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STATE OF ALASKA
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Dear Resource Development Council Member,

I welcomed the opportunity to participate in this year's Meet Alaska Energy Conference and to share with you my recent announcement about positive, administrative changes to the Economic Limit Factor (ELF). Due to my administration's action, effective February 1, 2005, the tax regime that will apply to Prudhoe Bay and six of its satellites will be consistent with how their owner's actually operate and administrate them.

The purpose of the ELF was to encourage companies to continue to operate marginal fields which, absent this incentive, would be shut down or perhaps never drilled because of the field's economics.

While the math of the ELF can be complex, the underlying concept is simple: Every field has an economic limit, which is a proxy for operating costs. Production below the economic limit is not taxed, thereby allowing a producer to recover its costs. If a field has production above the economic limit then the tax kicks in. If a satellite field has an ELF of zero, that implies that all the production is needed to recover costs.

The Department of Revenue's (DOR) decision recognizes that for Prudhoe Bay satellites, an ELF of zero overstates the proxy costs. The situation is much like a taxpayer who claims expenses of $7, which upon audit are shown to be only $3. The DOR was given the statutory authority to make these adjustments to make sure that the proxy cost deductions don't get too far out of line from the intended cost deductions.

Currently 51 percent of all North Slope barrels are free barrels to pay no tax to the state. By 2042 over 81 percent of all North Slope barrels will not be taxed under the current ELF formula.

Because it is my administration's goal to get Alaska oil to market, I support the intended purpose of ELF to enable companies to produce sufficient oil to recover costs from an individual field before taxes are paid to the state on the remaining oil. It is our policy is to make certain that taxes are never a reason to shut down a field.

However, ELF was never intended to provide tax breaks to profitable fields. This decision does not change ELF – just its application to six fields near Prudhoe Bay that now are being operated as one. This consolidation was determined by the owner companies.

Borealis, Midnight Sun, Orion, Polaris, Point McIntyre, and Aurora are not remote satellite fields. They are integrated into the Prudhoe Bay Production facilities and are collectively managed and viewed by the oil companies as a single robust field. My approval of the DOR decision simply mirrors how the oil companies are treating these fields – as a single production unit. Other fields such as Kuparuk and Alpine are not affected by this decision.

It has been 15 years since ELF was last modified. Reflecting my concerns I directed a review of how ELF was operating under existing statutes. I met with the producers in November specifically to ask that they propose a solution in helping us modify the application of ELF. Their trade organization, the Alaska Oil and Gas Association, responded in a letter dated December 16, 2004, that there should be no change. In light of their letter I agreed that this administrative change was appropriate based on the information we had. I contacted each major producer prior to the ELF announcement.

Under our constitution, I have a responsibility to the Alaska people to ensure Alaska is paid its fair share of resources that are extracted. The producers are not without recourse. I have invited them to show DOR any information which they may possess which shows the DOR's decision was wrong or misapplied.

Another important consideration for Alaskans is that the owners of TAPS have proposed a 20 percent increase in the TAPS tariff for 2005. This increased charge imposes, on average, a 64 cent charge on every barrel of oil shipped through TAPS by any company who doesn't own a piece of the pipeline. Every state royalty barrel and every independent producer's barrel now faces a higher cost hurdle. If unchanged, this decision alone will cost Alaska over $60 million by the end of next year. This is hardly consistent with the argument that any additional charges borne by North Slope crude will simply price it out of the market.

Moreover, there is absolutely no excuse for shutting down a field based on the ELF adjustment. The first satellite field, Point McIntyre, began operating in FY1994 when oil was $14 per barrel. Oil is currently more than $40 per barrel. Alaska is a competitive investment target. The recent decision to update ELF does not change that. The DOR was correct in its recommendations on adjusting the ELF application.

Finally, I continue to be ready to review any proposal to modify ELF and other incentives to increase oil exploration, investment and oil flow through TAPS – as long as it's right for Alaska.

Sincerely yours,

Frank H. Murkowski
Governor