

HOUSE FINANCE COMMITTEE

April 8, 2013

8:03 a.m.

8:03:38 AM

CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 8:03 a.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Mark Neuman, Vice-Chair
Representative Mia Costello
Representative Bryce Edgmon
Representative Les Gara
Representative Lindsey Holmes
Representative Scott Kawasaki, Alternate
Representative Cathy Munoz
Representative Steve Thompson
Representative Tammie Wilson

MEMBERS ABSENT

Representative David Guttenberg

ALSO PRESENT

Becky Hultberg, Commissioner, Department of Administration;
Curtis Thayer, Deputy Commissioner, Department of Administration;
Nicki Neal, Director, Division of Personnel, Department of Administration; Representative Mike Hawker; Kris, Curtis, Legislative Budget and Audit; Hanna Sebold, Alaska Bar Association; Representative Wes Keller; Joe Balash, Deputy Commissioner, Department of Natural Resources; Jeff Cook, Regional Director, External Affairs, Flint Hills Resources, North Pole; Representative Doug Isaacson.

PRESENT VIA TELECONFERENCE

Steve Van Goor, Alaska Bar Association, Anchorage; Tom Obermeyer, Anchorage; Douglas Blattmachr, Alaska Trust

Company, Anchorage; Dave Shaftel, Sahftel Law Offices, Anchorage.

SUMMARY

HB 63 EXTEND BAR ASS'N BOARD OF GOVERNORS
HB 63 was HEARD and HELD in committee for further consideration.

HB 102 RETIREMENT PLANS; ROTH IRAS; PROBATE
HB 102 was HEARD and HELD in committee for further consideration.

HB 134 MEDICAID PAYMENT FOR MEDICATED PRESCRIPTION
HB 134 was SCHEDULED but not HEARD.

HB 195 STATE EMPLOYEE COMPENSATION AND BENEFITS
HB 195 was HEARD and HELD in committee for further consideration.

SB 2 INTERSTATE MINING COMPACT & COMMISSION
SB 2 was SCHEDULED but not HEARD.

SB 16 BD OF ARCHITECTS, ENGINEERS, SURVEYORS
SB 16 was SCHEDULED but not HEARD.

SB 24 MARINE TRANSPORTATION ADVISORY BOARD
SB 24 was SCHEDULED but not HEARD.

SB 37 EXTEND SUICIDE PREVENTION COUNCIL
SB 37 was SCHEDULED but not HEARD.

SB 51 EXTEND BAR ASS'N BOARD OF GOVERNORS
SB 51 was SCHEDULED but not HEARD.

SB 65 RETIREMENT PLANS; ROTH IRAS; PROBATE
SB 65 was SCHEDULED but not HEARD.

SB 86 APPROVE FLINT HILLS ROYALTY OIL SALE

SB 86 was REPORTED out of committee with a "do pass" recommendation and with one previously published fiscal note: FN1 (DNR).

SB 95 STATE EMPLOYEE COMPENSATION AND BENEFITS

SB 95 was SCHEDULED but not HEARD.

8:05:05 AM

#hb195

HOUSE BILL NO. 195

"An Act relating to the compensation, allowances, geographic differentials in pay, and leave of certain public officials, officers, and employees not covered by collective bargaining agreements; relating to certain petroleum engineers and petroleum geologists employed by the Department of Natural Resources; relating to increased pay for certain partially exempt employees of the state in specific circumstances; making conforming amendments; and providing for an effective date."

8:06:19 AM

BECKY HULTBERG, COMMISSIONER, DEPARTMENT OF ADMINISTRATION, explained that the legislation implemented the provisions negotiated through bargaining agreements with the general government and supervisor's unit and applied them to the non-covered service. The change would provide the department consistency with the cost of living, a reduction of leave accrual, a cap on leave amount and decreases on the pay increment. Regarding the pay increment, she noted that employees above an "F" step would receive a raise of 3.75 percent every other year. The reduction in the pay increment decreased the state's long term legacy costs.

Commissioner Hultberg noted several provisions in the bill that enhanced the department ability to recruit and retain high-quality skilled professionals. Finally, the bill would provide implementation of the geographic pay differential for one of the last phases of remaining employees. The geographic pay study was provided in 2008 and the terms were implemented in all collective bargaining agreements, when applicable.

8:07:58 AM

CURTIS THAYER, DEPUTY COMMISSIONER, DEPARTMENT OF ADMINISTRATION, provided a sectional analysis. He noted that the new leave accrual rates were addressed in sections one through four.

8:08:49 AM

AT EASE

8:12:17 AM

RECONVENED

Mr. Thayer presented his sectional analysis with the PowerPoint presentation titled "Alaska Department of Administration Overview of HB 195 and SB 95" (copy on file).

Mr. Thayer began with slide 2: "What are HB 195 and SB 95 About?"

- Consistency with cost of living, reduction of leave accrual, cap on leave amount and decreases in the pay increment
- Enhance ability to recruit and retain highly-skilled professionals
- Implementation of Geographical Pay Differential for last phase of remaining employees

Mr. Thayer continued with slide 3: "Overview of the Bill Sections."

- Section 1-4: Leave Accrual and Cap
- Section 5: Petroleum Engineers/Geologists
- Section 6-8: Cost of Living Increases
- Section 9: Pay Increments
- Section 10: Partially-Exempt Salaries
- Section 11-14: Geographic Pay Differentials

Representative Costello asked if the bill addressed the ability of the employee to transfer leave.

Mr. Thayer replied that employees with over 1000 hours would be grandfathered in. The new cap applied to employees with less than 1000 hours. The estimate for cashing-out

leave for employees who had accrued greater than 1000 hours in the fiscal note was approximately \$40 million.

Co-Chair Stoltze suggested that the pain would be delayed for future budgets.

[8:14:45 AM](#)

Representative Costello asked if an employee could transfer leave to another employee.

Mr. Thayer replied in the affirmative.

Co-Chair Stoltze asked how the leave was valued among different pay ranges.

NICKI NEAL, DIRECTOR, DIVISION OF PERSONNEL, DEPARTMENT OF ADMINISTRATION, responded that the value of the leave donor was converted to the value of the recipient.

Representative Costello asked if an employee could exceed the cap set in the bill.

Ms. Neal stated that the donated leave was treated differently, and was not subject to the cap.

Co-Chair Stoltze explained that legislators did not accrue leave.

[8:16:29 AM](#)

Co-Chair Austerman asked about slide 4 and the statement that "employees with a balance that exceeds 400 hours as of 12/16/2013 are exempt from the maximum accrual limit until such time as his/her balance equals 400 hours or less." He asked if employees with more than 400 hours would be strategically ratcheted down.

Ms. Neal replied that the employees with over 400 hours would be required to use 112.5 hours per year. The hope was that the balance would be decreased by the mandate, although some employees would be grandfathered in.

[8:17:55 AM](#)

Mr. Thayer discussed slide 5: "Petroleum Engineers/Geologists."

- Removes exclusion of positions in Division of Geological and Geophysical Surveys (DGGS)
- Only 1 position - DGGS, Energy Section Manager (currently SU Geologist V) - vacant since March 17, 2012.
 - Position requires complete understanding of petroleum systems analysis and exploration that is obtained primarily through industry experience
 - Industry salaries are approximately 50 percent higher than current authorized salary (data from Assoc of Petroleum Geologists 2011 Survey)
 - Two national searches failed - No qualified applicants after 45 days of recruitment and advertising in national trade publications
- Amendment applicable to DNR, DGGS only

[8:18:59 AM](#)

Mr. Thayer detailed slide 6: "Cost of Living Increases."

Sections 6-8

- Effective 7/1/13 - 1 percent
- Effective 7/1/14 - 1 percent
- Effective 7/1/15 - 2.5 percent
- Consistent with terms of recently negotiated collective bargaining agreements
- Applies to noncovered classified and partially exempt (PX) and many exempt employees of the executive branch, employees of the legislature (AS 24.10.011 and AS 24.10.210), and the judicial branch

[8:19:32 AM](#)

Mr. Thayer discussed slide 7: "Pay Increments."

Section 9

- Effective 7/1/15 the percentage between pay increments (J and above) will decrease from 3.75 percent to 3.25 percent
- Consistent with terms of recently negotiated collective bargaining agreements

- Applies to noncovered classified and PX employees - also applies to many exempt employees through polity
- Applies to legislative branch if a policy has been adopted (AS 39.27.011(j))

8:19:59 AM

Mr. Thayer discussed slide 8: "Partially Exempt Salaries."

Section 10

- Partially Exempt (PX) positions are subject to classification and pay plans which limits flexibility
- State often not competitive for top talent - need some flexibility for mission critical positions
- Governor or designee on case-by-case basis:
 - o serves critical governmental interest of state
 - o employee possesses exceptional qualifications
 - o recruitment difficulties exist; or
 - o necessary to compete with labor market
- Applies to executive branch Partially Exempt (PX) employees only

8:21:03 AM

Representative Costello asked about an employee's range and step when initially hired by the state.

Mr. Thayer replied that the state was permitted to hire an A through F step, but the governor was allowed, on a case-by-case basis, to go beyond the F step for an exceptional candidate, or when recruitment difficulties were faced.

Representative Kawasaki asked about how frequently the partially-exempt salaries were used. He asked if the legislature would review the issue.

Mr. Thayer replied that he had faced two instances addressing partially-exempt salaries in the last 18 months. The tool allowed for ease when hiring an attractive candidate for a difficult position.

8:22:31 AM

Representative Gara wondered about section 3 and the use of 10 days of personal leave. He asked if a person was in a specialty position and was seen as indispensable, would they be allowed to take time off.

Mr. Thayer replied that provisions existed to waive the mandatory usage with permission of the director or immediate supervisor.

Representative Gara asked if a person was not able to use the leave, would they lose it.

Mr. Thayer replied that a person would not lose the leave if they had written permission. He clarified that if the supervisor stated that they were not eligible to use the leave then the waiver for mandatory usage would be employed.

[8:24:17 AM](#)

Co-Chair Austerman asked how many state employees were in the 10 year service.

Mr. Thayer replied that during negotiations the supervisory unit (SU) displayed 1100 employees with over 1000 hours. He noted that SU had one third of their 8200 employees with more than 1000 hours. Only four legislative employees had over 1000 hours. The 1000 hour cap was negotiated with the unions as a break-even point.

[8:26:01 AM](#)

Mr. Thayer discussed slide 9 "Geographical Pay Differentials." He noted that a report was produced by the McDowell Group in Fall of 2008. The report was completed in 2009 and addressed geographical pay differentials. The group used South Central Anchorage as the base and implemented the geographical differential for other unions. Anchorage was shown at zero percent above the base, while Fairbanks was at 3, Juneau and Sitka at 5, and rural Alaska would extend from 37 to 60 percent. He stated that the executive branch saw 483 employees receive an increase, 122 with frozen pay, and 727 without change. For the legislative branch, 145 employees would see an increase, 24 with frozen pay, and 204 without change.

[8:27:32 AM](#)

Representative Kawasaki recalled that the 2008 McDowell study was controversial for Fairbanks, as it omitted the cost component for energy. He asked when the survey would be updated.

Mr. Thayer replied that the department planned to have the study done every five years pending an appropriation from the legislature.

Representative Kawasaki asked about the potential absence of an appropriation from the legislature.

Mr. Thayer replied that the study would be maintained until the department had an updated survey.

Co-Chair Stoltze explained that money would not be spent unless appropriated by the legislature.

Representative Gara stated that OCS found it difficult to attract social workers to Bethel. He asked how the 50 percent salary adjustment for Bethel compared to the present figures.

Ms. Neal replied that the geographical differential for Bethel was approximately 29.12 percent.

[8:29:12 AM](#)

Representative Edgmon asked why Nome would be categorized in the 37 percent above-base category.

Mr. Thayer replied that he would contact the McDowell group for an answer. He stated that the study included information about housing, utilities, food and transportation. He assumed that home prices affected the percentage for Nome.

Representative Edgmon stated that the price of fuel in Dillingham was much higher than that in Nome. He noted that the cost of fuel was a significant piece of the rural communities' cost of living.

[8:30:32 AM](#)

Co-Chair Stoltze understood that a lack of action on the proposed legislation might lead to a detrimental fiscal impact for the state. He requested elaboration on the issue of accrued leave.

Mr. Thayer replied that the value of leave was a key point in union negotiations. He stated the total leave value was \$164 million for all state employees. He stated that 10 employees with the greatest leave balances had approximately 35 thousand hours of leave banked. The department sought to find a cap for the leave to temper the liability. He stated that the bill would cut the liability by more than two thirds. He stated that the department worked with the unions to decrease the leave accruals.

Mr. Thayer noted that the paid time off incorporated an employee's sick leave. He pointed out that the 1000 hours represented approximately six months' worth of leave. He admitted that the leave amount was negotiated by the unions. He stated that the union's leave was valued at the union's current earnings. He noted that Alaska was the only state in the nation lacking a cap on leave.

[8:34:25 AM](#)

Co-Chair Stoltze noted that a new type of unfunded liability might result if the cap was not instituted.

Mr. Thayer agreed. He pointed out that the Department of Administration (DOA) requested money from various departments to pay for cashed-in leave. The hope was that the caps combined with employee retirements would lead to a decrease in the state's liability.

Co-Chair Stoltze asked if a senior engineer with the Department of Transportation and Public Facilities (DOT/PF) with a large amount of leave would compromise the state's ability to hire social workers at lower entry levels.

Mr. Thayer agreed that some employees had banked up to 4000 hours of leave. He added that DOA must better explain options other than banking leave, such as deferred compensation, since the cashed-in leave presented a tax liability for the employee.

[8:36:46 AM](#)

Representative Gara asked if a person who had accrued large amounts of leave must relinquish it.

Co-Chair Stoltze noted that the bill was without retroactive provisions.

Representative Gara understood that an employee accrued approximately 5 weeks of leave per year.

Mr. Thayer replied that accrual rates would remain the same. He clarified that the state did not have sick leave. He stated that the cap applied to those employees with less than 1000 hours of leave. The mandatory usage applied to all employees upon passage of the legislation.

Representative Gara asked how much leave a new employee would earn in three years.

Mr. Thayer moved to slide 4 and noted that the new scale allowed for a slight reduction in leave.

[8:39:22 AM](#)

Representative Costello asked about the overall fiscal impact of the bill.

Mr. Thayer offered to provide the calculations for the committee.

Co-Chair Stoltze requested categorization of the potential savings or mitigated losses.

Mr. Thayer replied that calculation were compiled for one of the unions, and finding showed that leave owed to employees with more than 1000 hours was \$1.6 million. With the 1000 hour cap, the liability would be \$400 thousand.

[8:41:28 AM](#)

Representative Costello appreciated the department's offer to educate employees.

Mr. Thayer replied that the proposed education would benefit both the state and the employee.

Representative Kawasaki asked about section 10 and partially-exempt salaries. He wondered if a person might

try to negotiate directly with the governor under this term.

Mr. Thayer replied that the department would attempt to attract people into state service for a particular position. Only when a commissioner or director had a difficult time filling a position, would they go to the governor's office to ask for such a variance. The process to achieve the variance would be long and rigorous.

[8:43:45 AM](#)

Representative Kawasaki asked about section 5 and DGGs. He recalled that one position was more difficult to fill. He asked if every DGGs Geologist 4 would encounter the same challenges upon vacancy.

Mr. Thayer replied that the need was applicable to only one position.

Vice-Chair Neuman asked about section 10 and the issues of employee retire-rehire. He asked if an employee must provide written proof that another applicant was not capable of performing the tasks in the job.

Ms. Neal stated that the retire-rehire program sunset two years ago. If position recruitment were present, the employee could reenter a position and waive the retirement contribution.

[8:45:44 AM](#)

Representative Edgmon MOVED Amendment 1. He stated that the conceptual amendment would bring judges and justices into the bill with a cap of \$100 thousand. The change would affect 23 positions throughout the state. He understood that current law allowed judges and justices a geographical pay differential, which was limited to \$7 thousand.

Co-Chair Stoltze requested a written amendment.

Representative Edgmon apologized that the written amendment was not in the hands of committee members.

[8:47:56 AM](#)

AT EASE

[8:48:34 AM](#)

RECONVENED

HB 195 was HEARD and HELD in committee for further consideration.

#hb63

HOUSE BILL NO. 63

"An Act extending the termination date of the Board of Governors of the Alaska Bar Association; and providing for an effective date."

[8:49:47 AM](#)

REPRESENTATIVE MIKE HAWKER presented the sunset bill. He noted that the bill could be found on the Division of Legislative Budget and Audit's (LB&A) website. The proposed legislation extended the Alaska Bar Association's sunset date from 2013 to 2021 in accordance with recommendations made by the state's legislative auditor. The auditor conducted an evaluation of the Board of Governors using criteria under AS 44.66.050(c), which was summarized in the report included in committee members' files.

Representative Hawker continued that all previous findings from prior audits were resolved. The remaining issue stood as a matter of judgment between the legal and legislative profession regarding the mandatory continuing education for attorneys. The auditor recommended that the Alaska Supreme Court increase the mandatory education hours for attorneys.

[8:51:52 AM](#)

Representative Gara pointed out that the Alaska Bar Association continued charging attorneys money despite an inactive status. If the fee was not paid, an attorney must take the bar exam a second time to practice law. He wished to see an amendment preventing the practice.

Co-Chair Stoltze stated that he did not wish to regulate the bar.

Representative Hawker referred to "Shakespeare's Council."

Co-Chair Stoltze suggested a subcommittee process for the proposed amendment.

Representative Gara withdrew his request.

[8:55:01 AM](#)

KRIS, CURTIS, LEGISLATIVE BUDGET AND AUDIT, explained the recommendation in prior sunsets that the board support an increase to the mandatory continuing legal education requirement. Current mandatory requirements were three credits per year. She stated the board's voluntary requirement of an additional nine credits, with 60 percent of members meeting the requirement. She pointed out that the board conducted a survey of their members to determine whether they supported an increase; over 90 percent did not. She stated that LB&A made the recommendation again.

STEVE VAN GOOR, ALASKA BAR ASSOCIATION, ANCHORAGE (via teleconference), stated that he was available to answer questions.

Representative Gara asked about the fairness of the Alaska Bar Association's fee for inactive attorneys.

Mr. Van Goor replied that an inactive status with the bar association was an option for members choosing not to practice law. He stated that inactive members were charged a fee to retain the structure, licensing and discipline functions of the association. An inactive member supported the infrastructure and ability to return to practice. A failure to pay inactive dues did not require the member to retake the bar exam, but instead subjected the member to administrative suspension. The suspension could be cured by paying the past due fees and a penalty.

Co-Chair Stoltze compared the fee to that of an automobile registration fee.

Representative Gara suggested that inactive members must pay for infrastructure supporting active members.

Mr. Van Goor replied that the Alaska Bar Association supported the public service functions. Inactive members were not charged the same amount as active members, but they did have the ability to practice law again.

Representative Gara disagreed with the policy.

[8:59:40 AM](#)

Representative Holmes joked that Representative Gara's fees helped to lower her own as an active member of the Alaska Bar Association.

[9:00:12 AM](#)

HANNA SEBOLD, ALASKA BAR ASSOCIATION, was available for questions.

Representative Gara expressed his opinion that the practice of collecting fees from inactive members was not just and reasonable. He asked that Ms. Sebold request that the Alaska Bar Association change the rule.

Ms. Sebold answered that she would bring the matter to the board.

Representative Holmes discussed current mandatory hours for continued education. She stated that three hours of mandatory ethics and an additional nine hours of recommended hours of "other" continuing education credits. She asked if the association had a position on the issue of changing the policy.

Ms. Sebold deferred the question to Mr. Van Goor.

Mr. Van Goor replied that a rule proposal had been made to the Alaska Supreme Court to clarify the mandatory continuing education policy. He explained that the board suggested a rule change while conducting a survey of its membership and comments were collected before the rule was submitted to the court. The court would then schedule an administrative rules conference, which the association was invited to attend. He suggested to LB&A that the audit was the time to raise the concerns expressed in the House State Affairs Committee. He stated that the court had the final call about the number of hours required for members of the bar. The court had the ability to increase the number of hours and was in the decision making process.

[9:04:34 AM](#)

Representative Holmes asked for clarification on the recommendation regarding an increase in the mandatory number of continuing education hours. She asked if the

association had presented a recommendation about the requirement.

Mr. Van Goor answered that the proposed rule clarified portions of the mandatory continuing education requirements without a specific recommendation for increasing the hours. He hoped to discuss the audit's concerns at the rules conference.

Co-Chair Stoltze thanked Mr. Van Goor for clarifying the diminished relevance of the people's body in the process.

[9:05:57 AM](#)

Representative Munoz asked the number of active and inactive bar members in Alaska.

Ms. Sebold replied approximately 4100 total members, with 2600 in active status.

[9:06:32 AM](#)

TOM OBERMEYER, ANCHORAGE (via teleconference), called attention to the bar exam. He claimed that the Alaska Bar Association had the ability to limit applicants who pass the bar exam. He noted that Missouri implemented a state practice portion for the exam. He stated that Alaska had less than 100 applicants. He explained that he had paid and studied for the bar exam for 29 years. He spoke to the debt incurred in law school. He believed that the exam passage rate was arbitrary. He disagreed with the audit's recommendation of an 8 year extension.

[9:11:57 AM](#)

Co-Chair Stoltze CLOSED public testimony.

Representative Hawker understood the dilemma regarding the separation of powers between the legislative, legal and executive branches of government. He requested consideration for a change in statute or letter of intent accompanying the bill to provide the great impact of the legislature's concern. He pointed out the committee's tradition of separating policy calls from reauthorizations.

Co-Chair Stoltze stated that the audit recommendation was also important.

HB 63 was HEARD and HELD in committee for further consideration.

[9:15:58 AM](#)

AT EASE

[9:19:32 AM](#)

RECONVENED

#hb102

HOUSE BILL NO. 102

"An Act relating to property exemptions for retirement plans, individual retirement accounts, and Roth IRAs; relating to transfers of individual retirement plans; relating to the rights of judgment creditors of members of limited liability companies and partners of limited liability partnerships; relating to the Uniform Probate Code, including pleadings, orders, liability, and notices under the Uniform Probate Code and the Alaska Principal and Income Act, the appointment of trust property, the Alaska Uniform Prudent Investor Act, co-trustees, trust protectors, and trust advisors; relating to the Alaska Principal and Income Act; relating to the Alaska Uniform Transfers to Minors Act; relating to the disposition of human remains; relating to the tax on insurers for life insurance policies; relating to insurable interests for certain insurance policies; relating to restrictions on transfers of trust interests; relating to discretionary interests in irrevocable trusts; relating to the community property of married persons; and amending Rule 64, Alaska Rules of Civil Procedure, and Rule 301(a), Alaska Rules of Evidence."

[9:19:40 AM](#)

REPRESENTATIVE WES KELLER, stated that Alaska first modernized trust in the state planning laws in 1997. He noted recommendations from the trust were made for changes in the law. He thought that the trust and estate planning efforts led to some of the best applicable legislation in the United States. The proposed legislation included many of the recommendations including measures for retirement plan assets.

DOUGLAS BLATTMACHR, ALASKA TRUST COMPANY, ANCHORAGE (via teleconference), testified in support of the legislation.

Representative Costello asked if the bill addressed revocable living trusts.

Mr. Blattmachr replied no, the bill dealt with IRAs and other matters.

Co-Chair Stoltze wondered why the policy issues were important.

Mr. Blattmachr replied that the Alaska Trust Company had been working with the legislature to enhance Alaska's trust legislation. He stated that Alaska had become a premier location for estate and financial planning. The process drew millions of dollars in revenue to the state.

DAVE SHAFTEL, SAHFTEL LAW OFFICES, ANCHORAGE (via teleconference), stated that he worked with a group of attorneys and trust officers since 1997 to assist in making recommendations to the legislature for the improvement of Alaska's laws regarding estate planning.

[9:25:43 AM](#)

Representative Holmes noticed that the bill was similar to another seen last year. She asked about changes between the two bills.

Mr. Shaftel responded that one position was added to assist the Internal Revenue Service (IRS) in granting rulings for non-grantor trusts. He noted that the IRS would grant the rulings for lifetime's powers of appointment. He stated that some of the statute's less applicable portions were deleted. He noted the new provision that conformed to the statute of limitations. He noted a provision that allowed for transfers of individual retirement accounts to grantor trusts for planning purposes. He stated that the other provisions in the bill were reviewed in committee last year.

[9:27:44 AM](#)

HB 102 was HEARD and HELD in committee for further consideration.

9:28:49 AM

AT EASE

9:29:01 AM

RECONVENED

#sb86

SENATE BILL NO. 86

"An Act approving and ratifying the sale of royalty oil by the State of Alaska to Flint Hills Resources Alaska, LLC; and providing for an effective date."

9:29:36 AM

JOE BALASH, DEPUTY COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, provided a presentation for orientation. He provided a PowerPoint presentation: "Royalty In-Kind (RIK) Sale to Flint Hills Resources." He noted that the state's interest was generally 12.5 percent at legacy fields and the royalty could be collected in cash value or in physical possession of the product produced. The statutes that governed the sale of royalty were laid out in title 38, with the presumption that taking royalty in-kind was in the state's best interest. He discussed slide 2: "Royalty in-Value versus Royalty in-Kind:"

The state has a choice to take its royalty in-value (RIV) or in-kind (RIK).

- When the State takes its royalty as RIV, the lessees who produce the oil also market the State's share along with their own production and pay the State the value of its royalty share.
- When the State takes its royalty share as RIK, the State assumes ownership of the oil, and the commissioner disposes of it through the sale procedures prescribed by AS 38.05.183.

9:30:50 AM

Mr. Balash discussed slide 3: "Non-Competitive RIK Sale Process." He noted that an informal letter of solicitation led to two interested parties; one was Flint Hills and the other Tesoro.

- Statute presumes State's Best Interest is met by

- o Taking royalty in-king - AS 38.05.182(a)
- o With sale to in-state buyer - AS 38.05.183(d)
- o Accomplished through a competitive process - AS 38.05.183(a)
- August 13, 2012 Informal Solicitation of Interest sent to:
 - o North Slope Producers
 - o In-state Refiners
 - o Industry specific & general media

[9:32:21 AM](#)

Mr. Balash discussed slide 4: "RIK contract terms."

- Proposed 2013 contract is similar to 2004 contract
 - Proposed 2013 contract, like 2004 contract, does not directly reference RIV valuation in RIK price calculations
- Key Contract provisions
 - o Price
 - o Quantity
 - o Term
 - o Special Commitments
 - o In-State Processing and Local Hire

Mr. Balash detailed slide 5: "RIK Contract Price."

ANS Spot Price - \$2.15 - Tariff Allowance + Quality Bank Adjustment - Line Loss

- ANS Spot Price = Average US West Coast Price for Alaska North Slope oil.
 - o Reported by industry publications: Platts, Telerate, Reuters
- \$2.15 = RIK DIFFERENTIAL
 - o Destination - Marine Costs so RIK > RIV.
 - o Subject to a one-time adjustment of no more than + \$0.15 per barrel.
 - o This amount = \$1.65 per barrel in the current 2004 contract.
- Tariff Allowance = TAPS and Pipelines Upstream of PS-1.
- Quality Bank Adjustment = as reported by the TAPS Quality Bank Administrator
- Line Loss = 0.0009 times the netback price

Mr. Balash discussed slide 6, "2013 RIK Contract Quantity:"

- Initial Quantity Range
 - 18,000-30,000 barrels per day
 - May be adjusted after 12 months, with Commissioner approval
- Termination of Contract
 - No or zero nomination for 3 months terminates contract
 - Contract terms comparable to the private market
- Refinery Turnaround
 - Contract allows FHR the flexibility to cease royalty oil purchases during maintenance
- Guarantees, reserves and proration clauses included
 - 24,000 barrels per day with 15 percent reserves for other RIV or RIK interests

Mr. Balash discussed slide 7, "2013 RIK Contract Term:"

- FHR initially sought a ten-year contract
 - Creates supply and price risk
 - Increases counterparty risk
 - Limits the State's ability to supply other RIK buyers
- DNR negotiated a five year term
 - April 1, 2014 to March 31, 2019
 - Possible extension condition for:
 - Large capital improvement at the North Pole Refinery
 - Binding support for a North Slope natural gas transportation system

[9:35:34 AM](#)

Mr. Balash discussed slide 8: "2013 RIK Contract Quantity." The graph illustrated a 10-year royalty profile. He explained that the total contract demand for Flint Hills was less than half of the state's total royalty volume. The percentage increased throughout the years with a projected 82.1 percent of royalty value accounted for in a single sale. He mentioned that the seasonal variability on North Slope production made the terms instituted by Flint Hills difficult for the state to meet.

[9:37:04 AM](#)

Mr. Balash discussed slide 9: "Commissioner's Decision Criteria."

AS 38.05.183(e) states that the commissioner must sell the state's royalty oil to the buyer who offers "maximum benefits to the citizens of the state." In making this determination the commissioner must consider:

1. The cash value offered
2. The projected effects of the sale on the economy of the state
3. The projected benefits of refining or processing the oil in state
4. The ability of the prospective buyer to provide refined products for distribution and sale in the state with price or supply benefits to the citizens of the state
5. The eight criteria listed in AS 38.06.070(a), as reviewed by the Royalty Board

Mr. Balash discussed slide 10: "Royalty Board's Decision Criteria."

AS 38.06.070(a) states that the Alaska Royalty Oil and Gas Development Advisory Board must consider:

1. The revenue needs and projected fiscal condition of the state
2. The existence and extent of present and projected local and regional needs for oil and gas products
3. The desirability of localized capital investment, increased payroll, secondary development and other possible effect of the sale
4. The projected social impacts of the transaction
5. The projected additional costs and responsibilities which could be imposed upon the state and affected political subdivisions by development related to the transactions.
6. The existence of specific local or regional labor or consumption markets or both which should be met by the transaction
7. The projected positive or negative environmental effects related to the transactions
8. The projected effects of the proposed transaction upon existing private commercial enterprise and patterns of investment

[9:38:28 AM](#)

Mr. Balash discussed slide 12: "Figure 1: Royalty In-Kind Sales History." He stated that the refinery depicted had purchased royalty oil from the state.

Mr. Balash discussed slide 13: "Best Interest of the State Served by the RIK Contract with Flint Hills Resources (FHR)."

- Cash Value Offered with Contract
 - Cash value of \$3.5-5.9 Billion over 5 years
 - Analyzed for Consistent value between RIK and RIV
 - Volume weighted average of current reported netback price (11 AAC 03.026(b))
 - Anticipated increases in marine transportation allowance will favor RIK contract
- Positive effect on the State
 - Maintain stability in in-state refining and distribution of refined products
 - Supports jobs and economy of Fairbanks North Star Borough

Co-Chair Stoltze reflected on prior testimony about pipeline physics and the importance of the facility.

Mr. Balash replied that the issue was discussed on slide 14.

[9:39:55 AM](#)

Mr. Balash discussed slide 14: "FHR's North Pole Refinery."

- Strategically located on Trans-Alaska Pipeline System (TAPS)
- Current throughput of 82,000 - 84,000 barrels per day of ANS crude
- Producing approximately 22,000 - 25,000 barrels of refined product
- All crude and constituents that are not transformed into refined product are injected back into TAPS (with a penalty paid)

[9:41:33 AM](#)

Mr. Balash discussed slide 15: "FHR's North Pole Refinery."

- FHR produces approximately
 - 672,000 gallons of jet fuel per day
 - 143,000 gallons of gasoline per day
 - 41,000 gallons of home heating fuel per day
 - 68,000 to 194,000 gallons per day of product consisting of HAGO, LAGO, naphtha, asphalt, refining fuel, and a small volume of high-sulfur diesel
- 680,000 gallons per day shipped to Anchorage via the Alaska Railroad
- 230,000 gallons of ultra-low sulfur diesel and gasoline on the backhaul to Fairbanks
- FHR owns 50 million gallons of storage facilities
 - 30.7 million in Anchorage and 19.3 million in Fairbanks

[9:42:30 AM](#)

Mr. Balash discussed slide 16: "Proposed Contract Benefits."

- Proposed contract is expected to:
 - Maintain status quo of in-state refining behavior
 - Produce 330 million gallons of refined product or 18 percent of gasoline and 26 percent of jet fuel consumed in Alaska
 - Provide approximately \$140 million per year in gross regional product sales for the Fairbanks North Star Borough (FNSB)
 - Support 1,300 direct and indirect jobs in the FNSB
 - Sustain \$100 million in annual earnings in FNSB
 - Provide socio-economic stability against energy costs

Mr. Balash discussed slide 17: "Projected Impacts if not Approved."

- If FHR stops refining, anticipated effects include:
 - Loss of approximately 1,300 direct and indirect jobs in the Fairbanks North Star Borough
 - State could experience increased utilization of the social safety net

- o Possibility of population redistribution
- o Increased and decreased infrastructure utilization and maintenance with population shift
- o Impact to the fuel supply for the Fairbanks and Anchorage airports, affecting trade and tourism and the Alaska Railroad
- o Loss of heat source for warming low flow in TAPS

[9:44:02 AM](#)

Representative Gara stated that the less oil in TAPS the more expensive the tariff. The more expensive the tariff, the less money the state received in taxes for the oil. He asked if a discount for royalty in-kind oil would increase the cost in taps and impact state revenue.

Mr. Balash replied that if the state received royalty in-value and the current contract returned approximately \$120 million more than the expected value. He stated that the current terms in the contract would not achieve the same monetary surplus or addition due to the short term and small volume. The department was confident that they would receive an increment of value for the state.

Representative Gara understood that taking less oil from North Pole would increase the tariff south of North Pole. If the oil was not purchased from the state, it would be purchased from the oil companies, which would also increase the tariff.

Mr. Balash concurred, if supply was available from another source.

[9:46:24 AM](#)

Representative Gara noted evidence that refiners had increased the mark-up for gas produced and sold by 100 percent in the last five or six years, which might be responsible for the high cost of gas in Alaska. If the state offered oil to the refinery, would the department offer a return on limitation of markup for consumer gas?

Mr. Balash replied that investigations by the Department of Law evaluated the market behavior of Alaska's refineries and distributors. The conclusion of the investigation was that collusion or anti-competitive behavior was not an issue. The contract continued a term written in the

previous one. The term stated that when Flint Hills produced and sold wholesale gasoline, they must offer a price comparable to that sold in Anchorage. Anchorage was a water-borne market with an additional refinery.

[9:48:53 AM](#)

Representative Costello asked about the commissioner's identification of the economic effect. She asked if the department accounted for the 26 percent loss of avgas, which was supplied through Flint Hills to the state's economy.

Mr. Balash replied that the refinery produced a tremendous amount of jet fuel, but he was unaware of the avgas production.

[9:50:28 AM](#)

Co-Chair Stoltze asked the connection for defending the army bases in Alaska.

Mr. Balash replied that Petro Star Inc. was owned by Arctic Slope Regional Corporation (ASRC) and enjoyed certain contracting preferences with the United States Department of Defense. He stated that Petro Star Inc. supplied most of the fuel for the military bases in the interior. He stated that Flint Hills was supportive of the Interior community at large. The families supported by their employment with Flint Hills provided the backbone of the community.

Co-Chair Stoltze asked about the military facilities.

Mr. Balash replied that the military facilities must consider the loss of Flint Hills as a back-up to the Petro Star facility. He mentioned a provision in the contract intended to enable Flint Hills to become a customer of the North Slope Transportation Project. If natural gas was made available to the Interior the cost of operating the bases would be reduced. The contract could help with the retention of those installations.

[9:53:14 AM](#)

Co-Chair Stoltze noted that an effect felt in one region of the state impacted all of Alaska.

Representative Wilson stated that one tower was shut down resulting in an unforeseen impact in her district. The fuel provided allowed for electric energy for the district.

[9:54:31 AM](#)

Representative Kawasaki asked about the special commitment contract extension on page 22. He noted that the special commitment was tied as a reward for substantial investment. He read about a request for an extension. He wondered if the issue would be revisited with the royalty board.

[9:55:11 AM](#)

Mr. Balash replied that the initial step included negotiations with the department. Upon conclusion of the negotiation process, the royalty board and legislature would provide the next steps. The provision was intended to truncate the negotiation process. The terms would be agreed upon and presented to both the board and the legislature in five years.

[9:56:04 AM](#)

JEFF COOK, REGIONAL DIRECTOR, EXTERNAL AFFAIRS, FLINT HILLS RESOURCES, NORTH POLE, spoke in support of SB 86. He mentioned his productive negotiations with the Division of Oil and Gas through the Department of Natural Resources. He stated that he began working for the refinery in 1994 and he had seen the oil enter the refinery at increasingly lower temperatures. He explained the refinery's important task of returning oil to TAPS. He pointed out that the refinery had only one source of crude and electricity costs were four times higher than refineries in the state of Washington without the benefit of natural gas.

Mr. Cook continued that the five year contract would provide the stability and certainty of crude oil at a fair price with expansion as a result. Though the current contract did not expire until April 1, 2014 the pressure to pass the bill was strong this session. He discussed the negotiation process regarding one-year supply contracts for jet fuel and other projects.

[9:59:01 AM](#)

Representative Thompson understood that the refinery produced 26 percent of the jet fuel consumed in Alaska. He stated that the Anchorage port had storage tanks for the import of jet fuel for Ted Stevens International Airport. He asked about the change in competitiveness.

Mr. Cook replied that his refinery was limited to one source of crude. He added that the change in energy costs placed Flint Hills at a disadvantage.

Representative Thompson asked about the impact of the large transportation cost required to bring jet fuel to Alaska from Asia.

Mr. Cook replied that the differential in his refinery's energy cost was \$12 higher than the West Texas Intermediate (WTI).

Representative Thompson asked if natural gas in the Interior would help with competitiveness.

Mr. Cook replied yes. He hoped for projects that would allow the company to enter the export business again and expand for greater competitiveness in the jet fuel market.

[10:01:02 AM](#)

REPRESENTATIVE DOUG ISAACSON testified in support of the legislation.

Co-Chair Stoltze CLOSED public testimony.

[10:02:11 AM](#)

Co-Chair Stoltze noted that he placed great emphasis on Interior issues.

Representative Costello discussed the zero fiscal note.

Co-Chair Stoltze stated that the bill's fiscal terms were best described in the contract.

Mr. Balash agreed.

[10:03:24 AM](#)

Representative Wilson MOVED to REPORT SB 86 out of committee with individual recommendations and the accompanying fiscal note.

SB 86 was REPORTED out of committee with a "do pass" recommendation and with one previously published fiscal note: FN1 (DNR).

#sb21

CS FOR SENATE BILL NO. 21(FIN) am(efd fld)

"An Act relating to the interest rate applicable to certain amounts due for fees, taxes, and payments made and property delivered to the Department of Revenue; providing a tax credit against the corporation income tax for qualified oil and gas service industry expenditures; relating to the oil and gas production tax rate; relating to gas used in the state; relating to monthly installment payments of the oil and gas production tax; relating to oil and gas production tax credits for certain losses and expenditures; relating to oil and gas production tax credit certificates; relating to nontransferable tax credits based on production; relating to the oil and gas tax credit fund; relating to annual statements by producers and explorers; establishing the Oil and Gas Competitiveness Review Board; and making conforming amendments."

CSSB 21 (FIN) am(efd fld) was SCHEDULED but not HEARD.

#sb51

SENATE BILL NO. 51

"An Act extending the termination date of the Board of Governors of the Alaska Bar Association; and providing for an effective date."

SB 51 was SCHEDULED but not HEARD.

#sb65

SENATE BILL NO. 65

"An Act relating to property exemptions for retirement plans, individual retirement accounts, and Roth IRAs; relating to transfers of individual retirement plans; relating to the rights of judgment creditors of

members of limited liability companies and partners of limited liability partnerships; relating to the Uniform Probate Code, including pleadings, orders, liability, and notices under the Uniform Probate Code and the Alaska Principal and Income Act, the appointment of trust property, the Alaska Uniform Prudent Investor Act, co-trustees, trust protectors, and trust advisors; relating to the Alaska Principal and Income Act; relating to the Alaska Uniform Transfers to Minors Act; relating to the disposition of human remains; relating to the tax on insurers for life insurance policies; relating to insurable interests for certain insurance policies; relating to restrictions on transfers of trust interests; relating to discretionary interests in irrevocable trusts; relating to the community property of married persons; and amending Rule 64, Alaska Rules of Civil Procedure, and Rule 301(a), Alaska Rules of Evidence."

SB 65 was SCHEDULED but not HEARD.

#hb134

HOUSE BILL NO. 134

"An Act requiring Medicaid payment for scheduled unit dose prescription drug packaging and dispensing services for specified recipients."

HB 134 was SCHEDULED but not HEARD.

#sb95

SENATE BILL NO. 95

"An Act relating to the compensation, allowances, geographic differentials in pay, and leave of certain public officials, officers, and employees not covered by collective bargaining agreements; relating to certain petroleum engineers and petroleum geologists employed by the Department of Natural Resources; relating to increased pay for certain partially exempt employees of the state in specific circumstances; making conforming amendments; and providing for an effective date."

SB 95 was SCHEDULED but not HEARD.

#sb2

SENATE BILL NO. 2

"An Act enacting the Interstate Mining Compact and relating to the compact; relating to the Interstate Mining Commission; and providing for an effective date."

SB 2 was SCHEDULED but not HEARD.

#sb16

SENATE BILL NO. 16

"An Act relating to the Board of Registration for Architects, Engineers, and Land Surveyors and to the Department of Commerce, Community, and Economic Development."

SB 16 was SCHEDULED but not HEARD.

#sb24

SENATE BILL NO. 24

"An Act relating to the Alaska Marine Transportation Advisory Board."

SB 24 was SCHEDULED but not HEARD.

#sb37

SENATE BILL NO. 37

"An Act extending the termination date of the Statewide Suicide Prevention Council; and providing for an effective date."

SB 37 was SCHEDULED but not HEARD.

#sb38

CS FOR SENATE BILL NO. 38(FIN)

"An Act extending the termination date of the State Medical Board; relating to the executive secretary of the State Medical Board; and providing for an effective date."

SB 38 was SCHEDULED but not HEARD.

#sb18

CS FOR SENATE BILL NO. 18(FIN) am

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

SB 18 was SCHEDULED but not HEARD.

ADJOURNMENT

[10:04:43 AM](#)

The meeting was adjourned at 10:04 a.m.