

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

October 19, 2007

9:02 a.m.

MEMBERS PRESENT

Senator Charlie Huggins, Chair
Senator Bert Stedman, Vice Chair
Senator Lyda Green
Senator Gary Stevens
Senator Bill Wielechowski
Senator Thomas Wagoner
Senator Lesil McGuire

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Senator Hollis French
Senator Kim Elton
Senator Lyman Hoffman
Senator Joe Thomas
Senator Bettye Davis
Senator Johnny Ellis
Representative Jay Ramras

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: SB 2001

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

WITNESS REGISTER

PATRICK GALVIN, Commissioner
Department of Revenue
PO Box 110400
Juneau, AK 99811-0400

POSITION STATEMENT: Gave presentation on SB 2001 and answered questions.

JONATHAN IVERSEN, Director
Tax Division
Department of Revenue
PO Box 110400
Juneau, AK 99811-0400

POSITION STATEMENT: Assisted with presentation on SB 2001 and answered questions.

BOB GEORGE
Gaffney, Cline & Associates Inc.

POSITION STATEMENT: Assisted with presentation on SB 2001 and answered questions.

RICH RUGGIERO
Gaffney, Cline & Associates Inc.

POSITION STATEMENT: Assisted with presentation on SB 2001 and answered questions.

KEVIN BANKS, Acting Director
Division of Oil & Gas
Department of Natural Resources
400 Willoughby Avenue
Juneau, AK 99801-1724

POSITION STATEMENT: Answered questions pertaining to SB 2001.

MARCIA DAVIS, Deputy Commissioner
Department of Revenue
PO Box 110400

Juneau, AK 99811-0400

POSITION STATEMENT: Assisted with presentation on SB 2001 and answered questions.

ACTION NARRATIVE

CHAIR CHARLIE HUGGINS called the Senate Resources Standing Committee meeting to order at [9:02:23 AM](#). Present at the call to order were Senators Bert Stedman, Lyda Green, Gary Stevens, Bill Wielechowski, and Chair Huggins. Senator Thomas Wagoner arrived shortly thereafter, and Senator Lesil McGuire arrived as the meeting was in progress. Also in attendance were Senators Hollis French, Kim Elton, Lyman Hoffman, Joe Thomas, Bettye Davis, and Johnny Ellis, and Representative Jay Ramras.

SB 2001-OIL & GAS TAX AMENDMENTS

[9:03:08 AM](#)

CHAIR HUGGINS announced consideration of SB 2001.

SENATOR WAGONER joined the committee.

CHAIR HUGGINS reminded members that the previous day Dr. Pedro van Meurs and Daniel Johnston had discussed PPT, known as both the petroleum production tax and the petroleum profits tax. Chair Huggins asked Commissioner Galvin how the position recommended on behalf of Governor Palin had evolved. In particular, he wanted to know what tipping points had convinced the governor to recommend the net tax concept for the current legislation, especially since she'd campaigned on the gross tax concept. He also asked the commissioner to reflect on the presentations by Dr. van Meurs and Mr. Johnston.

[9:07:32 AM](#)

PATRICK GALVIN, Commissioner, Department of Revenue (DOR), noted those topics would be covered at the joint meeting Sunday, October 21. Today he would give an overview that frames Alaska's Clear and Equitable Share (ACES) and the oil tax policy in general; the administration's slide presentation on ACES was provided in hardcopy form, dated 10/18/07. He also would describe sections of the bill. Noneconomic issues would be addressed, since the following two days were for fiscal issues.

COMMISSIONER GALVIN began the slide presentation. He emphasized that ACES is about investment, recognizing Alaska needs to invest in oil development to maximize the opportunity for companies to pursue new oil resources. In addition, ACES is

about investing today's opportunities for surpluses to cover tomorrow's needs. When the State of Alaska moved to PPT there was a fundamental shift in its oil tax policy, changing its relationship with the oil and gas industry. With the combination of deductions and credits, companies can reduce their tax burden or may receive a payment from the state of 42 to 52.5 percent of their capital investment costs in oil development. As a result, the state becomes the single largest investor in new development on the Alaska North Slope (ANS), which entails taking on the risks associated with whether such investment decisions pan out.

COMMISSIONER GALVIN showed a graph labeled "ANS Production Forecast (Spring 2007)" that depicts historical and forecasted ANS production scenarios for FY 2000-2020. Slated to be revised soon by DOR, it reflects the level of production expected with no additional investment in the next 15-20 years. The area on the graph labeled "under evaluation," where investment decisions haven't yet been made, is critical to sustaining current production levels. Thus the state is putting so much value in the tax system, incentivizing this development.

CHAIR HUGGINS welcomed Senators French, Elton, and Hoffman.

[9:11:57 AM](#)

COMMISSIONER GALVIN showed slide 5, "Investing Today's Surplus for Tomorrow." He said in addition to investing in oil development, ACES provides a fair share of oil revenues to meet today's fiscal needs; provides surpluses during times when oil sells at a premium so this can be saved and invested to protect the overall economy from the need for future sales or income tax; and provides stability in the fiscal system to shelter and foster economic diversification.

COMMISSIONER GALVIN turned to slide 6, "State Budget Forecast (Spring 2007)," which depicts an example of revenue shifting. He noted there currently are surplus revenues - more than the state expected - because of high oil prices. If saved for the future, these revenues can provide economic stability and foster that investment opportunity.

[9:13:31 AM](#)

CHAIR HUGGINS asked whether the idea is to tailor the operating budget and capital budget for a source of savings.

COMMISSIONER GALVIN replied yes. It is a combination of bringing in revenue and having the fiscal discipline to not

spend it all in a current year. That's an important message of the governor and this administration: recognizing this time of premium revenue because of current high oil prices. In further response, he affirmed that the administration is working on the upcoming budget, but he hadn't been involved in discussion of the target amount of reduction in the operating budget; rather, he'd focused on oil tax issues. He suggested Karen Rehfeld of the Office of Management & Budget (OMB) could answer.

SENATOR STEDMAN asked when they would get into the definition of "fair share."

9:14:50 AM

COMMISSIONER GALVIN answered that it is reflected in the slide being shown: striking the balance where the state gets the additional revenues it can under today's fiscal opportunities, while preserving investment opportunity for ANS developers in order to get the revenues the state can - not leaving any money on the table. He couldn't say what that number would be. Over the next few days the administration would provide compelling information not available to the legislature or the state previously; this would assist in evaluating investment decisions faced by companies today, along with the impact of moving that share out, getting more for future investment for state revenues while retaining the amount of investment expected otherwise.

SENATOR STEDMAN referenced the previous chart. He asked whether the administration agrees with the legislature about trying to move forward surplus moneys, as done last year to the tune of more than \$1 billion, to try to fill that gap. He suggested it is a continuation of what the legislature has been doing, not a new direction.

COMMISSIONER GALVIN concurred, emphasizing the importance of recognizing today's opportunity to capture that surplus and use it for the future.

9:17:20 AM

SENATOR WIELECHOWSKI highlighted figuring out the balance between investment and getting the maximum benefit. He referred to budget forecasts in the chart and to the \$3 billion deficit shown from 2014 or 2015 to 2020. He expressed concern that while this budget forecast is using the current PPT - which was supposed to encourage new investment and new revenue - it doesn't appear to be happening in the forecast.

COMMISSIONER GALVIN responded that the budget numbers primarily reflect two variables: production and price. Those large gaps are because within the price model it goes out seven years and then drops to an historical long-term expected price, a number half of today's price. That is only changed every other year. Although it's an anomaly with how price forecasts are modeled, it also reflects that declining production curve. He agreed a large part of the concern is from the expectation that ten years from now there'll be two important parts of that investment need: 1) there must be a lot of investment in order to just have the expected revenue, and 2) there must be ways to encourage it, if there is to be any chance of increasing that or flattening it out more.

COMMISSIONER GALVIN noted production estimates haven't been changed due to altered behavior because of the switch to PPT or ACES. There is no data yet to indicate whether the changed behavior is happening or will happen. However, they are hopeful and confident that with this large amount of investment, Alaska will be one of the most attractive places worldwide for new entrants to invest, given the economic benefits up front in these projects. But until that is seen and they actually find oil - and there are many variables - it cannot be built in to the production forecast. He expressed hope that through this shift taking place in investing Alaska's resource into new development, that change will begin to be seen. He agreed it's an important part of the discussion.

SENATOR WIELECHOWSKI noted if the state does nothing and the oil valuation is left as is, the state is looking at prolonged deficits according to DOR estimates. He asked whether Alaskans then could potentially be exposed to an income or sales tax or lose their permanent fund dividends (PFDs).

COMMISSIONER GALVIN replied he believes the change from doing nothing to going to ACES clearly increases that share and keeps production opportunities neutral; that will bring in more money. However, he doesn't think keeping things the same will inevitably lead to the scenario Senator Wielechowski described. There are unknowns. Prices might stay above \$100 for a long time, for example. Rather, the belief is that moving to ACES or something similar would better reflect the opportunity for bringing in more revenue to minimize that risk.

[9:22:22 AM](#)

CHAIR HUGGINS asked whether the number-one variable is production, and if that isn't addressed it will be hard to get at the challenge in the next ten years or so.

COMMISSIONER GALVIN clarified that production is probably the one variable which the state has some ability to affect. In further response, he agreed that the state wants to see investment, but it's also the issue of targeting that investment. Increasing production involves a number of factors, but it boils down to attracting needed investment and the factors that drive investment decisions. One part will be economic attractiveness. Also playing a role will be making the land available, having the permitting system work, and having facilities available at reasonable prices.

CHAIR HUGGINS asked what two things Commissioner Galvin would choose from SB 2001 if he had to make that choice, from his perspective as commissioner of revenue.

COMMISSIONER GALVIN replied he hoped he wouldn't have to choose only two. He then said ACES provides two primary advantages for the state: 1) the tools to protect the state's interests with a net tax and 2) what the administration considers a more fair share of the revenues in that balance. Out of the discussion in the next weeks, he'd like to have the necessary tools identified and to end with a fair share. He declined to identify a primary tool, saying they all work together; the absence of one would make the others meaningless.

[9:26:11 AM](#)

SENATOR MCGUIRE arrived.

COMMISSIONER GALVIN elaborated on the presentation schedule for the next three days. He concluded by saying Sunday's joint session would include the nuts and bolts of the tax-system analysis, and he indicated a sectional analysis of the bill itself would be the final item in the schedule. If questions arose today, he might ask members to wait until the experts on that subject were available over the next three days.

[9:33:16 AM](#)

SENATOR WAGONER remarked that he looks at PPT as a work in progress. As he hears from the consultants, he sees more things wrong. He suggested this is the one chance to avoid bungling it. He remarked that he'd read the "Our Fair Share" paper from the commission working in Alberta, Canada, on its new tax structure, which was guided by Dr. van Meurs in large part.

SENATOR WAGONER voiced concern about a lack of willingness to do different tax rates for various parts of Prudhoe Bay. Suggesting the need to look at legacy fields, regardless of whether it takes multiple pieces of legislation, he said he doesn't think there is anything magic about "one shoe size fits all" under this bill. He asked if there is anything wrong with having different tax rates in various parts of the state. For example, legacy fields could be at a higher price, marginal fields could be at "20/20," and for heavy oil there could be incentives when it's under a certain value such as \$40.

[9:35:53 AM](#)

COMMISSIONER GALVIN indicated those issues were looked at closely during the administration's analysis over the last several months. He recognized the need to explore opportunities that relate to segregating and identifying that one particular type of development is different economically from another type and therefore could withstand a different tax system. Thus there is a gross tax floor proposed to only apply to legacy fields. And the distinction is recognized in terms of what development is appropriate for what tax system.

COMMISSIONER GALVIN noted there are practical limitations in trying to segregate production coming up through the same pipes and facilities. This is particularly true for heavy oil or some new development being encouraged within existing legacy fields. Especially when costs are added into the mix, a question is this: At what point is one barrel taxed under one system, but another taxed under another system, with different deductions?

COMMISSIONER GALVIN highlighted the challenges for DNR to identify new participating areas within an existing unit, and to say one is a separate development - with separate geological and engineering components - in order to segregate it for a different tax system. He also proposed imagining the type of behavior and decisions by companies that would result. He opined such a system couldn't be administered in a way that preserves the intent. The many limitations would be discussed Sunday.

SENATOR WAGONER referred to talk of the legacy fields, 10 percent on the gross. He recalled he'd amended in the gross floor at \$25 a barrel, but now looks back and questions whether it will ever return to \$25 unless the bottom falls out of the world economy. He added he isn't prepared to say that gross on

the legacy fields at \$40 will ever kick in. It may be a stopgap measure, but may never do anything for the state.

COMMISSIONER GALVIN clarified that he wasn't saying the gross-tax floor is the only type of segregation possible. Rather, it is one way of recognizing there is a distinction.

[9:39:58 AM](#)

SENATOR WIELECHOWSKI recalled yesterday's remarks from Dr. van Meurs and Mr. Johnston that some countries' systems deal differently with various types of oil such as heavy oil, even within fields. Senator Wielechowski said that seems to make the most sense. If the goal is to maximize profit and investment, there could simply be one valuation rate for legacy fields that were designed to make a profit at \$10 to \$12 dollars a barrel, and then another system that encourages investment for heavy oil and exploration fields. He said intuitively it doesn't seem that complicated. He urged exploring that.

COMMISSIONER GALVIN noted it would be discussed Sunday.

CHAIR HUGGINS interpreted Dr. van Meurs' remarks to be that he'd done such a "mosaic" elsewhere, but recommended against it for Alaska. However, Chair Huggins recalled that Mr. Johnston had a contrasting view.

SENATOR WAGONER cautioned that it would be a bad mistake if the legislature didn't get advice from Dr. van Meurs, Mr. Johnston, or someone of that quality. He asked for a request from the Legislative Budget & Audit Committee chair that someone of that level, with worldwide recognition as an oil and gas economist, be placed on staff so the legislature can have access. He suggested this should have been done weeks ago.

CHAIR HUGGINS said he respected that. Regardless of whether someone likes them, they are experts with international expertise, and people should at least listen to them and assess their message, and then continue from there.

CHAIR HUGGINS welcomed Senator Davis.

[9:43:30 AM](#)

COMMISSIONER GALVIN turned to slides 11 and 12, "Tools to Protect the State."

JONATHAN IVERSEN, Director, Tax Division, Department of Revenue, highlighted four categories of administrative tools under ACES:

1) information, including data collection, usability of data, and public disclosure; 2) ensuring there are enough of the right sort of auditors to protect the state's interests; 3) lease expenditures, including refining some definitions and exclusions as well as adding some exclusions; and 4) credit adjustments.

MR. IVERSEN addressed slide 13, noting PPT provides for some minimal recording of information, primarily on an annual basis. There isn't express authority for monthly filings of information, and there isn't a monthly tax return for PPT.

CHAIR HUGGINS asked if anything precludes DOR from having more stringent requirements and reporting.

MR. IVERSEN acknowledged it is a good question. There is broad authority to request information under the general powers of the commissioner. What is requested here is specific clarity, to avoid disagreements about what DOR has the power to require.

COMMISSIONER GALVIN added although it can be argued the authority exists, it can lead to long, entangled discussions with taxpayers as to whether they view that authority as including a particular item. It makes for a highly inefficient exchange of information. In a number of areas the legislature needs to clarify that the authority specifically exists.

CHAIR HUGGINS asked if there'd been some industry foot dragging.

COMMISSIONER GALVIN replied yes. Aspects of the information described here have been requested, with responses less than enthusiastic. There is a sense that the taxpayers question whether the state is in a position to request such information. Statutory clarity is needed.

[9:47:54 AM](#)

SENATOR GREEN referred to slide 14, "PPT provides for minimal reporting of information, primarily on an annual basis." The first bullet read, "Reporting is not commensurate with other world-wide net-tax jurisdictions." She asked what the typical reporting would be.

COMMISSIONER GALVIN deferred to the Gaffney, Cline & Associates Inc. ("Gaffney Cline") experts who would testify shortly.

[9:48:23 AM](#)

SENATOR McGUIRE referred to the first bullet on slide 16, "DOR may require a producer, explorer or operator to file monthly

reports with information necessary to administer the tax." She asked why it says "may," since she would want it to be uniform and would be concerned that it would be administered arbitrarily.

MR. IVERSEN replied that PPT currently doesn't have a monthly reporting requirement. By regulation, DOR has implemented a reporting requirement by virtue of its interpretation of that for operators. Non-operators must submit identifying information with their monthly payments.

COMMISSIONER GALVIN emphasized that the statutory language generally reflects the legislature's granting of authority to a department or commissioner in this way: Rather than requiring the commissioner to require the taxpayer to make a monthly report, it authorizes the commissioner to act within his or her discretion. There may be questions of what type of reporting it is, such as whether it is a broad or narrow report. The typical drafting standard therefore is to say the commissioner may require it. That puts the authority in the commissioner's hands along with the discretion to decide how to implement it.

SENATOR WIELECHOWSKI asked how Alaska's current reporting requirements compare with those worldwide for net profit systems.

COMMISSIONER GALVIN deferred to the Gaffney Cline experts.

[9:50:26 AM](#)

MR. IVERSEN returned to slide 14, "PPT provides for minimal reporting of information, primarily on an annual basis." He noted this makes it difficult for the state to understand and respond to dynamic industry needs, and also hampers DOR's ability to make informed policy decisions and to administer and regulate the tax. Furthermore, not having these provisions clear in statute leads to delay and conflict with taxpayers.

MR. IVERSEN turned to slide 15, "ACES Requires Reporting." He said currently annual statements are required to be filed with the annual tax payment, but only for those paying the tax. By contrast, ACES says this also is required for producers and explorers, regardless of whether a tax payment is due. The annual reporting requirements expand the list of required information that will have to be delineated on returns. In addition, explorers and producers that have lease expenditures or credits but no production must still file with the department their relevant expenditures, adjustments, and credits.

9:51:30 AM

CHAIR HUGGINS asked whether industry members are objecting to providing more information.

MR. IVERSEN replied there are several sides to it. First, DOR has requested forecast information, which it hasn't received, and has requested information on a monthly basis, which it may receive, depending upon the taxpayer. Monthly reports may be a stack of papers a foot deep. While information may be there, it isn't in a usable format and cannot be accessed in a timely manner; it would have to be audited and dug into. Hence what is sought here is monthly information, with authority to get the needed information in a usable form so it can be input into the database and used to formulate decisions.

SENATOR WIELECHOWSKI asked what forecast information has been requested and why it is needed.

MR. IVERSEN answered it is budget documents reported between working-interest owners and operators as part of the unit, or similar documents if the operator is the same working-interest owner or for an explorer. These discuss costs, operating expenditures, and capital expenditures, but not a forecast of oil prices. The purpose is to help DOR hone its forecasting. As ACES is drafted for operators, DOR's forecasting information would be limited to those pieces and exchanges of correspondence and information currently being generated.

9:53:54 AM

SENATOR WIELECHOWSKI asked how the system works now. Do producers send DOR a list of deductions they're taking?

MR. IVERSEN replied it varies, depending on the taxpayer. There are described general categories of deductions, but not so DOR can immediately see whether a certain amount has been deducted specifically for something like a pipeline replacement. And while some taxpayers may provide backup for individual nuts and bolts, it isn't something DOR can just open up the return and see; he cited corrosion issues as an example. Rather, DOR would see a general summary. With some taxpayers, the most adequate reporting will be at a summary level of operating or capital expenditures by unit, and then talk about deductions and credits. Sometimes it isn't that clear, though. Thus the desire is to completely standardize this so the information can be input and used in the tax system.

SENATOR GREEN asked whether the requirement that an annual statement must be filed, regardless of whether a tax payment is due, extends to any other group of taxpayers in Alaska that DOR deals with.

MR. IVERSEN acknowledged it's a valid question, but said he didn't know because DOR administers so many different tax types. He surmised there may be some instance where annual statements are provided regardless of whether a tax payment is due; for instance, regular income taxes still have a filing requirement.

SENATOR GREEN asked if the extra reporting would seem intrusive.

MR. IVERSEN said that's a good point. Some annual filing is already done by explorers and companies that don't owe tax, because they want the credits. The beginning of the requirement for filing credits is March 31. A lot of the information is already being provided. He noted this is with an eye toward being able to get all the information, have it be usable, and do it the correct way right now.

[9:57:01 AM](#)

CHAIR HUGGINS asked why the state can't get a reporting system from a company that makes software such as TurboTax.

MR. IVERSEN replied that although DOR has a template which was drafted and put together, this has proven exceedingly complex for taxpayers to use. And it hasn't addressed the database issue. The department has done a scoping contract on the database; DOR wants to ensure that what it prescribes will interface and that there won't be battles to get the needed information. The template is on the Tax Division's web site; there are a number of interrelated Excel pages. It's not a simple operation.

[9:59:03 AM](#)

CHAIR HUGGINS again suggested perhaps a professional organization could do this for the state.

COMMISSIONER GALVIN clarified that DOR is in the midst of developing the information system to backstop this whole information requirement. It will be akin to TurboTax in that the information will be input and the tax will be calculated; it will be in a form that can be submitted to the Internal Revenue Service (IRS). The state will tell companies how to structure their information, organize it, and provide it to DOR so the department can quickly integrate it into its system and ensure

it understands what is being provided. The part of TurboTax where it gets into legal nuances of deductions, with a tutorial for the taxpayer, probably won't happen. The goal is to organize the information and get the companies to provide it in a useful manner.

10:00:46 AM

MR. IVERSEN noted slide 16 clarifies DOR's authority, showing points touched upon already. He said ACES also provides DOR explicit authority to require producers, explorers, and operators to file reports or records needed for forecasting. Those are the budget documents he'd referred to before.

CHAIR HUGGINS surmised there is some staffing in the proposal. He mentioned the producers who would be required to file and asked whether feedback had been received from them.

MR. IVERSEN said feedback has been mixed in terms of the actual information requirements. Looking at historical data, there has been a measure of compliance with what has been requested, but typically at a macro level; however, some have submitted the information DOR would need on a monthly or annual basis, and are continuing to do so. By contrast, the taxpayers have been very reluctant to provide forecasting information.

10:02:18 AM

SENATOR GREEN asked if Mr. Iversen would be reluctant to provide the information if he were in their shoes.

MR. IVERSEN answered that without express statutory authority, yes.

SENATOR GREEN asked how he'd feel even with express statutory authority.

MR. IVERSEN said he'd comply or else it would violate the law.

SENATOR GREEN clarified that she was asking whether there is a practical standard to ensure cooperation, or whether DOR is looking for information that companies might feel is their own business, not the state's.

MR. IVERSEN acknowledged that as a valid question. He said indeed, that has been some of the feedback. However, what DOR is requesting isn't atypical in other jurisdictions operating under a net tax worldwide. The Gaffney Cline testifiers would address this.

COMMISSIONER GALVIN pointed out that the issue is whether or not the state feels there is a legitimate state purpose in acquiring that information. Thus the effort has been to tailor the language of the request to focus on just what they think would have some state purpose, rather than using it as a fishing expedition for reasons not directly connected to something for which the state needs information.

SENATOR GREEN asked whether there'd likely be a variety of answers to that question if she asked a wider group of people.

COMMISSIONER GALVIN surmised industry folks would be skeptical about what would be in the state's interest, and may even downplay the importance of forecasting to the state. He indicated the administration would assess how important it is to have information about costs and to forecast future revenue, weighed against the perception of getting too involved with respect to individual taxpayers.

COMMISSIONER GALVIN noted the other factor is the perceived risk from providing that information. When a company says it sees the state would have some public interest but believes it is outweighed by the risk of providing it, it reflects on the security that the state will hold this information, as well as whether or not there is a state interest that may conflict with the company's and that may give the state some advantageous position if it acquires the information. That needs to be explored to ensure that if there is such a situation, the state would create a safeguard, or else the state would recognize that there really wasn't such a case. He indicated there would be further discussion of this.

[10:05:45 AM](#)

SENATOR WIELECHOWSKI said it sounds like the argument for having a gross system based on the wellhead price, with no deductions but incentives for different types of exploration and behavior.

COMMISSIONER GALVIN agreed it would be preferable to identify a gross-based system that provides the economic framework being sought, with the balance of getting the investment but also getting the revenue; it wouldn't entail deductions and auditing. However, Sunday's analysis will show that this balance cannot be found with a gross system. There are negative economic impacts. If there is a net tax, they must ensure that the state is covered in such a scenario.

COMMISSIONER GALVIN returned to forecasting. He reiterated that the move to PPT fundamentally changed the relationship between the state and the industry. Now the state is a tremendously active investor in actual expenditures that companies will make. Because the exposure is so significant, it is now almost imperative to receive this information. The state is 40 to 50 percent invested in these new expenditures that will be made, and needs to know how the companies plan to expend it. But while it is a fundamental shift in the relationship, the industry will react to it slowly.

10:09:03 AM

SENATOR WIELECHOWSKI highlighted talk about encouraging investment. He recalled that Spencer Hosie, an expert hired by the state, had said when companies take out a lease there is an expectation of producing when it is reasonably profitable. Noting Alaska has been an extremely profitable place to do business, Senator Wielechowski asked why companies have to be given more when they take out a lease and it is their legal obligation to develop the oil. He acknowledged perhaps this should be discussed in the Senate Judiciary Committee instead.

COMMISSIONER GALVIN responded that one factor driving investment decisions will be the legal requirements or risk of losing a lease if companies don't make that decision to go forward with the development. That alone may not get them to make the investment, though, because they may decide it won't make them enough money. If there isn't an expectation of somebody else waiting in the wings who would come in, grab that lease, and invest that money, then there won't be the investment.

SENATOR WIELECHOWSKI suggested if a company takes out the lease, holds it, and can make a reasonable profit, then it is legally obligated to develop that resource. A leaseholder doesn't allow someone else to develop that property.

COMMISSIONER GALVIN replied they are talking about two different things. If a company is allowed to hold the lease and exclude other companies from that opportunity, he agreed with the need to ensure the issue is forced as to whether it will be developed. That's a separate lease-related management issue. Whether they'll actually go forward with that decision is based upon more than whether they're legally obligated; it is also based upon whether they'll make any money. And they must be forced to make that choice. He agreed they need to look at the economic question and make a decision.

COMMISSIONER GALVIN noted the tax policy, however, involves not just the individual leaseholder and the need to have that decision made. There is also a need to ensure the underlying project is economic so somebody will invest. When DOR goes through that seven-field analysis, it doesn't distinguish whether it's one particular company or another and a lease obligation for that particular field. Instead, DOR looks at whether a prudent investor would make an investment of this nature, given the economic factors that can be identified. The role of the tax in this situation is to ensure that the tax system doesn't provide a barrier or disincentive to that opportunity. The state has other tools to try to force that issue, and to try to force that decision from an individual lessee's perspective.

COMMISSIONER GALVIN added that what's important when this is addressed Sunday is to think about it across the board: Is our tax system going to result in this project being one that anybody - any company that is looking at it reasonably - would go forward with? That's the question in this context.

CHAIR HUGGINS noted several committee members sit on the Senate Judiciary Committee as well. He recalled that the economic limit factor (ELF) system was a gross-based system. He remarked that he didn't believe there were any silver bullets.

[10:13:24 AM](#)

CHAIR HUGGINS welcomed Representative Ramras.

SENATOR McGUIRE referred to Senator Wielechowski's remarks. She suggested it would be helpful to legislators over the years to do an economic analysis of whether new companies are coming in, why, and whether or not the tax system is driving investment. It goes beyond whether it's a fair share. Senator McGuire said she doesn't feel legislators have ever gotten a clear answer as to whether the state's policies are attracting investment.

CHAIR HUGGINS noted the committee had requested that DOR take the elements of PPT being addressed in the proposed amendments and describe the relationships and desired results.

COMMISSIONER GALVIN indicated DOR was close to completing that side-by-side comparison.

SENATOR STEDMAN requested a brief overview of the normal life cycle of production in the oil basins over the years. He

observed that this likely would be seen by a lot of people around the state.

COMMISSIONER GALVIN responded that it would be included in Sunday's discussion of economic field modeling.

10:16:45 AM

SENATOR STEVENS recalled that for the year 2012 it was predicted that almost half the oil going through the pipeline is yet to be discovered. He surmised it gets even worse in the future.

COMMISSIONER GALVIN returned attention to the ANS production profile on slide 4, but surmised that what Senator Stevens was recalling was described in the revenue source book put out by DOR. Looking at 2012 on slide 4, Commissioner Galvin noted the line on the bottom that says "low" is the estimated production level if no other projects are brought online. For 2012, a significant amount - perhaps 100,000 barrels a day - is expected to come from projects not currently producing but moving towards development. Another 100,000 barrels comes from projects not currently being developed but waiting for that investment decision; given the timeframe, these likely are discoveries - the oil has been discovered but there hasn't been a decision on whether to invest the money to develop it. Although it isn't half the production in 2012, at least a quarter of the expected development that year that will come from these two categories.

10:19:04 AM

SENATOR WIELECHOWSKI kept the focus on slide 4. He asked whether the leases exist on the properties described as "under development" and "under evaluation."

COMMISSIONER GALVIN noted they're both state and federal.

SENATOR WIELECHOWSKI asked whether the cost to the companies to extract the oil is known for these properties.

COMMISSIONER GALVIN replied that this is part of the models which will be shown Sunday.

SENATOR WIELECHOWSKI remarked that if the oil can be pulled from these properties and a profit can be made at \$60 a barrel - much lower than today's \$90 a barrel - clearly these are profitable projects. He surmised the ones under evaluation aren't going to cost a huge amount of money.

COMMISSIONER GALVIN suggested that's overstating the point of the slide: The administration believes, given current expectations of what will be deemed profitable or not, that these projects should get the green light and go forward. The companies are the ones that must make the investment decisions.

SENATOR WIELECHOWSKI disagreed on that point, saying the oil belongs to Alaskans. If the companies take out a lease and don't develop it, the state needs to tell them to develop the property if it's profitable.

COMMISSIONER GALVIN added "or give up the lease."

SENATOR WIELECHOWSKI agreed.

COMMISSIONER GALVIN said the question for this chart isn't whether the state can mandate that companies invest and therefore risk the money. Rather, in the context of the leases, the state can say to invest the money or get off. The underlying question is whether the project is economic so that there'd be somebody to substitute and make that investment decision. If the result is that the company which has the lease - and therefore has the data and understands the geology and associated costs - decides it's not economic and gives up the lease, will anybody come in and develop it? For that, the leasing decision needs to be isolated. Hence the models to be discussed Sunday try to isolate that investment decision.

CHAIR HUGGINS cited Cook Inlet as an example where it's difficult to find someone who wants to develop it, because of economic issues. He acknowledged the comparison is apples and oranges.

[10:22:57 AM](#)

MR. IVERSEN turned to slide 18, "Information Management Database." Noting electronic reporting would feed directly into the database, he said this would accommodate the ELF-based data and would be integrated with the division's accounting systems. Data to be collected includes volumes; wells and production; and profit-based data, including tracking of credits under ACES.

MR. IVERSEN turned to slide 10, "DOR-DNR Information Sharing." He said there are current statutory limits, and this addresses the difficulties DOR and DNR face in their respective regulatory roles. There are some restrictions on what they can and cannot share. The proposal is to remove those while maintaining overall confidentiality of the information. What would pass

between the two departments would be taxpayer information from DOR and information related to oil and gas leasing from DNR that pertains to administration of the tax. This information would still be confidential with respect to the public.

CHAIR HUGGINS asked why there is a confidentiality requirement for departmental research and when it was put in place.

MR. IVERSEN replied it has been in place for a number of years. As for why, ACES amends AS 43.05.230, DOR's confidentiality requirements; part of it discusses what can and cannot be disclosed.

COMMISSIONER GALVIN elaborated. He related his impression that the rules on confidentiality were written primarily to separate the public from state information. When the question of sharing was eventually framed between the agencies, somebody from the Department of Law (DOL) was asked whether it was allowed under current statute; DOL said it is pretty broadly written confidentiality and doesn't expressly provide for sharing between the departments. The issue was dropped because of lack of interest in pursuing the change. He surmised it wasn't specifically put in place, but came about through the express desire to have fairly stringent confidentiality, with the subsequent interpretation being a limited ability to share between the two departments.

[10:26:41 AM](#)

CHAIR HUGGINS observed that the IRS system tries to be protective of taxpayer information. He mentioned safeguards and asked whether "need to know" still applies.

COMMISSIONER GALVIN replied yes. One expectation within the two departments is that it isn't a free current of flowing information. Rather, it will be based upon a request. There must be a particular need for it within the context of that agency's responsibilities. The security of confidential information is paramount to both departments. The one advantage to making the move at this time is that both agencies have incorporated the importance of confidentiality into their protocols and procedures - and this is inherently within the recognition of each employee.

COMMISSIONER GALVIN related his experience working at DNR's Division of Oil & Gas. He said he knows the ends to which confidentiality is protected with regard to geological and some commercial information that comes through that division.

Individual employees recognize the sensitivity, and he similarly sees vigilance at DOR with respect to keeping confidential the taxpayer information. Thus he's comfortable that the two departments will retain vigilance and respect for confidentiality. He noted the flow between the two agencies will need to be regulated as well, to ensure there isn't a change in that respect.

[10:29:00 AM](#)

MR. IVERSEN referred to the last bullet on slide 19. He indicated this information sharing allows each agency to be a better and more informed regulator.

COMMISSIONER GALVIN pointed out DNR also has a management role with respect to the state's ownership of the resource. It isn't simply as a regulator that it would use this sharing of information. It is a vital part of the state's ownership role.

[10:29:55 AM](#)

SENATOR GREEN recalled vigorous tension in the past between DOR and DNR with respect to their roles and responsibilities. She asked if this exchange of information would have been requested four to ten years ago.

COMMISSIONER GALVIN replied he couldn't speculate. Having watched the department's relationship over the past few years, he said part of the tension sprang from not knowing what the other had. There was a resistance to sharing information because of what they perceived as their responsibilities to ensure their own confidentiality. That breeds a certain amount of distrust. As to which caused what, it is difficult to identify. It isn't in the state's best interests to have two departments that don't trust each other and share information. He suggested the need to either remove the root of the problem, if it's the sharing of the information, or to assuage the potential conflict by allowing the information exchange.

[10:31:51 AM](#)

SENATOR GREEN asked if any shift in authority comes with the information sharing.

COMMISSIONER GALVIN said absolutely not.

[10:32:18 AM](#)

MR. IVERSEN read from slide 20, "Guideline Interpretation." He said another aspect of ACES is that DOR would like to be able to issue advisory bulletins for information and guidance to

producers, explorers, and other interested people concerning DOR's interpretation of production tax statutes and regulations. He noted that now there arguably is a problem with doing that because of the Administrative Procedure Act (APA). The department wouldn't want to be in the position of issuing a regulation without following the procedural course. This would be an informative, advisory, nonbinding type of opinion.

CHAIR HUGGINS, recalling that Deputy Commissioner Davis had mentioned this concept, remarked that it appears to be common sense. He said he'd have thought this was done all along.

COMMISSIONER GALVIN pointed out that although something might make sense, DOL might say there isn't authority to do it. If the department tries to expand the interpretation, DOL says it wouldn't advise it. It ends up in a situation where the agency cannot do what it believes is in the interest of the taxpayer and the state because the law doesn't provide that express authority. Although it is a commonsense answer, there was resistance when trying to pursuing it in the past.

[10:34:00 AM](#)

MR. IVERSEN addressed slide 21, "Statute of Limitations," which read: "Period within which tax must be assessed is extended from 3 to 6 years from date of filing tax return." He said before it does the audits, DOR wants the information on how the joint-interest billing audits between the part-working-interest owners and the operators have proceeded. Those audits take years to complete, and often issues remain. This would give additional time to obtain the information. Also, the state is dealing with upstream costs now. Being able to do this in three years poses a problem because both upstream and downstream costs must be dealt with. In order to be fully informed, DOR wants six years as the statute of limitations for these returns. This would only be for returns filed under AS 43.55, the oil and gas production tax.

[10:35:30 AM](#)

CHAIR HUGGINS asked what "assessed" means in this context.

MR. IVERSEN noted he'd hesitated to use that word. He explained that there would be an audit period, generally a year or more for any given year of tax information filed, and then DOR would do the assessment after that.

[10:36:22 AM](#)

CHAIR HUGGINS observed that this doubles the time. He asked how the industry views this.

MR. IVERSEN predicted the industry reaction, based on past experience, will depend on the individual taxpayer. Some taxpayers have no problem granting waivers of additional time. Many times it ends up being three to six years anyway because of amended filings. Already the first filing starts in March, and then joint partnership returns are filed with the federal government the following autumn, so the state receives an amended return already. Some taxpayers, when the state is in the audit process and needs additional time to complete the audit, have no problem waiving additional time. Some do.

SENATOR WIELECHOWSKI recalled Dr. van Meurs' testimony yesterday that the PPT law weakened the interest for late payments in AS 43.55.020(g); that ACES maintains it; and that it's an added incentive to overdeclare costs. Senator Wielechowski asked whether DOR agrees and would support increasing the penalties for overdeclaring costs.

COMMISSIONER GALVIN replied this is something they're interested in looking at. He indicated some language has increased penalties for noncompliance with respect to reporting and other things. But they'd be looking at ensuring that noncompliance is seen as something with unfavorable consequences.

[10:38:58 AM](#)

MR. IVERSEN turned to public disclosure, slide 22. He related that under general authority of the commissioner, DOR currently can disclose information at a high statistical level. With ACES, they seek to expressly allow publication of oil or gas production, production taxes, effective tax rates, gross value at the point of production, transportation costs for oil or gas, qualified capital expenditures, production tax values, lease expenditures and adjustments to them, and tax credits.

MR. IVERSEN explained that the proposal is to do this in a way that still maintains a level of taxpayer confidentiality. They would use an aggregate of three or more taxpayers. This clarifies that some of the procedures DOR currently employs in other tax areas are satisfactory to the legislature, and that DOR can go ahead and use those procedures for the oil and gas production taxes.

SENATOR GREEN asked whether the taxpayers are named in the aggregated information.

MR. IVERSEN replied no. He turned the presentation over to the Gaffney Cline experts.

10:40:21 AM

BOB GEORGE, Gaffney, Cline & Associates Inc., began by offering background, saying he has a degree in geology but has mostly been in the commercial and strategic arenas. Much of his 35 years of industry experience has been with Gaffney Cline, a 40-year-old international consultancy with about 150 people around the world. Gaffney Cline has major offices in Houston, the United Kingdom (UK), and Singapore, and offices in Buenos Aires, Sydney, and Moscow. Offering a broad range of technical strategic consultant services to most players in the industry, it does work for governments and national oil companies as well as international oil companies. Thus he feels there is a fairly balanced perspective on what the industry looks for, requires, does, says it likes to do, and so on.

MR. GEORGE noted that with respect to government and national oil company activity, his firm has done a lot of work on policy, licensing, and fiscal areas. It has advised governments in Brazil, Venezuela, Colombia, Mexico, Kuwait, Saudi Arabia, and Timor/Timor-Leste on a variety of issues, particularly resource promotion; structuring of contracts, which sometimes includes fiscal systems; and helping market those to the companies, hopefully ending up with successful licensing.

10:43:36 AM

RICH RUGGIERO, Gaffney, Cline & Associates Inc., told members he'd worked 20 years for "big oil" and thus could provide that perspective on how decisions were made and how activities took place. He'd been project general manager for Atlantic LNG, completing the commercial and financial aspects of some Trinidad projects, and could provide background. In 1990-96 he was a commercial manager in the North Sea and thus could provide perspective relating to the UK and Norway and how decisions were made, based on changes or no changes in the tax codes in those areas. In his six-plus years with Gaffney Cline he has worked predominantly on the side of governments in their dealings and commercial dealings with the international oil community.

10:45:23 AM

SENATOR WIELECHOWSKI asked what percentage of Gaffney Cline's work is for governments or for the petroleum industry.

MR. GEORGE estimated today it is 30-40 percent in the government/national oil company area, though some of that work may be on a commercial transaction if a national company is looking to move internationally and acquire properties. The remainder is for oil companies or expert testimony for law firms, service companies, or other players in the industry.

CHAIR HUGGINS asked if Gaffney Cline has conflict-of-interest concerns.

MR. GEORGE replied no. During the next few days there'd be a focus on issues of reporting by companies in selected countries around the world and how some of that information is used, as background to some issues discussed already by Commissioner Galvin and Mr. Iversen.

MR. GEORGE referred to information in a memo from Gaffney Cline dated October 19, 2007, and to a handout titled "Oil and Gas Reporting and Disclosure In Selected Countries" that accompanied the slide presentation. He pointed out that companies are very used to reporting to fiscal and regulatory bodies just about everywhere they operate around the world. This is nothing new or unusual. The degrees of disclosure are generally detailed, but vary among jurisdictions. They include historical information of what actually took place, prospective activity such as field-development plans, and ongoing activity including budgeting activity. This goes down to individual well data and production data information, which is common everywhere.

MR. GEORGE noted he hasn't focused on that type of technical data here, perhaps because it is common and seems less controversial. Rather, he has put more emphasis on the cost side of information that is disclosed, which seems to raise more questions about how prevalent it is worldwide.

MR. GEORGE explained that data is provided both to the resource managers such as DNR and the fiscal or taxation authorities such as DOR. Depending on the locale, different setups may or may not include a national oil company that may act in some or both of those realms. Generally, there is flow among the multiple organs of the state that may be involved in this. Where there is a fiscal authority, perhaps the flow on an individual taxpayer basis tends to be held reasonably confidential, with generally tighter limitations on disclosure. But a lot of field-level operating information, which may include cost information, is also disclosed to the resource manager.

MR. GEORGE noted Gaffney Cline would talk about what companies report as well as what companies disclose, but as two separate issues despite the obvious linkage, since the information must be received in order to report it. Public reporting for transparency issues, as well as marketing issues, is fairly prevalent in a lot of countries, and aggregation is fairly common where that's done. But in some places and situations, additional information is provided in greater detail. That is roughly what would be covered, with some illustrations.

[10:50:01 AM](#)

MR. RUGGIERO added that a general, overall principle is that other governments aren't asking the oil companies, in their generosity, to provide this information. Rather, generally states are saying these are their resources. The right to exploit a resource is leased to the company under terms of a contract or concession, but it is still the state's resource. It is quid pro quo, giving the right to develop and exploit those resources if the company continues to keep the state updated with all the relevant information. Rather than the company being asked by the state to do something, it is expected in these other countries that this type of data flow will occur.

SENATOR MCGUIRE pointed out that Alaska has only three main producers. Referring to the slide shown by DOR that discussed using an aggregate of three to maintain confidentiality or generality, she suggested it would be hard to disguise which company was being discussed in Alaska. She asked whether other countries have that situation.

[10:51:54 AM](#)

MR. RUGGIERO answered that one of the best examples, shown in a memo from his firm, talks about Timor-Leste, the world's newest country. Gaffney Cline was a primary author of its legislation on licensing and petroleum activity in proprietary areas. Its prime minister had encouraged Gaffney Cline to sign on to the World Bank's transparency initiative. In terms of Timor, the oil companies had characterized the degree of transparency there as providing a sunburn. The law there requires the publication of contracts and leases, as well as the total taxes paid by a company. Thus aggregation won't occur in Timor.

MR. RUGGIERO said although some companies might say that hasn't been tested yet, since it's still in its initial development, there is production in which it has 90 percent equity, in a joint treaty area between Timor-Leste and Australia; one of ConocoPhillips' crown jewels, it is the Bayu-Undan to Darwin LNG

development. The data from that, as it flows to the Timor government - which gets 90 percent of the government value there - is published under Timor law. He surmised there is a growing move to get as much information to the state and to make that as transparent as possible, to ensure everything is aboveboard.

[10:54:09 AM](#)

MR. GEORGE added that most countries probably have more than three players. He highlighted an example from Nova Scotia, where they have more players but there are far fewer players in the producing area. There is an illustration of required disclosure for the development plan and an update.

MR. RUGGIERO suggested this gets to a question asked by Senator McGuire about disclosure of data. If developing a field a couple of decades ago, he generally had only one market to sell into or one set of infrastructure to put his production down. If he publicly disclosed specifics about his capital expenditures (CAPEX) or operating expenditures (OPEX), then the other side he was dealing with, such as a state-run gas company, would offer him a price based on what they knew those to be, so he'd just make a profit above his threshold to invest. Today, however, with world markets and market pricing based on open competition, oil companies don't run into that and aren't as exposed to having their price pushed down, because there isn't just a single monopoly buyer or outlet for the product. Thus a lot of fears that a couple of decades ago were real commercial fears may exist to a much lesser extent today, if at all.

[10:56:41 AM](#)

MR. GEORGE addressed slide 3 of the Gaffney Cline presentation, "Why Does Alaska Need to Receive Data?" Saying this relates to data from the oil companies, Mr. George emphasized stewardship of the state's resources. He noted he'd modified a quotation from the Alberta Royalty Review Panel that says the energy resources of the state belong to the people of Alaska, and those organs of the state responsible for managing that resource have to have a certain amount of information in order to manage it properly. It's always a judgment call as to what amount is needed. Mr. George suggested looking at how other places do it and what a company routinely supplies, for instance. This is the sort of information being discussed now for field, cost, geological, and other information.

MR. GEORGE advised members that the state must have a full understanding of the technical and commercial issues surrounding the operation of the business. Thus it is looking for the

information. It needs the ability to plan and control the exploitation policy, and it has budget and financial issues in order to encourage the activity which goes along with that. He summarized by saying these are fairly universal principles in countries with petroleum around the world. It wouldn't be unique to Alaska in any way.

10:58:51 AM

CHAIR HUGGINS surmised that societal norms differ in various countries with respect to what is divulged. He cited examples, asking whether there are factors with respect to the norms in Alaska or the United States that may tailor this a bit or even make it simpler.

MR. GEORGE answered that he couldn't comment on what legal strictures may apply, but nothing proposed here is particularly outrageous, unusual, or groundbreaking. He'd accept that there are differences in the ways countries do things in all sorts of areas. Energy - petroleum in particular - has a lot of focus around the world, and the issues of disclosure around that are important.

MR. GEORGE referred to Mr. Ruggiero's mention of the World Bank initiative, saying it is aimed particularly at Third World countries where there is a lot of tax revenue going in and then sort of a black hole as to where it all goes. There generally is a trend, regardless of that, towards issues of transparency, proper responsibility, and stewardship, so people can see how things are taking place. From commercial and marketing standpoints there are some issues related to that as well.

11:01:22 AM

MR. RUGGIERO conveyed an anecdote revolving around an energy minister who decided to be the first to try something after research revealed it isn't done elsewhere. Mr. Ruggiero said although there are norms, changes continue to redefine the industry and how it works. While norms don't corral something, they become they basis upon which to build.

SENATOR WIELECHOWSKI asked if he thought Alaska was getting the data it needs to properly manage its resource.

MR. RUGGIERO related that in their first visit here and in their discussion with the group, in general he was surprised at the lack of data at the disposal of DNR or DOR to run their business and steward the asset.

SENATOR WIELECHOWSKI asked if they would make recommendations or whether such suggestions had been incorporated into ACES.

MR. GEORGE replied they hadn't written any clauses, but had talked broadly about the issues of data capture and what might be reasonable and rational in order to do that. He noted there was some discussion of how much is specified in statute versus what is left to the regulating agencies.

[11:03:49 AM](#)

SENATOR WIELECHOWSKI asked how Alaska fits with net-tax governments in terms of the information required or received.

MR. RUGGIERO suggested holding that question until they'd gone through some examples.

SENATOR STEDMAN indicated his own question about comparisons with other states also could wait.

COMMISSIONER GALVIN pointed out that the experts can discuss the range worldwide for transparency and information required. The state then has to decide how it wants to fit within that. The Gaffney Cline expertise is used to provide that sort of safe harbor, to decide where to comfortably place Alaska so the industry isn't being asked to do anything outside what it normally would be expected to do in other jurisdictions.

[11:05:38 AM](#)

MR. GEORGE turned to slide 4 of the Gaffney Cline presentation, "Forms Of Reporting and Sharing." He said production and well data are routine reporting everywhere. Typically it is monthly information. In many jurisdictions it can be pulled off the Internet, or it may be found in an annual publication. More germane to discussions here is the annual or semi-annual field-level reporting.

CHAIR HUGGINS asked what elements go into well data.

MR. GEORGE explained that most if not all countries have statutory requirements to submit information to the governmental regulatory body on drilling of the well, logs, perhaps drawings of the wells, and core data. Usually there are confidentiality provisions for two to five years, sometimes less. Better organized countries have organizations where that information is collected and collated; this becomes a resource for everyone once the confidentiality period has passed. Countries generally see this as an important aspect of how they get companies to

come in there, because there is information available and new ideas can be shared.

11:08:00 AM

COMMISSIONER GALVIN pointed out that some of this information is already collected by DNR and, to some extent, the Alaska Oil & Gas Conservation Commission (AOGCC). No changes are being suggested to the current well data and other requirements here, which appear to be operating fine.

SENATOR WAGONER asked: If the State of Alaska has the core data, would that become valuable when leases are reoffered after a company has decided not to proceed?

MR. GEORGE answered generally yes. Every regime he could think of would see it as good because it would help with the understanding. Usually when there is a relinquishment, even within the statutory period, that becomes available in the public domain. He noted slide 4 doesn't show seismic data, but this typically would go into the public domain after a period of time, depending on how it was acquired; this isn't universal, though, since there are places where it is held confidential.

11:09:59 AM

COMMISSIONER GALVIN emphasized that most of the authority the State of Alaska will use to get well data and core samples, for example, comes from its ownership of the resource. If a lease was on federal land, however, the state wouldn't have the same access to information, since the federal government keeps it private within its own system. The Gaffney Cline example looks at it as if it were a single government across the board.

SENATOR WIELECHOWSKI asked if it is fair to assume most governments that own the resource get the information and it isn't confidential. He also asked what the rationale would be for a government to keep such information confidential.

MR. RUGGIERO replied that most governments around the world collect extensive amounts of data. Each has slightly different but fairly similar rules with respect to the confidentiality. For example, many times seismic data, core data, and early well data on exploratory wells may be kept confidential for two to five to ten years, depending on what has been negotiated or is in the legislation. The confidentiality is to allow the company that has spent money acquiring that data the time to analyze it and attempt to create a commercial operation on the properties for which there is a lease. After the leases are returned and

relinquished, that data becomes valuable to the state for encouraging new players to try to develop that acreage.

MR. RUGGIERO, answering as to what time period he would recommend that the state set for confidentiality, explained that if land is currently under lease, generally the confidentiality time period corresponds to the period for the lease. A lot of the "two to five to ten" is in the production sharing agreements, and generally this coincides with the fact that they either have to develop it or must relinquish it within those time periods. But if there is a lease in perpetuity, for as long as there is production, then there is no benefit necessarily for the state to make the data public, because no one else can do anything with that data so long as the property is under a legal lease.

SENATOR WIELECHOWSKI asked if there is any disadvantage in making it public at that point. He noted the public could see that a development is economic, for example, and ask why it isn't being developed.

[11:13:52 AM](#)

MR. RUGGIERO cited his experience in the North Sea, where data was held confidential by the DNR equivalent there. If what he found on his section was very near the lease boundary, there may have been discussions and some release of that information to the adjoining lessee in order that there could be a combined development of that resource, since it was in the state's best interest that it be developed as a single entity or unit, rather than having different developments with various timeframes on each side of that lease line.

[11:14:34 AM](#)

SENATOR GREEN asked about an advantage gained by a competing bidder on an adjoining lease.

MR. GEORGE replied this goes to the question of how long the information is held confidential. It's a period of time to protect the reasonable commercial interest. He reminded members that the companies themselves engage in extensive scouting activities and may swap information, sometimes explicitly. There is a smorgasbord of things that result in the transfer of knowledge and so forth, including the movement of people among companies. In that case, the people don't take the information, but would have an understanding that cannot be erased.

[11:15:46 AM](#)

COMMISSIONER GALVIN clarified that these questions relate to well data and aren't relevant to the tax legislation. It hasn't gotten to that aspect. As for having information remain confidential from other lessees and so forth, there is a fairly complex statutory and regulatory framework related to keeping confidentiality and the ability of the DNR commissioner to decide whether to extend it, depending on whether there is unleased acreage in the area for which the data may provide some competitive advantage to the company which acquired it. The state wants that opportunity to be maintained so the company has an incentive to make the investment. When it gets to the tax returns, he anticipated focusing on what the proprietary value is that is being weighed against public disclosure.

11:17:01 AM

SENATOR McGUIRE highlighted the different philosophical system in the United States, with its emphasis on capitalism. She also asked what the federal government and the State of Texas require, for example.

MR. GEORGE replied that ownership and management can differ. The state can own it and yet it can be exploited entirely by commercial enterprises, which happens in many countries. As owner, the state has a responsibility to see that the resources are managed and exploited in a fashion that people judge to be optimum, given the social and political values. He cited the differences between the UK and Norway, which have generally similar resource bases. In the UK it isn't the dominating economic force, whereas Norway has far fewer people and the industry dominates the economy. They look at it very differently, in a manner deemed appropriate by the stewards and, ultimately, the people.

MR. GEORGE turned to whether Alaska and the U.S. are different. He agreed sometimes even the domestic divisions of oil companies seem to consider it un-American to ask for information or to provide it, even though they're happy to do so elsewhere in the world. He added that very few areas outside of the U.S. have private land holdings.

11:20:04 AM

SENATOR McGUIRE asked what the federal government requires, for example, in the National Petroleum Reserve-Alaska (NPR-A), as far as transparency and disclosure.

COMMISSIONER GALVIN replied there isn't an analogous production tax on the federal side, although there is an income tax.

SENATOR McGUIRE asked about well data.

COMMISSIONER GALVIN said he could find out. He added that for well data there is much more public release than for taxpayer information, which currently is kept confidential always. For well data, both on the state and federal sides, there is eventual release; it is a matter of what the timeframe is when it becomes public. He noted that seismic data, not under consideration here, has a different confidentiality restriction and generally could be held confidential by the state indefinitely; that is a policy call that may need revisited at some point in order to encourage investment. Rather, the focus is on the taxpayer and how to balance that interest with respect to public disclosure.

CHAIR HUGGINS relayed his understanding that the contract for a lease is many pages thick.

COMMISSIONER GALVIN clarified that the lease agreements are just six to eight pages.

CHAIR HUGGINS suggested this would add another half a page to require the data. He asked whether that is being done.

COMMISSIONER GALVIN said yes, it is part of it.

CHAIR HUGGINS surmised the new lease part is taken care of through the leasing process.

COMMISSIONER GALVIN explained that beyond the leases, the primary vehicle for public release of the data being discussed is AOGCC; DNR doesn't provide that service. Through statutory authority, AOGCC has the means to determine whether something has become eligible or ripe for being made available publicly; it then goes up on its web site.

COMMISSIONER GALVIN noted the only caveat is this: If someone requests extended confidentiality through AOGCC and DNR, the commissioner of DNR currently has authority to grant that in certain circumstances when there is a proprietary, commercial interest for the company to keep that confidential in order to exploit an opportunity, usually related to a future lease sale. That is an exception to the rule that it becomes public after a certain amount of time. It's already in place and is statutory, not part of the lease.

[11:24:22 AM](#)

CHAIR HUGGINS asked: If we didn't do anything being discussed here, for new leases can DNR take care of it, given its authority?

KEVIN BANKS, Acting Director, Division of Oil & Gas, Department of Natural Resources (DNR), answered that it only applies to state land. He said he thinks DNR has access under arrangements with AOGCC for onshore well data. Lauding Commissioner Galvin's earlier replies, with respect to state land Mr. Banks said AOGCC collects well data for any wells in the state's jurisdiction, and DNR has access - with some variation - to all that data for state land and some for private and federal land also. As for confidentiality and extended confidentiality that applies, generally wells are kept secret for two years plus 30 days' notice, or 25 months.

MR. BANKS said the DNR commissioner has the right under AS 31.05.035 to extend confidentiality where unleased acreage is nearby. Basically, a property right is afforded to the person drilling the well, who has the economic incentive then to drill, knowing there will be an opportunity to have some advantage in leasing the acreage around the exploration prospect, should that time come. Generally, he believes - at least for North Slope state land where much of the acreage has already churned through the process - that extended confidentiality will be granted under perhaps more limited conditions. He opined that it is good for more information to be in the public domain.

CHAIR HUGGINS suggested the question now isn't whether the state has the information. Rather, it is about confidentiality.

MR. BANKS agreed, noting seismic information is generally kept secret for ten years. There are two aspects to it. It is more of a commodity and is more easily traded among companies. And it requires more process to be very useful, and thus there is a cost after it is acquired.

[11:28:26 AM](#)

COMMISSIONER GALVIN added that AOGCC, the regulator of public disclosure of this information, has jurisdiction encompassing all land within the state. So the well data that will be acquired and provided includes federal, private, and state land. What DNR is managing is simply the state land portion of that. Through the leases, they have the right to acquire the data outside of the AOGCC portion as it relates to state land. But when it gets to the confidentiality portion of the picture, what

is being looked at is AOGCC's public disclosure rules, as opposed to DNR's acquisition rules.

CHAIR HUGGINS asked if offtake as it applies to gas will be public information.

MR. BANKS replied that the capacity of an oil field to produce gas sometime in the future involves AOGCC's management. For state lands, DNR's responsibilities as well to know what that tradeoff will be is generated from information acquired by the producers; this has a different order of confidentiality associated with it because of how the data and the kinds of reservoir characteristics and so forth are proprietary - not necessarily well data specifically or information specifically related to taxpayer information. Mr. Banks said AOGCC will govern its role in that and will model it independently of the companies or will review the models that the companies have; DNR will do the same. Although there is an opportunity to share, this is only to the extent there is cooperation from the producers collecting that kind of information.

CHAIR HUGGINS took that answer to be no, such offtake information wouldn't be public information.

[11:31:18 AM](#)

COMMISSIONER GALVIN responded that there are two different aspects. When AOGCC determines what it will allow the offtake to be in a particular field, that is part of a very public process. What Mr. Banks was referring to is that information which will be used by AOGCC to evaluate and make this determination may include some confidential information which it will keep out of the public record for proprietary reasons, and that ultimately the decision on what offtake is allowed will be part of the public record.

The committee took an at-ease from [11:31:59 AM](#) to [12:32:26 PM](#).

MR. GEORGE turned to cost information, field-related information provided to a regulatory body in many countries. He said typically this reporting is annual or semi-annual, perhaps more frequently in some jurisdictions, particularly if there are quarterly returns and so forth. Depending on the nature of the information, it goes to the resource administrator such as DNR or to the fiscal authority such as DOR. It depends a bit on local circumstances. There is sharing between those parties, with confidentiality issues. The degree of sharing varies by country. The flow is perhaps greater into the taxation/fiscal

authority than back out of it. Taxpayer information generally isn't shared, while field-level information usually is. There generally is a distinction between those two, especially relating to the resource assets themselves.

[12:34:09 PM](#)

MR. GEORGE said in terms of how this information is distributed beyond the government entities - the public reporting - it is mostly in aggregate or summary form. Occasionally it goes into detail; he would show examples. Some countries provide field-level summaries of reserve information and CAPEX, more often as a total, looking at the asset as a whole; he would show an illustration. In his experience, OPEX usually aren't disclosed much at a field level; they are a harder level of costs to see in the public domain and therefore tend to be held confidential.

MR. GEORGE explained that there are subscription services where one can get a good idea about this information; he would touch on that later because it relates to transparency and marketing issues that arise in conjunction with fiscal and resource-management policy in countries. The data quality varies, sometimes being accurate and sometimes indicative. The oil companies themselves engage in guidance to these subscription services as to the level of information. While they might not want to put the information out, they also are recipients and consumers of it. Thus it is a gray area.

MR. GEORGE said sometimes that information may come out in statutory disclosures for market listings, particularly where smaller companies are involved. Those reports frequently have detailed information on the properties they hold. Where they may be a partner with a bigger company there may be some detailed disclosure. Over time, the system combines to provide fairly reasonable ideas of what is going on; he would provide an example later. He noted the rest of the presentation was to present examples of the disclosure requirements themselves and how this plays back in the public reporting.

[12:37:09 PM](#)

CHAIR HUGGINS welcomed Senator Ellis.

MR. GEORGE highlighted the examples done for the UK, Norway, Denmark, and Nova Scotia. He said the UK has a requirement to disclose data, particularly at a field level. Typical information that is disclosed includes detailed development plans that have economic information, as well as collated annual or semi-annual data that companies are required to report on.

There also are tax returns for PRT - the petroleum revenue tax - for the equivalent of legacy fields, the older fields. In reply to Chair Huggins, he said PRT is somewhat analogous to Alaska's PPT, but is a "mosaic" done on a field-by-field or project-by-project basis. Companies have to disclose that in order to make estimates for returns on the fields at that level.

CHAIR HUGGINS inquired about "growing pains" and conflicts over this sort of process in the UK.

MR. GEORGE replied it has evolved over 35 years, with cat-and-mouse issues between regulatory bodies and companies on exactly how things are disclosed or pricing, particularly for valuation or royalties at various points in time, although royalty is gone now. Systems have built up, evolving to where both parties find it workable; this is amended from time to time. As a side issue relating to fiscal stability, he noted the UK has probably had more tax changes than any other country; some are major tweaks, every so often, and some are smaller. Usually there has been a reasonable basis of expectation and balancing. While not everything has been successful, largely it has been, looking at activity levels and so on. He commented that change doesn't always cause problems.

CHAIR HUGGINS asked whether what Alaska is considering is evolutionary, revolutionary, or in between.

MR. GEORGE answered he doesn't think it's revolutionary at all. The system of information collection reflected how the fiscal system operated. That has changed and requirements have changed. In the UK he thinks there is a fair amount of discretion passed down to the administrative levels in order to make it work. If it's administered in a confrontational way, the industry suffers, causing everything to suffer with it. The way to know whether something is workable for both sides is to look at whether activity takes place.

[12:43:13 PM](#)

MR. RUGGIERO expanded on the disclosure of cost data. Relating his experience in the 1990s, he said the regulator had ultimate approval over whether to allow development to go forward. In the UK that essentially had become a rubber-stamp process because the application for development wasn't made until it was known it would be approved. There was a review every four to six months about issues relating to operations, corrosion, expected facilities upgrades, and so forth, all the way to discussing work on potential developments such as what geologic

or geoscience work had been completed; what this revealed about the prospect's possible size; and, if preliminary engineering work had been done, what type of development it would be, what the rough cost would be, and what production levels were being designed for and why. At each meeting with the ultimate regulatory body there'd be a frank discussion of exactly what the understanding of the numbers was. Thus the regulator was treated much as a joint-interest partner would be as far as projected costs for bringing that development to market.

SENATOR WIELECHOWSKI opined that the UK had perhaps 15 oil tax changes in the last ten years.

MR. GEORGE said he hadn't counted, but illustratively this was correct. They were changes or tweaks.

SENATOR WIELECHOWSKI asked whether he'd understood correctly that this didn't discourage investment.

MR. GEORGE answered that he could think of one or perhaps two instances where it slowed investment. For the majority, however, no. Even the more recent upward changes probably haven't slowed investment. Drilling activity still seems to be there.

SENATOR WIELECHOWSKI recalled Dr. van Meurs' testimony yesterday that this is the third time in three years that Alaska is changing things, which will negatively impact how investors look at Alaska. He asked whether the current testifiers agree with that as well as Dr. van Meurs' statement that oil companies look negatively at Alaska as far as investment.

COMMISSIONER GALVIN proposed holding that topic until tomorrow, when it would be discussed at length.

SENATOR GREEN asked: Is there a difference in the UK and Norway as far as ownership by the government of the development and exploration companies? And is investment done differently?

MR. GEORGE answered that the resources in the ground are owned by the state, as in Alaska, where the state or federal government owns the resources. As for ownership of companies, the UK had that starting in 1975 on the oil side, though it was privatized in 1981 or 1982; for gas, it was privatized in the 1980s. Norway has a more mixed situation. Its state oil company, Statoil, was partially privatized in 2001 and continues to operate as a global company. It is perhaps 70 percent state-

owned, and although it has state members on its board it operates fairly much as an independent company. The ministry awards licenses and decides who gets them. They may make a partner a successor or might not put anyone in there; it's an open issue.

SENATOR STEDMAN asked whether the crown or the government of Great Britain has any equity interest in BP.

MR. GEORGE answered it is a fraction of a percent, if any. The main interest they had - about 30 percent - was sold off in 1987, immediately following the market crash.

[12:49:42 PM](#)

CHAIR HUGGINS asked when net versus gross would be discussed.

MR. GEORGE replied it would be tomorrow. Concluding with slide 7, he said some of this information would be published in an aggregated form. Showing slide 8, "United Kingdom," he noted this spreadsheet form is what companies must submit on field-level information; to his belief it is done annually, but may be more frequent. On the form he'd highlighted production, sales volume, CAPEX, OPEX, and tariffs. It provides an annual time series, a best estimate at a point in time, although in this case it isn't something a company is necessarily held to under threat of penalty. Rather, it is the expectation of how the exploitation on a particular field will go, what will be invested, and so forth. If there are major changes, then changes are made on the form. He gave details. In response to Chair Huggins, he said Alaska's form might be a bit different as to the levels of detail provided.

MR. GEORGE showed slide 9, "Annual UKCS Income and Expenditure summarized on an annual basis," related to 1970-2005. He said it shows oil and gas produced in the UK continental shelf; what expenditures were made each year, including decommissioning costs, which are starting to become a bigger issue as fields begin to be decommissioned; and average prices. This is published on the web site and put out yearly in hardcopy form.

CHAIR HUGGINS asked whether this information is confidential for a period of time.

MR. GEORGE replied no, it is straight off the web site. Continuing with the UK, slide 10, "Medium-term forecasts derived from annual returns," he said this shows that some forecast information put into the public domain, indicating the expected

level of expenditures. Since it is from 2003-2010, it shows both a forecast and some history, split among the amounts of exploration expenditure, development expenditure, and operating expenditure. This is based upon companies' returns.

MR. GEORGE addressed slide 11, "Cost trends." He noted one publication has an analysis of how cost trends have run in recent years, showing actual 2005 and 2006 amounts, as well as survey results and anticipated costs for fields that are expected to start up over the next two or three years. This information is aggregated, relating to the UK continental shelf as a whole.

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MR. GEORGE turned attention to Norway, slide 12. He said there is a similar set of inputs to the government. Companies have to make applications for development and provide a lot of information there. Annually or semi-annually they also provide highly detailed breakouts to the Norwegian petroleum directorate as to how they see exploitation going, not just for field reserves but also for resources. This is done to update state forecasts of revenue for management and planning purposes and for determining trends. The graphic illustrates something published yearly, in this case by the Norwegian petroleum directorate, with a lot of background information summarized so people can get a good handle on what is going on; where money is being spent; and issues related to health, safety, and the environment, for example.

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MR. GEORGE continued with Norway, slide 13, "Field / discovery listing of resource volumes." He said this is just one illustration of field-level information that is published. It shows the amount of oil and gas in place. Many places publish this information fairly readily, so he surmised there isn't anything too controversial here.

MR. GEORGE showed slide 14, "Detail on field-by-field basis," saying it's part of the 2007 book he'd been talking about. It depicts the projected production forecast and history, how much oil is expected to be, how much is being produced, how much is expected to be recovered, and how much capital has been spent and is anticipated to be spent going forward. It has geological and operational-type summaries about the field, including how it will be produced and where it fits into the big picture.

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MR. RUGGIERO related his experience in the UK and Norway that there is active participation by various government agencies to look at these production forecasts and then make decisions with respect to the development and timing that will ensure maximum utilization of existing infrastructure.

MR. GEORGE added that Norway has been keen at looking at this aspect, making sure that costs are kept in check as much as possible and that facilities and infrastructure are utilized in an optimum fashion, rather than building new infrastructure or hauling it too far in one direction or another as a result of ownership issues.

MR. GEORGE continued with Norway, slides 15 and 16, "Medium-term forecasts derived from annual returns." He noted the bar graphs show the degree of expected investment. This comes from the fact that companies have submitted detailed information. It is a year-by-year, field-by-field or resource-by-resource forecast shown in an aggregated form. This is continually updated. Slide 17, "Source of Investment," shows where the investments come from in terms of the type of company involved, split between large Norwegian companies and other large companies, and then smaller and new companies. This gives some sense of whether new players are being attracted and so forth. In this case, there was an influx of new players after 2000, which resulted after Norway decided to open things up a little more and encourage new companies to come in.

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MR. GEORGE turned to Denmark, slides 18-21, noting he'd provided examples. Although the disclosures are generally the same as in the UK and Norway, Denmark has only five major players, to his belief. In this case, they are putting out an annual time series showing money invested in individual fields; thus what a particular company is doing could readily be worked out. The ownership interests are well published anyway, so it isn't an issue. They also put a forecast of expenditures out there. He pointed out that this is a level of detail beyond what exists in most places.

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CHAIR HUGGINS referred to the field listing of annual capital investments shown in the slides for Denmark. He asked whether that data is available retrospectively for Alaska.

COMMISSIONER GALVIN said no. He pointed out that cost information would be discussed Sunday, including the nature of

cost data acquired by the state over the years. The bottom line is this: There isn't any other cost data for the fields.

CHAIR HUGGINS asked whether this is because it has never been requested or considered.

COMMISSIONER GALVIN answered that clearly it is the former. In his experience with DNR, there was great interest in getting cost data, which would have been highly useful in some decision making within the department. But there was concern about facing the question of what the public need is for the information and whether the state's involvement might push decisions. There was tremendous resistance to using it in the active management of the resource. Now that the tax system requires receiving this information in order to even understand the tax system, however, it spotlights the fact that the state doesn't have it, has never gotten it, and needs it.

1:04:39 PM

MR. GEORGE continued with Denmark, slide 21, "Detail on field-by-field basis," noting it is the same type of publication put out in Norway. The government puts out detailed information that anyone can see, relating to individual fields, how they're performing, and how they fit into the bigger picture.

MR. GEORGE turned to Nova Scotia, slides 22-25, saying there is a requirement for public review and there is a detailed disclosure available on a web site. There are several parts of a big publication describing the fields, including development, impact, environment, and so on. He highlighted one for the Deep Panuke field operated by EnCana, which has been running 12 to 18 months and was approved a couple of weeks ago. It shows a lot of detailed information that he'd pulled off the web site; available to anyone, it shows sales forecasts under different assumptions, a fair amount of cost forecast information, and an indication of expected annual operating expenses. He provided details.

MR. GEORGE addressed slide 25, pointing out that when this was approved a couple of weeks ago there was a condition put on it relating to economic data. It states that the proponent - EnCana and its partners - shall inform the board of any material changes to the cost information and production profiles that were submitted with the development plan; to be submitted with the annual production report, it should include details of operating and capital expenditures for the previous two years and the current year, and projections for the next two years.

Thus it is fairly explicit in terms of requirements, including keeping this information up to date.

MR. GEORGE turned to the final slide, slide 26, "Publicly Available Sources," which had a subheading that read: "Example detailed field cash flow available from Deloitte's subscription service." Noting it's a different issue, not related to a mandate by any government body for information sources, he said this is what is readily available to anyone who wants to pay money to a subscription service. Whereas this example is from Deloitte's, there are others.

MR. GEORGE explained that slide 26 shows one page out of 15-20 for a particular field, in this instance, the Manus field in the UK North Sea operated by BP. Those pages contain detailed information on geology; individual wells; the reservoir, including how it has performed and the way they've gone about developing it; and associated costs. A summary page shows a highly detailed cash flow outlook. In this instance it uses Deloitte's price assumptions, but it is readily available for others to strip that out and put in their own price assumptions.

MR. GEORGE said this is a year-by-year forecast of production, capital and operating costs, and so on. Is this information exactly what BP and its operating partners believe? It may not be exactly. But these subscription services have existed for 30 years. This is done for every field in the UK, perhaps a couple of hundred, as well as those in Norway and other countries. The source is government publications and information put out in press releases or company publications from time to time. Significantly, the companies also give guidance with respect to whether these look reasonable. While they probably aren't perfect representations, they are generally held to be a pretty good guide to what that individual field looks like or what a collection of fields and interests looks like.

MR. GEORGE continued, noting these are used heavily by the companies themselves when looking for opportunities or trying to decide what would happen if several were combined or if a company were to be acquired, for example. This type of publication has driven quite a lot of activity in the area because companies can get a fairly good assessment of what is going on and what opportunities exist. He described it as part of a matrix of information that sits there in North Sea countries and a number of others as well, driving the overall activity level within a country.

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MR. RUGGIERO summarized by saying they'd tried to find a number of regimes analogous to Alaska. He referred to comments yesterday, emphasizing that in those regimes with production-sharing agreements, most agreements require work plans and budgets that are submitted and approved annually throughout the operation. For example, a development plan will be not only what a company plans to spend that year, but also likely what is planned to be spent for investment in that development over a series of years.

MR. GEORGE added it would be over the life, in fact.

MR. RUGGIERO said there'd be limits. Even within an approved plan, any expenditure above a certain level would require the preapproval of a regulatory body. As stated yesterday, there is much more control from a state perspective in a lot of the production sharing contract (PSC) environments. Whatever was seen here, there'd actually be a much higher level of submission and control in PSC environments.

CHAIR HUGGINS recalled discussion that the most important variable was production. He also recalled that yesterday Mr. van Meurs recommended not making any changes to the PPT and had said with respect to auditors that "you don't know what you don't know because you haven't audited." Chair Huggins asked whether that was correct.

COMMISSIONER GALVIN asked whether Chair Huggins was talking about the current situation.

CHAIR HUGGINS said yes. He gave his understanding that Alaska is a little more blind than it could be if there were a system like those just described in other countries. He asked for the commissioner's opinion.

COMMISSIONER GALVIN answered that the oil industry is conducted the same way around the world, incurring the same types of costs and having mostly the same types of operations in an analogous environment. Thus the type of information generated by these companies and provided elsewhere is known, which is why Gaffney Cline was asked to provide this information. Also known is the type of information the State of Alaska wants to receive.

COMMISSIONER GALVIN pointed out, however, that the fine-tuning and inner workings aren't known by the state for each field with respect to how the ANS fields operate and the economics that

drive them. Clearly lacking are an historic reference and a more recent snapshot. Now the information is just based upon one year, which the state was able to use to provide a picture going forward; that has helped tremendously over the last 12 months to recast the state's expectations.

COMMISSIONER GALVIN continued. As to whether the state will be better off in two or three years reconsidering the decisions, based upon better information, he said this is a legitimate line of inquiry. There will be more known in terms of economic models in two or three years. But the balance is this: Do we recognize that there's a need to make a change, based upon what we know now? And what is the cost associated with waiting? Suggesting this can be further explored another day, he gave the administration's perspective of recognizing significant costs associated with waiting one to three years and then making a dramatic change, versus doing what it can now, knowing what it does now, which is more than was known a year ago.

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MR. RUGGIERO added that this is an evolutionary process, but must start somewhere and sometime. He cited the handling of corporate overhead as an example where he has seen evolution when they started getting this cost information. For instance, the Timor accounting rules have a cap of 2 percent of qualified CAPEX and OPEX to be charged as corporate overhead. He recalled working in venues where the corporate overhead charged was anywhere from plus or minus 2 percent to as high as 15 percent of actual in-state, direct capital and operating expenditures.

MR. RUGGIERO asked: What is a fair allocation of corporate overhead for a number of these large, major oil companies against their tax liability in Alaska? And are they allocating to Alaska the same percentage they allocate under the same rules that they allocate to all their other operations around the world? By getting this basic data, he said, he wouldn't go to where Dr. van Meurs did, that the oil companies have included items that shouldn't be there. By contrast, what he saw was that as profit-minded companies, they pushed it to what they believed to be the fence line of the law, staying just inside that. As DOR gathers data, it will be able to make better-informed decisions as to what is fair and reasonable with respect to those types of deductions, Mr. Ruggiero predicted.

CHAIR HUGGINS gave an analogy, suggesting the question is at what point people have the necessary information to make a good decision.

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SENATOR WAGONER surmised two important questions to companies will be as follows: How much did you deduct against your liability with the State of Alaska for corporate overhead? And what percentage of your corporate income came from Alaska deductions? He asked if that is a way to figure out whether they're taking a fair share or more than their fair share of corporate costs off of the Alaska tax bill.

COMMISSIONER GALVIN clarified that the example used for corporate overhead doesn't reflect Alaska's current tax law. Under PPT, they aren't allowed to deduct for overhead. Rather, they can take a percentage allowance, up to 3 percent. He suggested there is a sense that in moving to a net-based tax, calls will be made based upon the perceived public interest of allowing certain deductions but not others. The end result will be a system that is different from what it was thought it would be initially, because mutually everyone will learn more about the acceptance level for certain costs.

SENATOR WAGONER said his question wasn't about PPT, but was an analogy, asking whether it would be a fair way to arrive at a point to say that something is a fair amount to deduct from the corporate overhead, versus the corporate income from the production in Alaska.

MR. RUGGIERO opined that there are a number of ways to determine what is fair. Another way he has seen it done is this when gathering such information: Company A says it's X percent, Company B say Y, and Company C says Z. They're all listened to as to why they believe their numbers are right. The decision makers start to educate themselves, take that data in, and then make an assessment from the State of Alaska's position as to what is believed fair and correct.

CHAIR HUGGINS thanked Mr. George and Mr. Ruggiero for their presentation.

1:24:11 PM

MR. IVERSEN returned to the administration's presentation on ACES, slides 24-28, "Auditors." He explained that DOR has 18 auditor positions with 5 vacant, and DNR has 7 royalty auditor positions with 2 vacant. Lately there has been difficulty in recruiting auditors. One problem is below-market-level salaries, and the employee classification system doesn't allow for a targeted increase. Demand in the oil and gas arena has

raised salary levels, and the state isn't as competitive as it should be.

MR. BANKS agreed, saying he and Mr. Iversen have practically traded auditors in recent months. They've tried different remedies: DNR now has its own authority to audit royalty and net profit shares, and a classification review a few years ago resulted in all auditors getting a pay raise. However, he still views the pay as inadequate to attract the kinds of employees needed to fill these positions. The attempt is to come up with creative solutions to fill gaps and complete a backlog of audits.

CHAIR HUGGINS reported he'd talked to Marcia Davis about this. He suggested the need to look at inflation.

MARCIA DAVIS, Deputy Commissioner, Department of Revenue, indicated DOR is mindful of the challenge of balancing the need to hire individuals with a high level of experience and credentials in order to position the state to be efficient at this high-value function; this relates to both the production tax side, which delivers almost half the state's revenue, and the royalty side. This small group of auditors must defend and protect the line on probably 80 percent of the revenues that come in. At the same time, DOR appreciates the talent and hard work of its other auditor staff on the corporate income side who do valuations for property tax and so forth.

MS. DAVIS explained that DOR has been forced to hire junior people with little or no experience on the industry side, and to "grow them" internally. While they gain exposure to the other auditors, they lack the depth to be efficient. She emphasized the state's pay scale for others elsewhere in the system who are tasked with such enormous responsibility. She said it is a challenge and the department will hold the line as far as other staff. There is an issue in all departments as to whether state employment has kept pace with the private sector and so forth. There will be an overall review and solution to the broader issue, but this is seen as a separate issue. She indicated DOR is highly concerned about holding that line as well, because otherwise this effort cannot move forward.

MR. BANKS added with respect to inflation that clearly - as reflected in the department's fiscal note - there is a time during this transition when a lot of effort will be needed. There will be in-house people, but also contractors brought in to assist. While the department will avoid bringing on a lot of

people who require future employment, a balance must be struck in bringing in outside help so that they don't immediately walk away with the intellectual property that the department wants to keep in-house.

CHAIR HUGGINS explained that he'd asked because of earlier comments about saving money for a rainy day.

SENATOR WIELECHOWSKI agreed with the concept of raising benefits and salaries to attract more auditors. However, he cautioned against moving them into the exempt classification. Citing his experience as a hearing officer for the state, he recalled that when he wrote a decision that a party didn't like there'd be a call to his boss. An auditor shouldn't serve at the will of the governor, with an unpopular decision perhaps resulting in being fired. He said maybe it can be structured so these auditors aren't exempt and have some protection.

MS. DAVIS replied that she appreciated that concern, which she'd heard expressed from others. However, she noted that auditors are certified public accountants (CPAs) and have explicit professional standards to comply with in performing audits. She related her sense that auditors have two gears: right and wrong, with nothing in between. She acknowledged the differences among administrations, though, and suggested perhaps mechanisms could be put in place to ensure that those professional standards are never compromised.

MR. IVERSEN lauded the ethics and dedication of DOR's auditors in trying to do the right thing and reach the correct result.

SENATOR WIELECHOWSKI clarified that he wasn't implying that wasn't the case. Rather, the system is working well, and he was cautioning against changing it, jeopardizing it by having the fear that if an audit isn't done as a higher authority would like, the person's job would be on the line.

CHAIR HUGGINS asked whether there are other mechanisms to accomplish this without exempt status.

MS. DAVIS highlighted the constraint: The job classifications have been set up, the Department of Administration (DOA) has a fairly rigid system, and she didn't know how to get around trying to force a reclassification.

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MR. IVERSEN elaborated. He said the state's classification and pay plan applies to job class families. So in order to raise wages for oil and gas auditors, the state would have to raise wages for all auditors in all jobs that generally fall within that same category. For instance, people who serve a quasi-auditing function would arguably be part of that, including the chief of operations and deputy director. The oil and gas auditors are sort of a special case right now because of market demand. It has created a niche market for that type of experience. They can't be kept in the classified service and still retain internal alignment. Thus the issue would involve a highly detailed classification study that also looks at all those other positions, which would essentially water down the validity of what they're trying to get at here.

CHAIR HUGGINS countered that by looking three years into the future, when there are new administrators who want new auditors because they work for someone they're trying to get rid of. He expressed concern that the potential is there, but there is a need for continuity in the workforce and for the employee.

SENATOR WAGONER said he finds it shocking that the legislature and DOR can't create another classification of auditors within the existing system with good enough pay to attract corporate auditors into the system. Citing the University of Alaska as an example, he suggested there is always a way without going through a total salary study if there is a need to hire specific people for a specific task. He asked why this is different.

MS. DAVIS gave her initial reaction that this is a complex area because of all DOA's pay classifications and the various union agreements in place. The state has entered into contractual arrangements with the unions as to how, when, and where they'll deal with job classifications and any modifications to those, for instance. There may be constraints within current contracts. However, she proposed coming back to the legislature with a written statement from one of the department's experts on administration and either describing an alternative means to change the pay within that narrow band, if there is one related to legislation, or else identifying constraints within the contracts.

CHAIR HUGGINS requested that DOA be brought to the table along with DOR in order to continue this conversation.

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MR. IVERSEN returned to the presentation, slide 27, "ACES creates exempt class of Oil and Gas Tax and Royalty auditors." He explained that current auditors would have the option of moving to exempt status or staying with the union. Showing slide 28, "Contract Auditors," he said ACES provides funding for contract auditors over the next four years to assist and/or lead in auditing and also to bring department folks up to speed with respect to training and actual field training and field audits, working hand-in-hand.

CHAIR HUGGINS asked whether this may be a mechanism to make the transition work if that concept is expanded and the "personnel lag factor" gets up to a speed such that folks could be hired appropriately for the welfare of all.

MR. IVERSEN replied this raises a good point. He mentioned the possibility of having the committee hear from union representatives. However, he noted there is an argument relating to union contracts: The state cannot contract for services when it would cost more for those services, if the state can do those services itself. It would drive the exempt-status issue, because an exempt salary would mean not paying more than for in-house folks.

1:43:45 PM

MR. IVERSEN addressed lease expenditures, beginning with slide 29. He explained that PPT uses general categories of allowable lease expenditures, with a set of exclusions. Under ACES, those exclusions would be retained and added to. The department would have statutory power to delineate allowable lease expenditures via regulations. This allows operating in world where there are inclusions, rather than exclusions, in order to have clarity and reduce conflicts with taxpayers once audits begin.

CHAIR HUGGINS asked whether the following take on the PPT debate the previous year was correct: The legislature's expectation was that it was creating those general categories and that DOR's task was to create regulations and implementing instructions to provide clarity and make this enforceable.

MS. DAVIS answered that was the underlying premise. However, PPT was written to be self-implementing because of the need to move quickly. Even without regulations, it defined the scope of what was permissible: it had to be directly related and reasonably related to the upstream expenditures. Although further delineated by the department's regulations, it didn't

require such regulations to get it going. By contrast, ACES would require the department regulations to affirmatively describe that deduction as well. It is no longer self-implementing as a statute, but places the burden on the department to further enumerate and flesh out those authorities for a deduction.

MS. DAVIS, in further reply, said whereas PPT set out the broad scope of the type of deductions allowed, ACES tries to address the following concern: An administration that doesn't aggressively manage those deductions essentially allows industry to come in and deduct anything and everything that fits within the broad statutory definitions. Thus the desire is to be clear as to the allowable deductions. There will be an opportunity for public comment, by industry and concerned citizens as to whether what is or isn't a deduction has been clarified. It's a minor word change but may have a big effect, depending on whether or not the job is being done properly.

CHAIR HUGGINS commented it's a little more proscriptive than he'd envisioned; he suggested visiting about it later.

MR. IVERSEN added although the authority is arguably there already, this makes it crystal clear so that when they describe something there won't be an argument as to whether the authority exists.

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MR. IVERSEN continued with lease expenditures, slide 31, "Repeals," which read:

Provisions allowing the department to substitute cost billings under unit operating agreements in place of general standards for allowing lease expenditures
- 43.55.165(c) and (d).

He explained that subsections (c) and (d) are proposed for repeal from AS 43.55.165, lease expenditures. These allow the department to substitute cost billings under unit operating agreements in place of general standards for allowable lease expenditures. Under (c), if DOR finds that parts of an operating agreement are substantially consistent with general standards for allowing lease expenditures, then DOR may authorize a producer to treat as lease expenditures the costs that are billable under the operating agreement.

MR. IVERSEN noted that (d) takes that same principle a step further. If the department makes that same finding of substantial consistency with the general standards for deductible lease expenditures, and also makes a further finding that one of the working-interest owners other than the operator has the incentive and ability to effectively audit, then the department accepts as allowable lease expenditures the costs that are billed and not disputed by the working-interest owners under the agreements.

MR. IVERSEN went on to say these provisions essentially sidestep the state's ability to audit. They also add a subjective finding, potentially forcing the state to accept a joint-interest audit, findings that may not be in the state's best interests, given that resolutions to disputes under these operating agreements aren't made with the state's interests in mind. The concern, as a policy matter, is too much control by the taxpayers and too little control by the department once these findings are made - especially under (d), where the auditing power would be restricted to looking at the specific exclusions in the statute and restricted to confirming what is actually billed under the agreement.

CHAIR HUGGINS remarked that what Mr. Iversen was saying seemed a bit greedy. He then asked whether this is a revolutionary change or an evolutionary process being entered into here.

MR. IVERSEN answered that the department has not accepted any of the joint operating agreements under these provisions; that bridge hasn't been crossed. But these two provisions shift responsibility from DOR to the taxpayer as to the final determination of what costs are billable and allowable as deductions for purposes of lease expenditures. In drafting its second set of regulations - yet to be completed - DOR has had tremendous difficulty interpreting what these provisions mean and what its duties will be under them.

MR. IVERSEN elaborated, saying this puts DOR in a strange and difficult position: To ensure there is proper auditing undertaken between the working-interest owners and the operator, DOR must check, keep control of, and have continuous working knowledge of the operating agreements. The accounting procedures under those are evolving or in flux, and DOR essentially has to audit the auditing. And the determination of "substantial consistency" isn't exact compliance with the general terms of the statute, so it could lead to disparate treatment among taxpayers. Mr. Iversen highlighted the gap

between general allowables under the statute and what is actually intended to be disallowed under it.

MS. DAVIS added that DOR has tried to find ways to not make more work for itself, with the goal of setting good standards and having more certainty for taxpayers and DOR. In looking at these two provisions under PPT, it found a disconnect with how they relate to operating agreements, and there was no basis for making a particular call. One unit agreement would beget another, and these have a bit of a life of their own. For DOR to sit and cast judgment was too cumbersome. Thus language is inserted that captures the ability to look at these operating agreements, but on a cost basis, to say DOR shall consider, among other factors, typical industry practices, which include the operating agreements in place in Alaska, as well as standards done before under the net profit share lease (NPSL). The department has made it an obligation to look to those, as guides, and can efficiently reach in, target a cost, see how it's handled under the operating agreement, and decide that indeed it is in step. It keeps DOR from being dragged into a process that doesn't yield as much benefit as what is proposed.

CHAIR HUGGINS summarized that this reduces ambiguity on both sides.

MS. DAVIS agreed.

MR. IVERSEN concurred, noting it isn't a huge change as to what is or isn't allowed. In further reply, he surmised the taxpayers would resist having these provisions repealed because they allow taxpayers more control over what costs are allowable.

MS. DAVIS added that it says DOR "may" choose to do this, if convinced by all these various proofs and standards. She suggested industry members might ask how long they'd have to make their case to try to have DOR sanction the operating agreement as the definitive statement of what is or isn't allowed. And if the agreement is modified, that battle would have to be waged again. Thus while it may be nice in a utopian government-industry relationship, pragmatically it probably doesn't have any long-term value.

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MR. IVERSEN turned to exclusions for lease expenditures, slide 32, indicating this relates to AS 43.55.165(e). It disallows deductions of costs incurred for repair, replacement, or deferred maintenance of facilities and equipment, other than

a well, that results in or is undertaken in response to an event that results in an unscheduled interruption in production or a release of oil and gas. Mr. Iversen noted this takes a policy tack similar to Senator Wagoner's SB 80 in terms of addressing some maintenance costs that have caused problems. This particular provision would trigger based on an unscheduled shutdown, reduction in production, or spill.

MR. IVERSEN predicted this would encourage proactive maintenance. Furthermore, there is an exclusion in the statute for Acts of God: inevitable or catastrophic occurrences that couldn't be prevented through proper maintenance and reasonable behavior on the part of the operator.

SENATOR WIELECHOWSKI recalled yesterday Dr. van Meurs had said this was already taken into account when PPT was constructed last year. There was 30 cents a barrel taken in order to deal with it. Senator Wielechowski asked whether the testifiers agreed.

MS. DAVIS recalled that Commissioner Galvin testified on that point, likely during hearings on SB 80, and that the information from Dr. van Meurs in the record showed that the 30 cents was intended to cover the routine and ordinary - not extraordinary and excessive costs. With respect to Dr. van Meurs' testimony yesterday, she opined that he'd misunderstood the scope of the current bill and had been stating concern that a 24-year-old auditor would have to determine what is or isn't good maintenance. Ms. Davis said that's why ACES was written as it was: They don't want that kind of judgment call made.

MS. DAVIS noted while it would be simple to strike "gross" in front of "negligence" and then to battle about whether something was negligently maintained, this would lead to a long, costly legal battle, pitting DOR against the industry on important issues as to what the standards should be. Rather, the desire is to have a bright-line test for the following impacts to the state: 1) disrupted production and 2) spills and environmental contamination.

MS. DAVIS explained that the state isn't an expert on field operations. It is up to the industry to figure out how to get there. If either impact happens, there will be an economic consequence, since immediate repair and replacement costs cannot be deducted. Industry will have to decide the level of proactive maintenance to avoid those. Some maintenance issues don't impact production or create spills. The state wouldn't

get into the industry's business to that degree. Instead, the line would be drawn where it hurts the state deeply: in its pocketbook because of production or in contamination of the environment.

SENATOR WAGONER related how the 30 cents came about. He said it had nothing specifically to do with BP's North Slope oil spill. In his office one Saturday, Senators Wagoner, Dyson, and Wilken had discussed with Dr. van Meurs how to get closer to a gross system with the PPT. One scenario was using an amount, and Dr. van Meurs later came up with 30 cents after studying information. The amendment they discussed was a deduction in the overall cost of maintenance, period. The following Monday BP announced the oil spill. Dr. van Meurs then sent a memo to Senator Wagoner that mentioned the spill and indicated the 30 cents would take care of it. Senator Wagoner said there was no intention for the 30 cents to take care of the BP spill due to lack of maintenance. But this would handle SB 80 and all other occurrence in the future of that nature. Senator Wagoner said he'd be happy with this if it passes.

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CHAIR HUGGINS responded that he didn't disagree, but had heard Dr. van Meurs say it was a mechanism that potentially could address such things. He asked Ms. Davis about her use of the term "extraordinary" with respect to costs, since the language doesn't specify that.

MS. DAVIS apologized for using that term, but said it is clearly what would catch the state's intention. A disruption or cessation of production usually won't be a tiny cost item.

CHAIR HUGGINS asked whether there is any risk that having more scheduled maintenance might interrupt production.

MS. DAVIS noted this is a good question. Clearly, DOR will need to implement this through regulation, and there are threshold questions of what is considered unplanned. For example, someone could "plan" a production shutdown if there were a perceived problem. Thus DOR is considering what the standards should be for the reactive phase, for example, within 24 hours of an event or two days, looking at the zone of typical events and how they play out. The state wants to reward proactive and not reactive behavior. If someone experiences a problem, steps in, and must shut down and react, that cost itself won't be deductible. If the company then decides this could happen elsewhere and proactively takes measures, however, the state is comfortable

sharing those costs because at least the company is managing the production shutdown. Oil companies are intelligent in how they reroute or otherwise mitigate production impacts when they have time to do so. Thus the state encourages such behavior. As for the reactive phase, it needs further delineation.

MS. DAVIS expressed confidence that the industry is as profit-motivated and as interested in not having disrupted production as the state is. Therefore, rational business minds will prevail and intelligent choices will be made as to how and when shutdowns occur and how spills are avoided. She opined that the industry is doing a decent job of it now.

SENATOR MCGUIRE remarked that because Prudhoe Bay is a 30-plus-year-old field, she is concerned there'll be a reaction the other way, shutting the entire thing down and then doing the scheduling; she trusts that the state will work through that. She then asked whether this completely supplants the gross-negligence concept.

MS. DAVIS answered no. This would be apart from that standard, which might apply to a broader range of things. This just targets the specific repair/replacement deferred maintenance costs that people have concerns about.

SENATOR WIELECHOWSKI recalled that the SB 80 debate was over negligence. He asked whether the same standard is in here.

MS. DAVIS replied it's strict liability. Whether the disruption is caused by an intentional act, a negligent act, or a reasonable, responsible act isn't germane. If there is a disruption to production or a spill, the cost isn't deducted.

SENATOR WIELECHOWSKI recalled that the previous discussion included encouraging companies to act proactively; he suggested that having more of a negligence standard is a little more proactive. Also recalling discussion of language that said a responsible operator should act, he said it seems a little more fair.

MS. DAVIS responded that it may cut it too close to the bone. This was looked at when analyzing SB 80; the discussion was to take the existing PPT law, which has a gross-negligence standard, and establish a negligence standard. Referring to the "reasonable operator" standard on the North Slope, she pointed out that there aren't a lot of standards, and those which exist are ones they've established. Thus DOR found a bit of a legal

morass in this challenging area that probably won't be clarified until there've been many years of litigation and debate.

MS. DAVIS reported it was felt that this needed to be addressed quickly, and this alternative to the approach described by Senator Wielechowski will get a quicker response for the behavior the state is looking for. She observed that financial incentives usually drive behavior more strongly than legal nuances and threats of being sued for negligence.

SENATOR WIELECHOWSKI asked what happens if someone shoots a hole in the pipeline.

MS. DAVIS indicated the Acts of God standards were adopted from the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) laws, the Superfund requirements. What this does is say a third-party act won't be considered unless it could have been anticipated or prevented. There is a fairly good body of law around these Acts of God standards, with a requirement to mitigate and prevent such acts if they are predictable or reasonably foreseeable.

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CHAIR HUGGINS recalled a trip last summer to the North Slope, where an operator mentioned scheduled maintenance for a holding tank. He surmised if he himself were an operator, he'd perhaps double the size of the holding tank and deduct the cost because it is part of maintaining the flow so there is no disruption. He asked whether that is a stretch.

MS. DAVIS indicated the operator would pay 60 percent of the cost of doubling that holding tank, balancing it against the possibility that the existing tank is adequate. She expressed confidence that a company would correctly size the operation for what it needs; oil companies are rational and intelligent in how they approach their facilities and equipment needs. While they might build in a 5-percent cushion in certain areas for a safety margin, it's probably in the state's best interests. She opined that the state is probably more affected by lost production than a company is, because it is the state's revenue stream, whereas the company has other operations to mitigate cash flow.

CHAIR HUGGINS requested confirmation that the administration has discounted using "gross negligence" as an operative term.

MS. DAVIS explained that gross negligence is currently the standard among working-interest owners, even in terms of their

ability to push back against an operator and refuse to pay a bill because the operator was grossly negligent. To her knowledge, there has never been an instance where that has been established by a working-interest owner against an operator, however. It is a very difficult standard in terms of establishing what the norms are for an appropriate operator on the North Slope.

SENATOR STEVENS noted his concern had been about excessive maintenance. However, he interpreted Ms. Davis's testimony as being that gold plating won't be an issue because the companies will pay the lion's share of those repairs.

MS. DAVIS agreed gold plating isn't expected. As for a 5 percent or 10 percent margin to mitigate risk because of concern about downtime on production, some may be seen. But it would be in the state's best interests, for the reasons she'd stated.

SENATOR STEVENS asked whether there is oversight for maintenance.

MS. DAVIS answered that as a result of an important initiative brought last year, DNR's Petroleum Systems Integrity Office (PSIO) now works more closely in monitoring and being engaged in the maintenance standards of the ANS industry. It is a growing office and will be working out its relationship and how it monitors and manages the industry.

MR. BANKS elaborated. He said PSIO will work with the industry to find gaps in the state's regulatory process with respect to oversight responsibilities for the equipment, oil spills, and so forth on the North Slope, and to look for any gaps in companies' internal systems. It will rely on industry standards for third-party-type certification and internal mechanisms within the companies to establish maintenance schedules and the management of safety issues. It may participate and then validate whether companies are meeting those standards. This may be at a high level at first, but will drop down as needed. This is where PSIO is headed; it isn't there yet, but will provide a view into how the producers are taking care of their equipment.

MS. DAVIS added that as the department implements regulations to manage this there'll be some areas of facilities or infrastructure that the industry has specific concerns about. It may give rise more frequently to issues about production disruption or slowdown, and the department will be very

interested to engage with them. Great care will be taken to design the rules so they are clear, make sense, and achieve the intended purpose.

CHAIR HUGGINS requested confirmation that regardless of whether a company has done the right thing, no deductions for costs could be taken if there was a shutdown.

MS. DAVIS affirmed that. The goal is that if an impact to production happens once, the company will become proactive as a result and will figure out to prevent it elsewhere. In further response, she opined that it's even more important with aging infrastructure, which truly requires proactivity. Also, if something has aged out in one part of the infrastructure, it very likely exists in several other places. The state will allow a deduction if a company learns from an event and tries to get ahead of it. Even if there are production impacts, the state probably wants to know it's managed and that these impacts are coming, rather than being continually surprised.

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CHAIR HUGGINS welcomed Senator Thomas.

SENATOR WAGONER asked what happens, for example, if there is a shutdown because of a faulty hose on a turbine, when the maintenance program being used had been defined by the manufacturer of the turbine.

MS. DAVIS answered it doesn't matter whether an operator had behaved perfectly and bought a faulty hose. The standard is whether there is a production impact, period. What it does influence is whether the company has a spare hose on the shelf, which would make the impact short-lived and easy to fix. The beauty of having strict liability is that the state won't be spending years in court and so forth, arguing about whether the field management was reasonable.

SENATOR WIELECHOWSKI surmised there'd likely be a lawsuit against the company that produced the faulty hose.

The committee took an at-ease from [2:27:24 PM](#) to [3:12:53 PM](#).

MS. DAVIS noted Mr. Iversen had left to join Commissioner Galvin on the House side. Continuing with lease expenditures and repair/replacement issues, she turned to slide 33, "Exclusions," which said this clarifies that costs to construct, acquire, or operate a refinery or crude oil topping plant are not

deductible, but that the cost of diesel used for production can still be deducted as an operating expense.

MS. DAVIS explained that a refining process happens in place on the North Slope, adjacent to fields where oil comes out of the ground or is piped from a lease area; it is processed and turned into diesel, which is then used at the lease site or by third parties and so forth. Diesel gets used in the trucks and in power plants to power some facilities there. There is a significant crude oil topping plant at Prudhoe Bay and one at Kuparuk; those supply the needs of the operators as well as third parties. Before these plants existed, ANS operators used to truck diesel up from Fairbanks.

MS. DAVIS said the challenge for these plants is due to concerns about air emissions, containment issues, and sulfur. There is a lot of sulfur in ANS oil. As it is refined and turned into diesel it has fairly high emissions. Thus they are running into limitations and being phased out because of air quality control regulations. So the choice for the producers will be to build new plants or upgrade plants to remove the sulfur - a very expensive process - or else to truck fuel up from Fairbanks, resulting in higher operating costs and potentially higher environmental exposure because of the trucks. She recalled hearing anecdotally that ConocoPhillips, if it doesn't modify the Kuparuk plant, will be bringing up about ten trucks of diesel a day.

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SENATOR GREEN asked why it wouldn't be deductible.

MS. DAVIS noted one challenge is that the existing PPT law allows deduction of leasehold expenses if they are direct expenses upstream of the point of production. However, oil that comes out and then goes into a refinery process is really more of a midstream process, an offline manufacturing process not seen as part of the direct flow from the well to the point of production, which is what was originally envisioned as a cost that should be deducted. Clearly, however, the use of diesel fuel is an expense of operation.

MS. DAVIS said by allowing it here, the state clearly is allowing diesel costs as part of the OPEX; that is not being excluded. But if a company has a crude oil topping plant and decides it is in its economic interest to modify it or do something with it - but not on the state's nickel - the company can still deduct the cost of that fuel. The oil is essentially

free, since the company doesn't pay tax on it. Thus the calculation of a deduction, if the company operates such a topping plant, will be the fair market value of diesel on the North Slope, calculated by figuring how much it costs to buy it there, which includes the transportation cost and purchase price, but not the fair market value of the barrel of oil that is essentially passing through the system free, without tax. The choice is this approach or, if the company doesn't run such a plant, deducting the actual cost of the diesel and trucking.

MS. DAVIS further explained that the state doesn't see the net tax as designed to handle these manufacturing or midstream types of things. The hope is that producers will be thoughtful and creative, as they always are when facing high costs. Some technological solutions on the horizon may lower the cost of the diesel plant, perhaps some gas-to-liquids ideas or transitioning to powering with gas as well. The state wants to encourage anything that improves air emissions and so on. If the full cost is borne by the industry, the state hopes it will lead to the most efficient long-term solution. If government steps in and pays 50 percent, by contrast, it may perpetuate a solution that might not be the most economically efficient.

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SENATOR WAGONER asked how many of these topping plants are on the North Slope.

MS. DAVIS answered there are two primary ones; there may be smaller ones as well. She reiterated the challenge of dealing with sulfur and looking for ways to handle the fuel needs. Observing that when the oil companies face a challenge they usually come up with good solutions, she emphasized that the state doesn't want to impede the process, but also doesn't want to throw money into a system that leads to an inefficient solution.

SENATOR STEDMAN asked whether Ms. Davis was talking about excluding a credit or excluding a credit and also declining a deduction.

MS. DAVIS answered it would be excluded as a leasehold expenditure. So it would be the cost associated with operating as well as building or modifying. Thus it would be the operating expense and the capital expense associated with the plant. With that said, the state would still allow as an operating expense the value of the cost of the diesel itself. The cost of the "outflow product" would be deductible.

CHAIR HUGGINS asked about trucking fuel to the North Slope as an alternative. He recalled hearing about a larger number of trucks than Ms. Davis had mentioned, and also recalled hearing that some resource states aren't allowing trucks on roads because of maintenance issues. He suggested that inviting more trucks to drive the Dalton Highway is counterproductive both environmentally and because the state's department of transportation has to maintain it.

MS. DAVIS concurred, noting it is a tradeoff. The state would incur higher costs on maintaining and repairing the haul road, but it would be offset by the consideration that the legislature would have to make in deciding whether the state should pick up the approximately 50 percent cost associated with the \$300 million plant. The question is what would really drive the correct policy choices in each instance.

MR. BANKS elaborated. He noted the federal Environmental Protection Agency (EPA) will require ultra-low-sulfur diesel, which truck engines being built now are designed to burn. In some respects the choice is up to the company: modify the topping plants to make ultra-low-sulfur diesel, truck it up, or seek another alternative. The state will allow a deduction for the cost of buying diesel to run in the trucks, because it is a qualified lease expenditure, but the company provides the solution. Although it would great to have some kind of low-sulfur credit that takes into account what the trucks are burning on the way up and down, it really isn't an option.

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MS. DAVIS turned to slide 34, which read in part, "Disallows deduction of Dismantlement Removal and Restoration (DR&R) expenses." She said this exclusion from leasehold expenditures was substantially disallowed with PPT. It disallows abandonment costs associated with the North Slope. The PPT disallowed costs associated with the amount of production as of the effective date of the PPT bill, so the lion's share will likely be historical production, not that from April 1, 2006, forward.

MS. DAVIS explained the internal state government conflicts that were discovered. It will be a big challenge if the state allows a deduction for the remaining abandonment costs associated with production from April 1, 2006, forward. The arbiter for looking at the level of abandonment - the threshold of whether enough has been done both under the lease and under the statutes - is DNR; it will be looked at under that standard. However, the

state will be paying about half those costs, and thus there will be an inclination to make decisions based on whether they affect state revenue in that respect. Meanwhile, the Department of Environmental Conservation (DEC) will be looking at its standards.

MS. DAVIS further explained that the state will be either dishonoring one policy or the other within its government, which is untenable. Furthermore, when these investments were made they fully were recognized to have the obligation of the abandonment costs, and depreciation has been taken all along for these costs. Thus the tax benefits have been received already. Therefore, it was felt that the appropriate solution was to get rid of the rest of the abandonment costs for this.

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SENATOR GREEN asked whether initial contracts or lease agreements said abandonment costs are to be shared by the state.

MS. DAVIS answered no, it was actually the opposite. It was fully their burden. She turned to slide 35, which read:

Disallows tax-exempt entities from obtaining transferable credit certificates under AS 43.55.023, and from transferring production tax credit certificates under AS 43.55.025

She explained that this provision is a little archaic, not affecting many entities. It stemmed from a municipal entity that has gas leases and interests and is in a position to be paying some costs in generating credits. However, it isn't subject to the production tax law in the first place. It's not in the game for the burden part, but potentially could be in the game for benefits. Thus this would level the playing field, saying that if there is no participation in paying tax, then there is no ability to monetize credits.

CHAIR HUGGINS asked which municipality this applies to.

MS. DAVIS said the Municipality of Anchorage is the one entity she knows of.

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MS. DAVIS jumped ahead to slide 38, relating to Cook Inlet, noting it was put in the wrong place, as a credit adjustment, but is actually a leasehold expenditure issue. The body of slide 38 read:

Clarifies that deductions arising from Cook Inlet operations must first be used up in Cook Inlet and may not be shielded by tax ceilings

- Consistent with existing regulations

She explained that this issue was found when writing the regulations. There is a right way to do it under the regulations, and all parties involved in Cook Inlet understand how it needs to be. But the statute wasn't clear. Thus this clarifies that when there are leasehold expenditure deductions relating to a Cook Inlet operation, those must be absorbed and used up to the PPT tax level, even though the ceiling is under ELF. It reduces the amount available as a "carry forward loss" for future years. The goal is not to have the ceiling escalate as to how much cost is available to carry forward; it needs to still track what would be allowed under PPT, even though that bill wouldn't be paid. So this is a cleanup, keeping it consistent with the regulations.

SENATOR WIELECHOWSKI highlighted capital investment credits. He recalled yesterday Dr. van Meurs had said that beyond the 20 percent capital investment credit there is, in his view, no need for further exploration incentives; he'd provided examples of the state paying 70, 80, or 90 percent of the cost of exploration. Senator Wielechowski also recalled hearing talk that if new gas wells are developed, the state gets nothing because so many credits would apply. He asked whether ACES corrects that in any way.

MS. DAVIS noted on Sunday Mr. Banks would address exploration credits and how ACES makes changes to either enhance or level the playing field for explorers. She turned to slides 36 and 37, "Credit Adjustments." Slide 37 read:

Eliminates Transitional Investment Expenditure (TIE) Credits

- Credits are based on expenditures from as far back as 2001 and are not transferable
- TIE credits are available only to incumbents and not new entrants

She clarified that this is the TIE credit in PPT. This allows producers who had leasehold expenditures - capital credits - five years prior to the passage of PPT to capture those past investments and to cast them forward as capital credits at a

rate of 20 percent of those each year, not to exceed 10 percent of the total tax bill.

MS. DAVIS recalled that Dr. van Meurs and perhaps Mr. Johnston had spoken about this yesterday. She said there are differing views. However, economists largely ask why state funds would be used that do not serve as an incentive. When these funds were spent, there was no expectation of credits. The state is trying to tighten it up and get more bang for its buck on things that actually yield a future benefit. The recommendation is that TIE credits be eliminated going forward.

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SENATOR STEDMAN recalled that the TIE credits were examined in several committees and that the department had been supportive of this and had worked through modeling exercises with the legislature. He asked whether the expectations in the modeling were fairly close to what has been claimed or whether there was some huge discrepancy.

MS. DAVIS responded that she'd get back to him on this. She opined that the state received about \$45 million in credit requests under this in the first year, but couldn't say whether it matched the forecast. In further response, she said if they get a breakdown for different areas, they'll provide it. But they don't always have that level of detail.

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SENATOR WAGONER asked whether the final PPT bill version last year retained a two-to-one on the "look back": to get a one-dollar credit, a company would have to expend two additional dollars.

MS. DAVIS affirmed that.

SENATOR STEDMAN asked whether there was any indication that this particular section had encouraged expansion and development to get the two-to-one.

MS. DAVIS said she'd take a look, but the department keeps coming up dry when asked whether it is increased spending or just higher costs. She surmised the answer wouldn't be found until books could be looked at and so forth.

[3:33:03 PM](#)

SENATOR STEDMAN asked whether a policy call must be made without numeric backup, then. Or are there numbers that aren't in the

state's best interests and thus the desire is to change the policy? He asked who is driving the train.

MS. DAVIS acknowledged these are good questions. She said even if there were precise numbers about capital expenditures, tying this to the motivation - whether or not a capital expenditure in a forward year is attributable to the TIE credit match or to the capital or exploration credit itself - would be difficult. Many elements in PPT and the ACES revisions were designed to motivate future investment. For the state to pick which it would be challenging. In response to Chair Huggins, she indicated DOR would bring a side-by-side comparison tomorrow. She pointed out that there is one other credit, not included in the slides.

CHAIR HUGGINS asked to hear Senator Wielechowski's questions first.

[3:34:29 PM](#)

SENATOR WIELECHOWSKI asked whether it is true, as stated by Dr. van Meurs yesterday, that the gas line is dead and uneconomic. He also asked whether ACES impacts construction of the gas line in any way. He suggested at some point Alaskans need a response.

MS. DAVIS replied that the administration wouldn't support the broad statement that Dr. van Meurs made regarding the gas line economics. It is hard to judge what he is comparing, although clearly he's looking at a line from Alaska through Alberta and Back East. She said the netbacks from Back East are some of the old data. It also ignores that the Alaska Gasline Inducement Act (AGIA) set up an application process designed to elicit applications not only from the North Slope to the Midwest, but also that could potentially be driving gas to Valdez for a liquefied natural gas (LNG) plant, for instance. There are various options.

MS. DAVIS said Dr. van Meurs' statement that North America's markets have changed ignores that Alaska's gas has more than the North American market. She cited the "hungry" market for LNG in Asia and other parts of the world. Ms. Davis expressed confidence that there'll be some interesting proposals, a variety of applications that reflect different markets and structures; those are expected by the end of November.

SENATOR WIELECHOWSKI asked whether ACES impacts AGIA or the gas line.

[3:36:48 PM](#)

MS. DAVIS answered that the focus in the bill is oil. The administration doesn't want to ask the legislature to change things in an air of speculation or hypotheticals. A lot more will be known in the next few years about a potential gas commercialization project. There'll be a much clearer view of how industry looks at the economics and who the state's competitors are worldwide. Although PPT and ACES both treat oil and gas the same, gas has some different economics. She predicted a directional change in the next few years that will be favorable to industry in terms of making the tax structure more facilitative of the process.

[3:38:44 PM](#)

CHAIR HUGGINS referred to slide 21 shown by Dr. van Meurs yesterday, recalling the following: He'd said the gas pipeline isn't economically feasible now, based on two variables, gas price risk and cost overruns; he'd mentioned about \$20 billion and that this had at least doubled; and he'd said "it's dead unless you liquefy the gas." Noting the state would spend huge amounts in pursuit of a gas pipeline, Chair Huggins expressed hope that people are working hard to ensure the state doesn't get blindsided and would consult with such experts. For example, what if there is an encouraging application and the state spends its money, but Dr. van Meurs was correct?

MS. DAVIS emphasized that before the state makes a monetary commitment, it will have to have been verified by state experts to be credible, realistic, and designed to provide a path to an economic project. This is part of the administration's obligation in making a presentation to the legislature when coming forward with a proposal believed to do that. At that point, the administration will have to show why it believes that application is credible and addresses precisely these risks relating to gas prices, cost overruns, and other market factors. These key questions must be addressed first.

[3:41:16 PM](#)

CHAIR HUGGINS pointed out that the administration's task, within a hundred and some days, is to choose somebody's application and then hand it to the legislature. It is a big task. He encouraged using all available assets, including Dr. van Meurs.

SENATOR WAGONER urged Chair Huggins to write to Dr. van Meurs on behalf of this committee, asking him to specify what pipeline he was talking about. For instance, was it a 52-inch pipeline from

the North Slope to Chicago, or a 48-inch pipeline from the North Slope to Alberta?

SENATOR STEDMAN related his understanding that under the AGIA process someone doesn't have to own gas reserves. The state could still issue the license to someone who has no gas to go in the line at all.

MS. DAVIS affirmed that.

SENATOR STEDMAN added to Senator Wagoner's point, suggesting the need for a conversation with the Legislative Budget & Audit Committee about having some further work done on that comment so it can be addressed during this special session.

[3:43:00 PM](#)

CHAIR HUGGINS noted they're viewing a snapshot today to look at the tax issue, but it cannot be done in a sterile environment. He suggested the department's task is to help bridge this through multiple years to ensure this is economically viable for the state.

MS. DAVIS returned attention to the final credit, saying it would be addressed further on Sunday when there is discussion of ACES and the structure of the different economic settings, including how it changes PPT. One slight change in the way credits are handled is the 10 percent gross-tax floor for legacy fields. One aspect is that capital credits that arise in those fields stay in those fields. Thus Prudhoe Bay and Kuparuk credits would stay within those two fields, although they could cross over. Otherwise, it defeats having a floor.

SENATOR STEDMAN requested that the side-by-side comparison, which Ms. Davis would try to provide tomorrow, address "ring fencing" and why it was excluded last time. He clarified that there had been discussions when looking at PPT and setting a tax rate as to whether particular areas such as Prudhoe Bay and Kuparuk should be treated differently from the rest of the oil basin, or whether everything should be aggregated to get an average calculation that would be easier to administer. He recalled there'd been some complexities with the ring fencing approach, although it would allow a tiered tax structure.

[3:45:54 PM](#)

MS. DAVIS acknowledged the request. Concluding the presentation on ACES, she advised members that tomorrow there would be discussion of Alaska's position in the global competition,

focusing on the net tax and the changes suggested with ACES, including how it positions Alaska to compete with other jurisdictions. Sunday there would be a look through the eyes of the industry with respect to how it views Alaska and the opportunities for reinvestment and new investment.

CHAIR HUGGINS thanked the participants. SB 2001 was held over.

There being no further business to come before the committee, Chair Huggins adjourned the Senate Resources Standing Committee meeting at [3:47:06 PM](#).