

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

March 22, 2013

1:05 p.m.

**MEMBERS PRESENT**

Representative Eric Feige, Co-Chair  
Representative Dan Saddler, Co-Chair  
Representative Peggy Wilson, Vice Chair  
Representative Craig Johnson  
Representative Geran Tarr  
Representative Chris Tuck

**MEMBERS ABSENT**

Representative Mike Hawker  
Representative Kurt Olson  
Representative Paul Seaton

**OTHER LEGISLATORS PRESENT**

Representative Doug Isaacson  
Representative Andrew Josephson

**COMMITTEE CALENDAR**

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 21(FIN) AM(EFD FLD)

"An Act relating to the interest rate applicable to certain amounts due for fees, taxes, and payments made and property delivered to the Department of Revenue; providing a tax credit against the corporation income tax for qualified oil and gas service industry expenditures; relating to the oil and gas production tax rate; relating to gas used in the state; relating to monthly installment payments of the oil and gas production tax; relating to oil and gas production tax credits for certain losses and expenditures; relating to oil and gas production tax credit certificates; relating to nontransferable tax credits based on production; relating to the oil and gas tax credit fund; relating to annual statements by producers and explorers; establishing the Oil and Gas Competitiveness Review Board; and making conforming amendments."

- HEARD & HELD

HOUSE BILL NO. 158

"An Act authorizing the commissioner of natural resources to implement a hunting guide concession program or otherwise limit the number of individuals authorized to conduct big game commercial guiding on state land."

- HEARD & HELD

**PREVIOUS COMMITTEE ACTION**

BILL: SB 21

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/16/13	(S)	READ THE FIRST TIME - REFERRALS
01/16/13	(S)	TTP, RES, FIN
01/22/13	(S)	TTP AT 3:30 PM BELTZ 105 (TSBldg)
01/22/13	(S)	Heard & Held
01/22/13	(S)	MINUTE(TTP)
01/24/13	(S)	TTP AT 3:30 PM BUTROVICH 205
01/24/13	(S)	Heard & Held
01/24/13	(S)	MINUTE(TTP)
01/29/13	(S)	TTP AT 3:30 PM BELTZ 105 (TSBldg)
01/29/13	(S)	Heard & Held
01/29/13	(S)	MINUTE(TTP)
01/31/13	(S)	TTP AT 1:00 PM BUTROVICH 205
01/31/13	(S)	Heard & Held
01/31/13	(S)	MINUTE(TTP)
02/05/13	(S)	TTP AT 3:30 PM BUTROVICH 205
02/05/13	(S)	Heard & Held
02/05/13	(S)	MINUTE(TTP)
02/07/13	(S)	TTP AT 3:30 PM BUTROVICH 205
02/07/13	(S)	Moved SB 21 Out of Committee
02/07/13	(S)	MINUTE(TTP)
02/08/13	(S)	TTP RPT 1NR 4AM
02/08/13	(S)	NR: DUNLEAVY
02/08/13	(S)	AM: MICCICHE, GARDNER, FAIRCLOUGH, MCGUIRE
02/08/13	(S)	LETTER OF INTENT WITH TTP REPORT
02/09/13	(S)	TTP AT 10:00 AM BUTROVICH 205
02/09/13	(S)	-- MEETING CANCELED --
02/11/13	(S)	RES AT 3:30 PM BUTROVICH 205
02/11/13	(S)	Heard & Held
02/11/13	(S)	MINUTE(RES)
02/13/13	(S)	RES AT 3:30 PM BUTROVICH 205
02/13/13	(S)	Heard & Held
02/13/13	(S)	MINUTE(RES)
02/15/13	(S)	RES AT 3:30 PM BUTROVICH 205

02/15/13 (S) Heard & Held  
02/15/13 (S) MINUTE(RES)  
02/18/13 (S) RES AT 3:30 PM BUTROVICH 205  
02/18/13 (S) Heard & Held  
02/18/13 (S) MINUTE(RES)  
02/20/13 (S) RES AT 3:30 PM BUTROVICH 205  
02/20/13 (S) Heard & Held  
02/20/13 (S) MINUTE(RES)  
02/22/13 (S) RES AT 3:30 PM BUTROVICH 205  
02/22/13 (S) Heard & Held  
02/22/13 (S) MINUTE(RES)  
02/25/13 (S) RES AT 3:30 PM BUTROVICH 205  
02/25/13 (S) Heard & Held  
02/25/13 (S) MINUTE(RES)  
02/27/13 (S) RES AT 3:30 PM BUTROVICH 205  
02/27/13 (S) Moved CSSB 21(RES) Out of Committee  
02/27/13 (S) MINUTE(RES)  
02/28/13 (S) RES RPT CS 3DP 1DNP 2NR 1AM NEW  
TITLE  
02/28/13 (S) LETTER OF INTENT WITH RES REPORT  
02/28/13 (S) DP: GIESSEL, MCGUIRE, DYSON  
02/28/13 (S) DNP: FRENCH  
02/28/13 (S) NR: MICCICHE, BISHOP  
02/28/13 (S) AM: FAIRCLOUGH  
02/28/13 (S) FIN AT 9:00 AM SENATE FINANCE 532  
02/28/13 (S) Heard & Held  
02/28/13 (S) MINUTE(FIN)  
03/01/13 (S) FIN AT 9:00 AM SENATE FINANCE 532  
03/01/13 (S) Heard & Held  
03/01/13 (S) MINUTE(FIN)  
03/01/13 (S) RES AT 3:30 PM BUTROVICH 205  
03/01/13 (S) -- MEETING CANCELED --  
03/02/13 (S) RES AT 10:00 AM BUTROVICH 205  
03/02/13 (S) -- MEETING CANCELED --  
03/04/13 (S) FIN AT 9:00 AM SENATE FINANCE 532  
03/04/13 (S) Heard & Held  
03/04/13 (S) MINUTE(FIN)  
03/04/13 (S) FIN AT 1:30 PM SENATE FINANCE 532  
03/04/13 (S) Heard & Held  
03/04/13 (S) MINUTE(FIN)  
03/05/13 (S) FIN AT 9:00 AM SENATE FINANCE 532  
03/05/13 (S) Heard & Held  
03/05/13 (S) MINUTE(FIN)  
03/05/13 (S) FIN AT 1:30 PM SENATE FINANCE 532  
03/05/13 (S) Heard & Held  
03/05/13 (S) MINUTE(FIN)  
03/06/13 (S) FIN AT 9:00 AM SENATE FINANCE 532

03/06/13 (S) Heard & Held  
 03/06/13 (S) MINUTE(FIN)  
 03/06/13 (S) FIN AT 1:30 PM SENATE FINANCE 532  
 03/06/13 (S) Heard & Held  
 03/06/13 (S) MINUTE(FIN)  
 03/06/13 (S) FIN AT 3:00 PM SENATE FINANCE 532  
 03/06/13 (S) -- Public Testimony --  
 03/11/13 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/11/13 (S) -- MEETING CANCELED --  
 03/11/13 (S) FIN AT 1:30 PM SENATE FINANCE 532  
 03/11/13 (S) -- MEETING CANCELED --  
 03/12/13 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/12/13 (S) Bills Previously Heard/Scheduled  
 03/12/13 (S) FIN AT 1:30 PM SENATE FINANCE 532  
 03/12/13 (S) Heard & Held  
 03/12/13 (S) MINUTE(FIN)  
 03/12/13 (S) FIN AT 4:00 PM SENATE FINANCE 532  
 03/12/13 (S) Heard & Held  
 03/12/13 (S) MINUTE(FIN)  
 03/13/13 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/13/13 (S) Heard & Held  
 03/13/13 (S) MINUTE(FIN)  
 03/13/13 (S) FIN AT 1:30 PM SENATE FINANCE 532  
 03/13/13 (S) Heard & Held  
 03/13/13 (S) MINUTE(FIN)  
 03/14/13 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/14/13 (S) Moved CSSB 21(FIN) Out of Committee  
 03/14/13 (S) MINUTE(FIN)  
 03/18/13 (S) FIN RPT CS 2DP 1DNP 1NR 3AM NEW  
 TITLE  
 03/18/13 (S) DP: KELLY, MEYER  
 03/18/13 (S) DNP: HOFFMAN  
 03/18/13 (S) NR: FAIRCLOUGH  
 03/18/13 (S) AM: DUNLEAVY, BISHOP, OLSON  
 03/18/13 (H) RES AT 1:00 PM BARNES 124  
 03/18/13 (H) Scheduled But Not Heard  
 03/19/13 (S) RLS AT 9:00 AM FAHRENKAMP 203  
 03/19/13 (S) -- MEETING CANCELED --  
 03/20/13 (H) RES AT 1:00 PM BARNES 124  
 03/20/13 (H) Scheduled But Not Heard  
 03/21/13 (S) TRANSMITTED TO (H)  
 03/21/13 (S) VERSION: CSSB 21(FIN) AM(EFD FLD)  
 03/22/13 (H) RES AT 1:00 PM BARNES 124

BILL: HB 158

SHORT TITLE: DNR HUNTING CONCESSIONS

SPONSOR(s): COSTELLO

03/05/13	(H)	READ THE FIRST TIME - REFERRALS
03/05/13	(H)	RES, JUD, FIN
03/11/13	(H)	RES AT 1:00 PM BARNES 124
03/11/13	(H)	Heard & Held
03/11/13	(H)	MINUTE(RES)
03/13/13	(H)	RES AT 1:00 PM BARNES 124
03/13/13	(H)	Heard & Held
03/13/13	(H)	MINUTE(RES)
03/15/13	(H)	RES AT 1:00 PM BARNES 124
03/15/13	(H)	Heard & Held
03/15/13	(H)	MINUTE(RES)
03/18/13	(H)	RES AT 1:00 PM BARNES 124
03/18/13	(H)	Heard & Held
03/18/13	(H)	MINUTE(RES)
03/20/13	(H)	RES AT 1:00 PM BARNES 124
03/20/13	(H)	Heard & Held
03/20/13	(H)	MINUTE(RES)
03/22/13	(H)	RES AT 1:00 PM BARNES 124

**WITNESS REGISTER**

MICHAEL PAWLOWSKI, Oil & Gas Development Project Manager  
Office of the Commissioner  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Provided a PowerPoint sectional review of CSSB 21(FIN) am(efd fld).

BRUCE TANGEMAN, Deputy Commissioner  
Office of the Commissioner  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Answered questions related to CSSB 21(FIN) am(efd fld).

JOE BALASH, Deputy Commissioner  
Office of the Commissioner  
Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** Provided a PowerPoint explanation of the gross revenue exclusion provision in CSSB 21(FIN) am(efd fld).

TEMPLE DAVIDSON, Unit Manager  
Central Office  
Division of Oil & Gas  
Department of Natural Resources (DNR)

Anchorage, Alaska

**POSITION STATEMENT:** Answered a question regarding CSSB 21(FIN) am(efd fld).

THOR STACEY, Lobbyist

Alaska Professional Hunters Association (APHA)

Auke Bay, Alaska

**POSITION STATEMENT:** During the hearing on HB 158, suggested changes to the language in Version U.

TIM BOOCH, Master Guide 176

Kodiak, Alaska

**POSITION STATEMENT:** During the hearing on HB 158, testified in opposition to Version U.

DICK ROHRER

Kodiak, Alaska

**POSITION STATEMENT:** During the hearing on HB 158, suggested changes to the language in Version U.

MIKE MCCRARY

Deadhorse, Alaska

**POSITION STATEMENT:** During the hearing on HB 158, testified in opposition to Version U.

SMOKEY DON DUNCAN, Master Guide 136

Fairbanks, Alaska

**POSITION STATEMENT:** During the hearing on HB 158, testified in opposition to Version U.

DAN WINKELMAN

Bethel, Alaska

**POSITION STATEMENT:** During the hearing on HB 158, testified in support of Version U.

ISRAEL PAYTON, Registered Guide 1111

Wasilla, Alaska

**POSITION STATEMENT:** During the hearing on HB 158, testified regarding Version U.

NATE TURNER, Registered Guide 1036

Nowitna River, Alaska

**POSITION STATEMENT:** During the hearing on HB 158, testified in support of Version U.

JOE WANT, Registered Guide AA006

Fairbanks, Alaska

**POSITION STATEMENT:** During the hearing on HB 158, testified regarding Version U.

VIRGIL UMPHENOUR, Master Guide 158  
Fairbanks, Alaska

**POSITION STATEMENT:** During the hearing on HB 158, suggested changes to the language in Version U.

#### **ACTION NARRATIVE**

[1:05:48 PM](#)

**CO-CHAIR ERIC FEIGE** called the House Resources Standing Committee meeting to order at 1:05 p.m. Representatives Tarr, P. Wilson, Johnson, Saddler, and Feige were present at the call to order. Representative Tuck arrived as the meeting was in progress. Representatives Isaacson and Josephson were also present.

#### **SB 21-OIL AND GAS PRODUCTION TAX**

[1:06:19 PM](#)

CO-CHAIR FEIGE announced that the first order of business is CS FOR SENATE BILL NO. 21(FIN) am(efd fld), "An Act relating to the interest rate applicable to certain amounts due for fees, taxes, and payments made and property delivered to the Department of Revenue; providing a tax credit against the corporation income tax for qualified oil and gas service industry expenditures; relating to the oil and gas production tax rate; relating to gas used in the state; relating to monthly installment payments of the oil and gas production tax; relating to oil and gas production tax credits for certain losses and expenditures; relating to oil and gas production tax credit certificates; relating to nontransferable tax credits based on production; relating to the oil and gas tax credit fund; relating to annual statements by producers and explorers; establishing the Oil and Gas Competitiveness Review Board; and making conforming amendments."

[1:07:14 PM](#)

MICHAEL PAWLOWSKI, Oil & Gas Development Project Manager, Office of the Commissioner, Department of Revenue (DOR), first highlighted the main provisions of CSSB 21(FIN) am(efd fld) as compared to those previously considered by the committee under

the companion bill, HB 72 [slide 2]. He said the other body added a provision adjusting the interest rate for delinquent tax payments and refunds of tax overpayments, decreasing the rate to 3 percent above the annual rate charged by the 12th Federal Reserve District. Another provision was added establishing a corporate income tax credit for qualified oil and gas service industry expenditures. The production tax rate was adjusted in the other body to a 35 percent flat tax rate and the repeal of progressivity was retained. Tax credits were adjusted to eliminate the current 20 percent capital expenditure tax credit for the North Slope after December 31, 2013, and the loss carry forward credit was increased to 35 percent for the North Slope after December 31, 2013. A \$5 per barrel tax credit was added by the other body as a balance mechanism to the 35 percent flat tax. The gross revenue exclusion (GRE) was refined and expanded, establishing the same 20 percent exclusion from the gross value at the point of production for oil and gas produced from: 1) new units; 2) new participating areas in existing units; and 3) metered wells subject to demonstration by the producer of certain conditions to the Department of Natural Resources (DNR) and Department of Revenue (DOR). The other body added a provision establishing an Oil and Gas Competitiveness Review Board. As in the original bill, the committee substitute (CS) holds harmless the provisions south of 68 degrees [North latitude], which is the dividing line between the North Slope basin and the areas referred to as Middle Earth and Cook Inlet.

[1:10:45 PM](#)

MR. PAWLOWSKI next provided details of the main provisions in the bill, starting with the interest rate for delinquent taxes [slide 3] in Section 4, page 2, lines 16-27, of the bill. This issue relates to the tension between the time DOR has to conduct audits and the interest rate that is charged by the state for delinquent taxes, as well as charged to the state when a producer overpays its taxes. Under existing language, the interest rate is 5 percentage points above the interest rate charged to member banks by the 12th Federal Reserve District or an annual rate of 11 percent, whichever is greatest. It is known that interest rates change over time as the Federal Reserve policies are set as the markets move. The interest rate of 11 percent or the federal rate was reasonable at the time it was established, but since then the divergence between the actual rate of interest and the 11 percent has widened. The interest rate set by the other body is more similar to what goes on in the federal Internal Revenue Service (IRS) provisions, which is 3 percent above the greater amount of the Federal

Reserve district. The provision eliminates that tension between a fixed rate and a rate that floats with the actual market rate of interest because there could be a situation where under the lesser of, interest rates would rise above that 11 percent rate and the mechanism would have the same problem it has currently, which is that the actual rates of the market are lower and the 11 percent rate is higher. The provision applies in both directions - when someone overpays the state so the state must provide a refund or when someone underpays the state so must pay the state the underpayment.

[1:13:11 PM](#)

MR. PAWLOWSKI, responding to Co-Chair Feige, said the original statute was established in 1991.

[1:13:30 PM](#)

MR. PAWLOWSKI, responding to Representative Tuck, confirmed that under CSSB 21(FIN) am(efd fld) the applied interest rate would be the same whether it is the state owing a taxpayer or the taxpayer owing the state. In further response, Mr. Pawlowski confirmed this is also the case under current law.

REPRESENTATIVE TUCK inquired whether lowering the interest rate would incentivize taxpayers to be loose in calculating their taxes, given the state has not audited the industry.

MR. PAWLOWSKI replied he would not describe it as loose, in that it goes both ways and the rules often change. For example, transportation regulations were recently changed by the Federal Energy Regulatory Commission (FERC) that led to amendments to tax returns. The federal government can make changes to tariffs that have changes on taxes that were paid over time. The tax rate under Alaska's complex net system varies monthly and an outside action by a federal agency could have an impact on tax payments going back years. Therefore, both the state and the industry are at risk in that type of thing.

[1:15:05 PM](#)

BRUCE TANGEMAN, Deputy Commissioner, Office of the Commissioner, Department of Revenue (DOR), addressing Representative Tuck's statement about audits, stressed there are many misconceptions regarding audits. He explained DOR is currently auditing 2007, in which half the year was under the production profits tax (PPT) and the other half was under Alaska's Clear and Equitable

Share (ACES). The department is well within the statutory guidelines of six years; once through 2007 the department will accelerate through the ACES years because it will be able to combine years for certain companies. The general misconception being heard is that since DOR is auditing 2007, it has no clue what happened during 2008-2012, which is not true. Corporations pay taxes on a monthly basis under ACES, so DOR receives revenue on a monthly basis and receives a vast amount of information on a monthly basis. Every March 31, called the thirteenth month, a true-up is conducted of the previous 12 months of information that DOR has already received. It is in the taxpayer's best interest to be as accurate as possible and it is in DOR's best interest to review those monthly payments to make sure they are as accurate as possible. On that thirteenth month true-up, DOR does an analysis and then it goes into the queue for the audit.

[1:17:10 PM](#)

CO-CHAIR FEIGE asked whether DOR has noticed over the years a systematic underpayment of taxes.

MR. TANGEMAN replied they seem to be fairly accurate and go both ways with some overpayments and some underpayments, which is why it is a two-way street for the interest rate provision.

MR. PAWLOWSKI interjected that the information can be seen by legislators who are willing to sign a confidentiality agreement. The audits are taxpayer-specific information along the same lines as an individual's IRS personal tax information.

[1:18:22 PM](#)

REPRESENTATIVE TUCK said his concern is not so much the information as it is ensuring that the taxes are done correctly. He inquired how often there are overpayments to the state versus underpayments and is DOR able to do that month by month.

MR. TANGEMAN responded the monthly payments are an estimated payment using the taxpayer's estimated capital and operating expenditures; so there will be pluses and minuses each month, but they will not be large swings. It is the thirteenth month in March that true up those twelve months and brings in the side boards that much tighter, and then it gets in the queue for the audit.

MR. PAWLOWSKI added that in 2010, Senate Bill 309 made an adjustment that these interest rates could be waived due to a

retroactive change in regulation. He encouraged members to be very cautious about grabbing specific instances of overpayment or underpayment because over time the rules have been changed both prospectively and retroactively. When the department retroactively changes a regulation or a federal decision is made or the law is changed retroactively, it can result in overpayment or underpayment. This interest rate is very important in the relationship that happens when the rules change on taxes that were already filed.

MR. TANGEMAN concurred there has been a number of changes starting with PPT, then ACES, and through today. When a change to regulations or statute is made and is retroactive and affects a previous tax filing, both the taxpayer and DOR have the right to re-open that if a change needs to be made. For example, for 2007 DOR received re-openers through 2010. The entire return is not re-opened; the taxpayer is able to re-open the specific part of that return that was affected and the clock starts ticking again on that six-year window.

[1:21:04 PM](#)

CO-CHAIR SADDLER asked what the interest rate is on delinquent tax payments in other jurisdictions.

MR. PAWLOWSKI answered the interest rate in CSSB 21(FIN) am(efd fld) of 3 percent above the 12th Federal Reserve District rate was modeled after a portion of the IRS rates. He offered to research the rates of other jurisdictions.

CO-CHAIR SADDLER inquired whether that is what is normally called the discount rate or overnight rate.

MR. PAWLOWSKI replied that is beyond his level of understanding, but said this was an amendment entered by the other body.

MR. TANGEMAN offered to provide the committee with the specific IRS language that will put it into context.

[1:22:04 PM](#)

REPRESENTATIVE TARR said it sounds like Mr. Tangeman is suggesting these audits can be accomplished in a timely fashion and that DOR is looking at this information regularly. However, she continued, members still do not have that 2007 information, so somewhere in that system it is perhaps not as easily accomplished as is being suggested. She offered her belief that

the concern is not about retroactive adjustments due to changes, but rather that members want to look at the overall picture of whether the credits under ACES are actually working to incentivize investments that will lead to new production. Without that audit information, members do not have the full picture of what is happening. Members want to know if there is truth in reporting, which is why that audit information is needed. She requested Mr. Tangeman to speak to this.

MR. TANGEMAN clarified re-openers are allowed if changes are made to state or federal statutes. It is a misconception that DOR does not know what happened in 2007 because an audit has not been done. He said he strongly disagrees with that because DOR does know what was provided on a monthly basis and then trued up on March 31, 2008. The information DOR has provided and has based decisions on takes into account actual information. The state is in a much stronger position now because tax decisions can be based on looking back at actual information and how the state and industry has reacted under the net tax system of ACES. In 2007 the state was not in that position. Last year DOR presented a five-year look back specifically on the capital credit; there are staff within the tax division that work solely on tax credits. He said he will provide Representative Tarr with a copy of the five-year look back on those tax credits. It is very telling, he continued, because DOR was able to break it down into five categories of where those credits were being utilized in the state.

[1:24:48 PM](#)

MR. PAWLOWSKI resumed his presentation, noting the qualified oil and gas industry service expenditure tax credit [slide 4] is in Section 7, page 3, beginning on line 14 of the bill. He said this provision recognizes that a healthy oil and gas service industry is critical to having a healthy oil industry. Certain work, such as the pads and drilling, can be done only in the field in Alaska. However, work that supports the oil industry does not necessarily have to be done in Alaska. This provision attempts to create an additional incentive for encouraging support work, such as modification and manufacturing, to happen in Alaska. This tax credit is limited to 10 percent of the qualified service industry expenditures or \$10 million, whichever is least. To qualify for this nontransferable credit a company must be a taxpayer and must apply the credit against its corporate income tax liability. The nexus to the oil industry is that it has to be the in-state manufacture or modification of tangible personal property that has a useful

life of three years or more that is used in the exploration, development, or production of oil and gas. This would include modules, additional work on infrastructure, and such things that are actually used in the oil industry. This benefit goes directly to those companies that are actually providing the modified or manufacturing materials to the industry, not to the oil and gas industry itself. Drawing attention to page 3, lines 30-31, he pointed out that these expenditures cannot then be taken as a deduction, or as a credit and a deduction under another provision in this title. An oil producer that has a fabrication shop would therefore be unable to take expenditures that qualify for this credit as a write-off against its production tax.

[1:28:05 PM](#)

CO-CHAIR SADDLER asked for examples of the kind of process, or product, or service most likely to enjoy this credit.

MR. PAWLOWSKI related that examples heard in testimony included the hot oil units being built in Anchorage and modules fabricated on the Kenai Peninsula. Modules could be purchased and shipped to Alaska; or, they could be built in Alaska employing people in the state, which is what this credit is intended to incentivize. He said the limitation on the credit that a person must be a taxpayer to receive the credit could provide some incentive for companies to actually become taxpayers under Alaska's corporate income tax code.

[1:29:00 PM](#)

REPRESENTATIVE TUCK asked whether the producer having a module built would be able to write off what it pays to build or modify that module, or would the tax credit go to the company that has the contract to do the module.

MR. PAWLOWSKI answered the company that is actually doing the manufacture or modification is the one that files for the tax credit.

REPRESENTATIVE TUCK posed a scenario in which a module-building company in Louisiana puts in a lower bid than a module-building company in Alaska. He inquired what the incentive is for the producer to pick the Alaska company since the producer would not get a tax credit from picking the Alaskan manufacturer.

MR. PAWLOWSKI replied the company doing the contract does not get the benefit. The company actually doing the work gets the tax benefit, which allows that company to compete better on that contract and that bid because it can put this tax credit into its analysis of what it is doing as a company to compete better. Representative Tuck's concern is shared by the other body and the administration. A module, or work like that, is not necessarily something that has to be done in Alaska, but providing an incentive for that activity to happen in Alaska and to make Alaska's businesses more competitive was seen as a reasonable provision to support the overall effort.

[1:30:49 PM](#)

REPRESENTATIVE TARR observed the fiscal note states that there is "no data with which to quantify the revenue impact of this provision, although it is possible that the impact may be as high as a negative \$25 million per year" and "the revenue impact of this provision is indeterminate". She asked what information the committee should go on to determine the kind of exposure this particular provision would give the state, particularly given that it cannot go below zero which would be further committing, which, technically, the state cannot do.

MR. PAWLOWSKI responded that in developing the fiscal note the department looks at the total number of taxpayers that may be eligible for this type of credit, and the level of their income tax returns, in estimating the impact. He said it is correct that the corporate income tax credit cannot be used to reduce a corporate income taxpayer's liability below zero.

[1:31:58 PM](#)

REPRESENTATIVE TARR surmised that adding at least \$25 million per year would be the best thing to do for knowing the potential fiscal impact of this provision.

MR. PAWLOWSKI answered the table on page 4 of the fiscal note integrates all of the assumptions that go into the total revenue impact. The \$25 million per year upper estimate has already been added on line 9 of the fiscal note; that is added into the revenue impact and subsequently the bottom line fiscal impact of the legislation. So, it has already been included.

[1:32:47 PM](#)

CO-CHAIR FEIGE understood "they would be able to claim the credit if they received the work order from the company."

MR. PAWLOWSKI replied correct. "If the company made the expenditures, the credit would be based on those expenditures," he said. For example, say an Alaskan company buys a truck from out of state and then that company puts \$200,000 into upgrading that truck for use in arctic conditions on the North Slope. The credit would be based on the \$200,000 of modifications to the machinery, not the overall value of the machinery. It is limited to the modification expenditures, not the actual work order.

[1:33:35 PM](#)

CO-CHAIR FEIGE concluded that each time there is a benefit, or there is a credit, it does not necessarily mean that someone took business away from a Lower 48 provider; rather, it gives Alaskan welders, fabrication shops, and machinists at least a 10 percent leg up. A certain amount of new business could then be expected to go to Alaska companies that otherwise would have gone Outside and this could represent a significant amount of money going into the Alaska economy.

MR. PAWLOWSKI concurred, adding it is important to note that to qualify for this credit the company must be paying taxes to the State of Alaska under the corporate income tax. Another important nexus is that this is tangible personal property with a useful life of three years or more use in the exploration, development, or production of oil and gas. That type of property is subject to the state's oil and gas property tax, so it feeds into the overall equation that benefits the state throughout. He further agreed it is about more spending for actual additional work in the state, which is the intent of this provision as it was added in the other body to accomplish.

[1:35:09 PM](#)

CO-CHAIR FEIGE commented that that could represent a significant number of jobs and a significant amount of additional money going into the Fairbanks and Anchorage economies which would then flow through the rest of the state's economy.

CO-CHAIR SADDLER posited there are benefits to this kind of thing that are outside the scope of the actual fiscal note and not just the general fund. It also helps the industry and there are benefits to having the presence of a healthy, capable

support industry, which tends to lower the cost of development in Alaska and which speaks to the overall goal to reverse the decline of production.

MR. PAWLOWSKI concurred there are ancillary benefits that are impossible to model in the fiscal note. The ability to hold down costs in the industry itself is critical to the state which operates on a net tax system. The more efficient, the more profitable the companies are, the more profitable the state's share is.

[1:36:30 PM](#)

REPRESENTATIVE TUCK surmised this might be a way to get people who do not have a corporate liability to change their status to corporate to take advantage of this tax credit.

MR. PAWLOWSKI agreed, saying companies that file as limited liability companies are not corporate income tax payers. To qualify for this credit, a company would have to reorganize under a structure that is subject to the corporate income tax.

REPRESENTATIVE TUCK inquired as to the percentage of service companies that are currently limited liability versus corporate.

MR. PAWLOWSKI replied he could not venture a guess.

REPRESENTATIVE TUCK said it would be nice to know how many companies this might affect.

[1:38:08 PM](#)

REPRESENTATIVE TARR returned to the fiscal note and maintained that the \$25 million mentioned in the note is not reflected in the math. Additionally, she observed, if this is intended to be a revenue generator, there is also no actual revenue-positive portion included in the fiscal note.

MR. PAWLOWSKI answered if he implied there was an attempt to model a revenue positive, there is not. It is a negative \$25 million estimate. Drawing attention to page 4 of the fiscal note, he reviewed the amounts in each line under the column for fiscal year 2014, saying lines 9 and 10 are each a negative \$25 million.

REPRESENTATIVE TARR responded she double checked the math and the aforementioned is in the language but not the math for total revenue impact.

MR. PAWLOWSKI said he will check the fiscal note and get back to the committee afterwards.

[1:40:28 PM](#)

MR. PAWLOWSKI resumed his presentation, moving to the tax rate provision [slide 5] in Section 9, beginning on page 4, line 29. Referring specifically to page 5, line 5, he said the flat tax rate of 25 percent was changed by the other body to 35 percent. Repeal of the "sum of" language, he continued, is similar to that in the original bill and reflects repeal of the progressivity function. The provision applies to oil and gas produced after December 31, 2013.

MR. PAWLOWSKI next reviewed changes to Section 2, page 2, lines 3-10, regarding the community revenue sharing fund [slide 6]. As originally introduced, the legislative discretion for appropriations was linked to receipts from the corporate income tax. The other body removed this reference since the corporate income tax is functionally general fund revenue. The linkage was made to the general fund, not to specific fund source. The legislature's discretion to appropriate, the actual mechanism of the appropriation, and the funding are not changed. Guidelines for the appropriation, page 2, lines 8-10, are retained at either \$60 million or up to \$180 million a year. There is no change to the eligibility determinations for communities or the actual program itself.

[1:42:28 PM](#)

REPRESENTATIVE TARR asked Mr. Pawlowski to provide a comparison of the thinking from the original bill that made it more specific as to the fund source. She related she has heard concern from folks about the changes and said there is a feeling that the original version left a little more stability as to there being funding for the revenue sharing program.

MR. PAWLOWSKI replied the original bill linked it to the corporate income tax. He understood it was a principle issue in the Senate regarding interpretation of the constitution and the dedication of funds. It is different in that the administration had initially identified a direct stream of revenue that the legislature then appropriates on an annual basis. A subsequent

argument was that it could be more stable by applying it to the general fund more broadly and maintaining the appropriation guidelines. He acknowledged there is some concern around it.

[1:43:54 PM](#)

CO-CHAIR FEIGE understood that when the legislature came up with progressivity it tied the revenue sharing funds to that statute. He inquired where the revenue sharing funds came from prior to their being tied to progressivity.

MR. PAWLOWSKI responded it came from the general fund.

[1:44:29 PM](#)

REPRESENTATIVE P. WILSON offered her concern that municipalities are facing the same problem of decreasing income as the state. She said she would therefore like to return to this particular provision at a later time.

[1:45:08 PM](#)

MR. PAWLOWSKI continued his presentation, addressing changes to the qualified capital expenditure tax credit [slide 7]. He said the substantive change in Section 15, page 13, lines 1-3, is no different than what the committee had seen before in the treatment of the qualified capital expenditure credit. The capital expenditure credits for activity on the North Slope are not available after January 1, 2014; therefore, expenditures have to be made before January 1, 2014, to qualify for this credit for the North Slope. A change made by the original bill was that until this bill is passed, capital credits on the North Slope and credits on the North Slope must be divided over two years. The decision was to close out this program and allow the tax certificates to be taken in a single year. An impact of those credits is seen in the fiscal note for fiscal year 2014, which is about \$400 million to close out the state's obligation for the credits that are based on the expenditures in 2013.

MR. PAWLOWSKI, in response to Representative P. Wilson, said [Section 15] begins on page 12, line 14, but the actual meaningful language is on page 13, lines 1-3. He further responded this can be seen in the fiscal note on page 4, line 6. He clarified he is flagging for members the fiscal obligation that comes from the qualified capital expenditure credits being taken in one year, as opposed to spread across two, because

closing out this program frontloads the fiscal impact in fiscal year 2014.

[1:48:02 PM](#)

REPRESENTATIVE TARR asked why not let the capital expenditure credit run out over the two years to reduce the fiscal impact [in 2014], given the fiscal impact of the bill.

MR. PAWLOWSKI answered the fiscal impact is an obligation with the state's credits that is based on industry expenditures. The administration's concern was pushing that fiscal impact off into the future when it is just a real fiscal impact. It is a choice of deferring the state's obligation to fiscal year 2015 or taking care of it in the near term, so ultimately it is a policy call.

REPRESENTATIVE TARR presumed the program could be closed out and administered over two years as it has currently been working so that the fiscal impact could be divided in two.

MR. PAWLOWSKI replied the other intent in allowing recovery of the credit in a single year was recognizing that ending the qualified capital expenditure credit program has an impact on some businesses that are making decisions. Providing an additional boost as an exchange for ending that program would allow the state to get an obligation off the books and also provide a benefit to the companies that are currently in development.

[1:50:07 PM](#)

REPRESENTATIVE ISAACSON inquired whether there is any discussion with the industry to know if this would exclude any projects that are currently being planned.

MR. PAWLOWSKI responded removal of this credit for sure has an impact on companies. The qualified capital expenditure credit is a piece of the system the companies look at in evaluating work that can happen in Alaska. The context it needs to be put in, however, is that the system is being made more competitive overall compared to the current system. So there may be some impact, but there is also an improvement in the overall economic climate that goes along with the rest of the tax changes. To some degree, loss of the qualified capital expenditure credit is actually offset by the per barrel credit.

1:51:27 PM

REPRESENTATIVE TUCK understood the qualified capital expenditure credit is for all companies on the North Slope, whether new or existing. By making it for expenditures before January 1, 2014, and the \$5 per barrel [credit], it seems that these new provisions will not apply to "those guys" for possibly many, many years. He asked whether this is an intentional shifting from the new players to the old players, given it takes about 10 years to go from exploration to production.

MR. PAWLOWSKI requested he be able to address this question when he discusses the carried forward tax credit.

1:53:00 PM

REPRESENTATIVE TARR noted the qualified capital expenditure credit has been characterized as allowing gold plating. Given the date certain of the bill as written, she inquired whether there are any concerns that people will try to hurry and take advantage of that. She further inquired how that would dovetail into the January 2014 implementation of these provisions that would include the \$5 per barrel and, thus, a "double-whammy potential" for that to happen.

MR. PAWLOWSKI answered the issue of gold plating should not be tied to the qualified capital expenditure credit. Rather, gold plating is an effect of the marginal tax rate in conjunction with the capital credits that provide state participation and spending that can reach significant levels; that is actually a function of the ability to buy down a company's tax rate that can lead to some interesting distortions in behavior. When talking about gold plating the focus should not be on a particular credit, but rather taking a step back and looking at the system as it currently exists as a whole. A dilemma of walking through sectionals is the way these interact together. The ability of companies to frontload expenditures and ramp up activity to take advantage of credits and deductions before they shift off into the future is part of the reason why the effective date of January 1, 2014, was chosen rather than a later effective date. Because the season is really over the winter, it would be relatively difficult to frontload into 2013, which is a reason why the administration decided not to put a later effective date. The department has a good handle on the rules and regulations about frontloading and prepaying, and the administration believes the January 1, 2014, effective date

diminishes that possibility, although that is not say it cannot happen under any circumstance.

1:55:45 PM

MR. PAWLOWSKI turned back to his presentation, saying the issue mentioned by Representative Tuck is dealt with in Section 16, page 13, line 4, regarding the carried-forward tax credit [slide 8]. Companies that do not have production do not have revenues against which to write off expenditures, nor do they have the ability to use that \$5 per barrel credit. In the bill as originally introduced by the administration, a company had to carry forward the loss carry forward credit until production and that was given a time value of money increase of 15 percent. However, in CSSB 21(FIN) am(efd fld), page 13, lines 6-10, the loss carry forward credit was increased to 35 percent to match the base rate of the tax and allowed to be monetized, so no longer does this credit need to be carried forward and applied against production. A new entrant that does not have a liability would be able to generate 35 percent credit based on its lease expenditures and its loss and that would provide the incentive that Representative Tuck was earlier asking about for a new entrant that does not have a liability and is looking for some of that state support up front.

1:57:58 PM

MR. PAWLOWSKI, continuing his response to Representative Tuck's earlier question, stated the bill, as originally introduced, required that a company without a production tax liability - without production - had to wait to get this credit by carrying forward the credit until the company had production. In the original bill, the value of that credit increased at a rate of 15 percent a year. The other body heard testimony similar to that heard by this committee, and the discussion resolved around the state foregoing tax revenue in the future versus participating for this group of companies. The other body decided to simplify the system and allow the companies to come to the state for the cash payment or transfer of this credit. Under ACES, a company gets a 20 percent capital credit plus the 25 percent loss credit. Under CSSB 21(FIN) am(efd fld), those companies would get a 35 percent loss credit that can be turned into the state for a monetary payment. In further response to Representative Tuck, Mr. Pawlowski confirmed this would be on an annual basis.

1:59:36 PM

MR. PAWLOWSKI, responding to Representative P. Wilson, confirmed this provision will enable a small company that does not have a big cash flow to get some funds so it can continue its work.

[1:59:59 PM](#)

MR. PAWLOWSKI resumed his presentation, addressing the newly created \$5 per oil barrel tax credit [slide 9] contained in Section 22, page 16, lines 4-9. He said this credit applies to each barrel of oil that is subject to tax under the production tax. This credit is applicable to the producer's tax liability for the year the oil was produced, is not transferable, and any unused portion may not be carried forward for use in a later calendar year. Further, this credit may not be applied to reduce the producer's tax liability below zero. The other body added this provision to balance the high, high base rate of 35 percent. The provision essentially creates a progressive system without using the progressivity mechanism that exists in current statute. Under the current system, credits are provided for upfront capital expenditures. This provision would provide a credit for directly targeted production - if a barrel is not produced, there is no \$5 per barrel. For example, to earn \$100 million in credits under the current system, the producer would spend \$500 million in capital (20 percent of \$500 million would be \$100 million). Under CSSB 21(FIN) am(efd fld), the same \$100 million credit would be earned by adding 20 million barrels of production (20 million barrels at \$5 a barrel is \$100 million). The other body shifted away from incentives that are directly tied to the expenditure of funds to incentives that are directly tied to the production of oil.

[2:02:09 PM](#)

REPRESENTATIVE TARR drew attention to page 4 of the fiscal note, line 8, regarding the \$5 per taxable barrel allowance. Noting the provision's impact of negative \$425 million in fiscal year 2014 that doubles to an impact of negative \$825 in fiscal year 2015, she asked which DOR forecast the figures are based on.

MR. PAWLOWSKI replied it is based on DOR's fall [2012] forecast. The impact is less in fiscal year 2014 because the law is effective January 1, 2014, and therefore only encompasses half that fiscal year; 2015 is the first fiscal year in which the bill is in effect for the entire year.

[2:03:18 PM](#)

MR. PAWLOWSKI returned to his presentation, explaining that the gross revenue exclusion (GRE) for North Slope oil and gas [slides 10-11] is an additional incentive directly tied to production. The GRE, Section 29, page 21, beginning on line 17, provides an additional benefit for new production that is based on 20 percent of the gross value of new oil or gas that meets one of three criteria. As in the original bill, one criterion is that the oil or gas is produced from a lease or property that does not contain a lease that was within a unit as of January 1, 2003. This is for the new areas in new units, recognizing that two of the units that qualify are ones that were brought on during a period of multiple changes in the tax system. The second criterion is oil or gas produced from a participating area established after December 31, 2011, that was within a unit formed [under AS 38.05.180(p)] before January 1, 2003. So these would be new pockets of oil within the existing units. The third criterion is that the oil or gas is produced from a well that has been accurately metered and measured by the operator to the satisfaction of the commissioner of the Department of Revenue (DOR), the producer demonstrates to DOR that the well is producing from a reservoir that the Department of Natural Resources (DNR) has certified was not contributing to production before January 1, 2013, and the producer demonstrates to DOR the volume of oil [or gas] produced from that well. This was an attempt by the other body to bring the GRE into the legacy units in a way that targeted some of the harder to reach oil that is not contributing to production in the currently producing forecast of oil, so new production within the existing units. In the other body it was easy to agree on the application of the gross revenue exclusion to new units in new areas, but there was a lot of work on how to get the GRE into the legacy fields to apply to some of the harder to reach oil, which is where most of the oil is in the near term.

2:06:30 PM

CO-CHAIR FEIGE, for purposes of investment and making a decision whether to drill in a particular area, inquired at what point in this timeline DNR would approve that particular production. He further inquired whether DNR would wait for the company to actually produce from that new reservoir or would approve it ahead of time before the investment decision is actually made.

MR. PAWLOWSKI offered his belief that the intent is to push it to something that can be done before the investment decision is made.

CO-CHAIR FEIGE surmised DNR will address this in its comments.

[2:07:11 PM](#)

REPRESENTATIVE TARR noted discussion occurred in the other body that the third criterion is too broad and would apply to areas that are already planned for production. Regarding the January 2013 date, she suggested the date could be shifted to make it more clearly only apply to new oil so as not to incentivize development that was already going to happen.

MR. PAWLOWSKI responded [the administration's] perspective on the idea that already-planned development, and the distinction that it is not new oil, is very difficult and problematic and deserves more thorough conversation. For example, Liberty was planned to happen for years in the production forecast. Counting that as new oil because it is in the revenue forecast is a best guess of what might happen in the future, and saying somehow that that is not new oil is perhaps a step too far. The point in this language is that DNR is the one that defines what is not contributing to production. The contributing to production date of 2013 is because it comes into effect in 2014. So, if that pool of oil, or that trapped pocket of oil in the reservoir, was not contributing to production this year, then that is new production. Because DOR must take a very conservative look at what the fiscal impact of that might be, there was much discussion regarding the range put on the potential fiscal impact of this provision. The actual impact of the provision will depend on what the companies can prove to DNR. The issue DOR had in developing the fiscal note was providing the broadest possible spectrum for policymakers to make a decision, and that is why a broad range is seen in the fiscal note. Many projects have been in the revenue forecast over the years and then disappeared. The concept of what is truly new oil is new oil that is being developed that is not contributing to production today. The wellbores in the revenue forecast are defined as the currently producing.

[2:09:52 PM](#)

REPRESENTATIVE TARR inquired whether the committee could get more information if that date was pushed out one year to when the new policy is actually implemented and then the fiscal impact looked at.

MR. PAWLOWSKI offered to provide a letter that DOR prepared and sent to the other body that had a description of where this fiscal impact range comes from and the actual barrels that are being forecast in the production forecast. He said the letter would help provide an idea of the way the dates can work. He cautioned members about looking at the production forecast as a given because it has been seen over the years how much it is actually not a given that that new production is going to happen, Liberty being just one example.

[2:10:54 PM](#)

CO-CHAIR FEIGE asked whether it is the Alaska Oil and Gas Conservation Commission (AOGCC) or the Division of Oil & Gas that actually certifies that it is a producing well.

MR. PAWLOWSKI deferred to Deputy Commissioner Balash for an answer.

[2:11:27 PM](#)

MR. PAWLOWSKI continued his presentation, noting the other body added an Oil and Gas Competitiveness Review Board to statute [slide 12]. This provision is in Section 33, page 22, beginning on line 25, and is modeled after the competitiveness review board created in the province of Alberta, Canada. The other body's intent was to provide a venue for institutionalized knowledge that is de-politicized by having both the public and the private sector sitting together to look at the impact and effects of regulations and fiscal terms on Alaska's place in the world. The proposed new statute, AS 43.98.050 beginning on page 23, line 26, establishes the board's duties and requires the board to provide annual written findings and recommendations to the legislature. The provision recognizes that while fiscal terms are critical to the health of Alaska's oil and gas industry, the good work by DNR, as well as other activity the state can do, matter as well. Page 24, line 3, states the board "identify factors that affect investment in oil and gas exploration, ... including tax structure, ... infrastructure; workforce availability; and regulatory requirements". The board's goal is to recognize that it is a broad spectrum of issues affecting the competitiveness of the state. The board is set to sunset December 31, 2022, and is made up of nine members.

[2:13:38 PM](#)

CO-CHAIR SADDLER, regarding the importance of stability and predictability, inquired whether this review board will be seen as a good or bad message to industry, given it will be looking at what changes need to be made.

MR. PAWLOWSKI answered he understands the concern that industry and many Alaskans have about the variability of the tax system. He said it is important to note that those changes are not always statutory; many over the years have been regulatory. For example, the Murkowski Administration, through a regulatory change, aggregated the economic limit factor (ELF) in the Prudhoe Bay Unit, which led to a substantial tax increase. So, it is important to recognize it is not just statutory changes that can and have led to perceptions of instability. The other body looked at the benefits that an institutionalized, de-politicized board had on the province of Alberta, and saw it as a positive and as a message to Alaskans that it is not just deciding to take a step forward and saying things are done. The world and technology are changing and Alaska needs to be ever vigilant about how to consistently be competitive as well as be more competitive.

CO-CHAIR SADDLER concluded the state actually still has the capacity to do that kind of continual horizon scanning now, and this just formalizes it for 10 years as a feedback loop.

[2:15:56 PM](#)

REPRESENTATIVE TARR understood Alberta is about \$4 billion in debt based on changes to its royalty structure for the oil sands. She asked how such a board has worked in Alberta and why Alaska would want to use that as a model.

MR. PAWLOWSKI confirmed the Oil and Gas Competitiveness Review Board in Alberta led to the change in the province's royalty terms, but said production and investment increased dramatically after the change was passed. While Alberta is in a deficit today, he proposed that Alberta is not necessarily in a deficit because it changed its terms, but because growth in oil supply in the mid-continent and transportation bottlenecks out of Alberta are resulting in the province's oil selling for dramatic discount to the world market.

[2:16:50 PM](#)

CO-CHAIR FEIGE inquired what that price is.

MR. PAWLOWSKI believed it was in the range of \$50-\$60.

CO-CHAIR FEIGE related that a parliamentary representative from Alberta visited his office and was complaining about the province getting \$55 a barrel for its oil. He opined that an "Excel pipeline" could move that oil and provide a better price to Alberta.

[2:17:10 PM](#)

MR. PAWLOWSKI, speaking to the competitiveness review board, reported Alberta's premier recently stated that despite the short-term deficit Alberta is currently in, it is not the intent of the province to change its taxes on the oil industry to overcome that short-term deficit. Alberta is taking a long-term look at the investment that is coming into the province, which is huge.

[2:17:48 PM](#)

REPRESENTATIVE P. WILSON recalled that after Alaska made its changes, Alberta's board also made changes. However, because of the board, Alberta realized it before Alaska and changed things right away. So, she surmised, having the board helped the province be on the ball much better than what Alaska is doing.

MR. PAWLOWSKI said the aforementioned interpretation of what happened in Alberta is fair, based on his work talking to the province. He encouraged members to look at the benchmarking slides provided to the committee by Econ One in an earlier presentation for western Canada. There was a marked decline in the rate of investments in Alberta and an increase in Saskatchewan because Alberta made its changes, investment moved to Saskatchewan and British Columbia because of the proximity. In the other body, the legislature's consultant stated the ability to quickly move things away from Alaska is much more difficult than in the Lower 48 or Alberta. So, the delay in reaction in Alaska has not been as severe as it was in Alberta, but Alaska has had a similar decline, which is seen in the benchmarking slides of Alaska's failure to keep up with the rate of growth in investment that is going on around the world right now.

[2:19:41 PM](#)

REPRESENTATIVE TARR inquired whether Mr. Pawlowski believes the language under the duties of the competitiveness review board is

broad enough that the board would be looking at transportation issues. She surmised the name "competitiveness review board" could be interpreted to be broad enough to be looking at all of those factors so as to prevent the oversights that happened in Alberta.

MR. PAWLOWSKI, in response, drew attention to page 24, lines 3-6, and said there could perhaps be additional language in that section of the bill to talk about identifying factors that affect investments. The administration, he added, is interested in a dialogue with the committee about any changes or expansions to the issues in the bill.

[2:20:49 PM](#)

CO-CHAIR FEIGE next turned to the Department of Natural Resources' presentation about the gross revenue exclusion. He noted that CSSB 21(FIN) am(efd fld) made some changes to this provision from what was written in HB 72.

[2:21:32 PM](#)

JOE BALASH, Deputy Commissioner, Office of the Commissioner, Department of Natural Resources (DNR), discussed the three-part test for the gross revenue exclusion [slide 2], stating that a producer can qualify its production for the gross revenue exclusion (GRE) by satisfying one of the three parts, but cannot qualify twice. The first of the three ways to qualify is for production from a unit formed after 2003. The only two currently producing units that fit that definition are the Nikaitchuq and Oooguruk units. The second of the three ways to qualify is for production from a unit formed prior to 2003, provided that production comes from a participating area (PA) that was formed after 2012. Moving to the third of the three ways to qualify, he related that the other body wanted to identify a way for production from legacy units and legacy PAs to qualify. Thus, the third way is for production that is demonstrated to DNR to be from a reservoir not currently contributing to production. He said the GRE targets what everybody wants, which is new production.

[2:23:52 PM](#)

MR. BALASH explained the North Slope has 18 units and within those units are 38 separate participating areas [slide 3]. A given piece of land that is a unit might have multiple reservoirs and multiple formations that are at different depths.

The PAs are used as a way to define the ownership horizontally and vertically. Leases and units are two dimensional and PAs go to the third dimension. Regulations describe the authorities and processes that DNR uses in managing its units to govern these PAs [11 AAC 83.351, PA formation, expansion, contraction; 11 AAC 83.343, Plans of development; 11 AAC 83.371, Allocation of production and costs; 11 AAC 83.303, Protect all parties]. Moving to slide 4, which identifies the PAs in nine of the North Slope units and the year those PAs were formed, he pointed out that Prudhoe Bay has the highest number of PAs and that the Northstar Fido PA is no longer pending as it was approved in 2012.

[2:25:40 PM](#)

MR. BALASH said the North Slope's largest unit, and the mother lode, is the Prudhoe Bay Unit. Using animation on slide 5, he demonstrated "a topside view" of what the underlying PAs look like, first showing the initial production area (IPA), and then the PAs at differing depths: Lisburne; West Beach; Point McIntyre; Niakuk, which was two separate PAs that were combined later; Midnight Sun; Polaris; Aurora; Borealis; Orion; and Raven. Most of the acreage in the Prudhoe Bay Unit is occupied by at least one PA if not multiple PAs, he noted.

[2:27:10 PM](#)

MR. BALASH then demonstrated what the aforementioned look like from the vertical perspective [slide 6], beginning with the IPA, and mother lode, of Sadlerochit [in 1977]. The Lisburne PA came in 1983; West Beach, Point McIntyre, and North Prudhoe Bay came in 1993; the combined Niakuks came in 1994; and Midnight Sun [came in 1998]. He explained these are all occurring sometimes at different depths and other times at the same depth but from separate formations that are distinct and defined differently geologically, and the oil in each has different geochemistry. A number of blocks of land have PAs in all four horizons, a testament to the richness of Alaska's hydrocarbon system. These are all distinct layers of reservoir rock that produce oil, but they are different accumulations, and, generally speaking, are not in communication with one another.

[2:29:05 PM](#)

MR. BALASH said the Division of Oil & Gas evaluates and approves participating areas using the process spelled out in 11 AAC 83.351, PA formation, expansion, contraction [slide 7]. Very

important is that a PA may include only the land capable of producing or contributing to production of hydrocarbons in paying quantities. That means if a well is drilled into a field it is going to drain oil from the reservoir in question, so the participating area that is contributing to production is really important to everybody - the owners of the field, the State of Alaska, as well as the individual lessees inside the field. It is important because that is how both the money and the costs are divided up. Everybody "in the sandbox" has an interest in making sure these PAs reflect reality to ensure everybody's interests are protected. As the given PA moves into production, it can be seen through differences in pressure or flow whether there is acreage within the PA that is not contributing and therefore should not be included. That portion of the PA would then be contracted out and left back into the larger unit. It is here that DNR uses its unitization criteria [11 AAC 83.303] for evaluating whether and when to grant a PA. It goes to the fundamental governance of the department's oil and gas leases, which is to promote conservation, prevent waste, and protect all of the parties.

[2:31:38 PM](#)

MR. BALASH, continuing his discussion of DNR's evaluation and approval of PAs, explained that when preparing to move into production, the operator of the unit submits application [slide 8]. Submittal includes [Exhibits C and D] which lay out the legal descriptions of where and at what depths the PA is. The exhibits also lay out the specific allocation factors; it is not simply a matter of counting up the acres or square footage of rock or pore space, but actually goes to where the oil is in the reservoir and how much of it is on the specific properties in question. [Exhibits E and F] are included if it is a net profit share (NPS) lease; while there are not many of those, it is important to call that out. Moving to slide 9, he added that Exhibits C and D lay out specifically the amount of oil contained in place and on which leases, as well as what tract factor is going to be used in the allocation of cost and production of the share of the barrels that get produced.

[2:33:25 PM](#)

MR. BALASH explained that once development activities commence and a PA is formed, a Plan of Development (POD) [required under 11 AAC 83.343] is submitted to the department [slide 10]. That POD lays out the process and means by which the lease and unit is going to be developed and produced. Those plans come into

the Division of Oil & Gas for review and approval. They lay out where the facilities are going to be, the pipelines, any production islands that need to be made, and also identify any gathering lines that bring production from outlying areas into the production facilities and processing facilities themselves. That POD is submitted annually for review and approval; it is very rare that the division does not approve a POD, especially once a field is in production. The POD is essentially the red button on the desk, so if there is not a POD approved, the operator is not supposed to be producing the oil. That is not good for anyone, including the state, so what usually results is a negotiation of sorts between the lessees, the operator, and the Division of Oil & Gas. Those things are rather technical in nature. It is part of the division's day-to-day business and something [the department] thinks is going to be useful as it moves forward in evaluating how this third bucket of qualification for the GRE is going to actually play out.

[2:35:17 PM](#)

MR. BALASH informed the committee that the third qualifying mechanism for the GRE will likely come into play in the tract allocation factors, given the division goes through this process on an annual basis [slide 11]. The department has a specific regulatory process [11 AAC 83.371] for allocating production. It is part of Exhibit C that is submitted when the PAs are formed and which provides the bases for calculating the tract factors of acreage, original oil in place, the amount recoverable, and the value of the hydrocarbons. Each of the working interest owners receive their revenue and pay their cost based on these tract factors. It is part of the negotiation that goes on among the private parties themselves as well as the state. The state has its own interest in ensuring that those tract factors reflect the state's ownership of the barrels in the field, especially when there are leases with multiple royalty rates. From time to time revisions need to be made to the allocation factors, he continued [slide 12]. As production unfolds, PAs either expand or contract and work is done with the operators over time to make sure that those PAs remain as accurate as possible.

[2:37:29 PM](#)

MR. BALASH provided an example of the aforementioned using the Kuparuk River Unit, noting that slide 13 shows the unit boundary as well as the main PA boundary inside the unit. He explained that the various bubbles depicted inside the field show all of

the wells that have been drilled. [The green bubbles depict] the wells that are producing oil [and the blue bubbles depict] water injection; in some cases it is both, depending upon the maturation of the field. Last year, ConocoPhillips Alaska, Inc., drilled Shark's Tooth in the southwest portion of the Kuparuk River Unit. It was billed as an exploration well, but was in a participating area. Conoco announced a discovery and DNR has had preliminary discussions with the operator about whether the Shark's Tooth discovery is in the PA or is new production [slide 14]. The department understands that the accumulation itself probably lies beyond the original Kuparuk PA boundary, but that some portion of it is clearly inside the PA boundary. So, as the department thinks about this third test on the qualification for the GRE, the operator is going to have the burden of showing to DNR geologically, probably using four dimensional seismic or other technical tools, why it believes this particular accumulation is not contributing to the production from the wells located to the northeast. This is going to be an interesting dialogue that unfolds between the division and industry, he posited, because for acreage to be included in the PA it is presumed to be contributing to production. The operator is therefore going to have to make the argument, as well as demonstrate, that what it is targeting through a given well or plan of development is actually going to result in the production of barrels that are not currently contributing to the production stream from that PA.

[2:40:37 PM](#)

MR. BALASH related the department thinks there are a couple of ways to engage in that dialogue with the companies and will probably look at establishing some regulations to govern that process. Making it a part of the annual Plan of Development reviews is one way to go about it, so DNR would have as part of its approval a very specific element in that approval that identifies the location in the PA that is going to qualify for the GRE. Then, DNR's hands would basically be clean of the issue, at which point it could be turned over to the Department of Revenue to work with the lessees on how they are going to account for those barrels and count them when calculating the value of the GRE in the overall tax calculation.

[2:41:42 PM](#)

CO-CHAIR FEIGE, regarding using the third way to qualify for the GRE, drew attention to slide 14 [Shark's Tooth Well] and asked whether that is something DNR could determine fairly early in

the overall project timeline, even before an investment decision would have to be made.

MR. BALASH replied yes, DNR thinks there are ways to do that. However, in this particular case the discovery well itself was drilled into a participating area, so conversation will start with providing information on why the company thinks this particular accumulation or part of the reservoir is not contributing to production today. Whether that is a conversation that needs to happen prior to the company's planning that goes into the ultimate POD in a given year is something that DNR will be sitting down and working out. Today, with the legislation evolving the way it is, DNR does not have everything mapped out specifically as far as what that process will look like. But what the department does know, is that when talking about a reservoir that is in a participating area already, then industry is going to have to come to DNR and demonstrate on technical terms why it is this well is not contributing to production today.

[2:43:38 PM](#)

CO-CHAIR FEIGE presumed chemical differences in the oil and differing reservoir pressures would be the kind of indicators that DNR would be looking at.

MR. BALASH responded by providing an extreme example but one that highlights how it really works. When BP discovered Badami some 20 years ago and moved into development in the late 1990s, BP had drilled the wells, tested the pressure, and shot the seismic. Thinking it understood what was there BP built the production facilities and a pipeline, but when the unit was actually opened up for production, the production dropped off rapidly, which was not expected. The reason was that this accumulation of oil was actually separated by lots and lots of faults, so there was not communication throughout the reservoir rock as BP had expected and counted on.

[2:45:12 PM](#)

MR. BALASH continued, explaining that, today, four dimensional seismic is used in the legacy fields of Kuparuk and Prudhoe Bay. This uses the element of time to create a fourth dimension in which it can be seen visually where the oil is moving and, importantly, where it is not. If it can be seen that identified oil is not moving into those production wells, then something is keeping that oil from moving in. Today, industry is drilling

more sophisticated, directionally targeted wells that penetrate those particular pockets to allow the production to occur. Sometimes there is a sense that an oil field is like a balloon or bag full of oil - just drill the well and suck out the oil. In reality, especially in some of these more complicated reservoirs, it is more like a Hefty bag full of all kinds of bags, balloons, and Ziploc bags. A lot of them are filled with oil, some are filled with gas, and others are filled with water. When drilling the wells it is a matter of ensuring that all of the fluids are actually being drained, not just some of the isolated ones, by making sure there are penetrations into each of the pockets of the rock that contains the oil. This particular provision added by the Senate is going to require a lot of work between industry and the departments, but it is a provision that is going to be pretty powerful in ensuring that more of the people's oil is produced.

[2:47:42 PM](#)

CO-CHAIR SADDLER inquired how it can be proved that a reservoir in a participating area has not previously [contributed] to production.

MR. BALASH answered one way is with four dimensional seismic, in which multiple three dimensional images are taken of the same area over time. So, over time, it can be seen graphically where the oil, water, and gas are moving in the reservoir, and specific parts of the reservoir that are not moving can be identified. If they are not moving, it could be for any number of reasons, but primarily it is likely due to some fault or break in the rock itself or a penetration geologically with some other strata that is shielding that portion of the reservoir from flowing through the rest of the sandstone into the production wells. He said another way is one he has been told about by reservoir engineers. In this method, massive reservoir models are used to track the pressures and fluid dynamics to tell how much energy is in the reservoir, where it is, and where it is going. Predictions are then compared against the actual results to learn what is going on inside the reservoir itself. Thus, reservoir models and four dimensional seismic can be used to demonstrate to DNR that a given area is not in fact contributing to production.

[2:50:39 PM](#)

CO-CHAIR SADDLER commented it sounds like there is no clear answer of yes or no that there is contribution. He asked

whether there is a probability or reliability factor that must be applied to this.

MR. BALASH replied the risk of undertaking the new activity is on the operator. The risk is on the operator if an area that looks like it is not contributing is drilled and then the operator does not get anything out of it.

[2:51:29 PM](#)

CO-CHAIR SADDLER inquired whether acreage judged not to be contributing goes into a "fallow" category in which there is no point any more to drill in that area.

MR. BALASH responded he was told by a "guy with a lot of white hair once that 'technology changes, markets change, but rocks don't change.'" There are portions of the fields that 30 years ago will be described as "fallow", but that today are worth going after. The key is in the active management of the unit and PAs, and that those parts contributing to production be recorded as such in the PAs in these tract factors. If, over time, it is found that it is not contributing, DNR contracts that out of the PA and leaves it to the operator to possibly find an opportunity in the future. Returning to slide 6, he pointed out that the Kuparuk horizon has a lot of unaffiliated acreage. While he cannot say how much of that might contain hydrocarbons, to the extent that there are hydrocarbons present, whether they are economic is going to be the question. Something that is not a PA today is not being produced, but technology improvements or market condition changes may make some of those additional hydrocarbons commercial and worth pursuing. That is the kind of opportunity that is trying to be unlocked here. In further response to Co-Chair Saddler, he confirmed that the GRE is supposed to encourage and incentivize that.

[2:54:06 PM](#)

REPRESENTATIVE P. WILSON requested further elaboration on the evaluation and approval of participating areas [slides 7-8].

MR. BALASH answered DNR follows an order in the management of leases and the production of oil; the order starts with the lease and then exploration is undertaken. For oil accumulation that is thought to cover multiple leases the companies come [to DNR] and get a unit. Once they have that unit the operator provides DNR with a Plan of Development (POD) that tells what,

where, and when something will be built, what will be drilled and where, and where the production, then, is going to come from. The PA is really an expectation as the operator moves into development and it is to include the depth of the unit itself, and the acreage, that the oil is thought to be and where the drilling will occur to produce it. For example, if the depth is between 6,500 and 6,300 feet under the [surface] outline of an area - that would be the participating area (PA) inside the unit and that is what DNR records in the unit files. The operator then executes the Plan of Development, moves into production, and begins to count the money.

[2:56:12 PM](#)

REPRESENTATIVE P. WILSON understood there would be a PA for the precise [aforementioned] area within the unit and surmised there would have to be another PA if, within that unit, there is oil at a different [depth].

MR. BALASH, using slide 6, confirmed and illustrated that there can be separate PAs at different depths because they are, in fact, different accumulations of oil.

[2:57:06 PM](#)

REPRESENTATIVE P. WILSON returned to slide 7, saying she does not understand the three criteria [listed under 11 AAC 83.303]: promote conservation, prevent waste, and protect all parties.

MR. BALASH replied DNR exercises its authority to form a unit and manage the development of the resource for these three [aforementioned] reasons; they are the criteria on which DNR bases its decisions. In Texas 150 years ago, people used to drill wells everywhere they could, causing energy in the reservoir to be wasted because there would be less ultimate recovery of the hydrocarbon. While the Alaska Oil and Gas Conservation Commission (AOGCC) is ultimately responsible for conservation of the resource, there is a role of DNR's management that is incorporated when the department evaluates units and participating areas.

[2:58:24 PM](#)

REPRESENTATIVE P. WILSON surmised, then, that Alaska does not want to waste its resource, and if too many wells are drilled there would not be enough pressure to get all of the oil out.

MR. BALASH responded yes, that is a part of it.

REPRESENTATIVE P. WILSON inquired how the state controls that.

MR. BALASH answered it is not so much the state telling how many wells can or cannot be drilled, but the state ensuring there is a clear plan for the development of the reservoir itself so it is developed in a prudent way. The ultimate approval for wells is granted by AOGCC, but as the owner of the resource [the state] wants to ensure there are not "food fights" over who gets to drill the wells and who gets to be in charge of the field. It gets to be a very important point when there are multiple lessees in the same unit, such as in Prudhoe Bay and Kuparuk.

REPRESENTATIVE P. WILSON understood the state also wants to keep the land as environmentally good as it can, so does not want to needlessly drill different places.

MR. BALASH replied correct.

[3:00:14 PM](#)

REPRESENTATIVE TARR inquired whether it would be better to determine what would count as new production through regulation or through more direct language in the bill.

MR. BALASH responded DNR thinks the language in the bill today is workable, but the department is unsure whether it will be so prescriptive as to set out a regulation that guides its approval process. The department wants to be able to provide the lessees with some clarity as to how DNR will go about certifying that a portion of the reservoir is not contributing to production, but the department has not landed on that exactly. In the end, it will probably be a combination of both - there is probably going to be an avenue through the POD process and probably an avenue through something more rigid that is laid out in regulation. The statute provides DNR with the authority and ultimately that is going to be something DNR can spell out one way or the other. The key words in the statute are "contributing to production".

[3:02:03 PM](#)

REPRESENTATIVE TARR posed a scenario where the reason for previously not developing something was cost related and asked whether that reason could be considered appropriate for something to qualify as new production.

MR. BALASH answered it will probably be more of a technical question than a cost question. The cost question will come up in the decision of whether to undertake the activity necessary to get at those hydrocarbons. For example, would it be worth the money to drill a separate well in the portion of a reservoir with an accumulation of, say, 100,000 barrels? That will be a cost equation weighed by the operator, while DNR will consider just the technical question of whether it is contributing and, if it is not, then it is eligible for the GRE.

3:03:17 PM

REPRESENTATIVE TARR observed that on slide 4 the Nikaitchuq PA is shown as coming in 2011, but the exhibits on slide 9 are dated as received in 2010. She inquired whether it takes about a year from the time the paperwork for a PA is submitted until the PA is actually approved. She further inquired whether there are any PAs under consideration right now that are not shown on slide 4.

MR. BALASH replied all of DNR's processes take some time. The department goes through a thorough evaluation of the material that comes in because it is important. As far as whether it is typical to take a year, it probably has more to do with the POD cycle and how DNR goes about approving first the unit, then the PODs, and then the timing of the PA coming in is pretty close to when [the operator] is going to actual development drilling and production. So, sometimes there is a lag between approval of the POD, the actual construction, and then the PA itself. He deferred to a representative of the Division of Oil & Gas to address whether there are any pending PAs.

3:04:57 PM

TEMPLE DAVIDSON, Unit Manager, Central Office, Division of Oil & Gas, Department of Natural Resources (DNR), stated there are currently two PA expansion applications pending on the North Slope, a PA formation application that just recently came in, and a couple [of PA applications] that the division thinks it may see later in the year.

3:05:30 PM

MR. BALASH, responding to Representative Tuck, confirmed that a PA is determined by DNR.

REPRESENTATIVE TUCK surmised there would be coordination between DNR and the Department of Revenue (DOR) in determining whether a field or a PA qualifies for the GRE.

MR. BALASH responded not much coordination is needed for a unit or a PA. The paperwork that DNR does in its normal course of business will be used by the lessee to prepare the lessee's taxes; therefore, that part will be relatively siloed. However, it is this third category where the coordination between the departments is going to have to step up a little bit, and an example of that kind of coordination can be seen in the changes to the production forecast that DOR puts together. He said DNR's Division of Oil & Gas was much more involved over the past year in helping DOR put those numbers together and risk weight the future new production in a way that made sense.

[3:06:59 PM](#)

REPRESENTATIVE TUCK asked whether any other departments would be involved for the third item to qualify for the GRE. He further asked whether this would be a negotiations process with the industry, given it may be hard to define exactly the PAs.

MR. BALASH replied he would not call it a negotiation so much as a verification exercise. "They come in, they make application, they demonstrate to us, they show us why it is they think particular acreage should be included in the PA, and they generally provide the kind of information our staff needs to make those approvals. If they don't have the information, we ask for more ...." A dialogue definitely takes place, but he would not go so far as to call it a negotiation.

[3:08:11 PM](#)

REPRESENTATIVE TUCK inquired whether DNR has an appeal process or other method for reaching agreement if it disagrees with the package that is presented. He requested further detail on how that agreement is reached.

MR. BALASH answered the POD process and the PA process each take place at the division level and are signed off by the division director. Those decisions can be appealed to the commissioner and ultimately to superior court.

[3:09:08 PM](#)

REPRESENTATIVE TUCK understood there is an appeal, but asked whether [the division] makes recommendations for modifications in those cases where there is a disagreement. He explained he is trying to see whether there is a partnership that is taking place or whether it is a yay or nay answer that can be appealed.

MR. BALASH directed attention to slide 10 and stated that if the POD submitted by the operator is deemed insufficient for approval, then DNR can propose modifications. If the operator agrees, the POD is approved. If the operator disagrees there is the potential that the POD expires, which neither DNR nor the operator wants.

[3:10:05 PM](#)

[CO-CHAIR FEIGE held over CSSB 21(FIN) am(efd fld).]

[3:10:19 PM](#)

The committee took an at-ease from 3:10 p.m. to 3:19 p.m.

#### **HB 158-DNR HUNTING CONCESSIONS**

[3:19:12 PM](#)

CO-CHAIR FEIGE announced that the next order of business is HOUSE BILL NO. 158, "An Act authorizing the commissioner of natural resources to implement a hunting guide concession program or otherwise limit the number of individuals authorized to conduct big game commercial guiding on state land." [Before the committee was the proposed committee substitute, version 28-LS0555\U, Bullard, 3/20/13, adopted as the working document on 3/20/13.]

[3:19:28 PM](#)

CO-CHAIR FEIGE opened public testimony [on the proposed committee substitute (CS), Version U].

[3:19:46 PM](#)

THOR STACEY, Lobbyist, Alaska Professional Hunters Association (APHA), referred to page 3, lines 3-9, of Version U and suggested the word "determine" on line 6 be replaced with "recommend" so that the language on lines 4-7 would read "the commissioner of fish and game shall recommend ... the number and type of concessions". He said the APHA agrees that a statutory

link between the Alaska Department of Fish & Game (ADF&G) and this program is appropriate and that overall it is constructive.

MR. STACEY noted the language in Version U on page 3, lines 12-19, is a response to the concern that an individual hunting guide could hold a total of six federal and state concession permits. However, he pointed out, AS 08.54.750 already holds a registered guide to three guide use areas irrespective of land status within those, and therefore this concern is already addressed in statute. The APHA feels that if concessions were further counted against the total it could cause significant portions of state land, or small inholdings within guide use areas, to be unused or extraordinarily valuable, which is not necessarily within the intent of keeping those three area limitations intact.

MR. STACEY said development of a transporter concession [Version U, page 3, beginning on line 25] is perhaps the most significant change from the original bill. He said APHA is very supportive of big game commercial services generally having good public oversight and is supportive of the concept of a transporter concession program. However, he cautioned, the guide concession program took seven years of diligent hard work to develop and that question is now before this body as a fully developed concept. The APHA is hopeful that the same process would be applied to the future transporter concession program.

[3:22:39 PM](#)

CO-CHAIR FEIGE, responding to Representative Tuck, clarified that Mr. Stacey is referring directly to the proposed CS, [Version U], and the amendments [to the original bill] that were incorporated into the CS.

[3:22:54 PM](#)

REPRESENTATIVE TUCK requested reiteration of how the number of concessions is already addressed in statute.

MR. STACEY replied an individual registered hunting guide can hold only three guide use areas. Guide use areas are subunits of a game management unit (GMU). For example, a guide use area in GMU 9 would be referred to as 0309 and there might be 20 different guide use areas. These guide use areas take into account physical boundaries, barriers, historic use, and so forth. The attempt was to draw them up with 100 percent land status - all federal or all state, some private - but that was

impossible to do as can be seen by the checkerboard on the map of the state land status. Within a guide use area there is usually a majority of state or federal land, but sometimes there are minority pieces within that. Sometimes a person might have to apply for a permit for a very small piece within his/her guide use area. If a person does not have the ability to do so because he/she has, say, three federal concessions, then that tiny inholding of state land could, if in a very favorable location, dominate the rest of the guide use area. Or, it could go unused because it is not a big enough unit to be valuable as a concession, but it is unused because the federal concession holder could not apply for land use authorization there.

[3:24:35 PM](#)

REPRESENTATIVE TUCK stated the intent of this provision is to open it up for more opportunities for more people. He understood Mr. Stacey to be saying, however, that this is adequately done under current state statute.

MR. STACEY responded correct.

REPRESENTATIVE TUCK further understood Mr. Stacey to be saying that keeping this provision in the proposed CS could create a potential problem.

MR. STACEY answered the potential problem is that there are small inholdings that are either extraordinarily valuable or unintentionally unused. The state has a historic compromise where guides are limited to three geographic areas; the individual land status within is the question with a concession program. The APHA's position is that it is already addressed in statute.

[3:25:34 PM](#)

REPRESENTATIVE JOHNSON understood Mr. Stacey to be describing a state concession area that might have a small federal area inside it or vice versa. He asked whether APHA's concern would be satisfied with a provision that excludes a state area within a federal area or an area within a state area.

MR. STACEY replied if there is a sliver, and that sliver is excluded, there would need to be a definition of sliver - how small does small become. One person's definition of a sliver might be a very valuable piece of beach in a brown bear area. The guide use areas already in place, he explained, have drawn

in those compromises - historic use, physical barriers, and so forth. The APHA's position is that the guide use area is the best type of three-area limitation. Additionally, the industry is currently set up around that so a guide cannot control too much land.

[3:27:03 PM](#)

REPRESENTATIVE JOHNSON understood if this proposed provision was implemented a guide could hold three federal concessions and three state concessions, excluding the small slivers.

MR. STACEY responded absolutely. He posed a scenario of three different landholders within one guide use area, each of which has concessions covered under this provision. A guide would have to apply for each one of those concessions, but another guide could also apply for those concessions. So this guide use area can now provide more opportunity. A guide is not guaranteed to get that just because he/she has the guide use area. There could be three difference concessions within one guide use area, which is an extreme example and very rare situation within the state. So a guide would not want to be prevented from applying for concessions within another guide use area because he/she is already geographically limited to that area. He allowed it is confusing to add this layer of guide use area, but it is part of the professional licensing.

[3:28:19 PM](#)

REPRESENTATIVE JOHNSON commented that "guide use area" is somewhat of a new term.

CO-CHAIR FEIGE stated, "'Guide use area' is what they are using now".

REPRESENTATIVE JOHNSON presumed that guide use areas would go away with the concessions.

MR. STACEY stated guide use areas would not go away. In the vast majority of the state, he continued, there is one type of concession within each guide use area so that a concession boundary and a guide use area boundary line up. However, it is not that way everywhere. For example, "I register for 0902 and 2602, let's say, different guide use areas. Generally it is the same land status within those, but there are some specific differences where you might have to hold two different concessions in that area now."

[3:29:18 PM](#)

REPRESENTATIVE JOHNSON understood that would be true whether it is state or federal under this program, "so you'd still have to hold two if it's all on state land."

MR. STACEY answered absolutely. The concern is that if a guide has such a small concession that it is not economically viable and the person that has the majority of the land status around it cannot apply it, it would lay fallow and be unused.

[3:29:43 PM](#)

REPRESENTATIVE JOHNSON inquired what is keeping someone else from applying for that and making it not unused.

MR. STACEY replied there is a low density of animals and not all land is created equal. It takes so much land to create economic viability. No one can have a reasonable opportunity if too small of a concession is within a guide use area and the person with the federal land that is surrounding it cannot apply for it. As it stands currently, the federal operator is just paying \$500 to hunt on state land there now; that operator does not have to compete at all. It is within his guide use area, so he would not be getting more land than what he has currently.

[3:30:39 PM](#)

REPRESENTATIVE JOHNSON said he needs to become familiar with the guide use area under the new concession area. He asked whether [the guide use area] is going to go away and said his understanding is that the new concession area becomes the guide use area.

MR. STACEY responded the guide use areas were drawn up with historical compromise, such as what is big enough to be commercially viable depending on the part of the state. For instance, guide use areas in Southeast Alaska are much smaller than in the Arctic. So these guide use areas came out of "a situation with commerce" and now the landholder - the state or federal agency or whoever it is - has attempted to match these concessions with the borders of the guide use areas, and the vast majority of them were successful. There are very few instances where the situation being talked about would happen, but it could cause that land to be unused, which is not something APHA would want to see happen.

3:31:49 PM

CO-CHAIR FEIGE announced the committee would ask the Department of Natural Resources (DNR) to provide further clarification.

CO-CHAIR FEIGE requested witnesses to address their comments specifically to the amendments that were incorporated into Version U.

3:32:37 PM

TIM BOOCH, Master Guide 176, testified he conducts hunts on Native, state, and federal refuge lands. Regarding the provision for the Department of Natural Resources (DNR) to be able to deal with transporters, he maintained that that is the Big Game Commercial Services Board's job to do. As written in Version U [page 3, line 26], he said the "may" just means maybe, not for sure. This guide concession program has a number of things the guide industry and APHA do not support. There are things that need to be ironed out and he has little confidence that they will. He said he has offered alternatives to this in his [earlier] comments to DNR and to the committee. The Board of Game and the Big Game Commercial Services Board are the state's tools tasked and funded to regulate the guide industry and allocate the resources. However, they are hamstrung by this plan, which is evidenced in the cherry picking allocation/application of the drawing permits.

MR. BOOCH stated the Kodiak model represents the time tested, precedent-setting allocation for drawings in the state. For high-profile, guide-required species that focus the attention of guides and residents on a limited resource, the Board of Game has developed a very good system. The [3/13/13] testimony by Mr. Tiffany of the APHA did not bring up the guide/client agreement, an established pre-requisite in these drawings that establishes a relationship with the guide and the hunter. He disagreed with Mr. Tiffany's testimony that Cabela's and big box booking agencies can flood the drawing such that a guide cannot have a viable guide business in a drawing, and pointed out that there are viable guide businesses on Kodiak Island, which has nine state land guide use areas with multiple guides. The Board of Game and the Big Game Commercial Services Board should be allowed to use those tools, and those tools do work. He urged HB 158 be tabled until the legislature decides on this most important cultural and economic issue in Alaska.

3:35:45 PM

REPRESENTATIVE P. WILSON said it sounds like Mr. Booch is saying "the big game guys" have tried to circumvent the Board of Game to get legislators to do something different.

MR. BOOCH replied he is not saying that. Continuing, he said there are a number of different powers in this. The APHA is a leading conservation group and voice, but there is not a consensus within the APHA. That is not because the board of directors and the people involved have not tried to represent that; it is that some of the members feel they are not welcome to. Those people who are Class A guides, or assistant guides, or apprentices, or who do not do a lot of hunts, feel they are not even pertinent in the issue. The point is there are certain members of the Board of Game who have bought into this and legitimately feel it is their task to promote this and so they have deferred from implementing a standard uniform drawing permit application, which is the Kodiak model. It covers every problem that possibly can occur. Mr. Tiffany's [3/13/13] testimony that the guide concession program is going to get rid of the need for a drawing is not true, he asserted. "If it is a guide required for nonresident species where multiple guides and residents compete, if it is within ... easy access and it is a high profile hunt, then it is going to be a drawing regardless of what DNR does."

3:37:44 PM

MR. BOOCH, continuing his response to Representative P. Wilson, said the Big Game Commercial Services Board should also be allowed ... There is now a precedent setting regulation in Unit 9 where there is spatial distribution between camps. However, the board did not include in that regulation the DNR registered camps, which is where the established guides are. The board just said permanent camps, but that is a precedent setting tool right there [that could be] implemented statewide and include DNR camps. A federal style perspective is not needed and DNR running the guide industry is not needed. The Big Game Commercial Services Board will regulate where a guide establishes a camp, so DNR does not have to try to deny anybody. A guide wanting a camp could either have a DNR camp or could go get one still. On a prospectus with this 14-day statewide permit, a guide could not prove where he/she hunts. These are alternatives, he said. The Board of Game has dropped the ball and is cherry picking in these allocations. One area has an up to 10 percent allocation, which means nothing to the guide

industry if the residents take it all. The policy used for drawing allocation is the past 10 year average, but that is not done. Or there is a 50 percent guide allocation for Koyukuk moose. Or there is the Kodiak Island model of separate nonresident and resident allocation, and the guide/client agreement up front establishes a relationship with the guide and the hunter. The hunter has to be registered prior to the drawing application. Establishment of the Kodiak model eliminated guides that were prospecting. There are tools that can be used. [The bill] has gaps and big glaring mistakes that should be looked at.

3:40:14 PM

Mr. BOOCH, in response to Co-Chair Feige, agreed to provide further information about the Kodiak model to Representative P. Wilson. Responding to Representative Tarr, Mr. Booch agreed to send information about how he is regulated by the U.S. Fish and Wildlife Service, Native corporations, and DNR.

3:41:08 PM

DICK ROHRER testified he served on the Big Game Commercial Services Board for five years when it specifically went through the whole state with lots of public input at many board meetings to adjust the guide-outfitter use area boundaries and add within those the state guide concession area boundaries. He concurred with the changes suggested by Mr. Stacey. The guide-outfitter use area boundaries as they exist today, and that whole body of legislation and regulation, cannot go away, he said. He spent 10 years working to get those boundaries, specifically on Kodiak Island, to coincide so that the guide-outfitter use area boundary would be the same as the brown bear permit area boundary would be the same as the federal concession area boundaries. That works fine on Kodiak on federal land, except for specific areas that are very small, as pointed out by Mr. Stacey. For example, there is an area that has three nonresident bear tags in the spring and two in the fall. A small portion of that area is federal land, a small portion is state land, and a larger portion is private land. This area is an example of where it makes sense, and the Big Game Commercial Services Board has the regulations and the authority, to allow the federal concessionaire to attempt to have the state concession within that guide-outfitter use area boundary. Since it is only five possible nonresident bear hunters per year, it is not reasonable to have potentially four different operators

in that area. He reiterated that the guide-outfitter use area boundaries, as they exist today, may not go away.

3:43:53 PM

MIKE MCCRARY testified this issue started in 2007, was developed behind closed doors, and did not come out to the public until 2010 in a series of informational meetings. The public never really had any input on change and the development of this program, he charged. There are alternatives that have not been looked at. This bill gives DNR authority, but if DNR did not have the authority to do this program, his question is what process DNR used to go through the development of this program that is now before the committee. Occupational licenses are designed to provide assurance to the public that the licensee is qualified and meets the professional standard. Occupational licenses are not transferable and are issued to a person and not a company. A hunting license is issued to a person and is not transferable. For example, a person cannot be paid to be a commercial pilot until qualified to provide that public service. The common thread between a hunting license, guide license, and pilot's license is that they are issued to individuals, are not transferable, and the person meets certain standards before he/she can benefit from that license economically. He therefore suggested that if the number of guides needs to be limited, the person actually conducting the hunt be limited to the licensed professional qualified guide, not the private pilot and not the assistant guide. If this program is implemented, it will be financed on the backs of the public's wildlife resources, and those resources are set aside, protected, by the constitution for the common use of all Alaskans. For all Alaskans to benefit from such a proposed program as this one, it would absolutely have to make a profit for the state that can be shared by Alaskans.

3:47:12 PM

SMOKEY DON DUNCAN, Master Guide 136, testified he has been self-employed in this industry since 1986. He said he can tell committee members have not had time to read his comments on the proposed amendments that he sent by electronic mail yesterday because otherwise members would not be confused about the [differences between] guide use areas and guide concessions. He urged his comments be read before the committee votes. He said last week's Big Game Commercial Services Board meeting had the worst attendance ever - many guides have and are giving up. Effort to include the Alaska Department of Fish & Game's (ADF&G)

input into the guide concession program is a welcome change, but is six years too late; DNR has proceeded too far without substantial industry input. What is really needed is area-by-area input by ADF&G or the Board of Game. The legislature, in all fairness, should create the assistant transporter license so they can pay their fair share. Currently, one person is licensed as a transporter business and a transporter may have multiple assistants who pay nothing and are not vetted like an assistant guide.

MR. DUNCAN said a guide use area is not the same as a concession area. Typically, under guide statutes a guide must have permission for 5,000 acres of upland to pick a guide use area. Regarding Mr. Stacey's reference to guide use areas being developed on historical use, Mr. Duncan maintained that those were the illegal, exclusive guide use areas. "Basically, they went back to almost exactly the same lines they used when the Owsichek [decision] ruled that it was illegal," he said. He thanked Representative P. Wilson for her amendment to bring in ADF&G and use data, facts, and evidence to determine if anything needs to be done. If the problem areas are addressed, the rest of the state can be left alone. Guides objecting to the guide concession program do not feel it is fixable; there should be a return to "square one" with participation by guides, transporters, ADF&G, Board of Game, and [Big Game Commercial Services Board].

[3:50:16 PM](#)

REPRESENTATIVE TARR noted several people have suggested that now is not the time; however, she understood this proposal has been worked on for a number of years. She asked Mr. Duncan how long it would take if the process was started over.

MR. DUNCAN replied the best action, the right thing to do, is to start from square one and do it right. He said he does not believe public input was ever there and charged that DNR did this behind closed doors and did it for a reason - it did not want APHA controlling the input and the other 90 percent of guides felt abandoned and gave up. He said he believes there will be substantial change in DNR's program if a meaningful process is begun that includes ADF&G, the Board of Game, and the industry. That will result in a very viable program supported by the vast majority of guides, he predicted, but this program here actually has the vast majority of guides adamantly opposed to it. The Board of Game and the Big Game Commercial Services Board both dropped the ball, putting DNR in a bad spot. He

recalled ADF&G's representative testifying that it is not in the allocation business because that is the Board of Game's concern. These conflicts will go away, he maintained, if everybody has their cards on the table and these tough allocations between guides, transporters, and air taxis are dealt with. He further urged that the term "transporter" include anybody who is taking a hunter afield for money, whether by air taxi, horseback, or four wheelers.

[3:53:26 PM](#)

DAN WINKELMAN testified he is a resident hunter in favor of HB 158, for which he has been waiting 30 years and which will do much for stewardship of the land, conservation, addressing overcrowding, and preserving resident hunter opportunities. He said his family has been hunting in Unit 19 since after World War II when his grandfather and great uncles hunted there, and in 1964 his father built three cabins in Unit 19C. He has hunted nearly every major draw from the Big River and the Stony River all the way around the western side of the range through the Middle Fork of the Kuskokwim River. His family has inholdings specifically on the Windy Fork. He has hunted the Dillinger and the South Fork and the Jones River all the way up to Tonzona along the edge of the park.

MR. WINKELMAN said over the years he and his family have seen guides come and go, with some years worse. The Board of Game took some action a few years ago with Unit 14A that pushed a lot of guides into Unit 19C. The discussion that there is not a problem with guides in Unit 19 is completely false, he asserted. Any law enforcement, ADF&G, and the biologist, Roger Savoy in McGrath, can tell the committee that during the months of August and September many planes are seen on all of the major drainages all the way through the Alaska Range on the west side. This has been particularly worse since the Board of Game took action on Unit 14A, which pushed new guides over to [Unit 19]. With HB 158, the key to remember is that there needs to be full implementation across the state and not just addressing certain specific so-called problem areas. Otherwise, because guides are well equipped, well financed for the most part, and young and very mobile, they will go wherever they have to go and that is seen in Unit 19.

[3:56:50 PM](#)

ISRAEL PAYTON, Registered Guide 1111, testified the language of "may" versus "shall" on transporters is weak. Transporter is a

term defined by the Big Game Commercial Services Board and transporter needs to include everyone who provides commercial services to a hunter. The question to ask here is whether it is a guide issue or the allocation of resident hunter versus nonresident hunter, which is what it truly boils down to because right now this would restrict where guides could operate. Nothing is restricting the nonresident drop-off hunter. What is the difference between the two? One hires a guy to help them find the game, the other does not. There is no land stewardship on that end. He said he is a lifelong Alaskan and it is unfortunate to have to say that some of the worst stewards of the land are Alaskans. Guides are not even the user group, he argued. The nonresident hunter is the one buying the license and using the resource. The guide is just assisting that person and the Board of Game, ADF&G, the Big Game Commercial Services Board, DNR, State Troopers, and the [Division of Corporations, Business and Professional Licensing] oversee all of that.

MR. PAYTON acknowledged the guide industry is split on this, but said the question is whether Alaska is at carrying capacity for guides, which is not known. The facts he has sent the committee indicate guided hunters in Alaska are down. Sheep numbers have remained stable as has hunter participation. There will always be hot spots and low spots, but for the most part everything remains stable. Legislators must delve into this and ask who should be limited and will this help the resource. It does not limit nonresident hunters coming to Alaska and they are the ones using the resource. Guides are not using the resource; they are assisting the users of the resource. One of two things can happen with this program. There are 300 concessions and roughly 300 contracting guides on state land and DNR could be fair and give every guide one concession, but there is no viability in having one of these small little concessions. Or DNR could give the top 100 guides three concessions each, which would be very viable but would put 200 working guides on state land out of business.

[4:00:39 PM](#)

NATE TURNER, Registered Guide 1036, testified he has been a registered hunting guide for over 12 years and is the current vice chair of the Board of Game. A member of the Alaska Professional Hunters Association (APHA), he takes 10-12 hunters per year on state, U.S. Bureau of Land Management (BLM), and U.S. Fish and Wildlife Service lands. He has U.S. Fish and Wildlife Service guiding concessions. He employs 5-6 Alaskans each year as assistant guides, most of them rural residents. He

is a trapper most of the year in the same area that he guides. For the last 23 years he has made his entire living from hunting and trapping on those lands. About 80 percent of his income comes from guiding, while about 80 percent of his time is spent trapping. He also works as an assistant guide for one other registered guide in the state because it is his only opportunity to actually be in the field with his clients. He said he is basically in support of HB 158 and added that DNR has made a very meaningful step in a very detailed and laborious process of creating a program that addresses multiple factors regarding stewardship and conservation issues. This comes from the Board of Game primarily, but it started with the public coming to the Board of Game. He said he agrees with Mr. Stacey's recommended changes.

[4:03:03 PM](#)

REPRESENTATIVE P. WILSON inquired whether Mr. Turner thinks limiting it to three on state lands would cause people to go to other available lands, such as tribal land.

MR. TURNER replied the answer depends on whether BLM incorporates its lands into this program, which he expects the agency will do because it is looking at this possibility right now. Yes, it would definitely increase pressure on private lands, he continued, because people would try to utilize those if they were unsuccessful in obtaining a state or federal concession.

[4:04:07 PM](#)

REPRESENTATIVE TARR related the committee was told the process began with a white paper distributed in 2009 with a 113-day comment period in which almost 300 comments were received. She requested those witnesses who felt left out of the process to e-mail the committee about their experience with this process.

MR. TURNER commented his personal experience is that this has been a very detailed and open process. Admittedly, DNR took the public comments and went behind closed doors to work on it, which caused a lot of concern in the industry as well as resident hunters. The Board of Game addressed that by asking to be incorporated into the program so it could speak directly to some of the issues and concerns that the board had identified. He said the Big Game Commercial Services Board did that as well. Since involvement of these two boards in the DNR process, and ADF&G being at the table, he said he personally believes that

most of the concerns outlined through the public process have been addressed. In his opinion, the primary voices being heard now about not participating in the public process are from people who did not think this would get as far as it has and now they are afraid and showing up at the last minute.

4:06:53 PM

JOE WANT, Registered Guide AA006, testified he became involved in the guiding industry in 1958 packing water, wood, and horses between Chickaloon and the Little Oshetna River. The next spring he took a job on Kodiak Island with the same job description except that he packed bear hides instead of horses. Based on his 50 years of association with the guiding industry, he said he does not believe that guides are stewards of the resource in the context that is being presented for this bill, although they are concerned about the resource. In the late 1980s or early 1990s, ADF&G came to the industry saying something needed to be done about the sow harvest; however, the industry as a whole, with two exceptions, fought it tooth and nail until economically there was an alternative that was better than the one that was in front of them. That does not mean that guides are a bunch of sleaze balls that want to kill everything; rather, business plans and the way guides approach a resource are based far more on a guide's personal attitude towards guiding than it is the amount of game that is present in the area. As far as stewards of the resource, his opinion is that ADF&G staff and the Board of Game oversee these issues and spend millions of dollars each year trying to determine the amount of game that can come out of a specific area. For example, over \$500,000 was spent trying to determine the number of bears on the Kenai Peninsula and the number was placed at somewhere between 400 and 600, which shows how inexact the process is. While he would hope he is either in support of, or opposed to, this bill, his bottom line is the hope that the legislature will maintain some sort of monitoring system over this if the bill is passed and DNR goes forward with the program.

4:09:40 PM

VIRGIL UMPHENOUR, Master Guide 158, testified in regard to paragraph (c), page 3, lines 12-19, of Version U. He said one of the guide use areas he operates in has five landowners inside it: a state township, BLM land, Koyukuk National Wildlife Refuge land, Doyon regional corporation land, and village of Huslia land. He currently has three permits for that guide use area, including a permit from DNR for which he pays \$1,000 a

year. Because all three of his guide use areas have multiple landowners, he must have multiple permits to operate in those guide use areas. He stated he is glad to see the transporters included in [Version U].

MR. UMPHENOUR said he has been involved in hunting and fishing politics for years. He is currently chairman of the Fairbanks Fish & Game Advisory Committee. He has spent eight years on the Board of Fisheries and leaves tomorrow for Whitehorse, Yukon, for seven days of salmon treaty meetings. A lot of time has been spent on this, he noted; he has provided comments to DNR and the department has made many changes. Originally, the proposal was totally unacceptable, but it is getting close to acceptable now. He said he would like to see paragraph (c) changed so that if a person has two federal concessions plus a state concession inside one state guide use area, that that is not counted "as all three of them."

[4:12:13 PM](#)

REPRESENTATIVE P. WILSON inquired how much Mr. Umphenour pays in total for all of his permits.

MR. UMPHENOUR replied he pays the state \$1,000 a year plus a client day use fee of \$3 per client per day. For his refuge permit he pays the U.S. Fish and Wildlife Service \$13 per client use day. For BLM he pays 3 percent of the gross. For some of his Native corporation permits he pays a flat \$500 per client. So, for about 20 clients a year, he pays a total of \$7,000 or \$8,000 in fees per year.

[4:13:27 PM](#)

CO-CHAIR FEIGE closed public testimony [and held over HB 158].

[4:13:33 PM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 4:13 p.m.