

HOUSE FINANCE COMMITTEE

May 2, 2018

9:29 a.m.

9:29:00 AM

CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 9:29 a.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 Mark Neuman - Alternate
Representative Dan Ortiz
Representative Lance Pruitt
Representative Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

Representative Steve Thompson

ALSO PRESENT

Jane Pierson, Staff, Representative Neal Foster; Mike Barnhill, Deputy Commissioner, Department of Revenue; Ken Alper, Director, Tax Division, Department of Revenue; Jim Beckham, Deputy Director, Division of Oil and Gas, Department of Natural Resources; David Teal, Director, Legislative Finance Division; Representative Charisse Millet; Representative Jennifer Johnston; Representative Chris Birch; Representative Jonathan Kreiss-Tompkins; Representative Lora Reinbold; Representative George Raucher; Representative Mark Neuman.

PRESENT VIA TELECONFERENCE

Emily Nauman, Legislative Legal Services;

SUMMARY

HB 331 TAX CREDIT CERT. BOND CORP; ROYALTIES

CSHB 331 (FIN) was REPORTED out of committee with a "do pass" recommendation and with three new fiscal notes: two indeterminate fiscal notes and one fiscal impact note by the Department of Revenue; and one previously published zero note: FN1(DNR).

#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."

[9:29:51 AM](#)

Co-Chair Seaton MOVED to RECIND action on Conceptual Amendment 11 [The amendment was considered during the April 27, 2018 meeting.]

Representative Pruitt OBJECTED.

Co-Chair Seaton explained his motion. He noted that the sunset date changes conflicted with the "028" credits [AS.43.55.028. Statute containing credit provisions] and the timing in relation to the bond issue. He voiced that a future legislature could consider the action.

Co-Chair Foster indicated Representative Charise Millet had joined the meeting.

Representative Pruitt WITHDREW his OBJECTION

There being NO OBJECTION, it was so ordered.

Co-Chair Seaton WITHDREW Conceptual Amendment 11.

Co-Chair Seaton MOVED to ADOPT proposed committee substitute for HB 331 (FIN), Work Draft (30-GH2863\O, Nauman, 5/1/18).

Representative Wilson OBJECTED for discussion.

Co-Chair Foster invited Ms. Pierson to the table to explain the changes in the committee substitute (CS).

[9:32:52 AM](#)

JANE PIERSON, STAFF, REPRESENTATIVE NEAL FOSTER, reviewed the changes to the bill by reading from a prepared statement:

Page 1. Lines 1-5 Title The title in version 0 is amended to include language acknowledging the issuance of bonds, the payments and refunds of unused portions of certain tax credits issued under AS 43.20, and the changes to the oil and gas tax credit fund added by amendment #3.

Page 1, Line 13 - Page 2, Line 11 AS 37.18.010 Technical and conforming changes were made.

Page 2, Lines 17 - 25 AS 37.18.030(a) "powers of the corporation" was added to the subsection title. Purchases or payments was changed to "purchases, refunds and payments". "Transferred" was changed to "disbursed" consistent with the rest of the bill. The restriction on bonding in the last sentence before December 31, 2021, now excludes refunding bonds from this subsection.

Representative Wilson referenced line 21 and wondered about the change from "shall" to "may." Ms. Pierson responded that the change occurred when Legislative Legal Services (LAA) was drafting the bill and making technical and conforming changes. She deferred to LAA for further clarification.

[9:35:03 AM](#)

EMILY NAUMAN, LEGISLATIVE LEGAL SERVICES (via teleconference), explained that in the "A" version of the bill the sentence mandated that all proceeds from the bonds were disbursed to the commissioner {Department of Revenue (DOR)] for purchases of tax credits under AS.43.55.028. However, on page 3, lines 15 through 18 the section allowed the proceeds to be deposited into the reserve fund. She reasoned that the word "shall" conflicted with both options and she changed the word to "may" to conform to the language on page 3. Representative Wilson deduced that the

word "may" was not implying an option to not pay the credits. Ms. Nauman responded affirmatively and added that "may" allowed some proceeds to be deposited into the reserve fund.

Ms. Pierson continued reading from her prepared statement:

Page 2, Lines 26 - 29 AS 37.18.030(b) Language was changed to parallel the bond approval structure language in art. IX, sec. 8, Constitution of the State of Alaska.

Page 3, Lines 15-23 AS 37.18.040(a)(2) This paragraph was broken into subparagraphs for clarity.

Page 3, Lines 24 - Page 4, Line 2 AS 37.18.040(b) The reference to subsection (h) was removed, consistent with the removal of subsection (h).

Page 4, Lines 3-7 AS 27.18.040(c) The phrase "as defined in (b) of this section" was problematic since "required debt service reserve" was not defined in (b). (defined in AS 26.67.290(b)) Reference to (h) was also removed, consistent with the removal of subsection (h).

Former subsection AS 37.18.040(h) was removed. It appears that the former subsection (h) was a holdover from drafting the pension obligation bond authorization and per legislative legal, it appears to serve no purpose in this bill.

Page 6, Lines 11-17 AS 37.18.050(d) A cross reference was added to (b) in addition to the reference to (a) since some of those actions happen under (b).

Page 6, Lines 23-24 AS 37.18.060 Language was added stating the corporation shall publish notice of the adopted resolution.

Representative Wilson asked where the notice would appear. Ms. Pierson deferred the answer to DOR.

[9:40:02 AM](#)

MIKE BARNHILL, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, responded that legal notices were often published in

publications that were distributed statewide like the "Alaska Journal of Commerce." The statute did not specify where the legal notices were to appear. Representative Wilson asked whether legal notices were common practice with bonds. Mr. Barnhill responded that the legal notice was placed by the bond corporation to broadcast that a resolution was published. He indicated that the statute of limitations was 45 days; the public had 45 days to file a lawsuit.

Ms. Pierson continued with the summary.

Page 7, Lines 3-6 AS 37.18.080 This section was changed to Purposes; limitation on issuances from Purposes and sufficiency of revenue. There does not appear to be a sufficiency of revenue provision in this bill.

Page 7, Lines 12 - 18 AS 37.18.090(b) Changes language to parallel the bond approval structure language in art. IX, sec. 8, Constitution of the state of Alaska.

Page 8, Line 4 - AS 37.18.090(e) was added to the O version. "The corporation is authorized to incur expenses to carry out this section."

Page 8, Lines 11-18 - AS 37.18.110 Limitations on Judicial Action was added per Amendment #2.

Page 8, Line 29 - Page 9, Line 4 AS 37.18.190(4) Drafting correction deleting "means and includes" to conform with the legislative drafting manual.

Former Sec. AS 37.18.900(5) was removed the definition of "department" is not used in this chapter.

[9:43:05 AM](#)

Representative Wilson asked to return to page 8, lines 19-23. She wondered why the section numbers were changed. Ms. Pierson deferred to LAA.

Ms. Nauman explained that renumbered sections were due to drafting decisions. The numbering change occurred so that the entire "numbering set" of the chapter would not be used.

Representative Neuman referred to page 8, lines 11 through 18, Section AS.37.18.11 that pertained to the limitation on judicial action. He wondered if the language was "boiler plate" type policy or if the language was something new.

[9:44:59 AM](#)

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, acknowledged that the legality of the bond issue was in question. He indicated that if challenged, the administration wanted a quick resolution to prevent a lawsuit after the bonds were already sold. The administration felt that dealing with legal challenges "sooner rather than later" enabled the plan to move forward faster. He furthered that a fair amount of precedent regarding limitations on judicial action existed. He noted that similar language was placed in legislation related to the Stranded Gas Act, Alaska Gasline Inducement Act (AGIA), and the Alaska Gasline Development Corporation (AGDC).

Representative Neuman asked if the language had been used before. Mr. Barnhill indicated that he had never seen the provision used regarding bonds. However, it had been used in conjunction with other state statutes in the context of gas development. Representative Neuman interpreted the language in a manner that he thought dictated to industry that the state had the absolute authority on how to use the bonds. He voiced that the "bottom line" interpretation and message to industry was that "the state was going to be correct no matter what the dispute is." Mr. Barnhill stated that the provision was in direct response to the conflict in legal opinion between LAA and the Department of Law. He reported that the likelihood of litigation was plausible, and the department wanted to engage in the process as soon as possible. He indicated that the proposal was not the only situation where a state entity issued subject to appropriation debt and thought it was necessary to get through the litigation quickly to remove the "cloud" from the concept of subject to appropriation debt.

[9:48:14 AM](#)

Representative Neuman relayed his experience with Knik Arm Bridge and Toll Authority (KABATA) employing a revenue bond proposal to repay the state. He commented that the revenue bonds needed a known revenue source. He indicated that the current bond proposal; issuing revenue bonds without a

revenue source was the reason for the legal question. He characterized the scenario as "unique" and concluded that a "unique judicial action plan" was necessary in case of legal challenges. He maintained that there were "significant differences" between DOL and LAA and he thought "it was a huge red flag." He wondered why the language was necessary. Mr. Barnhill explained that the department did not view the bill's structure as a revenue bond per say. The bond was structured to be issued by a state corporate entity that did not receive revenue, therefore used a subject to appropriation tool, which was at the center of the legal dispute. He declared that the method was "unusual", but the point of the language was to move it along the legal process and gain "clarity" from the state Supreme Court "as quickly as possible." Representative Neuman asked whether the state could accomplish the same goal without the legal challenges "by simply stating that the legislature could appropriate up to \$180 million per year for 5 years to pay off oil and gas tax credits out of the general fund (GF)." Mr. Barnhill asked whether he meant that the security for the bonds used legislative appropriation "upfront." Representative Neuman replied that the proposal "was still a moral obligation of the state." The bill specified the payment schedule without knowing the interest rates, the amount of debt, and the purchase price of the bonds. He thought that the same result could be accomplished by granting DOR the appropriation authority or create a corporation with the authority to comply with the payment schedule in the bill; \$180 million per year for 5 years up to \$800 million. Mr. Barnhill responded that he "wished" a resolution was "that easy." He deduced that Representative Neuman's scenario "would suffer from the same problem." Representative Neuman asked whether the reason was that the scenario still relied on legislative appropriation. Mr. Barnhill answered in the affirmative.

[9:52:08 AM](#)

Vice-Chair Gara surmised that the bond issuance would not proceed without an opinion from the attorney general and the legislature would receive a letter from the National Bond Council who would issue an opinion after a legal review. Mr. Barnhill replied that Vice-Chair Gara was correct. Vice-Chair Gara voiced that the process provided him with the assurance he needed regarding the legislation.

Ms. Pierson continued to read from her prepared statement:

Page 9, Lines 7- 16 AS 43.20.046(e) Language was added regarding subject to appropriation by the legislature Language was also added to allow the Department of Revenue to make a refund using the oil and gas tax credit fund, from money disbursed to the commissioner, or both.

Page 9, Lines 17 - 26 AS 43.20.047(e) Language was also added to allow the Department of Revenue to make a refund using the oil and gas tax credit fund, from money disbursed to the commissioner, or both.

Page 9, Line 27 - Page 10, Line 5 AS 43.20.053(e) Language was also added to allow the Department of Revenue to make a refund using the oil and gas tax credit fund, from money disbursed to the commissioner, or both.

Page 10, Lines 6-13 AS 43.55.028(b) New language added by amendment #1. The balance of the amendment is found in (r)of this section.

Page 10, Line 14 - Page 11, Line 11. AS 43.55.028(e) Language was added to allow the purchase of tax credits with money in the oil and gas tax credit fund, money disbursed to the commissioner, or both. Language was also added on line 24 - 27 that reflect amendment #3.

Page 12, Lines 4-12 AS 43.55.028(i) This section was rearranged to be in alphabetical order, as is standard for definitions sections. "For the purchase in this section" was removed from the definition of "true interest cost." Because the bonds will be purchased under AS 43.55.028, the language was unnecessary and confusing.

Page 12, Line 30- Page 14, Line 8 AS 43.55.028(k) In an effort for clarity, some of the repetitive language was removed regarding notice and ties other provisions to the 10-day notice of acceptance.

Page 14, Lines 9- 26 AS 43.55.028(l) Proration language has been moved into subparagraphs to provide clarity.

Page 14, Line 27 - Page 16, Line 8 AS 43.55.028(m)
This draft the phrase "each year" in multiple places
in this subsection, since the first sentence specifies
that the discount rate applies each year after the
first year. Amendment # 4 is included in subsection
(m) and (n).

Page 16, Lines 9-15 AS 43.55.028(n) Language was added
to state that penalties do not occur, if the applicant
could not incur the expenditures due to natural
disaster, injunction or other court order.

Page 16, Lines 29 - Page 17, Line 2 AS 43.55.028(r)
New language relating to amendment #1 on the double
draw.

Page 17, Lines 10-12 AS 44.37.230(a) expands the
requirements for the Department of Natural Resources
to assist the Department of Revenue were expanded.

[9:56:36 AM](#)

Ms. Pierson continued reading from a prepared statement:

Page 19, Lines 1-4 AS 44.37.230(g) gives the
Department authority to request information from an
applicant and to require the applicant to provide
additional information.

Page 19, Line 18. Sec 13 Repealer section. Section 13
repeals specific sections of HB111.

The most important section being repealed is Sec. 31,
which is itself a repealer of a bunch of sections of
law including all of 43.55.028. It also repeals a
number of sections specific to purchasing credits
through the .028 fund (for example 43.20.053(e). The
rest of 053 is the refinery credit. The (e) is how the
.028 fund is used to purchase them.

Most of the other repealed sections from HB111 are all
conforming, the change language to adapt to the fact
that certain statutes are no longer repealed. Since
they're not being repealed, we don't need the
conforming amendments. All of this together is in Sec.
13 of HB331.

The last item listed in Sec. 13 is repealing Sec. 43 of HB111. This one is the condition that triggers the repealer: the commissioner of revenue says there are no more credits to buy.

Representative Wilson asked whether all the information was confidential. Mr. Alper replied that the Department of Natural Resources (DNR) might want to weigh in. He responded that whatever revenue DOR received was confidential tax payer information. He thought that DNR had a similar confidential taxpayer relationship through royalty payments and would act similarly with HB 331.

[9:57:41 AM](#)

JIM BECKHAM, DEPUTY DIRECTOR, DIVISION OF OIL AND GAS, DEPARTMENT OF NATURAL RESOURCES, answered that any additional information the department would request were financial statements, reserve reports, and geological and geophysical engineering information that would likely be held confidential after the analysis was completed.

Ms. Pierson continued with Page 19, Line 18, Section 13 of the legislation related to repealers. She deferred to DOR and LAA to explain the changes.

Mr. Alper delineated that HB 111 (Oil & Gas Production Tax; Payments; Credits) [CHAPTER 3 SSSLA 17 - 07/27/2017] was adopted the previous session, contained a contingent set of repealers. Once the last tax credit was paid off a process was triggered that eliminated the 028 fund and all corresponding statutes would be repealed. The problem was that there were many sections in the CS that referenced the fund and the process "would be orphaned without the language that was being repealed." The way the administration chose to resolve the issue without adding many pages of additional language to the bill was to simply "eliminate the future contingent repealer." Therefore, the language provided that "once the credits were paid the fund statutes would be left in place," which enabled an expedient way for the CS to contain a simpler bill structure. The section repealed the future effective dates and the actual repealer section in HB 111. He indicated that when the credits were paid off the credits were eliminated but the statutes remained in place.

Co-Chair Foster invited Ms. Nauman to comment.

Ms. Nauman concurred with Mr. Alpers statements.

Ms. Pierson continued:

Page 19, Line 19 - Page 20, Line 11 - Notice to the Revisor of Statutes. Provides language for the Commissioner of Revenue to provide the revisor of statutes information when bonds and the oil and gas tax credit fund are no longer being used.

Co-Chair Seaton informed the committee that the repealer section in the CS accomplished the provisions contained in the withdrawn amendment. He added that the provision alerted a future legislature to repeal the statutes that were no longer in effect.

Mr. Alper interjected that similar language was in Section 43 of HB 111 and was the conditional trigger that set the repeals in motion. The language in Section 14 of the CS merely notified a future legislature of the need to repeal the statutes.

[10:03:22 AM](#)

Ms. Pierson relayed the changes on Page 20:

Page 20, Line 24 Repeals Section 46, ch. 3, SSSLA 2017 which is the delayed effective date.

Mr. Alper explained that Section 13 of HB 111 contained the substantive repealers and Section 46 was the effective date section related to the repealers. He concluded that Section 16 of the CS was functionally an effective date section in another bill.

Co-Chair Foster noted that Representative Lora Reinbold and Representative George Raucher were in the audience.

[10:04:40 AM](#)

Representative Ortiz asked for a general summary of the changes between the original version and the CS. Mr. Barnhill responded that the CS contained the amendments the committee adopted in the previous meeting. In addition, the CS attempted to align the differences in the bill drafting preferences between DOL, LAA, and the bond council according to LAA preferences. Representative Ortiz asked if

the effect of any of the changes made the bill more resistant to legal challenges. Mr. Barnhill believed the drafting changes provided more clarity but not "immunization against legal attack."

Representative Ortiz cited Ms. Nauman's legal opinion previously submitted [refer to 4/21/2018 meeting (copy on file)]. He asked if her opinion remained the same. Ms. Nauman responded in the affirmative and added that none of the changes in the CS resolved any of the legal issues she identified in her legal memo. However, the bill did address one of the constitutional issues she identified. She explained that originally money was transferred from the bonds to the corporation to the commissioner who then purchased tax credits. The process was not subject to legislative appropriation and she believed that all the transfers of funds moving in and out of the general fund was subject to appropriation. The new CS provided that the legislature must appropriate the money that would be used to purchase the tax credits and included the conforming changes necessary throughout the bill.

[10:08:10 AM](#)

Representative Wilson referenced page 14, subsection (l) and asked why the subsection was rewritten. Mr. Alper replied that the subsection was written and included (c)(1), (2), and, (3) to describe the sequence of the calculation and how it was calculated and prioritized. He noted the change was stylistic and was previously in paragraph format and included the words "proration methodology" versus "proration amount" in the CS. The underlying logic was identical to provisions in the original bill. He delineated that all holders of certificates that requested money in the earliest years had priority over later years' requests, and equal priority was granted within the same year; all the 2016 credits would be paid first, subsequently the 2017 and 2018 would be paid sequentially. He pointed to the language in Section 18 that defined the statutory appropriation based on the current revenue forecast before the application of tax credits. The specificity eliminated any potential dispute over the appropriation formula. Therefore, subsection (l) enabled DOR to calculate the schedule of payments for any credit holders to which the discount rate was applied, contained in subsection (m).

Representative Wilson cited that page 18, line 11 contained the phrase "an overriding interest agreement." She reported that the words "overriding interest" was removed and asked why. Mr. Alper thought the section described an overriding royalty contract agreement and the word agreement in the bill referred to the overriding royalty contract. Representative Wilson noted that on lines 23, 25, and 27 [page 18] the words "or leases" were removed and questioned why.

[10:11:19 AM](#)

Mr. Beckham deferred to Ms. Nauman regarding why the stylistic change was made. He noted that "lease or leases" was not that critical and any lease that was proposed for an overriding royalty agreement would be considered.

Ms. Nauman stated that she could answer both of Representative Wilson's previous questions. She believed that the phrase "overriding royalty interest agreement" was cumbersome therefore, removed "overriding royalty interest," left the word "agreement," and defined agreement as an overriding royalty interest agreement on page 19, line 14. She remarked on the singular use of the word "lease." She clarified that on page 17, line 26 and lines 29 and 30 the language was "lease or leases" to acknowledge that a proposed agreement could possibly include more than one lease. She pointed to page 18, lines 16 through 31 related to information collected on the lease and detailed that the singular implied that the information would be derived from any lease subject to the agreement. In addition, use of the singular conformed to LAA's drafting manual that preferred use of the singular.

Representative Wilson appreciated the letter Mr. Beckham sent in response to her previous questions regarding the overriding royalty interest (ORRI) agreements HB 331 would authorize (copy on file) but wanted more clarity. She offered her interpretation of what the agreement was and inquired whether she was correct.

[10:14:17 AM](#)

Mr. Beckham did not understand Representative Wilson's question. Representative Wilson was trying to understand "what the agreement would look like." She asked whether a company that chose to enter the ORRI agreement versus a

capital expenditure would need a field that was already producing oil, if so, would the agreement grant the state a percentage of the oil "as their [the company's] donation versus doing a capital project." She wondered whether she was "completely wrong." Mr. Beckham thought her question centered around the lease and whether the field was in production. He answered that the lease was not required to be in production at the time of the ORRI request. The department would have to access the potential production and timing of production to assist in accessing the risk and whether the ORRI met the requirements of the bill. Representative Wilson wondered what would happen if the state decided to take the risk, but the production was under the estimates. She asked whether the company would be penalized or if the state accepted the losses. Mr. Beckham understood that there was no such recourse provision in the CS, which was typical for an ORRI and the reason why it was rarely used and the least preferred of the funding options for projects. He detailed that an entity offered a company money in exchange for an ORRI when the project was in production and the investor was repaid first before expenses or taxes were deducted from the project. He reiterated that that was the nature of an ORRI and no recovery clause was included in the bill should a field not go into production.

[10:17:41 AM](#)

Representative Wilson asked about the interest rates on bonds and whether they were set or flexible. She wondered if the state was "held harmless" against raising interest rates. Mr. Barnhill indicated that the bonds were priced by the market. He communicated that if the bonds were issued on a fixed rate basis, which was the administration's intent, the interest would be set, and the coupon rate would not change.

[10:18:31 AM](#)

Co-Chair Seaton referred to page 14, lines 27 and 28 dealing with subsection (m). He read the following: "... the department shall discount the assumed payment amount each year after the first year by a discount rate." He moved to page 15 and pointed to lines 5 through 9 and read:

the discount rate is the true interest cost plus 1.5 percent but may not exceed 10 percent. For a purchase

of a transferable tax credit certificate issued under AS 43.55.023 or a production tax credit certificate issued under AS 43.55.025, the discount rate is the true interest cost plus 1.5 percent, but may not exceed 10 percent, in total,...

Co-Chair Seaton pointed out that net present value was not mentioned, and he wanted assurance that the words "each year" implied that the calculations were cumulative based on the net present value and the 1.5 percent not exceeding 10 percent related to the discount rate did not assume that amount was the total discount on the repurchase of credits 3 years into the future. Ms. Nauman concurred with his conclusions regarding cumulative calculations. Co-Chair Seaton concluded that considering the meaning of cumulative and the 10 percent in total could not be interpreted as a 10 percent total discount rate. He asked whether he was correct. Ms. Nauman replied that the neither version of the bill specified whether the discount rate was cumulative or compounding and there was no change between the versions. She did not believe the change to "may not exceed 10 percent" modified the understanding and was analogous to the previous language. Co-Chair Seaton was trying to determine whether the language in the prior version was problematic. He wanted to clarify on the record that the calculation was based on the net present value and the interest rate was cumulative each year.

Mr. Barnhill emphasized that Co-Chair Seaton's conclusions were the absolute intention of DOR and he reminded the committee he included the calculation in a previous presentation {provided on April 21, 2018 (copy on file)}. regarding HB 331.

Co-Chair Seaton wanted to ensure that the intent of the CS repealed sections of session law enacted in HB 111 from the prior session. He emphasized that it was not the intent of the repeals in Sections 13 or 16 to extend the ability of a person to earn a purchasable tax credit certificate. The ability to transfer tax credit certificates ended on July 1, 2017 with the passage of HB 111. He maintained that "nothing in the bill was intended to change that."

[10:24:24 AM](#)

Representative Guttenberg pointed to page 20, line 20 and noted the term "expressly designate." He wondered why the

word expressly was included. Mr. Alper explained that Section 15 of the CS broadly stated that if regulations were still being drafted after the effective date of the bill the intent of the CS allowed the regulations to be retroactive to the effective date. He believed that the word expressly noted the intent that regulations applied retroactively. However, the department could not presume retroactivity applied; the department had to state the intent.

Mr. Barnhill explained that with respect to retroactive statutes the law required that retrospective applications were made explicit. He assumed the law also applied to regulations.

Co-Chair Foster wanted to finish the motion to adopt the CS.

Representative Wilson WITHDREW her OBJECTION.

There being NO OBJECTION, the committee substitute for HB 331 (FIN) was adopted.

[10:27:10 AM](#)

Representative Neuman asked whether the ORRI provisions were included because of prior agreements at the time the credits were offered and if the new agreements would override the prior agreements. Ms. Nauman was unable to answer the question and deferred the answer to DNR. Representative Neuman asked whether Cook Inlet agreements were made with different companies at the time the credits were offered. Ms. Nauman would have to do some research to answer that question.

Representative Neuman was concerned that the legislature did not know what agreements the credits were issued under. He wondered how the previous agreements, that were offered to incentivize exploration, would be impacted. He noted that the various companies had different needs and the legislature granted the department "leeway" to negotiate agreements. He wondered whether the ORRI provisions would override prior agreements.

[10:30:04 AM](#)

Mr. Barnhill explained the roll of the overriding royalty agreements served in the CS. He communicated that the purpose was for the companies to access a lower discount rate. The bill set a discount rate of 10 percent for repurchased tax credits, but if they wanted to get more for the credits they could offer an overriding royalty. Nothing in the bill impacted existing overriding royalties. The bill established an application process for a tax credit holder to submit an offer for an overriding royalty to DNR. The department evaluated the value of the agreement's worth to determine whether the offer equaled the amount of the increment received through the lower discount rate. He added that any other previous overriding royalty agreements remained in effect.

Representative Neuman reiterated his question. Mr. Alper wanted to clarify the difference between an overriding royalty agreement and a royalty. He detailed that a large portion of oil and gas production in Alaska was located on state land. The state, as the landowner signed a lease and received a royalty, which was a percentage of the amount of production and a portion was deposited into the permanent fund. An overriding royalty agreement did not change the royalty. He characterized the agreement as a "side deal separate and distinct from the land use royalty agreement." An overriding royalty was not limited to state land and did not supersede any previous contracts with producers. Representative Neuman inquired whether the issued credits were considered a moral obligation to the state. Mr. Alper responded that the state never signed a contract related to credits; credits were written in statute and offered based on certain exploration activities performed by the producers. He furthered that the credits had value "statutorily." The producers could use the credits to offset taxes or were traded or sold to other companies and subject to appropriation or could be sold back to the state for cash. The state never committed to full reimbursement of the credits, however the state paid the credits in full for 8 years in a row, but the state was not obligated to do so.

[10:35:21 AM](#)

Representative Kawasaki referred to DNR's letter regarding ORRI agreements. He read the following from the letter:

Subsection (f) requires DNR to evaluate a company's proposed agreement based on several factors. This will likely require DNR to consider sensitive and proprietary information about the company's finances, development plans, geological, geophysical and engineering information and resources under its leases.

Representative Kawasaki asked how the department factored in risk of failure over the life of an ORRI agreement. Mr. Beckham replied that the risk assessment was a complex process that DNR's commercial analyst would go through. He noted that the modeling process was similar to the production forecast. He could not explain the details of the risk calculations. Representative Kawasaki referred to an example provided in the letter:

DNR would consider the criteria in AS 44.37.230(f) to determine whether the anticipated net present value of OilCo's proposed ORRI agreement would meet or exceed the \$9 million-dollar difference between the purchase amount of the certificate at the lower discount rate with the ORRI agreement and the high discount rate without the ORRI agreement. The 30 barrel per day ORRI is nearly 11,000 barrels annually for the life of the lease. At \$50 per barrel, that is approximately \$550,000 per year.

Representative Kawasaki deduced that DNR would accept an ORRI agreement like the one exemplified. He asked what happened if the amount of production was lower or the price per barrel was lower than the amount predicted in the agreement. Mr. Beckham explained that the payment would be different than what was calculated; higher or lower. The example was simplistic and was designed to show the type of agreement the department would consider an acceptable agreement and was anticipating receiving. Representative Kawasaki restated his question regarding failure; if the price of oil or production dropped below what was specified in the agreement. Mr. Beckham noted that he was uncertain about what Representative Kawasaki considered a failure. He delineated that the percentage calculated for the ORRI was described in the bill and was a straight percentage on the total production without deduction for taxes and expenses, if the production or price decreased the ORRI payment would be less.

[10:39:43 AM](#)

Representative Kawasaki asked whether other ORRI agreements carried a statutory penalty if the producer failed to meet the obligation and goals of the agreement. Mr. Beckham responded that there were no penalty provisions in ORRI agreements. He clarified that an ORRI was an investment by an investor into a project with a promise to be paid on total production before any expenses. The risk was whether the project came into production. The investor lost money in the event production never happened and had no recourse to recover the funds. He furthered that regarding the ORRI, if the project happened with a lower production rate a temporary built-in royalty modification was paid until the project could "stand on its own without the royalty modification and the original lease provision rate applied. Representative Kawasaki asked if he anticipated many companies holding tax credits would take advantage of the ORRI provisions. Mr. Barnhill thought the likelihood was difficult to predict. Presently, the department had not received "any expressions of interest."

[10:42:00 AM](#)

Representative Grenn noted that the bill referred to "a tax credit certificate." He asked whether each certificate was considered separately in the case of a company holding multiple certificates. Mr. Alper reported receiving questions from industry regarding whether credits could be split. He referred to the matter as the "splitting issue." He pointed out that in general, companies were holding multiple tax credit certificates for multiple years and projects for different types of activities such as well lease expenditure credit, exploration credit, or operating loss credits. He announced that DOR would accept splitting at the individual certificate level. He exemplified that if a company had four seismic certificates and only wanted to waive its confidentiality on two, receive a lower discount rate, and use the discount rate on the other two certificates such actions were acceptable. He qualified that the only caveat was that a company must offer all their credits.

[10:44:28 AM](#)

Vice-Chair Gara opined that the bill contained "pluses and minuses" and that the bill avoided \$300 million in credit

payments for several consecutive years that the state could not afford. He defined that currently the law allowed companies to deduct the credits against oil taxes in any year they desired, and it was beyond the state's control. He asked for an estimate of what the price of oil would be if companies could deduct \$200 million to \$300 million off their production taxes. Mr. Alper replied that the ability to purchase tax credits to offset taxes was constrained over the last several years because of the low price of oil. He explained that the producers had been paying production tax based on the minimum tax; 4 percent floor. Regulations specified that a company was prohibited from using purchased credits to decrease its taxes below the minimum tax. The price of oil had to support a tax above the minimum called the "crossover" for an entire tax year in order for companies to use their per barrel credits to lower their production tax. The crossover point varied among companies, but an average estimate was \$65/bbl. He added that in the scenario when the price varies between prices above and below the minimum floor it created the concern over "migrating credits." The \$8.00 per barrel credit earned over several months in one year could be used to offset taxes in the "true up" to "drag" taxes down to the floor during a year of migrating credits. He delineated that if the price of oil remained in the "mid-seventies" per barrel of oil for one year the production taxes would be \$300 or \$400 million above the minimum tax revenue; the price that allowed producers to purchase credits and "buy themselves back down" to the minimum tax. Vice-Chair Gara asked whether in the future, without the bill, could the state lose between \$200 million to \$300 million in production taxes at a full year of \$75/bbl. Mr. Alper responded in the affirmative. He deduced that the longer the state made credit payments the larger the probability that the credit holders would sell the credits at "whatever price they could get." Conversely, if demand increased due to higher oil prices he foresaw scenarios where companies purchased hundreds of millions in credits to reduce their taxes. He concurred that the administration wanted to avoid the scenario through the legislation.

[10:49:38 AM](#)

Representative Wilson asked if the state owed the credits. Mr. Alper responded in the affirmative. She asked whether the previous discussion related to how the credit holders could utilize their credits was in current statute and

whether nothing new was being created in the bill beside the bond package. Mr. Alper replied in the affirmative. He elaborated that the credits were worth "100 cents on the dollar." He believed that Vice-Chair Gara's concern related to a hardship situation where a credit holder sold their certificate for 50 cents on the dollar and received 100 percent benefit offset against its own taxes. The original benefit was intended for the small explorers and was diluted when passes on to the major producers.

Representative Wilson heard negative criticism of the bill related to the payment scheduled. She asked whether the state would be able to meet the bond obligation and if it placed "the retirement issue in more jeopardy" with passage of the legislation. Mr. Barnhill answered that under current cash flow projections published by the Office of Management and Budget (OMB) the administration did not share the concerns. Representative Wilson had met with the department and discovered that the state "could make more money off of our money" through the bond proposal than through paying a specified amount each year. The state was controlling its liability. She wanted to ensure the public that the state was not jeopardizing the state's retirement obligation. She cited the presentation on April 21, 2018 on slide 18 ["State of Alaska Department of Revenue HB 331: Oil and Gas Tax Credit Bond Proposal" (copy on file)] that showed the state's debt capacity and credit rating. She relayed that the way the state was paying its debt, the state, in the end, should have a better credit rating and less debt.

[10:53:00 AM](#)

Representative Neuman observed that the state recently received \$275 million from 2011 tax returns. He noted that the money was typically deposited into the Constitutional Budget Reserve (CBR), but the deposit was not mandated via statute. He asked whether the payment could be used to pay the credits. He mentioned that a bill was passed in the prior week that allowed other use of the tax funds. Mr. Alper thought that he was referring to a newspaper article that reported the \$275 million was the total of the audits that the tax division had completed in the last year, which was requested to be paid before the statute of limitations went into effect. The money had not been paid but had been requested in a "Notice and Demand" letter. The companies could appeal through a long process; often the amount paid

was reached through a settlement. He emphasized that he money received through tax audits was "absolutely the property of the CBR" under Article 9, 17 (a). He added that Representative Neuman was referring to changes made in the prior year that related to retroactivity to offset prior year taxes, so long as there was not a burden placed on the CBR and issues related to the Trans-Alaska Pipeline System (TAPS) settlement. A legal opinion sought by DOR that stated that the TAPS issue was related to transportation and any tax settlement was not subject to Article 9 of the constitution requiring the deposit into the CBR. Representative Neuman contended that the legislature "made the rules" and knew money was "used otherwise." He asked whether regarding the legislation, the typical investment strategies were being considered. Mr. Barnhill thought Representative Neuman was referring to whether the Alaska Permanent Fund or other investment funds of the state could purchase the bonds issued under the bill. He explained that there was nothing in the bill that encouraged or discouraged any state investment fund to purchase the bonds and was simply not addressed. Representative Neuman deduced that the risk to industry increased if the companies did not know the value of the bonds, which equaled more cost. He reiterated that DOR had basic standards for investing and wondered whether the proposal considered the guidelines. Mr. Barnhill responded that when the bond corporation issued the bonds the coupon price would be set by the market estimated in the range of 3.6 percent and instruments subject to appropriation. The market would add a premium to the coupon to compensate for the risk. The risk premium was not anticipated to be significant based on the state's "excellent credit history." Any purchaser of the bonds would be aware of the subject to appropriation nature of the bonds and would know the coupon rate.

[10:58:56 AM](#)

Co-Chair Foster asked Mr. Teal to review the fiscal notes. He also noted Representative Dan Saddler in the audience.

[10:59:14 AM](#)

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, reviewed the fiscal notes for HB 331. He reported that the previously published DNR, Division of Oil and Gas fiscal note FN1 (DNR), was zero. He remarked that DNR could absorb the costs of commercial analyses of any overriding royalty

interest agreement applications if the number of applications were low. He turned to the previously published DOR zero fiscal note FN3 (REV), appropriated to Taxation and Treasury for FY 2019 that included a cost in the outyears of \$2.5 thousand for a yearly agent fee that applied for the length of the bond. He moved to the previously published DOR fiscal impact note FN4 (REV), appropriated to Administration and Support in the amount of \$737.9 million, which authorized the use of the bond proceeds to purchase participating tax credit certificates. He noted that currently the fund source code 1178 was a temporary code for undesignated general fund (UGF) use. In the future, a new fund code would be created to reflect the subject to appropriation bonds.

Representative Wilson asked why the fiscal note contained the UGF fund source versus a designated general fund (DGF) fund source since the money would come from the sale of the bonds. Mr. Teal replied that the Legislative Finance Division (LFD) used a temporary fund source in situations necessitating a new fund source code because the bill might not pass into law; therefore, creating fund codes with no applications. He confirmed that the bond sale proceeds were not UGF and would be an "other duplicated fund code." The bonds were not counted as an expenditure, but the annual appropriation of debt service was, and "in theory" was considered a general fund (GF) cost.

[11:03:27 AM](#)

Mr. Teal moved to the new Debt Service fiscal impact note appropriated to Oil & Gas Tax Credits Financing in the amount of \$27 million in FY 19. He noted that in the future the appropriation was anticipated to increase to roughly \$123 million but the future years were indeterminate because the amount required to pay the bonds depended on the bond financing and other variables.

Mr. Alper drew attention to a table on the second page of the previous two fiscal notes that contained the expected bond payments through FY 28. He relayed the assumptions made to determine the figures. He pointed to the \$737.9 million noted as the "amount paid with discount" and \$27 million interest payment in FY 19 and explained that the numbers assumed that all \$807 million in outstanding credits were sold into the program and all would receive the lower 5.1 percent discount rate. He ascertained that

the actual numbers would be less than the assumed numbers shown on the fiscal notes. He noted that the chart showed the anticipated payment total and the interest and principal amounts.

[11:06:04 AM](#)

Representative Wilson asked what would happen if the legislature did not make the appropriation. Mr. Alper believed that the bond markets would respond disapprovingly, and the non-payment would negatively impact the state's bond rating. Representative Wilson wanted the consequences stated on the record. She stressed the importance of keeping to the payment schedule.

Representative Kawasaki stated that the fiscal note showed a 10-year bond period. He thought the time period was longer. Mr. Alper answered that the bill did not specify or codify bill terms or the payment schedule. He indicated that the trustees of the corporation would set them, and the market would accept the terms. Therefore, the length would be established after the bill passed. He reminded committee members that there would be a second, third, and fourth round of smaller issue bonding for late coming tax credits that would all be on their own 10 year payment schedule. Representative Kawasaki deduced that the 32nd Legislature would anticipate an estimated bond payment of \$113 million. Mr. Alper answered in the affirmative.

Mr. Teal pointed out that the fiscal note did not show the savings from the amount that was currently deposited into the Oil and Gas Tax Credit Fund, which would be eliminated in lieu of debt service payments. He noted that there was not a fiscal note because there was no way to determine what the savings would be or how much the savings would be compared to the current approach. He emphasized that in the long run the debt service payments should be approximately equal to the purchases that would be made without the bill on a net present value basis. The bonding approach would pay the credits off immediately and the legislature would continue to pay, but as debt service rather than fund capitalization.

[11:11:29 AM](#)

Representative Ortiz remarked that if HB 331 was adopted the state was obligated to purchase \$807 million in

credits. He wondered about credits that had yet to be applied for, which he believed were about \$200 million. He inquired whether the bill addressed the outstanding credits. Mr. Alper replied that the estimated number of outstanding credits was \$150 million, and most were anticipated the coming summer from 2017. He communicated that the future issues were addressed in the bill that authorized the multiple bond issuances and the ability to issue bonds through FY 2021. He expected issuances once per year for four years. The department could not think of a way to build the information into the fiscal note due to many unknowns. He delineated that the actual bond payments were anticipated to increase because of the second, third, and fourth round of issuances. However, more than 80 percent of the credits would be issued in the first bond issuance and the remainder would be "remnants of the sun setting bond program."

[11:13:25 AM](#)

Co-Chair Seaton MOVED to report CSHB 331(FIN) out of Committee with individual recommendations and the accompanying fiscal notes.

Representative Wilson OBJECTED for discussion.

Representative Neuman believed the credits should have been paid a long time ago. He was concerned about the process due to the constitutionality question associated with the legislation. He stressed that the bill added "a tremendous amount of risk" and increased debt; the risk was proportionate to cost. He stated that the financial terms were unknown. He maintained that generally, there was a letter of interest pertaining to revenue bonds. The legislature had not yet seen any interest. He remarked that the legislature had a bad "track record" when claiming a bill would produce savings. He asserted that the bill created more rules telling industry what they had to do to receive credits that they initially acted in good faith obtaining. He stated that the legislature continued to introduce legislation to increase oil and gas taxes. He spoke about the fiduciary responsibility of the state. He repeated his concern about increased risk. He believed that the legislature should have just paid the debt off within 5 years. He stressed that the state's economy was suffering and contended that the bill involved great risk to the state. He had no confidence in the legislation.

11:19:53 AM

Representative Wilson spoke about a refinery in her region that received tax credits that were saving millions of dollars for the state. She was comfortable with the bill. She appreciated the answers to questions she asked. She stated that the bill did not cost the state more money. The state would benefit from more production. She was encouraged by Representative Guttenberg's amendment that encouraged local hire. She thought the bill was the next best way to incentivize production on the North Slope. She hoped the state learned that it must abide by the rules it established. She thought that the market place provided sufficient checks and balances to make her comfortable with the bill.

Representative Wilson WITHDREW her OBJECTION.

Representative Kawasaki OBJECTED for discussion.

Vice-Chair Gara voiced that he had "mixed feelings" about the bill. He believed the that risk issue favored the bill because the amount the state paid for the credits would be known. He had not offered amendments because he thought it would delay the bill's passage. He supported a "clean" bill moving through the process. He did not believe the state was doing well in terms of revenue. He discussed some items he would have wanted included in HB 331. He favored closing "the corporate tax loophole" on oil and gas companies. He thought the companies should pay the same tax whether they were listed as C corporations, S corporations, or LLC's; not as they were listed with the Securities and Exchange Commission (SEC) but by activity. He thought increasing oil taxes would be appropriate, but he did not believe that the amendment would pass and further delay the end of session. He maintained that oil taxation could be done in a way that encouraged development but was fairer to the state. Finally, on a technical point - the risk the state took by leaving on the books the ability for other companies to purchase the credits at a discount was a "terrible deal" for the state. He provided a scenario where a company could purchase the credits at a discount and charge the state the full amount. The state would not know how much it would owe the following year for credit repayment. He cautioned that the bill provided stability, but the provision "lurks as a risk" to the state's financial stability.

11:26:47 AM

Representative Kawasaki expressed concerns with the bill. He referred to the legislature's own legal counsel testimony regarding their issues with Articles 8 and 11 of the state Constitution and the dedication of funds in Article 9 and noted that they believed their concerns were valid. He had not seen a legal opinion signed by the attorney general that stated otherwise. He felt that the committee was not listening to their own legal counsel. He added that without hearing definitively from the administration he had trouble supporting the bill. He reported that the bill authorized a \$1 billion bond without a vote of the people and he maintained his concern. He commented that the state could not currently pay its obligations for schools, public safety, roads, and maintenance. He believed that the state should have paid the statutory amount for Permanent Fund Dividends. He noted that the subject to appropriation aspect "gave him very little comfort" because it was imperative to pay the bond debt. He worried that the bill encumbered future legislatures. He did not believe the bill was ready for passage.

11:30:52 AM

Representative Pruitt thanked DOR for its work towards analyzing a mechanism that would repay the debt. He appreciated LAA expressing its concerns. He believed that the effect the bill had in determining whether bonding was a mechanism that could continue to be utilized was appropriate to define. He clarified there was an opinion from the Attorney General Lindemuth that had come out earlier in the morning. He pointed out that the memo highlighted the conversation that took place at the constitutional convention. He read from the opinion:

B. Neither the text of the constitution nor the deliberations of the delegates to the constitutional convention reveals the intent to prohibit issuance of bonds subject to appropriation.

Representative Pruitt opined that there was not an attempt to prohibit the types of subject to appropriation issuances. In addition, the constitution recognized that public corporation bond payments would be financed by legislative appropriation and was a framework that was

being established. He highlighted the long history of subject to appropriation use by municipalities and the long-standing precedence that existed. He reported that the Supreme Court had also looked at "the plain meaning and purpose of the [constitutional] provision and the intent of the framers" in the recent case of *Wielekowski v. the State*. He believed that by analyzing what the thought process was when the constitution was established placed "the bill on good footing." He thought the efforts of DOR and Representative Guttenberg ensured that the "money would be put back into the state" and "intended to put people back to work and put more oil down the pipeline." He stated that King Economics determined that the bill would save the state money when compared to paying through the statutory formula and by leaving it in the Earnings Reserve Account (ERA) the bonding enabled the state to make more money in interest. He thought the bill had been well thought out and was well discussed. He thought it was a positive effort for the state. He asked for members' support. He thanked both Co-Chairs for allowing the process to unfold.

11:38:19 AM

Representative Ortiz appreciated the comments of Representative Pruitt. He had concerns about the bill and wanted to associate himself with the comments of Representative Kawasaki.

Co-Chair Seaton noted that the DOL legal opinion had been distributed to committee members [the memo was not distributed during the meeting and was not on file.]

Representative Kawasaki WITHDREW his objection.

There being NO further OBJECTION, it was so ordered.

CSHB 331 (FIN) was REPORTED out of committee with a "do pass" recommendation and with three new fiscal notes: two indeterminate fiscal notes and one fiscal impact note by the Department of Revenue; and one previously published zero note: FN1(DNR).

Co-Chair Foster indicated the committee would be recessed [note: the meeting never reconvened].

ADJOURNMENT

11:40:20 AM

The meeting was adjourned at 11:40 a.m.