

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

April 9, 2018

2:04 p.m.

MEMBERS PRESENT

Representative Andy Josephson, Co-Chair
Representative Geran Tarr, Co-Chair
Representative John Lincoln, Vice Chair
Representative Harriet Drummond
Representative Justin Parish
Representative Chris Birch
Representative DeLena Johnson
Representative George Rauscher
Representative David Talerico

MEMBERS ABSENT

Representative Mike Chenault (alternate)
Representative Chris Tuck (alternate)

COMMITTEE CALENDAR

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."

- HEARD & HELD

PRESENTATION(S): ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT
AUTHORITY

- HEARD

PREVIOUS COMMITTEE ACTION

BILL: HB 331

SHORT TITLE: TAX CREDIT CERT. BOND CORP; ROYALTIES

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

02/07/18	(H)	READ THE FIRST TIME - REFERRALS
02/07/18	(H)	RES, FIN
03/30/18	(H)	RES AT 1:00 PM BARNES 124
03/30/18	(H)	Heard & Held

03/30/18	(H)	MINUTE (RES)
04/04/18	(H)	RES AT 1:00 PM BARNES 124
04/04/18	(H)	Heard & Held
04/04/18	(H)	MINUTE (RES)
04/06/18	(H)	RES AT 1:00 PM BARNES 124
04/06/18	(H)	Heard & Held
04/06/18	(H)	MINUTE (RES)
04/07/18	(H)	RES AT 2:00 PM BARNES 124
04/07/18	(H)	-- Continued from 4/6/18 --
04/09/18	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

KENDRA ZAMZOW PhD, Environmental Geochemist
Center for Science in Public Participation
(No local address provided), Alaska

POSITION STATEMENT: Provided a PowerPoint presentation entitled, "Testimony on Ambler Mining District Industrial Access Road," dated 4/6/18, and answered questions.

GENE THERRIAULT, Team Lead
Interior Energy Project
Alaska Industrial Development and Export Authority
Department of Commerce, Community & Economic Development
Anchorage, Alaska

POSITION STATEMENT: Answered questions during testimony on the Ambler Mining District Industrial Access Project.

MIKE BARNHILL, Deputy Commissioner
Office of the Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Co-Provided a PowerPoint presentation entitled, "Company X Tax Credits: Potential Impact of HB331/SB176," revised 4/18/18, and answered questions during the hearing of HB 331.

KEN ALPER, Director
Tax Division
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Co-Provided a PowerPoint presentation entitled, "Company X Tax Credits: Potential Impact of HB331/SB176," revised 4/18/18, and answered questions during the hearing of HB 331.

ACTION NARRATIVE

[2:04:18 PM](#)

CO-CHAIR GERAN TARR called the House Resources Standing Committee meeting to order at 2:04 p.m. Representatives Tarr, Parish, Talerico, Rauscher, and Josephson were present at the call to order. Representatives Birch, Johnson, Lincoln, and Drummond arrived as the meeting was in progress.

PRESENTATION(S): Alaska Industrial Development and Export Authority

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CO-CHAIR TARR announced that the first order of business would be further testimony on the [Ambler Mining District Industrial Access Project (Ambler Access Project)]. The project was first presented by the Alaska Industrial Development and Export Authority (AIDEA), Department of Commerce, Community & Economic Development, at the committee meeting on 4/6/18.

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KENDRA ZAMZOW, PhD, Environmental Geochemist, Center for Science in Public Participation, informed the committee she is a 30-year resident of Alaska. Dr. Zamzow said the Center for Science in Public Participation is a nonprofit and her role there is to review technical documents on mining projects and identify potential risks for communities and Tribes. She said she concluded, from her review of the Ambler Access Project to date, it is too soon for the state to invest in infrastructure to support the project, because exploration in the Ambler Mining District has not achieved a level of confidence that mining can be conducted profitably. The conclusion is based on the following:

- deposits have not been identified as measured resources or proven reserves, which would provide a level of certainty that mining could be profitable
- drilling has been limited and extensive drilling is needed to define an ore body
- only one company is exploring the area of known deposits

DR. ZAMZOW acknowledged the region has known deposits of copper and zinc; however, the costs of mining said deposits are unknown, and therefore, the profitability of mining is also unknown. She said the early stage of exploration showed rich

deposits in the district, and the middle stage of exploration will reveal more about the ore body (slide 1). Language used when mining companies report to investors reflects the profitability of a mine; for example, rich ore means a mineral resource, and increasing levels of confidence in the ore body are reported as inferred, indicated, and measured resources. To date, there are no measured resources - which would reflect high confidence - found in the Ambler Mining District. She explained the term "mineral resources" reflects a level of confidence in the ore body, and the term "mineral reserves" reflects confidence the ore body can be mined profitably. Furthermore, reserves reflect economic costs such as infrastructure, water treatment, and closure. She characterized the Arctic Mine deposit as a massive sulfide deposit containing geochemistry that would increase the cost of the mine's closure, and also affect the profitability of the mine. The term "reserves" are either proven [higher level] or probable [lower level], and the Arctic Mine deposit prefeasibility study, released on 4/6/18, reported probable mineral reserves. She stated her first concern is that after the state pays for the road without proven mineral reserves, mining may not occur, and directed attention to a disclaimer required on reports issued by mining companies (slides 2 and 3). She remarked:

[The disclaimer] indicated mineral resources, which is what we have right now, from the drilling at Arctic, may or may not ever be upgraded to the measured, which is the high confidence level.

DR. ZAMZOW continued to her second concern and noted between 2004 and 2017, less than 100 boreholes were drilled at the Arctic deposit and less than 60 were drilled at the Bornite deposit; however, hundreds more are necessary to define the ore bodies. Slide 4 was four graphs which illustrated how drilling boreholes infers information to define the ore body and she explained, "you can go from what you had hoped might be a very large resource [that] could end up to be somewhat scattered, and that really changes how mining could occur, whether mining would be profitable, and how it would be done. For instance, whether it would be surface or underground." The Donlin project site, [Placer Dome Inc.], reached a high level of confidence after five years of exploration, and during 2006-2008, NovaGold continued drilling two hundred boreholes per year. At the Pebble Mine site, [Northern Dynasty Minerals Ltd.] identified five billion pounds of measured resources within three years of exploration and drilled an average of one hundred thirty-five boreholes per year between 2002-2008. She advised the

aforementioned levels of exploration are needed to determine whether an ore body can become a mine, and to provide the geotechnical information needed to design a mine and a tailings facility. She restated her second concern about the slow rate of exploration [at the Arctic Mine site]. Slide 5 illustrated the four mine deposit sites identified by AIDEA in the Ambler Mining District, as follows: Arctic and Bornite are being developed by Trilogy, and Sun and Smucker appear to have no activity. Dr. Zamzow reviewed the following key points (slide 6):

- rich ore does not make a mine and limited drilling has not produced a sufficiently high level of confidence in any of the mine sites in the Ambler Mining District
- the state should wait for confidence levels of measured resources and proven reserves

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REPRESENTATIVE RAUSCHER asked whether the mine would go forward.

DR. ZAMZOW opined it would not go forward in the near future, but "several decades from now, that's certainly a possibility."

REPRESENTATIVE BIRCH asked for the presenter's qualifications and the motivation behind her testimony.

DR. ZAMZOW informed the committee she holds a degree in environmental chemistry with a focus in biogeochemistry, which is the study of trace metals and mining. For the last ten years she has reviewed the geology and hydrology of ore bodies, looking for potential risks, which vary with individual mines. Her testimony is based on work that was completed at the request of the Brooks Range Council, and her time to testify today was paid by The Wilderness Society. The Center for Science in Public Participation is supported by a mix of grant money and clients.

REPRESENTATIVE BIRCH pointed out the Ambler Access Project is a road project that has been compared to the Delong Mountain Transportation System (DMTS), and inquired as to Dr. Zamzow's observations specifically related to the road.

DR. ZAMZOW stated the mining issues are raised due to her concern that the road may not be paid for if there are no mines;

because mining is speculative at this point, the state should wait to provide a road.

REPRESENTATIVE LINCOLN advised the state would not invest or authorize bonds without exercising due diligence. Further, a level of investment, exploration, and an environmental impact statement (EIS) are facets of [the legislative] process. He questioned the urgent need to advocate for "something that strikes me as being pretty obvious"

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DR. ZAMZOW expressed her understanding AIDEA is moving forward with EIS - potentially to fund a pioneer road, at a cost of \$300 million - without definite confidence in ore bodies, and that would be a waste of money. A road to a port is an entirely different situation, but for a road that would be repaid by mines, it is important to determine whether there will be mines accessed by the road.

REPRESENTATIVE LINCOLN urged for further testimony at the appropriate time.

REPRESENTATIVE PARISH asked what proportion of mines have a low level of activity prior to opening, and if the road were built, how would access affect the likelihood the [Arctic] mine would open.

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DR. ZAMZOW said she did not have enough information to determine whether a mine would open or not and discussed the history of three other mines. Background information on the Red Dog Mine is limited, although it is known the mine progressed from its first drill hole to mine operations in 13 years; in contrast, NovaCopper and Trilogy have been drilling in the Arctic Mine exploration area for over 16 years. At the NovaGold operation at Galore Creek [in British Columbia, Canada] 700 holes were drilled before indicated and measured resources were located, and there were 400 drill holes without reaching measured resources at Rock Creek [in Nome, Alaska]. Exploration at the Rock Creek Mine located approximately 20-30 million tons of "indicated" which is roughly equal to what has been located at "Ambler." The Rock Creek Mine operated for two months before closing for various reasons. Dr. Zamzow opined several hundred drill holes are needed to define the ore body and that could

take another decade. She restated her concern is about the state investing in EIS at this stage.

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CO-CHAIR TARR surmised Dr. Zamzow's position is that the EIS process is premature and the state should wait until mining companies reach the exploration results of measured resources.

DR. ZAMZOW said that would be wise.

REPRESENTATIVE LINCOLN inquired as to the total cost estimated for EIS.

DR. ZAMZOW said she did not know.

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GENE THERRIAULT, Team Lead, Interior Energy Project, AIDEA, DCCED, was unsure what has been expended to date; however, a previous legislative appropriation has been spent on assuming the project from the Department of Natural Resources (DNR), scoping meetings, and documents prepared by other agencies. In addition, AIDEA requested consultants provide estimates of the cost to advance the project to a record of decision (ROD), which he estimated at \$1 million. The question for policymakers is to consider how much has been invested, and whether the value of the funds expended is greater if the project continues to ROD, although continuing to ROD does not guarantee the road project would advance. He corrected a critical misstatement heard by the committee on 4/6/18 by directing attention to [AS 44.88.120. Nonliability On Bonds.], which prohibits AIDEA from obligating the state and specifies that bonds issued by AIDEA do not constitute an indebtedness or other liability of the state, or of a political subdivision of the state. Mr. Therriault advised AIDEA provided money to determine whether the Ambler Access Project could be permitted; if so, AIDEA would not spend state money without a legislative appropriation and would not issue bonds without a business plan to ensure the users of the road pay back the bond indebtedness. The mission of AIDEA is to facilitate projects' access to the bond market without obligating the state.

REPRESENTATIVE LINCOLN surmised an additional \$1 million is needed to finish EIS.

MR. THERRIAULT estimated there are \$2 million to \$3 million left in the original appropriation and offered to provide more detailed information.

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REPRESENTATIVE LINCOLN observed AIDEA garners about \$20 million per year as earnings from DMTS, which represents 40 percent of its profits and 80 percent of its bonding capacity. He stressed approximately \$2 million invested to finish EIS on a project that is extremely important to his constituents, and other Alaska residents, is more than warranted -- especially when AIDEA earns over \$20 million per year from one road in Northwest Alaska.

MR. THERRIAULT affirmed DMTS has been a very good project for the state; AIDEA has repaid all the original capitalization plus almost \$400 million. He restated AIDEA - without using general fund dollars - provides access to other people's money and is an economic engine for the state.

CO-CHAIR TARR asked for the amount of the appropriation in the FY 12-FY 13 budget for the Ambler Mining District Access portion of former Governor Sean Parnell's Roads to Resources initiative.

MR. THERRIAULT will provide the requested information.

HB 331-TAX CREDIT CERT. BOND CORP; ROYALTIES

[2:32:24 PM](#)

CO-CHAIR TARR announced that the final order of business would be 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."

REPRESENTATIVE BIRCH related his and his constituents' support of the bill which would honor the state's commitments and positively affect the state's economy. He urged the committee to act expeditiously.

The committee took a brief at ease.

[2:35:12 PM](#)

MIKE BARNHILL, Deputy Commissioner, Department of Revenue (DOR), directed attention to two slides entitled, "COMPANY X Tax Credits: Potential Impact of HB331/SB176." He informed the committee the slides are examples of the estimates DOR provided to each tax credit holder; however, the figures provided on the slides are de-identified and thus do not represent any one of the 37 companies who hold tax credit certificates. One slide reflects figures for fiscal year 2019 (FY 19) through FY 24, and the second slide reflects figures for FY 19 through FY 31.

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KEN ALPER, Director, Tax Division, DOR, explained the purpose of the slides is to show how a company with \$50 million in 2016 credits and \$50 million in 2017 would be paid off. The slide illustrating figures for FY 19-FY 24 was prepared as if HB 331 was enacted; the slide illustrating figures for FY 19-FY 31 was prepared as if HB 331, amended to fund a smaller, alternative appropriation, was enacted.

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The committee took an at-ease from 2:37 p.m. to 2:39 p.m.

[2:39:32 PM](#)

MR. ALPER restated the slides are a hypothetical example of information that was twice provided by DOR to each of the 37 impacted companies. He first directed attention to the slide illustrating figures for FY 19-FY 24 and gave an example of a company with \$50 million in the "first pool" of 2016 credits and \$50 million in the "second pool" of 2017 credits. If \$184 million were appropriated in FY 19, it would represent about 45 percent of the \$400 million in total 2016 tax credits, and credit holders would be paid approximately \$0.45 on each \$1. Thus, the example company would be eligible for \$23 million in FY 19; in FY 20, a statutory appropriation of \$168 million would pay an additional 40 percent, and the example company would get \$21 million. The FY 21 appropriation of \$168 million would be split to pay off the last of the 2016 credits and the first of the 2017 credits. Further, FY 22 and FY 23 appropriations would continue to pay off the example company's share of the 2017 pool, as affected by the number of years the discounts rates are applied, until FY 24. Mr. Alper said the columns on the slides labeled Face Value show what the example company expects to get paid; the columns labeled Discount Rates show the money the example company would receive under the terms of HB 331 and HB

331, amended. He concluded the example company, depending on its discount rate, would be offered either \$85 million or \$91 million if it chose to relinquish \$100,000 million in credits and participate in the program. He directed attention to the slide illustrating figures for FY 19-FY 31 and explained the figures on this slide reflect a forthcoming amendment which would lower the appropriation schedule and base the schedule on a percentage of the actual taxes received, rather than the "raw" tax calculations, thus the appropriations would be in the \$40 million to \$60 million range. The example company would not receive 2016 credits until FY 25-FY 26, due to more years affected by its discount rate. In this situation, the credit holders would receive dramatically less, and the state would borrow less.

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REPRESENTATIVE PARISH asked, "Which of these two scenarios, would you say, more accurately reflects, or more closely reflects, the net present value of these credit assets to the companies?"

MR. ALPER stated the credit holders' internal economics and valuing are unknown to DOR; however, he expressed his belief the companies are anticipating a statutory appropriation, similar to what the state has appropriated in the last two years.

REPRESENTATIVE PARISH surmised the tax credit holders are amenable to [the proposals shown on both slides].

MR. ALPER recalled testimony from a representative of one of the banks that holds debt that is guaranteed by the tax credits owed to one of the credit holders: from the bank's perspective, the reduced appropriation schedule would enable a company to pay off its debt to the bank. However, from the perspective of the company, a reduced appropriation would not repay the company that did the [exploration] work, and he provided an example. Mr. Alper said, "So, I think you would get a different answer if you had a representative of the actual explorer up here, rather than their banker." In further response to Representative Parish, he said the companies [holding tax credit certificates] would like an amount that would enable them to continue in business.

MR. BARNHILL restated the administration is seeking a fair balance between various interests through its introduction of HB

331; however, if the forthcoming amendment were to be adopted, HB 331 would no longer be fair. He remarked:

We're trying to find a way, not only to clear the decks, but clear the decks in a way that accomplishes a variety of purpose. Paying off the tax credit holders is certainly one of those purposes, but, just as important, is attempting to reestablish the state's credibility, with respect to the oil and gas industry. And restore ... Alaska, in the perspective of the oil and gas industry, as a place to come and invest money
....

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REPRESENTATIVE BIRCH expressed support for HB 331 as introduced. He asked how many businesses are impacted by the inability of the state to fulfil its obligation to pay the tax credits.

MR. ALPER said there are 37 companies - approximately 20 of which received cash in 2017 for pro rata shares of 2016 credits - that have credits. There are new companies with 2017 credits, some of which are very small and received \$10,000 or less, such as some of the working interest partners within the Point Thomson Unit.

REPRESENTATIVE BIRCH observed the affected businesses are largely Alaska businesses with Alaskan employees. He returned attention to the discount rates shown on the slides and noted one tier would incentivize investment in Alaska and restore Alaska's credibility.

MR. ALPER expressed his hope that both discount rates would help restore Alaska's credibility; the lower rate rewards reinvestment because to qualify for the lower rate a company would have to spend all of its appropriation on "qualified capital expenditures" - which are capital expenditures upstream of the point of production in its oilfields - within the next two years. He provided an example.

REPRESENTATIVE BIRCH restated his support for the bill.

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CO-CHAIR JOSEPHSON surmised the forthcoming amendment may cause [small, independent, oil and gas industry businesses] to either

sell their assets under the current statute or suffer foreclosure.

MR. BARNHILL agreed.

REPRESENTATIVE PARISH gave an example of a small multimillion-dollar oil and gas company with a marginal oilfield and asked whether said company could be prevented from "agreeing to an overriding royalty interest and then pulling up stakes the next year."

MR. ALPER stated if that were the intent, the company would be lying to the Department of Natural Resources (DNR) because the overriding royalty interest is a negotiated agreement.

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REPRESENTATIVE PARISH moved Amendment 1, labeled 30-GH2863\A.2, Nauman, 4/6/18, which read [original punctuation provided]:

Page 13, line 14:

Delete "before the application of any tax credits"

CO-CHAIR JOSEPHSON objected.

REPRESENTATIVE PARISH explained Amendment 1 would return the language in HB 331 to the current statutory language, which does not make any reference to the application of tax credits, and would give DOR the option to follow a repayment schedule based on actual taxes received. Amendment 1 would reduce the risk to the state, reduce the amount of debt incurred by the state, and bring appropriations closer to the real market value of the assets. Further, Amendment 1 would constrain subsidies paid to multinational interests.

REPRESENTATIVE BIRCH expressed his opposition to Amendment 1.

REPRESENTATIVE RAUSCHER questioned whether this was another situation in which "they roll the dice again and invest in Alaska."

REPRESENTATIVE PARISH said, "... they decided to invest in Alaska, sure, they, presumably read their, their contracts, I certainly hope that they did. I have nothing but respect for people and their ability to serve their rational self-interest. Where it gets murky is when you start moving around other

people's money." He assured the committee [HB 331] contemplates spending - not the oil industry's money because tax credits [are not money] - money that belongs to the people of Alaska. Further, Amendment 1 would balance the interests of the industry with those of Alaska in an equitable way.

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MR. BARNHILL recalled the original intent of the tax credit program was for the state to invest alongside the oil and gas industry to expand the exploration and development of oil and gas resources. [HB 331] seeks to create a cycle of new investment and new production that would result in new revenue to the state for the benefit of its citizens; however, Amendment 1 signals industry that Alaska is not competitive with other oil and gas basins around the world. He urged the committee to consider the long-term ramifications of Amendment 1.

CO-CHAIR TARR noted several of the state's current problems, that are related to the tax credit program, may have been avoided. She said her concern is if the state's financial situation does not improve, and HB 331 is enacted - because nonpayment of debt secured by bonding would downgrade the state's financial position - payments on the bonds would be elevated and prioritized over other programs such as healthcare and education.

REPRESENTATIVE TALERICO related he had considered offering an amendment, however, he carefully reviewed previous testimony on the bill presented by representatives of the Department of Law and DOR. After revisiting Sections 3-11, he stated his preference to move the bill, without amendments, to the House Finance Committee for further review and additional expert testimony.

[3:04:32 PM](#)

REPRESENTATIVE PARISH withdrew Amendment 1. Representative Parish moved Amendment 2, labeled 30-GH2863\A.3, Nauman, 4/9/18, which read [original punctuation provided]:

Page 6, line 25:
Delete "1.5"
Insert "two"

Page 13, line 24:
Delete "of 10 percent a year"

Insert "based on the true interest cost plus seven percent"

Page 13, lines 29-30:

Delete "1.5 percent and is less than ten percent applies each year"

Insert "two percent"

Page 14, lines 3-4:

Delete "1.5 percent and is less than ten percent applies each year"

Insert "two percent"

CO-CHAIR TARR objected.

REPRESENTATIVE PARISH cautioned HB 331 exposes the state to a good degree of risk. If the state's true cost of interest rises, that would erode the incentive for companies to participate in the proposal, and for meeting the four requirements for a discounted rate. He pointed out if the distance between the higher discount rate and the state's rates close, it will reduce the incentive to reinvest in Alaska. Amendment 2 would also increase the differential that covers the state's risk, in the event of a drop in oil prices, by increasing the difference to the true cost of borrowing from 1.5 percent to 2 percent.

[3:07:11 PM](#)

REPRESENTATIVE BIRCH asked for an assessment of Amendment 2 by the representatives from DOR.

MR. BARNHILL advised the first change brought by Amendment 2 increases the "cushion" from 1.5 percent to 2 percent. He said Amendment 2 does not provide additional protection to the state if there is a drop in the price oil; in fact, the 1.5 percent added to the true interest cost is designed to replicate the state's opportunity cost of capital, which is about 5 percent, and reflects the rate of earnings garnered from earnings reserve accounts, general funds, and the constitutional budget reserve. He opined 1.5 percent is sufficient for the purpose of HB 331 due to the long-term nature of the bill. The second change made by Amendment 2, which would increase the default discount rate for participants, is not an issue of protecting the state, but is "tipping that balance more in the state's favor. We picked 10 percent intentionally to, kind of, be a median point if you will. ... We'd prefer not to do that at this point in time."

REPRESENTATIVE PARISH stated a drop in the price of oil would dramatically affect the state's opportunity cost by changing the schedule of repayment under the existing statute.

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MR. ALPER remarked:

I think what Representative Parish is referring to is we're sort of locking in the payment schedule at the bonding moment. We are going to make them a one-time offer, we're going to give them a bunch of money based on what the schedule of payments would be if our spring 2018 forecast comes in true. If, in fact, the price of oil is lower ... that schedule would decline, and those companies would actually be getting less, so they'd be benefitting, so to speak, from the structure in the bill. Likewise, if the price of oil were to be higher than forecasted in the spring, they would be losing out by taking the offer at this point cause it turned out the scheduled payments would have been higher than anticipated. So yes, to the extent that is true, it's exaggerated a little bit by increasing the, the interest rate, the, the spread.

[HB 331 was held over.]

[3:12:28 PM](#)

ADJOURNMENT

The meeting of the House Resources Standing Committee was recessed at 3:11 p.m., to be continued April 10, 2018, at 8:00 a.m.