

MINUTES
SENATE FINANCE COMMITTEE
February 26, 2004
9:03 AM

TAPES

SFC-04 # 21, Side A
SFC 04 # 21, Side B
SFC 04 # 22, Side A

CALL TO ORDER

Co-Chair Gary Wilken convened the meeting at approximately 9:03 AM.

PRESENT

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

Also Attending: TOM IRWIN, Commissioner, Department of Natural Resources; KEVIN BANKS, Analyst, Commercial Section, Division of Oil & Gas, Department of Natural Resources; ALLEN WRIGHT Vice President, Public Affairs, Flint Hills Resources; ALLEN LASATER, Vice President, Environmental Health & Safety, Flint Hills Resources and the future President of Flint Hills Resources, Alaska; JEFF COOK, Representative, Williams' Alaska Petroleum Inc; PHILIP REEVES, Assistant Attorney General, Civil Division (Juneau), Department of Law; DAVE STANCLIFF, Staff, Administrative Regulation Review Committee, Office of Senate President Gene Therriault; ANDY HEMENWAY, Hearing Officer, Department of Administration

Attending via Teleconference: There were no teleconference participants

SUMMARY INFORMATION

SB 348-ROYALTY OIL CONTRACT SALE APPROVAL

A Committee heard from the Department of Natural Resources, the Department of Law, and the industry. A committee substitute was adopted and the bill reported from Committee.

SB 203-OFFICE OF ADMINISTRATIVE HEARINGS

The Committee heard from the sponsor, the Department of Administration, and adopted a committee substitute. The bill was held in Committee.

SB 273-ASMI BOARD/ SEAFOOD TAXES & ASSESSMENTS

Scheduled but not heard.

#sb348

SENATE BILL NO. 348

"An Act approving the sale of royalty oil by the State of Alaska to Flint Hills Resources Alaska, LLC, and Flint Hills Resources, LLC; and providing for an effective date."

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

Co-Chair Wilken informed that this legislation would provide legislative approval of a royalty oil contract between the State and Flint Hills Resources, Alaska, LLC, regarding the sale of the State's North Slope royalty oil.

Co-Chair Wilken explained that a new version of the bill is before the Committee solely because the original version of the bill was drafted before the February 25, 2004 signing of the agreement.

Co-Chair Green moved to adopt the Version 23-LS1772\D committee substitute as the working document.

Senator Bunde objected in order to clarify that the reason for the committee substitute was to update information specific to the signing of the agreement.

Co-Chair Wilken concurred.

Senator Bunde withdrew his objection.

There being no further objection, the committee substitute was ADOPTED.

TOM IRWIN, Commissioner, Department of Natural Resources, informed the Committee that the Department distributed several handouts including one titled "Best Interest Finding and Determination For

the Sale of Alaska North Slope Royalty Oil To Flint Hills Resources Alaska, LLC" dated February 12, 2004 [copy on file], a copy of the contract between the State and Flint Hills Resources (FHR) [copy on file], a copy of "The Alaska Royalty Oil and Gas Development Advisory Board Resolution 04-1" dated February 17, 2004 [copy on file] from the State's Royalty Board, and a copy of the Department's Division of Oil and Gas forthcoming presentation titled "Sale of North Slope Royalty In-Kind Oil to Flint Hills Resources" [copy on file}.

Commissioner Irwin read a section from the Introduction on page one of the Best Interest Findings handout as follows.

From an in-depth consideration of the potential economic, environmental, and social impacts, and the various requirements for sale of the State's royalty oil, with a focus on the criteria specified under the terms of AS 38.05.183(a) and (e) and AS 38.06.070(a), the commissioner finds that a negotiated long-term contract for the sale of the State's royalty oil to FHR is in the State's best interest.

Commissioner Irwin explained that AS 38.05.183 obligates the Commissioner of the Department of Natural Resources to review the proposal and AS 38.06.070 obligates the Royalty Board to review it. He declared that "this is an incredibly good contract for the State" as well as a good contract for FHR. It moves that State forward. He acknowledged the efforts of the State's negotiating team which included Kevin Banks, Senior Analyst, Department of Natural Resources; Philip Reeves, Assistant Attorney General, Civil Division (Juneau), Department of Law; Mark Myers, Director, Division of Oil & Gas, Department of Natural Resources; and Janet Wilson Baxter, Legislative Liaison, Office of the Commissioner, Department of Natural Resources.

Senator Olson recalled that news releases pertaining to this agreement as specifying that FHR agreed that the price of its petroleum products in Fairbanks would not exceed those of Anchorage. He supported the concept and wondered if this benefit could be extended throughout the State.

Commissioner Irwin stated that the FHR and the State's negotiating teams worked hard to develop this agreement. The State considers the arrangement of aligning the wholesale prices in Fairbanks with those in Anchorage "as a major step forward." This would not impact retail prices as other issues such as volume and transportation come into consideration. While this agreement does not apply to other areas of the Alaska, some benefit is anticipated as other locations' wholesale purchasing originates in either Fairbanks or

Anchorage.

Senator Bunde asked whether it would "be fair to assume that the cost of producing would be the same" in Fairbanks or Anchorage "so that the wholesale prices would reflect actual costs.

Commissioner Irwin responded that two issues are involved in this discussion: one being the dynamics of open market competitiveness of products that are brought in California and other places from outside of the State. The second dynamic is that there is an active refinery in Fairbanks. In theory, due to the open market competitiveness, prices should be less expensive in Anchorage as "that is where the cheapest route is." On the other hand, the Fairbanks refinery is using Alaska gas. Utilizing that logic, Fairbanks should be cheaper as there are no shipping costs involved. The negotiating team considered addressing the wholesale price to be the fairest approach for Alaskans.

Senator Bunde applauded the fairness efforts. An alternative suggestion would be to allow higher wholesale prices in Anchorage to support the wholesale price in Fairbanks.

Commissioner Irwin stated that the intent was not to raise the price in one location to make it fairer for the other as competitiveness with the outside world must continue. In addition, this Company must be competitive "across the board."

Senator Bunde acknowledged. He asked that further information regarding efforts to develop a fuel system in Fairbanks that would allow it to be more competitive with the Anchorage system be provided.

Commissioner Irwin expressed that these issues would be addressed in the forthcoming presentation.

KEVIN BANKS, Analyst, Commercial Section, Division of Oil & Gas, Department of Natural Resources, stated that his presentation, portrayed in the aforementioned handout titled "Sale of North Slope Royalty in-Kind Oil to Flint Hills Resources," would provide the background of the State's Royalty In-Kind (RIK) oil program and the highlights of the agreement with FHR, including the RIK arrangement with them.

Mr. Banks recounted that two years prior, Williams Alaska Petroleum Inc. decided to sell its North Pole refinery to FHR. To make the sale attractive, securing a long-term oil contract with the State was a condition of that purchase. This legislation would provide FHR with ten-year long-term contract with the State that would

allow the refinery purchase to transpire. He noted that Williams' gas stations and convenience stores would be sold to a separate entity. FHR would acquire the refinery and some of "the terminalling facilities in Anchorage and Fairbanks." Williams' interest in the Trans-Alaska Pipeline System (TAPS) property at the Anchorage International Airport would not be included.

Mr. Banks explained that the State owns approximately one-eighth of the production of oil on the North Slope. This oil could either be received as Royalty in Kind (RIK) or Royalty in Value (RIV). The RIV process would allow the lessee to sell the product and pay the State its share of the revenue. In the RIK process, the State would take possession of the oil and sell it to its own customers. These arrangements have been in place in excess of 25-years. He reviewed some previous RIK and RIV contract terms.

Mr. Banks shared that the decision to contract with Flint Hills was made after a thorough overview of the marketplace. During the negotiations with FHR, the State's negotiating team was provided expert assistance by a private consultant firm. Negotiations began in July 2003.

Senator Bunde asked how the negotiations addressed pertinent issues such as how volume purchasing would affect jet fuel price parity.

Mr. Banks stated that while high volume customers might enjoy a lower price than smaller operators, the contract expressly states that similar customers would pay the same price whether they are in Anchorage or Fairbanks.

Senator Bunde asked whether they would pay the same price regardless of the cost to FHR.

Mr. Banks responded that in addition to price, demand is also a consideration. While high volume customers might pay a lower cost than small volume purchasers, the fairness lies in the fact that the same price would be charged to that customer in either location.

Senator Bunde commented that this sounds like "artificial price supports," a practice that did not bode well in the farming industry.

Mr. Banks noted that, as specified in its Resolution, the Royalty Board has reviewed and approved this agreement. The Department is requesting that the Legislature also approve the contract.

Mr. Banks reviewed some of the contract components: sale of oil

would range between 56,000 and 77,000 barrels per day which would allow for seasonal demands; once every twelve months, FHR could request a change in the volume with the minimal quantity being specified at 24,000 barrels per day for the first five years of the contract and the maximum being 77,000 barrels a day or 85-percent of the State's royalty production on the North Slope. In the second five-year portion of the contract, while FHR would be required to continue to meet the special commitment components of the bill, which would be addressed later in the presentation, FHR could only reduce the quantity to less than 24,000 barrels per day by receiving zero barrels per day for twelve months. After those twelve months, they could request to increase their barrel consumption; however, the Commissioner must approve the quantity, as the Department might have agreed to provide other customers its oil allotment. Therefore, FHR "would be taking a chance" were it to reduce its barrel quantity, as it might not be able to increase it. The State has attempted to establish an agreement that would limit FHR's ability to arbitrage the State's oil against the marketplace to the State's or other producers' disadvantage. The goal was not to establish "some kind of price cap."

Mr. Banks referred the Committee to the "Price" chart in the handout.

*Price

- State will get a premium of \$0.30 per barrel above the price of Royalty in-Value ("RIV")
- State will receive additional annual revenue ranging from \$2.6 million and \$8.4 million per year, depending on volumes.

Co-Chair Wilken asked the volume that Williams has typically acquired from the pipeline.

Mr. Banks specified that while approximately 220,000 barrels might flow through the refinery each day, Williams' actually purchases 50,000 or 55,000 barrels per day from the State and an additional 20,000 barrels from other producers. The balance is re-injected into the pipeline.

Co-Chair Wilken asked how recently the refinery purchased 24,000 barrels per day.

Mr. Banks responded that while it might have been within the last three or four years, it was only on a month-by-month basis.

Mr. Banks noted that, as depicted in the "Example Calculation of FHR RIK Price" chart in the handout, the formula utilized in this

agreement is modeled after those utilized by the producers and the in-State refineries when Alaska oil is sold at Pump Station No. 1.

Price

Example Calculation of FHR RIK Price

	ANS Spot Price
-	\$1.55
-	Interstate TAPS Tariff
+	
-	PSVR Ref. Stream-IPA/Lisb. Stream
-	Line Loss
-	FHR Price
-	Royalty Field Cost Payment to Lessees
=	RIK Value

Mr. Banks continued that the negative \$1.55 is the component that represents the deduction applicable to the cost of marine transportation of Alaskan oil to the West Coast. In this number, the State is also "capturing the market value of our oil." The industry utilizes a factor of approximately \$1.85 and the State's utilization of the \$1.55 price would result in a higher price in RIK.

Mr. Banks noted that, "looking back in time demonstrates that the proposed RIK contract price would have been favorable to the State." This is depicted on the chart on page four of the handout. He noted that the destination price agreed upon in royalty prices has been lower than anticipated. This benefits the State. "The real difference in the premium that we expect to receive under this contract is developed in the difference between that \$1.55 deduction and the transportation deduction that the producers take."

Mr. Banks stated that commitments that are unique in this agreement include the following.

Special Commitments/State Benefits

- Equipment Installation for Clean Fuels Processing
- Anchorage Tank Removal and Tank Farm Evaluation
- Shipment by Rail
- Fairbanks International Railroad
- Wholesale Gasoline Rack Price Parity

Mr. Banks stated that as specified in the agreement, FHR would be investing up to one million dollars in equipment to support clean fuels processing in order to meet Environmental Protection Agency

(EPA) requirements by the end of 2006. In addition, FHR has agreed to work with the Government Hill Community Council in Anchorage to expedite tank removal in one area while constructing a new tank farm in another location. FHR would also address environmental issues at the former site. FHR would also transport fuel and gasoline between Anchorage and Fairbanks via the Alaska Railroad.

Senator Bunde asked why the commitment to ship via the Alaska Railroad was pursued rather than shipping it "as economically as possible."

Mr. Banks responded that the Railroad was concerned that FHR might construct a pipeline as an alternative mode of transportation. However, rail shipment is the most economic and consistent manner with which to ship product from Fairbanks to Anchorage. FHR would have not have agreed to this component were that not the case.

Co-Chair Wilken stated that further discussion in this regard would occur during FHR's testimony.

Senator Bunde opined that were the Railroad to increase business, perhaps it could pay a dividend to the State.

Mr. Banks noted that FHR has also agreed to work with the State to evaluate improvements to the fuel supply system at the Fairbanks International Airport terminal and its hydrant system. In addition, they have agreed to promote Fairbanks among air cargo carriers.

Mr. Banks stated that Fairbanks is ideally geographically suited to ship cargo from Asia to Europe whereas Anchorage is more ideally suited to handle cargo shipments from Asia to the Lower 48. While there is competition between the two airports, some shipping routes are more suitable to one than the other. Therefore, total cargo movement for the whole State would be the goal, with shipment centers being moved to Fairbanks from Russian locations. As discussed earlier, gas price parity would be instituted.

Senator B. Stevens asked whether the "Interstate TAPS Tariff" identified in the RIK pricing calculation would be the "Tariff Allowance" discussed in Section 3, on page eight of the "Best Interest Findings and Determination" handout.

Mr. Banks affirmed that it is.

Senator B. Stevens opined that the "Line Loss" component detailed on the chart and in Section 5, page nine of the Best Interest Findings booklet, would appear to be "an insignificant number." He asked whether the fact that the pipeline is not operating at

capacity is a factor.

Mr. Banks stated that the "Line Loss" component was previously "a much larger number" as the pump stations along TAPS removed oil from the line for fuel. This is no longer the case. Therefore, Line Loss is truly a change in volume as the oil cools in the pipeline and the balances on each end of the line fluctuate. He agreed that it is a fairly small number, equating to a penny or a penny and a half.

Senator B. Stevens asked whether information pertaining to the "FHR Price," as specified in the calculation, is that as located in the paragraph on page eight of the "Best Interest Findings" handout. He asked whether the State would bear the expense of transporting the crude oil to Pump Station No. 1.

Mr. Banks responded no. The "Royalty Field Cost Payment to Lessees" provides the Lessees with a field cost deduction, whether the State receives its oil through RIK or RIV. Setting the FHR price above that deduction as specified on the calculation chart would allow the State "to receive sufficient credit to pay the RIV fuel cost deduction."

Senator B. Stevens voiced confusion as to whether the State bears the cost of the tariffs north of Pump Station No. 1.

Mr. Banks responded that the Price graph in the presentation handout assumes that the crude oil being taken from Prudhoe Bay occurs at Pump Station No. 1 rather than from another site such as Kuparuk River Unit which has another set of tariffs that would apply between it and Pump Station No. 1.

Senator B. Stevens asked whether those transportation deductions are factored into this tariff rate or would be absorbed in another manner.

Mr. Banks responded that the deduction would be incorporated into the price, and would, therefore, result in a lower price.

Senator B. Stevens understood that fuel taken from Kuparuk and other sites would be incorporated into the price.

Mr. Banks commented that oil from Kuparuk would have a "net back" which would be lower than the pump price for Prudhoe Bay. This is similar to how the lessees' RIK is calculated.

Mr. Banks clarified that wholesale rack price parity would apply to posted wholesale prices in Anchorage and Fairbanks. This would

allow the Division to ascertain whether similar prices are being charged in these markets. There is concern that higher expenses in Fairbanks might increase prices in Anchorage. However, the markets are different as there is an excess supply of gasoline produced in the Anchorage market that must be exported. Anchorage producers could either export their excess supply to a refinery in another location or decrease production. These pressures serve to result in lower prices in Anchorage than experienced in Fairbanks. This would serve to benefit customers in Fairbanks. Fairbanks' conditions would not result in lowering Anchorage's price.

Mr. Banks noted that FHR has agreed to hire locally when possible. It is anticipated that the \$100 million Clean Fuels project would have a significant construction and employment impact for a short term. Currently, the refinery has 150 full time positions with an annual payroll of approximately \$8 to \$12 million. He noted that the State's previous agreement with Williams required that 80 percent of the RIK oil sold to them must be used in the refinery. The agreement with FHR specifies that they would make all commercially reasonable efforts to use the royalty oil in their refinery. This would insure that employment efforts would be supported.

Senator Hoffman asked whether any consideration was given to the tax structure and liabilities of FHR due to the fact that it is a Limited Liability Corporation (LLC).

Mr. Banks replied yes, that "sometimes painful discussions" in this regard occurred, particularly since the State could not view the financial strength of FHR, "an LLC and a privately held corporation," as opposed to Williams, which was a publicly held corporation and subject to certain reporting requirements. As a result, a provision was incorporated into this agreement specifying that an advisor would be retained to examine FHR finances and their future perspectives and a report would be provided to the State in regards to these matters. Were the "health of FHR" to fall below a certain bond rating it would be required to post a Standby Letter of Credit (LC) with the State equating to the sale of 90 days of sale oil. This would be approximately \$120 million LC.

Senator Hoffman asked for the difference between a LC and a bond.

Mr. Banks replied that, "an LC is made out to the State." For example, this would provide the State with "an unfettered ability to cash it" were this contract to go into default.

Senator Hoffman asked whether there is a difference in the tax structure of an LLC and a corporation.

Mr. Banks replied that he was unsure.

Senator Bunde understood that an LLC would not pay a corporate income tax.

Senator Hoffman asked regarding the Department's fiscal note. He also asked the amount of money the State would receive at 24,000 barrels per day level.

Mr. Banks responded that 24,000 barrels per day would provide the State \$2.6 million a year based on the previously discussed thirty-cent premium. An expected range would be between \$2.6 million and \$8.4 million. It is anticipated that the initial volume would range between 56,000 and 77,000 barrels per day.

Senator Hoffman asked that the tax impact in regards to an LLC verses a corporation be provided.

Co-Chair Wilken supported that request.

Senator Bunde questioned how the State would benefit from FHR shipping product via the Alaska Railroad as the Railroad is "a quasi private enterprise" and that the property tax generated from the refinery would not be contributed to the State.

Co-Chair Wilken thanked the Department of Natural Resources for its presentation.

ALLEN WRIGHT Vice President, Public Affairs, Flint Hills Resources, introduced himself and Mr. Allen Lasater, the prospective President of Flint Hills Resources, Alaska. Both currently reside in Wichita Kansas.

SFC 04 # 21, Side B 09:50 AM

Mr. Wright complimented the State's negotiating team for their professional and thorough approach to the negotiations. The end product is considered to be beneficial to both entities.

Mr. Wright reviewed a handout titled "Flint Hills Resources Who We Are, Culture and Philosophy, Commitment to adding value" [copy on file]. FHR is one of the leading producers of fuels and base oils for lubricants and other petrochemical and commodity products. Headquartered in Wichita Kansas and owned by Koch Industries, FHR has sixty years of experience in this field. It is tightly focused

on its goals, growth, and success based on a "culture of principled entrepreneurship" with a commitment to integrity and to consumer needs. Its innovative approach to business, combined with safety, efficiency, and environmental protection operational goals, has resulted in the development of value-added fuels for customers. Its 2,000 employees support these endeavors. The company will be sustainable for the long run.

Mr. Wright shared that the company has two refineries; one in Minnesota with a 280,000 barrel a day refinery capacity and a refining and chemical plant in Texas, which produces in excess of 300,000 barrels a day. FHR is one of largest heavy crude oil refineries in the United States. The production of clean fuels is a focus.

Mr. Wright expressed that the purchase and sale agreement of the Williams' refinery that was announced in November 2003, is contingent upon the approval of this contract with the State. This is an exciting opportunity. FHR is committed to the "clean fuels" enhancements outlined by Mr. Banks.

Mr. Wright reviewed some the company's projects that would lend expertise to this proposed undertaking.

Senator Bunde asked whether the company has other transportation agreements that specify that its products must be transported by a specific mode of transportation, such as the proposed agreement with the Alaska Railroad.

Mr. Wright responded that the Texas operation utilizes its own proprietary rail line. The Minnesota refinery is serviced either by truck or other common carrier lines.

ALLEN LASATER, Vice President, Environmental Health & Safety, Flint Hills Resources and the future President of Flint Hills Resources, Alaska, clarified that no specific transportation mode is required at the other operations.

Mr. Wright noted that FHR has a joint venture interest in a company called Excel Paralubes, which is located in Louisiana. This plant produces base oils and other lubricants. FHR also has developed a diverse fuels marketing system that has 160 terminal locations throughout the United States. This system markets gasoline, jet fuel, diesel, heating oil, and performance fuels.

Mr. Wright stated that in regards to Environmental health and safety issues, "the company strives for 100 percent compliance" with environmental and safety issues "while meeting the

expectations of the commodities in which we operate." Clean fuels have been brought to the market "well in advance of federal guidelines." Environmental standards measures support the company's goals.

Senator Bunde voiced appreciation of the fact that the company could meet the environmental standards of Minnesota, as they are quite stringent. Continuing, he asked regarding the company's Minnesota plant's "BluePlanet" gasoline; specifically how it compares to what is currently being produced at the North Pole Refinery and whether the company would be implementing this approach in Alaska.

Mr. Wright responded that BluePlanet is similar to the product that would be produced at the North Pole refinery.

Mr. Lasater explained that BluePlanet is a low sulfur gasoline that meets Minnesota's 2006 environmental requirements. The company completed this requirement years prior to the deadline. The company would be producing fuel similar to BluePlanet in Alaska, as similar requirements would become effective in Alaska in January 2007.

Mr. Wright noted that "transparency" is very important to FHR. An alliance has been formed with communities in Minnesota to develop a website that would allow access to the company's environmental performance. The company's efforts in Environmental, Health and Safety issues have also been acknowledged in Texas.

Mr. Wright also conveyed that the company is an active participant in the communities in which it operates. He reviewed some of the partnerships, sponsors, and other sorts of participation that have occurred in its various locations.

Co-Chair Wilken noted that the company has provided an "Environmental, Health and Safety Facts" brochure [copy on file].

Mr. Lasater stated that FHR is committed to operating a successful refinery in Alaska, as supported by its commitment to the production of clean fuels.

Co-Chair Wilken recalled that Williams had conducted a significant expansion of this refinery in the mid 1990s which increased the refinery's production by up to 60-percent. He asked the amount of that investment as this would assist in placing the proposed \$100 million investment in perspective.

Mr. Lasater stated that Williams's third crude oil refinery unit, which produces 100,000 barrel per day, became operational in 1998.

He recalled that the investment might have totaled \$80 million.

JEFF COOK, Representative, Williams' Alaska Petroleum Inc, clarified that Williams' expended \$71 million on that project.

Co-Chair Wilken understood, therefore, that the \$100 million FHR diesel conversion upgrade slated for the refinery would be significant.

Co-Chair Wilken asked whether the \$100 million diesel conversion would result in there being more than one type of diesel produced at the North Pole Refinery.

Mr. Lasater responded that the conversion would allow for two types of diesel to be produced. Federal rules for on-road diesel, which becomes effective in 2006, would prohibit a sulfur content exceeding 15-parts per million. Off-road and other diesels such as heating fuel could contain higher sulfur levels; however, it is anticipated that these fuels sulfur content would be restricted in the future.

Co-Chair Wilken asked whether the proposed conversion would affect the quantity of oil that would be removed from the pipeline, specifically whether it would increase demand.

Mr. Lasater replied that it should not increase the demand.

Co-Chair Wilken asked when the conversion project might begin.

Mr. Lasater stated that the engineering of the project began in the fall of 2003. The timing is considered "critically tight" for 2006. Engineering would be completed in 2004, the project's foundation would be constructed in 2005, and the equipment would be installed in 2006. The company is confident that it would meet the 2007 gasoline timeline requirement. The 2006 diesel requirement date is June 2006. The short construction season in the State might present an obstacle.

Senator Bunde asked whether this \$100 million improvement might impact the wholesale price of gasoline and diesel.

Mr. Lasater replied that the cost of production would increase. However, historically the refining business has not been a cost-plus based business, as the price would be more dependent on free market competition. While the cost to the company might increase, the market conditions would have more affect on the price consumers would pay.

Co-Chair Wilken asked FHR's position in regard to transporting its products via the Alaska Railroad.

Mr. Lasater understood that this relationship, which was developed at the request of the State, was based on a couple of factors. The refinery currently accounts for approximately fifty percent of the revenue generated by the Railroad. The only alternate shipping method would be a pipeline and, were that avenue pursued, it would "have quite an impact to the State as far as the viability of the Railroad." However, at the conclusion of the contract, construction of a pipeline would be an option.

Senator Bunde understood therefore, that FHR had not initiated the Railroad provision.

Mr. Lasater affirmed, however, clarified that for "the foreseeable future" no other option exists.

Co-Chair Wilken inquired as to when Williams' sale of its convenience stores might occur.

Mr. Lasater explained that the sale of the convenience stores would coincide with the date that FHR acquires the refinery.

Co-Chair Wilken asked regarding the company's position on local hire.

Mr. Lasater stated that the current workforce is viewed by FHR as a key element in the success of this acquisition. While the company might bring in some of its management team to run the operation, the intent is to not reduce the work force to save money, as it common in some acquisitions. Instead, he continued, the refinery's direction combined with the clean fuel investment would require an expanded work base including increased contractual work.

Senator Olson expressed that one of concerns in the State is the environmental affect of industry, specifically in regards to such things as spills that might negatively affect fishing grounds and the fragility of the tundra. Therefore he voiced concern that Koch Industries, FHR's parent company, has been sizably penalized for environmental violations in recent years. He asked what safeguards could be established to prevent violations from occurring.

Mr. Wright responded that the Company assumes full responsibility for the company's environmental record, good and bad, and that the company "has learned a great deal from those experiences and as a result has implemented management and compliance monitoring systems that allow the company to prevent similar situations from re-

occurring. Specifically, the Texas facility's Clean Air violation occurred due to employee error. The error was uncovered during a company audit, the employee was dismissed, and the company alerted the EPA to the violation. The Company is currently on probation. While a separate subsidiary of Koch Industries had been investigated for inaccurate measurements relating to its oil acquisitions, a jury did not find that FHR had committed any wrongdoing in this regard and, even though FHR settled in that lawsuit, it provided no admission of guilt. Furthermore, in this agreement, FHR would not be purchasing crude oil at the wellhead.

Senator Hoffman asked whether the Koch Industries subsidiaries that had the violations filed against them were established as LLC companies.

Mr. Wright replied that he unsure as, at various times, Koch Industries has utilized different business structures. He recounted the names of the entities involved in the violations; however, could not recall their business structure. He stated that this information would be provided.

Senator Hoffman voiced that this information would be appreciated as LLCs "have less liability and that is the reason" that they are established. The State should investigate this further as were negative circumstances to occur, the liability on the part of an LLC might differ from the specified violation determinations.

Mr. Wright stated that the current company structure's performance is one that has received high ratings from the EPA and other environmental groups. "It is performing at an industry leader level."

Co-Chair Wilken thanked Mr. Wright and Mr. Lasiter for their comments and voiced that the State is looking forward to the development of a mutually beneficial working relationship with Koch Industries.

PHILIP REEVES, Assistant Attorney General, Civil Division (Juneau), Department of Law noted that, at the Department of Law's request, the Department of Revenue has specified that the State's corporate income tax utilizes the same guidelines as the federal income tax which treats most LLCs as corporations for most tax purposes. A definitive answer in this regard would be provided.

Co-Chair Wilken stated that this would be further monitored as the legislation advances.

Co-Chair Green moved to report the bill from Committee with

individual recommendations and accompanying fiscal note.

There being no objection, CS SB 348 (FIN) was REPORTED from Committee with a new zero fiscal note, dated February 26, 2004 from the Department of Natural Resources.

AT EASE: 10:22 AM / 10:23 AM

#sb203

CS FOR SENATE BILL NO. 203(JUD)

"An Act relating to administrative hearings, to hearing officers, and to administrative law judges; establishing the office of administrative hearings and relating to that office; and providing for an effective date."

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

Co-Chair Wilken communicated that this legislation would create an independent office of hearing officers under the administration of a chief administrative law judge (ALJ), within the Department of Administration. The bill's sponsor would be providing further information in regards to the office's structure. An explanation pertaining to the fiscal note would be forthcoming.

Co-Chair Wilken asked whether there was any objection to the adoption of the Version 23-LS0903\Z committee substitute as the working document.

There being no objection, Version "Z" was ADOPTED.

[NOTE: A formal request to adopt the Version "Z" committee substitute was offered later in the hearing.]

DAVE STANCLIFF, Staff, Administrative Regulation Review Committee, Office of Senate President Gene Therriault, the bill's sponsor, explained the this committee substitute has been developed to address technical issues and to "clean up" various components of the bill as identified by the Legislative Legal Division and the Administration. He referenced a handout provided by the Regulation Review committee titled, "Changes Included in SB 203(FIN)" [copy on file] that specifies the eight changes made in the committee substitute. The first substantive change is located in Section 66, line 30, page 31 of the bill and reads as follows.

Sec. 66. AS 39.52.170 is amended by adding a new subsection to

read:

(d) A public employee who is in a permanent full-time position as a hearing officer or administrative law judge may not accept employment as a hearing officer or enter into a contract to act as a hearing officer, administrative law judge, or judicial officer for the federal government, another state, a municipality, or a Native tribe.

Mr. Stancliff stated that the municipal jurisdiction specification was added to the list to avoid possible conflicts of interest.

Senator Olson understood the rationale for this section, as it would apply to such large communities as Anchorage or Fairbanks; however, he asked how Rural locations with limited numbers of hearing officers would be affected.

ANDY HEMENWAY, Hearing Officer, Department of Administration, responded that currently the State has 25 hearing officers, all of whom are located in Anchorage, Fairbanks, or Juneau. These individuals travel to other locations or participate via teleconference as required. Therefore, this requirement would not affect smaller communities.

Senator Olson continued to voice discomfort with the inclusion of municipality employees in the list.

Mr. Hemenway stated that the purpose of this language is to avoid any conflict of interest that might arise regarding decision-making on behalf of one sovereign entity verses another's policies or interests.

Senator Olson questioned how a hearing officer, whose role is one of neutrality, could have a conflict of interest.

Mr. Hemenway expressed that the intent would be to avoid any "inherent" conflict of interest. There might be a perception that a hearing officer who works on behalf of the State might tend to rule in its favor in a situation involving the State and a municipality, for example.

Senator Olson observed "that it sounds like we are trying to protect ourselves from ourselves."

Mr. Stancliff commented that the second change is located in Section 65 on page 31 of the bill. While the bill provides protection to the ALJ from inappropriately contact or influence from agencies or Legislative agencies, it did not provide that protection to hearing officers. This is addressed in Section 65.

Mr. Stancliff stated that recently enacted legislation incorporated new processes at the request of Associated General Contractors (AGC) in regard to dispute resolution. In order to allow that process to develop, those processes has been eliminated from the jurisdiction of the legislation.

Mr. Stancliff continued that the Administration has requested that hearing officers be provided the same type of code as judicial officers have in that a person could request a different hearing officer preside over the hearing. This language is included in Section 3, Subsection 44.21.570(c) on page ten, beginning on line eleven.

Mr. Stancliff stated that the definition of an administrative hearing is expanded in language in Section 3, Subsection 44.21.599 (1) on page 11. This section reads as follows.

(1) "administrative hearing" means a quasi-judicial hearing before an agency, but does not include an informal conference or review held by an agency before a final decision is issued.

Mr. Stancliff, addressing Senator Olson's concern about the prohibition of hearing officers working for the State and another jurisdiction specifically in regards to how this might affect a small Rural area, stated that this language would serve to address the concern. Highly contested cases would be heard at the higher administrative level.

Mr. Stancliff stated that Number Six on the Regulation Review Committee list would address some conflicts the legislation incurred with agency's "cease and desist" authority. This language is located in Section 8, on page 13, beginning on line 16.

Mr. Hemenway explained that this language would primarily address the bill's conflict with the Department of Community and Economic Development's cease and desist orders for regulated professions.

Mr. Stancliff stated that a technical change incorporated in this committee substitute is that the clarification of the duties and responsibilities of ALJs and hearing officers is clearly defined in the bill.

Senator Bunde mentioned that separate legislation relating to worker's compensation would incorporate a panel of ALJs. Therefore he asked how these two pieces of legislation would interact.

Mr. Stancliff replied that this is an unknown, as the integration

stage of the procedure has not been conducted. However, this should be addressed as the processes advance.

Senator Bunde stated that the bill in question is SB 311-INSURANCE & WORKERS' COMPENSATION SYSTEM.

Mr. Stancliff acknowledged.

SFC 04 # 22, Side A 10:40 AM

Senator Hoffman asked whether the possible conflict of interest issue that might arise by a hearing officer being employed in a second job is addressed in this committee substitute.

Mr. Stancliff responded that substantial discussion has occurred in this regard, specifically whether hearing officers should be allowed to practice law outside of their public employee position. This bill is restrictive in regards to possible conflicts.

Mr. Hemenway noted that language in Section 3, Subsection 44.21.540(c) on page six, lines 24 through 27 addresses the concern regarding a second job. However, while this bill contains language in this regard, it does not expressly prohibit work in a second job outside of their employment with the State.

(c) An administrative law judge employed by the office must devote full time to the duties of the office unless appointed to a position that is less than full-time. An administrative law judge employed by the office may not perform duties inconsistent with the duties and responsibilities of an administrative law judge.

Mr. Hemenway understood the intent of this language to be that a person employed as an ALJ should "not also hold a second job within the Administration," such as being a Deputy Commissioner, for example.

Senator Hoffman stated that rather than being concerned about an individual's ability to hold a second job, his primary concern was their ability to privately practice law.

Mr. Stancliff responded that while this concern was addressed, the decision was made not to include it. However, the Chief Administrative Law Judge would be developing a judicial canon similar to that currently in place for the State Judicial Branch. New regulations governing ALJS would also be developed that might

address this issue. It is not, however, required, in Statute.

Senator Hoffman asked whether the independent practice of law would present a conflict of interest for hearing officers.

Mr. Hemenway shared that this issue is a primary concern. The Judicial Canon does prohibit judges from practicing law. The essential question is whether this should also apply to administrative hearing officers. This is worth considering.

Responding to Senator Hoffman's question, Mr. Hemenway declared that there is certainly the potential for conflicts of interest in this area. The question is whether it should be addressed through regulation or Statute.

Senator Hoffman declared that if there is the potential for conflict of interest, it should be included.

Mr. Stancliff stated that the State currently contracts with a number of hearing officers and this process would be continuing. Therefore, consideration must be given to this situation.

Mr. Stancliff stated that the final change in the bill pertains to Section 46(b) on page 26 of the bill and regards the amount of time that hearing officers might spent in regard to insurance rate setting. Currently, the Director of the Division of Insurance currently spends more that 1,000 hours in this regard. Were the rate setting responsibility to shift over to the ALJs, it would significantly increase the fiscal note. There are some Division of Insurance duties however, that could be transferred to the Central Panel without much impact.

Mr. Hemenway voiced that rate setting responsibilities should not be conducted by the Central Panel.

Mr. Stancliff concurred and stated that were those responsibilities to become the responsibility of the Central Hearing Panel, the fiscal note would be cost prohibitive and the bill would falter.

Co-Chair Wilken asked regarding the validity of the University of Alaska's two-page brief [copy on file] requesting an exclusion from the jurisdiction of the bill.

Mr. Stancliff commented that the brief might have some validity. The determination regarding the University is under review. However, he voiced, "that no State hearing officer should be exempt from the protections and higher standards" being developed in the bill. The University has a high quality process and meets those

standards.

Co-Chair Wilken asked how the University's request would be addressed.

Mr. Stancliff replied that an amendment would be developed to address their exemption.

Co-Chair Green moved to adopt the Version 23-LS0903\Z committee substitute as the working document.

There being no objection, the Version "Z" committee substitute was formally ADOPTED as the working document.

Co-Chair Wilken stated that the fiscal note discussion would occur during the next hearing on the bill.

Senator Hoffman asked whether there is a shortage of hearing officer applicants in the State.

Mr. Hemenway responded that in his perception, as positions open, there are a number of good applicants.

Co-Chair Wilken noted that the bill would be HELD in Committee.

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ADJOURNMENT

Co-Chair Gary Wilken adjourned the meeting at 10:52 AM.