CONFUSION AND THE POWER OF ALASKA'S THREE MAJOR NORTH SLOPE PRODUCERS

Do Alaska's Big Three Oil Companies Deliberately Confuse the Public to Increase Oil Profits by Reducing Taxes? (And what does this updated analysis tell us about the consolidation and conduct of the three major companies that produce more than 90 percent of Alaska's North Slope oil?)

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This updated article makes two fundamental contributions to the understanding of Alaska North Slope petroleum economics by (1) condensing the lengthy piece, "The Power of the Big Three: A Case Study on Petroleum Development in Alaska," posted on this web site on June 6, 2016, and (2) sharing, from a variety of perspectives, an extensive analysis of the March 26, 2016 issue of The Economist, a British magazine that criticized the U.S. acquiescence to this nation's abuses of corporate power. -- RAF

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On six separate occasions in the oil industry's successful 2013 campaign to replace Alaska's progressive state petroleum income tax with a reduced flat tax, North Slope oil producer ConocoPhillips presented legislators with a misleading chart that lent false support to the suite of slides that the company was sharing with legislators. ConocoPhillips, which is one of three major North Slope producers that together account for more than 90 percent of North Slope oil production, bills itself as Alaska's oil and gas company. For this reason, it is surprising that the company's erroneous chart, mislabeled and unsupported by hard data, was repeatedly distributed, incorrectly showing industry shares of total revenues diminishing at state expense as current oil prices increased from $80 to $130 per barrel. This misleading chart contributed to the confusion that helped ConocoPhillips push its flat tax through the state Legislature, increasing the company's remarkably profitable North Slope operations. The following year, when the new state oil tax was challenged in 2014 in a statewide referendum, British Petroleum -- the North Slope's second major producer -- created additional public confusion with inaccurate data in frequently repeated television advertisements. That was the second successive year that misinformation repeatedly distributed by one of the three major North Slope producers helped these three production leaders – ExxonMobil, ConocoPhillips and British Petroleum --- preserve their profit increase.

This repeated profit misinformation, documented in reports on this web site, strongly suggested that the major producers may have been deliberately creating confusion to increase their profits from their consolidated control of North Slope operations. But in this remote state, the dubious conduct of the major North Slope producers that misreported basic facts to the public has been largely ignored. For this reason, it is not altogether surprising that this state was not mentioned when the British magazine *The Economist* recently took the United States government to task for favoring large corporations in its "special report on big data, social media and politics," published in its March 26, 2016 issue. While that magazine made no reference to Alaska, some of the British magazine’s conclusions on this subject had much in common with the Alaska case study on petroleum development.

This analysis does not offer the general statements of *The Economist* as proof of the validity of the Alaska case study conclusions. Case study documentation has previously been presented on this web site, which has demonstrated the validity of its conclusions by using accurate data and assuring readers that relevant facts are understood in proper context (see, for example, “The Power of the Big Three: A Case Study on Petroleum Development in Alaska”). For these reasons, the Alaska case study may be viewed as support for British journal observations that appear in that magazine’s critique of this country’s national economic system.

Following its introductory overview, the original case study began with the following four background questions:

- Does the Alaska state fiscal system fail to produce information on production profits that is conducive to public understanding?
- Is the North Slope corporate enterprise profitable for its producers?
- From the standpoint of public policy, do the major producers use their consolidation and economic power to promote passage of new laws that would enhance their profitability?
- Do the three major North Slope producers also use their ownership of the Trans-Alaska Pipeline System (TAPS) to reduce their reported net profits (and therefore the taxes they must pay), to the detriment of both the state and their competitive North Slope producers?

The answer to each of these four questions was “yes,” and each response was accompanied by detailed explanations. The lessons of this Alaska case study pointed to conclusions based on a research methodology that places information in proper perspective by distinguishing facts from unsupported generalities. In addition, the facts reported in this case study indicated the need for careful consideration of the economic structure that has put more than 90 percent of

North Slope production in the hands of three major oil companies that also own a similar percentage of the Trans-Alaska Pipeline System, known as TAPS. The overlapping ownership of production facilities and the pipeline transportation of that production underscored the importance of pipeline tariff overcharges.

The current Alaska financial crisis began when oil prices crashed in 2014, but the state Legislature has yet to adopt adequate measures to reduce the annual budget deficit, now estimated at approximately $3.2 billion per year. Most recently, at the end of June Republican Governor Bill Walker announced that he was once again calling the Legislature back to special session to deal with his proposals for budget reductions and new revenue sources. This state is still currently mired in the precedent-setting fifth extension of the regular 90-day legislative sessions that began in January 2015 and January 2016.

This summary review of Alaska's petroleum development history and the state's unusual economic structure seeks to cut through political confusion and legislative paralysis by focusing on the overlooked fiscal effects of the consolidation of North Slope petroleum production and pipeline transportation. As oil prices soared for 15 years before the 2014 global oil price crash, Alaska and its three major oil producers took in big bucks. As noted above, these transnational companies controlled more than 90 percent of the state's oil production from the Prudhoe Bay field and reaped additional profits from their ownership of TAPS. Described when it was built as the world's largest privately financed construction project, TAPS dealt with the harsh northern climate while carrying oil over spectacular mountains and fast-flowing rivers on the 800-mile journey from the North Slope to the port of Valdez.

Because pipeline tariffs (shipping charges) were a part of the petroleum production costs, under Alaska's unusual North Slope consolidation excessive TAPS tariffs reduced the industry tax payments to the state and also handicap competition from other North Slope producers. Over the years, TAPS tariff overcharges by the major producers have been a frequent subject of litigation.

But when Alaska's recent petroleum revenue problems were considered by public officials at the end of 2015, discussion of the North Slope petroleum industry's consolidated corporate structure and the tariff overcharges were missing from state petroleum policy deliberations. This review of Alaska petroleum development points to the need to fill this gap by introducing readers to the significance of Alaska pipeline tariff overcharges. These highlights will also demonstrate the lesson that the complexities of petroleum development may require researchers to look beyond prominently displayed press accounts and historical studies to find facts, statements and background information that are pertinent to public policy but are not readily available in this era of information overload.

In an early historical example of a significant statement on TAPS problems that was ignored in Alaska, in 1997 Conoco Oil company veteran Archie Dunham told an interviewer with *Hart's Oil & Gas Investor* why his company had traded its North Slope Milne Point field to British Petroleum and left Alaska at the end of 1993. According to Dunham, who had just been promoted to serve as president of that company:

> 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. It was a valuable strategic lesson.

In 2007 -- ten years after Dunham's statement -- economist Joseph Stiglitz vociferously complained about industry cheating in Alaska. His published reference to pipeline tariff overcharges was more specific than Dunham's. Moreover, six years earlier Stiglitz had been awarded a Nobel Prize for his research on problems he attributed to asymmetrical information that handicapped individuals, competitors and developing nations in their dealings with industry. In his introductory chapter to the 2007 publication of the book *Escaping the Resource Curse*, which he co-edited with two Columbia University colleagues, Stiglitz reported that major oil company producers in Alaska were supposed to share their gross receipts with the state government but were not playing honestly. Here is an excerpt from this Nobel Laureate's overlooked statement about Alaska:

> By overestimating their costs by just a few pennies per gallon (and multiplying those pennies by hundreds of millions of gallons) the oil companies would increase their profits enormously. They could not resist the temptation. They also found other ways to cheat, such as selling their oil to their own subsidiaries, recording a lower than fair market value … or using other subsidiaries to ship their oil out and then reporting fictionally high shipping cost.

Noting that expensive and time-consuming investigations led to a series of delayed settlement payments in excess of six billion dollars from major North Slope oil producers, Stiglitz concluded that in Alaska "there was no doubt that cheating had occurred."

In the following year, Alaskan academics apparently failed to recognize the distinction between specific facts and generalizations and overlooked the documented evidence on North Slope consolidation and profitability. They also ignored the views of Nobel Laureate Stiglitz on this subject. The opening chapter of their book, *The Political Economy of Oil in Alaska: Multinationals vs the State,* featured a section titled, "Alaska: The Exception that Proves the Rule?" This rhetorical homage to Alaskan exceptionalism depended on the phrase that at least two distinguished authors -- Sir Arthur Conan Doyle (in the words of Sherlock Holmes) and Ambrose Bierce (in *The Devil's Dictionary*) – had previously ridiculed for linguistic abuse of the words "prove" and "rule." While the documented court evidence on tariffs can be difficult to follow because the legal cases typically involve prior-year tariff filings and court decisions don't get made until subsequent challenges and their opposing views can be reviewed, numerous legal decisions ruled against the TAPS pipeline owners. Nevertheless, the academics failed to observe that the state had frequently failed to protect the interests of independent shippers from the major North Slope petroleum firms that were getting rich from North Slope development.

Two years later, in 2010 Sean Parnell was elected to the governor's office after filling in for more than 16 months as chief of state after Sarah Palin had resigned from her elected position. From his new position as chief of state, Parnell, who had a history of close ties with ConocoPhillips, launched a campaign to cut the Alaska's tax on the oil industry. During 2011 and 2012 the state senate blocked Governor Parnell's efforts to secure tax cuts for industry producers. One of the leading opponents of Parnell's proposed tax cut and a defender of the progressive ACES tax regime the Legislature had adopted during Palin's special session was Democrat Senator Joe Paskvan, a hard-working attorney from Fairbanks who had developed strong information on behalf of the state as co-chair of the Legislature's Resources Committee. Paskvan and Senator Joe Thomas, another Fairbanks Democratic tax cut opponent, lost their seats in the 2012 elections and the leadership of the senate changed hands, improving the prospects for Parnell and the industry to enact an Alaska tax cut proposal to replace ACES.

In 2013 and 2014 the major North Slope producers provided significant funding, first to enact and later to defend the tax cut under Senate Bill 21 (SB 21), which favored producer interests by greatly increasing industry's share of profits at rising prices with a profits-based production tax at low prices that would replace the state's progressive ACES oil profits tax with a flat tax at higher prices. As noted above, while the Legislature debated this tax cut proposal in 2013, ConocoPhillips presented the highly misleading bar chart on industry profitability to committees in both state houses on six separate occasions. The following year, when the newly passed SB 21 was challenged in a statewide referendum, much of the 2014 campaign money was spent on television advertising, in which British Petroleum repeatedly ran an inaccurate television advertisement. The successive distributions of misinformation in 2013 and 2014 during the successful campaign to cut oil taxes raised questions concerning the conduct of the major North Slope producers that warrant further consideration.

The seriously flawed and misleading chart unveiled in the 2013 ConocoPhillips suite of slides was not the center of the industry campaign. Nevertheless, that slide was repeatedly presented to legislative committees of both houses. This erroneous document, with its diminishing green swath at the top of 13 mislabeled bars of equal height, created the exaggerated and false impression that industry production profits declined steadily and dramatically at state expense under ACES when oil prices increased from $80 to $130 per barrel. In fact, however, the opposite was the case. Although oral testimony on this chart was technically accurate on carefully selected elements, the chart itself was poorly labeled and lacked comprehensive data on industry production costs, taxes and profits for the prices shown. For this reason, it was not immediately evident that the diminishing green swath did not match the Department of Revenue data that ConocoPhillips had cited in the misleading chart. Uncorrected in each of its several presentations, this misleading ConocoPhillips graphic overview helped ConocoPhillips replace the progressive ACES tax with a flat tax, even though ACES was already giving the industry numerous tax breaks and was not eating up all the industry profits at real-world prices.

In distributing this chart on repeated occasions, ConocoPhillips was taking advantage of the ambiguity of the term “Marginal Share” of government and industry production returns, which appeared at the top of the chart without definition. The term “marginal” generally refers to relatively small cash increments, but as used in the oil patch this term also refers to the entire difference between the market price of a barrel of oil and that barrel’s costs of production and transportation – a much larger sum of money. At the left side of the misleading ConocoPhillips chart, the bars were identified as percentages of the “Marginal Share.” But the figures shown beneath the vertical bars were incorrectly identified as representing the “ANS West Coast Oil Price,” with oil prices increasing at five-dollar per barrel intervals, from left to right, from $80 to $130 per barrel. Notably missing from this chart was a clarifying label that would have informed readers that the term “marginal share” actually represented only a

$1 per-barrel price increase -- not the entire “ANS West Coast Oil Price” per barrel. And at the bottom of the chart, the mislabeled vertical bars incorrectly appeared to represent the gross value and total profits per barrel -- not the marginal $1 per barrel price increase, which was only a tiny fraction of the total profits earned at increasing prices. Further contributing to misimpression, the vertical bars were labeled as representing the ACES “Progressivity effect.” Each bar showed the state share in red, increasing from left to right as oil prices rose to fill almost all of the last bar on the right, which was incorrectly labeled as representing total revenues at $130 per barrel, rather than marginal profit revenues.

The diminishing green swath at the top of each bar in this chart represented the industry share, which dropped steadily from left to right, with the industry share falling from roughly 30 percent of the left-hand bar to approximately 10 percent of the right-hand bar. Due to the mislabeling of these bars, this green swath graphically created the false impression that industry oil prices fell as oil prices rose under the progressive ACES tax regime. As noted above, however, the opposite was the case because the chart’s vertical bars represented additional marginal revenue available as oil prices increased. Each time that chart was presented, the company’s economic specialist told viewers what the chart showed at various prices. But he failed to explain why ConocoPhillips thought the declining marginal revenue percentage – which actually represented an addition to the industry’s per-barrel revenue – was important. Consequently, the improperly labeled chart formally made the rounds electronically, with the diminishing green swath at the top of each bar creating confusion by falsely indicating that the industry was receiving less money as oil prices increased, when the opposite was the case.

The following year, when the newly passed SB 21 was challenged in a statewide referendum, much of the 2014 campaign money was spent on television advertising, in which producing partner British Petroleum repeatedly ran an inaccurate television advertisement. Although 2014 marked the second successive year that major North Slope producers had plagued Alaska with frequently repeated misinformation, that year was so tumultuous for Alaska that this erroneous reporting was scarcely noticed in this state. British Petroleum began that year by inundating the television airwaves with an erroneous piece of historical information on oil production in its advertisement aimed at supporting the SB21 oil tax cut, recently passed by the Legislature and up for reconsideration in a statewide referendum scheduled for August 2014.

According to press reports, in this campaign the petroleum industry outspent the tax cut opponents by 20 to 1 to preserve the tax cut at the polls by the relatively narrow statewide voting margin. The British Petroleum television advertisement began with this inaccurate statement by one of its North Slope workers:

> Twenty years ago two million barrels a day flowed down the pipeline. Today it's about five hundred thousand.

In fact, state records show that twenty years earlier the amount flowing down the pipeline, which had been decreasing for several years, was actually 1.56 million barrels per day – approximately 22% less than the peak of 2.01 million barrels per day, which had occurred seven years earlier.

In preparing this erroneous television advertisement, British Petroleum apparently chose its featured speaker carefully; the company's advertising representative was Frank Paskvan, a British Petroleum North Slope employee who was the brother of former Alaska Senator Joe Paskvan, who had developed facts in opposition to oil tax cuts until the industry managed to defeat him in the 2012 election. In contrast to the careful selection of the British Petroleum speaker, the factual inaccuracy of this frequently repeated British Petroleum advertisement raised this question: Were the major North Slope oil producers simply sloppy in their failure to check the facts in their campaigns, or were they deliberately distributing misinformation to create confusion to weaken opposition to their proposed tax cut? Since 2014 was the second successive year in this campaign that a major North Slope producer had repeatedly distributed public misinformation, it is reasonable to conclude that the latter is the case.

These web site reports on petroleum development in Alaska help put various Alaska state issues into appropriate perspective by focusing on the economic consolidation of Alaska's three major North Slope oil producers, and their dubious conduct. Although the British magazine looked at other national aspects of U.S. policy but did not mention Alaska, facts in the Alaska case study provide further support for the general observations that *The Economist* published in its March 26, 2016 articles when that magazine criticized this nation's acquiescence to U.S. corporate abuses of power. The Alaska case study observations are based on documented information that was gathered over decades of first-hand experience and presented on this web site and does not depend on the British magazine general statements.

In light of this understanding, some of the British magazine's general statements receive further support from Alaska case study information. Sample extracts from some of these magazine statements follow:

- "If steep earnings are not luring in new entrants, that may mean that firms are abusing monopoly positions, or using lobbying to stifle competition."
- "Unfortunately…incumbent firms are becoming more entrenched, not less. Microsoft is making double the profits it did when antitrust regulators targeted the software firm in 2000….A tenth of the economy is at the mercy of a handful of firms—from dog food and batteries to airlines, telecoms and credit cards…. Few plan to pass the gains on to consumers."
- "Getting bigger is not the only way to squish competitors….[since 2007-08] the task of navigating bureaucratic waters has become more central to

firms' success. Lobbying spending has risen by a third in the past decade, to $3 billion….And new regulations …keep rivals out."

- "Having limited working capital and fewer resources, small companies struggle with all the forms, lobbying and red tape. This is one reason why the rate of small-company creation in America has been running at its lowest levels."
- "The role of giant fund managers with crossholdings in rival firms needs careful examination."
- "One way American firms have improved their moats in recent times is through creeping consolidation."
- "Concentrated industries, in which the top four firms control between a third and two-thirds of the market, have seen their share of revenues rise."
- "The ability of big firms to influence and navigate an ever-expanding rule book may explain why the rate of small-company creation in America is close to its lowest mark since the 1970s…. Small firms normally lack both the working capital needed to deal with red tape and long court cases, and the lobbying power that would bend rules to their purposes."

As noted above, each of these preceding comments closely reflects Alaska's experience with petroleum development, even though Alaska was not mentioned by the magazine. Moreover, the similarities between Alaska case study findings and the preceding observations in *The Economist* suggest that this web site's findings support the magazine conclusions.

Several of the other conclusions drawn by *The Economist* were apparently focused on national rather than state and local issues. For example, *The Economist* briefing article noted the relevant federal responsibilities were mostly divided between the Department of Justice (DOJ) and the Federal Trade Commission (FTC). For a variety of reasons, the magazine noted, that system didn't work well and "Americans' mistrust of their economic system and the companies that make so much money in it has so far been channelled into calls for protectionism and government intervention." Additionally, *The Economist* observed that "the industry is now suffering from low oil prices," and that "new commitment to competition could be the source of optimism that America is desperately searching for."

In evaluating the significance of this complicated picture of the British magazine's critical observations on the United States, it should be noted that the comments of March 26, 2016 issue of *The Economist* were carried in a publication whose cover featured a headline at the top of a cartoon, in which a pyramid of dollar bills appeared under the American flag. Above the cartoon the headline read, "Winners take all," while a subheading -- beneath the headline and just above the cartoon – displayed this message: "Why high profits are a problem for America." In putting all of these pieces together, this updated analysis concludes that the Alaska case study provides empirical support for the observations of *The Economist.*