

SENATE FINANCE COMMITTEE  
February 25, 2014  
9:10 a.m.

[9:10:18 AM](#)

CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 9:10 a.m.

MEMBERS PRESENT

Senator Pete Kelly, Co-Chair  
Senator Kevin Meyer, Co-Chair  
Senator Anna Fairclough, Vice-Chair  
Senator Click Bishop  
Senator Mike Dunleavy  
Senator Lyman Hoffman  
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Senator John Coghill; Jordan Schilling, Staff, Senator John Coghill; Michael Pawlowski, Deputy Commissioner, Strategic Finance, Department of Revenue; Joe Balash, Commissioner, Department of Natural Resources; Angela Rodell, Commissioner, Department of Revenue.

SUMMARY

SB 64            OMNIBUS CRIME/CORRECTIONS BILL

SB 64 was HEARD and HELD in committee for further consideration.

SB 138          GAS PIPELINE; AGDC; OIL & GAS PROD. TAX

SB 138 was HEARD and HELD in committee for further consideration.

PRESENTATION: THE HEADS OF AGREEMENT AND THE MEMORANDUM OF UNDERSTANDING, RISKS, AND BENEFITS

#sb64

SENATE BILL NO. 64

"An Act establishing the Alaska Sentencing Commission; relating to jail-time credit for offenders in court-ordered treatment programs; allowing a reduction of penalties for offenders successfully completing court-ordered treatment programs for persons convicted of driving while under the influence or refusing to submit to a chemical test; relating to court termination of a revocation of a person's driver's license; relating to limitation of drivers' licenses; relating to conditions of probation and parole; and providing for an effective date."

9:11:15 AM

SENATOR JOHN COGHILL, related that the bill had the three overriding goals of improving public safety, slowing the growth of the prison population, and saving the state money. He related that if things were not changed, the Senate Finance Committee might to consider how to build the state's next big prison. He stated that the bill was a cooperative effort between himself, Senator Ellis, Senator French, and Senator Dyson that had been under development for well over a year and half. He continued that the bill was the result of many hours of testimony and that the sponsors had hammered out a good piece of legislation that the committee would be able to appreciate. He thought that there were several things in the bill that would help the state turn the corner on a variety of things that "really kicked the feet out from under us," which was the drug and alcohol problem in Alaska. He stated that the legislation would give the Department of Corrections (DOC), the Department of Health and Social Services (DHSS), and the Department of Law (DOL) real tools to help manage a population that needed better avenues. He stated that Alaska needed to figure out how to deal with the issue of sobriety, as well as how to keep people accountable and not spend the most amount on jail time. He spoke of the need let people have as much freedom as possible and be productive while still protecting public safety.

Senator Coghill related that in his mind, there were several over-arching aspects as the bill was being put together. He reported that he had always had an eye to the victim and that in Alaska, victims were quite often left without remedy. He thought that even as Alaska was trying to give avenues for those who had offended, the state wanted to make sure that the public was safe and that the victims were given every opportunity for restoration; he thought that there were avenues to do this under the 24/7 Sobriety Program. He reported that the 24-7 program allowed people to be productive while under accountability, which allowed them to pay restitution in other ways; he thought that the bill fell into what Senator Dyson had pushed on restorative justice. He added that the protection for the victim and the need for accountability were heavily embedded in the bill in the most cost-effective ways. He noted that the legislation contained a sobriety program and established the Alaska Criminal Justice Commission that would study the question of whether there were areas of Alaska's mandated sentencing laws that the legislature should be looking at; the bill would provide the commission with a list of things to think about and would require it to come back to the legislature with a report.

Senator Coghill thought that through the Alaska Criminal Justice Commission, it was time to examine how Alaska looked at its criminal code, mandatory sentencing, and how the sentencing had fit in real life; this would not be done with the intent of how to be soft on crime, but to be as real as possible in accountability. He stated that that imbedded in the bill was a Probation Accountability and Certain Enforcement (PACE) program that acted swiftly in the event of a parole violation. He noted that the sponsors were requesting that a fund be established within the bill that would allow the state to have a programmatic approach for those exiting jail; he noted that there were several ways to setup a fund and hoped that he would have a clearer path forward on that issue the next time the bill was before the committee.

Senator Coghill noted that thresholds for felony theft had not been adjusted since 1978 and thought that it represented an important thing to do because currently, Alaska could produce felons for things that really did not rise to the level of a felony; under certain circumstances, they could be a felon if they offended more than once. He noted that under the bill, some of these felonies needed to

be adjusted and that the time value of money and crime needed to be considered. He noted that the sponsors were asking DOC and DHSS to assist in creating better risk and needs assessments. He thought that the bill would help protect the public and keep people more accountable. He reported that the Senate Judiciary Committee had included a section for people who picked up children and did not have good identification; the section held people to a level of accountability if they did not have the right to pick up a child at school. He concluded that were multiple aspects in the bill, but its real focus was public safety, accountability, and avoiding building another prison that would cost the state \$300 million or more.

[9:18:25 AM](#)

Senator Dunleavy pointed to the fiscal notes attached to the bill and inquired if the cost would represent an increase to the budget or a transfer from another area. Senator Coghill replied that the way the bill was written, it would be a general fund appropriation to the state, but added that he would have his staff propose ways to decrease that cost and produce a CS. He stated that decreasing the bill's cost really revolved around the recidivism fund. He observed that the legislation did have an expected savings that was very hard to quantify which was the reduction in cost of keeping people accountable outside of jail versus the higher cost of incarceration. He related that the cost savings would be very hard to quantify, but it was expected to occur. He thought that there might be an estimation of what that savings was sometime in the future but reiterated that he was unsure if the DOC would be able to quantify the number.

[9:20:30 AM](#)

JORDAN SCHILLING, STAFF, SENATOR JOHN COGHILL, spoke to a PowerPoint presentation titled "Senate Bill 64 Omnibus Crime/Corrections bill" (copy on file). He spoke to slide 1 of the presentation and read off his talking points (copy on file):

SLIDE 1

Mr. Chairman, thank you for hearing Senate Bill 64 today in light of a full schedule.

Just to bring you up to speed on where SB 64 has been:  
(2) senate state affairs  
(2) joint judiciary  
(7) senate judiciary

The Senate Judiciary Committee received input from the Department of Law, Dept. of Corrections, the Court system, Public Defender, and as a result of that feedback, this CS was formed.

Today we go over version D.

Mr. Schilling spoke to slide 2 and spoke from his talking points:

SLIDE 2

The state is not receiving good value for the money spent on our corrections system. 2 out of 3 of our prisoners return to prison quickly after release. Most of these offenders return in the first 6 months - which is one of the worst recidivism rates in the country. So, we must ask ourselves: with state revenues falling, is this how we want to spend our money?

Mr. Schilling spoke to a graph on slide 3 and reported that currently, the price of incarceration was \$159 per day, per inmate and was about \$54,000 per year, which was approximately twice as much the cost in the Lower 48.

Mr. Schilling addressed slide 4 and read from his talking points:

SLIDE 4

Today Alaska is at a crossroads. If the prison population continues to grow at its current rate, the state's prisons will be, yet again, at full capacity in just two years. So, the state must today either start planning to build a new prison, start sending prisoners out-of-state, or, look at programs that are proven to work - things other states are doing today - to reduce recidivism, reduce our DOC budget, and put off a huge capital expense (and an operating expense) of building another prison.

Mr. Schilling related that the graph on slide 4 was from the Legislative Finance Division. He stated that the red line was the maximum capacity of the prison system and that the blue line was the prisoner population. He stated that the prison population in Alaska was growing at a steady 3 percent per year and that in 2016, where the blue and red lines intersect, was when the system would be over capacity. He stated that the horizontal cells at the bottom of slide showed the budget and relayed that lately, it had increased about 7.3 percent per year.

[9:23:14 AM](#)

Co-Chair Kelly requested Mr. Schilling to repeat the figure. Mr. Schilling confirmed that the corrections budget had been increasing 7.3 percent per year.

Mr. Schilling pointed to slide 5 and read his talking points:

SLIDE 5

Many states have been faced with the same problem - the problem of needing a new prison every 5 or 10 years. Those states identified the things driving their prison growth and developed policies to address them.

Over the last couple years, 15 of those states actually closed prisons.

Texas and Kansas were among the first states to make some big changes. Texas was faced with building 4 new prisons. Instead of doing that, they funded some of these programs, and they ended up not needing a single new prison, and they actually closed a prison a few years later... so we can look to what other states have done to see what works.

Kentucky's omnibus corrections bill is projected to save them \$420 million over the next 10 years.

Arkansas' omnibus bill is expected to save \$875 million.

We haven't done much in corrections reform. The vast majority of Alaska's criminal statutes were rewritten

in 1982. The Alaska criminal code was based on the best research at the time. Research, however, has continued to advance during the last 25 years and much has been learned about effective ways to address our prison problem.

9:24:29 AM

Mr. Schilling discussed slide 6 and related that the bill had three main goals, which were to increase public safety, reduce recidivism, and reduce costs.

Mr. Schilling addressed slide 7 and spoke from his talking points:

SLIDE 7

Now, the DOC has similar goals. This is the mission statement of the Department of Corrections.

- 1) Secure confinement
- 2) Reformative programs
- 3) Community Reintegration

That mission is pulled right from the Alaska Constitution. So, it's not that their goals are wrong, but it's how they allocate resources to achieve those goals.

Mr. Schilling spoke to the charts on slide 8 and read from his talking points:

SLIDE 8

This is how they allocate those resources. The Department places a major emphasis on secure confinement, and barely any emphasis reformative programs or community reintegration. Yet those are the very areas where we can affect recidivism.

If we keep doing the same thing, we'll keep getting the same results. These are the results we're getting right now.

Mr. Schilling discussed the top pie chart on slide 8 and stated that it depicted how DOC allocated its full-time positions; 86 percent of the positions were focused on the warehousing aspect, 4 percent were focused on reformative programs, and 10 percent were for supervised release.

Mr. Schilling directed the committee's attention to the graph on slide 9 and addressed his talking points:

SLIDE 9

The Department of Corrections made this graph and it shows the drop in recidivism over the past few years. While it may look like a dramatic decrease is occurring, you'll notice this is about 1.5% reduction over 4 years. That's not enough, and it's not happening quick enough. At that rate, our prison system will be at capacity by 2016. And 63% is still one of the highest recidivism rates in the country.

Mr. Schilling discussed slide 10 and spoke from his talking points:

SLIDE 10

SB 64 has 8 main pieces to address our recidivism problem:

- SB 64 establishes a 24/7 Sobriety Program used to prevent offenders from drinking. The program includes twice-a-day alcohol testing and swift punishment if alcohol is consumed.
- SB 64 creates the Alaska Criminal Justice Commission to evaluate the system and make recommendations.
- SB 64 expands a program called P.A.C.E. which is a different way of doing probation that prevents violations and new crimes.
- SB 64 requires the Dept. of Corrections to conduct more assessments of their prisoners.
- SB 64 establishes a Recidivism Reduction fund in the Department of Corrections to grant money to transitional re-entry programs.
- SB 64 increases the felony theft threshold from \$500 to \$750. The threshold was established in 1978 and has never been adjusted for inflation.

- o Lastly, SB 64 incentivizes treatment and expands the ability to get credit for time in treatment.

Mr. Schilling inquired if Co-Chair Kelly would like him to go through the bill section by section. Co-Chair Kelly replied in the affirmative.

[9:27:35 AM](#)

Mr. Schilling pointed to slide 11 and addressed his talking points:

SLIDE 11

The first 3 sections of the bill fill a gap in our criminal codes relating to attempted child abduction.

These sections of the bill resulted from an amendment in Senate Judiciary.

Mr. Schilling related that while the first 3 Sections of the legislation did not deal directly with recidivism, it had a strong public safety aspect.

Mr. Schilling discussed slide 12 and spoke from his talking points:

SLIDE 12

If a potential abductor goes to a school/daycare and attempts to pick up a child that doesn't belong to them, the only charge currently on the books that can be made against the person is Criminal Mischief.

These sections create a crime of "custodial interference in the 2nd degree" if an attempted abduction like that is made.

[9:28:41 AM](#)

Vice-Chair Fairclough inquired if there were comments or discussions about cases of custody in divorces situations in the Senate Judiciary Committee. She wondered what would happen if a mom who had custody of her child sent a neighbor to pick up the kids and that because of the volatility of the situation, a restraining order, or some other unknown, the school did not want to release to a

friend who the child knew; she wondered how this situation would be dealt with and pointed out that the father might claim that it was an abduction. Mr. Schilling responded that it was a good question and relayed that the issue had been discussed in the Senate Judiciary Committee. He directed the committee's attention to page 2 on line 16 of the legislation and stated that it was where the language was added that stated that in order for a crime to be committed, a person must have no legal right to pick up the child; the language had been added to address the type of situation that Vice-Chair Fairclough had referred to. He explained that if someone who had custody of a child gave a person permission to pick that child up, that would suffice as a legal right.

Mr. Schilling addressed slide 13 and related that the next 15 sections of the bill, which were Sections 4-19, dealt with Alaska's felony theft threshold.

Mr. Schilling directed the committee's attention to slide 14 and discussed his talking points:

SLIDE 14

Sections 4-19 address the felony theft threshold. The dividing line between a misdemeanor theft and a felony theft is \$500. If you steal something over \$500, it's a felony. If you steal something under \$500, it's a misdemeanor. That dividing line, the felony threshold, was established by the legislature over 30 years ago.

Because that amount has never been adjusted, it fails to take into account 30 years of inflation. \$500 in 1978 had much more purchasing power than it does today. In fact, \$500 in 1978 is equivalent to \$1800 today. In other words, what amounted to a misdemeanor 30 years ago may now constitute a felony.

Mr. Schilling discussed slide 15 and related that the graph showed where Alaska was compared to other states on the West Coast regarding felony theft thresholds. He reported that Alaska had was one of the last holdouts that had a felony threshold rate this low for theft. He added that the graph needed to be updated and that not only had Colorado adjusted theirs in 2007, but that it had done so again recently. He stated that property crimes made up the

largest portion of Alaska's felonies and that the sponsors were seeking a modest increase in the threshold from \$500 to \$750.

[9:31:19 AM](#)

Mr. Schilling addressed slide 16 and stated that the following statutes were those that would need to be adjusted if the felony theft threshold was changed from \$500 to \$750:

- Theft 2nd degree
- Theft 3rd degree
- Theft 4th degree
- Concealment of merchandise
- Removal of identification marks
- Unlawful possession
- Issuing a bad check
- Fraudulent use of an access device
- Vehicle theft in the 1st degree
- Criminal mischief 3rd degree
- Criminal mischief 4th degree
- Criminal mischief 5th degree
- Criminal simulation
- Misapplication of property
- Defrauding creditors.

Mr. Schilling spoke to slide 16 and stated that the reason that there were 15 sections in the bill dealing with statutes was because of the number of them that were affected by the threshold change.

Mr. Shilling read from his talking points:

A felony conviction carries lifelong consequences. There are thousands of consequences and barriers that follow a felony for the rest of his or her life.

A felony conviction greatly diminishes the ability of that individual to lead a productive life.

This problem disproportionately affects those in rural Alaska. A basic window, if broken in Anchorage might only be a misdemeanor, but that same window in rural Alaska could trigger a felony. As inflation continues, this problem will get worse.

One criticism we have heard is that some think theft will increase.

Co-Chair Kelly inquired if the sponsor had had discussions about the \$750 dollar amount and thought that it did not seem achieve that much. Mr. Schilling responded that when Senator Coghill had originally introduced the idea several years prior, the suggested new threshold had been \$2,500 and that when the bill was again reintroduced the previous session, it was at \$1,500, but was amended down to \$1,000; it was then amended again down to \$750 in the Senate Judiciary Committee. He agreed that the number was not very significant if it was going by inflation.

Co-Chair Kelly thought that the threshold in the bill needed to higher than \$750 and inquired if the cost of a dented fender in the charge of criminal mischief would be applied under the legislation. Mr. Schilling responded that Co-Chair Kelly was correct.

Vice-Chair Fairclough believed that small businesses are the ones advocating for a smaller threshold because they felt that breaking a storefront window in Anchorage rose to the level of a felony.

Vice-Chair Fairclough referenced slide 15 and noted that only 10 states were provided. She inquired if the 10 states on the slide were the bottom 10 and requested a range inside of the U.S. where the level might be set. She recalled that the bill had been originally introduced with a new felony theft threshold of \$2,500 and now appeared to still be second to the bottom at \$750. She felt that businesses were not aware of how much the current threshold was costing the state in the form of corrections and the Alaska Court System. She understood the offense and that perhaps if businesses wanted to keep the threshold low, they could help carry the burden. Mr. Schilling responded that Vice-Chair Fairclough was correct in that not every state was listed on slide 15 and that there were, in fact, states that had a lower such threshold than Alaska. He stated that it was also true that the National Federation of Independent Business had pushed back on the bill's concept.

[9:34:44 AM](#)

Mr. Schilling directed the committee's attention to slide 20 and thought that it was important to understand that theft under \$500 was still a class A misdemeanor and carried up to a year in jail and up to a \$10,000 fine; furthermore, these crimes would not go unpunished, but the threshold was being adjusted to track the original intent of the legislature when it had put in the \$500 limit.

Vice-Chair Fairclough wondered what the bar graph on slide 15 represented inside of the U.S. She inquired whether it represented the high and the low or another category. Mr. Schilling responded that the x-axis was showing a dollar amount and that Alaska's current bar was about \$500; the numbers next to the bars were the years that the thresholds had been established. He noted that Alaska's threshold was established in 1978, but the state just above it on the chart, which was Nevada, had a threshold of \$650 that was established in 2011.

Vice-Chair Fairclough commented that there were 50 states and that she was looking for a range. She inquired if the chart's states reflected the high and the low or were there numbers that were not shown on the extrapolation for the graph. Mr. Schilling responded that the graph did not reflect a high or low range, but that he would produce the information for the committee.

Vice-Chair Fairclough stated that she was trying to get a range for the committee. Mr. Schilling replied that he had seen a low threshold of about \$300, but that he could not recall which state that was; he believed that \$2,000 was the new threshold for Colorado.

Vice-Chair Fairclough inquired if Mr. Schilling thought that the high was Colorado at \$2,000. Mr. Schilling responded that he believed that it was.

Mr. Schilling spoke to slide 17 and related that there had been concerns by the business community that the bill would result in increased crime and theft; however, other states had not seen those effects from similar legislation. He pointed to slide 17, 18, and 19's graphs and related that they had come from the PEW Research Center, which had conducted a lot of research on the issue. He noted that Arkansas had raised its threshold in 2011 and that instances of theft remained unchanged.

Mr. Schilling discussed slide 18 and related that Ohio had increased its threshold in 2011; theft had actually dropped there since then.

Mr. Schilling discussed slide 19 and pointed out that South Carolina had doubled its threshold in 2012; again, crime was steady.

Mr. Schilling addressed slide 20 and related that it was a visual representation of what the sections did.

Mr. Shilling spoke to his talking points for slide 20:

These sections also raise the lower threshold of \$50 that sits between a class A misdemeanor and a class B misdemeanor to \$250.

So, we propose to increase the threshold to \$750. It's a modest amount, but it's a step in the right direction.

[9:37:28 AM](#)

Vice-Chair Fairclough inquired why the threshold was being changed if there were results that showed it did not make a difference on the crime rates. Mr. Schilling replied that the purpose was to reduce the number of people who were receiving felonies for crimes above \$500, but under \$750. He furthered that the sponsor was trying to reduce the collateral consequences that followed someone for the rest of their lives if they received a felony conviction. He offered that it was becoming easier and easier to receive a felony conviction.

Co-Chair Kelly thought that the point was that the crime level did not go up as a result of the changing the felony theft threshold; it could benefit the state by having the cost be a lot less with the same amount of crime. He observed that the sponsor was also trying to address a human element with the change, but that it could not be quantified.

Vice-Chair Fairclough requested that the presentation be directed back to slide 17 and noted that when she looked at the graphs, she saw something different. She offered that in Arkansas, it appeared as though theft had been trending downward until the threshold had been raised there. Mr. Schilling responded that the uptick in the graph was right

before the state had changed the threshold and that it appeared to him as though the line was level at the point at which it was changed.

Vice-Chair Fairclough observed that there was an inflection downward in one of the categories of theft. Mr. Schilling replied in the affirmative.

[9:39:09 AM](#)

Senator Bishop requested the average age of people who committed felony theft. He wondered if most of these types of crimes were committed by people who were 18 and 19 years old and expressed that he wanted to paint the picture. He added that felony theft could be a barrier to a young person who was seeking employment and noted that it prohibited these people from working on the pipeline. Mr. Schilling responded that he would work with the Alaska Court System to determine if that was a number that he could obtain.

Vice-Chair Fairclough inquired if there had been discussion in the Senate Judiciary Committee about a judge's discretion related to the bill. She relayed that some judges had indicated to her that the legislature was so prescriptive in what it did that there was sometimes very little latitude for judges to consider what was happening in the court room or to an individual who might be a troubled child who threw a rock or might be a multiple offender. She further clarified the question and wondered if the discussion of giving judges the flexibility of weighing an individual perpetrator's circumstances in his decision. Mr. Schilling responded that the issue had not been discussed specifically in regard to the felony theft threshold, but that he understood that giving judges very little discretion was a problem.

Vice-Chair Fairclough recalled the example of a mischievous child breaking a window and thought that perhaps exceptions could be made in certain cases. She appreciated the work of the bill's sponsor but had heard from the judicial system that the legislature was getting very prescriptive and that a having justice versus prescriptive penalties was something that was sometimes out of judges' hands.

Mr. Schilling addressed slide 22 and read off of his talking points:

SLIDE 21

Alaska has, for decades, been in a long struggle with alcohol. It has reached epidemic proportions and costs the state millions each year. The societal cost of alcohol is huge too - from FASD and suicide to domestic violence and sexual assault.

Alcohol is a factor in many (if not most) crimes - For example, alcohol is involved in 75% of domestic violence offenses -- and if we can address that area, alcohol abuse, we could see a huge reduction of recidivism in Alaska.

Sections 20-22 establish 24/7 in pre-trial.

24/7 Sobriety is a program developed in 2005 in South Dakota. It curbs alcohol use, it makes the public safer, and it reduces recidivism. The best part is that it costs the state next-to-nothing.

24/7 Sobriety is a growing trend in the U.S. There are 3 states with an established program (SD, ND, & MT), 11 states with pending legislation, and 5 more states operating pilots.

The program has one goal: sobriety 24 hours per day, 7 days a week. The program requires the participant to:

- 1) refrain from alcohol and
- 2) show up twice-a-day for a breath alcohol test.

(The court may also order remote monitoring in certain cases.)

Mr. Schilling spoke to slide 22 and discussed his talking points:

Participation in the program can be required as a condition of probation, parole, or pre-trial.

So, if an offender commits a crime, and alcohol is a factor in that crime, the court can order that person on 24/7 Sobriety, either as a condition of their release before trial, or as part of their probation. It is a particularly effective program for repeat DUI offenders.

9:43:56 AM

Senator Hoffman requested that Mr. Schilling address how remote monitoring would work in rural Alaska. Mr. Schilling deferred to DOC regarding where the department's monitors could and could not be used; however, he had information later in the presentation that would cover some of the devices and ways that it would work in rural Alaska.

Mr. Schilling continued to address slide 22 and spoke to his talking points:

So, if an offender commits a crime, and alcohol is a factor in that crime, the court can order that person on 24/7 Sobriety, either as a condition of their release before trial, or as part of their probation. It is a particularly effective program for repeat DUI offenders.

Mr. Schilling addressed slide 23 and discussed his talking points:

SLIDE 23

All testing fees are paid by the participant, so it's a self-funded program. The cost is anywhere from \$4-5 dollars per day, which the offender pays - and that's enough to sustain the program.

Mr. Schilling discussed slide 24 and addressed his talking points:

SLIDE 24

There are several ways to test: in-person, ankle bracelet, home-based device, or a portable Breathalyzer. While in the program, participants remain in society, conduct their daily lives, go to work, pay their fees, and fulfill their responsibilities, as long as they remain sober.

Mr. Schilling spoke to slide 24 and stated that the device on the far left side was a portable breathalyzer and the one in the middle was a home-based device that was being used in a pilot program in Anchorage; the device on the far

right was an ankle device referred to as the SCRAM bracelet and was something that DOC was using.

Mr. Schilling discussed slide 25 and addressed his talking points:

SLIDE 25

Someone can be on the program anywhere from a week to a couple years.

The program was based on personal responsibility and accountability, backed by swift and certain sanctions if there is a violation. If the offender blows hot, they receive a swift sanction (arrested immediately, a quick hearing, and a short jail sentence, usually 1-3 days.)

Mr. Schilling discussed slide 26 and read from his talking points:

SLIDE 26

The program works. Most people on the program quit drinking completely, and another 30% quit drinking after their first couple violations.

24/7 Sobriety is a public safety measure. South Dakota has been collecting data on their program for almost 10 years now, and the results are very exciting.

Mr. Schilling pointed to slide 27 and addressed his talking points:

SLIDE 27

They have seen a 9% decrease in domestic violence and a 12% decrease in drunk driving. The program is reducing recidivism and saving them money.

The bottom line is: a majority of the people in the program quit drinking completely, and that's good for public safety and good for the budget.

[9:46:29 AM](#)

Mr. Schilling addressed slide 28 and read from his talking points:

SLIDE 28

The next section, 23, makes changes to AS 12.55.027. This section of law lays out the requirements to receive credit for time served in a treatment program.

By relaxing these requirements on treatment programs, the program can offer better treatment, and participants can more readily earn credit for time served there. Remember, offenders have little incentive to enter (and pay for) a treatment program if they won't get credit for their time.

Mr. Schilling discussed slide 29 and spoke to his talking points:

For 25 years, it was the Court that made determinations of what counted as credit for time served in a treatment program, based on years of caselaw, starting with Nygren v. State in 1983. In 2007 the legislature enacted this section of law.

Now, it is laid out in statute, and is much more restrictive than it was pre-2007. It leaves little room for an offender to participate in activities that programs would like to provide, such as going to a job center, attending church, vocational classes, or going to AA and NA meetings.

If we relax the requirements in this statute, it encourages rehabilitation and treatment, and allows treatment programs to do more. And it brings the statute more in-line with how things were done prior to 2007.

The way these changes are written in SB 64, we're still preventing credit for time served for going to dinner and a movie.

So, SB 64 says that in order to get credit for time served, one must live in a treatment facility and can only get a "day pass" for things like employment, voc. tech classes, AA or NA meetings, and any other purpose that is directly related to their treatment. This

encourages treatment, which is by far less expensive than a prison bed.

Mr. Schilling related that Sections 26 through 28 of the bill dealt with the expansion of PACE.

Mr. Schilling pointed slide 30 and discussed his talking points:

SLIDE 30

When an offender is put on probation, they are given a list of things they can't do - like use drugs. If they violate the conditions of their probation by using drugs, it's called a "probation violation" and that can trigger you going back to jail. In Alaska, we have a big problem with people on probation getting these violations or committing new crimes and repeatedly coming back into the prison system. This revolving door of people coming in and out of the prisons is one of the biggest drivers of our high recidivism rate. But more important to this committee, it is one of the biggest cost drivers to the Department of Corrections.

[9:49:28 AM](#)

Mr. Schilling spoke to slide 31 and addressed his talking points.

SLIDE 31

There is a way to stop this revolving door. There is a different way of doing probation and it's a program called P.A.C.E. (Probationer Accountability and Certain Enforcement).

Mr. Schilling pointed to the pie graph on slide 31. He related that the green slice represented 14 percent and was the amount of people who were serving time currently solely based on a probation violation.

Mr. Schilling continued to address slide 31 and read from his talking points:

...it was first developed in Hawaii and is now being used in 17 other states. It reduces the number of re-

arrests, reduces the amount of drug use, reduces the number of missed appointments, and ultimately reduces the number of people going back to jail.

It's an intensive program for offenders who have been identified as likely to violate the conditions of their probation. The program involves frequent and random drug tests and responds to any violation with swift, certain, and short terms of incarceration.

Probation-as-it's-currently-done-today comes with high rates of violations. For example, despite rules requiring sober living, probation-as-usual oftentimes affords offenders opportunities to continue using drugs, which in most cases means continuing to commit other crimes. Drug testing tends to be too infrequent and sanctions are too rare and too delayed. When sanctions are imposed, they tend to be too severe (months, or occasionally years, in prison) rather than a 2-3 day jail term.

P.A.C.E. takes away the discretion of the Probation Officer because when someone violates a condition of his or her probation by, for example, testing positive for drugs or missing an appointment, under P.A.C.E, that individual is arrested immediately and brought to court within 72 hours. At the court hearing, the judge imposes a sanction of a short jail term, commonly two to three days. If the offender violates his or her terms again, the process is repeated. In short, every single probation violation is dealt with quickly and a sanction is imposed each time. In contrast, under "probation as usual," revoking someone's probation or holding a court hearing might not occur until several probation violations are reported. As a result, the process can require several costly court hearings over a six-month period and can be generally characterized as anything but "swift and certain."

This is more intensive probation, but it can be scaled at low cost. In Hawaii, the program grew from 35 probationers to more than 1400 without adding courtrooms, judges, court clerks, police officers, or jail cells. To begin putting a tourniquet on our rate of recidivism, this bill establishes PACE statewide immediately, which the Department of Corrections estimates needing additional personnel for.

Mr. Schilling observed that the bill did have a fiscal note that accounted for the need of the additional personnel within DOC.

9:52:25 AM

Co-Chair Kelly observed that the fiscal note for the bill was for about \$1.6 million and inquired if there was any way to anticipate the savings that it would result in. Mr. Schilling replied that there were ways to estimate the savings and believed that the sponsor had a report from the Division of Legislative Research to that effect. He thought that the report was in members' packets (copy on file) and stated that further along in the presentation, he would discuss the reduced number of days in prison that people had under P.A.C.E.

Mr. Schilling continued to address slide 32 and stated that P.A.C.E. probationers were 55 percent less likely to be arrested for a new crime and were 72 percent less likely to use drugs. He noted that the graph depicted a precipitous drop off after the first violation of a positive urinalysis.

Mr. Schilling spoke to slide 33 and stated that P.A.C.E. probationers were 61 percent less likely to skip appointments.

Mr. Schilling addressed to slide 34 and relayed that P.A.C.E. probationers were ultimately 53 percent less likely to have their probations revoked, which was where a cost savings could be found because they were not coming back to prison.

Mr. Schilling spoke to slide 35. He stated that the graph also reflected the likelihood of P.A.C.E. probationers' probation being revoked, but it reflected the state's pilot P.A.C.E. program in Anchorage.

Mr. Schilling discussed slide 36 and stated that it showed how many less days a PACE probationer would spend in prison; they served 48 percent fewer days in prison. He reported that when the cost of incarceration was \$160 per day, a 48 percent decrease was huge. He observed that each new probation officer in Alaska paid for their own salary

and benefits if they kept just 2 people out of prison for a year.

Mr. Schilling directed the committee's attention to slide 37 and discussed his talking points:

SLIDE 37

The Department of Corrections evaluates inmates to figure out their risks and needs. This type of evaluation can give the DOC an idea of the underlying reasons that person committed the crime like if they have a substance abuse or a mental health problem. Based on this assessment, you have a good idea if the offender needs to be in PACE, if he could use substance abuse or mental health treatment, basically, discovering what the underlying issue is.

[9:54:45 AM](#)

Mr. Schilling spoke to slide 38 and related his talking points:

SLIDE 38

The department uses a 54-item assessment, which identifies problem areas in an offender's life and helps predict their likelihood of recidivating.

The assessment looks into 10 areas like family/marital issues, attitudes, substance abuse or alcohol issues, etc.

However, when someone is sentenced to serve time in prison here in Alaska, more often than not, we do not evaluate or assess that person. The Department of Corrections assesses less than half of the felons coming through the system, and assesses hardly any misdemeanants, even though misdemeanants are the future felons.

You can't link an offender to treatment if you don't assess them. You can't understand the underlying, root causes for their crimes if you don't assess them. In speaking with the department, a risk-needs assessment takes about 45 minutes to complete.

Mr. Schilling addressed slide 39 and read from his talking points:

SLIDE 39

So, this section [Section 29] of the bill requires the Department to perform a risk-needs assessment on all offenders who have been sentenced to 30 days or more. This will mean a significant increase in the number of assessments the Department conducts. The Department estimates needing additional probation officers to do these assessments.

Co-Chair Kelly wanted the record to reflect that Co-Chair Meyer had rejoined the committee.

Mr. Schilling discussed slide 40 and relayed his talking points:

SLIDE 40

When someone has served their entire sentence, they are released from prison. Every state releases their prisoners differently. Some states transition that person into a halfway house or some other type of gradually phased re-entry. But here in Alaska, more often than not, these prisoners are released into the parking lot of the prison without any resources whatsoever. This is one of the root causes of our high recidivism rate - we dress them in the clothes they entered prison with, and we release them into the parking lot. They don't have first month's rent or a deposit, and they can't get a job. They certainly can't afford treatment. And if you're from rural Alaska, you're probably being released in a city you're unfamiliar with. So, as a result, many of those recently released go straight to a homeless shelter and are back in jail in no time.

It's this approach to re-entry that is the main cause of Alaska's high recidivism rate. Of all of the recidivism we're seeing, most of it occurs in the first 6 months.

If, during those first 6 months after release, we could, put them in a transitional re-entry program - a place with a structured environment, sober living, treatment, and help getting a job or education in their own communities -- we could greatly improve their chances of not reoffending.

[9:57:13 AM](#)

Mr. Schilling discussed slide 44 and related his talking points:

This section creates a fund to start those types of programs. This fund will distribute money to programs that have those 4 things: case management, sober living, substance abuse treatment, and work placement.

By putting some focus on re-entry, we can drastically reduce our rate of recidivism. This fund would be managed by the Department of Corrections, which comes with a fiscal impact to administer the fund.

Mr. Schilling discussed slide 46 and related that the bill established the Alaska Criminal Justice Commission, which was simply a commission that would review, analyze, and evaluate the effect of laws and practices within the state's criminal justice system. He stated that an original CS to the bill had the commission set at 17 members, but the amount had been reduced to 12; the commission had a sunset date established of 5 years.

Mr. Schilling addressed slide 47 and stated that the Alaska Criminal Justice Commission had some powers and duties that were essentially pulled from the state constitution, did not have an executive director, was staffed by the Alaska Judicial Council, and provided an annual report to the legislature.

Mr. Schilling discussed slide 49 and related the applicability and transitional provisions in the bill. He noted that the bill had an effective date of July 1 of the current year; however, the legislation gave DOC the ability to start working on the regulations immediately.

[9:58:51 AM](#)

AT EASE

10:12:06 AM

RECONVENED

#sb138

SENATE BILL NO. 138

"An Act relating to the purposes of the Alaska Gasline Development Corporation to advance to develop a large-diameter natural gas pipeline project, including treatment and liquefaction facilities; establishing the large-diameter natural gas pipeline project fund; creating a subsidiary related to a large-diameter natural gas pipeline project, including treatment and liquefaction facilities; relating to the authority of the commissioner of natural resources to negotiate contracts related to North Slope natural gas projects, to enter into confidentiality agreements in support of contract negotiations and implementation, and to take custody of gas delivered to the state under an election to pay the oil and gas production tax in kind; relating to the sale, exchange, or disposal of gas delivered to the state under an election to pay the oil and gas production tax in kind; relating to the duties of the commissioner of revenue to direct the disposition of revenues received from gas delivered to the state in kind and to consult with the commissioner of natural resources on the custody and disposition of gas delivered to the state in kind; relating to the authority of the commissioner of natural resources to propose modifications to existing state oil and gas leases; making certain information provided to the Department of Natural Resources and the Department of Revenue exempt from inspection as a public record; making certain tax information related to an election to pay the oil and gas production tax in kind exempt from tax confidentiality provisions; relating to establishing under the oil and gas production tax a gross tax rate for gas after 2021; making the alternate minimum tax on oil and gas produced north of 68 degrees North latitude after 2021 apply only to oil; relating to apportionment factors of the Alaska Net Income Tax Act; authorizing a producer's election to pay the oil and gas production tax in kind for certain gas and relating to the authorization; relating to monthly installment payments of the oil and gas production tax; relating to interest payments on monthly installment payments

of the oil and gas production tax; relating to settlements between producers and royalty owners for oil and gas production tax; relating to annual statements by producers and explorers; relating to annual production tax values; relating to lease expenditures; amending the definition of gross value at the 'point of production' for gas for purposes of the oil and gas production tax; adding definitions related to natural gas terms; clarifying that credit may not be taken against the in-kind levy of the oil and gas production tax for gas for purposes of the exploration incentive credit, the oil or gas producer education credit, and the film production tax credit; making conforming amendments; and providing for an effective date."

10:13:00 AM

^PRESENTATION: THE HEADS OF AGREEMENT AND THE MEMORANDUM OF UNDERSTANDING, RISKS, AND BENEFITS

MICHAEL PAWLOWSKI, DEPUTY COMMISSIONER, STRATEGIC FINANCE, DEPARTMENT OF REVENUE, began a PowerPoint presentation titled "The Heads of Agreement and the Memorandum of Understanding, Risks, and Benefits" (copy on file). He recalled that the committee had heard from the administration's consultants over the last several hearings and that the current presentation would attempt to bring back the prior ones before the committee as a summary and would describe some of the thought processes of the administration when it put together the Heads of Agreement (HOA) and the Memorandum of Understanding (MOU) with TransCanada. He noted that the presentation would also provide context for the committee and comment on what had been presented to date.

Mr. Pawlowski spoke to slide 2 titled "Guidance Document & SB 138." He related that it was important to remember that there were only three documents that the committee would be working through. He reported that to date, the committee had been focusing on the HOA, which broadly described a roadmap to advance the large Alaska liquefied natural gas (AKLNG) line through a phased process; it also described key commercial terms. He stated that the MOU was a document that described an agreement to transition out of the Alaska Gasline Inducement Act (AGIA) license and into a more traditional commercial relationship with TransCanada. He

stated that the HOA and MOU really described to the legislature and the public how the administration would use the power that it would be granted if SB 138 was passed; they were guidance documents and a road map. He stated that SB 138 would look at three big questions: should the state participate in the in the AKLNG project, what percentage of the gas share the state would take, what process was used for the development of the project-enabling contracts, how the legislature would work with the administration through the phased process, as well as how the administration came back for approval before the legislature in the future.

Mr. Pawlowski addressed slide 3 titled "Introduction":

- Should the State participate in the AK LNG project?
  - What are some of the benefits?
  - What are some of the risks?
  - Can the risks be mitigated?
  
- Should the State partner with TransCanada?
  - Does partnering with TransCanada advance State interests?
  - What are the risks and benefits of partnering with TransCanada?

Mr. Pawlowski discussed slide 4. He stated that when you looked at the AKLNG project, one of the most compelling interests for the state to advance a project this large was the potential revenues that it would bring to Alaska in the latter part of the current decade and into the middle part of the next one. He reported that the Department of Revenue (DOR) saw the opportunity of the commercialization of North Slope gas as providing a significant additional revenue stream on top of Alaska's already robust oil tax revenues. He stated that the bill had additional benefits such as getting gas to Alaskans, growing the economy, and creating jobs. He concluded that for the Senate Finance Committee, the administration would be diving further into how the project would look regarding potential investments and revenues in future presentations.

[10:16:50 AM](#)

JOE BALASH, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, spoke to slide 5. He related that the slide had been presented by Deepa Poduval from Black & Veatch Consulting

the prior week and that it consolidated and highlighted the key findings and recommendations of the study that the Department of Natural Resources (DNR) had commissioned the previous year on how to maximize the state's royalty value. He recalled the history that was being discussed in committee the previous Thursday and that in 2012 the project had started to pick up steam; it was clear at that point that liquid natural gas (LNG) was the most likely path to the commercialization of North Slope gas. He reported that as an institution, DNR had grown to understand how to protect the state's royalty interest in a North American based project, but was not entirely sure how to do that in an LNG project; the study from Black & Veatch was commissioned in order gain understanding of what those differences were, as well as what risks and opportunities an LNG project would present to the state from a royalty perspective. He stated that as DNR evaluated not only the differences from a regulatory and commercial standpoint, it had also evaluated its current set of fiscal terms and fiscal regime in order to ascertain whether or not there was anything DNR really needed to do.

Commissioner Balash offered that ultimately, as slide 5 would show, it became clear that with large, complex, and expensive projects, there was a competitive window that Alaska could fit into; however, the administration would have to work to make sure state made it in the window. He related that the findings of the study had really helped inform the decision making of DNR and DOR regarding the conversation that was going on with the producers in the context of the HOA. He reminded the committee that the administration had been struggling to overcome the misalignment of interests between the state and the North-Slope Lessees; it had been through the Black & Veatch study that the administration had seen a path whereby, if structured properly, state participation could maximize the value proposition for Alaska's royalty, while mitigating some of the risks that the state would be exposed to if it were to take an equity position in the project. He concluded that having the study conducted at the same time as the discussions between the state and producers had been beneficial to the process.

[10:20:31 AM](#)

Senator Hoffman inquired if the Black & Veatch study was available. Commissioner Balash replied in the affirmative and added that he would provide it to the committee.

Commissioner Balash continued to speak to slide 5 and pointed to the bottom-middle box. He related that the inherent risks of state participation in the project was something that DNR had spent a lot of time trying to understand, as well as resolving those risks with the project sponsors.

Commissioner Balash addressed slide 6:

#### The HOA: A Step Toward Mitigating Risks

The Heads of Agreement begins the process of mitigating risks identified in the royalty study by committing the Parties to a phased approach to the project.

Key State concerns are recognized and Parties commit to developing agreements during Pre-FEED and FEED.

- Marketing Risk
- Expansion Principles
- Regulatory Framework and 3rd Parties

Commissioner Balash stated that fundamentally, the parties that were best situated to help the state mitigate the various risks were the same ones that it would be in partnership with. He reported that most of the risks either came in the upstream in the management of the gas and production or occurred downstream in the marketing aspects of the LNG sales process; it was here that the administration had found several ways these things could be managed. He stated the upstream side had balancing agreements that would be necessary between the different fields and leases and explained that there were varying royalty rates between the two primary fields of Point Thomson and Prudhoe Bay; the exact order in which those fields get produced could leave the state short or long on its share of the gas. He explained that one of the things that the administration would be seeking during the pre-FEED stage was to develop the offtake and balancing agreements upstream with the North Slope producer; concurrently, it would be working on the initial marketing efforts and potential disposition

agreements with those producers on an individual basis. He stated that the producers had the expertise and marketing professionals in the field that were dealing with LNG buyers that were in Pacific markets.

Commissioner Balash relayed that there were also some broader interests of the state that the administration wanted to keep in mind, first of which was the opportunity for expansions. He stated that the opportunity for expansions was something that had been important to DNR for many years and offered that Alaska had tremendous potential for additional gas development beyond Prudhoe Bay and Point Thomson; expansion opportunities were key to maximizing this potential. He added that the regulatory framework also allowed for access by third parties. He reported that the administration had chosen to use had a proprietary construct that allowed the state to pay for its share of the project, which it would through the tariffs anyway, but also allowed the state to control the terms of that section of the project. He stated that the administration felt that the above approach was a broad way to solve multiple problems, maximize the opportunity for the state from a royalty perspective, and at the same time, mitigate the key uncertainties that were identified; however, the agreements necessary to mitigate those risks had to be developed in a step-by-step fashion.

[10:24:42 AM](#)

Commissioner Balash spoke to slide 7. He related that while there were some key principles laid out in the HOA, there were a lot left that needed the details worked out; over the next 18 months during pre-FEED, the state needed to focus on putting those details on paper, obtain a clear understanding what the obligations of the parties are to one another, and how risks would be shared. He stated that during pre-FEED, the state would be picking up its share of the development cost, that there was an opportunity to have TransCanada lighten the state's load a bit on those costs from a cash perspective. He stated that what the administration was trying to show on the slide's chart was that the state's steps were going to be made commensurate with of those taken by other parties. He related that the administration was seeking 18 to 24 months and roughly \$100 million in the collection of agreements and legislation to explore an opportunity that it thought was tremendous. He hoped that once the pre-FEED step was completed, the

project would be back before legislature for approval with the additional detail and a body of additional agreements; he added that approval for project's next step would come with another commitment of 2 to 3 years and upwards of \$400 million. He added that the \$400 million could be a lesser amount, depending on partnership opportunities.

[10:26:35 AM](#)

Senator Bishop requested Commissioner Balash to speak to the state's consultants who were advising Alaska on the issue and observed that the public might not be aware of who was helping the state. Commissioner Balash replied that that the state-gas team had people who dealt with the companies on a daily basis, but behind them were the state's consultants at Black and Veatch. He reported that Black and Veatch was a global engineering firm that is involved directly with the design and construction of LNG project such as the AKLNG project; the company's business consultancy, which Ms. Poduval was a member of, had provided direct guidance and research regarding how these sorts of agreements, as well as the commercial agreements were put together. He related that Peter Abt, a managing director at Black and Veatch, had several decades of global gas experience, most recently working for GAZPROM in Russia. He stated that aside from Black and Veatch, there were some subcontractors on that contract that widened the base of experience in assessing fiscal regimes and certain market conditions, as well as intelligence. He stated that one of the subcontractors, Daniel Johnston, was familiar face and had advised either the legislature or the administration in the past and contributed to the competitiveness review on the project. He pointed out that the state's outside counsel on the legal side was Greenburg Traurig, which was also an international law firm. He stated Ken Minesinger had served as general counsel to a number of North American pipelines.

[10:30:55 AM](#)

Senator Hoffman directed the committee's attention to slide 7 and related that there were three different categories of funding that reflected the different levels of commitment. He inquired when the legislature would need to make those commitments and further queried if the payments for 2016, 2017, and 2018 would have to be made in 2016 or if they were spread out over three different legislative sessions.

Commissioner Balash replied that there were probably several ways to deal with that and which would partially depend on whether the state still had a cash call exposure through the liquefaction portion of the project; the administration had identified a partnership possibility with TransCanada and it may be able to identify additional partners during the marketing phase in the liquefaction portion. He stated that if the state was able to secure those partners, there might not be a need for cash calls during 2016, 2017, and 2018 on the part of the state; however, no partners had been identified yet, so the slide referenced \$180 million to \$450 million over the phase. He stated that each party would be responsible for meeting their cash-call requirements and that currently, the frequency of the commitment was not yet written into the agreement. He thought that it was premature to know with certainty, but that the state could expect to have a significant cash commitment in 2016.

10:33:06 AM

Commissioner Balash addressed slide 8 and related that there were 3 major components of the project that all fit together in order to produce LNG for marketing to the Pacific markets. He stated that one of the components was the gas treatment plant at Prudhoe Bay that would remove the CO<sub>2</sub>, H<sub>2</sub>S, and other impurities that would result in a very pure methane stream with some other potential hydrocarbons to help keep the BTU content high; that gas stream will be fed into the pipeline that will travel throughout the state at a relatively high pressure and would end into a liquefaction plant located at tidewater that was expected to be in Nikiski.

Commissioner Balash spoke to slide 9 and stated that the question was what the state's share of the project would be; a range of 20 percent to 25 percent had been identified in the HOA as the state's share. He stated that range had been determined through discussions with the companies, but was also a reflection on the findings of Black and Veatch's work to identify the minimum threshold for state participation to make the risks Alaska was taking on worth it. He noted that the set of commercial commitments in the project were very long-term, and that the administration thought that having a share lower than 20 percent was too low; conversely, the state's potential partners did not want it to have an open-ended upper end and a top end

number 25 percent had been arrived at. He noted that the legislation settled on state participation at about 22 percent and relayed that the number was calculated by taking the state's royalty interest, which was fixed at Prudhoe Bay and Point Thomson and expect it to produce roughly 75/25 split between the two fields in the long-term; on a blended basis, 13 percent was the figure for royalty. He related that the 13 percent royalty share was added to the production tax share to produce the total state gas share number. He observed that the math was not straightforward, and that the production tax rate of 10.5 percent was out of 100 units of gas; it was not that 10.5 percent out of 100 units of gas but was that percentage after the royalties were taking out. He expounded that the state's total share of the gas was actually 10.5 percent of the remaining 87 percent after royalty plus the 13 percent. He concluded that the total state gas share would then be used to determine the state's equity participation number on the project's three major components. He pointed to the slide's gray boxes and noted that the corresponding capital investment required to achieve the state investment in the 3 percentages of 20, 22, or 25.

Co-Chair Kelly inquired if there was a slide that covered risk and cash calls. Commissioner Balash replied that there was a slide further back in the HOA section of the presentation and that Commissioner Rodell would address it.

[10:38:14 AM](#)

Vice-Chair Fairclough thought that Commissioner Balash had touched on her question on the blended rate on the royalty gas. She recalled that in the Senate Resource Committee, a floor had been set so that the Alaska's revenue from the project could never go to zero and inquired if that committee had set it at 10.5 percent. Commissioner Balash believed that it was 12.5 percent.

Vice-Chair Fairclough inquired if 12.5 percent was the average of the lease rates. Commissioner Balash replied 12.5 percent represented the base royalty rate for leases that have an additional component like a net-profit share or a sliding scale. Vice-Chair Fairclough wondered if it should be set at a blended rate and thought that the Point Thomsons lease was at a higher rate of 16 percent. Commissioner Balash responded that there were some leases

that had a 16 percent rate, which was a 1/6 rate; however, there were a lot of 1/7 leases.

Vice-Chair Fairclough relayed that the intent in setting a floor in the Senate Resources Committee was to make sure that Alaskans received the value that was negotiated on the lease. She observed that the floor was set at the low end and wondered if it should be blended because of the discussion on the point of production. She noted that the state would never go above the 15 percent gross tax as was stated in the HOA and wondered about the play between 16 percent lease rate and Prudhoe Bay. She wondered how the actual gas tax would be adjusted to stay within the range of the blended number that the administration was showing the committee.

[10:40:44 AM](#)

Co-Chair Kelly requested Commissioner Balash to restate Vice-Chair Fairclough's original question before he answered. Commissioner Balash replied that when DNR offered acreage for lease at competitive sales, the terms of the leases were noticed before the bids were brought in; it was intended to be a transparent process. He related that when Prudhoe Bay had been first put up for lease in 1969, the terms were generally set at a 1/8 or 12.5 percent royalty share. He reported that when Prudhoe Bay had first been developed and the Trans-Alaska Pipeline System (TAPS) had been constructed, there were additional sales in an around Prudhoe Bay that offered terms at slightly different rates; in some cases, the royalties were made higher and in others, a net-profit share lease was offered for sale. He explained that a net-profit share lease had a royalty rate of 12.5 percent, but the bid variable was a percent of the profit earned on that lease rather than being a bonus bid; it was a payment that came in to DNR in addition to the royalty. He reported that DNR had certain leases that had a sliding scale royalty that had the base royalty set at 12.5 percent, 1/7, or 1/6, but the royalty rose upward as prices increased. He observed that DNR had a large variety of terms on its leases and recalled that after initial production at Prudhoe Bay, the department began offering some of its other leases at an even higher initial royalty rate; that was generally why Point Thomson coming in a higher royalty. He stated that Point Thomson had some leases at mostly 1/7, some at 1/8, as well as some net profit sharing and sliding scale leases; all of those

leases get blended together at the unit level and depending on the field's production and how the individual tracks were allocated for production purposes, it drove the math for how much of the gas was "royalty gas."

Commissioner Balash continued to address Vice-Chair Fairclough's question and stated that in the Prudhoe Bay case, the track factors were fairly straight forward; DNR had seen a lot of production and cycling of the gas, knew where it was coming from, and knew how to allocate the production. He stated that Prudhoe Bay's terms had been rationalized among the producers and there was less chance for disputes; however, when dealing with something as big as SB 138's proposed gasline, production from both fields would be needed to support the project. All of the proven 24 trillion cubic feet (TCF) of Prudhoe Bay and all of the proven 8+ TCF would be needed to support the sales and purchase agreements (SPA) that would finance to project. He relayed that the exact timing of when both of two fields would be in production was not known currently and furthered that part of the timing would depend on approvals from the Alaska Oil and Gas Conservation Commission (AOGCC) and part would depend on other construction windows. He stated for example that if the state agreed on an overall number that resulted in 22 percent state gas share and the Point Thomson production came early, it may find it itself with slightly more than 22 percent at that location; the state wanted to avoid not having enough capacity in the terms of infrastructure to move all of the state's gas in the first year. Conversely, if Point Thomson gas was not being produced in the first year and it was all from Prudhoe Bay, the state could find itself short on gas because Prudhoe Bay by itself would be slightly less than 22 percent. He stated that the challenge for all parties involved was to develop a balancing agreement, so that there was a way to long-term balance the 22 percent gas share of the state as well as other parties shares regardless of which field came online first; this was something that the state and ConocoPhillips were very aligned on because that company had a very different ownership pattern for both fields.

Commissioner Balash continued to address Vice-Chair Fairclough's questions and discussed the floor for the purposes of SB 138. He stated that the authority DNR was requesting was to modify the leases that had a net profit share or sliding scale component so that it could fix a

number rather than having one that fluctuated; having certain leases within units that went up and down would make the balancing agreement harder to solve. He stated that the question was what the fixed number would be. He explained that if the base royalty rate in Prudhoe Bay was 12.5 percent and sliding scale went up as high as 20 percent, DNR would probably ask for something closer to 20 percent and British Petroleum would probably want something closer to 12.5 percent. He thought the Senate Resources Committee had been trying to make sure that the state did not receive under 12.5 percent; he thought that Vice-Chair Fairclough was asking if that number should be higher than 12.5 percent to get closer to the expected blended number and not lose value. He thought that the state needed to pay extra attention to number language that would work across the North Slope and fields and not put the state in a position where it could not resolve the number from a commercial standpoint. He added that the state may want to have a formula that was reflective of the base royalty rate for any given lease plus some number, so that the number was not hard wired that may actually be lower than the base rate, for example, at Point Thomson. He used 13 percent as an example and stated that on a blended, long-term basis, it would be the state's royalty share; however, if 13 percent was viable at Prudhoe Bay, it would be too low at Point Thomson. He concluded that the state would want a more formulaic floor instead of a set number.

[10:50:02 AM](#)

Vice-Chair Fairclough understood the interplay and the point of production, but wondered if the state was forgoing about 1.5 percent interest on gross because of its ability to meet cash calls or the certainty in the alignment of the other partners. She stated for example that if one was looking at Point Thomson without blended rates and the legislature wanted to tax gas at 10.5 percent, which was added to the 16 percent lease, the state's share would be about 26.5 percent; however, it was proposed that the cap be 22 percent based on the blended rates. She noted that if the state's tolerance for risk was greater, it could have a cash call that when up to 25 percent; it would still be missing an opportunity to make another 1.5 percent based on the current lease structures that were determined years prior if it was blended into the current proposal of a 10.5 percent gas tax. She inquired if her understanding was correct.

Mr. Pawlowski replied that Vice-Chair Fairclough was correct and that the balancing agreements were critical for the state and other parties; however, he clarified that the 10.5 percent would not come out to 26.5 percent, because the 10.5 was "after." He noted that what DNR was trying to illustrate in slide 9 was the direct relationship between the tax rate and state's investment in infrastructure. He noted that these numbers did not represent the state's total interest in the project and that all that was being discussed were royalties, production tax, and a share of infrastructure; in addition to this, the state and local governments had property taxes and there was also corporate income tax, which were both separate from what was considered state revenues on the project. The concept that was being advanced with bill was the state-tax rate in combination with a royalty that would set Alaska's share in the infrastructure.

Vice-Chair Fairclough inquired if Alaska would see a rate of return on its cash investments when it placed cash on the table to mitigate risk. Mr. Pawlowski replied that the return on investment that the Alaska would receive was laid out in the TransCanada MOU if state used an equity option; it was the exact same rate of return that TransCanada was earning on its equity amount position. He added that the return on state's investment on the liquefaction had not been set yet and was part of what the concept going forward needed to be. He concluded that the state would get a return through the sale of its gas in the investment in the infrastructure.

[10:54:13 AM](#)

Vice-Chair Fairclough wanted to be sure that the state was discussing a single aspect inside the proposed investment to strategy, but that there was more going on that the state was trying to offer the lowest possible transportation costs, which had not been gone through yet. She appreciated the understanding that the administration had regarding the balancing agreement and how important it was. She noted that the balancing agreement was a future agreement that would need to be brought back to legislature for approval.

Co-Chair Kelly indicated that he and Senator Dunleavy had to leave for another engagement.

10:55:11 AM

AT EASE

10:56:46 AM

RECONVENED

Co-Chair Meyer noted that several members were attending the press availability due to time constraints.

10:57:16 AM

Commissioner Balash spoke to slide 10 and stated that it was a re-illustration of the three major components of the project with each of the parties' respective ownership shares shown. He noted all parties would have a share of the gas treatment facility, the pipeline, and the LNG plant. He explained that the benefit was in letting each party setup financing in a way that suited its long-term interests. He noted that for years, the state had been in an adversarial footing relative to the three majors that were on the slide regarding matters with TAPS and tariffs charged. Through the state's lease agreements and the production tax system, it did provide for a recognition of the costs of transportation and the question was what that cost was. He reported that the construction cost of infrastructure was straightforward and relatively easy to identify; how that cost was financed was what drove the ultimate transportation charges. He reported that generally the state was interested in lowest possible cost of capital, which usually meant a higher debt component and lower share or return; for that reason, DNR had paid a lot of attention to the how the state's partners financed infrastructure. He stated that in the construct that was proposed in the HOA, the state taking on its share in all three components meant that it did not have to care about the relative financing of the three other partners because it was not all being blended into a single tariff and was not being used to calculate the production tax or royalty values; instead, the state would be in a position to order its financing in a manner that it thought best served Alaska's long-term interests or put together partnerships on transportation services with terms that worked for Alaska.

Commissioner Balash responded to Vice-Chair Furlough's question regarding Alaska's return on equity (ROE) at the

LNG plant. He noted that regardless of what the ROE was set for on the state's share of the project, the Alaska was paying itself and could set the ROE at 6 percent or 12 percent; however, if it was set at a higher number, it would just mean that it would come out of the royalty proceeds from LNG sales and result in a lower royalty number. He concluded that as long as the state was charging itself, it would be shifting funds from one pocket to another in moving the ROE around. He stated that the ROE became more important regarding the state's partners and thought that Commissioner Rodell would be able to walk through some slides on the MOU to illustrate that point.

[11:01:10 AM](#)

Commissioner Balash spoke to slide 11 and related that the committee had seen it presented the prior week by Ms. Poduval. The slide checked the royalty study's findings against the HOA. He related that the alignment through equity recommendation was achieved in a very direct manner in the HOA. He added that DNR's and its contractor's analysis showed that the current alignment improved the economic metrics for producers and the commercial attractiveness for the project; the alignment also took some steps, though not all of them, to reduce overall government take. He stated importantly, the current alignment preserved the state's royalty value, but it did not answer all of the questions; it did take steps to manage some of the risks, but there were issues with the capital costs that the HOA did not address directly. He stated that there was some language in the HOA that DNR thought had great potential to benefit the state and mitigate the risks of RIK marketing and price exposure; each of the producer companies were prepared to come forward individually assist the state in the disposition and sale of its LNG. He stated that DNR thought that overall structure went a long way to providing a path forward with 3rd-party access to the line and expansion opportunities, which was an issue that the state and the lessees were having trouble with; the construct seemed to work for the state and lessees and held great promise.

[11:04:04 AM](#)

Commissioner Balash discussed slide 12:

Key Takeaways: Heads of Agreement

- LNG is a significant opportunity for Alaska and Alaskans.
- Phased process with commensurate steps.
- Off-ramps for all Parties.
- Maintains AGDC momentum on Alaska Stand-Alone Pipeline (ASAP).
- Creates opportunities to mitigate State risks identified in royalty study.
- Major risk is cost of State participation.

Commissioner Balash spoke to the first bullet point on slide 12 and stated that the project was not only an opportunity in terms of benefit to treasury, but also in the business and job opportunities that it would represent. He thought that the peak construction was estimated to result in about 15,000 jobs and after that peak, the long-range operation would require something on the order of 1,000 jobs that were be in Alaska as long as those SPAs were in place; the SPAs would probably be in place for 20 or 30 years. He stated that process itself took a phased approach and that the legislation was not asking for a 20 or 30-year commitment; the bill was asking for measured authority, some time, and some cash. He reported that there were off-ramps for all of the parties and that the HOA itself expired at the end of 2015. He stated that the big risks that the state might face in the project had been identified and the state had begun to measure ways to mitigate those risks; he thought that a lot of those problems would be solved in the next phase through further commercial negotiation and agreement with the other project parties. He added that cost was a major risk for the State of Alaska and stated it would be very important to monitor the state's cash flows during the period of construction. He noted that state needed to be careful of the role of financing the opportunities for cash exposure during the period of 2019-2023, which was where partnerships had the greatest opportunity to mitigate the state's risks in the future.

[11:07:15 AM](#)

Vice-Chair Fairclough noted that Commissioner Balash had referenced the state's ROE and how it could have an impact on tariff rates as the state was trying to provide lower-cost energy to Alaskans. She requested Commissioner Balash to expand on the comment; she was thinking about the Interstate Commerce Clause and how it would fit inside of the state's ability to try to reduce the tariff charges. She thought that the commissioner might want to mention Federal Energy Regulatory Commission (FERC) regulation on the pipe versus the rate. Commissioner Balash replied that the state had traditionally relied on rate making on pipelines to protect its interests, which was most easily seen in the case of TAPS. He stated that over the last decade and a half as Alaska had hoped for pipeline connected to the Lower-48, the state would have been relying on FERC and the Canadian side's National Energy Board (NEB) to connect producing fields with a liquid and transparent market place; this would have meant highly regulated infrastructure to carry the gas from fields to market in a very straight forward way to value the state's royalty interest. He stated, however, as the project focused to an LNG project, the state faced a different sort of value proposition where it would no longer take its own gas to a transparent and liquid hub; instead, that gas would be taken to locked-in buyers who had agreed to specific terms for very long period of time and were in a propriety deal. He furthered that the LNG marketplace was generally not transparent or liquid and the value question became a little cloudier. He noted that with LNG there was still a pipeline involved, but there was the addition of a liquefaction plant, and that FERC did have some jurisdiction over liquefaction facility, which was generally limited to environmental health and safety matters; FERC did not regulate for access by 3rd parties or rates. He observed that the state faced a little bit of a question mark because under the lease agreements, the state was entitled to its royalty share, but the lessees were entitled to a reasonable transportation deduction; because liquefaction was part of the process of transporting gas, the question was how to go about determining what the reasonable charge was for liquefaction. He explained that that area of liquefaction was not regulated, the state could not rely on FERC to tell it the answer; the state was left largely to settle those differences in commercial agreements or in litigation.

Commissioner Balash continued to address Vice-Chair Fairclough's comments and thought that the state needed to look at the cost of that infrastructure, the debt relative to equity was financed, and what the return on that equity was. He stated that if the state was using its own money to construct the project, it could charge a very relatively high ROE; if it did that, it was subtracting value from the market price in the SPAs that got deducted and resulted in a smaller and smaller wellhead value where royalty was calculated. He stated that the higher the state pushed those tariffs and the smaller it made that net-back, the less value that was created for the Permanent Fund; it also started to affect the starting point for the price of gas to Alaskans and the state faced an odd dilemma. He explained that the state could arrange the financing so that the liquefaction charge was really high, and the pipeline charge was really low, gas could be moved to Alaskans at what would appear to be a low price; however, the state would really be shifting the costs from one pocket to another and would be susceptible to accusations of interfering with the marketplace. He would rather not speculate on where those lines were in order to preserve them for future discussions with counsel and regulators; however, there were some odd interplays that could occur depending on the overall structure and what the price was from a net-back perspective at the North Slope.

11:14:40 AM

Mr. Pawlowski spoke to Vice-Chair Fairclough's earlier question regarding how Alaskans and other parties could see what the cost of moving gas through the pipeline was and stated that it was found in the MOU with TransCanada. He thought given the proprietary nature of the project, TransCanada brought in the best of both worlds in that there was a 3rd party actor providing the transparent terms for potential shippers. He thought that the terms highlighted on slide 13 were very competitive compared to other gasoline projects that were regulated by FERC.

11:16:09 AM

ANGELA RODELL, COMMISSIONER, DEPARTMENT OF REVENUE, spoke to slide 13 and the memorandum of understanding. She stated that the state's participation in the project would require significant financial and human resources. DOR believed that the path forward was to take advantage of the already

existing partnership with TransCanada under the Alaska Gasline Inducement Act (AGIA) framework; this and the investment made by both the state and TransCanada made the company a natural partner to assist in moving the project forward. She believed that the state did need a partner in the project because at the end of the day it was a state government and had an obligation to Alaskans to continue to provide a safe and prosperous environment to live in. She reported that the state did not have the right expertise and that TransCanada was an independent pipeline company that knew how to build pipelines; the company had also spent the last 6 years developing an understanding the environment and challenges that were unique to Alaska. She stated for the above reasons, she and Commissioner Balash had determined that entering into the MOU with TransCanada was in the best interest of the state.

Commissioner Rodell addressed slide 13:

#### The Memorandum of Understanding

The MOU with TransCanada provides a roadmap for a transition from the AGIA license to a more traditional commercial relationship with TransCanada.

The MOU describes how the State will:

1. Abandon the AGIA license.
2. Partner with TransCanada in the midstream (Transmission lines, GTP and Pipeline) of the AKLNG project.
3. Provide for active interest in expansions.

#### Key Terms of MOU:

##### 1. Favorable Debt to Equity Ratio

- 75/25 ratio for rate-making purposes reduces the State's tariff.

- Lower tariffs improve the State's overall cash flows.

##### 2. Cash Contributions by TransCanada

- TransCanada as project developer reduces the State's exposure to cash calls and obligations until the pipeline is in service.

### 3.Improved Value to the Treasury

- When you consider the opportunity cost of utilizing the State's capital (which earns 6% in the treasury), our NPV is improved overall.

### 4.Expansions

- TransCanada committed to 70/30 capital structure for expansions.

### 5.Gas to Alaskans

- At least 5 offtake points

- Distance sensitive rates with three zones for delivery

[11:19:06 AM](#)

Commissioner Rodell spoke to slide 14:

MOU: Transporting Alaska's Gas: The MOU details TransCanada's terms of service for transporting Alaska's State Gas Share via the GTP and Pipeline. It is further contemplated that a subsidiary corporation of AGDC will be established to carry the State's interest in the LNG plant.

Commissioner Rodell spoke to slide 14 and related that the slide's diagram attempted to depict how the state transitioned its gas share. She noted that TransCanada came in with the state's gas share on the gas treatment facility and transmission, as well as with the pipeline. The subsidiary of AGDC would take the state's gas share in the LNG facility.

Commissioner Rodell addressed slide 15:

Exhibit B of the MOU: Contains a term sheet for the State to exercise an equity option up to 40%\* of the partnership established by TransCanada for the relevant portion of the midstream.

Commissioner Rodell stated that the option to exercise equity on slide was important because it would allow the state to make a decision if it wanted to take more on after pre-FEED when more was known about what the demands of the project and the demands on the state would be.

[11:20:37 AM](#)

Commissioner Rodell spoke to slide 16:

MOU: Describes how the State will share the responsibility for its share of the project with TransCanada

Commissioner Rodell stated that slide 16 was another picture of what was discussed on the previous two slides and did assume a 25 percent equity participation for the ease of illustration.

Commissioner Rodell discussed slide 17 and noted that it was one of slides that Black & Veatch had included in a previous presentation. She thought that it was important to show because it depicted how the levers were interconnected and what various decisions' impacts would be. She reported that if the state wanted to decrease the equity by 5 percent and increase the debt, it represented the equivalent of about \$200 million in additional net present value (NPV) to the state; there was clearly value in having a higher debt, lower equity percentage. She noted that increasing the ROE by 1 percent would result in a loss of \$100 million to the state. She noted that for each year of delay in the project operation resulted in a loss \$800 million in NPV to the state. She relayed that the slide spoke to the value of maintaining momentum and striving to get to the final investment decision (FID) in 2018.

Commissioner Rodell addressed slide 18 and stated that DOR wanted to understand what the other pipelines had as the debt/equity structures and ROE. She stated that the information on the slide came from the public filings within the FERC certificate orders; the pipelines were natural gas pipelines located within North America that showed that capital structures tended have much higher equity than what was in the MOU with TransCanada. The ROE of the slide's pipelines was 13 percent or 14 percent. She offered that the slide showed that the state had negotiated

a fair deal with TransCanada and that it was the right way to go.

11:23:42 AM

Commissioner Rodell spoke to slide 19 and related that one of the things that DOR was working on, which she thought would be presented to the committee at future meetings, was a more detailed analysis of the cash calls and how it interacted with state's budget, revenue projections, and other commitments that the state had; however, that was not included in the current presentation. She related that the slide showed what kind of cash commitments the state was being asked to make on the project. She reported that if the state chose to go it alone, about \$108 million would be needed to fund Alaska's portion of the pre-feed, which was in the fiscal notes for the FY15 budget. She clarified that these exact amounts were not in budget, but that the FY15 notes attached to the bill would include amounts to fund the state's investment in pre-Feed. She offered that if the state chose not to exercise the 40 percent buyback option with TransCanada, the state's investment for the pre-FEED period would about \$43 million; DOR would be asking for money to repay TransCanada the 40 percent in the FY16 budget if the state decided to go forward with the option. She pointed out that if the state wanted to go it alone, the FEED stage would cost another \$400 million; mostly likely this amount would be included in the FY16 budget with supplemental in FY17 and FY18 as the cash calls were better understood. She stated that without using the buyout option, FEED would cost the state about \$180 million; if the state chose to exercise the 40 percent buyback, the cost looked closer to \$340 million.

Commissioner Rodell continued to speak to slide 19 and stated that the state would have to evidence that it had the money to make the commitments either through appropriation or some other mechanism. DOR was continuing to explore what the other mechanisms might be available to the state in terms of making that evidence. She stated that DOR was looking at if it was possible pursue a line of credit or letter of credit that the state could draw on without running an appropriation risk.

Co-Chair Meyer stated that the committee did have SB 138 in its possession and that it was ok to refer to the bill.

[11:26:59 AM](#)

Vice-Chair Fairclough was looking at the time value of money wondered and the committee's deliberation of the \$3 billion into the pension plan; she wondered why the state would not set aside \$452 million to get to pre-FEED. She observed that the \$452 million would earn interest in an account and the state would still have all of its off-ramps and cash. He thought that debt was part of the reason, but requested an explanation of the reasons behind not doing this. Commissioner Rodell replied that it was a good point and that setting aside that money had value. She stated that part of the reason DOR had not proposed setting aside the funding were concerns of not wanting to create any constitutional issues around dedicated funds if it was kept inside the Constitutional Budget Reserve (CBR) Fund for that purpose. She was concerned about the legislature's ability to carve off a piece of that funding and how it would be appropriated out and not appear like a multi-year appropriation. She thought that there was value in setting that amount aside, but that what the potential competing demands might be on the budgetary side needed to be recognized. She added that DOR was working on a detailed analysis of setting that money aside.

[11:29:33 AM](#)

Mr. Pawlowski added that one thing to be careful about when thinking about how to structure setting money aside to get to pre-FEED was the horizon over which the money could be invested. He stated that when existing funds were used that were leveraging off of the way the money was currently invested now, it was important to pay close attention to when the cash was actually needed. He thought that the balance of whether the money was better managed in one fund versus another fund was important, and if it was efficient to keep it separate when it was part of the state's reserves and was being managed under the current practices.

Vice-Chair Fairclough thought that the timeframe was short enough that the money could be issued as a grant to AGDC. She noted that the legislature gave grants to non-profits and understood that her idea was on a much larger scale. She thought that the proposal for the \$3 billion was to transfer those assets in the form of its current state and move the management responsibilities over the Alaska Retirement Management Board (ARMB) versus paying for

selling products that the state was managing and rebuying them, which would result in administrative cost overheads. She added that the \$3 billion would go to paying a debt that actuarially was presented to the public on Alaska's finances; she wondered if that was the difference in the dedicated fund issue between the \$3 billion infusion and her suggestion of setting \$452 million aside for the project. Commissioner Rodell replied that the legislature was restricted currently from carving off and dedicating reserves for a specific cause and that the question was if it was willing to make an appropriation either as a grant or as appropriation to the Alaska Capital Corporation; the legislature could also create a new vehicle to house the money. She stated that there was tension surrounded how the funding would be set aside and structurally created so that it was clearly identified for the purpose of funding or acting as a backstop to the state's participation in the project during the pre-FEED and FEED gates; DOR would then adjust the asset allocation and investment of that to take into account when those cash calls were going to happen.

Vice-Chair Fairclough stated that the state did not need another new organization to be stood up and thought that using an existing structure would be ideal.

[11:33:13 AM](#)

Co-Chair Meyer thought that Vice-Chair Fairclough had a good point and recalled setting up a fund to put money in for building a pipeline and other capital projects; he thought that the fund was still available and was housed in Alaska Housing Finance Corporation (AHFC). He thought that fund was setup to earn good interest for money that sat there and that there was possibility to do what Vice-Chair Fairclough was suggesting. Mr. Pawlowski replied that the legislation did contemplate the creation of a new fund within AGDC, which was done to protect the missions of AGDC, but Vice-Chair Fairclough's comments opened the question of how the state would want to use the fund. He thought that discussing the fund and its possible uses was a good dialogue for the committee to have with the administration.

[11:34:17 AM](#)

Senator Hoffman wondered if FID would take place late in 2018 or in 2019, as well as what form it would come in.

Commissioner Rodell replied that it was expected that the state would be wrapping up the FEED stage at the end of the 2018 calendar year and that FID was expected at the start of calendar year 2019.

Senator Hoffman inquired what form the FID would be presented in and whether it be legislation. Commissioner Rodell replied that it would require legislation because it was the point at which the state would decide if it really wanted to move forward with the pipeline.

Senator Hoffman inquired if that would take place in late 2018 or in 2019. Commissioner Rodell replied that it was hard to say at this stage, but believed that it would most likely occur during the regular session of 2019.

Senator Hoffman noted that the timing was a big decision because 2017 and 2018 would be one legislative session and that 2019 and 2020 would be another. Commissioner Rodell replied that Senator Hoffman raised a very valid point and to the extent that FEED was successful, the administration would be coming back for approval sooner rather than later.

Vice-Chair Fairclough noted that the unique point at FID would mean that the state had secured gas contracts for the volume and would have a defined tariff number. She hoped that if the state went that far, the economics would be positive for Alaska. Commissioner Rodell replied that the administration would also have much higher defined costs of the project as well.

[11:36:55 AM](#)

Commissioner Rodell addressed slide 20 and stated that it gave a pictorial of how having partners could reduce the state's investment during peak construction and what the value of sharing that risk was to the state. She reported that if the state did the project without a partner, it would have significant cash outlays throughout the period and it reached in excess of potentially \$3 billion per year for 2 or 3 years during peak construction; that cash outlay was reduced almost in half if the state allowed TransCanada to carry all of the state's participation in the midstream and the gas treatment facility.

[11:37:53 AM](#)

Vice-Chair Fairclough if TransCanada would still be as likely, based on their rate of return for shareholders, to mitigate cash calls during FID if the state set aside the money she had referenced earlier to get the state to pre-FEED and the decision points; this way state would not be paying TransCanada interest on equity. She wondered if there was any kind of interplay or dependency in the current negotiated contracts that allowed TransCanada to not go forward with the state's option at FID if the state had not been an active participant in the project in the years prior. Commissioner Rodell thought that when the FID decisions were reached there would a re-assessment by both sides and that as the MOU was currently written, TransCanada and the state could decide to not to continue that partnership. She added that the administration expected to continue going forward with the project. She stated that TransCanada not being able raise the money and not being able procure debt to finance the state's share portion was an off-ramp in the MOU; in this case, the state would have to come up with the funding. She stated that there was risk that TransCanada would not be able to go forward with the project, but the possible reasons for that happening were finance risks that all participants were exposed to.

Vice-Chair Fairclough noted that if the project reached FID, the numbers would be much more refined and that the project should be able stand on its own and be economically viable for both the State of Alaska and a potential equity provider.

Commissioner Rodell addressed slide 21:

CAN THE STATE GO IT ALONE? - STATE'S DEBT CAPACITY

- Financing the State's share of the AKLNG Project on the State's balance sheet - key issues:
- At what cost of debt?
- Debt servicing as what % of general fund unrestricted revenue.

Scenario 1

(lower interest)

- SOA Debt at 4.6%

- Debt Service limited to 3% of GFUR

Scenario 2

- SOA Debt at 4.9%
- Debt Service limited to 5% of GFUR

Scenario 3

(higher interest)

- SOA Debt at 5.6%
- Debt Service limited to 6% of GFUR

\* High-level, indicative assumptions based on input from Department of Revenue

Commissioner Rodell spoke slide 21 and stated that DOR had given Black & Veatch certain assumptions when making the scenarios. She pointed out that in Scenario 1 it was assumed that the debt would be appropriation debt would be AA+ rated because it would be one notch below the state's AAA credit rating. She noted that the assumption that the scenarios would use appropriation debt was because general obligation debt required a vote of the people and that there were currently no revenues available to finance under a straight revenue construct. She addressed Scenario 1's debt service and stated that it assumed the state's current debt obligation of 5 percent of unrestricted General Fund Revenue; the scenario would take the state up to 8 percent, which was considered good a financial construct. She noted that Scenario 2 would add 5 percent and would take the total obligations of the state up to 10 percent of its unrestricted General Fund Revenue; it would be at an A rating and would cost more because of the lower credit rating. She stated that Scenario 3 would have BBB rating.

Commissioner Rodell continued to address slide 21 and related that the more unrestricted General Fund Revenues that the state attached to the project over and above its current debt commitments the lower the rating and the higher cost. She pointed out that Scenario 1 provided the lowest cost of debt, but it also gave out the least amount of proceeds; under Scenario 3 had the most proceeds produced, but at a higher cost.

[11:43:15 AM](#)

Commissioner Rodell addressed slide 22 and stated that when Black & Veatch had formulated the different scenarios, it

had started off at the 20 percent equity stake because the company thought that it was a good place to start. She stated that the slide showed that if the state did not partner for the project, the state would generate approximately \$3.5 billion-\$6 billion in debt depending on the interest the rate; the remaining balance would have to come from equity. She noted that with the partnership with TransCanada in scenarios 2 and 3, the state was able to fund a larger proportion of its participation with debt progressively in each one.

[11:44:22 AM](#)

Co-Chair Meyer thought that Alaska was not currently over-leveraged with debt, but wondered if there was any concern that the SB 138's project would get the state in over its head regarding debt. Commissioner Rodell responded that there was concern about how the extra debt would affect the state's position and fathered that the state's revenue source was volatile during the projects time period and seemed to be going down. She concluded that DOR did have concerns regarding how much debt the state could take on, but that the state was not over-leveraged; the state was not using all of the capacity that was available to it. She relayed that the state had to recognize that it had debt obligations that were in the form unissued general obligation that had already been authorized by the voters and the School Debt Reimbursement Program; the reimbursement program did not have any limits or caps. She stated that the pension liability was recognized by the rating agencies as a state liability. She offered that how the state structured its partnerships, as well as how it would participate in the project was very important due to the above concerns; additionally, the concerns were the reasons that the state going it alone was a very troublesome option from her standpoint.

Co-Chair Meyer noted that the prospect of the state going forward with the project alone was troubling to him and other committee members as well and pointed out that some of the debt, such as the School Debt Reimbursement Program, could not be controlled. He explained that under the reimbursement program, the state would have to pay 70 percent of the costs of building a new school if the municipality passed a new school.

[11:46:39 AM](#)

Senator Hoffman noted that the state did not know what its credit rating would be in 8 years and that it may not be AAA, especially with the bleed of at least \$1 billion out of the general fund over that time period. He thought that Alaska credit rating could drop drastically and noted that he did not hear DOR discussing that eventuality. He thought that the state balancing its own finances would be a key factor in getting loans. Commissioner Rodell replied that the point was valid and that she had been assuming that the state would continue to balance its checkbook; however, the Senator Hoffman was correct that there were scenarios under which the pressures of spending versus revenues created a downgrade on the state's credit rating. She explained that the uncertainty was why slide 21 arranged the debt to show what an A and BBB rated structure would look like. She thought that another risk that had not been recognized in the presentation regarding debt was what the future demands on state infrastructure would be to support the project.

[11:48:34 AM](#)

Mr. Pawlowski directed the committee back to slide 4 and related that it represented the tension that the administration struggled with internally. He commented on the slide's projection and relayed it reflected Black & Veatch taking DOR's risk analysis, very conservative revenue forecast case and running a future project based on it. He reported that where the blue line would go after 2018 or 2019, depended a lot on what happened with the projections the department was currently providing the state and the upside potential, which was presented in the Revenue Source Book. He relayed that upside potential reflected higher levels of production that DOR saw indications of, but were not counting on. He stated that in the long-term, commercializing North Slope gas had the potential to provide a material additional revenue stream and that as the department looked at the long-term versus short-term, it tried to manage the short term responsibly enough to get to the longer-term blend of oil and plus gas revenue, which would provide a robust revenue future for the state; this was ultimately what DOR was trying to do with the HOA and with the partnership with TransCanada.

[11:50:16 AM](#)

Senator Hoffman noted that it was an eight-year span and that oil and gas over the last eight years fluctuated widely. He did not see much fluctuation in DOR's chart. He stated that no one had a crystal ball, and no one had predicted the price of oil to be \$114 per barrel. He thought that state did not know what would happen to the price of oil or gas.

Vice-Chair Fairclough recalled the prior discussion of the bullet pipeline versus a big line and that there had been an attempt to get consensus for years for a bullet line to get to provide energy in state, specifically for rural Alaska; there had been great opposition to the bullet line because of the worry of the tariffs being too high. She stated that the legislature had the big line before it as an option and that it was absolutely uncertain; she was unsure of Alaska's tolerance for risk on the project. She noted, however, that Alaska currently had the reverses to take it through that number and that if it stalled for even two years, the timeline was pushed and the reserves became even more dependent on the volatility of that particular moment in time.

Commissioner Rodell spoke to slide 23:

Key Takeaways: MOU

- Delays in momentum will generally outweigh gains in commercial terms.
- Partnering with TransCanada:
- Advances key State interests (expansion & access) during Pre-FEED and FEED.
- Supports larger State Gas Share by sharing risk in construction.
- Provides transition out of AGIA with passage of enabling legislation.
- Off-ramps exist with TransCanada in MOU.

Commissioner Rodell reported that the state would be revisiting the project and how the state would move forward every legislative session because there would be decisions to be made at each point regarding contracts or appropriations.

[11:53:40 AM](#)

Commissioner Rodell discussed slide 24:

## Summary

- State participation in the AK LNG project:
- Maximizes the value of the State's resources.
- Improves competitiveness of AK LNG project.
- Puts State in a position to mitigate risks.
- Partnering with TransCanada:
- Advances key State interests (expansion & access) during Pre-FEED and FEED.
- Supports larger State Gas Share by sharing risk in construction.
- Phased process allows all Parties to mitigate risks.

[11:54:17 AM](#)

Senator Dunleavy noted that as he listened to the questions and comments and he was thinking about the four quarters of partnership between ConocoPhillips, BP, ExxonMobil, and the State of Alaska. He inquired if there was anything preventing the state from talking to and taking on additional partners that may want gas in order to lower the state's risk on the project even further. Commissioner Rodell replied in the negative and added that she expected that the state moved closer to FEED and FID and had more certain information, that buyers would be interested in getting a piece of the transmission facility to ensure access. She concluded that in 5 years, the financial construct for the state's portion of the project would look very different from the current plan.

[11:56:01 AM](#)

Senator Dunleavy noted that the presentation had various scenarios of investment for the state and the return and observed that this was for the state's quadrant. He observed that the state could bring in partners that would help reduce that load within its own quadrant. Commissioner Rodell replied in the affirmative.

[11:56:22 AM](#)

Co-Chair Kelly directed the presentation back to slide 24 and requested an explanation of the state's ability to mitigate risk. Mr. Pawlowski responded that Senator Dunleavy had pointed to one place where risk mitigation was possible. He explained that the when the state had a share

of the project and freedom to bring in partners, as was the case with TransCanada, Alaska had an opportunity to share some of the risk; for instance, if an LNG buyer wanted to enter into a long-term contract with the Alaska, the state may ask the long-term buy to shoulder the take or pay commitment in moving the gas from the North Slope all the way through the project. He related that being an active participant in the project opened doors for the state to have an asset to share and enabled a wide variety of opportunities to explore during pre-FEED.

[11:58:02 AM](#)

Senator Hoffman directed the presentation back to slide 13 and discussed the two bullet points under key term #5, which were the 5 take-off points and distance sensitive rates to 3 zones to delivery. He thought that somewhere along the long line before FID, the time frame and the specifics of the delivery of gas to all Alaskans needed to be worked out in order to let the state's residents know that the project would make Alaska a more affordable place to live. He thought that getting gas to all Alaskans was critical element of the project for Alaskans.

[11:59:18 AM](#)

Senator Dunleavy inquired if it was the state's responsibility of delivering cheap gas to Alaskans or if the entire concept worked to that end and was a responsibility shared by all of the partners. Mr. Pawlowski replied that the terms of the MOU was solely dictating to TransCanada how it would charge for gas moving in state; however, the actual shares of what would be delivered in state and what that would look like was yet to be determined. He concluded that the structure of how that responsibility would be managed was all part of the design work and development in pre-FEED. HE concluded that gas would be provided to Alaskans and the MOU with TransCanada set specific rates to protect Alaskans with the distance sensitive delivery.

Senator Dunleavy stated that the concept of getting affordable gas to all Alaskans was very important to people in Alaska and that he would be looking at this element and the risk versus income. He noted that one could invest in an ideas, but that how much the state would invest in the project versus how much it would get out of it, as well as

getting affordable gas to Alaskan was what would drive his decisions on the issue.

[12:01:29 PM](#)

SB 138 was HEARD and HELD in committee for further consideration.

[12:01:47 PM](#)

Co-Chair Kelly discussed the following meeting's agenda.

#

ADJOURNMENT

[12:02:25 PM](#)

The meeting was adjourned at 12:02 p.m.