

SCOMM

148:5

ALASKA STATE LEGISLATURE

REPRESENTATIVE KURT OLSON

- Chair, Labor and Commerce
- Vice-Chair, Oil and Gas
- Member, Community and Regional Affairs

Session: January – May
State Capitol
Juneau, AK 99801-1182
Phone: 907-465-2693
Fax: 907-465-3835



Interim: May – December
145 Main Street Loop, Ste 221
Kenai, AK 99611
Phone: 907-283-2690
Fax: 907-283-2763

Official Business

Sponsor Statement

HB 128 – Disallows PPT Reductions for Improperly Maintained Facilities

HB 128 cleans up language and closes a loophole in the recently passed Petroleum Production Tax (PPT) legislation.

As currently written, producers may deduct or use as credits, expenses for repairs made to infrastructure that has been improperly maintained. Once HB128 is enacted, deductions or credits against the PPT for these types of repairs will be subject to review and approval.

This bill instructs the Commissioner of the Revenue to consult with the Commissioner of the DEC and the Chair of AOGCC. Relying on standard practices of the industry, they will determine the portion of the costs related to repair or replacement of improperly maintained property or equipment available for deduction or use as a credit.

This concept came forward as an amendment in the Senate Resources Committee in early August of 2006. The ongoing corrosion problem currently experienced by BP serves to emphasize the importance of this change in statute.

The responsibility for the expenses related to repairs made to improperly maintained infrastructure should not lie with the State of Alaska.

I respectfully ask for your support of this bill.

ALASKA STATE LEGISLATURE

REPRESENTATIVE KURT OLSON

- Chair, Labor and Commerce
- Vice-Chair, Oil and Gas
- Member, Community and Regional Affairs

Session: January – May
State Capitol
Juneau, AK 99801-1182
Phone: 907-465-2693
Fax: 907-465-3835



Interim: May – December
145 Main Street Loop, Ste 221
Kenai, AK 99611
Phone: 907-283-2690
Fax: 907-283-2763

Official Business

Sectional Analysis

HB 128 - Disallows PPT Reductions for Improperly Maintained Facilities

Section 1: amends AS 43.55.165(e) which establishes lease expenditures not available for use as credits or deductions to the Petroleum Production Tax (PPT).

New subsection (19) establishes new language regarding costs related to the repair and replacement of improperly maintained property or equipment.

These costs are subject to review by the Commissioner of The Department of Revenue, the Commissioner of the Department of Environmental Conservation and the chair of the Alaska Oil and Gas Conservation Commission, relying on industry standards.

Section 2: provides for applicability to the oil and gas produced after March 31, 2006, as with the PPT.

Section 3: provides for transitional language for payment of additional taxes or installment payment due as a result of disallowing any expenditure set out in Section 1.

Section 4: provides for retroactive date to the same period as the PPT.

DRAFT CS HB 128

Comparisons between original bill and draft CS
25-LS0561\E vs work draft 25-LS0561\M

Page 3:

Line 21:

- Add "commissioner of natural resources"
- Delete "the chair of"
The intent is to include DNR as part of the consulting group and also have all members of AOGCC, not just the chair.

Line 22:

- Delete "relying on" and add "taking into consideration"
Makes language more general in nature.

Subsection (A), beginning on Line 24:

- Delete "improperly maintained property or equipment" and replace with "property or equipment that was not maintained or was improperly maintained".
Clarifies subsection (a) to insure "not maintained" is also established as criteria.

Subsection (B), beginning on Line 27:

- Add "a lack of"
Clarifies subsection (b), that improper or no maintenance are included.

Subsection (C), beginning on Line 29:

- Delete subsection and replace with:
"Incremental operating expenses incurred as a result of operating facilities or equipment at diminished capacity when that diminished capacity is caused by the lack of or improper maintenance of property or equipment"

To clarify incremental expenses for diminished capacity as a result of lack of or improper maintenance of facilities.

25-LS0561\JM
Bullock
2/22/07

CS FOR HOUSE BILL NO. 128()

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FIFTH LEGISLATURE - FIRST SESSION

BY

Offered:

Referred:

Sponsor(s): REPRESENTATIVES OLSON, Harris, Ramras, Guttenberg, Neuman, Holmes, Thomas, Stoltze, Joule, Fairclough, LeDoux, Kerttula, Wilson, Lynn, Crawford, Gara, Gruenberg, Doll, Doogan, Edgmon, Buch

A BILL

FOR AN ACT ENTITLED

1 **"An Act relating to allowable lease expenditures for the purpose of determining the**
2 **production tax value of oil and gas for the purposes of the oil and gas production tax;**
3 **and providing for an effective date."**

4 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

5 *** Section 1.** AS 43.55.165(e) is amended to read:

6 (e) For purposes of this section, lease expenditures do not include

7 (1) depreciation, depletion, or amortization;

8 (2) oil or gas royalty payments, production payments, lease profit
9 shares, or other payments or distributions of a share of oil or gas production, profit, or
10 revenue;

11 (3) taxes based on or measured by net income;

12 (4) interest or other financing charges or costs of raising equity or debt
13 capital;

14 (5) acquisition costs for a lease or property or exploration license;

- 1 (6) costs arising from fraud, wilful misconduct, or gross negligence;
2 (7) fines or penalties imposed by law;
3 (8) costs of arbitration, litigation, or other dispute resolution activities
4 that involve the state or concern the rights or obligations among owners of interests in,
5 or rights to production from, one or more leases or properties or a unit;
6 (9) costs incurred in organizing a partnership, joint venture, or other
7 business entity or arrangement;
8 (10) amounts paid to indemnify the state; the exclusion provided by
9 this paragraph does not apply to the costs of obtaining insurance or a surety bond from
10 a third-party insurer or surety;
11 (11) surcharges levied under AS 43.55.201 or 43.55.300;
12 (12) for a transaction that is an internal transfer or is otherwise not an
13 arm's length transaction, expenditures incurred that are in excess of fair market value;
14 (13) an expenditure incurred to purchase an interest in any corporation,
15 partnership, limited liability company, business trust, or any other business entity,
16 whether or not the transaction is treated as an asset sale for federal income tax
17 purposes;
18 (14) a tax levied under AS 43.55.011;
19 (15) the portion of costs incurred for dismantlement, removal,
20 surrender, or abandonment of a facility, pipeline, well pad, platform, or other
21 structure, or for the restoration of a lease, field, unit, area, body of water, or right-of-
22 way in conjunction with dismantlement, removal, surrender, or abandonment, that is
23 attributable to production of oil or gas occurring before April 1, 2006; the portion is
24 calculated as a ratio of the amount of oil and gas production, in barrels of oil
25 equivalent, associated with the facility, pipeline, well pad, platform, other structure,
26 lease, field, unit, area, body of water, or right-of-way occurring before April 1, 2006,
27 to the total amount of oil and gas production, in barrels of oil equivalent, associated
28 with that facility, pipeline, well pad, platform, other structure, lease, field, unit, area,
29 body of water, or right-of-way through the end of the calendar month before
30 commencement of the dismantlement, removal, surrender, or abandonment; a cost is
31 not excluded under this paragraph if the dismantlement, removal, surrender, or

1 abandonment for which the cost is incurred is undertaken for the purpose of replacing,
2 renovating, or improving the facility, pipeline, well pad, platform, or other structure;
3 for the purposes of this paragraph, "barrel of oil equivalent" means

4 (A) in the case of oil, one barrel;

5 (B) in the case of gas, 6,000 cubic feet;

6 (16) costs incurred for containment, control, cleanup, or removal in
7 connection with any unpermitted release of oil or a hazardous substance and any
8 liability for damages imposed on the producer or explorer for that unpermitted release;
9 this paragraph does not apply to the cost of developing and maintaining an oil
10 discharge prevention and contingency plan under AS 46.04.030;

11 (17) costs incurred to satisfy a work commitment under an exploration
12 license under AS 38.05.132;

13 (18) that portion of expenditures, that would otherwise be qualified
14 capital expenditures as defined in AS 43.55.023(k), incurred during a calendar year
15 that are less than the product of \$0.30 multiplied by the total taxable production from
16 each lease or property, in BTU equivalent barrels, during that calendar year, except
17 that, when a portion of a calendar year is subject to this provision, the expenditures
18 and volumes shall be prorated within that calendar year;

19 (19) costs or that portion of the costs determined by the
20 commissioner, in consultation with the commissioner of environmental
21 conservation, the commissioner of natural resources, and the Alaska Oil and Gas
22 Conservation Commission and taking into consideration the standard practices
23 of the industry, to be

24 (A) related to the repair and replacement of property or
25 equipment that was not maintained or was improperly maintained;

26 (B) incurred to maintain the operational capability of
27 facilities or equipment shut down because of a lack of or improper
28 maintenance of property or equipment; or

29 (C) incremental operating expenses incurred as a result of
30 operating facilities or equipment at diminished capacity when that
31 diminished capacity is caused by the lack of or improper maintenance of

1 property or equipment.

2 * **Sec. 2.** The uncoded law of the State of Alaska is amended by adding a new section to
3 read:

4 APPLICABILITY. Section 1 of this Act applies to oil and gas produced after
5 March 31, 2006.

6 * **Sec. 3.** The uncoded law of the State of Alaska is amended by adding a new section to
7 read:

8 TRANSITIONAL PROVISIONS. (a) A person that filed a statement under
9 AS 43.55.030 before the effective date of this Act and deducted lease expenditures that may
10 not be deducted under AS 43.55.165(e), as amended by sec. 1 of this Act, shall file an
11 amended return and pay any additional tax within 90 days after the effective date of this Act.

12 (b) A person required to make an installment payment of estimated tax under
13 AS 43.55.020(a) for a period not included in a return required to be filed before the effective
14 date of this Act shall determine the amount of the underpayment, if any, that is attributable to
15 lease expenditures that may not be deducted under AS 43.55.165(e) as amended by sec. 1 of
16 this Act. The amount of any underpayment determined under this subsection shall be paid
17 within 90 days after the effective date of this Act.

18 * **Sec. 4.** The uncoded law of the State of Alaska is amended by adding a new section to
19 read:

20 RETROACTIVITY. Section 1 of this Act is retroactive to April 1, 2006.

21 * **Sec. 5.** This Act takes effect immediately under AS 01.10.070(c).

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: HB128-DOA-AOGCC 2-28-07
 Bill Version: HB128
 () Publish Date: _____

Revision Date/Time (Note if correction): _____

Dept. Affected: Administration

Title: Oil and Gas Production Tax

RDU: AOGCC

Component: AOGCC

Sponsor: Representatives Olson, Harris, Ramras, et. Al.

Requester: House Oil and Gas

Component No. 2010

Expenditures/Revenues

(Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services	0.0	0.0	0.0	0.0	0.0	0.0
Travel	0.0	0.0	0.0	0.0	0.0	0.0
Contractual	250.0	250.0	250.0	250.0	250.0	250.0
Supplies	0.0	0.0	0.0	0.0	0.0	0.0
Equipment	0.0	0.0	0.0	0.0	0.0	0.0
Land & Structures	0.0	0.0	0.0	0.0	0.0	0.0
Grants & Claims	0.0	0.0	0.0	0.0	0.0	0.0
Miscellaneous	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	250.0	250.0	250.0	250.0	250.0	250.0

CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
-----------------------------	-----	-----	-----	-----	-----	-----

CHANGE IN REVENUES ()	0.0	0.0	0.0	0.0	0.0	0.0
-------------------------------	-----	-----	-----	-----	-----	-----

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts	0.0	0.0	0.0	0.0	0.0	0.0
1003 GF Match	0.0	0.0	0.0	0.0	0.0	0.0
1004 GF	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts	0.0	0.0	0.0	0.0	0.0	0.0
1037 GF/Mental Health	0.0	0.0	0.0	0.0	0.0	0.0
1162 AOGCC Receipts	250.0	250.0	250.0	250.0	250.0	250.0
TOTAL	250.0	250.0	250.0	250.0	250.0	250.0

Estimate of any current year (FY2007) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal: ☐

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

If HB128 is passed the AOGCC in conjunction with other State agencies would be charged with determining whether the lease expenditures incurred for repair, replacement, or incremental operating expenses were as a result of a lack of or improper maintenance of property or equipment. The Commission would also need authority under AS 31.05.030 to implement these need responsibilities.

1 contract Engineering Investigator for 2/3 of year, which equals \$250,000 a year.

Prepared by: Jody J. Colombie, Special Assistant I
 Division: Alaska Oil and Gas Conservation Commission
 Approved by: Rachael Petro, Deputy Commissioner
 Agency: Department of Administration

Phone 465-2200
 Date/Time 2/28/07 9:39 AM
 Date 2/28/07 10:00 AM

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: HB 128-DEC-SPAR 2/20/07
 Bill Version: HB 128
 () Publish Date: _____

Revision Date/Time (Note if correction): _____

Dept. Affected: Dept of Environmental Conservation

Title OIL & GAS PRODUCTION TAX EXPENDITURES

RDU Spill Prevention and Response

Component Director's Office

Sponsor Olson et al

Requester House Special Committee on Oil and Gas

Component No. 1392

Expenditures/Revenues

(Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES

CHANGE IN REVENUES ()

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2006) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal: ☐

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

No additional costs are expected with this legislation.

Prepared by: Larry Dietrick
 Division: Spill Prevention and Response

Phone 465-5250
 Date/Time 2/20/07 4:00 PM

Approved by: Larry Hartig
 Agency: Department of Environmental Conservation

Date 2/20/2007

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: HB128-DC-R-TAX-2-22-07

Bill Version: HB 128

() Publish Date:

Revision Date/Time (Note if correction):

Title Oil & Gas Production Tax: Expenditures

Dept. Affected: Revenue 04

RDU Taxation and Treasury

Component Tax Division

Sponsor Representative Olson

Requester (H) Oil and Gas

Component No. 2476

Expenditures/Revenues

(Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services						
Travel						
Contractual	124.9	124.9	124.9	124.9	124.9	124.9
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	124.9	124.9	124.9	124.9	124.9	124.9

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()	*	*	*	*	*	*
-------------------------------	---	---	---	---	---	---

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	124.9	124.9	124.9	124.9	124.9	124.9
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	124.9	124.9	124.9	124.9	124.9	124.9

Estimate of any current year (FY2007) cost: 31.2

Check this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

*This bill would add certain costs relating to improperly maintained property or equipment to the list of costs that do not qualify as lease expenditures under AS 43.55.165, the petroleum profits production tax system. Under the bill, the commissioner of revenue, in consultation with the commissioner of environmental conservation and the chair of the Alaska Oil and Gas Conservation Commission, would determine whether costs are specifically disallowed under this provision. The provision would disallow any costs incurred to (1) repair or replace improperly maintained property or equipment; and/or (2) maintain the operational capability of facilities or equipment that are either shut down or are diminished in capacity. The bill effective date is retroactive to April 1, 2006 - the effective date of the petroleum profits tax (PPT).

Prepared by: Jon Iversen and Cherie Nienhuis

Division: Tax

Approved by: Jerry Burnett

Agency: Department of Revenue

Phone: 269-1033

Date/Time: 2/22/07 11:00 AM

Date: 2/22/2007

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

BILL NO. HB 128

ANALYSIS CONTINUATION

The impact this bill would have on petroleum tax revenues is indeterminate. Costs identified as disallowed under this bill could be categorized as either operating costs or capital costs. The PPT authorizes eligible operating costs to be deducted from the petroleum profits tax at a rate of 22.5%; the PPT authorizes capital costs to be both deducted at a rate of 22.5% and credited at a rate of 20%, for a combined production tax savings of 42.5%. Any set of disallowed costs is likely to be split between these two categories in a way that is distinct from that of another set of costs.

Administering this legislation would require one full-time equivalent (FTE) with expertise in oil and gas industry practices on the level of a petroleum engineer. The department currently contracts with a petroleum engineer for five years at a cost of \$624,650, or \$124,930 per year, for technical support related to petroleum production. It is anticipated that the department would be required to carry a second contract of this magnitude or greater in order to fulfill the requirements of this legislation.

Black's Law Dictionary (8th ed. 2004),

NEGLIGENCE

negligence, n. 1. The failure to exercise the standard of care that a reasonably prudent person would have exercised in a similar situation; any conduct that falls below the legal standard established to protect others against unreasonable risk of harm, except for conduct that is intentionally, wantonly, or willfully disregarding of others' rights. • The term denotes culpable carelessness.

"*Gross Negligence.* As it originally appeared, this was very great **negligence**, or the want of even slight or scant care. It has been described as a failure to exercise even that care which a careless person would use. ~~Several courts, however, dissatisfied with a term so nebulous ... have construed~~ **gross negligence as requiring willful, wanton, or reckless misconduct, or such utter lack of all care as will be evidence thereof** But it is still true that most courts consider that 'gross negligence' falls short of a reckless disregard of the consequences, and differs from ordinary negligence only in degree, and not in kind."

IMPROPER

improper, adj. 1. Incorrect; unsuitable or irregular. 2. Fraudulent or otherwise wrongful.

MAINTENANCE

maintenance, n. 1. ~~The continuation of something, such as a lawsuit.~~ 2. ~~The continuing possession of something, such as property.~~ 3. ~~The assertion of a position or opinion; the act of upholding a position in argument.~~ 4. **The care and work put into property to keep it operating and productive; general repair and upkeep.** 5. ~~Financial support given by one person to another, usu. paid as a result of a legal separation or divorce; esp., ALIMONY. • Maintenance may end after a specified time or upon the death, cohabitation, or remarriage of the receiving party.~~

RES IPSA LOQUITUR

res ipsa loquitur (rays ip-s<<schwa>> loh-kw<<schwa>>-t<<schwa>>r). [Latin "the thing speaks for itself"] *Torts.* The doctrine providing that, in some circumstances, the mere fact of an accident's occurrence raises an inference of negligence so as to establish a prima facie case. -- Often shortened to *res ipsa*. [Cases: Negligence c=1610. C.J.S. Negligence §§ 744-748, 754-756.]

"The phrase 'res ipsa loquitur' is a symbol for the rule that the fact of the occurrence of an injury, taken with the surrounding circumstances, may permit an inference or raise a presumption of negligence, or make out a plaintiff's prima facie case, and present a question of fact for defendant to meet with an explanation. It is merely a short way of saying that the circumstances attendant on the accident are of such a nature as to justify a jury, in light of common sense and past experience, in inferring that the accident was probably the result of the defendant's negligence, in

the absence of explanation or other evidence which the jury believes." Stuart M. Speiser, *The Negligence Case: Res Ipsa Loquitur* § 1:2, at 5-6 (1972).

"Res ipsa loquitur is an appropriate form of circumstantial evidence enabling the plaintiff in particular cases to establish the defendant's likely negligence. Hence the res ipsa loquitur doctrine, properly applied, does not entail any covert form of strict liability.... The doctrine implies that the court does not know, and cannot find out, what actually happened in the individual case. Instead, the finding of likely negligence is derived from knowledge of the causes of the type or category of accidents involved." *Restatement (Third) of Torts* § 17 cmt. a (Tentative Draft No. 1, 2001).



Representative Scott Jiu Wo Kawasaki

Alaska State Legislature

District 9 Fairbanks

MEMORANDUM

TO:

Department of Law
Department of Revenue: Tax Division
Alaska Oil and Gas Conservation Commission

FROM:

Representative Scott Kawasaki

DATE:

February 27, 2007

RE:

Questions about the proposed CS for HB 128

I have some questions about how the administration will interpret language in the proposed CS for HB 128 (25-LS0561\M). Although I will not be able to attend the committee meeting on Thursday, March 1, I hope the answers will be helpful to the other committee members.

1. How are "standard practices of the industry" determined? Is this used anywhere else in law?
2. If a company behaved differently in Alaska compared to everywhere else in the world because of Alaska's tax structure, would these altered behaviors be considered standard practices of the industry?
3. Could BP claim their handling of the OTLs to be a standard practice of the industry because it maximized their tax advantages under PPT?
4. Are there any conceivable situations where it could be a standard practice of the industry to not maintain or improperly maintain a piece of equipment? If so, would related expenses be deductible?
5. Is it possible for an operator to know if expenses will be deductible under PPT prior to making the expenditure?
6. Is it possible for an operator to know if their maintenance practices are adequate to qualify potential future expenses for deduction under PPT?
7. Can political changes affect how the proposed maintenance standard will be applied? Can they do so for maintenance performed before potential political changes?

Copy: Representative Olson
Senator Wagoner
Members of the House Special Committee on Oil and Gas

In Juneau • State Capitol Juneau, Alaska 99801

In Fairbanks • 1292 Sadler Way Fairbanks, Alaska 99701

Juneau • (907) 465-3466 • Fax (907) 465-2937 • Fairbanks • (907) 456-7423 • Fax (907) 451-9293

Email: Representative_Scott_Kawasaki@legis.state.ak.us

Disallowing "deemed capital maintenance" costs

August 8, 2006

Pedro van Meurs

The shut down of Prudhoe Bay has brought in sharp focus that some of the facilities on the North Slope may be in poor shape.

The repair of such facilities could involve billions of dollars over the next two decades.

This raises firstly a fairness issue. Should companies receive a tax deduction and tax credit together for 40% of the value (under the 20/20 system) for replacing a pipeline that was defective and not properly maintained (as BP admitted during their short presentation to the Senate Committee). The pipeline replacement may also be subject to the "2 for 1" formula which would raise the contribution of Alaska to 50%.

However, at the same time this raises a broader issue. It is likely that over time more defective equipment will be identified that needs repair or replacement. The Prudhoe Bay oil field is now 30 years old and the continued operation for the next 30 years may pose a variety of problems.

In cost control there has always been a rather important "grey area" between "repair" and "betterment or replacement".

Under accounting rules if expenditures are made to replace an asset or improve the asset in a manner that provides it with a longer technical asset life, these costs are typically considered "capital" expenditures, if an asset is merely repaired it is an "operating" expenditure. For auditors it is often difficult to determine the difference.

Under the PPT the capital expenditures can be deducted and also receive a tax credit of 20%. Operating costs can only be deducted. It is therefore logical for companies to try to consider repairs as much as possible as capital expenditures by arguing that they created a "betterment" of the equipment. Or they may decide to simply replace the asset even if it can be repaired because of the tax deductions and credits. This could be an area of misuse under the PPT. A significant percentage of the operating costs could slip into the capital costs to the detriment of the State.

For all these reasons one could simply disallow a small part of the total capital expenditures as "lease expenditures". In this case they cannot be deducted or used for tax credits.

My suggestion is to disallow the first \$ 0.30 per BTU equivalent barrel as "lease expenditures".

A section could be added to AS 43.55.165 (e) of the bill as follows under non deductible lease expenditures (*non legal language*):

- (20) deemed capital maintenance expenditures which shall be capital expenditures equal to US \$ 0.30 per BTU equivalent barrel taxable production.

The US \$ 0.30 per BTU equivalent barrel is based on reasonable capital maintenance costs of fields for which I have (confidential) information. Based on a production of 900,000 barrel equivalent per day, this means that about \$ 100 million in capital expenditures per year will not be deductible for PPT purposes. Based on a PPT rate of 20% and a tax credit rate of 20% this means that the companies will pay \$ 40 million more tax per year.

I believe that this would provide a good answer to possible public criticism that under the PPT we would provide 50% of the replacement costs of pipelines as a result of the Prudhoe Bay shut down. I believe this would be popular with the Senate and the House. This could enhance the probability that the PPT would pass.

adn.com

Anchorage Daily News

Print Page

Close Window

BP warns against more tax**LEGISLATURE: An amendment would ban certain deductions.**

By SABRA AYRES

Anchorage Daily News

(Published: March 1, 2007)

JUNEAU -- A BP representative told lawmakers Wednesday that adopting proposed changes to the state oil and gas tax to disallow energy companies from deducting expenses incurred from improper facility maintenance would result in fewer investment dollars for Alaska's energy industry.

The state's Petroleum Production Tax, which lawmakers passed last year, already taxes energy companies at a rate that is too high, said Tom Williams, a senior tax consultant for BP. The proposed amendment on repair costs as a result of improper maintenance is unclear and could hurt the state's future energy industry, he said.

"The PPT is suboptimal for the state because the rate is too high," Williams told the Senate Resources committee. He added that the PPT as written already addresses repair costs. Passing the amendment would mean the state would be "double-dipping" into existing provisions, he said.

The bill was introduced by Sen. Tom Wagoner, R-Kenai, and signed on by 17 other sponsors from both sides of the aisle. A similar House bill has an equally high number of bipartisan sponsors.

The measure was sparked by pipeline leaks last year that resulted in the largest oil spill ever on the North Slope and a decrease in production as Prudhoe Bay pipelines were shut down for repair.

BP, which runs Prudhoe on behalf of itself and other major owners, including Exxon Mobil and BP, is under investigation by federal authorities and has been criticized by members of Congress and federal pipeline regulators for lax pipeline maintenance.

Last month, BP told the Legislature it planned to deduct the cost of the repairs, a move that would save the oil producer as much as \$11 million on its tax bill.

Lawmakers argue that the pipeline corrosion that caused the oil spill was a result of years of neglect and the state shouldn't have to pay for the repair costs. Sponsors of the bill said they had hoped to protect the state from the high costs of improper maintenance practices.

But despite the bipartisan popularity of the bill, it has run into several roadblocks, and now more questions are being raised about how to get a passable version of the bill written.

Energy producer groups argue that the bill's terminology is problematic, particularly in how to define "improper maintenance."

While gross negligence is clearly defined, no such standard exists in the bill for what constitutes improper maintenance, said Jason Brune, executive director of the Resource Development Council for Alaska, a nonprofit organization representing energy producers and resource businesses.

"The predictability just isn't there with this bill," Brune said.

Representatives from the Department of Natural Resources' Division of Oil and Gas said they supported the idea behind the bill but also had concerns with the difficulties in defining improper maintenance.

The state should look to Outside certification agencies, like the American Petroleum Institute, for ways to create standards when defining what is gross and improper maintenance, said the chairman of the Alaska Oil and Gas Conservation Commission, John Norman.

Sen. Lesil McGuire, R-Anchorage, a sponsor of the bill and a member of the committee, agreed. McGuire said the legislation wouldn't do the job "unless we put out what our rules and standards are."

The bill also calls into question whether and how far back the proposed legislation could retroactively apply. While many sponsors have said they hoped passing the bill would block BP from deducting repair costs incurred after last year's oil spill, some feared the legislation could tie the state up in future legal battles.

In a letter to Wagoner, the legislative counsel said the bill's language would allow the legislation to work retroactively to April 1, 2006, the date the PPT took effect.

But according to testimony from Robert Mintz, a consultant for the Department of Revenue, cases involving retroactive changes to existing state tax laws "have seen an uphill battle" in the courtroom.

"The Legislature should be cautious when changing laws targeted at a particular entity or event," Mintz said.

Both House and Senate versions of the bill failed to move out of committee, but were rescheduled.

Wagoner, the main sponsor of the legislation, expressed frustration Wednesday at the bill's lack of progress.

"It seems that we are being dragged back into the PPT debate, which never had any discussion on the maintenance issue," he said.

Daily News reporter Sabra Ayres can be reached at sayres@adn.com or 907-586-1531.

Print Page

Close Window

Copyright © 2007 The Anchorage Daily News (www.adn.com)



THE ALLIANCE

...for responsible development of Alaska's Oil, Gas & Mineral Resources

360 West Benson Blvd., Suite 200 * Anchorage, AK 99503 * Phone (907) 563-2226 * Fax (907) 561-8870

Feb. 26, 2007

The Honorable Vic Kohring
Chairman, House Oil & Gas Committee
Alaska State Legislature
State Capitol (MS 3101)
Juneau, Alaska 99801-1182

Dear Senator Huggins,

The Alaska Support Industry Alliance, a trade association whose 400 members provide goods and services to Alaska's oil, gas and mining industries and more than 30,000 jobs for Alaskans, would like to express our opposition to House Bill 128. We believe the bill is unnecessary, unfair and premature. It will accomplish little but to spawn disputes and uncertainty, and it will be a further disincentive to the long-term oil and gas investment that's the lifeblood of Alaska's economy. We urge you not to pass it out of the House Oil & Gas Committee.

The bill is unnecessary. Current legislation already denies tax credits for lease expenditures resulting from fraud, willful misconduct or gross negligence, and disallows costs related to spills.

The bill is unfair, and would result in double taxation. The flat 30-cent-per-barrel tax credit exclusion in the new Petroleum Production Tax (PPT) explicitly was intended to cover all maintenance expenditures - those resulting from "proper" and "improper" maintenance. HB 128's additional exclusion for costs incurred due to "improper maintenance" constitutes double taxation. Producers across the board are denied deductions for maintenance costs under the umbrella of the 30-cent-per-barrel provision of the PPT, then would be denied additional tax credits on a case-by-case basis for some of the same maintenance expenditures under HB 128.

The bill is a petri dish for tax disputes. Terms in HB 128 such as "improper" maintenance and "diminished" capacity are vague and undefined, leaving interpretation in the hands of several commissioners, headed by the commissioner of Revenue. By contrast, the 30-cent provision offers clarity and certainty. We may not like it, but at least everyone understands the rules.

Alliance opposition to HB 128
Page 2

The bill is premature. It's been less than 6 months since the legislature retroactively imposed the largest tax increase in Alaska's history on North Slope producers, roughly tripling severance taxes. Regulations for the new PPT haven't even been drafted yet, and HB 128 proponents already want to change it. The Alliance believes additional changes at this time will further undermine Alaska's reputation as a stable and predictable place to invest, resulting in fewer jobs and business opportunities for Alaskans.

HB 128 may seem like prudent politics to some, but it's poor public policy. The Alliance opposes this proposed legislation and urges you not to move it out of the House Oil & Gas Committee. Thank you for your consideration.

Sincerely,

Signed

Paul Laird
General Manager



Doug Suttles

President

February 15, 2007



BP Exploration (Alaska) Inc.
P.O. Box 196612
900 E. Benson Boulevard
Anchorage, Alaska 99519-6612

Honorable Members
Alaska State Legislature
State Capitol
Juneau, AK 99801

Dear Ladies and Gentlemen:

A number of questions have been raised about BP's intent to deduct certain costs related to the Prudhoe Bay field shutdown last August. I am writing to confirm our position on this issue and at the same time reiterate BP's commitment to and plans for our business in Alaska.

Direct: 907 564 5422
Main: 907 561 5111
Fax: 907 564 5900
doug.suttles@bp.com

With respect to the deductibility of costs, we can only speak for BP. Taxes are paid on a company wide basis rather than a field specific basis and BP cannot speak for the other Prudhoe Bay owners on tax issues.

BP follows the law when it files its taxes. Accordingly, BP will assume the appropriate deductions & credits for the costs associated with the repair and replacement of the Prudhoe Bay Oil Transit Lines (OTLs). Specifically, BP will deduct appropriate costs associated with repair of the OTLs and will seek authorized credits for capital costs to replace them. Similarly in compliance with the PPT Laws, we will not seek to deduct costs associated with cleaning up the oil spills.

To put this issue into context, I would like to openly share our estimated 2006 production taxes.* For the final nine months of 2006, the period over which PPT was applicable, we estimate that BP's production taxes will almost triple from \$180 million under the old ELF-based tax to more than \$500 million under PPT. Over the same period, BP's share of the deductions and credits associated with the costs of inspection, business resumption, and replacement of the OTLs will result in a total deduction of around \$11 million in 2006, which we have included in our 2006 production tax estimate.

We believe our approach is appropriate for the following reasons:

- 1) It is important to realize that the OTLs are some 30 years old and were sized for significantly higher production than we will have in the future. The OTLs would have been replaced in the normal course of business, even if the events of last year had not taken place.
- 2) We are in the process of building a new state of the art pipeline system for the future life of Prudhoe Bay. This is not a like-for-like replacement. Rather, we are investing in a brand new system, with pipe diameter sizes very different than the original design to reflect the reduced production from these maturing oilfields. The new system will have new chemical injection systems, upgraded pig launchers/receivers, upgraded leak detection system, and a Fusion Bond Epoxy external coating for longer life. The system will be in operation for decades to come. We believe this investment is in the best interests of the State of Alaska and the North Slope producers.

We appreciate the opportunity yesterday to discuss our Alaska business with the Senate Resources Committee and update them on the commitments we made in August 2006.

BP LETTER

February 15, 2007

Page 2 of 2

BP remains fully committed to the ongoing integrity of its facilities. As we embark on a vision of our next 50 years in Alaska, we will continue to make significant investment in facility renewal. This is not about replacement. It is about designing and constructing new facilities in a way that underpins the future and ensures the operability of the North Slope for decades to come.

With respect to PPT, last year the Legislature held long and difficult debates that ultimately led to the passage of PPT. The regulations are still being formalized as this legislation has not been in place for very long. We are only just preparing to submit our first tax returns under this new system. As a result, we believe it is premature to consider changes to the structure or intent of the current legislation. We believe it would be prudent for all parties, including producers and the State, to wait until PPT is fully implemented and we have real experience of its operation and impact before making any changes.

I hope I have provided you with the clarity of BP's intentions that many of you have been seeking and the reasoning behind the decisions we have made.

I look forward to working with the legislature as we progress our vision for our business in Alaska, including the commercialization of Alaska Gas, and as we bring our vision of a 50-year future to reality.

Sincerely,

A handwritten signature in black ink, appearing to read "Doug Suttles", with a stylized flourish at the end.

Doug Suttles

* Please note that, in disclosing in this letter certain specific tax information and BP's tax positions regarding PPT, BP does not intend to waive the confidentiality of any of its tax materials and information under applicable law (including AS 43.05.230), other than the particular information disclosed.

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL & GAS

SARAH PALIN, GOVERNOR

550 WEST 7TH AVENUE, SUITE 800
ANCHORAGE, ALASKA 99501-3880
PHONE: (907) 269-0800
FAX: (907) 269-8838

The Honorable Tom Wagoner
Alaska State Legislature
State Capitol
Juneau, Alaska 99801-1182

Dear Senator Wagoner,

This is in response to your letter to Tom Irwin dated February 12, 2007. Thank you for the opportunity to review SB 80 regarding certain credits and deductions against the Petroleum Production Tax. I would like to offer a few comments and suggestions regarding the bill. Some of these issues have been discussed with the State Pipeline Coordinator's Office, the Alaska Oil and Gas Conservation Commission (AOGCC), and the Department of Environmental Conservation (DEC).

I agree that the commissioner of Natural Resources should be one of the commissioners with whom the Department of Revenue (DOR) consults on certain costs related to improperly maintained property or equipment. The Department of Natural Resources (DNR), in representing the state as the landowner, is preparing to closely review the issue of system integrity and take necessary action as part of the function of the Petroleum System Integrity Office (PSIO). As the coordinating agency of the DNR, the PSIO will have the leading role coordinating system integrity issues with other agencies such as the DEC and AOGCC.

Second, I would point out that it may be difficult for the agencies to rely on "standard practices of the industry." Although "standard industry practices" is a commonly used term, it is not a term of art. You could attempt to define and reference standards, such as ISO standards and guidelines, set by various associations such as API and ASME. However, standards for corrosion control and monitoring are not well established. There are no standards that the Division of Oil and Gas is aware of that would provide a measure from which to base a decision for corrosion and maintenance of facilities and equipment.

As an alternative, the Division of Oil and Gas is recommending language be included that defines the standard as "considering practices undertaken by a reasonable and prudent operator under the same or similar circumstances."

It may also be difficult for agencies to define or establish "improper maintenance" or "improperly maintained" in order to use it as a standard for costs. The Division of Oil and Gas suggests that you consider wording such as "improper maintenance as indicated by an unanticipated failure." Alternatively, you might consider "proper maintenance" defined as the replacement of equipment based on a regular or routine surveillance of the property, equipment, or facilities.

"Develop, Conserve, and Enhance Natural Resources for Present and Future Alaskans."

DNR LETTER COMP. BILL

Division of Oil & Gas

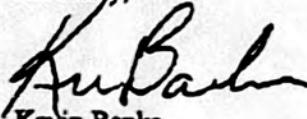
2/15/07

Page 2 of 2

Finally, I would suggest that DOR be required to provide its consulting agencies with specific data and records relevant to the repair, replacement, and maintenance of the property, equipment, or facility for which lease expenditures are being claimed under AS 43.55.165. Of course, the taxpayer confidentiality provisions in AS 43.05.230 would apply to this information.

DNR is continuing to study the bill and may have additional suggestions for you. Again, I appreciate the opportunity to offer comments and to work with you.

Sincerely,



Kevin Banks
Acting Director

cc: Tom Irwin, Commissioner, DNR
Jonne Slemons, Acting Coordinator PSIO
Marie Croasley, DO&G

STATE OF ALASKA

ALASKA OIL AND GAS CONSERVATION COMMISSION

SARAH PALIN, GOVERNOR

333 W. 7TH AVENUE, SUITE 100
ANCHORAGE, ALASKA 99501-3539
PHONE (907) 278-1433
FAX (907) 278-7542

February 16, 2007

The Honorable Thomas H. Wagoner
Alaska State Legislature
State Capitol, #427
Juneau, AK 99801

Re: SB 80

Dear Senator Wagoner,

This is in response to your February 12 letter requesting comments regarding the referenced legislation.

As an independent regulatory agency, the Alaska Oil and Gas Conservation Commission (AOGCC), does not have a position either in favor of or against this bill. We do however, understand, and agree with the premise that an operator should not be allowed to shift costs resulting from substandard maintenance practices to the State through tax deductions for lease expenditures.

Our main concern with the bill is the absence of a precise definition of improper maintenance. The bill proposes relying on standard practices of the industry to gauge whether there has been improper maintenance; but often there are no established industry standards to rely upon. Even when standards have been established by the American Petroleum Institute (API) or similar professional organizations, they are normally only recommended practices. Also, such industry guidelines are subject to change, which raises a question about whether an operator should be held to the most recent standard or to the standard prevailing when the alleged improper maintenance decision was made.

In some instances it will be obvious that there has been improper maintenance. In other instances (particularly well systems and equipment) the AOGCC will be required to consider design, installation, operation, and maintenance (all are integral to a determination of impropriety); and, making some determinations will require detailed investigation (perhaps including testing- non-destructive, destructive, metallurgic, etc.) and application of expertise not readily available within this agency.

Another concern is the fact that much of the equipment and systems in an oilfield that are subject to maintenance (and thus failure due to improper/inadequate maintenance) are not regulated by either AOGCC or Department of Environmental Conservation. This raises questions about how to judge "improper maintenance" in the absence of regulatory authority and oversight responsibility for such systems and equipment.

AOGC LETTER COMP. BILL

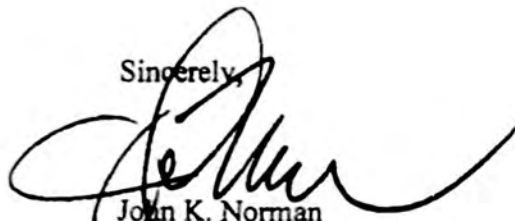
Finally, one can never lose sight of the fact that significant technological advances have occurred as a result of innovations which at the time were departures from standard industry practices. Also, engineers sometimes learn more through failure than from success. Often there is no indication something is being done improperly until a failure has occurred, but it is through analyzing the failure that the root cause can be determined and changes made going forward. This is simply the nature of engineering. In fact, there is a book entitled "To Engineer is Human: The Role of Failure in Successful Design" that describes and gives examples of this process.

Let me reiterate that we understand and agree with the intent of this legislation which is to prevent an operator from shifting financial responsibility to the State for costs resulting from the operator's improper maintenance practices. We do however, wish to point out some of the practical difficulties that may arise in determining whether maintenance has been improper.

One last point - we suggest deleting the words "the chair of" at line 22 on page 3. It is our supposition that the bill is worded this way to ensure prompt consultations on maintenance issues. We can assure you however that consultation with the commission (as opposed to just the chair) will not delay our response time should we be given this responsibility

Thank you for allowing us this opportunity to comment.

Sincerely,



John K. Norman
Chairman

cc: Pat Galvin, Commissioner
Department of Revenue

Larry Hartig, Commissioner
Department of Environmental Conservation

Tom Irwin, Commissioner
Department of Natural Resources

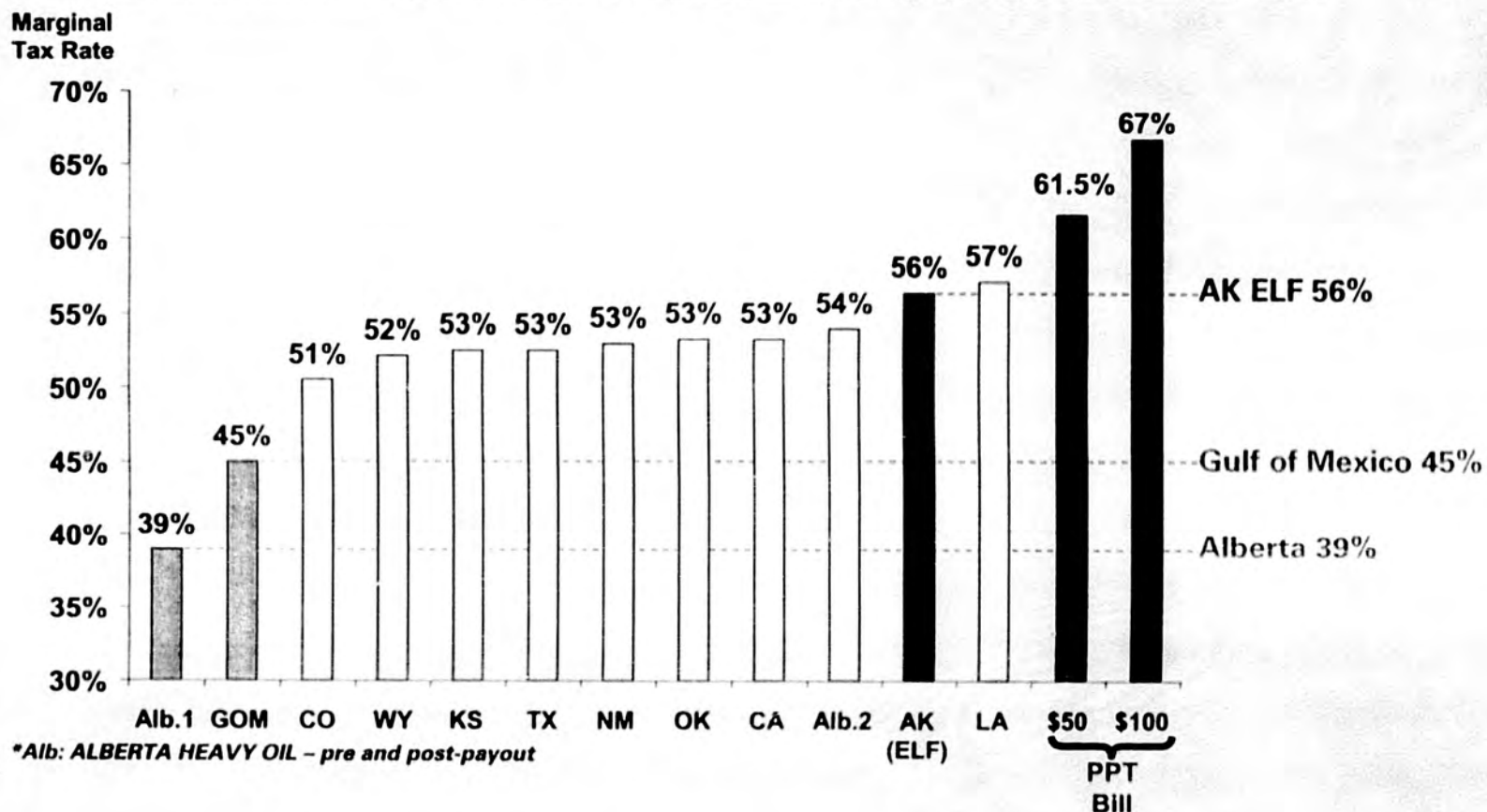
BP Presentation to the House Oil & Gas Committee

Juneau, February 22nd 2007



- PPT is working for the State of Alaska:
 - Pieces fit together and the taxpayers can comply
 - BP's 2006 production tax nearly tripled from ELF to PPT
- Will Alaska attract sufficient investment to stem production decline?
 - PPT has greater incentives for investment than the ELF
 - But we believe the rate is too high to be optimal for the State
- HB 128 would introduce unnecessary uncertainty
 - Potential ambiguity with existing provisions
 - Unnecessary: \$0.30/bbl exclusion addressed the same concern
- Five year period to review success of PPT (AS 43.55.180)

Alaska has adopted the highest marginal tax rate in the North America



Alberta & Gulf of Mexico are booming while Alaska production is declining

BP data

BP Presentation to the House Oil & Gas Committee

Juneau, February 22nd 2007



- PPT is working for the State of Alaska:
 - Pieces fit together and the taxpayers can comply
 - BP's 2006 production tax nearly tripled from ELF to PPT
- Will Alaska attract sufficient investment to stem production decline?
 - PPT has greater incentives for investment than the ELF
 - But we believe the rate is too high to be optimal for the State
- HB 128 would introduce unnecessary uncertainty
 - Potential ambiguity with existing provisions
 - Unnecessary: \$0.30/bbl exclusion addressed the same concern
- Five year period to review success of PPT (AS 43.55.180)

Marginal
Tax Rate

70%

65%

60%

55%

50%

45%

40%

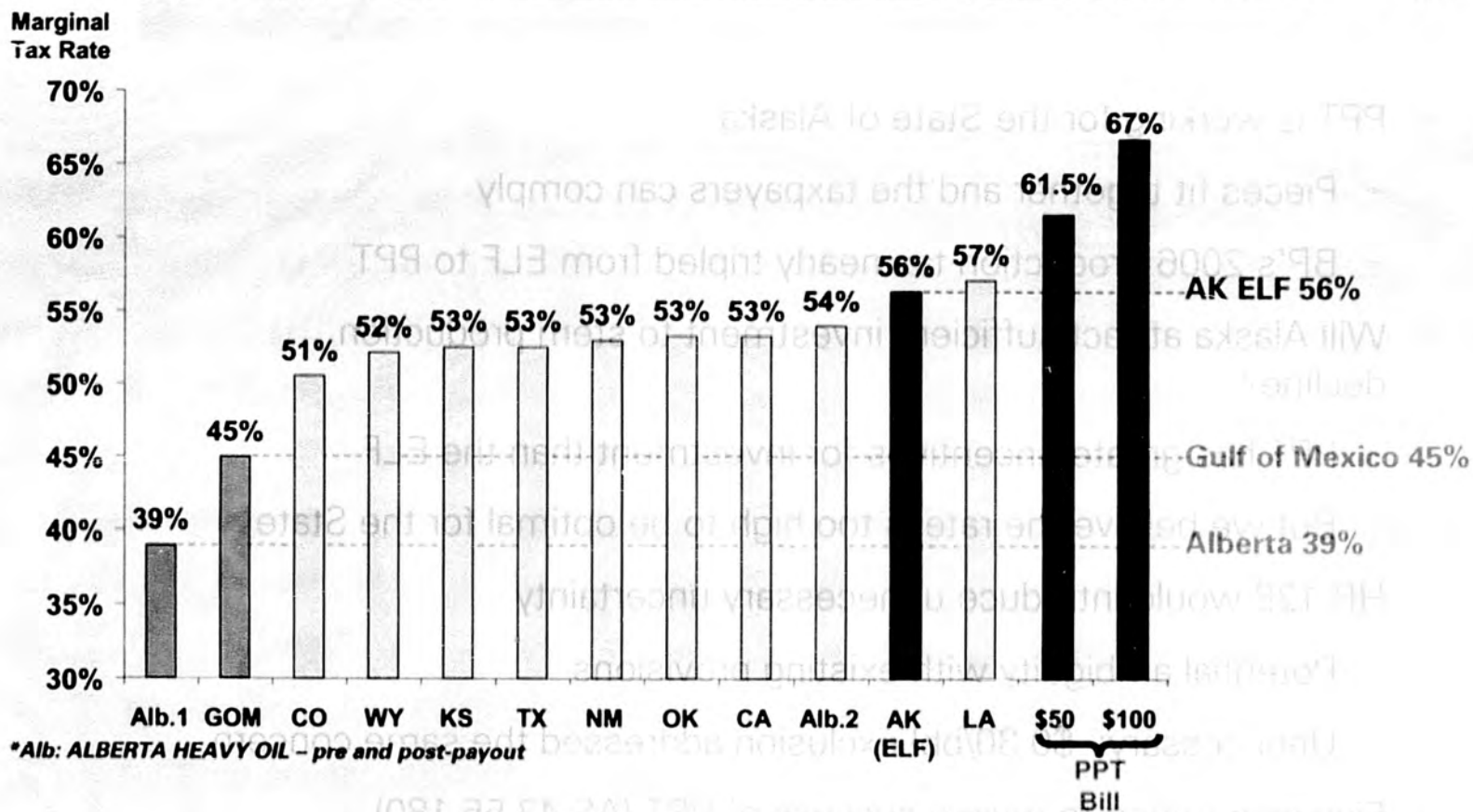
35%

30%

Alberta & Gulf of Mexico are booming while Alaska production is declining

BP data

Alaska has adopted the highest marginal tax rate in the North America



Alberta & Gulf of Mexico are booming while Alaska production is declining

BP data



March 2, 2007

BP Exploration (Alaska) Inc.
900 East Benson Boulevard
P.O. Box 186812
Anchorage, Alaska 99518-6812
(907) 561-5111

The Honorable Kurt Olson
State House of Representatives
Alaska State Capitol, Room 110
Juneau, AK 99801-1182

RE: Response to Prudhoe Bay Pigging Inquiry

Dear Representative Olson:

During Tom Williams' testimony to the House Oil and Gas Committee on behalf of BP Exploration (Alaska) Inc. ("BPXA") on Thursday February 22, 2007, you raised two questions for which Mr. Williams needed to obtain additional information before responding. Specifically, you asked whether BPXA had pigged the oil transit lines since the ARCO acquisition and when the lines had been pigged.

BPXA last ran an in-line inspection tool ("smart pig") in October 2006 in the Eastern Operating Area ("EOA") and in November 2006 in the Western Operating Area ("WOA"), in each case we completed two runs to collect the inspection data required. Prior to these runs in 2006, the last time BPXA ran a smart pig was in 1998. The 1998 smart and maintenance pig runs on the WOA oil transit lines revealed no significant corrosion and only modest solids returns. We also are aware that ARCO Alaska conducted a 1990 pig run in the EOA oil transit lines, while it had operational accountability for facilities on that side of the field. Another smart pig run had been scheduled for mid-2006. Unfortunately the WOA leak occurred before this took place.

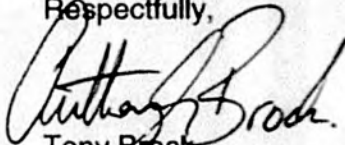
Since this past summer, BPXA has initiated a pigging schedule whereby cleaning (also called maintenance) pigs are run on a weekly basis. In addition to cleaning any solids and water residue that may have accumulated in the lines, pigging is one of a number of techniques used to control corrosion.

BPXA uses pigging, ultrasonic testing (UT), visual inspections, corrosion inhibitors and other techniques as appropriate for each individual oil field's and each line's characteristics and history. While corrosion in oil field production, processing and transmission facilities is a result of natural physical forces and cannot be completely prevented, BPXA's program was designed to control corrosion, extending the useful life of our North Slope infrastructure.

Since August, BPXA has made a number of changes in our operations. The most significant is a change to our organizational structure with the addition of a Technical Director. The Technical Director reports directly to the President of BPXA and provides independent assurance of our infrastructure integrity management.

I trust that this is responsive to your inquiry. If we can be of further assistance to your understanding of these matters, please don't hesitate to contact us.

Respectfully,

A handwritten signature in dark ink, appearing to read "Anthony Brock". The signature is fluid and cursive, with the first name "Anthony" written in a larger, more prominent script than the last name "Brock".

Tony Brock
Technical Director

cc Members House Special Committee on Oil and Gas