

ALASKA LEGISLATURE COMMITTEE FILES 2007-2008 SRES 12656

25-LS0425M  
Bullock  
2/21/07

**CS FOR SENATE BILL NO. 80( )**

**IN THE LEGISLATURE OF THE STATE OF ALASKA**

**TWENTY-FIFTH LEGISLATURE - FIRST SESSION**

**BY**

**Offered:**

**Referred:**

**Sponsor(s): SENATORS WAGONER, Therriault, Dyson, Wilken, Elton, French, Kookesh, Thomas, Wielechowski, Green, Stevens, Olson, Davis, Stedman, Ellis, Huggins, Hoffman**

**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

WORK SHEET  
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Line 26 (B)  
- encourages an operator  
to keep operating  
while repairing it  
- is it really in  
states interest  
to do such



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 → "good oil field practices"

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

*must mean something other than "gross" (already in (6) so must mean "ordinary"*

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).

**Draft CS SB 80**

**Differences between original bill and this draft:**

**Page 3:**

**Line 21:**

Add "commissioner of natural resources"

Delete "the chair of"

- Intent is to include DNR as part of consulting group and also have all members of AOGCC, not just the chair.

Delete "relying on" and replacing with "taking into consideration"

- This language is more general in nature.

**Line 24:**

Subsection (a) clarifying language to make certain that "not maintained" was also established as criteria.

**Line 27:**

Insert "a lack of"

To clarify that both improper or no maintenance is involved.

**Line 29: delete previous subsection (c). insert new language:**

"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 result of lack of or improper maintenance of facilities.

**AMENDMENT**

OFFERED IN THE SENATE

BY SENATOR WAGONER

TO: CSSB 80( )

- 1 Page 3, lines 22 - 23:
- 2 Delete "the standard practices of the industry"
- 3 Insert "good oil field practice"

**AMENDMENT**

**OFFERED IN THE SENATE**

**BY SENATOR WAGONER**

**TO: CSSB 80( ), Draft Version "M"**

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 the**  
23 **amount of the underpayment of an installment under (b) of this section does not begin to**

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

# LEGAL SERVICES

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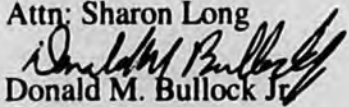
State Capitol  
Juneau, Alaska 99801-1182  
Deliveries to: 129 6th St., Rm. 329

## MEMORANDUM

April 4, 2007

**SUBJECT:** Amendments M.1 and M.2 to CSSB 80( ), Draft Version "M"  
(Work Order No. 25-LS0425\M.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-LS0425\M.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

*okay*

**AMENDMENT**

OFFERED IN THE SENATE

BY SENATOR WAGONER

TO: CSSB 80( ), Draft Version "M"

1 Page 3, lines 21 - 22:

2 Delete "Alaska Oil and Gas Conservation Commission"

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



**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,

- Page 4 of 5
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.

Page 3 of 3  
/s/Sarah Palin  
Governor

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# LEGAL SERVICES

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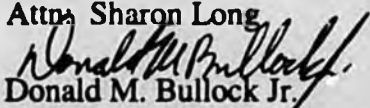
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Juneau, Alaska 99801-1182  
Deliveries to: 129 6th St., Rm. 329

## 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

**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.

## STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

DIVISION OF OIL &amp; GAS

SARAH PALIN, GOVERNOR

650 WEST 7<sup>TH</sup> AVENUE, SUITE 800  
ANCHORAGE, ALASKA 99501-8000  
PHONE: (907) 269-8000  
FAX: (907) 269-8000

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."*

Division of Oil &amp; Gas

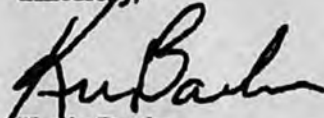
2/15/07

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 99501-3630  
PHONE (907) 279-1433  
FAX (907) 278-7842

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.

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 in a cursive style.

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

## Mary Jackson

---

**From:** Hay, Linda [Linda\_Hay@dec.state.ak.us]  
**Sent:** Monday, February 19, 2007 12:29 PM  
**To:** Mary Jackson; Konrad Jackson  
**Subject:** SB 80 DEC Comments

**Attachments:** Hay, Linda.vcf



Hay, Linda.vcf (541  
R)

Mary & Konrad - Here are the initial reactions from our folks in the Spill Prevention and Response Division. I will be over in the Capitol this afternoon and can stop by if either of you would like. Based on the legislation as currently written, we will be issuing an indeterminate fiscal note. Please bear in mind that this could change with possible amendments:

SB 80 & HB 128 provides a mechanism whereby costs or that portion of the costs related to repair and replacement of improperly maintained property or equipment would not be considered lease expenditures and thereby precluded from consideration for certain deductions or credits.

The legislation requires the determination be made in consultation with the Commissioner of Environmental Conservation and chair of AOGCC.

Whether or not such costs should be considered lease expenditures is a Revenue policy matter outside DEC's jurisdiction.

The extent to which the DEC Commissioner can contribute to the determination is probably limited. DEC may or may not have information or access to information regarding the operation or maintenance of certain property or equipment. It is likely that DEC would not have information or access to information related to property or equipment that is not subject to DEC regulation or oversight. DEC also is not likely to have cost information for property or equipment it does regulate. For example actual spill response costs or costs for repair or replacement of pipelines is not something required by DEC where those costs are directly borne by the operator.

DEC can offer its technical expertise or insights so there is likely no downside to inclusion in the consultation process. It should just be recognized that DEC's ability to be definitive or to have information or access to information important to this determination is probably limited.

It is possible that Revenue or DNR has a better means for acquiring this information through their various leasing or taxing authorities and it would seem that adequate substantiation for such costs would be subject to accounting rules and justification to substantiate any requests. In that regard the PPT regulations might be an avenue where the justification for including any such costs as lease expenditures would have to be documented and substantiated to the extent needed for accountants and the state to make a determination.

Linda Hay  
Legislative Liaison  
Dept. of Environmental Conservation  
Commissioner's Office  
907-465-5290 direct

# STATE OF ALASKA

## DEPARTMENT OF REVENUE

### Tax Division

*Sarah Palin, Governor*

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● 550 W 7th Ave Suite 500  
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February 28, 2007

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

Dear Senator Wagoner:

You requested additional comments on SB 80 after changes were made in response to suggestions from the agencies. Specifically, you asked for the department's position on the revised SB 80 and the language of the bill, and the department's ability to promulgate regulations to implement the revised bill.

The administration believes that expenses related to repairing and replacing property or equipment that was not maintained or was improperly maintained should not be deductible or allowed as credits against taxes. While we will take the steps that we can take by law to exclude such deductions and credits, we would need to prevail in arguing that costs associated with improper maintenance were not deductible or could not form the basis for a credit to the extent they were, for example, attributable to gross negligence, were not ordinary and necessary business expenses, or were impermissible billings by an operator to other working interest owners under an arm's length, negotiated operating agreement.

If we drafted regulations that incorporated the standards of SB 80, such regulations would not find explicit support under current law, and could be legally challenged. The question would be whether such regulations were a reasonable interpretation of the statute. Therefore, we recommend that if the legislature desires that costs associated with improper maintenance definitely not be deductible or allowed as credits, the legislature ensure that such explicit language is in a statute.

The Department's concern is not with the intent or necessity of SB 80, it is with implementing the bill. The Department does not want to lose its discretion to deny deductions or credits under current law, nor does it want SB 80 to swallow the intent of allowing deductibility and credits for regular maintenance costs.

Page 2  
Senator Wagoner  
February 28, 2007

Changing "relying on" into "taking into consideration" standard industry practices on line 22 of the bill has remedied these concerns; the Department may consider standard industry practices where appropriate, but it need not rely exclusively upon them.

The Department supports SB 80, with the caveat that the bill not limit the Department's discretion to deny deductions or credits under current law. As revised, the bill does not restrict the Department's discretion under current law and the Department can promulgate regulations accordingly.

Sincerely,



Jonathan E. Iversen  
Director

# STATE OF ALASKA

## DEPARTMENT OF REVENUE

### Tax Division

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February 20, 2007

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

Dear Senator Wagoner:

Thank you for the opportunity to review SB 80 regarding allowable lease expenditures for credits and deductions under the Petroleum Production Tax. I would like to offer a few comments on the bill.

First, the term "standard practices of the industry" may be difficult for the agencies to apply. It is my understanding that "standard industry practices" are not well defined when it comes to corrosion and maintenance. It is thus unclear what mechanism the Tax Division would employ to allow or exclude a deduction or credit for a certain cost.

I am also concerned about "relying on" the "standard practices of the industry" because the taxpayers would be providing and setting the standard. Whether the concept of "standard practices of the industry" is an appropriate benchmark depends on whether the industry has set and followed an appropriate standard.

Accordingly, I suggest changing "relying on" to "taking into consideration." This change would expand what the Department of Revenue could consider in determining whether a taxpayer improperly maintained property or equipment. Changing the language to "taking into consideration" doesn't limit the inquiry to industry practices, where the industry practices are inappropriate.

In addition, section (19)(C) seems unclear. This section excludes costs "for operating facilities or equipment at diminished capacity in proportion to the amount of diminished capacity that is caused by the improper maintenance of property or equipment." A possible interpretation could be that the taxpayers should not operate facilities unless they are going full bore (not at diminished capacity). If there are other facility costs the bill is trying to exclude, the language may need to be more specific, with a focus on "incremental operating expenses incurred as a result of operating facilities or equipment at diminished capacity that is caused by improper maintenance of property or equipment."

Page 2

The Honorable Tom Wagoner

February 20, 2007

With these edits, the language of the bill would be as follows:

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

- (19) costs or that portion of the costs determined by the
- (20) commissioner, in consultation with the commissioner of environmental
- (21) conservation and the chair of the Alaska Oil and Gas Conservation Commission
- (22) and taking into consideration [relying on] the standard practices of the industry, to be
- (23) (A) related to the repair and replacement of improperly
- (24) maintained property or equipment;
- (25) (B) incurred to maintain the operational capability of
- (26) facilities or equipment shut down because of improper maintenance of
- (27) property or equipment; or
- (28) (C) incremental operating expenses incurred as a result of operating
- facilities or equipment at diminished capacity that is caused by improper
- maintenance of property or equipment [for operating facilities or
- equipment at diminished
- (29) capacity in proportion to the amount of diminished capacity that is caused
- (30) by the improper maintenance of property or equipment].

It is worth noting that AS 43.05.230 and AS 40.25.100 protect sensitive taxpayer information through confidentiality. To the extent SB 80 would require the Department of Revenue to share such information with other agencies, those agencies would be subject to the confidentiality requirements.

The Tax Division is studying the bill and will likely have further suggestions. Thanks again for the opportunity to provide input. We look forward to working with you.

Sincerely,



Jonathan E. Iversen  
Director



Doug Suttles

President

February 15, 2007



BP Exploration (Alaska) Inc.  
P.O. Box 198612  
900 E. Benson 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.

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.

# ENHANCEMENT OF THE "GROSS" CHARACTER OF THE PPT BILL

August 5, 2006

Pedro van Meurs

This memo has been written at the request of Senator Wagoner. The request was to provide ideas as to how the "gross" character of the PPT bill can be enhanced.

This memo does not reflect the views of the Administration and is solely meant to provide Senator Wagoner with my professional advice on these ideas.

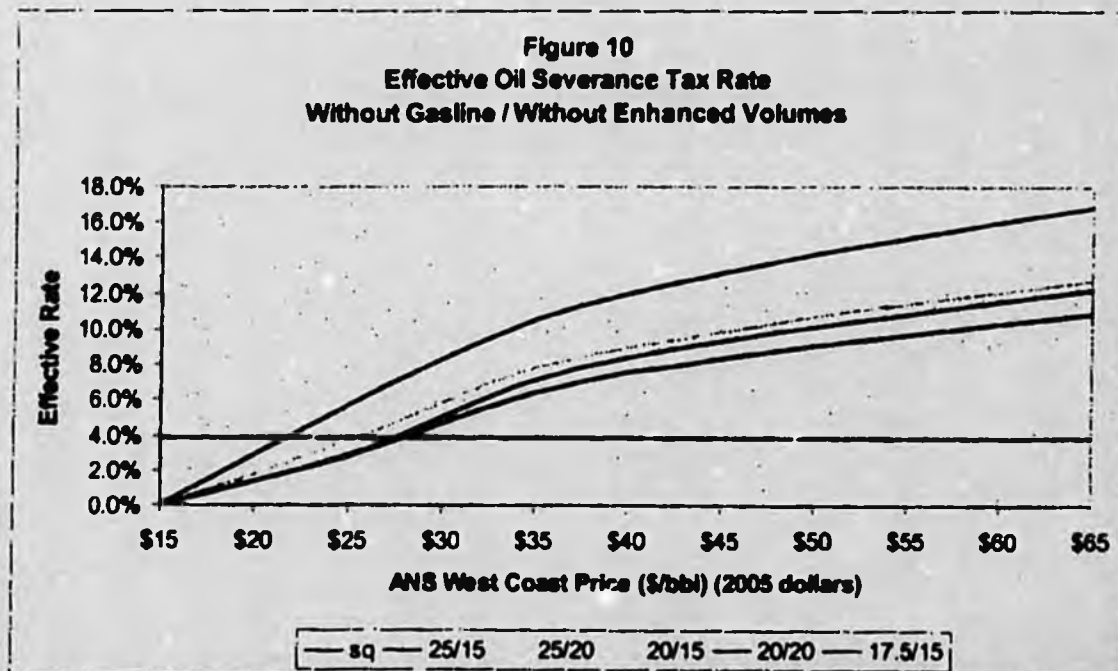
## FLOOR

Considerable concern has been expressed about the fact that under some circumstances of low prices and high levels of investment, the PPT may result in less severance tax than we would have received otherwise under the current severance tax.

This can be prevented with the introduction of a "floor", very similar as was introduced in House Bill 3004.

The floor would be based on the gross value at the point of production of the taxable oil and gas.

Roger Marks presented to the Legislature in February this year a direct comparison between the various proposed PPT systems and the 4% average on gross that would be otherwise applicable to the year 2006.



These graphs prove that at about \$ 25 per barrel the current ELF produces about the same amount as a 22.5/20 PPT.

If we assume the adoption of a 22.5/20 PPT than one could take the position that the PPT should not be less than 4% of gross when the ANS West Coast price exceeds \$ 25 per barrel.

HB 3004 introduced the concept that at lower prices the North Slope oil becomes obviously less economic and it would be counter productive to continue to tax the oil industry. Therefore HB 3004 proposes a scale with a lower floor at lower prices.

This overall concept could be combined with the results of the analysis of Roger Marks as follows:

Over an ANS price of \$ 25 per barrel	--	4%
When ANS is between \$ 20 and \$ 25 per barrel	--	3%
When ANS is between \$ 17.50 and \$ 20 per barrel	--	2%
When ANS is between \$ 15 and \$ 17.50 per barrel	--	1%
Below \$ 15 per barrel	--	0%

Each year the floor would be compared with the tax payable under the PPT and if the floor is higher, the higher amount would be paid.

Following is an example how the floor would work based on a PPT tax rate of 20% and a floor of 4%:

Gross Revenues	100	100	100
Cost deductions	40	90	120
Net Revenues	60	10	- 20
PPT Tax	12	2	-4
Floor	4	4	4
Tax payable	12	4	4

If the Gross Revenue based PPT is higher than the Net Revenue based PPT this extra payment can not be recovered in following years as a deduction. In other words this excess cannot be carried forward in order to be recovered in future years.

Of course, the payment of the differential between the Gross and Net Revenue based PPT cannot be taken as a deduction for the Net Revenue based PPT.

However, any carry forward credits as a result of a tax loss based on the Net Revenue based PPT remain unaltered.

Also under this scheme companies would not lose their capital investment credits of 20%.

It is also suggested that the additional non-transferable tax credits under Sec. 43.55.024 of the proposed House Bill 3001 (FIN) will still be creditable against the Gross Revenue Based PPT if this is higher than the Net Revenue Based PPT. These additional non-transferable tax credits were meant to protect small companies and encourage companies outside Cook Inlet and the North Slope. The Gross Revenue based PPT should not harm such companies.

**INCREASE THE NON DEDUCTABLE ITEMS**

The more costs are being excluded from the Net Revenue calculation the more the overall calculation becomes more similar to a Gross Revenue calculation. Therefore, the Gross Revenue character of the tax can be enhanced by simply adding to the list of items that are not considered lease expenditures.

There are two important cost components that could be excluded from lease expenditures:

- Costs related to gas development under a stranded gas contract, and
- Capital maintenance expenditures.

*Gas development costs under a stranded gas contract.*

Much concern has been expressed about the fact that with a net revenue based system there could be a joint cost problem in Point Thomson and other similar fields if the stranded gas contract would be implemented.

It is argued that all Point Thomson development and operating costs would be deductible under the PPT. At the same time under the stranded gas contract, companies would provide a 7.25% share to the State on gross and not pay the 20% or 22.5% PPT on gas. It is perceived that Point Thomson is being cross subsidized from what otherwise would be tax on oil under the PPT.

My view is that this is not a fair comparison, since reasonably all costs can be absorbed by the condensates. Nevertheless, this issue remains a concern of the Legislators.

It would be possible to add a further item on the list of non deductible costs under proposed AS. 43.55.165 (e) of House Bill 3001 (FIN) written as follows (*non legal language*):

- "(19) 75% of the capital and operating costs associated with the Point Thomson Unit and other gas fields that are being developed under a contract under AS.43.82, with respect to working interest owners which have concluded such a contract."

The 75% is based on the energy equivalent value considering that Point Thomson may have 400 million barrels of condensates and 7 - 8 Tcf of gas. In other words, the capital and operating costs would be allocated on an energy equivalent basis between condensates and gas. It is believed that many potential gas fields on the North Slope will have condensates and that these percentages may vary. For purposes of the bill, this percentage would be simply fixed.

The 25% allocated to condensates would be deductible for PPT purposes and would receive the related tax credits.

The 75% allocated to gas would not be deductible for PPT purposes and would not receive the related tax credits.

It can be assumed that the PTU would require a \$ 2.5 billion capital expenditure. Based on a 100% working interest, this arrangement would not receive a PPT tax reduction of \$ 750 million during development of the field. Assuming a \$ 1 billion operating expenditure over the life time of the field, it would mean that over time companies would pay \$ 150 million more tax during the operation of the field.

This is a significant tax increase, but in the total scheme of PPT taxation over the next 30 years this may represent only 1%-2% more tax.

Nevertheless, it would make the economics of Point Thomson development less attractive on an incremental basis and it would therefore make the entire gas project less attractive economically.

An interesting side effect of this arrangement is that it would place Chevron and other minority interest holders in a much better position relative to the sponsors. These companies have expressed concern that they would be discriminated against relative to the three sponsors. If Chevron and others do not join the stranded gas contract or would not be able to enter into a uniform upstream contract, they would at least benefit considerably relative to the Sponsors since they would receive the full tax deductions and credits. At the same time such companies would, of course, have to pay the full PPT on their gas income and therefore it is logical to permit them these tax credits and deductions.

**Deemed Capital Maintenance Costs**

Another concern that is regularly expressed is that the State should not permit the deduction of costs related to replacing equipment that is becoming defective or gathering lines that need to be replaced because of corrosion or other problems. The argument is that these assets should have been better maintained in the first place.

It should be noted that in most oil and gas fields, assets will have to be replaced after the technical life of such assets has expired. Therefore, such replacements are reasonable lease expenditures and are required to protect the health and safety of the workers and to protect the environment. Nevertheless, it is possible to exclude them from the lease expenditures under AS 43.55.165 (e) if this is politically desirable. A section could be added as follows (*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 22.5% and a tax credit rate of 20% this means that the companies will pay \$ 42.5 million more tax per year.

An interesting side effect is that companies that would have a low level of capital expenditure per barrel would feel the effect more on a relative basis than companies that would have a high level of capital expenditures per barrel. Companies that re-invest strongly are therefore harmed less by this provision than typical harvesters.

APR  
 May

FY 07	44m
FY 08	38.6m

## **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 pipeline 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.

# LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES  
LEGISLATIVE AFFAIRS AGENCY  
STATE OF ALASKA

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FAX (907) 465-2029  
Mail Stop 3101

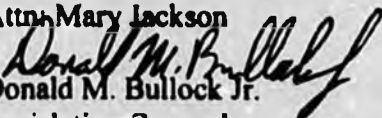
State Capitol  
Juneau, Alaska 99801-1182  
Deliveries to: 129 6th St., Rm. 329

## 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).

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 by John Norman, Chair  
& Commissioner AOGCC

Dated: 4-18-07

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?

## TIME LINE - PPT

PPT Concept Introduced	PPT Overview - H & S Resources	1/18/2006
Joint Finance Meeting	PPT Overview - H & S Finance	2/1/2006
PPT SB 305	Introduced	2/21/2006
PPT SB 305	1st Hearing S Res	2/22/2006
BP Spill Incident	5:45am 3/2/06: GC-2	3/1/2006
PPT SB 305	S Res Moved out	3/29/2006
Senate Resources Mtg.	BP Spill Update	4/26/2006
PPT SB 305	Failed to concur 10:10	5/9/2006
PPT SB 2001	Introduced	5/20/2006
PPT SB 2001	CC Report Failed	6/8/2006
PPT HB 3001	Introduced	7/12/2006
Draft Gross Tax Bill	Distributed by Sen. Wagoner	7/27/2007
PVM Memo #1	Memo to Wagoner - "Gross"	8/5/2006
BP Shutdown	August shut down corrosion	8/7/2006
PPT HB 3001	Transmitted to Senate	8/7/2006
PPT HB 3001	NGD Heard & Held	8/7/2006
PPT HB 3001	NGD Heard & Held	8/8/2006
PVM Memo #2	Memo re 30 cent - unknown recipient	8/8/2006
Amend #7	30 cent provision	8/9/2006
Amend #9	improper maintenance	8/9/2007
Amend #10	replaced #7 30 cent provision	8/9/2006
Amend #11	floor for gross - passed	8/9/2006
Amend #13	replaced #9 improper maintenance	8/9/2006
PPT HB 3001	NGD Amendments - Moved out	8/9/2006
PPT HB 3001	Transmitted to House	8/10/2006
PPT HB 3001	House Concur	8/10/2006
Joint Resources Mtg.	BP Corrosion Issue Hearing	8/18/2006

as an "anonymous" email he received

Inter ofc communication from BP

**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, M&M Coord - FOC; PBU, CIC NS TL Fells/Phillips; Crawford, Gary R; Patsley, 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

**Sharon Long**

---

**From:** John Norman [John\_Norman@admin.state.ak.us]  
**Sent:** Wednesday, April 25, 2007 1:20 PM  
**To:** John Norman; Sharon Long  
**Subject:** Re: [Fwd: AOGCC Comments regarding SB 80/HB128-OIL and GAS PRODUCTION TAX: EXPENDITURES]  
**Attachments:** John\_Norman.vcf

John Norman wrote:

**Subject:**AOGCC Comments regarding SB 80/HB128-OIL and GAS PRODUCTION TAX: EXPENDITURES  
**Date:**Fri, 20 Apr 2007 15:43:17 -0800  
**From:**John Norman <John\_Norman@admin.state.ak.us>  
**Organization:**State of Alaska  
**To:**Mary Jackson <Mary\_Jackson@legis.state.ak.us>  
**CC:**Patrick S Galvin <patrick\_galvin@revenue.state.ak.us>, Kevin R Banks <kevin\_banks@dnr.state.ak.us>

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

4/25/2007

Previous SB80  
packet inserts

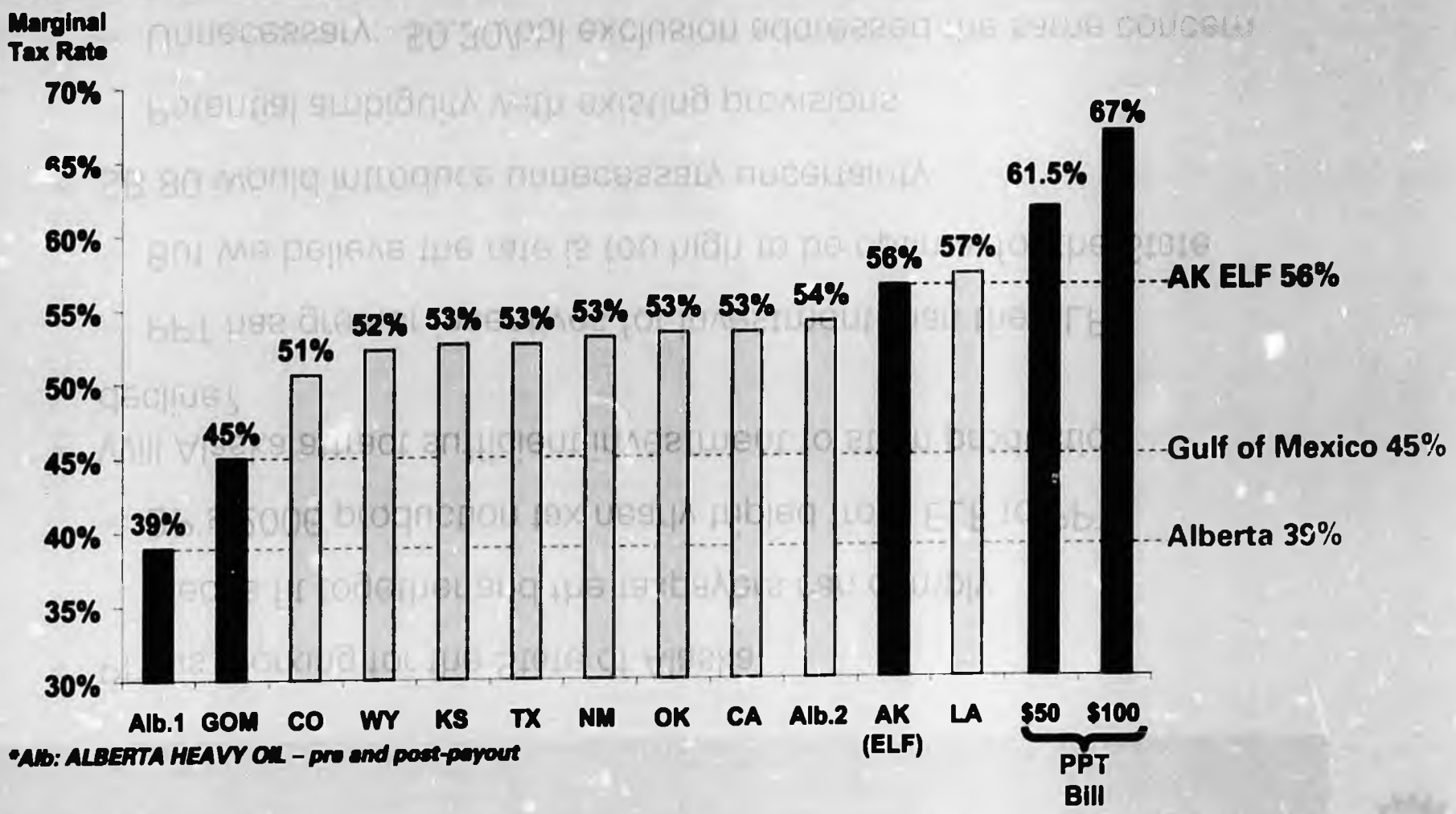
# BP Presentation to the Senate Resources Committee

Juneau, February 28th 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
- SB 80 would introduce unnecessary uncertainty
  - Potential ambiguity with existing provisions
  - Unnecessary: \$0.30/bbl exclusion addressed the same concern
- Five year period to review success of PPT (AS 43.55.180)

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



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

# ALASKA STATE LEGISLATURE

Sen. Charlie Huggins, Chair  
Sen. Bert Stedman, Vice Chair  
Sen. Lyda Green  
Sen. Gary Stevens  
Sen. Lesil McGuire  
Sen. Bill Wielechowski  
Sen. Thomas Wagoner



State Capitol, Room 119  
Juneau AK 99801-1182  
907-465-3878  
Fax: 907-465-3265  
800-862-3878

## Senate Resources Committee

Wednesday February 28, 2007  
3:30 p.m. – 5:00 p.m.

### AGENDA

+ **Workdraft [25-LS0425\M] CSSB 80 - 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**

#### Available for Questions

**Mary Jackson, Staff to Senator Wagoner**

**Don Bullock, Attorney, Legislative Legal & Research Svcs**

**Larry Dietrick, DEC**

#### Available online for Questions

**Kevin Banks, Director, Div. of O & G, DNR**  
**AND JACK HARTZ, Petroleum Engineer, DNR**  
**John Hartz, Petroleum Engineer, Div. of O & G, DNR**

**John Norman, Ak Oil & Gas Conservation Commission**

**John Iverson, Dept. of Revenue**

**1. Gavel In:**

**Call to Order:** Senate Resources Committee  
Time \_\_\_\_\_

**Date** Wednesday February 28, 2007

**Members Present:**

ViceChair, Senator Bert Stedman  
Senator Gary Stevens  
~~Senator Lyda Green~~  
Senator Lesil McGuire  
Senator Bill Wielechowski  
Senator Tom Wagoner  
& myself, Senator Charlie Huggins

**Members by Teleconference:**

2. Today we're continuing with SB 80
3. On line from DNR: Kevin Banks & Jack Hartz  
DOR: John Iverson  
AOGCC: John Norman  
DOL: Rob Mintz
4. Here in the room from DOL: Ethan Falatko  
DEC: Larry Dietrick
5. Public Testimony  
Expecting BP; Conoco Phillips  
& likely other public
6. Meeting adjourned at \_\_\_\_\_.

**1. Gavel In:**

Call to Order Senate Resources Committee  
Time \_\_\_\_\_

Date **Wednesday February 21, 2007**

**Members Present:**

**ViceChair, Senator Bert Stedman  
Senator Gary Stevens  
Senator Lyda Green  
Senator Lesil McGuire  
Senator Bill Wielechowski  
Senator Tom Wagoner  
& myself, Senator Charlie Huggins**

**Members by Teleconference:**

- 2. Today we're hearing SB 80 concerning allowable lease expenditures for the purpose of determining the production tax value of O & G for the purposes of the O & G production tax  
+ Ms. Mary Jackson, staff to Sen. Wagoner will present the bill.**
- 3. Open bill to public testimony. Consider time limit on testimony**
- 4. Close public testimony**
- 5. Note: We will not meet on Friday. Next meeting Monday Feb. 26.**
- 6. Meeting adjourned at \_\_\_\_\_.**

February 28, 2007

Senator Charlie Huggins, Chair  
Senate Resources Committee  
State Capital Room 205  
Juneau, AK 99801-1182

The Honorable Chair & Members of the Senate Resource Committee,

The Alaska State Chamber of Commerce is concerned about SB 80. SB 80 changes the tax structure of the recently enacted Petroleum Production Tax (PPT). The State Chamber believes changing the tax structure so quickly will have long-term negative impacts on the future of Alaska's economy. We believe that the consequences as a result of SB 80 have not been fully considered with regards to all businesses in Alaska.

The State Chamber of Commerce strongly believes that SB 80 takes the wrong approach in creating a fair business environment. No business can possibly prosper or operate in a rapidly changing business climate. We urge the legislature to not pass this legislation from committee.

With the passing of the PPT legislation last year, the state effectively tripled the production taxes on the oil industry in Alaska. Last year's action will result in roughly a \$1 billion increase in revenues to the state this fiscal year. Under the enacted legislation, Alaska's oil producers are allowed to deduct operating costs from taxes. In addition, they are also allowed to take a 20% tax credit for capital investments as an incentive for improving North Slope infrastructure. To counter-balance deductions the legislature implemented language that disallows deductions arising from fraud, willful misconduct, or gross negligence.

SB 80 aims to preclude expenditures associated with improper maintenance of property or equipment. What exactly is improper maintenance? SB 80 does little to define improper maintenance, potentially creating more confusion and litigation. SB 80 appears to limit any type of deduction if shown it was due to improper maintenance. Doubtfully, any company would throw away millions of dollars in shipping Alaska's oil just to save a few dollars on pipe. Any company grossly negligent in its operations is already unable to use any deduction whether it is for maintenance or anything else. Then for what purpose does SB 80 serve Alaska? Enacting SB 80 won't give Alaska more oil, will not make up for lost state revenues due to offline pipe nor will it create more jobs or force any company to sign a gas pipeline contract.



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