

ALASKA STATE LEGISLATURE
SENATE JUDICIARY STANDING COMMITTEE

November 2, 2007

5:28 p.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

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

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)
11/01/07 (S) JUD AT 9:00 AM BUTROVICH 205
11/01/07 (S) Heard & Held
11/01/07 (S) MINUTE(JUD)
11/02/07 (S) JUD AT 5:00 PM BUTROVICH 205

WITNESS REGISTER

DONALD BULLOCK, Attorney
Legislative Legal and Research Services Division

Legislative Affairs Agency
Juneau, AK 99801-1182

POSITION STATEMENT: Explained changes in CSSB 2001, version K.

PATRICK GALVIN, Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Provided perspective on CSSB 2001, version K.

ROBERT MINTZ, Consulting Attorney for the Administration
Kirkpatrick & Lockhart Preston Gates Ellis LLP (K&L Gates)
Anchorage, Alaska

POSITION STATEMENT: Responded to questions related to CSSB 2001, version K.

NANETTE THOMPSON, Petroleum Manager
Division of Oil & Gas
Department of Natural Resources
Anchorage, AK

POSITION STATEMENT: Responded to questions related to CSSB 2001, version K.

ACTION NARRATIVE

CHAIR HOLLIS FRENCH called the Senate Judiciary Standing Committee meeting to order at [5:28:19 PM](#). Senators McGuire, Huggins, Therriault, Wielechowski and Chair French were present at the call to order.

SB 2001 - OIL & GAS TAX AMENDMENTS

[5:28:45 PM](#)

CHAIR FRENCH announced consideration of SB 2001 and asked for a motion to adopt the committee substitute.

SENATOR WIELECHOWSKI moved to adopt committee substitute (CS) to SB 2001, labeled 25-GS0014\K. Hearing no objections, version K was before the committee.

CHAIR FRENCH asked Mr. Bullock to explain the change in the CS that reinserted the progressivity tax rate but not the floor.

[5:29:54 PM](#)

DONALD BULLOCK, Attorney, Legislative Legal and Research Services Division, said version K is a combination of the bill that came out of the Resources Committee and the governor's

bill. The biggest difference between the Resources Committee CS and this version is that two of the three tax provisions that the governor offered are brought into this bill. The governor proposed moving the nominal tax rate from 22.5 percent to 25 percent and lowering the floor from 40 to 30 for the progressivity tax. Her bill also proposed a floor tax of 10 percent of the gross value at the point of production for the fields that have been in production a long time and that continue at high production. This bill does not include that last part of the tax but it does include the 22.5 to 25 percent increase and it includes lowering the floor to 30 as well as changing the progressivity rate from 0.2 percent to 0.4 percent. Sections 15, 16, and 17 of the bill address the tax changes.

MR. BULLOCK said the progressivity tax payment schedule has also changed. Currently payments are scheduled on a monthly basis which affects calculating the installment payment. The governor's bill determined progressivity on a calendar year basis. The installment payment was based on the nominal tax rate and then a pay-up at the end of the year or by March 31 of the year after the calendar year for which the tax is due. Version K goes back to the monthly calculation so the installment should keep current.

[5:31:59 PM](#)

MR. BULLOCK said there are no substantive changes in the credit provisions of the bill. The nominal tax rate plus the progressivity are combined into one section in this bill as they were in the governor's bill. Changes that deal with eligibility for transitional investment expenditure (TIE) credits made in the Senate Resources Committee were incorporated. Also in the section that establishes the tax rate there's a maximum of 50 percent, which is a combination of 25 percent nominal rate plus the multiple of .4 percent that applies to the progressivity rate. Other changes in this draft compared to the Resources Committee CS are the inclusion of a class of disallowed expenditures relating to poorly maintained equipment. That's the corrosion issue from SB 80, which wasn't addressed in prior versions. Version K adds the provision that if there is maintenance that's the result of improper maintenance before, then those costs are disallowed. That's in section 44, which amends AS 43.55.165(e). This bill also includes the expansion of the statute of limitations to six years as proposed in the governor's bill. These changes are found in Sections 1, 14, and 37.

[5:35:29 PM](#)

MR. BULLOCK further explained that this bill changes the classifications and reduces to four the number of exempt oil and gas audit manager positions. Intent language regarding the positions has been added to Section 51.

[5:36:42 PM](#)

MR. BULLOCK explained the changes regarding the replacement of transportation costs made in the Petroleum Production Tax (PPT). In PPT three conditions were required to be met to replace "actual" with "reasonable" costs. Version K changes it back so any one of the three conditions can trigger the substitution.

SENATOR THERRIAULT asked which section he's referencing.

MR. BULLOCK replied it's Sections 39 and 40.

MR. BULLOCK continued. A requirement was added to AS 43.55.165(b), stating lease expenditures that may be deductible must be incurred in the state. Additionally, a new provision in Section 33 gives the Department of Revenue (DOR) the authority to require a producer to report and publish the gross value at the point of production for a calendar year and the corresponding lease expenditures. Section 46 allows the DOR to publish that information. It does not include reporting the credits.

[5:40:11 PM](#)

MR. BULLOCK said Section 36 has a new section - AS 43.55.055. This is a new penalty for understatements of tax that must be shown on the return. He added that there will be a technical amendment in the near future to correct a misstated number.

MR. BULLOCK said in Section 38 an amendment to AS 43.55.110 gives DOR authority to reward a person who provides information to the department about non-compliance with the requirements of AS 43.55 that leads to collection of an increase in the tax, penalty, or interest. The reward is subject to appropriation. The information that is sought is information related to: understated gross value at the point of production; overstated lease expenditures; or overstated transportation costs.

[5:41:36 PM](#)

SENATOR THERRIAULT referring to Section 38, page 27, lines 15-16, asked if the reward could amount to millions of dollars even with a 10 percent cap.

MR. BULLOCK replied it could, but the department is given discretion to determine the compensation.

5:42:43 PM

SENATOR THERRIAULT asked if the department would be given the authority to cap the amount.

MR. BULLOCK replied it's within their discretion to have the reward be less than 10 percent.

CHAIR FRENCH noted that the bill has many provisions that had to be included because of the ripple effect of bringing in two out of the three fiscal changes.

MR. BULLOCK agreed, and said that that the governor's bill changed the way taxes were described in AS 43.55.011 so any references to former sections had to be changed.

CHAIR FRENCH said it might be easier to review changes by topic rather than section by section.

CHAIR FRENCH called an at-ease at 5:45PM.

5:54:19 PM

CHAIR FRENCH called the committee back to order.

PATRICK GALVIN, Commissioner, Department of Revenue, Juneau, reviewed Sections 16 and 17. He explained that the Department of Revenue (DOR) was working with a "twenty-five percent rate with progressivity that starts at a net \$30 trigger with a .4 degree slope." Credits were approached as provided in the Senate Resources CS. Based on those assumptions he provided information for fiscal years 2008, 2009, and 2010. He stated it was also important to note that the effective date of the fiscal terms is January 1, 2008.

COMMISSIONER GALVIN said that three different dollar assumptions were run. He continued:

One was at our current price forecast, which starts in FY 2008 at \$71.65. And for that price...this CS would result in \$2.699 billion. That compares to status quo PPT of \$1.915 [billion]. Continuing in the forecasted price for 2009 is \$64.55—going down. The draft CS in \$2.732 billion compared to a status quo PPT of \$1.693. Then in 2010 the projected price is \$60.05. The CS \$2.356 billion compared to status quo PPT of \$1.531.

We also ran them at \$60 price and then \$80 price. The \$60 we ran as a nominal, which had it increasing each year. So I'll tell you the price at \$60 basically in today's dollars each year.

For 2008 it's \$1.613 billion for the CS compared to status quo PPT of \$1.051 [billion]. For 2009 the CS is \$2.308 compared to status quo PPT of \$1.435. In 2010 the CS \$2.398 compared to PPT \$1.562.

CHAIR FRENCH asked for the nominal price in 2009.

COMMISSIONER GALVIN answered \$61.65 and in 2010 \$63.35.

[5:59:36 PM](#)

COMMISSIONER GALVIN clarified that the price forecast is also in today's dollars. The forecasted price for 2009 in 2009 dollars is \$66.30 and in 2010 it's \$63.40 so the numbers should be similar for the two runs in 2010. He continued:

Finally at \$80. 2008 \$3.619 for the CS compared to \$2.650 for status quo [PPT]. In 2009 - running all your numbers you've got a nominal price of \$82.20 - the CS would be \$4.709 [billion]. Status quo PPT \$3.031 [billion]. In 2010, nominal price \$84.46. The CS \$4.900 [billion] and status quo PPT \$3.266 [billion].

Those are the numbers that our revenue model shows would be generated by the fiscal terms proposed in the CS.

[6:01:26 PM](#)

CHAIR FRENCH asked Commissioner Galvin for the administration's view of the tax increases with respect to giving Alaska a fair share and impacting industry.

COMMISSIONER GALVIN replied the Alaska's Clear and Equitable Share (ACES) proposal contains a gross tax floor as well as a progressivity rate that is not nearly as steep as what is proposed in the CS. The administration still supports that trade off but recognizes that the legislature is taking a slightly different approach. We don't see that the proposal necessarily will crimp investment, but we do recognize that progressivity based upon the margin as opposed to the gross value will provide investment incentive for entities looking at pursuing more

economically stressed projects. It's a reasonable fiscal tradeoff.

CHAIR FRENCH asked if the change would be reasonable.

COMMISSIONER GALVIN answered it would be reasonable and fair.

SENATOR WIELECHOWSKI asked if the governor supports the change.

COMMISSIONER GALVIN answered it's an entire package, but she would support this trade-off as it stands.

[6:03:48 PM](#)

SENATOR HUGGINS said he wants to see qualifiers that show how the deduction was reached.

COMMISSIONER GALVIN responded that an important component of this trade-off is the operating principle of making gains when prices are high so that becomes the protection for lower prices in the future.

SENATOR HUGGINS said he hopes future budgets will reflect the desire to save money and contain spending.

COMMISSIONER GALVIN said the governor supports saving and recognizes that in her budget.

[6:05:36 PM](#)

SENATOR WIELECHOWSKI clarified that this proposal is a trade-off. The state is taking a little bit of risk at the low end of prices by giving up the gross, hoping to make it up when oil prices are high.

COMMISSIONER GALVIN agreed.

CHAIR FRENCH asked Mr. Bullock to talk about the statute of limitations in Sections 1, 14, and 37.

MR. BULLOCK said Section 1 is a statement of legislative intent, but it would not be particularly helpful in determining how the section applies that extends the statute for six years.

MR. BULLOCK said Section 14 is a conforming change in the current statute of limitation.

CHAIR FRENCH asked if the statute of limitation will be six years when the bill is finished.

MR. BULLOCK replied yes, for AS 43.55 taxes. There is a different statute of limitation in Chapter 5 of Title 43 that generally applies to other taxes in the title.

CHAIR FRENCH asked if that is why it says three years in Section 14.

MR. BULLOCK answered yes.

CHAIR FRENCH asked if AS 43.55.075 is the operative change.

MR. BULLOCK said yes; it's in Section 37. It was in the governor's bill, but not in the Senate Resources CS.

[6:08:26 PM](#)

CHAIR FRENCH asked for an explanation of how the statute of limitations works.

COMMISSIONER GALVIN explained that the standard statute of limitations for tax issues is three years. The section in question provides an exception. For oil production tax the statute of limitations is six years as opposed to three.

SENATOR WIELECHOWSKI said the public has justified concerns about going to a net profit tax, and to dispel some of those concerns this is one tool that will be critical. The state will conduct many audits and this provision will help protect the state's interests.

SENATOR THERRIAULT asked for an explanation of the link with Section 1.

COMMISSIONER GALVIN said Section 1 is a reference to a particular regulation that references a regulatory decision that is made after a taxpayer has filed a tax return. That decision has a retroactive application and the taxpayer is obligated to provide notice of the decision to the department along with an amended tax return that's retroactive to the particular decision. The statute of limitations would start with the amended return. This is to ensure that if the statute of limitations is changed within this chapter, then for the purposes of that regulation the intent is that it applies the full statute of limitations to that also.

SENATOR THERRIAULT said an interpretation of AS 43.05.260 would embody that particular set of regulations.

COMMISSIONER GALVIN agreed; that's the cross reference.

6:12:21 PM

CHAIR FRENCH asked for an explanation of auditors referenced in Sections 9 and 51.

MR. BULLOCK explained that Section 9 [Section 10] amends the statute that lists all the exempt positions in the state. This section differentiates oil and gas audit managers from auditors that may already be employed with the department. This section adds emphasis on their being employed in a professional policy making capacity, which is a key determination of an exempt position. Section 51 is intent. It refers to the creation of four auditor positions in the DOR.

CHAIR FRENCH said there has been much discussion about auditors, and he thought the current number of auditors in classified service would be maintained at seventeen. He asked if this CS would add four new positions to that number.

COMMISSIONER GALVIN answered no. His understanding is four out of the seventeen existing positions would become exempt.

CHAIR FRENCH said the committee intent was to create four new positions to increase the size of the staff. He believes it is necessary to create four new positions.

6:16:14 PM

COMMISSIONER GALVIN said this is a compromise between the various interests which addresses his primary request, but it doesn't completely tackle the need to attract the personnel necessary for the department's audit staff. Qualified auditors are a broader issue that will need to be addressed statewide. Department of Natural Resources (DNR) audit needs, which were included in the original bill, are not addressed here. He said this is the starting point for getting the personnel he needs.

CHAIR FRENCH said it is important to get this right.

SENATOR HUGGINS said auditing is the cornerstone to success and he wants to err on the side of "robustness." He will recommend follow-up in the Finance Committee.

6:18:17 PM

CHAIR FRENCH asked how many auditors are necessary.

COMMISSIONER GALVIN said he won't know until he has the people in place. The system must be designed first, and that might take a couple of years. Consultants say four highly skilled people are needed along with existing staff.

SENATOR MCGUIRE said she doesn't want this provision to reduce morale within the department. She believes the current auditing staff at DNR and DOR works hard and is doing a good job. She said she believes that training is an important component.

COMMISSIONER GALVIN replied that he shares Senator McGuire's sentiments because morale is important. Training and other experiences that provide a sense of fulfillment are vital to employee well-being and retention.

[6:23:27 PM](#)

CHAIR FRENCH said this provision was intended as a compromise.

SENATOR THERRIAULT asked if the provision affects only DOR auditors.

COMMISSIONER GALVIN answered yes.

SENATOR THERRIAULT asked if the original bill addressed DNR concerns.

COMMISSIONER GALVIN replied yes; the original bill provided exempt tax auditor positions for DOR and exempt royalty auditor positions for DNR.

SENATOR THERRIAULT asked for the chair's intent regarding DNR.

CHAIR FRENCH said the intention was to keep DNR auditors in classified service. He understood that what was really necessary was to have high level analysts in DOR.

COMMISSIONER GALVIN said he has heard testimony that there are other solutions to the classified service issues. He wants to continue to work in that direction as well.

CHAIR FRENCH said right now he wants to craft a solution that works for DOR.

CHAIR FRENCH asked again if the number of proposed auditors should be increased.

COMMISSIONER GALVIN answered no; four is the number that meets his current expectations.

6:27:48 PM

SENATOR MCGUIRE encouraged Commissioner Galvin to look at the "like-pay for like-work" issue.

Commissioner Galvin replied current employees can be impacted when new employees are brought into positions above them. It is an issue that must be dealt with.

6:30:56 PM

CHAIR FRENCH asked for an explanation of Section 43, pages 30-31, pertaining to in-state expenditures.

MR. BULLOCK said it amends AS 43.55.165(b) and addresses direct costs and spending activity restrictions.

CHAIR FRENCH asked if it is constitutional to limit tax deductions to expenditures that occur within the state.

MR. BULLOCK said these types of requirements are subject to a low level of scrutiny and are a tax policy matter for the state. In this case the state is identifying what expenses can be taken to reduce the value of the oil and gas that's taxable. He thinks federal or state constitutions would not be violated by this provision.

6:34:00 PM

CHAIR FRENCH asked if this provision allows a deduction for steel, for example, to be bought in Tulsa then shipped to the North Slope.

MR. BULLOCK answered the steel would have to make it to Alaska in order to be deducted.

CHAIR FRENCH summarized it's a deductible expense if the item is shipped to Alaska and used in Alaska; if it never gets to Alaska then it's not deductible.

MR. BULLOCK added that DOR would ultimately need to adopt by regulation conditions for identifying costs that are incurred in the state.

CHAIR FRENCH asked about people who work in Alaska and fly to a home in Texas or Oklahoma.

MR. BULLOCK said if those people are working in the state the expenses would be deductible. If they work out of state, even if it is Alaska related, the deduction would not be allowed under this provision.

CHAIR FRENCH clarified his question using an example of a petroleum engineer located in Houston working on a lease for the North Slope. Those wages would not be deductible because that work does not take place in the state. Whereas a petroleum engineer working in Anchorage on a North Slope expenditure would be eligible for deduction.

MR. BULLOCK agreed with his characterization of the issue.

[6:36:23 PM](#)

SENATOR HUGGINS asked Commissioner Galvin if there are any activities that he is concerned about in this provision.

COMMISSIONER GALVIN replied his department does not have any particular concerns. This provision came from other interested parties.

CHAIR FRENCH addressed the question and said that in a net profit regime, deductions for labor costs should come from money being spent in the state.

SENATOR THERRIAULT asked if there is information about what percentage of deductions will not be allowed under this provision.

CHAIR FRENCH said he didn't know. Part of the reason for including this provision is to address to what extent board room discussions in Houston will be assigned as a lease expenditure against the state's gross revenue.

SENATOR THERRIAULT said that component is probably small in the whole scheme. Perhaps at the project design level this provision would have more of an impact.

CHAIR FRENCH said this is the area where he sees this provision benefiting the state. He can imagine engineering, geologic work, or financial analysis being outsourced. He sees this as a trade off for a net profit system that benefits industry by not collecting taxes until they show a profit. In exchange for that, money will be spent in Alaska on jobs.

[6:41:06 PM](#)

MR. BULLOCK commented that the PPT allows a one-dollar deduction for every dollar in allowable lease expenditure. That dollar reduces the taxable value for PPT purposes by a dollar thereby creating a 22.5 cent revenue deduction. This is a legitimate policy matter when looking at which expenditures to allow.

SENATOR THERRIAULT relayed that in production sharing contracts a local hire requirement is generally part of the agreement.

6:42:30 PM

CHAIR FRENCH asked for an explanation of publication of profits in Section 46.

MR. BULLOCK explained that the section has two parts. He referred to AS 43.55.040 on pages 23-24, which authorizes DOR to require a producer that has an average total production in the state of more than 100,000 barrels a day for a calendar year, to report the gross value at the point of production of the producer's taxable oil and gas and the total amount of the lease expenditures. Those are two elements that are used to determine petroleum production tax. Turning to Section 46 he said the first part requires an aggregation of three or more producers for certain types of information. Page 37, lines 6-7 refers to the information that the department would be authorized to request. It allows the department to publish the gross value at the point of production and the total amount of the lease expenditures that each producer that met the 100,000 barrel per day requirement was required to report.

SENATOR THERRIAULT asked if this is a blanket requirement, or if it would be implemented only if a company wished to take advantage of credits and deductions.

MR. BULLOCK answered there is no contingency, the department can simply ask for reporting.

CHAIR FRENCH noted that this is another trade-off provision in a net-profit system. If the State of Alaska allows credits and deductions against certain expenses, the public exchange of information is reasonable.

6:45:58 PM

CHAIR FRENCH asked about the penalties provision in Section 36.

MR. BULLOCK said Section 36 inserts a new penalty in AS 43.55.055 to address substantial and gross understatement of tax. Gross understatement brings a higher penalty than

substantial understatement. Definitions of "substantial understatement" and "gross understatement" are included in statute. He noted that an amendment will arrive shortly to correct an error. It will change 10 percent to 20 percent.

CHAIR FRENCH said the amendment, labeled 25-GS0014\K.8, reads as follows:

Page 25, line 22:
Delete "10"
Insert "20"

CHAIR FRENCH set the amendment aside temporarily. In response to a question from Senator Therriault he labeled it Amendment 1.

[6:48:06 PM](#)

CHAIR FRENCH turned to the section dealing with Qui Tam "whistle-blowers" and asked how it would work.

MR. BULLOCK said this amends AS 43.55.110, which is in Section 38. The provision is on page 27, line 11. This section of the bill offers an incentive for someone aware of a reporting problem, to inform the state and thereby set an audit in motion. If an adjustment to a tax results in more money to the state, DOR is allowed to pay a reward to the person who provides the tip based on the percentage that the state gained as a result of the tip.

CHAIR FRENCH asked for clarification that the provision does not give anyone the right to go to court to proceed against a company whose deduction may or may not be lawful.

MR. BULLOCK agreed; DOR would take the action in the form of an audit. The provision allows DOR an "informant" tool.

SENATOR WIELECHOWSKI said the committee should consider making the provision revenue neutral by assessing the reward amount in addition to the penalty.

MR. BULLOCK explained that the appropriation for the reward would come from the penalty assessment. The state would receive the tax that's due plus interest on that amount.

SENATOR WIELECHOWSKI asked for clarification of the provision as currently written.

MR. BULLOCK replied the legislature has the option of appropriating award money out of the penalties that are

received. The reward may not exceed 10 percent of the tax, penalty and interest that's collected.

CHAIR FRENCH understood Senator Wielechowski's point which is to avoid reducing the state's overall collection. The difficulty is that the legislature must appropriate the money, he added.

MR. BULLOCK acknowledged that and pointed out that part of the issue is that the state might not have acquired the information otherwise.

CHAIR FRENCH said the state has to give something up for the receipt of new tax revenue.

[6:54:08 PM](#)

SENATOR WIELECHOWSKI asked if the company could be penalized and also be required to pay the cost of the informant's reward.

MR. BULLOCK said he was not aware of any such precedence.

SENATOR THERRIAULT asked why language addressing the appropriation for the "purpose from penalties collected" is included. Aren't the penalties general funds dollars?

MR. BULLOCK said the language is identifying a source that may be considered by the legislature if it chooses to appropriate reward money.

SENATOR THERRIAULT pointed out that someone might provide information where the state gets additional tax and interest but there might not be a penalty. The benefit that's paid is just general fund dollars.

MR. BULLOCK replied the reward would not be paid out of the actual increase to the state. Money would be available at the discretion of the department to make an award based on what the state gained as a result of the tip. The provision only says that the award cannot be more than 10 percent of whatever the state recovered.

SENATOR THERRIAULT said if the reward is a percentage of the tax, interest, and penalty, the reward would clearly not be more than the worth of what the state gained; thus, why would the source of reward money need to be indicated?

[6:57:28 PM](#)

MR. BULLOCK responded the money has to be appropriated and identified. There is no link between the appropriation and the payment.

SENATOR THERRIAULT asked if the provision would be the same if on page 27, lines 11-12 the language said "subject to a legislative appropriation the department may compensate a person who provides information."

MR. BULLOCK replied yes.

CHAIR FRENCH said a possible Amendment 2 has been identified.

SENATOR MCGUIRE asked about the rationale for the ten percent cap.

CHAIR FRENCH replied he did not have a specific cap in mind, except to contain it so there would be a definite gain to the state.

[6:59:29 PM](#)

SENATOR MCGUIRE asked if a penalty section was set up when the legislature privatized attorney general and consumer liability, and if there was a uniform standard.

MR. BULLOCK said he didn't know. His approach to this particular reward is money is being spent to get information that results in more taxes to the state.

SENATOR WIELECHOWSKI asked if the provision exposes the state to liability if an award is not appropriated.

MR. BULLOCK replied it does not; any reward is subject to legislative appropriation.

[7:01:05 PM](#)

CHAIR FRENCH turned to provisions of the bill that deal with corrosion.

MR. BULLOCK explained that corrosion is a disallowed lease expenditure in AS 43.55.165(e). In this draft Section 44 contains those exclusions. The "corrosion issue" is on page 34.

CHAIR FRENCH asked what was changed in the provision.

MR. BULLOCK replied language has been added beginning on page 34, line 10, that's based on SB 80. It disallows costs incurred

for repair, replacement or deferred maintenance of a facility other than a well that was improperly maintained.

CHAIR FRENCH said the provision is meant to deal with unforeseen problems not addressed specifically in the bill.

SENATOR THERRIAULT asked if Mr. Bullock has any concerns about the interpretation and application of the provision.

MR. BULLOCK replied that the definition of "improperly maintained" could be a factual issue for which the DOR will develop standards over time.

[7:04:08 PM](#)

COMMISSIONER GALVIN said the difficulty of implementing this type of standard is trying to identify which definition fits any given situation. Auditors needed something to trigger a further review and that is why the department chose interruption of service as a guideline.

MR. BULLOCK agreed with Commissioner Galvin, and pointed out that the provision provides for a standard of care evaluation as to whether the costs are reasonable.

COMMISSIONER GALVIN explained that the reference to "could not have been prevented or avoided in the exercise of due care foresight" is a small exception to the provision.

SENATOR THERRIAULT asked if a previous situation would have been addressed under the current language of the bill.

[7:09:37 PM](#)

COMMISSIONER GALVIN said it would not reasonably be interpreted that way. Most likely, a company would admit to a more narrow violation.

SENATOR WIELECHOWSKI recalled that the administration supported SB 80 and wondered when the thinking changed.

COMMISSIONER GALVIN responded the administration feels strongly that this issue has to be addressed and recognizes that during the previous legislative process the SB 80 approach was identified as the appropriate direction. In developing the ACES plan the administration took a broader view of what it was trying to accomplish and walked through the process with auditors. After that the administration came up with what was thought to be a better approach.

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CHAIR FRENCH asked if the word "unscheduled" on page 34, line 6, modifies the word "reduction." Certainly it modifies "interruption."

COMMISSIONER GALVIN asked Robert Mintz to respond.

ROBERT MINTZ, Consulting Attorney for the Administration, Kirkpatrick & Lockhart Preston Gates Ellis LLP (K&L Gates), said "unscheduled" modifies both "reduction" and "interruption."

CHAIR FRENCH said that's why he wanted to include the catchall phrase from SB 80. He can imagine huge tax disputes revolving around whether a shutdown was scheduled or not.

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COMMISSIONER GALVIN said he recognizes the need for clarifying regulations to make this work in real world scenarios. One particular aspect is what it means to be "unscheduled." These standards would be developed through interaction with industry and the regulatory process.

CHAIR FRENCH said that the provision is meant for major cataclysmic events and maintenance issues.

COMMISSIONER GALVIN agreed. The purpose of this provision is to identify those major cost components that should not be subject to state credit.

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CHAIR FRENCH asked if there were any other changes that need to be addressed.

MR. BULLOCK highlighted that tanker transportation costs had not been fully discussed. There were three requirements for substitution of "actual" costs with "reasonable" costs and under PPT all three conditions had to be met. Now any one of the three conditions can be met.

SENATOR THERRIAULT said he understands that Sections 39 and 40 need to be the same, but he wants to make certain the language works as intended. He also suggested that on page 27, line 30, the word "conditions" should be singular.

MR. BULLOCK agreed. He then said two things happened. First the section is triggered by any one of the conditions in Section 39.

Once they're triggered the actual costs that were reported are replaced by reasonable costs. Then the latter part of subsection (b) in bill section 40 tells you to look at fair market value of like transportation and the other options. He doesn't know the policy behind putting in the Regulatory Commission of Alaska or other regulatory commission.

SENATOR THERRIAULT gave an example of an ongoing dispute about control between RCA and FERC. RCA controls intrastate transportation down the TAPS line and FERC controls transportation out of state under the TAPS settlement methodology. If he were a non-TAPS owner shipper he may pay the TAPS settlement rate. That'd be a true cost because nothing comes back through a subsidiary. This language seems to say that if a regulatory body has rendered a decision, it's prema facia that the department should use that to determine just and reasonable. That could bind the department.

COMMISSIONER GALVIN said he understands Senator Therriault's reasoning. The administration believes that the substitution of "or" for "and" in Section 39 is appropriate. Doing both undermines the purpose of the first change. The idea is to say that all three conditions must be met for the prima facia standard to be used.

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MR. BULLOCK said the section rejects prices that a person taking the deduction has control over, in favor of standards over which that person has less control.

SENATOR THERRIAULT observed that the shippers that own the pipeline are paying the tariff, but to themselves. He doesn't agree that placing the "or" in subsection (b) undermines the purpose because that would say conditions 1, 2, and 3 have to be triggered. There was testimony that condition 3 never gets triggered because a pipeline off the North Slope is the only reasonable transportation.

COMMISSIONER GALVIN suggested asking Mr. Mintz about this issue.

MR. MINTZ offered the view that it's consistent to change "and" to "or" in both places. Also he agrees the plural should be changed to the singular. Finally, if the committee is concerned about the last sentence in subsection (b) it could be deleted.

SENATOR THERRIAULT said he is unsure of the impact because sometimes the RCA has made a determination on what is just and reasonable.

MR. MINTZ said the purpose of the sentence might seem unclear, but the provision only comes into play when the department decides to substitute reasonable cost for actual cost. The first sentence lists several types of evidence that the department can use to determine what reasonable costs are. The second sentence says the tariff rates on file with the agencies mentioned is powerful evidence of what reasonable cost is. Generally speaking, the tariff paid by a shipper is considered the actual cost. It's only if one or more of the three criteria in (a) is triggered that the department would use something else based on reasonable costs. He also noted that on page 27, line 31, it would be preferable to change the word "shall" to "may."

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SENATOR WIELECHOWSKI wondered if the section addressing reasonable costs for transportation should be cut altogether.

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CHAIR FRENCH called a recess.

7:47:35 PM

CHAIR FRENCH called the meeting back to order, and mentioned that Nan Thompson with the Department of Natural Resources is available for questions.

COMMISSIONER GALVIN asked Ms. Thompson to explain how the language in Sections 39 and 40 works together to ensure DOR assesses the appropriate reasonable cost deductions for transportation.

NANETTE THOMPSON, Petroleum Manager, Division of Oil & Gas, Department of Natural Resources, said deleting the language on lines 3-5 on page 28 is a good idea because of the way tariff filings are done with the Regulatory Commission of Alaska and FERC. Tariff rates are sometimes filed and paid by the shippers. A process for protesting a tariff exists but sometimes the process of adjudicating those protests takes a number of years. If the standard is only "tariff rates properly on file" a situation could exist where a deduction that is much larger than is appropriate could go on for a number of years before the right amount is paid. Also, transportation rates properly on file are not always reviewed by a regulatory agency. More often in FERC practice than the Regulatory Commission of Alaska,

tariff rates are negotiated. As a practical matter those rates aren't reviewed unless there's a protest.

CHAIR FRENCH asked if negotiated rates go on file.

MS. THOMPSON replied they are put on file, but not all filed rates have been reviewed and determined to be just and reasonable. In fact a filed rate may be paid for a number of years before it's found not to be just and reasonable. The TAPS tariff is a good example. It was many years after the original filing that the RCA made a finding that the rate was not reasonable. Shippers paid the cost during that time and under this provision those costs would be deductible.

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SENATOR MCGUIRE expressed concerned with the exceptions in Section 39. The second "or" on line 25 gives me some consternation, she said.

MS. THOMPSON replied she too is concerned with the first "or" in the sentence. She wants to think about it but it may work to change the "or" to "and" so that the exception requires both conditions.

SENATOR THERRIAULT asked Ms. Thompson to also ponder changing "shall" to "may" on page 27, line 31.

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SENATOR THERRIAULT asked Commissioner Galvin if the administration supports the seismic data language that was in the original bill.

COMMISSIONER GALVIN said yes. The administration continues to support the entire proposed exploration incentive credit amendments. He understands this committee isn't going to deal with that issue, but they'd be happy to see any part get back in the bill. He asked if Mr. Mintz had anything to add.

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MR. MINTZ highlighted that the relationship between monthly and annual calculations in Sections 15 and 16 on pages 10 and 11 needs to be reconciled.

MR. BULLOCK, referring to Section 21 on page 13, said one of the changes from the governor's bill was to look at progressivity on a monthly basis rather than over a calendar year. The intention is to look each month to see if the progressivity tax applied

and if it did, calculate it and make the installment payment under AS 43.55.020(a). The administration's approach changed the installment payments so the progressivity tax would be paid when the final return was filed, or by April 1 of the following year.

CHAIR FRENCH said his intent is to change to monthly across the board.

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MR. MINTZ said in that case the calculation of the installment payment before credit would be the actual tax payment. There wouldn't be a difference between the estimated and actual payments. There's no problem, but it should be clarified in Section 15.

COMMISSIONER GALVIN noted that the monthly rate is based on an estimate of annual costs, and asked if there would be a reconciliation of those costs at the end of the year.

MR. MINTZ said that is still covered in the bill. Conceptually this can still be viewed as an annual tax composed of twelve monthly parts.

MR. BULLOCK added that the installment payments are like estimated tax payments. For example, the failure to pay a penalty wouldn't necessarily apply for underpayment of installment. In this case there would be interest penalty from the time of the underpayment until it's paid. When the final return is due, it is an annual true-up.

CHAIR FRENCH asked Mr. Mintz if he could conform the sections overnight.

MR. MINTZ replied he could try.

MR. BULLOCK commented the old tax is paid on a monthly basis, so each year there were twelve different starting dates for the statute of limitation period. With the annual tax it's just the one date so it's clearer.

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MR. MINTZ referred to page 24, paragraph 6 and said he assumed it meant the oil and gas produced during the year. He asked if that's correct.

CHAIR FRENCH replied it's meant to be what their gross tax value is.

MR. MINTZ questioned why that's required in the annual return.

MR. BULLOCK explained the difference is that this is a required report that will be made public under AS 43.55.890. It's added by bill section 46. Paragraph 2 says the department may publish the gross value at the point of production and the total amount of the lease expenditures for each producer required to report under AS 43.55.040.

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MR. MINTZ, referring to Section 36, page 25, suggested that if this penalty is meant to be in addition to or instead of other penalties provided under existing law, it would be beneficial to clarify that. It might be preferable to say that the penalty is in addition to other penalties that are provided by law.

MR. BULLOCK agreed that's been done elsewhere in tax laws.

CHAIR FRENCH said that'd be addressed in the amendment phase of the proceedings.

SENATOR WIELECHOWSKI referred to Qui Tam and suggested adding the cost of the informant reward to the penalty incurred by a company.

COMMISSIONER GALVIN pointed out that the administration hasn't taken a position on Qui Tam, but it makes sense to make it revenue neutral.

MR. BULLOCK warned against dedicated fund issues; the money would go into the general fund and then it'd be reappropriated.

COMMISSIONER GALVIN interpreted it as an additional 10 percent penalty; it doesn't necessarily designate that the penalty goes to the informant.

SENATOR THERRIAULT noted that the penalty is not to exceed ten percent of the money gained by the state and demonstrated that it could become mathematically complicated.

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MR. MINTZ said he concurs that the provision in Sections 42 and 43 on page 30 to limit lease expenditures to costs incurred within the state, does raise questions about the commerce clause and constitutionality.

CHAIR FRENCH agreed it's an issue, but he believes it's a challenge that's worth taking.

SENATOR WIELECHOWSKI added that the stipulation only kicks in if the company wants to take deductions. It's beyond rational basis to say as a state that we want to promote Alaska business and Alaska hire.

MR. MINTZ said he wonders whether Section 38 that provides incentives to whistle blowers is a substantial enough issue to be mentioned in the bill title. Also, on lines 6-7 where it refers to civil penalties related to oil and gas production tax payments, he suggests it would be more complete to also mention reports.

MR. BULLOCK explained that bill titles are a compromise. This generally relates to everything about oil and gas production taxes.

There being no further business to come before the committee, Chair French adjourned the meeting at [8:13:22 PM](#).