ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE
April 11, 2003
3:33 p.m.

MEMBERS PRESENT

Senator Scott Ogan, Chair
Senator Thomas Wagoner, Vice Chair
Senator Fred Dyson
Senator Ben Stevens
Senator Kim Elton

MEMBERS ABSENT

Senator Ralph Seekins
Senator Georgianna Lincoln

COMMITTEE CALENDAR

SENATE BILL NO. 142
"An Act designating the Department of Natural Resources as lead agency for resource development projects; making conforming amendments; and providing for an effective date."
MOVED CSSB 142(RES) OUT OF COMMITTEE

SENATE BILL NO. 50
"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."
HEARD AND HELD

PREVIOUS ACTION

SB 142 - See Resources minutes dated 4/9/03.

SB 50 – See Resources minutes dated 3/26/03.

WITNESS REGISTER

Ms. Janet Burleson-Baxter
Department of Natural Resources
400 Willoughby Ave.
Juneau, AK 99801-1724
POSITION STATEMENT: Answered questions about permitting procedures related to SB 142 and stated support for the concept of a lead agency

Ms. Mary Siroky
Department of Environmental Conservation
410 Willoughby
Juneau, AK 99801-1795
POSITION STATEMENT: Answered questions related to SB 142

Mr. Dick LeFebvre
Acting Deputy Commissioner
Department of Natural Resources
400 Willoughby Ave.
Juneau, AK 99801-1724
POSITION STATEMENT: Answered questions about SB 142

Ms. Mary Jackson
Staff to Senator Wagoner
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Explained the changes made in Version I of SB 50

Mr. Mark Myers
Director, Division of Oil and Gas
Department of Natural Resources
550 W 7th Ave.
Anchorage, AK 99501-3560
POSITION STATEMENT: The Administration has taken no position on SB 50 but he supports Senator Wagoner's proposed amendment

ACTION NARRATIVE

TAPE 03-27, SIDE A
Number 0001

CHAIR SCOTT OGAN called the Senate Resources Standing Committee meeting to order at 3:33 p.m. Senators Stevens, Wagoner, Elton, Dyson and Chair Ogan were present. Chair Ogan announced the committee would take up SB 142 first.

SB 142-DNR LEAD RESOURCE DEVELOPMENT PROJECTS

CHAIR OGAN said that most of the questions he raised about SB 142 at the April 9 hearing have been answered. At that hearing, Senator Lincoln suggested putting a sunset date in the legislation. He supports that suggestion and would like to see the program reviewed by the legislature in the second year of the next administration. He asked Ms. Burleson-Baxter if she would like to testify.

MS. JANET BURLESON-BAXTER, Department of Natural Resources (DNR), told members that she, Dick Lefebvre, Bob Loeffler and Cam Leonard were available to answer questions.

SENATOR ELTON thanked the representatives from DNR and DEC for bringing him up to speed on this legislation, as he was absent from the last hearing. He then said he had several questions to ask on behalf of Senator Lincoln, who was excused. The first question was about the appeal process under the new system. He noted Senator Lincoln was concerned that the new permitting office would be in charge of issuing permits while the individual agencies would hear the appeals.

MS. BURLESON-BAXTER said none of the agencies would lose their authority over appeals of their respective permits. An appeal could be brought to the DNR project office but if the issue surrounded an individual permit, the adjudicatory process would be dealt with through the existing appeal procedure of the particular agency.

MS. MARY SIROKY, Department of Environmental Conservation (DEC), affirmed Ms. Burleson-Baxter's explanation.

SENATOR ELTON then asked, on behalf of Senator Lincoln, if the cost of the new office would be minimal because the cost will be transferred to the permittee. He questioned whether the cost will be difficult to estimate until DNR knows how many major permit applications it will have.

MS. BURLESON-BAXTER nodded affirmatively.

CHAIR OGAN pointed out the fiscal notes are zero but the funds for this legislation are included in the Governor's operating budget request. He commented that approach keeps the number of committee referrals down but questioned what will happen if no new positions are funded in the budget. He said putting the actual cost of the positions on the fiscal note would be clearer.

MR. DICK LEFEBVRE, Acting Deputy Commissioner, DNR, said DNR has a number of large projects in the queue already. DNR anticipates that the reimbursable services lined up for this year will continue into next year. The component in the budget recognizes some of those funds. Whether SB 142 passes or not, DNR will need authorization to receive and expend those funds, which is why DNR used the budget as the main vehicle to carry the funding request.

CHAIR OGAN asked if DNR could be the lead agency if the funding request in the operating budget is not met.

MR. LEFEBVRE said it could.

SENATOR ELTON commented that when the legislature directs departments to make an unallocated budget reduction, the legislature does not know where that reduction will take place. He agreed the bill should have a fiscal note that reflects the source of the funds and how those funds will be spent.

SENATOR STEVENS said his interpretation of the section being repealed on page 3, AS 46.35.070, is that a state agency still has the responsibility to issue the permit but the coordinator is being changed, which is the reason for the zero fiscal note.

MR. LEFEBVRE said that is correct.

SENATOR ELTON offered a conceptual amendment to include a sunset date that takes effect two years into the next administration.

SENATOR STEVENS objected for the purpose of discussion. He then asked the department to comment on the sunset provision and how the three-phase team concept would be implemented with a sunset provision. He also asked what program the state would revert to if the sunset took place, and whether it would be the program in existing Section 4.

CHAIR OGAN pointed out that Section 4 is not being used at this time.

SENATOR STEVENS asked DNR staff to comment on the sunset concept.

MS. BURLESON-BAXTER said DNR likes the concept of the bill. She pointed out the concept of the lead agency began during the Hickel Administration and was continued through the Knowles Administration to this one. She said if a sunset provision is included, she believes DNR would try to carry on with the team concept as best as it could because it has been successful for DNR in the past.

SENATOR STEVENS pointed out that DNR would have no authority to continue as the lead agency if a sunset took place.

MS. BURLESON-BAXTER said DNR would not have prescriptive statutory authority but it might engage in a memorandum of understanding.

SENATOR ELTON said his understanding is that a sunset would require the state agencies to revert to the ad hoc process used now. He said the argument for a sunset review is that it would set in motion a process to answer some of the questions, i.e., is the new office charging the permittees an appropriate amount. A sunset review would give the legislature the opportunity to review the definition of a large natural resource project and tweak or eliminate aspects of the program that are problematic. A sunset also reminds the department that the program will be reviewed, which induces good behavior.

MR. LEFEBVRE told members one benefit of having clear statutory authority is that the federal agencies, when preparing environmental impact statements (EIS), would know who they have to deal with. Right now, they must deal with state agencies individually unless state agencies agree amongst themselves prior to the start of a project.

SENATOR STEVENS said in his opinion, some of the annual sunset reviews undertaken by the legislature are routine reauthorizations. The legislature has the authority to make changes to a program at any time, if need be. He said while a sunset review forces the legislature to review a program, there is a dividing line between a reauthorization and a review and evaluation. He said DNR's annual report to the legislature should keep legislators informed about how DNR's authority as lead agency is being utilized.

SENATOR WAGONER said he planned to support the amendment but would prefer an annual review because sunset reviews are very time consuming. He believes this legislation is one of the most important before the legislature this year.

SENATOR STEVENS said he believes in putting the onus on DNR to describe how this concept is working by requiring it to present an annual report to the legislature.

MR. LEFEBVRE pointed out that one of the benefits of the lead agency concept is that it is voluntary on the part of the permit applicant. If the applicant is not satisfied with the project process, the legislature will know about it well in advance of the next legislative session.

SENATOR DYSON said inherent in the missions and measures process is an annual review by the Legislative Finance committees. He said he believes most sunset review time lengths should be doubled because they are very time consuming. However, because this is a new concept, he feels a sunset provision is valid so that the legislature makes sure an annual review takes place every year.

SENATOR ELTON said he prefers the formalized process of a [sunset] review.

CHAIR OGAN pointed out the next DNR commissioner could be very anti-development and a lot of power has been consolidated within that position. He advised that it might be prudent to take a formal look at this change in a few years as a check and balance measure.

SENATOR WAGONER said his concern with a sunset review is that the legislature has the right to review this piece of legislation any time it deems it necessary but he feels the legislature should watch this program change closely because it is new. He expressed concern that 2008 is a long time from now so he proposed a sunset review in two years.

SENATOR ELTON accepted Senator Wagoner's proposal as an amendment to his amendment.

SENATOR DYSON objected.

The motion to adopt the amendment to the amendment, to change the date of the sunset review from 2008 to two years, carried with Senators Stevens, Wagoner and Elton in favor, and Senators Dyson and Ogan opposed.

MS. SIROKY told members that from the agencies' perspective, a longer time frame for a sunset review would be better. She expressed concern that projects take a significant amount of time from start to finish so a two-year window might not be long enough to see whether the process is working. She suggested a four or six year window.

CHAIR OGAN moved to amend the amendment to require a sunset review in four years.

There being no objection, the motion carried.

The committee then voted on the amended amendment, that being whether to include a sunset provision [to take effect in four years]. The motion carried with Senators Dyson, Elton, and Ogan in favor, and Senators Wagoner and Stevens opposed.

There being no further testimony, SENATOR WAGONER moved SB 142 as amended from committee with individual recommendations and its accompanying fiscal notes. There being no objection, the motion carried.

The committee took a brief at-ease.

SB 50-ROYALTY GAS CONTRACTS

CHAIR OGAN informed members that a proposed committee substitute had been prepared, Version I, which is essentially the same as the House Finance Committee substitute to HB 57.

SENATOR WAGONER moved to adopt Version I as the working document of the committee.

CHAIR OGAN objected for the purpose of discussion. He then informed participants that he did not intend to move the legislation from committee today because Version I makes substantive changes to the last version of the bill. In addition, an amendment has been proposed.

MS. MARY JACKSON, staff to Senator Wagoner, sponsor of SB 50, verified that Version I is the companion legislation to CSHB 57(FIN), which is in the House Rules Committee. She explained the differences in Version I as follows:

- On page 2, the merged utility and manufacturing language was separated into two subsections, (1)(A) and (1)(B). New language was added to line 23 that reads, "for a contract entered into for a circumstance described in (1)(A) of this subsection." Section (1)(A) is specific to the utilities and is existing language in statute. Section 1(B) is new and contains the requirements for manufacturers of agricultural chemicals. She told members that separating the requirements of utilities and manufacturers into two sections reads more clearly.
- On page 3, line 9, the word "and" was changed to "or"; the net result being that any one of the exceptions would come

into play, rather than all of them. That change was recommended by the Administration.

MS. JACKSON said Chair Ogan previously asked whether the legislation contains a mechanism to allow the commissioner to negotiate a contract so that the State of Alaska would share in the profit as well as the risk. She said such a provision would lead to a better fiscal note and told members the sponsor has provided a proposed amendment on that subject for the committee's consideration.

SENATOR STEVENS referred to Section 2(B)(ii) on lines 5, 6 and 7 of page 3 and asked why it contains the words "tangible benefits to the state" and differs from Section (2)(A)(ii) on page 2.

MS. JACKSON explained that Section (2)(A) applies to the utilities. Section (2)(B) is new [and applies to value-added manufacturers]. Those words were added so that if the commissioner determined that a royalty reduction would lead to certain benefits related to employment opportunities or some other unknown tangible benefit, the commissioner could go forward with a contract.

SENATOR STEVENS said he thought tangible benefits were included in respect to the manufacturer, not just the utility.

MS. JACKSON said that is correct.

SENATOR STEVENS said the two sections seem to be contradictory in terms of tangible benefits.

MS. JACKSON referred Senator Stevens to subsection (A) on page 2, regarding the utilities contracts. She pointed out the language that begins on line 26 is the same as the language on page 3, line 5, however it is specific to the manufacturer of agricultural chemicals.

SENATOR STEVENS asked if that language is more aligned with subsection (A) than it was in the last version.

MS. JACKSON said it is essentially the same; it has just been separated into two sections.

SENATOR STEVENS said he thought the commissioner could consider royalty reductions by offsetting other tangible benefits in the last version. Now, Version I says the royalty reduction receipts would not be balanced, which is contradictory. He said the word "not" should not be included.

TAPE 03-27, SIDE B

SENATOR ELTON clarified that the list of items on page 3 contains the reasons the commissioner could deny a contract based on a written finding, one being that the royalty reduction would not be balanced by employment opportunities or any other tangible benefit to the state. He asked why this language is more specific for the manufacturers, as it further defines benefits as employment opportunities or other tangible benefits.

CHAIR OGAN commented that if the state lets a utility lock into a certain price and the state loses some money, Alaskan consumers will benefit with cheaper electricity. With manufacturers, the public benefit is not as tangible. In the original bill, the manufacturers asked to be treated like a utility. However, Agrium and its employees might have benefitted but at an expense to the state.

MS. JACKSON said that is a fair analysis. She pointed out that language on page 2, line 27, of Version I includes a bar that the utilities must reach. The language on page 3 includes the bar the manufacturers must meet.

SENATOR ELTON commented that in the case of the manufacturer, the consumers who benefit could be overseas and not Alaskan consumers.

SENATOR WAGONER remarked that one benefit is jobs in Kenai. Right now, Agrium is operating at 75 percent capacity and may be losing money everyday it operates. If this bill helps Agrium operate at 100 percent capacity, it will maintain and increase jobs. He noted if one of Kenai's petrochemical plants shuts down, the chances of it ever reopening is very low. He pointed out that Agrium is a big part of the economy on the Kenai Peninsula.

CHAIR OGAN expressed concern that this legislation singles out one type of industry and sets a precedent for other industries, such as the LNG plant at Pt. Mackenzie that ships LNG to Fairbanks.

MR. MARK MYERS, Director of the Division of Oil and Gas, DNR, told members that in regard to the previous discussion about Sections (2)(A) and (2)(B), Senator Elton was correct when he pointed out that the royalty reduction is granted unless one of those four conditions exists, in which case the commissioner can deny it.

SENATOR STEVENS asked if the commissioner will have to prove that the royalty reduction would not be balanced and not have a positive impact on the economy.

SENATOR ELTON said he did not understand Mr. Myers' explanation because if the commissioner can deny the royalty reduction based on the first factor listed, the commissioner would not consider the second factor, that the royalty reduction would not be balanced by employment opportunities or other tangible benefits.

MR. MYERS said that is correct as the four variables are independent. The commissioner can deny the reduction if any one of the four variables exists.

CHAIR OGAN asked Mr. Myers if he anticipates that this legislation will set a precedent for other industries.

MR. MYERS said the petrochemical industry could argue, as Agrium has, that it adds a lot of value to the state based on gas-to-liquids (GTL) projects, for example.

CHAIR OGAN asked if, under the Stranded Gas Act, the commissioner of revenue was given the ability to negotiate royalty payments for the petrochemical and GTL industries.

MR. MYERS answered the commissioner cannot change the rate but valuation methodologies can be negotiated. The producers proposed similar treatment to the previous administration in terms of their gas leases.

CHAIR OGAN felt justification could be made that this incentive should be given to other industries.

MR. MYERS agreed and said DNR understands Agrium's concern that it needs a good supply of gas to get up to 100 percent capacity.

CHAIR OGAN asked if more gas is available but not at the price Agrium needs to be profitable.

MR. MYERS said supply and demand is balanced at this time but, at current rates of consumption without additional exploration success, Cook Inlet will begin to squeeze out those who are willing to pay less for the gas. Typically, the utility market pays a higher value, followed by LNG, followed by the agricultural manufacturer. That will put Agrium in a tight spot when deliverability is less. He noted that a good deal of exploration is going on in Cook Inlet at this time.

SENATOR STEVENS expressed concern about the differences between Section (2)(A) and Section (2)(B) [the four factors the commissioner can use to deny a reduction], and pointed out that Section (2)(A) contains the word "and" while Section (2)(B) contains the word "or". Therefore, all variables must exist in Section (2)(A) while only one variable must exist in Section (2)(B) for the commissioner to deny a royalty reduction.

MR. MYERS indicated the original bill contained the word "and" and he does not know why this version was changed to "or". He said Version I in its current form sets a different standard for agricultural manufacturers than it does for the utilities. All four conditions must exist for the commissioner to deny an application from a utility.

SENATOR STEVENS said he believes the statement on page 2, lines 21-22, should be changed because he reads it to mean that (A) and (B) fall under that statement.

MS. JACKSON said the issue is that the standards for the new manufacturer are more restrictive. For a utility, the commissioner must enter into a contract unless all four conditions are met. For a manufacturer, the commissioner shall enter into a contract unless any one condition is met. She repeated the provision is more restrictive for the manufacturer than it is for the utility.

SENATOR STEVENS said he understands the intent but he does not read those sections that way because both (A) and (B) are subsections of Section (1)(aa)(2).

SENATOR ELTON said the bill makes it easier for the commissioner to deny a contract with a manufacturer than with a utility.

MR. MYERS told committee members the Administration has taken no position on the bill but said he supports the proposed amendment.

CHAIR OGAN removed his objection to adopting the work draft, therefore the motion to adopt Version I as the working document before the committee carried.

SENATOR WAGONER moved to adopt Amendment 1, which reads as follows:

> Page 3, after line 11, insert "(C) in granting an application under this section, the commissioner may use or accept an amount in excess of the price for the gas established in the contract but less than would otherwise be due under the lease when it is in the best interest of the state."

CHAIR OGAN objected for the purpose of discussion. He told members he intended to adjourn the meeting without adopting the amendment to give members a few days to consider it.

CHAIR OGAN said Amendment 1 is a profit sharing amendment that will allow the state to share in any upside.

SENATOR WAGONER told members Amendment 1 was written in consultation with Division of Oil and Gas staff, who said it is necessary to allow the commissioner to negotiate profit sharing.

SENATOR ELTON pointed out that Amendment 1 will cause a change in the fiscal note.

SENATOR WAGONER agreed Amendment 1 will make the fiscal note much more powerful.

CHAIR OGAN told members the committee would take up SB 50 and the proposed amendment on Monday and adjourned the meeting at 4:45 p.m.

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