

12256 HOUSE RES

# REVISED FISCAL NOTE

**STATE OF ALASKA**  
**2007 LEGISLATIVE SESSION**

Fiscal Note Number: \_\_\_\_\_  
 Bill Version: HB128-DOA-AJGCC 3-9-07  
 () 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 2006	FY 2008	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	50.0	50.0	40.0	30.0	20.0	20.0
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
<b>TOTAL OPERATING</b>	<b>50.0</b>	<b>50.0</b>	<b>40.0</b>	<b>30.0</b>	<b>20.0</b>	<b>20.0</b>
<b>CAPITAL EXPENDITURES</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>CHANGE IN REVENUES ( )</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**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	50.0	50.0	40.0	30.0	20.0	20.0
<b>TOTAL</b>	<b>50.0</b>	<b>50.0</b>	<b>40.0</b>	<b>30.0</b>	<b>20.0</b>	<b>20.0</b>

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 HB 128 is passed the AOGCC in conjunction with other State agencies would be charged with determining whether a taxpayer followed standard industry practices for purposes of eligibility for deductions of costs related to the repair and replacement of improperly maintained property or equipment.

The estimate in this fiscal note is based upon our understanding that the work we may be called upon to perform will be within our traditional area of regulatory oversight (ie: downhole and at the wellhead); and, that the petroleum Systems Integrity Office (SIOC) will provide consultation and conduct investigations at the point where our jurisdiction ends.

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

Phone 793-1221  
 Date/Time 3/9/07 1:05 PM  
 Date 3/9/2007



Official Business

# ALASKA STATE LEGISLATURE

## SENATOR THOMAS H. WAGONER

- Member, Resources
- Member, Community & Regional Affairs
- Member, World Trade

Session: January – May

State Capitol, #423

Juneau, AK 99801

Phone: 907-465-2828 Fax: 907-465-4779

Interim: May – December

145 Main Street Loop; Suite 226

Kenai, AK 99611

Phone: 907-283-7996 Fax 907-283-8127

DATE: May 2, 2007

TO: House Resource Committee Members

FROM: Senator Tom Wagoner

RE: HB 128

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Attached is a Press Release from Chair John Dingell, Committee on Energy and Commerce, United States House of Representatives.

Also attached is a letter from Rep. Dingell and Rep. Stupak (Chairman of Subcommittee on Oversight and Investigations) to BP, dated May 2, 2007.

Finally, I have attached a letter from BP to Rep. Stupak and Rep Whitfield from BP, dated April 30, 2007.

I can not imagine that you would fail to support this legislation after you read these documents.

HENRY A. WAXMAN, CALIFORNIA  
EDWARD J. MARKEY, MASSACHUSETTS  
RICK BOUCHER, VIRGINIA  
EDOLPHUS TOWNS, NEW YORK  
FRANK PALLONE, JR., NEW JERSEY  
BART GORDON, TENNESSEE  
BOBZY L. RUSH, ILLINOIS  
ANNA G. ESHOO, CALIFORNIA  
BART STUPAK, MICHIGAN  
ELIOT L. ENGEL, NEW YORK  
ALBERT R. WYNN, MARYLAND  
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VICE CHAIRMAN  
LOIS CAPPS, CALIFORNIA  
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JOHN BARROW, GEORGIA  
BARON P. HILL, INDIANA

DENNIS B. FITZGIBBONS, CHIEF OF STAFF  
GREGG A. ROTHSCHILD, CHIEF COUNSEL

ONE HUNDRED TENTH CONGRESS

**U.S. House of Representatives**  
**Committee on Energy and Commerce**  
**Washington, DC 20515-6115**

JOHN D. DINGELL, MICHIGAN  
CHAIRMAN

JOE BARTON, TEXAS  
RANKING MEMBER  
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J. DENNIS HASTERT, ILLINOIS  
FRED LUPTON, MICHIGAN  
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ED WHITFIELD, KENTUCKY  
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JOHN SULLIVAN, OKLAHOMA  
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MICHAEL C. BURGESS, TEXAS  
MARSHA BLACKBURN, TENNESSEE

May 2, 2007

Mr. Robert A. Malone  
Chairman and President  
BP America, Inc.  
200 Westlake Park Blvd.  
Houston, TX 77079

Dear Mr. Malone:

We are in receipt of your April 30 letter (attached) requesting a postponement of the hearing scheduled for May 3, 2007, before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce entitled "2006 Prudhoe Bay Shutdown: Will Recent Regulatory Changes and BP Management Reforms Prevent Future Failures?" This hearing had been planned for some time as a follow up to our September 7, 2006, hearing. It was intended to assess the adequacy of efforts BP and various regulators have taken to address the organizational and mechanical failures leading to the March 2, 2006, leak in the "Western Operating Area" transit line and the subsequent discovery of severe corrosion and leaking in the "Eastern Operating Area" transit line.

Your request for a postponement of the hearing is based upon your recent discovery that "information relevant to the September, 2006 hearing was not provided to the Subcommittee." In addition, this information was apparently neither disclosed to you nor Steve Marshall, the former President of BP Alaska, before your testimony at our September hearings. The discovery of this material has clearly raised questions about the adequacy of your response to the Committee, as well as previous spending decisions made by your company—concerns that you clearly acknowledge in your April 30 letter and that form the basis for your request for additional time to investigate both issues in more detail.

Despite numerous requests for such material, going back nearly a year, it was only on April 17, 2007, that BP provided the Committee with a number of BP documents which reveal important internal discussions suggesting a severe cost-cutting atmosphere existed in your crude oil production operations at Prudhoe Bay. On their face, this new material raises concerns that shortsighted cost-cutting may have led to the spills and corrosion problems in Alaska. Some of

# CORRECTION

THE FOLLOWING DOCUMENT(S)  
HAVE BEEN REFILMED TO  
ASSURE LEGIBILITY OR PAGINATION



Rev. 6/98

Central Microfilm Services  
Department of Education & Early Development  
State of Alaska



Official Business

# ALASKA STATE LEGISLATURE

## SENATOR THOMAS H. WAGONER

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[Home Page](#) > [The Public Record](#) > [News Release](#)



## **NEWS RELEASE**

**Committee on Energy and Commerce**  
**Rep. John D. Dingell, Chairman**

**For Immediate Release: May 2, 2007**  
**Contact: Jodi Seth or Alec Gerlach / 202-225-5735**

### **BP Withheld Key Documents from Committee; Thursday Hearing Postponed to May 16**

The Subcommittee on Oversight and Investigations of the House Energy and Commerce Committee has rescheduled the hearing entitled **"2006 Prudhoe Bay Shutdown: Will Recent Regulatory Changes and BP Management Reforms Prevent Future Failures?"** The hearing will now be held on **Wednesday, May 16, 2007 at 9:30 a.m. in 2123 Rayburn House Office Building.**

The hearing, which was previously scheduled for May 3, was postponed after the Committee discovered BP had withheld key documents regarding cost-cutting measures on corrosion mitigation activities at the Prudhoe Bay field. BP requested additional time to prepare for the hearing, conduct research into these issues and provide additional materials. In August 2006, BP initiated a partial shutdown of Prudhoe Bay due to corrosion.

"We now know that BP proceeded with cost cutting measures that may have compromised pipeline safety while earning \$22 billion in profits, but what we don't know is why," said Rep. John D. Dingell (D-MI), Chairman of the Energy and Commerce Committee.

"These documents appear to show a severe cost cutting environment with respect to corrosion mitigation in the Prudhoe Bay field," added Rep. Bart Stupak (D-MI), Chairman of the Oversight and Investigations Subcommittee. "At the May 16th hearing we hope to ferret out whether cost cutting, as reflected in these documents, had any impact on the safe operations on that field."

Attached is a letter from BP Chairman and President Robert Malone to Chairmen Dingell and Stupak in addition to a response from the chairmen.

[Read the letter](#) 

- 30 -

Prepared by the Committee on Energy and Commerce  
2125 Rayburn House Office Building, Washington, DC 20515

HENRY A. WAXMAN, CALIFORNIA  
EDWARD J. MARKEY, MASSACHUSETTS  
RICK BOUCHER, VIRGINIA  
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ONE HUNDRED TENTH CONGRESS

**U.S. House of Representatives**  
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**Washington, DC 20515-6115**

JOHN D. DINGELL, MICHIGAN  
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JOHN BULLIVAN, OKLAHOMA  
TIM MURPHY, PENNSYLVANIA  
MICHAEL C. BURGESS, TEXAS  
MARSHA BLACKBURN, TENNESSEE

May 2, 2007

DENNIS B. FITZGIBBONS, CHIEF OF STAFF  
GREGG A. ROTHSCHILD, CHIEF COUNSEL

Mr. Robert A. Malone  
Chairman and President  
BP America, Inc.  
200 Westlake Park Blvd.  
Houston, TX 77079

Dear Mr. Malone:

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Your request for a postponement of the hearing is based upon your recent discovery that "information relevant to the September, 2006 hearing was not provided to the Subcommittee." In addition, this information was apparently neither disclosed to you nor Steve Marshall, the former President of BP Alaska, before your testimony at our September hearings. The discovery of this material has clearly raised questions about the adequacy of your response to the Committee, as well as previous spending decisions made by your company—concerns that you clearly acknowledge in your April 30 letter and that form the basis for your request for additional time to investigate both issues in more detail.

Despite numerous requests for such material, going back nearly a year, it was only on April 17, 2007, that BP provided the Committee with a number of BP documents which reveal important internal discussions suggesting a severe cost-cutting atmosphere existed in your crude oil production operations at Prudhoe Bay. On their face, this new material raises concerns that shortsighted cost-cutting may have led to the spills and corrosion problems in Alaska. Some of

Mr. Robert A. Malone  
Page 2

the documents discuss stopping the injection of corrosion inhibitor to meet budget targets. Others suggest that other activities related to corrosion mitigation had to be reduced or put on hold due to budget constraints.

Equally troubling, these documents raise questions about the accuracy of Mr. Marshall's testimony when he suggested that "cost is not a consideration" as it relates to issues of both safety and integrity in Prudhoe Bay operations.

It is our understanding that significant redesign and rebuilding has already occurred on some of the key transit lines that failed last year. It is also our understanding that BP has made a number of management and personnel changes in Alaska, and that these efforts appear to be taking the company in a positive direction. We applaud your company for those undertakings. Nevertheless, to assess whether BP's new path forward will be successful, the Committee needs to explore whether the climate of top down cost-cutting affected the health, safety, or the environment of the Prudhoe Bay field and its workers. In order to make such a determination, we need you to respond to the questions raised by the newly discovered documents, as well as all previous requests for information made by this Committee.

As you know, in response to our receipt of the newly discovered documents, we forwarded to you another document request on April 30, 2007, which included: (1) documents that discuss whether BP managers ordered that corrosion inhibitor be turned off due to budgetary constraints; (2) answers to the question of if, when, and where corrosion inhibitor may have been turned off, and what consequences this may have had on program integrity; (3) records related to requests for smart pigging and maintenance pigging from officials in the Prudhoe Bay's Corrosion, Inspection, and Chemicals (CIC) Group from 2000-2005; and (4) e-mails sent or received by the CIC group related to reducing, suspending, or cutting back on corrosion inhibitor.

We are pleased that BP has promised to respond quickly to this request and accept BP's explanation that it needs "additional time to complete investigations and document searches, and to ensure the Subcommittee has all of the information it needs to complete its work."

Based upon your assurances that you need additional time to comply with our document requests and to be prepared to respond to the issues raised by the newly discovered internal BP documents, we have acquiesced to your request for a continuance and have rescheduled the hearing for 9:30 a.m. on Wednesday, May 16, 2007. At that hearing, we expect you and other BP officials to be prepared to address the following issues:

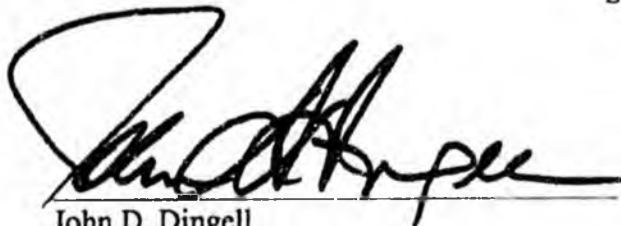
- BP's plan to rebuild and sustain the integrity of the oil pipeline system, including the Eastern Operating Area and Western Operating Area transit lines that failed and caused last year's shutdown. How is this effort progressing and what are the expected milestones for completion?

Mr. Robert A. Malone  
Page 3

- Whether BP believes the environment of cost-cutting as apparently reflected in some of these documents affected the ability of workers to safely operate the Prudhoe Bay field and, in particular, ensure adequate corrosion control. To the extent BP believes these documents do suggest a climate where workers had to make difficult decisions between budget savings and program integrity, what steps does the company intend to take to prevent the reoccurrence of such an atmosphere?
- What role did top down cost-cutting play in both Texas City and Alaska? What changes is BP institutionalizing that would reflect the lessons learned from both Texas City and Alaska, as identified in the Baker Panel report, the Booz Allen Hamilton report, and the Chemical Safety Board Investigation report?
- How will BP ensure that there is no tolerance for retaliation against workers who may attempt to raise safety and health concerns? In addition, as new concerns arise, how will BP put in place a transparent mechanism to ensure they are resolved in a timely manner?

If you have any questions regarding this matter, please contact us or have your staff contact Christopher Knauer or Richard Miller with the Committee staff at (202) 226-2424.

Sincerely,



John D. Dingell  
Chairman



Bart Stupak  
Chairman  
Subcommittee on Oversight and Investigations

Attachment

cc: The Honorable Joe Barton, Ranking Member  
Committee on Energy and Commerce

The Honorable Ed Whitfield, Ranking Member  
Subcommittee on Oversight and Investigations  
Committee on Energy and Commerce

bp



Robert A. Malone

Chairman & President

BP America Inc  
4101 Winfield Road  
314 O  
Warrenville, IL 60555  
USA

April 30, 2007

The Honorable Bart Stupak  
Chairman  
Oversight and Investigations  
Committee on Energy and Commerce  
2352 Rayburn House Office Building  
Washington, DC 20515

The Honorable Ed Whitfield  
U.S. House of Representatives  
2411 Rayburn House Office Building  
Washington, DC 20515

Direct 630 821 2688  
Fax 630 821 2590  
Mobile 325 226 4111  
MaloneRA@bp.com

Dear Chairman Stupak and Representative Whitfield:

A hearing currently is scheduled before the Subcommittee on May 3, 2007, as a follow on to the September 7, 2006 hearing regarding the Prudhoe Bay issues resulting from the two Oil Transit Lines (OTLs) on the North Slope of Alaska. For the reasons explained below, BP respectfully requests that the hearing be rescheduled.

First, it has recently come to my attention that information relevant to the September, 2006 hearing was not provided to the Subcommittee – or to the President of BP Alaska or me. By way of background, as you know, I commissioned an investigation into the reasons that the OTL leak detection Compliance Order by Consent (COBC) was not disclosed to the Subcommittee prior to the first hearing. While that investigation is not yet complete, I have received, reviewed and provided to the Subcommittee staff the Interim COBC Report.<sup>1</sup> The Interim COBC Report identified a breakdown in our response and preparation process that resulted in relevant documents not being provided. Some of these documents are the same documents that the Subcommittee staff has identified as raising questions on the impact of the budget process on operational decision-making during 2000 - 2005.

Second, some of the documents recently produced to the Subcommittee staff raise concerns about previous spending decisions that cause me concern. We need time to determine how the concerns and frustrations expressed by workers were ultimately resolved. For example, as set out in some of the documents, it appears that there were serious discussions about discontinuing injection of corrosion inhibitor into some of the Produced Water lines in 2001- 2004. I do not know whether this happened at all; or, if it did, for how long, or what was the impact on the lines. I want to have, and I want the Subcommittee to have, a complete understanding of what happened in this case and why.

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<sup>1</sup> I am advised that the final investigation cannot be completed until all the relevant documents are reviewed and any necessary follow up interviews are completed.

The Honorable Bart Stupak  
The Honorable Ed Whitfield  
April 30, 2007  
Page Two

Additionally, I was troubled to see in some of the documents the extent of the frustration being expressed by the workforce throughout the 2000-2005 time frames. I want to eliminate the frustration voiced in many of the documents by creating a culture in which workers are confident their concerns will be heard and addressed before they would ever reach the level of frustration expressed in these historical documents. This process takes time, but I believe that we are making changes in the way we manage our business, and in building a positive safety culture.

I recognize that the Subcommittee wants to ensure that BP fully understands what led to the situation in Alaska and that it incorporates the lessons learned into its processes going forward. I want to do that as well. In order to do that, I would request additional time to complete investigations and document searches, and to ensure that the Subcommittee staff has all of the information it needs to complete its work.

Finally, as we have explained to the Subcommittee staff on a number of occasions, BP is involved in a substantial document production process in cooperation with various governmental investigations of the Prudhoe Bay spills of 2006.<sup>2</sup> Despite enormous effort the database is not yet complete. In some cases, the searches may have to be refined. As a result some of our responses on specific issues are not yet complete, while certain questions may require additional information, research and investigation. This will also apply to responding to the document request that we understand the Subcommittee is submitting to us today.

It has always been my intention to be fully responsive to the Committee, and I apologize for the breakdown in our process that has occurred. For these reasons, I respectfully request that the May 3 hearing be rescheduled so that we are able to more fully develop the record prior to the hearing.

Regards,



Robert A. Malone

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<sup>2</sup> As we said in our transmittal letter of April 17, 2007, we have created a searchable database of over 20 million documents, which we winnowed down in the interest of providing the subset of documents that appeared most relevant to the Subcommittee's interests. Our letter noted that we anticipated and welcomed additional questions. Following our further discussions with Subcommittee staff, we are searching for additional responsive documents and will invest the time and resources needed to provide them.

[REDACTED]

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**From:** [REDACTED]  
**Sent:** Friday, June 04, 1999 6:48 PM  
**To:** [REDACTED]  
**Subject:** FW: PW Inhibitor at GC2 and GC3

Here's one for our HSE files. We'll see if this is a "safe" way to do business  
[REDACTED]

---

**From:** PBU, CIC Prod Chem Todd/Spino  
**Sent:** Friday, June 04, 1999 11:42 AM  
**To:** PBU, GC2 OpsTmLdr; PBU, GC2 Lead Techs; PBU, GC3 OpsTmLdr; PBU, GC3 Lead Techs  
**Cc:** PBU, Mkt Coord - FOC; PBU, CIC NS TL Feltz/Phillips; Crawford, Gary R; Palsley, Dominic M.; Woolam, Richard C.; 'RA Brown'; Sprague, Kip P  
**Subject:** PW Inhibitor at GC2 and GC3

All,

Due to budgetary constraints, the decision has been made to discontinue the PW inhibitor (EC1081A) currently being injected at GC2 and GC3. The GC2 bulk tank should run out within the next two days and it will not be refilled. Please shut the pump down and flush the equipment with water once the tank is empty. The GC3 tank was recently filled and is estimated to last about 13 more days (around June 17th). Again, when the tank is empty, please shut the pump down and flush the equipment with water.

The current plan is to inject the remaining inventory of EC1081A into the high risk S-69 line that runs from M to S pads. At a 40 ppm rate, we will have enough product to treat this 40,000 BWD for about 250 days.

Best Regards,

John Todd

**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.

# 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						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>						
-----------------------------	--	--	--	--	--	--

<b>CHANGE IN REVENUES ( )</b>						
-------------------------------	--	--	--	--	--	--

**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)						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

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 Phone: 465-5250  
 Division: Spill Prevention and Response Date/Time: 2/20/07 4 00 PM  
 Approved by: Larry Hartig Date: 2/20/2007  
 Agency: Department of Environmental Conservation

# FISCAL NOTE

**STATE OF ALASKA**  
**2007 LEGISLATIVE SESSION**

Fiscal Note Number: HB128-DOR-TAX-2-22-07

Bill Version: HB 128

( ) Publish Date: \_\_\_\_\_

Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected: Revenue 04

Title: Oil & Gas Production Tax Expenditures RDU: Taxation and Treasury

Sponsor: Representative Olson Component: Tax Division

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						
<b>TOTAL OPERATING</b>	<b>124.9</b>	<b>124.9</b>	<b>124.9</b>	<b>124.9</b>	<b>124.9</b>	<b>124.9</b>

<b>CAPITAL EXPENDITURES</b>						
-----------------------------	--	--	--	--	--	--

<b>CHANGE IN REVENUES ( )</b>	.	.	.	.	.	.
-------------------------------	---	---	---	---	---	---

**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)						
<b>TOTAL</b>	<b>124.9</b>	<b>124.9</b>	<b>124.9</b>	<b>124.9</b>	<b>124.9</b>	<b>124.9</b>

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.

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

SARAH PALIN, GOVERNOR

650 WEST 7<sup>TH</sup> AVENUE, SUITE 800  
ANCHORAGE, ALASKA 99501-3580  
PHONE: (907) 269-2800  
FAX: (907) 269-2838

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 Simons, Acting Coordinator PSIO  
Marie Crosley, DO&G

# STATE OF ALASKA

SARAH PALIN, GOVERNOR

## ALASKA OIL AND GAS CONSERVATION COMMISSION

333 W. 7th AVENUE, SUITE 100  
ANCHORAGE, ALASKA 99501-3538  
PHONE (907) 276-1433  
FAX (907) 276-7542

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,

A handwritten signature in black ink, appearing to read "John K. Norman", written over the typed name and title.

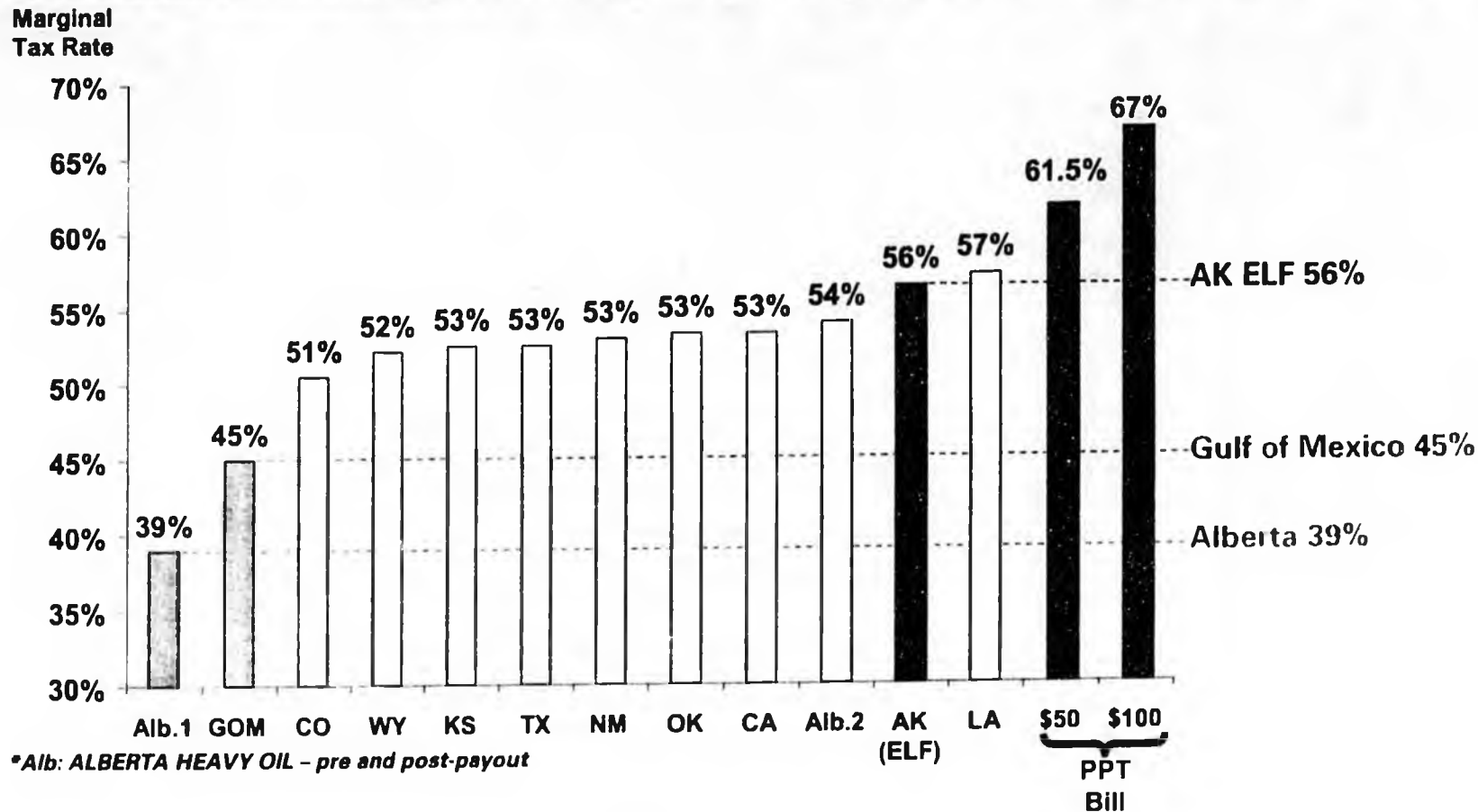
John K. Norman  
Chairman

cc: Pat Galvin, Commissioner  
Department of Revenue

Larry Hartig, Commissioner  
Department of Environmental Conservation

Tom Irwin, Commissioner  
Department of Natural Resources

# 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

**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, a** 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 ¶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

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## MEMORANDUM

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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



# 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.  
PO Box 106612  
900 E. Betsart Boulevard  
Anchorage, Alaska 99519-8612

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". The signature is stylized with a large initial "D" and "S".

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.

bp

March 2, 2007

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.

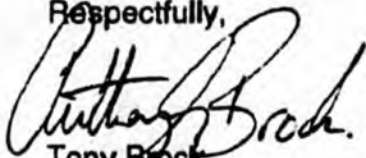
Since this past summer, BPXA has initiated a pigging schedule whereby cleaning (also called maintenance) pigs are run on a weekly basis. In addition to cleaning any solids and water residue that may have accumulated in the lines, pigging is one of a number of techniques used to control corrosion.

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 cursive script, appearing to read "Anthony Brock".

Tony Brock  
Technical Director

cc Members House Special Committee on Oil and Gas

# 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.

# BP Presentation to the House Oil & Gas Committee

Juneau, February 22<sup>nd</sup> 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)

25-LS0561M  
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, Guttentberg, 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 uncodified 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 uncodified 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 uncodified 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).

CONCEPTUAL AMENDMENT 1

OFFERED IN THE HOUSE

TO: CSHB 128(O&G)

1 Page 3, lines 21 - 22:

Delete "Alaska Oil and Gas Conservation Commission"

2 Insert "person in the Department of Natural Resources who is the lead person for  
3 exercising oversight over the maintenance of oil and gas facilities, equipment, and  
4 infrastructure in the state"

**Konrad Jackson**

---

**From:** John Norman [John\_Norman@admin.state.ak.us]  
**Sent:** Wednesday, April 25, 2007 11:36 AM  
**To:** Konrad Jackson  
**Cc:** Cathy P Foerster; Dan T Seamount; Kevin R Banks  
**Subject:** Re: HB 128 / SB 80 Amendments  
**Attachments:** John\_Norman.vcf

Dear Konrad,

We believe this amendment will simplify and improve the bill. AOGCC is one of the agencies named in Administrative Order No. 234 so we will still be able to provide advice and recommendations to Revenue through PSIO with DNR as lead agency. This will allow us to supply expertise from our area of regulatory oversight within a framework that facilitates coordination with other state agencies.

Thanks for checking with us and please let me know if you or Representative Olson have questions.

John

Konrad Jackson wrote:

Dear Mr. Norman,

As with Senator Wagoner's proposed amendment to SB 80 that would remove the AOGCC and replace it with the PSIO, Representative Olson will be offering the same amendment to HB 128 in House Resources.

I wanted to drop a quick note to inform you of his intentions and get any comments you may have in regards to this amendment.

Thank you for your time.

Konrad Jackson  
Staff to Representative Kurt Olson  
Phone: 907-465-2693  
Fax: 907-465-3835

4/30/2007

Mary:

This is in reply to your e-mail sending the PSIO amendment to SB # 80 that Senator Wagoner intends to introduce. We reviewed the proposed amendment and believe it will improve the bill.

Attached are written comments we sent to the committee on Wednesday when asked to be available to testify on SB 80. This proposed amendment specifically addresses a concern expressed in section 2 (e) of our attached comments which recommended PSIO be the designated lead because of its responsibility to oversee facility and equipment maintenance. Pursuant to section 2 of Administrative Order No. 234, dated April 18, 2007, AOGCC is one of the participating agencies and will be able to provide coordinated advice and consultation to the Department of Revenue through PSIO.

We also suggested at lines 22 and 23, p.3 of the bill, that the term "good oilfield practices" be substituted in place of "the standard practices of the industry". We don't know if this was considered.

As you know, we have the utmost respect for the sponsors of this bill. Other comments (in our attachment) identify policy considerations we felt obligated to bring forward. Having done so, you may assure Senator Wagoner we will do our absolute best to implement this bill in whatever form it is adopted.

These comments reflect the views of the commissioners of the AOGCC and you may distribute this e-mail as you see fit.

John K. Norman  
Chair,  
AOGCC

4-20-07  
3:45 PM

*[Faint handwritten notes and signatures, including "Mr. Norman" and "John K. Norman"]*



**Sarah Palin**  
GOVERNOR

**STATE OF ALASKA**  
OFFICE OF THE GOVERNOR  
JUNEAU

April 18th, 2007

## ADMINISTRATIVE ORDER NO. 234

I, Sarah Palin, Governor of the State of Alaska, under the authority of art. III, secs. 1 and 24, of the Alaska Constitution, and AS 44.17.060, name the commissioner of the Department of Natural Resources as the coordinator of oversight of facilities, equipment, infrastructure, and activities designed to explore for, produce, process, or transport oil and natural gas from, across, or within state oil and natural gas units or leases. This Order authorizes and directs increased and assertive oversight activities on state oil and natural gas units and leases by the Department of Natural Resources. These oversight activities include all activities relating to all facilities, equipment, and infrastructure. This Order also provides for coordination among state agencies of oversight on oil and natural gas matters on state land.

Nothing in this Order affects the authorities or responsibilities of state agencies with permitting, authorization, or oversight authority over oil and natural gas activities on state oil and natural gas units and leases, including advocacy by the Department of Law before the Federal Energy Regulatory Commission and state regulatory commissions, the development of fiscal terms under AS 43.82 or any later-enacted statute on development of such fiscal terms, or construction and maintenance of surface and air transportation infrastructure by the Department of Transportation and Public Facilities under other legal authority.

### FINDINGS

1. It is in the best interests of the people of this state and the nation that oil and natural gas exploration, production, and transportation facilities within this state be designed, constructed, operated, and maintained in a safe and environmentally sound manner. Oversight by state agencies with legal jurisdiction over the facilities, equipment, infrastructure, and activities designed to produce and transport oil and natural gas must be efficient, effective, and capable of ensuring compliance with state law.
2. It is in the best interests of the people of this state and the nation that oil and natural gas infrastructure in this state be designed, constructed, operated, and maintained to minimize the economic impacts to ongoing functions of state government caused by unplanned interruptions or reductions in oil and natural gas production in this state.

3. It is in the best interests of the people of this state and the nation that oil and natural gas infrastructure be maintained to avoid premature abandonment, which would cause waste of the state's resources.
4. It is in the best interests of the people of this state to utilize existing state government structures and processes to the maximum extent possible, and to effectively coordinate all state resources associated with oversight of facilities, equipment, infrastructure, and activities designed to produce oil and natural gas from state oil and natural gas units and leases.
5. The Department of Natural Resources has the authority under AS 38.05 and AS 44.37.020(a), and under state oil and natural gas leases, to exercise oversight of all oil and natural gas facilities, equipment, infrastructure, and activities on state oil and natural gas units and leases.

### ORDER

To further these findings, I, Sarah Palin, Governor of the State of Alaska, order and declare the following:

1. In regard to matters other than those relating to the development, and adoption or issuance, of regulations, standards, permits or other authorizations under federal, state, or local law, or to facilities subject to the United States Federal Highway Administration or the United State's Federal Aviation Administration oversight, the commissioner of the Department of Natural Resources is the lead official for communication and coordination with appropriate federal agencies, and with local governments, related to oversight of oil and natural gas exploration, production, and transportation on state oil and natural gas units and leases. The commissioner of the Department of Natural Resources may delegate duties under this Order to a qualified designee from the Department of Natural Resources.
2. The commissioner of the Department of Natural Resources is the lead official for communication and coordination among the following Designated Agencies regarding oil and natural gas infrastructure and activities on state oil and natural gas units and leases: Department of Environmental Conservation; Department of Fish and Game; Department of Public Safety; Department of Revenue; Department of Transportation and Public Facilities; Department of Labor and Workforce Development; Department of Law; Department of Natural Resources; Alaska Oil and Gas Conservation Commission; and the director in the Governor's Office in Washington, D.C.
3. The commissioner shall establish a Petroleum Systems Integrity Office (PSIO) and designate a Petroleum Systems Integrity Office Coordinator (PSIOC). The PSIOC is the lead state official in exercising oversight of the maintenance of facilities, equipment, and infrastructure for the sustained production and transportation of oil and natural gas resources in this state, including such facilities, equipment, and

infrastructure not currently within the jurisdiction of a Designated Agency.

4. Each Designated Agency shall appoint a Liaison Officer who shall report to the head of that Designated Agency. The Liaison Officer shall coordinate with the PSIOC. Liaison officers shall serve as the primary point of contact representing their respective Designated Agency.
5. The PSIOC shall establish, conduct, and coordinate through the Liaison Officers a process to comprehensively assess current state agency jurisdictions, standards, and practices on matters subject to this Order. That assessment shall identify all state agencies' detailed statutory and regulatory authority and practices; any gaps in statutes, regulations, resources, practices, or oversight regarding oil and natural gas facilities, equipment, infrastructure, and activities on state oil and natural gas units and leases; and the risks associated with any gaps. Analysis done under this paragraph is intended to preclude duplication of effort, and provide a comprehensive and cost-effective approach to determine the appropriate state oversight of oil and natural gas facilities, equipment, infrastructure, and activities on state oil and natural gas units and leases.
6. The PSIOC shall lead the interagency effort, through the Liaison Officers, to evaluate industry oversight of oil and natural gas facilities, equipment, infrastructure, and activities on state oil and natural gas units and leases. Designated agencies, to the extent authorized through existing legal authorities, shall require the industry businesses to provide a comprehensive description of current practices that includes the quality control, quality assurance, monitoring, inspection, and other practices the business uses to ensure the integrity and reliability of oil and natural gas facilities, equipment, infrastructure, and activities. The PSIOC shall coordinate the review of these evaluations and descriptions, identify gaps, and seek remedial action. The PSIOC shall make recommendations to the commissioner of the Department of Natural Resources regarding enforcement actions by the Department of Natural Resources and cases to be referred to other state, local, or federal agencies for appropriate civil or criminal penalties available under the law.
7. On an ongoing basis, the PSIOC shall coordinate the oversight activities of the PSIO with the Designated Agencies. The Designated Agencies shall participate in interagency activities led by the PSIO and provide other technical assistance as requested by the PSIO.
8. Unless contrary to any dispute resolution process in statute or regulation, in the event of an interagency dispute between Designated Agencies regarding a matter covered under this Order, Liaison Officers shall raise the issue to the PSIOC, who shall resolve the interagency dispute to the maximum extent possible in accordance with law. If the interagency dispute cannot be resolved by the PSIOC, the matter shall be elevated to the affected Designated Agency heads and the commissioner of the Department of Natural Resources. If an interagency dispute cannot be resolved by the affected Designated Agency heads and the commissioner of the Department of Natural Resources, the matter shall be elevated to the governor.
9. Consistent with AS 44.23.020, the attorney general, as legal advisor for the state, shall provide legal services to the PSIO, the PSIOC, and all Designated Agencies.

10. This Order is for administrative purposes only. It neither creates any third-party rights nor modifies the statutory and regulatory authority of Designated Agencies.
11. The PSIOC shall submit to the commissioner of the Department of Natural Resources and to the governor periodic progress reports that summarize evaluation, coordination, review, and oversight activities done under this Order and accomplishment of those activities.

## DEFINITIONS

In this Order,

1. "Designated Agencies" means the Department of Environmental Conservation; Department of Fish and Game; Department of Public Safety; Department of Revenue; Department of Transportation and Public Facilities; Department of Labor and Workforce Development; Department of Law; Department of Natural Resources; Alaska Oil and Gas Conservation Commission; and the director in the Governor's Office in Washington, D.C.;
2. "equipment" means machinery that is not a permanent fixture, is located on either a state oil and natural gas unit or lease, and is used to operate, construct, clean, or otherwise service oil and natural gas infrastructure and facilities;
3. "exploration facility" has the meaning given in AS 46.04.900;
4. "facilities" includes exploration facilities, oil terminal facilities, and production facilities;
5. "infrastructure" means all oil and natural gas pipelines, both onshore and offshore, including production facilities, line pipe, valves, and other appurtenances connected to line pipe, pumping units, and fabricated assemblies associated with pumping units, flow lines, separation facilities such as gathering centers and flow stations; transmission pipeline; above-ground oil storage tanks; oil or natural gas processing facilities, including seawater and produced water facilities; and all offshore platforms intended for use in oil and natural gas exploration or production
6. "Liaison Officer" means an officer or employee from a Designated Agency appointed to represent and report to the head of that Designated Agency and to serve as the primary point of contact between that Designated Agency and the PSIO and PSIOC;
7. "oil terminal facility" has the meaning given in AS 46.04.900;
8. "production facility" has the meaning given in AS 46.04.900;

9. "PSIO" means the Petroleum Systems Integrity Office established under this Order;
10. "PSIOC" means the Petroleum Systems Integrity Office Coordinator designated under this Order;
11. "transmission pipeline" has the meaning given in 18 AAC 75.990.

### **REVOCATION OF AND RELATIONSHIP TO OTHER ADMINISTRATIVE ORDERS**

Administrative Order No. 229 is revoked. This Order supplements Administrative Order Nos. 134 and 187 and shall be interpreted as being complementary to those Orders. Unless contrary to any dispute resolution process in statute or regulation, any conflict among the Orders shall be resolved by the heads of the affected Designated State Agencies; if an interagency disagreement remains, the governor will resolve the conflict.

This Order takes effect immediately.

DATED at Juneau, Alaska, this 18th day of April, 2007.

/s/Sarah Palin  
Governor

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CONCEPTUAL AMENDMENT 2

OFFERED IN THE HOUSE

TO: CSHB 128(O&G) (Version 25-LS0561\K)

1 Add a new paragraph (4) to AS 43.55.165(j):

2 (4) "improper maintenance" is defined as any maintenance that is not  
3 consistent with good oil field practice.

4

5 Add a new paragraph (5) to AS 43.55.165(j):

6 (5) "good oil field practice" is defined as a practice that is generally  
7 accepted to be good, safe and efficient in carrying out oil field operations,  
8 including, but is not limited to, the design, construction, testing, operating, and  
9 maintaining of production, processing and transportation facilities and equipment,  
10 consistent with standards such as the American Petroleum Institute (API) or  
11 American Society for Testing and Materials (ASTM), federal regulations,  
12 maintenance programs consistent with the program requirements set forth by the  
13 person in the Department of Natural Resources who is the lead person for  
14 exercising oversight over the maintenance of oil and gas facilities, equipment,  
15 and infrastructure in the state, or other applicable standards for the production,  
16 processing and transportation of oil, gas, produced water, and other fluids.

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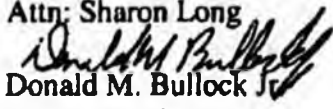
State Capitol  
Juneau, Alaska 99801-1182  
Deliveries to: 129 6th St., Rm. 329

## MEMORANDUM

April 4, 2007

**SUBJECT:** Amendments M.1 and M.2 to CSSB 80( ), Draft Version "M"  
(Work Order No. 25-LS0425M.1 and M.2)

**TO:** Senator Charlie Huggins  
Chair of the Senate Resources Committee  
Attn: Sharon Long

**FROM:**   
Donald M. Bullock Jr.  
Legislative Counsel

You faxed over two amendments to CSSB 80( ), currently before your committee, and asked about the effect of the amendments on the bill and existing law.

### **Amendment 25-LS0425M.1**

Amendment M.1 replaces "the standard practices of the industry" with "good oil field practice". This amendment was requested by the administration as a better standard for the commissioner to take into consideration when determining whether the repair or replacement of property or equipment was related to no maintenance or improper maintenance.

"Good oil field practice" is described in the *Manual of Oil and Gas Terms*<sup>1</sup> as:

A term occasionally used to indicate that operations are carried out in a proper and workmanlike manner. It has been used in the same way as the phrase "everything is A.P.I.," which refers to the American Petroleum Institute's set of standards covering aspects of petroleum operations.

The State of California has used the term in a regulation relating to oil field facilities and equipment maintenance. That part of the regulation describing "good oilfield practice"<sup>2</sup> is as follows:<sup>3</sup>

<sup>1</sup> Howard R. Williams & Charles J. Meyers, *Manual of Oil and Gas Terms* at 495 (12th ed., 2003).

<sup>2</sup> The California regulation uses "oilfield" rather than "oil field."

<sup>3</sup> 14 CCR 1774 (2007).

(e) Pipelines shall be designed, constructed, tested, operated, and maintained in accordance with *good oil field practice* and applicable standards, such as the American Petroleum Institute (API) (API Rec. Prac. 1110, 3rd Ed., Dec. 1991, and API Spec. effective 1990) or American Society for Testing and Materials (ASTM) (ASTM Designation Stand. Spec., 1991), Code of Federal Regulations 49, Part 192, or other applicable standards for the transportation of oil, gas, produced water, and other fluids.

*Good oilfield practice* includes, but is not limited to:

(1) Utilization of preventative methods such as cathodic protection and corrosion inhibitors, as appropriate, to minimize external and internal corrosion.

(2) Employment, where practical, of equipment such as low-pressure alarms and safety shut-down devices to minimize spill volume in the event of a leak.

(3) Evaluating the applicability of locating any new pipelines or parts of a pipeline system that are being relocated or replaced above ground.

The use of pipe clamps or screw-in plugs are not considered good oilfield practice for permanent repair of pipeline leaks.

[Emphasis added.]

One reason that I have found it difficult to describe the standard for the maintenance of oil and gas production facilities is that Alaska seems to be unique, or within a very limited group,<sup>4</sup> that get involved with production costs upstream from the point of production. This was a new concept introduced as part of the petroleum production tax (PPT) legislation. When taxes are based on the value at the point of production, which is the general rule for production taxes, upstream costs are not a factor. Thus, there is little law on the categorization of costs. A reference to "good oil field practice" will provide at least some guidance to the Department of Revenue when it is establishing an acceptable level of maintenance for which a deduction of cost is allowed, and then the disallowance of costs when the maintenance is absent or improper.

So far as the bill relates to existing law, the bill adds a paragraph to AS 43.55.165(e). That subsection describes costs that may not be deducted as lease expenditures when computing the taxable value of oil and gas production. The amendment merely provides

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<sup>4</sup> I have not found another state that allows a deduction for upstream production costs for the purpose of calculating a tax on oil and gas production.

Senator Charlie Huggins  
April 4, 2007  
Page 3

additional direction to the commissioner of revenue when the commissioner is determining which expenditures relating to an oil and gas lease are deductible.

**Amendment 25-LS0425M.2**

Amendment M.2 makes technical and not substantive corrections to the bill. Page 1, lines 2 - 4 and 14 - 16, clarify those costs that are not deductible.

Page 1, lines 7 - 8 and 17 - 18, change the reference to the specific paragraph added by the bill rather than referring to the amendment of the entire subsection.

Page 1, lines 6 - 18, clarify language in the uncodified sections of the bill.

Page 1, line 21, through page 2, line 1, adds a subsection to the transitional provision explaining when interest would apply to an underpayment of a tax or installment payment resulting from the enactment of the bill.

If I may be of further assistance, please advise.

DMB:ljw  
07-194.ljw

## Heath Hilyard

---

**From:** Dennis Denney [ddenney@spe.org]  
**Sent:** Monday, March 26, 2007 10:41 AM  
**To:** Heath Hilyard  
**Subject:** good oilfield practice

Hello Heath.

Here is what I found.

"good oilfield practice: a practice that is generally accepted to be good, safe, and efficient in carrying out oilfield operations"

From: Hyne, N.J. 1991. *Dictionary of Petroleum Exploration, Drilling, & Production*. Tulsa, Oklahoma: PennWell Books 224.

As you mentioned, it is a very general term.

Regards,

Dennis Denney  
Technology Editor, *JPT*  
222 Palisades Creek Drive  
Richardson, TX 75080  
972.952.9340

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# LEGAL SERVICES

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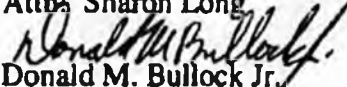
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Juneau, Alaska 99801-1182  
Deliveries to: 129 6th St., Rm. 329

## MEMORANDUM

March 12, 2007

**SUBJECT:** Disallowance of costs associated with lack of or improper maintenance (CSSB 80( ) ; Work Order No. 25-LS0425\M)

**TO:** Senator Charlie Huggins  
Chair of the Senate Resources Committee  
Attn: Sharon Long CSSB 80

**FROM:**   
Donald M. Bullock Jr.  
Legislative Counsel

You asked for an explanation of AS 43.55.165(e)(19)(B) and (C), as offered in CSSB 80( ) that is being considered by your committee.

CSSB 80( ) proposes to amend AS 43.55.165(e) by adding an additional category of lease expenditures that are not deductible for the purpose of determining the production tax value of oil and gas. The production tax value of oil and gas is taxed at the rate stated in AS 43.55.011 and is generally determined by deducting certain lease expenditures from the gross value of oil and gas at the point of production.<sup>1</sup> AS 43.55.165(a) provides that, with certain exceptions, the lease expenditures are "the ordinary and necessary costs upstream of the point of production of oil and gas." AS 43.55.165(e) lists 18 types of expenditures that may not be included as lease expenditures for the purpose of determining the production tax value of oil and gas.

CSSB 80( ) adds an additional category of expenditures that may not be considered lease expenditures. The expenditures that would be disallowed under the bill are expenditures that were incurred because property or equipment had not been maintained or had been improperly maintained. The proposed new paragraph identifies three categories of costs that would be disallowed when the reasons for those costs are related to the failure to maintain property or equipment in accordance with the standard determined by the commissioner of revenue with the advice and counsel of the commissioner of environmental conservation, the commissioner of natural resources, and the Alaska Oil and Gas Conservation Commission.

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<sup>1</sup> AS 43.55.160(a).

Senator Charlie Huggins  
March 12, 2007  
Page 2

The first category of disallowed expenses are the costs of repairing and replacing the actual property or equipment that was neglected.<sup>2</sup> These costs are described in AS 43.55.165(e)(19)(A), in sec. 1 of the bill.

The costs disallowed under AS 43.65.165(e)(19)(B) and (C) are costs that directly result from the maintenance failure. For illustration purposes, assume that some component of a production facility fails because the operator had not maintained that component as expected, taking into consideration the standard practices of the industry. The costs of replacing or repairing that component would be disallowed under paragraph (19)(A).

Now assume that the component failure took two days to repair and during those two days oil was not delivered to a treatment facility and that facility was then shut down. While that repair was being made, there was no flow of oil, no production tax because no oil was being produced, and there were costs associated with maintaining the shutdown and non-productive facility. Under AS 43.55.165(e)(19)(B) as offered in sec. 1 of the bill, the costs incurred to maintain the facilities or equipment shutdown as the result of failure of the component that had to be repaired or replaced may not be deducted.

Change the facts a little so that the flow to the facility is not completely stopped, but the volume is cut in half. Assume further that the facility described in the previous paragraph continues to operate, but of one-half of the level at which it operates when the failed component is operational. If the costs of operation at one-half the normal volume are actually three-quarters of the cost of operating at full capacity, the difference between half the costs and three-quarters of the costs would be disallowed under AS 43.55.165(e)(19)(C) as proposed in CSSB 80( ). The disproportionate costs that resulted from the reduced flow would be disallowed under the bill.

CSSB 80( ) presents two issues for consideration by the committee. First is the level of diligence expected from a taxpayer with regard to the maintenance of production facilities. Should the state expect a level of diligence consistent with a standard that is determined by taking into consideration the standard practices of the industry, something less, or something more?

Second, if costs associated with a lack of maintenance or improper maintenance are disallowed, should the disallowance of the costs be limited to the failed equipment or all costs that result from that failure? In sec. 1 of CSSB 80( ), AS 43.55.165(e)(19)(A) disallows the cost related to the repair or replacement of the equipment that failed and (e)(19)(B) and (C) disallow costs that would not have been incurred or would have been proportionately less had the neglected equipment not failed.

If I may be of further assistance, please advise.

DMB:med  
07-166.med

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<sup>2</sup> I use the word "neglected" here as a short hand for "not maintained or improperly maintained" and not to introduce a standard not contemplated in the language of the bill.

## **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.

From:  
Sent:  
To:  
Subject:

Friday, June 04, 1998 6:48 PM

FW: PW Inhibitor at GCC2 and GCC3

Here's one for our HSE files. We'll see if this is a "safe" way to do business

From: PW Inhibitor at GCC2 and GCC3  
Sent: Friday, June 04, 1998 11:42 AM  
To: PW Inhibitor at GCC2 and GCC3  
Cc: PW Inhibitor at GCC2 and GCC3  
Subject: PW Inhibitor at GCC2 and GCC3

All,

Due to budgetary constraints, the decision has been made to discontinue the PW Inhibitor (EC1061A) currently being injected at GCC2 and GCC3. The GCC2 bulk tank should run out within the next two days and it will not be refilled. Please shut the pump down and flush the equipment with water once the tank is empty. The GCC3 tank was recently filled and is estimated to last about 13 more days (around June 17th). Again, when the tank is empty, please shut the pump down and flush the equipment with water.

The current plan is to inject the remaining inventory of EC1061A into the high risk B-66 line that runs from MI to 8 pads. At a 40 ppm rate, we will have enough product to treat this 40,000 BWD for about 250 days.

Best Regards,

John Todd

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## MEMORANDUM

April 23, 2007

CSSB 80

**SUBJECT:** Legislative intent (SB 80; Work Order No. 25-LS0425(A))

**TO:** Senator Tom Wagoner  
Attn: Mary Jackson

**FROM:**   
Donald M. Bullock Jr.  
Legislative Counsel

Refers to Aug. 8, 2006  
Memo from Pedro  
- Per Comm. Galvin --- is no longer  
confidential

While I was attending the hearing of the Senate Resources Committee on SB 80 on April 20, 2007, a memo was offered for the purpose of explaining the intent behind the enactment of AS 43.55.165(e)(18). You asked whether the memo may be considered as evidence of the legislature's intent behind the enactment of that provision.

The simple and short answer is, no.

I have found no reference to the particular memorandum in the minutes of the August 9, 2006 meeting of the Special Committee on Natural Gas Development at which AS 43.55.165(e)(18) was adopted as an amendment to the bill.<sup>1</sup> Indeed, the commissioner of revenue testified at the Senate Resources Committee meeting on April 20, 2007, that the memo was not publicly released until after the change in administration. Under these facts, the memorandum was never available to the legislature and there is no basis for using the memorandum as evidence of the intent of the legislature at the time the amendment was adopted, and ultimately, when the bill was passed.

Without evidence of legislative intent to the contrary, AS 43.55.165(e)(18) means no more than what it presents:

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

(18) that portion of expenditures, that would otherwise be qualified capital expenditures as defined in AS 43.55.023(k), incurred during a calendar year that are less than the product of \$0.30 multiplied by the total taxable production from each lease or property, in BTU equivalent barrels.

<sup>1</sup> The minutes for this August 9, 2006 meeting are published on the Internet at: [http://www.legis.state.ak.us/basis/get\\_single\\_minute.asp?session=24&beg\\_line=00142&end\\_line=02090&time=1026&date=20060809&comm=NGD&house=S](http://www.legis.state.ak.us/basis/get_single_minute.asp?session=24&beg_line=00142&end_line=02090&time=1026&date=20060809&comm=NGD&house=S).

Senator Tom Wagoner

April 23, 2007

Page 2

during that calendar year, except that, when a portion of a calendar year is subject to this provision, the expenditures and volumes shall be prorated within that calendar year.

The paragraph includes no reference to the standard of maintenance or repair required before an expenditure may be deducted.

By comparison, the bill under consideration by the Senate Resources Committee, SB 80, attempts to impose a standard of care on an operator; if an operator falls below the standard, the associated expenditures will be disallowed as a deduction.

If I may be of further assistance, please advise.

DMB:lmb  
07-106.lmb

**Alaska Oil and Gas Conservation Commission's  
Comments regarding SB 80/HB128-OIL and  
GAS PRODUCTION TAX: EXPENDITURES**

This legislation is proposed as a law of general application throughout the State of Alaska. With that in mind the Alaska Oil and Gas Conservation Commission's ("AOGCC") comments are framed without regard to any particular incident and instead with a view to how the law might apply throughout the state and in particular to new investors contemplating oil and gas operations in Alaska.

1. Policy Considerations:

- a. Is it advisable to deny leasehold expenditure deductions for costs resulting from errors which are not the consequence of fraud, willful misconduct, or gross negligence? Subsection (6) of AS 43.55.165(e) already disallows deductions for the expenses arising from fraudulent, willful misconduct or gross negligence.

Proposed subsection (19) would extend cost disallowance to acts other than those already addressed by subsection (6). Subsection (6) addresses costs related to willful misconduct or gross negligence, so we interpret subsection (19) as intended to disallow costs arising because of ordinary negligence. This would impose a penalty on the operator beyond what is customary in agreements between co-owners who enter into operating agreements for development of a commonly owned resource. Such agreements almost always absolve an operator of liability for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct. If it were otherwise and operators were liable for ordinary negligence (which is another way of saying making a mistake) they would be in the position of guaranteeing a trouble free operation. No operator would be willing to make that guarantee. It is generally recognized in the business world that mistakes happen but only when they result from willful misconduct or gross negligence is an operating partner normally penalized.

With the foregoing in mind subsection (19) departs from normal business practice and sets a higher standard than business partners in the oil and gas industry normally demand of each other. Similar reasoning could be applied to new operators contemplating operations in the State of Alaska under what they might perceive as a tax structure unforgiving of mistakes.

- b. Denial of Facility Shut Down Expenses. Subsection (19) (B) would deny expenses incurred to maintain operational capability of facility or equipment shut down because of improper maintenance. Is it good policy

to deny operational maintenance costs if the operator believes that the best course of action is to shut down the entire facility in order to carry out necessary repairs? Denial of operational capability maintenance costs could discourage operators from shutting down when in fact a complete shut down is the most prudent course of action.

- c. Should Not Discourage Innovation. The oil and gas industry is constantly evolving. A tax regime should not discourage innovative techniques. Examples of such techniques are the astounding advances that have been made in recent decades in the area of directional drilling, coiled tube drilling, and subsea completions. Any attempt to rigidly codify "good oilfield practices" could inadvertently retard the natural learning experience that comes with allowing operators to experiment with differing techniques.

## 2. Practical Considerations:

- a. Standard Terminology. The phrase "Standard Practices of the Industry" in subsection (19) is vague and ambiguous. On the one hand it could mean the written standards adopted by professional organizations intended as guidance documents for the industry; or it could simply mean the standard practice prevailing in the industry in a particular locale.

In determining whether an operator's conduct has resulted in waste of a resource the AOGCC has generally used "good oilfield practices" as a standard by which to measure an operators practice in installing operating and maintaining equipment. See AS 31.05.170(15).

- b. AOGCC's preferred term. Good oilfield practices is the term used to indicate that operations are carried out in a proper and workman like manner. It is used in the same way as the phrase "everything is A.P.I.," which refers to the American Petroleum Institute's set of standards covering aspects of petroleum operations. Williams & Meyers, Manual of Oil and Gas Terms (13<sup>th</sup> ED.) p 453. It is therefore, AOGCC's recommendation that the phrase "good oilfield practices" be substituted for the current phrase "standard practices of the industry".
- c. Absence of Regulatory Guidelines for Maintenance. There is lack of current regulatory guidelines. Much of the equipment and systems in oilfields that are subject to maintenance are not currently regulated by either AOGCC or DEC. This raises questions about how to gauge "improper maintenance" in the absence of regulatory responsibility for such systems and equipment.

- d. Regulations. There will be a need for AOGCC and other agencies to promulgate regulations if AOGCC is assigned responsibility under this bill. These regulations should provide general guidance to the industry, including new operators coming into the State, concerning what constitutes "good oilfield practices." Toward this end we would look to the American Petroleum Institute's standards and recommended practices, as well as standards recognized by the National Association of Corrosion Engineers (NACE), the American Society of Mechanical Engineers (ASME), the International Standards Organization (ISO) and similar respected organizations.
- e. Agency Expertise. There is a need for specialized expertise. AOGCC geologists and engineers work to regulate operations downhole and immediately around the production string but traditionally have not moved further downstream except when required to determine whether a failure of equipment resulted from an operator's failure to employ good oilfield practices thereby resulting in "waste" of hydrocarbon resources.

We are aware that Governor Palin has announced activation of the Petroleum Systems Integrity Office ("PSIO") and AOGCC is one of the agencies designated to participate on that team. We contemplate that the PSIO staff will implement a quality assurance program with inspections conducted by or under the direction of PSIO to ensure compliance with approved programs. AOGCC will have a designated representative working with PSIO and AOGCC expertise can be called upon as necessary to consult with the Department of Revenue through PSIO. Such an arrangement will avoid duplication of effort and ensure consistency of standards, directives, and inspection reports since all would be coordinated through PSIO.

### 3. Difficulties In Determining Root Cause:

In some instances it will be obvious that there has been improper maintenance. In other instances, the AOGCC would be required to consider design, installation, operation, and maintenance, all of which are integral to a determination of negligence. Additionally some determinations will require detailed investigation including but not limited to destructive and non-destructive metallurgical testing and application of other expertise not readily available within the AOGCC.

### 4. Date Stamping Negligent Conduct:

Standards are continually evolving and it will be important to decide whether conduct that led to the failure should be judged in light of the standards prevailing when

the original decisions were made or judged by the most current standards. Additionally, properties are often sold or traded within the industry. Is it good policy to deny a good faith purchaser the benefit of leasehold expenditures incurred as result of mistakes which may have been made many years before by the prior owner?

bp  
March 2, 2007

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.

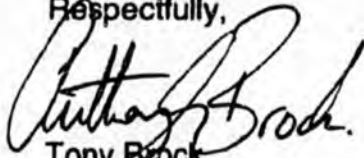
Since this past summer, BPXA has initiated a pigging schedule whereby cleaning (also called maintenance) pigs are run on a weekly basis. In addition to cleaning any solids and water residue that may have accumulated in the lines, pigging is one of a number of techniques used to control corrosion.

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 black ink, appearing to read "Anthony Brock". The signature is written in a cursive, flowing style.

Tony Brock  
Technical Director

cc Members House Special Committee on Oil and Gas

2006

Insert":

(19) costs or a portion of the costs determined by the commissioner, in consultation with the commissioner of environmental conservation and the chair of the Alaska Oil and Gas Conservation Commission, to be

(A) related to the repair and replacement of improperly maintained property or equipment; or

(B) incurred to maintain the operational capability of facilities or equipment shut down or operating at diminished capacity because of improper maintenance of property and equipment"

SENATOR GREEN objected for explanation.

SENATOR WAGONER explained that he has presented this amendment on behalf of Senator Therriault.

SENATOR THERRIAULT said the amendment was prompted by the recent shutdown of a portion of the TAPS line due to maintenance issues, which raised the question of how repairs would be handled in a net-based PPT system. The amount of oil produced in the affected fields is approximately 375,000 barrels per day. His calculations indicate that the operating costs, even when there is no production, are about \$1 million per day. The amendment allows the commissioner of revenue, in consultation with the commissioner of the Department of Environmental Conservation (DEC), and the chairman of the Alaska Oil and Gas Conservation Commission (AOGCC) to determine what costs are attributable to lack of maintenance and disallow those costs.

1:38:20 PM

SENATOR BEN STEVENS commented that paragraph (B) on line 8 might encourage a complete shut down, because the operating expenses would not be deductible when operating at diminished capacity.

SENATOR THERRIAULT said he does not think it would have that effect, because agency personnel have the latitude to look at the costs and agree what is and is not reasonable and allowable.

SENATOR BEN STEVENS reiterated that he believes it would encourage a total shutdown and that it might provide a disincentive to replacing bad equipment.

SENATOR THERRIAULT repeated that, because the commissioners have the flexibility to make determinations on a case-by-case basis, he does not believe that would be the case.

CHAIR SEEKINS used an automobile maintenance analogy to illustrate how the agency representatives might make the determination and asked if that is how Senator Therriault sees it working.

SENATOR THERRIAULT agreed with his analogy and emphasized that this refers specifically to improperly maintained equipment.

1:43:47 PM

MR. DICKINSON, Consultant to DOR, commented that his interpretation of the amendment is that all operating costs would be disallowed as long as the plant is operating at

Minutes from:  
Senate Special Committee on  
Natural Gas Development  
RE: shut down costs

AMENDMENT

OFFERED IN THE HOUSE

TO: CSHB 128(O&G)

1 Page 4, lines 9 - 10:

2 Delete "lease expenditures that may not be deducted"

3 Insert "costs that may not be treated as lease expenditures or claimed as a credit based  
4 on costs that may not be claimed as lease expenditures"

5

6 Page 4, line 10:

7 Delete "AS 43.55.165(e), as amended"

8 Insert "AS 43.55.165(e)(19), as enacted"

9

10 Page 4, line 13, following "AS 43.55.020(a)":

11 Insert "before the effective date of this Act"

12

13 Page 4, line 15:

14 Delete "lease expenditures that may not be deducted"

15 Insert "costs that may not be treated as lease expenditures or attributable to a credit  
16 based on costs that may not be claimed as lease expenditures"

17 Delete "AS 43.55.165(e) as amended"

18 Insert "AS 43.55.165(e)(19), as enacted"

19

20 Page 4, following line 17:

21 Insert a new subsection to read:

22 "(c) Interest on an additional amount of tax due under (a) of this section or on  
23 the amount of the underpayment of an installment under (b) of this section does not

1 begin to accrue until 90 days after the effective date of this Act."

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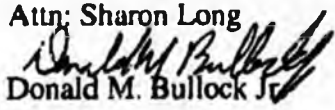
## MEMORANDUM

April 4, 2007

CSSB 80

**SUBJECT:** Amendments M.1 and M.2 to CSSB 80( ), Draft Version "M"  
(Work Order No. 25-LS0425M.1 and M.2)

**TO:** Senator Charlie Huggins  
Chair of the Senate Resources Committee  
Attn: Sharon Long

**FROM:**   
Donald M. Bullock Jr.  
Legislative Counsel

You faxed over two amendments to CSSB 80( ), currently before your committee, and asked about the effect of the amendments on the bill and existing law.

### **Amendment 25-LS0425M.1**

Amendment M.1 replaces "the standard practices of the industry" with "good oil field practice". This amendment was requested by the administration as a better standard for the commissioner to take into consideration when determining whether the repair or replacement of property or equipment was related to no maintenance or improper maintenance.

"Good oil field practice" is described in the *Manual of Oil and Gas Terms*<sup>1</sup> as:

A term occasionally used to indicate that operations are carried out in a proper and workmanlike manner. It has been used in the same way as the phrase "everything is A.P.I.," which refers to the American Petroleum Institute's set of standards covering aspects of petroleum operations.

The State of California has used the term in a regulation relating to oil field facilities and equipment maintenance. That part of the regulation describing "good oilfield practice"<sup>2</sup> is as follows:<sup>3</sup>

<sup>1</sup> Howard R. Williams & Charles J. Meyers, *Manual of Oil and Gas Terms* at 495 (12th ed., 2003).

<sup>2</sup> The California regulation uses "oilfield" rather than "oil field."

<sup>3</sup> 14 CCR 1774 (2007).

(e) Pipelines shall be designed, constructed, tested, operated, and maintained in accordance with *good oil field practice* and applicable standards, such as the American Petroleum Institute (API) (API Rec. Prac. 1110, 3rd Ed., Dec. 1991, and API Spec. effective 1990) or American Society for Testing and Materials (ASTM) (ASTM Designation Stand. Spec., 1991), Code of Federal Regulations 49, Part 192, or other applicable standards for the transportation of oil, gas, produced water, and other fluids.

*Good oilfield practice* includes, but is not limited to:

(1) Utilization of preventative methods such as cathodic protection and corrosion inhibitors, as appropriate, to minimize external and internal corrosion.

(2) Employment, where practical, of equipment such as low-pressure alarms and safety shut-down devices to minimize spill volume in the event of a leak.

(3) Evaluating the applicability of locating any new pipelines or parts of a pipeline system that are being relocated or replaced above ground.

The use of pipe clamps or screw-in plugs are not considered good oilfield practice for permanent repair of pipeline leaks.

[Emphasis added.]

One reason that I have found it difficult to describe the standard for the maintenance of oil and gas production facilities is that Alaska seems to be unique, or within a very limited group,<sup>4</sup> that get involved with production costs upstream from the point of production. This was a new concept introduced as part of the petroleum production tax (PPT) legislation. When taxes are based on the value at the point of production, which is the general rule for production taxes, upstream costs are not a factor. Thus, there is little law on the categorization of costs. A reference to "good oil field practice" will provide at least some guidance to the Department of Revenue when it is establishing an acceptable level of maintenance for which a deduction of cost is allowed, and then the disallowance of costs when the maintenance is absent or improper.

So far as the bill relates to existing law, the bill adds a paragraph to AS 43.55.165(e). That subsection describes costs that may not be deducted as lease expenditures when computing the taxable value of oil and gas production. The amendment merely provides

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<sup>4</sup> I have not found another state that allows a deduction for upstream production costs for the purpose of calculating a tax on oil and gas production.

Senator Charlie Huggins

April 4, 2007

Page 3

additional direction to the commissioner of revenue when the commissioner is determining which expenditures relating to an oil and gas lease are deductible.

**Amendment 25-LS0425M.2**

Amendment M.2 makes technical and not substantive corrections to the bill. Page 1, lines 2 - 4 and 14 - 16, clarify those costs that are not deductible.

Page 1, lines 7 - 8 and 17 - 18, change the reference to the specific paragraph added by the bill rather than referring to the amendment of the entire subsection.

Page 1, lines 6 - 18, clarify language in the uncodified sections of the bill.

Page 1, line 21, through page 2, line 1, adds a subsection to the transitional provision explaining when interest would apply to an underpayment of a tax or installment payment resulting from the enactment of the bill.

If I may be of further assistance, please advise.

DMB:ljw  
07-194.ljw

# Bill History/Action Display



**BILL:** SB 80

**SHORT TITLE:** OIL & GAS PRODUCTION TAX: EXPENDITURES

**BILL VERSION:**

**CURRENT STATUS:** (S) RES

**STATUS DATE:** 02/09/07

THEN FIN

**SPONSOR(s):** SENATOR(S) WAGONER, Therriault, Dyson, Wilken, Elton, French, Kookesh, Thomas, Wielechowski, Green, Stevens, Olson, Davis, Stedman, Ellis, Huggins, Hoffman, McGuire

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

**Bill Root:**

**Bill History**

Jrn-Date	Jrn-Page	Action
02/09/07	0201	(S) READ THE FIRST TIME - REFERRALS
02/09/07	0202	(S) RES, FIN
02/09/07	0202	(S) REFERRED TO RESOURCES
02/14/07	0248	(S) COSPONSOR(S): HOFFMAN
02/21/07	Text	(S) RES AT 3:30 PM BUTROVICH 205
02/21/07	Text	(S) Heard & Held
02/21/07	Text	(S) MINUTE(RES )
02/23/07	0351	(S) COSPONSOR(S): MCGUIRE
02/28/07	Text	(S) RES AT 3:30 PM BUTROVICH 205
02/28/07	Text	(S) Heard & Held
02/28/07	Text	(S) MINUTE(RES )
04/18/07	Text	(S) RES AT 4:00 PM BUTROVICH 205
04/18/07	Text	(S) Scheduled But Not Heard -- Time Change --
04/20/07	Text	(S) RES AT 3:30 PM BUTROVICH 205
04/20/07	Text	(S) Heard & Held
04/27/07	Text	(S) RES AT 3:30 PM BUTROVICH 205
04/27/07	Text	(S) Moved CSSB 80(RES) Out of Committee

Similar Subject Match or Exact Subject Match

OIL & GAS  
 PIPELINES  
 RESOURCES  
 REVENUE  
 TAXATION

**Bill Root:**

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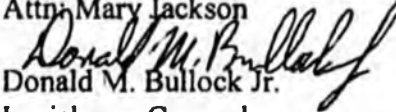
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Juneau, Alaska 99801-1182  
Deliveries to: 129 6th St., Rm. 329

## MEMORANDUM

February 26, 2007

**SUBJECT:** Ex post facto (SB 80; Work Order No. 25-LS0425)

**TO:** Senator Thomas Wagoner  
Attn: Mary Jackson

**FROM:**   
Donald M. Bullock Jr.  
Legislative Counsel

You asked whether enactment of SB 80 would violate the prohibition against ex post facto laws in the United States and Alaska Constitutions<sup>1</sup> because the disallowance of certain deductions applies retrospectively to April 1, 2006, the effective date of the PPT.

The answer is no.

During the meetings of the Senate Resources Committee on SB 80 and the House Special Committee on Oil and Gas on HB 128, a person appearing before the committees stated that the retrospective effect of the bills is prohibited under the ex post facto clauses. I have been unable to find any authority for this statement regarding the change in tax law offered in these bills.

To the contrary, both the United States Supreme Court and our own Supreme Court have upheld retrospective tax legislation.

In 1912, the United State Supreme Court noted that, "It is however, settled that [the ex post facto prohibition of Art. I, § 9 of the Constitution] is confined to laws respecting criminal punishments, and has no relation to retrospective legislation of any other description."<sup>2</sup> The proposed disallowance of expenses resulting from the lack of maintenance or improper maintenance are not criminal punishment provisions and only

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<sup>1</sup> Art. I, sec. 9, Constitution of the United States; art. I, sec. 15, Constitution of the State of Alaska.

<sup>2</sup> *Johannessen v. United States*, 225 U.S. 227, 242; 32 S. Ct. 613, 617; 56 L. Ed. 1066, 1072 (1912). The *Johannessen* case involved an immigration issue, but the principle that the application of the ex post facto clause is limited to laws regarding criminal punishment is cited as authority for denying an ex post facto challenge in cases reviewing tax laws with retrospective effect. See, e.g. *Mathes v. Commissioner of Internal Revenue*, 63 T.C. 642, 644 (1975).

Senator Thomas Wagoner  
February 26, 2007  
Page 2

affect the amount of tax for which a producer is liable. Though any taxpayer may consider a greater amount of tax as "punishment," the bill you are sponsoring does not involve the type of criminal punishment addressed by the ex post facto clause.

The United States Supreme Court has also upheld retrospective tax legislation against a due process challenge. In *United States v. Carlton*,<sup>3</sup> the court upheld the retroactive application of a curative measure in 1987 to a provision enacted the prior year; the actual retroactive effect of the 1987 amendment extended for a period only slightly greater than one year. In *Carlton*, the court noted that "Congress acted promptly and established only a modest period of retroactivity," and "Congress 'almost without exception' has given general revenue statutes effective dates prior to the dates of actual enactment." The Court noted a 1938 decision upheld a Wisconsin income tax enacted in 1935 that imposed a tax on dividends in 1933 for the proposition that, "the 'recent transactions' to which a tax law may be retroactively applied 'must be taken to include the receipt of income during the year of the legislative session preceding that of its enactment.'"<sup>4</sup> SB 80 proposes to amend tax legislation that was became effective August 20, 2006, just over 6 months ago.

Note that retrospective application of changes in tax laws on the oil industry have been upheld by the Alaska Supreme Court. In 1985, the Alaska Supreme Court upheld the retrospective effect of oil and gas income tax legislation that was signed into law in July 1978 and was retroactive to January 1, 1978.<sup>5</sup> Seven years later, the same court upheld the retrospective effect of a change in the economic limit formula applicable to the production tax on oil and gas; in that case, the Act was effective August 6, 1989, and was retroactive to January 1, 1989.<sup>6</sup> In neither case did the taxpayers assert the ex post facto prohibition as authority for challenging the retrospective application of the tax, but unsuccessfully argued that the retrospective application was effectively an "effective date" that required a two-thirds majority vote under art. II, sec. 18 of the state constitution.

In my opinion, the retrospective application of SB 80 or HB 128 would survive a challenge under the ex post facto clauses of the United States and Alaska constitutions.

If I may be of further assistance, please advise.

DMB:ljw  
09-100.ljw

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<sup>3</sup> *United States v. Carlton*, 512 U.S. 26; 114 S. Ct. 2018; 129 L. Ed. 2d 22 (1994).

<sup>4</sup> *Carlton*, 512 U.S. at 33, 114 S. Ct. at 2023, 129 L. Ed. 2d at 30, citing *Welch v. Henry*, 305 U.S. 134, 83 L. Ed. 87, 59 S. Ct. 121 (1938).

<sup>5</sup> *Atlantic Richfield Company v. State, Dep't of Revenue*, 705 P.2d 418 (Alaska 1985), appeal dismissed, 474 U.S. 1043, 106 S. Ct. 774, 88 L. Ed. 2d 754 (1986).

<sup>6</sup> *ARCO Alaska, Inc. v. State, Commissioner of Revenue*, 824 P.2d 708 (Alaska 1992).

TESTIMONY  
OF  
THE ALASKA OIL AND GAS ASSOCIATION  
BEFORE THE SENATE RESOURCES COMMITTEE  
REGARDING  
HOUSE BILL 128

March 23, 2007

Good afternoon, Mr. Chairman and Members of the Committee.

My name is Judith Brady and I am the Executive Director of the Alaska Oil and Gas Association, or AOGA. AOGA is the trade association for the oil and gas industry in Alaska. Our 16 members account for the majority of oil and gas exploration, development, production, transportation, refining and marketing activities in the state. The testimony I am presenting today reflects the consensus of the members of the AOGA Tax Committee, with no dissent. On behalf of each of them I thank you for this opportunity to testify about House Bill 128.

Just last August the Third Special Session of the Twenty-fourth Legislature passed a version of a new "Petroleum Production Tax" or PPT after the Regular and prior Special Session that year had failed to find consensus over it. The PPT has replaced the previous ELF-based production tax and establishes significantly higher tax rates than those under the ELF. According to a recent, publicly released letter from BP's new Alaska president, Doug Suttles, to the members of this Committee and the rest of the Legislature, the change from the ELF-tax to PPT nearly tripled BP's Alaska production taxes from \$180 million to over \$500 million just for the nine months in 2006 when the PPT was in effect. While I am not in a position to say with similar detail what the effects have been for other companies, I can assure you that the PPT was a major tax increase for the industry as a whole.

In fact, one of the two goals of the new tax was to increase tax revenues to the State of Alaska in times of higher prices. The second goal was to encourage new exploration and production and to that end the new tax offered credits and shared the risk of certain categories of costs.

Not surprisingly, many legislators were enthusiastic about the higher taxes to the State, and not as enthusiastic about the credits or the concept of the State sharing some of the risk by providing incentives for certain categories of cost.

There were literally dozens of concerns about this new approach to tax legislation. And there were, I believe, literally dozens of hours of hearings and work sessions to work through these concerns: what costs would be included; how to decide if a cost was appropriate; what standards of review would be used; how to prevent the State "being gamed" by the companies; how to prevent the companies "being gamed" by the State; how the credits could be used; what should the tax rate be; when should the progressive factor kick in?

On August 6 last year BP discovered a leak in the Flow Station 2 Oil Transit Line in the Prudhoe Bay field, notified the appropriate regulatory authorities, implemented procedures to stop the leak and clean up the spill, and began the process for suspending production from the entire field. The House of Representatives was informed just before it voted on final passage in Third Reading of CSHB 3001(FIN), the bill to enact the PPT, which then passed the House by a 29-10 vote.

As more information was released, the level of concern regarding the effect of the spill under the proposed new tax legislation heightened. Legislators did not want the State of Alaska to end up paying for the result of spills under the PPT if the standards had been ignored.

As a result, Section 1 AS 43.55.165(e) – the identification of what “lease expenditures” would *NOT* include, and setting the standards for review, received even closer scrutiny.

While there was discussion of various other standards, the final standards adopted by the legislature, were based on words that have meaning in law: “lease expenditures would not include costs arising from *fraud, willful misconduct or gross negligence*”.

It was further decided that “costs incurred for containment, control, cleanup, or removal in connection with any *unpermitted* release of oil or a hazardous substance” would not be included as lease expenditures.

On August 9, the Senate Special Committee on Natural Gas Development – the so-called Super Committee, because a majority of the Senate was members of it – reviewed a new amendment with the exact same language as HB 128 which is in front of us today. The language was introduced twice, once as Amendment 9 and once as Amendment 13. The difficulties with the amendment were immediately apparent: What does “improperly maintained” mean? “What does “diminished capacity” mean? Who decides in the first place – an auditor? How can Commissioners without specialized expertise make these findings? Does there have to be an incident, like a spill. If so that is already taken care of under “unpermitted releases”. If no incident takes place, does that mean the State can decide what maintenance costs are appropriate under every circumstance?

Legislators and State Department of Revenue personnel expressed concerns about the difficulties of interpretation. After debate, neither amendment was adopted.

Instead the Senate Special Committee on Natural Gas Development adopted an amendment proposed by Dr. Pedro van Meurs, an international gas consultant retained by the State. The van Meurs amendment had been presented to the Super Committee as an alternative. It provided for a flat 30¢ per barrel exclusion from what would otherwise be a producer’s “capital” portion of its “lease expenditures.” The van Meurs amendment became AS 43.55.165(e)(18) in SCS CSHB 3001(NGD), the Super Committee’s committee substitute for House Bill 3001. The following day the Senate passed the Super Committee’s version of the PPT bill, the House concurred, and it went to the Governor for signature.

Dr. van Meurs explained in the hearing that "maintenance is a reasonable deduction for PPT; but is sometimes hard to decide which expenditures fall into that classification. The simplest solution is to take some base expenditure that really will be replacement and over the next 20-30 years disallow a modest floor of the capital expenditures." (August 9, 2006 Minutes Senate Special Committee on Natural Gas Development)

The flat 30¢ per barrel exclusion – which sets a floor for maintenance cost and avoids the problems of case-by-case decisions as to whether maintenance (repair or replacement) is required because equipment or facilities have been improperly maintained - was adopted. Amendment 13, requiring case-by-case decisions as to the reason for the repair or replacement – almost identical to HB 128 was not adopted. Dr. van Meurs favored using a proxy in order to have clarity and certainty and to avoid disputes.

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I would note that the legislature is not debating whether to amend the PPT legislation to drop the 30 cent per barrel proxy cost which accrues for every producing company - whether there is an incident or not. What is being proposed here is a "per activity decision" of proper maintenance – in addition to the flat surcharge that was intended as a proxy for such a decision.

However, it may be helpful that this amendment be debated again. For PPT to function effectively, it is important that both the legislators and the industry understand how the legislation works and why it should work as intended. If either side feels "gamed", we will be in court sooner, regardless of what kind of tax it is.

AOGA opposes HB 128 for four reasons.

First, we believe that the state is already protected from being inappropriately charged with lease expenditures as a result of spill incidents under the current law.

Second, HB 128 has unintended, but potentially significant, implications that could well extend far beyond the specific situation at Prudhoe Bay that was the impetus behind the Bill.

Third, it is an *ex post facto* law that is forbidden under the federal and Alaska constitutions.

Fourth, HB 128, because of the ambiguity of its language, creates ambiguity throughout the entire PPT legislation related to costs and credits.

Before detailing AOGA's specific concerns with this proposed legislation, we would like to express our general concern with the premature and possibly unwarranted assumptions regarding the Prudhoe Bay oil leaks. HB 128 is aimed directly at Prudhoe Bay and appears to be based on the assumption that because the corrosion on the Prudhoe Bay transit lines was more severe than expected, then those lines were "improperly maintained". This is to judge BP's conduct, and that of Atlantic Richfield, as the operator of the eastern side of the Prudhoe Bay field before the BP ARCO merger in 2000, without having the decisions of the federal and state regulators and/or the courts. We like to believe that companies, like individuals, are innocent until proven guilty. There certainly does need to be the level of concern and scrutiny exhibited by the industry and

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... a producer's lease expenditures for a calendar year are the ordinary and necessary costs ... that are direct costs of exploring for, developing, or producing oil or gas deposits located within the producer's leases or properties in the state ....

HB 128, in contrast, would introduce a completely new and subjective term for judging whether maintenance-related costs would be "lease expenditures"; and this new term would be the "improper"-ness of the maintenance in question.

The already existing statutory terms in AS 43.55.165 — "willful misconduct", "gross negligence", "ordinary and necessary costs", and "direct costs of exploring for, developing, or producing oil or gas" are already clearly and fully defined. "Willful misconduct" and "gross negligence" are terms from the common law, specifically the law of torts, and the judicial precedents establishing their meanings go back literally hundreds of years. "Direct costs" are defined in a substantive sense by the examples in AS 43.55.165(b)(1), and in a geographical sense by AS 43.55.165(b)(2).

To the extent that the concept of "improper" maintenance is encompassed by any or all of these other, already existing statutory terms, it is superfluous. To the extent it may mean something different from the terms already in the statute, the concept of "improper" maintenance is ambiguous because there is nothing to guide taxpayers or tax administrators about which of the existing terms it is different from and in what ways it is different from each of them.

2. Implications extend statewide. Corrosion is not a problem unique to fields on the North Slope. It is a challenge everywhere there are structures and facilities made of iron or steel. Moreover, corrosion is something that, at most, you can only slow down. Sometimes you can slow it down a great deal, but you cannot stop it completely.

This means that the older an iron or steel structure or facility is, the greater the cumulative effects of corrosion are.

Prudhoe Bay will mark the 30<sup>th</sup> anniversary of the start of its production in June of this year. But in the Cook Inlet a number of fields will have their 40<sup>th</sup> anniversaries this year, and a few are closing in on their fiftieth. Our members with Cook Inlet interests are concerned that this legislation, which seems aimed at a particular situation that arose on the North Slope, may have unexpected implications and repercussions for them in Cook Inlet.

There are operations in the Inlet area that will eventually need to be replaced or significantly repaired in order to remain in operation. When those facilities and structures are eventually replaced, there is nothing in HB 128 to protect them from claims that they were "improperly" maintained and thus the costs of repairing or replacing them are limited or disallowed altogether. This uncertainty over whether the costs will be fully recognized as deductions, and whether the tax credits are "capital" portion of those costs will be fully allowed, could lead to fields or facilities being permanently shut-in instead of remaining in production even longer.

3. Ex post facto legislation is forbidden under the federal and Alaska constitutions. On this point let me begin by saying I am not a lawyer, but I was chief administrative judge of a federal appeals board for 8 years so have some familiarity with constitutional issues.

Section 10 of Article I of the United States Constitution declares that "[n]o State shall ... pass any ... ex post facto Law[.]" According to *Black's Law Dictionary* an *ex post facto* law is:

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How would HB 128 fall within this definition? First, it clearly would be a law with retrospective effect because Bill Section 2 makes the changes "appl[icable] to oil and gas produced after March 31, 2006" and Bill Section 4 explicitly says those changes are "retroactive to April 1, 2006." The Bill then seeks to change the consequences or relations of these prior operational activities after the fact. Thus, HB 128 constitutes an *ex post facto* law which, if passed, would be unconstitutional.

4. HB 128 creates ambiguity that threatens the effective implementation of the PPT. With respect to providing clarity about how the taxes work, HB 128 promises to create ambiguity between its "improper"-ness standard and the other, well-defined statutory standards already in place for determining which expenditures are proper under the PPT. With respect to providing certainty about what a taxpayer owes, this ambiguity under HB 128 promises to engender countless disputes about whether maintenance was "improper" or not, and to the extent it was, how much of the costs of repairing it or otherwise dealing with the situation should be disallowed as a result.

The question of what costs are deductible is central to the concept of the PPT as an incentive to new investment and new production. The tax rate under the legislation is extremely high – the tradeoff was, in part, related to cost sharing and credits.

AOGA has already testified that we believe the tax rate is too high. Now we are placed in the position of testifying that along with the high tax rate, the determination of costs and credits will spiral off into a black and never ending hole of litigation.

If HB 128 passes the question of what costs are deductible becomes open at each audit. Auditors will be obligated to test each "cost" submitted against a standard of "improperly maintained" or "diminished capacity". This simply is not workable. The determination is not even related to an incident – such as an unpermitted spill – but rather to the act of "repair and replacement".

I will paraphrase the same comments to you as we provided to the Department of Revenue during the hearings on the first regulations under the PPT:

"We want to avoid long years of court battles over the application and interpretation of the statute and regulations. We experienced enough of those battles in the 1970s, '80s and early '90s. What we need to avoid a repetition of that hard experience are statutes and regulations that will give clear answers to the questions of what the taxable value of oil and gas is and which costs are deductible in determining that value."

We strongly believe that HB 128 is a step backward in achieving effective clarity in the PPT.

One final observation: There is consensus that Alaska's future challenge is focused on declining oil and gas production, and about how this decline can be slowed. If North Slope production continues to decline at 6.5% a year as it has steadily been doing since the early 1990s, it will be down to 400,000 barrels a day by the end of 2017. It is this reality that drives the need for a gas pipeline and the need for new oil production as the continued base of Alaska's economy. It is this reality that led legislators to take an entirely new approach to oil and gas tax – one that would encourage investment and production by sharing some of the cost. This does not translate into taking a smaller share than the State should have – it is about encouraging more production so the State continues getting its share. HB 128 goes in the wrong direction from this prudent tax policy. For all these reasons, then, AOGA opposes HB 128, and we respectfully urge you not to move it out of your committee.

Thank you again for this opportunity to testify today.



**Board of Directors, Anchorage Chamber of Commerce  
Resolution 2006/07-06**

**In Opposition to changes to the Petroleum Production Tax, SB80 and HB 128**

**WHEREAS** the Anchorage Chamber of Commerce is, by definition, an organization designed to protect and promote the interests of business; and

**WHEREAS**, on April 7, 2006, the Anchorage Chamber Board of Directors publicly stated "an effective, petroleum production tax [PPT] should accomplish several goals including:

- a. shifting to the worldwide standard of a production profits tax structure is expected to generate increased revenue for the state of Alaska;
- b. providing a basis for fiscal stability for the oil and gas industry thereby encouraging gas pipeline construction;
- c. addressing the interests of both large and small producers;
- d. encouraging investment in technology and infrastructure to maximize North Slope oil production;
- e. creating an environment that encourages exploration and development of all of Alaska's oil and gas resource base;
- f. stirring economic development which, in turn, will provide new jobs and new business opportunities;" and

**WHEREAS**, the Anchorage Chamber of Commerce Board of Directors supported the PPT as outlined above, recognizing an increase of more than \$1 billion in taxes, nearly tripling taxes previously paid by the oil and gas industry; and

**WHEREAS**, the enacted PPT legislation allowed deductions for operating costs from taxes, a 20-percent tax credit for capital investments, and language that disallowed deductions arising from fraud, willful misconduct, or gross negligence; and

**WHEREAS**, the Anchorage Chamber of Commerce recognizes the need for an additional \$2-\$3 billion in investment in the North Slope to meet the production demands of the Alaska Department of Revenue's forecast; and

**WHEREAS**, a stable regulatory climate is a necessary component of any city or state encouraging business investment; and

**WHEREAS**, as proposed, SB80 and HB 128 change the tax structure of the PPT passed by the Legislature less than one-year ago aiming to disallow energy companies from deducting expenses incurred from improper facility maintenance; and

**WHEREAS**, as written, SB80 and HB 128 do not include definitions for "improper maintenance", among other terms; and

**WHEREAS**, the Alaska Departments of Environmental Conservation, Department of Natural Resources, and the Alaska Oil and Gas Commission have separately documented concerns about their respective ability to implement such ambiguous law; and

**WHEREAS**, the proposed legislation subjects the State of Alaska and production companies to lengthy and costly lawsuits that could distract from other projects.

**NOW THEREFORE BE IT RESOLVED** the Anchorage Chamber of Commerce is opposed to proposed legislation changing the substance of the Petroleum Production Tax;

**AND BE IT FURTHER RESOLVED** that:

1. Senate Bill 80 and House Bill 128 are not only bad law but also bad business practice and should not be passed by the Legislature.
2. The promulgation of state tax law changes to punish businesses for operational mistakes is unconscionable.
3. The Legislature should set tax law, not attempt to be the enforcer. Such is the purview of the executive branch of the government.
4. Punitive tax law changes after the offending fact sets a disturbing trend in government regulation of business.
5. If passed in its current form, SB 80 and HB 128 should be vetoed by the Governor.

**AND BE IT FURTHER RESOLVED** that this resolution be sent to members of the State of Alaska Legislature, State of Alaska Governor Palin, Anchorage Mayor Begich, Alaska Oil & Gas Association, Resource Development Council, Alaska Support Industry Alliance, chambers of commerce statewide, and the 1,200 member businesses who comprise the Anchorage Chamber.

Approved the 16 day of March 2006.



Willam J. Evans, 2006-07 Chair



Stacy Schubert, President

TESTIMONY  
OF  
THE ALASKA OIL AND GAS ASSOCIATION  
BEFORE THE SENATE RESOURCES COMMITTEE  
REGARDING  
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....

How would HB 128 fall within this definition? First, it clearly would be a law with retrospective effect because Bill Section 2 makes the changes "appl[icable] to oil and gas produced after March 31, 2006" and Bill Section 4 explicitly says those changes are "retroactive to April 1, 2006." The Bill then seeks to change the consequences or relations of these prior operational activities after the fact. Thus, HB 128 constitutes an *ex post facto* law which, if passed, would be unconstitutional.

4. HB 128 creates ambiguity that threatens the effective implementation of the PPT. With respect to providing clarity about how the taxes work, HB 128 promises to create ambiguity between its "improper"-ness standard and the other, well-defined statutory standards already in place for determining which expenditures are proper under the PPT. With respect to providing certainty about what a taxpayer owes, this ambiguity under HB 128 promises to engender countless disputes about whether maintenance was "improper" or not, and to the extent it was, how much of the costs of repairing it or otherwise dealing with the situation should be disallowed as a result.

The question of what costs are deductible is central to the concept of the PPT as an incentive to new investment and new production. The tax rate under the legislation is extremely high – the tradeoff was, in part, related to cost sharing and credits.

AOGA has already testified that we believe the tax rate is too high. Now we are placed in the position of testifying that along with the high tax rate, the determination of costs and credits will spiral off into a black and never ending hole of litigation.