

SENATE FINANCE COMMITTEE  
March 18, 2010  
3:14 p.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 3:14 p.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair  
Senator Bert Stedman, Co-Chair  
Senator Charlie Huggins, Vice-Chair  
Senator Johnny Ellis  
Senator Dennis Egan  
Senator Joe Thomas

MEMBERS ABSENT

Senator Donny Olson

ALSO PRESENT

Leslie Houston, Director, Division of Administrative Services, Department of Corrections; Dwayne Peeples, Deputy Commissioner, Department of Corrections; Richard Svobodney, Deputy Attorney General, Department of Law; Dave Balisdell, Director, Administrative Services Division, Department of Law; Linda Perez, Administrative Director, Office of the Governor; Karen Rehfeld, Director, Office of Management and Budget, Office of the Governor; Roger Marks, LB&A Consultant, Logsdon and Associates; Pat Galvin, Commissioner, Department of Revenue;

PRESENT VIA TELECONFERENCE

SUMMARY

SB 230 BUDGET: CAPITAL, SUPP. & OTHER APPROPS

SB 230 was HEARD and HELD in committee for further consideration.

SB 253 APPROP: DEFERRED MAINTENANCE/REPLACEMENT

SB 253 was HEARD and HELD in committee for further consideration

SB 305 SEPARATE OIL & GAS PRODUCTION TAX

SB 305 was HEARD and HELD in committee for further consideration.

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Co-Chair Stedman discussed housekeeping.

#sb230

#sb253

SENATE BILL NO. 230

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

SENATE BILL NO. 253

"An Act making capital appropriations for deferred maintenance projects, equipment replacement, and emergency repairs; and providing for an effective date."

**Department of Corrections**

LESLIE HOUSTON, DIRECTOR, DIVISION OF ADMINISTRATIVE SERVICES, DEPARTMENT OF CORRECTIONS, discussed the appropriation and deferred maintenance requests.

DM AMD 49376  
Deferred Maintenance Projects  
\$6,500,000

The department requested general fund dollars to support 11 projects. The projects, listed by priority, were as follows:

- Anvil Mountain: Replace security control system located in both security control stations. Fire/Life safety code requirement  
\$750,000
- Anvil Mountain: Construct new utilidor. Fire/Life safety code requirement  
\$1,500,000
- Anvil Mountain Correctional Facility: Replace failing septic tank with waste water treatment plant.  
\$1,500,000
- Palmer: Replace fire pump and fix sprinkler piping.  
\$750,000
- Wildwood: Replace roofing system.  
\$940,000
- Spring Creek: Analyze security control system and perimeter security.  
\$145,000
- Ketchikan: Design secure efficient lighting system.  
\$55,000
- Ketchikan: Replace existing lighting system with secure and efficient lighting system.  
\$390,000
- Palmer: Replace obsolete fire alarm panels in medical, administration, warehouse and maintenance shop.  
\$200,000
- Hiland Mountain: Replace and expand exterior freezer.  
\$140,000

- Wildwood: Replace fire alarm system.  
\$130,000

Co-Chair Stedman solicited questions pertaining to the project list. No questions being offered, Ms. Huston continued to the FY11 capital budget request. Two items comprised the departmental request:

CAP RN 45637  
Anchorage Correctional Complex Renovation and  
Remodeling  
\$350,000

CAP RN 41516  
Community Jails Repairs, Renovations, and Equipment  
\$100,000

Co-Chair Stedman solicited questions pertaining to the project requests.

#### **Department of Law**

CAP 49182  
Fairbanks and Anchorage Key Card Office Access  
\$150,000

DAVE BALISDELL, DIRECTOR, ADMINISTRATIVE SERVICES DIRECTOR, DEPARTMENT OF LAW, explained that the request would fund implementation of a Key Card system in Anchorage facilities. Metal keys were currently being used in the facilities. When the keys are lost, all locks in the building must be changed, which is of considerable expense to the department. Key Cards would alleviate the issue.

Senator Thomas wondered about future technology involving retinal scans. Mr. Blaisdale replied that the technology is available but expensive.

Co-Chair Stedman invited questions pertaining to the request.

#### **Office of the Governor Language**

LINDA PEREZ, ADMINISTRATIVE DIRECTOR, OFFICE OF THE GOVERNOR, gave an overview of the two capital budget project requests.

CAP 49388  
Division of Elections Technology Refresh  
\$123,800

The request represents the scheduled replacement of desktop computers, software, and operating systems, within the department, every four years.

CAP RN AMD 48416  
Elections Reform Under the Federal Help America Vote Act  
\$1,499,900

Ms. Perez explained that the request was to expend federal monies received in the election fund from the Help America Vote Act, which is an ongoing appropriation from the federal government to better the process of elections throughout the state.

KAREN REHFELD, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, pointed out changes in the capital language sections of the budget. There were four amendments in the language section that had already been transmitted. Section 7 allows for state agencies to refer to Legislative Budget and Audit concerning incoming requests for federal or other program receipts. Section 8 is the Fund Transfers portion of the bill. Sub-section (a), speaks to the Alaska Capital Income Fund. Sub-section (b) pertains to the federal Help America Vote Act funds; Line 24 was amended to read \$1,425,000. Line 25 was amended to read \$74,900 from the general fund for the matching portion. Because the Division of Elections had been notified that the match requirements had been met and no additional funds were necessary, the administration planed to submit an amendment that would remove the general fund match requirement.

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Ms. Rehfeld discussed Sub-sections (c), which was a \$25 million request for the Renewable Energy Fund. The amount in Sub-section (d) was amended to read \$140 million, based

on the latest information available from the Department of Revenue (DOR).

Co-Chair Stedman requested a detailed breakdown of who was being paid by TransCanada, and how much. Ms. Rehfeld replied that DOR compiled a monthly report, and that copies would be made available for the committee.

Ms. Rehfeld continued to Sub-section (e), which speaks to the Alaska Industrial Development Export Authority (AIDEA) dividend into the power project fund. Section 9 is the insurance claim section. Section 10 is the National Petroleum Reserve- Alaska Impact Grant Program, which was reduced to \$4,847,165, for specific grants. The revenue was derived from leasing, and the additional revenue had not been anticipated during this period, thus the reduction of the grant amount in the budget. Section 11 deals with the cost of certificates of participation.

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Ms. Rehfeld highlighted that one of the proposed amendments concerns the Alaska Class Ferry. The amendment requests access to \$60 million that had been set aside in the vessel replacement fund, and the redirection of two prior federal appropriations for fast ferries to the Alaska Class Ferry Project. Section 12 provides for the lapse of various capital appropriations and an effective date.

Co-Chair Hoffman asked for a list of lapse extension projects. Ms. Rehfeld explained that the section describes appropriations made in the various components of the entire capital budget that would have a lapse extension for capital projects.

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Senator Thomas noted similar Information Technology (IT) project requests within different departments. He wondered if individual contractors had been hired by departments to research the IT requests. Ms. Rehfeld replied that an extensive IT planning process was employed yearly, and projects went through internal review. The departments share information in order to prevent duplication of information between agencies. She felt that the items that had been brought forward were of significant importance to the department. All IT projects are reviewed by the

Enterprise Investment Board, which is comprised of Ms. Rehfeld, the Commissioner of Administration, a representative of the technical group and one other member. The board goes through the review process of agency requests and formulates budget decisions and recommendations to the governor.

Co-Chair Hoffman asked why Alaska Housing Capital Corporation funds, and not the general funds, were being considered as the funding source for the \$150,000 Alaska Gas Inducement Act reimbursement fund. Ms. Rehfeld stated that the administration felt that the funding source was the most appropriate source for the project.

[3:31:05 PM](#) AT EASE

[4:10:28 PM](#) RECONVENE

#sb305

SENATE BILL NO. 305

"An Act relating to the tax on oil and gas production; and providing for an effective date."

Co-Chair Stedman introduced the bill.

Co-Chair Hoffman MOVED to adopt CSSB 305 26-LS1577\S as a working document. Co-Chair Stedman OBJECTED for the purpose of discussion.

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ROGER MARKS, LB&A CONSULTANT, LOGSDON AND ASSOCIATES, began the power point presentation, "SB 305: CS Version S & Amendments" (copy on file). He discussed Slide 2, "Version S Committee Substitute", which lists the recent changes in the language of the bill:

- Title has tightened scope further
- Technical changes in Section 5
  - Some of the proposed changes to AS 43.55.020(a)(1) did not need to be there- CS reverses those changes.
- Technical change- new Section 8

- Gives authority to department to adopt regulations to allocate AS 43.55.170 adjustments to lease expenditures between oil and gas.

Co-Chair Stedman requested further discussion on Section 8. Mr. Marks explained that in lease expenditures were discussed in AS 43.55.170. The accounting could be tricky and care should be taken that neither costs nor revenue was double counted. When discussing the split of oil and gas progressivity, it becomes necessary to define which lease expenditures apply to oil and which apply to gas. Section 8 gives the administration the authority to adopt regulations concerning how the lease expenditures should be divided.

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Co-Chair Stedman REMOVED his OBJECTION to the CS. There being NO OBJECTION, the CS 26-LS1577\S was ADOPTED as a working document.

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PAT GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, discussed the fiscal note. He stated that the method of acquiring and managing information from taxpayers would need to be changed prior to the decoupling of oil and gas, and funding was necessary in order to implement the changes. Currently, oil and gas production statewide is combined when determining the progressive tax rate. The potential change in state revenue was indeterminate.

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Commissioner Galvin continued. The bill would affect current producers and the department had examined potential annual financial impact through the tax receipts. Referenced in the fiscal note was the range of tens of millions to hundreds of millions in a given year. The number fluctuates, which has added to uncertainty.

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Co-Chair Stedman understood the numbers had been flexible. Commissioner Galvin agreed. He added that the potential impact was that more revenue could be expected when the price of gas and oil were divergent, and less than the status quo when prices were closer to the 10 to 1 ratio.

Co-Chair Stedman requested that the fiscal note be rewritten due to changes made by the amendments. He referenced the language in the fiscal note. Commissioner Galvin said he would provide as many numbers as possible. Co-Chair Stedman said the committee would work with the department to craft a comprehensive fiscal note. Commissioner Galvin stated that the language was not in reference to the expected market price. Co-Chair Stedman and Commissioner Galvin discussed the semantics of "normalcy" as it was written in the fiscal note. Co-Chair Stedman's maintained that the normalcy, under the price relationship between gas and oil, was a different normalcy than between the British Thermal Unit (BTU) equivalency.

Co-Chair Stedman MOVED to adopt Amendment 1.

Co-Chair Hoffman OBJECTED for the purpose of discussion.

Mr. Marks continued to Slide 3, "Amendment 1: Tax Neutrality on Current Activity", which explains the intent of the amendment:

- Currently some producers produce oil and gas.
- If you separate oil & gas for calculating progressivity, progressivity on oil will be undiluted by gas and taxes will increase.
- It is not intent of bill to raise taxes on current oil and gas activity
- Amendment 1
  - Credit equal to difference between tax determined under bill and tax determined now
  - Credit expires in 2015

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Co-Chair Stedman noted that the credit would expire in 2015.

Mr. Marks explained that the 2015 expiration date would protect the state from a collapse in oil revenue if an AGIA plan is implemented, without causing taxes on current activity. Hopefully discussions on a tax regime for gas will have occurred by the 2015 date.

Senator Thomas inquired about Cook Inlet gas production. Mr. Marks responded that there were sets of producers that had North Slope oil and Cook Inlet gas. Those producers, based on current activity, would see tax increases without the amendment.

Co-Chair Stedman REMOVED his OBJECTION to Amendment 1. There being no further OBJECTION the amendment was ADOPTED.

Co-Chair Hoffman MOVED Amendment 2.

Co-Chair Stedman OBJETED for the purpose of discussion.

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Mr. Marks continued his presentation. He explained that Prudhoe Bay was producing 270,000 barrels of oil per day. Oil cannot be removed from the earth without the accompaniment of natural gas. The gas is separated and some is placed back in the ground to re-pressurize the field for oil production. If in the future the gas is also marketed, Prudhoe Bay would become an oil and natural gas field, which most fields are. The costs to produce oil and gas are joint, which makes it necessary to allocate costs between oil and gas in order to tax them separately. Slide 5, "Amendment 2: Cost Allocation", details the changes made by amendment 2, and are as follows:

- Retain current agency authority, and
- Consider BOE approach
- Costs to produce oil and gas are truly joint costs: the same process that produces one produces the other
- Benefit of current approach (AS 43.55.165(h)) that gives department authority to adopt regulations for allocation costs between oil and gas:
  - As recipient of confidential cost data they are in the best position to evaluate costs
  - A regulatory process allows more time
  - The regulator process is public

Mr. Marks explained the BTU Equivalent Barrel (BOE) Approach. He stated that it was the same approach that was

currently embraced in the departmental regulations. The mechanics (AS 43.55.900(3)) read:

1 barrel of oil= 1 BOE  
6 mmbtu's to the barrel  
Gas mmbtu's/6= gas BOE's

Mr. Marks said that the rationale for the BOE approach is that the same costs that produce oil also produce gas. The BOE method puts oil and gas on an "apples to apples" basis in terms of relative produced volumes.

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Mr. Marks continued. Slide 7, "Problems with other Methods", which details the different approaches that could be taken to allocate costs. He discussed the various approaches and the scenarios that could come into play:

- Item by item attribute
  - Inappropriate where costs are truly joint
- Dominant use (either all oil or all gas)
  - Inappropriate when large volumes of both are produced
- Deemed approach (deemed one unless item is 100 percent the other)
  - Inappropriate when large volumes of both produced
- Reserves
  - Uncertain numbers/subject to taxpayer control
- Gross value
  - Upstream costs should not change with downstream prices

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Mr. Marks continued to Slide 8, "A Note on 15 AAC 55.220":

- Department of Revenue's proposed regulation on AGIA uses the Gross value approach to allocate the total tax between oil and gas

- Allocation tax is different than allocating costs
- Gross value is a very material determinant of the differences in tax value between oil and gas
- Allocating tax by gross value for this purpose is reasonable

Mr. Marks addressed the concern for the treatment of Point Thomson. Slide 9, "A Note on Allocation of Capital Costs Associated with Developing Pt. Thomson", reads:

- High development costs will be incurred prior to gas sales: these costs will be allocated against oil
- Pt. Thomson is also an oil (condensate) field (est. 300 million barrels)
- Could be developed such that it produces condensate years before it produces gas
- PPT/ACES were deliberately designed so that cost deductions and credits would be utilized immediately

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Mr. Marks reiterated that the amendment allows the department to maintain authority for the allocation of lease expenditures.

Co-Chair Stedman removed his OBJECTION to the amendment. There being NO OBJECTION, Amendment 2 was ADOPTED.

Commissioner Galvin expressed appreciation for the language in Amendment 2. The desire of the department would be to put the language into statute in order to avoid problems in the regulatory process.

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Co-Chair Stedman stated that the committee was determined to work with the department on the language pertaining to cost allocation. He asserted that this was not the main

reason that the bill was on the table but hoped that significant conversation on the issue would be had before 2015. Commissioner Galvin replied that if the allocation was to be based on current or projected costs, there were significant costs that would be joint costs in production. He felt other considerations would need to be examined. He assured the committee that the department would continue to work with the committee, but felt that further guidance would be necessary.

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Co-Chair Stedman said that a solution was necessary. He requested that the department provide records from the last three years on the impact of the dilution, dealing with Cook Inlet and the North Slope, to educate the committee on the numbers. Commissioner Galvin said that Amendment 1 makes the fiscal note moot. Co-Chair Stedman said that a new fiscal note would be needed to ensure that the public has the opportunity to see the language and the fiscal impact.

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ADJOURNMENT

The meeting was adjourned at 4:50 PM.