

**ALASKA STATE LEGISLATURE  
HOUSE JUDICIARY STANDING COMMITTEE**

May 7, 2007

1:30 p.m.

**MEMBERS PRESENT**

Representative Jay Ramras, Chair  
Representative Nancy Dahlstrom, Vice Chair  
Representative John Coghill  
Representative Bob Lynn  
Representative Ralph Samuels  
Representative Max Gruenberg  
Representative Lindsey Holmes

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

CS FOR SENATE BILL NO. 121(L&C)

"An Act relating to discharge from small commercial passenger vessels; relating to information-gathering requirements for small commercial passenger vessels; providing for an effective date by repealing the delayed effective date found in sec. 16, ch. 153, SLA 2004; and providing for an effective date."

- MOVED CSSB 121(L&C) OUT OF COMMITTEE

HOUSE BILL NO. 128

"An Act relating to allowable lease expenditures for the purpose of determining the production tax value of oil and gas for the purposes of the oil and gas production tax; and providing for an effective date."

- MOVED CSHB 128(RES) OUT OF COMMITTEE

HOUSE BILL NO. 245

"An Act relating to theft and concealment of merchandise."

- BILL HEARING CANCELED

**PREVIOUS COMMITTEE ACTION**

BILL: SB 121

SHORT TITLE: CRUISE SHIP DISCHARGE & INFO

SPONSOR(s): SENATOR(s) ELTON

03/14/07 (S) READ THE FIRST TIME - REFERRALS  
03/14/07 (S) L&C  
03/20/07 (S) L&C AT 1:30 PM BELTZ 211  
03/20/07 (S) Heard & Held  
03/20/07 (S) MINUTE(L&C)  
03/22/07 (S) L&C AT 1:30 PM BELTZ 211  
03/22/07 (S) Moved CSSB 121(L&C) Out of Committee  
03/22/07 (S) MINUTE(L&C)  
03/23/07 (S) L&C RPT CS 2DP 3NR NEW TITLE  
03/23/07 (S) DP: ELLIS, DAVIS  
03/23/07 (S) NR: BUNDE, STEVENS, HOFFMAN  
04/04/07 (S) TRANSMITTED TO (H)  
04/04/07 (S) VERSION: CSSB 121(L&C)  
04/05/07 (H) READ THE FIRST TIME - REFERRALS  
04/05/07 (H) RES, JUD  
05/02/07 (H) RES AT 1:00 PM BARNES 124  
05/02/07 (H) Moved Out of Committee  
05/02/07 (H) MINUTE(RES)  
05/03/07 (H) RES RPT 5DP 3NR  
05/03/07 (H) DP: SEATON, EDGMON, ROSES, WILSON,  
JOHNSON  
05/03/07 (H) NR: GUTTENBERG, KAWASAKI, GATTO  
05/07/07 (H) JUD AT 1:00 PM CAPITOL 120

BILL: HB 128

SHORT TITLE: OIL & GAS PRODUCTION TAX: EXPENDITURES

SPONSOR(s): REPRESENTATIVE(s) OLSON

02/12/07 (H) READ THE FIRST TIME - REFERRALS  
02/12/07 (H) O&G, RES, FIN  
02/22/07 (H) O&G AT 3:00 PM CAPITOL 124  
02/22/07 (H) Heard & Held  
02/22/07 (H) MINUTE(O&G)  
03/01/07 (H) O&G AT 3:00 PM CAPITOL 124  
03/01/07 (H) Moved CSHB 128(O&G) Out of Committee  
03/01/07 (H) MINUTE(O&G)  
03/05/07 (H) O&G RPT CS(O&G) 3DP 1NR  
03/05/07 (H) DP: DOOGAN, RAMRAS, OLSON  
03/05/07 (H) NR: SAMUELS  
03/19/07 (H) RES AT 1:00 PM BARNES 124  
03/19/07 (H) Heard & Held  
03/19/07 (H) MINUTE(RES)  
03/21/07 (H) RES AT 1:00 PM BARNES 124  
03/21/07 (H) Heard & Held  
03/21/07 (H) MINUTE(RES)

03/23/07 (H) RES AT 1:00 PM BARNES 124  
 03/23/07 (H) Heard & Held  
 03/23/07 (H) MINUTE(RES)  
 03/26/07 (H) RES AT 1:00 PM BARNES 124  
 03/26/07 (H) -- MEETING CANCELED --  
 03/28/07 (H) RES AT 1:00 PM BARNES 124  
 03/28/07 (H) Heard & Held; Assigned to Subcommittee  
 03/28/07 (H) MINUTE(RES)  
 05/01/07 (H) RES SUBCOMMITTEE AT 9:00 AM BARNES 124  
 05/02/07 (H) RES AT 1:00 PM BARNES 124  
 05/02/07 (H) Failed To Move Out Of Committee  
 05/02/07 (H) MINUTE(RES)  
 05/04/07 (H) RES AT 1:00 PM BARNES 124  
 05/04/07 (H) Moved CSHB 128(RES) Out of Committee  
 05/04/07 (H) MINUTE(RES)  
 05/05/07 (H) RES RPT CS(RES) 1DP 1NR 6AM  
 05/05/07 (H) DP: GATTO  
 05/05/07 (H) NR: EDGMON  
 05/05/07 (H) AM: SEATON, GUTTENBERG, KAWASAKI,  
 ROSES, WILSON, JOHNSON  
 05/05/07 (H) JUD REFERRAL ADDED AFTER RES  
 05/07/07 (H) JUD AT 1:00 PM CAPITOL 120

**WITNESS REGISTER**

SENATOR KIM ELTON  
 Alaska State Legislature  
 Juneau, Alaska

**POSITION STATEMENT:** Spoke as the sponsor of SB 121.

MICHAEL JONES, Director  
 Marine Operations  
 Lindblad Expeditions  
 New York, New York

**POSITION STATEMENT:** Spoke in support of SB 121.

RUTH HAMILTON HEESE, Assistant Attorney General  
 Environmental Section  
 Civil Division (Juneau)  
 Department of Law (DOL)  
 Juneau, Alaska

**POSITION STATEMENT:** During hearing of SB 121, answered questions.

REPRESENTATIVE KURT OLSON  
 Alaska State Legislature  
 Juneau, Alaska

**POSITION STATEMENT:** Spoke as the sponsor of HB 128.

KONRAD JACKSON, Staff  
to Representative Kurt Olson  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Spoke on behalf of the sponsor of HB 128,  
Representative Olson.

DON BULLOCK, Attorney  
Legislative Legal Counsel  
Legislative Legal and Research Services  
Legislative Affairs Agency (LAA)  
Juneau, Alaska

**POSITION STATEMENT:** During discussion of HB 128, offered  
comments and answered questions as drafter of HB 128.

ETHAN FALATKO, Assistant Attorney General  
Oil, Gas & Mining Section  
Civil Division (Juneau)  
Department of Law (DOL)  
Juneau, Alaska

**POSITION STATEMENT:** During discussion of HB 128, offered  
comments and answered questions.

KEVIN BANKS, Acting Director  
Central Office  
Division of Oil & Gas  
Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** During discussion of HB 128, offered  
comments and responded to questions.

JONATHAN IVERSEN, Director  
Anchorage Office  
Tax Division  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** During discussion of HB 128, offered  
testimony and answers to questions.

JUDY BRADY, Executive Director  
Alaska Oil and Gas Association (AOGA)  
Anchorage, Alaska

**POSITION STATEMENT:** Provided comments and answered questions in  
opposition to HB 128.

MARY JACKSON, Staff  
to Senator Tom Wagoner  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** During discussion of HB 128, responded to a question pertaining to federal investigations on behalf of Senator Wagoner, sponsor of the Senate companion bill.

#### **ACTION NARRATIVE**

**CHAIR JAY RAMRAS** called the House Judiciary Standing Committee meeting to order at [1:30:11 PM](#). Representatives Ramras, Lynn, Holmes, and Dahlstrom were present. Representatives Coghill, Samuels, and Gruenberg arrived as the meeting was in progress.

#### SB 121 - CRUISE SHIP DISCHARGE & INFO

[1:30:37 PM](#)

CHAIR RAMRAS announced that the first order of business would be CS FOR SENATE BILL NO. 121(L&C), "An Act relating to discharge from small commercial passenger vessels; relating to information-gathering requirements for small commercial passenger vessels; providing for an effective date by repealing the delayed effective date found in sec. 16, ch. 153, SLA 2004; and providing for an effective date."

[1:30:51 PM](#)

SENATOR KIM ELTON, Alaska State Legislature, speaking as the sponsor of SB 121, relayed that the bill restores the alternative compliance discharge protocols for small ships, which were passed unanimously by both bodies of the legislature in 2004, as House Bill 522, and which were written in conjunction with the Department of Environmental Conservation (DEC). However, the ballot initiative regarding cruise ship taxation, regulation and disclosure inadvertently included a repeal of those protocols. This repeal was not the intention of the ballot initiative sponsors, and was not noticed by the legislature. Neither the initiative sponsors, members of the public, nor any member of the legislature has testified against SB 121. He concluded by saying in part, "This is something that needs to be fixed."

CHAIR RAMRAS asked how it is known that the initiative sponsors and the public didn't mean to put the same restrictions on the small cruise ships as the large cruise ships.

SENATOR ELTON responded that those restrictions on waste water were not imposed by the ballot initiative. These restrictions were already passed into law by the legislature. However, the small cruise ships do not have the space on board for the required waste water technology. The alternative protocol, addressed in House Bill 522, was written for cruise ships with fewer than 150 overnight berths. The ballot initiative is a compliance review and did not impose any restrictions on waste water that were not already imposed by law.

REPRESENTATIVE GRUENBERG, asked Senator Elton to clarify the sequence and the process.

[Chair Ramras turned the gavel over to Vice Chair Dahlstrom.]

SENATOR ELTON responded, explaining that when House Bill 522 was introduced, and subsequently passed, it was put into a statute that was going to be repealed if the ballot initiative passed. The legislature just failed to notice that they were amending a statute that could be repealed by the proposed cruise ship initiative.

REPRESENTATIVE GRUENBERG asked whether the statute was being brought back to its unamended status.

SENATOR ELTON replied yes, and he elaborated that SB 121 also includes a sunset clause for 2016, as the bill sponsor projected that technology would be adequately improved by then.

REPRESENTATIVE GRUENBERG pondered whether the legislature should consider developing a procedure to deal with any similar problems that may arise in the future.

[Vice Chair Dahlstrom returned the gavel to Chair Ramras.]

SENATOR ELTON responded that he was willing to help but warned that such a procedure might take a lot of thought to consider all the possible scenarios; the problem may be inherent in the initiative process.

CHAIR RAMRAS, after mentioning a possible conflict of interest, turned the gavel over to Vice Chair Dahlstrom.

[1:41:19 PM](#)

MICHAEL JONES, Director, Marine Operations, Lindblad Expeditions, noted that Lindblad Expeditions has been operating two small 62-passenger vessels in Southeast Alaska since 1989. These two identical sister ships are both U.S. built, flagged, owned, operated, and crewed. Both vessels dock in Juneau, Petersburg, and Sitka. He commented that the original legislation, House Bill 522, provided a process for the DEC to review and approve alternate compliance programs for small passenger vessels, and the system worked well. He reflected that the ballot initiative inadvertently removed the small ship alternate compliance program. He concluded by stating that Lindblad Expeditions supports SB 121.

[1:43:30 PM](#)

RUTH HAMILTON HEESE, Assistant Attorney General, Environmental Section, Civil Division (Juneau), Department of Law (DOL), in response to a question regarding the department's fiscal note, said that the initials "GP" stand for "general permit". She clarified that SB 121 is not requiring small cruise ships to have a permit; rather, the bill is drafted such that the best management practices (BMP) apply to small cruise vessels. She said she believes that SB 121 does not intend for a permit system.

REPRESENTATIVE GRUENBERG asked whether the DOL and the DEC have finished reviewing the bill.

MS. HAMILTON HEESE responded that both reviews have been completed and "the bill would restore the program consistent to what it was before."

REPRESENTATIVE GRUENBERG asked whether the DOL had any legal issues with SB 121.

MS. HAMILTON HEESE replied that she did not believe the DOL had any problems with the bill.

VICE CHAIR DAHLSTROM asked if there was any more testimony, and, there being none, closed public testimony on SB 121.

[1:47:16 PM](#)

REPRESENTATIVE LYNN moved to report CSSB 121(L&C) out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, CSSB 121(L&C) was reported from the House Judiciary Standing Committee.

VICE CHAIR DAHLSTROM returned the gavel to Chair Ramras.

HB 128 - OIL & GAS PRODUCTION TAX: EXPENDITURES

[1:47:54 PM](#)

CHAIR RAMRAS announced that the final order of business would be HOUSE BILL NO. 128, "An Act relating to allowable lease expenditures for the purpose of determining the production tax value of oil and gas for the purposes of the oil and gas production tax; and providing for an effective date." [Before the committee was CSHB 128(RES).]

CHAIR RAMRAS offered his understanding that the need for legal definition of the phrase "improper maintenance" resulted in HB 128 being referred to the House Judiciary Standing Committee.

[1:49:47 PM](#)

REPRESENTATIVE KURT OLSON, Alaska State Legislature, sponsor, concurred with Chair Ramras.

REPRESENTATIVE GRUENBERG inquired whether there was also a second issue concerning retroactivity.

REPRESENTATIVE OLSON explained that HB 128 attempts to address the question of who pays for improper maintenance on the North Slope, either the citizens of Alaska or the responsible party. Last year, this bill was offered as an amendment to the production profits tax (PPT) legislation, but didn't reach the Senate floor. This bill is now the companion bill to SB 80. He urged support of the bill. In response to a question, he expressed his belief that the retroactivity question was addressed in the last committee.

[1:51:58 PM](#)

KONRAD JACKSON, Staff to Representative Kurt Olson, Alaska State Legislature, explained on behalf of Representative Olson, sponsor, that the issue of retroactivity was already addressed by Legislative Legal and Research Services. He said that the PPT legislation was a tax bill, the retroactive clause was an amendment to that bill, and that such a clause is not unusual. In reviewing HB 128 for the committee, he recounted that it amends the PPT by adding another paragraph to AS 43.55.165(e), which currently lists 18 items not considered lease

expenditures, and are therefore not tax deductible. The proposed paragraph (19) will disallow as lease expenditures any expenses for repair or replacement of facilities or equipment that weren't properly maintained.

MR. JACKSON went on to further explain AS 43.55.165(e)(19) and its three subparagraphs, (A), (B), and (C). If, for example, an improperly maintained facility "A" results in diminished capacity or a shut down, this may cause the downstream facility "B" to also be shut down or have diminished capacity. In that case, those expenses incurred at facility "B" attributable to the shut down in facility "A" would also cease to be lease expenditures. He finished by stating that "the people of Alaska do not end up paying for someone else's mistake."

MR. JACKSON explained that the proposed paragraph (20) refers to the "lead person for exercising oversight". This is a position recently created by the governor via Administrative Order No. 234. This new position, Petroleum Systems Integrity Office Coordinator (PSIOC), will ensure that the infrastructure and production facilities in the state are maintained. The Petroleum Systems Integrity Office (PSIO) will be within the Department of Natural Resources (DNR).

CHAIR RAMRAS recollected that while attending a joint House and Senate Resources Standing Committee meeting on August 31, 2006, the committee discussed the value of lost oil revenue and whether that would ever be recaptured. He offered his belief that HB 128 won't address that loss, but will instead address the cost from improper maintenance.

MR. JACKSON concurred.

[2:00:40 PM](#)

DON BULLOCK, Attorney, Legislative Legal Counsel, Legislative Legal and Research Services, Legislative Affairs Agency (LAA), after confirming that he drafted HB 128, explained that as no other state gets involved in giving upstream deductions when calculating the value on which the severance tax is based, he was unable to find any other similar standards to model. The production tax value under PPT is calculated by starting with the gross value at the point of production and then subtracting the costs of production. As a rule, ordinary and necessary expenses are allowed to be deducted. The costs listed in AS 43.55.165(e) are specifically not allowed to be deducted. Starting with the premise that this is a new approach, he

explained that he looked at what the state is giving up when it gives a deduction.

MR. BULLOCK, acknowledging the costs of deductions, explained that the oil companies are not allowed to deduct any capital expenditure costs below the value of 30 cents times the total annual production [of BTU equivalent barrels of oil]. When oil production goes down, this "floor" of deduction limits goes down, and then more capital expenditure costs would be allowable deductions. With the credits and the deductions, the state could share up to 42.5 percent of the field costs. He said they tried to define in HB 121, what level of [indisc.] are the operators expected to meet in return for the deduction. The standard in the bill is "good oil field practice." If the operator's performance does not meet this standard, the state will not give the deductions.

CHAIR RAMRAS raised the issue of enforceability that he believed was one of the concerns of the Department of Law (DOL).

MR. BULLOCK replied that it is common auditing practice to determine what is "ordinary and necessary." The standard for general deductions for oil field production costs is "ordinary and necessary" and this is the standard applied by the state in AS 43.55.165(a). In response to a question, Mr. Bullock replied that "ordinary and necessary" is the normal terminology also used in tax law.

[2:09:01 PM](#)

ETHAN FALATKO, Assistant Attorney General, Oil, Gas & Mining Section, Civil Division (Juneau), Department of Law (DOL), reflected that the DOL was comfortable with the bill. He said he could not recall what question there may have been as to the issue of enforceability, though he clarified that he was "pinch hitting" for a colleague as the spokesperson from the DOL.

REPRESENTATIVE GRUENBERG provided that he did not want to include language in the bill that will promulgate litigation. He then asked for a clarification on the process after a deduction is taken.

[2:11:16 PM](#)

KEVIN BANKS, Acting Director, Central Office, Division of Oil & Gas, Department of Natural Resources (DNR), explained that the Department of Revenue (DOR) has responsibility for collecting

taxes. He noted that HB 128 will add provisions [to AS 43.55.165(e)] that will not allow cost [deductions] due to "improper maintenance", with some definition as to how that will be accomplished.

CHAIR RAMRAS asked that the witnesses speak specifically about retroactivity.

MR. BULLOCK opined that there is not a problem with the retroactive provision [included in Section 5]. He offered that the PPT legislation was already retroactive. The U.S. Supreme Court in Welch v. Henry ruled that given the importance of taxes, the state legislature can amend a tax and apply it retroactively. He surmised that if other provisions of the PPT legislation have resulted in less [revenue] than anticipated, then the legislature would have the power to go back and make corrections. He suggested that this bill is similar to those types of adjustments which the court has allowed. After a reasonable amount of time has passed for the legislature to look at the effect of the law, it does have the power to make a retroactive change in the law.

MR. FALATKO concurred with that summation, that it was consistent with his research. Given the current timeline, he said he did not believe this should be an issue.

MR. BULLOCK said there have also been more recent Alaska Supreme Court cases that have upheld the retroactivity of production tax regulations.

[2:16:04 PM](#)

REPRESENTATIVE GRUENBERG indicated that all of his questions have been answered.

MR. BANKS, in response to a question, said that he is comfortable with the legislation, even should it progress into litigation. He went on to explain the relationship between the DNR and the DOR. The DOR auditor may flag a cost, believing it to be associated with an improper maintenance issue. At that point, the DOR has the option to consult with the DNR or the PSIO. The PSIO staff will be able to offer consulting services to the DOR to help determine whether the cost is improper, as defined in this legislation.

MR. BANKS further explained that the purpose of the PSIO is to coordinate the oversight of those oil industry activities

upstream of the regulated pipelines. He said the PSIO intends to coordinate the regulatory authorities of: the Department of Environmental Conservation (DEC) for environmental protection; the DNR for land use, water use, and coastal zone management; and the state according to the stipulations that apply under its leases and unit agreements with the lessees. In addition, he said, the PSIO will be working with some federal agencies, including the DOT&PF.

MR. BANKS clarified that the PSIO will provide oversight to ensure the industry has appropriate quality assurance programs in place, regardless of what changes are made to the PPT legislation. The PSIO staff will monitor industry activities, and provide consulting services to the DOR should any questions arise concerning costs associated with improper maintenance. He offered his belief that should the legislation be litigated, the PSIO would assist the DOR by providing expert witness testimony.

REPRESENTATIVE GRUENBERG surmised that HB 128 addresses the deductibility of the cost of correcting the damages. He asked whether, as a company would have been failing to maintain the equipment, there would be other tax issues from prior tax years that ought to be reviewed.

[2:23:56 PM](#)

JONATHAN IVERSEN, Director, Anchorage Office, Tax Division, Department of Revenue (DOR), in response to a question, offered to explain the process as it was encountered during the normal audit cycle, which would begin in the winter. He explained that the auditors would be looking in suspect areas for large or unusual expenses. The auditor, exercising some discretion, would pick suspect areas, check any authorizations for expenditures (AFE's), and ask for documentation to the deductions the taxpayer is requesting. He suggested the auditors would also focus on areas that make the news. A parallel track to this would be litigation, whereby part of a claim could be for lost taxes. He concluded by explaining that the DOR would only become aware of any tax issues when the taxpayer has claimed the expenses.

REPRESENTATIVE GRUENBERG surmised that the state would potentially be proceeding on two fronts: litigation for damages by the DOL, and correct tax filing by the DOR. He asked whether the statute of limitations is long enough with regard to the two issues of damages and back taxes, in order to protect the state's interests to the maximum extent possible.

MR. IVERSEN, in response to the question, said that the DOR has three years from the time the return is filed to complete its audits. If HB 128 is passed, amended returns would need to be filed by the taxpayers within 90 days of the bill's passage.

MR. BULLOCK added that Section 4 contains the transitional provisions, which describe what is expected of the operators and producers if this bill passes. He clarified that there is, in general, a three-year statute of limitations. The DOR has three years to audit and the taxpayers have three years to file amended returns. In response to a question, he offered his belief that there is a statute of limitations for six years on [damages] claims that the state can file.

REPRESENTATIVE GRUENBERG, referring to an earlier comment regarding claims for taxes lost, requested confirmation that the state would not be barred by a statute of limitations.

[2:32:41 PM](#)

JUDY BRADY, Executive Director, Alaska Oil and Gas Association (AOGA), said that the AOGA opposes HB 128. She offered some background context on the oil tax history in Alaska. Alaska had a gross tax with the Economic Limit Factor (ELF) production tax. From 1987 to 2005, the average price of oil per barrel was \$18. The tax level for the oil producers was 67 percent. The state of Alaska had one of the highest tax rates in the world. She directed attention to the references of the higher tax rates (70-80 percent) by other countries on oil producers. She noted that this higher tax rate package included an allowable return rate of 150 percent on the oil producers' capital investments within the first five years. She pointed out that these countries took the risks along with the oil producers, and then the countries demanded a very high return.

MS. BRADY offered her belief that the state of Alaska took no risk with the companies and [still] demanded a very high return. She reported that the production of oil is falling from the 1988 production rate of 2.1 million barrels per day to the current rate of 700,000 barrels per day. She suggested that with maturing oil fields and higher capital costs, if the state wants a higher tax rate with higher prices, the state will have to take some of the risks. She offered her belief that this higher tax for higher risk was what the "PPT was all about." The PPT is a different system than any other state.

[Chair Ramras turned the gavel over to Vice Chair Dahlstrom.]

MS. BRADY continued, reiterating that the state needs to take part of the risk in return for receiving higher taxes when oil prices are higher. She relayed that members of the legislature have always been concerned with protecting the state's interests; they did not want the state to pay for gross negligence, willful misconduct, fraud, or any costs incurred for containment control, clean up, or removal in connection with any unpermitted release of oil. The state has zero tolerance for spills. Ms. Brady continued with background of the oil tax history in Alaska, recounting the August 6, 2006, British Petroleum (BP) oil leak on the North Slope and the subsequent August 9 meeting of the Senate Special Committee [on Natural Gas Development], at which time the members expressed that the state not accept any responsibility for costs or losses related to spills. She remarked that two prior amendments have been offered with regard to improper maintenance, but each was voted down in committee.

MS. BRADY continued to explain that when the discussion of improper maintenance came up this year as HB 128, there were many sponsors, as members were concerned. She offered her belief that the DEC, DNR, DOR, and Alaska Oil and Gas Conservation Commission (AOGCC) all had problems with how [HB 128] was worded, as it contains no standards for corrosion. From AOGA's viewpoint, Alaska is already protected. She pointed out that during November 2006, the state withdrew \$8 million from the [Oil and Hazardous Substance Release Response Fund] for a DOL and DEC study regarding the recovery of all state costs and lost revenues occasioned by the August 6 spill. That study is still ongoing.

MS. BRADY commented that under PPT the state has already taken action to separately review all the issues being discussed today. This review is ongoing, and being conducted under existing authorizations. She referred to the [current non-deductions to lease expenditures listed in AS 43.55.165(e)], noting that she believes these [non-deductions] already address those issues that HB 128 is intended to address. Costs arising from fraud, willful misconduct, gross negligence, or for containment control, clean up, and removal would not be [allowable lease expenditures]. Legislators last year and this year have made clear they don't want the state to participate in the cost for risks that were badly handled by the oil companies.

[2:41:44 PM](#)

MS. BRADY asked how an auditor will make a decision every time a capital cost is shown as a deduction. She commented that the main decisions would be obvious. She suggested that for the other less obvious decisions, the legislature include a proxy [based on Dr. A Pedro H. van Meurs suggestion to disallow the first \$0.30 per BTU equivalent barrel as "lease expenditures"]. This would increase the taxes the oil industry pays by about \$45 million each year, a reasonable maintenance requirement for a field of this size. This would be paid by the oil producers each year, whether or not there is an incident or a maintenance issue. She opined that HB 128 proposes to add amendments to the PPT which are not required because the state's interests are already protected. She warned that passage of HB 128 will make the implementation of the PPT very difficult. She also predicted that the bill's passage could lead to a return of the problems within the ELF system, when the legislation did not present clear direction.

MS. BRADY predicted that should this lead to billions of dollars in tax disputes, neither the companies nor the state agencies would be able to progress, as they would be concerned with influencing the outcome of the disputes. If an auditor begins to red flag items in the first year of a three year audit, and allowing for an additional three years after the completion of the audit for an amended response, a decision will be unclear for many years. She questioned what would be the red flag for an auditor, as HB 128 does not tie to a particular incident, but instead to a capital expense requested as a deduction.

MS. BRADY called attention to the [PSIOC] position, commenting that this person will be given authority equal to the commissioners of the DNR, the DOR, and the DEC, yet this person will not have been subject to confirmation by the legislature. She cited two items that she believes will be difficult to tie to the issue of improper maintenance: related incremental operating expenses and diminished capacity. She reflected that during a repair situation, operators should not be thinking about curtailing capacity and the resulting issues of an audit; instead, they should be focusing on what is necessary for safety.

MS. BRADY also expressed concerns regarding the retroactivity provision in the bill. She summarized that the AOGA thinks this may offset the whole purpose of the [PPT] which was to combine higher risk with higher taxes. She expressed concern with a [possible] constant legal struggle. She emphasized that no

other state does what is being proposed [via AS 43.55.165(e)(19)] and the operators don't require this degree of "simple negligence issues" among themselves.

[2:47:14 PM](#)

CHAIR RAMRAS observed that if the oil companies didn't take the deductions, in this instance for a level of negligence, the legislature wouldn't have had to contemplate what he characterized as onerous legislation. He offered an analogy of auto insurance and the decision after an accident between personal payment or filing a claim. He stressed that had the producers assumed responsibility for the oil leak and paid the full cost without using the deductible formula allowable under PPT, there would have not been a need for HB 128. He said he lays the blame squarely at the feet of the oil producers for not handling the situation properly, and the result has been this legislation. He concluded by stating that the responsibility of the House Judiciary Standing Committee is to consider whether the legal tools in HB 128 are sufficient to defend the state's interests.

MS. BRADY offered that it would be good for the committee to have a DOL representative involved in the aforementioned response fund study to determine what cost the state believes it deserves. The additions proposed via HB 128 are already being administered by the DEC and the DOL.

MR. FALATKO responded to a question on the issue of statute of limitations that he had not yet reviewed them.

MR. BULLOCK pointed out that HB 128 is a tax bill and deals with qualifications to take deductions and credits. The issues involving losses the state may have are separate litigation. If those losses include a loss of tax revenue, then the loss would be determined by the net amount due after the application of the deductions under the current law and those deductions provided by this tax bill. He concluded that the bill is subject to the three-year statute of limitations.

REPRESENTATIVE SAMUELS asked whether, if BP chose not to take the deductions, that would become an admission in a criminal case, and, therefore, it has to take the deductions.

MR. BULLOCK reminded the committee of the confidentiality of a tax return. The DOR would be precluded from disclosing the deduction and whether or not it was taken on the return. He

added that these tax records would be difficult for the FBI to seize.

REPRESENTATIVE SAMUELS asked whether the definition of "improper" has been sufficiently determined.

MR. BANKS relayed that proposed AS 43.55.165(j) contains a definition of "good oil field practice" that references industry standards as published by the American Petroleum Institute and federal regulations, and this does address "improper maintenance" by reference to those standards.

REPRESENTATIVE SAMUELS asked whether the ongoing criminal case had been determined to be a federal or a state case.

MR. FALATKO offered that he was not aware whether criminal charges have been filed.

REPRESENTATIVE SAMUELS asked if there is a federal investigation of BP or any individuals.

REPRESENTATIVE OLSON responded that he had not heard.

MR. FALATKO allowed that he was not aware of an investigation.

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MARY JACKSON, Staff to Senator Tom Wagoner, Alaska State Legislature, conveyed on behalf of Senator Wagoner, sponsor of the Senate companion bill, that federal congressional offices are holding hearings, which are currently postponed pending receipt of materials promised from the company under question.

MR. JACKSON explained that members' packets contain a memorandum from U.S. Representative John Dingell, Chairman, Committee on Energy and Commerce that reference the hearings.

REPRESENTATIVE SAMUELS asked again whether having criminal charges filed against it would affect BP's coming forward and claiming the deduction. He wanted to know if BP not filing a deduction would be used against it as an admission of guilt.

MR. JACKSON replied that he did not know.

REPRESENTATIVE SAMUELS offered his recollection that the federal government had pondered filing criminal charges against both BP and specific company employees.

CHAIR RAMRAS relayed that the congressional hearings on the Prudhoe Bay shutdown had been rescheduled for May 16 and that BP was scheduled to appear.

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REPRESENTATIVE GRUENBERG referred to the language in proposed AS 43.55.165(j)(4) and asked why it doesn't include other gases.

CHAIR RAMRAS pointed out that gas is already broadly defined.

MR. BULLOCK offered that [the wording in the proposed amendment] relates to "good oil field practice" and the implication includes good gas field practice. Generally gas is associated with oil, but the committee could add to the bill to more directly address the gas issue. The wording is simply trying to establish standards that would be used as a basis.

CHAIR RAMRAS observed that it is a broad definition.

REPRESENTATIVE LYNN mentioned a reference to "gas facilities" in Section 2 of HB 128.

CHAIR RAMRAS expressed satisfaction that HB 128 is a tax bill with defensible language that the DOL can take into a court of law.

MR. BANKS, in response to an earlier question, relayed that most engineers consider the movement of all types of fluids, and that gas is simply a different state of fluid.

REPRESENTATIVE GRUENBERG surmised that this would include the transportation of gases other than hydrocarbon gases.

MR. BANKS agreed that this would be possible.

MR. BULLOCK added that the language in proposed AS 43.55.165(j)(4) simply pertains to the standards that would be expected in an oil field, whatever they would be transporting through the pipeline. He allowed the language was to include things other than production from the wells and this language leaves that open.

CHAIR RAMRAS stated the committee members did not have any amendments to add, and asked if the administration had any amendments that would enhance HB 128.

MR. IVERSEN responded that he had nothing to add.

CHAIR RAMRAS concluded, then, that the state, the drafter, the Department of Oil & Gas, and the DOR were all satisfied.

MR. BULLOCK concurred that the bill provides a standard that can be applied.

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REPRESENTATIVE DAHLSTROM moved to report CSHB 128(RES) out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, CSHB 128(RES) was reported from the House Judiciary Standing Committee.

#### **ADJOURNMENT**

There being no further business before the committee, the House Judiciary Standing Committee meeting was adjourned at 3:05 p.m.