

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

March 19, 2007

1:05 p.m.

**MEMBERS PRESENT**

Representative Carl Gatto, Co-Chair  
Representative Craig Johnson, Co-Chair  
Representative Vic Kohring  
Representative Bob Roses  
Representative Paul Seaton  
Representative Peggy Wilson  
Representative Bryce Edgmon  
Representative David Guttenberg  
Representative Scott Kawasaki

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

HOUSE BILL NO. 165

"An Act relating to providing field accommodations for big game hunters."

- MOVED HB 165 OUT OF COMMITTEE

HOUSE BILL NO. 149

"An Act relating to the authority of the Department of Environmental Conservation to require certain monitoring, sampling, and reporting and to require permits for certain discharges of pollutants; relating to criminal penalties for violations of the permit program; and providing for an effective date."

- MOVED CSHB 149(RES) OUT OF COMMITTEE

HOUSE BILL NO. 128

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

- HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 165

SHORT TITLE: BIG GAME GUIDES AND TRANSPORTERS

SPONSOR(s): REPRESENTATIVE(s) LEDOUX

02/28/07 (H) READ THE FIRST TIME - REFERRALS  
02/28/07 (H) RES  
03/12/07 (H) RES AT 1:00 PM BARNES 124  
03/12/07 (H) Heard & Held  
03/12/07 (H) MINUTE(RES)  
03/19/07 (H) RES AT 1:00 PM BARNES 124

BILL: HB 149

SHORT TITLE: POLLUTANT DISCHARGE PERMITS

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

02/21/07 (H) READ THE FIRST TIME - REFERRALS  
02/21/07 (H) RES, JUD  
03/12/07 (H) RES AT 1:00 PM BARNES 124  
03/12/07 (H) Heard & Held  
03/12/07 (H) MINUTE(RES)  
03/19/07 (H) RES AT 1:00 PM BARNES 124

BILL: HB 128

SHORT TITLE: OIL & GAS PRODUCTION TAX: EXPENDITURES

SPONSOR(s): REPRESENTATIVE(s) OLSON

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

**WITNESS REGISTER**

RICK METZGER

Akhiok, Alaska

POSITION STATEMENT: Testified on HB 165.

DICK ROHRER, Member  
Big Game Commercial Services Board  
Fairbanks, Alaska

POSITION STATEMENT: Explained the process that led to the introduction of HB 165.

RICK ELLINGSON, Commercial Fisherman  
Kodiak, Alaska

POSITION STATEMENT: Testified in support of HB 165.

PETE HANNAH  
Kodiak, Alaska

POSITION STATEMENT: Testified in support of HB 165.

CAMERON LEONARD, Senior Assistant Attorney General  
Natural Resources Section  
Civil Division (Fairbanks)  
Department of Law  
Fairbanks, Alaska

POSITION STATEMENT: During hearing of HB 149, answered questions.

LYNN TOMICH KENT, Director  
Division of Water  
Department of Environmental Conservation  
Anchorage, Alaska

POSITION STATEMENT: During hearing of HB 149, answered questions.

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

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

JONATHON IVERSEN, Director  
Anchorage Office  
Tax Division

Department of Revenue  
Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 128.

JONNE SLEMONS, Acting Coordinator  
Engineering Integrity Coordinator's Office  
Division of Oil & Gas  
Department of Natural Resources

Anchorage, Alaska

POSITION STATEMENT: During hearing of HB 128, answered questions.

ROD MINTZ, Attorney at Law

K & L Gates

Anchorage, Alaska

POSITION STATEMENT: During hearing of HB 128, answered questions in his capacity as an attorney for the Department of Revenue and the Department of Law regarding production tax matters.

JOHN NORMAN, Commissioner/Chair

Alaska Oil & Gas Conservation Commission

Department of Administration

Anchorage, Alaska

POSITION STATEMENT: During hearing of HB 128, answered questions.

#### **ACTION NARRATIVE**

**CO-CHAIR CARL GATTO** called the House Resources Standing Committee meeting to order at [1:05:31 PM](#). Representatives Gatto, Johnson, Edgmon, Kawasaki, Kohring, Wilson, and Roses were present at the call to order. Representatives Guttenberg and Seaton arrived as the meeting was in progress.

#### HB 165-BIG GAME GUIDES AND TRANSPORTERS

[1:05:58 PM](#)

CO-CHAIR GATTO announced that the first order of business would be HOUSE BILL NO. 165, "An Act relating to providing field accommodations for big game hunters."

[1:06:25 PM](#)

RICK METZGER began by informing the committee that Representative LeDoux sponsored HB 165 in response to his urging. He related that the language of HB 165 was unanimously approved by the Big Game Commercial Services Board.

[1:07:28 PM](#)

DICK ROHRER, Member, Big Game Commercial Services Board, said that he concurs with everything that Mr. Metzger said during the first hearing of HB 165. He related that Mr. Metzger first

brought his concerns to the Big Game Commercial Services Board in December 2006. At that meeting all necessary parties were gathered in the same place to agree on what was needed for Mr. Metzger to rent his cabin. It was determined that the transporter license did not exactly fit what Mr. Metzger desired and that the Big Game Commercial Services Board could not change a regulation as it needed to be a statutory change. At a [later] teleconference it was determined that the simplest way to address the situation was through an exemption from the Guide Transporter statute requirements for those who own a private cabin, lodge, or house that is located in the field.

[1:10:15 PM](#)

RICK ELLINGSON, Commercial Fisherman, related his support for HB 165. Mr. Ellingson opined that it is tough to make a living in rural Alaska. He further opined that the [original] ruling by the Big Game Commercial Services Board did not make sense and thus he said he was encouraged with the introduction of HB 165 as it will put Mr. Metzger and a few others back in business.

[1:11:45 PM](#)

PETE HANNAH informed the committee that he is a private landowner in Kodiak who supports HB 165.

[1:12:08 PM](#)

CO-CHAIR GATTO, upon determining no one else wished to testify, closed public testimony.

[1:12:45 PM](#)

CO-CHAIR JOHNSON moved to report HB 165 out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, it was so ordered.

HB 149-POLLUTANT DISCHARGE PERMITS

[1:13:44 PM](#)

CO-CHAIR GATTO announced that the next order of business would be HOUSE BILL NO. 149, "An Act relating to the authority of the Department of Environmental Conservation to require certain monitoring, sampling, and reporting and to require permits for certain discharges of pollutants; relating to criminal penalties

for violations of the permit program; and providing for an effective date."

[1:14:36 PM](#)

REPRESENTATIVE GUTTENBERG expressed concern about the loss of some of the research that might not be directly related to a specific project. He asked if the loss of research could be a loss to permitting or to other projects in the future.

[1:16:46 PM](#)

CAMERON LEONARD, Senior Assistant Attorney General, Natural Resources Section, Civil Division (Fairbanks), Department of Law, said that nothing in HB 149 will change or diminish the Department of Environmental Conservation's (DEC) ability and authority to do this kind of water body assessments and monitoring. The legislation merely has to do with which requirements, in connection with a particular project, belong in permits versus outside of the permits.

[1:17:24 PM](#)

REPRESENTATIVE GUTTENBERG maintained that his concern is still who will do it.

[1:17:55 PM](#)

REPRESENTATIVE WILSON moved that the committee adopt Amendment 1, which read [original punctuation provided]:

Page 4, line 4:  
Following "pollutants":  
Delete "listed"  
Insert "as defined"

Page 4, line 10:  
Following "(a)"  
Insert "and (d)"

CO-CHAIR JOHNSON objected to Amendment 1 for discussion purposes.

[1:18:36 PM](#)

MR. LEONARD stated that the changes in Amendment 1 are changes that were reached after considerable discussion with the

Environmental Protection Agency (EPA) to address their concerns. The first change on page 4, line 4, addresses EPA's request that Alaska's term "waste material" be as broad as the EPA's term "pollutants." Although Section 6 of the legislation inserts a new subsection that would specify that, the EPA prefers that the language say, "includes pollutants as defined in" rather than "listed in".

[1:19:37 PM](#)

CO-CHAIR GATTO asked if there is any possibility that something listed would be undefined.

MR. LEONARD explained that the EPA wanted to be clear that Alaska's statute included those items listed as well as the definition.

[1:20:12 PM](#)

MR. LEONARD then turned to the second portion of Amendment 1, which addresses the "state of mind" necessary to pursue criminal violations. He reminded the committee that negligent violations of the Clean Water Act (CWA) can give rise to criminal charges, although they do not have to. Alaska's statutes require criminal negligence under [AS 46.03].790 and thus to satisfy EPA and to show that the state's program is as stringent as EPA's, new subsection (i) is inserted. This new subsection specifies that for purposes of the Alaska Pollutant Discharge Elimination System (APDES) program, simple negligence is sufficient. To further clarify, the language "and (d)" was added to Section 8 in order to specify that the new program under subsection (i) would also apply to oil spills, subsection (d), since such would also be a violation of the CWA.

[1:21:20 PM](#)

MR. LEONARD, in response to Representative Guttenberg, stated that the title of Section .790 is "Criminal penalties". He then confirmed Co-Chair Gatto's understanding that [statute] had simple negligence rather than criminal negligence in order to cover class A. Mr. Leonard further confirmed that this would also be under a class A misdemeanor. Therefore, no penalties are being changed.

[1:21:57 PM](#)

REPRESENTATIVE SEATON asked whether this allows the state to select a gross negligence standard or something other than simple negligence.

MR. LEONARD replied no, adding that a higher state of mind than EPA specifies cannot be required in order to have the program approved. He specified that [APDES] could require a higher state of mind if the desire is to pursue a felony charge or other higher charge. For a simple misdemeanor charge, more than negligence cannot be required and still meet EPA's approval criteria.

[1:22:48 PM](#)

CO-CHAIR JOHNSON removed his objection to Amendment 1. There being no further objection, Amendment 1 was adopted.

[1:23:07 PM](#)

REPRESENTATIVE SEATON expressed concern with regard to the scope of things that will be left out of NPDES permits and thus not available to the public.

[1:24:59 PM](#)

LYNN TOMICH KENT, Director, Division of Water, Department of Environmental Conservation (DEC), related that revisions to the regulatory water quality standards are public noticed for comment, as well as all of the supporting science and information driving a potential change to the water quality standards. Therefore, basically anything the department has is available to the public also.

[1:25:39 PM](#)

REPRESENTATIVE SEATON related his understanding that one of the intents for taking this primacy is to keep things outside of the permit requirement and thus it will not be available to third parties. Representative Seaton asked if information will still be available to third parties to propose additional revision of regulations for those requirements made outside the permit or does the information become public when the department decides to revise the regulations.

MR. LYNN answered that any additional studies or additional information requested of the permittee outside the context of a permit is available for public review.

[1:27:03 PM](#)

CO-CHAIR GATTO, referring to the language "into any waters" on page 3, line 1, clarified his understanding that the aforementioned language only refers to surface waters. He asked whether there is any value in adding the word "surface".

MR. CAMERON highlighted that the full phrase is "waters of the United States", which is the language required in order to ensure that Alaska's program is as inclusive as that of the EPA's. The EPA was concerned, he related, that the former language "surface waters" isn't exactly the same as "waters of the United States".

CO-CHAIR GATTO questioned whether the language refers to "surface water" or "subsurface waters."

MR. CAMERON reminded the committee that the federal definition of "waters of the United States" also gets into wetlands, which may or may not be included in the definition of "surface waters" depending upon one's perspective. Mr. Cameron opined that the department felt it had to use the EPA's terminology in order to address their concerns. In further response to Co-Chair Gatto, Mr. Cameron related his agreement that HB 149 allows the state to deal with the federal government and take authority for enforcement as well as the permitting program itself.

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MR. CAMERON, in response to Representative Seaton, said he believes that adopting the federal definition as was done in the regulations and using the terminology in HB 149 should not cause confusion, except that the federal definition itself is subject to ongoing litigation and recent decisions from the U.S. Supreme Court. If one reads the statute and regulations in tandem, the coverage of the program is clear.

[1:30:08 PM](#)

REPRESENTATIVE SEATON related his understanding that one of the reasons [for HB 149] is to have less third-party suits for information. He noted that the department does not track the number of lawsuits threatened or filed and thus it does not know how many third-party suits about information that would not have been included under DEC's definition.

REPRESENTATIVE SEATON expressed his concern that there is a \$5.8 million fiscal note and the state is not gaining. He related his theory that when the state budget is reduced in future years and there are less [staff] then it will result in the delay of permit issuance.

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MS. KENT clarified that the program is envisioned and budgeted as a \$4.8 million program. She pointed out that DEC has already been engaged in a permitting program and working with EPA on its permitting program. The increase to the program was about \$1.5 million which was the incremental amount that brought forward the full resources necessary to implement NPDES in the state.

CO-CHAIR GATTO surmised that it is not a self-sustaining program and thus still needs general funds.

MS. KENT related that currently the program has full funding under the base budget for implementation of the NPDES. In further response to Co-Chair Gatto, Ms. Kent opined that it would be up to the legislature how the funding goes in the future. She informed the committee that the DEC operates other programs under a primacy mode and all the programs that it takes on from the federal government are subject to ongoing federal review to ensure sufficient funding to implement the program. She then confirmed that [APDES] is funded in part by general funds, federal funds, and fees. The fees for the program were set by House Bill 361, which passed a number of years ago, that allows the department to charge for direct cost of providing services.

[1:33:49 PM](#)

REPRESENTATIVE SEATON related his understanding that the fees are expected to almost double under NPDES primacy.

MS. KENT replied yes. The department's direct cost of implementing the program in which the department writes, issues, and performs compliance work results in an increase in the department's direct costs by a factor of about 1.8.

MS. KENT, in response to a question from Representative Guttenberg, related that at NPDES program approval, the department will need to revise the existing fees. The approach to the fees was established by House Bill 361 and that remains in place. The change is in regard to the direct work that will

be done that supports the permitting and compliance, which will cause the fees to increase.

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REPRESENTATIVE GUTTENBERG referred to the recommendations from the work group on page 20 of the NPDES Workgroup Report. He drew attention to the following language, "The large community wastewater workgroup member does not think primacy will provide significant benefits to this segment of the regulated community and does not support primacy." He invited comment.

MS. KENT informed the committee that the large community wastewater workgroup member was from the Municipality of Anchorage (MOA). She related that the permit for Anchorage's facility will remain with EPA and will not transfer over to the state. Therefore, that member did not see any benefit to NPDES primacy since it would not impact Anchorage's facility. In further response to Representative Guttenberg, Ms. Kent related that DEC did not make any distinction, for work group purposes, regarding what is a large facility versus a small facility.

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REPRESENTATIVE GUTTENBERG asked if Fairbanks, Wrangell, and Sitka are covered.

CO-CHAIR GATTO surmised that Representative Guttenberg is interested in whether there is a fixed number that determines coverage or non-coverage.

MS. KENT specified that all of the facilities with a discharge to a surface water body will need a NPDES permit.

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MR. CAMERON related that the situation with MOA is unique in that it enjoys a waiver from the requirement of providing secondary treatment for its domestic wastewater. The waiver is only available to large municipalities that discharge to marine waters, and thus none of the Interior communities are eligible for that waiver. In fact, MOA may have the only facility enjoying that waiver.

MS. KENT recalled that four to five communities qualify for the aforementioned waiver. She offered to provide the committee with a list of those facilities [enjoying the waiver]. She then

pointed out that those facilities would still need to have a NPDES permit, but the EPA would maintain the responsibility to issue the permits and ensure compliance with those permits. The department would continue to certify those permits much like it already does with existing permits.

1:40:10 PM

REPRESENTATIVE SEATON asked if the fees for those facilities would increase by a factor of 1.8 or would those fees remain at the level the EPA and the state charge.

MS. KENT responded that the fees [for the facilities receiving a waiver] would be the same as they are today since those fees are based on the department certifying the permit.

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REPRESENTATIVE EDGMON commented that this legislation addresses an enormous issue. He then asked whether HB 149 is all-encompassing to the point that one could say that it deals with the state's wastewater permitting program in its entirety.

MS. KENT answered that HB 149 is all-encompassing in terms of wastewater discharges to waters of the U.S. Although the [department] does have other state authorities that require those discharging wastewater to the surface of the land or to ground water to obtain an authorization from DEC, that program is unaffected by these NPDES primacy efforts.

1:42:33 PM

REPRESENTATIVE EDGMON, referring to the March 19, 2007, memorandum from Ms. Kent, highlighted that on the first page it relates that the CWA allows penalties of up to \$31,500 per day per violation. Using the Pebble Mine as a backdrop, he inquired as to the amount of penalties.

MR. CAMERON clarified that the department does not have the same penalty amounts as EPA because under the state's existing statutes the state can seek recovery in the amount of up to \$100,000 for the initial violation and not more than \$10,000 for each day after that.

REPRESENTATIVE EDGMON clarified that his question was regarding placing HB 149 in relation to a project of the scope of the Pebble Mine.

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REPRESENTATIVE EDGMON related his understanding that Section 2 seems to be straightforward in regard to requiring prior authorization from the department for the discharge of solid or liquid waste. However, Section 4(e)(4) includes the following qualifier "if the discharge is incidental to the activity and the activity does not produce a discharge from a point source". Therefore, he inquired as to why a similar qualifier is not included in Section 2. He also inquired as to whether [the aforementioned qualifying language] came from the original work group and is in addition to the EPA requirements.

MR. CAMERON explained that Section 2(a) is the general statement that certain activities require authorization while Section 4(e) specifies exceptions that are not covered under Section 2(a). Section 4(e) specifies those activities that are exempt from the requirement of obtaining an authorization unless they result in a discharge into waters of the U.S. Therefore, discharges to land or ground water would not need prior state authorization.

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REPRESENTATIVE EDGMON inquired as to who makes the determination as to whether the discharge is incidental to the activity.

MR. CAMERON said that someone at DEC would have a judgment call to make.

MS. KENT related that DEC's permit staff would make that decision when someone asks whether an authorization from DEC is necessary or from a public complaint in which someone questions what someone else is doing.

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CO-CHAIR GATTO drew attention to page 2, line 25, which inserts the language "**publicly owned treatment works**". He asked if that language means only government owned.

MR. CAMERON pointed out that it is a term that is defined in federal regulations to mean government owned, not privately owned.

CO-CHAIR GATTO surmised then that if there was a privately owned treatment works that was larger than a similar government owned treatment works, there is an exclusion.

MR. CAMERON noted his agreement, and related that the department tried to extend the scope of this exemption to include privately owned treatment works that have been authorized by the department. However, that would have gone beyond the exemption under federal law and could not be approved by EPA.

[1:49:09 PM](#)

REPRESENTATIVE SEATON directed attention to page 3, line 19, which addresses firing/rifle ranges and the language: "**, unless it results in a discharge into waters of the United States.**" In a situation in which a skeet or trap range and the pellets go into the water, he asked if these will be non-exempt and will DEC require a NPDES for lead in those areas.

MS. KENT informed the committee that such facilities are currently required to obtain an NPDES permit from EPA and this [legislation] doesn't change the requirements for obtaining a NPDES permit for a firing range.

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REPRESENTATIVE SEATON related his understanding that existing statute exempts such facilities, but the new language on page 3, line 19, changes that exemption to a non-exemption if the facility [discharges into] the water.

MS. KENT reminded the committee that this portion of statute includes the disposal of liquids and solid waste to the lands and waters of the state. Therefore, the exemption was to remove the requirement to obtain a state authorization for firing munitions at a firing range. However, because EPA's NPDES permit program requires an NPDES permit for firing into waters of the U.S., the state NPDES does as well. Therefore, the department maintained a carve-out such that a permit is not required for a firing range that discharges to land. Still, a permit under the NPDES program run by the state or the EPA does require a NPDES permit.

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CO-CHAIR GATTO recalled the firing range in Eagle River and reminded the committee that the lower end of the Eagle River is

next to the inlet. If munitions land in wetlands, which ultimately end up in the waters of the U.S., "does that pretty much nullify everybody from doing anything every time," he asked.

MS. KENT related her understanding that the EPA required the Eagle River Flats to apply for a NPDES permit for the range, which she opined is still an active range. She said she suspected that the EPA did not issue a permit, although it required a permit application to be submitted.

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REPRESENTATIVE WILSON commented that in Sitka there is a firing range over waters, which led to a change in the makeup of the shot.

[1:53:19 PM](#)

CO-CHAIR JOHNSON moved to report HB 149, as amended, out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, CSHB 149(RES) was reported from the House Resources Standing Committee.

HB 128-OIL & GAS PRODUCTION TAX: EXPENDITURES

[1:53:46 PM](#)

CO-CHAIR GATTO announced that the final order of business would be HOUSE BILL NO. 128, "An Act relating to allowable lease expenditures for the purpose of determining the production tax value of oil and gas for the purposes of the oil and gas production tax; and providing for an effective date."

[1:54:27 PM](#)

REPRESENTATIVE SEATON moved that the committee adopt CSHB 128(O&G) for discussion purposes. There being no objection, CSHB 128(O&G) was before the committee.

[1:55:20 PM](#)

CONRAD JACKSON, Staff to Representative Kurt Olson, Alaska State Legislature, speaking on behalf of the sponsor, explained that HB 128 was introduced in order to close the perceived loophole in AS 43.55.163 that specifies the lease expenditures that are not available for credit or deduction against the production

profits tax (PPT). The sponsor, he related, believes that it is not appropriate for Alaskans to be held responsible for the expenses of repair or replacement of property or equipment that is improperly maintained or not maintained at all. The sponsor does not intend to open up the entire PPT, he further related. Mr. Jackson pointed out that CSHB 128(O&G) includes some minor changes on page 3 such as the inclusion of the commissioner of the Department of Natural Resources (DNR) and the entire Alaska Oil and Gas Conservation Commission (AOGCC), and inclusion of a provision that would address equipment that was not maintained. He noted that the committee packet should include an amendment that has been suggested by the Department of Revenue (DOR). He indicated that the sponsor is amenable to the adoption of the amendment.

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CO-CHAIR GATTO asked if the oil companies, in failing to properly maintain [their equipment], did something "not right" or something illegal.

MR. CONRAD deferred to Mr. Bullock with Legislative Legal Services. He then related his understanding that under the PPT if an oil company does not properly maintain a transit line, for example, which creates the need for repair, those expenses would ultimately be deductible from the PPT.

CO-CHAIR GATTO related his understanding that under the PPT expenses, maintenance, and repairs are deductible. Furthermore, replacement is probably deductible, he opined. Co-Chair Gatto expressed his desire to be on firm legal ground regarding whether what the oil companies did not do was a violation that would cause the introduction of legislation removing the oil companies' ability to take deductions.

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JONATHON IVERSEN, Director, Anchorage Office, Tax Divisions, Department of Revenue, related DOR's support for HB 128. The administration, he clarified, supports excluding these costs from being deducted or from being allowed as credits. Although the current law, depending upon the factual circumstances, would provide the ability to exclude a cost that is attributable to gross negligence, for example. Therefore, some or potentially all of the costs [being targeted by HB 128] would be excluded under the current law. Mr. Iverson related that DOR supports HB 128 because it clarifies the actual status of the law.

Furthermore, the legislation would add strength to any regulation that DOR would write. If the legislature wants to have a clear manner in which to exclude these costs, then it should be done in the statute because regulations written under the current law would be subject to legal challenge.

MR. IVERSEN then turned to DOR's interpretations of [subparagraphs] (B) and (C) on page 3. At this point, DOR interprets subparagraph (B) to address costs incurred to maintain operational capability of facilities or equipment during a shut down due to improper maintenance or practice. Therefore, an auditor would completely exclude all operating costs for equipment or facilities during a shut down when due to improper maintenance or lack thereof. Subparagraph (C) on page 3, he related, would come into effect during times of diminished production such as when production is reduced by half due to improper maintenance while the costs of operation are only reduced by one-third, for instance. In such a situation, the portion of the reduction in operating costs that does not track the reduction in production would be excluded. In other words, an auditor would exclude an operating cost to the extent the percentage reduction in production is greater than the percentage reduction in operating costs when the production is reduced due to failure to properly maintain the property. Mr. Iversen noted that HB 128 incorporates one of DOR's early suggestions [in paragraph (19) on page 3] to use the language "taking into consideration". The aforementioned was desired in the case the standards do not apply to the situation and thus DOR is given more flexibility to have the discretion to consider or give weight to any given practice, depending upon the circumstances.

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CO-CHAIR GATTO highlighted the difficulty with the language "improperly maintained" because "proper" versus "improper" will have to be defined. He then posed a situation in which a company saved \$100 from improper maintenance and then spent \$100 on fixing the improper maintenance. In such a situation, should the company be penalized if it is a wash in money?

[2:08:08 PM](#)

REPRESENTATIVE ROSES, in terms of allowed deductions, asked if the companies are allowed to depreciate the line. He further asked if the companies take a depreciation off of their corporate taxes or their PPT.

MR. IVERSEN answered that capital expenditures under PPT are both "deducted" immediately and subject to a credit. Therefore, there is not a depreciation type of expense under the net profits scenario. In further response to Representative Roses, Mr. Iversen specified that the line itself is not a depreciable commodity, if there were no repairs or replacements.

REPRESENTATIVE ROSES posed a situation in which a company, due to negligence, has to replace the pipe in the 18th or 19th year of its 15- to 20-year [estimated life]. In such a situation, would the entire amount of that repair not be allowed [as a deduction] since in another year the pipe would have to have been replaced. Representative Roses specified that his concern is one of equitability since he recalled that the PPT included language stating that any negligence [was not allowed as a deduction].

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REPRESENTATIVE WILSON pointed out that a company for which it was costly to maintain something and that company chose not to maintain it for a while knowing that when it had to be fixed, the cost of doing so could be deducted. On the other hand, if such a repair cannot be deducted, the company may maintain it in order to avoid more costly repairs later that would not be deductible.

MR. IVERSON opined that those would be business-driven decisions rather than tax-driven decisions. The equipment at issue was in place prior to the enactment of the PPT, he noted.

REPRESENTATIVE WILSON asked if HB 128 would make a difference from now on.

MR. IVERSON said that he believes HB 128 would make a difference because it improves the incentives. As a policy matter, it pushes the incentives toward proper maintenance and giving a limit as to where the credits would be allowed and whether the costs being discussed would be deductible.

[2:12:45 PM](#)

REPRESENTATIVE ROSES related his understanding that although negligence already disallows a deduction, HB 128 provides clarity. However, once it's retroactive the situation is changed due to an occurrence rather than predicting it prior.

Therefore, Representative Roses said that he supported HB 128, save the retroactivity provision.

[2:14:32 PM](#)

REPRESENTATIVE SEATON, returning to depreciation, posed a situation in which something in the oil field is designed for a useful life of 30 years. Under this provision if something happens to it even when it lasted through its full design life, would it be considered nondeductible because the company did not expend a lot of money to obtain a lifetime beyond its expected life.

MR. IVERSON clarified that under current law costs due to gross negligence can be excluded. He then opined that it is really a facts and circumstance type of determination, especially since the life of technology is constantly changing. The aforementioned, he further opined, is why DNR and the AOGCC are involved so that they would have the ability to evaluate whether a pipeline would reasonably be expected to last to a certain age.

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CO-CHAIR GATTO commented that none of the committee members are experts on pipelines, but everyone is an expert with regard to maintenance and make choices on maintenance every day. He then questioned whether anything could have been done to extend the life of the pipeline to 35 years when it would have needed to be replaced even with maintenance. Co-Chair Gatto asked whether the state is going too far in penalizing a company for failing to do a certain amount of maintenance not knowing what the appropriate amount was.

MR. IVERSON reminded the committee that under the Pipeline Systems Integrity Office (PSIO) within DNR, the quality assurance programs required should address an ongoing maintenance plan in which revisions to life expectancy and related revisions to planned maintenance are incorporated.

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JONNE SLEMONS, Acting Coordinator, Engineering Integrity Coordinator's Office, Division of Oil & Gas, Department of Natural Resources, in response to Co-Chair Gatto, explained that the Leak Monitoring and Engineering Integrity Coordinator's Office (LMEICO) was not actually an emergency order, although it

may have had that appearance since it was initiated immediately after the August shutdown of a portion of Prudhoe Bay. She related that LMEICO was intended to be a long-term plan/project and the PSIO replaces it in order to distinguish between the scopes of the two programs, which are significantly different from an administrative point of view.

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REPRESENTATIVE SEATON surmised then that if anything has to be replaced and it did not have proper maintenance, then it may not be deductible. He further surmised that the aforementioned will be determined by the commissioners. Representative Seaton said, "Whether it's pumps or valves, or well casings, or anything else, if there was any possible way they could've extended the life of that and not whether it's an emergency shutdown, but if it just has to be replaced, then ... this calls into question whether that's going to be deductible and creditable. Is that correct?"

MR. IVERSON said it does call that into question, although how far that determination is to go should be made clear by the legislature on the record. He confirmed that improper maintenance will be called into question, but it may not necessarily only be in regard to the extension of the item's useful life.

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REPRESENTATIVE SEATON clarified that the [legislation] isn't necessarily addressing breakdowns. He related his understanding that any time something is being replaced it would have a capital credit when it is replaced because the item is worn out. He asked if the deductibility and creditability of the capital expenditure and operation money would be called into question, if an item is showing wear and tear that could have been maintained in order to extend the item's useful life.

MR. IVERSON responded that he believes that is correct with the caveat that the issue is whether the item "achieves" its useful life rather than extending its useful life.

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REPRESENTATIVE SEATON then posed a situation in which a facility with a 30-year design life expectancy that exceeds that 30-year

design life, "we're now going to ... or we have the possibility of disallowing the capital replacements or not."

MR. IVERSON said he thinks that is an option in either case, but it would depend on the facts of any given case. The actual useful life of an item may change depending on technology and practices in the field.

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ROD MINTZ, Attorney, K & L Gates, informed the committee that he is working with the Department of Revenue (DOR) and the Department of Law (DOL) on production tax matters. With regard to Representative Seaton's question, Mr. Mintz posed an example of a facility with an expected useful life of 25 years that had to be replaced after 23 years due to improper maintenance. He said he understood Representative Seaton's question to be whether in the aforementioned situation the legislation would disallow the entire replacement costs although only two-twenty-fifths of that would be attributable to the improper maintenance. The current legislation could be read as having that effect. However, the introductory language of the proposed paragraph (19) refers to "that portion of the costs", which could mean an allocation as to the portion of the costs that are attributable to the improper maintenance versus the replacement costs necessary in the ordinary course of events. Mr. Mintz said that this is a situation in which it might be beneficial to have some legislative clarification as to the intent of the sponsors on this matter.

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REPRESENTATIVE SEATON surmised then that clarification is necessary.

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REPRESENTATIVE ROSES recalled that early on the committee was told that this language would help clarify the situation and thus [the department] would not have to depend on negligence or gross negligence to determine whether the situation under discussion would be deductible. Representative Roses related his understanding from Mr. Mintz that even if the language was interpreted to mean an allocation as to the portion of the costs attributable to the improper maintenance, the amount of maintenance that contributed to the item not meeting its full life would have to be determined. Would that be any less

difficult legally to define or defend as negligence or gross negligence, he asked.

MR. MINTZ said that there are really two issues: the legal standard and what the facts show. Under any legal standard, the department will have to review the facts, consult with other agencies, and apply the legal standard to the facts. There will be controversy about that, especially when lots of money is at stake. With regard to whether there is sufficient clarity as to what the legal standard is, Mr. Mintz opined that the legislation would clarify that there is a broader legal standard in terms of disallowing costs than exists under the current law. The current law essentially utilizes a standard of gross negligence. If improper or lack of maintenance was due to something lesser than gross negligence, such as imprudent conduct or ordinary negligence, then it would be more difficult to exclude that under the current standard than the standard being proposed in HB 128. Therefore, if the desire is to make the applicable standard more bullet proof, that would be beneficial. The need to evaluate the facts under a particular circumstance would remain, although there would be a better standard in terms of the policy the legislature is interested in implementing.

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REPRESENTATIVE ROSES asked if it would be difficult to prove gross negligence in a situation in which someone uses water instead of corrosion inhibitors.

MR. MINTZ reiterated the need to apply the standard to the facts. He opined that there are surely situations in which the conduct or failures and omissions on the part of a person are so egregious that it would be easy to prove gross negligence. However, gross negligence is certainly a narrower standard that would apply to fewer cases than either ordinary negligence or the standard proposed in HB 128.

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CO-CHAIR GATTO opined that the language "improperly maintained" is difficult because there could be situations in which only a section of the pipe is corroded. In such a situation, the question becomes whether the pipe was improperly maintained over its entire length or would the corroded portion only be subject to the improper maintenance rule.

MR. MINTZ said that the question is the extent to which the phrase "portion of the costs" is intended to provide an allocation between the costs actually due to lack of maintenance and the costs that would have been incurred in any event. Again, he reiterated that the state could benefit from guidance from the legislature as to what it intends.

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REPRESENTATIVE SEATON related his understanding that the standard being implied in HB 128 is improper maintenance rather than negligence. He pointed out that improper maintenance does not need to be negligence. He inquired as to the "bullet-proof relationship" between improper maintenance and negligence that would be utilized in all cases.

MR. MINTZ stated that negligence is a very well-recognized concept in the law while improper maintenance seems to be a new concept for which he was not sure of the guidance available for it. It seems that by adopting something other than a negligence standard seems to indicate legislative intent to have a broader standard. Furthermore, rather than reviewing the standard of care the operator/producer is using, it reviews the results of the maintenance practices or omissions. Therefore, Mr. Mintz opined that it would be possible that costs would be excluded under the improper maintenance standard but would not necessarily be excluded under a negligence standard.

REPRESENTATIVE SEATON surmised then that improper maintenance and negligence are not identical terms. Furthermore, improper maintenance can cover more things than negligence and thus is a much broader standard.

MR. MINTZ replied, "I don't know that I could quantify it as being much broader or somewhat broader, but I do think it is broader."

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REPRESENTATIVE GUTTENBERG highlighted that this state has a long history of litigation with the oil industry and often simply to define terms. He asked if the state's relationship with the oil industry has resulted in definitions of the following terms: "not maintained," "improperly maintained," "diminished capacity," "standard practices of the industry," or "good practices of the industry."

MR. MINTZ answered that as far as the tax law is concerned, the state does not have those definitions. However, there is some jurisprudence in regard to "good oil field practices" and "reasonable producer standards." As to what standards exist that would address this, he deferred to DNR and AOGCC representatives.

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JOHN NORMAN, Commissioner/Chair, Alaska Oil & Gas Conservation Commission (AOGCC), Department of Administration, explained that the AOGCC is reviewing this from the viewpoint of the law of general application that will reach into the years ahead, although recent events may be driving this. If HB 128 passes, AOGCC will do its best to implement it. Mr. Norman then offered that there are basically four categories of behavior of an individual or company. Those four categories are as follows: an intentional or willful act; gross negligence or willful or wanton conduct done in careless disregard to the consequences; negligence; and strict liability in which no concern is given to what led up to the incident. The first two categories, an intentional act and gross negligence, are already included in the legislation in Section 1(e)(6). The category of strict liability is partially addressed in Section 1(e)(16). That leaves the third category of negligence [in question]. He noted his agreement with Mr. Mintz that an argument could be made that the legislation disallows property that was not properly maintained or that was negligently maintained. "Normally, in gross negligence it often leaps out at you and the obvious cases and situations will sort themselves out," he opined. He further opined that such cases will be screened out by Section 1(e)(6). He suggested that Section 1(e)(19) will be more difficult because it seems to address ordinary negligence, although he said he did not presume to know. Therefore, if the legislation used the language "negligently maintained," the discussion would be ended.

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MR. NORMAN suggested that if the intention is to penalize negligent maintenance without imposing a strict liability, then it might be best to use the term "negligence" for clarity. He said that the words "good oil field practices" are preferred by the AOGCC, and that it is his understanding that they are also preferred by DNR and DOR. Those terms already appear in Alaska law, specifically in AS 31.05.170(15) and in a number of places in the state's regulations. He said that it is a more objective

and precise standard than one that says "standard practices of the industry" which might invite a company to look at what others in the oil field are doing and it is conceivable that the prevailing number of operators there are all operating not in accordance with good oil field practices. If they are all doing it, they could argue that this is "standard practice" in this field. He noted that there are a number of oil fields in the world that do not practice what AOGCC would consider "good oil field practices."

MR. NORMAN addressed the issue of replacement. He noted that various components - compressors and gaskets, for example - have a certain useful life, but that this is not necessarily exact. Consequently, this could be inviting early replacement of component parts that actually still have a longer life. When the time comes to implement the bill's provisions by regulation, AOGCC would strive to promulgate regulations in a manner that does not discourage innovation, such as the pioneering of new techniques and production methodologies. He said that this is necessary because it sometimes takes years to figure out that something does not work.

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MR. NORMAN advised the committee to re-think the policy being established by Section 1, paragraphs (19)(A) and (B), because operators are often reacting to an event. Paragraph (19)(A) denies the cost of repair and replacement of property or equipment that was not maintained or was improperly maintained. Paragraph (19)(B) denies the cost of an operational shutdown of the entire facility if it occurs as the result of improper maintenance. He stated that AOGCC believes operators should be allowed a certain amount of latitude in determining what is the best way to respond to an event. For example, the safest and most prudent way to handle a particular repair or replacement might be to shut down the facility for a certain period of time. However, under this new policy, an operator may instead elect to keep everything running so as not to lose the deductibility of the repair or replacement.

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MR. NORMAN pointed out that in partnership operating agreements, the operating partners, as among themselves, do not normally penalize an operating partner for simple negligence, because no one would want to be an operator if, in effect, they are being required to become an insurer of a perfect operation. He

requested that the legislature give AOGCC some guidance regarding whether Section 1, paragraphs (6) and (16), mean "negligence" or something broader than that, perhaps even approaching strict liability.

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REPRESENTATIVE ROSES asked whether the term "good oil field practices" is the measure that would be used in determining intentional, wilful, or gross negligence.

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MR. NORMAN stated yes, it would certainly be a measure. However, he said that what is looked for is the level of culpability, or the degree of fault. For example, whether an incident is not only a failure to follow good oil field practices, but it is done in a knowing way and often with careless disregard of the consequences. Occasionally in these types of incidents, there will be memoranda to management with management replying "Yes, we hear you, but we're opting to go forward." He reiterated that usually gross negligence cases are egregious violations that "jump out at you." He stated that AOGCC's approach, unless directed otherwise by the legislature, is to measure this type of incident against good oil field engineering practice. He said that it is the operator's conduct that identifies and brands the incident as gross negligence, as opposed to just simple negligence where no one was aware that this type of incident might occur.

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MR. NORMAN, in response to a question, noted that [the incident which triggered this legislation] occurred in a transit line exiting a treatment facility. He said that, in theory, this line should have carried pipeline quality oil that would have flowed on through and that is why this was a surprise, at least on the one event that occurred. He related that there is testimony by various operators that supports the notion that maintenance is performed up to the anticipated length of useful life. He stated that he did not know the facts in this particular situation, and that if he did he would be unable to comment because it would prejudge something that will ultimately come before the AOGCC. However, he said that he can safely state that it is less likely to find this level of corrosion in a transit line as opposed to what is expected in a gathering line. Foreseeability is always an element of negligence - if

something occurs and it is not foreseeable, then normally an operator is not held to have been negligent.

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CO-CHAIR GATTO announced that CSHB 128(O&G) is being held over.

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**ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 2:54 p.m.