

**ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS**

March 20, 2006

9:01 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Max Gruenberg

COMMITTEE CALENDAR

HOUSE BILL NO. 492

"An Act relating to the transfer of the state's interest in certain gas to the Alaska Retirement Management Board for the purpose of satisfying the unfunded accrued actuarial liability of the state and employers of teachers in the state to state retirement systems; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 492

SHORT TITLE: NATURAL GAS ROYALTIES TO FUND PERS/TRS

SPONSOR(S): FINANCE BY REQUEST

03/15/06	(H)	READ THE FIRST TIME - REFERRALS
03/15/06	(H)	W&M, FIN
03/20/06	(H)	W&M AT 9:00 AM CAPITOL 106

WITNESS REGISTER

REPRESENTATIVE MIKE KELLY
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: During the hearing of HB 492, provided information and answered questions.

BILL VAN DYKE, Acting Director
Division of Oil and Gas
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: During the hearing of HB 492, he explained the possible challenges to the proposed transfer of gas assets to address the unfunded liability of the state retirement systems.

BOB SHEFCHIK, Chief of Staff
Mayor's Office
Fairbanks North Star Borough
Fairbanks, Alaska

POSITION STATEMENT: Testified in support of HB 492.

GARY BADER, Chief Investment Officer
Treasury Division
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: During the hearing of HB 492, answered questions.

TOM BOUTIN, Deputy Commissioner
Treasury Division
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: During the hearing of HB 492, provided information and answered questions.

DON BULLOCK, Attorney
Legislative Legal and Research Services
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: During the hearing of HB 492, answered questions regarding the possible legal implications.

MIKE BARNHILL, Assistant Attorney General
Labor and State Affairs Section
Department of Law (DOL)
Juneau, Alaska

POSITION STATEMENT: During the hearing of HB 492, answered questions regarding the possible legal implications.

DICK MYLIUS, Acting Director
Division of Mining, Land and Water
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: During the hearing of HB 492, answered questions on the DNR fiscal note.

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at [9:01:05 AM](#). Representatives Weyhrauch, Moses, Seaton, and Wilson were present at the call to order. Representatives Rokeberg and Samuels arrived as the meeting was in progress.

HB 492-NATURAL GAS ROYALTIES TO FUND PERS/TRS

[Includes brief mention of SB 141 and HB 475.]

[9:01:18 AM](#)

CHAIR WEYHRAUCH announced that the only order of business would be HOUSE BILL NO. 492, "An Act relating to the transfer of the state's interest in certain gas to the Alaska Retirement Management Board for the purpose of satisfying the unfunded accrued actuarial liability of the state and employers of teachers in the state to state retirement systems; and providing for an effective date."

[9:02:31 AM](#)

REPRESENTATIVE MIKE KELLY, Alaska State Legislature, provided background information to the bill on behalf of the House Finance Committee of which he is a member. He relayed that passage of SB 141 last year and the proposed legislation in HB 475 are initial steps to ensure the \$6 billion unfunded liability of the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) does not increase. He explained other attempts to address the liability: having the state fund the increases, holding the annual increases to 5 percent, and proposed legislation addressing everything from pension obligation bonds to continuing the annual payments. He noted that the annual payment is climbing from "\$38 [million] last year [and] will reach its terminal velocity at somewhere around \$140 million." He opined that whereas there may be "some howling" in future discussions, [HB 492] is one possible solution of several and has tremendous potential for upside assistance in addressing the increasing debt.

REPRESENTATIVE KELLY directed the committee's attention to the slideshow information in their packets prepared by Bob Shefchik from the Fairbanks North Star Borough, one of the organizations that might benefit from the [solution proposed in HB 492]. He explained that Mr. Shefchik's prepared information suggests using future assets to address the liabilities as opposed to relying solely upon cash payments or financing through pension obligation bonds. Representative Kelly noted that on page 2, it shows the present annual impact in fiscal year 2007 (FY 07) totaling \$124 million which, with the 5 percent increases per year, results in annual costs at terminal velocity totaling approximately \$400 million a year. He highlighted that potential gas assets would match future liabilities and "thereby stop the annual payment requirement for the unfunded portion of [PERS and TRS]." He remarked that this would result in the state being "fiscally solvent relative to the unfunded liability." Furthermore, in conjunction with the defined contribution plan for new hires, he added that a new plan would be in place enabling more money be available for the state, the university, the municipalities, and the schools. He listed the changes for the current year as a result of this plan: the cost of state government would be lowered by \$44 million; \$10 million would be available to the university; the municipal payment costs would be lowered by \$26 million; and \$44 million in funding would be made available to school classrooms. He then listed the results of the plan for FY 08 and beyond: state government costs lowered by \$140 million; \$26 million more to the university; municipal payment costs lowered by \$55 million; and \$193 million more for the classrooms.

REPRESENTATIVE KELLY informed the committee that the proposed transfer of interests in known natural gas reserves would have no impact on the permanent fund and other constitutional obligations. Furthermore, he said that the amount of these transferred assets would be "equal to the future liability stream" and, in the event this legislation passes expeditiously, it would freeze the PERS and TRS rates beginning in FY 07. Referring to the reduction of future gas revenue streams, he opined that it would take "quite a bit of work to evaluate, appraise, and identify those resources to be transferred to the Alaska Retirement Management Board (ARMB).

[9:13:30 AM](#)

REPRESENTATIVE SAMUELS asked Representative Kelly if he was referring to all gas in the state.

REPRESENTATIVE KELLY said he was referring specifically to North Slope gas.

REPRESENTATIVE SAMUELS, on the premise that "the royalty doesn't exist until the gas hits the ground and is developed," asked whether Representative Kelly meant "only if the natural gas pipeline is built." Additionally, given the royalty doesn't currently exist and the gas pipeline may or may not be built, he asked Representative Kelly how he ran his numbers.

[9:14:24 AM](#)

REPRESENTATIVE KELLY suggested that Don Bullock, an attorney with the Division of Legal and Research Services, address this.

REPRESENTATIVE SAMUELS proceeded to list the other issues he wished addressed, such as those regarding private royalties and the effect on the National Petroleum Reserve-Alaska (NPR-A) should Alaska royalties be less [than expected]. He also asked about different royalty sets per lease and noted that whereas the most common one is 12.5 percent, not all are at this same percent. He concluded that it "seems problematic to try to value a royalty on something which is obviously further along now than it's ever been"

REPRESENTATIVE KELLY said he felt it important to note that "the revenue stream required to extinguish these future liabilities is also kicked out there; it's a 25-year run." He then informed the committee that HB 492 currently does not have specific language addressing municipalities. He explained that when the bill was introduced by the House Finance Committee, there had been considerable discussion regarding whether the municipalities should be handled differently than the other entities. He said that an amendment had been drafted to include municipalities.

CHAIR WEYHRAUCH said he would like to address this at a future meeting.

[9:17:21 AM](#)

REPRESENTATIVE SEATON expressed his belief that the intent of this legislation is not to pay the past service cost liability based on an assumption of obtaining revenues generated through a gas pipeline that has yet to be built. He said he would like to know projected increases in the liability until such point in time that revenues are actually generated. He also relayed that

he had questions regarding the approximate 50 percent of the liability resulting from those federal employees funded through the state. He expressed his belief that this legislation proposes the state pay "that half of the federal liability."

9:19:58 AM

REPRESENTATIVE SAMUELS explained that "the companies will get to book the reserves after [the Federal Energy Regulatory Commission] (FERC) sanctions the project." He opined that this regulatory process would be slow and tedious. Furthermore, once it's finally completed, companies will want to book the reserves "to pump up their shareholder value" and the state, in accordance to this legislation, would want to book the reserves to [pay the unfunded liability]. He expressed his belief that it would make better sense to postpone passing this legislation until after the regulatory process when the state could better determine which steps to take.

9:21:08 AM

REPRESENTATIVE SEATON, in regard to the transfer of assets, noted that this legislation does not address the selling of assets by the ARMB. He said that if he were on the ARMB, given its fiduciary responsibility, he would want to examine how to monetize [assets] in a shorter time to earn interest to then pay off the liability. He expressed his belief that this "would be a transfer out of complete state control" He asked whether [HB 492] had any provisions preventing the [ARMB] from using assets in that way.

CHAIR WEYHRAUCH requested this be addressed by Gary Bader, Chief Investment Officer with the Treasury Division, Department of Revenue (DOR), when he testified.

9:22:08 AM

REPRESENTATIVE WILSON expressed her concern for postponing addressing the unfunded liability for another 10 years and said that the debt would continue "to grow quite a bit in that time because we're not doing a thing about it." She asked Representative Kelly if he discussed the results of delaying with the actuaries and whether he knew how high the percent would grow should the state delay.

REPRESENTATIVE KELLY said he agreed and that theoretically the liability would grow "until the ramp on the employers' shares

hits the terminal velocity and stops that." Furthermore, he said that if "the gas interest was not sufficient to generate the extinguishment of that past service liability, [the risk] is still there."

REPRESENTATIVE WILSON said that she would want specific facts as to what the percentage of debt would be overall in delaying 10 more years.

CHAIR WEYHRAUCH informed the committee that this information could be obtained from the ARMB.

REPRESENTATIVE SEATON offered his understanding that [the proposed legislation] would not only address the unfunded liability but would wipe out the past service costs. Additionally, he relayed that with assets available to [accomplish this], there would be "no ramping up of employer fees ... we would go back to just the normal cost because the system would have the assets to equal the liability." He opined that "under those circumstances, [the state would actually] be reducing the percentage funding of money in the fund, and transferring them to perceived assets that will be monetized in the future" He noted that because some of these payments are due in the next 10 years, the state will actually be making the PERS and TRS payments from money not yet received, thereby reducing the cash value of all other assets in the fund. How much of a reduction and how much of the state's other asset base would be lowered by past service cost payments, are questions he said he would like addressed given the possibility that the gas may not be flowing until 2015.

[9:26:21 AM](#)

REPRESENTATIVE KELLY sought confirmation from Representative Seaton that what he was referring to is a "mismatch." That is, there would be a risk to having the state begin writing checks for the actual outflow without the matching inflow of gas resources.

REPRESENTATIVE SEATON said that this is correct though noted it is different than a past service cost liability growing at 8.25 percent. With this legislation, "we're actually eating up [the state's] asset base from the rest of the fund," he explained, and should the gas pipeline project not come online by 2015, it would be an imaginary asset - "something we think will equal the \$5 billion net present value"

REPRESENTATIVE KELLY said he agrees and that the risk is there.

9:28:22 AM

BILL VAN DYKE, Acting Director, Division of Oil and Gas, Department of Natural Resources (DNR) relayed that he understands this committee is investigating ways to fund the retirement system and said, "Obviously, in one way or another, [Alaska's] resource wealth is going to be part of that solution." He then presented three significant challenges the bill presents. The first, he noted, is that not only does the current or expected gas royalty in the Cook Inlet area fall short of the [needed] "\$5 billion," very little gas is presently sold or marketed on the North Slope. A second concern, he indicated, is the fact that the transfer of exclusively natural gas rights, by either the state or a third party, has not been done to date. He explained that what has previously been transferred are complete oil and gas estates to other entities in land trades or land assignments, to such entities as Native corporations, the Alaska Mental Health Trust Authority, the university, or the federal government. However, he relayed that never before has the state tried to sever oil rights from gas rights for the purpose of solely transferring the gas rights to a third party. He then referred to a third concern regarding the transfer of oil and gas interests which is the fact that a net of the permanent fund and school fund share has not been done to date. He clarified that when transferring land to a third party, "it's been the entire estate, and the permanent fund loses its right ... to royalties from that transferred mineral estate." He opined that reserving or preserving a share for the state - for either its permanent fund or its school fund - poses a challenge. Additionally, he noted that the challenge would be determining who would be responsible to assure that both these funds receive their share and suggested that this might involve "some sort of an overriding royalty or participatory share ... in the fee itself" to [assure] it occurs and is legally binding.

MR. VAN DYKE, drawing upon his former training in engineering, informed the committee that natural gas [primarily] exists in the same reservoirs with oil and that there have been very few gas-only reservoirs discovered in the North Slope to date. He listed the most common gas accumulations up north and relayed that they are combination oil and gas pools which would require "delicate surgery" to carve out the gas interest alone. He referred to previous management and accounting challenges in splitting the ownership of oil and gas in the same reservoir,

field, or lease, and expressed his belief that this, in itself, "really was a headache." He said that he would recommend avoiding the split oil and gas ownership if at all possible. He then highlighted that the total statewide gas royalty revenue for calendar year 2005 (CY 05) was approximately \$61.8 million gross and about \$46.1 million net of the permanent fund and school fund. For North Slope gas alone, he cited that CY 05 revenue was approximately \$11.1 million gross, \$8.3 million net, and most of the gas is otherwise reinjected back into the ground. Assuming that a value has been assigned to the gas, he remarked that "somewhere between half and all of the total known royalty gas on the North Slope" might represent an amount equal to the \$5 billion [needed to fund the state retirement system]. He opined that since there is no gas pipeline currently under construction, it would be a challenge to assign a value for the gas which, at present, is being re-injected in the ground. Furthermore, he surmised that whereas the North Slope gas could be booked as "official reserves," using accepted accounting standards, "assigning any book value to those resources today is probably not appropriate." He informed the committee that assigning any value to the yet-to-be-discovered gas on the North Slope - on either unexplored leases or on unleased state land - is more of a challenge and one he would not recommend. He relayed that the exploration risks on these unexplored lands is too difficult to quantify.

[9:37:00 AM](#)

CHAIR WEYHRAUCH requested Mr. Van Dyke focus further testimony on the general concept of the bill. He asked whether the perspective would be any easier in replacing the words "natural gas" with the word "oil."

MR. VAN DYKE opined that although it would certainly be easier to assign a value to the [oil] resource, a question of "split estate" would still be created. He provided an example of this by noting the different interests, motivations, and management practices the ARMB might have in oil rights versus those with interests in gas rights.

CHAIR WEYHRAUCH asked whether the problem would be somewhat easier if the gas was restricted to that of Cook Inlet.

MR. VAN DYKE expressed his belief that it would be easier if the legislation referred to only the gas in the Cook Inlet, Beluga, and Kenai fields. However, he remarked that there isn't a lot

of value remaining in the Cook Inlet reserves. "We just can't come anywhere near \$5 billion in value," he said.

9:39:03 AM

REPRESENTATIVE SEATON inquired as to whether the transfer of the potential asset versus the transfer of a revenue stream from that asset, would change Mr. Van Dyke's perception.

MR. VAN DYKE explained that from an accounting and management standpoint, those oil and gas revenues specifically dedicated to funds, such as the permanent fund and the school fund, work fine and far more easily than having to transfer "the actual ownership interest in the resource."

REPRESENTATIVE SEATON asked whether part of the anticipated problem in splitting North Slope gas from oil may in part be a result of unequal field shares and the variety of opinions regarding whether to reinject gas or market it.

MR. VAN DYKE affirmed that determining the speed at which fields are produced is one type of problem that often results in tension between field owners.

9:41:51 AM

BOB SHEFCHIK, Chief of Staff, Mayor's Office, Fairbanks North Star Borough, informed the committee that he prepared some of the initial concept work and cost savings estimates available in the committee packets. He opined that "the issue of rising PERS and TRS rates for public employers really is an impending budgetary crisis for years to come." Additionally, he remarked that the \$5.7 billion, which "slowly ratchets up 5 percent a year," is a 20- to 23-year problem for employers when determining how to meet payroll expenses and pay bills. He expressed his belief that HB 492 provides an alternate solution to the annual increase [of 5 percent]. He stated that finding a different way to meet the past service rate and finding an asset that would generate cash in the future, "really was the crux behind [this legislation]." Returning to earlier questions posed by the committee, he explained how he envisions the concept will work in conjunction with the ARMB. Assuming that DNR is able to find sufficient [gas] reserves with assets to match the \$5.7 billion, he relayed that the ARMB would then value the asset transfer annually as it establishes the rates. He said:

If [the project] proceeds and a gas line is in motion, clearly the value of the gas is more certain. If in 3 to 5 years, there still is no action, [the state] could expect a responsible ARMB to write down the value of that asset based on the risk of it ever coming to market. So the window of potential loss of payments and the increase of the liability, I wouldn't put at 10 or 15 years. I would put it at 3 or 4 [years] because [the state] will have an ARMB that's annually going to evaluate the value of the gas."

MR. SHEFCHIK then returned to earlier discussion regarding what happens should there be no gas pipeline by 2015. He expressed his belief that although this risk is real, it is one the state would be aware of prior to 2015 and would then return to the same solution currently used - that of increasing rates with methods paying off the unknown liability. He suggested that this scenario might cost the state "3 years of ratcheting payments, not 15 [years]." Although the current solution [for addressing the long-term liability] is cash-based across 23 years, he opined that it need not be. Rather than using a cash flow solution, he highlighted that this bill proposes using a balance [sheet] approach by transferring a future asset to offset a future liability. Additionally, he clarified that the 5 percent annual increases on salaries could be eliminated and rates set at a 13 to 14 percent normal cost rate. He said:

The committee has already identified a number of the problems - that the value of the gas reserve is dependent on getting gas to market. In 3 to 5 years those reserves, if there is no progress on the gasoline, ... would get written down to near zero and we would be at the same point we are now at 8 percent for the 3 or 4 years that ... rates didn't ratchet up. The bill does offset competing requirements of the constitution: the requirement to meet pension liabilities, versus dedicated funds in appropriation, and it does reduce future discretionary revenues from gas. However, ... they're neither insurmountable [nor] greater than the problems created by the status quo.

MR. SHEFCHIK informed the committee that the [Fairbanks North Star] Borough is supportive of the ideas embodied in HB 492. He relayed that although the borough would like to see municipalities included [in the bill], it's "supportive of even a partial solution to this huge problem." Referring to [Dr.

Pedro] van Meurs' testimony in February, he offered his understanding that future gas royalties were estimated high enough to address the state's retirement liability.

[9:48:58 AM](#)

CHAIR WEYHRAUCH sought confirmation of his understanding that the asset is on paper only and that there is no real way for ARMB to monetize that to where the liability is actually reduced.

MR. SHEFCHIK opined that it would be no different than other assets the state currently has. He referred to the risk of the gas pipeline not being completed and not getting to market, as one of the key pieces in valuing the future assets.

CHAIR WEYHRAUCH inquired as to whether there was any benefit to: identifying revenue-producing lands - whether they are oil, gas, timber, or otherwise; bestowing the authority to receive and sell those lands upon the ARMB; transferring assets to the ARMB for the purpose of reducing the unfunded liability; and when [the liability] reverts to zero, having [the assets] revert to the state.

MR. SHEFCHIK remarked that this would only be a benefit if the state could identify those revenue-producing lands that were not already committed elsewhere. Furthermore, should the state pull a revenue-producing asset from the current mix, he opined that it would cause a ripple effect throughout state operations. In response to Chair Weyhrauch's query that this would hold true for any committed resource, he countered that the pension obligation is different in that it has a constitutional basis unlike commitments to other projects such as those for improving state roads or parks.

[9:51:43 AM](#)

REPRESENTATIVE SEATON, in noting that the state is obligated by its constitution to make payments on the past service costs, inquired as to why it's necessary to specifically identify "some future valuation" of gas revenues to pay these costs. He expressed that he is uncertain as to what the legislation is effectively trying to accomplish.

MR. SHEFCHIK explained that the difference is due to the nature of the commitment and the identification of the assets.

[9:53:33 AM](#)

REPRESENTATIVE KELLY commented on the differences between university endowments and the [transfer of gas assets] proposed in HB 492. Upon noting that the "valuation can bob up and down," with increased exposure during this fluctuation, he asked Mr. Shefchik what risks might be associated with that.

MR. SHEFCHIK informed the committee:

If you let it run for 10 years, the risks associated with that are the current value times 8 percent and that's bigger than one would want to take. Clearly, the progress in the next two or three years would determine whether or not this was continued on or a different solution would be needed. It really would have to be treated by the ARMB as a real asset similar to a real estate investment or ... it would just be putting the problem off into the future ... hoping that things get better, and that would be a bad thing.

MR. SHEFCHIK returned to earlier discussion regarding the state liability and the percent of federal liability that is passed through. He explained that during his five years of finance work at the Geophysical Institute at the University of Alaska Fairbanks (UAF), there were those on federally funded projects - funds with generally fixed amounts and not based on the actual cost of projects. He relayed that "by having a system that lowers the retirement cost onto projects, ... it frees up more direct costs ... whether it's roads or research, that plows back into the economy. It does make for a cost share but doesn't reduce the amount of federal money that's coming into the state; it changes it so that it's direct costs." Additionally, he opined that as the PERS and TRS rates climb, those agencies considering funding research proposals, may look negatively upon the retirement rate being offered. He opined, "It would indeed help offset federal payments toward PERS and TRS, but [wouldn't] reduce the amount of federal money coming into the state; it would just change what it would be paid for."

[9:57:57 AM](#)

REPRESENTATIVE SEATON sought confirmation of his understanding that the state's current asset base would be reduced in addition to the lowering of the percentage of funding within the state system. He expressed his belief that "it's much larger than the

8.25 percent interest rate on the money; it's actually eating up the asset."

MR. SHEFCHIK said he does not know the answer to this because he doesn't know the cash flow projections of the PERS system.

[9:59:11 AM](#)

REPRESENTATIVE SAMUELS sought confirmation from Representative Kelly that he was referring specifically to the cash flow and that the transfer of leases would not be under ARMB control.

REPRESENTATIVE KELLY clarified that whereas the management of the land stays with DNR, the interest in the gas would transfer "for it to have any value to the ARMB."

[9:59:55 AM](#)

REPRESENTATIVE ROKEBERG inquired as to whether the title would rest with the State of Alaska or with ARMB. Additionally, he asked whether Representative Kelly was referring to "the income stream rather than the vesting of title."

REPRESENTATIVE KELLY deferred discussion of this to Don Bullock, an attorney with Legislative Legal and Research Services.

[10:00:56 AM](#)

GARY BADER, Chief Investment Officer, Treasury Division, Department of Revenue (DOR), announced that the ARMB has no position HB 492. He relayed that the board is scheduled to meet this week with Mr. Shefchik and others to ask questions and gather information to help the board prepare suggestions on how the legislature might address the state's unfunded liability: either all at once or "more likely in increments." He noted that whereas the cash flow, as proposed in the bill, would equal nearly a third of the fund, no cash would be generated for an unknown number of years. He added that the ARMB would give further consideration to the possibility that passage of the bill, "might ... make [the retirement system] fully funded, but without a revenue stream, we begin falling further behind by at least \$400 million a year"

[10:03:41 AM](#)

CHAIR WEYHRAUCH asked Mr. Bader to explain his relationship to the ARMB.

MR. BADER clarified that he is a chief investment officer for DOR and that the department is staff to the ARMB.

CHAIR WEYHRAUCH inquired as to whether, the board has the statutory authority to obtain and manage an asset such as the one proposed in the bill.

MR. BADER offered his understanding that the board does have this authority, however, indicated that Michael Barnhill from the Department of Law, would know the answer to this. Then returning to earlier discussions on the transfer of assets, he said it was his understanding that according to the wording in the draft legislation, once the unfunded liability is fully addressed, [the assets] revert back to DNR. He opined that this "creates a marketability" and relates to the question of whether the asset could be monetized.

[10:05:14 AM](#)

REPRESENTATIVE SEATON asked Mr. Bader to provide the committee the schedule of payments on the past service costs. Whereas the committee does have the amortized rate of contributions required to pay the debt, he expressed that it does not have a schedule of payments the state is required to make.

MR. BADER said he could provide the committee with a close approximation of these figures.

[10:06:54 AM](#)

TOM BOUTIN, Deputy Commissioner, Treasury Division, Department of Revenue (DOR), informed the committee that the department learned from the auditors, KPMG International, that the asset would have to be "measurable and have to be available to pay liabilities in the current year in order to book it as a value." He offered his understanding that according to generally accepted accounting principles (GAAP), there isn't a way to book assets that have not actually been purchased. He provided an example of the estimated 7 billion barrels of oil remaining on the North Slope and explained that these are neither booked nor depleted assets by the state. Furthermore, he added, the Alaska Permanent Fund Corporation (APFC) does not book the royalties it expects to receive from those barrels of oil. The same would apply, he said, to the resources in the timber and coal industries; those assets do not appear on the state's balance

sheet. He expressed his understanding that GAAP doesn't allow this.

[10:09:31 AM](#)

REPRESENTATIVE SAMUELS opined that there is a difference between selling the cash flow after development [of the gas] to doing so while [the gas] is still under ground and therefore would be subject to considerably more rules. He asked Mr. Boutin how he predicted it would play out in the long run should the gas be transferred while it's still in the ground.

MR. BOUTIN suggested that these might be questions better addressed by DNR than DOR. He repeated that the KPMG auditors will look to see that the [gas asset] is measurable and available to pay current year liabilities. "Whether there's a way to have this asset in this bill be both measurable and available for current year expenditures, I don't know," he said.

[10:11:55 AM](#)

REPRESENTATIVE ROKEBERG relayed that he is a "great skeptic" of this legislation, however, said he appreciated the resulting debate. He asked whether DOR could provide a variation of this approach that would meet the requirements stipulated by KPMG and still fund the liability of the state's retirement system.

MR. BOUTIN said that DOR has not examined other similar approaches. Regardless of the approach, he remarked that an asset would need to start earning 8.25 percent and that the rate is assumed by the actuary to be long term, doubling every nine years. He relayed that a booked asset that wasn't appreciating at an 8.25 percent rate, starts diminishing the earnings immediately. He said that the sponsors of the [retirement] plans now have some investments that are relatively illiquid such as those investments in private equity and real estate. These assets, he explained, were purchased at a fair market value and hopefully bring in a return that is even greater than the 8.25 percent. "It's an investment concept ... every plan sponsor has to have, and anybody talking about filling this gap has to have," he opined.

[10:15:39 AM](#)

REPRESENTATIVE SEATON inquired as to whether "lease rentals, royalties, royalty sale proceeds, net profit shares, and other receipts related to the gas interests," listed on page 2, lines

29-30, would be [considered] liquid before gas is flowing down the pipeline.

MR. BOUTIN said that others at DOR and DNR might know the answer to this.

REPRESENTATIVE KELLY remarked that this problem is much more sensitive to the required earnings rate of 8.25 percent than to the cash flows. Without the liquidity, he expressed his belief that the unfunded liability will continue to grow.

MR. BOUTIN relayed that the actuary annually provides the amount required to meet both the future liability and to amortize the past service liability over 25 years. He explained that employers haven't been meeting the contribution rate needed to amortize the past service liability over this 25-year period because of the cap set each year on any increases to those rate. He expressed that he has "never been able to buy into the model that says that employers are being charged an interest rate of 8.25 percent on the past service liability."

[10:18:20 AM](#)

REPRESENTATIVE ROKEBERG, referring to an earlier question by Representative Seaton, said that there would be a value to the [gas] asset, regardless of whether it's actually flowing, but only if that asset could be alienated. He offered his belief that, "you could monetize it but ... only if you sold your interest."

[10:18:50 AM](#)

CHAIR WEYHRAUCH noted that it's this committee's mission to explore and determine ways to fund the state's [retirement] liability. He referred to the meeting held last year in Anchorage, with experts from the National Conference of State Legislatures (NCSL) who presented the many ways other states are addressing their pension fund liabilities. He highlighted that some of the states investing in property have done well, unlike those states investing in pension bonds. With Alaska being a resource-rich state, he remarked that identifying and applying this kind of asset, and using it as a future revenue stream to pay off the debt without harming the other job functions of the state government, would seem a viable approach. However, he opined that "it's monetizing the asset and getting it to the ARMB to pay the unfunded liability [that] seems to be the problem."

[10:20:21 AM](#)

REPRESENTATIVE ROKEBERG returned to his earlier question as to whether there would be a benefit to assigning a current-producing oil and gas lease - or any other natural resource asset - to the [ARMB] to reduce some of the unfunded liability. He suggested that it "may run afoul constitutionally," but there may be some benefit to it. However, he remarked that it would decrease the amount of cash flow available for general fund expenditures.

[10:21:32 AM](#)

REPRESENTATIVE SAMUELS, in response to Representative Rokeberg's remarks, opined that North Slope gas is needed "to make it worthwhile" and that the companies can't book [the gas] until FERC sanctions the project; there is no value to company shareholders until this is accomplished.

MR. BOUTIN relayed that unlike the oil companies, both the state and APFC have a "higher test" because they comply with GAAP: even when oil companies book North Slope oil, the state doesn't book its share of the oil nor does the permanent fund book its expected royalties from known oil reserves.

REPRESENTATIVE SEATON inquired as to whether there would be any problem with having the state acquire the asset as gas, not royalty payments, and then at some future point in time, the gas would be sold to create the revenue stream.

MR. BOUTIN said it was not clear to him that this "would allow booking today an asset value that would help fill this unfunded liability hole and thereby reduce employer contribution rates today." If wording to describe this option were given to him, he said he would present it to the state's actuary and KPMG.

REPRESENTATIVE SEATON said he agreed with Mr. Boutin's earlier testimony on the issue of cash payments versus the 8.25 percent on the net present value. He opined that what is actually happening is that the net present value is being determined by back-calculations on scheduled cash payments.

MR. BOUTIN stated his agreement.

[10:26:19 AM](#)

REPRESENTATIVE ROKEBERG asked Mr. Bullock whether this legislation, enacted as written, would run afoul of dedicated funds as addressed in the state constitution.

[10:26:30 AM](#)

DON BULLOCK, Attorney, Legislative Legal and Research Services, Alaska State Legislature, said that because the state's interest in gas would go to the ARMB and because the earnings from that would be dedicated to offset the unfunded liability, a dedicated fund issue is raised. He informed the committee that whereas Article IX, Section 7 of the Alaska State Constitution prohibits dedicating state funds, Article XII, Section 7 competes with this as follows:

Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired.

MR. BULLOCK surmised, "It's possible that a court will look at these competing sections and say that in this case, this is an exception to the prohibition on dedicated funds."

[10:27:49 AM](#)

REPRESENTATIVE ROKEBERG inquired as to how the transfer of Mental Health Trust Authority authorized receipts ("MHTAAR") was justified and asked whether it was a requirement of the Alaska Statehood Act.

MR. BULLOCK said he was not familiar with the MHTAAR, however, he relayed that Section 6, subsection (i) of the Alaska Statehood Act, specifies that those underlying mineral resources below land received from the federal government at the time of statehood, can't be transferred away from state. He clarified that as long as the transfer takes place within the state, such as to the university or the ARMB, the state would still retain ownership and not be in violation of the Alaska Statehood Act.

REPRESENTATIVE ROKEBERG sought confirmation that this same act also requires the state "look after local communities."

MR. BULLOCK stated his agreement.

REPRESENTATIVE SEATON asked Mr. Bullock to define the legal parameters for the transfer of assets as opposed to the transfer of a revenue stream with a conditional release of that asset.

MR. BULLOCK explained the underlying concept of the bill. He relayed that the state's ownership in the natural gas is actually being transferred to the ARMB; however, DNR will continue to manage the land on behalf of the ARMB. Additionally, he highlighted that there's a provision in the bill that would require the ARMB reimburse DNR for the cost of that management. Other aspects of the bill, he noted, include DNR's management of reserves, leasing gas interests and deducting the contributions made to the permanent fund as well as to the public school trust fund. The net income would then be transferred to the ARMB, he said, and "DNR will continue to manage the interest just as any other interests that the state has."

[10:30:35 AM](#)

REPRESENTATIVE SEATON posed a situation in which the ARMB wishes to monetize its asset - the ownership of the gas - and inquired as to whether it would be possible for the board to sell it to a state entity such as University of Alaska.

MR. BULLOCK explained that under the Alaska Statehood Act, the ARMB "could not sell [its] interest in the gas."

REPRESENTATIVE SEATON rephrased his question asking whether it wouldn't be possible for the ARMB to sell to the university which has had gas interests transferred to it previously.

MR. BULLOCK said this might be possible if the asset can be identified and is saleable.

[10:32:22 AM](#)

REPRESENTATIVE SAMUELS sought confirmation of his understanding that the sale of assets could not be made to a company such as ExxonMobil Corporation.

MR. BULLOCK said this was correct and further clarified that under the Alaska Statehood Act, the state's assets may be leased with a royalty interest retained; however, the land and its underlying resources may not be sold.

REPRESENTATIVE SAMUELS asked whether it was possible to transfer the royalty itself and not the land.

MR. BULLOCK explained that then it would become an issue of "whether it's the income stream or the gas itself."

REPRESENTATIVE SAMUELS asked how autonomous the ARMB is, whether it's under the control of the governor, and whether its members are appointed for specified terms or serve until just cause for removal.

MR. BULLOCK said he is uncertain as to the particular status of the employees of the board, however, noted that there are political appointees that serve on the board as well as representation from DNR and DOR. The ARMB, he clarified, has the fiduciary responsibility to manage the funds responsibly regardless of administration changes. Furthermore, he said that "the obligation under the Alaska State Constitution not to impair the retirement funds continues regardless of political entities." In further response to Representative Samuels as to possible conflicts of interest among ARMB members, the commissioner of DNR and other top administrators, opined that "anything is possible; however, the unfunded liability will continue and the ARMB, regardless of what happens to [its] investment in the gas, would have to come up with the money, at least some other way."

[10:35:44 AM](#)

MIKE BARNHILL, Assistant Attorney General, Labor and State Affairs Section, Department of Law (DOL), informed the committee that although there appears to be constitutional concerns with the bill, he is not prepared to provide a definitive answer as to whether it would actually be in violation of dedicated funds. He relayed that [DOL] will research this further. He referred to the 2004 Alaska Supreme Court decision on the transfer of university lands. He highlighted that the court determined that this transfer was not an appropriation but rather a non-monetary asset transfer. Whether [HB 492] proposes a similar transfer of assets, has not yet been determined. He relayed that although there is constitutional protection of the state pension funds, he expressed his uncertainty as to "whether a court would consider that and say that somehow excuses this bill from the dedicated funds prohibition." He opined that they are "two entirely separate provisions in the constitution that aren't linked or necessarily in conflict." As per the request of Chair Weyhrauch, he explained that his last point was in response to

Mr. Bullock's suggestion that "because there's a constitutional provision to protect and not to diminish the retirement systems, that somehow the courts would give the benefit of the doubt to the legislature if there was a bill with a potential dedicated funds violation." He reiterated his doubt that the courts would do this.

CHAIR WEYHRAUCH relayed that with the likelihood of the bill being amended, the actions of committee may overtake the legal analysis.

10:39:40 AM

DICK MYLIUS, Acting Director, Division of Mining, Land and Water, Department of Natural Resources (DNR), informed the committee that he was available to answer only those questions on the DNR fiscal note. He explained that because the note assumes a transfer of property interests to the [ARMB], it focuses on federal research and the preparation of deeds. He highlighted that whereas this falls under the purview of the Division of Mining, Land and Water, any technical issues are the purview of the Division of Oil and Gas.

10:41:01 AM

REPRESENTATIVE KELLY inquired as to whether Mr. Mylius envisioned the actual transfer to be that of the land interest.

MR. MYLIUS offered his understanding that it involves the transfer of the "gas interest" to the ARMB. In further response to Representative Kelly, he relayed that any previous testimony did not alter his understanding of the basis for the calculation of the fiscal note.

REPRESENTATIVE SEATON inquired as to whether DNR would foresee any problems should the ARMB intend to monetize the interest and transfer it within the state, such as to the University of Alaska.

MR. MYLIUS expressed his belief that this would not be a problem as the university is still an entity of the state. In further response to Representative Seaton regarding any other foreseeable problems, he suggested that the attorney general's office might be better able to address this. He expressed his uncertainty as to whether the ARMB has the authority to transfer title of a portion of the state's land.

10:43:17 AM

CHAIR WEYHRAUCH announced that HB 492 would be held over.

REPRESENTATIVE KELLY, [referencing the upcoming ARMB meeting], in addition to KPMG's approach to liquidity, opined that it might be helpful to know whether the assumption of a gas contract would perfect the usefulness of the asset.

10:44:44 AM

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 10:44 a.m.