

HOUSE FINANCE COMMITTEE  
March 18, 2010  
1:37 p.m.

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CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:37 p.m.

MEMBERS PRESENT

Representative Mike Hawker, Co-Chair  
Representative Bill Stoltze, Co-Chair  
Representative Bill Thomas Jr., Vice-Chair  
Representative Allan Austerman  
Representative Mike Doogan  
Representative Anna Fairclough  
Representative Neal Foster  
Representative Les Gara  
Representative Reggie Joule  
Representative Mike Kelly

MEMBERS ABSENT

Representative Woodie Salmon

ALSO PRESENT

Marcia Davis, Deputy Commissioner, Office of the Commissioner, Department of Revenue; Derek Miller, Staff, Representative Mike Kelly.

PRESENT VIA TELECONFERENCE

Kevin Banks, Director, Division of Oil & Gas, Department of Natural Resources; Cody Rice, Petroleum Economist, Tax Division, Department of Revenue.

SUMMARY

HB 280      NATURAL GAS

CSHB 280 (FIN) was REPORTED out of Committee with a "do pass" recommendation and with a new zero

note by the House Finance Committee for the Department of Revenue and previously published fiscal notes: FN1 (ADM), FN2(CED), FN3 (DNR).

HJR 8           CONST. AM: APPROP. LIMIT/MINERAL REVENUE

HJR 8 was HEARD and HELD in Committee for further consideration.

#hb280

HOUSE BILL NO. 280

"An Act relating to natural gas; relating to a gas storage facility; relating to the Regulatory Commission of Alaska; relating to the participation by the attorney general in a matter involving the approval of a rate or a gas supply contract; relating to an income tax credit for a gas storage facility; relating to oil and gas production tax credits; relating to the powers and duties of the Alaska Oil and Gas Conservation Commission; relating to production tax credits for certain losses and expenditures, including exploration expenditures; relating to the powers and duties of the director of the division of lands and to lease fees for the storage of gas on state land; and providing for an effective date."

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Co-Chair Hawker discussed previous committee actions related to HB 280 amendments. He noted that conversations had led to the conclusion that Amendment 2, previously adopted by the committee, could be more effectively presented.

Co-Chair Hawker MOVED to RESCIND Amendment 2. There being NO OBJECTION, it was so ordered. Amendment 2 was RESCINDED.

Co-Chair Hawker MOVED to ADOPT Amendment 5:

Page 15, following line 9:

Insert a new subsection to read:

"(o) For the purposes of (m) and (n) of this section, a Cook Inlet well lease expenditure that is incurred in the Cook Inlet sedimentary basin that is

(1) directly related to a well. A lease expenditure is directly related to a well if

(A) during exploration and development, the lease expenditure is a qualified capital expenditure as that term is defined in (1) of this section;

(B) during production, the lease expenditure is an expenditure that is intended to increase, enhance or mitigate the decline of well production and directly related to the processes of operating a well and moving fluids to the assembly of valves, pipes, and fittings used to control the flow of oil and gas from the casinghead, but does not include the processes of gathering, separating, and processing well fluids downstream from that assembly;

(2) an overhead expenditure authorized under AS 43.55.165(a)(2) and calculated on the Cook Inlet well lease expenditures allowed under (1) of this section; or

(3) an expense for seismic work conducted within the boundaries of a production or exploration unit."

Co-Chair Stoltze OBJECTED for discussion.

Co-Chair Hawker explained that Amendment 5 accomplishes the same intent as Amendment 2 with better language and specifically utilizes existing statute with existing regulations.

MARCIA DAVIS, DEPUTY COMMISSIONER, OFFICE OF THE COMMISSIONER, DEPARTMENT OF REVENUE, added that Amendment 5 addressed Department of Revenue (REV) concerns regarding use of the term "lease expenditures" with a only a reference to Internal Revenue Code (IRC) 263 for describing the types of costs that would be allowed as a credit in the exploration and development phase. She reported that the sponsor had become more comfortable with using the current clause in AS 43.55.023 [Alaska's Clear and Equitable Share (ACES), Alaska oil and gas production tax credits, here called "023"], which references qualified capital expenditures and has a definition that encompasses the IRC 263 intangible cost concept. Instead of creating a new term that means roughly the same thing, subsection (o)(1)(A) was modified to reference the qualified capital expenditure.

Ms. Davis continued that subsection (o)(1)(B) addresses administration concerns that the tax credit given during the production phase could potentially cover well operations such as well abandonment and suspension.

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Ms. Davis reported that to clarify intent the sponsor had agreed to insert language specifying that the lease expenditure is intended to "increase, enhance or mitigate the decline of well production." She detailed that the language would tighten the scope of the costs that would be allowed in the production phase.

Representative Gara asked whether the overhead expenditure language in (o)(2) incorporates the existing rule with the formula determining what can be written off as overhead expenditures. Ms. Davis responded that the current rule would not allow overhead expense as a credit. She believed the issue would be a policy call for the committee. She pointed out that the sponsor was open to adding language directing the department how to calculate the overhead expenditure portion of the credit. The amendment subsection includes the language. The overhead credit (4.5 percent of costs under current regulation) will be calculated with reference to the costs listed in (o)(1)(A) and (B). The calculation would apply 4.5 percent to the costs to derive the overhead element of the credit. She added that the underlying overhead lease expense that is deductible will not change; there is more clarity to the extent that there is now credit that incorporates an additional financial incentive related to overhead.

Ms. Davis clarified that the 4.5 percent was of the costs listed in either (1)(A) or (1)(B).

Representative Gara asked whether overhead expenditures would be allowed to be deducted on top of the 4.5 percent. Ms. Davis replied yes. She explained that costs that qualify as lease expenditures are first deducted from the gross proceeds to arrive at a net production tax value.

Representative Gara queried whether overhead expenditures are allowed under ACES (referring to deduction, not credit). Ms. Davis responded yes. She added that under ACES, overhead is only allowed as a lease expenditure

deduction; the cost element is not picked up in any other credit under current law. The credit being discussed would be the only credit existing with an overhead element.

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Representative Gara queried the relationship between ACES and the proposed legislation regarding the 4.5 percent. Ms. Davis responded that they were the same; in order to understand how much overhead is associated with the incursions of any category of cost (related to lease expenditures), the department derives an allowed amount of overhead which is deemed to be 4.5 percent of the costs. The rule is used to derive the amount of overhead. All the lease expenditures are a deduction; in addition, 4.5 percent of the lease expenditures are considered the overhead expense. The two added together equal the deduction at the basic level of calculating the net production tax value. Credits are applied when the tax rate has been calculated and a tax amount is established. When REV came to interpreting the credit being discussed, the department would look at the costs that are either in category (1)(A) or (1)(B) and determine if they qualify. Forty percent of the qualifying amount would be characterized as a (o)(11)(m) credit. In addition, a credit would be created that is 4.5 percent times whatever was deemed to be the base underlying lease expenditures, creating an overhead element that would then become an expense to which the 40 percent credit is applied.

Representative Gara summarized that a credit would be received on top of the deduction and the credit would be based on overhead, defined as roughly 4 percent of the lease expenditures. Ms. Davis agreed.

Co-Chair Hawker concurred completely. He pointed to concerns that previous language could apply to statewide activities of an organization. He believed the language in Amendment 5 clearly limited the subject to qualified capital expenditures specifically related to activity in the Cook Inlet basin.

Representative Gara asked whether the intent of language in subsection (o)(1)(B) was to limit the credit to work that expands or prevents mitigation of production. Ms. Davis replied that the language intends to target the credit at any activity that will cause production to increase, such

as well reworking. The goal is to encourage expenditures that would maintain and keep up production. The natural course of a well is decline; anything done to forestall the decline adds production.

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Representative Gara summarized that a producer could choose either 40 percent of the credit for work that promotes production or the existing 20 percent for the flat credit. Ms. Davis agreed.

Co-Chair Stoltze WITHDREW his OBJECTION. There being NO OBJECTION, it was so ordered. Amendment 5 was adopted.

Co-Chair Hawker MOVED to ADOPT Amendment 3:

Page 5, following line 22:

Insert a new bill section to read:

"\*Sec.4. AS 38.15.035 is amended by adding a new subsection to read:

(n) The director may not deny an application for a lease or assignment of a lease of state land for the development and operation of a gas storage facility solely because the gas storage facility would be used exclusively or primarily to store gas owned by the owner or operator of the gas storage facility. In this subsection, "gas storage facility" has the meaning given in AS 31.05.032."

Renumber the following bill sections accordingly.

Co-Chair Stoltze OBJECTED for discussion.

Co-Chair Hawker summarized that there were three types of storage that could exist in Cook Inlet:

- Gas storage owned by a public utility for its own benefit and the benefits of its customers.
- Third-party open-access storage that could be owned by someone in the business of providing storage for a fee. This category would be available to a utility.
- Proprietary storage owned by a producer in the inlet to warehouse their own gas.

Co-Chair Hawker stressed that HB 280 is structured to provide incentives for the first two types of storage.

Rates for both are regulated by the Regulatory Commission of Alaska (RCA) and both qualify for the incentives offered in HB 280. He noted that the third type of storage (warehouse storage used by a producer for their own gas) is specifically not regulated in the bill and specifically not rewarded by the bill, in order to incentivize storage to promote energy security for individual Alaskan consumers.

Co-Chair Hawker pointed out that there are people involved in regulation that do not wish to allow any further gas storage permits in Cook Inlet for proprietary storage. Amendment 3 would direct the regulators at the Department of Natural Resources (DNR) to not deny application for a storage lease "solely" because the gas storage facility would be used exclusively or primarily for proprietary storage.

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Co-Chair Hawker informed the committee that the issue had been brought to his attention by producers in Cook Inlet who want to establish storage facilities to manage their own gas. The producers were told by DNR that proprietary storage is not going to be allowed, only open-access storage.

Co-Chair Hawker believed the regulators should not prohibit producers from the development of needed storage capacity. He expected disagreement from DNR. He argued that restricting producers would compromise the state's long-term objective of having ample in-state storage, especially not offering tax and inventory incentives that would be allowed to open-access third-party storage.

Co-Chair Hawker concluded that the amendment would preserve an option for an independent producer to create storage for their own inventory management.

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KEVIN BANKS, DIRECTOR, DIVISION OF OIL & GAS, DEPARTMENT OF NATURAL RESOURCES (via teleconference), noted that there are currently three storage facilities in Cook Inlet. Two of the facilities have been leased by DNR and would fall in the category of proprietary storage. He stated that DNR has had discussions with producers and has tried to accommodate an expansion in the marketplace for storage requirements.

Mr. Banks informed the committee that there are no opportunities for underground storage of any sort in Cook Inlet in anything but an existing oil and gas lease; the current oil and gas leases do not allow for the injection of outside substances into the reservoirs. In order to use a depleted resource reservoir as storage, a storage lease has to be promulgated.

Mr. Banks believed that issuing a storage lease would create a private right to a public land resource that had not existed before. The department judged that the storage leases could last forever and believed that a public purpose should be served when allowing private rights over public land.

Mr. Banks continued that DNR views proprietary storage as an issue of supply management for a particular producer who has certain obligations under various commitments that have already been made. The producer makes a choice to use the storage to provide for their customers because it is less expensive than other alternatives, such as drilling more wells or adding more compression in existing fields. There may also be reasons that a producer cannot drill more wells or add compression, such as commercial misalignments with business partners. He described an example: one producer in a field has a customer with steady gas supply requirements and a second producer in the same field has a customer with dramatic fluctuation in gas requirements from month to month. The second producer must come up with a storage solution, but is unable to drill more wells without the agreement of the first producer. The two producers go to DNR to try and solve the problem.

Mr. Banks stressed that there are issues with deliverability and supply and demand, but there are also institutional economic challenges to each of the producers. The challenges are not necessarily physical problems.

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Mr. Banks believed that some principle of third-party access should be realized in offering a storage lease. He pointed to a category that had not been considered in discussions so far: new producers in Cook Inlet who want to drill for gas and could potentially help by adding more supply. Without access to storage, the producers would only

be able to produce gas during winter months. He wanted DNR to be able to anticipate the challenge by insisting on some kind of third-party access.

Mr. Banks disagreed that DNR was creating difficulties related to how third-party access would work. During discussions regarding third-party access, the department had wanted to consider the particular situation of a company coming to them needing proprietary storage to meet existing contracts. The department wanted to allow for the supply requirement to be met and provide for some kind of third-party access as the contracts fall off and storage space becomes available. He thought the AS 42 (utility regulations) would apply in the situation. Under AS 42, a regulated storage facility may have only one customer using it, but as space becomes available and people want access to the storage, appeal could be made to the RCA for permission to have the utility provide the storage on a non-discriminatory basis.

Mr. Banks offered that another option would be allowing third-party access when a lease was assigned or transferred to someone else. He noted that new producers coming to Cook Inlet would be discouraged without access to storage.

Mr. Banks stressed that DNR wanted to "unbundle" the service of storage so that there was a clear price signal in the marketplace and utilities, consumers, and producers would know that gas would cost more in the wintertime than in the summer. He suggested limited gas consumption during the higher use time to improve deliverability.

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Mr. Banks commended the evolution of the legislation. He thought the department had worked well with the sponsor.

Mr. Banks agreed with the goal of achieving third-party storage. He commented on the credits built into Section 10 that would be awarded only to a storage facility. He pointed to line 26, page 9: "where the storage facility must be available for the storage of gas that is owned by a utility regulated under AS 42.05" and opined that "available" was a "quirky" word to use, but he interpreted it to mean that if a utility needs the storage and the storage is available, the credit would be awarded.

Mr. Banks remarked that there may not be a proprietary storage problem if the credits are valuable and working and effectively creating third-party storage. He was concerned that all the applications could be for third-party access storage if companies choose to take a credit and build utility storage.

Co-Chair Stoltze queried DNR's position on Amendment 2. Mr. Banks urged caution regarding the amendment. He noted that the storage leases would last a very long time and that the market is changing. He wanted the state to evolve with the market so it has something like the gas markets in the Lower-48, where almost all storage is third-party storage. He opined that third-party access type storage is a step towards deregulating the market rather than imposing more regulation.

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Co-Chair Hawker believed his position on Amendment 2 was in alignment with DNR's position. He maintained that the amendment delineates an outer perimeter and does not establish the standard or norm for storage in Cook Inlet. The legislation would create reasonable benefits to encourage producers to manage their own inventory and perhaps go beyond that. The central focus is promoting third-party regulated facilities. He underlined the word "solely" in the amendment: application will not be denied "solely" because it will be proprietary storage.

Co-Chair Hawker did not believe DNR would be compromised on determining lease terms. He noted that even the original production leases create a private property right; the storage lease would create a private property right in a public asset, but the storage would only exist to serve a public asset.

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Representative Gara voiced concerns about creating enough storage. He asked whether there were enough wells in Cook Inlet to use for storage if one-party storage were allowed. Mr. Banks replied that all the available storage already belongs to current producers. He could not imagine a situation in which a third party would drill a well in order to create new storage. He thought it more likely that some kind of commercial arrangement would be made with the

oil and gas lessee, and that the gas storage lease would be awarded eventually because of the deal between the oil and gas lessee and the storage sponsor.

Representative Gara asked what would happen if one company dominated available storage and would not lease to a utility. He wondered whether there were other storage opportunities. Mr. Banks answered that there were enough opportunities and that companies were planning for the storage they would need, though some opportunities were more efficient than others. He stated that every company currently in business could develop their own proprietary storage in order to get through the cold months.

Representative Gara queried the possible harm of allowing exclusive storage. Mr. Banks believed that HB 280 would provide the incentives needed for new gas development, but that the state would also need to rely on other lessees who do not currently have access and may not have it when the time comes. He provided the example of Armstrong: the company could develop the North Fork Unit and deliver gas to ENSTAR, but if ENSTAR cannot find storage, Armstrong would have to find it or be limited to the expensive prospect of running wells in the wintertime.

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Representative Gara asked whether a company would want regulated ability to use someone else's existing storage facility because the cost to build its own storage facility was too high. Mr. Banks returned to his Armstrong example: the company does not have access to subsurface horizon that can be used for storage. They are producing, but do not yet have depleted reservoirs, and would have to find a company that has an empty one.

Representative Gara was concerned about the inability to find affordable storage if there is not regulated access to another company's storage. Mr. Banks replied that the company might be forced to produce only in the winter months when the demand is high enough to take the gas; this might discourage new producers.

Co-Chair Hawker agreed with the hypothetical, but he pointed out that in reality there will be large, open-access storage facilities created in Cook Inlet. He emphasized that the purpose of HB 280 was specifically to

resolve impediments to establishing large, open-access facilities, especially the need for regulatory and inventory management certainty. He cautioned against a hypothetical reflecting what would happen without HB 280. He stressed that a working market is evolving in the Cook Inlet area that will include adequate storage. He underlined the importance of the outer perimeter that HB 280 was attempting to create.

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Representative Gara asked whether the measure could be written so that other companies could use the storage. Mr. Banks suggested a sunset provision for Amendment 3; for example, that leases could require third-party access for applications that came after 2014.

Co-Chair Hawker believed the department already had the latitude to make public-interest determinations. He emphasized the limitation "solely" on the open-access criteria. He was hesitant to micromanage the regulatory process. He argued that the bill would protect the ability of an individual producer to manage their own inventory.

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Co-Chair Hawker pointed out that ConocoPhillips and other producers have already diverted gas to the community in recent winters, to their own detriment. He did not want to cast big oil as bad.

Co-Chair Stoltze WITHDREW his OBJECTION to Amendment 3.

Representative Gara OBJECTED.

A roll call vote was taken on the motion.

IN FAVOR: Thomas, Austerman, Doogan, Fairclough, Foster, Joule, Kelly, Hawker, Stoltze  
OPPOSED: Gara

The MOTION PASSED (9-1). Amendment 3 was ADOPTED.

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Representative Kelly stated that Amendment 5 had solved problems he had had with HB 280, especially the "solely"

language. He queried the possibility of a negative tax situation. Co-Chair Hawker replied that the drafters had taken care to prevent the situation.

Co-Chair Hawker noted that fiscal note 4 was outdated and requested an updated note by REV. He spoke to funding for a continuing auditor position. He did not expect gas storage to happen quickly or for there to be a lot of applications in the near future. He advised zeroing out the incremental expense, leaving the change in revenues as indeterminate, and submitting the question of additional positions to the continuing budget process.

Co-Chair Hawker highlighted mistakes in the outdated fiscal note, including that the maximum credit amount had been reduced by half.

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Representative Kelly read from fiscal note 4 (REV) analysis:

The language relating to credits has the potential to be interpreted quite broadly with the potential for large reductions in state revenues when compared to future developments that might occur under the current law.

Representative Kelly commented that the obvious number was the reduction [of allowed credits] from \$30 million to \$15 million. He asked if there were other concerns that he was not seeing.

Co-Chair Stoltze stated his intent to have REV submit fiscal notes and any commentary or analysis to the committee on department letterhead.

Co-Chair Hawker pointed out concerns brought by REV related to opportunity to "game the system." He asserted that the issues were already specifically addressed, including delineating that pipe packing would not be used as a storage facility under the bill.

Representative Gara questioned whether the credit of \$1.50 per Mcf might in some years be greater than the amount expended by an entity; the first year they would get \$1.50 per Mcf to develop the storage facility but the fiscal note

says the cost is not expected to be higher than \$0.72 per Mcf. He wanted assurance that during the first year the state would not pay a credit larger than expenditures.

Co-Chair Hawker believed the fiscal note analysis was misleading. He stated that the investment tax credit related to the construction of a storage facility is a one-time credit offered only at construction; it is not a cost-of-service calculation. He gave the example of a person who decides to go into the taxi business and buys a taxi cab for \$15,000 and then charges a customer \$0.50 per mile for a ride.

Co-Chair Hawker asserted that the credit in the bill functioned differently. The credit is one time. He reported that information gathered shows that capital cost estimates between \$7 million and \$15 million per Bcf are expected for Cook Inlet gas storage facilities. Approximating roughly at 10 percent on cost credit provides the \$1.50 front-end credit. The credit has nothing to do with the annual cost of service.

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Representative Gara questioned where in Section 10 the bill limits someone to the cost of development of the storage facility and not the cost-of-service. Co-Chair Hawker noted that he would entertain an amendment to allow the credit on an annual basis. He explained that Section 10 describes a tax credit being available in an amount equal to \$1.50 per Mcf of working storage capacity (certified under the provisions of the bill). He detailed that the Alaska Oil and Gas Conservation Commission (AOGCC) would certify the working storage capability; the credit would be calculated on that basis. He added that there was nothing in the section about a benefit occurring more than once; the bill is an investment tax credit bill. He pointed to line 11 saying the credit would be available against a tax imposed for the "taxable year" in which the gas storage facility commences commercial operations. He felt the language was clear about the fact that the item was one time.

Representative Gara was comforted that the expense was a one-time expense for the development of storage, and comforted by Amendment 5. However, he wanted assurance that the \$1.50 per Mcf granted would never be greater than the cost of constructing the storage facility. He wanted

correct numbers. Co-Chair Hawker stated that the \$1.50 amount arrived at in the bill was based on analysis resulting from proprietary discussions with proposers of a significant natural gas storage facility in Southcentral Alaska. His understanding based on preliminary estimates was that the cost of gas storage development would be between \$7 million and \$15 million per Bcf of storage capacity. He recognized the latitude of the figures. He added that subsequent conversations with the some of the same people indicated to him that costs would escalate.

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Representative Gara pointed to line 19 on page 9 of the bill saying that someone would be eligible for the credit if they had storage capacity of one-half Bcf or more. He questioned the numbers. Co-Chair Hawker replied that the section referred to also contains the additional requirements for a facility to receive and qualify for the credit. He asserted that the requirements include that the working gas storage capacity be at least one-half Bcf, or 500 Mcf. He noted the importance of also having a withdrawal capacity in case operations are too slow; that is the reason for the minimum withdrawal capability requirement of 10 Mcf per day, also certified by AOGCC. In addition, there are requirements related to anti-churning and provisions stipulating that an existing proprietary facility cannot receive credit for converting to an open-access facility. The facility must also be accessible for utility-owned gas.

Representative Kelly thought the proposition was a good one given the numbers described. Co-Chair Hawker agreed.

CODY RICE, PETROLEUM ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE (via teleconference) clarified that a cost of service includes capital and operating expenses. He added that a cost of service is typically a levelized cost and includes the allowable rate base, or the costs of construction and the operating expenses as deemed allowable by the regulating entity, and an allowable return on equity.

Co-Chair Stoltze asked that the analysis be submitted in writing to the committee. Mr. Rice replied that he would pass the information on.

Vice-Chair Thomas MOVED to report CSHB 280 (FIN) out of Committee with individual recommendations and the accompanying fiscal notes.

CSHB 280 (FIN) was REPORTED out of Committee with a "do pass" recommendation and with a new zero note by the House Finance Committee for the Department of Revenue and previously published fiscal notes: FN1 (ADM), FN2(CED), FN3 (DNR).

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#hjr8

HOUSE JOINT RESOLUTION NO. 8

Proposing amendments to the Constitution of the State of Alaska limiting appropriations from certain mineral revenue, relating to the balanced budget account, and relating to an appropriation limit.

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REPRESENTATIVE MIKE KELLY, SPONSOR, introduced the proposal to change the constitution to include a balanced budget mechanism. He believed Alaska was moving in the direction of revenue shortages and cuts in government services because of declining oil revenue and growth in state budget at the rate of 10 percent per year. He stated concerns about possible consequences.

Representative Kelly noted that Alaskans had signaled their desire to have costs controlled in 1982 with a spending limit measure and in 1990 with a Constitutional Budget Reserve (CBR) measure. He asserted that neither of the mechanisms had solved the fiscal problems.

Representative Kelly reminded the committee about a previous attempt at ten-year forecasting legislation. He referred to other work on the unfunded liability, which saved municipalities from sinking and set a course to repay the debt over a 25-year period. He believed more should be done.

DEREK MILLER, STAFF, REPRESENTATIVE MIKE KELLY, introduced a PowerPoint presentation, "HJR 8, Balanced Budget

Resolution, March 18, 2010" (copy on file), beginning with Slides 2 and 3:

- In 1982, voters approved an amendment to the Alaska Constitution to control state spending.
- The amendment established an annual appropriation limit of \$2.5 billion plus adjustments for changes in population and inflation.
- In today's dollars: For FY 09, the Office of Management and Budget estimated the limit to be approximately \$8.3 billion.

Mr. Miller turned to the FY 09 budget passed (Slide 4):

- The unsustainable FY 09 budget passed by the legislature after vetoes was \$6.7 billion (unrestricted General Fund revenue), or \$1.6 billion less than the 1982 constitutional spending limit.
- Translation: The 1982 spending limit passed by voters is ineffective; or, we're doing a great job of controlling government growth.

Mr. Miller spoke to the Constitutional Budget Reserve Fund, (Slides 5 and 6):

- In 1990, another attempt was made by voters to impose budget stability. Voters approved a Constitutional Amendment creating the Constitutional Budget Reserve Fund (CBRF).
- The CBRF was created to receive and protect excess revenues generated in high revenue years rather than leaving excess funds in the General Fund (where they could be easily spent). Taking money from the CBRF requires a supermajority  $\frac{3}{4}$  vote, making it more difficult to tap and therefore arguably a spending controller.

Mr. Miller turned to a graph on Slide 7 depicting through a steadily rising line what state general fund spending would have been FY 1990 through FY 2010 if it had been simply adjusted for inflation at 3 percent.

Mr. Miller described the graph on Slide 8, with a second, contrasting line depicting actual general fund spending throughout the same period. The second line is volatile and erratic compared to the steady inflation-adjusted line. He

noted the sharp rise in recent years when the price of oil went up and there was more money to be appropriated.

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Mr. Miller pointed to a third graph on Slide 9 with a third, green line added illustrating the total general fund revenue (including non-mineral revenue). He highlighted the sharp peak in the green line for FY 08 and argued that mineral revenue, including mineral lease rentals, royalties, bonuses, and production taxes on oil and gas, are the most volatile part of the state's revenue base.

Mr. Miller turned to Slide 10, the same graph with a fourth, black line added in order to compare what spending would have looked like over the time period if HJR 8 had been imposed in 2000. He noted that spending would have been significantly lower than what was actually spent over the period until FY 10. In FY 10, the state would have been able to access account funds.

Mr. Miller described Slide 11 as a clear visual of what the measure would do. The left column shows revenue from oil after the permanent fund is paid. The five-year average is calculated and if revenue from the year is lower than the five-year average, funds could simply be transferred from the Balanced Budget Account (BBA) by the legislature up to the five-year limit. Revenue received during the year in excess of the five-year average is automatically transferred back into the BBA, which the legislature can access during low-revenue years.

Mr. Miller assured the committee that the BBA does not touch certain "Sacred Cows" (Slide 12):

- Permanent Fund Dividend
- Permanent Fund Corpus
- Permanent Fund Earnings
- Amerada Hess

Mr. Miller also assured the committee that the BBA is not subject to the CBR sweep. He pointed to a bar graph (Slide 14) covering calendar years (CY) 2006 through 2010. Adding the numbers from CY 2006 through CY 2010 and dividing by five produces the five-year average.

- HJR 8 transfers funds into the BBA when oil prices are high and, with a simple majority vote, transfers funds out of the BBA to fill the gap when oil prices are low. When the balance of BBA exceeds 2 years of appropriations, excess will be transferred into the CBR.

Mr. Miller spoke regarding a similar graph on Slide 15. He then turned to Slide 16 and detailed the relationship between the BBA and CBR:

- The BBA is limited to a maximum amount equal to oil appropriations for 2 years. Any excess will be transferred to the CBR.
- The CBR: HJR 8 transfers funds into the CBR when the BBA exceeds its 2 year limit. The legislature would still need a  $\frac{3}{4}$  vote to access the CBR.

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Mr. Miller stressed that HJR 8 is about fiscal responsibility (Slide 17):

- Encourages a better budgeting system than "when you have it, spend it - when you don't, cut."
- Provides a simple but effective mechanism to help save budget surpluses and avoid deficits while encouraging government to live within its means.
- Eliminates need for complicated "rat holing" and "parking" of excess funds to avoid  $\frac{3}{4}$  vote.

Mr. Miller addressed the issue of why the budget should be a constitutional amendment (Slide 18):

- The legislature can easily overpower, ignore or change statutory appropriation constraints.
- Let the people speak concerning this simple fiscal framework. It may be the only fiscal plan they will endorse at this time.

Mr. Miller maintained that the measure would dovetail with a Percent of Market Value (POMV) approach to funding government. He concluded with excerpts from Brandner's Legislative Digest No. 29/07 Dec. 19, 200& (Slide 20):

- Fiscal policy is more than savings and sound bites; it requires long-haul skilled political crafting.
- Long term fiscal policy has been elusive in Alaska, especially since the beginning [of] the pipeline flow and the flow of easy money. The citizen taxpayer close scrutiny faltered and was replaced by all of us with our hands out. There are reasons why we have failed, and continue to do so.
- We play the budget game from the seat of our pants.
- Lawmakers are besieged with demands to spend, especially when there is the perception or the reality as is the current case, that there is money on the table. Fiscal restraint then becomes someone else's business, or the business of tomorrow, although tomorrow brings the same appetites.
- The same people who demand that they see a critical need in their community, or in relation to their institution or industry, will still say the Legislature "spends too much."

[3:13:15 PM](#)

Representative Kelly summarized by calling the proposed measure a gentle movement towards fiscal stability. He calculated that the state's savings would have generated about \$4 billion more if HJR 8 had been in effect since 2000. He pointed out that change thus far had assured that the state's revenue-sharing dollars are average now; he believed the proposed legislation would have the same sort of impact.

Co-Chair Stoltze recalled taking up similar legislation in the past. He commended the work done.

Representative Austerman agreed and believed the proposal fit into discussions that the committee had been having.

Vice-Chair Thomas commented that the fiscal framework was not simple.

HJR 8 was HEARD and HELD in Committee for further consideration.

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ADJOURNMENT

The meeting was adjourned at 3:15 PM.

