HOUSE FINANCE COMMITTEE
April 23, 2018
1:35 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:35 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
Representative Lance Pruitt
Representative Steve Thompson
Representative Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Sheldon Fisher, Commissioner, Department of Revenue; Ken Alper, Director, Tax Division, Department of Revenue; Mike Barnhill, Deputy Commissioner, Department of Revenue; Deven Mitchell, Executive Director, Alaska Municipal Bond Bank Authority, Department of Revenue; Representative Chris Birch; Representative George Raucher.

PRESENT VIA TELECONFERENCE

Thomas Ryan, ING Group, New York City; Peter Clinton, ING Group, New York City; Kara Moriarty, CEO, Alaska Oil and Gas Association, Anchorage; Pat Foley, Caelus Alaska, Anchorage; Jeff Hastings, CEO, SA Exploration, Anchorage;

SUMMARY

HB 331 TAX CREDIT CERT. BOND CORP; ROYALTIES

#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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Co-Chair Foster invited Commissioner Fisher to come to the table.

SHELDON FISHER, COMMISSIONER, DEPARTMENT OF REVENUE, appreciated the focus and the attention to the bill. He believed the bill was a good and prudent policy. He was available to answer specific questions or concerns.

Representative Wilson mentioned a previous discussion about evening something up. She asked if the legislature would change something if a company decided to wait their turn. She asked for more information.

Commissioner Fisher responded that the bill was structured in a way that companies would be able to choose whether to participate. The department had worked with companies to convey the intent of the bill. He relayed that one of the value blocks was the fact that the legislature did not have to appropriate a full $184 million; it could appropriate a lesser amount. He relayed that what the department presented assumed that everyone participated. Under that scenario, interest would need to be appropriated in the amount of $27 million, based on participation from all parties. If someone chose not to participate and would have been entitled under the normal course to get a $5 million payment during the year, the interest payment would decline slightly because they would not be a part of the bonding. Additional funding might be necessary to care for the company's interest. The department's goal was to understand and inform the legislature what it anticipated would happen as it rolled out, should the bill be enacted. The department had had multiple communications with the companies over the last several months. So far, no one had informed the department that they did not intend to

participate. They either informed the department that they wanted to participate, or they were still thinking about it and would get back to the department.

Representative Wilson was concerned that if a company chose to wait to participate, they would be negatively penalized.

Commissioner Fisher indicated that the department's intention was that companies would neither be advantaged or penalized by choosing not to participate.

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Representative Ortiz asked if the bill could negatively impact the ability of the state to bond for infrastructure projects and deferred maintenance. Mr. Barnhill in the prior meeting had indicated that the bill could have that impact. He asked the commissioner to elaborate.

Commissioner Fisher responded that, as a general matter, it was the department's view and understanding that the legislation would not have a substantial impact on the state's capacity to bond. There were a couple of reasons for his answer. First, the debt was already on the state's financial statement. It could be viewed as refinancing by taking an existing obligation and financing it in a different way. Second, there was a schedule presented in a previous meeting that showed the cumulative amount of general fund money used to finance other debt including the pension obligation payments. It also showed the current debt flattening out. The current plan would stabilize to 25 percent for a longer period rather than peaking over 30 percent of undesignated general funds (UGF). He thought it would open up capacity because there would be more available UGF. He remarked that the credit agencies viewed it as an interesting and as a helpful tool to manage the obligation. He thought the negative impact would be minimal. He did not have a dollar figure but would see if he could quantify it.

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Representative Guttenberg provided a hypothetical scenario in which a company took money from the state at a discounted rate to pay off loans and outstanding debt with a plan in place for reinvestment. He wondered what would

happen if the company sold to another entity in terms of the obligation to fulfill that plan by the new owner.

Commissioner Fisher heard 2 questions. The first had to do with reinvestment and paying off current debt and the source of capital a company would use to reinvest. He hoped some banks would be testifying later in the meeting. One of the things a number of people from financial institutions and credit holders had articulated to the state was that when they had a debt in default, it was very difficult and expensive for them to attract additional capital. The default had to be disclosed and their balance sheet, in essence, had a cloud over it associated with the defaulted instrument. By virtue of receiving the money, much of it would go to paying off existing debt holders. If companies were able to clean up their balance sheet resolving their outstanding liability, they could attract capital from a number of sources. He reported that a number of credit holders had investors prepared to invest if their debt could get resolved.

Commissioner Fisher addressed Representative Guttenberg's second question about a company setting forth a plan. The Department of Revenue (DOR) had the statutory direction to review a company's plan. The department would look for a schedule of investments, how a company would use the money, and assurances of sources for capital to support a company's plan. He reported that DOR was working with the Department of Law to determine consequences for a company that did not fulfill its obligations. Currently, the departments were discussing the repayment of benefits should a company defaulted on their commitment. He provided an example. If the payment was 90 percent under the lower discount rate ($90 million payment versus $85 million payment resulting $5 million benefit), they would have to repay the benefit plus some additional amount in the form of a penalty that would induce a company to continue with their commitment to reinvest. Generally, a company's obligations would transfer with the sale of their business.

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Representative Guttenberg questioned the definition of a qualified expenditure in the federal tax code as it related to the state's purpose of reaching development and production as quickly as possible. He asked for clarification.

Commissioner Fisher would have to come back with a response. As a general matter, he was assuming that the companies had the same goal in mind as the state. He would need time to think about how to respond.

Representative Kawasaki asked about the structure of the bill. He asked how a bond corporation worked as an instrumentality of government.

Commissioner Fisher thought the answer would be presented as part of the sectional analysis later in the meeting. He asked if he could defer the question until then.

Representative Kawasaki was okay with waiting for an answer.

Representative Grenn asked the commissioner to talk about how all of the different stake holders had come together on the issue.

Commissioner Fisher explained that the department developed the solution after the governor had requested a way of dealing with the tax credits. The governor's concern was putting Alaskans back to work. The department developed the strategy outline and a structure by going through a few different scenarios. The department also sat down with different participants with different perspectives. The department structured the bill as a balance, trying to account for all of the different interests. Not many changes were made in response to the meetings. Initially, many of the credit holders were frustrated with the thought of taking less for their money. He thought that over time people started to see that the bill included a fair balance of interest. It was not necessarily skewed one way or another. People started gravitating to the legislation as a potential solution.

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Co-Chair Seaton was concerned with 2 scenarios being offered; 10 percent or 5.1 percent. He thought the lower rates would be substantially different for each producer or explorer. It was his first time hearing that DOR rather than Department of Natural Resources (DNR) would be handling the agreements to overriding royalty interests (ORRI). The amount of value for an ORRI might be quite

different among projects and there might be time delays. He reported hearing that as soon as the state reached 10 percent the royalty interest would go away. He was uncertain how the ORRI was being written and whether it was fair to the state to reduce the interest rate. He asked the Commissioner to address both items.

Commissioner Fisher explained that when he stated a moment prior that the state would be examining the plans for reinvestment, he intended it to mean just the plans for reinvestment. He clarified that the ORRI was something DNR would be negotiating, not DOR. The plan for reinvestment would be examined and approved by DOR. He noted that the intent of the bill with respect to the ORRI was that the credit holder would have the right to present a plan or proposal. The Department of Natural Resources would examine that proposal based on their view of the opportunity. The intent was for the state to be taking some risk with the field developer but also sharing in the upside. If he implied that once the 10 percent was paid off, the royalty would disappear, it was not the intent of the bill. In other words, he imagined that a company could offer to give the state a royalty interest that lasted 10 years, for example. The Department of Natural Resources would evaluate the proposal based on the time value of money, the risk, and the return. There would be scenarios where the state might not make as much as expected or make considerably more. The department's expectation was that if someone gave an ORRI, it would be for the life of the field. There would be risk to the state as well as upside opportunity. It was not the intent for the state to bare all the risk without any upside associated with the ORRI.

Co-Chair Seaton noted that, generally, plans of development got delayed rather than accelerated. He was concerned about the time commitment.

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Vice-Chair Gara thought the bill had both pros and cons. He understood the policy. It would be easier for him to support the bill if the legislature had raised some oil money. However, it seemed like money only flowed one way. He relayed that the $600 million that the oil tax bill passed by the House, would have easily paid for this. One of the pros was that if the state did not take action, a provision was included in the law that would let the oil

industry buy the credits for a fraction of $1 but deduct a full $1 from their taxes. He was concerned about a massive liability with huge deductions if BP, Conoco, or Exxon started buying up the credits for $.60 on the dollar. He asked if the commissioner considered allowing the state to purchase the credits for less than what they were worth, like the major oil companies were allowed.

Commissioner Fisher had been asked the question before. There were two things the department was trying to balance. There was no question that there were certain companies that would sell their credits for a deep discount. However, he did not believe it extended to all of the companies. One of the department's goals was to finally address the issue for the state and the industry. Another objective of the department was to provide a balanced solution. He was not suggesting that the bill reflected the best financial decision for the state. He thought it was neutral to modestly positive for the state. It required the credit holders to bare the cost of the interest. The solution was thoughtful and respected by the oil industry and the financial industry. He thought it served the state well in the long term. He felt that balancing the various interests in the way the bill did was appropriate and better for the state in the long run.

Vice-Chair Gara asked if the department had considered giving the state the same right as the major oil companies to buy the credits at less than face value.

Commissioner Fisher responded that the state was buying them at less than face value. The state had never considered a deep discount when the department did its modeling. The proposal brought forward in the bill tried to balance some of the other factors he had mentioned.

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Representative Pruitt was uncertain whether the legislature had expressed the importance of where the money would go. He mentioned concerns that had been expressed about the money potentially being used to pay off banks. He asked how important it was for the money to open up opportunity for further investment.

Commissioner Fisher responded that, at a high level, it was difficult for a company in default on a credit to attract

additional debt or equity investment. Representations and warrantees would be required. The existence of debt gave the debt holder the ability to put the company into bankruptcy. The threat of bankruptcy, even if the bank was in forbearance, made future investors uncomfortable with a credit. Cleaning up a company's balance sheet offered tremendous benefit. Companies would structure their debt based on the cash flow they expected. They would be able to create a capital structure more sustainable in the long-term.

Commissioner Fisher continued that one of the things the legislature would hear from ING was that they were over-collateralized. They might have, for example, $100 million of debts and $140 million of credits. In other words, when they got paid there would be some money that would be returned to the companies. There would be money going back to the companies and would be available to the companies for their operations.

Co-Chair Foster acknowledged Representative Chris Birch and Representative George Raucher in the audience.

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THOMAS RYAN, ING GROUP, NEW YORK CITY (via teleconference), had a couple of points he wanted to make. He had made similar points in the resource committee hearings two weeks prior. The company had been working with two specific borrowers in Alaska, both of whom were nearing full production. ING financed the tax credits beginning in 2015. Those loans were still outstanding, past due, and in default. ING had been working with the companies to restructure their loans for the past couple of years. He thought one of the key hallmarks of the transactions was that ING provided short-term liquidity to companies at very inexpensive rates against their tax credits with the expectation that they would be repaid and cashed out quickly. Obviously, that did not happen, and the terms of the loans were extended even though they were in default. The money was already spent by the companies in Alaska. Significant amounts of money including debt that the companies raised and equity that they raised were spent. The equity of the credit money was taxed and was expected to come back from the state: The equity was used as collateral for ING's lending purposes.

Mr. Ryan continued that clearly circumstances had changed over the last number of years. ING had been patient and had worked as diligently as possible with the state and with the companies to keep them liquid and in operation. Both of the companies had significant capital investment plans going forward. They also had further capital to finance those plans. The fact that they had defaulted balance sheets prevented them from moving forward with their plans. The companies had been trying stay afloat over the past few years.

Mr. Ryan reported that ING was over-collateralized. There was a concern that somehow the companies would take the money and run. ING was a committed lender to the State of Alaska and lent to several different industries in Alaska. He noted that much of the money that the credits were coming back against had already been spent. There would be excess that would go back to the projects to spend further as well as raising new capital. From the very beginning, ING had been asking for a restructuring of debt on the balance sheet, which meant that everyone would have to experience a bit of pain in the restructuring. The credits were being refinanced at a discount. ING was realistic about things. He suggested that once the balance sheets were cleaned up, it might be possible for the projects to be refinanced and operations furthered.

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PETER CLINTON, ING GROUP, NEW YORK CITY (via teleconference), commented on the bill. He reported that things had not worked out as intended for anyone. The situation was similar to a private credit restructuring when a company had to restructure because of an unforeseen event impacting its revenues or earnings to the point of not being able to pay its original debts. The difference had to do with the length of time that it took for the state to address its problems. It had to address them through the annual legislative process. Typically, the first thing private companies did when restructuring was to stop making their payments. Next, they had to decide which payments were a priority. In the state's case, it had some tough decisions to make because of having several other priorities.

Mr. Clinton reported that the size of the problem needed to be determined. The state did so when it stopped issuing the

tax credits and ended up where it was today - needing to solve the problem of how to pay the credits. He thought the proposal was balanced and fair. The proposal was also consistent with the packet of proposals that would be seen in private industry when a company took an obligation and tried to identify a solution in which everyone participated. He thought the bill asked everyone involved to participate. The bill asked the parties that were owed money to accept a discount. The bill also asked those participants who benefited from the program to commit to reinvesting in the state. The bill would take near-term appropriations and spread them out over a longer period. While he appreciated there was some concern about not having great visibility over a 10-year period regarding repayment capacity, it was not dissimilar to other types of organizations. Collectively, the proposal on the table made good sense. It was true to a formula that was used in the private sector.

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Representative Wilson asked who made the final decision on the discount. She asked who owned the credits presently.

Mr. Ryan responded that one of the positive features of the program was that when ING financed the credits they essentially purchased them from the companies. The tax credits were issued in ING's name as the recipient. He reiterated that ING was overcollateralized and had an obligation to give back to the companies anything in excess of what ING was owed. It would be a joint decision. He furthered that ING would look at the final capital investment plans of the company going forward and the right discount. ING and each company would decide collectively what the right strategy was for both parties. Much of the decision would come down to the final details of a company's plan. For example, it might be possible to split the credits into multiple buckets with different rates. ING was still working on the details.

Representative Wilson used a hypothetical scenario in which a credit was worth $100 million, and ING was given $90 million. She asked if the company would have to make up the difference of $10 million.

Mr. Ryan responded, "If we're overcollateralized, yes." He explained the bank had two different deals. The first deal

was overcollateralized to a large extent and the other was not. Depending on the exact final details of the plan and the plans of the company, ING might take a loss on one deal and the other deal might have some excess that would be returned to the company. He furthered that depending on the size of the discount, some of it would be borne by ING in one case and all of it would be borne by the company in the other. Until the final details were available it would be difficult to make a prediction.

Representative Wilson was trying to get something on record. She suggested that if the company owned the note they could guarantee that they would do a certain amount of work in the following couple of years. She was not sure the bank could make the same obligation. She wanted to make sure the legislature was not putting the banks at a disadvantage. The banks could only do a 10 percent discount rather than a 5 percent discount. She was trying to figure out the difference between the bank owning the note versus the company owning the note.

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Representative Grenn noted that the testifiers used the term "fair and balanced." He wanted to use the term as a way of framing a conversation he had regarding the state's reputation the last few years and instilling or hurting a confidence in the state's oil and gas tax policy. He asked how the proposal would impact the state's reputation regarding investment in the state's oil and gas tax policy compared to the status quo of the past few years.

Mr. Clinton offered his perspective. He thought it would greatly enhance the state's reputation. He suggested rephrasing the question to reflect how much the state's reputation would hurt by not doing something like what was being proposed. He thought the state's reputation had already been damaged significantly. He indicated that private lenders were not put off by similar situations where something unexpected happened that had to be addressed. Ultimately, lenders looked for the ability of a predictable payout. His job was to manage the expectations of senior management regarding a payout timeline. He relayed that if he had a report each year that a payout was subject to appropriation and that the amount was in dispute, it would not be predictable. However, if the state were to adopt a program, such as the bond, where it paid

something off at a discount over a longer term, institutions would be more than happy to accept the tradeoff - the tradeoff of predictability. He relayed that one of ING's loans would not likely lead to a loss because it had overcollateralization. Another loan might lead to a small loss. In cases that lead to a loss, for ING, it led to a more desirable outcome than the uncertainty that would continue to exist without a solution.

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Representative Grenn thanked the testifiers for their comments.

Vice-Chair Gara expressed confusion about the issue about the state's reputation. He mentioned that for many years the state paid credits as they came in. Circumstances changed with the oil price crash in 2015, which hurt everyone including the state. Since that time when the state stopped paying every single dollar, the state shifted to what the statute stated. The statute defined that the state paid 10 percent of the production tax revenue if oil was over $60 per barrel and 15 percent if oil was less than $60 per barrel. He reported that the legislature had followed the statute. He was confused as to why the state's reputation would be hurt. He assumed that ING read the statute before lending money. He was bothered by the idea of the state's reputation being damaged because the state had been following the law. He asked if ING had read the law.

Mr. Ryan indicated that the bank had been aware of the terms and the state's historical performance. ING was mindful that future legislative budgets could not be bound. ING based its lending decisions on speaking with several entities including DOR, DNR, and the governor's office. ING was aware of what happened and that a future event could potentially slow down payments to the formula. The bank stress-tested the payments and scenarios. Based on the representations it had from stakeholders and ING's modeling, the lender felt comfortable with event risk. There was no question that the event happened taking everyone by surprise. He did not think anyone was saying that the state was not honoring the letter of the law. However, there were some reasonable expectations made and discussions had amongst serious stakeholders in Alaska prior to ING making its decision. He indicated that based

on a willingness to pay and the state's ability to pay, the bank was asking for some predictability. As a bank, ING would like to lend more and with its projects it would like some certainty. He furthered that when the projects and the equity was put into the projects in Alaska there were promises made of prompt payment of credits in exchange for cash. He agreed that the relationship of the state was a good one. However, they thought the bill, by adding clarity and certainty at a discount, would help show the state's goodwill and compliance with the legislation. ING had experienced positive dealings with the state in the past and he hoped, with the passage of the bill, it would continue to do business in Alaska.

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Representative Pruitt noted that earlier in ING's testimony Mr. Ryan had referenced the genesis of working with some of the oil companies and offering liquidity at cheap rates because of the state's precedent of paying the companies off over a short term. He assumed there were terms that would allow for lower interest rates or certain payment schedules that took into account the state would pay the credits within a reasonable amount of time. Mr. Ryan had also expressed that ING had been working with the companies in renegotiating the terms. He wondered how the bank was adjusting and reorganizing the debt. He asked if a higher interest rate would be imposed.

Mr. Clinton replied that the imposition of a higher interest rate would be typical in any credit restructuring. A general loan agreement would include a default rate, which was generally 2 percent above the contracted rate. ING's default rate kicked in when a loan was not repaid. There were other rights and remedies available to ING, which it did not exercise in these cases. For instance, ING could have foreclosed on the company or caused the company to file for bankruptcy by taking certain actions. However, forcing the company into bankruptcy would not result in ING getting paid any sooner or solve the company's problems. There were other creditors involved with the companies who were standing aside waiting for certain developments to happen to lead companies back to financial health. Since ING's only source of payment was through the tax credits, it stood by and let the other creditors control the outcome. He reported ING staying in close contact with the other creditors.

Representative Pruitt asked if interest could be used against a tax liability - therefore, less tax available to the federal government or the state entity. He wondered if interest was the cost of doing business.

Mr. Clinton answered there was a cost of doing business. ING had implied costs that were not balance sheet costs. They were calculated the way ING thought it did business, with a cost of capital. ING had things called risk weighted assets - capital the bank set aside based on the quality of assets it had. He conveyed that when a bank had a loan of $100 million that was past due without any immediate repayment in sight, then the bank had a significant amount of capital set aside against that loan which could not be used for new loans.

Mr. Ryan asked if Representative Pruitt was speaking about the interest expense for the bank's customers. If so, their interest was typically deductible against their tax liability.

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Representative Pruitt was asking about the interest expense of the customer. He noted that it effected the state's ability to get additional tax for Alaska. He asked if ING had been unable to extend capital to the Alaska oil and gas sector because of the current circumstance.

Mr. Clinton responded in the affirmative. He elaborated that ING ran a significant oil and gas business out of one of its Houston offices. The company had a portfolio equal to $2.5 billion with 40 to 50 different followers. Since the beginning of the energy crisis, about 10 of those borrowers filed for bankruptcy. ING was fortunate in most of those instances that the level it lent at was not empiric. However, there were significant loses to other investors. ING continued to lend to those companies after they came out of bankruptcy. ING continued to make new loans in the production industry in Houston as well. ING looked and the process and the predictability of outcomes before conducting the financial analysis to assess whether the next opportunity to lend to a company made sense. The fact that a company had incurred some problems previously did not exclude ING lending to them again.

Vice-Chair Gara thanked Mr. Clinton and Mr. Ryan for the tone of their testimony.

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Co-Chair Foster commented that it was good for members to thank testifiers but cautioned members to be mindful of what others might infer from legislators' statements.

KARA MORIARTY, CEO, ALASKA OIL AND GAS ASSOCIATION, ANCHORAGE (via teleconference), introduced herself and read from a prepared statement:

> For the record, my name is Kara Moriarty and I am the President/CEO of the Alaska Oil & Gas Association, commonly referred to as "AOGA." AOGA is a private trade association that represents the majority of oil and gas producers, explorers, refiners, and transporters of Alaska's oil and gas. The following testimony reflects the opinion of our membership.
>
> AOGA supports an expedited resolution this year to refund the earned credits. Companies earned these credits by investing hundreds of millions of dollars to hire Alaskans for the exploration and production of oil. The delay in the rebates has damaged the state's reputation and chilled future investment; caused projects to be shelved, resulting in negative economic impacts to the state and local communities; and many Alaskans are now out of work, especially within the oil and gas industry.
>
> AOGA believes the state should honor all outstanding earned tax credits in full, and in as expedited process as possible. The Governor's bill is an innovative approach that seeks to refund a portion of the earned credits via bonding to raise the money, then refunding the credits at a reduced rate. The Governor proposes to lower the refunding rate to cover the state's bond finance costs. AOGA has concerns about the steep discount rates and other provisions of the bill. But AOGA is committed to working with the administration and legislature to finding an equitable

solution – it's simply too important. AOGA does applaud the administration for acknowledging that refunding these payments is a critical step this year.

AOGA supports an equitable plan that will refund the entirety of the earned credits this year: Let's send a strong signal to investors that Alaska is open for business and attract much needed new investment to employ Alaskans, produce more oil, and drive Alaska's economy forward. Thank you.

Ms. Moriarty made herself available for questions.

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Representative Grenn asked if she had unanimous consent to testify.

Ms. Moriarty confirmed that she had to have unanimous consent on matters of tax, which tax credits were a part of tax policy.

Representative Grenn asked if some of the members were not owed tax credits.

Ms. Moriarty responded that Representative Grenn was correct. However, the companies that did not have earned tax credit certificates were supportive of getting the credits paid sooner rather than later because having a healthy oil business, large or small, was important to the entire industry. It was important to have strong companies across the board. She represented companies like Caelus and Petro Star that were holding tax credit certificates that had not received their payments in full. The lack of payments hampered these companies in their ability to continue to do business and attract investment in Alaska. She also represented companies that were never eligible for cash payments such as BP, Exxon, and Hilcorp. The organization looked at the issue holistically and, having a healthy business climate for all companies was very important to all of her membership.

Representative Wilson asked if AOGGA's members were concerned about the additional requirement of investing in Alaska within the following 2 years.

Ms. Moriarty responded that AOGA member companies were very committed to the State of Alaska. Alaska Oil and Gas Association would prefer that the credits were paid in full because the companies spent the money and believed the credits were owed. Her members also recognized the position the state was in and were trying to find an innovative approach when prices were in a lower-for-longer range. She thought all of the companies she represented planned to be in Alaska. She had not heard any objections from her membership about putting together future development plans to make the discount contingent on future spending. She reiterated that, in a perfect world, members would like to be paid in full without any type of discount. The companies that she represented were very committed to investing in Alaska.

Representative Wilson asked if the intent of DOR was to utilize a development plan as an indicator of reinvestment for a company that already had a development plan in place - with or without the credits.

Ms. Moriarty thought the issue was something that members had to work through with the state. She needed further clarification whether the state was expecting a brand new development plan or something already in place. She thought the companies that would take advantage of the program would work closely with the state. If they had to provide something additional, hopefully it would not be any more onerous than what they have had to provide for their lease in the first place.

Representative Wilson asked if in-state refineries were under the same obligation for 2 years as the other oil companies with tax credits. The tax credits were not written exactly the same. She asked about the 2-year stipulation.

Co-Chair Foster mentioned that there were folks calling in, but the committee was only hearing invited testimony. However, public testimony would be heard the following day at 1:30 P.M.

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Representative Thompson noted that in Ms. Moriarty's testimony she reported that hundreds of millions of dollars had been invested by the oil companies. In actuality, he

thought the total investment dollars were well over billions. He wanted to clarify that companies had invested billions of dollars in Alaska because of the tax incentives and only received a percentage back in the form of tax credits.

Ms. Moriarty agreed with Representative Thompson that that companies had invested billions. They did not get all of their money back except the portion that was part of the credit as stated in law.

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PAT FOLEY, CAELUS ALASKA, ANCHORAGE (via teleconference), suggested the bill represented the end of an era. He noted that Pioneer started its business in Alaska in 2002 under profit-based production tax (PPT). Between Pioneer and Caelus, they had invested over $2 billion in the state. They participated in about a dozen exploration wells, developed Oooguruk, commenced operations on its Nuna development, and made a substantial discovery in Smith Bay. All of the work he mentioned had been done under various tax credit programs that helped assist the company's financing. All of the credits had ended with the passage of HB 111 [Legislation passed in 2017 - Short Title: Oil and Gas Production Tax; Payments: Credits].

Mr. Foley thought HB 331 would bring an end to the state's obligation to repay the tax credits. He articulated that the state had been the beneficiary of a number of items as a result of the investments made by the oil companies. He also asserted that the large number of investments in the state was beneficial as was a diverse population of explores and developers. He asserted that Alaska was a high-cost environment with substantial barriers to entry. The tax credit program that began more than a decade ago helped to level the playing field between the large existing legacy producers and the new companies trying to grow and incubate their businesses in Alaska. The state had seen benefits from all of the tax credit programs through jobs, production down tax taps, and increased royalty payments. He indicated that it was not the big legacy producers that had been the beneficiaries of the recent tax credit programs. It was companies like Caelus, Repsol, Brooks Range, Great Bear, Doyon, CIRI, Arctic Slope Regional Corporation (ASRC), Blue Crest, Fury, and SAE that

have made the investments and were entitled to the payments that would hopefully result under the bonding program.

Mr. Foley asserted that if the bill was able to become law and the credits were paid to the bonding program, it would demonstrate the state taking great steps to help its reputation and making good on its obligations. It would also help to put money back into the hand of developers allowing new investments to be made in Alaska.

Mr. Foley believed that HB 331 represented good policy - a win for the state, and a win for investors. The credit holders would be paid out earlier than what the statutory minimum formula provided. Companies would take a small haircut, a discount they were willing to accept. The amount of the discount (the interest cost of the repayment) was similar to the company's cost to capital at 10 percent. If his company was able to enjoy the lower discount rate it would be economical money and a fair deal for the state and the investor. The state helped clear all of its obligations to repay the taxes and, from a cash flow standpoint, the state minimized its 2018 cash obligations. Absent the program, he believed the statutory minimum obligated a payment of about $184 million. He thought Commissioner Fischer had testified that the interest payment the state would incur in 2018 was about $27 million.

Mr. Foley offered that he thought it was good policy that the bill provided two different discount rates. It created an incentive for more activities in the state. It encouraged investors to put money back into the state. He thanked Representative Wilson who reminded the committee that the tax credit holders had made literally billions of dollars in investments in the state. Those investments had resulted in jobs, production, royalties, and other tangible benefits to the state. The investments had earned the tax credit certificates. The bonding program would resolve the repayment of those tax credit certificates. He thanked the administration for making it a priority to repay the tax credit obligation that existed. He asked the committee to pass HB 331 and for the legislature to write the bill into law. He thanked the committee and offered to answer any questions.

2:55:05 PM

Representative Grenn asked Mr. Foley if he could share the amount Caelus was owed in tax credits.

Mr. Foley responded that the amount was close to $190 million in tax credit certificates.

Representative Grenn asked what would be happening at Caelus the day after the passage of the bill.

Mr. Foley responded that the company would be happy. The company had loans against the $190 million in tax credit certificates. The company would be poised to pay off the loans and to attract additional investment through equity or debt or a combination to allow Caelus to move forward with the Nuna project and to drill an additional appraisal well in Smith Bay. It should set the environment to facilitate other investment in the state.

Representative Wilson thanked Caelus for its investment. She asked him if he was comfortable with the added requirements to receive the higher discount.

Mr. Foley responded in the affirmative. He believed Caelus would be in a position to make investments in the state that exceeded the $190 million tax credit certificates. He was confident his company would be entitled to the lower discount rate. Having said that, even if his company was discounted at 10 percent, he would have to go into the market to borrow more money. He thought the cost to borrow that money would be in the neighborhood of 10 percent.

Representative Wilson asked if Caelus had put any projects on hold as a result of the credits not being paid.

Mr. Foley responded, "Yes and no." Although it was not a direct connection, the fact that credits were not being paid and discussions continued at the legislature about reshuffling production taxes made it difficult for Caelus to attract investment dollars. He elaborated that Caelus had been out in the market place for more than a year trying to obtain financing for the Nuna development and additional work at Smith Bay. It had been difficult for Caelus to obtain financing. The company had yet to be successful. He hoped the legislation would be a first step in facilitating the company's ability to attract capital.

Representative Wilson thanked Mr. Foley again for his investment.

Representative Pruitt asked Mr. Foley what the value of $190 million would translate to in future Alaskan jobs and potential production.

Mr. Foley responded that Pioneer and Caelus have had as many as 900 employees and contractors working for them simultaneously on the slope. Today they had less than 50 working on the North Slope and about 50 employees in Anchorage. He indicated that Oooguruk had totally been developed within some kind of a tax credit program. The company had made about $30 million barrels of production thus far. The company's daily production was a little more than 13,000 barrels per day. He relayed that the company's Nuna development project was the next development project it hoped to begin work on soon. He claimed that the Nuna project would be about 15 million barrels plus, peak production was about 25,000 per day. Peak jobs would be over 200 or 300 during the construction phase. The total investment for Nuna would be more than $1 billion.

3:01:01 PM

JEFF HASTINGS, CEO, SAEXPLORATION, ANCHORAGE (via teleconference), read a prepared statement:

> Good Afternoon;
>
> I would like to start by extending my appreciation to Chairman Foster and Chairman Seaton and members of the House Finance committee for allowing us to participate in today's testimony.
>
> For the record my name is Jeff Hastings. I am the Chairman and Chief Executive Officer for SAExploration, and the managing member of Kuukpik/SAE, our Joint Venture with the north slope, native village of Nuiqsut. My family has lived in Alaska since 1987.
>
> Our core business is offering seismic data acquisition services to the oil and gas industry. We are not an oil company – we simply provide the seismic data to help the State and companies know where to look in order to find oil more effectively and efficiently.

Our company has employed an average of 400 Alaskans annually. We are the holders of approximately $50,000,000.00 of assigned tax credits and continue to wait for an additional $21,000,000.00 in assigned credits, which are still in the process of being verified and audited for more than two years. Since we are not an oil company, we do not have any long- term production prospects for making up the money that is owed our company for all the work we performed. Instead, we have been forced to restructure and downsize our company as we await payments from the State of Alaska.

Today I would like talk in support of HB331, which if passed would provide a mechanism to pay off the existing oil and gas tax credits owed by the State through the issuance of bonds.

Over the past couple years, we have felt adverse effects as a result of prolonging the period in which the oil and gas tax credits are verified, issued, and ultimately paid. As an Alaskan company and as Alaskans, we understand the state’s fiscal dilemma and appreciate the Legislature’s efforts to find long term fiscal solutions. But circumstances are such that we need to work together today to find a solution, and HB331 offers a pathway.

In our sector of the industry, seismic data collection, we have experienced a continuing downward trend in activity since the governor's first appropriation veto in Q2 of 2015. Year over year, a 50% decrease in the dollars being spent on new data, data needed to identify new reserves that the state needs for its economic well-being. In 2015, $200,000,000.00 was spent on new high-resolution data. In 2018 there will be less than $20,000,000.00 spent on new seismic data collection. Perhaps more importantly are the jobs that have been lost and continue to be reduced year after year. As a company we have gone from employing 400 Alaskans and multitudes of Alaskan subcontractors for 8 to 9 months a year, to a company that employees 150 Alaskans and a few select Alaskan contractors for 45 days in 2018. This is not a result of a loss in our market share to competition or a continued downturn in the commodity price. It is simply due to a lack of capital spending,

be it our clientele waiting on tax credits owed to them individually or a lack of confidence in the State's oil and gas tax policy. Their capital budgets are being directed to other basins and opportunities where there is a higher level of confidence.

The governor's tax credit appropriation vetoes, the debate about annual minimum appropriations, and the two DOR advisory bulletins 2016-01 and 2017-01, which effectively shut down the secondary market, have all combined to create a business environment without meaningful consistency. Please know that this isn't trying to cast blame or fault anyone – all of us are doing our best to cope with the State's fiscal situation. But I point these things out to you with the hope that we can move forward with HB331 as a solution.

Working together and passing this bill will create opportunities to bring online the reserves that the state desperately needs to solve our fiscal gap, opportunities which are now effectively sidelined due to the current situation. Except for one exploration effort in 2018, the capital needed to get us back to work is not being allocated. Project after project suspended because of a lack visibility, resulting in a lack of capital available, both the institutional capital and the private capital needed to move projects forward because of the continued erosion of confidence in the consistency of our oil and gas tax policy and plan to pay the outstanding credit liability.

Recent data from DOR would indicate that the 2016 and 2017 credits, depending on the annual allocation will not see payments begin until fiscal 2021 and may not see the full amounts paid until sometime beyond fiscal 2024 or 2025. This data would indicate an even more protracted period of low activity.

The DOR projections for commodity pricing over the near-term show that we cannot depend on an increase in price of oil to solve this issue. And yet as a state we need more production and more revenue generated by that production to bridge our fiscal gap and the future needs as a State. To do that we need the

industry off the sidelines and working to increase our throughput.

We believe HB331 provides a path to restarting the industries engine. Is it ideal - - no. On one side of the equation no one wants to have to take a haircut on monies owed. On the other you can argue why, should the State take on the debt and service of the debt even if the, discount provides for an offset.

The level of the discount will be a company by company choice. Dependent on the current projected payment by DOR, their cost of capital and their need for new project capital.

What HB331 does do is create confidence in when companies will be paid, how much they will be paid and normalizes the amount that the state will need to appropriate each year against the tax credit liability More importantly it gives us the ability and confidence as an industry to find the capital we need for new or suspended projects. And it puts our Alaskan families back to work.

Thank you for your time today and the opportunity to share our view point.

3:08:26 PM

Representative Thompson asked for a copy of Mr. Hastings' prepared statement.

Mr. Hastings confirmed that he had submitted it.

Co-Chair Foster indicated that Mr. Alper would be providing the sectional analysis.

3:09:15 PM

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, offered to review the bill in as much detail as the committee required. He also conveyed that he could potentially answer some of the questions that came up during testimony earlier in the meeting.

Mr. Alper specified that there had been a question on the prior Saturday posed by Representative Kawasaki. He had given a preview to the section and indicated that the bill did 4 things. He would keep the structure of the 4 subtopics as he reviewed the bill in greater detail. He reviewed the sectional analysis.

Section 1:

Exempts the bond corporation created in Sec. 2, and any overriding royalty interests negotiated under Sec. 11, from the procurement code.

Section 2:

Establishes the Alaska Tax Credit Certificate Bond Corporation within DOR. [Largely patterned after Alaska Pension Obligation Bond Corporation, AS 37.16]

37.18.010 Creates the corporation.

37.18.020 Establishes the board of directors, all of whom are state department commissioners.

37.18.030 Authorizes the corporation to issue bonds up to $1 billion and contract for associated services.

37.18.040 Authorizes the corporation to have a reserve fund which will hold funds to be used for repurchase, as well as funds appropriated for the purpose of interest and principal payments to bond holders.

37.18.050 Authorizes the corporation to set the terms of bonds to be issued.

37.18.060 Corporation must adopt a resolution to approve the issuance of bonds.

37.18.070 Gives certain enforcement rights to certain bond holders.

37.18.080 Bonds may not be issued unless the discount rate by which tax credits are purchased is at least 1.5 percent greater than the total interest cost of the bonds.

37.18.090 Corporation may refund bonds prior to the maturity date.

37.18.100 Bonds are legal instruments.

37.18.800 This chapter shall be liberally construed to carry out its purposes.

37.18.810 Corporation may adopt regulations necessary to implement this chapter.

37.18.900 Definitions.

Section 3:

Amends the Gas Storage Credit to enable repurchase of any credits via the bond program.

Section 4:

Amends the LNG Storage Credit to enable repurchase of any credits via the bond program.

Section 5:

Amends the Refinery Infrastructure Credit to enable repurchase of any credits via the bond program.

Section 6:

Amends various provisions of AS 43.55.028, the tax credit repurchase fund.

.028(e) The department may either use the tax credit fund money, or money disbursed from the bond program, to purchase tax credits. Written to maximize flexibility and retain the existing program and procedures.

Section 7:

.028(g) Clarifies that the current $70 million per company per year cap, with the associated "haircut", does not apply to repurchases via the bond program.

Section 8:

.028(i) Adds definitions for "money disbursed to the commissioner," and "total interest cost."
Section 9:
.028(j) Clarifies that if a company has an outstanding liability to the state, this can be offset against a payment via the bond program as well as via traditional repurchase.

Section 10:

.028(k) New section authorizing the department to negotiate a repurchase of all credits held by a company and describing how the holder of credits indicates their desire to participate in the program. This section contemplates that if a holder of credits existing at the time of a bond issuance declines to participate in the program, such holder is precluded from submitting such existing credits for purchase in connection with future bond issuances. This provision does not preclude such holder from submitting credits claimed after a bond issuance for purchase in connection with a future bond issuance.

.028(l) New section describes the mechanism by which the department estimates the expected cash flow to a company via the current repurchase process and expected schedule. From this estimate, a purchase offer can be calculated based on the discount rate determined in (m).

.028(m) New section establishing a base discount rate of 10 percent, with four methods to reduce this to a number equal to total interest cost + 1.5 percent.

1. For a seismic credit, the company has waived the 10-year confidentiality period for the data and allowed it to become public;
2. The company has agreed to an overriding royalty interest (ORRI) accepted by the Department of Natural Resources;
3. The company has committed reinvest the entire amount received within an Alaska oil and gas project within 24 months; or
4. The credit is against the corporate income tax, primarily impacting refinery infrastructure credits.

.028(n) New section clarifying that the amount of a credit in excess of the discounted amount purchased retains no value and cannot be used against taxes or sold.

Section 11:

Authorizes the Department of Natural Resources to negotiate Overriding Royalty Interests (ORRI). These are then valued, and a determination is made whether the incremental value received by the state warrants the approval of the lower discount rate for purposes of credit repurchase.

Section 12:

Authorizes DNR and DOR to adopt regulations to implement this act

Section 13:

Authorizes retroactive application of regulations.

Section 14:

Immediate effective date.

Mr. Alper summarized Section 1 having to do with the procurement code. There were two new pieces of the bill in which certain new state activity would not explicitly require going through the details of the state procurement process. First was the bond corporation and the second was the acquisition of those overriding royalty interests through DNR in Section 11.

Mr. Alper reported that Section 2 wrote a new chapter into statute, AS 37.18, which creating a new state bond corporation for the purpose of the Alaska tax credit certificate bond corporation within DOR. The section was modeled after very similar language specific to the pension obligation bond corporation law that passed through the body about 10 years prior. There were many subsections within Section 2 and took up about half the length of the bill.

Mr. Alper referenced AS 37.18.010 which created the corporation. He conveyed that AS 37.18.020 established a

board of directors which included three commissioners: one from DOR, one from the Department of Commerce, Community and Economic Development (DCCED), and one from the Department of Administration (DOA). He reported that AS 37.18.030 authorized the board could sell up to $1 billion in bonds. He was expecting multiple bond issuances, although, the first one would be the "big" one - roughly $700 million presuming most companies participated in the program.

Mr. Alper indicated that AS 37.18.040 was the reserve fund. It provided much of the meat of how the legislature would appropriate money to pay the principle and interest of the bonds. The language was spelled out in AS 37.18.040 and had a number of subsections. He moved to AS 37.18.050 which authorized the corporation to set the terms of the bond. The last bonds would be issued by the end of 2021. It fit in with the state's expectation that the last cashable tax credits, the last refinery credits, and potentially the credit the interior gas utility would request, would come into the state sometime in 2020.

Mr. Alper returned to Representative Wilson's question about refinery credits. The refinery automatically came into the system at the lower discount rate. It was a specific care-out in a later section of the bill. In terms of talking about getting the lower discount rate through a reinvestment commitment, it was external to the refinery credits. It applied to companies holding the more traditional operating loss or exploration spending type of credits. He would talk about it in greater detail when he reached the applicable section.

Mr. Alper continued to AS 37.18.060 which required the corporation to issue a resolution to authorize the selling of the bonds. Alaska Statute 37.18.070 housed enforcement rights. Alaska Statute 37.18.080 inserted a restriction which only allowed the state to issue bonds if the state received a discount the equivalent of at least 1.5 percent above the total interest cost. The total interest cost was a standard financial term which referred to the interest and associated fees.

Mr. Alper explained that 37.18.090 was a repurchase ability that allowed a corporation to buy them back prior to the maturity dates. Alaska Statute 37.18.100 indicated they

were an official legal instrument of the state. He reviewed AS 37.18.800, AS 37.18.810, and AS 37.18.900.

Representative Wilson asked why a corporation was being created.

Mr. Alper was aware that the method had been used previously. He cited the pension obligation bonds as a comparable example. As far as any legal reason or requirement, he deferred to Mr. Barnhill.

3:16:03 PM

MIKE BARNHILL, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, reported that at the outside of the design and envisioning how to construct the bill, the department had considered having the state bond committee issue the debt. It was on the advice of tax council that, specifically because the use of a corporation was approved by the Alaska Supreme Court in the Carr-Gottstein case, they thought it was a useful thing to include. The department had recently used the same structure 10 years prior for the pension obligation bond. The department thought it was a familiar structure for the legislature and did not anticipate any controversy.

Representative Wilson asked if the corporation would be dissolved once the final payment was made.

Mr. Barnhill replied there was no sunset clause in the bill and would remain on the books until the legislature decided to repeal it.

Co-Chair Seaton asked if there was any reason why the legislature would not want to include a sunset date after the fees were paid off.

Mr. Barnhill commented that there was no reason not to include a sunset. He was hesitant about defining a sunset date in the event there was some sort of refunding that extended the term. They would want to make sure the corporation existed all the way through the term. He thought the better practice might be to wait until the program was complete, at which time the department could come back to the legislature to repeal it.

Mr. Alper mentioned that the ability to issue the bonds was fixed in the bill and expired at the end of 2021. If a delayed repeal was going to be inserted it would need to be about 10 years after that time. There was a precedent in HB 111 that had a delayed repeal for the tax credit sections themselves in AS 37.18.028 1 year after the last credit was paid off. It was not a fixed date. Rather, it was when a condition was met. It was in a transitional section - a noncodified section at the end of the bill.

3:19:09 PM

DEVEN MITCHELL, EXECUTIVE DIRECTOR, ALASKA MUNICIPAL BOND BANK AUTHORITY, DEPARTMENT OF REVENUE, thought Mr. Alper provided great answers. If there was language that was conditional upon the maturity of all outstanding obligations, the entity would cease to exist, which would have to be after 2021.

Co-Chair Seaton commented that it would be nice not to have to come back with another bill to repeal the corporation.

Representative Pruitt asked if the corporation would have to remain in existence as long as the bonds were outstanding. The current model had the state paying out until 2031. He thought there was interest in inserting a sunset date for the corporation.

Mr. Mitchell clarified that it would be after the final payments were made rather than a specific date. He was unclear what the future held and did not think the legislature would want to limit flexibility into the future. He suggested that a hard sunset date of 2035 would be sufficient. He did not believe it would impair the state's ability to market and issue the bonds.

Representative Pruitt clarified. Mr. Mitchell responded in the affirmative.

Mr. Alper continued to review the sectional analysis. He indicated the next sections addressed Title 43, tax laws. Sections 3, 4, and 5 were connected. They were in AS 43.20, the corporate income tax statute. They reflected the three credits outside the traditional system that were also eligible for cash repurchase. Alaska Statute 43.20.046 was the gas storage credit used for the Kenai facility a few years prior. Alaska Statue 43.20.047 reflected the

liquified natural gas (LNG) storage credit that would be used for the interior gas utility. AS 43.20.053 was the refinery credit. All of these sections had a subsection that specified the credits were eligible for repurchase through the state's tax credit repurchase program. Sections 3, 4, and 5 were being amended to create an alternative repayment so that they would also be eligible to purchase through the new mechanism of the bonding fund. The term in the bill was "funds dispersed to the commissioner from the tax credit bond corporation" which meant the bond sales proceeds could be used to repurchase the credits. It created a parallel, alternative payment.

3:23:15 PM

Mr. Alper spoke to Sections 6-9 amending existing sections of AS 43.55.028, the tax credit fund and the rules around which the state used that fund to repurchase state tax credits. Alaska Statute 44.55.028(e) in Section 6 created the same alternative flexibility. It allowed the state to purchase credits with money in the fund or the fund could be used as a conduit to do the bond repurchase through the bond sales and the money dispersed to the commissioner from the bond corporation.

Mr. Alper continued to Section 7, a newer section that amended AS 43.55.028(g). The amendment was done 2 years previously through HB 247 [Legislation passed in 2016 - Short Title: Tax; Credits; Refunds; O and G]. House Bill 247 eliminated the Cook Inlet credits and inserted a cap that prevented a company from getting more than $70 million per year in cash repurchases. The department needed to create a statutory waiver, which was in Section 7 of the bill.

Mr. Alper reported that Section 8 contained definitions. One of the definitions was "money dispersed through the commissioner" which included the bond proceeds and total interest costs.

Mr. Alper relayed that Section 9, another new section, amended AS 43.55.028(j) which was added by HB 247. It ensured that if a company owed money to the state through another tax, royalty, fine, or a fee related to the oil and gas business, the state could offset them with the tax credit payments. The department could back out the obligations without a company's permission paying the

company the net amount. Section 9 was amended to also include the measure within the tax credit bonding program. In the case of a company that might stand to receive $90 million, if they owed $5 million to the state through something they were delinquent on, the state would pay its own liability and give the company the remaining $85.

3:26:04 PM

Mr. Alper continued to the bulk of the changes which were in Section 10. Section 10 added four new subsections to AS 43.55.028 that talked about how a company would participate in the program. The first subsection, AS 43.55.028(k) was the mechanism by which a company offered its tax credits to the program. The companies were solicited and indicated whether they wanted to sell. If they wanted to sell, companies could not pick and choose their credits because all the old credits would get bumped up to be first in line to get better access to the remaining cash. Alternatively, companies would be able to participate in a better rate in a second round. The statute clarified that a company had to commit all of its credits. If a company did not participate with the credits it had, those credits would not be available for purchase through the bonding program in subsequent years. If a company earned new credits between now and the second round, the new credits would be eligible in the second round of financing.

Mr. Alper continued to explain AS 43.55.028(k), which included the idea of timing. Companies had to make an irrevocable commitment by time certain, the commissioner came up with amount the state would give the company, and the company would either accept or reject the state's offer in writing. If a company rejected the states' offer, they waived their right to participate in future rounds through the program.

Mr. Alper explained AS 43.55.028(l) was the mechanism to calculate how much the state was going to pay a company based on the idea of an anticipated prorated amount. There were three new definitions embedded in subsection l; assumed payment amount, assumed appropriation, and assumed proration methodology. It clarified that the state would first pay all of the 2016 credits pro rata among all of the companies that held them, then the state would pay the 2017 credits. He suggested that assuming the state would make

annual calculations based on the statutory formula, the statutory formula was reference in subsection l in a way that clarified any ambiguity. It stated taxes levied by O-11 before the application of any tax credits. For the purpose of this calculation only the state was locking in 184 in 2019 and 168 in 2020 and beyond. Presuming the stream of appropriations appended, it defined any given company's share.

Mr. Alper continued that AS 43.55.028(m) defined the discount rate was 10 percent per year, unless a company met one of the four criteria (see above). He elaborated that in subsection (3) the reinvestment requirement was deliberated extensively and the 24 month commitment for reinvestment was decided on. He mentioned potential amendments to strengthen authority.

Mr. Alper discussed AS 43.55.028(n) noting that he did not expect to see it in the bill. He admitted not understanding it to start. It indicated that if a company was to sell something at less than face value, they could not turn around and keep the amount that was discounted to collect on later. By selling something at a discounted rate, it overtly retired the discounted amount.

3:31:21 PM

Mr. Alper moved to Section 11, which had to do with DNR. It addressed the process by which overriding royalty interests were negotiated and accepted. There had to be an offer that had to be valued, risked, discounted, and turned into cash flow. The offer had to be valued at a minimum of the difference between the higher discount rate and the lower discount rate. For example, a company would receive about $85 million at the 10 percent rate and about $92 million at the 5.1 percent discount rate - a $7 million difference. The overriding royalty interest had to be worth at least $7 million to the state for the Commissioner of DNR to be able to sign off on the transaction.

Mr. Alper reported that the remainder of the bill contained housekeeping sections that always appeared at the end of a complex bill. Section 12 authorized regulations. Section 13 authorized retroactivity of regulations. Section 14 outlined the bill would have an immediate effective date. If the bill passed without an effective date, it would go

into effect 90 days after the governor signed the bill into law.

Co-Chair Seaton referred to Section 6 on page 2 of the sectional. He asked for more information regarding 028 for the payment or disbursement of bonds. He asked if the section would impact constitutional or state debt.

Mr. Alper explained that the 028 fund was a fund in which the traditional appropriation passed through the fund. Without further appropriation, the DNR staff had been making the purchases of tax credits for the prior 10 years. The language in Section 6 stated that the money that came through the bonds could also be used to purchase the tax credits. It did not actually pass through the 028 fund. In fact, the conforming language on page 9 of the bill stated, "The Department may not purchase with money from the oil and gas tax credit fund more than $70 million in tax credit certificates." The real purpose of Section 6 was to establish that the old system still existed but that there were certain rules to the old system that did not apply to the bond system. In terms of debt capacity, he deferred to Mr. Mitchell.

3:35:37 PM

Co-Chair Seaton asked specifically about the department because the department spent from the 028 funds. He was concerned with state debt and the department doing the purchasing.

Mr. Barnhill responded that in DOR's and the Department of Law's view, debt as it was used in the Alaska Constitution (Article 9, Section 8) had a very specific meaning of "Term of Art." It meant that it was the kind of debt in which the state had pledged its full faith and credit of the state. If debt was issued that did not do that, then it was not debt governed by the Alaska Constitution. There was nothing in the bill that pledged the full faith and credit of the State of Alaska, therefore, it was not debt governed by the Alaska Constitution. The issue of revenue or other items in the bill that triggered the Alaska Constitution's definition of debt was not part of the bill. He reiterated that the bill did not pledge the full faith in credit of the State of Alaska. Instead, it disclaimed that the full faith in credit as not pledged and therefore, not state constitutional debt. The perspective was held strongly by

the Department of Law and the bond council. Many issuances using a variety of structures relied on that interpretation. He indicated that the anxiety discussed on the previous Saturday had never been contemplated but, the department remained comfortable that the constitutional issues were not triggered by the bill.

Mr. Mitchell mentioned that the statutes were modeled off the Pension Obligation Bond Corporation. The department had gone a significant way down the path of issuing those obligations and contemplating how that commitment to pay would be created. It was determined that there would be a funding agreement in place. The Department of Administration would enter into a funding agreement with the corporation. There would be a one-time deposit into the pension trust from the corporation's sale of bonds. In exchange for that there would be a commitment to pay from the state through DOA for purposes of satisfying the annual debt service of the corporation. The appropriation would be subject to the appropriation of the legislature every year. It was the model that the department anticipated using for the corporation, if the legislation was approved. There would be a funding agreement that the corporation would enter into with DOR. Having a public corporation at an arms-length legal existence from DOR helped in the effort. The Department of Revenue would enter into a contractual commitment with the corporation which would provide a one-time funding each time there was a transaction. In exchange, it would receive a commitment from the department to seek an annual appropriation for the funding agreement payment amounts. They would consist of the annual debt service related to the bond issuance and perhaps the annual $2,500 for paying agent services, an ongoing contractual fee with every bond issuance.

3:40:54 PM

Co-Chair Seaton wanted to make sure there were no complications when transferring the funds into the existing 028 fund. He asked if there was an amount that would provide a better rate. He asked Mr. Mitchell to comment.

Mr. Mitchell thought his question was interesting because there were different buyers that participated in different size transactions. Specific to taxable transactions, bigger was definitely better. There were investors that looked for a $50 million block size. In other words, it meant that

they wanted $50 million for themselves and wanted other people to have $50 million blocks so that there was a high probability for secondary market liquidity. It meant that they would be able to trade the paper later on in the event of their needing to get out of their position. The municipal market was a little different. It did not have some of the same thresholds that the taxable market had. In order to get the market's attention, it helped to have size. He suggested that a transaction of $100 million would attract the market's attention. A transaction of $5 million would attract a different class of buyers. Institutional investors would look at the larger transactions. The department did not know what it would be selling on a taxable tax exempt basis because it required additional tax work. If the department had an $800 million transaction that went 50/50 or 60/40 it would be a highlighted municipal market issuance. Due to tax law changes people could not do "advance for funds" anymore in the municipal market, and the ability to refinance bonds had diminished supply. Therefore, a $400 million or $500 million issuance coming out of an issuer would glean a significant amount of attention currently. On the taxable side, while it might not be billions, he thought it was a sufficient size to get good market interest in the transaction.

Co-Chair Seaton wanted DOR to look at Section 7 where the bill removed the $70 million cap. He suggested that if DOR anticipated it would be able to sell all of the bonds without any interest difference he was okay with it. Otherwise, he thought the legislature should consider some pro-rata amounts if the bond issuance was lower than what people were willing to pay. He wanted to be asking the appropriate questions on the sections in the bill.

Mr. Barnhill added that in terms of how it would work with deposits into the fund, with many transactions the department often funded money in an escrow account. There would be a requisition process for obtaining money out of the fund for qualified expenditures. He used the structure used at Goose Creek for an example. As the project was conducted and built by the Matanuska-Susitna Borough, there would be a requisition from the borough to the construction fund with sign-off from the state bond committee for the purpose of paying contractors. If there was going to be an issue with money being deposited directly into the fund, the structure could be considered as well.

3:45:38 PM

Representative Wilson asked if a specific plan was in the bill.

Mr. Alper responded that the concept of 2 years of interest only and the rising principle was not defined in the bill. However, the notion that the corporation had the authority to establish the terms was included in the bill. The market would help to establish the terms, as the people buying the bonds might have certain preferences. It was the intent of the administration to move forward with the way it modeled and presented it the prior Saturday.

Representative Wilson asked about the effects of it being higher.

Mr. Alper replied that if the interest rate was higher than the administration was showing, then the discount rate at which the state would be buying the credits would also be higher. In other words, the state would be buying them for a little less money to cover the fact that the interest was larger. The lower discount rate for the companies participating would not be set until the last minute at which time the state would likely know the interest rate. If Representative Wilson's question was about restructuring the timing of the payment, it would change the timing of the payments and increase the amount the state would have to pay in the first couple of years. The net effect was still advantageous to the state - the numbers were slightly different. Currently there was a $27 million fiscal note attached to the bill with the assumption of the state's interest obligation for 2019. He suggested that if the bonds were sold under different terms, the state would have to come back to the legislature with a supplemental request.

Representative Wilson was concerned about different terms for different companies. She was also concerned with adding another bonding obligation to the Public Employees' Retirement System (PERS) and Teacher's Retirement System (TRS) bonding obligation. She had a question for the commissioner. She referred to a company that had development plans currently. She wondered if they would be required to make new development plans to meet their obligation for 2 years of showing their intent to invest in

Alaska, or whether they could use what they had in place with DNR.

Commissioner Fisher commented that Representative Wilson had a great question. He would return with an answer at the next hearing.

3:49:40 PM

Representative Wilson did not want to make things more difficult for the companies, as it was a stipulation being added.

Commissioner Fisher responded to Representative Wilson's question about PERS and TRS. He explained that when PERS and TRS was added to the new schedule the state was flattening out the total amount of the payment as a percentage of state UGF. He thought there was a benefit. He remarked that PERS and TRS were rising and the tax credit bonds would be rising in the outyears. However, it would not peak at the same high level it would if the state did not do the proposed program.

Representative Wilson remembered that it also depended upon oil going up more than what it was presently. She recalled contemplating the price of oil going up. However, she did not want to bet the state's budget on the price of oil.

Commissioner Fisher conveyed that the administration believed that pushing the payments out was an appropriate strategy because of anticipating an improvement in the state budget. Under the status quo, if the state did not enact the legislation, the combination of debt, PERS and the TRS, and the credits would cap out at about 31 percent. He continued that with the program it capped out about 24 percent. His point was that the program would supply a smoother and flatter overall expense to the state, regardless of what happened with oil.

Representative Ortiz asked why the state might or might not want to pass HB 331. He recalled asking Mr. Mitchell if, with the passage of HB 331, there might be a potential impact on the state's ability to bond to protect the state's infrastructure. He asked Mr. Mitchell to further comment on what the state's ability to engage in a bond program for infrastructure might be if the bill were to pass.

Mr. Mitchell noted that, from a management perspective, there were pros and cons to the state having a liability that was being refinanced. It was not as impactful as a new obligation but would take a soft liability and make it a hard liability. There would be no optionality in payment and would have an impact on rating agencies. Also, it would be included in net tax supported debt when considering the state's debt capacity. He thought it would have not quite a full $800 million worth of impact on the state's capacity but an impact of about $200 million. In the debt affordability analysis release earlier in the year, the state opined that the current debt capacity of the state, given the metrics that the state followed and the current unrestricted general fund revenue forecast from the fall, was in the range of about $300 million to $400 million. There were several other variables in play. Without considering the other matters, it had an impact on the state's current ability to borrow.

3:55:08 PM

Representative Ortiz asked if it was safe to say that 10 years prior the state was more apt to be all things to all people. He asked if, by going down this road, the state was limiting its options for future legislatures and their ability to address certain issues.

Mr. Mitchell replied that there was a budgetary smoothing as a result of the proposal in the bill which allowed some flexibility. In an ideal world, the state would have a capital project plan that was embedded with a debt management component. There were highly essential projects funded on a routine and regular basis using a policy that flowed from one group of elected officials to the next. However, circumstances had been much more ad hoc.

Representative Guttenberg mentioned the legal opinion letter provided by Legislative Legal Services on the constitutionality of the bill. The legislature had also received a press release from the attorney general on the issue. He mentioned a document from the commissioner as well. He was looking for a broader basis to have a conversation.

3:58:07 PM

Vice-Chair Gara asked about the impact of the bill on the state's bonding capacity. He wondered about an amount or specific numbers.

Commissioner Fisher asked if the assumption would be that the Percent of Market Value (POMV) legislation passed.

Vice-Chair Gara responded both ways.

Commissioner Fisher replied that it might be fair. However, his assumption was that the notion of the capital budget was premised on the assumption there would be a POMV that would fund it. He could talk about it both ways. Obviously, if the POMV bill passed, the answer to Vice-Chair Gara's question would be much easier to answer.

Co-Chair Seaton explained that if a POMV passed there would be an expectation that the earnings reserve would be available for state spending and supporting state services. The difference was whether an asset was counted or not counted regarding a bondable amount.

Commissioner Fisher answered that with a POMV in place the state would experience a much larger bonding capacity amount.

Mr. Mitchell answered that the debt affordability analysis that the division released in January used the fall forecast. The state's historical metrics for purposes of determining capacity was to have general obligation debt and state supported debt be no more than 5 percent of UGF revenue. The division did not want the debt to be more than 8 percent if the school reimbursement debt was added. The division had not been incorporating the obligations that the state had placed upon itself through the payment on behalf of the employer situation with PERS and TRS. Employees were held harmless at percentage of payroll levels - not making them pay the actuarially determined payroll levels. He continued that with the analysis the department's projected UGF revenue was about $2.3 billion. The state's existing debt was declining because the program was mature and had step-down obligations. The state had some new obligations that had to be issued but were already authorized. He commented that a 10-year look-forward resulted in a debt capacity of between $300 million to $400 million. In other words, over the following 10 years the state could be highly confident in maintaining a credit

rating with a debt issuance program of that amount. The bill would have a significant impact on a percentage basis. He suggested that a guesstimate of $200 million impact was accurate, about half of the limited capacity.

Mr. Mitchell indicated that if a POMV passed, $1.7 billion would be available for UGF spending on an annualized basis and growing with inflation at 2.25 percent. The ratios looked much better. He did not believe it could be the same analysis that had been used in the past. The department needed to have a holistic review of the debt affordability analysis. He had been hesitant to go the high end of the historical analysis. It would increase the state's debt capacity by about $1.7 billion.

4:04:42 PM

Vice-Chair Gara asked if it would be $1.7 billion with the passage of the bill.

Mr. Mitchell replied that if the bill had a $200 million theoretical impact, the state would have a remaining capacity of $1.5 billion. He was projecting on the low end. He was reluctant to use the historical metrics without considering some of the shifts that had occurred since the department started conducting the debt affordability analysis with the payments on behalf of the employers. It would result in a harder liability from a credit rating perspective and would be included in the state's Comprehensive Annual Financial Report (CAFR) with the potential to have impacts.

Co-Chair Seaton had a question regarding Section 10 on page 3 of the bill. He referenced AS 43.55.028(m) and pointed to the first item regarding seismic credits. He used a scenario with two companies that were willing to release their seismic data immediately. One of the companies was in the early stage of development and the other conducted seismic testing several years prior. He wondered how the department would value the release of their seismic data.

Mr. Alper replied it was an important question which might help clarify the issue the department was discussing about seismic credits and what data would be provided. There were certain credits that were earned for seismic work that were still outstanding and unpaid. Those credits were for work done in the past couple of years. If there was seismic

shooting done 5 or 6 years prior and there were credits associated with them, they were long paid and not the seismic data being considered for early release. The department was looking for the seismic data that were specific to the credit shoots that had the open tax credits against them - a more recent vintage of tax credits. If the state had a case where a company had some seismic credits as well as other credits, it was only the seismic credit that would be bought down to the better discount rate. They would not be able to get all of their non-seismic credits at the better discount rates simply to give the data for their seismic credits. Mr. Alper asked if his explanation helped.

4:08:20 PM

Co-Chair Seaton responded in the affirmative. He opined that he had not been given a good explanation about how to get two rates. He provided a hypothetical scenario. He asked if it was an on-off lever of 10 percent or 5.1 percent.

Mr. Alper answered that the seismic credits were discrete. There was a finite amount of them within a set. He suggested that 10 percent to 15 percent of the total outstanding credits were seismic related. He imagined a split application where a company might have some outstanding seismic credits and not be able to obtain a better discount rate on a non-seismic credit. As far as the reinvestment requirement, the way the division interpreted it, the credit would not be able to be split. A company would need to make a commitment in the full amount of their cash out, whether $10 million or $200 million. The company would need to commit the full amount of their payment within the 24 month period. It did not anticipate someone splitting the particular provision.

Co-Chair Seaton asked about the overriding royalty. If a company had credits on several different operations, he wondered if the overriding royalty was on each part of the company's production. He provided another hypothetical scenario. He asked if the overriding royalty was based on the company's entire production or on the credits generated. He asked if it was proportional or company-wide.

Mr. Alper answered that the overriding royalty section was not explicit to the leases where there might have been

credits earned. The only requirement was that the company had tax credits eligible for repurchase and then negotiating an overriding royalty. They would be negotiating with DNR for royalty on an associated lease or on another lease under production. If they had a lease under current production, it might be perceived as more valuable to DNR because there might be much less risk associated with it. There was not a requirement that all of a company's leases be included. They needed to be offering something of value to the state. The commissioner of DNR would have to value the offering in such a way that it would be worth the incremental money.

4:12:06 PM

Co-Chair Seaton asked if Mr. Alper was referring to the net present value of the incremental amount based on the plan of development.

Mr. Alper answered there would be the expectation of the plan of development (when the company indicated they would come online). There would be a certain risking that would occur which was not unlike what DOR and DNR do in generating the production forecast. There was a level of uncertainty baked into the calculation, more or less reducing the value of what the company's projected cash flow would be. A present value would be assigned. The result of the calculation, the discounted risk present value, would have to be greater than the increment between the higher and lower discount rates. He referenced the $7 million difference - the difference between $85 million and $92 million. The calculation would result in something perceived to be at least $7 million to the state.

Co-Chair Seaton thought it was good to get out more explanation on developing the cost benefit to the state. He thanked the presenters.

Mr. Alper took some notes and offered to speak now or write a letter to the committee.

Co-Chair Seaton asked the department to submit the information in writing. He reviewed the schedule for the following day.

Representative Wilson asked if an amendment deadline for the bill had been set.

Co-Chair Seaton answered that amendments were due on Wednesday at 5:00 p.m. He recessed the meeting [note: the meeting did not reconvene].

#

ADJOURNMENT

4:15:27 PM

The meeting was adjourned at 4:15 p.m.