

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

May 28, 2016

10:09 a.m.

MEMBERS PRESENT

Representative Benjamin Nageak, Co-Chair
Representative David Talerico, Co-Chair
Representative Bob Herron
Representative Craig Johnson
Representative Paul Seaton
Representative Andy Josephson
Representative Geran Tarr
Representative Mike Chenault, Alternate

MEMBERS ABSENT

Representative Mike Hawker, Vice Chair
Representative Kurt Olson

COMMITTEE CALENDAR

HOUSE BILL NO. 246

"An Act creating the oil and gas infrastructure development program and the oil and gas infrastructure development fund in the Alaska Industrial Development and Export Authority; relating to the interest rates of the Alaska Industrial Development and Export Authority; relating to the sustainable energy transmission and supply development and Arctic infrastructure development programs of the Alaska Industrial Development and Export Authority; relating to dividends from the Alaska Industrial Development and Export Authority; and adding definitions for 'oil and gas development infrastructure' and 'proven reserves.'"

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 246

SHORT TITLE: AIDEA: FUNDS; LOANS; PROGRAMS; DIVIDEND

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

01/19/16	(H)	READ THE FIRST TIME - REFERRALS
01/19/16	(H)	RES, FIN
02/12/16	(H)	RES AT 1:00 PM BARNES 124

02/12/16	(H)	<Bill Hearing Canceled>
03/10/16	(H)	RES AT 1:00 PM BARNES 124
03/10/16	(H)	-- MEETING CANCELED --
03/16/16	(H)	RES AT 1:00 PM BARNES 124
03/16/16	(H)	Heard & Held
03/16/16	(H)	MINUTE(RES)
05/23/16	(H)	FOURTH SPECIAL SESSION BILL
05/23/16	(S)	FOURTH SPECIAL SESSION BILL - WITH PASSAGE OF HCR 401
05/27/16	(H)	RES AT 11:00 AM BILL RAY CENTER 208
05/27/16	(H)	Heard & Held
05/27/16	(H)	MINUTE(RES)
05/28/16	(H)	RES AT 10:00 AM BILL RAY CENTER 208

WITNESS REGISTER

KARA MORIARTY, President/CEO
Alaska Oil and Gas Association (AOGA)
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 246.

FRED PARADY, Deputy Commissioner
Office of the Commissioner
Department of Commerce, Community & Economic Development (DCCED)
Juneau, Alaska

POSITION STATEMENT: On behalf of the administration, answered questions related to HB 246.

GENE THERRIAULT, Energy Policy and Outreach Director
Alaska Energy Authority (AEA)
Alaska Industrial Development and Export Authority (AIDEA)
Department of Commerce, Community & Economic Development (DCCED)
Anchorage, Alaska

POSITION STATEMENT: On behalf of the administration, answered questions related to HB 246.

ACTION NARRATIVE

[10:09:16 AM](#)

CO-CHAIR BENJAMIN NAGEAK called the House Resources Standing Committee meeting to order at 10:09 a.m. Representatives Tarr, Herron, Johnson, Josephson, Talerico, and Nageak were present at the call to order. Representatives Chenault (alternate) and Seaton arrived as the meeting was in progress.

HB 246-AIDEA: FUNDS; LOANS; PROGRAMS; DIVIDEND

[10:09:54 AM](#)

CO-CHAIR NAGEAK announced that the only order of business would be HOUSE BILL NO. 246, "An Act creating the oil and gas infrastructure development program and the oil and gas infrastructure development fund in the Alaska Industrial Development and Export Authority; relating to the interest rates of the Alaska Industrial Development and Export Authority; relating to the sustainable energy transmission and supply development and Arctic infrastructure development programs of the Alaska Industrial Development and Export Authority; relating to dividends from the Alaska Industrial Development and Export Authority; and adding definitions for 'oil and gas development infrastructure' and 'proven reserves.'"

[10:10:23 AM](#)

CO-CHAIR NAGEAK opened public testimony on HB 246.

[10:10:37 AM](#)

KARA MORIARTY, President/CEO, Alaska Oil & Gas Association (AOGA), testified that AOGA is opposed to HB 246 even though the bill seems like a good idea on the face of it. She said AOGA is a diverse group of members, ranging from producers and explorers to refineries and pipeline companies. Despite the challenges the industry has been facing the past few years, none of AOGA's members has ever voiced concern about a shortage of state loans to weather this downturn. She questioned why state loan programs would be expanded when there is not a clear unmet need.

MS. MORIARTY recounted that AOGA as well as individual active explorers and producers across Alaska have testified repeatedly that the incentives and tax policies Alaska already has are working and doing exactly what they were supposed to be doing. They are accomplishing the very intent set out for HB 246 outlined in the Alaska Industrial Development and Export Authority's (AIDEA's) presentation dated March 16, 2016. For example, a slide in that presentation talks about AIDEA's intent for the bill and the current system is already accomplishing that. The current system is attracting small- and medium-sized companies to Alaska, production has increased from last year to this year, and new fields have come online. The current system is attracting new investment, resulting in more jobs, more production, and even more state revenue than there would have been without that investment. Utilities have testified that

increased investment and production have resulted in short-term energy supply contracts for Southcentral Alaska.

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MS. MORIARITY stated that, when necessary, small producers have secured existing loans from third-party lenders and these third-party [loans] were typically designed to cover the producer's portion of development costs that would be in addition to the amounts funded by the current tax credit laws. Even if more state loans were beneficial for the state, the state would be taking on greater risk about the creditworthiness of borrowers and the soundness of the loans, she posited.

MS. MORIARITY said AOGA believes HB 246 is especially flawed in its [proposed] definition of "proven reserves" under Section 13. She related that the Securities and Exchange Commission (SEC) has spent years developing a definition of "proven reserves" that would work with respect to honest "proven reserves" and that would prevent folks from scamming the public with oil and gas "prospects" with no reserves or without any truly "proven" ones as industry uses that term. This is said without intent to disparage the character or motives of anyone who has been supporting HB 246, she continued, rather AOGA wants to point out that if the definition of "proven reserves" is not right and is not consistent with the Securities and Exchange Commission (SEC), folks could come to Alaska to try to borrow from AIDEA with their own version of "proven reserves" as collateral. If the state is going to make any of these loans at all, AOGA believes the state must use the same definition that the SEC has developed, which would also let the SEC investigate and prosecute suspected abuses which would save the state money because it would not have to hire state inspectors or prosecutors to do it.

MS. MORIARITY concluded her testimony by urging that the state retain its current fiscal system versus creating a new and expanded loan program. Why create a new program when the current system is already achieving the desired results of the proposed oil and gas investment fund, she reiterated.

[10:14:54 AM](#)

REPRESENTATIVE HERRON requested Ms. Moriarity's opinion about whether companies would utilize this legislation if it were to become law.

MS. MORIARTY responded that it is hard to answer until it is known exactly what the terms would be. There could be limits on the loans as well as anything over a certain amount that would require legislative approval, which does not provide a level of certainty for the loan. She said it is too soon to tell, but opined that the current system is working.

[10:15:47 AM](#)

REPRESENTATIVE TARR inquired whether when stating "the current system" Ms. Moriarity is meaning the items that are proposed in HB 247 in addition to this proposed concept of a loan program.

MS. MORIARTY replied that AOGA is saying the state already has a fiscal system in place that is attracting new companies and increasing production. She said AOGA suspects what the state may do is use loans versus the current system of incentive credits and AOGA does not know why the state would replace one with the other when the state already has a system that it knows is achieving the results that it wants.

REPRESENTATIVE TARR noted that AIDEA is currently making loans to oil and gas infrastructure projects. On its own, HB 246 would set aside a fund that could do essentially the same thing that is being done with AIDEA dollars, but just not run into the problem of getting proportionally out of sync with the other sectors that AIDEA is also supporting. She requested Ms. Moriarity to comment on the bill as a stand-alone concept and whether AOGA is opposed to what AIDEA is doing currently by providing oil and gas infrastructure loans or the proposal to have its own fund.

MS. MORIARTY answered that one AOGA member has a small AIDEA loan, but it is not something that has been utilized very often. Most of the time companies are securing loans and private capital, so the AIDEA loan was something that BlueCrest Energy, Inc., decided to do; however, it is not necessarily something that the rest of AOGA's member companies utilize on a frequent basis. The state already has the capacity to offer loans if that is something the industry so desires and AOGA doesn't see how an expanded loan program would be beneficial for the state. Depending on how the bill passes, individual companies would decide what to do. While a few loans are out there now, the majority of AOGA members are not clamoring for more state loans to help them in this downturn.

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REPRESENTATIVE JOSEPHSON related that the administration has indicated for a second year in a row that it may not support an appropriation of the entire amount due on the credit system being talked about by Ms. Moriarity. If that happens and the administration effectively gives an IOU, he asked how that would compare to the level of certainty that AOGA's member organizations are looking for.

MS. MORIARITY replied that that obviously does create a level of uncertainty when investing state money in the industry whether it is through the state's current system of credits or a loan program. Why would the state expand a loan program when it knows the credit system is already achieving the desired results? Obviously [AOGA] would like to have certainty, but [AOGA] is just testifying on the concept. As currently drafted the bill has a very serious fatal flaw and folks may not even apply for loans based on the current definition of proven reserves, because it is not consistent with how companies currently determine their reserves for SEC purposes.

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REPRESENTATIVE TARR observed that page 7, line 17, of the bill talks about the reserves and that page 8, lines 3-4, state, "a process for confirming the existence of proven reserves sufficient to authorize financing". She posited that it does not seem like it would be an insurmountable problem to have those definitions be more in line. Regarding the definition of "proven reserves" on page 8, line 31, she inquired whether Ms. Moriarity could provide the committee with the language that Ms. Moriarity is referring to.

MS. MORIARITY agreed to follow up with the requested information so that it is consistent.

[10:21:42 AM](#)

REPRESENTATIVE CHENAULT, regarding AIDEA's classifications and existing percentages of money in the current pool of dollars available for loans, understood that about 14 percent was loans to either oil and gas support or oil and gas companies. But, he added, he does not know what the loan amounts are. Because [AIDEA] is concerned that it is starting to get heavily weighted into the oil and gas industry, there is apparently some interest in those type loans. It seems this would be more of a tool in a tool belt so that if an industry player decided it wanted to

look for capital this would be another option for them to look at capital. It may not be the best option for the company, but it certainly would be another option. He understood that the folks at AIDEA and the Department of Commerce, Community & Economic Development (DCCED) are concerned about going beyond 14 percent of the pie to one industry. Given today's [low oil prices], he allowed AOGA members are not real interested in going out for loans of any kind unless they are absolutely necessary. He said he is not asking a question of Ms. Moriarity but just stating how he sees what is going on with this proposed loan application.

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REPRESENTATIVE JOHNSON recalled from the bill's first hearing that it is kind of designed as a replacement for the tax credits in anticipation of changes to [Senate Bill] 21 [the current law passed in 2013, Twenty-Eighth Alaska State Legislature. So, he continued, he does not disagree with Ms. Moriarity's assessment that it is off the mark. He understood AOGA's concerns, but said he does not think this would replace the credits that are in the existing program and he is unsure how long the existing program can survive.

[10:25:01 AM](#)

REPRESENTATIVE HERRON referred to the document in the committee packet from AIDEA entitled, "Proposed ways to address concerns expressed on HB 246". He asked whether Ms. Moriarity is aware of this document and specifically Concern 3.

MS. MORIARITY responded that she distributed the document to AOGA's member companies early this morning, but has not yet heard back from anyone so cannot yet speak specifically. Regarding the definition of "proven reserves" in Concern 3, she said the administration's recommendation is still not consistent with what is already currently used. She reiterated that she will provide language to the committee that will be consistent on "proven reserves and will get back to the committee regarding the rest of the document.

[10:26:27 AM](#)

CO-CHAIR NAGEAK ascertained that no one else from the public wished to testify on the bill.

[10:27:07 AM](#)

FRED PARADY, Deputy Commissioner, Office of the Commissioner, Department of Commerce, Community & Economic Development (DCCED), noted he serves on AIDEA's board as designee for the DCCED commissioner. He said the origination of HB 246 came from the AIDEA board meeting where it reviews the "dashboard" of its loan portfolio and the board's concern with overweighting into the oil and gas sector. While [AIDEA] has not reached a firm conclusion as to whether that number is 14, 15, or 20 percent, he advised that it is a concern when 15 percent of a portfolio is in a single sector. The only other portfolio approaching that is mining, which is the Ambler investment dating back 20-plus years and is a stable, long-term income producer to AIDEA. The bill would provide a tool in AIDEA's toolkit irrespective of the tax credit issue.

[10:28:08 AM](#)

GENE THERRIAULT, Energy Policy and Outreach Director, Alaska Energy Authority (AEA), Alaska Industrial Development and Export Authority (AIDEA), Department of Commerce, Community & Economic Development (DCCED), reiterated the concern is that that segment of the pie becomes over-weighted and because oil and gas lending is a little bit riskier it starts to impact the rest of the lending to other sectors. The legislation would not create a new source of lending, but would allow the existing type of lending to continue given the concern that the portfolio may be getting tapped out.

MR. THERRIAULT, in regard to valuation of the reserves, stated that companies may have to adhere to SEC rule when selling stock and ensuring the proper valuing of the company for the purpose of selling stock on the open market. However, he pointed out, what is being proposed in HB 246 is just a means by which AIDEA would internally evaluate the value of a reserve, if those reserves are to be part of the collateral that is offered for a loan. He said AIDEA is open to suggestions for a revised definition that would be potentially acceptable to the companies. He explained that AIDEA tried to come up with a definition that was conservative so as to not place more value on a potential reserve than it should have, the effort is to err on the side of caution.

[10:30:24 AM](#)

REPRESENTATIVE CHENAULT understood, then, that proven reserves would only come into play if the corporation wanted to use that

as collateral for the actual loan versus some other mechanism that the corporation may have, such is above ground equipment.

MR. THERRIAULT answered that there are two issues where reserves would come into play. First, the lending is only supposed to be done for infrastructure to actually bring to market proven reserves. So AIDEA has to know that there is actually a resource there of a size and quantity that can actually go to market. Then, as the lending is being contemplated and AIDEA is trying to collateralize the loan, the main collateral would be the infrastructure itself - the machinery, the value of the gravel pad, the camp, and so forth. Also, a component can be an overriding royalty interest (ORRI) in the reserves themselves. He reminded members about yesterday's conversation regarding over-collateralizing the loan just to be on the conservative side, and said the value of the reserves themselves plus the value of the equipment that is actually being loaned on can be put together to provide good solid collateral for the loan.

[10:32:00 AM](#)

REPRESENTATIVE HERRON referred to the amendment proposed for Concern 3 at the top of page 2 in the document, which states in part: "... the proven reserves shall be reduced by ten percent in calculating the value of the proven reserves" He asked what the magic is about 10 percent.

MR. THERRIAULT replied the 10 percent is a reduction of the estimated volume and then the language that follows that reduction is the calculation of the price that would be applied to that reduced value. This is to err on the conservative side so that more value is not placed on that overriding royalty interest (ORRI) than really could present itself in the future if AIDEA had to call on that as part of the collateral.

[10:33:16 AM](#)

REPRESENTATIVE JOHNSON inquired whether AIDEA would rely on the Alaska Oil and Gas Conservation Commission (AOGCC), or someone else, or AIDEA internally to determine the proven reserves. He surmised that a SEC definition would clearly define proven reserve and so AIDEA would not have to go through that, but if it is not the SEC definition then AIDEA would need some definition to verify the reserve data.

MR. THERRIAULT responded that AIDEA would certainly use the resources of the state - the Division of Oil & Gas and AOGCC.

Also, the bill would allow AIDEA to hire consultants with specific expertise on an as-needed basis.

[10:34:23 AM](#)

REPRESENTATIVE SEATON stated he is concerned about proven reserves and the economics of those proven reserves, because the economics of a project within a portfolio or a company could be advantageous even if the economics as a stand-alone might not be. He said he wants to ensure the definition includes the economics of the project as a stand-alone project unless AIDEA would be getting the collateral of the entire company's portfolio, because it could be a situation of being a long ways away. He recalled that the committee has looked at making sure the gross value at the point of production is not below zero for tax purposes. While that might be a beneficial part of a company's portfolio, that could not stand alone economically if AIDEA were financing 50 percent of a project. He urged that this be worked into the proven reserves portion so it is not just the Alaska North Slope (ANS) West Coast (WC) value of proven reserves. He noted that yesterday AIDEA indicated it would take that into consideration in the redefined definition.

MR. THERRIAULT answered that he has posed the question to the Department of Law and is awaiting a response. He reiterated that the proposed definition would reduce the estimated volume by 10 percent and then the value of the proven reserve would be calculated. He explained how the value would be calculated: right now the price of oil is \$50 per barrel on the West Coast; but, the barrel being talked about is 2,000 feet underground on the North Slope; so, the cost of getting that oil to the surface and transporting it to the market would be deducted when calculating the value of that barrel of oil in the ground in that particular field. So, all of those production costs would be subtracted out.

MR. PARADY pointed out that there is a distinction here: in speaking of proven reserves, it is dealing with a collateralization on evaluation of collateral; the actual decision-making process relative to the loan is embedded in slide 13 [of AIDEA's 3/16/16 presentation titled, "AIDEA Oil and Gas Infrastructure Development Fund HB 246"].

[10:37:30 AM](#)

REPRESENTATIVE JOHNSON, in regard to a worst case scenario of bankruptcy, recalled AIDEA's claim that it had no losses with

Buccaneer because AIDEA got back its \$5 million. But, there was \$3 million in interest that was never paid. The state made out okay but the private sector did not fare so well in that bankruptcy, so at best it was a tie and maybe a loss for the economy. He further recalled AIDEA talking about some kind of surety bond and inquired whether there is any way in this loan process to guarantee that the private sector that is invested in this also has a position that is somehow protected. For example, AIDEA's 700,000 shareholders are part of this and own part of this company and those shareholders got stiffed for \$3 million on the Buccaneer deal. In addition to protecting AIDEA's shareholders, he further asked whether there is a way to protect the people involved when there are loans and those loans are used for vendors.

MR. PARADY replied he does not have that answer at his fingertips, but the AIDEA board has been discussing both the aftermath of the Buccaneer project as well as its own ongoing process where it is working on "Brooks Range". He said he will talk to Mr. Springsteen [AIDEA's executive director] and will provide the committee with a more comprehensive answer at its 5/30/16 meeting.

REPRESENTATIVE JOHNSON pointed out that even if AIDEA has never had a loss on a project, there are still vendors suffering and going out of business and people not being paid.

[10:40:03 AM](#)

REPRESENTATIVE JOSEPHSON referenced Mr. Therriault talking about ORRI, collateralization through infrastructure itself, and proven reserves, and asked whether AIDEA is allowed in the event of default to take "X percentage" of a private landholder's royalty share.

MR. THERRIAULT responded that he believes the collateral AIDEA took in the Mustang project is what is called an overriding royalty interest (ORRI) whereby a percentage of whatever is produced out of that field; when it is produced that value is pledged as collateral. He advised that the state must be careful to avoid actually taking ownership and putting itself in the position of an active participant that is being obligated for capital calls. By taking an ORRI position, the state creates one degree of separation from those active owners and thereby protects itself from capital calls. It also protects the state from becoming part of the stream that has ultimate dismantling, removal, and restoration (DR&R) responsibilities.

REPRESENTATIVE SEATON reiterated his request that AIDEA follow up with the Department of Revenue regarding gross value at point of production less than zero and how that would go into the calculations on eventual loaning on those deals. He reiterated the state needs to ensure it is protecting itself in any loans.

[10:42:40 AM](#)

CO-CHAIR NAGEAK expressed his concern that HB 246 would create another bureaucracy within a certain place that requires more staff, more space, and more everything.

MR. PARADY answered that AIDEA takes very seriously its responsibility to be efficient; for example, between AIDEA and the Alaska Energy Authority (AEA) there are currently 22 unfilled positions. He said AIDEA loans in this sector of the economy out of its revolving loan fund. Essentially HB 246 would set up a fourth fund to which AIDEA could access whatever funds it is capitalized with and continue to loan in this area because AIDEA is [currently] over-weighted. It is envisioned that the loan activity would be absorbed within AIDEA's existing staff. The bill would be switching the potential source of funding from the revolving loan fund to this proposed oil and gas infrastructure development fund. He said AIDEA's mission is supporting development of the Alaskan economy and helping create jobs, and it does project financing and refinancing. Examples of AIDEA successfully helping to grow the Alaska economy include the ship yard, ore terminal in Skagway, and the Ambler road. People come to AIDEA seeking its assistance in this area and in this downturn it would seem that trying to keep small- and mid-sized projects is worthwhile irrespective of the tax credit issue. It is within the umbrella of AIDEA's mission to keep working and it is not an intent to grow a bureaucracy; AIDEA pays for its operations out of its earnings.

REPRESENTATIVE TARR surmised the bill's zero fiscal note is a reflection of AIDEA's ability to do this proposed new fund with existing staff.

MR. PARADY replied yes. He noted that the cost associated with AIDEA's use of a consultant to evaluate a collateral is charged against that loan activity; the cost is not supported by the general fund, it comes out of a specific project.

[10:45:30 AM](#)

CO-CHAIR NAGEAK closed public testimony on HB 246 after ascertaining that no one else wished to testify.

[HB 246 was held over.]

[10:45:51 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 10:46 a.m.