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SENATE COMMITTEE REPORT

FIRST COMMITTEE OF REFERRAL

Date of 5-DAY NOTICE
IN ACCORDANCE WITH UNIFORM RULE 23

FURTHER

**FISCAL NOTE(S) MUST BE ATTACHED
IN ACCORDANCE WITH AS 24.08.035

DATE TURNED INTO OFFICE 4/28/89

4/20/89
Mr. President:

FIN Committee considered SB 299

amending the manner of calculating gross value of oil for purposes of
administration of the oil and gas properties production tax; efd

and recommended:

- replace with CS SB 299 (Fin) same title
- attached amendment(s) and new title
- SFC letter of intent adopted
- do pass
- do not pass
- no recommendation
- individual recommendations
- further referral to _____

FISCAL NOTE(S) attached zero ^{DOR} fiscal impact
 appropriation no FN attached Gov. FN introduced w/ bill

MEMBERS SIGNING DO PASS
[Signature]

[Signature]

OTHER RECOMMENDATIONS
NO REC - NO REC
[Signature] (NO REC)

Committee backup attached Chair signature and recommendation
[Signature] Co Chair

By the Senate Finance Committee

LETTER OF INTENT - SB 299

The Alaska State Legislature believes the expenses and costs referred to in SB 299 are not presently allowable as reasonable costs of transportation for determination of the gross value of oil or gas under AS 43.55.150(a). The purpose of passing SB 299 is to avoid lengthy and costly litigation by clarification of this point.

FISCAL NOTE

REQUEST:

Revision Date: _____
Title: An Act Amending the Manner of
Calculating Gross Value of Oil & Gas
Production
Sponsor: Sturgulewski, Kerttula
Requestor: _____

Agency Affected: Department of Revenue
BRU: Oil and Gas Audit Division

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	5,000	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: Attach a separate page for analysis.
SEE ATTACHED

Prepared By: Chuck Logsdon
Division: Oil and Gas Audit Division

Phone: 277-5627
Date: April 21, 1989

Approved by Commissioner: Hugh Malone
Agency: Department of Revenue

Date: 4/21/89

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

Changes in CSSB 299 (Fin) have no
fiscal impact. This fiscal note
is appropriate. 4/28/89 *al*

ANALYSIS:

This bill would disallow, in the calculation of gross value at the point of production, any increase in transportation cost associated with a catastrophic oil discharge. At this time, it is unclear what impact the Valdez spill will have on these costs (vessel repair or incremented chartering costs). If these costs amount to \$50 million and are included in the calculation of reasonable transportation costs, the severance tax would be reduced by \$5.5 million.

6-1272E ✓
Chenoweth
4/27/89

Original sponsors: Sturgulewski and
Kerttula

ADOPTED

1 IN THE SENATE

2 CS FOR SENATE BILL NO. 299 (*Finance*)
3 IN THE LEGISLATURE OF THE STATE OF ALASKA
4 SIXTEENTH LEGISLATURE - FIRST SESSION
5 A BILL

6 For an Act entitled: "An Act omitting from the calculation of the gross
7 value of oil, for purposes of administration of the
8 oil and gas properties production tax, certain costs,
9 losses, damages, and expenses relating to catas-
10 trophic oil discharges from vessels; and providing
11 for an effective date."

12 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

13 * Section 1. AS 43.55.150 is amended by adding a new subsection to
14 read:

15 (c) In determining the gross value of oil under (a) of this
16 section, the department may not allow as reasonable costs of transpor-
17 tation

18 (1) the amount of loss of or damage to, or of expense
19 incurred due to the loss of or damage to, a vessel used to transport
20 oil if the loss, damage, or expense is incurred in connection with a
21 catastrophic oil discharge from the vessel into the marine or inland
22 waters of the state;

23 (2) the incremental costs of transportation of the oil that
24 are attributable to temporary use of or chartered or substituted
25 service provided by another vessel due to the loss of or damage to a
26 vessel regularly used to transport oil and that are incurred in con-
27 nection with a catastrophic oil discharge into the marine or inland
28 waters of the state; and

29 (3) the costs incurred to charter, contract, or hire

1 vessels and equipment used to contain or clean up a catastrophic oil
2 discharge.

3 * Sec. 2. AS 43.55.140 is amended by adding a new paragraph to read:

4 (15) "catastrophic oil discharge" has the meaning given in
5 AS 46.04.120.

6 * Sec. 3. This Act is retroactive to the first day of the month in
7 which it takes effect, and applies to oil and gas produced on or after that
8 date.

9 * Sec. 4. This Act takes effect immediately under AS 01.10.070(c).

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STATE OF ALASKA
THE LEGISLATURE

POUCH Y STATE CAPITOL
JUNEAU, ALASKA 99811
907 465-3800


LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

April 21, 1989

SUBJECT: Retrospective application of Senate
Bills 286 and 299

TO: Senator Arliss Sturgulewski

FROM: Jack Chenoweth
Legislative Counsel 

Each of the two above-captioned bills has a retroactivity feature. The state's net income tax is computed and paid on an annual basis. Senate Bill 286, amending the net income tax, applies the changes made in that bill back to income earned since the start of this calendar year. The oil and gas properties production (i.e. "severance") tax is due and payable monthly. 1/ Senate Bill 299, amending the chapter that imposes the severance tax, applies the changes made in that bill back to production from the first day of the month in which the Act takes effect.

Since retroactivity is common to both, let me discuss the common concept in the material that follows.

1/ Under AS 43.55.020(a):

The gross production tax on oil or gas shall be paid monthly. The tax is due on the 20th day of each calendar month on oil or gas produced from each lease or property during the preceding month. If the tax is not paid before the end of the month in which it becomes due, the tax becomes delinquent.

Thus, tax liability is incurred and remitted on a monthly, not an annual basis. For oil production during December, 1988, the tax became due and payable January 20, 1989, and tax liability for oil production during January, 1989, becomes due and payable February 20, 1989.

April 21, 1989

A retroactive tax adjustment will apply if there is a valid public purpose served by giving retrospective effect to that adjustment. Here, the committee's deliberations may be critical. As the bills are considered, it would, in my judgment, be important to develop a record on which a court, if called upon to consider an argument, would conclude that there was a public purpose served by giving the amendments a retrospective effect.

A reasonable retrospective application will be sustained. The farther back the retroactive provision is given effect, the less likely a court would be to sustain the provision without a clear showing of public purpose. (To foreclose a claim altogether, in other legislation I have discouraged retrospective application of severance tax adjustments, for example, beyond the narrow period recognized under AS 43.55.-020(a), that is, a change amending the economic limit factor to be made retroactive only to the beginning of the month in which the bill is to take effect. That approach should not create any problems of retrospective applications since the tax liability would not have become due on that date.)

RETROSPECTIVE APPLICATION OF THE BILLS:

Tax statutes may be made retroactive. 2/ The threshold

2/ This office has also recently considered proposed retrospective application of severance tax adjustments, specifically relying on the federal and state constitutional prohibitions against passage of ex post facto laws. There are two ex post facto law prohibitions of the federal constitution. Article I, section 9, clause 3 is a limitation on the federal government, while article I, section 10, clause 1 imposes a similar limitation on the states. Alaska's constitution also contains a limitation in section 15 of article I.

Our previous conclusion that federal and state constitutional prohibitions against enactment of ex post facto laws would support a challenge to the amendment's retrospective application was surely in error. Federal court decisions have limited the application of the limitations to criminal or penal

Senator Arliss Sturgulewski
Page 3
April 21, 1989

consideration is that the retrospective application of the measure must not impair an obligation of contract. The impairment of contract consideration appears to be inapplicable in this instance. Retrospective application of a newly-enacted statute may, in some instances, impair obligations of contract, in violation of article I, section 10 of the United States Constitution and article I, section 15 of the State Constitution. However, the Alaska Supreme Court appears to have cut off an impairment of contract argument applicable to retrospective application of a tax amendment in Atlantic Richfield Co. v. State, 705 P.2d 418 (Alaska, 1985). To the argument that the oil and gas corporate income tax then in litigation impaired the obligation of the state's underlying lease contracts, the court concluded that "[the] argument [was] without merit":

. . . No lease provision has been impaired. In entering into the leases the state could not, and did not, contract away its power as a sovereign to tax income earned in the state. Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 102 S.Ct. 894, 71 L.Ed.2d 21 (1982) disposes of this issue:

Contractual arrangements remain subject to subsequent legislation by the presiding sovereign. Even where the contract at issue requires payment of a royalty for a license or franchise issued by the government entity, the government's power to tax remains unless it "has been specifically surrendered in terms which admit of no other reasonable interpretation." St. Louis v. United R. Co., 210 U.S. 266, 280, 28 S.Ct. 630, 634, 52 L.Ed. 1054 (1908).

455 U.S. at 148, 102 S.Ct. at 907, 71 L.Ed.2d at 36 (citations omitted); see also Exxon v. Eagerton, 462

statutes, concluding that retrospective tax legislation is not prohibited by the ex post facto clause. Personal Finance Co. v. United States, 86 F. Supp. 779 (D.Del., 1949). See 16A Am. Jur. 2d secs. 636, 677. Decisions in other state courts have similarly concluded. Parlato v. McCarthy, 69 A.2d 648 (Ct., 1949), Walker v. Commonwealth, 130 S.W.2d 27 (Ky., 1939). The Alaska Supreme Court has not extended application of the state constitutional ex post facto prohibition beyond penal or criminal matters. Danks v. State, 619 P.2d 720 (Alaska, 1980); Creekpaum v. State, 753 P.2d 1139 (Alaska, 1988).

U.S. at 187-94, 103 S.Ct. at 2304 - 2307, 76 L.Ed.2d at 508-12.

705 P.2d 418, at 438.

*

If legislation acts retrospectively, the nature and duration of its retrospective application should be reasonable. The arguments favoring a reasonable retrospective operation arise out of the equal protection and due process clauses of the state and federal constitutions.

Federal equal protection considerations:

State legislation retroactively imposing a tax is not necessarily and certainly invalid under the equal protection clause of the Fourteenth Amendment to the federal constitution. The inquiry to be made is one of whether the retroactivity impairs substantial, vested rights, and is reasonable in the circumstances. As to retroactively imposed new taxes, the courts have been reluctant to find a violation because of the impairment of a vested right. Welch v. Henry, 305 U.S. 134, 83 L.Ed. 87, 59 S.Ct. 121 (1938), rehearing denied 305 U.S. 675, 83 L.Ed. 437, 59 S.Ct. 250 (1938). 3/ Several state courts have agreed. See Garrett

3/ In Welch, the United States Supreme Court concluded that a Wisconsin state statute, enacted in 1935 and operating retrospectively to tax corporate dividends earned in 1933 which, when received, were deductible from gross income, did not violate the equal protection clause. The tax rates applied to the dividends differed from the rates applicable to other types of taxable income. As to the retrospective application of the new tax to dividends that were, when earned, exempt from tax, the court noted that:

The equal protection clause does not preclude the legislature from changing its mind in making an otherwise permissible choice of subjects of taxation. The very fact that the dividends were relieved of tax [in 1933], when the need was less, is basis for the legislative judgment that they should bear some of the added burden when the need is greater.

Freight Lines v. State Tax Commission, 135 P.2d 523, at 526, 527 (Utah, 1943); Colonial Pipeline Co. v. Commonwealth, 145 S.E.2d 227 (Va., 1965), reh. den. (1966), app. dismissed, 384 U.S. 268, 16 L.Ed.2d 523, 86 S.Ct. 1476 (1966). 4/

Numerous retroactive revisions of the federal and Wisconsin revenue laws . . . have imposed taxes on subjects previously untaxed and shifted the burden of old taxes by changes in rates, exemptions, and deductions. It has never been thought that such changes involve a denial of equal protection if the new taxes could have been included in the earlier act when adopted. If some retroactive alteration in the scheme of a tax act is permissible, as is conceded, it seems plain that validity, so far as equal protection is concerned, must be determined, as in the case of any other tax, by ascertaining whether the thing taxed falls within a distinct class which may rationally be treated differently from other classes. If such changes are forbidden in the name of equal protection, legislatures in laying new taxes would be left powerless to rectify to any extent a previous distribution of tax burdens which experience had shown to be inequitable, even though constitutional.

83 L.Ed. 87, at 92.

4/ In Garrett Freight Lines v. State Tax Commission, 135 P.2d 523 (Utah, 1943), the Utah Supreme Court, called upon to determine whether an excise tax levied on the use of diesel motor fuel that was used prior to the date the legislative act became law, found no equal protection violation:

It is well settled that a tax does not necessarily violate the Federal Constitution merely because it contains retroactive features. Milliken v. United States, 283 U.S. 15, 21, 51 S.Ct. 324, 75 L.Ed. 809 [(U.S., 1931)]; Billings v. United States, 232 U.S. 261, 34 S.Ct. 421, 58 L.Ed. 596 [(U.S., 1914)]; Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 125, 83 L.Ed. 87 [(U.S., 1938)]

. . . .

Neither the Federal Constitution nor the Utah

Federal due process considerations:

Retroactive imposition of a tax is not necessarily a violation of the due process clause of the Fourteenth Amendment to the federal constitution. The leading case is Welch, cited earlier, in which the United States Supreme Court determined:

The objection chiefly urged to the taxing statute is that it is a denial of due process of law because in 1935 it imposed a tax on income received in 1933. But a tax is not necessarily unconstitutional because retroactive. Milliken v. United States, 283 U.S. 15, 21, 75 L.Ed. 809, 814, 51 S.Ct. 324 [(1931)], and cases cited. Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process, and to challenge the present tax it is not enough to point out that the taxable event, the receipt of income, antedated the statute.

83 L.Ed. 87, at 93. But the assertion that due process is not violated is not absolute and, the court has said that

In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation.

Id.

Similarly, in Garrett Freight Lines, earlier cited, the Utah Supreme Court determined that the due process clause is not

Constitution has any provision in terms prohibiting retroactive legislation -- excepting that which forbids the enactment of ex post facto laws. [Citations omitted.] That clause relates to criminal and penal matters and does not affect legislation such as the statute here involved. Calder v. Bull, 3 Dall. 386, 390, 1 L.Ed. 648, 1 Kent Commentaries 409; 3 Story on Constitution 212; 18 C.J.S. Constitutional Law, sec. 435, p. 886.

a limitation on the state's ability to retrospectively impose a tax:

Although basing its case upon the due process clause, appellant does not show wherein the tax constitutes any arbitrary and oppressive discrimination except to assert that a tax based upon a transaction consummated prior to passage of the act amounts to a taking of property without due process. It has many times been questioned whether the due process clause constitutes any limitation upon the taxing power. In this connection we quote from Mr. Justice Sutherland of the United States Supreme Court in an opinion upholding the validity of a statute of the State of Washington levying a tax upon the sale of oleomargarine:

Except in rare and special instances, the due process of law clause contained in the Fifth Amendment is not a limitation upon the taxing power conferred upon Congress by the Constitution. * * * And no reason exists for applying a different rule against a state in the case of the Fourteenth Amendment. * * * That clause is applicable to a taxing statute such as the one here assailed only if the act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property. * * * Collateral purposes or motives of a Legislature in levying a tax of a kind within the reach of its lawful powers are matters beyond the scope of judicial inquiry. * * * Nor may a tax within the lawful power of a state be judicially stricken down under the due process clause simply because its enforcement may or will result in restricting or even destroying particular occupations or businesses, * * * unless, indeed, as already indicated, its necessary interpretation and effect be such as plainly to demonstrate that the form of taxation was adopted as a mere disguise, under which there was exercised, in reality, another and different power denied by the Federal Constitution to the state.

A. Magnano Co. v. Hamilton, 292 U.S. 40, 54 S.Ct. 599, 601, 78 L.Ed. 1109.

Garrett Freight Lines, 135 P.2d 523, at 527.

Courts have, however, considered retrospective tax legislation unconstitutional as a violation of the due process clause when, as Welch concludes, in light of "the nature of the tax and the circumstances in which it is laid," the legislation is "so harsh and oppressive as to transgress [that] constitutional limitation." Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87, at 93. The question is typically one of the degree of harshness, based upon consideration of factors such as (1) the effect of the retroactive application of legislation amending a tax on a taxpayer's voluntary act that was influenced by the taxpayer's understanding of tax incidence or consequence at the time of that act, especially if the tax to be imposed or amended is "novel," (2) the sufficient certainty of the taxpayer's expectation of money that is jeopardized by the retroactive legislation, (3) the length of the period of the legislation's retrospective application, and (4) the importance of the public purpose to be served by the action. The first three elements are, to some degree, based on the taxpayer's expectations, while the fourth involves a determination of a public interest that necessitated the actual enactment.

Computation and payment of the severance tax is not greatly determinative of taxpayers' taxable activities that generate the tax liability, nor does this proposed legislation seem to strike at activities of a taxpayer that reasonably relied on the current severance tax rates before this bill proposed amendment of that tax. It is the length of the period of the legislation's retrospective application and the importance of the public purpose to be served that need be most carefully considered.

State due process and equal protection considerations:

Nothing in my quick research suggested that an analysis under the state's "due process" clause, article I, section 7, would reach a conclusion at variance with the decisions based on the comparable federal provision discussed above.

State "equal protection" analysis differs, though the conclusion reached under that analysis is consistent with the conclusions reached under the analysis applicable to the federal provisions. In State v. Erickson, 574 P.2d 1 (Alaska, 1976), the court established a "single test"

Senator Arliss Sturgulewski
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April 21, 1989

approach for state-constitution based equal protection analysis, essentially requiring that the court (1) ascertain the purposes of the legislation to determine whether they are legitimate; (2) determine whether the means chosen to accomplish the objectives actually do so; and (3) balance the importance of the state's interest against the constitutional right involved. The state has plenary authority to tax. Assuming an adequate record, adding to tax liability on the income and severance taxes payable by major producers seems to bear a strong correlation to the state's efforts to impose a tax burden on those who are principally responsible for conducting marine operations in a way that is environmentally safe. By that analysis, if the retrospective application of the change is reasonable, the court should reject any state constitutional equal protection-based claim.

JC:gc
WKG9/099

Enclosure

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

P.O. BOX S
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300
TELEFAX: (907) 465-2389

April 28, 1989

The Honorable Rick Uehling
Alaska State Senate
P.O. Box V
Juneau, AK 99811

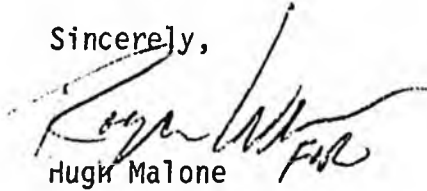
RE: Senate Bill 299

Dear Senator Uehling:

This letter is a follow-up to my earlier letter of today addressing the issues in SB 286 and SB 299.

If the draft letter of intent on SB 299 (enclosed) is adopted, I believe that the concerns expressed in my earlier letter are well met. The department has no objection to the legislation if the letter of intent is adopted.

Sincerely,



Hugh Malone
Commissioner

HM:m11
Enclosure

89-152

Department of Revenue
Amendment
April 28, 1989

SB 299

AMENDMENT

Section 1, lines 27 - 29

Delete Subsection (c)(3)

W. J. W.

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

P.O. BOX 5
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300
TELEFAX: (907) 465-2389

April 28, 1989

The Honorable Rick Uehling
Alaska State Senate
P.O. Box V
Juneau, AK 99811

RE: Senate Bill 286
Senate Bill 299

Dear Senator Uehling,

Thank you for the opportunity to comment briefly on Senate Bills 286 and 299, which would amend the corporate income tax and the severance tax to deal with spill-related costs. I appreciate the concern that is addressed by both bills -- the effect on the general fund of the recent disaster in Prince William Sound. However, I believe it would be unwise to proceed on either of these bills without a fair amount of further study.

Senate Bill 286 would amend the corporate income tax law (AS 43.20) to prohibit the deduction of spill related costs. I have attached a revised fiscal note, which contains an analysis that touches on some of the difficulties in this seemingly simple bill. For example, the bill might inadvertently prohibit the deduction of expenses to a fisherman who chartered his boat to help in the clean-up effort. And, the limitation of the deduction denial to Alaska spills raises constitutional problems. Further, since our corporate income tax is based on a share of worldwide income, the denial of deductions is very severely diluted in the case of a multinational taxpayer. Thus, the fiscal savings for the general fund are small.

Senate Bill 299 would amend the severance tax (AS 43.55) to limit costs of transportation allowable in the net back process to determine wellhead value. The taxpayer may not use costs of repairing vessel damage associated with a spill, or any extra cost incurred in substituting other vessels, or costs of vessels and equipment used in clean-up. It is my view that most of these costs are not currently permitted as reasonable costs of transportation, and that the department can meet most of these concerns by regulation. We are currently studying the need for regulations in this area. I am concerned that section (c)(3) of this legislation might imply that the costs listed are currently allowable, giving the oil industry an argument it does not now have.

Senator Rick Uehling
Page 2
April 28, 1989

In sum, I hope that the legislature goes slowly in this area. My department will be pleased to work with you and other interested legislators. I do not believe that precipitous action is either necessary or advisable.

Sincerely,

A handwritten signature in cursive script that reads "Hugh Malone". The signature is written in dark ink and is positioned above the printed name and title.

Hugh Malone
Commissioner

HM:m11
89-146

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

P.O. BOX 5
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300
TELEFAX: (907) 465-2389

April 28, 1989

The Honorable Rick Uehling
Alaska State Senate
P.O. Box V
Juneau, AK 99811

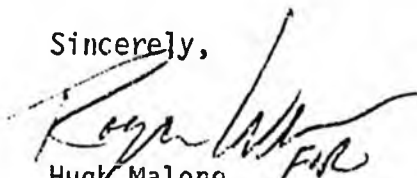
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Sincerely,



Hugh Malone
Commissioner

HM:m11
Enclosure

89-152

By the Senate Finance Committee

A/29/89

LETTER OF INTENT - SB 299

The Alaska State Legislature believes the expenses and costs referred to in SB 299 are not presently allowable as reasonable costs of transportation for determination of the gross value of oil or gas under AS 43.55.150(a). The purpose of passing SB 299 is to avoid lengthy and costly litigation by clarification of this point.