

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

April 11, 2010

12:37 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

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. 365

"An Act relating to sharing records regarding fish purchased by fish processors with certain federal agencies, to requirements to obtain and maintain a fisheries business license, and to payment of industry fees required of fish processors; and providing for an effective date."

- MOVED OUT OF COMMITTEE

SENATE BILL NO. 301

"An Act relating to the power project fund; authorizing the Alaska Energy Authority to charge and collect fees relating to the power project fund; authorizing the Alaska Energy Authority to sell and authorizing the Alaska Industrial Development and Export Authority to purchase loans of the power project fund; providing legislative approval for the sale and purchase of loans of the power project fund under the memorandum of understanding dated February 17, 2010; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

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
03/18/10	(S)	Heard & Held
03/18/10	(S)	MINUTE(FIN)
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

04/07/10 (H) Heard & Held
 04/07/10 (H) MINUTE(RES)
 04/09/10 (H) RES AT 1:00 PM BARNES 124
 04/09/10 (H) Heard & Held
 04/09/10 (H) MINUTE(RES)
 04/10/10 (H) RES AT 10:00 AM BARNES 124
 04/10/10 (H) Heard & Held
 04/10/10 (H) MINUTE(RES)
 04/11/10 (H) RES AT 12:00 AM BARNES 124

BILL: HB 365

SHORT TITLE: FISH PROCESSOR FEES, LICENSES, RECORDS

SPONSOR(s): MILLETT

02/23/10 (H) READ THE FIRST TIME - REFERRALS
 02/23/10 (H) FSH, RES
 03/09/10 (H) FSH AT 10:15 AM BARNES 124
 03/09/10 (H) Heard & Held
 03/09/10 (H) MINUTE(FSH)
 03/16/10 (H) FSH AT 10:15 AM BARNES 124
 03/16/10 (H) Moved Out of Committee
 03/16/10 (H) MINUTE(FSH)
 03/17/10 (H) FSH RPT 3DP 3NR
 03/17/10 (H) DP: MILLETT, BUCH, EDGMON
 03/17/10 (H) NR: KAWASAKI, KELLER, MUNOZ
 03/31/10 (H) RES AT 1:00 PM BARNES 124
 03/31/10 (H) Heard & Held
 03/31/10 (H) MINUTE(RES)
 04/10/10 (H) RES AT 10:00 AM BARNES 124
 04/10/10 (H) Scheduled But Not Heard
 04/11/10 (H) RES AT 12:00 AM BARNES 124

WITNESS REGISTER

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

POSITION STATEMENT: Testified and answered questions during the discussion of SB 305.

ROGER MARKS, Consulting Petroleum Economist
 Logsdon & Associates
 Anchorage, Alaska

POSITION STATEMENT: During the hearing on SB 305, discussed tax under the status quo versus decoupling.

REPRESENTATIVE CHARISSE MILLETT

Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Presented HB 365, as sponsor.

BOB THORSTENSON JR., Executive Director
Southeast Alaska Seiners Association
Juneau, Alaska

POSITION STATEMENT: Testified during the hearing on HB 365.

THOMAS LENHART, Assistant Attorney General
Natural Resources Section
Civil Division (Juneau)
Department of Law
Juneau, Alaska

POSITION STATEMENT: Responded to questions during the hearing on HB 365.

ROB ZUANICH, Manager
Southeast Revitalization Association
Juneau, Alaska

POSITION STATEMENT: Testified during the hearing on HB 365.

JOE PLESHA, Chief Legal Officer
Trident Seafoods Corporation
Seattle, Washington

POSITION STATEMENT: Testified in support of HB 365.

FRANK M. HOMAN, Chairman/Commissioner
Commercial Fisheries Entry Commission (CFEC)
Alaska Department of Fish & Game (ADF&G)
Juneau, Alaska

POSITION STATEMENT: Testified during the hearing on HB 365.

JEREMY JENSEN
Petersburg, Alaska

POSITION STATEMENT: Testified on behalf of himself in support of HB 365.

MITCH EIDE
Petersburg, Alaska

POSITION STATEMENT: Testified on behalf of himself in support of HB 365.

TROY THOMASSON
Petersburg, Alaska

POSITION STATEMENT: Testified on behalf of himself in support of HB 365.

ACTION NARRATIVE

[12:37:43 PM](#)

CO-CHAIR MARK NEUMAN called the House Resources Standing Committee meeting back to order at 12:37 p.m. [This meeting is a continuation of the recessed April 10, 2010, meeting.] Representatives Kawasaki, Guttenberg, Johnson, Tuck, Olson, Seaton, Wilson, and Neuman were present at the call to order. Representatives Edgmon arrived as the meeting was in progress. Also in attendance were Senator Paskvan, and Representatives Dahlstrom and Millett.

[12:38:10 PM](#)

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

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 the House committee substitute (CS) for committee substitute (CS) for SB 305(RES), Version 26-LS1577\M, Bullock, 4/10/11.]

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PAT GALVIN, Commissioner, Department of Revenue (DOR), indicated that he would be referring to a hard copy of a slide presentation [included in the committee packet], rather than actually showing the slides.

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COMMISSIONER GALVIN said the slides offer modeling tables, compare the overall oil and gas tax under SB 305 to the status quo, and they show the oil tax and gas tax components separately. He pointed out that 90 percent of the time, SB 305 results in numbers in green blocks, which means that it increases the overall tax revenue to the state, except in the few situations where there are red boxes. He directed attention to page 20, which begins the section of the slides that shows the modeling on gas production tax obligation, and page 21, which shows the comparisons of the gas production tax status quo compared to the gas production tax under SB 305. He explained that numbers in red boxes indicate that the status quo is higher

than what it would be under SB 305. Slide 21 shows figures based on barrels of oil equivalent (BOE) cost allocation; slide 22 shows figures based on point of production (POP) cost allocation, which he pointed out is still mostly red boxes.

COMMISSIONER GALVIN, in response to Representative P. Wilson, explained that the yellow boxes in the models mean that there is no difference between the status quo and SB 305. He said, "For those low oil prices, at any parity, there is no gas production tax, so it's all zero. It isn't until you actually start having a gas that's worth enough to have a gas production tax that you see the deviation."

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COMMISSIONER GALVIN noted that across the top of the models is shown the oil prices, and in the left-hand column is shown the gas price parity - the ratio between the oil and gas price. He demonstrated that at an oil price of \$40 and a gas parity of 8:1, the price would be \$4. Commissioner Galvin said one determination that was made was, under SB 305, how far costs would have to be pushed to oil in order to make the gas production tax obligation higher after decoupling. He stated a figure of 90 percent and said the results are shown on slide 24. He said the rest of the models show varying assumptions, including lower oil production.

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REPRESENTATIVE TUCK asked what has to be done in order to push the cost to 90 percent oil and 10 percent gas.

COMMISSIONER GALVIN responded that since the statute does not indicate a cost allocation method, the potential allocation method is "somewhat loose." He explained that the department would have to go through a regulatory process to develop that. He stated that the volume metric BOE basis and the POP basis are fairly straightforward, but other methods could be used that would result in different allocations. He said production could be set up at 100 percent, so that, for example, only those costs that are 100 percent gas would be attributed to gas. He said the department was not trying to identify a particular method, but rather was attempting to determine: "If the method [that] was chosen resulted in this kind of disparate treatment of costs, how far would they have to go in order to cause a different outcome?"

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COMMISSIONER GALVIN said the charts are significant. The charts that show a lot of green boxes indicate that under SB 305, the overall revenue would be increased. However, he emphasized that it is important to note that "this is not locked in." In fact, he recollected that the presentation to the committee on 4/10/10 "indicated that it's expected that it will be negotiated down." However, he said the slides, starting with 21, show what is going to be locked in. He said, "The red part is what gets set in the [Alaska Gas Inducement Act] AGIA inducement." The state gas tax obligation will be lower.

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CO-CHAIR NEUMAN directed attention to the model charts on slides 3 and 21, and noted that they are basically an inverse of each other. He offered his understanding that the figures in red on slide 21 are locked in, while the figures in green on slide 3 get locked in.

COMMISSIONER GALVIN responded that that is not correct. He explained that on slide 3, the only figures that are locked in are those in red. He said, "The oil portion is not locked in." He noted that some of the statements that had been made during the 4/10/10 hearing indicated that there is some confusion on this point. He offered further clarification, noting that the gas tax obligation is locked in at the open season, while the oil tax portion is not. Therefore, the numbers in green are not locked in. Furthermore, he offered his understanding that it is the expectation of the bill sponsor that those numbers are going to change before gas is actually produced.

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CO-CHAIR NEUMAN responded that the discussion is about gas obligations that would be locked in at the start of the open season, as with AGIA, not about locking in oil.

COMMISSIONER GALVIN said that is right, which, he explained, is why the discussion about a \$2 billion loss is not a reflection on what is actually being locked in; that is not part of the dynamic. He concluded, "What's being locked in is the gas portion of it, which is going to lower under SB 305 than under the status quo."

CO-CHAIR NEUMAN said he thinks Senator Stedman had [at a previous meeting] tried to make the point that the value of gas to the state is considerably lower. He said the amount of revenue from oil and gas that the state would be taking in to the General Fund revenue would be lower "because the gas prices are so much lower, and it dilutes the price of the oil."

COMMISSIONER GALVIN answered that is correct. He said that would be in effect when gas is shipped only if the legislature "decides not to change that between now and first gas."

CO-CHAIR NEUMAN said, "Only if we don't decouple it."

COMMISSIONER GALVIN responded no. He explained that there are other ways of dealing with it without decoupling it.

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REPRESENTATIVE TUCK, based on what was just imparted, offered his understanding that because of the current structure in place going into open season, the state is not locking in oil taxes whatsoever, but is putting a system in place that producers can take advantage of when the first open season begins. So, there is no dilution effect, unless the state allows the status quo to continue after the gas taxes have been set. He said the state has the opportunity to make changes later on. He concluded, "All we're really talking about is locking in the gas rate at open season."

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COMMISSIONER GALVIN replied that is correct. He reminded the committee that because of what the modeling results show, if the status quo is left in place through the open season and the higher gas tax amount is locked in, and then SB 305 is passed, the end result will be the same. He explained, "You can decouple afterwards in the same manner SB 305 proposes, and the lock-in at the open season will not impact that; you're not losing any ground."

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REPRESENTATIVE TUCK asked if "going to one bucket, two bucket, back to one bucket" would have the same effect as postponing SB 305 until after open season.

COMMISSIONER GALVIN answered no.

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REPRESENTATIVE GUTTENBERG, using a combination lock as a metaphor, described oil, gas, parity, cost allocation, and the dilution effect as ongoing, fluctuating components, and described the gas tax [obligation] scheduled for May 1 as the one tumbler that locks in place. He asked how long all the other components would remain in play.

COMMISSIONER GALVIN responded, "If somebody qualifies for the AGIA inducement, then they would have the right to that for 10 years after first gas."

REPRESENTATIVE GUTTENBERG, regarding the "one bucket, two bucket" scenario, asked if that entity would "come back and negotiate the fiscal terms."

COMMISSIONER GALVIN answered, "That was what was presented (indisc. - overlapping voices)."

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REPRESENTATIVE P. WILSON said she knows it is the gas obligation, not the gas tax, which gets locked in, but she asked Commissioner Galvin to shed light on that issue.

COMMISSIONER GALVIN said under the AGIA inducement, tax obligation on gas being shipped will be calculated under the taxes in place at the time. Those taxes are then compared to the gas production tax obligation under the tax system that was in effect at the beginning of the open season. He said, "It's the dollar amount that you would owe under the tax system in the future compared to what you would owe under the tax system at the time of the open season."

REPRESENTATIVE P. WILSON asked what the obligation would be right now if gas was being moved. She said she knows percentages and volume are not part of the calculation, but numbers are, and she asked Commissioner Galvin to offer a comprehensible explanation using numbers.

COMMISSIONER GALVIN responded that currently gas is not taxed separately; therefore, there is no separate gas tax rate.

CO-CHAIR NEUMAN asked, "What is the tax rate on gas right now, then?"

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COMMISSIONER GALVIN responded, "It is the combination of the oil and the gas taxed at 25 percent, plus progressivity." He continued as follows:

If you only had gas production, then that gas production would be taxed at 25 percent, plus progressivity. What we do for the purposes of being able to calculate your gas production tax obligation under today's system, is we allow you to basically calculate your total tax obligation under oil and gas combined. ... So, you take your oil and your gas production together, and you combine them under the current system, to establish what your overall tax obligation is. And then we use the percent of value represented by the oil and the gas to take proportionally that obligation and split it between oil and gas. And so, depending on the amount of a particular tax payer's oil and their gas, their overall rate, as it were, will be different. But what the modeling shows is that that method of combining your oil and your gas, taxing at today's system, and then [proportioning] that obligation between oil and gas results in a higher gas production tax obligation than what you would get if you calculated your tax separately under SB 305.

1:00:45 PM

REPRESENTATIVE P. WILSON offered her understanding that Commissioner Galvin is saying that overall it is best to separate, because that will result in a higher obligation to the state.

COMMISSIONER GALVIN responded that as it is currently structured, there will be a lower obligation to the state under the separate calculation than under the current calculation; a lower obligation to the state would be locked in. In response to Co-Chair Neuman, he said he means under gas; he explained, "They have no lock-in on their total obligation." The total obligation calculated would generally be higher when oil and gas are calculated together. He added, "But the oil portion is not locked in; only the gas portion is being locked in."

REPRESENTATIVE P. WILSON asked, "So, why would we do that if it's going to be less money to the state."

COMMISSIONER GALVIN said he thinks the argument is that doing so would provide further inducement at the open season. He deferred to the bill sponsor for further reasons.

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REPRESENTATIVE P. WILSON surmised that the idea is to offer inducement through a good deal on gas, and "as soon as they get that, then they're going to start working on us on the oil."

COMMISSIONER GALVIN said he thinks that is the idea behind "the two bucket thing."

REPRESENTATIVE P. WILSON proffered that the legislature must decide if this is a good idea.

COMMISSIONER GALVIN concurred that that is the job of the legislature.

[1:02:54 PM](#)

REPRESENTATIVE SEATON, directing attention to slides 21 and 22, surmised that whether a BOE or POP allocation, the state would be locking in a much lower rate on gas for the start of open season if it adopts CSSB 305(FIN).

COMMISSIONER GALVIN replied that he would not say that in all cases the state would locking in a much lower rate; he said it generally would be the same or lower, and only sometimes much lower.

REPRESENTATIVE SEATON, directing attention to the [yellow] boxes in the charts on slides 21 and 22, offered his understanding that "the only place where it basically appears to be the same in those is where it's zero."

COMMISSIONER GALVIN answered, "Generally it's where ... you're moving the costs to the side where you're lowering the gas value to the point where there isn't much tax being acquired under either system."

[1:04:33 PM](#)

REPRESENTATIVE SEATON, regarding Version M, "where we are rolling it in for a day or two and then rolling it out," asked how the calculations would be made and what the administrative liabilities or complications would be "on a short window of lock-in."

COMMISSIONER GALVIN answered that they would be significant. He said the department anticipates a tremendous amount of work to establish the two-day cost allocation and accounting method. He indicated he is talking about a method by which accounting would need to be taken care of for two days a month when calculating progressivity and two days a year when calculating base tax. He said there are seven different buckets to allocate between, and then some would be combined, and he predicted that would "take some figuring out." He said the Department of Law and Department of Revenue have been struggling over the last 24 hours to figure out how exactly this would be done, and there are still a lot of unanswered questions. He said, "For us it raises significant concerns about ... what would happen if you actually did this sort of two-day gimmick of popping [in] a tax system ... in a short period of time."

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REPRESENTATIVE SEATON asked if the administration would be constrained in its ability to negotiate gas and oil during the operation of the pipeline if there are conditional bids during open season and negotiations on fiscal terms is anticipated.

COMMISSIONER GALVIN responded that if the gas tax obligation that has been locked in is lowered, then arguably that would potentially impact what the expectations of the parties are in terms of what they have already acquired a right to and "what they would be seeking to work outside of that." Regarding [Version M], he expressed concern about the gimmick of "having the tax kind of pop in for two days and pop back out." He said the Department of Law finds no precedent for this and does not know what kind of legal issues that may raise. It could have a detrimental impact, because it creates a sense of, "Well, what did you do, what was this two-day thing?" He said decoupling or not decoupling and when it happens or doesn't is a policy call. Version M, he stated, "throws a whole different layer on top of that," which he said is, in and of itself, troubling. He recommended that the state make a decision on which tax system it wants and put it into place.

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COMMISSIONER GALVIN, in response to Co-Chair Neuman, said the current tax rate on oil and gas is 25 percent plus progressivity. If SB 305 is passed, then there would be one rate on oil and one on gas, and although they would be the same rate, decoupling would result in much different tax obligations to the State of Alaska. In response to a follow-up question, he clarified that the gas production tax that is being locked in would be lower if [SB 305] is passed, while the overall obligation of oil and gas would be expected to be higher.

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CO-CHAIR NEUMAN clarified that he wants to know what the total effect would be to the General Fund revenue, and he offered his understanding that Commissioner Galvin had just said that with or without decoupling, gas and oil will both be taxed at 25 percent plus progressivity. He further offered his understanding that under AGIA, rates for gas will be locked in for up to 10 years, so that at the projected rates, there would be a decline in revenue to the state's General Fund.

COMMISSIONER GALVIN said that is not correct. He explained that "the chart with all the green" - the chart that shows that the tax revenue is going to go up with SB 305 - is not being locked in. He observed that the committee seems to be in confusion regarding this issue, and he emphasized the willingness of the Department of Law to come offer clarification. He stated that overall, oil and gas obligation is not being locked in; what is being locked in is the gas production tax portion that is lower under SB 305.

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REPRESENTATIVE NEUMAN said, "So, the ... gas tax obligation will be locked in."

COMMISSIONER GALVIN answered, "No, it is not. The overall gas direct tax obligation is not locked in."

REPRESENTATIVE NEUMAN said, "Not the obligation, but the tax rate."

COMMISSIONER GALVIN responded, "No, it's not locked in either. You can change the oil tax any time after the open season."

CO-CHAIR NEUMAN observed that Commissioner Galvin had just said oil tax, and he said, "The gas tax will be 25 percent plus progressivity."

COMMISSIONER GALVIN corrected, "No, it won't. The gas production tax obligation that is calculated under the current system, which includes the regulations, is locked in - not the rate."

CO-CHAIR NEUMAN asked, "So, the 25 percent plus progressivity is not locked in?"

COMMISSIONER GALVIN answered, "No, it's not."

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CO-CHAIR NEUMAN offered his understanding that previously Commissioner Galvin had said it was, and he said he is confused.

COMMISSIONER GALVIN denied he had done so. He indicated that previously, when it was suggested that the tax rate was being locked in, he had specifically said it is not being locked in.

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REPRESENTATIVE EDGMON offered his understanding that decoupling would increase the overall tax obligation "on the oil side of the equation," and he opined that that may be a disincentive and could "engender certain behavior by the industry." He said, "So, the notion that ... this is all about oil, and that it's going to create more revenue for the State of Alaska over a period of time, has to undergo that test of the reality of maybe the higher tax, by virtue of decoupling, having an adversarial impact on the oil industry's behavior" He asked Mr. Marks if that is correct.

COMMISSIONER GALVIN answered yes.

[1:16:08 PM](#)

REPRESENTATIVE TUCK, referring to Version M, stated his understanding that once there is a gas production tax obligation determination in open season, potentially revenues to the state of oil and gas combined may decrease. However, initially the gas portion will be higher under status quo. He asked if a comparison has been made as to "what we would have in that scenario" with production profits tax (PPT). He asked, "Would

we still be up from where we were in 2007 under PPT program, revenue-wise?"

COMMISSIONER GALVIN answered that the issue "cuts" a couple different ways. He said the dilution effect of oil & gas is exacerbated by the steepness of the progressivity (indisc.), because what is happening is that as gas is brought in, the per barrel profit of the oil, combined stream, is being lowered, and because the progressivity line was steep, progressivity is falling at a rapid rate, bringing down value, as well. He said to answer Representative Tuck's question, he would have to compare two different numbers, and so, the answer is probably not one or the other. Using \$120 oil and \$8 gas as an example, he said the current tax system is bringing a lot more at \$120 oil. He mentioned slides that show, under a combined system, \$5.5 billion, which is considered to be a huge loss to the state, and he said that under PPT, that amount would not get "anywhere close to \$5.5 [billion]," because there would not be \$120 oil.

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CO-CHAIR NEUMAN questioned if consideration is being made to go back to PPT.

REPRESENTATIVE TUCK said "all this" was determined during discussion of Alaska's Clear and Equitable Share (ACES); back when the state was figuring out what needed to happen to get a gasline going. He said "this coupling situation" could be viewed as a form of incentive to get a gasline going for the state by allowing tax breaks to the oil industry. He said he is talking about behavior change. He expressed concern in going into open season without as much revenue leverage for negotiations "under just gas." Furthermore, he expressed concern regarding the opportunity for the oil and gas industry to take advantage of "maneuvering towards gas" by allowing discounts for oil. He opined that the state would still be better off than it was with the 2007 PPT plan "if we leave it as it is and go status quo."

REPRESENTATIVE TUCK said one policy decision is whether to keep things at status quo, where the oil and gas industry knows what to expect and the state has more leverage going into negotiations, or to decouple because of the concerns of the lost revenue that the State of Alaska will have. He questioned what the effects of decoupling would have on future gas negotiations, because there will be less revenue coming in under the gas

portion of decoupling. Version M, he highlighted, proposes a system "where we opt in and out." He offered his understanding that most oil and gas producers are actually looking for oil but finding gas along the way; they are able to "write off what they find in gas," but they may not be able to do so under the decoupling plan. He said, "I think that's the reason why ... we're going to this ... one bucket, two bucket, one bucket (indisc.)."

REPRESENTATIVE TUCK said he wants to see comparisons between the proposed plan and PPT.

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COMMISSIONER GALVIN said he thinks it would be an intriguing point of reference to go back to PPT, and he said he would attempt to formulate that model as soon as possible.

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CO-CHAIR JOHNSON said he thinks Representative Tuck's comments are accurate. He proffered that the purpose of [Version M] and "one bucket, two bucket, one bucket, two bucket" is to protect producers for cost allocation, so that if producers drill, allocating against gas, the producers would not be able to write that off until they sell the gas. He said it doesn't really have anything to do with whether or not decoupling happens.

[1:24:20 PM](#)

REPRESENTATIVE SEATON stated his understanding that the dilution effect between oil and gas is beneficial to production, drilling, and getting development going; however, a policy call is being made that as soon as gas starts down the pipeline, the dilution effect would be negative, and the state wants to get the maximum tax from oil, without any dilution effect from the gas rate. He asked for confirmation that that is correct.

[1:25:48 PM](#)

CO-CHAIR JOHNSON clarified that "the amendment" has nothing to do with whether or not he supports decoupling; it is an opportunity to protect against cost allocation problems that have been brought to his attention. He expressed his wish to see the bill moved out of committee "with a protection that doesn't disincentivize production."

1:28:46 PM

REPRESENTATIVE SEATON asked Co-Chair Johnson to confirm that he is talking about [Amendment 4], which is contained within Version M.

CO-CHAIR JOHNSON said that is correct.

REPRESENTATIVE SEATON said he understands the amendment, but that is not the only thing that may pass out of committee; the purpose of the bill is to decide whether to couple or decouple.

CO-CHAIR JOHNSON clarified that he does not think the larger policy call regarding coupling or decoupling has to do with bucket progressivity calculations. He continued as follows:

We're spending an awful lot of time on the two days - the window, and I want to be very clear why that was done: not to doing anything, not to lock anything in, wish we didn't have to do that; it is to protect future investment so that they can allocate their costs in a way that they can ... best maximize what we did when we passed ACES.

1:31:00 PM

REPRESENTATIVE SEATON asked, "So that's what the amendment does between now and the flow of gas at 1.5 [billion cubic feet] Bcf/day?"

REPRESENTATIVE JOHNSON said [Amendment 4] locks in a structure for cost allocation and taxes. The bigger issue, he said, is whether to chose coupling or decoupling. He reiterated that the committee is spending a lot of time on the bucket issue, and he would like the focus to be on coupling and decoupling.

1:32:11 PM

COMMISSIONER GALVIN, as a tax administrator, beseeched the committee not to put in place a two-day tax policy. He continued:

You can add in a cost allocation in the statute that says that costs will be allocated based upon current production, not upon some expectation of future production, and relieve this concern and have it so that you have a system in place on one day and a new

system the next day, and that's the tax policy of the state. To have it come in, come out, come in, come out ... [is] just not good tax policy.

COMMISSIONER GALVIN, in response to Co-Chair Neuman, said taxes for progressivity are done monthly, and taxes for the 25 percent base are done annually. He explained that taxes on progressivity are based on a monthly average price of oil and gas, which is why he is concerned about the proposed two-day separate tax system. He said daily production numbers are available; however, what is not known are: the selling price, the costs for that particular day, and how to take those costs and attribute them to a single day's worth of activity.

CO-CHAIR NEUMAN suggested that if the two-day plan saves the state billions of dollars, then perhaps the department could afford additional staff to manage it.

COMMISSIONER GALVIN remarked that if the plan were to save billions of dollars, then it may be worth it.

[1:34:44 PM](#)

REPRESENTATIVE EDGMON opined that this is an important point. He offered his understanding that it is not possible to predetermine what oil revenues would be in the future.

COMMISSIONER GALVIN said one issue is regarding what could potentially happen at the end of the month if the state shifts to a different tax system for two days.

REPRESENTATIVE EDGMON emphasized that there is no way to predict that the state will have so much more money by shifting the taxes for two days that it will be able to hire more people in the department.

COMMISSIONER GALVIN responded:

No, we won't have any more money this year as a result of this. In fact, we're going to lock in a lower tax rate, so there's no guarantee of more money anywhere down the line.

[1:36:22 PM](#)

REPRESENTATIVE EDGMON observed that many suppositions are being made, and he offered his understanding that the administration

is saying that it is difficult to base a model upon supposition. He said he wants to know if a plan is actually going to make money for the state.

CO-CHAIR NEUMAN related his understanding that the plan is not formulated to gain money, but to protect the state against losing money.

[1:37:38 PM](#)

REPRESENTATIVE GUTTENBERG asked if an analysis has been done by the Office of the Attorney General regarding [the two-day tax shift].

COMMISSIONER GALVIN answered yes. In response to a follow-up question, he said he would prefer that someone from the Office the Attorney General relates the details of the analysis to the committee.

[1:38:34 PM](#)

REPRESENTATIVE SEATON offered his understanding, based on all the examples the committee has been given, that the current system of taxation based on \$128 BOE gives the state \$5.5 billion in tax revenue, and "if we split them apart, we'll be able to get ... \$ 3 billion more revenue from the oil company." He said he is confused, because he has heard from oil companies and some testifiers that "tax extractions from the North Slope" are too high, and bills have been introduced to lower tax rates and progressivity. He asked Commissioner Galvin if he thinks an annual increase from \$5.5 billion to \$8.8 billion "extracted from producers on the North Slope" would have an effect on exploration, production, and operation on the North Slope.

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COMMISSIONER GALVIN said that would depend on the profitability of the operations in general. He explained, for example, that just because one tax obligation is higher than another, doesn't automatically make it a less attractive investment fund. He continued:

That said, when you look at the stated expectation of getting this maximum dollar that's identified - if you separate the two and ... keep the same system - I think that calls into question whether or not that provides an incentive for participation in a gas

project. That number's fairly significant, and it does not react to changes in prices like you'd like to see if you were an investor worried about your (indisc.).

[1:41:24 PM](#)

REPRESENTATIVE JOHNSON asked Commissioner Galvin if he understands what it is he is trying to do in regard to the "start/stop." He stated, "This is what [Legislative Legal and Research Services] came up with as a solution to my very simple request." He said he has a conceptual amendment that he does not think would quite work, because he said he thinks "for a period of time in between, the little guy's hurt - the explorer who has no production." He asked Commissioner Galvin if he could come up with an amendment to SB 305 so that the cost allocation would be applied to oil and the cost allocation between gas and oil would not be separated during the period until first gas flows. He said neither he nor Legislative Legal and Research Services could do so.

[1:42:36 PM](#)

COMMISSIONER GALVIN responded that there is a two-step policy call that would have to be made for that purpose. The first step is to choose a cost allocation method based upon either BOE or POP value. That allows the second step to be taken, which is that cost will be allocated based on current production rather than anticipation of future production. He emphasized that without knowing the actual underlying allocation methodologies, it is difficult to "write the second step." He concluded, "And so, if you want to go through both those steps and put that in place, then, yes, we can ... help write that for you." In response to a follow-up question, he said the cost allocation method for the Cook Inlet to North Slope relationship was on a BOE basis; there is no law of the land in terms of overall cost allocation.

[1:44:11 PM](#)

COMMISSIONER GALVIN, in response to Co-Chair Neuman, stated, "The way that we value gas is we use a [British thermal unit] Btu equivalent in order to be able to blend it with oil; that's your BOE combination." He offered his understanding that Co-Chair Johnson is asking what current cost allocation method is being used in "the one portion of the law in which we allocate costs." He continued as follows:

And in that we use a volumetric basis that would use a Btu equivalent. So, we can do that and expand that within this law to say that will be the system that's used across the board, and then we can say that it will be based upon the current production level." We can also ... give you both if you want; I can write one that says it's going to be on the relative value of the point of production, and then it will be allocated based upon current production, as well.

1:45:49 PM

REPRESENTATIVE JOHNSON asked Commissioner Galvin to explain how, after May 1, the state can go back to "doing it the way we are today."

1:46:12 PM

COMMISSIONER GALVIN said there are two issues created today by decoupling: the state currently allows producers to blend their oil and gas when calculating their progressivity rate; and the state has a different methodology to determine the tax obligation for gas that's produced in the state and for oil or gas that is produced in Cook Inlet, but allows all that to be blended for the purposes of determining progressivity for North Slope oil. He continued as follows:

The way that the bill is currently structured ... requires us to break it down into even buckets between Cook Inlet oil, Cook Inlet gas, North Slope oil, North Slope gas, and then blend the ones that we want to blend currently, and have those blended throughout so that we can have a system that sustains the open season and into first gas, and we don't have to have things change around.

You can do a cost allocation method that ensures that the costs are going to flow with the production and into the bucket that you're trying to have them apply against. I think that's what Roger attempted when he wrote the conceptual amendment he described, and we can work with him to refine that, so that that's the way that it would flow. But it has to have, as a base assumption, that you're either going to use a BOE or a POP methodology.

REPRESENTATIVE JOHNSON requested that Co-Chair Neuman write both amendments. He asked Commission Galvin if he has the aforementioned conceptual amendment.

COMMISSIONER GALVIN answered yes.

[1:48:09 PM](#)

CO-CHAIR JOHNSON said:

The concern is that -- and the committee can have this if they want to see what we're -- I think they may already have it -- but two -- number one works (indisc.) people no production that are ... only explorers and no production, it might, during the period of time, if the open season was expanded to more than a few days, they might have no place to apply their ... cost. So, if we could fix that point in this conceptual amendment, I'm more than happy to shred this. This is what our legal department came up with as a solution to the problem.

Then we get on to the bigger policy decision of whether or not we want to couple or decouple.

[1:49:09 PM](#)

CO-CHAIR NEUMAN offered his understanding that not all oil is the same; the amount of Btus makes a difference, and if it has more energy it is worth more.

COMMISSIONER GALVIN responded that Btus make a difference in regard to gas; however, with oil there are other issues with regard to impurities, et cetera, which establish the quality and value.

CO-CHAIR NEUMAN recollected being told that dry gas with a lot of methane lowers the value of the gas, whereas Prudhoe Bay gas or white gas with a lot of natural gas liquids in it is worth more, based on a Btu value. He said, then, that it is necessary to look at the quantities of gas and the value of it based on the Btus. In other words, he concluded that the amount produced multiplied by the Btu equivalent value equals the value of the gas.

COMMISSIONER GALVIN said there are more regulations involved; however, in response to Co-Chair Neuman, he said that is "one way to look at it."

[1:51:14 PM](#)

REPRESENTATIVE TUCK offered his understanding that it has been determined that the state would not lock in the dilution effect when it goes into open season in status quo; therefore, the state would not be locking in oil taxes. Furthermore, there is a concern that the state wants to keep things status quo, which is why Version M is before the committee, "to opt in, opt out, or go from one bucket to two buckets, [and] back to one bucket." He offered his understanding that the reason to go back to one bucket after a couple days is "to protect the gas and how it's combined with oil currently, so that oil and gas producers can continue with that tax advantage." Furthermore, he said "we" do not want to stifle the future of gas production by prematurely decoupling.

REPRESENTATIVE TUCK, regarding Co-Chair Johnson's concern about what decoupling would do to the current system until gas starts flowing, said it almost sounds like it would be better to wait to "do something like SB 305 until after open season."

[1:54:32 PM](#)

The committee took an at-ease from 1:54 p.m. to 1:56 p.m.

[1:56:58 PM](#)

ROGER MARKS, Consulting Petroleum Economist, Logsdon & Associates, told the committee that he would discuss the tax under the status quo versus decoupling, including what the numbers mean, what rates are behind them, and why one appears to be so much higher than the other. He directed attention to a slide presentation in the committee packet labeled "SB 305: Notes on Operation of Tax," which he said was presented on April 9 and was mistakenly labeled SB 350. He then directed attention to slide 6 of that handout, to the tax amount made under decoupling, which is \$333,539,063. He said that number divided by the gross rate is approximately 6 percent of gross. He recollected that someone had asked if that is similar to the economic limit factor (ELF) and whether it is a good idea to compare it to ELF. Mr. Marks said he would give a different perspective.

MR. MARKS said the \$333,539,063 was derived through the current tax, which is 25 percent of production tax value, plus progressivity, minus credits. He said decoupling does not change the tax rate; the rate would be locked in under SB 305. He relayed that this tax rate came out of ACES, and "insofar as ACES was appropriate then, it's appropriate now." He explained that because this is a net tax, as prices and production tax value rise, the tax, as a percentage of gross value, would be much higher.

[1:59:53 PM](#)

MR. MARKS reviewed that under the attributed gas tax - DOR's methodology using the status quo of allocating the total combined tax - the amount is \$1,199,688,523 [shown on slide 4]; under decoupling, the total is \$333,539,063.

MR. MARKS related that in marketing there is a term called anchoring, which is when marketers plant suggestions as to the worth of a product, often using what is called the manufacturer's suggested retail price (MSRP), and then lower the price to make people think they are getting a good deal. He offered examples. He said price anchoring is what is going on in terms of the \$1,199,688,523 versus the \$333,539,063. In response to Representative Tuck, he explained that he is suggesting that committee members are looking at the \$333,539,063 and thinking that that is a low number, because they are comparing it to the \$1,999,688.523. He said the latter number is high because of certain problems, which he said he will define.

[2:04:29 PM](#)

REPRESENTATIVE TUCK offered his understanding that these numbers were provided by Mr. Marks, and they are numbers that he is "using."

MR. MARKS confirmed that is correct. Regarding the perception that the \$1,999,688,523 is too high, Mr. Marks said "when you combine things," the result is the dilution effect, by which oil gets "diluted down" and gas gets "diluted up." When both oil and gas are combined, the progressivity is being calculated on a production tax value per BOE equivalent of \$46.98, which when put on a gas net value per Btu is \$7.83. When oil and gas are decoupled, the value of gas, undiluted by the oil, is apparent; when oil and gas are coupled, the gas value is being diluted by the oil to the \$7.83 amount. The net value per BOE of the gas

alone is \$9.98 or \$1.66 thousand thousand British thermal units (MMBtu). When combined, he said, the gas gets valued as if it's worth \$46.98 or \$7.83/MMBtu, thus under status quo, that gas with a value of \$1.66 is being taxed as if it has a value of \$7.83. He said that is one reason why the gas tax shown under status quo is so high.

[2:06:34 PM](#)

REPRESENTATIVE P. WILSON asked:

The real reason that we do it is so that they don't have to pay as much oil tax, because we're diluting the gas and the oil, and what this is allowing them to do is take off more expenses, right? So, that's why we did it, really, all together like that?

MR. MARKS indicated that the answer depends on whether history is interpreted such that it was intended that oil and gas should really be combined to compute the tax. He added, "And the way the tax was written it does this, but it's an effect that happens when you combine them." He offered his interpretation that when PPT and ACES were enacted, people were focused on oil and it applied to gas "by happenstance."

[2:08:28 PM](#)

MR. MARKS, in response to a follow-up question, said right now there is no gas that is diluting the oil, but with decoupling, all the costs would get to be deducted, and the decision would need to be made as to how much cost is oil and how much is gas.

[2:09:46 PM](#)

CO-CHAIR NEUMAN opined that absolutely nothing would be done except for in two days.

[2:09:54 PM](#)

REPRESENTATIVE TUCK recollected that someone had remarked that decoupling was never an issue in ACES. Conversely, he pointed out that during discussions of ACES there was a lot of talk about the coupling and decoupling issue.

MR. MARKS said his views are subjective, and the views of others may differ.

[2:11:21 PM](#)

REPRESENTATIVE SEATON relayed that when he was on the House Resources Standing Committee during the discussions on PPT, the committee considered progressivity, so, the issue is not unanticipated. Regarding Mr. Marks' previous explanation of price anchoring, he said he thinks folks are more sophisticated than that. He said that in the past, [the House Resources Standing Committee] talked extensively in an attempt to determine the proper Henry Hub and accelerator or decelerator for taxes. He said the whole purpose was to leave them together so that at negotiations the state could determine the proper relationship based on project cost and prices. He said he has a problem with the committee now attempting in one week to determine that the attributable costs are wrong and determining that another method should be chosen in order to fix a contribution from a gas tax for ten years after gas flows. He questioned the attempt to fix rates and the tax obligation calculated on gas production tax without the experts present.

REPRESENTATIVE SEATON asked Mr. Marks:

If you were going into negotiations on a pipeline, would you expect the ... MSRP to fool the oil companies; would you like to have your hands tied at a low rate before you ever went in; or would you like to have all of those issues on the table ... to be able to negotiate from a much stronger position?

[2:14:11 PM](#)

MR. MARKS clarified that his purpose in bringing up the MSRP analogy was to indicate why people may think the \$333,539,063 is too low, because they have the \$1,199,688,523, which is based on the combined methodology. Furthermore, he said the analogy was to show that the \$333,539,063 is based on the 25 percent tax rate in ACES, which is in place now and would be locked in, and to explain why there are "some problems with that high number" - why it may not be a productive number to lock in going forward. The analogy was not brought up as a means to discuss negotiation intricacies with the producers, he said.

MR. MARKS referred to a chart that he said he handed out "this morning."

[2:16:02 PM](#)

REPRESENTATIVE P. WILSON asked, "Just so I understand, the ... first two columns are decoupled, so, the second two columns are what?"

MR. MARKS answered that the first two columns include the exact same data that is on [slide] 6, which is that with oil and gas decoupled, the tax rate with progressivity is 53.99 percent for oil and 25 percent for gas.

CO-CHAIR NEUMAN asked Mr. Marks to explain decoupled tax rates and implied attributed tax rates.

MR. MARKS, regarding implied attributed tax rates, said when oil and gas are decoupled, the result is the ability to see what oil and gas are worth individually, undiluted by each other. When combined, the tax is based on \$46.98, and the value of the oil has been diluted down, while the value of the gas has been diluted up. Under decoupling, the oil is worth \$102.48; the gas is worth \$9.98 per BOE or \$1.66/MMBtu. He said with decoupling there are gross values and costs that are subtracted, and the production tax value is \$2,390,156,250, which is subject to the tax. He said, "So in this applied attributed tax rate, we have the same number: that's your production tax value, undiluted by the oil." He continued as follows:

But under the status quo, with the Department of Revenue using these attributed tax rates. If we look at this \$1.199 million as the tax, and we look at \$2.390 billion as the production tax value, what is the implied tax value that that ... means? And you would need a tax value of 61 percent applied to the net value of \$2.390 billion to get that tax.

So, the reason those numbers are so high under the status quo, with the combined methodology, is in essence in this example ... a 61 percent tax on the gas.

MR. MARKS said last night he reviewed the information from Commissioner Galvin that compares the gas combined and the gas decoupled, and he indicated that so much of the included charts are in red that "it looks like a civil war battlefield." He advised the committee to question whether high tax rates would be the best incentive for getting people to subscribe to the open season and whether "if that's what's being locked in" is the best environment in which "to start a deliberative process down the road."

2:20:05 PM

REPRESENTATIVE TUCK, referring to the Logsdon & Associates presentation dated April 9, 2010, stated, "So, ... when we look at implied attributed tax rates, we're not going to even consider the decoupled tax rates in making those determinations; it's all going to be in one bucket." In response to Mr. Marks, he clarified that his statement pertains to current law.

MR. MARKS clarified that under current law, "you'll get \$1.199 billion." He explained, "That's because you've calculated it combined by using \$46.98 as the value of the oil and the value of the gas, and you get this ... number here." He continued as follows:

If you look at ... the tax you get as a percentage of your production tax value, you ... would need a tax rate of 61 percent applied to the decoupled value of the gas, which is what the gas is worth undiluted by the oil. You would need a 61 percent rate to get that. So, in essence, under the status quo, if SB 305 doesn't pass, ... you would [be] taxing the production tax value of gas as it's undiluted by oil at a 61 percent tax rate.

2:22:03 PM

REPRESENTATIVE TUCK, referring to slide 4 of the April 9 presentation, oil and gas tax combined, asked what the gas to oil ratio was.

MR. MARKS responded that under the regulations of the Department of Resources, the total tax - the \$5.5 billion - is allocated based on the relative gross value; therefore, it is 22 percent gas and 70 percent oil. In response to a follow-up question, he said the ratio of the price of gas to the price of oil is \$120 to \$8.

REPRESENTATIVE TUCK observed that is a 15:1 ratio. He then directed attention to slide 2 of the same handout, to the upper-left chart, which shows the 15:1 ratio. He offered his understanding that Mr. Marks is saying that "we should be at 1.9 attributed to gas rather than what we have in PowerPoint 3." He continued:

We have two examples of one -- we have that one, it's 0.3.

MR. MARKS replied, "Right, and that's the 333 million we get under ... SB 305."

REPRESENTATIVE TUCK said, "And if we separate it we go to ... 1.2."

MR. MARKS confirmed that is correct.

[2:24:06 PM](#)

REPRESENTATIVE SEATON indicated that if the status quo is 1.2 attributable to gas, then there would be 4 times as much tax attributable to gas under the status quo as there would be under SB 305. He said the tax rate on gas is the only thing that is fixed into law at open season.

[2:24:37 PM](#)

REPRESENTATIVE TUCK said, "I just wanted to hear it one more time that that is 0.3 or 305 and 1.2 on status quo." He asked Mr. Marks if he agrees with "those two numbers."

MR. MARKS confirmed that is correct. He said, "And again, that matches these numbers here: there's the 1.2 on slide 4, when it's combined; and there's the 0.3 on slide 6 where they're decoupled."

[2:25:08 PM](#)

REPRESENTATIVE EDGMON directed attention to "the slide with the two bars" on "page 3," and he stated, "That \$3 billion has got to come from somewhere, right? And it's coming from the oil companies."

MR. MARKS replied that that \$3 billion is "the difference in production tax by diluting the value of the oil through..."

REPRESENTATIVE EDGMON said that represents an increase in tax of oil companies.

[2:25:55 PM](#)

MR. MARKS said what that actually represents is the drop in tax that would occur pursuant to having oil flowing by itself and

then having gas flow on top of that. The \$3 billion represents the decrease in tax resulting from the dilution of the oil value.

[2:26:23 PM](#)

MR. MARKS, in response to Chair Neuman, said under status quo the state would be making \$5.5 billion. He said that prior to a gas sale, the state will have \$8.7 billion in tax on gas alone. Under the status quo, if gas is brought in, the state ends up with \$5.5 billion, which means about \$3 billion of oil tax that was being paid before disappears, even though there is a big money-making gas operation overlaid on top of oil.

[2:28:14 PM](#)

REPRESENTATIVE EDGMON reiterated his concern that in the state's attempt to provide an incentive to the industry on the gas side, it may be providing a larger disincentive on the oil side. He surmised that Mr. Marks would disagree with that summation.

[2:28:48 PM](#)

CO-CHAIR NEUMAN announced that SB 305 would be held over.

[2:29:10 PM](#)

The committee took an at-ease from 2:29 to 2:35 p.m.

HB 365-FISH PROCESSOR FEES, LICENSES, RECORDS

[2:35:33 PM](#)

CO-CHAIR JOHNSON announced that the next order of business would be HOUSE BILL NO. 365, "An Act relating to sharing records regarding fish purchased by fish processors with certain federal agencies, to requirements to obtain and maintain a fisheries business license, and to payment of industry fees required of fish processors; and providing for an effective date."

[2:35:49 PM](#)

REPRESENTATIVE CHARISSE MILLETT, Alaska State Legislature, presented HB 365 as sponsor. She described HB 365 as "a completion of a bill that was started in 2002" regarding fisheries permit buybacks. She explained that the intent of allowing buybacks of fisheries permits is to stabilize and

sustain the fishery. The bill would allow a fishery to buy back a permit with the agreement of two-thirds of its permit holders, and would give the fishery access to \$21 million through the federal marine fisheries program. She noted that the Southeast Alaska Purse Seine fishery is the first to have elected to pursue the buyback. She related that fisheries that want to buy back a fishery must agree to a self-assessed tax of 3 percent on each sale of fish they catch to cover the costs of the program. Furthermore, the program is voluntary; only those fishermen who choose to sell their permits may do so. She reported that currently over half of the permits in the Southeast Alaska Purse Seine fishery are not being used. She remarked upon the unusual occurrence of a large group of fishermen coming to agreement on any issue.

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REPRESENTATIVE KAWASAKI said HB 365 was previously heard by the House Special Committee on Fisheries, but he did not recall there being a letter of intent, which he observed has been added. He questioned the reason for the addition of the letter of intent, and asked if the focus of the bill is being limited to Southeast Alaska.

REPRESENTATIVE MILLETT responded that the Southeast Alaska Purse Seine fishery is "the only group of fishermen that [has] decided to go forward with the fisheries buyback," although the buyback is open to all of Alaska's fisheries. Regarding the letter of intent, she noted that people in "the processor group" were concerned about "the ability of the \$21 million to buy back a portion of permits that exceeded what they thought they needed to keep their processors full." She indicated a connection between the letter of intent and the processors being comfortable with the legislation. In response to a follow-up question, she clarified that the letter of intent is specific to "this buyback program"; however, the bill itself does not limit participation to Southeast fisheries.

[2:40:04 PM](#)

REPRESENTATIVE P. WILSON noted that in the committee packet is a memorandum of understanding between the producers and fishermen.

[2:40:47 PM](#)

REPRESENTATIVE SEATON directed attention to language in Section 2, on page 3, and he asked the bill sponsor to confirm that

"department" is the Department of Revenue and "annual fee" is a business license fee.

REPRESENTATIVE MILLETT answered that is correct.

REPRESENTATIVE SEATON noted that there are other buyback programs, such as the Bering Sea Crab fishery program, which could fall under HB 365. He said there is a situation in the bill in which the Department of Revenue would be offering a business license and denying it based on federal provisions. He said the federal government has the ability to "search and seek" its own remedies. He opined that it is problematic for the state to deny a business the ability to operate in state waters because of a federal obligation, and he relayed that he would be offering an amendment to address this issue.

[2:42:35 PM](#)

REPRESENTATIVE MILLETT, in response to Co-Chair Johnson, confirmed that the buyback program has a federal funding mechanism. She said Representative Seaton's concern relates to an agreement between the Southeast Alaska Purse Seiner fishery and National Marine Fisheries Service (NMFS) to ensure that the fish tickets collected by processors make it to NMFS so it can not only collect the tax but also administer the program. She said this is the main focus of the bill, and Representative Seaton's amendment would gut that. She said that without the fish tickets there would be no ability to assess the tax. In response to Co-Chair Johnson, she indicated that the Department of Revenue was also involved in the agreement.

[2:44:16 PM](#)

REPRESENTATIVE SEATON clarified that Section 1 addresses the issue of fish tickets, but that he is concerned about language in Section 2, which proposes not allowing the Department of Revenue to issue a license to a processor. He said Sections 2 and 3 are about the fees and not about the data.

[2:45:15 PM](#)

REPRESENTATIVE JOHNSON said he would like the amendment mentioned by Representative Seaton to be offered in order to hear the testimony related to it.

[2:45:40 PM](#)

REPRESENTATIVE SEATON moved to adopt Amendment 1, labeled 26-LS1514\A.3, Kane, 4/1/10, which read as follows:

Page 1, lines 2 - 3:

Delete ", to requirements to obtain and maintain a fisheries business license, and to payment of industry fees required of fish processors"

Page 3, line 19, through page 5, line 6:

Delete all material.

Renumber the following bill section accordingly.

REPRESENTATIVE P. WILSON objected for discussion purposes.

[2:46:04 PM](#)

REPRESENTATIVE SEATON offered his understanding that the committee packet contains information regarding public law, the buyback, and the Reduction Act, and that payments and collections shall be in accordance with requirements of U.S.C. 1801 - not just a negotiation between Alaska authorities and NMFS, but a requirement under federal law to ensure payments are collected. He noted that the Internal Revenue Service (IRS) is a part of this, as well. He indicated that there is nothing under the federal law that requires it to also be under state law.

[2:47:37 PM](#)

CO-CHAIR JOHNSON reminded the committee of his intent to hear testimony and come back to the proposed Amendment 1, which he opined is germane to the entire bill.

[2:48:09 PM](#)

REPRESENTATIVE MILLETT asked the committee to remember that the program through which the Southeast Alaska Purse Seiners have worked to attain money is a federal one. Taking the business license portion of the bill out, she warned, will leave no mechanism for enforcement for the Southeast Alaska Purse Seiners to receive the money or pay it back. She said she cannot imagine that any processor would not "comply with this."

[2:49:39 PM](#)

BOB THORSTENSON JR., Executive Director, Southeast Alaska Seiners Association, testified that when the association began work on the buyback program in 2002, it was part of the Alaska State Legislature Salmon Task Force. He said the association already has total congressional authorization and has received \$3 million in the form of a grant from the federal government, and it has purchased 35 permits with that money. He said approximately one-quarter of the entire program has already been paid for by "you" and the federal government. He noted that at first, the processors had some concerns, but the association worked through those with a memorandum of understanding (MOU) and a letter of intent.

MR. THORSTENSON stated that the proposed Amendment 1 would "kill this and send us back into the dark ages." He said he appreciates the concern held by some people. He stated, "We didn't enter into this attempting to lead Alaskans into some type of a new relationship with the federal government where they could somehow shut down our processors and then we'd all be stuck not fishing." He said the association has spoken with all the major processors involved, and he offered his understanding that Trident Seafoods, for example, has said it pays taxes to the State of Alaska and has no intention of ever not doing so, "so, in that sense, this won't ever apply to us." He noted that the Department of Law, "CVC," and the Department of Revenue all had people at the table working on this issue; the issue was extremely vetted with the administration, and the purpose of his coming before the legislature today is to ensure that the issue is vetted with the legislature, as well. He reiterated that the association is opposed to the proposed Amendment 1, but emphasized the association's support of the bill, with the MOU and the letter of intent, and he urged the committee to support it.

[2:52:49 PM](#)

CO-CHAIR JOHNSON related that Mr. Thorstenson had said he had moved to Juneau "as a result of this bill."

[2:52:59 PM](#)

REPRESENTATIVE SEATON asked if the major processors to which Mr. Thorstenson had referred buy fish from federal waters.

MR. THORSTENSON estimated that nearly every one of the major Southeast Alaska purse seine and salmon processors "also buys fish in federal waters"; and nearly every one of them has had

its attorneys and/or CEOs, CFOs, and lobbyists look at this legislation.

REPRESENTATIVE SEATON concluded that in purchasing fish from federal waters, those entities would be required to hold an NMFS permit.

MR. THORSTENSON said he presumes so, but related that he personally does not purchase fish from or fish in federal waters.

CO-CHAIR JOHNSON questioned if the proposed Amendment 1 would "violate the agreements of the agreement."

[2:53:51 PM](#)

THOMAS LENHART, Assistant Attorney General, Natural Resources Section, Civil Division (Juneau), Department of Law, responded, "It is my opinion that the National Marine Fisheries Service would not go through with this program without it." He related that he has had the opportunity to work with council from NMFS, as well as "some of the program people" for the last three years, and he said the biggest sticking point in [NMFS] doing this program has always been a mechanism for them to have assurance that they will get repaid. He said this is different from other buybacks [NMFS] has done, because he indicated others have been in federal waters and done through federal programs where mechanisms are already in place. But in this program, [NMFS] would be funding a buyback in a fishery that is entirely state run.

MR. LENHART explained that NMFS has some cumbersome and uncertain mechanisms for collecting debt; it basically has to rely on a civil action, bringing in the U.S. Department of Justice to try to collect a debt. The entity has made it clear from the start that it needs "a little bit of a safe assistance here with the mechanism that would do two things." He said the first part of the bill would require the state to share with NMFS the information on fish tickets that would be confidential otherwise, so that NMFS would have some documentation of what has actually been caught and what is due. Mr. Lenhart stated that [NMFS] remains concerned about an appropriate mechanism to guarantee that money is collected by the processors and turned over to the federal government. He stated, "This was the one mechanism that people were able to agree upon." He offered his understanding, based on his conversation with NMFS over the

years, that the future of the whole program is "very much in doubt if this amendment goes through."

[2:56:36 PM](#)

REPRESENTATIVE SEATON, regarding the processors collecting money and the sharing of confidential information, asked, "How big of a hook is it for them to put a hold on a federal fisheries permit and [prevent] those folks from buying any fish from federal waters ...?"

[2:57:14 PM](#)

MR. LENHART said he has never had that discussion and cannot speak for NMFS. Notwithstanding that, he imparted that NMFS's council was "not comfortable with that" and "did not feel that was adequate."

[2:57:39 PM](#)

REPRESENTATIVE SEATON asked Mr. Lenhart to clarify if he is saying that it was not adequate or that "it wasn't proposed that they put a hold on the fisheries permits that the National Marine Fisheries Service issues, instead of requiring the state to put a hold on the licenses it issues."

MR. LENHART replied that based on his conversations with [NMFS] over the years, that entity does not feel it has "an adequate remedy." He reiterated that he did not specifically discuss what Representative Seaton is suggesting; however, he stated that [NMFS] was seeking any mechanism that it felt would be effective, and it concluded that it does not have one.

[2:58:31 PM](#)

ROB ZUANICH, Manager, Southeast Revitalization Association, stated, "This bill is essential to the implementation of our consolidation buyback program." He said that four years after the Alaska State Legislature passed a bill allowing salmon permit holders to form nonprofit associations to reduce or buy back permits in the fishery, the U.S. Congress amended the Magnusson Stevens Act, which made SRA eligible for a federal loan to finance the program. He noted that this would be the first time this program would be used in state water fisheries. He relayed that the loan would be administered by the fishery service and repaid by an assessment on the catch of fishermen remaining in the fishery. The loan will be funded, he said, and

fishery services need assurances that it can "timely audit repayment of the loan," and that there is a mechanism to ensure collection of the assessment. Mr. Zuanich stated that [HB 365] would provide that assurance. He said the bill language carefully balances the need of the fishery service and the buyer or processor of the salmon who is responsible for the collection and remittance of the assessment.

MR. ZUANICH said the proposed Amendment 1 not only would be fatal to the program, but also is misguided and fails to recognize that it is state fishermen and state processors that want this mechanism. He stated, "We could see nothing more detrimental than to have a recalcitrant buyer of salmon withhold the tax and then not remit it to the federal government to repay the loan we must repay." Equally troubling, he opined, would be processors or buyers that did not withhold the tax and had an unfair advantage over those processors who wanted to play the game fairly. He said the mechanism is not only required by the fishery service, but is also urgently needed by fishermen and processors who want this to be a fair, equitable, and fully-funded program.

[3:01:44 PM](#)

JOE PLESHA, Chief Legal Officer, Trident Seafoods Corporation, Testifying in support of HB 365, noted that Trident Seafoods Corporation has salmon processing facilities in Southeast Alaska, at Ketchikan, Petersburg, and Wrangell. He related that early on in this process, Trident had concerns that the magnitude of the buyback may be too great, because since at least 2002, processors have invested heavily in value-added and increased production of pink salmon, so that now "we are all searching for more boats to fish for our plants." Mr. Plesha expressed appreciation for the work of Mr. Thorstenson and the Southeast Alaska Purse Seiners fishery, with whom he indicated Trident was able to negotiate "a floor below which they've committed not to buy back permits," which allows Trident to support the proposed legislation, along with the letter of intent from the legislature acknowledging that the floor exists.

MR. PLESHA stated that while he appreciates the purpose for which Representative Seaton has offered Amendment 1, Trident has an accounting staff dedicated to ensure that the corporation correctly pays its taxes and meets all its requirements, and he expressed confidence that "we'll be able to do that without a great deal of extra burden." He clarified that Trident Seafoods

Corporation does not believe that the proposed Amendment 1 is necessary.

[3:03:30 PM](#)

FRANK M. HOMAN, Chairman/Commissioner, Commercial Fisheries Entry Commission (CFEC), Alaska Department of Fish & Game (ADF&G), stated that CFEC has worked for a number of years with the Southeast Alaska Purse Seiners fishery, and it is taking direction from state statute that was passed by the legislature in 2002 that authorized these programs. He said CFEC's role is to facilitate the wishes of the legislature. He said the procedures resulted from discussions during [the Alaska Joint Legislative Salmon Industry Task Force], which was attended by fishermen and processors. He characterized [HB 365] as the last phase of a series of legislative initiatives spanning the last 8-10 years.

MR. HOMAN, regarding the proposed Amendment 1, drew attention to language in Section 3, which states that NMFS would not be owed to arbitrarily seek to withhold a business license, but would have to exhaust all legal administrative remedies. Where this could occur, he said, is with "some maverick processor who's not following the rules"; however, he noted that the committee had just heard from one of the major processors that it does accounting and knows the procedures. He said he thinks it is unlikely that any processor would not comply with the federal requirements.

[3:06:34 PM](#)

REPRESENTATIVE SEATON said he was on the aforementioned task force and supported the program; however, he recollected that there never was a discussion of withholding state business licenses. He asked if that issue was a private negotiation.

[3:07:08 PM](#)

MR. HOMAN responded that the program in general was discussed [by the task force]; however, he offered his understanding that the specifics of HB 365 were not even on the table at that time. He said, "This came about in the last several years with negotiations with the National Marine Fisheries."

[3:07:31 PM](#)

JEREMY JENSEN testified on behalf of himself in support of HB 365. He related that he is a lifetime resident of Petersburg and has worked as a commercial salmon seiner for the past 10 years. He stated opposition to the proposed Amendment 1.

[3:08:18 PM](#)

MITCH EIDE testified on behalf of himself in support of HB 365. He related that he is a lifelong resident of Petersburg, and said he has operated a seiner in Southeast Alaska for 25 years. He said there are fishermen who support this legislation who have been trying for eight years to get this program started. He expressed his wish that his five-year-old will be able to take his place some day. He urged the committee to support the bill without the proposed Amendment 1.

[3:09:02 PM](#)

TROY THOMASSON testified on behalf of himself in support of HB 365. He said he is a lifelong resident of Petersburg, and he has been an owner/operator of a seiner for the last 10 years.

[3:09:32 PM](#)

CO-CHAIR JOHNSON, after ascertaining that no one else wished to testify, closed public testimony on HB 365.

[3:09:43 PM](#)

REPRESENTATIVE SEATON, referring back to Amendment 1, said the committee has heard in testimony that the processors have federal fisheries permits and obligations, and NMFS has full applicability to withhold licenses, as well as its own ways of enforcing this program. He said there have been instances where federal government has "come down with REAL ID" to enforce certain things, and the state has consistently said it does not want to tie its hands with the requirements of the federal government when those requirements are not appropriate. He noted that listed on page 3, [line 26, through page 4, line 6], there are "a number of conditions where we can withhold a business license"; however, he said nowhere in the language does it say that "we're going to withhold these for ... federal government obligations." He said he understands that it is convenient for people to negotiate and say "we" will withhold our Alaska business licenses based on a desire by a federal agency - "not to exert their control through their own licenses" - but he said he thinks this is a matter of state's rights, and

he opined that it is important to "make the requirements in the states and the political subdivisions of the state - not the federal government."

[3:12:01 PM](#)

REPRESENTATIVE P. WILSON maintained her objection to Amendment 1.

A roll call vote was taken. Representatives Seaton and Kawasaki voted in favor of Amendment 1. Representatives Tuck, P. Wilson, Olson, Edgmon, and Johnson voted against it. Therefore, Amendment 1 failed by a vote of 2-5.

[3:13:09 PM](#)

REPRESENTATIVE EDGMON moved to report HB 365 out of committee with individual recommendations, accompanying fiscal notes, and letter of intent. There being no objection, HB 365, with attached letter of intent, was reported from the House Resources Standing Committee.

[3:14:15 PM](#)

CO-CHAIR JOHNSON recessed to a call of the chair at 3:14 p.m. [The meeting never reconvened.]