January 21, 2014

Department of Environmental Conservation

2014 Report on Financing and Managing the Prevention Account of the Oil & Hazardous Substance Release Prevention & Response Fund

Legislative intent language contained in the Operating budget (Ch14, SLA2013, page 13, line 19):

> *"It is the intent of the Legislature that the Department of Environmental Conservation provide recommendations to the Legislature on or before the start of the second session of the Twenty-eighth Alaska State Legislature, January 21, 2014, that identify ways to finance and manage the oil and hazardous substance release prevention and response fund as a viable, long-term funding source for the state's core spill prevention and response initiatives. The plan should include an analysis of prior expenditures from the fund for the remediation of state-owned contaminated sites, a proposal to expeditiously remediate state-owned contaminated sites, and a report on the Department's effort to achieve program efficiencies to restrain a draw on the oil and hazardous substance release prevention and response fund."*

Background

The Legislature established The Oil and Hazardous Substance Release Prevention and Response Fund (or "Response Fund") in 1986 to provide a ready and reliable source of payment of the expenses incurred by the Department of Environmental Conservation's (DEC) in responding to a release or threatened release of oil or hazardous substances and the expense of establishing and maintaining spill prevention, preparedness and response programs that reduce the risk of oil and hazardous substance spills (A.S. 46.08.005 and .010). Also, in 1986, the Legislature adopted A.S. 46.08.030, which provides:

> *"It is the intent of the Legislature and declared to be the public policy of the State that funds for the abatement of a release of oil or a hazardous substance will always be available."*

In the wake of the *Exxon Valdez* disaster in 1989, the Alaska Legislature passed a bill to levy a $.05 per barrel "conservation surcharge" on crude oil production, to be deposited into the Response Fund and used to fund the State's spill prevention, preparedness and response programs.

Legislation passed in 1994 changed the 1989 conservation surcharge structure and created two separate accounts, the Response Account and the Prevention Account. The $.05 per barrel surcharge was divided so that $.02 was dedicated to building and maintaining a $50.0 million Response Account and $.03 was dedicated to funding a Prevention Account. The Response Account is a reserve that may be used to finance the State's response to an imminent and substantial release or threat of release of oil or another hazardous substance. The Prevention Account is used to pay the operating expenses for the State's spill prevention, preparedness and response programs.

The 1994 legislation and declining oil production has eventually resulted in the Prevention Account being unsustainable for operational funds for the Division of Spill Prevention and Response. In 2006, legislation changed the division of receipts so that $.04 per barrel was dedicated to funding the Prevention Account, and $.01 to the Response Account. This helped to slow the decline, but was not a complete solution.

As described below, the current and past administrations have worked with the Legislature to explore and implement different measures to slow the rate of drawdown of the Response Fund. Again, these measures have not been sufficient to counteract the effect of declining production and make the Response Fund sustainable. In the Office of Management and Budget's response to the legislative Intent in HB284 passed in 2012, OMB provided the following: "The options to address the declining balance of the Fund are clear: increase production, and utilize general funds to address the shortfall in the interim… Additional general funds, estimated to be $6 million, will be needed on an annual basis for spill prevention and response until such time as there are increases in oil production that will offset the general fund requirements."

Prevention Account Funding Sources

The three primary sources of funds going into the Prevention Account are: the four-cent per barrel surcharge on crude oil produced in the State, interest earned on the principal balance held in the fund, and spill response costs recovered by the State from responsible parties. The amounts generated by the surcharge have historically been much larger than amounts generated by either interest on the balance in the account or cost recoveries. Due to the continued decline in crude oil production in the State, the amounts in the Prevention Account will not be sufficient in FY16 to fund the current level of services by SPAR even assuming no increases in costs from inflation and labor agreements. Without additional appropriations to the Prevention Account or fund source changes in SPAR's operating budget, there will be a continuing operating budget shortfall starting in FY16. The projected estimated shortfalls through FY22 are shown on Attachment 1.

This shortfall has been anticipated for a number of years and there have been discussions between the Legislature and the Administration on how to address the problem, at least until crude oil production rises sufficiently that the four cent per barrel surcharge once again generates sufficient funds to cover continuing operating costs (1,012,100 bbls/day would be needed).

Means to Help Sustain the Prevention Account

A number of measures have been implemented to increase the amounts going into the Prevention Account or to slow the draw down on the Prevention Account thus extending it to a point that increased crude oil production will again make the account sustainable. Measures to reduce the rate of the draw down on the account include:

- Restraining growth of SPAR and instituting program efficiencies

  Over a ten year period (from the FY2005 Authorized budget to the FY2015 Governor's request), the Division of Spill Prevention and Response has grown by just 2 PCNs. Over that same period, the Department's appropriation from the Prevention Account has increased just 1.6% annually, a rate lower than inflation and the State's growth in negotiated personal services costs over the same period. This lower than expected rate of growth is the result of $1,062,000 in budget decrements in FY2006, FY2007, and FY2011. During this same time period, SPAR avoided compromising its level of service delivery by increasing the efficiency of program operations. Meanwhile, the Division also took on new responsibilities such as regulating the operation of flow lines, non-tank vessels over 400 gross ton and the transportation of fuel by the railroad.

- Cutting back on uses of the Prevention Account

  The Legislature also eliminated expenditures from the Response Fund to Local Emergency Planning Committees (LEPCs), Department of Military and Veteran Affairs (DMVA), and Department of Transportation and Public Facilities (DOT&PF) to offset declining surcharge revenue.

  DEC has eliminated a loan and grant program for the removal of underground storage tanks, withdrew efforts to fund a statewide hazmat team, and eliminated funding for any purposes outside SPAR's core mission. While these activities were all allowable uses of the account, in light of declining funds, they were eliminated in favor of only the most germane activities.

  Most significantly, after FY 2011, DEC stopped requesting capital appropriations from the Prevention Account for cleanup of state-owned contaminated sites[1]. DEC had been coordinating cleanup on state-owned sites since 1991 under a Memorandum of Agreement (MOA) with other state agencies. Funds from the Prevention Account, totaling $17.090 million, had been spent on assessment, management and cleanup of state-owned or managed contaminate sites. Again, this was an appropriate use of the Prevention Account[2], but by stopping this practice and turning to general funds for appropriations to pay for expenses on these sites, this significantly reduced the rate of drawdown of the Prevention Account. This does not mean that DEC has reduced the level of effort in addressing these sites. As explained below, DEC anticipates a relatively level amount of requests for general funds for state clean-up projects going forward that will allow DEC to timely and efficiently address priority sites.

Measures designed to increase amounts going into the Prevention Account include:

- The 2006, legislative increase in the surcharge from $.03 to $.04 per barrel to the Prevention Account to compensate for declining surcharge revenue from reduced crude oil production.

- Appropriations into the Prevention Account from other sources:
  a. FY2006: $655,500 underground storage tank revolving loan funds[3]
  b. FY2007: $1,800,000 commercial passenger vessel funds[4]

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1 Several legislative appropriations from FY2011 and prior funded by the Prevention Account for state-owned/lead contaminated site cleanup remain active, but the remaining balances are nearly fully expended.
2 The account was audited by the Legislature in 2008 and no unauthorized uses of the account were noted.
3 Ch4, FSSLA05, p73, l28 – due to an insufficient balance in the USTRLF, only $665,500 of the $991,187 appropriated was transferred into the fund. This transfer was for the full final balance of the USTRLF, which was subsequently closed with no remaining balance.
4 Ch33, SLA06, p75, l3

c. FY2008: of $2,000,000 general funds[5]

- Increase collections from Potentially Responsible Parties. DEC and the Department of Law have been evaluating cost recovery procedures with an aim to making them more efficient and effective. In 2013, DEC overhauled the administrative cost recovery process and automated many cost tracking and accounts receivable activities. By automating this process, DEC now issues cost recovery statements that are more accurate and timely, and has much better data available to pursue aged receivables.

Other potential means to increase amounts going into the Prevention Account include expanding the surcharge to apply it to refined products produced, stored or transported within the State, initiate fees for services currently funded through the Prevention Account and increasing the amount of the surcharge on crude oil production. Each of these would require legislation. Among the factors that the Legislature might want to consider if it entertains any of these potential options is the financial and reporting burdens it might impose on the public and industry, the costs of administering the collection of the new fees or taxes and what, if any, impact the fees and costs would have on efforts to increase crude oil production and lower energy costs in the State. These issues are beyond the purview of DEC's authorities.

Conclusion:

DEC will continue to only fund maintenance of existing core prevention and response services and only fund increases related to inflation (no increment in services, despite increases in oil and gas development and production).

Once oil production increases to 1,012,100 bbls/day, surcharge receipts will once again provide sufficient funding for the prevention and response programs at current levels. Until then, DEC will require general funds to address anticipated annual shortfalls and continue critical programs. Projections provided by DEC show that the Prevention Account will be depleted by the end of FY2015. General funds will likely be required in FY2016. DEC will provide the Legislature with the updated analysis of the balance and expenditures from the oil and hazardous substance release prevention and response funding during the upcoming legislative session.

Any further efforts to reduce expenditures from the Prevention Account, without support from other fund sources, would impair DEC's ability to prevent and respond to spills both large and small. With increasing exploration and production, and so much new activity in Cook Inlet and the Arctic, DEC must maintain its robust spill prevention and response capacity.

Remediation of State-owned contaminated sites

DEC stopped requesting capital appropriations from the Prevention Account for the clean-up of contaminated sites after FY2011, however, the clean-up work continued using the balances from previous Capital appropriations beyond FY2011. Between FY1999 and FY2012, the Department expended $17.09

[5] Ch29, SLA08, p211, l31

million from the Prevention Account for the remediation of state-owned contaminated sites. DEC estimates a backlog of over $50 million for sites where work remains to be done. Expeditious remediation of these sites will require significant general fund investment in the coming years. The Legislature appropriated $3.0 million in the FY2014 budget, and DEC is actively engaged in cleanup efforts with these funds.