

MINUTES
SENATE FINANCE COMMITTEE
Second Special Session
May 21, 2006
4:24 p.m.

CALL TO ORDER

Co-Chair Lyda Green convened the meeting at approximately [4:24:13 PM](#).

PRESENT

Senator Lyda Green, Co-Chair
Senator Gary Wilken, Co-Chair
Senator Con Bunde, Vice Chair
Senator Fred Dyson
Senator Bert Stedman
Senator Lyman Hoffman
Senator Donny Olson

Also Attending: SENATOR BEN STEVENS; SENATOR GARY STEVENS; SENATOR RALPH SEEKINS; SENATOR TOM WAGONER; SENATOR KIM ELTON; SENATOR CHARLIE HUGGINS; DAN DICKINSON, CPA, former Director of the Tax Division, secured as a consultant to the Office of the Governor

Attending via Teleconference: From an Offnet Location: ROBERT MINTZ, Attorney with Preston Gates Ellis law firm, former Assistant Attorney General, Oil, Gas & Mining Section, Department of Law, secured as a consultant to the Department of Law

SUMMARY INFORMATION

SB 2001-OIL AND GAS TAX

The Committee heard from the chair of the Senate Rules Committee and consultants to the Department of Law and to the Office of the Governor. A committee substitute and six amendments were adopted. The bill was reported from Committee.

#sb2001

SENATE BILL NO. 2001

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the production tax; providing that provisions of AS 43.55 do not apply to certain oil and gas subject to a contract executed under the Alaska Stranded Gas Development Act; amending the definition of 'gas' as that definition applies in the Alaska Stranded Gas Development Act; making conforming amendments; and providing for an effective date."

This was the second hearing for this bill in the Senate Finance Committee.

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Co-Chair Wilken moved to adopt CS SB 2001(FIN), 24-GS2094\G as a working document.

Without objection, Version "G" was ADOPTED as the working document.

[4:25:29 PM](#)

Amendment #7: This amendment deletes Section 30 on page 29 lines 3 through 8 as well as all references to the provision of Section 30 elsewhere in the bill. The deleted language of Section 30 reads as follows.

Sec. 30. AS 43.55 is amended by adding a new section to article 4 to read:

Sec. 43.55.890. Relationship to Alaska Stranded Gas Development Act. During the period that a valid contract executed under AS 43.82, as amended, is in force, AS 43.55.011 - 43.55.310 do not apply to oil or gas for which a producer is obligated to make payments in lieu of taxes or oil surcharges. A payment in lieu of taxes included delivery of gas to the state in lieu of taxes.

Co-Chair Green moved for adoption of the amendment and objected for purposes of explanation.

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SENATOR RALPH SEEKINS reviewed the history of the bill to explain the reason for the amendment. The language being deleted by this amendment had been originally included in the bill to alleviate the concern on the part of Legislators and the citizens of the State "as to whether or not" the provisions crafted in this Petroleum Production Tax (PPT) bill might also be "putting terms in place" for the separate and then unseen Alaska Stranded Gas Development Act (ASGDA) legislation; specifically that the payment in lieu of taxes language in the ASGDA legislation "would be excluded from the PPT bill of general applicability". Now that the ASGDA legislation had become available, the determination was that the issue was moot as "it was just a restatement of a truism that we know already exists". Retaining this language would confuse the issue.

Senator Seekins stated that omitting this language would clarify "on the record that the terms of that gas contract, if approved, stand alone by themselves and ... do not appear anywhere in this law of general applicability for PPT".

Co-Chair Green removed her objection.

Co-Chair Wilken stated that the memorandum [copy on file] dated May 20, 2006 to Co-Chair Green from Don Bullock, Legislative Council, Division of Legal and Research Services, Legislative Affairs Agency which addressed Section 30, was an important factor in his decision to support the amendment; specifically the paragraph at the bottom of page 3 that reads as follows.

The Attorney General's opinion offers that the contracting away issue could be avoided by having the contract recognize that future legislatures may make changes to the tax. However, if the contract precludes future legislative action, the art. IX, sec. 1 prohibition against contracting away the taxation power would need to be resolved. The enactment of sec. 30 in Co-Chair Green 2001 seems to be an effort to provide legislative endorsement of contracting away the state's power to tax under AS 43.55.

Co-Chair Wilken also appreciated the information on page 7 of the memorandum that reads as follows.

Article IX, sec.1, Constitution of the State of Alaska, prohibits the state from contracting away the power to tax,

but art. IX, sec. 4 allows the legislature to grant a suspension or exemption from tax by general law. Section 30 of SB 2001 appears to provide a legislative endorsement of a contract provision that contracts away the power to impose a tax under AS 43.55. The legislative "endorsement" of contracting away the power to tax does not make the contracting away constitutional. Accordingly, I believe that it is more likely than not that a court would find that sec. 30 is void under art. IX, secs. 1 and 4 of state constitution.

However, if sec. 30 or a contract provision of the type authorized in sec. 30 is not held invalid, art. 1, sec. 15, Constitution of the State of Alaska, and art. 1, sec. 10, Constitution of the United States, would prohibit a subsequent legislature from passing a law that impairs the obligations in that contract.

Co-Chair Wilken concluded that these three paragraphs were instrumental in compelling him to support the amendment.

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Senator Seekins noted that the information in the third paragraph supported his earlier remarks in that the deletion of Section 30 would have "no affect on the issue; it would simply remove this reference" to the ASGDA contract from the PPT bill.

Without further objection, Amendment #7 was ADOPTED.

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Co-Chair Green noted the adoption of Amendment #7 would require eliminating the reference to the ASGDA from the bill's title. This issue would be addressed later in the meeting.

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Amendment #8: This amendment inserts language following "multiplied by the price index determined under (h) of this section" in subsection (g) of AS 43.55.011 added by Section 5, on page 4 line 13. The amended language reads as follows.

(g) In addition to the taxes levied under (e) and (f) of this section, during each month for which the price

index determined under (h) of this section is greater than zero, there is levied on the producer of oil or gas a tax for all oil and gas produced during that month from each lease or property in the state, less any oil and gas the ownership or right to which is exempt from taxation or constitutes a landowner's royalty interest. Except as otherwise provided under (i) of this section, the tax levied under this subsection is equal to .1 percent of the production tax value of the taxable oil and gas as calculated under AS 43.55.160, multiplied by the price index determined under (h) of this section. However, application of this subsection may not, when added to the tax levied under (e) of this section, impose a tax levy of more than 50 percent of the production tax value of taxable oil and gas as calculated under AS 43.55.160.

This amendment also deletes the language following "divided by the" of subsection (h) of AS 43.55.011 on line 17 and inserts new language. The amended language of the subsection reads as follows.

(h) For purposes of (g) of this section, the price index for a month is calculated by subtracting 35 from the number that is equal to the quotient of the production tax value of the taxable oil and gas produced during that month, as calculated under AS 43.55.160, divided by the sum of (1) the number of barrels of that oil less three-quarters of the number of barrels of the taxable oil produced during that month from leases or properties in the Cook Inlet sedimentary basin, and (2) two-thirds of the number of barrels of oil equivalent of that gas, less (A) one-sixth of the number of barrels of oil equivalent of the taxable gas produced during that month from leases or properties in the state located south of 68 degrees 15 minutes North latitude outside the Cook Inlet sedimentary basin, and less (B) one-third of the number of barrels of oil equivalent of the taxable gas produced during the month from leases or properties in the Cook Inlet sedimentary basin. For purposes of this subsection, a barrel of oil equivalent is the amount of gas that has an energy content of 6,000,000 British thermal units. The department by regulation shall establish sampling, testing, and averaging methods for determining the energy content of a producer's gas produced during a month.

This amendment also inserts language following "expenditures for the calendar year" of subsection (f) of Sec. 43.55.160. Determination of production tax value of oil and gas., added to article 1 of AS 43.55 by Section 25, on page 25 line 17. The amended language reads as follows.

(f) In place of the adjusted lease expenditures for a month under (a) of this section, a producer may, at any time, elect to substitute, for every month of a calendar year, 1/12 of the producer's adjusted lease expenditures for the calendar year. An election made under this subsection applies to calculation of the tax under AS 43.55.011(e) and (g).

Co-Chair Green moved for the adoption of Amendment #8 and objected for discussion.

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DAN DICKINSON, Certified Public Accountant, formerly, Director, Tax Division, Department of Revenue, and secured as a Consultant by the Office of the Governor, addressed the first and third components of the amendment.

Mr. Dickinson stated that the first component resembled language included in the version of SB 305, relating to the establishment of a PPT system, passed by the House of Representatives during the regular session and similar to language adopted by this Committee during its first hearing on this bill. This language is being proposed because it was considered "appropriate" to include the entirety of conforming amendments in the bill.

Mr. Dickinson stated that the effect of this provision would be to limit the percent of the value of the barrel the State would receive under the current Progressivity element. For example, were the price of oil to increase to \$300 or \$400 dollars per barrel, a situation could arise "where this tax took 110 percent of the value of the barrel".

Mr. Dickinson stated that, even at the 50 percent limitation proposed in the amendment, "the PPT would take 50 percent of the value of the barrel; the other 50 percent would have to account for the producer's profits, the producer's return, plus their royalty payments, their federal income tax payments, their State income tax payments and their property taxes. Even a 50 percent

split here is not a 50 percent split of the economic rents, it simply says mechanically the Progressivity factor will, at this point, stop increasing".

Mr. Dickinson calculated that the discrepancy "would even out" at approximate prices of \$180 to \$190 per barrel. This should be a consideration, as the prices experienced over the last two years were certainly not forecast by many.

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Mr. Dickinson stated that the third component of the amendment addressed the section of the bill "dealing with the mechanics of annualization"; or, the process involving matters such as annual payments. The language would specify that Progressivity payments would "be included in those mechanics".

Mr. Dickinson reiterated that both of these components had been included in the version of SB 305 passed by the House of Representatives.

Mr. Dickinson then addressed the portion of the amendment that would insert language to AS 43.55.011(g). A significant portion of this provision is a reiteration of the concepts of AS 43.55.160 pertaining to the net calculation formula. That calculation is "the total net value and you divide through by the barrels and gas that created that". An issue of concern to this calculation is that "there have been a number of revenue exclusions that remove barrels from the calculation of the net value or remove amounts of gas".

Mr. Dickinson continued that as a result of the various revenue exclusions, a producer could elect to "shrink the pot" by removing "one-third of the North Slope gas revenues, ... two-thirds of the Cook Inlet gas revenues, ... three-quarters of the Cook Inlet oil revenues; and ... one-half of gas revenues between the Cook Inlet and the North Slope". Thus, a distortion would be created after the calculation was divided "through by the total number of barrels".

Mr. Dickinson concluded that the language in this portion of the amendment would "simply repeat the steps" specified in AS 43.55.160, explaining that in computing the "dollar per barrel equivalent, you basically do the same steps for the denominator".

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Mr. Dickinson continued addressing the last two sentences of language this portion of the amendment would insert to subsection (g), which reads as follows.

For purposes of this subsection, a barrel of oil equivalent is the amount of gas that has an energy content of 6,000,000 British thermal units. The department by regulation shall establish sampling, testing, and averaging methods for determining the energy content of a producer's gas produced during a month.

Mr. Dickinson explained that this language would change the gas to oil conversion methodology utilized in the Progressivity element of the bill from the current Million Cubic Foot (MCF) "volumetric" measurement to an energy equivalence methodology based on the British thermal unit (BTU). The BTU conversion methodology was commonly utilized in other international Progressivity factors. In adopting this methodology, a separate formula would be applied to convert "between the volumes and the BTUs".

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Mr. Dickinson reviewed the information depicted in an untitled six page handout [copy on file] dated May 21, 2006 which depicted several Progressivity scenarios. The first scenario titled "Progressivity Base Case - Oil Only" demonstrates the additional revenue the State would receive with the adoption of the Progressivity provision of this amendment.

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Mr. Dickinson stated "the most illustrative" point is depicted on the second page of the handout that shows the affect of a 50/50 oil and gas mix on Progressivity. He chose to illustrate this percentage mix because Econ One Research Inc., the consultants hired by the Legislature, had previously utilized the 50/50 mix scenario in one of their presentations. However, he stressed the point "that no producers have anywhere near a 50/50 mix".

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Senator Bunde understood that the top line on the 50/50 mix graph depicted the level of Progressivity tax attributed only to oil at various barrel prices and that the bottom line depicted the tax resulting from the 50/50 oil and gas mix.

Mr. Dickinson affirmed. The Progressivity tax would not be triggered, under the 50/50 oil and gas mix, until the price of oil was approximately \$90 per barrel. It would also increase at a much slower rate after that point as compared to the tax based solely on oil. He reiterated that the use of a 50/50 split was strictly a "mechanic notion" and would be unlikely to occur on the North Slope under current production conditions.

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Mr. Dickinson stated that the handout also exemplified a 90 percent oil and ten percent gas mix. This would more accurately reflect the mix that could occur on the North Slope.

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Mr. Dickinson stated that the last page of the handout exemplified calculations specific "to converting some of the [gas] volumes" and other steps that would be required by the adoption of this amendment. He informed, "You will still find that a producer that has gas will probably have a slightly smaller Progressivity factor than a producer that has oil". While this would be the historical trend, instances would arise "when those relationships can reverse". The purpose of the graphs was to provide "a sense of the distortion" that would accompany a mix of oil and gas calculation that would occur despite the effort of this amendment to "correct that and have the Progressivity be, I think, what Members intend, when they are looking at a net Progressivity".

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Mr. Dickinson, in response to a question from Senator Stedman, affirmed that the "mix" presented in the third scenario was ten percent gas and 90 percent oil. At the \$50 per barrel price, "after the netting out of costs, you'd have about \$35 for oil but you'd be showing a loss of about \$10 for the equivalent of gas".

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Mr. Dickinson noted that the information in the handout also included a scenario that reflected a 90 percent oil and ten percent gas mix absent the "GRE".

Senator Stedman concluded that the language being proposed in this provision would address the conversion distortion issue.

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Mr. Dickinson affirmed.

Co-Chair Green removed her objection to the adoption of the amendment.

Without further objection, Amendment #8 was ADOPTED.

[4:44:24 PM](#)

Amendment #9: This amendment deletes "6.67 percent" and inserts "11.25 percent" to the language of AS 43.55.011 (f)(3)(B), added by Section 5 on page 4 line 4. The amended language reads as follows.

(B) notwithstanding (2) of this subsection, for gas the tax is equal to 11.25 percent of the gross value at the point of production of the gas.

Co-Chair Green moved for adoption and objected for explanation.

Mr. Dickinson informed of "a special rate craved out for private royalty interests" in the PPT. The provisions of AS 43.55.011(f) addressed the concern that, over time, the parties of the "contractual relationship" might "figure out mutually beneficial ways that in fact would leave the tax collector in a position" that had not been anticipated. Thus, if the State was to determine that the process had been manipulated to reduce the taxpayer's tax liability under this section the rate would revert to the normal PPT rate. However, because three separate valuations pertaining to the gas tax rate are included in the bill, the provision of subparagraph (B) was inserted with the percentage of 6.67 specified. The accurate percentage rate has since been determined to be 11.25 percent. This issue only pertains to "a fraction of one percent of the total leases".

Co-Chair Green removed her objection.

There being no further objection, Amendment #9 was ADOPTED.

[4:47:02 PM](#)

Amendment #10: This amendment makes grammatical changes through the deletion of the commas and insertion of "and" in the phrase "direct, ordinary, and necessary" where it appears in the language of subsection (c)(1) of Sec. 43.55.160. Determination of production tax value of oil and gas., added to article 1 of AS 43.55 by Section 25 on page 20, line 20. The amended language reads as follows.

(c) For purposes of this section,

(1) a producer's lease expenditures for a period are the costs upstream of the point of production of oil and gas that are incurred on or after April 1, 2006, by the producer during the period and that are direct and ordinary and necessary costs of exploring for, developing, or producing oil or gas deposits located within the producer's leases or properties in the state or, in the case of land in which the producer does not own a working interest, direct and ordinary and necessary costs of exploring for oil or gas deposits located within other land in the state; in determining whether costs are direct and ordinary and necessary costs of exploring for, developing, or producing oil or gas deposits located within a lease or property or other land in the state,

(A)...

Co-Chair Green moved for adoption of the amendment and objected for purposes of explanation.

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Mr. Dickinson explained that this amendment would address an issue pertaining to the term "ordinary and necessary" as defined in AS 43.55.

Co-Chair Green clarified that "the phrase 'ordinary and necessary' is a term of art used as a phrase not as two characteristics".

Mr. Dickinson affirmed. The intent of the term "ordinary and direct" without a comma after "ordinary" would identify a cost as being "direct and ordinary and necessary".

Co-Chair Green withdrew her objection.

Without further objection, Amendment #10 was ADOPTED.

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Amendment #11: This amendment changes the title of the section added to the uncodified law of the State of Alaska by Section 28 on page 34 line 25, by deleting "REGULATIONS AND". The amended title is "TRANSITION: RETROACTIVITY OF REGULATIONS." This amendment also deletes the language of subsection (a) of the section. The deleted language reads as follows.

(a) The Department of Revenue may proceed to adopt regulations to implement the changes made by this Act. The regulations take effect under AS 44.62 (Administrative Procedure Act), but not before the effective date of the law implemented by the regulation.

Co-Chair Green moved for adoption of the amendment and objected for an explanation.

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Mr. Dickinson deferred to Robert Mintz.

[4:49:43 PM](#)

ROBERT MINTZ, Attorney with Preston Gates Ellis law firm, and former Assistant Attorney General, Oil, Gas & Mining Section, Civil Division, Department of Law, secured as a consultant to the Department of Law, explained that Section 38 currently contains two subsections pertaining to regulations to implement the PPT tax provisions. The PPT method was initially proposed to become effective July 1, 2006 and therefore language was included to allow the Department of Revenue to begin the regulatory drafting process prior to that date. The enabling language was no longer necessary because the current version of this bill has an immediate effective date.

Co-Chair Green noted that after the word transition, on the amendment should be a colon not a semicolon.

Co-Chair Green removed her objection.

Without further objection, Amendment #11 was ADOPTED.

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Amendment #12: This conceptual amendment deletes "providing that provisions of AS 43.55 do not apply to certain oil and gas subject to a contract executed under the language through Alaska Stranded Gas Development Act;" following "tax" in the title of the bill on page 1 lines 3 through 5. The amended language reads as follows.

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the production tax; amending the definition of 'gas' as that definition applies in the Alaska Stranded Gas Development Act; making conforming amendments; and providing for an effective date."

Co-Chair Green moved for adoption.

In response to a question from Co-Chair Green, Mr. Mintz explained that the language "amending the definition of gas as that definition applies in the Alaska Stranded Gas Development Act" as denoted on lines 5 and 6 of the title should be retained because the Alaska Stranded Gas Development Act (ASGDA) incorporated the definition of gas from the production tax statute. Amendment of the definition for statutes pertaining to the PPT bill would also amend the definition in ASGDA.

Without objection, Amendment #12 was ADOPTED.

Co-Chair Wilken offered a motion to report CS SB 2001, 24-GS2094\G, as amended, from Committee with individual recommendations and accompanying fiscal notes.

There being no objection, CS SB 2001 (FIN) was MOVED from Committee with zero fiscal note #1 from the Department of Natural Resources and a new \$1,174,200 fiscal note dated May 21,

2006 pertinent to the Department of Revenue from the Office of the Governor.

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Co-Chair Green expressed appreciation for the efforts of the Committee and others involved in developing this legislation.

#

ADJOURNMENT

Co-Chair Lyda Green adjourned the meeting at [4:54:11 PM](#).