

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

March 4, 2006

2:02 p.m.

**MEMBERS PRESENT**

Representative Jay Ramras, Co-Chair  
Representative Ralph Samuels, Co-Chair  
Representative Jim Elkins  
Representative Carl Gatto  
Representative Gabrielle LeDoux  
Representative Kurt Olson  
Representative Paul Seaton  
Representative Harry Crawford  
Representative Mary Kapsner

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Representative John Coghill  
Representative Peggy Wilson  
Representative David Guttenberg  
Representative Les Gara  
Representative Beth Kerttula  
Representative Bill Stoltze  
Representative Reggie Joule  
Senator Thomas Wagoner

**COMMITTEE CALENDAR**

HOUSE BILL NO. 488

"An Act repealing the oil production tax and gas production tax and providing for a production tax on the net value of oil and gas; relating to the relationship of the production tax to other taxes; relating to the dates tax payments and surcharges are due under AS 43.55; relating to interest on overpayments under AS 43.55; relating to the treatment of oil and gas production tax in a producer's settlement with the royalty owner; relating to flared gas, and to oil and gas used in the operation of a lease or property, under AS 43.55; relating to the prevailing value of oil or gas under AS 43.55; providing for tax credits against the tax due under AS 43.55 for certain expenditures, losses, and surcharges; relating to statements or other information required

to be filed with or furnished to the Department of Revenue, and relating to the penalty for failure to file certain reports, under AS 43.55; relating to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue, under AS 43.55; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the oil and gas production tax; relating to the deposit of money collected by the Department of Revenue under AS 43.55; relating to the calculation of the gross value at the point of production of oil or gas; relating to the determination of the net value of taxable oil and gas for purposes of a production tax on the net value of oil and gas; relating to the definitions of 'gas,' 'oil,' and certain other terms for purposes of AS 43.55; making conforming amendments; and providing for an effective date."

- HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 488

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

02/21/06	(H)	READ THE FIRST TIME - REFERRALS
02/21/06	(H)	RES, FIN
02/22/06	(H)	RES AT 12:30 AM HOUSE FINANCE 519
02/22/06	(H)	Heard & Held
02/22/06	(H)	MINUTE(RES)
02/23/06	(H)	RES AT 12:30 AM HOUSE FINANCE 519
02/23/06	(H)	Heard & Held
02/23/06	(H)	MINUTE(RES)
02/24/06	(H)	RES AT 12:30 AM HOUSE FINANCE 519
02/24/06	(H)	Heard & Held
02/24/06	(H)	MINUTE(RES)
02/25/06	(H)	RES AT 10:00 AM SENATE FINANCE 532
02/25/06	(H)	Joint with Senate Resources
02/27/06	(H)	RES AT 12:30 AM CAPITOL 124
02/27/06	(H)	Heard & Held
02/27/06	(H)	MINUTE(RES)
02/28/06	(H)	RES AT 12:30 AM CAPITOL 124
02/28/06	(H)	Heard & Held
02/28/06	(H)	MINUTE(RES)
03/01/06	(H)	RES AT 12:30 AM CAPITOL 124
03/01/06	(H)	Heard & Held
03/01/06	(H)	MINUTE(RES)

03/02/06 (H) RES AT 12:00 AM CAPITOL 124  
03/02/06 (H) Heard & Held  
03/02/06 (H) MINUTE(RES)  
03/03/06 (H) RES AT 12:30 AM CAPITOL 124  
03/03/06 (H) Heard & Held  
03/03/06 (H) MINUTE(RES)  
03/04/06 (H) RES AT 2:00 PM HOUSE FINANCE 519

#### **WITNESS REGISTER**

JIM EASON, Consultant  
to the Legislative Budget and Audit Committee  
POSITION STATEMENT: Provided an analysis of HB 488.

#### **ACTION NARRATIVE**

**CO-CHAIR RALPH SAMUELS** called the House Resources Standing Committee meeting to order at [2:02:26 PM](#). Present at the call to order were Representatives Elkins, Seaton, LeDoux, Ramras, and Samuels. Representatives Olson, Gatto, Crawford, and Kapsner arrived as the meeting was in progress.

#### HB 488-OIL AND GAS PRODUCTION TAX

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CO-CHAIR SAMUELS announced that the first order of business would be HOUSE BILL NO. 488, "An Act repealing the oil production tax and gas production tax and providing for a production tax on the net value of oil and gas; relating to the relationship of the production tax to other taxes; relating to the dates tax payments and surcharges are due under AS 43.55; relating to interest on overpayments under AS 43.55; relating to the treatment of oil and gas production tax in a producer's settlement with the royalty owner; relating to flared gas, and to oil and gas used in the operation of a lease or property, under AS 43.55; relating to the prevailing value of oil or gas under AS 43.55; providing for tax credits against the tax due under AS 43.55 for certain expenditures, losses, and surcharges; relating to statements or other information required to be filed with or furnished to the Department of Revenue, and relating to the penalty for failure to file certain reports, under AS 43.55; relating to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue, under AS 43.55; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the oil and gas

production tax; relating to the deposit of money collected by the Department of Revenue under AS 43.55; relating to the calculation of the gross value at the point of production of oil or gas; relating to the determination of the net value of taxable oil and gas for purposes of a production tax on the net value of oil and gas; relating to the definitions of 'gas,' 'oil,' and certain other terms for purposes of AS 43.55; making conforming amendments; and providing for an effective date."

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JIM EASON, Consultant, Legislative Budget and Audit Committee, said he came to Alaska as a petroleum geologist and has worked for Conoco and Arco, as well as the United States Geological Survey evaluating off-shore acreage in Alaska. He then worked for the state as the director for the predecessor of the Division of Oil and Gas. He has since been a consultant for industry, governments, and law firms. He said there have been all sorts of mathematical issues, but he wants to talk about his perspective. He has seen the "quasi-legal side" of states protecting their interests.

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MR. EASON said there are geological connections that aren't obvious "if you are just going to focus on the economics." He said "the numbers you've been looking at are wrong, but it's not necessarily bad." He noted the geological risk of reduced large discoveries, but there are new ideas and new technology.

MR. EASON said Pedro van Meurs' report helps evaluate "what the numbers mean." The report notes that smaller fields are the main target on the North Slope, and the proposed profit-based petroleum production tax (PPT) is primarily a tax on existing production. The 50 million-barrel high-cost, low-productivity case "is a very important benchmark for large producers because this is a fairly representative case of most of the incremental developments that may take place on the North Slope. This case will therefore see a significant improvement over all economics while on average there's no increase in tax, assuming that large companies maintain a long-term price forecast in the \$25 to \$30 range." Mr. Van Meurs is saying there is geological and forecasting risks, which is relatively minimal because there is history there. Undiscovered resources are "totally hypothetical." Price forecasts are notoriously unreliable.

MR. EASON said some wells penetrate many different reservoirs, and a company in Cook Inlet defined "well" to take advantage of the ELF. He said most people assumed that the accumulations in Prudhoe Bay were part of the Prudhoe Bay field, and it was disaggregated. He reflected on mistakes the state made when beginning competitive oil and gas lease sales. An attorney, who was provided by the Western Oil and Gas Association, influenced these decisions, causing years of litigation. In 1977, "the words of the lease finally began to take on real significance. The state's first royalty receipts indicated that everybody seemed to be paying royalties on a very different basis."

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MR. EASON spoke of the issues around the leases, including how the state determines the fair and reasonable allowance for transportation. He said litigation lasted 17 years. For Prudhoe Bay it was agreed that "the state would pay a field cost no matter what, if it was in kind or in value, on a negotiated amount." The settlement did not provide a mechanism to look back. He said that agreement is still alive and governs what the state's obligations are at Prudhoe Bay, and the state pays "just about a dollar a barrel." There are some [indecipherable] leases still there and are associated mostly with production.

MR. EASON said that while the case was pending, the producers settled and produced the Trans-Alaska Pipeline System Settlement Methodology, and "for years and years, everyone that I've talked with who does not own a piece of the pipeline feels that the actual settlement values on that pipeline are prohibitively expensive for some companies to produce on the North Slope and at a minimum, very costly."

MR. EASON said the effects [of the methodology] have grown over time, and it is a big impediment for some. It is the same with facilities-access, he noted. He said, "By the time the early 90s was rolling around, litigation was still going on, the administration made a decision to try to settle the case on the remaining issues before the trial date because the climate had really gotten ripe." The litigation was expensive, he said. Three people were selected to meet with the big producers to settle the "simple question" of how to value the oil. The agreement resulted in three different settlement agreements with Phillips Alaska, Inc., BP, and ExxonMobil Corporation. "Basically they looked to a proxy for the lease terms that they had before [indecipherable] value. Those are just set aside, and the deal was that we created a new way of valuing North

Slope oil." He said the basic agreement looked to the relative movement of the average prices of the spot reported prices for [indecipherable]. "It was designed so they would try to replicate the value...of ANS in the market and hopefully, with the provisions that were designed into it, continue to do that, continue to produce the same economic result." He said the agreements have been in effect since about 1992. There have been "a number of re-openers" and negotiations, he said. Both sides are happy, he opined.

MR. EASON added, "The key is, without the ability to compensate if your decision is wrong, you run the risk of a really disproportionate result." He said the question of the point of production that was "so important in the royalty litigation...is an issue that needs to be clear in both parties' minds...how it may affect existing production practices but also how it may translate to the major gas sale."

MR. EASON said the state anticipated major gas sales in 1980 during the settlement agreement, and there are some provisions that will materialize over time as the project moves forward. The changes made in tax statutes "change some of the things that will have, or be impacted by, the decisions incorporated in any agreements that affect those in the future. And we can't really say much about that other than that right now." Looking at HB 488, there is a new definition for both gas processing facilities and gas treatment facilities, "and we have asked...to get some greater certainty about what the intent and the interpretation of some of these features might be and how that may change over time." He stated that it is very important that those questions be answered because they provide some uncertainty with potentially great significance.

MR. EASON said another issue is the breadth of credit and deductions in HB 488. The bill speaks to qualified expenditures for exploration, production, and development, but no one knows what that is. As it is written, it could be argued that it is "everything and anything that you can imagine." He said he is not alone in that thought. He said smaller companies would like those terms better defined, and the state should know its future exposure to that. He said it will be time consuming but worth it, and the hard calls would be "your calls, obviously." It will help avoid ambiguity and give an understanding to the implications of this decision. He said one issue is the question of abandonment costs, and the state should have some sense of what that might be. The state will be underwriting these costs, which is a major change from today.

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MR. EASON said the Department of Revenue told the legislature it has not included abandonment costs in all its estimates. He has not seen any estimate of the costs of abandoning the Cook Inlet platforms. As an example of a way Alaska could begin to examine this potential cost to the state, he looked at the costs of abandoning platforms on the California coast.

REPRESENTATIVE GUTTENBERG asked Mr. Eason about abandonment costs in Prudhoe Bay. He asked if he is talking about the "r and r'" and what's been in place since the original leases. He asked if the past can be set aside as no longer valid.

MR. EASON asked if he is referring to the Trans-Alaska Pipeline System. He said that "would stay just as they are because it's a transportation. Arguably you can't guarantee nobody would claim that, but I'm looking upstream of the transportation. But including the transportation—the pipelines, the flow stations, all the things upstream of that—I believe under this bill would be subject to your support in abandoning."

REPRESENTATIVE GUTTENBERG said, "So it has to be in the bill, otherwise it doesn't happen?"

MR. EASON said that is correct.

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REPRESENTATIVE GATTO said, "I think he's referring to what we call demobilization, removal, and rehabilitation." That money is supposed to be set aside for that eventual day in an amount sufficient to make it all happen. He asked if new legislation could eliminate that.

MR. EASON said he is talking about field abandonment. "I do not believe anybody has physically put money aside for that. They are contemplating it. They are in some fashion accounting for it." He doubts anybody has put money aside for it, but it is a known, and substantial, obligation.

CO-CHAIR SAMUELS said it is just a future liability.

REPRESENTATIVE GATTO said, "I thought it was a nickel, and I think the only thing we're talking about was removing the

pipeline." He still wants to know if it is a promise to pay or is it money in the bank.

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MR. EASON said there is no bank for the money. He said it is completely separate from the TAPS and upstream from it. It would be all the wells that have been drilled, the pads, and whatever the state requires. Other agencies will play a role, including the Fish and Wildlife Service and the Environmental Protection Agency. "The question is: who pays for it?" Under existing law and existing leases, the companies can deduct those costs from their federal and state corporate income taxes. They can't deduct from the petroleum tax, but will under this bill. He warned that there is an exposure to allowing credit on top of the deduction, even though DOR has said that is not the intent.

MR. EASON said most of those costs are unknown. The 23 platforms that will be abandoned in California will cost anywhere from \$10.29 million to \$129 million. It will cost more in Alaska, but not as high as the high estimate, he surmised. Under the net profit share leases, the lessee pays a royalty and is forced to pay a share the net profits above that, he said. So there are running accounts for those leases in certain fields. Every month and year the costs are accumulated and carried forward, "so at any point in time you can look and see what the development account balance is that's growing with interest." That gives an indication for two fields, and the estimated cost for the Endicott field is about \$110 million, he said. The Northstar field has a \$75 million exposure for abandonment. He looked at the applications for royalty reductions, which are confidential. But the range for royalty applications range from 7-20 percent of the total combined facility and well costs. "Those are very large numbers, and I think they are large enough that you should be concerned about trying to find out as much as you can...[of] an estimate of what those costs might be spread across all the known facilities today." It is significant, he opined.

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CO-CHAIR SAMUELS noted the Mr. Eason said small companies want cost recovery definitions laid out in statute, but it has been the large companies requesting such from him. He added that if it is in statute, the industry will ask future legislators to change it "and into the political system we go where common sense sometimes doesn't quite bubble to the top." The benefit

of putting it in regulation is the bureaucrats can speak the same language, but then the industry complains about the power of the regulators, who are the most qualified people to make the determinations. He asked for Mr. Eason's opinion.

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MR. EASON told the committee to prioritize the policies that need the most clarification. He said to focus on costs that may be the greatest, and then define or limit those costs. He suggested to think of it as a negotiation, and it will not be unusual to "split, refine, qualify, place sideboards." There could be a limit on the percentage of recovery that tries to measure the production profile with its expected revenue. "The worst possible event you would want is to have falling prices when you didn't expect them, really declining production because the fields haven't materialized, and a bill for the [indecipherable]. And that's the worst case...I can remember when, back in the early 80s, we were looking very seriously at statute to make sure that we had the statutory minimum in case the prices fell below the field costs and all the other considerations for the state's royalty oil. So...those thing can change very dramatically in very short order."

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REPRESENTATIVE SEATON surmise that Mr. Eason is saying is that terms defined in statute need to be modifiable in regulation, giving the state more flexibility but more chance of lawsuits because people understand the terms differently.

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MR. EASON said he would stop short of calling for all of them in statute. He suggested defining them in advance by the department or by consensus, "so that there's an understanding." He said to identify places where there have been problems and fix them or come to an understanding. He said a working group has been recommended for all of the producers, and he noted that the Alaska Oil and Gas Association may have done that. He stressed that there are broad terms in [HB 488] that can be interpreted in costly ways, and he said to resolve those.

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MR. EASON he said there was some language in HB 488 with historic themes. He noted that when negotiating agreements and

appeals, the state was urged to resolve them by resorting to the unit operating agreements for guidance or clarification. Regarding the bill he said, "anytime I see a legislative directive to an administrative agency that they'll use 'substantial weight', I know that somewhere there's somebody that's going to tell you what that is, and it's likely to have a different opinion between parties." He added that the fact that it's connected with an operating agreement, again, "is sort of a recurring theme. You may, as a matter of policy, want to do that if you have more comfort or exposure to them. But...they are agreements among the working interest owners in a unit. They aren't agreements with the state. The state has no control over the terms and prove them or deny them." He said some things that the parties agree to will not be in the state's interest. There are many operating agreements and they differ, he stated, and they are given to the state as a courtesy and are not required. The agreements are routinely amended and the state often doesn't have the current agreement. As a royalty owner the state needs to explore that more, he said. The implications are unknown.

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MR. EASON said another recurrent theme is adopting the royalty settlement agreement values for determining value for severance taxes. He noted that three different settlement agreements were negotiated in resolving the oil phase of Amerada Hess. At any point in time those numbers usually were different, he said. Sometimes the calculation of crude is dramatically different, because one agreement allows actual costs "and then some." "If you start thinking about which one of those you might want to use, there's probably a concern there...how would you do that mechanically and why would you do that?"

MR. EASON said looking back at the performance of the state's royalty settlement values against the severance tax payments in the first ten years showed consistent higher average severance tax value than royalty settlement agreement value. That number has grown larger in the last five years, he stated, with an average of about \$0.40 a barrel. There is a concern that it will grow. Theoretically, the department has the authority to consider all these things for indicators of value, and the effort to memorialize it in statute raises a flag, because doing that has produced a lower result.

MR. EASON said the royalty settlement agreements provide for arbitration rather than litigation. He spoke of his involvement

in the agreements and DOR's role. He said DOR enjoys some deference from the courts. The arbitration proceedings for the settlement doesn't have full discovery opportunities and the decision-making process is much narrower. He said adopting the royalty settlement agreements isn't clear whether that is the fiscal terms only or the arbitration option for making tax decisions, which is a very different world with risk.

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CO-CHAIR RAMRAS asked Mr. Eason how the House Resources Standing Committee was handling the legislative proceedings on HB 488.

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MR. EASON said the process and effort is good, and Daniel Johnston will give the committee his sense of the appropriate way to go.

CO-CHAIR RAMRAS asked about Mr. Eason's confidence in DOR.

MR. EASON said he said the DOR people are qualified, but "you would be well-served to have as many eyes looking at this problem as you can." He said the bulk of the expertise in the state is in DNR, which works every day with every aspect of the oil and gas industry. He said to make sure that DNR people are complementing and consulting with DOR, which he achieved when he was the director of the Oil and Gas Division.

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CO-CHAIR RAMRAS said there are rumors that "our guys" are not smart enough to take on "their guys," because the best people migrate to the high paying jobs in the industry. He asked if the state can handle this task or if the producers will be "high-fiving each other on their way out of town."

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MR. EASON said he has met people in the state who are as good as anyone in the industry, but industry has "more of them and generally they stay up longer and start earlier." There is a built-in competitive advantage that goes beyond intellect and talent. He said the "resources were always insufficient...to assure you that you were covering all the bases." The state's work is precipitated by events out of its control. The industry

has the advantage of pursuing specific programmatic agendas into the future.

REPRESENTATIVE GARA brought up the royalty settlement methodology issue. Section 20 of HB 488 comes up with a new way of assessing the gross value of oil that will be taxed. He asked if the rewrite raises the potential to lose millions or billions of dollars compared to current law. He asked if a producer will be able to choose between two tax methods, giving them the opportunity to choose the lowest tax formula.

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MR. EASON said the PPT is based on profits. He said the producers have always wanted both royalty and tax "using those values." Historically, "had you done that under the existing production tax gross system, you would have lost money eight out of the last ten years that the settlement has been in effect." In the last five years, the state would have lost more money—"a big number." He said the intent and exact rules and procedures are not clear. "If you can find out what that is you will get a better sense of what it might cost you." He added that all the numbers are averages, and "all we know at this point is that on the average the royalty settlement values have not performed as well as the severance tax values under the existing system."

REPRESENTATIVE GARA asked, "If we said 'no', we're just going to go with how we calculate the value under current law...could we do that under the PPT? Would it mesh or do we have to change our definition of how we calculate the value?"

MR. EASON said the way values are calculated now, the department has regulations that they would presumably follow. "I believe they have the authority now, under regulations, to make changes in how they value, and I presume they would just continue to do that...The flag that is raised is why the emphasis in this bill to reinforce that option exclusive of others." He said the concern is not knowing what the operating agreements provide and that the state can't affect them, "but you're being asked in this bill to do something that is—raises a question as to why. You're being asked to say in statute that the agency must give substantial weight to those." He asked what that weight is, and said it will be resolved in law or arbitration. He asked if and why operating agreements are intended to be used since operating agreements can be changed and are out of the state's control.

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REPRESENTATIVE SEATON mentioned that allowable costs do not include headquarter operations. If there were two operators who agreed to take off \$600 million for headquarter costs, for example, "then we would be stuck into recognizing those headquarter costs as an allowable deduction because we're giving substantial weight to the operation agreement?"

MR. EASON said the if statute doesn't allow that, "I can't believe that they would knowingly allow it through some other mechanism." He said the concern is how far the state wants to go regarding the costs of exploration, production, and development. It may be a policy matter, but he has seen many things suggested as allowable costs. He noted that anyone doing their income tax tries to figure out every [deduction]. It is more important to have protection for both parties without unexpected disadvantages to either. He stressed getting the best information from many sources.

REPRESENTATIVE LEDOUX asked where "substantial weight" is defined.

MR. EASON said it is not defined in HB 488, and it may vary.

REPRESENTATIVE LEDOUX asked if the courts defined it in Alaska.

MR. EASON said he doesn't know.

REPRESENTATIVE CRAWFORD said he makes a great case for the constitutional requirement that one legislature can't bind a future legislature.

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REPRESENTATIVE KERTTULA asked him to suggest language regarding the royalty settlement methodology and operating agreements.

MR. EASON said that is his intent.

REPRESENTATIVE GUTTENBERG said Mr. Eason is stressing getting the definitions right. It sounds like the perception is that DOR is a backstop, and he asked if it's possible to build in the intent that if the call is close, "it goes to the home team."

MR. EASON said the attorneys will likely say no.

REPRESENTATIVE COGHILL said he heard discussions about the royalty settlement methodology and the sharing of profits and where that fits for the processing and treatment facilities. It will be interesting "on how we set the areas." He asked for help in understanding those parameters.

MR. EASON said one important issue on the royalty side is how to define the point of production. With all decisions and settlements, the legislature corrected that for the future leases, "they just said you can't do that anymore. You can't issue a lease that allows a field cost." There are still many out there, and the healthy majority of the leases in Prudhoe Bay are. There is already a field cost settlement for oil and some allowances for gas. He said the Kuparuk original area was also "in the deal." There are many leases that are unclear, but it is related to how to define point of production. There is the issue of what is merchantable, which can change depending on where you are.

MR. EASON said the state can write the regulations "so as to move in a situation where you are going to build facilities, depending on how the regs define the point of production. Some facilities potentially will be able to claim deductions and credits under this bill, and some may not if they aren't configured in the way that takes advantage of...I don't mean unfairly, just does this in recognition of what the tax consequences are." He said there isn't much gas being produced now, but the hope is for a major gas sale. The decision on how and where to place those facilities is not clear, he said. Because of that uncertainty, there is a valid question of how much and what pieces the state will assume the responsibility for carrying those deductions and credits. It is important to determine the intent of the parties and what is upstream or downstream relative to the pipeline.

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REPRESENTATIVE COGHILL said, "We're going to have to start defining what they can deduct." He noted that the movement of gas and oil will be part of the discussion in that regard.

MR. EASON said the processing and production facilities can change over time. Currently, "you know that from the wellhead to the final product there's—you can control where things happen with the technology." He said the Division of Oil and Gas may be able to help. He said the issue has been big in the past

with large consequences. The state will be faced with a large project, and the goal is to clarify the intent.

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REPRESENTATIVE LEDOUX said rather than incorporating nebulous phrases into the bill such as "operating agreements will be given substantial weight," why not just list each item that would be accepted as a reasonable cost? It is better to argue about it now than to argue in court for the next 15 years.

MR. EASON stated that some companies prefer this route, and it may not be the best solution but is one solution. He said he is not the only one who thinks that it is important to do.

CO-CHAIR SAMUELS noted that if the statute misses something, it will be difficult to change it.

REPRESENTATIVE WILSON spoke of abandonment costs, and asked Mr. Eason if he said the legislature has to be careful because of the credits with no timeline. "Would you suggest that we put a timeline on the credits so that we don't inadvertently end up doing a bigger portion of that abandonment cost ourselves, or did you say that maybe we should just look at a percentage?"

MR. EASON said there are two policy calls. The bill now includes abandonment costs as part of development and production, so that would mean underwriting the full cost of abandonment. The state can decide to underwrite a percentage of those costs or decide to only allow new developments. Many players entered into projects years ago with an understanding, he said. But he stressed looking at the numbers. He noted that the bill is designed to encourage exploration and development, but there is nothing intellectually wrong with sharing in the costs of abandonment. It could be done based on the volumes produced, he said, and there are many options besides the bill, which underwrites all those costs of abandonment. He said it is important to know what those figures will be.

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REPRESENTATIVE COGHILL asked for an explanation of arbitration as set in the bill in terms of working on the definitions.

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MR. EASON said there is currently no provision for arbitration. He said producers have wanted to substitute arbitration for litigation. Some arbitration is fast but not all; sometimes it takes a year to pick an arbitration panel, he said. At times, litigation is better for complex issues. Producers are more comfortable with arbitration because they do a lot of it, he stated, but they find themselves being sued a lot.

REPRESENTATIVE COGHILL said, "Do we get better definition through litigation? And then the discovery issue, is that because you can force proprietary information to come to the table through litigation against arbitration?"

MR. EASON said he would not say that litigation gave better clarification, generally. He said some judges resolve all your concerns and others raise new ones. Some arbitrators are limited in their decisions. He said his experience is that the state has been disadvantaged by the relative wealth of information when it comes to a dispute. The state has the reports and numbers and a relatively imperfect sense of why and how, he added. The producers don't have to discover very much; they have all the information.

REPRESENTATIVE COGHILL noted that the state is always on the defensive in those situations, but with rule-making the state can be in the offensive position.

REPRESENTATIVE SEATON asked if the problem on abandonment is an incentive to shut down in marginal production.

MR. EASON said there are probably many ways to evaluate that. He said the cost of continuing to produce is underwritten to some degree, and [allowing deductions of abandonment costs] could create different outcomes. He said the fundamental issue is figuring out how much financial exposure the state might have and making a judgment at that point. He said the legislature doesn't have enough information right now to make the decision of underwriting those costs.

[3:57:16 PM](#)

REPRESENTATIVE SEATON asked about the tax flow being reduced, and giving the industry an allowance on abandonment expenses, and especially credits. A future legislature may have a small flow of cash coming in, and it might be more important for future legislatures when the fields are declining, he surmised.

MR. EASON said that is fair. "You know you've got these things and you know somebody's going to have to abandon them, and you know that now it's not your problem, and tomorrow it will be."

REPRESENTATIVE LEDOUX suggested fashioning an arbitration clause to make discovery just as liberal as under litigation.

MR. EASON said it may be possible if there is agreement, but arbitration terms can't be dictated. There is nothing in HB 488 that directs the parties to arbitration. It is suggested by other language, he said. It is something that can be explored.

[4:01:03 PM](#)

CO-CHAIR RAMRAS spoke of previous testimony that expressed that indemnification should not be excluded as a cost. He asked if the bill is excluding Alaska micro-players and if there is a special remedy for that.

MR. EASON said helping Alaskan companies is a legal issue, but it may be able to be done creatively. He said helping small companies, "is a perennial question...You have to be sensitive to it but there's no end of things that people...can think of that they need help with." The state has a commendable record of being responsive to small companies, like providing exploration licensing. He said that people have revisited bonding, and those numbers have decreased. He spoke of exploration credits, and noted that the state is already providing incentives on a limited basis.

[4:06:10 PM](#)

MR. EASON said there have been companies and individuals that "were really playing above their heads," and the state bears the risk by encouraging small entities without ending up with an uncontrolled spill and no liability or coverage. There is a host of things that can happen, including litigation, and this business requires a certain level of underwriting.

[4:07:07 PM](#)

[HB 488 was heard and held.]

#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at [4:08 PM](#).