

SENATE FINANCE COMMITTEE
February 13, 2008
9:03 a.m.

CALL TO ORDER

Co-Chair Hoffman called the Senate Finance Committee meeting to order at [9:03:11 AM](#).

MEMBERS 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

MEMBERS ABSENT

None

ALSO PRESENT

Karen Rehfeld, Director, Office of Management and Budget; Pat Pitney, Vice President, Budget and Planning, University of Alaska; Nancy Slagle, Director, Division of Administrative Services, Department of Transportation and Public Facilities; Pat Galvin, Commissioner, Department of Revenue; Michael D. Williams, Chief Economist, Tax Division, Department of Revenue; Jerry Burnett, Director, Division of Administrative Services, Department of Revenue.

PRESENT VIA TELECONFERENCE

Michelle Rizk, Director of Budget, University of Alaska; Pat Pitney, Vice Chancellor, Administrative Services, University of Alaska.

SUMMARY

SB 256 "An Act making supplemental appropriations, capital appropriations, reappropriations, and other appropriations; amending certain appropriations; ratifying certain expenditures; making appropriations to capitalize funds; and providing for an effective date."

SB 256 was HEARD and HELD in Committee for further consideration.

[9:03:19 AM](#)

SENATE BILL NO. 256

"An Act making supplemental appropriations, capital appropriations, reappropriations, and other appropriations; amending certain appropriations; ratifying certain expenditures; making appropriations to capitalize funds; and providing for an effective date."

DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES

Section 7 - 9. Statewide Aviation: Funding for Southeast Airport Leasing Officer

Funding of this existing position, located in Juneau, will increase the direct contact with airport tenants and on-site airport management personnel which will lead to better oversight of airport tenant operations. Duties of this position include negotiating leases, permits and concession agreements that generate revenues sufficient to cover the costs of this position.

\$35,000

NANCY SLAGLE, DIRECTOR, DIVISION OF ADMINISTRATIVE SERVICES, DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES (DOT/PF), stated the item requests \$35,000 in receipt supported services authority to add a position for a leasing officer for Southeast region to deal with rural airport leasing issues. There is a backlog of work that needs to be addressed. The receipt supported services are generated by airport leasing revenues that the position would collect.

Section 7 - 9. Measurement Standards and Commercial Vehicle Enforcement: Travel to remote sites for inspections.

Alaskan businesses are more frequently requesting Weights and Measure Inspectors to perform an inspection or re-inspection outside of the normal inspection cycle. When this occurs, the business requesting the inspection agrees to pay for all costs associated with the trip. In the past, the overall amount of trips was minimal, but the number of trips has been steadily increasing over the past several years as companies become aware of this service.

\$30,000

Ms. Slagle reported the item as requesting receipt supported services authority for measurement standards and commercial vehicle enforcement. It allows the department to receive and

expend monies for third party individuals requesting a certification of weighing or measuring devices in rural areas. The requests are outside the normal routine or have failed previous inspection. The community provides funding for the department to travel to do the inspection.

Section 7 - 9. State Equipment Fleet: Credit card payments for increased cost of fuel.

The State Equipment Fleet (SEF) maintains contracts which allow a vehicle credit card to be used to purchase fuel and necessary consumables. These charges are paid directly by SEF and subsequently, SEF bills executive branch state agencies for reimbursement.

\$326,000

Ms. Slagle informed the committee that the item requests funds for the equipment fleet to receive and expend monies specifically related to fuel costs. They hold the main contract for all state vehicles for fuel and administer the credit card process.

Section 7 - 9. Central Region Facilities: Fuel and Utility Increases.

Fuel prices continue to be higher than our base funding level of \$1.84/gallon and additional funding provided through Sec 22, Ch 28, SLA 2007. Likewise, utility rates (electricity, natural gas, water/sewer, waste disposal) have continued to rise and require additional funding. Janitorial Contract Increases \$58.4 - Central Region Facilities has 12 janitorial contracts that service 18 facilities throughout Central Region. Numerous contracts expired and were rebid resulting in net price increases.

\$315,800

Section 7 - 9. Northern Region Facilities: Fuel and Utility Increases

Fuel prices continue to be higher than our base funding level of \$1.93/gallon and additional funding provided through Sec 22, Ch 28, SLA 2007. Likewise, utility rates (electricity, natural gas, water/sewer, waste disposal) have continued to rise and require additional funding.

Section 7 - 9. Southeast Region Facilities: Fuel Increases

Fuel prices continue to be higher than our base funding level of \$2.37/gallon and additional funding provided through Sec 22, Ch 28, SLA 2007. Janitorial Contract Increases \$35.1 - The Juneau 7-Mile Complex, AMHS Reservations Building and the Ketchikan Court and Office Building are currently under contract for janitorial services. In June 2006, the three year contracts for both 7-Mile Complex and the AMHS Reservations Building were scheduled to expire. In May 2006 Invitations to Bid were advertised for new three year contracts. The low bid for this combined contract came in higher than the total of the previous contracts.

Ms. Slagle explained that the three items relate to DOT/PF's three regional facilities components. The majority of the items request funding for fuel and utility cost increases. She reminded the committee of a separate appropriation that has provided for fuel and utilities above what is in the department's base, and emphasized that the appropriation was not increased for FY 08; the items cover increases above that amount. In addition, the Central and Southeast Region items include increased costs for janitorial contracts that were changed through re-bidding or through expiration and re-bidding.

Ms. Slagle commented that the next three items were related to increased fuel costs, specific to highways and aviation:

Section 7 - 9. Central Region Highways and Aviation Fuel and Utility Increases

Fuel prices continue to be higher than our base funding level of \$1.84/gallon and additional funding provided through Sec 22, Ch 28, SLA 2007. Likewise, utility rates (electricity, natural gas, water/sewer, waste disposal) have continued to rise and require additional funding.

Section 7 - 9. Northern Region Highways and Aviation Fuel and Utility Increases

Fuel prices continue to be higher than our base funding level of \$2.01/gallon and additional

funding provided through Sec 22, Ch 28, SLA 2007. Likewise, utility rates (electricity, natural gas, water/sewer, waste disposal) have continued to rise and require additional funding.

Section 7 - 9. Southeast Region Highways and Aviation Fuel and Utility Increases

Fuel prices continue to be higher than our base funding level of \$1.84/gallon and additional funding provided through Sec 22, Ch 28, SLA 2007. Likewise, utility rates (electricity, natural gas, water/sewer, waste disposal) have continued to rise and require additional funding. Skagway Lease Increase \$51.0 - The Skagway maintenance station sits on leased property. The lease is required in order to retain legal rights to use the property. Commodity Increases: The harsh winter of 2006-2007 in Southeast Alaska diminished levels of available chemicals and sand used on roads and airports to a very low level. This necessitated the purchase of larger quantities of both to provide for the upcoming 2007-2008 winter season. Additionally, snow plowing blades were used heavily and were in need of replacement.

Ms. Slagle added that the item for Southeast region also includes \$51,000 for a new lease for the maintenance station in Skagway. The station is on private land that was recently purchased by another private investor. The department is looking at purchasing the land in the future, which will require approximately \$475,000 in capital budget funds. The Southeast item also includes a commodity increase related to winter chemical and sand purchases.

[9:09:22 AM](#)

Section 7 - 9. Marine Vessel Operations

IBU [Inland Boatman's Union of the Pacific] arbitration settlement related to the grounding of the M/V LeConte.

\$142,500

Ms. Slagle explained that when the M/V LeConte went aground in 2004, there was no language in the union contract allowing the department to contract out for services without using Marine Highway employees. The department

needed to continue providing services to Alaskans and other passengers, but without that language, the department was in violation of the contracts. An arbitrator found against the state and is requiring payment of \$142,500 to the union.

Section 7 - 9. Marine Vessel Operations

MMP [International Organization of Masters Mates and Pilots] arbitration settlement related to the grounding of the M/V LeConte.

\$251, 400

Ms. Slagle stated that the item was for the MMP settlement. Language added to the contracts allowed the state to expand out-port service, but arbitration determined that inadequate notification was provided to the union for the contracting services. The new language required thirty days notice, which does not apply to emergency response. The department is still working to understand appropriate timing of notifications. The department believed that signing the contract for the services for a month out and letting the union know about it at the same time was adequate notice. The arbitrator said that it needed to be at the time of the RFP being issued. The department is in negotiations to be able to respond in future to emergency situations.

[9:11:49 AM](#)

Section 7 - 9. Marine Vessel Operations

The Alaska Marine Highway System (AMHS) projects fuel cost increases of \$1,880.0 due to higher than expected prices. The AMHS FY08 business plan reflects a fuel budget based on \$2.60/gallon. AMHS is currently paying \$3.00/gallon and burning 10.2 million gallons annually. Another 4.7 million gallons are yet to be purchased this year.

Ms. Slagle noted that the item covers fuel cost increases for the Alaska Marine Highway system.

Section 10 - 12. Capital Ports and Harbors: Long Range Transportation Plan

Funding to prepare a statewide ports and harbors plan, to be undertaken cooperatively with the

Corps of Engineers and the Denali Commission. Supplemental funding is requested as the Request for Proposals (RFP) to develop a long range port and harbor transportation plan is expected to be advertised in May of 2008.

\$500,000

Ms. Slagle described the capital budget request to pursue a ports and harbors long-range transportation plan, called "2030". The draft 2030 transportation plan made it evident that this area is lacking. The department has been working with the Corps of Engineers and the Denali Commission to go forward with a plan; both organizations are providing matching funds. This is a change in direction for the state, which has been attempting to divest ports and harbors and hand them over to local communities.

[9:13:37 AM](#)

Section 15(a). Traffic Signal Management: Anchorage Traffic Signal TORA (Transfer of Responsibility Agreement)

The Department reached an agreement with the Municipality of Anchorage in 2005 for continued maintenance and operation of the State's traffic and street lights in downtown Anchorage. This agreement allows for an increase based on the Consumer Price Index (CPI) and additional signals in future years.

\$97,000

Ms. Slagle explained that the item would provide CPI for contracts the state has had for maintaining street lights and traffic signals in the municipality of Anchorage. The state has a transfer of responsibility agreement (TORA) with the municipality that they provide the maintenance and upkeep for the lights and signals.

Section 15(b). Capital: Airport Improvement Program Appropriation

The FY08 Airport Improvement Program appropriation increases by \$1,500.0 due to the allocation change below:
Sec 1, Ch 30, SLA 2007, Pg 105, Ln 27

Section 15(c). Capital: Airport Improvement Program Allocation

Amend Unalaska: Airport Environmental Analysis by \$1,500.0 from \$1,500.0 to \$3,000.0

Sec 1, Ch 30, SLA 2007, Pg 110, Lns 8-10

Updated planning information is needed by the Federal Aviation Administration (FAA) for use during the preparation of an Environmental Impact Statement (EIS) for improvements to the airport. The FAA would like to begin work on the EIS in March to take full advantage of the 2008 field season for data collection and analysis. This is the second phase of the project and the contractor is already on board. This project is ready to go forward now.

Ms. Slagle described the first item as the appropriation level for the airport improvement program line; the second item represents the actual allocation for an increase to complete an environmental analysis for the Unalaska airport. This is federal receipt authority. The Federal Aviation Administration is managing the project but has to direct the money through the state. The project is in its second phase and ready to move forward.

[9:15:42 AM](#)

Section 15(d). Capital: Surface Transportation Program
Appropriation

The FY08 Surface Transportation Program appropriation increases by \$5,000.0 due to the allocation change below:

Sec 4, Ch 30, SLA 2007, Pg 110, Lns 15-16.

Section 15(e). Capital: Surface Transportation Program
Allocation

Amend Anchorage: Old Seward Highway Reconstruction, O'Malley Road to Brandon by \$5,000.0 from \$11,500.0 to \$16,500.0
Sec 4, Ch 30, SLA 2007, Pg 111, Lns 30-33

The need for additional funding is due to adjustments in the engineer's estimate to reflect increased costs due to inflation. Fast track supplemental funding is necessary to advertise and award the construction contract in the spring to allow for a full first season of construction.

Ms. Slagle described the paired items as the appropriation and allocation levels for an increase for reconstructing the

building in Seldovia. The item is an increase over previous authorization. The project is ready to advertise immediately. The Federal Aviation Administration wants DOT/PF to get the project going as soon as possible.

Section 15(i). Capital: Surface Transportation Program
Allocation

The FY05 Surface Transportation Program appropriation increases by \$3,000.0 due to the allocation change below:

Sec 1, Ch 159, SLA 2004, Pg 40, Lns 12-13

Amend Haines: Ferry Terminal to Union Street [THROUGH TOWN TO OLD HAINES HIGHWAY] by \$3,000.0 from \$13,000.0 to \$16,000.0

Sec 15(b)(5), Ch 6, SLA 2005, Pg 24, Lns 13-14

This project is ready to bid and construction can occur as early as this spring if supplemental authorization is provided. This timeframe will allow full advantage of this year's construction season. This additional authorization is requested to fully cover the engineer's estimate as well as inflationary factors occurring after the development of the estimate. In addition, a scope change has been requested. At the start of this project in 1996, the terminus on the town side was identified as "Mud Bay Road". This term proved to be confusing to community members. In response, DOT&PF has determined that it was in the best interest to define the terminus side of town as "Union Street". This terminus avoids confusion as to the limits of construction work within the city center of Haines.

Ms. Slagle defined the allocation as a combination of a project name change and the addition of \$3 million. She described community confusion regarding where the project is located; the department believes a name change will clarify that. Additional funding is needed to cover increased costs. Construction can begin in the spring.

[9:19:11 AM](#)

Section 15(j). Capital: Surface Transportation Program
Appropriation

The FY02 Surface Transportation Program appropriation increases by \$750.0 due to the allocation change below:

Sec 1, Ch 61, SLA 2001, Pg 35, Ln 19.

Section 15(k). Capital: Surface Transportation Program Allocation

Amend Ketchikan: Tongass - Third Avenue Extension Completion by \$750.0 from \$10,000.0 to \$10,750.0

Sec 1, Ch 61, SLA 2001, Pg 41, Lns 18-21

This project adds a new route for storm water to reach tidewater, and is necessary to respond to neighborhood problems concerning current drainage patterns. These urgently needed changes will prevent damage to private properties from high water flows on the downhill side of the Third Avenue Bypass. This funding is needed so that construction bids can be solicited early in the year, before heavier rainfall later in the season.

Ms. Slagle described the two items as the appropriation and allocation levels to amend the Ketchikan Tongass-Third Avenue extension completion. The project has been completed except for drainage problems that need to be resolved to avoid impact to private homes. The installation of the new drainage has environmental approval and can be constructed once the easements are obtained.

Section 15(l). Capital Appropriation: Susitna Valley High School Rural Beacon System

Funds are requested to cover the emergency installation of a temporary school crossing beacon system at the Susitna Valley High School. Last summer, the permanent school building sustained catastrophic fire damage rendering the school facility unusable. Subsequently, portable temporary school facilities were set up at the local senior center to house the students for the next two school years, while the permanent building is reconstructed. This temporary facility is directly across the Parks Highway from the permanent location, causing students to cross the highway to get to and from classes.

\$180,000

Ms. Slagle detailed the request to cover the cost for the emergency installation of a temporary school crossing beacon in Susitna. Last summer the Susitna Valley High School burned down and the students are temporarily housed in the senior center, which necessitates students crossing the Parks Highway. An emergency beacon system was set up for safety.

[9:21:02 AM](#)

Section 26(a). Capital: Appropriation

Amend: Emergency and Non-Routine Repairs (Sec 1, Ch 82, SLA 2006, Pg 85, Lns 17-18) by \$128.2 from \$250.0 to \$378.2 to cover the costs of the Kenai Peninsula Flood - \$48.2 and the Copper River Highway - \$80.0.

Ms. Slagle pointed out that DOT/PF did not receive capital funds in the current fiscal year for emergency and non-routine maintenance. The item requests funds for work related to the Kenai Peninsula flood in November, and to address erosion on the Sterling Highway, the Copper River Highway, and in Ninilchik.

Section 26(b). Capital: Scope Change

Scope Change - Pilot Station: Airport Relocation [RUNWAY REHABILITATION] in Sec 1, Ch 3, FSSLA 2005, Pg 73, Lns 11-12.

A scope change is requested as the Pilot Station airport rehabilitation project became a relocation project in the Master Planning process. The master plan recommended the airport be relocated to a nearby ridge which is aligned favorably with the wind, situated on excellent material and does not have obstructions.

Ms. Slagle explained the next item as a name change request on a previous appropriation for Pilot Station. Previously the project was identified as "Runway Rehabilitation." It is not feasible to lengthen the runway at its current location. The master plan recommended relocating the airport.

Section 26(c). Capital: Scope Change

Scope Change - Stony River Airport Relocation and Airport Improvements [REHABILITATION] in Sec 100, Ch 2, FSSLA 1999, Pg 63, Lns 6-7.

The initial rehabilitation project scope was to include an extension of the runway. The project has been revised to relocate the airport due to the village's encroachment at the existing facility as well as the topographical constraints caused by the airport's current location between meanders of the Kuskokwim River.

Ms. Slagle said the request changes the name of the Stony River Airport. The issue is the encroachment of the village on the existing facility; the airport will be relocated.

[9:23:40 AM](#)

Section 26(d). Capital: Airport Improvement Program Appropriation

The FY07 Airport Improvement Program appropriation increases by \$9,000.0 due to the allocation change below:

Sec 1, Ch 82, SLA 2006, Pg 88, Ln 32.

Section 26(e). Capital: Airport Improvement Program Allocation

Amend Kipnuk: Airport Reconstruction by \$9,000.0 from \$2,600.0 to \$11,600.0

Sec 1, Ch 82, SLA 2006, Pg 91, Lns 3-4

Funding delayed to July would delay significant draw down of the grant until the following construction season. FAA is requiring early fiscal year delivery dates to ensure that projects are developed and bid early enough to take advantage of the construction season in the year the grant is issued.

Ms. Slagle detailed the two items as appropriation and allocation levels for an amendment for the Kipnuk Airport reconstruction project. The project will resurface the runway and provide lighting and a snow removal equipment building. The department is requesting an increase because the engineer's estimate has increased significantly. The project will be ready to advertise in May.

Section 26(f). Central Region Support Services

The Environmental Protection Agency (EPA) has initiated an enforcement action against DOT&PF, alleging multiple violations of the Clean Water Act. In addition, EPA is requesting information regarding sand and gravel sources. EPA believes that DOT&PF and its contractors have been

operating material sites without appropriate storm water permits.

The EPA has proposed settling the case if the State agrees to the entry of a consent decree(s) that could involve the payment of significant fines (Idaho and Hawaii have paid fines between \$500,000 and \$1,000,000), be required to conduct supplemental environmental projects, and provide training within DOT&PF.

This funding would be used to collect evidence, present a defense and begin negotiating a settlement. It is anticipated that costs are expected to be at least \$500.0 during calendar year 2008 so an extended lapse date through June 30, 2009 is requested.

\$500,000

Ms. Slagle turned to the last item requesting GF for collecting evidence, developing a defense, and negotiating with EPA regarding violations in connection with construction projects and dealing with the 2002 Kenai floods. The majority of the violations identified have to do with issues such as paperwork, permitting, or identifying a qualified inspector. The department does not think any of the violations are related to contamination. She gave the example of a violation related to the Kenai flood: EPA said the department put too much rip wrap back into the river compared to what was there before. Part of the funding would be used to take aerial photos of the area to compare and determine the appropriateness of the department's response.

[9:26:43 AM](#)

Co-Chair Stedman referred to the item addressing the grounding of the M/V LeConte and asked if there was anything in the contract with the union to cover catastrophic situations such as grounding. He questioned whether the state had to pay for ferry service after the grounding. Ms. Slagle responded in the affirmative. She explained that at one time there was no language for contracting out. When the language was added, there were no stipulations on how to deal with emergencies. Thirty-day notification was required.

Co-Chair Stedman questioned the presence of the item in the supplemental. He thought it should have been in the operating budget. Ms. Slagle remarked that the grounding was in 2004. She added that the expenditure is for 2008 to be able to be in compliance with an arbitrator's decision.

[9:29:14 AM](#)

Co-Chair Stedman wanted to know where the money would go. Ms. Slagle responded that the amount is paid to the union. Co-Chair Stedman asked if it went to employees or to the

union fund. Ms. Slagle replied that she was not sure where the money goes within the union. She did not think it went to individual union members.

Co-Chair Stedman wanted final information on who gets the money. Co-Chair Hoffman asked Ms. Slagle to get the information for committee members.

Co-Chair Stedman asked if the department would recommend modifications of the fuel calculation for the upcoming operating budget in order to reduce supplemental requests for fuel.

KAREN REHFELD, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET (OMB), explained that OMB has been looking into the issue carefully because of the supplemental requests. She said that some of the requests would be incorporated into the amended budget request.

[9:31:18 AM](#)

Senator Dyson was intrigued by the M/V LeConte settlement. He wondered how the union contract limited the state's ability to respond to an emergency and asked if something should be done in future to better respond to emergencies.

[9:32:30 AM](#)

Senator Elton queried why the request regarding the ports and harbor long-range plan was in the supplemental if the money would be required in the current fiscal year. He asked if the department considered using commercial vessel funds. Ms. Slagle explained that DOT/PF does not advertise projects without adequate funding in place. She did not think there had been specific identification of projects to be funded from the cruise ship tax.

Ms. Rehfeld added that there was potential to use the cruise ship tax funds in that manner.

[9:34:31 AM](#)

Co-Chair Hoffman asked when the long-range transportation plan for ports and harbors would be completed. Ms. Slagle did not know the answer but offered to find out.

[9:35:24 AM](#)

Co-Chair Stedman thought most of the harbors had been turned over to municipalities except for a few without the tax base or revenue source to support them. He asked what the long-range plan would encompass besides that. Ms. Slagle replied that the plan encompassed more than state-owned harbors. It will include and try to identify the needs of rural areas.

The Corps of Engineers and Denali Commission are interested in looking at the needs for all ports and harbor facilities in order to evaluate available funding.

Co-Chair Hoffman asked what the involvement of local governments would be in the planning process. Ms. Slagle thought local governments would be very involved.

Co-Chair Stedman queried using agencies outside DOT/PF when the department has 70 to 80 planners. He also wondered why the item is not a normal capital expenditure.

[9:38:01 AM](#)

Co-Chair Hoffman requested that the committee be provided with the scope of work.

Senator Elton also wanted the scope of work. He asked whether the Corps of Engineers and Denali Commission have committed money to the project, and if so, how much. He wondered how the plan fits within the wider scope and regional transportation plans.

[9:39:06 AM](#)

Ms. Slagle replied that both the Corps of Engineers and the Denali Commission have committed \$500,000 apiece for the project. She said she would answer the question of how the project fits into the regional plans.

Senator Elton referred to the \$500,000 request to negotiate a settlement with the EPA. He pointed out that the department had mentioned that some of the dollars would go to Southcentral Region and wondered why the project was identified as Central Region support services. He also suggested breaking the item into two sections, since the description describes costs over two fiscal years.

Ms. Slagle explained that Southcentral is part of Central Region. The department thought that was the most appropriate place to put the funds as the Central Region is coordinating discussions with the EPA. Regarding the split of two fiscal years, she said the department is not sure what expenditures would be in the upcoming year. At one point there was discussion about the item being in the capital budget, but she thought it made sense to have it in the operating budget.

[9:41:44 AM](#)

Senator Elton asked if EPA had concerns only in the Central Region. Ms. Slagle responded that currently most of the items are in Central Region. She added that if the state

does not address the issues, there could be broader ones in the future.

[9:42:26 AM](#)

Senator Huggins asked if the subject of highway safety corridors was being addressed. He did not see anything concrete being done. He recalled that there were four and maybe five highway safety corridors.

Ms. Slagle thought two safety corridors had been identified and a third was being considered. She referred to actions that were being taken. She maintained that some portions of the program have been successful in reducing accidents.

[9:44:49 AM](#)

Senator Huggins agreed that such progress takes time, but he could not justify how long it has taken to constituents. He encouraged the department to be proactive and create highway safety corridors as well as solve the problems and save lives.

[9:45:55 AM](#)

Co-Chair Stedman asked if the capital products had been included in the Statewide Transportation Improvement Program (STIP), and if they were, if STIP has been submitted and approved by the federal government. Ms. Slagle responded that the state was in the process of developing an amendment to STIP, but the long-range transportation plan had to be completed first. She did not know if federal highways had agreed to the plan.

Co-Chair Stedman requested information regarding costs of polling. He thought there was a poll underway in Ketchikan and one concerning the marine highway. He wanted to know the revenue sources and costs of the polls and why DOT/PF is conducting them. Ms. Slagle said the department would address the question directly with the senator.

Senator Olson queried details regarding the Pilot Station airport relocation. Ms. Slagle understood that the existing runway is narrow, not long enough, and has dangerous cross winds. The community feels the current runway is a safety hazard. A plan to extend the runway is not feasible in the present location. In addition, a school was built adjacent to the runway. This is a safety issue. The master plan determined it would be more appropriate to move the airport to a nearby ridge. The FAA has approved that plan.

[9:49:42 AM](#)

Co-Chair Hoffman asked if emergency requests for flooding in Copper River and Susitna Crossing were high enough priority for the governor to use the emergency fund. Ms. Slagle responded that the governor had not declared either of the events disasters, so federal dollars were not available. This is considered heavy maintenance, and the responsibility of the state.

Co-Chair Hoffman remarked that the governor does have emergency funds available and wondered why they were not being used. He queried the criteria used to access emergency funds.

Ms. Rehfeld responded that the governor has contingency funds. She did not know if the projects were considered for the funds. She said she would find out more.

[9:52:15 AM](#)

UNIVERSITY OF ALASKA

Section 7 - 9. Statewide Services: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Anchorage Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Kenai Peninsula Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Kodiak College: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Matanuska-Susitna College: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Prince William Sound Community College: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Bristol Bay Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Chukchi Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time

funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Fairbanks Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Interior-Aleutians Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Kuskokwim Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Northwest Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Juneau Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Ketchikan Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

Section 7 - 9. Sitka Campus: Increase Fuel Costs

Funding received in FY08 as part of the fuel trigger mechanism only replaced the FY07 one-time funding, leaving UA at the FY07 funding level. Therefore, in addition to the existing funds received through the fuel trigger mechanism in FY08, UA is requesting a FY08 supplemental to cover the utility increases from FY07 to FY08.

MICHELLE RIZK, DIRECTOR OF BUDGET, UNIVERSITY OF ALASKA (testified via teleconference), outlined the items totaling \$2.3 million for utility cost increases in excess of what the trigger mechanism covered for each campus. The mechanism only replaced the FY 07 one-time funding.

Co-Chair Stedman stated that a substantial number of campuses are in hydro-based communities. He asked if the university has considered conversation from oil to electric boilers to save money.

PAT PITNEY, VICE CHANCELLOR, ADMINISTRATIVE SERVICES, UNIVERSITY OF ALASKA (testified via teleconference), responded that she expected each of the campuses to look at the costs of major renewal and replacement upgrades as they establish their priorities. A boiler transition from oil to electric would apply. She thought the Sitka campus was the only one that would allow a hydroelectric option. Electric utilities in other regions are run through coal or diesel.

Co-Chair Stedman pointed out that Juneau, Kodiak, and Ketchikan are also on hydroelectric.

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Pat Pitney remarked that depending on the campus, there are both electric utility and diesel boilers. Not all buildings have stand-alone boilers; some use local electric utilities for their heat.

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DEPARTMENT OF REVENUE

Co-Chair Stedman called for the fall 2007 revenue forecast used for FY 08 numbers. He emphasized that he wanted to gear the discussion towards the mechanics of the gas tax to refresh understanding of the complicated relationship between the gas tax and the net tax.

PAT GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, reported that the department's staff puts together the Revenue Sources Book twice each year. He added that the presentation would have more detail than in the past to provide a clear picture of the new tax system.

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MICHAEL D. WILLIAMS, CHIEF ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE (DOR), described the plan as a team effort involving economists and staff as well as OMB and the Department of Treasury. He stressed that forecasting is a dynamic process and methods vary by revenue source. The official forecast is updated twice each year. The finalized spring forecast is expected April 11. The information is difficult to process as it comes in various forms. The department is attempting to develop a fully integrated management information system to better handle the data.

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Dr. Williams said he would cover four topics:

1. 2008 Unrestricted Revenue
2. Key Assumptions, including methods used to forecast production tax
3. Volatility
4. Evaluation of Price Forecast

Dr. Williams pointed out that there are two types of projected revenue: unrestricted revenue and restricted revenue. His discussion would focus on unrestricted revenue, defined in the Revenue Sources Book as:

Revenue not restricted by the constitution, state, or federal law, trust or debt restrictions or customary practice. Most legislative and public debate over the budget each year centers on this category of revenue.

Dr. Williams turned to general purpose unrestricted revenue for FY 2008 for oil and non-oil. There are four categories of oil income:

1. Royalty, \$1.8 billion, or 28 percent of the total;
2. Production tax, \$3.4 billion or 50 percent;
3. State corporate income tax, 9 percent; and
4. Property tax, less than 1 percent.

Dr. Williams said that together the four categories total around \$5.9 billion, or 89.5 percent of the budget. The total budget is \$6.6 billion; the remainder is non-oil income.

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Dr. Williams detailed that all the various tax categories, such as corporate income tax, mining tax, insurance premiums, and so on, represent about 58 percent of the non-oil total. Investment income represents 26 percent, and other income is around 16.1 percent. Mining accounts for about 11.4 percent of non-oil revenues; chapter three of the revenue sources book is devoted to mining, an area that is getting more public debate. He encouraged the committee to study the chapter, which covers the mines in operation, mines being developed, and exploration for new mines.

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Co-Chair Stedman informed the public that the Revenue Sources Books are available online at the Department of Revenue and can be downloaded and read. He noted that the books change twice each year and concentrate on different areas.

Senator Huggins queried the fish tax number. Dr. Williams replied that the fish tax is not showing as it is relatively small. He said that chapter five in the Revenue Sources Book deals with non-oil income; page 58 shows that fish tax for FY 08 was \$23.6 million.

Co-Chair Stedman requested the oil price the figures are based on. Dr. Williams replied that the assumptions for oil are based on \$72.64 per barrel, with production of 730,000 barrels per day.

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Co-Chair Stedman remarked that taxes like fish taxes are dwarfed by the oil source. Mining and fish taxes increase over several years. Historical data is available.

Senator Elton stressed the importance of the Permanent Fund as a revenue source that dwarfs everything. He wondered why it was not reflected under non-oil revenues.

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Dr. Williams replied that the Permanent Fund is categorized as restricted funds, which are non-oil earnings. Revenue from royalties goes into the Permanent Fund; that money is invested in stocks, bonds, real estate, and so on. The earnings from that are not directly from oil, but from the investments. In general, invested income is considered restricted revenue.

Senator Elton asked what restrictions are put those funds. Dr. Williams said the funds are restricted by law. He did not know the laws that applied but could find out.

Senator Elton thought a majority vote in both bodies could access those earnings for expenditure.

Co-Chair Stedman agreed the realized earnings reserve could be accessed.

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Dr. Williams compared the spring 2007 to the fall 2007 forecasts, the two forecasts for FY 08. The total forecast budget increased by \$3 billion or by 85.9 percent, which is substantial. The main reason for the increase was the production tax, which increased \$2.4 billion, or 240 percent. The royalty increased about \$0.4 billion, or 30 percent. Oil price was 32 percent higher in the fall forecast, and production was 4.3 percent less. Royalty is the state's share of the oil produced. Generally, royalty is about 12.5 percent. If prices go up, revenue is expected to go up the same amount. He pointed out that actual royalty went up 30.5 percent, while prices went up 32.5 percent. The difference occurred because production went down about 4.5 percent.

Dr. Williams reported that income tax was up about 17 percent. The state uses apportionment in collecting corporate income tax, which goes beyond Alaskan prices and volumes; it is affected by international prices. Non-oil went up about 20 percent; one of the drivers was the higher prices for minerals. Overall the total budget between the

two forecasts increased close to 86 percent. The main driver was the production tax, which increased 24 percent.

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Co-Chair Stedman asked a question about how current price changes could affect the forecast. Dr. Williams responded that most likely there would be a higher figure depending on production and costs. Prices appear to be dominating.

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Dr. Williams turned to key assumptions for production tax. Production tax statutes are new, which has caused the main difference. The formula used comes from the Revenue Sources Book (Figure 4.4, "ACES Tax Liability Calculation," page 32, Revenue Sources Book, 2007, <http://www.tax.alaska.gov/programs/documentviewer/viewer.aspx?1202f>):

$$\text{ACES Tax Liability} = [(\text{Value} - \text{Costs}) * \text{Tax Rate}] - \text{Credits}$$

The terms used in the equation are defined as follows:
Value = Volume of Oil and Gas Produced X Wellhead Value
Costs = Operating Expenditures + Capital Expenditures
Tax Rate = 25% + 0.4% for every \$1 barrel that this "net income" exceeds \$30
Credits = (20% X Capital Expenditures)* + (20% X Eligible Transition Expenditures)** + Base Allowance
*spread over two years

**limited to those credits earned while the PPT was in effect and could not be used

Dr. Williams explained that the tax liability is a function of value minus cost, times the tax rate, minus the credits. Value is equal to the volume of oil and gas produced at the wellhead. Value refers to taxable barrels, so excludes royalties. The costs are operating expenditures plus capital expenditures, and the tax rate is 25 percent, which is the base rate, plus 0.4 percent for every dollar per barrel that this net exceeds \$30 per barrel. Credits equal 20 percent of capital expenditures, plus 20 percent of eligible transition expenditures, plus a base allowance.

Dr. Williams emphasized how important it was to understand the basic formula.

Dr. Williams turned to the chart on page 32 of the Revenue Sources Book, which compares the current tax law, Alaska Clear and Equitable Share (ACES) with the previous tax law, Petroleum Profits Tax (PPT). He listed and compared key areas:

- Lease expenditures: ACES—must be affirmed by regulations; PPT—ordinary and necessary.
- Standard deduction: ACES—for Prudhoe Bay and Kuparuk; PPT—no standard deduction.
- Base rate: ACES—25%; PPT—22.5%
- Progressive factor: ACES—0.4%; PPT—0.25%
- Maximum tax rate: ACES—75%; PPT—47.5%

Co-Chair Stedman requested clarification regarding the tax rate. Mr. Galvin replied that figure is not accurate; it should be 50 percent.

Co-Chair Stedman asked for information on maximum marginal rates versus the average rate.

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Dr. Williams explained that what happens with the calculation of production tax under ACES is that as profits increase, the marginal tax rate for the entire production increases. He suggested thinking in terms of fixed amount of cost, and price just increasing. As that occurs, the volume subject to the progressive tax gets larger and larger. The marginal tax rate is 75 percent at a certain price, around \$92.50 per barrel.

Co-Chair Stedman requested further information. He surmised that when the industry does well, through oil prices going from a gross to a net structure, the state's treasury does well.

Dr. Williams agreed that state does very well. In terms of the concept of having a net-based tax, the companies as well as the state are well served. If costs were much higher or prices lower or volumes were lower, or any combination to make the situation less profitable, the companies would pay much less tax. The credits stimulate investment and progressivity ensures that the state receives its fair share.

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Dr. Williams addressed the subject of credits. Under PPT, all credits were given in the first year. Under ACES, they are spread out over two years.

Dr. Williams turned to page 36 of the Revenue Sources Book (Fall 2007, Figure 4-6, "Basic Data used for ANS Oil and Gas Production Taxes"). He encouraged the committee to study the page as it contains useful information. He stated his goal to familiarize the committee with how to read the data. He

pointed out the components of the chart, including the major categories:

- State Production Tax Revenue from the North Slope;
- Key North Slope Assumptions;
- Implied North Slope Data, resulting from taking the assumptions and dividing one unit by another; and
- Notes.

Dr. Williams detailed that three fiscal years are presented in the columns:

- FY 2007, which is history;
- FY 2008, which is current, a projection based on historical data with a forecast; and
- FY 2009, which is completely forecast.

Dr. Williams read all the notes at the bottom of the page, and stressed their importance:

1. Costs for FY 2007 are unaudited and for the entire North Slope. Cost data reported July 2006 through December 2006 are actuals. January 2007 through June 2007 are estimates.
2. Costs for FY 2008 and FY 2009 are estimated after having reviewed the annual filings from oil companies and incorporating adjustments based on our assessment of future cost increases.
3. Assumptions for the transitional credits and the \$12 million credits are not included in the table.
4. The average production value per barrel presented in this table would differ from estimates the oil companies would prepare for tax liability purposes for several reasons: [a] the data in the chart are North Slope wide averages; [b] different companies have different cost structures and operate in different fields; [c] a company computing this average for tax liability purposes would only include the barrels it gets to keep, i.e., the company would exclude the barrels it pays in royalty.
5. FY 2008 ANS West Coast price forecast is as of November 30, 2007.

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Dr. Williams highlighted the most important points of the chart. He did not intend to list the data but wanted the committee to conceptually understand what is available. He touched on key North Slope assumptions, the first category. Three assumptions for prices are laid out.

Dr. Williams explained that the wellhead value is obtained by subtracting the transit costs, which are between the West Coast price and the wellhead value. The next items are production in barrels per day, royalty barrels per day, and taxable barrels per day. Then operating expenditures (OPEX) and capital expenditures (CAPEX) are listed. He said to keep in mind that for the OPEX there is the standard deduction for Prudhoe Bay and Kuparuk for CAPEX. There are no restrictions on the CAPEX. There are also credits for the CAPEX.

Dr. Williams elaborated on implied data. The credits can be calculated if the CAPEX are known. For lease expenditures per barrel, if the OPEX are divided by the number of barrels, the result is the OPEX per barrel; the same applies for CAPEX. For the average production value per barrel, one is divided by the other.

Dr. Williams added that future Revenue Sources Books will contain the same table; he encouraged the committee to become familiar with it. Finally, the table has the production price collected per barrel.

[10:31:04 AM](#)

Senator Huggins asked if the examples were about oil. Dr. Williams affirmed that they were. Senator Huggins wondered how to convert the examples to gas. He asked if both were addressed in ACES. Dr. Williams replied that both were addressed in ACES. He added that Deputy Commissioner Marcia Davis had given a presentation to the Senate Resources Committee about the subject. Oil and gas are taxed the same and have a different cost structure and different transit costs. On a Btu barrel equivalency, they have different values. There are a number of factors that are different, but all three of the factors come into play when looking at the tax basis.

Senator Huggins asked if the first sale of North Slope gas was going to Fairbanks. He thought that was exempt from the provisions mentioned.

Dr. Williams remembered some exemptions, but he was not sure. He had assumed they would pay tax; it would most likely be under the ELF (Economic Limit Factor). Compared to the bigger picture of dollars collected for oil, the amount would be small, about \$1.5 million.

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Mr. Galvin added that the exemption was the so-called Cook Inlet tax treatment. That would be applied to any gas produced for the purpose of use within the state. There would be similar treatment in terms of calculation; the

difference is the rate applied will not be 25 percent but something significantly lower. This would result in much lower tax due.

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Co-Chair Stedman informed the committee that he had asked Commissioner Galvin to prepare a presentation on the tax structure of the gas supply into Fairbanks because of the expansion of the methodology used in Cook Inlet going north. He wanted the committee to fully understand what the tax collection is and what it is not. He also wanted them to understand that the tax structure for the large gasline would be different.

Mr. Galvin explained that the increase in production expenses would be small and the increased tax due would be fully born by production. The tax rate would be affected. The department would put together a model of how the tax would be calculated on a small sale.

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Co-Chair Stedman thought there were two questions. The first was regarding the impact of the expansion of the Cook Inlet provisions to the north, and how that affects the state treasury. The second question was the dilutive effect of gas to the oil tax, which would be addressed in more detail in the future.

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Co-Chair Hoffman asked the reasons for substantial increases in transit costs. Dr. Williams remarked that it was due first to volume of oil going through the Trans-Alaska Pipeline System (TAPS), and second to methodology. Regarding the volume of oil, tariffs are computed by adding OPEX and other relevant expenses and dividing them by volume, which results in the per barrel charge. On the North Slope currently, volumes are declining but some costs are increasing. This results in a higher cost per barrel.

Dr. Williams reported that there has also been a transition from the TAPS settlement methodology to a cost-based methodology. He believed that enters assumptions in 2009. Looking at what is going on with the costs themselves, there is a strategic reconfiguration. Large costs and smaller volumes impact the tariff per barrel.

Co-Chair Hoffman questioned if the percentage will increase more rapidly because of further declines in volume. He wondered what the projected figure would be in three to six years.

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Dr. Williams pointed to page 109 of the Revenue Sources Book (Fall 2007, Appendix on Prices, B-2b, "Nominal Net-back Forecasts"), which contains the forecast for the TAPS tariff. He noted that it declines as it moves into the cost of service methodology versus the TAPS settlement methodology. Overall, it increases, after first going down. Towards the end the driver is decreasing volumes.

Mr. Galvin added that the switch between the methodologies is occurring in a forecasted way between FY 09 and FY 10. In 10 years the forecast would be back up to current levels.

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Senator Thomas wondered if the potential in Prudhoe Bay had been considered in this forecast. Dr. Williams replied that the department has a volume forecast that includes fields currently in production, fields under development, and fields that are being evaluated. To the extent a new producer is under development, such as Oooguruk, the new volumes are incorporated into new forecasts. Forecasts go out many years; the Revenue Sources Book has a ten-year outlook.

Senator Thomas questioned how actual, historical numbers overlap with fiscal years and line up with tax years. Dr. Williams responded that all actuals are historical data and all data are in fiscal years. The recent change to the PPT meant forecasting methods had to be altered to incorporate calendar annual tax into fiscal year forecasting.

Senator Thomas queried what date a projected forecast change to a historical or actual forecast.

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Dr. Williams replied that historical data are usually finalized at the end of October and then would become historical or actual.

Commissioner Galvin reported that the receipts are tracked through June 30 and reported in October. A series of reports are reconciled with an annual calendar year tax return. Assumptions are then readjusted.

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Senator Huggins asked for an explanation of department plans regarding methodology. Dr. Williams described the dynamic nature of forecasting. Everything changes and requires a new response. A proactive approach entails looking into the

future to find the best method of dealing with these changes.

Dr. Williams gave examples of his proactive methods in various situations. The department was keenly aware of changes regarding the TAPS settlement methodology; they knew they had to develop different ways to forecast. He relayed another example related to cost. When the department first started projecting costs, they did not have much actual data. When they knew that costs were related to prices, they adjusted the formula so that when prices changed, costs changed.

Dr. Williams pointed out that costs are related to many things, including the maturity of a particular oil field, general inflation, technology, and so on. The question is how to develop methodology to estimate or forecast costs with all those factors. That is a current challenge.

Dr. Williams spoke of looking at how other entities respond to similar situations. They found one group that actually projects costs; the department is considering using an index of their projected costs and applying it to Alaska's costs and adjusting for such things as technology and one-time events.

Senator Huggins asked about shut-downs. Dr. Williams said that was covered by one-time events.

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Mr. Galvin related stories on coming up with estimates.

Dr. Williams remarked that when DOR evaluates a forecast, they look for errors, which are often repetitive. He puts together charts, which can reveal such things as overestimating production values. When the reasons for overestimating volumes were evaluated, two causes were discovered: the fact that the technology associated with heavy oil was taking longer to develop and implement, and the fact that Alaska is dealing with mature infrastructure. This means more time must be allocated for maintenance and down time. These factors caused the department to change the formulas. This is an example of being proactive, which they do with all revenue sources and attributes.

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Dr. Williams considered the computations for estimating the production tax. This is for the North Slope only. The top line reads "Total taxable value," which excludes royalty. For FY 08, this is about \$15.5 billion; for FY 09, it is about \$13.4 billion. The numbers are broken down into prices, volumes, and costs. The total is the wellhead price

times the number of taxable barrels. Deductible lease expenditures are about \$4.3 billion for FY 08 and \$4.3 billion for FY 09. Comparing this to the previous chart reveals a difference. The footnote reads, "Lease expenditure excludes the \$0.30 per barrel CAPEX exclusion." The CAPEX exclusion was not on the previous chart. The net taxable income is then about \$11.3 billion for FY 08 and about \$9 billion for FY 09. This is aggregate, for all the producers. For each producer, there needs to be an estimate of what is due under the base tax rate plus progressivity. Adding that up for all the producers comes to about \$3.7 billion in FY 08 and about \$2.7 billion in FY 09. From that, credits are subtracted. Credits are used against tax liability; producers have revenue which they can offset with credits. Non-producers would get something from the state. There are two categories of credit, which leaves the state with tax revenue of about \$3.4 billion in FY 08 and about \$2.2 billion in FY 09.

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Co-Chair Stedman requested more information to be presented after the meeting recess. He specifically wanted the gross value of what the resource is worth when it comes out of the ground. Dr. Williams asked if he wanted taxable barrels plus royalty barrels added together times the net value at the wellhead. He said he could get the information.

Co-Chair Stedman also requested more information on the sensitivity of the dollar per barrel. He pointed out that deductible lease expenditures do not include property tax. Dr. Williams said he would check on that.

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Senator Thomas asked where federal taxes were computed. Dr. Williams revealed that federal taxes are not used in computing production taxes. Production taxes are costs expenses for companies when they file federal income taxes. Federal income taxes are not an expense for the companies in paying production taxes at the state level.

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Co-Chair Stedman asked about credits used against tax liability and credits for potential state purchase. Dr. Williams advised thinking in terms of producers. Companies that have production or revenue have credits for their capital expenditures that can be used to offset their tax liability. By contrast, credits for potential state purchase apply to explorers that have capital expenditures but no production revenue. Under ACES, those companies would get checks from the state for credits, as opposed to offsetting tax liability.

Co-Chair Stedman pointed out that the offset is not always shown, and there will be a request for a payment for the credit. He advised remembering there are two credits when working on the budget.

[10:59:04 AM](#)

Senator Elton questioned if FY 08 total taxable value was based on last November's prices, and does not reflect the reality of recent prices. Dr. Williams responded in the affirmative.

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Dr. Williams addressed the Co-Chair's questions and the tax rate before he continued with the informational overview.

Dr. Williams read from Section 15 of the ACES bill, Statute 43.55.011(e), which covers the base tax rate:

The annual production tax value of the taxable oil and gas as calculated under 43.55.168(1) is multiplied by 25 percent.

Dr. Williams elaborated that in Section 17 the bill deals with progressivity. 43.55.011(g) says that the sum determined under this paragraph may not exceed 50 percent. Therefore, the maximum progressivity factor is 50 percent. Adding the progressivity factor to the base rate equals 75 percent. The tax rate in the Revenue Sources Book is correct at 75 percent.

Co-chair Hoffman queried how much of the revenue was attributed to the multiplying factor in future reports.

JERRY BURNETT, DIRECTOR, DIVISION OF ADMINISTRATIVE SERVICES, DEPARTMENT OF REVENUE, explained that for a bill in the House, the department did a fiscal note showing the estimated progressivity surcharge for the next five years, which shows the approximately \$900 million range in FY 08 and the \$350-400 million in future years.

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Co-Chair Stedman suggested working with the administration and/or DOR consultants to analyze the average and marginal tax rate along with the progressivity impact at varying dollar amounts for oil. There is substantial impact at \$80-90 per barrel prices. He wanted to know what components of the tax are driving what dollars.

Dr. Williams noted the point led to an earlier question regarding the impact on revenue if prices increase \$1. He reminded the committee how taxes are estimated under ACES. The price, the cost, and the volume are needed. When discussing increasing prices \$1 per barrel, there is an assumption that costs and volumes remain the same. Those are major assumptions. He also explained that the information is not linear. If prices are \$35 per barrel, the progressive factor is 0.4 percent for the volumes, but when the price is \$80 per barrel, there is more volume. When prices go up there is a non-linear relationship. In addition, at very high prices, progressivity goes to 0.1 percent. He gave the figures requested (which assume keeping volumes and costs constant):

\$60 a barrel would mean an extra \$120 million
\$80 a barrel would mean an extra \$160 million
\$100 a barrel would mean an extra \$195 million

Dr. Williams noted the funds are General Fund unrestricted revenue.

Dr. Williams referred to sensitivity charts on page 37 of the Revenue Sources Book that forecast prices for FY 08 and FY 09. He noted the charts each have the forecast prices for high and low prices. The middle category has high costs which calculates numbers if costs are ten percent higher at constant volumes. The last category assumes low costs, at 90 percent.

Dr. Williams next pointed to page 95 of the Revenue Sources Book, with additional sensitivity matrices. At the bottom of the page is a chart, "FY 2009 General Fund Unrestricted Revenue with Price Sensitivity." The vertical scale is in billions of dollars and shows how revenues change to the state as prices go up.

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Dr. Williams addressed the question of property taxes, which are deductible as lease expenditures; the department estimates they will be about \$200 million in 2008.

Dr. Williams discussed the gross value of production. The ANS West coast price in the forecast of \$72.64 per barrel is multiplied by the total volumes at Pump Station #1; the totals are estimated to be about \$19.5 billion for FY 08 and about \$17 billion for FY 09. That includes both royalty and taxable barrels. Subtracting the transit cost brings the wellhead value for both royalty and taxable barrels to about \$17.9 billion for FY 08 and \$15.4 billion for FY 09. When the royalty barrels are removed, the taxable barrels are left, at about \$15.6 billion in FY 08 and \$13.4 billion in FY 09.

Co-chair Stedman clarified that for FY 08 the starting number is \$19.4 billion, with adjustments bringing it to \$15.5 billion.

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Dr. Williams continued with the presentation. He divided volatility into three areas: crude oil price volatility, crude oil production volatility, and crude oil costs. Historically, volatility has referred to price volatility. He highlighted that in the forecasting business, all three are dealt with.

Dr. Williams started with crude oil price volatility and referred to a graph on a slide. He detailed that the prices were ANS West Coast dollars per barrel. The highlighted area is the 95 percent confidence interval, which is based on statistics derived from the mean of daily prevailing value prices. The average, or mean price is \$71.93. The distribution, or range of prices, surrounds that mean. One standard statistic is called the standard deviation. Two standard deviations translates to the 95 percent confidence level. The range is \$96.54 on the high end and \$47.72 on the low end. This means that a forecasted number within that range is correct approximately 95 percent of the time.

Dr. Williams noted that the low for the calendar year 2007 was \$47.72 per barrel and occurred in January. The high was \$96.54 per barrel and occurred in November. He emphasized that the price more than doubled during the year. If the actual volatility was compared with previous years, the amount of volatility in 2007 was higher than other years historically. Therefore, volatility is increasing. Prices came down as rapidly as they went up in the cycle of business commodities. He asserted the importance of this.

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Dr. Williams turned to crude oil production volatility and referred to a chart on ANS crude oil production in barrels per day for the calendar year. The average is about 739,745 barrels per day. Most of the data points fit in the 95 percent confidence interval, but the low was 305,299 barrels per day, which occurred in August. This was associated with the planned closure of the TAPS pipeline for the strategic reconfiguration. He reminded the committee of an earlier discussion about purposely lowering the forecast. There are both planned and unplanned events, which makes the situation more volatile and more challenging to forecast. The field is mature and a lot of unpredictable things happen.

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Co-chair Stedman recalled the accuracy of a petroleum consultant's testimony regarding production amounts. Dr. Williams agreed that the consultant was pleased when he saw the graphs. He granted that the problem with forecasting is how frequently the forecast is wrong.

Dr. Williams examined cost volatility, which was not an issue prior to having a net tax. He referred to a chart put together by Cambridge Energy Research Associate (IHS/CERA) depicting the Upstream Capital Cost Index. The series depicts historical data from 2000 through mid-2007 and a forecast out to the third quarter of 2007. This is upstream capital costs only, developed by the consulting company using data from 28 projects world wide.

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Dr. Williams indicated that the rapid rise in oil prices has taken oil companies by surprise as well as the state. He reminded the committee that steel is a commodity that is a major component used in the oil business. China is now exporting steel, so prices could come down. Commodities tend to move in cycles.

Co-chair Stedman commented that industry representatives have been asked to come to the committee to talk about price changes in capital costs and to speculate about what is in store for the future.

Dr. Williams advised getting a spokesperson from the steel industry to talk specifically about who is exporting and importing, the types of steel, and their opinions about the market. The oil companies may do their own forecasts or rely on a service, but he stressed the importance of learning about steel.

[1:23:45 PM](#)

Senator Dyson referred to earlier testimony about the price of oil, specifically regarding geopolitical tensions. He said international experts he had spoken to reported that a significant part of the rise in oil prices was caused by the decline of the value of the U.S. dollar compared to international currencies, a factor which was not in Mr. William's presentation. He asked if the costs on the graph were in constant dollars. Dr. Williams believed the numbers were in nominal dollars that are indexed.

Senator Dyson pointed out that what would happen with the loss of the value of the dollar was not shown. He thought costs would be distorted. Dr. Williams agreed.

Senator Dyson asked how the loss of value of the dollar would affect costs. Dr. Williams deliberated that costs

might be lowered. The 28 projects the data was collected from are located world wide, so the currency is foreign. He was not able to speculate on how much the costs would be affected. He added that labor is also a key factor in projects around the world. This goes beyond the value of the dollar; there is also a lack of petroleum engineers. He recalled when crude oil prices fell by 50 percent in 1986, which was the beginning of contraction in the oil and gas industry. There were a lot of mergers and acquisitions as companies attempted to remain profitable. When they merged with one another, they got assets and were able to reduce their administrative overhead, so the cost per barrel fell. There was less demand for petroleum engineers at that time, so people were out of work and there were fewer graduates from universities in the field. Twenty years later, there is a demand for petroleum engineers, but the universities are not preparing them, and previously trained engineers are beginning to retire.

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Dr. Williams concluded his presentation on volatility by stating that there were record unrestricted revenues, continued dependency on oil, and volatility in three areas: prices, volumes, and costs.

Senator Thomas remarked that he was pleased with the volatility of crude oil because it has been upward, and that he was concerned about production volatility being up and down. He was concerned about the volatility of the vast majority of Alaska's revenue source. Non-oil revenue is not enough to even pay for any one segment, such as education. He wanted to consider what should be done rather than hoping for increased production.

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Dr. Williams agreed getting 90 percent of the state's income from oil was a major concern.

Co-chair Stedman commented on possible future revenue, which could be large enough to equal all other tax collections outside of oil and gas.

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Dr. Williams turned to the subject of forecasting crude oil prices. He had two types of analysis:

1. Dollars per barrel: current and next year, comparing DOR forecasts with actual dollars per barrel.
2. Percent error: comparing DOR with New York Mercantile Exchange (NYMEX) and the Energy Information Administration (EIA) of the U.S. Department of Energy.

Dr. Williams began with current year comparisons (Slide 17). The vertical axis is dollars per barrel; the horizontal has FY 99 through FY 08. The red dash line represents the forecast for the current fiscal year; the blue line depicts actual prices. For the fall of 2007, DOR is projecting FY 2008. He highlighted that the forecast is close to actual and that DOR tends to underestimate. The red dash line in general is below the blue line. The difference is down at the bottom at the left; it is about \$2 per barrel or 7 percent.

Dr. Williams turned to Slide 18 which depicts the next year, which starts in FY 2000, one year out. He pointed out that the distance between the blue and red lines is greater. This is because DOR underestimates compared to the actual, and the error is larger, about \$12 per barrel or 32 percent. In the near term, the errors are smaller; the further out the forecast, the larger the errors.

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Dr. Williams next compared DOR forecasts with other organizations (Slide 20). On the vertical axis of the chart is the percent error; the horizontal axis has five years, FY 03 through FY 07. Red is DOR forecasts and shows percentage errors from the actual numbers. He pointed out that in FY 03, DOR was off 8 percent, NYMEX was off 4 percent, and the EIA was off 1 percent. In FY 04, DOR was 13 percent, NYMEX 13 percent, and EIA 12 percent. In general, DOR's average error for the current year is about 6 percent, NYMEX is 4 percent, and EIA about 4 percent.

Co-Chair Stedman asked when he had become employed by DOR. Dr. Williams replied January 2005.

Dr. Williams reported that the errors are larger across the board for all the organizations at two years out. The DOR average is 33 percent, NYMEX is 25 percent, and EIA is 24 percent.

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Dr. Williams emphasized that prices have been going up on all the charts. This is the first time in 150 years of recording prices that prices have increased five years in a row.

Dr. Williams examined the next chart (Slide 22), which looks forward and depicts the quarterly prices of West Texas Intermediate (WTI) in dollars per barrel. At the bottom are actual prices for quarters three and four for 2007. The red dash line represents DOR; the solid blue with black squares line represents Strategic Energy and Economic Research

(SEAR); the pink line represents JP Morgan; the dark green line represents EIA; and the solid blue line represents Morgan Stanley.

Dr. Williams pointed out that DOR forecasts prices higher than the other organizations, who say that prices are unsustainable at the current level and are looking for correction downward. The Organization of Petroleum Exporting Countries had a meeting recently and publicized that \$80 per barrel was a price at which they would review, or reduce, production. Dr. Williams did not know if they would do that, but stated there is rationale for near-term support for crude oil prices.

Dr. Williams stated in summation that DOR tends to underestimate actual prices, is more accurate in the near term, and the data is inconclusive when compared with other organizations.

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SB 256 was HEARD and HELD in Committee for further consideration.

ADJOURNMENT

The meeting was adjourned at 1:39 PM.