

**ALASKA STATE LEGISLATURE**  
**SENATE STATE AFFAIRS STANDING COMMITTEE**

April 13, 2018

4:09 p.m.

**MEMBERS PRESENT**

Senator Kevin Meyer, Chair  
Senator David Wilson  
Senator Cathy Giessel  
Senator John Coghill  
Senator Dennis Egan

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 136(TRA)

"An Act relating to motor vehicle franchises, motor vehicle dealers, motor vehicle manufacturers, and motor vehicle distributors."

- MOVED CSHB 136(TRA) OUT OF COMMITTEE

SENATE JOINT RESOLUTION NO. 9

Proposing amendments to the Constitution of the State of Alaska relating to the Alaska permanent fund and to appropriations from the Alaska permanent fund.

- MOVED SJR 9 OUT OF COMMITTEE

**PREVIOUS COMMITTEE ACTION**

BILL: HB 136

SHORT TITLE: MOTOR VEHICLE DEALER FRANCHISES

SPONSOR(S): REPRESENTATIVE(S) CLAMAN

02/20/17	(H)	READ THE FIRST TIME - REFERRALS
02/20/17	(H)	TRA, L&C
03/16/17	(H)	TRA AT 1:00 PM CAPITOL 17
03/16/17	(H)	<Bill Hearing Canceled>
03/21/17	(H)	TRA AT 1:00 PM BARNES 124
03/21/17	(H)	Heard & Held

03/21/17 (H) MINUTE (TRA)  
 04/13/17 (H) TRA AT 1:00 PM BARNES 124  
 04/13/17 (H) -- MEETING CANCELED --  
 03/27/18 (H) TRA AT 1:15 PM BARNES 124  
 03/27/18 (H) Heard & Held  
 03/27/18 (H) MINUTE (TRA)  
 03/29/18 (H) TRA AT 1:15 PM BARNES 124  
 03/29/18 (H) Moved CSHB 136 (TRA) Out of Committee  
 03/29/18 (H) MINUTE (TRA)  
 03/30/18 (H) TRA RPT CS (TRA) NT 5DP  
 03/30/18 (H) DP: SULLIVAN-LEONARD, DRUMMOND, CLAMAN,  
 KOPP, WOOL  
 04/02/18 (H) L&C AT 3:15 PM BARNES 124  
 04/02/18 (H) Heard & Held  
 04/02/18 (H) MINUTE (L&C)  
 04/06/18 (H) L&C AT 3:15 PM BARNES 124  
 04/06/18 (H) Moved CSHB 136 (TRA) Out of Committee  
 04/06/18 (H) MINUTE (L&C)  
 04/09/18 (H) L&C RPT CS (TRA) NT 5DP  
 04/09/18 (H) DP: SULLIVAN-LEONARD, STUTES,  
 JOSEPHSON, KNOPP, KITO  
 04/09/18 (H) TRANSMITTED TO (S)  
 04/09/18 (H) VERSION: CSHB 136 (TRA)  
 04/10/18 (S) READ THE FIRST TIME - REFERRALS  
 04/10/18 (S) STA  
 04/11/18 (S) STA WAIVED PUBLIC HEARING NOTICE, RULE  
 23  
 04/12/18 (S) STA WAIVED PUBLIC HEARING NOTICE, RULE  
 23  
 04/12/18 (S) STA AT 3:30 PM BUTROVICH 205  
 04/12/18 (S) -- MEETING CANCELED --  
 04/13/18 (S) STA AT 3:30 PM BUTROVICH 205

BILL: SJR 9

SHORT TITLE: CONST. AM.: PERMANENT FUND APPROP; DIVIDEND

SPONSOR (s): SENATOR (s) STEDMAN

01/16/18 (S) PREFILE RELEASED 1/8/18  
 01/16/18 (S) READ THE FIRST TIME - REFERRALS  
 01/16/18 (S) STA, JUD, FIN  
 04/12/18 (S) STA WAIVED PUBLIC HEARING NOTICE, RULE  
 23  
 04/12/18 (S) STA AT 3:30 PM BUTROVICH 205  
 04/12/18 (S) -- MEETING CANCELED --  
 04/13/18 (S) STA AT 3:30 PM BUTROVICH 205

**WITNESS REGISTER**

SARA PERMAN, Staff  
Representative Claman  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Provided an overview and sectional analysis of HB 136.

GARY SLEEPER, Attorney  
Alaska Automobile Dealers Association  
Anchorage, Alaska

**POSITION STATEMENT:** Addressed questions regarding HB 136.

MARTEN MARTENSEN, Owner  
Continental Auto Group  
Anchorage, Alaska

**POSITION STATEMENT:** Testified in support of HB 136.

LESTER NICHOLS, Owner  
Fairbanks Nissan  
Fairbanks, Alaska

**POSITION STATEMENT:** Testified in support of HB 136.

STEVE ALLWINE, President  
Mendenhall Auto Center  
Juneau, Alaska

**POSITION STATEMENT:** Testified in support of HB 136.

SENATOR BERT STEDMAN  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Sponsor of SJR 9, provided an overview.

#### **ACTION NARRATIVE**

[4:21:38 PM](#)

**CHAIR KEVIN MEYER** called the Senate State Affairs Standing Committee meeting to order at 4:21 p.m. Present at the call to order were Senators Giessel, Wilson, Coghill, and Chair Meyer.

#### **HB 136-MOTOR VEHICLE DEALER FRANCHISES**

[4:22:24 PM](#)

**CHAIR MEYER** announced the consideration of House Bill 136 (HB 136).

[4:22:53 PM](#)

SARA PERMAN, Staff, Representative Claman, Alaska State Legislature, Juneau, Alaska, noted that Chair Meyer is the sponsor of the Senate's companion bill, Senate Bill 47 (SB 47). She provided an overview of HB 136 as follows:

The driving forces behind HB 136 were the repeated conversations about the need to statutorily update franchise agreements between auto dealers and auto manufacturers; much of this discussion was driven by issues with warranty practices and franchise termination.

When we first introduced this bill last year, it looked very different; however, we had trouble getting it out of "first gear" when we hit a "speed bump" with the auto manufacturers. With their concerns in mind we decided to "throw the bill in reverse" and work to find a compromise between all parties. While the bill "idled" in the House Transportation Committee, Representative Claman and Senator Meyer brought both manufacturers and auto dealers to the table and we've worked out a revision that is now acceptable to both auto dealers and manufactures; this is the version in front of you today.

The CS of House Bill 136 updates warranty policy to be more consumer friendly, it provides customers who live in remote locations either off-the-road system or more than 100 miles from a dealer with a reasonable option for warranty repair coverage. As it stands, customers currently need to pay to get their vehicle to and from an authorized dealer for warranty repairs. With House Bill 136, the manufacturer will be responsible for warranty repairs in the remote location or shipping the vehicle to and from an authorized location at no cost to the consumer.

House Bill 136 also updates the rates that manufacturers may pay auto dealers for warranty work. The updated rates may not be less than the rates that the auto dealer charges customers for similar non-warranty-retail work; this equalizes the rate for repair work across the board.

"Shifting gears," House Bill 136 amends statutes concerning terminations and succession of franchises.

Manufacturers must have good cause for terminating the franchise and must provide dealers with notice and allow dealers to attempt to fix areas out of compliance with franchise agreements before terminating the dealer. During the sale of a franchise, a manufacturer must also take into consideration whether the potential buyer is an immediate family member, partial owner, or meets the standard requirements when approving the sale.

[4:22:59 PM](#)

SENATOR EGAN joined the committee meeting.

[4:25:33 PM](#)

MS. PERMAN referenced the sectional analysis HB 136 as follows:

**Section 1**

Adds legislative intent language to uncodified law, "It is in the public interest to protect have warranty service for new motor vehicles and maintain fair competition among auto manufacturers and auto dealers."

**Section 2**

Amends AS 45.25.010: Applicability: AS 45.25.020 - 045.25.310 apply to franchise agreements between manufacturers and Alaska auto dealers.

**Section 3**

Amends AS 45.25.110(a): Manufacturers may not terminate an auto dealer unless they have complied with notice requirements and shown good cause for termination. Auto dealers have up to 120 days to correct areas out of compliance with the franchise agreement. The manufacturer may terminate a franchise if the dealer has systemically engaged in fraud.

**Section 4**

Adds new subsection to AS 45.25.110, "Good cause to terminate a franchise does not include the failure of an auto dealer to meet sales or service goals due to factors beyond the control of the dealer including market conditions or insufficient supply of new motor vehicles."

**Section 5**

Amends AS 45.25.140(a), updates and amends the manufacturers repurchase requirements upon termination of a franchise agreement. The manufacturer must repurchase current year models of new motor vehicles, certain new motor vehicle models from the prior year, parts, trademark signs and equipment, special tools, computer, printers, and electronic hardware.

**Section 6**

Amends AS 45.25.150(b), if a franchise termination occurs, auto dealers have an obligation to mitigate damages under a lease and mitigate the costs of facility relocations, alterations or remodels.

**Section 7**

Adds new subsection to AS 45.25.150, if a franchise termination occurs, manufacturers must pay the costs of relocation, alteration or remodeling of an auto dealers facilities if they were required by the manufacturer and were completed within three years of termination.

**Section 8**

Repeals and reenacts AS 45.25.160. This section establishes a procedure for the proposed transfer of a dealership:

- Manufacturers may not prevent the sale of a franchise to a potential buyer who is capable of being licensed as an auto dealer and who meets the manufacturers' standards.
- Upon receipt of the notice to transfer the franchise, manufacturers have 30 days to request supplemental information after which the manufacturer has 75 days to give notice of rejection of the transfer.
- The manufacturer has the right of first refusal to a transfer with limitations. The manufacturer has the same notice requirements for the right of first refusal as they have for rejecting the transfer outright. A manufacturer may not exercise the right of first refusal if the transfer of the franchise is to a family member or a managerial employee owning 15 percent or more of the dealership. If a manufacturer exercises the right of first refusal, then the manufacturer must provide the auto dealer with

the same compensation as offered by the proposed buyer. The manufacturers must also pay the legal fees incurred for the preparation of the void transfer agreement.

**Section 9**

Amends AS 45.25.180(d), expands the factors that the superior court must consider in a lawsuit addressing whether good cause exists to establish or relocate a dealership.

**Section 10**

Adds new subsection to AS 45.25.180, establishes the burden of proof in a franchise lawsuit. A manufacturer has the burden of proof to establish good cause for establishing or relocating a dealership that the manufacturer has proposed. An auto dealer must establish good cause for any establishment or relocation that the auto dealer proposes.

**Section 11**

Amends AS 45.25.190, this section updates the statutory references in the arbitration section.

**Section 12**

Adds new sections to article 2 of AS 45.25, this section addresses warranty work and pay rates for warranty work:

- **Sec 45.25.200:** A manufacturer must pay an auto dealer for all warranty work if the auto dealer provides documentation of the need for the repairs. The auto dealer must submit the claim within 90 days of the completed warranty work, and a manufacturer must approve the claim within 30 days of receipt. If the manufacturer rejects the claim, they must provide notice of their reasons to the auto dealers, who may correct the issues within 30 days of receipt of the rejection. A manufacturer may conduct an audit of warranty repairs performed, which must be done within a year of the claim. Only one audit can be performed per year.
- **Sec 45.25.210:** A manufacturer must provide auto dealers with a schedule of compensation for warranty work. The rates may not be less than the rates that the auto dealer charges customers for

similar retail work. To establish this warranty rate, auto dealers shall submit 100 sequentially ordered claims. Rates for special events and manufacturer specials are not considered in this calculation.

- **Sec 45.25.220:** If a vehicle needs warranty repairs and is located in a remote location, the manufacturer shall make reasonable efforts to repair the vehicle in the remote location. If the repairs cannot be made on site, the manufacturer may arrange, at no cost to the owner, to ship the vehicle to a location where repairs can be completed. The manufacturer is responsible for returning the repaired vehicle to the remote location. The manufacturer may direct auto dealers to refer customers in remote locations to the manufacturer. Auto dealers may subcontract warranty work in a remote location. "Remote location" refers to a location that is not accessible by road or is 100 road miles or more from an auto dealer.
- **Sec 45.25.230:** Manufacturers shall provide auto dealers with specific instructions for the preparation of new vehicles before delivery to buyers, compensation for the preparation, and the amount of time allowed for preparation.

### **Section 13**

Repeals and reenacts AS 45.25.300 regarding unfair practices, manufacturers may not:

- Require or coerce auto dealers to relocate or remodel their facilities if the changes are unreasonable.
- Require auto dealers to purchase a set number of certified pre-owned vehicles or lease return vehicles.
- Refuse to deliver for sale a line or make of vehicles that manufacturer makes.
- Require auto dealers to purchase unreasonable advertising displays or an unreasonable number of signs.
- Require auto dealers to accept vehicles, parts, accessories or equipment they did not voluntarily order.

- Increase the price of a vehicle ordered by the auto dealer between the time of order and the time of payment.
- Require or coerce auto dealers to join an advertising association or contribute to an advertising campaign.

**Section 14**

Repeals and reenacts AS 45.25.990(19), defines "terminate" for this chapter.

**Section 15**

Adds new paragraph to AS 45.25.990, defines "schedule of compensation" and "warranty work" for this chapter.

**Section 16**

Repeals AS 45.25.320.

MS. PERMAN reviewed the "substantial parts" of HB 136 as follows:

**Section 3**

Is about dealership terminations. Manufactures may not terminate dealers without good cause and meeting the proper notice requirements.

**Section 4**

Expands upon that good cause, if a dealer cannot meet sales goals due to factors out of the dealer's control, such as lack of inventory or delayed shipments, it does not amount to good cause for termination.

**Section 5**

When terminating dealerships, the manufacturer must repurchase all current year models, certain new motor vehicles from the previous year, trademark signs, parts, tools, computers and equipment.

**Section 8**

Is about the transfer of dealerships. Manufactures are given the right of first refusal for transfers; however, they may not prevent the transfer of a dealership if the potential buyer is capable of being licensed as an auto dealer and meets the manufacturers standards. Manufacturers also may not reject the transfer of a dealership to an immediate family member

of the current owner or a managerial employee who owns 15 percent or more of a dealership.

**Section 12**

Covers warranties, manufactures have the burden of repairing warranty vehicles for consumers that live in remote, off-road locations or more than 100 miles from a dealership; this is places like Kodiak or Nome where someone may have a brand-new Mercedes but there isn't a Mercedes dealer in town, they have the burden of repairing it either in the location or paying for it to be transfer to an authorized shop and then paying of it to come back at no cost to the consumer. This section also changes the rates dealers are paid for warranty work to match the amount they are paid for non-warranty retail work.

**Section 13**

Lists unfair practices and among these manufactures may not require unreasonable advertising displays or require dealers to join advertising associations.

[4:27:39 PM](#)

SENATOR WILSON asked what the shipping costs are to ship a vehicle to off-road locations.

MS. PERMAN answered that there were concerns about the use of a third party to do warranty work with the manufacturer unable to guarantee the work that the manufactures preferred to take on the burden of doing the maintenance themselves to maintain their reputation and brand.

SENATOR WILSON asked who sets vehicle transportation in motion.

MS. PERMAN replied that she was not sure but noted that the burden falls on the manufacturer.

SENATOR COGHILL asked how the new law will affect existing franchises. He inquired if the legislation requires immediate conformity.

MS. PERMAN replied that she would defer to the lawyer for the Alaska Auto Dealers Association, Gary Sleeper.

[4:31:18 PM](#)

GARY SLEEPER, Attorney, Alaska Automobile Dealers Association, Anchorage, Alaska, explained that the bill was drafted to be

remedial and apply to existing franchise agreements but only to the extent permitted by the Alaska Constitution and the United States Constitution. He noted that the provision was approved by the manufactures and detailed that it may or may not be applied retroactively depending on the particular provision at stake and decided on a case-by-case basis.

[4:33:00 PM](#)

SENATOR COGHILL remarked that many manufactures can come down with requirements and asserted that the provision provides a backdrop for some protection. He noted that franchises have requirements for advertising, quality and volume. He asked if the bill provides enough "Alaska unique protection."

MR. SLEEPER answered yes. He explained that section 13 identifies a couple of unfair practices. He noted that a new section was added to say that the manufactures cannot require a new auto dealer to purchase unreasonable advertising. He detailed that the intent was to give the Alaska dealers the right to pushback a little bit when manufactures try to require participation in expensive advertising campaigns, especially when designed for a national audience rather than an Alaska audience.

SENATOR COGHILL asked if the arbitration addressed in the bill is a new technique.

MR. SLEEPER answered that the amendment was technical and conforming to correctly cite the statute. He added that there was no change from the existing law.

CHAIR MEYER thanked Ms. Perman for providing partial credit for the legislation but asserted that all the credit goes to her and Representative Claman. He conceded that he did not think it was possible to get both groups in agreement but somehow "A rabbit was pulled out of a hat." He noted that Senator Coghill has tried to get similar legislation passed for many years as well. He continued as follows:

This "vehicle" has been "going many miles" and I want to thank you for not "wrecking this vehicle" and "keeping it on the road."

[4:36:39 PM](#)

CHAIR MEYER opened public testimony.

[4:36:47 PM](#)

MARTEN MARTENSEN, Owner, Continental Auto Group, Anchorage, Alaska, testified in support of HB 136. He disclosed that work began on the legislation four years ago. He detailed that the bill was over 30 pages long but Representative Claman recommended the bill be pared down. He revealed that Representative Claman mediated between the Alaska Auto Dealers Association and the manufactures. He asserted that the legislation protects dealers and its customers.

CHAIR MEYER emphasized that the bill is neither for the auto dealers or the manufactures, but for consumers.

[4:39:00 PM](#)

LESTER NICHOLS, Owner, Fairbanks Nissan, Fairbanks, Alaska, testified in support of HB 136. He opined that a good deal is only good if it was good for everybody and asserted that HB 136 "fits that criteria." He said the bill is good for Alaska consumers, dealers and manufactures. He emphasized that the bill helps Alaskans protect the work that he and other auto dealers have put in to create a legacy. He said having the ability to hand his dealership on to his children is important to him. He added that there are a lot of Alaskan consumers living in outlying areas that need assistance in warranty issues.

[4:42:59 PM](#)

STEVE ALLWINE, President, Mendenhall Auto Center, Juneau, Alaska, testified in support of HB 136. He noted that he is also a member of the Alaska Auto Dealers Association board of directors as well as the state director for the National Automobile Dealers Association. He asserted that HB 136 serves to update state franchise law that has not been updated since originally written in 2002. He said HB 136 will serve dealers, employees and consumers throughout the state, especially those in remote areas. He added that HB 136 addresses dealer succession by clarifying the ability for qualified people within an organization to own the dealership without a manufacturer jumping in with a right of first refusal. He emphasized that the bill provides that a dealer will be compensated for warranty issues and recalls at the same retail level that's charged to a consumer that walks into a dealership for repairs. He added that the bill allows dealerships the ability to fix a warranty issue that is discovered while fixing an initial warranty issue, something that currently is not allowed. He summarized that the bill addresses consumers in outlying areas by providing the option to either find someone locally that is qualified for warranty repairs or to have the automobile sent back to the dealer.

SENATOR COGHILL said he supported the bill.

[4:48:50 PM](#)

CHAIR MEYER closed public testimony.

[4:49:35 PM](#)

SENATOR GIESSEL noted that she has a bill that addresses a similar situation for heavy commercial equipment franchisers and she will be using HB 136 as a model.

She moved to report CSHB 136(TRA), 30-LS0561\N from committee with individual recommendations and attached zero fiscal note.

[4:50:14 PM](#)

CHAIR MEYER announced without objection the motion carried.

[4:50:24 PM](#)

At ease.

**SJR 9-CONST. AM.: PERMANENT FUND APPROP; DIVIDEND**

[4:52:51 PM](#)

CHAIR MEYER announced the consideration of Senate Joint Resolution 9 (SJR 9).

[4:53:24 PM](#)

SENATOR BERT STEDMAN, Alaska State Legislature, Juneau, Alaska, sponsor of SJR 9, emphasized that his presentation addresses the Alaska Permanent Fund (Fund) management and does not address a fiscal system solution for the state; although, SJR 9 is a major portion of a fiscal solution. He referenced his investment background 30 years in the past where he worked with the City and Borough of Sitka regarding changing their permanent fund to a percentage of market value, something that was not too dissimilar from the intent of SJR 9. He conceded that it takes time to get people comfortable with the change and noted that the process had taken 4 years where the Sitka's permanent fund was changes from an all-bond portfolio to a balanced portfolio with 60-percent equity and stocks to give more growth, and 40-percent bonds to provide more income and stability with a 5-year lookback to provide "smoothing" to stabilize cash flows.

He referenced slide 2 from his visual presentation of SJR 9, "Permanent Fund Protection" as follows:

- The Permanent Fund can be a budget stabilization fund with a limited payout method that allows the fund to continue to save and grow:
  - Budget Stabilization:
    - Alaska Has two "rainy day" accounts:
      - Constitutional Budget Reserve (CBR),
      - Statutory Budget Reserve (SBR).
  - Permanent Fund:
    - The Permanent Fund has two purposes:
      - Save,
      - Grow.
- The Permanent Fund consists of the Principal and the Earnings Reserve Account (ERA). If the ERA is used to balance the budget on an ad hoc basis, the Permanent Fund's value will decrease, which conflicts with its purpose.

SENATOR STEDMAN summarized slide 2 as follows:

The Permanent Fund is really a composition of two major accounts, the Constitutional Budget Reserve (CBR), the protected principle of the constitution, and the Earning Reserve (ERA) that is not constitutionally protected, but from the state's perspective, the Constitutional Budget Reserve (CBR) is a "rainy day" account along with a Statutory Budget Reserve (SBR) and it's been "raining" financially speaking for several years now and those are diminished relative to their historic peaks. We are in a position now where we want to restructure, look at seriously restructuring the Permanent Fund (Fund). The Permanent Fund (Fund) is something that is set in place for future generations and we are supposed to save and grow the assets.

[4:56:53 PM](#)

He referenced slide 3: "The Permanent Fund Established" as follows:

- The Permanent Fund was established in 1976 by a vote of the people to save a portion of Alaska's oil wealth for future generations and limit overspending by the Legislature.

SENATOR STEDMAN commented on slide 3 and noted that the Fund was created by a vote of the people for a storage mechanism for the wealth generated from the state's finite oil, gas and other resources. He pointed out to the adult Alaskans in the room that the Fund has been in place for the entirety of their adult lives and has grown due to the state's hard work over time.

He referenced slide 4: "The Permanent Fund Is an Alaska Success" as follows:

- Graph on the "Historical Values of Principal and Earnings Reserve" (1976-2016).
- The Permanent Fund is an Alaska success. Current value of \$65 billion from a total contribution of \$39.9 billion.

He commented on slide 4 that the chart showed the constitutionally-protected principal and the ERA which represented the trading profits from the net gains and losses along with dividends and interest income. He pointed out that the ERA changes a lot due to constant economic changes that goes on worldwide.

[4:59:22 PM](#)

He referenced slide 5: "ERA Is Variable and Uncertain" as follows:

- ERA is variable and uncertain. By its nature it lacks stability to be relied upon for budget stabilization:
  - 2000:
    - ERA: \$2.973 billion,
    - Principal: \$23.543 billion.
  - 2001:
    - ERA: \$2.384 billion,
    - Principal: \$22.431 billion.
  - 2002:
    - ERA: \$1.136 billion,
    - Principal: \$22.389 billion.
  - 2003:
    - ERA: \$0.100 billion,
    - Principal: \$24.094 billion.
  - 2004:
    - ERA: \$0.859 billion,

- Principal: \$26.541 billion.
- 2005:
  - ERA: 1.440 billion,
  - Principal: \$28.522 billion.
- 2006:
  - ERA: \$2.585 billion,
  - Principal: \$30.325 billion.
- 2007:
  - ERA: \$4.132 billion,
  - Principal: \$33.695 billion.
- 2008:
  - ERA: \$5.321 billion,
  - Principal: \$31.213 billion.
- 2009:
  - ERA: \$0.420 billion,
  - Principal: \$29.496 billion.
- 2010:
  - ERA: \$1.210 billion,
  - Principal: \$32.045 billion.
- 2011:
  - ERA: \$2.308 billion,
  - Principal: \$37.832 billion.
- 2012:
  - ERA: \$2.081 billion,
  - Principal: \$38.253 billion.
- 2013:
  - ERA: \$3.994 billion,
  - Principal: \$40.909 billion.
- 2014:
  - ERA: \$6.211 billion,
  - Principal: \$45.002 billion.
- 2015:
  - ERA: \$7.162 billion,
  - Principal: \$45.638 billion.
- 2016:
  - ERA: \$8.570 billion,
  - Principal: \$44.200 billion.
- 2017:
  - ERA: \$12.816 billion,
  - Principal: \$46.970 billion.

SENATOR STEDMAN commented on slide 5 and pointed out the "no bars at all" for the ERA for the years 1996-1998 and 2003. He noted that the Fund is constitutionally protected where the Legislature cannot access the corpus without a vote of the people. He pointed out that the trading profits and dividends in

the ERA can be appropriated by the Legislature. He added that inflation proofing the Fund comes from the ERA as well. He noted that the Legislature was presently talking about taking funds from the ERA for the following fiscal year to pay the state's bills.

SENATOR STEDMAN addressed slide 5 and noted the years 2003 and 2009 as follows:

In 2003 we had \$24 billion in principal and \$100 million in the ERA, the next year a little less than \$1 billion in the ERA. If we jump up to 2009, we see the ERA down to \$420 million, next year it is \$1.2 billion. So, when we take a look at relying on the Permanent Fund and pulling money out of it, we all recognize that we can only pull funds out of the lighter colored bar on the top [ERA]. Well, some years there isn't any, and I would like to also highlight that we haven't, in the Legislature, appropriated monies out of the ERA other than dividends, inflation proofing just goes into the other account, we've taken a little bit every year off for internal management of the Permanent Fund, it kind of runs itself, but for all significant analysis it's basically we haven't touched it until this year.

He explained that the intent of his presentation was to look at the Fund from several different angles. He offered that the state could look at the Fund as either a "milk cow" for revenue to get as much out without collapse for budgetary needs, or the strategy, which he recommends, would be to isolate the state's needs and to ask how the Fund should be structured and managed for its long-term viability for future generations. He said he was concerned with the current structure which relies on draws from the ERA but noted that times like 2003 and 2009 when there was virtually no earnings reserve would occur again. He asserted the state needs to take a serious look at the current structure's constitutionally protected Fund and the ERA which the Legislature can appropriate from. He conceded that he was worried that the state was in peril of over drawing the Fund.

[5:04:53 PM](#)

He referenced slide 6: "Current Principles For The Permanent Fund: Save and Grow" as follows:

- A "Permanent" Savings Account: The fund should conserve part of the state's revenue from mineral resources to benefit all generations of Alaskans. AS 37.13.020(1).
- The Fund's Principle Should Be Protected While Prudently Invested The fund should be managed to protect the principal while maximizing total return. AS 37.13.020(2).
- The Fund's Purchasing Power Over Time Should Be Preserved While Maximizing Return AS 37.13.120(a).

SENATOR STEDMAN commented on slide 6 as follows:

If we take a look at the Permanent Fund and follow and not get away from the guiding principles, it's a savings account and we should conserve it for future generations, there's no doubt about it. Our forefathers set up this structure and it's held up, frankly, worldwide as a model. Without going through the effects of purchasing power, the "thief of the night" of inflation, we all understand that, we want to come up with something that is going to protect us.

[5:05:25 PM](#)

He referenced slide 7: "SJR 9 Does Not Alter The Fund's Principles: Save and Grow:" as follows:

- SJR 9 merges the ERA into the principal, which constitutionally protects the whole Fund from legislative appropriation:
  - Current Alaskans shouldn't take ad hoc draws from the Fund that will significantly affect its value to future Alaskans.
  - Overspending will decrease the Fund's benefit to future generations - this is the opposite of saving.

He commented on slide 7 and noted that one of the most critical parts is to put the ERA into the constitutionally protected corpus of the Fund, a fund that the Legislature cannot draw any money out unless a constitutionally-protected mechanism was also set up. He continued as follows:

We should not have ad hoc draws. The adults today I don't feel should have ad hoc draws that are going to significantly or minorly impact the future balance of

the account. The monies or the value of the Permanent Fund is possibly to use a little bit today but it's really for future generations, our grandkids, our great grandkids that aren't even born yet, future generations. When we have an oil field that is 100 years old and not much future in front of it, that we have built up a massive amount of wealth for future Alaskans. If we allow the current needs, today and the near distant future, if we let our spending desires and our budgetary desires drive the structure of the Permanent Fund, we could easily make a mistake that hurts our long-term objectives and goals of protecting it for the future of the kids, our future Alaskans.

[5:07:35 PM](#)

SENATOR STEDMAN referenced slide 8: "SJR 9 Does Not Alter The Fund's Principles: Save and Grow:" as follows:

- SJR 9 limits any draw from the Permanent Fund to an annual 4.5 percent of its 5-year average value:
  - This draw limit is conservative and sustainable.
  - 4.5 percent is well under the Permanent Fund's growth performance.
- 1 year (FY2017):
  - Total growth: 12.89 pct.,
  - Objective (CPI + 5 pct.): 6.63 pct.
- 3 years:
  - Total growth: 6.21 pct.,
  - Objective (CPI + 5 pct.): 5.92 pct.
- 5 years:
  - Total growth: 8.85 pct.,
  - Objective (CPI + 5 pct.): 6.32 pct.
- Since inception:
  - Total growth: 8.79 pct.,
  - Objective (CPI + 5 pct.): 7.67 pct.

He said based on the information disclosed on slide 8 he proposes that the ERA be combined with the Fund's constitutionally-protected principal so that "The whole thing is constitutionally protected." He added that a draw limit would be placed on the Fund that dictates what annual percentage could be taken out. He specified that the Fund's potential rate of return would be dictated by its asset mix, then the real rate less inflation. He emphasized that the Fund's current management structure would not be altered, that it be left intact to do their job and manage the Fund.

SENATOR STEDMAN explained that SJR 9's proposes a 4.5-percent draw, a percentage that takes into the targeted rate of return with the historic inflation rate of 2.5 percent. He emphasized that the rate of return must be north of the inflation target plus the draw, a percentage that leaves a little bit of room. He proposed that at the end of the fiscal year the 4.5-percent payout of the Fund be based on a 5-year average to smooth out the volatility. He pointed out that a 5-year average could be calculated using the first five years out of a 6-year timeframe to make sure everyone knows how much money would be drawn up to the 4.5 percent. He continued as follows:

That's why there's a five-year average, you use the average rates of return targeted by your asset allocation and then you add in your inflation and you basically have your structure. So, some of the most important points when we restructure this Permanent Fund: first, you got to get on the road you want to be on, do you want to be on a road that you are going to just look at it as a milk cow and strain, which is one road; or, you can go down the other road and say, "I don't care initially what the fiscal position of the state is, I'm not going to let it drive the management and structure of the Permanent Fund, I want the best structure for the Permanent Fund and then I'll come over here and work on this other problem."

[5:13:13 PM](#)

He referenced slide 9: "SJR 9 Protects The Fund: Mechanics Of The Draw and The Split" as follows:

- \$65 billion Permanent Fund:
  - 4.5 pct. draw:
    - 2.0 pct. dividends,
    - 2.5 pct. to remain in the Permanent Fund, augment the dividend, or for state services.

He commented on slide 9 and noted that there was nothing "magical" in his proposed 4.5 percent draw for a split with 2 percent for dividends and 2.5 percent for state services. He opined that the proposal would be easy for the public to look at and see where the money is going. He pointed out that the committee might through its process decide to change the percentages. He noted that the Legislature could decide in years of higher oil prices to reinvest the state services' percentage

back into the Fund, or to pay a higher dividend, perhaps due to situation that occurred a few years ago to address higher heating fuel prices. He said the third option would be in times like today where the state needs the 2.5 percent to come into the treasury to pay for basic services. He emphasized that his proposal provides flexibility.

5:16:20 PM

SENATOR STEDMAN referenced slide 10: "SJR 9 Protects The Permanent Fund - 'Let's Talk Dividends'" as follows:

- Since 1982 the dividend has disbursed \$22 billion to Alaskans:
  - Equitable distribution of resource wealth to those who own the resources.
  - SJR 9 provides a predictable and transparent dividend via constitutional formula.
  - Dividends will once again be reliable and linked to the investment success of the fund.

He commented on slide 10 and noted that some people have said the dividend money should have been left in the Fund where the state would have \$100 billion; however, he pointed out that Alaska is the only state where the citizens own the subsurface. He emphasized that the intent is to share and continue to share the wealth that all Alaskans own.

He referenced slide 11: "SJR 9 - Projected 4.5 Percent Draw and Dividend Amounts" as follows:

- FY 2020:
  - 4.5 pct. draw: \$2.513 billion;
  - 2.0 pct. draw for dividends: \$1.117 billion,
    - Dividend: \$1,816;
  - 2.5 pct. draw for General Fund: \$1.396 billion;
  - Total ending Fund value: \$67.017 billion.
- FY 2021:
  - 4.5 pct. draw: \$2.638 billion;
  - 2.0 pct. draw for dividends: \$1.172 billion,
    - Dividend: \$1,906;
  - 2.5 pct. draw for General Fund: \$1.369 billion;
  - Total ending Fund value: \$68.984 billion.
- FY 2022:
  - 4.5 pct. draw: \$2.766 billion;
  - 2.0 pct. draw for dividends: \$1.172 billion,
    - Dividend: \$1,998;

- o 2.5 pct. draw for General Fund: \$1.537 billion;
- o Total ending Fund value: \$70.882 billion.
- FY 2023:
  - o 4.5 pct. draw: \$2.911 billion;
  - o 2.0 pct. draw for dividends: \$1.294 billion,
    - Dividend: \$2,103;
  - o 2.5 pct. draw for General Fund: \$1.617 billion;
  - o Total ending Fund value: \$72.792 billion.

SENATOR STEDMAN commented on slide 11 and noted that if the 4.5-percent draw was used, changing the draw percentage would take a vote of the people. He pointed out that markets are not linear but the projections on slide 11 are linear. He admitted that some people would say the projected dividend amounts are ghastly but noted that the state would currently be paying out a \$2,800 dividend with a picture of the governor holding a big check like previous governors had done. He said the state was experiencing different economic times but emphasized that the dividend should be based on the portfolio's value where Alaskans get 2 percent of the market value over 5 years. If the economy expands the dividend goes up, if the economy shrinks the dividend goes down. He added that new oil and gas coming online would add to the Fund as well.

He summarized that SJR 9 would take the politics out of the dividend where 4.5 percent mechanically comes out with 2 percent for dividends and the remaining balance for the State of Alaska. He conceded that state services would require the draw for the foreseeable future but asserted that the state can find its way out of relying heavily on the Fund going forward.

[5:20:45 PM](#)

He summarized as follows:

Let me recap because it's a different conversation that has been in the press for months. This is driven off of how to manage the Permanent Fund without being unduly influenced over our own financial position, good or bad for the State of Alaska, and how do we set it up to split the earnings and benefit directly with the people and have the ability of the state treasury and or leave the monies in the fund to grow, and then we can look at this projection and we can see roughly \$1.4 billion this next year into our budget. We all know sitting here, we've all been up to our neck in budget mess the last several years, we know we are going to need a lot more than that.

What we did 30 years ago in Sitka is we had a spending rate of 6 percent. The financial markets were a lot different then, they had a lot higher dividend yields and the administrator at the time, he needed cashflow because we lost our pulp mill. We on the investment committee wanted a lower payout because we wanted the future value for the community and we settled in on a 6 percent payout; that's run for years and that has been ratcheting back a quarter percent a year. We had political difficulties in ratcheting it back because it's like, all governments are the same, they get used to the cashflow, it's very hard to pull it back.

So, I would suggest, and hopefully we will over the next several years, go forward with a discussion and a conclusion that we are going to set the Permanent Fund up in isolation regardless of our needs and desires, then overlay that with a transition from where we are at that given time to where we need to be with the Permanent Fund; in other words, we may not, and this is kind of getting kind of one step further, we may not want to say starting in 2020 we are going to have a 4.5-percent payout, just bang. We might want to start, I think in the building now, we are talking about 5.25 percent, we might want to start with a higher one and ratchet ourselves back over several years like 0.25 percent back so we can get to the position where we want the Permanent Fund to be run without undo influence, but we work in the real world and we have real bills to pay, so we have to have some flexibility. So, don't get the impression I am advocating that one day we come with a number and shut the door on the Permanent Fund and lock it up and we can't put everybody in a pickle, we can work these things through.

Mr. Chairman, I waited 30 years to come before your committee to talk about percent of market value, that's how long I have been working on percent of market value. Nothing new to me, my staff just laughs, they don't have to prepare the boss for anything, just stick him in front of the group, it's very simple.

We had sent this piece of legislation back several times to the drafters, they over complicate it, with good intentions. For the public I think to become

comfortable with the restructuring of the Permanent Fund, it needs to be very clear, very transparent, "No bells and whistles of this arm wiggles money comes out of this end," just straight forward. Under this plan we would close the door for any draws over 4.5 percent and the Permanent Fund would manage the fund, it would be inflation proofed, we wouldn't have any inflation discussions on the floor of the Legislature because it is automatically done. The Department of Revenue would get a check coming in, we would have the discussion on what do we want to do with our share, the state's share, the 2.5 percent, the other 2 percent goes out as a dividend, and then we manage the financial affairs of the state with what we have.

[5:25:55 PM](#)

CHAIR MEYER asked if the forefathers and mothers who put the Permanent Fund and dividend together intended the dividend to go into the constitution.

SENATOR STEDMAN answered as follows:

I firmly believe that the Earnings Reserve needs to be rolled into the principal and the entire Permanent Fund needs to be constitutionally protected. I think having the portion, the 2-percent dividend portion or the split, in this case we are talking about a 4-percent draw, so the split of the draw is open for public discussion, I think the Judiciary Committee has been working on that. My expectation is it would be less than a 50:50 probability that that would prevail in the final version of this piece of legislation, it is much more critical that the 4.5-percent draw is protected than the dividend.

CHAIR MEYER asked if the 2.5 percent for the General Fund would be used for inflation proofing the Fund.

[5:27:56 PM](#)

SENATOR STEDMAN answered no and explained as follows:

The inflation proofing is derived as a component off of your rate of return; for instance, if you had a 2-percent inflation in this scenario, you would have to make at least 6.5 percent or more a year, so if you make 6.5 percent and you took out 2 percent inflation, that leaves you with the 4.5 percent. So, if you run

your draw up too high relative to the performance of your portfolio, you will erode your purchasing power, that's why it is so critical that the draw rate is less than the targeted after-inflation rate of return, if you make them the same you have no room for error and the probability is not good that you will step on your foot, most likely. So, you draw that down, you move that draw number down to give you some real rate of return after inflation, after your withdrawal, so it's growing beyond the rate of inflation every year.

[5:29:21 PM](#)

CHAIR MEYER asked what would happen if the Fund does not make at least 6.5-percent rate of return. He inquired if the dividend or the General Fund would be impacted.

SENATOR STEDMAN explained as follows:

When you have really robust markets, we are going to payout 4.5 percent a year on a five-year average regardless of what the market does. Market could go up, market could go down, market could stay flat, doesn't matter, 4.5 percent every year. There will be times, in fact there will be more up markets than down markets, on average, that's why economies get larger and larger on average, that's why the markets get bigger. So, there will be more years when you make extra, you'll make your 4.5 percent draw, you will make your 2 percent inflation, whatever your inflation is at the time, 2.5 percent, whatever. You might make 12 percent in a year or 15 percent in a year, and all of that is great because you are jumping up in your return.

There will be years like when you go back and look at recessions, 2008 and 2009, 2000, go back to 1978 with "Black Monday," you can go back about every decade you'll have a dip. In those dip years you'll still get a draw of 4.5 percent over the 5-year average, but the 5-year average is going to be coming down because your market value is going down. Some would argue, "Well, then from the previous year you spent part of the principal," let's say you only made 1 percent in a given year and you take out 4.5 percent as an example, some would argue, "Well, then you spent some of the principal," but that's true in certain regards, but that's why you want this structure so when we have

down years you have the smooth cashflow coming out because your up years are going to more than offset that. To turn it upside down you just bring your payout rate 6-8 percent, and then your down markets push your value down, your purchasing power, you can't afford down markets, that's why it's more comfortable to have a draw rate with some cushion in it, that's why it is not at 4.75-5.25 percent, but that's also the discussion and the evolution in the Legislature. The Legislature may decide that 4.5 percent is too conservative, they want 4.75 percent to 5.25 percent. I think the Permanent Fund will have some discussions or some input on some of that, what rates they are comfortable with, but there will be times when you have a down market and it could last two to three years.

[5:32:38 PM](#)

SENATOR GIESSEL asked how he calculated for population during the four years he portrayed.

SENATOR STEDMAN answered 1 percent growth.

He continued as follows:

I think what we did on these we took the amount of dividends that they paid, the number, and just divided it into the dollars, I don't have the equation in front of me, that's how we derived the \$1,800 dividend. I think it was 615,000, the actual dividend checks are paying out, trying to get it as close as we could, and then population historically has been growing at 1 percent, I think lately it has been shrinking, so if the population shrinks, I think in this case \$1.116 billion would be divided amongst fewer people.

SENATOR GIESSEL commented as follows:

I don't question at all the mathematical accuracy of what your calculation shows or the mathematical logic of it at all, but as someone who deals in the realm of people, if we had a dividend that was growing like this, I believe our population would grow and I believe that our Medicaid costs would mushroom to say nothing of Office of Children's Services issues and our substance abuse issues. Again, I'm not thinking

about this in a mathematical way, I'm thinking about the impact that this kind of a dividend, over \$2,000, will have on people. This is pretty serious as I look at it in a serious in a negative way.

[5:34:45 PM](#)

SENATOR STEDMAN answered as follows:

The draw rate was driven off of the asset allocation, their investments and then performance, and that's what set that. The dollar amounts are driven off of the happenstance of the size of the fund, \$65 billion, and the 5-year average just happened to be what the average was. If in through the process that the Legislature felt that 2 percent for a dividend is too big, you could take it down to 1.5 percent and add 3.0 percent on the other side, add that 0.5 percent to the general fund. You could move those numbers around to whatever the Legislature feels comfortable, but at the end of the day we need, I firmly believe, the public support for a constitutional amendment to restrict and collapse the Earnings Reserve into the corpus and block the Legislature's ability to do ad hoc withdrawals or we are going to spend the money.

SENATOR COGHILL said he agreed with Senator Stedman on collapsing the ERA into the corpus. He remarked that Senator Stedman's proposal was an endowment approach that takes out volatility. He admitted that he struggles with putting a constitutional amendment in for the right of a dividend. He opined that Senator Stedman's proposal was an excellent approach of managing the wealth but noted that he would much rather have the wealth go to a dividend in statute that could be revisited. He explained that he did not want to put the dividend alongside any other right in the Alaska Constitution. He added that the state must address how to determine residency in Alaska due to the state's transitory military population as well as the act of people swearing that they are going to move back. He concurred with Senator Giessel on the question she brought up of people moving into the state "just for the right." He opined that Senator Stedman's proposal is the best management structure that he has seen to date.

[5:38:50 PM](#)

SENATOR STEDMAN suggested that the resolution be discussed in the Senate Judiciary Committee. He said he would not be opposed to the dividend's constitutional protection being removed or

adjusted with a flexible formula. He emphasized that the key point was to protect the entire Fund with a constitutional protection from the Legislature.

SENATOR STEDMAN said the 4.5 percent draw was a comfortable and safe draw, albeit a lot of people would consider the draw to be on the low side. He opined that the Legislature would not establish a draw rate that was excessively high because the Permanent Fund Corporation would object if they saw an erosion of value.

He said he thought the concerns that Senators Coghill and Giessel brought forward were part of the process the Legislature goes through when each committee works on a bill and changes it. He opined that how to control the size of the dividend was a legitimate discussion because the state may end up with a portfolio nest egg for future generations that is large enough to run the state on.

[5:41:14 PM](#)

SENATOR COHILL concurred that the Fund should be preserved for future generations with a structure that was a tried-and-true method. He agreed that the resolution should move along to the Senate Judiciary Committee.

SENATOR STEDMAN commented that those that think the proposal is concrete, "Thou shalt not change it, it's perfect," are going to be surprised. He emphasized that he is adamant of constitutional protection of the corpus, preferably the ERA in closing that door. He reiterated that the discussion on the dividend and payout structure was just part of the process. He concurred that there is a downside to constitutionally putting the dividend in as well as the growth of a very large dividend that attracts some social issues.

[5:42:54 PM](#)

CHAIR MEYER opened and closed public testimony.

SENATOR COGHILL agreed with the resolution's focus and said legislators' responsibility was to bring as much stability to the Fund as possible. He opined that the state has created a treasure that needs to come to the time of life that it can go on the next generation.

CHAIR MEYER pointed out that SJR 9 has a zero fiscal note.

[5:45:12 PM](#)

SENATOR GIESSEL moved to report SJR 9, version 30-LS1085\0, from committee with individual recommendations and attached zero fiscal note.

5:45:24 PM

CHAIR MEYER announced there being no objection, the motion carried.

5:46:13 PM

There being no further business to come before the committee, Chair Meyer adjourned the Senate State Affairs Standing Committee at 5:46 p.m.