

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
**May 06, 2003**  
**9:01 AM**

**TAPES**

SFC-03 # 77, Side A  
SFC 03 # 77, Side B  
SFC 03 # 78, Side A

**CALL TO ORDER**

Co-Chair Gary Wilken convened the meeting at approximately 9:01 AM.

**PRESENT**

Senator Lyda Green, Co-Chair  
Senator Gary Wilken, Co-Chair  
Senator Con Bunde, Vice Chair  
Senator Robin Taylor  
Senator Ben Stevens  
Senator Donny Olson  
Senator Lyman Hoffman

**Also Attending:** SENATOR TOM WAGONER; REPRESENTATIVE MIKE HAWKER;  
REPRESENTATIVE CARL MORGAN; REPRESENTATIVE MIKE CHENAULT; LOREN  
GERHARD, Southeast Conference;

**Attending via Teleconference:** From an offnet location: SARA  
FISHER-GOAD, Alaska Industrial Development and Export Authority;  
KEVIN BANKS, Division of Oil and Gas, Department of Natural  
Resources; MIKE NUGENT, General Manager, Agrium; From Anchorage:  
KEVIN PEARSON, Anchorage Economic Development Corporation, and  
ARDOR Director; SUE COGSWELL, Price William Sound Economic  
Development District; WANETTA AYERS, Executive Director, Southwest  
Alaska Municipal Conference; From Fairbanks: JANET DAVISON,  
Community Research Center, Fairbanks North Star Borough; KATHRYN  
DODGE, Economic Development Coordinator, Fairbanks North Star  
Borough; DEB HICKOK, President and Chief Executive Officer,  
Fairbanks Convention and Visitors Borough, and member, Economic  
Development Commission of the Fairbanks North Star Borough; JIM  
DODSON, Chair, Fairbanks Economic Development Corporation

**SUMMARY INFORMATION**

SB 177-PERS/TRS COLA FOR ACTIVE DUTY MILITARY

The bill reported from Committee.

HB 203-AIDEA DIVIDENDS TO STATE

The Committee heard from the sponsor and the Alaska Industrial Development and Export Authority. The bill was held in Committee.

HB 79-AK REGIONAL ECONOMIC ASSISTANCE PROGRAM

The Committee heard from the sponsor and representatives from economic development organizations. A committee substitute was adopted and the bill was reported from Committee.

HB 57-ROYALTY GAS CONTRACTS

The Committee heard from the sponsor of this bill and a companion Senate bill, the Department of Natural Resources, and industry representatives. The bill was held in Committee.

HB 170-MOTOR VEHICLE REGISTRATION FEES

This bill was scheduled but not heard.

#SB177

SENATE BILL NO. 177

"An Act relating to cost-of-living benefits for retired members in the public employees' retirement system and the teachers' retirement system who are called to active military duty; and providing for an effective date."

This was the second hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken reminded the Committee of discussions on the feasibility of incorporating the provisions of SB 26 with this bill. He informed that "fiscal complications" are involved and therefore each bill would be considered independently.

Co-Chair Green offered a motion to report SB 177 from Committee with individual recommendations and accompanying fiscal note.

There was no objection and SB 177 MOVED from Committee with fiscal note #1 from the Department of Administration.

#HB203

HOUSE BILL NO. 203

"An Act relating to the definitions of 'net income' and 'unrestricted net income' for purposes of calculating the dividends to be paid to the state by the Alaska Industrial Development and Export Authority; and providing for an effective date."

This was the first hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken stated that this bill "clarifies the definition of 'net income' in regards to the annual dividend that AIDEA [Alaska Industrial Development and Export Authority] pays to the State. If passed, in FY 04 AIDEA dividend would raise somewhere between \$9 and \$18 million."

REPRESENTATIVE MIKE HAWKER testified on behalf of the House Finance Committee that this bill addresses a "circumstance encountered" in AIDEA operations and financial reporting in relation to the statutory net income of the Authority. Under the provisions of current statute, he informed that, AIDEA would not contribute "it's regular" dividend to the State general fund in FY 04. He explained that current statute provides that AIDEA "shall distribute to the State a judgmental determination between 25 and 50 percent of its net income" to the State general fund for "general purposes".

Representative Hawker specified that the definition of "net income subject to distribution" is the purpose of this legislation, noting the accounting of net income by AIDEA is "somewhat different than what the State believes [should be] subject to the dividend calculation." He explained that current statute exempts inter-government transfers, capital contributions and grants; opining, "Clearly, those items that are not part of the operating results of AIDEA that should be subject to some kind of a dividend."

Representative Hawker shared that this bill proposes including the "write-down of fixed or hard assets, [i.e.] previous investments that one would call impairment losses" to the income items not utilized in the calculation of net income for dividend distribution. He exampled the write-off in the past year of substantial investments in the Alaska Seafood International (ASI) processing plant in Anchorage as well as the Healy Clean Coal project. He reminded that these investments were made by AIDEA "many years ago" and that the write-down of those assets had no affect on the cash flow of the Authority, nor its ongoing

operations during the reporting year. He elaborated that the investments had not provided a cash return to AIDEA for a number of years.

Representative Hawker instructed, "these types of impairment losses are not uncommon; they are to be anticipated in operating an operation like AIDEA." However, he expressed concern with the ability of AIDEA to utilize write-downs of past investments as a device to avoid payment of a dividend. He noted that AIDEA currently has \$789 million unrestricted net assets, \$356 million of which is unrestricted cash and investments. Therefore, he surmised this legislation would "facilitate a steady, regular, recurring and predictable dividend from AIDEA," to the benefit of financial planning for the State. He furthered that the provisions of this legislation would not impose an egregious restriction on the Authority's net income. Rather, he opined, it would provide a "stable environment" for relations with the Authority's debtor agencies, lenders, "the financial community and the State and the Nation as a whole."

Representative Hawker predicted this legislation would result in an additional \$18 million AIDEA dividend for FY 04, which he considered "appropriate at this time".

Senator Bunde asked if the provisions of this legislation would comply with generally accepted accounting principles (GAAP).

Representative Hawker replied that this bill would reconcile the difference between GAAP, the required procedure by which AIDEA reports financial statements, to a statutory definition of net income, whereby the Legislature would create a dividend policy. This policy, he said, would "modify the accountant's definition of the all inclusive net income to exclude these particular items." In his professional opinion, as a Certified Public Accountant, he assured this would be in accordance with GAAP.

Co-Chair Wilken referenced a letter of opposition to this bill dated April 1, 2003, from AIDEA.

Senator Olson wanted to know why AIDEA opposes this legislation.

SARA FISHER-GOAD, Alaska Industrial Development and Export Authority, testified via teleconference from an off net location about the Board's primary concern with the precedence a statutory change to dividend calculations could set in creating a situation whereby AIDEA could not pay a dividend.

Senator Olson asked the sponsor if this legislation would result in

the Authority investing in "less than profitable" ventures.

Representative Hawker asserted this would not affect the investment policy of AIDEA. He recalled legislation passed the prior session, which significantly redefined net income and unrestricted net income and was precipitated by "the accounting world's change in its presentation of financial statements". He characterized the current legislation is a "finalization" of the changes made in the earlier legislation and actually a "housekeeping" matter than a policy direction. He surmised it would not encourage AIDEA to operate in a manner other than the most prudent and in best interest of the State.

Senator Taylor asked why the losses on investments, which have been occurring for some period of time, are only recently reported as such. He questioned whether the reasons are political. He compared the practice to the recent national events involving the alleged dubious accounting practices of the Enron Corporation. He contended that the previous gubernatorial administration reported the value of the seafood plant and the clean coal project as higher than their actual worth. He therefore asked if the current Murkowski Administration corrected the accounting procedures and subsequently wrote down the losses.

Representative Hawker was unable to speak to the motives of actions taken by AIDEA. However, he spoke to the practice of preparing financial statements, which involves judgment decisions, particularly judgments to the "realizability" of the value of assets. He further informed that the impaired value of "long lived" assets has been a matter of controversy due to inconsistencies. As a result, he noted, accounting standards have been changed in the past several years.

Senator Taylor asked if the State regularly audits AIDEA. If so, he questioned why auditors had not identified the losses in the past and subsequently require the Authority to account for them. He pointed out that AIDEA had the ability to pay dividends to the State during the previous administration.

Ms. Fisher-Goad spoke to a trigger mechanism that determines when impairment losses are recognized. She informed that losses for the Healy Clean Coal project have been written down once prior to the occasion of the previous fiscal year. She noted that because ASI underwent a process of refinancing and restructuring, the impairment loss was not "recognized" until the previous fiscal year. She stated that AIDEA produces audited financial statements each year and that each legislator should receive copy of the report.

Senator Taylor requested that financial auditors within the Division of Legislative Finance review the financial statements. He was concerned why the losses were not reflected earlier. He assured he supports the legislation.

Co-Chair Wilken listed considerable discussion on the two projects as well as pending federal legislation to "bail out" the clean coal project as possible factors in the timing of the write-downs.

Co-Chair Wilken pointed out that the fiscal note amount indicates an indeterminate cost to implement this legislation; however the accompanying analysis estimates the cost to be between \$8 million and \$9 million. He asked if a more definitive figure was available. He also wanted an estimate of future revenues to the State as a result of the changed dividend amounts.

Representative Hawker responded that the fiscal note is indeterminate because the statute provides a "range upon which the dividend may be judgmentally determined." The range, he said, is between 25 to 50 percent of net income. He calculated a possible dividend of \$9,058,000 at 25 percent and \$18,170,000 at 50 percent. He was unaware of any disputes to the accuracy of these figures.

Co-Chair Wilken surmised that in a year that AIDEA unrestricted net assets and/or investments was unfavorable, the State has the option of not receiving a dividend.

Representative Hawker affirmed and clarified that current statute provides that the legislature would be "statutorily post scribed from taking any cash from AIDEA."

Senator Taylor suggested that with statutory change, AIDEA could be liquidated and approximately \$700 million deposited into the State general fund.

Co-Chair Green asked for a definition of impairment losses.

Representative Hawker qualified that accounting terms are defined similar to the manner in which attorneys define legal terms. He described impairment loss as an investment in a "tangible hard asset," such as a building, that has a "productive capacity", i.e. would generate a return when utilized, but is no longer capable to do so and subsequently "pay for itself". He exemplified a building fire as an event that could result in an impairment loss because the value of the building would be less than the investment. He specified that a major fire would be considered a catastrophic impairment loss. He furthered that other events could result in an

impairment loss, telling of the investment in a coal loading facility, with the return on investment dependent upon a contract for the use of that facility. If the contract is not renewed, he pointed out, the value of the facility is impaired and an impairment loss results. He stated that an impairment loss is reported in financial statements as an estimate of the reduction in value.

Co-Chair Green referenced a portion of the sponsor statement [copy on file], which reads as follows.

Under current statute there will be no AIDEA income available for a dividend in fiscal 2004 as a result of impairment losses recognized on the Healy Clean Coal Project and Alaska Seafood International. Still, AIDEA has \$789 million in unrestricted net assets and \$356 million of unrestricted cash and investments from which a dividend could be paid. The dividend formula proposed in House Bill 203 would make \$9 to \$18 million of this money available for a dividend to the State in FY 04.

Co-Chair Green next directed attention to a handout titled "Management Discussion and Analysis" [copy on file], which compares assets and liabilities of FY 02 and FY 03. This information is contained on page 13 of the AIDEA 2002 Annual Report [portions of which are on file.] She asked if the unrestricted net income and unrestricted cash figures cited in the sponsor statement reflect the FY 03 amounts shown on the Analysis, and how the amounts compare to previous years.

Representative Hawker replied that the amounts listed in the sponsor statement reflect the amounts current as of June 30, 2002. For comparison purposes, he referenced page 16 of the AIDEA 2002 Annual Report, titled "Balance Sheet" [copy on file]. He stated that the figures are based on a two year "back trailing calculation".

Co-Chair Green requested historical information from 2001 and 2002 for comparison purposes. She wanted to know whether a trend exists in the "status of AIDEA".

Representative Hawker listed the cash and equivalence component for FY 02 as \$14,415,000; FY 01 as \$28,600,000; and FY 00 \$27,400,000. He next listed the current investment securities amounts for FY 01 as \$400,000,000 and \$352,000,000 for FY 00. He stated that the reductions were as a result of the write off of the impairment loss from the two facilities.

Co-Chair Wilken asked the unrestricted net assets of FY 00

Representative Hawker answered \$856 [million], qualifying this amount is an "approximation, recognizing the change in format." He furthered that the amount in FY 01 was \$877 [million], and \$789 [million] in FY 02.

Senator Taylor asked whether this legislation must be passed to ensure the State receives a dividend from AIDEA in the upcoming fiscal year.

Co-Chair Wilken affirmed.

Senator Olson referenced the June 30, 2002 Balance Sheet and asked the percentage of AIDEA earnings derived from the Red Dog Mine and how this legislation would affect that operation.

Representative Hawker deferred to AIDEA

Senator B. Stevens directed attention to pages 20 and 21 of the AIDEA 2002 Annual Report titled, "Notes to Basic Financial Statements" [copy on file]. He pointed out note (1) Organization and Operations, lists the initial AIDEA bond obligation of \$85 million for the Healy Clean Coal Project and \$48 million for ASI, totaling \$133 million. He noted the write-down of the loss in these investments is \$93 million and he asked if additional write-downs would occur for the balance of approximately \$41.6 million invested in these projects.

Representative Hawker again deferred to AIDEA.

Senator B. Stevens continued to page 26 and (7) Net Investment in Direct Financing Leases, Notes and Development Projects [copy on file] and cited a portion as follows.

The components of the Authority's net investment in direct financing leases at June 30, 2002 are (stated in thousands):

Minimum lease payments receivable	\$824,645
Less unearned income	(495,031)
Less impairment loss	(25,600)
Net investment in direct financing leases	\$304,014

Senator B. Stevens surmised the unearned income represents lease payments or finance payments not collected. He requested an explanation of the impairment loss in this context as it appeared to be recorded as a payment not received rather than as an asset.

Representative Hawker explained the two investments made into these projects, one into a hard asset, the other financing leases for operations. He furthered that the second investment essentially created a loan to provide funding to support the project. In this instance, he said the asset is a loan to be repaid in the form of a lease. The unearned income, he stated, represents the repayment of the loan and the impairment loss represents a further reduction in the value of the investment that would not be recouped.

Senator B. Stevens clarified two forms of impairment losses were realized, one in the value of the asset, the other in the value of future revenues from that investment.

Representative Hawker affirmed and noted the loss of value to the State in this asset is manifested in the leases.

Ms. Fisher-Goad addressed the remaining \$41.6 million invested in the Healy and ASI projects that had not been written down to date. She first clarified that no bonds were issued for the investment in ASI.

Senator B. Stevens asked if AIDEA therefore purchased the facility outright without bond financing.

Ms. Fisher-Goad affirmed. She explained that the value of ASI, for the purpose of reporting an impairment loss, was determined by calculating the "alternative use value" of the building.

Co-Chair Wilken again asked the status of the \$41.6 million, and whether it would be reported as an impairment loss in future financial statements.

Ms. Fisher-Goad was not prepared to answer to the future of the two projects. She noted that impairment losses were reported for the projects, but emphasized that assets continue to depreciate and are reported as such regardless of whether an impairment loss occurs.

Senator B. Stevens noted the potential that impairment losses on these investments would be reported in future financial statements would influence his support of this legislation because such write-downs could impede the Authority's ability to pay a dividend to the State.

Co-Chair Wilken understood that AIDEA recognizes \$133 million in asset value, and although \$91 million has been written down, the remainder of the investment has not yet "been dealt with".

Representative Hawker rephrased the question to AIDEA: He asked in the context of future prospects, what is the current book value of the coal project and of the ASI investments, and the prospects for further impairment recognitions in future fiscal years.

Ms. Fisher-Goad repeated that she was not prepared to provide the current book value of these assets nor whether the Authority expects future impairment loss recognition.

Co-Chair Wilken requested this information be provided to the Committee.

Ms. Fisher-Goad stated she would provide this information later in the week.

Senator B. Stevens also requested information regarding the impairment losses reported over the past five years. He indicated language on page 14 of the AIDEA 2002 Annual Report, titled "Management's Discussion and Analysis" [copy on file] referencing a \$10,419 impairment loss recorded in FY 01 for the Skagway Ore Terminal. He expressed interest in the frequency of impairment loss reporting by AIDEA.

Ms. Fisher-Goad would provide this information the following day.

Co-Chair Green also requested information regarding the unrestricted cash investments and unrestricted net assets for the same five years.

Ms. Fisher-Goad noted significant accounting changes were implemented the previous year, cautioning that comparison would be difficult.

Senator Taylor remarked that this legislation provides that if impairment losses are recognized and allowed as an exclusion from net income, a dividend would be available to the State in the current fiscal year. He opined this issue is more important than a determination of impairment losses in past years. Therefore, he emphasized the importance of this legislation. He commented that although he appreciated that the recording of the impairment losses, as well as changing accounting principles, have "cleaned up the books". However, he stressed his "attitude toward AIDEA" and the asset base, is unchanged. He preferred to report the bill from Committee and address the questions later in the process.

Co-Chair Wilken noted adequate time remained in the legislative session to address this bill.

Co-Chair Wilken agreed this bill would provide a revenue source that should be implemented.

SFC 03 # 77, Side B 09:48 AM

Co-Chair Wilken ordered the bill HELD in Committee.

#HB79

HOUSE BILL NO. 79

"An Act extending the termination date of the Alaska regional economic assistance program; and providing for an effective date."

This was the first hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken explained that this bill sponsored by the House Community and Regional Affairs Committee would reauthorize "the Alaska Regional Economical Assistance Program, better known as ARDOR [Alaska Regional Development Organization], for five years until July 1, 2008. He announced he prepared a committee substitute that would change the extension date to one year.

REPRESENTATIVE CARL MORGAN, Chair, House Community and Regional Affairs Committee, read talking points into the record as follows.

The Alaska Regional Development Organizations (ARDOR) Program is the State's contribution to regional initiatives for developing Alaska's economy.

There are currently 13 ARDORS statewide.

The Legislature first created the ARDOR Program in 1988.

The ARDOR Program provides a network of organizations to plan and support economic development at the regional level.

Board members participation reflects a local commitment.

Each ARDOR, with 15-20 members, constitutes 150 plus local, civic minded individuals who volunteer their time to achieve a stronger economic base in their region.

The ARDOR Program is providing a return for the State's

investment.

The State provides \$620,000 in grant funds. The ARDORs [have] used these grant funds to leverage over \$3 million in other funds.

House Bill 79 extends this successful program to July 1, 2008.

Representative Morgan noted each ARDOR receives over \$47,000 in State funding.

Co-Chair Wilken spoke to a proposed committee substitute to extend the commission for one year instead of the five years provided in the bill.

Co-Chair Green moved for adoption of HB 79, 23-LS0493\D as a working draft.

Co-Chair Wilken objected to speak to the changes proposed in the committee substitute. He pointed out the \$620,000 cost to the State to fund this program. He indicated the 2003 annual report submitted to the Legislature by ARDOR [copy not provided], is unclear whether each regional organization is successful. He noted the Southeast Regional Conference demonstrates success and an ability to measure that success; however, he commented that others are "a little lax as to where and what they're spending their money on and whether indeed there's any results."

Co-Chair Wilken referenced a letter dated April 11, 2003 from himself to Commissioner Blatchford of the Department of Community and Economic Development [copy on file], suggesting elimination of the ARDOR Program in FY 05. However, rather than eliminating the program, Co-Chair Wilken informed the Committee of his intention to review the matter during the legislative interim to ensure funds allocated to the program are used wisely.

Co-Chair Wilken next directed attention to a letter to the House Community and Regional Affairs Committee from the Alaska Municipal League, dated February 20, 2003 [copy on file]. He informed this letter also requests implementation of performance measures.

Co-Chair Wilken surmised the Department is agreeable to this intent. Therefore, he suggested extending the program only one year to allow for review of the findings the following legislative session. He assured that if no problems are identified, the program could be extended further.

Senator Olson requested the opinion of sponsor regarding the

proposed committee substitute.

Representative Morgan qualified that he had not reviewed the proposed committee substitute and that he had no control over the will of the Senate Finance Committee.

Senator Olson shared the co-chair's concerns about accountability; however he attributed this to the maturing process of the participants. He questioned the "wisdom" of a one-year termination date.

Co-Chair Wilken reiterated this change would focus effort on "developing the worth of the \$650,000 expenditure." He suggested all or a portion of these funds might be better spent elsewhere. Regardless, he said the expenditures should be reviewed and the findings "embodied" in the FY 05 budget.

Senator Olson asked the amount of federal funding involved in the program.

Representative Morgan replied that the State appropriation garners over \$13 million annually.

There was no objection and the committee substitute, Version "D", was ADOPTED as a working draft.

KEVIN PEARSON, Anchorage Economic Development Corporation, and ARDOR Director, testified via teleconference from Anchorage in favor of extending the ARDOR Program. Although the ARDOR Program provides a small percentage of the funding for economic development activities in Anchorage, he emphasized the sole reliance on these funds by outlying communities. He was also concerned with the "message" an extension of only one-year would portray to investors.

Mr. Pearson charged that the onus is on the Legislature as to what information is needed to measure the program's success and justify the expenditure. He furthered that the program is successful and information is available to demonstrate this.

SUE COGSWELL, Price William Sound Economic Development District, testified via teleconference from Anchorage about the participation in the ARDOR program since 1991 and as an economic development district since 2001. She told of projects to build a seafood processing plant in Valdez, an economic development summit held in Cordova and the hope for additional economic growth.

WANETTA AYERS, Executive Director, Southwest Alaska Municipal Conference (SWAMC), testified via teleconference from Anchorage in

favor of reauthorization of the ARDOR Program on behalf of the 54 communities and 131 members of the Conference. She informed that the Conference was formed in 1986 and earned ARDOR designation in 1989. She reported that State funding comprises 22 to 25 percent of the Conference's budget during the past several years; federal funding comprises approximately 25 percent; and over 50 percent of the funding is derived from earned income. She noted that as a designated economic development district, SWAMC saves the communities of Southwestern Alaska "hundreds of thousands of dollars, if not millions" annually by reducing the local match requirement for federally funded projects. She furthered that the SWAMC allows area communities to be more efficient and in a "better position to take advantage of market opportunities".

Ms. Ayers told the Committee that in FY 02, SWAMC was selected by the US Congress to administer a \$30 million stellar sea lion mitigation fund. She noted that little direction was provided in the enabling legislation, although review of other mitigation programs, the SWAMC board established three goals: achieve the soonest possible distribution of fund to those directly impacted but federal fisheries closures and restrictions, to minimize administrative costs to one percent or less, and develop a negotiated settlement process that has widespread support from the communities, businesses and individuals most impacted. She reported that all three objectives were achieved. She stated this is one example of accomplishments ARDOR groups could realize.

Ms. Ayers opined that a one-year extension rather than a four-year extension of the program would be "an indication of the State's lack of commitment to economic development." She stressed the need for an on-going commitment.

Co-Chair Wilken assured that if review of the ARDOR Program determines that the expenditures are justifiable, he would support increased funding for the program.

JANET DAVISON, Community Research Center, Fairbanks North Star Borough, testified via teleconference from Fairbanks about her job duties in monitoring economic development activities in the Borough and measuring "gains and losses" in the community. She suggested the Entrepreneurial Statement report she produces is a "starting place" for measuring the success of economic development efforts. She stressed that the funds allow for economic development efforts in rural communities. She spoke to the benefits of the ARDOR Program and the economic development opportunities it continues to provide in both urban and rural communities.

KATHRYN DODGE, Economic Development Coordinator, Fairbanks North

Star Borough, testified via teleconference from Fairbanks that economic development is a long-term commitment and does not demonstrate results overnight. She remarked that a five-year extension of the ARDOR Program would send a message of commitment. She expressed that the Fairbanks ARDOR Program "compels" the community to focus on economic development and encourages the development of public and private partnerships in the "pursuit of future economic development for the Borough and for the State."

Ms. Dodge described the local program's development of a comprehensive economic development strategy and the subsequent increased momentum and prioritization of projects. She stated the local ARDOR Program obtained \$331,000 in economic development grants secured using the \$44,000 State appropriation during the past year. She gave examples of expenditures of these funds, including assistance commercial fish processors in the region, hosting public safety regional training ranges and development efforts to create a cold weather testing industry.

DEB HICKOK, President and Chief Executive Officer, Fairbanks Convention and Visitors Borough, and member, Economic Development Commission of the Fairbanks North Star Borough, testified via teleconference from Fairbanks that she understood the hard budget decisions faced by the Committee, but stressed that economic development is important. She spoke to the opportunity for "grass roots" or "bottom up" economic development. She attested to the success of the ARDOR Program in Fairbanks and the resulting "heightened climate of economic development" since inception of the program. She described the history of the organization, now operating under the direction of professionals and receiving a larger percentage of funding from the Borough. She disagreed with Co-Chair Wilken's proposal for one-year extension, as this is too short a goal for measurement.

JIM DODSON, Chair, Fairbanks Economic Development Corporation, testified via teleconference from Fairbanks that the Corporation is a recipient of funding from the Fairbanks North Star Borough. He encouraged support of original version of the bill. He spoke to measurable results in economic development and stressed the need for economic development opportunities in the State. He pointed out that additional funds would be needed in the future. He supported a five-year extension of the ARDOR Program.

Senator Olson asked the potential increase or decrease of federal funds received if the Program were extended one year rather than five.

Co-Chair Wilken suspected no impact.

LOREN GERHARD, Southeast Conference testified in Juneau, that the \$47,000 appropriation to the ARDOR Program provides one-third of unencumbered funding for the Conference, which is leveraged approximately ten-to-one to receive federal funds and other grant program funding. He stated that all of the funds are used for improving economic opportunities in the Southeastern region. Outside Juneau, he pointed out, the region is suffering economically, and remarked that the ARDOR Program is a cost-effective way to ensure that regions are addressing economic development specific to each region.

Co-Chair Wilken opined that the report prepared by the Southeast Conference is superior to the reports submitted by the other ARDOR Programs. He expressed that this report would be used as an example in efforts to improve the Program.

Senator Olson asked the impact a shorter termination date would have on the Southeast Conference.

Mr. Gerhard replied that it would not affect the Program and the receipt of federal funds, although it could effect planning for future projects. He emphasized the benefits of the ability to utilize the State appropriation as unencumbered funds to leverage federal funding.

Senator Taylor offered a motion to report HB 79, 23-LS0493\D from Committee with individual recommendations and accompanying fiscal note.

Without objection, SCS HB 79 (FIN) with the \$650,000 fiscal note #2 from the Department of Community and Economic Development, MOVED from Committee.

#HB57

CS FOR HOUSE BILL NO. 57(FIN)

"An Act amending the manner of determining the royalty received by the state on gas production as it relates to the manufacture of certain value-added products."

This was the first hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken stated this bill "allows the Department of Natural Resources commissioner to adjust the value of the State's royalty share for gas used by a manufacturer for agricultural chemicals."

He noted a proposed committee substitute "Version C" was submitted to the Committee by the sponsor. He requested a presentation of the bill and a comparison of "Version C" to the House Finance committee substitute [referred to as "Version X"].

REPRESENTATIVE MIKE CHENAULT, Sponsor, explained this bill "adds certainty to in-State value-added manufacturing". Currently, he informed, royalty prices are calculated in four different ways which causes problems for manufacturers because the price of gas is uncertain, as well as the royalty owed on that gas. He explained that four years after the sale of product, an audit could determine that the price was considerably higher, costing the manufacturer \$4 to \$5 million in additional royalties. He stated this legislation would permit manufacturers to negotiate the price of the gas to allow the manufacturers to sell it at a price that allows for a profit.

SENATOR TOM WAGONER clarified this legislation pertains to the "price of the State royalty share of gas".

Senator Bunde commented that residents of the Kenai Peninsula oppose the level of State spending; however, this legislation proposes increased State funding. He understood the need to support viable industry. He asked the estimated cost to the State.

Representative Chenault cited the fiscal note, which predicts the cost to be between zero and \$11,5 million in lost royalty payments. He listed the factors, including the negotiations reached by the commissioner, employment opportunities and tangible benefits to the communities.

Senator Taylor asked the version the sponsor supports.

Representative Chenault responded that the proposed committee substitute, Version "C" mirrors Senate companion legislation and reflects a compromise agreed upon by the Senate.

Senator Wagoner reiterated Version "C" is the preferred version.

Senator Taylor moved for adoption of CS HB 57, 23-LS0303\C as a working draft.

Without objection the committee substitute was ADOPTED as a working draft.

Senator Taylor revisited the potential cost to the State.

Senator Wagoner clarified the maximum \$11.5 million predicted loss

of royalty revenues would occur over a period of several years.

Senator Taylor asked if this estimate is based on the provisions of committee substitute Version "C" or the House Finance committee substitute.

Representative Chenault replied Version "C".

Co-Chair Wilken noted a draft fiscal note, dated 5/5/03, addresses the provisions in Version "C".

Senator Hoffman expressed concern that chemical fertilizing plants nationwide are currently failing because the methane gas used in stock feed is worth more than the finished product. He questioned therefore the benefits of this legislation to provide jobs.

Representative Chenault could not speak to businesses elsewhere failing, but stressed the economic impact the loss of jobs on the Kenai Peninsula that would occur if the local facility failed. He informed that personnel layoffs are currently under consideration, although he attributed this to new ownership and because the plant is operating at 70 percent of capacity.

Senator Hoffman asked if the sponsor would consider a shorter time period for a negotiated price to minimize the loss of royalty revenues.

Representative Chenault indicated he would have to give the matter consideration before offering support.

Co-Chair Wilken referenced page 2 of the draft fiscal note, which details the potential loss of royalties over the five-year period.

Co-Chair Wilken asked for an explanation of the current process and why the royalty rate changes. He also asked for additional information on the impact on the State general fund.

Representative Chenault remarked that this bill would not affect current contracts for gas supplies. He explained the existing process whereby the State and the producer negotiate a royalty amount without input of the manufacturer. He stated that upon review after four years, the State could determine that the negotiated royalty was not a "fair price".

Co-Chair Wilken asked for an example of the producers in this context.

Representative Chenault exemplified Unocal and Marathon, noting that

all gas producers are involved in the royalty negotiation.

Co-Chair Wilken clarified the producer negotiates a long-term contract for the "price of that feed stock" with the State.

Senator Wagoner told the Committee that the previous owner of the manufacturing plant also discovered and produced the gas. Currently, he said, Union Oil produces the gas, and Agrium operates as the manufacturer.

Co-Chair Wilken next clarified the States receives 12.5 percent in royalty from Unocal, the producer, which sells that gas to Agrium.

Representative Chenault affirmed and continued that the State could conduct an audit of the royalty price negotiated with Unocal and subsequently could determine that Unocal paid less than the worth of the gas.

Co-Chair Wilken understood an agreement of the price was negotiated.

Representative Chenault reiterated the existence of four different methods to calculate the royalty amount. As a result, he stated the State could determine additional payment is required, at which point, Unocal would collect the funds from Agrium.

SFC 03 # 78, Side A 10:36 AM

Co-Chair Wilken asked if retroactive price adjustments are a condition of the agreements between Unocal and Agrium.

Representative Chenault affirmed.

Representative Chenault reiterated this legislation would not impact current contracts, however in future contract negotiations Agrium, i.e. the manufacturer, would participate in negotiations and the royalty price would remain at the negotiated amount for the term of the contract.

Co-Chair Wilken asked if Unocal were able to receive a higher price from the sale of gas to a buyer other than Agrium, whether the difference would be assessed to Agrium.

Senator Wagoner told of the contract providing that Unocal would supply gas to Agrium at a negotiated price. He noted one exception is increased utility demand during winter months.

Representative Chenault emphasized this legislation would provide assurances that under the terms of future contracts, the manufacturer would pay the negotiated royalty price.

Co-Chair Wilken asked if new contracts would be implemented in FY 05 and FY 06.

Representative Chenault informed that one long-term contract is in effect currently and that the remainder of the gas purchases are subject to "spot market". He stated that the manufacture is attempting to purchase an adequate supply of gas to operate the facility.

Senator Wagoner furthered this legislation allows the commissioner to negotiate profit sharing with Agrium if determined to be in the best interest of the State.

KEVIN BANKS, Division of Oil and Gas, Department of Natural Resources, testified via teleconference from an offnet location, that leases negotiated since statehood are market-value leases. He explained that the royalty value is subject to an evaluation using four different measures to determine the market value of the royalty. He noted that some leases in other states are gross proceeds leases, which provides that the royalty paid by the lessee is equal to the amount that the lessee sold the gas. He stated the sale price of the gas is one of the four measurements utilized for determining market value of royalty in Alaska and that the State is allowed to consider the price between the lessee and its customers compared to the market value as measured by other mechanisms. Therefore, he pointed out, the sale price and the royalty price could differ under the provisions of the lease agreement if the market value is higher.

Mr. Banks stated that determinations of higher royalty amounts are often made after an audit and after the initial royalties have been paid. In these instances, he said, the lessee is required to pay additional royalty amounts two or more years later.

Mr. Banks pointed out that gas supply contracts commonly allow the lessee and its customer to agree to an "excess royalties" term. He exemplified contracts between gas producers operating in Cook Inlet and utility companies include this provision.

Mr. Banks outlined the fiscal note estimates the amount of gas that would be sold to Agrium and other entities, such as utilities, in the future, not including gas currently under contract. He stated the fiscal note assumes that a royalty contract would provide for

the State to collect additional royalties in the event the market value is determined higher.

Co-Chair Wilken asked if an audit calculates the price of gas if it were sold to a utility company, compared to the price charged Agrium, and collects the difference from Agrium. He asked if this legislation eliminates this review and stipulates that the value of gas sold to utility companies has no bearing on the royalty amount due from Agrium.

Mr. Banks affirmed.

Co-Chair Wilken clarified that this bill establishes a procedure by which the royalty price is determined through negotiation, and asked which parties are involved in these negotiations.

Mr. Banks replied the suppliers and Agrium negotiate and that the State has no involvement.

Co-Chair Wilken asked if the State is therefore relinquishing the utility value, or alternative customer value of gas sold to Agrium, and for the benefit of fertilizer production on the Kenai Peninsula.

Mr. Banks affirmed. He pointed out that Version "C" provides that the commissioner has the discretion to set a royalty price for between \$2 and \$2.43, as exemplified in the draft fiscal note. He stated that under normal circumstances the value is \$2.43 and the contract value is \$2.00.

Co-Chair Wilken asked how the commissioner would determine the actual amount.

Mr. Banks replied the commissioner must ensure that the contract price is not unreasonable low, and that the prospective reduction in royalty receipts would be balanced by employment opportunities in the fertilizer manufacturing plant.

Senator Hoffman asked how often during six-year term of the contract would the commissioner make a determination of the royalty amount, once or more often.

Mr. Banks explained the process, whereby each lessee would submit an application to commissioner and provide the terms of a contract with Agrium listing the negotiated prices. He said this information would be used in calculating the royalty and would occur only once in the life of the contract.

Co-Chair Wilken announced the bill would no report from the Committee during this hearing.

MIKE NUGENT, General Manager, Kenai Nitrogen Operations, Agrium, testified via teleconference from an offnet location that this legislation is "one piece of a pie, which could provide producers in Cook Inlet with stability, and Agrium with certainty of what they are to manufacture the products we sell." He informed that natural gas is the major raw material used to develop products.

Mr. Nugent asserted the nitrogen facility is one of few major value-added manufacturing operations in Alaska, is the second largest producer of nitrogen products in the United States, and that six-percent of the total nitrogen products are produced in North America. He listed the Pacific Rim countries that import Agrium products, including Korea, Taiwan, Mexico, and Thailand, and the need to be competitive in world markets. He remarked that the company currently is competitive because of the facility's location close to markets, the highly skilled workforce and the stable political climate; unlike the competitors located in Russia, Indonesia, Saudi Arabia and Venezuela. However, he pointed out these countries enjoy "extremely low" natural gas prices, which puts Agrium at a disadvantage. He stated this legislation would lessen the disadvantage.

Mr. Nugent informed that this bill would allow the commissioner to accept the price negotiated by the producer and the manufacturer, Agrium, as the amount by which royalties would be calculated.

Mr. Nugent pointed out the fiscal note does not reflect economic impacts provided by Agrium, including wages, purchase of goods and services, taxes and new development to Alaska, and instead only considers the price of natural gas. He stated that the analysis is based on forecasts, which involve several variables that are difficult to predict, such as volume, price and ownership. He furthered that the analysis assumes that the facility is operated at full capacity.

Mr. Nugent shared that the facility is not operating at full capacity because Cook Inlet suppliers are unable to deliver adequate natural gas supplies. He stated the plant is currently operating at 75 percent of capacity, which results in lower revenue for the State of approximately \$2 million if 2003. He warned that unless able to fund producer to supply a large quantity of natural gas at a competitive price, Agrium could eventually fail as a business and the State and local communities would receive no revenues from the operation.

Mr. Nugent told of repeated discussions with producers in Cook Inlet in which the primary concerns were the additional royalty charges the producer is subject to. He cited a letter to the City of Kenai from Aurora Power Resources, Inc. dated February 11, 2003, which reads as follows [copy on file].

Aurora Gas, LLC is aggressively pursuing the development of natural gas producing properties, primarily on the West side of Cook Inlet. Oil and gas exploration and development is a high cost, high-risk endeavor. As a producer looking for to market our natural gas there is a great hesitation to enter into a gas sales agreement with a purchaser, such as Agrium, because it adds yet another layer of risk to a producer. A producer selling gas to Agrium runs the risk, in fact the probability, that certain years after selling its gas to Agrium, the State will assert a claim that royalty needs to be paid on a higher value than the arms length negotiated contract price. This additional royalty, plus interest accrued at a higher-than-market rate, would have to be born by the producer and/or by the purchaser.

It is for this reason that Aurora Gas, LLC and its natural gas marketing affiliate, Aurora Power Resources, Inc. strongly endorse this legislation and the concept that royalty should be paid on the basis of arms length negotiated contract prices. Accordingly, we salute and support the draft resolution in support of HB 57 and urge the Kenai City Council to adopt same.

Mr. Nugent spoke of the increased difficulty of development of natural gas reserves caused by the unknown State royalty values.

Senator Taylor noted he was absent during portions of the testimony asked why the chair intended to hold the bill in Committee.

Co-Chair Wilken indicated questions related to the fiscal note.

Senator Bunde referenced Mr. Nugent's testimony asserting that the fiscal note does not take into account taxes collected from Agrium in determining the cost of this legislation. He requested further information on this matter, specifically what taxes.

Co-Chair Wilken instructed the sponsor to provide a detailed sponsor statement explaining the bill.

Co-Chair Wilken ordered the bill HELD in Committee.

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**ADJOURNMENT**

Co-Chair Gary Wilken adjourned the meeting at 10:59 AM