

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
**February 22, 2007**  
**9:03 a.m.**

**CALL TO ORDER**

Co-Chair Lyman Hoffman convened the meeting at approximately [9:03:03 AM](#).

**PRESENT**

Senator Lyman Hoffman, Co-Chair  
Senator Bert Stedman, Co-Chair  
Senator Charlie Huggins, Vice Chair  
Senator Kim Elton  
Senator Donny Olson  
Senator Joe Thomas  
Senator Fred Dyson

**Also Attending:** KAREN REHFELD, Director, Office of Management and Budget, Office of the Governor; MIKE BARNHILL, Assistant Attorney General, Labor and State Affairs Section, Civil Division, Department of Law; JIM MERRINER, Chief of Staff, Office of the Lieutenant Governor; LARRY OSTROVSKY, Chief Assistant Attorney General, Statewide Section Supervisor, Oil, Gas and Mining Section, Civil Division, Department of Law; NICO BUS, Director, Division of Support Services, Department of Natural Resources; JERRY BURNETT, Director, Administrative Services Division, Department of Revenue; ERIC SWANSON, Director, Division of Administrative Services, Department of Administration;

**Attending via Teleconference:** From an offnet location: KEVIN BANKS, Acting Director, Division of Oil and Gas, Department of Natural Resources.

**SUMMARY INFORMATION**

SB 61 -SUPPLEMENTAL APPROPRIATIONS

The Committee heard from the Office of Management and Budget, the Department of Law and the Office of the Lieutenant Governor. The bill was held in Committee.

SB 82 -SUPPLEMENTAL APPROPRIATIONS: OIL & GAS

The Committee heard from the Office of Management and Budget, the Department of Law, the Department of Natural Resources, the Department of Revenue and the Department of Administration. The bill was held in Committee.

SB 83 -SUPPLEMENTAL APPROPRIATIONS

This bill was scheduled but not heard.

[9:04:42 AM](#)

Co-Chair Hoffman directed attention to materials providing additional information on the supplemental appropriation requests [copies on file.]

[9:05:26 AM](#)

Co-Chair Hoffman noted that Karen Rehfeld, Director, Office of Management and Budget and David Teal, Director, Division of Legislative Finance, would update the Committee on the history of oil and gas matters.

#SB61

[9:06:21 AM](#)

SENATE BILL NO. 61

"An Act making appropriations for qualified regional seafood development associations, for investigation and litigation relating to the public employees' retirement system and the teachers' retirement system, and for a special advisory election; and providing for an effective date."

This was the first hearing for this bill in the Senate Finance Committee.

[9:07:31 AM](#)

KAREN REHFELD, Director, Office of Management and Budget, Office of the Governor, introduced the legislation. She noted the total

appropriation request was \$13,156,300, of which \$1,156,300 was general funds and \$12 million was other funds.

Ms. Rehfeld informed that the original submission of the bill had been amended. One amendment changed an effective date to allow the Department of Law, Civil Division, Labor and State Affairs section to pay outstanding investigation invoices for services rendered in October 2006.

[9:07:55 AM](#)

Department of Commerce, Community and Economic Development

Section: 1

Department: Commerce

Results Delivery Unit (RDU) or Component: Office of Economic Development

Supplemental Need: Regional Seafood Development Tax pass-through to the Copper River/Prince William Sound Marketing Association. This appropriation was inadvertently omitted from the FY 07 budget bills. The 1% tax assessment generated \$152,464 during calendar year 2005, which was to be appropriated to the association as of July 1, 2006.

Legislative Finance Division (LFD) Notes: The Department informed Leg. Finance about this problem in August, 2006. The Department is using Fisheries Revitalization funding to fill the gap until this tax can be appropriated.

\$0

Ms. Rehfeld overviewed this item.

[9:08:40 AM](#)

Department of Law

Section: 2(a) - (b)

Department: Law

RDU or Component: Civil Division, Labor and State Affairs

Supplemental Need: Funding for the investigation and proposed litigation related to actuarial services received by the State of Alaska. The investigation would be completed during FY 07. The amount of the appropriations is the estimated cost to complete the investigation and take the case from inception through trial.

Amendment Date: 2/16/07

Amendment No.: ES Law A

Amendment Explanation: Revise the funding split in sec. 2 to be in accordance with the Division of Retirement and Benefit's cost allocation plan and thus reflect:

72% PERS, and increase of \$369,000 to \$8,640,000, and  
28% TRS, a decrease of \$369,000 to \$3,360,000

LFD Notes: It is unclear how long the litigation is expected to continue, but this funding is available for the life of the project. The Department of Law believes there is sufficient evidence of gross negligence to warrant pursuing the case. There is no guarantee that the state will receive any compensation if the state prevails. Funding is requested to cover current attorney fees.

\$8,271,000 PERS

\$3,729,000 TRS

\$12,000,000 Total Funds

Ms. Rehfeld reviewed this request.

[9:09:23 AM](#)

Co-Chair Hoffman asked if \$100,000 was appropriated for this effort in FY 07.

[9:09:31 AM](#)

Ms. Rehfeld responded that approximately \$400,000 was appropriated to "begin an investigation" and this supplemental request was for funding to complete the investigation. The total cost of the investigation was estimated to be \$850,000. The remainder of the supplemental appropriation would be expended to "proceed with litigation."

[9:09:51 AM](#)

Co-Chair Hoffman asked if the funding were appropriated in this legislation, when the Department of Law would proceed with the lawsuit.

[9:10:05 AM](#)

MIKE BARNHILL, Assistant Attorney General, Labor and State Affairs Section, Civil Division, Department of Law, testified that once the funds were received, the Department would file the lawsuit.

[9:10:37 AM](#)

Co-Chair Hoffman asked what options other than the calculation of an hourly fee, had been considered in estimating the cost of this undertaking.

[9:10:49 AM](#)

Mr. Barnhill had considered utilizing a contingency fee as well as the cost to the State as measurements of the estimated cost and had determined that an hourly fee method would generate the best return for the State.

[9:11:10 AM](#)

Co-Chair Hoffman asked whether the Alaska Retirement Board (ARM) supported this litigation effort.

[9:11:20 AM](#)

Mr. Barnhill affirmed the Board was in support, noting a resolution indicating such [copy on file].

[9:11:29 AM](#)

Senator Thomas asked if an anticipated recovery amount had been estimated.

[9:11:55 AM](#)

Mr. Barnhill replied that such an amount had been projected. However, because the compliant had yet to be filed, the amount should only be disclosed to the Committee in the confines of an executive session.

[9:12:22 AM](#)

Senator Thomas asked if the basis of the case would be errors or omissions on the part of the actuarial contractor.

[9:12:37 AM](#)

Mr. Barnhill affirmed that the Department has researched the situation extensively. He again declined to divulge further

detail, as it would be a more appropriate discussion held in an executive session.

[9:12:59 AM](#)

Co-Chair Hoffman announced his intent to convene an executive session in the future to receive a detailed overview on the situation. The issue was significant and had the potential to generate "several million dollars" for the State.

[9:13:21 AM](#)

Co-Chair Stedman surmised the \$12 million requested would fund the process through obtainment of a trial date and that an additional appropriation would be requested to fund the actual trial expenses.

[9:13:48 AM](#)

Mr. Barnhill corrected that \$12 million was the anticipated total cost, including a trial and any appeal. He could not guarantee the amount would be accurate, but assured it was the Department's best estimate.

[9:14:14 AM](#)

Senator Elton noted that the \$850,000 cost of the investigation portion of this effort had not been detailed. He asked whether the investigation was complete.

[9:14:38 AM](#)

Mr. Barnhill responded that "for all intents and purposes" the investigation was complete and that \$850,000 was the accurate cost.

[9:15:02 AM](#)

Senator Olson spoke to the process involved in lawsuits, noting that the case would not reach trial for one to two years. He therefore questioned the need to provide these funds as a FY 07 supplemental appropriation.

[9:15:36 AM](#)

Mr. Barnhill explained that the funding was requested before FY 08 to allow the Department to "get started now". The investigation was complete and the Department entered into a "tolling agreement" with Mercer Consulting last summer, which was anticipated to expire March 8, 2007.

[9:16:04 AM](#)

Co-Chair Hoffman contended that the State was ultimately responsible for funding the \$8 to \$10 billion unfunded liability. In retrospect the original employer contribution rates were too low and should have been higher. He asked why the Department of Law "feels" that the State had a "strong case" sufficient to justify a \$12 million expenditure.

[9:17:12 AM](#)

Mr. Barnhill reiterated the due to the nature of the claims he would defer his response until the executive session was convened.

Mr. Barnhill did share that in the investigation process, the Department contracted with other actuaries and a law firm with experience in this area. After review of the situation between the State and Mercer Consulting, these consultants concluded that the State has "good claims" for actuarial malpractice. This is consistent with the State's and the ARM Board's fiduciary duty to pursue these claims.

[9:18:03 AM](#)

Co-Chair Hoffman asked the "track record" of other companies' suits against actuaries.

[9:18:20 AM](#)

Mr. Barnhill answered that approximately six cases have occurred involving a pension fund claim of actuarial malpractice against an actuarial. The outcome of these cases was "mixed". Mercer Consulting had been sued by a company and the judge issued an award of \$3 million against a claim of \$23 million. Los Angeles County filed a claim for \$2 million against an actuary, which was settled for a confidential amount. A claim by the State of Texas was dismissed on summary judgment and is now being appealed. However, instances of success exist. The firm

contracted by the Department has had "great success" and therefore "we think we'll have great success".

[9:20:26 AM](#)

Office of the Governor

Section: 3

Department: Governor

RDU or Component: Elections

Supplemental Need: Funding for the costs associated with the April 3, 2007, special advisory election required by ch. 1, FSSLA 2006, on the subject of employment benefits for same-sex partners of public employees and retirees.

LFD Notes: Although a fiscal note identified costs associated with this election, the note never became an appropriation; this request does not provide duplicate funding.

\$1,156,300 General Funds

Ms. Rehfeld explained this item pertains to costs associated with the scheduled statewide election. The Division of Elections had begun efforts and had obligated funds.

[9:21:17 AM](#)

Senator Elton asked the amount spent to date.

[9:21:27 AM](#)

JIM MERRINER, Chief of Staff, Office of the Lieutenant Governor, testified that \$228,000 had been obligated to date.

[9:21:47 AM](#)

Senator Dyson understood that some absentee ballots had been mailed to voters. He asked the cost to stop the election process were this appropriation request not funded.

[9:22:12 AM](#)

Mr. Merriner answered, "Like I said, from what I understand, and I have the documentation here, it appears that \$228,000 had been obligated to date. In other words, by April 3rd, \$228,000 have already been obligated in terms of printing and so if for some

reason this supplemental was not to pass, we would have \$228,000 that the Elections would have to somehow come up with that money."

[9:22:56 AM](#)

Senator Dyson repeated his question that, if the election were cancelled, what would be the cost to mail notices to those who were mailed absentee ballots to disregard the ballots.

[9:23:22 AM](#)

Mr. Merriner did not have an estimate.

[9:23:28 AM](#)

Senator Dyson asked if any ballots had actually been mailed.

[9:23:33 AM](#)

Mr. Merriner responded that ballots had been printed, but he was unsure whether any absentee ballots had been mailed to voters.

[9:23:44 AM](#)

Co-Chair Hoffman asked if the election could only be cancelled through the passage of legislation; the election would still be held even if funding were not allocated.

[9:24:11 AM](#)

Ms. Rehfeld affirmed that without a change in statute, the Division would be required to continue with the election. The Department of Law has advised the Division on the actions necessary to conduct this election.

[9:24:42 AM](#)

Co-Chair Hoffman clarified that the only way the election could be canceled would be to pass legislation before the date of the election.

[9:24:55 AM](#)

Ms. Rehfeld shared this understanding.

[9:24:59 AM](#)

Mr. Merriner furthered that if the appropriation were not made, the Division would still incur costs, including the hiring of poll workers. However, the Division would be unable to pay the vendors and poll workers, ensuing in lawsuits for payment.

[9:25:55 AM](#)

Ms. Rehfeld then noted that Sections 4 through 7 pertain to Lapse Provisions, Retroactivity, and Effective Date.

[9:26:16 AM](#)

Co-Chair Hoffman established that the Committee had no questions on these items.

Co-Chair Hoffman ordered the bill HELD in Committee.

#SB82

[9:26:24 AM](#)

SENATE BILL NO. 82

"An Act making supplemental appropriations and other appropriations; amending the lapse dates of certain appropriations; and providing for an effective date."

This was the first hearing for this bill in the Senate Finance Committee.

[9:26:29 AM](#)

Ms. Rehfeld stated that the total appropriation request in this legislation was \$33,071,700, all of which is general funds. The intent was to assist efforts to construct a natural gas pipeline, get natural gas to market and address other oil-related issues.

[9:27:27 AM](#)

Department of Law

Section: 1

Department: Law

Results Delivery Unit (RDU) or Component: Capital - Oil, Gas & Mining

Supplemental Need: Work related to the state gas pipeline and bringing North Slope natural gas to market, and other oil and gas projects. The Department of Law's Oil, Gas & Mining section continues to play a major role in the State's top priority project related to the construction of a gas pipeline and bringing natural gas to market. A number of contracts with outside counsel and experts are underway and will continue to be needed as negotiations continue. In addition the Department of Law anticipates the Exxon Royalty Reopener will go to trial in either FY 07 or FY 08 and continues to prepare for a four to five week hearing before the Federal Energy Regulation Committee (FERC) considering (in part) the state's and Anadarko's challenges to the TransAlaska Pipeline Service (TAPS) 2005 FERC tariff.

Legislative Finance Division (LFD) Notes: Anticipated expenditures: FY 07: \$8,700,000; FY 08: \$12,800,000  
\$21,500,000 General Funds

LARRY OSTROVSKY, Chief Assistant Attorney General, Statewide Section Supervisor, Oil, Gas and Mining Section, Civil Division, Department of Law, testified that he would "put this request from the Oil, Gas and Mining Section into some context", given the significant amount. The appropriation was "divided between" approximately \$9 million for expenditure in FY 07 and approximately \$12.8 million for expenditure in FY 08. He explained, "The reason we rolled these together is because we tend to look at lawsuits not in terms of fiscal years, but in terms of the life of a suit. So we looked at the year ahead, especially since it's February already."

Mr. Ostrovsky spoke to the decision to submit the request as a supplemental appropriation rather than included in the FY 08 budget. He divided the Oil, Gas and Mining Section into two categories; litigation and non-litigation, the second of which he defined as "gasline".

[9:29:29 AM](#)

Mr. Ostrovsky stressed that the natural gas pipeline project was the highest priority of the Murkowski Administration, and was

likely the highest priority of the Palin Administration as well. Combined in FY 06 and FY 07, almost \$10.5 million was expended on this effort. This amount was more than anticipated during the drafting of the regular budget proposals. It was expected that a contract would be agreed upon with producers by January 2006 and that the Legislature would approve that contract during that legislative session. Instead, the contract was not released until May, two special sessions were held and the contract was still not approved.

[9:30:43 AM](#)

Mr. Ostrovsky informed that 90 percent of the Section's efforts were spent on activities not related to the natural gas pipeline, but rather on litigation and providing advice to State agencies. In FY 06 and FY 07, the Division expended \$8.89 million for outside council. The recovery from that expenditure was over \$92 million; a "better than ten-to-one ratio." This ratio was "historically typical". He knew of no case that the Division prosecuted in which the State had not recovered the fees invested as well as "quite a bit more." This was not "necessarily because we're the world's greatest lawyers," but because the State only pursues those cases in which it determines to have the strongest evidence to support a favorable verdict, such as payments owed by taxpayers, royalty owed by a lease holder, or issues pertaining to pipeline tariff.

[9:32:08 AM](#)

Mr. Ostrovsky identified the Trans Alaska Pipeline System (TAPS) tariff as requiring the largest portion of the requested appropriation, with the exception of the natural gas pipeline efforts. A proceeding was currently before the Federal Energy Regulatory Commission (FERC). A hearing lasting two and one-half months recently concluded in Washington D.C. and the matter was "in the post hearing briefing."

Mr. Ostrovsky remarked that this case had "enormous consequences to the State." Three years ago, the Regulatory Commission of Alaska (RCA) determined that the "just and reasonable" tariff on oil transported through TAPS for in-state use was approximately \$1.96 per barrel.

[9:33:07 AM](#)

Mr. Ostrovsky stated that the TAPS owners "filed with the FERC for a tariff" for 2005 "and going forward a tariff north of \$5.00". This was the same "barrels of oil traveling through the same pipeline" with a tariff of \$1.96 for intrastate-bound oil and over \$5 for interstate-bound oil. The State's royalties and taxes were "based on a net back". He described this as follows. "You look at a barrel of oil - you back out the transportation costs."

Mr. Ostrovsky explained, "Where the two sides are now, between \$5 and \$1.96, has an impact we estimate in taxes and royalties of almost \$100 million a year through the life of TAPS" according to the provisions of the TAPS settlement agreement. The agreement could "end as soon as 2009 or continue to 2011".

Mr. Ostrovsky reiterated, "This is a case with large stakes", and noted that "big cases such as this tend to be very expensive cases" due to higher rates for attorneys with experience before the FERC. The Department estimated approximately \$2.5 million would be expended on this case in the current year and approximately \$1.3 million on this case "and some other tariff related cases" in the following year.

Mr. Ostrovsky informed that the TAPS owners "did a strategic reconfiguration" of the TAPS "line", which had "exceeded costs by hundreds of millions of dollars", which may not be "prudently incurred costs." Those costs not prudently incurred should not be "rolled into the rate base."

Mr. Ostrovsky then told of several corporate income tax cases. He was unable to discuss the details of these cases in a public session because the name of the taxpayer must be kept confidential. These cases were "worth many many millions of dollars" and due the size and nature of the cases, which were "document intensive", are also expensive to pursue. The taxpayers are international corporations and the process of determining the income subject to Alaskan taxes is extensive.

Mr. Ostrovsky gave an example of a case in which the first set of materials received in the discovery process contained over 200,000 documents. He predicted that the State would receive "many many times this" before the case was complete.

Mr. Ostrovsky reported that the Department was also involved in "a number of royalty matters that probably won't be that

expensive" and would likely be handled in arbitration. Royalty matters were addressed almost every year and subjected to arbitration. Approximately \$1.5 million had been expended on these matters involving outside counsel in the past year with a return to the State of over \$23 million. Of the cases handled internally, the Department had recovered approximately \$44 million.

[9:36:43 AM](#)

Mr. Ostrovsky admitted that expenses were underestimated for the Point Thomson litigation. He originally projected the cost at approximately \$1 million because it was expected to be addressed as an administrative appeal. Administrative appeals "tend to be easier cases to handle because there's a finite record ... briefing and oral argument in front of the court". The expenses of discovery and trial preparation are not incurred. However, "that case has morphed into something far larger" and currently involve five lawsuits. Exxon Mobil, Chevron, Conoco Phillips and BP filed appeals, each in separate cases. Additionally, Exxon Mobile filed an "original action for breach of contract to the Point Thomson Unit Agreement" and was requesting damages. Outside counsel would be employed for these cases, some of which have been consolidated. These cases would be "very expensive to manage."

[9:38:23 AM](#)

Mr. Ostrovsky stated that efforts related to the proposed natural gas pipeline project would also require funding. He had anticipated expenditures for the previous year to be \$500,000 per month, an amount precipitated by the use of "\$500 per hour lawyers". The continuation of this level of expenditure would be dependant upon Governor Palin's "approach". The approach taken by former Governor Murkowski was "very very lawyer intensive" involving "many many months of negotiations." The Governor's office had "controlled the pace and scope of things" through "meeting law" with many qualified attorneys spending considerable time in Juneau and Anchorage "a lot of times sort of waiting for things to happen."

Mr. Ostrovsky noted that the current Administration had indicated a different approach. The Department of Law had been given more control over budgetary items, including costs related to the natural gas pipeline project. A new firm had been engaged

to assist the Department in addition to Morse and Forrester, a firm used by the State for 35 years. A third firm, based in Washington D.C., had represented the Alaska Legislature and had also been hired by the Department.

[9:40:20 AM](#)

Mr. Ostrovsky reported that "almost nothing", which he defined as "the few hundreds of thousands" of dollars had been spent on the natural gas pipeline project effort during the months of December 2006 and January 2007, while the Palin Administration was being established. However, if a gas pipeline agreement was passed, significant work would be required to progress the matter through the FERC process. This process would "define the scope and the tariffs and this and that."

[9:41:19 AM](#)

Mr. Ostrovsky totaled the aspects of his comments as justification of his request of \$8.75 million for FY 07 and \$12.8 million for FY 08. Approximately \$500,000 per month would be expended on natural gas pipeline efforts and the remainder would be expended on litigation matters.

[9:41:37 AM](#)

Mr. Ostrovsky remarked that a "perfect storm of important matters - matters that are really significant to the State treasury at this time" has occurred.

[9:41:47 AM](#)

Co-Chair Hoffman commented on the large amount of this proposed appropriation. He requested a detailed accounting of expenditures intended for FY 07 and those anticipated for FY 08, as well as projected expenditures on the matter before FERC regarding justification of a \$5 per barrel tariff and expenditures relating to the proposed natural gas pipeline.

[9:42:42 AM](#)

Co-Chair Hoffman asked the witness's opinion of whether the decrease in the amount of oil transported through the TAPS was the justification of the increased tariff.

[9:43:07 AM](#)

Mr. Ostrovsky deferred to the Assistant Attorney General assigned to this case to provide details. He agreed that, as the flow decreases in the pipeline, the cost per barrel increases. Conversely, this was balanced against depreciated assets, which were also countered with new investment in the pipeline. The RCA had considered all these factors, in addition to "a reasonable rate of return" to the TAPS owners, to determine the \$1.96 per barrel rate. The TAPS owners subsequently requested "more for interstate" transport. The State argued based on the "Interstate Commerce Clause", that discrimination should not be allowed between interstate and intrastate "barrels" and requested that FERC utilize the RCA methodology for determining a reasonable rate of return. However, the TAPS owners argue in support of "exactly the opposite" solution, which would require the FERC to increase its tariff to match the RCA tariff.

[9:44:44 AM](#)

Co-Chair Hoffman asked whether, given the significance of the FERC determination, it would set a precedence of increased tariffs as production on the North Slope continues to decline.

[9:45:06 AM](#)

Mr. Ostrovsky affirmed. The tariff methodology was "one of the most significant fiscal issues facing us because the dollars are so large."

[9:45:28 AM](#)

Co-Chair Hoffman asked if production was currently approximately fifty percent of peak production.

[9:45:34 AM](#)

Mr. Ostrovsky guessed the peak flow was approximately two million barrels per day and the current rate was approximately 800,000 barrels per day.

[9:45:40 AM](#)

Co-Chair Hoffman asked the history of tariffs at peak production compared to the current FERC-recommended tariff of over \$5 per barrel.

[9:45:53 AM](#)

Mr. Ostrovsky deferred to Philip Reeves, the attorney handling this matter. Mr. Reeves could provide a written or oral history of the TAPS Settlement Agreement, which established the rates, as well as information related to the current matter. Litigation began on the rate system "almost as soon as the TAPS line was built" and was resolved after "many years", addressing tariff depreciation, cost per barrel allowances, and other relevant matters. The settlement agreement was open to renegotiation starting in 2007. The State could vacate that agreement two years after providing notice and "attempting" to renegotiate its provisions. The State provided such notice on January 1. He anticipated that the State would enter into negotiations with the TAPS owners to attempt to reduce tariffs. However, this process was awaiting the outcome of the current litigation.

[9:47:32 AM](#)

Co-Chair Hoffman requested Mr. Reeves' information be submitted in written form to the Committee.

[9:47:44 AM](#)

Senator Thomas, referencing testimony taken by the Senate Resources Committee from industry representatives, asked if the State had reserved adequate funding for litigation relating to PPT.

[9:48:07 AM](#)

Mr. Ostrovsky was unsure. More information would be available after the first tax payments were made and after the Department of Revenue has reviewed the filings.

[9:48:33 AM](#)

Senator Thomas requested additional explanation of the cost overruns of the TAPS litigation. He understood the process was not completed.

[9:48:53 AM](#)

Mr. Ostrovsky replied that the project was originally budgeted at approximately \$250 million. An updated estimate of over \$450 million was issued last year and the cost had increased since. Factors included parts that were ordered with incorrect specifications. Normal care and diligence in engineering and design would prevent some of the expenditures.

[9:49:37 AM](#)

Senator Thomas asked the success rate of related litigation in the past 30 years.

[9:49:54 AM](#)

Mr. Ostrovsky shared his experience of the last year and one-half of a success ratio of ten to one. He recalled prior success as "very substantial". Industry representatives claim that such success "leads to a climate of uncertainty" because retroactive payments were required. However, the Department considers its duty to "hold people to their obligations". Asserting the State's rights and requiring parties to fulfill their obligations does not create such a climate of uncertainty. Rather, the climate of uncertainty is created when a party pays less than what is owed.

[9:51:23 AM](#)

Department of Natural Resources

Section: 2(a)

Department: Natural Resources

RDU or Component: Capital

Supplemental Need: Gas Pipeline Analysis

Outside experts and consultants will be retained for work related to the gas pipeline, including outside legal counsel and experts on federal pipeline law and FERC procedures. A consultant to advise the state on crafting an RFP [request for proposals] consistent with the Alaska Gasline Inducement Act (AGIA) for gasline proposals and with analyzing those proposals under AGIA for gasline proposals and with analyzing those proposals under AGIA will also be retained.

LFD Notes: RFP Consultant: \$4.5 million

FERC Experts and Outside Counsel: \$1.25 million  
Additional Work Needs: \$800,000  
\$6,550,000 General Funds

NICO BUS, Director, Division of Support Services, Department of Natural Resources, detailed the request that would be expended in two fiscal years. Experts would be contracted to address FERC procedure, tariffs, cost overrun, royalty evaluation, enforcement, remedies, lease terms and other matters. The consultant would subcontract many of the activities. Of the appropriation, \$4.135 million would be expended in FY 07 and \$2.4 million would carry forward to FY 08.

[9:53:12 AM](#)

Co-Chair Hoffman asked the portion of this appropriation that would be related to the Governor's proposed Alaska Gasline Incentive Act.

[9:53:29 AM](#)

Mr. Bus responded that the entire appropriation would be directed toward the effort.

[9:53:48 AM](#)

Co-Chair Hoffman asked why the funds were not requested in the form of a fiscal note accompanying the proposed legislation rather than as a supplemental appropriation request.

[9:53:56 AM](#)

Mr. Bus expressed intent to begin efforts in February, before the effective date of the proposed legislation.

[9:54:17 AM](#)

Senator Elton asked if a system exists to overlap receipt of services from outside counsel on FERC matters.

[9:54:57 AM](#)

Mr. Ostrovsky answered that such oversight is conducted. He described in detail how the Department of Natural Resources request included provisions pertaining to legal services and how

other expert services would be billed as subcontract work through the primary legal services contractor. He told of the legal advice necessary for drafting the request for proposals in addition to other types of advice.

[9:57:49 AM](#)

Senator Elton recalled serving in the Executive Branch and the requirement at the time that any outside legal counsel be secured through the Department of Law.

[9:58:15 AM](#)

Mr. Ostrovsky affirmed that the Department of Law hires the legal counsel. However, experts in other fields are sometimes billed through legal counsel as subcontractors.

[9:59:27 AM](#)

Mr. Bus assured that duplication of services would not occur. The Department of Natural Resources requires some legal expertise, which it obtains through the Department of Law.

[9:59:53 AM](#)

Co-Chair Hoffman pointed out that \$4.5 million was requested for efforts to ensure that the proposed natural gas pipeline project be competitive for all applicants. The projected cost of the project itself had increased to \$30 billion and would be one of the largest construction projects in North America. He questioned the expenditure of \$4.5 million given the unlikelihood that just one oil company would construct the pipeline. Instead, a group of producers, such as those involved in the contract negotiated by the Murkowski Administration, would likely undertake the project.

[10:01:39 AM](#)

Mr. Bus replied that the request for proposals was necessary to determine the benefit of such activities. If a party other than the three producers that were involved in the previous pending contract submitted a "better offer" the \$4.5 million would have been a worthwhile investment.

[10:02:04 AM](#)

Co-Chair Hoffman asked if this would apply given the parties that owned the rights to the gas reserves.

[10:02:16 AM](#)

Mr. Bus answered yes.

[10:02:22 AM](#)

Section: 2(b)

Department: Natural Resources

RDU or Component: Capital

Supplemental Need: Oil and Gas Lease Litigation

This project will help offset the costs of litigation arising out of the DNR's exercise of the state's rights under its leases and the unit agreement (Point Thomson appeal). This request will help fund the costs of outside experts and legal counsel.

LFD Notes: The Point Thomson appeals were filed in December 2006, so funding is not included in the current FY 07 or FY 08 budget.

\$1,500,000 General Funds

Mr. Bus outlined this request.

[10:03:02 AM](#)

Mr. Ostrovsky interjected that he had overviewed this matter in his earlier statement. The Department of Natural Resources would employ experts, which would be hired as subcontractors to outside legal counsel secured by the Department of Law.

[10:04:28 AM](#)

Section: 4(a)

Department: Natural Resources

RDU or Component: Gas Pipeline

Supplemental Need: Extend lapse date from June 30, 2007, to June 30, 2008, for the Bullen Pt. Road right-of-way permitting multi-year allocation in sec. 7(d)(1), ch. 6, SLA 2005, pg. 11, as amended by sec. 34(c), ch. 82, SLA 2006, pg. 151. The amount expected to be available is \$100,000. The lapse extension also applies to sec. 7(d)(2) Division of Oil and Gas Increased Workload, which expects

\$150,000 to be available. The lapse extension also applies to sec. 7(d)(3) Commissioner's Office increased workload. This allocation is expected to be fully expended by June 30, 2007.

LFD Notes: As of 2/20/07:

Bullen Pt. Road appropriation, original amount = \$2,400,000 and the current balance = \$534,000  
Oil & Gas Increased Workload appropriation, original amount = \$2,025,000 and the current balance = \$776,300  
Commissioner's Office. Workload appropriation, original amount = \$150,000 and the current balance = \$86,600

\$0

Mr. Bus outlined the four elements of this item.

[10:05:46 AM](#)

Co-Chair Hoffman asked the status of the road project and why the project was behind schedule.

[10:05:55 AM](#)

Mr. Bus explained the road would link Point Thomson to the North Slope road system and must be completed to allow for development of a natural gas pipeline.

[10:06:26 AM](#)

Co-Chair Hoffman again asked why the project was not on schedule.

[10:06:31 AM](#)

Mr. Bus spoke to the lengthy permitting process through the US Corps of Engineers, and the need to begin the process early to allow for this project to proceed.

[10:06:56 AM](#)

Senator Olson asked the number of employees that would be hired.

[10:07:06 AM](#)

Mr. Bus responded that consultants, including surveyors, would be utilized for the Bullen Point road project. The appropriation requested for the increased workload of the Office of the Commissioner would be utilized to continue funding staff positions within the Commissioner's Office as well as the Division of Oil and Gas.

[10:07:32 AM](#)

Senator Olson asked if all the positions would be located in Anchorage.

[10:07:35 AM](#)

Mr. Bus affirmed.

[10:07:37 AM](#)

Senator Olson asked the intended status of the positions employed to secure the right of way on the Bullen Point Road once that project was permitted.

[10:07:47 AM](#)

Mr. Bus replied that the personnel needs of the Bullen Point Road permitting process were mostly contracted. Once the permitting process was complete, the Department of Transportation and Public Facilities could begin construction of the road.

[10:08:01 AM](#)

Senator Elton asked the location of the proposed road.

[10:08:09 AM](#)

Mr. Bus explained that the proposed road would connect Point Thomson to the Haul Road.

[10:08:17 AM](#)

Senator Elton asked if the project should be held until other issues involving Point Thomson were resolved.

[10:08:28 AM](#)

Mr. Bus stressed the need to develop the infrastructure necessary to develop the resources at Point Thomson. The reserves at the Point Thomson field were significant and securing the right of way to the site was a critical aspect of construction of a natural gas pipeline.

[10:08:55 AM](#)

Senator Elton understood but surmised that lease ownership disputes of the Point Thomson resources were "getting in the way" of infrastructure development.

[10:09:15 AM](#)

Mr. Bus gave an analogy of the unfeasibility of a subdivision that had no access to it.

[10:09:34 AM](#)

Senator Elton asked the length of time to construct the road once the permits were issued.

[10:09:56 AM](#)

Mr. Bus deferred to Mr. Banks.

[10:10:04 AM](#)

KEVIN BANKS, Acting Director, Division of Oil and Gas, Department of Natural Resources, testified via teleconference from an offnet location to the importance of an access road to Point Thomson. This field contained one of the largest concentrations of undeveloped resources in North America and construction of a road would occur. Permits should be obtained now because the litigation would not continue for "decades".

[10:11:20 AM](#)

Senator Thomas asked the location on the Haul Road that the Bullen Point Road would intersect. He asked if the site would be on the downhill side of the security gates, or through territory with existing industry claims on the eastern side.

[10:11:45 AM](#)

Mr. Banks would confirm his understanding that the new road would intersect the Haul Road "above" the security gate.

[10:12:00 AM](#)

Senator Olson asked what entity would own and maintain the road once it was completed.

[10:12:13 AM](#)

Mr. Banks responded that the State would initially own the right of way, which would be transferred to the leaseholder. Similar to the operation of other roads located on the North Slope, the Bullen Point Road would be maintained by the owner of the right of way. Timing would determine the party that would actually construct the road. If the State transferred the right of way to the lessee before construction, the lease holder would build and maintain the road. This scenario was the expectation of the Department.

[10:14:09 AM](#)

Senator Elton asked if the right of way were transferred after construction was complete, whether the lessee would reimburse the State for the construction cost.

[10:14:33 AM](#)

Mr. Banks was unsure.

[10:14:42 AM](#)

Senator Elton requested the history of instances in which the State secured permits and right of ways then transferred ownership.

[10:15:05 AM](#)

Mr. Bus assured he would provide this information.

[10:15:09 AM](#)

Co-Chair Hoffman asked who the current landowner was.

[10:15:15 AM](#)

Mr. Bus replied that the State and the federal government owned different portions of the land in question.

[10:15:23 AM](#)

Co-Chair Hoffman clarified that none of the land was owned by a Native corporation.

[10:15:27 AM](#)

Mr. Bus indicated he would verify this.

[10:15:39 AM](#)

Section: 4(b)

Department: Natural Resources

RDU or Component: Gas Pipeline

Supplemental Need: Extend lapse date from June 30, 2007, to June 30, 2008, for the gas pipeline risk analysis and royalty issues multi-year allocation in sec. 20(c)(1), ch. 3, FSSLA 2005, pg. 107, line 2. The amount expected to be available is \$1,500,000. The lapse extension also applies to sec. 20(c)(2) gas pipeline corridor geologic hazards and resource evaluation. This allocation is expected to be fully expended by June 30, 2007.

LFD Notes: AS of 2/20/07:

Gas Pipeline Risk Analysis appropriation, original amount = \$2,500,000 and the current balance = \$1,661,600

Gas Pipeline Corridor Geologic Hazards & Resource Evaluation appropriation, original amount = \$2,000,000 and the current balance = \$71,500

\$0

Mr. Bus outlined portions of this request. The Corridor would be located between Delta and the Canadian border.

[10:16:55 AM](#)

Section: 4(c)

Department: Natural Resources

RDU or Component: Gas Pipeline

Supplemental Need: Extend lapse date from June 30, 2007, to June 30, 2008, for the Bullen Pt. Road right-of-way permitting multi-year allocation in sec. 20(d), ch. 82, SLA 2006, Pg. 151. The amount expected to be available is \$800,000. The lapse extension also applies to sec. 20(d)(2) Division of Oil and Gas Increased Workload. This allocation is expected to be fully expended by June 30, 2007. The lapse extension also applies to sec. 20(d)(3) Commissioner's office increased workload, which expects \$10.0 to be available.

LFD Notes: As of 2/20/07:

Bullen Point Road Right-of-Way Permitting appropriation, original amount = \$800,000 and the current balance = \$800,000

Oil & Gas Increased Workload appropriation, original amount = \$675,000 and the current balance = \$106,100

Commissioner's Office. Workload appropriation, original amount = \$50,000 and the current balance = \$20,000

\$0

Mr. Bus explained this item was similar to that of Section 4(a).

[10:17:48 AM](#)

Co-Chair Hoffman requested an overview of the expenditures made to date.

[10:18:02 AM](#)

Senator Thomas, returning to Section 4(b), asked for an explanation of the resource evaluation.

[10:18:16 AM](#)

Mr. Bus replied that geologists would study the proposed pipeline corridor to determine any geological hazards such as fault lines. At the same time, the geologists would identify gravel extraction sites for utilization during construction.

[10:18:51 AM](#)

Co-Chair Hoffman asked if this project would require an Environmental Impact Statement (EIS) study.

[10:19:06 AM](#)

Mr. Banks responded that the portions of the corridor located on federal lands could require an EIS; however, because the corridor would be onshore, a full EIS might not be required. Determination would depend upon the US Corp of Engineers assessment of the construction project.

[10:20:11 AM](#)

Department of Revenue

Section: 3(a)

Department: Revenue

RDU or Component: Capital

Supplemental Need: Commercialization of North Slope Gas

\$419,500 - two internal economists to work on gasoline issues

\$1,630,000 for two contractual economists and/or commercial analysts' firms to assist in modeling and analyzing tax incentives and impacts, marketing options and criteria to evaluate applicants and proposed projects

\$50,900 for other costs, including financial and legal research

LFD Notes: The funding for the two economists (currently on staff) is based on 17 months work; the funding for contractual economic and legal analysis is an estimate of what might be needed under AGIA

\$3,000,000 General Funds

JERRY BURNETT, Director, Administrative Services Division, Department of Revenue, outlined this item, testifying that the Department would coordinate with the Department of Natural Resources and the Department of Law to ensure that no duplication of legal work occurred.

[10:21:17 AM](#)

Co-Chair Hoffman again noting that this appropriation was intended for expenditures related to legislation that would be introduced at the request of Governor Palin, asked why it was not contained in a fiscal note rather than as a supplemental budget item.

[10:21:39 AM](#)

Mr. Burnett understood the pending legislation would be introduced the following week and would pass into law after full review by the Legislature. The intent is to begin working on analysis efforts prior to the bill's adoption. This was especially important with regard to upgrading the capabilities of the Department's economists.

[10:22:31 AM](#)

Co-Chair Hoffman asked if the economists would be hired solely for the term of this project.

[10:22:37 AM](#)

Mr. Burnett responded that the length of employment would depend upon the terms of the contract as well as needs for additional work. The positions would be hired as "project economists".

[10:23:27 AM](#)

Senator Olson pointed out that the previous expert hired by the Department was Pedro Van Meurs. Senator Olson asked the intended expenditure on expert services for AGIA, noting the request of over one million for "specialized legal counsel".

[10:23:59 AM](#)

Mr. Burnett answered that during the Murkowski Administration the departments of Law, Revenue and Natural Resources expended approximately \$24.9 million on legal counsel, economists and other expert services. Mr. Van Meurs was paid a total of \$2.8 million by the State. Mr. Burnett could not provide an estimate of future expenditures.

[10:24:59 AM](#)

Section: 3(b)  
Department: Revenue  
RDU or Component: Tax Division  
Supplemental Need: Petroleum Production Tax (PPT)  
implementation costs:

\$521,700 for three positions and contracts for developing regulations, expenses for public hearings and legal advice on regulations  
Fiscal note identifies almost \$1.4 million for a full years implementation. That is the amount requested for FY 08. This is identified as the bare minimum necessary for FY 07.  
\$521,700 General Funds

Mr. Burnett stated that this funding was necessary to implement the provisions of HB 3001 adopted by the 24th Legislature. That bill included a fiscal note for \$1.4 million, although an appropriation was never made and subsequently no funding was provided to implement the Petroleum Profits Tax (PPT). The Department had begun implementation efforts, including computer programming and proposing regulation, to allow for the collection of the tax. The first payment was due the following week.

[10:26:53 AM](#)

Section: 3(c)  
Department: Revenue  
RDU or Component: Tax Division  
Supplemental Need: Language to allow the department to make refunds for capital expenditures and lease bids as provided in the PPT, AS 43.55.023(f).  
LFD Notes: This language appropriates the funding for the transferable tax credit refunds in FY 07. Expected to be significantly less the projected \$25 million in the Gov's FY 08 budget.  
\$0

Mr. Burnett relayed that Department analysis predicted that the claimed tax credits would be less than \$25 million as originally projected.

[10:27:44 AM](#)

Section: 4(b)  
Department: Revenue  
RDU or Component: Commissioner's Office  
Supplemental Need: Extend lapse date from June 30, 2007, to June 30, 2008, for the gas pipeline development multi-year appropriation made in sec. 20(e), ch. 3, FSSLA 2005, pg.

107, line 13. The amount expected to be available is \$100,000.

LFD Notes: Funding is being used in FY 07 to fund the 2 exempt gasline economists currently working for the department. FY 08 funding for these positions is being requested in the \$3 million request in 3(a) above.

\$0

Item: 12

Section: 4(b)

Department: Revenue

RDU or Component: Alaska Natural Gas Development Authority

Supplemental Need: Extend lapse date from June 30, 2007, to June 30, 2008, for the gas pipeline development multi-year appropriation made in sec. 20(f), ch. 3, FSSLA 2005, pg. 107, line 16. The amount expected to be available is \$500,000.

\$0

Mr. Burnett explained these items pertain to lapse date extensions.

[10:28:19 AM](#)

Senator Elton cited a memorandum dated February 9, 2007 from Eric Swanson of the Department of Administration to Joan Brown of the Office of Management and Budget [copy on file] in support of this appropriation. The memorandum reads in part, "Litigation with EXXON over Pt. Thomson has interrupted the flow of necessary data from that operator to our staff and consultants."

Senator Elton requested background information. He remarked that "some kind of mission" must continue regardless of litigation and an obligation by the party to provide information.

[10:29:10 AM](#)

Mr. Burnett would provide additional information.

[10:29:18 AM](#)

Co-Chair Hoffman also expressed interest in this matter.

[10:29:36 AM](#)

Senator Thomas asked whether the State would provide funding to the Alaska Natural Gas Development Authority (ANGDA) for efforts to develop a natural gas pipeline.

[10:30:11 AM](#)

Mr. Burnett responded that funding for the Authority was not included in the Governor's proposed budget. He alluded to a request of \$5 million for ANGDA. The Department of Revenue would not "sponsor" this request, but would not oppose it either.

[10:30:47 AM](#)

Senator Thomas asked if the reason was to avoid indication of a bias toward ANGDA because a natural gas pipeline proposal based on interstate use of natural gas could be made in competition to other proposals.

[10:31:11 AM](#)

Mr. Burnett affirmed.

[10:31:22 AM](#)

Department of Administration

Section: 4(b)

Department: Administration

RDU or Component: Alaska Oil and Gas Conservation Commission

Supplemental Need: Extend the lapse date from June 30, 2007, to June 30, 2008, for the gas pipeline development multi-year appropriation made in sec. 20(a), ch. 3, FSSLA 2005, pf. 106, line 21. The amount expected to be available is \$250,000

LFD Notes: \$1.2 million was appropriated for FY 06-07. \$950,000 already obligated through the end of this year leaving \$250,000 balance. This extension will allow the department to wrap up current work on studies needed to set gas off take rates for Pt. Thomson.

\$0

ERIC SWANSON. Director, Division of Administrative Services, Department of Administration, testified to this item. The

Department expected to encumber approximately \$322,000 of this appropriation during the remainder of FY 07.

[10:32:34 AM](#)

Senator Elton asked if the witness was aware of the situation in which Exxon was not supplying necessary data to staff and consultants.

[10:33:02 AM](#)

Mr. Swanson did not have this information but would speak to the chair of the Alaska Oil and Gas Commission (AOGC).

[10:33:22 AM](#)

Ms. Rehfeld announced this concluded overview of the supplemental requests in this legislation.

Co-Chair Hoffman ordered the bill HELD in Committee.

#

**ADJOURNMENT**

Co-Chair Lyman Hoffman adjourned the meeting at [10:34:19 AM](#)