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The Oil Patch

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Richard A. Fineberg

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How Profitable Is Oil, and Who Gets It?

Mysterious Oil Numbers Tell A Troubling Story in Juneau: Adding "H" to ACES, You Get ACHES (Alaska's Confusing, Hidden and Elusive Share) and PAINS (Piecemeal, Artificial, Incomplete Number Systems)

Bad Numbers, Legislative Stalemate

NEW!! The Reduced Oil Imports Report:

Conservation Gains (2012 - 2030): 46.9 billion barrels. Arctic Refuge (2012 - 2030): 1.8 billion barrels

New Report on EIA Data (Nov. 26, 2011)

By Richard A. Fineberg
May 8, 2012
(Posted May 8, 2012))

A funny thing happened on the way to the state legislature's special session: Legislators simultaneously encountered the past and the future. In doing so, they demonstrated that those who don't learn from their history are condemned to re-live it.

The factors that determine the profitability of oil start with constantly changing world oil prices. From this uncertain figure, elements that must be subtracted include varying and unverified field costs, disputed pipeline costs that contain a chunk of profits if the company happens to own the pipeline (which the major North Slope producers do but the smaller new producers don't) and uncertain federal income taxes that are reduced from the nominal rate by deductions that can be taken in future or past years, to the company's best advantage, rendering current year figures mythical.

Even the tax label ACES - Alaska's Clear and Equitable Share - is misleading. There are so many hidden factors that the letter "H" might be added, changing ACES to ACHES: Alaska's Confusing, Hidden and Elusive Share. The root of the problem might be characterized as PAINS: Partial, Artificial and Incomplete Number Systems.

The following summary review of oil and gas activities during the last two inconclusive legislative sessions in Juneau suggests that legislators and administrative officials both suffer from ACHES and PAINS.

For the second year in a row, Governor Sean Parnell seemed bent on throwing large sums of state revenue to oil companies in the questionable belief that tax breaks were necessary and the desperate hope that the tax inducements could successfully trump geology and economic realities. In 2011, HB 110, the governor's reckless giveaway proposal, passed the lower chamber like runaway stagecoach in an old Western movie. The situation stalemated when members of the Senate, led by their President Gary Stevens (R-Kodiak), displayed an impressive preference for reason over rhetoric. ***[1]*** The resulting special session failed to break that legislative impasse.

The Governor's approach and the industry's advertising campaign in 2012 bore a striking similarity to those of 2011. This time around, by mid-session there were three major oil and gas bills in play:

- Passed by the House in the first session of the two-year legislative term and still in the Senate, HB 110 hovered over the session, backed by an industry advertising campaign.
- The House majority pushed another ill-conceived energy bill; HB 9 would give a

Welcome

(August 2004)

At this web site you will find fact-based information and commentary about economic and environmental aspects of oil industry operations in Alaska, with special emphasis on the North Slope oil fields and the Trans-Alaska Pipeline System (TAPS). Due to the oil industry's power, political clout and media skills, much of the information you will find here is not widely reported or readily available elsewhere.

Three major petroleum companies -- BP, ConocoPhillips and ExxonMobil (originally Sohio, ARCO and Exxon) -- control more than 90 percent of the North Slope production and own a similar share of the Alyeska Pipeline Service Company, which built and operates TAPS. The sprawling North Slope complex centers around Prudhoe Bay, the largest producing oil field ever discovered on the North American continent. About one million barrels of oil per day is pumped from beneath the frozen substrate and loaded into TAPS for the 800-mile journey across Alaska to the ice-free port of Valdez in Prince William Sound. There, the oil is loaded on tankers that carry approximately one-third of the oil consumed daily in the western United States.

Alaska's North Slope development and its pipeline link to market provide unusual opportunities to observe the actions of decision makers, as well as greater access to the central participants than most other places afford. Based on this experience and supplemented by information from two pipeline-dependent petroleum provinces of the Former

new, untested state agency unbridled powers to push an in-state natural gas pipeline. ***[2]***
- Meanwhile, the Senate Resources Committee was studying matters carefully and crafting a different oil tax approach. Instead of the giveaway giveaway to the operators of the historically profitable but declining legacy fields proposed in HB 110, the Senate Resources Committee's SB 192 favored increasing existing incentives for new development. ***[3]***

Alert reporters occasionally picked up stories on the Senate Resource Committee's efforts, but the headlines could not be considered big news. The audit problems, for example, were not a new development. In 2008 Revenue Department officials had warned that in the absence of automated systems to gather data on revenue payments, the antiquated state revenue collection system was headed for an administrative train wreck. In 2011 the Legislature belatedly authorized $34.7 million for a multi-year project to set up an automated revenue collection system that would integrate the dysfunctional petroleum leviathan with the state's other revenue collection systems. ***[4]***

With work on the new revenue collection program just beginning in 2012, the Revenue Department was still unable to tell inquiring legislators where hundreds of millions of dollars from state coffers, authorized to offset industry capital expenditures, had landed. Was that money promoting exploration and development of new fields, as some legislators hoped, or was most of it being used for drilling and well workovers in existing fields, including the "legacy" fields, Prudhoe Bay and Kuparuk, which had already recouped investment costs many times over in preceding years? ***[5]***

While the Governor and the House majority coalition seemed to be vying with each other in an irresponsible race to give state money to the industry, the Senate Resources Committee was quietly trying, quietly and carefully, to identify information and fiscal policies most likely to be of use in the uncertain world of rising oil and falling natural gas prices.

Soviet Union, the information presented here points to two significant conclusions:

- *(1) petroleum developers can and frequently do use pipelines to maximize profit and inhibit competition, to the detriment of host populations; and*
- *(2) the chronic discrepancy between promise and practice on major oil projects frequently places the populace and the environment at significant and needless risk.*

The material presented here was researched and compiled by Richard A. Fineberg, founder and principal investigator of Research Associates of Ester, Alaska. Fineberg has observed Alaska petroleum development for three decades as a prize-winning reporter, as an advisor to the Governor of Alaska on oil and gas policy and as an independent consultant to investors, government agencies and non-profit organizations. In recent years his horizons have expanded to include two oil provinces in the Former Soviet Union, the Caspian Basin and Sakhalin Island. Often controversial, Fineberg's petroleum research has earned a reputation for dedication to factual accuracy and carefully reasoned analysis.

A fundamental premise of this web site is that it falls to each of us, as citizens, to inform ourselves and respond appropriately to the issues and events that shape the broad directions of our society and the detailed fabric of our social interactions. Based on the fact-driven information presented here, readers can come to independent judgments regarding the authenticity of the content, the significance of the relevant facts and the logic and appropriateness of the conclusions. In effect, each of the topics reported here can stand alone as a documented case study in petroleum development.

During the 3-1/2 decades since the discovery of the nation's largest oil field at Prudhoe Bay on Alaska's North Slope, events from Watergate to the collapse of powerful corporate entities such as Enron and WorldCom demonstrate that large institutions frequently fail -- often by grotesque margins -- to live up to legal and moral obligations

For example, in early February 2012 the Senate Resource Committee held hearings on the Dec. 30, 2011 state Superior Court decision on property tax valuation of the Trans-Alaska Pipeline System (TAPS) for the years 2007 through 2009. In April 2011, Senate President Stevens had relied heavily on the predecessor to that decision, by the same judge, when he stepped down from the Senate podium to call for a halt to HB 110. The latest pipeline property tax case in Superior Court covered three tax years together - 2007 through 2009 - and updated the arguments of the previous decision.. A major issue in determining the property tax was the longevity of the pipeline. The court findings - that TAPS was likely to continue carrying North Slope crude oil for at least another half century - functioned to counter the assertion that the HB 110 tax breaks were needed to keep TAPS from shutting down. ***[6]***

The following items are offered as examples of the significant historical facts the Senate Resources Committee brought to light in its carefully documented 2012 deliberations:

- The historical fact of TAPS tariff overcharges and the failure of the regulatory process to remedy this problem in a timely manner suggests that the three major oil companies, who own a 95% share of TAPS and control a similar percentage of North Slope production, may wield to the detriment of independent competitors. Alaska has experienced (and continues to experience) oil pipeline overcharges that contradict the conventional wisdom that owner-shippers will seek low tariffs because they are shippers, too (as reported frequently in the pipeline economics section of this web site). Under these circumstances, it seems presumptuous to assume that the state can easily negotiate low tariffs for natural gas shipments from the North Slope.

- The committee records include testimony on the dominating power of TAPS by veteran economic expert Charles Cicchetti, Ph.D., Cicchetti, who specializes in energy, finance and environmental economics,

and to deliver on their public pronouncements. Concurrently, the major oil companies who have played such a large role in Alaska's development have performed their tasks with a chronic and troubling discrepancy between promise and practice.

Despite lavishly funded advertising campaigns and public relations efforts urging that Alaska's oil companies can be trusted as the avatars of social salvation, closer examination reveals a profound gap between what these companies say and what they do. With equally disturbing regularity, when confronted with evidence of those failures, government has failed to protect the public interest. This web site explores the economic and environmental impacts of those failures in concrete terms in the belief that well-informed individuals can and will make a positive contribution to the course of human development.

Reports on pipeline and petroleum development issues found in the "Oil Patch" section of this web site may be understood as case studies providing insight into the relationships among powerful corporate and government institutions and the complex interactions between individuals and institutions. At this broad level, a growing body of research on the political and economic aspects of petroleum development known as petropolitics suggests that the price of oil wealth includes, with disturbing frequency, poverty, a widening gap between rich and poor, economic stagnation, corruption, dictatorship and war.

The petropolitical approach to petroleum development goes far beyond the conclusions presented here regarding pipeline economics and the industry's chronic discrepancy between promise and practice. While one reader may take the fact-based case studies presented here to support a petropolitical interpretation of petroleum development, another reader may apply the same information to a different understanding of social activity; in any event, these case studies are fact-driven and therefore stand alone.

In sum, the principal purpose of this web site is to gather in one place many of the basic facts regarding the environmental impacts and economic results of oil development in Alaska and testified in the TAPS property tax case that after Conoco, Inc., traded its North Slope properties to BP and left Alaska in 1993, the company's Chairman and CEO, Archie Dunham, declared:

> "We traded all our Milne Point properties in Alaska to BP). It broke my heart to trade Milne Point, but we had to do it. All the value of that property was taken away from us in the pipeline tariffs." ***[7]***

(Read More: click here.)

elsewhere - information that industry and government prefer to ignore or to spin. Using case studies presented with fidelity to reason and factual accuracy, FinebergResearch.com brings to public attention information about economic and environmental issues related to petroleum development that is not readily available elsewhere.

[October 16, 2012 Update]

As major oil producers, the governor and citizen supporters attack legislators who oppose the proposed major cuts in the state's oil tax, ***Fineberg reviews ConocoPhillips (CP) SEC reports revealing that since Alaska adopted a cost-based, progressive production tax regime in 2006: (1) CP has made steady profits from Alaska, in contrast to mixed returns elsewhere, while (2) CP anticipates Alaska under the present tax regime will remain CP's top performing region.***

"Oil profits weather 'Hurricane' - ConocoPhillips expects Alaska to outperform every other oil province," *Fairbanks Daily News-Miner,* Oct. 14, 2012 (Community Perspective); and
"ConocoPhillips does fine under ACES regime," *Anchorage Daily News*, Oct. 14, 2012 (Compass).

[May 2012 posting]

Richard Fineberg's earlier comments and observations on the Alaska State Legislature's 2011 and 2012 petroleum taxation and fiscal policy deliberations:

Establishing a Rational Foundation for Review, Formulation and Implementation of Alaska's Oil and Gas Fiscal Policy, April 7, 2011 [rev. April 2012], 79 pages.

Letter to Senator Bert Stedman, Co-Chair, Senate Finance Committee, April 2, 2012 [rev. April 7, 2012], 21 pages (includes March 22, 2012 testimony on HB 9).

Letter to Senator Joe Paskvan, Chair, Senate Resources Committee, April 9, 2012, 5 pages.

"Solid info critical to resolving oil economics," *Anchorage Daily News,* April 21, 2012 (Compass).

"Aches, pains and oil taxes: The weaknesses in governor's plan were coming out," *Fairbanks Daily News-Miner*, May 6, 2012 (Community perspective).

Adding "H" to ACES, You Get ACHES & Pains . . .
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How Profitable Is Oil, and Who Gets It?

Mysterious Oil Numbers Tell A Troubling Story in Juneau: Adding "H" to ACES, You Get ACHES (Alaska's Confusing, Hidden and Elusive Share) and PAINS (Piecemeal, Artificial, Incomplete Number Systems)

Bad Numbers, Legislative Stalemate

By Richard A. Fineberg
May 8, 2012
(Posted May 8, 2012)

ACHES (Alaska's Confusing, Hidden and Elusive Share) and PAINS (Piecemeal, Artificial, Incomplete Number Systems) . . .
(Continued from Home Page)

While senators were methodically identifying important background information on North Slope petroleum history, intriguing new developments were demonstrating the need for the same kind of careful examination and analysis of current Alaska petroleum development issues and proposals. For example:

- " In the recent TAPS property tax case decision, it was revealed that BP had withheld as confidential its 2005 findings that TAPS could handle throughput levels far lower than those claimed by Alyeska, the TAPS operator, in which BP holds a dominant 47% ownership share. undermines the credibility of TAPS officials who testified to the House in 2011 that immediate action was necessary to counter critical low throughput problems on TAPS. This disclosure demonstrates the importance of ensuring that the veil of confidentiality does not deny policymakers the information necessary to set future development policies. ***[8]***
- During careful questioning of data presented by the Legislature's own consultants and the Revenue Department, it became evident that both presenters were substituting an illusory nominal 35% federal income tax rate for the lower effective rates at which corporations actually report and pay. their federal income tax. A study of corporate tax breaks prepared by two Washington, D.C. tax analysis groups reports that oil companies pay significantly lower rate, on average, than the nominal 35% rate. In light of this distinction, it is difficult to accept the resulting outputs as an accurate basis for formulating tax policy. ***[9]***

- ConocoPhillips is in the process of selling its refinery holdings; trade analysts note that the refineries are notably less profitable than the company's production properties, and some analysts recommend against buying them. However, the company is keeping its ownership stake in TAPS. ***[10]***
- The plan to build a natural gas pipeline through Canada pipeline to carry natural gas to the Lower-48 is presently being converted to an all-Alaska pipeline connection to an in-state port for natural gas shipment to Asia. ***[11]*** If the state had not bet on the wrong horse in the 2008 special session, Alaska could have been working on this plan for the last three years.

Lessons about the difficulties figuring out the future of the volatile natural gas industry were lost on the House leadership as HB9 romped through the House like a runaway stagecoach in an old Western movie. Despite the history of poor state performance in the natural gas arena, HB 9 would increase the chances for another natural gas failure by elevating confidentiality, eliminating transparency, eroding checks and balances and eviscerating judicial review.

Meanwhile, the shortened, 90-day session rules were setting the stage for unhealthy late-session compromise legislation. When a political agreement did not materialize, the Governor, pushing for replacement legislation similar to HB 110, called for another special session. As the 2012 special session began, the Legislature cleared the deck to focus on oil and gas by unanimously approving the only unrelated bill, which strengthened penalties for sex trafficking, But the Governor's new oil tax bill failed to generate enthusiasm from any quarter; even allies of the Governor criticized the confusing bill, while the Department of Revenue unable to answer critical questions about the bill, offering the Governor only weak support. The Governor, blaming Senate inaction, withdrew his revised oil tax bill and the special session surprisingly ended in confusion. ***[12]***

In the aftermath of the session demise, some veteran observers castigated legislators for failure to take action. For example, on the Alaska Edition weekly television news commentary April 29, which devoted more than two-thirds of its time to the demise of the special session, veteran reporter Steve MacDonald (KTUU-TV, Anchorage) was asked to comment on the idea that complexity was overwhelming the Senate in Juneau. In response, MacDonald opined:

> "Then maybe they need to get out of the Legislature. Because these are the folks that we elect to go down and make these kind of decisions, and if it's too hard for them, then maybe they'd better find another job. This is what the people putt hem down in Juneau for. Simple as that. They can't point fingers. . .There are people's whose lives are really on the brink of disaster because of high energy prices."

When moderator Michael Carey pointed out that the oil legislation dealt with shares of petroleum net revenue - not with what consumers pay for oil and gas, MacDonald responded by continuing to hammer on alleged legislative indecisiveness. He acknowledged that if the Governor's tax bill passed, that would result in

> ". . . . one to two billion dollars worth of revenue that comes out of the economy that will go to the oil companies . . . that could be] used to fuel construction jobs. . . [so] it's not an easy choice. But somebody's got to make

> a choice, they got elected to do it. They had 30 days to seriously concentrate on this issue. And they've had *experts*, they've had *studies*. What more do they want?" ***[13]***

In fact, some senators did want something more. When the Senate Resources Committee sent SB 192 to the Finance Committee, the bill contained provisions establishing a new Petroleum Information Management System (PIMS), whose purpose was "to collect, secure, distribute, store, retrieve, and archive information related to oil and gas exploration, development, and production in the state." PIMS was intended to be accessible to the public and was intended to improve the administration of the oil and gas production tax and to facilitate development. The Resources Committee gave responsibility for the new agency to the Alaska Oil and Gas Conservation Commission (AOGCC). ***[14]*** The Senate Finance Committee reassigned the new agency to the Revenue Department, but Revenue Commissioner Bryan Butcher said he would rather not accept that responsibility because his department was already overworked implementing regulations for the tax system while trying to complete audits and establish the automated revenue collection system. ***[15]*** Unwanted by some and lost in the legislative shuffle, the fate of the short-lived PIMS proposal serves as a reminder of the importance of accurate, comprehensive and clear petroleum numbers - and of the difficulty in obtaining those numbers.

Although MacDonald was correct that the Legislature did not addressed the serious hardships that Alaska bush and urban interior residents are experiencing due to high energy prices, the oil tax plan dealt with problems in a different arena (as Carey pointed out). While castigating the Legislature for inaction, MacDonald failed to recognize that the Senate, despite the irrational tenor of the times, fulfilled a high public service in two ways: (1) seeking better historical information and better data to put petroleum development issues into proper perspective, while (2) refusing to be stampeded into supporting bad bills.

Endnotes

(1) Patti Eppler, "Stevens: Parnell's hurry-up oil tax approach bad for Alaska," Alaska Dispatch, April 11, 2011.

The House Speaker and his cohorts, who frequently warned that that the state was "facing the specter of having the trans-Alaska Pipeline system close down," were so eager to move HB 110 that they ignored the counsel and sagacious questions of their own Resources Committee Co-Chair, Rep. Paul Seaton, whose arguments against HB 110 can be found in a Nov. 29, 2011 slide presentation, "ACES or NOT: Flaws in the HB 110 Approach to Reinvestment," on the House majority's home page. *[Sentence added May 15, 2012.]*

(2) CSHB 9(FIN) am passed the House March 27, 2012.

(3) CSHB 110(FIN) passed the House March 31, 2011; CSSB 192(RES) CSSB 192(RES) passed the Senate Resources Committee March 5, 2012; CSSB 192(FIN) passed the Senate Finance Committee April 11, 2012 but landed in legislative limbo and was referred to the Rules Committee April 12, 2012.

(4) The $34.7 million capital appropriation for a commercial, off-the-shelf (COTS) tax revenue management plan was authorized in the 2011 capital budget, enacted during the special session (Ch. 5, FSSLA 2011 [HCS CSSB 46[FIN]; project reference no. 52485), approved and transmitted by the Governor June 29, 2011.

(5) For a typical press account of confusion about tax credits, see: Alex deMarban, "Alaska oil tax credits:

Where have all the billions gone?" Alaska Despatch, Feb. 3, 2012.

(6) See: "Decision following Trial de Novo," in *BP Pipelines (Alaska), Inc., et al. and Fairbanks North Star Borough and City of Valdez (Appellants and Cross-Appellants) v State of Alaska Department of Revenue, et al. (Appellees)*, Case No. 3-AN-06-08446 CI (Consolidated), Alaska Superior Court, Dec. 30, 2011 (2007, 2008 and 2009 Assessed Valuations of the Trans Alaska Pipeline System), 502 and 505 (reproduced by attorneys Robin Brena and Craig Richards, "Senate Resources Committee Presentations," Feb. 6-8, 2012, slides 52 and 58).

(7) "Getting to the Future First" (interview with Archie Dunham), Hart's Oil & Gas Investor, August 1996, p. 41. Cited by Charles J. Cicchetti, "Expert Report of Charles Cicchetti, Ph.D.," March 7, 2011, pp. 29-30 (in *BP Pipelines [Alaska], Inc., et al. and Fairbanks North Star Borough and City of Valdez [Appellants and Cross-Appellants] v State of Alaska Department of Revenue, et al. [Appellees]*).

(Three years after Dunham's statement on TAPS, during ARCO-BP merger deliberations, the Conoco CEO was asked whether he would be interested in returning to Alaska. Not without a share of TAPS, he replied. Dunham did return to Alaska - merging with Phillips Petroleum shortly after that company acquired ARCO's Alaska properties, including the second largest ownership share of TAPS.)

(8) See: "Decision following Trial de Novo," 406, 408 and 412 (reproduced by attorneys Brena and Richards, slides 65-67); and Dermot Cole, "Court ruling makes Alyeska low-flow study look more like a political document," *Fairbanks Daily News-Miner*, Jan. 3, 2012.

(9) For background, see: Robert S. McIntyre, et al., Corporate Taxpayers & Corporate Tax Dodgers, 2008-10 (Citizens for Tax Justice and Institute on Taxation and Economic Policy), November 2011, passim. For a summary of the nominal v. effective federal income tax rates, see Richard Fineberg, "Aches, pains and oil taxes: The weaknesses in governor's plan were coming out," *Fairbanks Daily News-Miner* (Community Perspective), May 6, 2012.

(10) See: Christopher Helman, "As ConocoPhillips Spins Off Refining Assets, Think Twice Before Buying The New Phillips 66," *Forbes*, April 30, 2012.

(11) Becky Bohrer, "Decision expected on request by TransCanada to alter gas line," *Anchorage Daily News*, April 4, 2012.

(12) Office of the Alaska Governor, "Governor Removes Oil Tax Legislation from Special Session Call," April 25, 2012 (Press Release No. 12-055).

(13) Michael Carey (Host), "The Special Session; and a New Film Incentive Credit Bill," *Alaska Edition*, April 27, 2012 (http://www.alaskapublic.org/2012/04/27/the-special-session-and-a-new-film-incentive-credit-bill/).

(14) CSSB 192(RES) (Work Draft 27-LS1305\E, March 1, 2012.

(15) See: Alaska Department of Revenue, "Comments on CSSB 192 (FIN) Work Draft 27-LS1305\O" (Presentation to the Senate Finance Committee), April 6, 2012, Slides 8 and 9.