**ALASKA STATE LEGISLATURE**
**SENATE JUDICIARY STANDING COMMITTEE**
November 1, 2007
9:05 a.m.

**MEMBERS PRESENT**

Senator Hollis French, Chair
Senator Charlie Huggins, Vice Chair
Senator Bill Wielechowski
Senator Lesil McGuire
Senator Gene Therriault

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Senator Gary Stevens
Senator Bettye Davis
Senator Thomas Wagoner
Senator Lyda Green
Senator Johnny Ellis
Senator Joe Thomas

**COMMITTEE CALENDAR**

SENATE 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: SB2001

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

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|---|---|---|
| 10/18/07 | (S) | READ THE FIRST TIME - REFERRALS |
| 10/18/07 | (S) | RES, JUD, FIN |
| 10/19/07 | (S) | RES AT 9:00 AM BUTROVICH 205 |
| 10/19/07 | (S) | Heard & Held |
| 10/19/07 | (S) | MINUTE(RES) |
| 10/20/07 | (S) | RES AT 8:00 AM BUTROVICH 205 |
| 10/20/07 | (S) | Heard & Held |
| 10/20/07 | (S) | MINUTE(RES) |
| 10/21/07 | (S) | RES AT 1:00 PM HOUSE FINANCE 519 |
| 10/21/07 | (S) | Heard & Held |
| 10/21/07 | (S) | MINUTE(RES) |
| 10/22/07 | (S) | RES AT 11:30 AM BUTROVICH 205 |
| 10/22/07 | (S) | Heard & Held |
| 10/22/07 | (S) | MINUTE(RES) |
| 10/23/07 | (S) | RES AT 9:00 AM BUTROVICH 205 |
| 10/23/07 | (S) | Heard & Held |
| 10/23/07 | (S) | MINUTE(RES) |
| 10/24/07 | (S) | RES AT 10:00 AM BUTROVICH 205 |
| 10/24/07 | (S) | Heard & Held |
| 10/24/07 | (S) | MINUTE(RES) |
| 10/25/07 | (S) | RES AT 10:00 AM BUTROVICH 205 |
| 10/25/07 | (S) | Heard & Held |
| 10/25/07 | (S) | MINUTE(RES) |
| 10/26/07 | (S) | RES AT 1:30 PM BUTROVICH 205 |
| 10/26/07 | (S) | Heard & Held |
| 10/26/07 | (S) | MINUTE(RES) |
| 10/27/07 | (S) | RES AT 9:00 AM BUTROVICH 205 |
| 10/27/07 | (S) | Moved CSSB2001(RES) Out of Committee |
| 10/27/07 | (S) | MINUTE(RES) |
| 10/28/07 | (S) | RES AT 0:00 AM BUTROVICH 205 |
| 10/28/07 | (S) | -- MEETING CANCELED -- |
| 10/29/07 | (S) | RES RPT CS 1NR 6AM NEW TITLE |
| 10/29/07 | (S) | NR: GREEN |
| 10/29/07 | (S) | AM: HUGGINS, MCGUIRE, STEVENS, STEDMAN, WIELECHOWSKI, WAGONER |
| 10/29/07 | (S) | JUD AT 9:30 AM BUTROVICH 205 |
| 10/29/07 | (S) | Heard & Held |
| 10/29/07 | (S) | MINUTE(JUD) |
| 10/30/07 | (S) | JUD AT 9:00 AM BUTROVICH 205 |
| 10/30/07 | (S) | Heard & Held |
| 10/30/07 | (S) | MINUTE(JUD) |
| 10/31/07 | (S) | JUD AT 9:00 AM BUTROVICH 205 |
| 10/31/07 | (S) | Heard & Held |
| 10/31/07 | (S) | MINUTE(JUD) |

**WITNESS REGISTER**

DAN DICKINSON, Consultant
to the Legislative Budget & Audit Committee
**POSITION STATEMENT:** Testified and answered questions during hearing on SB 2001.

STEVE PORTER, Consultant
to the Legislative Budget & Audit Committee
**POSITION STATEMENT:** Testified and answered questions during hearing on SB 2001.

MARILYN CROCKETT, Executive Director
Alaska Oil and Gas Association (AOGA)
**POSITION STATEMENT:** Introduced Tom Williams and answered questions during hearing on SB 2001.

TOM WILLIAMS, Chair
Alaska Oil and Gas Association Tax Committee
**POSITION STATEMENT:** Testified and answered questions during hearing on SB 2001.

JONATHAN IVERSEN, Director
Tax Division
Department of Revenue
Anchorage, AK
**POSITION STATEMENT:** Testified and answered questions during hearing on SB 2001.

JULIE HOULE, Section Chief
Resource Evaluation
Division of Oil & Gas
Department of Natural Resources
Anchorage, AK
**POSITION STATEMENT:** Testified and answered questions during hearing on SB 2001.

JACKIE STEWART
Juneau, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

TIM ARNOLD
Juneau, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

DONALD BENSON
Matanuska-Susitna Borough
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

MARK SHARP
Fairbanks, AK
**POSITION STATEMENT:** Voiced concerns during hearing on SB 2001.

BUZZ OTIS
Great Northwest
Fairbanks, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

JERRY McCUTCHEON
Anchorage, AK
**POSITION STATEMENT:** Stated concerns during hearing on SB 2001.

STU GRENIER
Anchorage, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

AVES THOMPSON, Executive Director
Alaska Trucking Association
Anchorage, AK
**POSITION STATEMENT:** Testified on SB 2001 and PPT issues.

JASON BRUNE, Executive Director
Resource Development Council
Anchorage, AK
**POSITION STATEMENT:** Testified on SB 2001 and PPT.

JEFFREY KNAUF
Girdwood, AK
**POSITION STATEMENT:** Testified in support of original SB 2001.

EMILY FORD, Government and External Affairs Manager
Anchorage Chamber of Commerce
Anchorage, AK
**POSITION STATEMENT:** Testified on SB 2001 and PPT.

JIM SYKES
Palmer, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

DAWN MENDIAS
Chugiak, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

SIG RUTTER
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

MARY AND JIM ODDEN
Nelchina, AK
**POSITION STATEMENT:** Testified on SB 2001 via a joint statement read by Mary Odden.

MALCOLM RAY
Eagle River, AK
**POSITION STATEMENT:** Voiced concerns during hearing on SB 2001.

DANIEL B. WINN
Homer, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

KELLY WALTERS
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

PAUL KENDALL
**POSITION STATEMENT:** Voiced concerns during hearing on SB 2001.

TOM LAKOSH
**POSITION STATEMENT:** Voiced concerns during hearing on SB 2001.

MARSHALL BYRD
Anchorage, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

GLORIA DESROCHERS
Fairbanks, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

JARED HAMLIN
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

BILL WARREN
Nikiski, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

JIM ADAMS
Nome, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

RANDY SELMAN
Wasilla, AK

**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

SHANNYN MOORE
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

JOHN RANDALL
Wasilla, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

STEVE MORAWITZ
Wasilla, AK
**POSITION STATEMENT:** Testified on SB 2001 during public hearing.

**ACTION NARRATIVE**

**CHAIR HOLLIS FRENCH** called the Senate Judiciary Standing Committee meeting to order at 9:05:24 AM. Present at the call to order were Senators Huggins, McGuire, Therriault, Wielechowski, and Chair French. Also in attendance were Senators Stevens, Davis, Wagoner, Green, Ellis, and Thomas.

9:05:42 AM

**SB 2001-OIL & GAS TAX AMENDMENTS**

CHAIR FRENCH announced the consideration of SB 2001. Members would hear from the legislative consultants about net-versus-gross tax systems and other topics including their reactions to the model presented yesterday by Rich Ruggiero and Bob George of Gaffney Cline & Associates (Gaffney Cline). They'd also hear from the Alaska Oil and Gas Association (AOGA) on net versus gross. Then a few cleanup matters relating to legal issues would be addressed; these include the size of settlements from litigation and royalty versus tax. The administration might provide input about defining the point of production; a handout was available. There also might be testimony about sharing information. Public testimony was scheduled for the evening.

DAN DICKINSON, Consultant to the Legislative Budget & Audit Committee, concurred with yesterday's testimony about net versus gross. He indicated Commissioner Galvin of the Department of Revenue (DOR) had articulated a number of things clearly, and Gaffney Cline had laid out the reasons a net tax is always preferable to a gross tax when focusing on investment objectives and trying to have a degree of progressivity.

MR. DICKINSON told members he'd always heard that the main reason for wanting a gross tax is because of lack of trust, that

somehow companies will find a way to increase their deductions and manipulate it so the state gets nothing. He gave an historical perspective, saying he'd spent seven or eight years involved with the Amerada Hess litigation, which was related to royalty under the net system.

9:08:32 AM
MR. DICKINSON, in response to Chair French, said he'd worked as a consultant on that, building models and doing quantitative work, and then as the liaison between the litigation team headed by Wil Condon and the settlement team headed by Julian Mason. He explained that the Amerada Hess litigation was filed in June 1977, within days of the first oil going into the Trans-Alaska Pipeline System (TAPS), and it proceeded throughout the 1970s and 1980s. The case was called Amerada Hess because that company was listed first alphabetically; when that company settled in perhaps 1989, it became the Arco case because Arco was listed next; and when Arco settled, it became Amerada Hess et. al. because people didn't want to keep changing the title.

MR. DICKINSON said final settlement of those issues didn't occur until 1996 or perhaps 1997. Thus there was nearly 20 years of litigation about a so-called simple gross royalty. Referring to a question from Senator Wielechowski previously, he emphasized that this wasn't just fighting about one deduction. There were huge issues. For the first 10 or 15 years, the big issue related to the value of the oil.

MR. DICKINSON observed that now people are accustomed to having a publicly reported spot price, futures, NYMEX, and a huge market in what are called "paper barrels" that are traded - much larger than the number of liquid barrels traded. In addition, there are three reporting-assessment services to which someone can subscribe, and many newspapers publish information. There is constant talk of "the price of oil." In the 1980's, however, the so-called official price was typically set by Saudi Arabia, although other companies had official prices. "We didn't know how much our oil was worth," he said, characterizing oil as a barter game, a barter business.

MR. DICKINSON explained that companies have production and refineries all over the world. Rather than taking their own oil to their refineries, they get oil from the nearest production. Thus barrels get traded, all over the place. For example, one tanker from Saudi Arabia contained oil that had changed hands 27 times before it hit the Gulf coast. There also were price controls. He recalled in 1980, under President Carter's "phased

decontrol," every month part of a barrel had a price control on it and part didn't; every month it changed. It was a nightmare to figure out the value.

9:12:09 AM
MR. DICKINSON continued with the history, noting Mark Rich was pardoned for the crime of buying tankers of controlled oil and selling it as uncontrolled oil. The controlled price was perhaps $6 or $7, whereas the decontrolled price was $30. "Huge fights," Mr. Dickinson remarked. Under President Reagan, decontrol went away. But the windfall profits tax came in, with a series of challenges. For example, Prudhoe Bay was controlled under one regime and Kuparuk under another. This required tracing the oil. A huge panoply of issues focused around price.

MR. DICKINSON added that a small group of DOR auditors grappled with that issue for 15 years; simultaneously, it was grappled with on the royalty side. It never went all the way to court because both sides had fairly decent arguments. By the time those cases settled out, billions of dollars had been paid to the state, including interest.

9:13:42 AM
CHAIR FRENCH welcomed Senators Stevens and Davis.

SENATOR THERRIAULT referred to the dispute over the royalty valuation; he recalled testimony yesterday that because it is a contractual arrangement, litigation might take longer. However, what is being discussed with PPT - known as both the petroleum production tax and the petroleum profits tax - relates to a sovereign entity carrying on its duties. Thus there is hope, though no guarantee, that the litigation track on that would be less, because the courts give the agencies administrative discretion.

MR. DICKINSON responded that he believes the record would almost exactly prove Senator Therriault's point. Noting he was talking about information in the public record, Mr. Dickinson said if one looks at price control and the "bubble era" until the price crashed in 1986 - the first ten years of Alaska North Slope (ANS) production - two cases, involving BP and Arco, were resolved earlier than Amerada Hess. But for Exxon, the third major producer, it took a couple of years longer to finalize settlement of the tax issues than for Amerada Hess.

MR. DICKINSON added that said he was being a little simplistic, because Amerada Hess had TAPS as the first big issue; then the

pricing issue, which dominated that; and then the tanker issues. In conclusion, however, he agreed it can go on a quicker track for tax issues.

SENATOR THERRIAULT surmised that instead of arguing over a definition of price or delivery point, for instance, the standard is whether the tax system is fair or whether it is applied in an arbitrary or capricious manner; if not, the decision typically goes with the sovereign entity.

9:16:15 AM
MR. DICKINSON replied yes and no. If the statute uses a term like "price" or "value," the question that arises is what was meant. Those words still have to have meaning brought to them, and the government doesn't automatically prevail over the taxpayer. There is a question of who has the burden of proof and so forth.

MR. DICKINSON referred to Spencer Hosie's memo, saying he was talking about how long one goes through the internal process. In support of Senator Therriault's point, Mr. Dickinson recalled that Mr. Hosie had said once something leaves what was then the office of tax appeals - now the administrative law judge - and goes to court, it is just like any other court dispute, with discovery and so on. It may not be like a contractual dispute, but the state is essentially just another party in court along with the defendant. The case he'd mentioned earlier would have moved through the internal appeals more quickly.

9:18:02 AM
SENATOR WIELECHOWSKI asked whether there are regulations in effect that deal with write-offs under the net-profit section in the royalty statutes, AS 38.05.180.

MR. DICKINSON affirmed that.

SENATOR WIELECHOWSKI asked where those regulations are in the Alaska Administrative Code (AAC). He suggested Mr. Dickinson could tell him later.

MR. DICKINSON said those regulations are specifically referenced in the PPT law as a standard the state can consider, among other things, when writing its regulations for the tax.

SENATOR WIELECHOWSKI explained that he has been hearing concern from people in his district about lease expenditures as they

relate to the deductions. He said there are no regulations, although regulations were promised last year within 30 days.

MR. DICKINSON replied he wasn't sure it was physically possible to do it in 30 days. The minimum process is about 120 days.

SENATOR WIELECHOWSKI recalled hearing they'd be rolled out within 30 days.

9:18:50 AM
MR. DICKINSON said there are regulations in place that deal with lease expenditures, although they might not deal with great specificity for those portions. In further response, he said he believes those are part of the AAC, fully adopted.

SENATOR WIELECHOWSKI asked whether work currently is being done on new regulations to further define lease expenditures.

MR. DICKINSON answered that those specific concerns were put off "for a phase two." What is expressed in the current regulations may be viewed as more general.

9:19:49 AM
SENATOR WIELECHOWSKI explained that the concern relating to lease expenditures is this tremendous gray area of what is or isn't a cost. He asked about ways to tighten it in the current legislation. He asked whether it is possible to tie either the regulations or auditing requirements to federal Securities Exchange Commission (SEC) and Internal Revenue Service (IRS) filings. Those are much stricter, with heavier penalties.

MR. DICKINSON answered not only is it possible, but to the extent it's feasible, "we've done that." Because the SEC and IRS are federal agencies, what exists is a negative test. For example, a company cannot get a capital credit unless it told the federal government it was a capital investment. Typically, companies try to move things to the expense side to get an immediate write-off; for something labeled "capital" there is no write-off until it is placed in service, and then there is a 5- or 6- or 10- or 19-year write-off.

MR. DICKINSON noted a company looks at its worldwide expenses. The problem is how to parse Alaska expenses from non-Alaska expenses, because the SEC and IRS don't really care. The large companies have interrelationships in certain fields in Alaska, and thus they'll look over their shoulder and audit expenses of the other companies. He said this was one attempt to get at

that problem. Clearly, there are places where that doesn't work, such as Badami and Milne Point, which are owned 100 percent by BP; there is no second-guessing there, and nobody looking over the shoulder.

MR. DICKINSON said people can also create scenarios, such as: What if Exxon agrees to overpay in Prudhoe Bay, meaning the State of Alaska bears the brunt, and then they get it back in a different field Exxon operates for BP? He personally believes such behavior isn't seen frequently. Rather, auditors from Exxon typically look at Prudhoe Bay with respect to keeping costs down.

9:23:32 AM
MR. DICKINSON suggested what one oil company is willing to reimburse another company for is a pretty good standard - though not perfect - of how to capture the costs, looking at the tensions that exist among these different companies. He added that when the department writes regulations, he isn't sure how much more specific it can get. He expressed hope that the department's list won't be ten pages long, because some of those will be vague and folks will have to figure out whether something is included or not.

SENATOR WIELECHOWSKI noted the statute says producers' lease expenditures for a calendar year include costs. The question is how to define costs to be written off, although there is some guidance and statutory reference. He said this is a highly important area, and he didn't know that the committee had spent enough time on it. Potentially. $1 billion could be coming to the state and yet a company could claim costs of $800 million to write off.

9:25:25 AM
MR. DICKINSON responded that the language says costs have to be actual, direct, ordinary and necessary - which ties to the IRS filter - costs of exploring for, developing, or producing oil or gas. In some sense, it's a broad category, everything necessary to find the oil, get it out of the ground, and get it into a pipeline. But it doesn't include the kinds of things people have talked about such as lobbying costs, donations, and so on.

SENATOR WIELECHOWSKI replied, "We've asked DOR about that and they said, 'Well, we don't think it is, but we can't really say for sure.'" He reiterated that it is a big gray area.

MR. DICKINSON responded that he believes DOR's question was whether those have been included in the costs the companies have filed. He indicated the department doesn't know because it hasn't audited yet. He clarified that he'd been talking about whether, if DOR found those things, it could simply say they weren't allowed. He opined that appeals officers and everybody who has read the statute should hold the department up on that, agreeing it was inappropriate. Rather than what is or isn't included, he was saying what should or shouldn't be, and an audit would reveal how closely those two match.

9:27:07 AM
CHAIR FRENCH noted it is easy to measure gross value at the point of production. But the new variable, the new black hole, is costs, which were 100 percent over what was projected. What if they're wrong again? He said he didn't know whether the legislature had the political will to come back and tinker with the system once again, and a mistake might remain for a decade.

MR. DICKINSON highlighted two possible interpretations of a 100 percent increase in costs. One is that folks got together and found invoices they hadn't found before; such issues will be addressed by the auditors. The other is that as prices rose dramatically, those who provide things to oil service companies raised prices, and companies wanting to get production on line quickly met those prices; thus the economic wealth flowing from having a commodity sell for $80 a barrel - when the investment was made with an expectation of $30 - was distributed to everyone who served that industry. He said if the cost structure has indeed gone up, the state needs to understand that; it clearly wasn't anticipated previously.

MR. DICKINSON added that the commissioner was articulate in pointing out that if there were a gross tax that couldn't accommodate such change, possibilities might be eliminated for development in areas that weren't anticipated. Thus it is important to distinguish between costs rising inappropriately, which auditors can ferret out, and rising as an unanticipated consequence of this being a new world, with $90 oil.

CHAIR FRENCH asked Mr. Porter to comment on net versus gross and other aspects of the tax system being contemplated. Then he asked to hear from Mr. Porter and Mr. Dickinson about the model presented yesterday by Gaffney Cline, including internal rates of return (IRRs) on North Slope production, at least for Kuparuk and Prudhoe Bay.

9:29:55 AM

STEVE PORTER, Consultant to the Legislative Budget & Audit Committee, reinforced what Mr. Dickinson had said, noting PPT may have worked exactly as it should have, but "we just were surprised by the numbers." The companies can't just come up with $800 million out of the air. It must be actual costs. The padding will be when they take actual costs from Houston, Texas, or another project that is marginally related. The question is whether there is a direct relationship.

MR. PORTER said he'd never seen an audit where the auditor didn't disallow something. A percentage of items will be disallowed, based on a difference of interpretation. Corporations are corporations. They'll look at the law. If they think a cost may be allowed, they'll put it in. The state's auditors will then look at it and may interpret it differently. This is a common debate.

MR. PORTER noted each time a tax is changed, a level of legal uncertainty is created, new interpretations of the law. It is to be expected, whether the system is gross or net. The responsibility with respect to this law is to tighten the range of things over which there might be a difference of opinion. Over the next four or five years, more certainty will be created through regulation and litigation. He said it isn't an area he is concerned about because it takes time, money, and process.

MR. PORTER highlighted a longer-term need to build a system that stands the test of time. In his world, that means 15 years. Whether it's gross or net, the need is for a system that works, not worrying about gaming. He said gaming doesn't occur. What occurs is people looking out for their own best interests. If that occurs, it will happen over the next four or five years and then get tightened down to where it isn't as big a problem as in the past.

MR. PORTER cited oil and gas settlements as an example where there have been huge fights but a small differential. Although the present concerns are valid, he emphasized making sure the tax is right. It will bring in many billions of dollars, while the fights will be over millions of dollars. Thus the legislature must recognize the perspective and get the structure right, ensuring conflict is minimized after that. If this is done, legislators will have done their job.

9:35:19 AM

CHAIR FRENCH said 15 years strikes him as about the best one can hope for. In his view, the last significant change was in 1989, and around 2004 it was time to make a change. Better late than never, he added.

CHAIR FRENCH welcomed Senator Wagoner.

SENATOR THERRIAULT remarked that the desire to achieve that 10 to 15 years - without being able to anticipate price, production, whether it is heavy oil, and so on - has really factored into his moving from gross towards the net. He recalled testimony that a highly workable gross-based system can be perfect for today's scenario with respect to price and production and yet get out of balance in a year or five years. Thus it seems the net mechanism is a large part of trying to achieve 10 or 15 years' worth of stability, because the system internally corrects for those little things and hopefully treats both sides fairly so stability can be achieved. He asked whether that is true.

9:37:00 AM
MR. PORTER answered that when he came up here, he was thinking about progressivity, initially thinking perhaps it doesn't matter whether it is a gross or net tax. The more he works with the numbers, however, the more what Senator Therriault was talking about occurs: The gross is more static, and the net allows the tax itself to be more stable for a longer time period before getting into a discontinuity - a lack of balance - between what the state and the industry are receiving. Thus he is now supportive of a net system from a progressivity standpoint. It provides the most flexibility.

SENATOR HUGGINS offered an analogy to football posed by some of his constituents, concluding that a net system allows some dexterity and flexibility so the team isn't stuck with whatever play was called in the huddle.

9:38:51 AM
SENATOR McGUIRE gave an analogy of individual property tax based on how many improvements are made to ones' house, with a higher rate unless improvements are made. The flat rate is like the gross-based tax, paid no matter what. It is simple, but there is no incentive to make improvements. She highlighted incentivizing behavior with carrots and sticks, saying hyper-progressivity is fine, since more is taken when companies make more, but it ought to be based on net.

CHAIR FRENCH concurred, suggesting important "sticks" to maintain are an aggressive auditing capability and aggressive penalties. He cited the IRS as an entity that puts a little fear into people's minds about taxes. He estimated that worldwide Exxon makes $100 million in profits daily. Required is a penalty commensurate with its financial standing. When looking at the broad picture, therefore, the legislature should keep everyone on the straight and narrow through auditing capabilities and penalties.

SENATOR WIELECHOWSKI returned to direct costs. He referenced AS 43.55.165(b)(1)(A), Section 57 of Version A of the bill, which read in part:

> (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;

He expressed concern that this language allows a capital item to be treated as an operating expense.

MR. DICKINSON explained that when a dollar is spent, whether capital or operating, it is allowed as a deduction. Under current law, 22.5 cents of that comes out of the state's pocket. The company immediately deducts both capital and operating costs. For capital costs, then, there is an additional credit. But in that first rank they're treated identically.

9:43:34 AM
SENATOR WIELECHOWSKI asked about tightening the language to define operating expenses as defined by general accounting practices, rather than as costs.

MR. DICKINSON opined that "we have a tighter standard." There are generally accepted accounting principles and the "ordinary and necessary" test used by the IRS. He said he believes "ordinary and necessary" will be a tighter standard. But there's always a question of whether to look at book or tax, and there are different sets of rules for various things.

MR. DICKINSON explained, "What we opted for, in general - and I think you'll see this in the regulations as well - is to look at

the tax rules and tax timing, when that was available." The generally accepted accounting standards won't help in figuring out what's an Alaskan cost and what isn't, for example, because those deal with how a company reports its operations and its balance sheet to the rest of the world.

SENATOR WIELECHOWSKI noted Section 56 of Version A of the bill, page 46, talks about a reasonable allowance for the calendar year as determined under regulations by the department.

AN UNIDENTIFIED SPEAKER said it's Section 19 of Version M, which is CSSB 2001(RES); the language is on page 16. Lines 9-11 read:

> (2) a reasonable allowance for that calendar year, as determined under regulations adopted by the department, for overhead expenses that are directly related to exploring for, developing, or producing, as applicable, the oil or gas deposits.

SENATOR WIELECHOWSKI interpreted this to be defining it in regulation such that a reasonable allowance for directly related overhead is 9 percent. But it doesn't say what a directly related expenditure is when it comes to overhead. He asked whether the committee might want to tighten it up.

9:46:08 AM
MR. DICKINSON asked whether he was referring to the 9 percent, to the Department of Natural Resources (DNR) regulations.

SENATOR WIELECHOWSKI affirmed that.

MR. DICKINSON said most of the rest is saying, "Here are the direct costs." He apologized that he didn't have it in front of him. He said it is carefully defined, because otherwise it's not allowed. When identifying what's allowable, usually one is also defining what's direct. Typically, everything allowed gets that 9 percent markup. There isn't really a third category of things that are allowed but not considered direct.

9:47:03 AM
SENATOR McGUIRE asked whether joint or common costs are excluded currently. She referred to page 4 of a memo from Spencer Hosie, forwarded by Marcia Davis. Senator McGuire noted the discussion was about potential complexities of administering a net tax, including that, through time and evolution, a heavy audit will probably ferret out a lot of these things. One concern would be inappropriate joint or common costs that a company may pass on.

She asked whether there is a way to specify that a direct cost excludes a percentage of those, or some other definition.

MR. DICKINSON agreed it's possible, but the problem would be defining joint costs, figuring out how much is applicable and how much isn't. With respect to PPT, he said he'd personally spent a year and got to meet some of the world's experts on joint costs because there was a central gas facility that was making things for production as well as for sale. For this billion-dollar facility, the largest of its kind in the world, they'd had to figure out whether each bolt or nut was deductible. This is one reason the legislature passed a law that said there is a circle drawn around the North Slope and that all the operations there are deductible.

MR. DICKINSON surmised an issue might occur if a company has a strategic initiative to monetize heavy gas and has a bunch of scientists that spend six months in Alaska working on the project and have another demonstration plant in Calgary, for instance. Somebody would have to figure out how much of their time is Alaskan and how much isn't. He'd rather have an auditor do that - with a general prescription that says it has to be a direct cost of developing, finding, or producing - than to say joint costs will be split 50-50.

9:50:11 AM
SENATOR McGUIRE asked about creating a rebuttable presumption that joint or common costs are excluded and it is up to the company to prove otherwise. The burden would be on the company.

MR. DICKINSON said that could be done, but the issue won't be to exclude them. They won't come in unless they actually have some relationship to Alaska; then the question would be what percentage applies. He opined that it isn't desirable to say that if a company decides to develop heavy oil and thus spends half its time looking at Alaska and half looking at another heavy oil deposit elsewhere, then Alaska would exclude 100 percent of those costs.

SENATOR McGUIRE agreed, saying that is a great analogy. Any company's promotion of developing heavy oil, even worldwide, may ultimately benefit Alaska. However, in the example where half is in Calgary and half in Alaska, clearly the state wouldn't want to allow for the deduction in Calgary. She again asked: Given that the state doesn't have the resources - although it will try to hire more expert auditors - what about shifting the

burden of proof to the company, with a rebuttable presumption against joint or common costs?

9:51:59 AM
MR. DICKINSON reiterated that it could be done, but there'd be separate fights about whether something was a joint and common cost. There are lots of debates about the point at which some common elements truly become common costs, rather than just corporate overhead that the state excludes. While seeing Senator McGuire's point, he expressed concern about the applicability. However, the case just talked about is one where it might work.

SENATOR WIELECHOWSKI referred to Section 20 of Version M, page 17, lines 8-11, which reads in part:

> (B) standards adopted by the Department of Natural Resources that determine the costs, other than items listed in (e) of this section, that a lessee is allowed to deduct from revenue in calculating net profits under a lease issued under AS 38.05.180(f)(3)(B), (D), or (E).

He asked how "net profits" is defined.

MR. DICKINSON replied most royalties on the North Slope are under a DL-1 lease. In the 1980s, people responding precisely to the concerns mentioned today had asked whether gross-based royalties are best; they wanted to try net royalties. There'd be a base rate paid, but also a development account into which all costs would go. When a profit was finally made, the company would pay the state some percentage. The bids on that went as high as 80 percent of those net profits, to his recollection.

MR. DICKINSON said what this language refers to is the specific regulations. Mentioning Endicott, a couple of leases at Milne Point, and some left at Kuparuk, he said at the maximum he'd guess 7-10 percent of oil production is from leases defined as net profit share leases (NPSLs).

9:54:56 AM
SENATOR WIELECHOWSKI asked whether there is a definition of net profits in the regulations.

MR. DICKINSON replied there is a definition of what the net profit share applies against. These regulations say what costs can be put into the development account. There is an important

reason why there are only specific things mentioned. For example, the time value of money is recognized in the net profit share. As money sits in the development account, it is multiplied by an interest component; there is a carrying cost. Under PPT, it's explicit that financing costs are not an allowable deduction. Thus it's a little different.

MR. DICKINSON added that how one looks at the value of the oil or gas is part of DNR's regulations; the amount of profit once it reaches payout has to do with those things. This is very different from the standards in the tax statute. The four sections there focus on cost deductions.

9:56:17 AM
CHAIR FRENCH asked whether Mr. Porter and Mr. Dickinson had been able to review the model presented yesterday afternoon by Gaffney Cline.

MR. PORTER replied no.

MR. DICKINSON said they'd requested a copy and had heard they may be able to get it soon. He offered to comment on the details after seeing it, and said they could comment in general now with respect to testimony yesterday.

CHAIR FRENCH noted this committee would be forwarding the bill soon, but wanted to get at least a general view.

MR. DICKINSON reminded members about two conclusions drawn by the presenters of the model. First, it perhaps make sense to have steeper progressivity to capture more on the upside. Second, it may make sense in this other arena to have a lower-based tax rate. He said it is important to note that, under current law, investments are made with what some call "30 cent dollars." He went to the board to illustrate.

9:58:55 AM
MR. DICKINSON posed a scenario in which he is a company deciding whether to invest a dollar, looking at the tax year in which the investment would be made. He could deduct that dollar from his PPT return filed that year, with the deduction at 22.5 percent.

CHAIR FRENCH suggested that the dollar be for steel pipe with which to drill a well.

MR. DICKINSON explained that when he deducts it, he gets back 22.5 cents; his tax bill is lowered that amount. If there is

5 percent progressivity, the state pays another 5 cents. Steel is a capital expense, so he gets a credit, another 20 cents off his tax bill. In an extreme instance, if he has been making investments before, there are transitional investment expenditures (TIE) credits available; those must be matched dollar for dollar by new incremental spending, and since he is spending this new dollar he gets 10 percent additional credit. This totals 57.5 cents. He'd spend 42.5 cents out of pocket and the state would pick up 57.5 cents.

MR. DICKINSON continued with his illustration. If a 35 percent federal tax rate is assumed, not taking into account the ability to capitalize and take depreciation, the IRS takes 35 percent. Before that, however, it allows deducting the 57.5 percent, giving a 35 cent deduction for the out-of-pocket portion. Thus the federal government picks up about 18 cents of that, and his payment drops to roughly 23 cents.

MR. DICKINSON asked who is really spending that dollar. He answered that it's the State of Alaska, because it's trying to get investment by spending 57.5 cents; the federal government, which through the deductions is spending about 18 cents; and the company, spending about 23 cents. The company's out-of-pocket expense would be fairly small.

MR. DICKINSON asked: Why wouldn't people want to invest under this regime? He answered that in year two, there is no depreciation and no effect beyond an operating piece. An extra barrel of oil is generated, and of the profit from that, the state takes 22.5 percent and the federal government takes 35 percent. So the company pays a smaller piece, but it isn't as small a piece as was contributed for the initial investment.

MR. DICKINSON concluded that for dollars being invested, it's as if the company is investing 23-cent dollars. Those get recaptured over time. As that is discounted, when the recapturing occurs, it's less heavily favored and so the IRR or net present value (NPV) goes very high because of all this upfront support from the state and the federal government.

10:04:31 AM
SENATOR THERRIAULT surmised that the immediate rebate of cash from the state is what really pumps up the company's NPV calculations. Those are hard, real dollars returned to the company's pockets immediately. The state's benefit is the additional "22.5 take" on the barrels that then get produced, year after year, for a number of years.

MR. DICKINSON affirmed that, saying it's 22 or even the additional 5 percent. As Mr. Ruggiero pointed out yesterday, if the state has a lower discount rate than the companies, it's a win-win situation. The immediate benefit to the company is up front, where the discount rate matters most, and the benefit to the state, to the company's detriment, is further out, "where they sort of discount it away and we take full advantage of it."

10:05:43 AM

MR. PORTER added it's not so much that the company gets a return to its pockets immediately, because this is all about expenditures. He said NPV in a layman's world is how much less someone has to spend today for the money that will be shared tomorrow - the shared money being the state's 57.5 percent, the federal government's 18 percent, and the company's 42.5 percent. That all has to be put together. It's nice to have that upfront benefit, which is the benefit of the net, but as the tax rises the company gets fewer dollars per barrel in those out years. That's the balance.

SENATOR THERRIAULT reported hearing that the State of Alaska under PPT has picked up about 52 percent of the costs, but its revenue share is only 39 percent; he has been asked where the fairness is. Under ACES, however - the governor's plan called Alaska's Clear and Equitable Share set forth in the original SB 2001 - it was pitched to him that the rebalancing is this: The state's share rises to 44 or 45 percent, to his belief, while the state's share of costs comes down. Thus it's more of a match. He asked if the testifiers could verify those rough numbers.

MR. PORTER replied he couldn't testify directly as to the percentages because he didn't know what model generated them. In principle, though, one can go back to "a low price world and a high price world," since the percentages change around the world based on that due to progressivity. In a high oil-price world, not a high cost world, the state definitely wants that increased percentage because it doesn't hurt as badly and the state wants a fair share. In a low price world, that progressivity drops out and the state's percentage drops as well. This is the desired balance. It actually works. He added that in a high price world, the state wants to get a fair percentage while not hurting more high-cost environments such as West Sak where the desire is to help out; the net allows this.

10:08:28 AM

MR. DICKINSON added he'd have to look at the numbers, but the effect Senator Therriault had mentioned would be happening directionally. Under ACES, in this example, 20 percent would drop out immediately; a little bit more would be picked up by the federal government; the progressivity might be a little different; and then, with respect to the terms of recovery later on, the only increase would be 22.5, going up to 25.

SENATOR THERRIAULT referred to the point that the federal government would pick something up. He said if the state drops off an expense, one would normally think it would shift to the company side. But only a portion of it does.

AN UNIDENTIFIED SPEAKER affirmed that.

SENATOR THERRIAULT said a portion gets shifted to the federal treasury. He surmised Alaskans would agree that if some investment costs can be shared with the federal treasury, that's a win-win situation in Alaska for a company and the state.

CHAIR FRENCH asked whether the testifiers agreed.

MR. DICKINSON said it was absolutely correct. It generally would be 35 percent federal sharing.

10:09:50 AM

MR. PORTER said he wanted to reinforce a piece that Mr. Dickinson had mentioned as well, in terms of not only what the model suggested, but also in coming to the conclusion, from a practical standpoint, of making sure to keep a low, stable base tax as well as a higher progressivity that better matches the economics of projects "on a broader statement than the other way around." He emphasized capturing the progressivity piece, but also having a stable tax base.

SENATOR WIELECHOWSKI noted he'd heard conflicting things about a low base price. While understanding how higher progressivity keeps more money in Alaska, he'd thought a somewhat higher base rate would actually encourage investment with respect to some of the more difficult fields because there is a higher deduction.

MR. PORTER replied he'd struggled with that after hearing it yesterday. From a number-crunching standpoint, he understands how one can get there. But if he were the taxpayer and the state raised his tax so there was higher deductibility, it would take a dollar out of his pocket and give it to the state. On an individual, unique project basis, it's possible to make that

happen on paper. From a broad standpoint, however, he has a hard time with those economics. He surmised that if it were true on a broad basis, the industry would be here lobbying for higher taxes.

10:12:18 AM
SENATOR WIELECHOWSKI agreed it doesn't make intuitive sense. But when the net present values were shown, for instance, on a 35 percent tax rate with a higher progressivity than ACES, it actually had a higher NPV than at a 22 percent tax rate.

MR. PORTER replied NPV isn't the only determination of project economics. It's only one element that an oil company or any other taxpayer would use.

SENATOR WIELECHOWSKI asked Mr. Dickinson what experience he had with respect to working with oil companies in their boardrooms.

MR. DICKINSON answered none. He then said it is counterintuitive, but he thinks the notion is that one can look at an isolated benefit when the company makes the investment, but the investment is going to "peel off barrels" and then it is "a detriment to those barrels." Thus there is a need to sit down and do the math. People have to look at those too. If people just could invest with 23-cent dollars, they'd run to do it. But the other shoe falls at some point. The desire is to find that balance.

MR. DICKINSON surmised one lesson to be drawn from the model is that for something like infill drilling - where the risks are as low as they can be for any project in the oil industry - it makes sense to add a lot of support at the front end and then capture a larger piece on the outer end.

CHAIR FRENCH suggested Mr. Dickinson could make a case for a two-tiered tax structure: one for Kuparuk and Prudhoe Bay infill drilling, the center of the target, and another for new exploration that is away from existing infrastructure and is more risky because of uncertainty with respect to looking for new oil.

MR. DICKINSON answered that one could make the case. However, one could also make the case that judgments can be made about things and how to do them. But one way is to just look at the dollars spent. He noted that earlier he'd been going to say that under the reviled economic limit factor (ELF) system, costs were recognized. But there was a proxy created for them.

CHAIR FRENCH said it was a mathematical model.

MR. DICKINSON concurred, saying it was a mathematical model that required looking at field size and well productivity, believing that to be a good way to measure costs; barrels were excluded so people could recover their costs. It worked in that people didn't want to change it for many years. But prices quadrupled. Whereas a few dollars a barrel had been excluded previously, it became $50 or $60.

MR. DICKINSON added that a proxy for costs never works. It gets away from the basic idea that spending - provided there are controls to ensure it is real spending on production or exploration - is the best way to figure out the tax rate and the rate at which investments will be measured.

10:16:14 AM
SENATOR THERRIAULT suggested that relates to this idea of the old severance tax being basically a gross tax with the ELF modifier, which couldn't accommodate the higher price. When the price spiked upward, the system became unstable because it couldn't self-adjust.

MR. DICKINSON replied he thinks that is exactly right. It couldn't accommodate changes in technology. He noted there was an aggregation order that he signed in January 2005, recognizing changes in the field that may not have been anticipated fully when that structure was created, and how that affected costs. He said all kinds of things can happen that make the proxies or assumptions less valid over time. He opined that going to a net system may not be perfect over all time, but goes a lot further towards providing stability because it recognizes a whole range of changes, so long as those changes are always reflected in the costs and investments people are willing to make.

SENATOR THERRIAULT suggested part of it was evaluating whether it was time to jump to the new system. As the price per barrel rose, people realized it wasn't fair to the state. But then the price would drop. Turning to the concept of a two-tiered tax system, he surmised that further exploration in the legacy fields is as close to low risk as can be seen worldwide with respect to drilling and getting extra barrels.

MR. DICKINSON said he wouldn't even categorize it as exploration. It's infill drilling.

SENATOR THERRIAULT asked: Because the expense of doing that is lower, does the net system already have a bit of a differential tax structure for legacy fields, since with lower costs there are lower deductions and so the effective tax rate that a company pays for that infill drilling is higher automatically?

10:18:43 AM
MR. PORTER replied that's exactly what the Gaffney Cline presentation showed. He said it's not perfect, fine-tuned down to the penny. Roughly speaking, however, with respect to taxing cash flow generated from these legacy fields - which he characterized as the sweet spot, with comparatively low overhead on a per-barrel basis - they get taxed a lot higher because their cash flow starts sooner. If it costs $20 a barrel for expenses, they'll start getting taxed on the cash flow at that point, whereas the West Saks of the world start at $40. Calling the net an equalizer, he said Gaffney Cline did an excellent job of presenting that ratio, which actually works in a net world.

SENATOR THERRIAULT asked the consultants to really look at the different components, the mathematical cells in the model. He asked whether, in general, there was any component from the discussion yesterday that they felt was suspect or needed proving up. He noted that even Chair French had said yesterday that the numbers were fairly eye-popping.

MR. DICKINSON replied that he would repeat the cautions from Gaffney Cline, the builders of the model, that this was taking infill drilling from one project and someone else's projection of the barrels, put together with some prices. He said it wasn't meant to be a universal model. He then specified that his biggest concern would be folks drawing broader conclusions from the model than the data might support. If DNR is using the data and doing things so these models can go for more projects, he said that's a great analytical tool.

The committee took an at-ease from 10:20:57 AM to 10:37:28 AM.

CHAIR FRENCH welcomed Marilyn Crockett and Tom Williams of AOGA.

MARILYN CROCKETT, Executive Director, Alaska Oil and Gas Association, noted AOGA is a trade association for the oil industry in Alaska. She introduced Tom Williams, who would present AOGA's testimony today.

TOM WILLIAMS, Chair, Alaska Oil and Gas Association Tax Committee, specified that he is senior royalty and tax counsel

for BP Exploration (Alaska) Inc. and a former tax administrator with DOR, but was speaking as chair of the AOGA Tax Committee. He began by addressing a question asked by Senator McGuire with respect to a presumption. He read the first two sentences from existing AS 43.05.245, relating to assessment and collection of tax:

> If a taxpayer fails to file a return or report required by this title in the time required by law or regulation, or makes an erroneous or fraudulent return, the department shall proceed to assess the license fees, tax, penalties, or interest and make a return from information that it obtains. An assessment or a return subscribed by the department in accordance with this section is presumed sufficient for all legal purposes.

MR. WILLIAMS said "erroneous" is the operative word in the first sentence. If auditors went in and looked at something, unless they were convinced the expenditure was appropriate, they could disallow it and the disallowance would be presumed correct. That's also why a jeopardy assessment that DOR can do is such a powerful tool. Then there is a categorical disallowance, and the taxpayer has the burden of showing everything, including even the parts the taxpayer had satisfied the auditor about. This is existing law. So there is a presumption of correctness with the auditor.

10:39:51 AM

MR. WILLIAMS turned to his testimony. He explained that AOGA takes "gross" as referring to a production tax levied on the gross value at the point of production as defined in AS 43.55.900(12). The prior ELF-based tax was such a gross tax. Furthermore, AOGA take "net" to refer to a production tax levied on the value that remains after subtracting the operating and capital costs of the oil and gas operation from the gross value at the point of production.

MR. WILLIAMS said the present PPT is an example of a net tax, with the lease expenditures, as defined in Section 165 of the statutes, being the costs deducted from the gross value to get this taxable production-tax value. Or the production-tax value under PPT is equivalent to a value at the rock face, where the oil flows into the well and is severed from the reservoir.

MR. WILLIAMS suggested the fundamental question with respect to gross versus net isn't about which tax can generate more revenue

for the state. If one tax generates "x" dollars, it is always possible to find a rate for the other tax that generates a like amount. Instead, the question is how realistic the production tax should to be in terms of its effects on the real world. Oil and gas aren't renewable. No new oil or gas is created to replace what's being taken out of the ground. Consequently, the more that is removed from a reservoir and produced, the more difficult and expensive it becomes to produce the next barrel of oil or cubic foot of gas from what remains.

MR. WILLIAMS highlighted the huge resources of viscous and heavy oil known to exist on the North Slope. Because of the physical characteristics of the oil itself and the reservoirs where it's found, the oil is physically difficult to produce, starting with the first barrel. Viscous oil - which flows more slowly than conventional oil but can still be pushed through the rock into the wells by injecting water - is primarily found in the West Sak formation. The West Sak rock is crumbly; a lot of fine particles of rock are entrained in the oil as it flows into the well and then turns into an oily sludge. This sludge has to be removed from the oil at the surface. It must be handled and disposed of with great care, since it is a hazardous material for purposes of healthy, safety, and environmental laws.

MR. WILLIAMS described heavy oil as too thick to be pushed through the reservoir rock by water injection. It is found in the Ugnu formation not far below the permafrost. One promising technology for producing this oil involves getting the reservoir rock to flow like a stream of sand into the well, carrying the oil with it, and then separating out the oil at the surface.

10:43:14 AM
MR. WILLIAMS pointed out that the same health, safety, and environmental issues for hazardous materials apply to the handling and disposal of this sand, which translates into high production costs, even as production starts.

CHAIR FRENCH asked if West Sak oil is lighter than Ugnu oil.

MR. WILLIAMS affirmed that. Continuing, he said if the state didn't want to take such factors into consideration, it might levy a flat tax of "x" cents a barrel over a thousand cubic feet. Simple to administer and forecast, it would resemble the gross tax discussed. But the discussion here is about gross versus net.

MR. WILLIAMS showed a graph illustrating production economics for a hypothetical conventional oil field, with a tax on gross value. Five bars depicted the economics of the field in five stages of its life. Also depicted were the state's one-eighth royalty on the gross value; a flat gross tax; and operating costs for the field, which rise with time as the oil is depleted. In the middle was an area representing what is left for the producer - in this case, the net operating margin.

10:46:42 AM
CHAIR FRENCH said members recognize that expenses generally rise over time. He asked, however, whether the tiny expenses shown at the beginning of the illustration take into account the enormous upfront capital costs of getting to this stage. He then surmised it is from the first day of production forward.

MR. WILLIAMS affirmed the latter, saying the point is that it starts off with those costs. This is shown in percentages because it holds true no matter what price is assumed. It shows that costs rise over time and consume increasingly more of the value of the oil. A field will continue to produce until it starts losing money on a cash-flow basis. This is barring some catastrophic event such as what happened in 1933 when a refinery next to the Katalla field, Alaska's first oil field, burned down, eliminating the way to turn that oil into the kerosene needed by miners; the field was never used again.

MR. WILLIAMS continued with the gross-tax graph, showing a section that depicted a loss. Up to that point, wealth is created by producing the oil and gas. Beyond that, wealth is destroyed by continuing to operate. He said given the enormous challenge that Alaska faces from the decline in North Slope oil production, one great concern is the effect on investment as a field's operating margin is increasingly squeezed by rising production costs per barrel.

MR. WILLIAMS said while the actual operating margin for the rest of the field isn't usually a significant factor in the economic analysis for new investment, the graph can illustrate a general deterioration in the quality of new investments available as a field ages. For instance, drilling 100 or so infill wells last year added about 70,000 barrels a day to North Slope production. But drilling 100 such wells next year might only add 60,000 a day; the year after that, it might be only 50,000.

10:50:09 AM

MR. WILLIAMS continued with the gross-tax graph. He said as margins of incremental investments become squeezed, as that quality deteriorates, fewer and fewer investment opportunities remain that are economically viable. If all North Slope investment opportunities in a company's portfolio resembled Bar 1 in the graph, the company would likely go forward with all the investments it could; it illustrates a situation not unlike Prudhoe Bay when it first came into production and ramped up to 1.5 million barrels a day. As the opportunities look increasingly like Bar 2, a company still would take most, but not all, of the investments; the cash might not be available to invest in them all.

MR. WILLIAMS said as the portfolio begins to resemble Bar 3, the company clearly would start having fewer and fewer commercially viable opportunities; the margin would start to be one-third to one-quarter of the value that the barrel represents, and although some still would pencil out - because of the time value of money, for instance - there'd increasingly be numbers such that this timing effect wouldn't be enough. If opportunities look like Bar 4, with a thin margin, perhaps no investments would be made. And certainly the company wouldn't be investing if they look like Bar 5.

MR. WILLIAMS contrasted this with what happens when the tax is on net value, like PPT. He showed a graph depicting the same hypothetical field and five stages of rising production costs. For this net tax, by design it starts out with Bar 1 equaling the gross tax on the first graph. But as the field ages, each bar on this new graph has a smaller tax segment.

MR. WILLIAMS noted even in Bar 5, a very late stage in a field's life, there is a positive operating margin. All other things being equal, a net tax allows production to continue longer than it would under a gross tax. Furthermore, if investment opportunities resemble Bar 1, a company would likely try to make as many investments as it can. Each succeeding stage is better than in the earlier graph because of the greater margins. If there is a better portfolio of opportunities, a company is likely to make more investments at each stage of a field's life than under a gross tax, he concluded.

10:54:02 AM
CHAIR FRENCH asked whether the illustration holds the price and volume the same across the years.

MR. WILLIAMS replied that because it's using percentages rather than dollar amounts, the point holds true regardless of price. As fields are depleted, they reach these various stages in their lives regardless of what the price is. It will only be a matter of how long it takes. In further response, he said if there is a long-term, sustained high level in the value of oil or gas, it tends to reset the clock back with respect to the graph. Conversely, a sustained period of low prices tends to accelerate it forward.

CHAIR FRENCH asked if it could go from Bar 1 to Bar 5 in a year.

MR. WILLIAMS said hopefully not, but in theory, yes.

10:55:26 AM
SENATOR THERRIAULT surmised the change in price might move the margin back one bar for a year or two, until the costs caught up and squeezed the margin.

MR. WILLIAMS affirmed that, but didn't know whether it would be a year or two or a longer period of time. It would depend on the economics talked about by Mr. Dickinson. A sudden increase in demand because of high oil prices might accelerate the rise in the price of goods faster than normal. But it doesn't necessarily happen; it depends on how fast the oil price changes and so forth.

MR. WILLIAMS closed by indicating the decline of North Slope production is the greatest challenge facing Alaskans. He said the only way to slow the decline and soften its impacts is to make investments to produce more oil. As shown, a net tax will result in more investments than a gross tax will, other things being equal. That's the reality Alaska faces. This isn't the first legislature to grapple with this reality, and probably won't be the last. All the industry can do in this process is to explain what the real-world effects promise to be from tax policies. The policy choices are up to the legislature.

MR. WILLIAMS said whatever is chosen, the industry will comply and continue to do business in Alaska, striving to unlock the great potential Alaska still has. But it is known that one choice will allow the industry to do more than the other will, between gross and net. He expressed hope that the legislature will choose the better one.

10:57:50 AM

SENATOR THERRIAULT noted a net system self-corrects and so on. He recalled yesterday's presentation by Gaffney Cline and the modeling of this system, including the slowing of the decline, acknowledging that the bulk of the known resource on the North Slope is in those legacy fields, and modeling the numbers for squeezing out the additional heavy and viscous oil. He asked Mr. Williams whether he had any criticism of the numbers shown yesterday with respect to such a net system.

MR. WILLIAMS replied AOGA hasn't yet reached a position to be able to answer that. He offered to try to respond in a timely manner for this committee. He noted members could ask him about what was going on in the 1970s and 1980s, the time period Mr. Dickinson had discussed; he'd had to work with that and could provide some historical facts. As for testifying in response to Gaffney Cline's presentation, however, he'd been preparing his testimony at the time and thus wouldn't be able to comment personally either.

10:59:42 AM
CHAIR FRENCH said he appreciated the late-breaking nature, but it is the same for the legislature, which needs to produce a bill within 30 days. The information shown yesterday was a revelation for many. It was like peeling the skin off the claims heard about relative risk and investment needs. For him at least, it showed what the rate of return is, and it was stunning. He suggested before too long it will be time for AOGA and other industry representatives to tell legislators what, if anything, was wrong with those numbers and why a higher tax rate doesn't fairly compensate the state and still allow for enormous rates of return for companies, at least in the center of the target - the 70 percent range that is represented by infill drilling in the legacy fields, Prudhoe Bay and Kuparuk.

MR. WILLIAMS replied that in terms of specific numbers, they're as good as the assumptions that went in behind them. He had no idea whether those assumptions were explicitly shared yesterday or would become available. But AOGA's comments would be of a qualitative nature, rather than quantitative.

CHAIR FRENCH responded that he has a disk with the model on it and a disk has been given to BP to analyze. Furthermore, he'd been encouraging the administration to put the model on the Internet so every Alaskan can look at it and twirl the knobs. If there is a profits-based tax, then the State of Alaska becomes a partner, at some level paying the industry back for the investments it's making. The price of that, to him, is

openness: "We see your numbers, you see ours." That way, it will be known that the parties are being fair to one another.

SENATOR WIELECHOWSKI agreed as a policy maker, saying if there is a criticism to that model, he wants to hear it. To him, that model was extremely compelling - seeing that capital expenditures (CAPEX) and operating expenditures (OPEX) could be increased 200 percent at a 15 percent discount rate, there could be a 30 percent tax rate and 0.5 progressivity, and still there'd be rates of return in the 50 percent region. If the model is wrong, he wants to know, because that model will factor heavily in his decision about what to do with respect to the valuation rate.

MS. CROCKETT replied AOGA would be happy to look at the model. Although they'd not been present yesterday and didn't have the benefit of the slides, there is a hard copy available. She requested a disk as well, to ensure all AOGA members get a chance to look at not only the numbers that can be tweaked with the "knobs," but also the structure of the model itself, the mathematical equations, evaluating whether the risk factor is part of this consideration, how the heavy oil plays into it, and so on, which she surmised were discussed yesterday.

11:03:24 AM
SENATOR HUGGINS announced the Senate Finance Committee would like to hear AOGA's ongoing analysis or any critiques.

SENATOR THERRIAULT recalled that some numbers around which the model was built came from part of AOGA's testimony. He said he believes the state and the legislative consultants are pulling information from all different sources. He agreed with Senator Wielechowski that the information will shape people's opinions, if not here, then certainly in the Senate Finance Committee. Given that AOGA is a "consensus organization," legislators certainly want to hear from them.

SENATOR THERRIAULT noted the model specifically talked about the legacy fields. He recalled he'd asked questions yesterday relating to the belief that those are where most of the value is and the desire to ensure that whatever is set works both there and for the satellite fields and those beyond the existing infrastructure.

MR. WILLIAMS replied he doesn't know what the model said about legacy fields, but there are different kinds of investment that have been described, including the renewal investment, the

infill drilling investment, and the heavy oil investment. The bulk of the heavy oil is under what are defined as legacy fields. He surmised that was covered yesterday, but didn't know whether it was "one size fits all," for example.

11:05:39 AM
SENATOR McGUIRE said she thinks AOGA ends up being the perfect organization to put this into perspective for the legislature. New entrants, heavy into exploration, have one position. Operators of the legacy fields have a different perspective. And AOGA houses all those opinions. Even if it occurs in the Senate Finance Committee, she'll be highly interested in hearing from AOGA.

SENATOR McGUIRE emphasized not wanting to put anything in place that will impair development; it may not be "one size fits all," a concern that has been discussed. There also is the perspective that it's too complicated to do two separate systems of taxation. She suggested the need for more detail, since the committee is looking more towards the net system and how it will impact development for future generations and with each individual type of industry. She opined that AOGA is the best entity to do this, since it would be better than hearing from individual companies that might be biased.

MS. CROCKETT said AOGA is happy to answer any questions they can, within the constraints of a trade association organization for which antitrust provisions prevent talking about costs, for example. They don't talk about sales, price, or costs within the confines of the association. But that doesn't mean AOGA can't - at a higher level, without getting into that level of detail - pass some judgment and provide some counsel based on their perspective and on the industry's perspective regarding the proposals before the committee today.

SENATOR THERRIAULT surmised AOGA, as a consensus organization, has come to a consensus on the ads shown around the state. Characterizing the legacy fields as the goose that lays the golden egg for the state and industry in Alaska, he said the claim is that what is being contemplated will kill that goose. However, people who've worked in the industry have put together models showing: 1) it isn't close to the tipping point with regard to that production and 2) the rates of return, even with what is anticipated and talked about, are such that any company would decide to invest the next dollar to produce new barrels of oil. Suggesting the claims in the ads therefore might not be

true or might not befall the state, Senator Therriault said hearing some comment in reply would be useful.

11:09:31 AM
MS. CROCKETT replied that a number of ads are being run and so there may be some confusion about which ones AOGA is running. That aside, the focus of AOGA's advertising or educational campaign has been to make folks aware that the top issue facing Alaska today is a decline in production. Setting aside the fiscal regime, Alaskans need to pay attention right now to stemming that decline.

MS. CROCKETT again noted she hadn't seen the presentation yesterday and couldn't respond. But with respect to the fields just mentioned, she said for the easy barrels, clearly the bulk of new production that will save the industry from a steep decline is in those fields. The different kinds of new oil that will come on are all critical. She cited exploration; heavy oil; bringing new fields on line; and production from existing fields, which will provide most of that production in the near term. She said that's been the focus of AOGA's message.

11:10:50 AM
CHAIR FRENCH wrapped up by saying that, to him, that's the beauty of the model. It was looking exactly at those legacy fields and the infill drilling that will produce the biggest bang for the buck over the foreseeable future. The committee was very excited and interested in seeing what was revealed yesterday. He agreed with Senator Huggins' earlier statement that AOGA will be facing more questions about it in the future.

The committee took an at-ease from 11:11:25 AM to 11:24:54 AM.

CHAIR FRENCH welcomed Senator Green.

CHAIR FRENCH noted the committee would address two topics: 1) how litigation under a tax system differs from litigation under a royalty system, and 2) information sharing. He invited Mr. Iversen to give his presentation.

JONATHAN IVERSEN, Director, Tax Division, Department of Revenue, began with some history, noting the state has operated under varying parameters over time. Now it is entirely different in terms of what the state knows and its standards, both in the market and in statute and regulation; this contrasts with standards in the late 1970s, when production started ramping up,

and the 1980s and then the 1990s, when some settlements of really big cases happened.

MR. IVERSEN elaborated, saying it's a different world than in the late 1970s and early 1980s, when the state was entering entirely new royalty and tax territory. The state lacked a substantial body of case law and regulations. Of primary importance was that it lacked objective measures of value. These were new issues, and it was a gray, murky area with respect to production companies as well as the State of Alaska. The lack of objective measures of value perhaps had the greatest impact. There wasn't a defined market or price set for ANS oil.

11:27:23 AM
CHAIR FRENCH suggested this is hard for the public to grasp, since people are used to seeing the price of a barrel of oil published daily in the newspaper, for instance. He asked why oil prices weren't as quantifiable previously.

MR. IVERSEN noted he isn't an oil markets expert. He surmised, however, that because there wasn't an established market, particularly for ANS oil, what caused much of the conflict between taxpayers and the state was this: It required using an established area such as West Texas intermediate oil or some other regular market value; doing a regression analysis or some other analysis or else using a "market basket" of different types of crude oils with known markets from different parts of the country or the world; and then imputing a value for ANS oil based on that. There weren't a lot of sales of ANS oil. There weren't established contracts. And there wasn't an established pattern of how much the oil would go for.

MR. IVERSEN continued, saying when Platts came out with its index in the mid-1980s, setting an ANS spot price, it changed the world. In times of high production, with 2.2 million barrels running down the pipeline annually, a variation of one cent or five cents a barrel in the value of oil makes a tremendous difference. This is a huge risk area for the state and for those paying tax and royalty.

11:29:10 AM
SENATOR THERRIAULT referred to Mr. Iversen's remark that there weren't a lot of sales at the time. He gave his understanding that oil was being shipped and going to market, but companies were selling the oil to themselves. There weren't many at-arm's-length sales to determine the true market price. The sales price couldn't be used because if a Sohio tanker was

taking it down for sale to a Sohio refinery, for example, people questioned whether to trust that price as the true price.

MR. IVERSEN replied that was an astute clarification. There weren't a lot of third-party contracts for setting market value. Because of not having established values or an established regulatory framework, there were aggressive assessments by auditors who were protecting the state's interests. That is the auditor's job. Where there was a lot of gray area, sometimes the auditors pushed to the edges of that gray area to benefit the state, to represent the state in those transactions.

MR. IVERSEN said, furthermore, the state was entering an era of digging into taxpayer records. Taxpayers weren't accustomed to that, and there was some reticence to provide needed information. Thus there were aggressive, so-called blue sky audits that resulted in an imputation of tax liability.

MR. IVERSEN elaborated, noting from there a process would begin. Some cases involved tremendous dollar amounts; those would linger for decades or a decade and a half and then settle at some point. The litigation costs had to be considered, particularly for the enormous cases. These gray areas eventually reached "some sort of strong framework." In addition, many times the strong issues for the state would be settled first.

MR. IVERSEN added that historically, with respect to discussions or rumors about low settlement values such as values below 50 percent, that might be just for issues that were weak for the state to begin with. The auditors did their best to represent the state's interests, and as they went through a learning curve and pulled through the issues that are strong for the state, those would be at higher settlement values.

MR. IVERSEN pointed out that royalty cases suffered some of those same issues, but there was an additional impact because royalty is based on a contract, a lease agreement. Thus there have been contractual interpretation issues that are another step away from regulations and statutes. He offered to address that in a couple of minutes.

MR. IVERSEN reiterated that the world has changed since then. In the mid-1980s Platts came out with its reporting for ANS oil, and there were more defined regulations. The state also has gained respect from pushing back all those years and being aggressive in its audits. Furthermore, the state and the

taxpayers understand where they need to be, so there isn't as much gray area between the two positions.

11:33:19 AM
SENATOR WIELECHOWSKI asked how much has been recovered through the audits.

MR. IVERSEN said he didn't have that figure. This morning he'd consulted with the Department of Law (DOL), which doesn't keep statistics comparing the settlement amount with the original claim. What ends up happening is that during these assessment periods after an auditor makes an assessment, the taxpayer submits additional documentary evidence substantiating the claim. There is an allowance for corrections through that.

SENATOR WIELECHOWSKI explained that he'd asked because of a statement made previously. The discussion had been about an overall amount of billions of dollars and that by going to a net system, perhaps there'll be arguments over millions of dollars. He asked Mr. Iversen whether that's reasonable, judging by his experience, or whether audit disputes may involve hundreds of millions of dollars.

MR. IVERSEN said that is a good point. Compared with historical numbers, risk in terms of dollars is substantially lower now. When a dispute is based on the value of oil - the basis for all the calculations in a gross tax system - and there are transportation costs and other costs to get to that gross-value point of production, it's a much bigger impact, particularly when looking at millions of barrels being pushed through. By comparison, for the downstream portion there'll always be areas of disagreement.

MR. IVERSEN added that historically, the department has taken one position and the taxpayers another; it's the nature of doing business. But the major issues are defined. There is clarity now with respect to the major downstream cost issues. The upstream issues aren't as global or significant monetarily as these enormous cases that began in the 1970s and 1980s. Now the state will be looking at more discrete cost issues. Therefore, dollar for dollar on the issues, it will be a smaller amount.

11:36:06 AM
MR. IVERSEN returned to his presentation, saying now there are more objective market measures; there are credible markets for ANS crude; the state knows what the third-party contracts are saying; and there isn't a need to assert so aggressively in a

gray area, since the gray area is much smaller. This narrows the room for dispute. Now most cases settle in DOR unless the department is just wrong; if that happens, it acknowledges the mistake. Unless there's an actual mistake, most cases settle at 80-100 percent, a much higher settlement number than previously.

CHAIR FRENCH asked whether that is for audits of tax matters between DOR and the oil industry.

MR. IVERSEN affirmed that.

CHAIR FRENCH explained that a lot of folks come to him with concerns about a net system, worried there'll be fights for years and the state will end up settling for 10 cents on the dollar. He gave his understanding that Mr. Iversen was saying his experience over the last few years, however, is that the settlements are between 80 cents and full value on the dollar.

MR. IVERSEN concurred.

SENATOR WIELECHOWSKI noted another concern he hears is that arguments have been over one item, the tariff rate, whereas now there'll be hundreds or thousands of items. Although there might not be one large number, DOR potentially will get flooded with various issues. He asked Mr. Iversen whether he'd considered that and whether DOR has the auditors required, since the number of auditors isn't increasing a tremendous amount under this legislation.

11:38:08 AM
MR. IVERSEN answered they've thought about those pieces. There certainly will be areas of dispute for upstream costs under PPT and ACES. But what exists is a much more established realm of authority, even for upstream costs. Internal Revenue Code standards are referenced by statute; there are net profit share regulations; joint billings and audits are already being done between unit operators and working interest owners; and a lot of what's happening upstream boils down to accounting, not necessarily the vagaries of the market, where there's just simply not an input they need to make the tax calculation in term of how much a barrel goes for.

MR. IVERSEN further replied, with respect to auditors, that they hadn't expressly asked for additional positions. He acknowledged the need to have the crew fully manned in order to administer this tax. Right now, they're down 6 positions out of 18, including the specialist position and audit supervisor.

That is the issue they're trying to hit with some of the statutory requests for the exempt positions.

SENATOR WIELECHOWSKI recalled that from data he has seen, recruitment was opened October 12, four applications were received, and then recruitment was closed the day before the special session started. He asked why. He also recalled there'd been another area where there was a pending hire and then recruitment was closed the day before the special session.

11:40:21 AM
MR. IVERSEN replied he didn't know which instance Senator Wielechowski was referring to with respect to the pending hire, but he was aware of some applications for the Auditor III or flex positions. Recruitment closed because of the special session, since those were positions the department had looked at and was submitting for exempt treatment. Out of fairness to the applicants, to the department, and to the state, they'd wanted to ensure it was clear and aboveboard. They've recruited rigorously, certainly for as long as he has been on board and well before that, spending more than $100,000. It has been spotty, however. There are very good-quality folks on board, but there isn't a full crew. They're down one-third.

CHAIR FRENCH segued from the complexity of legal disputes to their duration. He asked why legal disputes won't last for a decade under a net tax system.

MR. IVERSEN replied that he had a couple of answers. First, whereas the ANS royalty litigation spanned decades, in the tax realm now the cases move fairly quickly. There is a well-established administrative process. An audit is done, and a taxpayer that doesn't like the audit can appeal and have an informal conference in the department. If the taxpayer is still dissatisfied after that step, having submitted evidence and information for DOR to make a decision, the case moves out of DOR to the Office of Administrative Hearings for presentation to an administrative law judge. Then it can go to court.

MR. IVERSEN explained that although it still takes time to work through the system, the state doesn't have to go through numerous motions for summary judgment and huge, deep discovery requests in gray, muddy areas for a typical case. Of course, some cases have areas of dispute that need to be taken to superior court and require time. But there has been a fundamental change in the standards compared with the historical

situation of litigation spanning decades. The standards have changed and the world has changed.

11:44:15 AM
MR. IVERSEN referred to a memorandum from Spencer Hosie that had been provided to the committee.

CHAIR FRENCH requested a summary for the public. He opined that Mr. Hosie has a fair amount of credibility in the area of litigation and willingness to take on the industry. He said he was heartened to see Mr. Hosie's estimate of how long litigation would take, given that he believed Mr. Hosie had every reason to push it to the high side.

MR. IVERSEN summarized that in his memorandum, Mr. Hosie compares what happened with the ANS royalty litigation Mr. Iversen had referenced earlier. It was filed by the state in 1977. The oil phase was resolved in 1992, and the gas case was resolved in 1995. That's a long case. There were some reasons, as Mr. Hosie points out.

MR. IVERSEN said, first, the state wasn't acting as a sovereign in that case. As a taxing authority, the state acts as a sovereign. Then, however, the state was acting as a party to a commercial contract; this put it into a realm of litigation, as for any breach-of-contract claim where there isn't authority to serve and enforce subpoenas. He told members, "We've got express statutory authority to do that." He indicated now the state's regulations are clear and can be relied upon in expediting dispute resolution. In a civil lawsuit, by contrast, ongoing discovery can take a lot of time and money.

MR. IVERSEN noted, second, the ANS royalty case involved a number of matters of first impression, which he'd touched upon before. Those were issues of valuation, transportation costs, and so on. They relate to contract interpretation because the royalty suit is based on contract.

MR. IVERSEN said, third, there was an issue of market value in order to establish that. The state had to track every barrel of ANS oil produced to its market destination, an incredibly weighty undertaking. Fourth, rather than having a tax dispute between a taxpayer and that state, the ANS royalty litigation involved all the ANS producers. Thus there were multiple opponents, different angles on the same issues, and different issues. In such a case the difficulty, complexity, and length of time multiply exponentially. During that litigation, the

state approached the industry as a whole. This was a matter of first impression; the state was breaking new ground.

MR. IVERSEN turned to the tax. He noted Mr. Hosie writes - which Mr. Iversen agreed with - that it isn't royalty and the state is acting as a sovereign. The basic rules will be set forth in statute. Mr. Iversen said this goes to Senator Wielechowski's earlier question. The disputes will be on the margin. They won't be based on the fundamental principles of what's going on. For instance, it will be a question of whether a cost is properly classified as a capital expense as opposed to an operating expense, or that it isn't a direct cost but should be overhead.

MR. IVERSEN said because a tax dispute is confidential and taxpayer information is confidential, it also narrowly confines this to a single-taxpayer dispute. This is unless, for some reason, the taxpayers want to get together on an issue; however, Mr. Iversen didn't know of such an issue, since they don't like to share each other's confidential information.

11:48:30 AM
SENATOR McGUIRE asked why the state chose to waive its sovereignty in the 1970s when it entered into those lease agreements.

MR. IVERSEN replied he didn't know specifically. A royalty dispute in the United States typically is a contractual matter; the terms are negotiated. Historically, those royalties started out at one-eighth, whereas now much higher royalty rates are seen nationwide, depending on how hot the prospect is.

SENATOR THERRIAULT surmised it wasn't necessarily a decision to waive sovereignty. Rather, a lease is a contractual document. There isn't any sovereignty involved.

SENATOR McGUIRE said she gets the lease idea, but wants to know what went into the decision making, since other nations choose to exert their sovereignty.

CHAIR FRENCH remarked that it's fascinating as a matter of historical perspective. His misperception, as he'd said yesterday, was that a royalty is the most powerful taking. He said it seems funny that it would be resolved as an equal partner with the person from whom it's being taken, rather than as a king reaching down to his subject.

SENATOR THERRIAULT suggested it isn't a reaching out. Rather, that royalty share is agreed upon through a contractual arrangement, not through the exercise of sovereign power.

11:50:51 AM
MR. IVERSEN added that the royalty contract is a negotiated deal, more so with private landowners. There isn't a lot of private royalty in Alaska, but in Texas, Oklahoma, and Wyoming one sees a lot more negotiated deals. That's where the terms start to vary. Although it is an "historic creature," he didn't know when it was decided to take it as a landowner or royalty owner, rather than a sovereign taxing entity.

MR. IVERSEN closed by saying while DOR is open to discussing settlements with taxpayers on issues where there may be doubt as to the state's position - for example, if DOR perhaps has been too aggressive with respect to an item - it always considers that litigation is time consuming and expensive. However, the state never enters into settlement lightly.

11:52:32 AM
SENATOR THERRIAULT referred to CSSB 2001(RES), Version M of the bill, page 15, which rewrites AS 43.55.165(a). He drew attention to language beginning on line 30 that reads in part, "allowed by the department by regulation", as well as lines 9-10 on the following page, which reads in part, "(2) a reasonable allowance for that calendar year, as determined under regulations adopted by the department".

SENATOR THERRIAULT asked: Since the beginning of AS 43 says DOR, as most departments, has a general granting of power to write regulations, why does this bill specifically include this language twice? And why isn't the language at least consistent between the two sections?

MR. IVERSEN replied that this is to completely clarify it. Although DOR has general authority to draft regulations implementing the tax and interpreting it, the desire is to make it abundantly clear that for purposes of allowable lease expenditures, DOR intends to affirmatively set forth - through regulation - what costs are allowed, thus narrowing the room for dispute and for gray areas. By contrast, PPT has a gray area of allowable items but specific exclusions. The intent here is to maintain the specific exclusions and then delineate affirmatively, by regulation, what is included. To the extent that the language may differ, he said this particular affirmative regulation would be toward lease expenditures.

11:55:10 AM
SENATOR THERRIAULT again asked why the terminology differs between the two pages.

MR. IVERSEN noted the two places are Section 43.55.165(a)(1)(B) and (a)(2), which talks about overhead. Overhead is addressed separately. It is a formatting change as well. In PPT, overhead was allowed as sort of a separate category: "direct costs shall include overhead." Typically, however, overhead isn't considered a direct cost. So that has been moved. This would be a separate regulation and has already been promulgated for overhead itself. This is to clarify that.

MR. IVERSEN added that there are direct costs and lease expenditures, and then, as seen here, the difference lies in subsection (a)(1)(B)(iii), page 16, lines 7-8:

> (iii) the costs must be direct costs of exploring for, developing, or producing, as applicable, oil or gas deposits; and

He said one qualification for lease expenditures is that costs must be direct costs of exploring for, developing, or producing. This gets into "direct cost land," and then it is recognized that overhead isn't a direct cost. The overhead allowance is discussed starting on line 9 of that same page.

11:57:17 AM
SENATOR THERRIAULT reiterated that having such language inserted like this is a little unusual. He referred to subsections (a)(1)(B)(i), (ii), and (iii) on page 16, which read:

> (i) the costs must be incurred upstream of the point of production of oil and gas;
> (ii) the costs must be ordinary and necessary costs of exploring for, developing, or producing, as applicable, oil or gas deposits; and
> (iii) the costs must be direct costs of exploring for, developing, or producing, as applicable, oil or gas deposits; and

He asked whether inclusion of this language may empower a commissioner sometime in the future to just change the regulations and perhaps start dropping things off the list or changing it so that it no longer matches up with the policy. He

noted this gives a policy direction, with DOR to work out the details. This might be fine now, while there is an understanding, but what about in the future? What power does that language give to a future commissioner?

MR. IVERSEN replied that he anticipates over time DOR will change regulations as the department learns about the process. But under all circumstances DOR must obey the statutory directives. These directives - with the exception of this provision about "setting forth affirmatively by regulations" - are the same as in PPT. In terms of having a dramatic change as far as what is or isn't allowed, nothing like that is being done. There still must be compliance with the statute.

MR. IVERSEN pointed out a further delineation in Section 20 of CSSB 2001(RES) as to what direct costs include. This language is in PPT, the current law, but has been moved as a conforming change. Page 16, starting at line 30, talks about what the department has to consider in determining whether costs are allowable lease expenditures. Looked at are typical industry practices and standards in the state that determine the costs, other than the exclusions that will be allowed, and also the standards adopted by DNR for its NPSL leases. These items shall be considered among other factors.

MR. IVERSEN also noted that direct costs include some reference to the Internal Revenue Code for what is being done for federal income tax purposes; that is on page 16. And there is some other guidance, that activity doesn't need to be physically located on or near the actual premises of the lease or property necessarily, as long as it still is a direct cost.

MR. IVERSEN concluded by saying there is substantial statutory guidance as to what DOR can or cannot do. If at some point a commissioner set forth regulations outside the statutory bounds, the regulatory process would have to be approved by the Office of the Attorney General and the lieutenant governor. If something were out of line, it would be challenged and the regulation would be declared illegal.

12:01:04 PM

SENATOR WIELECHOWSKI noted the law currently says costs of arbitration, litigation, or other dispute resolution activities are not lease expenditures. He asked whether that includes auditing costs. For example, if DOR has audited a company and the company then uses its own auditors, can those expenses be written off?

MR. IVERSEN answered that to some extent, those sorts of costs will be overhead. Overhead includes advertising, lobbying, litigation at a corporate level, auditing at a corporate level, and so on. Overhead is set in statute as an allowance related to direct costs. By regulation, DOR sets forth what that allowance is. So the actual amount spent on overhead doesn't affect what the company is allowed to deduct as overhead. What matters is what the company spends on direct costs, because overhead is only a percentage of that.

SENATOR WIELECHOWSKI asked whether a company can write off the ads being run on television right now, for instance, or lobbying costs.

MR. IVERSEN replied no. He clarified that the overhead allowance is a percentage of both direct and indirect costs. It doesn't matter how much is spent for items like lobbying, advertising, health club fees, and so on.

SENATOR WIELECHOWSKI asked whether those items he'd mentioned could be included in a company's overhead.

MR. IVERSEN answered that what a company does for corporate bookkeeping purposes has no bearing on what the state allows as a deduction for overhead.

12:03:27 PM
CHAIR FRENCH requested a ballpark figure for the overhead allowance.

MR. IVERSEN replied in the typical case it will be 3 percent of direct costs for exploration, development, and operations in the state, plus 9 percent of indirect costs for exploration, development, and production in the state. For production of hydrocarbons, it's narrow. Lobbying expenses and advertising aren't costs associated with exploration, development, and production of hydrocarbons. In response to Senator Therriault, he provided a brief example.

SENATOR WIELECHOWSKI asked whether DOR audits direct and indirect costs.

MR. IVERSEN affirmed that.

SENATOR WIELECHOWSKI surmised DOR hasn't seen advertising, lobbying, or public relations costs included.

MR. IVERSEN replied he hasn't, but DOR hasn't done any audits yet under PPT. The department would be looking for those sorts of things certainly.

SENATOR WIELECHOWSKI surmised those would be disallowed.

MR. IVERSEN affirmed that, saying overhead is an area DOR is always watching for.

The committee took an at-ease from 12:05:59 PM to 1:31:37 PM.

CHAIR FRENCH turned attention to information sharing.

MR. IVERSEN referred to CSSB 2001(RES), Version M, noting information sharing appears in two separate sections. The first covers information from DNR to DOR and the second from DOR to DNR. These provisions clarify that DOR can share with DNR tax returns, reports, and other documents filed under AS 43.55, the production tax statutes. The first provision is found on page 3, Section 1, new paragraph (12).

CHAIR FRENCH asked what the situation has been between the departments until now.

MR. IVERSEN replied that several statutes govern confidentiality for each department. The agencies have been extremely guarded because of that confidentiality and the severe criminal penalties for disclosure of taxpayer information, in particular, as well as a lot of concerns relating to DNR and proprietary information. The lack of clarity has led to an artificial wall between the agencies in terms of what can and cannot be transmitted. When this bill was being developed, for instance, it became apparent that this can pose some real problems in terms of smart policy making.

MR. IVERSEN elaborated, saying when a certain amount of taxpayer information cannot be shared with the resource-management agency, and likewise a certain amount of resource-management information cannot be shared with the taxing authority on a tax related to resources, it creates some real problems. These are seen through the modeling and some of the visual aids put forth. There is a certain amount of information about the impacts on certain fields, for example; the background and modeling for that are driven by DNR because it involves resource-based information. Certain confidentiality restrictions apply with

respect to taxes as well, and DNR folks cannot get that information.

MR. IVERSEN explained that what is sought with this legislation is to be able to share that information so both agencies - pursuant to their respective functions - can be smart, can be up to speed, and can be good regulators in their respective capacities without being hamstrung by the inability to receive information that is necessary for a regulatory call or to fulfill statutory obligations.

CHAIR FRENCH returned to page 3, observing that paragraph (12) appears to be a directive to the commissioner of DNR which says the director shall, on request - which he surmised means a request from DOR - furnish records, files, or other information related to the administration of AS 35.05.180. He asked what that statute refers to.

MR. IVERSEN replied that is oil and gas leasing. In that context, it's leasing, unitization, and those issues.

CHAIR FRENCH continued reading from paragraph (12), provided below:

> (12) on request, furnish records, files, and other information related to the administration of AS 38.05.180 to the Department of Revenue for use in forecasting state revenue under or administering AS 43.55, whether or not those records, files, and other information are required to be kept confidential under (8) of this subsection; in the case of records, files, or other information required to be kept confidential under (8) of this subsection, the Department of Revenue shall maintain the confidentiality that the Department of Natural Resources is required to extend to records, files, and other information under (8) of this subsection

He noted AS 43.55 is the tax statute.

MR. IVERSEN specified that it's production tax.

CHAIR FRENCH summarized by saying if DNR is supposed to keep something confidential, DOR also will. But it's allowed to be transmitted from one to the other without restriction.

MR. IVERSEN concurred. He said this is based upon the premise that both agencies have been dealing with confidential information, have protocols, and are very concerned - each in its respective realm - about confidential information. That overall umbrella of confidentiality would still exist, but between the two agencies there would be passage of information.

1:37:15 PM
SENATOR THERRIAULT recalled recent testimony about concern that the two departments perform different functions for the state. Whereas DOR collects revenue, DNR negotiates to get the land into production. With respect to sharing of information, it was alleged that DNR would go to DOR and get all kinds of information on companies' future plans and thus DNR could tailor or change the acreage leasing and so on, to take advantage. He asked whether Mr. Iversen had heard this concern in other committees and whether there is some protection against it.

MR. IVERSEN answered that he hadn't heard that particular concern. But there has been concern that DOR would pass information on oil pricing to DNR for use in royalty-in-kind (RIK) sales and purchases. He said that's kind of a red herring because DOR isn't asking for actual price information. Rather, DOR is looking for cost information, including forecasted cost information, in order to do more accurate forecasts and improve its audit functions.

MR. IVERSEN highlighted another aspect: There's a competitive market already for buying and selling oil. The companies are sharing that same information with other working interest owners who are, in turn, buying and selling oil on the market. Thus he opined that the concern with respect to DNR, at least in terms of RIK, is a non-issue. He added that DOR doesn't anticipate abuse of the information. The goal here is for each department to be educated to the extent necessary for performing its duties. If some knowledge will help DNR make a decision on unitization that is appropriate for the state, then this would further that goal.

SENATOR THERRIAULT asked if there is language Mr. Iversen could identify that limits the information DOR can request.

MR. IVERSEN replied that for the purposes of DNR providing information to DOR, it has to be for use in forecasting state revenue under AS 43.55 or administering AS 43.55. That, in and of itself, is a restriction. It has to be for those legitimate

purposes, rather than rooting around for income tax information, for example.

1:41:06 PM
SENATOR THERRIAULT explained that he wants to be sensitive to the fact that the state needs information but not more than necessary, such as bank records. He asked whether this changes the dynamics of the negotiation.

MR. IVERSEN suggested it might help to jump to the second section, which is Section 12 in CSSB 2001(RES), Version M.

CHAIR FRENCH noted this relates to DOR's reciprocal requirements and abilities. He asked Mr. Iversen to describe those.

MR. IVERSEN read from Section 12, which states:

> * **Sec. 12**. AS 43.05.230(h) is amended to read:
> (h) The commissioner shall, upon request, furnish to the Department of Natural Resources copies of tax returns, reports, **and other** documents filed under **AS 43.55 or** AS 43.65, and the Department of Revenue's determinations and workpapers **under those chapters**. The Department of Natural Resources shall maintain the confidentiality that the Department of Revenue is required to extend to the returns, reports, documents, determinations, and workpapers furnished to the Department of Natural Resources under this subsection.

MR. IVERSEN reiterated that AS 43.55 is the production tax. Here it's being limited to matters filed under the production tax statutes. That then links with DNR and its administration of oil and gas properties in the state. Also, AS 43.65, the mining license tax, currently is in statute.

MR. IVERSEN pointed out that the new language "under those chapters" on line 10 was inserted in the committee substitute in lieu of, to his belief, what was in the original ACES bill, "AS 43.55 or AS 43.65". He surmised it doesn't make any difference substantively, but is different language that prevents having to cite the statutes again. He indicated the reciprocal confidentiality requirement in the latter half of Section 12 is what Chair French referenced a few minutes ago. He summarized by saying there are limits.

1:43:15 PM

SENATOR HUGGINS recalled that one major limitation on exchanging information seemed personality-driven, rather than statutory.

MR. IVERSEN replied it's a bit of both. The ultimate basis for the confidentiality is statute-driven. Folks in DOR are very wary of the penalties imposed by statute. But because there isn't a bright line for information that can be shared, they don't want to get into a gray area. That's where the personalities come in. There may have been some issues with that in the past, with the two agencies perhaps being at odds.

MR. IVERSEN said although DOR is trying to work cooperatively now, the agencies' natural cautions that have developed over time are part of the issue here. Without the clarity, it will be difficult to get around. With penalties like those DOR has to deal with, unless there is clarity it is a very, very, fine line, and they don't like to get too close to it. In response to Senator Huggins, he said there are no additional penalties under ACES with regard to these particular provisions.

SENATOR asked him to review the penalties.

MR. IVERSEN noted several provisions in current law address confidentiality; he would mention the main ones. There are several DNR confidentiality provisions. Three in particular are: AS 38.05.035(a)(9), with respect to maintaining records; AS 38.05.036(b), regarding royalty, net profit share leasing, and exploration-incentive credits; and AS 38.05.036(f), which addresses auditing.

MR. IVERSEN said for DOR there are a couple of statutes. The primary driver here is AS 43.05.230, which sets out penalties. That section relates to disclosure of tax returns and reports. Subsection (a) says in part that it is unlawful for a current or former employee or agent of the state to divulge the amount of income or the particulars set out or disclosed in a report or return made under this title. He noted "title" means the DOR statutes. Subsection (f) of that statute says a wilful violation is punishable by a fine of not more than $5,000, or by imprisonment for not more than two years, or both.

1:47:50 PM
CHAIR FRENCH requested confirmation that someone can be put in jail for divulging this information without statutory authority.

MR. IVERSEN affirmed that for a wilful violation. He also said there is an express exception to the Public Records Act for

confidential taxpayer information. Those are the main operative statutes in terms of confidentiality.

CHAIR FRENCH asked whether there were further questions about confidentiality or information sharing. He then turned attention to seismic data. He specified that the discussion would be about the original version of SB 2001, Version A, rather than CSSB 2001(RES).

SENATOR THERRIAULT highlighted Sections 36-44 of Version A.

1:49:18 PM
JULIE HOULE, Section Chief, Resource Evaluation, Division of Oil & Gas, Department of Natural Resources, noted that Kurtis Gibson, the division's deputy director, would try to join in but had another commitment. Ms. Houle explained that she would talk about the ACES bill with respect to Sections 36-44, which were removed from the bill and relate to AS 43.55.025.

CHAIR FRENCH asked her to focus on information sharing rather than financial aspects, which would be left to the Senate Finance Committee.

MS. HOULE told members AS 43.55.025 is a program with DOR. The Division of Oil & Gas gets involved because it collects the confidential seismic or well data for DOR and makes the determination for DOR under this program that, yes, the companies have turned in the data. In general, DOR, which administers this program, will ask questions of the division; DOR determines whether or not the company gets the money. Generally, DOR doesn't look at the data unless a question arises as to whether something should be an allowable cost. Part of the language in the ACES bill was just to shore up some of these requirements that the division has found, in collecting data, to be troublesome.

MS. HOULE noted it added two other things to the bill: 5 percent credits for all seismic surveys and an extended timeline for drilling wells, from 150 to 540 days. As an investor with all these exploration-incentive credits, the state is one of the largest investors in Alaska for wells and "seismic." With the 5 percent credit for a seismic survey shot prior to 2003, there is value, not for whoever shot the data, but for the explorer years from now who wants that data without the restrictions of a licensing agreement.

MS. HOULE explained that with the 5 percent credit, the state would be purchasing data that the commissioner deemed of value to future explorers. The state would own the data and then hand it out to companies interested in exploring. That was the intent. She noted people in her group are petroleum geologists, geophysicists, and engineers; they'd said if they were explorers coming to Alaska they'd want access to data to get started and then could decide where to then focus their exploration. Data like this would be of huge value.

1:52:37 PM
CHAIR FRENCH asked to what extent this data has been commercially abandoned. Why is it no longer the property of the seismic crew or the company that employed the seismic crew?

MS. HOULE answered that the companies still have the data. However, it is of little value to them at this point because they have newer surveys. The older data is likely sitting in their vaults. While it's not of much use to them, it can be of great value to a new company coming in.

CHAIR FRENCH asked where this is in the process of leasing.

MS. HOULE answered that someone interested in an area in Alaska would first want to acquire seismic data. This allows looking at the big picture of what potentially exists underground, looking for the older wells drilled in the area, and combining those to come up with prospects. With respect to exploration, most fields on the North Slope have been discovered looking for something else; fortunately, the original objective was deeper. She emphasized that much of it is happenstance in exploration.

1:53:59 PM
MS. HOULE referred to the extension of the time to drill wells from 150 to 540 days. She noted Armstrong, which came in to drill the Oooguruk area, was able to drill three exploration wells in one season, all within three miles of each other. The extension would give an incentive to an explorer who is actively trying to explore an area.

MS. HOULE indicated another predictability process DNR wanted to describe was to allow companies to come in for preapproval. This is for two reasons. First, now some seismic data is partially shot over state land and partially over private land. The state only gets the data shot over state acreage and thus the survey is of little value; credit is provided, but it isn't as useful to a future explorer. So private owners need to be

made aware, up front, that if they want this credit, the whole survey will be provided to the state and in ten years it will be available to the public.

MS. HOULE explained that currently the only way seismic data can be available publicly is through the exploration incentive credit (EIC) process. In response to Chair French, she said the EIC is an incentive for explorers to look for oil and gas outside of the existing units. Now if someone comes in to apply for a seismic permit from the State of Alaska and the permits group, that data never becomes public. Through this EIC process, the data becomes public in ten years.

1:56:10 PM
SENATOR THERRIAULT gave his understanding of the current EIC process: The company decides to spend the money and then comes to the state to request reimbursement after the fact. Part of the effort with this set of statutory changes is to have a process wherein the company comes to the state first for preapproval for whatever the company will do for the credit.

MS. HOULE affirmed that, emphasizing predictability. She said if the state is investing up front, it wants to be able to know what is being invested in. And the company knows, up front, that its credit will more than likely be given.

SENATOR THERRIAULT surmised if the company follows through on the plan it has been presented and that has been preapproved, then the company will qualify.

MS. HOULE affirmed that, adding that preapproval won't be an onerous process. Her group has people who know the State of Alaska well and can easily assist in the process in a fairly short order. This reduces uncertainty, and the company knows it will get the credit. With respect to data sharing, this way the state acquires seismic data that can be provided to the public in a timely manner: ten years for newly shot seismic data, and within a month of getting a credit for the older seismic data from before 2003.

SENATOR WIELECHOWSKI asked what an average seismic survey costs.

MS. HOULE indicated geophysicist Paul Anderson works for her group and is familiar with it. She said on the North Slope it is $25,000 to $35,000 a square mile, actually less than at Cook Inlet, where it is $90,000 to $120,000 a square mile. In further response, she said if the seismic survey is outside of a

unit and 25 miles away from infrastructure, the company receives 40 percent credit. If it's within 25 miles of existing units, it is 20 percent. "Similar to the wells also, under that program," she added.

The committee took a brief at-ease.

1:58:36 PM
CHAIR FRENCH welcomed Senator Ellis and Senator Wagoner to the meeting, indicating they'd been present for some time.

MS. HOULE, in response to Senator Therriault, explained that it's easier to shoot seismic data on the North Slope because in the winter the geophones can be set out and it can be done quickly. At Cook Inlet it can only be shot at slack tide, and the terrain is much more difficult to shoot on land. Also, there are a couple of other types of data that DNR is asking for. One is fluid analyses, very important for heavy oil. The other is core data, which the state would then provide to future explorers. The reason to provide this data to the public is so future explorers can have a good data set to start with.

CHAIR FRENCH asked: It isn't as if the state is selling someone's proprietary information, is it?

MS. HOULE replied no, they're not looking at it that way. Rather, they're viewing it as the state investing by giving credits in a proper timeframe. Two years within drilling of a well or ten years within shooting seismic data, the data becomes public. The company that shot the data may no longer be interested in the area, but someone else might be. It makes the prospectivity better for new explorers coming to Alaska.

CHAIR FRENCH asked: What if whoever shot the data is still interested and is perhaps just proceeding slowly?

MS. HOULE answered that if they had the leases all tied up, it wouldn't be a problem. And if they wanted to keep the data confidential, they wouldn't have to apply for the exploration incentive credit. If they didn't want the money, they wouldn't have to provide the data.

SENATOR WIELECHOWSKI asked: If a company wants to keep this information confidential, it just doesn't take the credit?

MS. HOULE said yes. But under the rules of the Alaska Oil & Gas Conservation Commission (AOGCC), which permits wells, within two

years of drilling a well, in general, the well "becomes public." In further response, she said except for under this current AS 43.55.025 program, there is no other way that seismic data becomes publicly available. There is one caveat: The charter data from the BP merger is available, but someone must sign a licensing agreement, and someone who gets that data after signing such an agreement cannot hand it to someone else.

2:02:05 PM
MS. HOULE concluded by saying the data sharing was to shore up the language in the EIC program, which is working pretty well. Most of the EICs applied for generally have been for seismic and wells in the National Petroleum Reserve-Alaska (NPR-A) area.

SENATOR THERRIAULT said it seems this is one thing the state can do to help new entrants. He referred to the modeling done by Gaffney Cline yesterday on the legacy fields, noting this is potentially very meaningful outside those fields.

MS. HOULE concurred, saying this is very important for new entrants who want to get started in an area but don't have any data to begin with. It is definitely outside the legacy fields. In order to qualify for the credits, it must be greater than three miles from an existing well, and more than 25 miles from an existing unit to get the additional 20 percent.

SENATOR THERRIAULT gave his understanding that there was some criticism of the 5 percent credit allowance that a commissioner can use to get access to the old data. The commissioner now would have power to issue these credits. He asked Ms. Houle to touch on that.

MS. HOULE agreed there was an objection raised about that. She said there is a process that her Resource Development group has to go through to evaluate whether that data is indeed in the best interest of the state. There would have to be a finding and decision, and then it would be presented to the commissioner. But the commissioner couldn't willy-nilly just give credit for data if someone in her group deemed it not usable to future explorers. She indicated her group had been looking at this from the point of view of a potential explorer and what type of data such an explorer would want.

MS. HOULE, in further response, said that would be available within 30 days after purchase, because basically the state would be purchasing it without a licensing agreement restriction, and

after 30 days the older data would then become publicly available.

SENATOR THERRIAULT noted it would be a quick turnaround. He again highlighted the change in the current system that would give applicants preapproval instead of having to request a credit after the fact.

MS. HOULE said the preapproval would be for new seismic shoots and new wells. That data would be confidential for ten years. In further response, she said currently who applies for an EIC, whether it was granted or not, and when the data will become available aren't in the public record. Language in this bill would require that DOR put it on its website so companies know certain data will be available. Now it's all confidential.

CHAIR FRENCH surmised if it can be listed publicly, then folks can see what's available, make an informed choice, and actually access the data in a meaningful way.

MS. HOULE agreed, noting it will help people know what areas they might want to explore. Otherwise, they'd have to go to the different companies to get data. If three companies had participated in a seismic shoot, for example, two might be okay with trading the data but the third might not; then it wouldn't become available.

The committee took an at-ease from 2:07:06 PM to 6:06:42 PM.

CHAIR FRENCH opened public testimony.

JACKIE STEWART, Juneau, informed members that she was speaking as an individual but has been in business in Alaska over 20 years. The last 8.5 years she has been the business counselor for the Small Business Development Center, which serves all of Southeast Alaska. Because financial statements are difficult, she spends a lot of time consulting with people about them, including the difference between gross revenue and net profit. She expressed amazement that the legislature would consider taxing on net profit, which she characterized as "whatever you want it to be." She invited members to attend a class she was teaching November 28 on the subject and also offered to consult with members individually; she clarified that she didn't intend it to be demeaning.

MS. STEWART said companies always complain when taxed. Last year they complained about the taxes they wound up getting; now

they seem to think it was a sweet deal and continue to complain. She recalled a Chamber of Commerce meeting where a woman said this is about jobs, not taxes, and the state is taxing oil companies at 64 percent; Ms. Stewart had asked what percentage of that is royalties, but the woman had said she didn't know.

MS. STEWART surmised legislators understand the difference between royalties and taxes, though. Royalties pay for the resource, which the companies don't own; it's their cost of goods. To her understanding, the state has arranged to tax partly on royalties and then have a tax that is basically a sharing of the risk. At the Chamber of Commerce meeting the two were confused, however, as if the 64 percent were all taxes.

MS. STEWART urged legislators to do what she believes should have been done last year: tax based on gross revenue, not net profit. The latter only leads to lots of work for attorneys. She said any company can claim expenses that are legitimate; she cited an example. She then asked: Do we really want to argue with oil companies over what their expenses are and whether they're legitimate?

MS. STEWART recalled Governor Palin said she wants this tax to be transparent, be fair, and encourage resource development. Ms. Stewart agreed, but emphasized keeping it simple and easy for Alaskans to understand. If it is simple, it will be fair and will eliminate having to spend time and money on litigation.

MS. STEWART also suggested if oil companies want the tax percentage reduced, taxing the gross does that. She opined that oil companies make 30-34 percent profit, but posed a scenario in which a company makes 10 percent profit, average for a company. If 100 percent is gross revenue and the company makes 10 percent profit, then 1 percent of gross revenue is the same as 10 percent of profit. Taxing on gross reduces the percentage.

6:13:31 PM
TIM ARNOLD, Juneau, speaking on his own behalf, said he has been employed in the mining industry 30 years and came to Alaska from Nevada four years ago, thinking the state was pro-business and pro-mining. Although he still feels that way, other factors have him worried about doing business in Alaska. Asserting all is not well in the private sector, he cited impacts to the Southeast Alaska timber industry, mining, fishing, and tourism.

MR. ARNOLD expressed appreciation for legislators' concern with ensuring the state is funded adequately and the growing needs of

its citizens are met. But he said the private sector actively generates the bulk of the state's revenue. Thus it is critical that Alaska have a healthy business climate, positioned to compete on a global scale for the investment necessary to develop small and big projects in Alaska's resource industries. These projects will keep local and state government revenue streams and will provide jobs for Alaskans.

MR. ARNOLD said there are plenty of hurdles for the private sector. He hopes legislators are cautious about creating new ones through new taxes, higher taxes, or any other measures. He opined that the most learned body to make laws was designed to be, and is, the state legislature. Legislators should craft a proper message about how willing Alaska is to promote business. Alaska fell to 47 out of 50 states in a recent Forbes magazine ranking of business climates, he recalled. He said the legislature's decisions in this historic session should be ones that will preserve and attract a business climate, whittling that number down a few notches.

6:16:56 PM
DONALD BENSON described himself as a 55-year lifelong Alaska resident and third-generation descendant living in the Matanuska Valley. He strongly encouraged members to add back key elements of the ACES plan that were stripped out in the previous committee: the .02 progressivity; the $30 trigger; the 25 percent tax rate; and the most important administrative tools that expand the list of reporting, return, and expenditure information, which the administrative accountants need badly.

MR. BENSON requested passage of ACES to restore public trust and bring Alaska its fair share of oil and gas revenues. He said the governor's plan will do this. He recalled polls in the past weeks showing 72 percent or more of the public agree that Alaska isn't getting its fair share and that PPT is broken in some manner; the latest poll shows 83 percent approval for Governor Palin and her administration. He said Alaskans are telling the legislature their position; they are the voters. He asked members to follow the will of the people by making ACES the new tax system. It is an accounting system and must be intact in order to work for Alaska and the administration. He said ACES ensures Alaska will be treated as an equal partner.

CHAIR FRENCH noted Senator Thomas of Fairbanks was present.

6:20:04 PM

MARK SHARP told members he was representing the future of the state: his children and grandchildren. A 52-year Fairbanks resident, Mr. Sharp said he counts himself among the growing number of Alaskans who've become disenchanted or disgusted with the integrity and ineffectiveness of the legislature. He opined that most Alaskans simply don't trust legislators; that many representatives are ignoring the governor; that the legislature has abdicated responsibility to police its own, and thus the federal government has had to step in; and that the legislative branch has become paralyzed. He indicated he'd provided testimony and input about tax ideas several times but felt he wasn't being listened to.

MR. SHARP said Alaskans face a staggering energy crisis, with Cook Inlet gas drying up and Railbelt heating oil at $3 or $4 a gallon, higher at Dutch Harbor. He mentioned rampant greed of the "big three" oil companies, which have set another record for profits while crying impoverishment. Referring to his previous testimony, he said both resources committees have abdicated responsibility to assess the value of the oil resources and to develop a fiscal policy to maximize the benefit to Alaskans - which he surmised is being interpreted as maximum benefit to the oil industry.

MR. SHARP suggested legislators who aren't corrupt are complicit for closing their eyes to the criminal activity. Worse, as they sequester themselves in Juneau with scores of oil lobbyists, Alaskans are frozen out of their own political process and thus have lost control of their economic future. He asked what it would have taken to schedule a committee meeting or two along the highway system, rather than having legislators listen over a crackly intercom; perhaps then they'd hear folks say to keep it simple. Mentioning a point-of-production-based tax and capturing Alaska's fair share, Mr. Sharp said allowing the oil companies to "write the PPT legislation and then use it as a starting and finishing point was, and is, insane."

6:25:52 PM
BUZZ OTIS, Great Northwest, noted Great Northwest is a construction group; he indicated he has been in business in Fairbanks 33 years. Unlike the previous speaker, he believes most politicians in Juneau are there to do a good job for Alaska and are honorable people; he thanked them for their service. However, he believes Alaska is at an economic crossroads. Federal funding is being challenged, which likely will continue. He cited challenges to the mining and housing industries, predicting the construction industry will follow soon.

MR. OTIS urged caution, asking members to come up with a formula that is stable and will encourage long-term investment in the oil fields, not only on the North Slope but also in Cook Inlet. He noted Doyon and some of its partners are exploring in the Nenana Basin, for instance. He also expressed the need to not have to revisit this issue. A business person whose taxes are revisited every year or 18 months would be nervous about making an investment for the long term. It's all associated with risk.

6:28:24 PM
JERRY McCUTCHEON, Anchorage, representing himself, said the use of ridiculous illustrative examples needs to stop because they have a bad habit of later becoming facts. He asked: Why do you think the oil companies are using DNR/DOR numbers rather than their own? Referring to Exxon's testimony today, he said some state employees put out an illustrative example that proves the oil companies' case better than industry numbers do.

MR. McCUTCHEON referred to the Gaffney Cline examples and said 250,000 barrels a day as the oil-pipeline minimum flow and shutdown point is nuts and stupid, even if it's only illustrative. He suggested trying 50,000 barrels a day at $80 oil, for $1.5 billion a year; at $40, for $750 million; and at $20, for $375 million. Mr. McCutcheon negated the idea that oil companies would shut down the line if the throughput were only 50,000 barrels a day at $20 a barrel, abandoning billions of dollars of North Slope infrastructure and then having to pay for its removal.

MR. McCUTCHEON recalled today Exxon told the House Resources Standing Committee there's another 53 billion barrels to be discovered in Alaska, not counting 30 billion of viscous oil or 30 billion of heavy oil. He said a perfect example of "no abandonment" is the Cook Inlet platforms, where not one of them makes economic sense "the way you people have been calculating things." He said it costs more to remove the platforms than to keep them, which is why they're still there.

MR. McCUTCHEON opined that Prudhoe Bay has already produced 6.1 billion barrels, more oil than would have been produced if a gas line had been constructed in the 1980s; at least another 9 billion barrels remain to be produced. It is a good time to discuss the Cook Inlet platforms, he said, for those who persist in demanding a gas line and expensive oil recovery. He added that there is more "once-recoverable oil that is now unrecoverable" under the platforms than was recovered, over a

billion barrels, worth at least $80 billion at today's prices. He explained that the gas that came up with the oil had been sold off. He cited the example of Swanson River, where the percentage of oil recovery was three times that of the platforms.

MR. McCUTCHEON suggested since Alaska will own Point Thomson if Governor Palin doesn't sell Alaska out, Alaska should sue the Prudhoe Bay owners for a realignment of Prudhoe Bay interests with Point Thomson - just as Prudhoe Bay owners have sued one another several times to sort out ownership, the last time being a decade ago. He concluded by saying the injection of Point Thomson gas into Prudhoe Bay would make the State of Alaska the largest shareholder of Prudhoe Bay.

6:33:42 PM
STU GRENIER, Anchorage, recalled yesterday hearing on the radio that Alberta, Canada, raised its royalties by 20 percent. He said that is very simple. Everyone understands what it means. By contrast, ACES has a lot of people scratching their heads. He noted at a meeting at East High a few weeks ago there was mention of raising royalties or something equivalent for the two big producing fields, Kuparuk and Prudhoe Bay. That is simple. People would understand and support it.

MR. GRENIER similarly proposed giving tax breaks on what hasn't been produced yet and raising royalties, or something equivalent, for those fields. He expressed concern that the ship is going down economically because of the oil flow. Legislators must start making hard decisions so Alaska doesn't end up with infrastructure it cannot pay for. They also must do something to help the state in the long run, 30 or 40 years from now, such as taking the increased royalties from the big fields and then developing hydro projects along the Railbelt. At least then there'd be usable energy for future Alaskans.

MR. GRENIER pointed out that whatever doesn't get developed because of raising taxes or royalties will still be in the ground for future generations to develop. Nothing says this generation has to develop everything now for its own benefit. He expressed concern that the legislature isn't fiscally conservative. Whatever comes from future taxes or increased royalties should go into long-term productive projects that will benefit future generations, rather than just having "a big party" now. Saying the oil companies are smooth, getting their tax breaks and producing propaganda, he asked for something

simple and clear, increasing royalties as he'd discussed, with the hope of having something to show for all this money later.

6:38:37 PM
AVES THOMPSON, Executive Director, Alaska Trucking Association (ATA), Anchorage, said ATA is a 50-year-old statewide organization representing trucking interests from Barrow to Ketchikan. Its more than 200 member companies represent all the diverse trucking operations in the state, and many associate members provide goods and services to this industry. In Alaska, trucking employs over 20,000 people, 1 out of every 14 in the workforce. Payrolls total over $900 million annually. Most of the several thousand family-owned and corporate trucking businesses have fewer than 10 employees.

MR. THOMPSON turned to PPT issues and SB 2001. He said while the emphasis seemingly has been on raising taxes to increase state revenue, ATA believes the better way to maximize benefits to Alaska is to provide good-paying, long-term jobs for this and future generations. The state needs to focus on slowing the production decline. Investments need to 1) continue in existing fields, 2) be made in heavy oil, and 3) be made to promote development of new fields. Existing field development should be the first priority, since most new production in recent years has occurred in such fields. Without this base production, heavy oil and other new field development will face major additional challenges.

MR. THOMPSON said the oil and gas business is capital-intensive; it takes many years for a return on investments. Increases to taxes lengthen that recovery time and can negatively impact project economics and investment decisions. While tax policy should produce state revenues, it is more important to encourage future investment to develop Alaska's abundant resources. He urged keeping the tax rate low and using incentives to increase such investment, thereby providing good, long-term jobs for this and future generations.

6:41:33 PM
JASON BRUNE, Executive Director, Resource Development Council (RDC), Anchorage, noted his wife works for Alyeska Pipeline. He described RDC as a business association with a diverse membership including companies and individuals from all the state's natural resource industries, as well as Native regional corporations, local governments, organized labor, and more.

MR. BRUNE emphasized sending a positive message that Alaska is open for business. He said Alaska was allowed to become a state because of its rich natural resource wealth, but it appears its industries are under attack; he gave examples. Turning to the oil and gas industry, he expressed concern that yet another tax increase would send a bad message. Ballot Measure 2 last year sent a message that Alaska may in the future tax reserves that are in place; although it failed, it could come forward again.

MR. BRUNE said Alaska lacks the infrastructure and has high costs of doing business. Total government take presently is around 64 percent. Under Governor Palin's bill it could approach 68-70 percent, even higher with progressivity. He urged committee members to reject any amendments that would increase it further.

MR. BRUNE noted this morning former Governor Knowles spoke to RDC. Mr. Brune encouraged reading comments at akrdc.org. He said former Governor Knowles stressed the importance of the partnership between the state and the oil and gas industry, and also emphasized - as RDC has done for years - the importance of putting a long-term fiscal plan in place. He mentioned incredible oil revenues of the past two years, matched by the two largest budgets ever.

MR. BRUNE acknowledged the state's sovereign right to raise taxes, but said this doesn't mean it should. As for Alaska's fair share, he asked what a fair share is and what legislators pay, for instance, as a fair share to help run state government. He said Alaska is the only state in the US without either a state income tax or a state sales tax, and Alaskans also receive permanent fund dividends (PFDs), $1,654 each this year.

MR. BRUNE said RDC believes a fiscal plan must include not only industry taxes, but also a broad-based tax, some use of the permanent fund, and spending restraints. "Industry tax after industry tax" does not a fiscal plan make. Nor does it send a positive message to those contemplating investing in Alaska, bringing future jobs. He urged legislators to put all this together as part of a fiscal plan. He also urged them to let PPT, put in place last year, work.

6:46:51 PM
JEFFREY KNAUF, Girdwood, said he really likes the ACES bill as it was presented, believing it provides for the fair and equitable taxation Alaskans are looking for. He views the oil industry as looking a hundred years ahead, and he finds it

exceptionally hard to believe the reserves aren't there, for instance.

MR. KNAUF predicted any amendments to the original ACES bill would likely result in a petition process, which he'd strongly support. He said he knows what it is like to be impacted dramatically by the Exxon Valdez incident and how it was handled. He doesn't feel adequately represented. Exxon is a substantial part of an industry that he doesn't believe can be trusted.

MR. KNAUF said he believes ACES more than adequately addresses that, and in the long term it provides good revenue to the state. Because oil companies cannot regulate themselves, he counts on the state to present something such as ACES and follow through; otherwise, he believes there will be an aggressive petition process to put it on the ballot.

6:51:57 PM
EMILY FORD, Government and External Affairs Manager, Anchorage Chamber of Commerce, said her member-driven, nonprofit organization has more than 1,200 members representing 75,000 employees. She read a condensed version of a letter recently approved by the board of directors and sent to the governor and the legislature. Ms. Ford said while appreciating the desire to ensure that the most vital component of Alaska's petroleum tax regimen was the result of sound public policy, they have significant concerns regarding the review.

MS. FORD therefore requested the following actions: 1) review PPT to ensure it is sound public policy, but don't discard it simply because of circumstances involving dishonest lawmakers surrounding its passage; 2) if there are legitimate doubts concerning the effects of PPT, don't be afraid to allow it to exist for a sufficient time to allow reliable data to be generated, consistent with the original legislation, which provided for review after five years; 3) take all appropriate caution to protect Alaska's reputation as a stable tax environment that encourages and promotes business opportunities and investment; and 4) consider any revenue enhancements only in conjunction with developing a fiscal plan, a spending-and-savings plan for the State of Alaska.

6:55:17 PM
JIM SYKES, Palmer, representing himself, said he was former executive director of Oil Watch Alaska, formed in the mid-1990s to ensure the state gets its fair share and oil companies are

treated fairly as well. He referenced a report released December 9, 1998, by Richard Feinberg of Fairbanks, "How Much Is Enough," which said the state wasn't getting enough oil revenue. On that day, oil hit $10 a barrel. Mr. Sykes said the industry, while still making a profit at $10 a barrel, denied it was making money. However, it was learned from oil company insiders and government officials that the report - which was based on publicly available information - was close to the mark. Even at extremely low prices, oil is extremely profitable.

MR. SYKES surmised oil companies have the ability to move less-profitable heavy oil, especially at today's sky-high prices. Had the report's six recommendations been followed, there'd be no need to be here today. It centered on a "windfall equal-sharing tax" under which "x" amount is taken out of the full price of oil. If the state is an equal partner, its share should rise and fall along with the oil industry, resulting in a fair share no matter what the price of oil is. The report called for a surcharge to kick in at about $18.50 a barrel. The current discussion is about adding a surcharge after $40, $50, or $60 a barrel. He opined it should be closer to $25 a barrel.

MR. SYKES highlighted problems. Long term, the aging oil fields and infrastructure are increasingly expensive and thus a net-profits tax will assuredly result in greater write-offs against profits. Short term, Exxon, BP, and ConocoPhillips could rig the system and take advantage of profits they make on behalf of their shareholders. With respect to information not provided from the companies, he said if the state doesn't have the tools to monitor a net-profits tax, those should be enacted; it may require a commission.

MR. SYKES agreed with Mr. Benson that the portions stripped out of ACES should be put back. Mr. Sykes said deductions on newer and smaller fields should only be allowed for verifiable, cash-only field expenses. There should be more public disclosure of information. And write-offs for lobbying, media campaigns, and so on should be prohibited. The cost of cheating and delay must be greater than the cost of proper reporting and the payment. Also, access to North Slope facilities by new explorers must be guaranteed.

MR. SYKES asked legislators to look at actual transportation costs related to TAPS; for companies that both produce oil and ship it through the pipeline, there must be a real cost attached, not just what they say costs are. At the same time,

those costs must protect independent companies, which are aced out of the pipeline because they're not owners.

MR. SYKES disagreed with the contention that taxes prevent investing and further exploration on the North Slope and that the oil producers may leave. He said they won't leave at $80 or $40 a barrel. Mentioning former Governor Walter Hickel, he said a partnership with the oil companies must be equal. He asked legislators to reexamine the situation thoroughly.

7:02:54 PM
DAWN MENDIAS, Chugiak, a retired teacher, said the profit motive is strong and the state shouldn't underestimate its resources. As long as any profit exists, the oil companies will stay. Alaska is a known and stable location, unlike many other places where these companies still operate. Ms. Mendias also cautioned against thinking of this as a partnership. Rather, it's a business relationship. The state owns the resources, which constitutionally are for the benefit of Alaska's people.

MS. MENDIAS said PPT is flawed, passed in haste and choreographed by the oil companies. Corporations have one goal: profit for their shareholders. Fairness isn't included. Because legislators are dealing with agents of the oil companies, however, they tend to personalize it and be fair. Instead, legislators should get as much as possible for Alaska, especially since the oil is declining. As for giving PPT time, time is money. The state cannot afford to lose billions of dollars waiting.

MS. MENDIAS said these companies have slick public relations, accounts that can play with net profits, and some Alaska legislators who are weak, stupid, pliant, or corrupt to help achieve their goals. She asked how it can be that while companies rake in record profits - which they won't even reveal upon questioning - Alaska's schools, swimming pools, social programs, village health programs, and infrastructure scramble for funding.

MS. MENDIAS encouraged legislators to raise taxes and take back what belongs to Alaskans, now and for the future. A 25 percent tax might not be enough. She said ACES is okay unless something even more beneficial for Alaska's bottom line can be brokered. Whatever it is, choose something simple. Tax the gross.

7:06:50 PM

SIG RUTTER, a 30-year Alaska resident, said after construction of TAPS was completed in 1976, he went to work on the pipeline in 1977. The construction camps were full of people and yet little was being done. They were flown to remote hilltops by helicopter and then sat around campfires telling stories all day; at night they returned to camp, where a big spread awaited.

MR. RUTTER said the workers knew something extraordinary was going on, but didn't know what. Later, lawsuits claimed that by wasting money, the industry majors were able to drive the tariff up so high that only they could afford to bid on future leases. Independent drillers from Texas, Oklahoma, and Wyoming were unable to compete because only the pipeline owners could afford to ship their oil profitably through TAPS. The state and its people, because of the royalty, paid for all the waste.

MR. RUTTER said he believes all this talk about providing a fertile investment climate is poppycock, whether it's coming from the Chamber of Commerce or others. Expressing disgust with the legislature, he discredited the idea of a partnership with industry; opined that a profits-based tax will result in a lot of nonsense, crime, and corruption; and said it is about time the oil companies start paying their own way.

MR. RUTTER recalled when TAPS was built, workers expected it to last 20 years; he surmised that figure came about because the legislature provided a 20-year depreciation schedule. Now TAPS has gone 10 years beyond its projected life. The oil companies have basically received a free ride, because they were allowed to subtract costs from the state's royalties. Strongly blaming the Republicans, he asked: How many times do we have to pay for this pipeline? He said once the depreciation ran out, the companies started talking about new incentives and whatnot, and he believes some fields pay no royalties at all.

7:11:01 PM

MARY AND JIM ODDEN, Nelchina, testified via a joint statement read by Mary Odden. They've lived in Alaska since the mid-1970s, working in the public and private sectors. They currently own and operate a community newspaper serving the Copper River Valley; their business is tied to the local economy and to some intangible qualities of life in Alaska. They consider themselves fiscal conservatives who also recognize that state government bears responsibility for maintaining public education, safety, resource management, transportation infrastructure, and care for the weakest citizens.

MS. AND MR. ODDEN, through Mary Odden, said they support a careful design of a fiscal design for Alaska. The best long-term interests of Alaskans aren't necessarily those of the oil producers; legislators should determine where those diverge. They support the governor's ACES plan, which they don't believe will hurt the oil and gas industry. If the ACES tax percentage is lowered, a progressivity component should balance it. They request a price or cost protection for legacy fields such as Prudhoe Bay. They also ask that reporting requirements for companies be preserved. Transparency is critical. Alaska needs the tools. Finally, legislators should adopt some form of Senator Dyson's amendment which asks that a future percentage of the progressivity component be dedicated to repaying the constitutional budget reserve (CBR) account.

7:15:06 PM
MALCOLM RAY, Eagle River area, described himself as an oil and gas owner with properties in 14 states in the Lower 48. He pays from 3 percent production tax in some states up to 7 percent in Oklahoma. He considers a tax over 10 percent to stifle his company's ability to explore for oil and gas, or even to conduct lower-risk oil and gas projects. He would never bring his company to Alaska under the current circumstances and fiscal situation, Mr. Ray told members. He has lived in Alaska three times; this time, he's been here 10 years.

MR. RAY said there is an initiative in Alaska currently being championed by a self-righteous governor with no knowledge of private industry. Changing the tax rate for a single industry three times in as many years is an atrocity against the state and its future well-being, and is a direct attack on people in the Lower 48 who must pay even higher prices for natural gas to heat their homes. He predicted Alaska will be like a Third World country if this continues.

MR. RAY said he has personal knowledge of the waste and corruption in this government, beyond what has made the news in the last few years. He opined that the real corruption is in the governor's office, not the few legislators who may have worked with their buddies for a few thousand dollars.

MR. RAY referred to a five-page report dated August 3 from Governor Palin's administration, surmising it's a hoax and cannot be substantiated; Mr. Ray said he is very professional when requesting information and has had a request in for over a week, but DOR won't send data supporting how this report was arrived at. Also, while a net-profits tax is in line with how

individuals pay federal income tax, and while other states have net-based income tax, the report says the State of Alaska doesn't know how to administer this tax. He closed by saying other states aren't nearly so greedy with respect to this particular industry.

7:19:42 PM
DANIEL B. WINN noted he has lived in Alaska 38 years, mostly around Homer. A commercial fisherman, he also is a retired laborer out of Local 341. He believes a gross-based tax is best. A net-based tax pits the state against some of the best lawyers and accountants in the US; he questioned whether the State of Alaska has the resources to deal with that. He wants a tax to be straightforward, based only on the gross.

MR. WINN said there are shortcomings with respect to state oversight of the oil industry. The pipeline is 10 years beyond its expected life, he indicated. He'd worked in Valdez several years ago, and the place isn't well kept. Citing the settling ponds as an example, he expressed concern that there will be massive expenses for Valdez and all along the pipeline. He suggested considering that while figuring the tax out, and putting money away for further inspections and so on.

MR. WINN also said the system is a little flawed because each year the legislature decides how much money goes towards oversight. That makes it difficult to hire outside consultants or engineering companies that could actually do the work and inspect it. He agreed with former Governor Jay Hammond, saying industry should pay its own way, including commercial fishing.

MR. WINN opined that Alaska hasn't been getting its fair share from the oil industry because of their accounting procedures. He hopes legislators will pass something based only on the gross, even for new fields. If they want to specify certain areas where deductions can be made, that is fine, but it should be really clear and simple. He added that he can't believe some people think the oil industry is being overtaxed by the state.

7:23:56 PM
KELLY WALTERS spoke in favor of a tax on the gross. He said when PPT passed last year, originally there weren't enough votes. Before that, under then-Governor Murkowski, the deal was negotiated in secret with the oil companies; at the last minute a special session was called and it was revealed to be tied to a proposed gas pipeline. It wasn't really covered in the newspaper that this was a net-profits tax, he said, or that

85 percent of the state's revenue would be tied to the efficiencies of the oil producers. He indicated it provided a disincentive to efficiency, since the higher the costs they can write off, the lower their taxes - and hence the lower the state's revenue - will be.

MR. WALTERS said with a net-profits tax, the state absolutely needs a legal and accounting infrastructure to ensure it's getting a fair share. It is a bad idea. He recalled Governor Palin had campaigned on taxing the gross; he'd seen a couple of her presentations. In terms of the investment discussed by the media, he opined that if there is profit to be made, the oil companies will find a way to do so. However, it doesn't appear there has been significant investment, even with incentives.

MR. WALTERS referred to the recent trials involving Alaskan lawmakers, saying there has been a merger of the interests of the government with those of the oil producers. Suggesting this is fascist, Mr. Walters concluded by asking legislators to not be fascist and to tax the gross.

7:27:07 PM
PAUL KENDALL began his teleconferenced testimony by protesting the process.

CHAIR FRENCH acknowledged the frustration of not being able to testify in person, but pointed out that no matter where the committee met, most of the state wouldn't be there.

MR. KENDALL thanked Governor Palin, saying he thinks she is well-intended, but specified that he supports a gross-based tax. He disagrees with PPT's complexity. Today the pipeline is two-thirds empty; it has taken several years to get there. One would think oil companies would be knocking at the door, but they haven't. Nor does he see the three major oil companies having a lot of contractors looking for more oil. He asked whether what goes in the pipeline is measured against what goes out, for example. He also noted that the oil company representatives aren't sworn in when testifying. He suggested that should happen.

MR. KENDALL expressed concern about Commissioner Galvin's testimony, since he represents the state's interests, does oil forecasting, and also acts as an investment banker and so on. Mr. Kendall said it seem every form of testimony is suspect, including his own. The legislature has failed to make these people stand up and be accountable. They should be sworn in and

should be asked to testify. He said he believes Alaska has a bright future, but he's frustrated when looking at the totality of events, such as not opening the Arctic National Wildlife Refuge (Arctic National Wildlife Refuge (ANWR)) to development.

MR. KENDALL left his phone number, 222-7882, suggesting people need to reach out to form their own means of dialogue, which is what happens when leadership seems to fail to represent the people because it has no vision and no foundation. He clarified that he believes there is a bright, magnificent future close at hand. He acknowledged that many are well-intended and do shine.

7:33:14 PM
TOM LAKOSH asked members to consider his written and oral testimony as well as critical documents and comments attached to an e-mail he'd sent.

CHAIR FRENCH noted his e-mails would become part of the record.

MR. LAKOSH said although there are many issues, he would correct misrepresentations in material publicly disseminated by a legislative consultant and DOR. Presented yesterday, this is the representation that PPT and the amended ACES system of tax deductions and credits are necessary and/or the preferred mechanism to advance legacy oil field infill drilling that is designed to stem oil-field production decline.

MR. LAKOSH told members the material omission is that the lease provisions for the fields already require the lessee to "drill those wells as a reasonable and prudent operators would drill, having due regard for the interest of the state". That is from the standard lease form, page 6. They also omitted that "the commissioner will require amendments that the commissioner determines necessary to protect the state's interests" in consideration of lessee's plan of operations. That's from page 4 of the standard lease, and the same language is found at 11 AAC 83.158(e).

MR. LAKOSH said a fair legislative investigation mandated by Article I, Section 7, of Alaska's constitution would necessarily require the following three actions: First is a full apology on the committee floor and in all Alaskan publications of record. Second is a presentation by Gaffney Cline depicting the necessary infill drilling and heavy oil extraction required of lessees pursuant to the diligence and prevention of waste provisions in section 13 of the leases in question.

MR. LAKOSH told members the modeling should assume multiple standards of "reasonable profit" as garnered by all other Alaskan corporations and showing utilization of all windfall profits above such reasonable rates of return already garnered to date, and it should incorporate existing DOR oil price projections and any necessary extrapolation into the future, to show a projection of lifetime field-decline rates and projected revenues comparable to the presentation in question.

MR. LAKOSH said the third action required is calling the DNR commissioner and his knowledgeable Division of Oil & Gas staff before the committee to explain: 1) the relevant lease provisions; 2) his administration of these leases, both consistent and inconsistent with constitutional, statutory, regulatory, and contractual mandates to preserve the state's interest; and 3) in cooperation with Gaffney Cline, what specific operational plans he'll develop in administration of lessees' duty to fully extract all hydrocarbons on their leases, in conformance with the applicable leases.

MR. LAKOSH referred to discussion in the House Resources Standing Committee today, where he said legislators finally recognized leases are an important part of this discussion. He also referenced a presentation by Pioneer that explained the other side of the same coin; he said they have a net-profit lease provision being impaired by a net-profits tax. Expressing concern that leases which typically address drilling, exploration, and production costs are being impaired by this net tax/credit legislation, he opined that this is prohibited by Article I, Section 15, of Alaska's constitution.

7:39:27 PM

MARSHALL BYRD, Anchorage, on behalf of his family's future, expressed discouragement with the government's ability to lead this great state and to lay a foundation for the future. He said leadership has been overreacting and leading from emotions. He cited examples involving Matanuska Maid; Point Thomson; and the Alaska Gasline Inducement Act (AGIA), which he said effectively shut out those companies with the resources to deliver such a huge project. He suggested these send a clear message, beyond just the oil industry, that Alaska isn't the place to invest and do business. Now under consideration is what he considers the knockout blow: raising taxes a third time before the ink has dried on PPT.

MR. BYRD asked that the legislature lead with logic and vision, securing his family's future by sending a message that Alaska is

a place to do business. He asked that PPT be left in place long enough to see whether it works, and asked legislators to focus instead on diversifying Alaska's economy. He asked: If the current tax structure is creating a budget surplus, why take more? And what will it be spent on? He requested that future jobs for his three sons not be traded for a bloated government.

7:41:21 PM
GLORIA DESROCHERS, Fairbanks, an Alaska resident since 1960, said it appears lawmakers have been sweet-talked by the oil industry. They should put the interests of Alaskans ahead of the oil companies and should act as the parent, not the child. She lauded Frank DeLong, indicating he'd said Indonesia has taken control of its own resources, for instance, with positive results for Indonesia, and with "big oil" making enough profit to stay.

MS. DESROCHERS said oil companies have no allegiance to anything but profits. Alaskans should have at least as much desire and duty to themselves with respect to their own profits. She urged members to be open and listen to the wisdom of those like Frank DeLong, whom she called a goldmine of experience and knowledge. She also wanted to know the sources and reasoning behind information on oil-resources issues that have controlled legislative decisions thus far.

7:46:30 PM
JARED HAMLIN told members he was also representing his wife and young daughter; all three were born in Alaska and want to see Alaska "continue on with its resources." He said the oil tax is being revisited because the last change occurred under a cloud of corruption and bribery. When any industry makes accusations about instability because of revisiting something, it should be considered whether the industry itself is the reason behind it. He asked for legislators to put something in place such that it doesn't have to be revisited again.

MR. HAMLIN said the problem with PPT is it requires massive amounts of accounting and so on, for which the state has to attract workers to go up against lawyers and accountants for the oil industry. Another flaw is the massive amounts of write-offs the industry can do. As far as Governor Palin's tax plan, he said he likes some portions, but others seem jumbled up and technical. Alaskans need something simple, more like a gross tax. However, he disagreed with even using the word "tax" because it's more like a fee, since the state is paying the industry to take the oil out.

MR. HAMLIN said Alaska is unique and utilizes those resources, under the constitution, for Alaskans to live. It also has a unique product to offer. The state needs to get the best value for the long term. He agreed with earlier testimony that it doesn't all have to be produced today. If the oil companies don't want to play ball, they'll come back sooner or later. He proposed having a higher tax than currently; getting a fair share based on the world average; and having this happen sooner rather than later - not waiting to see what PPT will do. He surmised it costs a lot every day while people sit and wait for a broken plan to try to fix itself.

MR. HAMLIN suggested moving forward. He agreed with wanting to have businesses invest in Alaska; he emphasized sending a clear message. He referred to ads from the oil industry, saying a lot of people are scared the industry will leave. "We know that's not true," he told members, surmising they all know the oil industry won't leave Alaska if they institute a world average or fair share, whatever those mean. Mr. Hamlin said he wants an increased share to go to Alaska for its product and to still keep a good, healthy relationship with the oil industry. He expressed hope that this will help in the future with respect to mining as well.

7:51:48 PM
BILL WARREN, Nikiski, said he came to Alaska in 1951 and was representing his three-year-old son; he doesn't want the state's resource to be dried up like a prune when his son reaches Mr. Warren's age, as is the case in Cook Inlet. He opined that that State of Alaska is in big trouble. The "big three" are in Prudhoe Bay, which has led to a chain of events and a monopoly, with little competition. There is no Railbelt energy policy. Agrium has failed. Gas prices are rising. There is a failed gas line contract. He mentioned shenanigans going on and so forth, saying if Exxon doesn't like the risk, it should get out of the business and manufacture shoes.

MR. WARREN highlighted public suspicion of the government, saying all this corruption, indictments, and convictions give reason for suspicion. He mentioned fear of ongoing tax litigation by entities like Exxon. Recalling his own work on the pipeline and doing maintenance work at Valdez, as well as working from Ketchikan to Barrow, Mr. Warren predicted a tremendous amount of write-offs for maintenance because of the mature mechanical and electrical systems.

MR. WARREN highly recommended a gross tax with very nice credits to those "who actually do things in the state of Alaska, and not Oklahoma or Texas." The extra money from this tax increase should be used wisely. There should be a plan developed for in-state gas use immediately, appointing the Alaska Natural Gas Development Authority (ANGDA) to be the vehicle; he alluded to Harold Heinze of ANGDA.

MR. WARREN also mentioned training and true apprenticeships, saying there won't be a need to compete later if everything is prebuilt in Alaska, whether for a spur line or a stand-alone line to Prudhoe Bay, which the tariffs have proven economical. He concluded by saying the big three oil companies have an increasingly smaller "grazing range" in the world.

SENATOR THERRIAULT agreed about the increasingly smaller grazing range, saying there have been national articles about it. He also agreed that with the trials of lawmakers, there is reason for suspicion. Alluding to the debate on PPT last year, however, he said there were people in the building asking questions, trying to expose what they felt was going on; he said Senator French was right there with him. He opined that going through this new process will lift that cloud.

7:56:41 PM
JIM ADAMS, Nome, indicated this is the state's opportunity to receive a portion of its due.

7:57:14 PM
RANDY SELMAN, Wasilla, gave some personal history, noting he now has descendants working on the North Slope. He said he feels PPT isn't tainted and that taxes do affect capital projects because they're a liability and correspond directly to the net present value and return on capital for any project.

MR. SELMAN said North Slope payrolls are probably in the top 5 or 10 percent in the US with respect to net income for individuals; they're also more than 50 percent of the operating cost of doing business there. North Slope construction and drilling costs are some of the highest in the world, and facilities are some of the most expense as well. This is due to the extreme environment there.

MR. SELMAN recalled two weeks ago, two strong companies in the oil business gave back 300,000 acres to the Bureau of Land Management (BLM) because they'd decided those were uneconomical to explore. He said the oil business is highly competitive and

companies are investing worldwide. He challenged members to help Alaska stay competitive, which he believes means lowering taxes, not raising them.

MR. SELMAN emphasized getting new oil into the pipeline and keeping folks employed in Alaska until a gas pipeline can be built, which will get Alaska to the next 50 years. If legislators do anything with respect to ACES, he asked that they pick up some of the important administrative portions that can improve PPT. Please don't raise taxes, he concluded, saying Alaska is headed in the wrong direction and will be noncompetitive worldwide.

8:00:27 PM
SHANNYN MOORE, describing herself as a lifelong Alaskan and concerned citizen, said she is tired of the "jellyfish approach" to Alaskan politics, the lack of spine. "This is our state," she said. "This is our resource. And this is our future. We are the shareholders - not the shareholders of Exxon, not the shareholders of BP nor anywhere else." Indicating former Representatives Tom Anderson and Pete Kott as well as Representative Vic Kohring had been found guilty, she said this legislature has been corrupted. This tax is being revisited because of it. And it isn't known whether more indictments are coming. She asked whether this tax, if it goes through, will be revisited as well.

MS. MOORE suggested the Anchorage Chamber of Commerce should talk to the Chambers of Commerce in Cordova, Valdez, Kodiak, Homer, and so on to see how reliable oil companies are to them. "Don't blink," she said. "Don't look away." She said the testimony heard during the daytime hours came from oil companies that lie, saying they'll have a hard time paying their bills and won't be able to explore; she totally discounted this, surmising $94 a barrel should be enough incentive.

MS. MOORE emphasized that legislators are there for Alaskans. This is Alaska's oil. Just because the oil companies are taking it doesn't mean they get to negotiate what part they'll give to Alaska. She said the oil companies trying to manipulate the legislature are the same ones that lie to Alaskans; she cited almost 19 years of manipulation by Exxon, alluding to the Exxon Valdez disaster, and said ConocoPhillips rallied the legislators and won PPT; she questioned how anyone could want to keep it. She concluded by saying legislators only owe Alaskans. They don't owe the oil companies.

8:04:53 PM
JOHN RANDALL, Wasilla, noted he has called Alaska home since 1949 and was president of the first borough assembly on the Kenai Peninsula. He recommended scrapping PPT and giving consideration to a policy they'd used in those first few years: payment in lieu of taxes. Under this, taxes on certain parts of the facilities are excused for a period of time. In this way, Alaska will be - at least in part - indemnified against occurrences such as the Exxon Valdez oil spill or malfeasance in maintenance of property. Whether the price of oil is high or low won't matter. An agreement should be reached that they pay in advance a sum that he reckons to be in the billions of dollars, paid into both the permanent fund and the CBR.

MR. RANDALL said he'd talked about this with now-Governor Palin when she first was running for office and passes it along to legislators now. He offered to talk further with anyone about this. He also noted that today a legislator from his district is a convicted felon.

8:07:52 PM
STEVE MORAWITZ, Wasilla, a 49-year Alaska resident, said he believes there needs to be a vote on PPT. The oil companies used unethical means to influence the legislature, and he surmised it's likely that more senators are on the payroll of big oil. The voters of Alaska need to know where legislators stand so they can be held accountable. He specified that he favors the recommended 25 percent.

CHAIR FRENCH asked whether anyone else wished to testify. He highlighted the lack of trust of the legislative process that had been heard, acknowledging it's somewhat understandable. Speaking for the committee, however, he said he didn't see any dishonesty or misdeeds here. Rather, he sees a lot of hard work. He thanked the testifiers and held SB 2001 in committee.

There being no further business to come before the committee, Chair French adjourned meeting at 8:09:33 PM.