

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

April 20, 2007

3:36 p.m.

MEMBERS PRESENT

Senator Charlie Huggins, Chair
Senator Bert Stedman, Vice Chair
Senator Gary Stevens
Senator Lesil McGuire
Senator Thomas Wagoner

MEMBERS ABSENT

Senator Wielechowski
Senator Lyda Green

COMMITTEE CALENDAR

CS FOR HOUSE BILL NO. 186(FSH)

"An Act relating to sharing with certain federal agencies records required of sport fishing guides; and providing for an effective date."

HEARD AND HELD

SENATE BILL NO. 80

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

HEARD AND HELD

SENATE BILL NO. 111

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

HEARD AND HELD

SENATE JOINT RESOLUTION NO. 4

Urging the attorney general, the producers of natural gas in the Cook Inlet region, and the Regulatory Commission of Alaska to work to secure long-term and affordable supplies of natural gas for the people and businesses of the state.

SCHEDULED BUT NOT HEARD

PREVIOUS COMMITTEE ACTION

BILL: HB 186

SHORT TITLE: SPORT FISHING GUIDE RECORDS

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

03/12/07 (H) READ THE FIRST TIME - REFERRALS
03/12/07 (H) FSH, RES
03/19/07 (H) FSH AT 8:30 AM BARNES 124
03/19/07 (H) Heard & Held
03/19/07 (H) MINUTE(FSH)
03/21/07 (H) FSH AT 8:30 AM BARNES 124
03/21/07 (H) Moved CSHB 186(FSH) Out of Committee
03/21/07 (H) MINUTE(FSH)
03/22/07 (H) FSH RPT CS(FSH) NT 4DP 2NR
03/22/07 (H) DP: JOHNSON, LEDOUX, EDGMON, SEATON
03/22/07 (H) NR: JOHANSEN, HOLMES
03/26/07 (H) RES AT 1:00 PM BARNES 124
03/26/07 (H) -- MEETING CANCELED --
03/28/07 (H) RES AT 1:00 PM BARNES 124
03/28/07 (H) Moved CSHB 186(FSH) Out of Committee
03/28/07 (H) MINUTE(RES)
03/29/07 (H) RES RPT CS(FSH) NT 6DP 2NR
03/29/07 (H) DP: ROSES, WILSON, SEATON, EDGMON,
GATTO, JOHNSON
03/29/07 (H) NR: KAWASAKI, GUTTENBERG
03/30/07 (H) TRANSMITTED TO (S)
03/30/07 (H) VERSION: CSHB 186(FSH)
04/02/07 (S) READ THE FIRST TIME - REFERRALS
04/02/07 (S) RES
04/20/07 (S) RES AT 3:30 PM BUTROVICH 205

BILL: SB 80

SHORT TITLE: OIL & GAS PRODUCTION TAX: EXPENDITURES

SPONSOR(S): SENATOR(S) WAGONER

02/09/07 (S) READ THE FIRST TIME - REFERRALS
02/09/07 (S) RES, FIN
02/21/07 (S) RES AT 3:30 PM BUTROVICH 205
02/21/07 (S) Heard & Held
02/21/07 (S) MINUTE(RES)
02/28/07 (S) RES AT 3:30 PM BUTROVICH 205
02/28/07 (S) Heard & Held
02/28/07 (S) MINUTE(RES)
04/18/07 (S) RES AT 4:00 PM BUTROVICH 205
04/18/07 (S) Scheduled But Not Heard
04/20/07 (S) RES AT 3:30 PM BUTROVICH 205

BILL: SB 111

SHORT TITLE: KODIAK NARROW CAPE PUBLIC USE AREA
SPONSOR(s): SENATOR(s) STEVENS

03/12/07 (S) READ THE FIRST TIME - REFERRALS
03/12/07 (S) RES, FIN
04/20/07 (S) RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

TOM WRIGHT
Staff to Representative Harris
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Sponsor of HB 186.

DOUGLAS VINCENT-LANG
Special Projects
Alaska Department of Fish and Game (ADF&G),
Juneau AK
POSITION STATEMENT: Commented on HB 186.

STEVEN DAUGHERTY
Department of Law
Anchorage AK
POSITION STATEMENT: Answered questions on HB 186.

MICHAEL HURLEY, Director
State Government Relations
ConocoPhillips Alaska
Anchorage AK
POSITION STATEMENT: Opposed SB 80.

KEVIN BANKS, Director
Division of Oil and Gas
Department of Natural Resources (DNR)
Anchorage AK
POSITION STATEMENT: Commented on SB 80.

PAT GALVIN, Commissioner
Department of Revenue (DOR)
Juneau AK
POSITION STATEMENT: Commented on SB 80.

JOHN IVERSON, Director
Tax Division
Department of Revenue (DOR)

Anchorage AK

POSITION STATEMENT: Commented on SB 80.

DOUG LETCH

Staff to Senator Stevens

Alaska State Capitol

Juneau, AK 99801-1182

POSITION STATEMENT: Commented on SB 111 for the sponsor.

MAYOR JEROME SELBY

Kodiak Island Borough

POSITION STATEMENT: Supported CSSB 111(RES).

ACTION NARRATIVE

CHAIR CHARLIE HUGGINS called the Senate Resources Standing Committee meeting to order at [3:36:49 PM](#). Present at the call to order were Senators Wagoner, Stedman, McGuire, Stevens and Huggins.

CSHB 186(FSH)-SPORT FISHING GUIDE RECORDS

[3:37:54 PM](#)

CHAIR HUGGINS announced CSHB 186(FSH) to be up for consideration.

TOM WRIGHT, staff to Representative Harris, sponsor of HB 186, said that it makes minor amendments to AS 16.05.815 that allows the ADF&G to share information about sport fishing guides for law enforcement purposes with the National Oceanic and Atmospheric Administration (NOAA) and the National Marine Fishery Service (NMFS) and to the International Pacific Halibut Commission (IPHC).

CHAIR HUGGINS asked the ADF&G why this information needs to be shared.

DOUGLAS VINCENT-LANG, Special Projects, Alaska Department of Fish and Game (ADF&G), explained that the allocation of halibut has been before the North Pacific Fishery Management Council (NPFMC) recently and one of the preferred alternatives that was favored by charter boat operators is having an annual limit rather than a one-fish bag limit or instituting even more restrictive measures that would affect the daily opportunity of guided anglers to catch fish. However after an analysis, it was found that an annual limit could not be established without

having the ability to share log book information with NMFS enforcement. The only other way to track an annual limit would be for charter boat operators to have a state log book for state managed species as well as a duplicate federal log book for halibut. The Council and many charter boat operators view annual limits as an opportunity, but don't want to burden the charter boat operators by requiring a duplicate log book program. So, they are now asking to allow sharing of log book information for enforcement purposes only with the NMFS enforcement and with the IPHC. The shared information would remain confidential with one minor exception - if a violation actually went to court, that piece of information associated with the violation would become public. However this information would still remain confidential meaning that those confidential records could not be released.

[3:40:02 PM](#)

SENATOR STEVENS said he knows a lot of fishermen who are very concerned about giving out information and probably wouldn't tell their own mothers where they caught halibut. How can people be assured that this information that is shared with federal agencies is going to be protected as much as it was when it was in state hands.

MR. VINCENT-LANG replied under the statute the information remains confidential except for enforcement purposes. He reminded the committee that log book information is already shared for the purposes of fishery management plan development. The only reason you would be fearful is if you have a violation.

[3:41:29 PM](#)

SENATOR WAGONER asked what the penalty would be if information gets out accidentally. Charter boat operators are concerned that this information is their client list which is how they make their living. Competitors will do bulk mailing to their client base and offer them a trip at a reduced rate if they have access to that information.

[3:43:44 PM](#)

MR. VINCENT-LANG replied that he didn't know the exact penalty, but it wouldn't be any different than the penalties associated with the current sharing of commercial fish ticket information with NMFS enforcement. Commercial fishermen have that same worry.

SENATOR WAGONER said that commercial fishermen fish a much larger geographic area and guides have areas that are much more

specific, so this information would be much more damaging to them.

MR. VINCENT-LANG said he would get the penalty information for him.

STEVEN DAUGHERTY, Department of Law, said he was looking for an answer to that question.

CHAIR HUGGINS remarked that it is very easy to find information about anybody on the Internet and asked what makes him think this information won't be able to be found there, too.

MR. VINCENT-LANG replied that the department has an MOU with the federal government saying it won't release this information if it is not kept confidential.

CHAIR HUGGINS asked if another course of action could get the same results.

MR. VINCENT-LANG replied that the other course of action would be for charter boat operators to have a duplicate federal recording program.

[3:46:33 PM](#)

CHAIR HUGGINS asked why the client base is germane to where the fish are caught.

MR. VINCENT-LANG replied that the past log book program included summary harvest information by trip, but the Council needs good harvest records to develop quotas and allocation guidelines as well as individual fishery quota systems (IFQs). To assure accurate reporting, the Council started recording angler-by-angler harvest and are sub-sampling those entries for accuracy.

CHAIR HUGGINS asked him to explain the moratorium.

MR. VINCENT-LANG responded that some people are confused because the NPFMC recently adopted a halibut sport charter moratorium and entries in these log books will be used to establish a management plan. Operators might be confused about how this bill would affect their ability to enter into that moratorium. However, the department can already share information with the Council for developing that management plan. HB 186 will allow enforceability once the moratorium is in place. So, it doesn't necessarily translate into the eligibility for the moratorium.

SENATOR STEDMAN asked if there is any linkage to potential IFQs for the charter industry.

MR. VINCENT-LANG replied that the information could potentially be used by the Council in deciding on whether to go to an IFQ system or not, but this bill doesn't get it any closer to that decision. He said that the state has a vote on the Council.

[3:49:38 PM](#)

CHAIR HUGGINS asked if the commissioner of ADF&G supports this bill.

MR. VINCENT-LANG answered yes.

CHAIR HUGGINS asked what the boat operators have to say about this issue.

MR. VINCENT-LANG replied that he has talked to a lot of different boat owners who exhibited uniform support for an annual limit for charter anglers. However, everyone was quite shocked when they found out that state log book information could not be shared with the federal system and that a duplicate federal reporting program would have to be put in place. That's why the Halibut Commission adopted the one-fish bag limit, which is not the preferred alternative for the industry.

SENATOR STEDMAN said the City of Sitka has imposed a surcharge on export of fish boxes because of its concerns over the large amount of product being flown out of town and the amount of product being flow out of town with the same name on the 50-pound boxes. He asked if that community and possibly others could set up systems that track the export of fish to the ADF&G so the different reporting could be cross-referenced.

MR. VINCENT-LANG replied that wouldn't be part of this legislation. He elaborated that Sitka was worried about a couple of different issues when it adopted that export tax. Part of it was concern over local user conflicts, which the department is concerned about too and it is looking at a variety of different mechanisms to address - including the development of local area management plans. Sitka has one of those plans, but it needs to be updated - because since the original plan was developed, a subsistence long-line fishery has been instituted in the area which needs to become a part of it.

[3:53:28 PM](#)

SENATOR STEDMAN said Sitka is the first city to institute this kind of surcharge and has more concerns that a large amount of product goes unreported. He thought the more cross reporting the state has, the more accurate the information regulators will have.

MR. VINCENT-LANG replied that is what the Council liked about the annual limit which is based on how much fish an individual needs on an annual basis.

MR. DAUGHERTY found a partial answer to penalties for disclosure of confidential information in 18USC19.05. It said they "shall be fined under this title or imprisoned for not more than one year or both and shall be removed from office or employment." He hadn't been able to determine the fine, yet, but he thought the termination of employment and imprisonment for one year were fairly substantial penalties and should be sufficient to assure a pretty high degree of confidentiality.

SENATOR WAGONER said, "It sounds good to me."

[3:56:34 PM](#)

CHAIR HUGGINS asked how this information is transmitted.

MR. VINCENT-LANG replied electronically and only upon request to the requesting person.

CHAIRS HUGGINS said they would set HB 186 aside.

[3:58:11 PM](#) at ease [4:01:22 PM](#)

SB 80-OIL & GAS PRODUCTION TAX: EXPENDITURES

CHAIR HUGGINS announced SB 80 to be up for consideration.

[4:01:53 PM](#)

MICHAEL HURLEY, Director, State Government Relations, ConocoPhillips Alaska, said he opposed SB 80 for three reasons. First, he said it was important to put SB 80 in the context of the petroleum production tax (PPT) that doubled their taxes and ConocoPhillips remains concerned that the current level of tax in PPT will not lead to the kind of additional investment that is needed on the North Slope to keep the pipeline running.

He opposed SB 80 first, because it is premature. Even before the regulations are written, the legislature is beginning to whittle

away at what deductions there are. He referred to page 27, line 12, of the PPT handout that said:

In determining whether costs are lease expenditures, the department shall consider, among other factors, (1) the typical industry practices and standards in the state that determine the costs other than the costs listed in subsection(e) of the section. That an operator is allowed to bill a working interest owner that is not the operator under unit operating agreements....

MR. HURLEY said this language is relatively broad and the legislature gave the department a fair bit of flexibility as to how it is going to determine typical industry practices. The regulations for PPT have not been completed and they still may take into account the kinds of circumstances that SB 80 is trying to address.

[4:05:15 PM](#)

Second, he said they are concerned with the process that is put in place by this bill. It refers to improper maintenance, which in his view is a poor standard because, for one thing, it has no judicial history. It will be analyzed by Department of Revenue (DOR) auditors who have no real experience or expertise in evaluating the propriety of a maintenance program - especially if they only get to it during an audit cycle which can happen one to three years after the fact. It would also lead to a lot of disputes between the companies and the state. He said a better standard is needed.

Third, Mr. Hurley said he believed the existing statute already deals with the kinds of specific circumstances that are being brought out SB 80. First, the lease expenditures definition is there; it just doesn't have regulations written for it yet. Second, the existing exclusions that are already in subsection (e) of the PPT including subsection (6), which is where the definition specifically already excludes costs arising from fraud, wilful misconduct and gross negligence, and subsection (16) which already excludes costs associated with spill response and cleanup.

Finally, under subsection 18 (e), he said, the 30-cent-a-barrel disallowance of the deduction is already in the PPT explicitly to cover these particular circumstances.

[4:07:27 PM](#)

He referred the committee to the August 8, 2006 memo from Pedro van Meurs.

[4:08:19 PM](#) at ease [4:16:41 PM](#)

CHAIR HUGGINS announced that they had two memos from Dr. van Meurs, one dated August 5 and the other August 8, both from 2006. He said the August 8 memo, at one point, had a confidential classification.

PAT GALVIN, Commissioner, Department of Revenue (DOR), said the August 8 memo was an internal communication within the previous administration that at the end discussed strategy which suggests that it wouldn't have been public at the time, but from the fact that the bill already passed and it was released by a previous member of the administration, it is not confidential any more.

CHAIR HUGGINS said he called Dr. van Meurs who said he wrote both of the memos and he meant what he said in both of them. He invited anyone who had questions about them to give him a call. He asked Commissioner Galvin if he thought the information in the memos was pertinent to this discussion.

COMMISSIONER GALVIN replied that he thought it was pertinent to how the previous administration viewed this issue.

[4:20:11 PM](#)

MR. HURLEY went to the 3rd paragraph in the August 8 memo where the issue was raised about the question should companies receive a 40 percent tax credit for replacing a pipeline that was defective and not properly maintained. Further down at the end of the first page, Dr. van Meurs recommends the 30-cent-per-btu equivalent barrel disallowance of a deduction, which is what ended up being subsection (18) in the PPT bill. That 30 cents is removed every month currently.

In the final paragraph on the second page of the memo Dr. van Meurs concludes that he believed this provided a good answer to the public criticism that under the PPT companies would be paying 50 percent of the replacement costs of the pipeline as a result of the Prudhoe Bay shutdown and Mr. Hurley concluded, "This memo leads me to believe that 30 cents was meant to cover the very stuff we've been talking about that is at issue under SB 80."

MR. HURLEY said that deductibles can be looked at on a case-by-case basis or a disallowance can be set at a general level to

cover those kinds of things. "We believe that choice was made by the legislature in adopting the 30-cent disallowance, which is doing it on a proxy, if you will."

[4:23:38 PM](#)

SENATOR STEDMAN asked him if his firm was going to submit deductions for the repair and replacement of those pipes along with the oil spill cleanup costs and to comment on its current policy.

MR. HURLEY replied that the oil spill cleanup costs that have already been incurred have not been deducted because they aren't allowed as a deduction under subsection (16) under 165(e). With respect to the costs of tearing the lines out and replacing them - that is under discussion with the operator who hasn't actually pulled the lines out and replaced them yet. The unit, itself, has a process whereby if the operator wants to propose an investment of some kind - of a significant maintenance investment or investment in new property, plant and equipment - they come forward to the other working interest owners with an Authorization for Expenditure (AFE) to get approval to make that expenditure. The other working interest owners at Prudhoe Bay do not have an AFE to replace those lines - yet. His company would take a hard look at the proposed expenditures and have lots of spirited discussions and questions about them. But, so far, ConocoPhillips has not been asked to pay for them.

[4:27:07 PM](#)

SENATOR STEDMAN recalled discussions last year of replacement and maintenance issues on the Cook Inlet platforms - so the state doesn't get "gamed." The 30 cents per barrel was used, which worked out to \$1 billion for 10 years with an oil flow of 900,000 barrels a day. He asked if they should go back and look at that. "Is that too low or too high?"

MR. HURLEY replied that he didn't know. That number was based on Dr. van Meurs' analyses that he hadn't seen. The problem is in identifying what "improperly maintained" means and the 30 cents was supposed to deal with that. It's hard to put a range on what that number ought to be, he said. "This one just happened to be a number that represented Dr. van Meurs' professional judgment and I don't know how good it was."

[4:30:13 PM](#)

SENATOR WAGONER refreshed everyone's memory one more time on the 30 cent issue because he was the one who brought it about originally on the floor. He stated:

It had nothing to do with how much or how little maintenance was going to be done or anything else - other than the fact that I asked Mr. van Meurs to see how he could formulate getting the PPT bill that we had in front of us that was based on net profits closer to a gross bill. And he said one way to do it would be to calculate 30 cents a barrel and that would make about - well, at the time we're talking some \$80 million difference in the amount of maintenance that could be written off against the PPT on the net basis versus the gross basis - that's where the 30 cents came from. It's not rocket science; it's a formula that Pedro came up with. That's exactly why it's in there. It had nothing to do with capex or anything else.

[4:31:24 PM](#)

SENATOR STEDMAN said they need to pull the minutes of those meetings when the issue was discussed because there is clearly a difference of opinion. He said this discussion went on for quite some time.

[4:32:16 PM](#)

SENATOR WAGONER said the amendment for the 30 cents was drafted on 8/5, which was a Saturday. It was offered as Amendment 7 on 8/9, the day after the Pedro van Meurs' number 2 memo, which was not presented to the special committee because it was a confidential memo to the administration. There was about a 15-minute discussion on it on the floor before it passed. Then they went to Amendment 11, which was the gross floor amendment.

SENATOR WAGONER stated he was the maker of the amendment and "There wasn't a long-term discussion over this at all. Dr. van Meurs mentioned the fact that over a period of years for a large maintenance item, the 30 cents would make up that cost. He elaborated:

But my whole point in this thing is we're not talking about a large maintenance item. If that pipe is replaced, we're talking about a capital expenditure. Now if they decide to go in there and sleeve the pipe, like Mr. Hurley is saying, they may still decide to do, I don't know. And that is a possibility if they find through inspection that they've sleeved the pipe in certain areas that they can maintain the existing pipe.

But we're confusing ourselves in discussing a 30-cent amendment to a bill that was to take care of some maintenance costs which otherwise could be written off and which gave me more comfort getting closer to a gross bill than a net bill with a future potential capital expenditure. That's where the confusion is.

4:35:33 PM

MR. HURLEY went to the first memo that had the title of enhancement of the gross character, on page 5, that had a subheading called "Deemed Capital Maintenance Costs." He said that:

After discussing the gross floor stuff for the first four pages, Dr. van Meurs begins that fifth page with another concern that is regularly expressed - is that the state should not permit the deduction of costs related to replacing equipment. That is it's a different concern. That's another concern that was brought up. That is why I remain convinced that the 30 cents a barrel was designed to cover that - in Pedro's mind.

SENATOR WAGONER responded:

Whether it's maintenance on equipment, capital equipment or maintenance on other oil field services, it's still maintenance, Mr. Chairman, and I just don't want to get us off track and confused because it was meant for maintenance. That's what I asked Pedro to do and that's what he did.

I'll just say one thing more and Mr. Hurley was correct and he brought it up - I've got a note here - as far as the regulations - this bill was meant to give the state one more tool in the toolbox and I think we'd be much better off having this passed and amended to the PPT bill prior to them writing the regulations so it could be taken it into consideration at the time they write the regulations instead of having to come back later and rewrite regulations and readdress them again.

4:37:36 PM

CHAIR HUGGINS went to Mr. Hurley's item 2 on process and improper maintenance and asked for the source of the handouts he gave the committee.

MR. HURLEY replied that they came from the 27th page of the PPT bill which you can get off of BASIS.

[4:38:12 PM](#)

CHAIR HUGGINS asked if Mr. Hurley was concerned with the specificity of the term "improperly maintained."

MR. HURLEY replied yes. He said that the AOGCC and others have also testified as to their concerns about that particular standard. Some standards have more or less case law behind them and "improper maintenance" doesn't have a whole lot of history behind it. The "gross negligence standard" in subsection (6) is pretty well defined and does have a lot of case law behind it. There is case law behind the phrase "negligence". Also, in the oil and gas business there is case law behind what is called the "prudent operator standard" which is the standard that most of the companies hold each other to. But, he repeated, there isn't a whole lot of legal history behind the phrase "improper maintenance".

CHAIR HUGGINS asked Mr. Banks for his thoughts on maintenance procedures.

[4:39:49 PM](#)

KEVIN BANKS, Director, Division of Oil and Gas, Department of Natural Resources (DNR), indicated that as the Petroleum Systems Integrity Office (PSIO) goes forward it will have an oversight role on maintenance and care of the facilities upstream of the point of production as well as in the flow lines and so forth within each of the units on state lands. The PSIO will employ a couple of engineers and a quality assurance specialist who will work with the producers to develop quality assurance plans to examine the kinds of standards that they will propose and apply to maintenance programs and validate that as the companies implement those plans that they are following the guidelines that they've assumed.

The PSIO will develop a track record of proper maintenance in that case so should an event occur and the DNR is called upon to provide consultation to the DOR, it should have record of whether or not the firm has complied with its maintenance plan. "To me that would suggest we will have some evidence about whether or not proper maintenance has occurred."

CHAIR HUGGINS asked more directly: "Would it concern you if we had more specific terms that alluded to typical or proper or common industry practices and standards?"

MR. BANKS replied: "I don't want to get too far ahead of myself here and I'm not a lawyer, but I think the answer to that would be that looking to good oil field practices or standard practices is probably sufficient in my view."

CHAIR HUGGINS asked if he wanted to add other things in that respect.

MR. BANKS responded:

I see a process evolving over time that I don't think that this particular, you know, the issue of improper maintenance will arise very frequently. I think that auditors as they examine the records and the books of the taxpayer will be alerted to events - will be alerted to a question of improper maintenance if something goes awry - that under normal audit procedures I don't know that we would be hearing very often from the Department of Revenue with a question as to whether or not proper maintenance or improper maintenance had occurred.

[4:44:33 PM](#)

CHAIR HUGGINS said he was working on his truck and looking at the owner's manual that has a relatively comprehensive time schedule for maintenance. He asked if that sort of formatted process is what he envisioned for his organization.

MR. BANKS answered that is a reasonable analogy. Developing the standards will be half the battle. They would initially begin to see where there may be gaps in the operators own regulations and maintenance planning. He would also consult with the lessees look over gaps in industry standards and fill those in. So eventually they would have a kind of check list established - to make sure they are changing the oil as often as the book says they should.

[4:46:05 PM](#)

SENATOR STEDMAN asked how tight the standards will be when the regulations are finished.

MR. BANKS replied he is staffing the PSIO right now and their first job will be to see where in its own and other agency's regulations there may be gaps concerning the types of facilities that are covered. He thought they would rely largely on the third-party certifying-type agencies like those offered by the American Mechanical Engineers and other certifying organizations. Finally, the PSIO would look at the plans the companies themselves are using. Further, he said:

As to whether or not we will be developing comprehensive regulations to that effect, that may not be necessary. We want to fill in the gaps that we have and rely on the regulations and the authorities under our leasing unit agreements that are already in place.

SENATOR STEDMAN asked him to speak a little more directly to the issue at hand concerning deductibility.

[4:49:09 PM](#)

COMMISSIONER GALVIN responded the tax director could better respond to how the PPT regulations relate to deductible expenditures.

JOHN IVERSON, Director, Tax Division, Department of Revenue (DOR), explained that the second regulation package for the PPT would include honing in on what lease expenditures are as well as the roll that the joint venture audits are going to play in determining what lease expenditures are going to be allowable. They have just started ramping up on that; he anticipated the regs would come out in the late fall of 2007.

[4:50:46 PM](#)

COMMISSIONER GALVIN went back to the question of the purpose of the 30-cent deduction and he said he didn't have this position a year ago and he wasn't involved in the discussions. On the question of whether the 30-cent deduction was intended to cover possible negligence or improper standards used for maintaining the equipment, he had the two Pedro van Meurs memos and the committee minutes in which this amendment and another amendment were brought. He continued:

First off, when you look at the two documents from Pedro van Meurs, it's amazing actually to think about the timing of these things, because we had the - as Senator Wagoner discussed - the first document which was directed to Senator Wagoner on August 5 preceded by a day the beginning of the shutdown on Prudhoe and

brought this issue into focus for the discussion contained in the August 8 document. What I think is interesting to look at is how I believe they are consistent with each other in terms of their overall statement of the purpose of this deduction.

As Senator Wagoner stated, the intent of the August 5 discussion had to do with moving the net aspects of the PPT to reflect something similar to a gross type scenario. And he ran through a few different ways in which that can be affected and the four was one and Senator Wagoner brought that amendment and this 30 cents deduction was another aspect of that. Within the discussion of the purpose of the 30-cent deduction, there is a discussion of the fact that equipment eventually ages and needs to be replaced and under PPT, those replacement costs would be characterized as capital expenditures and would be subject to both the exemption 22.5-percent value, and the credit, whatever that at the time - it was still up for discussion. And the question became in those instances should those be allowable and in the nature of this discussion, the distinction between properly maintained equipment that needs to be replaced and improperly maintained equipment wasn't really made. It just didn't come up. The discussion was solely on the issue of properly maintained and how these things age and the fact that these are a regular expenditure and whether or not they should be deductible under one scenario or another. And so the 30-cent deduction was...

[4:54:43 PM](#)

CHAIR HUGGINS interrupted to say he thought there was a negligence factor.

COMMISSIONER GALVIN answered:

Not in the discussion from this period of time. There is not discussion of negligence in the nature of the 30-cent deduction.

CHAIR HUGGINS responded that it wasn't made in the context of the 30-cent deduction, but it was made somewhere else.

COMMISSIONER GALVIN continued:

So, the 30-cent was created clearly. Mr. van Meurs was the one who came up with the idea of coming up with 30 cents - he bases upon his experience. He comes up with this as a response to Senator Wagoner's desire for this more gross type of structure.

After the event at Prudhoe Bay, we get to the August 8 memo. And we have to put ourselves back to that particular point in time. It was a day after the announcement.

So continuing, so we turn to the August 8 memo, now we're a day after the big press announcement and the discussion of the need to replace the entire infrastructure. At that particular point in time, it was a matter of speculation as to whether or not this was due to just the aging of the infrastructure or due to some improper level of maintenance. And Mr. van Meurs addresses that right from the get-go - that the shutdown at Prudhoe has brought into sharp focus that some facilities on the North Slope may be in poor shape - not there characterizing it one way or the other.

In the third paragraph he talks about the issue of fairness. First, it's an issue of fairness whether companies should receive a tax deduction for replacing a pipeline that was defective and not properly maintained - and says that, you know, this is out there. However, at the same time it raises a broader issue. So, this is separate from the question of whether it has been properly maintained. It is likely that over time, more defective equipment will be identified that needs repair or replacement. It's just a factor of any field. And then he goes into the distinction between whether that should be an allowable capital expenditure when you replace these things or whether you should set this type of 30-cent catch-all.

And then closes out with, I believe, this will provide a good answer to the public criticism that under PPT we would provide 50 percent of the replacement costs for pipelines as a result of the Prudhoe Bay shutdown - again not attributing that to whether that was properly maintained or not properly maintained - the fact that we're going to have to make that kind of a

contribution to the replacement. And then makes that sort of political statement about how that would help gain support for the bill.

4:58:34 PM

Then when you turn to the following day, on August 9, the Special Committee on Natural Gas Development, the Senate Committee that Senator Wagoner offered these amendments in, I looked at those minutes and they provide a fairly detailed picture of how the discussion went. You first had what was Amendment 7, which was the 30-cent deduction and there was a great deal of discussion about how that would work and what the purpose of it was and in no place do they discuss negligence or properly maintained versus not properly maintained. It's just whether or not equipment that eventually runs out and needs to be replaced should be a capital expenditure or whether you should have a separate way of accounting for that so that we don't end up paying for that entire amount from the state's perspective.

And so we continue on and eventually some questions were raised about the nature of the language and that amendment was withdrawn for the purposes of adjusting the language. Then following that, you have Amendment 10, no Amendment 9, which was basically this bill. It's talking about lines being properly maintained and whether or not that should be properly deducted. And the discussion continues as for everything that we're talking about now whether that standard can actually be implemented, whether or not that something that should be considered or not. And at no point during that discussion is there a reference to oh that 30-cent thing that we just talked about is intended to address this situation. They are not intermixed and discussions are separate. And that discussion ends with, again, a recognition that there is some language that needs to be changed and so that amendment is set aside.

CHAIR HUGGINS asked if Amendment 7 passed.

COMMISSIONER GALVIN replied no, not yet:

So continuing through that day, that same day, Amendment 10 was forwarded and this was basically Amendment 7 with the new language...

CHAIR HUGGINS remarked: "Amendment 9 was withdrawn."

COMMISSIONER GALVIN continued:

Amendment 9 was withdrawn or tabled whatever it was, the reference is that ahhh Amendment 9 was 'set aside the amendment while Senator Therriault redrafts the language.'

SENATOR WAGONER inserted: "And that became Amendment 13 if you go on down."

COMMISSIONER GALVIN continued:

So, I continue through the record and you get to Amendment 10 which is the redraft of the 30-cent provision and that is adopted. And then a little while later, you get to Amendment 13, which is Senator Therriault's redraft of the negligence issue or the improperly maintained standard. So, 'costs or a portion of the costs determined in consultation with DEC and the AOGCC relying on standard practice of the industry relating to the repair and maintenance of improperly maintained property and equipment' which is basically the framework for SB 80.

Again they talked to it for a while and at no point do they reference back that this has already been dealt with in the amendment that they just passed - the 30-cent provision. It's considered to be a completely different issue. Basically, this is setting the standard where the previous one just had to do with any replacement of any equipment.

So, when I look at all of this together - and let me just add one last thing in terms of my own experience in trying to evaluate this question. When the bill was first introduced this session, I had discussions with folks within the department who participated in the PPT discussion and they felt fairly clearly that the 30-cent haircut, as it was called, was intended to deal with improperly maintained equipment. That was

the idea that was held, I believe, within the administration's team.

5:02:24 PM

Now, that said, that was never discussed during the hearing process and I'm not sure when it actually became the position of the administration, but that is the position of the previous administration with regard to the purpose and intent of that 30-cent provision - that it was meant to be all-inclusive of both properly maintained and improperly maintained replacement provisions.

But as far as the both - when you look at the van Meurs documents, there's a distinction made in those documents between the question of whether improperly maintained equipment should get a deduction and the 30-cent provision which is in the context of just standard replacement of equipment and how that should be treated or how that can be basically addressed through this vehicle so that we're not covering all those costs.

And then you get to the next day when they're discussed in committee and there's no connection between the two issues. And so, just my own reflection on the record would indicate to me that from the legislative perspective the two were not considered to be the same issue and the 30 cents was not intended to cover improperly maintained equipment. And I think that that is a logical connection. I think it is an issue that is ripe for our discussion in terms of the nature of SB 80 and whether or not when we talk about what types of costs should be deductible whether there is - we've got a standard of gross negligence that's explicit in the current statute. And the question becomes based upon what we have subsequently learned, and what we can project out given the need for the PSIO, given why we're putting all that into place, it's strictly a policy question from the state's perspective as to whether or not we're going to bear those costs associated with a particular standard of care. And I think that the question of what that standard of care should be is one that this committee should pay close attention to and I think the previous discussion was right on point in terms of that particular language and I know that John Iverson and

Kevin Banks have participated in the discussions within the administration on that standard and I think they're kind of moving towards some language that maybe is part of an amendment that is being - that is going to be presented here, but in terms of the 30-cent question, I come away from the record, at least, with an understanding that it was not designed or intended to be something that covered improperly maintained equipment.

[5:06:00 PM](#)

CHAIR HUGGINS asked him to explain what the value of the 30 cents is to the state.

COMMISSIONER GALVIN explained:

When you look at the level of production for FY07 - and this is a projection for the remainder of the year - and this would include the April and May of '06 that was from the effective date of the bill - the amount that the 30 cents would amount to is approximately \$83 million. So, that would basically be excluded from being deductible as a capital expenditure, which would mean that the actual taxable, the change in the tax that would be paid would be roughly \$44 million - it's 52 percent of that figure - for FY 07. For FY 08, based upon our current production estimates, the amount of the exemption is \$73 million, which would change the tax paid. It would increase the amount of tax that we receive by \$38.6 million.

CHAIR HUGGINS asked him what the value to the state is.

COMMISSIONER GALVIN replied, "The \$38.6 million and the \$44 million for FY07." He added that that number would decline with the decline in production.

[5:07:46 PM](#)

CHAIR HUGGINS asked how the DOR operates since the regulations are not drafted yet.

COMMISSIONER GALVIN replied that was a very good question and that the department had received the first set of returns that were based on the taxpayers' interpretation of what the law means based upon the statute and the regulations that are in place now. As those regulations are further defined, they will

have the opportunity to adjust their returns and their payments based upon that information.

[5:09:10 PM](#)

SENATOR MCGUIRE asked if Senator Wagoner envisioned a process by which the taxpayers would be able to appeal a decision. She asked if the regulations would define what improperly maintained property or equipment means.

COMMISSIONER GALVIN answered yes if this bill passes. The way it would work is the department would get a tax return with a certain payment. As they audit the tax return they would identify expenditures that should not have been deducted and make a claim for an additional payment based upon that audit. That claim would go through the regular tax appeal process.

SENATOR MCGUIRE asked if his intent would be to sort of survey the world of production and equipment to define what "improper maintenance" means.

COMMISSIONER GALVIN replied he didn't think that could be done in a regulation given the complexity of the types of systems they may be dealing with. He expanded:

There is a question as to the amount of clarifying regulations we could reasonably expect.... To a certain extent what the bill is structured to do is to rely upon the standards Kevin Banks was referring to that are going to be generated through the PSIO office. And that is not going to be embedded in our regulations. That will be something that we developed through that channel in terms of identifying what the appropriate level is. And in the end it really comes down to whether we feel comfortable collectively that the standard of improperly maintained or whatever it ends up being is one that reasonable people can decide what it means.

[5:12:23 PM](#)

SENATOR MCGUIRE said she would like to see certainty and predictability no matter what industry it is. She directed:

If you want to do business in Alaska, you shouldn't have to go to 25 different books. You shouldn't have to wade through mountains of paperwork. You should be able to figure out very clearly this is the law of the land and these are your rights and responsibilities

and these are the consequences and if you violate or if you fail, here is the process by which you go through. And it should be very clear.

5:14:49 PM

COMMISSIONER GALVIN said there is a high level of complexity in deciding what an allowable deduction is for those who have to implement the PPT. He stated:

The question becomes to what extent would adding this type of a standard to that evaluation affect the expectation of predictability and reasonable assurance of what should be and what should not. I think it is possible to come up with a standard that basically stays within the same level of complexity that we currently have in PPT in trying to draw that line. With the state establishing a policy decision that there is a difference between properly maintained equipment that results in replacement and improperly maintained equipment that results in replacement and that we've taken responsibility for the step that's properly maintained through that 30-cent issue and those that are not, we're not going to take responsibility for paying for. And the question becomes once the state decides that's a proper policy decision to make, can we come up with the language that's going to draw that line. And I think my recommendation would be that the committee first decide whether or not that's a proper policy decision to make and then from that, can we draw the line in a way that provides a level of assurance that is commensurate with the rest of PPT as opposed to a level of assurance that goes even beyond what PPT can provide in itself.

5:17:47 PM

SENATOR MCGUIRE said the concept in law is mens rea, which means what you were thinking or your intent. When you are talking about maintenance and improper maintenance, you're talking about lots of people and their mens rea. She elaborated:

What did they intend? What was their corporate philosophy, what was the individual intent, of a whole lot of people in terms of equipment and their maintenance?.... Wagoner, I agree with the policy. I'm just saying it is lot more complex than I think people really - I mean people probably do realize. But the

fact is especially based on what moment in time where those thoughts formed. So, if I started out, for example the predicted life of Prudhoe Bay, of TAPS, was 30 years at one point. So, here we are 30 years later. So, if I made a decision at year 10 or year 15 believing I had 15 years left or 10 years left, maybe it's a different decision than I would have made if I would have thought it was going to go - you know the lifespan would have been longer. So, it's going to be very complex and like I say I just really, really, felt strongly at the time and I still do that a gross tax just straight across and then decide where you want to give incentives. Those are easy to decide - viscous oil, whatever, whatever, but here we are with the morass that I thought we'd be in. So, more government jobs.

CHAIR HUGGINS commented, "The good news is we've made the most money ever off - revenue wise. So, their numbers are based on it. A lot of money."

[5:19:27 PM](#)

SENATOR WAGONER said he wanted to respond to her question about what the intent was. He produced an interoffice memo from BP that he received anonymously dated June 4, 1999, 11:42 am. He stated:

The first sentence says, 'Due to budgetary constraints, the decision has been made to discontinue the PW inhibitor currently being injected at GC2 and GC3.'

The last line says, 'The current plan is to inject the remaining inventory of EC1081A into the high risk S69 line that runs from M to S pads. At a 40 parts per minute rate (PPM), we will have enough product to treat this 40,000 wd for about 250 days.'

There's the intent. They shut down the maintenance for budgetary constraints as far as the injection of corrosive inhibitors.

[5:21:21 PM](#)

SENATOR STEDMAN said he saw a paradox:

We've got the legislative record, which I think is good that you brought that forward and went through

that and then if I understood your testimony correctly, that you had conversations with the staff that were around at the time and they recollect this being the 30-cents being put in there to deal with a maintenance issue, which appears to be a disconnect from the legislative minutes that you reviewed. Did anybody try to connect that dot and why they would draw that conclusion?

COMMISSIONER GALVIN responded:

I guess the question comes from the fact that it originated from Pedro van Meurs to Senator Wagoner for a particular purpose. Events unfolded right during that same period of time with regards to Prudhoe. And when it came up the next day, the discussion at the time did not reflect mirroring of these two things being for a particular purpose. Now as the bill continued and as the Prudhoe event continued to unfold and the nature of whether it was properly or improperly maintained began to evolve, I think folks within the previous administration continued to evolve their interpretation of what it was intended to do. That, as we all experience, that was probably separate from the understanding within the legislature. So, all we can do is go by what was in the discussion at the time. I can't put myself in the minds of individual legislators whether or not they were having conversations with the administration aside in terms of what the purpose of this was. I don't know if we'll ever get to that point. I think it just comes down to - in the end what I conclude is that it ultimately doesn't have to be relevant to this decision. Because it's unclear, the question becomes whether this legislature today considers maintenance to be something that should be deductible or not.

[5:23:44 PM](#)

CHAIR HUGGINS commented that looking at the budgetary constraints memo and the bill, and its co-sponsors, he agreed with the essence of the bill, however he cautioned:

But we are making policy that goes forward. As the chairman of this committee, I want to make sure that what we do is fair to all. Remember this also has a retroactive component - back to 1 April, as I recall. So, most of us do not like to have people do to us

retroactively, if you will. I'm not here and I feel very uncomfortable with the fact that we have a letter here from BP saying they're going to charge us, I recall, \$11 million for write-offs. I don't support that, but in the same token, the bill we got here - we're talking about public policy. You're behind on your regulations. I think we're going to change, as was adequately pointed out in the case by Mr. Hurley, that we're introducing something before we ever got the dust settled on the other. That may be okay, but whatever comes out of this committee I want to make sure is functional.

It may get changed later on, if you will, but it needs to be a good product that is not just a knee-jerk based on we don't like a producer or that we're carry over of an emotional pact piece from last year or the year prior that didn't pass and that we do it objectively and it rests on its own merit and that it's well-staffed within the state and if it has a retroactive component, it has one. My assumption is that it will have one, though I felt very uncomfortable in PPT doing retroactivity. I would hate for Uncle Sam to send me IRS notices retroactively about things that I had to do and I think that we have to be aware of that state-wise.

[5:25:32 PM](#)

SENATOR WAGONER responded that the retroactivity in the PPT wasn't an arbitrary date. It coincided with the ability of the companies to write off capital expenditures they had previously. "There was pretty sound reasoning behind that and the reason I put the retroactive date on this was just to make it coincide as part of that bill - so it was a more cohesive package."

CHAIR HUGGINS said he didn't want the bill to be event-driven and he set it aside.

SB 111-KODIAK NARROW CAPE PUBLIC USE AREA

[5:26:53 PM](#)

CHAIR HUGGINS announced SB 111 to be up for consideration.

SENATOR STEVENS, sponsor of SB 111, said this establishes a new 46,000-acre public use area on Narrow Cape. It is used for a wide range of activities and is one of the few surfing areas in Alaska. It is subject to grazing leases as well as use by the Kodiak Launch Complex. It recognizes the special and multiple

use activities within this area and increases the protection to insure that the public can continue to use this area and acknowledges the very valid rights for the rocket launch and the grazing.

DOUG LETCH, staff to Senator Stevens, said there are currently five public use areas recognized in the state. Narrow Cape is the only place in Kodiak that you can drive to for all these different activities and it's a very popular recreation spot. SB 111 allows the department to have the management plan that they have already. Resolutions in support of SB 111 from Kodiak Island Borough and from the City of Kodiak are in their packets. He noted a proposed CS that comports with the House version.

[5:31:29 PM](#)

SENATOR MCGUIRE moved to adopt CSSB 111(RES), version K. There were no objections and it was so ordered.

MR. LETCH said the CS adds grazing to the top uses listed on page 1, line 12, at the request of the buffalo ranchers in the Narrow Cape area. On page 2, line 3, "shall" is deleted and "may" is inserted. This eliminates any need for a fiscal plan since the management plan has already been accomplished. The legal description was changed on page 3, line 30, to delete a section of the ocean because they just wanted to focus on the land.

[5:33:58 PM](#)

CHAIR HUGGINS asked if the Knik Public Use area would be managed as a park is in this bill.

MR. LETCH replied that this bill has no reference to park language. SB 111 doesn't change anything that's in place; it just guarantees things will continue. Another provision says if the state decides to dispose of the land, that it would require legislative approval. On page 2, line 26, section (e) language says "The commissioner may not manage the Kodiak Narrow Cape Public Use Area as a unit of the state park system."

[5:35:21 PM](#)

MAYOR JEROME SELBY, Kodiak Island Borough, said there is no other public recreation area on the Kodiak road system that is available. Other land on the road system is privately owned. He emphasized they are not trying to lock the land up forever, but they want to raise the bar so that it can't be disposed or used in some other manner without the community knowing about it. The impetus for this bill came from the attempt to transfer this

land to the University of Alaska in a bill they had never heard of and no one said anything to them about a number of years ago. He said there is unanimous support for SB 111 from all the users including the rocket launch folks, the grazing folks, the public recreation folks, the hunters and the fishers. No one is being excluded.

CHAIR HUGGINS said CSSB 111(RES) would be held. There being no further business to come before the committee, he adjourned the meeting at [5:37:40 PM](#).