STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE of the COMMISSIONER

FRANK MURKOWSKI, GOVERNOR

State Office Building
PO Box 110400
Juneau, AK 99811-0400

Telephone : 907-465-2300
Fax : 907-465-2389

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The Honorable Lyda Green
Alaska State Capitol, Room 516
Juneau, Alaska 99801

Dear Senator Green:

Yesterday Senator Wilken asked whether the Governor's Op Ed (attachment one), "changed the rules" by pointing out the risk the Legislature faced of losing the gasline by going above the 20 percent Petroleum Production Tax (PPT) rate which the Governor negotiated with the Producers' Chief Executive Officers (CEOs). I asked if I could respond in writing so that I could carefully separate out the **agreement** which the Governor reached from the **process** the Administration has proposed for securing that agreement.

The Agreement

On February 21, 2006 the Governor announced that the Producers had agreed to his proposal to change the Economic Limit Factor (ELF-based) production tax to a net production tax with a tax rate of 20 percent and a credit of 20 percent. In addition the CEOs agreed to move forward with the gasline agreement which had been reached with the Producers on February 18, 2006—including the economic terms of the Gas Contract.

Obtaining agreement to the 20 percent tax rate, which was first proposed to the Producers in August 2005, was the culmination of a consistent, determined effort by the State negotiating team. We never changed the 20 percent tax rate. The Governor increased the tax credit proposal from 15 percent to 20 percent because he wanted to enhance the opportunity for investment due to his concern about the six percent per year rate of decline of oil flow in the Trans-Alaska Pipeline System (TAPS).

The Administration has never been in doubt that the 20 percent tax rate is a ceiling as far as the Producers are concerned. Unfortunately it has been perceived by some in the Legislature as a floor from which to increase the tax rate. It is in fact a safe harbor by which Alaska is assured of moving forward on the gasline project and having a significant increase in the production tax. In the words of the old spiritual by "drifting away from the shore" of the safe

harbor we risk the gasline. For the reasons described in the Governor's Op Ed, this risk is not worth the "reward" of what we believe will be a short-lived, incremental increase in revenue from a higher tax rate. It will not maximize the return from Alaska's resources as the Constitution commands us to do.

The Process

Attachment two is a diagram showing the process. The first step is stand-alone legislation, which changes severance tax policy from the current ELF structure. This new tax policy needs to be good for the State with or without the gasline. The second step is authorization to place fiscal certainty on oil into the gasline contract (assuming you grant the Administration such authority.) The third step is for the Legislature to consider ratifying the gas contract with oil fiscal certainty included. By oil fiscal certainty, I mean that the law setting out the tax policy for severance taxes (which maybe amended in step two) is locked in for the term agreed to in the contract.

This process resolves the chicken and egg problem, with which we were faced. We could not put out the contract without including fiscal certainty on oil. But until you granted us the authority to negotiate fiscal certainty on oil, we could not put out the contract. By fixing the tax policy and then getting authority to negotiate fiscal certainty on oil based on that policy, we have resolved the chicken and egg problem.

In conclusion, the Administration has been very transparent on this;

1. the Governor announced the 20-20/gasline package agreement on February 21, 2006 and has repeated on numerous occasions that this was the agreement, and
2. the process for securing this agreement has been discussed with Legislature and discussed publicly and with the press on numerous occasions.

Thank you for your consideration.

Very truly yours,

Bill Corbus
Commissioner