

MINUTES
SENATE FINANCE COMMITTEE
March 23, 2004
9:04 AM

TAPES

SFC-04 # 54, Side A
SFC 04 # 54, Side B

CALL TO ORDER

Co-Chair Gary Wilken convened the meeting at approximately 9:04 AM.

PRESENT

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

Also Attending: SENATOR SCOTT OGAN; SENATOR BERT STEDMAN;

Attending via Teleconference: From Anchorage: HAROLD HEINZE, Chief Executive Officer, Alaska Natural Gas Development Authority; From Fairbanks: KEVIN WALSH, Certified Public Accountant, Walsh, Kelliher and Sharp;

SUMMARY INFORMATION

SB 271-NATURAL GAS DEVEL AUTHORITY PROJECTS

The Committee heard from the sponsor and the Alaska Natural Gas Development Authority. The bill moved from Committee.

SB 300-ATTORNEY'S LIEN

The Committee heard from the sponsor and a certified public accountant. An amendment was adopted and the bill moved from Committee.

SB 322-SALMON ENHANCEMENT TAX

The Committee heard from the sponsor. The bill was held in Committee.

#SB271

SENATE BILL NO. 271

"An Act amending the purpose of the Alaska Natural Gas Development Authority to include planning, developing, constructing, managing, or operating an economically viable gas pipeline project from the North Slope of Alaska by a route that parallels the Trans Alaska Pipeline System or the Alaska Highway; authorizing evaluation of opportunities for private sector involvement in the project; amending requirements related to the Authority's preparation of a development plan; and providing for an effective date."

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

Co-Chair Wilken stated this bill, sponsored by Senator Ogan, "expands the responsibility of the Alaska Natural Gas Development Authority to include the review of the economic viability of a gas pipeline that parallels the Trans Alaska Pipeline."

SENATOR SCOTT OGAN testified that he introduced this legislation after spending time last summer with Senator Dyson at various meetings in Canada. Senator Ogan stated that in his capacity as chair of the Energy Conference, he traveled through Western Canada to lobby the province of British Columbia to join the Conference. He relayed that he learned that the Trans Canada pipeline would have adequate capacity to transport natural gas were a pipeline constructed in Alaska to the Canadian border.

AT EASE 9:07 AM / 9:07 AM

Senator Ogan opined that Alaska "must have all possible tools in the toolbox" in its efforts to develop natural gas resources. He reminded of ongoing negotiations between the Murkowski Administration and Mid America Group. He was unsure of the status of these negotiations, but understood an agreement would be reached for stranded gas development.

Senator Ogan indicated this legislation would allow consideration of constructing a tax-free natural gas pipeline in Alaska to the Canadian border. He preferred that the private sector undertake this project, but in the event it does not, he said this legislation would provide an opportunity for the State to undertake

the project.

Senator Ogan asserted that a primary focus of the Energy Council is determining how the US would deal with the upcoming energy shortage. He commented on the inability to obtain a permit to construct a nuclear power site and the near impossibility to obtain a permit to operate a coal burning facility. He reported that the supply of natural gas available in the Lower 48 is unable to meet demand and subsequently the costs have increased. As a result of these factors, he expressed this is the appropriate time for Alaska to pursue development of natural gas resources for distribution to other states.

Senator Ogan warned that if Alaska does not take advantage of this opportunity immediately, entities from other countries would. He cited that by the year 2020, the US would import between 11 and 24 percent of its liquefied natural gas from other countries. He noted this estimate includes an assumed 4.5 billion cubic feet of natural gas produced in Alaska. He told of "offshore" facilities under construction, some of which are undertaken by producers also operating in Alaska.

Senator Ogan spoke of producers' preference to ship natural gas from tidewaters because the expense of approximately \$2.5 billion is less than the proposed \$7 or \$8 billion project in Alaska. However, he did not deem this to threat the ability to construct a natural gas pipeline in Alaska.

Senator Ogan informed that a shared effort is the only feasible way to finance a natural gas pipeline in Alaska.

Senator Ogan pointed out this bill would extend the termination date of the Alaska Natural Gas Development Authority until January 1, 2005. He also noted the addition of subsection (12) to the uncodified law enacted in Section 5(a), 2002 General Election Ballot Measure 3, contained in Section 4 of the bill to read as follows.

(12) an evaluation of the opportunities for private sector involvement in the planning, development, construction, management, and operation of the gas transmission pipeline project.

Senator Ogan had understood the omission of this language in the original ballot initiative was an oversight. He commented to his "comfort" in adding this language. He asserted, "Usually government is good at fixing things until they're broke." He asserted construction of a pipeline is not an appropriate role for

government and that private industry should finance such a project. However, he remarked that involvement of government could garner better financial terms for private entities. He surmised that Trans Canada, Mid America Group, or a producer could take advantage of these financing opportunities.

Co-Chair Green asked if the extension of the termination date to January 1, 2005 would be adequate. She understood concerns regarding time constraints.

Senator Ogan agreed this is an "aggressive date". He noted current law provides that the Authority is terminated one year following the first meeting of the Board of Directors, which occurred in June 2003. However, he stressed the immediate need to secure a commitment to construct a pipeline. He again warned that if not done in Alaska, natural gas supplies for the U.S. would come from elsewhere.

Co-Chair Green requested a map showing the current proposed route of a natural gas pipeline and how a pipeline route, as proposed in this legislation would differ.

Senator Ogan did not have maps with him, but described the proposed route paralleling the Alaska-Canada Highway from Delta to the Canadian border.

Co-Chair Green requested maps be provided to her.

Senator Olson asked if the proposed pipeline to the Canadian border would be tax-free and asked for clarification.

Senator Ogan affirmed. He explained that if the government owned the pipeline, through, the Alaska Natural Gas Development Authority, as a quasi-public private corporation, the pipeline would be tax exempt. He compared the Authority to the Alaska Rail Road Corporation, in that its assets are not taxable. He qualified that an agreement with affected communities for payment in lieu of taxes would be necessary. He noted such arrangements are expected for the current proposed pipeline route. He surmised the private sector would want to take advantage of this tax-exempt status. He furthered that the State would receive a higher return because royalties are calculated after tariffs and taxes are deducted from the transportation costs. He remarked that any efforts to reduce transportation costs would result in higher profit and earnings for the State.

Senator Hoffman asked about the need to acquire right of way access to lands in which the pipeline would traverse.

Senator Ogan replied that a significant portion of the land involved is Tetlin-owned and that possibly other lands owned by Doyon Limited located near Tok could be affected. He noted the need to acquire rights of way, but pointed out the myriad of landowners in other areas of the state.

Co-Chair Wilken clarified that Senator Ogan's reference to natural gas supplied from "offshore" sources does not relate to operations in the Gulf of Mexico for example, but rather from countries other than the United States.

Senator Ogan affirmed.

Co-Chair Wilken referenced a report "Alaska Natural Gas Development Authority Benefits to Alaskans" issued in September 2003 [copy not provided]. He asked how the information in this report differs from the report required of the Alaska Natural Gas Development Authority by the ballot initiative of 2002 and referenced in Section 4 of this bill.

Senator Ogan did not know.

HAROLD HEINZE, Chief Executive Officer, Alaska Natural Gas Development Authority, testified via teleconference from Anchorage that the Authority's motives as a public corporation are to maximize benefits to Alaska. Therefore, he stated, the Authority is "willing to do or not do lots of things." He explained the Authority has "no particular interest" in participating in the gas development business unless "very identifiable benefits" to Alaskans are involved. He exemplified that of all the rhetoric pertaining to development and transportation of Alaskan natural gas pipeline, the Authority is the only party addressing the issue of delivering gas to the Cook Inlet area. Regarding specific projects, he relayed that the Authority welcomes this legislation because it allows the Authority to contribute to the "State's overall team effort in the broadest sense and without any real restriction." He cautioned, however, that this legislation should not be construed as a directive to the Authority to pursue certain actions. He spoke of the Authority's "unique financing abilities" regarding taxes, debt, debt structure, interest rates and other variables that could potentially lower the financing costs of any project. He surmised this is an appropriate role for the Authority, if it would assist in progressing the project.

Mr. Heinze stressed that the Authority never considered using State funds to finance any natural gas pipeline project and rather that funding should be from "the normal money sources that are available

to the private sector." He explained that State involvement allows greater flexibility and lower interest rates for a private entity funding the project. He remarked that if the Authority does not "test" itself "against the normal market, we think the State could make a very bad mistake."

Mr. Heinze reminded that the provisions of Ballot Measure 3, creating the Authority specifically provide for a natural gas pipeline from Prudhoe Bay to Valdez in the Prince William Sound with a spur line from Glennallen into the Cook Inlet area. He noted this bill broadens that perspective to allow the Authority to consider a pipeline route following the Alcan Highway to the Canadian border. He stressed the value of having this option to allow the Authority to choose a route in the best interest of Alaska.

Mr. Heinze informed that a route following the Alyeska Trans Alaska Pipeline from Prudhoe Bay to Valdez has rights of way already acquired through the pipeline corridor. He noted that the Yukon Pacific Corporation has acquired right of ways from private landowners for this route, which the Authority would acquire for a natural gas pipeline. He also noted that under imminent domain laws, private-owned lands could be acquired at fair market value. He furthered that the portion of the route between Glennallen and the Cook Inlet is largely located on State-owned land and as an agency of State government the Authority could utilize these lands.

Mr. Heinze compared this to the proposed route along the Alaska Canadian Highway, which would be located on a significant portion of private-owned land and State-owned land. He understood that no party has obtained rights of way for this route. He considered the right of way issues in Alaska relatively minor in comparison to lands in Canada located along the proposed route. He stated the Trans Canada organization would have to address First Nations and other landowner issues.

Mr. Heinze spoke to the proposed extension of the termination date of the Authority. He noted the first meeting of the Board of Directors was held on June 16, 2003 and according to current statute, the Authority would expire one year from that date on June 13, 2004. He agreed that meeting this deadline would be challenging, but assured it could be accomplished "within a couple of months". He did not oppose an extension to the end of the year 2004, but informed that the Authority intends to complete its work by the end of the 2004 summer.

Mr. Heinze reported that the Authority has not adopted a business structure and must first investigate whether it should be

classified as a nonprofit organization, a corporation "with a very low profit objective, a utility, or another status. He remarked upon the "tremendous opportunity" the Authority had to become exempt from federal income tax, to issue tax-exempt bonds, and achieve favorable debt to equity ratios and low interest rates. He stressed the importance of all issues combined. He expressed the Authority's intent to hire a consulting firm to review and provide advice as to how to provide the lowest cost of service.

Mr. Heinze addressed the issue of natural gas imported into the US. He asserted "major forces at work around world working very dynamically, looking at the United States as a place to move their gas to." He stressed the importance of reaching a decision regarding Alaska natural gas expediently. He agreed with Senator Ogan that if efforts to develop and transport the resource from Alaska were delayed, Alaska would be "left out of the game."

Mr. Heinze summarized that the Authority operates in the best interest of Alaska, and would benefit from the ability to consider all options.

Co-Chair Wilken again referenced the report "Alaska Natural Gas Development Authority Benefits to Alaskans" and restated his question about comparison of this report to the report required in Section 4 of this bill.

Mr. Heinze replied the existing report is a compilation of a "fairly large number" of Alaska consulting firms and reflects an attempt to identify actions relevant for advancing the project. He informed that since the report was issued, the Authority has received only minimal funding and the recommendations of the report would require approximately \$2.5 million to implement. Therefore, he informed, most of the recommended efforts have not been undertaken. He noted that a benefit analysis that provides a testing model should be finalized by the end of the month. He predicted that all other aspects specified in the development plan, including a revenue sharing plan with municipal governments, would be addressed by the upcoming summer. He assured the Authority has a "fairly good understanding" of possible projects and costs. He summarized the report issued in September represents efforts the Authority would have preferred be done, although funding and time have been inadequate to undertake them all.

Senator Olson asked the impact of this legislation on the existing tax structures of the North Slope Borough, the Fairbanks North Star Borough and other local governments.

Senator Ogan responded that if the Authority constructed a pipeline

were constructed from Prudhoe Bay to the Canadian border, the pipeline would be tax-free. He noted the same status was envisioned for a Prudhoe Bay to Valdez route and would require negotiation to address local government concerns. He listed examples of increased costs to local governments with the location of a pipeline in the community from: school enrollment, wear and tear on local roadways and emergency services.

Mr. Heinze remarked that in recognition of the increased costs, the Authority is directed by the provisions of Ballot Measure 3, as shown in Section 4 of the bill, to include a revenue sharing plan with municipal governments in the development plan. He spoke of intentions to recognize that despite exemption from taxation, the Authority would be "morally obligated" to identify ways for local governments to address the increased expenses and also to share in the revenue generated.

Senator Olson surmised that this legislation has not been "accepted with enthusiasm" by the North Slope Borough or the Fairbanks North Star Borough.

Mr. Heinze replied that this bill does nothing to change the Authority's tax status established in Ballot Measure 3. He qualified that this bill "raises eyebrows" to this realization. He emphasized that he has been forthright in expressing to local government a willingness to identify ways to offset the impacts a pipeline would have on the communities.

Senator Ogan stressed that the State has an "overwhelming" interest in having an independent entity constructing the pipeline because both producer and the State would share equal interest in maintaining low tariffs. He remarked that a natural gas pipeline would also benefit the State because it would encourage development in other areas of the North Slope, such as the Foothills region. He elaborated on the benefits to the State and to the North Star Borough in the development of the Foothills resources. He understood that Senator Olson has concerns with this legislation, but Senator Ogan argued that revenues from the development of the Foothills region would outweigh the tax exemption of the pipeline.

Senator Hoffman surmised this legislation should therefore include a requirement of the Authority to include a plan for payment in lieu of taxes for local governments.

Co-Chair Wilken asked if subsection 5(a)(5) of Ballot Measure 3, contained in Section 4 of the bill would suffice. This language stipulates that the Authority must include a plan for revenue sharing in its development plan.

Senator Hoffman opined that this language is not specific enough to assure that payment in lieu of taxes would be addressed.

Senator Ogan was unsure. He stated that the impact on local governments must be considered and deferred to the Senate Finance Committee as the appropriate entity to address the matter.

Mr. Heinze line 9, recalled that the ballot initiative was drafted to model the Alaska Gasline Port Authority already in existence. He defined the Alaska Gasline Port Authority as a consortium of three local governments formed with the intent to export natural gas from the North Slope, using a tax-exempt method and a revenue sharing plan.

Senator Bunde pointed out the stipulation that the Alaska Natural Gas Development Authority "must include" a revenue sharing plan with municipal governments in its development plan. He surmised this affords flexibility.

Co-Chair Green offered a motion to report the bill from Committee with individual recommendations and previous fiscal note.

There was no objection and SB 271 MOVED from Committee with zero fiscal note #1 from the Department of Revenue.

Co-Chair Wilken directed attention to information distributed to members from the Department of Labor and Workforce Development responding to issues that were raised during hearings the previous week.

Senator Bunde commented that the largest portion of Alaska's population is between the ages of 35 and 50, which he characterized as the "working ages". He furthered that given no changes to current trends the smallest portion of Alaska's population would be aged 30 to 50 by the year 2015. He opined this should be understood when considering efforts to create jobs and implement an income tax. He pointed out that the smallest population age group would be required to contribute the most.

#SB300

SENATE BILL NO. 300

"An Act relating to an attorney's lien, to court actions, and to other proceedings where attorneys are employed."

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

Committee.

Co-Chair Wilken stated this bill sponsored by Senator Stedman, "addresses a ruling by the Ninth Circuit Court of Appeals. The Court held that Alaskans who win an award in court must pay federal income tax on the award, including attorney fees, and then when the plaintiff pays the attorney, the income is taxes a second time."

SENATOR BERT STEDMAN read the sponsor statement into the record as follows.

SB 300 eliminates an unfair and potentially disastrous federal income tax issue affecting Alaskan taxpayers and prevents the IRS [U.S. Internal Revenue Service] from taxing two Alaskans on the same income. SB 300 corrects this unjust treatment of Alaskans under current 9th Circuit rulings.

Because of a peculiarity in Alaskan law, Alaskans who win in court may pay federal income tax on phantom income. When Alaskans file their federal tax return, they must report any litigation recovery allocated to attorney fees as gross income, even though they receive no economic benefit from those fees. The federal government taxes that portion of the prevailing side's award twice; once as income to the client and again as income to the client's attorney. Incredibly, there is no federal tax deduction to offset this inequity. It's even possible for someone to win in court but come out with a net loss after paying legal bills and taxes.

Under current Alaska lien law <AS 34.35.430>, attorneys have a "subordinate lien" or ownership interest in the "cause of action". Other states, including Oregon, use different language to specify that as long as an attorney has filed an appropriate lien and is owed money by the winning client, all fee awards or payments made to the client belong exclusively to the attorney. In so vesting the attorney with the property interests of the award, those states avoid the unfair tax burden currently imposed on Alaskans. Instead, any portion of an award retained to pay attorney costs, is not income to the client.

SB 300 changes Alaskan law to prevent the IRS from taxing Alaskans on income they don't receive. This bill recognizes that court awarded fees which pass through to one's attorney is income to the attorney. And as such, the attorney is responsible for paying federal income tax on that portion of their income.

Senator Stedman noted that when drafting statutes for the legal system, Alaska mirrored the state of Oregon statutes in many ways and that Oregon has this same inequity. He gave an example of a case involving the wrongful termination of an employee, in which that employee prevailed and received a "small" award in addition to attorney fees. Under current statute, Senator Stedman pointed out this employee would receive a net loss because the employee would be required to claim the attorney fees as income and pay federal taxes on that amount.

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Senator Stedman continued that many plaintiffs do not have adequate resources to absorb the tax burden of this additional income, which they did not receive.

Co-Chair Green referenced a letter dated February 6, 2004 to Senator Stedman from Kevin Walsh, of Walsh, Kelliher and Sharp. She asked if this legislation would only apply to cases heard in the Alaska Court System or to cases before the Human Rights Commission as well.

Senator Stedman understood this legislation applies only to the award of attorney fees from court cases.

KEVIN WALSH, Certified Public Accountant, Walsh, Kelliher and Sharp, testified via teleconference from Fairbanks in support of this bill and about his 25 years experience and service as chair of the IRS/CPA Liaison Committee and chair of the Tax Committee of the Alaska Society of CPAs. He emphasized this bill was not sponsored at the request of the Alaska Bar Association (ABA). He stated he supports this bill because he was "tired of" the IRS becoming the prime beneficiary of court settlements.

Co-Chair Green restated her question.

Mr. Walsh affirmed this legislation only relates to awards issued as a result of a court case.

Senator Olson asked how this legislation would affect federal IRS rules.

Mr. Walsh replied that the IRS considers property rights as described in state laws. He stated that the Ninth Circuit Court of Appeals held that the property rights were such that plaintiffs must pay tax on their attorney fees under California law, Arizona

law and Alaska law. However, he noted that the Court found that the state of Oregon laws were somewhat different and therefore provided that the plaintiff's attorney is the only party liable for the property rights taxes.

Senator Bunde clarified that the impetus of this bill is not the Alaska Bar Association and asked the ABA position.

Mr. Walsh affirmed the ABA did not initiate this legislation, commenting that all credit or blame falls to him. He qualified that he asked the Association for assistance in drafting this legislation; however, noted that the ABA does not take positions on legislation. He relayed that the president of the Association has indicated interest in the matter. He also informed that he requested the opinion of the Alaska Legal Services Corporation, which represents disadvantaged parties, but had not received a reply. He wanted to ensure this legislation would not benefit attorneys at the expense of taxpayers. He referenced an article published in the Wall Street Journal [copy on file] regarding the National Taxpayer Advocate, Nina Olson's attempt to have the US Congress address the matter through federal law, although he stated these efforts have been unsuccessful. However, he remarked that the Alaska Legislature has the ability to change statute in a manner that the federal Ninth Circuit Court of Appeals could affirm.

Senator Bunde never mind other discussion re tort reform they say in it for benefit of the people.

Co-Chair Wilken referenced letters in support of this bill from the Windfree Law Office and Cook Schuhmann and Groseclose, Inc. Attorneys at Law [copies on file].

Senator Olson asked the reason for the language contained in the bill as opposed to language changing existing statutes governing property rights.

Mr. Walsh replied that he had requested the ABA provide him with language identical to that adopted by the state of Oregon and ruled adequate by the Ninth Circuit Court of Appeals.

Senator Olson cautioned this "remedy" might inadvertently provide a loophole relating to property rights.

Co-Chair Wilken asked if the Senate Judiciary Committee had discussed this possibility.

Senator Stedman replied it did not.

Co-Chair Wilken asked if Senator Olson wanted this bill held in Committee to address this concern.

Senator Olson deferred to the sponsor and the co-chair.

Co-Chair Wilken suggested highlighting the issue with intent it be addressed when the bill is considered in the House of Representatives.

Co-Chair Green wanted assurance that in remedying the tax consequence, this legislation would place the attorneys "in front of" of plaintiffs regarding receipt of settlement payments.

Senator Stedman assured it would not allow such "front-running". He stressed that the laws governing attorney's trust accounts are "extremely tight" and this legislation would not grant the attorney additional claim to a settlement.

Co-Chair Green asked if this requires that a client who receives a settlement make payment to an attorney.

Senator Stedman described the "flow of funds" to a trust account governed by the attorney then distributed to the client.

Co-Chair Green surmised if 100 percent of an award amount were paid to the client who then fails to pay the attorney fees, the client would not be required to pay taxes on that amount. She asked how this could be justified.

Mr. Walsh responded that the individual receiving funds would be taxed for the entire amount that person is entitled to. He explained that an attorney could file a lien against the client if not paid for services. He also noted that if an attorney chooses to not collect a fee, the client would be liable for taxation on the entire amount of a settlement.

Co-Chair Wilken noted this bill does not specify an effective date and asked whether the sponsor would support an immediate effective date.

Senator Stedman supported this.

AMENDMENT #1: This conceptual amendment adds a new Section 3 to the bill providing for an immediate effective date of the provisions of Sections 1 and 2.

Co-Chair Green moved for adoption.

Without objection the amendment was ADOPTED.

Co-Chair Green offered a motion to report the bill from Committee as amended with individual recommendations and accompanying fiscal notes.

There was no objection and CS SB 300 (FIN) MOVED from Committee with zero fiscal notes #1 from the Department of Natural Resources, #2 from the Alaska Court System, and #3 from the Department of Law.

#SB322

SENATE BILL NO. 322

"An Act relating to the rate of the salmon enhancement tax."

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

Co-Chair Wilken stated this bill, sponsored by Senator B. Stevens, by request "authorizes regional aquaculture associations to hold elections to change the tax rates for the salmon enhancement tax."

Senator B. Stevens testified that this legislation would provide another option for regional aquaculture associations, which are comprised of commercial fishers in the region and the hatcheries operating in that region. Currently, he stated that statute provides the ability for members of the associations to assess themselves one, two, or three-percent. He noted those rates have not changed since 1976.

Senator B. Stevens explained this bill would increase the allowable rates from four to ten percent, and permit the associations to "super access themselves" for the purpose of paying off debt, if they so choose. He characterized this legislation as a modernization of the salmon enhancement program. He stated this legislation is an attempt to mitigate concerns of industry participants relating to the percentages of "cost recovery versus common property."

Senator B. Stevens referenced a spreadsheet titled "Alaska Hatchery Commercial Common Property & Cost Recovery Return Data - 1993-2003" [copy on file], showing the "cost recovery percentages" and "commercial harvest percentages". He indicated that over several years, the cost recovery percentage has averaged approximately 30 percent. He remarked that this demonstrates the declining value of the fish produced, therefore forcing an increase in the number of fish required to pay the operation costs of the hatcheries. He

reiterated this legislation would permit the members of an association to opt to harvest a greater number of fish and increase their assessment to generate revenue for hatchery operations. He stressed that such a change could not be implemented without a majority vote of the permit-holders in the region.

Senator B. Stevens informed that currently the commercial fishers could pay no more than three-percent and thus forcing cost recovery methods to cover a larger portion of the operating expenses.

Co-Chair Wilken referenced letters in opposition to this bill [copies on file].

Senator B. Stevens addressed the letter from Kate File and agreed she has a legitimate concern, although it is not germane to this legislation. He explained this legislation does not pertain to the cost recovery practices of non-profit hatcheries. He assured that this bill only applies to those areas included in a regional association, and that the members of the associations have the authority to impose these taxes on themselves.

Co-Chair Wilken requested an explanation of cost recovery in the context of this legislation.

Senator B. Stevens gave an example of a hatchery that produces ten million fish with annual operating costs of \$4 million. He explained the current process whereby the hatchery contracts with certain commercial fishers to catch and return five million fish to the hatchery to pay the operating costs. The remaining five million fish, he continued, are available for catch by other commercial fishers and taxed at a rate of two percent to recover additional costs. He stated this bill would "change the dynamics" and allow the commercial fishers to assess a higher tax on their portion of the harvest and thus reduce the number of fish reserved for contracted harvesting and increase the number of fish available to them for harvest.

Co-Chair Wilken citing the spreadsheet, noted that one third of the hatchery produced fish are harvested for the purpose of paying operating costs.

Senator B. Stevens affirmed, qualifying that the percentage varies by region depending upon the number of hatcheries operating in a region.

Senator Bunde pointed out that cost of producing fish increases over time, although the price of fish varies. He surmised that with a large debt service, a hatchery would have to take virtually

all the fish it produces to pay its operating costs. He stated this bill offers the option to pay overhead costs down in years of higher prices.

Senator Bunde commented that participation in associations is optional for commercial fishers in some areas and there is concern that fishers might not vote. He predicted that this legislation could provide more incentive for participation if fisher's tax assessments could change.

Senator Hoffman asked the percentage of hatcheries still producing pink salmon.

Senator B. Stevens replied that most hatcheries are producing pink salmon, with the largest productions in Prince William Sound. He relayed that trends indicate the cost recovery percentages is rising.

Senator B. Stevens listed the Northern Southeast Regional Aquaculture Association (NSRAA), a region comprised of several hatcheries, is an example of how this legislation could be beneficial. He told how this association paid its costs down early, and was able to limit the amount of cost recovery harvesting. However, he pointed out that cost recovery has increased in recent years due to lower fish prices. He explained this association could chose to reduce the percentage of cost recovery harvesting by paying a higher tax assessment. He stressed this would be a choice determined by the members of the association through an election process. He also noted that the association members could subsequently reduce its taxes in the event of a market change and increased prices. He opined this legislation provides "self determination" within an association. He expressed this could allow for the release of more fish for commercial harvest and change the current trend of hatcheries catching a significant percentage of the fish they produce to pay the operating expenses of the hatchery.

Co-Chair Wilken asked how the cost recovery percentage is determined. He noted the increase of the NSRAA cost recovery percentage and asked if it was a result of increased debt.

Senator B. Stevens was uncertain of the NSRAA situation. He detailed that each hatchery submits a plan to annually to the regional planning team, which is approved by the board of directors of the regional association.

Co-Chair Wilken asked why the Douglas Island Pink and Chum (DIPAC) hatchery is not relevant to this legislation.

Senator B. Stevens replied DIPAC is a private nonprofit corporation and is therefore not included in a regional aquaculture association. He stated it operates only under the authority of its board of directors and has no involvement from a regional planning team. He noted this speaks to Ms. File's concern about increased cost recovery percentages without input from area commercial fishers.

Senator Hoffman asserted the more fish produced, the lower percentages of cost recovery. He asked for affirmation that the value of pink salmon is from roe.

Senator B. Stevens affirmed. He relayed discussions regarding the declining value of pink salmon and subsequent increased production, resulting in a downward cycle.

Senator Hoffman indicated this is his concern.

Senator B. Stevens agreed this is the reason this bill is necessary. He detailed the price fluctuation for pink salmon over 20 years ranging between 80 cents per pound to the current eight cents per pound. He referenced a graph titled, "Alaska Historical Commercial Salmon Catches (all species) 1878-2003", prepared by the Department of Fish and Game [copy on file], showing that hatchery activities have contributed to an increased stabilized production rate of almost 100 million fish annually statewide. However, he pointed out that the value has diminished.

Co-Chair Wilken asked if the hatchery program was implemented in 1978.

Senator B. Stevens affirmed. He informed that most hatcheries in Alaska had been State-owned, but currently most are either held by an association or a non-profit corporation.

Senator Hoffman pointed out the supporting documentation for this legislation does not indicate the percentages of hatchery salmon. He understood the hatchery programs primarily operate in Prince William Sound and Southeastern Alaska, although the largest fishery is located in Bristol Bay.

Senator B. Stevens agreed the Bristol Bay fishery has the highest value. He spoke to the price trends for sockeye salmon, which average between 80 cents and \$1.80 per pound.

Senator Hoffman countered that Senator Dyson would say that increased production of pink salmon in Prince William Sound during

the 1980s and 1990s resulted in a flood of the market and impacted the sockeye salmon fishery. He also noted other factors such as farmed fish have impacted the fishery markets.

Senator Bunde added that foreign market crashes have had a significant impact on the fishing industry. He commented on the State trend of receding from the "hatchery business", while making efforts to enter the "oil business". He suggested this should be considered.

Senator Bunde asked if the demand for cost recovery increases, whether the Department of Fish and Game would be pressured to facilitate cost recovery to limit fishing in distant waters to allow more fish to return closer to the hatchery location.

Senator B. Stevens replied the matter would be a regional management decision.

Co-Chair Wilken told of discussions to operate a fish hatchery in Fairbanks to supply fish to Interior and Southeast Alaska, and asked whether this hatchery would be included in the provisions of this legislation.

Senator B. Stevens answered it would if it practiced cost recovery and depending upon whether it produced fish for commercial harvest or personal and subsistence use, as well as the volume of fish produced. He added that such a hatchery would participate only if it secured funding through the Fisheries Enhancement Revolving Loan Fund. He indicated on a map showing the locations of hatcheries within Alaska [copy on file]. He noted that hatcheries located at Fort Richardson and Fort Elmendorf are not included, as they produce fish for personal use.

Co-Chair Wilken understood the proposed Fairbanks hatchery was intended to produce fish for personal and subsistence use.

Senator B. Stevens expressed he has discussed the hatchery issue extensively, and that this is legislation is an option for those regional aquaculture associations to utilize if they chose.

Co-Chair Green clarified this legislation would stipulate no mandates.

Senator B. Stevens affirmed.

Co-Chair Wilken ordered the bill HELD in Committee.

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ADJOURNMENT

Co-Chair Gary Wilken adjourned the meeting at 10:36 AM