

ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE

February 13, 2012

2:05 p.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Peggy Wilson, Vice Chair
Representative Alan Dick
Representative Neal Foster
Representative Bob Herron
Representative Cathy Engstrom Munoz
Representative Berta Gardner
Representative Scott Kawasaki

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE JOINT RESOLUTION NO. 26

Urging federal agencies to work with the Alaska Department of Fish and Game, Southeast Alaska Native leaders, and other interested parties to establish strategies and plans for the sustainable management of the reintroduced sea otter population of Southeast Alaska.

- MOVED CSHJR 26(RES) OUT OF COMMITTEE

PRESENTATION(S): A FIVE-YEAR LOOK BACK: OIL INDUSTRY CAPITAL EXPENDITURES BY CATEGORY 2006-2010

- HEARD

HOUSE BILL NO. 9

"An Act requiring the Joint In-State Gasline Development Team to report to the legislature recommended changes to state law that are required to enable or facilitate the design, financing, and construction of an in-state natural gas pipeline so that the in-state natural gas pipeline is operational before 2016; and providing for an effective date."

- BILL HEARING CANCELED

PREVIOUS COMMITTEE ACTION

BILL: HJR 26

SHORT TITLE: SEA OTTER MANAGEMENT

SPONSOR(s): REPRESENTATIVE(s) P.WILSON

03/31/11	(H)	READ THE FIRST TIME - REFERRALS
03/31/11	(H)	RES
02/03/12	(H)	RES AT 1:00 PM BARNES 124
02/03/12	(H)	Heard & Held
02/03/12	(H)	MINUTE(RES)
02/13/12	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

ARTHUR MARTIN, Staff
Representative P. Wilson
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: On behalf of Representative P. Wilson, prime sponsor, introduced the proposed committee substitute for HJR 26, Version I.

GREG BROWN
Juneau, Alaska

POSITION STATEMENT: Expressed concern with HJR 26.

JULIANNE CURRY, Executive Director
Petersburg Vessel Owners Association (PVOA)
Petersburg, Alaska

POSITION STATEMENT: Testified in regard to HJR 26.

TINA BROWN, President
Alaska Wildlife Alliance (AWA)
Juneau, Alaska

POSITION STATEMENT: Expressed concern with HJR 26.

MIKE MILLER, Chairman
Indigenous People's Council for Marine Mammals (IPCoMM)
Sitka, Alaska

POSITION STATEMENT: Testified in support of HJR 26.

BRYAN BUTCHER, Commissioner
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: Provided a PowerPoint presentation on oil industry capital expenditures between 2006 and 2010.

DONA KEPPERS, Audit Master
Production Audit Group
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: Shared in the providing of a PowerPoint presentation on oil industry capital expenditures between 2006 and 2010.

ACTION NARRATIVE

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CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting to order at 2:05 p.m. Representatives Dick, Herron, Gardner, Seaton, and Feige were present at the call to order. Representatives Munoz, Foster, Kawasaki, and P. Wilson arrived as the meeting was in progress.

HJR 26-SEA OTTER MANAGEMENT

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CO-CHAIR FEIGE announced that the first order of business would be HOUSE JOINT RESOLUTION NO. 26, Urging federal agencies to work with the Alaska Department of Fish and Game, Southeast Alaska Native leaders, and other interested parties to establish strategies and plans for the sustainable management of the reintroduced sea otter population of Southeast Alaska. [Before the committee was Version B, the proposed committee substitute (CS) labeled 27-LS0717\B, Bullard, 1/27/12, adopted as the working document on 2/3/12.]

CO-CHAIR SEATON moved to adopt the proposed committee substitute (CS) for HJR 26, Version 27-LS0717\I, Bullard, 2/6/12, as the working document. There being no objection, Version I was before the committee.

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ARTHUR MARTIN, Staff, Representative P. Wilson, Alaska State Legislature, explained that the language in Version I is the result of working with the Sealaska Heritage Foundation. During

the 2/3/12 hearing on HJR 26 a concern was raised of the ability of Native peoples to sell sea pelts to anyone. Therefore, all mention of the sale of intact sea otter pelts was removed from the resolution and language was crafted in two changes that clarify the issue. The first change is on page 3, line 1, where the language now reads that "Alaska Natives are limited to selling only 'authentic' and 'traditional' Native handicrafts". The second change begins on page 3, line 31, and addresses a previous discussion that the Marine Mammal Protection Act limits the allowable uses of sea otters to only "authentic" and "traditional" handicrafts. Because the definition of authentic and traditional is too restrictive, the change here asks that these terms be replaced with "Alaska Native articles of handicraft".

MR. MARTIN reported that the sea otter issue has made headlines and the sponsor is happy that the issue is being elevated to this level and heard by the committee. If current policies of inaction continue it is believed that in just a few years humans will have little share of the dive fishery resources for commercial or subsistence harvesting. Areas that once had an abundance of sea cucumbers, geoduck clams, red sea urchins, and Dungeness crab are being depleted by sea otter predation.

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REPRESENTATIVE KAWASAKI, regarding ecology and the hope that management will include an ecosystem balance, questioned Mr. Martin's last statement because the [first] further resolved clause does not state that managing for a balanced ecosystem is the plan. He understood the resolution to say that the state is not taking a position on whether to start actively managing populations of sea otters, but to urge federal agencies to revisit [the 1994] management plan.

MR. MARTIN agreed it is Representative P. Wilson's opinion that the ecosystem is out of balance because of increased sea otter populations. He maintained, however, that the resolution itself does not state an opinion; it just asks that a discussion be had between the appropriate state and federal departments and the Native peoples based on the research that has been done.

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REPRESENTATIVE KAWASAKI opined that the [November 2011] McDowell Group report [entitled "Sea Otter Impacts on Commercial Fisheries in Southeast Alaska"] does not say that sea otters

were the major part of the decline of sea cucumbers and a certain shellfish. Responding to Mr. Martin, he said the report clearly states that the declines in sea urchins and other species were not due to sea otter predation.

MR. MARTIN recalled reading such a clause in the report, but said he could not remember whether that clause was referencing geoducks, sea cucumbers, or sea urchins. However, he continued, [Appendix 2] of the report does show conclusive evidence that sea otters have had a direct and indirect impact on species such as the sea cucumber and geoduck clams.

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CO-CHAIR FEIGE opened public testimony on HJR 26.

GREG BROWN stated that HJR 26 was developed by a special interest group that hired a consultant to substantiate its beliefs. He said he has had many dealings with consultants all over the world through his previous work as CEO of one of the largest companies in Latin American, and consultants get to be big and successful by writing reports that the people who are paying them want to hear. He said that even the title of the McDowell report is misleading and should instead be "The Effect of Sea Otters on a Few Specific Fisheries in Southeast Alaska" given there are dozens of fisheries in Southeast Alaska that are not even mentioned in the report.

MR. BROWN said other possibilities should be looked at. For example, sea otters could improve other commercial fisheries and are a keystone species. He noted that the State of Oregon has issued a report regarding ocean acidification that is not covered [in the McDowell report]. Additionally, tourism viewing and wildlife viewing is a \$30 billion industry in the U.S. and has grown over 6 percent annually even during this current economic downturn. In the city of Juneau the business of wildlife viewing is worth over \$30 million. One whale, over its lifetime, is worth over \$32 million to the city of Juneau and a bear at Pack Creek is worth \$132,000 annually to the city. The reintroduced wolves of Yellowstone National Park are worth \$35 million annually.

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MR. BROWN maintained that sea otters could be worth as much as \$5 million annually in increased tourism. To support his statement he read from a 2005 California study report: "The

eventual expansion of southern sea otter populations in range would provide more than \$100 million of annual income economic benefit to California households." Allowing that reports can be argued, he pointed to an example of economic benefit in Monterey, CA, which began holding the Sea Otter Classic 22 years ago when sea otters were reintroduced there. He said this extravaganza, which will be running again in April 2012, features amateur and pro cycling events as well as family activities, attracting more than 50,000 bicycle enthusiasts from around the world. The classic also plays host for the largest consumer bike expo in the world. None of these have been considered in the [McDowell] report, he pointed out.

MR. BROWN, again allowing that any report can be argued, related that he searched for the most neutral report that he could find and came upon a 2006 Master's thesis by Sarah Poirier of McGill University. The thesis talks about the benefits of sea otters around Victoria Island and the increase in tourism and economic prosperity that can be gained by utilizing that opportunity. The thesis also supports that the keystone species of sea otters is real and provides extreme detail about why it is real and where it comes from.

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MR. BROWN explained that his point in discussing economics and other alternatives is that if nature was embraced and not fought everyone could become rich because the opportunity is there for this to happen. He said the committee is making a decision based on the recommendations of a financial special interest group and the report paid for by that special interest group is very biased, woefully incomplete, and insulting. He recounted an old rule in business that says to get 80 percent of the information, add judgment, and then make a decision because one can never get 100 percent of the information. In this case, he argued, there is less than 20 percent of the information. He urged the committee to take time to get the rest of the facts and not rush to judgment.

REPRESENTATIVE GARDNER asked what keystone species means and how that plays out.

MR. BROWN understood from Dr. Mary Willson [of Juneau] and the aforementioned thesis that sea otters control the number of sea urchins and sea urchins are directly related to the amount of kelp. When kelp is healthy other fisheries are also healthy, such as salmon and fisheries similar to salmon.

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JULIANNE CURRY, Executive Director, Petersburg Vessel Owners Association (PVOA), specified that PVOA has about 120 vessels and businesses and its members are active personal use, subsistence, and sport fishermen who are affected by the species that are affected by sea otters. She said nobody is looking for widespread and unchecked harvest of sea otters; people are looking for a balance, but in Southeast Alaska there is not a good balance with what is happening with resources. She noted that Version I does not include the allowance of Alaska coastal Natives to sell and trade raw pelts to non-Natives. Without that language, she said it will be difficult to support the resolution because that is a time-honored tradition and PVOA feels it is very important for Alaska coastal Natives to be able to sell raw pelts. However, she continued, the rest of the resolution is heading in the right direction. She observed that PVOA's letter is missing from the committee packet, but drew attention to the resolution from the City of Petersburg and the letter from the Southeast Alaska Subsistence Regional Advisory Council (RAC), which has heard hours and hours of testimony about this issue.

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REPRESENTATIVE HERRON, regarding the inability of Alaska Natives to sell to non-Natives, asked whether Ms. Curry is suggesting there be a quota for pelt use and that once that quota is reached then pelts could be sold by Natives to non-Natives.

MS. CURRY replied that PVOA would be looking for the U.S. Fish and Wildlife Service, or the U.S. Congress through an amendment of the Marine Mammal Protection Act, to interpret the definition of significantly altered differently. She said PVOA would like for coastal Natives, who are allowed to harvest sea otters under current regulations, to be able to sell a sea otter pelt to a non-Native.

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REPRESENTATIVE P. WILSON pointed out that she did meet with Native groups to discuss the resolution and it was re-worded to the way that the Native groups wanted. She inquired whether there has been a change since then.

MS. CURRY responded that much of the conversation so far about significantly altered and handicraft has been driven by the artisan market and she understood that that conversation has helped in the shaping of the current bill. However, she continued, there is a significant number of just harvesters who would like to be able to sell raw pelts, although she does not know why they are not coming forward with testimony. She shared that she would like to have a raw sea otter pelt to put on one of her two couches to accompany the raw pelt of an arctic fox that she already has. While she understood the concern about the sale of raw pelts potentially industrializing the current artisan market, she remained unconvinced that that should trump the overall good that would come from returning the right of Alaska Natives to sell a raw pelt.

REPRESENTATIVE P. WILSON said she would be glad to add anything that might help with those concerns as the resolution moves along, but the harvesters will need to call her office.

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TINA BROWN, President, Alaska Wildlife Alliance (AWA), noted that her non-profit organization, whose board is comprised only of Alaskans, is committed to the preservation and protection of Alaska's wildlife. She said AWA has critical concerns about HJR 26 because the resolution appears to call for the implementation of predator control on sea otters. While understanding this is a resolution and not a bill, she stressed that there would be negative consequences if the resolution is adopted. It is intended to be a foot in the door for those advocating for predator control on sea otters. The sponsor's statement on the Internet seems clear in the call for predator control on sea otters because it says that action must be taken now rather than waiting for studies. Additionally, at a previous hearing the executive director of the United Fishermen of Alaska (UFA) testified that HJR 26 is probably not enough to help his fishery, but it is a step in the right direction.

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MS. BROWN related that at a presentation by the Alaska Department of Fish & Game (ADF&G) last week a member of the audience said predator control on sea otter population was necessary and urged that it be opened up to all Alaskans, not just Native Alaskans. This issue is escalating, she continued, and the resolution has not yet been passed. She noted that HJR 26 urges state and federal governments to work with ADF&G to

reduce sea otter populations, but said that ADF&G does not have a shining reputation for wildlife management: the department is shooting wolves from aircraft in the Kenai Peninsula; snaring bears, including sows, and then shooting their cubs; gassing wolf pups in their dens; and is allowing non-resident hunting in some active predator control areas. Alaska's reputation for wildlife management is deeply tarnished right now, she said. Imagine the negative press if Alaska started what people would consider predator control on sea otters. Imagine the reaction of tourists and potential tourists. Imagine the reactions of Alaskans.

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MS. BROWN concurred that sea otters are a keystone species and said that without sea otters there will be no great kelp forests because the otters keep sea urchins under control. She related that a panel of scientists at the recent Board of Fisheries meeting in Petersburg stated that research on sea otters in Southeast Alaska is underway and more research is needed. It was also stated at the meeting that the carrying capacity for sea otters in Southeast Alaska, before they were wiped out, is unknown. At this same meeting, the Board of Fisheries stated that one species should not be placed in higher regard than another and the board specifically referred to sea cucumbers versus sea otters. Prudence is the wisest approach to this issue, she advised. Opening the door for predator control on sea otters also opens the door for predator control on other protected species, such as Steller sea lions and humpback whales, and people are already talking about that.

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MS. BROWN said the consequences of HJR 26 could be devastating. If the intent of the resolution is to provide greater economic benefits to Native Alaskans via a more liberal use of sea otter pelts, then re-word the resolution to say that. However, if the intent of the resolution is to use Native Alaskans as a tool to start predator control on sea otters, then the Alaska Wildlife Alliance strongly opposes the resolution.

CO-CHAIR SEATON noted that the committee has adopted Version I, which would do what Ms. Brown suggests in regard to expanding the usage in handicrafts, such as allowing for a zipper. Since Version I has no expansion of who can hunt and has no sales to non-Natives, he asked whether it would fit the criteria that Ms. Brown has laid out.

MS. BROWN pointed out that the resolution has numerous whereas clauses and some of the wording in those clauses need to be changed to not address predator control. She offered to go through the clauses and mark the areas of concern. She said previous oral testimony and the written testimony clearly view the resolution as a step towards predator control on sea otters.

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REPRESENTATIVE HERRON asked whether predator control in any form is unnecessary.

MS. BROWN replied that she did not say that; she said that more studies need to be made, which is what scientists said at the Board of Fisheries meeting. While she is not a biologist, she said she knows that sea otters are good for the marine environment and fisheries. Since sea otters are just making a comeback right now, it seems wise to see what happens and not jump into anything.

REPRESENTATIVE HERRON inquired whether it is being said that there is not enough science on wolves and bears.

MS. BROWN responded that ADF&G cannot always be depended upon to make wise management decisions.

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REPRESENTATIVE MUNOZ noted that the Marine Mammal Protection Act is very restrictive in the use of sea otter materials for Alaska Native handicrafts. She asked whether Ms. Brown perceives that a threat could happen on the national level if the act is re-opened, even though the resolution is directed at Alaska Natives and their uses.

MS. BROWN agreed that the resolution is directed at Alaska Natives, but stressed that the committee needs to be very precise and specific in the wording so that it does not appear to be a step toward predator control on sea otters. She said she gets nervous when she looks at the sponsor statement and when she looks at some of the wording in the resolution. The Alaska Wildlife Alliance supports the Native community and if that is the sole purpose then the language about sea otter populations increasing and being too much does not have a place in the resolution. If the economic benefit is wanted for the

Native community - wonderful, but leave out the idea of reducing sea otter populations.

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MIKE MILLER, Chairman, Indigenous People's Council for Marine Mammals (IPCoMM), noted that IPCoMM is comprised of 18 organized marine mammal hunting groups in the state of Alaska. His group has a co-management umbrella agreement with National Marine Fisheries Service (NMFS) and the U.S. Fish and Wildlife Service to deal with issues of common concern around the state on the mammals under the Marine Mammal Protection Act. He said it has been interesting to listen to all the different points and he agrees with points brought out by both sides. He offered his support for HJR 26. He understood the concern about the resolution being used for getting into a predator control program and said he does not want the act used for anything along those purposes. He agreed, however, with the resolution's statement about establishing strategies and plans for sustainable management of sea otter populations, which is very consistent with everything the Native community has worked for.

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MR. MILLER appreciated the changes made to the resolution and said he supports Version I. The resolution is being looked at with two different approaches. The Native community definitely has concern about the impact that sea otters have and wants to conserve the species, but conservation is the wise use of a resource, not preservation. Protection is needed for both the otters and the resources that the communities rely on for subsistence and commercial purposes. He said headway could be made on the root of the problem by dealing with definitions, such as significantly altered, and the Marine Mammal Protection Act would not need to be opened up for that.

MR. MILLER stated that he has worked on this issue for about 15 years. He facilitated the harvest management workshop for the U.S. Fish and Wildlife Service and a tannery was started in Sitka to promote economic opportunities for tribal members in the community. He expressed his organization's great concern with some of the enforcement actions that have happened and which have created confusion amongst the hunters and artisans. He concluded by supporting Version I with no changes to it.

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REPRESENTATIVE GARDNER, regarding the current use of sea otters, asked who determines who qualifies as Native and how a Native harvester would know that a buyer is qualified to own it.

MR. MILLER explained that there is an exemption in the Marine Mammal Protection Act, Section 101(b), for Alaska coastal Natives to harvest and make use of sea otter for handicrafts, as well as to trade and sell pelts to other qualified Natives. In regulation the definition of Alaska Native for purposes of the act is one-quarter blood quantum or greater who lives on the coast. However, there is some question as to how that is figured out by the different solicitors of the respective agencies, although that is how they say they enforce that. For many people who are one-quarter blood or a bit more it would be hard to determine that they are unless they show identification and that raises questions about how that would be enforced. A lot of this comes back to questions about how things are enforced and there needs to be some clarity on those things before sea otters can really be fully utilized to help Natives.

REPRESENTATIVE DICK commented that he is the only non-Native in his family and all his family members have a Bureau of Indian Affairs (BIA) card that shows what fraction Native Alaskan they are.

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CO-CHAIR FEIGE closed public testimony on HJR 26 after ascertaining that no one else wished to testify.

CO-CHAIR SEATON reiterated that he thinks Version I cleans up the potential problems in the resolution. He said he would not make a motion to move the resolution if it allowed sale to non-Natives because that would hurt the Native artisan community and the authenticity of sales to tourists and others, as well as have a situation in which one shooter on a boat that was qualified and the rest of the people onboard would be non-Natives. The sponsor has done a good job of expanding the use within the Native community without getting into the situation of less control on the harvest.

REPRESENTATIVE MUNOZ agreed with Co-Chair Seaton. However, she suggested to the sponsor that some of the editorializing language be toned down so as not to build up hysteria around the issue. She said she agrees with the resolution and thinks it is important.

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REPRESENTATIVE KAWASAKI agreed with the previous two speakers and noted that Version I calls for coming up with local plans. He appreciated the sponsor's willingness to change the language dealing with Alaska Native and traditional artifacts and agreed with the previous speaker about how the resolution should be fixed further. Regarding the McDowell Group report, he maintained that a lot of study has not been done and much more needs to be done for any management plan. Referring to citations in the report that ADF&G has closed seven areas for sea cucumbers presumably for sea otter predation, he said it is inconclusive. He further noted that no geoduck harvests have ever been closed due to sea otter predation, although ADF&G has identified some areas where there could be sea otter predation. Continuing his reference to the report, he said sea otter predation impacts on red sea urchins since 2005 have not been compiled, and the decline of red sea urchin in recent years is related to market factors, not due to sea otter predation. He further noted that the abalone fishery collapsed almost certainly because of excessive harvest in the 1970s and 1980s, not due to sea otter predation. He said he would like to ask ADF&G numerous questions about how it comes up with the various numbers. He urged that there be thoughtful debate about this and offered his appreciation of the sponsor's willingness to continue in this regard.

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REPRESENTATIVE DICK understood the concern of those people asking for more study and said that if hunting was begun tomorrow it would be premature. He maintained, however, that with predator control for wolves the cry for more study went on for eight years and resulted in no moose populations. He said he is sure that there will be more study on the sea otter issue, given the timing of the resolution.

CO-CHAIR FEIGE stated that a good part of the resolution is simply to get the U.S. Fish and Wildlife Service to come up with a plan.

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CO-CHAIR SEATON moved to report the committee substitute (CS) for HJR 26, Version I, labeled 27-LS0717\I, Bullard, 2/6/12, out of committee with individual recommendations and the accompanying zero fiscal note. There being no objection, the

House Resources Standing Committee reported CSHJR 26(RES) out of committee.

The committee took an at-ease from 2:49 p.m. to 2:55 p.m.

PRESENTATION(S): A FIVE-YEAR LOOK BACK: OIL INDUSTRY CAPITAL EXPENDITURES BY CATEGORY 2006-2010

[2:55:46 PM](#)

CO-CHAIR FEIGE announced that the next order of business would be a presentation regarding a five-year look back on oil industry capital expenditures between the years 2006 and 2010.

BRYAN BUTCHER, Commissioner, Department of Revenue (DOR), noted that the genesis for this look back came about during discussions in this committee about how much information the Department of Revenue (DOR) and the State of Alaska had regarding what has been seen from the tax credits and the breakdown of capital expenditures from the industry. The department began working with the companies to get information that breaks down capital expenditures by category for the last five years. The department started out with a large number of categories for the look back, but had to shrink that down to a limited number because each company does things differently. Moving forward, the department will be working with the companies to include a larger number of categories. All companies will know that the department expects a breakdown in certain categories for both capital and operating expenditures, and this will provide decision makers with more information to look at.

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REPRESENTATIVE KAWASAKI, regarding each company doing things differently, inquired why the state does not establish the categories that the companies must keep. He commented that it is currently a reverse engineering situation.

COMMISSIONER BUTCHER agreed and said DOR will be doing that moving forward. However, he pointed out, the companies that have already filed five years' worth of returns have different limits. The department met with a couple of dozen companies while working on this process and they all had different ways of categorizing their expenditures. The problem was in the looking back and getting categories that all the companies could provide data on in a quick fashion, since DOR needed to gather the

information in time for this legislative session. Going forward DOR will work on specifically what it wants and the companies will know what and how they need to categorize for the department.

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REPRESENTATIVE KAWASAKI asked whether the raw data is available to legislators or only to the department, given confidentiality agreements.

DONA KEPPERS, Audit Master, Production Audit Group, Tax Division, Department of Revenue (DOR), explained that DOR started with a very long list of capital expenditure categories. She and another audit master met with the companies four different times and came up with five major categories. Working with the companies, the department pre-defined what went into those categories and that is what the companies compiled for this look back exercise. Looking forward, DOR has already pre-defined a very long proposed list for capital expenditures (capex) as well as operating expenditures (opex) and the department has met once with the companies to begin this exercise of compiling costs so that legislators are able to make sound decisions.

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COMMISSIONER BUTCHER explained the purpose of tax credit provisions (slides 3-4), which first began with exploration tax credits in 2003 under Senate Bill 185. That bill "provided for a reduction in royalty on certain oil produced from Cook Inlet in addition to the tax credit provisions." The goals "were to increase exploration and increase the state's knowledge of the natural resource base." The sponsor statement for the bill said that it would encourage companies to drill more wells looking for information. The bill provided that drilling within an existing unit would not qualify, nor would wells under current development and exploration plans. Since Senate Bill 185 passed while the state had a gross tax, rather than the [current] net tax, the state did not have much information on what the capital and operating expenditures of companies were. Under that bill, the state would stop "recovering the cost" once a well was successful because it was assumed that a producer would continue development at that point. Wildcat exploration would qualify for a 40 percent credit, but the explorer was required to submit information to the Department of Natural Resources (DNR) about

the geology and resource base that were discovered during the exploration activities.

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COMMISSIONER BUTCHER outlined the purpose of the five-year look back (slide 5): to provide informative cost information to decision makers; to break down capital expenditures and how they relate to credits; to understand the benefits and impacts of current statutes and regulations; to create a process and reporting mechanism to collect and compile expenditure information in non-standard formats to catch up on the years of data collection in which DOR was collecting the information in a format that could not be detailed to the legislature and others; and to establish a historical basis for future analysis and comparisons. He added that much of this kicked into high gear when the state moved from a gross tax to a net tax.

COMMISSIONER BUTCHER reviewed the process of information gathering for the look back (slide 6), which included: in-house discussion and review to come up with a list of the potential categories; conducting four workshops with industry in which participation averaged 15 companies per workshop; industry providing active participation and written comments; establishing capital cost expenditure categories; and developing the five-year look back and more expansive, forward-looking reporting categories.

COMMISSIONER BUTCHER discussed the use of the cost expenditure categories for the five-year look back (slide 7). He explained that the compilation of capital expenditures is for the years 2006 to 2010 and does not include 2011 because the companies will not have their true-ups for that year until March 31, 2012. Moving forward the companies will begin submitting this detailed information for the various categories with their annual production tax returns. Most, if not all, of this information is based on confidential information, he noted.

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COMMISSIONER BUTCHER outlined the five capital expenditure categories used for the 2006-2010 look back (slide 8): 1) geological and geophysical (G&G), including work or costs associated with the performance or acquisition of seismic and/or G&G data; 2) exploration drilling, including drilling of an exploration well, drilling of a post-discovery appraisal well prior to development, sidetracks on a discovery well, and

appraisal costs, including coring and testing discover wells; 3) development drilling, including costs associated with well drilling, completions, planned multi-laterals of development wells, including costs upstream, and all costs related to well workovers and completions; 4) facilities, including well tie-in costs, increases to capacity, expansions of existing facilities such as increasing oil, gas, or water handling, de-bottlenecking or processing facilities, improvements to reliability or reduced operational costs, production control system upgrades, costs for information technology, communications equipment, nonproduction control systems, camp sites or accommodation facilities, medical facilities, laboratories, warehouses and maintenance buildings, and new or replacement transit lines, gathering lines, and flow lines, or the addition of new production lines and/or pumps to transit or downstream lines, but not repairs to the lines; and 5) other capital, including significant capital equipment, health, safety, environment, and other non-drilling costs not captured in the other four categories. He noted that the categorized capital expenditure data represents about 90 percent of the costs related to credit applications that the department has received.

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MS. KEPPERS explained that slide 9 depicts the costs related to qualified capital expenditures during the years 2006 to 2010. The two categories with the largest expense were facilities at \$4.2 billion and development at \$4.2 billion. In 2007 development went up a bit, in 2009 it took a downturn, and in 2010 it took another upturn. The overall trend for all [five] categories is increased spending and the increases are likely maintaining production. Spending increased in development drilling and facilities in 2007 and 2008, but declined in 2009, which was the first year that ACES would possibly have had some effect on budgets and activities. The increase in spending in both development wells and facilities in 2010 was greater than in years prior to 2009 and provides no significant indication of ACES influences, but it may be a reflection of the credit program and more targeted spending for credits qualifying for spend.

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MS. KEPPERS said that when looking at this from the big picture of total companies, the development drilling spending could be viewed as relatively flat with no generally demonstrated dramatic increase during the four-year period of 2007 to 2010.

Facilities spending mirrored development and could be interpreted as simply supporting existing production from existing fields. The slight fluctuation in total expenditures for these categories could be attributed to annual cost increases, not necessarily a reflection of increased overall development activity. The historical capital expenditures for this five-year look back period are \$9.3 billion for these five major categories.

MS. KEPPERS next reviewed the historical capital expenditures specifically for drilling and G&G during this five-year look back (slide 10). A two-fold increase occurred in development drilling in 2007 and then spending stayed fairly level for the remainder of the reporting period of 2008 to 2010. She said this agrees with statements made by some companies that they have had level spend to develop existing fields and are not pursuing new finds or development of new fields. In response to Co-Chair Feige, she confirmed that slide 10 depicts spending for the entire state, not just the North Slope. She added that the slide represents a 90 percent reporting of large and small companies.

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MS. KEPPERS moved to discussion of the expenditures for facilities and other capital expenditures [slide 11]. She pointed out that many different costs are lumped into facilities, as was outlined by Commissioner Butcher. Both industry and the department recognized that this is a huge cost category, but industry was unable to break down these costs fast enough for the time allowed for doing this. She said this will be better in the look forward and DOR will be able to provide more definitive descriptive costs. In this look back, facilities was the largest category of investment by all the companies and there was some for new development and some for replacement of aging facility operations. To make this a better chart for study in the look forward, DOR has proposed five more levels of categories to the industry: three separate levels for facility categories; one for facility support costs, including rate increasing facility costs and nonrate increasing facility costs; and pipeline costs, including capital replacement cost and normal capital cost.

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MS. KEPPERS turned to slide 12 and explained that DOR had a hard time figuring out how to stay within the confines of

confidentiality requirements when splitting these total costs into something usable. She said the department had wanted to do costs by categories for the independents as well as costs by those categories for the majors. However, for the independents it was found that for 2008, 2009, and 2010, DOR could not meet the aggregation rule of three companies or more. Therefore, DOR could not break down these schedules by cost category, which resulted in the big grey bars depicted on slide 12. Total capital expenditure for independents over the five-year period came in at \$2.6 billion. Capital expenditure increased from 2008 to 2010 by approximately 67 percent.

MS. KEPPERS noted that the department also could not break down these schedules by cost category for the majors, again resulting in big grey bars as depicted on slide 13. The majors had an aggregate capital expenditure of \$6.7 billion for the five-year period. The data indicated no major increases in overall spending totals, particularly in the most years of 2008 through 2010 in which the increase was only 5 percent. She added that going forward it is known that there will be more players and more cost categories. The department will soon have the information for 2011 for these five categories, she advised, but for 2012 there will be a much greater level of detail.

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COMMISSIONER BUTCHER related the conclusions drawn from the aforementioned information (slide 14): DOR now has more actual information regarding oil and gas spending habits in the state than ever before and is striving for more; capital expenditures between 2007 and 2010 increased from approximately \$2 billion a year to \$2.4 billion a year; explorers spent money mostly on the drilling of wells and G&G; companies in the development stage spent money largely on development drilling and facilities; companies in transition spent money in multiple areas depending on the stage they entered a project; companies in mature production phase spent money on maintenance and upgrade of facilities and development wells; and more players are active in the field. This information does not tell much more than what was already known, he continued, but it solidifies what was suspected. He said the companies were at first a bit skeptical of this process, but there was no push back and the companies worked well with the department.

COMMISSIONER BUTCHER noted that calendar year 2011 will be the last year of the capital expenditure look back and this information is due from the companies by 3/31/12 (slide 15).

Additional workshops with industry will be held and moving forward for calendar year 2012 the companies will know the detailed categories that are to be included in their Annual Cost Supplemental Information Report due on 3/31/13. This report will include a breakdown of operating expenditures as well as capital expenditures. Calendar year 2012 will be the first year in which the department dictates to the companies how items are to be separated out and compiled.

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MS. KEPPERS added that for the look forward, DOR has expanded the list from five categories to a proposed list that is currently four pages long. The department must pre-define what goes into each category, which is an arduous task. She said DOR has already held one workshop with industry and looks forward to the next workshop at which the operating expenditure list will be discussed. Basically, DOR is trying to merge the accounting systems that are unique to each company and doing it the first time is hard. She said this is an exciting time for DOR because the department is able to actually compile something and look at it. She thanked members for their questions, saying that they made the department look, dig, and work with. A foundation layer for historical data is being laid with the capital expenditure and operating expenditure categories and this foundation will at some point import into the revenue management system. This opens up more and better information in real time, which is important to legislators.

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REPRESENTATIVE P. WILSON asked whether legislators, once this new system is in place, will be able to state what they would like to accomplish and DOR will be able to suggest what needs to be tweaked to make that happen.

COMMISSIONER BUTCHER replied that the Department of Revenue will certainly have more information to look at for having such discussions. When trying to assign tax credits to a particular result, he pointed out that many of the tax credits that DOR is presently paying out are to companies that are currently exploring and doing business now. In 10 or 12 years the state will probably be able to look back at this tax credit and say that the credit did or did not do something. So, DOR will have more information to have the discussion, but it may not be as definitive as what would be liked.

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REPRESENTATIVE P. WILSON surmised that for the next time the companies will know what categories they are expected to provide information for.

MS. KEPPERS responded yes and said that at this point DOR has a proposed list of categories that are defined. It is a matter of meeting with the companies through a workshop to go through the categories to see if those can be merged based on how DOR has defined them. The state has an obligation to prescribe and define and to give industry the guidelines it needs to follow. The partnership in the workshops has worked effectively. She pointed out that this is a huge, time-consuming task because the state is talking with both the accounting and the tax departments of the companies and in the larger companies those are two totally separate divisions. The department must bring those people together with what it knows, while keeping in mind the kinds of information that legislators need to see, such as trends and asking DOR for different kinds of analyses.

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REPRESENTATIVE P. WILSON inquired whether new regulations need to be written and, if so, has that been done.

MS. KEPPERS answered that the Department of Revenue already has the authority to prescribe and define.

COMMISSIONER BUTCHER, in further response to Representative P. Wilson, explained that DOR has the right to do this under its current regulations. However, the department never had the time to ask these questions because it was trying to catch up on regulations for the petroleum production profits tax (PPT) and then regulations for Alaska's Clear and Equitable Share (ACES). While examining whether regulations were needed, the Department of Law determined that under DOR's current regulations these are reasonable for DOR to ask. He added that in addition to the accounting and tax departments mentioned by Ms. Keppers, DOR must also work with the information technology departments because it is not so easy to come in with a list of the 50 categories that DOR wants, especially for the smaller companies. The department is working with the companies to try to make it work for everybody without costing them millions of dollars to implement.

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CO-CHAIR SEATON commented that this was stimulated by Representative P. Wilson's bill about getting information released. He asked whether there are any questions or any categories of information that the state has the legal right to receive that the companies have not been submitting. He further asked what percentage of state credit is paid on the totals of \$2.6 billion for independent companies and \$6.7 billion for the majors, as depicted on pages 12 and 13. He said the department could get back to the committee with the information.

COMMISSIONER BUTCHER agreed to do so.

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REPRESENTATIVE GARDNER inquired what the role of the global financial crisis has been in the amount of capital expenditures as opposed to just the role of the state's tax regime. She said DOR could get back to the committee with this information.

COMMISSIONER BUTCHER agreed to do so.

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ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:28 p.m.