

ALASKA LEGISLATURE COMMITTEE FILES, 1989-1990
5989 HOUSE RESOURCES

8672

393

Table 1

PRICE/REVENUE SENSIVITY SCHEDULE
 Unrestricted State Revenue¹
 (Millions \$)

ANS Price Lower 48 ²	FY 1989	FY 1990
\$10 /bbl	1724	1139
11	1769	1238
12	1827	1373
13	1885	1507
14	1943	1641
15	2001	1775
16	2060	1909
17	2117	2043
18	2176	2178
19	2240	2312
20	2292	2446

¹ Based on Department of Revenue mid scenario assumptions Fall 1988 Forecast updated for actual marketing and production data through December 1988, new 1989 TAPS tariff filing, and spot price information for January 1989.

² The average ANS price for all lower 48 sales is approximately \$0.80/bbl less than the U. S. Gulf price.

Table 2

Updated with actual data thru DEC/JAN FY 1989 and calendar year 1989 TAPS filing

Spot prices added for JAN/FEB

Assumptions based on October 1988 forecast by DOR - Mid scenario

14 Feb 89

PRODUCT/REVENUE MONTH/YEAR	1988	JUNE	JULY	AUG	AUG/SEP	SEP/OCT	OCT/NOV	NOV/DEC	DEC/JAN	JAN/FEB	FEB/MAR	MAR/APR	APR/MAY	MAY/JUN	1989	90 Q1	90 Q2	90 Q3	90 Q4	1990
14 OPEC MARKER - \$/bbl	18 2900	14.3100	13.3200	13.3100	11 8100	10 4600	10 6100	12 6800	14 3667	12 5000	12 5000	12 0000	12 0000	12 4889	11 5300	11 8300	12 5300	12 3300	12 0550	
15 TRANS & MARKET DIFFERENTIAL	0 5389	1 0700	0 9700	0 8900	1 8200	2 1900	1 1000	0 1079	1 9333	0 4470	0 4470	0 3880	0 3880	0 9783	0 8580	0 7830	0 8776	0 8306	0 8373	
16 AVG. ANS OIL PRICE @ U.S. GULF \$/bbl	18 8289	15 3800	14 2900	14 2000	13 6300	12 6500	11 7100	12 7879	16 3000	12 9470	12 9470	12 3880	12 3880	13 4662	12 3880	12 6130	13 4076	13 1606	12 8923	
17 AVG. ANS OIL PRODUCTION MMbbls/day	1 8940	1 8399	1 9160	1 9654	1 9748	1 9674	1 9833	1 9510	1 9270	1 9270	1 9270	1 9270	1 9270	1 9414	1 8310	1 8290	1 8250	1 8290	1 8295	
18 AVERAGE ANS WEST/GULF MARKET DIFFER	2 4796	-0 4878	-0 8756	-0 5250	-0 6687	-0 5837	-0 7866	-0 7438	-0 5230	-0 5330	-0 5430	-0 5390	-0 5490	-0 6140	-0 5810	-0 6190	0 6640	0 6880	0 6300	
19 TRANSPORTATION TO U.S. GULF		2 7820	3 1640	2 7186	3 0014	3 0527	2 8004	2 7399	3 1730	3 1830	3 1930	3 1890	3 1990	3 0163	3 2310	3 2690	3 3140	3 3380	3 2880	
20 AVG. TAPS TARIFF \$/bbl	3 6827	3 1860	3 1770	3 1700	3 1640	3 1610	3 1660	3 1811	3 0100	3 0100	3 0100	3 0100	3 0100	3 1029	3 0100	3 0100	3 1310	3 1440	3 0730	
21 AVG. NON PRUDHOE TCOST/QUAI/MTDIF	0 1984	0 1984	0 1984	0 1984	0 1870	0 1670	0 1870	0 1872	0 1872	0 1872	0 1871	0 1871	0 1871	0 1899	0 1866	0 1866	0 1866	0 1866	0 1866	
22 WT. AVG. ANS OIL ROY WHV \$/bbl	10 4682	9 7012	8 6262	8 6330	7 9463	6 8330	6 3522	7 4435	10 4528	7 0998	7 0999	6 5409	6 5409	7 7730	6 5414	6 7664	7 4300	7 1800	6 9820	
23 AVG. CGF NGL MM bbl/DAY	0 0457	0 0587	0 0547	0 0555	0 0604	0 0597	0 0612	0 0607	0 0550	0 0550	0 0550	0 0550	0 0550	0 0572	0 0543	0 0540	0 0540	0 0593	0 0554	
24 AVG. PROCESS COST NGL	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	5 5200	
25 DAYS IN PRODUCTION MONTH/YEAR	368	30	31	31	30	31	30	31	31	29	31	30	31	365	92	92	90	92	365	
26 AVG. PET REV ELF	0 7950	0 7963	0 7918	0 7930	0 7906	0 7876	0 7863	0 7835	0 7898	0 7896	0 7894	0 7892	0 7890	0 7899	0 7807	0 7609	0 7644	0 7637	0 7674	
27 SEVERANCE RATE ADJ. FACTOR	0 9939	0 9707	1 0000	0 9772	0 9651	0 9942	1 0282	1 0046	0 9894	0 9862	0 9850	0 9914	0 9912	0 9991	0 9831	1 0143	1 0261	1 0058	1 0073	
28 AVG. EFFECT FLOOR ADJ. ELF	0 7902	0 7730	0 7946	0 7749	0 7630	0 7830	0 8085	0 7871	0 7815	0 7787	0 7776	0 7825	0 7821	0 7822	0 7675	0 7718	0 7843	0 7682	0 7729	
29 WT. AVG. NOMINAL SEV TAX RATE	0 1496	0 1480	0 1480	0 1481	0 1481	0 1481	0 1481	0 1481	0 1479	0 1479	0 1479	0 1479	0 1479	0 1480	0 1477	0 1477	0 1477	0 1477	0 1477	
30 ANS OIL SEVERANCE TAX MM\$	789 8297	56 4826	52 6900	52 7948	46 5105	42 2525	39 5738	45 8803	63 1047	39 9555	42 6497	38 2626	39 5202	559 6773	109 1890	113 4763	124 0300	119 8400	466 5353	
31 ANS NGL SEVERANCE TAX MM\$	7 2386	0 6438	0 4604	0 4692	0 3845	0 2124	0 1339	0 3164	0 7353	0 2203	0 2355	0 1473	0 1522	4 1111	0 4462	0 5412	0 8155	0 7920	2 5919	
32 ANS TOTAL OIL & NGL SEVERANCE TAX MM	797 0683	57 1263	53 1504	53 2640	46 8949	42 4649	39 7077	46 1968	63 8401	40 1758	42 8852	38 4099	39 6724	563 7884	109 6352	114 0175	124 8155	120 6320	469 1302	
33 ANS OIL CONSERVATION TAX MM\$	2 4319	0 2036	0 2078	0 2132	0 2073	0 2147	0 2082	0 2110	0 2100	0 2000	0 2100	0 2000	0 2100	2 4959	0 5800	0 5800	0 5800	0 5800	2 3200	
34 AVG. ANS OIL ROYALTY RATE	0 1254	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1257	0 1260	0 1260	0 1260	0 1260	0 1260	
35 ROYALTY RATE ADJ. FACTOR	0 9918	1 0332	1 0383	0 9504	0 9649	0 9510	0 9536	0 8547	0 9963	0 9928	0 9918	0 9936	0 9938	1 0111	0 1111	1 0224	1 0356	1 0149	1 0210	
36 EFFECTIVE ROYALTY RATE	0 1244	0 1299	0 1305	0 1195	0 1213	0 1195	0 1199	0 1074	0 1252	0 1248	0 1247	0 1249	0 1249	0 1274	0 1288	0 1305	0 1279	0 1286	0 1286	
37 AVG. ROY FIELD COST DEDUCT \$/bbl	0 5790	0 6500	0 6500	0 6500	0 6500	0 6500	0 6500	0 6500	0 6521	0 6543	0 6564	0 6586	0 6607	0 6591	0 6566	0 6722	0 6788	0 6689	0 6689	
38 ANS OIL ROYALTIES B4 PF&PSF CONTRIB	897 6531	68 4139	61 8312	58 1441	52 4285	45 0786	40 6759	44 1424	73 3201	44 9522	47 9849	42 4723	43 8791	623 3232	126 2430	132 2397	145 3700	139 8900	543 7427	
39 ANS NGL ROYALTIES B4 PF CONTRIB	10 3787	0 9255	0 6620	0 6746	0 5527	0 3054	0 1924	0 4550	1 0572	0 3167	0 3386	0 2117	0 2188	5 9107	0 6433	0 7802	1 1757	1 1417	3 7410	
40 TOTAL ANS OIL & NGL ROYALTIES B4 PF M	908 0318	69 3394	62 4932	58 8187	52 0812	45 3839	40 8684	44 5973	74 3773	45 2690	48 3235	42 6840	43 0979	629 2339	126 8863	133 0199	146 5457	141 0317	547 4837	
41 ANS OIL ROY PF&PSF GF ADJ FACTOR	0 7450	0 7223	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7398	0 7395	0 7395	0 7395	0 7395	0 7395	
42 ANS OIL ROYALTIES NET GF MM\$	676 4337	51 2973	46 2325	43 5141	39 1955	33 5750	30 2344	32 9931	55 0243	33 4900	35 7497	31 5777	32 6236	465 5072	93 8324	98 3682	108 3706	104 2930	404 8642	
43 TOTAL GF ANS OIL PRODUCT REVS MM \$	1475 9838	108 6273	99 5908	96 9913	86 2977	76 2546	70 1503	79 4009	119 0744	73 8658	78 8449	70 1875	72 5060	1031 7915	204 0477	212 9657	233 7961	225 5049	876 3144	
44																				
45 ANS OIL FRODN REV' CURRENT FY MOLY CASI	FLOW ANALYSIS AND COMPARISON WITH OFFICIAL DOR FORECAST																			
46 GF ANS OIL PROD REV ACT COIL	1475 9838	108 6273	99 5908	96 9913	86 2977	76 2546	70 1503	79 4009	79 7896	74 3863	79 3770	70 6931	73 0164	983 4183	205 3528	214 1707	233 7961	225 5049	878 8326	
47 LAST DOR REVENUE FORECAST (OCT88)	1475 9838	108 2807	98 2827	88 5195	79 8616	77 9302	75 3984	77 8927	119 0744	73 8658	78 8449	70 1875	72 5060	1031 7915	204 0477	212 9657	233 7961	225 5049	876 3144	
48 UPDATED DOR ANS REVENUE FORECAST	1475 9838	108 6273	99 5908	96 9913	86 2977	76 2546	70 1503	79 4009	119 0744	73 8658	78 8449	70 1875	72 5060	1031 7915	204 0477	212 9657	233 7961	225 5049	876 3144	
49																				
50 UPDATED REVENUE FORECAST DIFFERENCE	0 0000	0 3466	1 3081	8 4717	6 4361	-1 6756	-5 2381	1 5082	39 2848	-0 5205	-0 5321	-0 5055	-0 5104	48 3733	-1 3052	-1 2131	0 0000	0 0000	-2 5182	
51 YTD CUM UPDATED FORECAST DIFFERENCE	0 0000	0 3466	1 6547	10 1264	15 5625	14 8869	9 6488	11 1570	50 4418	-49 9213	-49 3892	-48 8837	-48 3733	48 3733	-1 3052	-2 5182	2 5182	2 5182	2 5182	

CMBIGSHORTDECSHORT WK1

Actual Data

King
Tallman
Cote
Chenhall
Bartholomew

Voting "No" Westfall
Absent: None
4 votes required for passage
Effective Date: 1/16/89

K E T C H I K A N G A T E W A Y B O R O U G H

RESOLUTION NO. 821

A RESOLUTION OF THE ASSEMBLY OF THE KETCHIKAN GATEWAY BOROUGH, ALASKA, SUPPORTING LEGISLATION ADJUSTING THE ECONOMIC LIMIT FACTOR; AND ESTABLISHING AN EFFECTIVE DATE.

R E C I T A L S

A. The State of Alaska will lose approximately \$200 million this fiscal year from the application of the Economic Limit Factor (ELF) to Prudhoe Bay.

B. Revenue losses to the State due to the tax break allowed by the ELF are projected to total more than \$1 billion during the next five years.

C. The Alaska economy is beginning to emerge from the deepest recession in 30 years. Yet, without additional sources of revenue, public spending this year and next likely will be severely reduced.

D. Cuts of this magnitude would have a devastating effect on the entire economy and on Alaska's local governments.

E. The ELF was originally intended to serve as a tax break to encourage oil production in marginal fields. Prudhoe Bay and Kuparek are respectively the largest and second largest oil fields in North America and are in no sense marginal fields.


F. While oil prices have dropped, oil company profits continue to climb.

Section 1. The Assembly of the Ketchikan Gateway Borough urges the State of Alaska Legislature to 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 largest fields on the continent.

Section 2. The Borough Clerk is directed to send copies of this resolution to the Governor and District Legislators.

Section 3. Effective Date. This resolution is effective upon adoption.

ADOPTED this 16th day of January 1989.


BOROUGH MAYOR

City council endorses

Cordova Times 1/2/88

The Cordova City Council met in a special session Saturday morning to debate the Economic Limit Factor (ELF). For the past two years, the Cowper Administration has been seeking to adjust ELF. Opponents to adjusting ELF say it would not promote economic development. The Cowper Administration believes differently and is currently soliciting support from cities around the state.

The fiscal crisis the state finds itself in now may bring the results Cowper seeks. Oil

revenues comprise close to 85 percent of the government's revenues, according to the revenue commissioner's office.

For an hour, councilmembers debated whether to approve a resolution endorsed by the Cowper Administration requesting the legislature to enact legislation adjusting ELF to encourage oil production at marginal fields and remove the tax break to the two largest and profitable oil fields on the continent. In essence the adjustment

will remove Prudhoe Bay and Kuparek from ELF tax breaks.

Mayor Erling Johansen circulated copies of a letter and model resolution he received from Gov. Cowper's office. The administration says the State of Alaska will lose approximately \$200 million this fiscal year from the application of ELF to Prudhoe Bay, according to the letter.

"Essentially the legislature is split," Johansen told the council. "Democrats are for revising it

ELF tax changes

and Republicans are against that."

Johansen informed the council he needed to know the city's stance on ELF prior to his attendance at the Annual Conference of Mayors Jan. 12 and 13 where the Governor, Lieutenant Governor, and Commissioner of the Department of Community and Regional Affairs will be in attendance. The council unanimously passed the resolution. Councilmembers Dave Rawlins and Doug Lape were absent.

According to Cliff Groh, special

assistant to Revenue Commissioner, Hugh Malone, an adjustment in ELF would enhance economic development and raise more revenues for the state. "It's (been) a bitter and controversial fight," Groh said. "The nominal tax rate is 15 percent. In some cases, ELF reduces that to zero. Prudhoe Bay sometimes pays 12 percent. By adjusting ELF, we would raise the effective rate closer to 15 percent. Higher oil prices would bring in more state revenues and if prices drop the state's loss is less."



CITY OF KOTZEBUE
P.O. BOX 48 • KOTZEBUE, ALASKA 99752

RECEIVED
JAN 30 1989

January 25, 1989

GOVERNOR'S OFFICE

City Hall
442-3401
Police Dept.
442-3351
Fire Department
442-3404
Public Works
Dept.
442-3435
Day Care Center
442-3157
Planning Dept.
442-3465
Building Inspector
442-2623
George Francis
Memorial Library
442-3816
Recreation Center
442-3065
Teen Center
442-3379
Regional Fire
Training Center
442-3921

The Honorable Steve Cowper
Governor
State of Alaska
P.O. Box A
Juneau, Alaska 99811-0101

Dear Governor Cowper;

Enclosed please find Resolution No. 89-3; A Resolution supporting adjustment of the Economic Limit Factor (ELF) which was unanimously passed by the Kotzebue City Council at it's January 19th, 1989 meeting.

The City Council feels the State's municipalities support could be generated if municipal assistance and revenue sharing funding was tied to the ELF repeal.

Sincerely,

Michael Scott
City Manager

MS/zkl

Enclosure

cc: City Council

CITY OF KOTZEBUE

RESOLUTION NO. 89-3

A RESOLUTION SUPPORTING ADJUSTMENT OF THE ECONOMIC LIMIT FACTOR (ELF).

WHEREAS; the State of Alaska will loose approximately \$200 million this fiscal year from the application of the Economic Limit Factor (ELF) to Prudhoe Bay, and;

WHEREAS; revenue losses to the State due to the tax break allowed by the ELF are projected to total more than \$1 billion during the next five years, and;

WHEREAS; the Alaska economy is beginning to emerge from the deepest recession in 30 years. Yet, without additional sources of revenue, public spending this year and next likely will be severely reduced or in the red; and

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

WHEREAS; the ELF was originally intended to serve as a tax break to encourage oil production in marginal fields. Prudhoe Bay and Kaparek are the largest and second largest oil fields in North America and are in no sense marginal fields, and;

WHEREAS; the application of ELF in its current form actually discourages oil production at some truly marginal fields; and

WHEREAS; while oil prices have dropped, oil company profits continue to climb.

BE IT RESOLVED that the City of Kotzebue support adjustment of the Economic Limit Factor (ELF) 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 largest fields on the continent.

Alaska Conference of Mayors
March 24, 1988
Juneau, Alaska

ALASKA CONFERENCE OF MAYORS

RESOLUTION NO. 88- 20

A RESOLUTION OF THE ALASKA CONFERENCE OF MAYORS
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; and,

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

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

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

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

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

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; and,

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

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

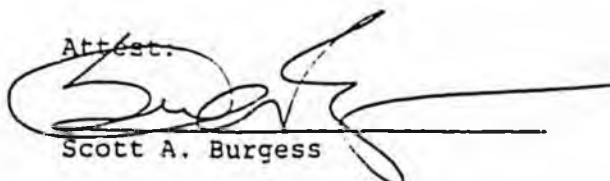
NOW, THEREFORE, BE IT RESOLVED that the Alaska Conference of Mayors urges the Alaska Legislature to enact legislation that would adjust the Economic Limit Factor to make it work as originally intended so as to encourage oil production at marginal fields and not give an unneeded tax break to the Prudhoe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

ADOPTED this 24th day of March 1988.



Erling Johansen, President
Alaska Conference of Mayors

Attest.



Scott A. Burgess

By: Jeff Weltzin
Valerie Therrien
Introduced: 03/26/07
Advanced: 03/26/07
Amended: 04/09/07
Adopted: 04/09/07
Reconsideration
Filed: 04/10/07
Reconsidered: 04/23/07
Substituted by Phil
Yunker: 04/23/07
Adopted: 04/23/07

106 1987
RESOLUTION NO. 87-043

A RESOLUTION ADDRESSING THE STATE OF ALASKA'S
ECONOMIC LIMIT FACTOR

WHEREAS, the Economic Limit Factor enacted by the legislature
in 1981 was intended to promote marginal oil field development; and

WHEREAS, the fields currently producing oil in Alaska differ
from one another with regard to production costs and profitability; and

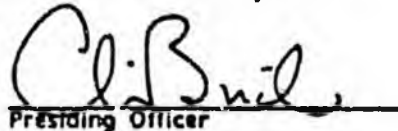
WHEREAS, it is good public policy to encourage commercial
production at marginal fields and avoid premature shut-downs in
production; and

WHEREAS, a fair and equitable form of oil taxation is beneficial
to the residents of the state and the industry; and

WHEREAS, the existing statute dealing with the Economic Limit
Factor is faulty in a number of technical aspects and does not fulfill its
intended purpose.

NOW, THEREFORE, BE IT RESOLVED that the Fairbanks North
Star Borough Assembly urges the Governor and the Legislature to examine
each oil field individually, evaluate the economic characteristics of each
field, and set taxes accordingly.

PASSED AND APPROVED THIS 23RD DAY OF APRIL, 1987


Presiding Officer

ATTEST:


Clerk of the Assembly



City and Borough of Sitka

304 LAKE STREET. SITKA, ALASKA. 99835

RECEIVED

JAN 12 1989

sc copy
return to me

GOVERNOR'S OFFICE

January 9, 1989

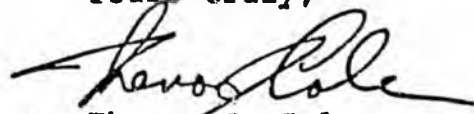
The Honorable Steve Cowper
Governor of the State of Alaska
P.O. Box A
Juneau, Alaska 99811-0101

Dear Governor Cooper:

The Assembly of the City & Borough of Sitka requested that I write to you expressing their support of your position on the Economic Limit Factor (ELF). They are also concerned with the future funding of education and wish to study the matter further before expressing a position on that matter. The Assembly appreciates your giving them the opportunity to respond to these issues.

Thank you for your consideration.

Yours truly,


Theron J. Cole
Municipal Attorney

TJC:COOPER:klw

Mutual opportunities

WE MUST listen carefully to precisely what Bill Wade said. Not to do so could mean a misinterpretation of the message delivered by Mr. Wade, the president of Arco Alaska, Inc.

His was an exciting speech, to be sure, as he addressed yesterday's luncheon forum of the Anchorage Chamber of Commerce.

He used clear and simple words.

Arco, he said, is prepared to invest more than \$7 billion in Alaska over the next 10 years.

That's more than \$700 million a year.

Considering Alaska's down economy, the announcement should have evoked cheers.

But listen carefully.

He didn't say Arco *would* spend \$7 billion between now and 1998.

He said the company was *prepared* to spend that much money, if . . .

Unfortunately, it's a big if.

TO MAKE the vitally important decisions that will justify such investments, Mr. Wade said, Arco "will require reasonable oil prices and a stable tax policy."

And that's totally understandable.

Reasonable oil prices, obviously, are not something the State of Alaska can deliver. Whether we like it or not, Alaskans — and all Americans, for that matter — are at the mercy of the ministers of the Organization of the Petroleum Exporting Countries. When it comes to global oil prices, OPEC calls the tune.

But Alaska is in control of its destiny on the second aspect of Mr. Wade's short list of requirements.

Stable tax policy is com-

pletely in the hands of the administration and the legislature at Juneau.

With wisdom and reasonable attention to reality, we won't go after the neck of the goose that lays our golden eggs.

If the legislature and the administration would lock long term — 10 years in this case, as Arco is looking — it will be obvious that it is in the state's best interest to keep oil taxes steady, if for no other reason than to permit the industry to plan with certainty.

ABSENT THAT, we can anticipate a long and gloomy period of attempting to recover from the deep depression that now engulfs Alaska.

But by adopting an attitude of cooperation with the industry, mutual success can be achieved.

According to Mr. Wade, Arco is ready to put \$3 billion in development of known reserves in the Prudhoe Bay and Kuparuk fields — where he says more than 1,000 additional wells should be drilled.

Another major commitment, he said, is planned — assuming things can move forward — in the initial development of the West Sak field, an area with 20 billion barrels of oil in place. But it's an area requiring the development of difficult and expensive technology to make production possible.

The 10-year program, he emphasized, now represents plans on the drawing board.

But, he said, "our goal is to make them a reality."

Alaska should share that goal, and help make it achievable by not doing something stupid through the regulatory and/or legislative process.

Walking on thin ice

Sunday, March 13, 1988, The Anchorage Times

WE'RE GOING to be in trouble again unless the ladies and gentlemen of the Alaska House quit messing around with a tax system that's working — one that's providing jobs and helping to sustain and expand the state's oil industry in a down economy.

But instead, beating an old drum and proclaiming that white is black, Democratic House Speaker Ben Grussendorf of Sitka and some of his colleagues once again are hell-bent on changing the rules at the expense of the oil companies.

Forget the golden eggs. Attack the goose that lays them.

Raise the cry of "giveaway." Call out that Big Dirty Oil is taking our heritage and our money and throwing only scraps to us Alaskan peons. Lay on more taxes so that the government in Juneau will have more money and the legislators will have more dollars to scatter hither and yon among their individual districts, thus helping ensure their return to office at the next election.

THIS TIME — as it was a year ago — the target is the Economic Limit Factor, the so-called ELF tax formula designed and put into place some three years ago to encourage oil companies to keep drilling, to keep looking for new fields to replenish those in decline or soon to face decline.

On the basis of the complex formulas of ELF, the oil companies operating in Alaska — and employing huge numbers of people and providing the state with virtually its entire revenue source — have made their long-term plans, mapped their budgets, set up drilling and production schedules.

And ELF is paying off.

Alaska is the beneficiary of the results.

But Mr. Grussendorf, a Sitka teacher, knows better. As a populist, he raises the shout that the oil companies have received a "tax break" that is costing Alaskans millions of dollars a year.

If he had his way, and if he and his Democratic colleagues prevail, Alaska will lay yet another tax increase on the oil industry.

And that's precisely what a change in the ELF statute would be — a tax increase.

Pure and simple that and nothing more.

THE EFFECT would be to impair the oil companies — the big employers of the state — to continue some drilling programs and very likely force them to delay, or even abandon, others.

The state government — and Mr. Grussendorf and the legislators — would get more money.

But Alaskans would lose jobs and opportunities.

The economy, struggling to recover from a depression that has been devastating to thousands of Alaskans (if not to some legislators), would take another blow to the midsection.

And action repealing or significantly amending ELF would send yet another negative — terribly negative — signal to domestic and foreign business and industry leaders whose capital investment in Alaska are so desperately needed. We would be telling them, in a loud and clear voice, that they can't trust Alaska to keep its word, can't trust the state to keep the playing field level, can't trust Alaska as a place for the investment of venture capital and dollars.

And that's shockingly the reverse of what we should be doing.

ARCO head: ELF repeal would deter industry

The Associated Press

FAIRBANKS

The head of ARCO Alaska Inc. came to Fairbanks with a promise of economic hope and a warning.

"Don't call it a threat," ARCO President Bill Wade said Tuesday. "It isn't that."

The promise of hope was ARCO's plan to spend more than \$7 billion on oil-related work in Alaska during the next 10 years, with industry-wide expenditures estimated at \$20 billion to \$25 billion during that time.

The warning was that an increase in oil taxes might make ARCO and other oil comp-

anies think twice about making such a large investment in Alaska.

Wade made his comments in an address to about 250 people attending the Fairbanks Chamber of Commerce luncheon Tuesday.

He said tax increases in Alaska, such as repeal of the economic limitation factor, or ELF, would send the wrong signal to the oil industry, particularly while it is going through such turbulent times.

Despite fluctuating oil prices on the world market, ARCO believes it has a bright future in the state. "ARCO is bullish on Alaska," Wade said.

The key to further ARCO investments in Alaska, Wade said, is whether Atlantic Richfield Co.'s board of directors feel the company is working in a stable tax and regulatory climate. Atlantic Richfield is ARCO Alaska's parent company.

Wade said ARCO's \$7 billion plan was submitted to Atlantic Richfield directors last January. "Clearly, my objective as president



William Wade

of ARCO is to make this plan become a reality. We still have so much to do in this state," he said. That includes work on existing oil fields, more exploration, and bringing other known oil reservoirs, such as West Sak, into production, he said.

"We see tremendous exploration opportunities waiting here," Wade said. "But tax stability is the key, that's why you hear us talking so much about it and about the ELF."

Wade was referring to legislation put forward by the state House of Representatives to remove the ELF from application to Prudhoe Bay.

A form of oil-production tax, the ELF was initiated in 1977 and revised in 1981. As written, it lowers the taxes paid by the industry on oil production from Prudhoe Bay to encourage industry investment of the money in other Alaska oil exploration, development and production activities. Sponsors of

the law envisioned new job opportunities for Alaskans and new revenues for the state.

However, the ELF isn't working the way its sponsors planned, according to Rep. Mark Boyer, a Fairbanks Democrat who has been pushing hard for partial repeal of the ELF incentive.

Boyer cited testimony from Conoco that the proposed ELF revision would provide the incentive the company needs to develop the Milne Point oilfield, a marginal oil field on state land.

"If we don't do something, we leave oil in the ground in marginal fields and we continue to give a tax break to some of the largest companies in the world," Boyer said.

He said the House proposal, if enacted, would bring \$179 million additional dollars to the state in its first year, and \$1.4 billion over the next five years.

But the oil industry says House Democrats want to revise the ELF to bring more money into state coffers so they can appropriate it for projects in their districts in an election year.

In an interview Tuesday, Wade said the

effort to repeal the ELF seems "hypocritical" because legislators aren't trying to increase taxes on any other state industry to make up for the state's revenue shortfall.

Because the Prudhoe Bay oil field, the largest in North America, is on state land, the oil industry pays a royalty in addition to state severance taxes on its Prudhoe operations.

ARCO Alaska, he said, paid the state \$300 million in severance taxes and \$300 million in royalties to the state in 1987. The oil industry accounted for 94 percent of all the taxes paid to the state last year, Wade said.

State taxes in 1987, he said, made up ARCO's largest expenditure. He also said the company spent \$457 million in Fairbanks between 1982 and 86.

At the luncheon, Wade said the industry invested in state oil fields other than Prudhoe Bay — fields more expensive to develop — because the state's stable tax climate encouraged it to do so.

"Now times get a little tough, on our industry particularly, and they want to change the rules. That doesn't seem fair," he said. "How would you feel if it were your company and your industry?"

Arco's plans unaffected by lower oil prices

By Ray Tyson
Times Business Editor

Oil prices would have to slip further and remain depressed for six to nine months before investment plans by Arco Alaska Inc. were seriously threatened, company president Bill Wade said.

However, Wade said Tuesday after a speech to the Society of Petroleum Engineers, he doesn't expect oil prices to continue their slide.

In fact, Wade said he expects prices to rise and hold at about \$20 a barrel into the 1990s and then rapidly increase.

Arco fashioned its \$7 billion, 10-year capital budget for Alaska based on \$20-a-barrel oil.

About \$3 billion of Arco's budget is earmarked to develop known oil reserves, including West Sak, a field on the North Slope believed to contain as much oil as the giant Prudhoe Bay reserve.

Since last fall, however, the price

of North Slope crude has declined steadily to \$12.75 a barrel on the West Coast and \$13.75 on the Gulf Coast.

Arco based its 10-year budget on the West Texas Intermediate benchmark, which has been hovering in recent weeks at about \$15-to-\$16 a barrel.

Wade said the oil industry as a whole will spend \$20-\$25 billion on projects in Alaska over the next 10 years, if oil prices are steady and the tax climate is favorable.

"If we go to \$10 a barrel and stay there, obviously we are not going to have \$7 billion to spend," Wade told the gathering of petroleum engineers at the Anchorage Hilton Hotel.

"The message is that Arco is very bullish on the state . . . there is a lot of investment opportunity . . . and we are hoping oil prices will be good," he said.

Wade said oil prices will remain "volatile," but he said price-to-production ratios, in the short term, will

be controlled by OPEC, depending on what is in the cartel's best interest at the time.

OPEC has indicated a desire to eventually increase prices to \$20 a barrel, Wade said.

"We try not to get caught up in the day-to-day, seasonal movements of oil prices," he said. "Short-term things are not what we base long-term decisions on."

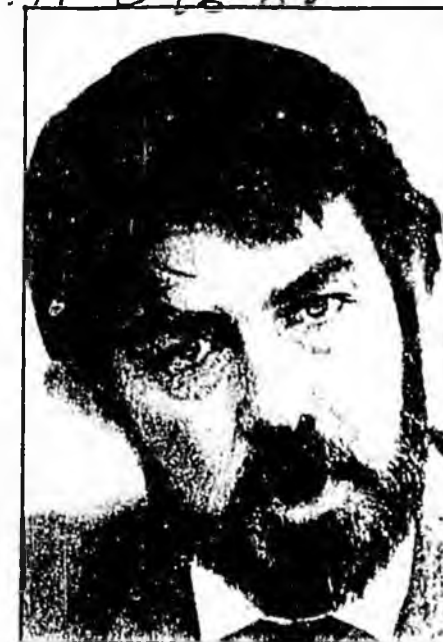
Wade also suggested any tax increases on the oil industry may disrupt investment plans for Alaska.

He said the roughly \$300 million in taxes the state collects from Arco each year is more than the company spends on payroll, supplies and materials in Alaska.

"This state has a pretty unhealthy tax structure," Wade said.

"We (industry) are paying 95 percent of the tax receipts — that's a really unhealthy dependence on one industry. We have been the golden goose that has run the state."

AT 3-16-88



Bill Wade
... planning on \$20 oil

ELF repeal question continues to capture writers' fancy

Issue bigger than one tax break

In recent communications Jan Faiks and others have demonstrated commendable loyalty to ARCO and BP. Nonetheless, it seems unlikely that revoking the ELF tax cut on our immensely profitable Prudhoe Bay field will alter oil company expenditures in Alaska. Nor should we fear the effects of leaving less accessible oil underground until the price is right, even if that only benefits our children.

I certainly favor continued investments in Alaska by large foreign corporations like BP and "Outside" companies like ARCO, and agree that we must avoid taxing them "for all they are worth" while they remain. But I also resent the way Fink, Faiks, Halford, Abood, Paul Fischer and many others turn limp whenever the discussion comes around to taxes on the oil industry. For if our politicians can be bought and sold like potato chips, who is there to negotiate on our behalf?

The real issue is far greater than a single unnecessary ELF tax break. Alaska's biggest problem is the continuing corruption of our representative form of government by all those Big Oil dollars, while advertisements promise future jobs and good times galore as long as we don't challenge their rule. Fortunately, we still have regular elections.

— Arndt Von Hippel

What did industry do to state?

Let's look at some facts. When we pay our income taxes, we complain but we pay the taxes. No one comes up and says he since he doesn't like the law he doesn't have to pay taxes. Why should it be any different for any industry? Alaska has fair oil taxes so leave the law alone.

As for our legislators, I sincerely believe that all or almost all of the ones from Anchorage should be excused from any bills concerning the oil industry because of conflicts of interest. This is if any members of their family are working for any oil firms,

or if more than a thousand dollars' contribution was made to them in any form from the oil industry they are under too much pressure to make a fair decision after selling their vote.

Let's stop saying, "What did the oil industry do for Alaska," and put it in a true form and say, "What did the oil industry do to Alaska?" It is time to start thinking what is best for Alaska and do it.

— E.A. Endicott

Article might give wrong idea

Shame on Hal Spencer for his article on Alaska's ELF tax break for the oil companies and their donation of bucks to Sen. Jan Faiks. People may get the idea that Sen. Faiks is the finest that oil companies can buy.

— Bob Caughey

A subsidy is a subsidy

A subsidy is a subsidy regardless if it is the old-timers' \$250 a month or ELF. The first test of any subsidy is need; the second test is that need is so great that the subsidy funds must be raised by another segment of our social economic structure. Then if in the public's mind that the subsidy is needed and affordable then and only then should any subsidy be enacted by the legislature or Congress.

In my opinion, based on public information, the Forbes article on March 21, 1988, and U.S.A. report and annual corporate reports of the North Slope companies, it is apparent that the ELF subsidy is *neither needed or affordable* at this time.

— Bruce Kendall Sr.
former Speaker of the House

Let's pay Faiks \$45,000

Rarely is such honesty so forthcoming from the power brokers as it is today from our own politicians in Juneau. Senate president Jan Faiks, an "oil industry" ally

who received almost \$40,000 in oil industry campaign donations in 1986" (Daily News, March 15) is blatantly up front about where her loyalty lies. If this is going to cost the state, and thereby all Alaskans, \$1.4 billion over the next four years, perhaps we the people should offer her \$45,000 and call the oil industry's bluff. This is serious econo-

I call on all Alaskans to either donate to the Faiks for Alaskans fund or call their senators and ask them to repeal the latest oil industry "tax break."

— Paul Kroenung

ELF repeal threatens projects

Prudhoe Bay may not be considered a marginal field, but some major industry activities there are marginal. The easy oil has already been produced, and "marginal projects" aimed at squeezing out more oil from beneath the tundra will hold the key to additional production and state oil revenues.

There is much more drilling and development work to do in the aging Prudhoe Bay field, but repeal of the economic limit factor will only dampen the economics of marginal projects. These investments, which cost industry hundreds of millions of dollars and justified with ELF in mind, mean more jobs, more exploration, more development and more revenue. But all this could be threatened if taxes under ELF are increased.

Any negative effect of the ELF formula is currently offset by increased revenue to Alaska from additional drilling and production. Yet the state claims that because ELF has created an incentive for operators to drill more wells, tax revenue "losses" will be greater than anticipated. As a result, the state wants to repeal ELF, in effect penalizing industry for increasing production and generating new revenues for Juneau.

With or without ELF, the tax rate at Prudhoe Bay will still exceed that of any other state. If government opts for even higher taxes on industry, a few years of higher government revenues and larger state budgets might be purchased, but only at the cost of future prosperity and private sector jobs.

— Carl Portman, public relations director
Resource Development Council

Senate honors a commitment that never existed

JUNEAU — As the chief justice spoke, the president of the Senate and the speaker of the House exchanged notes one morning in early March. Ben Grussendorf offered a deal to Jan Falks, but with another quotation bound for glory she declined.

"...The ELF is an organizational matter and has my word of honor," the Senate president wrote. "It is a matter of grave personal commitment on my part."

Using that line like a live grenade, Grussendorf accused Falks in a "Dear Alaskans" letter, reprinted in the Daily News Friday, of selling out to the oil industry over a tax loophole that's "a pickpocket, purse-snatcher and thief of jobs."

Those are heavy words to describe a small part of state law re-born in obscurity during one of the most tumultuous months in Alaska politics. It was June, 1981, when the economic limit factor was repealed and re-enacted by a legislature turned upside down in an overthrow of the House leadership.

Flush with money that year, the legislature was trying to reach a settlement with the oil industry over a lawsuit filed against the state's oil and gas income tax. The ELF was not at issue then, but an estimated \$7.3 billion was at stake in the court battle, and the state — unsure of winning — wanted to hedge its bets.

The House and the governor pushed for a back-up tax on producing oil reserves that would kick in if the state lost the income tax case. The Senate wanted to settle with the industry by taking the offending law off the books. A chain of events that June gave the Senate a victory:



john greely

- On June 9, the House passed its back-up tax over the objections of GOP leader Joe Hayes (who would become speaker in six days) that "the way to solve the problem is not with this bill, but to reach a settlement with the oil industry."

- On June 10, the Senate rejected the House bill and appointed Republicans Ed Dankworth and Don Bennett to a three-man negotiating team. The House team was led by Democrats Terry Gardiner and Tony Vaska.

- On June 15, the House leadership was replaced by a Hayes-headed coalition.

- On June 17, Hayes replaced Gardiner and Vaska on the negotiating committee with Republicans Rick Halford and Pat O'Connell.

- On June 24, the free conference committee issued a bill patterned after the Senate's approach to income taxes. It was adopted 17-2 by the Senate and 21-17 by the House just before the legislature adjourned.

Gov. Hammond signed the law, but the litigating oil companies rejected this settlement offer and chose to take the case to the

U.S. Supreme Court, where five years later they lost a 5-to-3 decision. While it won in court, then, Alaska lost several hundred million dollars in removing from the books a corporate income tax whose legal foundation was to be proved solid.

That's 20-20 hindsight of course.

What's far more topical is the fact that the 1981 legislature stuck the state with a tax loophole through which the industry is now driving a truck loaded with even more profits from Prudhoe Bay.

Enacted originally in 1977, the ELF was a feature of law giving oil producers a break on state severance taxes as individual wells reached their "economic limit." Aimed primarily at Cook Inlet, where producers were squeezing out mere hundreds of barrels of oil, the ELF was never to apply to the most prolific wells on the North Slope until well into the next century, if then.

But a funny thing happened on the way to the millenium. During those two weeks in 1981, the legislature altered the ELF in such a way that starting in 1987, the biggest oil field in North America was declared to be at its "economic limit." That timed a tax break with the peak production years of Prudhoe Bay, hardly the intent of state law.

Hammond could have vetoed the ELF alterations seven years ago, but that would have meant tubing an overall tax settlement before the industry had a chance to reject it. Instead, he demurred, saying that "as for the possible revenue effects in 1988 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."

Perhaps Hammond never figured on Falks making a "grave personal commitment." Of course, the Anchorage Republican wasn't in office then and it would be a few years yet before she would disclose that "Waikiki is no picnic" and "the rich deserve representation, too."

Falks was quick to cover her tracks last week by saying her personal commitment was actually a government commitment to the industry not to raise taxes. The public is getting its fair share of Prudhoe Bay, she said.

But that bit of back-tracking not only is wrong, it's also beside the point, as legislators sweating blood over the state budget shortfall are seeing in grim reality. Under pressure to raid the permanent fund, cut state services, or both, legislators are being bound by a "personal commitment" to preserve a tax loophole that was never intended to exist, or at best is premature, but through which an estimated \$1.2 billion will flee the state treasury in the next five years.

So, to borrow Grussendorf's canine analogy of last week, the House speaker may be just a wild dog howling at the moon, but when it comes to the ELF issue, the Senate president and her colleagues are riding a hound that just won't hunt.

□ John Greely, a Juneau radio reporter, covered the legislature for a variety of news organizations from 1972-82. He was Gov. Bill Sheffield's deputy press secretary and press secretary from 1982-1988.

Oil industry runs ads to keep tax break

Association chief says campaign designed to counter moves to cut exemption

By HAL SPENCER *ADN 4/1/88*
Daily News reporter

In one television advertisement, children are shown enjoying the Loussac Library in Anchorage, a facility, the ad says, "made possible by oil and gas development in Alaska."

In another, happy teens play with computers and basketballs in the gleaming new North Pole High School "built with pride by the people of North Pole and made possible by oil and gas development in Alaska."

A third ad shows colorful Eskimo dancers performing at the Arctic Museum in Kotzebue, a facility also brought by oil and gas development, the ad says.

The television ads, sponsored by the Alaska Oil and

Gas Association, never mention the word taxes. But the ads are a direct response to legislative moves to suspend a controversial oil severance tax reduction for Prudhoe Bay producers, said the association's executive director, Bill Hopkins on Thursday.

Prepared by Mystrom Advertising Inc. of Anchorage for use in television markets all over the state, the ads have drawn fire from House Speaker Ben Grussendorf, who calls them misleading.

Hopkins, on the other hand, said the ads, and four newspaper ads on the same subject, are a legitimate and reasonable response to a push by Grussendorf and other legislative Democrats, as well as by Gov. Steve Cowper, to suspend or revise the Economic Limit Factor, or ELF, a

severance tax formula used to encourage development of marginal fields.

The ads are intended "to raise awareness of the public of where these things (facilities) have come from. What we are saying is the benefits we have in Alaska are many and varied, but they all come from the same source, oil and gas development," Hopkins said.

Grussendorf, D-Sitka, contended the television ads are misleading because they suggest that the oil and gas industry brought Alaskans fine new facilities, when, in fact, it was petrodollars from state-owned oil leases that paid for the facilities. In other words, Grussendorf said, the state allowed the industry to make huge profits developing the state's oil. The indus-

try did not do "the state" favor by doing so, as the ads seem to imply, he said.

Grussendorf said he sees one good result of the ads: "They're an economic stimulation for the media to get them through until election ads start," he said.

Actually, Hopkins asserted, the ads suggest a partnership between the state and the oil industry. True, the state owns the oil producing leases, but it was the industry that discovered and then developed the oil, he said.

Mystrom account executive Cheryl Tatom, who helped create the television ads, said "We're not saying the oil industry did all this. We're saying it couldn't have taken place if the oil industr-

and by Bradley Advertising Inc., are more direct in linking state tax loads to oil activity. One quotes a Doyon Drilling official as saying "There's a new sense of optimism" and increased drilling activity since the ELF "kicked in" last summer.

AOGA is the trade association of Alaska oil and gas producers, and is funded by producers ranging from ARCO Alaska to Standard Alas-

ka Production Co. Hopkins declined to divulge the cost of the ad campaign.

The ELF, state revenue officials contend, will cost the Alaska treasury more than \$1 billion in taxes over the next five years. Gov. Steve Cowper and House Democrats argue that the ELF should be suspended or revised so that it does not apply to Prudhoe Bay, the richest oil field in North America pumping 1.5

million barrels of oil a day.

Oil industry officials, including the presidents of Standard Alaska Production Co. and ARCO Alaska, Inc., say Prudhoe is wearing out. They say it has reached its economic limit at current oil prices and tax rates, and needs the severance tax reduction.

The officials say further oil and gas development at Prudhoe and elsewhere on the

North Slope could be retarded or halted if the industry is forced to shoulder a heavier tax burden.

Grussendorf and other lawmakers worry that revenue lost to the ELF may be made up in a budget crunch with earnings reserves of the Alaska Permanent Fund.

Hopkins and other industry officials say state government should employ another solution — reduce state spending to match revenue.

hadn't been in Alaska. I guess we were just trying to make people realize how important the industry is to Alaska."

But Grussendorf said the ads seem to say quite clearly that if it were not for the oil and gas producers, libraries, schools and museums would not exist in Alaska.

Some of AOGA's newspaper ads, prepared by Mystrom

ELF dealing a critical blow to state's budget

By HUGH MALONE

The Economic Limit Factor is a tax break for oil companies that has gone awry. The ELF has helped throw the state into a fiscal crisis, and is also inhibiting oil development at marginal fields.

The ELF formula reduces the state's severance tax on oil depending on the productivity of a particular well. When the ELF was originally created in 1977, the intent was to keep taxes low at marginal oil fields — such as those in Cook Inlet — so as to encourage production. At highly profitable fields — such as Prudhoe Bay — the ELF was supposed to match a field's tax rate with its productivity, and thus tax rates would fall as a field's production began declining.

The ELF is not working as intended. The tax law does not operate to encourage production at marginal fields. In fact, the ELF provides an

insufficient tax break to bring fields like Milne Point into production.

Meanwhile, the ELF provides a massive and unnecessary tax break to fields like Prudhoe Bay, which need no help at all. The ELF reduces the effective severance tax rate by 20 percent on the Prudhoe Bay field. Prudhoe Bay is the largest oil field in North America, and probably the most profitable "supergiant" field in the world. Data in Petroleum Intelligence Weekly show that after paying all expenses and taxes, the oil companies are making profits of \$6 million a day from the North Slope.

The application of the ELF formula to highly profitable fields such as Prudhoe Bay and Kuparuk is causing the state to lose substantial revenues. Unless the legislature modifies the ELF as proposed — assuming that oil prices are at \$15 to \$16 a barrel over the

next 16 months — the Department of Revenue estimates that the state will lose \$150 million to this fiscal year and \$152 million in the next.

The loss of revenue caused by the current ELF is a major reason the state faces more than a \$400 million shortfall in the budget. This shortfall is 20 percent of the total budget. Simply cutting the budget by 20 percent in one year — such as some have suggested — would devastate the Alaska economy just as it begins to climb out of a deep recession. The University of Alaska's Institute of Social and Economic Research has stated that across-the-board cuts of \$400 million would ripple across the economy and ultimately cause more than 9,500 Alaskans to lose their jobs.

A better approach is to alter the ELF by passing proposed legislation called House Bill 164. The bill would modi-

The tax law does not operate to encourage production at marginal fields. In fact, the ELF provides an insufficient tax break to bring fields like Milne Point into production.

fy the ELF to shift tax breaks to marginal fields that really need them. The net effect of these changes is also to collect \$1 billion in additional revenue over the next five years that would otherwise be lost.

Two additional reasons make it critical that we change the ELF now. The first reason is that changes made in 1981 in the state income tax that oil companies pay have cost the state more than \$1 billion.

According to Petroleum In-

telligence Weekly oil companies in Alaska pay an effective state income tax of only 3 percent. This rate is only a third of the 9.4 percent rate paid by other Alaska businesses. This loss of "fiscal horsepower" from the state income tax on oil companies makes it even more important to ensure that our severance tax and its ELF work properly.

The second reason making it critical to change oil taxes now is that North Slope oil is

a one-time bonanza of non-renewable wealth. The resource is leaving the state at a rapid rate. More than half of the oil ever discovered in Alaska has already been produced. Once this oil leaves Alaska, the revenue is lost. The state needs to change its oil tax laws now before it is too late.

□ Hugh Malone is Commissioner of Revenue. He served in the Alaska House of Representatives from 1973 through 1984.

Oil company reports don't support need for tax break

On Sept. 21, 1986, I warned readers of this page that a little-known provision of state law called the Economic Limit Factor, or ELF, could put a multi-million dollar dent in Alaska's oil revenue.

That column was the midwife to the birth of the ELF as a public issue, and it has certainly grown since then.

The ELF is supposed to be a tax break to encourage development of the poorer oil fields in Alaska. It was rewritten in 1981, at the same time the Legislature voted to abandon the separate accounting method of oil industry income tax.

The severance tax was raised slightly in 1981 to make up for the income we would lose without a full tax on oil industry profits here, but the ELF was rewritten to insert a loophole in those higher taxes. We were told ELF was needed to keep the severance tax from being a burden on smaller oil fields.

At that time, then-Gov. Jay Hammond repeatedly swore the measure was "revenue neutral," that it would not reduce oil income. In fact, we now know that his measure as cost us hundreds of millions of dollars.

As a sidelight, the man who wrote the ELF formula and crafted the rest of Hammond's package was Tom Williams, Hammond's commissioner of Revenue. Williams is now employed by Standard Alaska Petroleum Co., owner of half the oil in Prudhoe Bay.

As my earlier column warned, the ELF was to go into effect for the



**Fred
Pratt**

Prudhoe Bay field in June, 1987. The most recent Department of Revenue estimates I've received say the ELF will cost the state \$1.2 billion over the next five years.

Revenue officials argue that Prudhoe Bay is obviously not a marginal oil field, and they are urging the Legislature to exempt it from the ELF tax deduction.

This all comes to mind since the president of ARCO Alaska, Bill Wade, was in town two weeks ago crying and moaning about his company's taxes. This self-serving lamentation from the oil companies has become so common in Alaskan public affairs that we all tend to tune it out, a matter that Wade acknowledged even before he began.

Wade sang the usual tune of how the oil companies would like to do a lot of work in Alaska, but they need a stable tax climate with no tax increases in order to plan their capital projects.

Now most Alaskans know why we don't lose lots of sleep over the poor oil industry's taxes, but for Wade and other newcomers, it's probably good to expend a few paragraphs in explanation.

First, let's dispose of this face-

tious "stable tax climate" argument.

Alaska has changed oil company taxes only once in the last decade, and that was 1981 when we lowered them. This year we're due to lower them again if the ELF formula goes into effect. How many of your businesses face that kind of tax situation? Why should the oil companies be any different?

ARCO is the only public corporation left among the oil companies that have their major dealings here. The other, Standard Oil Co., is a subsidiary of British Petroleum and its results are buried deep within that company's finances. Exxon Corp. is the third-largest Prudhoe Bay owner, but Alaska plays a small part in Exxon's overall operations.

ARCO owns about one-third of the Prudhoe Bay field, and it's the largest owner of the Kuparuk field. Alaska North Slope production is 70 percent of ARCO's total, so its financial reports are the best reading we have on the profitability of our oil industry.

So how has ARCO been doing?

According to ARCO's own reports, the company has been doing quite well despite the 1986 plunge in oil prices.

In the first quarter of 1987 ARCO was producing 472,000 barrels per day of oil from the North Slope, up from 427,600 in the first quarter of the previous year. This helped offset the lower oil prices it was receiving.

In the second quarter of 1987

ARCO reported its profits had more than doubled from the previous year. Its net income was \$330 million, or \$1.80 per share, up from \$150 million, or 83 cents a share, on only a 15 percent increase in gross revenue.

This wasn't due to downstream profits, but from the Alaskan crude oil end. ARCO's profit from refining and marketing operations plunged 63 percent to \$45 million from \$121 million the year earlier.

The dramatic doubling in profits came from crude oil earnings and some relatively minor accounting changes and contract settlements, and it was posted when ARCO was still getting only a relatively modest \$12.76 per barrel for its crude oil.

For the first half of 1987, ARCO's profits increased 27 percent to \$569 million while its revenue was \$7.85 billion, nearly identical to the same period of the previous year.

The trend continued. ARCO ended 1987 with the highest per-share profits of its history, \$6.68, with \$1.22 billion earned on revenue of \$16.83 billion. Its fourth quarter profits were more than four times what it earned the year before.

In the second half of 1987 ARCO went shopping. The company had amassed cash and securities of \$3.5 billion, up from \$2.4 billion the year before, and Wall Street analysts estimated its flow of funds from continuing operations exceeded \$3

billion in 1987, up from \$1.3 billion in 1986.

ARCO set out on a plan to triple its operations outside the U.S. It entered a bidding contest with BP for Britoil PLC, a Scottish North Sea company. When BP bought out ARCO's 24 percent share of Britoil, ARCO made a tidy after-tax profit of \$110 million for the first quarter of this year.

ARCO used this money to buy Tricentrol PLC, a smaller North Sea firm, for \$331 million. ARCO estimates it got Tricentrol's oil reserves for about \$4 per barrel.

A story in the Wall Street Journal earlier this year called ARCO "one of the nation's most profitable oil companies" and said its per-share profits in 1987 were actually higher than what it was earning in the days of \$30-per-barrel oil.

On March 30, ARCO president Lodwick Cook told a meeting of New York security analysts that ARCO will earn more than \$2 a share just in the first quarter, which is well ahead of 1987's record-setting performance. This can't happen when North Slope oil prices were running \$3 a barrel lower than the year before.

Is this an industry that needs a tax cut just to stay in business?

Free-lance journalist Fred Pratt has been covering Alaska business and politics for the past 15 years.

4-11-88 FANM

ELF: from myth to reality and back

ADN Editorial 4-20-88
Tom Williams is the man who claims credit for writing the controversial oil tax law known as the ELF, or economic limit factor. The Hammond administration revenue commissioner defended his creation at Monday's Anchorage Chamber of Commerce lunch. His theme was ELF: the myth vs. the reality.

Mr. Williams, now a tax planner for Standard Alaska Production Co., took his audience from myth to reality, but he then led them back to myth again.

He did debunk the myth that the ELF was a tax change born of the billion-dollar oil tax cut passed by lawmakers in 1981. The ELF first took effect in 1977.

Mr. Williams also debunked the myth that ELF never applied to Prudhoe Bay until last year. It applied to Prudhoe Bay when it passed in 1977, but the 1981 tax law suspended the ELF on Prudhoe until last summer.

As Mr. Williams also pointed out, the original ELF was not strictly a Republican creation. Gov. Steve Cowper spoke in favor of the ELF when he served in the state House in 1977.

But then Mr. Williams proceeded to leave his listeners with a few myths of his own.

First is his claim that the ELF is doing exactly what it's supposed to do: reduce taxes on fields as they approach their economic limit — the point at which production becomes so costly, the field is shut down.

No one, except an oil executive defending a lucrative tax break, could argue that Prudhoe Bay is near its economic limit. The average oil well at Prudhoe produces 2300 barrels a day; nationwide, the average is about 15 barrels. The investment firm Solomon Brothers estimated that ARCO made an operating profit of \$7 a barrel at Prudhoe Bay in 1987. Yet the ELF has cut severance taxes at Prudhoe Bay by nearly 20 percent.

Mr. Williams also says ELF is not a tax break. Whenever the ELF came up, he says, it was in conjunction with a tax increase: first in 1977, again in 1981.

Mr. Williams' point is a half-truth. Oil severance tax rates were indeed increased in 1977, and again in 1981. But Mr. Williams neglects to mention that the 1981 law, pushed by Republicans, also repealed the oil income tax called separate accounting. That move has already cost the state \$1 billion. Mr. Williams, who as revenue commissioner helped write those changes, said at the time they would cost only \$130 million.

It's important to remember that Gov. Steve Cowper and the House do not want to do away with the ELF. They have proposed a new ELF formula that does the same job — encourage production from fields that really need tax help — at less cost to Alaskans.

Beneficiaries of today's ELF, like Mr. Williams' employer Standard Alaska, object to any change. But Conoco, which owns a truly marginal field at Milne Point, has expressed support of the House formula. So, when industry officials sing the praises of today's ELF, don't be fooled by self-serving myths.

Marked recovery for most in 1987

The oil industry's story in 1987, as presented in recent annual reports, was decidedly brighter than in 1986. There was a widespread recovery in profits, cash flows were higher, and long-term debt was reduced in most cases. However, operating figures changed relatively little, with only three leading companies reporting a significant rise in oil product sales. Natural gas and chemicals were more buoyant. The changing fortunes of the seven majors put Royal Dutch/Shell into equal first-place with Exxon on most criteria, while BP jumped into third position.

FOLLOWING what was for most of them a turbulent and difficult year in 1986, the major integrated oil companies made the best of a partial recovery in prices during 1987. Omitting Texaco as a special case, (see below), the other four US-based majors reported profits ranging from \$1.0bn for Chevron to \$4.8bn for Exxon. With substantial increases for Amoco and Chevron outweighing declines by Exxon and Mobil, their combined total was 3% better at nearly \$8.5bn; while the Europe-based Royal Dutch/Shell and BP groups both scored very considerable gains. The earnings recovery, stimulated by the rally in crude oil prices since the lows of 1986, has already been reviewed in our March issue (see page 101). Basically, it involved an upsurge in exploration/production profits despite generally lower volumes. Downstream profits were depressed until the fourth quarter, but have since rebounded strongly in the first quarter of 1988 (see page 203). Last year, cash flow improved for all except Texaco and Royal Dutch/Shell, but capital investments were held in check below 1986 levels, while asset sales helped to reduce long-term debt in most cases. Operating data for the five US groups registered little change in oil reserves and production, refinery runs and product sales; but natural gas sales rose by 5% on average, and there was a widespread boost for chemicals. The emphasis in some of the reports is on opportunities for expansion upstream through reserve additions at relatively modest prices, while the stress downstream is on upgrading and to some extent on joint ventures with others — including OPEC state companies seeking integrated status through commitments inside the main consuming areas. Finally, the relative position of the seven majors under review has changed, with Royal Dutch/Shell pulling broadly level with Exxon and BP leaping into third place.

Amoco Although still the smallest of the five US majors in terms of asset values and product sales, Amoco last year was perhaps the outstanding performer of them all with its 41% increase in cash flow and 82% rise in net income (see Table). While retaining its position as one of the USA's leading crude oil and natural gas producers and fifth largest refiner with 5% of the domestic market, its policy in recent years has been to emulate the larger internationals by expanding overseas, where it is now active in some forty countries and has 35% of its proven crude reserves. Emphasis on upstream activities at home and abroad led to the replacement of 130% of production during the year through a combination of exploration successes, improved recovery, and acquisitions. That was probably the best result for any major company, and represented a significant turnaround from

1986 when reserves had declined sharply. The improvement featured major additions to reserves in the US onshore, Egypt, China, and the North Sea. It will be followed this year by the addition of 121 million barrels of oil and gas liquids and 3 trillion cubic feet of natural gas from the \$4bn (C\$5.5bn) acquisition of Canada's Dome Petroleum, agreement on which formed the highlight of Amoco's 1987 report. This will make the company the biggest natural gas producer and reserve holder in North America, not to mention Dome's crude oil production and undeveloped heavy oil properties. The continuing drive to expand internationally has been underlined by a recent decision to direct over 50% of exploration and production spending to foreign operations over the next five years, up from around 34% during the past twenty years. Downstream activities last year featured a continued rise in sales of lead-free gasoline, where Amoco is the market leader, and a dynamic performance for chemicals with profits up 64%.

Chevron Despite its healthy rise in cash flow and net income* and its better than average increase in product sales, Chevron's report does not enthuse over what it saw as an "uncertain" year — in some ways "even more demanding than 1986". Operating earnings failed to reach the levels desired, although new programmes are expected to result in significant improvements during 1988. Obviously, there is cause for satisfaction in the continued reduction of long-term debt, with the burden cut by over half since the \$13.3bn acquisition of Gulf Oil in 1984 and the debt ratio down from 51% to 31%; but the board's attention is currently directed to the need for continued streamlining. Chevron is selling smaller, inefficient fields and consolidating operations by trading properties with other companies where feasible; concentrating its marketing efforts on the growing Sun Belt area of the southern states; looking at joint ventures such as last year's agreement with Nippon Oil on US drilling; and exploiting new "niche businesses" within the scope of its present operations. Upstream consolidation has meant accepting some reduction in output (Chevron's US production was 7% down last year and the worldwide total down by 3%), but the report notes that new production has begun offshore California while secondary and enhanced recovery are providing good returns onshore. Production is rising in Canada, and overseas operations have stayed profitable. West Africa

* Since the annual report appeared, Chevron has restated earnings for the past two years to meet new accounting standards. To reflect deferred taxes arising from the 1984 acquisition of Gulf, 1986 has been restated to show a \$1.41bn loss, while net income for 1987 has been increased to \$1.25bn.

despite the recent enforced sale of 20% of its Angolan offshore interests) and Indonesia continue as major sources of crude production, along with the North Sea; and Chevron is looking ahead to the start-up next year of the Australian LNG 'megaproject' in which it has a one-sixth share. Downstream, the company retains its position as the USA's largest seller of refined products in general and second largest in gasoline sales, with important positions too in Canada, the UK (through Gulf Oil Great Britain), and the eastern hemisphere — where it markets in over fifty countries through 50%-owned Caltex. Chemical earnings more than doubled to a record high last year.

Exxon In contrast to Amoco and Chevron, the largest of the US majors might almost be said to have 'marked time' during 1987. Exxon's production rose by only 2%, refinery runs were nearly 2% down, and the product sales were unchanged at 4 043 000 barrels/day — still way ahead of its US competitors but lower than the Royal Dutch/Shell Group's 4.9 mb/d. The recovery in the upstream business on the bases of higher prices and lower operating costs (along with improved earnings from chemicals) was not enough to offset the squeeze on margins downstream, and net income overall fell by 10% to \$4.84bn — only \$100m ahead of the Shell Group's figure expressed in dollars. However, Exxon continued to expand its asset base, unlike most of its competitors, as the value of fixed assets rose by 8% to \$53.4bn and total identifiable assets by 6% to \$74bn. Exxon's upstream strength was enhanced by liquid reserve additions equal to 114% of its production during the year, due in part to purchases of 450m barrels of oil equivalent for

about \$1.3bn. Much of this came from properties in the USA, Canada and Australia acquired with Celeron Oil & Gas, SLIpetro and Delhi Petroleum respectively. Reflecting the current emphasis on selectivity, the number of exploration wells drilled was down, but rising production is expected in future on the basis of, for example, last year's start-ups at Endicott in the Arctic and Clyde in the North Sea, the commencement last December of shipments from North Yemen, and the continuing development of new fields in Australia, Malaysia and elsewhere. If 1986 was the year of restructuring (see PE 6/87 page 214), last year was a time for testing the new structure which grouped international oil and gas activities outside North America under Exxon Co International and similarly consolidated coal and minerals operations under Exxon Coal & Minerals Co. Altogether, Exxon claims that its new organisational efficiency added \$375m to net income last year alone. Meanwhile, it sought to offset the drop in net income and the rate of return by making a two-for-one stock split, raising the dividend, and repurchasing 58 million Exxon shares.

Mobil As with Exxon, Mobil's upstream gains failed to offset its earnings decline downstream, and net income was 11% down on balance. Yet it rated the year a positive one for its competitive position, noting in particular the continued upgrading of refineries at home and abroad, impressive results for the natural gas business, and the return of the Montgomery Ward unit to profitability. (Subsequently, however, Mobil decided to wind up its previously diversified strategy by selling MW for \$1.5bn, see PE 4/88

MAJOR OIL COMPANIES: ANNUAL RESULTS

Financial data in million dollars (except BP and R/D Shell). Operating statistics in thousand b/d (except where otherwise indicated).

	Net income (a)	Depreciation & depletion (b)	Cash flow from operations (c)	Cash dividends (d)	Capital & exploration expenditures (e)	Long-term debt (f)	Value of fixed assets (g)	% return on equity (h)	Oil reserves (i)	Oil production (j)	Refinery runs (k)	Product sales (l)	Natural gas sales (m)
US-based groups													
Amoco													
1986	747	2 418	2 842r)	849	3 181	2 993	18 169	6.5	2 424	810	914	1 032	2 819
1987	1 360	2 295	4 012	847	2 979	2 773	18 129	11.6	2 580	802	895	1 021	3 001
% change	+82	-5	+41	—	-6	-7	—	—	+6	-1	-2	-1	+6
Chevron													
1986	715	2 787	3 920	818	3 018	7 310	22 746	4.6	3 513	1 389r)	1 800	2 264r)	2 329
1987	1 007	2 514	4 416	818	2 841	5 885	21 736	6.4	3 348	1 338	1 878	2 335	2 402
% change	+41	-10	+13	—	-6	-19	-4	—	-5	-3	+4	+3	+3
Exxon													
1986	5 360	4 415	9 048	2 603	7 200	4 294	49 289	17.5	6 512	1 796	3 032	4 043	5 329
1987	4 840	4 239	9 826	2 686	7 100	5 021	53 434	14.7	6 634	1 835	2 981	4 043	5 227
% change	-10	-4	+9	+3	-1	+17	+8	—	+2	+2	-2	—	-2
Mobil													
1986	1 407	2 471r)	3 771	898	3 003r)	7 885	24 304	9.6	3 018r)	727r)	1 545	2 274	3 434r)
1987	1 258	2 546	3 974	903	2 942	7 064	24 946	7.9	2 953	709	1 563	2 362	4 052
% change	-11	+3	+5	+1	-2	-10	+3	—	-2	-2	+1	+4	+18
Texaco													
1986	725	2 732	3 683	722	2 369	6 857	21 661	5.3	3 225	1 146	1 934	2 740	2 705
1987	(-4 407)	2 552	2 984	181	2 234	5 917	18 722	—	3 089	1 065	1 892	2 734	2 767
% change	—	-7	-19	-75	-6	-14	-14	—	-4	-7	-2	—	+2
Five US majors													
1986	8 954	14 823	23 264	5 890	18 771	29 339	136 169	—	18 692	5 868	9 225	12 353	16 616
1987	4 058	14 146	25 212	5 435	18 096	26 660	136 967	—	18 604	5 749	9 209	12 495	17 449
% change	-55	-5	+8	-8	-4	-9	+1	—	—	-2	—	+1	+5
Europe-based groups													
Financial data in £m													
British Petroleum													
1986	499	3 202r)	4 461	623	3 303	3 290	15 418	8.2	4 658	1 434r)	1 895	2 740	637
1987	1 391	2 173	5 217	670	2 762	3 107	15 302	13.4	5 005	1 514	1 822	2 622	680
% change	+179	-32	+17	+8	-16	-6	-1	—	+7	+6	-4	-4	+7
Royal Dutch/Shell													
1986	2 540	3 160	7 145r)	1 340	4 678r)	4 218	30 548	10.5k)	7 263r)	1 803r)	3 220	4 395	6 205
1987	2 383	2 959	5 023	1 529	4 380	3 169	27 148	12.0k)	7 914	1 766	3 244	4 900	6 538
% change	+14	-6	-30	+14	-6	-25	-11	—	-9	-2	-1	+11	-5

a. After write-downs and extraordinary gains or losses. b. Excluding proceeds from sales of assets. c. Excluding cost of major acquisitions. d. At year-end. e. Net income as percentage of average stockholders' equity. f. In million barrels including natural gas liquids. g. Production of crude oil and gas liquids. Purchases are excluded where possible. h. In some cases processing agreements with other companies are included. i. Billion cubic feet/day. j. Rate of net production. k. Net income as % of average net assets. l. Restated or revised.

page 140). Another positive feature was the 10% reduction in long-term debt, due in part to continued asset sales. The debt-to-capitalisation ratio is now down to 34% from the uncomfortably high level of 49% reached three years ago after the \$5.7bn acquisition of Superior Oil in 1984. Crude oil production and reserves were both marginally lower than before, but exploration and development continued apace with a discovery rate of 40% in wildcat drilling — including major finds in the USA, North Sea and Nigeria. A resumed rise in production is expected before long. Downstream, Mobil's product sales were up by an above-average 4% in volume, the best result for any of the US majors. Motor gasoline sales grew at twice the industry rate in the USA and boosted the company's market share for the third successive year, from 5.6% in 1984 to 7% in 1987. Mobil also claims a 10% share in the lubricants business in areas where it operates. In common with most of the majors, it reported a steep rise in chemicals earnings, especially in the USA and Saudi Arabia.

Texaco For the greater part of 1987 Texaco was in something like a state of siege, following its resort to the protection of the bankruptcy code in April, but its prolonged trials and tribulations finally ended in the closing days of the year with the agreement to settle Pennzoil's litigation for a payment of \$3bn. Backed by shareholder and court approval of its restructuring plan (see *PE* 5/88 page 180), it now hopes to resume its former role in the industry — albeit in a slimmer form after asset sales likely to total \$5bn. Proceeds will be used to reduce debt and fund high potential capital projects. It seems likely that the future emphasis will be on the upstream, including joint ventures with others such as those already made with Nippon Oil and Petrobras for the Gulf of Mexico. Downstream commitments will be reduced at home and abroad through the partial sale of some refineries and marketing assets, in addition to the already announced intention to sell Deutsche Texaco outright. Reverting to 1987, the financial figures were mostly adverse and consequently depressed the overall totals shown for the five US majors in our table. Including a \$2.8bn charge associated with the Pennzoil settlement, Texaco showed a massive net loss of \$4.4bn compared with 1986 profits of \$725m; cash flow was down by 19% to under \$3bn; and dividend payments were of necessity suspended after the first quarter (but will be resumed this month). Although only 70% of production was replaced by reserves additions, this was better than in 1986; and operating results were otherwise satisfactory. There were declines in crude production in North and South America, but gas sales rose and oil product sales were level at 2.7mb/d.

British Petroleum The year was especially momentous for BP, dominated as it was by the acquisition of the 45% minority shareholding in Standard Oil for £4.7bn, the UK government's sale of its remaining holding in BP, and the first moves in the take-over for Britoil. Merging Standard fully into BP (it was previously only 55%-owned) provided access to the full potential of the US market and established BP as one of the world's three largest oil companies*. The government share sale, though disappointing at the time due to the stock market crash, effectively doubled the

number of shareholders while the associated issue of £1.45bn in new equity helped to offset the cost of the Standard acquisition. (The emergence of the Kuwait Investment Office as a major shareholder is seen as a problem for the UK government rather than BP itself). Finally, the offer for Britoil, which later became unconditional and closes this month, will result in a major expansion of BP's already considerable North Sea production base. To strengthen the group's key interests, some of the smaller businesses were merged into larger ones last year (e.g. upstream gas into BP Exploration) and US operations were restructured under the newly-formed BP America, comprising Standard Oil plus the former BP North America. BP America is the group's largest overseas holding and source of profit — and it ranks as the twelfth largest US company in its own right. In common with others, BP had difficulty in recovering higher crude oil costs in the marketplace last year, but E & P profits doubled and minerals earnings trebled. The end result was a rise of 70% in net income before extraordinary items, and as much as 179% after allowing for these in the 1986 figures. Cash flow was up by 17% — relatively more than for any other company apart from Amoco — to £5.2bn. Although refinery runs and product sales were both 4% down in volume, BP's crude production was 7% up at 5.0 mb/d and natural gas sales likewise increased by 7%. Capital spending proper fell by a sixth in sterling terms, reflecting in part the weakness of the dollar, but the group's business portfolio was enlarged by increased spending on acquisitions, up from £484m to £794m.

Royal Dutch/Shell Group Highlights of 1987 for the Anglo-Dutch group, by now vying with Exxon for the first place in the oil industry league table, demonstrate the wide range of its interests in such features as its continued leadership in the US motor gasoline market, a return to the Italian market, acquisition of several companies in the chemicals and other fields, the commissioning of new downstream ventures in China, and start-up of a new gold mine in Australia. In the oil sector it showed the best increase of any company in product sales (up 11% to 4.9 mb/d), the biggest increase in oil reserves (up 9% to over 7.9bn barrels), and an improved rate of refinery utilisation at 88% of distillation capacity. Against the trend elsewhere, refinery runs increased marginally. The financial data show that it outpaced most of its competitors with a 14% improvement in net income and an equivalent boost in dividend payments. The latter followed increases of 26% in 1986 and 20% in 1985. Meanwhile, long-term debt was reduced by a remarkable 25% to £3.2bn, thus further demonstrating the group's financial strength — which has since been underlined by record first-quarter 1988 profits, putting it ahead of Exxon (see Company Information). As regards the balance of its activities, the group is already widely spread with interests including coal and metals as well as oil, gas and chemicals; so there are no plans for major new diversification, although acquisitions within the scope of existing businesses will doubtless continue. With equity production representing only 54% of refinery runs last year (compared with 83% in the case of BP), upstream expansion through discoveries of new fields and enhanced recovery from others must be top priorities. At the same time, the report notes, "new products will be developed to meet the needs of consumers, operations will be made even more efficient, and new markets will be developed." □

* See Companies in the News, *PE* 5/87 page 160, for a detailed account of the background to the bid and the advantages of full merger.

State policy in perspective

An historical look at the "ELF"

Almost from the discovery of Prudhoe Bay in 1969, Alaska lawmakers have faced a dilemma in oil-tax policy:

The problem was how to levy an "appropriate" (whatever that might be) state severance tax on the Prudhoe Bay field without putting the same tax on smaller, mature oilfields in Cook Inlet that would soon be approaching their economic limits.

It was no particular good-will gesture toward Cook Inlet producers, however, the policy goal was to save jobs and local community tax-base in Cook Inlet, while also collecting severance taxes at the full rate from Prudhoe Bay.

The solution, designed in 1970 by oil consultants Walter J. Levy and Milton Lipton (then under contract to the legislature) was a "progressive" severance tax that would levy higher taxes on high-producing wells, like those at Prudhoe Bay, but then lower the tax on wells producing fewer barrels, such as the Cook Inlet. It involved the same concept as the graduated federal income tax — the greater the income, the greater the tax.

There have been structural changes in the severance tax since 1970 — including major revisions in 1977 and 1981 — but the policy has been consistent. Today, state leaders not only want to keep Cook Inlet running as long as possible, but also encourage development of "marginal fields" on the North Slope, oil deposits near Prudhoe that, while large, are barely economic in the high-cost North Slope environment.

This spring, Alaska legislators are considering more changes to the severance tax. In doing so, they are looking closely not only at how much more revenue a tax change might bring, but how it would affect development of new, marginal fields as well as the ongoing development work in Prudhoe Bay.

Changes In The Tax

From 1970 to 1977, Alaska had a "stair-step" graduated severance tax with rates that increased from five to eight percent of the wellhead value of oil depending on how much the well produced. This was the formula devised by Walter Levy and Milton Lipton.

In 1977, the tax was changed to a flat 12.5% tax on wellhead value for all production, but with the "Economic Limit Factor," a formula that reduced the effective rate of tax as the well production fell and it approached the economic limit. In adopting such a change, legislators attempted to build more flexibility into the Economic Limit Factor (it could then be different for each field, fitting more closely to its economics, rather than locked into specific brackets), while also increasing the amount of tax on Prudhoe.

In 1981, there were other changes: As part of the legislative package that also repealed Alaska's controversial separate accounting income tax on oil, legislators increased the severance tax to 15%. In addition, a number of other complex changes were made.

• New fields coming into production after mid-1981 were to enjoy a lower 12.5% tax for the first five years. After that, the

tax would increase to 15%. Since Prudhoe Bay was already in production, it bore the full 15%.

• The Economic Limit Factor would not apply to Prudhoe, until 1987. After that, the declining Prudhoe Bay wells would get the same benefit of the "ELF" as wells in other oilfields, such as Kuparuk, Milne Point and Cook Inlet.

" . . . companies think that an additional 1.5 billion barrels could be coaxed out of the reservoir through enhanced oil recovery projects or more intensive drilling or waterflood."

In practical terms, the effective tax on Kuparuk and Milne Point are in the range of five to six percent compared to 15% on Prudhoe, the Department of Revenue says. When the new Endicott field goes into production, the tax will be in the three percent range, the department says. If the West Sak heavy oil deposits are ever developed, the effective rate of tax could be almost zero, because of razor-thin economics.

One of the options being considered in Juneau this spring is to continue the exclusion of the Economic Limit Factor on Prudhoe, so that Prudhoe would continue to carry the whole tax, while other fields enjoyed lower tax rates.

But complications arise, as they usually do when governments attempt to design complex and intricate tax systems.

New Prudhoe Development

If the Economic Limit Factor is designated to encourage development of new "marginal" fields, what about marginal areas of the big Prudhoe field? Only 40 percent of Prudhoe's oil will be recovered through primary and secondary (mainly waterflood) production. The companies think that an additional 1.5 billion barrels of oil could be coaxed out of the reservoir through enhanced oil recovery projects or more intensive drilling or waterflood. But it will be marginal, "high cost" oil. A high tax could discourage development of these added reserves, just as it would a brand new, "marginal" field.

If major new commercial oil production in the near future will be from Prudhoe itself, the same tax policy that applies to smaller fields should also apply to Prudhoe, to encourage development of these reserves.

Strategic Shift ^{10/13}

Restructured Oil Firms Suffer Little Hardship As Crude Prices Plunge

Profits Soar, Reflecting Years
Of Severe Cost Cutting
And Efforts to Diversify

Plastic Bags and Pesticides

By ALLANNA SULLIVAN

Staff Reporter of THE WALL STREET JOURNAL

NEW YORK — On Friday, a selling panic gripped global oil markets. OPEC was in disarray. Saudi Arabia had opened the floodgates. From Brussels to New York, oil prices crashed to their lowest level in more than two years.

Yet through it all, on the floor of the New York Stock Exchange, Robin Stonehill was leaning ho-hum against the post where he trades shares of Atlantic Richfield Co. "The stock is stable," he nonchalantly said. "The investment community isn't paying any attention to the price of oil today."

Why should it? Despite plunging prices, ARCO's profit is surging. So, in fact, are the profits of Exxon Corp., Mobil Corp., and nearly every multinational oil company. Despite the continuing collapse of oil prices, profits of the nation's 18 biggest oil companies will leap by about one-third this year, to nearly \$20 billion—far exceeding the profits of every major airline and auto maker combined.

A New Look

Through a radical restructuring spanning less than a decade, Big Oil has abandoned the days when profits moved in lock-step with oil prices. Indeed, for the first time in its 129-year history, the oil industry has positioned itself to make money—big money in some cases—even when oil prices fall out of bed. (For an article on the drop in oil prices, see page A3.)

"It is one of the most sweeping and most dramatic restructurings of any industry," says Philip Verjeer, visiting fellow at the Institute for International Economics in Washington.

The turnaround is due partly to cost-cutting on a scale that has hit few industries. Almost 300,000 oil-patch employees have lost their jobs—20 times the number of financial-industry workers idled since last year's stock-market crash.

Exxon alone cut about \$375 million in costs just last year. (Only two years ago and Exxon employees occupied 13 floors of the

Oil: Profits and Prices

	PROFITS OF 18 INTEGRATED COS. (In billions)	MIDEAST LIGHT CRUDE (Per barrel)
1987 First Qtr.	\$2.936	\$17.25
1987 Second Qtr.	3.507	17.38
1987 Third Qtr.	3.429	17.65
1987 Fourth Qtr.	3.600	17.02
1988 First Qtr.	4.398	15.05
1988 Second Qtr.	4.257	14.68

Source: Energy Performance Review, Arthur Andersen & Co.

oil giant's New York skyscraper. Today, after layoffs and transfers, only 300 workers remain on seven floors. And the building, part of the legacy of Exxon founder John D. Rockefeller, has been sold to a Japanese group.

But Draconian cost cutting alone doesn't account for the surge in profits. By radically overhauling the process by which it refines and distributes oil, the industry has managed to keep consumer prices high, even as crude-oil costs plunge. Big Oil, long adept at exploring and pumping, has also finally learned the art of selling—by going after market niches with new grades of gasoline, for instance, and by manufacturing such high-value petrochemical products as Mobil's Hefty Storage Bags. In recent years, all large oil companies have slashed the number of gasoline stations through which they move their products, eliminating any unprofitable or even marginal operations.

There isn't any evidence that major oil companies have conspired to keep retail oil prices high. But consumer groups complain that regulators have been inattentive to the issue. Three times during the Reagan Administration, the Citizen-Labor Energy Coalition, based in Washington, D.C., has approached the Justice Department with claims that consumer prices were too high relative to the falling price of crude. Two years ago, in response to such a complaint, the coalition received only a thank-you note in return, said Edwin Rothschild, assistant director of the group.

The Cost of Sales

Behind the turnaround is a fundamental reshaping of the internal structure of the major oil companies. For more than a century, oil companies have consisted of two halves. There was an exploration or production division that drilled wildcat wells and kept the oil flowing—the so-called upstream business. The oil companies pumped crude furiously and "sold" it to themselves at market prices, which, in nearly every year until the price crash of 1986, were sufficient to guarantee huge profits.

Then there was the "downstream" side—all the refineries and filling stations that "bought" the oil, poor stepchildren of the romantic and profitable wildcatting and oil-pumping business. "Service stations were just a way to move oil," says Thomas Manning, vice president of Purvin & Gertz Inc., a refining-consulting firm in Houston. Money-losing retail operations were a global phenomenon. Total Compag-

nie Francaise des Petroles of France once chose where to sell products according to a guidebook called "Losses at Posted Prices."

Such losses were practically guaranteed because there were simply too many refineries and gasoline outlets. By the late 1970s, the industry was operating more than 300 refineries, many of them among the world's largest factories. Service stations grew ubiquitous, often four to an intersection, with price wars erupting regularly.

Then the industry began awakening to a painful truth: The crude-oil gravy train was screeching to a halt. The U.S., it became clear, was rapidly running out of oil. Governments in Asia, Africa and the Middle East nationalized their oil fields. "Now that [the companies] don't own the oil, they must run the rest of their business to make money," Mr. Manning says.

The answer lay largely in marketing. No longer could oil companies blindly push products with broad national advertising, as Texaco once did with its "Texaco Star Theater." The industry began choosing geographical markets carefully, cannily introducing new products and pricing shrewdly.

"It wasn't until this decade that big oil companies focused on ensuring that the refining and marketing businesses operate profitably," said Robert Stobaugh, a business professor with the Harvard Business School.

Headhunters have noticed the change. "Our clients want marketing people who understand the concept of 'positioning' a product, even if he comes from the fast-food or soft-drink industry," says Joseph Collard, an oil and gas specialist at Spencer, Stuart & Associates, an executive-search firm. In the past, he said, oil companies generally wanted people with technical backgrounds.

The industry also eliminated excess refining capacity, mothballing in this decade more than a third of its refineries. The resulting tight supplies now force the oil industry to import not just crude oil but also gasoline.

And as supplies of gasoline tighten, the industry is doing all it can to get consumers to buy more. High-tech gasoline stations decked out in eye-catching colors dot the landscape, replacing the mom and pop operations that had become part of American folklore. In addition to the old standby products—tires, batteries and accessories—gasoline stations now sell bread, milk, beer and Playboy magazine.

Computerized pumps at these designer stations have more than tripled the speed at which gasoline moves to the customer. The "smart pumps" can handle the credit-card payment, log the sale for inventory purposes and then reset themselves in a flash for the next patron—at huge cost savings to the oil companies.

A New Flavor

Like cereal and soap makers, the oil industry is rapidly introducing new products, further segmenting a market that once consisted solely of "regular" and "high-test." Most of the majors have introduced, at least in some regions, a medium-octane gasoline that most cars don't need but that consumers are buying in droves, largely because of advertising. Exxon, for instance, just introduced its Exxon Plus medium grade in six states.

Although the medium-grade gasoline costs very little extra to produce, it fetches several cents a gallon more than regular unleaded gasoline. In some cases, profit margins are two times higher. And best of all, clever marketing of the new grades generally causes consumers to "buy up" from the less expensive gasoline, rather than "buy down" from the premium grade.

The companies have also become very fussy about where they sell their gasoline, withdrawing from the most competitive areas and building a presence in locations where they can dominate. Tenneco Inc., a big gasoline retailer in the South, even quit selling gasoline in its hometown of Houston because it didn't have a big enough share of the market to make it worth the company's while.

Atlantic Richfield pulled out of the Atlantic states. Amoco Corp. makes gasoline in Texas but recently quit selling it there, except at the lone outlet where refinery employees can fill up. Exxon and Texaco Inc. recently swapped dozens of gasoline stations, mostly in California and Nevada to consolidate their hold on markets that are closest to their respective refineries. All told, the industry has closed 26,514 service stations since 1982, nearly a quarter of the total.

Tough Times for Independents

As the big companies cut costs, they can also cut prices, sometimes driving independent distributors out of the business altogether. Steven Riggins, whose family runs 16 gasoline stations in New Jersey, says the number of independent gasoline suppliers in his market has shrunk by one-half in only the past year. They have abandoned their businesses because of slim profits. As a result, Mr. Riggins is stuck buying from the majors. "There definitely isn't the pick anymore," he says.

As the majors achieve market dominance, they naturally can charge more. An ARCO station in Boulder City, Nev., which competes with only one independent retailer, has charged 10 cents more for a gallon of gasoline than ARCO stations in Las Vegas, only 15 miles away, where at least four major oil companies compete.

Gasoline is far from the only product producing huge profits these days. The petrochemicals business, for years a dumping ground for the by-products of gasoline refining, has become the diamond in Big Oil's hydrocarbon crown.

In fact, the oil industry has nudged the petrochemical industry out as the top player in its own business. Oil firms now produce three of every five pounds of building-block petrochemicals—ethylene, propylene, butadiene, benzene and paraxylene—from which up to 85% of petrochemicals in the U.S. are made.

Petrochemicals also are going into an increasing proportion of high-value consumer packaging and products—no longer just the bowling ball, for instance, but also

OGJ group profits jump 74.4% in first 9 months

Downstream operations are lifting profits for most of the 23 U.S. oil firms in the Oil & Gas Journal group.

During the first 3 quarters of 1988, the group's net income jumped 74.4% from a year ago to \$16.647 billion. Group third quarter net profits climbed 34.1% from last year to \$4.552 billion. Profits totaled \$6.039 billion in the second quarter and \$6.027 billion in the first quarter.

Falling crude oil prices helped boost refining and petrochemical earnings but cut upstream income.

Thirteen of the companies in the group reported capital and exploration expenditures of \$19.824 billion for the first 9 months of 1988, up 29.7% from the same 1987 period.

Downstream gains. Companies scored downstream earnings gains in the U.S. and worldwide.

Refining margins widened as crude prices fell and product prices held steady on the strength of rising demand, which also lifted volumes.

According to the Energy Information Administration (EIA), demand for petroleum products for the first 3 quarters of 1988 averaged 16.884 million b/d, up 303,000 b/d from the same period of 1987.

International Energy Agency estimated non-Communist product demand at 49.23 million b/d, up 2% from the first 3 quarters of 1987.

U.S. refinery crude acquisition costs fell 15.3% to an average of \$15.13/bbl during the period. Meanwhile, the U.S. average pump price for all types of motor gasoline climbed to 96.24¢/gal from 94.83¢/gal a year ago. The average price of residential heating oil moved up to 80.27¢/gal from 78.37¢/gal in 1987.

An increase in the average refinery utilization rate to 84.8% from 83.2% helped reduce operating costs and further improved margins.

Here's a sample of company refining and marketing results for the first 9 months of the year:

- Exxon Corp. reported profits of \$414 million in the U.S., compared to a \$50 million loss a year earlier, and \$835 million outside the U.S., up from \$185 million in 1987.

- Mobil Oil Corp. had income of \$333 million in the U.S., up \$263 million, and \$368 million outside the U.S., up \$197 million.

- Chevron Corp. earned \$411 million in the U.S. vs. \$2 million a year earlier, \$154 million outside the U.S. vs. \$26 million in 1987.

- Texaco Inc. earnings totaled \$402 million in the U.S., compared to a

Breakout of the OGJ group's profits and revenues

	First 9 months				Third quarter			
	Net profits*		Revenues		Net profits*		Revenues	
	1988	change	1988	change	1988	change	1988	change
	Million \$	from 1987	Million \$	from 1987	Million \$	from 1987	Million \$	from 1987
Exxon	3,880	18.1	65,522	6.5	1,225	15.0	21,888	-0.2
Shell	1,851	134.1	15,923	3.8	352	-16.2	5,445	-3.7
Amoco	1,688	71.7	17,878	7.3	552	34.0	5,948	3.4
Mobil	1,625	85.9	40,987	10.4	557	68.8	13,116	-0.2
Chevron	1,593	56.8	21,998	1.1	420	41.4	7,156	-6.9
Pennzoil	1,439	5,357.5	1,649	23.3	39	745.1	617	37.2
ARCO	1,192	34.8	13,776	11.5	391	24.1	4,592	3.4
Texaco	1,008	183.9	26,799	3.3	239	121.3	8,689	-3.0
Phillips	515	25,650.0	8,630	8.1	215	593.5	2,850	1.7
USX [†]	363	-21.8	7,594	3.7	168	40.0	2,504	0.6
Unocal	339	123.0	7,432	5.3	97	234.5	2,581	0.2
Conoco	320	64.1	8,502	5.3	71	-6.6	2,790	-2.0
Occidental	295	46.0	14,133	11.2	103	139.5	4,913	16.4
Ashland/	224	68.4	8,200	17.1	66	0.0	2,200	4.8
Tenneco	224	-	9,634	10.7	7	-	3,025	9.0
Coastal	86	10.5	6,169	13.4	9	-21.4	1,921	8.3
Kerr-McGee	77	15.7	2,054	4.4	30	62.4	660	-4.9
Amerada Hess	58	-81.3	3,070	-12.5	16	-59.1	925	-17.6
Murphy	13	-27.2	1,110	-1.7	10	29.5	382	-10.6
Quaker State	9	-	613	-6.1	4	-35.1	192	-5.5
Louisiana Land & Exploration	(34)	-292.7	574	-4.9	(55)	-1,048.3	182	-14.1
Maxus	(59)	-	446	-11.3	(36)	-	131	-22.5
Sun	(69)	-126.0	7,280	1.0	72	-47.4	2,460	-2.4
Total	16,647	74.4	289,973	6.6	4,552	34.1	95,167	0.2

*As reported. May include nonrecurring gains and losses. †Reflects 1.7 billion extraordinary gain due to settlement with Texaco. ‡Oil and gas segment only. §Operating income before interest and taxes. ¶After-tax operating income. ††Fiscal year and fourth quarter.

How profits and spending compare

	Net profits		Capital & exploration expenditures			
	1988	1987	1988	1987	% change from 1987	% of net income 1988
	Million \$	Million \$	Million \$	Million \$		
Exxon	3,880	3,285	5,091	4,205	21.1	131.2
Shell	1,861	795	2,714	1,841	47.4	145.8
Amoco	1,688	983	2,341	1,788	30.9	138.7
Mobil	1,625	874	2,228	2,010	10.8	137.1
Chevron	1,593	1,016	2,245	1,808	24.2	140.9
Texaco	1,008	355	1,722	1,240	38.9	170.8
Phillips	515	2	550	486	13.2	106.8
USX*	363	464	651	525	24.0	179.3
Unocal	339	152	779	529	47.3	229.8
Occidental	295	202	599	337	77.7	203.1
Kerr-McGee	77	66	215	152	41.7	280.4
Amerada Hess	58	309	594	230	158.0	1,025.5
Maxus	(59)	(485)	95	136	-30.1	-
Total	13,243	8,018	19,824	15,287	29.7	149.7

*Oil and gas segment only.

loss of \$63 million in 1987. Outside the U.S. earnings were \$291 million, up from \$118 million.

- Shell Oil Co.'s oil products segment earned \$480 million, up from \$272 million.

- Amoco Corp.'s earnings from worldwide refining, marketing, and transport operations climbed to \$631 million from \$147 million in 1987.

Chemical, upstream results. Lower crude costs also boosted earnings from chemical operations.

Examples of 9 month company chemical performances: Phillips Pe-

troleum Co. \$690 million vs. \$333 million for the same period of 1987; Mobil \$482 million, more than twice the year-earlier net; ARCO \$670 million vs. \$280 million; Amoco \$539 million, up 77%; Shell \$480 million vs. \$272 million; Texaco \$135 million vs. \$50 million; Chevron \$283 million, up 56.4%; and Exxon \$966 million, up \$403 million.

Almost all OGJ group companies had lower exploration/production earnings. An exception was Phillips, which posted a gain to \$443 million from \$234 million a year earlier.

Wall Street Journal

Arco's Earnings Set a Record; Amoco Net Falls

By **FREDERICK ROSE**
Staff Reporter of THE WALL STREET JOURNAL
Atlantic Richfield Co., boosting its quarterly dividend, reported record fourth-quarter profit and announced an indefinite extension of a stock-purchase program.

Separately, Amoco Corp. said its fourth-quarter net income declined less than 1%, to \$375 million, or \$1.45 a share, as increased profit from refining and marketing operations was offset by declining results from crude oil and natural gas production.

Los Angeles-based Arco's quarterly dividend increase, to \$1.125 a share from \$1, is

the company's first boost since 1985, when it undertook a massive recapitalization and cost-cutting program that trimmed its common stock by more than 25%, slashed costs and boosted the dividend at that time to \$1 from 75 cents.

The latest increase had been expected but came earlier and at the high end of analysts' forecasts. Analysts said yesterday's announcements underscore the effectiveness of Arco's 1985 recapitalization, which was widely questioned when it was announced. "They have been vindicated," said Eugene Nowak, an analyst at Dean Witter Reynolds Inc.

The increased dividend will be paid March 30 to stock of record Feb. 17. Arco and Amoco shares both fell yesterday amid a broad slide of oil stocks on news of declining oil prices. Arco was off 12.5 cents, at \$85 a share. Amoco dropped \$3, to \$75.625 a share. The shares of both companies are quoted on the New York Stock Exchange.

Arco's fourth-quarter net income rose

1/27/89

15%, to \$391 million, or \$2.22 a share, from \$340 million, or \$1.86 a share, a year earlier. The latest quarter was Arco's highest ever. Revenue declined 1.6%, to \$4.54 billion from \$4.62 billion. The average shares outstanding declined 3%, to 176.9 million from 183.5 million a year earlier.

Contributing to the earnings increase, after-tax profit from Arco's refining and marketing operations jumped 76%, to \$88 million from \$50 million. Profit at the company's Lyondell Petrochemical Co. unit, currently the subject of an initial public offering that will reduce Arco's stake to just under 50%, was nearly trebled at \$151 million compared with \$56 million a year earlier. These increases and others were countered in part by a 38% drop in the company's after-tax profit from crude oil and natural gas production, to \$95 million from \$154 million in the year-earlier quarter.

Arco's indefinite extension of its stock buy-back continues a program started in 1985, under which the company purchased 62.6 million shares—or about 35% of the

amount previously outstanding—at an average price of \$63.47 a share. Analysts said they expect the company to continue the purchases at about the recent rate of its buy-back, which, since November 1987, has brought in 7.6 million shares at an average of \$77.01 a share.

Arco's net income for the year rose 29%, to \$1.58 billion, or \$8.78 a share, from \$1.22 billion, or \$6.68 a share, a year earlier. Revenue increased 7.9%, to \$18.32 billion from \$16.98 billion. The average number of shares outstanding declined 1.6%, to 180.4 million from 183.3 million.

Separately, Chicago-based Amoco reported fourth-quarter net income of \$375 million, or \$1.45 a share, compared with \$377 million, or \$1.47 a share, a year earlier. Revenue climbed 4.3% to \$6.19 billion from \$5.94 billion.

Amoco's net income for 1988 totaled \$2.06 billion, or \$8.01 a share, a 52% increase from \$1.36 billion, or \$5.31 a share, a year earlier. Revenue increased 6.6%, to \$23.93 billion from \$22.46 billion.

Anchorage June 2/8/89 C2

BP chief threatens cutbacks

Attacks tampering with ELF

By RAY TYSON
Times Business Editor

A top executive for BP America said Tuesday the company will be forced to cut back on projects in Alaska if the state tampers with the Economic Limit Factor, a tax incentive designed to encourage drilling in marginal oil fields.

E. John P. Browne, executive vice president of BP America, also told members of Commonwealth North the state must learn to live with lower oil prices, just as oil companies have done.

"If Alaska goes ahead and changes the ELF for Prudhoe Bay, we will have no choice but to cut back our planned developments there and elsewhere in the state," Browne said. "Our own budgets were built on real costs and our estimated price of oil."

Gov. Steve Cowper and House Democrats want to change the ELF to help raise more tax revenue to boost an ailing state treasury.

Browne said BP Exploration, formerly Standard Alaska Production Co., had planned to have four rigs working at Prudhoe Bay this year.

"Without ELF, we will have to consider fewer rigs," he said. "That's at least 125 fewer jobs for every rig not working, lower production, and the loss of revenues which will no longer be economic. A change in ELF will be a

short-term solution with longer-term damage."

While oil executives have criticized Cowper's plan to change the ELF, Browne's message was particularly hard-hitting.

"Not even Keynesian economists deny, anymore, that the best way to gain more state income from taxes and royalties is to encourage more development to tax," Browne said. "You plant the seeds, you don't eat your seed corn. But knowing and doing aren't the same, alas."

Like BP did, Browne said, the state must put its "house in order . . . to compete on an international footing."

"In a world with ample supplies of oil, costs must be reduced and taxes stabilized here to allow new sources of oil to be produced," he said. "Otherwise the investment will simply go to the countries or states where better opportunities exist."

Browne said the "glory days" of abundant oil money in Alaska are over.

"No matter how many excuses we give ourselves, the fact remains that Alaska has chosen high-cost government which can no longer be financed from high-cost oil," he said.

"Calling the situation a money problem is like saying the Hindenberg has gas trouble, the Titanic had an ice problem or that Noah had water woes. This is reality, Alaska is in danger of losing its way."

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PRICE

Changes in oil company tax break

By LARRY PERSILY *ADN 2/10/89*
The Associated Press

JUNEAU — Changes in state oil taxes proposed by the Cowper administration would generate an estimated \$3 billion in extra revenue by 2010, more than \$5,500 for every person in the state.

Despite the large amount of money at stake, the issue is not the cash, said Rep. Cliff Davidson, D-Kodiak. The question

facing legislators is establishment of a fair oil tax policy, said Davidson, co-chairman of the House Resources Committee.

The committee Thursday started four days of hearings on the state's Economic Limit Factor, also known as ELF, a tax break for marginally profitable oil fields.

The oil industry opposes a change in the ELF formula, but Gov. Steve Cowper is trying again this session to win legislative

could generate \$3 billion by 2010

approval for his proposal.

Not only does the administration want the ELF formula changed, but it would prefer that lawmakers make the changes retroactive to July 1987, when the tax break took effect for Prudhoe Bay.

"It can go backwards in time," said Revenue Commissioner Hugh Malone.

If the changes were retroactive to 1987, as proposed by Malone, the measure

would add almost \$400 million to the state treasury in fiscal year 1990 for three years of taxes.

Changes in ELF passed the Democratic-controlled House in 1987, but died in the Republican-led Senate last year. The House Finance Committee introduced legislation again this session.

House Resource hearings will continue today, Saturday and Monday.

House panel starts oil tax hearings

By LARRY PERSILY

THE ASSOCIATED PRESS

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The committee Thursday started four days of hearings on the state's Economic Limit Factor, also known as ELF, a tax break for marginal oil fields.

"What's fair to the industry, what's reasonable, what's appropriate?" Davidson asked.

"Are we getting maximum benefits from it (oil) for the people of the state," without discouraging oil companies from working in Alaska?

The oil industry opposes a change in the ELF formula, but Gov. Steve Cowper is trying again this session to win legislative approval for his proposal.

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Changes in ELF passed the Democratic-controlled House in 1987, but died in the Republican-led Senate last year. The House Finance Committee introduced legislation again this session, with House Bill 118 before the resources committee for its first hearings.

Changes are needed in ELF to correct problems that go back more than 10 years, Malone said.

The tax-break formula was adopted in 1977 to encourage oil companies to develop marginal fields, he said.

In 1981 lawmakers suspended the tax advantages of ELF at Prudhoe Bay until 1987.

ELF affects the severance or production tax paid by companies on the oil they pump out of the ground. The severance tax, which is separate from corporate income taxes, produced about one-third of the state's general fund revenues in the past 10 years, Malone said.

In 1987 the suspension of the ELF tax savings was lifted and the oil companies cut more than \$100 million a year from their severance tax bills at Prudhoe Bay, Malone said.

"Instead of helping marginal fields, the ELF formula now mostly provides a massive and unnecessary tax break to two fields which are not marginal at all, Prudhoe Bay and Kuparuk," the revenue commissioner said.

The administration wants ELF changed to reduce the tax break for the state's largest oil fields at Prudhoe and Kuparuk. The legislation also would increase the tax break for marginal fields.

For every dollar in new tax savings on smaller fields, oil companies would pay about \$10 more in higher severance taxes at Prudhoe and Kuparuk, Malone explained at a press conference Thursday.

"We should have done it in 1987, it would have been better to do it in 1988," and the legislature should not miss its chance to change ELF in 1989, Malone said.

The House Finance Committee bill would generate about \$96 million in additional revenue in fiscal 1990, unless the changes are retroactive, according to Revenue Department estimates.

Annual revenues would climb to \$187 million in fiscal 1993 and then gradually fall until they run out in 2010.

By 2010, the proposed changes in ELF would have earned the state almost \$3 billion in additional severance taxes, the department said.

House Resource hearings were to continue today, Saturday and Monday, with administration officials, oil company representatives, elected officials and public testimony scheduled for the hearings.

What is ELF?

- The ELF is one factor in calculating severance tax rates, but does not affect oil royalties.
- The ELF encourages additional development as oil fields mature.
- The ELF prevents oil fields from being shut in prematurely.

ANSWER: All three are correct. The ELF, which stands for Economic Limit Factor, was created by the Legislature, recognizing that oil would become more expensive to develop as fields mature. It encourages additional development in existing fields by a formula which charges higher taxes to more productive wells and lower taxes to less productive wells.



Wanted: A business of his own

By Jim Henderson
USA TODAY

1-30-89
P. 4B



By Barb Kinnay

CAPITAL HOLIDAY: Mark Nelson and Tina Jenso on vacation last month in Washington, D.C.

Nelson's finances

Assets		Interest	
Checking accounts	\$1,350	Alaska state resident dividend	800
Money market fund	82,000	Net rental income	(800)
Municipal bonds	8,900	Total	\$72,450
Real estate	146,000	Annual expenses	
401(k) retirement plan	14,000	Food	1,200
Individual retirement account	21,700	Clothes	600
Mortgage note	18,000	Telephone	1,800
Furnishings	2,000	Cleaners	120
Misc. (coin collection, guns, tools)	14,000	Auto expenses	900
Pickup truck and car	7,500	Car insurance	240
Total	\$326,450	Entertainment	1,800
Liabilities		Vacations	2,400
Real estate loan	\$79,000	Donations to church and charity	300
Net worth	\$248,450	Medical expenses	240
Annual income		Gifts	900
Salary	\$64,000	Misc. personal expenses	240
Plumbing work	3,000	Federal income taxes	13,800
		Social Security	3,605
		Available for savings	45,505
		Total	\$72,450

Source: USA TODAY research

Mark Nelson is ready to begin Stage 2 of his life's dream of owning and running his own business.

Stage 1 was to make as much money as quickly as possible so he could buy a business. Stage 2 is finding and buying one.

At 28, Nelson has a net worth of nearly a quarter of a million dollars, and it's getting fatter by the day.

After graduating in 1983 from the University of Idaho with a degree in accounting and finance, he headed to Alaska from his hometown of Lewiston, Idaho, to make big bucks in the oil boom. He spent a year in the offices of an oil firm in Anchorage and then transferred in Prudhoe Bay, north of the Arctic Circle.

He's an administration manager for Alaska Petroleum Contractors Inc. His work schedule: three weeks on — 12 hours a day, seven days a week — then three weeks off. His salary: \$64,000 a year.

"The beauty of my job is that I'm not only paid a good salary, but for the six months a year I'm up there, all my living expenses are paid for." Back in Lewiston, he lives with his mother and stepfather and works as a plumber. His stepfather owns a plumbing business.

He has invested in three rental properties in the Lewiston area: a duplex, a commercial building that houses a real estate office and a sign-making company, and a condominium that he owns in partnership with his mother, a Realtor.

"Real estate values haven't gone through the roof in Lewiston like they have in California and the East Coast, but they're pretty stable and have gone up a little each year," he says.

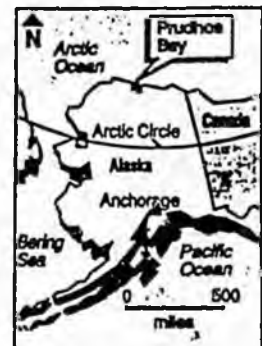
The properties are worth about \$146,000. He paid a total of \$127,000 for them and owes \$79,000 on mortgages.

During the past two years, Mark has been spending more of his time off traveling. He also has fallen in love. He met Tina Jenso, 26, of Copenhagen, Denmark, in 1981 when he spent a summer backpacking in Europe. They plan to get married next spring. Tina will move to the USA. They plan to work together in Alaska while they research a business to buy, then work in it together.

Mark has been to the Soviet Union, China, Hong Kong, Japan, and Africa. "But I try to do it as cheaply as possible," he says. "Backpacks and youth hostels." His company-paid plane flights to Prudhoe Bay qualify him for frequent-flyer mileage.

Besides real estate, most of his money is invested in a money market mutual fund and tax-free municipal bonds, bought through his father, a broker for D.A. Davidson & Co., a regional brokerage based in Great Falls, Mont.

Mark is "wide open" about what kind of business he wants. "I want to go about it the right way and take my time searching for the right business. I don't mind working hard, and I figure if things don't work out I'll still be young enough for a comeback." His only criteria at this point: "Some place warmer than Alaska, and no rat-race cities like L.A. or New York."



By John Sherlock, USA TODAY

Hearing on ELF set to consider cut in tax break

JUNEAU (AP) ^{2/3/89 AT} More than \$115 million in fiscal 1990 taxes will be at stake when the House Resources Committee next week opens this session's hearings on legislation to amend the state's oil tax structure.

The committee has scheduled four days of hearings on House Bill 118 to amend Alaska's Economic Limit Factor, known as ELF, a tax break intended to provide incentives for the development of marginal oil fields.

The House Finance Committee proposal would cut the tax break on the state's larger oil fields such as Prudhoe Bay and in return offer a bigger tax break on smaller fields.

The Revenue Department estimates the House bill would generate \$115 million in extra revenue next year and more than \$2 billion over the next 16 years.

"We intend to give this legislation a fair and complete hearing," said Rep. Cliff Davidson, D-Kodiak, co-chairman of House Resources.

A similar bill passed the Democrat-led House last session, but died in the Republican-controlled Senate without a single committee hearing.

Opposition to the bill comes primarily from the oil industry, Davidson said.

House Resources will meet the afternoon of Feb. 9 and 10 to hear from Cowper administration officials.

Oil industry testimony is scheduled for the afternoon of Feb. 11, and a statewide teleconference is set for the afternoon and evening of Feb. 13 to hear from the public, Davidson said.

T U E S D A Y

SECTION E Feb. 14, 1989

Public tells House about ELF

By LARRY PERSILY
The Associated Press

JUNEAU — House Resource Committee members listened to public testimony on state oil tax policies Monday and heard the same arguments as were presented by oil industry and administration officials last week.

Some members of the public said oil taxes are too low and should be raised to earn a fair share of the state's one-time resource at Prudhoe Bay.

Others said state government should be cut instead of going to the oil companies for higher taxes to pay the bills.

The committee is considering House Bill 118, which would change the state's oil production tax schedule and could boost state revenues by more than \$2 billion over the next two decades.

"The state of Alaska has a non-renewable resource that is leaving the state, and I believe we have to take full advantage of it," said James Barton, a Fairbanks truck driver and former North Slope construction worker who testified Monday in favor of raising oil taxes.

"The state is sending the wrong message to potential investors," said Bill Bivin, of the Bethel Chamber of Commerce and Native corporation.

Gov. Steve Cowper and many lawmakers want to change the Economic Limit Factor, known as ELF, a 12-year-old tax savings intended to encourage development of marginal oil fields.

The bill before the Resources Committee would raise taxes on the state's largest fields at Prudhoe Bay and Kuparuk, and would offer a larger tax break for smaller fields.

The result would be millions of dollars more each year for the state treasury.

ELF never was intended to provide such a huge tax savings for Prudhoe Bay during its profitable years, Cowper said. Oil companies deny that ELF gives them unfair tax savings at Prudhoe Bay.

The committee spent two days last week listening to Cowper administration officials testify in support of changing ELF, and then the oil industry had its turn at the table Saturday and spoke against the bill.

Monday's hearing was devoted to public testimony, and another public hearing is planned for Wednesday, said Rep. Cliff Davidson, D-Kodiak and co-chairman of the committee.

Juneau fisherman and teacher Alan Stein said the social ills caused by oil development are high, but taxes are too low.

"The oil industry should pay its fair share of those inflictions and wounds," he said in favor of changing ELF.

The problem is not oil taxes, but "the bloated level of government services and bureaucracy," said Ken Flynn, the owner of an Anchorage advertising agency.

Alaska needs a stable tax policy that does not change with political and fiscal tides, said Martin King of Fairbanks, who owns a trucking company that serves oil fields.

Robert B. Atwood
President and Publisher

Elaine Atwood
Assistant Publisher

William J. Tobin
Vice-President, Editor-in-Chief

Shabby government

A LOT OF monkey business is going on as the Democrats in the legislature and Gov. Steve Cowper and his troops try to drum up support for raising taxes on the oil industry. They are trying to do so by jiggering with the Economic Limit Factor, the formula by which the state assesses levies on petroleum production.

The effort is turning into a big flop, and that's just as well. But meanwhile the public is being subjected to a lot of governmental hooey, and a lot of legislative and administrative time is being wasted that should be devoted to doing something positive for the people of the state.

The facts are simple. The state, in a rare show of wisdom a dozen years ago, created a graduated severance tax on oil production. Wells producing the most oil paid the higher taxes. Wells in declining stages of production paid less. The idea was to encourage oil companies to utilize revenue that otherwise would have been paid in taxes on declining wells in the search for new production, that would keep dollars flowing into the state treasury.

And the plan has worked marvelously well.

THE INDUSTRY has reinvested millions of dollars in the task of enhanced recovery from marginal fields, creating thousands of jobs over the years, keeping support industries viable and enlarging the state's share of oil revenues.

As a result of ELF, as the formula is called, new exploration has moved ahead and hundreds of millions of dollars in new drilling has been accomplished or scheduled.

Gov. Cowper, however, in seeking more dollars to keep the government bureaucracy fat and growing, wants to extract more money instantly from the oil companies. With the help of House

Democrats, he's trying to do it by labeling the ELF as a "tax break" for the industry.

What his effort obviously is, however, is a proposed enormous tax increase on an industry employing thousands of Alaskans who need tax stability to solidify their employment. According to industry figures, the governor's proposed changes in the ELF formula would result in an increase of more than 100 percent in taxes against Kuparuk and an increase of more than 40 percent against Prudhoe Bay over the next 10 years.

Those proposals are unconscionable.

BUT CONSIDER the shenanigans that have been used to try to put this scheme across.

Democratic Rep. Cliff Davidson of Kodiak, chairman of the House committee holding the ELF hearings, scheduled testimony by the administration and the anti-oil environmentalists on Thursday and Friday, a week ago, in Juneau, when the ELF-change advocates would get prime time media coverage. He scheduled the oil industry's chance to respond last Saturday afternoon, when nobody was around.

In teleconference followups, those on hand here were polled to see whether they were for or against ELF changes before they were called upon to express their views — and guess which group got the most committee attention.

Then the governor wrote letters urging people favoring changes in the ELF to appear at two other hearings, which were called without notice for Monday — and sponsors let it be known that a body count of numbers would carry the most weight with the committee, rather than the substance of anyone's views.

The whole business is a sorry charade.

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Tye Lake lawsuit

Contractor agrees to pay state \$6 million

A.M.
SATURDAY

The Anchorage Times



STATE OF ALASKA

HOUSE OF REPRESENTATIVES

Box V, Juneau, Alaska 99811

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February 27, 1989

William J. Tobin, Editor
The Anchorage Times
P.O. Box 40
Anchorage, Alaska 99510

Dear Mr. Tobin,

Enclosed is a letter to the editor in response to your editorial entitled "Shabby government," which appeared on Saturday, February 18, 1989.

I trust that you will print this response in fairness to me and the other members of the House Resources Committee. The Committee has worked very hard on the ELF legislation to ensure a fair hearing.

Thank you for allowing me the opportunity to tell my side.

Sincerely,

A handwritten signature in cursive script that reads "Cliff Davidson".

Representative Cliff Davidson
Co-Chair, House Resources Committee

CD/jn



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ELF: A QUESTION OF FAIRNESS

Dear Editor,

Recently (February 18), The Anchorage Times editorialized on the ELF legislation currently before the House Resources Committee. In your comments on HB 118, you attacked both the legislation and the process by which the Committee is reviewing the issue.

The debate on ELF should lead to the determination of an appropriate, reasonable, justifiable and equitable state tax policy for gas and oil produced on state owned property. What taxes should the oil industry be paying? And, at what rate? What tax incentives should be offered? Which numbers -- on costs, profitability, recoverable reserves, etc. should be used?

Oil has made Alaska a wealthy state. But that should not obscure the fact that Prudhoe Bay, the only supergiant oil field in North America, has also provided phenomenal profits for the North Slope oil producers, as well as a reliable and plentiful supply of "cheap Alaska reserves" for additional transportation and refinery profits. How much, then, the oil companies are taxed is not the only question.

Equally important is what share of Alaska's oil wealth should go to maximize benefits to the people of the state. This is the resource policy imbedded in our State Constitution which all elected officials are sworn to uphold: "The legislature shall provide for the utilization, development and conservation of all natural resources belonging to the state for the maximum benefit of its people." (Article 8, Section 2).

These are the questions with which the House Resources Committee has been grappling during its extensive hearings on ELF. The Committee is working hard toward developing a tax policy that encourages investment by the oil industry. And everyone wants a tax policy that captures for Alaskans a fair and equitable share of the non-renewable, irreplaceable oil wealth that belongs to us all.

I believe that the intent and effect of HB 118 is laudable and would help future oil production in Alaska. It would reduce oil taxes on small oil fields and encourage additional exploration.

- more -

Your attack on my handling of the ELF hearings was wildly inaccurate. I have conducted extensive hearings to bring out the facts concerning ELF and what constitutes a fair share of the oil wealth for all Alaskans. We have had over 20 hours of testimony, including six from the Administration, six and a half from the oil industry and six from the public.

Contrary to your assertion that we held public hearings without notice, the ELF public hearings were scheduled and announced more than a week in advance. In fact, your paper printed our hearing schedule on February 3, and specifically mentioned the hearing that your editorial accused us of holding "without notice." Your suggestion that we would hold public hearings and then attempt to exclude the public is sloppy journalism and ludicrous.

My main concern is the development of a reasonable and responsible tax policy for Alaska. It needs to be fair to the oil companies, and it needs to be fair to the people of Alaska. The issue of ELF is only a part of that policy, but it deserves close examination.

Cliff Davidson

Representative Cliff Davidson
Co-Chairman, House Resources Committee

Anchorage Times
February 3, 1989

Hearing on ELF set to consider cut in tax break

JUNEAU (AP) ^{2/3/89 AT} — More than \$115 million in fiscal 1990 taxes will be at stake when the House Resources Committee next week opens this session's hearings on legislation to amend the state's oil tax structure.

The committee has scheduled four days of hearings on House Bill 118 to amend Alaska's Economic Limit Factor, known as ELF, a tax break intended to provide incentives for the development of marginal oil fields.

The House Finance Committee proposal would cut the tax break on the state's larger oil fields such as Prudhoe Bay and in return offer a bigger tax break on smaller fields.

The Revenue Department estimates the House bill would generate \$115 million in extra revenue next year and more than \$2 billion over the next 16 years.

"We intend to give this legislation a fair and complete hearing," said Rep. Cliff Davidson, D-Kodiak, co-chairman of House Resources.

A similar bill passed the Democrat-led House last session, but died in the Republican-controlled Senate without a single committee hearing.

Opposition to the bill comes primarily from the oil industry, Davidson said.

House Resources will meet the afternoon of Feb. 9 and 10 to hear from Cowper administration officials.

Oil industry testimony is scheduled for the afternoon of Feb. 11, and a statewide teleconference is set for the afternoon and evening of Feb. 13 to hear from the public, Davidson said.



It's getting to be a zoo

It's getting to be a zoo around here.

This is great, but keeping up with it all is driving us crazy.

Take this week, for example.

The President's coming to town. So are more than 90 Soviets from Moscow to Siberia, tagging along on Dixie Belcher's Juneau music ambassadorship of many years. A big annual resources conference opens, following on the heels of a big oil forecast conference. The construction industry has another large meeting, rural Alaskans are gathering in Southeastern, seminars and business functions are proliferating, noise levels have increased in Congress on arctic oil development and Southeastern timber's future, the state House and Administration are turning up the heat on new oil taxes, and that's just for starters.

There are so many opportunities jumping around this state that we're falling all over ourselves trying to keep up. (All the while guarding our pockets from the gummint).

Guess how we know that the level of activity and opportunity has increased significantly, so as to justify commentary.

It's the mail and the calendar. In recent weeks, with the volume of great mail we receive, we could fill

a 60-page newspaper with interesting information. And pretty photos. And clear charts and graphs. With the news scoops we stumble on everywhere, we could fill another 20 pages. With all the events we can't all attend at once, we could fill still more pages.

Alas, we are shackled by the old limitations of ink on paper, we can only print all the news that fits.

Judging by active weeks such as those in recent months, we can say with some confidence that the recovery certainly has begun. Until all of this economic chumming yields the fish, we're repackaging parts of the Journal to cram in more information.

Have fun reading it all. And keep up the good mail and phone calls.

Short ELF editorial

To cram more information, we need shorter editorials around here. Here's a short one on the ELF:

Tinkering with oil taxes is not only greedy and goofball, it is dirty pool.

We also think the House Resources Committee last week engaged in some dirty pool of its own making. Over hearings extending more than four days, guess where the industry most impacted by this tax increase was scheduled for giving

testimony? On a Saturday morning at 8 a.m.

For those of us who aren't in oil or don't pour over legislative production as our daily bread, guess how the House labelled the hearings? "Hearings on the ELF," perhaps, something we might all readily understand? Nope. "HB 118, Oil & Gas Properties Production Tax" is what the hearings were called.

We checked out the hearings a few times, and, as our Gene Rutledge puts it, "The ELF bill will never see daylight in the Senate."

That is good. But it would have been better if people all over the state didn't have to invest the hours to say No one more time. ELF modifications are bad business. Let's stop beating the dead horse.

Underdog winners

Last week Thursday as these words went into type, the doberman had just won best of show at the Westminster Kennel Club in Madison Square Garden (judging by the description of the new champion, we'll likely see it in Sports Illustrated soon).

One of these years, Roxy's going to win the Rondo. And the North American and the Race of Champions.

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REPRESENTATIVE CLIFF DAVIDSON • DISTRICT 27 • Box 746, Kodiak, Alaska 99615 • (907) 486-8250

February 27, 1989

Sally J. Suddock, Editor
Alaska Journal of Commerce
900 West 5th Avenue, Suite 410
Anchorage, Alaska 99501

Dear Ms. Suddock,

This letter is in response to your "short ELF editorial" of February 20th. Any tax policy is an on-going process of review and re-examination. Alaska's tax policy on oil and gas produced on state property should be no exception.

Who's to know which changes are in order to ensure public policies, over time, are doing their job? Certainly public policy that "never sees the light of day" is policy doomed to darkness. I think more highly of and expect more from those fine Alaskans serving as our Senators, those dedicated men and women who are constantly working for the public's interest and our state's welfare.

To set the record straight, by my recollection, during my three years of serving on the House Resources Committee, there has never been an 8:00 a.m. Saturday hearing -- and there certainly wasn't one on Saturday, February 11, as you erroneously report.

I trust that you will print this response in fairness to me and the other members of the House Resources Committee. The Committee has worked very hard on the ELF legislation and on giving HB 118 a fair hearing.

Thank you for allowing me the opportunity for telling my side.

Sincerely,

Handwritten signature of Cliff Davidson in cursive.

Representative Cliff Davidson
Co-Chair, House Resources Committee

CD/eed

cc: All Alaska State Senators

Davidson ran hearing poorly

This is to voice my outrage at the way the statewide teleconference on House Bill 118 (on modifying the Economic Limit Factor, or ELF) was handled from Juneau Feb. 13 by Rep. Cliff Davidson (D-Kodiak) co-chairman of the House Resources Committee.

I, along with 60 others in Anchorage, were "polled" on whether we were "for" or "against" the legislation. Instead of allowing us to testify in the order in which we registered, Davidson "bumped" us to hear others in favor of the bill; in other words, those with views coinciding with his. This resulted in considerable delay for those wishing to testify against the bill.

Davidson's snappy, often rude behavior toward people testifying against HB 118 was unprofessional and completely out of line. A public hearing is for the public, and if Mr. Davidson doesn't like the views of the majority of Alaskans — who believe in private enterprise rather than a government-run economy — then perhaps he should reassess why he became an elected official.

To end on a positive note, I would like to commend the folks at the State Legislative Affairs office in Anchorage for doing a great job on the teleconference despite the lack of protocol on the part of Rep. Davidson.

— Frank Baker
Chugiak



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February 27, 1989

"Letters from the people"
Anchorage Daily News
P.O. Box 14-9001
Anchorage, Alaska 99514-9001

Dear Editor,

This letter is in response to Frank Baker's letter appearing in your February 25 "Letters from the people." In his letter Mr. Baker criticizes my handling of a statewide teleconference on HB 118, the ELF, which is being heard before the House Resources Committee.

It is always good to receive criticism, whether constructive or otherwise, after conducting a statewide teleconference. Any tax policy is a complex issue. Alaskan oil and gas production tax policy on state properties is especially complex, because it is historically difficult to "puzzle" together. That is why we are having extensive hearings on HB 118 -- to fully cover the many and varied perspectives and components of this complex issue.

In my first statewide teleconference, I did take testimony from four people out of the order in which they had signed in (two in Anchorage and two in Fairbanks). Due to the large number of persons who had signed in to testify, thus knowing beforehand that not everyone who signed up would get the opportunity to testify, it was my judgement call that a balance of views, for and against and from different geographic areas, all be heard. Additional public testimony was taken after the dinner hour on Monday, as well as on the following Wednesday. All individuals who "stuck it out" were able to be heard.

I truly appreciate and respect all publicly offered testimony. I have tried hard to be fair in all hearings on HB 118, whether testimony came from the public, oil company representatives or the Administration. You will find in the public record that members of the committee stated that they believed the hearings had been fair. Further, I have been complimented for my fairness in the hearings by oil industry lobbyists, most of whom I hold in high regard, as well as oil executives from within Alaska and several who came to the hearings from "Outside."

Thank you for allowing me the opportunity to tell my side of the issue.

Sincerely,

A handwritten signature in cursive script that reads "Cliff Davidson".

Representative Cliff Davidson
District 27

ELF hearing process was unfair

The public testimony before the House Resources Committee regarding HB118 (ELF revisions) was grossly mismanaged. In his letter to the editor printed in the Daily News Feb. 13, Gov. Cowper indicated that "citizens who support that effort (passage of HB118) can participate in a public hearing with the House Resources Committee Monday, Feb. 13."

Apparently, the House Resources Committee took the governor's words literally!

Although normal procedure is that those wishing to testify sign in on arrival and speak in order of arrival, the committee decided to bypass this procedure and allow those testifying in favor of HB118 priority over those opposed. Rep. Davidson ignored the signed and posted speaking order. He insisted that speakers opposed to HB118 be alternated with those in support of HB118, regardless of arrival time or place on the roster. Rep. Davidson claimed this would give equal time to both sides.

What he actually did was rob citizens opposed to the bill their chance to testify. In addition, priority was given to elected and former officials, further reducing time available to those wishing to testify. Furthermore, in an attempt to discredit the testimony of those opposed to HB118, the committee requested that persons testifying indicate whether or not they derived their livelihood from the oil industry.

This was patently unfair and extremely frustrating for those of us who took time off from our jobs to testify on an issue that affects all Alaskans. Public testimony should be a time for all concerned citizens to voice their opinions on an issue, regardless of their stance on that issue or their place of employment.

— Jennifer Reed

Debate on ELF clouded

The Anchorage Daily News devotes tremendous editorial space to its version of open and honest government, while brutalizing politicians who don't meet the ADN's standards.

Yet, when Rep. Cliff Davidson, D-Kodiak, limited testimony at a recent ELF hearing primarily to those who support changing the ELF (raising oil severance taxes), not a peep was uttered by the self-righteous ADN.

The Associated Press story the ADN ran on the ELF hearings gave no indication of how the public testimony ran. Moreover, the opposition would have been higher if all those who attended had been allowed to testify. Someone in Anchorage finally protested the hearing, claiming that of the 60 people wanting to testify, all but two were opposed to ELF changes.

The ADN published a letter by Gov. Steve Cowper the day of the ELF hearings in which he said, "Kuparuk ... will pay less than before the loophole took effect 18 months ago." This is a lie! Cowper's ELF changes will increase Kuparuk's severance tax from 8.3 percent to 13.2 percent — higher than in any other state.

Lies and denial of the public process are being used to cloud the ELF debate.

— Jerry Foster

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nam equates to the U.S.S.R.'s presence in Afghanistan. Into self-flagellation who better such nonsense need only keep track of the number of Afghan refugees who, after the fall of Kabul, head across the Hindu Kush for sanctuary in the Soviet Union and compare them with the millions of Indochinese boat people who continue to risk their lives in hopes of building a new life in the United States.

Then there is the matter of the troop withdrawals. You wouldn't know from most current accounts that the U.S. withdrew from Vietnam of its own accord on a timetable of its own making. In the summer and fall of 1969 (almost six years before the fall of Saigon) the U.S. 9th Infantry Division and 3rd Marine Division left Vietnam. In 1970, the 1st Infantry Division was

reprinted from the Daily News-Miner

withdrawn, as were the 4th and 25th Infantry Divisions. The 1st Cavalry Division and the 1st Marine Division departed in early 1971, and in the winter of 1971 (still over three years before the end of the war) the last U.S. division-sized units—the Americal Division and the 101st Airborne Division—were withdrawn.

When the United States signed the Paris "Peace" Accords in January 1973, its ground combat forces had long since left Vietnam. By comparison, when the Soviet Union signed the "Afghanistan Settlement" in Geneva on May 15, 1988, its forces were still actively engaged in combat with the Afghan guerrillas. Where all U.S. military forces were withdrawn from Vietnam within 60 days of the signing of the Paris Accords, it has taken the

...had literally destroyed themselves with their ill-conceived... no bones about the fact that for the following seven years (i.e., for a period longer than World War II) the war became primarily a matter for the regular forces of the North Vietnamese Army rather than for the Viet Cong.

In 1972, the NVA also made a disastrous miscalculation. With almost all U.S. ground combat forces withdrawn, they thought the South Vietnamese Army would be easy pickings, so they launched their multi-division cross-border Easterly invasion. But, to their surprise this attack was turned back with terrible losses by a determined South Vietnamese Army backed up by the massive application of U.S. air power.

Thus, in 1973, when the U.S. de-

...all the roads were open to travel, the markets were over-loaded with food, and refugees continued to vote with their feet and flock into the government-controlled areas.

The Soviets must wish they had it so good. Kabul, in 1989, finds itself in almost exactly the opposite situation as Saigon in 1973. In Afghanistan, it is the guerrillas that dominate the battlefield. The mujahedeen rebels control the countryside and interdict the roads whenever they choose to do so. Kabul is a city under siege, and reports are that foodstuffs are becoming scarce. Abandoned by the majority of the Afghan people, there are serious doubts that the Najibullah regime can survive.

Having said all this, there may yet be a valid comparison between Vietnam and Afghanistan, a comparison that grows out of the fact

...not only refusing to honor its guarantees under the Vietnamese government that it would reenter if the accords were violated. Improving relations with the Soviet Union was deemed more important than the survival of an erstwhile ally.

Now, even as the last Soviet soldier leaves Afghanistan, objections are beginning to be raised to the propriety of sending arms and equipment through Pakistan. Once again, there are those who argue that improving relations with the Soviet Union is far more important than honoring guarantees to a rag-tag ally. And, if it persists in such pusillanimity, once again the United States may find itself snatching defeat from the jaws of victory.

Harry G. Summers Jr. is a former colonel in the U.S. Army. His column is distributed by the Los Angeles Times Syndicate.

Gadd also said that he billed... \$392,000 for constructing an airstrip in Costa Rica that designed to help supply the Com on the Southern Front in Nicaragua.

Gadd said North enlisted his help build the airstrip for military supply missions to Nicaraguan Contras while

Soldier pleads guilty to spying

WASHINGTON (AP)—An Air Force warrant officer admitted at opening of his court-martial that he was involved in a five-year conspiracy to provide classified military information to War Pact nations.

Warrant Officer James W. III, 30, of New York City, pled guilty to all 10 counts of espionage attempted espionage and failed to obey Army regulations that prohibited against him after his arrest last December in Georgia.

Col. Howard C. Eggers, the military judge presiding at the court-martial at Fort McNair here, did not immediately accept Hall's guilty plea. Under Army regulations, he will hear the prosecution's case against Hall and defense witnesses before deciding Hall's guilt punishment.

Court officials said Eggers' verdict and sentence probably not come before Friday.

Under a defense-initiated trial agreement disclosed by the court martial today, Hall pleaded guilty to all charges against him in exchange for government agreeing not to seek the death penalty.

The rest of the government agreement on a sentence for Hall was not disclosed.

Letters to the Editor

The Daily News-Miner welcomes letters to the editor, P.O. Box 710, Fairbanks, AK 99707. Each letter must carry the name and address of the writer, which will be published. Letters that are libelous or in poor taste will be rejected. Thank-you letters will be published in the "Applause" column. Because of space limitations, the following rules generally apply: A letter may not be longer than 350 words. Copies of letters from one person to another will not be published. No one may publish more than one letter per month. Political endorsement letters from outside our readership area will not be published. The Daily News-Miner reserves the right to edit or reject any letter submitted.

Butt out

March 1, 1989
4743 Da Niece St.
North Pole, AK 99705

To the editor:

In Sunday's News-Miner I read another letter by pro-lifer Donna Holbrook condemning an abortion which quite likely gave the mother a better chance of surviving the coma she is in.

Her letter was an example of the bigoted, radical beliefs of pro-lifers, and others who are against abortion for any reason. I have no time or patience with anyone who

would presume to know what's best for a pregnant woman. That is such a serious, personal condition that it should be discussed and decided upon only by the lady and the father and/or close relatives, and all other big-nosed, busybodies should butt out.

Michael Allen

Close a loophole

March 1, 1989
P.O. Box 82679
Fairbanks, AK 99708

To the editor:

I found it interesting that Mr.

Corbet was kind enough to advise the public who were unable to attend hearings on HB 118 with the "real facts." Particularly since he was only present on Monday evening; not during the "more than four hour" afternoon session he alludes to.

His statement regarding the way House Resources Chair Cliff Davidson conducted the hearings is not factual. After some early attempt to allow a balance of views, the forum against was abandoned and testimony was taken in order of sign-in. At least in Fairbanks. Reports

from Anchorage, the source of most opposition, indicated that the oil industry had stacked the hearing with employees and that a number of citizens left without testifying.

It really shouldn't surprise anyone that those testifying in favor of eliminating an oil company tax loophole would be working (or non-working) people, citizens who care about Alaska, public officials who have a responsibility to protect the resources and public interest groups. Or that those opposing any changes in oil taxation are industry employees and contractors. The chambers are run by oil executives, no surprise there either.

Clearly there is a great "silent majority" who didn't take part in these public hearings. When any one industry dominates an economy or state, the tentacles become long and deep. The brutal truth is that Alaskans are as en-

slaved to Big Oil as any drug junkie is to the source of the next fix. I fear it may take more courage than we have to break the addiction.

A starting point would be to express justifiable outrage at the farce hearings on SB 97 promises to be. The Senate Special Committee on Oil and Gas, chaired by Drue Pearce, will "hear" public testimony on this bill March 18. Other committee members are: Paul Fischer, Rick Halford and Tim Kelly. Can we really expect an impartial hearing from senators who are either openly employed by the industry or receiving most campaign funds from it? Or that the bill won't die in committee?

This group needs to be pressed hard to put the bill out on the floor for a vote. Alaskans deserve to know exactly who their elected representatives really serve.

Tom Favero

FDNM 3/6/89



BP EXPLORATION

TESTIMONY
OF
BP EXPLORATION
ON
HOUSE BILL NO. 118

BP Exploration (Alaska) Inc.
900 East Benson Boulevard
P.O. Box 186612
Anchorage, Alaska 99519-6612
(907) 581-5111

(February 11, 1989)

Mr. Chairman, Members of the Committee: Good afternoon. My name is Thomas K. Williams, and I am here to testify on behalf of BP Exploration (formerly known as Standard Alaska Production Company) and its parent, BP America, regarding the changes to the Economic Limit Factor (ELF) proposed in House Bill No. 118. We believe the proposed changes are unnecessary, ill-advised, unfair and ill-conceived, and should not be adopted.

Unnecessary Changes. The changes are unnecessary because the present ELF formula is working perfectly well and as intended. Without an ELF, the production tax is a regressive tax. That is, the tax is the same regardless of how easily a field can afford to pay it. The ELF makes the tax progressive by assessing more profitable fields at a higher rate of tax, while allowing a lower tax rate for less profitable ones. Every field during its life makes a transition from a profitable phase to an increasingly less profitable one, until there eventually is no profit left at all and production ceases.

The present ELF formula reflects this transition as and when it occurs. It does so by asking what fraction of a field's current production is needed to cover the direct costs of getting that production out of the ground. When the fraction is small,

it means the field has a large operating margin that can be tapped for higher taxes. When the fraction is close to one, it means almost all the production is needed to cover costs, and the field cannot afford to pay a lot of tax. The ELF has been the key that has allowed Alaska to impose a tax with the highest rate in the nation (15%), without suffering any loss of production or development as the result of doing so.

The present ELF works perfectly fine for marginal fields. Milne Point is often cited as an example where the present ELF failed to work. The fact is, the ELF had reduced the tax rate to zero for Milne Point during the last half of the time it was in production. That is the ultimate in tax relief, and the proposed ELF formula in HB 118 cannot and will not provide any further relief for Milne Point than that.

Ill-advised Changes. The proposed changes to the ELF formula in HB 118 are ill-advised because the ELF would no longer depend on a field's relative profitability in setting the actual rate of tax. The changes being proposed appear to be intended to lower tax rates for fields with less than 150,000 barrels a day of production, while increasing them for fields with more.

This would place emphasis on a wholly inappropriate factor, field size. A field's size has, at best, only a loose relationship with how profitable it is and how much tax it can reasonably afford to pay. For example, in terms of dollars returned for each dollar invested, the most profitable field in Alaska's history is the McArthur River field, which never reached

the 150,000 barrel-a-day level. Yet this field would have been given tax relief as a "marginal" field under HB 118, even at its heyday.

The proposed changes are also ill-advised because the State stands to gain more from additional investment and development of Prudhoe Bay and Kuparuk than it will from any of the "marginal" fields on the North slope. The Eileen (West End) Project at Prudhoe Bay, for instance, will add over 100,000,000 barrels of new reserves. This single project is larger than either Milne Point or Niakuk. Yet the proposed new ELF formula would make it even more difficult to justify economically the investment in these large but increasingly marginal projects at Prudhoe Bay.

Testimony yesterday by the Cowper Administration endorsing changes to the ELF formula suggested that there are marginal fields just waiting for the ELF to be changed and then they will start producing. You were told, for example, that HB 118 could let Niakuk start up four years earlier. Well, you have been told wrong. What is holding Niakuk up is a permit for the causeway that it needs. And Milne Point already had a tax rate of zero under the present ELF, so I don't see how HB 118 could make a real difference there. The fact is, there are no commitments to develop any other new fields, no announced plans, not even any serious discussions. No one is saying that they will start up a new marginal field if you change the ELF formula for them. So don't let yourselves be misled into thinking there is a lot of marginal production to be gained by changing the ELF.

What you are hearing, and what you undoubtedly will continue to hear, are warnings about what changing the ELF will mean for marginal projects in the large fields. Such warnings, cautions,

caveats, or whatever you want to call them, are NOT intended to be threats. The industry is not going to pick up its marbles and go home if you change the ELF. But changing it will make some projects too expensive for us to afford. HB 118 will adversely affect the economics for developing the periphery of the two large fields and for continued in-fill drilling on closer well spacing to maximize recoverable reserves and keeps production as high as possible.

UNFAIR CHANGES. The proposed changes are unfair in at least three fundamental respects. First, fields in similar economic situations would be taxed at very dissimilar rates. For example, when Prudhoe Bay is averaging 500 barrels a day per well, its tax rate under this formula would still be approximately 11.95 percent, while Lisburne's rate at 500 barrels a day per well would be nearly a thousand times smaller -- only 0.016 of one percent. I have attached a worksheet to my written testimony, which shows how these numbers have been calculated.

Second, HB 118 is unfair because the oil industry is already being disproportionately taxed relative to other industries in Alaska. In the January 1989 edition of Alaska Business Monthly, economist Andrew Safir writes that oil and gas contributed 33.3 percent of Alaska's "gross state product" in 1986, the latest year for which figures are available. But although petroleum represents only one third of the economy, it accounts for 90 percent of

the money the State of Alaska collects each year. It is unfair to demand more taxes from the oil industry when all other industries enjoy such smaller burdens.

Third, the proposed changes to the ELF are unfair because the State is already receiving a fair share (or more) from North Slope oil production. In 1981 there was a political consensus that the wealth of the petroleum resource should be shared roughly equally among the three interests sharing in it -- the State of Alaska, the oil industry and the IRS. As far as Alaska was concerned, it would be content that it was receiving its fair share as long as that share did not go below 30 percent. Figures published by the Department of Revenue in 1985 and 1986 show that the State has stayed above this 30 percent minimum for each fiscal year since 1981. In fact, the 1986 analysis, which was published by the Cowper Administration before the ELF debate flared up, shows that the State's share of net production and pipeline revenues this fiscal year would be 69.4 percent at \$7.00 wellhead prices, and 55.4 percent at \$9.00 wellhead prices. The latest revenue forecast, from last October, predicts an average wellhead price this fiscal year of \$7.36 (mid case), which means the State is likely to be closer to the 69% figure instead of the 55% one. In the future, as operating costs continue to go up and production starts to go down, the trend will be for the State's share of the net revenue to increase rather than decrease.

Ill-conceived Changes. If the intent of HB 118 is to have the same tax rate for a 150,000 barrel-a-day field as under

the present tax, with lowered rates for smaller fields and increased rates for larger ones, then the formula in the bill is wrong. The math simply does not work. This is because the bill takes the exponents in the wrong order.

The sequence in which exponents are taken makes a big difference. For example, take

$$4^{3^2}$$

This may be easier to think about (and certainly easier to type!) if we use a caret ("^") to indicate that an expression is an exponent. The expression above would then look like this: 4^{3^2} .

Without any parentheses to indicate a different order, the correct sequence in a compound exponent is to start at the top and work down or, when using carets to indicate exponents, to start at the right and work left. Thus, we first raise three to the second power: three squared is nine.

$$\begin{aligned} 4^{(3^2)} &= 4^{(3 \times 3)} \\ &= 4^{(9)} \end{aligned}$$

Then we raise four to the ninth power. Four times itself nine times is 262,144.

$$\begin{aligned} 4^9 &= 4 \times 4 \times 4 \times 4 \times 4 \times 4 \times 4 \times 4 \times 4 \\ &= 262,144 \end{aligned}$$

If we went the other way, starting with four and working our way to two, then four cubed is 64, and 64 squared is 4,096.

$$\begin{aligned}
(4^3)^2 &= (4 \times 4 \times 4)^2 \\
&= (64)^2 \\
&= 64 \times 64 \\
&= 4,096
\end{aligned}$$

As you can see, this produces a very different result from the first. The order in which compound exponents are applied is crucial in determining the outcome.

The formula in HB 118 takes the exponents in the wrong sequence from what seems to be intended. In the present ELF formula there are two components: a "base" and an exponent. If we use "A" to represent the base and "B" to represent the exponent, the present formula is A^B . HB 118 introduces a new component, a second exponent, into the formula between "A" and "B;" "A" and "B" are the same in the proposed formula as they are in the present one, so the difference between the two formulas is this new, second exponent. If we call this new exponent "C," then the new formula is $A^C{}^B$. But is this $(A^C)^B$ or $A^{(C^B)}$? As HB 118 is written, the formula is $A^{(C^B)}$.

"C" is defined in the bill to be $[150,000/(TP/WD)]$. In other words, "C" equals 150,000 divided by the average daily production from the field during the tax period. It is plain that "C" is intended to equal 1.0 for a 150,000 barrel-a-day field, because then "C" equals 150,000 divided by 150,000. But if the number one is raised to any power, the result is still one. For a 150,000 barrel-a-day field, $A^{(C^B)}$ will be $A^{(1^B)}$, or A^1 . Any number raised to the first power is the same

number, so $A^{(1)}$ is the same as "A." Hence the ELF for a 150,000 barrel-a-day field will be "A" under HB 118, instead of A^B . The ELF will not be the same, and in fact the tax will be higher for a 150,000 barrel-a-day field under HB 118 than it is under the present law (assuming in the present law the 300 B/D/well presumption for the field has not been rebutted and shown to be 460 B/D/well or more).

In conclusion, then, the proposed changes to the ELF formula are unnecessary because the present formula is not broken and does not need to be fixed. The proposed changes are ill-advised because field size is not a reliable indicator of a field's economic health and ability to withstand a high rate of tax. They are also ill-advised because they over-emphasize the importance of so-called "marginal" fields at the expense of marginal projects in the large fields: marginal projects in large fields can have greater overall benefits for Alaska and Alaskans than the development of small fields. The proposed changes to the ELF are unfair, first, because of the wildly different treatment that will occur between comparably profitable fields; second, because of the disparity between the present level of taxation on the oil industry and the burden on any other resource industry; and third, because the State is already receiving more than a fair share of the value of the resource. The proposed changes to the ELF are ill-conceived because the formula in the bill is mathematically deficient and fails to achieve the

apparent objective of keeping the tax rate the same for fields producing 150,000 barrels a day.

Thank you for this opportunity to testify to you today. I would be pleased to answer any questions the Committee may have.

Prudhoe Bay

Average Production Rate per Well = 500 B/D
Number of Wells (projected) = 745
Fieldwide Production = 372,500 B/D

$$\begin{aligned} \text{"A"} &= (1 - [\text{PEL}/\text{TP}]) \\ &= (1 - [(300 \times 745) / 372,500]) \\ &= 0.400000 \end{aligned}$$

$$\begin{aligned} \text{"B"} &= [150,000 / (\text{TP}/\text{Days})] \\ &= [150,000 / 372,500] \\ &= 0.402685 \end{aligned}$$

$$\begin{aligned} \text{"C"} &= [(460 \times \text{WD}) / \text{PEL}] \\ &= [(460 \times \text{WD}) / (300 \times \text{WD})] \\ &= [460 / 300] \\ &= 1.533333 \end{aligned}$$

$$\begin{aligned} \text{Tax Rate} &= \text{ELF} * 15\% \\ &= [A^{(B^C)}] * 15\% \\ &= [0.400000^{(0.402685^{1.533333})}] * 15\% \\ &= [0.400000^{0.247902}] * 15\% \\ &= [0.796801] * 15\% \\ &= 11.95202\% \end{aligned}$$

Lisburne

Average Production Rate per Well = 500 B/D
Number of Wells (projected) = 81
Fieldwide Production = 40,500 B/D

$$\begin{aligned} \text{"A"} &= (1 - [\text{PEL}/\text{TP}]) \\ &= (1 - [(300 \times 81) / 40,500]) \\ &= 0.400000 \end{aligned}$$

$$\begin{aligned} \text{"B"} &= [150,000 / (\text{TP}/\text{Days})] \\ &= [150,000 / 40,500] \\ &= 3.703704 \end{aligned}$$

$$\begin{aligned} \text{"C"} &= [(460 \times \text{WD}) / \text{PEL}] \\ &= [(460 \times \text{WD}) / (300 \times \text{WD})] \\ &= [460 / 300] \\ &= 1.533333 \end{aligned}$$

$$\begin{aligned} \text{Tax Rate} &= \text{ELF} * 15\% \\ &= [A^{(B^C)}] * 15\% \\ &= [0.400000^{(3.703704^{1.533333})}] * 15\% \\ &= [0.400000^{7.445755}] * 15\% \\ &= [0.001089] * 15\% \\ &= 0.01634\% \end{aligned}$$

HOUSE RESOURCES COMMITTEE
HEARING FEB 11 1989

BP EXPLORATION FIGURES
WHERE THE PRODUCTION REVENUE GOES

FY 89

	\$ MILLIONS	\$/BBL	
TOTAL REVENUE	5,300	7.36	
PRODUCTION COSTS	2,440	(3.39)	
NET REVENUE (THE "PIE")	2,860	3.97	100%
TO ALASKA GOVERNMENT			
ROYALTY	627	0.87	
PRODUCTION TAX	547	0.76	
PROPERTY TAX	214	0.30	
INCOME TAX	130	0.18	
TOTAL	1,518	2.11	53%
TO FEDERAL GOVERNMENT	455	0.63	16%
TO INDUSTRY	887	1.23	31%

TAPS Tariff (\$/bbl)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 89	3.22	3.09	3.09
FY 90	3.36	3.05	3.07
FY 91	2.90	3.08	3.05

Wellhead Value (\$/bbl)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 89	6.49	7.36	8.82
FY 90	3.63	7.00	10.94
FY 91	5.79	11.02	18.28

Total Alaska Production Volume (mmbbs/day)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 89	1.92	1.97	1.97
FY 90	1.82	1.86	1.88
FY 91	1.71	1.76	1.81

Inflation (%)

	<u>Low</u>	<u>Mid</u>	<u>High</u>
FY 89	3.36	4.19	5.19
FY 90	3.15	4.15	5.55
FY 91	3.00	4.15	5.80

(Utilized to generate nominal dollar value of the revenue projections.)

GENERAL FUND UNRESTRICTED REVENUES

(Millions of Dollars)

TAXES	FY 1988	FY 1989 ESTIMATES			FY 1990 ESTIMATES			FY 1991 ESTIMATES		
	Actuals	Low	Mid	High	Low	Mid	High	Low	Mid	High
Income										
Corporate General	23.4	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0
Corporate - Petroleum (1)	<u>158.0</u>	<u>122.0</u>	<u>130.0</u>	<u>138.0</u>	<u>115.0</u>	<u>125.0</u>	<u>138.0</u>	<u>109.0</u>	<u>120.0</u>	<u>144.0</u>
Total	<u>181.4</u>	<u>136.0</u>	<u>144.0</u>	<u>152.0</u>	<u>129.0</u>	<u>139.0</u>	<u>152.0</u>	<u>123.0</u>	<u>134.0</u>	<u>158.0</u>
Gross Receipts										
Alaska Business License	1.4	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Fish - Canned/Shorebased (2)	13.8	13.2	13.2	13.2	12.0	12.0	12.0	14.0	14.0	14.0
Fish - Floating	8.7	11.3	11.3	11.3	9.0	9.0	9.0	9.0	9.0	9.0
Salmon Enhancement (3)	5.8	8.9	8.9	8.9	7.0	7.0	7.0	7.0	7.0	7.0
Seafood Marketing (4)	2.7	3.3	3.3	3.3	2.5	2.5	2.5	2.5	2.5	2.5
Insurance Companies	23.7	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0
Electric & Telephone Coops	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Mining License Tax	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>
Total	<u>58.5</u>	<u>62.5</u>	<u>62.5</u>	<u>62.5</u>	<u>56.3</u>	<u>56.3</u>	<u>56.3</u>	<u>58.3</u>	<u>58.3</u>	<u>58.3</u>
Severance										
Oil & Gas Production	816.4	489.0	544.9	641.7	357.5	482.2	730.5	330.7	483.3	726.6
Oil & Gas Conservation	<u>2.3</u>	<u>2.5</u>	<u>2.5</u>	<u>2.5</u>	<u>2.3</u>	<u>2.3</u>	<u>2.3</u>	<u>2.1</u>	<u>2.2</u>	<u>2.2</u>
Total	<u>818.7</u>	<u>491.5</u>	<u>547.4</u>	<u>644.2</u>	<u>359.8</u>	<u>484.5</u>	<u>732.8</u>	<u>332.8</u>	<u>485.5</u>	<u>728.8</u>
Property										
Oil & Gas	<u>96.2</u>	<u>90.1</u>	<u>90.1</u>	<u>90.1</u>	<u>86.0</u>	<u>86.0</u>	<u>86.0</u>	<u>82.3</u>	<u>82.3</u>	<u>82.3</u>
Sale/Use										
Alcoholic Beverages	12.1	11.6	11.6	11.6	11.5	11.5	11.5	11.5	11.5	11.5
Fuel Taxes - Aviation	9.0	9.0	9.0	9.0	9.1	9.1	9.1	9.1	9.1	9.1
Fuel Taxes - Highway	19.3	19.5	19.5	19.5	19.6	19.6	19.6	19.6	19.6	19.6
Fuel Taxes - Marine	5.3	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4
Tobacco Products	<u>6.1</u>	<u>6.2</u>	<u>6.2</u>	<u>6.2</u>	<u>6.1</u>	<u>6.1</u>	<u>6.1</u>	<u>5.9</u>	<u>5.9</u>	<u>5.9</u>
Total	<u>51.8</u>	<u>51.7</u>	<u>51.7</u>	<u>51.7</u>	<u>51.7</u>	<u>51.7</u>	<u>51.7</u>	<u>51.5</u>	<u>51.5</u>	<u>51.5</u>
Other										
Estate	<u>0.3</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>
TOTAL TAXES	<u>1206.9</u>	<u>832.5</u>	<u>826.4</u>	<u>1001.2</u>	<u>683.5</u>	<u>818.2</u>	<u>1079.5</u>	<u>648.6</u>	<u>812.3</u>	<u>1079.6</u>

	<u>Actuals</u>	<u>Low</u>	<u>Mid</u>	<u>High</u>	<u>Low</u>	<u>Mid</u>	<u>High</u>	<u>Low</u>	<u>Mid</u>	<u>High</u>
<u>LICENSES & PERMITS</u>										
Business (5)	8.6	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Non-Business	19.7	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5	19.5
Total	28.3	27.0	27.0	27.0	27.0	27.0	27.0	27.0	27.0	27.0
<u>INTERGOVERNMENTAL RECEIPTS</u>										
Federal Shared Revenues (6)	8.9	8.5	8.5	8.5	8.0	8.0	8.0	7.5	7.5	7.5
<u>STATE RESOURCE REVENUE</u>										
<u>Sale/Use</u>										
Bonus Sales (6)(7)(8)	5.6	10.1	10.1	10.1	0.0	0.0	0.0	0.0	0.0	0.0
Investment Earnings (9)	132.6	105.8	109.0	113.4	19.6	29.1	67.2	15.4	15.4	29.9
Rents (6)(7)(8)	6.0	6.3	6.3	6.3	6.5	6.5	6.5	6.5	6.5	6.5
Royalties (6)	694.8	393.8	469.8	563.4	194.1	470.8	680.3	223.4	450.5	711.1
Sale of State Property (5)	3.8	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Gravel, Timber, etc.	1.1	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Total	843.9	521.0	600.2	698.2	225.2	471.4	759.0	250.3	477.4	752.5
<u>Facilities Related Charges</u>										
Airports	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Ferry System—SE	26.0	30.5	30.5	30.5	31.9	31.9	31.9	33.5	33.5	33.5
Ferry System—SW	3.8	4.3	4.3	4.3	4.5	4.5	4.5	4.6	4.6	4.6
Other (5)	0.7	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Total	32.3	37.6	37.6	37.6	39.2	39.2	39.2	40.9	40.9	40.9
<u>Services Related Charges</u>										
Court System	5.5	5.5	5.5	5.5	5.6	5.6	5.6	5.7	5.7	5.7
Other (5)	2.0	2.6	2.6	2.6	3.0	3.0	3.0	3.2	3.2	3.2
Total	7.5	8.1	8.1	8.1	8.6	8.6	8.6	8.9	8.9	8.9
TOTAL RESOURCE REVENUE	883.7	566.7	645.9	743.9	273.0	519.2	806.8	300.1	527.2	802.3
<u>MISCELLANEOUS REVENUE</u>	16.1	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
<u>SPECIAL SETTLEMENTS (10)(11)</u>	161.9	221.2	221.2	221.2	0.0	0.0	0.0	0.0	0.0	0.0
<u>TOTAL UNRESTRICTED REVENUE (12)</u>	2305.8	1670.9	1814.0	2016.8	1006.5	1387.4	1936.3	998.2	1389.0	1931.4
MENTAL HEALTH TRUST INCOME ACCOUNT (13)	0.0	83.6	90.7	100.8	50.3	69.4	96.8	49.9	69.5	96.6

* Footnotes on the following page.

ARCO

Position Paper

Testimony, ELF
Resources Committee, House of Representatives
Juneau, Alaska
February 11, 1989

On February 11, 1989, Mr. Ben L. Odom, Senior Vice President of Operations of ARCO Alaska, Inc. will offer testimony concerning House Bill 118 to the Resources Committee of the Alaska State House of Representatives. Mr. Odom will express ARCO Alaska's opposition to any changes to the Economic Limit Factor (ELF) and specifically the modifications dictated by H.B. 118. The effects on the oil industry of H.B. 118 will be discussed and specific examples will be provided showing the Kuparuk River Unit of which Arco Alaska is both the operator and a Major investor. Discussion will revolve around how operations and future plans related to Kuparuk can and will be negatively impacted by H.B. 118. Economic evaluations and various exhibits will be used to illustrate how the Bill would function to deter oil industry exploration and production in Alaska.

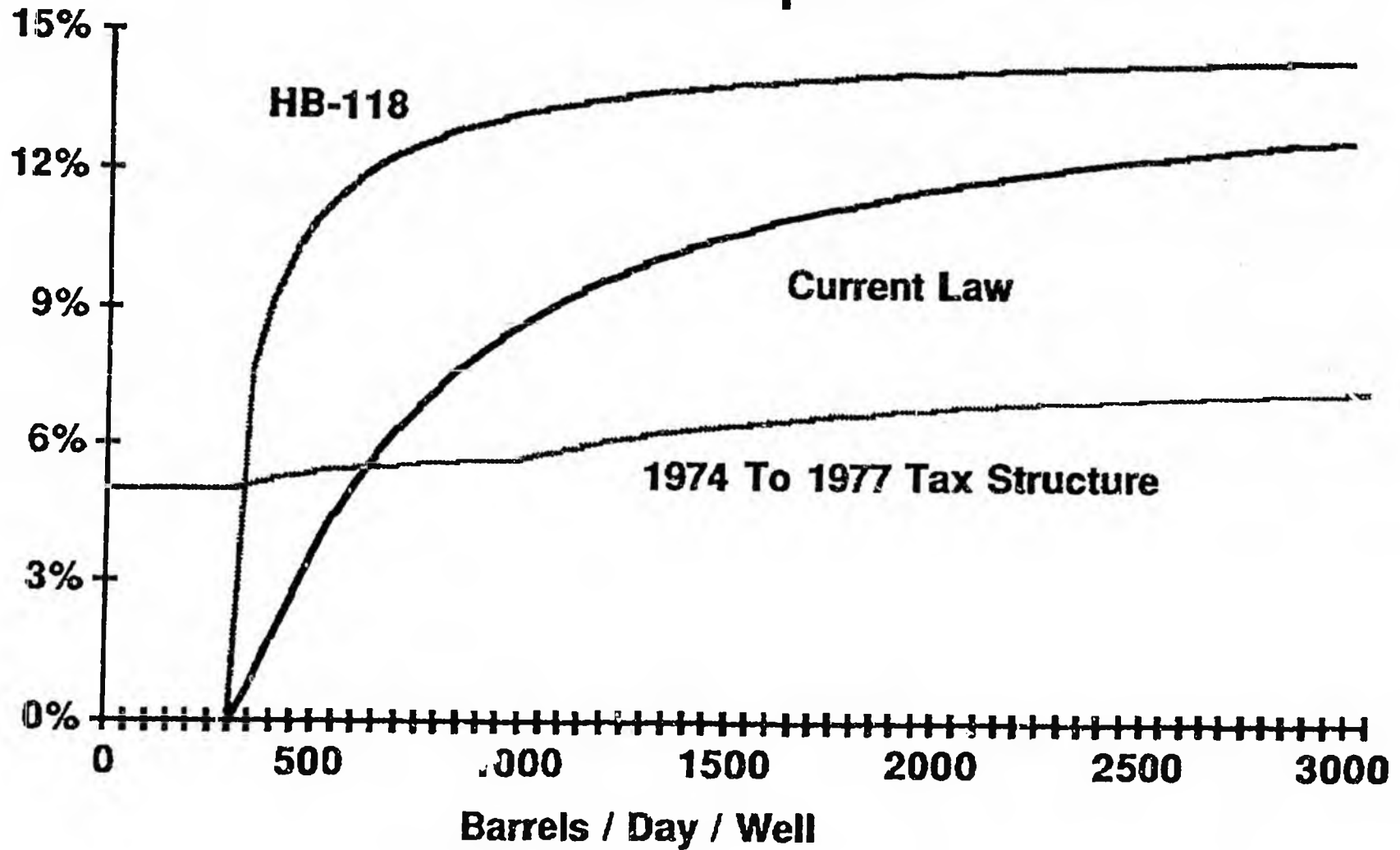
The near and long term economic welfare of the State of Alaska and the oil industry are extraordinarily intertwined. House Bill 118 is a change in fundamental tax policy that is detrimental to the oil industry. Any change in the ELF Oil and Gas Properties Production Tax laws that adversely effects the ability of the industry to develop the state's oil and gas resources, is detrimental both to the state and to the industry.

PROJECT PORTFOLIO

KUPARUK

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

Effective Severance Tax Rates For Kuparuk



Testimony, ELF
Resources Committee, House of Representatives
Juneau, AK
February 11, 1989

Good afternoon. My name is Ben Odom. I am Senior Vice President of Operations of ARCO Alaska, Inc. I appreciate the opportunity to offer testimony today concerning yet another proposed modification to the Economic Limit Factor of the Alaska Oil and Gas Properties Production Tax.

I feel certain that it will come as no surprise to you that ARCO Alaska opposes any changes to the Economic Limit Factor (ELF) which would have the effect of increasing the oil and gas industry's tax burden. We certainly identify with your problems concerning the potential budget deficit generated by the drop in crude oil prices. We have had to make a number of difficult decisions because of lower crude prices, including organizational restructuring and substantial reductions in costs, because our revenues, like yours, were and are, tied to the price of crude oil.

Our economics for making investment decisions contain two principal components. Estimated prices and estimated costs. We know we can't control prices, and we have learned we don't have the ability to predict them very well either. That leaves only cost. Other than the actual costs of transporting the crude oil, the largest single cost we have in Alaska is not the result of the remoteness of the fields or even the cold. The largest single item of cost we face in Alaska is taxes. Higher costs or lower prices result in exactly the same thing -- more oil left in the ground -- more oil that could be recovered becomes uneconomic to recover. That oil which is left in the ground because it is uneconomic will not return any royalties to the State, and it's from these royalties that the contributions are made to the Permanent Fund. It will not result in the payment of any production tax nor generate any income tax. Oil left in the ground will not create jobs. It will not utilize the facilities already available for its production, therefore, those facilities will generate less ad valorem tax revenues. The ELF helps to reduce the regressive effect of a gross production tax and prevent the premature cessation of oil production. Short-term fixes resulting in higher costs today have the result of removing jobs today and revenue from the future.

High crude prices have meant more tax and more royalty for the state. Those high prices have also equated to more crude oil reserves and more jobs to produce those reserves. However, reserves are not the equivalent of the total amount of crude oil in a reservoir. There is also an economic consideration. Reserves are instead only equal to the amount of crude oil that can be economically produced. Added crude reserves come when prices have been high enough to provide the economic incentive to pay for the technology specific to each reservoir and to pay for workers and equipment to implement that technology in each reservoir. Low prices mean reduced crude reserves; high costs likewise mean reduced crude reserves.

I want to show you this afternoon some information about the Kuparuk River Unit which should give you cause to move carefully in considering changes to the ELF. It is my understanding that the administration has prepared the 1990 budget based on a \$14 Gulf Coast North Slope crude price. I would like to call your attention to Exhibit I, which indicates the impact on the Kuparuk River Unit of a \$14.01 crude oil price. Kuparuk is the second largest oil field in North America with a current daily production rate of around 300,000 barrels. Our studies indicate nearly a billion barrels of oil can be produced with the existing wells and facilities. Half as much again is recoverable with additional capital spending. One might suppose that this field is an extremely profitable investment. But contrary to what you read in the papers or see on television, at \$14 a barrel, Kuparuk is anything but profitable. As the exhibit so clearly shows, the State already, with the current ELF, receives more than 100% of the available net revenue on each incremental barrel of crude.

Even at its current peak production rate, only the State of Alaska, not the Kuparuk investors, receives a profit. These numbers paint a rather bleak picture at \$14 a barrel. How can increasing the production tax burden by 160% over the next ten years, as HB-118 would do, be justified when you look at the economics? The State would certainly appear to be receiving a great deal more than a fair share of the available revenue.

The producer's return on each incremental barrel of oil will determine whether additional investments are made to produce more oil. Kuparuk has no natural

gas cap to force the oil from the ground. From the day the first barrel was lifted, pressure has been decreasing, and production on a per-well basis would decline without extensive additional investment in enhanced recovery projects. These new investments are very costly and can only provide for a slower decline in production than would otherwise occur. The loss per barrel that you see is the amount that must support the economic decision of whether we continue to create additional crude oil reserves in the Kuparuk River Unit. Do we operate a drilling rig to do well workovers to produce more barrels when we lose \$.14 on each barrel? Does it look better to double the production tax and increase the loss to \$.32? There is not a multiplier or an exponent which will convert this loss to an economic incentive to spend more money, to generate more barrels at a loss. What is at issue is the one half billion barrels in the ground that require additional wells and investment to produce.

We are currently looking at a long-range plan for Kuparuk involving what we hope to be a continuing development package. As attached Exhibit II shows, there are many development projects left to be done at Kuparuk, and they would require additional capital of almost \$1.6 billion and would create additional Alaskan jobs amounting to nearly 4000 man years of construction. Many of those projects will stay on the drawing board unless we have higher crude oil prices or lower costs -- or both. We can't do it without your help. The industry can't live with low prices and higher taxes. Among these projects, for example, is a drill site on the periphery of the Kuparuk field. Our plans call for a project consisting of 12 wells to be drilled on the site, providing an additional 12 million barrels of new oil reserves. Under the State's price forecasts and the present tax laws, this project is only marginally economic. If HB-118 is enacted, this project won't happen. Twelve million barrels of oil and effectively \$35 million in State revenue will be left in the ground. Of the \$35 million, \$14 million would go into the Permanent Fund.

The importance of tax burden in a project evaluation cannot be overstated. The ELF plays a pivotal role in mitigating the regressive nature of the Alaska production tax by taking into account the economic realities of oil field operations. Those realities are that it doesn't matter how large or small the field is, what does matter is that each new project must stand on its own by showing a positive net present worth. Although prices are still very low, the current ELF

provides a small but measurable incentive to help reduce some of the costs associated with producing more oil.

When I initially came to Alaska in 1968, the severance tax rate was 1%. A step production tax was introduced in 1974 to help mitigate the production tax burden on wells whose production was at certain low levels. This step methodology was modified in 1977 with the introduction of the ELF, and the maximum statutory rate was increased to 12.25%. Again in 1981 the statutory rate was increased to 15%, the highest production or severance tax rate in the nation. In addition, the application of the ELF was limited during the first ten years of production. As the curves in Exhibit III indicate for the Kuparuk Field, the burden on the production tax has not only changed by calculation method, but it has continually increased. Kuparuk would clearly be paying less production tax under prior laws than it would be paying under HB-118. As the top line of the graph plainly shows, HB-118 does not provide a slowly declining tax rate, or even a step decline, as production drops off. HB-118 is more on the nature of a cliff, where the production of the wells in the field must be so low before any reduction in tax is realized that under North Slope economic realities, the wells could not be operated at these production levels. This can be restated by saying that the Kuparuk Field will shut down before the ELF in HB-118 mitigates anything but an insignificant amount of the production tax.

An increase in taxes also has the direct effect of reducing the amount of capital available for exploration and production in the state. The modification of the ELF embodied in HB-118 is an increase in taxes. This bill provides only a short term revenue boost to cover excessive current government spending. It will not solve the fiscal difficulties the state now faces, and if it is enacted, it will be at the expense of long-term stability and growth. Too much of the oil industry's resources are being drained out of resource development and into government. It is time for the Legislature to set the pace for Alaska by putting into place policies that attract new investment and provide incentives to increase current investments. The current ELF formula does help to provide incentives to increase production, while HB-118 severely limits those incentives and effectively reinstates the regressive inequities of the gross production tax.

In closing, I would like to state that ARCO Alaska believes that HB-118 will not be advantageous to the economy or the citizens of Alaska. Its enactment would place an onerous additional tax burden on the oil industry that would remove to other states or countries funds that could otherwise be spent on additional investment in Alaska. HB-118 would create a disincentive to future Alaska exploration and development and will not maximize the recovery of Alaska's oil resources. ARCO Alaska strongly opposes House Bill 118.

ARCO

**ANS Net Revenue
Kuparuk River Field**

	<u>Current Law</u> \$/bbl	<u>HB-118</u> \$/bbl
Assumed Crude Price	14.01	14.01
Tanker Freight	2.70	2.70
Quality Differential	0.40	0.40
TAPS Tariff	3.11	3.11
Kuparuk Pipeline	0.70	0.70
Pipeline Loss	0.10	0.10
Wellhead Price	<u>7.00</u>	<u>7.00</u>
Production Cost and Capital Recovery	<u>5.43</u>	<u>5.43</u>
Total Net Revenue	1.58	1.58
State Royalty	0.82	0.82
Severance Tax	0.54	0.82
Property Tax	0.44	0.44
State Income Tax	-0.01	-0.02
Total State	<u>1.79</u>	<u>2.06</u>
Federal Income Tax	<u>-0.07</u>	<u>-0.17</u>
Producer Profit	-0.14	-0.32

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

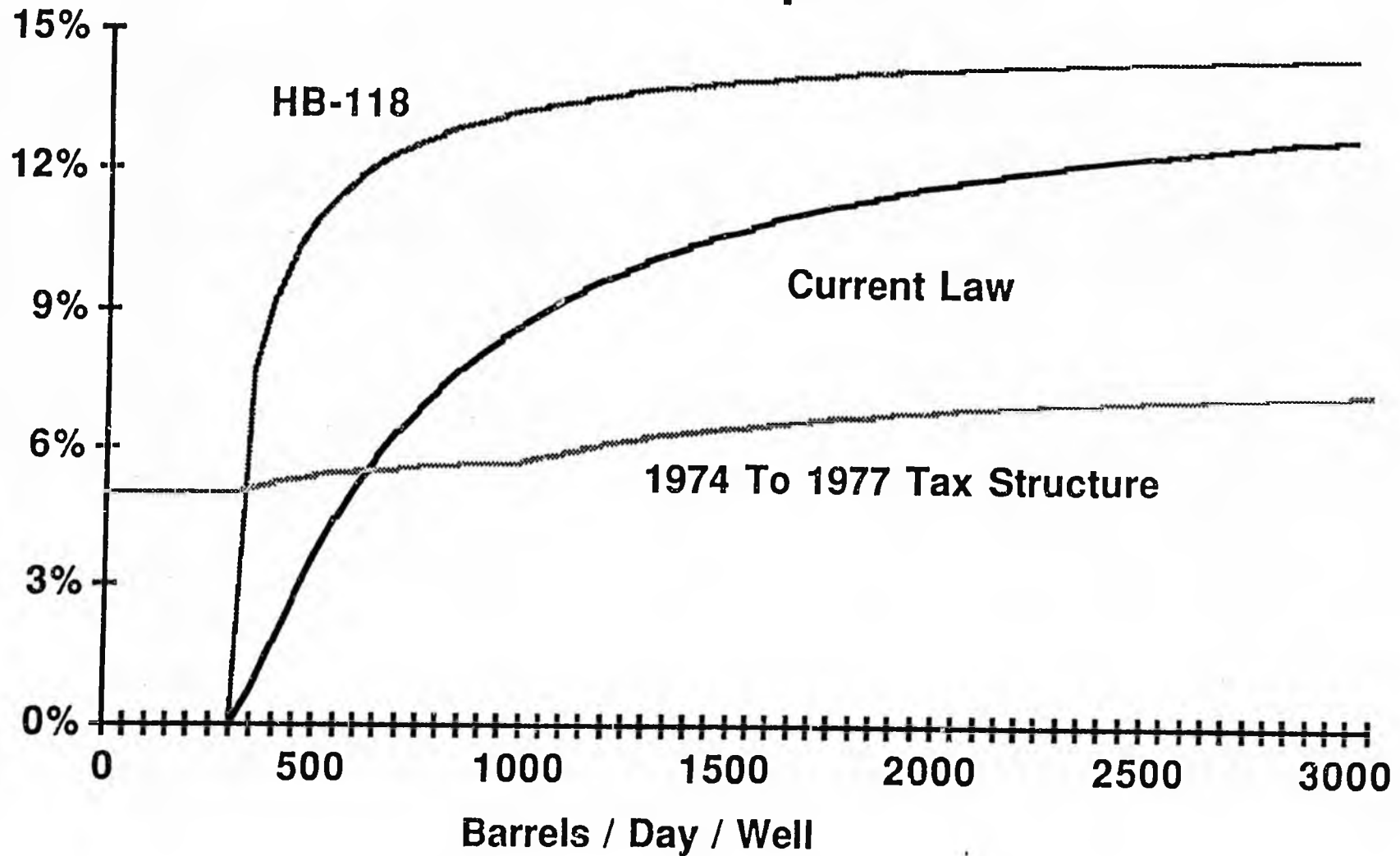
PROJECT PORTFOLIO

KUPARUK

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

II

Effective Severance Tax Rates For Kuparuk



TESTIMONY OF

GERALD SERENA

FOR

EXXON COMPANY, U.S.A.

BEFORE THE

HOUSE RESOURCES COMMITTEE

HB No. 118

FEBRUARY 11, 1989

MY NAME IS GERALD SERENA AND I AM A TAX LAWYER FOR EXXON COMPANY, U.S.A. EXXON IS A WORKING INTEREST OWNER IN THE PRUDHOE BAY, KUPARUK, LISBURNE, AND ENDICOTT FIELDS. WE APPRECIATE THE OPPORTUNITY TO PRESENT OUR VIEWS ON HB 118 THIS AFTERNOON.

HB 118 IS ONLY 25 LINES LONG, BUT NONETHELESS IT WOULD RESULT IN A MAJOR CHANGE IN LONG-STANDING OIL PRODUCTION TAX POLICY IN ALASKA THAT COULD SERIOUSLY IMPACT CONTINUED DEVELOPMENT OF THE TWO LARGEST OIL FIELDS IN THE UNITED STATES, WITHOUT ADDING ANY MEANINGFUL OFFSETTING BENEFIT TO DEVELOPMENT OF OTHER SMALLER FIELDS IN ALASKA. IT WOULD DO THIS BY REVISING THE ECONOMIC LIMIT FACTOR ("ELF"), USED IN CALCULATING THE EFFECTIVE PRODUCTION TAX RATE FOR PRUDHOE BAY AND KUPARUK, RESULTING IN IMMEDIATE INCREASES IN TAX RATE OF MORE THAN 20% AT PRUDHOE BAY AND ABOUT 60% AT KUPARUK. MAKE NO MISTAKE ABOUT IT. HB 118 DOES NOT CLOSE A "TAX LOOPHOLE"; IT DOES NOT CORRECT A "TAX GIVEAWAY". AFTER WE SIFT THROUGH ALL THE POLITICAL RHETORIC, AFTER WE REDUCE THE COMPLEXITY OF THE NEW DOUBLE EXPONENTIAL FORMULA TO UNDERSTANDABLE TERMS, HB 118 IS NOTHING MORE THAN AN INCREASE IN THE PRODUCTION TAX RATE FOR MORE THAN 90% OF ALASKA'S OIL PRODUCTION. IT EFFECTIVELY ELIMINATES THE BENEFIT OF ELF, A PROVISION OF THE PRODUCTION TAX LAW THAT WAS DESIGNED TO REDUCE THE PRODUCTION TAX BURDEN ON A FIELD AS IT MATURES AND THE AVERAGE WELL RATE DROPS, A

PROVISION THAT HAS BEEN AN ESSENTIAL PART OF ALASKA'S PRODUCTION TAX POLICY SINCE 1977.

WHY IS THIS TAX RATE INCREASE BEING PROPOSED NOW? SOME WOULD TELL YOU IT'S NECESSARY TO STABILIZE DECLINING STATE REVENUES. THEY IGNORE THE CAUSE AND EFFECT RELATIONSHIP BETWEEN HB 118 AND FURTHER NORTH SLOPE DEVELOPMENT. SOME WOULD HAVE YOU BELIEVE THAT THE OIL COMPANIES CAN ANTE UP A LITTLE MORE TO HELP BALANCE THE BUDGET OVER THE NEXT TWO YEARS, THAT THEIR PROFITS ARE MORE THAN ENOUGH TO ALLOW THIS. THEY IGNORE THE ECONOMIC REALITY THAT PROJECTS IN ALASKA COMPETE WITH OTHER PROJECTS THROUGHOUT THE WORLD FOR LIMITED INVESTMENT DOLLARS. I WON'T TAKE UP YOUR TIME TODAY WITH A DISCUSSION OF THE PHILOSOPHY OF STATE SPENDING PROGRAMS OR THE ABILITY OF CERTAIN TAXPAYERS TO SUPPLEMENT REVENUE SOURCES TO MEET THEM. INSTEAD, MY REMARKS WILL FOCUS ON HOW THE TAX INCREASE WHICH WOULD BE BROUGHT ABOUT BY HB 118 WOULD JEOPARDIZE THE RECOVERY OF ADDITIONAL OIL AT PRUDHOE BAY.

FIRST, AS BACKGROUND, LET'S TAKE A BRIEF LOOK AT THE HISTORY OF ELF. ELF WAS FIRST ADOPTED IN A MAJOR REVISION OF ALASKA'S PRODUCTION TAX LAWS IN 1977, AT THE TIME WHEN PRUDHOE BAY PRODUCTION BEGAN. PRIOR TO THAT TIME, THE MAXIMUM OIL TAX RATE WAS 8%. THE 1977 CHANGE IN THE LAW SIGNIFICANTLY

INCREASED THE BASIC RATE TO 12.25%, BUT ALSO INCORPORATED THE ELF IN RECOGNITION THAT THE BASIC RATE SHOULD BE SCALED DOWN IN APPROPRIATE CASES. ELF RESULTED IN AN EFFECTIVE OIL TAX RATE FOR THE PRUDHOE BAY FIELD OF APPROXIMATELY 11.3% AS OF JUNE 1981.

IN JULY 1981, THE BASIC RATE WAS AGAIN INCREASED, FROM 12.25% TO 15%, AND THE ELF FACTOR WAS FIXED AT 1.0 FOR THE FIRST TEN YEARS OF PRODUCTION FROM THE PRUDHOE BAY FIELD. THIS SUSPENDED THE APPLICATION OF THE ELF FACTOR AT PRUDHOE BAY FOR SIX YEARS UNTIL THE SUMMER OF 1987, TEN YEARS AFTER PRUDHOE BAY PRODUCTION BEGAN. DURING THAT WHOLE TIME WE PAID PRODUCTION TAX AT A 15% RATE -- THE HIGHEST IN THE NATION. IN THE CASE OF THE PRUDHOE BAY FIELD TODAY, THE ELF FACTOR REDUCES THE BASIC TAX RATE OF 15% TO APPROXIMATELY 12.3%.

IN 1988, AVERAGE DAILY OIL PRODUCTION AT PRUDHOE BAY DECLINED TO 1.45MB FROM THE 1.50MB AVERAGE ACHIEVED IN PRIOR YEARS, AND WE ANTICIPATE THAT THIS DECLINE WILL CONTINUE. THIS IS A NORMAL PHYSICAL OCCURRENCE FOR AN OIL FIELD, WHICH IS A DEPLETING NON-RENEWABLE DEPOSIT OF PETROLEUM. THE FACT OF DECLINE WAS INEVITABLE; THE OCCURRENCE, HOWEVER, WAS DELAYED UNTIL NOW BY AN EFFICIENT AND OPTIMAL DEVELOPMENT PLAN IMPLEMENTED BY THE OWNERS. THAT DEVELOPMENT PLAN CONTINUES TO BE IMPLEMENTED AT PRUDHOE BAY

TODAY, WITH FURTHER DEVELOPMENT DRILLING, GAS HANDLING FACILITIES, AND EXPANSION OF ENHANCED OIL RECOVERY ON THE DRAWING BOARD. THESE INVESTMENTS WILL INCREASE RECOVERABLE RESERVES AT PRUDHOE BAY AND WILL MAINTAIN HIGHER LEVELS OF PRODUCTION. THE TYPES OF PROJECTS THAT CONTRIBUTE TO THIS EFFORT ARE BOUNDED ONLY BY TECHNOLOGICAL INNOVATION AND ECONOMIC FEASIBILITY.

MANY FUTURE PROJECTS TO MAINTAIN PRODUCTION AND INCREASE RECOVERABLE RESERVES AT PRUDHOE BAY ARE MARGINAL INVESTMENTS, SIMILAR TO THE PROJECTS TO DEVELOP SMALLER FIELDS ON THE NORTH SLOPE. WHILE HB 118 MIGHT LOWER THE PRODUCTION TAX FOR SOME SMALLER FIELDS, IT WOULD DISCOURAGE MARGINAL PROJECTS AT PRUDHOE BAY. SUCH A TAX POLICY IS HARD TO UNDERSTAND, SINCE IT IS CONCEIVABLE THAT THE UNDEVELOPED MARGINAL RESERVES AT PRUDHOE BAY MIGHT EXCEED THE POTENTIAL RESERVES OF ALL THE SMALLER FIELD PROSPECTS IDENTIFIED TO DATE. THE RESULT WOULD BE LESS TOTAL OIL RECOVERY FROM PRUDHOE BAY AND CONSEQUENTLY LESS ROYALTY AND TAXES FOR THE STATE OF ALASKA AND FEWER JOBS FOR ALASKANS.

SINCE THE INITIAL DEVELOPMENT, EXXON HAS EVALUATED AND SUPPORTED SEVERAL PROJECTS TO INCREASE RECOVERY AT PRUDHOE BAY. THESE PROJECTS HAVE INCLUDED WELLS ON CLOSER SPACING, ENLARGEMENT OF FLUID HANDLING

FACILITIES, ARTIFICIAL LIFT, AND WATER INJECTION. THE COST PER BARREL FOR THESE PROJECTS TO INCREASE RECOVERY WAS TWICE THE COST OF THE INITIAL DEVELOPMENT.

THIS TREND TOWARD LESS PROFITABLE PROJECTS WILL CONTINUE. FUTURE PROJECTS WHICH ARE BEING PLANNED INCLUDE WELLS ON EVEN CLOSER SPACING AND IN THINNER OIL COLUMNS, ADDITIONAL ENHANCED OIL RECOVERY, DEVELOPMENT OF SMALLER RESERVOIRS, AND NEW IDEAS SUCH AS HORIZONTAL DRILLING. THE COST PER BARREL FOR THESE PROJECTS WILL BE MORE THAN FIVE TIMES AS MUCH AS THE INITIAL DEVELOPMENT. IN THE FUTURE, OTHER MARGINAL PROJECTS WILL BE DEFINED AS RESEARCH CONTINUES.

JUST HOW MANY OF THESE MARGINAL PROJECTS WILL BE JUSTIFIED AT PRUDHOE BAY? HOW MANY OF THE MORE THAN 10 BILLION BARRELS TO BE LEFT AFTER CURRENT DEVELOPMENT IS COMPLETED CAN BE RECOVERED? NO ONE KNOWS FOR CERTAIN BECAUSE THE ECONOMICS ARE MARGINAL AND A NUMBER OF FACTORS WILL HAVE AN IMPACT ON THE LIMIT TO WHICH SUCH PROJECTS CAN BE JUSTIFIED.

BUT ONE THING IS CERTAIN, HB 118 WOULD PLACE FUTURE MARGINAL PROJECTS AT PRUDHOE BAY IN JEOPARDY. THE PRODUCTION TAX INCREASE PROPOSED BY HB 118 SIGNIFICANTLY REDUCES THE INCENTIVE TO PRODUCE THESE MARGINAL BARRELS.

LOSS OF MARGINAL PROJECTS AT PRUDHOE BAY WILL REDUCE THE RATE OF PRODUCTION AND ULTIMATE OIL RECOVERY, THEREBY REDUCING JOBS, STATE ROYALTY AND TAX COLLECTIONS.

IT IS AN ECONOMIC FACT OF LIFE THAT COMPANIES LIKE EXXON ENDEAVOR TO COMMIT THEIR CAPITAL AND RESOURCES ONLY TO PRUDENT INVESTMENTS THAT PROVIDE THEIR SHAREHOLDERS WITH A REASONABLE RETURN. THEY ARE MOST SELECTIVE IN THIS PROCESS. TWO DECADES AGO THE QUALITY OF NORTH SLOPE INVESTMENT OPPORTUNITIES CAUSED EXXON TO COMMIT BILLIONS OF DOLLARS IN THE INITIAL DEVELOPMENT OF PRUDHOE BAY AND CONSTRUCTION OF TAPS. AS A RESULT, PETROLEUM DEVELOPMENT IN ALASKA HAS ACCOUNTED FOR ABOUT 85% OF STATE REVENUES DURING THE PAST 12 YEARS AND IN ADDITION HAS ESTABLISHED THE NEARLY \$10 BILLION ALASKA PERMANENT FUND. HOWEVER, EACH SUCCEEDING DEVELOPMENT PROJECT MUST STAND ON ITS OWN FEET AND THE METHODOLOGY FOR EVALUATING THE QUALITY OF THESE PROJECTS TODAY IS THE SAME AS THAT APPLIED AT THE TIME THE INITIAL INVESTMENT WAS MADE.

MAJOR DEVELOPMENT PROJECTS AT PRUDHOE BAY REQUIRE THE APPROVAL OF ALL THREE OF THE MAJOR OWNERS. EACH OF THE PRUDHOE BAY OWNERS EVALUATES THE ECONOMICS OF A NEW PROPOSED INVESTMENT BASED ON THE NEEDS OF ITS COMPANY, UNDER CRITERIA ESTABLISHED BY ITS MANAGEMENT. EXXON IS NOT PRIVY TO THE

DECISION-MAKING PROCESS AT ARCO OR BP, SINCE OUR COMPANIES ARE IN KEEN COMPETITION, AND I CANNOT COMMENT ON THEIR PROCEDURES. I CAN HOWEVER TELL YOU SOMETHING ABOUT HOW EXXON EVALUATES FUTURE DEVELOPMENT PROJECTS AT PRUDHOE BAY. THIS PROCESS INCLUDES THE EVALUATION OF VARIOUS TYPES OF RISK - GEOLOGIC RISK, RESERVOIR RISK, DRILLING RISK, AND POLITICAL/ECONOMIC RISK INCLUDING CRUDE OIL PRICES AND TAXES. THE INTRODUCTION OF HB 118 ADDS TO THE OVERALL RISK BY AFFECTING OUR PERCEPTION OF FUTURE TAX STABILITY IN ALASKA. UNDER HB 118, THE PRODUCTION TAX RATE AT PRUDHOE BAY DURING THE MID-1990'S IS PROJECTED TO BE ALMOST THREE TIMES HIGHER THAN UNDER CURRENT LAW.

EXXON OBVIOUSLY HAS GREAT INTEREST IN OPTIMIZING RECOVERY OF OIL AT PRUDHOE BAY IN VIEW OF THE ENORMOUS INVESTMENTS IT HAS MADE TO DATE. HOWEVER, FUTURE DEVELOPMENT PROJECTS MUST STAND ON THEIR OWN FEET AND ARE EVALUATED PRIMARILY ON THE BASIS OF RETURN ON THE FUNDS INVESTED. WE DO A DISCOUNTED CASH FLOW ANALYSIS WHICH OFFSETS ALL PROJECT EXPENDITURES REQUIRED AGAINST ADDITIONAL REVENUES PROJECTED, BASED ON THE ADDITIONAL OIL RECOVERY OUR ENGINEERS PREDICT AND THE PRICE WE ANTICIPATE THAT OIL WILL BRING IN THE MARKET WHEN PRODUCED. IF THE ECONOMICS ARE ATTRACTIVE, THE PROJECT WILL BE APPROVED; IF NOT, THE PROJECT WILL LIKELY NOT PROCEED.

THERE ARE TWO ELEMENTS OF THIS FORMULA OVER WHICH EXXON HAS LITTLE CONTROL - CRUDE OIL PRICE FORECAST AND ALASKA TAXATION. WITH RESPECT TO CRUDE OIL PRICES, WE TRY TO FORECAST AS ACCURATELY AS POSSIBLE BASED ON ECONOMIC, POLITICAL, AND GEOLOGICAL INTELLIGENCE FROM AROUND THE WORLD. I DON'T HAVE TO TELL YOU THAT THIS HAS BEEN A LESS THAN PRECISE SCIENCE IN RECENT YEARS. THE VAGARIES OF THE WORLD PETROLEUM MARKETS ARE SURELY ONE OF THE REASONS WE ARE HERE TODAY TALKING ABOUT THIS PRODUCTION TAX INCREASE. WITH RESPECT TO ALASKA TAXATION, WE ASSUME A STABLE TAX POLICY BASED ON FAIRNESS AND UNIFORM ADMINISTRATION.

STATE TAX LIABILITY IS A CRITICAL FACTOR IN APPLYING THE ECONOMIC EVALUATION FORMULA I HAVE DESCRIBED. PRODUCTION TAXES ARE ESPECIALLY SIGNIFICANT SINCE THEY ARE BASED ON GROSS VALUE OF OIL PRODUCED IRRESPECTIVE OF THE PROFITABILITY OF THE PRODUCER. HB 118 SEEMS TO BE BASED ON THE PREMISE THAT PRODUCTION TAXES ARE, IN EFFECT, TAXES ON THE OIL FIELD, NOT ON THE OIL COMPANY, AND THAT LARGER OIL FIELDS SHOULD CONTRIBUTE AT A HIGHER RATE THAN SMALLER FIELDS. LET ME MAKE IT CLEAR - OIL FIELDS DON'T PAY TAXES; OIL COMPANIES PAY TAXES. OIL COMPANIES, LIKE ALL OTHER COMMERCIAL ENTERPRISES, ARE IN BUSINESS TO MAKE A PROFIT. WHEN TAXES ARE INCREASED SO AS TO CUT TOO DEEPLY INTO THAT PROFIT, INVESTMENT ACTIVITY WILL INEVITABLY BE TRIMMED BACK.

TAX POLICY MAKERS SHOULD NOT CONFUSE THE PRODUCTION RATE OF A FIELD WITH ITS PROFITABILITY. HB 118 IMPOSES A HIGHER PRODUCTION TAX RATE ON LARGER FIELDS. THE AVERAGE PRODUCTION RATE PER WELL AT PRUDHOE BAY DURING THE MID-1990'S IS PROJECTED TO BE THE SAME AS AT LISBURNE TODAY. HOWEVER, HB 118 WOULD IMPOSE A PRODUCTION TAX RATE ON PRUDHOE BAY AT THAT POINT IN TIME WHICH WOULD BE SIX TIMES HIGHER THAN ON LISBURNE TODAY. THIS DOESN'T MAKE SENSE.

PROJECTS UNDER CONSIDERATION TODAY TO INCREASE RECOVERABLE RESERVES AT PRUDHOE BAY REPRESENT STATE-OF-THE ART TECHNOLOGY, WITH COST PER BARREL SEVERAL TIMES HIGHER THAN THE INITIAL DEVELOPMENT PROJECTS AT PRUDHOE BAY. THE REDUCTION IN CRUDE OIL PRICES OVER THE LAST FEW YEARS HAS ALREADY CUT THE GO-AHEAD MARGIN SHORT. AN INCREASE IN PRODUCTION TAX AT THIS TIME WOULD ONLY FURTHER COMPOUND THE PROBLEM.

IT IS ESTIMATED THAT OVER 10 BILLION BARRELS OF OIL WILL BE LEFT IN THE PRUDHOE BAY RESERVOIR AFTER CURRENTLY PLANNED DEVELOPMENT HAS BEEN COMPLETED. TO OBTAIN THE MAXIMUM RECOVERY, MORE AND MORE marginally PROFITABLE PROJECTS MUST BE IMPLEMENTED. FUTURE PROJECTS MAY INCLUDE:

DRILLING ON CLOSER SPACING,

DRILLING IN THINNER OIL COLUMNS,
EXPANDING ENHANCED OIL RECOVERY PROJECTS,
DEVELOPING SMALLER RESERVOIRS, AND
EXPANDING WORKOVER PROGRAMS.

IMPLEMENTING SUCH MARGINAL PROJECTS WILL ALLOW FOR PARTIAL RECOVERY OF THIS 10 BILLION BARRELS. HOW MUCH ADDITIONAL RECOVERY WE MAY EXPECT IS UNCERTAIN. HOWEVER, THESE PROJECTS HAVE TO BE JUSTIFIED BASED ON A SIMILAR RISK ASSESSMENT APPLIED TO EARLIER PRUDHOE BAY PROJECTS. THIS INCLUDES THE RISK OF A CHANGE IN THE TAX STRUCTURE.

WHILE THE CURRENT PRODUCTION TAX RATE IS HIGH COMPARED WITH OTHER STATES, IT HAS REPRESENTED A STABLE PRODUCTION TAX POLICY, WHICH HAS ENCOURAGED ENORMOUS INVESTMENT. TO ELIMINATE ELF NOW, AT THE HISTORICAL TIME WHEN IT WAS INTENDED TO HAVE ITS IMPACT AND BENEFIT, WOULD BE A DEPARTURE FROM THIS STABLE TAX POLICY SO RADICAL AS TO SEND A CLEAR MESSAGE TO OIL COMPANIES, AND OTHER INVESTORS, THAT STABILITY AND FAIRNESS ARE NOT NECESSARILY CHARACTERISTICS OF ALASKA'S TAX POLICY. YOU MUST CONSIDER THE REPERCUSSIONS CAREFULLY BEFORE YOU SEND THAT MESSAGE. ELIMINATION OF ELF WILL MEAN THAT INVESTMENT DOLLARS AND JOBS SLATED FOR MARGINAL NORTH SLOPE PROJECTS ARE MORE LIKELY TO GO TO LOWER RISK PROJECTS ELSEWHERE.

WE HAVE ONE FINAL COMMENT. HB 118 WOULD REPEAL THE PROCEEDING UNDER CURRENT LAW WHEREBY A TAXPAYER CAN REBUT THE STATUTORY PRESUMPTION OF 300 BARRELS PER DAY AS PRODUCTION AT THE ECONOMIC LIMIT. THE TAXPAYER CAN DO THIS UNDER CURRENT LAW BY INTRODUCING EVIDENCE ON THE ECONOMICS OF THE PARTICULAR FIELD. HB 118 WOULD ARBITRARILY FIX THIS RATE AT 300 BARRELS PER DAY FOR ALL FIELDS. THE PROVISION IN CURRENT LAW WAS DESIGNED TO PROVIDE TAX RELIEF FOR MARGINAL FIELDS SO THAT THE PRODUCTION TAX BURDEN WOULD NOT BE A FACTOR IN SHUTTING DOWN THE FIELD. IT WORKS! THE OWNERS OF THE MILNE POINT FIELD APPLIED FOR RELIEF BEFORE THE DEPARTMENT OF REVENUE UNDER THIS PROVISION SUCCESSFULLY IN 1986. IN VIEW OF THE ADMINISTRATION'S DESIRE TO ENCOURAGE DEVELOPMENT OF MARGINAL FIELDS, IT MAKES NO SENSE TO REPEAL THIS PROVISION.

TO SUMMARIZE, EXXON URGES YOU NOT TO SUPPORT HB 118. IT COULD HAVE A PROFOUND EFFECT ON FUTURE DEVELOPMENT INVESTMENT AT PRUDHOE BAY, COMPOUNDING THE ALREADY SERIOUS SITUATION BROUGHT ABOUT BY LOWER CRUDE PRICES. ANY BENEFITS TO ALASKA FROM MARGINAL FIELD DEVELOPMENT PROVIDED BY HB 118 WOULD BE MORE THAN OFFSET BY THE IMPACT ON ROYALTY AND TAX COLLECTIONS AT PRUDHOE BAY AND KUPARUK. TO PASS HB 118 INTO LAW WOULD BE ILL-ADVISED AND SHORT-SIGHTED. CONTINUED STABILITY IN PRODUCTION TAX POLICY WILL STRIKE THE BEST BALANCE BETWEEN FUTURE DEVELOPMENT AND STATE