

HOUSE FINANCE COMMITTEE
February 4, 2016
1:33 p.m.

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CALL TO ORDER

Co-Chair Neuman called the House Finance Committee meeting to order at 1:33 p.m.

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair
Representative Steve Thompson, Co-Chair
Representative Dan Saddler, Vice-Chair
Representative Bryce Edgmon
Representative Les Gara
Representative Lynn Gattis
Representative David Guttenberg
Representative Scott Kawasaki
Representative Cathy Munoz
Representative Lance Pruitt
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Pat Pitney, Director, Office of Management and Budget, Office of the Governor; Ed Fogels, Deputy Commissioner, Department of Natural Resources; Mark Myers, Commissioner, Department of Natural Resources; Fabienne Peter-Contesse, Director, Division of Support Services, Department of Natural Resources.

SUMMARY

HB 293 APPROP: SUPP/CAP/OTHER APPROPRIATIONS

HB 293 was HEARD and HELD in committee for further consideration.

FY 17 BUDGET OVERVIEW: DEPARTMENT OF NATURAL RESOURCES

#hb293

HOUSE BILL NO. 293

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

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PAT PITNEY, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, addressed the supplemental budget. She referenced handouts titled "FY2016 Supplemental Summary" dated February 1, 2016 and "FY2016 Supplemental Bill." She relayed that the supplemental was lean and included less than 30 transactions. The two largest requests were for fire suppression funding at \$47.5 million Unrestricted General Fund (UGF) and a request associated with the Permanent Fund Dividend.

Co-Chair Neuman asked Ms. Pitney to go down the list of requested increments.

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Ms. Pitney addressed the handout titled "FY2016 Supplemental Bill." She began with a request of \$450,000 for the Division of Finance for a statewide single audit increase (line 2). She elaborated that the funding was for a payment to the Division of Legislative Audit; the cost had been \$300,000 for the past 10 years, but the division had submitted a bill of \$750,000 effective FY 16.

Co-Chair Neuman asked why the cost had increased.

Ms. Pitney answered that the increase was not due to additional work. She explained that in the past the \$300,000 had been a set amount collected for the audit. She believed that in the difficult budget cut environment, the division was charging more on an hourly basis; based on the hours worked the cost was \$750,000. She noted that the increase had been unexpected.

Co-Chair Neuman clarified that the reason for the expenditure was that the legislature passed legislation for audits on individual departments. He asked for verification

that the money was for expertise in the departments to conduct the audits.

Ms. Pitney clarified that the request was related to routine general audit work, not the DHSS audit work. She moved to line 3 related to funds (an increase of \$118,000) for the Office of Public Advocacy for increased caseload and litigation costs. She elaborated that the past fall the office had experienced a significant caseload. The heavy caseload included costs related to the "Fairbanks Four" case, which had taken place in a high-intensity time-frame [a recent legal case involving four individuals released from jail based on a turned over decision]. Lines 4 and 5 included increases for receipt authority [for appointed counsel] for Designated General Funds (DGF). The requests included funding estimated to be collected for work on behalf of individuals the departments did not have receipt authority for. The requests would increase GF receipt authority to capture funds collected above budgeted authorization; it was estimated that the funding would be available due to the estimated Permanent Fund Dividend amount.

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Ms. Pitney addressed line 6 for the Department of Corrections (DOC). She elaborated that the department received money from the federal government for federal prisoners. The increment represented the amount the state could collect for federal related prisoners, which would offset the UGF costs; the state was reimbursed for housing federal prisoners. Line 7 included a technical correction to add the fiscal note for the Alaska Safe Children's Act Task Force support costs of \$10,000. She elaborated that the fiscal note had come at the end of the last session and the Legislative Finance Division had categorized it as a missed technical issue. Line 8 was a grant for the Air Quality Division of the Department of Environmental Conservation for diesel emission reductions. She detailed that the grant would allow certain entities to purchase cleaner diesel equipment; there was no match required and no ongoing costs to the program.

Ms. Pitney addressed formula cost increases for subsidized adoption and foster care (lines 9 and 10). The increments were strictly based on the formula associated with the number of children in subsidized adoption and foster care.

She noted that the two increments were the next largest items in the supplemental request following the increment related to fire suppression.

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Ms. Pitney moved to lines 11 through 14 that included increases to juvenile justice facility staffing. The Division of Juvenile Justice had an adjustment of roughly \$1 million annually for the past 7 years. The adjustment had been added to the FY 17 base request; the item had not always been a supplemental because prior to the current year, the commissioner of the Department of Health and Social Services (DHSS) had the ability to move money across appropriations up to a certain amount - the funding had been covered mid-year under that ability to shift funding. She explained that before the commissioner had the ability to move money, the \$1 million adjustment had appeared almost annually in the supplemental budget. She informed the committee that the administration hoped to never make the request again because going forward it was included in the base budget. Line 15 gave receipt authority to DHSS to collect over collection of [Statutory Designated Program Receipts] from Medicaid school-based claims.

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Ms. Pitney spoke to lines 16 through 18 related to DOL. Line 16 was associated with pending tobacco cessation litigation, which was a multi-state arbitration. The request would use tobacco funds for increased attorney time associated with the litigation. Lines 17 and 18 related to work DOL conducted on behalf of the Alaska Oil and Gas Conservation Commission (AOGCC) and the Regulatory Commission of Alaska (RCA); the increments requested receipt authority payment for the workload associated for legal work. She elaborated that AOGCC and RCA collected fees from the industry to cover costs. Line 19 related to fire suppression activity related to declared emergencies. She highlighted a major fire that had occurred in the Wasilla area. She explained that the \$47.5 million represented costs incurred in the 2015 fire season. The funds had already been spent; if the upcoming fire season was bad there could be additional costs in FY 16.

Ms. Pitney addressed lines 20 through 22 associated with the Department of Revenue (DOR) Treasury Division for

external management fees due to better-than-expected performance in the Retiree Health Insurance Fund, Public School Trust Fund, and Power Cost Equalization Endowment Fund. Lines 23 through 26 related to the Department of Transportation and Public Facilities (DOT) and represented DGF and other fund requests to accept receipts collected in the various components (airport leasing in the Central, Northern, and Southcoast regions); the request would match receipt authority with the available funding, measurements, and standards.

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Ms. Pitney moved to line 29 and 35 related to the Alaska Land Mobile Radio (ALMR) system. Line 35 was a reappropriation of approximately \$1.3 million and line 29 was a request for \$1 million; the total would provide \$2.3 million to meet the necessary software and hardware upgrades to maintain the ALMR system in the short-term. Beginning in FY 18, the administration anticipated costs in the range of \$5 million per year to maintain the state's emergency communications system. She noted that DNR, the Department of Military and Veterans Affairs (DMVA) and the Alaska State Troopers all used the ALMR system. Line 30 included a request for emergency repairs of failing water lines at the Anvil Mountain Correctional Center. She elaborated that the past spring the center spent \$700,000 in deferred maintenance funding to patch the water lines; the center had to drop the number of prisoners and ration water to keep the facility open (there were about 100 prisoners in the center on a daily basis). She stated that \$1,084 would be required for a long-term fix. Line 31 included an increment for the emergency repair of the Eklutna overpass; after insurance settlements there remained a \$344,000 need to cover the one-time emergency repair.

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Ms. Pitney moved to the language section beginning on line 35, which started with a reappropriation for ALMR. Line 36 was a reappropriation from the completed Tanana River Bridge project to the Alaska Railroad Corporation for positive train control upgrades. The state would receive a match against Federal Transit Administration money to finish the positive train control upgrades required by federal law. The state received at 90 percent match on the

funding; the project would reappropriate roughly \$1.7 million to complete the \$17 million project. Lines 37 and 38 were judgements and settlements through DOL. Line 40 was a two-part request. She explained that given the governor's Permanent Fund Protection Act, the Permanent Fund Dividend was estimated to be \$700 million, which would be taken from the fund's earnings reserve account. She detailed that the dates for the appropriation in the FY 16 bill listed the appropriation for dividends paid during FY 16. She elaborated that the FY 16 dividends had already been paid; therefore, the language was technically incorrect. The increment corrected the error and would appropriate money for the fall 2016 dividend.

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Ms. Pitney addressed line 41 that contained lapse of appropriations and retroactive language consistent with language required for the supplemental. The language section also included an effective date.

Co-Chair Neuman pointed to lines 9 and 10 related to foster care. He wondered why the items (particularly line 10) were not included in the base budget. He reasoned that the administration knew the items were anticipated to grow and had been growing.

Ms. Pitney explained that the issue reflected her inexperience in the FY 16 budget. She noted that the FY 17 budget included an increase that more closely matched the expected foster care cost. She explained that it was a formula-driven amount based on the number of children in the system.

Co-Chair Neuman asked why the amount in line 9 [\$2.8 million] had not been anticipated with a fiscal note. Ms. Pitney asked for clarification.

Co-Chair Neuman referenced language on the spreadsheet that the Office of Children's Services (OCS) anticipated a 19 percent increase in the number of children. He recalled that the legislature had allocated additional money in the past to add OCS staff. He wondered why the money had not been included when the appropriation had been made to cover the costs.

Ms. Pitney believed the prior funding was associated with helping with the high OCS caseload. She did not believe the increase in children needing service had been anticipated.

Co-Chair Neuman replied that he would follow up with Ms. Pitney at a later time.

Representative Gara asked for verification that the request on line 9 was associated with the daily base rate paid to foster families (\$30 for a child without special needs up to over \$100 for a child with special needs).

Ms. Pitney replied that the line item was reflective of the per person cost associated with the children receiving the care.

Representative Gara asked for verification that the increment was for money going to foster families. Ms. Pitney replied in the affirmative.

Representative Gara referred to the description of the increment on the spreadsheet that used the term "special needs." He discussed that the number of foster children had increased from 2,500 to 2,800. He noted that the supplemental went towards paying for the extra children in the system. He asked for verification that the money was not only for special needs children. Ms. Pitney replied in the affirmative. The amount represented the total cost of the formula program associated with foster care.

Representative Gara asked for verification that the funds would not go to additional staff. Ms. Pitney replied in the affirmative.

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Representative Gara asked if the supplemental reflected the current formula meaning approximately \$1.4 million would be allocated to pay the Permanent Fund Dividend. Alternatively, he asked if the supplemental anticipated the passage of the governor's proposed change to the Permanent Fund Dividend.

Ms. Pitney replied that the supplemental assumed the passage of the governor's proposal on the Permanent Fund Dividend.

Representative Gara had never seen a budget based on legislation that had not been adopted. He reasoned that there was currently a formula on the books specifying what the dividend would be. He acknowledged that the number would change if a bill passed, but he wondered why the budget would include a dividend amount for a formula that had not been adopted.

Ms. Pitney replied that the proposal represented the governor's budget plan. She stated that the governor's budget reflected most of the governor's proposals. She spoke to the specific item and explained that the budget language had specified that the amount was appropriated for FY 16 dividends. She explained that FY 16 dividends had already been paid.

Representative Gara asked for verification that the increment [line 40 of supplemental summary spreadsheet] had nothing to do with the FY 17 dividend. He thought he had heard Ms. Pitney say that the amount of the projected dividend appropriation was being changed based on the passage of the governor's new dividend plan for FY 17.

Ms. Pitney answered that the governor's proposal related to the Permanent Fund Dividend change would come under the FY 17 amendments of \$700 million.

Representative Gara asked if the governor's FY 17 budget reflected dividend payments based on current statute or based upon the passage of the governor's bill. Ms. Pitney replied that it would be the dividend amount on the governor's proposal.

Representative Gara thought that was odd and did not believe it had occurred in the past.

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Co-Chair Thompson did not see the \$200 million veto in oil and gas tax credits. He wondered how the state would deal with the issue.

Ms. Pitney answered that the plan for the oil and gas tax credits was outlined in the governor's proposed oil and gas tax credit reform bill. The bill anticipated the Oil and Gas Tax Fund would cover FY 16 through FY 18 earned tax credits, assuming the passage of the reform bill. The FY 17

governor's budget included \$73 million, which was the minimum statutorily required amount. Assuming the reform, there would be \$1 billion for the credits expected to be earned in the current system, which the administration expected to be closed at the end of FY 16. Credits earned through the end of FY 16 would be paid in FY 16 through FY 18. There would also be \$200 million to capitalize an Alaska Industrial Development and Export Authority (AIDEA) oil and gas infrastructure development loan fund.

Co-Chair Thompson asked if \$200 million would go towards paying the debt incurred when the governor had vetoed the \$200 million in credits. He mentioned the \$1 billion tax credits that would come due and wondered if the state would owe \$1.2 billion. He noted that the state currently owed \$200 million.

Ms. Pitney replied in the negative. She clarified that the \$1 billion included the \$200 million in the current year, \$500 million to \$600 million in the following year, and \$300 million to \$400 million the year after.

Co-Chair Thompson asked for verification that the \$200 million was the current debt. Ms. Pitney answered in the affirmative.

Co-Chair Thompson referred to a reappropriation of \$1.6 million in the remaining funds from the Tanana Bridge project (the project had come in under the bid) to the positive train control. He explained that the previous year the Railroad Corporation had come to the legislature for an additional \$55 million. The legislature had authorized the railroad to bond its own bonds with no state obligation for \$38 million. The legislature had told the railroad to not make any other requests related to positive train control. However, the current request was for another \$1.6 million. He did not believe it made sense to ask for additional funds.

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Ms. Pitney replied that the difference between \$55 million and \$38 million was \$17 million. The state had the opportunity to pay for the \$55 million with 90/10 Federal Transit Administration matching funds. The reappropriation provided the 10 percent state match to complete the \$55 million.

Co-Chair Thompson thought the federal transportation dollars the state was slated to receive in the next two years would go towards making bond payments. He furthered that the legislature had been told no money would be owed by the state.

Ms. Pitney replied that they were talking about two different sets of federal transportation money. The payments for the \$38 million would come out of the corporation's annual amount. The line item in the supplemental was outside the corporation's normal funding, which had a 90/10 match and would allow the completion of the [positive train control] project.

Co-Chair Thompson asked for verification that the funds could be used against the positive train control. Ms. Pitney replied in the affirmative.

Co-Chair Neuman asked if the Railroad Corporation still needed the full [\$38 million] bonding authority. Ms. Pitney answered in the affirmative. She stated that it was a \$55 million completion - the \$38 million plus the \$17 million equaled the \$55 million.

Representative Kawasaki pointed to line 2 and surmised that the Division of Legislative Audit had requested additional money from the Department of Administration (DOA), Division of Finance for the completion of an audit. He asked how the situation had happened.

Ms. Pitney answered that the annual payment to the Division of Legislative Audit had been \$300,000 for a minimum of 10 years. She explained that a recent memorandum of agreement specified an increase from \$300,000 to \$450,000 [the total bill was \$750,000]. She remarked that it was short notice given the constraints facing all departments. She stated that the amount would be included in an amendment assuming that it would be the cost charged going forward.

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Representative Kawasaki wondered if the administration felt it was being gouged by the legislature. Ms. Pitney replied that the charge was probably consistent with the hours the audit required. The administration had anticipated that the cost would be \$300,000, but it had increased to \$750,000.

She furthered that it could not be accommodated within the regular budget given the short timeframe. She believed the Division of Legislative Audit was only trying to cover the costs it was incurring during tighter budgetary times.

Representative Kawasaki referred to line 19 related to fire suppression activity. He thought the number was substantial [\$47.5 million]. He asked if the item had been under-budgeted or if it had been a bad year. He wondered about projected cost for the next year.

Ms. Pitney answered that fire suppression was not typically budgeted; it was more experience related and had traditionally been a supplemental request. She relayed that it had been a high fire year. Accurate budgeting for fire suppression would be fairly difficult. She explained that unused funds allocated to fire suppression rolled forward to the next year because of the unpredictable nature.

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Ms. Pitney noted she had inadvertently missed a \$48.8 million ratification of the prior year's fire suppression activity (line 46). She explained that the figure represented the amount that had not been budgeted the previous year (FY 15). She elaborated that it had been the practice to include the item in the supplemental budget. She reasoned that the practice could change; she thought a \$40 million place holder on any given year was not an unreasonable expectation.

Representative Kawasaki looked at lines 29 and 35 related to ALMR. He stated that the funding was currently fixed in the DOA budget. He did not know how many millions of dollars the state paid in maintenance each year. He wondered why the item was listed as a one-time capital request.

Ms. Pitney answered that the funding would go towards software and hardware upgrades and fixing the equipment for the statewide emergency communication system ALMR. The increment was a one-time capital request. Separately there were operating funds for ALMR in DOA's budget, which was responsible for maintaining the system. System users were DNR, DMVA, and many municipalities. She stressed that the increment did not reflect the last cost into the system; the system was expensive. She furthered that there was over

\$30 million in additional system needs for upgrades, radios, and so forth; the requests would begin in \$5 million to \$6 million increments in FY 18. She emphasized that ALMR was the backbone of the emergency communication system in the state. She noted that the administration was asking if alternatives existed.

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Representative Kawasaki did not believe the committee had ever reviewed the unallocated cuts made by the legislature. He thought it felt out of place to talk about supplementals before understanding what happened with the unallocated cuts from the prior year.

Representative Guttenberg pointed to line 16 related to tobacco cessation litigation. He referred to language in the description that the administration was studying the impact of the supplemental request for an FY 17 budget amendment. He wondered if settlement costs had been received; if so, he asked where they had gone. He queried whether additional settlement funds received went into the General Fund or other.

Ms. Pitney answered that all settlement costs went into the General Fund or the Constitutional Budget Reserve. The money did not offset first the litigation cost.

Representative Guttenberg asked if they were seen as receipt authority for those funds. Ms. Pitney replied in the negative. The funds went straight into the revenue bank; otherwise it would mean an appropriation of General Fund before the funds were used.

Representative Guttenberg asked how the settlement funds were categorized when they were received back from litigation. He asked if the funds were listed as the authority to receive the funds back from litigation. Alternatively, he wondered if the funds were lumped into the General Fund. Ms. Pitney replied that she would follow up.

Co-Chair Neuman requested a report on the fund including how much it was generating and where the money was going.

Representative Guttenberg was also interested in how the settlement funds were accounted for.

Co-Chair Neuman asked to receive the same information for the alcohol fund.

Representative Guttenberg spoke to the additional cost for external management fees under DOR (lines 20 and 21). He asked if the management fees were based on better than expected returns on funds. He asked if the increase was appropriate for the returns.

Ms. Pitney replied in the affirmative.

Representative Guttenberg asked how much better the performance was. Ms. Pitney would follow up with information from DOR.

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Representative Wilson pointed to line 9 related to the increase in foster care funds. She stated that the description read that OCS anticipated a 19 percent increase [in the number of children receiving foster care special needs funds]. She stressed that the number was huge. She asked for verification that the increment was based on anticipated growth and not current foster homes.

Ms. Pitney replied that the number was based on the number of children who had entered the system throughout the past fall. Based on the current figures, the administration anticipated a 19 percent increase by the end of the fiscal year.

Representative Wilson was bothered by the situation. She stated that following the funding increase provided to OCS the previous year, the agency had taken many more children into the system (children she believed could be somewhere else). She pointed to an increment on line 10 in response to an increase in subsidized adoptions and guardianships. She referred to recent testimony from OCS that how much extra funding may be needed for a child was negotiated between OCS and the adoptive and/or guardian parent. She wondered if the increment was anticipated. She wondered if a deal was open-ended and the state received a bill at the end.

Ms. Pitney replied that the item on line 10 was based on the number of children in the process and the amount of

money associated with each of those individuals. She explained that as there were more identified children in the foster care or subsidized adoption systems, the cost based on the formula amount increased.

Representative Wilson countered that the item on line 10 was not a formula program, but was an addition to the formula for guardianship and/or adoption. She furthered that if the child had no special needs the additional cost was zero, but the number increased for children with intensive medical needs or other. She requested to see actual numbers to give meaning to the 19 percent increase (line 9). She pointed to line 10 and stated that the contracts were negotiated between the potential adoptive and/or guardian parent with OCS. She reiterated that it was not a formula. She wondered how the numbers had been determined.

Ms. Pitney replied that she could follow up with exact numbers.

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Representative Wilson remarked on the 19 percent increase in foster children. She noted that she did not see the Public Defender's Office listed in the supplemental and reasoned that 90 percent of the parents in the OCS process had public defenders. Additionally, she did not see a request reflecting a need for more guardians ad litem or for the attorney general's office. She noted the committee had heard the previous day how much more the things were costing. She wondered if there would be increases in the areas she listed.

Ms. Pitney replied that all offices were receiving pressures as General Fund reductions were made and as service requirements were either staying the same or increasing. The state was doing the best it could to serve the population.

Representative Wilson stated that the legislature must have given the DHSS a lot of money if the department could absorb a 19 percent increase in its workload. She did not believe 19 percent of the state's children needed to be leaving their homes. She was disturbed by the high number and had many constituents involved in related issues. She believed the department needed to come up with alternatives

to taking children out of their homes and breaking up families. She stressed that the families did not get put back together; the impact was seen in other areas such as the correctional system. She thought it was awful.

Representative Gattis referred to line 20 related to increased external management fees in the DOR Treasury Division. She found the better-than-expected returns to be surprising because her personal investment portfolio had gone down. She wondered about the investment managers who had provided increases to funds under DOR. Once the numbers were received she wanted to explore the issue further. She turned to line 29 related to ALMR. She wondered why the funds had not been requested in the budget and why they had been included in the supplemental.

Ms. Pitney replied that the funds had been requested by the Department of Public Safety (DPS) through DOA as part of the budget process. As costs were scrutinized, the administration asked the departments to find what they could to mitigate the cost for the system and the necessary upgrade (it was a vendor-based system). Subsequently the departments came back with the reappropriation that did not meet the needs, nor did the \$2.3 million. The original request had been \$5 million. The administration had communicated to the departments that due to tough financial times the departments should determine how to use the amount of money to keep the system going.

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Representative Gattis noted that the ALMR increment was in her finance subcommittee budget and she would look into the issue further. She moved to line 31 related to the Eklutna overpass, which she was familiar with. She referred to the increment description and observed that the overpass had been hit in 2010, but had become an FY 16 supplemental. She remarked that six years had gone by. She asked why the funding was being requested at present instead of in the past. She wondered if the insurance settlement had gone through a private carrier or a company.

Ms. Pitney replied that the remaining cost was the amount left after dealing with the company's insurance. She detailed that the work had been completed and then the disagreement had occurred. She continued that the disagreement had been worked through and the increment

(line 31) was the remaining project funding required after all of the settlements.

Representative Gattis asked if the insurance had come through a company and if the state could have gone to the company for the difference. She reasoned that the company's vehicle had hit the overpass. She asked if the company was in business.

Ms. Pitney replied that she could provide details about the settlement. The increment in the supplemental was the amount remaining after reaching the agreement with the company and its insurance carrier.

Representative Gattis understood. She was looking anywhere possible to get compensation from the party responsible for the damage.

Co-Chair Neuman asked why the company had not paid for the entire cost of the damage. He understood that it was an insurance settlement.

Ms. Pitney did not know the specifics of the parties involved, but the amount reflected what was left after the settlement.

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Vice-Chair Saddler echoed Representative Wilson's concerns related to the 19 percent foster care increase (line 9). He remarked that the increase was huge. He stated if there was something going on that necessitated the increased cases it was something the legislature needed to know about. He noted that the description stated there was no increase in the governor's amended budget. He wondered why the \$2.6 million request would not get built into the base budget if the need would be continuing.

Ms. Pitney answered that the amount was not in the amended budget; it was an increase put in the FY 17 proposal.

Vice-Chair Saddler pointed to lines 24 through 26, which indicated an increase of approximately \$700,000 on airport leasing. The committee had heard from the commissioner of DOT that the department had not modified its lease rates. He wondered if some airports had received increases in

lease rates or if the increase was a result of increased leasing activity.

Ms. Pitney answered that "it is in the receipt authority," which resulted in the ability to utilize the receipts.

Vice-Chair Saddler asked if it was predicated on an anticipation of more leasing or higher rates. Ms. Pitney replied that it was predicated on money the department was collecting in the current year based on FY 16 rates.

Vice-Chair Saddler asked for verification that there had been no change in rates. Ms. Pitney could not guarantee that there had been no rate increases at any of the airports. She elaborated that the increment was not predicated on a wholesale rate increase; it was based on rates paid in the current year. She explained that previously, the receipt authority had been below the amount of revenue collected.

Vice-Chair Saddler stated that he hoped the FY 17 DOT budget would increase the receipt authority on account of increased leasing rates.

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Representative Gara made corrections related to the foster care increments. He discussed that the legislature had funded additional staff positions in OCS the previous year due to understaffing. Since that time, the number of children in foster had increased from 2,500 to 2,800. He stressed that the number had increased by 1,100 over the past six years. He stated that OCS had gotten more aggressive about taking children out of their homes, which was something the committee could discuss with the agency. He stressed that the number of children taken out of their homes had been increased over a six-year period; the increase was not related to the 27 new positions hired the previous year. He specified that the new staff had not been hired to take more children out of their homes. He remarked that the extra staff had been taken up by the increase in 300 kids. He stated that the fact that there were more kids in the system was terrible. He spoke to the increase in subsidized adoptions and guardianships on line 10. He believed the increase was a good thing in some ways; it meant kids were getting out of the foster care system and into permanent homes. In order to encourage people to adopt

kids out of the foster care system, the state subsidized the adoption cost.

Representative Gara referred to the \$1.6 million increment for the Alaska Railroad Corporation. He remarked that the railroad ran autonomously. He believed the entity used every single penny provided, continued to come back to the legislature for more money, and the legislature never saw how the money was spent. He asked if the administration had determined whether the railroad could cover the cost for the positive train control system.

Ms. Pitney answered in the affirmative. She specified that the cost had been \$55 million; the railroad had bonded using its revenue for \$38 million of the total. The state had secured a 90 percent (federal) match if the state could come up with the remaining 10 percent. The reappropriation from a completed project allowed the state to obtain the federal matching funds. Out of a \$55 million commitment, the railroad was locating all but \$1.6 million. She explained that the federal [positive train control] requirement was significant and the train system did not have that many passengers.

Representative Gara thought there was a project underway that was building a longer rail line to Point Mackenzie. He thought completion of the project would not happen for quite some time; therefore, he wondered if that project had some unspent money that could be borrowed to pay for the positive train control system.

Ms. Pitney replied that it was possible. She noted that the Point Mackenzie project was not complete and the administration had looked for remaining funds in a completed project.

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Representative Wilson asked if the state could loan the money to the railroad and the railroad could pay the state back in receipts (like it was doing with the bonding portion). Ms. Pitney answered that the legislature could work with the railroad to determine if the option was possible.

Representative Wilson thought a loan may be a good option. She recalled that an Interior delegation had used about \$80

million and had no capital projects. She remembered hoping the \$1 million would come back to the state.

Co-Chair Neuman asked for verification that the governor's budget amendments would be received by day 30 of the current legislative session (particularly the amendments allocating unallocated reductions).

Ms. Pitney replied that the task represented significant work. The administration was progressing towards that date.

Co-Chair Neuman noted the amendments were needed.

HB 293 was HEARD and HELD in committee for further consideration.

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AT EASE

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RECONVENED

^FY 17 BUDGET OVERVIEW: DEPARTMENT OF NATURAL RESOURCES

[2:37:25 PM](#)

ED FOGELS, DEPUTY COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, introduced the PowerPoint Presentation: "State of Alaska Department of Natural Resources House Finance Budget Overview" dated February 4, 2016 (copy on file). He addressed an organizational chart on slide 3 that included the commissioner, two deputy commissioners, and division directors. He turned the meeting over to Commissioner Myers.

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MARK MYERS, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, began with slide 4 and specified that the department's mission was to develop, conserve, and maximize the use of Alaska's natural resources consistent with the public interest. He reported that the state's submerged and surface lands accounted for 160 million acres (bigger than the State of California). He detailed that the state had a world-class resource endowment; it ranked in the top 10 in its mineral and oil and gas endowment (the best in the Arctic). He highlighted the state's timber, agriculture,

land, and water; the state contained about 40 percent of the country's surface water. He noted that Minnesota had 10,000 lakes, whereas Alaska had 3 million. The state also had 12,000 rivers. He shared that the state's resource endowment empowered the state's economy. The department's first core service was responsible commercial development and use of state land and natural resources, consistent with the public interest, for long-term wealth and employment. He detailed that the service was very specific to the economic development that comes with the lands for renewable (e.g. tourism) or non-renewable (e.g. oil, gas, and mining) resources. He explained that together the items formed the state's economy. He noted that development on federal land in the state was very restricted (there were over 200 million acres of federal land in Alaska); therefore, most development occurred on state land or on the 44 million acres of Alaska Native land. The state was very dependent on its lands for the development of its economy. Much of the state's economy not directly related to the development of resources, was dependent on the associated economic development. He explained that community development in forestry and agriculture brought in significant money to local communities and built sustainability. He referred to an external study showing that Alaska was unique in its level of endowment; it also had the highest return on its land than in any other state.

Commissioner Myers continued to address slide 4. He relayed that people tended to think of DNR as a primarily regulatory agency. He explained that DNR was primarily a commercial, economic development agency; it was responsible for resource and royalty management and ensuring the availability of capital coming out of the resources for tax purposes. He explained that the state's tax structure was a product of the state's resource development and royalties. The department was very sensitive to the state's ability to rationally and prudently develop its land.

Commissioner Myers discussed that DNR's second core service was to mitigate threat to the public from natural hazards by providing comprehensive fire protection services on state, private, and municipal lands; and through identifying significant geologic hazards. He communicated that the past year had been the second largest wildfire year on history (approximately 5.1 million acres had burned). The largest wildfire year had been 2004 when 6.6 million acres burned. He stated that fires would increase;

the cost of fighting fires probably represented the department's largest budget item. The department did much of the work with hazards and risks related to earthquakes, landslides, floods, coastal erosion, volcanic eruptions, and other. He referred to a 7.1 earthquake in Anchorage and landslides in Sitka as examples. The department conducted work - largely through its geological survey - to understand, mitigate, and warn the public about the hazards.

Commissioner Myers addressed the department's third core service: to provide access to state lands for public and private use, settlement, and recreation. The department sold land for agricultural and public settlement uses. Additionally, the department made sure state land was available for things like a small dock permits and other. He mentioned providing access across lands and referred to problems with the federal government related to the issue. The department's fourth core service was to ensure sufficient data. He detailed that the agency used substantial geological data and all types of other data necessary to manage lands and to work with other stakeholders for environmental impact studies and permitting processes. He pointed to a pie chart on slide 4 and noted that the largest portion of DNR's budget went to economic development.

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Commissioner Myers highlighted land ownership on slide 5. A map illustrated the checkerboard nature of the state's landscape; the state's lands were shown in pink. He explained that connecting the lands, gaining access across federal lands, and managing the remoteness of the land was not inexpensive. He noted that the department had to visit the sites; the majority of state land had no road or airport access. He addressed DNR office locations on slide 6. The slide included a map with office locations indicated by red dots. He elaborated that the map reflected the complexity and variation in the landscape (from arid deserts to temperate rainforest); the resources in the areas varied extremely. The state was the least mapped and most poorly understood places in the world. He equated the lack of understanding about the remote areas of Alaska with the bottom of the ocean. He explained that data acquisition, understanding, evaluating, and maximizing value required DNR to do a fair amount of work.

Commissioner Myers addressed the 7 major divisions beginning on slide 7. He spoke to the Division of Agriculture; Division of Forestry; Division of Geological and Geophysical Surveys; and the Division of Mining, Land and Water (which had been three separate divisions in the past, but had been combined for efficiency).

Co-Chair Neuman asked Commissioner Myers to provide budget numbers when going through the divisions.

Commissioner Myers returned to the Division of Agriculture, which had 39 positions and accounted for about 3.7 percent or \$7 million (\$2.8 UGF) of the department's overall budget. The Division of Forestry had 234 positions and accounted for 22.6 percent or \$43 million (\$24 million UGF). He detailed that 88 percent of the division's budget went to fire suppression; the remaining funds went to forest management and timber sales for forest harvests. He noted that the amounts did not include the governor's supplemental fire budget. The Division of Geological and Geophysical Surveys (DGGS) accounted for 4.4 percent or \$8.5 million (\$4.4 million UGF) of the department's total budget. He specified that it was probably DNR's most leveraged division; it was dependent on more than 40 percent outside funds used for research (slide 8). The Division of Mining, Land and Water (DMLW) was the department's largest division with 205 employees and accounted for \$26 million (\$9.6 million UGF) of DNR's total budget.

Commissioner Myers moved on to the Division of Oil and Gas, which was DNR's most lucrative economic division and the most technical with the highest level of more expensive, highly skilled geologists, engineers, commercial analysts, and other (slide 9). The division had 111 employees and accounted for 11.6 percent or \$22 million (\$8.9 million UGF) of the department's budget. The Division of Parks and Outdoor Recreation (DPOR) operated the largest park system in the country with 133 positions and accounted for 8.6 percent or \$16 million (\$3.2 million UGF) of the department's total budget. He detailed that the division was becoming independent of state UGF with volunteers outnumbering employees approximately 8 to 1. He elaborated that the division was about 40 percent independent of UGF in terms of its ability to raise money on fees for use of facilities. He relayed that there was proposed legislation

that would allow the department to sell parks merchandise; with the additional revenue, the department hoped the division would become 50 percent independent on UGF.

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Commissioner Myers spoke to the Division of Support Services, which accounted for 6.8 percent or \$13 million (\$5.6 million UGF) of DNR's total budget (slide 10). One of the division's responsibilities was running the Recorder's Office, which was a crucial function for the state and was mostly self-funded. The division was also responsible for running the department's information technology (IT) infrastructure, human resources, and managing sales and other contracts. He noted that Administrative Services only accounted for \$2.3 million UGF, the remaining funds went to IT. He moved to slide 11 and relayed that the Office of the Commissioner was a relatively small portion of the department's budget. A relatively large new (in the last several years) portion of the department's budget was the North Slope Gas Commercialization (NSGC). The agency was mostly self-contained, but did receive direct support from other divisions such as the Division of Oil and Gas for work on the gasline. He detailed that the agency had 21 positions, 5 of which were filled with state employees, several were unfilled, and the remainder were filled with contractors.

Commissioner Myers addressed the Office of Project Management and Permitting (OPMP). There had been a strong desire within the legislature and administration to accelerate permitting. The goal was to make permitting easier, more coordinated, and more efficient, without compromising the process. The faster the projects could be permitted, the better it was for economic development. He continued that the better and stronger the process, there was less public concern and less litigation. The office's total budget was \$7.7 million (\$912,800 UGF); about \$5.6 million of the budget was funded by project applicants. The office permitted large projects and worked with federal and other state agencies to provide coordination.

Commissioner Myers discussed the Alaska Mental Health Trust Land Office, which was a pass through office that reported to the Alaska Mental Health Trust Authority (AMHTA) board. The office's function within DNR was to manage the AMHTA lands to return the value for mental health programs. He

highlighted performance measures showing the mining, land, and water permit backlog on slide 13. The legislature allocated significant funding in FY 12 and FY 13, which had visibly helped to reduce the backlog to about 1,000 (down from a peak of 2,600). In 2015, 93 percent of the permit applications were granted within the year. He relayed that the improvements went in tandem with the Unified Permitting Program with the goal of creating a single application structure for permitting and processing permits.

Commissioner Myers continued to speak to performance measures on slide 14. The slide included a graph showing OPMP coordinated projects, which had continued to increase over the past three years (primarily in oil and gas projects shown in red). He noted the projects were user-desired and funded. He explained that large mining, transportation, and renewable energy projects liked to use the service. The UGF allocated to OPMP went towards helping the department evaluate the changes in federal permitting processes and make state comments back when it thought new federal standards were problematic. The information was provided to the commissioner and governor's office. For example, the process had been used recently in response to the Obama Administration's structural permitting changes to things like mining, oil and gas, and general land use management.

Commissioner Myers addressed the FY 16 budget on slide 16. He detailed that UGF allocated to DNR had been reduced by \$7.6 million (approximately 10 percent) and 76 positions. He referred to a handout provided to committee members listing all of the deleted positions ["Department of Natural Resources FY2016 and FY2017 Position Deletions as of February 2, 2016" (copy on file)]; the handout listed whether people had been in the deleted positions, whether they retired, let go, or moved to another job within the organization. He noted that the handout also provided a breakout of job classification (i.e. professional, clerical, or technical). He knew there had been questions about whether the positions represented real bodies. He asked a colleague to elaborate on the topic.

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FABIENNE PETER-CONTESSA, DIRECTOR, DIVISION OF SUPPORT SERVICES, DEPARTMENT OF NATURAL RESOURCES, directed attention to the position deletion handout and explained

that the department had removed 76 positions in FY 16 (one of which had been transferred to the Department of Transportation and Public Facilities (DOT)). She detailed that 41 of the positions had been vacant, 34 had been filled, 22 people had been laid off, 9 people had retired, and 3 took lateral transfers. The department had also removed all of the funding for the positions, which totaled \$4.4 million. The department currently had 12 positions slated for deletion in FY 17 (at present 2 of the 12 positions were filled). She specified that approximately 34 percent of the eliminated positions were at the expert/professional level; the individuals in the positions were highly educated, specialized, and difficult to replace. She highlighted that 39 percent of the positions were at the technical level and 26 percent were at the entry level. She added that the handout broke the eliminated positions out by location and division (the details of every position were on the second page).

Commissioner Myers continued to address slide 16 titled "DNR FY2016 Budget Cut Highlights." The department's overall philosophy in managing the cuts was to avoid the elimination of major programs, which included forestry and agriculture. He remarked that the elimination of forestry and agriculture would have nasty effects on communities. There were parts of agriculture that directly related to other areas such as the invasive plants program, and inspections for agriculture/timber export. He detailed that there was codependency between divisions and the department wanted to ensure position cuts in one area did not damage other programs. The department had decreased certain capacities in programs knowing it would hurt, but with the goal of avoiding breaking anything; the method had been to go down to the director level and work the issues systematically to try to manage cuts the best it could. He added that the cuts were real and had resulted in programmatic effects. In FY 16, 4 positions including 2 scientists evaluating coal/geothermal/energy resources had been cut from DGGs; additionally, the airborne geophysical survey program had been eliminated. He explained that no new airborne geophysical data had been collected (the data helped the state understand its mineral attribution), but there was a small amount of LIDAR [Light Detection and Ranging] from DOT and other areas that DNR had helped to process.

Commissioner Myers highlighted that 9 positions in the Division of Oil and Gas had been cut by the restructuring of work processes. The department had hit some of its analytical capacity, which made him uncomfortable, but it was a result of the time. He discussed the importance of understanding the West Coast market and tanker transportation costs related to the royalty negotiations and reopeners, in terms of "leaving it in value." He explained that reopeners with companies had brought up millions of dollars. The commercial staff had been kept as intact as possible. He explained that much of the commercial capacity had been used on the gasline, but it had not been funded by the gasline; therefore, the supplemental budget had provided funding to put 2 commercial positions back in.

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Co-Chair Neuman asked Commissioner Myers to move onto the governor's highlights.

Commissioner Myers moved to slide 18 titled "DNR FY2017 Governor Budget." He explained that position cuts in the FY 17 budget resulted in a 9 percent change in net employees from FY 16. The slide showed that historically DNR had not really grown from year-to-year [the chart began with FY 07]. The number of permanent full-time employees had peaked in FY 07 and had decreased since that time. He elaborated that in order to make workload adjustments the department had hired many more temporary part-time positions. He communicated that DNR had already been managing effectively to workload by not filling full-time positions, but its staff had been decreased by 70 positions since 2007 (about 9 percent full-time). The department's total employees were down by about 100. The department did not have any increases in employees.

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Ms. Peter-Contesse pointed to slide 19, which included a highly detailed matrix showing how the budget scenarios were developed between the FY 16 management plan and the FY 17 governor's budget. She believed slide 20 was a more useful way of looking at the budget. She began with the bottom line, which showed the FY 16 management plan to FY 17 governor's budget increased by 43 percent in UGF (primarily related to the AKLNG gasline project), a 14

percent overall increase, and a 1.3 percent increase in people. She explained that excluding AKLNG, the department's budget was down 7.5 percent in UGF and 2 percent overall. She specified that DNR's budget was down 16.5 percent and 8 percent in personnel between FY 15 and FY 18. The next couple of slides included the specifics of the "ins and outs"; the outs were mostly the one-time items that come out for adjusted base (e.g. Seed Potato Program, Mount McKinley Meat and Sausage, the unallocated reduction, and other). The governor's FY 17 budget resulted after factoring in all of the items and adding the of the governor's increments and decrements.

Commissioner Myers addressed details on slide 21 titled "DNR FY2017 Budget Highlights: Reductions." He reiterated his earlier statement that the department had worked to avoid the elimination of any major programs. The department had looked at areas where it could try to make some decreases. He began with the Division of Oil and Gas and explained that reductions had been made to best interest finding, lease sale preparation, public record requests for oil and gas, communications, and other. Two positions had been cut from the division. He noted that the cuts did not mean best interest findings would be eliminated, but they would not be as thorough. There was some risk with the approach, but the department was faced with either making the cut or canceling lease sales, which it chose not to do. The department had also looked at ending the exploration licensing program, but did not want to do that at the current time. Within DGGS, the department had reduced production and content of the annual mineral report, would no longer attend mineral and energy trade shows (the state received interest from mineral and oil and gas companies at trade shows, but it could no longer afford to attend), and had reduced software licensing costs. He noted that from 2013 there were 16 new independent companies in the oil and gas arena in Alaska since 2013; some of that increase was attributable to DNR's ability to present companies with technical data at tradeshow (e.g. NAPE and APG tradeshow).

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Mr. Fogels addressed the remainder of the departments on slide 21. The governor's budget proposed to reduce the DMLW stewardship budget by \$363,000, which would reduce its ability to send employees out into the field to monitor

activities the department had permitted. Additionally, it would reduce the division's ability to maintain high-use sites such as the Knik public use area and the Kasilof River. He explained that the department may not have the ability to pump out the sanitary facilities as often. The Division of Forestry would reduce annual road maintenance in some of the state forests. He explained that roads may be graded every other year instead of annually. Additionally, one long-term administrative position would be eliminated. The governor's budget would eliminate the Citizen's Advisory Commission on Federal Areas, which would eliminate two positions. Funding would be reduced for Parks Management and Access; a position would be moved into the federally funded Boating Safety Program, which would reduce DNR's ability to issue permits on state park land. Additionally, one part-time Kodiak state parks system would be eliminated.

Mr. Fogels continued to address slide 21. He detailed that the budget would make light cuts to the Division of Agriculture and would reduce the division's seasonal mechanic's capacity, Alaska Grown Marketing and farm site inspections and assistance for a total of \$87,800.

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Ms. Peter-Contesse relayed that a position dealing with the audits of land sale contracts would be deleted from the Support Services Division (slide 21). She noted that it may slow patents for entities buying state land and for defaulted contracts (with individuals) on land the state was trying to get back to resell. She spoke to agency-wide reductions and explained that DNR was working with DOA on chargeback DNR paid for IT and human resources to find efficiencies. Additionally, the department was working to find efficiencies in facility costs; DNR was included in the statewide pilot program on cross-departmental efficiencies for leases. She elaborated that the department was trying to find a better way of managing facilities in order to prevent duplication of efforts across agencies. The department had also begun implementing five-day mandatory furloughs for about 60 senior staff in FY 16 to meet the unallocated budget reduction; the requirement would continue into FY 17.

Commissioner Myers noted that the furloughs were for exempt employees; it was not currently possible to do the same

with union employees, but he believed it was being discussed. He highlighted that the unallocated one-time salary increases would be removed in the FY 17 budget. He believed there was some expectation it could be done through administrative staff and staff efficiencies; however, he saw no practical way to do that. The department's proposal was to allow DNR to shift from UGF to DGF; DNR had more than \$20 million in extra generated revenue from DGF for things like gravel sales, that went directly into the General Fund. To sustain some of the department's programs it wanted increased authority to use DGF; if that did not occur, it would lead to shutting down a major program. He shared that the full analysis was not complete, but he was looking at a significant reduction in the Division of Agriculture as the least harmful of all the possible cuts (the cut would still be harmful). He could not find further savings in administrative efficiencies, given what the department had already done administratively.

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Commissioner Myers continued to discuss FY 17 budget highlights on slide 22. The budget included a fund source switch from UGF to DGF for \$2 million in DMLW program receipts from fees. The department had the capacity to use the strategy more on a year-to-year basis.

Mr. Fogels discussed one-time base budget items on slide 22. He explained that that two items had been transferred to one-time item status in the FY 16 budget: the Seed Potato Program and the Mount McKinley Meat and Sausage Plant. The governor's budget proposed to reinstate the items into the department's base. The department felt strongly that the Seed Potato Program should be included in DNR's base budget - it represented a critical function of the Division of Agriculture. He stressed that it was essential for the agricultural potato industry to start off with clean, virus-free, generation zero seed; if it was not possible, seed would come in from outside the state, which would introduce viruses and the purity of the state's potato stock would be hurt. The department was in agreement that a different business model for the Mount McKinley Meat and Sausage Plant was needed. He detailed that by putting the funding at a one-time status it had been successful in forcing the conversation in the industry that something different had to happen. The industry was actively trying

to figure out a way to privatize the facility. He noted that past attempts at privatization had been unsuccessful, but there was significant interest in the topic at present. The department was also pursuing some other avenues, but more time was needed to look at options. He stressed that the facility was critical for the Southcentral's meat industry; without the plant, the meat industry would be severely damaged. Therefore, the plan had to involve some type of transition to enable the plant to continue to operate while a solution was being devised. For example, if a new plant was built in another location, it would be necessary to keep the current facility running until the new space was ready. He pointed out that the \$2 million required to run the plant came out of the Agricultural Revolving Loan Fund, not the General Fund. He continued that even though the plant averaged an annual loss of \$155,000, the money was merely a draw on the fund, which was level and continuing to provide all loans the agricultural industry needed. Effectively, the interest paid by farmers who had taken out loans was subsidizing the plant's loss. He concluded that the facility was at a steady state, but he believed everyone agreed that something different needed to happen.

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Commissioner Myers spoke to the North Slope Gas Commercialization, which accounted for a large portion of DNR's UGF budget (slide 22). He detailed that the budget had been predicated on the buyout of TransCanada's portion in the project and the current commercial negotiation; approximately half of the money was for the Department of Law (DOL). He explained that DOL had contracted with several world-class firms and two lead commercial negotiators for AKLNG. Based on his experience, he believed it was the best negotiating team the state had ever had. Additionally, there was a significant amount of money in the budget for marketing, which presumed a complex marketing structure. He referred to conversations during special session about the high cost of marketing. The state was negotiating commercial structure of marketing with the producers; there were structures that were much simpler and more reliant on the project working together. Marketing as a whole was the state's preferred position; it did not want to be competing with its partners in the equity market on its own.

Co-Chair Neuman noted that there would be further in-depth discussions about the topic in the future. He noted that there may be questions at the end of the presentation related to the topic.

Commissioner Myers highlighted that the department was looking for ways to cut the North Slope Gas Commercialization budget, but it was dependent on the ultimate marketing structure, which was currently under negotiation. He addressed a pie chart illustrating the department's operating budget by division on slide 23. Fire suppression was the largest portion of the pie at 22.6 percent, the North Slope Gas Commercialization represented 18.6 percent, followed by DMLW, the Division of Oil and Gas, and much smaller portions for the remaining divisions. He stated that fire suppression and gaslines had dominated the department's budget recently. He addressed slide 24, which included a pie chart representing the department's operating budget by fund category. He detailed that UGF funded the things that generated state revenue. He explained that it was not possible to find matching or grant money for oil and gas lease sale; however, outside sources would fund scientific work and other components. He stated that the UGF was a very significant component of the dollars that came back to the state. For example, DNR-generated revenue was about \$17 for every \$1 of total state money; if taxes were factored in, the amount was \$39 for every \$1, which equaled about \$7.7 million coming back to the state for every DNR employee. He emphasized that the rates of return were unheard of in any other state. The department believed a better model would be to put more DGF in - money the department was bringing in - in order to sustain the services generating the huge rates of return.

Commissioner Myers turned to slide 25 titled "Department Comparison." The department represented approximately 1.7 percent of the state's overall budget. He remarked that the service part of government and formula driven programs drove the budget. Combined, the resource agencies accounted for a very small portion of the budget.

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Commissioner Myers moved to slide 26 titled "DNR Revenue Generation." He explained that given the volatility of commodity prices, the royalty was a more stable revenue source than taxes (particularly in a net profit-share

system). He turned to slide 27 titled "Revenue Actuals and Forecast." He detailed that the royalty was increasingly a higher percentage of the department's internally generated revenue. He noted that the royalty was volatile to commodity prices, but less so [than taxes]. He expounded that over a decade, about \$2.5 billion came back to the state through DNR. He pointed to the chart on slide 27: the blue line represented taxes and the red represented royalties. He noted that the chart showed \$1 billion at the bottom; there had been a significant decline in royalty revenue, but it was not nearly as volatile as a net profit-share tax system. He advised that when considering the state's portfolio of income sources, to think of royalties under the current system as one of the most stable sources; it was also the corpus of the Permanent Fund.

Ms. Peter-Contesse addressed charts prepared by the Legislative Finance Division on slides 29 through 36. She noted that a portion of the charts excluded AKLNG. She began on slide 29 (without AKLNG) and relayed that DNR represented about 2 percent of the state's overall budget. The chart included General Fund only and showed that from FY 07 to FY 17, DNR was about \$8.3 million below the rate of inflation. Slide 30 also excluded AKLNG and showed that the department was down 98 positions since FY 15 and 64 fewer than FY 16. She turned to slide 31, which showed appropriations within DNR (no AKLNG). She detailed that permitting had increased in 2012 and 2013 when DNR had received appropriations from the legislature to reduce permitting. She noted that as indicated in a performance graph earlier in the presentation, the effort had been effective. She explained that in FY 17 the department used \$65 million UGF in FY 17 compared to \$65.9 million UGF in FY 07.

Ms. Peter-Contesse moved to slide 33, which showed appropriations within DNR (GF only, including AKLNG). She pointed to a bump in the FY 15 management plan when AKLNG had been added to the UGF budget. In FY 16 the fund source had been changed to Instate Pipeline Fund (classified as other funds), which had resulted in a drop in the blue line, followed by an increase in FY 17 for the \$35.7 million in UGF. She noted that the fund source changes were reflected in the blue line.

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Mr. Fogels addressed the presentation conclusion on slide 37. He noted that per legislative direction, DNR was still working to find efficiencies and eliminate unnecessary regulations and statutes. He explained that one past piece of legislation had fixed many issues with DNR statutes. Additionally, Representative Munoz had introduced an important bill to streamline the department's land exchange process, which would save DNR significant work. The department was looking at ways to streamline its mining process in areas from claims to placer permitting. He continued that DNR was looking at smarter ways to conduct timber sales because there were fewer staff to do the work. He explained that DNR was required to regulate low-hazard dams, but it was questioning whether the work was necessary. The department was also working to determine if it could fix regulations for water (e.g. redirection of water around construction sites took significant staff time); DNR was also evaluating permits processes for docks, wharfs, erosion control structures, and other.

Commissioner Myers shared that earlier in the week he had signed a preliminary best interest finding on a royalty oil sale to Tesoro (the information was also on the department's website). He detailed that as North Slope oil production had declined, available oil for instate refining had decreased. He elaborated that large companies had excess tanker capacity and had commitments to the Lower 48 (particularly California) to supply their refineries; subsequently, Alaska's local refineries had been crunched. He explained that in the process, the state had taken its royalty oil in-kind rather than in-value. He continued that the department had just finished negotiation with Tesoro for a contract, which would provide approximately \$14 million more in-kind; it also prevented the refinery from needing to import more oil from the Bakken in North Dakota as it had been doing. He highlighted that Alaskan jobs were created, Alaskans got to use Alaskan oil in their cars, and the state received about \$1.95 per barrel more than leaving it with the producers. He furthered that the preliminary best interest finding had been a tough commercially negotiated deal, which would go to the royalty board and then to the legislature for approval during the current session. He remarked that the deal represented an example of how DNR was working to use the state's resources as a multiplier to create jobs and increase value. He added that it was not the only royalty oil contract the department was working on. He expected that by the end of the year, it was

likely that 95 percent of the state's oil would be sold to in-state refineries in-kind. He concluded that skilled commercial teams were needed to work on the issues. He reiterated that it was possible to use the state's resources as a multiplier, which was a goal within DNR - to provide maximum value for Alaskans, while providing revenue back to the treasury.

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Co-Chair Neuman relayed that he had participated in many discussions with Commissioner Myers and Mr. Fogels related to reviewing DNR regulations. The effort had been to focus on DNR as a model project in reducing regulations; as an entity, the department had shown it brought in revenue by selling Alaska's resources. However, there continued to be a tremendous amount of regulations that put burdens on industry and required duplicative paperwork. He had asked DNR to bring the legislature regulations the department needed to continue to protect its mission statement; but he wanted to start getting rid of the other regulations to ensure Alaska continued to be a good place to work, while protecting its resources. He noted that all agencies were working on a review of their regulations and he expected DNR to come back shortly with some solid recommendations.

Representative Pruitt spoke to the North Slope gas commercialization. He referred to \$18 million that would go to the Department of Law. He asked what portion of the remaining funds would go towards marketing.

Commissioner Myers replied that he did not have the numbers on hand, but the number was significant. He furthered that going to a FEED [Front End Engineering and Design] decision in January had been presumed; currently the department was in the process of hiring a temporary six-month world-class expert to build the structure. He elaborated that the effort had been delayed somewhat because the goal was to understand that the commercial arrangement with producers impacted the structure. He continued that the preferred structure was a much smaller organization. He reiterated that the marketing cost was a significant portion of the allocation. He noted that salaries for the contracted position approached \$1 million or more when factoring in bonuses. The position had not yet been hired, but they would need to be in place as the project entered FEED; at that point the state would be negotiating contracts in

order to have them in place at FID [Final Investment Decision].

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Representative Pruitt stated that there had been an option for joint venture marketing. He noted that it was obvious that the presentation did not include that option. He asked if the administration had determined the state would not be party to joint venture marketing. He asked for verification that if the money was appropriated the legislature would not have another opportunity to have a say in whether the policy decision was appropriate.

Commissioner Myers answered that he had to be careful with his answer related to confidentiality. He stated that he "would do handsprings" if there was a four-party joint venture marketing. The state's position had been that joint venture marketing was a solution in upstream alignment in gas supply, the gas marketing agreement, cargos in the downstream, expansion, and other; the administration believed it was a fundamental alignment piece. However, the partners did not all agree with that view. Therefore, active negotiations were underway and no resolution had yet occurred. He furthered that his strongest recommendation would be for four-party joint venture marketing and the administration had made the point clear in its position. He could not say what would occur as negotiations were far from complete at present. The other alternatives were individual joint venture marketability of all of the producers, which meant staff would have to be duplicated; it would require the state to have a marketer in each of the organizations (i.e. with BP, ConocoPhillips, and ExxonMobil). The state would also have to guarantee surety of supply, which would require a few upstream staff to work with customers. He summarized that it was a much larger structure, which the budget had been designed around. He remarked that alignment on joint venture may not be reached with the parties, which meant the state may end up equity marketing a portion of its gas; in which case, the state would require an equity marketing structure.

Co-Chair Neuman relayed that he had asked whoever oversaw the budget to look at royalty in-kind structures, law, and when, where, and how the appropriations would be made.

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Representative Pruitt asked if the governor was going to call the legislature back into special session.

Commissioner Myers replied that he believed the governor wanted to [call the legislature into special session]. He continued that the governor wanted to have the contracts negotiated (he referred to a letter the governor had sent); however, during project briefings with the Alaska Gasline Development Corporation (AGDC) and DNR Deputy Commissioner Marty Rutherford, the legislature had also heard that negotiations were not there yet. The negotiations were tough, but moving slowly. He believed all parties were looking at what the alternatives may look like. He noted that it was too early to say [whether there would be a special session], but at the current pace it was challenging.

Representative Pruitt asked if there would be a financial discussion with the legislature if it was called into special session. He explained that Commissioner Myers had just highlighted a very complex issue and he was trying to determine if it was the only time the issue would be before the legislature. He wondered if the legislature should spend more time digging into the issue or if it would be appropriate to wait on the funding until a special session.

Commissioner Myers answered that the budget included other items in addition to the marketing component. He believed the money for DOL to fund key negotiators was critical because the negotiation would continue. Without ongoing funds, the state would not have the ability to retain the contractors at the beginning of the next fiscal year, which may result in a break in continuity if there was no special session. He noted that the legislature had hired very good consultants and he was happy to work with analytica, which could then provide the legislature with its own expert judgement. The administration did not object to an independent review.

Co-Chair Neuman noted that Representative Pruitt was looking at the issues.

[3:30:11 PM](#)

Representative Guttenberg stated that the hardest part about commercialization was that so much of what the state

did was public, which held things up. He remarked on Alaskan food products and stressed "we're killing our ag industry in this state." He continued that there were significant rules broken by the private sector in agriculture in Alaska. He mentioned Alaskans producing fruit trees; he had personally harvested 10 pounds of apples in his first crop earlier in the year. He reiterated that they were destroying the state's agricultural opportunities; they were not enhancing or supporting the industry and were moving backwards. He remarked that he loved the oil and gas work, but he reasoned that everyone needed to eat. He noted that the state was getting rid of the Farm to School program. He stressed that everyone talked about food security, but he believed Alaska was going backwards.

Representative Gara pointed to the department's operating budget by core service on slide 19. He observed the slide showed a \$1.3 million cut in UGF from FY 16 to FY 17. However, the "other" fund category showed reductions from \$49 million down to \$40 million and a \$2 million decrease in DGF. He asked why the other and DGF cuts were so large. He asked for detail on the DGF cut.

Ms. Peter-Contesse pointed to slide 20 for detail. The \$2 million fund source switch was included in the FY 17 governor budget decrements. She explained that the department had reduced \$2 million in UGF and increased \$2 million in designated program receipts in mining, land, and water. She elaborated that the receipts came in from material sales, leases, and other.

Representative Gara observed that for FY 16 to FY 17, the cuts to other funds and DGF outpaced the cuts to UGF by a significant amount. He wondered what money was not coming into the other category. He surmised that typically UGF received the largest cut.

Ms. Peter-Contesse replied that that the other category included the reversal of the AKLNG one-time item of \$8.9 million. She explained that the Division of Legislative Finance took the one-time items out, which were then seen in the governor's request as a UGF increase in FY 17. She explained that it had been categorized as other in the Instate Pipeline Fund in FY 15.

Co-Chair Neuman asked the department to provide the committee with any further analysis it may come across.

Co-Chair Thompson discussed the meeting schedule for the following day.

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ADJOURNMENT

[3:34:59 PM](#)

The meeting was adjourned at 3:34 p.m.