ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE
November 3, 2007
9:12 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Mike Chenault
Representative Sharon Cissna
Representative Les Gara
Representative Max Gruenberg
Representative Kyle Johansen
Representative Mike Kelly
Representative Beth Kerttula
Representative Kurt Olson
Representative Ralph Samuels

COMMITTEE CALENDAR

HOUSE BILL NO. 2001
"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to the issuance of advisory bulletins and the disclosure of certain information relating to the production tax and the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; amending the State Personnel Act to place in the exempt service certain state oil and gas auditors and their immediate supervisors; establishing an oil and gas tax credit fund and authorizing payment from that fund; providing for retroactive application of certain statutory and regulatory provisions relating to the production tax on oil and gas and

conservation surcharges on oil; making conforming amendments; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB2001
SHORT TITLE: OIL & GAS TAX AMENDMENTS
SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

10/18/07	(H)	READ THE FIRST TIME - REFERRALS
10/18/07	(H)	O&G, RES, FIN
10/19/07	(H)	O&G AT 1:30 PM HOUSE FINANCE 519
10/19/07	(H)	Heard & Held
10/19/07	(H)	MINUTE(O&G)
10/20/07	(H)	O&G AT 12:00 AM HOUSE FINANCE 519
10/20/07	(H)	Heard & Held
10/20/07	(H)	MINUTE(O&G)
10/21/07	(H)	O&G AT 1:00 PM HOUSE FINANCE 519
10/21/07	(H)	Heard & Held
10/21/07	(H)	MINUTE(O&G)
10/22/07	(H)	O&G AT 9:00 AM HOUSE FINANCE 519
10/22/07	(H)	Heard & Held
10/22/07	(H)	MINUTE(O&G)
10/23/07	(H)	O&G AT 9:00 AM HOUSE FINANCE 519
10/23/07	(H)	Heard & Held
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10/24/07	(H)	O&G AT 9:00 AM HOUSE FINANCE 519
10/24/07	(H)	Heard & Held
10/24/07	(H)	MINUTE(O&G)
10/25/07	(H)	O&G AT 10:00 AM HOUSE FINANCE 519
10/25/07	(H)	Heard & Held
10/25/07	(H)	MINUTE(O&G)
10/26/07	(H)	O&G AT 10:00 AM HOUSE FINANCE 519
10/26/07	(H)	Heard & Held
10/26/07	(H)	MINUTE(O&G)
10/27/07	(H)	O&G AT 2:00 PM HOUSE FINANCE 519
10/27/07	(H)	Heard & Held
10/27/07	(H)	MINUTE(O&G)
10/28/07	(H)	O&G AT 2:00 PM HOUSE FINANCE 519
10/28/07	(H)	Moved CSHB2001(O&G) Out of Committee
10/28/07	(H)	MINUTE(O&G)
10/29/07	(H)	O&G RPT CS(O&G) NT 4DP 1NR 2AM
10/29/07	(H)	DP: SAMUELS, NEUMAN, RAMRAS, OLSON
10/29/07	(H)	NR: DOOGAN
10/29/07	(H)	AM: KAWASAKI, DAHLSTROM

10/29/07	(H)	RES AT 1:00 PM HOUSE FINANCE 519
10/29/07	(H)	Heard & Held
10/29/07	(H)	MINUTE(RES)
10/30/07	(H)	RES AT 9:00 AM HOUSE FINANCE 519
10/30/07	(H)	Heard & Held
10/30/07	(H)	MINUTE(RES)
10/30/07	(H)	RES AT 6:30 PM HOUSE FINANCE 519
10/30/07	(H)	Heard & Held
10/30/07	(H)	MINUTE(RES)
10/31/07	(H)	RES AT 9:00 AM HOUSE FINANCE 519
10/31/07	(H)	Heard & Held
10/31/07	(H)	MINUTE(RES)
11/01/07	(H)	RES AT 9:00 AM HOUSE FINANCE 519
11/01/07	(H)	Heard & Held
11/01/07	(H)	MINUTE(RES)
11/02/07	(H)	RES AT 9:00 AM HOUSE FINANCE 519
11/02/07	(H)	Presentations by:
11/03/07	(H)	RES AT 9:00 AM HOUSE FINANCE 519

WITNESS REGISTER

STEVE PORTER, Consultant
for the Legislative Budget and Audit Committee
Alaska State Legislature
Tehachapi, California
POSITION STATEMENT: During hearing of HB 2001, answered questions.

BOB GEORGE
Gaffney, Cline & Associates
Houston, Texas
POSITION STATEMENT: During hearing of HB 2001, answered questions.

MARCIA DAVIS, Deputy Commissioner
Department of Revenue (DOR)
Juneau, Alaska
POSITION STATEMENT: During hearing of HB 2001, answered questions.

MARK HANLEY, Public Affairs Manager, Alaska
Regional Public Affairs
Anadarko Petroleum Corporation
Anchorage, Alaska
POSITION STATEMENT: During hearing of HB 2001, answered questions.

CLAIRE FITZPATRICK, Commercial Senior Vice President
BP Exploration (Alaska) Inc.
(No address provided)
POSITION STATEMENT: During hearing of HB 2001, answered questions.

KEVIN MITCHELL, Vice President
Finance & Administration
ConocoPhillips Alaska, Inc.
(No address provided)
POSITION STATEMENT: During hearing of HB 2001, answered questions.

DAN SECOURS (PH)
ExxonMobil Corporation
(No address provided)
POSITION STATEMENT: During hearing of HB 2001, answered questions.

RICH RUGGIERO
Gaffney, Cline & Associates
Houston, Texas
POSITION STATEMENT: During hearing of HB 2001, answered questions.

BERNARD HAJNY, Manager
Production Tax & Royalty
BP
(No address provided)
POSITION STATEMENT: During hearing of HB 2001, answered questions.

PATRICK GALVIN, Commissioner
Department of Revenue
Juneau, Alaska
POSITION STATEMENT: During hearing of HB 2001, answered questions.

JOHN MESSENGER, Staff
to Representative Kerttula
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: During hearing of HB 2001, provided explanation of Amendment 20.

ACTION NARRATIVE

CO-CHAIR CARL GATTO called the House Resources Standing Committee meeting to order at 9:12:38 AM. Representatives Gatto, Johnson, Fairclough, Roses, Seaton, Wilson, Edgmon, Guttenberg, and Kawasaki were present at the call to order. Also in attendance were Representatives Chenault, Cissna, Gara, Gruenberg, Johansen, Kelly, Kerttula, Olson, and Samuels.

HB2001-OIL & GAS TAX AMENDMENTS

9:14:03 AM

CO-CHAIR GATTO announced that the only order of business would be HOUSE BILL NO. 2001, "An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to the issuance of advisory bulletins and the disclosure of certain information relating to the production tax and the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; amending the State Personnel Act to place in the exempt service certain state oil and gas auditors and their immediate supervisors; establishing an oil and gas tax credit fund and authorizing payment from that fund; providing for retroactive application of certain statutory and regulatory provisions relating to the production tax on oil and gas and conservation surcharges on oil; making conforming amendments; and providing for an effective date." [Before the committee is CSHB 2001(O&G).]

[The committee briefly discussed how it would proceed.]

9:20:26 AM

STEVE PORTER, Consultant for the Legislative Budget and Audit Committee, Alaska State Legislature, remarked that the financial points aren't the only important things to consider. In fact, many of the amendments before the committee today address administrative issues that will have a substantial impact on the daily business of the stakeholders. He mentioned that he is interested in the questions the committee has because issues beyond the financial matters haven't been fleshed out as thoroughly.

9:22:05 AM

REPRESENTATIVE FAIRCLOUGH referred to a presentation given by Gaffney, Cline & Associates, Inc. (GCA) during which there was discussion of the topic of gold plating. There was discussion

about progressivity and a climbing price per barrel market in which the state would be 100 percent responsible for all of the costs a producer would invest into a project. She requested discussion with regard to the state's perspective and whether the producer should have "some skin in the game" or whether 100 percent state contribution is appropriate in a changing, transitioning, basin if the desire is to have smaller explorers enter.

9:23:39 AM

BOB GEORGE, Gaffney, Cline & Associates, reminded members that the chart shown yesterday illustrated the impact of the tax reduction on capital investment at different points on the net margin chart. The chart basically looked at a system that was entirely based on the net margin as well as a system on the net margin for setting the progressivity rate and then applied to the gross value at the point of production. The chart illustrated that the effective capital expenditures on a pure net system has the following two effects: it lowers the progressivity component of the tax rate and it lowers the tax base. The combined effect of these results in a tax break that's greater than the actual rate of tax. Therefore, as one moves up the curve from a base level of 25 percent to a maximum rate of 50 percent, the effect can - by doing nothing else - result in that investment of $1 returning $.80-$.90. On a theoretical basis, it can tip over 100 percent. Furthermore, a tax credit on top of that can push it slightly higher. There are ways to address the aforementioned, such as by placing an absolute tax cap that limits the tax break to some number that he recalled was at 70 percent for illustrative purposes. The aforementioned was the position, in terms of the mathematics, laid out yesterday.

9:25:56 AM

CO-CHAIR GATTO offered an anecdote in which a store had a sale and various other discounts going on that could result in the consumer being paid $5 to purchase an item. The store may tell the consumer that he/she can't stack the discounts, and therefore the consumer would have to chose the type of discount to take. He opined that the aforementioned scenario is similar to yesterday's chart that had a line through it specifying 70 percent. He commented, "That struck me ... that it is possible ... to get more than 100 percent discount, then perhaps that something we should look into."

9:27:24 AM

CO-CHAIR JOHNSON recalled when he consulted retail clients and informed the committee that what Co-Chair Gatto is speaking of is a loss leader. He pointed out that often retailers [offer multiple discounts] in hopes that a consumer will purchase other merchandise on which it makes a larger profit. He opined that Co-Chair Gatto's analogy is appropriate in that on occasion, there may be a loss leader and that stores gamble that once a consumer is in the store, he/she will purchase the high ticket item. "There's a reason retailers do it and there's a reason we should do it," he opined.

9:28:50 AM

MARCIA DAVIS, Deputy Commissioner, Department of Revenue (DOR), concurred with the point that it is a balance when there's a situation in which the state's share of the costs is fairly high. She opined that one must keep in mind that it's only part of the picture as Alaska's fiscal structure is essentially a flat tax in the guise of royalty and the state has property tax and corporate income tax. Therefore, there's a base income stream that comes from the activity. However, it remains important for the legislature to see how the system works. She acknowledged that there can be some level of gold plating, but not significant amounts. Perhaps, the advantage in Alaska is that most large investments will take several years to come about. Ms. Davis said that until gold plating is rampant, there may be other ways in which to control it. As a body, the legislature has been balancing incentivizing investment with obtaining a fair share. Therefore, it must remain somewhere in the middle and be calibrated as it proceeds.

9:31:11 AM

MARK HANLEY, Public Affairs Manager, Alaska, Regional Public Affairs, Anadarko Petroleum Corporation, opined that to the extent that there might be minimal gold plating, "I don't think anybody wants, as a state, to see that you can have more money than it cost to put something in ... that does create an issue." On the other hand, he said he suspected that one would have to look very closely to find that. Furthermore, to get there would mean that the tax rate would be so high that by the time there is production "you're not getting anything." Mr. Hanley expressed an interest in seeing the specific numbers and the example as it's difficult to comment on something that he didn't see.

9:32:50 AM

CO-CHAIR GATTO recalled that it was within a narrow range of oil prices.

9:33:03 AM

MR. GEORGE clarified that the effect he described does occur at high margins, not just high prices. Although the take increases when sitting, there's also a very high margin. However, if there was a situation in which there were high prices with low margins, the take wouldn't be so high.

CO-CHAIR GATTO interjected that price isn't equal to margin.

MR. GEORGE confirmed that to be correct.

MR. HANLEY inquired as to the assumptions of such a scenario. He related his assumption that the example would be one in which the entity has existing production and is making an additional investment.

MR. GEORGE said that the situation reviewed a spectrum. He clarified that an entity with no production at all would receive the tax credit as well as the net operating loss (NOL) credits. The issues being discussed are those situations in which the margins are high and those with the most impact to the margins are those with a small amount of production that is high margin production such that the capital expenditures are a high proportion of the operating margin.

9:35:13 AM

REPRESENTATIVE FAIRCLOUGH opined that companies are investing more than just the production coming through the line and the costs. She requested that someone speak to the credits or investments. She then related her understanding that companies who are investing are obtaining the exploration credits as well as some capital contributions, depending upon the location in relation to an existing well. She inquired as to whether companies are recouping under the escalation example presented yesterday, "there are still expenses that are outside the realm so that company has it's skin in the game."

9:36:32 AM

MS. DAVIS said that in terms of thinking about the credits and the deductions allowed under this revision of the tax system, it's easy for folks to review the numbers. In response to queries regarding whether the state is giving away too much, Ms. Davis says she asks herself whether she would purchase a Cadillac after receiving a $100 gift certificate in the mail for it. She further said that her response is that she wouldn't purchase the Cadillac unless she was intending to do so prior to the receipt of the gift certificate. In regard to the tax system, Ms. Davis stated that gold plating is an area in which the system is broken such that there are so many incentives that have allowed credits to combine that the value of what is being induced is not worth what was given to [induce investment]. To find the balance between a mature field with infill drilling versus bringing in new entrants and explorers, is a real challenge, she opined. Where that line is cut may be different under different circumstances, which is why there is a credit specifically for exploration that is set at a level that's perhaps different than a standard capital credit that would be applied for mature fields. Therefore, each time credits or inducements are given, the state must ask itself whether it's in a position to receive more than what was given. The concern with regard to gold plating is only in instances in which there are inducements for "silly behavior". In terms of the chart and where the state sits with regard to exploration activity, Ms. Davis deferred to Mr. George.

9:39:10 AM

REPRESENTATIVE FAIRCLOUGH pointed out that BP, ExxonMobil Corporation ("ExxonMobil"), and ConocoPhillips Alaska, Inc. ("ConocoPhillips") and explorers such as Anadarko Petroleum Corporation ("Anadarko") and Pioneer have investments throughout the state, some of which produce and others of which don't. In a situation in which a company drills a dry hole, does it recoup its costs under the system related by Mr. George, she asked.

MR. GEORGE stated that under the petroleum production profits tax (PPT)an entity that has no income at all would, qualify for 22.5 percent and 20 percent on the NOLs. He related his understanding that as proposed the aforementioned would increase slightly. The companies would receive 20 or 40 percent investment credits depending on the location of the exploration well. With a 20 percent credit and a 25 percent base rate, they would be operating on a 45 percent tax rebate.

MS. DAVIS pointed out that there is a difference between the state being willing to share the cost in a failure outcome [versus sharing the risk in a successful outcome]. She opined that only sharing the cost in a successful outcome doesn't induce much. Industry, she highlighted, is looking for some mitigation of the risk on the down side. The aforementioned is a completely different concept than gold plating in which the state puts in money for which it may not get anything. "But, what we did get out of it: we induced the behavior to go out, search, and take risks," she said.

9:41:10 AM

REPRESENTATIVE EDGMON asked whether a cap is in order.

MS. DAVIS related that the administration sees that there is an anomaly that occurs in the mid range. It comes down to a balance, in terms of putting together the rates of investment, what the state is trying to induce. The administration's perspective is that it's willing to see what the will of the body is because that balance of encouraging investment versus the state's fair share provides benefits in both directions. The administration hasn't taken a position on advocating a cap at a specific level at this time.

CO-CHAIR JOHNSON posed a situation in which an oil company that comes to Alaska, spends $5 million drilling a well. In such a situation, he surmised that since there's no production and no taxes, the state pays nothing because there's no revenue against which the tax can be charged.

MS. DAVIS confirmed that the oil company wouldn't pay the production tax, but by virtue of the activity if the company invests, it has capital credit certificates that can be sold or the state will purchase back in the following year. Therefore, there's capital. The state's corporate income tax works on an apportionment factor such that if the company also has activities in other locations in the world, the state takes a fraction in terms of how much infrastructure and laborers are in the state. Therefore, a company could have no income and still pay corporate income tax in Alaska, by virtue of the aforementioned activity. However, the administration is still incentivizing companies to stay and take the risk and induce the company to do so by giving the company something even if the worst happens.

CO-CHAIR JOHNSON surmised, then, that once a company enters, the state will make money because there will be a benefit to the state for that tax credit.

MS. DAVIS concurred.

9:44:22 AM

REPRESENTATIVE ROSES offered his understanding that the state gets more than that. He recalled that some of the concerns expressed by the explorers and the producers relates to the vast amount of information the state would receive in the form of core samples, seismic data, and drilling data that it wouldn't have received had the well not been drilled. Therefore, the question is whether the amount of money being given in a credit is equal to what it would cost for another entity to gather the information in another manner. He opined that the answer is yes, otherwise the state wouldn't have developed a plan to provide these credits.

9:45:10 AM

REPRESENTATIVE SEATON continued discussion on the example in which an entity comes into the state with no revenue. He related his understanding that an explorer could qualify for 30 or 40 percent tax credit on its investment for exploration. Any losses, expenses above and beyond revenue, would be converted into net operating loss credits, which can be sold or transferred. Therefore, the expenses an [explorer] incurs come as credits as well as the credits for capital expenses. He indicated that [an explorer entering with no revenue] is in the worst position while those receiving a higher benefit from the state are those that have revenue. Those entities with revenue at a high price and progressivity exists, depending on how progressivity is structured. If it's on the net basis, the company would receive the state proportion of that contribution because they can subtract it from the oil taxes they would've paid. Representative Seaton opined:

> So, if we're at the level of margin where they're paying max, then that's another 25 percent of their costs that are paid by the state in the form of decreased taxes paid from their other operations. So, the explorers ... do not have that benefit .... If you do progressivity on the net ... because they have no progressivity because they don't have any credit from that because they had no revenue. And so, there

> is definitely a difference and ... the explorers are definitely not treated as ... fairly as those with revenue.

9:47:23 AM

REPRESENTATIVE FAIRCLOUGH requested hearing from the producers and explorers regarding their position as to gold plating.

9:47:55 AM

CLAIRE FITZPATRICK, Commercial Senior Vice President, BP Exploration (Alaska) Inc., related that from BP's perspective the concept of the cap has the same effect as the floor. She related her understanding that the over 100 percent concept kicks in when there is a high margin, and therefore there are high prices such that costs aren't necessarily at the point at which one would equate a link to the high price. Therefore, it's a spike scenario. She clarified that she's referring to potentially low production in a theoretical situation in which there are high margins and thus cash is being generated. As pointed out by Ms. Davis, Ms. Fitzpatrick stated that she doesn't make decisions based on a spike price but rather views it over a variety of prices. She emphasized that years of planning [go into these decisions]. Ms. Fitzpatrick opined:

> If there is that scenario, and it's sustained, where you have a period of higher margins. If there's money available to do the investment, is that actually the thing you're trying to stop? By putting a cap in place, that is a scenario in the same way as the floor. And you might, in fact, prevent the investment you might be trying to encourage. But what I'm not sure is I'm aware that it was presented ... very clearly as this was a theoretical position, I have no ideas as to when or how or if that would happen in Alaska. And what is the level of investment that would need to be happening for that to actually occur? And I'm not sure whether that's, in fact, information that might be relevant ... if it's ... in a scenario where prices are staying at $90, $100, $120 costs are staying at a $50 world and there's $60 billion of investment going on. If we're in that scenario, I think we're having a very different conversation.

KEVIN MITCHELL, Vice President, Finance & Administration, ConocoPhillips Alaska, Inc., began by characterizing it as a

theoretical point. He acknowledged that there is a scenario that can lead to very high credits. At the point when there is the potential for the maximum state contribution toward those investments, it's also the point at which the underlying tax the state is collecting is at its highest because it's at the highest margin and the progressivity has peaked out. The aforementioned would be the best of times for everyone. Clearly the industry has the benefit of the high margin and the state has the benefit of the very high rates and the maxed out progressivity. With regard to gold plating, Mr. Mitchell said that he didn't see a scenario within his company in which investment decisions would be made on the basis that there might be a scenario under which the company could recoup more credit than the initial outlay. Within any company, there's a natural tension as the capital budgets are reviewed, debated, and set that will prevent gold plating type activity. "It's not what we do to invest capital because we think we might get additional ... tax credit back," he stated.

9:52:51 AM

REPRESENTATIVE SEATON surmised that Mr. Mitchell is saying that at the high margins, the extra credit or deduction generated isn't the driver of corporate decisions or the sanctioning of a project or proceeding with a project.

MR. MITCHELL concurred.

REPRESENTATIVE FAIRCLOUGH questioned, "On that point, then, why wouldn't we cap it?" She related her understanding from the companies that the [credit] doesn't matter. However, some members think it does matter because "we want to make sure that there are additional holes punched in the ground, and other things happening." Representative Fairclough opined that while it doesn't drive that one particular decision in those high prices, [the state is] trying to [consider the additional jobs, wells, et cetera.]

MR. PORTER commented that he wasn't sure everyone was referring to the same meaning of cap. He clarified that he assumes that what is meant by the term cap is that the benefits are being capped in order not to push the producers and the state over 100 percent. He directed attention to the chart, and pointed out that over 100 percent is reached because of the 20 percent credit. With regard to capping the capital to protect the state in an environment with extremely high cash flow on a per barrel basis, he explained that the aforementioned would likely be

addressed as one approaches taking 25 percent of the production tax and 12.5 percent of the royalty and the percent of the base tax. He opined that in a high environment, the situation could be addressed by reducing the capital expenditures (capex) in the top, in terms of capex credit.

9:56:44 AM

MR. PORTER turned to the notion that the state is taking 100 percent of the risk. He opined that the state is taking a substantial amount of the cash in the beginning, and therefore the companies are placed in a low margin area in which everyone is making a lot of cash. He indicated that the effect of future cash flow is that it will be shared. The aforementioned is merely the production tax world. He reminded the committee that [the state] still receives from the companies corporate income tax, property tax, and royalty. Therefore, he said that the state has a disproportionate portion of the take. The model laid out by Gaffney Cline illustrates that from the net present value (NPV) basis one can observe the relationship. If one were to input the PPT into the model, the balance on a NPV basis is fairly close. Mr. Porter pointed out that [the state] arrives at 100 percent by taking a huge amount of the tax to begin with, which can be prevented by dropping the capex credit in an extremely high environment. He commented that it would be an unusual world.

9:59:08 AM

REPRESENTATIVE FAIRCLOUGH opined that when the state invests Alaskan's money in the form of a credit, the desire is to benefit Alaskans. The aforementioned is achieved by encouraging more production and more oil flowing into the pipeline. She clarified that she wants discussion with regard to comments that it's "a bad thing" to leave the progressivity at a gross at 50 because it doesn't reflect costs and encourage investment. She related that the question is whether the gross floor is appropriate and should be checked later or is the net more nimble and flexible to create an investment that increases production.

10:00:53 AM

DAN SECOURS (PH), ExxonMobil Corporation, offered that in ExxonMobil's view, one must review Alaska's past and what it wants in the future. He said that although gross taxes can work, it as well as the progressivity trigger on gross are

problematic because both don't tax economic reality. He pointed out that in such a situation the costs and investment risks aren't taken into consideration as the hypothetical profit that may or may not be present is being taxed. Therefore, the aforementioned can lead to problems of investment and concerns with regard to "shutting in and not making those investments." From the perspective of a very high tax, which the state already has and is now considering increasing, going on the gross compounds the problem, he opined. As was indicated earlier, companies continue to pay royalty, property, and income taxes. He emphasized the need to [know the] underlying impact on current investment. He suggested that from his perspective, one must question what's in the best long-term interest for Alaska to help stem the decline.

10:03:09 AM

CO-CHAIR GATTO inquired as to what's in the long-term best interest of the state.

10:03:29 AM

MR. PORTER suggested breaking down the tax into impacts to Prudhoe Bay, Kuparuk River Unit, satellite fields, and explorers, especially as it relates to the cap. He reminded the committee that the net tax is on a dollar per barrel basis. For example, if in Prudhoe Bay and Kuparuk River Unit one receives $100 worth of cash flow per barrel, the capital can't even be spent to reach the point of 100 percent because the actual total capital that would have to be spent far exceeds the capabilities. The only way to reach 100 percent is if a field reaches the end of its useful life. There are some things that might occur on a marginal basis that could maybe create a situation in which capital spending exceeds the relationship on a per barrel basis. Mr. Porter opined that it's possible to reach the disproportionate relationship and perhaps in the small world that's desirable in the short term because it will be paid for since the state would give the company the capital benefit on the front-end while the state will pickup the tax on the backend. The value to the state in terms of jobs and revenue, "roughly works in that environment," he opined.

10:05:34 AM

MR. HANLEY indicated that Anadarko fits the scenario of a small producer. He said that if Anadarko is successful in a large field in which it's the operator, the taxes could be reduced to

zero from Alpine. If Anadarko were the operator of another multi-billion development to bring another Alpine field online, the credits in a normal world environment would likely result in Anadarko not paying taxes, he explained. However, the company can't reduce the tax below zero and a 12.5 percent royalty would still be paid and thus the state would continue to receive money from that as well as some property taxes. Mr. Hanley opined that the aforementioned is what he believes the state wants for a very short term, in terms of NPV, because Anadarko would hopefully develop the sites that would result in production. At the time of production there would be a higher tax rate and the credits will have already been used such that the state would receive a much larger net margin. He highlighted the long lead times for development and the cost to develop projects, which is why [Anadarko] has pitched the net profit system in which the state offers help on the front-end, thus allowing a company to afford to pay more on the backend. The aforementioned is exactly what this system does, he pointed out.

10:10:05 AM

REPRESENTATIVE ROSES noted his agreement that a company may reduce its production taxes to zero, but that's the tradeoff the state is making so that the company can bring on more oil to fill the pipe. The aforementioned is exactly why the credits were included. However, he expressed concern with the model being presented as factual as it's a theoretical snapshot in time in a particular scenario. The legislature must review everything on the North Slope in totality.

10:13:46 AM

CO-CHAIR GATTO explained that in the past the term production tax meant that a resource that is irreplaceable is being depleted. "One way or another we have to convert a nonrenewable resource into an renewable resource, and that's why we have a permanent fund," he said. Therefore, whatever production tax the state has must be useful for the purpose of [the permanent fund].

10:15:55 AM

REPRESENTATIVE WILSON, returning to Representative Roses' comments, pointed out that each of the graphs and charts were merely a snapshot in time and weren't complete pictures since they didn't have all the parts of the equation.

10:17:19 AM

REPRESENTATIVE FAIRCLOUGH said she supports the administration's efforts to obtain information regarding costs that are real and the ability for auditors to review those. However, she said she is uncertain regarding how that information will be kept confidential, although she noted that there has been mention of regulations. Therefore, she inquired as to how the administration will ensure the aforementioned. She requested discussion regarding the six-year audit, the transparency of the information, and confidentiality between the exchange of information.

10:19:03 AM

MS. DAVIS relayed that the problem with regulations are that they are intended to be a control by the state of third parties. Essentially, the protocols and rules adopted within the agency will manage the information, as is the case now. The department will manage where the information is located, how it's locked up, how the department maintains complete awareness of who looks at it and when, and ensure that whomever that information is shared with maintains the same degree of control and procedures as the department. She maintained that the department takes this seriously and would seek assurance that the department's controls are imposed wherever the information goes.

REPRESENTATIVE FAIRCLOUGH maintained that she is still uncertain that confidentiality can be maintained, and referred to a recent incident wherein it wasn't. She expressed interest in obtaining [documentation] "to hold this administration's feet to the fire in regards to information that ... will be new to the department in a sharing manner." Representative Fairclough emphasized that those working for the state are extremely dedicated and trying to do the right thing. She commented that she has confidence that they can do the right thing, but she expressed interest in seeing a chain of custody with regard to information that will pass from one department to another.

MS. DAVIS offered to provide written information regarding the state's protocols with regard to confidential taxpayer information and the initial impressions as to how the department contemplates managing the additional information received due to HB 2001. She noted that the initial impressions would have to evolve and improve.

REPRESENTATIVE FAIRCLOUGH stated that she supports the administration's need for the information and need to exchange it. However, she expressed the need to have this point addressed before the legislation reaches the House floor.

MS. DAVIS informed the committee that the administration has been advised of concern regarding prior instances of disclosure of confidential information by one of the producers. The details of those instances have been requested in order to improve protocols.

10:23:56 AM

REPRESENTATIVE FAIRCLOUGH expressed the need to have an appropriate penalty for breaches of confidential information.

MS. DAVIS reminded the committee that a breach of confidential information is a felony. However, because it's a felony embodied within DOR's statutes, as opposed to the criminal law statutes, it doesn't bear the designation of a class C. The administration feels the aforementioned penalty is a significant penalty.

CO-CHAIR JOHNSON said that he isn't comfortable with confidentiality rules being in regulation. To that end, he announced that he has an amendment being drafted to address confidentiality in statute. He offered to provide the amendment to the administration in order for it to review it and offer comments.

10:26:33 AM

MR. SECOURS said that ExxonMobil also shares some of Representative Fairclough's concerns with regard to information, statute of limitations, confidentiality, et cetera. With respect to the administration's proposal to extend the statute of limitations to six years, he questioned why it is being changed now. He emphasized that an audit under the PPT hasn't even been started. Part of the foundation of the PPT was to simplify the audit process by, for example, using the joint interest billings. With regard to comments that the joint interest billings is something that companies can game the system on, he assured the committee that isn't the case. He emphasized that ExxonMobil won't pay others any more than it has to; there's no incentive to do so. The joint interest billings are audited over 100 staff weeks every year. For the department to perform its own audits is a waste of the department's

resources as well as a company's. The statute of limitations has worked in the past and companies have generally given extensions when it's necessary. Mr. Secours emphasized that it makes no sense to extend it to six years, and furthermore it places a burden on the companies.

MR. SECOURS turned to information sharing. As was indicated by Mr. Haymes, [ExxonMobil] met with DOR months ago and said it would be willing to share information and would like to help the process. However, there have to be some safeguards. He pointed out that the proposed law includes a provision in which the DOR auditor can ask any explorer or producer every month for any document it deems necessary. He inquired as to how compliance would occur since every month could be different. Mr. Secours noted his agreement with Co-Chair Johnson that the statute should [specify] clear standards with regard compliance. He then turned to the proposed penalties related to compliance. He highlighted the penalty of $1,000 a day for every document or report requested [not received]. For example, what if the department requested 50 items, 48 of which the company [provides] and 2 it believes to be duplicative and covered by one of the 48 items. The company submits the 48 items and relates that it believes the other 2 are covered. After six months, the department reviews the information and says that the 2 aren't covered within the 48. If those two items are five pages, that amounts to $5,000 a day for six months, which sums almost $1 million. He questioned whether that makes sense or is fair. He emphasized that the [proposed law] doesn't provide any closure or guidelines as it will be left to the department's regulations.

MR. SECOURS then addressed [AS 43.55.890], which specifies that the department, regardless of propriety, will disclose tax information so long as it's aggregated with at least three taxpayers. He questioned which three taxpayers will be aggregated. Furthermore, it's not that difficult to distill the information and determine the taxpayers, which raises the question of confidentiality. Mr. Secours questioned why the information is aggregated with only three taxpayers rather than all taxpayers. He indicated that there could be questions as to whether this provision violates federal law. "We can't give information to our competitors, yet if they can discern it from that information the department releases; is that wrong," he asked. He further asked why that information is necessary, pointing out that there are no guarantees.

CO-CHAIR GATTO acknowledged that there are no guarantees, but noted his disagreement that there are no safeguards. He recalled Mr. Iversen's testimony regarding the three-taxpayer scenario whereby the information of ExxonMobil and two of the smallest companies were aggregated, everyone could tell much about ExxonMobil. However, there has been a history of information that hasn't been forthcoming in a reasonable manner. Co-Chair Gatto said he didn't believe that when the department performs an audit that it disregards everything submitted and does its own.

10:33:27 AM

MR. PORTER, referring to taxpayer confidentiality and the possibility of combining any taxpayers, opined that detailed taxpayer information can be extrapolated from that. Every other taxpayer in the state enjoys umbrella protection in which there is a prohibition regarding revealing a specific amount of data that has the potential of revealing individual taxpayer information. The aforementioned should be included in the proposed law.

CO-CHAIR GATTO said he agrees that's a good idea. He acknowledged that there will be breaches and the hope is to minimize them. Furthermore, the hope is that if there is a breach to find those responsible, take care of it, and make up for it. He then recalled that more time is beneficial because limiting the time to the existing three years will result in not receiving information about some issues. He opined that it's not the department's intent to defraud or gain an advantage, rather it's a reasonable request. Therefore, until there is evidence of abuse that will continue, Co-Chair Gatto surmised that he will likely remain in favor of the extension.

MR. PORTER recalled his time in a position that received reports regarding whether companies were current with tax evaluations and audits. The three-year timeframe provides a balance such that the agency ensures it has enough staff to perform the audits timely. Moving that to six years, extends the amount of time auditors have to get to [the audits]. He indicated that an extension of the statute of limitations will delay the process. With the three-year timeframe, there is a polite negotiation between the industry and the department in which the department requests an extension and everyone voluntarily agrees to do so. If the industry isn't amenable to an extension, the agency will protect itself and assign a high audit number. He opined that everyone understands that there is a benefit to extending some

of these deadlines. Mr. Porter said that one of the main reasons he likes the three years over an extension to six years is because it maintains the pressure on the agency to perform the audits in a timely fashion.

10:39:31 AM

REPRESENTATIVE FAIRCLOUGH said that she understands the administration's position on the matter of the proposed six-year extension. She then noted her agreement that there is a timeframe in which there is a pressure point that encourages the work be completed.

10:40:45 AM

RICH RUGGIERO, Gaffney, Cline & Associates, reminded the committee at a [House Special Committee on Oil and Gas meeting Gaffney, Cline & Associates] presented a document regarding data submission. That document identified that the type of information DOR is trying to obtain is provided regardless of the U.S. Securities Exchange Commission (SEC) and anti-trust concerns. He specified that the information is being provided in other venues by the very companies that have spoken today because they are required to do so. He noted that he has suggested that if there was more time, the legislation shouldn't be written to provide the information to DOR because the oil companies will say that all information given to DOR is taxpayer information. The aforementioned will be problematic, he opined. He then informed the committee that forecast data isn't taxpayer information, although it comes from a taxpayer. The type of data being requested normally goes to energy ministries or other commercial entities established to help manage and steward a country's resources. Therefore, he suggested that members be cognizant of what is truly taxpayer, tax return, information versus information that has to come from a taxpayer.

10:42:40 AM

MR. SECOURS clarified, "I don't disagree with what he just said, in some respects." He confirmed that the information DOR is requesting from tax returns is being given. However, the concern is in regard to publication of that information, which under the new law is allowed. The concern, he reiterated, is that it wouldn't be difficult to take apart aggregated taxpayer information and determine who is who. He reiterated the earlier question as to why the information is aggregated only between

three taxpayers. The taxpayer protected information needs to be protected.

10:43:58 AM

MS. DAVIS pointed out that the language refers to aggregating the information with no fewer than three taxpayers. She acknowledged that notwithstanding any statute passed by the legislature, the provision is governed by the constitutional laws regarding privacy. Additionally, there are federal laws that would preempt state law, such as those addressing trademarks. Ms. Davis noted her agreement with Mr. Porter's comment that the existing language [should include] a proviso that the information can't be deconstructed. The administration doesn't intend to put out information that's readily "deconstructable" as it understands the other legal constraints in play.

10:45:21 AM

REPRESENTATIVE WILSON asked whether Mr. Secours really believes the department will aggregate information from a large company with two smaller companies.

MR. SECOURS stated that he doesn't know what the intent is, only what the proposed statute says. The concern is that some of the information may already be published by other companies in other venues. Again, he opined that it won't be difficult to deconstruct the information. Furthermore, this information includes contract information, sales price data, which is data that the company can't disclose. He reiterated that he doesn't know what the department will do nor the necessity for this provision. He reiterated his earlier question as to why aggregating taxpayer information from three taxpayers was chosen versus aggregating all taxpayer information.

10:47:52 AM

MS. DAVIS, in response to Representative Wilson, clarified that the department's intention with this provision is to ensure the Alaska public can see how the money is flowing. The intent was to be able to aggregate information so as to ensure that the incentives the state is giving to explorers are working as intended, that the incentives being given to mature fields are or aren't encouraging reinvestment, and illustrate how it's impacting the decline. The aggregation is to look at units without targeting in an attempt to display something about a

taxpayer. This is about classes of development to ensure Alaskans that the balance struck by the legislature is working and if not, there's the opportunity to ask questions of the legislature.

10:50:51 AM

MR. PORTER opined that it's important to review the current law in the context of the proposed law. The current law allows DOR to publish any statistical information so long as individual taxpayer information isn't revealed. Therefore, he questioned why it would be necessary to combine and reveal the tax information of three taxpayers unless the intent is to reveal individual taxpayer information, which he didn't believe to be the intent. Mr. Porter said that the aforementioned can already be done so long as individual taxpayer information isn't revealed. The provision isn't necessary because the standard umbrella covers it.

MS. DAVIS specified that one of the reasons the administration wanted to set it out specifically is that the current law regarding statistical information is fairly oblique. Historically, statistical information has been "rolled up", that is in gross production and gross taxes paid. As the department has asked for information that it hasn't requested in such detail in the past, the companies are shocked. Ms. Davis likened the situation to growing pains. For instance, there have been challenges against providing information due to SEC concerns or that the state, since it markets its royalty oil, could be a competitor. Hopefully, that can be worked out. Since there has been resistance, the legislation was made very explicit in mandating the types of information required on an annual basis and on a monthly basis. Ms. Davis emphasized that [the administration] wants to make it clear to the Alaskan public that the information will be more detailed than what was received historically. Furthermore, this explicit statement in the legislation is necessary for staff.

10:56:28 AM

CO-CHAIR JOHNSON inquired as to why not obtain the information from all [the companies] and provide it to the public so that it can't be extrapolated out for individual companies.

MS. DAVIS related that some of the newer countries are opening up this information from the beginning. The challenge for Alaska is that the state can't change the U.S. Constitution and

trademark laws, and therefore there will be constraints with regard to what can be shared.

CO-CHAIR JOHNSON specified that he is inquiring as to why the state doesn't aggregate [all the companies] completely.

MS. DAVIS said that the challenge is that the incentives are different for explorers versus mature fields. Furthermore, they're different on the North Slope versus the Cook Inlet. Once the information [from the various situations] is rolled together, it's relatively meaningless statistics.

REPRESENTATIVE SEATON returned to the matter of the statute of limitations. He related his understanding that industry wants the state to maintain that the basis for audits will be the audited joint billing statements. Therefore, he inquired as to how soon after [DOR] receives the joint billing statements are they audited and available to the state. He further inquired as to whether additional time is included in the auditing process if the industry wants to use the joint billing statements as the basis for starting state audits.

10:59:52 AM

MR. SECOURS said he isn't certain what timeline that would be. He informed the committee that the joint interest billings are audited as soon as they are received. If there is a situation in which there is a time lag and there are adjustments, those adjustments would be to decrease costs. Therefore, any adjustment would flow through to the return through an amended return or through the current period, depending upon how it's structured. Mr. Secours acknowledged the concern of the state, but emphasized that these [joint interest billings] are the only costs that a non-operator see. Therefore, it doesn't make sense for the state to not review those at the beginning because those are the charges the parties have agreed to pay. Mr. Secours opined that it doesn't make sense for the state to completely ignore [these joint interest billings], although CSHB 2001(O&G) basically does just that. The legislation deletes AS [43.55].165(c)(d). Although those provisions aren't mandatory, it provides the department the option to review joint interest billings. He questioned what it [means] when the legislature takes away the specific authority to use joint interest billings.

11:01:45 AM

REPRESENTATIVE SEATON inquired as to how soon after the initial filing to the state in March are the audited joint billing statements available.

11:03:28 AM

BERNARD HAJNY, Manager, Production Tax & Royalty, BP, stated that BP's perspective regarding the proposed audit extension provision is similar to that of Mr. Secours. With regard to joint interest billing audits, he related his understanding that those joint billing audits begin almost immediately after the cycle ends. He noted his agreement with Mr. Secours in that the idea is that as those [audits] occur, post true up revisions would be filed. He explained that BP filed its return on March 31, 2007, and at that time the company is relying on many of the partnership returns from Prudhoe Bay and Kuparuk. At that time those partnership returns aren't necessarily completed as they aren't filed until September or October of this year. Therefore, BP files on the basis of a draft tax trial balance and those will be reviewed again and the company will re-file its tax return for 2006 in the near term. Within that return, interest will be included if it's a deduction that shouldn't have been taken or there was a change in capital to operating expense. To the extent that same thing occurs within a joint interest audit, that will also be re-filed because there is no desire to allow interest to continue to accrue on something that might be found in an audit.

MR. HAJNY returned to the proposal to extend three to six years. He explained that currently for the production tax there is a three-year period to audit. In some of the other tax and royalty areas there is a six-year provision. Traditionally, DOR has been very good regarding keeping the audits up to date. To the extent DOR isn't able to do so, the department requests an extension that BP has traditionally given. In areas where there is a six-year provision, the historic experience is that "we're six and seven years back." With regard to aggregation of information that will be published, Mr. Hajny said that BP has the same concerns as Mr. Secours, specifically in regard to the publication of the information. Although it may not be the intent to determine which taxpayer's information it is, there have been situations in which people have been able to glean that it's BP's information. Additionally, information could be published from which one could determine what information is about Prudhoe Bay versus Kuparuk and the specific economic standpoint within each unit.

11:09:00 AM

MR. HAJNY, in response to Co-Chair Gatto, said that he would hope that the Tax Division tries to put themselves in the shoes of a company prior to publishing information. He said that in working with most of the staff within DOR, he believes that they try to think it through before publishing information.

REPRESENTATIVE GUTTENBERG said that he hopes that in 30 years people will look back and say this is the point at which the state placed itself in a competitive relationship with the industry. He mentioned that many of the consultants that have been present recently have been amazed with regard to how little information the state has regarding the behavior of the oil patch. He then pointed out that there are many records from which the public and industry can glean information that helps them understand a competitor. In order for the [legislature] to do the best job it can for the state, it must understand the behavior of the industry. He said that of course, he expects for there to be pushback from the industry.

11:11:43 AM

REPRESENTATIVE ROSES offered his understanding that Ms. Davis has said that in order to aggregate this information, the different sections must be separated in order to analyze. He expressed hope that the administration isn't picking one region to determine if what is being done today is the right model.

MS. DAVIS noted her agreement that one can't pick only one sector to determine whether the plan is a failure or success. She highlighted that when the goal is to incentivize exploration, it's about the rocks. Therefore, despite the best intentions and efforts to incentive exploration, the results hoped for may not occur, which is simply the reality, she opined. Clearly, the entire package must be reviewed to judge overall success and acknowledge that any element may fail simply due to bad rocks.

REPRESENTATIVE ROSES emphasized the need to view this proposal in its totality rather than merely a snapshot at one time and price.

11:14:17 AM

MS. DAVIS, noting that she is mindful of the value of the unit accounting processes and how rigorously ExxonMobil would review

its operator billings, inquired as to the length of time that ExxonMobil would have to challenge the audited items in a unit process.

MR. HAJNY said that he wasn't sure whether there is specific time or limit in which those can be challenged.

MS. DAVIS related her understanding that the length of time is six years, which was a driving factor for the administration. She then reviewed the timeline in which there is a March filing with the state and then once the federal filing is complete, say in November or December, an updated or restated state filing is necessary. The aforementioned is approximately 9-10 months past when the state's statute would begin to run in March. The concern is that if there are remaining issues that an operator has to deal with from owners, those can potentially be debated for six years. Therefore, the state would still be waiting for finalized or revised information. There is a level of uncertainty at the unit level with the debate among owners that affect what the filing is for the state. She then highlighted that when the state requests an extension of the statute of limitations, the company has the legal right to refuse to do so. Therefore, to the extent the state can't count on receiving an extension, the state has to perform a "blue sky audit." She said that she doesn't like to be in the position of performing a blue sky audit because it forces the state into an aggressive hostile mode in which it has to over reach and challenge the company with something from which it has to chisel back. Ms. Davis said, "While I appreciate the desire to put the hammer on the department to say, 'Here's your three years ... make or break.' I also have heard ... this body say, 'For gosh sakes don't come to us and ask us for any more help in hiring auditors.'" Furthermore, there is also the complaint that government is too large with the request for double the amount of auditors.

11:18:26 AM

MR. RUGGIERO said he is surprised that the company representatives don't know the terms of the joint operating agreement (JOA) as it specifies the length of time a non-operator would have to challenge the actions of the operator. The JOA would also specify the date by which the operator has to supply and/or respond to requests or inquiries.

REPRESENTATIVE FAIRCLOUGH asked whether the other regimes publicize information [similar to what ACES requests] to the general public.

MR. RUGGIERO informed the committee that the previous committee was provided with a memorandum that reviewed a number of other countries, with extensive detail provided mainly for the European countries, which are very democratic-like in terms of operations. Although Mr. Ruggiero agreed that price data shouldn't be discussed, he questioned why production is considered confidential taxpayer information. He then inquired as to where the confidential nature of the capex and the operating expenditures (opex) are when it's aggregated since the state is participating through the deductions and tax breaks. He indicated that the capex and opex can be obtained in many other countries. Mr. Ruggiero highlighted that the country of East Timor has signed the World Bank's transparency initiative. If that were adopted in Alaska, the lease agreements and all of its terms would be made public. Furthermore, sales agreements, except for pricing information, would be made public as would returns and total tax paid by individual. The World Bank is really pushing such transparency initiatives, he remarked. Mr. Ruggiero said that he remains aghast at the lack of data in Alaska. He characterized the comments [from company representatives] today to be a lot of rhetoric on the principle taxpayer information. However, no one wants to have the tax form made public. He suggested the need to review the information being required and then make the call regarding what is truly taxpayer information that should remain confidential and what is merely operating information that is provided elsewhere around the world.

11:22:42 AM

REPRESENTATIVE FAIRCLOUGH clarified that she merely wants to know whether the information Alaska is requesting is published in a similar manner as in other regimes.

MR. RUGGIERO replied yes.

MR. HAJNY, referring to the statute of limitations, pointed out that when a re-filing occurs, the statute of limitations is reset. To the extent that's necessary, then the department would have additional time.

CO-CHAIR GATTO said he understood that the clock is reset when an amended return is filed. However, he said he wasn't sure it

was reset when there is merely a number change of something that is insignificant.

MR. HAJNY read the following portion of AS 43.05.260:

> Sec. 43.05.260. Limitation on assessment.
> (a) Except as provided in (c) of this section and AS 43.20.200(b), the amount of a tax imposed by this title must be assessed within three years after the return was filed, whether or not a return was filed on or after the date prescribed by law.

MR. HAJNY related that he would interpret the aforementioned to include amended returns.

11:25:23 AM

CO-CHAIR JOHNSON offered his belief that the legislature is present because there was a revenue shortfall, which he attributed to expenses. He asked from where did those expenses come. If those expenses are due to too many Alaskans being hired, or too many wells being drilled, or too much capital being invested, he said he may question why the legislature is in session. He asked if this is a situation in which the state shouldn't spend or develop any more or hire any more Alaskans because the state will simply raise taxes if there continues to be a revenue shortfall. He requested that the administration comment on the aforementioned. He then asked [oil industry representatives] to comment on what such a situation means in terms of investment [in Alaska's oil].

11:28:28 AM

MS. DAVIS offered that Co-Chair Johnson's question highlights how critical it is for DOR to obtain the information it is requesting. She pointed out that a revenue shortfall doesn't occur unless the forecast is wrong. Therefore, the better information and cooperation from the industry, the more accurate the department's updates are. In terms of whether that would change the behavior of the companies, testimony from the companies have related that investments are reviewed in terms of the NPV and an investment choice is made with a long lead time. Therefore, whether the state experiences a revenue shortfall probably won't change the behavior of the companies, she opined. In further response to Co-Chair Johnson, Ms. Davis said the department's ability to specify from where the shortfall came will depend on the department's ability to review the PPT

expenses as well as the companies' records for opex and capex. She noted that the department is taking some measures to perform some spot audits on PPT and two large operators have been cooperative on that matter. She emphasized that the department has limited resources, in terms of auditors, to get at the answer to why there was a revenue shortfall.

CO-CHAIR JOHNSON said he knows the department doesn't have the information. He questioned why the administration is proposing fixing a system that may or may not be broken. Furthermore, if it is broken, there's no knowledge as to why.

11:32:22 AM

MS. DAVIS pointed out that the department has as much information as it did when this body met to debate PPT. In fact, it has more information this time. The governor wanted to have this special session, if for nothing else, to restore the public trust, even if that means the legislature says that the right thing is already in place. In response to why the legislature is here today, Ms. Davis relayed that the governor felt it was important for the public to see the legislature either reaffirm the PPT [or make changes to it].

11:33:55 AM

CO-CHAIR GATTO pointed out that the state is dealing with all the companies and a small staff and needs specific information that companies may or may not want to reveal. In order for the state to determine why there was a revenue shortfall, DOR must obtain audited information, he opined.

11:36:30 AM

CO-CHAIR JOHNSON suggested that Co-Chair Gatto made his point, that the legislature doesn't have the information to make these decisions. He related his understanding that the revenue shortfalls were based on expenses, which are jobs. He opined that last year the legislature knew there would be problems, which is why they included the 2011 revisit of the PPT. Co-Chair Johnson stressed that he wants more information before he tweaks the tax rate. He further stressed that if a dollar is taken from someone, it's a dollar that he/she can't invest. There are two ways to generate revenue: taxes and the economy, he opined. He remarked that he's not willing to gamble his children's future based on snapshots. He reiterated his earlier statement regarding the need for more information.

11:39:18 AM

REPRESENTATIVE GUTTENBERG surmised that if the state was a company that just negotiated a deal and suddenly its corporate officers were sent to jail and the stocks plummeted, the shareholders would come calling and suggest reviewing the deal. He acknowledged that the numbers can be read in various ways. He then said that the state is at a disadvantage from the corporate world because of transparency. He commented that the state as a sovereign needs to be able to do the business of the state. Representative Guttenberg predicted that whatever tax policy is adopted, the legislature will be back next year tweaking it.

11:43:03 AM

REPRESENTATIVE WILSON recalled a comment that the goal last year with the PPT was to raise so much money. However, she stressed that wasn't her goal. She opined that the PPT was developed to ensure that Alaska received its fair share of oil revenues as the price of oil rises. Although there may not be any proof at this point that anything is broken, the state has the responsibility to review the tax.

REPRESENTATIVE ROSES, referring to Representative Guttenberg's example of the state as a corporation, pointed out that the state is the only entity that's able to renegotiate a contract that it has already negotiated. That places the producers at a disadvantage. Furthermore, this isn't a renegotiation but rather is imposed on the producers.

11:48:09 AM

MR. RUGGIERO pointed out that the state doesn't have all the information. Many have spoken about models, which is how this industry evaluates its business. Furthermore, there has been much use of snapshots, which is all DOR can do since it doesn't have information. With regard to hypothetical situations, Mr. Ruggiero clarified that the model being used is not hypothetical and is based on the data [the oil industry] provided to the state. Moreover, the model isn't a snapshot and is a full cash flow model that runs a full 11 or 12 years. The model, he emphasized, contains all the pieces of the tax and is very nearly the type of model [the oil companies] would have. The only shortcoming on that model is that it's limited to the infill drilling or the drilling enhancement within the legacy

fields. The state then [under the model] begins to have the perfect knowledge and real information. Now, the legislature must do something with the information that's been presented to it. Mr. Ruggiero suggested that as the committee deliberates, it should think of placing the state in the position of being able to negotiate when necessary or legislate when necessary and doing so from a position of knowledge.

11:51:51 AM

REPRESENTATIVE EDGMON surmised that with ACES the state is looking at incremental change not wholesale change as perhaps has occurred during a complete change in political regime that lead to a tripling of the tax. He requested that Mr. Ruggiero provide the global perspective to the situation.

MR. RUGGIERO acknowledged that there has been much discussion regarding benchmarking, which is a snapshot of where Alaska is compared to other countries. He noted that when one compares Alaska to other regimes, it can't be done by merely picking a single item in a fiscal package. Overall, on a marginal take basis, Alaska is below the world average. Although Alaska is more expensive, Alaska has the rock. Drawing from his negotiation skills, Mr. Ruggiero related that if the state goes into negotiations only understanding the state's position and what the state needs, the state may achieve it fairly quickly and walk away happy. However, to be fair to Alaskans, the position of all parties must be known as well. The aforementioned is what this session is addressing. He recalled that the last session on this issue was one in which what the state needed was addressed without really reviewing the needs of the companies. Therefore, this session the legislature is faced with making the decision as to what is a fair share to the state as well as the companies. Mr. Ruggiero noted that much is changing outside of Alaska's control, such as the federal government recently announcing increased royalties in the Gulf of Mexico. He then remarked that the high take only comes when [the oil companies] are making lots. He emphasized that $100 margin per barrel, after opex, capex, shipping costs, et cetera is a significantly large number and it's prudent, he opined, for the legislature to increase progressivity to take more at the higher margin.

11:56:56 AM

REPRESENTATIVE EDGMON asked if what this proposal proposes is more drastic than what occurred in Alberta.

MR. RUGGIERO said, "That becomes a tough one because if I increase something from 7 to 14, it's 100 percent increase. If I increase something from 68 to 69 percent, ... it's only a 3.2 percent increase."

11:57:37 AM

CO-CHAIR JOHNSON posed a scenario in which an entity wants to buy an [oil] company such as BP and Gaffney, Cline and Associates, Inc. is hired to consult. Will the model being presented today by GCA be utilized in the aforementioned scenario, he asked.

MR. RUGGIERO answered that a much more extensive model would be used than what legislature began with because when buying a company one must review the totality of the company's assets.

CO-CHAIR JOHNSON specified that in his scenario the entity is buying the North Slope assets, and again asked if Mr. Ruggiero would use the same model as presented today.

MR. RUGGIERO specified that he wouldn't use that model for such a purchase because it isn't a model of the North Slope assets. The model being used is a model of the infill drilling program, an incremental model on top of the base. The aforementioned is important, he opined, because the Alaska Oil and Gas Association (AOGA), which said it has 100 percent consensus of all the companies, has said that 70 percent of the near-term and medium-term future of Alaska is in the infill drilling program. He clarified that he understood AOGA to say that 70 percent of the future was additional oil coming out of the legacy fields.

MS. FITZPATRICK said that she said that 70 percent of the Department of Natural Resources' (DNR) production profile for the next 20 years will come from Prudhoe Bay and Kuparuk. Ms. Fitzpatrick emphasized that she didn't say that it would be from "infield" drilling. That "infield" model does illustrate the investment decisions BP made in the world of $20 [per barrel of oil], which are still producing at $80 [per barrel of oil] and are making more money for both the company and the state.

CO-CHAIR GATTO pointed out that Mr. Ruggiero was referring to a statement made by AOGA, which provided the committee with a booklet that the companies certified, authorized, and endorsed.

MS. FITZPATRICK said that she would review AOGA's testimony. She then opined that the model is based off a slide that was presented in BP's presentation. Ms. Fitzpatrick said, "I think Mr. Ruggiero ... is correctly making sure that people understand it is one portion, it is not what is 70 percent of the future."

12:02:18 PM

The committee took an at-ease from 12:02 p.m. to 12:28 p.m.

12:28:22 PM

MS. DAVIS clarified that she didn't want the public to have a misimpression regarding the operating agreements, the complexity around the accounting provisions, and the details. Each unit has it's own set of rules and thus vary and differ from field to field. The administration, she related, doesn't believe that any [of the companies present] would know something and not present it. She related her understanding that the operators will provide a very clear statement unit-by-unit in regard to the time period for audits.

12:30:10 PM

MR. MITCHELL, referring to the audit timing, offered his understanding that Prudhoe Bay is a three-year window and Kuparuk and Colville River are two-year windows. Historically, to the extent that there are outstanding items from the joint interest audits, DOR can also hold open [the audits] for those areas. With regard to the topic of statute of limitations, the primary concern of the industry is in regard to allowing for extra time as it's taken. For example, typically audits are completed in year three of the three-year window. He stated that it's to everyone's benefit for the audits to be completed in as timely a fashion as possible.

MR. SECOURS pointed out that there can be extensions after the six years. He then related his belief that due to human nature if six years is the timeframe, that's likely how long it will take. With regard to the comments that the oil industry isn't providing information to the department, he questioned what information isn't being provided because already the companies are providing their tax returns, which include all the costs, deductible costs, capex, and opex. "We've always said we would be willing to help them understand and forecast. So, if they're looking for forward-looking data, absolutely, as long as they're safeguards and reasonableness to it, we'd all be willing to give

it to them," he said. Mr. Secours clarified, "We give them everything they've asked for."

CO-CHAIR GATTO remarked that it must take an enormous amount of time to audit a tax return from an oil company. Still, the state would need to acquire information for forecasts. Whatever data is needed for a forecast is unknown because it's impossible to accurately forecast. Therefore, it's hard to get enough information for forecasting.

12:33:43 PM

MS. DAVIS informed the committee that the department was unsuccessful in obtaining forecast information it sought from the key players. She said she understood that the individuals with the information have a duty and obligation to the owners they represent, and therefore have a legal obligation to not release that information unless it's legally required to do so. Therefore, by setting a legal standard requiring that information be provided to the state within certain boundaries, it provides license for the individuals holding the information to share it and do so without violating their duties or obligations to their owners.

MS. DAVIS, in response to Co-Chair Johnson, clarified that it's incorrect to say that the department can obtain all the information it needs from filed tax returns. Although the department may be able to determine a rough break between opex and capex, the department has to derive certain understandings from federal returns. She pointed out that the department doesn't have uniformly all the federal returns filed that have other detailed break outs on opex. Of the expenses the department sees, the information doesn't provide any knowledge as to how much of the expenses are jobs, drilling, or increases in the price of goods.

12:36:33 PM

CO-CHAIR JOHNSON asked whether what is being proposed via the legislation will provide the department with the information it needs.

MS. DAVIS related her belief that this legislation will give the department the ability to dissect and understand the costs, and thus would be able to provide the legislature with the information it needs to make decisions. However, she provided

one caveat in that the department is currently information poor and doesn't know what it doesn't know.

CO-CHAIR JOHNSON indicated that he wants to ensure the administration acquires the information it needs and doesn't have to come back to the legislature. He suggested that the department could meet with industry representatives to determine what information is needed as that's the type of partnership he would like to develop.

REPRESENTATIVE ROSES expressed concern with the language "or any other data that we deem important." He inquired as to the meaning of what is important.

[Following was a brief discussion regarding how the committee would proceed.]

12:50:21 PM

MR. PORTER inquired as to what makes the most sense, from a modeling standpoint, in regard to the relationship between the best base tax and progressivity tax. Often the question is can the industry stand an increased tax. However, he opined that in his world the question is regarding what is the relationship that makes the most effective investment climate for both existing fields, puddles, exploration, and heavy oil. He said that he sees the relationship between the base tax and the progressivity such that there can be a lower stable base tax and a higher progressivity.

MR. RUGGIERO recalled a prior meeting in which he presented five goals. He explained that when GCA helps a country or entity it listens to that entity and realizes the challenges that will arise. Mr. Ruggiero related that the goal [of the legislature] was that when prices are such that the margin is very high, then the desire is to have a high tax rate. At the same time, the state has to recognize that the very units that might produce those high margins also are the units that have a lot of upside potential. Therefore, the secondary goal of designing a system that provides the right incentive for those investments comes into play. The third [goal] relates to new investors in relation to the combination of the credits that can be obtained for operating losses and for investment. The fact that in Alaska those with no revenue stream can right those off via paper and turn that into dollars from the state makes Alaska one of the best places to do that. That could be made better by taking the base rate to zero for very little margin and continue

to offer the credits. However, he opined that what's being discussed strikes a good balance between base rate incentives and the ability to cash in on those. He noted that what's being proposed to the various committees is predominantly meeting all three key goals.

12:54:47 PM

REPRESENTATIVE ROSES, referring to the original legislation, reminded everyone that there was a base rate of 25 percent with a progressivity factor. He recalled that during several of the presentations he heard several of the experts expressing the need to craft a model by which the state obtains a larger portion when the margin is higher and lower it when there is greater risk and less profitability. Therefore, he questioned whether the aforementioned would be accomplished if the base rate was lowered or stayed the same and progressivity kicked in earlier but at a smaller rate that ratcheted up at varying levels. He then inquired as to the overall relational affect.

MR. RUGGIERO agreed that for those with projects that will only exist at the low end of the net margin curve, lowering numbers on the low end makes those projects look more attractive.

REPRESENTATIVE ROSES asked whether incremental increases to a net progressivity piece would result in arrival at that 25 percent cap at a faster rate than if it was a steady factor.

MR. RUGGIERO said that if the steady factor is equal to or less than the starting rate under the four different ratcheted levels, one would arrive at the end point sooner. However, if the initial progressivity rate was significantly above the first, second, or third rate change, then the higher straight-line progressivity would likely arrive [at the end point] sooner. He opined, "So, it depends on what the one fixed rate that you're comparing to in the relation to the numbers you've got into the one where you've got, say, four changes to the progressivity."

12:58:30 PM

REPRESENTATIVE ROSES surmised then that the faster the rate arrives at the maximum level of 25 percent in the legislation means that there is less profitability for the producers. However, it also ensures that as prices rise, the producers know that they have capped out on the amount they have to contribute. He asked if that would change the attitude or the dynamic by

which an entity would make decisions regarding whether to invest or not.

MR. PORTER indicated that it's a matter of how much cash flow the state will give before it takes the progressivity as well as the slope of the line. He confirmed that if the slope is pushed up quicker, it will take more money out of the oil industry's pocket than under the current law. However, pushing it back, even at a higher sloped line, the NPV [of the oil companies] may not be impacted as much. The key issues of progressivity are in regard to where to start the trigger, the types of slopes, which allows a delay in the front-end impact more and increases the slope toward the end. Determining the desired start point and the upper point at which the state will start to share [to 50-50] provides the ability to create the slope.

1:01:02 PM

REPRESENTATIVE ROSES then turned to the cap on the credits. Representative Roses said that the steeper the line, the steeper the slope and the much greater the oil industry's required investment must be to capitalize against the credits in order to move them incrementally down the slope. "In other words, when you make those incremental increases, it greatly enhances the amount of investment they would have to make in order to slide back down that slope to a lesser tax level; is that not correct," he asked.

MR. RUGGIERO said that he would have to work through the model to be sure. However, he related his belief that the conclusion is actually opposite of the scenario Representative Roses proffered. The steeper the progressivity curve means that for a small change in margin one would go from a very high production tax to a very lower production tax. Therefore, it wouldn't take much investment to make a significant change in the taxable cash flow as well as a significant change in the progressivity factor. The oil industry will receive maximum impact for not that large of an investment relative to cash flow. It's actually on the shallower part of the progressivity curve that the ability to make any major movement to change the rate of tax paid would have to be a significant change in the margin per barrel. Therefore, a significant investment, an estimated 20-30 percent of cash flow, would have to be reinvested on the low part [of the progressivity curve] in order to obtain the same change on the steep part.

1:03:45 PM

CO-CHAIR JOHNSON offered his understanding that in the year 2000, GCA had a contract with Australia for a liquefied natural gas (LNG) project in which GCA suggested that taxes might need to be lowered in order to ensure that the project was viable. He asked for an explanation of the difference in recommendations between the project in Australia and Alaska's project. He acknowledged that the two projects aren't an apples-to-apples comparison.

MR. RUGGIERO informed the committee that he started working with GCA in 2001, and therefore would have to speak with others regarding the project. However, from his personal experience working on the Trinidad LNG project, he recalled speaking to that government about a fiscal package to help forward the project. He further recalled that he discussed a model not too dissimilar to what is being discussed for Alaska. He explained that as the internal price deck is run, there are estimates on construction costs and an idea of what types of arrangements that have to or can be made with regard to partnerships. Therefore, the entire package of what the future is believed to look like [is reviewed]. At the point when the decision to invest was made in Trinidad, he recalled that it was $1.80 Henry Hub and expecting $2.40 or so in Boston and Spain. In that situation, the NPV and internal rate of return (IRR) were below what the corporate executives needed before making a positive project election. The government of Trinidad was told that if it could see its way through the tax breaks in the first project, it would likely build upon itself and become a catalyst for the country to move forward. At the time, tax considerations were obtained. He noted that as the market and prices got better, there have been several reactions to the multi-year tax holidays. He also noted that the government of Trinidad was brought in as a 10 percent equity partner and thus is receiving its fair share in the upside. That project has expanded greatly and has brought much development and income to Trinidad.

1:09:32 PM

CO-CHAIR JOHNSON surmised then that lower taxes resulted in more projects. He further surmised that raising taxes potentially stops projects. Co-Chair Johnson reiterated his earlier statement that he would trade jobs and employment for money in the treasury because he doesn't believe the state wants more money to be spent.

MS. FITZPATRICK suggested thinking about the issue in terms of more than just a project. Although companies invest in projects, the company is actually running a business. Therefore, the company reviews the totality of the project and the business, which includes the cash flow as well as profitability.

1:12:21 PM

MR. RUGGIERO said that there is evidence of entities investing in an even higher tax environment. He then commented that the Australia project in 2000 would be a very narrow snapshot, for which the consultants have been criticized. Furthermore, it depends on the circumstances at the time as to what recommendations would be made. He related his belief that [in Alaska] most of the decisions being made are point-forward decisions and thus it comes down to where Alaska's tax policy fits into the future decision-making of the companies represented today, as to whether or not they will choose to invest in Alaska.

CO-CHAIR GATTO remarked that [the state] is trying to influence the companies and vice versa. Co-Chair Gatto referred to the situation as one of partnership otherwise there is a winner and a loser.

MS. FITZPATRICK indicated her agreement with regard to partnership, adding that she doesn't believe [BP] is in a position of trying to influence the state but rather attempting to share information and the company's perspective.

CO-CHAIR GATTO inquired as to why BP is spending money on advertising in Alaska since BP doesn't sell gas in the state.

MS. FITZPATRICK answered that [the advertising] is about providing information to the public. In further response to Co-Chair Gatto, Ms. Fitzpatrick related her belief that the advertising is about investing today for Alaska's tomorrow.

CO-CHAIR GATTO said, "I could go along with that if ... I thought you actually thought that was necessary to tell us that. But, we know the pipe is two-thirds empty, ..."

MS. FITZPATRICK said she can only comment on BP's advertising.

REPRESENTATIVE ROSES, drawing from his experience running a business, opined that often advertising doesn't have anything to

do with the information but rather is to protect an image or improve [an image]. If the public has been keyed into the fact that the legislature is present to discuss oil taxes because the state hasn't been getting its fair share and the advertisement were to say that it's not about taxes but rather about how much oil is in the pipe, then it's an appropriate position to let the public know. He opined that there are two sides to the advertising piece. He further opined that [the oil industry] was advertising for the general public rather than the legislature. Representative Roses then turned to the issue of influence and related that no lobbyist came to him to discuss any of the positions, amendments, et cetera. "Any lobbyist or oil company executives that I talked to did nothing more than what the administration did when they came to my office, and that's to give me information. Never once did they try to leverage a position, persuade position, persuade about an amendment, or to offer suggestions of what I should or should not do. This has been completely out in the open" he related.

1:17:57 PM

REPRESENTATIVE ROSES, returning to the Trinidad situation discussed earlier, asked whether, after negotiation of the lower tax rate and the subsequent market increase, the country wanted to raise the taxes.

MR. RUGGIERO said it would depend on the specific piece of the deal being discussed because there's an upstream piece, a pipeline across the island, an LNG plant, and a natural gas liquids (NGL) plant.

REPRESENTATIVE ROSES asked then if the country of Trinidad decided to restructure the taxes and increase them once prices [increased].

MR. RUGGIERO replied no, but added that part of the upside Trinidad would experience, if it came, is through the country's ability to leverage a 10 percent ownership share. Therefore, if the environment was better than anticipated, the country was able to participate and gain that advantage through that equity participation.

CO-CHAIR GATTO asked if that 10 percent ownership share was part of the initial agreement.

1:19:24 PM

MS. FITZPATRICK offered her understanding that it was a 10 percent equity ownership in the same way as Anadarko may be 10 percent equity owner in one of the fields in the North Slope. It's a very different structure, and furthermore the 10 percent equity ownership was agreed upon prior to construction.

1:20:05 PM

The committee took a brief at-ease.

1:21:36 PM

REPRESENTATIVE SEATON mentioned that an amendment incorporated into CSHB 2001(O&G) resulted in the Cook Inlet tax rate applying to everything south of the Brooks Range. He asked whether any [of the oil industry representatives] have any objection to a restriction on that to be nonindustrial use such that it's not a feed stock for industry at the lower tax rate, nor a GTL, or LNG for export. "So, basically commercial and ... residential use in the state of Alaska and having that tax rate, but not having this thing come in and be some kind of marker for large gas production," he said.

1:23:01 PM

MR. HANLEY said that gas needs to be addressed. He then noted that Anadarko, a non-owner, doesn't have discovered gas in Prudhoe Bay or Kuparuk and is drilling in the foothills. Anadarko, he related, would like to see a level playing field in regard to having the same types of tax rates as those in other parts of the state that have gas that will compete with that from Anadarko. How the state wants to restrict the rate set by Cook Inlet through 2022 is a policy call on the part of the legislature. Anadarko would prefer that rate to apply to as much gas as it can in order to help the project to go forward, he said.

REPRESENTATIVE SEATON pointed out that the legislature isn't recommending a major gasline tax rate on gas. The amendment [incorporated in CSHB 2001(O&G)] is intended to address residential and commercial uses of gas produced in Alaska. He asked if there is any problem restricting it to the non-industrial, non-explorer use.

MR. HANLEY reiterated that it's a policy call. He then opined that Anadarko's position would be that if the lower tax rate is

going to be applied to consumer use, then it should be applied to all gas.

REPRESENTATIVE SEATON surmised then that Mr. Hanley is saying that the geographical restriction is something that Anadarko would like eliminated, but whether [to apply a lower tax rate] for consumer use in the state remains a policy call.

MR. HANLEY confirmed that Anadarko views removing the geographical restriction as a benefit because Anadarko may then choose to bring its foothills gas to a local market. He opined that Anadarko would like to compete on the same level as a company with gas in Bristol Bay, the Nenana Basin, or the Copper River Basin. He pointed out that, for instance, those in the Nenana Basin will have a competitive advantage over Anadarko in the foothills because Anadarko is located farther from the markets.

REPRESENTATIVE SEATON asked if there is general agreement with regard to Anadarko's position on the aforementioned.

MS. FITZPATRICK responded, generally yes. However, she offered to review any amendment on that and inform the committee of any potential unintended consequences.

[Following was a brief discussion regarding how the committee would proceed.]

1:32:25 PM

REPRESENTATIVE ROSES relayed his appreciation for the information that's been presented and the education he has received on this topic.

MS. DAVIS concurred with Representative Roses' comments and related her pride with regard to the hard work being done by members and staff. She then remarked that she is pleased to be part of the process that is designed to improve Alaska's standing as a partner and get up to speed in a net world. This is truly a significant step in moving toward a more dynamic understanding of industry and making the state more nimble and better able to spot opportunities and secure the future.

1:35:16 PM

MR. HANLEY relayed that his goal in testifying is to give members an idea of his company's perspective. He highlighted

the need for members to keep in mind during the amendment process that changes result in different impacts on different players. Mr. Hanley agreed with the administration's original proposal that the net operating loss should be equivalent to the tax rate as it's a fairness issue. With regard to EIC credits, he related his impression that the issues he raised can be worked out.

1:39:02 PM

MR. SECOURS echoed the comments of Mr. Hanley. He then reminded the committee that snapshots can sometimes paint the wrong picture. He then highlighted that in order to achieve some of the margins that have been discussed, the oil price would have to be very high as would the base tax rate, which would tax all the underlying investments necessary to get to that level. Therefore, one must question whether in the long term that will lead to the additional investments desired in this mature region. He then recalled that Ken Thompson has said that this can be reviewed in 3- to 5-year segments and be satisfied with the outcome at that time. However, oil and gas investments take 5-7 years, not only to make the decision, but to move from drilling to production. Therefore, what's decided with ACES could impact those additional investments.

1:40:59 PM

MR. MITCHELL said he has been encouraged with the level of open dialogue and genuine desire to understand the issues. He noted that he has been a strong proponent of the net tax structure and it seems there is general support for that. He opined that staying with the net structure both at the top and bottom end of the range will drive the correct result and be a more sustainable tax structure than a structure that includes elements of gross tax. Mr. Mitchell further opined that the right net structure will be the most sustainable for the state and industry while ensuring ongoing development.

1:42:33 PM

MR. RUGGIERO thanked the committee for the opportunity to be part of the process, and expressed the hope that his information has helped in this process.

1:43:43 PM

MS. FITZPATRICK related her understanding that the [legislature] wants to design something that's flexibility in order to avoid the need to revisit it while achieving the desired investment in the barrels and the revenue sought. She acknowledged that as the process moves toward making a net tax structure work, there is the need for forecast information. However, she reminded the committee that a forecast isn't a promise and hoped the legislators keep that in mind with regard to the state's forecasts.

1:45:34 PM

CO-CHAIR GATTO echoed earlier comments that this has been a great education and very valuable, which he appreciated.

The committee took an at-ease from 1:47:00 PM to 1:55:22 PM.

CHAIR GATTO announced that the committee would be in recess until 3:00 p.m. The committee reconvened at 3:17:03 PM.

3:17:32 PM

REPRESENTATIVE SEATON moved that the committee adopt Amendment 2, labeled 25-GH0014\L.42, Bullard/Bullock, 11/3/07, which read:

> Page 13, lines 8 - 22:
> Delete all material and insert:
> "(o) In addition to the tax levied under (e) of this section, for each month for which the producer's average monthly production tax value of the taxable oil and gas exceeds $30 for each BTU equivalent barrel, there is levied on the producer of oil or gas a tax for all oil and gas produced that month from each lease or property in the state, less any oil and gas the ownership or right to which is exempt from taxation or constitutes a landowner's royalty interest. Except as otherwise provided under (j) and (k) of this section, the tax levied under this subsection is equal to the sum over all months of the calendar year of the amount calculated under this subsection. For each month for which this subsection applies and for which the average monthly production tax value of the taxable oil and gas is
> (1) not more than $40 for each BTU equivalent barrel, the tax is equal to 0.2 percent of the gross value at the point of production of the taxable oil and gas for that month multiplied by the

number that represents the difference between the average production tax value for each BTU equivalent barrel of the taxable oil and gas for that month and $30; or

(2) more than $40 but not more than $50 for each BTU equivalent barrel, the tax is equal to two percent of the gross value at the point of production of the taxable oil and gas for that month plus 0.3 percent of the gross value at the point of production of the taxable oil and gas for that month multiplied by the number that represents the difference between the average production tax value for each BTU equivalent barrel of the taxable oil and gas for that month and $40;

(3) more than $50 but not more than $60 for each BTU equivalent barrel, the tax is equal to five percent of the gross value at the point of production of the taxable oil and gas for that month plus 0.4 percent of the gross value at the point of production of the taxable oil and gas for that month multiplied by the number that represents the difference between the average production tax value for each BTU equivalent barrel of the taxable oil and gas for that month and $50;

(4) more than $60 for each BTU equivalent barrel, the tax is equal to nine percent of the gross value at the point of production of the taxable oil and gas for that month plus 0.5 percent of the gross value at the point of production of the taxable oil and gas for that month multiplied by the number that represents the difference between the average production tax value for each BTU equivalent barrel of the taxable oil and gas for that month and $60."

CO-CHAIR JOHNSON objected.

3:17:44 PM

REPRESENTATIVE SEATON explained that Amendment 2 addresses progressivity with a net trigger that's calculated on the wellhead value. He further explained Amendment 2 utilizes the governor's proposed $30 net profit and proceeds in four steps. The first step at $30 net profit is .002, which is what's included in ACES. At $40 net profit it goes to .3, at $50 net profit it rises to .4, and at $60 net profit it rises to .5. The reasoning behind the aforementioned is that at lower net profit margins, the slope is lower and thus there is less impact

when less money is in company's hands. Still, the increasing slope obtains the state's equal share rate at $116. This is calculated on the current production rate used for ACES and PPT, which is 754,300 barrels per day. Although a preliminary [report] has come out with 723,000 barrels per day, the relationship would remain the same such that they would move down with that production amount.

3:20:05 PM

REPRESENTATIVE ROSES related his understanding that Amendment 2 doesn't address the base rate on net.

REPRESENTATIVE SEATON responded that's correct. He recalled that the companies testified that their decisions are impacted by high costs because a progressivity tied specifically to a price would be very unpredictable when inflation and cost increases occur.

3:21:14 PM

REPRESENTATIVE ROSES stated that whether he can support Amendment 2 is dependent upon the base rate. If the base rate changes substantially from what is currently in the PPT, he said he may want to revisit Amendment 2.

CO-CHAIR GATTO reminded the committee that any amendment can be amended.

3:22:04 PM

REPRESENTATIVE WILSON surmised then that Amendment 2 takes care of the problem of gold plating and that the state isn't in over its head with regard to the risk it's taking.

REPRESENTATIVE SEATON answered that's correct. Under Amendment 2 the progressivity is treated separately and no tax deduction is received for the progressivity. However, the tax deduction remains for the specified base amount and the tax credits are still received. He added that Amendment 2 also addresses the situation in which the state contribution is added at the high prices and isn't calculated into the sanctioning of projects.

3:23:04 PM

REPRESENTATIVE GUTTENBERG inquired as to the equivalent number of .002 at $30 of the net at the gross.

REPRESENTATIVE SEATON clarified that the .002 is a calculation on the gross. The trigger point is the $30, and therefore it would be $30 plus the cost and results in about $48 if the $18.65 in the latest model by Mr. Dickinson is used. He highlighted that the lines come together at basically the same place as it's exactly the same takeoff as ACES. The only difference is that if it were keyed to a $50 gross, then over time that would change due to inflation and it doesn't compensate for development with high cost versus infill drilling with low cost. Therefore, triggering it on the net self-adjusts and addresses the problems that have been identified by the producers. He noted that the calculation isn't on the wellhead or the gross value.

3:25:29 PM

REPRESENTATIVE WILSON surmised then that Amendment 2 will allow the state to capture more of its fair share than under PPT or ACES.

REPRESENTATIVE SEATON replied yes, adding that the breakpoint is the 25 percent equal share point at $116.

3:26:59 PM

CO-CHAIR JOHNSON removed his objection to Amendment 2.

3:27:22 PM

REPRESENTATIVE ROSES recalled hearing expert testimony that a model that will withstand the test of time should be on progressivity of the margin, which is fairly interchangeable with net in this discussion. He further recalled testimony that such a model should be designed that when profits or margins are at the greatest, the state should be able to take its greatest share and place it in a savings account to use when it happens to fall. He asked if the model [proposed in Amendment 2] captures the state's largest share when the profits are at a higher margin.

REPRESENTATIVE SEATON replied yes, but noted that the model could be designed such that the equal share, 25 percent, isn't captured until much later. However, that's well beyond the point at which companies are making decisions to sanction projects to go forward. This amendment is meant to obtain the

state's money as soon as possible without impacting investment decisions.

REPRESENTATIVE ROSES further recalled hearing testimony that the state should share in the responsibility when it's lower without eliminating its ability to receive revenue and should share in opportunities for encouraging exploration also. He asked if Amendment 2 achieves the aforementioned.

REPRESENTATIVE SEATON answered that he believes so because the progressivity is smaller at the $30-$40 range and as each barrel becomes more profitable, the rate increases. Therefore, he opined that it's much more inducive for the industry to sanction projects and move forward with them.

3:30:34 PM

REPRESENTATIVE SEATON, in response to Representative Edgmon, confirmed that Amendment 2 doesn't change the base rate and only addresses the progressivity by treating it as a separate tax not an additional portion to the base rate. He explained that it's based on a calculation times wellhead value not on the base rate. In further response to Representative Edgmon, the 25 percent on the spreadsheet wasn't used in any of the calculations. The yellow boxes are the ones that can trigger or change.

3:31:48 PM

REPRESENTATIVE SEATON, in response to Co-Chair Gatto, confirmed that this model could be done in several ways, and the document specifies what can be modified. He remarked that this illustration is much easier to understand.

3:32:49 PM

CO-CHAIR JOHNSON renewed his objection to Amendment 2. He inquired as to the tax increase the state will be imposing on the industry, at today's prices, as opposed to PPT and ACES. He suggested using $90 as the price.

REPRESENTATIVE SEATON said that he included the tables in order to directly compare at any price wish. For instance, at $55 ACES would be $18 while the PPT wouldn't have kicked in until another $5 and this model creates $23. At $90, ACES results in $1,264,000, PPT results in $1,141,000, and the progressivity in [Amendment 2] would result in $2,399,000. He reminded the

committee that the model he used is based on 754,300 barrels per day, although the current preliminary is that production will be at 720,000 barrels. Therefore, that would result in a decrease of about $100 million. He noted that this is the annual tax in which the price stays the same throughout the year.

3:35:26 PM

CO-CHAIR JOHNSON surmised then at today's price, then this is a tax increase of just south of $1 billion.

REPRESENTATIVE SEATON replied yes.

3:35:50 PM

A roll call vote was taken. Representatives Wilson, Seaton, Roses, Guttenberg, Edgmon, Kawasaki, and Gatto voted in favor of Amendment 2. Representatives Fairclough and Johnson voted against it. Therefore, Amendment 2 was adopted by a vote of 7-2.

3:37:15 PM

REPRESENTATIVE WILSON moved that the committee adopt Amendment 6, labeled 25-GH0014\L.65, Bullard/Bullock, 11/3/07, which read:

> Page 18, following line 25:
> Insert new bill sections to read:
> "*** Sec. 26.** AS 43.55.025(a) is amended to read:
> (a) Subject to the terms and conditions of this section, a credit against the production tax **levied by** [DUE UNDER] AS 43.55.011(e) [OR (f)] is allowed for exploration expenditures that qualify under (b) of this section in an amount equal to one of the following:
> (1) 20 percent of the total exploration expenditures that qualify only under (b) and (c) of this section;
> (2) 20 percent of the total exploration expenditures [FOR WORK PERFORMED BEFORE JULY 1, 2007, AND] that qualify only under (b) and (d) of this section;
> (3) 40 percent of the total exploration expenditures that qualify under (b), (c), and (d) of this section; or

(4) 40 percent of the total exploration expenditures that qualify only under (b) and (e) of this section.

*** Sec. 27.** AS 43.55.025(b) is amended to read:

(b) To qualify for the production tax credit under (a) of this section, an exploration expenditure must be incurred for work performed [ON OR] after **December 31, 2007** [JULY 1, 2003], and before July 1, 2016, [EXCEPT THAT AN EXPLORATION EXPENDITURE FOR A COOK INLET PROSPECT MUST BE INCURRED FOR WORK PERFORMED ON OR AFTER JULY 1, 2005,] and

(1) may be for seismic or **other** geophysical exploration costs not connected with a specific well;

(2) if for an exploration well,

(A) must be incurred by an explorer that holds an interest in the exploration well for which the production tax credit is claimed;

(B) may be for either **a** [AN OIL OR GAS DISCOVERY] well **that encounters an oil or gas deposit** or a dry hole; [AND]

(C) must be for **a well that has been completed or abandoned at the time the explorer claims the tax credit under (f) of this section; and**

(D) must be for goods, services, or rentals of personal property reasonably required for the surface preparation, drilling, casing, cementing, and logging of an exploration well, and, in the case of a dry hole, for the expenses required for abandonment if the well is abandoned within 18 months after the date the well was spudded;

(3) may not be for testing, stimulation, or completion costs; administration, supervision, engineering, or lease operating costs; geological or management costs; community relations or environmental costs; bonuses, taxes, or other payments to governments related to the well; **costs arising from gross negligence or violation of health, safety, or environmental statutes or regulations;** or other costs that are generally recognized as indirect costs or financing costs; and

(4) may not be incurred for an exploration well or seismic exploration that is included in a plan of exploration or a plan of development for any unit on May 13, 2003.

*** Sec. 28.** AS 43.55.025(c) is repealed and reenacted to read:

(c) To be eligible for the 20 percent production tax credit authorized by (a)(1) of this section or the 40 percent production tax credit authorized by (a)(3) of this section, exploration expenditures must

(1) qualify under (b) of this section; and

(2) be for an exploration well, subject to the following:

(A) before spudding the well, (i) the explorer shall submit to the commissioner of natural resources the information necessary to determine whether the geological objective of the well is a potential oil or gas trap that is distinctly separate from any trap that has been tested by a preexisting well; and (ii) the commissioner of natural resources must make an affirmative determination on that question; the commissioner of natural resources shall decide whether to make that determination within 60 days after receiving all the necessary information from the explorer and based on the information received and on other information the commissioner of natural resources may consider relevant;

(B) for an exploration well other than a well to explore a Cook Inlet prospect, the well must be located and drilled in such a manner that the bottom hole is located not less than three miles away from the bottom hole of a preexisting well drilled for oil or gas, irrespective of whether the preexisting well has been completed, suspended, or abandoned;

(C) after completion or abandonment of the exploration well, the commissioner of natural resources must determine that the well adequately achieved the explorer's stated geological objective.

*** Sec. 29.** AS 43.55.025(f) is amended to read:

(f) For a production tax credit under this section,

(1) an explorer shall, in a form prescribed by the department and**, except for a credit under (*l*) of this section,** within six months of the completion of the exploration activity, claim the credit and submit information sufficient to demonstrate to the department's satisfaction that the claimed exploration expenditures qualify under this section;

(2) an explorer shall agree, in writing,

(A) to notify the Department of Natural Resources, within 30 days after completion of seismic or geophysical data processing, completion of [A] well **drilling**, or filing of a claim for credit, whichever

is the latest, for which exploration costs are claimed, of the date of completion and submit a report to that department describing the processing sequence and providing a list of data sets available; [IF, UNDER (c)(2)(B) OF THIS SECTION, AN EXPLORER SUBMITS A CLAIM FOR A CREDIT FOR EXPENDITURES FOR AN EXPLORATION WELL THAT IS LOCATED WITHIN THREE MILES OF A WELL ALREADY DRILLED FOR OIL AND GAS, IN ADDITION TO THE SUBMISSIONS REQUIRED UNDER (1) OF THIS SUBSECTION, THE EXPLORER SHALL SUBMIT THE INFORMATION NECESSARY FOR THE COMMISSIONER OF NATURAL RESOURCES TO EVALUATE THE VALIDITY OF THE EXPLORER'S CLAIM THAT THE WELL IS DIRECTED AT A DISTINCTLY SEPARATE EXPLORATION TARGET, AND THE COMMISSIONER OF NATURAL RESOURCES SHALL, UPON RECEIPT OF ALL EVIDENCE SUFFICIENT FOR THE COMMISSIONER TO EVALUATE THE EXPLORER'S CLAIM, MAKE THAT DETERMINATION WITHIN 60 DAYS;]

(B) to provide to the Department of Natural Resources, within 30 days after the date of a request, **unless a longer period is provided by the Department of Natural Resources,** specific data sets, ancillary data, and reports identified in (A) of this paragraph; **in this subparagraph,**

(i) a seismic or geophysical data set includes the data for an entire seismic survey, irrespective of whether the survey area covers nonstate land in addition to state land or land in a unit in addition to land outside a unit;

(ii) well data include all derivative products, results, and copies of data collected and data analyses for the well; well logs; sample analyses; geophysical and velocity data including vertical seismic profiles and check shot surveys; and tangible material including, for each whole core collected, a lengthwise cut slab that is at least 1/3 of the whole core volume, and representative samples, as specified by the Department of Natural Resources, of other gaseous, liquid, or solid material collected from drilling or testing the well;

(C) that, notwithstanding any provision of AS 38, information provided under this paragraph will be held confidential by the Department of Natural Resources

(i) in the case of well data, until the expiration of the 24-month period of confidentiality described in AS 31.05.035(c), without extension, after which the Department of Natural Resources [FOR 10

YEARS FOLLOWING THE COMPLETION DATE, AT WHICH TIME THAT DEPARTMENT] will release the information after 30 days' public notice;

(ii) in the case of seismic or other geophysical data, other than seismic data acquired by seismic exploration subject to (*l*) of this section, for 10 years following the completion date, at which time the Department of Natural Resources will release the information after 30 days' public notice;

(iii) in the case of seismic data obtained by seismic exploration subject to (*l*) of this section, only until the expiration of 30 days' public notice issued on or after the date the production tax credit certificates are issued under (5) of this subsection; and

(D) that, in the case of well data, the explorer will not make a request under AS 31.05.035(c) that the commissioner of natural resources keep the data confidential for longer than the 24-month period of confidentiality described in AS 31.05.035(c);

(3) if more than one explorer holds an interest in a well or seismic exploration,

(A) each explorer may claim an amount of credit that is proportional to the explorer's cost incurred;

(B) in the case of a well, each explorer holding an interest in the well shall agree, in writing, that the explorer will not make the request described in (2)(D) of this subsection;

(4) the department may exercise the full extent of its powers as though the explorer were a taxpayer under this title, in order to verify that the claimed expenditures are qualified exploration expenditures under this section; and

(5) if the department is satisfied that the explorer's claimed expenditures are qualified under this section **and that all data required to be submitted under this section have been submitted**, the department shall issue to the explorer a production tax credit certificate for the amount of credit to be allowed against production taxes **levied by AS 43.55.011(e); the credit is available for immediate use; notwithstanding any contrary provision of AS 38, AS 40.25.100, or AS 43.05.230, the following information is not confidential:**

(A) the explorer's name;

(B) the date of the application;

(C) the location of the well or seismic exploration;

(D) the date of the department's issuance of the certificate; and

(E) the date on which the information required to be submitted under this section will be released [DUE UNDER AS 43.55.011(e) OR (f)].

*** Sec. 30.** AS 43.55.025(g) is amended to read:

(g) An explorer**, other than an entity that is exempt from taxation under this chapter,** may transfer, convey, or sell its production tax credit certificate to any person, and any person who receives a production tax credit certificate may also transfer, convey, or sell the certificate.

*** Sec. 31.** AS 43.55.025(h) is amended to read:

(h) A producer that purchases a production tax credit certificate may apply the credits against its production tax liability under AS 43.55.011(e) [OR (f)]. Regardless of the price the producer paid for the certificate, the producer may receive a credit against its production tax liability for the full amount of the credit, but for not more than the amount for which the certificate is issued. A production tax credit allowed under this section may not be applied more than once.

*** Sec. 32.** AS 43.55.025(i) is repealed and reenacted to read:

(i) For a production tax credit under this section,

(1) a credit may not be applied to reduce a taxpayer's tax liability under AS 43.55.011(e) below zero for a calendar year; and

(2) an amount of the production tax credit in excess of the amount that may be applied for a calendar year under this subsection may be carried forward and applied against the taxpayer's tax liability under AS 43.55.011(e) in one or more later calendar years.

*** Sec. 33.** AS 43.55.025(k) is amended by adding a new paragraph to read:

(4) "preexisting well" means a well that was spudded more than 540 days but less than 35 years before the date on which the exploration well to which it is compared is spudded.

*** Sec. 34.** AS 43.55.025 is amended by adding a new subsection to read:

(*l*) Subject to the terms and conditions of this section, if a claim is filed under (f)(1) of this section before January 1, 2016, a credit against the production tax levied by AS 43.55.011(e) is allowed in an amount equal to five percent of an eligible expenditure under this subsection incurred for seismic exploration performed before July 1, 2003. To be eligible under this subsection, an expenditure must

(1) have been for seismic exploration that

(A) obtained data that the commissioner of natural resources considers to be in the best interest of the state to acquire for public distribution; and

(B) was conducted outside the boundaries of a production unit; however, the amount of the expenditure that is otherwise eligible under this section is reduced proportionately by the portion of the seismic exploration activity that crossed into a production unit; and

(2) qualify under (b)(3) of this section."

Renumber the following bill sections accordingly.

Page 31, line 25:
Delete "32 - 34, and 37"
Insert "41 - 43, and 46"

Page 31, line 27:
Delete "31, and 38"
Insert "31, 32, 34, 40, and 47"

Page 31, line 29:
Delete "Sections 26 and 27"
Insert "Sections 35 and 36"

Page 31, line 30:
Delete "sec. 26"
Insert "sec. 35"

Page 31, line 31:
Delete "sec. 27"
Insert "sec. 36"

Page 31, following line 31:
Insert a new subsection to read:
"(d) Sections 26 - 29 and 33 of this Act apply to exploration expenditures incurred for work performed after December 31, 2007, that are the basis

of tax credits that may be claimed against taxes levied for oil and gas produced after December 31, 2007."

Reletter the following subsection accordingly.

Page 32, line 1:
Delete "sec. 29"
Insert "sec. 38"

Page 32, line 3:
Delete "29"
Insert "38"

Page 32, line 31:
Delete "32 - 34, and 37"
Insert "41 - 43, and 46"

Page 33, line 2:
Delete "26, 27, 31, and 38"
Insert "26 - 29, 31 - 34, 35, 36, 40, and 47"

Page 33, line 19, following ".":
Insert "(a) Section 30 of this Act is retroactive to July 1, 2003.
(b)"

Page 33, line 20:
Delete "32 - 34, and 37"
Insert "41 - 43, and 46"

Page 33, line 21:
Delete "26, 27, 31, and 38"
Insert "26 - 29, 31 - 34, 35, 36, 40, and 47"

Page 33, line 22:
Delete "sec. 44"
Insert "sec. 53"

[End of Amendment 6.]

REPRESENTATIVE FAIRCLOUGH objected for purposes of discussion.

3:37:26 PM

REPRESENTATIVE WILSON explained that basically Amendment 6 reinserts the incentive credits. Currently, a claim for credit

from a producer can only be submitted after the survey and well are done. At that point there is a decision between the department and the producer as to whether it can be used as a credit. Amendment 6 provides that the aforementioned request is done ahead of time and thus the producer can have the knowledge beforehand. She opined that it makes it a bit easier for the department and the producer to be partners. Currently, only the seismic data gathered after July 1, 2003, is available for credit and that data is held confidential for 10 years. Amendment 6 proposes a 5 percent credit for any seismic data collected outside of current units and deemed of value by the commissioner of DNR. This data would become immediately available to the public. She suggested that this data could be useful for companies as higher prices may make a project formerly deemed uneconomic economic.

3:41:38 PM

REPRESENTATIVE EDGMON requested the administration's view on Amendment 6.

The committee took an at-ease from 3:45 p.m. to 4:02 p.m.

4:02:11 PM

REPRESENTATIVE WILSON, noting that there is an error in Amendment 6, withdrew her motion to adopt Amendment 6, labeled 25-GH0014\L.65, Bullard/Bullock, 11/3/07, at this time.

4:03:26 PM

REPRESENTATIVE SEATON moved that the committee Amendment 3, labeled 25-GH0014\L.14, Bullock, 11/1/07, which read:

> Page 17, following line 3:
> Insert a new bill section to read:
> "*** Sec. 23.** AS 43.55.023(b) is amended to read:
> (b) A producer or explorer may elect to take a tax credit in the amount of **the** [20 PERCENT OF A] carried-forward annual loss **multiplied by the nominal tax rate in AS 43.55.011(e)**. A credit under this subsection may be applied against a tax due under AS 43.55.011(e). For purposes of this subsection,
> **(1)** a carried-forward annual loss is the amount of a producer's or explorer's adjusted lease expenditures under AS 43.55.165 and 43.55.170 for a

previous calendar year that was not deductible for that calendar year under AS 43.55.160(b) and (e)**; and**

(2) "nominal tax rate" means the tax rate stated in AS 43.55.011(e) that is not the tax determined at the minimum tax rate that may be applicable under AS 43.55.011(f)."

Renumber the following bill sections accordingly.

Page 31, line 25:
Delete "Sections 24, 25, 32 - 34, and 37"
Insert "Sections 23, 25, 26, 33 - 35, and 38"

Page 31, line 27:
Delete "31, and 38"
Insert "32, and 39"

Page 31, line 29:
Delete "Sections 26 and 27"
Insert "Sections 27 and 28"

Page 31, line 30:
Delete "sec. 26"
Insert "sec. 27"

Page 31, line 31:
Delete "sec. 27"
Insert "sec. 28"

Page 32, line 1:
Delete "sec. 29"
Insert "sec. 30"

Page 32, line 3:
Delete "29"
Insert "30"

Page 32, line 31:
Delete "secs. 24, 25, 32 - 34, and 37"
Insert "secs. 23, 25, 26, 33 - 35, and 38"

Page 33, line 2:
Delete "26, 27, 31, and 38"
Insert "27, 28, 32, and 39"

Page 33, lines 19 - 20:
Delete "Sections 24, 25, 32 - 34, and 37"

Insert "Sections 23, 25, 26, 33 - 35, and 38"

Page 33, line 21:
Delete "26, 27, 31, and 38"
Insert "27, 28, 32, and 39"

Page 33, line 22:
Delete "sec. 44"
Insert "sec. 45"

CO-CHAIR JOHNSON objected for the purposes of discussion.

4:03:38 PM

REPRESENTATIVE SEATON stated that Amendment 3 addresses the net operating loss carry-forward credits. Currently, those credits are at a 20 percent rate rather than a 22.5 percent rate that's deductible for expenses for people that have production. Amendment 3 identifies the tax rate for the net operating loss credit to be the same as for the nominal tax rate, which is the base rate under the production tax credit. Therefore, under Amendment 3 the net operating loss carry-forward credit will be the same as the base rate.

4:04:52 PM

CO-CHAIR JOHNSON withdrew his objection.

There being no further objection, Amendment 3 was adopted.

4:05:14 PM

REPRESENTATIVE SEATON moved that the committee adopt Amendment 4, labeled GH0014\L.15, Bullock, 11/1/07, which read:

Page 1, line 4, following "**latitude;**":
Insert "**providing a penalty for the underpayment of an installment payment of the production tax on oil and gas;**"

Page 17, following line 3:
Insert a new bill section to read:
"*** Sec. 23.** AS 43.55.020 is amended by adding a new subsection to read:
(i) A civil penalty shall be added to the amount of an installment payment required under (a)(1) - (4) of this section if the full amount of the payment is

not paid by the date the payment is due. The penalty is equal to five percent of the difference between the amount of the installment payment that was made timely and the amount of the installment payment required under (a)(1) - (4) of this section. If no part of the required installment payment was made timely, the penalty is equal to five percent of the installment payment required under (a)(1) - (4) of this section. The penalty is in addition to the interest imposed under (g) of this section and a penalty added under AS 43.05.220, if any."

Renumber the following bill sections accordingly.

Page 31, line 25:
Delete "Sections 24, 25, 32 - 34, and 37"
Insert "Sections 25, 26, 33 - 35, and 38"

Page 31, line 27:
Delete "31, and 38"
Insert "32, and 39"

Page 31, line 29:
Delete "Sections 26 and 27"
Insert "Sections 27 and 28"

Page 31, line 30:
Delete "sec. 26"
Insert "sec. 27"

Page 31, line 31:
Delete "sec. 27"
Insert "sec. 28"

Page 32, line 1:
Delete "sec. 29"
Insert "sec. 30"

Page 32, line 3:
Delete "29"
Insert "30"

Page 32, line 31:
Delete "secs. 24, 25, 32 - 34, and 37"
Insert "secs. 25, 26, 33 - 35, and 38"

Page 33, line 2:

Delete "26, 27, 31, and 38"
Insert "27, 28, 32, and 39"

Page 33, lines 19 - 20:
Delete "Sections 24, 25, 32 - 34, and 37"
Insert "Sections 25, 26, 33 - 35, and 38"

Page 33, line 21:
Delete "26, 27, 31, and 38"
Insert "27, 28, 32, and 39"

Page 33, line 22:
Delete "sec. 44"
Insert "sec. 45"

REPRESENTATIVE ROSES and GUTTENBERG objected.

4:05:27 PM

REPRESENTATIVE SEATON explained that Amendment 4 reinstates a 5 percent penalty for underpayment of more than 10 percent of a monthly estimated tax. He recalled numerous discussions relating that the state wasn't receiving the correct amount of tax due to costs and underreporting.

4:06:06 PM

CO-CHAIR GATTO asked if a penalty is different than interest.

REPRESENTATIVE SEATON responded yes.

CO-CHAIR GATTO asked if the 5 percent penalty is in addition to the interest owed.

REPRESENTATIVE SEATON replied yes, adding that the penalties on the monthly estimated tax is done by an IRS calculation. He noted that the penalty is implemented for an overpayment as well as an underpayment. Therefore, if there is an overpayment, the state would owe the IRS interest.

4:07:20 PM

REPRESENTATIVE GUTTENBERG noted that he has a similar amendment, although it has more sections. He then removed his objection.

REPRESENTATIVE ROSES removed his objection.

There being no further objection, Amendment 4 was adopted.

4:08:22 PM

REPRESENTATIVE SEATON moved that the committee adopt Amendment 5, labeled 25-GH0014\L.4, Chenoweth/Bullock, 11/1/07, which read:

Page 1, lines 3 - 4:
Delete "**and south of 68 degrees North latitude**"

Page 13, following line 20:
Insert a new subsection to read:
"(q) For a calendar year before 2022, the tax levied by (e) and (o) of this section for gas produced from a lease or property that is outside of the Cook Inlet sedimentary basin that is sold and processed into liquefied natural gas in the state at a facility with a maximum processing capacity that does not exceed 10,000,000,000 cubic feet a year may not exceed the product of the amount of taxable gas produced during the calendar year from the lease or property, multiplied by the average rate of tax imposed under this chapter for taxable gas produced from all leases or properties in the Cook Inlet sedimentary basin, multiplied by the average prevailing value for gas delivered in the Cook Inlet area for the 12-month period ending March 31, 2006, as determined by the department under AS 43.55.020(f). This subsection applies only to gas produced from a lease or property after December 31, 2007."

Page 14, line 27, following "production":
Insert "**;**

(6) notwithstanding (1) of this subsection, that part of the installment payment determined by (2) and (3) of this subsection that is attributable to the production of gas that is subject to the limitations under AS 43.55.011(p) or (q) is the result obtained by multiplying the volume of gas produced during the month by the average rate of tax imposed under this chapter for taxable gas produced from all leases or properties in the Cook Inlet sedimentary basin, multiplied by the average prevailing value for gas delivered in the Cook Inlet area for the 12-month period ending March 31, 2006, as determined by the department under (f) of this section"

REPRESENTATIVE GUTTENBERG objected.

4:08:35 PM

REPRESENTATIVE SEATON explained that Amendment 5 addresses an alternative mechanism for transferable credits to be purchased. If the legislature provides the Alaska Retirement Management Board (ARM Board) the statutory authority to acquire credits, Amendment 5 would allow them to sell [the credits] to DOR. Therefore, the legislature wouldn't have to open up the tax statute to do so. He pointed out that in order for this to be applicable, the legislature would have to modify the ARM Board's statutes.

CO-CHAIR GATTO asked if Amendment 5 would provide the ARM Board with a guaranteed rate of return.

REPRESENTATIVE SEATON clarified that the rate of return is established in another section of legislation yet to be considered by the legislature. Amendment 5 is simply the authorizing language to allow the ARM Board to act as a producer with a tax liability. Under Amendment 5 the ARM Board could purchase tax credits for an amount established in other legislation and DOR can reimburse the ARM Board. The notion behind Amendment 5 is to simplify and streamline a mechanism for the explorers with transferable credits to be able to be reimbursed. He mentioned a letter specifying that about 12 explorers support this procedure allowing another mechanism for redeeming the transferable credits.

4:11:22 PM

REPRESENTATIVE GUTTENBERG asked if the ARM Board has been contacted regarding whether it would be likely to use these credits. He also asked if Representative Seaton has obtained an opinion regarding [whether this falls under] the call.

CO-CHAIR GATTO interjected that [Amendment 5] is related to taxes.

REPRESENTATIVE SEATON related that Legislative Legal and Research Services didn't raise any concern with regard to Amendment 5 not falling under the call. He reiterated that Amendment 5 doesn't modify the ARM Board statutes, which would be necessary to modify, but simply allows this mechanism to act

as an oil company in purchasing credits. He recalled that when this was reviewed in the House there was communication from the ARM Board in support of this proposal as well as a letter of support from DOR. The authorizing sections, not included in HB 2001, require that the commissioner of DOR give prior approval.

4:13:47 PM

REPRESENTATIVE GUTTENBERG posed a scenario in which Amendment 5 is adopted, and asked if the severability clause "would take this out if it's ... over that line?"

MS. DAVIS related that DOL said that pursuant to state law a severability clause is implied in all legislation that's passed, and therefore it was deemed unnecessary.

4:14:46 PM

REPRESENTATIVE GUTTENBERG removed his objection.

CO-CHAIR JOHNSON objected.

4:14:56 PM

CO-CHAIR JOHNSON inquired as to where the legislation establishing the $.92 on dollar is in the legislative process.

REPRESENTATIVE SEATON said that it passed the House and is sitting in the final committee of review in the Senate.

CO-CHAIR JOHNSON then inquired as to the repercussions of passage of Amendment 5. He then posed a scenario in which [Amendment 5] is incorporated into statute, but the authorizing legislation isn't adopted. In such a scenario, could the ARM Board reduce the floor to $.50 on the dollar and purchase the tax credits at a fire sale from a producer, he asked.

REPRESENTATIVE SEATON reiterated that this provision doesn't allow the ARM Board to do anything as the other legislation will have to pass to authorize the ARM Board. This provision merely allows the establishment of credits, and the current ARM Board statutes don't allow it to sell the credits.

4:17:19 PM

CO-CHAIR JOHNSON asked, "Are you sure? ... In what of the statute is the ARM Board not allowed to that this would not override and supersede?"

REPRESENTATIVE SEATON specified that the language in Amendment 5 modifies the sections of law relating to oil taxes and credits. However, the ARM Board has its own constraints in other statutes, and therefore the other statutes have to be modified to authorize the ARM Board to [sell the credits]. The provision in Amendment 5 authorizes the oil tax statute portion only and the ARM Board doesn't have statutory authority to engage in this practice without the passage of the other pending legislation.

4:18:48 PM

CO-CHAIR GATTO highlighted the following proposed language in subsection (l), "Subject to appropriations made by law, if and to the extent that purchase of transferable tax credits by the Alaska Retirement Management Board is authorized by law ...." He echoed the earlier comments that the authorizing legislation hasn't yet passed.

4:19:19 PM

REPRESENTATIVE ROSES, drawing upon his experience as a member of the ARM Board, opined that the ARM Board works very hard to balance the portfolio. Furthermore, it holds a certain amount of money in reserve in the event a good opportunity arises. He assured the committee that the ARM Board would jump on this opportunity and use it as often as it's able to do so.

4:20:16 PM

CO-CHAIR JOHNSON removed his objection.

There being no further objection, Amendment 5 was adopted.

4:20:40 PM

REPRESENTATIVE ROSES moved that the committee adopt Amendment 7, labeled 25-GH0014\L.25, Chenoweth\Bullock, 11/2/07, which read:

> Page 19, following line 26:
> Insert a new bill section to read:
> "*** Sec. 27.** AS 43.55.030(d) is amended to read:
> (d) Reports **required under this section** [BY OR ON BEHALF OF THE PRODUCER] are delinquent the first

day following the day the report is due. **The person required to file the report is liable for a penalty, as determined by the department under standards adopted in regulation by the department, of not more than $1,000 for each day the person fails to file the report at the time required. The penalty is in addition to the penalties in AS 43.05.220 and 43.05.290 and is assessed, collected, and paid in the same manner as a tax deficiency under this title. In this subsection, "report" includes a statement.**"

Renumber the following bill sections accordingly.

Page 31, line 25:
Delete "32 - 34, and 37"
Insert "33 - 35, and 38"

Page 31, line 27:
Delete "31, and 38"
Insert "32, and 39"

Page 31, line 29:
Delete "27"
Insert "28"

Page 31, line 31:
Delete "sec. 27"
Insert "sec. 28"

Page 32, line 1:
Delete "sec. 29"
Insert "sec. 30"

Page 32, line 3:
Delete "29"
Insert "30"

Page 32, line 31:
Delete "32 - 34, and 37"
Insert "33 - 35, and 38"

Page 33, line 2:
Delete "27, 31, and 38"
Insert "28, 32, and 39"

Page 33, line 20:
Delete "32 - 34, and 37"

Insert "33 - 35, and 38"

Page 33, line 21:
Delete "27, 31, and 38"
Insert "28, 32, and 39"

Page 33, line 22:
Delete "sec. 44"
Insert "sec. 45"

REPRESENTATIVE KAWASAKI objected.

CO-CHAIR GATTO mentioned his understanding that Amendment 7 must pass in order for Amendment 8 to be considered.

4:21:09 PM

REPRESENTATIVE ROSES related his agreement. He then explained that Amendment 7 reinserts the penalty phase for lack of reporting that was in ACES and removed.

4:21:42 PM

REPRESENTATIVE KAWASAKI withdrew his objection.

There being no further objection, Amendment 7 was adopted.

4:21:58 PM

REPRESENTATIVE FAIRCLOUGH moved that the committee adopt Amendment 8, labeled 25-GH0014\L.26, Kurtz/Bullock, 11/2/07, which read:

Page 21, line 30, following "**matters**":
Insert "**;**

(6) assess against a person required under this section to file a report, statement, or other document a penalty, as determined by the department under standards adopted in regulation by the department, of not more than $1,000 for each day the person fails to file the report, statement, or other document at the time required; the penalty is in addition to any penalties under AS 43.05.220 and 43.05.290 and is assessed, collected, and paid in the same manner as a tax deficiency under this title; the penalty shall bear interest at the rate specified under AS 43.05.225(1); notwithstanding authority

granted under AS 43.05.070 to compromise a penalty, the department may not under that section compromise a penalty under this paragraph by agreeing to accept less than 50 percent of the penalty originally assessed by the department"

CO-CHAIR JOHNSON objected for discussion purposes.

4:22:07 PM

REPRESENTATIVE FAIRCLOUGH relayed her understanding that penalties often result in negotiations in which it's in the benefit of the taxpayer to wait versus paying anything on the settlement. She expressed interest in the administration's comments. Line 13 of Amendment 8 removes some bargaining power, which could result in litigation.

4:23:33 PM

MS. DAVIS relayed her belief that Mr. Iversen, Tax Division, has provided the committee with information as to how the state has approached the resolution of various tax matters in the past. Ms. Davis expressed slight concern with choosing a single amount and having it apply to small and large players. However, she said she took some comfort with the language proposed "of not more than $1,000". Therefore, she said she understood that once the penalty is established, this language intends to address the ability to negotiate it down. So long as this language doesn't impair the initial assessment of the penalty, she opined that the limitation is okay.

4:25:09 PM

REPRESENTATIVE FAIRCLOUGH stated that Amendment 8 is intended to signal that when the state has something due, it won't negotiate down to zero. The hope is to provide the administration teeth in regard to not negotiating down further.

4:25:28 PM

REPRESENTATIVE ROSES commented that he will reluctantly support Amendment 8 as it's in best interest of the state.

4:26:17 PM

CO-CHAIR JOHNSON removed his objection.

There being no further objection, Amendment 8 was adopted.

4:26:34 PM

REPRESENTATIVE SEATON withdrew Amendment 9, for the moment.

4:27:07 PM

REPRESENTATIVE SEATON moved that the committee adopt Amendment 10, labeled 25-GH0014\L.13, Bullock, 11/1/07, which read:

Page 26, line 14:
Following "negligence,":
Insert "**criminal negligence,**"
Following "**law,**":
Insert "**including a violation of 33 U.S.C. 1319(c)(1) or 1321(b)(3) (Clean Water Act),**"

Page 28, line 6, through page 29, line 1:
Delete all material.

Renumber the following paragraph accordingly.

4:27:13 PM

REPRESENTATIVE GUTTENBERG objected.

4:27:28 PM

REPRESENTATIVE SEATON pointed out that Amendment 10 looks at qualified lease expenditures. Currently, the legislation specifies that lease expenditures don't include violation of law. Amendment 10 adds that lease expenditures don't include criminal negligence, including criminal negligence as a violation of 33 USC 1319(c)(1), the Clean Water Act. Amendment 10 also deletes Section 19, regarding unscheduled disruptions. He opined that Amendment 10 puts all companies on notice that if they do something found to be criminally negligent, the resulting costs are nondeductible as a lease expense.

4:30:29 PM

CO-CHAIR GATTO asked if there is a value to lines 5 and 6 as numbered on Amendment 10 as they are probably already included whether specified or not.

REPRESENTATIVE SEATON answered that could be, but pointed out that without that it could be left to the interpretation of the courts. Specifying the particular types of violations covered is definitive.

4:31:51 PM

REPRESENTATIVE ROSES expressed concern with regard to changing laws retroactively, but said that he will address that with the effective date when the legislation is before the House.

4:32:44 PM

REPRESENTATIVE GUTTENBERG related his understanding that by adding criminal negligence, the bar is being raised.

REPRESENTATIVE SEATON said that the language basically cites the standard recently used in the court. He said he isn't trying to propose language that would result in a simple error making all costs nondeductible.

4:33:52 PM

REPRESENTATIVE FAIRCLOUGH announced that she will support Amendment 10. She highlighted that Amendment 10 will remove the need for legislation in the other body, and therefore finalizes a concern of Alaskans regarding companies that don't fully maintain equipment. She reminded the committee that two producers in a joint agreement with a producer who had a recent spill told the committee that they haven't received any cost allocations for the spill nor cleanup to date, although she acknowledged that it can take up to a year to audit those.

4:35:08 PM

REPRESENTATIVE SEATON said that's his understanding as well, but there is a letter from the producer stating its intention to charge those costs as lease expenditures. More than once this producer has stated publicly that it will charge those costs as lease expenditures, he stated. This matter can be addressed by two routes, including a guilty plea or the language in paragraph (19) of Section 33. He highlighted the difficulty in defining the standard "**due care or foresight**".

4:37:03 PM

REPRESENTATIVE GUTTENBERG removed his objection.

There being no further objection, Amendment 10 was adopted.

4:37:23 PM

REPRESENTATIVE SEATON moved that the committee adopt Amendment 11, labeled 25-GH0014\L.12, Bullard/Bullock, 11/1/07, which read:

Page 26, following line 2:
Insert new bill sections to read:

"* **Sec. 33.** AS 43.55.165(b) is amended to read:

(b) For purposes of (a) of this section,

(1) direct costs include

(A) an expenditure, when incurred, to acquire an item if the acquisition cost is otherwise a direct cost, notwithstanding that the expenditure may be required to be capitalized rather than treated as an expense for financial accounting or federal income tax purposes;

(B) payments of or in lieu of property taxes, sales and use taxes, motor fuel taxes, and excise taxes;

(C) a reasonable allowance, as determined under regulations adopted by the department, for overhead expenses directly related to exploring for, developing, and producing oil or gas deposits located within leases or properties or other land in the state;

(2) an activity **must be physically located in the state** [DOES NOT NEED TO BE PHYSICALLY LOCATED ON, NEAR, OR WITHIN THE PREMISES OF THE LEASE OR PROPERTY WITHIN WHICH AN OIL OR GAS DEPOSIT BEING EXPLORED FOR, DEVELOPED, OR PRODUCED IS LOCATED] in order for the cost of the activity to be a cost upstream of the point of production of the oil or gas.

*** Sec. 34.** AS 43.55.165(b), as amended by sec. 33 of this Act, is amended to read:

(b) For purposes of (a) of this section,

(1) direct costs include

(A) an expenditure, when incurred, to acquire an item if the acquisition cost is otherwise a direct cost, notwithstanding that the expenditure may be required to be capitalized rather than treated as an expense for financial accounting or federal income tax purposes;

(B) payments of or in lieu of property taxes, sales and use taxes, motor fuel taxes, and excise taxes;

(C) a reasonable allowance, as determined under regulations adopted by the department, for overhead expenses directly related to exploring for, developing, and producing oil or gas deposits located within leases or properties or other land in the state;

(2) an activity must be physically located **on the premises of the lease or property from which oil or gas is recovered** [IN THE STATE] in order for the cost of the activity to be a cost upstream of the point of production of the oil or gas."

Renumber the following bill sections accordingly.

Page 31, line 25:
Delete "32 - 34, and 37"
Insert "32, 33, 35, 36, and 39"

Page 31, line 27:
Delete "38"
Insert "40"

Page 32, line 31:
Delete "32 - 34, and 37"
Insert "32, 33, 35, 36, and 39"

Page 33, line 2:
Delete "38"
Insert "40"

Page 33, line 20:
Delete "32 - 34, and 37"
Insert "32, 33, 35, 36, and 39"

Page 33, following line 20:
Insert new bill sections to read:

"*** Sec. 46.** The uncodified law of the State of Alaska is amended by adding a new section to read:

CONTINGENT EFFECT. Section 34 of this Act takes effect only if a court of competent jurisdiction enters a final judgment on the merits, the final judgment is no longer subject to appeal, and the final judgment nullifies the effect of AS 43.55.165(b), as amended by sec. 33 of this Act.

*** Sec. 47.** If sec. 34 of this Act takes effect, it takes effect on the day after the last day on which the final judgment described in sec. 46 of this Act is no longer subject to appeal."

Renumber the following bill sections accordingly.

Page 33, line 21:
Delete "38"
Insert "40"

Page 33, line 22:
Delete "sec. 44"
Insert "secs. 47 and 48"

CO-CHAIR JOHNSON objected for discussion purposes.

4:37:38 PM

REPRESENTATIVE SEATON recalled testimony by some of the producers that there were deductions taken for things not in Alaska and for items that may or may not arrive in Alaska in a timely fashion. Amendment 11 specifies that capital deductions occur when an item arrives in Alaska and allows for a full credit and deduction when the item arrives. He related that his intention with Amendment 11 is to constrain gaming of the net tax for capital expenditures. The amendment also includes a fallback provision, a contingent effect [in proposed Section 46], and therefore the state doesn't have to worry about a lawsuit due to the Commerce Clause.

4:40:03 PM

REPRESENTATIVE FAIRCLOUGH emphasized that she wants jobs for Alaskans. She then expressed concern that although the state is trying to encourage exploration and development, this presents another hoop and may have the unintended result of discouraging exploration and investment in Alaska.

4:41:26 PM

REPRESENTATIVE ROSES commented that he may want to remove his name from Amendment 11 as it doesn't capture his intent. He specified that his intent was to give credits for manufactured equipment that arrives in Alaska. "That doesn't mean to say that I didn't want them to get credits to start the construction, but I certainly think the state ought to be able

to go back and recapture those credits back from the producer if, in fact, that equipment does not arrive on our shore," he said.

4:42:20 PM

CO-CHAIR JOHNSON said he shares Representative Roses' concern with regard to the intended intent of Amendment 11, and therefore announced that he will remove his name from Amendment 11 as he doesn't intend to support it. He said he didn't want the state to be in a position in which the credits can't be captured if it takes three years to build the equipment. He, too, said he doesn't want to discourage investment and exploration in Alaska.

4:43:11 PM

REPRESENTATIVE FAIRCLOUGH said that she supports the equipment coming to Alaska and understands the concern of gaming. She related her understanding that the concern with gaming is that if a developer, producer, or explorer contracts a rig for Alaska, but the environmental or taxing climate changes and causes the developer, producer, or explorer to take the drilling operation from which credits were received to Venezuela and Alaska's project is put on hold. She then suggested that the committee could take a brief at-ease in order to develop language that better gets to the intent of Amendment 11.

CO-CHAIR GATTO announced that he would entertain an at-ease if that's the will of the sponsor of Amendment 11.

REPRESENTATIVE SEATON said it would be fine to take an at-ease. However, he highlighted that modules are being built in Anchorage, albeit they're more expensive to build in Anchorage, Alaska, than in Louisiana. If the desire is to take tax money and give credits to those building modules in Louisiana, then do as the law currently says. On the other hand, if the desire is to stimulate jobs in Alaska for such, Amendment 11 does so.

4:45:56 PM

REPRESENTATIVE ROSES asked if the administration has the ability to track these credits to determine whether the equipment for which a credit was given actually arrives in Alaska.

4:46:31 PM

PATRICK GALVIN, Commissioner, Department of Revenue, said that if a provision required that equipment deducted as a cost has to arrive in Alaska at some point during its use, it would become an audit issue such that it would be tracked. He related the administration's belief that it could be tracked and could ensure compliance with the law.

4:47:21 PM

REPRESENTATIVE ROSES recalled the testimony from the producers regarding the amount of time to get something online and set up. He said he didn't want restrictions to build equipment or have equipment in Alaska to result in the loss of the opportunity for wells to be built.

4:48:20 PM

CO-CHAIR GATTO posed a scenario in which a module is built in Argentina, shipped to Tacoma, and is intended to go to the North Slope. However, something happens on the North Slope that results in the module not arriving in Alaska. In the aforementioned scenario, the credit money would be tied up until some activity occurs that results in the module entering [Alaska's] waters. He suggested that it's in the same realm as a penalty in interest. He opined that the entity that builds the equipment should have something at risk as they have an advantage in regard to deciding whether the equipment will actually arrive in Alaska. Although he acknowledged that things can change and folks certainly have to adapt to changes, he said he hesitates to tie up credits.

4:50:33 PM

REPRESENTATIVE ROSES, recalling conversations with producers, related that he was lead to believe that the rigs built for Alaska are vastly different than those for elsewhere. Therefore, the likelihood of a rig built for Alaska being used elsewhere is low.

CO-CHAIR GATTO recalled testimony that Arctic drilling rigs are being built. However, he commented that there's other equipment besides such specialized equipment.

4:51:36 PM

REPRESENTATIVE GUTTENBERG asked if it's just the activity of building a module or is it the entire cost of building the

module. He then pointed out that steel, valves, and stems aren't manufactured in Alaska. "If what we're talking about is the expense of physically putting it together, that makes a lot more sense. I ... think if we say the entire activity and all the costs going into it, then we're going into the contingent effect of taking it out. If you want to amend it to say that the expense of actually putting it together and transporting it from here to there. Perhaps, we can talk about that," he said

4:52:52 PM

CO-CHAIR GATTO clarified that he has no objection to the credit when everything happens as planned. However, he indicated that [it's problematic] when the credit has been given, but there's been no activity in Alaska as a result of the credit.

4:53:17 PM

REPRESENTATIVE EDGMON suggested that the committee's time might be better served by placing Amendment 11 at the bottom of the pile unless there's a quick fix.

4:53:43 PM

REPRESENTATIVE SEATON withdrew his motion to adopt Amendment 11.

4:54:04 PM

REPRESENTATIVE FAIRCLOUGH moved Amendment 12, labeled 25-GH0014\L.22, Cook\Bullock, 11/2/07, which read:

> Page 13, line 22, following ".":
> Insert "All money received by the state as a result of the application of this subsection shall be deposited by the department into a separate account in the general fund known as the progressivity savings account."

REPRESENTATIVE KAWASAKI objected.

REPRESENTATIVE FAIRCLOUGH recalled that when ACES was introduced to Alaskans, the governor discussed that now is the time to save money. However, there has been testimony specifying that there's no language specific to saving that money. Amendment 12 intends to place a line in the general fund to take all the money generated from the progressivity taxation with the intent of it being available for use in years when revenue falls short.

4:55:10 PM

REPRESENTATIVE WILSON requested that her name be added to Amendment 12.

4:55:19 PM

CO-CHAIR JOHNSON reminded the committee that a previous amendment raised the taxes on oil companies through the progressivity [that amounts] to about $1.5 billion. He opined that if the taxes are being raised that much, the state should save it.

4:55:48 PM

REPRESENTATIVE EDGMON said that although he supports the intent of Amendment 12, he opposes the amendment overall because it proposes fairly sweeping action, which should be considered in the House Finance Committee.

REPRESENTATIVE FAIRCLOUGH pointed out that this money would still come back before the legislature in a budget. Amendment 12 merely sweeps a lot of money, if oil taxes remain high, into an account. Should anyone in the legislature want to touch that account, there's an opportunity for Alaskans to speak out about it. These funds could be used to bridge funding for education and power cost equalization. "The governor said let's save the money. And I don't think that I can get it into the permanent fund ... the CBR [capital budget reserve fund], but I do think that Alaskans deserve to be able to see it in the budgeting process and see if people are going to try to access it," she said.

4:58:11 PM

CO-CHAIR JOHNSON said that although he appreciates the intent, the legislature will have access to the account with a simple vote. With that in mind, Co-Chair Johnson offered an amendment to Amendment 12 such that raising the taxes should be done in conjunction with a long-range fiscal plan. Although he applauded Representative Fairclough for proposing to save the fund, he opined that there are no political consequences to funds placed in an account. He further opined that if the legislature is truly serious about saving this money, it should be placed in the permanent fund as it requires a 50 percent vote to withdraw those funds. Furthermore, there are serious

political consequences to withdrawing funds from the permanent fund.

5:00:07 PM

CO-CHAIR JOHNSON moved that the committee adopt a conceptual amendment to Amendment 12 such that the account in the general fund to which these funds should be deposited be specified as the permanent fund.

CO-CHAIR GATTO objected to the conceptual amendment to Amendment 12. He highlighted that a substantial amount of money is already owed to the CBR as previous withdrawals are expected to be replaced. He related his belief that no less than half of [the funds received as a result of the application], if not all of them, should be placed in the CBR since that's an obligation. "This is a great idea, but I think we need to satisfy our debts before we establish a brand new account," he opined.

5:01:17 PM

CO-CHAIR JOHNSON remarked that he doesn't disagree with the saving part. However, he pointed out that withdrawals from the CBR requires a three-quarter vote. He indicated that oftentimes the capital budget grows as the legislature attempts to complete its work on time. Co-Chair Johnson said that he objected to placing the funds in the CBR as it's a license to spend.

CO-CHAIR GATTO pointed out that as proposed in Amendment 12, only a simple majority is required to spend the funds while it takes a 75 percent majority to spend funds from the CBR.

5:02:27 PM

REPRESENTATIVE FAIRCLOUGH stated that she supports these funds going into the permanent fund or the CBR, although she said she wasn't sure she could muster support. Therefore, she requested heeding the initial request to take the governor seriously in regard to finding a way to bridge the fiscal gap in lean years. She clarified that she didn't ask the attorneys to set up legal hurdles with regard to the legislature's access to the funds because she felt that the greater conversation would occur in the House Finance Committee. However, she opined that it would be important for this committee to take seriously its duty to save the money as this committee knows that production is down.

5:04:15 PM

CO-CHAIR JOHNSON suggested that in the long-term it will be less expensive to take the three-quarter vote out of the CBR than the 50 percent out of the permanent fund dividend. He emphasized that if he ever casts a vote [to withdraw funds] from the permanent fund dividend, it will require justification.

5:04:55 PM

REPRESENTATIVE ROSES remarked that he agrees with the concept of savings, which is why his name is on Amendment 12. However, withdrawing funds from the permanent fund requires a lot of political will. Trying to withdraw funds from the CBR is also difficult. With regard to earlier comments that Amendment 12 should have a fiscal plan connected to it, Representative Roses assured the committee that both sponsors of Amendment 12 would be "on board with that." He highlighted that four members of the House Resources Standing Committee sit on the House Special Committee on Ways and Means in which there have been discussions [regarding a long-term fiscal plan]. However, that would be considered outside of this call, he related.

5:06:20 PM

CO-CHAIR GATTO opined that it's difficult to deposit a significant amount of money into the permanent fund and have it show up as a significant addition. He, again, reminded the committee that the legislature owes money to the CBR. Although a three-quarter vote from each body is an enormous hurdle, he opined that it will occur when the state is in trouble. He related his hope that this amendment survives.

5:07:38 PM

CO-CHAIR JOHNSON clarified that conceptual amendment to Amendment 12 would read: "That the money saved shall be deposited into the permanent fund."

5:08:47 PM

REPRESENTATIVE SEATON objected to conceptual amendment to Amendment 12.

5:08:54 PM

REPRESENTATIVE EDGMON commented that conceptual amendment to Amendment 12 further illustrates the complexity of the issue and

why this needs to be a stand-alone item deserving further and broader discussion in the House Finance Committee. He related his opposition to both the conceptual amendment to Amendment 12 as well as Amendment 12.

5:09:41 PM

REPRESENTATIVE WILSON stated her opposition to conceptual amendment to Amendment 12. She recalled seven years ago when the state was facing fiscal difficulties that resulted in cutting budgets and borrowing from the CBR. She said that more was borrowed from the CBR than necessary, which she attributed to the three-quarter vote. She highlighted that with a simple majority vote funds could've been withdrawn from the earnings reserve fund, but that never occurred.

5:10:44 PM

CO-CHAIR JOHNSON related his belief that if there's the desire to spend the money, it requires extreme fortitude. He reiterated that when the state raises taxes on oil companies, the resulting money needs to be part of some difficult to get or long-range planning fund. He said that Representative Wilson made his case because she pointed out that it was much easier to tackle the three-quarter vote and buy some votes rather than to face the political consequences of a [simple majority vote]. Co-Chair Johnson then called the question.

5:12:04 PM

A roll call vote was taken. Representative Johnson voted in favor of conceptual amendment to Amendment 12. Representatives Wilson, Seaton, Roses, Guttenberg, Edgmon, Kawasaki, Fairclough, and Gatto voted against it. Therefore, conceptual amendment to Amendment 12 failed to be adopted by a vote of 1-8.

5:12:36 PM

REPRESENTATIVE FAIRCLOUGH commented that by including the language proposed in Amendment 12, it will be addressed by the House Finance Committee as it's the next committee of referral.

5:14:02 PM

REPRESENTATIVE SEATON announced that he isn't going to support Amendment 12 because he has seen what happens with special accounts. He noted his agreement with Representative Wilson's

comments. He then commented that the state has a general fund and the state has been saving. Therefore, he questioned how people come to the opinion that the state hasn't been saving money. In fact, $1 billion has been placed in the education fund and $200 million in the Alaska Housing Finance Corporation (AHFC). Although the money has been put forward, it hasn't been tied up in ways that make it inaccessible.

5:16:28 PM

REPRESENTATIVE GUTTENBERG noted his agreement with Representative Seaton because even if the funds are deposited into the proposed account, it would still be general funds. However, he said he also agrees with the amendment's sponsor that it's the obligation of this committee to make all recommendations to other committees regardless of the line item. He then announced that at this point he doesn't support Amendment 12.

5:17:04 PM

CO-CHAIR JOHNSON highlighted the large amounts owed to the CBR, the Public Employees' Retirement System (PERS), and Teachers' Retirement System (TRS) liability. He opined that with the $1 billion at today's prices, much of the aforementioned could be paid off. Therefore, he noted his disagreement with the notion that the state has been frugal. Although he agreed that the state should save money, he opined that Amendment 12 merely creates an account that the public won't know about five years from now.

5:18:56 PM

CO-CHAIR GATTO related his belief that this proposal should be vetted through the normal committee process rather than being attached to this legislation.

5:19:24 PM

REPRESENTATIVE FAIRCLOUGH echoed earlier comments that regardless this money will fall into the general fund. To not support the proposed savings account moves the money into the same place proposed [in Amendment 12] with the same restrictions. "There is no reason that you should vote not to support saving the progressivity," she emphasized. In fact, the committee just voted to raise $1.5 billion with no feed back from the producers or modeling. She expressed amazement that

the committee wouldn't save this money for Alaskans. Representative Fairclough noted her agreement that the House Finance Committee should ring fence this fund, but this committee should make a recommendation regarding a nonrenewable resource to save it and allow Alaskans to benefit from it over and over.

5:20:56 PM

REPRESENTATIVE ROSES informed the committee that he agreed to sponsor Amendment 12 because the governor has asked the legislature to save the money, and establishing a savings account for the progressivity makes it easier to know how much money the progressivity model generated.

5:21:55 PM

REPRESENTATIVE WILSON said that she added her name to Amendment 12 because legislators have a responsibility to the citizens of Alaska to know the outlook for the next 10 years. She questioned what happens if oil prices decline.

5:22:45 PM

A roll call vote was taken. Representatives Roses, Fairclough, Wilson, and Johnson voted in favor of Amendment 12. Representatives Seaton, Guttenberg, Edgmon, Kawasaki, and Gatto voted against it. Therefore, Amendment 12 failed to be adopted by a vote of 4-5.

5:24:09 PM

REPRESENTATIVE FAIRCLOUGH moved that the committee adopt Amendment 13, labeled 25-GH0014\L.27, Chenoweth\Bullock, 11/2/07, which read [with handwritten changes]:

Page 22, line 3:
Delete "six"
Insert "three"

CO-CHAIR JOHNSON objected for discussion purposes.

5:24:21 PM

REPRESENTATIVE FAIRCLOUGH opined that it's bothersome to hear that an expansion of time to perform the auditing is necessary because good business practice [supports] getting business done

sooner rather than later. If the audit division believes it needs six years, then perhaps more auditors are needed to actually accomplish the task. She pointed out that taxpayers are already liable under penalties and procedures for an enormous amount of money that they carry forward on their books. Representative Fairclough recognized that there's a new auditing system and the need for time, and recalled that approximately 85 percent of the large-end audits require additional time. She then pointed out that the PPT system really hasn't been audited and expressed hope that the ACES proposal will provide clearer transparency with the cost factors, which should help in the preparation of the audits as well as moving them along in a timely fashion. If the aforementioned doesn't occur, additional auditors can be hired through the budgeting process. With that in mind, Representative Fairclough encouraged support of returning the timeframe back to three years.

5:28:28 PM

COMMISSIONER GALVIN characterized the proposal to extend the auditing timeframe to six years as an acknowledgement of reality. He confirmed that with the largest taxpayers, most require more than three years. Furthermore, the state is entering a more complex system. Although more auditors are being added, he guaranteed that the burden will much greater than can be met in three years. Without extending the statute of limitations, he opined that it guarantees the auditors will be up against the deadline on each audit and face either making a claim and formalizing the process or requesting additional time. He assured the committee that the statute of limitations isn't used as a deadline because the auditors are working on things daily to get them done as quickly as possible. The request to go to six years is simply a reflection of reality and an attempt to protect the state's interests.

5:30:19 PM

REPRESENTATIVE ROSES explained that initially he was very supportive of six years, but retracted from that once he heard that there is the ability to extend. He then recalled testimony relating that as a matter of policy one of the taxpayers won't grant extensions, no matter the location. Therefore, he asked if the administration is writing policy to address the one entity that doesn't wish to do extensions.

COMMISSIONER GALVIN answered that the administration believes it's appropriate to set the statute of limitations within the

timeframe that it's believed the work can be done. Therefore, he specified that the administration isn't seeking six years to address the one entity that doesn't wish to do extensions.

MS. DAVIS explained that the auditors have to make requests of large international corporations regarding transportation costs and things that may or may not have occurred in the state. A tremendous amount of information is required from the taxpayer and the state has to either be hard-nosed with deadlines or allow the company to comply by providing it additional time, which would require the company to grant an extension to the statute of limitations. The thought was that by extending the statute of limitations to six years, it was a matter of maintaining decent working relations, she said.

5:35:09 PM

REPRESENTATIVE FAIRCLOUGH recalled hearing earlier this afternoon that issues with those complying with the extension are typically resolved within six months. She inquired as to the typical timeframe to complete a tax return when the auditors are up against the three years.

COMMISSIONER GALVIN answered that Mr. Iversen, Tax Division, DOR, testified that the extensions are typically six months.

REPRESENTATIVE FAIRCLOUGH opined that there's a reasonable expectation to not have liabilities that lag into the future for incredible lengths of time. Therefore, she requested consideration of a shorter time period in relation to what taxpayers have to do, especially since three years gets results from most of the taxpayers.

5:37:48 PM

CO-CHAIR GATTO highlighted that six years is permissive, and therefore the audit could be completed in less than six years. He expressed concern that up against the deadline, an additional action will have to be taken to request an extension and gather the data to determine how much can be done within the deadline. He said that he wants the auditors to have six years in order to avoid facing the aforementioned.

5:38:43 PM

COMMISSIONER GALVIN explained that the representation provided with regard to how it works within the three years is a

representation of the prioritization that already occurs. That prioritization results in most issues being cleared out with only a few complicated audits pushing up against the limit. The commitment to the legislature and the taxpayer, he related, is to complete the audits in as diligent a timeframe as possible, regardless of the statute of limitations. The question is in regard to how often the auditors will be placed in the position of seeking an extension or an alternative track if the extension isn't granted. He informed the committee that the auditors have advised the administration that six years is the appropriate timeframe to manage the task before them with this new tax and complete the bulk of the audits.

CO-CHAIR GATTO expressed hope that with a new cadre of auditors, the division finds itself ahead of schedule. He said that he is perfectly willing to support the proposed six years.

5:40:27 PM

REPRESENTATIVE KAWASAKI inquired as to the number of accountants and auditors utilized under the economic limit factor (ELF) as opposed to how many there are now.

COMMISSIONER GALVIN specified that when the PPT was passed there were 10 auditors. Seven additional positions have been authorized, although they haven't all been filled. At this point, the total number of auditors remains at 17. He commented that doubling the number of auditors doesn't necessarily mean that the timeline can be cut in half as the timeline is based on factors beyond the auditors doing the work. "We believe we can manage the work within the number that we've requested and within the parameters that we requested in the bill," he opined.

REPRESENTATIVE KAWASAKI maintained his objection.

5:42:28 PM

REPRESENTATIVE WILSON recalled testimony that the state requires tax returns from the oil companies to be provided by March. However, the oil companies' year isn't complete and they don't have to do their tax returns for the company until October after which the true-ups for the partners are completed. The true-ups can take up to six months. Therefore, she surmised that before the auditors can even start looking at the true data, it's almost two years into the situation.

COMMISSIONER GALVIN clarified that the oil companies provide the state with their initial statement by April 1st. Generally, the oil companies run their primary accounting, internal auditing, and joint interest billing between partners on a schedule that's associated with the federal tax return deadline, which is in the fall. Another level of accounting, analysis, and auditing occurs in preparation for the federal tax return. At that point, the state can obtain a more detailed picture, although some outstanding issues between the partners may remain. Depending upon the outstanding issues, there may be the need to wait until the state goes further. He noted that an audit strategy for a particular year with a particular taxpayer can be developed. The two years is what the state expects to be the timeline for its process from that point forward. The aforementioned, he clarified, isn't a result of their processes taking longer.

REPRESENTATIVE WILSON said that she wanted to get on the record that the timeframes don't gel and thus can easily be extended beyond two years, outside of the department's control. She then asked if the thoroughness of the audits will be impacted if the extension to six years isn't achieved.

COMMISSIONER GALVIN responded that without the requested six years, the department will be more often forced into a situation in which it would make claim or request an extension. If the department is forced to make claim, it would be based on an incomplete audit, and therefore the claim would be made on the maximum expected for the potential liability. Basically, it's a less ideal conflict resolution process or way of arriving at a conclusion to the audit. The department is trying to avoid placing the state in the aforementioned position.

REPRESENTATIVE WILSON opined that it's very important to get as much as possible while checking credits, the auditors should be given the flexibility necessary to perform correct audits. Therefore, she opined that she would likely not support Amendment 13.

5:46:53 PM

REPRESENTATIVE ROSES related his understanding that once the joint interest billings are filed, the companies provide the department with an amended return.

COMMISSIONER GALVIN explained that the oil companies will complete their federal tax return. If that federal tax return

requires them to make an amendment to the department, they would do so.

MS. DAVIS said that an answer to such a question would require an audit of every year by taxpayer. From an operator and working interest operator standpoint, the battles within the unit are ruthless and lengthy. The aforementioned process can take a long period of time. In fact, although the process is lodged within three years, the process can take up to six years. In fact, she said she's seen it take 10 years. Even once it's resolved, the department would still need to audit to confirm that the lower costs turned into an amended return to the department. However, the problem is that the aforementioned will happen outside of three years.

5:48:54 PM

REPRESENTATIVE ROSES related his understanding that once an amended return is submitted, the statute of limitations begins.

MS. DAVIS noted her agreement.

REPRESENTATIVE ROSES asked then if it's conceivable that if the statute of limitations was extended to six years, an amended audit could potentially result [in the audit process taking] 12 years.

MS. DAVIS confirmed that there would be an additional period on that issue.

COMMISSIONER GALVIN highlighted that the additional time period would be only on the issues of the amended return.

REPRESENTATIVE ROSES commented that he tends to want to give the department the tools it needs to perform the best job it can. However, he said that he wanted to ensure that the other parties involved aren't allowed to use the time to play the system.

5:50:14 PM

REPRESENTATIVE FAIRCLOUGH posed a scenario in which the statute of limitations is six years and a taxpayer has underreported its tax return. She asked whether liability would be calculated on the entire six years.

COMMISSIONER GALVIN answered that the tax issues are isolated to the tax year in question.

REPRESENTATIVE FAIRCLOUGH related her understanding that the interest and the penalty is calculated on the six years if the true-up doesn't occur until six years.

COMMISSIONER GALVIN noted his agreement.

REPRESENTATIVE FAIRCLOUGH pointed out that business is placed at risk for six years. Furthermore, earlier statements that without an extension to the six years the state would forego future joint agreement liabilities are untrue because when a new federal return is filed, it provides a new opening for the state to collect the difference.

COMMISSIONER GALVIN clarified that would be the case only if the oil company filed a new state tax return. The filing of a new federal return doesn't change the state's statute of limitations. The oil company would only have to true-up with the state after filing an amended federal return if it chose to do so and report it to the state.

REPRESENTATIVE FAIRCLOUGH inquired then as to how the six years helps the department.

COMMISSIONER GALVIN responded that it gives the department longer to find changes in a federal tax return.

REPRESENTATIVE FAIRCLOUGH surmised then that the department doesn't have a system by which it checks to determine if the oil companies have amended their federal tax returns.

MS. DAVIS pointed out that the state doesn't receive the federal tax returns as a matter of course.

5:52:06 PM

REPRESENTATIVE FAIRCLOUGH opined that while extending the statute of limitations to six years provides the administration flexibility, the business interest is on the hook. Furthermore, she recalled testimony that these audits are resolved within six months after the completion deadline.

COMMISSIONER GALVIN clarified that those [audits] that have reached the statute of limitations generally result in an extension of six months, sometimes a year or longer.

REPRESENTATIVE FAIRCLOUGH reminded the committee that it was told that those [audits requiring an extension beyond the current statute of limitations] amounts to 85 percent of large taxpayers. "Again, we're penalizing an entire system of people that are contributing to our economy by keeping a liability out there when we only have very few people, by your comments ..., that actually cross the three-and-a-half year period," she opined.

5:53:46 PM

COMMISSIONER GALVIN said he took exception to Representative Fairclough's indication that an extension of the statute of limitations penalizes the companies. As Ms. Davis mentioned earlier, much of the time has to do with the exchange between the parties. It's a bit of a mischaracterization to say that changing the statute of limitations from three years to six years is penalizing the taxpayers, rather it's a matter of recognizing that the three-year statute of limitations will force both the department and the company against that deadline more often than thus far. The desire, he opined, is to have a deadline commensurate with the workload.

5:54:57 PM

REPRESENTATIVE FAIRCLOUGH moved that the committee adopt an amendment to Amendment 13 such that it would read as follows:

Page 22, line 3:
Delete "six"
Insert "four"

REPRESENTATIVE KAWASAKI objected.

5:55:35 PM

CO-CHAIR JOHNSON inquired as to how joint interest billings work as he said he understands that they are no longer a starting point for auditing.

COMMISSIONER GALVIN clarified that joint interest billings will be used as a starting point for auditing, which is why its specified in ACES. Existing law made the use of joint interest billings mandatory in certain cases and permissive in others. The administration, he related, wanted a general statement specifying that the department could use the industry standards as well as the joint interest billings as a way of

characterizing whether costs are "in or not." He said that [the general statement] provides the department with the discretion to use the joint interest billings.

5:56:54 PM

CO-CHAIR JOHNSON inquired as to why not mandate that the audits start with the joint interest billings as that may shorten the period of time.

COMMISSIONER GALVIN explained that the joint interest billings represent an agreement between the entities with regard to the costs agreed upon amongst companies that are appropriate to be billed to a particular unit. Those costs don't necessarily match what the state classifies as an allowable expense. The department doesn't want to be bound by what the companies agreed upon but rather believes it's appropriate for the state to identify what to deduct from its tax code. Therefore, the language should be permissive to use the joint interest billing in instances when it's useful, but not mandate it as it may not represent what would be useful [under the state's definitions].

5:58:03 PM

REPRESENTATIVE KAWASAKI related that he maintained his objection to the amendment to Amendment 13.

A roll call vote was taken. Representatives Fairclough and Johnson voted in favor of the amendment to Amendment 13. Representatives Roses, Guttenberg, Edgmon, Kawasaki, Wilson, Seaton, and Gatto voted against it. Therefore, the amendment to Amendment 13 failed to be adopted by a vote of 2-7.

5:58:48 PM

A roll call vote was taken. Representatives Fairclough, Roses, and Johnson voted in favor of Amendment 13. Representatives Guttenberg, Edgmon, Kawasaki, Wilson, Seaton, and Gatto voted against it. Therefore, Amendment 13 failed to be adopted by a vote of 3-6.

The committee took an at-ease from 5:59 p.m. to 6:41 p.m.

6:42:22 PM

REPRESENTATIVE SEATON moved that the committee adopt Amendment 26, labeled 25-GH0014\L.62, Wayne/Bullock, 11/3/07, which read:

Page 1, lines 4 - 5:
Delete "**and south of 68 degrees North latitude**"

Page 13, line 25:
Delete "and no part of which is north of 68 degrees North latitude"

Page 13, line 31, through page 14, line 2:
Delete "produced from a lease or property for which the start of regular deliveries of marketable gas is after December 31, 2007"
Insert
"(1) produced from a lease or property for which the start of regular deliveries of marketable gas is after December 31, 2007; and
(2) not supplied for
(A) consumption as petrochemical feedstock for a manufacturing process;
(B) processing into liquefied natural gas for export from the state; or
(C) conversion to a liquid"

REPRESENTATIVE KAWASAKI objected.

6:42:33 PM

REPRESENTATIVE SEATON explained that the purpose of Amendment 26 is to equalize opportunities for commercialization of natural gas across Alaska for consumer use. He further explained that Amendment 26 deletes the language specifying that the gas receiving the Cook Inlet gas credit has to be south of 68 degrees North Latitude and replaces it with language specifying that the gas receiving the preferential tax treatment can't be used for industrial purposes as defined in subparagraphs (A)-(C) of Amendment 26. The purpose is to allow a tax break, the lower tax, to go to gas supplied to Alaska residents and to commercial entities and for power generation throughout the state, no matter the source.

6:44:36 PM

REPRESENTATIVE KAWASAKI withdrew his objection.

6:44:45 PM

REPRESENTATIVE SEATON stated that Amendment 26 doesn't set the gas rate for industrial use from the North Slope or elsewhere in the state. Amendment 26 specifically excludes LNG, industrial use out of state, or conversion of a liquid such as GTL. He reiterated that this [tax break] is only meant for residential and commercial power generation in the state and doesn't set a tax rate for a gasline for LNG exports.

6:45:44 PM

REPRESENTATIVE WILSON objected for discussion purposes. She inquired as to how Amendment 26 would impact Fairbanks natural gas.

REPRESENTATIVE SEATON pointed out that Amendment 26 specifies in subparagraph (B) that it doesn't include processing into liquefied natural gas for export from the state. Therefore, if there was LNG or propane that was servicing within the state, it would receive the preferential tax. However, if it's exported or used in a manufacturing process, it wouldn't receive the preferential tax.

REPRESENTATIVE WILSON withdrew her objection.

6:46:50 PM

CO-CHAIR JOHNSON objected for discussion purposes.

REPRESENTATIVE GUTTENBERG expressed the need to hear from the administration regarding Amendment 26.

6:47:15 PM

COMMISSIONER GALVIN opined that Amendment 26 may have some unintended consequences. He explained, "If you read it as is, if there is a pipeline from the North Slope that goes across land into Canada and the gas is used for whatever purposes there, for residential purposes, we would be giving them the Cook Inlet favorable tax treatment." It isn't exclusive to in-state use, but is simply exclusive to industrial purposes. He informed the committee that the administration has drafted an amendment that basically accomplishes the same thing by stating that if there's gas produced within the state, outside of Cook Inlet, that will be used in the state, it will receive the Cook Inlet tax treatment. The administration's amendment doesn't distinguish between whether the gas is used for feed stock or otherwise, as the administration doesn't view that as an issue.

He relayed that the administration believes it's appropriate for gas produced in Cook Inlet that will be used in the state to say that it's going to receive the Cook Inlet tax treatment.

6:49:08 PM

REPRESENTATIVE SEATON related his view that the aforementioned is problematic if there's a GTL plant on the North Slope that coverts the gas to oil and it's used in the state. Without an exclusion, the Cook Inlet preferential tax treatment would be given for a commercial process. He indicated that he would be willing to withdraw Amendment 26 and entertain combining it [with the administration's amendment].

6:49:55 PM

CO-CHAIR JOHNSON recalled that there is a mine located north of 68 degrees North latitude with gas deposits that it could use to generate electricity. He asked if the adoption of Amendment 26 would create restrictions on [a project] on state lands. He also asked if the plant in Kenai won't be able to take the tax credit because it's exporting LNG.

COMMISSIONER GALVIN pointed out that it's in a separate section, and therefore would only apply to gas produced outside of Cook Inlet that's liquefied and shipped. The primary concern with Amendment 26 is that it's overly broad. He opined that there's the possibility of what the administration desires in addition to a definition that limits the in-state use to exclude conversion into liquid, which would be a simple solution that also satisfies Co-Chair Johnson's concern. Commissioner Galvin said that for basically in-state uses of the gas there is an advantage in ensuring that they aren't disparately treated in comparison to Cook Inlet. Therefore, he recommended reviewing the more comprehensive amendment and adding a clarification to avoid the situation mentioned by Representative Seaton.

6:52:52 PM

CO-CHAIR JOHNSON asked if the committee has the administration's amendment.

COMMISSIONER GALVIN informed the committee that the amendment is currently being converted into the proper form by Legislative Legal and Research Services. The amendment should be included in the next batch of amendments.

6:53:59 PM

REPRESENTATIVE GUTTENBERG reminded the committee that companies obtained their lease with certain assumptions. However, Amendment 26 would create a restriction. He asked whether that's an issue.

COMMISSIONER GALVIN clarified that [the amendment] isn't restricting the company's use, rather it's defining the tax treatment that will be applied for a particular use. Therefore, if the gas will be used for in-state consumption, there will be a specific tax treatment whereas gas that's exported out of the state would receive a different tax treatment.

6:54:59 PM

REPRESENTATIVE GUTTENBERG turned to the restrictions of the trade.

COMMISSIONER GALVIN informed the committee that the language in the administration's amendment is structured differently.

6:55:58 PM

REPRESENTATIVE SEATON withdrew Amendment 26.

6:56:20 PM

REPRESENTATIVE ROSES suggested that the reference to page 1, lines 4-5 of Amendment 26 should refer to page 1, lines 3-4.

[Following was discussion regarding committee procedure with regard to the amendments.]

7:03:01 PM

REPRESENTATIVE SEATON moved that the committee adopt Amendment 11, labeled 25-GH0014\L.12, Bullard/Bullock, 11/1/07, [text provided previously].

REPRESENTATIVE FAIRCLOUGH objected.

7:03:44 PM

REPRESENTATIVE SEATON reminded the committee that Amendment 11 was held earlier in order to determine if there was language to accomplish the reporting of capital credits and capital

expenditures by the industry when [the item/equipment] reaches the state. Language to that end wasn't found, he said. Therefore, Amendment 11 is before the committee as it was when it was first before the committee. He reminded the committee that Amendment 11 specifies that capital expenditures and capital credits will be declared as lease expenditures by the oil companies when [the item/equipment] reaches the state. One of the benefits of the aforementioned is that it provides one of the few incentives for stimulating jobs in Alaska. He then drew attention to the contingent effect on page 3 of the amendment. That provision would come into play if the final judgment of a challenge that Alaska had an advantage over another state nullified the effects, then Section 47 would take effect and thus the capex would be culled and credited when the items reach the leasehold. He opined that the aforementioned addresses the earlier question regarding the Commerce Clause.

7:06:02 PM

REPRESENTATIVE FAIRCLOUGH announced her intent to oppose Amendment 11. She restated her belief that Amendment 11 will deter investment in Alaska. Although the amendment may increase jobs in Alaska, the smaller explorers won't be able to take credits until the items are in state. She pointed out that the language on line 16 of Amendment 11 doesn't read well.

REPRESENTATIVE SEATON noted that it's the language of the drafting attorney, but said that it could be checked if the amendment is adopted.

7:07:31 PM

REPRESENTATIVE ROSES announced that he wanted to remove his name from Amendment 11.

CO-CHAIR GATTO announced that Representatives Johnson and Wilson also wanted to remove their names from Amendment 11.

7:08:00 PM

A roll call vote was taken. Representatives Edgmon, Kawasaki, Seaton, Guttenberg, and Gatto voted in favor of Amendment 11. Representatives Fairclough, Roses, Johnson, and Wilson voted against it. Therefore, Amendment 11 was adopted by a vote of 5-4.

7:09:46 PM

REPRESENTATIVE SEATON withdrew Amendment 9.

7:10:12 PM

CO-CHAIR JOHNSON moved that the committee adopt Amendment 14, labeled 25-GH0014\L.35, Cook/Bullock, 11/3/07, which read:

Page 2, line 29, following "imposed":
Delete "**tax information, records, and files received from the Department of Revenue under AS 43.05.230 shall be kept confidential in accordance with that section;**"

Page 10, line 7, following "provided in":
Insert "**(j) of this section and**"

Page 10, following line 10:
Insert a new bill section to read:
"*** Sec. 12.** AS 43.05.230(f) is amended to read:
(f) A wilful **or reckless** violation of the provisions of this section or of a condition imposed under AS 43.55.040(1)(B) is punishable by a fine of not more than **$25,000, or by imprisonment for not more than five years, or both. A violation of the provisions of this section or of a condition imposed under AS 43.55.040(1)(B) because of gross negligence is punishable by a fine of not more than** $5,000, or by imprisonment for not more than two years, or by both."

Renumber the following bill sections accordingly.

Page 10, line 12:
Delete "The"
Insert "**Except as provided in (j) of this section, the** [THE]"

Page 10, line 18, following "subsection.":
Insert "**All materials and information furnished to the Department of Natural Resources must be clearly stamped, marked, or otherwise designated, on each page, as being tax materials or information that is required to be kept confidential under this section.**"

Page 10, following line 18:
Insert a new bill section to read:

"*** Sec. 14.** AS 43.05.230 is amended by adding new subsections to read:

(j) Notwithstanding any provision of AS 38.05 or AS 41.09, the commissioner may not furnish to the Department of Natural Resources any information or materials obtained by the department under AS 43.55 that disclose a person's

(1) budget or plans, or lack of a budget or plan, for bidding in any oil and gas lease sale to be held, or planned or scheduled to be held, by the Department of Natural Resources under AS 38.05;

(2) budget or plans, or lack of a budget or plan, for bidding to purchase, making an offer to purchase, or soliciting a proposal from the Department of Natural Resources to sell under AS 38.05.183 and AS 38.06, state royalty oil or gas, or both, taken in kind under AS 38.05.182;

(3) operating and capital budgets for the current and following calendar years for a lease or property producing oil or gas, or both, including any assumptions in those budgets regarding market prices or conditions for oil and gas, unless the Department of Natural Resources certifies in writing to the department that it has no plan to offer for sale or bid under AS 38.05.183 and AS 38.06, during the current and following two calendar years, state royalty oil or gas taken in kind under AS 39.05.182 other than to renew or extend an existing contract to sell state royalty oil or gas taken in kind; or

(4) planned operating and capital budgets for either or both of the second and third calendar years after the current year for a lease or property producing oil or gas, or both, including any assumptions in those planned budgets regarding market prices or conditions for oil and gas, unless the Department of Natural Resources certifies in writing to the department that it has no plan to offer for sale or bid under AS 38.05.183 and AS 38.06, during the current and following two calendar years, state royalty oil or gas taken in kind.

(k) If the department becomes aware that any material or information that is confidential under this section has been unlawfully disclosed or is about to be unlawfully disclosed in violation of this section, or has probable cause to believe that the information has been or is about to be disclosed, the department shall, within 72 hours of first gaining the

awareness or having probable cause, notify each person whose confidential material or information is or may be included in that actual, apparent, or threatened disclosure. The department shall cooperate to the fullest extent permitted by law with each person it notifies under this subsection to prevent the disclosure, if possible, and, if the disclosure has occurred or appears to have occurred, to recover as quickly as possible all material or information and to minimize its further disclosure and dissemination. When the department believes that an unlawful disclosure has occurred, it shall report the crime as quickly as practicable to the division in the Department of Public Safety responsible for the Alaska state troopers.

(*l*) Each other state agency that receives confidential material or information under this section shall, with respect to an actual, apparent, or impending unlawful disclosure of that information, have the same duty and authority to respond to the situation that the department has under (k) of this section.

(m) In this section, "oil" and "gas" have the meanings given in AS 43.55.900."

Renumber the following bill sections accordingly.

Page 30, line 17:
Delete "Notwithstanding"
Insert "(a) Subject to (b) of this section and notwithstanding"

Page 30, line 22:
Delete "lease or property, unit, or"

Page 31, following line 4:
Insert a new subsection to read:

"(b) The department may not select a group of producers or explorers for purposes of publishing a category of aggregated information for them if the amount in that category of information for one of the group accounts for more than 40 percent of the group's total for that category."

Renumber internal references to bill sections in accordance with this amendment in a way that makes sections 12 and 14, added by this amendment, effective

immediately and omits them from the applicability and retroactive sections. Below are all internal bill section references in this bill:
Page 31, lines 25, 27, 29, 30, and 31
Page 32, lines 1, 3, 13, 16, 19, and 31
Page 33, lines 2, 19 - 20, 21, and 22

[End of Amendment 14.]

CO-CHAIR GATTO objected.

7:10:43 PM

CO-CHAIR JOHNSON pointed out that Amendment 14 calls for more penalties for violations and requires the department to clearly mark and identify all the confidential information, which strengthens the confidentiality of the department. He related that Co-Chair Gatto has assured him that once the amendment is cleaned up [with respect to narrowing its focus to the call], it will be presented to the House Finance Committee. At this time, Co-Chair Johnson withdrew Amendment 14.

7:12:03 PM

CO-CHAIR JOHNSON moved that the committee adopt Amendment 15, which read:

Page 10, line 19 - Page 33, line 23
Delete: Sec. 13 through Sec. 45

CO-CHAIR GATTO objected.

7:12:29 PM

CO-CHAIR JOHNSON explained that Amendment 15 provides the administration with the desire to have the administrative fixes to provide the necessary information to the legislature. Without enough information on the first sections of the legislation, he questioned why the committee is making a decision on the remainder of the legislation. He emphasized that the committee doesn't have enough information to make the decisions it's being asked to make. Furthermore, the business community across the state is shuddering.

7:14:22 PM

A roll call vote was taken. Representative Johnson voted in favor of Amendment 15. Representatives Seaton, Roses, Guttenberg, Edgmon, Kawasaki, Fairclough, Wilson, and Gatto voted against it. Therefore, Amendment 15 failed to be adopted by a vote of 1-8.

7:15:18 PM

REPRESENTATIVE GUTTENBERG moved that the committee adopt Amendment 16, labeled 25-GH0014\L.16, Wayne/Bullock, 11/3/07, which read:

Page 1, line 8, following "**supervisors**":
Insert "**and to allow them to participate in the public employees' retirement system defined benefit plan**"

Page 9, following line 15:
Insert new bill sections to read:
"*** Sec. 10.** AS 39.35.095 is amended to read:
Sec. 39.35.095. Applicability of AS 39.35.095 - 39.35.680. The [FOLLOWING] provisions of **AS 39.35.095 - 39.35.680** [THIS CHAPTER] apply only to members first hired before July 1, 2006**, or members who are eligible under AS 39.35.159 to elect the defined benefit plan** [: AS 39.35.095 - 39.35.680].
*** Sec. 11.** AS 39.35 is amended by adding a new section to article 3 to read:
Sec. 39.35.159. Election of retirement benefits by oil and gas auditors. Notwithstanding any contrary provision of this chapter, an oil and gas auditor under AS 39.25.110(42) may, within 30 days after commencing employment or within 30 days after the effective date of this section, whichever occurs later, elect to participate in the defined benefit plan established in AS 39.35.095 - 39.35.680 in lieu of participating in the defined contribution retirement plan established under AS 39.35.700 - 39.35.990. A person making an election under this section may not change the election more than 30 days after commencing employment. The board shall establish transfer procedures by regulation."

Renumber the following bill sections accordingly.

Page 31, line 25:

Delete "Sections 24, 25, 32 - 34, and 37"
Insert "Sections 26, 27, 34 - 36, and 39"

Page 31, line 27:
Delete "Sections 14 - 20, 31, and 38"
Insert "Sections 16 - 22, 33, and 40"

Page 31, line 29:
Delete "Sections 26 and 27"
Insert "Sections 28 and 29"

Page 31, line 30:
Delete "sec. 26"
Insert "sec. 28"

Page 31, line 31:
Delete "sec. 27"
Insert "sec. 29"

Page 32, line 1:
Delete "sec. 29"
Insert "sec. 31"

Page 32, line 3:
Delete "secs. 13 and 29"
Insert "secs. 15 and 31"

Page 32, line 31:
Delete "secs. 24, 25, 32 - 34, and 37"
Insert "secs. 26, 27, 34 - 36, and 39"

Page 33, line 2:
Delete "secs. 14 - 20, 26, 27, 31, and 38"
Insert "secs. 16 - 22, 28, 29, 33, and 40"

Page 33, lines 19 - 20:
Delete "Sections 24, 25, 32 - 34, and 37"
Insert "Sections 26, 27, 34 - 36, and 39"

Page 33, line 21:
Delete "Sections 14 - 20, 26, 27, 31, and 38"
Insert "Sections 16 - 22, 28, 29, 33, and 40"

Page 33, line 22:
Delete "sec. 44"
Insert "sec. 46"

CO-CHAIR JOHNSON objected.

7:15:28 PM

REPRESENTATIVE GUTTENBERG explained that Amendment 16 allows the new oil and gas auditors the ability to have the option of entering the state's defined benefit plan or the defined contribution plan. This will help address the difficulties in recruiting and retaining these individuals.

[Following was discussion regarding how the committee would proceed.]

7:30:27 PM

REPRESENTATIVE FAIRCLOUGH inquired as to the administration's view of Amendment 16.

COMMISSIONER GALVIN stated that the administration doesn't support Amendment 16.

7:30:51 PM

REPRESENTATIVE WILSON opined that it's not fair for new entrants to be able to pick which benefit package, and therefore she said she wouldn't support Amendment 16.

7:31:23 PM

REPRESENTATIVE ROSES opined that Amendment 16 isn't the best way to handle the issue, although it does need to be addressed. He echoed Representative Wilson's comment with regard to fairness. He mentioned the unfunded liability of PERS and TRS and the need to permanently address PERS and TRS.

7:33:11 PM

REPRESENTATIVE SEATON related his belief that reopening the class and establishing a new class won't stand the test. Therefore, he urged members to vote against Amendment 16.

7:33:45 PM

REPRESENTATIVE GUTTENBERG emphasized that the new oil and gas auditors are being given high status, pay, and have even been taken out of the classified category. The [unfunded] liability of PERS and TRS is small compared to what the state will receive

by bringing in these exempt auditors. He highlighted that Amendment 16 merely provides these new oil and gas auditors an option.

7:35:01 PM

A roll call vote was taken. Representatives Kawasaki, Guttenberg, and Edgmon voted in favor of Amendment 16. Representatives Fairclough, Wilson, Seaton, Roses, Johnson, and Gatto voted against it. Therefore, Amendment 16 failed to be adopted by a vote of 3-6.

The committee took an at-ease from 7:36 p.m. to 8:16 p.m.

8:16:50 PM

CO-CHAIR GATTO reconvened the meeting.

8:17:01 PM

REPRESENTATIVE GUTTENBERG withdrew Amendment 17.

8:17:17 PM

REPRESENTATIVE EDGMON withdrew Amendment 18, but highlighted the importance of providing a fund for energy assistance particularly for those in rural Alaska.

8:18:27 PM

REPRESENTATIVE GUTTENBERG moved that the committee adopt Amendment 19, labeled 25-GH0014\L.39, Bullard/Bullock, 11/3/07, which read:

> Page 10, following line 18:
> Insert a new bill section to read:
> "*** Sec. 13.** AS 43.05.241 is amended by adding a new subsection to read:
> (b) In an appeal under this section, an amount due under AS 43.55 shall be paid within 30 days after the date of the service of the informal conference decision. In place of payment of the amount due, the taxpayer may file a bond with the department or place funds equal to the amount of the tax obligation in an escrow account, under escrow instructions approved by the department."

Renumber the following bill sections accordingly.

Page 31, line 25:
Delete "Sections 24, 25, 32 - 34, and 37"
Insert "Sections 25, 26, 33 - 35, and 38"

Page 31, line 27:
Delete "Sections 14 - 20, 31, and 38"
Insert "Sections 15 - 21, 32, and 39"

Page 31, line 29:
Delete "Sections 26 and 27"
Insert "Sections 27 and 28"

Page 31, line 30:
Delete "Section 26"
Insert "Section 27"

Page 31, line 31:
Delete "sec. 27"
Insert "sec. 28"

Page 32, line 1:
Delete "sec. 29"
Insert "sec. 30"

Page 32, line 3:
Delete "secs. 13 and 29"
Insert "secs. 14 and 30"

Page 32, following line 3:
Insert a new subsection to read:
"(e) AS 43.05.241(b), added by sec. 13 of this Act, applies to informal conference decisions under AS 43.05.240(a) entered on or after the effective date set out in sec. 45 of this Act."

Page 32, line 31:
Delete "secs. 24, 25, 32 - 34, and 37"
Insert "secs. 25, 26, 33 - 35, and 38"

Page 33, line 2:
Delete "secs. 14 - 20, 26, 27, 31, and 38"
Insert "secs. 15 - 21, 27, 28, 32, and 39"

Page 33, lines 19 - 20:
Delete "Sections 24, 25, 32 - 34, and 37"

Insert "Sections 25, 26, 33 - 35, and 38"

Page 33, line 21:
Delete "Sections 14 - 20, 26, 27, 31, and 38"
Insert "Sections 15 - 21, 27, 28, 32, and 39"

Page 33, line 22:
Delete "sec. 44"
Insert "sec. 45"

CO-CHAIR JOHNSON and REPRESENTATIVE ROSES objected.

8:18:51 PM

REPRESENTATIVE GUTTENBERG explained that if there's an informal conference committee decision between a taxpayer and the state and there's a dispute, then the amount due shall be paid to the state either in bonds or funds in an escrow account. Basically, Amendment 19 transfers the responsibility or pressure on who wants to settle. He opined that the other side will be more willing to come to the table and reach a resolution if the funds are placed in an escrow account.

8:19:42 PM

REPRESENTATIVE SEATON inquired as to whether an informal conference decision is an appropriate place for the liability to occur for the deposit of funds.

COMMISSIONER GALVIN specified that the service of the informal conference decision would be the beginning of the formal administrative appeal process. "If there is a desire to ... put the money up and we'll decide who's going to end up with the disputed amount, that would be an appropriate timeframe to do so," he said. In response to Co-Chair Johnson, Commissioner Galvin stated that the administration doesn't object to Amendment 19.

8:21:20 PM

REPRESENTATIVE ROSES reminded the committee that just a few hours ago the committee substantially increased the revenue to the state and has instituted fines, penalties, and requirements. Now to require that the money be placed in a escrow account seems to be over the edge, he opined. Therefore, Amendment 19 isn't an amendment he can support at this time, he stated.

8:22:20 PM

REPRESENTATIVE WILSON asked if Amendment 19 would be beneficial to the administration in any way.

COMMISSIONER GALVIN noted his agreement with the sponsor that Amendment 19 could change the taxpayer's perspective in regard to drawing out the issue. However, there are other provisions, such as the penalties and interest, that create that motivation and thus it's a matter of striking a balance.

8:23:28 PM

REPRESENTATIVE FAIRCLOUGH asked if more management would be required with the proposal in Amendment 19.

COMMISSIONER GALVIN responded no, in regard to the form of additional personnel. However, additional administrative steps would be required to manage it and thus there would be some workload associated with the proposal in Amendment 19.

REPRESENTATIVE FAIRCLOUGH asked if the passage of HB 2001 [as amended] today would [send the message] that Alaska is open for business or are doors being closed as "we continue to weigh down a proposal from the governor."

COMMISSIONER GALVIN, with regard to Amendment 19, noted his agreement that the committee needs to balance the message being sent to the industry and reflect upon whether that's being achieved. He then said he shared the concern that adding more penalties, oversight, and distrust does send a negative message.

8:26:01 PM

REPRESENTATIVE FAIRCLOUGH announced that once the amendment process has concluded she may want to reconsideration the 50 percent penalty. She expressed concern with regard to the message the amendments are sending.

8:26:38 PM

REPRESENTATIVE GUTTENBERG highlighted that Alaska is a resource state. He opined that many of these issues are sovereign issues and taking control of the state for the state is important.

8:28:31 PM

REPRESENTATIVE ROSES related his assumption that no more personnel would not be needed, although additional time may be spent on the matter. Therefore, he related his further assumption that an additional fiscal note would be required.

COMMISSIONER GALVIN said that a fiscal note would only be necessary in instances in which additional personnel is necessary. If it's merely a matter of an additional loop with no additional personnel, then there wouldn't be a fiscal impact.

8:29:24 PM

CO-CHAIR JOHNSON maintained his objection.

8:29:38 PM

A roll call vote was taken. Representatives Guttenberg, Edgmon, and Kawasaki voted in favor of Amendment 19. Representatives Fairclough, Wilson, Seaton, Roses, Johnson, and Gatto voted against it. Therefore, Amendment 19 failed to be adopted by a vote of 3-6.

8:30:29 PM

REPRESENTATIVE EDGMON moved that the committee adopt Amendment 20, labeled 25-GH0014\L.18, Bullard/Bullock, 11/2/07, which read:

> Page 17, following line 3:
> Insert a new bill section to read:
> "*** Sec. 23.** AS 43.55.023(a) is amended to read:
> (a) A producer or explorer may take a tax credit for a qualified capital expenditure as follows:
> (1) **Unless** [NOTWITHSTANDING THAT A QUALIFIED CAPITAL EXPENDITURE MAY BE A DEDUCTIBLE LEASE EXPENDITURE FOR PURPOSES OF CALCULATING THE PRODUCTION TAX VALUE OF OIL AND GAS UNDER AS 43.55.160(a), UNLESS] a credit for **an** [THAT] expenditure is taken under AS 38.05.180(i), AS 41.09.010, AS 43.20.043, or AS 43.55.025, a producer or explorer that incurs a qualified capital expenditure may [ALSO] elect to take a tax credit against a tax due under AS 43.55.011(e) in the amount of 20 percent of that expenditure;
> (2) a producer or explorer may take a credit for a qualified capital expenditure incurred in connection with geological or geophysical exploration

or in connection with an exploration well only if the producer or explorer provides to the department, as part of the statement required under AS 43.55.030(a) for the calendar year for which the credit is sought to be taken, the producer's or explorer's written agreement

(A) to notify the Department of Natural Resources, before the later of 30 days after completion of the geological or geophysical data processing or completion of the well, or 30 days after the statement is filed, of the date of completion and to submit a report to that department describing the processing sequence and provide a list of data sets available;

(B) to provide to the Department of Natural Resources, within 30 days after the date of a request, specific data sets, ancillary data, and reports identified in (A) of this paragraph;

(C) that, notwithstanding any provision of AS 38, the Department of Natural Resources shall hold confidential the information provided to that department under this paragraph for 10 years following the completion date, after which the department shall publicly release the information after 30 days' public notice."

Renumber the following bill sections accordingly.

Page 18, following line 22:
Insert a new bill section to read:

"*** Sec. 26.** AS 43.55.023(k) is amended to read:

(k) In this section, "qualified capital expenditure"

(1) means, except as otherwise provided in (2) of this subsection, an expenditure that is a lease expenditure under AS 43.55.165**, that is not also a lease expenditure deducted by a producer under AS 43.55.160,** and **that** is

(A) incurred for geological or geophysical exploration; or

(B) treated as a capitalized expenditure under 26 U.S.C. (Internal Revenue Code), as amended, regardless of elections made under 26 U.S.C. 263(c) (Internal Revenue Code), as amended, and is

(i) treated as a capitalized expenditure for federal income tax reporting purposes by the person incurring the expenditure; or

(ii) eligible to be deducted as an expense under 26 U.S.C. 263(c) (Internal Revenue Code), as amended;

(2) does not include an expenditure incurred to acquire an asset (A) the cost of previously acquiring which was a lease expenditure under AS 43.55.165 or would have been a lease expenditure under AS 43.55.165 if it had been incurred after March 31, 2006; for purposes of this subparagraph, "asset" includes geological, geophysical, and well data and interpretations; or (B) that has previously been placed in service in the state; an expenditure to acquire an asset is not excluded under this paragraph if not more than an immaterial portion of the asset meets a description under this paragraph."

Renumber the following bill sections accordingly.

Page 31, line 25:
Delete "Sections 24, 25, 32 - 34, and 37"
Insert "Sections 23, 25 - 27, 34 - 36, and 39"

Page 31, line 27:
Delete "31, and 38"
Insert "33, and 40"

Page 31, line 29:
Delete "Sections 26 and 27"
Insert "Sections 28 and 29"

Page 31, line 30:
Delete "sec. 26"
Insert "sec. 28"

Page 31, line 31:
Delete "sec. 27"
Insert "sec. 29"

Page 32, line 1:
Delete "sec. 29"
Insert "sec. 31"

Page 32, line 3:
Delete "29"
Insert "31"

Page 32, line 31:
Delete "24, 25, 32 - 34, and 37"
Insert "23, 25 - 27, 34 - 36, and 39"

Page 33, line 2:
Delete "26, 27, 31, and 38"
Insert "28, 29, 33, and 40"

Page 33, lines 19 - 20:
Delete "Sections 24, 25, 32 - 34, and 37"
Insert "Sections 23, 25 - 27, 34 - 36, and 39"

Page 33, line 21:
Delete "26, 27, 31, and 38"
Insert "28, 29, 33, and 40"

Page 33, line 22:
Delete "44"
Insert "46"

[End of Amendment 20.]

CO-CHAIR JOHNSON objected.

8:30:51 PM

REPRESENTATIVE EDGMON explained that the intent of Amendment 20 is to not allow a taxpayer to utilize the deduction and the credit, and thereby double dip.

8:31:35 PM

JOHN MESSENGER, Staff to Representative Kerttula, Alaska State Legislature, began by informing the committee that he was the deputy commissioner in DOR for a few years and was also in the attorney general's office for a few years in which he represented DOR. After leaving state service, Mr. Messenger related that he was in private practice for 20 years during which he worked with staff in DOR and Department of Law regarding various matters defending the state's tax structure in lawsuits raised by the oil industry. He noted that he also worked in private practice defending tax audits in the severance tax and the oil and gas corporate income tax area. He noted that he is an attorney. In response to Representative Roses, Mr. Messenger confirmed that during this special session he is working for Representative Kerttula.

8:33:21 PM

CO-CHAIR JOHNSON asked if Mr. Messenger is staff or a hired consultant.

MR. MESSENGER specified that he is staff.

8:33:45 PM

MR. MESSENGER explained that under the PPT if a capital expenditure can be deducted under .160, .165 and also receive a tax credit for that same capital expenditure under the proposed legislation, a company can "double up" on the same expenditure. During times of higher oil prices the combination of taking a deduction and a credit as well as taking a federal income tax deduction and deducting it for state income taxes can result in the state and federal government paying close to 100 percent or even more than 100 percent of the expenditure. Amendment 20 specifies that a company can't deduct and take a credit on the same capital expenditure.

8:36:02 PM

REPRESENTATIVE ROSES, recalling past presentations, asked if it would be fair to characterize Amendment 20 as a cap on the credits.

MR. MESSENGER opined that Amendment 20 proposes a different approach, such that a company that takes a deduction can't take a credit and vice versa.

8:37:21 PM

COMMISSIONER GALVIN, in response to Representative Fairclough, explained that the fundamental structure of the tax is the concept that a deduction is received as well as a credit. Accepting Amendment 20 would result in an alteration of all of the economics provided and thus would change the entire tax system.

8:38:22 PM

REPRESENTATIVE SEATON asked if there is any time at which the value of the tax deduction would not exceed the tax credit. He related his assumption that if there's 22.5 percent or 25 percent deductibility from the capex, under almost every

circumstance the deductibility will exceed the 20 percent capital credit.

COMMISSIONER GALVIN noted his agreement with Representative Seaton's assumption.

8:39:15 PM

REPRESENTATIVE SEATON surmised then that the effect of Amendment 20 is to cancel out the 20 percent tax credit entirely because it will always be exceeded by the benefit of the deductibility of the tax.

REPRESENTATIVE EDGMON replied yes.

8:39:48 PM

REPRESENTATIVE ROSES reminded the committee of the problems with the cap, and then announced that he will oppose Amendment 20.

8:40:48 PM

REPRESENTATIVE FAIRCLOUGH inquired as to the "tax consequence" this places on the industry.

REPRESENTATIVE EDGMON said that he has brought Amendment 20 forward to discuss it and have the committee determine whether it's too aggressive.

8:41:29 PM

REPRESENTATIVE FAIRCLOUGH opined that this characterization that these credits are double dipping is a new concept as she has understood them to provide an incentive and encourage development. She expressed the need to know the fiscal impact of reducing the credit by almost 50 percent of what the industry currently receives.

COMMISSIONER GALVIN pointed out that the net effect of Amendment 20 would be to make the 20 percent credit moot. Given that capital expenditures are projected to be in the neighborhood of $2 billion this year, the effect of Amendment 20 would be to add an extra $400 million tax burden.

8:43:12 PM

REPRESENTATIVE WILSON opined that a balance between fairness and production is being sought. She expressed concern that Amendment 20 eliminates the state sharing in some of the risks, and questioned the impacts that will have on a company's decision to invest in the state. She related that she is in opposition to Amendment 20.

8:44:42 PM

REPRESENTATIVE SEATON reminded everyone that with the progressivity the credits aren't allowed to be deductible because the investments are at very high margins. Therefore, the state didn't need to contribute those funds through deductibility because it's beyond the level at which people will be making investment decisions. The capital credits and the deductibility under the base are designed to stimulate decisions for investment. The non-deductibility of the progressivity is what keeps the gold plating from going forward, and therefore there isn't concern with regard to the cap.

8:46:17 PM

REPRESENTATIVE GUTTENBERG inquired as to the effect the progressivity chart, previously adopted [through an amendment], have on investment credits. He then inquired as to the maximum deductions available to be taken with this one off the table.

8:46:53 PM

COMMISSIONER GALVIN, regarding the progressivity, said the credit remains 20 percent. Commissioner Galvin said:

> The nature of the question goes to: Have we over contributed to a capital investment? What Representative Seaton was alluding to is: Does the structure of the progressivity that you provided was based upon a calculation on the gross value. And so, you don't get the ... the multiplying affect of the impact being felt on allowing the base to affect the deduction and having the progressivity calculated against it, a deducted amount, and then the credit on the top of that. But, there still is going to be an effect because your rate's going to continue to go up, and your investment is going to bring down your margin, which will bring down your progressivity which will bring down your calculated amount. So, I think in the end the actual percentage that we end up having

> ... is probably still going to be in the range of, at the maximum level, probably 70-80 percent - calculating including federal and all the others. ... the slides that you may be referring to were the models that were looking at the marginal effect of one extra dollar being .... I think with the progressivity that you adopted, you're still going to hit that point at some point, it just will be further up the scale.

8:49:35 PM

MR. PORTER said that Commissioner Galvin provided a fair representation of the impact of taking out the 20 capex as proposed under Amendment 20. The relationship between impacts to legacy fields versus more expensive fields wasn't necessarily evaluated because the more expensive fields have a higher lifting cost and thus would've received a higher percentage of the capex. Therefore, they would receive a disproportionate hit [under Amendment 20]. To fully understand Amendment 20 and its impacts, the tax models would need to be remodeled under this proposal.

8:51:10 PM

REPRESENTATIVE ROSES asked if Mr. Porter would recommend whether Amendment 20 should be supported.

MR. PORTER indicated that it's difficult to respond to such a large change, a $400 million shift, without more review. In response to Co-Chair Johnson, Mr. Porter affirmed that he is a legislative consultant and his work product is public and available to any member of the legislature.

8:53:34 PM

REPRESENTATIVE FAIRCLOUGH related her belief that although Representative Edgmon's proposal is worth considering, it's late in the process. Therefore, she said that she would not support Amendment 20, but look to the House Finance Committee to model the impacts of the amendments passed and the impact Amendment 20 will have.

8:55:36 PM

CO-CHAIR JOHNSON asked if the administration supports Amendment 20.

COMMISSIONER GALVIN replied no.

8:55:54 PM

REPRESENTATIVE EDGMON opined that he has at least accomplished the goal of initiating discussion, and acknowledged that it's a bit beyond the scope of where the committee is. Therefore, he withdrew Amendment 20.

8:56:23 PM

CO-CHAIR GATTO suggested that Amendment 20 be introduced to the House Finance Committee early on.

8:56:39 PM

[A discussion ensued regarding how to proceed with the amendments remaining. HB 2001 was held over.]

9:00:03 PM

ADJOURNMENT

The House Judiciary Standing Committee meeting was recessed at 9:00 p.m., to be continued at 10 a.m. November 4, 2007. [The meeting reconvened November 4, 2007.]