HOUSE FINANCE COMMITTEE
April 21, 2018
1:05 p.m.

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CALL TO ORDER

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Co-Chair Foster called the House Finance Committee meeting to order at 1:05 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Les Gara, Vice-Chair
Representative Jason Grenn
Representative David Guttenberg
Representative Scott Kawasaki
Representative Dan Ortiz (via teleconference)
Representative Lance Pruitt
Representative Steve Thompson
Representative Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Mike Barnhill, Deputy Commissioner, Department of Revenue; Ken Alper, Director, Tax Division, Department of Revenue; Deven Mitchell, Executive Director, Alaska Municipal Bond Bank Authority, Department of Revenue; Emily Nauman, Deputy Director, Legislative Legal Services; Jerry Luckhaupt, Revisor, Legislative Legal Services; Bill Milks, Attorney V, Civil Division, Labor and State Affairs Attorney, Department of Law; Mary Hunter Gramling, Attorney V, Civil Division, Natural Resources, Department of Law; Representative Lora Reinbold; Representative Gary Knopp.

PRESENT VIA TELECONFERENCE

Sheldon Fisher, Commissioner, Department of Revenue; Douglas Goe, Partner, Orrick, Herrington, and Sutcliffe LLP, Portland; Representative Dan Ortiz.

SUMMARY

HB 331 TAX CREDIT CERT. BOND CORP; ROYALTIES

HB 331 was HEARD and HELD in committee for further consideration.

Co-Chair Foster reviewed the agenda for the meeting. He invited testifiers to the table.

#hb331
HOUSE BILL NO. 331

"An Act establishing the Alaska Tax Credit Certificate Bond Corporation; relating to purchases of tax credit certificates; relating to overriding royalty interest agreements; and providing for an effective date."

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SHELDON FISHER, COMMISSIONER, DEPARTMENT OF REVENUE (via teleconference), thanked members for the hearing and for all of their hard work. He relayed that the state had struggled with addressing its financial challenges originating with a substantial drop in oil prices. One of the challenges was that the state could no longer afford to pay its oil and gas tax credits, which had been the prior practice. There was a general sense from the legislature and the administration that the practice was not sustainable. The state currently owed approximately $800 million in credits to companies that had invested in Alaska. The pertinent question was how to address the issue. He reported the administration's proposal [in HB 331] was atypical - it was not an increase in revenue or a spending cut. The bill proposed the use of debt to pay off the credits.

Commissioner Fisher stated that the proposal was slightly unusual as it would use debt and ask credit holders to accept a discount on the credits. The discount would pay off the interest that would accrue on the debt; therefore, the bill was generally cost neutral to the state - it included a very modest benefit to the state. Paying the

credits was important to the state's economy and the oil industry, which had been the source of most of the state's funding. The administration believed the bill would provide an opportunity to put Alaskans back to work, provide an infusion of cash into an industry that was critical to the state, and result in oil production more quickly than expected.

Co-Chair Foster acknowledged Representatives Gary Knopp and Lora Reinbold in the audience. He asked members to hold their questions until the end of the presentation.

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MIKE BARNHILL, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, introduced himself. He introduced the PowerPoint presentation titled "State of Alaska Department of Revenue HB 331: Oil & Gas Tax Credit Bond Proposal" dated April 21, 2018 (copy on file). He highlighted others available for questions. He began on slide 2 and relayed that one of the primary objectives of the bill was to encourage economic stimulus in the oil and gas sector. The uncertainty regarding the tax credits had led to stalled projects and frozen credit. There were a variety of ways of addressing the owed tax credits. The administration supported addressing the credits in a way that directly confronted the uncertainty in the oil and gas sector, particularly when it came to small oil and gas exploration companies. The goal was to get the funds to companies to enable them to payoff loans, begin to make new investment, and hopefully bring new jobs and production to the state.

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Mr. Barnhill turned to slide 3 titled "Bill is Structured to Balance Competing Interests." The administration recognized there were numerous stakeholders involved and its goal was to provide a solution that struck a balance between the various perspectives and objectives. He pointed to the red circle of arrows on slide 3 and reported the administration recognized there were extreme fiscal constraints in the state's budget due to the declining oil price. The bill matched the cost of the debt service in a cost neutral way to expected state cash flows. In the early years there would be relatively small debt service payments and in later years the payments would be higher because the administration anticipated state revenues would increase

going forward. The administration wanted to support small oil and gas exploration firms to produce new production and to get them to redeploy capital into the state's oil and gas basins and encourage projects that had been underway when uncertainty arose regarding the tax credits.

Mr. Barnhill explained that the uncertainty regarding the payment of the tax credits had eroded the state's credibility in terms of a place that welcomes investment in the oil and gas sector. He noted that Alaska competed with other oil and gas basins worldwide and when companies decided where to invest, they considered the credibility of the location and the prospect for return on investment. He pointed to a drawing of a moose on the right side of slide 3, which was meant to remind people that when the state engaged in marketing the oil and gas tax credits (the information dated to 2013), the state had made representations there would be cash in the form of tax credits representing an investment of the state alongside exploring firms and producers. He believed it was helpful to remember there had been expectations in place that would help the companies achieve the state's goals of getting small firms into the state exploring and producing oil in new basins.

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KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, advanced to slide 4 and provided a 15-year history of tax credits in Alaska. He began with 2003 when the legislature passed an exploration incentive credit that was a percentage of exploration cost. At the time, the state still had gross revenue-based tax. The net profits tax was already on the books by the time the Petroleum Production Tax (PPT) legislation passed in 2006. Alongside PPT had been the idea of transferrable credits and credits tied to net operating losses (NOLs) for the first time, as part of the net profits system and to a limited extent, the ability of state repurchase. In 2007, the legislature passed Alaska's Clear and Equitable Share (ACES), which included tax changes and the Oil and Gas Tax Credit Fund. Also, included in the ACES bill was the statutory formula that had been significant topic of conversation in the past several years - establishing that a percentage of the production tax revenue (however defined) should go to the fund annually to purchase the credits. The language had been routinely ignored - the amount appropriated in

beginning in FY 08 and through FY 15 had been open-ended language allowing the purchase of whatever was requested. The language had been sitting in statute since the passage of ACES in 2007.

Mr. Alper continued to review the historical oil and gas tax credit background. He explained that 2010 greatly expanded the scope of credits, primarily due to the Cook Inlet Recovery Act that added the new 40 percent well credit, new applicability of credits, and changed some of the rules, which resulted in giving large credit subsidies for Cook Inlet exploration, primarily targeted at the utility gas (keeping lights on in Southcentral Alaska). Additionally, credits for exploration in the Interior had been increased. The passage of SB 21 had been a major change to the tax system. The bill removed the North Slope capital credit, increased the size of the NOL credit to align with the base tax rate, and added the new per barrel credits that were not cashable but represented a large component of the current tax calculation (the credit was a sliding scale for most production, tied to the price of oil).

Mr. Alper continued that in recent years, as the state entered a fiscal crisis and discovered the tax credit regime was no longer affordable, two major pieces of legislation had passed the legislature that were winding down the program. In 2016, HB 247 was primarily known for eliminating the Cook Inlet credits and locking in a very low tax regime indefinitely in the Cook Inlet area. The bill had also established a seven-year sunset on the new oil benefits called gross value reduction (GVR) that were part of SB 21. In 2017 the legislature had ended the creation of new cashable credits (a cap and end had been applied to the program) - there were still a few trickling in, but there were now a finite number of tax credits that the state needed to contemplate how to monetize and close out. The purpose HB 331 was to close the book on that era of tax credits.

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Mr. Barnhill advanced to slide 5 and addressed the benefits of oil and gas tax credits to date. He detailed that tax credits had been instrumental in resolving gas shortages in the Cook Inlet/Railbelt region. The threat of brown-outs was completely gone, largely due to the tax credits and the

investment the state made in developing gas resources in Cook Inlet. Elsewhere on the North Slope there was potential for new production from new areas including Pikka and Nuna [fields]. He detailed that the opportunities were exciting for Alaska and the purpose of HB 331 was to help secure the potential for new production going forward.

Mr. Barnhill relayed that slide 6 and slide 7 included statistics about the amount the state had spent in tax credits and the result of the expenditure. The state had spent $3.6 billion in total cash purchases through the end of FY 18, $2.5 billion of the total had gone to producing companies. The North Slope had 86 million barrels of oil to date and Cook Inlet had produced 89 million barrels. The bottom of slide 6 showed the outstanding tax credits and their location. The North Slope balance was $514 million, and the non-North Slope was $293 million.

Mr. Barnhill continued that on slide 7, which showed anticipated production related to tax credit investments for the next 10 years. Combining all of the numbers equaled an annual potential of 129 million barrels of oil from the North Slope and 20 million barrels of oil the Cook Inlet region. The intent of the bill was to help secure the state's existing investments in Alaska's oil and gas resources. He reported positive news that the price of oil had reached about $73 per barrel during the current week. The administration wanted the companies currently exploring with the goal of producing to have the ability to take advantage of a rising price environment.

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Mr. Barnhill reviewed how the state arrived at its current situation on slide 8. He reported that until recently, the state had been able to pay all tax credits when presented. He remarked there could be a long discussion on whether it had been the original intention of the legislature or how the legislature intended to pay the credits, but until the price of oil collapsed in 2014 the state paid the credits when presented. In FY 16 there had been a veto that reduced the payment to $500 million. In FY 17 and FY 18 the payment had been set at the Department of Revenue's (DOR) statutory calculation amount. He explained that under AS [43.55] .028 the legislature was called upon to appropriate a certain amount to the oil and gas tax credit fund; the amount appropriated was based on the price of oil. He detailed

that if the price of oil was less than $60 [per barrel], the statutory formula called on the legislature to appropriate 10 percent of the value of the taxes levied under the oil and gas production tax. If the price was higher than $60 [per barrel] the legislature was called upon to appropriate 15 percent of the taxes levied. The administration recognized the statute was subject to appropriation - the legislature could choose to appropriate some, all, or none. He turned to an annual appropriation schedule from the Revenue Sources Book on slide 9 that had been produced by DOR based on the statute.

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Mr. Alper elaborated on the two tables on slide 9. The top table presumed the statutory formula. He noted the asterisk next to the FY 24 number [of $89] implied the actual formula would be more than the number listed, but DOR believed the amount listed was the only amount required to finish paying the credits. The administration was aware of the $807 million owed and an additional $140 million or so working their way through the system. The last credit would be paid in FY 24 if the price forecast held and the legislature appropriated at the statutory schedule in FY 24. He explained that if a lower amount was appropriated, it would impact those relying on the funds and could slow continued exploration and development.

Mr. Alper highlighted that currently, many of the companies could not access additional funds because they were delinquent on existing debts that were in some cases pledged by the expected tax credit payments. There was an alternative way of calculating the formula depending on whether the 10 or 15 percent was taken before or after the application of tax credits against liability. The House's version of the FY 19 operating budget was passed presuming the smaller number in the schedule. He pointed to the table on the bottom of slide 9 and detailed that the appropriation would be much smaller at $40 million or $50 million per year and there would still be $700 million remaining to be paid in FY 24. Under the alternative formula, it would take 15-plus years to pay off the tax credits instead of 6 years.

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Mr. Alper continued to slide 10 that included an example to show how the formula envisioned in HB 331 would be applied. The example used a theoretical company with $100 million in tax credits, $50 million to be issued in 2016 and $50 million to be issued in 2017. The existing regulation scheduled and ranked the credits based on time first; the initial appropriations would pay off the 2016 credits in a pro rata formula first and the 2017 credits second. He explained that the more newer credits a company had, the quicker it would receive its money, whereas later credits would mean the company would receive its money later. The example used a company with both types of credits. The bill envisioned that, presuming the statutory appropriation occurred, a company would receive a certain amount of money per year for several years.

Mr. Alper detailed that the cash flow would be turned into a value based on a net present value type discount rate. The bill contained two different discount rate options. The more advantageous to industry was a rate of approximately 5.1 percent and would be set at the time bonds were issued based on the state's actual interest cost (total interest cost to borrow the money plus 1.5 percent). The state's interest cost was estimated at 3.6 percent. The companies that did not choose to meet the threshold would receive a 10 percent discount rate. He elaborated that the 10 percent rate had been chosen as a midpoint. The administration recognized that the state's cost of capital was somewhat lower at 3 to 5 percent, but many of the companies in question had a cost of capital in the 15 to 17 percent range - they were working in the private equity markets; therefore, the state was offering something better than what they could obtain from the markets, while still advantageous to the state. The 10 percent base rate was hard coded in the bill.

Mr. Alper explained that to qualify for the lower rate the company would have to meet one of four criteria including: agree to an overriding royalty interest, commit to reinvest the money in Alaska, agree to early waiver of confidential seismic data, or have refinery or gas storage credits. He elaborated on the criteria and stated that if the state was going to give a company $90 million, the company had to make a commitment to invest the money in the next two years in oil project capital expenditures. He explained that seismic exploration work was held by the state and released publicly ten years later; if the company agreed to give up

its ten-year exclusive confidential right to the seismic data it would receive the better discount rate. He highlighted that a small number of the credits were for refinery expansion projects. He elaborated that because the refinery projects did not neatly fit into other boxes, the administration decided those companies would automatically come in at the better discount rate. In general, the refinery projects had lead to some type of economic improvement for Alaska. For example, the asphalt plant in North Pole was providing lower priced asphalt to the Department of Transportation and Public Facilities and the state was seeing immediate economic benefits. The discount would be applied to each year of payments starting in the second year. He likened it to a compound interest in reverse.

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Mr. Alper turned to the graph on slide 11 and continued with the theoretical example of a company with $100 million in credits split between 2016 and 2017. He returned to the statutory appropriation and explained that in FY 19 there would be $184 million appropriated. He explained that if there was a company with $50 million out of the approximate $400 million in FY 16 credits, it would stand to receive about $23 million out of the $184 million. Likewise, of the $168 million appropriated in FY 20, the company would receive about $21 million until it was paid in full in FY 23. He was speaking about the column titled "face value."

Mr. Alper continued to address the table on slide 11 and pointed out the columns showing years discounted and discount rates. He explained that starting in year 2, the actual payment was reduced based at the 10 percent or 5.1 percent per year, compounding. The first year the discount would be applied once, the second year it would be applied twice, and so forth. The total effect was shown in the totals at the bottom of each column. He explained that if the theoretical company was able to get the 5.1 percent discount rate, the state would be purchasing its $100 million credits for slightly over $91.5 million. With the 10 percent discount rate the company would receive just under 85 cents on the dollar. He relayed it would be the company's choice subject to its ability to offer something to be deemed eligible to receive the better discount. Participating in the program would cost the company between 8.5 percent and 15 percent of its face value.

Mr. Barnhill commented that every tax credit holder that could potentially participate in the program had received the table shown on slide 11 personalized with their own numbers to see how they would be impacted.

Mr. Alper reported that for the most part the companies had responded positively. He communicated that a substantial majority had expressed interest in participating in the program.

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Mr. Alper explained that slide 12 showed that the same analysis applied if the lower statutory appropriation mechanism was provided. In other words, instead of the $184 million in the coming year, the $41 million was plugged in and applied in the subsequent year. The example showed that rather than paying off the last of the company's credits in FY 23, it would not get paid in full until FY 31. The same $100 million face value would be received, but the discount rates became much more onerous because of the compound interest effect of waiting the additional number or years to which the discount rate was applied. By FY 31, when the company received its last $5 million, after 12 years of discounting its value was only $1.6 million to $2.8 million. He pointed out the discount was dramatic.

Mr. Alper continued that even at the 5.1 percent discount rate, the company would still be losing 27 percent of the face value. At the 10 percent discount it would lose 44 percent of face value. There was a dramatic difference between slides 11 and 12 based on the time factor and presumed appropriation included in the formula. Although there was some ambiguity and debate over what the current statutory formula said, the bill would hardcode the presumption of the larger formula. He detailed that if the bill passed, there would not be a question over how the numbers would be calculated. The bill would not change the statutory appropriation formula, which would remain at the will of the legislature. For the purpose of calculating discount rates, the bill assumed the larger appropriation schedule for the offers.

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Mr. Alper moved to slide 13 and explained that a multi-step process would occur if the bill passed. First, DOR would reach out to the companies to get a binding statement of their intent to participate in the program. The interested credit holders would make an irrevocable commitment. The state needed the commitment in order to know what to borrow from the market. He detailed the state would need to know which companies would participate and which discount rate they would qualify for. The known credits as of January 2018 was $807 million - those credits would qualify first. Based on what portion came in at which discount rate, the total bond issuance would be between $683 million and $738 million plus any financing fees paid to underwriters. The administration's hope was to receive the bond issuance as soon as August 2018.

Mr. Alper explained there were additional pending tax credits not included in the $807 million. The first group included the last NOL credits allowable under law. He noted that HB 111 (passed in 2017) cut the NOL credits off in mid-2017. He elaborated that the 2017 tax returns were currently under review by the tax division and would mostly be issued in July 2018. There were inevitably credits that would trickle in late due to late applications. Other remaining credits included refinery credits that sunset in 2020 and the credit to the Interior gas utility for its primary gas storage tank in Fairbanks. He detailed that if the gas utility work was completed by 2020, it would be possibly the last cashable tax credit to come in. The credits would be eligible for subsequent bond offerings that would be issued in 2019, 2020, and possibly 2021. The bill would sunset after 2021 and the state would no longer have the ability to issue bonds.

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Mr. Alper explained the third step would be to purchase the certificates (slide 14). The 10 percent rate fell in between the state's and companies' cost of capital. The 5.12 percent rate would be pinned down in the last weeks - the exact amount would not be known until the state went to market. Companies would receive the lower rate if they offered any one of four options:

1. Overriding royalty of equivalent value
2. Investment commitment of equivalent value within 24 months

3. Waiver of seismic data confidentiality waiver, or
4. Refinery / gas storage credit

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Mr. Alper discussed that borrowing money cost money. The state would be paying interest to whoever purchased the bonds. However, the interest the state would pay would be less than the discounts received from buying the credits from companies. The idea was that the state would breakeven or make a small amount of money on the relative value between what it gained from the discount and what it got from the interest. There was no specific hardcoding of the bonds in the bill, but the assumed formulas included a ten-year payback where the first two years would be interest only, the debt service would be increased in years three through five, and a flat payment to fully pay off the debt would occur in years six through ten. The rationale behind the assumptions was that DOR saw the state's finances improving in three to four years with the presumption of a percentage of market value and improvements to the overall fiscal situation. The department believed it would be in the state's interest to push some of the larger costs into the later years. Meanwhile, there would be short-term budgetary gains from making the interest only payments in the initial years.

Mr. Alper explained that the smaller subsequent bond issues were structured with a ten-year system as well, but years one through nine would be interest only and a balloon payment would take care of the rest in year ten. He reiterated that the administration was looking for cost equivalency - it was not trying to make money off the backs of the companies, but it was also not looking to pay out of pocket for the debt service.

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Mr. Alper addressed a table showing anticipated cash flow to the state before and after the proposed program (slide 16). The Cohorts 1 through 4 referred to the four bond issues. Cohort 1 was the initial large bond that would take place in the coming fall to pay off the $807 million. The assumption in the table was that everyone would participate and that everyone would receive the more advantageous 5 percent discount rate, which meant the maximum borrowing and maximum payments on the state's part. He noted that the

statutory payment equaled $946 million. He detailed that if the amount was turned into a net present value (meaning the state's time was worth 5 percent per year) it would be about $810 million. Meanwhile, the ten years of payments in Cohort 1 were $27 million in the first two years, $61.6 million in the third year, and $123 million in future years. Cohorts 2 through 4 were smaller and pertained to the last credits that would trickle into the system. The total payments for the first five years were lower than they would be under the statutory formula.

Mr. Alper elaborated that until FY 24 the bond program would have smaller payments than status quo. In the end, the state would pay out slightly less than $1.1 billion, but the present value of that cash flow with the 5 percent discount was $782 million. In present value terms, even if all companies participated and took the most advantageous structure, the state would still gain about $27 million in value versus the status quo.

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Mr. Alper moved to slide 17 and addressed the bill's impact on debt capacity and credit rating. The administration believed the bill's impact on the state's debt capacity would be limited because the existing credits were an obligation of the state that showed up on its balance sheet as a liability. He noted that in some ways, the bill was a restructuring of an existing debt. He explained it was similar to the way the state made Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) payments on behalf of local jurisdictions - it was money owed that the state was buying down. The bill would have a neutral to positive impact on the state's credit rating, indicating a desire and plan to payoff obligations.

Mr. Alper reported that the bill would reduce the FY 19 payment of $184 million (8.1 percent of anticipated UGF revenue) to $27 million in interest payments (1.1 percent of UGF revenue). He elaborated the shift constituted a big short-term improvement to the state's cash flow. He explained that future payments would be flattened in a very advantageous way.

Mr. Alper advanced to slide 18 and continued to address the bill's impact on debt capacity and credit rating. The slide included a table from the Revenue Sources Book showing

fiscal years [FY 18 through FY 27] and associated UGF in addition to existing state debt service obligations for things like general obligation bonds, state supported debt service (e.g. Goose Creek Correctional Center debt), school debt reimbursement, and expected statutory payment into PERS and TRS. He noted that the numbers added up to roughly 20 percent per year of future unrestricted revenue (the first gray column). The next two sets of columns were "either/or" scenarios. The second gray column depicted the statutory tax payments scenario where payments in the next several years would be over 30 percent per year. The third gray column showed the debt service scenario where there would be smaller numbers in the present stepping up to larger numbers in the future. He elaborated there would be a sequence of numbers remaining around 25 percent over the long-term, which would flatten out the state's obligations and push a bit into future years.

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Mr. Alper concluded the presentation with slide 19. The bill was part of the governor's economic stimulus plan. The administration anticipated the bill would result in substantial reinvestment in Alaskan projects nearly immediately, which would lead to jobs and future oil in the pipeline. Small producers had been encouraged to come to Alaska, in part by tax credits. The bill would help unfreeze pending development projects.

Mr. Alper stressed that the great majority of the companies wanted to develop oil and gas they had discovered and were trying to straighten out their finances to do so. The credits needed to be paid off in order for companies to complete their projects. The administration believed the bill would help re-establish Alaska as a premier oil and gas exploration and production basin. The goal was about diversifying the North Slope - bringing new players into Alaska to help provide some competition for the three major companies that had largely dominated oil and gas production for the last 40 years. The ultimate goal was more revenue from production. The secondary benefit was moving the cost of the tax credits into future years that better matched the state's anticipated cash flow.

Co-Chair Foster indicated that he would open up the meeting for questions. Following a question period, the committee

would discuss the constitutionality of the bill. He reviewed the available testifiers.

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Vice-Chair Gara communicated that he had a huge amount of respect for Mr. Alper and Mr. Barnhill, but he was upset by the presenters' testimony about the state losing its credibility (slide 3). He wanted to consider the bill fairly. He stressed that from 2008 to 2015 the state paid much more in tax credits than statutorily required. He believed the state had still paid more than required in subsequent years. He interpreted tax credit statute to specify that the state owed 10 percent of the revenues it took in from production taxes. He believed revenue meant the money the state received, not the money it would have received if it had a 35 percent tax, which was the way the administration interpreted it. In any case and under any circumstances, the state had paid more than required. He was angered by the inference that legislators had somehow risked the state's credibility by paying more than required. He wanted to consider the bill on its merits but did not appreciate that the presentation started out with an accusation.

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Mr. Barnhill responded that the respect the administration had for the legislature was mutual. He clarified that when the administration reported there had been an erosion of the state's credibility it was not an accusation; the administration was merely reporting what it was hearing. He reasoned that it may or may not be fair. All of the events Vice-Chair Gara had articulated about the state going above and beyond were true. He believed the oil and gas industry understood why the payments had been reduced to the statutory level - the price of oil had collapsed and there had been a high degree of fiscal constraints, which had taken the state quite some time to sort through. He believed it was important for all Alaskans to recognize that Alaska was in competition with oil and gas basins worldwide.

Mr. Barnhill elaborated that boards of directors and owners of companies had opportunities to go elsewhere and they compared the relative prospectivity in Alaska with relative prospectivity elsewhere. He continued that two years back

when the state had begun paying less than, there had been a disruption of expectations. He understood the statute said what it said, and the legislature operated accordingly; nevertheless, he believed it was important to understand the expectations were for a higher level of payment. Primarily because there had been various projects under development and close to development and bank loans had been secured on the expectation that the money would be coming faster regardless of the legislature's power to appropriate some, all, or none. He clarified that it was not an accusation, merely the facts. The last thing he wanted was for someone to take offense or consider it was their fault. He stated it was the nature of the beast; there was no fault, it was just the fact. The goal was to find a balanced solution that could work for multiple stakeholders.

Mr. Alper added that in the early years it was not so much that the state had paid more than it had to. In many of the earlier years the state had very large amounts of production tax revenue, upwards of $6 billion per year in a couple of the years. Based on those amounts, the statutory formula would have resulted in a very large number. The department had determined what would have been appropriated had the formula been followed. In the early years, the state would have over-appropriated; it would have resulted in more money in the fund than had been requested by companies. He elaborated that it would have more or less endowed a fund - the department had seen the fund reach up to $700 million in its model.

Mr. Alper continued that starting in about 2013 the state would have been drawing down the fund and buying credits faster than new money would have been put in as the price of oil began to decline. The fund would have hit zero in about FY 15 and the state would have been pretty much in the same place. He believed the issue was in expectation - had the state gone this route, when it arrived at 2016 and later, companies would have understood how the appropriation worked. Whereas instead, companies had developed the expectation the annual budget would be written in an open-ended way. The effect would have been the same, but companies had come to rely on the idea that no matter what, the state would be appropriating to the amount requested, which in retrospect may have been a bit of a mistake.

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Vice-Chair Gara rejected the idea that companies had developed an expectation. He reasoned that of course a company wanted to receive as much as it could get. He believed companies read the statute when they applied for the credits. He stressed that the statutory calculation was 10 percent of the revenues generated from production tax, whereas the calculation used by the administration was 10 percent of money the state would have received if it had a 35 percent tax. He elaborated that statute specified 10 percent of revenue at prices over $60 per barrel. He stated the argument could easily be won in a court. He continued it was a much smaller amount of revenue owed under the statute than shown on slide 16. He would pose additional questions later. He was angered by the presentation.

Mr. Barnhill regretted that Vice-Chair Gara was angry. He communicated that they completely understood the difficulties and recognized there were different and valid interpretations of the statute. The goal was to push through the different interpretations to solve a problem. The problem was not the differing legal interpretations of the statute. The desire was to jump start exploration and production at present and to get the benefit of the state's investments through the oil and tax credit program it had already made, in order to get new production. New production would hopefully result in jobs, new royalties, new taxes, new funding for the state and for the Permanent Fund Dividend program. He did not believe it was necessary to argue the statute, but that it was necessary to solve the problem.

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Representative Ortiz wondered if HB 331 would have negative, positive, or neutral effects on the state's ability to finance an infrastructure package and/or finance the gas pipeline.

DEVEN MITCHELL, EXECUTIVE DIRECTOR, ALASKA MUNICIPAL BOND BANK AUTHORITY, DEPARTMENT OF REVENUE, the legislation had some pros and cons related to debt capacity and credit quality. As shown in the presentation, there was a reamortization of an existing obligation that would provide some budgetary relief. The state had a liability that was being refinanced with a discount on the existing liability

that offset the cost of the extended amortization. At the same time, the state was taking a liability that was "soft," meaning the legislature had greater discretion in choosing amounts it would appropriate for the obligation. There was the potential for an increase in the state's relationship with the oil and gas sector and business in general that the state's word was something other parties could rely on. He believed there could be some positive impacts related to the Alaska Gasline Development Corporation (AGDC) because the bill would demonstrate the state following through on its prior commitments. There would be some impact on the state's debt capacity and ability to fund other projects once the liability became an annual obligation the capital markets would be reliant on.

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Representative Wilson thanked the administration for the bill, which provided an option. She believed it had been well considered. She thought SB 21 had helped increase oil development, but further development had been hampered. She asked how much income the state received in the years the credits were due. She stated that the credits may have been turned in for development that may have been in FY 16, FY 17, and FY 18.

Mr. Alper replied that the great bulk of the credits issued in the calendar year 2016 were for work done in 2015. Companies that filed tax returns in March of 2016 received credits later that year. The work done in 2015, which led to the credits, for the most part had not yet resulted in production. He furthered that the companies hoped to be in production in the next several years. In the North Slope the credits were primarily NOLs, when companies were producing they were most likely not operating at a loss; however, in 2015 the price of oil had been so low, there had been producers operating at a loss. The Cook Inlet credits were largely tied to spending. He cited the 25 percent well lease expenditure credit. There were companies operating and possibly profitable that were earning credits simultaneous with their work. He did not believe he could easily determine the amount of production the 2015 and 2016 spending profiles led to.

2:04:04 PM

Representative Wilson noted they were discussing credits of approximately $800 million. She asked how much revenue the state had received during that same period of time. She assumed the state had received something in terms of oil because production had been incentivized.

Mr. Alper responded that the pending credits associated with 2015 and 2016 were approximately $800 million; the total oil and gas revenue over the two years was $2 billion or $3 billion. He stated it was relatively small historically speaking. He returned to slide 6 and referenced $3.6 billion in cashable credits that had been paid out beginning in FY 07 through the end of FY 18. During the time the $3.6 billion went out the door, a very large amount of oil and gas revenue came into the state. He believed the revenue was in excess of $40 billion. He detailed it had been a time period when the state had larger budgets, bigger capital budgets, and had put down the savings it had been working through over the past four years of the current fiscal crisis.

Representative Wilson stated her understanding that a formula would still be utilized for companies who decided to opt out of the plan. She asked which formula would be used - a lower one or one that many legislators believed they should have been using all along.

Mr. Alper replied that the legislature would appropriate a number. At present, the operating budget was in conference committee and had two different numbers. He conjectured the outcome could be either number or somewhere in between. It was important to structure the legislation so companies that chose not to participate would not be unfairly advantaged by their nonparticipation. He elaborated that if a company was holding a credit that would normally be further back in the line and everyone got out of the line in front of them by joining the program, that the company would not receive more than it otherwise would have had the program not existed.

Mr. Barnhill added that DOR had been in touch with each of the 37 tax credit holders on a fairly regular basis. One of the things the department wanted to know in advance was how many of the 37 tax credit holders were definitely not going to participate in the program. Currently, no one within the group had said they would definitely not participate. The vast majority had communicated they were interested or

likely to participate. The department had communicated to the companies its desire to know definitively in the relatively near future.

2:07:33 PM

Representative Wilson was concerned about Mr. Alper's statements that a company who opted out of the program and waited in line would not get any more than the people who took the program. She believed the point of opting out of the program would be for a company to stay whole. She reasoned if a company waited it should not have to receive a discount to its credits. She stated she would wait until an amendment came before the committee. She asked what the state's yearly payments would be if all companies decided to participate in the program (in comparison with current payments).

Mr. Alper asked if Representative Wilson was asking what the appropriation would be in the absence of the bill. He wondered if she was asking how long the companies would be waiting. He referenced slide 16 and asked if she was referring to the number in the statutory payment column of the table.

Representative Wilson clarified she was asking a different question. She asked how much the state's annual payments would be if it had to bond for $800 million. She wondered if there would still be a balloon payment at the end of nine years and asked if the entire $800 million would be owed at that time.

Mr. Alper pointed to the Cohort 1 column on slide 16, which presumed how to pay off the $807 million if the method included interest only for two years, a fraction of the principal for years three through five, and a balanced payment for the remaining five years. The schedule could easily be restructured to have a flat payment over ten years of whatever the number would be to amortize $807 million. He clarified it was actually $740 million because of the discount. With a flat rate the state would be looking at payments between $105 million and $110 million per year rather than the Cohort 1 schedule that paid less at the beginning and $123 million in the last few years.

Representative Wilson surmised it would be higher than if the state went with the $40 million, which was one of the

ways to look at the credits, versus the $200 million in conference committee. She was trying to ensure the state did not end up in a bind. She asked if the department had talked to the Division of Retirement and Benefits about the amount owed to PERS and TRS. She asked whether the state could be faced with deciding which of the items to fund if oil remained around the current price.

2:10:19 PM

Mr. Barnhill turned to slide 18. The chart showed how the various payment obligations stacked up going forward. He pointed to the column labeled "statutory payment to PERS/TRS" and believed it was what Representative Wilson was referencing with respect to anticipated state assistance payments. The numbers were shown as a percentage of UGF to show the relative burden each of the obligations had. The information in the gray column to the left was pulled from Mr. Mitchell's state debt report. To the right of the column included two scenarios of how the tax credits would be paid in terms of the percentage burden on UGF. Under the status quo, the statutory formula as DOR had interpreted it and published in the Revenue Sources Book, created a lumpy cash outflow profile where the burden increased sharply in the next four years because the payments were in the $170 million to $184 million range. Whereas, the bill proposed a backloaded debt service (shown on the right of the table). The department had taken the anticipated payments for PERS/TRS into consideration. In recognition of that, the administration was proposing a backloaded debt service to better match the anticipated cash outflows and reduce the impact to the General Fund.

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Representative Grenn referenced earlier comments made by Vice-Chair Gara and was reminded of a quote "trust is earned in drops and lost in buckets." He believed that regardless of whatever expectations had been set up in the first years of paying credits back, the state's reputation had been created in the past several years. He believed that reputation, whether right or wrong, was brought into company board rooms and executive sessions. He thought the bill went a long way in helping to correct that reputation. He asked if the department had talked to banks and creditors about the proposals. He wondered what the reaction had been.

Mr. Alper responded that the chart on slide 11 had been sent to all 37 companies. He noted there were companies with credit in the hundreds of thousands and others with credit in the hundreds of millions, meaning there was a widely disparate set of information the department shared. In particular, there were two major banks that had credits assigned to them - there were provisions in statute that allowed the companies to pledge the credit by assigning it to a financer. The tax division would make payments directly to the assignees. He noted that about half of the credits fell into that category. The banks did not get to choose whether a company participated, but they did have significant leverage because many were in forbearance and were delinquent on loans.

Mr. Alper believed banks would be putting pressure on companies to participate. One of the companies, ING, had testified to the House Resources Committee and had communicated its initial goal was to be made whole. He elaborated that ING was owed $100 million, but the company had $140 million in credits. If the state bought the credits at 70 cents on the dollar, ING would be made whole, but that was not their preferred outcome because they wanted their customer to succeed. He continued that ING's hope was for the system to be closed out. Once the loans were made current, ING would be much more comfortable making additional loans to let the companies continue on their work, which was ultimately the goal of the bill.

2:15:41 PM

Representative Grenn asked how many of the 37 companies that fell into Cohort 1 on slide 16.

Mr. Alper replied that the 37 companies held the $807 million. Cohort 1 was the assumption that all $807 million would sell into the bill in round one once the bill was passed.

Representative Grenn asked Mr. Alper to explain what would happen to a company that chose not to participate.

Mr. Alper replied that the amount borrowed in the bonding program would shrink by that amount [to account for a company not participating]. He provided a theoretical example where $100 million chose not to participate. The

$707 million would go through the discounting process and bonds would be purchased. The $100 million would be awaiting appropriation. He explained that if the program passed, the legislature may not ever appropriate money into the tax credit fund again. In that circumstance, the company would be waiting until it got into production - waiting until it had a tax liability to offset the credit against or it would retain the ability to sell its credit to another producer (generally one of the major producers with an ongoing tax liability).

Mr. Alper continued that alternatively, the legislature could appropriate a limited amount to the tax credit fund. He used a scenario where the House passed a budget with a $49 million appropriation included. As the only company that elected not to participate in the HB 331 proposal, the company may expect to receive the entire $49 million. The department did not want to interpret the scenario in that way - DOR felt it would unfairly advantage the company for not participating. Under normal circumstances, the company's share would have been $10 million or $15 million. The state would want to dole that money out over a number of years to treat the company the same as it would have been treated had the bond bill not passed.

Mr. Barnhill returned to slide 11. He indicated that one of the features of the bill, was its requirement for companies to participate with all of their credits. He highlighted the hypothetical company on slide 11 and explained that if it opted not to participate it would receive $23 million in year one (if the legislature made an appropriation). He characterized the scenario as all or nothing. If a company did not participate it ran the risk that it could receive some, all, or none of the payments in years two through five. He explained that the legislature had the legal authority to appropriate some, all, or none according to statute. For that reason, the administration believed companies had evaluated the risks of not participating. At present, no companies had communicated they would not participate.

Representative Grenn asked whether the passage of the bill had the potential to reduce UGF by $150 million (based on the statutory appropriation schedule on slide 9).

Mr. Alper responded in the affirmative but noted there were a couple of assumptions that were necessary to overcome

first. He elaborated that if the statutory appropriation passed it would be $184 million (the number in the Senate's current version of the operating budget in conference committee. Whereas, if the bill passed, it included a $27 million fiscal note for debt service. The $27 million would be added to the budget with the expectation that most or all of the $184 million could be eliminated, which would reduce spend by around $150 million.

2:20:39 PM

Representative Thompson was angered at the thought that the credits had not yet been paid. He remarked that the there had been a real problem where Cook Inlet had been running out of gas. He recalled Anchorage had been preparing for rolling brownouts. The state had been faced with determining how to incentivize bringing more companies to Alaska. The [credits] had worked and Cook Inlet was no longer running out of gas. Simultaneously the state had discovered there was less and less oil coming down the pipe line. He referenced slide 3 showing that the state had been after encouraging new companies to come to the state to do more exploration and locate more oil.

Representative Thompson reiterated that the incentives had been successful. Small companies had found substantial reservoirs of oil that would add 200,000 barrels or more to the pipeline around 2021 to 2023. By not paying the credits, the companies had not been able to borrow money to get the oil into the pipeline. He stressed the importance of fulfilling the state's obligation to pay the credits in order to creat more jobs and put more oil into the line. The revenue would fund schools, highways, and health and social services. He believed everything in the budget was subject to appropriation by the legislature. He thought it was unfortunate that the state had not been able to pay the credits off. He understood that the crash in oil prices had not been anticipated, but he believed denying the money owed to companies was wrong. He underscored that the bill would get the money back into the market and would create jobs. He supported the legislation.

2:23:18 PM

Co-Chair Seaton was disturbed to hear that the state anticipated more revenues going forward and that POMV gave more revenue to pay the credits in the future. He thought

that counting on savings to pay larger bills in the future was not something that should be projected with the bill. He referenced the idea that the 10 or 15 percent production tax that had been voted on would go towards paying credits; however, over 60 percent of all production tax received by the state was going to pay the $184 million. He did not believe anyone had voted to put 60 percent of the tax received in the .028 fund. He stated it was categorically incorrect.

Co-Chair Seaton continued that he had heard several times that the Cook Inlet credits had worked. He pointed out that two things had happened in Cook Inlet simultaneously. The Regulatory Commission of Alaska (RCA) had limited the price charged for gas at about $2.25/mcf. At the same time, the gas producers received $6.58 to $7.50/mcf so they made money. He stressed that no one would have explored for gas, even with tax credits, if the limitation had been $2.25/mcf. He advised members to include the increase in price allowed in regulation when discussing the issue. He stressed it had been a major factor enabling people to explore.

Co-Chair Seaton was amenable to using DOR's interpretation of the statutory tax calculation; however, if some companies chose not to participate, he would emphasize that the alternative calculation should exist at a much lower statutory rate. He addressed reinvestment and remarked that the provision asking a credit holder to agree to an overriding royalty interest made sense [to qualify for a lower rate, the credit holder had to meet one of four provisions (slide 10)] for a company that had an oil project. He surmised the situation did not pertain to a company with seismic data where it could agree to an overriding royalty but would never be producing oil anyway. He hoped the bill would allow a company to agree to an overriding royalty and that the Department of Natural Resources (DNR) and DOR had to approve it made sense. He was trying to determine how the second bullet point "commit to reinvest the money in Alaska" worked.

2:27:57 PM

Co-Chair Seaton continued that he had heard from had heard from the banks that the majority of funds that would go to the oil companies would go to paying off existing bank loans. He stated that the money would not be residing with

the oil companies, but would go towards wiping out their debt. He stated that the companies had been able to get the financing using tax credits as the underlying value. He asked how the commitment to spend the money in Alaska going to work if most of the money would go to repay banks.

Mr. Barnhill regarding companies that had pledged their credits to a bank - their credit was currently frozen. He spoke to a hypothetical situation where a company had assigned its credits, its credit was frozen, and it wanted to access the lower discount rate, the company would submit a qualified plan of capital expenditures to DNR (similar to other programs administered by DNR) and had to make the expenditure in two years in order to qualify. He explained that DNR already had a process to ensure that the expenses were qualified and that they would be made.

Mr. Barnhill elaborated that DOR's understanding from the banks was that unfreezing the current credit situation and uncertainty would enable the company owner to obtain new financing. One of the banks had shared that the credit had not frozen in Texas for as long as it had in Alaska. He detailed there had been work-outs and restructurings, but primarily because of a much different cost structure, Texas, Oklahoma, and elsewhere had been able to clear through the credit issues very quickly to get credit flowing again allowing companies to get credit and drill. He explained it was not the case in Alaska, primarily because the state had a much higher cost structure and due to uncertainty regarding the tax credits. The goal with the bill was to get as much certainty as possible, if a company wanted to access the lower discount rate, that the money would be invested over two years in Alaska.

2:32:05 PM

Co-Chair Seaton asked Mr. Barnhill to follow up with information about the consequence that would occur if a company did not follow through with the plan. He asked if there would be a forfeiture of the lease to the state. He mentioned Norway as an example. He would be more comfortable if there was a commitment [from companies] that the work plan would be followed through.

Mr. Barnhill believed the suggestion was a great idea. He deferred to Mr. Alper for further comment.

Mr. Alper replied that it was not explicit. He elaborated that the bill referred to the term qualified capital expenditures, a term in statute relating to the original 20 percent qualified capital expenditure credit on the North Slope. The type of activity the companies would have to commit to and invest would be upstream capital expenditures (oil field development work). He did not know what the remedies would be if a company made the commitment and later reneged. The department would get back to the committee about the issue.

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Mr. Barnhill addressed Co-Chair Seaton's question about companies that decide not to participate in the program if the bill passed. He restated Co-Chair Seaton's view that the appropriation made for those companies be under the alternative statutory formula, which produced a much lower statutory appropriation should the legislature decide to appropriate. He reported that the idea was not something the administration had considered. He stated the team would need to weigh the pros and cons of the method. From a policy perspective, one of the obvious benefits was that it would help encourage companies on the fence with respect to participating, to participate. He reasoned it would bring certainty to the statutory interpretation. He expounded that with the understanding that the legislature could appropriate some money or none, it may encourage companies to make a certain decision.

Mr. Barnhill moved to Co-Chair Seaton's point about price regulation in Cook Inlet. He had not been aware of the price regulation and appreciated the information. He wanted to present what had happened in Cook Inlet fairly and accurately. With respect to statutory interpretation, the administration recognized the alternate legal arguments. The administration was trying to push through the debate and come up with a solution that would benefit Alaska as a whole. For better or for worse, several years back DOR had come up with the interpretation it had; it had published the interpretation through a series of calculations in the Revenue Sources Book.

Mr. Barnhill addressed Co-Chair Seaton's first question about whether anything the department said assumed that POMV would come into its anticipated cash flow. He turned to slide 18 and explained that the gray column to the left

["Subtotal: Current Obligations without Tax Credits") came out of the DOR debt report. The anticipated UGF came from the Office of Management and Budget's (OMB) cash flow projections and did not include Permanent Fund earnings. There was another chart that Mr. Mitchell had started including on request that showed what would happen if Permanent Fund revenues came into the UGF.

Co-Chair Seaton thought he had heard a statement earlier in the presentation and reasoned that if the statement was not anticipated it should come out of the presentation. Mr. Barnhill responded, "fair enough."

2:37:13 PM

Representative Guttenberg observed that the whole situation was built on actions in the past; however, if the past was not considered, the mistakes would be repeated. He thought the bill was trying to fix things from the past. He stressed that the number of non-Alaskans working in the oil and gas industry was 37 percent and rising. He elaborated that he had been a part of that world for a number of decades and his experience was that companies did not hire Alaskans. He continued that everyone talked about jobs - it was included in the presentation several times; however, he wondered who the jobs were for.

Representative Guttenberg continued that companies on the North Slope had been managing the workforce for 30 to 35 years. He found the situation unacceptable. He planned to discuss the issue further when the committee talked about the relationship between the bonds and the industry. He referred to the comment that was made about Texas' cost structure versus Alaska's cost structure. He believed the issue was only relevant in that the system had stabilized in Texas more quickly. He underscored that Texas was a different world from Alaska in terms of lease owners. He continued there were thousands of lease owners in Texas, whereas the state was the leaseholder in Alaska.

Representative Guttenberg remarked that the bill only looked at "us and paying off the tax credit holders." He asked about the state and its borrowing capacity and its relationship with paying off loans. He spoke to all of the conditions the state had and the variables between "everything hitting the fan and being able to pay them off

sooner." He asked if there would be a presentation about that as well.

Mr. Barnhill addressed the issue of Alaskans not being hired or losing jobs at a quicker rate in the oil and gas industry. He stated it had been a problem the state had struggled with from the beginning. He elaborated that the state had taken laws that require Alaska-hire to the U.S. Supreme Court; the court had ruled it was very difficult to enforce local-hire preferences. Nevertheless, every gubernatorial administration since 1977 had some initiative to try to encourage, coerce, or cajole the industry into hiring more Alaskans. The issue had been and always would be a concern. He acknowledged and validated Representative Guttenberg's concern and relayed the concern was shared by everyone. The bill tried to provide a solution that would enable the industry to hire more Alaskans. The administration would do everything it could within the boundaries of U.S. constitutional law to make sure it happened.

Mr. Barnhill stated he would pass on the comment regarding the Texas cost structure. He had merely been passing on a comment provided by one of the banks involved regarding its observation about the differences between Alaska and Texas. The issue was leading the state to come up with a solution that would hopefully put Alaska, Texas, and other oil and gas basins on more equal footing when it came to companies' decisions about whether and where to invest. He asked Representative Guttenberg to rephrase his question pertaining to future presentations.

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Representative Guttenberg stated that the committee had been talking about paying off the tax credit holders. He asked about the state's relationship with the bond market. He spoke to the state's liability it would or would not be able to pay off. He asked about other risks.

Mr. Barnhill answered that HB 331 was a proposed restructuring of an existing obligation of approximately $800 million. He explained that the obligation would still exist if the bill passed and debt was issued. The reason the administration had proposed of a backloaded debt service structure was to get at Representative Guttenberg's concern related to the risk the state would not pay or

would have difficulty in paying the obligation. Based on DOR's anticipated cash flow, the risk would be reduced by matching the obligations and cash flows related to all state obligations to the state's anticipated cash flow. He acknowledged that it did not take all of the risk away. The administration was trying to craft a solution based on the best information available in a way that poses the least risk possible to the state going forward, while still accomplishing the objective of jump starting the particular oil and gas industry sector.

Representative Guttenberg appreciated Mr. Barnhill's comments about the local hire, the U.S. constitution, and the commerce clause. He stated it was well established and was the law, but it was not the problem. He explained that if the state was using General Fund dollars on a project, it asked the company to hire more Alaskans, because it was paid for with Alaskan dollars. He was interested in knowing about the areas outside the commerce clause. In some cases, the state had incentives built into statute. He asked if "this is outside of that or is this similar?" He stressed the need to hire students from the state's engineering schools, apprentice and trade programs, and others. He underscored that currently over $500 million in payroll was leaving the state according to the Department of Labor and Workforce Development. He explained the state had an inherent vested interest in a part of the economy that it was not capturing. He thought the state should be able to do it in a way that was neutral for others.

2:46:02 PM

Mr. Alper thought Representative Guttenberg was asking that if the state was going to give a company the additional advantage of the lower discount rate, whether it could encourage companies to the extent legally possible to hire Alaskans. He was prepared to work with Representative Guttenberg to try to find a way to address something within the language of the bill. He stated that it was a judgement call - companies would be applying for a lower discount rate and the DOR commissioner was determining it was in the best interest of the state. He speculated that perhaps something could be addressed in the language. There were always the legal limitations of trying to force [Alaskan hire]. He was prepared to help in any way within the department's powers to provide comfort in the bill.

Representative Guttenberg commented that Co-Chair Seaton had asked about reinvesting in Alaska. He stated the legislature did not have any oversight over a plan submitted by the industry or qualified expenditure information. He wondered how to deal with a situation where a company qualified but the terms were more favorable to the company than to the state. He cited a theoretical example where the company wanted to do wellhead work, but the state wanted increased development and production. He asked how the state would have any command over what qualified as a qualified expenditure.

Mr. Alper referred back to a table on slide 11 showing the side-by-side comparison of the two discount rates for a theoretical producer. The company would receive $85 million without the reinvestment commitment and slightly less than $92 million with the reinvestment commitment. Under the current version of the bill, if a company showed intent to spend $92 million in upstream development work in the next two years, it would receive the $92 million. In the absence of the commitment it would receive $85 million. The great bulk of the companies were non-producers that currently did not have much, if any production. The companies with production were looking to greatly expand that production. The department had not contemplated a restriction on what sort of expenditure, other than the requirement to meet the definition of qualified capital expenditure (upstream oil and gas development work). A capital expenditure met a federal depreciation standard. He did not think there was significant risk of companies trying to work around that by doing maintenance work, given the nature of the companies involved. He thought perhaps companies would offer additional information during public testimony.

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Representative Pruitt referred to slide 4. He clarified that in 2013 the per-barrel credit that had replaced the capital credit was part of the tax and did not actually add to the taxable credits currently owed by the state. He thought the bullet point could be confusing.

Mr. Alper explained that the old ACES regime had the capital credit, which was eligible for cash repurchase. Although it had generally been used by major producers to reduce the tax calculation and the credit had not typically been paid to the majors. He explained that the per barrel

credit was never cashable; it could be used to offset a company's taxes in the current year but could not be carried forward, transferred, or cashed.

Representative Pruitt referred to slide 7 regarding the amount of production that had come from the current credits. He stated that certain investment had come from the credits that had not yet been booked; therefore, it could not be included in the projected information. He asked for the accuracy of his statements.

Mr. Alper replied that it was difficult to discuss specifics because of taxpayer confidentiality. He used Caelus as an example because the company had publicly talked about tax credits it was owed. He detailed that Caelus was a producer and had an operating field in Oooguruk it had purchased from Pioneer.

Mr. Alper moved to slide 6, which listed 86 million barrels of oil [on the North Slope] in existing production. The presentation included the production profile for a similar field and what it would be expected to produce in the next ten years. The 106 million [barrels] on slide 7 was the continuing production from currently producing fields that were related in some way to previous year tax credits. The 23 million barrels listed in the second bullet point was the production from fields that received tax credits thus far and that initial production was expected in the next few years. He noted it was a small number that was expected to grow dramatically in the future. He cited Armstrong's Pikka field as an example. He continued that they could be talking about many millions of barrels years into the future; some of that production would start to be seen in the outyears of the ten-year production forecast.

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Representative Pruitt returned to slide 10 and asked about the various options that would enable a company to receive the lower discount rate. He requested additional detail about the overriding royalty interest. He mentioned seismic data. He wondered if the state would be able to receive the state would receive the interest presently or in five years.

Mr. Alper replied that Section 11 of the bill was a DNR section and created a process by which a company would

offer and negotiate an overriding royalty interest with DNR. He explained that a company would communicate it was prepared to offer "x" amount (e.g. an extra 1 or 2 percent) on the particular leases for a given period of time (e.g. ten years). Under the bill, DNR would come up with a present value based on the additional revenue it anticipated to come to the state and the associated risk that the revenue would come to fruition. He turned to slide 11 and expounded that DNR would look at the increment the company was asking for. Under the theoretical scenario on slide 11, the producer would get an extra $7 million (the difference between the lower and the higher discount rates). If the company believed the additional value of what was being offered from the state was greater than $7 million, it would agree to the overriding royalty interest.

Representative Pruitt asked about the seismic data bullet point on slide 10.

Mr. Alper answered that if a company received credit for doing seismic work, it submitted the information to DNR where it was kept in a library and published after a ten-year period. He explained that the publication was perhaps used by other companies to invest in leases nearby. He noted that in 2017 there had been items in the news where ten-year old seismic data was publicly released. He explained that the company had the 10 years exclusive rights, but the state was in possession of the data for its own planning purposes and scheduling lease sales. To qualify for the lower discount rate under the bill a company would give up its exclusive right and the state would have the ability to publish the seismic data immediately.

2:56:44 PM

Representative Pruitt referenced the commitment for a company to reinvest the money in Alaska (slide 10). He believed the goal appeared to be moving the 37 companies into utilizing the credits. He provided a hypothetical scenario where 36 companies decided to use the option offered under HB 331, meaning there was 1 remaining company the state was still paying under the minimum. He believed that company may have a bonus and benefit the other companies did not receive. He continued that the legislature would not appropriate up to the gross or net. He reasoned the one company could receive a windfall and

everyone else "playing good" did not. He suggested including a provision specifying that if a company did not participate, the state would pay out as if the pro rata was still in place. Therefore, if a company was supposed to get a small portion of the amount, it would still receive the same amount. He asked if the administration would be amenable to the idea.

Mr. Barnhill indicated that Representative Parish had asked the same question in the House Resources Committee. He believed the change would be beneficial and the department had prepared the amendment to submit at the appropriate time.

Representative Pruitt addressed the cohort debt service payment scenarios on slide 16. He believed he understood why Cohorts 2 through 4 used interest only initially and a balloon payment at the end. He thought the balloon payment had been scheduled to occur after Cohort 1 had been paid off. He pointed out that the first payment for Cohort 1 was around $27 million. He noted that the Senate had been amenable to pay $181 [million] for FY 19, whereas the House had included $47 million. He recognized the current fiscal situation and did not want to push something off to an unknown.

Representative Pruitt believed Mr. Alper had stated earlier that the forecast for additional oil and gas revenue due to increased throughput made DOR comfortable that there would be increased revenue in the future. He believed it had been separate from a conversation about a POMV. He reasoned that the future was still unknown. He asked why the particular system with interest and a low payment in the beginning had been decided upon in Cohort 1. He asked if there had been another mechanism that would allow the state to pay an amount it was already comfortable paying in the current year, which would mean a less substantial burden in outyears.

Mr. Barnhill responded that there was an infinite number of ways to model debt financing. The model on slide 16 had been developed to match debt service to anticipated UGF revenue. One legitimate criticism of the structure was when any debt service was backloaded, it meant increased financing costs over time. The way to counter that was to flatten or frontload the debt service profile, which saved on financing costs and may reduce risk slightly in terms of

the coupon the state had to pay in order to market the loans. The administration was striving for what it believed was an optimal balancing based on the variety of competing concerns; however, it recognized there may be other optimals for debt service including a flatter payment schedule.

Mr. Barnhill communicated that DOR had prepared a model to review different scenarios of debt service and had provided the model to the Legislative Finance Division earlier in the session. He offered to go through the model with members outside of the meeting. Ultimately, the goal for the net present value line on the table was for cashflows under statute versus cash flows under debt service roughly penciled out in order to maintain a cost neutral approach.

Mr. Barnhill agreed there were a variety of ways to reach that goal and the administration recognized that some committee members would be more comfortable with a flatter or front-loaded debt service schedule. Ultimately, the discretion to structure the debt service fell within the authority of the directors of the state tax credit bond corporation. He elaborated those directors of the state bond committee included the commissioners of DOR, the Department of Administration, and the Department of Commerce, Community and Economic Development. The administration was willing to engage in discussion to try to find some optimal approach that worked.

Co-Chair Foster noted he anticipated a minimum of three meetings on the topic.

3:04:05 PM

Representative Pruitt remarked that over the past few years he and the administration had disagreed on the past, but he appreciated that the administration had brought the bill forward. He reasoned that whatever happened in the past regarding the reason for the tax credits and the agreement behind them, no longer mattered. He stated that what mattered was the money was owed and it was impacting how the state was viewed in international markets. He thanked the administration for developing the bill, which he believed was one of the most important things the state could do to get back on stable footing.

Representative Kawasaki commented that he had been in the legislature through ACES, the Cook Inlet Recovery Act, and several iterations of tax bills. He had never felt the state would be in a position where it would be giving out more in credits than it was receiving in production tax. He also appreciated that the administration had brought a proposal forward, but he believed there was a difference of opinion about what the state should do. He noted that the committee had heard much about how the bond would work, but not about how the bill would work. He asked if a review of how the bill would work would be provided at a later time.

Mr. Alper replied that the administration had submitted a sectional analysis that he could review at any time. He explained there were four components of the bill. Initially, the bond corporation was created and had various rights and responsibilities in how reserve funds were established, funds passed through, and credits were purchased. Second, there were numerous technical changes to existing tax credit statutes to clarify that the bill option was in addition to the existing system, which would remain in place as an option for companies that chose not to participate. Third, there were specific procedures about how a company would engage in the program; how it would offer its credits; how the state would value the credits and determine a company's anticipated cash flow in the absence of the program; what a company's proration would be if the statutory appropriation occurred; what a company's cashflow would be; how to discount the cashflow; and how a company would get higher or lower of the variable discount rate.

Mr. Alper explained that Section 10 of the bill included all of the nuts and bolts of the new program. The fourth part of the bill was the overriding royalty interest - the process to negotiate a value with DNR and to find it acceptable. He could provide greater detail when he reviewed the sectional.

Co-Chair Foster relayed the committee would move to constitutional questions and would take up a more detailed sectional analysis at the next bill hearing.

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Representative Kawasaki provided a scenario where a company agreed to reinvest a given amount of money in the state and

qualified for the 10 percent discount rate, but then found itself in default. He asked if the state would be out the money.

Mr. Alper replied there was not currently a remedy in the bill. He detailed that DOR would work internally and with DNR to determine whether a remedy could be added. Under the theoretical scenario on slide 11 the state would be out $7 million. The hypothetical company would have received the lower discount - it had received an extra $7 million by promising to reinvest the money. The department would follow up on what the options for state recourse may be if the company reneged on its agreement.

Representative Kawasaki noted that the bill addressed how debt was assumed and that it would still be subject to appropriation. He asked how it would work. He wondered how it would work to have a subject to appropriation statute, while having a debt to bond holders. He asked if it was similar to the statute specifying the state owed a particular amount to producers.

Mr. Barnhill answered that Section 2 of the bill was the authority to create the corporation that would issue the debt. The language in the section was almost entirely taken from statute pertaining to the Alaska Pension Obligation Bond Corporation. In both cases the corporations had the ability to statutorily issue subject to appropriation debt.

Mr. Barnhill explained the corporations were not authorized to issue debt that would bind the state's appropriation power or to issue "big D" constitutional debt that pledges the full faith and credit of the state. He underscored it was an extremely important distinction that would be discussed by attorneys later. When the state issued debt that pledges the full faith and credit of the state it constitutionally required approval from the legislature and the people. The pledge was functionally a transfer of appropriation power to the court system. He expounded it was the only situation he was aware of in the state's constitutional system where the courts took over for the legislature in terms of being able to appropriate. He summarized that if the state issued general obligation debt and bound the state with a pledge of the full faith and credit and the legislature refused to appropriate debt service, the court system could step in and order the debt

service; the courts would override the legislature's appropriation power.

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Mr. Barnhill elaborated that debt that was short of that, the legislature at all times maintained its ability to appropriate what it chose (just like under the tax credit program). He read from page 4, line 15, subsection (g) of the bill:

> To ensure the maintenance of the required debt service reserve in the reserve fund, the legislature may appropriate annually to the corporation for deposit in the fund...

Mr. Barnhill pointed to page 4, lines 22 and 23:

> Nothing in this subsection creates a debt or liability of the state.

Mr. Barnhill noted bond counsel was available for questions. The administration believed the obligation in the bill would be subject to appropriation.

Co-Chair Foster noted they would get into the issue more later.

Mr. Mitchell spoke to the nature of the subject to appropriation commitment. Currently, if the legislature chose not to appropriate for the obligation there would be a further degradation of the relationship with the state's primary industry. If the legislation passed, bonds were issued, and the legislature chose not to appropriate, there would be credit action taken against the state and a loss of access to capital markets. There would be negative ramifications in either case - both may impact the state's credit quality. From his perspective it was more of a bright line when it came to any consideration of taking on a capital market obligation secured by the state's subject to appropriation commitment as a term of art within the industry, which is one notch. He elaborated that if the state was AA, it was an AA- credit rating. He explained it was a very high pledge of the state organization to make the payments into the future. He believed the distinction was important.

Representative Kawasaki remarked that there would be discussion about the constitutionality later on. He stated that the payments would be subject to appropriation under the bill. He compared the situation to not paying a personal credit card. He reasoned he would receive a huge interest rate spike and the bank could take other belongings. Once the state committed to the concept it would be committing to a particular schedule of payments.

Mr. Mitchell agreed there would be a schedule of payments. He also agreed there would be no recourse. He explained that in the event of a default on a signature loan there was not much recourse for the lender other than to ding a person's credit score and perhaps limit their access to additional loans. He explained it was comparable to what would happen to the state if it defaulted on an obligation contemplated in the legislation.

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Representative Kawasaki asked how much more the state could be obligated at the present time with its current rating.

Mr. Mitchell answered there was gradation to the answer. In the instance of the credits there was an existing liability the state had historically been paying at a certain level. As demonstrated in the percentages of UGF revenue, there was some benefit to the restructuring of the obligation; however, it became a hard liability that would be included in the state's net tax supported debt, rather than an operating obligation of the state. The debt proposed in the bill would have some impact on the state's debt capacity. He shared that the debt affordability analysis for the current year, which relied on the historical definition of UGF revenue (no POMV or Permanent Fund income), estimated the debt capacity in the $300 million to $400 million range. He explained that because the bill dealt with an existing obligation, the administration argued that it would not have a one-for-one type of impact on capacity. He estimated it at the $200 million range. He characterized it as an art rather than a specific science.

Mr. Mitchell explained that when the department had worked with the rating agencies with the Pension Obligation Bond Corporation's issuance, which had been proposed at $2.2 billion, it would more than double the state's debt commitments. There had been no rating action by Fitch or

Moody's. He noted that S&P had expressed some concern about the size of the increase in net tax supported debt and had discussed a one-notch rating adjustment to the state as a result of the issuance. He stated there was an impact, but if the debt had all been new money for general obligation bonds to build a dream list of capital projects, all three agencies would have downgraded the state's rating and probably by more than a notch.

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Representative Tilton asked about the 5.1 percent discount rate and the confidence level in the state's ability to do that in the current environment.

Mr. Barnhill answered that the department had been in constant communication with underwriters about the rates the state may be able to access. The department had used a true interest cost rate of 3.26 percent, which remained a good rate. Rates had ticked up a bit lately, but for various reasons, including the possibility that some of the bonds could be issued on a tax-exempt basis, DOR believed 3.26 percent was a good estimate. He reiterated that the department remained in close contact with underwriters who provided a good idea of rates.

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Vice-Chair Gara believed the credits were a real obligation the state needed to pay. The question was whether the state could come up with an affordable way to pay - the governor had proposed HB 331. He was not keen on coming up with new ways for the state to spend money. He stated there was still something on the books that he found concerning. He used a scenario where the current bill proposal turned out to be unconstitutional, meaning the state would have to come up with a new way to pay the credits. Under the current plan if the state paid $35 million to $40 million per year at oil prices of $60 per barrel, the state would still owe $500 million in ten years. He agreed that was not the best way forward. He was not enthusiastic about adopting the bill and maintaining every way to pay off the credits on the books. He commented on the unconstitutionality of the bill's method. He highlighted the option for any company with profits to pay 60 cents on the dollar and receive a 100 percent deduction off the taxes paid. He asked for detail on the option.

Mr. Barnhill was gratified and humbled that there had been some success in convincing people of the problem that needed to be solved. He had done his own research and was absolutely persuaded that the approach was constitutional and that the state had issued subject to appropriation debt for decades. He was also persuaded that the constitutional framers knew what they were doing when they adopted a debt restriction in the constitution pertaining to debt pledging the full faith and credit of the state. He hoped they could move forward with the proposal given the late date. Additionally, it would be discouraging for his team to start anew. He hoped to move forward and set the minds of legislators and the public at rest that the bill was a legal and standard way of restructuring obligations. He deferred to Mr. Alper for additional detail.

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Mr. Alper answered it was important to recognize there were three different ways to monetize or get value for the tax credit. The cashing out by the state subject to appropriation was always number three - it had been the last one added and just happened to be the one that dominated the system for much of recent history. The initial option had been to offset a company's own taxes - a company could earn a credit and reduce its taxes if it had a tax liability. He elaborated that if a company did not have a tax liability, but it anticipated one within several years, it may be in the company's best interest to hold the credits. Vice-Chair Gara's question was about the transferability of credits. For example, if a company was holding a $10 million tax credit, a major oil company with a tax liability could purchase and use the credit against its tax liability. The transfer of credits did not happen much for a number of years, but they were starting to happen again. It was important to recognize it was a market transaction - someone would buy the credits for whatever they could, and someone was going to sell them for as much as they could. In 2006 and 2007 there was talk the credits were selling for 70 cents on the dollar - he did not know how much truth there was to that. He remarked it was that and anxiety over the number being too low and unfair to explorers that created the idea of state repurchase at 100 percent.

Mr. Alper continued that when the state had been buying the credits there had been no need for a secondary market. In recent years when there may have been a secondary market, the market did not develop, primarily due to a lack of ability to use the credits. Under current law, it was not possible to use purchased credits to go below the floor. When the price of oil had been $40 per barrel, the major producers had been paying at the floor and had no ability to purchase the credits. He elaborated that if the major producers had offered to buy the credits, they would have offered a relatively deep discount because they could not use them immediately - they would have been buying the credits on the hope that two or three years later the price of oil would recover and they could then use the credits. He mentioned a temporary circumstance related to the Trans-Alaska Pipeline System (TAPS) settlement where some of the major producers owed past year liabilities because of a settlement that reduced the tariff (transportation cost) in 2011 through 2013. The department believed companies would buy some credits to offset additional tax liability in the past.

Mr. Alper explained that prior to the passage of HB 111 in 2017 allowing the use of credits going back in time had not been allowed. He continued that oil prices had increased into the $70 per barrel range. He explained that if a major producer's tax would be $200 million above the minimum tax, they would be in the market for $200 million in tax credits. He believed that if the company could buy the credits - he used 60 percent for $120 million, the companies would leap at the option. The company selling it would want closer to $190 million. The administration hoped that putting the offer on the table where it would buy credits at 85 cents to 90 cents on the dollar, would put a floor under the secondary market. No one would be selling to producers for 60 cents if the state was offering 85 cents. The state was in some ways protecting the explorers from the possibility that the market price would be too low.

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Mr. Alper continued to answer that in the absence of the bill, some explorers would get more desperate - some were closer to bankruptcy than others and would be looking to cash out for whatever they could. He elaborated that if there was a limited demand and several hundred million

dollars of supply, the market price would be low, and people would be selling credits for a much lower price. He believed the solution to the weak secondary market was passing HB 331.

Vice-Chair Gara asked if the bill option were to disappear off the books, whether the other option would remain. Under that scenario, if oil was at $80 per barrel, the state could see $200 million worth of deductions from the oil production tax at a time when the state was in a fiscal crisis. He was concerned about adding another way to pay tax credits and leaving all the other existing options on the books. He was concerned about the potential of paying 60 cents on the dollar and charging the state a dollar on the dollar.

Mr. Alper responded that many of the conversations had taken place the preceding year when HB 111 had been debated. One of the concerns the state and legislature had was about multibillion dollar investment projects that under the old system would be leading to billions of dollars in tax credit - additional obligation that the state could not afford and may never be able to afford. He believed he had stated that if the obligations were out there and there was a $150 per barrel oil spike for one year, the state may not see any revenue because the major producers would be scooping up all of the tax credits to offset them. That program had been ended and the state was no longer producing new tax credits. He concluded that to the extent there was a problem, the problem of companies offsetting their taxes with purchased tax credits was temporary.

Mr. Alper detailed that he would be anxious about eliminating the ability to sell the credits for two separate reasons. First, companies selling the credits may need the money and if they did not have the ability to use them and did not have the appropriation to monetize them, it could drive them into bankruptcy. In certain circumstances, even selling at a discount might be advantageous to bankruptcy. The state could set a minimum price and implement restrictions, but it could not legally force anyone to purchase another company's tax credits. Second, the tax credits were sometimes pledged as collateral. He detailed that someone would lend money against the tax credit or to a company and would be promised the tax credit. In those circumstances, if there

was a default, the tax credits could change hands without the state having any voice in the matter. He would not want to encumber that transaction because it may prevent a company from being able to borrow the money in the first place.

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Representative Wilson asked for verification that the credits were had been earned by companies that invested billions in Alaska, hired Alaskans, and produced oil that funded government. Mr. Barnhill replied in the affirmative.

Representative Wilson surmised that the credits were like a refund check for companies that had already done the work. Mr. Barnhill answered in the affirmative.

Representative Wilson stated that the companies had done the work the state had asked and previously the state had given the refund when it came due. She reasoned that the state was putting more obligations on companies despite the fact they companies fulfilled their end of the deal. She asked for the accuracy of her statement.

Mr. Barnhill asked for verification that Representative Wilson was referring to the discount the state was asking companies to take on the face value of their tax credits.

Representative Wilson stressed the issue was not only about asking the companies to take less for the work they had done. She explained the bill would implement four new obligations on the companies in order to qualify for a lower discount rate [slide 10]. She reasoned that not only would companies be asked to take a discount, they would be asked to fulfill additional requirements to receive the discounted money.

Mr. Barnhill affirmed that the bill asked companies to take a discount to participate in the program. The goal of the legislation was to craft a fair balance between state interests and oil and gas tax credit holder interests. The flip side was without the program and the ability to pay in the current year, the companies would have to wait. He explained that waiting involved a time value of money calculation. He elaborated if the state paid companies in two to four years from the present, the value of the dollar would be less in the future than at present. The goal was

to produce a payment to companies in the present that was worth more than a payment in two to four years' time. He continued that the administration was aiming for a solution the companies would see as fair and that would be cost neutral or a slight benefit to the state.

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Representative Wilson had been in favor of looking at the discount portion - she could see that under the higher or lower discount, everyone would not get paid immediately. She was concerned about adding requirements for credits a company had already earned. She wanted to ensure the public realized that companies had held up to their end of the deal. She referenced the conversation about including a provision on Alaskan-hire. She believed in Alaskan-hire, but it was an additional obligation to the credits and for a company to move up on the payment list order. She wanted to be careful about the requirement. She pointed out that the commercial fishing industry was made up of something like 70 percent out-of-state workers. She did not believe it was fair to constantly talk about that the oil and gas industry was not hiring enough Alaskans, while not making the same argument about other industries. She wanted the public to understand that the state had already benefitted from the oil industry in the past. She remarked that it had led to years with higher capital and unfortunately higher operating budgets as well. She wanted to be careful not to put more obligations on industry that had held up its own.

Representative Pruitt asked for clarification about the amount of credits compared to what the state's production tax would be. He thought the Revenue Sources Book projection with the governor's numbers would be around 45 percent of production tax.

Mr. Alper answered that the larger number may have been an FY 18 number - he would need to follow up. He agreed that under the FY 19 forecast, the number was about 45 percent. He detailed that $184 million (the state's determination of the statutory number owed) was a percentage of $410 million (the production tax forecast for FY 19). He concluded the number was roughly 40 to 45 percent.

Representative Pruitt believed it was an important clarification. He added the state received royalty and corporate income tax as well.

Co-Chair Foster moved to the constitutionality portion of the meeting. He relayed the committee had received a legal opinion from Legislative Legal Services and an opinion from the Attorney General's Office. He asked Legislative Legal Services to address the committee.

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AT EASE

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RECONVENED

Co-Chair Foster referenced a Legislative Legal Services document dated April 13, 2018.

EMILY NAUMAN, DEPUTY DIRECTOR, LEGISLATIVE LEGAL SERVICES, noted the agency had authored more than one legal opinion. She asked for the author of the memorandum Co-Chair Foster was referring to.

3:42:08 PM
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RECONVENED

Co-Chair Foster referenced an April 13, 2018 memorandum to Co-Chair Seaton [authored by Emily Nauman] from Legislative Legal Services (copy on file).

Ms. Nauman introduced herself.

JERRY LUCKHAUPT, REVISOR, LEGISLATIVE LEGAL SERVICES, explained that the agency's purpose was to identify issues and concerns to help the legislature when it made decisions. The agency's concern with HB 331 was based on the financial provisions of the state's constitution including the dedicated funds clause, the general obligation debt provisions of Article IX, Section 8, and other debt provisions in Sections 10 and 11. The agency's concern was also based on the discussions of the constitutional framers at the time of the provisions had been created and the reasons they sided for the provisions. Additionally, the concern was based on the decisions of the Alaska Supreme Court. He detailed there were six or seven supreme court decisions that touched on the provisions and

the state was still feeling out what the sections of the constitution all mean. There had been discussion and litigation over the years about what the provisions mean. The agency's concern was also based on the past actions, prior acts, session laws, and bills passed by the legislature in comparison to what HB 331 would do.

Mr. Luckhaupt shared that the agency's big concern was that the approach in the legislation appeared to be different than the approach the legislature had taken in the past to authorize debt. While the bill appeared to be modeled after the pension obligation bonds approved nine or ten years in the past (none of which had been issued), the approach [in HB 331] was slightly different. The past approach involved pension obligation bonds - the state was going to issue the bonds and through arbitrage and funding the state's costs would have been decreased slightly. The bonds would have been backed by contracts that the Pension Obligation Bond Corporation would enter into with municipalities and the state to repay the bonds. The agency's concern [with HB 331] was the only possible repayment seemed to be the appropriations the legislature would make to the corporation by itself.

Mr. Luckhaupt returned to Article IX, Section 8 of the state's constitution specified that no state debt shall be contracted unless authorized by law and ratified by a majority of the voters. At the time of the constitution it had been limited to capital improvements. The provision had been successfully amended once with regards to housing for veterans. He noted that in 2017 the people voted down a proposal to allow the issuance of general obligation debt for student scholarships. There had also been other past proposals to allow general obligation debt. He explained that general obligation debt allowed someone to come after the assets of the state - a debtor could use the court system to seize property of the state to fulfill the debt.

Mr. Luckhaupt continued that Article IX, Section 10 dealt with interim borrowing and specified that the state could borrow all of the money it needed to as long as it was repaid by the next fiscal year. The language was to cover situations where receipts coming in had not been sufficient to meet payments going out and where balancing out was needed.

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Mr. Luckhaupt stated that [Article IX] Section 11 was listed in the constitution as exceptions. The section dealt with restrictions on contracting debt. Article IX, Section 8 specified that no state debts shall be contracted. The same language was used under exceptions - the restrictions on contracting debt did not apply to debt incurred by a public corporation or enterprise of the state or a political subdivision of the state where the only security for the debt was the revenues of the corporation or the enterprise.

Mr. Luckhaupt noted that political subdivisions were also included, but that was not important for the purpose of the current conversation. Legislative Legal Services was concerned that the provision specified the only security for the debt was the revenues of the public corporation. In the past with pension obligation bonds there had been contracts, but nothing had ever been done. In prior years when former Governor Walter Hickel had bought the "spam can" building [in downtown Juneau] and the prison, at the time the state had certificates of participation and lease purchases. The Carr v. Gottstein case had made its way to the Alaska Supreme Court - the court had ruled that leased purchase agreements were not debt under the constitution. Prior to Carr v. Gottstein, the supreme court, in the Chefornak case [Village of Chefornak v. Hooper Bay Construction, 1988] specified that constitutional debt was debt evidenced by paper (bonds or other notes) providing for the repayment of money. He concluded that the bill would issue bonds, which appeared to be constitutional debt.

Ms. Nauman provided more specifics. She believed the administration would rely on the finding in Carr v. Gottstein that simply because a bond was subject to appropriation that it did not equal debt under the constitution. She stated that Carr v. Gottstein did not open and close the issue. She detailed that the case had been about a lease purchase, which had been distinguished from bonds in several places. There were multiple cases in Alaska that specifically used bonds as an example of constitutional debt. She continued that bonds were discussed explicitly in the constitutional convention minutes and within the constitution, which specified the restrictions on debt did not apply to the issuance of revenue bonds. It appeared to her that bonds were a

different type of instrument - a borrowing of money - and there was not a case that resoundingly provided a solution to the problem.

Ms. Nauman continued there were many other states that had come down indicating subject to appropriation bonds were not part of borrowing limits. Alaska's constitution was written with the knowledge of that, which was acknowledged in the constitutional convention minutes. She believed the government's authority was rooted in the constitution and she had not found anything in the constitution specifying bond debt was permitted. She was not willing to say that the subject to appropriation debt was not permissible. She explained that her memorandum specified that the issue was a big question mark for her. She did not have any tools or case law providing ultimate clarity. She wished she could provide the clarity, but she did not have it to give.

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Mr. Luckhaupt continued that Alaska's constitution was different and had been drafted in the 1950s - it had been completed before Alaska's statehood. He explained the drafters had looked to the issues taking place in other states and did not want some of the issues that had occurred, especially back East, where states had multiple dedicated funds and money was tied up going to the state transportation commission (or something) and there was no money for other state services. Most states allowed dedicated funds, but Alaska did not. He elaborated that most states had limits on the amount of debt they could have at a given time. For example, 1, 2, or 5 percent of their assessed valuation. He explained that Hawaii had drafted its constitution at the same time as Alaska and had included a monetary limit on the amount of debt it could have. Alaska's drafters had decided to limit what the state could have general obligation debt for and had specifically provided an exception for debt from public corporations and enterprises that were secured by their revenues. He believed it implied that the public corporations and enterprises had some revenues of their own. He relayed it was what the state had in the past.

Vice-Chair Gara remarked on all of the hours spent on the opinions provided by Legislative Legal Services and the Attorney General's Office. He provided a scenario where the answer did not become clear to the committee after hearing

all of the testimony. He asked if there was a way to include something that would get an expedited supreme court review of the question, so it would not linger for many years.

Mr. Luckhaupt answered that unfortunately there was not a provision in the state's constitution allowing the state to seek advisory opinions from the supreme court. The provisions existed in a number of other states, but not in Alaska.

Vice-Chair Gara asked for confirmation there was nothing the legislature could include in the bill that would get a quicker review. He asked for verification that it would still be up to the court under the rules the court followed for accepting a case for review.

Mr. Luckhaupt did not believe anything of that nature would be successful. Some of the issues as approached over the years had gone to the supreme court - it was part of the process of a young state to discover what the provisions of the constitution meant. The drafters could not have envisioned every scenario that would arise in the future. He mentioned a situation where someone brought up a declaratory judgement action. He referenced the past Meyers v. State case pertaining to tobacco bonds. He detailed that a person concerned about the issue had brought a law suit and alleged the state could not issue the tobacco bonds it had issued at the time.

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Representative Wilson asked if retirement bonds would fall under the same issue as the bonds in the proposed legislation.

Ms. Nauman answered that she had not been asked specifically to look into pension obligation bonds and she was not an expert in that area. She clarified that her legal opinion was limited to HB 331. It was her understanding there was some sort of revenue intended for the corporation, which was the distinguishing characteristic.

Mr. Luckhaupt elaborated that the distinguishing characteristic [of the pension obligation bonds] was a plan for contracts with the corporation, contracting with the

Department of Administration or other to issue the bonds and receive payments in the future, which would have been appropriations. The contracts would also be entered into with municipalities. In exchange, in theory, there would be a lower amount they would have to pay in the future as the bonds were issued the state would explore the arbitrage and make some money. That language was different than the HB 331 language.

Representative Wilson she surmised that with the pension obligation bonds or the particular retirement and benefits corporation, money went to the corporation because people pay into retirement. She did not believe there would be revenue going into the corporation under HB 331 with exception to the $800 million. She inferred there would be no revenue going into the corporation to help pay for it.

Ms. Nauman agreed. She referred to her memorandum, which discussed the classic definition of revenue bonds (the phrase revenue bonds was used under Section 11 of the state's constitution) pertained to capital projects where a state corporation was established to build a bridge bonds for the funds to build the bridge relies on the tolls of the bridge to repay the bonds. She imagined it was the thought of the framers when they had included the language in the constitution.

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Representative Pruitt used the University as a real-life example. He asked if the University was able to spend money without appropriation by the legislature.

Mr. Luckhaupt answered that the legislature appropriated the money to the University in its budget. The University had some funds the legislature had appropriated into that the University was then able to spend without further appropriation, including some bonds the University had issued.

Representative Pruitt referenced the $37.5 million the University had put into the University of Alaska - Fairbanks engineering building. He did not recall that a general obligation bond had been voted on allowing the University to use the funds on the building. He asked if Mr. Luckhaupt was indicating the University had money available to pay for the building. Alternatively, he

wondered if the University would not have the ability to pay the bond back unless the legislature appropriated the money (even though it was in a block grant that would include UGF, certain DGF such as tuition).

Mr. Luckhaupt answered that the legislature had to appropriate every year because of the state's dedicated funds clause. He explained it was slightly different than the idea [in HB 331] of appropriating for bonds. The University is a public corporation of the state with revenues of its own. The fact the state had to appropriate to the University just like it appropriated to other state departments was not relevant. He underscored that the state could not have dedicated funds except for those that existed at statehood or for those required as participation in a federal program. That funding occurred annually. However, to actually provide that the only revenue of a public corporation was the appropriations of the legislature from regular tax revenues, it would be the portion of the Legislative Legal Services opinion that talked about what revenues were, the general tax revenues of the state would be the only revenue provided to the corporation. Other public corporations and enterprises had their own revenues. The University had its own revenues including the endowment and tuition. The fact that the University relied on a General Fund appropriation because those revenues were not sufficient to pay all of the services of the University, was not relevant in his mind to the corporation that would be created by HB 331.

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Mr. Luckhaupt provided an example pertaining to state-issued sport fisheries bonds. He detailed the issue had been identified as a public enterprise of the state. He elaborated that the enterprise brought in revenues - a special fee had been added to every sport fishing license to increase sport fishing opportunities around the state. He explained they had been financed through a series of bonds. He cited the Knik Arm bridge project as another example. He detailed that the bridge would have tolls, but the tolls were not projected to cover the entire cost of the bonds. He elaborated that the legislature had provided Knik Arm with substantial funds for the project to spend as it needed. He continued that an Anchorage parking garage had been created as a public enterprise of the state and had its own revenues being used to pay back the bonds.

Representative Pruitt provided a scenario where he went to the bond market to get a bond. He stated the payment would be based on "x" revenues such as the cost of parking or other. He thought that because the state could not dedicate funds it meant that the state did not have the ability to bond for almost anything it had bonded for. He reasoned that if it was not allowable to dedicate parking fees to the parking garage, the bond would not be a revenue bond and an appropriation would be required. He thought the scenario violated what Mr. Luckhaupt had highlighted - the state could not do revenue bonds if it meant the legislature had to appropriate for them.

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Mr. Luckhaupt answered that he would have to look at the bonds again. He had looked at some of the bonds in the past and the state had identified that revenue would be provided and subject to appropriation because it had to be subject to appropriation under Alaska's constitution. The person who chose to purchase the bonds had to decide whether they were secured enough. He was referring to the language in the state's constitution that talked about that a public corporation or enterprise may issue revenue bonds, which was not considered debt of the state; it was not debt covered by the constitution - it was an exception if the sole security for the debt came from revenues of the public corporation. In the past the legislature had tried to structure the issued debt instruments to have an identifiable revenue source that was different than the general tax revenues of the state. The crux of the issue for Legislative Legal Services was that in the case of HB 331 it did not appear there was a revenue source other than general tax revenues of the state.

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Representative Pruitt spoke to his concern about the argument by Legislative Legal Services. He stated that the argument had the potential to tear down a large portion of the way the state currently managed its debt. He referenced the argument that bonding had to go before voters or it had to be revenue from a corporation. He cited the University's $300 million and explained the University had not specified that revenues it received would go to particular items. He stated items had been backed based on the faith and credit

of the state to continue appropriating to the University. He asked if Legislative Legal Services was concerned that it was changing the way the state would manage debt and would prevent the state from operating the way it had in the past.

Mr. Luckhaupt replied that he did have concerns with some of the state's existing debt. The situation was not unique. He remarked that the bill took the issue further and the legal opinion had taken the issue further than concerns raised by the agency in the past. The agency's job was to advise the legislature on the constitution and about concerns that may be in a bill. The agency believed the bill was different than previous iterations of debt. The agency had identified what it believed was a distinguishing factor based on the language of the constitution. He stated that the constitutional framers had put the information in to avoid obligating the state's full faith and credit.

Ms. Nauman elaborated that if all of the revenues were subject to appropriation it would mean that any of the debt under discussion would be outside of the constitution. She had to believe the constitutional provisions meant something and were there to operate as a restriction in some way on the state's ability to act. She believed it was necessary to read the two sections together. She was not sure what the resolution was; there was not a specific case or article of the constitution that provided the answer.

Co-Chair Foster asked to hear from the administration.

Representative Pruitt wanted to understand why the issue was arising now if the practice had been done for seventy years. He stated that no one had ever challenged the practice in court. He surmised that perhaps it was the goal to have the supreme court to make a ruling to eliminate the ambiguity. He stated that the issue had not been brought up in the past and it had been practiced in some capacity. He believed Legislative Legal Services was arguing that the practice had not been used in the past. He wondered why the issue arose at this point in time.

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Ms. Nauman agreed that the question had not been answered. She noted that Alaska was a relatively new state. She did not know what legal opinions had been given with other

bills that may have proposed a structure similar to HB 331. She had been told by the administration that it had looked into the issue and had resolved it. She stated that until she saw a case or some language that definitively provided the answer - it may be a supreme court case - she could not advise it was a certainty.

Representative Pruitt believed that if Alaska did not have precedent through case law it should be reviewing cases from other states. He thought 32 states used subject to appropriation as well. There was case law in some states and he believed they had largely ruled in favor of the concept under discussion.

Ms. Nauman answered in the affirmative. She had reviewed other states and confirmed that a majority of the states, but not all, had fallen on the other side of the issue. She added that Alaska's constitution was fundamentally different than most of the other states.

Mr. Luckhaupt added that the state's supreme court had looked at other similar issues. The progression had started with DeArmond [DeArmond v. Alaska State Development Corporation, 1962] where bonds had been issued by the Alaska State Development Corporation. Someone had sued and claimed the bonds were illegal in Alaska. The bonds had only been secured by the revenues of the Alaska State Development Corporation. He elaborated that the corporation had been issuing loans to businesses and the loans were repaid to the state. The supreme court had ruled the practice did not constitute general obligation debt and was allowed under Article IX, Section 11 of the state's constitution. Then came the Walker v. Alaska State Mortgage Association [1966] case, which preceded Alaska Housing Finance Corporation (AHFC) and the Alaska State Housing Authority (ASHA) (the two entities had merged into AHFC). Another example was the Meyers v. AHFC case, where someone has sued because of the tobacco bonds. The state had received a lump sum payment in a settlement; the Alaska Supreme Court had ruled it had not been the general tax revenues of the state being pledged or given to the public corporation. There had been no dedicated funds clause problem. He continued that the public corporation had received a sum of money from the state in annual payments for the lawsuit settlement and the public corporation had then issued bonds. In that case, the court ruled that the

bonds had been issued by a public corporation with its own revenues.

Mr. Luckhaupt communicated there had been decisions over time, but Legislative Legal Services believed the bill was different than what had been looked at in the past where there had been some attempt to identify a revenue source. He shared that the Legislative Legal Services opinion did not go beyond the requestor unless that person shared it someone else. It was his 29th session and he had written myriad opinions over the years and the majority had not gone beyond legislative offices. He stated it did not mean that the legal opinion that had been shared was something new or that the agency was trying to do something to the bill. The only reason the agency was discussing its opinion with the committee was due to someone's decision to release it.

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Mr. Luckhaupt shared that the agency did not have an answer or a case on point. Other states' constitutions were different than Alaska's. The agency could not say that because of action in another state such as Indiana that it would be constitutional in Alaska. He stated that the language in Alaska's constitution had been adopted by a different group and in the case of Pennsylvania, it had been adopted almost 80 years after Pennsylvania's constitution.

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Co-Chair Foster invited the administration to the table. He listed documents including a memorandum from Mr. Mitchell to DOR Commissioner Sheldon Fisher dated April 16, 2018, a letter from the Department of Law (DOL) and Mr. Mitchell and to Senator Cathy Giessel dated March 2, 2018, a document on frequently asked questions of DOR, and a press release by the Department of Law (copies on file).

Vice-Chair Gara appreciated the document from DOL. He did not anticipate leaving the room with ultimate clarity on who was right.

BILL MILKS, ATTORNEY V, CIVIL DIVISION, LABOR AND STATE AFFAIRS ATTORNEY, DEPARTMENT OF LAW, introduced himself.

MARY HUNTER GRAMLING, ATTORNEY V, CIVIL DIVISION, NATURAL RESOURCES, DEPARTMENT OF LAW, introduced herself.

DOUGLAS GOE, PARTNER, ORRICK, PORTLAND (via teleconference), stated that he was online.

Co-Chair Foster asked if Greg Blonde and Leslie Krusen [additional Orrick bond counsel] were online with Mr. Goe. Mr. Goe believed they were online at different locations.

Mr. Milks shared how DOL had viewed constitutional debt for quite some time. He referenced the words subject to appropriation, which had been used throughout the hearing. The bonds proposed in the bill were subject to appropriation bonds, not general obligation bonds. As the department understood the Alaska constitution and Alaska caselaw it was the point where the road divided. Under the state's constitution there was constitutional debt (general obligation debt) in Article IX, Section 8 that was limited for certain purposes and required voter approval because it pledged the full faith and resources of the state.

Mr. Milks explained that regardless of whether or not the legislature wanted to appropriate money or had appropriated money to pay general obligation bonds, the bonds must be paid, and the court could direct that the money come out of the state treasury. Whereas, the debt in HB 331 was subject to appropriation. He believed it almost immediately became apparent to him that HB 331 did not include constitutional debt because it was an important obligation; however, if someone purchased a subject to appropriation bond and the issuer did not make a debt payment, unlike a general obligation bond where the court would order payment, if the purchaser went to court the court would rule that the bond specified it was subject to appropriation. He explained the point had been the key dividing line for DOL for a long time.

Mr. Milks referenced the discussion about legal cases and relayed that DOL believed a key case was Carr v. Gottstein. He explained that the case addressed whether debt was always debt. He stated that constitutional debt was a term of art that describes an obligation involving borrowing. He

clarified that the term did not describe what the specific financial instrument may have been that created an obligation involving borrowing. He elaborated that constitutional debt was an obligation involving borrowing where there was a promise to pay in the future whether funds were available or not. The department believed it was the lynchpin of the analysis. The bill dealt with subject to appropriation bonds and the legislature would retain its power to appropriate the debt service on the bonds. The bonds would be important obligations as testified to by Mr. Mitchell; however, the current discussion dealt with a limited and specific legal question. He furthered that because the bonds in HB 331 were subject to appropriation, it had led DOL to determine the bill was proper and legal. Additionally, the department had worked with bond counsel on the bill, which had led DOL to the view that HB 311 was almost identical to pension obligation bond statutes written ten years back.

Mr. Milks reiterated that the issue was subject to appropriation. He continued that the Mr. Mitchell could explain that when a general obligation bond was purchased the purchaser understood that the court could order the payment (the discretion was gone from the legislature in that case), but the purchaser received slightly less interest than it would on subject to appropriation bonds.

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Mr. Milks continued that there had been substantial experience in Alaska with subject to appropriation bonds. The department's view was the constitution identified constitutional debt as full faith and credit debt. Even during the period the framers had written the constitution (prior to statehood), the territory had been issuing revenue bonds backed up by subject to appropriation debt (the territorial legislature's annual appropriation). The department believed the bonds in HB 331 were lawful.

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Mr. Milks relayed he would ask bond counsel to provide a broader national perspective. He reported that subject to appropriation bonds were sold regularly from all states and municipalities; the purchasers made assessments on their interest in the bonds. He addressed the opinion from Legislative Legal Services that was not saying the bonds

were unconstitutional, but the agency was not prepared to say they were constitutional. He noted that DOL had already presented the bill to the Senate Resources Committee and when the department had learned of the memo it had vocalized its view that the bonds were lawful and constitutional. He detailed that if the bill passed and bonds were issued, DOL would have to issue an opinion. He referenced the pension bonds that had been proposed a couple of years earlier would have been backed by the annual appropriation of the legislature to the Pension Bond Corporation. He elaborated that the state (not the municipality) would have been responsible for refinancing its pension debt. He stated that prior mention of a contract was not really applicable.

Mr. Milks continued that DOL had to certify that it believed the bonds were lawful. Additionally, bond counsel had to independently look at Alaska law and had to certify the bonds were lawful. He stated that subject to appropriation was a fundamental constitutional principal. He referenced an earlier conversation about the tax credits. He elaborated there was a statutory appropriation and some disagreement between the two legislative houses about how much to appropriate. He agreed that the funds were subject to appropriation. He reported DOL had a big case in the past year that challenged a statutory payment program and the Alaska Supreme Court had ruled subject to appropriation. The department believed that once subject to appropriation was included, it dealt with a core constitutional principal.

Mr. Milks referenced a question by Vice-Chair Gara asking whether a provision could be inserted in the bill if there was enough concern about the legality of the bonds. He agreed that a provision could be inserted. He shared that a colleague had pointed out a provision in the Alaska Gasline Inducement Act (AGIA) AS 42.90.420. In DOL's view it did not create a problem for the court because it was not being asked to issue an advisory opinion. He continued that it set a specific statute of limitations; the timeframe had been set at 90 days under AGIA and it was not unusual for states issuing bonds to put a 60-day or 30-day limit so when the entity that may issue the bonds issued public notice to issue bonds, there was a statutory provision that tried to provide information in the event of a potential challenge.

Mr. Milks asked Mr. Goe would weigh in on how the state's bond counsel looked at Alaska's authority to issue bonds and how the nation looked at subject to appropriation bonds.

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Mr. Goe introduced himself as a partner and vice chair of public finance for Orrick, Herrington & Sutcliffe LLP (Orrick); the firm served as State of Alaska bond counsel. He detailed that without the firm's unqualified opinion on bonds, Wall Street would not purchase the bonds. Wall Street required an unqualified opinion of bond counsel. The bonds were legal, valid, and binding obligations. Additionally, if the bonds were tax exempt they were also exempt from federal income tax. The firm was privileged to be the leading bond counsel firm nationally; by dollar volume sometimes the firm was twice the next leading firm.

Mr. Goe outlined that Orrick had worked closely with Mr. Milks and DOL in examining the memorandums and constitutional deliberations prior to Article IX, Section 8 being put in the state's constitution. The firm and DOL had also carefully reviewed the Alaska caselaw on the issues. The firm had concluded that the Carr v. Gottstein case was the determinative case on the issue; it was also consistent with the majority of cases that had considered the question around the country. One of the more recent cases on the subject was a 2003 case of the New Jersey Supreme Court. In the Carr v. Gottstein case, the Alaska Supreme Court was with the majority of courts in holding that debt subject to appropriation is not constitutional debt. He detailed that the specific type of debt limits applied in constitutions and sometimes applied in statute and voter approved city, borough, or county charters. The question that that always arose was what debt meant when there was a debt limitation.

Mr. Goe identified that there were two broad exceptions noted in caselaw and legislative counsel had noted one of those, which was what was sometimes called the revenue bonds exception reflected in Article IX, Section 11 of Alaska's constitution. He continued that sometimes in state law it was also referred to as the special fund doctrine, where there was a source of revenues or special fund that was the payment (not general tax revenues); therefore, it did not constitute debt.

Mr. Goe detailed that the other major exception was subject to appropriation debt. As had been noted, the supreme courts, under a very broad range of state constitutions, had determined that debt subject to appropriation was not constitutional debt. He noted that subject to appropriation was not subject to statutory limitations or a charter debt limit if it was the applicable limitation being considered by the court. The firm earned its reputation on giving unqualified opinions, which it took very seriously before being prepared to deliver. Based on existing Alaska Supreme Court precedent, Orrick was comfortable that HB 331 was constitutional. He continued that if the bill was enacted assuming the opinion of DOL and customary things, the firm expected to be able to render its opinion to the state and the bond market that the bonds would be valid and binding obligations of the tax credit bond corporation and would not be debts of the state. He was available to answer any questions.

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Mr. Mitchell noted that he was not an attorney, but he worked in the municipal bond market on a regular basis. He referenced examples given earlier about the University, the potential Knik Arm crossing toll revenue bond structure, the Goose Creek Correctional Center lease revenue bonds, the Alaska Native Tribal Health Consortium's residential housing building, the Anchorage jail, the Seward Spring Creek Correctional facility, and the Juneau court plaza building. He underscored that the revenue pledged for all of the examples had only been derived from state appropriation in some way. He emphasized that no other revenues had existed. He stated it was the same thing contemplated by HB 331. He referenced the discussion about the Pension Obligation Bond Corporation. He detailed that because the corporation had the ability to enter into contracts with municipal employers for the purpose of funding unfunded liability it may be liable. He stressed that the only employer with an unfunded liability that would benefit was the state based on make whole payments the state had or the limits at 22 percent or 12.5 percent of payroll within the two systems [PERS and TRS respectively]; the state was the only obligated party.

Mr. Mitchell continued that the same could be done with the HB 331 proposal. He explained that the bill could direct the holders of the tax credits assign them to the

corporation. He explained it was the same thing - the money would be coming from the General Fund "no matter how you slice it." He did not believe the arguments made earlier in the meeting meshed well. He understood the concern and that the language was not a hard declaration that there was an issue with the constitution. He stated that the declaration alone in the bond world caused concern. From his perspective, the dissenting opinion [from Legislative Legal Services] was troubling because in the event bond counsel provided an unqualified opinion and the bond purchase moved forward, the purchaser may ask to be paid more.

Mr. Mitchell believed that based on past practices of the state and the laws, the issue had been interpreted and defined prior to statehood. He elaborated that the bonds had to be approved by the legislature, which had not always been the case. In the past, when ASHA had issued lease revenue bonds the state supported through lease payments it had not required legislative approval. State law had been tightened up since those early years. Up until the Wildwood Correctional facility had been financed, the state could issue COPs [certificate of participation] for real property for up to $5 million. He explained it had been cut to generally zero because the administration at the time had gotten clever and had done a $4.9 million COP to acquire the land and a $4.9 million COP to improve the land. The legislature had been heavily involved in regulating the financial tool since statehood.

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Representative Guttenberg corrected that the opinion from Legislative Legal Services was not a dissenting opinion. He remarked the state had separation of powers. He did not believe Orrick would have the ability to issue an unqualified opinion without pointing out that the legislative attorneys had a difference of opinion. He reasoned in one way or another it would cost more money or hold the process up until clarity came from the courts. He asked if his assessment was accurate.

Mr. Milks answered that the legislature had the opinion from Legislative Legal Services staff and DOL had provided analysis to the Senate Resources Committee. Attorney General Lindemuth intended to issue a formal attorney general opinion on the topic of subject to appropriation bonds.

Mr. Goe restated his understanding of the question. The firm took all facts and circumstances into account when delivering its opinion. The firm would certainly prefer that there not be a legislative legal opinion out there. He referenced Mr. Mitchell's comment about whether the opinion would be a cost to the state because the state had an obligation to disclose all material facts. He believed it would be the case. Whether the legislative opinion would impact Orrick's ability to deliver its opinion remained to be seen. If the attorney general issued a formal legal opinion on the case it would aid Orrick in the ability to deliver an unqualified legal opinion. He believed there could still be a cost to the state of the legislative counsel opinion because under federal securities laws the state may have an obligation to disclose the existence of the opinion and the state may incur higher interest costs. He believed that if Orrick and DOL stepped up and delivered their opinions, the bond market would still accept the opinions and buy the bonds.

Representative Guttenberg referenced Vice-Chair Gara's question about an expedited hearing. He noted that existed for redistricting issues. He asked if the administration was free to ask the courts for a declaratory judgement in the case of HB 331. He asked if there was some process to go forward.

Mr. Milks answered that in response to a question by Vice-Chair Gara, Assistant Attorney General Gramling had identified a specific statute of limitations provision in AGIA. Some other states had a similar provision for bond bills to try to get a quick opinion. He clarified that the state was not looking for litigation and DOL intended to go forward with a formal attorney general opinion.

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Representative Grenn read from page 2, lines 19 through 22 of the bill:

> The bonds do not constitute a general obligation of the state and are not state debt within the meaning of art. IX, sec. 8, Constitution of the State of Alaska. Authorization by the voters of the state or the legislature is not required.

Representative Grenn asked about the importance of the language. Additionally, he inquired about exceptions in Article 11.

Mr. Milks answered that the language in the bill was important to clarify that the bonds were subject to appropriation. When the bonds were marketed and bought in the future the language made it clear they were not general obligation bonds of the State of Alaska. Article IX, Section 11 was an exception to Section 8 (Section 8 dealt with constitutional debt - full faith and credit debt). Permitted constitutional debt included general obligation bond debt and public corporation revenue bonds. He continued that subject to appropriation bonds were not full faith and credit - no one could go to court (unlike a full faith and credit bond) and obtain a judicial order to pay debt service. He referenced page 4, line 16 of the bill that included the statement that the "legislature may appropriate." He clarified that the [subject to appropriation] were still important obligations. The department was addressing the narrow issue of how it saw the issue of constitutional debt.

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Representative Pruitt referenced testimony by Legislative Legal Services that Alaska had a different state constitution than other states. He asked how different Alaska's constitution was from other states in terms of obligations. He thought it was fascinating that New Jersey had used the Carr v. Gottstein case from Alaska. He understood that it did not necessarily mean something from New Jersey would fit into Alaska's framework. He asked if there were enough similarities with other states to help in discussions if the particular issue went to court in Alaska.

Mr. Goe replied in the affirmative. He believed other states were instructive in terms of using it. Other state constitutions varied - the common denominator among all constitutions was the use of the term "debt." The question became how one interpreted the term debt. For example, he considered whether housing loans for veterans was an exception. Additionally, capital improvements were commonly seen related to state debt limits. He explained that the relevant question for the conversation at hand was what

debt meant for constitutional purposes. He believed they could learn from other states on the issue.

Mr. Goe elaborated that it was Orrick's view and the view of DOL that the Alaska Supreme Court had already spoken - it had considered a broad range of objections in Carr v. Gottstein case and had come down solidly in ruling that subject to appropriation debt did not qualify as constitutional debt within the meaning of Article IX, Section 8. He believed it was the reason the New Jersey Supreme Court had quoted the case as standing for the principle (with the majority of other supreme courts around the country) that subject to appropriation debt was not debt within the meanings of the various constitutions.

Representative Pruitt asked who would argue the case on the state's behalf. Mr. Milks answered that if a law was passed by the legislature it was the Attorney General's responsibility to defend Alaska's laws.

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Representative Wilson asked that when people bought the bonds if they were told that the bonds were worthless if the legislature decided not to pay. She believed that's what had been indicated.

Mr. Mitchell replied that [the market] was told there was a risk of failed appropriation. They were also provided with the history of the state and its payment on all of its municipal market subject to appropriation pledges and the importance of the municipal capital market to the State of Alaska and its future and the ability to provide for capital projects large and small. The market would consider the negative impacts that would result from a failure to appropriate and would need enough assurance that they believed the state would pay. At the end of the day credit was a buyer's belief that someone would repay them.

Representative Wilson stated that most of the examples provided were attached to buildings or something tangible, whereas the bonds in HB 331 were not. She asked for verification there would be language on the bonds specifying there was nothing backing them and that the paper may be worth more than the payment the buyer may receive.

Mr. Mitchell replied yes. He noted that they did not own a title position on a building if the state failed to pay. The state would lose access to the building for a period of time and then the building becomes the state at the term lease whether the state paid or not. There may be a two or three-year extension depending on how the lease language was written. The other best example of a similar entity being proposed was the Pension Obligation Bond Corporation. There was an existing liability of the state, there was not real property involved, the state was going to enter into a contractual commitment to pay that was going to be provided to the public corporation in exchange for the lump sum deposit into the retirement trust, and the payment was subject to appropriation. There were no PERS employer payments backing the bonds, it was the state's subject to appropriation pledge; if the state did not appropriate, there would have been no recourse.

Representative Wilson stated that the difference discussed by Legislative Legal Services was that in order for the bonds to be legal they were associated with an organization taking other revenue in.

Mr. Mitchell clarified that the Pension Obligation Bond Corporation had no right to employer or employee contributions that went into the trust. The contract that would have been the basis of the financing was the Department of Administration entering into a contract with a pension obligation bond corporation. He explained that pledge was securitized, pledged to the third parties, and was subject to appropriation. Once the money was deposited into the trust it was gone.

Vice-Chair Gara spoke to the importance of a clear legislative record. He did not know which opinion was correct. He clarified that his remarks were not intended to communicate that he believed the bill was or was not constitutional. He believed there were good faith opinions on both sides. He spoke to the thoroughness that Ms. Nauman went through in analyzing [Article IX] Sections 8 and 11 [of the state constitution]. He was disappointed he had not heard much from DOL about the sections. He thought the merits of the bill should be addressed.

5:06:01 PM

Representative Kawasaki agreed and appreciated the work by Legislative Legal Services. He had asked for a legal opinion [from DOL] but had been referred to the press release. He hoped to get an opinion from the attorney general. He would write his questions down and would submit them. He asked who to direct the questions to.

Co-Chair Seaton asked members to submit the questions through the chair. He remarked that the issue was difficult, and he was glad the discussion had occurred. He noted that the next meeting was currently unscheduled. He recessed the meeting to a call of the chair [note: the meeting never reconvened].

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ADJOURNMENT

5:08:12 PM

The meeting was adjourned at 5:08 p.m.