

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

October 19, 2007

1:35 p.m.

MEMBERS PRESENT

Representative Kurt Olson, Chair
Representative Nancy Dahlstrom
Representative Mark Neuman
Representative Jay Ramras
Representative Ralph Samuels
Representative Mike Doogan
Representative Scott Kawasaki

MEMBERS ABSENT

All members present

OTHER MEMBERS PRESENT

Representative Bob Buch
Representative John Coghill
Representative Brice Edgmon
Representative Anna Fairclough
Representative Berta Gardner
Representative Carl Gatto
Representative David Guttenberg
Representative John Harris
Representative Lindsey Holmes
Representative Wes Keller
Representative Mike Kelly
Representative Beth Kerttula
Representative Bob Roses
Representative Woodie Salmon
Representative Paul Seaton
Representative Bill Stoltze

Senator Green
Senator Huggins

COMMITTEE CALENDAR

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."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB2001

SHORT TITLE: OIL & GAS TAX AMENDMENTS

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

10/18/07	(H)	READ THE FIRST TIME - REFERRALS
10/18/07	(H)	O&G, RES, FIN
10/19/07	(H)	O&G AT 1:30 PM HOUSE FINANCE 519

WITNESS REGISTER

PATRICK GALVIN, Commissioner
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: During hearing of HB 2001, testified in support of the proposed Alaska's Clear and Equitable Share (ACES) option, presented the opening segments of a three day presentation on ACES, and responded to questions.

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

POSITION STATEMENT: During the hearing on HB 2001, testified in support of the Alaska's Clear and Equitable Share (ACES) option, presented the Information Use/Reporting/Sharing segments of the proposal, and responded to questions.

BOB GEORGE, Consultant
Gaffney, Cline and Associates
Houston, Texas

POSITION STATEMENT: During hearing on HB 2001, presented the Information Reporting Standards in Other Countries segment of

the Alaska's Clear and Equitable Share (ACES) model, and responded to questions.

RICH RUGGIERO, Consultant
Gaffney, Cline and Associates
Houston, Texas

POSITION STATEMENT: During hearing on HB 2001, presented the Information Reporting Standards in Other Countries segment of the Alaska's Clear and Equitable Share (ACES) model, and responded to questions.

KEVIN BANKS, Acting Director
Division of Oil and Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: During hearing of HB 2001, responded to questions.

ACTION NARRATIVE

CHAIR KURT OLSON called the House Special Committee on Oil and Gas meeting to order at [1:35:09 PM](#). Representatives Olson, Doogan, Kawasaki, Dahlstrom, Neuman, Samuels, and Ramras were present at the call to order. Also present were Representatives Buch, Coghill, Edgmon, Fairclough, Gardner, Gatto Guttenberg, Harris, Holmes, Keller, Kelly, Kerttula, Roses, Salmon, Seaton, and Stoltze, and Senators Green and Huggins.

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HB2001-OIL & GAS TAX AMENDMENTS

[1:36:24 PM](#)

CHAIR OLSON announced that the only order of business would be 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."

CHAIR OLSON stated that this series of meetings would begin with a presentation by the governor's Production Tax Team, and he made clear his intent to conduct committee meetings throughout the week until all questions on the topic of the petroleum production profits tax (PPT) have been exhausted.

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PATRICK GALVIN, Commissioner, Department of Revenue (DOR), stated that the DOR presentations, are meant to clarify how the Alaska's Clear and Equitable Share (ACES) option was developed. The petroleum profits tax (PPT) was evaluated and alternatives considered to bring this option as a viable alternative. Some of the information to be brought forward was not available to the committee, when the PPT was passed a year ago.

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COMMISSIONER GALVIN directed attention to the committee handout titled: The Palin-Parnell Administration presents ACES (Alaska's Clear and Equitable Share), last updated 10/18/07, and stated that the ACES proposal is about investment in two different ways: via new oil development, and via investing today's surpluses and saving them for tomorrow's needs. He noted that by adopting the PPT a fundamental shift in the state's relationship with the oil and gas industry occurred. Under the system of PPT, he explained, companies can reduce their tax bill, and pay less money to the state, or receive a payment from the state in the amount between 40 and 52.5 percent of their investment dollars. This effectively makes the state of Alaska the single largest investor in new development on the North Slope. Also through this system, the oil companies are allowed to make the investment decisions, while the state assumes the fiscal risks associated with the developments.

COMMISSIONER GALVIN drew attention to page 4, to illustrate production levels as tracked from 2000, and forecast through the year 2020. The chart indicates the expected trends, as compiled by DOR, comparing status quo operations, under development projects, and projects under evaluation. Commissioner Galvin stressed that the tax system should provide incentives to the oil companies for investment in the forecasted projects. A critical needs exists, he opined, to "get these projects going." The object of ACES is to provide desired incentives while

seeking a fair share of oil revenues for the states current and future fiscal needs. Calling attention to pages six, seven, and eight, of the handout, he explained how revenue shifting could occur to provide a balanced economic future for the state using the ACES model.

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COMMISSIONER GALVIN explained that DOR has separated the ACES structure into three modules, to be heard over the next three days. He began with the section titled "Tools to Protect the State."

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REPRESENTATIVE DOOGAN stated that the tax policy proposal of ACES is considered an investment in North Slope oil, and asked how the viability of this investment is to be judged by the legislature.

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COMMISSIONER GALVIN stated that Sunday's presentation, "Investment Climate and Sectional," will address this type of question. How the question relates to expected return and whether or not a project can go ahead without state assistance, does relate to this part of the presentation. He provided an analogy of the tax system adjustments to a television with electronic tuning knobs. He stressed the importance to imbed the ability for the state to effect economics via "fine tuning" the controls. Each economic factor plays a part in the tuning aspect, with varying effects across the board. The Sunday presentation will go into depth on these economic tuning "knobs," exploration incentives, and the ACES sectional overview of where they appear in the bill itself. He said:

On Sunday we're going to talk about the exploration incentive programs. We recognize that the new entrants that could come in and look at the fields that are unattractive to the current incumbents are ... key if not a ... vital aspect of the state's economic future. And we believe that, through the ACES program, building on what exists within PPT, we're actually making Alaska probably one of the most attractive places in the world for companies to ... come in ... and begin an exploration opportunity.

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REPRESENTATIVE SAMUELS clarified that DOR expects this model to make Alaska attractive to new exploratory companies.

COMMISSIONER GALVIN responded: "Yes."

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REPRESENTATIVE SAMUELS paraphrased a quote by Mr. Galvin, as reported from a town meeting, that, "ACES is not about investment; we're not making the investment climate better."

COMMISSIONER GALVIN responded that the statement was made during a press conference. It was a statement which he made in response to a question regarding whether ACES was to improve the investment climate for the legacy fields. He clarified this statement as meaning that by creating ACES, DOR was not claiming to improve the investment climate, but to preserve the opportunity for investment in projects that appear to be going forward, "with those particular areas ... units." Further, he proclaimed that the PPT provides a disproportionate benefit to incumbents as opposed to explorers. With ACES, DOR is attempting to provide a level balance and create an investment climate that may be unmatched elsewhere in the world.

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REPRESENTATIVE RAMRAS, directing attention to page 5, opined that the governor has "pegged her political capital" to reorganize the tax structure, but not maintained a balance with the POMV (percent of market value), or other aspects that require attention. If this is about balancing to investment interests, he queried, is state spending being regarded as an investment interest. Restated his question for clarification, and asked: "Balancing to investments interests, what are those two investment interests?"

COMMISSIONER GALVIN stated that the investment interests are: investing in North Slope development through tax credits, with a tax structures that encourages continued development; and investment of current oil revenue excesses to cover future deficits.

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REPRESENTATIVE RAMRAS capsulated the argument before the committee to be an ongoing discussion about the duality of philosophy based on how oil industry dollars are handled. On the short term horizon, dollars can be shifted from the oil and gas industry, into the state treasury without hurting the long term prospects or investment climate; or by shifting these short term dollars the image of this state as a positive investment climate, may be tarnished.

COMMISSIONER GALVIN opined that disagreement stems from whether or not the state's oil revenue share, in the current time frame, can be accomplished while maintaining the same level of investment interests.

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REPRESENTATIVE HARRIS referred to page five and asked where the administration is intending to invest surplus revenues; has that been determined. He stated that a 50:50 split between the permanent fund and the state employee retirement system would be his choice, and asked if concepts would be brought forward for consideration.

COMMISSIONER GALVIN replied that the investment topic would not be addressed during this special session.

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REPRESENTATIVE HARRIS continued on page 5, and read the bullet point, "Protect Economy from Future (Sales or Income) Taxes." He asked whether these surplus revenues are expected to occur for only a short time, and is this program anticipated to stave off taxes for an extended period of time.

COMMISSIONER GALVIN responded that it all depends on when the shortfalls begin to kick in and when the price of oil begins to drop. However, he stressed that during this premium price time, the state should be reaping the benefits and planning for future needs.

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REPRESENTATIVE HARRIS referred to the final bullet on page 5, "Provides Stability for Diversification of Alaska's Economy," and stressed that the oil and gas industry is providing 87 percent of the state's revenues. He asked: "How in the world, are we going to replace that, if we don't increase the volume?"

COMMISSIONER GALVIN pointed out that the premise is to change the terms in order to take advantage of the currently available share; it is not being proposed to bring in more money in order to replace the fall in production. By bringing the money in from the oil sector now, funds can be captured and invested to provide money for the future. This strategy will utilize today's oil and gas revenues to provide a shelter for new, diversified industries that the state may foster in the future.

REPRESENTATIVE HARRIS surmised that this program is basically attempting to minimize taxes to future, developing industries.

COMMISSIONER GALVIN said, "That is correct."

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REPRESENTATIVE NEUMAN commented that the bullet on page 5, "To Meet the State's Current Fiscal Needs," has been pointed out by previous industry representatives as being "exactly what scares industry." That is, government increasing taxes on an industry for the primary reason of covering fiscal needs. He asked how the state can measure investment in taxes, how is it considered in ACES, and "what if that doesn't work, where are we going to go?"

COMMISSIONER GALVIN responded that the impact of the tax system on the investment decisions being made, will be the main topic of the presentation/discussion on Sunday. Considering to what level taxes can be raised before companies begin to withdraw their investment dollars, is a critical component to the ACES model. At what point will an oil and gas company change an investment decision from a yes to a no, based on the tax structure that has been employed by the state government, will be the center of the discussion on Sunday [October 21, 2007].

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REPRESENTATIVE NEUMAN inquired whether Sunday's presentation will provide projections to compare the PPT and ACES, side by side.

COMMISSIONER GALVIN answered that PPT will be illustrated as the status quo with the ACES comparisons being made point by point.

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REPRESENTATIVE SAMUELS asked whether, save the auditor's pay, the DOR budget is expected to be flat for FY07.

COMMISSIONER GALVIN cited the auditor contracts and the information management systems, for data availability, as the variables.

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REPRESENTATIVE SAMUELS requested that a projection be made to indicate how long the CBRF (capital budget reserve fund) depletion, as indicated for 2013, page 7 graph can be "staved off." Obviously, given a six percent decline in revenue sources, the CBRF may be dipped into within seven or eight years, he predicted. Additionally, he asked:

What are the consequences of [DOR] being wrong, and investment did get effected; and how much risk is the state taking then ... what are the consequences to the economy as a whole.

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REPRESENTATIVE DOOGAN provided three questions for the Sunday discussion: What will this investment cost the state; what will the state receive in return; and how likely is it that the investment will be made without realizing the expected return. He said that by "essentially leaving money on the table in our tax policy, ... that's an investment [and] I'm going to want it analyzed as an investment."

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COMMISSIONER GALVIN directed attention to the page 12 bullets, and read the four major categories identified as necessary to protect the states interests: "Information; Auditors; Lease expenditures; and Credit adjustments." The information aspects of ACES are three pronged: collecting the data from the tax payers, using it within the state system, and providing for a level of public disclosure. Continuing on page 14, he stated that the PPT provides for minimal reporting of information, primarily available on an annual basis with a tax return. This reporting is not commensurate with other world-wide net-tax jurisdictions, and will be elaborated on in the forthcoming Gaffney-Cline presentation. From the states perspective the administration becomes more difficult to manage, when the tax is based on the gross vs. net value with costs considered a primary

component of the tax calculation. Information disclosure from the taxed companies ceases to be a clear cut entity and disputes may occur. Consequently, he said, the authority of the agency comes into question, which may lead to delays and conflicts with the taxpayers.

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REPRESENTATIVE HARRIS asked whether requesting a statutory change effecting information disclosure is a current issue with the [oil] producers.

COMMISSIONER GALVIN replied that it is primarily evident when requesting forecasting information. Having the reporting expectations "clearly spelled out" would help to stream line the communication realm.

REPRESENTATIVE HARRIS requested a demonstration of how this is handled globally.

COMMISSIONER GALVIN responded that it will be reported on in this presentation.

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REPRESENTATIVE NEUMAN suggested that it would be important for state departments to work interdepartmentally via policy procedures versus statutory regulations.

COMMISSIONER GALVIN offered that this issue will be addressed during the presentation.

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COMMISSIONER GALVIN continued by reading the page 5 bulleted outline for reporting, "Annual statement must be filed by all producers and explorers regardless of whether a tax payment is due; Expands the list of specific information requirements for returns; and Explorers and producers that have lease expenditures or credits but no production must file with the department, all relevant expenditures, adjustments, and credits." He stressed the need for this information to be reported in a useable format; compatible with the state system.

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COMMISSIONER GALVIN moved to page 16 bulleting the DOR authority. The statutory changes in ACES provide that: DOR may require a producer, explorer, or operator to file monthly reports with information necessary to administer the tax; and authority to require producers, explorers, and operators to file reports or records needed to forecast state revenue. This will bring Alaska on par as a partner in the information sharing realm with the companies, and allow better forecasting and revenue planning by state authorities.

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REPRESENTATIVE HOLMES asked if this reporting level will require comparable effort from all exploration companies; major/minor.

COMMISSIONER GALVIN responded that every operator should already have this information available, and it should not cause an undue burden on any company.

REPRESENTATIVE HOLMES queried whether this information will be of significant use to the state, without placing additional reporting burdens on any individual companies.

COMMISSIONER GALVIN answered that it will provide a benefit to the state on the forecasting of revenues, and it also provides a leg-up on trends. Additionally, it should be noted that other countries are provided this type of information already by oil and gas companies who are mutual operators in Alaska.

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REPRESENTATIVE RAMRAS read the filing format bullet on page 17: "Information currently filed with department is extremely variable and inconsistent." If this is correct, he asked, how is it to be known that the forecast for the failure of PPT is not mistaken.

COMMISSIONER GALVIN provided that two different levels of detail need to be considered regarding this statement and the PPT forecast. The filing format has to do with receiving information in a form compatible with the department information management database. However, the information used to forecast the deficit was based on calculations from information provided directly to the department and brought to the legislature. The operating expenditures were significantly higher than expected, and the capital expenditures in the past calendar year were less than predicted. The impacts realized between operation and

capital expenditures are interactive; the impact on the capital expenditures serves to dampen the overall impact on the operational expenditures. What has happened this year is that the capital expenditures are going to far exceed what was expected and, he said:

We're going to have a double whammy. ... They're not providing us with their monthly statements but those payments are matching our model in terms of the costs that we were expecting for this fiscal year. So it would appear that we're pretty close ... to what we have modeled and that gap between what was included a year ago and what we are experiencing now ... it's real.

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REPRESENTATIVE RAMRAS provided a scenario as an example of capital investment choices, and how that has effected his private sector business. He suggested that investing in operating expenses is a worthwhile focus and creates new infrastructure. Additionally, he said, "If costs are going up, you're punishing the [oil] industry for doing exactly what we designed the PPT to do."

COMMISSIONER GALVIN concurred that costs are rising, and the costs are fully deductible. The relationship between operating and capital expenses is being respected in ACES, he pointed out but maintained that at the time this was discussed [for PPT] the numbers provided were incorrect.

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REPRESENTATIVE HARRIS asked, "If a gross tax system were in place would this information be necessary?"

COMMISSIONER GALVIN responded that it would depend on the nature of the system being utilized. Most of the systems currently under discussion have included a component for a deduction in capital expenditures; specific information would be needed for that model, as well.

REPRESENTATIVE HARRIS interjected, "That wouldn't be a gross system, though."

COMMISSIONER GALVIN suggested, "At some point along the line we can talk about the use of language and the use of whether gross

versus net is an accurate description of the choices that exist."

REPRESENTATIVE HARRIS restated, "I didn't say a modified gross, I said a gross. Merely based upon a value of a certain product at a certain point, period."

COMMISSIONER GALVIN answered, "If anybody were proposing a strict gross with no deductions for any additional costs, then the discussion about what information we needed is probably mute."

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REPRESENTATIVE SAMUELS expressed a fear that these numbers could continue to fluctuate, requiring continuous adjustments by future governors and commissioners. Setting a tax system at a target number appears to be an inappropriate method, he said, and could prove to be too high or too low at any given time; continuing the stability question. "We're going to have another tax fight, on gas, right before the open season," he predicted.

COMMISSIONER GALVIN disagreed that a fight would be a forgone conclusion; only if the economics proved it necessary, he said.

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REPRESENTATIVE SAMUELS referred to his previous question regarding the accuracy of DOR's predictions.

COMMISSIONER GALVIN opined that it is important to realize that with better information being received, fine tuning can occur that has not been possible before. He expressed confidence in understanding that Information which drove the system one year ago has been matured by experience and found to be in error. A higher level of intelligence is now achievable by those in administration.

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REPRESENTATIVE SAMUELS admonished: "The next administration is going to think exactly the same thing."

COMMISSIONER GALVIN advised that there is no way to counter today, how a future administration will enter into the situation. The important work, he said, is to create the best system possible for today. The global market, he opined, will

perceive the states reassessment of the situation as a legitimate adjustment based on current information vs. making a change three years from now, which could be construed as a systemic problem in the state system.

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COMMISSIONER GALVIN turned to page 18, to explain the necessary format for the oil companies to submit their information; designed to improve the means by which to manipulate and utilize the massive amounts of expected data. He elaborated on the three bulleted aspects, which read: Electronic reporting form would feed into database where information would be readily available and usable for regulatory purposes, including auditing, forecasting, responding to inquires, and generating reports; Will accommodate ELF-based [economic limit factor] data and will be integrated with the division's accounting systems; and Will collect on volumes, wells and production, and will include profit-based data, including tracking credits, required under ACES.

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COMMISSIONER GALVIN expanded on DOR-DNR information sharing needs and issues. As bulleted on page 19, the ACES model: Clarifies DOR authority to share with DNR information contained in tax returns; maintains DOR confidentiality requirements under current law; Clarifies DNR authority to share with DOR oil and gas leasing information - maintains DNR confidentiality requirements under current law; and Allows each agency to be fully informed and be more responsive to dynamic industry needs - helps to facilitate informed policy making and analysis. He emphasized the need to clarify statute for state agency access versus what is provided to public entities.

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CHAIR OLSON asked if the confidentiality and information security are only state issues, or constituting a potential SEC [Security Exchange Commission] problem.

COMMISSIONER GALVIN answered, "No."

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REPRESENTATIVE SAMUELS asked why this has not already occurred, and opined that a valid reason for the current status may exist.

COMMISSIONER GALVIN offered that the confidentiality statutes were initially written without agency sharing issues in mind. The oversight has become apparent through the evolution of the relationship between the state agencies.

REPRESENTATIVE SAMUELS suggested that the downside of changing statute could be an inherently adversarial relationship between departments, if one agency were to gain the upper hand politically speaking. Also, he cautioned, it is not the responsibility of DOR to establish policy on royalty reductions.

COMMISSIONER GALVIN said it is up to the governor to oversee that state agencies are undertaking their respective roles appropriately. In further response, he maintained that it has been an evolutionary process between the agencies, not an intentional, or optimal means of operation.

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REPRESENTATIVE NEUMAN opined that sharing information between agencies could also lead to further questions, and convoluted paperwork. If a legislative goal were to help minimize "red tape," this could be a step in the opposite direction.

COMMISSIONER GALVIN stated his prediction that the information sharing will provide companies the ability to coordinate responses and minimize duplicity. He stressed the importance of encouraging communication, particularly between agencies charged with overlapping responsibilities.

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REPRESENTATIVE NEUMAN asked if ACES provides regulatory authority to DOR that will allow these issues to be addressed.

COMMISSIONER GALVIN responded that general authority exists for the commissioner to promulgate regulations to administer responsibilities under statute. He stated, "We need to have the statute written in a way that directs how those regulations are supposed to ... what the actual policy is that's being implemented." The lack of clarity in the statute provides the potential for the regulations to be challenged, as well as difficulty when the agency is grappling with the legislative intent for the regulation.

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REPRESENTATIVE NEUMAN offered that the legislature may exercise their role of agency regulation review.

COMMISSIONER GALVIN pointed out that a part of the ACES package asks the legislature to exercise oversight and provide DOR with policy guidance to properly manage the regulatory faction.

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REPRESENTATIVE SAMUELS asked if, when DNR acts as a competitor in the market place with RIK (royalty in-kind), does access to confidential information from DOR provide an advantage; could this become a point of litigation for unfair practices.

COMMISSIONER GALVIN recalled that this point has previously been raised, and suggested that the answer may be found in other testimony coming before the committee. To a follow up question, he responded that the state agencies would not be privy to any information that the oil and gas companies are not already providing to other industry partners.

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REPRESENTATIVE NEUMAN asked what the current constraints are for information sharing.

COMMISSIONER GALVIN said the constraints mentioned refer to information shared with the public, not the state.

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CHAIR OLSON asked what the commissioner would have done differently in developing the PPT.

COMMISSIONER GALVIN explained that he was not part of that process, and was serving in DNR at the time the bill was crafted.

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REPRESENTATIVE SAMUELS offered a review of what occurred during the formation of the original PPT; present committee members and visiting representatives were in attendance.

REPRESENTATIVE RAMRAS asked if Representatives Kott, Kohring, or Anderson were present in the committee room, or in the offices of the chairman.

REPRESENTATIVE SAMUELS stressed that the named representatives were never present. He continued, stating that the nine citizen legislatures present had a bill put before them for consideration. Discussion points included: the rate; a progressivity addition; an upfront, tax free deduction, as an exploration incentive valued at \$73 million; a five year claw back; and an effective date. These five "pieces" were considered. The outcome, he reported, resulted in the addition of the progressive feature, removal of the \$73 million from the "big three" producers who would have used it, elimination of three-quarters of the claw back, which was eventually eliminated entirely, and the effective date was moved back by three months. In rough calculations, he tallied, these adjustments to the bill provided \$500 million to the state coffers.

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COMMISSIONER GALVIN emphasized that what is being offered to the committee today is information that was not available a year ago; it may introduce a perspective that will lead the body to a different conclusion.

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REPRESENTATIVE KERTTULA stated that the House Finance Committee did request information, from the department, that was not forthcoming. Thus, she said, the information being currently disclosed, and the opportunity to revisit the bill is valid.

[3:10:33 PM](#)

JONATHAN IVERSEN, Director, Tax Division, Department of Revenue (DOR), explained how the Guideline Interpretation, page 20, would allow DOR express authority to issue advisory, non binding, bulletins for information and guidance to producers, explorers and other interested persons concerning DOR's interpretation of production tax statutes and regulations. He advised that this provision protects the dissemination of information from being construed as a violation of the administrative procedures act. The statute of limitations for tax assessment, page 21, is proposed to be extended from 3 to 6 years. This, he said, would only apply to the oil and gas production tax. The first reason for this change is "we're now

in the world of upstream costs as well as downstream costs; we have essentially more to handle." Additionally, he said, having reviewed how this is handled in other states, precedent has been established. It also allows audit determinations to have the benefit of joint interest audit findings. These findings, he furnished, typically take several years to complete with unresolved issues that extend beyond a 3-5 year time period.

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REPRESENTATIVE NEUMAN inquired what response this proposal has received from the industries.

MR. IVERSEN answered that he could not recall the statute of limitation provision having been addressed directly. However, he speculated, it will vary depending on the tax payer. This is because some companies are willing to waive time for audits to be performed, others may object to this provision if it causes a conflict with corporate policy for handling tax issues. To a follow-up question, he responded, that the size of the company or investor is not determinative.

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COMMISSIONER GALVIN offered that is may be an aspect of the corporate culture, and whether a particular company operates in a cooperative or adversarial manner.

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MR. IVERSEN directed attention to the final page of his segment, page 22, and said this is more of a clarification rather than a new area. He assured that the department has been, and continues to be, sensitive to confidential information while publishing appropriate statistics. To a question from the committee he responded that the aggregate tax rate across the slope is approximately 28 percent.

The committee took an at-ease from [3:17:42 PM](#) to [3:38:16 PM](#).

[3:40:14 PM](#)

BOB GEORGE, Consultant, Gaffney, Cline and Associates, provided the background of Gaffney and Cline and the scope of their global operations that extend from consultation for various governments, as well as technical and strategic services to the

oil and gas sector. This work, he noted, provides a broad perspective and understanding of how the industry operates.

[3:41:27 PM](#)

RICH RUGGIERO, Consultant, Gaffney, Cline and Associates, provided his background in the industry and as a consultant with Gaffney Cline.

[3:42:55 PM](#)

MR. GEORGE directed attention to the committee handout titled "Oil and Gas Reporting and Disclosure in Selected Countries - Focus on Cost/Field Detail Reporting," and began by stating that oil companies around the globe are required to disclose data on a detailed basis. This includes both historic information as well as planning/forecast/future outlooks for wells and fields. Responding to a question from the committee, he clarified that the data provided to the resource manager and fiscal taxation authorities of a government, also constitutes what is disclosed publicly. As bulleted on page 2 of the handout, reporting, and public disclosure are two separate issues. The government typically receives a greater volume of consistent, routine, management information versus the common, aggregate, summary form provided to the public.

[3:45:09 PM](#)

MR. GEORGE directed attention to page 3, and suggested that the name of a country or state could be interchanged in the title as it refers to any steward of a resource, not a unique principle for Alaska. Disclosure is imperative to fulfill budgetary and fiscal responsibilities, and monitor feedback for proper planning and control policy management of a resource.

[3:46:47 PM](#)

MR. GEORGE provided that the focus of this part of the presentation is directed towards the reporting of cost information and sharing. Typically, field level information is collected and reported on a semi-annual or annual basis; generally provided to the regulatory body which stewards the resource. Some of the same information will be utilized as the tax return basis and furnished to the relevant fiscal body. Sharing typically occurs between the parties, however, a separation is postured based on the field level information

relevant for planning purposes, as opposed to cost review information necessary for taxation.

[3:48:32 PM](#)

MR. GEORGE referred to page 5 indicating what type of reporting is typically available to the public: aggregated/summary form, field-level summaries of reserves and capex (capital expenditure). Operating expenditure (opex) information is rarely disclosed at the field level; public subscription services are the primary source of dissemination.

[3:50:12 PM](#)

MR. RUGGIERO stressed that in global venues reporting is expected and not considered a requirement above and beyond other expectations. The oil companies are not asked but expected to provide this information as an essential part of the exploitation of a resource.

[3:50:59 PM](#)

MR. GEORGE moved to examples of disclosure information, beginning with page 7. The UK (United Kingdom), Norway, Denmark, and Nova Scotia were used for the examples. The UK requires data disclosure that includes a field development plan with exploitation costs; annual and semi annual data/statistical analysis, including detailed information on older fields subject to petroleum revenue taxes (PRT). This information is aggregated and available via web sites. Pages 8 and 9 are examples of the standardized forms used to report the data. The same information is reported on a field by field basis on an annual time series, and indicates the production, sales volume, capex, opex, and tariffs. This information is summarized on a historically to complete annual income and expenditure reports.

[3:56:18 PM](#)

MR. GEORGE explained, that, as illustrated on the graph and bar charts, pages 10 and 11 respectively, the information is not only used for historical tax purposes but also aggregated to provide forecasts and cost trends for the near future.

[3:57:17 PM](#)

MR. RUGGIERO interjected that the formality of this type of data is reviewed with a regulatory body, twice a year. Discussions

focus on the health and productivity of the fields. This type of dialogue, he opined, provides regular opportunities to set the pace for existing and future activities, as well as to ensure the optimum usage of facilities.

[3:59:51 PM](#)

REPRESENTATIVE NEUMAN referred to the bill Section 49, new language on page 35, paragraph (6), addressing the assessment of penalties for failure to report, and asked for a comparison to the penalties imposed by the example countries.

MR. GEORGE responded that, as far as specific penalties, he could not offer a comparison, however, for non-compliance a company would be jeopardizing future approvals for operations/expansions within a venue.

[4:01:04 PM](#)

MR. GEORGE pointed out that there are distinctions drawn between the reports due for taxation purposes vs. those for regulatory informational filings. The UK and Norway maintain a discretionary award system, which takes into account a companies track record on the lease application.

REPRESENTATIVE NEUMAN restated his interest to discover how any penalties would compare.

[4:02:15 PM](#)

MR. GEORGE continued with page 12, stating that the disclosure required by Norway is more stringent than what is required in the UK. The companies operating there, provide the Norwegian Petroleum Directorate (NPD)/Ministry semi annual information on existing, as well as undeveloped fields. The information is used by Norway for planning on a national level. He stressed again how these requirements are built into the structure of doing business with these countries. He explained the detailed examples of Norway's required reporting, illustrated on pages 13 and 14, titled "Field/discovery listing of resource volumes," and "Detail on Field-by-field basis," respectively. The data provides production forecasting by year, reserve recovery, total capital investment that has historically taken place, and ultimate investment expectations.

[4:04:38 PM](#)

MR. GEORGE continued, describing the graphs on pages 15, 16, and 17 illustrating how the information is "replayed" to generate medium-term investment forecasts, excluding exploration costs. He reiterated the need to differentiate between the information that is provided for the purposes of planning and expectations. Revising these plans, and making changes, would not be viewed as a "crime." This is different than the requirements for filing of tax information, and the appropriate set of rules on disclosure established for that purpose. The investment source graph allows Norway to determine how the country is doing in "attracting new blood," where each company is based, and tracking the size of the companies operating in the area.

[4:06:33 PM](#)

MR. GEORGE qualified the inclusion of Denmark as a comparison country. Although it operates on a smaller scale, with approximately 5 operators, it is important to acknowledge how the field by field reporting is required, and how it is disclosed in the public domain. This reporting is illustrated on pages 19, 20, and 21.

[4:08:13 PM](#)

MR. GEORGE turned to page 22 to discuss the Nova Scotia example. This country requires a public review of field developments, the most recent approval was granted October 3, 2007, on the Deep Panuke off shore field. Page 23 illustrates the detail of the sales gas forecast provided in the review data for this development. In response to a committee question, he clarified that this is a forecast based on volume not price. It does include cost estimates. Further, it contains a requirement to routinely update the information, and forecast, in the annual production report. Page 25 provides the explicitly information disclosure requirements.

[4:10:13 PM](#)

REPRESENTATIVE SAMUELS referred to page 23, and asked how realistic a cost forecast projected ahead ten years could be considered.

MR. GEORGE explained that the life of the field is a major component, with various phases of development to be considered. In the terms of accuracy, it would be subject to normal forecasting probability assessments.

REPRESENTATIVE SAMUELS inquired whether there is a penalty for a gross error in forecasting.

[4:12:31 PM](#)

MR. GEORGE answered that he is unaware of there being an explicit financial penalty; as explorations proceed, additional information becomes available, which allows fine tuning and refinement of forecasts. On this basis, changes will occur as a gradual series of adjustments, which the regulator will expect. Some regimes will experience problems, particularly on large projects, and penalties may be imposed as a mechanism to advance a major change. However, daily fees have not been routinely stipulated.

MR. RUGGIERO interjected that the expectation exists for the forecast data to be uniform, provided to all entities/agencies involved, and provide a level of surety.

[4:14:54 PM](#)

REPRESENTATIVE SAMUELS queried whether contractual obligations reside in Alaska's large holding leases, regarding production forecasting.

COMMISSIONER GALVIN suggested that "part of the problem is" that the lease requirements contain no provisions for cost information.

[4:15:39 PM](#)

MR. GEORGE provided page 26, as the final aspect of his presentation. It is an abstract from a field report, publicly available from Deloitte's subscription service. This 15-20 page report is updated continuously to supply information on particular fields. The report includes production forecasts and costs, as well as cash flow for operating and capital costs. Having information in the public domain serves several purposes, he explained. The oil companies not only provide this type of information but also consume it from one another. Thus, an incoming company has the ability to assess activity in an area, as they formulate plans for possible investment. He cautioned that reporting information in this genre does not necessarily conform to statutory requirements.

[4:18:53 PM](#)

MR. RUGGIERO directed attention to a GCA (Gaffney, Cline & Associates Inc.), Memorandum, of October 19, 2007, RE: Oil and Gas Reporting and Disclosure in Selected Countries. At the bottom of page three, he stated, Timor-Leste is introduced as a country with legislation that is an exception to what has been discussed. It is important to consider to what extent different "countries are going with respect to data acquisition and data publication." This is also reflected by the data disclosure trends being expected by the World Bank, and other funding banks.

[4:21:13 PM](#)

REPRESENTATIVE NEUMAN cited that costs are rising and historically demand has increased. However, he pointed out, in the example of the UK expenditures, decreases are forecast. Further, the cost is rising considerably. The Norway example indicates a level line. The Denmark historical data on capital investments reads flat, but the sales forecast for Nova Scotia, in the same region, shows a mean decrease of 5.7 in 2010, to 2.7 in 2017. The October 19, 2007, memorandum asks GCA, he read, "... to prepare a brief overview of how the acquisition, distribution, and publication of oil company data are handled in other oil and gas producing regimes." How, he inquired, were these countries selected to illustrate this request.

MR. GEORGE clarified the decline and production reports presented. If production levels are declining faster than the inflation in the costs, an overall reduction will be seen.

REPRESENTATIVE NEUMAN reiterated that the countries used for the examples are all indicating a declining production rate, while the demands and costs for gas are increasing, and asked again why these countries were chosen.

MR. GEORGE responded that the regulations and operations of this group were considered comparable with Alaska.

REPRESENTATIVE NEUMAN offered his hope that supply and demand for Alaska's gas is increasing.

[4:24:42 PM](#)

MR. RUGGIERO interjected that this report was compiled as an example of data that is available, collectable, and reportable from these chosen countries. How reports are generated by data requested from the oil companies. These examples were not, he

emphasized, chosen to present data analysis and comparison to Alaskan production.

MR. GEORGE offered that these countries are also significant for the level of public disclosure provided.

[4:26:00 PM](#)

REPRESENTATIVE SAMUELS asked why areas of the U.S. were not used in the examples, and existing reporting requirements for companies operating in U.S. waters.

MR. GEORGE responded that the cost information disclosed elsewhere in the U.S. does not provide for a similarly high level, including on the Gulf of Mexico.

REPRESENTATIVE SAMUELS queried whether there are any reporting requirements from which to draw a comparison from within the U.S.

MR. GEORGE answered that information requested from the Internal Revenue Service (IRS) would prove to be historic versus forecasting data.

[4:28:57 PM](#)

REPRESENTATIVE SAMUELS asked, "Is there a problem that we have that they don't have ... a U.S. law that ... I don't even have a good example for you. But you didn't have an example of the United States here."

MR. RUGGIERO offered that GCA has provided examples of jurisdictions where oil revenues constitute the majority of the countries overall treasury intake. These countries have a reason to be concerned, therefore, with the direct management of the information provided by the oil companies. Additionally, it has been suggested that to require disclosure by private companies is un-American. Outside of America these requirements are expected as part of normal business practices.

REPRESENTATIVE SAMUELS asked again if there is an inherent "problem" in the U.S. disclosure system, as it relates to the IRS and the SEC.

MR. GEORGE responded that it is not necessarily a problem so much as "the way it is done."

[4:29:19 PM](#)

REPRESENTATIVE DAHLSTROM inquired whether the terminology utilized to describe oil operations is universal on a global basis; specifically the definitions and use of "legacy field" and "new development".

MR. GEORGE responded, "No." The legacy field concept may be the one term used most consistently.

COMMISSIONER GALVIN suggested to hold that question until the presentation on Saturday [October 20, 2007], when the question of how to categorize fields could be better addressed.

[4:30:56 PM](#)

REPRESENTATIVE COGHILL observed how other countries hold lease agreements than are considerably different than those held by Alaska. He pointed out that Commissioner Galvin has indicated that Alaskan authorities have already "signed leases that ... take some of the teeth out of our ability for other information beyond the look back for tax information." Access to further information may be limited, and he asked for discovery of what limits/accessibility Alaska may be under for disclosure of field information.

MR. GEORGE granted that the issue of how countries apply the forecasting information and the fiscal taxation process differs. Licensing requirements may also play a significant role.

COMMISSIONER GALVIN clarified that the Alaska leases do require specific "down hole" and well data for DNR management purposes. However, the data for production costs and business aspects are not a requirement. In the context of this bill, information held relevant pertaining to the state tax structure, is a recent development. As far as the state requesting this information, there have been no state or federal legal barriers identified.

[4:35:39 PM](#)

REPRESENTATIVE KERTTULA asked if the state is receiving the information necessary to make the spectrum of decisions that are before the legislature.

COMMISSIONER GALVIN established that there are two levels to consider: the cost issue seen in the context of the overall revenue economics, and field specific data. The nature of the

type of information that the department is going to be acquiring is relevant to assuring compliance with the tax system, but not as necessary for determining what that tax system should be.

[4:39:06 PM](#)

CHAIR OLSON requested a side by side comparison "of the top points that you are asking for," of Wyoming, Texas, Louisiana, and Oklahoma, and perhaps four other states; we could just check them off, whether the other states are doing this or they aren't doing it.

COMMISSIONER GALVIN agreed to furnish the requested information, and pointed out that each state has a tax system established on a different basis and not analogous to how Alaska relates to the oil and gas industry.

CHAIR OLSON suggested that the differences be footnoted.

[4:42:24 PM](#)

REPRESENTATIVE SAMUELS referred to the list on page 22 regarding public disclosure to ask "what right now is there controversy about that you don't disclose."

MR. IVERSEN responded that what is being asked is to have clarification to "boil that down to an aggregate of three or more tax payers." The department is asking to be able to create a more meaningful data presentation on a high statistical level.

REPRESENTATIVE SAMUELS requested a further example.

MR. IVERSEN stated that it would "be akin" to what is already being accomplished with other tax types. By reporting in the aggregate, confidentiality concerns are satisfied, and the anonymity of the data source is protected.

COMMISSIONER GALVIN interjected that more concrete examples will be provided to the committee.

[4:44:53 PM](#)

MR. IVERSEN described the current auditor situation: 18 oil and gas production auditors, including the supervisor and specialist positions. Five of these positions are currently vacant. Additionally, DNR has seven royalty auditor positions; two of which are vacant. The state has suffered difficulties

recruiting and retaining auditors. An exempt status is being sought for the oil and gas auditors to allow the wage structure to be manipulated separately from other classified state auditors.

[4:46:10 PM](#)

REPRESENTATIVE DOOGAN queried if this will provide the opportunity to compensate the auditors at a higher rate than they currently receive.

MR. IVERSEN replied, "That is correct." To a follow-up question he stated that the ranges vary in the four classes of state auditors. He provided the annual base pay rates from state auditor I through Auditor IV, respectively: \$47-67,000; \$54-77,000; \$62-88,000; and \$70-101,000. The supervisor for that section is \$77-110,000, and the Oil and Gas Tax Specialist, the expert in that group, is \$76-109,000. He estimated that an increase of 25 percent would bring these positions into a competitive scale in the federal and private markets.

COMMISSIONER GALVIN clarified that a competitive rate, to attract senior/experienced workers, the high-end positions may require an increase greater than 25 percent.

[4:49:52 PM](#)

CHAIR OLSON asked if the quoted rates reflected salary or combined salary and benefits.

COMMISSIONER GALVIN said the numbers quoted represent salary.

[4:50:24 PM](#)

REPRESENTATIVE NEUMAN recalled that the state departments were directed to cut their salary costs by ten percent in FY 07. He asked if this had an effect on DOR's ability to audit.

COMMISSIONER GALVIN responded that the auditor positions were considered priority positions and did not suffer cuts.

REPRESENTATIVE NEUMAN asked how DOR complied with the directive.

COMMISSIONER GALVIN reported that DOR was in a position to receive additional federal funding, thus the directive was fulfilled without a drop in DOR services.

REPRESENTATIVE NEUMAN underscored the importance of employing proper auditors.

[4:52:27 PM](#)

REPRESENTATIVE KERTTULA referred to the open auditor positions.

MR. IVERSEN restated that currently five openings exist with a sixth to occur soon. To a follow up question he said that DOR has been actively recruiting to fill the positions, since he became Commissioner, and he outlined the efforts that have been expended.

REPRESENTATIVE KERTTULA queried whether candidates are not accepting job offers, and what is cited as the issue; or are acceptable candidates not being found.

MR. IVERSEN stated that pay has been an issue, and candidates are not necessarily meeting the minimum qualifications.

REPRESENTATIVE KERTTULA asked if the state situation regarding retirement has been a concern.

MR. IVERSEN conceded that he has not been privy to that specific concern, however he deferred for a definitive response.

[4:55:11 PM](#)

COMMISSIONER GALVIN answered that this issue has been mentioned in the context of overall recruitment within the division but it cannot be identified with a specific complainant.

REPRESENTATIVE KERTTULA recalled that a classification study was completed which indicated that there were other classes of auditors or employees that needed to be increased.

MR. IVERSEN concurred, stating that it was completed two years ago. The outcome was that every auditor should be increased by two ranges.

REPRESENTATIVE KERTTULA clarified that this would separate out the oil and gas auditors, providing them with an increase, but not the other auditors who were also identified.

MR. IVERSEN said: "Right."

REPRESENTATIVE KERTTULA asked for clarification of what exempt status means; surmising it means employed "at will."

MR. IVERSEN responded, "Yes, you're right."

[4:56:28 PM](#)

REPRESENTATIVE DAHLSTROM inquired as to whether there was consideration given to hire an auditor who would be exempt, paid well, and report to the commissioner.

COMMISSIONER GALVIN explained that the concept began when he suggested that there needed to be a small group of highly experienced auditors to serve as the primary managers. These experienced auditors would direct the development of the program as well as the audits while utilizing the existing structure as part of the overall team. When Mr. Iversen and Ms. Davis worked through implementing the aforementioned, they recognized that there were management, morale, and other issues associated with such a plan. Furthermore, empirical data highlights that existing auditors aren't paid up to competitive standards. Commissioner Galvin acknowledged the implications of doing this in light of the overall recruitment and retention issue as addressed by the governor's administrative order to perform a study regarding the state's ability to recruit and retain employees. The aforementioned is ongoing and separate from this discussion. He said that he's trying to isolate this as best as it can be without unexpected consequences. Separating the oil and gas tax auditors as an exempt class would undermine DNR's ability to have the exact same qualified staff doing work on the royalty side as well. Therefore, the oil and gas royalty auditors and the oil and gas tax auditors had to be included as one group to move into this class.

[5:00:04 PM](#)

REPRESENTATIVE DAHLSTROM noted her agreement that this is a crisis situation that needs to be addressed. However, she expressed concern that a governor could use [auditor] positions for political payback, and thus appointees may not be qualified.

COMMISSIONER GALVIN related that the fear and risk she speaks of doesn't bear out. Although the opportunity exists, it doesn't appear to happen because the institution remains even after political changes. Positions that require technical expertise to reasonably perform the job provide security [that the position will be filled by uniquely qualified individuals]. He

acknowledged the perception that, as an exempt employee, one serves with the threat of always being told what to do for political purposes. However, that's not how it works in reality, he maintained.

5:02:34 PM

CHAIR OLSON requested copies of the study referenced by Mr. Iversen.

5:02:50 PM

REPRESENTATIVE RAMRAS mentioned that a similar situation exists with biologists, another unique field that is experiencing a migration of employees. He then thanked Kevin Banks, Division of Oil & Gas, for his service with an understaffed division. Representative Ramras inquired as to the following: how much would it cost to outsource [the auditing function]; what is currently being paid for the auditing function; what is the fiscal note for changing the group of auditors to exempt status; how much revenue is presently being managed; what would be the outcome of a well-armed group of auditors; what would be the private sector's equivalent of experience for a state auditor I, II, III, and IV.

COMMISSIONER GALVIN, regarding the costs, explained that of the five vacant positions four are at a lower level and the intention is to reclassify those four positions such that they're senior level auditors. Based on individual experience and responsibilities, decisions would be made on salaries in reference to a similar situation in the competitive market. The aforementioned results in a fiscal note estimating about \$1.1 million per year in the cost for salary and benefits associated with making this adjustment to the entire class. Most of that would [fund] reclassifying those four lower level positions.

5:06:17 PM

REPRESENTATIVE RAMRAS inquired as to the cost to outsource [the entire auditing function], what amount of revenue would they manage, and what is the incremental value of a well-armed group [of auditors].

COMMISSIONER GALVIN answered that he doesn't have a number. As a point of reference, there's a proposal to have contractual auditing services for the first four years in order to get the program off the ground. The aforementioned is estimated to cost

around \$1 million a year. He estimated that having the full-time positions become contractors would cost more than what's specified in the fiscal note for exempt class status. From a policy standpoint, Commissioner Galvin said he believes it's in the state's best interest to maintain these as full-time state positions, rather than contractual personnel and the private sector variables involved. He said that he could provide the committee with information of some cost comparisons with regard to what would be needed [to contract out the auditing function].

5:09:07 PM

REPRESENTATIVE RAMRAS surmised that Commissioner Galvin is concerned that institutional knowledge would be lost if one group migrated to another organization.

COMMISSIONER GALVIN opined, "It doesn't seem to be in the state's interest to put ourselves subject to the knowledge of an outside source for such a critical function."

5:09:57 PM

REPRESENTATIVE RAMRAS inquired as to the incremental value of being fully staffed with the look back component.

COMMISSIONER GALVIN said it would be purely speculation based upon an estimate of what the over reporting is expected to have been under PPT. He offered to provide the committee with information relating to other oil and gas auditing in terms of value to the state going through the auditing process.

5:10:48 PM

REPRESENTATIVE RAMRAS inquired as to the dollar volume that the [auditors] manage. He also inquired as to the cost of the entire package focused on oil and gas development. He recalled that it was an incremental increase of \$1.1 million. He inquired as to the amount of payroll and the dollar volume of the audit for which they're responsible on an annual basis. Representative Ramras said that he wouldn't be hesitant to allocate another \$1.5 million to safeguard a \$3.8 billion revenue stream, especially when there's perhaps an incremental value of \$100 million.

COMMISSIONER GALVIN said that he doesn't have the exact number, but estimated that the overall salary and benefit for all 18 petroleum auditor positions is about \$2 million. The \$2 million

being paid to auditors is well below any margin of error for a \$2 billion total exposure. Although he said he didn't want to speculate in terms of the opportunity costs associated with not performing a full audit, given the scale of the numbers it's clear that the auditors are worth it.

[5:14:10 PM](#)

REPRESENTATIVE RAMRAS characterized ACES as an \$800 million tax because he believes that is the state's objective. He then surmised then that what's being discussed is an insignificant sum relative to the dollars being managed.

COMMISSIONER GALVIN said he wouldn't refer to it as managing but rather "that they may be able to recover."

REPRESENTATIVE RAMRAS clarified, "Were managing the state's exposure to any errors in the auditing of those figures as being reported by a pretty broad variety of oil companies that are participating." He opined that when one refers to explorers, it refers to more than the three oil companies. Furthermore, there are companies with different variables in terms of size and fields. Therefore, to go from 1 million to 2 or 3 million is of no concern. He recalled similar concerns from the Alaska Oil and Gas Conservation Commission (AOGCC) and the Regulatory Commission of Alaska (RCA) [regarding exempt status]. Still, Representative Ramras said that he is in support of exempt auditors.

COMMISSIONER GALVIN, regarding ACES being a targeted \$800 million tax, said that it's dangerous to have a tax designed to target a certain revenue number. He assured the committee that through the analysis, the last thing calculated was the determination of the ultimate revenue with a package [as proposed in ACES]. The process wasn't that the tax system will have to produce a specified amount or revenue.

[5:17:09 PM](#)

REPRESENTATIVE RAMRAS inquired as to how much more [ACES] would generate in taxes with the current numbers available.

COMMISSIONER GALVIN estimated that it would generate about \$600 million at \$60.

[5:17:24 PM](#)

REPRESENTATIVE DOOGAN recalled that the current law includes a provision requiring a look back in 2011. He asked if that provision is in ACES as well.

COMMISSIONER GALVIN answered that he didn't believe that provision had been impacted. In further response to Representative Doogan, Commissioner Galvin opined that if the department doesn't obtain its auditors, the question will become one of a level of confidence in the result. With the auditors being requested, the audit would be more in keeping with a more direct read of whether the costs deducted were appropriate. Commissioner Galvin said that he's trying to provide the best tools to ensure confidence that the audits are in keeping with the intent of the statute.

REPRESENTATIVE DOOGAN surmised then that if the [auditing] department was fully staffed, the information would be more current than might otherwise be the case.

COMMISSIONER GALVIN replied, "Yes."

[5:20:04 PM](#)

REPRESENTATIVE SAMUELS recalled that this exact issue surfaced during the regular session, in separate legislation, and the legislature failed to reach a consensus on moving forward on the matter. The issue isn't new, he said.

[5:20:41 PM](#)

REPRESENTATIVE HOLMES asked if there are any other options to raise the salaries of these auditors besides making them exempt.

COMMISSIONER GALVIN explained that the classification study utilized the existing infrastructure of the state to establish what the appropriate pay should be. Because of the systemic nature, a salary change for the auditors would result in having to make determinations for analogous positions as well as for the auditors. The result is based on the current attempt to raise [the auditors' salaries] through the existing channels. He opined that utilizing contractors has limitations, and thus contract employees may not be utilized without violating the contractual provisions of an existing labor agreement. The situation has driven [the administration] to address this issue individually. Classifying the auditors as exempt is the easiest and most direct way in which to address the situation.

[5:23:32 PM](#)

REPRESENTATIVE DOOGAN posed a scenario in which a gross tax was instituted on the legacy fields and the remainder of the net tax was left in place. In such a scenario, would the auditor requirement decrease, he asked.

COMMISSIONER GALVIN responded, "The devil's in the details." He explained that a so-called gross tax with a 40 percent capital credit will still be auditable; due to the incentivizing expenses it may even pose more significant auditing challenges. In further response, he confirmed that unless it's a purely gross tax, these auditors will be necessary.

The committee took an at-ease from 5:25 p.m. to 5:38 p.m.

[5:38:45 PM](#)

COMMISSIONER GALVIN turned the committee's attention to page 29, regarding lease expenditures.

[5:39:18 PM](#)

MR. IVERSEN, referring to page 30, explained that currently the PPT sets forth a general standard as to what expenditures are allowed as lease expenditures with a series of exclusion. The amendment [proposed in ACES] would specify and make express that the department must, by regulation, set forth affirmatively what are allowed to be included as lease expenditures by regulation. The legislation also proposes to repeal AS 43.55.165(c) and (d), which are provisions that allow the department to substitute cost billings under the unit operating agreements in place of general standards for allowable lease expenditures. Under subsection (c) if DOR finds that an operating agreement is substantially consistent with the general standards for allowing lease expenditures, DOR may authorize a producer to treat as its lease expenditures the costs that would be billable under that agreement.

[5:40:55 PM](#)

REPRESENTATIVE SAMUELS surmised then that by repealing those provisions, the department has taken away its ability to do so even if it chooses to.

MR. IVERSEN said that as he reviews the issues that arise as a regulatory matter, the problems these provisions have caused will become clear.

[5:41:32 PM](#)

REPRESENTATIVE SAMUELS posed a scenario in which at Prudhoe Bay British Petroleum (BP) is the operator who will bill ExxonMobil for a portion of the costs. He surmised that the department doesn't want the ability, even for itself, to use that billing in the PPT calculation.

COMMISSIONER GALVIN pointed out that AS [43.55].165(a) and (b) provide the ability of the department to look to whatever means it feels is appropriate to establish those standards. That general authorizing language would encompass these types of provisions as something the department could look to as an indication.

[5:42:37 PM](#)

REPRESENTATIVE SAMUELS surmised then the department doesn't view it as giving up anything, but rather [repealing AS 43.55.165(c) and (d)] would provide clarification.

COMMISSIONER GALVIN noted his agreement. If the department believes it would be beneficial in a certain instance, then [the cost billings] can be utilized. However, the experience has been that the combination of AS 43.55.165(c) and (d), as it relates the joint interest billing, results in the department being "hamstrung" in terms of whether it has to be used or not used. There isn't the level of flexibility that he believes is appropriate. He pointed out that the flexibility exists in AS 43.55.165(a) and (b), and therefore (c) and (d) aren't necessary.

[5:43:19 PM](#)

REPRESENTATIVE SAMUELS recalled the debate last year in which the intent was to provide the flexibility to DOR. Therefore, if [repealing AS 43.55.165(c) and (d)] achieves that, it's fine.

[5:43:47 PM](#)

REPRESENTATIVE NEUMAN recalled that Dr. van Meurs has said that having someone in place to determine what could be allowed for repairs and maintenance would be an auditing nightmare.

However, this provision seems to allow that. Therefore, he requested comment. He then related that a constituent had requested that he ensure that lobbyists not be allowed to deduct their costs.

COMMISSIONER GALVIN said that's not allowed. With regard to the standards determining what is proper maintenance versus improper maintenance, Commissioner Galvin acknowledged that challenge and ACES attempts to ensure that the state doesn't pay for the replacement of improperly maintained equipment.

MR. IVERSEN specified that ACES utilizes the same policy tack as SB 80 did with regard to improper maintenance. However, the provision within ACES intends to have a much more objective trigger point of an unscheduled interruption in production or a release or spill of oil or gas. Costs incurred for repair, replacement, or deferred maintenance of facilities and equipment, other than a well, would be excluded. The aforementioned provides a brighter line and encourages proactive maintenance, he opined. He noted that the legislation includes an exclusion for "Acts of God," inevitable catastrophe, or third party acts that couldn't have been reasonably prevented through the diligent operation of the taxpayer.

[5:46:49 PM](#)

CHAIR OLSON asked whether pigging a feeder line in the Prudhoe Bay unit for eight years would be covered by the aforementioned provision.

MR. IVERSEN responded that any repair, replacement, or deferred maintenance costs associated with an unscheduled interruption in production or a shut down would be excluded.

COMMISSIONER GALVIN acknowledged that determining an industry standard, such as maintenance via interval line pigging, could result in a fairly subjective discussion. When dealing with the question of negligence versus non-negligence, it could become a long-term issue. The proposed standard attempts to move away from a subjective analysis of the behavior that led to the incident and have more of a strict liability issue, such that the costs incurred when there's an unplanned incident won't be covered. He mentioned that there may be some exclusions. Basically, it's the best call that can be made without entering an endless factual dispute, and encumbering the tax program in incident management and retroactive evaluation. He indicated,

"And trying to make it something that can be done on more of an accounting basis."

[5:48:48 PM](#)

REPRESENTATIVE DOOGAN asked why wells were excluded.

MR. IVERSEN explained that it's a policy call for the legislature to consider. He characterized the wells as the "cash register that drives the whole machine," which is the reason [they were excluded].

COMMISSIONER GALVIN interjected that, from an operational standpoint, interruption of production at a well is not directly equated to a lack of maintenance, as there could be many other driving factors. Being able to separate the system integrity portion from the other factors causing a well interruption, becomes the policy call. The administration's focus has been primarily on facilities/pipelines and ensuring they are properly maintained.

[5:50:25 PM](#)

REPRESENTATIVE DOOGAN said that he could think of a scenario in which a company doesn't act prudently, and thus a well explodes and cuts production on the North Slope. Therefore, he questioned why such negligence is different than what results when a company neglects to pig a feeder line.

[5:50:59 PM](#)

COMMISSIONER GALVIN pointed out that under a bright line strict liability standard, more events are potentially included than with the standard of determining properly or improper maintenance. He further pointed out that most of the things that one would consider to be improperly maintained are likely to be included in [this strict liability standard], although some incidents that occurred as a result of fully responsible decisions may also be included. At the well level, the impact associated with the aforementioned is on an individual well and doesn't impact a gathering line that will have a major impact. He opined that being able to identify whether a well is shut down due to planned or unplanned reasons is a management responsibility that will "dwarf anything associated with the potential shutdowns of other aspects of the system." On balance, less bang for the buck is achieved by placing emphasis on the well.

5:52:39 PM

REPRESENTATIVE DOOGAN inquired as to where a situation in which an employee driving a forklift into the pipeline would fall.

COMMISSIONER GALVIN answered that it would be an unscheduled shutdown that wouldn't be deductible.

5:53:22 PM

REPRESENTATIVE SAMUELS recalled that when SB 80 was moving through the process, DOR testified in favor of it. However, he recalled reading that SB 80 couldn't be administered under its language and thus the language proposed in HB 2001 was suggested. He inquired why the change.

COMMISSIONER GALVIN specified that his testimony [on SB 80] indicated that the administration was always working to improve the language with regard to the standard that would be used. [The language] changed numerous times as the best standard was sought. He confirmed that the overall policy was one that was very much supported by the administration, and therefore the objective was to develop the best standard possible. With the time to do so, a better standard was developed [in HB 2001].

REPRESENTATIVE SAMUELS said that he doesn't want to pass legislation only to have [the administration] return in two years because it didn't work. The aforementioned would've been the case if SB 80 had passed. He said that he understood that Commissioner Galvin supported the policy goal, but the language didn't work. He then turned to the term "unscheduled interruption" and asked if it's a term in law.

COMMISSIONER GALVIN said that clearly there needs to be a regulatory process, in terms of how to provide a more refined picture in terms of the taxpayers' standpoint.

REPRESENTATIVE SAMUELS related his assumption that maintenance on any facility or business in which there would be the need to shutdown for specific repairs would be considered a part of the normal course of business.

COMMISSIONER GALVIN said that the deductions for [those type of things] would be allowed.

5:56:32 PM

REPRESENTATIVE NEUMAN suggested that unless all the situations are specifically stated, enforcing this type of policy could prove to be difficult.

COMMISSIONER GALVIN opined that having the state reimburse a company a portion of their costs for replacing and properly maintaining equipment wasn't in the state's best interest. Therefore, the attempt has been to develop a clear policy that identifies those things that would fall under that [reimbursable] category. There's likely to be conflict, litigation, and disputes about the implementation of the standard, for which the state will pay. The question is whether that cost is worth the value of not having paid for the replacement of equipment that unexpectedly breaks.

[5:58:56 PM](#)

REPRESENTATIVE NEUMAN opined that the legislature, through the PPT, tried to provide the administration the authority to have some leeway in those decisions. However, he recalled that Commissioner Galvin presented to the House that [the department] didn't have the statutory authority to do so. Therefore, he asked if any provision in ACES provides that authority.

COMMISSIONER GALVIN specified that this language in ACES is necessary in order for the [department] to have the statutory authority to exclude those deductions in regulations. In further response to Representative Neuman, Commissioner Galvin confirmed that inclusion of this exclusion in ACES will provide the statutory authority.

[6:00:11 PM](#)

REPRESENTATIVE KERTTULA said that she wanted to be certain that this wouldn't pre-empt the prudent management standard and that it would still be available for use in relation to wells.

COMMISSIONER GALVIN specified that nothing in the provision under discussion or within this tax standard would preclude the state from pursuing damages for lost revenue associated with a shutdown that resulted from negligence or some lease violation. This provision simply addresses whether the tax code will allow it or not.

[6:01:08 PM](#)

MR. IVERSEN continued with page 33. He explained that ACES proposes to exclude from lease expenditures the costs to construct, acquire, or operate a refinery or crude oil topping plant. Under the language of HB 2001, the company could deduct, as an operating expense, the incremental value that would be attributable to the refined product. Therefore, the difference between the value of the diesel when it comes out of the plant and the prevailing value of the crude would remain as a deduction. However, this would exclude from costs, the actual capital costs to construct, acquire, or operate a refinery and the associated operating expenses. He pointed out that the legislature needs to decide whether a deduction in credit for a refining operation is too great a tax break for a product that would otherwise be purchased. He noted that a purchase of diesel would be allowable as a lease expenditure.

6:03:03 PM

COMMISSIONER GALVIN explained that in the production of oil there is a need for diesel fuel. That diesel fuel is used in a number of ways so a large amount is utilized. Operationally, the company could build a local refinery and create this diesel on the North Slope. The alternative is to get it elsewhere and bring it to [the North Slope]. The question [within ACES] is whether the cost of building the refinery would be considered a production cost in the nature of a capital expenditure that would receive the deduction as well as the state capital credit addition, or whether the diesel and the value of its use would be considered an "expansible" cost. This is particularly relevant because ConocoPhillips Alaska, Inc., has an obligation under Alaska's environmental requirements to use low sulfur diesel, and have penciled out the opportunity of building a refinery on the North Slope at a cost of \$300 million. As long as Conoco can receive the PPT-related credits and deductions, this will be considered an economic project, otherwise they will continue to truck in the diesel. In question is whether the state should provide an approximate \$135-\$150 million subsidy for the building of this refinery.

6:05:38 PM

REPRESENTATIVE SAMUELS opined that if he were the Conoco refining company and built the refinery, he would simply charge the Conoco exploration company a per gallon cost in order to obtain what is desired from the tax break.

COMMISSIONER GALVIN provided a calculation for formulating the fair market value of the diesel; as a transported product vs. produced and refined on the North Slope.

REPRESENTATIVE SAMUELS surmised then that the policy call is to specifically preclude a \$300 million project from being developed on the North Slope.

COMMISSIONER GALVIN interjected that it would be specifically excluded from being deductible, and therefore not qualified for a state credit on the production.

[6:06:48 PM](#)

REPRESENTATIVE SAMUELS reminded that if [the company] doesn't have the deductions, the diesel will continue to be transported. He said, "[It's] a project on the bubble ..., and with the deductions they build it; without the deductions they truck it."

COMMISSIONER GALVIN concurred that's the way it has been presented.

[6:07:04 PM](#)

REPRESENTATIVE SAMUELS opined that he will have to think about that because it represents projects pushed on and off the bubble; between the private sector and the government. He questioned whether this diesel is available [within the state]. If it isn't, are the daily costs of exploration and operation being driven up.

COMMISSIONER GALVIN suggested that the industry be asked those questions. He offered his view that if the refinery were going to be located in Fairbanks, would the same amount of the subsidy be included. He said:

Or if it was another operation that was going to be built, would the state be looking at providing an upwards of 40, 45, 50 percent subsidy for any development project that would generate jobs and generate all the spin-off opportunity; that's a policy call to make for the state.

[6:08:40 PM](#)

REPRESENTATIVE HOLMES asked how the department came to the conclusion to exclude this tax deduction.

COMMISSIONER GALVIN opined that if it were any other development project of a similar nature, the department would review the overarching policy of whether the state is going to provide that large of a subsidy to make the project economic. Furthermore, when one reviews whether it should be included in the PPT issue, there are many incremental costs associated with production. He said:

If they decide to ... take the work from somebody else and build something that we're going to end up subsidizing every effort to move from a purchase product to a manufactured product, that's a slippery slope I don't want to start moving down.

COMMISSIONER GALVIN acknowledged that it's a cost of production, and said that it's merely a matter of how it should be represented. He stated his belief that it should rise and fall on its own merit, in terms of a project to manufacture a product.

[6:10:36 PM](#)

REPRESENTATIVE NEUMAN expressed concern with regard to what changes will stop development or investment in Alaska. He asked if low sulfur diesel is even available in Alaska.

COMMISSIONER GALVIN related his understanding that low sulfur diesel would need to be trucked up.

CHAIR OLSON interjected that a new clean diesel facility just opened up in Nikiski.

[6:11:35 PM](#)

KEVIN BANKS, Acting Director, Division of Oil and Gas, Department of Natural Resources, noted that the facility in Nikiski is the only source of low sulfur diesel in the state. He noted that Flint Hills was going to build a low sulfur diesel refinery in North Pole, but due to the economics chose to instead contract with Tesoro to have it manufactured. In a sense, these topping plants might be thought of as competing with the North Pole refineries.

COMMISSIONER GALVIN commented that it's a question of who will receive the benefit of that state subsidy.

6:12:47 PM

REPRESENTATIVE NEUMAN opined that competition is a good thing. He pointed out that this \$350 million project is on hold. He then said that he would consider it an operating expense as industry has to change to make itself more efficient.

6:13:16 PM

REPRESENTATIVE DOOGAN surmised that whatever it takes to build this plant will be imported so there wouldn't be much in the way of transportation money. It is fair to assume that there would be a number of North Slope construction and operational jobs associated with this project. Agreeing with the commissioner, he said that he will want to see substantial numbers in the way of return on the \$150 million [subsidy].

6:15:16 PM

MR. IVERSEN directed attention to page 34, which focuses on the exclusion of dismantlement, removal, and restoration (DR&R) expenses. He explained that DR&R are the expenses to dismantle and remove the equipment that has been used on the North Slope, and restoring the area afterwards. Under existing state law, DR&R is required, and performed to the satisfaction of the DNR commissioner. Therefore, a subsidy of DR&R costs creates a potential conflict of state goals. The PPT only excluded the portion of DR&R expenses attributable to production prior to April 1, 2006. Page 35 addresses the exclusion of disallowing tax-exempt entities from obtaining transferable credit certificates under AS 43.55.023, which are the qualified capital expenditure certificates, and from transferring production tax credit certificates under AS 43.55.025, which is the exploration incentive credits. The notion is that an entity that isn't paying any tax shouldn't receive any credits.

6:17:09 PM

REPRESENTATIVE RAMRAS inquired as to why.

MR. IVERSEN responded that the assumption is that the entity isn't paying a tax.

COMMISSIONER GALVIN pointed out that these are companies that are actively producing oil and gas, incurring expenses, and applying for credits when they're not subject to ultimately paying the tax under that system.

6:18:49 PM

REPRESENTATIVE SAMUELS requested an example of what is trying to be stopped.

COMMISSIONER GALVIN reminded the committee that the department has an obligation to not disclose any taxpayer information. He then clarified he's referring to a tax exempt entity. For example, if the port authority was able to obtain leases, or buy into a situation, and it produced oil and gas, under interpretation of the law they're not subject to paying production tax. This [exclusion] is merely a clarification specifying that such an entity doesn't qualify to receive a credit under the tax as well.

6:20:08 PM

REPRESENTATIVE SAMUELS related his understanding that whether the tax is paid or it's sold, the end result is the desire for the investment made to obtain more oil.

COMMISSIONER GALVIN opined that the desire is for the investment to get more oil, because ultimately we'll get tax on the oil.

6:20:42 PM

REPRESENTATIVE DOOGAN asked whether there is a category of company to which this would apply. For instance, would it apply to the so-called "state-owned oil companies."

COMMISSIONER GALVIN replied no, and added that the port authority is the best example.

REPRESENTATIVE SAMUELS highlighted that the port authority is owned by the municipality.

6:21:38 PM

MR. IVERSEN continued with page 37 regarding transitional investment expenditure (TIE) credits, which are based on a pool of expenditures from as far back as 2001. These TIE credits aren't transferable and essentially are only available to incumbents who have incurred lease expenditures prior to the passage of PPT. Therefore, it won't be available to new entrants because allowing these credits would incentivize behavior that has already taken place.

6:22:18 PM

REPRESENTATIVE RAMRAS questioned, "Why wouldn't it also just be a deal, is a deal, is a deal?" He recalled this being an issue with regard to retroactive taxes.

COMMISSIONER GALVIN opined that's one of the reasons why the administration isn't suggesting that the move to ACES be retroactive. He reminded the committee that the provision addresses expenditures made prior to the passage of the PPT. The benefit was received from April 2 to December 31, 2007, and from that point forward any credits incurred won't receive the uplift associated with the TIE credit.

6:23:58 PM

REPRESENTATIVE DOOGAN inquired as to the reasoning for including the TIE credits.

REPRESENTATIVE SAMUELS explained that the original [PPT] legislation had a five-year look back. The philosophical reason was that if the money was expended with the expectation of a rate of return on the investment, but the rate of return was diminished because the tax was increased, then the entity should be able to take a deduction. The oil produced by investment made two years ago is oil that's being produced today. He continued:

In House Resources we eliminated that and we said, 'Five years ago you've made your money back, four years ago you've made your money back.' Last year, in one year we had 100 percent, two years ago it was 50 percent, and one it was 25 [percent]. So, we eliminated probably three-quarters of it. An amendment in House Resources, Representative Kapsner, eliminated the entire thing. And philosophically, the argument was we're looking back on the taxes, there was an amendment to go back to January 1st. At that time ... it was only February The amendment was to go back to the 1st of January. There wasn't the will of the committee to have retroactive taxes, which the will of the legislature drastically changed later that August. So, the argument was made to eliminate that too. If you're not going to look back on the taxes, don't look back on the expenditures. It was eliminated completely, passed out of the first

committee. And at the same time in the Senate, they came up with a different way of looking at it that said for every \$2 that you spend today, then you can recoup one of your last five years of expenditures.

REPRESENTATIVE SAMUELS noted that once the aforementioned was adopted in the Senate, it carried through every version of the legislation from that point forward. This action was considered to be the middle ground.

COMMISSIONER GALVIN commented that having it in effect for a year-and-a-half may have resulted in the same value.

[6:27:10 PM](#)

MR. IVERSEN, referring to page 38, explained that deductions arising from Cook Inlet operations must first be used in Cook Inlet and may not be shielded by the tax ceilings. He explained that Cook Inlet has a tax ceiling, which is the amount it was taxed before the passage of PPT. This provision would consider the ELF and the PPT calculation for each lease or property in Cook Inlet. To the extent that there are lease expenditures that are in excess of what would be below the ceiling, and in order to avoid double dipping as per regulation, the portion attributable to the ceiling and what would be taxable under PPT can't be converted into a carry-forward credit.

[6:28:54 PM](#)

REPRESENTATIVE RAMRAS asked if Commissioner Galvin believes that tax policy impacts the behavior of the taxpayer.

COMMISSIONER GALVIN replied yes. "We believe that we can have a tax policy that will direct behavior and result in more investment," he said.

REPRESENTATIVE RAMRAS asked whether a policy change will change taxpayer behavior.

COMMISSIONER GALVIN answered, "That's the nature of our question for this entire session."

[6:29:45 PM](#)

REPRESENTATIVE SAMUELS suggested a situation in which a company such as ConocoPhillips Alaska, Inc., would use the credits as double dipping.

MR. IVERSEN said that the company has already received the benefit of the ceiling amount. Therefore, to the extent that the benefit has already been obtained, the lease expenditures would serve to drive it down to the normal production tax value.

[6:31:26 PM](#)

REPRESENTATIVE NEUMAN expressed the need for the public to understand why a gross tax system won't work. He then related that he was told that the governor instructed [the commissioner] to develop a gross system of taxation of the oil industry.

COMMISSIONER GALVIN clarified that [the department] was told to develop a transparent system to provide a balance between revenue and investment.

[6:33:23 PM](#)

REPRESENTATIVE NEUMAN commented that in reviewing ACES, he sees a model that is the same as the PPT. He asked if that statement is accurate.

COMMISSIONER GALVIN confirmed that the net tax component of ACES is built upon the PPT, and that ACES and PPT are close to the same model.

REPRESENTATIVE NEUMAN questioned why a gross system won't work in Alaska.

COMMISSIONER GALVIN said the details in response to that question will be provided in the presentation on Sunday.

[HB 2001 was held over.]

[6:34:46 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 6:34 p.m.