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REVENUE AND TAXATION COMMITTEE

STATE CAPITOL, ROOM 2013
(916) 322-3730

WADIE P. DEDDEH
CHAIRMAN

INTERIM HEARING
OIL SEVERANCE TAXATION

WITNESS AGENDA

Thursday, October 15, 1981, 1:30 p.m. - 4:00 p.m., Los Angeles

Opening Statement,
Wadie P. Deddeh, Chairman, Assembly
Revenue and Taxation Committee

1. Assemblyman Tom Bates - Author (AB 1597)

2. Commissioner Gene Varanini
California Energy Commission

3. Dave Brainin
Department of Finance

4. Mason Gaffney, Professor of Economics
U. C. Riverside

5. Steve Archibald
Assembly Office of Research

6. Bob Gustafson
Board of Equalization

7. Steve Barrow
California Tax Reform Association

8. Jim DeMaras
California Independent Producers Association

9. Carl Nielson
MCO Holdings Inc.

10. Richard L. Fishman
Union Oil

11. Norma Mayfield
Government Finance Director
League of Women Voters of California

12. Tom Clarke
Getty Oil

13. Gene Tackett, Chairman
Kern County Board of Supervisors

6% gross well head

$500 ea

6% is deductible Fed

Guy Phillips involved

Cal has no severance tax

assignees Bates, Oakland

2/3 vote required

Intervim hearing

3 hr. hrg; 15 th

Tax incidence. Shifting.
(Cal. is a net importing state).

OCS oil

"1st use tax"

15th of Oct, 1-5

State Bldg. L.A.

Lenny 4

445-7554 Sacto.

464-0786 Oakland

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Assembly

California Legislature

THOMAS H. BATES
MEMBER OF THE ASSEMBLY
TWELFTH DISTRICT

CHAIRMAN
SUBCOMMITTEE ON MENTAL HEALTH AND
DEVELOPMENTAL DISABILITIES

October 6, 1981

Dr. Mason Gaffney
Department of Economics
University of California
Riverside, California

Dear Dr. Gaffney:

Thank you so much for your willingness to testify on the oil severance tax on October 15. I have enclosed a hearing notice and a packet of background material on Assembly Bill 1597.

The economics of oil severance taxation has not previously been examined by the Legislature. One bill has been introduced and discussed extensively which proposed to replace the current property tax on oil in the ground with a severance tax which would generate equivalent revenues. However, most of the discussion of that bill, which failed passage, focused on how to determine the appropriate tax rate, particularly since Proposition 13 confused the issue of assessments on oil in the ground, and on how to distribute the revenues generated by the tax. The committee and the Legislature have heard very little about the economics of the severance tax in general.

The issues which you may want to address include:

1. The incidence of the oil severance tax: Can it be shifted forward to consumers? Who will bear its burden within the industry (producers, royalty owners, refiners)?

2. The conceptual basis of a severance tax: To what extent is it a tax on unearned economic rents, and to what extent is it a tax on productive activity? Is natural resource taxation an appropriate way of replenishing a limited tax base in California?

3. The interaction of a state severance tax with federal tax law: What is the difference between the nominal rate and the effective rate for the producer? What effect on the tax position of the oil companies will the new federal tax bill have?

4. The effect of a severance tax on production of oil in California: To what extent will the severance tax affect production on the margin, under what conditions of oil production? Will the effect of rising prices on production counteract any negative affect of the severance tax? Generally, what is the ability of the industry to bear this additional tax?

5. The appropriate structure of a severance tax: Can some of the potential negative affects on production be avoided by exemptions for stripper wells, high cost recovery techniques, declining well productivity, etc.? Are there other ways of structuring a tax on oil which are better and can be defended as a tax on a resource rather than a "punitive" tax on a particular industry?

6. Empirical data from other states: What have been the effects and impacts of severance taxes on other western states, and what have been the most workable ways to structure the tax?

7. The possibility of taxing OCS oil: Can a "first use" tax be designed which would effectively tax OCS oil for California?

These questions are only meant to be suggestive. As an expert in the field of natural resource economics, you should feel free to define some of the issues as you see them. Also, given the relatively short notice until the hearing date, you are obviously not expected to be exhaustive, but rather, to contribute on the basis of your already extensive knowledge.

Again, I truly appreciate your willingness to participate, and I will be in touch with you before the hearing.

Sincerely,

Lenny Goldberg

Lenny Goldberg
Administrative Assistant to
THOMAS H. BATES
Member of the Assembly

LG:jds

Enclosure

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REVENUE AND TAXATION COMMITTEE

STATE CAPITOL, ROOM 2013
(916) 322-3730

WADIE P. DEDDEH
CHAIRMAN

September 24, 1981

MEMORANDUM

TO: COMMITTEE MEMBERS
INTERESTED PARTIES

FROM: ASSEMBLYMAN WADIE P. DEDDEH

RE: INTERIM HEARING NOTICE - OIL SEVERANCE TAX

The Assembly Revenue and Taxation Committee will hold a hearing on AB 1597 (Bates), on the subject of oil severance taxation, in Los Angeles on October 15, 1981. The particulars are as follows:

Subject: AB 1597 (Bates)
Oil Severance Tax

Date: Thursday, October 15, 1981

Location: State Building, Room 1138
107 S. Broadway
Los Angeles, California

Time: 1:30 p.m. to 4:00 p.m.

All persons wishing to testify at the hearing should contact Helen Jones, Committee Secretary, at (916) 322-3730 at least four days prior to the hearing. Any prepared testimony submitted to the Committee Secretary by October 1, 1981 will be distributed to Committee members in advance.

EW:al

AMENDED IN ASSEMBLY MAY 18, 1981

CALIFORNIA LEGISLATURE—1981–82 REGULAR SESSION

ASSEMBLY BILL No. 1597

Introduced by ~~Assemblyman~~ ~~Bates~~ *Assemblymen Bates, Berman, Floyd, and Kapiloff*
(Coauthors: Senators Greene and Sieroty)

March 25, 1981

An act to add Part 23 (commencing with Section 43000) to Division 2 of the Revenue and Taxation Code, relating to taxation, and making an appropriation therefor, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1597, as amended, Bates. Taxation: oil.

Existing law provides for a property tax of 1% of full cash value, as defined.

This bill would tax producers of oil at 6% of gross market value, as defined, for the privilege of severing oil, as specified, on an after January 1, 1983. The tax would be in addition to ad valorem property taxes or any yield tax imposed in lieu of an ad valorem tax.

The taxes would be deposited in the School and Services Fund in the State Treasury, which the bill would create, and would be continuously appropriated to the Controller for the payment of refunds and administration costs and allocation to local agencies and school districts, as specified.

Section 3 of Article XIII A of the Constitution provides that any changes in state taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by increased rates or changes in methods of computation must be imposed by an act passed by not less than ⅔ of all members elected to each of the 2 houses of the Legislature.

This bill would require a vote of not less tnan ⅔ of all

members elected to each house of the Legislature pursuant to Section 3 of Article XIII A of the Constitution.

The bill would take effect immediately as a tax levy.

Vote: ⅔. Appropriation: yes. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. Part 23 (commencing with Section 43000) is added to Division 2 of the Revenue and Taxation Code, to read:

PART 23. OIL SEVERANCE TAX

CHAPTER 1. DEFINITIONS

43000. This part shall be known and may be cited as the "Oil Severance Tax Law."

43001. Except where the context otherwise requires, the definitions given in this chapter govern the construction of this part.

43002. "Oil" means petroleum, crude oil, mineral oil, and casinghead gasoline.

43003. "Barrel of oil" means 42 United States gallons of 231 cubic inches per gallon computed at a temperature of 60 degrees Fahrenheit.

43004. "Person" has the same meaning as set forth in Section 6005.

43005. "Board" means the State Board of Equalization.

43006. "Month" or "monthly" means calendar months.

43007. "Producer" means any person owning, controlling, managing, or leasing any oil well and/or any person who produces in any manner any oil by taking it from the earth or water in this state, and shall include any person owning any royalty or other interest in any oil or its value whether produced by him, or by some other person on his behalf, either by lease, contract, or otherwise.

43008. "Oil production" or "total oil produced" means the total gross amount of oil produced including all royalty or other interest; that is, the amount for the purpose of the tax imposed by this part shall be measured or determined (a) by tank tables compiled to show 100 percent of the full capacity of the tanks without deductions for average losses in handling or (b) by meter or other measuring device which accurately determines the volume of "production" or "total oil produced."

43009. "Severed" or "severing" means the act of extracting or withdrawing from below the surface of the soil or water of any oil, whether the extraction or withdrawal is by natural flow, mechanical flow, forced flow, pumping, or any other means employed to get the oil from below the surface of the soil or water. It includes the withdrawing by any means whatsoever of oil upon which the tax has not been paid, from any surface reservoir, natural or artificial, or from a water surface.

CHAPTER 2. IMPOSITION OF TAX

43101. There is hereby imposed on every producer of oil in this state for the privilege of severing oil from the earth or water in this state for sale, transport, storage, profit, or commercial use at the rate of 6 percent of the gross market value at the well of all oil produced within this state, on and after January 1, 1983.

43102. The tax imposed by this part shall be in addition to any ad valorem taxes imposed by the state, or any of its political subdivisions, upon any property rights attached to or inherent in the right to producing oil, upon producing oil leases, and upon down-well or nonrecoverable machinery or equipment actually used in the operation of the well or any yield tax which is imposed in lieu of an ad valorem tax. Any interest in the land, other than that herein enumerated, shall be assessed and taxed as other property within the jurisdiction in which the property is situated.

43103. No equipment, material, or property shall be

exempt from payment of ad valorem tax by reason of the payment of the gross severance tax as herein provided.

CHAPTER 3. RETURNS AND PAYMENTS

43200. The gross severance tax on oil imposed by this part shall be due and payable to the board on a monthly basis. The tax shall be due and payable on or before the last day of the calendar month based on the amount of oil severed during the preceding calendar month.

43201. On or before February 28, 1983, and on or before the last day of each calendar month thereafter, every producer shall file a return for the preceding calendar month with the board in such form as the board may prescribe, together with the tax due as provided in Section 43200. The return shall set forth such information as the board may prescribe, including, but not limited to, all of the following:

(1) The location of the well by county and tax rate area.

(2) The name of the producer.

(3) The gross amount of the oil severed in barrels of oil.

(4) The total value of the oil at the time of severance.

(5) The prevailing market price of oil sold at the time of severance.

43202. If any person fails to timely file the return required by Section 43201, a penalty of 10 percent of the amount of the tax shall be added to the amount due, together with interest at the rate of 1 percent per month from the due date to the date of payment.

CHAPTER 4. DETERMINATIONS

43300. If the board is not satisfied with the return or returns of the tax or the amount of the tax required to be paid to the state by any person, it may compute and determine the amount required to be paid upon the basis of the facts contained in the return or returns or on the basis of any information within its possession or that may

come into its possession.

43301. The amount of the determinations, exclusive of penalties, shall bear interest at the rate of 1 percent per month, or fractions thereof, from the last day of the month following the month for which the amount or any portion thereof should have been returned until the date of payment.

43302. If any part of the deficiency for which a determination is made is due to negligence or intentional disregard of this part or authorized rules or regulations, a penalty of 10 percent of the determination shall be added thereto. too low.

CHAPTER 5. REFUNDS

43400. If the board determines that any amount, penalty, or interest has been paid more than once or has been erroneously or illegally collected or compiled, the board shall certify such fact to the State Board of Control which shall refund that amount to the person, or the person's successor or assignee, administrator, or executor.

CHAPTER 6. ADMINISTRATION

43500. The board shall enforce the provisions of this part and may prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of this part.

43501. Every person producing oil in this state shall keep whatever records, receipts, invoices, and other pertinent papers in that form which the board may prescribe and shall make them available for inspection and audit by the board at whatever time and place which the board and the person shall agree.

CHAPTER 7. DISPOSITION OF PROCEEDS

43600. All fees, taxes, interest and penalties collected pursuant to this part shall be deposited in the State Treasury to the credit of the Schools and Services Fund,

which is hereby created. The money in the fund is hereby continuously appropriated to the Controller for allocation as follows:

(a) To pay any refunds authorized by this part.

(b) To pay the board for the cost of administration of this part.

(c) The balance, to be allocated to local agencies and school entities, as defined in Section 95, for the general support of schools and the purposes of local government and county services, *to be distributed in the following manner:*

(1) Forty percent to be distributed to school districts on the basis of an equal dollar amount per average daily attendance, irrespective of revenue limits.

(2) Thirty percent to be distributed to counties in proportion to their respective populations.

(3) Thirty percent to be distributed to cities in proportion to their respective populations.

SEC. 2. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

O

INFORMATION ON AB 1597: SEVERANCE TAX

1. Basic provisions of the bill:

AB 1597 enacts a 6% severance tax on the gross market value of crude oil at the wellhead. This money would be placed in a Fund for Schools and Services, to be distributed directly to schools, cities and counties, according to a formula to be determined.

2. Explanation of severance tax:

The severance tax is a tax on oil as it comes out of the ground, based on the price at the wellhead. For example, if the wellhead price is $30 per barrel, a 6% severance tax would yield $1.80 per barrel to the Fund. The tax would be administered by the State Board of Equalization. A 6% severance tax on oil produced in California would yield approximately $500 million per year at current market prices for oil. As the world price of oil increases, the tax revenues will increase accordingly.

3. Basic justification for the bill:

Schools and local government no longer have an adequate tax base, and have to rely continually on the state for bail-out money. Combined with the need to fund personal tax relief, the state needs a new and more appropriate tax base for ongoing and dependable local support. It is appropriate for the state's taxpayers to share in the depletion of its most important nonrenewable resource -- oil.

4. Severance taxes in other states:

California is the only major oil-producing state without a severance tax on oil. Our current property tax system taxes oil at the lowest rate of the 15 top oil-producing states. Alaska, for example, has a severance tax of 12.25%, plus a special corporate income tax on oil and gas. Louisiana's rate is 12.5%, Montana has a combined rate of 13.75%, Oklahoma's is 7.1%, and North Dakota recently added 6.5% to their provious in lieu production tax of 5%, for a total of 11.5%. For comparison, current ad valorem taxes in in California are equivalent to an estimated rate of between 2.2% to 3.1%.

5. Incidence of the tax:

With the deregulation of oil, severance taxes will not be passed on to the consumer. World market prices, primarily determined by OPEC, set the going rate for a barrel of oil. Businesses and consumers are already paying the world market price, while the oil companies reap the benefits of deregulation. Moreover, evidence from other states reveals that comparable states with varying severance tax rates show no differences in price at the pump. This tax will allow the public to share in a small percentage of the substantial redistribution of profits and income to the oil companies and away from other businesses and from consumers.

6. Real vs. nominal tax rate:

Federal windfall profits tax law allows oil companies to write severance taxes off their federal tax liabilities. This write-off, combined with those on federal and state income taxes, means that the real cost of the severance tax to the oil companies is likely to be closer to half of the nominal rate of taxation.

7. Oil industry profits:

Oil industry profits accounted for 40% of profits earned by all U.S. manufacturing firms last year. Cash-rich oil companies are therefore in a powerful position relative to other types of businesses, particularly with the cost of borrowing so high. Profit rates in the oil industry have continued to increase while those of other businesses have declined in recent years. This results from favorable S.P. rather than productive efficiency.

8. Administration:

A severance tax is easy to administer in an equitable manner. Wellhead prices and amounts of production are relatively easy to ascertain, and returns relatively easy to verify. Adjustments for small "stripper" wells and other equity problems have been made in other states, and can be incorporated if necessary.

9. Economics of the severance tax:

From the point of view of many economists, this tax makes good economic sense. It is a tax primarily on what is referred to as economic rent. That is, it taxes a part of the value which has increased as a result of the activities of others -- in this case, OPEC -- which has accrued to the owner of a resource. While it may have a small effect on production at the margin, this will be recovered by future taxes when the marginal oil is brought out of the ground at higher prices.

10. Costs of deregulation:

Deregulation and increased production has costs to the state as well as benefits -- costs of increased air pollution and more rapid depletion on a nonrenewable resource. A severance tax will allow the public to share in some of the benefits as well as the costs.

LOS ANGELES TIMES

May 27, 1981

Oil Tax Could Help State Pay Its Bills

By TOM BATES

As the prices of oil and other minerals have skyrocketed, many Western states have enacted severance taxes on mineral production, to keep for the benefit of their citizens some part of the profits from mineral extraction.

This issue is now coming to California. Of the 15 leading oil-producing states, only California is without a severance tax on oil. Meanwhile, California citizens have borne the burden of high personal and property taxes to support schools, local government and the state. Proposition 13 and the indexing of income taxes have relieved this heavy personal tax burden but have left California without an adequate tax base to pay for schools and local government.

We need to borrow an idea from North Dakota, Alaska, Louisiana and Montana. California should enact a severance tax on oil produced in the state, and use the revenues to fund local schools, cities and counties. I have introduced a bill in Sacramento, Assembly Bill 1597, which would do just that.

A severance tax is a tax on the production of a mineral as it is severed, or removed, from the earth. AB 1597 calls for a 6% tax on the gross market value of oil at the wellhead. At this rate, each $30 barrel of oil produced would yield $1.80 in revenues, with a total of $500 million to the state during the first full year. My bill proposes that the state collect this money and distribute it directly to schools, cities and counties.

The need is clear: Services such as police, fire and schools have been deteriorating because the current local tax base used to support them is inadequate. The state's surplus has disappeared because Sacramento has been forced to bail out local governments. And so-called "permanent" solutions to the state's fiscal problems turn out to be makeshift, as we lurch from budget crisis to budget crisis.

It would be entirely inappropriate to return to a system of burdensome personal taxation. But taxation of our mineral wealth would allow Californians to share in a small part of the wealth created by depletion of the state's natural resources.

Currently, California has only a local property tax on oil in the ground. If this tax were collected as a severance tax, the revenue collected would equal a rate of about 2.5%. By comparison, Alaska, Montana, Louisiana, North Dakota and Wyoming tax oil at rates of 10% and higher. Some states have had these taxes in effect for a long time; others have recently enacted or raised them. California stands at the bottom of the tax list for oil-producing states.

Deregulation of oil prices entirely eliminates the oil companies' contention that this tax would be passed on to consumers. While deregulation has meant huge profits for the oil companies and increased prices for consumers, it has also meant that rates determined by the Organization of Petroleum Exporting Countries set the going price for a barrel of oil. The oil companies will not be able to hike prices above the current world market price, and would be forced to bear the burden of the tax.

Consider Alaska, which levies a special corporate income tax on oil and gas in addition to its 12.25% severance tax. If Alaska removed these taxes, the price of oil would not drop, because we would still have to pay the world market price.

Another way to understand this issue is to look at states with comparable situations and various severance-tax rates. Before North Dakota increased its severance tax by 6.5%, its oil-tax rate was much lower than neighboring Montana's, but gasoline prices did not differ accordingly. In fact, during the recent successful initiative effort to raise the rate in North Dakota, oil-company representatives admitted that they could not pass the tax increase on to consumers.

The real tax that oil companies pay, of course, will be substantially less than the full 6% proposed in AB 1597. After deductions from federal windfall-profits taxes and income taxes, the effective tax rate will be closer to 3%, or 90 cents on a $30 barrel. About $250 million of the tax money to be collected by the state would otherwise end up in the federal government's coffers.

Another argument put forth by the oil companies against the severance tax is that it would negatively affect production, particularly of heavy California oil and oil from small wells. In fact, any marginal effects of the tax are more than counteracted by the much greater incentive to produce brought about by deregulation and the increasing price of oil. If production were at all slowed at $30 a barrel, the state would more than recapture the revenue when the oil is brought out of the ground at $40. In addition, adjustments have been made in many states for high-cost recovery methods, wells with declining productivity and "stripper" wells producing 10 barrels a day or less. One of the advantages of this tax is that it is relatively easy to make adjustments for such problems and still administer the tax in an efficient and fair manner.

Oil-company profits now account for 40% of all profits made in U.S. manufacturing. The modest suggestion that a small percentage of these profits made in California be recycled to our schools, cities and counties merits consideration and support.

Assemblyman Tom Bates is a Democrat from Oakland.

The Sacramento Bee

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C. K. McCLATCHY, *editor, president, 1883-1936*
WALTER P. JONES, *editor, 1936-1974*
ELEANOR McCLATCHY, *president, 1936-1978*
Vol. 247—No. 46,886
Monday, April 3, 1981

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Editorials

A Severance Tax On Oil

There are two proposals in the Legislature to impose a severance tax on oil produced in California. The first, by Assemblyman Bill Lockyer, would replace the confused and uncertain property tax on both oil and gas with a severance tax on every barrel of oil and every cubic foot of natural gas; money so collected would be returned to the counties in which the oil and gas are produced.

The other proposal, far more important and likely to be more controversial, is a measure by Assemblyman Tom Bates that would impose a 6 percent severance tax on oil produced in California and use it to help bail out local schools, cities and counties. While the Lockyer proposal would simply replace one tax with another, and thus raise little in additional funds — though some would be raised in the future, as energy prices go up — the Bates bill would yield an estimated $500 million immediately and more in the years to come.

Both deserve serious attention, Lockyer's because it clarifies and simplifies taxes on oil company assets, Bates' because it represents a thoughtful attempt to resolve some of the state's pressing post-Proposition 13 problems.

While California's corporate taxes are higher than those of most other states, this is the only major oil-producing state without a severance tax. Alaska, for example, has a severance tax of more than 12 percent, plus a corporate tax on oil and gas. Louisiana's severance tax is 12.5 percent; Texas' is 7 percent plus a 1 percent property tax.

Because of the differences in corporate and property taxes among different states, and because those taxes are imposed on different bases, the numbers may not be strictly comparable — which is why the Bates bill, which would represent additional tax on the industry, needs careful examination. At the same time, however, the proposal has obvious merits, particularly in light of the fact that property taxes, which had been regarded as California's alternative to the severance tax, have been so severely limited by Prop. 13. Because oil prices are determined by the world market — most importantly by OPEC — a severance tax on oil probably could not be passed on to the consumer; in part, it would cut into industry profits; in part, it would be written off against the federal windfall profits tax.

There is no question that a severance tax would be easier to administer than the property tax; nor is there any question that, with the restrictions imposed by Prop. 13, the severance tax would permit the state to share in the increasing profitability of oil. The Bates proposal requires serious study to make certain that, in combination with the state's corporate taxes, it does not discourage exploration and development in California. On that point, a spokesman for a major oil industry organization said that while oil companies will undoubtedly oppose the Bates measure, the proposal does not impose "an impossible rate" on the industry. Bates calls this "the right tax at the right time for the right purpose." If the numbers turn out as they now appear, it might be just that.

Idem, Sev. Tax.

1. Montana case resolved constitutionally.
   a. Not an intangible
   b. States can classify, if there is a legit. purpose.

2. Prop. 13
   95% of what Jarvis-Gann said was re home taxes. Nothing re oil & gas.
   Fair to infer, was no voter intent to untie oil & gas. Was an unintended by product, in the heat of the moment.
   Decline in real value of gas tax. "Revenue bracket creep."

Summary - 3. Sequence
   1. ~~Is const. — if a public purpose.~~
   2. ~~The purpose is . . .~~
   3. ~~Bona fide economics? No.~~
   4. Will it ~~stifle~~ the indy? Not much.
   5. Special problems of heavy oil, advanced recovery, call for modifications, more toward net proceeds approach, so as state shares costs as well as sales.

IV C

4. Leases normally carry a royalty. On new leases, this ~~ed.~~ simply mean a lower royalty.

IV & C

~~The existence of tax royalties w/in the indy~~

Ideas. 2

itself suggests that pvt. business has not found them a severe burden. This is bcs. of the IV A nature of the resource. If you find nothing, no matter; if you find something, revs >> costs, no matter, until prodn. declines, then can renegotiate.

5. Burden w/in the indy. falls on:

a. ~~Both~~ Owners of present royalties, under exist. IV C contracts. This is no ~~question~~ distinction, they have no control over prodn. rates. Cd. even tax them at a higher rate.

IV B b. ~~Lessees~~ ~~the~~ under contract. ~~They are~~ equity. ~~Lessors have already saddled them w. 12½%~~

IV D c. Potential lessors. They will get lower bonuses + royalties. ~~(or lower bonus)~~

IV E d. Refiners? Only in a few special cases. a refiner might depend on hi-cost oil from one buying area (or oil-shed), + have to pay more to get oil produced.

On other hand, he cd. accept oil at a slower rate, build less capacity, use it longer -- a sustained-yield policy. The oil will be produced eventually.

IV E 6. Discrimination is largely a gen. of time. The oil will come out someday.

IV G 7. Sev. tax is stand-in for env. effluent tax
~~Heavy oil is dirty oil.~~

IV H 7A. Sev. tax recoups govt. spending on streets, CHP, etc.

8. Undiscovered oil is not like ~~idle land~~ a power drop.

IV E 1b you ~~don't use~~ latter now, gone forever. Oil is a fund.

9. Sev. tax as tax on rents.

III ~~III b, c~~ Rent ≡ fat in the pvt. sector.

~~b. To tax rents, 2 aspects~~

End { i. Tax base must be a source of rent.
ii. ~~Taxable~~ Tax itself must not destroy rent.

IV C { Oil + gas rate hi on (i). Lots of money there, + lots of that money is pure gravy, above resp. incentive.

Sev. tax not too good re (ii). -- in the abstract. Cd. be improved on. But when (i) is well met, (ii) matters less. a blunt instrument for a blunt situation. Low ε of prodn. Hi cost margins, but low-cost core. The core yields the fat; the margins ~~adaptive~~ are the lean, where you just make wages, so to speak. Reduce pr. non-land inputs by 10%, reduce prodn. by 2%. (Reduce net social surplus

by ~~nearby ownership~~ very little.)

~~10+. P-13 reduced local servs. Reagan reduc. fed. spending. Big new burdens on states.~~

II 10. Case for special tax on exhaustible res.

II, C 1.a. It is legal, & always has been. Prudent investors have known this. Is a risk they have assumed. There are sophisticated investors, they know this. (They often play dumb to get sympathy, but these are not widows & orphans, innocents & illiterates.)

There are people who prefer risk. E.g. their case for bonus bidding on OCS.

II D 2.b. ~~Title to~~ Land was ~~sold~~ mostly public domain 100 yrs ago or less. Granted to pvts. mainly to dev. ag. & irrig. Minerals included mainly by oversight. Their discovery was a windfall -- let alone their values today. If on OCS, fed. wd. still be auctioning.

OCS not given to riparian owners.

Public sentiment has ∴ view there as peculiarly affected by public int.

II E. 3.c. Ownership highly concd., giant multinat. corps.

Progressive. 4.d. Shareholders mainly absentees; many for. nats. or expatriates

pet-setters.) 5.e. ~~ok~~ Recent huge changes in wealth, favoring these concd. owners.

(Improve balance of powers.

Berg. in prospect, more huge $s.

6.f. ~~Decline in gas tax, "income bracket creep."~~

II, F 7.g. ~~Env.~~ damage, surrogate effluent charge.
Heavy oil is dirty oil.

II G 8.h. Exhaustible nature of resource.
Worst that can happen is, defer prodn. to future. Many favor this contingency. Not like waste of flowing water.

II, H 9.i. Recoup subsidies, ~~to downstream~~ users; to water use

II, I 10.j. Plug misc. tax loopholes.

II, J 11.k. Deductible, U.S. tax.
~~II,~~ add this to absentee ownership, causes $ Cal. balance of pmts.

?. 12.l. Gives you a shot at taxing OCS.

~~13.m. (Landlords on Fed upland?)~~

13.n. Other states have sev. taxes.

11. Bes. sic. tax is on person, rather than things, some funny things happen on the way to the tax base.)

Net proceeds tax avoids this.
Used in Idaho, Utah, Nevada + S.D. (not always by name.)

assn's J., 12/77.

allows much higher rate

12. 3 ways to adapt to hi-cost
a. Sliding rate, based on flow
b. Rate classes, based on major known recovery techniques. E.g. oil from steam injection
c. Net proceeds.

R. Paschall, "A Comparison of Minerals Tax Systems;"

The Assn's J., Dec. '77, Vol. 12 #4, pp. 221-37.

N7: Juneau work

The 'Net Proceeds to Mines' Approach to Taxation

Robert H. Paschall, State Board of Equalization

Presented at AIME National Convention
February 1976

ABSTRACT

Some systems of taxation of mineral-producing properties contain built-in inequities and administrative difficulties, and some systems also provide an uncertain tax base. These shortcomings serve to promote ongoing controversies between the mineral industries and tax authorities and to create suspicion of the motives of both parties. All major methods of minerals taxation are examined here, and the "net proceeds" system is proposed as an equitable, reliable, and easily administered solution to past problems.

COMMENTS ON CERTAIN TAX SYSTEMS

It is most useful to approach the subject of the net proceeds method of taxation by first citing other methods of minerals taxation and remarking on their shortcomings from the standpoints of either industry or government or both.

The ad valorem property tax is applied in some jurisdictions, notably California and Arizona. California has the unique disadvantage of local administration by county assessors, which means that the assessment and taxation of mines is not uniform. But, the ad valorem property tax has serious difficulties even when it is state-administered. It requires annual reappraisal of all mines as a response to changing price levels and other debatable factors. Worse yet, this annual reappraisal calls for three different subjective judgments. Put in the form of a question, what are the ore reserves, what will the annual rate of production be over the life of the mine, and what rate of return should be used to convert future net income to present value? The reader might say that some of these things are impossible to decide in certain cases, and he may be right, but in an ad valorem tax jurisdiction they are necessary.

A number of states have a gross production or severance tax on different types of minerals, including oil and gas. It is contended here that a severance tax is by its very nature an inequitable tax because it has no relationship to the ability to pay. As a result, marginal mines are penalized. Of course, economics, not size, is implied by the use of the word "marginal." When the price of copper is low some very large copper mines are marginal, even though their output remains high and their past

investment costs amount to perhaps one hundred million dollars. The fact that a severance tax is levied on gross revenue rather than on net income creates the inequity. Two mines with similar gross revenues may have radically different abilities to pay because of different stripping ratios, mining costs per ton of rock, distances to mill, and so on.

If ability to pay is a good criterion, then why not use a Federal-type income tax? There are several reasons why it is a poor tax on anything or anybody, mines or other. It has become so complicated that it might be viewed as a haven of employment for accountants and lawyers. And a complex tax is seldom a good tax.

An income tax on mines also provides a rather uncertain tax base. After one subtracts depletion, depreciation, amortization, and general office overhead, not to mention operating and maintenance expenses, one may often wonder how a given mine remains in operation.

Of course, it is evident that the Federal income tax is a tax on persons as opposed to a tax on property. That is, the tax is levied on the net income of the owner of a mine-- whether an individual, partnership, or corporation-- and not on the net income of the mine itself.

THE NET PROCEEDS TAX APPROACH

Now we are prepared to consider the net proceeds tax, which (1) is a tax on property rather than on persons, (2) does not require manipulation by a certified public accountant, (3) takes account of the ability to pay, and (4) does not call for subjective judgments by a valuation engineer. The net proceeds tax system, by the way, has been used successfully in the State of Nevada for more than a century.

Let us look at net income-- net proceeds, if you will-- through the eyes of the mining superintendent and the mill superintendent. Rather than "net proceeds" they may think in terms of "gross profit" or "net operating profit" or "operating net income" generated by their cost centers, but these terms are very nearly synonymous with net proceeds.

These superintendents don't concern themselves with tax depletion and depreciation. The way that accountants choose to allocate general office overhead doesn't keep them awake nights. What they do watch and do record are their development costs, their mining costs, and their milling costs. If these costs are kept well below gross income, the operation will generate a healthy cash flow, and that's where the action is.

Briefly, the net proceeds tax for a given year is computed in this manner. First the gross revenue for the past year is computed. This gross revenue may be generated at either the mine or mill, depending on the point of sale of the mineral product. "Gross revenue" is simply annual net production multiplied by the market price of the mineral commodity. A company's intra-divisional transfer price should not be used in computing gross income.

Three sorts of deductions are made from gross revenue to derive the net proceeds. The first deduction, which may itself embrace several items, consists of all of the past year's mining and milling expenses required to yield the salable product. The second deduction is the past year's development costs.

The third deduction is a charge for amortization of all of the improvements and personal property used in generating the gross revenue. This property includes all buildings and other structures and the mining and milling machinery and equipment. The deduction of the amortization charge removes the contribution to gross revenue that is made by the improvements and the personal property, which may then be separately subjected to ad valorem property taxation.

There is a sound fiscal reason for this deduction. The income to some mineral operations is strongly cyclical. If the income to the mineral deposit-- that is, the net proceeds-- plunges to zero in a given year, the still-valuable machinery and equipment serve as the tax base for that year.

One other aspect of net proceeds taxation that should be noted is the treatment of royalty income. Royalty payments should be deducted from the operator's gross revenue. If the royalty interest is owned by a government, it is tax-exempt in most jurisdictions. If it is privately owned, a net proceeds tax bill is sent to the owner of the interest, with his royalty income serving as the tax base.

It might be thought that the taxation of a privately owned royalty interest constitutes a tax on persons rather than a tax

on property, but that is not the case. The royalty interest is legally a part of the total property interest, and it is that interest that is subject to taxation; in turn, the owner of the interest is liable for the tax payment.

The net proceeds itself (and the taxable royalty interest, if any) then constitutes the tax base, and is subject to a tax levy at a rate determined by the government administering the tax.

Exactly what kind of tax is the net proceeds tax? That question is best answered by observing the kinds of taxes that it is not. It is not an ad valorem tax, because one year's net proceeds is most certainly not value, at least in the fair market sense. It is not a severance tax, because the tax base is far removed from gross income.

By elimination, it is obviously a form of income tax, although it is blessedly removed from the complexity of I.R.S. regulations. Also by elimination, it avoids the subjective judgments of ad valorem taxation, the inequities of severance taxation, and the minimizing of mining income provided by the taxation of persons rather than of property.

A few observations on tax philosophy may be in order, although they are tentative and may be subject to challenge. The net proceeds tax appears to be a neutral tax so far as stimulation or retardation of mineral production is concerned. Accelerated production and net proceeds would tend to maximize the tax, at least in present-worth terms. Retarded production would minimize the miner's own net income in present-worth terms. Neither goal is apt to be sought in itself by the mining industry. Furthermore, and this seems inescapable, the tax itself, since it reflects operating net income, is also a reflection of the market demand for the mineral. And that demand is a much stronger determinant of the rate of mining than the prospective payment of the tax.

In closing: the net proceeds tax is remarkably simple to administer, it is fair, and it is reliable. It appears to be the least imperfect method of mines taxation in a highly imperfect world.

THOMAS MELLON EVANS

With $140 million expected from his

Late in the afternoon of Aug. 7, 1975, Thomas Mellon Evans, chairman of Crane Co., telephoned John B. M. Place, chairman of Anaconda Co., the copper giant that had fallen on hard times. Almost simultaneously, the Dow Jones wire service reported that Crane's directors had approved a $125 million investment to buy 5 million shares of Anaconda stock. Anaconda's shares were at $15, near their historic low, and Crane offered $25 subordinated debentures per share. The phone call was the first notice that Place had received of Evans' interest in his company.

Like many other chief executives faced with potential control by Evans, Place adamantly resisted the offer. He filed lawsuits, pressured for congressional hearings to generate unfavorable publicity about the bid, bought a company competitive with Crane, and made an abortive plan to merge with Tenneco Inc. But Evans outmaneuvered him at every turn, eventually acquiring 4.1 million shares, or 18.6%, of Anaconda for his company—at 20% less than he originally offered. Evans then proceeded to stimulate Atlantic Richfield Co.'s interest in Anaconda, which produced an ARCO tender for 27% of the copper company.

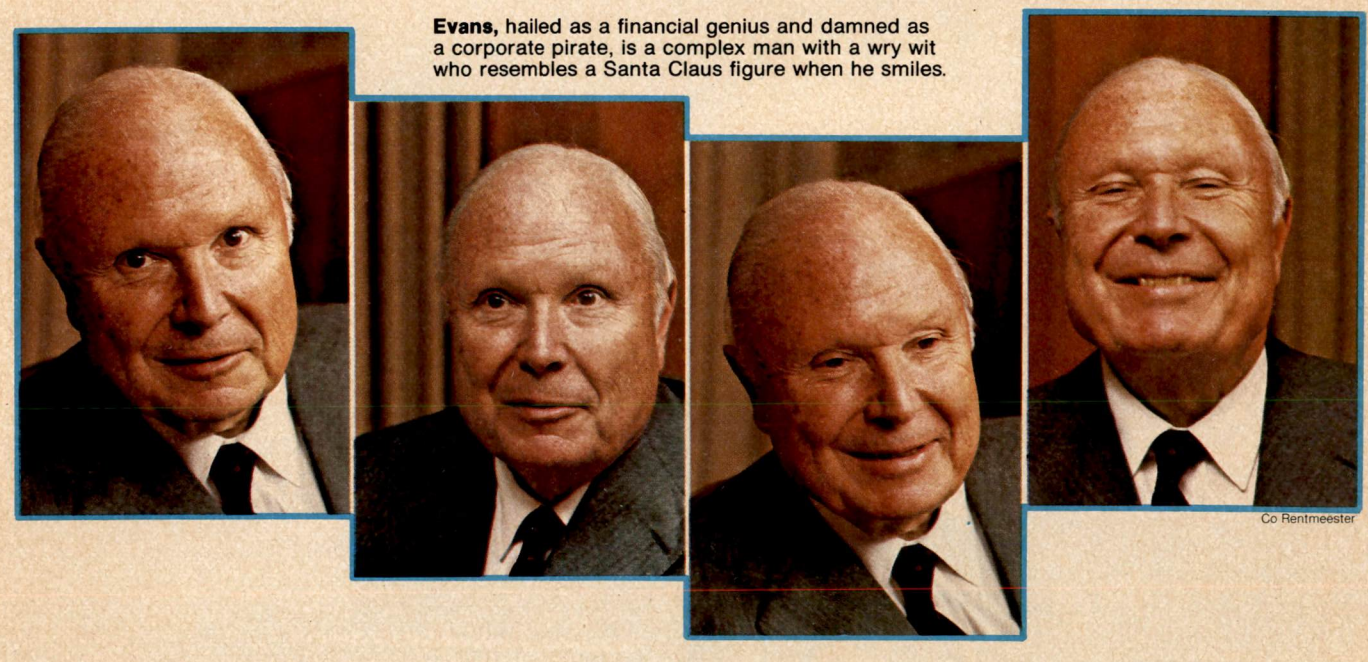
Next week, barring federal intervention or an unexpected turndown from Anaconda shareholders, ARCO will complete its merger with Anaconda in a cash and stock deal worth about $34 for each share of Anaconda stock.

For his efforts, Evans will have turned a tidy paper profit for Crane of about $57.6 million or 70% on the $82.4 million investment in less than one year. Moreover, he has been buying back the bonds that Crane issued for the Anaconda stock at a discount. And because the $6 per-share cash portion of the ARCO tender is considered an intercompany dividend, Crane will pay an effective tax rate on this part of the gain of only 7.5%. Says Evans: "It's one of the best investments I've ever made."

In addition to the $24.6 million cash, Crane ends up holding slightly more than 2 million ARCO shares. If the deal goes through, the cash and stock together will be worth about $140 million. Evans claims that he will be content with the ARCO holding, but it has not been his style to hold investments in companies without also controlling and running them. Crane's president, Dante C. Fabiani, says, "We're going to be looking to put that money to work."

Evans himself says that he is still looking for an inflation hedge for his stockholders. "It's a tough thing to find these days," he says. He mentions real estate or "one of the extractive industries" as a possible hedge, although he eliminates copper as a possibility. "I've had it with copper," he quips. As for nickel, he says, "There's only one company in that, Inco, and that's too big for us." Zinc and lead he dismisses as "not too much in demand these days." That leaves coal, oil, and gas. And there are several attractive, small companies that have recently been targets of other companies' tenders: Aztec Oil & Gas Co. is one. Evans cagily refuses to be pinned down, saying, "We've got a good oil investment there in ARCO."

For the future, he expects that the nature of his targets will change. In the past, he usually looked for family-owned or closely held businesses as acquisitions. Now these are "pretty much

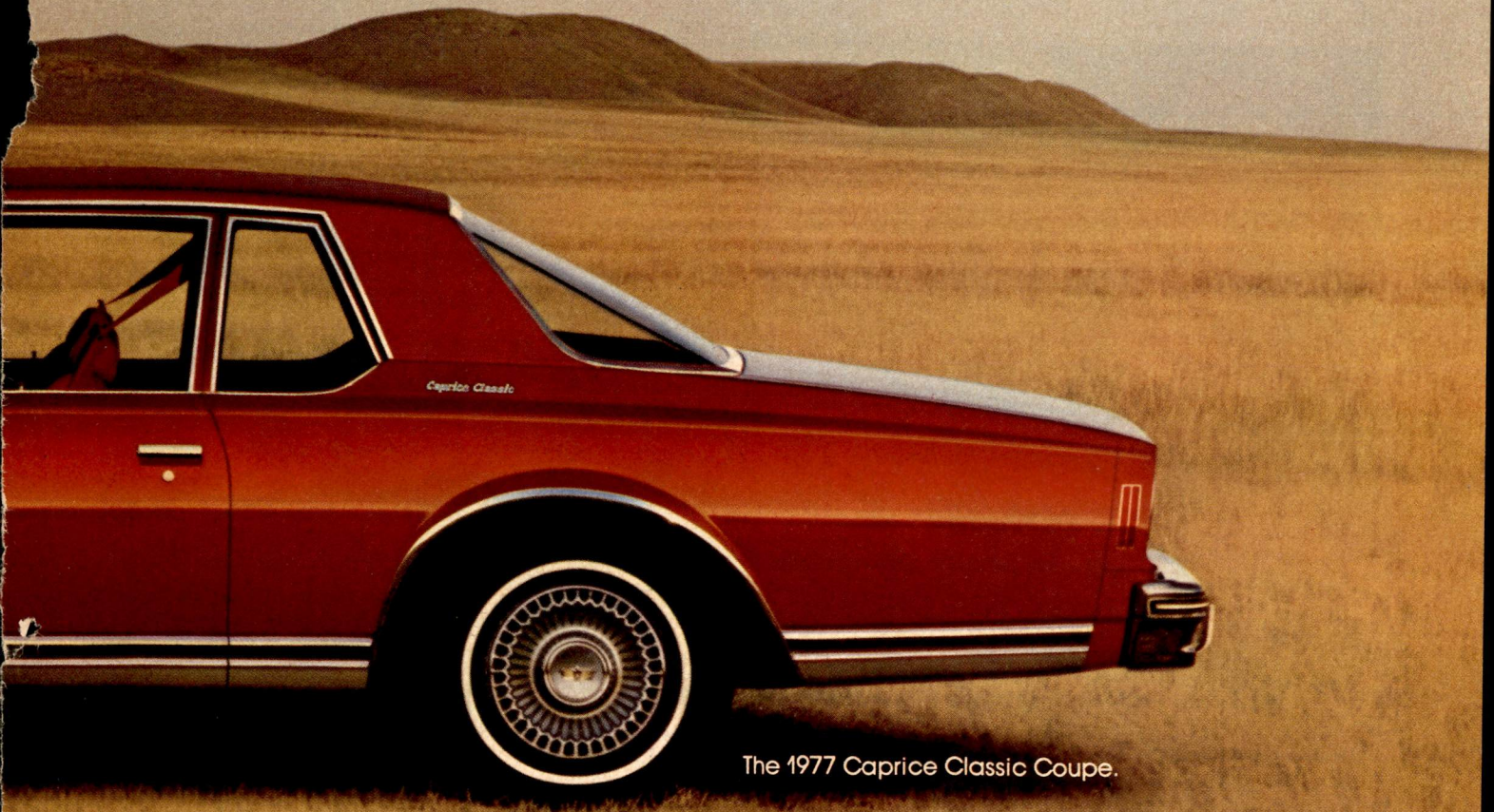


Evans, hailed as a financial genius and damned as a corporate pirate, is a complex man with a wry wit who resembles a Santa Claus figure when he smiles.

Co Rentmeester

Chevrolet

More rear seat leg room.
in city traffic. **More** corrosion protection.
entry and exit. **More** appropriate for the times.
to the 1976 full-size Chevrolet.



The 1977 Caprice Classic Coupe.

more like it.

Chevrolet

A CORPORATE ENTREPRENEUR HITS THE JACKPOT: WHAT COMES NEXT?

Anaconda deal, he will seek new targets

played out," he says. Instead, he will be looking for companies with low price-earnings ratios that have little institutional interest in their stocks. Evans blames the low ratios of asset-rich companies largely on the brokers' loss of fixed commissions. "There's no incentive for selling stock in these companies any more," he says. And he holds that institutional trading—which he calls "the big card game between Goldman, Sachs and Salomon Bros."—will keep price-earnings ratios up in only a small number of stocks and down in the rest.

Evans' Anaconda raid points to the direction that future tenders, particularly unfriendly ones, will take. Anaconda's stock was widely held, and the company had vast assets, much of which lay dormant because of capital squeezes, inflation, and the deep recession. There was little institutional interest in the company. And institutional trading is where the action is today, as small shareholders drop out of the market.

So, with its stock price low and its stockholders restless, Anaconda was vulnerable to a tender that offered higher income or quick cash. The same danger faces many managements today. This year I-T-E Imperial Corp. was swallowed up by Gould Inc., USM Corp. was taken over by Emhart Corp., and Foremost-McKesson Inc. has been a target of Victor Posner's Sharon Steel Corp.

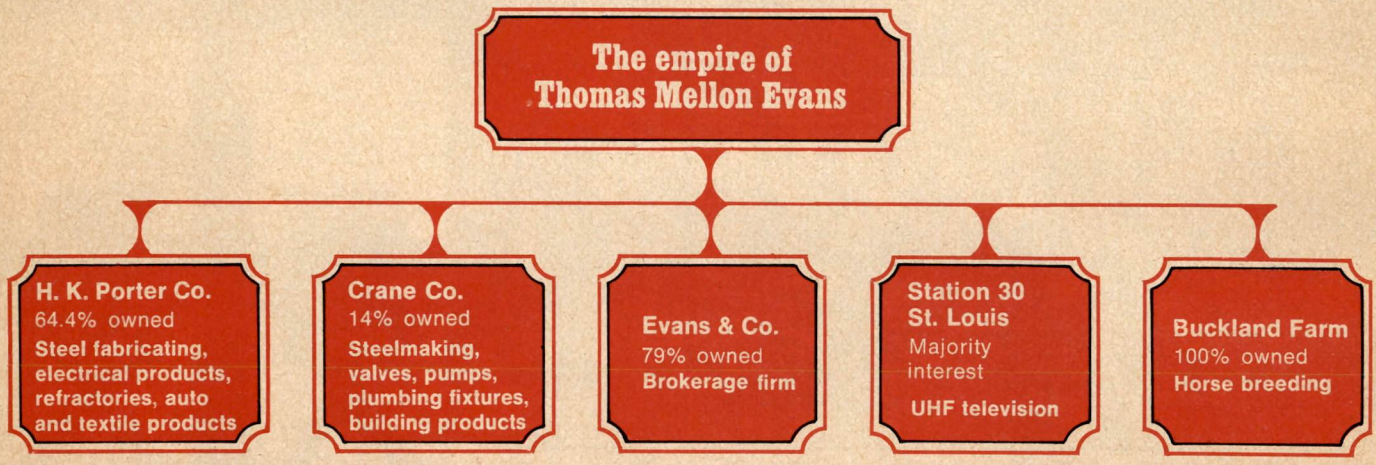
Another unusual tactic for Evans in the Anaconda raid was the fact that Crane owned no Anaconda stock. Usually Evans quietly buys up slightly less than 5% of a company's stock before he makes his bid. "That way we make a profit if they go to someone else," chuckles Evans. Fast, aggressive and invariably offering a price well below book value, Evans' tender offers nearly always have profited the two major public companies he controls: Crane, with sales of $1.1 billion and H. K. Porter Co., with sales of $267 million. His acquisition and operating methods have also earned him a reputation as a feisty infighter, an astute trader, a financial wizard, and as a pirate, robber baron, or shark, depending on whether the assessor is an observer or a victim.

In his nearly four decades of operating Porter and close to two decades of running Crane, Evans has made more than 80 acquisitions. Now 66 years old, he shows no signs of slowing down. The Anaconda venture, potentially one of the most profitable he has ever made, is only one of five similar deals he has entered in the past 18 months. He also moved on Copper Range, Inspiration Copper, Missouri Portland Cement, and Fansteel. After a bitter battle he won 52% of Missouri Portland Cement Co. Fansteel capitulated after Porter raised its bid. The two small copper companies found other partners, but Crane came out with about $2.5 million in profits.

How has Evans managed to be so consistently successful? "His organization is well-managed," says Robert A. Charpie, president of Cabot Corp. "It moves quickly, efficiently, and intelligently. I guess you could call the hallmark of Evans' operations ruthlessness and efficiency." Ivan Boesky, who heads his own arbitrage firm, calls Evans "a hell of a trader." And the president of a firm that specializes in preparing—or fighting—tender offers, says, "Tom is 100% a bottom-line guy."

Complains one executive who negotiated unsuccessfully for some assets that Crane was selling: "He's too sharp. He wants the best part of every deal. You get overcautious when you're dealing with him. You don't even go into the bargaining session unless it looks like it's really to your advantage." Robert Alpert, who bought some property from an Evans company and is now embroiled in lawsuits over a payment on a mortgage that the company took back, gives this assessment: "He's a brilliant financier, but he's also a rude and ruthless entrepreneur who ignores the niceties in normal business practice."

Is Evans disturbed by the hostility he engenders? "I don't think so," he answers. "After all, the responsibility of management is to earn as much as



possible for stockholders, and also, these days, to see if he can help them hedge inflation." Still, he adds, "No one likes to see his company taken away from him. But it's better for the stockholders." To make money for his stockholders, Evans has consistently bought assets cheaply, sold off or closed down losing or marginal operations, streamlined or fired managements, moved plants to other states to avoid high-cost union rates, and put his operating divisions under tight fiscal controls.

Although only distantly related to the Mellon family, Evans got his start at a Mellon holding—Gulf Oil Corp.—after his graduation from Yale in 1931. While working at Gulf, he borrowed some Gulf stock at 3% interest from W. L. Mellon, then the company's chairman, and when Gulf's stock rose in 1936 and 1937, he got a $15,000 return on his investment. With that stake, he began buying the defaulted bonds of H. K. Porter, a manufacturer of small steam locomotives. When Porter came out of reorganization in 1939, Evans emerged as the major stockholder of a company that had no earnings and a product that was losing market rapidly. The war years helped turn the company around. Then he began to look for acquisitions.

Laying the groundwork

By 1955 the company was selling $80 million worth of rubber products, refractory materials, electrical equipment, and steel and copper products—all the result of Evans' acquisitions. At that time, Evans owned about 75% of the company, and was beginning to look for new adventures. He found them in Crane Co., an old-line plumbing manufacturer, with stodgy sales. Evans began buying into Crane as a personal investment, ending up with control by 1959. There has never been an equity tie-in between Crane and Porter.

Often his acquisitions stirred up bitterness in families when Evans came into their companies and chopped away at deadwood and corporate fat. But Evans says: "We've given stockholders a good run for their money. And we paid dividends, too." An investment of $3,500 in Crane stock in 1959, the year Evans took over, is worth about $29,000 today, and the investor would have gotten $7,100 in dividends, as well.

Critics claim that Evans has worked extreme hardships on his managements, employees, and the communities in which his companies operate. But one banker argues: "It takes a strong man without too nice a conscience to build an empire. He's tough but he's honest. In this age of permissiveness, maybe he's a throwback, but a lot of stockholders out there could do a lot worse than have Tom Evans mind their money."

Indeed, Evans' policies have been eminently successful. At Crane, in the past five years alone, he boosted sales 41%, to $1.1 billion, and earnings have soared 470%, to $63.8 million. And Evans owns 14% of Crane. At Porter, where he holds 64% of the stock, the results have been less dramatic over the past 10 years. Sales have remained relatively static, averaging about $275 million. And earnings have been erratic, moving from $7.4 million in 1966 to a $1.9 million loss in 1970 and to a $9.3 million profit in 1975, as Evans bought and sold businesses to realign the company in more profitable areas.

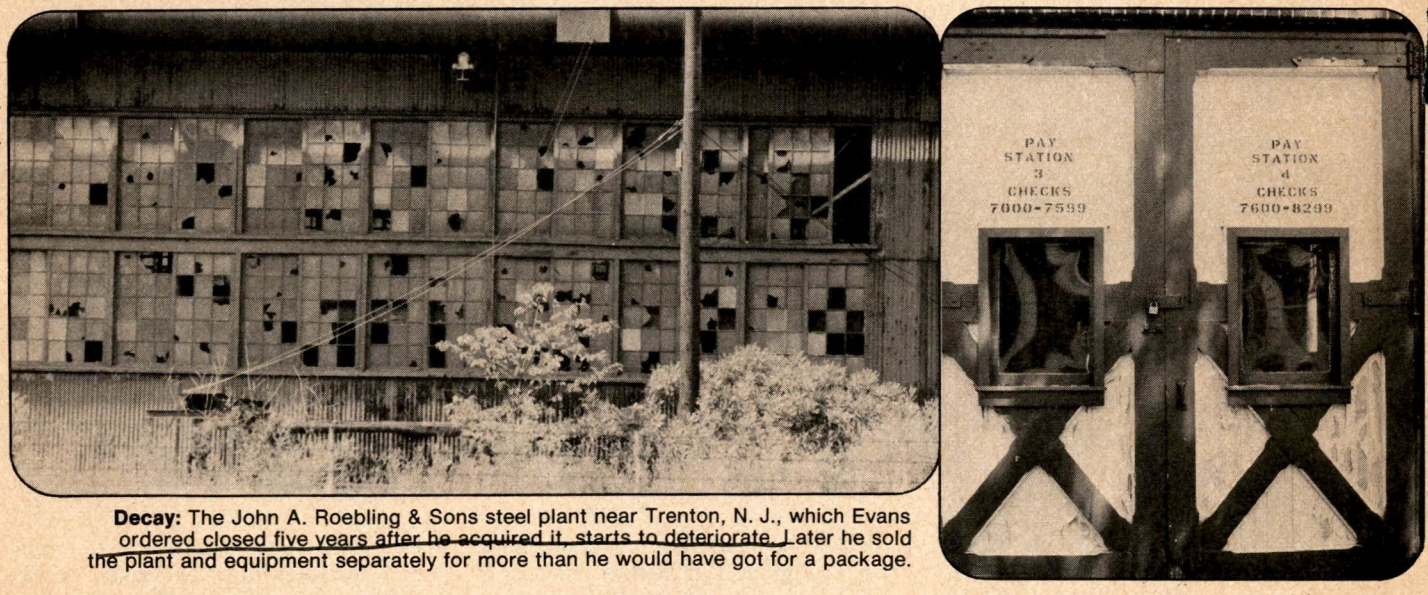
But though Porter has not grown as dynamically as Crane in recent years, its balance sheet is a conservative accountant's dream. Its debt-equity ratio is 1 to 24, and its current assets-to-liabilities ratio is better than 2 to 1. Last year Evans turned over Porter's chairmanship to his second son, Edward P. Evans, 34, but he remains chairman of its executive committee. Says a chief financial officer of a major company: "It's a dream situation for a young man. If he's got a lot of drive, he can do a lot with those assets. And if he's not too imaginative, it's a solid company where he can't go too wrong."

Evans retains his base of operations at Crane, the one-time plumbing manufacturer and distributor that he converted through acquisitions primarily to a steel and valve producer. From Crane's New York headquarters, Evans runs Crane, a St. Louis television station in which he has the majority interest, Evans & Co. (his 79%-owned brokerage firm), and his horse breeding farm, Buckland Farm, in Gainesville, Va.

A complex man who can be both charming and disarming, Evans has a wry, ready wit and an unexpected modesty. When he smiles, he resembles a Santa Claus figure. But when challenged or annoyed, his features take on the impassive and calculating expression of a top-notch poker player. He is restless and impatient with anyone who is unprepared. Says Fabiani, "He has a great facility for keeping everybody on their toes and completely mentally alert. We have to do our homework."

For those unprepared, the Evans onslaught can be devastating. "His temper is well-known," says one insider. One former Porter executive, accustomed to his wrath, kept a sign on his desk with an arrow pointing to a nearby window, reminding himself that "Happiness is just three feet away."

Pictures by Harry Gehlert

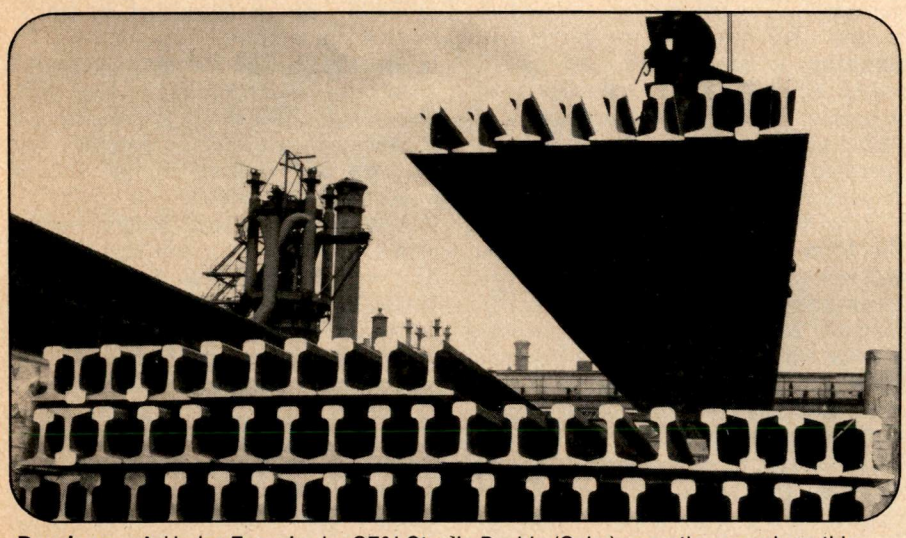


Decay: The John A. Roebling & Sons steel plant near Trenton, N. J., which Evans ordered closed five years after he acquired it, starts to deteriorate. Later he sold the plant and equipment separately for more than he would have got for a package.

His office is Spartan, without the plush appointments surrounding many chief executives. A focal point is a small TV screen flashing continuous stock prices, which Evans views almost constantly. Next door, in Evans & Co., is his private trading room, a cluttered jumble of financial statements and business information, where Evans spends at least a portion of every working day. Only in the most dire emergency will an executive disturb him there.

In his trading room, Evans works out the deals that have brought profits to his companies and often woes to the managements of his targets. His primary interest, he says, is the financial side of the business, and for the most part he leaves Crane's day-to-day operations to Fabiani.

What does Evans look for when he makes an acquisition? He analyzes Anaconda as an example. "The book value is about $50 per share." (At the time of his original offer the stock was selling at about one-third book.) "Let's look at assets, cash, inventory, and short-term accounts receivable," he goes on. "The inventories are listed at $260 million. But they had LIFO [last-in-first-out accounting for inventories] reserves of $216 million. That's $8 or $9 a share. That's a cushion. Then there were those claims against OPIC. If properly handled, they're entitled to that." Anaconda had $159 million in claims against Overseas Private Investment Corp. stemming from the expropriation of its Chilean properties under the Allende government.



Development: Under Evans' rule, CF&I Steel's Pueblo (Colo.) operations, such as this rail mill, have never been as profitable or as streamlined as they are today.

Analyzing Anaconda

"Anaconda's property, plant, and equipment—it's hard to know what it's worth," Evans continues. "But you get an old company like this, with land all over the country—minerals—there's probably a good deal of value there that doesn't show. Then you have $80 million in investments. It's pretty rich with assets. They hadn't been doing much with it.

Evans is highly critical of Place's management of Anaconda. "I don't know why he ever went into that deal with Amax," he says. The deal was a joint venture to develop an Arizona copper mine, which has been a drain on Anaconda, accounting for $7.7 million of the company's $39.8 million loss last year. "Place went and dug a hole in the ground and poured $200 million into it, and he can't deduct it because there are no earnings," says Evans. "They have that tax loss carryforward from the expropriation. He should have gotten himself out of debt, because when they borrow money at 9% and have no income, it's like someone else borrowing at 18%."

Evans' initial offer for each share of Anaconda stock was a $25 subordinated Crane debenture. But after Place paid $40 million to buy Walworth Co., Crane's competitor in the valve business, Evans dropped his offer to $20 debentures, implying that Anaconda had reduced its net worth by 20%. Some observers accused Evans of being vindictive because Place had tried to block him by raising an antitrust specter. But Crane's Fabiani disagrees: "For years as a public company Walworth had lost money. Their plants were old, and they hadn't spent a great deal of money modernizing them."

Not only did Evans work out his own evaluation of Anaconda, but he put together his own bid, shrewdly assessing characteristics of Anaconda's shareholders. Most were small investors. No one, not even directors, held more than 5% of the stock. "Income," says Evans, "is the most important thing to the little guy." So his offer of a debenture paying $1.60 per year would look good to a shareholder getting Anaconda's 60¢-per-year dividend. To make the debentures competitive with higher-rated, better-yielding bonds, Evans included a 10-year sinking fund provision. Because Crane's debenture had an average life of five years, the average yield on it would be closer to 11.5% than to its 8% face value. And to make the exchange attractive to arbitrageurs and brokers, he offered a 70¢ premium.

Mergers without brokers

The only element that he was unable to control was Place himself. But when Place bought Walworth and it seemed that Evans might be stymied, Evans found a way around the antitrust difficulty. "One morning I thought, 'We'll stipulate that we won't go after more than 22.5% of Anaconda or go after seats on their board.' " The ploy worked, and a federal judge agreed to the Crane investment. Since then, a Justice Dept. suit has asked that Crane divest its holding because of the antitrust implications, but the case has been postponed. If ARCO succeeds in merging with Anaconda, the suit will be moot because Crane will tender its Anaconda stock.

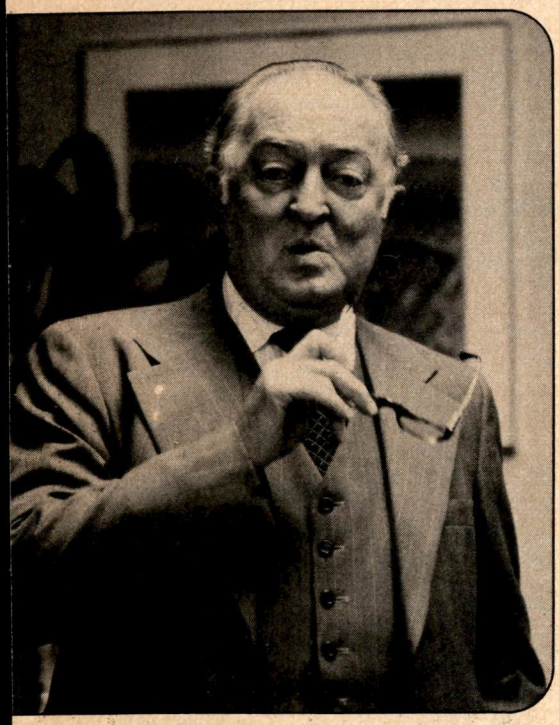
Evans claims that he never wanted to take over Anaconda. "It was too big for us," he says. But he did not want Tenneco to take over the copper company, either. Tenneco intended to give Anaconda stockholders a new convertible preferred stock for their shares, and Evans considered this new issue to be "a big roll of wallpaper." Through a broker, he approached two oil companies to be merger partners for Anaconda, but he stirred up no interest. Then he remembered an old friend: Robert O. Anderson, chairman of ARCO.

It took little effort to interest Anderson and ARCO in Anaconda. ARCO had made studies on acquiring Anaconda as far back as 1968, but because of ARCO's North Slope activities, it had put the plan on a back burner. With North Slope crude becoming a reality by 1977, ARCO was again looking at acquisitions. According to Evans, he kept "nagging at them until they made their offer." Still, Anderson was taking no chances. He demanded and got from Evans an agreement that Crane would not tender its Anaconda stock at the time of ARCO's cash purchase, nor sell it without giving ARCO first refusal rights. Now, Evans notes, should the ARCO merger not go through, the new series of nonvoting preferred stock that ARCO got for its $100 million investment in Anaconda is convertible to common stock if ARCO were to sell it. So, a purchaser would control more than 50% of Anaconda, if he joined it to Crane's holding.

For Evans, buying a company cheaply

is half the battle. Running it is the other. A company that can be bought substantially under book value usually brings problems along with it, both from mismanaged assets and high overhead. So Evans applies to management the same relentless pressure that he puts into the acquisition, forcing the company to adopt the economies he insists on at all his operations. Discretionary spending is closely monitored. "To spend $2,000 or more, you need the approval of the top office," says Fabiani. "We're very tight." The labor force is closely scrutinized, and layoffs are prescribed routinely where productivity or production is down.

Management must provide reports twice a day, both by phone and in writing, on backlogs, sales, inventory, and



Joan Sydlow—BW

Crane's Fabiani: "Some people say that I'm tougher than Evans."

production, and they are closely monitored by Fabiani. "Some people say I'm tougher than Evans," says Fabiani. It is particularly galling for managers accustomed to operating under looser corporate styles to accommodate themselves to Evans' stringent disciplines, and the turnover rate is high. "Once a year there is a rating sheet on everyone who makes over $18,000 per year," says Fabiani.

The fact that Evans is the largest shareholder in each of his companies may be coincidental to his commitment to making money for his shareholders. Says one insider: "I've seen Evans explode over a piece of advertising that showed how successful his management was. 'Dammit,' he said, 'How can I justify that kind of expense to the stockholders?' " But to upgrade machinery or products, Fabiani says, "Tom Evans is the greatest guy in the world to approve capital expenditures for cost savings."

Closing down losers

Perhaps the most telling criticism of Evans is that he closes marginal or unprofitable operations and ignores the devastation that these actions wreak on communities. In New Jersey alone, he has closed three Porter and two Crane operations, including John A. Roebling & Sons Corp., a steelmaker that Crane picked up with CF&I Steel Corp. Those shutdowns all came within a five-year period beginning in 1968, and they put 3,400 people out of work. Because of this, Representative Frank Thompson Jr. (D-N. J.) calls Evans "the corporate embodiment of *Jaws*, the great white shark."

Evans rebuts the criticism, using Roebling as an example. "Roebling was run downhill by the family when we took it over. We offered it to every steel company in the country, and nobody would buy it. The unions wanted us to tie it to our Pueblo (Colo.) operations of CF&I, although it had never been operated that way before. I talked to them, but I got nowhere."

Subdistrict director Joseph Yeager of the United Steelworkers remembers it differently. He says: "If they had come to us and said they were in jeopardy, maybe it could have been saved through a wage cut. Or we could give up some benefits. I participated in some discussions in Evans' New York office. He was cold and calculating. He was talking business with us, and meantime he was watching that stock market very, very closely. He'd pick up the phone and say 'buy' or 'sell' while he was talking to us. He was a pretty shrewd businessman, but the dollar bill was his sole judge."

Evans argues that there was no way to save the plant. "We could have run it a little longer until our money ran out," he says, "but we built up Pueblo instead." In any case, Evans later sold the equipment and the plant separately, and, according to one insider, "made more money that way."

While Evans may have added to New Jersey's unemployment rolls, a pair of CF&I officials in Pueblo say their company has never been as profitable—and as streamlined—as it is today. Part of that is certainly due to Evans' zealous cost controls and emphasis on profitability. He has built CF&I into the 13th largest steel mill in the country since Crane acquired it in 1969, spending some $250 million on capital improvements. Last year, CF&I contributed 50% to Crane's $125.7 million operating profits vs. 54% to its $20 million profits in 1970.

On the drawing boards is an additional $160 million in capital spending to modernize a rail mill, open a new coal mine, and expand an ore mine at Guernsey, Wyo. "If you do your homework, there's no problem getting funds," insists Robert J. Slater, who moved up as president of CF&I last spring. "Crane ownership has stimulated us to look at programs to be more profitable," adds Edwin F. Lord, who is CF&I's vice-president of sales.

Paring down

There has been some cost-cutting. In addition to the New Jersey closedowns, CF&I has closed its Denver offices, consolidated operations at Pueblo, and shut down plants in Massachusetts and California. All told, nearly 4,000 employees are gone.

The changes have made CF&I very profitable. Slater says that return on investment is 18%, compared with 4% before Crane. The industry average is about 10%. Contributing to the profitability is the fact that, "We're sitting in a rapidly developing marketplace, and we own and control all our natural resources," says Slater.

Actually, CF&I was Evans' second choice for an investment in 1968. His first was Westinghouse Air Brake Co., which, after a bitter battle, went to American Standard Inc., Crane's competitor in the plumbing business. Evans immediately charged stock violations and instituted a lawsuit against American Standard's management. Evans has since won his suit, and the amount of damages is now being assessed by the courts. "They manipulated the stock," says Evans indignantly. "They bought at 50 and sold under the counter the same day at 44." But Evans would have preferred to win Wabco rather than the suit. "It's been American Standard's largest source of income," he says.

Evans talks of retirement but does not set a date on such a move. "I could always pay more attention to my horse farm," he says. He shares with the Mellon family an intense interest in horse breeding since he converted his Gainesville farm from cattle to horses in 1964. But sport is not the object. "It's a very competitive, tough business," he says. "We try to make money out of it, but it's hard to do. You keep trying to upgrade the breeding. If you don't have a good mare, it's almost never any good. We call it the bottom line." ■

"Coalition Against Nuclear Training for the Shah." President Wiesner, however, contends that the faculty's position "will have no effect on the implementation of the Iran deal."

"Flash rumor—The Shah of Iran has offered M.I.T. a $2 million bribe to be made the Compton Lecturer!" (the Institute's prestigious annual faculty lectures), reports *Thursday*'s Scott Batterman. Earlier in his column, "Venom," Batterman speculates: "With Iran trying to buy the Nuke E. department, I've heard rumbles through the corridors about the possibility of a competitive bid entered by Saudi Arabia, while Spain is interested in picking up some good Chem. E. tools." Perhaps it's true? Just the other day (February 25) *Nuclear Weekly* reported that Brazil is buying up to eight West German nuclear power plants from the European Consortium, URENCO-CENTRIC.

What seems clear is that democratization of the technology for nuclear destruction is being extended to the wealthier of the "modernizing" countries previously associated with the capitalist-Western bloc. The diplomatic phase in which the United States controlled the Western arms trade, along with other policies (e.g., defense of the Central Highlands in Vietnam) appears a failure. What we now witness is the move by sectors of the new industrial state to capitalize on this reality. At the university level this formula expresses itself as subversion of the traditional idea of the university as "free" and "open." Academic resources have always been the preserve of those wealthy enough to purchase them (indeed that is the linchpin in the radical critique of education), but now at M.I.T. and other universities the situation may be so extreme as to destroy the traditional concept of the university—for the worst principled case: "Bombs for the Shah." □

ELK HILLS RIP-OFF

STANDARD OIL KEEPS POPPING UP

GEORGE L. BAKER

Washington

A lot of strange things are happening in the name of Operation Independence, the attempt to make the United States self-sufficient in energy by 1985. And one of the oddest is a plan to tap four petroleum reserves held in trust by the Navy since the 1920s.

It is natural enough for interest to focus on the reserves, particularly on Elk Hills in California and Pet 4 in Alaska. Elk Hills contains a minimum of 1.3 billion barrels of oil, all ready to be pumped out with a minimum of effort or expense. Pet 4, 23 million acres, contains 10 billion to 33 billion barrels. If the estimate is accurate, this field would dwarf the commercial Prudhoe Bay, lying directly east of Pet 4. The Navy's two other reserves, Teapot Dome in Wyoming and Buena Vista close to Elk Hills, hold too little oil to warrant much excitement.

Last year, at the height of the Arab embargo, Congress was all set to turn the reserves over to the oil companies to do with as they saw fit. The move failed because of the intransigence of the House Armed Services Committee, which passionately resists anything that faintly smacks of an attack on national defense. When they found their way blocked in one committee, proponents of exploiting the reserves conceived an end run. Why not transfer control of the reserves from the Navy to the oil-industry-dominated Interior Department?

Brushing aside warnings that a similar transfer in the 1920s had precipitated the infamous Teapot Dome scandal, the pliable House Interior Committee a few weeks ago reported out a bill so weak and carelessly drawn that it would give the Interior Secretary virtual *carte blanche* to decide how oil companies might make one of the richest land grabs in memory. Reposing control of the reserves in Interior would certainly assure production, for the department has one function—to give away the nation's natural resources—and it performs that admirably.

Yet, laudable as is the goal of increased domestic oil production, tapping the reserves for the purpose raises disturbing questions, some of which have hardly been given thorough scrutiny. For instance, given its record, how would the Interior Department structure bids to produce from Elk Hills? The normal government royalty for an unexplored field is from 10 to 16 per cent of the wellhead price of crude. But at Elk Hills the oil is spotted and ready to be produced. Navy witnesses testified that it costs less than $1 to produce a barrel of that oil, which can be sold by commercial oil companies for at least $10. How would Interior recapture what obviously is a huge public benefit? Various officials of Interior have said the department would ask for competitive bidding, but that doesn't mean much in the oil industry. Further, the bill, which is likely to be enacted soon, gives no guidelines as to how the bidding should be done.

Indeed, would Interior be able to get any competitive bids? There is a great deal of evidence to show that the major oil companies in California, led by the San Francisco-based Standard Oil Co., would continue to maintain their stranglehold on the access to and price of oil. Congress has paid scant attention to possible violations of antitrust law by some of the companies that would be either producing or purchasing oil from Elk Hills. The investigation, begun in 1970 by the U.S. Department of Justice, has only lately been revived after a dormant period that coincided with John Mitchell's reign. But those who are pushing for production at Elk Hills—including several otherwise knowledgeable Congressmen, such as Reps. John

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other nations, notable for extreme authoritarian rule (Iran, Brazil, Spain, Nationalist China), are now exhibiting signs of such interest. At the heart of elementary nuclear weapons technology is plutonium, a rare element accumulated through the processing of waste from nuclear reactors.

As a signatory to the Nuclear Non-Proliferation Treaty, the Shah has the right to process his own nuclear wastes from the ten reactors soon to be acquired. Iran will, therefore, technically achieve nuclear weapons capacity. An evaluation of this capability hinges on interpretations of the nature of the Iranian state from evidence of conduct and propaganda. The Shah, a self-admitted absolute dictator with a will to re-create the Persian Empire of his ancestors, stated on CBS's *Sixty Minutes* that he had executed two prominent writers, Khosrow Golsorklti and Iaramat Daneshian, while adding confirmation to six more victims. He came to power in 1953 through one of the better known CIA coups, and rules with a tyrannical will (assisted by Ambassador Richard Helms). The country's village population today subsists on an average per capita income of $200 (U.S.). Some 20,000 to 40,000 political prisoners (including Gholam Hussein Sa'edi, Iran's greatest modern playwright, and prominent social scientists and educators) are proof that Iran lacks democratic freedoms. The state's grandiose schemes for accretion of the Persian Empire are lost on the majority of the population (who as Kurds, et al., do not share the Shah's Persian chauvinism), but not on the Iraqi Kurds, or the Dhofar Liberation fighters, who face Iranian mercenaries and Omani troops.

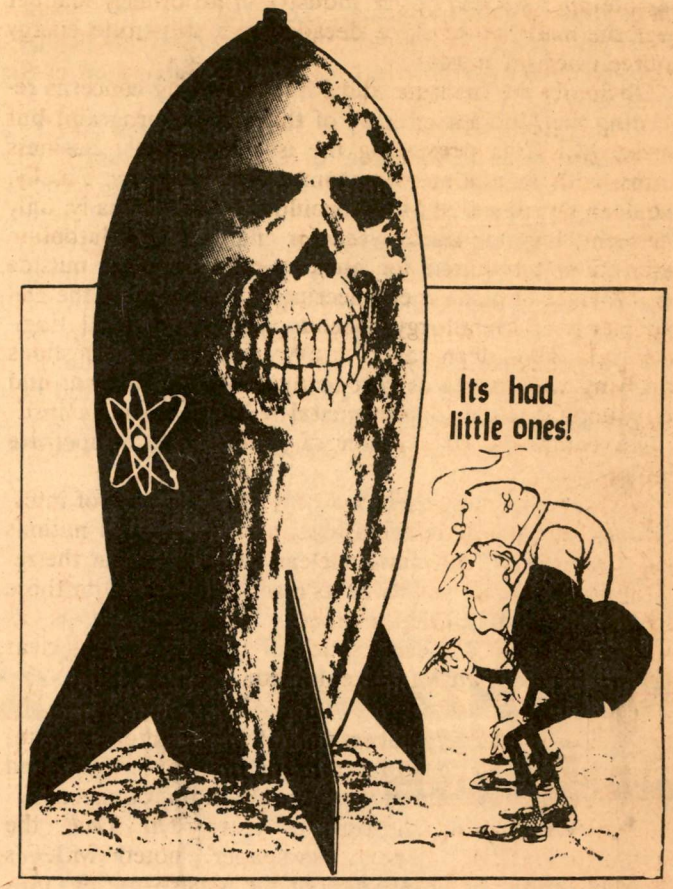
Given the Shah's probability of obtaining nuclear weapons, as suggested by the evidence, SACC addressed the institute's "last defense . . . academic freedom." Of all the issues to be entertained in the Iranian Uranium debate, this is:

> The most difficult, subtle and irrelevant, yet we must face it. It is to be faced sooner or later by science. In our world of books, ideas and problems that end at 5 P.M., the free interchange of ideas is regarded as an absolute value. We submit that the deal in question has nothing to do with the exchange of ideas—this is vocational training to prop up a repressive regime. Training of the nuclear technicians of an absolute dictator is quite opposed to the freedom to teach philosophical systems which differ from those prevailing (which people don't miss much), or the freedom of political or artistic expression. *The bearers of technology must censure themselves or eventually experience censure from without.* (SACC's emphasis).

Technology may indeed be too important to be left to technologists.

One recalls Kurt Vonnegut's *Player Piano* as Dr. Jerome Wiesner, president of M.I.T., former science adviser to John F. Kennedy and a moderate in Institute politics, responds to a question at "The Great Iranian Uranium Connection" regarding his role in this affair and his earlier role in developing the "electronic battlefield."

> *Wiesner*: In the automated battlefield all we were doing was trying to end the Vietnam War, *my way* (emphasis his). The issue is whether we want to make a grand moral play and exclude the [Iranian] students.
>
> *Vonnegut*: This book is not . . . about what is, but a book about what could be. The characters are molded after persons as yet unborn, or, perhaps, at this writing, infants. It is mostly about managers and engineers. At this point in history, 1952 A.D., our lives and freedom depend largely upon the skill and imagination and courage of our managers and engineers, and I hope that God will help them help us all stay alive and free.



Uluschak, Edmonton Journal (Canada)

A student letter in *Thursday*, M.I.T.'s independent student newspaper, suggests that there is still hope. A junior engineering student writes of his "malaise" stemming from "this plan [which] borders on professional prostitution. . . . I have been taught and convinced that engineering and science are ultimately concerned with the needs of mankind." The letter is but a part of *Thursday*'s continued attack on the selling of the Institute which began in March with an exposé, "Iran Buys Course XXII" (Nuclear Engineering). *Thursday* then tried to wake the dead with a special issue, *Monday*, that featured coverage of a lecture by M.I.T.'s ex-student body president and ex-student revolutionary, Michael Albert, who had appeared to discuss "What Is To Be Undone" (from the title of his recent book). Albert had been expelled from the Institute for his militant politics and *Thursday* hoped he could spark some student interest in contemporary politics. Following issues of *Thursday*'s carefully choreographed opposition to the Iranian Uranium Connection included "Iran Sneak Attack," reporting the administration's attempt to rush faculty endorsement of the proposal, and "Faculty Comes Through," covering the news that a faculty coalition had successfully tabled discussion of the issue (for three weeks) and announcing the formation of a

Melcher (D., Mont.) and Alphonzo Bell (R., Calif.) profess little knowledge of it.

Everywhere you turn Standard's name pops up. It owns 20 per cent of Elk Hills and when oil is pumped from there the company will make a substantial profit. At present, because the field is operated under a contract whereby Standard and the government pool their reserves, the oil company isn't able to get to its oil. If commercial production were authorized, it could do so.

While it is evident that a few oil companies would benefit by drawing on the reserves, it is a good deal less clear that the public or government would be enriched. Theoretically, the planned 300,000 barrels a day from Elk Hills would reduce dependence on overseas oil by that amount. But there are no assurances that the oil companies would not simply continue those imports and shut down other domestic wells—especially since imported oil fetches the uncontrolled price of $10 a barrel, as would oil from Elk Hills, while much of domestic production is still controlled at the "old" oil price of $5.25.

It seems to have occurred to no one that, rather than give the companies a huge parcel of public property, a more workable and equitable approach would be to use the reserves as a building block for a government-owned oil exploration and production company. That proposal has been kicking around Congress for several years and is gaining considerable strength. As it stands, the government merely acts as agent for oil companies that want to exploit a resource that belongs to everyone.

The concept of retaining for the government what belongs to it surely would be in the public interest, but in Washington these days little thought is given to public interest. Certainly it isn't a concept that would weigh heavily on the conscience of the Interior Department. For years, the Bureau of Land Management, an Interior agency, allowed private oil developers to poach oil from the edges of all four reserves; it has only recently halted the practice in response to rising protests.

In fact, the department is acting as if it already had the reserves in its grasp. It has plotted routes for the eventual construction of a pipeline to carry oil from Pet 4, and it has established what it calls the North Slope Project in Palo Alto, to study the subsurface geology. Since most of Prudhoe Bay has already been explored, one can conclude that Pet 4, with its vast riches, is the center of its interest.

The Ford Administration has not exactly fronted for the Interior proposal, lest unkind parallels be drawn between it and the Harding administration, but it is clear that Ford's people are doing nothing to discourage the idea. Rather than move straight ahead, the President has chosen an oblique way to get at the reserves and to prod Congress into action. As part of his energy package, he has proposed the establishment of what he calls the National Strategic Petroleum Reserve, which would stockpile 1.3 billion barrels for commercial and military use in the event of another embargo. Oil would be stored in salt domes in Texas and Louisiana and in steel tanks to be constructed throughout the country. Some people haven't taken to the idea. Rep. Otis Pike (D., N.Y.) said it sounded to him vaguely similar to an earlier scheme proposed by Interior Secretary Albert Fall when he agreed to lease Elk Hills and Teapot Dome in exchange for construction of oil storage tanks in Hawaii.

No one is talking about such a scandal this time, but there remains nevertheless the antitrust question. Investigators are trying to find out if six companies—Standard, Shell, Union Oil, Tidwater, Mobil and Texaco—have violated the Sherman Act by using their control of California pipelines to squeeze out competition from independent refiners. Further, they want to know if a "posted price" system, employed by several of the majors in moving oil throughout the state, is illegal price-fixing. The questions are intriguing, but the Interior Committee, in hearings dating back to last year, has never found time to explore them.

As long ago as 1970, memoranda prepared by Justice attorneys warned that competition for oil produced at Elk Hills might be strangled by the companies and that the government would receive less money than it deserved. The key figure in the setup is Standard, the nation's fifth largest oil company. As then Deputy Atty. Gen. Richard Kleindienst wrote in a 1970 letter to then director of the Bureau of the Budget Robert Mayo, Standard "is the largest producer and purchaser in the locality, indeed in the whole state. Moreover, Standard owns the only pipeline connected to the field, which any purchaser of Elk Hills oil must use for the first link in transportation to any refinery. The Standard line, however, is a private carrier, handling only oil owned by that company."

"Acting in concert with other companies," Kleindienst continued, "Standard could drive the Elk Hills wellhead price down, while still maintaining it at a higher price at the point where delivery is actually made to the refinery. Consequently, in order to move the oil, any purchaser must make arrangements for sale to Standard and repurchase from it at the delivery point."

Because of its privileged position, Standard, even if it produced not a drop at Elk Hills, could thus control the flow of oil from the reserve; and it could dictate the price and terms to any firm that wanted the oil from its pipeline, particularly independent firms which must rely on the good will of the majors.

But that is only part of the story. Last year a joint legislative committee in California, headed by the current state Controller Ken Cory, examined how the pipeline system in the state operated and how crude oil prices were set. Late last year, the committee concluded that crude oil flows into California according to a "closed system in which market price is a deliberate illusion veiling the real value of that supply and the division of revenues therefrom."

The committee said this after examining company records and discovering that oil is very seldom sold in the open market. It is customarily traded from one company's pipeline to another company's pipeline at a so-called "posted price," which is artificially set. Accordingly, "There is no free market for crude oil in which a willing buyer and willing seller can bargain. Most of the crude oil is not traded on the market. It is kept within the select group of seven [companies]; produced by them, singly and jointly, and sent either directly to the producer's refinery or traded within the group without reference to the 'market price.' "

In Congressional testimony, Keith I. Clearwaters, deputy

assistant attorney general for antitrust, said the Justice Department has intensified its antitrust investigation, but as yet has no conclusive evidence of violations. He added, "We are still investigating, however, and I would not want to suggest that the charge cannot ultimately be made."

Though no evidence has been received that independent refiners have been denied access to oil by major oil companies, Clearwaters said investigators are also looking into allegations by the Cory committee. "That is, whether there is an implied agreement to fix the prices of crude oil." Such a possibility could be inferred, he said, because "there is a pattern of substantial uniformity of postings" by at least four majors, including Standard.

Given this demonstration of rather sleazy free enterprise on the part of the major oil companies, one wonders if those who advocate turning the Navy reserves over to the Interior Department have tried to foresee the consequences. Though Congress appears to be in a panic to give away the oil, the least it can do is wait until the antitrust questions are resolved. To do otherwise would be an abdication of public responsibility.

The Navy's case for holding onto its oil for World War III is rather weak, but the proposal to hand over the oil to Interior for distribution among a few industry giants, is even more dubious. To do so will almost certainly mean that the taxpayer, once again, has his pocket picked.

As Rep. John E. Moss (D., Calif.), a persistent critic of production at the reserves, has noted, "Past patterns of behavior by [Standard] and Interior do not inspire confidence in their ability or desire to protect the public interest." But then, one man's national emergency is another man's larceny. □

SOVIET-AMERICAN TRADE

CAN'T WE DO ANYTHING RIGHT?

O. EDMUND CLUBB

At a meeting with Soviet trade officials in Moscow on April 10, Treasury Secretary William E. Simon voiced an American desire "to participate fully in the opportunities offered by open international trade"—that is, trade with the USSR. If that is the case, it is worthwhile to recall a Congressional assessment that found Soviet-American trade prospects reasonably favorable. According to a study by a subcommittee of the House Foreign Affairs Committee, "Economic advantages to the United States are likely to be centered on such specific sectors as imports of petroleum and natural gas and exports of soybeans, feed and cereal grain, and computers, and other high-technology products."

The report foresaw that the exchange "by any projection is not likely to represent a large share of United States trade," but it still calculated that, if projects involving the exploitation and sale of Soviet natural gas to the United States were approved, the trade might grow to a total of $5 billion annually. Moreover, it was thought that significant long-term political benefits might accrue from the growing economic exchange. "Overall," the report said, "such political gains might far outweigh the relatively modest economic returns."

That 105-page study was made public on June 9, 1973, on the eve of Soviet party leader Brezhnev's arrival in Washington for a meeting with President Nixon. The study had been prepared in the light of general principles enunciated by Nixon and Brezhnev when they had met in Moscow in May 1972, and in view further of the three-year agreement signed by the two countries in October 1972. That latter agreement, designed to be a solid base for a new economic relationship, granted most-favored-nation (MFN) treatment to the USSR in exchange for settlement of the Soviet lend-lease debt to the United States. There seemed real promise of *mutual* benefit. And at Yalta, in June 1974, Nixon and Brezhnev signed a ten-year agreement providing a broad framework for the expansion of economic exchanges and cooperation between the two countries.

The contretemps of December 1974 is fresh in the public memory. In the face of a clear warning from Brezhnev on October 15 that the attaching of political conditions to trade agreements would be improper and "unacceptable" to the Soviet Union, Congress on December 20 passed the Trade Reform Act bearing the Jackson-Vanik amendment, which makes the extension of MFN treatment to the USSR conditional upon a Soviet grant of freedom of emigration for its citizens. Furthermore, the Senate Foreign Relations Committee, diverging radically from the line taken in the study prepared by its House counterpart, had decided that it would not be in the best interest of the United States to have official American participation in the development of Soviet natural-gas resources. So when extending the lending authority of the Export-Import Bank for four years at the $25 billion level, Congress in December stipulated that no Export-Import Bank credits might be used for the production, transportation or distribution of energy materials from the USSR. Finally, Congress put a $300 million ceiling on credits that might be extended to the USSR for any purpose, with that amount to be extended over four years and the maximum in any one year to be $75 million. The $300 million limit might be exceeded only if the President deemed it in the national interest *and the Congress approved.* Congress had not established such limits on total credits for any other country.

The immediate sequel is well known: Moscow refused to

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