ALASKA STATE LEGISLATURE
HOUSE LABOR AND COMMERCE STANDING COMMITTEE
April 24, 2017
3:17 p.m.

MEMBERS PRESENT

Representative Sam Kito, Chair
Representative Adam Wool, Vice Chair
Representative Andy Josephson
Representative Louise Stutes
Representative Chris Birch
Representative Gary Knopp
Representative Colleen Sullivan-Leonard

MEMBERS ABSENT

Representative Mike Chenault (alternate)
Representative Bryce Edgmon (alternate)

COMMITTEE CALENDAR

HOUSE BILL NO. 229
"An Act relating to a bond or cash deposit required for an oil or gas business; relating to claims against an oil and gas business; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 229
SHORT TITLE: OIL & GAS BUSINESS BOND
SPONSOR(s): REPRESENTATIVE(s) SEATON

04/14/17	(H)	READ THE FIRST TIME - REFERRALS
04/14/17	(H)	L&C
04/24/17	(H)	L&C AT 3:15 PM BARNES 124

WITNESS REGISTER

REPRESENTATIVE PAUL SEATON
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: As prime sponsor, introduced HB 229.

FRED PARADY, Deputy Commissioner
Office of the Commissioner
Department of Commerce, Community, and Economic Development (DCCED)
Juneau, Alaska
POSITION STATEMENT: Testified regarding HB 229 and answered questions regarding the bill.

ACTION NARRATIVE

3:17:54 PM

CHAIR SAM KITO called the House Labor and Commerce Standing Committee meeting to order at 3:17 p.m. Representatives Kito, Sullivan-Leonard, Stutes, Knopp, Birch, Josephson, and Wool were present at the call to order.

HB 229-OIL & GAS BUSINESS BOND

3:18:33 PM

CHAIR KITO announced that the only order of business would be HOUSE BILL NO. 229, "An Act relating to a bond or cash deposit required for an oil or gas business; relating to claims against an oil and gas business; and providing for an effective date."

3:19:01 PM

REPRESENTATIVE PAUL SEATON, Alaska State Legislature, as prime sponsor, introduced HB 229. He said the bill would suspend until January 1, 2019, the surety bond or the cash deposit required for oil and gas businesses operating in Alaska. The suspension would provide time to the Department of Commerce, Community, and Economic Development (DCCED) to develop the regulations needed to do that, he explained. Providing background, he noted that last year the surety bond was incorporated into House Bill 247. The necessity for the bond, he related, is that small companies without deep pockets come to Alaska and go bankrupt. The bankruptcy code allows the bankruptcy court, whether that court is in Alaska or Houston, Texas, to go back 90 days from the time the bankruptcy was filed and require Alaskan businesses to repay the money they received for supplying materials or labor to the [oil or gas] company and this money is then given to security creditors.

REPRESENTATIVE SEATON drew attention to a newspaper article in the committee packet regarding [Buccaneer Energy Ltd.

("Buccaneer")], a company that came to the Cook Inlet with a jack-up rig that was financed in large part by the Alaska Industrial Development and Export Authority (AIDEA). The State of Alaska filed for bankruptcy, he said, and the bankruptcy court ordered the businesses that had supplied fuel, water, moorage, and other services [to Buccaneer] to repay that money so that the [court] could give the money to secured creditors. A look was therefore taken, he explained, to determine how to prevent unsecured creditors, suppliers in Alaska, from being at risk for security creditors that didn't do their due diligence on a company and can claw back money from Alaskan suppliers for 90 days prior to when that bankruptcy was filed.

REPRESENTATIVE SEATON said the purpose of the surety bond or cash [deposit] was to get over this unfair situation. However, he continued, there have been some glitches in how to provide that surety bond to oil and gas companies and DCCED is here to testify in that regard. The bill is simple in that it is just delaying the imposition of the surety bond or cash deposit so that the department has time to get its regulations in place.

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REPRESENTATIVE KNOPP offered his appreciation to the sponsor for bringing forth the bill and noted that many of his friends have been stung. He pointed out that that particular bankruptcy law is applicable to everything, not just oil and gas. He inquired whether the bill is specific to oil and gas or would be applicable to every industry.

REPRESENTATIVE SEATON replied that HB 229 does not have broader implications and is specific to oil and gas companies that get a license. The requirement would terminate when the company goes into commercial production, he continued, because a lease is something to attach to and so people could sue. There are other requirements, but at that point in time [the legislature] wasn't trying to make something that every company would have to have on the books forever. He reiterated that new people come into Alaska who don't have experience here and, in several instances, they have gone bankrupt while [the state] is providing oil and gas tax credits or other financing like the AIDEA loan. There is no way to circumvent the bankruptcy court, he noted, so the purpose of this was to go to unsecured creditors. The thought was that if something was payable to just unsecured creditors, the bankruptcy court might not be able to take that unsecured, creditor-directed payment and give it to secured creditors.

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REPRESENTATIVE JOSEPHSON asked whether the regulations could be written in a way that would allow for [Alaska's] unsecured creditors to trump secured creditors and be acceptable with the bankruptcy code.

REPRESENTATIVE SEATON responded that that was the purpose of directing it through a surety bond that was directed to pay unsecured creditors. While legislation sometimes gets changed around, he continued, the order of payment from the surety bond [is first to] material equipment and supplies delivered in the state. The company wouldn't own [the surety bond]. Secondary after that is labor including employee benefits and third is taxes and such.

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REPRESENTATIVE JOSEPHSON recalled that there are ways of using the Uniform Commercial Code (UCC). Two chapters in particular are Article 2 on sales and Article 9 on secured transactions where someone could try to perfect a security interest. He said he doesn't know if that is even necessary if this gets done right. He inquired whether the sponsor is saying that the impetus for [HB 229] is that the department just needs more time to promulgate regulations.

REPRESENTATIVE SEATON answered yes, that is what the department has told him. Work was being done through Legislative Legal and Research Services to figure out how to do this and the surety bond or cash bond payable to certain businesses was the only way that came up as a possibility. He said he doesn't think this has been tested in court and so it is not known 100 percent that it will work, but if it is not payable to secured creditors, then the thought is that there is more likelihood that the unsecured creditors wouldn't have to repay those amounts. There would be some hurdles that would have to be jumped over for the bankruptcy lawyers instead of just issuing a letter that says a business owes a certain amount of money that it was paid for fuel or water that that business had supplied to the [oil and gas company] and that the [oil and gas company] had used, but now that business must pay back the money because there is somebody else wanting the money.

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REPRESENTATIVE BIRCH asked whether the oil and gas industry is the only industry required to provide a surety bond or cash deposit. He further asked whether this would be done uniformly across other businesses, such as fish processors or aviation businesses.

REPRESENTATIVE SEATON replied that this was targeting a specific problem. Buccaneer was the first instance where it became evident that there wasn't a way for suppliers to know that the company was getting ready to file bankruptcy. Due diligence for a fuel supplier, he said, is not the same kind of due diligence that secured creditors should be applying. This was specifically targeted at small companies coming to Alaska without deep pockets and relying on state credits to finance their business and then when something went wrong, they went out of business and small suppliers in Alaska were left on the hook. Therefore, this isn't generally applicable across all businesses in Alaska. It was specifically targeted at oil and gas and it is required before the company gets an oil and gas license and so would be attached to that business.

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REPRESENTATIVE BIRCH inquired whether the sponsor sees any merit in applying a uniform approach to other enterprises that might be similarly situated that are outside the oil and gas business.

REPRESENTATIVE SEATON responded that whether or not there would be merit, it is very complex to target something that is broad across the entire business spectrum of Alaska. This was an attempt to solve a problem that required a state license to perform, he explained, and there was some due diligence by the state that wasn't adequate because the state gave them a license to start drilling. This was targeted at a certain aspect of what was proceeding and seen in several cases in Alaska and not in general businesses. He said he thinks that someone else expanding something to general businesses would have a lot of impact if it were talking about every business in the state.

REPRESENTATIVE BIRCH said he thinks there are various mechanisms that can be applied. As an example, he shared a story about an airplane that was attached for money in the amount of $60,000 that was owed. However, he stated, he is not familiar with this particular [mechanism].

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REPRESENTATIVE SULLIVAN-LEONARD recalled that when Buccaneer had problems with the jack-up rig, it stored the rig in the Homer port. She asked whether Buccaneer paid the City of Homer.

REPRESENTATIVE SEATON confirmed that Buccaneer had a business relationship with the Port of Homer and said he thinks there was about $20,000 in port fees due. But, he continued, more than anything, the proposal would target small businesses that supplied materials and so [the Port of Homer] would be the third tier. He reiterated that the surety bond would be applied first to material equipment and supplies delivered in the state. Second, any remaining money would be applied to labor including employee benefits. Third, it would be applied to taxes and other amounts due a city or borough in that order and then repair of public facilities, and finally taxes and other amounts due to the state. This was targeting small business suppliers that had provided supplies within 90 days of the [oil and gas] company filing bankruptcy and being ordered by the bankruptcy court to pay back the money received for those supplies that were used up by the company. It was trying to protect small businesses because small businesses don't have any way to do due diligence on these companies, he added.

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REPRESENTATIVE SULLIVAN-LEONARD inquired whether [the bankruptcy court] was going after the City of Homer to get back the fees that had been paid, like what [the bankruptcy court] is doing with the small businesses here.

REPRESENTATIVE SEATON replied that the City of Homer had to pay back the port fees that had been collected, which were about $8,000 or $20,000.

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REPRESENTATIVE WOOL inquired whether in the sponsor's opinion $250,000 is enough, given that several of the Buccaneer debts were $70,000.

REPRESENTATIVE SEATON responded, "No, … it depends on how far down the scale you are trying to go. If you are going to the first one – material equipment and supplies delivered in the state – that is mostly the small businesses." There could be some on the second criterion, he noted, which is labor including employee benefits. He said the intent was not to get in between the relationship between a prime contractor and an oil company

but to [address] "the small, unsecured people" who are actually delivering a product that is used up and now they not only don't have the product but they have to pay back the amount of money "that product was used for." So, he continued, it was trying to cover a specific range of small businesses that don't have the ability in their normal operations to do the due diligence to determine whether an oil company has too thin a financial backup and would go bankrupt.

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REPRESENTATIVE KNOPP said he agrees with Representative Wool that given all the claims, $2 million to $3 million is more appropriate. He asked why $250,000 was chosen for the bond. He recalled the sponsor stating that the bond would be in effect until the company came into production. However, he noted, Buccaneer was in production with the Kenai Loop gas fields that were producing a fair amount of gas in good contracts. He asked what the sponsor thinks is the point at which a company can get rid of that bond.

REPRESENTATIVE SEATON answered it is a question of whether to "leave it on forever." He said it was his call early on to say that once someone goes into commercial production there's probably something that can be attached, something of value, so there could be lawsuits the other way as well. The problem, he continued, is that small operators can't hire a lawyer to go after somebody for $20,000. He pointed out that Representative Birch's example of $60,000 owed in fuel, and for which a plane was attached, was not a situation of bankruptcy. Had it been bankruptcy, the plane could not have been attached. Representative Seaton stated it comes down to finding a point where operations have been going on long enough and the company is now having actual production or commercial production. So, he reiterated, it was a call. He further noted that having it go for forever was objected to. Should ConocoPhillips, BP, or folks coming into production in Cook Inlet have to carry a surety bond on the books forever? The intent here, he said, was to get to small [oil and gas] companies that were coming in with thin financial resources.

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REPRESENTATIVE BIRCH inquired whether the sponsor has a sense for the cost of a surety bond. For example, he asked, what would be the incremental cost or additional cost of providing that level of assurance.

REPRESENTATIVE SEATON replied that if he remembers correctly from when this was done, a construction bond, which is a kind of surety bond, was about 2.3 percent per year. But, he continued, he doesn't know what it is now and hopefully that is something the department knows from having moved forward.

3:40:45 PM

FRED PARADY, Deputy Commissioner, Office of the Commissioner, Department of Commerce, Community, and Economic Development (DCCED), began his testimony by thanking Representative Seaton for bringing this legislation forward last session. He related that Representative Seaton has spent the last six months working with the department as it tries to implement these provisions that are going to be delayed by HB 229 should it pass. Speaking candidly, he stated that the department did not foresee the complexities that are involved in implementing these bonding requirements as outlined in Alaska Statute (AS) 43.70.25. Since the passage of House Bill 247 last year, the department has been working to find the least burdensome way to put these requirements into action and that is AS 43.70.025, which is the bond itself, and AS 43.70.028, which is the pecking order for release of those funds. Those statutes provide important protections for small businesses that contract with oil and gas companies, he said, and DCCED is fully committed to implementing them.

MR. PARADY outlined some of the obstacles that DCCED has encountered. He said the first stumbling block the department came across is seemingly innocuous, but it is the process of identifying which businesses to which the bond applies. All business licenses are associated with one or more North American Industry Classification System codes (NAICS), he explained. When Director Fagerstrom, the state's lead business license person, dug into the details of it she found there are some 23 different codes that could be considered, having petrochemical in the title. The department narrowed it down to applying to four. An example of the kind of problem that is encountered, he related, is that NAICS code 211111 is crude petroleum and natural gas extraction. It was a surprise to find this code attached as a secondary code to the business license of Usibelli Coal. While no one anticipates this applying to Usibelli Coal, he continued, this is what is encountered when looking at those classification systems and sorting out where it applies and when it doesn't.

MR. PARADY said it is important the department get right the application of the proper code and to which businesses it applies because other surety bonds in DCCED's Division of Corporations, Business and Professional Licensing are attached to a professional license rather than to a business license. He stated that the department doesn't currently have a process for attaching bonding requirements to business licenses without unnecessarily delaying business licenses for those who are not doing work that is subject to the bonding requirements for the specific NAICS code.

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MR. PARADY pointed out that the regulatory framework for these statutes must include a simple way to identify which businesses are required to post bond, and then a mechanism is needed to release the bond when a company begins producing oil or gas in commercially viable quantities. That takes coordination between DCCED, the Department of Revenue, and the Department of Natural Resources, which DCCED has been actively working on. It is a matter of trying to not impose an undue burden and of trying to make that process clear. There are many questions to be sorted out. For example, in releasing a surety bond based upon commercial production, what if a company has commercial production in the North Slope but the bond is applicable to an activity in Cook Inlet? There are also questions about subsidiaries and hierarchy and which level of the company to attach the requirement to.

MR. PARADY said DCCED has put forth a good faith effort to develop these regulations. The department put out a scoping notice to solicit public comment and industry input and received two comments, of which one was a response from ConocoPhillips. He stated that the department believes a constructive solution can be found. However, he continued, implementing the statute without a sound regulatory framework is impractical for all parties involved and therefore DCCED approached Representative Seaton to seek the delay that is before the committee in HB 229.

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REPRESENTATIVE BIRCH remarked that it seems to him there is an inching towards a "nanny state" of babysitting businesses that don't have the wherewithal to research who their customers are and basically getting stiffed by a customer. Regarding small business, he asked whether there is a size of business that is big enough that it doesn't stand an opportunity to collect on a

bill through the claims court, whereas a business doing less than $1 million a year in revenues does have an opportunity. He further asked whether there is a mechanism for distinguishing between a supply that is a big company and one that is a small business.

MR. PARADY deferred to Representative Seaton, the original sponsor, for an answer. He noted, however, that AS 43.70.028 lists the pecking order of who gets paid and the first is material equipment and supplies delivered in the state, the second is labor including employee benefits, and then it goes to taxes and repair public facilities. There is an effort in that identification to target the smaller [businesses], he continued, but to his knowledge there is not a definition of small business that is applicable.

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REPRESENTATIVE BIRCH offered his understanding, then, that there is no distinguishing between a large national supplier versus a local supplier in Homer as far as recovering against the bond or the party that has gone bankrupt.

MR. PARADY again deferred to Representative Seaton but said that to his best understanding the hierarchy that is there was an effort to address that. However, he cautioned, as was alluded to by Representative Josephson, care must be taken when considering bankruptcy laws and what is applicable in that an Alaska-only distinction cannot be easily drawn, and care must be taken in how creditors are dealt with in that regard. Of course, he continued, this is intended to address unsecured creditors as opposed to secured creditors.

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REPRESENTATIVE BIRCH asked whether this applies to any other businesses or any other enterprises in Alaska or in any other state that Mr. Parady is familiar with where the State of Alaska intercedes to require a backstop on a contract. He said he is not familiar with the state intervening to protect suppliers in this manner.

MR. PARADY replied he is not familiar with the research that was done to bring this concept forward and is not aware of a similar provision in another oil and gas state. But, he noted, this is statute that is applicable within the state of Alaska. The

challenge is in finding out how to make it work, and DCCED needs more time to do so.

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REPRESENTATIVE KNOPP addressed the complexities of implementing the surety bond and said it is a small business protection measure to try to protect the small businessperson from a bad deal. He said he questions the actual need for the surety bond now that House Bill 247 has been repealed. There is no longer that incentive to reinvigorate Cook Inlet, he continued, so most focus will be on the North Slope. He opined that if it was a $2 million to $3 million bond, he would "be all over it," but time is being spent trying to figure this out for too little benefit. The department has put effort into this over the past year and more will be required going forward for a $250,000 bond. He noted that the bond would be divisible by multiple claims, some in the range of $70,000, and questioned whether the effort that will be put into solving the complexities will be worth the gain. He asked whether there is still a need for it after the repeal of House Bill 247. He also asked who is going to have to post the bond and whether it is somebody who is financially dependent on borrowing money from the state or looking forward to the generous credits offered by the state. He further asked who is going to determine when the bond needs to be posted and what the requirements are going to be for that.

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MR. PARADY responded that the aforementioned are broad questions about equity and fairness in small business and he would like to narrow them. He offered his belief that Representative Knopp is referring not to the repeal of House Bill 247, but to the repeal of oil and gas tax credits in general. He said House Bill 247 is current statute that DCCED is tasked with implementing. He said the path the department is trying to find going forward is how to implement it effectively, and DCCED is seeking a delay so it can do so.

MR. PARADY said that regarding the larger questions asked by Representative Knopp, he would punt those back to the wisdom of the legislature because the legislature gave the department this statute. As the legislature works its way forward with it, he continued, tweaks might be needed. He stated he can't speak to the size of the bond, but he can speak to the reality of what brought Representative Seaton's measure forward because he sits on the board of AIDEA. There was a situation where the place of

secured creditors was firmly established in the pecking order, but unsecured small Alaska businessmen were left holding the bag. The amount that was set upon at $250,000 was a judgment call, he continued. While he is not aware as to the cost of the bond, he recalled that Representative Seaton referenced 2.3 percent when asked about this by Representative Birch. He related that in earlier parts of his career he did mine reclamation bonding that ran 2.5 percent. At that level, he calculated, a $250,000 bond could cost on the order of $6,500-$7,000 and so it isn't insignificant. If the bond were to be increased to $2 or $3 million, the business cost would be increased accordingly. Therefore, he said in closing, he would leave the aforementioned questions to the future and seek the delay that DCCED is requesting so it can try to do a decent job with this.

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REPRESENTATIVE KNOPP agreed he misspoke and that it was repeal of some of the credits and not repeal of House Bill 247. He said the question that haunts him is solving the complexities versus the gain and whether it would be better to rethink this or whether the thought is that it can be reasonably done for what little guarantee is going to be offered.

MR. PARADY answered that the little guarantee of $60,000, $100,000, or $250,000 that is being offered to small businesses is a substantive contribution to their future liability, and he said he thinks there is value in it. But, he continued, a path forward through the details of who it applies to, what NAICS code, how it's released, what constitutes commercial production, and what level of subsidiary is required to carry it needs to be found. If DCCED fails to find a path it will be back before the committee with additional information and back in front of Representative Seaton trying to match the department's regulatory framework to the direction that's being given in this bill.

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CHAIR KITO opened public testimony on HB 229. There being no one wishing to testify, Chair Kito announced that HB 229 was held over.

3:55:13 PM

ADJOURNMENT

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 3:55 p.m.