

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

April 25, 2005

8:39 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Norman Rokeberg
Representative Ralph Samuels
Representative Peggy Wilson
Representative Max Gruenberg

MEMBERS ABSENT

Representative Paul Seaton
Representative Carl Moses

COMMITTEE CALENDAR

HOUSE JOINT RESOLUTION NO. 1

Proposing a balanced budget amendment to the Constitution of the State of Alaska relating to an appropriation limit.

- HEARD AND HELD

SPONSOR SUBSTITUTE FOR HOUSE JOINT RESOLUTION NO. 2

Proposing amendments to the Constitution of the State of Alaska creating and relating to the gas revenue endowment fund, relating to deposits to the fund, limiting appropriations from the fund based on an averaged percent of the fund market value, relating to deposits to the permanent fund, and relating to deposits to the budget reserve fund.

- HEARD AND HELD

HOUSE BILL NO. 223

"An Act levying a tax on certain known resources of natural gas, conditionally repealing the levy of that tax, and authorizing a credit for payments of that tax against amounts due under the oil and gas properties production (severance) tax if requirements relating to the sale and delivery of the natural gas are met; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HJR 1

SHORT TITLE: CONST AM: BALANCED BUDGET AMENDMENT

SPONSOR(S): REPRESENTATIVE(S) ROKEBERG, BERKOWITZ

01/10/05 (H) PREFILE RELEASED 12/30/04
01/10/05 (H) READ THE FIRST TIME - REFERRALS
01/10/05 (H) W&M, JUD, FIN
04/25/05 (H) W&M AT 8:30 AM CAPITOL 106

BILL: HJR 2

SHORT TITLE: CONST. AM: GAS REVENUE ENDOWMENT FUND

SPONSOR(S): REPRESENTATIVE(S) HAWKER

01/10/05 (H) PREFILE RELEASED 12/30/04
01/10/05 (H) READ THE FIRST TIME - REFERRALS
01/10/05 (H) W&M, JUD, FIN
04/01/05 (H) SPONSOR SUBSTITUTE INTRODUCED
04/01/05 (H) READ THE FIRST TIME - REFERRALS
04/01/05 (H) W&M, JUD, FIN
04/25/05 (H) W&M AT 8:30 AM CAPITOL 106

BILL: HB 223

SHORT TITLE: NATURAL GAS PIPELINE INCENTIVE/ GAS TAX

SPONSOR(S): REPRESENTATIVE(S) CROFT

03/17/05 (H) READ THE FIRST TIME - REFERRALS
03/17/05 (H) W&M, O&G, RES
04/25/05 (H) W&M AT 8:30 AM CAPITOL 106

WITNESS REGISTER

REPRESENTATIVE ETHAN BERKOWITZ

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Testified as sponsor of HJR 1.

REPRESENTATIVE MIKE HAWKER

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Testified as sponsor of HJR 2.

REPRESENTATIVE ERIC CROFT

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Testified as the sponsor of HB 223.

MARK GNADT, Staff

to Representative Eric Croft
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Offered information on HB 223.

MICHAEL HURLEY, Director of State Government Relations
ConocoPhillips Alaska, Inc.
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 223.

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at [8:39:46 AM](#). Representatives Weyhrauch, Rokeberg, Wilson, and Gruenberg were present at the call to order. Representative Samuels arrived as the meeting was in progress.

HJR 1-CONST AM: BALANCED BUDGET AMENDMENT

[8:40:31 AM](#)

CHAIR WEYHRAUCH announced that the first order of business would be HOUSE JOINT RESOLUTION NO. 1, Proposing a balanced budget amendment to the Constitution of the State of Alaska relating to an appropriation limit.

REPRESENTATIVE WILSON moved that the committee adopt CSHJR 1, Version 24-LS0156\Y, Cook, 3/7/05, as its working document. There being no objection, Version Y was before the committee.

[8:41:12 AM](#)

REPRESENTATIVE ROKEBERG, speaking one of the sponsors of HJR 1, explained that Alaska has no constitutional requirement for a balanced budget, instead Alaska has a statutory requirement for the succeeding years after a current year of a balanced budget. He related his belief that Alaska should have a balanced budget policy, particularly for the current fiscal year. The constitution and the statutes seem to allow a situation in which there is a current deficit that is financed by tax anticipation notes and [the legislature can] merely budget for the succeeding year's budget, which would result in continual deficits to be corrected after the fact. This resolution is the first step in developing a long-range fiscal plan, he added.

[8:42:53 AM](#)

REPRESENTATIVE ETHAN BERKOWITZ, Alaska State Legislature, speaking as one of the prime sponsors, said this resolution proposes two things: to transition to a balanced budget requirement and to require the legislature to pass a balanced budget. He related that the constitutional amendment should be simple and easy to understand with statements of principle. Any further explanation of what constitutes "balanced" can be addressed statutorily, he said. He added that this resolution will aid in finding consensus between both parties' caucuses.

CHAIR WEYHRAUCH inquired as to the cite for the statutory requirement to have a balanced budget for succeeding years.

REPRESENTATIVE ROKEBERG specified that the statute is AS 37.07.020(c).

[8:47:09 AM](#)

REPRESENTATIVE WILSON asked how HJR 1 would change the [process that the legislature currently undergoes when balancing a budget].

REPRESENTATIVE ROKEBERG answered that there might not necessarily be many differences in terms of the "end product," instead the change will be the process the legislature uses to get to that end product. This process will provide assurance to the public that the legislature has adequate funds. He related that the constitutional budget reserve (CBR) fund has been utilized often in order to balance the budget, which is evident to the public. However, this year supplemental budgets, new funds, and other devices have been utilized, all of which seems to confuse the public, he opined. Representative Rokeberg reiterated that [under the current process] it would be possible for the legislature to actually pass an imbalanced budget and then realign in the next legislature, which he opined is bad public policy.

[8:48:58 AM](#)

CHAIR WEYHRAUCH related his understanding that in the context of HJR 1, the term "balanced" refers to revenues equaling expenses rather than "fair."

REPRESENTATIVE BERKOWITZ answered, "Yes."

[8:49:12 AM](#)

CHAIR WEYHRAUCH proposed a hypothetical situation in which the legislature passes a budget in which revenues equal expenses, and related his understanding that the legislature could appropriate the funds to the CBR and the corpus of the permanent fund while not having enough money for state government. He surmised that the aforementioned could be considered "balanced." Furthermore, the governor could veto, through his line item authority, provisions of any budget legislation and thus the governor could throw the budget out of balance. He asked whether the aforementioned actions of the governor could be considered an unconstitutional act because this resolution only provides for the legislature.

REPRESENTATIVE ROKEBERG responded that the resolution's language speaks to the submission of the budget by the governor, with follow-up action by the legislature. He opined that the aforementioned is an "excellent point" that will have to be addressed in subsequent legislation.

[8:50:55 AM](#)

CHAIR WEYHRAUCH asked how this resolution would prevent fiscal gaps from occurring during low oil prices. He then questioned whether this resolution would be bad public policy because it would force the spending of money [the legislature] doesn't want to spend because oil prices are so high and revenues are greater than anticipated expenses.

[8:52:30 AM](#)

REPRESENTATIVE BERKOWITZ related his belief that a balanced budget requirement forces fiscal discipline because there is no requirement for any legislature, in a year of surplus, to spend all its revenues. He recalled that previous discussions concerning long-range fiscal plans have been "too fast and too controversial" and as a consequence no progress is made. Representative Berkowitz opined that in order to make progress, the legislature needs to slowly remove some of the options for tangential amendments and debates.

[8:54:01 AM](#)

REPRESENTATIVE ROKEBERG reiterated that there is no requirement [in HJR 1] to spend more than the state has, which is merely sound fiscal prudence. He then focused on Representative

Wilson's question regarding potential changes with the passage of HJR 1, and suggested that this resolution would prohibit the tactic of a bifurcated budget. He explained that a bifurcated budget could result from a situation in which the majority is not able to obtain a three-quarter vote and thus decides to adjourn the session without passing a budget. The aforementioned would result in a partially funded cash flow that doesn't go into the CBR, and upon returning in January the [budget] would be revisited. Although he opined that the aforementioned tactic isn't particularly prudent, it has been discussed out of frustration.

8:55:37 AM

REPRESENTATIVE GRUENBERG related his belief that HJR 1 is very clear and most voters could understand it. Although he acknowledged Representative Berkowitz's concern that there are too many undefined terms in HJR 1, he pointed out that the courts and the legislature define the terms rather than the constitution, which is what differentiates the constitution from a statute. He reiterated that the resolution should be simple so that people can understand it.

CHAIR WEYHRAUCH commented that one of the issues that he reviews with these types of amendments is regarding the balance of power between the executive and the legislative branch. In reviewing HJR 1 it seems that the following language: "[Section 16.] General fund appropriations by the legislature shall not exceed anticipated revenue." cedes authority to the executive branch. However, the resolution doesn't specify the governor's authority once that happens. Also all of [the appropriation legislation] would have some impact on the budget and necessitate review of the mix as a whole in order to determine the effect on revenues and expenditures. He questioned how one would manage that in the legislature and the executive branch. He also questioned whether [the legislature] would simply cede the authority for the balanced budget amendment to the governor because if [the legislature] passes bills that don't have a balance, then it may be engaging in [an] unconstitutional act.

8:59:34 AM

REPRESENTATIVE ROKEBERG, speaking to Representative Gruenberg's comments regarding the original HJR 1, related that the statement, "The budget for each fiscal year shall be balanced with the appropriations do not exceed the amounts available for expenditures under the appropriations," is different than

stating, "Appropriations shall not exceed anticipated revenues." He related his belief that there is a significant problem with the [definition of] "anticipated revenues," particularly because Alaska has various sources of funds available for appropriation, including the CBR and various dedicated funds. The debate is whether or not those are considered "revenues," which is why Version Y takes a more "neutral" standpoint on the issue.

REPRESENTATIVE ROKEBERG then turned his attention to Chair Weyhrauch's comments, and stated that the budget building process should ultimately be determined by the legislature and balanced before adjournment. The duty of the Finance Committees is to explain to the legislature the expenditures in the budget [and how they] will be covered by available revenues. The legislature can't restrict the ability of the governor to exercise his veto power because that's a conflict of law within the constitution. However, by exercising his/her veto power, the governor can only decrease spending as opposed to increasing it.

[9:02:24 AM](#)

REPRESENTATIVE GRUENBERG related his understanding that 44 states have balanced budget amendments. He opined that perhaps an analysis of the aforementioned amendments could help determine the appropriate language for Alaska's proposal. He related that he strongly supports a balanced budget amendment. He offered that the amendment could simply state, "General fund appropriations shall not exceed anticipated revenue" in order to clarify the purpose of the resolution. He asked if the resolution should state that each house in the legislature has to pass a balanced budget to the other house or should it state that the final budget bill given to the governor has to be balanced. He noted that Representative Berkowitz intended [the later to be the intent of HJR 1]. Representative Gruenberg then surmised that the final budget signed by the governor must be balanced as well, to which he noted both sponsors nodded in agreement. He asked if this resolution refers to [budget] bills individually or the "whole ball of wax."

[9:06:10 AM](#)

REPRESENTATIVE BERKOWITZ replied, "It's the whole ball of wax." For instance, there could be a situation in which budget bills were running at a deficit, but a revenue bill provided enough revenue so that the entire package came into balance, he explained.

REPRESENTATIVE ROKEBERG acknowledged that there are provisions in the constitution that make distinctions between the operating and capital budgets. Therefore, it's important to clearly state on the record that the intention is for the resolution to be all encompassing.

REPRESENTATIVE GRUENBERG asked if there are other states that have constitutional provisions that accomplished encompassing all the budgets [including the capital, operating, and supplemental budgets].

REPRESENTATIVE BERKOWITZ noted that the committee packet should include information from the National Conference of State Legislatures (NCSL).

REPRESENTATIVE GRUENBERG clarified that his interest is in regard to [specific] text [from those states that have constitutional provisions that accomplished encompassing all the budgets].

[9:08:07 AM](#)

REPRESENTATIVE WILSON related that she agreed with the intention of this resolution, however, the public doesn't have the "time or sometimes the inclination" to become as educated as the legislature. She opined that she has a hard time transferring the final decision to the public because they aren't as informed as is an individual who is elected and whose job she believes it is to become informed on the issues. Representative Wilson said, "There's going to be a cost involved and bottom line, I don't think ... much will change ... in the long run."

[9:10:19 AM](#)

REPRESENTATIVE BERKOWITZ highlighted that during his service in the legislature he has voted against every single constitutional amendment, except for subsistence. He opined that there shouldn't be a constitutional change unless it's a statement of purpose that's absolutely necessary. The requirement of a balanced budget is an issue that the public can quickly understand, he opined. Furthermore, providing an opportunity to debate and vote on such a requirement will give the public more confidence as to what happens in Juneau and would ensure the public that the legislature isn't engaging in deficit spending. Currently, the legislature does, to a certain extent, engage in deficit spending, by using the principal of the CBR.

Representative Berkowitz further opined that the public understands balancing the budget, it's simple.

[9:12:30 AM](#)

CHAIR WEYHRAUCH commented that he appreciates these discussions taking place because it's important to have a record fleshing out constitutional amendments.

[9:12:41 AM](#)

REPRESENTATIVE ROKEBERG related that many Alaskans, including himself, assumed there was a balanced budget mandate. However, no such constitutional mandate exists. He offered that this resolution responds to the lack of a balanced budget requirement.

CHAIR WEYHRAUCH again directed attention to the following language in the original [HJR 1]: "[Section 16.] General fund appropriations by the legislature shall not exceed anticipated revenue." He related his understanding that under the aforementioned language the legislature could pass all the bills it wants and rely on the spring revenue forecast and what the oil prices are going to be in the future. Under such a scenario, the legislature could say that it anticipates high revenues and thus pass a high budget. However, when the revenue forecast falls short of its predictions because the price of oil was overestimated, then the legislature can blame [the forecasters] for not anticipating the revenue shortfall.

[9:14:59 AM](#)

REPRESENTATIVE BERKOWITZ offered that the term "general fund" is very restrictive because it ignores the various other funds like the CBR and other dedicated funds, which are issues that fall outside the GF. Therefore, the exceptions would swallow-up the intent. Furthermore, language such as "Expenditures shall not exceed revenues" raises the issue of what constitutes revenue.

CHAIR WEYHRAUCH highlighted that the key word in Version Y is "balanced". He recalled that when the U.S. Congress passed the Gramm-Rudman-Hollings Act they began to do things such as value Yellowstone as an asset of the U.S. Therefore, he requested clarification on the meaning of the term "balanced" in the context of this amendment because accountants will see ledger issues. He then posed a situation in which the legislature is providing for a balanced budget and a citizens' initiative wants

to institute a tax for cruise ships that would provide additional revenues. In such a situation would the citizens' initiative not work on tax policy because the legislature is going to pass through a balanced budget.

REPRESENTATIVE ROKEBERG said, in reference to the last instance, no because it's not the intent to further restrict the legislature's hands and the initiative process is really an extension of the legislature's ability to enact legislation. He reviewed the language that he had considered and related that ultimately the discussion between he and Representative Berkowitz centered on the simplicity of constitutionalizing "balance" rather than getting caught up in the minutia.

REPRESENTATIVE BERKOWITZ pointed out that the language of Section 12 of the constitution is clarified by the term "balanced." He highlighted that the aforementioned section makes reference to "proposed expenditures and anticipated income." Although the definitions of those terms might be unsettled, the totality of the understanding of what a balanced budget is with proposed expenditures and anticipated income would all be contained within the current language of the constitution, he said. Because the aforementioned terms are contained in the current language of the constitution, there is no need to address the issue of injecting new terms.

[9:18:36 AM](#)

CHAIR WEYHRAUCH related his belief that if this language goes before the public, [the resolution] will pass because everyone shares the notion of living within his or her means. Despite that popular support, Chair Weyhrauch expressed concern about the nuance of the amendment and what it means for the function of government, the appropriation process, and the balance of power between the executive and the legislative branches.

[9:19:11 AM](#)

REPRESENTATIVE GRUENBERG highlighted that Colorado, Louisiana, and Montana all have balanced budget amendments that are simple, general, and similar to the original HJR 1. He opined that the public could understand the aforementioned constitutional amendments, particularly Louisiana's because it deals with oil and gas revenues. He reiterated that any constitutional amendment brought before the voters needs to be simple in order to prevent confusion and mistrust of the legislature.

9:20:39 AM

REPRESENTATIVE ROKEBERG said that Representative Gruenberg just made the sponsor's case for a one-word change.

REPRESENTATIVE GRUENBERG said he agreed, but opined that the resolution seemed to state that only the governor would have to submit [a balanced budget].

REPRESENTATIVE BERKOWITZ offered that Section 2 [should clarify that].

REPRESENTATIVE GRUENBERG suggested that it should not just be limited to the legislature and should be put in the passive in order to avoid the veto issues.

9:21:20 AM

REPRESENTATIVE BERKOWITZ agreed that Section 2 doesn't address the governor's requirements and that is something that needs to be addressed. By the same token, as with any constitutional amendment, there are going to be interpretive statutes that go with it. He related his understanding that a balanced budget occurs when expenditures match income because those are the terms that are in the constitution. As a matter of constitutional policy, it's not wise to put the definition [of balanced budget] in the constitution rather it should occur statutorily. Representative Berkowitz suggested that every legislator should read the publication entitled, "Guidelines for Constitutional Amendments". He then reviewed the eight guidelines suggested by the aforementioned publication.

9:24:14 AM

REPRESENTATIVE WILSON commented that she has not seen this legislature pass a budget when there aren't matching expenditures. Therefore, she asked how this resolution will change the process.

9:25:03 AM

REPRESENTATIVE ROKEBERG replied that this resolution anticipates the time when the legislature will be short of anticipated revenues, which will force the legislature to finally develop a long-range fiscal plan. He noted that over the last decade, the legislature, during times of substantially reduced revenues, has been forced to review what sources of revenue are available and

what expenditures should be reduced. However, the state has been fortunate in that money has come forth or price volatility has swung in the state's favor. Representative Rokeberg stressed that one of the purposes of HJR 1 is to force some discipline on the legislature and the public.

[9:26:25 AM](#)

REPRESENTATIVE GRUENBERG recalled that during the Cowper Administration, the legislature didn't pass a budget and so there was a special session. He further recalled that recently the legislature passed a budget that wasn't balanced and thus the governor had to veto many things. However, this resolution seems to require the legislature to pass a balanced budget before it adjourns.

[HJR 1 was held over.]

HJR 2-CONST. AM: GAS REVENUE ENDOWMENT FUND

[9:27:32 AM](#)

CHAIR WEYHRAUCH announced that the next order of business would be SPONSOR SUBSTITUTE FOR HOUSE JOINT RESOLUTION NO. 2 Proposing amendments to the Constitution of the State of Alaska creating and relating to the gas revenue endowment fund, relating to deposits to the fund, limiting appropriations from the fund based on an averaged percent of the fund market value, relating to deposits to the permanent fund, and relating to deposits to the budget reserve fund.

CHAIR WEYHRAUCH thanked Representative Hawker for all his past work with the House Special Committee on Ways and Means.

[9:28:24 AM](#)

REPRESENTATIVE MIKE HAWKER, Alaska State Legislature, sponsor, opined that this resolution is one of three critical structural framework elements needed to craft long-term sustainable fiscal policy. He said:

This bill would propose a constitutional amendment to address one of those critical issues and that's the long-term sustainability of having ... the liquid capital cash available to meet our ongoing state needs, not only for this generation but for future generations. I draw your attention to the sponsor

statement ... I think all Alaskans, at one time or another, have heard what is referred to as the "Great Alaska Prayer" and that is: "Lord please grant me another Prudhoe Bay, I promise not to fritter this one away." I don't think anything could be more accurate in its conception. This state has had an incredible amount of wealth. Our wealth is natural resource based; these are extractive resources, that once we have severed the resource and sold it, it is gone forever. These are not renewable resources particularly our oil and gas, which makes the foundation of the state's revenue base We've certainly got fisheries, timber, [and] other resources that are clearly in the renewable category, but the physical financial magnitude of those resources pales in comparison to our oil and gas resources. What this specific constitutional amendment proposes to do is it makes the statement that when we start developing our natural gas, that great resource on the North Slope, that this time instead of spending the money we take from that gas as we sever disposable non-renewable resource we take all the proceeds from that severance, that sale, and place it into its own permanent fund. ... if you allow me the latitude to call it a gas permanent fund, [the] idea [is] to model it exactly on our existing permanent fund but the difference being that this time instead of just taking constitutionally 25 percent of the revenues generated, we take all of it. And we make the commitment that says we will convert this money that we receive into an endowment that will meet the state's needs for generations. [A] critical element of this bill is that the endowment I propose to have managed in the format of the [percent of market value] POMV mechanism The one differential in this amendment is that it makes it very clear that in this gas permanent fund ... that the money available in the future under the POMV may be used for any public purpose, taking care of our state, except paying dividends to individual Alaskans; I think it's a critical distinction we need to make here. This is the fund that will take care of our public needs in the future.

REPRESENTATIVE HAWKER turned attention to the chart entitled "Gas Revenue Endowment Fund (GREF)", which details the projected benchmark of production and tax estimates provided by the Department of Revenue. He highlighted that in year 2030

operating under the POMV mechanism, the money coming from a POMV is the same amount as is being received from the severance of resources. Every year beyond 2030, there is actually more revenue available to the state under the POMV mechanism, when the earnings on reinvestment of the principal are included than is being taken from the extractive process itself. The point of this resolution is to [implement mechanisms] to provide a sustainable, stable, and predictable economic base for the state, he reiterated. He offered that it is appropriate and correct for the legislature to put before Alaska a constitutional framework for a fiscal plan. He noted that HJR 1, HJR 2, and passing a POMV methodology for the existing permanent fund are material sources of bridging the gap between today and the 10 to 15 years before gas comes online. The aforementioned components are essential to the constitutional framework that is being demanded by the citizens of Alaska, he surmised.

[9:36:36 AM](#)

CHAIR WEYHRAUCH asked if the GREF was for gas from the Alaska North Slope (ANS) gas.

REPRESENTATIVE HAWKER replied yes, it specifically excludes existing producing reserves elsewhere in the state.

[9:36:56 AM](#)

CHAIR WEYHRAUCH asked if today the state obtains any revenue from ANS gas.

REPRESENTATIVE HAWKER responded that there is a very small amount of gas produced on the North Slope from a small 4-inch line that is feeding some of the pump stations and providing basic utility fuel. He explained that natural gas is methane, butane, ethane, propane, and the difference lies in the number of carbon atoms in the molecule. Currently, the industry is moving natural gas liquids (NGLs) through the Trans-Alaska Pipeline System (TAPS) as part of the oil flow. As a result of a processing activity, the molecules can be liquefied, run through the pipeline, and separated for use later. He clarified that references to a gasline refer to moving only methanes and liquefied propane gas (LPGs). He specified his intent to only grab the methane and LPGs not the heavier NGLs in order to have a separate accounting, which is easier for the industries involved.

[9:39:36 AM](#)

REPRESENTATIVE HAWKER, in response to Representative Wilson, clarified that C₄, which is butane, is in both NGLs and LPGs. He recalled that the oil industry attempted to put butanes down the TAPS pipeline, but as production volume slowed it is no longer safe or technically feasible to do so. This constitutional mechanism provides no incentive for an industry to choose [what natural gas to obtain], the industry will simply opt for what is best technically. Furthermore, this resolution is not a tax or revenue mechanism that has any effect on the industry, but rather is a mechanism for the state to do something with the royalties it receives, he said.

[9:41:07 AM](#)

REPRESENTATIVE WILSON alluded to her belief that what HJR 2 proposes is what the original framers of the permanent fund dividend had in mind, although it was changed. She indicated that originally the intent [with the permanent fund] was to use it to run the state when the revenues from the pipeline slowed down. Therefore, she noted her agreement with the provision in HJR 2 that [specifies any appropriation from the proposed fund can't be used to provide dividends or other payments to all residents]. Representative Wilson concluded by lauding the concept of HJR 2 and the hope that this resolution is passed and no future legislature changes it.

REPRESENTATIVE HAWKER said that HJR 2 is about the current legislature having the vision to ensure fiscal discipline and a sustainable economic base for Alaska.

[9:44:21 AM](#)

REPRESENTATIVE HAWKER, in response to Chair Weyhrauch, related that the POMV mechanism specifically states that the "look-back" period would be five fiscal years and it would be the first five of six years pre-dating. The purpose of the six years is to allow the legislature to "know exactly how much money is on the deck, available to spend that year," at the beginning of session. Therefore, the legislature won't be guessing the oil prices, which is one of the great fallacies of the current system, he stated. He highlighted that the look-back period shall be implemented by law. The provision addressing the look-back period read as follows:

Appropriations from the gas revenue endowment fund for a fiscal year may not exceed five percent of the average of the market values of the fund on June 30 for a number of previous fiscal years as provided by law. However, for purposes of calculating the amount that may be appropriated from the fund for a fiscal year, the market value of the fund for the fiscal year immediately preceding that fiscal year shall not be included.

REPRESENTATIVE HAWKER explained that under the aforementioned provision future legislatures can decide how wide a look-back window should be, which he said provides him greater comfort in proposing the fixed 5 percent POMV.

[9:47:02 AM](#)

REPRESENTATIVE GRUENBERG asked if the committee wanted to adopt the amendment in the bill packet in order to have a committee substitute (CS) for the next meeting on HJR 2.

CHAIR WEYHRAUCH responded that he wanted to postpone adoption of the amendment because there may be more to come.

REPRESENTATIVE HAWKER concurred, and said he would be happy to accommodate any further concerns. He noted that the amendment in the bill packet makes it clear that any incidental gas products going down TAPS don't get included in this calculation.

[9:48:23 AM](#)

REPRESENTATIVE HAWKER, in response to Representative Wilson, related his belief that the only massive gas deliveries that will make a significant economic impact on long-range planning will come from the North Slope, which is why the resolution is restricted to that. He relayed that other areas of the state with existing gas production have small potential and thus he said he didn't want to create conflicts with existing activities. Moreover, he said that he didn't want to create a fund that doesn't have enough to manage the state in the long run, he noted.

CHAIR WEYHRAUCH announced that HJR 2 would be set aside.

HB 223-NATURAL GAS PIPELINE INCENTIVE/ GAS TAX

[9:49:36 AM](#)

CHAIR WEYHRAUCH announced that the final order of business would be HOUSE BILL NO. 223 "An Act levying a tax on certain known resources of natural gas, conditionally repealing the levy of that tax, and authorizing a credit for payments of that tax against amounts due under the oil and gas properties production (severance) tax if requirements relating to the sale and delivery of the natural gas are met; and providing for an effective date."

9:50:09 AM

REPRESENTATIVE ERIC CROFT, Alaska State Legislature, sponsor, testifying via teleconference, stated that HJR 2 details the expectation of gas to be online in 2012, and therefore many residents and those in state government are gearing up in anticipation of those revenues. State government is hoping to address how to save and spend the anticipated revenues from a gasline. He opined that there's a significant probability that the major gas producers, the lease holders on the North Slope, are interested in producing other gas fields before ANS gas; perhaps because the internal rate of return is higher in other gas fields such as Qatar, Russia, and Indonesia. Furthermore, the aforementioned countries might be "less subtle" regarding the decision of whether to develop. He related his belief that if the major oil companies told the Indonesian government they plan to delay development for 10 to 15 years, the Indonesian government would cut the project and allow another producer to develop. Countries unconstrained by constitutions can be more direct about preserving their interests and assuring their sovereign interests are protected. He explained that through a combination of internal rates of returns and other pressures, other sovereign nations are putting their gas reserves ahead of Alaska's. He highlighted that although Australia and New Zealand have constitutions, they require the oil companies to develop the resource leased within 10 years, or else it becomes the property of the state and is leased out to another company. He expressed concern that Alaska has let itself be placed on the "back burner" for too long. He recalled that after the oil pipeline was built the citizens of Alaska expected a gas line, and since then the state has been in a frustrating cycle for nearly 25 years.

REPRESENTATIVE CROFT recalled that the legislature has heard much testimony on the duty to produce under the leases. The oil companies do not, as a matter of law, have the ability to deny a "reasonably profitable" gasline project in order to develop a

more profitable project in a Third World country. If Alaska doesn't do something to assert its sovereignty, then Representative Hawker's aforementioned chart is going to be off by at least 10 and probably more like 15 to 20 years, he suggested. The legislature holds these resources in trust for the people of the State of Alaska, he noted. Although every state legislature holds something in trust, Alaska is somewhat unique because it holds the major income producing property of the state, the subsurface resources, in trust to manage in the best interest of the people. This legislature has done a good job of that management, but a rather poor job with regard to seeing that the gas is developed. If this project is delayed for a substantial period of time, Alaskan's lose another increment in the notion that it's the state's resource, choice, and decision. He said he doesn't want Alaska to defer to outside powers when it comes to resource decisions.

REPRESENTATIVE CROFT informed the committee that HB 223 was modeled after the Kentucky Stranded Coal Act, which resulted after the West Virginia coal companies bought-up Kentucky leases in order to prevent competition with other coal ventures. Kentucky decided that if the coal companies weren't going to develop the coal, the state would tax the companies for the resource in the ground. This legislation specifies that starting in 2007 there would be a tax on gas reserves. However, that tax would stop once the line is built and oil companies agree to sell or commit the gas to a bona fide project and from that point forward the oil companies would receive credit for future severance taxes paid.

[9:58:58 AM](#)

REPRESENTATIVE GRUENBERG recalled that most mid-continent oil leases have a clause requiring production or the lease is lost.

REPRESENTATIVE CROFT recalled that according to Spencer Hosie, an oil and gas attorney on contract with the Legislative Budget and Audit Committee, and representatives from a firm in Houston, Texas, it's a clear principle of law that there is an implied duty to produce and market in every lease. A leaseholder does not have the right to take an otherwise viable project, which is one with a reasonable rate of return, and not develop it because it would make more money elsewhere; there is a legal obligation to develop. The only defense is impossibility or commercial impracticability in that the project doesn't make a reasonable rate of return. For instance, if Exxon wants all of its project to have an internal rate of return of 25 to 30 percent and

Alaska's project only makes 18 percent, Alaska's project is reasonably profitable and they have to develop it despite other attractive prospects worldwide, he concluded.

[10:01:08 AM](#)

REPRESENTATIVE WILSON inquired as to why the fee only applies to gas in units leased before 2002 that have more than more then 1 trillion cubic feet (tcf) of known gas.

REPRESENTATIVE CROFT responded this legislation didn't want to discourage any exploration on the North Slope, and therefore [HB 223] concentrates on the reserves that have remained undeveloped for decades. This legislation doesn't penalize a company for discovering a new field. The point, he clarified, is to identify the known fields that have not been sufficiently acted upon by the leaseholders.

[10:02:33 AM](#)

REPRESENTATIVE SAMUELS turned attention to page 2, lines 6-7, which read: "gas to be consumed as fuel in its state-approved oil and gas unit of origin within five years of January 1 of the tax year". He asked if "gas to be consumed as fuel" refers to gas burned as fuel on the North Slope and not being reinjected.

REPRESENTATIVE CROFT related his understanding that some of the gas is being used for the producers' fuel needs in order to heat and power the facilities, so the aforementioned language addresses that. In further response to Representative Samuels, Representative Croft replied that reinjecting gas can produce more oil but that determination is made on each individual field by the Alaska Oil and Gas Conservation Commission (AOGCC), the state, and leaseholders. However, at some point if there aren't gas handling facilities or places to store it, a field can't be marketed. He highlighted that Prudhoe Bay is reaching it's gas-handling capacity because as a field matures there tends to be more gas than oil. Therefore, this legislation is intended to motivate gas production and develop a place to store it, preferably a gas pipeline that brings gas to market, he noted. After the pipeline [is in use], the tax goes away and the AOGCC can balance field-by-field decisions regarding [reinjection, etcetera]. He then mentioned the need to clarify whether, under the language on page 2, lines 6-7, that fuel could be consumed for reinjection and power [for the maintenance of oil and gas facilities] because the intent was to provide an exemption for both.

10:07:46 AM

MARK GNADT, Staff to Representative Eric Croft, Alaska State Legislature, explained that the list of [hydrocarbon] exemptions for taxation is based on a 1997 letter from ExxonMobil Corporation to the AOGCC, which related their methodology for determining what gas is available to market.

10:08:47 AM

REPRESENTATIVE SAMUELS requested a copy of that letter. He then requested clarification as to what other "nonconventional gas resources" would be.

MR. GNADT said he would research that and provide an answer.

10:09:46 AM

MICHAEL HURLEY, Director of State Government Relations, ConocoPhillips Alaska, Inc., related that ConocoPhillips Alaska, Inc. strongly opposes the gas reserves tax. The producers have been diligently working with the administration to "hammer out a fiscal contract which would provide the certainty to move the project forward," and that effort would be severely disrupted by enactment of this kind of punitive tax, he said. He opined that a project can't be taxed into existence. A tax of this sort doesn't act as any kind of incentive, but rather increases the uncertainty surrounding gas development in Alaska. Furthermore, it removes resources and efforts from the critical negotiations producers are trying to pursue, he opined. He relayed that progress is being made in the discussions with the administration and he urged not to add to the distractions which have already "plagued these efforts."

10:11:10 AM

CHAIR WEYHRAUCH inquired as to Mr. Hurley's thoughts regarding land that is leased for resource development that isn't developed and whether that land should revert back to the state or should the company pay taxes on the resources in the ground.

10:11:46 AM

MR. HURLEY stated that all of Alaska's oil and gas leases have a set term [for development]. He recalled that most of the North Slope leases are set at 7 to 10 years depending on the

particular vintage of the leases. The primary term details that if an explorer does not find commercial quantities of hydrocarbons, the leases revert back to the state, he added. In response to Representative Samuels, Mr. Hurley clarified that the language used [in the leases] was "wells capable of producing paying quantities of oil and gas".

[10:13:01 AM](#)

REPRESENTATIVE SAMUELS inquired as to when Point Thompson's term expires.

MR. HURLEY said that he doesn't know, but recalled that the Point Thomson wells are relatively old vintage leases and had wells capable of paying quantities. He related that discussions with the Department of Natural Resources, the administrator of those leases, have occurred for many years.

REPRESENTATIVE SAMUELS then posed a scenario in which there are paying quantities of oil and gas, although only the oil is being developed. He asked if Mr. Hurley would interpret there to be development because the oil is being developed.

MR. HURLEY replied yes.

[10:14:34 AM](#)

REPRESENTATIVE CROFT commented that Representative Samuels has identified the problem in that the leases have provisions, but those [provisions] can be extended if oil and gas has been found but not yet developed. In fact, Point Thomson is on its 21st plan of development extension, which has resulted in penalties for failing to meet benchmarks on development of that project. If both oil and gas are in paying quantities and both are reasonably profitable, he questioned whether it would be sufficient to produce the oil and warehouse the gas under the terms of the lease. Although he didn't know, he opined that he would hope not because he believes there is an independent obligation to produce each if it's reasonably profitable. However, if the oil can be produced and the gas warehoused, then the gas could be put on hold for decades with no consequence to the producers. Allowing the aforementioned, he opined, places Alaska's interests second and means the legislature isn't doing its job. This legislation offers another way to address the concern by saying that although [the producers] may be violating their legal obligations, there would be consequences, other than going to court, for not developing Alaska's gas.

[HB 223 was held over.]

ADJOURNMENT

10:17:13 AM

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 10:17 a.m.