ALASKA LEGISLATURE COMMITTEE FILES, 2005-2006 8672

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seen will take place in the capital when Alaska becomes a state. The taking of Alaska's mineral resources without leaving some reasonable return for the support of Alaskan governmental services, and the use of all people of Alaska will mean a betrayal in the administration of the people's wealth."

Now we've got a lobby here, and the lobby is doing exactly what we'd expect it to do because it cares about profits. That lobby has spent lots of money to elect people who will support their interest, spent lots of money on campaign ads, and you know all this. So what it comes right down to it, you have to make the decision based on the facts as you know them. And I hope this information I've given you will help you make that decision more effectively. One of the things I think you might think about is that effective date clause, folks. You know, the oil industry said they were going to use the money from the, that didn't go into the state coffers to help develop Alaska's oil fields. We saw the ARCO ads to that effect. And they said they'd create more jobs if we let the ELF apply to Prudhoe Bay. I don't think either of those things have happened. Statistics don't show that there were that many jobs created and the numbers that we have surely don't indicate that any of that money that was made available to he companies as a consequence of the ELF applied to Prudhoe, ever found its way into a whole Alaska. I think that if there was ever a broken promise, that's the broken promise that you ought to think about. And you ought to make this bill retroactive to July 1, 1987. The chart that Mr. Malone's people showed you yesterday showed that big dip. Just build a bridge across that dip. Thank you.

CHAIR: Thank you, Mr. Erickson. I certainly have been impressed with your testimony. I think you've done a very thorough job for the Committee, and for the people of the State of Alaska, in presenting the facts as you see them. At this point, I would ask that the members of the committee who have any questions of Mr. Erickson. Mr. Hudson, please.

REPRESENTATIVE HUDSON: Thank you, Mr. Chairman. I just wanted to kind of separate, separate where I was coming from the other day when I talked about do we confer and negotiate with people on tax issues in the State of Alaska. And you made a very strong point of showing where the Constitution says, "...and we shall not surrender the powers of taxation." I don't think anybody has ever even, absolutely ever considered that we'd be surrendering that power. The very fact that we have the gentlemen right over here sitting down and negotiating, or talking with, or conferring with someone who is a business person who is going to be doing business in the State of Alaska, is, I think, probably what we normally would do. And that, I just wanted that to be straightened out because I senses that you were, you were almost flailing that thing when you came to that part of your speech. And since I brought the subject up it's been my feelings all along that if we're interested in encouraging development in the State of Alaska, we have to take these things into consideration. And when we're fashioning a first-ever tax policy in the State of Alaska, or something of that nature, I think we have to make certain, as I said, if we're trying to tax a fish company for example, or seafood processing, or encouraging them to situate themselves on our shores, you have to take into consideration there can't be profitability. I think you've shown in the rest of

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Oil and Gas Pipeline Committee

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

MR. BAUMAN:

I don't. Thank you very much.

MR. GARDINER:

Thank you very much. Monte Taylor.

MR. TAYLOR:

Ladies and gentleman, my name is Monte Taylor. I am the Alaska Operations Manager for Exxon Company USA I will briefly discuss the general issue of oil industry taxation in Alaska, and why we oppose passage of the backstop bill. I would like to start by reviewing some past history in order to place my comments in perspective. The oil and gas leases that provide most of the present Prudhoe Bay production of just over 1.5 million barrels a day, were purchased from Alaska in 1965 and 1967. From the producer's point of view exploration in the Arctic was a bleak prospect at that time. Climatic conditions were no more harsh than they are today, but there were few airstrips on the North Slope, no roads, no staging areas, and very little infrastructure for logistical support. At the time the leases were sold, the standard method of leasing was competitive cash bonus bidding with one eighth retained royalty. Exploration on some of the new leases was begun in 1966. Some of the companies involved were SOHIO, ARCO, which was then Richfield, Chevron, Mobil, and Phillips. Exxon was involved as a 50% partner with Richfield. The early exploration results were less than promising - numerous dry holes had been drilled on the Slope when ARCO and Exxon decided to drill just one more well. As we all know, that final well discovered oil, what appeared to be at the time a large discovery, and was later confirmed to be the biggest oil field on the North American continent. If a way could be found to develop that field and get the oil to market then Alaska could look forward to sharing in the benefits of the find, one eighth of all the oil produced free and clear of all investment and operating risk. In 1969, Alaska held another lease sale near the area of the discovery, again retaining a one eighth royalty. A total of $900 million in bonus bids was received for 164 tracts or about $5.5 million per tract in that third sale. As we now know most of the acreage sold in that sale was outside of the productive limits of the Prudhoe Bay field. All of you know the trials and tribulations of the next decade after the discovery in 1968, with all the parties trying to solve what seemed to be at the time insurmountable problems. But somehow the government, the U.S. government, the state government, the local government, the Alaska natives, and the producers saw all that through with the passage of the Native Claims Settlement Act granting the right of way for the pipeline, construction of the pipeline, and the Prudhoe Bay facilities, Valdez, and so forth. Then the oil began to flow through the pipeline in June of 1977. From the time of the discovery in 1968 to the time the oil began to flow, 10 tax increases were imposed on the oil industry. Each time we heard the statement that the State had sold the leases for too cheap a price, that the State had in effect given away the oil. Perhaps I should emphasize here that the sales were by competitive bid with the terms set by the State. Those terms were one eighth royalty, plus whatever cash bonus each company was willing to put up, with the highest bonus receiving the bids only if the State believed that the bonus was adequate. We don't think that changing conditions justify changing that agreement any more than we think drilling all dry holes in a sale area justifies a refund of the bonuses. After all, those who bought the off structure leases for $900 million in the Prudhoe Bay sale haven't asked the State for a refund. And those of us who participated in the Gulf of Alaska sale aren't too happy about the results; but we are abiding by the original agreement. As you know, the price of crude has risen dramatically over the past few years. The basic reason, of course, is the domestic and worldwide shortage of long-term oil supplies. These price increases have raised the revenues from oil fields all over the world. As a result, the revenue from Prudhoe Bay has exceeded the prior expectations of both the industry and the State. Perhaps it bears note in here, that the State has received the full benefit of those increases through royalties and taxes that automatically adjust to the increased wellhead values. For example, the State's royalty share in 1978, which was the first full year of production, was $200 million. In 1981 the State's royalty share is $1.46 billion, a 630% increase in the royalty share because of the increase wellhead values and most of that increase came from the increased wellhead values. Both the State and the industry have been very fortunate to share in the discovery and development of North America's largest oil field. The industry has been involved in some unsuccessful ventures also and expects to repeat that pattern in the future. The replacement costs for a barrel of oil produced and sold have increased dramatically in the past few years, not only through inflation but through the increasing need to develop and explore in frontier areas and deeper horizons. There are obvious legal and equity reasons why states should not attempt to change an agreement through the powers of taxation. However, we do recognize that changing times and changing expectations can require some changes in the tax structure. In the case of Alaska we believe it is obvious that we have paid more than our fair share of taxes. We pay a 20 mill State property tax imposed only on the petroleum industry, a severance tax rate that is the second highest in the nation, and substantially higher than the rate imposed on other extractive industries in Alaska, and even a special tax to pay for the cost of regulating us. We were also subject for some time to the regular 9.4% income tax that has historically been imposed on all businesses in Alaska. After the 1978 special oil and gas income tax was passed, which taxes our income differently from all other Alaska businesses, a lawsuit was filed challenging the constitutionality of the new special tax. What does all this have to do with the bill at hand? Simply that the bill at hand does not solve the problem at hand. It is merely an attempt to disguise another tax increase. The complexity of the bill will only invite further litigation which may possibly challenge the entire tax structure in Alaska. For example, the bill creates the illusion of allowing a windfall profits tax deduction on the State income tax. The bill says the deduction is granted. But then it turns around and sets a tax rate on the reserves tax which takes the money back again. A deduction without a benefit is hardly a legitimate deduction. Another severe problem with the bill is the provision allowing for, and indeed calling for, a revision of the millage rate each year. This provision builds instability into the tax system, and assures an annual confrontation between the State and the industry. The bill will also be still another warning to other industries who might venture to this State. It would say again, for example, to the coal industry, look at what happened to the oil industry after they bought the leases, after they did the exploration, after they made the discovery, after they built the $8 billion pipeline, and after they invested tremendous sums in Prudhoe Bay and in vessels to get the oil to market. Ten tax increases occurred during the time the investments were being made, and in 1978, after the bulk of the initial effort had been invested, another major tax increase. This last increase, in one single action, raised the effective income tax rate to 6 times that of other inter-state businesses in Alaska, and denied the oil industry even the most obvious of tax incentives granted to other businesses in the State, for example accelerated depreciation. Now in 1981, the legislature is considering still another tax increase on one industry to protect the State against the possibility that the law passed in 1978 is unconstitutional. We also note from the findings and purposes, and the transmittal letter, that the legislation proposes to exclude gas from the reserves tax because of a reluctance to adversely influence investment decisions on gas development or the gas pipeline. There is a strong implication that this might be changed in the future after investment decisions are made. Apparently the State will do the same thing on gas that it has done on oil. We are glad, at least, to see a recognition that tax rates do in fact influence investment decisions. But we can hardly understand how a continuation of that type of policy can improve the business climate or add to the stability that is so badly needed in Alaska. Our view is that passing this law would be an unconscionable action for the legislature to take against it's most productive industry. We further submit that such action would be counter productive to the best interest of the State because it will only reinforce the perception by the business community that this State has a very poor investment climate. I can think of no better shot in the arm for future development, not only by the oil industry, but by other potential investors, than for the State to repeal the special oil and gas income tax. And then to be able to point out to potential investors that the State does not have the highest taxes any more on the oil industry of any state, that all businesses are treated equally for income tax purposes at least, and that the State has taken positive steps to encourage development. There is no doubt in my mind that the State and the people would ultimately benefit from a dramatic and positive step like that. There is also no doubt in my mind that this State will not benefit by passing a backstop bill - it will only serve as a clear indication that the legislature is not interested in seeking a resolution of the current litigation. We have here, it seems to me, two extreme positions - outright repeal, which in some legislators' view at least, would unreasonably reduce State revenues, and the backstop tax which by its statutory language is a tax increase over the four year period, and has the potential to be a further tax increase each year as the millage rate is reconsidered. We submit that somewhere between these two extreme positions, of repeal or backstop there must be a middle ground that will stabilize the tax structure, solve the uncertainty of future State revenues, and permit us to plan with more certainty on future involvement in the State of Alaska. Although we are confident of our legal grounds, Exxon would much prefer to see a legislative solution of this issue. As we see it, there are four basic elements to such a solution. First, maintenance of strong short and long term revenue bases for the State. Second, equitable treatment of corporations, including oil companies, doing business in Alaska. Third, elimination of the fiscal uncertainties which now hang over the heads of both the State and the oil industry with regard to the tax issue.

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

MR. GARDINER:

Representative Cotten.

MR. COTTEN:

Thank you for your testimony, Mr. Taylor. Noticing the annual Exxon ad campaign, the newspaper ads and so forth, that say let's talk -- in one of those ads, you've talked abo here today too, that the State has changed the tax laws several times since 1969. One of the questions I have is, do you think any of those changes have been justified or, more specifically, do you think that tax that was in place in 1969 should never have been changed?

MR. TAYLOR:

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

MR. COTTEN:

I appreciate that. I think it is a pretty honest answer. I think one of the purposes of this bill is to maintain some stability. We think we are in a situation where the revenues are predictable. I think that is obviously the major thrust of this bill, to maintain a revenue stream as is. Of course, we are in court - you are suing the State, you and other companies are suing the state over the constitutionality of another law that was passed. This, as you know, attempts to maintain that revenue stream.

MR. TAYLOR:

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

MR. GARDINER:

Representative Rogers.

MR. ROGERS:

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

MR. TAYLOR:

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

MR. ROGERS:

In terms of which tax ...

MR. TAYLOR:

In terms of the income tax only.

MR. ROGERS:

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

MR. TAYLOR:

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

MR. ROGERS:

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

MR. TAYLOR:

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

MR. ROGERS:

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

MR. TAYLOR:

Yes, it could be done other ways, but there just happens to be a lawsuit, which we think is a very valid lawsuit, on the income tax itself.

MR. ROGERS:

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

MR. TAYLOR:

Did he do that math right?

MR. GARDINER:

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

MR. TAYLOR:

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

MR. RANDOLPH:

Mr. Taylor, I have several questions for you. First, you alluded several times to the fact that you think this backstop legislation does, in fact, institute a tax increase. The information we were given yesterday, and the fiscal notes on it, indicate that it basically breaks cut even. What accounts for the discrepancy between your attitude and the administration's attitude on this matter?

MR. TAYLOR:

I think what you have to do is look at the assumptions that went into the fiscal note. The statutory language in the bill says that the millage rate will be 30 mills for the first year, for 1982, and then 25 mills thereafter. The fiscal note, in our opinion, makes an unfounded assumption that a legislature in four years from now will change the millage rate from the statutory language of 25 mills and make it 20 mills. That is the basis for the 1985 figures in the fiscal note. That didn't make sense to me, so I ratioed the reserve tax back up in '85 to make the fiscal note track the statutory language. In that case, the total four year effect, in the low case that is quoted in the fiscal note, instead of being $164 million negative, is $218 million positive. The high case effect, instead of being $483 million positive, which we consider a big number, becomes $964 million positive or almost $1 billion. We have here a potential tax increase based on the statutory language of $1 billion. I hardly think that justifies saying that the tax system remains essentially unchanged, or whatever the words were in the transmittal letter. Does that answer your question?

MR. RANDOLPH:

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

MR. TAYLOR:

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

MR. GARDINER:

It seems to me somewhat an answer to that question is that there was this 10 year history where the State and the industry went back and forth over -- there even was one oil tax increase that the industry came in and supported in 1973. The last time the legislature acted was over the income tax bill and, probably, you could distinguish this bill -- I think there is some argument over numbers and that is something the Committee will want to get in over this bill as to exactly how much revenue it does raise, but, I think, the intent of the draft of the bill was to raise as close as possible, and I think the Commissioner went into this, to backstop the same amount of revenue. That is a lot different posture from the other 10 years of legislation, which, there was no doubt about it, each of those bills was intended to raise revenue. In the last couple of years I don't think the legislature has seriously considered any oil tax increases. In fact, I don't -- if you put the argument aside as to whether this does or doesn't, I don't think there has been a bill that has been seriously promoted - there may have been, I think there were some bills introduced, but I don't think they got hearings. To me it says that there was all this change, and not all of it was due to us or the industry, in terms of changing the value of oil, but I think, at least in my own mind, the process was concluded when the income tax bill was passed. Now other things have transpired, namely, the suit - and that's why we are here.

MR. TAYLOR:

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

MR. RANDOLPH:

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

MR. MALONE:

Thank you Mr. Chairman. Mr. Taylor, I suppose that you follow, at least to some degree, the progress of the State budget and spending.

MR. TAYLOR:

Yes.

MR. MALONE:

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

MR. TAYLOR:

Yes, sir, I do.

MR. MALONE:

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

MR. TAYLOR:

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

MR. MALONE:

Roughly what percentage increase would you say that is?

MR. TAYLOR:

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

MR. MALONE:

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

MR. TAYLOR:

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

MR. MALONE:

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

MR. TAYLOR:

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

MR. MALONE:

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

MR. TAYLOR:

Net income on production in the State of Alaska. I don't know that figure. And if I did, it is confidential information. It is part of our company you know. But it is fairly easy to figure. The wellhead value that the State gets is something close to the wellhead value that the producing department gets. We have to pay the expenses out of that. The State doesn't have to pay the expenses. It's something comparable -- the total industry is something comparable to the State, less than the State. And we have 20% of that.

MR. MALONE:

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

MR. TAYLOR:

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

MR. MALONE:

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

MR. TAYLOR:

Yes, sir.

MR. MALONE:

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

MR. TAYLOR:

I can't name one project. I can say that our exploration fairly clearly is not as expansive as it might be with a more moderate tax structure. We moved, we had an exploration office here in the same offices I have, we moved some of those people out, back to Texas, because they found better prospects elsewhere. That was partly the land situation, partly this tax structure - the exploration manager just decided he had a better place to go. It is nearly always that way. What the effect of an investment climate has, in my opinion, after a good many years work in that problem, and making a lot of investment decisions, is that what happens you don't go look. If Exxon goes in to an area that looks promising, from the standpoint of tax structure, the oil structure that you might find, the logistics of the whole deal - and it looks promising and drills a well and finds oil - we might find more or less than we expected to find - if we find an oil field, even that we feel is marginal, as compared to what we look for, we will try our best because we have already made a big investment to develop that oil field. We might do it cheaper, we might do it different, we might delay it 5 years, we might do lots of things - but -- it's hard to find examples anywhere in the world where you find a major oil field that you don't eventually develop. There's no question in my mind that there's a lot of major oil fields around the world that nobody has ever found for various reasons, and some of them is because you don't have land to go look at, or you just don't go look because you think some government is going to take it away from you, in the case of some of the foreign operations. A positive investment climate, though, makes a tremerdous difference in the attitudes of the people making those decisions. We have not made investment decisions on -- we have discoveries, as you probably know, in the Duck Island area and the Point Thompson area. I can't say whether we will develop those yet or not. We will look at the economics after we get the fields better defined. We will put in all the taxes that we expect, that we know we are going to have to pay, and we will project, based on the history, probably, some increase in taxes in the State of Alaska. If it comes out and looks poor, we won't develop them. And if it looks good, we will. I don't know how that investment decision will come. The bigger problem is lack of exploration when the investment climate is poor. In my opinion - that is just my personal -- well, that's just how it works.

MR. MALONE:

...one last question. Investment climate, you know, is -- a simple statement might be that if the State had no oil taxes we would have a perfect investment climate as far the State's tax policy. In fact, that wouldn't be very realistic because if we didn't have them, and you made investment decisions based on that, any state government or any government would probably have the taxes after all.

MR. TAYLOR:

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

MR. HAYES:

Thank you Mr. Chairman. I would like to follow up on one of the questions that Representative Malone touched on, which was the lawsuit. One of the concerns that I have is that the backstop law that is proposed by this piece of legislation would just add one more lawsuit on top of the lawsuit we already have and, I believe would result in just extending the time when we finally get some conclusion in the courts. We've heard the administration, I believe it was yesterday, indicate that they felt the backstop approach was much more legally secure than the present chapter 21 or the 1978 law. Either they said it was more secure now or more secure than the perception they had at the time they enacted the 1978 law. What is your opinion on that? Do you think that's true? If not, why note?

MR. TAYLOR:

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

MR. HAYES:

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

MR. TAYLOR:

In its simplistic terms, there are other areas that have reserve taxes, for instance. So maybe in that sense that's more secure. The concept of separate accounting is not the accepted concept by most states right now - most are on modified apportionments. To that extent chapter 21 is, maybe more suspect. But you get into other things in this law about the setting of the millage rate and the retroactivity provisions and all sorts of complexities that -- is the reason I wouldn't comment because all those things might add up to a bigger deal than the separate accounting on the other side.

MR. GARDINER:

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

MR. TAYLOR:

I will be here.

MR. GARDINER:

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

MR. TAYLOR:

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

MR. GARDINER:

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

MS. FAKES:

Thank you, Mr. Chairman. I do have a plane to catch. I do appreciate this. My name is Jan Fakes. I am a member of the Board of Directors of the Anchorage Chamber of Commerce so I reside in Anchorage. I serve with the Board, with the Chamber as their legislative action Chairman. I have been sent here by the Chamber to express to you their strong desire to repeal 43.21, and their strong opposition to the backstop tax. For the sake of time, we have brought a member of the legislative action committee with us today by the name of Dan Coffee who is an attorney in town and he has been studying this issue for the Chamber on a volunteer basis since January. With your permission, Mr. Chairman, I'd like to turn the rest of the testimony over to Dan.

MR. GARDINER:

That would be fine.

MR. COFFEE:

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

SB 50 The Fair Share Bill

March 18, 2005

Senate Resources Committee

The 'ELF' in Alaska's Oil Taxes

- There are four main taxes that the oil industry pays:
- Royalty – 12.5%
- Property – 20 mils per dollar, or 2%.
- Corporate income – 9.4% .
- Production – 15% before ELF.

The 'ELF' in Alaska's Oil Taxes

- The 15% production, or severance tax varies because of the ELF, or economic limit factor.
- At its simplest, the ELF is a number between zero and one. Multiplying the production tax by a field's ELF lowers that field's tax burden.

The ‘ELF’ in Alaska’s Oil Taxes

- Kuparuk’s ELF is..054 for FY 2006
- .054 times 15 equals .081
- Thus, Kuparuk pays a 0.81% production tax.
- Prudhoe’s ELF is .8435.
- Prudhoe pays a 12.65% production tax.

The 'ELF' in Alaska's Oil Taxes

- **The formula is actually quite complex:**

AS 43.55.013. Economic Limit Factor.

(b) The economic limit factor for oil production of a lease or property shall be computed according to the following formula:

$$(1-[PEL/TP]) \exp ([150{,}000/(TP/Days)] \exp [(460 \times WD)/PEL])$$

where:

PEL = the monthly production rate at the economic limit;
TP = the total production during the month for which the tax is to be paid;
WD = the total number of well days in the month for which the tax is to be paid;
Days = the number of days in the month for which the tax is to be paid; and
exp = exponent.

The 'ELF' in Alaska's Oil Taxes

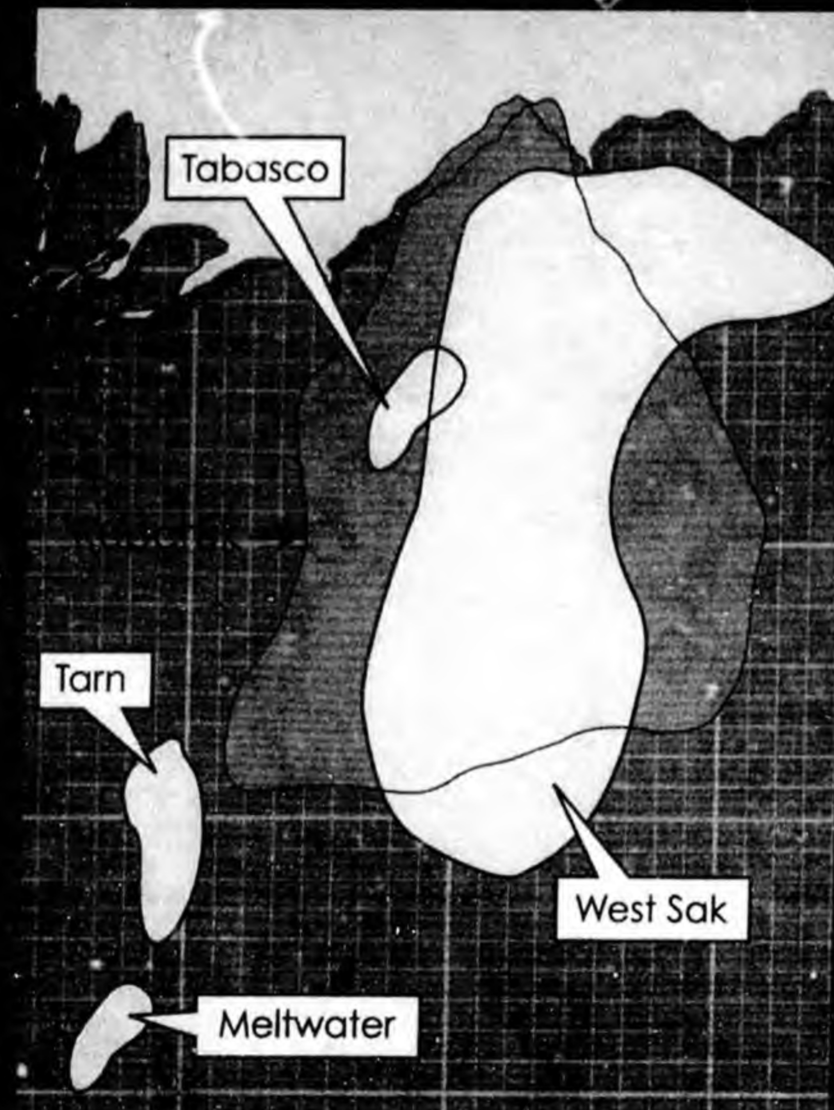
- ELF was designed to encourage "small" field development.
- There are twenty fields now producing on the North Slope.
- Nine pay no production tax at all.

Production Tax Revenue

- In 2003, the State took in $599 million in production taxes.
- The average price that year was $28 per barrel.
- The average ELF was .50, meaning the average production tax rate was 7.5%.

Kuparuk and its neighbors

Tarn,
Meltwater,
Tabasco,
and
West Sak



Kuparuk and its neighbors

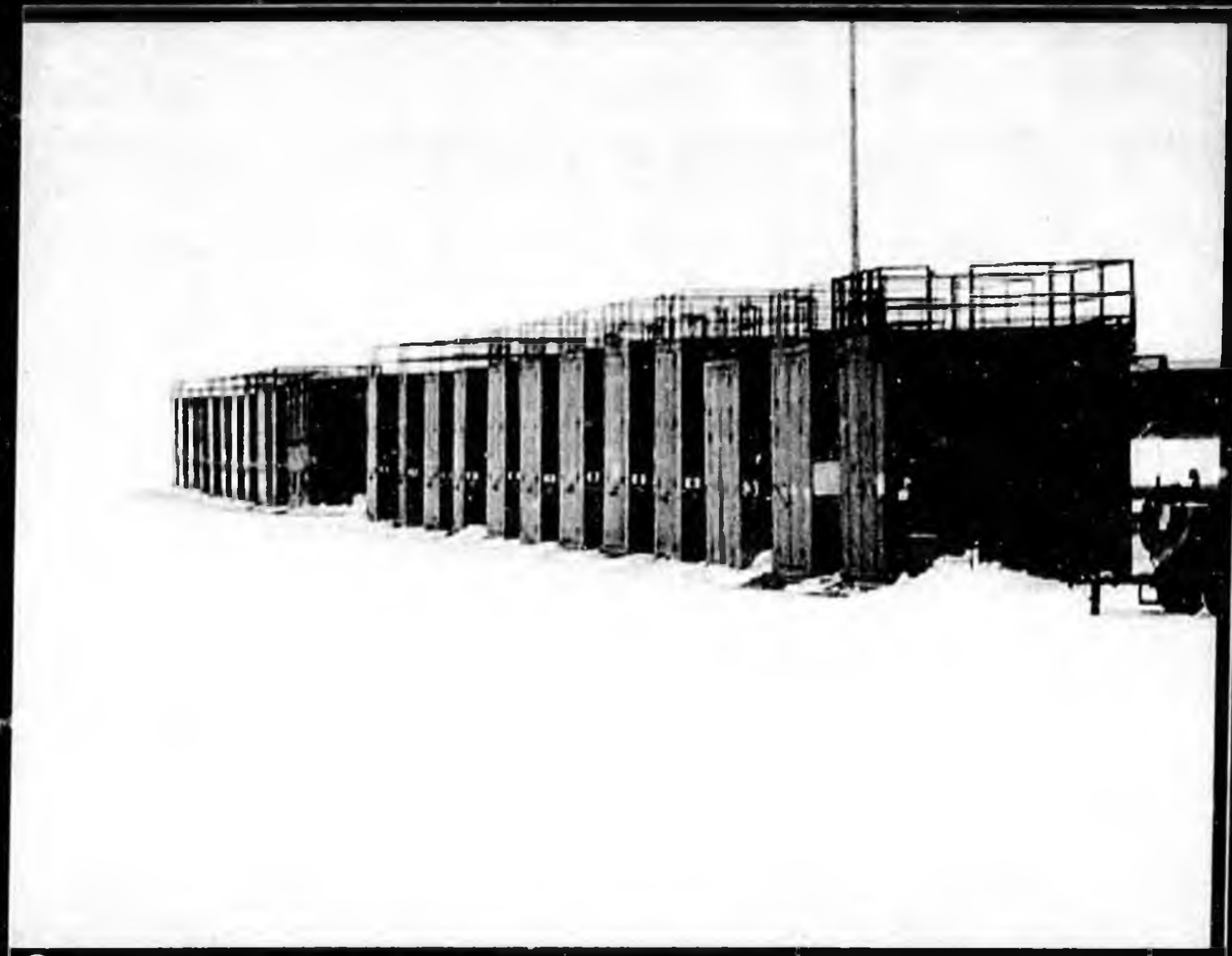
- The Tarn field made 696,248 bbls in January 2005. Approx. 22,450 per day.
- The field has produced 65,000,000 bbls to date. It is one of the top thirty largest fields in the U.S.
- Tarn has a 0.013% ELF meaning it will pay a 0.2% production tax in 2005.
- Tarn's ELF will go to zero in 2007.

Kuparuk and its neighbors

- Tarn is produced via Kuparuk's facilities.

Kuparuk and its neighbors

- Tarn required two drill sites and three ten mile pipelines



Kuparuk and its neighbors

- The Meltwater field, also produced through Kuparuk's facilities, required only one drill site.
- In 2003, Meltwater produced 5800 bbls of oil per day and paid no production tax.
- This modest field will make the producers 2,000,000 bbls of oil this year.
- At $50 per barrel, that is $100 million.

How the "Fair Share" bill works

- Two principle reforms:
- The first simply establishes a minimum 5% production tax. All fields must pay the minimum 5%.
- In January 2004, the Dept. of Revenue estimated that this provision alone would raise $75 million at $22 per barrel.

How the "Fair Share" bill works

- The second major reform bases the ELF on the price of a barrel of oil.
- As the price rises, so does the ELF. As the price of oil falls, so does the ELF.
- The bill sets $16 to $20 oil as the norm, and allows this "range" to increase with inflation, to recognize that prices rise over time.

How the “Fair Share” bill works

- Example: At lower oil prices the production tax would be reduced. If oil goes to $12 per barrel, the formula would divide 12 by 16 to yield .75. Thus the production tax on an oil field would be reduced by 25%.

How the "Fair Share" bill works

- If oil prices fall below $10 per barrel, the bill would waive half the production tax and would defer the other half until prices rise above $16 per barrel.

How the "Fair Share" bill works

- Higher prices: At $30 oil, the new formula would divide 30 by 20 yielding 1.5.
- Thus, a field with a 10% production tax would pay an adjusted 15% production tax.
- The production tax cannot exceed 25% under the bill.

How the “Fair Share” bill works

- The bill exempts ‘heavy oil’ (less than 20 API gravity) from any of its measures. Heavy oil, like that contained in the West Sak reservoir, requires more expensive drilling and production measures.

How the "Fair Share" bill works

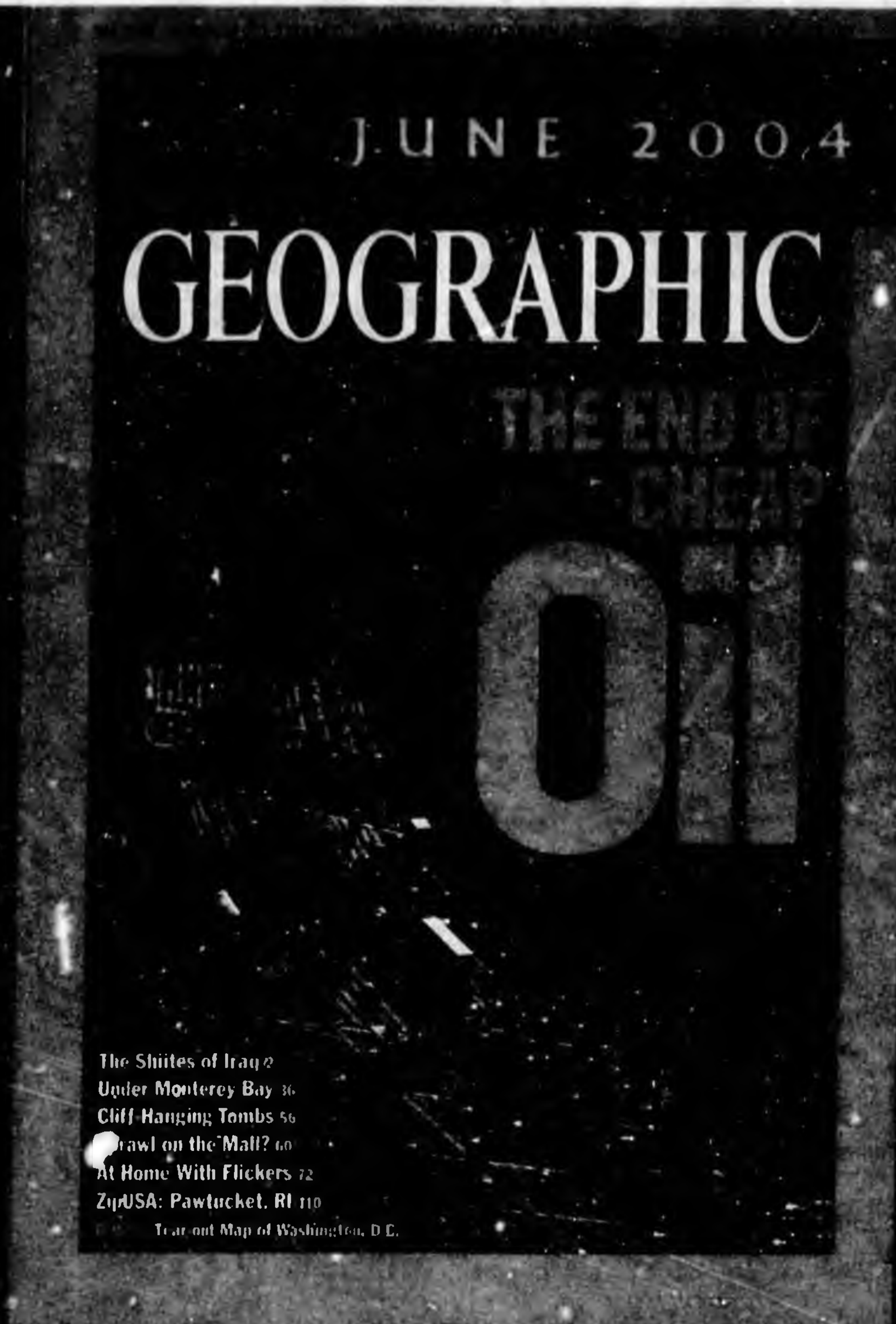
- Finally, the bill allows taxpayers "production tax relief." If the taxpayer can demonstrate that the field would be economical but for the production tax, the Department of Revenue has the power to waive the tax for that field.

Why Make a Change?

- "Despite its name of Economic Limit Factor, it ignores the biggest single economic determinant, which is price."

-- Dan Dickenson, Director, Tax Division quoted in The Petroleum News January 11, 2004.

Why Make a Change?



THE WALL STREET

LEADING THE NEWS

Spike in Oil Prices Is Likely in '05

As oil prices approached a new high yesterday, industry analysts said they are anticipating price increases to more than $60 a barrel this year. Some analysts are even beginning to talk of the possibility of greater increases—to $75 or $80 a barrel—in the event of a major supply disruption, unless red-hot demand for crude cools in Asia and the U.S.

Wall Street Journal, March 5, 2005; p. A3

Oil Industry Profits

- ExxonMobil: Fourth quarter 2004 profits were $8.4 billion, the biggest quarterly profit ever for a U.S. company.
- BP: $4.4 billion
- ConocoPhillips: $2.4 billion
- Total quarterly profits: $15.2 billion in ninety days. $7 million per hour.

Governor Walter J. Hickel

"Crisis in the Commons: the Alaska Solution"

Governor Walter J. Hickel

- "Few world leaders are thinking about how we should care for and use the commons…for the benefit of the total."
- "Especially for the benefit of the local population…rather than for a political leader, a ruling family, an oligarch, or a group of multi-national corporations."

Governor Walter J. Hickel

- In 1909 President Roosevelt began the process of separating the ownership of land from the minerals below.
- "The Mineral Leasing Act of 1920 .... recognized that the commons belonged to the public and required that income from the development of the commons must be paid to the public's government."

Governor Walter J. Hickel

- Alaska's Statehood Act was modeled on the 1920 Mineral Act. The subsurface energy resources were specifically designated to the new state.
- "We kept the resource wealth in public hands…but we harnessed the free enterprise system to develop our wealth…all in the framework of a constitutional democracy."

Wood Mackenzie Study

- An international consulting firm says Alaska is a more profitable place to do business than the average of almost 60 oil and gas producing regions it surveyed worldwide.
- Higher than average costs, but lower than average government “take” at prices above $16 per barrel.

Wood Mackenzie Study

- At $35 per barrel, Alaska is 19th of 55, well above the median.
- At $35 per barrel, the total "take" is 58% compared to a global average of 73%.
- The difference between 58% and 73% -- 15% -- amounts to a subsidy of the oil industry.

Other Countries' Adjustments

- United Kingdom upped their minimum rate from 30 to 40 percent.
- Argentina introduced an export tax.
- Venezuela removed heavy oil royalty incentives.
- Nigeria increased its share of government profit.

Source: Petroleum News January 30, 2005

What Will the Industry Say?

- Won't discuss the fact the bill lowers taxes at low prices.
- Won't discuss the fact the bill raises the "normal range" each year to account for inflation.
- Won't discuss the fact the bill allows for production tax relief if it is justified.

ELF in 1989

"To the extent that production, net production, stays in the ground, the Permanent Fund is going to be a loser because the royalties that would have been collected won't be collected. The oil is still in the ground where it doesn't do anybody any good."

-- Tom Williams of British Petroleum on 2/22/89 before the House Resources Committee.

ELF in 1989

"My concern is that any additional taxes on the oil industry will have an adverse affect on the future drilling on the North Slope. This action will fundamentally impact not only the petroleum industry, but also the State's ability to encourage new economic development."

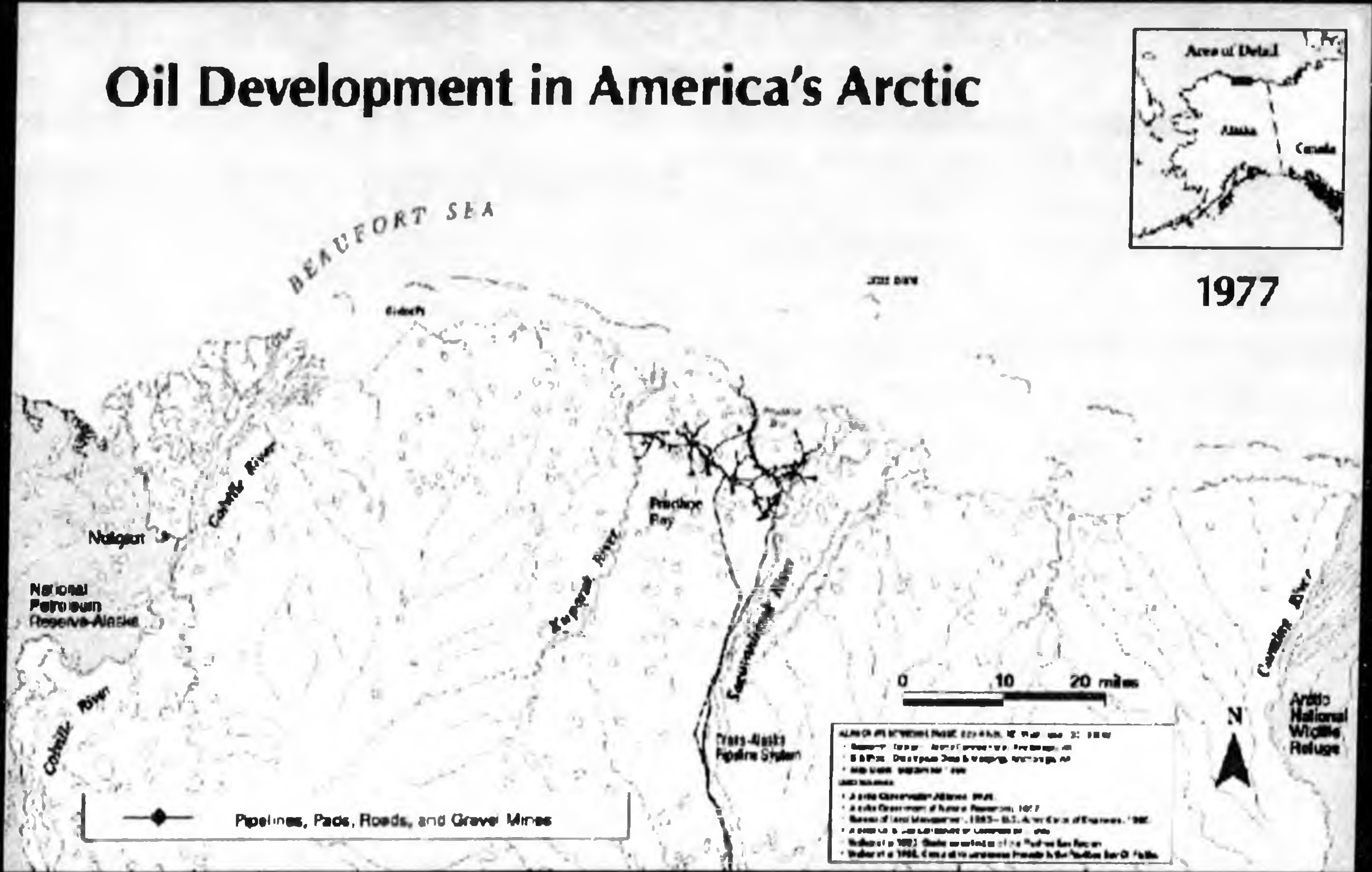
-- Morris Thompson, President, Doyon Drilling on 1/13/89 before the House Resources Committee.

ELF in 1989

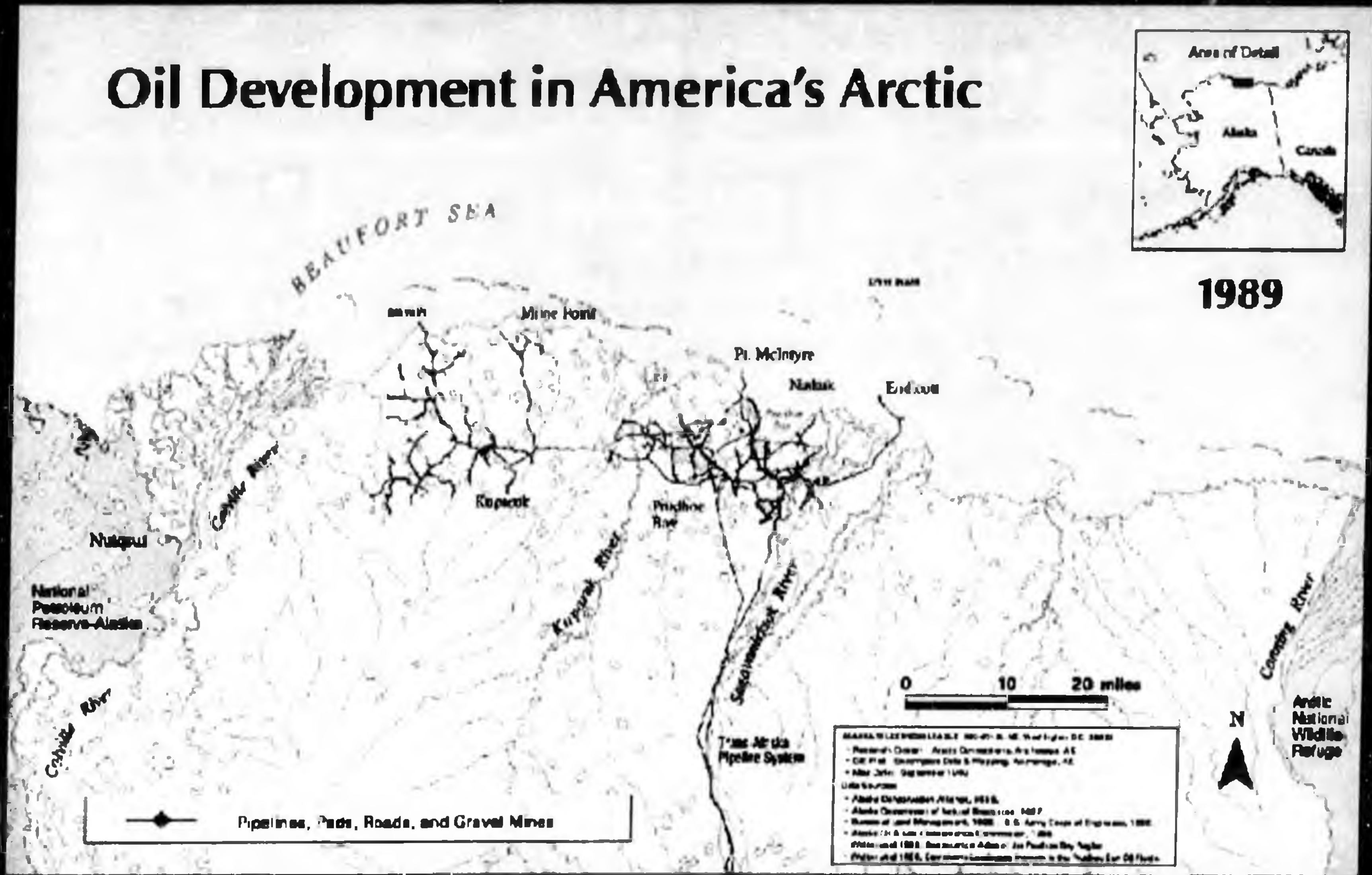
"[This bill] would place an onerous additional tax burden on the oil industry that would remove to other states or countries funds that otherwise would be spent on additional investments in Alaska."

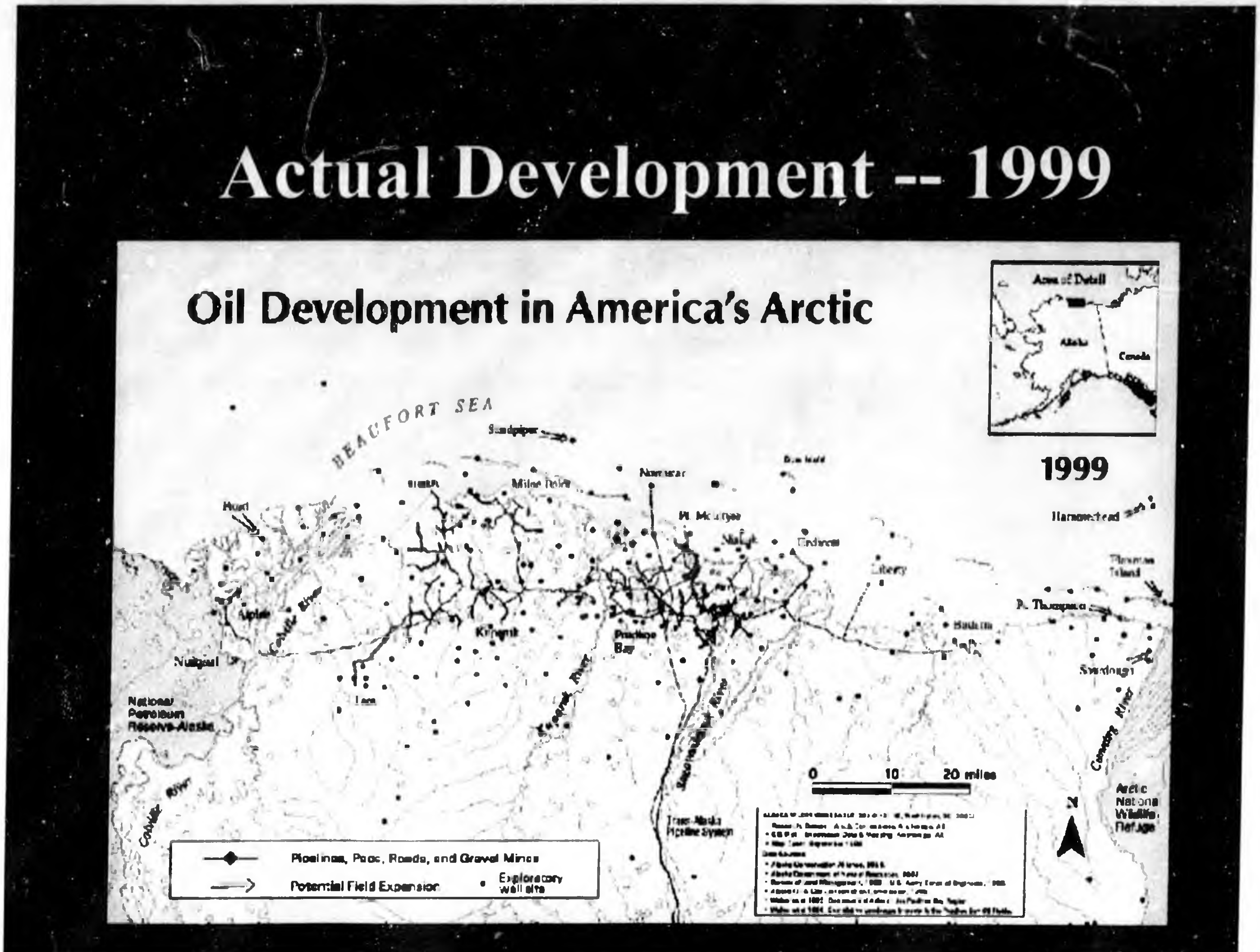
-- Ben Odom, Senior VP of Operations, ARCO Alaska, on 1/13/89 before the House Resources Committee.

Actual Development -- 1977



Actual Development -- 1989




Actual Development -- 1999
Oil Development in America's Arctic
Area of Detail
Alaska
Canada
1999
BEAUFORT SEA
Sandpiper
Milne Point
Northstar
Pt. McIntyre
Endicott
Liberty
Hammerhead
Pt. Thompson
Badami
Sourdough
Alpine
Kuparuk
Prudhoe Bay
Nuiqsut
National Petroleum Reserve-Alaska
Colville River
Trans-Alaska Pipeline System
Canning River
Arctic National Wildlife Refuge
0 10 20 miles
N
Pipelines, Pads, Roads, and Gravel Mines
Potential Field Expansion
Exploratory well site