should go to Japan, or go to the gulf coast, and so on. Now, we anticipate of course when the pipeline was first built that we probably _____ to Cherry Point, or Long Beach and let it go at that. Now you're anticipating building a pipeline to the east coast from California. Are we going to have to share in that pipeline construction cost?

RICHARD DONALDSON - To some extent yes, but probably not as much as you're worried about. The reason is this. There will be a lot of new exploration and development in oil in Alaska and on the west coast. As we get some stability, I hope in national energy possibly. People with refineries begin to build new refineries to replace old ones or perhaps expand existing ones that will handle _____ in sour crude of the Alaskan type, so you may see more oil finding a home on the west coast than you could now guess today, but they will also find more offshore on the west coast, and maybe on shore, and the crying need for all of this is on the eastern part of the country. Now the reason I say worry a little bit less is that the country needs west and east

transportation. Pipeline transportation has historically been the best one to move oil in bulk at the lowest cost, and the project we have, we think tends to follow that precedent, but it doesn't mean that the only oil going through that pipeline will be Alaskan oil. There may be some. There may be some offshore California oil. There may be _____ oil, a lot of different oil, but you should recognize that the existence of that pipeline is a real plus to the State of Alaska and to us because it provides an escape valve to a market. Oil can move on to the next most economic spot, and this means it's worth more, maybe not quite as much as it would on the west coast, but a lot more than if it didn't have those facilities, and one thing that sometimes I think we tend to forget is the driving economics on us is to sell the oil at the best price that we can, and if you chose to take royalty on some of it, that's fine, but if you say that's a lot of risk, we have to do it for you under the leases, and our driving force is to get the same best price and you've got kind of a double piece of insurance here.

REPRESENTATIVE ELIASON - Even with the unknown costs, double costs, what was the return anticipated originally then on the investment?

RICHARD DONALDSON - I'm pulling these numbers out of my memory. In the files of your committee from last year, you will find testimony that I gave, and I think it was on March 29,

1976. In that testimony are the actual numbers. I'm just suggesting that's in your file. The rate of return really held almost constant through that six year period even though all this change was going on. That just happened, it wasn't planned. The original cost in the field and pipeline was much much less than it is now, and what you had going in was on those costs and on the value of oil in the world at that time. Now, you're talking about three and four dollar oil not thirteen dollar oil. A rate of return for each dollar invested was on a 14-16 base. What happened was that both sides of the equation kept going up, and the three times we studied it '70, or '72, '74, and '76 there was a little change in the numbers, but it was still within that range. Now that was a range of 14-16%. You have to understand we have a driving force to go ahead with that project because we can foresee a shortage of oil in the United States in the near term, and SOHIO was an oil deficient _____, so what we were looking at was the return at the low end of what would be a normally acceptable range, but we were willing to do it because it was the source of supply and you can't run this business without supply. Less than that, you're getting down into the utility area, and what you have is a guaranteed market and a guaranteed source, it's sort of like you've got the coal pile there burned, and you don't have all this uncertainty that you have in oil exploration. When we look ahead to the kind of thing that David Goodman

addresses, what kind of return do you really look at as a company? If you're going ahead, and you look at the risk elements, some are more or less in different places. You may see a range that bottoms out at about 15% and you may have something as high as 25% or maybe even a little more to be an acceptable risk in this area of our business.

Now, when you put up a gasoline station, you know marketing and all the things that Ken has in his experience, the risk factor is there, but not nearly as much, so you might say you'd accept something in the 15% range, but going into the new frontier area or offshore, you at least like to have the expectancy of going in or something toward the upper end of that range, so _____ is just what Mr. Goodman's testimony is characterized to be, it's a utility rate of return, and he does distinguish it there.

REPRESENTATIVE ELIASON - I guess what bothers me is that when you analyze the project, your stay is relatively the same, but when he testified, if they had known there's was going to be so low, they might not have been able to finance to start with.

RICHARD DONALDSON - What he's saying is that _____ was right. _____ was wrong. If we had said it was 10 or 12% going in, you probably wouldn't have done it. Our number said it was 14 - 16% and that's enough of a difference to say okay, we'll take the risk and go. Does that answer it?

REPRESENTATIVE ELIASON - Not really?

RICHARD DONALDSON - I guess I don't understand. At the back of our testimony, Attachment E on Page 5, at the bottom of the page, you have the paragraph that begins Mortata states. This is from Mr. Goodman's testimony, and what he is saying is Mortata states that 12% is equitable. Mr. Goodman goes on to say, no it isn't, they couldn't have financed it on that basis, and what I've added to that which then caused the confusion was our estimate going in was higher than Mortata and we decided to go ahead. So I think if you look at this section here, it probably would answer the question.

SENATOR RADER - What kind of objective evidence, what would be the thing that would show up where the state is at or above a reasonable taxation rate considering the cost, the risk and also the expectations of perhaps a bonanza _____ occasionally. I can see how if we get too high the activity just doesn't occur. There is no oil industry here. If we're too low, there's going to be a lot of oil industry here. How would you objectively measure, for instance, you know if you were running a department store, why, you could say our sales have dropped off, but if you were at General Motors or somewhere else there would be some objectives tests that we could use here as to whether or not we're approaching a reasonable tax level when you consider profitability, risk, the possibility

of a bonanza, the stability even of the government with which you're dealing which is the State government, which I'm sure has to be cranked into part of your concern here. What kind of evidence would you have - no more exploration, no more interest in drilling, no more lease bidding, or what?

RICHARD DONALDSON - It's easy to see, if everything stopped. You could say, well, that's too much. It's a little harder to sort it out when it's something other than that.

SENATOR RADER - Or even if everything stops, I guess it might mean there wasn't enough oil here to make it worthwhile for anybody to.....

RICHARD DONALDSON - Okay, I think the first thing you have to recognize is that most all of the studies have indicated that a high probability of the new resources are in Alaska. Some of the numbers that I have looked at have said that maybe in the \$13 or \$14 price for world oil, if Alaskan oil was allowed to compete with that, you would expect over the next thirty years that perhaps as much as 33% of all the oil found in the United States could be found in the north of Alaska or south of Alaska offshore. It's a tremendous potential, so I think you first have to start with the assumption that most people believe that it's here. It's other places too, but there's a lot here, so that's not quite

the equasion. The second thing is that you don't have either a go or no go. We've had to adopt the Tanzer proposal last year. Some people testified before your committee that we shut the State down. You might have had that case. What is more likely is how do you sense the business activity. There are a couple ready barometers. One is called Caparik, and the other is called Lisbern and that's marginal economics today. Obviously if you raise tax, it keeps it off the _____ list in some people's judgment. On the other hand, if world oil prices moved up a dollar or so, and Alaskan oil is allowed to be in the market place in that level, and delivered, then these two fields or strata may well come in and develop a pipeline. There's another thing that you can measure it, drilling activity is one, on the other hand if you're not leasing any lands, that tempers it, but let's assume there's reasonable lease land available. I think dealing with various _____ corporations, and the willingness of companies to enter into exploration arrangements there is another barometer, and what you look at is many things. You get a sort of feel from the pulse, but the key thing is, given the cost of doing business and giving the cost of the tax burden, the economics in total is so diminished as to reduce the attractiveness of it, and the only way I know you can solve it is to have some discussions with people about some cases, and there is some proprietary data, but you can begin to get a feel. I have a feeling you're close to or possibly over the line, but that's my own personal feeling.

SENATOR RADER - Let's take the Caparik and the Lisbern formations. As I understand some of them are underlying the _____ formation. So in other words, you actually have leases right now on those sands. Do you have any production wells on them at all? How much exploration have you done on them?

RICHARD DONALDSON - Some.

SENATOR RADER - I would assume that the reason you don't have any production is because at the present posture of pricing and tariff and market, that it's not worthwhile.

RICHARD DONALDSON - and texture and quality of oil, it's not economic or marginally economical.

SENATOR RADER - You can sight then, I suppose to this committee then as a concrete fact that at least a sand of that marginal quality is not readily producible under the present circumstances.

RICHARD DONALDSON - Probably so, it's something we keep looking at because there's a lot of oil there.

SENATOR RADER - Because again, we don't know what the federal government is going to do here in three months or six months, nor do you know what the State government's going to do.

RICHARD DONALDSON - But we have told them that they take some of these actions out of their pricing decisions that take all essentially lower the value of Alaskan oil delivered may have wiped out Caparik and Lisbern. In the same sense, I have tried to point out to you that tax passed here in the State have exactly the same economic effect directly.

SENATOR RADER - Are you continuing to explore these other sands or not?

RICHARD DONALDSON - The exploration thing is not my area, Senator. I suspect we can give you some information on that, but I'm really not qualified to speak on that particular point. Yes, we are doing some exploration up there, but the details, I'm just not familiar with.

SENATOR RADER - You sighted the willingness of the corporations to go into joint ventures with the native corporations or to explore for a percentage. As I understand it, some of those contracts provide for a 50% return to the native corporation of the net profitability as well as an over-ride of a normal _____ . Am I in error on that or not?

RICHARD DONALDSON - I'm not familiar with all of the terms of the leases. Some of the companies that are engaged in that could respond to you. All of those however are the product of negotiation. What we have in these other cases

are leases that were entered into some years ago, and all this stuff has come on and now going in on new negotiations. Maybe one corporation can negotiate a better contract than another. You'd have to look at the individual transaction, the prospects in the area, and really ask someone whose involved in that to give you comment if they would.

SENATOR RADER - Can you think of any other objective evidence of when we were hitting the top or near the top or below it?

RICHARD DONALDSON - I can't at this point. I'm just getting loggy, but it's a fair question, and maybe one we ought to give some attention to and see if we can do it. The kind of thing that you get into in your own studies if you're trying to devise a longer term policy that you say okay that's the rule of the game, I understand and I will either go or not on these judgments that you have to make.

SENATOR RADER - I appreciate the fact that no matter what we did on a tax policy probably Prudhoe Bay would be produced mainly because even if you're losing money, you would have to minimize your losses. If you've got ten billion dollars up there, and you were only going to end up with the final return of 9 billion, you'd still have to do it because you only lose 1 billion that way instead of by damming the whole works of ten. So it isn't a question then really of the producability of Prudhoe Bay, that's going to happen no matter

what we do.

RICHARD DONALDSON - But, how that's treated is a big signal to the rest of us of what else do you want to do? I don't mean that in a threatening way, you just listen very carefully.

SENATOR RADER - I make that statement only because people say well you know they're not going to pull out, and I can say of course they're not going to pull out, but neither are they going to pull in.

RICHARD DONALDSON - Tom Williams, in his testimony addressed this to some extent, and if he's scheduled to testify here, you may want to ask him that question. I'm not trying to load it on Tom, but he's given some attention to this, and I think it would be of help to you.

SENATOR HUBER - Dick, considering Alaska taxes, you say we may already have gone over the motor line, and the fact that the State is going to have a surplus revenue according to your figures which I may not agree with, when do you plan on applying for an Alaska State subsidy to help you out?

RICHARD DONALDSON - No comment.

SENATOR HUBER - There are a few other points that I would like to touch on, although Senator Rader touched on most of