

SENATE FINANCE COMMITTEE
March 13, 2012
1:02 p.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 1:02 p.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Lesil McGuire, Vice-Chair
Senator Johnny Ellis
Senator Donny Olson
Senator Joe Thomas

MEMBERS ABSENT

Senator Dennis Egan

ALSO PRESENT

Senator Joe Paskvan; Jeff, Stepp, Staff, Senator Joe Paskvan; Patrick Gamble, President, University of Alaska; Daniel R. Fauske, Chief Executive Officer and Executive Director, Alaska Housing Finance Corporation, Department of Revenue and President, Alaska Gasline Development Corporation; Joe Dubler, Vice President and Chief Financial Officer, Alaska Gasline Development Corporation and Director of Finance, Alaska Housing Finance Corporation, Department of Revenue; Les Campbell, Director of Budget, Alaska Housing Finance Corporation, Department of Revenue.

PRESENT VIA TELECONFERENCE

Mark Myers, Vice-Chancellor, Research, University of Alaska, Fairbanks.

SUMMARY

SB 160 BUDGET: CAPITAL

UNIVERSITY OF ALASKA
ALASKA HOUSING FINANCE CORPORATION
DEPARTMENT OF PUBLIC SAFETY

SB 160 was HEARD and HELD in Committee for further consideration.

SB 192 OIL AND GAS PRODUCTION TAX RATES

SB 192 was HEARD and HELD in Committee for further consideration.

#SB192

SENATE BILL NO. 192

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

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SENATOR JOE PASKVAN, began on slide 60 of a PowerPoint presentation [also heard during the March 13, 2012 morning meeting] titled "Committee Substitute for Senate Bill 192 (RES) Oil and Gas Production Tax Rates" (copy on file). He referred to a hearing before the Committee on Energy and Natural Resources, United States Senate, New Developments in Upstream Oil and Gas Technologies: Testimony by Kevin Banks, Director, Division of Oil and Gas, Alaska Department of Natural Resources (May 10, 2011). He explained that Mr. Banks had spoken about potential for production and throughput through the Trans-Alaska Pipeline System (TAPS) including heavy and shale oil. He quoted from Mr. Banks' testimony:

There are no known conventional resources on State or Native lands that are likely sufficient to replace the decline in the existing production rates.

Senator Paskvan believed that although the state should remain optimistic about heavy and shale oil and Outer Continental Shelf resources, the information from Mr. Banks was poignant. He moved to slide 61 titled "TAPS Throughput Continues Steady Decline" that included testimony from a March 1, 2012 Senate Resources Committee meeting. He had asked Scott Jepsen, Vice President, External Affairs, ConocoPhillips Alaska whether Alaskans should expect to see 1 million barrels a day from state lands in conventional

oil with the \$5 billion investment over the next ten years. Mr. Jepsen had remarked previously that the expenditure of the \$5 billion would commence in the upcoming three years, but would be spent over the next six to ten years. Mr. Jepsen had indicated that 1 million barrels a day was a good aspirational goal, but he didn't think it was possible to get there with conventional oil. Mr. Jepsen hoped that other types of technologies may increase throughput from shale or heavy oil.

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Senator Paskvan addressed slide 62 "Other Oil Producing Regions Enjoying Production and Employment Booms" and the resurging North American oil production issues. He referenced how technology had created an upheaval in the North American natural gas markets. The slide highlighted the transfer of technology that had transformed the natural gas field and its promise to improve oil production in the United States. The technology had caused the surge in natural gas production, which was transforming the outlook for oil production in America. He quoted material from the slide (source: Citi Investment Research & Analysis, February 15, 2012):

Advances in the use of horizontal drilling and hydraulic fracturing have unlocked vast reserves of hydrocarbons originally trapped in highly dense shale rocks. The two shale oil plays that have benefited most from this transformation so far are the Bakken and Eagle Ford.

Senator Paskvan noted that Bakken was located in North Dakota and that Eagle Ford was in Texas. He hoped that the shale and heavy oils would arrive in and benefit Alaska in the near future. He asked his staff to walk through the subsequent slides related to rig counts.

JEFF, STEPP, STAFF, SENATOR JOE PASKVAN, referenced a comment by Senator Paskvan that Alaskans expected policy makers to act like "sophisticated owners of a world-class resource." He stated that part of being a sophisticated owner was performing a sophisticated analysis of the relevant issues. He pointed to comparisons made between Alaska, North Dakota, and Texas. He quoted from slide 62:

The unrelenting increase in oil rig count has been driven by two major forces: the sustained, high price of the commodity and the promise of improved oil production using the technology that has transformed the gas sector.

Mr. Stepp elaborated that the technology referred to in the quote was horizontal drilling and hydraulic fracturing. He looked at a map of the Baker Hughes oil rig count in Bakken, North Dakota on slide 63. According to the Baker Hughes website and app the current active rig count was 196; all of the rigs were for shale "oil play," a strategy not currently used in Alaska. He stressed that there was a substantial amount of infrastructure in North Dakota compared to Alaska's North Slope. The map indicated the presence of many state highways and county roads that provided access to infrastructure hydraulic fracturing technology.

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Senator Paskvan turned to slides 69 and 70: "Other Oil Producing Regions Enjoying Production and Employment Booms." He referred to an article: Alaska Economic Trends: Alaska's Oil Industry September, 2008 (copy on file). He believed that it was a fact that there had been dramatic improvements in technology in the past decade. The article addressed examples including, horizontal drilling, ultra extended-reach drilling, 3-D and 4-D seismic surveys, drill bit sensors, and other advancements that reduced the number of wells that needed to be drilled; the number was significantly lower than it was ten years earlier. Slide 70 addressed that the national oil and gas industry had been a leader in productivity gains throughout the 1990s and that the industry had been able to perform more work with fewer workers (page 6 of the Alaska Economic Trends: Alaska's Oil Industry September, 2008). He furthered that the industry goal of fewer workers did not match up with the state's goal of increased employment for Alaskans in the industry. He stressed that policy makers should expect to see continued advances in technology given the industry's motivation to continue the development of new technologies to perform more work using fewer workers.

Senator Paskvan directed attention to slide 71 that compared Alaska to other oil producing states. Based on the size of Alaska's oil industry work force a person would not

guess how important oil was to the state's economy according to the Alaska Economic Trends: Alaska's Oil Industry September, 2008. He cited from the report that "Alaska produced 15 percent of the nation's domestic oil supply in 2007 but employed only 3 percent of the U.S. oil and gas work force...(page 10)."

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Senator Paskvan pointed to slide 72 that continued to focus on how Alaska compared to other oil producing states:

One big reason is simply that Alaska's oil fields enjoy large economies of scale. Prudhoe Bay is the largest oil field in the nation and doesn't need a huge work force to produce its oil...

In Texas, Oklahoma, Wyoming and other oil-producing states, some oil is produced from very small fields. There are 400,000 marginal fields or stripper wells operating in the U.S. and a stripper well produces 10 barrels of oil or less per day. In many of the states, there are literally thousands of families and small companies engaged in producing oil - something nearly totally absent in Alaska.

Senator Paskvan recalled that when legislators had been in Texas in 2011 they had been told that the average Texan well produced less than 5 barrels a day; something unknown to Alaska where the production per well greatly exceeded the amount. He read from slide 73 "Other Oil Producing Regions Enjoying Production and Employment Booms":

Technology advances lead to more drilling and more jobs in the new, unconventional (i.e., shale) oil plays in North Dakota and Texas.

At the same time, technology advances lead to fewer wells and fewer jobs in the mature, conventional oil plays on Alaska's North Slope.

Senator Paskvan relayed that the state awaited the application of technology in conventional resources in heavy and shale oils and hoped for breakthroughs in the area in order to compare to Texas and North Dakota.

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Senator Paskvan discussed slide 74 "Competition is High - Many Other Areas to Invest Around the World." He observed that the Alaska North Slope remained a world class basin; the Prudhoe Bay field was one of the ten largest fields in the world. He pointed to the vertical integration of the "big three" on the central North Slope [BP, ConocoPhillips, and ExxonMobile] and discussed that dollars were made by distribution from the upstream to midstream and at the wellhead. The industry was in a transition from "majors only to mid-majors and independents." He related that national oil companies had limited the areas in which investments could be made. The final bullet point addressed the concept of immobile capital including sunk costs; the incentive was to keep areas functioning as long as possible; a significant Central North Slope infrastructure that remained attractive to the industry.

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Senator Paskvan reviewed components included in SB 192 beginning on slide 76: "CSSB 192(RES) Rationale and Overview." He highlighted that the legislation:

- Preserves Industry-Friendly Components of ACES
- Reduces the Rate and Cap of Progressivity
- Rewards Increased Production
- Establishes a Gross Minimum Tax
- Separates oil and natural gas for purposes of calculating the progressivity portion of the production tax
- Creates an Oil Information System

Senator Paskvan elaborated that the goal of the oil information system was to make the access to information more readily available to policy makers.

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Senator Paskvan highlighted industry-friendly components of Alaska's Clear and Equitable Share (ACES) that SB 192 would

preserve. Expenditures and transportation costs were preserved so the calculation of production tax was applied after the removal of the deductions. The bill maintained the current tax credits. He explained that for the same dollar a company could deduct a 20 percent credit (a company could deduct 100 percent of the dollar spent in the year it was spent), which was a powerful investment incentive. The royalty rate that ranged from 12.5 percent to 16 percent was preserved and was attractive to the industry; royalty rates ranged from 25 percent to 30 percent in other states including North Dakota and Texas. The concept of royalty modification was sustained; if an operator was able to prove a need for assistance the Departments of Revenue and Natural Resources could reduce the royalty down to as low as 3 percent to allow the fields to continue production.

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Senator Paskvan addressed the progressivity rate and cap reduction that would occur under SB 192 (slide 78). The bill retained the original trigger of \$30 in production tax value (PTV). He explained that the PTV was assessed after deductions for transportation costs and for qualified and operating expenditures. The PTV was a \$30 gap that was maintained at the base 25 percent, at which point the progressivity rate was reduced from a 0.4 per dollar increase in PTV to a 0.35 per dollar increase that was capped at 50 percent. At 50 percent there was a second trigger on the progressive tax rate calculation to further reduce the rate of progressivity from 0.35 per dollar to 0.1 per dollar up to 60 percent. The 60 percent progressivity cap was a reduction from the current 75 percent cap. He stressed that the reductions were significant and material.

Senator Paskvan pointed out that the bill would reward increased production (slide 79). He relayed that a joint Senate Finance and Resources Committee meeting had heard from petroleum consultant Pedro van Muers who had addressed the concept of an allowance for an increase in new oil or incremental oil; it had been deemed important that the bill provide incentives based on the concept. An allowance was included that would reduce a company's PTV by \$10 for new and/or incremental barrels produced.

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Senator Paskvan communicated that the bill would establish a gross minimum tax of 10 percent on the legacy fields of Kuparuk and Prudhoe Bay to ensure that the revenue streams would always maintain a minimum floor. In addition to the adjustment for the oil industry at high oil prices the bill factored in the potential for oil price volatility and the need to balance the risk to the state at low oil prices. He relayed that consultants had expressed the need for ACES to be durable in a wide range of price environments; the provision helped achieve that goal and protected the state at the downside.

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Senator Paskvan reviewed the decoupling of the oil and natural gas taxation systems on slide 81. He explained that the tax rate applied in Alaska was based on the combined BTU [British Thermal Unit] value of oil and gas; oil and the BTUs created by oil were valued substantially higher than BTUs of natural gas. There was a dilution effect that dramatically reduced revenue streams to the state if the taxes were not decoupled. The legislation removed the dilution effect by having progressivity calculated distinctly for oil and gas.

Senator Paskvan detailed that SB 192 would create an oil and gas information system (slide 82); it was believed that as much historical and current oil and gas information as possible should be available to policy makers to help them make decisions based on substantive data. The Alaska Oil and Gas Conservation Commission (AOGCC) would be required to develop the electronic Petroleum Information Management System in order to make information more readily available to policy makers.

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Senator Paskvan believed that there was more reason for optimism related to Alaska's future than ever before (slide 84). There were 7 billion to 8 billion barrels of conventional oil on the Central North Slope; additionally there were other resources including, heavy and shale oils, undiscovered conventional oil, Outer Continental Shelf in the Beaufort and Chukchi Seas, National Petroleum Reserve-Alaska, and the Alaska National Wildlife Refuge. The North Slope was worth more currently than it had been over 30

years earlier because the value of oil had increased. He noted that spending forecasts were up; there had been significant work performed below ground in well workovers and there had been a rebuilding of infrastructure below and above ground. He believed the work would set the stage for a "viable and vibrant" oil industry for decades to come. He recalled that Cathy Foerster with AOGCC had reported that the North Slope was healthy. He agreed with the Department of Natural Resources (DNR) advertisement that read: "Alaska: We're Open for Business"; he believed that the state was competitive and had a world class resource to offer. He pointed to a recent Petroleum News headline "North Slope Booms"; legislators had been told in the past year that exploration on the North Slope was at a level that had not been seen in 40 years; as such, there were currently not enough rigs to perform all of the work that North Slope operators wanted. He referred to a practice called "hot sheeting" where workers alternated sleeping in beds due to the numerous employees working on the North Slope.

Senator Paskvan concluded that Alaskans wanted to see the legislature act like a sophisticated owner of a world class resource and expected that Alaska would obtain the maximum value for its resources for its citizens.

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Senator Thomas wondered whether members' packets included the following detailed information: a memo from Mark Meyers regarding mergers and market concentrations, Prudhoe Bay development history and future potential (slides 31 through 33), and the optimization of production from mature fields (slide 34).

Senator Paskvan replied that his office would provide the articles and any additional information that the committee wanted.

Senator Thomas referred to slide 60 and wondered whether Senator Paskvan had heard from the Department of Administration or DNR that remarks made by Kevin Banks to the U.S. Senate the prior year were false or misleading.

Senator Paskvan replied in the negative. He believed the remarks were true at the time they were made and continued to be true.

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Co-Chair Hoffman referred to an unlabeled handout from DNR's Division of Oil and Gas; it stated that the past two years of lease sales of the North Slope successfully leased a total of 1,276,000 acres to small companies. He asked how many wells had been drilled on the leases in the past two years.

Senator Paskvan responded that he did not have the information.

Senator Stedman would ask DNR to respond to the question at a later time.

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Senator Ellis asked about any Senate Resources Committee discussions related to lease terms and the duty to produce. Additionally, he was interested in any discussion on state direct financial investment (SDFI) to better align industry and state interests. He asked about facilities access; he had heard from individuals in the industry that there was no problem with facilities access and that it was a commercial transaction that could occur in the future.

Senator Paskvan affirmed that all of the topics had been discussed in the Senate Resources Committee. The ideas from members were valid, but the issue was whether tax legislation should be confined to the tax components. He believed that there should be some "footage on the cutting room floor" to keep the bill as precise as possible. He referred to a slide in the presentation that included remarks made by Bob Bartlett at the Alaska Constitutional Convention; Mr. Bartlett had discussed the acquisition of large tracks of land with the intent not to purchase. The Senate Resources Committee had discussed that there were exclusive rights provided under the lease structure that could be for 10 years where no activity occurred; the question was would the lease be tendered back to the state. The topics of duty to explore, produce, and sell had been a source of significant discussion in the committee. He hoped that issues would be better developed throughout the legislative session, particularly relating to the duty to produce.

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Senator Olson referred to the Gleason Decision (slide 36). He asked whether there were any points in the decision that were in the repeal or reconsideration process that may change the date from 2065 or 2075.

Senator Paskvan answered in the affirmative. There had been a state request for reconsideration of the decision. He elaborated that the prior week Judge Guidi had denied the state's application with respect to one component of the decision (the case had been transferred to Judge Guidi given that Judge Gleason was made a federal district court judge); Judge Guidi supported Judge Gleason's decision. He expected that the decision would be appealed, but as of yet the appeal for tax years 2007 through 2009 had not occurred.

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RECONVENED

#SB160

SENATE BILL NO. 160

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

UNIVERSITY OF ALASKA

PATRICK GAMBLE, PRESIDENT, UNIVERSITY OF ALASKA, introduced himself and other staff that were available to answer questions. He communicated that the \$37.5 million increment for deferred maintenance or replacement and renovation (the funding was for year three of a five-year program) was the only item in the governor's budget that was included in the current bill. He explained that the prior year he had proposed a two-year program to examine the university and state financial situation; the budget had been flattened considerably and the university had not asked for any planning or programming money for new projects. With the exception of the deferred maintenance area the university budget was in a good position due to a generous bond

issuance. When he had taken the position as president a deferred maintenance problem was identified and he and other university staff had marked it as the top priority. He furthered that other areas including any new construction would stay "lean and mean" during the deferred maintenance improvements. He noted that the university had already been given generous funding for construction and that the days of increasing the budget from year-to-year (as in the past ten years) were over; employees had been told that the budget would at least be flat and could decline depending on the economy.

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President Gamble reemphasized that the number one priority was deferred maintenance, which was beginning to impact every corner of the university; it had the largest single ownership of state buildings, many of which were quite old. He clarified that the number one academic priority was engineering. He relayed that the question was how to programmatically maintain and improve the facilities; the university had not been programmatic about the upkeep of its facilities in the past. He added that operations and maintenance money had generally been funded on a year-to-year basis. He explained that the repurposing dollars for older engineering facilities became an accreditation problem when engineers were currently far in advance of where they had been when the facility was built. The deferred maintenance and replacement and renovation (R&R) were connected but separate; buildings could be reconditioned to add years to their life, but if the upkeep was not maintained systems could fail and were then moved to the deferred maintenance list.

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President Gamble stressed that the deferred maintenance list had become so large that the dollar amounts were staggering. He remarked that because the large numbers were competitive with other needs of the state the tendency was to not want to deal with them. He understood the legislature's challenge when confronted with the budget decisions. The university's request was for flat funding of deferred maintenance projects and no new money for programing, design, or engineering. The prior year the university had requested \$50 million for R&R (it had received \$2 million); the amount was needed on an annual

basis in order to avoid a problem similar to deferred maintenance. The legislature had authorized the sale of \$100 million in bonds for the university that would pay for them internally; he expressed appreciation for the funds and noted that the amount had been cut back to \$50 million. The university was striving to put the money to work as quickly as possible on pre-identified projects by each of the main campuses; each campus had been polled to determine the highest priority projects; the total cost for the priority "mission failure potential" projects was \$100 million. He stressed that the deferred maintenance was not an optional number that would go away if it was not funded in one year. The university had asked for another \$100 million and the R&R funds in the current budget, which had all been removed. The rate of accumulation of deferred maintenance from year to year had grown to compete with the governor's funds designated to reduce deferred maintenance; however, it only slowed growth that continued to accumulate. He expounded that the entity had its work cut out for it; it would use the \$37.5 million and had asked for \$15 million in receipt authority in case it was able to obtain federal money during the current year.

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President Gamble referred to a chart titled "FY 13 Sustainment Funding Plan for UA Facilities" that illustrated the effect of funding items versus not funding items. Even with the \$50 million and \$37.5 million funding allocations the deferred maintenance number had gone from \$750 million down to \$710 million; the growth had been slowed, but would begin all over again as soon as money stopped being directed at the items. The model was essentially unchanged from the prior year given that the concerns were still the same. He discussed the idea of a sustainment approach that would enable facilities to operate going forward and to bring the large deferred maintenance number down to a reasonable number; reasonable to the university was a number in mid-\$300 million dollar range as opposed to \$700 million.

President Gamble communicated that risk increased with advancing deferred maintenance (e.g. HVAC, roof, or plumbing failures). He compared one of the engineering buildings built in 1983 to airplanes constructed in the same year that were no longer functional; he explained that planes went to the "bone yard," but buildings went to deferred

maintenance. When failures occurred the university had to borrow from other fund sources to provide a band-aid for the problems. He provided an example of a Fairbanks dormitory that had been taken down due to an internal plumbing failure; as a result students had to move out and the university had lost the revenue. He hoped the legislature would enable the university to develop a programmatic plan to address the problem.

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President Gamble acknowledged that the governor's budget was the budget before the committee. He stressed that there was no padding to the deferred maintenance list; each represented a specific project at one of the university campuses.

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Co-Chair Hoffman recognized the importance of deferred maintenance. He recalled the first time the university had received funding for deferred maintenance years earlier. He listed various funding request items: \$2.5 million for parking security (page 3); \$561,000 for Mat-Su door lock key access; \$6 million for a master plan at the lower campus; \$3.6 million for a sports facility renovation; and \$6 million for campus roads, curbs, gutters, and ramps. He pointed out that campuses in Lower Kuskokwim had experienced failures due to extremely cold weather; the campus needed HVAC upgrades as the current system was causing teachers and students to have headaches. During the cold spell many individuals had to spend the night at the facility to provide 24-hour supervision of the system. He believed the issues represented higher priority problems than parking and security. He wondered whether the university had a list of repairs needed at rural campuses.

President Gamble replied in the affirmative. He elaborated that the number one priority specified by the Kuskokwim campus was a \$5.1 million project; \$900,000 would go to the campus if the university only received the \$37.5 million. He furthered that the dollars provided to the campus would increase proportionally based on funding received above the \$37.5 million. He added that the priority lists were provided by campuses.

Co-Chair Hoffman emphasized that the problem at the Lower Kuskokwim campus represented a health/life safety issue. He opined that the issue should rank higher than parking and security.

President Gamble agreed. He promised to look into the concern and explained that funding was reallocated from another area if safety issues existed.

Co-Chair Hoffman would provide the information.

President Gamble pointed to the chart and explained that projects were not prioritized and that they all fell under the urgent category.

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Senator McGuire asked President Gamble to meet with Dan Fauske [Executive Director, Alaska Housing Finance Corporation (AHFC), Department of Revenue] and report back to the committee on whether some of the replacement and upgrade projects would qualify under the loan program that originated under the omnibus energy package. She elaborated that the package included \$250 million for AHFC for upgrades and replacements on roof repair, HVAC systems, windows, power infrastructures, etc. She added that the program may present another funding option for the projects that would potentially free up funding for Senator Hoffman's district [Lower Kuskokwim].

President Gamble agreed. He would discuss the option with Mr. Fauske during a meeting the following week.

Senator Thomas pointed to a line on the chart representing the status quo; it was defined as "deferred maintenance backlog without adequate R&R." He wondered what was considered an adequate R&R number. He asked what funding amount would reduce the number below \$362.5 million. He asked whether \$100 million was the amount needed.

President Gamble explained that if the university received \$50 million per year for R&R the deferred maintenance line would still increase, but at a controllable slope. He detailed that if nothing was done the slope would increase by 15 to 20 degrees. The chart's assumption was that the \$50 million would help flatten the line; however, it would not take care of the deferred maintenance projects that had

already accumulated. The accumulated projects were separate (shown by the down-sloping green line on the chart). He explained that the light colored line indicated what would have happened if the university had received the requested \$100 million the prior year. The \$750 million total had been reduced to approximately \$710 million; however, if funds were not funneled to deferred maintenance as a separate entity, the number would continue to increase, albeit at a slower rate.

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Senator Thomas asked for details on the \$10 million Board of Regents budget request related to solutions for Alaska's energy needs and the relationship between the Alaska Center for Energy and Power and the industry.

President Gamble deferred the question to Mark Meyers, head of research at the university.

MARK MYERS, VICE-CHANCELLOR, RESEARCH, UNIVERSITY OF ALASKA, FAIRBANKS (VIA TELECONFERENCE), explained that the \$10 million proposal was for a partnership to develop statewide energy, which had three components: (1) work with Alaska Center for Energy and Power on hydrokinetic issues, rural energy systems like wind-diesel coupling, geothermal energy, etc.; (2) form an energy analysis group to gain an apples to apples project comparison, and to determine project risks and how they would integrate with each other; (3) integrated fossil fuel research. Research was largely funded by industry, but the petroleum research labs were old. The research included questions on shale oil, oil recovery, heavy oil, and environmental work on the North Slope related to water supply and new infrastructure. He relayed that investment in an integrated fashion would help to shorten the development cycle time of the alternative energy sources.

Co-Chair Stedman believed there were related documents that could be provided to the committee.

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Senator Ellis appreciated hearing that the number one non-deferred maintenance priority was engineering. He remarked that he and other members had been encouraging support of the funding for Fairbanks and Anchorage engineering

upgrades. He asked whether industry had come together to request the university's support for the engineering buildings. He referred to a recent address by U.S. Senator Mark Begich who had spoken in support of a \$5 million university increment for an unmanned drone program at the Eielson Air Force Base. Senator Begich was working to inform others in Washington D.C. that Alaska could be a center for excellence through the university related to the unmanned drone program. He asked President Gamble to speak to the items.

President Gamble responded that the demand for engineers was high in Alaska; graduates from the university had the advantage of partnering with companies in the state. Engineering areas included fisheries, mining, the North Slope, and other. He furthered that undergraduates were able to obtain hands-on experience while getting their graduate degrees; the retention was excellent for Alaska. He moved on to address the second question related to the unmanned drone program. He relayed that he was currently part of a group that advised the governor on military issues and was the chairman of the Alaska Aerospace Corporation. He discussed that Alaska could be one of the first places in the U.S. to put drones to work. Additionally, the state could help work out any airspace bugs the Federal Aviation Administration was dealing with. He had been pleasantly surprised by Senator Begich's recent request. Work was being done predominately at the Fairbanks campus on safely integrating drone operations in airspace. He expounded that the Alaska Aerospace Corporation saw potential for bringing drones into the state and conduction large scale operations potentially at a base like Eielson Air Force Base. He believed that drones were the future; Alaska's airspace was uncomplicated and encroachment was not a problem. He emphasized his support for the university's involvement.

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President Gamble stressed that there was cutting edge research underway primarily at the Fairbanks campus. He accentuated that scientific information provided to the committee from outside could be provided by the university. He furthered that the university wanted to conduct research that was directly applicable to Alaska's needs. He relayed that unfortunately the item had not made the current or last budget. He hoped that he could link the university's

answers to legislator's questions for a cheaper rate than offered by outside consultants. He asked for a reconsideration of the research component of the university's budget request.

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ALASKA HOUSING FINANCE CORPORATION

DANIEL R. FAUSKE, CHIEF EXECUTIVE OFFICER, ALASKA HOUSING FINANCE CORPORATION (AHFC), DEPARTMENT OF REVENUE, and PRESIDENT, ALASKA GASLINE DEVELOPMENT CORPORATION (AGDC), pointed to AGDC's \$21 million capital request.

Co-Chair Stedman informed the committee that it would hear from AGDC and then move to AHFC.

JOE DUBLER, VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, ALASKA GASLINE DEVELOPMENT CORPORATION AND DIRECTOR OF FINANCE, ALASKA HOUSING FINANCE CORPORATION, DEPARTMENT OF REVENUE, directed attention to page 10 of the governor's proposed FY 13 capital budget project detail sheets: Item 51753 (copy on file). He explained that the \$21 million request would continue AGDC's efforts to develop an instate gas pipeline from the North Slope to the Railbelt with off-takes in Fairbanks and Anchorage. The funding would allow for the continuation of engineering, data acquisition and refinement of engineering design, permitting, the environmental impact statement (EIS) process, the attainment of a federal and private right-of-way, subsistence impact review, project risk and phasing analysis, commercial analysis that would culminate in an open season in the end of calendar year 2013, preparation of a comprehensive financing plan, and discussions with affected parties along the alignment of the pipeline.

Mr. Dubler turned to a breakdown of the \$21 million request shown on a spreadsheet titled "Alaska Gasline Development Corporation: ASAP - Funding Outline Thru FEL 3" (copy on file).

Mr. Dubler reviewed the spreadsheet. He explained that commercial operations for FY 13 were budgeted at \$3.8 million; the item would include discussions with potential shippers, to develop markets for the gas, work with Prudhoe Bay operators and owners, and integration plans for commercial operations. He elaborated that there had been a

successful expression of interest in June 2011 and AGDC was currently working on an open season. Pipeline engineering and environmental permitting was budgeted at \$6 million; the increment included progression of the pipeline route, data collection and design, utilizing information to upgrade the project design, and cost estimates. The cost estimates were refined from the current plus or minus 30 percent interval down to a plus or minus 10 percent for the open season. He furthered that important requirements for a successful open season were fairly accurate design and cost estimates. The pipeline engineering had obtained a right-of-way for state land and a right-of-way for the federal land would be issued once the environmental impact statement was provided to the Bureau of Land Management; the rights-of-way represented a couple of large hurdles. Staff were currently working to obtain the right-of-way for private land.

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Co-Chair Hoffman asked about the right-of-way route. Mr. Dubler explained the route would go from the North Slope through Dunbar - with a lateral line going to Fairbanks - and would cut across the Minto flats to follow the Parks Highway through Big Lake to the Little Susitna River (where the current Enstar project was located).

Co-Chair Hoffman asked how the route had been determined. Mr. Fauske answered that the route had been determined a number of years earlier. The route was seen to be in compliance with the intent of HB 369, which had mandated the deliverability of gas from the North Slope to tidewater at the lowest cost. The entity had asked whether there was any information in the difference between the Parks Highway versus the Richardson Highway that would mitigate a \$0.5 billion difference; the Parks Highway was 93 miles shorter than the Richardson Highway and the pipeline would cost approximately \$5 million to \$6 million per mile. Additionally, the federal government would have to examine the longer alternate route for environmental factors to determine whether one of the routes was better environmentally. He explained that AGDC had been given one year from the passage of HB 369 to provide a report to the legislature and governor by July 1, 2011; the report had been provided and much of the existing information had been utilized.

2:27:29 PM

Co-Chair Stedman asked for detail on any overlaps with Alaska Gasline Inducement Act (AGIA) and any interest in private parties. He noted that he and others had "heartburn" with AGIA related to the 90 percent reimbursement and little private enterprise money to the state; the scenario would cost \$500 million and he was concerned that the state was heading towards "AGIA version 2" with a \$400 million cost. He asked what assurances could be provided that his concern would not come to fruition. He wondered about private enterprise.

Mr. Fauske relayed that AGDC had invited industry to a meeting in Anchorage to determine potential interest in the gasline. He related that under AGIA the gasline would be limited to 500 million cubic feet (mcf) of gas per day; the restriction was lifted if the location was below the 68th parallel. The meeting had required questions to be submitted in writing in advance. He furthered that the total amount of gas needed for Fairbanks, Anchorage, the military bases, and the Central Corridor was approximately 240 mcf of gas per day. The entity's concern had been whether there was a commercial interest in the 260 mcf of gas per day that remained; AGDC had been pleasantly surprised to find that the commercial interest existed. The 500 mcf of gas per day had been maxed out by the non-binding interest expressed. The commission was currently in discussions with the producers and was working on alignment going forward as requested by the governor. Work could include a spur line; the AGIA contract required 5 off-take points from the gasline.

Mr. Fauske pointed out that with the EIS that was expected to be completed in May 2012 and the transfer of lands to Department of Natural Resources under the state right-of-way, the project had made incredible progress. He discussed the frontend-loaded FELs 1 through 3; the project was currently at about plus or minus 30 percent and the goal was to reach FEL 3 in the fall of 2014 into 2015 (after an open season had been conducted and to look at sanctioning the project) and to reach plus or minus 10 percent. He remained very hopeful and believed that the project could be quite meaningful for bringing a gas supply to the Central Corridor of the state that hopefully reached outlying areas once gas was flowing.

2:32:02 PM

Co-Chair Stedman wondered where private enterprise was. He asked whether there were pipeline companies willing to do the work or whether the project was "just another scoping project being financed by the state." Mr. Fauske answered that AGDC had met with producers and pipeline companies. He stressed that the \$400 million work had to be done by the state prior to industry involvement. He relayed that nationwide builder/owner/operators had expressed a great deal of interest in the project. The commission was working to exchange information with producers to determine alignment. He remarked that there was legislation related to confidentiality agreements that had presented a problem because companies were unwilling to provide necessary information if it was not kept confidential. He reiterated that the work was going well.

Co-Chair Stedman expressed concern that industry had not shown up at the table. He wondered how much information had been purchased twice by the state due to an overlap with AGIA. Mr. Fauske did not believe any information had been paid for twice. He explained that ADGC was concentrating most of its work from Fairbanks south, while AGIA work continued in the north to avoid duplication. He had relayed to participants that the commission had promised the legislature that it would not duplicate expenses.

Co-Chair Stedman thought Mr. Fauske had referred to some duplication during a recent phone conversation.

2:34:53 PM

Mr. Dubler replied that AGDC had been in close contact with the AGIA Alaska Pipeline Project (APP). He explained that the confidentiality presented the biggest problem in the communications. Maps of the APP project had been shown to AGDC, but AGDC was not able to keep the information. He anticipated that there would be some overlap, but he did not know that there had been any as of yet. Most of the work done by the APP was different from the work done by AGDC; there were various types of data gathering required for a project (e.g. rivers and streams, bird, vegetation, and fish surveys, stream crossings, and other). The commission was hoping to get a confidentiality agreement in place that AGIA was comfortable with to enable more

meaningful conversation regarding the progression of work and to avoid charges for duplicate information.

[2:36:11 PM](#)

Co-chair Stedman surmised that there would be some caution given the amount of money spent on AGIA compared to what had been gained. The legislature had been told that it did not need to worry about the three major industry players and that utilities would step up to the plate that would enable a large line to be constructed through Canada; however, utilities had scoffed at the idea of committing without gas given the significant financial risk. He wondered whether the entity that Mr. Dubler had mentioned (that had expressed interest in the 260 mcf per day) was interested in taking commitments without gas.

Mr. Dubler replied that he could not divulge the name of the entity. He relayed that there was gas involved.

[2:37:46 pm](#)

Co-chair Stedman felt apprehensive as the legislature had been told similar things several years earlier on a different project.

Mr. Dubler responded that AGDC had been cautious as well, which had prompted the commission to conduct an expression of interest meeting in May 2011; the results showed that there was enough gas available on the north-side of the pipeline from producers and enough customers and shippers on the south-side of the pipeline to fill the pipeline at 0.5 billion cubic feet (bcf) per day. Although the interest was non-binding, AGDC was comforted by the achieved results; it was working towards a binding open season at the end of 2013 and expected to have firm transportation commitments for the entire capacity of the line.

Co-Chair Stedman asked for verification that the capacity would be 0.5 bcf per day. Mr. Dubler replied in the affirmative.

[2:39:05 pm](#)

Mr. Fauske relayed that the commission had been in discussions with Doyon in the Nenana Basin related to contract versus common carrier; the field had not been

proven, but was one of great interest. The commission had also been in discussion with mining entities that wanted gas for their projects. He stressed that there had been a great deal of interest stated by private enterprise in the project. He believed that because the debate had been ongoing people thought the project was just another study; therefore, it was difficult to gain interest. He had worked hard on the project and emphasized that he had no vested interest in the proposal. He was proud of the project and believed in it because it continued to make headway. He clarified that the project would be funded with revenue bonds. He referred to discussions that the project would require a large infusion of cash by the state; when he had taken the position he had believed the cost would be \$3 billion to \$4 billion. He had been pleasantly surprised by the tariff numbers showing that the project would only require \$400 million in state funds. He emphasized that there was no cash outlay by the state in any of the financial information that had been supplied.

Mr. Fauske stressed that the project had real potential. He opined that the producers and others would not stand by while the state moved gas off the North Slope without some type of involvement if it ended up being a stand-alone project. He had heard from Exxon and others that they would certainly want an equity piece equivalent to the amount of gas flowing. He agreed that a bigger line would be good, but stressed that there would need to be a large commercial activity paying the cost; the incremental cost of a 48 inch line from Prudhoe Bay to Fairbanks was \$2.8 billion. He held his reservations on the larger line and noted that AGIA had been working on it. The commission had avoided the area due to the \$500 million limitation and existing state activity pursuing the idea. He disagreed with people who thought a smaller line was not feasible. He wondered what the alternative would be (especially if the reserves in Cook Inlet were not as substantial as anticipated) and pointed to the dire conditions in Fairbanks and rural Alaska. He explained that HB 369 had resulted from a belief by some that the big line would not occur. He commended Anchorage Mayor Sullivan for engaging the public when he held a brown-out practice. He reminded people that the intent was to get gas to Alaskans; the beauty of a commercial application was to keep tariffs lower. He concluded that a perpetuating goal had been to beat the price of imported Liquid Natural Gas (LNG); the proposed analysis did just that. He noted that the number was

currently \$14 to \$16 per million cubic feet; tariffs to Anchorage would be \$9.63 and \$10.33 to Fairbanks.

[2:43:57 pm](#)

Co-chair Stedman stated that he was not questioning Mr. Fauske's good intention, but he was questioning where private enterprise was. He remarked that the state was not a shining model of bigger projects; he pointed to the recent prison that had cost around \$200 million as an example and added that the gasline project was substantially larger. The project could have negative repercussions on the state if it went upside-down. He opined that it was a bad business practice to move forward on a project without private enterprise at the state's side. He emphasized that additional red flags went up related to the privacy issues. The legislature had heard all of the "lines" delivered to it regarding AGIA and the state would be \$500 million down the drain. He did not want to see another \$400 million wasted and surmised that \$900 million could essentially fix Fairbanks' problem.

[2:45:07 pm](#)

Mr. Fauske agreed. He explained that the \$400 million was the price the state needed to pay to get industry at its side. He pointed to the FEL 1 through 3 "trumpet curve" and explained that milestones were reached along the process that would determine whether the project would proceed. He furthered that it could always be determined that the project was not worthwhile, but to reach the determination some money had to be spent to prove it.

Co-Chair Stedman remarked that whose money was the relevant issue. Mr. Fauske replied that the money was the \$400 million [that would be spent by the state].

[2:45:55 PM](#)

Co-Chair Hoffman discussed that none of the smaller state energy projects (between \$1 million to \$5 million) could move forward without a power purchase agreement; many of the grants had not come to fruition because they had not obtained the agreement. He could see the enthusiasm for the proposed project, but that was not a requirement; the legislature had a financial fiduciary responsibility for

the project. He asked for a list of mines that could potentially benefit from the proposed gasline.

[2:47:15 PM](#)

Mr. Fauske stressed that he had not ever advocated for the construction of a state-operated pipeline; he had voiced that the state could be an equity participant and owner. He stressed that the state needed to spend money to let industry know that the project was real. He noted that the industry would not spend the initial money.

Co-Chair Stedman felt that the fact the industry would not spend the money represented a red flag.

[2:48:10 PM](#)

Senator Thomas referred to needs addressed by the project on pages 11 and 12 of the governor's proposed FY 13 capital budget project detail sheets. He asked whether the expression of interest had been from instate users or companies planning to export gas. Mr. Dubler answered that that the expression of interest had been open to all interested parties.

Senator Thomas assumed that AGDC would know whether interested companies would import or export the gas. Page 12 of the governor's detail sheet specified that one of the needs the project would address was the decline of fields in Cook Inlet that "may not meet demand as early as 2014"; he asked if AGDC believed that was the case. He believed it was critical to know whether the interest was for exportation or for Cook Inlet. He stressed that the need for the project would be cancelled if Cook Inlet had 9 to 20 trillion cubic feet of gas. Mr. Fauske answered that the state's maximum need was 240 mcf. He surmised that the interest expressed in the remaining 260 mcf was probably not for local use.

Senator Thomas believed that it made sense to continue if the interest was for export, but he did not agree with the need specified on page 12 if the gas was not for export.

Mr. Dubler answered that the Railbelt used less than 250 mcf of gas and that the remaining 250 mcf would leave the state.

[2:50:37 PM](#)

Co-Chair Stedman believed the issue created another problem; the idea was to shift demand and build industry off of the gas. He was concerned about selling all of the gas, building a line and not being able to expand it.

Mr. Dubler responded that the 500 mcf AGIA restriction would be removed if the licensee abandoned the license or the state determined it was not actively pursuing the item. The proposed 24 inch, 2500 psi gasline with compression could go up to 1 bcf per day and would be able to accommodate a significant increase in state activity.

[2:51:39 PM](#)

LES CAMPBELL, DIRECTOR OF BUDGET, ALASKA HOUSING FINANCE CORPORATION, DEPARTMENT OF REVENUE, turned to the request for a new item 54796 related to domestic violence rental assistance for \$1,328,400 in general funds. The purpose of the item was to provide rental assistance to victims of domestic violence or sexual assault who had been displaced or were in need of alternate housing to prevent further harm to the household. Some of the outcomes included, rental assistance for up to 150 households statewide that had been displaced from permanent housing or were otherwise at risk of displacement because of recent or reoccurring domestic violence instances.

Mr. Campbell spoke to statewide project improvements (item 40068) in the amount of \$2 million in corporate dividends. The purpose of the project was to provide funding to address known and unknown conditions in AHFC housing stock. Outcomes included, advancements in providing funding for emergency repairs, roof replacements, fire alarm systems, allowing quick response to code changes and life safety issues, providing amenities, allowing quick response for seen conditions, and enhancing operations for individual project developments.

Co-Chair Hoffman requested a list of how the funds had been spent in the past three fiscal years.

[2:54:02 PM](#)

Mr. Campbell addressed a request for the Building System Replacement Program (item 47069) in the amount of \$1.5

million in corporate dividends. The program's purpose was to address the specific major repair and replacement identified in a five-year review. The program would reduce maintenance costs, increase the useful life of the structures, and increase tenant safety. The program was ongoing to replace component parts.

Mr. Campbell turned to a request for fire protection systems (item 47066) in the amount of \$2.2 million in corporate dividends. The purpose was to flush, evaluate, and make life safety code repairs to public housing fire protection systems throughout the state. Projected outcomes included maintenance cost reductions, increased structure life, and increased tenant safety. The ongoing project was projected to continue for several future fiscal years.

Mr. Campbell directed attention to item 47068 related to security systems replacement upgrades in the amount of \$500,000 in corporate dividends. The purpose was to upgrade existing security and door access systems to senior, disabled, and multi-family public housing complexes. Projected outcomes included increased security for residents, reduced theft and vandalism, reduced maintenance and custodial costs, and increased useful life of the structures. He relayed that Anchorage and Fairbanks were close to completion. The funds would target the Juneau area.

Mr. Campbell pointed to item 6323 for the Supplemental Housing Development Program in the amount of \$2,559,800 in corporate dividends and \$4,440,200 in general funds. The program's purpose was to supplement the federal housing funds provided to regional housing authorities to ensure safe, decent, and affordable housing statewide. Projected outcomes were: construction of affordable homes in up to 20 urban and rural communities; build onsite water and sewer facilities; provide energy efficient design features in homes; construct roads to project sites; provide electrical distribution systems; retrofit homes to provide safe and healthy environment; and provide clients with new, safe, and energy efficient housing. The program was for stock owned by regional housing authorities.

Mr. Campbell discussed item 6351 related to energy efficiency monitoring research in the amount of \$1 million in corporate dividends. The purpose was to conduct research analysis, information dissemination, and interchange among

members of the industry and between the industry and public. The project was ongoing and was a designated grant to the Cold Climate Housing Research Center in Fairbanks.

[2:57:36 PM](#)

Mr. Campbell moved to item 6334 for the Senior Citizen Housing Development Program in the amount of \$4.5 million in state general funds. The purpose was to provide funds for the development of senior citizen housing and accessibility modifications to senior's residences. To date the program had funded 1,209 senior units and had provided accessibility modifications to over 150 homes. The project outcomes for the current request was for three development projects (30 units), modifications for accessibility for 40 units, and technical grant assistance for building capacity and organizations developing senior housing. Program funds were used only to fund the development gap (the amount necessary to make the project financially feasible or the difference between all other funding sources expected to be contributed including, loan funds and the cost of the development projects).

Mr. Campbell highlighted item 6347 related to the Housing and Urban Development Capital Fund Program in the amount of \$750,000 in corporate dividends to work as a match for \$3.3 million in federal receipts. The purpose was to expand the supply of affordable low and moderate income housing and to strengthen the state's ability to design and implement strategies to achieve an adequate supply of energy efficient and affordable housing. The program had funded 44 rental projects containing 818 units, rehabilitated 373 low income homes, and assisted 315 low income families in purchasing homes.

[2:59:50 PM](#)

Co-Chair Stedman relayed that the capital budget item discussion would continue during the afternoon meeting on the following day.

Co-Chair Hoffman requested a report from AHFC showing the beginning balance of the proposed FY 13 level of funds available in AHFC receipts and dividends including funds the agency planned to expend, the amount it would receive under the budget, and the balance at the end of the fiscal year.

Co-Chair Stedman explained that because interest rates were so low there was concern about dividend impacts in areas including the permanent fund and the state retirement system. He asked the corporation to include projected AHFC dividend items for upcoming years.

Co-Chair Stedman discussed the schedule for the following day.

ADJOURNMENT

3:02:40 PM

The meeting was adjourned at 3:02 PM.