

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 28, 2007

1:04 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. 186

"An Act relating to sharing with certain federal agencies records required of sport fishing guides."

- MOVED CSHB 186(FSH) 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; ASSIGNED TO SUBCOMMITTEE

HOUSE BILL NO. 203

"An Act creating the Kodiak Narrow Cape Public Use Area."

- HEARD AND HELD

HOUSE BILL NO. 176

"An Act creating the Fort Rousseau Causeway State Historical Park."

- SCHEDULED BUT NOT HEARD

HOUSE BILL NO. 194

"An Act relating to fines for certain offenses involving aeronautics, alcoholic beverages, boats, fish and game, health care records and public health, medical review organizations, public restroom facilities, smoking, shelter cabins, refrigerators and similar equipment, radiation sources, high voltage lines, child labor, employment in underground mines, marriage licenses, motor vehicles and driver's licenses, ignition interlock devices, pipelines, use of the state seal, and emissions requirements; relating to the maximum fine provided for violations and infractions and to the definition of 'minor offenses'; redesignating certain fish and game misdemeanor offenses as class A misdemeanors; relating to violations and offenses that are committed on state land, water, and land and water or that are related to water management or dam and reservoir safety; amending Rule 8(b), Alaska District Court Rules of Criminal Procedure; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

HOUSE JOINT RESOLUTION NO. 4

Requesting the Federal Subsistence Board to reconsider its decision regarding the subsistence fishery priority given to Ninilchik residents.

- SCHEDULED BUT NOT HEARD

PREVIOUS COMMITTEE ACTION

BILL: HB 186

SHORT TITLE: SPORT FISHING GUIDE RECORDS

SPONSOR(S): REPRESENTATIVE(S) HARRIS BY REQUEST

03/12/07	(H)	READ THE FIRST TIME - REFERRALS
03/12/07	(H)	FSH, RES
03/19/07	(H)	FSH AT 8:30 AM BARNES 124
03/19/07	(H)	Heard & Held
03/19/07	(H)	MINUTE(FSH)
03/21/07	(H)	FSH AT 8:30 AM BARNES 124
03/21/07	(H)	Moved CSHB 186(FSH) Out of Committee
03/21/07	(H)	MINUTE(FSH)
03/22/07	(H)	FSH RPT CS(FSH) NT 4DP 2NR
03/22/07	(H)	DP: JOHNSON, LEDOUX, EDGMON, SEATON
03/22/07	(H)	NR: JOHANSEN, HOLMES
03/26/07	(H)	RES AT 1:00 PM BARNES 124

03/26/07 (H) -- MEETING CANCELED --
03/28/07 (H) RES AT 1:00 PM BARNES 124

BILL: HB 128

SHORT TITLE: OIL & GAS PRODUCTION TAX: EXPENDITURES

SPONSOR(s): REPRESENTATIVE(s) OLSON

02/12/07 (H) READ THE FIRST TIME - REFERRALS
02/12/07 (H) O&G, RES, FIN
02/22/07 (H) O&G AT 3:00 PM CAPITOL 124
02/22/07 (H) Heard & Held
02/22/07 (H) MINUTE(O&G)
03/01/07 (H) O&G AT 3:00 PM CAPITOL 124
03/01/07 (H) Moved CSHB 128(O&G) Out of Committee
03/01/07 (H) MINUTE(O&G)
03/05/07 (H) O&G RPT CS(O&G) 3DP 1NR
03/05/07 (H) DP: DOOGAN, RAMRAS, OLSON
03/05/07 (H) NR: SAMUELS
03/19/07 (H) RES AT 1:00 PM BARNES 124
03/19/07 (H) Heard & Held
03/19/07 (H) MINUTE(RES)
03/21/07 (H) RES AT 1:00 PM BARNES 124
03/21/07 (H) Heard & Held
03/21/07 (H) MINUTE(RES)
03/23/07 (H) RES AT 1:00 PM BARNES 124
03/23/07 (H) Heard & Held
03/23/07 (H) MINUTE(RES)
03/26/07 (H) RES AT 1:00 PM BARNES 124
03/26/07 (H) -- MEETING CANCELED --
03/28/07 (H) RES AT 1:00 PM BARNES 124

BILL: HB 203

SHORT TITLE: KODIAK NARROW CAPE PUBLIC USE AREA

SPONSOR(s): REPRESENTATIVE(s) LEDOUX

03/14/07 (H) READ THE FIRST TIME - REFERRALS
03/14/07 (H) RES, FIN
03/28/07 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

TOM WRIGHT, Staff
Representative John Harris
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Presented HB 186 on behalf of the sponsor,
Representative Harris by request.

DOUGLAS VINCENT-LANG, Special Projects Coordinator
Division of Sport Fish
Alaska Department of Fish & Game (ADF&G)
Anchorage, Alaska

POSITION STATEMENT: Provided information related to HB 186.

BERNARD HAJNY, Manager
Production Tax and Royalties Alaska
BP Exploration Alaska
Anchorage, Alaska

POSITION STATEMENT: Provided testimony focusing on specific provisions of HB 128 and their impact on the new petroleum production profits tax.

GARY ROGERS, Production Audit Manager
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska

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

MICHAEL HURLEY, Director
of State Government Relations
ConocoPhillips Alaska, Inc.
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 128.

MICHAEL FRALEY, Tax Counsel
ConocoPhillips Alaska, Inc.
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 128.

REPRESENTATIVE GABRIELLE LEDOUX
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Spoke as the sponsor of HB 203.

SUZANNE HANCOCK, staff
Representative Gabrielle LeDoux
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Presented HB 203 on behalf of the sponsor, Representative LeDoux.

DICK MYLIUS, Director
Division of Mining, Land and Water

Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: During hearing of HB 203, answered questions.

BILL BURTON, Owner
Kodiak Game Ranch
Kodiak, Alaska

POSITION STATEMENT: During hearing of HB 203, suggested including that existing grazing rights or leases be included as one of the purposes of the Kodiak Narrow Cape Public Use Area.

ACTION NARRATIVE

CO-CHAIR CARL GATTO called the House Resources Standing Committee meeting to order at [1:04:37 PM](#). Representatives Gatto, Johnson, Roses, Guttenberg, Wilson, and Edgmon were present at the call to order. Representatives Kawasaki, Kohring, and Seaton arrived as the meeting was in progress.

HB 186-SPORT FISHING GUIDE RECORDS

[1:04:54 PM](#)

CO-CHAIR GATTO announced that the first order of business would be HOUSE BILL NO. 186, "An Act relating to sharing with certain federal agencies records required of sport fishing guides."

[1:05:12 PM](#)

TOM WRIGHT, Staff, Representative John Harris, Alaska State Legislature, explained that HB 186 authorizes the department to release records required of sport fishing guides to the National Oceanic and Atmospheric Administration (NOAA) and the National Marine Fisheries Service (NMFS). He expressed hope that this would allow NOAA and NMFS to make better decisions regarding allocation and law enforcement.

[1:06:22 PM](#)

DOUGLAS VINCENT-LANG, Special Projects Coordinator, Division of Sport Fish, Alaska Department of Fish & Game (ADF&G), informed the committee that when the department originally addressed guide licensing and business licensing in the sport fish guide industry, there was agreement to make the information confidential. That agreement of confidentiality was made

because the logbook contained the client lists of the sport fishing businesses. He said that there was never the intent to not allow full enforcement of sport fish guiding around the state. An example of that recently arose in the North Pacific Fishery Management Council (NPFMC). In that case, the inability to share logbook information with NMFS enforcement eliminated the preferred alternative tool of both the sport fishing charter industry and NPFMC, in terms of regulating the fishery to obtain the guideline harvest level. Since the information couldn't be shared, the federal program would have to institute its own marine logbook program and the charter vessel operators would have to have two logbooks onboard. He related that even amending the statute as suggested in HB 186, the information would have to remain confidential unless there's a violation and the matter made it into the court system. Under the court system, the information pertaining to the violation would be public. Therefore, this legislation would merely allow sharing of confidential information with NMFS enforcement and the International Pacific Halibut Commission (IPHC) with the understanding that they would keep it confidential except for the enforcement of fishing regulations in the state.

[1:09:17 PM](#)

REPRESENTATIVE SEATON recalled that the original concern was that the information remain confidential, which the committee has been ensured is the case with this legislation. Representative Seaton said that he's comfortable with [CSHB 186(FSH)].

[1:09:49 PM](#)

CO-CHAIR GATTO related his understanding that Representatives Wilson and Edgmon agree with Representative Seaton's statement.

CO-CHAIR JOHNSON noted his agreement with this legislation.

CO-CHAIR GATTO then noted that the legislation is supported by the Southeast Alaska Fisherman's Alliance.

[1:10:42 PM](#)

CO-CHAIR GATTO, upon determining that no one else wished to testify, [announced that public testimony was closed].

[1:10:52 PM](#)

CO-CHAIR JOHNSON moved to report CSHB 186(FSH) out of committee with individual recommendations and the accompanying zero fiscal notes. There being no objection, it was so ordered.

HB 128-OIL & GAS PRODUCTION TAX: EXPENDITURES

[1:11:18 PM](#)

CO-CHAIR GATTO announced that the next order of business would be HOUSE BILL NO. 128, "An Act relating to allowable lease expenditures for the purpose of determining the production tax value of oil and gas for the purposes of the oil and gas production tax; and providing for an effective date." [Before the committee was CSHB 128(O&G), as amended at the March 23, 2008, hearing.]

[1:12:44 PM](#)

BERNARD HAJNY, Manager, Production Tax and Royalties Alaska, BP Exploration Alaska, paraphrased from the following written testimony [original punctuation provided]:

I would like to clarify that my testimony today focuses on the specific provisions of HB 128, and their impact on the new Petroleum Production Tax, or "PPT," from my perspective as someone within BP charged with complying with it. I am a tax professional, and not an expert in Oil Transit Lines, corrosion, pipeline operations or pigging; and it would be inappropriate for me to talk about those areas. I am here to talk about House Bill 128 and its implications for BP as one of Alaska's largest taxpayers.

Last month senior BP technical and operations management, Tony Brock and Mike Utsler, updated the Legislature on the status of our efforts to address the issues we discovered at Prudhoe Bay last year. I can confirm that both Tony and Mike are available in the future should this Committee require further updates on the technical and operations issues relating to Prudhoe Bay.

[1:14:18 PM](#)

There are two slides for my presentation today, which are printed out on the front and back of a one-sheet

handout that has been distributed to you. Please look at the first slide on my handout, which is the one entitled "BP Presentation to the House Resources Committee."

The PPT is working for the State of Alaska, and I mean "working" in three senses of the term. First, it is "working" in the sense that the PPT regulations by the Department of Revenue clarify in several crucial ways how the pieces of the PPT fit together. Taxpayers know what is expected of them in computing and making monthly installment payments, and in making the annual true-up on March 31st of the following year.

Second, the PPT is "working" in the sense of providing a major increase in state production tax revenues last year. For BP, its production tax nearly tripled from about \$180 million under the old [economic limit factor] ELF-based tax for the last nine months of last year, to over \$500 million under the PPT for those months. This is fully in line with the Legislature's expectations about the PPT's revenue effects.

Third, the PPT has promise to "work" in response to the question on my slide that asks, "Will Alaska attract sufficient investment to stem production decline?" The bulk of the known and likely opportunities in Alaska for investing in production are concentrated in the existing fields - that is, investing to slow their decline, to increase the ultimate recovery from them, and to discover ways to develop and produce the 20+ billion barrels of heavy and viscous oil that are already known. The PPT is significantly better suited for this future than the ELF ever was. In addition, through its credit for capital expenditures, it provides an investment incentive that was absent from the old ELF-based tax.

[1:16:29 PM](#)

MR. HAJNY continued:

But even though the PPT structurally has promise in attracting the new investment that will be needed to deal with the threat of declining production, BP believes the PPT is suboptimal for the State because the tax rate is too high. If you will look at my

second slide – the graph on the back of the one-page handout – you will find Alaska at the wrong end of the spectrum in terms of government “take” at the margin. Investments in Alaska must compete successfully against opportunities elsewhere, and by lowering the PPT rate Alaska would increase the competitiveness of its investment opportunities. The production from those investments will, we are convinced, increase the total revenues from Alaska’s property and income taxes and royalties by more than any reduction in the PPT that might result.

1:17:26 PM

Now, I would ask you please to turn back to the slide on the front of the handout. HB 128 would introduce unnecessary uncertainty into the PPT. We agree with the AOGA testimony given by Judy Brady about the overlap between existing terms in the PPT and the new standard of “improper” maintenance under this Bill, which either makes the Bill unnecessary or means its enactment will create serious ambiguities. I will not repeat that testimony now.

Those questions about what constitutes “improper” maintenance only deal with the matter of when the new provisions of HB 128 would be triggered. What I would like to focus on is what happens under HB 128 after that trigger is pulled. So I’d ask you to imagine a hypothetical future situation that indisputably arises from improper maintenance.

1:18:15 PM

MR. HAJNY continued:

If you look at page 3 of the Bill, beginning at line 23, you will see three subparagraphs in paragraph (19) that are designated “(A)”, “(B)” and “(C)”. It is these subparagraphs that specify what happens after the improper-maintenance trigger is pulled.

For the moment I would like to skip over subparagraph (A) in order to talk about (B) and (C), which raise questions about sound tax policy. Then I’ll come back to (19)(A), which presents an entirely different kind of issue.

Subparagraph (19)(B) disallows any costs determined by the Commissioner of Revenue to have been "incurred to maintain the operational capability of facilities or equipment shut down because of ... improper maintenance of property or equipment[.]"

The first thing to note is that the disallowance is not limited to stand-by costs for keeping up the operational capability of the property or equipment that was improperly maintained. When you read the Bill closely, you see that what is disallowed are the costs of sustaining the operational capability of shut-down "facilities or equipment", while the trigger is improper maintenance of "property or equipment" (emphasis added). Because these phrases are different, they cover different things. In other words, (19)(B) would permit disallowance of all costs of standing by and staying ready to resume production – even the portion of stand-by costs for facilities and equipment that were properly maintained.

[1:19:51 PM](#)

MR. HAJNY continued:

Does this make sense? (19)(B) penalizes spending money to "maintain ... operational capability" by disallowing those costs. I hope that we would want a field to get back up and running as soon as possible after a shut-down, but (19)(B) will be an obstacle to that.

Subparagraph (19)(C) similarly disallows costs determined by the Commissioner of Revenue to be "incremental operating expenses incurred as a result of operating facilities or equipment at diminished capacity when that diminished capacity is caused by ... improper maintenance of property or equipment." Here, again, the disallowance is not limited to diminished capacity of the "property or equipment" that was improperly maintained, but includes diminished capacity of any "operating facilities or equipment" (emphasis added).

Does this make sense from a tax policy point of view? Again, I don't think so. Subparagraph (19)(C) is

effectively saying that if it costs more to run a field at diminished capacity, the State will deter a producer from doing so by disallowing those costs. I should think that having part of a field in production, even at a higher-than-normal operating cost, is better than having it completely shut down – especially in light of state royalties and income tax which are both enhanced by keeping the field in production. If anything, (19)(C) should be reducing the PPT as an incentive for keeping as much of a field in production as possible, but it does precisely the opposite instead.

Thus, I submit, both (19)(B) and (19)(C) go off in exactly the wrong direction from what is sound tax policy for the State, and both of them should be taken out of the Bill.

[1:21:40 PM](#)

MR. HAJNY continued:

This gets me back to subparagraph (19)(A) on page 3 of the Bill at lines 23 - 24. Under this subparagraph any costs determined by the Commissioner of Revenue to be "related to the repair or replacement" of the improperly maintained property or equipment are disallowed. The problem with this new disallowance is that it "double-dips" on the flat-rate 30 cents-a-barrel disallowance under paragraph (18). Judy Brady has explained how this 30-cent disallowance by Pedro van Meurs was directed at exactly the same issue that (19)(A) addresses, and how the Senate Special Committee on Natural Gas Development then rejected a proposal like (19)(A) twice in favor of the van Meurs flat rate disallowance in paragraph (18). I will not repeat those details now.

Even paragraph (18) went too far and was ill-advised. Other provisions in the PPT law already address, and deal with, the questions about adequate maintenance, and do so in a fair and reasonable way. If the objective is to make the PPT a better law for the future, then HB 128 should repeal paragraph (18). Instead, the Bill proposes to compound the error not only by keeping paragraph (18), but also by adding

subparagraph (19)(A) to double-dip on the very same costs that paragraph (18) already disallows.

This concludes our testimony on HB 128. Thank you again for this opportunity to appear before you.

[1:23:15 PM](#)

MR. HAJNY, in response to Co-Chair Gatto, explained that the \$.30 is calculated such that \$.30 a barrel is multiplied by the total number of barrels produced. That dollar amount reduces both the capital expenses and the lease expenditures, and thus reduces the opportunity for a deduction and a credit. Therefore, it reduces the deduction against the 22.5 percent tax rate as well as against the 20 percent credit. He recalled that Dr. van Meurs estimated that the \$.30 will amount to about \$40 million at 900,000 barrels a day; \$40 million that the industry wouldn't be allowed to deduct as costs or to obtain as credits under the PPT. He opined that Dr. van Meurs was trying to point out that there are going to be expenditures dealing with maintenance and specific issues for which the \$.30 is to address.

[1:26:09 PM](#)

REPRESENTATIVE WILSON, referring to paragraph (18) on page 3, lines 13-18, pointed out that in the future there will be increases in inflation and increased costs to fix things. Therefore, it's probably not in the state's best interest to leave it as a flat amount because in the long-term someone will be responsible for paying the remainder beyond the flat rate.

[1:27:19 PM](#)

CO-CHAIR GATTO asked if BP made more money the year the petroleum production profits tax (PPT) was implemented, even though the taxes tripled.

MR. HAJNY responded that BP estimates that its taxes would nearly triple from \$180 million under the ELF to over \$500 million [under the PPT]. However, he said that he didn't know BP Alaska's net income or income figures during that same period for 2006. He acknowledged that oil prices were higher in 2006 than in the prior year.

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CO-CHAIR GATTO commented that he was curious as to whether the state and the companies both made money under the PPT. He said that he's trying to ascertain whether the effect of the PPT was truly devastating or somewhat negative.

MR. HAJNY explained that the point BP tried to make last year during the PPT hearings was that increasing the tax won't make Alaska more competitive in the basins where oil and gas is produced. In further response to Co-Chair Gatto, Mr. Hajny pointed out BP's graph shows that the marginal take for Alaska is higher than the provinces, which are generally oil and gas provinces, that BP has represented.

[1:29:56 PM](#)

CO-CHAIR GATTO asked if the federal government also made more money as compared to the prior year.

MR. HAJNY surmised that if the net income rises, the tax rate would increase.

CO-CHAIR GATTO opined then that part of the government take is an increase in the federal government take, not just the state government's take.

MR. HAJNY replied yes, adding that all provinces would've risen at the same level.

[1:30:44 PM](#)

REPRESENTATIVE SEATON referred to the chart from BP titled "Alaska has adopted the highest marginal tax rate in North America". He asked whether the chart for Colorado, Kansas, and Texas included the private royalties that are paid.

MR. HAJNY replied yes, and specified that the chart includes a one-eighth or 12.5 percent royalty across the board in order to have an apples-to-apples comparison.

[1:31:17 PM](#)

REPRESENTATIVE SEATON, referring to paragraph (19) on page 3, asked if shut downs due to preventive maintenance could be said to have been due to improper maintenance, and thus the incremental cost of operating the field with a portion of wells shut down wouldn't be deductible.

MR. HAJNY replied yes. Therefore, BP reads the legislation such that if an auditor determines that a portion of a piece of equipment was improperly maintained or installed, the operating costs while the field is down could be disallowed as deductible expenses.

[1:32:51 PM](#)

REPRESENTATIVE SEATON related his understanding that quite often a portion of a field's wells are shut down for maintenance. He surmised then that if it's determined that wells were shut down because they should've been maintained differently, then the incremental costs of operating the field wouldn't be deductible.

MR. HAJNY noted his agreement with Representative Seaton. For example, in a situation in which a seal or gasket was installed backwards, the language in [paragraph (19)] says that the cost associated with the whole compression facility could be disallowed as well as the associated operating costs while the company tries to fix it.

[1:34:42 PM](#)

CO-CHAIR JOHNSON asked if the \$.30 is deductible for the company's federal income taxes.

MR. HAJNY clarified that the \$.30 is an ordinary cost of doing business and would be deductible.

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CO-CHAIR JOHNSON inquired as to whether the rest of the maintenance would fall under the category of a regular business expense and be deductible from the federal income tax.

MR. HAJNY, noting that he is not a federal income tax expert, related his understanding that these would normally be deductible costs.

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CO-CHAIR JOHNSON asked:

Will that effect the 67 percent take - if you get to deduct these expenses from your federal income tax, will that reduce that take? ... If I understand you, the \$.30 is deductible, the maintenance ... that is

performed ... regardless how ... we categorize the maintenance. Will that deduction decrease the 67 percent, in your opinion?

MR. HAJNY answered that he didn't know.

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CO-CHAIR GATTO surmised that if a company has \$1 worth of maintenance and the state doesn't allow the \$.30, the company spends the \$1 and the company declares the \$1.

[1:37:24 PM](#)

CO-CHAIR JOHNSON inquired as to why the company wouldn't declare \$1.30 since the \$.30 is already included as a regular part of daily business.

CO-CHAIR GATTO noted his disagreement, stating that the \$.30 is a fictitious number until the company pays a bill. The \$.30 is only allowed to offset an expense. Therefore, if the company doesn't offset an expense, the \$.30 never existed, he opined.

[1:38:22 PM](#)

MR. HAJNY related his understanding that the costs are determined under the Internal Revenue Service (IRS) guidelines and not subject to what occurs under the PPT.

[1:39:10 PM](#)

GARY ROGERS, Production Audit Manager, Tax Division, Department of Revenue (DOR), related his understanding that \$1 spent, expense or capital, the IRS recognizes that as a \$1 expenditure. The IRS doesn't recognize the \$.30 that's a disallowance of that \$1 for the PPT.

[1:40:20 PM](#)

REPRESENTATIVE SEATON clarified that the deductions can be taken against the PPT, federal income tax, and the state's corporate income tax. Therefore, these aren't mutually exclusive deductions. The only way to achieve a higher amount, he opined, is based on the credits that are allowed for capital. When the credits are allowed, an entity can receive a credit portion of that entity's investment. In that some additional tax can be achieved, he noted.

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CO-CHAIR GATTO reminded the committee that this is really about defining improper maintenance. He said he's depending on the testimony from the companies to relate what they believe constitutes proper maintenance.

[1:43:35 PM](#)

REPRESENTATIVE ROSES recalled testimony in which there was discussion regarding the following four categories of negligence: intentional or willful neglect; gross negligence or disregard to the consequences that could occur; ordinary or common negligence; and strict liability. The testimony seemed to indicate that HB 128 is creating a definition of ordinary or common negligence and the result of that. Representative Roses opined, "I think part of what we're getting to here is trying to define what occurred by plugging up what we see as a loop hole." He then asked if during a partial shut down for regular maintenance, a company would replace equipment that is found to be faulty or leave it until it stops working.

MR. HAJNY said that he would be venturing into an area in which he's not familiar.

[1:46:55 PM](#)

REPRESENTATIVE ROSES related his guess that the company would probably replace that faulty equipment. If the company didn't replace it, he opined that it would be ordinary and common negligence. According to this legislation, the company in such a circumstance wouldn't be able to deduct any of the costs related due to the partial shut down. On the surface Representative Roses noted his agreement with Mr. Hajny that this is a bit excessive in that the state encourages maintenance but punishes the company when it does. Furthermore, Representative Roses said that he isn't fond of retroactivity.

[1:48:09 PM](#)

REPRESENTATIVE GUTTENBERG requested further explanation regarding Mr. Hajny's assertion that the PPT had higher incentives for investment than the ELF.

MR. HAJNY clarified that he's referring to the deductibility of the expenses and the credits associated with capital

expenditures. The intent appeared to be to incentivize investment, and therefore try to incentivize investment that would stem the decline in Alaska, he related. In further response to Representative Guttenberg, Mr. Hajny said that he didn't know what the world average is; the point of the slide is that Alaska would be well-served to move in the direction that the Gulf of Mexico, Canada, and Alberta are with regard to their tax regimes and marginal rates.

1:50:02 PM

REPRESENTATIVE SEATON, referring to page 3, line 19, inquired as to Mr. Hajny's understanding of the "costs" as a standard. He then asked if there's a criteria or is it merely a determination that the commissioner can make at any given time.

MR. HAJNY said that Representative Seaton has identified the biggest issue, the potential ambiguity and uncertainty, that BP has with this legislation.

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REPRESENTATIVE SEATON inquired as to how [the companies] will project the replacement and maintenance of equipment since these characteristics are not going to be incident driven but rather audit driven. He recalled that DOR has said that one of the criteria used by an auditor would be a high expense. "Do you feel that under this, it's going to be necessary to maintain that piece of equipment that's been replaced so that you can verify that you didn't replace it because it was improperly maintained," he asked. He explained that he's trying to address how to determine whether or not something was properly maintained or not since this is likely driven by an audit or tax return and will be a capital expenditure, "it will be long gone."

MR. HAJNY confirmed that the aforementioned, the fact that the audits are retrospective, is one of the difficulties companies will have with administering this. Companies will deduct costs and apply credits associated with expenditures as they are spent. The determination of whether that was replaced due to improper maintenance would potentially be determined years later. Trying to provide information that would prove equipment was properly maintained accompanied with the burden that the companies would be against during the audit could be difficult to document.

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CO-CHAIR GATTO commented that this reminds him of court hearings in which one can only be proven to be not guilty, not innocent.

[1:56:27 PM](#)

MICHAEL HURLEY, Director, of State Government Relations, ConocoPhillips Alaska, Inc., said that he would discuss ConocoPhillips Alaska, Inc. (ConocoPhillips) opposition to HB 128. As discussed in a prior hearing, Mr. Hurley opined that it's appropriate for the legislature to determine what it wants to allow or disallow under the PPT. However, Mr. Hurley said that he believes the \$.30 can be shown as related to and, in fact, because of the incidents that occurred at Prudhoe Bay. The current legislation seeks to duplicate that disallowance in a different way. He suggested that the legislature has the responsibility to decide which way to disallow it.

[1:58:38 PM](#)

REPRESENTATIVE WILSON interjected that she misspoke earlier and in fact it's the opposite of what she said.

[1:58:52 PM](#)

MICHAEL FRALEY, Tax Counsel, ConocoPhillips Alaska, Inc., related that ConocoPhillips opposes HB 128 for multiple reasons. The first reason is that ConocoPhillips believes HB 128 is a targeted tax. He pointed out that AS 43.56.165(e) includes numerous exclusions that reduce lease expenditures. Those disallowances of the lease expenditures were discussed throughout the regular session as well as three special sessions. It wasn't until the August 3, 2006, special session that AS 43.56.165(e)(18) was discussed, which was after the oil spill became public. He noted that AS 43.56.165(e)(19) was also discussed at the time, but ultimately the legislature decided to implement AS 43.56.165(e)(18), which is a broad disallowance versus a narrowly tailored disallowance. Mr. Fraley opined that a targeted tax is a bad way to set tax policy. Second, it's too early to reopen the PPT as companies are just now filing final returns for the last nine months of 2006. Furthermore, regulations have not yet been promulgated. Third, ConocoPhillips believes that existing statute already covers the issue addressed by HB 128.

[2:01:56 PM](#)

MR. HURLEY, referring to the document titled "30 Cents per Barrel Disallowance Example", explained the PPT calculation and reviewed an example of the PPT under ConocoPhillips' average barrel of oil last year, which was \$62.66. In response to Co-Chair Gatto, Mr. Hurley specified that the tariff was taken out prior to arriving at the \$62.66, which is the value of the oil at the lease line. He explained that the value on the West Coast minus transportation gets to the lease line, the point at which the costs and investments are subtracted. In the calculation, the tariff last year was in the range of \$4.25-\$4.50. In further response to Co-Chair Gatto, Mr. Hurley specified that the interstate rate is currently between \$5.00-\$5.50. Mr. Hurley confirmed that the [interstate rate] is still an issue that's being resolved.

[2:04:49 PM](#)

MR. HURLEY continued his review of the PPT calculation in the case of an average barrel of oil at \$62.66, which results in \$9.98 a barrel of tax, absent other items. He noted that the tax is actually higher than that because of the surtax. When the \$.30 comes into play, it's subtracted from the investment and that's what the company is allowed to claim on its PPT tax return although it spent \$.30 more than is allowed. The final tax return in this example illustrates that the \$.30 is deducted in two places, and thus instead of paying \$9.98 in severance tax, ConocoPhillips would pay \$10.11 because of the \$.30 disallowance.

[2:06:53 PM](#)

CO-CHAIR GATTO surmised then that in this example with the \$.30 disallowance, ConocoPhillips' tax increased by 1 percent.

MR. HURLEY specified that the tax increase was on 111 million barrels, which amounts to about \$14.5-\$15 million in this example.

[2:07:42 PM](#)

MR. FRALEY highlighted that ConocoPhillips will experience additional impacts, such as the 10 percent tie credit. The tie credit will be reduced for the first five to six years. Furthermore, any progressivity would create an additional impact. For simplicity, the aforementioned wasn't included in the example.

MR. HURLEY explained that [AS 43.56.165(e)(18)] is already in law to address maintenance.

[2:08:31 PM](#)

REPRESENTATIVE ROSES inquired as to the percentage of costs in the first part of the formula that would be attributed to maintenance.

[2:08:52 PM](#)

MR. HURLEY said it would depend on the field. For example, a field such as Prudhoe Bay that started in the 1970s would have a more significant portion of maintenance costs versus a relatively new field such as Alpine. He clarified that the numbers utilized in the example are an average number across all of ConocoPhillips' fields.

[2:09:31 PM](#)

REPRESENTATIVE ROSES inquired as to the overall costs that are attributable to maintenance.

MR. HURLEY said that he doesn't know. In further response to Representative Roses, Mr. Hurley said he would hope that if the incident-by-incident approach outlined in HB 128 is used, it wouldn't get rid of all maintenance. The department would have to show what sorts of things were improperly maintained.

[2:10:51 PM](#)

REPRESENTATIVE ROSES posed a situation in which half of ConocoPhillips' cost is maintenance, included in which are labor costs, and only half of it was attributable to some sort of negligence or shut down. The aforementioned would amount to only one-fourth of that. However, if the \$9.98 was disallowed under the normal deduction of cost, the cost of that barrel would be increased by an additional \$.35. Representative Roses opined that if ConocoPhillips is going to testify as to the financial impact this proposal will have on the company, at a minimum he said he expected some of the numbers would be available. He said that he's trying to get a realistic estimate as to what percentage of the costs are maintenance and when must a shut down occur to perform regular maintenance. Those are the times in which the possibility of an audit could trigger the

company's inability to deduct the costs because of being shutdown due to negligence.

MR. HURLEY explained that when he used this example, it wasn't intended to make a case about how large the number is. The example was only for illustrative purposes regarding how the disallowance works.

[2:13:56 PM](#)

REPRESENTATIVE SEATON surmised then that the example only relates to AS 43.55.165(e)(19)(A), the cost of maintenance, but not to AS 43.55.165(e)(19)(B) or AS 43.55.165(e)(19)(C), which have to do with the costs of operation if something was determined to be improperly maintained. Therefore, the \$.30 can't be related to direct cost because it's the cost of the nonmaintained items, plus a shut down or reduced operating expenses.

[2:14:46 PM](#)

MR. HURLEY clarified that \$.30 isn't in AS 43.55.165(e)(19) at all, but rather in existing law in AS 43.55.165(e)(18). He further clarified that the aforementioned already exists and is deducted from the PPT filings every month. Therefore, HB 128 includes an additional disallowance on an incident-by-incident basis based on subsections (a)-(c) over and above the \$.30 that's already being disallowed.

[2:15:44 PM](#)

CO-CHAIR GATTO recalled that Mr. Fraley objected to HB 128 because it's a targeted tax. Co-Chair Gatto pointed out various taxes that are targeted taxes, including the cruise ship tax, the fuel tax, the tire tax, a business license, a sales tax, or income tax. He asked Mr. Fraley to name some taxes that aren't targeted.

MR. FRALEY remarked that the taxes Co-Chair Gatto mentioned are generally applicable to the industry, and therefore aren't targeted taxes. He related that his definition of a targeted tax is one in which the tax is created due to a specific instance.

[2:16:47 PM](#)

REPRESENTATIVE GUTTENBERG inquired as to the level of incidence to which something has to arise and cause this to go into effect.

MR. FRALEY commented that one of the problems ConocoPhillips has with HB 128 is that it is unknown; no certainty is involved. "There's an imprecise standard, and then on top of that we don't know it's going to be applied and how it's going to be applied," he opined. Therefore, it's an unknown cost for ConocoPhillips and contributes to the opposition to HB 128.

[2:17:53 PM](#)

REPRESENTATIVE GUTTENBERG reminded everyone that last year when the PPT was passed, the general assumption was that the incidents causing these (indisc.) and repair costs weren't going to be deductible. However, now the legislature is being told that they will be deducted. He then recalled hearing that under the old ELF program there were few incentives and that when companies had cash in hand, they [didn't deduct the repair costs]. However, there was an incident when the companies had cash in hand and the proper maintenance wasn't performed. He opined that to reach a level at which this would kick in, it would have to be a fairly high level. The concern, he opined, is when the field shuts down, the pipe is corroded, and a significant amount of revenues are impacted.

[2:20:18 PM](#)

REPRESENTATIVE SEATON directed attention to page 3, line 19, and inquired as to whether that language has any direction with regard to what will be disallowed.

MR. FRALEY echoed earlier comments that the language seems ambiguous and penalizes an operator who tries to maintain facilities and equipment even when there's a shutdown. He stressed that operators who operate at a reduced capacity will be penalized for doing so.

[2:21:20 PM](#)

REPRESENTATIVE SEATON surmised then that within the legislation there's no standard or direction for a determination.

MR. HURLEY noted that they never reached their fourth point, which is that some of the ambiguity in the way in which the

legislation is constructed is troublesome and that is one. He pointed out that portion of cost doesn't provide a guide as to which portion of the costs "we're trying to figure out." He highlighted that it's difficult to tell what portion of the costs are from improper maintenance or regular wear and tear. The aforementioned is impossible to know, and thus companies wouldn't know how to file their returns and thus would have to be brought forth under an audit that occurs later when the different standard is applied.

[2:22:51 PM](#)

MR. FRALEY turned to ConocoPhillips' third point, which is that there are already protections in statute. For example, AS 43.55.165(e)(16) disallows the deduction of any oil spill cleanup costs. Furthermore, AS 43.55.165(e)(6) discusses gross negligence and any maintenance issue due to gross negligence wouldn't be deducted either.

[2:23:17 PM](#)

CO-CHAIR GATTO related his understanding when a company has oil spill cleanup costs, it would have to have in place much equipment in order to perform the cleanup. Therefore, he asked if the industry of cleaning up the oil would be part of the capital expenses that are all deductible.

[2:23:41 PM](#)

MR. HURLEY clarified that [cleanup equipment] is part of the companies' normal operating costs. The company pays for response vessels through a co-op amongst the different operators such that it's available when an incident actually happens. When there is an incident and vessels and cleanup products are used, the company with the spill has to resupply the co-op with all the items that it used, which isn't a deductible PPT expense. In further response to Co-Chair Gatto, Mr. Hurley said that the cleanup items were purchased several years ago.

[2:25:09 PM](#)

MR. FRALEY then directed attention to a handout titled "**Disallowing 'deemed capital maintenance' costs**" which offers another explanation of how AS 43.55.165(e)(19) works. He noted that this information was derived from Pedro van Meurs August 8, 2006, letter. He highlighted the following quote from Dr. van Meurs, "I believe that this would provide a good answer to

possible public criticism that under the PPT we would provide 50 percent of the replacement costs of pipelines as a result of the Prudhoe Bay shut down."

[2:26:17 PM](#)

REPRESENTATIVE ROSES remarked that there are parts of this legislation that he doesn't like at all. He noted that he agrees that there is already negligence and other factors in place that disallow [the deduction of the costs of improper repair and/or maintenance]. This legislation places the negligence at the level of ordinary negligence, which is a lesser requirement of proof for negligence. He said that he is seeking numbers that relate the tax ramifications on a per barrel basis as it provides something by which to weigh the ideas.

MR. FRALEY offered to provide the committee information with regard to the percentage of maintenance costs, noting that as a field ages there are more maintenance costs for those fields. With regard to how much of the maintenance costs will be disallowed, Mr. Fraley reiterated that he doesn't know. With regard to the actual language of the legislation, AS 43.55.165(e)(19) seems to specify that the final arbiter will be accountants and attorneys at DOR rather than engineers at the Alaska Oil and Gas Conservation Commission (AOGCC), which creates further uncertainty.

[2:29:07 PM](#)

REPRESENTATIVE GUTTENBERG surmised that there's a problem with defining with what's allowable and what's disallowable as well as what triggers the aforementioned. He indicated the possibility of requiring every regularly scheduled shut down to be reported and thus an unexpected shut down would cause a review into whether the proper maintenance was being performed.

[2:30:22 PM](#)

MR. HURLEY expressed concern that even if all the appropriate maintenance is performed, equipment could still fail. He opined that the investigation of all equipment failures would amount to a lot.

REPRESENTATIVE GUTTENBERG questioned the [feasibility] of investigating shut downs that result in the loss of revenue. He

acknowledged that incidents occur all the time, but last year's leak due to corrosion wasn't normal.

MR. HURLEY commented that last year's leak was extraordinary.

[2:31:19 PM](#)

CO-CHAIR GATTO appointed a subcommittee of the following members: Representative Johnson, Chair, and Representatives Wilson and Guttenberg.

[2:31:44 PM](#)

CO-CHAIR JOHNSON said that he is terribly uncomfortable making any decisions on HB 128 until some real numbers are available. He expressed the desire to have tax returns and the actual expenses and what DNR has decided.

[HB 128 was held over.]

HB 203-KODIAK NARROW CAPE PUBLIC USE AREA

[2:32:27 PM](#)

CO-CHAIR GATTO announced that the final order of business would be HOUSE BILL NO. 203, "An Act creating the Kodiak Narrow Cape Public Use Area."

[2:33:20 PM](#)

REPRESENTATIVE GABRIELLE LEDOUX, Alaska State Legislature, speaking as the sponsor of HB 203, informed the committee that it should have a proposed committee substitute (CS), which was necessitated by some changes to the legal description in the original legislation.

[2:34:18 PM](#)

SUZANNE HANCOCK, Staff, Representative Gabrielle LeDoux, Alaska State Legislature, explained that HB 203 sets aside a very special area of Kodiak for public use. Currently, there are five public use areas recognized in state law, the most recent is the Knik River Public Use Area. The Narrow Cape area of Kodiak has a long history of public use from beach combing to surfing.

REPRESENTATIVE LEDOUX interjected that Kodiak is a popular destination for extreme surfers.

MS. HANCOCK informed the committee that there is footage of Kodiak in the movie "Endless Summer II". She then informed the committee that Narrow Cape has an area referred to as Fossil Beach, where rocks bear the imprint of leaves from previous centuries. In fact, the committee packet includes a prize-winning photo and essay from a local Kodiak student regarding Fossil Beach. The area is also the home of the Kodiak Launch Complex. A few years ago there was an initiative to transfer this land to the University of Alaska, which triggered a review of possible steps to recognize and protect the important public use value of this land. Creation of a public use area will require the adoption of a management plan for the area, which should help manage any usage conflicts and ensure the important multiple use of the area.

[2:37:45 PM](#)

CO-CHAIR JOHNSON asked if this fits within the coastal management plan.

MS. HANCOCK deferred to the borough manager.

[2:38:03 PM](#)

REPRESENTATIVE WILSON asked if this legislation would prevent any activity from happening that currently does.

MS. HANCOCK specified that all who regulate land use will continue to do so under HB 203, unless through the management plan other things are determined.

[2:38:46 PM](#)

REPRESENTATIVE WILSON surmised that if the Narrow Cape area is set aside, no hunting would be allowed in the area.

[2:38:57 PM](#)

CO-CHAIR GATTO recalled when the Knik River Public Use Area was set aside, it didn't prevent fishing or any other use. Since HB 203 is modeled after the Knik River Public Use Area, he surmised that similar restrictions or nonrestrictions exist.

[2:39:49 PM](#)

REPRESENTATIVE KAWASAKI inquired as to the difference in the definition of a public use area versus a refuge, a sanctuary, or a critical habitat area. He then inquired as to whether an inclusive or exclusive list of what's allowed in a public use area would be necessary.

MS. HANCOCK deferred to the Department of Natural Resources (DNR).

2:40:37 PM

DICK MYLIUS, Director, Division of Mining, Land and Water, Department of Natural Resources, explained that a public use area is an area of state land that the legislature sets aside for retention or state ownership in order to accommodate a large number of multiple uses. The key component of a public use area is that it's to be retained in state ownership. Therefore, the disposal of the land is prohibited. The land remains state land and is managed by the Division of Mining, Land and Water for multiple use, including mining, oil and gas, hunting, and fishing. A public use designation, he noted, often identifies a higher level of management of the area and thus the division may be more active in managing public use areas as is the case with the Knik Public Use Area. Mr. Mylius said that the public use designation wouldn't significantly change how the area is managed. About three years ago the Kodiak area land use plan was completed. The management proposed in the public use area is very similar to that outlined area plan. He mentioned that the area land use plan didn't identify any land disposals in the area. The legislation makes the determination in the land use plan permanent.

2:43:18 PM

CO-CHAIR GATTO asked if a person with in holdings would be protected from losing his/her property.

MR. MYLIUS replied yes, and specified that the public use area only applies to state land. There are specific provisions included in HB 203, including the provision specifying that the state cannot use eminent domain to acquire any private in holdings. There is another provision in HB 203 that specifically provides access to in holdings. In terms of enforcement, Mr. Mylius pointed out that the Knik Public Use Area legislation included specific enforcement language that was given to DNR, which isn't currently provided on state land.

Therefore, a higher level of enforcement was provided for the Knik Public Use Area. He further pointed out that there is no such provision in HB 203, but it's addressed in HB 194.

[2:44:30 PM](#)

REPRESENTATIVE SEATON, referring to page 3, subsection (f), opined that there seems to be a mechanism for determining uses that cannot be done in the proposed Kodiak Narrow Cape Public Use Area. He asked if there could be a challenge that there's an incompatible use that would place at risk any of the existing uses. For instance, he surmised that mining, although allowed, would be challenged under this compatibility standard.

MR. MYLIUS stated that although the legislation specifically protects certain types of uses, such as the rocket launch facility, those uses can be restricted within certain areas through a land use plan. A land use plan requires a very public process. He noted that the mechanism for preventing mining would be a mineral closing order. The purpose for doing a management plan is so that existing uses can be reviewed and there's a mechanism for addressing conflicts.

[2:46:57 PM](#)

CO-CHAIR GATTO, referring to a color photo in the committee packet, noted that there is denotation of a ranch and a landing strip. He asked if that landing strip is merely a dirt runway or something that may ultimately be extended to accommodate more use.

MR. MYLIUS confirmed that it's a dirt landing strip, which he said he wasn't sure whether it's on state land or within the private in holding of the Kodiak Ranch. In further response to Co-Chair Gatto, Mr. Mylius specified that the Alaska Aerospace Development Corporation has very specific rights to some property [within the proposed Narrow Cape Public Use Area], but those won't be compromised by the legislation as they are existing rights. The Alaska Aerospace Development Corporation is a state agency that has an interagency land management agreement with DNR. Therefore, the corporation has the right to use the land for specific things and the ability to make certain land use decisions on its own within the property, subject to what's specified in the agreement.

[2:48:23 PM](#)

REPRESENTATIVE GUTTENBERG highlighted the fiscal note for \$150,000 over two years, which includes analysis specifying that the existing Kodiak Area Plan for State Lands adopted in 2004 may be sufficient to address the current public land use issues in the area. Therefore, he inquired as to the point of the fiscal note.

MR. MYLIUS pointed out that the legislation requires that the department perform a management plan, and therefore the fiscal note outlines the potential cost. However, the recent completion of the Kodiak Area Plan seems to address most of the immediate issues, and therefore the department doesn't see a burning need to perform a management plan. One option is to delete the requirement for a management plan from the legislation. He noted that the aforementioned wouldn't preclude the department from doing a management plan in the future.

[2:49:53 PM](#)

REPRESENTATIVE WILSON inquired as to the reason section 15 was included as part of the Kodiak Narrow Cape Public Use Area.

MR. MYLIUS responded that he wasn't sure of the reason it was included. He suggested that perhaps it would follow the land encompassed by a grazing lease or the land immediately to the north may not be state land. He offered to check that.

[2:51:01 PM](#)

BILL BURTON, Owner, Kodiak Game Ranch, informed the committee that he [has owned] the Kodiak Game Ranch, which raises buffalo, elk, yak, cattle, and horses, for around 40 years. Hunters and fishermen are taken in on horseback. The property includes a bunkhouse and leases a lodge for the launch facility. He confirmed that the ranch also includes a grass strip for private use. In response to Co-Chair Gatto, Mr. Burton specified that the landing strip is primarily for the Kodiak Game Ranch. Generally, people interested in using the landing strip contact him first since it's a private landing strip. He noted that when he purchased the ranch in 1967, the landing strip was there. There is a state road to the ranch that the ranch maintains. He noted that there are times when the gates are locked due to the location of the elk.

[2:55:27 PM](#)

MR. BURTON suggested that the language "existing grazing rights or leases" be inserted on page 1, line 8, following "perpetuate,". He acknowledged that the aforementioned language is included later in the legislation. These leases will be up for renewal in a few years, and inserting this language would help ranchers and the ranching industry.

[2:57:12 PM](#)

CO-CHAIR GATTO announced that the committee is running out of time today and will hold HB 203.

[2:57:32 PM](#)

REPRESENTATIVE SEATON moved to adopt the proposed committee substitute (CS) for HB 203, Version 25-LS0732\C, Bullock, 3/21/07 as the working document before the committee. There being no objection, Version C was before the committee.

[2:57:48 PM](#)

REPRESENTATIVE SEATON moved to adopt Conceptual Amendment 1, as follows:

Page 2, line 1, following "commissioner":
Delete "shall"
Insert "may"

The sponsor indicated her agreement with Conceptual Amendment 1 by nodding her head.

There being no objection, Conceptual Amendment 1 was adopted.

[HB 203 was held over.]

[2:58:27 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 2:58 p.m.