

HOUSE FINANCE COMMITTEE  
November 10, 2007  
1:30 P.M.

CALL TO ORDER

Co-Chair Chenault called the House Finance Committee meeting to order at [1:30:37 PM](#).

MEMBERS PRESENT

Representative Mike Chenault, Co-Chair  
Representative Kevin Meyer, Co-Chair  
Representative Bill Stoltze, Vice-Chair  
Representative Harry Crawford  
Representative Richard Foster  
Representative Les Gara  
Representative Mike Hawker  
Representative Reggie Joule  
Representative Mike Kelly  
Representative Mary Nelson  
Representative Bill Thomas, Jr.

MEMBERS ABSENT

None

ALSO PRESENT

Representative Paul Seaton; Representative Kyle Johansen, Representative David Guttenberg; Representative Lindsey Holmes; Representative Max Gruenberg; Representative Beth Kerttula; Representative Andrea Doll; Representative Mike Doogan; Representative Berta Gardner; Representative Mark Neuman; Representative Jay Ramras; Representative Bob Roses; Representative Carl Gatto; Representative Beth Kerttula; Representative Bob Buch; Pat Galvin, Commissioner, Department of Revenue; Dan Dickinson, Consultant, Tax Division, Department of Revenue; Kevin Banks, Director, Division of Oil & Gas, Department of Natural Resources

PRESENT VIA TELECONFERENCE

Robert Mintz, Assistant Attorney General, Department of Law, Anchorage

SUMMARY

HB 2001 An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to the issuance of advisory bulletins and the disclosure of certain information relating to the production tax and the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only

leases; amending the State Personnel Act to place in the exempt service certain state oil and gas auditors and their immediate supervisors; establishing an oil and gas tax credit fund and authorizing payment from that fund; providing for retroactive application of certain statutory and regulatory provisions relating to the production tax on oil and gas and conservation surcharges on oil; making conforming amendments; and providing for an effective date.

CSHB 2001(FIN) was REPORTED out of Committee with a "no recommendation" and with the forthcoming revised fiscal notes.

#hb2001

HOUSE BILL NO. 2001

An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to the issuance of advisory bulletins and the disclosure of certain information relating to the production tax and the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; amending the State Personnel Act to place in the exempt service certain state oil and gas auditors and their immediate supervisors; establishing an oil and gas tax credit fund and authorizing payment from that fund; providing for retroactive application of certain statutory and regulatory provisions relating to the production tax on oil and gas and conservation surcharges on oil; making conforming amendments; and providing for an effective date.

Co-Chair Chenault MOVED to ADOPT Amendment 1, 25-GH0014\N.19, Cook/Bullock, 11/10/07.

Co-Chair Meyer OBJECTED.

Co-Chair Chenault explained that the amendment was requested by Legislative Legal Services as a technical amendment to conform the legislation to current statute.

DAN DICKINSON, CONSULTANT, LEGISLATIVE BUDGET AND AUDIT COMMITTEE reviewed the amendment. The amendment adds three statutory references that were omitted. He explained that the ceilings in AS 45.55.011 (j) and (k) needed to be extended to subsection (o). The amendment also clarifies that the tax is asserted on the producer, rather than on the production of oil and gas, and that the ceiling will be the determining factor where a ceiling and floor could apply to the same oil and gas.

Representative Gara observed that the amendment addresses the concept that the gross tax floor should never be less

than the minimum 4 percent. He observed that the amendment makes an exception for AS 43.44.011 (i) or (o). Mr. Dickinson explained that AS 43.55.011 (i) refers to private lease hold interest. AS 43.55.011 (o) refers to gas used in state. Representative Gara concluded that if there is a ceiling, a higher tax, and a minimum, the minimum would be paid, not the higher tax. Mr. Dickinson confirmed that under AS 43.55.011 (f), the ceiling would limit the payment on taxable North Slope gas when the floor is higher than the ceiling.

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Representative Crawford asked for a definition of private lease holder. Mr. Dickinson explained that a private lease holder is defined in AS 43.55.011(i): ownership or right to which constitutes a landowner's royalty interest. The entity owns the land and has retained an interest in the land, such as a royalty, which makes them a producer from the point of view of the production tax, because they are producing 12.5 percent.

Mr. Dickinson noted that a reference to (g) was deleted on page 10, since (e) provides that the rates in (g) be used.

PAT GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, agreed with Mr. Dickinson's description of the amendment.

Co-Chair Meyer WITHDREW his OBJECTION.

There being NO further OBJECTION, Amendment 1 was ADOPTED.

Representative Hawker MOVED to ADOPT Amendment 2.

Representative Gara OBJECTED.

Representative Hawker explained that the amendment would provide legislative intent on AS 43.55.165(e)(6) by stating that producers would not be allowed to deduct costs that were "incurred as a result of monitoring and management decisions that fail to properly consider risks posed by changing operating conditions and result in failure to take necessary actions to prevent a pipeline spill." The amendment would clarify that the legislature did not intend that the costs associated with material actions such as the Prudhoe Bay shutdown were covered by PPT. The intent is to capture those costs as well as any similar actions that have occurred in the past or will occur in the future.

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Commissioner Galvin did not believe discussions regarding the disallowance of costs associated with replacement of improperly maintained equipment were limited to instances

where the action was taken to prevent a pipeline spill. The intent is to recognize that greater costs may be incurred when things are improperly maintained. He clarified that the intent is not to be limited to the costs that arise when one is not paying attention to the risk of a spill. The issue is whether the state's interest in the legislation was limited to the spill or the fact that the pipeline was shut down for a prolonged length of time. He cautioned that language presented in the amendment would be more limited in scope if the intent is to ensure that improperly maintained equipment and the associated replacement costs are not to be deducted.

Representative Hawker felt the language was broad enough to incorporate the aforementioned intent and would establish a valid future standard for disallowance of costs.

Representative Kelly noted the difficulty of voting on the amendment prior to discussing other penalty amendments.

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Representative Gara suggested the public would be best served with a policy that prevents interruption of service as well as spills. He felt the operator should be responsible for more than changing operating conditions. He felt the amendment limited the responsibility of the operator only to a spill in the case of changing operating conditions. He opined that an operator should be held responsible for all conditions leading to a shutdown.

Representative Hawker feared that the broader language would allow loopholes. The amendment was crafted to capture events such as the irresponsible maintenance activities that led to the shut down in 2006.

Representative Gara MOVED to AMEND Amendment 2: delete "changing" on line 7 and add "interruption of service or shut down" after the word "spill".

Representative Hawker OBJECTED. He spoke against the deletion of "changing." He felt the word "changing" was critical in capturing the 2006 events. Representative Gara expressed concern that "changing" infers that the operator is only responsible to stop risk caused by those operating conditions that are changing. The duty is to be responsible all the time.

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Commissioner Galvin spoke in support of the amendment to Amendment 2. He did not believe the deletion of "changing" would substantially change the amendment.

Representative Gara WITHDREW his Amendment to Amendment 2.

Representative Gara MOVED to AMEND Amendment 2 by adding, on line 9 of the amendment, after "spill", "interruption of service or shut down."

Representative Hawker WITHDREW his OBJECTION to Amendment 2.

There being NO further OBJECTION, Amendment 2, was ADOPTED as AMENDED.

[1:54:50 PM](#)

Representative Stoltze MOVED to ADOPT Amendment 3.

Co-Chair Meyer OBJECTED.

Representative Stoltze explained that Amendment 3 added intent language to clarify that the in-state gas provision is expressly intended for the benefit of Alaska citizens by allowing access to affordable gas.

Co-Chair Meyer WITHDREW his OBJECTION. There being NO further OBJECTION, Amendment 3 was ADOPTED.

[1:56:02 PM](#)

Representative Hawker MOVED to ADOPT Amendment 4, labeled 25-GH0014\N.1, Bullock, 11/9/7.

Representative Stoltze OBJECTED.

Representative Hawker explained that Amendment 4:

Deletes the provisions that removes auditors from classified services and places them in exempt status; and

Adds language directing the Department to develop and implement a classification plan for oil and gas auditors.

Representative Hawker acknowledged the difficulty of attracting qualified auditors and the escalation of compensation in the private sector, but thought the facts did not substantiate claims that the state was not able to recruit for the positions. Some positions have been filled and hiring for others has been suspended pending the outcome of the Special Session. He emphasized that independence is an importance characteristic of an auditor and expressed concern regarding the exempt status, which serves at the discretion of the Administration. He stressed that the purpose of the Personnel Act, under AS 30.25.010(5), was the "selection and retention of an employee's position secure from political influences."

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Commissioner Galvin spoke against the amendment and maintained that the exempt status and associated pay rate for hiring experienced auditors at the top level was critical to his ability to implement the net-based tax. Experienced auditors that understand how oil companies keep track of their books are needed to design effective and efficient audits. He continued to speak to the importance of exempting auditors in order to reach a level of pay that would allow the department to compete. He expressed concern with legislative manipulation of the classification system. He argued that the position should be exempt. He observed that investment officers and oil and gas positions working with royalty determinations are exempt.

Co-Chair Meyer pointed out that other ideas have been presented to support the intent mentioned by Commissioner Galvin. He suggested that the top four auditors could be exempt or expertise could be contracted. Commissioner Galvin wanted the ability to hire manager level positions at an experience level that could help set up the system and "hit the ground running". He accepted the limitation of hiring four exempt managers and noted that the fiscal note already anticipates the use of contract hiring, but emphasized that contracting out the work is not the solution, since he needs auditors "in house" to put the system in place. He acknowledged that there is "middle ground", but did not feel the amendment would provide the tools needed to implement the tax.

Representative Kelly spoke against the amendment. He did not want to give the Commissioner an excuse to be behind on audits. He did not think that the threat of firing by the Governor was a concern or that the positions needed protection.

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Representative Gara questioned why the Administration had not changed the classification system and opined that doing so would be the easiest solution. He expressed a concern that without passage of the amendment, auditors could be fired for "other reasons". He mentioned that there was nothing in the amendment that would keep the department from hiring contract auditors.

Commissioner Galvin testified that there is misinformation in the legislative building regarding the hiring of auditors. He explained that there was a nationwide search for auditors with oil and gas experience. From that search there were no auditors found willing to be hired for the job. As a result, auditors were brought in from the

Regulatory Commission of Alaska and another state agency. He reiterated that the state of Alaska could not attract auditors nationwide and further noted that there was some reclassification of the lowest level positions. He reiterated that using contractors is not the solution and will not protect the state system. He urged the legislature to provide the tools for the department and said that if the amendment is passed he will not have the tools he needs.

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Representative Crawford recalled discussions regarding the auditor position being an exempt status. He stressed that there have been many instances of political pressure on the exempt workers. He urged that another solution be found.

Commissioner Galvin disagreed. He said there is a perception that those in exempt positions will do whatever the executive says. He maintained that the perception is false. He noted that every critical position having to do with oil and gas is in exempt status. He went on to say that implementing a tax system requires that the auditors are experienced enough to understand the tax structures of the oil companies. He acknowledged that there is a difference of opinion and expressed concern that he must be able to hire the people he needs with a wage that is competitive. He requested that the committee consider allowing for at least four of the positions needed, to be exempt positions.

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Representative Hawker disagreed with Commissioner Galvin's characterization of the amendment; that it would deny the tools needed to do the job. He stated that the amendment would provide the best and most credible tools to do the necessary work. He explained that an auditor must be independent in fact and in appearance. He maintained that if an auditor does not appear that way it creates doubt.

Representative Kelly noted he was not attempting to raise the pay scale as indicated by the previous testimony.

[2:26:25 PM](#)

A roll call vote was taken on the motion.

IN FAVOR: Foster, Gara, Hawker, Joule, Nelson, Thomas,  
Crawford

OPPOSED: Kelly, Stoltze, Meyer, Chenault

The MOTION PASSED (7-4).

There being NO further OBJECTION, Amendment 4 was adopted.

RECESSED: [2:27:48 PM](#)  
RECONVENED: [2:51:16 PM](#)

Representative Kelly MOVED to ADOPT New Amendment 5, labeled 25-GH0014\N.30, Bullock, 11/10/07.

Representative Hawker OBJECTED.

Representative Kelly explained the amendment, which would increase progressivity to .4 percent.

[2:53:46 PM](#)

Commissioner Galvin spoke in support of the amendment.

Representative Kelly pointed out that CSHB 2001 (FIN) has a 25 percent base rate. He asked if that number was supported by the Governor. Commissioner Galvin stated that the Governor supports 25 percent as the base rate; the Administration would support the amendment with the 25 percent base rate.

Representative Hawker commented that production decline is the greatest challenge facing the state of Alaska. He discussed the difficulty of incenting companies to invest by establishing higher taxes. He also maintained the importance of the state receiving its fair share. He suggested that the way to deal with that could be through a windfall profits tax. He reported that his constituents do not support increasing or changing the production tax rate. He maintained his opposition.

[3:02:41 PM](#)

Representative Kelly disagreed with Representative Hawker. He said the amendment is about getting the state's value for the product and resource. He emphasized that the work of the legislature is to establish a solid future tax policy to send a message of stability to the oil companies. In order to rebuild the trust of the people of Alaska, progressivity should be at the rate that the Governor has recommended. He urged support.

[3:07:54 PM](#)

A roll call vote was taken on the motion to adopt Amendment 5.

IN FAVOR: Gara, Joule, Kelly, Nelson, Stoltze, Crawford  
OPPOSED: Hawker, Thomas, Foster, Chenault, Meyer

The MOTION PASSED (6-5).

There being NO further OBJECTION, Amendment 5 was adopted.

[3:08:46 PM](#)

Representative Hawker MOVED to ADOPT Amendment 6.

Representative Stoltze OBJECTED.

Representative Hawker explained that the amendment removes provisions that were added to impose civil penalties related to under payment of an installment payment: page 1, lines 3-5, delete "providing a penalty for the underpayment of an installment payment of the production tax on oil and gas". Producers have to estimate their entire year's expenses for the January payment. Interest is charged if the estimate fails. He felt the provision imposed civil penalties on taxpayers acting in good faith.

Commissioner Galvin noted support for the amendment.

Representative Stoltze WITHDREW his OBJECTION. There being NO further OBJECTION, Amendment 6 was adopted.

[3:12:59 PM](#)

Co-Chair Chenault noted that the effective dates on Amendment 5 were not clarified.

DAN DICKINSON, CONSULTANT, TAX DIVISION, DEPARTMENT OF REVENUE, thought Amendment 5 could be made effective at the same time as the bill, with the first taxes paid January 1, 2008, unless noted differently.

[3:15:04 PM](#)

Representative Gara MOVED to ADOPT Amendment 7.

Representative Stoltze OBJECTED.

Representative Gara explained that Amendment 7 deletes the Transitional Investment (TIE) credits. He opined that with other credits and incentives in the bill, the TIE credits are not necessary. He went on to say the TIE credits are unique to tax law.

[3:18:06 PM](#)

Commissioner Galvin stated that the Administration's position has remained consistent regarding credits. He explained that the current credits available suffice and added that the TIE credits violate the principles of the Administration. He further explained that the Administration did provide language to allow credit for those producers who have had exploration since PPT was passed.

Commissioner Galvin said the TIE credits are being frozen and may be used when production is realized. He spoke in support of the amendment.

In response to a question by Representative Gara regarding the cost to the state, Commissioner Galvin observed that TIE credits would cost the state \$1 billion with a 5-year look back. Under CSHB 2001 (FIN), the 3-year look back would cost the state \$750 million; with the amendment the cost would be less than \$50 million.

Representative Gara WITHDREW Amendment 7.

[3:22:14 PM](#)

There was discussion of conflict of interest. Representative Hawker commented on the proper use of conflict of interest statements.

Representative Crawford MOVED to ADOPT Amendment 8, labeled 25-GH0014\N, Finley/Bullock, 11/9/07.

Representative Hawker OBJECTED.

Representative Crawford discussed the fairness of one producer receiving credits and others not. Commissioner Galvin explained that the original bill was based on the principal that an entity that is not subject to the tax should not be eligible to take the credit offered under the tax.

[3:27:41 PM](#)

Representative Gara expressed concern with the amendment. He noted the discrepancy of reward for one portion of the state and not another. He characterized the amendment as a subsidy.

[3:31:00 PM](#)

Representative Kelly pointed out that the amendment is about a strict application of the tax on gas. He countered that it is a fairness issue and not about subsidizing customers.

Representative Joule spoke in support of the amendment.

Representative Hawker WITHDREW his OBJECTION.

Representative Gara OBJECTED for purpose of further discussion. He said the companies that are not taxed will receive a credit.

Representative Kelly disagreed and concluded that they are taxed on sales, not taxed on the portion of sales that are not taxable.

Representative Gara WITHDREW his OBJECTION.

There being NO further OBJECTION, Amendment 8 was adopted.

[3:36:01 PM](#)

Representative Hawker MOVED to ADOPT Amendment 9.

Representative Stoltze OBJECTED.

Representative Hawker explained that the amendment repeals and reenacts criteria to qualify for enhanced exploration credits (outlined in AS 43.55.025). He stated that upon completion of the well, the Commissioner of Department of Natural Resources must determine that the well "adequately achieved" the stated geological objective. He opined that this language was too subjective. He maintained that the amendment is to protect taxpayers who were operating in good faith by changing the wording to "was consistent with achieving".

KEVIN BANKS, DIRECTOR, DIVISION OF OIL & GAS, DEPARTMENT OF NATURAL RESOURCES, observed that the current language is in place to protect the state from those not acting in good faith. He acknowledged that the language proposed would still provide that safety and said the department did not have issue with the amendment.

Representative Stoltze WITHDREW his OBJECTION.

There being NO further OBJECTION, Amendment 9 was adopted.

[3:42:17 PM](#)

Co-Chair Chenault MOVED to ADOPT Amendment 10.  
Representative Stoltze OBJECTED.

Representative Hawker emphasized that his intention was to draft language that would better protect those taxpayers who operate in good faith, and to protect the state from those who do not. He addressed the current language in Section 32, AS 43.55.025. He observed that the previously deleted language was too restrictive and created a loophole. He felt that as a result the language was now too broad.

Representative Hawker explained that Amendment 10 would reinstate language "the explorer shall submit information necessary for the Commissioner of Department of Natural Resources to evaluate the validity of the explorer's compliance with the requirements of this section." The

amendment would also delete language on page 22, lines 11-19. He specifically noted the wording "include all derivate products". He maintained the language is too broad. He further expressed concern with the mandatory stipulation of providing "tangible materials". He felt that the specific requirements for core samples were too demanding and questioned if the demand was reasonable.

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Mr. Banks reviewed information that would be required under the provision. He observed that the information on page 22, line 14, is a form that comes to the department. He explained that the state becomes an investor by providing the credit thus interested in the results of the data. The tangible information is handed over to Alaska Oil and Gas Conservation Commission (AOGCC) for storage of the data in Eagle River. He added that this information is not confidential.

Mr. Banks elaborated on terms: the purpose of using the term "derivative products" was to receive information for a period of time. He agreed that perhaps there would be a better term for "derivative". He explained that the department would like the information. The legislation allows discretion to ask tangible materials to be held in a safe place to be stored with the entity until the period of confidentiality is over. The AOGCC does not receive adequate information at this date.

3:56:00 PM

Representative Gara asked Mr. Banks what value the information had and how it benefits the state. Mr. Banks replied that it allows the state to evaluate the prospects of its land. He elaborated saying that sharing the information makes the state land more valuable in its potential to encourage new leases and exploration.

Representative Hawker asked the committee to support the amendment with the caveat that access to tangible materials would be clarified.

Mr. Banks spoke in opposition to the amendment.

A roll call vote was taken on the motion.

IN FAVOR: Hawker, Joule, Nelson, Crawford, Foster, Meyer,  
Chenault

OPPOSED: Kelly, Stoltze, Thomas, Gara

The MOTION PASSED (7-4).

There being NO further OBJECTION, Amendment 10 was adopted.

[4:00:31 PM](#)

Representative Hawker WITHDREW Amendment 11.

Representative Joule MOVED to ADOPT Amendment 12.

Representative Hawker OBJECTED.

Representative Joule explained that the issue of private landowners and the disclosure of information regarding those lands were brought up in committee before the CS was drafted. He noted that though the department agreed that the issue should be addressed in the CS, it is not. The amendment would state that the information regarding private lands could not be released to the public without permission of the landholder.

Mr. Banks reiterated comments by Representative Joule.

[4:04:23 PM](#)

Representative Hawker MOVED to AMEND Amendment 12 to conform to Amendment 10. He asked that language be inserted on line 3 of the amendment to include "in this subparagraph". There being NO OBJECTION, it was so ordered.

Representative Chenault asked if the department supported the changes. Mr. Banks said they did not have a problem with it.

Representative Hawker WITHDREW his OBJECTION.

There being NO further OBJECTION, Amendment 12 was adopted.

Representative Gara MOVED to ADOPT Amendment 13.

Representative Hawker OBJECTED.

Representative Gara explained that the intent of the amendment is to provide the state with an enforcement mechanism when there are substantial underpayments of a tax. The amendment outlines penalties under three scenarios:

Minor underpayment = no penalty

Substantial underpayment = 10 percent penalty

Gross underpayment = 20 percent

Additionally, audit costs would be included in the penalty costs.

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Commissioner Galvin said the Administration supports the amendment.

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[4:36:54 PM](#)

A roll call vote was taken on the motion.

IN FAVOR: Nelson, Stoltze, Thomas, Crawford, Gara, Joule, Kelly

OPPOSED: Foster, Hawker, Meyer, Chenault

The MOTION PASSED (7-4).

There being NO further OBJECTION, Amendment 13 was adopted.

[4:37:58 PM](#)

Representative Gara MOVED to ADOPT Amendment 14 and then WITHDREW Amendment 14.

[4:38:36 PM](#)

Representative Thomas MOVED to ADOPT Amendment 15, labeled 25-GH0014\N.22, Kane/Bullock, 11/9/07.

Representative Gara OBJECTED.

Representative Thomas explained the amendment establishes a limitation on the ability of a producer who has a judgment against it, to receive credits. The producer would not receive credits until the judgment is satisfied.

Commissioner Galvin reiterated and clarified the amendment regarding receipt of a production credit.

Representative Gara WITHDREW his OBJECTION. Representative Kelly OBJECTED.

[4:41:35 PM](#)

Representative Kelly spoke about judgments against a producer. Commissioner Galvin said that the purpose of the provision is to address a judgment in court. He felt that the provision is a disincentive for prolonged litigation as the moneys owed are held in trust, not allowing interest to accrue.

Representative Kelly WITHDREW his OBJECTION. Co-Chair Meyer OBJECTED.

[4:44:35 PM](#)

Co-Chair Meyer asked for clarification of "producer". Commissioner Galvin explained that the provision would only apply to the entity that had the judgment against them.

Representative Stoltze questioned if the Administration was in favor of the amendment. Commissioner Galvin stated that they did not object to the amendment.

Co-Chair Chenault asked about litigation against corporations throughout the state. Commissioner Galvin responded that he did not know of any current judgment greater than \$100,000 in appeal.

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Co-Chair Meyer WITHDREW his OBJECTION.

There being NO further OBJECTION, Amendment 15 was adopted.

[4:47:14 PM](#)

Representative Gara MOVED to ADOPT Amendment 16.

Representative Hawker OBJECTED.

Representative Gara explained that the amendment allows the state to apply a "just and reasonable" rate for transportation costs. He elaborated on the current overcharging and the effect it has on the state and small explorers. He maintained that the overcharges deter production by small explorers and cost the state \$53 million per year in taxable revenue.

He concluded by saying the state is precluded from establishing just and reasonable rates due to current language in statute. Representative Gara requested the Administration's opinion.

Commissioner Galvin spoke of the potential affect of the amendment to future production. He clarified that it would not affect the price being paid by explorers for their oil in the line. The amendment addresses how much a company can deduct in transportation costs. The provision outlined in the amendment would allow the department to establish a rate on transactions outside already established thru a regulatory body. He further clarified that the estimated loss to the state would be closer to \$160 million.

Representative Gara asked if the Regulatory Commission of Alaska, under existing law, can regulate the in-state shipment. Commissioner Galvin stated that it can regulate shipment as it relates to the actual charge for "the interstate rate". That rate sets the payment the third party

pays the pipeline owner. The tax code establishes the appropriate deduction.

Representative Gara asked if the Administration supports the amendment or anything further regulating the rates that are charged on the pipeline. Commissioner Galvin replied that the Administration does support the amendment because it insures the appropriate deduction is allowed under the tax code. He further clarified that the tariff charged is regulated by FERC.

[4:54:23 PM](#)

Representative Gara WITHDREW Amendment 16.

RECESSED: [4:55:07 PM](#)

RECONVENED: [6:15:14 PM](#)

Representative Stoltze MOVED to ADOPT New Amendment 17, labeled 25-GH0014\N.29, Mischel/Bullock, 11/10/07.

Representative Hawker OBJECTED.

Representative Stoltze explained that the Administration requested the amendment regarding lease expenditures. It directs that the lease expenditures are those that would be allowed by the department by regulation. It authorizes the department to use Unit Operating Agreements and DNR Net Profit Regulations as guidance to establish standards. It removes the provision which would require the department to consider operating agreements the final word on lease expenditures.

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Commissioner Galvin stated that the amendment would restore one of the key provisions in the ACES bill; restoring the definition of what are allowable lease expenditures.

He pointed out that the amendment places joint interest billings in their appropriate role as an important tool, but yet the department is not bound by the structure of the joint interest billings.

Representative Kelly asked if the Commissioner thought the language on page 3, line 9, was strong. Commissioner Galvin said that the language requires that expenditures for non-"arms length transactions" do not exceed fair market value.

[6:21:28 PM](#)

Representative Hawker spoke against the amendment. He felt the legislature was being requested to "trust" without clear guidance in statute. He warned about the danger of

regulation taking precedence over statute. Commissioner Galvin said that though the department will have to implement regulations, the legislature has the ability to decide if the regulations are in line with intent.

[6:24:14 PM](#)

Representative Gara asked which portion of the amendment addressed joint interest billings. Commissioner Galvin pointed to two different places in the bill: page 2, line 23, and page 3, lines 19-20. Representative Gara thought it was difficult for legislators to determine the lists of allowable costs. He emphasized that it is the function of the legislature to provide guidance to the department for writing the regulations, not create the regulations.

Co-Chair Meyer voiced a concern regarding the possibility of regulations changing with a change of Administrations. Commissioner Galvin replied that it is a possibility that could happen but it would happen within the public process.

Co-Chair Chenault asked if joint interest billings were not used, what steps the Administration would take to make sure that industry meets the criteria. Commissioner Galvin replied that there would be requirements established for what type of information would need to be provided by the taxpayer. He explained that joint interest billings are one component that provides information already established between the operator and partners. If the department chooses not to use joint interest billings, there are information requirements in place to guide the taxpayer as to what kind of information they would need to provide. He noted that it is the intention of the department to use joint interest billings to the full extent they are able.

[6:29:02 PM](#)

A roll call vote was taken on the motion.

IN FAVOR: Nelson, Stoltze, Thomas, Crawford, Gara, Joule  
Kelly, Meyer  
OPPOSED: Foster, Hawker, Chenault

The MOTION PASSED (8-3).

There being NO further OBJECTION, Amendment 17 was adopted.

[6:29:48 PM](#)

Representative Crawford MOVED to ADOPT Amendment 18, labeled 25-GH0014\N.21, Luckhaupt/Bullock, 11/9/07.

Representative Hawker OBJECTED.

Representative Crawford explained that Amendment 18 provides a formula dealing with legacy fields producing more than 1 million barrels. The purpose of the amendment is to make the audit process easier for the department by providing a standard deduction - the impetus for the taxpayer is to control costs, rather than maximize expenditures to lessen the tax. The amendment provides for a 3 percent standard deduction per year remaining in effect until 2010.

[6:33:54 PM](#)

Commissioner Galvin testified that the concept has merit and should be considered. He acknowledged that there are still legislators uncertain about the net concept. He said it is a reasonable compromise to stick with a net approach while holding the cost picture constant. He reiterated that the Administration does not object to the amendment.

Representative Chenault asked Mr. Dickenson to come forward and discuss the amendment and some of the history regarding operating cost average.

DAN DICKINSON, CONSULTANT, LEGISLATIVE BUDGET AND AUDIT, provided an overview of the amendment. He mentioned the operating cost increase and maintained that this is the result of price increase. He asserted that the unfortunate aspect of the amendment is that if the standard is established, those with higher expenses will be penalized. By allowing a flat deduction, producers will not be allowed to deduct the costs.

[6:40:06 PM](#)

Commissioner Galvin commented that one of the adjustments to be made to the increase in costs would be to move away from the deduction being calculated on a per barrel basis and allowing it, instead, to be based on the total actual costs within the unit; recognizing that a large part of the operating costs, production decline, would bring the overall costs down. He reminded the committee that the language is intended to be a transitional provision and would be re-evaluated. He clarified that the cap is on total costs, not adjusted costs.

Representative Gara commented that Mr. Dickinson overstated the flaw and understated the benefit of the provision. He reviewed the intent of the amendment. He said the greatest benefit is that the standard deduction encourages exploration and capital expenditures.

Representative Gara continued saying that Alaska is new at regulating a profit's tax. He stressed that the provision is a well-thought-out, important provision, and he urged passage of Amendment 18.

6:46:23 PM

Mr. Dickinson reiterated the concern that the provision could penalize those explorers with higher costs of extracting and producing heavy oil.

Representative Crawford mentioned that the Administration does have the ability to adjust an audit. He referenced the testimony from Gaffney Kline that illustrates that high progressivity can result in a lower tax rate. He further pointed out that a company pays on an aggregate of the entire portfolio. He urged passage of the amendment.

Representative Gara stated that for heavy oil exploration and expenditures, a company would still receive all the deductions and credits under PPT and ACES. He also pointed out that the amendment sunsets in 2011 and currently, there is no expectation for the expansion to heavy oil before that date.

Mr. Dickinson pointed out that there is not actually a sunset, but rather a report due. Representative Gara acknowledged that was correct.

Commissioner Galvin clarified the intent of the audit recognition: if the 2006 numbers which provide the base for deductions each year overstate the lease expenditures by more than 10 percent, then the provision would require that the actual amount of the costs be reflected.

Mr. Dickinson reiterated concerns. Commissioner clarified intent to continue to receive the tax returns with the cost information in order to provide a report on the relationship between the actual costs and the standard deductions costs. He reported that the potential impact of this is not known - whether costs are going to go up in the aggregate for a particular unit or not. It is a matter of weighing respective risks. He agreed with Representative Gara's description of what is being balanced in this particular provision as it relates to perceived risk.

6:55:33 PM

Representative Crawford provided concluding comments about the ability to take a standard deduction and urged a yes vote.

6:57:32 PM

A roll call vote was taken on the motion.

IN FAVOR: Thomas, Crawford, Gara, Joule, Nelson  
OPPOSED: Stoltze, Foster, Hawker, Kelly, Meyer, Chenault

The MOTION to ADOPT Amendment 18 FAILED (5-6).

[6:58:20 PM](#)

Representative Gara MOVED to ADOPT Amendment 19, labeled 25-GH0014\N.25, Cook/Bullock, 11/9/07.

At Ease: [6:58:55 PM](#)

Reconvened: [6:59:27 PM](#)

(audio inoperative - audio resumes at 7:30 PM)

Representative Joule spoke in favor of alternative energy.

Representative Gara WITHDREW Amendment 19.

Representative Gara MOVED to ADOPT Amendment 20.

Representative Hawker OBJECTED.

Representative Gara explained that the intent was to disallow costs for lobbying, public relations, public reactions advertising or policy advocacy, and other activities not related to the direct costs of production or operation.

Representative Foster OBJECTED. He felt that it was unfair to allow the expenses.

A roll call vote was taken on the motion.

IN FAVOR: Crawford, Gara, Hawker, Joule, Nelson,  
Stoltze

OPPOSED: Thomas, Foster, Kelly, Chennault, Meyer

The MOTION PASSED (6-5).

There being NO further OBJECTION, Amendment 20 was adopted.

[7:04:34 PM](#)

Representative Gara WITHDREW Amendment 21.

Representative Gara MOVED to ADOPT Amendment 22.

Representative Hawker OBJECTED.

Commissioner Galvin explained that the amendment would restore ACES language and felt that without the amendment there would be no release of information. He maintained that the amendment would restore public confidence.

Representative Hawker emphasized the need to protect, but collect, and referenced the umbrella statute for taxpayer confidentiality.

Commissioner Galvin said that nothing prohibits the publication of statistics. He emphasized that the intended balance is to allow the release of statistical information while protecting individual taxpayer's rights.

[7:11:33 PM](#)

Mr. Dickinson explained that exposure to the state would occur if confidential information were released that would normally remain confidential. If there are fewer than three, the information is not published until there is an aggregation. He felt that the Revenue Source Book has a wealth of information and allows citizens to receive aggregated information. If broken down to three players their tax information would be jeopardized. Commissioner Galvin argued that the level of information would be low. He did not believe the knowledge of costs for operation would affect potential business.

A roll call vote was taken on the motion.

IN FAVOR: Crawford, Gara, Joule

OPPOSED: Foster, Hawker, Kelly, Nelson, Stoltze, Thomas, Chenault, Meyer

The MOTION to ADOPT Amendment 22 FAILED (3-8).

[7:16:17 PM](#)

Representative Nelson MOVED to ADOPT Amendment 23, labeled 25-GH0014\N.10, Kurtz/Bullock, 11/9/07.

Representative Stoltze OBJECTED.

Representative Nelson explained low income heating energy assistance program (LIHE). The amendment would match the federal appropriation and times it by five to capture a higher portion of low income homes. Alaska is benefiting from the high costs and the amendment would provide a state match.

Co-Chair Chenault acknowledged the issue, but did not feel that it was the appropriate time for it to be addressed.

Representative Thomas noted the high cost of fuel and the detrimental affects on seniors.

Representative Nelson pointed out that the trigger would be at \$50 a barrel, which would be the same as the current progressivity level. She stressed the difficulty of finding

an alternative mechanism and pointed out that the LIHE administration is in place.

[7:23:14 PM](#)

Representative Hawker questioned the position of the Administration.

Commissioner Galvin explained the desire to support energy assistance, but acknowledged the double edge sword of wanting to support the amendment. He spoke in support of addressing the issue during regular session.

Representative Joule pointed out that there is a trigger mechanism and felt the amendment was balanced.

Representative Stoltze felt that there would be many issues addressed in the next year including LIHE.

Representative Stoltze WITHDREW his OBJECTION.

There being NO further OBJECTION, Amendment 23 was adopted.

[7:29:23 PM](#)

Representative Joule MOVED to ADOPT Amendment 24, labeled 25-GH0014\N.13, Kurtz/Bullock, 11/9/07.

Representative Stoltze OBJECTED.

Representative Joule spoke in support of developing a long-term energy plan, including alternative energy. He stressed the importance of the issue.

Representative Joule WITHDREW Amendment 24 with the caveat that he intends to review the issue during the regular session.

RECESSED: [7:34:50 PM](#)

RECONVENED: [7:57:08 PM](#)

Representative Gara MOVED to ADOPT Amendment 25.

Co-Chair Chenault OBJECTED.

Representative Gara explained the amendment, which provides a "whistle-blower" provision with a "reward". The reward can not be more than 10 percent of the value of what is collected. He asserted that these types of penalties enforce compliance.

[7:59:52 PM](#)

Commissioner Galvin commented that the Administration does not object to the amendment; however, concern with the language is that the information provided is not otherwise information that the state would either have or would have acquired thru the normal operations of business. He said on line 9, "leads to" is intended to include the limitation that if the state acquires the information otherwise, then there would be no reward awarded.

Co-Chair Chenault WITHDREW his OBJECTION.

Representative Kelly OBJECTED saying that he felt the amendment went too far and that it might be better to put the money towards auditor wages.

Representative Stoltze asked if there were unintended consequences. Commissioner Galvin said it was a concern.

Representative Gara clarified two parts of the amendment. In order to receive compensation a person has to provide the information that "leads to" the collection of additional taxes. The second part required that the legislature appropriate funds. The intention is that the reward would not go to a state employee. He offered to amend the language to further clarify it.

[8:06:23 PM](#)

A roll call vote was taken on the motion.

IN FAVOR: Gara, Hawker, Joule, Nelson, Thomas, Crawford  
OPPOSED: Kelly, Stoltze, Foster, Chenault, Meyer

The MOTION PASSED (6-5).

There being NO further OBJECTION, Amendment 25 was adopted.

[8:07:13 PM](#)

Representative Kelly MOVED to ADOPT Amendment 26.

Co-Chair Chenault OBJECTED.

Commissioner Galvin commented that the language was intended to allow DNR to make (net profit share leasing program) regulations retroactively to April 1, 2006, (when PPT was enacted). Because of the inclusion of the credits the existing regulations are ambiguous as it relates to how the credits would be accounted for. The Department of Law (DOL) advised that without explicit statutory authority, DNR couldn't make the regulations retroactive.

Mr. Dickinson responded to a question from Co-Chair Chenault, explaining that the amendment deals specifically

with how oil and gas production taxes will be handled in a net profit share. Under current law, net profit share payments are not deductible.

[8:10:46 PM](#)

Mr. Banks clarified that net profit share payments are not a deduction under a production tax. The profit share in the lease is an after-tax calculation. In current regulations the lessee is allowed to deduct the production tax from the calculation of their net profit payment. He referenced the potential ambiguity of including credits in the calculation. Alaska Administrative Code, Title 11, Chapter 83, Article 240 (b) 4 references the calculation that the production tax may be deducted as a direct operating expense in the calculation of a net profit share. It also states the inclusion of early development incentive credits. He suggested the way to handle the lack of clarity is to revise the regulations and make sure the lessees are aware of how production tax will be managed.

He further pointed out that the production tax is a corporate wide tax and some allocation methodology will need to be developed to be associated for a profit on a single lease. He maintained that the regulations need to be adjusted to be fair and reasonable, accounting for the production tax payment the lessee makes.

In response to concerns voiced by Representative Kelly, Mr. Banks said the net profit share payment should be reflected in the calculation margin used by the taxpayer in calculating progressivity.

Mr. Banks said the provision provides clear authority to the department to go back to April 1, 2006, to correctly account for a corporate-wide production tax and allocate it to a net profit share lease. Representative Gara asked if this provided for more deductions. Mr. Banks replied no.

Co-Chair Chenault WITHDREW his OBJECTION. There being NO further OBJECTION, AMENDMENT 26 was adopted.

[8:18:31 PM](#)

Representative Gara MOVED to ADOPT Amendment 27. Representative Hawker OBJECTED.

Representative Gara explained how the amendment addresses retroactivity. He requested the department testify on what the revenue would be in the event the retroactivity amendment passes and a comparison if it does not. He spoke to saving the future from the oil tax.

[8:20:21 PM](#)

Commissioner Galvin stated that with the retroactivity provision, the difference in revenue would be (for 2008 July 1 - December 31) \$483 million. He went on to say adding the 6 months preceding that, the amount would be approximately \$130 million for a total of just over \$600 million.

Representative Gara pointed out that the Constitutional Budget Reserve has been drawn down and needs to be replenished.

Commissioner Galvin stated that the Administration does support retroactivity. Co-Chair Chenault questioned the support of retroactivity, but the lack of support for the ability of the taxpayer to retroactively receive credits. Additionally, he expressed concern for how the retroactivity could be seen as further changes to the tax structure and be interpreted as unstable. Commissioner Galvin appreciated the concerns expressed. He went on to say that retroactivity was not an original part of the bill but that the Administration supports it. In closing, he agreed that tax stability was important and that the Administration's goal is to have an effective tax system in place long term.

[8:25:23 PM](#)

Co-Chair Meyer discussed the retroactivity claims under PPT and asked for clarification on dates. Commissioner Galvin stated that the State is still in the same calendar year and the timeframe is legally defensible. Co-Chair Meyer pointed out that retroactivity was not included in the original ACES bill. Commissioner Galvin acknowledged that the Administration wanted to make it a collaborative effort with the legislature.

Representative Thomas was concerned about a precedence being set by adopting retroactivity.

[8:29:41 PM](#)

Representative Gara WITHDREW Amendment 27. Amendment 28 was rolled over to be heard after Amendment 29.

[8:30:10 PM](#)

Co-Chair Chenault MOVED to ADOPT Amendment 29, labeled 25-GH0014\N.2, Cook/Bullock, 11/9/07.

Representative Stoltze OBJECTED.

Co-Chair Chenault explained that the amendment would change the base tax rate from 25 percent to 22.5 percent, which he believes is the correct number. If the price of oil was \$85

per barrel, the original Governor's bill would bring in \$835 million. In the House Finance version it would be \$1.6 billion. Co-Chair Chenault agreed that the state should receive a portion from the high prices and registered a concern about the potential effects this may have on investment decisions. If the state attempts to take too much on the low end, there could be less investment, thereby impacting jobs. He stressed that the lower rate would spur development. He maintained that the current version is better than the ACES bill. He pointed out that ACES was similar to the House Finance PPT version as far as progressivity and base rate.

[8:36:39 PM](#)

Representative Stoltze stressed his respect for the Co-Chair's perspective and intent, but stated that he supports the original ACES bill.

Representative Thomas stated that he had supported 25 percent until he saw a movement toward retroactivity. He stressed the need to protect jobs.

[8:40:41 PM](#)

Representative Kelly pointed out that the retroactivity provision is not in the bill. He observed that the price of oil is over \$85, but it may not remain high. He expressed respect for those that support the lower rate, but felt that the trust of the people of Alaska requires a higher rate to ensure the tax law is not revisited. He emphasized consultants' testimony indicating that a 25 percent base tax rate is easily defensible and conservative. He felt that the Administration had been reasonable and pointed to the adoption of a net tax on base rate with progressivity. He noted the professionalism of the Chair.

[8:47:24 PM](#)

Co-Chair Meyer acknowledged that he did not know the definitive "right rate". He observed that the House is split on the issue (O&G adopted 22.5 percent and RES adopted 25 percent.) He expressed concern with the decline of production and observed that it has been masked by the high oil prices. He went on to stress the importance that whatever rate is adopted, it needs to result in more production and jobs. He felt that the lower rate would be more successful in increasing investment. He maintained that with the higher tax rate, Alaska would be less competitive. He emphasized that members should consider what rate would stimulate more jobs. He observed that public testimony was predominately in support of the lower tax.

[8:53:00 PM](#)

Representative Joule noted that his district warehouses the resource and that he supports a 22.5 percent base tax rate. He noted the right of members to disagree. Representative Gara expressed respect for his colleagues' opinions. He stressed the validity of changing votes from the previous year based on additional information. He acknowledged that he doesn't have the votes for retroactivity. He concluded that a 30 percent tax would not reduce investment according to Gaffney Cline and Associates. He further discussed merits of the bill.

[9:03:01 PM](#)

Representative Thomas noted that he would probably support 25 percent if retroactivity is not adopted.

A roll call vote was taken on the motion.

IN FAVOR: Hawker, Joule, Thomas, Foster, Meyer, Chenault  
OPPOSED: Nelson, Kelly, Stoltze, Crawford, Gara

The MOTION PASSED (6-5).

There being NO further OBJECTION, Amendment 29 was adopted.

Representative Kelly WITHDREW Amendment 28.

Representative Hawker asked for an explanation of the amendment. Representative Kelly explained that the intent of the amendment was to remove the sunset provision, if the 25 percent base rate with the progressivity portion passed. He emphasized this would send a message of stability to the oil companies.

Representative Crawford MOVED to ADOPT Amendment 30, labeled 25-GH0014\N.24, Cook/Bullock, 11/10/07.

Representative Hawker OBJECTED.

Representative Crawford explained the amendment, which would:

- Maintain all previous sections except for applicability to the "legacy fields" on the North Slope. The definition of legacy field is written to encompass Prudhoe, Kuparuk and Alpine fields.
- Implements a 17% tax for oil on the gross value at the point of production.
- Implements a 13% tax for gas on the gross value at the point of production.

- Intent language to allow the legislature to save up to 50% of the annual surcharge revenue in the Constitutional Budget Reserve (CBR).
- A .025 percent progressivity tax that is applied once the gross price of oil reaches \$40 and increases to 0.35 percent once the gross price of oil reaches \$70. The tax is capped at 25%. The progressivity structure also decreases the tax .025 percent when the price falls below \$40.
- A 40% credit applicable to all eligible capital expenditures after exceeding \$100 million .

[9:14:47 PM](#)

Representative Stoltze commented on the role of the Administration and the current outcome. He stated that he supports the tax being based on the net value and he agreed that the issue was complicated.

Representative Joule noted he would be a no vote.

Representative Hawker stated support for the amendment.

[9:23:24 PM](#)

A roll call vote was taken on the motion.

IN FAVOR: Nelson, Crawford, Gara, Hawker  
OPPOSED: Joule, Kelly, Stoltze, Thomas, Foster, Chenault,  
Meyer

The MOTION to ADOPT Amendment 30 FAILED (4-7).

[9:24:18 PM](#)

Co-Chair Chenault itemized the cleanup language regarding effective date. He added that unless the amendments had other specific dates in them, they would be effective July 1, 2008.

RECESSED: [9:24:51 PM](#)  
RECONVENED: [9:25:45 PM](#)

Co-Chair Chenault restated that the date will be January 1<sup>st</sup>, 2008.

Co-Chair Chenault thanked all members of the Committee and their staff.

[9:27:49 PM](#)

Representative Stoltze MOVED to REPORT CSHB 2001 (FIN), as amended, out of Committee with individual recommendations and with the forthcoming revised fiscal notes.

Representative Foster OBJECTED. He said he believed that linking all oil companies to corruption is slanderous.

9:29:45 PM

A roll call vote was taken on the motion to report the CS from committee.

IN FAVOR: Kelly, Nelson, Stoltze, Thomas, Gara, Hawker, Joule, Meyer, Chenault

OPPOSED: Crawford, Foster

The MOTION PASSED (9-2).

CSHB 2001(FIN) was REPORTED out of Committee with a "no recommendation" and with the forthcoming revised fiscal notes.

#

ADJOURNMENT

The meeting was adjourned at 9:30 P.M.