

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

April 7, 2010

1:05 p.m.

**MEMBERS PRESENT**

Representative Craig Johnson, Co-Chair  
Representative Mark Neuman, Co-Chair  
Representative Bryce Edgmon  
Representative Kurt Olson  
Representative Paul Seaton  
Representative Peggy Wilson  
Representative David Guttenberg  
Representative Scott Kawasaki  
Representative Chris Tuck

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Representative Nancy Dahlstrom

**COMMITTEE CALENDAR**

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 305(FIN)(TITLE AM)

"An Act providing that the tax rate applicable to the production of oil as the average on oil and gas production for appropriation to the community revenue sharing fund; production tax value of oil, gas produced in the Cook Inlet sedimentary basin, and gas relating to the allocation of lease expenditures and adjustments to lease expenditures; produced outside of the Cook Inlet sedimentary basin and used in the state increases and providing for an effective date."

- HEARD & HELD

HOUSE BILL NO. 337

"An Act relating to interest on certain underpayments or overpayments for the oil and gas production tax, to certificates for certain oil and gas production tax credits for qualified capital expenditures, and to alternative tax credits for expenditures for certain oil and gas development and exploration activities for the oil and gas production tax; relating to the

use of the oil and gas tax credit fund to purchase certain tax credit certificates; and providing for an effective date."

- MOVED CSHB 337(RES) OUT OF COMMITTEE

HOUSE BILL NO. 332

"An Act providing income tax credits for geothermal resource exploration and development."

- BILL HEARING CANCELED

HOUSE BILL NO. 411

"An Act providing income tax credits for geothermal resource exploration and development."

- SCHEDULED BUT NOT HEARD

HOUSE BILL NO. 320

"An Act removing the royalty obligation for geothermal resources."

- WAIVED HB 320 OUT OF COMMITTEE

#### **PREVIOUS COMMITTEE ACTION**

BILL: SB 305

SHORT TITLE: SEPARATE OIL & GAS PROD. TAX/ DEDUCTIONS

SPONSOR(s): FINANCE

03/08/10	(S)	READ THE FIRST TIME - REFERRALS
03/08/10	(S)	FIN
03/09/10	(S)	FIN AT 9:00 AM SENATE FINANCE 532
03/09/10	(S)	Heard & Held
03/09/10	(S)	MINUTE(FIN)
03/10/10	(S)	FIN AT 9:00 AM SENATE FINANCE 532
03/10/10	(S)	<Bill Hearing Canceled>
03/11/10	(S)	FIN AT 9:00 AM SENATE FINANCE 532
03/11/10	(S)	-- MEETING CANCELED --
03/12/10	(S)	FIN AT 9:00 AM SENATE FINANCE 532
03/12/10	(S)	Heard & Held
03/12/10	(S)	MINUTE(FIN)
03/18/10	(S)	FIN AT 3:00 PM SENATE FINANCE 532
03/29/10	(S)	FIN AT 9:00 AM SENATE FINANCE 532
03/29/10	(S)	<Bill Hearing Postponed>
03/31/10	(S)	FIN RPT CS 6DP 1AM NEW TITLE
03/31/10	(S)	DP: HOFFMAN, STEDMAN, THOMAS, EGAN, OLSON, ELLIS

03/31/10 (S) AM: HUGGINS  
 03/31/10 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/31/10 (S) Moved CSSB 305(FIN) Out of Committee  
 03/31/10 (S) MINUTE(FIN)  
 04/01/10 (S) TRANSMITTED TO (H)  
 04/01/10 (S) VERSION: CSSB 305(FIN)(TITLE AM)  
 04/05/10 (H) READ THE FIRST TIME - REFERRALS  
 04/05/10 (H) RES, FIN  
 04/07/10 (H) RES AT 1:00 PM BARNES 124

BILL: HB 337

SHORT TITLE: OIL AND GAS PROD. TAX: CREDITS/INTEREST  
 SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

02/10/10 (H) READ THE FIRST TIME - REFERRALS  
 02/10/10 (H) RES, FIN  
 03/10/10 (H) RES AT 1:00 PM BARNES 124  
 03/10/10 (H) Heard & Held  
 03/10/10 (H) MINUTE(RES)  
 03/27/10 (H) RES AT 10:00 AM BARNES 124  
 03/27/10 (H) Heard & Held  
 03/27/10 (H) MINUTE(RES)  
 03/29/10 (H) RES AT 1:00 PM BARNES 124  
 03/29/10 (H) Heard & Held  
 03/29/10 (H) MINUTE(RES)  
 03/31/10 (H) RES AT 1:00 PM BARNES 124  
 03/31/10 (H) <Bill Hearing Canceled>  
 04/07/10 (H) RES AT 1:00 PM BARNES 124

BILL: HB 320

SHORT TITLE: NO ROYALTY ON GEOTHERMAL RESOURCE  
 SPONSOR(s): REPRESENTATIVE(s) MILLETT

01/29/10 (H) READ THE FIRST TIME - REFERRALS  
 01/29/10 (H) RES, FIN  
 04/07/10 (H) RES REFERRAL WAIVED  
 04/07/10 (H) RES AT 1:00 PM BARNES 124

**WITNESS REGISTER**

MILES BAKER, Staff  
 Senator Bert Stedman  
 Alaska State Legislature  
 Juneau, Alaska

**POSITION STATEMENT:** Introduced SB 305 on behalf of the Senate Finance Committee, sponsor.

PATRICK GALVIN, Commissioner  
Department of Revenue (DOR)  
Juneau, Alaska

**POSITION STATEMENT:** Testified during the hearings on SB 305 and HB 337.

SENATOR BERT STEDMAN  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Provided background on the history of SB 305 on behalf of the Senate Finance Committee, sponsor.

SENATOR JOE PASKVAN  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Discussed SB 305.

#### **ACTION NARRATIVE**

[1:11:32 PM](#)

**CO-CHAIR MARK NEUMAN** called the House Resources Standing Committee meeting to order at 1:05 p.m. Representatives Neuman, Guttenberg, Olson, Johnson, Tuck, Seaton, Kawasaki, and Peggy Wilson were present at the call to order. Representative Edgmon arrived as the meeting was in progress.

#### **SB 305-SEPARATE OIL & GAS PROD. TAX/ DEDUCTIONS**

[1:12:06 PM](#)

CO-CHAIR NEUMAN announced that the first order of business would be SENATE BILL NO. 305, "An Act relating to the tax on oil and gas production; and providing for an effective date." [Before the committee was CSSB 305(FIN).]

[1:12:55 PM](#)

CO-CHAIR JOHNSON announced that amendments on the bill must be submitted by 4/8/10 in order to be introduced on 4/9/10. He said the schedule for the meeting would be to recess at 3:00 p.m. and return to a call of the chair to hear HB 337.

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MILES BAKER, Staff to Senator Bert Stedman, Alaska State Legislature, introduced SB 305 on behalf of the Senate Finance

Committee, sponsor. He stated that the current tax rate of oil and gas activities is based on the combined British thermal unit (Btu) value of oil and gas. However, oil and gas can have vastly different values on a Btu basis. The current structure, in conjunction with the uncertainty of future prices, exposes the state to significant financial risk under a major gas sale. In addition, this structure creates economic instability for any entity that chooses to participate in the development or financing of a natural gas pipeline in Alaska. Senate Bill 305 separates oil and natural gas for the purpose of calculating the progressivity portion of the production tax under AS 43.55. The intent of the bill is for progressivity surcharges for oil and Cook Inlet and in-state gas to be calculated together - but distinctly separate from export gas - instead of the current practice where oil and gas are combined. However, the progressivity mechanism is unchanged, and remains based on 0.4 percent of the production value that exceeds \$30 per barrel of oil, and \$30 per Btu barrel equivalent for gas. Furthermore, the base tax rate is unchanged at 25 percent of production tax value. Mr. Baker gave a description of the effect of the bill by saying it is "kind of creating two separate 'buckets' that we use to do our progressivity calculation. Instead of having one state-wide progressivity calculation, we would have two ... the first would be based on oil, Cook Inlet gas, and other in-state gas with the progressivity calculated together, and the non-Cook Inlet gas used in state would be treated as it is now."

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MR. BAKER continued to explain that the reason for this change is because there is some gas being produced in the state and the lower value of that gas is combined with the higher valued oil, and that brings down the value of the revenue to the state. The bill, by splitting out oil and gas, would preclude producers of gas to use that "dilution" against their oil tax liability. Mr. Baker clarified that the intent of the bill is not to create an additional tax liability, but the estimated cost of the dilution effect ranges from \$40 million to \$170 million per year. Thus, the state is currently giving up anywhere from \$50 million to \$200 million a year. Again, splitting oil and gas directly represents a tax increase, but this mechanism will separate the two for the purpose of a future major gas sale, and not have the impact affect the current minimal in-state gas use. Therefore, the two buckets allow for the dilution effect for current in-state gas, and for a separate calculation in the event of a major gas sale, or for export gas.

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CO-CHAIR NEUMAN asked whether the effect on state general fund revenue is about \$2 billion.

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MR. BAKER, in response, called attention to the document provided in the committee packet titled, "SB 305: The Separation of Oil from Gas for the Oil & Gas Production Tax," from Logsdon & Associates, and dated 4/7/10. He said the chart on page 13 shows oil and gas price parity relationships, and that the \$2 billion figure shown in scenario 3 is based on a \$120 oil price and an \$8 gas price, which is a parity that is equivalent to current prices, and what the U.S. Department of Energy (DOE) projects for the time period at the beginning of production from a gas pipeline. Therefore, with a \$120 price of oil and an \$8 price of gas parity, under the current tax structure and without the separation of how progressivity is calculated, the annual tax reduction from combining oil and gas is estimated to be \$2 billion.

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REPRESENTATIVE SEATON observed the estimate on page 13 assumes that gas is taxed separately at 25 percent plus progressivity to generate \$1.1 billion in tax revenue. He asked whether the sponsor has confidence that this tax rate would produce a gas pipeline.

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MR. BAKER asked for the question to be restated.

[1:23:29 PM](#)

REPRESENTATIVE SEATON restated his question, and added, "Did the sponsor ... the Senate Finance Committee, believe that it was in the realm of possibility that we would get a gas line at 25 percent profits tax plus progressivity?" He agreed that there is a discrepancy in numbers; however, most of the testimony heard by the committee asserts that those numbers are based on a tax rate that would never produce a gas pipeline.

[1:24:43 PM](#)

MR. BAKER recognized that with the price parity projections, there is concern that by going into an open season negotiation with the current tax structure, there would be a negative tax rate on Alaska's gas. He opined the sponsor feels that, at the minimum, the tax should be zero, and that the state should not go into negotiations "starting that far behind the power curve." Furthermore, it was also recognized that the gas progressivity structure, if left the same and affected by rates, slopes, and triggers, was all "set up on oil, those were never conceived to be the potentially proper progressivity mechanism that you would want if you were going to tax your gas separately." Thus the sponsor realized that all of those factors have to be on the table for negotiation under the terms of a conditional open season. In fact, royalty rates, progressivity, and all of Alaska's tax structure would be part of what would be negotiated. He concluded that splitting oil and gas results in a tax structure that does not work well for gas, however, this action acknowledges the state's intent to treat oil and gas separately for the first time.

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CO-CHAIR NEUMAN, noting the approaching open season, recalled that one of the inducements of the Alaska Gasline Inducement Act (AGIA) was to lock in the tax rate for up to 10 years. He questioned the wisdom of locking in the present tax rate when it would have a negative impact on general fund revenues. In addition, he opined the bill does not change tax structure, but looks at oil taxes and gas taxes differently as they are both energy producing components that are treated differently on the world market, and have different values.

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CO-CHAIR JOHNSON referred to the previous presentation of these estimates and pointed out that the \$2 billion estimate was not a prediction, but a number "carried out to a worst case scenario, and somewhere in between zero, and this number, is what we're basically gambling." He stressed that testimony by consultants on the related House bill was identical and the estimates were used illustratively.

[1:29:57 PM](#)

REPRESENTATIVE GUTTENBERG asked whether the Senate Finance Committee explored any scenarios or alternatives that create a

floor, "so that it would never go below that rate, on either side, or both, or a combination [there]of."

[1:31:13 PM](#)

MR. BAKER related that the Joint Committee on Legislative Budget and Audit (JBUD) hired Dr. David Wood, David Wood & Associates, United Kingdom, to create a robust model of Alaska's tax structure, taking into consideration all of the variables and unknowns. This model has been presented to other legislative committees; and in fact, the first point of his analysis was that Alaska's coupled tax structure is fundamentally flawed. Furthermore, the analysis indicated that there are many incentives used to encourage production, and Alaska must address the decoupling issue and regressive taxes, such as property taxes and royalty taxes, that are "built-in at the base level of their business." Although Dr. Wood could address the mechanics of the tax structure at the legislature's request, Mr. Baker opined that the sponsor of the bill decided "to tackle the decoupling."

[1:35:24 PM](#)

PATRICK GALVIN, Commissioner, Department of Revenue (DOR), informed the committee the decoupling issue is complex with many aspects to explore. He advised that his presentation is from "a very high level [and I] tried to boil down what I see as the issues, the policy issues, that are presented by this bill." In addition, significant analysis has been done this session, and the presentation attempts to cover the key points relative to the legislature's decision-making process.

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CO-CHAIR NEUMAN asked whether this is an issue of which the department is aware.

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COMMISSIONER GALVIN said yes. The "dilution effect" was built into the system as an intended result of the "net base tax system with the progressivity element." In fact, the department testified in 2007 as to its impact on incentives for heavy oil development and the gas project. Furthermore, in January 2008, the department cautioned that revenue from a gas line, based on prices then, would result in a reduction of oil taxes of about \$1 billion per year; in other words, that was presented as an

incentive for gas line development. Since then, oil and gas prices have caused the projection of the dilution effect to be much greater than anticipated, and the department now recognizes that there are significant advantages, in terms of the state's fiscal policy, of having the combination of oil and gas working together. Commissioner Galvin acknowledged, however, that there are extreme situations concerning the price differential between oil and gas that need to be addressed, hence the decoupling solution. Although there are less extreme ways to address the situation, such as a minimum tax mechanism, the Senate Finance Committee pursued decoupling, thus DOR has completed additional analysis of SB 305.

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COMMISSIONER GALVIN continued to explain that his testimony today will provide a context in which to look at the decoupling issue, clarify where the state currently is in the gas line development process, and examine expectations for the next few years. Open season for the Alaska Pipeline Project (APP) begins April 30, and Denali - The Alaska Gas Pipeline (Denali) submitted its plan to the Federal Energy Regulatory Commission (FEC) today. The open seasons will go through the summer, and negotiations on agreements will continue through this year.

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REPRESENTATIVE GUTTENBERG surmised the only decoupling issue facing the state now is with AGIA and not the Denali project.

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COMMISSIONER GALVIN clarified that the decoupling bill will affect the economics of either project because it will become the law of the land. He agreed, however, that the tax inducement in AGIA is not available for the Denali project.

REPRESENTATIVE GUTTENBERG confirmed that decoupling changes the state's tax law for all projects.

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CO-CHAIR NEUMAN asked how decoupling changes the tax structure.

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COMMISSIONER GALVIN explained that the current system combines oil and gas and taxes them as a whole because oil and gas are produced together. In contrast, wood and coal have energy value, but they are not produced with oil. However, oil and gas come out together, and if the state is going to have separate systems to tax them, then the state's current tax system must be changed, and SB 305 takes half of the calculation - revenue, less cost, equal profit - and splits those costs in a way yet to be determined. The result will be different economics for oil, for gas, and for the taxes on the underlying profits. Commissioner Galvin observed, "Regardless of whether the rate, the progressivity rate, the kick-off rate for progressivity, are changed, the fact of the matter is, we're going to end up with a different tax system for oil than we have now, [and a] different tax system for gas than we have now."

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CO-CHAIR NEUMAN opined that is the intent of the bill.

COMMISSIONER GALVIN agreed.

CO-CHAIR NEUMAN pointed out other gas and gas line developments that are underway.

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COMMISSIONER GALVIN returned to upcoming events related to the gas line projects and advised that the department is looking at precedent agreements, full commitments from shippers, sanctioning the project, and entering into transportation services agreements, all effective around 2014. Between now and then there will be ongoing discussions about project economics, the cash flow needed by producers, and the relative risks the state is willing to bear. At the conclusion of these discussions will be agreement on the amount of fiscal predictability that the producers are going to need to make commitments. He disagreed with the initial premise that the state's "take," including property taxes and royalty rates, is up for negotiation. Conversely, Commissioner Galvin expressed his belief that "fiscal certainty, fiscal predictability is something that the producers have clearly stated they require." However, the department looked at the economics of the project, in terms of cash flow, and believes that under the state's current system, as of now, there is adequate cash flow to the producers. He stressed that the state's position should be one

of not conceding the question of whether a change in the state's cash flow is required.

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CO-CHAIR NEUMAN recalled that one of the inducements under AGIA is that a participant in the first open season gets a "lock-in on your tax rate."

COMMISSIONER GALVIN clarified that the applicable rate is on the gas production tax.

CO-CHAIR NEUMAN said his point is that the state may make full commitments for shipping gas until 2014 at a locked-in rate, but continue to change rates for the fiscal predictability that the producers need.

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COMMISSIONER GALVIN explained that AGIA legislation assures a 10-year fiscal certainty aspect to gas production taxes; however, producers have consistently said 10 years is not long enough, and there is still uncertainty. Regardless of whether producers qualify for the AGIA inducement, he said he expects producers will ask for more durability and predictability after the open season. The question remains about how flexible the state will be in terms of its negotiation position.

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CO-CHAIR NEUMAN noted the Commissioner's reference to assumptions and stated his concern is with the law as it stands today.

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COMMISSIONER GALVIN said he was not contradicting current law at all.

[1:51:01 PM](#)

REPRESENTATIVE SEATON expressed his belief that Alaska's Clear and Equitable Share (ACES) inducement for gas was the difference between the tax rate during the first open season and what was subsequently negotiated.

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COMMISSIONER GALVIN advised that the inducement is the gas production tax obligation not the tax rate, but the obligation under the current system that sets the ceiling. He said, "Whatever the obligation, the gas production tax obligation that's under the current system in place, is what sets the ceiling."

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COMMISSIONER GALVIN, in response to Representative Guttenberg, said he would explain the difference between the rate and the obligation later in his testimony. He then turned to the subject of the primary considerations of today, and said that there will be a period of uncertainty during open season when there will be ongoing discussions in regard to the state's fiscal system, and what needs to be in place for the long-term. For example, if the state's interest can be protected during this period by achieving a gas pipeline, and by securing an appropriate share of revenue from oil and gas production once a gas pipeline is in place. On this issue there are two considerations: 1. whether our fiscal system is attractive enough to get a gas pipeline project; 2. whether the potentially locked-in portion of the fiscal system is set at an acceptable level for the state. To address these considerations, Commissioner Galvin said the department modeled the provisions of SB 305, in comparison to the status quo, using broad and varied comparisons from an oil price range of \$40 to \$200 per barrel and a gas price parity range of \$6 to \$26. The model also assumed oil production of 500 thousand barrels of oil per day (500 MMbbl/d); a 4.5 billion cubic feet per day (Bcf/d) gas pipeline; operating expenses (OPEX) of \$2.2 billion; capital expenses (CAPEX) of \$2.2 billion.

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COMMISSIONER GALVIN displayed a PowerPoint presentation by the Alaska Department of Revenue titled, "Comments on CSSB 305(FIN)," and dated 4/7/10. Slide 5 titled, "In all of the Cases Run: CSSB305(FIN) Results in a Lower "Locked-in" Gas Tax Obligation," illustrated two buckets, one of taxes defined by the bill and one of the status quo. Because the bill does not set a cost allocation, there are a variety of cost allocation methods that can be used by the model, such as an individual basis, or formulas using a Btu barrel equivalent (BOE) basis or a point of production (PoP) basis. He described some of these

methods and cautioned that "you get two different numbers, wildly different numbers, and we'll show you that."

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CO-CHAIR NEUMAN asked the commissioner to identify the colored areas on the slide. He then observed that the problem with Btu equivalents is that not all oil and gas are the same; in fact, there is a tremendous variation depending on the presence of natural gas liquids. To try to base the model on a Btu equivalent simply using "60 percent of your costs for gas, 40 percent for oil, well that gas could be so much different ... that's the issue I've always had with Btu equivalent.... I don't think it's an appropriate way to do it."

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COMMISSIONER GALVIN explained that if the gas stream is broken down into its Btu equivalents, more value is given to gas that has liquids in it, when compared to other gas, and it will take less of it to equate to one barrel of oil. This is a method that allows one to recognize that there is a difference in value and quality that can be set on a volume basis. On the other hand, the PoP value method can be used, which is based on the dollar value of the commodity itself. He advised that different cost allocation methods are used for analysis and because the bill does not specify which cost allocation method is to be used, the department has "no magic that I'm going to come up with, through a [regulatory] process that's going to somehow, empirically come up with one. But if you don't like Btu basis ... then it would be best to have that in the statute."

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CO-CHAIR NEUMAN restated his point that the department is using Btu equivalencies that are based on a percentage of gas and oil out of a well, in volume, yet the Btu values are different across just about every oil and gas field.

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COMMISSIONER GALVIN assured the committee that the Btu value is established based upon the quality of the product; however, he acknowledged that at this time, there is a cause for confusion during his presentation when he gives examples and assumptions. He returned to slide 5 and noted that the assumption, for the purpose of the model, is that the cost allocation would either

be on a BOE or a PoP basis, simply to make the presentation of the results of the model easier.

2:04:17 PM

REPRESENTATIVE P. WILSON observed that the PoP is the net after the tariff and asked, "Is that counting upstream or ... upstream and downstream, or just downstream?"

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COMMISSIONER GALVIN said for a gas pipeline, it includes the gas treatment plant, the main pipeline, and smaller pipelines to the market. Those are the only costs being deducted from the sales price to establish the PoP value. Gathering lines, processing plants, and wells are the costs that must be allocated; thus it needs to be determined which of the upstream costs are being incurred to produce both oil and gas, and how much will be deducted from oil revenue and how much will be deducted from gas revenue. Therefore, for a point of production basis, the percentages of the value of the gas and the value of the oil determine the way the costs are split. He stressed that this is not what the tax is based on, but these are the two methods being used in the model.

COMMISSIONER GALVIN, in response to Co-Chair Neuman's earlier question, said that on slide 5 the bar identified as CSSB305(FIN) is the separate gas tax and the separate oil tax, using the same tax rates that are in current law. The taxes are illustrated as separate because the bill calculates the taxes separately. To do that, the costs must also be separated, and the cost allocation will make the adjustment. Slides 5, 6, and 7 do not use numbers, but merely compare the relative size of the bars.

2:07:46 PM

COMMISSIONER GALVIN stated the right hand bar represents the status quo under the current combined tax system, and there is no separate gas portion or oil portion. However, because of the AGIA tax inducement, the department had to come up with a way to derive the gas production tax obligation so it could be compared to some future law that may be in place. In fact, in the present regulations, there is a method to attribute current production tax obligations between oil and gas, so the gas production tax can be established for AGIA tax inducement purposes. Therefore, slide 5 shows that for all of the

different price relationships, the gas tax being locked-in without changes is always higher than the tax set by the passage of the proposed decoupling statute.

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COMMISSIONER GALVIN, in response to Co-Chair Neuman, said the current system, under ACES, is the combined production tax that results in a single number for oil and gas together, that the producer owes to the state. For example, an oil and gas producer has a gas line, prepares its taxes, and determines its tax obligation to the state is \$5 billion. The department, under current regulation, uses the relative PoP value, and determines how much is the oil portion and how much is the gas portion. Thus the \$5 billion may be divided into \$2 billion for gas and \$3 billion for oil. In the same example, if oil and gas are separated and calculated differently, the gas tax portion will be less than \$2 billion in every price comparison.

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COMMISSIONER GALVIN continued to slide 6 titled, "In All of the Cases Run: CSSB305(FIN) Raises Oil Taxes," and pointed out that in all of the models that were run, the separate oil tax under the proposed decoupled law is larger than the attributed oil tax under the status quo. Furthermore, in 90 percent of the cases the combined tax obligation of separate oil and separate gas is larger than when the two are combined under the status quo. It is important to understand that while the overall state revenue is increased by separation, the portion that is "fixed" by the AGIA open season is always lower under SB 305 than under the status quo.

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CO-CHAIR NEUMAN asked whether the regulations are written yet.

COMMISSIONER GALVIN said the regulations are final.

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CO-CHAIR NEUMAN surmised that the regulations are final on evaluating PoP, yet Btu values are different. He asked whether the regulations tell industry and the department how to tax those different rates and volumes, based upon Btu equivalents at the PoP.

COMMISSIONER GALVIN said yes.

2:15:03 PM

CO-CHAIR NEUMAN asked for examples from different fields for comparison. In response to Commissioner Galvin's request for clarification, he remarked:

You have your point of production ... at the meter ... the point of production, and then your value of that is based on market values, so you've got that point of production value. Then, because the Btu equivalents are different between different oil and gas fields ... that produce both oil and gas, and because those Btu values are so much different between each one of those wells, what I'd like to see is a chart that talks about ... the Btu value...

COMMISSIONER GALVIN agreed to provide information on potential oil and gas mixes, the potential heat value of the gasses, and the calculation method for establishing that value.

2:16:30 PM

CO-CHAIR NEUMAN observed that the Gubik field has a lot of methane, and so has a very low Btu value, but possibly high levels of gas. Therefore, the low Btu value would be a disincentive to exploration. Co-Chair Neuman said this subject would be discussed at another time.

2:17:46 PM

REPRESENTATIVE P. WILSON understood Commissioner Galvin to be saying that if gas and oil taxes are separated, the state would make more money because it would make more on oil.

COMMISSIONER GALVIN agreed. He referred back to page 13 of the presentation by Logsdon & Associates, and pointed out that the gas is not being taxed differently, but that the oil is getting the full brunt of the tax against it. He said, "The oil is paying full progressivity at that price and it's not getting the benefit of the gas reducing the progressivity against the oil tax." In fact, by decoupling, the state is increasing the oil tax. He opined this change is not necessarily wrong, but that is "the mechanics of it." In addition, he clarified that the part being locked-in at open season is not the "so-called \$2 billion loss", but is the gas production tax obligation.

CO-CHAIR NEUMAN observed that is the dispute with the numbers.

COMMISSIONER GALVIN stated the legislature's economists are not disputing his statements - they have yet to testify on this.

[2:21:09 PM](#)

REPRESENTATIVE SEATON also referred to page 13 of the report by Logsdon & Associates, and asked whether the amount attributed to gas tax is higher because of the way the regulations read regarding the PoP value. In all of the scenarios, the gas alone tax is \$1.1 billion.

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COMMISSIONER GALVIN said yes, and added that if the numbers from page 13 are projected onto slide 5, at a \$120 oil price and an \$8 gas price, the separate oil tax (green) section of the left bar would be \$6.4 billion and the separate gas tax (red) section would be \$1.1 billion. The red and green sections combined would be \$7.5 billion. The bar on the right would be \$5.5 billion in total size, as the regulations take that \$5.5 billion and divide it between oil and gas; in fact, he estimated that the red section would be \$1.2 billion and the green section would be \$4.3 billion.

[2:23:32 PM](#)

CO-CHAIR NEUMAN noted some of these comparisons are shown on subsequent slides.

[2:23:50 PM](#)

COMMISSIONER GALVIN directed attention to slide 8, titled "Example Cases," and indicated that estimates on page 13 of the Logsdon & Associates report are based on splitting costs by 90 percent to oil and 10 percent to gas (90:10). He stated that this ratio represents "an extreme allocation that does not reflect either point of production or a BOE equivalent basis." He further explained that of the illustrated four graphs, the first being a BOE cost allocation at \$120 oil and \$8 gas, which is a 15:1 price relationship. The second was a PoP cost allocation at 15:1. The third graph was a BOE cost allocation at \$120 oil and \$15 gas, which is an 8:1 price relationship. The fourth was a PoP cost allocation at 8:1. The first graph also illustrates a total tax difference of about \$3 billion to

the state, exclusively because the oil tax is almost double. The attributed gas portion under the status quo is \$1.2 billion, but the separate gas tax is less, and that is the portion that would be locked-in at open season.

[2:26:54 PM](#)

COMMISSIONER GALVIN pointed out the second graph that illustrated the PoP method of cost allocation, and said that in this case, \$600 million in total state tax revenue is lost, oil is reduced to \$7 billion, and gas increases to \$900 million. Thus, the results of the proposed bill are dependent on the regulations, but regardless of which, the gas tax generated is less.

[2:28:05 PM](#)

CO-CHAIR NEUMAN said he thinks that is what the bill sponsor is trying to show.

COMMISSIONER GALVIN agreed it is a significant tax increase.

CO-CHAIR NEUMAN recognized the different values of PoP and BOE.

[2:28:39 PM](#)

REPRESENTATIVE SEATON observed that regardless of the scenario, if the tax is decoupled the amount of gas tax is going to be less than the amount attributed to gas. Therefore, the state would lock-in at open season a smaller amount of gas tax than under either allocation scheme under AGIA.

COMMISSIONER GALVIN said yes.

[2:29:57 PM](#)

REPRESENTATIVE P. WILSON opined decoupling would raise the oil tax.

COMMISSIONER GALVIN agreed.

[2:30:22 PM](#)

REPRESENTATIVE SEATON interjected that the significant action is that the state would be raising the oil tax but lessening the gas tax and, at open season, under AGIA, guaranteeing that the companies will have the tax liability on gas as the law exists

at that time; thus the tax attributable to gas under the combined status is higher, and if separated, there is a lower tax liability.

COMMISSIONER GALVIN said yes.

[2:31:14 PM](#)

CO-CHAIR NEUMAN indicated that the regulations do not take into account "higher oil tax productions."

[2:31:49 PM](#)

COMMISSIONER GALVIN clarified that the aforementioned regulations deal with attributing the current tax obligation for the purposes of the AGIA tax inducement. The department has produced a book on how to value the gas and oil, and what the tax value is; however, the department has not produced regulations that put in place a cost allocation method for all oil and gas, which the bill requires it to do.

[2:33:08 PM](#)

COMMISSIONER GALVIN directed attention to slide 9 titled, "Observations," and stated that CSSB 305(FIN) increases oil taxes, and in almost all cases increases total oil and gas taxes. It provides a higher starting point for further discussions with producers; however, it negatively affects projected gas pipeline economics. In addition, it would lock in a lower gas tax ceiling, which enhances the value of the AGIA tax inducement, but reduces the state's flexibility after open season. He then advised that the bill could be passed after open season without conflicting with the AGIA tax inducement.

[2:35:16 PM](#)

The committee took an at-ease from 2:35 p.m. to 2:36 p.m.

[2:36:23 PM](#)

SENATOR BERT STEDMAN, Alaska State Legislature, said he has not had an opportunity to review the presentation by the DOR. He noted that over the last three months there has been concern about the potential of a cross-subsidy at the time of the first large gas flow from Alaska's oil and gas basin. About two years ago, the Joint Committee on Legislative Budget and Audit hired Dr. Wood to study the issue of the tax structure within the oil

basin, and to consult with the legislature. Senator Stedman said the concern of some legislators was about the way the oil tax is structured. In fact, during the discussion about the Petroleum Production Tax (PPT), legislators took the discussion of gas off of the table and concentrated on the oil tax, eventually transitioning from the Economic Limit Factor (ELF) to PPT, and then to ACES. At the time PPT was written, former Governor Murkowski was adamant that progressivity was not to be included in the tax. However, during the development of ACES, the legislature included a component of PPT which was the multiplier Btu equivalency that is part of the tax structure today. As a matter of fact, the legislature has never taken a policy position on the gas tax itself and as the state approached open season, there was interest in discussing three issues of a gas tax: the subject of HB 305, the gas tax level, and progressivity on gas. The legislature, administration, and the industry agreed that sufficient information was not available at that time to develop legislation on the base gas tax, or on progressivity. However, one component remains in the current tax legislation.

[2:40:54 PM](#)

SENATOR STEDMAN further recalled that early in 2010, Mr. Tony Palmer, vice-president for Alaska gas development, TransCanada, Alberta, Canada, gave a presentation to the legislature regarding open season and revealed a range of tariffs and forward price expectations for oil and gas from the DOE for 2020-2030. The tariffs and price expectations were entered into a model, and the offset to the state's gas revenue "actually took out the royalties and then removed part of the revenue off of oil." Senator Stedman then had Dr. Wood complete more detailed analyses that showed the state would be facing a significant revenue offset and basically giving away its gas revenue, when the price ratio between gas and oil spreads. Historically, the price ratio has been between 8:1-10:1, but the state's tax structure is based on energy equivalency, about 6:1, thus if the price of gas and oil is in the range of 8:1 with oil being more valuable, the state is "relatively comfortable." However, in the last three years the ratio has been 14:1-20:1, and there are significant revenue offsets at 15:1. Today, DOE expectations are 15:1-17:1, and Dr. Wood can provide projections on how this would have affected the state's treasury.

[2:43:51 PM](#)

SENATOR STEDMAN expressed his belief that the ratio staying around 15:1 versus around 8:1 is more probable. Clearly, DOE forecasts and expectations are in the higher range; therefore, the state's position is unknown. At the time of the "open season lock-down day on May 1," the state will still have the ability to decouple, but the impact or flexibility from that action is substantially higher today because under AGIA, the flexibility surrounding the gas tax is lost. He maintained this is the cause for urgency and it is in the state's best interest to negotiate with two separate revenue streams. In addition, Dr. Wood has modeled the ability for the state to predict outcomes, and illustrated that when the price multiple is moved from 8:1-9:1 to 15:1-20:1, there are huge changes in cash flow resulting in significant financial damage to the state; in fact, when oil volumes are removed predictions become almost impossible.

[2:46:38 PM](#)

SENATOR STEDMAN opined members of the legislature did not recognize the magnitude of the state's possible loss, of around \$2 billion, when the ratio is 15:1. He argued that the probability of an outcome that is not in the state's interest is substantially higher than the other way around. Furthermore, the dynamics of a global market for shale gas and liquefied natural gas (LNG) arise as Alaska is "locked-in a position, under AGIA, where we can't, we don't have the flexibility." Senator Paskvan, who did not experience the PPT, ACES, and AGIA processes, was asked to help look at the legal aspects of this matter because, as Senator Stedman said, "Frankly, I'm very confident, that what's going on here is a world-class petro dollar shell game being played on the State of Alaska, there's actually no doubt in my mind." He cautioned that the legislature will be provided with charts, formulas, and regulations, but the fiscal regime of every hydrocarbon basin in the world comes down to the amount of cash flow to the industry and the sovereign - the state and federal government - and urged the committee to watch the cash flow.

[2:49:40 PM](#)

SENATOR STEDMAN provided the example of today's multiple of 20:1, which are an \$85 oil price and a \$4 gas price. Thirty days after the gas is turned on, he predicted DOR would report no increase in revenue, that no revenue was made from the gas, and that the oil revenue has declined. Nowhere else in the world is hydrocarbon given away; in fact, troubled basins are

incentivized through tax relief, royalty relief, and perhaps progressivity, but the hydrocarbon is not given away. Senator Stedman concluded that after all of the analyses, the answer is found in the cash. The bill is not an incentive for the industry and will not affect open season, but it will affect the state's ability to protect its revenue stream from the marketing of its gas.

[2:51:54 PM](#)

CO-CHAIR NEUMAN referred to the variance in differentials over time and pointed out that the ratio in 1982 was 20:1. He asked for the effect of present-day competition, pointing out that was not an issue for energy in the '80s. Today there is financial support from the government for hydro, solar, and wind energy; in fact, the world has changed, and the market in America has changed.

[2:53:45 PM](#)

SENATOR JOE PASKVAN, Alaska State Legislature, addressing the previous point regarding the difference between the price of the commodity and the Btu equivalency, said historically there is deviation from the 6:1 benchmark. He questioned what magnitude of risk that would make to the state, considering that the DOE forecasts a ratio of 14:1-18:1 for 100 percent of the time into the future. He advised that at 12:1 the production tax is eliminated, at 15:1 the royalty revenue is eliminated, and at 20:1 savings would be used to export the resource. Senator Paskvan said he reviewed this situation, "looking at it through the legal eyes," and his alert to the attorney general instigated almost \$1 million in research by the department of law (DOL). This is important, not because of the cost to the state, but because it is an indication that this is an extremely complex legal issue of "first impression" to the state, and holds significant legal risk. Therefore, the only answer would come at a time in the future when Alaska is being sued, billions of dollars are at risk, and the state is waiting for a decision from the Alaska Supreme Court. Senator Paskvan opined action can be taken before May 1 with zero legal risk, but after May 1, the attorney general has advised any action is subject to legal issues. He observed that Alaska has two world-class resources, oil and natural gas, and each resource should be addressed on its own merits; for example, the gas pipeline should stand alone, and decoupling now allows that to occur without the effect of dilution on the state's treasury. Senator Paskvan

concluded that this is not a Republican or Democratic issue, but an action to protect the state's treasury and cash flow.

[2:58:24 PM](#)

CO-CHAIR NEUMAN asked for Senator Stedman's opinion on taxing for value based on Btu equivalent.

[2:58:51 PM](#)

SENATOR STEDMAN responded that cost allocation is a difficult section of the bill due to its importance to cash flow between the state, the industry, and the federal government. There were two constraints when dealing with the issue of cost allocation: the administration was encouraged to use a barrel of oil equivalency through regulation, and there was an urgency to put the bill on the House calendar. He opined there is insufficient information to answer the cost allocation question; however, the departments have access to confidential information and are in a better position to find the correct answer, along with the legislature's expert consultants. Moreover, between now and sanctioning, that subject will come to conclusion during negotiations between the state and producers. Senator Stedman urged the committee to study Dr. David Wood's calculations on the revenue impact. Even today without gas running, for Cook Inlet and on the North Slope, the cross-subsidy impact over the last three years is about \$250 million to the treasury.

[3:01:35 PM](#)

REPRESENTATIVE P. WILSON observed that DOR scenarios indicated that decoupling dropped the gas revenue, but increased the oil tax. She asked whether Dr. Wood reported on this effect.

[3:02:34 PM](#)

SENATOR STEDMAN has heard a similar debate in the media and agreed, "You could look at it that way." However, the gas revenue is the state's revenue, not the industry's revenue. This is not a tax increase and that argument is a bizarre twist of the mathematics of what is going on. He remarked:

Have the gas tax calculation run and put a stack of cash on the table, have the oil tax run and put a stack on the table, and then start playing this shell game, and watch the state's pile go down, and the industry's pile go up. And everything else stays the

same. ... But to what references exactly that the commissioner made, I wasn't in the room, I haven't seen his presentation, so I can't really comment on that.

[3:04:05 PM](#)

[SB 305 was held over.]

[3:04:14 PM](#)

The House Resources Standing Committee meeting was recessed at 3:04 p.m. to a call of the chair.

[Transcription of the Gavel to Gavel audio recording from 6:38:09 p.m. to 6:42:55 p.m. follows:]

CO-CHAIR CRAIG JOHNSON called the House Resources Standing Committee meeting back to order at 6:38 p.m. Representatives Johnson, Neuman, P. Wilson, Guttenberg, Seaton, and Olson were present at the call back to order. Representatives Edgmon, Kawasaki, and Tuck arrived as the meeting was in progress. Representative Dahlstrom was also in attendance.

**HB 337-OIL AND GAS PROD. TAX: CREDITS/INTEREST**

CO-CHAIR JOHNSON announced that the next order of business would be HOUSE BILL NO. 337, "An Act relating to interest on certain underpayments or overpayments for the oil and gas production tax, to certificates for certain oil and gas production tax credits for qualified capital expenditures, and to alternative tax credits for expenditures for certain oil and gas development and exploration activities for the oil and gas production tax; relating to the use of the oil and gas tax credit fund to purchase certain tax credit certificates; and providing for an effective date."

CO-CHAIR JOHNSON stated the document before the committee is Version R. He recalled that Representative Guttenberg had moved Conceptual Amendment 3, labeled 26-GH2057\A.1, Bullock, 8/24/10, at the 3/29/10 meeting; however, the amendment was withdrawn so the meeting could adjourn without any business before it.

REPRESENTATIVE GUTTENBERG moved Conceptual Amendment 3, labeled 26-GH2057\A.1, Bullock, 8/24/10, which read:

Page 1, line 2:  
Delete ", "  
Insert "**and**"

Page 1, lines 3 - 4:  
Delete "**, and to alternative tax credits for expenditures for certain oil and gas development and exploration activities for the oil and gas production tax**"

Page 3, line 7:  
Delete "**AS 43.55.025(f)** [AS 43.55.025(f)(2)]"  
Insert "AS 43.55.025(f)(2)"

Page 3, line 9:  
Delete "**AS 43.55.025(f)** [AS 43.55.025(f)(2)]"  
Insert "AS 43.55.025(f)(2)"

Page 4, line 5, through page 9, line 5:  
Delete all material.

Re-number the following bill sections accordingly.

Page 9, lines 11 - 25:  
Delete all material.

Re-number the following bill sections accordingly.

Page 10, lines 2 - 6:  
Delete all material.

Re-number the following bill sections accordingly.

Page 10, line 19:  
Delete "Sections 4 - 12 of this Act take"  
Insert "Section 5 of this Act takes"

Page 10, line 20:  
Delete "sec. 17"  
Insert "sec. 9"

CO-CHAIR JOHNSON objected for the purpose of discussion.

REPRESENTATIVE GUTTENBERG explained that the amendment is conceptual because it was written for a different version of HB 337.

The committee took a brief at-ease.

[FTR audio recording restored.]

[6:42:55 PM](#)

REPRESENTATIVE GUTTENBERG, for "practical purposes at this time" withdrew Conceptual Amendment 3.

[6:43:10 PM](#)

CO-CHAIR NEUMAN informed the committee Version E "does not have the [Alaska Retirement Management (ARM)] Board amendment in there." He then moved to adopt Version E.

[6:43:47 PM](#)

CO-CHAIR JOHNSON announced the motion to bring back before the committee Version E, the effect of which allows the ARM Board to purchase the credits.

REPRESENTATIVE P. WILSON objected for the purpose of discussion.

CO-CHAIR NEUMAN pointed out that Version E "does not include the ARM Board version."

CO-CHAIR JOHNSON corrected his previous statement. He said, "That's the effect of what [Version E] does, it takes away the ARM Board version."

[6:43:55 PM](#)

REPRESENTATIVE P. WILSON spoke to her objection and asked why the ARM Board amendment should be removed from the bill.

[6:44:30 PM](#)

CO-CHAIR NEUMAN explained that his request to remove the ARM Board is not for the purpose of disallowing the board to purchase credits, in fact, he expressed his belief that these opportunities should be expanded; however, the committee received a legal opinion from Don Bullock, Attorney, Legislative Legal Counsel, Legislative Legal and Research Services, advising that the provision may violate the single-subject clause. Because of this advice, he stated that his intent is to provide other opportunities to use for purchases of the credits. In addition, Co-Chair Neuman expressed his understanding that the

commissioner of the Department of Revenue said the ARM Board would not purchase the tax credits.

[6:46:21 PM](#)

PATRICK GALVIN, Commissioner, Department of Revenue (DOR), advised that the inclusion of the ARM Board as a potential market for the credits is no longer necessary as other provisions of the bill remove any barriers to a credit-certificate holder getting 100 percent of his/her cash back from the state, whereas the ARM Board would offer 92 cents on the dollar. Furthermore, given the advice from Legislative Legal and Research that the provision raises the possibility of a single-subject violation, he said the department decided not to put something unnecessary in the bill and risk creating a legal issue.

[6:47:21 PM](#)

CO-CHAIR JOHNSON expressed his understanding that the bill now allows the state to purchase, "100 cents on the dollar," and there is no need for other options.

COMMISSIONER GALVIN said correct.

[6:47:34 PM](#)

REPRESENTATIVE KAWASAKI recalled previous debate on this version of the bill. He said,

Version R is the version that I've marked up, we've passed two amendments, at least discussed two amendments to this version, R. I think that the idea would be that if you don't want the ARM Board in there, that we could later amend it out. ... To switch from version to version I think is confusing, I'd prefer to stick with this version for now....

[6:48:20 PM](#)

CO-CHAIR JOHNSON observed that the committee could vote on that, as any member can make a motion.

[6:48:28 PM](#)

REPRESENTATIVE SEATON observed, "This is actually rescinding an action we took, without rescinding the action." He recalled

that the committee had a choice and discussed Version E, but Version R was adopted. He then reminded the committee he had provided a legal memo from 2008 quoting the supreme court, which held that in matters with such themes such as taxation, a "broad breadth" of interpretation is acceptable. Further, testimony by the commissioner pointed out that the bill deals with tax credits and with the ARM Board's ability to buy those specific tax credits in the bill, thus "this is probably the closest call you would ever had." Representative Seaton opined that a precedent has been set on the floor of the House that subjects as varied as scallops, hair crab, and fishing licenses have economic impact, as do Alaska Regional Development Organization (ARDOR) boards; yet these do not violate the single-subject rule. He disagreed with legislative counsel in this regard and objected to the adoption of Version E instead of Version R.

[6:50:50 PM](#)

CO-CHAIR JOHNSON noted there are two ways to handle this situation, one way is to rescind the committee's action, and both means are technically appropriate.

[6:51:12 PM](#)

REPRESENTATIVE OLSON asked the commissioner if he was speaking from experience and as a member of the ARM Board.

COMMISSIONER GALVIN said he was a member of the ARM Board. In further response, he advised that this has not been an issue for the ARM Board, thus has no previous experience; however, he said the advantages to the ARM Board that were previously identified are being eliminated by the bill. Therefore, he said he did not see the value of having the ARM Board alternative in the bill from the perspective of the credit-certificate holders. From the perspective of the ARM Board, it may have the opportunity to buy the certificates, but there will be no sellers.

[6:52:31 PM](#)

CO-CHAIR NEUMAN observed that the commissioner finds this provision unnecessary, and expressed his belief that the committee did not discuss Version E. Although there may have been other pieces of legislation that have not been challenged by the single-subject rule, if there is a challenge, it will cost the state money for a defense, which would affect legislation "which is desperately needed." He pointed out the current legal opinion from Mr. Bullock that there is the

possibility of a violation, and stated, "Then let's just not even go there."

[6:53:52 PM](#)

CO-CHAIR JOHNSON agreed that the provision is not needed, and opined the single-subject clause is of less concern than allowing 100 percent on the dollar from the state.

[6:54:09 PM](#)

REPRESENTATIVE P. WILSON asked whether that is the only difference in the two bills.

CO-CHAIR JOHNSON said yes.

[6:54:22 PM](#)

REPRESENTATIVE KAWASAKI advised it is easier and cleaner working on Version R and "amending out the portions of ARM Board for the folks that object to the ARM Board addition," rather than trying to add amendments into Version E.

[6:54:48 PM](#)

CO-CHAIR JOHNSON stated his intention "to vote to have Version R, and offer that amendment later."

[6:55:17 PM](#)

A roll call vote was taken. Representatives Edgmon, P. Wilson, Olson, and Neuman voted in favor of adopting Version E. Representatives Guttenberg, Kawasaki, Tuck, Seaton, and Johnson voted against it. Therefore, Version E failed by a vote of 4-5.

[6:56:37 PM](#)

CO-CHAIR JOHNSON said, "I'm going to vote no, but I want to qualify that with the amendments coming. And only because we've got amendments made to this, I would hope that everyone would remember this vote."

[6:56:39 PM](#)

CO-CHAIR NEUMAN moved Conceptual Amendment 4 which read:

Page 7

Delete lines 24-31  
Page 8  
Delete lines 1-2  
Title change  
Delete reference to ARM Board

CO-CHAIR JOHNSON restated the conceptual amendment and added that conforming language would also be appropriate.

[6:57:29 PM](#)

REPRESENTATIVE KAWASAKI objected for purpose of discussion.

[6:58:08 PM](#)

COMMISSIONER GALVIN pointed out a reference to the ARM Board in Sec. 3 on page 2.

[6:58:32 PM](#)

CO-CHAIR JOHNSON clarified the conceptual amendment is to remove the ARM Board from the title, and the bill, and for conforming language where appropriate.

[6:58:38 PM](#)

A roll call vote was taken. Representatives Tuck, P. Wilson, Olson, Edgmon, Neuman, and Johnson voted in favor of Conceptual Amendment 4. Representatives Guttenberg, Kawasaki, and Seaton voted against it. Therefore, Conceptual Amendment 4 was adopted by a vote of 6-3.

[6:59:33 PM](#)

REPRESENTATIVE SEATON offered Amendment 5 to rescind the committee's action on 3/29/10, in failing to adopt Amendment 2, labeled R.1, Bullock, 2/29/10, which was drafted to Version R, and which read:

Page 7, line 2:

Delete "that expenditure"

Insert "the expenditures during a calendar year that exceed the average annual well-related expenditures for the calendar years 2008, 2009, and 2010; the producer or explorer shall submit the amount of well-related expenditures for each of the years

2008, 2009, and 2010 at the time an election is made to apply the credit authorized by this subsection"

[Amendment 2 was amended on 3/29/10 to delete all references to "2010."

REPRESENTATIVE SEATON reminded the committee that Amendment 2 relates expenditures to the average expenditures during 2008 and 2009, thus the credits are extended to expenditures that exceed that average amount. The purpose of the amendment is to accomplish the goal of the bill which is to stimulate additional investment and production. In fact, the amendment would encourage companies to increase their investment and in-field exploration because they would get a higher credit if they exceeded the amount of their current annual expenditures.

[7:02:00 PM](#)

CO-CHAIR NEUMAN objected for the purpose of discussion. He asked the commissioner how much work it would be for the department to average all well-related expenditures for 2008 and 2009.

[7:03:21 PM](#)

COMMISSIONER GALVIN explained that it would not be possible for the department to determine this average based on the information received thus far from taxpayers regarding 2008 and 2009. The department would have to request that taxpayers provide supplemental tax returns, including documentation of their well-related expenditures. Currently, the tax reporting system does not break out expenditures in that way.

[7:04:12 PM](#)

CO-CHAIR NEUMAN asked whether the amendment would set a precedent for the DOR to average well-related expenditures for prior years; and if so, would this affect any changes in the tax code.

[7:04:57 PM](#)

COMMISSIONER GALVIN explained that it would establish for each taxpayer a fixed number for their 2008-2009 expenditures, and that number would determine whether the 30 percent credit created by the bill is available, or not.

[7:05:33 PM](#)

CO-CHAIR NEUMAN restated his question about whether there were any changes in the tax code, regulations, or statute since 2008 that affect well-related expenditures.

[7:05:53 PM](#)

COMMISSIONER GALVIN related that the regulations that define lease expenditures, as well as those that define qualified capital expenditures, have been put in place recently and are retroactive.

[7:06:32 PM](#)

CO-CHAIR NEUMAN assumed that if there have been changes dealing with well-related expenditures since 2008, additional changes may have negative impacts on companies that have made financial decisions.

[7:07:18 PM](#)

COMMISSIONER GALVIN clarified that the information submitted to the department for 2008-2009 would not have specified expenditures that were, or were not, well-related. Thus, new information from 2008-2009 would have to be provided so that taxpayers could seek a credit from 2010 forward. He recalled his previous testimony on this amendment, pointing out that taxpayers would be motivated to minimize their well-related expenditures for 2008-2009, perhaps with controversy. He concluded, "It's doable, as long as you take what they say for face value."

[7:09:35 PM](#)

CO-CHAIR NEUMAN observed that for the governor's bill a determination was made about penalties for taxes that were underpaid. If the state changes the rules, it may create an "inverse" situation that taxpayers would not be able to take advantage of. He also cautioned about the amount of work changes would require of the department and the producers.

[7:11:14 PM](#)

COMMISSIONER GALVIN advised that this amendment and the in-field drilling credit in the bill would not affect a tax liability from 2008-2009; however, when taxpayers submit a request for an in-field drilling credit, they must show that their well-related expenditures are consistent. The amendment will create some additional accounting issues, but it will not impact the past tax liability.

[7:12:41 PM](#)

CO-CHAIR NEUMAN noted that it would impact the value of a taxpayer's money.

[7:13:19 PM](#)

REPRESENTATIVE GUTTENBERG clarified that new information will be needed whether the amendment is adopted or not; in fact, the department will be looking at new reporting forms for well credits because well credits for capital and operating are all "new ground." He surmised that if the bill passes, auditors will be evaluating numbers from one year to the next to deal with well rework.

[7:14:50 PM](#)

COMMISSIONER GALVIN agreed that the nature of the credit itself requires a different accounting methodology than what is currently required for a taxpayer, but noted that the amendment does create a requirement for the taxpayer to retroactively resubmit information for 2008-2009.

[7:15:20 PM](#)

REPRESENTATIVE GUTTENBERG confirmed it does not change the past tax liability in any way.

[7:15:34 PM](#)

REPRESENTATIVE KAWASAKI asked how a company would view this aspect of the bill. For example, a company may decline the credit to avoid submitting additional information.

[7:16:01 PM](#)

CO-CHAIR JOHNSON reminded the commissioner that he is not required to answer for oil companies.

[7:16:06 PM](#)

COMMISSIONER GALVIN opined that if taxpayers are offered an opportunity to save money, they will.

[7:16:26 PM](#)

REPRESENTATIVE KAWASAKI further asked whether there is reason to believe that the companies may not disclose accurate information.

[7:17:06 PM](#)

COMMISSIONER GALVIN related that the amendment is something that the department could implement, but it will create complexities for DOR and for the taxpayer. He acknowledged that taxpayers may "low ball" their expenditures and added that, from a tax administration standpoint, the amendment imposes a burden.

[7:18:20 PM](#)

REPRESENTATIVE KAWASAKI guessed that the companies "are pretty honest when they do their taxes, right?"

[7:19:01 PM](#)

COMMISSIONER GALVIN advised that taxpayers will interpret the tax code to their maximum advantage, not to violate the statute, but to take advantage of accounting principles. This amendment will motivate taxpayers to lower their 2008-2009 expenditures in order to maximize their ability to obtain credits.

[7:20:24 PM](#)

REPRESENTATIVE KAWASAKI suggested the assessment of penalties for false claims of tax liability.

COMMISSIONER GALVIN assumed the normal tax penalties for misreporting tax return data would apply.

[7:21:28 PM](#)

CO-CHAIR JOHNSON opined that the amendment sets a policy for a number that only above which an oil company can take a tax

credit. This will create a disincentive and affect a decision to complete rework or not. He questioned whether the state wants to encourage in-field work, or create a barrier by setting an arbitrary number. The policy call is to either "raise the bar of disincentive," or to encourage companies to do all the work they can. It is basically whether the state wants more incentive or less incentive.

[7:23:25 PM](#)

REPRESENTATIVE KAWASAKI expressed his belief that the policy is to try to create an incentive for more investment and more jobs. The baseline set by the amendment identifies a company's present investment, and shows that it can put in more money and apply for a credit. He recalled testimony that companies might spend more in Alaska, but decisions to invest are "made in boardrooms in Houston and London, and they're not made here in the State of Alaska." Thus the amendment goes to the heart of why we are trying to push for credits for better investments and without it, the money goes to other states or countries.

[7:24:26 PM](#)

CO-CHAIR JOHNSON disagreed.

[7:24:35 PM](#)

CO-CHAIR NEUMAN read from Amendment 2, 26-GH2057\R.1, Bullock, 8/26/10, [amended and not adopted on 3/29/10] paraphrasing as follows:

Expenditures during a calendar year that exceed the average wellhead-related expenditures for '08 and '09 ... the producer or explorer shall submit the amount of well-head, well-related expenditures for those years at the time an election is made, applied, by the credit authorized by this subsection.

REPRESENTATIVE NEUMAN pointed out that the aforementioned subsection [found on page 6, line 25, of HB 337, Version R] in the bill deals with credits taken after June 30, 2010, and before July 1, 2016. He surmised the department would go back and average 2008-2009 and apply that information to the credit authorization in the subsection. Representative Neuman questioned whether the time, issues, and dates "all falls in line."

7:26:28 PM

COMMISSIONER GALVIN responded that the elimination of 2010 makes it mathematically possible to arrive at an average for comparison. However, the concern for the department is what happens when an attempt is made to isolate individual taxpayers, thus creating anomalies and unintended situations. For example, a taxpayer may have well-related expenditures in 2008, but not in 2009. The other issue of concern is that when taxpayers apply for tax credits, they are also members of partnerships with varied interests dependent upon lease relationships and other considerations. This problem is exacerbated if the state sets up a situation in which one partner is allowed to take a disproportionate advantage of a tax credit, even though "the concept is, you know, pure, the application ends up not being so." He warned that the situation would lead to manipulation, frustrating the underlying purpose.

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CO-CHAIR NEUMAN observed the problem would compound exponentially when multiple companies are involved.

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REPRESENTATIVE SEATON reminded the committee that the present structure allows for a 20 percent capital credit of 2008-2009 expenditures - expenditures and credits that were determined by the companies to be adequate incentives for the amount of work that they did. This bill not only allows 30 percent on capital credits, but expands the credits into additional well-related expenditures, which are of a greater proportion than the capital credits. Therefore, the bill allows for a very large credit "on a much broader sweep of expenditures, under this bill, than the 20 percent capital credit which was sufficient to get the amount of work that was done in 2008 and 2009; it's obvious it was enough incentive because they did the work with a 20 percent capital credit." Addressing the complexity involved to implement the amendment, he pointed out that the companies all have joint operating agreements and are sophisticated partners with clear financial arrangements. He acknowledged that since this is a new category of well-related expenditures, the companies will have to develop new computer models, but these will be based on standard accounting principles; in fact, the biggest question is the fiscal impact to the state. Representative Seaton referred to the analysis contained in Fiscal Note #3 **\*\*Corrected\*\***, dated 2/08/10, from Tax Division,

DOR, and stated that revenues are estimated to be reduced by \$325 million in 2011 for doing the same work that is already sanctioned, and that will garner a 20 percent capital credit. The fiscal note further indicates that revenues are estimated to be reduced by \$350 million from 2013 to 2016. He concluded that the amendment would likely reduce that loss by \$200 million per year.

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CO-CHAIR JOHNSON interjected that predicting a loss of revenue to the state is speculation, and questioned whether Representative Seaton could "extrapolate the numbers the way you are doing it."

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REPRESENTATIVE SEATON called attention to the Alaska Department of Revenue presentation dated 3/29/10, slide 2 titled, "Production Tax Revenue with Additional Well-Related Credit Under HB 337," found in the committee packet. The chart illustrated projected FY 08 expenditures in the amount of \$245 million, FY 09 expenditures in the amount of \$255 million, and FY 10 expenditures in the amount of \$297 million. This program will put all well-related expenses in these years in a new category that enjoys a 30 percent tax credit - not only raising the capital credit by 10 percent - but giving 30 percent on the new category of "intangible drilling and development costs." Although the numbers may be speculative, they have been provided by the department and indicate the reduction of the revenue stream, even though the companies are basically operating at exactly the same level as they have operated in the last year.

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CO-CHAIR JOHNSON acknowledged Representative Seaton's point; however, the facts are unknown and whether the bill spurs development will be known very quickly.

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REPRESENTATIVE SEATON speculated that the amendment will save the state about \$200 million per year, and asked the department whether the additional tax evaluations would be an unsustainable burden.

[7:37:43 PM](#)

COMMISSIONER GALVIN appreciated the committee's attempt to simplify the issue before it; however, he described the challenges faced by the department as it was trying to write a bill for a credit that will spur the development of additional wells. He cautioned against assuming that there will be the same number of well-related expenditure opportunities from one year to the next. As a matter of fact, companies operate on a basis of opportunity, development, schedules for fields, and sophisticated investment methods, including the economics of a specific well. The state does not have a methodology to discern whether certain costs are for work a company would be doing anyway, and other if costs are "additional stuff." The governor's bill attempts to give an across-the-board credit for well-related work because drilling wells is good for the state.

[7:40:25 PM](#)

REPRESENTATIVE TUCK acknowledged that the purpose of the bill is to change behavior, create jobs, and increase the flow of oil in the Trans-Alaska Pipeline System (TAPS). He stressed that the hope is to have production above and beyond what is already taking place, but the bill gives tax credits for work that is already being done. On the other hand, the amendment offers credit to those companies that are going above and beyond, thereby producing more jobs, more revenue for the state, and more oil for TAPS. Representative Tuck acknowledged the difficulties created by the amendment, and related that he supported the new capital and exploration credits, but said he had concerns about the operating portion. Spending more on its operating budget to produce more oil is beneficial to a company and to the state, but testimony before the committee has indicated that doing that may be hindered because of the current tax regime. Without the amendment, he said he was hesitant to include operating expenses, although he supported the original proposals that gave capital credits "where we know we're successful, and give a little bit more for that."

[7:42:53 PM](#)

REPRESENTATIVE EDGMON said a clear picture is not evident; in fact, there remains an element of false economy and speculation. Hearing the debate leads him to support the amendment, and he recalled that previous testimony on oil and gas topics failed to reveal the financial aspects of the industry. He cautioned, however, that the bill may not do what it intends to do, and it

could cost the state money in the process. Representative Edgmon then called the question.

[7:43:56 PM](#)

REPRESENTATIVE GUTTENBERG restated the estimated production tax revenue credits from aforementioned slide 2: \$297 million in FY 10; \$327 million in FY 11; \$336 million in FY 12; \$390 million in FY 13. He suggested that the companies will be happy with this bill in any form, even if they have to hire accountants, because they will receive unexpected credits for work that they were going to do anyway.

[7:45:02 PM](#)

CO-CHAIR JOHNSON observed that the bill may not work, and the amount of money involved is unknown; however, what is known is that employment on the slope continues to decline, and the state is losing \$100 million per year in revenue. The focus of the committee is on the loss of revenue to the state, but the committee did not even discuss the number of jobs that these credits create.

[7:45:50 PM](#)

REPRESENTATIVE NEUMAN maintained his objection to the motion.

CO-CHAIR JOHNSON clarified that a yes vote [on Amendment 5] would put Amendment 2 before the committee.

[7:47:16 PM](#)

A roll call vote was taken. Representatives Kawasaki, Tuck, P. Wilson, Seaton, Edgmon, and Guttenberg, voted in favor of [Amendment 5] rescinding the previous vote on Amendment 2. Representatives Olson, Neuman, and Johnson voted against it. Therefore, Amendment 5 was adopted by a vote of 6-3.

[7:47:19 PM](#)

CO-CHAIR JOHNSON announced that Amendment 2 was before the committee.

[7:47:26 PM](#)

REPRESENTATIVE SEATON moved to adopt Amendment 2.

CO-CHAIR JOHNSON objected.

COMMISSIONER GALVIN pointed out that Amendment 2 originally affected 2008, 2009, and 2010, but there was an amendment to the amendment.

CO-CHAIR JOHNSON, in response to Commissioner Galvin, clarified that Amendment 2, as amended, removes 2010 from the years that are averaged.

[7:48:39 PM](#)

A roll call vote was taken. Representatives Kawasaki, Tuck, Seaton, Edgmon, and Guttenberg voted in favor of Amendment 2, as amended. Representatives P. Wilson, Olson, Neuman, and Johnson voted against it. Therefore, Amendment 2, as amended, was adopted by a vote of 5-4.

[7:48:41 PM](#)

CO-CHAIR JOHNSON announced that HB 337 was before the committee.

[7:48:47 PM](#)

CO-CHAIR NEUMAN moved to report CSHB 337, out of committee with individual recommendations and the accompanying fiscal notes. He then withdrew his motion.

[7:49:24 PM](#)

CO-CHAIR JOHNSON, hearing no objection to the withdrawal of the motion, announced that the bill was before the committee.

[7:49:35 PM](#)

REPRESENTATIVE KAWASAKI offered Conceptual Amendment 6, which read as follows:

On page 3, line 1  
Delete the word "three"  
Insert the word "five"

[7:50:06 PM](#)

REPRESENTATIVE TUCK said that was an error that was previously noted.

[7:50:24 PM](#)

CO-CHAIR JOHNSON, hearing no objection, announced that Conceptual Amendment 6 was adopted.

[7:50:36 PM](#)

REPRESENTATIVE KAWASAKI offered Conceptual Amendment 7, which read as follows:

On page 6, line 26,  
After the word "expenditure"  
Insert "incurred"

[7:51:00 PM](#)

There being no objection, Conceptual Amendment 7 was adopted.

[7:51:47 PM](#)

REPRESENTATIVE NEUMAN moved to report CSHB 337, 26-GH2057\R, as amended, out of committee with individual recommendations and the accompanying fiscal notes.

REPRESENTATIVE GUTTENBERG objected for the purpose of discussion. He spoke to his objection by first reminding the committee the purpose of the bill is to encourage a heightened level of jobs for Alaskans and an increased level of oil production through TAPS; however, no analysis to support this result has been offered. Although passage of the bill implies that more jobs will be available after the industry is granted these credits, there is no guarantee, but only speculation. He read from written testimony given by an oil and gas attorney, Spencer Hosie, Hosie McArthur, San Francisco, California, to the Regulatory Commission of Alaska (RCA) [date and source not provided]:

Under the duty to develop, a royalty owner's project need not be the most economic development project on the producers' platter. After the lease is signed, the royalty owner is not in competition with other potential projects in this country and abroad for the producers' development dollars. Under the lease agreements, the producers' obligation is to continue to produce from and develop a field if reasonably

economic, despite individual preferences to defer development or invest capital dollars elsewhere.

7:58:10 PM

REPRESENTATIVE GUTTENBERG explained that Mr. Hosie is saying that a company that signs an oil and gas lease with the state is obligated to put the state on equal footing; in fact, the duty to develop the leases means they must. The only way the company is not obligated to do all the things the state grants credits for, is for the state to "let them off the hook." Furthermore, there is a duty to develop in the development clause of the resources section of the state constitution, thus when the state signs a lease agreement it expects development for the good of all Alaskans. Routinely, leaseholders ask for and receive credits for development; however, Mr. Hosie advises that the leaseholders alone have the duty to develop. Representative Guttenberg gave the example of former Governor Murkowski's statement that the leaseholders at Point Thomson have an obligation to develop. He concluded that well drilling, in-field drilling, and processes to enhance production are part of the schedule that every oil field has and now, 20-30 years into production, the obligation to enhance production remains with the leaseholder. He restated his objection to giving credits for actions that the leaseholders "knew that they were going to do." On the other hand, the standing of the bill would be improved if the sponsors provided definitive answers on jobs, the flow of oil, and revenue for the state. Representative Guttenberg said he could not support the bill.

7:58:26 PM

CO-CHAIR NEUMAN questioned the objectivity of the testimony quoted by Representative Guttenberg because the testimony was solicited by the state. He agreed that leases call for the due regard for the interests of the landowner, which is the state, and to that regard, he said the governor and the commissioner recognized the recent large increases in oil production along with a decrease in new investment. He said he disagreed with some earlier testimony about, "how we're giving this money away, well, it's just money that we're not taking." Representative Neuman opined that the "trade-out" is the sweet spot of the policy call that must be made by the legislature. He recalled that at the introduction of the bill, he assumed the governor and the commissioner believed the bill provides incentives for further exploration. Although there is less money coming in as revenue due to the credits, there is also less oil flowing

through TAPS, and the solution is more exploration, more oil flowing through TAPS, more jobs, more economic diversification, and more benefits to the state and the economy. He expressed his support for the bill.

REPRESENTATIVE GUTTENBERG maintained his objection.

[8:01:14 PM](#)

A roll call vote was taken. Representatives Tuck, P. Wilson, Olson, Seaton, Edgmon, Neuman, and Johnson voted in favor of HB 337, Version R, as amended. Representatives Guttenberg and Kawasaki voted against it. Therefore, CSHB 337(RES) was reported out of the House Resources Standing Committee by a vote of 7-2.

[8:02:26 PM](#)

REPRESENTATIVE SEATON asked Co-Chair Johnson to ensure that the committee receives copies of the revised fiscal note.

[8:02:37 PM](#)

CO-CHAIR JOHNSON agreed.

#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 8:03 p.m.