

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS STANDING COMMITTEE

March 31, 2005

3:36 p.m.

MEMBERS PRESENT

Senator Gene Therriault, Chair
Senator Thomas Wagoner, Vice Chair
Senator Charlie Huggins
Senator Bettye Davis
Senator Kim Elton

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

SENATE BILL NO. 152

"An Act making a special appropriation for a survey to review pay differentials; and providing for an effective date."

HEARD AND HELD

SENATE BILL NO. 121

"An Act establishing the State of Alaska Capital Corporation; authorizing the issuance of bonds by the State of Alaska Capital Corporation to finance capital improvements in the state; and providing for an effective date."

HEARD AND HELD

SENATE BILL NO. 122

"An Act establishing the Alaska capital income account within the Alaska permanent fund; relating to deposits into the account; relating to certain transfers regarding the Amerada Hess settlement to offset the effects of inflation on the Alaska permanent fund; and providing for an effective date."

HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 152

SHORT TITLE: APPROP: COST-OF-LIVING SURVEY

SPONSOR(s): SENATOR(s) WAGONER

03/24/05 (S) READ THE FIRST TIME - REFERRALS
03/24/05 (S) STA, FIN
03/31/05 (S) STA AT 3:30 PM BELTZ 211

BILL: SB 121

SHORT TITLE: STATE OF AK CAPITAL CORP.; BONDS
SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

02/28/05 (S) READ THE FIRST TIME - REFERRALS
02/28/05 (S) STA, FIN
03/31/05 (S) STA AT 3:30 PM BELTZ 211

BILL: SB 122

SHORT TITLE: AMERADA HESS INCOME; CAPITAL INCOME ACCT.
SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

02/28/05 (S) READ THE FIRST TIME - REFERRALS
02/28/05 (S) STA, FIN
03/31/05 (S) STA AT 3:30 PM BELTZ 211

WITNESS REGISTER

Amy Seitz,
Staff to Senator Wagoner
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Introduced SB 152

Michael Gardner
Kodiak, AK
POSITION STATEMENT: Testified in support of SB 152

Art Chance, Director
Labor Relations
Department of Administration
PO Box 110200
Juneau, AK 99811-0200
POSITION STATEMENT: Answered questions related to SB 152

Cheryl Frasca, Director
Office of Management and Budget
Office of the Governor
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Introduced SB 121 and SB 122

Deven Mitchell, Debt Manager
Department of Revenue
PO Box 110400
Juneau, AK 99811-0400

POSITION STATEMENT: Testified on SB 121 and SB 122

Mike Burns, Executive Officer
Alaska Permanent Fund Corporation
Department of Revenue
801 West 10th St, Suite 301
Juneau, AK 99801

POSITION STATEMENT: Testified on SB 121 and SB 122

Mike Barnhill,
Assistant Attorney General
Civil Division
Department of Law
PO Box 110300
Juneau, AK 99811-0300

POSITION STATEMENT: Testified on SB 121 and SB 122

ACTION NARRATIVE

CHAIR GENE THERRIAULT called the Senate State Affairs Standing Committee meeting to order at [3:36:35 PM](#). Present were Senators Wagoner, Huggins, Davis, Elton and Chair Therriault

SB 152-APPROP: COST-OF-LIVING SURVEY

CHAIR THERRIAULT announced the first order of business to be SB 152.

[3:37:02 PM](#)

AMY SEITZ, Staff to Senator Thomas Wagoner, explained that SB 152 would make an appropriation to the Division of Personnel to authorize a cost of living study covered in AS 39.27.030. It deals with pay schedules of state employees not covered under collective bargaining agreements. The most recent study was conducted in 1985 yet statute calls for such a survey to be undertaken at least once every five years. The sponsor feels it's time to look at the cost of living around the state and update the numbers.

Statute provides an adjustment to salary schedules for exempt and partially exempt employees based on where they work and reside. Classified employees receive similar adjustments based

on collective bargaining negotiations every three years. It's in the best interest of the state that similarly situated public employees are paid at the same rate as those who are classified. Conducting a cost of living study based on current costs around the state would level the playing field.

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SENATOR WAGONER reflected on the difficulty associated with having two different funding sources when he worked at the Kenai Community College. One funding source was the borough school district and the other was the University of Alaska.

It's important to treat state employees fairly and equitably and that's what this study intends to do, he said.

CHAIR THERRIAULT said he remembers the study from 20 years ago and it was "hard fought and painful."

SENATOR KIM ELTON asked how it was determined that the study would cost \$500,000. Also he questioned whether there shouldn't be a deadline established for completing the survey.

SENATOR WAGONER said the amount was best guess estimate. He didn't favor a deadline because you couldn't tell when the study might be awarded.

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CHAIR THERRIAULT opened public testimony.

MICHAEL GARDNER, a state employee from Kodiak, reported that he has worked in Anchorage, Bristol Bay and Kodiak over the course of more than 20 years and can therefore provide a unique perspective on the serious impact that a high cost of living can impose on a state family.

He raised three children in Bristol Bay and if he bought milk and bread locally it cost up to four times as much as in Anchorage. His other option was to use a catalog service and pay the Anchorage price plus airfreight. Housing options were limited and cost twice as much as in Anchorage.

Currently he lives in Kodiak where the cost of food is more reasonable but still far in excess of Anchorage prices. He said he lives off the road system and transportation to Anchorage can cost nearly \$300 per person.

"Geographical pay differential is a critical benefit to state employees serving in rural Alaska. In some instances state employees would be living in substandard conditions without it," he said.

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CHAIR THERRIAULT drew attention to the sheet titled "Geographic Pay Differential Comparisons" and asked Mr. Chance for an explanation of the numbers listed as "Outside Anchorage."

ART CHANCE, Director of Labor Relations, Department Of Administration, reviewed the chart and said he understands "Outside Anchorage" to be outside the Anchorage base in Alaska. Anchorage and Juneau are considered the Alaska and have a zero percent differential. For purposes of the Public Employment Relations Act the law requires that any state salary schedule must reflect the cost of living difference between Seattle and Alaska. The Alaska definition is normally the Anchorage/Juneau base.

CHAIR THERRIAULT asked if had any information on what such a study might cost.

MR. CHANCE said \$500,000 is realistic and offered the opinion that using the greater Puget Sound area is a more reliable base for comparison than Seattle proper.

Implementation brings another set of cost factors, he said.

CHAIR THERRIAULT asked whether the last study was fully implemented.

MR. CHANCE answered no and elaborated on difficulties associated with previous studies.

SENATOR ELTON asked if there should be a second section in SB 152 to provide for adopting some standard other than Seattle proper. If you do an RFP would your contractor have to use Seattle, he questioned.

MR. CHANCE replied he isn't compelled to do so. He suggested that either the Division of Personnel be given authority to design the target area or the Legislature should use its discretion because, "It is my belief that Seattle Washington per se ... is going to give you a very skewed comparative," he said.

SENATOR ELTON said given what's happened to the economy in Seattle the committee ought to consider a change that would allow the study to give a base other than Seattle.

CHAIR THERRIAULT asked if the purpose is to have equal salaries compared to the target or to come up with a target then compare all the different geographic areas of the state to it.

MR. CHANCE replied he doesn't have a lot of first hand knowledge regarding when the legislation was implemented about that, but he has read the record of the early 1980s Blue Ribbon Committee reports that the PERA changes that led to this were based on. The language in PERA clearly says there will be cost of living and wage differentials between Seattle and Alaska for Alaska Marine Highway System employees. However, it was applied to everyone subject to collective bargaining.

Some state employees work outside of Alaska and it becomes fairly important to have to have wage adjustments downward for those employees.

The other use of establishing a certain base is to understand how we relate to our market and whether or not we're appropriately paying our own employees. We need to know how to translate Alaska salaries to salaries somewhere in the Lower 48. Seattle is no longer a realistic comparative.

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CHAIR THERRIAULT noted AS 39.27.030 was modified in 1996 and also in 2000 and he was curious what those modifications were.

MR. CHANCE said the 1996 modification was made as a result of a suit. A judge ruled that the state had to conduct the study and the state's response was to repeal the statute.

CHAIR THERRIAULT announced he would set SB 152 aside.

SB 121-STATE OF AK CAPITAL CORP.; BONDS
SB 122-AMERADA HESS INCOME; CAPITAL INCOME ACCT.

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CHAIR THERRIAULT announced SB 121 and SB 122 to be up for consideration.

CHERYL FRASCA, Director of the Office of Management and Budget, Office of the Governor, said she would present the bills together.

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The Governor proposes to finance capital infrastructure projects by issuing bonds and the interest earnings from the "Amerada Hess" settlement would be used to pay them off. The list of capital projects that would be funded through this mechanism is included in the December Capital Budget that was submitted to the Legislature. This is very similar to state funds in that the final decision as to which projects are funded is left to the Legislature through the Finance Committees.

The Amerada Hess settlement relates to a lawsuit the state filed against the oil companies in the late '70s relating to the valuation of the state's royalty oil. The oil companies tried to keep the suit from proceeding in Alaska by arguing that all Alaskans would be biased. The federal court urged the Legislature to step in and address the issue. As a result legislation was passed in both the Cooper and Hickel Administrations that excluded the settlement proceeds from being included in the calculation of the Permanent Fund dividend.

A sub-account was established within the Permanent Fund to which all the settlement precedes have accumulated. In FY 92 \$82 million was deposited and at the end of FY 04 the balance had grown to about \$424 million. Unlike the dividend, there has been no return to the Alaska economy from the earnings. The proposal is to put those earnings to work. The bond mechanism allows leverage of the annual earnings over time to finance a larger package of capital projects.

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CHAIR THERRIAULT asked if the initial deposit was 25 percent of the Amerada Hess settlement and the rest of the money went into the state treasury.

MS. FRASCA speculated that the 75 percent balance went into the Constitutional Budget Reserve (CBR) once it was created. At the time that Amerada Hess was negotiated there was no CBR.

SB 122 creates an account into which the earnings of the Amerada Hess settlement would be placed and SB 121 creates the corporation that would issue the debt.

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SENATOR KIM ELTON said he assumes the Amerada Hess account is inflation proofed in the same way as the Permanent Fund.

MS. FRASCA said yes it is and the Legislature appropriates the earnings into the account.

SENATOR ELTON asked if the inflation proofing is designated to Amerada Hess or to the pot that includes Amerada Hess.

MS. FRASCA replied it's designated into the Amerada Hess sub account.

SENATOR ELTON asked if it's correct that under the proposal there would be no inflation proofing of Amerada Hess.

MS. FRESKA said that is correct. The \$424 million in principal would stay in the account and each year the earnings would go to pay the debt service on the bond package. The \$424 million wouldn't grow any larger, she said.

SENATOR ELTON declared that is a substantive policy shift and someone might want to discuss the net effect of no longer inflation proofing. This isn't just about spending the earnings. This is about spending principal because inflation would erode it over time, he said.

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DEVEN MITCHELL, Debt Manager, Department of Revenue (DOR), explained that the historical use of all the earnings has been appropriation to principal so it's been more than inflation proofed. As to the policy matter of whether it should be inflation proofed moving forward or not he said:

There is a slight automatic inflation proofing as much as the realized return rate of the Permanent Fund is less than their expected total return rate - to the tune of 57 basis points. So theoretically your fund will grow on an accrual or an accounting basis over time even though you do anticipate removing all realized earnings from the fund - from this Amerada Hess account. And so if you looked at it on a balance sheet it will grow from \$424 million if those assumptions materialize over time.

It's a separate issue as to whether there should be a statutory requirement that it be inflation proofed, he said.

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MR. MITCHELL said there are two distinct things going on with the two bills. The first bill would create the Alaska Capital Income Account. It would change the flow of money within the Amerada Hess settlement from accruing to principal to flowing into the new Alaska Capital Income sub-account in the Earnings Reserve. From there the funds would be available for annual appropriation for any purpose by the Legislature.

The second bill would create a new corporation called the State of Alaska Capital Corporation. It would have the ability to issue up to \$350 million in revenue bonds. The corporation would receive funding on an operating basis from agencies that benefited from capital projects. The operating leases would have to be renewed every year, which creates a mechanism for the funds to flow to the corporation. The corporation would have a variety of security features and financial tools to ensure that there would be a means to deal with volatility and to avoid use of any credit enhancements the state might provide.

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He drew attention to the schematics in the bill packet [see file]. They are designed to help explain how the corporation would work. He suggested the concept of the Alaska Capital Income Account is fairly easy to grasp.

The second schematic shows how money might flow into the State of Alaska Capital Corporation. The annual appropriation flows into a revenue fund of the corporation. It would fund operations of the corporation; the debt service reserve fund, which would have a moral obligation pledge of the State Alaska; and the bond redemption fund, which would advance fund debt service of the corporation on an annual basis.

Corporate bond payments flow from the bond redemption fund to investors and investors would purchase bonds from the corporate bond issue and that cash would fund the construction fund. There would be an obligation to repay those investors. The obligation would be made in a flexible manner such as a flexible amortization bond. They would pay interest only and have reserves in place to accommodate market volatility on the

earnings side. The model they used results in a 17 to 18 year amortization of all principal associated with the borrowing.

The construction fund would be managed by the Department of Revenue under the fiduciary responsibility of the commissioner and reinvested in fund projects through the existing Alaska Statewide Accounting System (AKSAS) system so no special accounting process would be needed to fund projects.

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SENATOR ELTON referenced the statement that the anticipated revenue stream of \$30 million would be available to pay off debt and questioned what the annual revenue stream would be if Amerada Hess were inflation proofed the same as the Permanent Fund.

MR. MITCHELL replied it would reduce borrowing power. The proposal leverages the revenue stream as far as you might want while maintaining the high probability that it would be repaid and be stand-alone self-supporting debt rather than a state obligation.

A key feature of the proposal is that it wouldn't be paid from the general fund. It has a moral obligation pledge on a reserve fund, but the expectation is that all debt service would be paid from the transfers from the Alaska Capital Income Account. Rating analysts for the State of Alaska have indicated that this would not impact the state's credit rating and it wouldn't be included as net tax supported debt of the state.

SENATOR ELTON asked if those problems couldn't be avoided by simply incurring less debt. If you reduce the revenue stream it would make sense to reduce the debt obligation.

MR. MITCHELL replied that would probably help the economics of the transaction but you'd have to pull back from the proposed project list.

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CHAIR THERRIAULT recapped saying the entire Permanent Fund is inflation proofed and the portion attributable to the Amerada Hess account currently goes into the "picket fence" too.

MR. MITCHELL said yes.

CHAIR THERRIAULT questioned whether that is required by statute or whether just the earnings are addressed.

MR. MITCHELL replied, "I believe they're one and the same; inflation proofing would be earnings, which would be allocable to this portion."

CHAIR THERRIAULT said he'd ask Mr. Burns the same question. He compared the tobacco settlement and Amerada Hess. The state couldn't control the flow of tobacco settlement funds so there was no assurance that they would continue, but part of the reason for going that route was so it wouldn't become a moral obligation of the state. For Amerada Hess there isn't control because of the vagaries of the market return, he said.

MR. MITCHELL agreed the state doesn't want any tie to the tobacco bonds because of the potential elimination of that revenue stream. Therefore the state sold that asset to a subsidiary of a public corporation that doesn't have other assets or any moral obligation of the state associated with the bonds. The investors required interest rates from that subsidiary that are commensurate with that type risk.

Amerada Hess is different in that the state would establish a corporation that is closely linked to the state. The corporation board would be the state bond committee, including the commissioners of administration commerce and revenue and staff would come from Department of Revenue personnel. There would be a moral obligation on the reserve, which is a requirement to get to that investment-grade rating level.

He reiterated that structural and financial tools would be included to ensure that there is no draw on that reserve. Modeling for this has included a Great Depression type down market to ensure that there is the ability to survive such a period, because "that's where we want to be at the end of the day." he concluded.

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CHAIR THERRIAULT asked Mike Burns where the Amerada Hess "picket fence" is located in statute.

MIKE BURNS, Executive Director, Alaska Permanent Fund Corporation, pointed to AS 37.13.145(d).

CHAIR THERRIAULT said he reviewed the statute and understands that the earnings are put back into the account. He wasn't sure whether the statute specifically requires that the inflation proofing go back into the "picket fence" as well. Inflation proofing and earnings are two different things, he asserted; the earnings come from the inflation proofing but it takes an appropriation.

MR. BURNS responded he didn't think it's a statutory requirement. He explained that the actual cash settlements were about \$194 million over a number of years. Those have been inflation proofed over the years by about \$77 million. About \$153 million in earnings have been added in bringing the total to \$424 million. The original \$194 million is, by definition, the principal of the fund and is statutorily required to be inflation proofed the same way as the Permanent Fund.

CHAIR THERRIAULT questioned whether statute required that the money go into the "picket fence" or could it have gone into the general principal of the Permanent Fund.

MR. BURNS said all of it's principal and the concept or existence of the "picket fence" is for accounting purposes so that the earnings from Amerada Hess don't go into the dividend calculation. Although reference is made to a sub account it's really managed together and is indistinguishable.

CHAIR THERRIAULT called a brief at ease from [4:23:34 PM](#) to [4:25:24 PM](#) to provide time to read the statute.

CHAIR THERRIAULT observed that AS 37.13.145(d) doesn't speak to inflation proofing, but subsection (c) does talk about inflation proofing the fund. He questioned why there's an accounting reason that the inflation proofing has to go into the Amerada Hess sub-account.

MR. BURNS explained that the original \$194 million was received in the same way as any other royalty the state has received. It's principal when it's received so under (c) it's required to be inflation proofed. Once it's inflation proofed then the inflation proofing becomes principal.

CHAIR THERRIAULT referenced the flow chart showing that the earnings come out of the Amerada Hess sub account and then go back in and remarked there should be some indication that inflation proofing goes back into the sub-account. He questioned

why all the inflation proofing doesn't go into the Permanent Fund.

MR. BURNS replied the arrow showing earnings returned to the Amerada Hess sub account includes inflation proofing. For a fund that can't be used for dividends there isn't any difference between the earnings and the inflation proofing.

CHAIR THERRIAULT said he understands but isn't sure he agrees.

MR. BURNS said that's the reason the sub-fund has grown faster than all the other funds; the earnings haven't ever been touched.

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SENATOR ELTON said the proposal suggests that when the sub-account was established the oil companies made a mistake by assuming that the only way the state would receive benefit and perhaps prejudice a jury would be through an increased dividend. If the proposal is successful the oil companies could argue that a jury could be prejudiced because the earnings would be used for capital projects.

MR. BURNS acknowledged you could make that argument, but this was an out of court settlement and the sub-account was created for something that ultimately never happened

CHAIR THERRIAULT asked Mr. Barnhill to come forward to respond to Senator Elton's assertion.

MIKE BARNHILL, Assistant Attorney General, Department of Law (DOL), said if you made that argument then you could say no tax case could go to an Alaskan judge and jury, but those cases are litigated all the time.

When the Permanent Fund dividend issue first came up the Alaska Supreme Court amended the civil and criminal rules to say that the receipt of a Permanent Fund dividend does not constitute good cause for disqualifying jurors. He declared the same would hold true for using the earnings from the Amerada Hess for capital projects.

CHAIR THERRIAULT acknowledged that the statute was passed in anticipation of a court challenge. He questioned whether the terms of the settlement agreement included similar language.

MR. BARNHILL said there are so many settlement agreements that he couldn't say for sure that any referred specifically to this language and whether it should stay on the books. Wilson Condon has looked at the issue and he may have given an opinion. DOL opines that if the Legislature wants to repeal the statutes and allow the earnings to flow back into the Permanent Fund dividends it could do so as a matter of law. Whether it's advisable as a matter of policy is a different issue.

Of principle concern is that the state said it would segregate the money so that the earnings wouldn't flow to dividends. Perception is important here because there might be opportunity to do that again in future litigation.

SENATOR ELTON suggested you could get beyond that problem in the future by simply making it part of the settlement agreement.

MR. BARNHILL responded there is no litigation on the horizon that's the size of the Amerada Hess litigation but it could happen.

SENATOR ELTON said it'd be interesting to know whether any settlements mention the "picket fence."

MR. BARNHILL replied he could get the information, but his guess is that it's not there. DOL has opined that it's legal to repeal the statute but the legislation does not repeal. It redirects the earnings from principal to the proposed income account.

CHAIR THERRIAULT said the account has been characterized as a self-licking ice cream cone in that no one gets to derive pleasure from it. The proposed mechanism is the only way for the state to derive benefit. The underlying question is do we have to continue to allow it to self-lick?

SENATOR ELTON said this might not be the only use of the Amerada Hess money. If the statute were repealed another use of the money could be for dividends. In that case the choice before the committee would be whether to use the money for capital projects or for dividends.

MR. BARNHILL referenced Wilson Condon's memo that says it's legal but inadvisable to let the money flow to dividends.

CHAIR THERRIAULT noted the memo was in the bill packet. He asked if there were further questions.

SENATOR ELTON said it would be helpful to know the annual income and the size of debt package that is sustainable if the Amerada Hess account were inflation proofed in the same manner as the rest of the fund.

CHAIR THERRIAULT asked Mr. Mitchell if that would be possible.

MR. MITCHELL answered yes.

CHAIR THERRIAULT concluded the hearing on SB 121 and SB 122.

There being no further business to come before the committee, Chair Therriault adjourned the meeting at [4:40:45 PM](#).