

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

February 28, 2012

3:33 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Senator Hollis French

OTHER LEGISLATORS PRESENT

Senator Cathy Giessel
Senator Dennis Egan
Senator Joe Thomas

COMMITTEE CALENDAR

SENATE BILL NO. 192

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

- HEARD & HELD

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
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 02/27/12 (S) Heard & Held
 02/27/12 (S) MINUTE(RES)
 02/28/12 (S) RES AT 3:30 PM SENATE FINANCE 532

WITNESS REGISTER

KARA MORIARTY, Executive Director
 Alaska Oil and Gas Association (AOGA)
 Anchorage, AK

POSITION STATEMENT: Said that all AOGA members believe meaningful changes to the tax system are necessary to stem the decline in oil production.

RICK ROGERS, Executive Director
 Resource Development Council (RDC)

Anchorage, AK

POSITION STATEMENT: Said that meaningful tax change is needed to increase oil production and that CSSB 192() is an improvement but doesn't move the needle enough.

DAVE CRUZ

Cruz Companies

Anchorage, AK

POSITION STATEMENT: Opposed SB 192 and supported HB 110.

MARK HYMAN

Beacon Occupational Health and Safety Services Inc.

Alaska Support Industry Alliance

Anchorage, AK

POSITION STATEMENT: Commented on changing the ACES tax structure to increase oil production.

DOUG SMITH, President and CEO

Little Red Services

Alaska Support Industry Alliance

Anchorage, AK

POSITION STATEMENT: Commented on changing the ACES tax structure to increase oil production.

ACTION NARRATIVE

[3:33:52 PM](#)

CO-CHAIR JOE PASKVAN called the Senate Resources Standing Committee meeting to order at 3:33 p.m. Present at the call to order were Senators Stedman, Wielechowski, McGuire, Stevens, Co-Chair Wagoner and Co-Chair Paskvan.

SB 192-OIL AND GAS PRODUCTION TAX RATES

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CO-CHAIR PASKVAN announced the consideration of CSSB 192 (), labeled 27-LS1305\B. He outlined the agenda, which included invited testimony from three of Alaska's resource trade associations: Alaska Oil and Gas Association (AOGA), Resource Development Council (RDC), and the Alaska Support Industry Alliance (the Alliance).

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KARA MORIARTY, Executive Director, Alaska Oil and Gas Association (AOGA), said AOGA is a professional trade association fostering the long term viability of oil and gas development for all Alaskans. They represent a diverse

membership and evaluate public policy proposals before taking a position.

SENATOR PASKVAN recognized Senator Giessel.

MS. MORIARTY said AOGA represents long time employers in Cook Inlet with Marathon and Tesoro and the newest companies, Apache and Hilcorp, as well as XTO that has been producing from two existing Cook Inlet platforms. Moving northeast to Valdez, they represent one of the smallest refineries in the United States, Petro Star, Inc., and the largest employer in Valdez, Alyeska Pipeline Service Company. Moving up the Richardson Highway to Fairbanks and North Pole, they have three members with the North Pole Refinery that Petro Star operates as well as Flint Hills' Refinery, and Alyeska continues to maintain a significant office and workforce in the Fairbanks area. Their companies have interests all across the North Slope, both onshore and offshore, from legacy companies such as BP and Exxon to the two newest producers, Pioneer and Eni Petroleum to the newest explorer, Repsol. And although Chevron divested its assets in Cook Inlet, it still holds interests in the North Slope. Finally, they also represent Shell and Statoil that are focused on developing federal resources. All told, AOGA members hold active leases for more than 1.2 million acres of state land. There is little doubt that they represent the majority of oil and gas exploration, production, development, transportation, refining and marketing activities in Alaska.

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She said one of the key purposes of AOGA or any professional trade association is to provide a forum for the discussion of matters of general interest to its members and it is their policy before taking a position on tax matters to have 100 percent consensus. AOGA did not support the changes that were made to the production tax system in 2006 and 2007. They believe then and now that the current tax system makes Alaska uncompetitive for investment dollars for long term development and production. All member companies believe meaningful changes to the tax system are necessary to stem the decline in oil production.

MS. MORIARTY stated that AOGA does not support the CS to SB 192. One of the most egregious provisions is that as the price of oil increases and as a higher tax is implemented all prior dollars are taxed at that higher rate. This could be addressed by a bracketing concept that sets tax rates at different levels as the price increases so that each level is taxed only once and at

a set rate, but the CS does nothing to change the onerous provision and thus continues an imbalance in the risk/reward investment environment in Alaska.

She said the Senate Bi-partisan Working Group recently issued a press release outlining what it wants from oil reform stating three things:

1. increased oil production
2. more jobs for Alaskans
3. sustained state revenue over the long term.

And while AOGA supports all of those tenets, in essence they all boil down to just one - increased production. Without it, having sustained revenue will be difficult and without revenue, jobs in Alaska are in danger. This CS creates potential deficits as early as 2015 that will grow larger in each succeeding year. In 2006 and 2007, many companies testified that ACES wouldn't attract the investment Alaska needs to change the production curve and it hasn't. In fact, production is significantly lower today than what Alaska was forecasting when it passed ACES in 2007.

One only needs to look to Cook Inlet for guidance, Ms. Moriarty said, where the legislature reacted to production concerns with bold and meaningful tax reforms targeted at making the Inlet commercially attractive. By all accounts, those reforms have been successful.

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MS. MORIARTY said that Alaska needs to appreciate the North Slope production problem with the same level of concern and react with similar bold and meaningful reforms. The overall government take in Alaska is too high and they supported the governor's proposal as a first step in providing meaningful reform. She offered to answer questions.

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SENATOR WIELECHOWSKI asked if HB 110 is a good first step, what other steps are needed if they pass a bill like it.

MS. MORIARTY answered that aside from addressing progressivity, the base rate should be lowered, the small producer tax credits should be extended and interest rates should be lowered. The change has to be comprehensive as laid out in the governor's bill.

SENATOR WIELECHOWSKI asked what she thought of the amendments and if she supported or opposed any one in particular.

MS. MORIARTY answered that AOGA has looked at the amendments, but was uncomfortable coming to a conclusion without knowing how they would fit together in a complete package.

SENATOR STEDMAN said it appeared that a Cook Inlet system would satisfy AOGA, but from the state treasury's perspective Cook Inlet has huge capital credits and virtually nothing on the other side for tax revenue. So, in his opinion Cook Inlet is broken, but in the opposite respect of north of the Brooks Range.

MS. MORIARTY said they aren't advocating Cook Inlet as a model for the North Slope, just saying that changes were made to spur exploration and development there and they hoped the same thing kind of thinking would apply on the North Slope.

SENATOR STEDMAN asked if they were advocating that the treasury run negative on the North Slope.

MS. MORIARTY answered that they were advocating for the right balance for the state and the industry.

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CO-CHAIR PASKVAN asked when she says government take is too high what her understanding was of government take of ANS crude at \$100 or \$120 under current cost structures.

MS. MORIARTY answered that she didn't have those figures in front of her, but federal tax, state royalty, production tax, corporate income tax and property tax are included in government take and today it is much higher take than it was five or six years ago.

CO-CHAIR PASKVAN asked what government take would be acceptable to them including the federal portion.

MS. MORIARTY replied that they don't have a magic acceptable number. It has to be the right balance and it is out of balance right now. Governor Hammond used to advocate for a third, a third, a third and they are not close to that standard.

SENATOR WIELECHOWSKI asked if she agreed with the governor and the DOR commissioner who recently said that ACES is competitive at \$60 to \$80 and that it gets high at around \$100.

MS. MORIARTY answered that they agree that even at \$60 to \$80 oil, some fields in Alaska are still marginal and their tax rate could still be too high. They agree with the governor that as progressivity kicks in Alaska gets a higher percentage especially at higher prices. They believe that Alaska could be more competitive.

SENATOR WIELECHOWSKI asked if faced with the choice of passing this bill or nothing what her position would be.

MS. MORIARTY replied that AOGA opposed this bill in its current form.

SENATOR WIELECHOWSKI asked if there was any sort of happy medium between this bill and HB 110 that would satisfy her members.

MS. MORIARTY replied until they put it in writing she couldn't answer that question.

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RICK ROGERS, Executive Director, Resource Development Council (RDC), introduced himself and said that one of their directors, Dave Cruz, Cruz Construction, was in the audience. He said he would reserve some of his time for Mr. Cruz to share his perspective.

MR. ROGERS said RDC is a statewide membership-funded organization, but unlike AOGA, it represents a broader spectrum, the five major resource industries in the state: forestry, fisheries, mining, tourism and oil and gas. Additionally, they have communities, all 12 regional Alaska Native corporations, organized labor, utilities, support businesses and all the folks that recognize the important role that resource development plays in the state's economy.

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MR. ROGERS said there's a sense of urgency and broad support for a meaningful adjustment to the production tax for increasing TAPS through-put and that some of the most vocal proponents for oil production tax reform are coming from the non-oil and gas members. The broader business community is fearful of what the accelerating decline curve means to the overall economy in Alaska and is convinced that ACES retards investment and contributes to the decline. The governor's 10-year budget projection has a sobering outlook a few years out.

He said the Senate seems to be focused on imposing the highest tax politically possible on the producers and that squeezing the last dollars from a productive private sector with an ever expanding state budget is not going to lead Alaska to a prosperous future. Taxing ourselves to prosperity is not a strategy. CSSB 192 is an improvement, but it does not move the needle enough.

MR. ROGERS said this is a historic turning point for Alaska and they find it unfortunate that rhetoric characterizes tax reform as a give-away. From their view, the objective is to empower the private sector to increase Alaska's productivity for the ultimate benefit of its citizens; he hoped that leadership could explain that a high tide will lift all ships and that royalties will increase only with increased production. They hoped the legislature as a whole could overcome what its consultant, Pedro van Meurs, referred to as difficult political issues.

MR. ROGERS said according to DOR statistics, at \$100 oil the tax in Alaska since 2005 has essentially tripled. The RDC supported HB 110, because industry has said its passage will result in at least \$5 billion in new investment in Alaska and he couldn't imagine the oil industry making a \$5 billion public commitment and then not following through. For instance, ConocoPhillips' capital investment is flat in Alaska compared to its capital investment in the Lower 48 that has increased by 104 percent. What the RDC really looks at is whether tax changes will result in meaningful investments by the private sector and they don't think CSSB 192 () will move that needle.

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SENATOR STEDMAN stated that Mr. Rogers' inference that the Senate is only interested in the highest possible tax rate was not helpful. That was not the direction they were heading. But there have been discussions about the tax structure at higher rates; just yesterday they looked at north of \$200 when much of the incremental profit would go to the state, not industry. On the other end of the scale, the State of Alaska offers a lot of up-front credits. He asked Mr. Rogers how much he thought the state should supplement capital projects for the industry.

MR. ROGERS replied that he stood corrected and was grateful that CSSB 192 did not reduce or remove exploration credits. However, the problem with exploration credits is that they are further out in the time line and the legacy fields need immediate work. He said the levers must work in concert with each other, and while they can incentivize exploration, eventually the new

resource would have to be brought into production and would be affected by whatever tax regime existed at the time.

SENATOR STEDMAN asked if he thought the State of Alaska should be in the position of paying 100 percent of capital costs for industry at oil prices over \$200 barrel as it is currently.

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MR. ROGERS responded that he was not prepared to comment on that.

SENATOR STEDMAN said that's part of the balancing act. A lot of people are concerned about the steepness of progressivity, but on the other side of the tax regime, the state pays a substantial amount of upfront costs to the industry - amounting to \$850 million in the 2013 budget, plus the immediate write off, which by some calculations is worth over \$1 billion (at \$110 barrel). As the price escalates, the state has substantial risk exposure with reimbursing capital costs. It's not fair to ask the state to lower one end of the scale and leave it exposed on the other end.

MR. ROGERS said those issues must all be addressed in one package, not just individually.

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SENATOR STEDMAN said he understood from previous testimony that industry likes Cook Inlet's tax structure and think it should be replicated on the North Slope! But, Cook Inlet has a negative cash flow into the state treasury and the problems in the Arctic are different. Clearly, the State of Alaska should not be in a position of paying the industry 100 percent of capital costs. It has already put over \$4 billion into the oil basin and yet they hear from industry that Alaska is closed for business. That attitude has a negative indication through multiple industries.

MR. ROGERS clarified that what he was saying was that the production tax north of the Brooks Range is not competitive on a global scale and is hampering business. Production is decreasing while oil prices are very robust and other jurisdictions in declining reservoirs have production that is level or increasing. The North Slope should be having more activity when prices are where they currently are.

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CO-CHAIR PASKVAN asked what he thought a reasonable rate of government (including federal) take is.

MR. ROGERS replied that the industry is comfortable with that level of government take in HB 110.

CO-CHAIR PASKVAN asked if they had come up with a rate under which anything would be acceptable and above which it would be rejected.

MR. ROGERS reiterated that they have accepted the revenue curve in HB 110.

CO-CHAIR PASKVAN said he was talking about the government take analysis.

MR. ROGERS said they look at total government take as a combination of federal taxes, royalties, state corporate taxes and property taxes.

CO-CHAIR PASKVAN said he was referencing Mr. Rogers' reference to the DOR's publication on the oil and gas fiscal regime that trebled under ELF and asked if he had analyzed what the ratio is under the current cost structures.

MR. ROGERS answered no. He said he had relied on the DOR's information and that his point had been to show the relativity of the significant changes that have been made over the last five years and that the mark was overshot.

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SENATOR MCGUIRE pointed out that industry has paid over \$73 billion in royalties as a result of renewed activity in Cook Inlet and commented that philosophically, the goal shouldn't always be to bring money into the government. Part of setting a good tax policy in a capitalist society is finding the balance between allowing dollars to flow in the private sector and the jobs to be created there.

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DAVE CRUZ, Cruz Companies, Anchorage, said he graduated from high school 36 years ago and got an opportunity to work on the pipeline and 31 years ago he launched what is now Cruz Companies. His companies build ice roads, provide drilling support services, tundra transport and mobile camps in Alaska, as well as private and public heavy civil construction, roads, airports and tug and barge services. They currently provide well-paying jobs in Alaska for 93 people and 110 people in North Dakota where they provide drilling support, rig moving and heavy

lift cranes. Cruz Companies went to work in North Dakota 17 months ago, because Alaska didn't have enough work. Cruz Companies and all the jobs it has generated wouldn't have happened if Alaska didn't have a healthy oil industry at one time. Oil pays for 90 percent of the state's government and no other resource is as significant.

MR. CRUZ said that Steven Forbes, editor and chief of Forbes Media, said to the Anchorage Economic Development Corps that Alaska's oil tax structure was one of the world's worst, second only to North Korea, and that HB 110 would remedy the tax provisions strangling the oil industry in Alaska, not CSSB 192.

He said in exchange for lowering taxes, the oil industry has offered a \$5 billion investment to increase production. The Senate didn't move on it, but instead went to look at Norway's model. They should have been looking at the Lower 48 model that even during a recession seems to be working well. He related that Baker Hughes' rig counts indicate that California has 43 rigs working, Colorado has 69, New Mexico has 81, Pennsylvania has 105, Louisiana has 139, North Dakota has 187, Oklahoma has 198, Texas has 920, and Alaska has a rig count of 9 as of last Friday with 4 sitting idle.

He said Alberta, Canada, provides a glimpse of what could happen to production in Alaska if meaningful changes are made to the oil tax structure. The industry there was idle in 2009 and thousands of people were out of work. The government adjusted the tax structure creating incentives to bring the industry back. It is now rebounding and 11,700 wells will be drilled this year; 700 rigs are operating there now.

MR. CRUZ said there is no comparison between the cost of production in Alaska and in other states. To negotiate a drilling project in Alaska will cost a couple million dollars and almost a year's time. In North Dakota a drilling project can be negotiated in a month and actually receive a state drilling permit in one week. North Dakota has a road and rail structure and private land is used for their ventures. They don't wait on a pipeline to move oil; they truck it to a gathering center and rail it to the East Coast every day.

He said that not one well they have worked on at Prudhoe has come into production and his main competitor has experienced the same thing. In North Dakota there is a 90 percent chance that a well they are working on will be in production within 60 days. In Alaska, the same thing takes years.

MR. CRUZ summarized that in 1975, the largest non-governmental employee in Alaska was the Southeast timber industry with multiple saw mills, two thriving pulp mills, thousands of well-paying jobs, but they were legislated out of business. The market did not shut them down. Governor Hickel taught Alaskans that they can control their destiny and they can change the production decline, too.

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CO-CHAIR PASKVAN recognized that Senator Egan and Senator Thomas were present.

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MARK HYMAN, Beacon Occupational Health and Safety Services Inc., said he would give testimony on behalf of the Alaska Support Industry Alliance along with Doug Smith, another member of the Alliance. Beacon provides medical, safety and training services and their clientele embraces the many diverse industries in Alaska as well as municipal, state and federal agencies. This includes many of the contractors, producers and explorers that represent the oil and gas industry in Alaska. Additionally, he was the immediate past president of the Alaska Support Industry Alliance that has nearly 500 member companies that employ 38,000 people.

At Beacon, he said, many of the new hires that are heading to the North Slope provide services for things like physicals, drug and alcohol testing and safety training. They also provide infield support of year-round medical clinics, safety professionals, onsite training and site control services. They have full time facilities in Anchorage, Kenai and Dead Horse and employ roughly 250 full-time employees. Their success as an Alaskan owned, Alaskan grown company is directly attributable to the major oil producers on the North Slope who have been exceptional corporate partners over the years.

MR. HYMAN said there is no doubt that there has been an increase in overall activity this year on the North Slope and the potential of Shell's offshore activity is coming this summer. However, none of it is going to stem the current rate of decline through TAPS any time soon. Dramatic change in the tax structure is needed to increase investment from the current producers and to encourage new producers to invest there.

MR. HYMAN said not all Alliance members work on the Slope, but they are all interested in a strong oil and gas industry,

because they are engineers, suppliers, accountants, IT, banks and many other services that don't directly contract with a producer or work on the North Slope but indirectly support the contractors and producers that do. These Alaskan based businesses, union and non-union, Native corporations included, are all interested in a strong Alaskan oil and gas economy, because of the benefits it brings to the state as a whole.

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DOUG SMITH, President and CEO, Little Red Services, said his business challenges aren't different than many Alliance members'. His company started in 1983 and has 140 employees; 70 percent are Alaska residents and 10 percent are previous residents who moved out of the state while being employed by them. Their primary concern is how the industry's uncertain future challenges making good capital decisions. For instance, a new hot oil unit built for Arctic needs is only available from one vendor in Red Deer, Canada, and the one he got in December cost \$2 million. Three years ago, the same unit was \$1.5 million. The \$.5 million difference was not related to the price increase in steel or parts, but to demand coming from Alberta last year. There is no potential rate increase to offset the impacts from the additional costs like this. This piece of equipment has a 20-year life span and it's hard for anyone to see ahead 20 years to say it was a good decision or not. He said the state needs to bring some certainty into its fiscal policy to allow for sound evaluation of long term projects and investments.

He said they are now considering refinancing their senior debt and the number one question they get from banks is what is going to happen with the tax structure in Alaska and how will that affect the future of your business and cash flow. He asked them to remember that when they look at making changes to the tax structure.

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SENATOR STEDMAN said he heard what they were saying about employment being down and costs being up, but legislators get conflicting information. For instance, employment in the oil basin is at its maximum, the DOR expects capital expenditures to go from \$2.7 to \$3.8 billion and barge and freight companies have indicated that shipment dollars are going towards maintenance items. Legislators had also been told that bunk houses and planes in the oil patch are full and the processing facilities are running at capacity. So they struggle with conflicting information.

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MR. SMITH agreed that the process is difficult to understand. He lost about 10 percent of his employees due to decreased work during the recession, but they found ways keep working. One way was delivering new infield technology to redirect water flood by injecting bright water polymer to increase oil recovery from existing BP wells.

MR. SMITH said he wanted someone to get the forecast right, because DOR's projections during ACES discussions were 100,000 barrels off from what oil production actually is today. ACES might not have passed if they had a better idea of what was going to happen in the economy. A conservative estimate going forward is needed so Alaska can have its best shot at getting into a more competitive posture.

CHAIR PASKVAN asked if his business was eligible for the capital expenditure credit.

MR. ROGERS answered no. He added that once they pay the federal government its share that the remainder should be fairly split between industry and the state.

CO-CHAIR PASKVAN commented that he heard in 2008 when oil went up to \$140 barrel that all the costs for the support structures dramatically increased, too, and in 2009 when oil declined, the majors suppressed the prices.

MR. ROGERS responded that his company prices are less now than they were in 2004 and he offered to show copies of their contracts. Some industries may have over-escalated prices more than what was fair and may be seeing themselves at the back of the line now, but a lot of them did not participate in that. He felt if you want to be a long term partner you have to treat each other with mutual respect and the state has to decide how to be a partner rather than a "pickpocket."

SENATOR STEDMAN said the DOR charts from yesterday's presentation were for the legacy fields and didn't include everyone up there. There had been discussion on fixing ACES at a high price, but outside of that there had also been discussions on how to tax incremental oil production to flatten the decline curve first and then get it back up to 600,000 incrementally. Pedro van Meurs suggested a \$25 allowance to the industry on incremental production and Senator Wagoner was working on a tax holiday methodology. They were trying to zero in on what they

perceive is the most challenging problem, but the problems with ACES are a lot deeper than they have time to deal with this winter.

MR. ROGERS said he appreciated that and his organization's members were trying to education themselves so they could remain objective.

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

4:50:55 PM

CO-CHAIR PASKVAN adjourned the Senate Resources Standing Committee meeting at 4:50 p.m.