

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

January 25, 2006

9:01 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Norman Rokeberg
Representative Ralph Samuels
Representative Paul Seaton
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Harry Crawford

COMMITTEE CALENDAR

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

HOUSE BILL NO. 374

"An Act relating to establishment of a retirement benefit liability account in the Department of Revenue and redirecting deposit of annual dividends of the Alaska Housing Finance Corporation to that account; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 375

"An Act relating to the retirement benefit liability account and appropriations from that account; relating to deposits of

certain income earned on money received as a result of State v. Amerada Hess, et al., 1JU-77-847 Civ. (Superior Court, First Judicial District); and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 223

SHORT TITLE: NATURAL GAS PIPELINE INCENTIVE/ GAS TAX

SPONSOR(S): REPRESENTATIVE(S) CROFT

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| 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 |
| 04/25/05 | (H) | Heard & Held |
| 04/25/05 | (H) | MINUTE(W&M) |
| 01/11/06 | (H) | W&M AT 9:00 AM CAPITOL 106 |
| 01/11/06 | (H) | Heard & Held |
| 01/11/06 | (H) | MINUTE(W&M) |
| 01/18/06 | (H) | W&M AT 9:00 AM CAPITOL 106 |
| 01/18/06 | (H) | Heard & Held |
| 01/18/06 | (H) | MINUTE(W&M) |
| 01/25/06 | (H) | W&M AT 9:00 AM CAPITOL 106 |

BILL: HB 374

SHORT TITLE: RETIREMENT BENEFIT LIABILITY ACCT/AHFC

SPONSOR(S): WAYS & MEANS

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| 01/17/06 | (H) | READ THE FIRST TIME - REFERRALS |
| 01/17/06 | (H) | W&M, STA, FIN |
| 01/20/06 | (H) | W&M AT 9:00 AM CAPITOL 106 |
| 01/20/06 | (H) | Heard & Held |
| 01/20/06 | (H) | MINUTE(W&M) |
| 01/25/06 | (H) | W&M AT 9:00 AM CAPITOL 106 |

BILL: HB 375

SHORT TITLE: RETIREMENT BENEFIT LIABILITY ACCT/PF

SPONSOR(S): WAYS & MEANS

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|----------|-----|---------------------------------|
| 01/17/06 | (H) | READ THE FIRST TIME - REFERRALS |
| 01/17/06 | (H) | W&M, STA, FIN |
| 01/20/06 | (H) | W&M AT 9:00 AM CAPITOL 106 |
| 01/20/06 | (H) | Heard & Held |
| 01/20/06 | (H) | MINUTE(W&M) |
| 01/25/06 | (H) | W&M AT 9:00 AM CAPITOL 106 |

WITNESS REGISTER

JACK GRIFFIN, Vice President
External Affairs
ConocoPhillips Alaska, Inc.
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 223.

MELANIE MILLHORN, Director
Health Benefits Section
Division of Retirement & Benefits
Department of Administration
Juneau, Alaska

POSITION STATEMENT: During discussion of HB 374 and HB 375, provided information on Alaska's health care system.

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at [9:01:47 AM](#). Representatives Weyhrauch, Moses, Samuels, and Seaton were present at the call to order. Representatives Gruenberg, Rokeberg, and Wilson arrived as the meeting was in progress. Representative Harry Crawford was also in attendance.

HB 223-NATURAL GAS PIPELINE INCENTIVE/ GAS TAX

[9:01:58 AM](#)

CHAIR WEYHRAUCH announced that the first 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."

[9:03:08 AM](#)

JACK GRIFFIN, Vice President, External Affairs, ConocoPhillips Alaska, Inc., said HB 223 is described by its sponsors as "creating an incentive for companies...to move forward on developing a North Slope gas project," and ConocoPhillips Alaska, Inc. (Conoco) has presented testimony in opposition before, so he does not want to repeat it. He said Conoco already possesses all the incentive necessary to move forward on

a North Slope gas project, and has "taken every reasonable step within its power to do so." He added that the committee knows well that Conoco has reached an agreement with the state on the base fiscal and other terms necessary to move the project forward. He said an agreement was reached in principle on October 21, 2005, and Conoco has worked diligently to resolve technical and drafting issues. He stated that Conoco now has a deal with the state that it is willing to use as a basis to move forward. Since reaching that deal, Conoco and the state have been trying to negotiate a comprehensive agreement that includes the other major North Slope producers.

MR. GRIFFIN said the agreement with the state is the culmination of a multi-year effort following a \$125 million cost study in 2001 to move the gas project to the next phase of development. His company took a leadership role in seeking a reauthorization of the Stranded Gas Development Act, which has led directly to its contract with the state. Conoco took a leadership role, he opined, in several pieces of federal legislation to streamline the permitting process and lower the cost of debt on the project. "Obviously we have taken a leadership role in crafting and in finalizing an appropriate fiscal contract for development of North Slope gas." He said the company is ready and willing to move to the next phase.

MR. GRIFFIN stated that the next step requires economies of scale that can't be met by his company alone. He told the committee that the governor said that the best and most efficient way to move forward is to conclude negotiations between the state and the three major North Slope producers. "We agree," he said. He added that HB 223 undermines the efforts by penalizing Conoco. "There is nothing ConocoPhillips can do to avoid imposition of HB 223's new tax, short of surrendering the billions of dollars we have already invested in the development at Prudhoe Bay." He said it has been suggested that the company can avoid this new tax by selling its gas, but he said that is not true. He said the tax is automatic and unavoidable. Supporters of the tax say it will be refunded if the North Slope producers move forward with the project, and he said that is misleading. The tax for his company will likely exceed \$200 million per year over the next ten years, he stated. That money will not be refunded for 10 to 25 years from now, he said, with no allowance for the time value of money. That, coupled with a limit on deductions, ensures that the refunds will only be a fraction of the taxes that are actually paid, he said. He concluded that the bill is bad public policy and

unfair, and there are a host of other issues that he has not addressed, including constitutional ones.

[9:09:52 AM](#)

REPRESENTATIVE SAMUELS asked how the agreement works between the three companies and if it was possible for Conoco to move forward without its Prudhoe Bay partners. He noted that Mr. Griffin said that Conoco can't ship or sell gas.

[9:10:37 AM](#)

MR. GRIFFIN said the unit agreement is a partnership for the development of the resources to ensure there isn't physical or economic waste of the resource within a given area. "Right now there are no clear provisions for allowing ConocoPhillips to move forward on its own. That is something that would have to be addressed if we ever got to that point. But clearly, as the governor stated, the best and most efficient way to move forward is to do so with the agreement of all of the major North Slope lease holders."

[9:11:34 AM](#)

REPRESENTATIVE SAMUELS said that when gas comes up, Conoco re-injects it. He asked if one third [of the gas] belonged to Conoco and was enough gas to pay the tariff to build a pipeline, could the company take that gas and claim it to be theirs with BP and Exxon's gas remaining in the ground.

[9:12:07 AM](#)

MR. GRIFFIN answered that it would be difficult but not impossible. He added that it would not be ideal for Conoco.

[9:12:36 AM](#)

REPRESENTATIVE SEATON asked if Conoco was to sell its one-third share of gas, if there would be a cause of action between the other parties if doing so would reduce the flow of oil from Prudhoe Bay. He asked if the production agreement requires the production of gas, and if only one party is producing gas, which then reduces the amount of oil, would that be a violation of the agreement.

[9:13:36 AM](#)

MR. GRIFFIN said, "I can't say it would be a violation; I think I could say that if one party to the North Slope unit agreement - or the Prudhoe Bay unit agreement and the Prudhoe Bay operating agreement - wanted to take its gas in kind without the participation of the other unit owners, we would most likely see the courts asked to resolve differences in interpretation of those agreements."

[9:14:14 AM](#)

CHAIR WEYHRAUCH said he thinks that is a "yes."

MR. SEATON said that oil companies have indicated that to him. He added, "Although it could legally be possible under gas, it would be legally very involved when you got into one owner taking part of the gas and that impact on the oil. And so I think we need to consider that as well."

[9:14:52 AM](#)

REPRESENTATIVE SAMUELS said he believes the Alaska Oil and Gas Conservation Commission and the court system would have "a lot of issues with how much gas you can take off and how much goes back in also, so it would be complicated even further."

[9:15:12 AM](#)

REPRESENTATIVE GRUENBERG asked, on the flip side, how Conoco prevents itself from being held up by one of the other parties who doesn't want to produce.

[9:15:23 AM](#)

MR. GRIFFIN said that is exactly how he would characterize the negotiations under the Stranded Gas Development Act. "We're all trying to come together on a set of commercial terms that works for all of the major North Slope gas owners." He added that if the state, Conoco, BP and ExxonMobil Corporation "are not all holding hands," moving forward on a gas project will be difficult.

[9:15:59 AM](#)

REPRESENTATIVE GRUENBERG said that is a new negotiation, but what he would like to know is what the agreement allows on an on-going basis. "Suppose one or more of you decides to cut down on the production, how does the one-of-you that wants to produce

stop the others from just stopping that?" He said he knows they are all smart enough to have figured that out, and he would like to know how.

[9:16:26 AM](#)

MR. GRIFFIN said, "Generally speaking, the working interest owners in a unit such as the Prudhoe Bay unit are going to be aligned in trying to maximize the production that can be derived economically from a unit like that." He added that there are complex agreements to govern the relationship between them.

[9:17:03 AM](#)

REPRESENTATIVE GRUENBERG said, "So you have already pre-agreed to agree."

[9:17:12 AM](#)

MR. GRIFFIN said, "Obviously we have agreements at Prudhoe Bay governing our relationship with the other working interest owners there, and we have come together for the purpose of maximizing the production and maximizing the value of the Prudhoe Bay oil and gas resource."

CHAIR WEYHRAUCH asked, "And not in restraint of trade?"

REPRESENTATIVE GRUENBERG asked if that agreement was in writing or just an oral understanding.

[9:17:59 AM](#)

MR. GRIFFIN said it is written in the Prudhoe Bay Unit Agreement.

[9:18:26 AM](#)

CHAIR WEYHRAUCH said the purpose of this bill is to develop Alaska's gas "to get those who are sitting on the gas to move forward on a gas pipeline. If we don't do that we're going to tax you. Once you develop it we will refund the tax." It is an incentive to move the gas to market to benefit Alaskans, so he asked why it is bad public policy.

[9:19:07 AM](#)

MR. GRIFFIN said it is bad public policy because Conoco has all of the incentives necessary. "This bill reaches too broadly," he opined. The state has provided the right incentive by authorizing the administration to enter negotiations with the other major North Slope gas owners on a set of fiscal terms that will increase investor confidence and allow this project to move forward. Using a tax "as a weapon to force private parties to expend billions of dollars on the state's behalf without regard to whether the investment makes sense, and there is nothing in the bill that requires that the investment actually makes sense, is a novel and unprecedented use of a state taxing authority," he stated.

[9:20:37 AM](#)

CHAIR WEYHRAUCH said, "The gas is used as part of the corporation's portfolio to show stockholders that the price of the stock is adequately valued because you are sitting on this large resource, and it is unfair to serve as a reserve for the benefit of the corporation just to show that on the bottom line." He added that it does Alaskans more good to have it developed. He said perhaps Conoco wouldn't be taxed because it is poised to go forward, but others should be taxed.

[9:21:21 AM](#)

MR. GRIFFIN said there is no benefit to a corporation to sit on Prudhoe Bay gas. "You cannot count that gas as part of your reserves base for purposes of reporting to the Securities and Exchange Commission and to your shareholders and potential shareholders until you've authorized the development of the project necessary to move that gas to market." He said even if the bill is constitutional, it is unfair because it reaches those who are in agreement with the state and are motivated to move forward.

[9:22:41 AM](#)

REPRESENTATIVE SEATON inferred that ExxonMobil Corporation, ConocoPhillips Alaska, Inc., and other owners of leases on the North Slope do not have any gas reserves listed in any of their holdings.

[9:23:11 AM](#)

MR. GRIFFIN said he can't speak for any other company, but "our understanding" is that "until you authorize the expenditures

necessary to make those reserves marketable, they don't become reserves for reporting purposes. They're known resources, but they're not reserves ... and that is what shareholders look at."

[9:23:57 AM](#)

REPRESENTATIVE ROKEBERG asked Mr. Griffin to provide information on the constitutional issues he spoke of. He noted that former Governor Hickel said this tax was a form of punishment, and Representative Rokeberg finds it "grossly unfair," because it points a gun at the company when in fact it is doing everything to move forward to market.

[9:25:18 AM](#)

MR. GRIFFIN said he agrees, and Conoco has done its utmost to work with the state, so it would be punishing a company for doing exactly what the state has requested.

[9:26:16 AM](#)

REPRESENTATIVE ROKEBERG said that Mr. Griffin testified that this legislation would require Conoco to pay \$2 million a year for 10 years. He asked if the company would stay in Alaska under those terms.

[9:26:46 AM](#)

MR. GRIFFIN said that he doesn't see Conoco leaving the state as a consequence of this bill. "The state is too important," he said, and it would be disappointing and have an effect on how the company looks at future investments in the state. He said he considers the state a partner of Conoco.

[9:27:41 AM](#)

REPRESENTATIVE ROKEBERG asked for Mr. Griffin's thoughts on former Governor Hickel's comment that the producers would not sell the gas to Yukon Pacific, and what Mr. Griffin thinks would have happened if the state had sold the gas to Yukon Pacific and how much the state would have lost.

[9:28:24 AM](#)

REPRESENTATIVE GRUENBERG, regarding Mr. Griffin's comment that his shareholders would be disappointed with HB 223, asked

whether the voters are shareholders too, "and don't you think they are disappointed when you don't produce?"

[9:28:51 AM](#)

MR. GRIFFIN said his message is that Conoco wants to move forward with North Slope gas development in partnership with the state, which will be a decades-long partnership. He said there are members of the Alaskan public who reflect some disappointment, but his company is working very hard. He said to keep in context "where we've been and where we are today." When Prudhoe Bay was developed, natural gas prices did not support transportation infrastructure. "The state would be in a far, far poorer place today had we been foolish enough to build a gas project back then ... We would have lost not only the value of the gas for all Alaskans, we would have also lost the value of approximately three billion barrels of oil at Prudhoe Bay that we have been able to recover as a consequence of re-injecting that gas."

[9:31:00 AM](#)

REPRESENTATIVE GRUENBERG said the legislature does not expect people to be clairvoyant, "but there is a reasonable expectation that if you enter into a lease, you will get a royalty as soon as possible, and it will be continuing. That's what any lessor requires." He wondered if it is fairly common to have a clause in a lease to require production and asked, "Isn't that pretty much of a standard elsewhere in the world?"

[9:32:32 AM](#)

MR. GRIFFIN said he is unfamiliar with a clause or law like HB 223 anywhere in the world. North Slope leases do have term limits, which are extended if the leases are in a unit. "We are in compliance with all of the requirements of those leases."

[9:33:33 AM](#)

REPRESENTATIVE WILSON said production of oil has been decreasing, and she asked what will production do without the gas being re-injected.

[9:34:14 AM](#)

MR. GRIFFIN said the company uses water for pressure maintenance and enhanced oil recovery on the North Slope, but he said he can't give an estimate.

[9:35:05 AM](#)

REPRESENTATIVE SEATON noted that Mr. Griffin said he is not aware of terms similar to the bill before the committee, and he asked if he was aware of any other contract provisions that seek the same goal of stimulating and ensuring production.

[9:36:12 AM](#)

MR. GRIFFIN said every resource owner has an incentive to encourage leaseholders to produce as soon as practical. He said in other jurisdictions around the world there might be production-sharing agreements, which are analogous to the negotiation his company is involved with in the Stranded Gas Development Act. Most lease provisions include lease term limits in the event that they are not developed, he said. The Alaska project is truly unique, at least in the United States, he opined.

[9:38:06 AM](#)

CHAIR WEYHRAUCH announced that HB 223 would be held over.

HB 374-RETIREMENT BENEFIT LIABILITY ACCT/AHFC
HB 375-RETIREMENT BENEFIT LIABILITY ACCT/PF

[9:39:29 AM](#)

CHAIR WEYHRAUCH announced that the next order of business would be HOUSE BILL NO. 374, "An Act relating to establishment of a retirement benefit liability account in the Department of Revenue and redirecting deposit of annual dividends of the Alaska Housing Finance Corporation to that account; and providing for an effective date." and HOUSE BILL NO. 375, "An Act relating to the retirement benefit liability account and appropriations from that account; relating to deposits of certain income earned on money received as a result of State v. Amerada Hess, et al., 1JU-77-847 Civ. (Superior Court, First Judicial District); and providing for an effective date."

CHAIR WEYHRAUCH said the committee received a letter and report yesterday from the chair of the Alaska Retirement Management Board (ARMB).

[9:41:01 AM](#)

MELANIE MILLHORN, Director, Health Benefits Section, Division of Retirement and Benefits, Department of Administration, said there are three primary drivers for the unfunded liability for the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS), and those are: rising healthcare costs, loss of investment income, and changes in assumptions. She said that she has a nine-page summary to present to the committee that speaks to the issue. The focus of her presentation, she said, will focus on rising healthcare costs for PERS and TRS and what the division is doing to manage these costs.

[9:42:08 AM](#)

CHAIR WEYHRAUCH asked that Ms. Millhorn highlight issues that need addressing by the legislature.

[9:42:39 AM](#)

MS. MILLHORN referred to her report regarding demographics of the retirees who have system-paid medical, where the member does not pay the premium cost. Beginning in 2001 through 2005, she explained, there was an increase in the population of those available to receive these benefits, which have an out-of-pocket maximum of \$800. "That is a very rich plan," she said. Out of \$256 million of claims for 2005, \$96 million is in the prescription drug area, she noted. She said she will talk about initiatives to deal with those costs.

[9:44:34 AM](#)

MS. MILLHORN said Commonwealth North reported that the costs in Alaska are 40 percent higher than in Seattle, Washington, and there are 110,000 uninsured parties in Alaska. She said that creates a vicious cycle, because uninsured Alaskans impact the insured. She said growth in enrollment is not going to change; there are up to 2,000 members a year who retire, which is a growth of 5.3 percent. "The benefit is richer for the retiree population than the active plan. And what that's referring to is the [deductibles] that I mentioned earlier...if that member retires from select benefits, which is the active plan, and they have the economy plan. The economy plan is a plan that we have in place for active employees where they pay nothing out of their pocket; that is a \$500 deductible. That has a family deductible of \$1000. That has an out-of-pocket amount of \$2000.

If an active employee chooses either the standard plan or the premium plan, they pay all of the costs associated with having a plan at 80 percent or 90 percent. The economy plan pays for 70 percent. So you would go from an active plan where you have costs associated with your medical expenditures that when you retire you don't experience that kind of cost share with the plan. So it is a very rich benefit when you have a retiree medical plan such as PERS and TRS."

[9:47:13 AM](#)

REPRESENTATIVE SEATON asked what percentage of active employees has the economy program.

[9:47:23 AM](#)

MS. MILLHORN said there are about 5,300 who are in the select benefits plan, and they cover about 8,900 dependents. She will get the information for him, she said.

[9:47:43 AM](#)

REPRESENTATIVE WILSON sought confirmation of her understanding that those still employed pay; however, when they retire, they do not pay.

MS. MILLHORN said this was correct.

[9:47:56 AM](#)

CHAIR WEYHRAUCH asked if the benefits are constitutionally guaranteed.

[9:48:02 AM](#)

MS. MILLHORN said a lawsuit in 2003 determined that medical benefits for Alaska's retirees are protected under Alaska's constitution, Article XII, Section 7.

[9:48:24 AM](#)

REPRESENTATIVE ROKEBERG said not to forget that all the bargaining units have their own insurance. The state used to have 25,000 employees plus dependents as active employees. However, he said, everybody retires on the plan, even from the bargaining units. "Big problem," he claimed.

CHAIR WEYHRAUCH asked the impact of that.

[9:48:57 AM](#)

MS. MILLHORN said it is "just a larger population that is available to have retiree medical benefits; it's not just the 5,300 and the dependents. There's approximately 14,500 state classified employees."

[9:49:18 AM](#)

REPRESENTATIVE SEATON asked if other bargaining units have the same active plan, and "do they have that same differential that we have?"

[9:49:54 AM](#)

MS. MILLHORN said she has not studied those health trusts, but "if you use ours as a barometer, yes, you're paying more as an active employee than you would be paying when you go to the retiree plan."

[9:50:13 AM](#)

CHAIR WEYHRAUCH said that since the benefits are constitutionally protected, would the only way to address healthcare be by managing the costs on the receiving end.

[9:50:33 AM](#)

MS. MILLHORN said, "The way that you can manage those costs are two ways: one is plan design and the second one is eligibility audits."

CHAIR WEYHRAUCH asked if managed care comes into play.

[9:51:09 AM](#)

MS. MILLHORN said managed care is a concept where there is a consortium of providers that have an agreement to have network kinds of costs. "Unfortunately, in the state of Alaska, because there are more patients than there are doctors who need to compete for patients, we don't have the same structure that other states enjoy when they have an HMO [Health Maintenance Organization] and other managed care available." She said Alaska's structure doesn't lend itself to managed care.

CHAIR WEYHRAUCH asked if there are structural impediments that exist by statute or by regulation.

[9:52:01 AM](#)

MS. MILLHORN said it is neither; physicians in Alaska don't have sufficient competition.

[9:52:20 AM](#)

REPRESENTATIVE ROKEBERG said he has been looking at that issue. There are small statutory barriers to entry for HMOs in Alaska, and those need to be reformed. He spoke with the commissioner of Health and Social Services about putting out a [request for proposal] for Medicaid management, which almost all other states have, which might be an impetus for a HMO to come to Alaska. He said the state has other types of managed care opportunities under current underwriting insurance laws in the state.

[9:53:22 AM](#)

CHAIR WEYHRAUCH asked how to resolve the statutory barriers.

REPRESENTATIVE ROKEBERG said his staff is working on it.

[9:54:48 AM](#)

REPRESENTATIVE SEATON noticed that "75 percent of retiree medical costs are incurred for pre-65 members." He asked about incentives for those people to work longer.

[9:55:52 AM](#)

MS. MILLHORN said it is beneficial to the system for those individuals to stay in the system longer, because when retirees reach age 65, "we coordinate with Medicare, and the cost is reduced." She said the system actually gives incentives for an employee to retire at the age of 55 and then go do something else. She added that SB 141 structurally redesigns the plan so that the individual receives that benefit, that cost-share, at the time that they are eligible for Medicare. That legislation reduces 75 percent of the medical costs, she said.

CHAIR WEYHRAUCH said, "That doesn't deal with the existing unfunded liability, nor the huge ballooning healthcare costs associated with Tier 1."

[9:57:33 AM](#)

MS. MILLHORN said, "That is the 800-pound gorilla that is a national issue, but I think there are some measures that are available to us, and we have taken the initiative in certain areas."

[9:57:45 AM](#)

REPRESENTATIVE WILSON asked Ms. Millhorn to put that on paper and to explain the difference of someone retiring at age 63 instead of age 65.

[9:58:36 AM](#)

MS. MILLHORN said for Tier 1 employees, their normal retirement age is 55, so as a Tier 1 employee, "if you chose to work longer, there's no expenditure, there's no premium, there's no claims cost to the retiree plan; however, if you retire at age 63, you, your spouse and your dependents (if eligible) would be eligible for system-paid medical. So at that point in time, our costs incur. However, when you turn 65, and you're Medicare-eligible, Medicare becomes primary, so anything that's allowable under Medicare for those expenditures first flows to Medicare, then flows to our plan."

[9:59:34 AM](#)

REPRESENTATIVE SEATON said he would like an average cost for the pre-65 members, "so we can figure out what benefit the system would gain for each year those persons would stay within the system."

[10:00:29 AM](#)

MS. MILLHORN said she can provide some projections on that.

[10:00:41 AM](#)

REPRESENTATIVE WILSON asked about working after the age of 55.

[10:01:56 AM](#)

MS. MILLHORN said that when someone is employed, "their active plan pays for their medical coverage. It is at the time that they decide that they are going to retire that the system pays their premium and pays all of their claims expenses." So as

long as they're in the system there are no costs that accrue to the retirement health plan.

REPRESENTATIVE WILSON asked about returning retirees.

[10:02:46 AM](#)

MS. MILLHORN said there was HB 161 when "the legislature made changes to that bill in order to ensure that their active plan was primary and that it suspended their retiree plan during their period of reemployment."

[10:03:17 AM](#)

MS. MILLHORN said there was a seminal law case in 1999, Retired Public Employees of Alaska (RPEA) v. Duncan, in which retirees wanted to be able to update the plan, "and the division was not reluctant to make those changes; however, they said that those changes must be cost neutral to the system." She added that those changes included increases and decreases. "When those changes were put into effect, January 1, 1999, increases and decreases...designed to be cost neutral, RPEA, NEA and ASEA filed suit." She said that case has been ongoing and is being litigated right now, and the legal costs to the system in this fiscal year will be about \$235,000.

[10:05:13 AM](#)

REPRESENTATIVE ROKEBERG said he doesn't care what the legal fees are, he wants to know the cost to the system if the state doesn't prevail. He questioned that the organizations requested the changes and then sued.

[10:05:55 AM](#)

CHAIR WEYHRAUCH asked if Ms. Millhorn said that the parties to the case signed off on the changes and then sued.

[10:06:05 AM](#)

MS. MILLHORN said it is her understanding that those retirees were active in asking for some of these changes and that they later brought suit.

REPRESENTATIVE GRUENBERG said that the committee should have the parties themselves explain their actions.

[10:06:30 AM](#)

MS. MILLHORN said the cost containment initiatives deal with two areas: plan-design changes and eligibility audits. "In 2004 we discovered that our plan booklet for our retirees did not comport with Alaska statute that individuals between age 19 and 23 had to be enrolled full time in college. That has been an issue for about 20 years." So 1000 dependents were removed, saving the system \$3 million. She said the division is now doing an eligibility audit to ensure benefits only go to those entitled. Recipients get the benefits on a tax-preferred basis, she said, and it jeopardizes the plan if the state is paying benefits to un-entitled people. She said the audit will save the system about \$16 million annually.

[10:08:17 AM](#)

REPRESENTATIVE WILSON asked whether dependents weren't checked on before.

[10:08:35 AM](#)

MS. MILLHORN said the division did not require documentation, and she is talking about, for example, a divorce that has occurred and the state still paid claims. "We have a demarcation line in which we are telling all of the parties who are receiving benefits that they must provide supporting documentation in order to continue to receive those benefits." She noted that national auditing firms have found that every time an eligibility audit is done, it is discovered that about 15 percent of recipients are not eligible.

[10:09:53 AM](#)

REPRESENTATIVE SEATON said the legislators had to submit similar documents when they started service.

[10:10:11 AM](#)

REPRESENTATIVE GRUENBERG asked if the level of auditing was the same as it was three or four years ago.

[10:10:46 AM](#)

MS. MILLHORN said the state had a comprehensive audit in 2004 that looked at claims processing and errors, and the division made changes in accordance with the audit.

[10:11:19 AM](#)

REPRESENTATIVE GRUENBERG asked for a copy of the audit and a list of changes that were made in response to it.

[10:11:26 AM](#)

MS. MILLHORN said another initiative is generic drugs. The cost savings is approximately \$4 million per year. She noted that there is an educational effort to get retirees to go from a brand name drug to a generic drug. "For every 1 percent movement, it's a million dollar savings to the plan," she said.

MS. MILLHORN stated that network savings is a very large cost saver for the plan. It is when the third party administrator goes out and negotiates with facilities and providers in order to arrive at a discounted rate, she said. In the last two years, the state has had a performance guarantee with Aetna in the contract where they must hit that network guaranteed amount. It is a direct savings to the plan, so if members go to those facilities that have a network-negotiated rate with Aetna, "our plan saves." The member saves too because there are less out-of-pocket costs, she noted. It represents a savings of about \$25.8 million for 2004. Aetna has to hit that negotiated rate each year, otherwise they lose revenue objectives, she stated. She said there was also a pharmacy rebate through Aetna for negotiated rates that comes to \$4 million each year.

MS. MILLHORN said, "We also successfully applied for, and will be receiving, Medicare part D," which is a 28 percent subsidy, representing \$7 million annually. The total savings of the initiatives are about \$59.8 million for calendar year 2006, she concluded.

[10:14:22 AM](#)

REPRESENTATIVE SEATON spoke of the escalation in medical costs in Ms. Millhorn's report, and he said it is different from the assumed rates.

[10:14:59 AM](#)

REPRESENTATIVE ROKEBERG asked if the managed-care principles that were negotiated are part of the litigation that was mentioned. He asked if that has been tested in the courts to know if the state can do that.

[10:15:24 AM](#)

MS. MILLHORN said the network savings are passive in the sense that "when our member goes to that facility or goes to that provider, we reap the benefits, but it is not punitive to them if they don't go."

[10:15:57 AM](#)

MS. MILLHORN said the members cannot be monetarily penalized now.

REPRESENTATIVE ROKEBERG asked if it was different for the active plans.

MS. MILLHORN said there is a [preferred provider] in Anchorage, and if members don't go, they are penalized.

[HB 374 and HB 375 were held over.]

[10:16:18 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 10:16 a.m.