

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON OIL AND GAS**

March 1, 2007

3:01 p.m.

**MEMBERS PRESENT**

Representative Kurt Olson, Vice Chair  
Representative Jay Ramras  
Representative Ralph Samuels  
Representative Mike Doogan

**MEMBERS ABSENT**

Representative Vic Kohring, Chair  
Representative Nancy Dahlstrom  
Representative Scott Kawasaki

**OTHER MEMBERS PRESENT**

Representative David Guttenberg

**COMMITTEE CALENDAR**

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(O&G) OUT OF COMMITTEE

HOUSE BILL NO. 89

"An Act providing for the use of petroleum production and other facilities by additional entities; amending the powers of the Alaska Oil and Gas Conservation Commission; relating to oil and gas properties production taxes and credits; providing for production tax adjustments to increase the amount of tax at high oil prices, reduce the amount of tax at low oil prices, and reduce the amount of tax on the production of heavy oil; relating to the determination of the gross value of oil and gas at the point of production; and providing for an effective date."

- HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

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

BILL: HB 89

SHORT TITLE: OIL & GAS PRODUCTION TAX

SPONSOR(S): REPRESENTATIVE(S) GARA, CRAWFORD, GUTTENBERG

01/16/07 (H) PREFILE RELEASED 1/12/07  
01/16/07 (H) READ THE FIRST TIME - REFERRALS  
01/16/07 (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

**WITNESS REGISTER**

MICHAEL HURLEY, Director  
State Government Relations  
ConocoPhillips Alaska, Inc. ("ConocoPhillips")  
Anchorage, Alaska  
POSITION STATEMENT: Testified in opposition to HB 128.

MICHAEL FRAILEY, Counsel  
Alaska Taxation  
ConocoPhillips Alaska, Inc. ("ConocoPhillips")  
Anchorage, Alaska  
POSITION STATEMENT: Testified in opposition to HB 128.

JASON BRUNE, Executive Director  
Resource Development Council for Alaska, Inc. (RDC)  
Anchorage, Alaska  
POSITION STATEMENT: Testified in opposition to HB 128.

JOHN K. NORMAN, Commissioner/Chair  
Alaska Oil and Gas Conservation Commission (AOGCC)  
Department of Administration (DOA)  
Anchorage, Alaska

POSITION STATEMENT: Answered a question regarding HB 128.

ROBERT E. MINTZ, Attorney at Law  
Kirkpatrick & Lockhart Preston Gates Ellis LLP  
Anchorage, Alaska

POSITION STATEMENT: Answered questions regarding HB 128.

STEVEN MULDER, Chief Assistant Attorney General - Statewide  
Section Supervisor  
Environmental Section  
Civil Division (Anchorage)  
Department of Law (DOL)  
Anchorage, Alaska

POSITION STATEMENT: During discussion of HB 128, answered  
questions regarding an investigation of the Trans-Alaska  
Pipeline System (TAPS) shutdown by BP Exploration (Alaska) Inc.

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

POSITION STATEMENT: Answered questions regarding CSHB 128.

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

POSITION STATEMENT: Answered questions regarding HB 128.

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

POSITION STATEMENT: Speaking as the drafter, answered questions  
regarding CSHB 128.

REPRESENTATIVE LES GARA  
Alaska State Legislature  
Juneau, Alaska

POSITION STATEMENT: As joint prime sponsor of HB 89, provided a  
PowerPoint presentation.

#### **ACTION NARRATIVE**

**VICE CHAIR KURT OLSON** called the House Special Committee on Oil and Gas meeting to order at [3:01:46 PM](#). Representatives Olson, Samuels, Ramras, and Doogan were present at the call to order. Representative Guttenberg was also in attendance.

HB 128-OIL & GAS PRODUCTION TAX: EXPENDITURES

[3:02:01 PM](#)

VICE CHAIR OLSON announced that the first 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 a proposed committee substitute (CS) for HB 128, Version 25-LS0561\M, Bullock, 2/22/07, which had been adopted as the work draft on 2/22/07.]

[3:02:52 PM](#)

MICHAEL HURLEY, Director, State Government Relations, ConocoPhillips Alaska, Inc. ("ConocoPhillips"), informed the committee that ConocoPhillips opposes HB 128. He recalled that last year effort, time, and energy were spent developing, debating, and passing the production profits tax (PPT). The result of the passage of the PPT was a tremendous increase in production taxes for the industry. Furthermore, ConocoPhillips does not believe that the PPT's tax credit incentives are sufficient to encourage new exploration and keep the industry healthy. However, he said, he is here today to testify against HB 128. Most of the discussion regarding this bill is focused on BP Exploration (Alaska) Inc. (BP), and the problems associated with the pipeline shutdown in August, 2006. Yet, ConocoPhillips will be heavily impacted by this legislation. Mr. Hurley said he deems HB 128 bad public policy and bad tax policy for the state.

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MICHAEL FRAILEY, Counsel, Alaska Taxation, ConocoPhillips Alaska, Inc. ("ConocoPhillips"), explained why ConocoPhillips opposes HB 128. The first reason, he said, is that it is a targeted tax, aimed at the situation [pipeline shutdown] last year in Prudhoe Bay. A generally applicable tax policy should

not be written in response to a specific set of circumstances. Additionally, he continued, amending the PPT before regulations are complete will create an atmosphere of instability. Mr. Frailey emphasized that the PPT statute already protects the interests of the state; for example, AS 43.55.165(e)(6), introduces legal standards that limit the deduction of "certain" costs. Furthermore, AS 43.55.165(e)(8) disallows the deduction of any legal costs producers may accrue against the state or against other working interest owners. Alaska Statute 43.55.165(e)(16) specifically disallows the deduction of lease expenditures related to an oil spill clean-up. He offered his belief that AS 43.55.165(e)(18), enacted after the [pipeline shutdown] at the Prudhoe Bay Unit, addresses the issue of improper maintenance. Mr. Frailey referred to Dr. Pedro van Meurs's letter of August 5, 2006, addressed to the Alaska state legislature. He said the following could be found on page 5:

Another concern that is regularly expressed is that the state should not permit the deduction of costs relating to replacing equipment that is becoming defective or gathering lines that need to be replaced because of corrosion or other problems. The argument is that these assets should have been better maintained in the first place.

MR. FRAILEY then referred to Dr. Pedro van Meurs's letter dated August 8, 2006, addressed to the Alaska state legislature. He quoted:

Should companies receive a tax deduction and tax credit together for [40 percent] of the value (under the 20/20 system) for replacing a pipeline that was defective and not properly maintained.... My suggestion is to disallow the first [30 cents] per BTU equivalent barrel as "lease expenditures".

MR. FRAILEY explained that the result of the 30-cent tax credit exclusion is that the industry will pay between \$40 million and \$42.5 million every year to provide for the repair or replacement of improperly maintained equipment or facilities. Therefore, HB 128 is addressing a problem that has already been solved and ConocoPhillips, he emphasized, is opposed to re-opening the tax regulations of the PPT.

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VICE CHAIR OLSON, sponsor of HB 128, assured Mr. Frailey that the legislative intent of HB 128 is not to re-open the PPT statutes. The intent is to address the application [by BP] for a tax credit exception for costs due to gross negligence. Vice Chair Olson relayed that this issue was not addressed prior to the passage of the PPT.

MR. FRAILEY stated that the fourth reason ConocoPhillips opposes HB 128 is that the bill proposes language that is without history in jurisprudence. The term "improper maintenance" is not a legal concept or term and its interpretation will be determined by the Department of Revenue (DOR). ConocoPhillips, Mr. Frailey continued, does not consider legal language or industry standards to be in the DOR's field of expertise. Finally, under HB 128, similarly situated taxpayers could be treated differently by auditors, he said. For all of the above reasons, Mr. Frailey concluded, ConocoPhillips opposes HB 128 and it believes that to encourage investment in the state, laws should be equitable, administrable, and stable.

[3:15:21 PM](#)

REPRESENTATIVE RAMRAS questioned whether ConocoPhillips was an advocate of "fiscal certainty on oil" last year.

MR. HURLEY affirmed that "fiscal certainty" was part of what was in "that particular contract."

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REPRESENTATIVE RAMRAS recalled that fiscal certainty was not an issue for ConocoPhillips. He said that ConocoPhillips was a good corporate citizen of the state but that it will be judged by the collective merits of the oil producing companies. Representative Ramras said that although he is empathetic to ConocoPhillips, he will help move HB 128 out of committee.

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REPRESENTATIVE SAMUELS asked Mr. Frailey the following questions: What is the commercial arrangement between ConocoPhillips and BP? If ConocoPhillips refuses to pay [its share of the pipeline shutdown], what will BP do? What are the arrangements between the [members of the] Prudhoe Bay Unit? If the operator proposes to spend \$100 million on a project, do the other owner companies need to agree? Will ConocoPhillips file

suit for its share of costs? Has ConocoPhillips made a corporate decision that those deductions will not be taken?

MR. FRAILEY stated that [the repair of] each segment is evaluated as an individual business case and if it is justified, ConocoPhillips will pay its share. The [pipeline shutdown] situation is being evaluated by ConocoPhillips. Ultimately, if ConocoPhillips believes there was gross negligence or [if BP was] an imprudent operator ConocoPhillips's corporate policy is to not pay.

[3:20:22 PM](#)

MR. HURLEY added that within the Prudhoe Bay Unit, the operators are required to get approval for major expenditures from the interest owners. The plans to repair and replace [pipeline transmission lines] will be sorted out amongst the owners following the normal policy on expenditures.

REPRESENTATIVE SAMUELS asked:

What's a timeline? ... [If] you decide that we're not going to pay ..., what does it do to the statute of limitations? ... Does BP attempt to take the entire amount off? How much of a quagmire do we get into when Exxon and [ConocoPhillips] tell BP ... the owners are not going to pay their fair share?

MR. HURLEY answered that the decision process within the Prudhoe Bay Unit should not extend beyond the normal DOR three year audit process. He added that a petition to stay the audit deadline can be filed, if necessary.

[3:22:51 PM](#)

REPRESENTATIVE DOOGAN remarked:

I want to make sure that I understand ConocoPhillips's position, here. You'll be more heavily impacted if these are not allowable deductions because you got a bigger share of the action there. You're going to have to pay more of the cost to repair it; ... but you have, I would assume, the opportunity to try to make BP pay the whole thing by arguing that they didn't do the job that you were paying them to do ...?

MR. HURLEY concurred.

[3:23:46 PM](#)

REPRESENTATIVE DOOGAN then asked Mr. Hurley why ConocoPhillips's believes that the PPT in its current form will not lead to more investment by the oil producers.

MR. HURLEY explained that ConocoPhillips considers the rate of the PPT and the windfall profits tax [30-cent tax credit exemption] to be excessive. The costs saved by the PPT tax credits are insufficient to be an incentive for new development and also to mitigate the negative effects of the taxes.

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VICE CHAIR OLSON pointed out that on February 22, 2007, the committee requested maintenance records from BP. This information, including the date that the feeder lines [at the Prudhoe Bay Unit] were last pigged, has still not been provided.

JASON BRUNE, Executive Director, Resource Development Council for Alaska, Inc. (RDC), informed the committee that the RDC is a business organization that has a very diverse membership. On behalf of RDC's members he said he is testifying today in opposition to HB 128. The RDC believes HB 128 is bad public policy and may set a precedent for other industries. The passage of the PPT legislation has tripled the oil production taxes collected by the State of Alaska from the oil industry. The PPT legislation allows producers to deduct operating costs from their oil taxes. Mr. Brune pointed out that taxpayers are also allowed to take a 20 percent tax credit for capital investments as an incentive for improvements to the North Slope infrastructure. Further, the PPT statutes mandate that lease expenditures do not include costs arising from fraud, willful misconduct, or gross negligence. He reminded the committee that HB 128 would preclude lease expenditures associated with improper maintenance of property or equipment; however, it does not define improper maintenance, he said. Mr. Brune continued to say that the state has the protection it needs for instances of gross negligence. Another major concern for RDC members, he said, is that HB 128 will create ongoing disputes between the state and the oil producers. Mr. Brune concluded his testimony by asking that HB 128 not be moved out of committee.

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REPRESENTATIVE RAMRAS asked Mr. Brune whether the RDC has prevailed upon BP to pay for the costs associated [with the pipeline shutdown]. He asked whether the RDC has talked to BP about corporate citizenship and how its decision jeopardizes future development around the Artic National Wildlife Refuge (ANWR) and in the Bristol Bay Fisheries Reserve."

MR. BRUNE answered no.

[3:31:15 PM](#)

REPRESENTATIVE SAMUELS called the committee's attention to HB 128 page 3, line 21. He noted that the chair of the Alaska Oil and Gas Conservation Council (AOGCC), in consultation with the commissioners of the Department of Revenue (DOR) and the Department of Environmental Conservation (DEC), will determine the standard of what is "improperly maintained." He then asked John Norman if he is concerned about this responsibility.

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JOHN K. NORMAN, Commissioner/Chair, Oil and Gas Conservation Commission (AOGCC), Department of Administration (DOA), responded that the AOGCC does foresee complexities in this responsibility. He referred to his letter to Senator Wagoner, dated February 16, 2007, that expressed the AOGCC's concerns and pointed out the absence of guidelines for industry standards. Mr. Norman agreed that the determination of the allowable costs will be a complicated assignment. However, he assured the committee that the AOGCC will be able to complete its required tasks.

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REPRESENTATIVE SAMUELS asked Robert Mintz if he could improve the vague language in HB 128.

ROBERT E. MINTZ, Attorney at Law, Kirkpatrick & Lockhart Preston Gates Ellis LLP, stated that he did not have language prepared to improve the bill; however, he said he would provide assistance to the Department of Law (DOL) regarding this matter. Mr. Mintz said there could be improvement in the language that might make it easier to administer HB 128 and still clearly address the committee's concern about the vague language. The term "improper," he said, may not connote "the failure to maintain."

[3:34:33 PM](#)

REPRESENTATIVE SAMUELS asked Steven Mulder if he had information about DOL investigations [into the pipeline shutdown].

STEVEN MULDER, Chief Assistant Attorney General - Statewide Section Supervisor, Environmental Section, Civil Division, (Anchorage) Department of Law (DOL), answered that although there is an ongoing investigation, no litigation has been filed at this time. He said that former Attorney General David Marquez formed a task force that is in the process of evaluating the documents collected after [the pipeline shutdown]. In answer to a question, Mr. Mulder said he is unable to predict a timeline for the DOL to make a recommendation about whether the state can recover losses of revenue due to [the pipeline shutdown]. He further explained that the DOL will not have receipt of all of the documents under subpoena from BP and other producers for 60 days or longer.

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REPRESENTATIVE SAMUELS expressed his concern that deductions [for the pipeline shutdown] will have been taken and five years may pass without the settlement of a [possible] lawsuit. He asked how the passage of time would affect a lawsuit if HB 128 is not passed.

[3:38:01 PM](#)

MR. MULDER said he is unable to answer that question.

REPRESENTATIVE SAMUELS asked Mr. Mulder whether he is aware of federal litigation [regarding the pipeline shutdown].

MR. MULDER confirmed that there is an ongoing federal investigation in process but that no litigation has been filed.

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REPRESENTATIVE SAMUELS inquired as to whether there are any criminal investigations being conducted by the state.

MR. MULDER confirmed that the Criminal Division of the DOL began an investigation in August, 2006, but he did not have further information.

REPRESENTATIVE SAMUELS asked whether, if HB 128 does not pass, and ConocoPhillips and ExxonMobil Corporation refuse to pay BP their portion of costs [of the pipeline shutdown], can BP deduct the entire amount.

KEVIN BANKS, Acting Director, Central Office, Division of Oil & Gas, Department of Natural Resources (DNR), said that his understanding is that the grounds for non-payment between the owners of the Prudhoe Bay Unit Operating Agreement are the same standards that apply under the PPT statute. If gross negligence is the case, the same standards apply and the deductions would not be an allowable cost.

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REPRESENTATIVE SAMUELS remarked:

If ... [ConocoPhillips] and Exxon do not pay BP. Because [of] their claim of gross negligence ... they make a deal internally. Is that subject to review by the state, or do you have access to the information? ... To avoid the gross negligence term being thrown out there by a ruling of a court in a civil suit between the two entities. ... If BP filed suit against the owners of the [Prudhoe Bay] unit to get [its] money back. Because they are going to spend the money, they're not going to have to get permission first, ... to do either resleeving or the new pipe - what happens in a lawsuit between three of the largest corporations in the world ten years from now when [the state looks] back on whether it was deducted or not? ... Does that create any kind of a problem whether we do or do not pass the bill?

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MR. BANKS advised the committee that in allowing or disallowing costs in the course of an audit, whether or not a partner in an operating agreement has paid another partner for costs, serves as evidence of a disallowed cost. Therefore, the auditor will review a charge made by the operator that has not been reimbursed by its partners. Mr. Banks continued by saying that there are statutes of limitations on tax cases. If three years were to pass after the event and a settlement or formal resolution was reached, the matter would be closed and the state may not have an opportunity to recover.

REPRESENTATIVE DOOGAN asked what the PPT auditing process would be if HB 128 does not pass. He also asked whether an auditor would review BP's application for deduction and make the determination as to whether BP can deduct the costs resulting from a [pipeline shutdown].

[3:47:17 PM](#)

JONATHAN IVERSEN, Director, Anchorage Office, Tax Division, Department of Revenue (DOR), answered that the DOR regulations allow for a three-year time period in which to conduct an audit. In the case of a dispute at the end of that time the parties can execute an extension or the state can issue a jeopardy assessment to preserve the state's claim. Mr. Iversen confirmed that the effect of a dispute between the interest owners is evidence for an audit and that a settlement reached by the parties will not control the tax division's actions during an audit.

[3:49:28 PM](#)

REPRESENTATIVE DOOGAN asked, "The state can contest deduction claims on its own hook, can't it?"

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MR. IVERSEN affirmed that the DOR will disallow a claim through the assessment and audit process. The taxpayer can agree or file an informal appeal that begins within the department and ends with a formal ruling before an administrative law judge. In necessary, the taxpayer can then submit a formal appeal to the Alaska Superior Court.

[3:50:59 PM](#)

REPRESENTATIVE SAMUELS recalled that the DOR is in favor of HB 128, but asked if there was a conflict with the DOL about the bill's language.

MR. IVERSEN indicated that the DOR is interested in addressing the issues of improper maintenance. The DOR, he continued, supports the change in Version M, at page 3, line 22, from "relying on" to "taking into consideration", standard industry practices.

[3:52:47 PM](#)

REPRESENTATIVE SAMUELS expressed his interest in knowing whether the settlement or ruling in a civil case could be used as evidence of a subsequent criminal case.

MR. MULDER acknowledged that this is an evidentiary question and that he would need to consult with the DOL criminal division for an answer.

[3:55:44 PM](#)

MR. MINTZ, provided an answer to an earlier question regarding a dispute or settlement between interest owners. He said that the basic elements of the PPT relate to the term lease expenditures; specifically, the costs that are deductible in calculating the production tax. Alaska Statute 43.55.165(a) defines lease expenditures as the ordinary and necessary costs that are the direct costs of exploring for, developing, or producing oil and gas deposits. Mr. Mintz explained that in determining whether costs are lease expenditures, the DOR will consider typical industry practices revealed in existing unit operating agreements and the DNR's regulations on what costs are deductible for net profit share leases. During the audit the department will be responsible for determining whether costs meet the general definition. He continued to say that AS 43.55.165(e) cites 18 exclusions; however, in subsections (c) and (d) the DOR is allowed to rely on operating agreement billings to determine what are deductible lease expenditures. If the DOR decides to use the operating agreement billings for determining lease expenditures under subsection (d), the DOR will rely on interest owners to accept or dispute amounts indicated in billings. Mr. Mintz concluded that if lease owners refuse to pay, then those costs will not be considered a lease expenditure and will not be deductible.

[4:02:04 PM](#)

DON BULLOCK, Attorney, Legislative Legal Counsel, Legislative Legal and Research Services, Legislative Affairs Agency (LAA), speaking as the drafter of HB 128, added his opinion that under the PPT statute, the legislature makes policy decisions on allowable credits and deductions and that [the bill] makes a policy decision about the level of care expected from a field operator and which costs the state is willing to share.

[4:03:24 PM](#)

REPRESENTATIVE SAMUELS, requested clarification of Mr. Hurley's estimate on the amount of time needed for the interest owners to decide whether payments will be made to BP for [the pipeline shutdown].

4:04:24 PM

MR. HURLEY offered his belief that there are several stages of decisions to be made by the interest owners. The first stage will be the submission of an authorization for expenditure (AFE) by the operator to the interest owners for approval. If the AFE is approved, the operator will, at a later time, bill the costs to the working interest owners. The approval or disapproval of an AFE quite often takes several months, Mr. Hurley said.

REPRESENTATIVE SAMUELS asked whether BP has begun the process of submitting to the interest owners its AFE for the [pipeline shutdown].

4:07:26 PM

MR. HURLEY replied that ConocoPhillips has not received an AFE from BP as of February 23, 2006. He added that an AFE is similar to a proposal and is not always public information.

4:08:29 PM

REPRESENTATIVE DOOGAN offered his belief that ConocoPhillips opposes HB 128 because it thinks the bill is targeted at BP. However, he noted, the legislature must write the laws of general application and must also look to possible future applications. In addition, he continued, it is unreasonable to expect that laws will not change. Representative Doogan said he is not convinced by ConocoPhillips's claim that the 30-cent tax exemption is sufficient to address the problem of BP's deduction of pipeline shutdown costs. Lastly, he continued, litigation is inevitable concerning oil production taxes due to the subject matter. Representative Doogan remarked:

What we're left with is a bill that right now only allows us, really, any latitude on a situation like the one on the North Slope, in the case of what are criminal standards. ... I can imagine situations in which you wouldn't be violating the criminal law and yet you'd still wouldn't want to allow the deductions. And it's my hope that's what this bill does and that

is why I'm going to be voting to send it out of committee.

The committee took an at-ease from 4:12 p.m. to 4:13 p.m.

[4:13:17 PM](#)

REPRESENTATIVE RAMRAS remarked that he is troubled by the vague standard in the language of HB 128, and noted that there is not a definition of "improper maintenance" in Black's Law Dictionary. He then referred to a speech given by Rex Tillerson, Chairman, and Chief Executive Officer, Exxon Mobil Corporation, and indicated that Mr. Tillerson said:

First we must provide greater understanding of the reality of the timeframes within which our industry works to deliver this uninterrupted supply of energy. These are timeframes that often transcend the political cycle and most certainly the media cycle. Many policy makers think in increments of two, four, or six years based on election cycles. In contrast, those of us in the energy industry think in increments of two, four, or six decades based on timelines to gain access to new acreage, explore for, discover, and bring to production the next sources of supply.

REPRESENTATIVE RAMRAS stressed that it is the failure of BP to pay the [pipeline shutdown] costs which has resulted in the creation of a [HB 128]. The responsibility for the resolution of this [pipeline shutdown] problem should not rest with the legislature. He said:

I am troubled when folks like us have to take up a bill like yours, Mr. Chairman, and react to a situation that we should not be placed in. We've been [working] ... since this past summer ... and there's no resolution ... for fixing this problem. ... They [oil companies] are requiring us as politicians to come up with a political solution for what really is just a good corporate citizenship problem. And I continue to be troubled even as I vote ... to recommend this bill move on. I think that BP has it well within their power to solve this problem and not invite for the next two, four, or six decades into our energy policy and management of Alaska's resources, a vague standard of this "improper maintenance" standard. It's an unknown thing and it's shameful

that we're going to have to litigate it. ... It doesn't instill a lot a goodwill.

4:19:35 PM

REPRESENTATIVE RAMRAS moved to report the proposed CS for HB 128 Version 25-LS0561\M, Bullock, 2/22/07, out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, CSHB 128(O&G) was reported from the House Special Committee on Oil and Gas.

The committee took an at-ease from 4:20 p.m. to 4:21 p.m.

HB 89-OIL & GAS PRODUCTION TAX

4:22:05 PM

VICE CHAIR OLSON announced that the next order of business would be HOUSE BILL NO. 89, "An Act providing for the use of petroleum production and other facilities by additional entities; amending the powers of the Alaska Oil and Gas Conservation Commission; relating to oil and gas properties production taxes and credits; providing for production tax adjustments to increase the amount of tax at high oil prices, reduce the amount of tax at low oil prices, and reduce the amount of tax on the production of heavy oil; relating to the determination of the gross value of oil and gas at the point of production; and providing for an effective date."

4:22:33 PM

REPRESENTATIVE LES GARA, Alaska State Legislature, sponsor of HB 89, informed the committee that there are two issues facing the state regarding the production profits tax (PPT). The issues of subsidies for the gas pipeline are the first concern. Although the intention was for the subsidies to benefit a producer-owned gas line, in fact, the subsidies will only benefit the holder of the Pt. Thompson, Alaska, oil lease and those who hold the current oil leases on the North Slope. The second issue, he said, is comparing Alaska's oil tax rate with the world average oil tax rate. Representative Gara asked whether, when the state is anticipating budget deficits within two years, should Alaska tax at \$1 billion to \$2 billion per year less than the world average. Oil is a world commodity, he said, and the oil production companies in Alaska also produce oil around the world.

REPRESENTATIVE GARA continued to explain that the oil tax rate is measured by "total government take." According to analyses by consultants Econ One Research Inc., Daniel Johnston & Co., Inc., and Wood Mackenzie Ltd., total government take is the portion of the oil's value that [Alaska] receives compared to the oil company's profit. Daniel Johnston estimates that the average world government take is approximately 67 to 70 percent. Wood Mackenzie projected that the world average government take is approximately 71 percent, including factors for the high cost of production in Alaska. After subtracting taxes, the producer's net income is approximately 30 percent Representative Gara noted. Under the PPT legislation, when the price of oil is \$60 per barrel, the total government take for Alaska is 61 percent. Again, when the price of oil is at \$60 per barrel, a one percent change in the total government take equals a \$200 million loss or gain in revenue. Analysis provided to the legislature last year by Econ One Research Inc., shows that an increase in revenue of \$100 million is produced by increasing total government take by .5 percent.

REPRESENTATIVE GARA pointed out that Alaska's taxes on oil production are between six and ten percent less than the world average tax rate. This difference equals a loss of about \$1.2 billion and \$2 billion per year to Alaska. He then suggested that the committee also consider oil production companies' profit margins. "ConocoPhillips Annual Reports, 2003-2006", indicate that Alaska-based profits for 2005 were \$2.55 billion, which is a profit margin of 43.1 percent. In 2006, with the PPT legislation in effect for three-quarters of the tax year, profits were \$2.33 billion, which is a profit margin of 37 percent.

[4:31:24 PM](#)

REPRESENTATIVE GARA returned to the subject of the subsidies provided by the PPT legislation. He said that it provides a \$3 billion, or 42.5 percent, subsidy for the development of Pt. Thompson. In addition, the oil companies will be able to deduct from their oil tax the costs of the development of gas fields. The cost of developing the gas line on the North Slope is estimated to be \$9.2 billion, including the cost of construction of the gas treatment plant. Representative Gara noted that most of the cost of and risk taken is during development of the gas pipeline, and so a subsidy by the state may be needed. However, he concluded, once the pipeline is in place, there is no need for Alaska to further subsidize the construction of the gas fields.

REPRESENTATIVE GARA surmised that Alaska will be obligated to pay \$1.2 billion of Pt. Thomson's development costs. The gas and oil field development at Pt. Thomson is expected to be a profitable venture and legislation is pending that provides for additional grant money for gas line development. Perhaps, Representative Gara suggested, the subsidy under the PPT statute is not needed. He pointed out that during the development of Pt. Thomson, there will be no income from the production of gas. At this same time, gas field development costs will begin to be deducted from oil tax revenues. Representative Gara said he feels the state needs to separate gas line development provisions from the PPT statute.

REPRESENTATIVE GARA then concluded with these remarks:

As budget gaps are on their way, ... does it make sense to tax [\$1 billion to \$2 billion] less than the world average for our oil commodity? And should we allow somewhere in the neighborhood of ...[\$1.5 billion to \$3 billion] worth of deductions from our oil taxes for companies developing gas fields once they know there's going to be a gas line in place? ... I think the answer to both questions is, we need to take another look at our oil tax law. ... These are both billion-dollar issues ... and I think we should resolve them in favor of changing both of those provisions in the PPT law. ...

[HB 89 was held over.]

[4:39:16 PM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 4:39 p.m.