

ALASKA LEGISLATURE COMMITTEE FILES 1987-1988 8672

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1 below those ceilings. Nothing in the agreement deprives
2 the Commission of its jurisdiction to look in the future
3 at whether the TSM rates are unreasonably high, nor does
4 anything prevent any non-signer, Petro Star or Arctic
5 Energy or whomever, from challenging those rates at any
6 point in the future. In fact, the agreement requires that
7 the Carriers file with the Commission every year revised
8 tariff sheets and to provide the Commission with data suf-
9 ficient to analyze the filings.

10 What your approval will establish is that the settle-
11 ment governs the intrastate rates that have been charged
12 to date; that any refunds owed under the agreement will,
13 once paid, extinguish the Carrier's refund liability and
14 that the pending TAPS intrastate rate dockets will be
15 terminated.

16 The other recently-opened proceedings, the dockets
17 involving the margin terminal costs and the TAPS connection
18 policy, will go forward unaffected by the result reached
19 in this case.

20 Now third, and this is crucial, you are not being
21 asked to decide whether the rates produced by TSM are just
22 and reasonable, nor are you being asked, as some of the
23 issue states seem to suggest, to figure out whether you can
24 apply some lesser standard if you conclude that the rates
25 are not just and reasonable. The question of whether the

1 TAPS rates are or are not just and reasonable in a rigid and
2 legalistic sense is precisely what the settlement proceeding
3 is designed to avoid. Because in order to determine whether
4 the rates are just and reasonable in the sense that Petro
5 Star and the Staff would use that term, you and we would
6 have to go through the full range of issues, the full range
7 of procedures that would be required if this proceeding
8 were to be fully litigated. In other words if, as the
9 settlement opponents suggest, the settlement can be approved
10 only if you find the TSM rates to be just and reasonable in
11 a technical sense, then there will be no cost savings, no
12 reduction in litigation burdens, no room to fashion any
13 kind of compromise outcome in trying to settle the case. The
14 effort involved in settling will be precisely the same as
15 the effort involved in litigation. And the hardening and
16 polarizing of positions will inevitably defeat the settle-
17 ment process.

18 We believe that your discretion -- and by that we
19 mean your power to use your good judgement, simply doesn't
20 compel you in that direction.

21 The real problem with the just and reasonable stan-
22 dard as Petro Star and the Commission Staff have used it is
23 that when you get to the bottom of their definition, all
24 they're saying is that just and reasonable means the result
25 that would be reached in litigation. And if that's right,

1 then the Commission simply has to understand that a rate
2 case before it can never be settled. Because in order to
3 approve a settlement it will have to decide the case and
4 it will have to do so on the basis of a complete record.
5 And we submit that the Commission has a great deal more
6 authority over its docket than that, and that that's what
7 the Alaska Supreme Court meant when it said in the Jaeger
8 case that the Commission must be free to determine whether
9 future proceedings are in the public interest.

10 If just and reasonable in the sense of the result of
11 litigation, the litigation outcome, isn't the test for
12 approving the settlement then what is? Settlement opponents
13 seem to be stumped by that question. And frankly, in view
14 of the Supreme Court's language that I just quoted, that
15 stumps us. We just can't understand the idea that this
16 Commission doesn't have the authority to agree to the
17 voluntary termination of a dispute on grounds that it finds
18 to be fair and reasonable and in the public interest. And
19 there really shouldn't be any mistake about it, this agree-
20 ment, this settlement that we have offered to you for your
21 approval is fair and reasonable and in the public interest.
22 It will end a litigation that is becoming legendary in its
23 dimensions and in its longevity. It's nine years old
24 already. There is no end in sight, and that's true even as
25 to rates that were charged in 1977. And it's no small matter

1 that in light of the interstate settlement, the entire
2 litigation expense from this point forward will fall solely
3 on the intrastate shippers.

4 Now apart from ending the rate case, the settlement
5 will result in the immediate payment of tens of millions
6 of dollars in refunds to independent parties who have made
7 it clear that the alternative that's been proposed to them
8 of awaiting the end of the litigation process to see if
9 they can do better than that is just flat-out unacceptable
10 to them.

11 The settlement will also see the immediate filing of
12 permanent and significant rate reductions. And finally,
13 it will bring a high degree of certainty to everyone con-
14 cerned; to the Carriers, who will finally be able to remove
15 the ten-year cloud of refunds from their books, and it will
16 be able to make educated projections for the first time
17 about their future revenues. And it will also provide
18 certainty to current and prospective shippers who for the
19 first time will know with certainty the most they will have
20 to pay for TAPS transportation into the 21st Century, and
21 that's a knowledge that will be impossible for them to
22 gain if the settlement is rejected.

23 Let's go back to the basics of what we have here.
24 It's an agreement between the parties -- and by that I mean
25 the State and the eight TAPS Carriers that have carried the

1 litigation burden of this case for a decade, coming to a
2 meeting of the minds that can end their dispute. The only
3 other parties that had expressed any previous interest in
4 the case, MAPCO and Tesoro, agree that this is a fair and
5 an economically attractive outcome and they actively sup-
6 port the settlement. This is no sweetheart deal. Both
7 sides came to the bargaining table with significant bargain-
8 ing power and with perspectives that, to say the least, were
9 poles apart. And all these parties are asking is that they
10 be allowed to stop fighting with each other on terms that,
11 for their own entirely independent reasons, they believe
12 to be acceptable even if not perfect.

13 Are those terms the one that the Commission would
14 Order after full litigation? Probably not. Does that matter?
15 Absolutely not. The resolution of complex cases requires
16 imaginative solutions, and that's what this is. The trade-
17 offs of the various concerns that are reflected in the
18 settlement agreement, the high front-end depreciation rates,
19 the low real rates of returns and so on, is something that
20 only the interested parties can accomplish in anything that
21 approaches a satisfactory way. And in this regard we
22 would commend to the Commission's attention a thoughtful
23 article in the August 21, 1986 issue of Public Utilities
24 Fortnightly entitled "Negotiated Settlements in Utility
25 Regulation, which was authored by the Chairman of the

1 New Mexico Public Service Commission, named Marilyn O'Leary,
2 in which she explored the very significant public interest
3 advantages in the settlement of rate cases.

4 Now in contrast to all this, what is it that the
5 settlement opponents are telling you that they want? As
6 best we can tell what they're really after when you get to
7 the bottom of it is to force the TAPS Carriers and the State
8 to keep on battling with each other even though we found
9 common ground that we can live with, just so that the non-
10 settling parties can have someone else to fight their bat-
11 tles for them. The settlement opponents have no right to
12 make us do that. And there is no conceivable public interest
13 rationale for forcing us to do so.

14 This agreement will cause no undue or no unfair
15 economic harm to any party and, in fact, will have no undue
16 impact at all on any non-settling party. It is simply
17 what our briefs and the testimony of Mr. Hildahl show it
18 to be; fair and reasonable and in the public interest as
19 a resolution of the dispute between the settling parties.
20 And we submit that you have the authority to approve the
21 settlement on those terms and that doing so would be a
22 proper and judicious exercise of your discretion.

23 JUDGE WILSON: Thank you, Mr. Brose.

24 We will now have the opening statement from MAPCO
25 Petroleum.

1 OPENING STATEMENT ON BEHALF OF MAPCO PETROLEUM, INC.

2 BY MR. JONES:

3 Commissioner Agi, Commissioner Knowles, Commissioner
4 Guess, Commissioner Whiteaker, and Judge Wilson. I'm the
5 Secretary and General Counsel for MAPCO Petroleum and
6 welcome this opportunity to appear this day to express our
7 view on this settlement as a shipper.

8 MAPCO Petroleum, an Alaska corporation, and an in-
9 state refiner, has been a party to these proceedings from
10 almost their inception in 1977. In fact, MAPCO Petroleum
11 is the only non-affiliated shipper who has participated
12 in the proceedings before the Interstate Commerce Commission,
13 the Federal Energy Regulatory Commission, the Alaska Public
14 Utilities Commission and its predecessor the Alaska Pipeline
15 Commission, that had led up to this hearing on the offer
16 of settlement.

17 As one of the largest non-affiliated shippers on
18 TAPS and as one of the companies with a significant and
19 real financial interest in the outcome of these proceedings,
20 we urge the Commission to approve the offer of settlement
21 submitted by the State of Alaska and on behalf of the eight
22 TAPS Carriers.

23 MAPCO Petroleum believes that the settlement is fair
24 and equitable and that it warrants the Commission's appro-
25 val for five primary and compelling reasons.

1 First, approval of this settlement will trigger pay-
2 ment by the TAPS Carriers of tens of millions of dollars
3 in refunds to the non-affiliated intrastate shippers.
4 Assuming the refunds are paid July 1, 1987, MAPCO Petroleum
5 now anticipates that it will receive a refund, including
6 interest, of approximately \$10 million. These refunds
7 cover shipments starting January 1, 1982 and running through
8 mid 1986, when the stipulation establishing temporary lower
9 intrastate rates went into effect.

10 Opponents of the settlement complain about the lack
11 of refunds for shipments made prior to 1982. But who are the
12 opponents? Only one, Petro Star, is presently a shipper,
13 but it did not commence shipments until late 1985. In
14 other words, none of the opponents of the settlement were
15 shippers prior to 1982. More importantly, the two shippers
16 who shipped most, if not all of the intrastate barrels
17 prior to 1982 and who would benefit from refunds for ship-
18 ments prior to 1982, both support the proposed settlement.

19 Failure to approve the settlement would result in an
20 undeterminable but presumably significant delay in the
21 receipt of any refunds by us and other intrastate shippers.
22 While one might think this is covered by interest on refunds,
23 such is not the case. Failure to receive the money now
24 results in what I call "lost opportunity costs". If
25 refunds are paid this year, that money is available for

1 investment in projects that meet the recipient's internal
2 rate of return for investments. Presumably such investment
3 will return more than simply investing the money in an
4 account and drawing interest. If this were not the case,
5 companies would simply place all their capital in interest-
6 bearing accounts and economic development would come to a
7 virtual standstill.

8 Second, approval of the settlement will result in
9 not only lower but also final intrastate tariff rates, not
10 only for the full-length intrastate shipments to Valdez,
11 but also for intermediate intrastate shipments to the GVEA
12 connection. Even though the TAPS Quality Bank Settlement
13 approved by this Commission in 1984 established a method-
14 ology for determining the intermediate intrastate rates
15 to the Golden Valley connection, no final rates can be
16 determined and, hence, no refunds calculated and paid until
17 the Commission approves a methodology and final full-
18 length intrastate rates.

19 Thus, not only will your approval of this settlement
20 establish full-length intrastate rates that as of January
21 1, 1987 would be about \$2.20 per barrel lower than they
22 otherwise would be, such approval will also result in
23 intermediate intrastate rates that are about \$1.30 per
24 barrel lower than they would be absent the settlement.

25 These significantly lower rates and the projected

1 lower rates in the future are made possible in part by
2 frontloading the tariffs in the initial years, particularly
3 the rates in effect prior to 1982.

4 The opponents object to this technique. Yet, again,
5 it is necessary for the Commission to focus on who is
6 impacted by the frontloading of the tariffs. The opponents
7 are not because they did not ship any barrels during this
8 period of time. The only intrastate shippers impacted by
9 the frontloading are the shippers who support the settlement.
10 If the settlement is not approved, then the stipulation
11 approved by you on May 1986 likely would cease. As you
12 recall, this stipulation established lower temporary intra-
13 state tariff rates based on the lower interstate tariff
14 rates resulting from the FERC's approval of the Interstate
15 Settlement Agreement, which agreement was virtually identi-
16 cal to the settlement agreement now before you.

17 If the stipulation ceases, the likely result would
18 be a weighted average increase in the full-length intra-
19 state tariffs of about \$2.20 per barrel, and a weighted
20 average increase in the intermediate intrastate rates of
21 about \$1.30 per barrel. For us this could result in an
22 increased crude oil cost of up to \$34,000.00 per day or
23 around \$1 million per month.

24 Third, by establishing a methodology that establishes
25 maximum rates that can be charged, approval of the settlement

1 would finally provide a degree of certainty as to future
2 rates. Such certainty is essential for the future planning
3 of projects and economic planning.

4 Fourth, approval of the settlement will bring an end
5 to almost ten years of expensive litigation. Not to
6 approve the settlement likely promises many more years of
7 costly litigation.

8 As a company and the only non-affiliated shipper who
9 has participated in the litigation for almost its entire
10 duration, the decision as to which alternative to choose
11 is easy. Hence, we do not agree or say that we do not care
12 what happens if you don't approve it. We certainly do
13 care, based on our ten years of experience.

14 Fifth, approval of the proposed settlement will
15 result in the full-length intrastate rates being the same
16 as the interstate rates. Since the same crude oil is being
17 transported the same distance through the same facilities
18 to the same destination, there is no basis for the intra-
19 state and interstate from Pump Station No. 1 to Valdez
20 to be different. As an interstate shipper to Valdez, we
21 would be very concerned about there being lower intrastate
22 tariffs for this same movement. Any such difference could
23 have an adverse impact on us and any other refiner similarly
24 situated when compared to other in-state refiners with
25 whom the interior refineries compete, because the cost

1 component represented by shipping barrels to Valdez would
2 be different simply due to what tariff the barrels were
3 shipped on, even though identical crude oil was shipped
4 the same distance through the same pipeline.

5 Finally, in reviewing the pleadings and testimony in
6 this proceeding, I would like to again remind you and ask
7 you to note as the Commission that it is important for
8 the Commission to evaluate and give strong consideration
9 to the fact that the largest non-affiliated in-state ship-
10 pers, those parties with by far the greatest economic
11 interest in the resolution of the rate case, support the
12 settlement. The parties opposing the settlement do not
13 have the same economic interest. In fact only one, as I
14 noted, is presently a shipper. The shipper Petro Star only
15 began shipments in late 1985. Arctic Energy is, at best,
16 a prospective shipper, since it has not yet constructed a
17 refinery. The third opposing party, the APUC Staff, also
18 has no economic interest in the outcome. Any economic
19 interest of the State of Alaska presumably is represented
20 by the State itself, which is not only a party but also a
21 signatory to the settlement agreement and offer of settle-
22 ment now before the Commission. Much of the Staff's opposi-
23 tion appears to consist of adopting the issues raised by
24 the State at the initial stages of the rate proceedings;
25 issues which the State now has settled with the TAPS Carriers.

1 Furthermore, approval of the settlement does not pre-
2 clude these parties from continuing to litigate the issues
3 they deem important. They are free to do so, but they
4 should not be free to do so at the expense of us and
5 of the other shippers who support the settlement.

6 MAPCO Petroleum should not be deprived of the benefits
7 of the settlement. In closing I would like to ask and point
8 to what happens to MAPCO Petroleum if the settlement is not
9 approved? Not only would we not receive in the near future
10 approximately \$10 million in refunds, but as I noted, the
11 intermediate intrastate tariff could increase by about
12 \$1.30 per barrel or at a cost to us at about or up to
13 \$34,000.00 per day. And even more so and ironically, since
14 the stipulation that was entered into in May of 1986 pro-
15 vides that in the event, in effect, the intrastate settle-
16 ment is not approved, the Carriers have the right to retro-
17 actively revert to the tariffs that would have been in
18 effect but for the temporary tariffs established by the
19 stipulation. The net effect of this is that we could find
20 ourselves instead of receiving \$10 million this year having
21 to pay up t \$10 million to the TAPS Carriers plus to
22 continue paying the increased costs in the future and also
23 the cost of litigation. Thank you.

24 JUDGE WILSON: Thank you, Mr. Jones.

25 We will have the opening statement from Commission
Staff, Mr. Bird.

1 OPENING STATEMENT ON BEHALF OF THE COMMISSION STAFF

2 BY MR. BIRD:

3 Commissioners, Judge Wilson. In order to respond to
4 Mr. Jones' last question, Petro Star and the Staff have
5 worked out a proposed schedule which I intend to address at
6 the close of my comments. And in order to address that
7 schedule, Petro Star has graciously granted me one or two
8 extra minutes for my allotted fifteen minutes, and with
9 Your Honor's approval, I will work as fast as I can to make
10 that schedule.

11 JUDGE WILSON: Proceed.

12 MR. BIRD: It is clear from the opening statements and
13 the briefs that all the parties to this proceeding agree on
14 two critical matters. First, that the rates produced by
15 TSM cannot be shown to be just and reasonable. And, there-
16 fore, the Commission should not approve the settlement on
17 the grounds that TSM rates are just and reasonable.

18 Second, that whether the APUC accepts or rejects
19 TSM, it will in either case have no effect whatsoever on
20 the revenue or budgetary considerations of the State of
21 Alaska.

22 The Staff takes great comfort from each of these
23 points, and in particular the latter. For we believe that
24 as a result of the '83 stipulation concerning revenues,
25 the FERC settlement and the provisions of 4206.400 and

1 Section 400 (b), each of the policy considerations are
2 benefits sought from the settlement by the settling parties
3 either has already been effectuated or can otherwise be
4 implemented in the near future.

5 Moreover, as the combined result of these circum-
6 stances, the Commission can proceed to implement the just
7 and reasonable standard established by Sections 370 and
8 410 (a) without concern for application of some lesser
9 untried standard as recommended by the State and Carriers.

10 Close inspection of the fallacy of the settling
11 parties' arguments demonstrates the accuracy of these con-
12 clusions. First, the Carriers argue that approval of the
13 settlement is necessary to put an end to litigation and to
14 provide them with the revenues for which they have bargained.
15 In fact, litigation will continue on the very same issues
16 and with the Carriers even if the settlement is disapproved.

17 Moreover, because of the '83 stipulation and the
18 FERC settlement, the Carriers' revenues are firmly estab-
19 lished now regardless of what this Commission does. The
20 State argues that the settlement is necessary to serve the
21 public's interest in ending litigation, allowing for
22 certainty in its planning, and in providing the State with
23 revenues now as opposed to the end of these proceedings.

24 In fact, the State need not participate in further
25 litigation because it will not be affected by its outcome

1 due to the '83 stipulation and the finished and approved
2 FERC settlement. Indeed, as Mr. Maynard and Mr. Loeffler
3 have each pointed out, the State's intention to absent it-
4 self from further litigation is clear.

5 As to revenues, the State has already been paid inter-
6 state revenues it stands to earn from TSM as a result of
7 the FERC's approval of the settlement. Thus, the State has
8 already gained most of the benefit of its bargain regardless
9 of what this Commission does.

10 As to interstate refunds, the Staff believes those
11 can be ordered paid pursuant to Sections A. S. 4206.410 (b)
12 at the close of these settlement review proceedings.

13 Next, MAPCO and presumably Tesoro would argue that
14 settlement must be approved so they can receive refunds
15 now. They also will argue that they need the settlement so
16 that they can glean the benefit of some certainty in their
17 operational planning, and, finally, so that they can avoid
18 further litigation costs. In fact, the Staff believes that
19 continued litigation can be brought to a fair and expeditious
20 resolution while providing for the immediate benefits
21 sought by MAPCO and Tesoro.

22 To illustrate this point more fully, as I have noted,
23 at the close of this opening statement I will recommend a
24 schedule and procedures by which MAPCO and Tesoro can be
25 paid the refunds they expect to receive from TSM at the

1 time they expect to be paid, and by wh. MAPCO and Tesoro
2 will pay TSM rates until just and reasonable rates are set.

3 These then are practical solutions to the issues
4 raised by the Staff and settling parties. Of course, the
5 owners and the State will and have argued that these practi-
6 cal solutions are unnecessary and that the Commission should
7 avoid the fact that TSM rates are unjust and unreasonable
8 by; one, applying the lower standard of review to the
9 settlement; and, two, by instituting a FERC procedure which
10 is heretofore untried by this Commission.

11 The Staff respectfully urges the Commission to reject
12 the settlement even under the lower standard recommended
13 by the settling parties, and to avoid an ad hoc application
14 of the Rule 602 procedure to these proceedings.

15 To put the settling parties' arguments into proper
16 perspective, it is important to take note of the statutory
17 context in which these arguments are made. First, and the
18 starting point is Section 370 (a). Section 370(a) is
19 straight-forward and it's clear - (reading) All rates
20 demanded and received by a pipeline carrier or by two or
21 more pipeline carriers for service furnished or to be
22 furnished shall be just and reasonable.

23 Section 410(a) erases any doubt about the Legisla-
24 ture's intent. It requires that when the Commission after
25 an investigation hearing finds that a rate is unjust or

1 unreasonable or unduly discriminatory or prejudicial, the
2 Commission shall determine a just and reasonable rate to be
3 observed or allowed, and then shall establish it by Order.

4 In conjunction with these standards, the Commission
5 has been empowered by A. S. 4206.140 (a)(2) to investigate
6 on its own motion the rates of pipeline carriers. And
7 finally, it is noted that there exists no statutes or
8 regulations which permit deviation from these standards as
9 required by Section 370(b).

10 The Staff believes that these statutes evidence a
11 Legislative intent to institute active regulation of intra-
12 state pipeline rates; and more specifically, an intent to
13 have this Commission actively participate in the setting
14 of rates so that intrastate interest not be penalized or
15 disadvantaged by any lack of resource.

16 Now, the Carriers and the State urge two principal
17 arguments to justify approval of the settlement pursuant to
18 a standard lower than just and reasonable. Neither is
19 persuasive. Initially it is suggested that Jaeger versus
20 this Commission permits the procedure and standard recom-
21 mended by the settling parties. Jaeger carries with it
22 many lessons, none of which support the reading given to
23 the case by the Carriers and the State. The Supreme Court
24 and the Commission before it considered in Jaeger the
25 question of whether a complainant had demonstrated sufficient

1 evidence to justify prosecution of his claims that certain
2 rates were discriminatory. While the Supreme Court found
3 that the Commission had the discretionary power to refuse
4 to allow Jaeger to pursue his claims, at no time did the
5 Supreme Court suggest or say that such discretionary power
6 exists for the purpose of lowering the statutory standard
7 for consideration of whether those rates were just and
8 reasonable or discriminatory. The right to have the
9 Commission act, referred to in the Carriers' and in Jaeger,
10 is completely different from the right to have the Commission
11 apply the just and reasonable standard or any other stan-
12 dard.

13 The settling parties also argue that the Commission
14 has inherent power to establish a FERC Rule 602(g) type of
15 procedure. The Staff rejects this argument for several
16 reasons. First, the settling parties' arguments are incon-
17 sistent with the statutory scheme which I have just discus-
18 sed and should be rejected on that basis.

19 Second, the application of a lower standard by way of
20 a separation of contesting parties from uncontesting
21 parties is unnecessary in this case, in light of the fact
22 that the settling parties have already received or can
23 otherwise receive the benefits they seek from this settle-
24 ment without approval of the settlement. As I have just
25 discussed because of the stipulation and the FERC settlement,

1 the Carriers have already been assured of their revenues.
2 The State need not continue to litigate and has said it
3 will not. The Carriers will have to continue to litigate in
4 any event with Petro Star and the Staff. MAPCO and Tesoro
5 can, pursuant to Section 410(b) and 400, receive the
6 benefits of the Carriers' and the State's bargain without
7 the necessity of the Commission approving the settlement.

8 Third, even if the Commission decides that a lower
9 standard is required in order to foster or encourage settle-
10 ments, the standard recommended by the State and the owners
11 is so amorphous as to be unworkable here.

12 Fourth, even if the lower, fair and reasonable and
13 at the public interest standard were applied, it should
14 be applied so that the outcome of this and any settlement
15 not be so divergent from traditional regulatory methodology
16 as to be outside a zone of reasonableness, and, therefore
17 to be against the public interest. In this case the
18 testimony of Rudy Bertschi clearly demonstrates that TSM
19 produces such results.

20 Now, the owners and the State have leveled various
21 criticisms at the Staff, at Staff's opposition and
22 Mr. Bertschi's testimony. I would like to quickly discuss
23 some of those points in order to put the Staff's position
24 in proper perspective.

25 The Staff has been portrayed as intransigent, as

1 improperly second-guessing the States Attorneys, as
2 improperly usurping the Department of Law's functions.

3 The Commission's regulations at 3(a)(a)(c) 48.275(j)
4 anticipate the Staff's role and analyzing and opposing, if
5 necessary, filed rates when those rates are contrary to
6 4206. The Staff's opposition is intended to focus here
7 on the question of whether these filed rates conform to
8 the requirements of 4206, and to recommend procedures by
9 which the integrity of the intrastate regulatory process
10 can be maintained. We do not question either the State's
11 power to settle or its motives in settling the TAPS case.

12 We have not proffered evidence to question the
13 importance of settlement to the State, the State's need for
14 revenues, adverse affects of prolonged litigation, the
15 State's budget planning needs or the long-term development
16 plans for oil transportation on the TAPS. In short, we
17 believe the States Attorneys have done the best job possible
18 in negotiations and we applaud their efforts.

19 What the Staff has attempted to do is to analyze
20 TSM in the context of the Commission's statutes, its regula-
21 tions and its precedent in order to assist the Commission
22 in performing its statutory requirements and in maintaining
23 the integrity of the process. We have endeavored to make
24 practical recommendations as to solutions to the questions
25 presented here, and we have endeavored to draw conclusions

1 as to whether the results of this settlement and if the
2 results of this settlement are consistent with this Com-
3 mission's statutory standards and its traditional regula-
4 tory methodologies.

5 It is respectfully suggested that this role is con-
6 sistent with the role envisioned by the Legislature for
7 the Commission; that being to act as an independent and
8 active participant in the rate-setting process so as to
9 protect all intrastate interests.

10 There is, we believe, abundance evidence in this
11 record of the need for such an independent participation
12 by the Commission. As reflected by the State's briefs,
13 and I would add by in part Mr. Maynard's comments today,
14 this settlement grew in large part from the State's frus-
15 tration with FERC's non-action, and with the State's
16 consequential inability to secure a final decision from
17 that administrative process and with the great expense of
18 this litigation. Tesoro's express concern with the cost
19 of this proceeding is further evidence of those pressures.

20 The Staff believes that the lesson of the State's ...
21 experiences with the FERC administrative process is clear.
22 If TSM is approved, others who might otherwise challenge
23 the Carriers' rates will not exercise their 4206 rights
24 because the cost of such a rate challenge will be prohibi-
25 tive. This is a lesson which is inconsistent with the

1 Commission's regulatory role.

2 A variation of the first criticism suggests that the
3 Staff is unwilling or incapable of recognizing the inherent
4 trade-offs and benefits of settlement. The State's argument
5 suggests that the nature of the settlement precludes the
6 type of analysis performed by the Staff since any settle-
7 ment is simply barter. Such an argument assumes its own
8 conclusion. For if we applied the State's logic, neither
9 the Staff, nor an independent shipper, nor the Commission
10 could ever question this or any other settlement. All
11 objections could be answered by suggesting that compromise
12 and trade-offs are in the nature of settlements. The
13 State's criticism effectively suggests that no benchmark
14 can be used to measure TSM and that the Commission should
15 accept it because it is a settlement. This is inconsistent
16 with 4206's charge to the Commission.

17 Finally, the owners and the State claim that the
18 Staff has attempted to mislead the Commission. Their most
19 pronounced criticism concerns the Staff's reference to
20 systemwide differences between TSM and BTM, or the bench-
21 mark tariff methodology. For several reasons, this
22 criticism is devoid of merit.

23 First, the Staff's testimony focuses primarily on
24 tariffs not total revenues. This criticism is clearly an
25 attempt to shift attention from that fact.

1 Second, and most importantly, the Staff has only
2 discussed the systemwide effects of TSM in order to mirror
3 the analytical approach first chosen by the Carriers' own
4 witness Mr. Hildahl. It is noted that Mr. Hildahl in his
5 opening testimony never broke out interstate effects in
6 his analysis. To ensure that there was no confusion in
7 anyone's mind, at page 12 of Mr. Bertschi's testimony, he
8 expressly noted the fact that he was not demonstrating
9 intrastate effects. That fact seems to have been lost on
10 the settling parties.

11 Fifth, the Staff has never suggested that the APUC
12 could affect the FERC settlement or increase or reduce the
13 State's revenues. In some, this criticism is a curious
14 nit to pick. Suffice it to say that the State and the
15 Carriers are wrong.

16 The second question of the '83 stipulation and the
17 APUC's effect on the State's revenues has also been raised.
18 Not only do we not want to hide the effect of the stipula-
19 tion, as I have discussed already, we take comfort from
20 its existence and its effect. As to the State's and the
21 owners' varied criticisms of Mr. Bertschi's testimony, I
22 will defer extensive comment in favor of letting
23 Mr. Bertschi demonstrate the fallacies of those criticisms.
24 Suffice it to say that BTM is not equal to the Staff's
25 litigation position. His testimony is not based on

1 inconsistent data, and Mr. Bertschi's testimony fairly
2 demonstrates the wide divergence of TSM from traditional
3 regulatory methodology.

4 In closing, and in order to provide MAPCO, Tesoro,
5 and the State with the benefit of the State's bargain,
6 and while litigating the just and reasonable rates, the
7 Staff and Petro Star recommend the following schedule and
8 procedures for expeditious and fair resolution of the
9 Carriers' filed rates: Simultaneous with the Order dis-
10 approving the settlement, it is recommended that the
11 Commission should set a schedule for the cost of construc-
12 tion briefing; within one month after the APUC's Order
13 disapproving the settlement, the parties should be required
14 to file briefs recommending what issues remain to be
15 resolved by the Commission in light of the Supreme Court
16 remand; thereafter, the Commission should set an expedi-
17 tious schedule for the filing of testimony on those issues
18 as well as a hearing date. It is suggested that such a
19 hearing could be scheduled for five to six months or even
20 sooner after resolution of the issues. This is because,
21 first, the cost of construction record is closed; second,
22 the non-cost of construction record is closed through 1981,
23 and the updating of operating costs for '82 through '86
24 can be done from public filings or information already
25 produced by the Carriers. The record for Phase I issues

1 has also been closed, and supplementation of that record
2 for methodological questions is not as complicated as the
3 owners would suggest. In fact, the Staff is willing to
4 stipulate to the Phase I record.

5 And finally, the Staff is prepared to forego long or
6 involved auditing procedures in light of the effectiveness
7 of such audits presumably performed on TSM numbers by the
8 State in its review of TSM.

9 Next, the Staff believes that the hearing before the
10 Commission and the post hearing briefs can be resolved in
11 three to five months. Thus, with strict adherence to the
12 Commission's schedule, the parties could present the case
13 for a decision within eleven to thirteen months after the
14 Commission's Order disapproving settlement.

15 During this period, MAPCO and Tesoro could be protected
16 as follows: Pursuant to Section 410(b), the APUC could
17 order refunds for MAPCO and Tesoro calculated against TSM
18 rates by declaring the end of a phase of the TAPS pro-
19 ceedings. Since the only rates on file now are TSM rates,
20 MAPCO and Tesoro will be paying TSM rates pending resolu-
21 tion of these proceedings by the Commission. Should the
22 Carriers file revised higher rates, the Staff will move
23 to suspend them pursuant to Section 400 and ask the
24 Commission to set interim rates for as long as 18 months
25 at the level of TSM rates. These would be appropriate rates,

1 since all of the settling parties have already agreed that
2 those rates are at least fair and reasonable.

3 In sum, the Staff believes that all the public interests
4 sought to be served by TSM have either already been met
5 by the FERC settlement and the stipulation or can be fairly
6 served by the Commission action recommended here. Thank you.

7 JUDGE WILSON: Thank you, Mr. Bird.

8 Now is the time for the opening statement of Petro
9 Star. Mr. Lewis.

10 MR. LEWIS: Thank you very much.

11 OPENING STATEMENT ON BEHALF OF PETRO STAR

12 BY MR. LEWIS:

13 My name is Yale Lewis. I am appearing on behalf of
14 Petro Star. Previous counsel have emphasized two points;
15 one, that the record before this Commission would not
16 sustain a finding that TSM produces just and reasonable
17 rates. Secondly, there seems to be general consensus that
18 the effect of disapproving this proposed settlement would
19 not adversely affect the revenue of either the State or the
20 TAPS Carriers.

21 I would like to emphasize an additional point. This
22 Commission's ruling on the intrastate tariffs will have an
23 enormous impact on Petro Star. Petro Star pays full
24 tariff for all of the oil that it brings out of Prudhoe
25 Bay and takes into North Pole. The effect of those tariffs

1 have an enormous impact on the profitability of its
2 operations. The effect of those tariffs have an enormous
3 impact on the price that its purchasers pay for the refined
4 products of Petro Star. The intrastate tariff is also
5 going to have an enormous impact on the building of an
6 intrastate industrial base. Compared with these very
7 important attributes, the notion that the settlement that
8 this Commission should approve this settlement simply to get
9 it out of the way or because there are other interests of a
10 more vague public interest nature is simply not the proper
11 way for a regulatory proceeding to proceed.

12 The statutory test is just and reasonable tariffs.
13 That's the only thing that a shipper can rely upon. A
14 shipper has to know before a shipper makes an investment
15 in new facilities or in expanded facilities that they will
16 be able to pay just and reasonable tariffs. If the standard
17 becomes one that can be something less or something more
18 or something different simply because more powerful interest
19 can agree upon some other settlement and impose that as a
20 just and reasonable tariff, the smaller, independent
21 intrastate business person simply cannot have the certainty
22 that is necessary for that interest to make the investment
23 that they need to make.

24 The proponents of this settlement are trying to
25 direct your attention away from the statutory standard and

1 towards the reasonableness of their settlement. Well, it
2 is our position that the reasonableness of their settlement
3 is really not before you. Your statutory function is to
4 approve tariffs, are they just, are they reasonable, are
5 they non-discriminatory, are they non-preferential. The
6 reasonableness of the settlement reached between the State
7 and the Carriers is simply not part of your statutory
8 scheme. You approve tariffs. They have reached a settlement
9 which to them seemed adequate. We're not quarreling with
10 the justice of their decision to reach a settlement, but
11 that doesn't establish just and reasonable rates.

12 Petro Star and any other intrastate industry is
13 entitled to rely with certainty upon your willingness to
14 prescribe, determine just and reasonable rates regardless of
15 what some other entities think constitute a good settlement
16 for them.

17 The emphasis of the State's counsel on the reasonable-
18 ness of a settlement puts some -- places me in some dis-
19 advantage because I have enormous respect for them as
20 lawyers. I don't second-guess the instructions that their
21 clients gave them when they were instructed to settle the
22 case. Petro Star, nor I have ever criticized them for
23 reaching the settlement they reached. Our position is
24 simply that it did not produce just and reasonable rates.

25 The 6.4 percent real return plus inflation plus 100

1 percent equity assumption produces a rate of return that
2 is an enormously high rate of return. It is not a compro-
3 mise rate of return. The rate base adjustments in the
4 settlement make no reductions for cost of construction
5 overrun. Every penny that was put in comes out. All the
6 settlement does is say that for some of that investment
7 the Carriers don't get this very large rate of return.

8 There is a component of the settlement which pro-
9 vides that the Carriers will get 35 cents per barrel plus
10 an inflation adjustment plus a doubling under the 100
11 percent equity assumption for every barrel of oil that is
12 produced. If there is substantial oil on the Arctic Slope
13 that is not presently in a proven reserve category, that
14 will produce rates of returns that are infinitely high.
15 That factor alone makes it impossible for this settlement
16 to be approved to the just and reasonable settlement. It
17 is not cost-based, and that is the essential element of
18 a just and reasonable tariff in every jurisdiction in this
19 country, it has to be cost-based. 35 cents a barrel is not
20 cost-based.

21 The two other issues that are so critically
22 important to Petro Star, as they would be to any other
23 intrastate shipper, are the pumpability factor and the
24 pooling agreement. This agreement has a provision in it
25 which is called the pumpability factor. Well, the Carriers

1 are already charging enormous surcharges for pumpability.
2 It's very hard to understand. The State presented very
3 persuasive testimony in the TAPS proceeding in the federal
4 TAPS proceeding and in this proceeding which was attached
5 to Petro Star's filing which makes it quite clear that
6 there is no engineering and no economic basis at all for
7 the pumpability factor.

8 Yet already before the ink is really dry on the
9 settlement, enormous surcharges are being charged to
10 Petro Star for oil coming out of Kuparuk based upon the
11 pumpability factor. Now the State, perhaps somewhat
12 embarrassed by this, says we shouldn't be too concerned,
13 you shouldn't be too concerned, we can complain about it
14 later.

15 Well, Petro Star is paying that surcharge on oil
16 that it shipped in 1986. That issue is real, it's now,
17 it can't be resolved by saying, "Well, Commission,
18 approve this agreement now and that issue can be dealt
19 with later". That issue has to be dealt with now because
20 it is affecting Petro Star now.

21 Finally, the pooling agreement is dealt with at
22 length in our testimony and I won't go into it further
23 here because it is well laid out in Professor Oster's
24 testimony and our briefs. But there are a number of
25 elements of this so-called settlement agreement that

1 preclude a finding of a just and reasonable tariff and
2 that are enormously detrimental to Petro Star.

3 We urge the Commission to follow the Staff's recom-
4 mendation to conclude the hearing as rapidly as possible,
5 establish just and reasonable rates. We believe that can
6 be done within a year. We believe that the suspension
7 power, the 18-month suspension power will preserve the
8 status quo during this period. Everybody will get the
9 benefit of their bargain, except MAPCO will lose its
10 opportunity cost for 18 months. Nevertheless, it will
11 continue to pay TSM tariffs, as will everybody else. The
12 State gets its revenue, the companies get their revenue,
13 you get the chance to exercise your statutory function to
14 determine just and reasonable rates. By the end of 18
15 months the status quo will have been maintained and you
16 will have a decision in place. We urge you to do that.
17 Thank you for your time and attention.

18 --JUDGE WILSON: Thank you, Mr. Lewis. At the pre-
19 hearing conference held this morning, Arctic Energy
20 Company indicated that it wished to waive its opening
21 statement.

22 Now is the time when the Commission encourages
23 interested members of the public to comment on the subject
24 matter of this hearing. Are there any members of the
25 public who wish to make a statement at this time? I have a

EXCERPT TRANSCRIPT

(Excerpt of transcription after the morning break.)

JUDGE WILSON: Mr. Maynard.

MR. MAYNARD: Thank you, Judge Wilson, members of this Commission. Governor Cowper has requested that I make a statement to correct a potential misimpression concerning this Administration's views and policies on settlements of this type.

The Governor believes that as a matter of policy these types of disputes should not be settled but instead should be litigated to conclusion. For that reason alone, if he had been in office, the Governor would not have entered into this Agreement and of this Settlement. Nonetheless, the Governor understands that the previous Administration had a different policy on settlements and entered into this Settlement under that different policy.

Further, the Governor has not independently reviewed either the merits or demerits of this Settlement as a settlement. Since the State will therefore continue to support this Settlement, it will continue to make itself available to and assist the Commission in its review of this Agreement.

Thank you, Judge Wilson.

JUDGE WILSON: Thank you, Mr. Maynard.

COMMISSIONER AGI: Are we modifying the State's

1 opening statement in any respect?

2 MR. MAYNARD: To the extent that the opening
3 statement gave the impression that the Governor's policy
4 was that settlements as a matter of policy were the way to
5 go, the opening statement is modified.

6 COMMISSIONER AGI: As far as participation in front
7 of this Commission by the Attorney General's Office?

8 MR. MAYNARD: In future proceedings?

9 COMMISSIONER AGI: In future proceedings.

10 MR. MAYNARD: There has not been any specific dis-
11 cussion of that. Nothing to my knowledge has changed that,
12 but there's been no discussion of that.

13 (End of requested excerpted portion of proceeding.)

14 * * *

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ELF ALTERNATIVES

DELAY ONLY

- \$87 million new revenue available in FY 88 (30th percentile).
- Revenue rises gradually through 1992, then drops abruptly by \$114 million when ELF again applies.
- Maintains Prudhoe tax at 15.0 percent.
- Kuparuk tax rate unchanged at 8.1 percent.
- No change in tax rates at Milne Point, Endicott, Lisburne, or other marginal fields.
- PEL adjustment unchanged. Falling oil prices could have magnified effect on severance tax revenue, i.e., 50 percent drop in wellhead price could produce 90 percent drop in revenue. State prohibited from asking for PEL adjustment if oil prices rise.
- Does not change provisions of current law allowing producers in large fields to gain tax rebates by adding wells producing at or near 300 barrels per day.

HOUSE SUBSTITUTE

- \$94 million new revenue available in FY 88 (30th percentile).
- Revenue rises gradually through FY 93, then declines gradually.
- Prudhoe tax rate reduced to 14.8 percent.
- Kuparuk tax rate increased to 11.7 percent.
- Decreases tax rates for Milne Point, Endicott, Lisburne, and other marginal fields. Eliminates tax for all existing Cook Inlet oil fields.
- Reduces chance that PEL adjustment would magnify effect of falling prices on severance tax revenue. State is allowed to petition for upward PEL adjustment.
- Eliminates negative tax rates on incremental revenue, but retains incentives for incremental production

1/87-2/88 N.S. K1/5 COUNTS

		<u>Std</u>	<u>ARCO</u>	<u>Comments</u>
Jan 87		2 End PB	Lib PB Kup	
Feb	same			
Mar.		2 End PB	Kup Lib.	drop ARCO PB
Apr.	same			
May	same			
June		2 End 2 PB	Kup Lib	add Std PB
* July	same			
Aug	same			
Sept		2 End 2 End	Kup Lib PB	add ARCO PB
Oct.	same			
Nov.	same			
Dec. 3		2 End	Kup	add Std A
Jan 88		3 PB	Lib PB	
+ Feb. 88		2 End 3 PB 1 W end/PB	Kup Lib PB	add Std PE (W. end - Eileen)

* - 7/22/87 - Petroleum info Weekly - Susan Andrews of ARCO gives advance notice of increased PE development drilling - increased activity "strictly the result of higher oil prices"

+ - By 2/88 Standard he increased its Puddle rig count by 3 (since 1/87) and brought on W. end/Eileen ARCO is same as 1/87 but had dropped/added one

Cotten-

I can explain but I need
to go to AMI now - want me
to stay? I'm in the Gallery.
Plus some short bullets in
your chair

AS

Alaska State Legislature

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(907) 561-7614

IN SESSION:
POUCH V
JUNEAU, ALASKA 99811
(907) 465-4714



Senator Mitch Abood
CHAIRMAN

Senate Committee on State Affairs

March 25, 1988

The Honorable Steve Cowper
Alaska State Capital
P.O. Box A
Juneau, Alaska 99811

Dear Governor Cowper:

Thank you for your letter, dated today, requesting a hearing on CSHB 164, the so-called ELF bill.

Your letter states "there seems to be some confusion here." I personally can't understand why this is. Be that as it may, there have already been five hearings held on this bill, during which extensive public testimony was taken. Because none of the issues have changed, it's not clear what new information would be gained by holding yet another hearing on this tax increase legislation.

In order to have all of the information on these public hearings, I would greatly appreciate any assistance you could provide on a particular matter relating to the bill. Yesterday, in the interest of furthering the public process, I requested a complete set of the file material the House Finance and Resources Committees accumulated during their review of HB 164. Representative Adams was kind enough to provide me with these materials yesterday afternoon for the House Finance Committee -- the same day I requested them.

Unfortunately, the House Resources Committee has yet to provide me with any of the requested materials. Because I am considering holding a hearing of the Senate State Affairs Committee on CSHB 164, it would be most appreciated if you could contact the House Resources Committee Co-Chairmen, Representative Cotten and Representative

Dear Mitch.

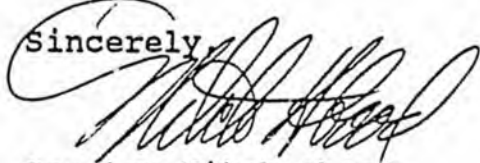
Hold a hearing and you will receive more material than you care to ever see

Sund

Herrmann, and request that they do what they can to find their files and provide me with a copy.

Thank you for any assistance you may be able to provide.

Sincerely,

A handwritten signature in black ink, appearing to read "Mitch Abood", written in a cursive style.

Senator Mitch Abood,
Chairman

cc: All Senators
All Representatives
Enclosures

Alaska State Legislature

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IN SESSION:
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Senator Mitch Abood
CHAIRMAN

Senate Committee on State Affairs

Hand-Delivered

March 24, 1988

Representative Sam Cotten, Co-Chairman
House Committee on Resources
P.O. Box V
Juneau, Alaska 99811

Dear Representative Cotten:

Could I please have a complete set of the file material which the Resources Committee used in its review of HB 164, "An Act relating to the oil and gas properties production tax; and providing for an effective date."

Thank you for your assistance in this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Mitch Abood".

Senator Mitch Abood
Chairman

Alaska State Legislature

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Senator Mitch Abood
CHAIRMAN

Senate Committee on State Affairs

Hand-Delivered

March 24, 1988

Representative Adelheid Herrmann, Co-Chairman
House Committee on Resources
P.O. Box V
Juneau, Alaska 99811

Dear Representative Herrmann:

Could I please have a complete set of the file material which the Resources Committee used in its review of HB 164, "An Act relating to the oil and gas properties production tax; and providing for an effective date."

Thank you for your assistance in this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Mitch Abood", written over a horizontal line.

Senator Mitch Abood
Chairman

&k12H

Alaska State Legislature

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Senator Mitch Abood
CHAIRMAN

Senate Committee on State Affairs

Hand-Delivered

March 24, 1988

Representative Al Adams, Chairman
House Committee on Finance
P.O. Box V
Juneau, Alaska 99811

Dear Representative Adams:

Could I please have a complete set of the file material which the Finance Committee used in its review of HB 164, "An Act relating to the oil and gas properties production tax; and providing for an effective date."

Thank you for your assistance in this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Mitch Abood", written over a horizontal line.

Senator Mitch Abood
Chairman

4/87 N.S. RIG COUNTS

		<u>Sta</u>	<u>ARCO</u>	<u>Comments</u>
Jan 87		2 End PB	Lib PB Kup	
Feb	same			
Mar		2 End PB	Kup Lib	drop ARCO
Apr	same			
May	same			
June		2 End 2 PB	Kup Lib	add set PE
* July	same			
Aug	same			
Sept		2 End 2 End	Kup Lib PB	add set PE
Oct	same			
Nov	same			
Dec. 7		2 End	Kup	add set A
Jan. 88		3 PE	Lib PB	
+ Feb. 88		2 End 2 PE 1 Ward/PB	Kup Lib PB	add set A (W. end - E. end)

* - 7/22/87 - Petroleum Info Weekly - Susan Andrews of ARCO gives advance notice of increased PE development drilling - increased activity "strictly the result of higher oil prices"

+ - by 2/88 Standard has increased its Paddock rig count by 3 (since 1/87) and brought on W. end/E. end ARCO is same as 1/87 but had dropped/added one

Model Resolution Supporting Adjustment of the Economic Limit Factor (ELF)

WHEREAS the State of Alaska will lose approximately \$200 million in the next fiscal year from the application of the Economic Limit Factor (ELF) to Prudhoe Bay;

WHEREAS the revenue losses to the State are projected to total more than \$1 billion over the next five years;

WHEREAS the Alaska economy is only now beginning to emerge from the deepest recession it has suffered in 30 years;

WHEREAS without the additional revenue the state budget for FY 89 will be almost \$400 million in the red;

WHEREAS cuts of this size would have a devastating effect on the economy and on Alaska's local governments;

WHEREAS the economic limit factor (ELF) was originally intended to serve as a tax break to encourage oil production in marginal fields;

WHEREAS the Prudhoe Bay oil field is in no sense a marginal field, but is instead the largest oil field in North America, and appears to be one of the most profitable oil fields in the world;

WHEREAS the application of the Economic Limit Factor to the Prudhoe Bay oil field is thus wasteful and unnecessary;

WHEREAS the application of the Economic Limit Factor actually discourages oil production at a truly marginal field such as Milne Point;

BE IT RESOLVED that the Alaska Legislature enact legislation that would adjust the Economic Limit Factor to make it work as originally intended so as to encourage oil production at marginal fields and not give an unneeded tax break to the Prudhoe Bay field, the largest and most valuable field in North America.

GETTING ALASKA'S SHARE OF OIL REVENUES

by Cliff Davidson (1)

Alaskans own Prudhoe Bay, the largest and most prolific oil field in U.S. history. We have derived tremendous benefits from its development: the Permanent Fund, our schools, many municipal improvements, and government services for children, the elderly and the disabled.

However, our share of the revenue from this field has recently been reduced, while the major oil companies are increasing their share and proclaiming their profitability in a tough oil market. For this fiscal year, about \$185 million has been directly transferred from Alaska to the corporate treasuries of several major international oil companies.

All over the state, people who need school improvements and municipal services are wondering why the Legislature allowed a reduction in oil and gas taxes when our state revenues are in precipitous decline.

The answer to the question is that the Legislature scheduled the tax break back in 1981, when oil prices were rising and it was thought that Prudhoe Bay would be in

1 - Cliff Davidson represents Kodiak in the State House and is a member of the House Resources Committee.

decline by 1987. Today it is clear that the industry will continue to operate, quite profitably, if the tax regime is restored. Yet the State Senate has refused to act on the oil tax bill, despite Governor Cowper's support for it and the State House's.

Last year the House passed a bill, introduced at the Governor's request, that did two important things:

- * prevented large tax breaks for giant oil fields like Prudhoe and Kuparuk, where tax incentives aren't needed, and

- * provided a new tax incentive for production from every other known field in Alaska, including marginal fields such as Endicott, Lisburne, and Milne Point, which was shut down in 1987 because it was uneconomic.

This approach makes sense. Forbes magazine recently reported that Atlantic Richfield is one of the most profitable oil companies in the world, and guess where the company gets 67% of its oil? From Kuparuk and Prudhoe Bay. Tax breaks are simply unnecessary for these oil fields.

The chief executive of Atlantic Richfield recently boasted that the company's profits are the "best in the

industry." The company has also publicly reported that it increased its Alaska production while reducing production from other sources. These aren't the actions of a company producing from a marginal property.

Meanwhile, British Petroleum last year completed its acquisition of Standard Oil. Now it owns 100% of that company, which got 98% of its oil production from Alaska. And Kuwait's national oil company has purchased more than 20% of BP. These aren't the actions of corporations worried about the profitability and potential of Alaska oil and gas production.

Some industry representatives claim that the tax break has encouraged more drilling on the North Slope. No proof has been offered that the new drilling provides Alaskans extra jobs or that the long-term production of Prudhoe and Kuparuk is being increased. Instead, we might just be seeing the hastier depletion of oil and gas reserves.

Industry representatives also talk about "tax stability." They imply that there was a compact between the 1981 Legislature and the oil and gas industry to install a tax break in 1987. But they neglect to mention that there were other issues -- legislative instability, legal battles, and inaccurate production projections -- that influenced the

1981 Legislature. They also don't seem to realize that today's legislators need to deal with today's problems.

In fact, it's clear that the industry actually supports tax changes when those changes benefit the industry. In 1981 the industry came to the Legislature (in a time of oil price inflation) and asked for tax breaks. The Legislature responded by instituting a new "unitary" tax system. Since that time, Alaskans have foregone billions of dollars worth of revenue that would have been collected under the former system.

Alaskans have a choice here: shall we continue to forfeit tax revenues that could be put to many purposes around the state, or shall we go ahead and collect taxes that won't harm the industry and will bring us back to where we stood a year ago? I'm strongly supportive of Governor Cowper's effort to rescind the oil tax break, and I'm glad that the House and the Governor are working together on a tax system that will truly serve the interests of all Alaska.

OIL WATCH

Division of Policy
Office of the Governor

DATE: March 1, 1988

PREPARED BY: R.A. Fineberg

Spot Prices

The ANS Gulf Coast spot price dropped to \$13.85-13.90 today. Over-supply and Saudi discounting again appear to be the principal factors in the latest price slump, which has driven the spot price down almost to its 12-month low (which occurred just before Christmas) and over \$2.00 below the price at the beginning of the year.

The Department of Revenue estimates current North Slope production at 2.03 million barrels per day.

Attached are updated graphs showing spot, contract and posted prices. Since the last time we provided these graphs (Oil Watch, January 14, 1988), ANS Gulf spot and posted prices have levelled out in the \$15 range. This makes \$15 a reasonable basis for projecting contract prices in the near-term -- at least prior to last week's drop.

Effects on Mean Forecast for FY 88 and FY 89

A simplified model borrowed from the Department of Revenue indicates that if the ANS Gulf price holds at \$15.00 for the remainder of the fiscal year, FY 88 revenues should be approximately \$40 million below the \$2,095 million mean forecast of Feb. 11.

If \$15.00 held throughout FY 89, the February 11 mean forecast for FY 89 (\$1,981 million) would be approximately \$170 million high.¹

Delphi Forecast

The forecast group will meet in Anchorage Monday and Tuesday, March 7-8. The completed forecast is expected early in April.

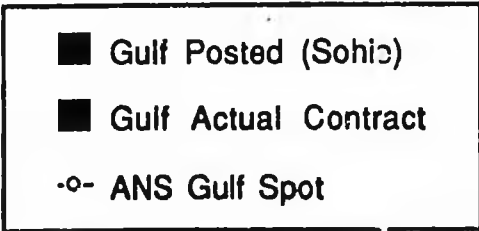
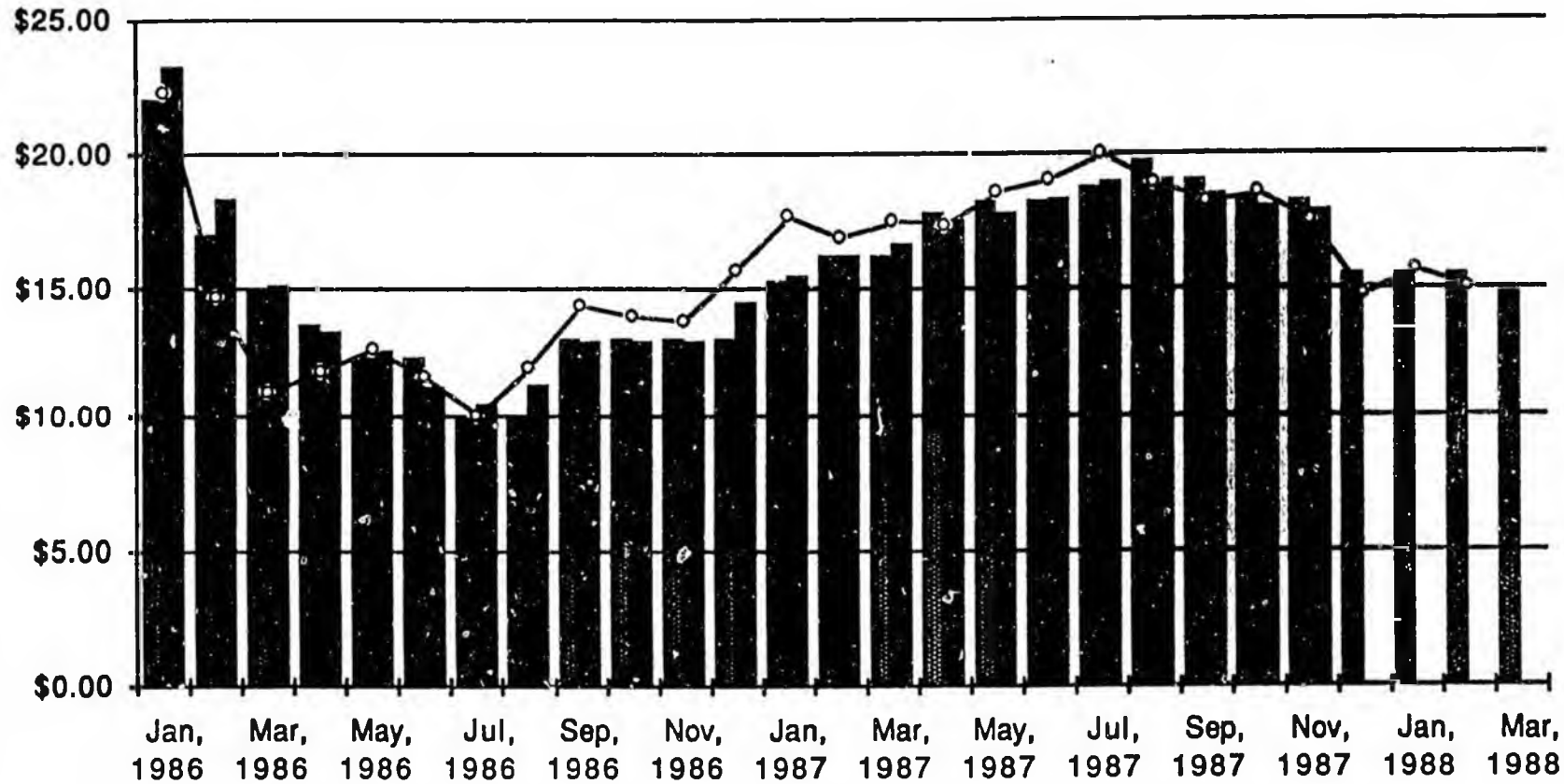
¹ The simple rule of thumb is that a \$1.00 change in price over 12 months changes Unrestricted General Fund revenues by approximately \$130 million. The FY 89 mean forecast price for ANS at the Gulf is \$16.32. $\$1.32 \times \$130 = \$172$ million.

Distribution:

Governor Steve Cowper
Garrey Peska, Chief of Staff
Mary Halloran, Director, Division of Policy
Jay Hogan, Director, Division of Budget Review
Hugh Malone, Commissioner of Revenue
Lennie Gorsuch, Deputy Commissioner of
Natural Resources
Cameron Kashani, Legislative Finance

ANS Gulf Actual v. Spot & Posted Prices (1986-88)

\$ / Barrel

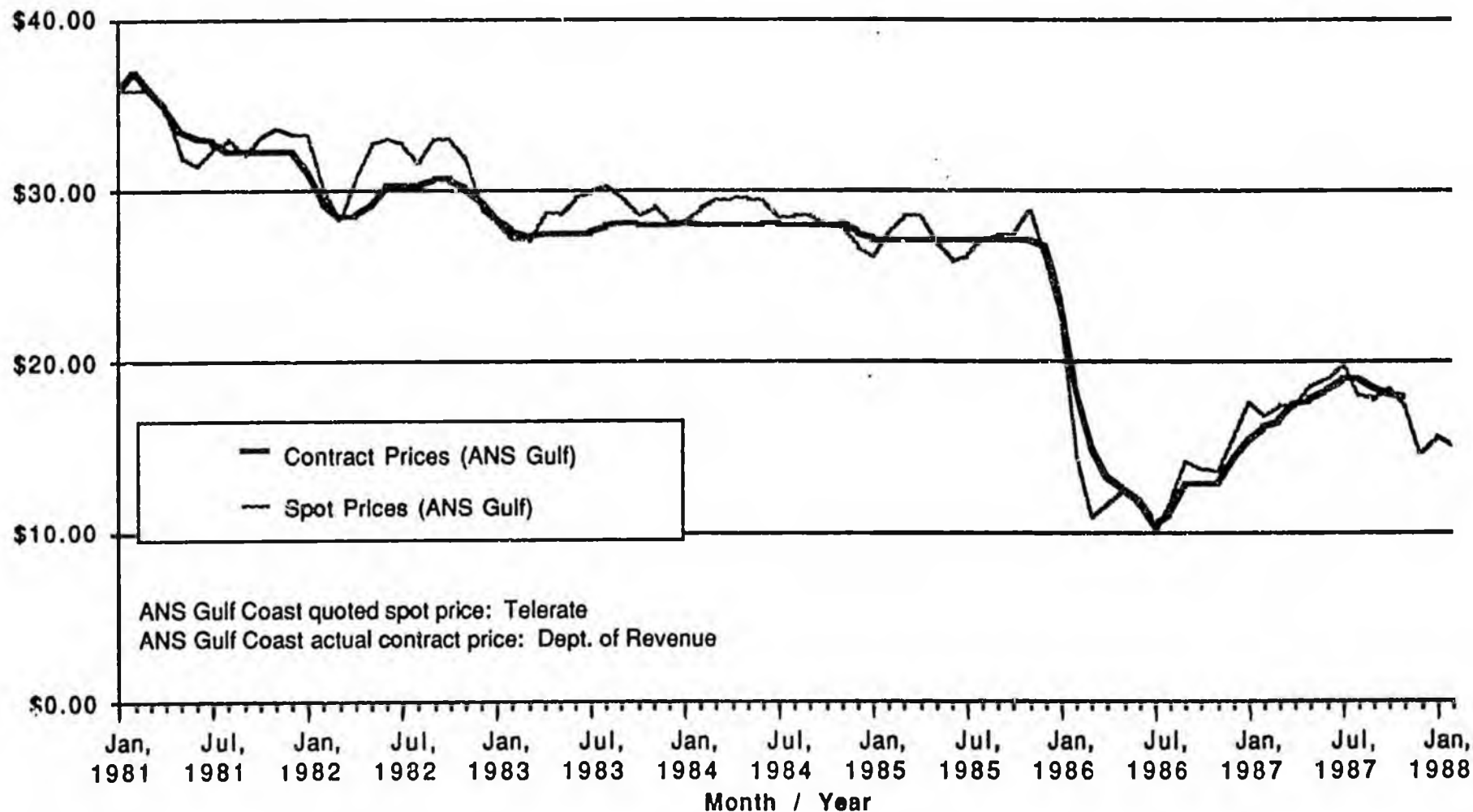


Source: Division of Policy

(from Standard posted price and DOR data; 3/1/88)

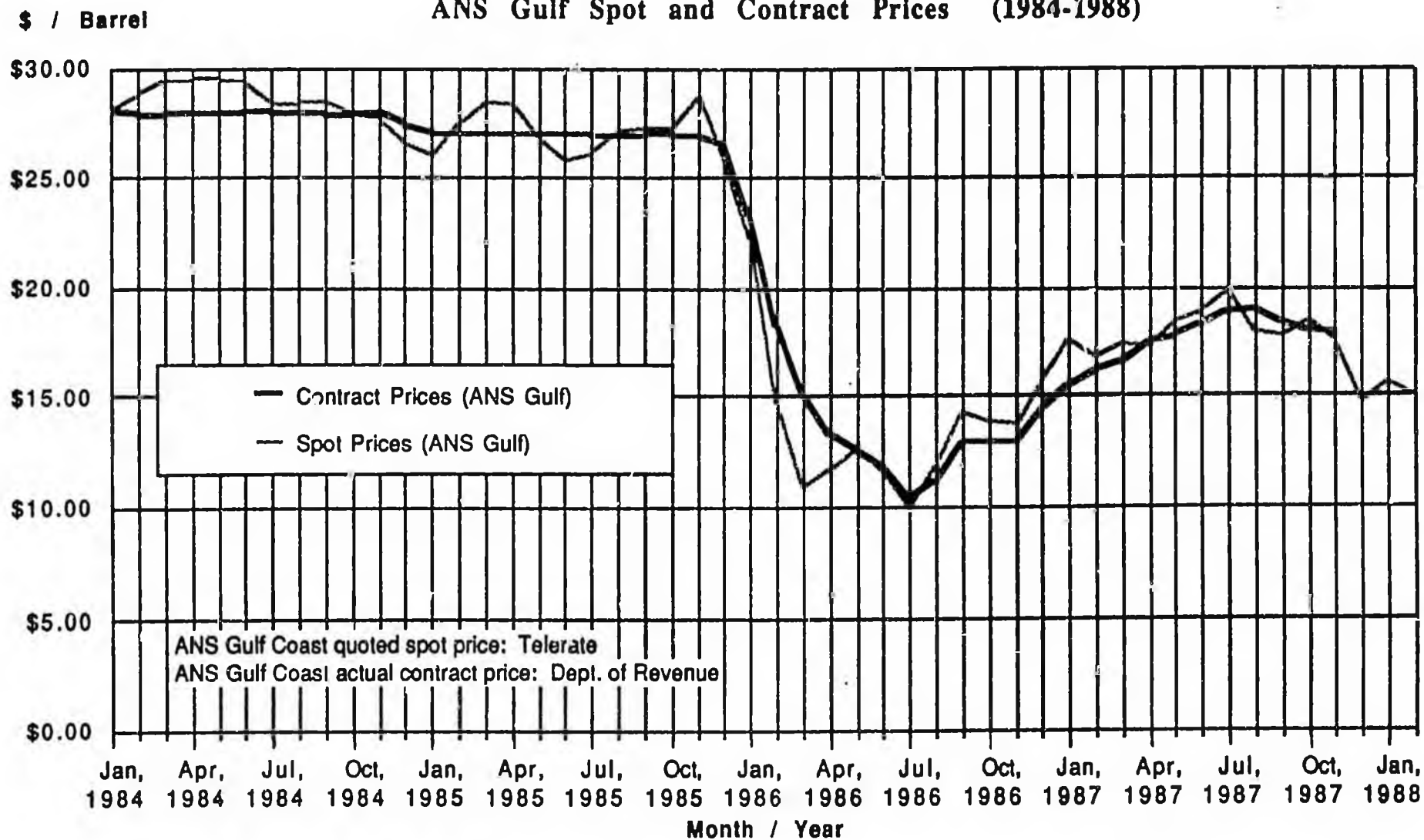
ANS Gulf Spot and Contract Prices (1981-1988)

\$ / Barrel



Source: Division of Policy, 3/1/88

ANS Gulf Spot and Contract Prices (1984-1988)



Contract Prices (ANS Gulf)
 Spot Prices (ANS Gulf)

ANS Gulf Coast quoted spot price: Telerate
 ANS Gulf Coast actual contract price: Dept. of Revenue

Source: Division of Policy, 3/1/88

3/25/88

Oil Profits Mostly Leaving Alaska

by
Gregg Erickson

Nineteen eighty-seven may have been a tough year for many Alaskans, but it was a very good year for the oil industry. According to the February 1 issue of *Petroleum Intelligence Weekly* (PIW), a respected oil industry trade publication, North Slope profits were \$1.56 billion, or \$4.3 million per day. Based on averages over January and February, current profits are even better--\$6.1 million per day.

The PIW report provides a fascinating, accountant's-eye view of industry operations in Alaska. The costs of keeping oil flowing from the North Slope fields -- labor, insurance, fuel, maintenance, and the like -- currently are \$1.7 million per day. That amount shrinks, however, compared with the state's daily \$4.7 million in royalties and various taxes.

The breakdown among the taxes is interesting. All profitable corporations in Alaska pay state corporate income taxes. For most non-oil companies the tax rate on Alaska income is the nominal 9.4 percent rate. According to the PIW article, the petroleum firms pay only 3 percent. The difference is presumably a result of the special system for assessing taxable income granted the industry in 1981. Savings to the industry from this difference: \$750,000 per day.

The PIW analysis assumes that the oil companies pay the full 34 percent federal tax on their Alaska income. That may be unrealistically high, but if it is true the feds are making daily collections of \$2.8 million.

Oil companies made major investments in Alaska to produce the oil and move it to markets. Companies recover those investments through depreciation charges. The PIW figures don't include pipeline depreciation, but for everything else depreciation comes to \$4.5 million per day.

Profits and depreciation are both cash returns to the companies; depreciation pays back the companies' investment, and

profits (currently \$6.1 million per day) are the cash left after depreciation and other costs have been covered. Taken together, profits and depreciation make up the cash flow that the companies must either reinvest in Alaska or take elsewhere. The total comes to a daily \$10.6 million.

Most of these dollars are going elsewhere. PIW doesn't provide figures for the rate of reinvestment, but producers say their current Alaska drilling programs are costing about \$400 million annually. For a generous estimate of bonus bids and costs of constructing of new North Slope facilities add a further \$300 million. That adds up to less than \$2 million a day.

In an accountant's terms, the oil industry is liquidating its assets in Alaska. For every \$2 the oil industry is reinvesting, it is taking \$8 out.

Why such a disparity? Oil companies allocate new investment based on expected returns. They clearly believe they can find good reinvestment opportunities for only about \$2 out of every \$10 they make in the state. That is not too surprising, since returns on future investments are hardly likely to equal returns now flowing from the super-giant, super-profitable Prudhoe and Kuparuk fields.

Do the companies deserve criticism for reinvesting so little of their Alaska returns in the state? That is an important question, but it is not an easy one. Making hard-headed decisions on deploying assets is what private firms do best. Doing that job well has won ARCO a reputation as one of the nation's most imaginative and best run corporations. Government should be cautious about interfering.

On the other hand, the \$8 cut of every \$10 leaving Alaska is a very high price to pay for the \$2 being reinvested. Certainly the dollars departing the state contribute little to Alaska's future.

Gregg Erickson is a senior economist with the state Division of Policy.

MEMORANDUM

State of Alaska

TO: The Honorable Steve Cowper
Governor


DATE: March 23, 1988

FILE NO: 0074q

TELEPHONE NO: 465-2300

THRU:

SUBJECT: March 1988 Revenue
Forecast


FROM: Hugh Malone, Commissioner
Department of Revenue

Commissioner's Preface

This forecast is the first since the release of the Gault Report on Alaska's revenue forecasting system.

It represents a fundamental change. Before, all revenue outcomes were assigned probabilities by the forecasters, but one case was advocated. Usually, that forecast (or some other) was felt to compel one fiscal policy over another. Here, though, policymakers are given a range of scenarios, each with its own assumptions on the economic, political, and other factors that may impact future oil prices and future revenues.

Among the several advantages of this approach, two stand out. First, all policymakers will more directly share in the responsibility for selecting the forecast number on which action is taken. More importantly, a forecast, no matter how accurate it may prove to be, does not dictate actions. Forecasts are not a substitute for debate on the size of budgets, the level and kinds of revenues, the amount of borrowing, or the savings we add to reserves or the Permanent Fund.

Administrative Notes

No final decision has been made as to how many complete forecasts (as opposed to updates) will be prepared each year, and by what dates. The prime considerations are the needs of the Governor, CMB, and the Legislature in the budget cycle. On the other hand, time must be allowed to judge the effects of actions by OPEC, especially their regular meetings in early June and early December.

Contents of Forecast

Oil Price Scenarios - an outline of the basic assumptions for the low, mid, and high case scenarios.

Table I - Revenue Summary - petroleum revenues, non-petroleum receipts and, finally, total unrestricted revenues. For the perspective it provides, the various scenarios are compared to the mean case last September, 1987.

- Figure I - Graph of FY 88-90 Estimates.
- Table II - Key Statistical Assumptions - oil prices, tariffs, thruput, etc.
- Table III - Detail of Revenues by Categories
- Figure II - Comparison of Historical Revenues to new Estimates
- Figure III - Recent History of ANS Crude Prices

Memo to Commissioner Hugh Malone Concerning the Preliminary Steps to Implement the Gault Report.

OIL PRICE SCENARIOS

Introduction

We have recently completed our March forecast of petroleum production revenues. The oil market over the last month can be characterized as deteriorating. This is due mostly to the reluctance of large oil reserve countries like Saudi Arabia to act as "swing" producers to defend price in a soft market. As a result, the oil revenue outlook is on balance lower than when we made our last forecast in September. At that time, we felt that prices would fall from the then current level of \$18.00/bbl to the \$15.00/bbl level in the spring. As it turned out, the price has fallen much further as evidenced by the current Standard/BP posted ANS price of \$13.75/bbl at the U.S. Gulf.

As a result of methodological review, we have implemented a scenario approach to attempt to clarify the specific market events and key player behavior which contributes to the large amount of uncertainty associated with the future of oil prices. Specifically, we have limited our analysis to three alternative scenarios of events leading to much different future oil prices. For the purposes of this memo, only the short run will be addressed.

The scenarios are driven by completely different assumptions about the price of oil. The primary requirements for the scenarios was that they be plausible and that they reflect a low, high, and mid range of the prices felt possible in the future. A brief description of each scenario as developed for the short term forecast follows.

Scenario 1 - Low

	<u>FY 88</u>	<u>FY 89</u>	<u>FY 90</u>
	(Millions of Dollars)		
Total Unrestricted Revenues	2,085.1	1,337.6	1,285.1
	(Price in \$ per barrel)		
(1) West Coast	14.36	10.92	10.77
(2) Gulf Coast	15.42	11.93	11.78
(3) Weighted Average	14.80	11.32	11.16

The low scenario is based on the following assumptions:

- 1) Slow world economic growth over the next two years in the range of 1.0 to 1.5% per year.
- 2) Because of the investments made in recent years to develop new fields, non-OPEC production is assumed to average 500,000 barrels per day higher in both 1988 and 1989.
- 3) The Iran/Iraq war continues to rage in starts and fits with no material impact on shipments of oil from the Persian Gulf. Iran output will be constrained to 2.0 million barrels per day while Iraq will produce 3.0 million barrels per day.
- 4) OPEC market share will therefore range between 17.5 and 17.7 million barrels per day.
- 5) OPEC producers will try to sell up to 18.6 million barrels per day.
- 6) OPEC will therefore be unable to move or hold price much above the lower end of the range over which the market has cleared over the past two years.

Scenario 2 - Mid

	<u>FY 88</u>	<u>FY 89</u>	<u>FY 90</u>
	(Millions of Dollars)		
Total Unrestricted Revenues	2,111.9	1,772.5	1,825.9
	(Price in \$ per barrel)		
(1) West Coast	14.82	14.17	14.95
(2) Gulf Coast	15.86	15.19	15.96
(3) Weighted Average	15.24	14.58	15.34

The middle price scenario is based on the following assumptions:

- 1) Modest world economic growth in the range of 2.0 to 2.5%.
- 2) Non-OPEC production will average 500,000 barrels per day higher in both 1988 and 1989 due to investments made in prior years.
- 3) The Iran/Iraq war continues to rage on in fits and starts with no major impact on the flow of oil from the Persian Gulf.
- 4) OPEC market share will range between 17.8 and 18.0 million barrels per day on average for 1988 and 1989.
- 5) OPEC tightens production discipline at the June meeting by allowing Iran to produce outside an official quota with Iraq trimming production to 2.3 million barrels per day. Strengthening prices in the summer result in OPEC production approaching 20.0 million barrels per day. This creates the seasonal inventory accumulation which has historically become a problem in the spring when no single producer or group of producers are willing to curtail production below quota to meet changes in seasonal demand patterns.
- 6) Price will therefore swing within the consensus range according to this OPEC cycle.

Scenario 3 - High

	<u>FY 88</u>	<u>FY 89</u>	<u>FY 90</u>
	(Millions of Dollars)		
Total Unrestricted Revenues	2,156.4	2,316.8	2,424.9
	(Price in \$ per barrel)		
(1) West Coast	15.42	18.13	19.11
(2) Gulf Coast	16.46	19.15	20.14
(3) Weighted Average	15.84	18.54	19.51

The high price scenario assumptions are as follows:

- 1) Strong world economic growth of 4% per year.
- 2) Non-OPEC production increases by 500,000 barrels per day in 1988 but no additional production in 1989.
- 3) The Iran/Iraq war continues, however, the combined production of both countries does not exceed 5.0 million barrels per day.
- 4) This implies an OPEC market share of 18.0 to 18.2 million barrels per day in 1988 and 18.7 million barrels per day in 1989.
- 5) OPEC sticks to a realistic quota of between 17.8 and 18.0 million barrels per day with key discretionary producers observing "seasonal" quotas.
- 6) Oil prices remain relatively stable close to the current official OPEC fixed price.

HM:JBR:mll

TABLE I

MARCH 1988 ESTIMATES OF UNRESTRICTED
 PETROLEUM AND NON-PETROLEUM REVENUES
 COMPARED TO SEPTEMBER 1987 ESTIMATES
 (Millions of Dollars)

PETROLEUM REVENUES

	<u>FY 1988</u>	<u>FY 1989</u>	<u>FY 1990</u>
SEPTEMBER MEAN ESTIMATE	1728.1	1676.1	1839.2
Oil Price (Average \$/bbl)	(16.45)	(15.62)	(16.37)
MARCH LOW SCENARIO	1750.6	1080.2	1067.1
Change from September	22.5	-595.9	-772.1
Oil Price (Average \$/bbl)	(14.80)	(11.32)	(11.16)
MARCH MID SCENARIO	1777.4	1476.1	1598.9
Change from September	49.3	-200.0	-240.3
Oil Price (Average \$/bbl)	(15.24)	(14.58)	(15.34)
MARCH HIGH SCENARIO	1821.9	2003.4	2129.9
Change from September	93.8	327.3	290.7
Oil Price (Average \$/bbl)	(15.84)	(18.54)	(19.51)

NON-PETROLEUM REVENUES*

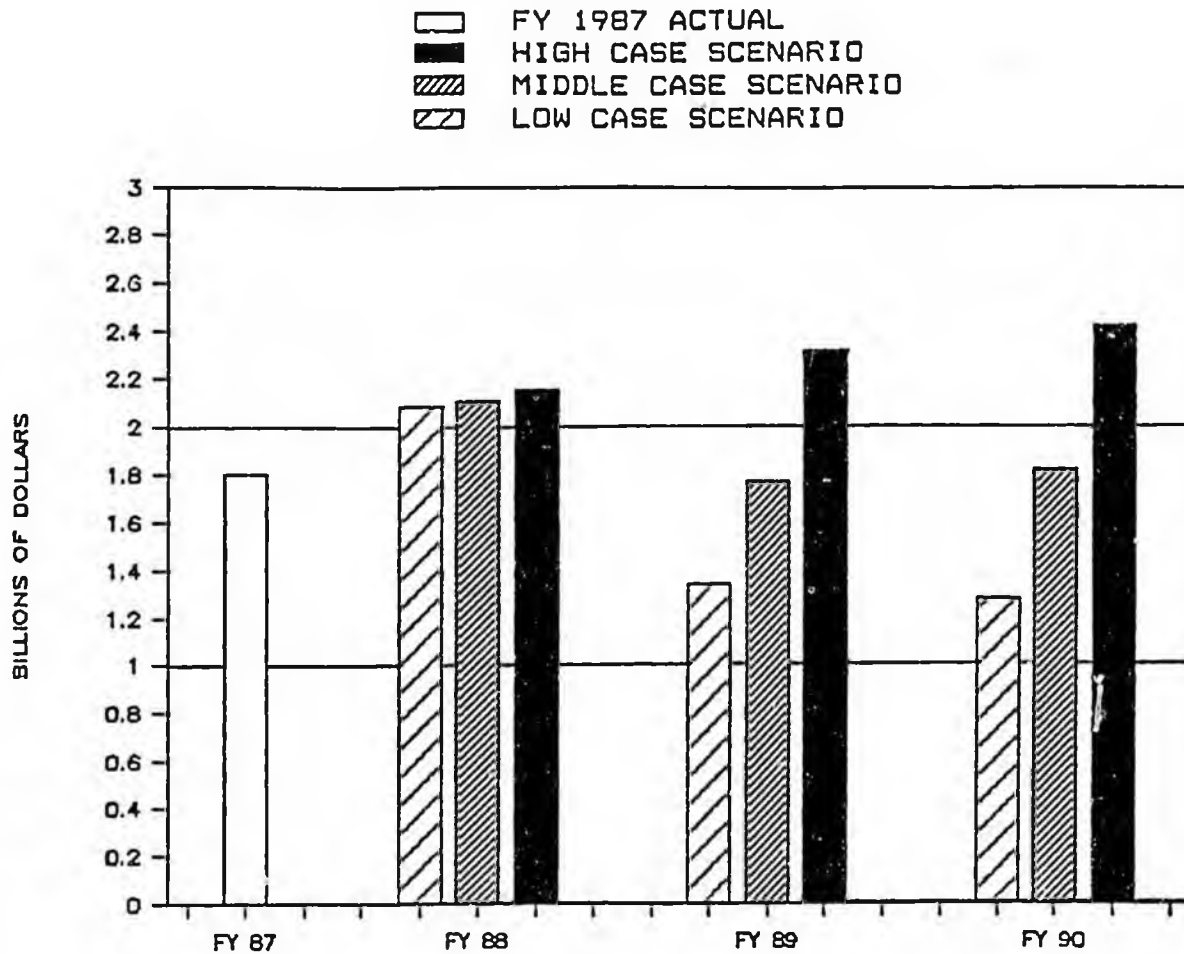
	<u>FY 1988</u>	<u>FY 1989</u>	<u>FY 1990</u>
SEPTEMBER MEAN ESTIMATE	337.2	314.5	288.5
MARCH LOW SCENARIO	334.5	257.4	218.0
Change from September	-2.7	-57.1	-70.5
MARCH MID SCENARIO	334.5	296.4	227.0
Change from September	-2.7	-18.1	-61.5
MARCH HIGH SCENARIO	334.5	313.4	295.0
Change from September	-2.7	-1.1	6.5

*Investment earnings constitute the major source of revisions
 (see attached Table III for detail summary)

TOTAL GENERAL FUND UNRESTRICTED REVENUES

	<u>FY 1988</u>	<u>FY 1989</u>	<u>FY 1990</u>
SEPTEMBER MEAN ESTIMATE	2065.3	1990.6	2127.7
MARCH LOW SCENARIO	2085.1	1337.6	1285.1
Change from September	19.8	-653.0	-842.6
MARCH MID SCENARIO	2111.9	1772.5	1825.9
Change from September	46.6	-218.1	-301.8
MARCH HIGH SCENARIO	2156.4	2316.8	2424.9
Change from September	91.1	326.2	297.2

FIGURE I
GENERAL FUND UNRESTRICTED REVENUES
 (FORECAST COMPARISON)



FY 87 Actual

Actual 1.7994 billion

FY 88 Estimates

Low Case 2.0851 billion

Mid Case 2.1119 billion

High Case 2.1564 billion

FY 89 Estimates

Low Case 1.3376 billion

Mid Case 1.7725 billion

High Case 2.3168 billion

FY 90 Estimates

Low Case 1.2851 billion

Mid Case 1.8259 billion

High Case 2.4249 billion

TABLE II
Key Assumptions for March 1988
Petroleum Revenue Projections
For FY 1988 - FY 1990

ANS West Coast Crude Oil Price (\$/bbl at Los Angeles, Calif.)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 88	14.38	14.82	15.42
FY 89	10.92	14.17	18.13
FY 90	10.77	14.95	19.11

ANS Gulf Coast Crude Oil Price (\$/bbl at Houston, Texas)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 88	15.42	15.86	16.46
FY 89	11.93	15.19	19.15
FY 90	11.78	15.96	20.14

Weighted Average ANS Crude Oil Price (\$/bbl)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 88	14.80	15.24	15.84
FY 89	11.32	14.58	18.54
FY 90	11.16	15.34	19.51

Percent of ANS to Gulf Coast

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 88	40	40	40
FY 89	40	40	40
FY 90	39	39	39

Taps Tariff (\$/bbl)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 88	3.61	3.61	3.61
FY 89	3.04	3.04	3.04
FY 90	2.46	2.46	2.47

Wellhead Value (\$/bbl)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 88	9.47	9.77	9.99
FY 89	6.12	9.05	12.68
FY 90	6.60	10.48	14.34

Production Volume (mmbbs/day)*

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 88	1.995	1.995	1.995
FY 89	2.032	2.032	2.032
FY 90	1.979	1.979	1.979

*Actual volume has averaged 1.976 for first six months of FY 88

Inflation (%)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 88	2.80	3.15	3.41
FY 89	3.04	3.81	4.74
FY 90	3.15	4.05	5.25

TABLE III

DETAIL SUMMARY OF MARCH 1988 REVENUE PROJECTIONS

PETROLEUM

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	FY 1987	FY 1988			FY 1989			FY 1990		
	ACTUAL	LOW	MID	HIGH	LOW	MID	HIGH	LOW	MID	HIGH
CORPORATE-PETROLEUM	120.4	120.0	120.0	120.0	120.0	120.0	120.0	120.0	120.0	120.0
SEVERANCE TAX	648.5	732.3	744.2	766.7	449.0	658.7	927.9	439.0	701.5	964.9
ROYALTIES	439.3	621.8	636.7	658.7	409.0	595.2	853.3	410.0	679.3	946.9
PROPERTY TAX	102.5	96.7	96.7	96.7	90.1	90.1	90.1	86.0	86.0	86.0
BONUS SALES	0.5	5.5	5.5	5.5	0.0	0.0	0.0	0.0	0.0	0.0
RENTS	3.8	4.1	4.1	4.1	4.3	4.3	4.3	4.3	4.3	4.3
INTERGOVERNMENTAL	9.0	8.3	8.3	8.3	7.8	7.8	7.8	7.8	7.8	7.8
SPECIAL SETTLEMENTS	70.5	161.9	161.9	161.9	0.0	0.0	0.0	0.0	0.0	0.0
SUB-TOTAL	1394.5	1750.6	1777.4	1821.9	1080.2	1476.1	2003.4	1067.1	1598.9	2129.9
% PETROLEUM	77.50%	83.96%	84.16%	84.49%	80.76%	83.28%	86.47%	83.04%	87.57%	87.83%

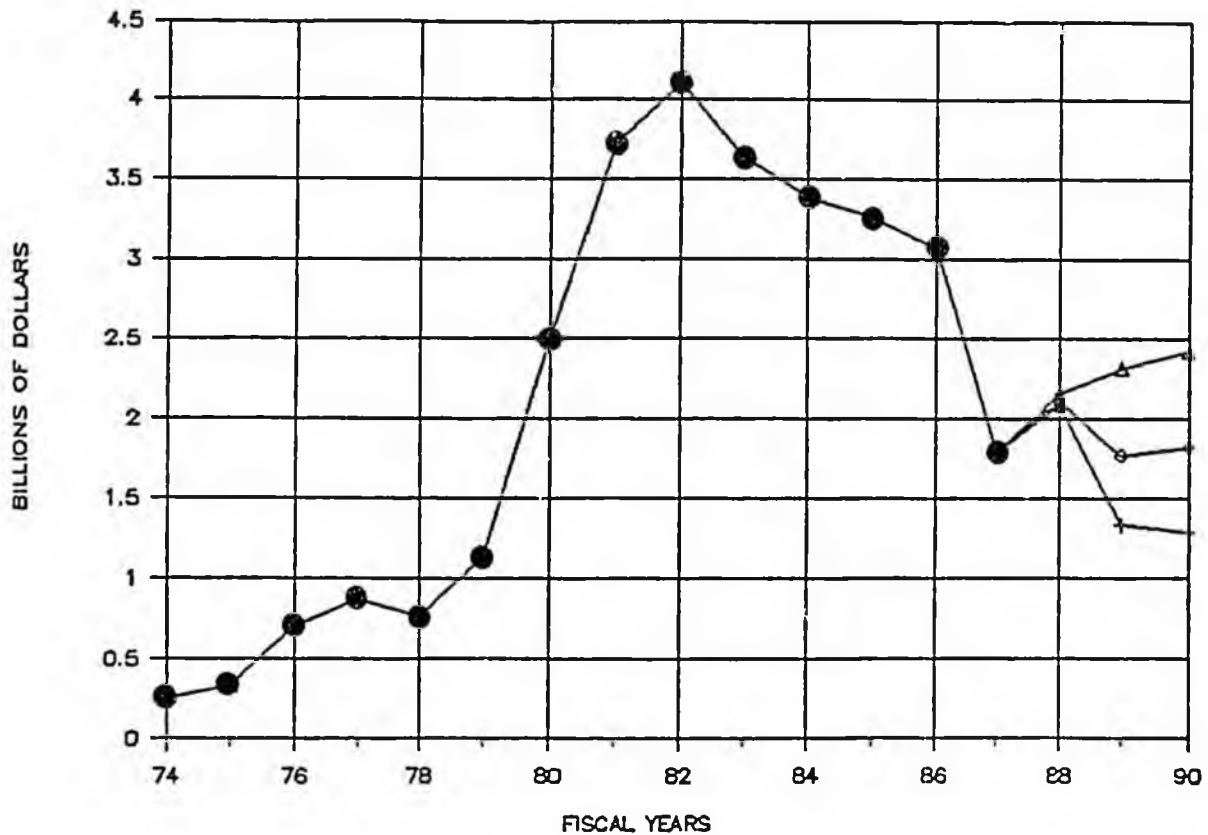
NON-PETROLEUM

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	FY 1987	FY 1988			FY 1989			FY 1990		
	ACTUAL	LOW	MID	HIGH	LOW	MID	HIGH	LOW	MID	HIGH
TAXES	132.8	113.5	113.5	113.5	116.8	116.8	116.8	119.5	119.5	119.5
LICENSES & PERMITS	29.2	27.5	27.5	27.5	26.5	26.5	26.5	26.5	26.5	26.5
INTERGOVERNMENTAL	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
INVESTMENT EARNINGS	161.9	125.0	125.0	125.0	44.0	83.0	100.0	0.0	9.0	77.0
STATE RESOURCES	63.4	52.8	52.8	52.8	54.4	54.4	54.4	56.3	56.3	56.3
MISCELLANEOUS	16.9	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
SUB-TOTAL	404.9	334.5	334.5	334.5	257.4	296.4	313.4	218.0	227.0	295.0
TOTAL	1799.4	2085.1	2111.9	2156.4	1337.6	1772.5	2316.8	1285.1	1825.9	2424.9
MENTAL HEALTH TRUST		0.0	0.0	0.0	66.9	88.6	115.8	64.3	91.3	121.2

FIGURE II
GENERAL FUND UNRESTRICTED REVENUES
 (HISTORICAL VS. PROJECTIONS)

- HISTORICAL ACTUALS
- △ HIGH CASE SCENARIO
- ◇ MIDDLE CASE SCENARIO
- + LOW CASE SCENARIO



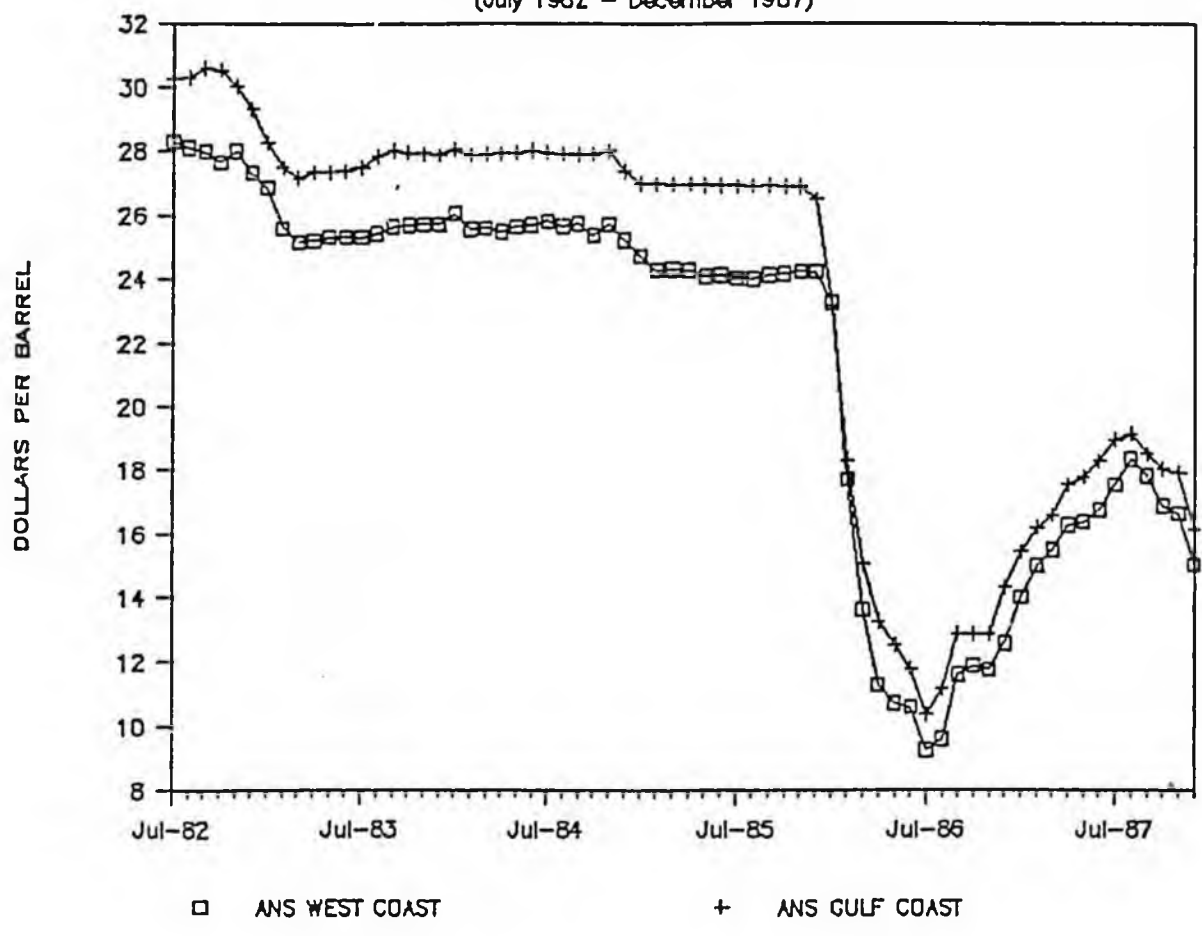
Revenue Actuals
(Nominal \$)

FY 73	.2082 billion
FY 74	.2549 billion
FY 75	.3334 billion
FY 76	.7098 billion
FY 77	.8743 billion
FY 78	.7649 billion
FY 79	1.1330 billion
FY 80	2.5012 billion
FY 81	3.7182 billion
FY 82	4.1084 billion
FY 83	3.6310 billion
FY 84	3.3901 billion
FY 85	3.2600 billion
FY 86	3.0755 billion
FY 87	1.7994 billion

Revenue Estimates
(Nominal \$)

<u>Low Case</u>	
FY 88	2.0851 billion
FY 89	1.3376 billion
FY 90	1.2851 billion
<u>Mid Case</u>	
FY 88	2.1119 billion
FY 89	1.7725 billion
FY 90	1.8259 billion
<u>High Case</u>	
FY 88	2.1564 billion
FY 89	2.3168 billion
FY 90	2.4249 billion

FIGURE III
HISTORICAL ANS CRUDE PRICES
(July 1982 - December 1987)



MEMORANDUM

State of Alaska

TO: Hugh Malone, Commissioner
Department of Revenue

DATE: March 23, 1988

FILE NO: 4112Y

TELEPHONE NO:

THRU: William Floerchinger, Director
Oil and Gas Audit Division

SUBJECT: Preliminary Steps to
Implement the Gault Report

FROM: Charles Logsdon, Petroleum Economist
Oil and Gas Audit Division

1. The most visible change in the forecast is the adoption of an unweighted three scenario approach rather than the development of a mean/variance probability approach to projecting oil revenues. We have retained, for the present, both approaches and will be looking for feedback from the forecast users.

2. The development of the scenarios by the price group (formerly called the Delphi group) will explicitly develop supply and demand projections for world crude oil markets. At this time, we will retain the group and use a Delphi method of price formation. Given a larger budget, a prestigious international consulting firm could be retained to augment this effort. At a minimum, subscriptions to trade and international data sources, which have been dropped in recent years due to budget reductions, need to be renewed.

3. The forecast should be done quarterly with specific deadlines of April 1, July 1, October 1, and January 1 (December 15 for preliminary to Governor). It is proposed that we also prepare a monthly summary which would revise the quarterly forecast to account for new information such as actual revenue collections or errors discovered after the forecast date.

4. The Saudi-Medium marker is retained for now for the following reasons although Saudi-Light would be a reasonable substitute.

a) Over time, the spot price of this crude has one of the highest statistical correlations with ANS prices as reported by Alaska producers.

b) Over time, the product yield for both topping and cracking refineries at the U.S. Gulf, as tracked by Platt's Oilgram, has one of the highest statistical correlations with ANS product yields.

c) Because the values of these two crudes tend to be quite close as measured both in terms of spot price and product yield, this tends to minimize the absolute error in determining the price differential between the two crudes.

Memorandum to Hugh Malone
March 23, 1988
Page 2

d) The behavior of Saudi Arabia is one of the most important, if not the most important, determinant of oil prices. Therefore, it is desirable to use a Saudi crude as marker particularly a sour crude which approximates ANS in quality.

5. We are in the process of coordinating more formally with both the Oil and Gas Conservation Commission and the Department of Natural Resources in developing assumptions about future production and well numbers.

CCL:pjt


MAR 15 1988

State of Alaska
Department of Revenue OFFICE OF THE COMMISSIONER
Oil and Gas Audit Division

M E M O R A N D U M

TO: Hugh Malone
Commissioner, Department of Revenue

THROUGH: William Floerchinger
Director, Oil and Gas Audit Division

FROM: Roger Marks 
Petroleum Economist

DATE: March 1, 1988

SUBJECT: Effect of TAPS Field Allocations on Revenues

The recent operation of TAPS at capacity, coupled with surges in production of the non-Prudhoe Bay fields on the North Slope, has raised concern regarding the State revenue implications of utilizing Prudhoe Bay as the "swing" producer to accommodate the other fields.

To examine these effects we disaggregated production from the four producing fields (Prudhoe Bay, Kuparuk, Lisburne, and Endicott) into 10,000 barrel per day "chunks." That way we could take a set volume (the chunk) from Prudhoe and allocate it to another field to see the overall revenue effect while keeping total North Slope production constant at the TAPS limit. This gives a per chunk effect that can be converted to any total amount desired. (For instance, a 100,000 barrel per day re-allocation would have roughly ten-times the effect of a one [10,000 barrel per day] chunk re-allocation.)

For the base case we used our current production assumptions. Under those assumptions Prudhoe Bay begins to decline after FY89 (mid-calendar 1990). Thus TAPS space should not be a problem after FY90. Therefore, we modelled five 10,000 barrel per day chunks (50,000 barrels per day) removed from Prudhoe Bay for the three years FY88-FY90, and added back 150,000 barrels per day in FY91. Similarly, for the other fields (one field at a time), we added five 10,000 barrel per day chunks for the same three years and removed 150,000 barrels per day in FY91. We kept price constant at \$10/bbl at the Prudhoe Bay wellhead.

The results are illustrated in Tables 1-4, which examine a re-allocation of 50,000 barrels per day from Prudhoe Bay to Kuparuk for the years FY88-FY90, with 150,000 barrels per day removed from Kuparuk and added back to Prudhoe Bay in FY91.

Tables 1 and 2 show the base cases for Prudhoe Bay and Kuparuk. Total severance taxes over the four years for both fields are \$2449 million, total royalties are \$2980 million, total undiscounted revenues are \$5430 million, and total discounted revenues (at eight percent) are \$4880 million.

Table 3 shows the impact on Prudhoe Bay of re-allocating five chunks to Kuparuk. Note that since the ELF is volume sensitive only the total severance taxes collected over the four years will be sensitive to the per year volumes. The total royalties will be unaffected as long as the total volume is constant. (Of course, the present value of both royalties and severance taxes will be affected by the time frame of their flows.) There is no appreciable change in the total severance tax over the four years. Given the large size of Prudhoe Bay, 50,000 barrels is relatively small, and the effect on the overall ELF and the per barrel severance tax is miniscule. Thus total revenue is unchanged and discounted revenues fall \$19 million.

Table 4 shows the impact on Kuparuk. Given the relative increased magnitude of the 50,000 barrels on the smaller field, the ELF and per barrel severance tax increase more than they decrease at Prudhoe Bay for the first three years, applied to the same number of barrels. For the final year the ELF and per barrel severance tax decrease more, but since they apply to less barrels the net effect is an increase in the Kuparuk severance tax of \$25 million from \$201 to \$226 million. Again, royalties are unchanged. Total undiscounted revenue is increased \$25 million, and discounted revenues increase \$36 million. The overall net effect to the State is an increase of undiscounted revenues of \$25 million, and an increase of discounted revenues of \$17 million.

Re-allocation to other fields would yield similar results. Thus it appears this practice may not be hurting the State.

year	psi price	10000 barrel per day chunks	volume	wells	elf	per bbl			total rev	disc rev
						sev tax	sev tax	royalty		
1988	10.00	156	569.4	631	0.820	613	1.00	662	1275	1275
1989	10.00	155	565.75	715	0.796	591	1.04	658	1249	1156
1990	10.00	150	547.5	803	0.765	549	1.00	636	1186	1017
1991	10.00	142	518.3	888	0.727	495	0.95	603	1097	872
						2248		2599	4807	4319

table 2
kuparuk - base case

year	psi price	10000 barrel per day chunks	volume	wells	elf	per bbl			total rev	disc rev
						sev tax	sev tax	royalty		
1988	10.00	28	102.2	315	0.532	65	0.63	110	175	175
1989	10.00	27	98.55	366	0.449	53	0.53	106	159	147
1990	10.00	27	98.55	396	0.411	48	0.45	106	154	132
1991	10.00	25	91.25	426	0.334	36	0.40	98	135	107
						201		421	623	561

table 3
prudhoe bay - 5 chunks

year	psi price	10000 barrel per day chunks	volume	wells	elf	per bbl			total rev	disc rev
						sev tax	sev tax	royalty		
1988	10.00	151	551.15	631	0.814	589	1.07	641	1230	1230
1989	10.00	150	547.5	715	0.789	567	1.04	636	1204	1114
1990	10.00	145	529.25	803	0.757	526	0.99	615	1141	978
1991	10.00	157	573.05	888	0.752	566	0.99	666	1232	978
						2248		2559	4806	4300

table 4
kuparuk - 5 chunks

year	psi price	10000 barrel per day chunks	volume	wells	elf	per bbl			total rev	disc rev
						sev tax	sev tax	royalty		
1988	10.00	33	120.45	315	0.596	85	0.71	130	219	215
1989	10.00	32	115.8	366	0.525	73	0.62	126	199	184
1990	10.00	32	116.8	396	0.491	68	0.56	126	194	166
1991	10.00	10	36.5	426	0.000	0	0.00	39	39	31
						226		421	640	597

Alaska State Legislature

INTERIM OFFICE
3111 'C' STREET, SUITE 535
ANCHORAGE, ALASKA 99503
(907) 561-7614

IN SESSION:
POUCH V
JUNEAU, ALASKA 99811
(907) 465-4714



Senator Mitch Abood
CHAIRMAN

Senate Committee on State Affairs

March 24, 1988

MEMORANDUM

TO: All Members of the Alaska Legislature

FROM: Senator Mitch Abood, Chairman
Senate Committee on State Affairs *M.A.*

SUBJECT: CS for House Bill 164, the so-called ELF bill

Attached you will find "The Truth About ELF," which I am providing to you for your information.

It is important to keep in mind that Petroleum revenue accounts for approximately 85% of all state revenue, and that the State of Alaska spends more than any other state on a per capita basis. In addition, between 1980 and 1986 the oil industry paid the state \$26 billion in taxes and royalties.

The ELF is working just as it was originally intended: it is creating jobs for Alaskans. It is stimulating economic activity in Alaska. It is providing an incentive for development of fields with higher development costs. It is increasing recoverable oil reserves.

The solution to Alaska's economic problems is not increasing taxes to fuel more government spending, as proposed by the Democratic Majority in the House of Representatives and the Governor. Instead, we should provide positive incentives for the further development of our private sector.

The Truth About ELF

- ✓ In 1977 the Legislature removed the stair-step production tax schedule and instituted a 12.25% (changed to 15% in 1981) tax rate on all oil production (in addition to the 12.5% royalty on all state leases). Since this tax burden would have shortened the economic life of all oil fields, the Economic Limit Factor (ELF) was developed to reduce the tax rate as fields approached their economic limits.
- ✓ From the beginning, the ELF applied to all fields in Alaska -- including Prudhoe Bay.
- ✓ During the period 1980 - 1986 the oil industry paid the State of Alaska \$26 billion in taxes and royalties.
- ✓ Oil revenue accounts for 85% of all revenue to the State of Alaska.
- ✓ Alaska's severance tax rate of 15% is the highest in the nation. This is a result of 11 oil and gas tax increases enacted since 1967.
- ✓ ELF reduces the 15% tax rate as fields mature and become more expensive to develop and operate.
- ✓ The absence of an ELF application to the marginal projects of the Prudhoe Bay Field could reduce the ultimate recovery factor for the reservoir.
- ✓ Even with the application of the ELF, the effective severance tax rate for Prudhoe Bay is the second highest in the United States.
- ✓ The tax impacts of the ELF are largely offset by increased royalty revenues to the state which result from higher current production.
- ✓ The ELF was designed as an incentive for producers to allow full and optimal developmental programs, and it has been extremely effective in pushing back production decline at Prudhoe Bay.
- ✓ The vast majority of the current \$400 million drilling program is being spent in Alaska. Each of the 8 rigs at Prudhoe, Kuparuk, and Endicott directly employs over 100 Alaskans, with over 200 more indirect jobs in support industries.

Alaska State Legislature

MAR 23 1988

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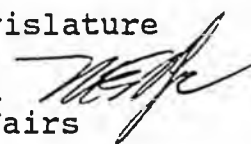
Senator Mitch Abood
CHAIRMAN

Senate Committee on State Affairs

March 23, 1988

MEMORANDUM

TO: All Members of the Alaska Legislature

FROM: Senator Mitch Abood, Chairman 
Senate Committee on State Affairs

SUBJECT: C3 for House Bill 164, the so-called ELF bill

Attached is a press release issued when Governor Hammond signed legislation in 1981 which related to the state's oil and gas taxation system, and the Economic Limit Factor (ELF). As stated in the press release, one of his conditions for signing the bill was that it "maintain the state's combined royalty and tax 'share'" at above 30 percent.

The key question then is what is the State of Alaska's current "share?" The following numbers are from "Petroleum Intelligence Weekly" (an independent publication), and they directly speak to Governor Hammond's point:

<u>Year</u>	<u>State of Alaska's Revenue Share</u>
1985	33.0%
1st half of 1986	41.8%
2nd half of 1986	63.7%
1st half of 1987	39.0%
2nd half of 1987	35.5%
1988 (through 2/1)	36.3%

Thus, the State government has been receiving far greater than a 30 percent share. You may then ask "well, but what about the future?"

Our own Department of Revenue has forecast that the State will receive far in excess of the 30 percent share Governor Hammond spoke of in the future, and here are the numbers they have forecast:

FY	State's share <u>\$13-14 market price</u>	State's share <u>\$15-16 market price</u>
88	79%	57%
89	92%	61%
90	96%	63%
91	103%	67%

Holy cats, all but one of their forecast shares are more than twice the 30 percent share Governor Hammond and legislative leaders had as an "essential condition." (Source: Department of Revenue: Larson, Logsdon, and Marks; Sensitivity Analysis of Projected Revenue Collections", December 1986, pages 82 and 93)

The ELF is working just as it was originally intended: it is creating jobs for Alaskans. It is stimulating economic activity in Alaska. It is providing an incentive for development of fields with higher development costs. It is increasing recoverable oil reserves.

The solution to Alaska's economic problems is not increasing taxes to fuel more government spending, as proposed by the Democratic Majority in the House of Representatives and the Governor. Instead, we should provide positive incentives for the further development of our private sector.

SB 158, HB 104

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU
JAY S. HAMMOND
GOVERNOR

NEWS RELEASE



FOR IMMEDIATE RELEASE
Date: _____
Time: _____
Place: _____
Name: _____
Address: _____
City: _____
State: _____
Zip: _____

HAMMOND SIGNS OIL & GAS LEGISLATION
7-27-81
6131

ALASKA HISTORICAL LIBRARY

FOR IMMEDIATE RELEASE

JUNEAU—Alaska Governor Jay Hammond late today signed into law a bill making major changes in the state's oil and gas taxing system, modifying the oil and gas taxing structure which has been in place for the past three years.

Hammond late Monday signed the oil and gas bill, PCCSSB 524, which besides amending the state's oil and gas laws provides corporate tax relief for most small businesses in the state.

Hammond said he signed the bill since it meets two essential conditions that he laid down in a letter to the Legislature June 23-- that any new oil and gas taxing bill must improve the state's case against a challenge by the oil industry over the state's taxing policies, and that the bill will maintain the state's combined royalty and tax "share" from its one-pipe resource at above 30 percent.

Hammond while saying the bill was not his first preference and is not perfect, said the bill meets his two major conditions.

MORE

Add 1-1-1-1

"It is the view of all pertinent state agencies that we should content ourselves with the present bill since a far worse alternative would be to take no action at all," Hammond said.

The Governor said the bill improves the state's legal posture in relation to a suit filed by the oil companies over the constitutionality of the 1978 state Oil and Gas Corporation Income tax in several ways.

--The bill adopts a series of amendments to ongoing state tax law designed to make the state's oil taxing policy, taken as a whole, look less unfair toward the oil industry. The amendments, designed to remove the "warts" from state tax law, amend state policy on depreciation, tax exemptions and a host of other issues.

--The bill provides for the deduction of the federal windfall profits tax from state tax payments. The windfall profits tax at the federal level had not been proposed when the state passed the oil and gas income tax in 1978, but the state's failure to permit a deduction for the federal tax has been considered a significant unfairness in the state's tax law.

--The bill makes additional technical changes to ensure that state Native corporations are afforded equal treatment under the income tax laws, regardless of whether they fall under the oil and gas income tax or the "ordinary" income tax, being reimplemented by the new tax law.

--And the bill allows the state to concentrate on the defense of the most questionable provision of the 1978 law, its reliance on "separate accounting" rather than income "apportionment," knowing the state will be returning to the apportionment formula to compute taxes starting on Jan. 1, 1982--limiting the state's tax liability under the existing law to just three years.

MORE

72
750!
43
74

The state in 1978 switched to requiring multinational oil companies to figure their state taxes on the basis of income they received worldwide based on the oil they extracted from the state. The law required the companies to use "separate accounting" in figuring their taxable income, rather than the traditional system of apportioning parts of their income earned from Alaska operations.

The companies sued arguing that the separating accounting system caused them to be taxed twice on their income, once in Alaska, and again in other states.

The state in the new tax law will be returning to a modified apportionment taxing formula, raising the state's severance tax to 15 percent from 12.25 percent to make up most of the revenue the abandonment of the old corporate oil and gas tax will cost the state.

While the apportionment approach to state taxation has been repeatedly upheld as constitutional by the Supreme Court, the court has yet to rule on a case where it was advocated by a taxing state, and has ruled twice against its use in cases brought by taxpayers.

"In short, the income tax in the future will incorporate a 'tried and true' approach to multistate taxation, whereas the present, separate-accounting approach does not," Hammond said.

He noted that several recent independent studies have questioned whether the new tax will cost the state more revenue than official state estimates. He said the latest official estimates by the state's Department of Revenue indicated the state between now and Fiscal Year 1985 will retain 31.2 percent of state oil income, compared to the current 31.8 percent.

Hammond said he has been assured that even if less favorable estimates were to prove correct, the bill will still retain the state 30.7 percent, meeting his bottomline requirement of a minimum of 30 percent.

MORE

"As for the possible revenue effects in 1981 and beyond, I have full confidence in the ability of the Legislature to deal at that time with whatever is required to retain the state's 'fair share' of our oil wealth," Hammond said.

He added he still intends this coming session to seek voter support for a policy statement that would support the state not letting its share of oil revenues fall below 30 percent. "It is incumbent upon all of us in public office to determine as clearly as possible what the electorate believes that 'fair share' to be," Hammond said.

He mentioned that the bill also substitutes a progressive tax table for the existing flat 5.4 percent corporate income tax—a tax which also contains a .4 percent surtax on taxable income over \$50,000. Under the new bill smaller corporations will pay 3 percent on their first \$10,000 of taxable income, 2 percent on their second \$10,000 and so on.

Hammond said the bill should result in a significant tax savings, especially for so called "Mom and Pop" family businesses in the state. The new bill also makes other modifications in the corporate tax law for 1981.

Hammond said the bill may need some modification next year, notably to clear up confusion over how the bill impacts the municipal revenue sharing formula—a formula formerly tied to the level of income from the oil and gas corporate income tax. He said he hopes that issue will be re-examined next session.

Statement of Governor Hammond on Signing HOUSE 524

I have today signed the Free Conference Committee Substitute for Senate Bill No. 524, the oil tax bill. I do so only after being reassured by the Departments of Law and Revenue that this legislation satisfies the two essential conditions that I set out in my letter to the Legislature last June 21st -- namely, that it will improve our case in the lawsuits over the oil and gas corporate income tax and that it will maintain the State's combined royalty and tax "share" in this one-time resource above 30 percent.

The Attorney General advises that several provisions in the bill will improve the State's legal posture.

- o First, it adopts the so-called "writs" amendments which I originally proposed in House Bill 192. These will eliminate a number of side issues in the litigation that could otherwise divert the court's attention from the basic issue in the case, which is whether states may use the "separate accounting" approach in taxing the income of multistate and multinational corporations.
- o Second, the Bill provides for the deduction of windfall profit tax payments. The windfall profit tax had not even been thought of when the present tax was passed in 1972, and it is generally recog-

nized that the failure to allow the deduction was an unintended, but significant unfairness in our income tax laws.

- o Third, the bill makes additional technical changes to ensure that Native corporations are afforded equal treatment under the income tax laws, regardless of whether they fall under the oil and gas income tax or the "ordinary" income tax.
 - o And fourth, oil and gas corporate taxpayers will start next year to pay income tax to the state under a modified apportionment approach. It is important to remember that the United States Supreme Court in recent years has repeatedly upheld the apportionment approach as a means for states to tax the income of multistate businesses. In stark contrast to this is the fact that separate accounting has yet to be ruled on in a case where it was advocated by the taxing state, and it has been rejected by the Court twice last year when it was advocated by taxpayers. In other words, the income tax in the future will incorporate a "tried and true" approach to multistate taxation, whereas the present, separate-accounting approach does not.
- Additionally, I am advised by the Department of

First: besides dealing with oil and gas taxes, this bill will provide significant tax relief for smaller corporations. Beginning this year, their tax rate will be one percent on their first \$10,000 of taxable income, two percent on their second \$10,000, and so on. For the many "mom and pop" enterprises that have incorporated themselves over the years, this is major relief from the present 5.1 percent rate on the first \$50,000 and 9.4 percent on any excess. Signing the bill now allows them to begin enjoying those benefits immediately, instead of waiting until the next session of the Legislature to see if something similar can be passed again.

Second, at present certain municipal revenue sharing refers to the total amount of income tax collected as the basis for the amount of revenue shared. Since this bill will reduce the actual income tax receipts (transferring much of the reduction over to the production tax), the formula for continued revenue sharing should be re-examined next year.

Revenue that the State's "share" during the period from FY 82 to FY 85 will be 31.2 percent. Some have objected to Revenue's estimate of the revenue effects of this bill and assert that the revenue consequences during that time will be as much as three or four times greater. However, even if the revenue effect should prove to be as great as those people fear, Alaska's "share" I'm advised will remain 30.7 percent -- thus still fulfilling my pronounced 30-percent requirement to avoid veto. As for possible revenue effects in 1981 and beyond, I have full confidence in the ability of the Legislature to deal at that time with whatever is required to retain the state's "fair share" of the oil wealth. Meanwhile, it is incumbent upon all the public officers to determine as clearly as possible what the electorate believes that "fair share" to be.

Critics of this particular bill have argued that it was hastily drafted and ill-considered and that the "backstop" approach -- which, incidentally, I introduced -- would have been far preferable. I can sympathize: the bill is not perfect, nor is it my preferred choice. I would rather have seen the people get a chance to vote on the question of whether Alaska's "share" in its oil wealth is too great, and I fully intend to introduce legislation next year that will give them precisely this opportunity. In the meantime, it is the view of all pertinent state agencies that we should content ourselves with the present bill. Since a alternative would be to take no action at all,

In conclusion I wish to make two final points.

Analysis by "Petroleum Intelligence Weekly"
2/1/88

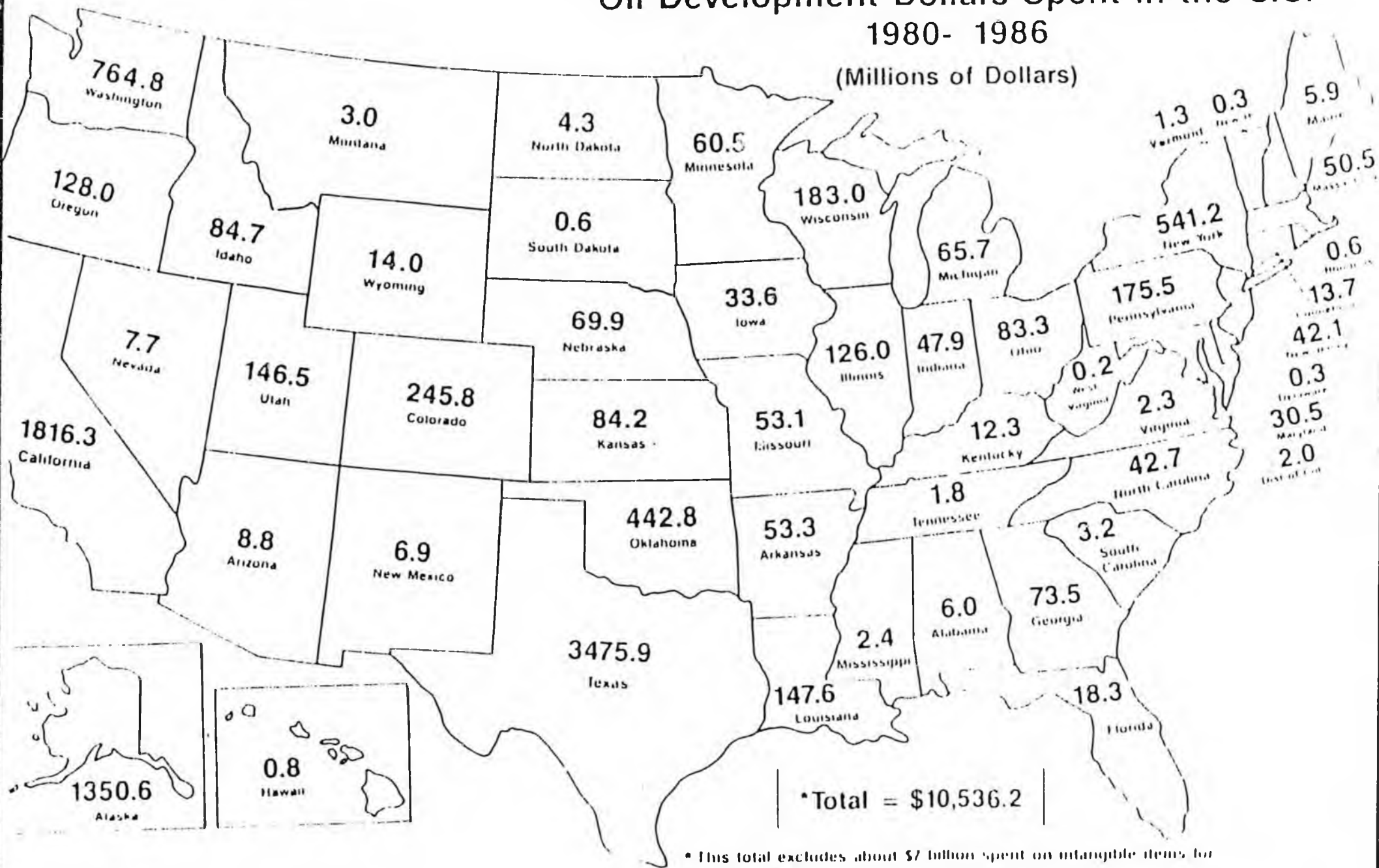
\$/bbl	Full Year 1985	1st Half 1986	2nd Half 1986	1st Half 1987	2nd Half 1987	Todate 1988
Avg West Coast Price	16.84	8.85	5.26	10.62	10.47	10.01
Producing Cost	0.90	0.75	0.75	0.85	0.85	0.85
Depreciation	1.53	2.17	2.17	2.25	2.25	2.25
Total Net Revenue	14.41	5.93	2.34	7.52	7.37	6.91
State Royalty	2.02	1.02	0.58	1.24	1.23	1.17
Severance	2.22	1.17	0.70	1.40	1.09	1.05
Property	0.21	0.18	0.18	0.15	0.15	0.15
State Income Tax	0.30	0.11	0.03	0.14	0.15	0.14
Total State	4.75	2.48	1.49	2.93	2.62	2.51
Federal Income Tax	4.58	1.64	0.41	1.61	1.67	1.54
Industry Profit (including TAPS)	7.26	2.45	1.09	3.51	3.62	3.29
State % of Net Revenue	33.0%	41.8%	63.7%	39.0%	35.5%	36.3%

ELF BULLETS

- As originally enacted in 1978, ELF was intended to give producers a break on severance taxes on low-production wells such as those in Cook Inlet. When Republicans took control of the House in the 1981 coup, they adopted the Senate Republicans' rewrite of the ELF law, which had the effect of allowing the tax break to be applied to Prudhoe Bay starting in 1987, well in advance of the "supergiant" field beginning its production decline.
- The House last year passed and sent to the Senate new legislation that would close the loophole allowing high-production fields to reap the tax-avoidance benefits of the ELF law. If the Senate does not approve the House bill, the State of Alaska will lose an estimated \$415 million over this fiscal year and the next, according to the Department of Revenue. The five-year loss, through FY 92, is estimated to total \$1.2 billion.
- The oil companies argue that changing the ELF now could cause them to cut some of the 2,400 jobs they claim the tax break has allowed them to bring to their North Slope operations, and they'd prefer the Legislature cut the state budget by \$400 million to cover the ELF loss. We know that nowhere near 2,400 North Slope jobs have been created, but even if that number were true, it's hardly likely the Alaska economy would receive the full benefit of those jobs, given the industry's history of hiring out-of-state residents to work on the Slope. Even more significantly, if we were to follow the industry's advice and cut another \$400 million from the state budget, the economy would lose more than 9,500 jobs -- jobs now held by Alaskans, not temporary workers who send their paychecks home to other states.
- The oil companies also argue that changing the ELF law to avoid the anticipated loss would disrupt their "stable tax climate." The implication that changing the ELF would represent an unfair tax burden on the industry or would somehow jeopardize profits simply is not supportable. The fact is the industry long ago recovered the initial capital costs from North Slope operations; after deducting all taxes, operating costs and even new investment costs, the companies as of 1986 had still managed to take approximately \$18.6 billion in net profits out of Alaska.

North Slope Alaska Oil Development Dollars Spent in the U.S. 1980- 1986

(Millions of Dollars)



*Total = \$10,536.2

* This total excludes about \$7 billion spent on intangible items for Kuparuk, East Prudhoe Bay, and Urethane oil fields

State of Alaska
MEMORANDUM

Office of the Governor

Division of Policy

P.O. Box AM, Juneau, AK, 99811

Tel. 465-3568 / Mail Stop 0164

TO: Mary Halloran
Director

DATE: 16 June 1987

FROM: Gregg Erickson *GKE*
Senior Economist

SUBJECT: Oil Industry Profits In Alaska

Professor Edward Deakin has completed his report on "Income and Investment Flows From Alaska Oil and Gas Producing Activities," prepared for Rep. John Sund and the legislature's Joint Tax Policy Committee. Deakin is Price Waterhouse Professor of Accounting at the University of Texas. This is the first time anyone outside the industry has documented in such detail the extraordinary profitability of the oil industry in Alaska.

As far as I am aware Rep. Sund has not yet decided when or in what forum to release the report. Some of the report's findings are highlighted below:

- In 1985 the industry in Alaska earned \$5.08 billion in profits (after all taxes, interest, depreciation and costs). In 1986, the year in which oil prices fell to historic lows, industry profits were \$3.45 billion [p. 4].
- In every year since 1978, profits removed from Alaska have exceeded investments in the state; in 1981 the industry's net investment position became positive. In 1985, \$4.54 billion was expatriated from Alaska, compared with \$0.57 billion reinvested [p. 8].
- Through 1986 the industry earned an after-tax rate of return of 16.9 percent on its Alaska investments. Through the year 2000 the after-tax rate is projected at 19.0 percent [p. 8].
- Using the average oil price assumptions underlying the June Dept. of Revenue forecast (\$10/barrel wellhead), Deakin forecasts the companies' 1988 profits from Alaska operations at \$3.92 billion [p. 37].

enclosures: 1) "Income and Investment Flows From Alaska Oil and Gas Producing Activities."
2) Deakin Vita.

cc: Representative J. Sund
Representative K. Brown
R. Fineburg
✓ J. Hartle

Three Oil Firms Report Lower Quarterly Profit

Standard's Decline Was 21%;
 Net Fell 98% at Ashland,
 20% at Atlantic Richfield

A WALL STREET JOURNAL News Roundup
 Three U.S. oil companies posted earnings declines for the latest quarter, reflecting lower profit margins.

Earnings fell 21% at Standard Oil Co., 20% at Atlantic Richfield Co. and a whopping 98% at Ashland Oil Inc.

At Ashland and Arco, product prices failed to keep pace with rising crude oil prices while at Standard, the drop reflected lower Alaskan crude oil prices compared with a year ago.

Standard Oil Co.

Cleveland-based Standard posted a 14% decline in first-quarter revenue to \$2.49 billion from \$2.91 billion in 1986.

The company said Alaskan crude oil prices dropped 23.1% to an average price of \$15.51 a barrel during the quarter, compared with \$20.18 in the year-ago period.

The company gets 97% of its oil from Alaska.

Standard said first-quarter operating profit from exploration and production dropped 30% to \$327 million from \$464 million in 1986, while operating profit from refining and marketing—aided by lower crude oil costs—jumped sharply to \$72 million from \$5 million in the year-earlier quarter.

The company said that exploration expenses dropped 72% to \$43 million from \$152 million in 1986 because of lower dry-

	MARCH 31 QUARTER NET INCOME		1987		1986		% chg.
	in millions	per share	in millions	per share	in millions	per share	
Arco	\$239	1.31	\$259	1.64	-	-	- 20
Ashland	\$0.7	.02	\$41.6	1.20	-	-	- 98
Standard	\$200	.85	\$253	1.08	-	-	- 21

hole and support costs, and lower field geological and geophysical expenses, among

Separately, Standard disclosed that its directors have been discussing British Petroleum Co.'s proposed purchase of the company with BP representatives. The disclosure suggests that the stalemate over the takeover proposal may be easing, and it also raises the possibility that Standard may be able to extract a higher price from BP.

Standard said its directors haven't yet reached a decision on BP's tender offer of \$7.4 billion, or \$70 a share, for Standard's publicly held shares. The company said the seven members of its special committee, which consists of directors who are neither Standard officers nor affiliated with BP, met yesterday and will continue their discussions.

other reasons:

Robert B. Horton, chairman and chief executive officer, said that despite the lower first-quarter results, the company has "done well, even with the lower prices. Refining and marketing results improved, and the cost-cutting and restructuring we did last year is paying off."

As previously reported, Standard said the special committee would make a recommendation on the tender offer no later than yesterday. The company didn't elaborate on the postponement. BP already owns about 55% of Standard's common shares.

Standard said BP had extended the tender offer to 12:01 a.m. EDT May 5 from 12:01 a.m. next Wednesday.

In New York Stock Exchange composite trading yesterday, Standard closed at \$71, up 50 cents, on volume of 2.2 million shares.

Ashland Oil Inc.

The Ashland, Ky.-based company said higher crude oil prices and excess inventory inventories contributed to an \$8.8 million operating loss in its second quarter ended

March 31.

Net income included a gain of \$9.5 million from the transfer of funds to an employee stock ownership plan.

The average number of common and common-equivalent shares outstanding increased to 32.1 million from 29.5 million in 1986.

Revenue dropped 11% to \$1.52 billion from \$1.71 billion in the 1986 quarter. Revenue excludes excise taxes.

Ashland, which had expected to report a decrease in earnings, said that it was hurt by the performance of its Ashland Petroleum Co. and SuperAmerica units. Ashland Petroleum posted an operating loss of \$34.6 million for the quarter, compared with operating profit of \$34.8 million in 1986. SuperAmerica, a chain of convenience and self-serve gasoline outlets, posted a \$51,000 operating loss during the quarter, compared with operating profit of \$17.5 million in the year-earlier period.

"While crude oil prices increased in line with OPEC policy, unseasonably warm weather and high product inventories throughout the industry kept product prices from increasing as rapidly," said John R. Hall, Ashland chairman and chief executive officer.

Ashland produces little crude. As a result, the company is hurt when prices for crude rise more rapidly than prices of gasoline and other refined products.

Mr. Hall nevertheless said that Ashland's profit margins are expected to pick up with the onset of the summer driving and road construction season.

Net income for the six months slid 70% to \$27.9 million, or 86 cents a share, from \$91.9 million, or \$2.68 a share, in the year-earlier six months. Revenue dropped 18% to \$3.02 billion from \$3.69 billion in the 1986 quarter.

Ashland shares closed yesterday at \$59.875, off \$1, in New York Stock Exchange composite trading.

Atlantic Richfield Co.

Los Angeles-based Arco said its profit decline resulted from lower margins that reflected the lag in the rise of product prices compared with crude-price in-

The Alaska producers are doing A-OK
 (Standard + ARCO)

Am. Daily News
 4/30/87

Texaco profit cut by 64%
 NEW YORK — Texaco Inc. said Wednesday that slumping crude and product prices, and fallout from its multibillion-dollar legal battle with Pennzoil Co., helped cut its first-quarter profit by 64 percent from a year earlier. The White Plains, N.Y.-based oil company, the nation's third-largest after Exxon Corp. and Mobil Corp., said it earned \$118 million, or 49 cents a share, in the first three months of this year. That compared with a profit of \$328 million, or \$1.37 a share, in the first quarter of 1986. Sales totaled \$8.5 billion, vs. \$9.6 billion in the earlier period.

Standard - much higher profit
 ARCO - higher profit

creases.

Revenue declined 13% to \$3.74 billion from \$4.29 billion.

But Lodwick M. Cool, chairman, said he was "extremely pleased" with the company's performance because it "demonstrates Arco's earning power in a lower crude-price environment."

Reductions in Arco's exploration and operating costs helped earnings in the latest period, Mr. Cool said. Exploration expenses totaled \$75 million in the quarter, down from \$137 million a year ago.

Arco shares closed yesterday at \$84.50, up 25 cents, in New York Stock Exchange composite trading.

POTENTIAL REVENUES
FY 1989 - FY 2000
 (UGF \$, Millions)

	<i>FY</i> 89	<i>FY</i> 90	<i>FY</i> 91	<i>FY</i> 92	<i>FY</i> 93	<i>FY</i> 94	<i>FY</i> 95	<i>FY</i> 96	<i>FY</i> 97	<i>FY</i> 98	<i>FY</i> 99	<i>FY</i> 2000
<u>POTENTIAL SOURCES</u>												
USE PF EARNINGS*:												
<i>Undistributed only</i>	533	407	299	209	104	0	0	0	0	0	0	0
<i>Dividends</i>	459	488	486	486	523	560	599	641	685	730	778	828
<i>Inflation proofing</i>	438	566	614	665	719	762	701	746	793	842	893	947
ADOPT INDIVIDUAL INCOME TAX	83	255	269	282	290	300	300	300	300	300	300	300
SEVERANCE TAX ELF REVISION	415**	280	272	249	217	200	185	160	142	136	124	144
RETURN TO SEPARATE ACCOUNTING	180	180	189	187	159	135	110	82	59	36	12	10
OIL & GAS PROPERTY TAX REVISION	160***	75	71	66	62	59	55	52	49	46	43	40
MOTOR FUEL TAX INCREASE	35	32	32	33	35	36	37	39	40	42	44	46

*Permanent Fund Corporation 1/31/88 projections. Amounts shown as available from components of Permanent Fund earnings assume no use of undistributed earnings or inflation proofing in prior years.

**FY 89 figure includes collections from two fiscal years: \$187 million in FY 88, and \$228 million in FY 89.

***FY 89 figure includes collections from two fiscal years: \$82 million due 6/88, and \$78 million due 6/89.

MAR 15 1988

State of Alaska
Department of Revenue OFFICE OF THE COMMISSIONER
Oil and Gas Audit Division

M E M O R A N D U M

TO: Hugh Malone
Commissioner, Department of Revenue

THROUGH: William Floerchinger
Director, Oil and Gas Audit Division

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SUBJECT: Effect of TAPS Field Allocations on Revenues

The recent operation of TAPS at capacity, coupled with surges in production of the non-Prudhoe Bay fields on the North Slope, has raised concern regarding the State revenue implications of utilizing Prudhoe Bay as the "swing" producer to accommodate the other fields.

To examine these effects we disaggregated production from the four producing fields (Prudhoe Bay, Kuparuk, Lisburne, and Endicott) into 10,000 barrel per day "chunks." That way we could take a set volume (the chunk) from Prudhoe and allocate it to another field to see the overall revenue effect while keeping total North Slope production constant at the TAPS limit. This gives a per chunk effect that can be converted to any total amount desired. (For instance, a 100,000 barrel per day re-allocation would have roughly ten-times the effect of a one [10,000 barrel per day] chunk re-allocation.)

For the base case we used our current production assumptions. Under those assumptions Prudhoe Bay begins to decline after FY89 (mid-calendar 1990). Thus TAPS space should not be a problem after FY90. Therefore, we modelled five 10,000 barrel per day chunks (50,000 barrels per day) removed from Prudhoe Bay for the three years FY88-FY90, and added back 150,000 barrels per day in FY91. Similarly, for the other fields (one field at a time), we added five 10,000 barrel per day chunks for the same three years and removed 150,000 barrels per day in FY91. We kept price constant at \$10/bbl at the Prudhoe Bay wellhead.

The results are illustrated in Tables 1-4, which examine a re-allocation of 50,000 barrels per day from Prudhoe Bay to Kuparuk for the years FY88-FY90, with 150,000 barrels per day removed from Kuparuk and added back to Prudhoe Bay in FY91.

Tables 1 and 2 show the base cases for Prudhoe Bay and Kuparuk. Total severance taxes over the four years for both fields are \$2449 million, total royalties are \$2980 million, total undiscounted revenues are \$5436 million, and total discounted revenues (at eight percent) are \$4880 million.

Table 3 shows the impact on Prudhoe Bay of re-allocating five chunks to Kuparuk. Note that since the ELF is volume sensitive only the total severance taxes collected over the four years will be sensitive to the per year volumes. The total royalties will be unaffected as long as the total volume is constant. (Of course, the present value of both royalties and severance taxes will be affected by the time frame of their flows.) There is no appreciable change in the total severance tax over the four years. Given the large size of Prudhoe Bay, 50,000 barrels is relatively small, and the effect on the overall ELF and the per barrel severance tax is miniscule. Thus total revenue is unchanged and discounted revenues fall \$19 million.

Table 4 shows the impact on Kuparuk. Given the relative increased magnitude of the 50,000 barrels on the smaller field, the ELF and per barrel severance tax increase more than they decrease at Prudhoe Bay for the first three years, applied to the same number of barrels. For the final year the ELF and per barrel severance tax decrease more, but since they apply to less barrels the net effect is an increase in the Kuparuk severance tax of \$25 million from \$201 to \$226 million. Again, royalties are unchanged. Total undiscounted revenue is increased \$25 million, and discounted revenues increase \$36 million. The overall net effect to the State is an increase of undiscounted revenues of \$25 million, and an increase of discounted revenues of \$17 million.

Re-allocation to other fields would yield similar results. Thus it appears this practice may not be hurting the State.