

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

February 13, 2012

3:37 p.m.

MEMBERS PRESENT

Senator Joe Paskvan, Co-Chair
Senator Thomas Wagoner, Co-Chair
Senator Bill Wielechowski, Vice Chair
Senator Bert Stedman
Senator Hollis French
Senator Gary Stevens

MEMBERS ABSENT

Senator Lesil McGuire

OTHER LEGISLATORS PRESENT

Representative Paul Seaton
Senator Cathy Giessel
Senator Dennis Egan

COMMITTEE CALENDAR

SENATE BILL NO. 192

"An Act relating to the oil and gas production tax; and providing for an effective date."

- HEARD & HELD

PRESENTATION BY DOR COMMISSIONER BUTCHER: FIVE YEAR LOOK BACK ON OIL INDUSTRY CAPITAL EXPENDITURES BY CATEGORY 2006-2010 & ACCESS TO INFORMATION

- HEARD

HOUSE BILL NO. 60

"An Act relating to aquatic farm permitting involving geoducks and to geoduck seed transfers between certified hatcheries and aquatic farms."

- MOVED HB 60 OUT OF COMMITTEE

PREVIOUS COMMITTEE ACTION

BILL: SB 192

SHORT TITLE: OIL AND GAS PRODUCTION TAX RATES

SPONSOR(s): RESOURCES

02/08/12 (S) READ THE FIRST TIME - REFERRALS
02/08/12 (S) RES, FIN
02/10/12 (S) RES AT 3:30 PM BUTROVICH 205
02/10/12 (S) Heard & Held
02/10/12 (S) MINUTE(RES)
02/13/12 (S) RES AT 3:30 PM BUTROVICH 205

BILL: HB 60

SHORT TITLE: GEODUCK AQUATIC FARMING/SEED TRANSFER

SPONSOR(s): SEATON

01/18/11 (H) PREFILE RELEASED 1/7/11
01/18/11 (H) READ THE FIRST TIME - REFERRALS
01/18/11 (H) FSH, RES
02/15/11 (H) FSH AT 5:00 PM CAPITOL 120
02/15/11 (H) Moved Out of Committee
02/15/11 (H) MINUTE(FSH)
02/16/11 (H) FSH RPT 2DP 3NR 1AM
02/16/11 (H) DP: AUSTERMAN, THOMPSON
02/16/11 (H) NR: HERRON, PRUITT, JOHNSON
02/16/11 (H) AM: KAWASAKI
03/09/11 (H) RES AT 1:00 PM BARNES 124
03/09/11 (H) Moved Out of Committee
03/09/11 (H) MINUTE(RES)
03/10/11 (H) RES RPT 5DP 3NR 1AM
03/10/11 (H) DP: MUNOZ, FOSTER, DICK, HERRON, SEATON
03/10/11 (H) NR: GARDNER, P.WILSON, FEIGE
03/10/11 (H) AM: KAWASAKI
03/16/11 (H) TRANSMITTED TO (S)
03/16/11 (H) VERSION: HB 60
03/18/11 (S) READ THE FIRST TIME - REFERRALS
03/18/11 (S) RES, FIN
02/13/12 (S) RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

BRYAN BUTCHER, Commissioner
Department of Revenue
State of Alaska

POSITION STATEMENT: Provided information related to SB 192.

BRUCE TANGEMAN, Deputy Director
Tax Division

Department of Revenue
Anchorage, AK

POSITION STATEMENT: Provided information related to SB 192.

DAN STICKEL, Assistant Chief Economist
Tax Division
Department of Revenue
Anchorage, AK

POSITION STATEMENT: Provided information related to SB 192.

DONA KEPPERS, Audit Master
Tax-Production Audit Group
Department of Revenue
State of Alaska

POSITION STATEMENT: Provided information related to SB 192.

JOHN LARSEN, Audit Master
Tax-Production Audit Group
Department of Revenue
State of Alaska

POSITION STATEMENT: Provided information related to SB 192.

REPRESENTATIVE PAUL SEATON
Alaska State Legislature
Juneau, AK

POSITION STATEMENT: Sponsor of HB 60.

PAUL FUHS
Alaska Sea Farms
Juneau, AK

POSITION STATEMENT: Supported HB 60.

ROGER PAINTER, President
Alaskan Shellfish Growers Association
Juneau, AK

POSITION STATEMENT: Supported HB 60.

JEFF HETRICK, General Manager
Alutiiq Pride Shellfish Hatchery
Seward, AK

POSITION STATEMENT: Supported HB 60.

ACTION NARRATIVE

[3:37:01 PM](#)

CO-CHAIR JOE PASKVAN called the Senate Resources Standing Committee meeting to order at 3:37 p.m. Present at the call to

order were Senators French, Stedman, Stevens, Wielechowski, Co-Chair Wagoner and Co-Chair Paskvan.

SB 192-OIL AND GAS PRODUCTION TAX RATES
PRESENTATION: FIVE YEAR LOOK BACK ON OIL INDUSTRY CAPITAL
EXPENDITURES BY CATEGORY 2006-2010 & ACCESS TO INFORMATION

[3:38:34 PM](#)

CO-CHAIR PASKVAN announced the continued consideration of SB 192. He recapped that some information had been provided to Commissioner Butcher regarding slide 6 and asked if he had been able to prepare a slide on the forward looking information.

BRYAN BUTCHER, Commissioner, Department of Revenue, State of Alaska, replied that Mr. Tangeman was working on that and would get it to him as soon as possible. In response to the issue of getting more information, he had been working with the Department of Law on what is appropriate and inappropriate to discuss in terms of the Gleason decision.

[3:40:38 PM](#)

COMMISSIONER BUTCHER addressed slide 13, a bar chart that compared ELF, PPT, ACES as introduced and ACES as passed saying the administration believed the pendulum had swing too far in terms of progressivity. ELF was not getting the state its fair share of tax and definitely needed to be reformed. That occurred with PPT, and ACES as proposed would have brought in a little bit more, but ACES as passed brought in considerably more. The Governor's oil tax bill is comparable to the ACES as proposed scenario.

[3:42:01 PM](#)

SENATOR STEDMAN asked if the numerics were out of the fall Revenue Sources Book that had the price of oil at \$109.47 and the volume expectations at 555 barrels a day (bb/d) and then had expectations out the following years to 2016.

COMMISSIONER BUTCHER answered that was correct.

SENATOR STEDMAN said he assumed the CAPEX and credits obtained with them are all derived from the forward looking information submitted to the department.

COMMISSIONER BUTCHER answered yes.

SENATOR STEDMAN said he assumed they would get updated charts with 2013 and forward in the same graphical presentation, because there was a difference in the verbal presentation versus the documents in the Revenue Sources Book.

[3:43:53 PM](#)

COMMISSIONER BUTCHER asked if he was referring to the updated expenditure information.

SENATOR STEDMAN said he was referring to Friday's testimony from the commissioner about expecting CAPEX to decline, yet the Revenue Sources Book says it's expected to increase to almost \$3,900,000 in FY15. You can't say CAPEX is going down on one hand and then show documents with it going up.

COMMISSIONER BUTCHER said he was preparing that request, but the point he was trying to make is that the forecast is for CAPEX to go up, but the department's forecasts have been overly optimistic for the past years.

[3:45:32 PM](#)

SENATOR STEDMAN said if there has been a substantial deviation from expectations they need to flesh it out and the Finance Committee needs to know that in the appropriations cycle.

COMMISSIONER BUTCHER agreed.

[3:46:34 PM](#)

SENATOR WIELECHOWSKI agreed that information would be helpful ask well as the reasoning behind why it is off, especially if it is lower. He addressed the current chart and asked why the administration proposed lowering oil taxes to level of ACES as proposed because industry had testified in opposition to both PPT and ACES as proposed. What makes him think that the industry will significantly increase their investment now when past testimony indicates they thought the tax was too high?

[3:47:57 PM](#)

COMMISSIONER BUTCHER answered this is only one piece of the bill that was introduced and secondly, after rolling out the bill, they talked to the companies again and most thought lowering taxes would make a material difference and result in more investment in Alaska.

[3:48:45 PM](#)

BRUCE TANGEMAN, Deputy Director, Tax Division, Department of Revenue, State of Alaska, added that trying to apply testimony

from several years back to today's discussion was a little dangerous because the oil price is the overriding part of the discussion. Back then they were looking at \$80 oil, tops.

[3:49:53 PM](#)

SENATOR STEDMAN stated the record would not match what he just said and he asserted that legislators had spent quite a bit of time working on ACES in the high priced environment.

[3:50:40 PM](#)

COMMISSIONER BUTCHER added that there is a difference between having hypothetical discussions about high oil prices and making capital decisions in a high oil price environment.

MR. TANGEMAN added that it's more important to see what the effect of the high oil pricing has been elsewhere, because "that is what is driving the boom in our competition."

[3:51:46 PM](#)

SENATOR FRENCH asked in the department's efforts to address competitiveness if he had seen any increase in applications for royalty relief that is on the books to help make non-economic developments economic. Why hadn't they seen more?

[3:52:42 PM](#)

COMMISSIONER BUTCHER answered that royalty relief can be used, but changing the tax structure would make a much bigger difference in potentially bringing investments in. Royalty relief can only occur when someone already has a lease or has explored and can lay everything out to the department with an explanation of what needs to happen to make something economic. It has been utilized only a few times in the state's history.

[3:54:12 PM](#)

MR. TANGEMAN added that he believed that royalty directly affects the amount of money that is going into the Permanent Fund and if there was a choice he would rather look at the tax's effect on state coffers.

SENATOR FRENCH said he was also sensitive about the Permanent Fund and asked if some proof should be offered that a tax break would result in more production than is already being contemplated. He didn't think the companies would tell them which projects are being held back right now by ACES or projects they will go forward with if they get a tax reduction, because royalty relief seems to be the place to test their desire to reduce the state take through the use of real evidence. No

increase in those applications signaled to him the lay of the economic land.

[3:55:57 PM](#)

CO-CHAIR PASKVAN asked questions about the details of industry/state split of PTV on a FY13 production tax estimate chart and Mr. Tangeman followed with answers.

SENATOR STEDMAN commented that there are three players at the table: the sovereign State of Alaska, industry, and the federal government. He said that whatever money is left over has to be split between the federal government and industry at something substantially less than the 35 percent federal rate.

[3:58:24 PM](#)

MR. TANGEMAN said this was a chart of production tax only; there is also property tax and corporate income tax.

CO-CHAIR PASKVAN said he understood that but he was continuing to have trouble understanding the chart.

[3:59:02 PM](#)

SENATOR WIELECHOWSKI clarified that last year ConocoPhillips made roughly \$2 billion, BP made roughly the same and no one knows what Exxon made, but probably the same as a one-third owner. He said he had calculated profits of \$6 billion for just last year and over \$30 billion since ACES had passed.

[3:59:50 PM](#)

MR. TANGEMAN said he wanted to invite Mr. Stickel, the department's assistant chief economist, to help set them straight.

DAN STICKEL, Assistant Chief Economist, Tax Division, Department of Revenue, State of Alaska, said when you are looking at the share of the total production tax value remaining to producers, it's not as simple as taking production tax value (PTV) and subtracting out the production tax liability. Income statements in Appendix D of the Revenue Sources Book show the PTV after royalty. To derive the producer take out of that number, you have to subtract the production tax as well as state corporate income taxes and state property taxes (for the total state share) and federal corporate income taxes. It's complex for both the industry and the state.

MR. STICKEL explained that this chart only addressed the significant changes from ELF to PPT to ACES.

CO-CHAIR PASKVAN remarked that part of the complexity in the FY13 chart on the state's \$4.7 billion is that figure includes at least \$400 million that the state is paying out in credits.

MR. STICKEL answered that was correct.

[4:02:29 PM](#)

CO-CHAIR PASKVAN, addressing slide 10, said one of the points they were trying to get to last Friday is that an analysis of CAPEX on drilling and G&G was performed based upon \$27 and if you apply FY13 hypotheticals with the most realistically current information that it comes out to less than \$21.

COMMISSIONER BUTCHER said he would have to look at those numbers.

CO-CHAIR PASKVAN said he welcomed the analysis.

SENATOR STEDMAN said it would be beneficial to convert the numbers to dollars through-put for the entire year rather than using per barrel numbers.

[4:04:51 PM](#)

MR. TANGEMAN said absolutely and that they were trying to make the complex simple enough to understand.

[4:05:29 PM](#)

MR. TANGEMAN said slide 14 was the "Marginal Government Take" under the current tax system (an additional dollar as the price of a barrel of oil goes up). At ANS prices over \$78, marginal government take was over 75 percent. That also means that government take is at least 75 percent of each additional profit a company can produce.

[4:06:17 PM](#)

SENATOR FRENCH asked questions about interpreting the slide and Mr. Tangeman and Mr. Stickel followed up with explanations.

[4:08:50 PM](#)

CO-CHAIR PASKVAN said he read the chart to be a PTV chart.

COMMISSIONER BUTCHER agreed and said there is always a lot of confusion on determining the difference between PTV and the price of oil.

[4:10:24 PM](#)

SENATOR STEDMAN said they had talked a lot about the marginal government take issue, but little on the effective tax rate. When do you use marginal and when do you use effective?

COMMISSIONER BUTCHER answered that effective tax is what is paid. Marginal is not as important, but it is talked about when companies speak specifically about progressivity at the high cost of oil.

[4:11:50 PM](#)

SENATOR STEDMAN said the average guy on the street doesn't understand marginal rate, particularly when it is delivered as the tax imposed by the state on the industry and that he wanted to see information on the effective rate. It needs more clarity, because it looks like a 90 percent effective tax rate and it's not.

[4:12:35 PM](#)

COMMISSIONER BUTCHER agreed.

CO-CHAIR PASKVAN agreed that they needed the effective tax rate presentation and to use FY13 numbers.

COMMISSIONER BUTCHER agreed that was a reasonable point, but going to FY13 becomes more of a projection than using actual numbers from previous years.

[4:14:00 PM](#)

SENATOR WIELECHOWSKI said he recalled at \$100 a barrel the effective tax rate was around 28 percent. He asked if having a higher marginal tax rate is a good policy call in the context of Norway that spikes the tax rate to 78 percent for the first dollar of profit. Alaska chose to have a lower tax rate at lower dollars and stair-stepped it up as profits went up (the oil companies made more and the state made more).

He explained that the oil companies were in harvest mode and making huge amounts of money and investing it elsewhere. The concept behind the high marginal tax rate was to say if you reinvest in the State of Alaska we're going to give you what amounts to a very large tax break. The effective tax rate still remains at 28 percent at \$100 a barrel, but the philosophy behind the marginal tax rate is that it would encourage reinvestment in the state. And record reinvestment levels have been seen every single year since ACES had passed. Is there any merit to having a higher marginal tax rate?

[4:15:29 PM](#)

COMMISSIONER BUTCHER answered that it makes sense to have the state share in a higher percentage of profits at high oil prices (progressivity), but the governor thinks the current take is too high.

[4:16:06 PM](#)

MR. STICKEL said slide 15 showed producer's share of profit oil and the upper end of it being taken away as the price goes up and that is what the problem is.

[4:17:05 PM](#)

SENATOR STEDMAN recapped that before PPT, progressivity didn't exist and the argument was the state should be happy because its dollars were going up when the price advanced. Some in the legislature weren't happy because the state's percent of the pie was going down. Now the department was showing the reverse where the state's percent was going up. So he could understand industry's concern, but industry wasn't concerned when the state was. He recalled that Governor Murkowski didn't support progressivity but he still signed the bill.

He then asked for the charts to synchronize ANS West Coast in dollars because the next slide goes to PTV, which deletes royalties and expenditures distorting the picture. It would be nice if the X axes lined up.

[4:19:01 PM](#)

COMMISSIONER BUTCHER agreed.

SENATOR WIELECHOWSKI said the state would do better under ELF if oil was under \$50 a barrel. ACES originally had a minimum floor, but the oil companies didn't like that. The bargain was to take out the state's protection at the low end, but in return the state wanted to get more at the high end. They have no idea if oil will stay this high (\$118-120 barrel). Since the commissioner said progressivity would become punitive to the oil industry at some point, what point was that?

[4:20:20 PM](#)

COMMISSIONER BUTCHER answered there was no specific spot; companies are different and have different views. This slide just illustrated the size of the state's take as the price of oil increases.

CO-CHAIR PASKVAN said it's also important to remember that whatever the numbers may be, Alaska has to approach this problem

wearing two different hats, as the resource owner and as a taxing jurisdiction.

[4:22:17 PM](#)

COMMISSIONER BUTCHER said he was correct, but when a company is looking at an economic model for \$115 a barrel and 72 percent going to the federal and state governments, that would definitely be factored in.

[4:23:09 PM](#)

MR. STICKEL said slide 16 looks at the profits in dollars instead of percentages like on the previous slide and it's a way to see the small growth the producer would realize at higher prices.

CO-CHAIR PASKVAN asked if it includes credit deductions.

MR. TANGEMAN replied that it assumed that 20 percent of capital expenditures are available for credit.

CO-CHAIR PASKVAN said another way to phrase that is there is a 40 percent exploration credit and asked if the 20 percent is only for operators with production or can the credit be turned into the state for cash.

MR. TANGEMAN replied this only looks at the 20 percent CAPEX credit; it doesn't make a distinction between refunding credits versus filing against a tax liability.

[4:25:09 PM](#)

SENATOR WIELECHOWSKI said he has heard the administration and others say when ACES was written, the price of oil was \$80 a barrel and no one expected these high prices, which implies that others believed ACES works at certain levels, but not at higher levels. At what point is ACES broke? At what point is the share no longer fair?

COMMISSIONER BUTCHER answered that he did not know there was an actual dollar amount, but it's more lopsided at high prices.

[4:26:19 PM](#)

SENATOR WIELECHOWSKI said people are asking them to fix the tax system and that is a critical question to answer.

MR. TANGEMAN agreed and said they need to hear from industry about it.

[4:27:08 PM](#)

CO-CHAIR PASKVAN added that he could infer a number of things from that statement, the least of which is that the administration has nothing to say on where the system is broke.

MR. TANGEMAN said he did not agree.

SENATOR WIELECHOWSKI said HB 110, proposing to roll back oil taxes, isn't the oil companies' bill; it's the administration's. He assumed when they wrote it that they had some inclination that the tax system was broken at some point, and now they are saying they don't know where it's broken.

COMMISSIONER BUTCHER answered that he didn't know of an exact dollar amount.

[4:28:20 PM](#)

MR. TANGEMAN responded, since he referred to HB 110, the two critical parts of that bill were putting a cap in place and putting the brackets in place, the brackets making it easier and more understandable to calculate tax and based it on the federal system, and it is still a higher tax than anywhere else in North America.

[4:29:11 PM](#)

SENATOR STEDMAN said the chart showing production tax values is confusing for the public. They need to be consistent and use the recent price range of around \$150 and fix it there before going north of it. He pointed out the implied 35 percent federal tax rate and remarked, "I'd like to know the accountants that work for BP, Conoco or Exxon where they pay 35 percent and I'll show you the next accountant that is going to get terminated."

[4:31:36 PM](#)

MR. TANGEMAN agreed and added that they are getting into the complexities of the current tax system. As the prices goes from \$35 to \$235, the only segment realizing the upside is the state; "the producers are more or less flat in comparison." The chart illustrates how the split looks between the three entities.

[4:32:23 PM](#)

SENATOR STEDMAN said first they should agree that the industry does not pay a 35 percent rate. ConocoPhillips publishes its information and they should get a ballpark figure from that of where their competitors are. His other point was that the production tax value is more complex than the marginal and effective tax rates and it's confusing to the public. It needs

to be "boiled down" so that Alaskans who own the oil can understand it.

[4:34:00 PM](#)

COMMISSIONER BUTCHER said he agreed and they were very willing to do that. Here they were trying to provide a snapshot that they would be lucky to get through in two hearings hitting on a bunch of topics. They would be here for weeks if they dug into the details.

SENATOR STEDMAN said he knew about the timeframe, but they were dealing with billions of dollars and the future of the state, and he personally wanted the details.

CO-CHAIR PASKVAN said he agreed with Senator Stedman. The whole purpose of the hearing starting last Friday was asking the Department of Revenue to define the problem. One of their concerns is starting to advance solutions when they don't know what the problem is.

[4:35:46 PM](#)

COMMISSIONER BUTCHER said he appreciated that, but they were trying in a fairly small number of slides in a small amount of time to do that. They would be "excited" to go into detail, but it's just not part of this presentation.

[4:36:20 PM](#)

COMMISSIONER BUTCHER said they used Pedro van Meurs Petro Cash model in comparing Alaska government take and life cycles to its international peers in fields over 50 million barrels. It was a country-by-country snap shot rather than state by state.

[4:37:13 PM](#)

SENATOR FRENCH asked if he thought Norway had a healthy level of industry investment.

COMMISSIONER BUTCHER replied he was not an expert on Norway, but there seems to be.

SENATOR WIELECHOWSKI said Norway has a 78 percent tax on the first dollar of profit. He asked if he thought we had to just look at the government take or are there other levers they should be pulling.

COMMISSIONER BUTCHER answered obviously there are differences; Norway is country and Alaska is a state; Norway has a state-

owned oil company; Norway controls their permits; there are a lot of differences. Permitting is a huge issue as well.

[4:38:56 PM](#)

SENATOR STEDMAN said they spent quite a bit of time last go-round looking at Norway as a comparative and one of the things that was pointed out is that their marginal tax rate is flat while ours is robust. He asked the department to come back with an effective and marginal tax rate comparison between the two.

COMMISSIONER BUTCHER said they would be happy to do that, but would have to discuss the apples and oranges differences those comparisons would expose.

SENATOR STEDMAN said he was trying to help his argument and said Norway has a flat marginal rate and that is probably one of the biggest issues on the table.

COMMISSIONER BUTCHER agreed to prepare the comparison.

[4:40:39 PM](#)

COMMISSIONER BUTCHER said he used the Petro Cash model again focusing on the largest jurisdictions of oil producers in North America: North Dakota, California, Texas, Alberta, Oklahoma, OCS in federal waters, in Alaska waters and ACES in Alaska. Government take was a percent of divisible income.

SENATOR STEDMAN asked him to rerun the slide with a comparative of the exporting basins that was presented to the Finance Committee a couple of hours ago by Dr. van Meurs.

[4:41:42 PM](#)

COMMISSIONER BUTCHER said he would be happy to do that; he noted that Alaska's peers shifted from what they were in 1997 to North America in 2012.

CO-CHAIR PASKVAN said slide 18 talks about divisible income and that seems to be PTV, but North Dakota, for example, has a royalty and a gross production tax system. How do you say it is divisible income if they are a gross system and we are partially a net system?

MR. TANGEMAN responded that this was modeled off of Dr. van Meurs' Petro Cash model and they could get him some details on how the model handled them.

CO-CHAIR PASKVAN said in comparing Alaska to Texas and North Dakota it should compare a percent of gross, because their systems are gross.

COMMISSIONER BUTCHER agreed.

[4:43:28 PM](#)

SENATOR STEDMAN said he meant total government take rather than divisible income.

COMMISSIONER BUTCHER said this slide showed that the government take is a percentage of divisible income and had a total government take over the life of the project.

SENATOR WIELECHOWSKI asked Mr. Brena and Mr. Richards last week if they had some suggestions other than tax changes, like vertical integration issues, lack of transparency and facilities access issues, tariff, and pipeline bottleneck issues. Do those have any merit?

COMMISSIONER BUTCHER asked if he wanted to be more specific.

SENATOR WIELECHOWSKI said he would get a list and would be interested in the department's opinion.

COMMISSIONER BUTCHER agreed to help him with that.

[4:45:32 PM](#)

COMMISSIONER BUTCHER started his five year look-back presentation and he brought Dona Keppers forward, saying she is one the three audit masters who oversaw the five-year look-back project. It came about primarily as a result of last year's discussions about tax credits and capital expenditures. The Department of Law determined that under current regulations DOR could ask industry for more of a breakdown in spending and that began the month after the legislative session ended. Some of the issues surfacing in their workshops with companies were that all had different ways of putting their numbers together, so two pieces were developed. First they asked companies to do a five-year look-back and break out their capital expenditures into five general categories. The second piece was doing a look-forward with a lot more detailed categories with not just capital expenditures but operating expenditures as well.

[4:48:43 PM](#)

CO-CHAIR PASKVAN asked him to jump forward to page 5 because some of it is self-explanatory.

COMMISSIONER BUTCHER said he was happy to do that. He said they spent a lot of time in-house discussing what categories should be used and conducted four workshops (one of which Senator Paskvan sat in on) with industry averaging about 15 companies per workshop. Industry was responsive and worked with them very well in trying to compile this information and helped establish the expenditure categories for both the look-back and the forward reporting.

[4:49:50 PM](#)

COMMISSIONER BUTCHER said the five-year look back was for 2006 to 2010. It doesn't go to 2011 because the true ups for 2010 come in then. The first of the five basic categories was geological and geophysical work (G&G) and includes work and/or costs associated with the performance or acquisition of seismic and/or geological and geophysical data. Exploration drilling was a different category that included drilling and exploration wells, an appraisal well that is post-discovery and prior to development and included side tracks on the discovery well, and appraisal costs including coring and testing discovery wells. The development drilling included costs associated with well drilling, completions, planned multi-laterals of development wells including costs upstream and all costs related to well work overs and completions. Facilities included well tie-in costs, expansions of existing facilities such as increasing oil, gas or water handling increases to capacity, debottlenecking or processing facilities' improvements to reliability or reduced operational costs, production control system upgrades, IT, communications equipment, control systems, camp sites, medical facilities, laboratories, warehouses and any facilities that would fall generally into that category. The fifth category was a catch-all for other capital expenditures which include significant capital equipment, health, safety, environment and other non-drilling related costs that weren't captured in the previous four categories.

[4:52:26 PM](#)

SENATOR STEDMAN asked him to point out what was available for the 20 percent capital credits with the immediate write off as he goes forward.

COMMISSIONER BUTCHER replied that he didn't have that kind of detail yet, but he would see what could be done. He added that the categorized capital expenditure data represents approximately 90 percent of the costs related to credit

applications that the department has seen. He then passed the presentation over to Ms. Keppers.

[4:53:17 PM](#)

DONA KEPPERS, Audit Master, Tax-Production Audit Group, Department of Revenue, State of Alaska, said the categorized capital expenditure data represents 90 percent of the costs related to qualified capital expenditures. That is important because it means a company can have costs greater than those reported for credit purposes, because they may have costs that they have chosen not to apply for a credit on.

She said slide 9 showed that 2006 includes nine months of PPT and indicated that the exemptions for the five-year period totaled \$9.3 billion. The two largest categories are facilities and development. She said the overall trend was for increased spending probably in maintaining production (as there are no major increases or decreases in any one category).

MS. KEPPERS said development drilling and facilities had increases in 2007 and 2008 and a decline in 2009 (the first year that ACES would have possibly 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. The figures provided no significant indication of ACES influences but maybe were a reflection of the credit program and more targeted spending for credits qualifying for spend.

[4:55:29 PM](#)

MS. KEPPERS said a broader perspective for total companies development drilling (\$4.2 billion) could be viewed as being relatively flat or generally demonstrated no dramatic increase during the four-year period. The other \$4.2 billion for facilities spend mirrored that of development and could be interpreted as simply supporting existing production from existing fields. The slight fluctuation in total expenditures for these categories could also be attributed to annual cost increases for labor or services, materials, and not necessarily reflective of an increase in overall development activity.

[4:56:21 PM](#)

CO-CHAIR PASKVAN asked if figures from 2009 were possibly consistent with the world and U.S. economic downturn.

MS. KEPPERS answered that all of that had an impact on costs. She said that slide 10, G&G and drilling costs, indicated increases from 2007 to 2008 and a decline in 2008 to 2009 and

then increasing from 2009 to 2010. She said the multi-year increases were not reflected in development drilling and after the increase in 2007, spending stays fairly level for the remainder of the reporting period. This agrees with statements made by some companies that they had level spend to develop existing fields and are not pursuing new finds or development of new fields.

[4:57:48 PM](#)

MS. KEPPERS said slide 11 showed facilities for all companies, and some of the costs were for new development; others were for replacement of aging facilities.

[4:58:33 PM](#)

SENATOR WIELECHOWSKI asked for some examples of CAPEX and OPEX for facilities.

JOHN LARSEN, Audit Master, Tax-Production Audit Group, Department of Revenue, responded that CAPEX would have a longer type life that would be related to buildings and vessels for handling the production; the OPEX is by and large labor and materials.

CO-CHAIR PASKVAN recognized Senator Egan in the audience.

[4:59:53 PM](#)

MS. KEPPERS said on slide 12 that costs between independents and majors were difficult to split out because for 2008, 2009 and 2010 the aggregation factor of three or more companies for confidentiality couldn't be met. So the costs got lumped together by year for the look back. The independents had a total CAPEX of \$2.6 billion. Capital expenditures increased in 2008 through 2010 by approximately 67 percent for the independents, which may be due to increased activity in the smaller producing fields.

[5:00:50 PM](#)

SENATOR STEDMAN asked for a rough idea of a figure for reimbursements the state would be making on the \$805 million in credits.

MS. KEPPERS replied they would have to work with Mr. Dees to get those details.

COMMISSIONER BUTCHER said they would do that.

CO-CHAIR PASKVAN said it would be interesting to have it for the majors as well.

MS. KEPPERS said they could do that.

[5:02:11 PM](#)

MS. KEPPERS said slide 13 was similar with total CAPEX for the major companies that amounted to \$6.7 billion. The increase for them for the same time period of 2008 to 2010 was approximately 5 percent. The data indicated no major increases overall in spending totals, especially in the most recent three years.

SENATOR STEDMAN asked when the request goes out for expectations in FY13-16 if could they break data down into the independents and the majors and just add them to the same charts so they don't have to flip back and forth.

MS. KEPPERS and commissioner agreed to do that.

[5:03:24 PM](#)

COMMISSIONER BUTCHER went to the conclusions on slide 14 and said they would be having further workshops and getting more details and everyone was invited. They are open to the public. He said capital expenditures from 2007 to 2010 increased from just under \$2 billion to about \$2.4 billion; explorers seemed to spend most of their money on drilling wells and G&G. Companies in the development stage spent money on development drilling and facilities; companies in transition spent money in multiple areas depending on what stage they were in; and companies in the mature production phase spent money on maintenance and upgrade of facilities and development wells. More players are active in the field, as well.

[5:04:56 PM](#)

COMMISSIONER BUTCHER said they were working on the proposed annual cost supplemental information report and will have one more year of look-back and starting with calendar year 2012 they will be able to use more detailed categories. He said they have discussed these issues with industry and had given them a general breakdown of different categories and definitions and a picture of where they are going with it. He hoped for a "fairly seamless move" so they can give the legislature more detail on expenditures with each additional year.

[5:05:48 PM](#)

CO-CHAIR PASKVAN thanked the presenters and held SB 192 in committee.

CO-CHAIR PASKVAN transferred the gavel to Co-Chair Wagoner.

HB 60-GEODUCK AQUATIC FARMING/SEED TRANSFER

5:06:12 PM

CO-CHAIR WAGONER announced the consideration of HB 60.

5:06:46 PM

CO-CHAIR WAGONER asked for a motion.

5:06:55 PM

CO-CHAIR PASKVAN moved to bring HB 60, version \A, before the committee for purposes of discussion.

CO-CHAIR WAGONER objected for purposes of discussion.

5:07:20 PM

REPRESENTATIVE PAUL SEATON, sponsor of HB 60, said he appreciated the timely effort the committee was taking on this bill. He said it works on trying to promote economic development around the coast of Alaska where it is difficult to establish new economic bases, especially ones that won't conflict in time with salmon and herring fishing. He said HB 60 allows for sub-tidal farming of geoduck clams. They average about 2.5 lbs. and are about 7 inches long. They are filter feeders and are generally two to three feet down in one place their entire life. Their habitat has worms and tunicates, a small sessile animal (naturally immobile) that aren't used commercially for subsistence, and nothing about geoducks has been found to inhibit their numbers.

His said his plan is necessary because the ADF&G has an informal policy of not allowing geoducks to go to the single certified hatchery in the state in Seward for raising and being distributed to farms anywhere other than where they are already occurring (only in Southeast). The recent geoduck conflict has been because wild stocks are harvested by divers and people want to put farms in good habitat which is where there is already a wild stock.

He explained however, that if the species would proliferate it would be a great bonus for Alaska, because right now fishermen are getting \$21 lb. for them. It is good for communities around the coast because geoducks, unlike oysters or muscles that have to be tended two or three times every summer, are put in the sediment with a small plastic piece of pipe with a net on the

top to keep out predators, two years later those are taken off, and in about seven years you are in harvest mode without doing anything else.

[5:11:13 PM](#)

REPRESENTATIVE SEATON began his video presentation at 5:11 and that ran until 5:14 p.m.

[5:14:41 PM](#)

REPRESENTATIVE SEATON said HB 60 simply says you can't use the absence of geoducks in an area to deny a plan permit. It would be for all areas around the Gulf of Alaska, Kodiak, Yakutat, Chignik and other areas out West, but not including Kachemak Bay, which is designated a critical habitat and doesn't allow bottom farming.

[5:15:18 PM](#)

REPRESENTATIVE SEATON said HB 60 limits farms to sub-tidal areas, so there is no interference with subsistence or sport fisheries. This is a clean and renewable fishery; it depends on clean water so people will make sure no pollution comes in.

He said the state has "larval drift zones" to make sure if you are enhancing a clam species you have to take the stock from that same area, raise the seed and then replant from that same stock so you don't get genetic crosses. And HB 60 is specifically for taking clam seed to an area where there are no natural stocks in the first place to alleviate that worry.

[5:16:44 PM](#)

CO-CHAIR WAGONER asked what the main predator for geoducks is as they are being raised.

REPRESENTATIVE SEATON answered when they are juveniles it's the star fish.

SENATOR STEVENS asked how the red tide would affect geoducks.

REPRESENTATIVE SEATON answered that geoducks are filter feeders and would be affected by a red tide bloom. This bill does not exempt any farm from all of the health and safety criteria that all Mari culture farms must deal with. So the geoducks have to be tested before they are sold.

[5:17:59 PM](#)

SENATOR STEVENS asked if there are shellfish hatcheries ready to supply the needs of this new industry.

REPRESENTATIVE SEATON replied the problem with having the only shellfish hatchery in the state is that its business plan was based on sale of seeds so it could be self-sustaining. Geoduck seed is much more valuable than oyster seed and without being able to distribute to more farms than just in Southeastern Alaska that business plan has not been realized. This bill should make the shellfish hatchery self-sustaining.

[5:18:35 PM](#)

SENATOR WIELECHOWSKI recalled concerns from ADF&G and asked if they had been resolved.

[5:18:56 PM](#)

REPRESENTATIVE SEATON answered yes, and the department is now neutral. They were concerned about the larval drift zones in terms of contamination and there is no question of that here.

[5:19:31 PM](#)

SENATOR FRENCH asked if he heard any opposition to the bill.

REPRESENTATIVE SEATON answered not since ADF&G came out with its concern.

[5:19:47 PM](#)

CO-CHAIR WAGONER opened the public hearing.

[5:20:56 PM](#)

PAUL FUHS, Alaska Sea Farms, said he supported HB 60 and that Alaska Sea Farms is the biggest operation growing geoducks in Southeast. He said if they pass this bill, it won't be a wasted effort. They would go immediately to a research permit and get some geoducks in the ground and see how they grow, mortalities and things like that. Geoducks are growing in Resurrection Bay right now. He said "the market has just gone off the deep end for geoducks" and that \$21 lb. to fisherman makes it the highest price fish in Alaska. It takes seven or eight years to grow them, but once you get them in the ground that is all you need to do. It's really good for rural Alaska, but what makes it so simple is the logistics: the transportation, the hatchery, the PSP testing is all there and that is what Southeast fights all the time. So it could be even more successful in Southcentral.

[5:21:53 PM](#)

SENATOR STEVENS asked how a person starts a geoduck farm.

MR. FUHS explained that you get a lease from the State of Alaska and from that you get exclusive use of the clams on your site. They don't worry about people coming and taking them because they are not a big item on most people's menu. But you have to prove that the water is clean and take over a year's worth of water samples; you can't be anywhere near a discharge line; you have to stake it off; you have to get a permit to transfer the seed from the hatchery, but that's it. The lease lasts for 10 years and is renewable. They have had some of these farms for 10 years and are just beginning to sell their first adult geoducks.

[5:23:04 PM](#)

CO-CHAIR WAGONER asked about much a first-year geoduck weighs.

MR. FUHS replied about two pounds after seven or eight years.

[5:23:46 PM](#)

ROGER PAINTER, President, Alaskan Shellfish Growers Association, said they supported HB 60. He said the geoduck market is strong and seems to be getting strong all the time. There are major geoduck aquaculture operations in Puget Sound that are doing very well, and two have had some interest in investments in Southcentral. And while he thinks they should be successful, they won't really know until the animals are put in the ground. They have been unsuccessful to this point in convincing ADF&G to do an experimental approach.

[5:25:45 PM](#)

SENATOR WIELECHOWSKI asked if someone for ADF&G was on line.

CO-CHAIR WAGONER said no, just someone from the shellfish hatchery.

SENATOR WIELECHOWSKI asked if it was run by the state.

CO-CHAIR WAGONER said someone indicated yes.

SENATOR WIELECHOWSKI asked Mr. Hetrick (on line) if he saw any problems to the ecosystem with this, a disease or anything.

JEFF HETRICK, General Manager, Alutiiq Pride Shellfish Hatchery, Seward, Alaska, answered no. They are currently using Resurrection Bay water that is filtered prior to coming into the hatchery and then they chlorinate the effluent prior to going back into the bay. So there should be no disease concerns. He said there are other clam populations, but sub-tidally they

don't expect any competition between geoduck clams and anything else.

[5:26:50 PM](#)

SENATOR WIELECHOWSKI asked how much acreage they anticipate leasing and how many geoducks they will allow per acre.

MR. HETRICK answered initially a fisheries resource permit would just be a small plot to prove the concept and identify the sites that would be applicable. The minimum size for a commercially viable farm for DNR and ADF&G is two acres, but he didn't know exactly how many geoducks get planted per acre - but hundreds of thousands.

SENATOR WIELECHOWSKI asked if there is spacing between the acreage.

MR. HETRICK answered that the acreage is fee-based, so you don't want to take more space than you actually need. But typically, farms are contiguous; acreage would be side by side. These sites require specific habitat and you wouldn't be taking steep rocky slopes, for instance; you'd look for gentle sandy bottoms or light gravel, which are "minimized." They are working with the Sea Life Center and some local dive shops to identify some locations for the first proof of concept program in Resurrection Bay. Perhaps others would step forward with other sites.

[5:28:28 PM](#)

SENATOR STEVENS asked how geoducks are processed, since they are off the road system.

[5:29:04 PM](#)

MR. FUHS replied that they are taken from remote locations now and delivered by the dock, but they are sold live. So as soon as they hit the dock they go into "chill mode" and are flown out immediately. They experimented with processing some of them, but the market didn't want that. They wanted live geoduck.

[5:29:39 PM](#)

SENATOR STEVENS asked if geoducks can survive for a period of time.

MR. FUHS answered yes; they found that the farms benefit the smaller airlines and ships, fuel, divers, and all the ancillary services that go around it.

[5:30:18 PM](#)

CO-CHAIR WAGONER asked if some of the Native corporations want to get into the geoduck industry; Port Graham would probably be a perfect place because it doesn't get a big surge and is shallow. Can they be transported to Homer on a boat and then be put on the airplane in Homer?

MR. FUHS answered yes.

SENATOR WIELECHOWSKI asked if geoducks are handpicked by SCUBA (self-contained underwater breathing apparatus) divers.

MR. FUHS replied yes; they are dug in so hard that the diver puts a water jet down in the mud and it loosens it up a little bit to where the geoduck can be wrestled out. It's tough work in about 15-40 feet of water, but a diver can harvest about 1,000 animals a day.

CO-CHAIR WAGONER asked if they use hookah gear.

MR. FUHS replied yes, sometimes hardhat, sometimes SCUBA.

CO-CHAIR WAGONER closed public testimony and removed his objection. He asked for a motion to move HB 60 out of committee with individual recommendations and attached fiscal note(s).

[5:31:57 PM](#)

CO-CHAIR PASKVAN said so moved. There were no objections and HB 60 moved from the Senate Resources Standing Committee.

[5:32:08 PM](#)

CO-CHAIR WAGONER adjourned the Senate Resources Standing Committee meeting at 5:32 p.m.