

**3/1/05**

**AMERADA**

**HESS**

**HFIN**

**FILE**

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Background Paper

**Use of the Amerada Hess  
Settlement to Fund  
Capital Projects**

Office of Management and Budget

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02/28/05

## Amerada Hess Royalty Oil Dispute and Settlement

### Settlement's History

The fight with North Slope oil producers started in 1977, almost as soon as oil began to flow through the Trans-Alaska pipeline. That year the state filed a lawsuit accusing oil companies of undervaluing their oil and gas and thus denying the state the full value of its 12.5% royalty share. In 1989, the state filed claims against 15 companies for \$902 million. The dispute became known as the Amerada Hess case, named after the first company listed alphabetically in the lawsuit.<sup>1</sup>

Royalty oil is the state's ownership share of the crude coming out of the ground. The state takes its royalty share in two ways: in-kind, which is sold to Railbelt refineries and a Fairbanks electrical utility; and in value, which is sold back to the producers and priced at the wellhead net of transportation costs. The problem came in figuring out how to value the royalty oil. The state claimed that the companies used "bookkeeping fictions and intracorporate transactions" to under value the oil at market and overstate transportation costs, which combined to artificially lower the wellhead value.<sup>2</sup> The production at issue occurred between 1977 and 1986 from the Kuparuk River and Prudhoe Bay oilfields.

The case became the longest running legal battle between the state and North Slope producers, lasting 18 years. One issue that came up early in the course of the litigation was that since 25% of royalty payments are dedicated to the Permanent Fund, earnings from settlement payments would eventually trickle into annual dividends paid out to Alaska residents. This issue was first raised in 1987 when three oil company defendants filed a lawsuit in federal district court to enjoin the Amerada Hess case from proceeding to trial in any court in Alaska. They claimed they could not receive a fair trial in Alaska because every judge and juror had a financial interest in the outcome of the case by reason of their respective annual Permanent Fund Dividends, which would be increased by any earnings derived from damages awarded to the state in Amerada Hess.<sup>3</sup>

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<sup>1</sup> The Amerada Hess company was actually a very minor player in the case and settled out of court with the state in 1989 for \$319,000.

<sup>2</sup> "State Settles Oil Fight - \$100 Million Ends 18-Year Battle," Ralph Thomas, *Anchorage Daily News*, April 7, 1995.

<sup>3</sup> Transmittal from Governor Heckel for SB 213, March 18, 1991.

*Amerada Hess Royalty Oil Dispute and Settlement*

In June 1988, the federal district court dismissed the action, ruling that the due process issue must be addressed in the state court before being asserted in the federal court. The companies appealed. In 1989, the Ninth Circuit Court of Appeals encouraged the parties to seek a legislative solution. Governor Cowper immediately introduced corrective legislation. This was ultimately passed into law (Ch 38, SLA 1989) in May 1989. Codified as AS 43.23.045 (b) Dividend Fund, it provided that:

*income earned on money awarded after trial in State v. Amerada Hess, et al, 1JU-77-847 Civ. (Superior Court, First Judicial District) shall be treated in the same manner as the Alaska permanent fund except that it is not available for distribution to the (dividend) fund, and shall be annually deposited into the principal of the Alaska permanent fund.*

Independently, in April of the same year the Ninth Circuit affirmed the district court's disposition, requiring the oil companies to raise the issue of disqualification in state Superior Court. The companies sought review by the U.S. Supreme Court but their petition was denied.

In October 1990, the companies filed a motion to disqualify the Alaska courts. In March 1991, Judge Carpeneti ruled that AS 43.23.045(b) removes most, but not all, of the sources of revenue flowing to the Permanent Fund dividend that created the bias. He also found that the statute failed to prevent additional monies from going to the dividend fund as a result of the so-called Amerada Hess price adjustment clauses in royalty-in-kind (RIK) contracts. He agreed with claims by the oil companies that if the state prevailed, it would result in a \$300 million judgement against refineries and the Fairbanks utility for in-kind purchases. Part of any judgement then would flow to the Permanent Fund and increase Permanent Fund Dividends (by \$10 in the first year, increasing to about \$40 in FY2015).

According to Judge Carpeneti, this failure to deal with RIK recoveries would require the Alaska court to disqualify itself. The result was another piece of legislation introduced by Governor Hickel in March of 1991 that became part of a more comprehensive rewrite of Permanent Fund statutes (19 Ch 134 SLA 1992) that included repealing AS 43.23.045(b) above. A new section was added to AS 37.13.145 Disposition of Income statute:

*(d) Notwithstanding (b) of this section, income earned on money awarded in or received as a result of State v. Amerada Hess et al, 1JU-77-847 Civ. (Superior Court, First Judicial District), including settlement, summary judgement, or adjustment to a royalty-in-kind*

*contract that is tied to the outcome of this case, or interest earned on the money, or on the earnings of the money shall be treated in the same manner as other income of the Alaska permanent fund, except that it is not available to the dividend fund, and shall be annually deposited to the principal of the Alaska permanent fund.*

One final note on the legal history: 19 Ch. 134 SLA 1992 contained a conditional repealer stating that if the Alaska Supreme Court made a final determination that "no judge or juror is disqualified from serving as a judge or juror solely because the judge or juror may qualify to receive a permanent fund dividend," subsection (d) would be repealed, i.e., earnings on the Amerada Hess principal would be added into the annual dividend calculation.

Eventually, almost all of the state's claims were settled out of court. The final piece fell into place in 1995, when the state settled an assortment of gas royalty claims against three companies—BP, Exxon, and Mobil—for the last \$100 million of about \$1 billion in total settlements. Altogether the state spent nearly \$100 million in building its legal case. Over the course of the litigation, the share of settlements deposited into the Permanent Fund totaled \$194.1 million. Realized earnings on the Amerada Hess settlement money since the first deposit in FY 92 have added another \$230.3 million to the settlement principal, which totaled \$424.4 million at the end of FY 04.

## Amerada Hess Settlement

	Principal			Realized Earnings (over inflation)			Inflation-proofing			Total Settlement Principal
	Beginning	Contributions	Ending	Beginning	Additions	Ending	Beginning	Additions	Ending	
FY 1992	Inception	82,099,000	82,099,000	0	0	0	0	2,005,000	2,005,000	84,104,000
FY 1993		16,411,000	98,510,000	0	4,641,000	4,641,000	2,005,000	4,541,000	6,546,000	109,697,000
FY 1994		13,213,000	111,723,000	4,641,000	5,620,000	10,261,000	6,546,000	3,615,000	10,161,000	132,145,000
FY 1995		61,717,000	173,440,000	10,261,000	6,145,000	16,406,000	10,161,000	5,060,000	15,221,000	205,067,000
FY 1996		2,860,000	176,300,000	16,406,000	18,441,000	34,847,000	15,221,000	5,864,000	21,085,000	232,232,000
FY 1997		7,847,000	184,147,000	34,847,000	21,377,000	56,224,000	21,085,000	7,058,000	28,143,000	268,514,000
FY 1998		24,622,000	208,769,000	56,224,000	31,254,000	87,478,000	28,143,000	6,853,000	34,996,000	331,243,000
FY 1999		0	208,769,000	87,478,000	36,086,000	123,564,000	34,996,000	5,102,000	40,098,000	372,431,000
FY 2000		6,886,000	215,655,000	123,564,000	30,331,000	153,895,000	40,098,000	8,307,000	48,405,000	417,955,000
FY 2001		13,587,000	229,242,000	153,895,000	7,687,000	161,582,000	48,405,000	14,543,000	62,948,000	453,772,000
FY 2002		(35,159,000)	194,083,000	161,582,000	(23,384,000)	138,198,000	62,948,000	(5,154,000)	62,112,000	394,393,000
FY 2002		0	194,083,000	138,198,000	0	138,198,000	62,112,000	4,318,000	62,112,000	394,393,000
FY 2003		0	194,083,000	138,198,000	0	138,198,000	62,112,000	6,160,000	68,272,000	400,553,000
FY 2004		0	194,083,000	138,198,000	14,713,000	152,911,000	68,272,000	5,133,000	77,405,000	424,399,000
	<b>Total</b>	<b>194,083,000</b>		<b>Total</b>	<b>152,911,000</b>		<b>Total</b>	<b>77,405,000</b>		

Note: FY2002 reductions are the result of an audit correction of an over deposit of settlement principal and related earnings.

# Legislation to Leverage Amerada Hess Settlement Earnings To Finance Capital Projects

## Summary

### 1. Create the Alaska Capital Fund

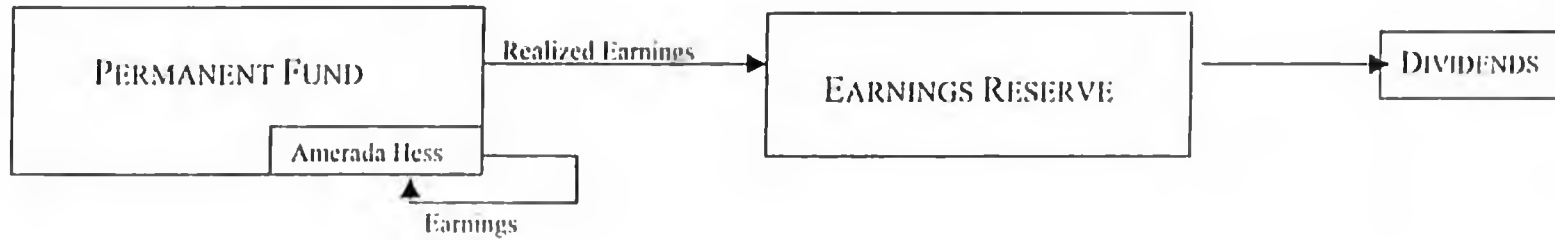
- Legislation establishes the Alaska Capital Fund
- The realized earnings off of the Amerada Hess principal (expected to be in the \$30+ million/yr. range) would be deposited into the Alaska Capital Fund.
- The Alaska Capital Fund is established within the Earnings Reserve Account of the Permanent Fund
  - ✓ The purpose of putting it in the ERA instead of the general fund is so the balance can be carried forward without being subject to the annual CBR sweep.
  - ✓ The ability to carry fund balance forward is critical to providing security of payment to Wall Street despite expected volatility of earnings.
  - ✓ The Alaska Capital Fund would be invested the same as the ERA and retain its own earnings.
  - ✓ The Alaska Capital Fund would accumulate realized earnings for 2 years, beginning in FY 05, before being drawn down to pay debt service.
  - ✓ The accumulated balance would fund reserve accounts to secure debt.
- AS 37.13.145(c) would be changed so there would be no inflation proofing of the Amerada Hess principal from the Alaska Capital Fund.
  - ◆ Changes are made to the Alaska Permanent Fund section of the FY 05 and 06 budget bills so that Amerada Hess realized earnings are deposited into the Alaska Capital Fund and Amerada Hess principal is exempt from inflation proofing.
  - ◆ The Amerada Hess portion of Permanent Fund principal would remain at \$424 million thereafter.

## 2. State of Alaska Capital Corporation Created

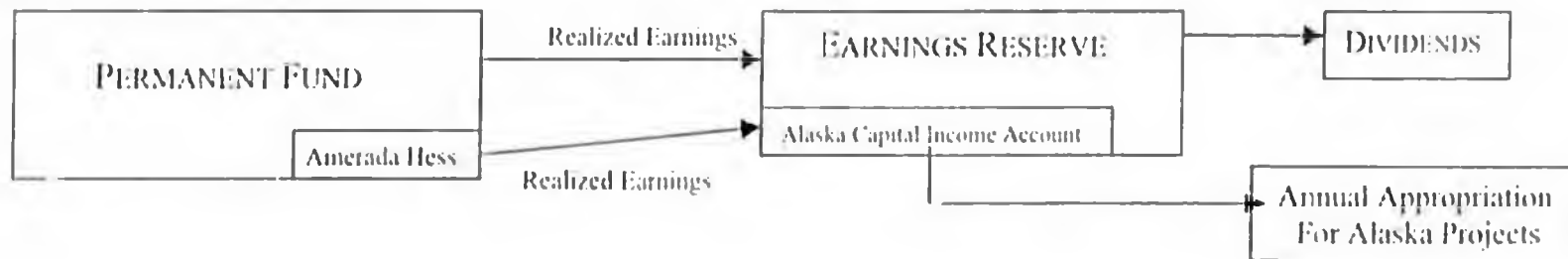
- Legislation establishes the State of Alaska Capital Corporation. The Corporation is closely linked to the Department of Revenue and State Bond Committee that would issue stand-alone moral obligation debt of the state totaling \$343 million.
  - ◆ The Alaska Capital Fund would be the source of revenue to pay debt service on bonds issued by the corporation.
  - ◆ Historically the Permanent Fund average annual earnings have been 8.94% and the ten year forecasted rate of realized return is 7.61%.
  - ◆ Modeling shows debt service may be paid with a realized rate of return as low as 5.5%, but given market volatility it is extremely important to be able to withstand short term bear markets.
  - ◆ A debt service reserve fund and an advance funded debt payment account along with the fund balance of the Alaska Capital Fund provide a high probability of an available funding source.
- Debt service on the bonds will be paid through annual legislative appropriations from the Alaska Capital Fund to the Corporation.
  - ◆ The moral obligation of the state is necessary to provide further assurance to bondholders that annual debt service payments will continue even during improbable unanticipated prolonged down market periods, when there may be low or negative Amerada Hess realized earnings paid into the Alaska Capital Fund.
  - ◆ Consultations with credit rating agencies and financial advisors have provided assurance that there will be no negative effect on the state's credit rating by issuing these bonds.
  - ◆ Investment grade ratings in the "A" range are expected on the bonds.
  - ◆ Bonds will be issued with a requirement to pay interest only with a final, theoretical principal maturity date of 20 years. Purchasers, however, understand that the actual repayment of principal will be based on Amerada Hess earnings deposited into the Alaska Capital Fund. Expectations are that the bonds will be paid off much sooner than 20 years.

# ALASKA CAPITAL INCOME ACCOUNT

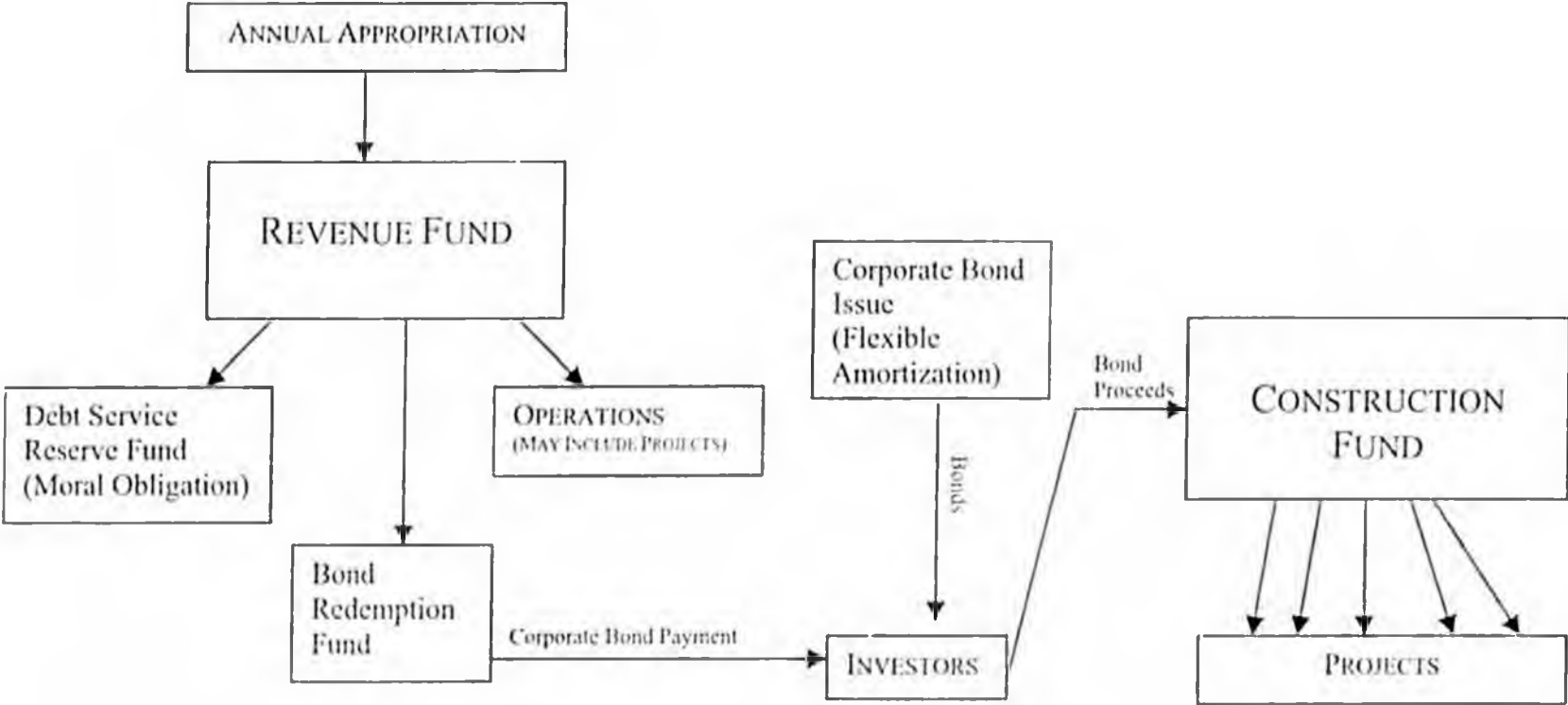
## CURRENT



## PROPOSED



STATE OF ALASKA CAPITAL CORPORATION



**Alaska Capital Income Account**

	Earnings Rate	Beginning Balance	Amerada Hess Earnings	Earnings	Transfer to SOA CC	Ending Balance			
Am Hess Principal			424,399,000						
Am Hess Transfer Rate									
Blended Rate									
2005	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2006	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2007	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2008	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2009	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2010	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2011	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2012	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2013	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2014	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2015	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2016	7.61%	-	32,296,764	1,228,891.87	33,525,656	-			
2017	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2018	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2019	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2020	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2021	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2022	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			average annualized earnings rate
2023	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			7.43%
2024	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2025	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2026	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2027	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2028	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2029	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2030	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2031	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2032	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2033	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2034	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2035	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2036	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2037	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			
2038	7.00%	-	29,707,930	1,039,777.55	30,747,708	-			

**State of Alaska Capital Corporation**

Revenue Fund

	Borrowing Rate	Earnings Rate	Beginning Balance	Lease Appropriation Received	Outstanding Bonds	Nominal Interest Payments	Flexible Principal Payments	Earnings on Fund Balance	Transfers In	DSRF or CF Transfers out / Operations Expense	Ending Balance
2005	6.00%	2.00%	-	33,525,656	-	-	-	-	-	-	33,525,656
2006	6.00%	2.00%	33,525,656	33,525,656	326,096,837	9,782,905	-	1,245,492	-	32,709,684	25,804,215
2007	6.00%	2.00%	25,804,215	33,525,656	326,096,837	19,565,810	20,198,250	1,852,830	-	100,000	21,318,641
2008	6.00%	2.00%	21,318,641	33,525,656	305,898,587	18,353,915	18,136,466	1,840,589	-	100,000	20,094,504
2009	6.00%	2.00%	20,094,504	33,525,656	287,762,121	17,265,727	19,088,705	1,829,597	-	100,000	18,995,324
2010	6.00%	2.00%	18,995,324	33,525,656	268,673,415	16,120,405	20,280,170	1,818,028	-	100,000	17,838,433
2011	6.00%	2.00%	17,838,433	33,525,656	248,393,245	14,903,595	21,556,900	1,805,737	-	100,000	16,609,332
2012	6.00%	2.00%	16,609,332	33,525,656	226,836,346	13,610,181	22,914,626	1,792,672	-	100,000	15,302,853
2013	6.00%	2.00%	15,302,853	33,525,656	203,921,719	12,235,303	24,357,903	1,778,785	-	100,000	13,914,088
2014	6.00%	2.00%	13,914,088	33,525,656	179,563,817	10,773,829	25,892,086	1,764,022	-	100,000	12,437,851
2015	6.00%	2.00%	12,437,851	33,525,656	153,671,731	9,220,304	27,522,899	1,748,330	-	100,000	10,868,634
2016	6.00%	2.00%	10,868,634	33,525,656	126,148,831	7,568,930	29,256,430	1,731,650	-	100,000	9,200,580
2017	6.00%	2.00%	9,200,580	30,747,708	96,892,401	5,813,544	28,321,199	1,685,858	-	100,000	7,399,403
2018	6.00%	2.00%	7,399,403	30,747,708	68,571,202	4,114,272	29,918,566	1,668,694	-	100,000	5,682,966
2019	6.00%	2.00%	5,682,966	30,747,708	38,652,637	2,319,158	31,792,357	1,979,952	32,609,684	100,000	36,808,794
2020	6.00%	2.00%	36,808,794	30,747,708	6,860,279	411,617	6,860,279	1,577,290	-	100,000	61,761,896
2021	6.00%	2.00%	61,761,896	30,747,708	-	-	-	1,244,013	-	100,000	93,653,616
2022	6.00%	2.00%	93,653,616	30,747,708	-	-	-	1,566,152	-	100,000	125,867,476
2023	6.00%	2.00%	125,867,476	30,747,708	-	-	-	1,891,544	-	100,000	158,406,728
2024	6.00%	2.00%	158,406,728	30,747,708	-	-	-	2,220,224	-	100,000	191,274,659
2025	6.00%	2.00%	191,274,659	30,747,708	-	-	-	2,552,223	-	100,000	224,474,589
2026	6.00%	2.00%	224,474,589	30,747,708	-	-	-	2,887,576	-	100,000	258,009,873
2027	6.00%	2.00%	258,009,873	30,747,708	-	-	-	3,226,316	-	100,000	291,883,896
2028	6.00%	2.00%	291,883,896	30,747,708	-	-	-	3,563,478	-	100,000	326,100,082
2029	6.00%	2.00%	326,100,082	30,747,708	-	-	-	3,914,096	-	100,000	360,661,885
2030	6.00%	2.00%	360,661,885	30,747,708	-	-	-	4,263,205	-	100,000	395,572,798
2031	6.00%	2.00%	395,572,798	30,747,708	-	-	-	4,615,841	-	100,000	430,836,346
2032	6.00%	2.00%	430,836,346	30,747,708	-	-	-	4,972,038	-	100,000	466,456,091
2033	6.00%	2.00%	466,456,091	30,747,708	-	-	-	5,331,833	-	100,000	502,435,632
2034	6.00%	2.00%	502,435,632	30,747,708	-	-	-	5,695,253	-	100,000	538,778,603
2035	6.00%	2.00%	538,778,603	30,747,708	-	-	-	6,062,361	-	100,000	575,488,674
2036	6.00%	2.00%	575,488,674	30,747,708	-	-	-	6,433,173	-	100,000	612,569,555
2037	6.00%	2.00%	612,569,555	30,747,708	-	-	-	6,807,727	-	100,000	650,024,989
2038	6.00%	2.00%	650,024,989	30,747,708	-	-	-	7,186,065	-	100,000	687,850,761

State of Alaska Capital Corporation							
Reserve Fund							
	Earnings Rate	Beginning Balance	Additional Contributions	Earnings on Fund Balance	Earnings Transfer Out	Termination of Reserve	Ending Balance
2005	4.00%	-				-	-
2006	4.00%	-	32,609,684	652,194	652,194	-	32,609,684
2007	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2008	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2009	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2010	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2011	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2012	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2013	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2014	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2015	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2016	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2017	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2018	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2019	4.00%	32,609,684		1,304,387	1,304,387	-	32,609,684
2020	4.00%	32,609,684		652,194	652,194	32,609,684	-
2021	4.00%	-		-	-	-	-
2022	4.00%	-		-	-	-	-
2023	4.00%	-		-	-	-	-
2024	4.00%	-		-	-	-	-
2025	4.00%	-		-	-	-	-
2026	4.00%	-		-	-	-	-
2027	4.00%	-		-	-	-	-
2028	4.00%	-		-	-	-	-
2029	4.00%	-		-	-	-	-
2030	4.00%	-		-	-	-	-
2031	4.00%	-		-	-	-	-
2032	4.00%	-		-	-	-	-
2033	4.00%	-		-	-	-	-
2034	4.00%	-		-	-	-	-
2035	4.00%	-		-	-	-	-
2036	4.00%	-		-	-	-	-
2037	4.00%	-		-	-	-	-
2038	4.00%	-		-	-	-	-

**State of Alaska Capital Corporation**

Construction Fund

Run Solver to force cell g38 to equal zero by changing cell d6.

	Earnings Rate	Beginning Balance	Bond Proceeds /Transfers	Earnings on Fund Balance	Project Cash Flow	Ending Balance				
2005	3.00%	-		-		-				
2006	3.00%	-	326,096,837	9,625,031	20,150,000	315,571,868				
2007	3.00%	315,571,868		3,458,439	88,467,690	230,562,617				
2008	3.00%	230,562,617		1,221,338	84,694,733	148,089,222				
2009	3.00%	148,089,222		822,628	94,070,000	54,841,850				
2010	3.00%	54,841,850		445,650	25,577,500	29,710,000				
2011	3.00%	29,710,000		375,000	5,085,000	25,000,000				
2012	3.00%	25,000,000		0	25,000,000	0				
2013	3.00%	0		0		0				
2014	3.00%	0		0		0				
2015	3.00%	0		0		0				
2016	3.00%	0		0		0				
2017	3.00%	0		0		0				
2018	3.00%	0		0		0				
2019	3.00%	0		0		0				
2020	3.00%	0		0		0				
2021	3.00%	0		0		0				
2022	3.00%	0		0		0				
2023	3.00%	0		0		0				
2024	3.00%	0		0		0				
2025	3.00%	0		0		0				
2026	3.00%	0		0		0				
2027	3.00%	0		0		0				
2028	3.00%	0		0		0				
2029	3.00%	0		0		0				
2030	3.00%	0		0		0				
2031	3.00%	0		0		0				
2032	3.00%	0		0		0				
2033	3.00%	0		0		0				
2034	3.00%	0		0		0				
2035	3.00%	0		0		0				
2036	3.00%	0		0		0				
2037	3.00%	0		0		0				
2038	3.00%	0		0		0				
										343,044,923.00

Cheryl Frasca  
Re: Repeal of *Amerada Hess* earning sequestration  
requirement in AS 37.13.145(d)

January 28, 2005

## MEMORANDUM

State of Alaska  
Department of Law

**To:** Cheryl Frasca  
Office of the Governor

**Date:** January 28, 2005

**From:** Wilson L. Condon  
Assistant Attorney General  
Oil, Gas & Mining-Anchorage

**Tel. No.:** 269-5255

**File No.:** N/A

**Re:** Repeal of *Amerada Hess*  
earning sequestration  
requirement in AS 37.13.145(d)

### I. INTRODUCTION

In 1991 the legislature enacted the current version of AS 37.13.145(d) as part of provisions governing management of the Alaska Permanent Fund Corporation ("APFC"). The statute imposes a financial sequestration requirement on earnings from settlement proceeds received by the State in ANS Royalty Litigation, commonly known as the *Amerada Hess* ("*AmHess*") litigation. In relevant part, AS 37.13.145(d) requires that:

[I]ncome earned on money awarded in or received as a result of State v. *Amerada Hess*, et al., IJU-77-847 Civ. (Superior Court, First Judicial District), including settlement, summary judgment, or adjustment to a royalty-in-kind contract that is tied to the outcome of this case, or interest earned on the money, or on the earnings of the money . . . is not available for distribution to the dividend fund, and shall be annually deposited into the principal of the Alaska permanent fund.

The legislature adopted the statute in order to negate an argument advanced by producers during the *AmHess* litigation that no Alaska judge or juror could be impartial in the adjudication of the matter because they had a financial stake in the outcome. According to the producers, any judgment returned would ultimately be deposited into the Alaska Permanent Fund, affecting the size of the annual Permanent Fund Dividend ("PFD").

Cheryl Frasca  
Re: Repeal of *Amerada Hess* earning sequestration  
requirement in AS 37.13.145(d)

January 28, 2005

All issues in the *AmHess* litigation were concluded and the case dismissed in 1995. Since the statute was adopted, the APFC has always used a separate sub-account to isolate any *AmHess* proceeds and the income earned on those proceeds. This sub-account is part of the principal account of the permanent fund. The purpose of the sub-account is: (1) to ensure that *AmHess* earnings are not included in the amount from which the PFD is annually paid; and (2) to track the amount to be transferred annually from the Fund's realized earnings account to Fund principal, and thereafter be allocated to the *AmHess* sub-account. Presently, no additional *AmHess* litigation proceeds are due from the producers, but annual earnings allocations and adjustments continue to be handled in conformity with AS 37.13.145(d).

## II. QUESTIONS PRESENTED

1. Can the legislature repeal AS 37.13.145 at this time?

## III. SHORT ANSWER

1. Yes, the legislature has authority under the provisions of AS 37.13.145. However, the bias challenge raised by the producers in *AmHess* is one that is capable of repetition in future litigation. Most likely, it would be raised again.<sup>1</sup> Therefore, repeal of AS 37.13.145 may undermine the State's position in future litigation that Alaska judges and jurors are not financially impacted by litigation proceeds. The producers will argue that an agreement by the State to segregate future litigation proceeds is illusory. They will contend that any segregation requirement will eventually be repealed, and the money thereafter commingled with PFD funds. Thus, under their argument, judges and jurors will retain an expectation of recovery from the proceeds in the matter before them, thereby requiring their disqualification.

## IV. DISCUSSION

As long as there are no contractual promises enforceable under the federal Contract Clause,<sup>2</sup> a valid general act may effectively repeal or supersede the provisions of a prior

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<sup>1</sup> This is so because the disqualification issue was never fully litigated on the merits through appeal in either the state or federal litigation arising out of *Hess*.

<sup>2</sup> U.S. Const. art. 1, § 10, cl. 2 ("[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts.").

Cheryl Frasca

January 28, 2005

Re: Repeal of *Amerada Hess* earning sequestration  
requirement in AS 37.13.145(d)

act.<sup>3</sup> Here, there is no contractual promise with the *AmHess* parties to maintain a sequestration requirement for any fixed period of time, or indefinitely. No judicial order mandates the treatment. The reasons prompting enactment of the provision became moot when all issues in the case were settled in 1995. Thus, as a legal matter, the legislature is presently free to repeal the sequestration requirements of AS 37.13.145(d).

In practical terms, repeal of AS 37.13.145(d) would mean that the annual realized income of the Fund would be increased by the amount earned from approximately \$400 million of assets. Under the current distribution formula, this means that the amount of the annual PFD would be increased as a result of inclusion of *AmHess* proceeds in "the amount available for distribution to the dividend fund."<sup>4</sup> The *AmHess* judges and potential jurors will now belatedly realize larger PFDs from repeal of the provision.

Although no legal obstacle impedes repeal of AS 37.13.145(d), the legislature may care to balance the benefits of such repeal versus the potential negative consequences. In the benefit column, there will be fairly insubstantial savings of APFD accounting time and bookkeeping entries isolating the funds and the earnings on those funds. Also in the benefit column, there will be an increased annual PFD available for all Alaskans. In the negative column, the legislature may have furnished the producers an evidentiary basis to argue in future litigation that "we all know that proceeds of this lawsuit will eventually find their way into the PFD, and therefore, no Alaskan judge or juror can be impartial."

I cannot say that a future state or federal court would entertain such an argument based on a one-time incidence of repeal. It is even more tenuous to suggest, as the producers would, that Alaskan judges and jurors follow the requirements of PFD accounting so closely to know of the repeal of AS 37.13.145(d). However, it may unnecessarily complicate future litigation. Therefore, in the absence of a more compelling justification for repeal than I currently see, I would counsel leaving the statute on the books.

WLC:AMP:cb

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<sup>3</sup> *State v. Lewis*, 559 P.2d 630 (Alaska 1977), cert. denied, 432 U.S. 901.

<sup>4</sup> AS 37.13.145(d).

## **Frequently Asked Questions About the Amerada Hess Capital Project Financing Proposal**

**1. Why issue debt instead of paying cash from the projected surplus?**

The rationale for issuing debt instead of paying cash for projects is that both current and future users will pay the cost while enjoying the useful life of the facilities.

**2. How will the settlement's earnings translate into money to fund state capital projects?**

Each year the settlement is estimated to earn \$30 million, which is expected to be enough to pay the debt service on \$340 million in bond proceeds. The Governor's FY 06 capital budget proposes to use these bond proceeds to pay for a number of capital projects—from road construction to taking care of some of the deferred maintenance needs in state facilities and parks.

**3. Why are you proposing the Alaska Capital Fund and State of Alaska Capital Corporation be created to sell these bonds? Why doesn't the State just sell limited liability moral obligation bonds itself?**

The main consideration in utilizing a public corporation to issue bonds is to separate it from state general fund indebtedness. One major benefit is to preserve the state's own debt capacity for potential equity ownership in the gasline.

**4. Won't this reduce my Permanent Fund dividend?**

No it will not. State law specifically excludes the interest earned from this settlement from being used in the calculation of the annual dividend amount. Right now the only role these earnings have played is to grow the size of the settlement from an original deposit of \$82.1 million in FY 92 to \$424.4 million in FY 04.

**5. We have been told that the State's credit ratings will be downgraded if it tries to sell bonds before recurring revenues match recurring expenditures. Since the State still doesn't have a fiscal plan, won't this issuance result in a downgrade?**

Consultations with rating agencies have provided assurance that these bonds can be structured to have no negative effect on the state's credit ratings. The bond proposal will be structured as self-supporting debt through the use of a new revenue source – Amerada Hess realized earnings.

6. **How would this proposal fit with the POMV constitutional amendment proposal that would annually pay out a percentage of the market value of the Permanent Fund?**

Two possibilities are: 1) Exclude the \$424 million Amerada Hess principal from the market value of the Permanent Fund in the POMV calculation; 2) Repeal the Alaska Capital Fund sub-account in the earnings reserve and fund debt service of the Alaska Capital Corporation from the POMV payout stream.

7. **Since you're taking interest earned by a settlement that is part of the Permanent Fund to pay debt service, couldn't you instead use those revenues to increase dividend checks?**

Amerada Hess realized net income is specifically excluded by statute from the annual dividend calculation. Legislation would have to be passed to change this. The marginal difference in the individual dividend by including Amerada Hess income would amount to about \$10 in the first year, increasing gradually over the next 11 years to about \$40 in FY 2015.

8. **Isn't this the "camel's nose under the tent" prelude to spending Permanent Fund earnings for purposes other than dividends and inflation proofing?**

No, because this proposal is limited to earnings on the Amerada Hess principal, which currently does not contribute to dividends or inflation proofing.

9. **What will happen if the Permanent Fund experiences several more bad investment years? Will the revenues be sufficient to pay debt service on these bonds? If not, how will the debt service be paid?**

The Alaska Capital Fund, out of which debt service payments will be made, will have a balance sufficient to cover 2+ years worth of debt service payments. Historically the Permanent Fund average annual earnings have been 8.94% and the ten-year forecasted rate of realized return is 7.61%. Projections show debt service may be paid with an average realized rate of return as low as 5.5%, but given market volatility it is extremely important to be able to withstand short term bear markets.

The bonds will be structured with an interest only debt service schedule with flexibility in repayment of principal, as earnings allow, to accommodate down market years. A final maturity will include all principal due, although it is anticipated that all bonds will be paid off much sooner. In the event earnings were low for an extended period of time, the bonds would be refinanced prior to the final payment to extend

the payment schedule. This flexibility will be further enhanced through implementation of a debt service reserve fund and an advance funded debt payment account. When combined with an anticipated residual fund balance in the Alaska Capital Fund, these structural and credit features provide a high probability of an available funding source to pay the debt service. In the unlikely event that all these precautions fail, the state then would have a moral obligation to make up any shortfall with general funds.

**10. How does this proposal square with the Governor's promise to not touch the Permanent Fund without a public vote?**

The general public will not be affected by this proposal at all since Amerada Hess earnings do not figure into dividends. There will be a public benefit from the capital projects financed from this source.

The following Capital Projects are proposed for  
FY 06 funding by the Alaska Capital Fund

**Project Review Listing  
FY06 Governor's Capital Budget**

**Multiple User Selected Fund Codes**

**Department of Administration**

<u>AP/AL Project Title</u>	<u>Fund Source Total</u>
AP Public Building Facilities Projects	
	2000 Bond Funds \$6,902,000
AP Maintenance Projects for Facilities Outside the Public Building Fund	
	2000 Bond Funds \$3,098,000
	<b>General Fund Total: 0</b>
	<b>Federal Total: 0</b>
	<b>Other Total: \$10,000,000</b>
	<b>Department Total: \$10,000,000</b>

**Department of Commerce, Community, and Economic Development**

<u>AP/AL Project Title</u>	<u>Fund Source Total</u>
AP Energy Projects	
	2000 Bond Funds \$250,000
AP City of Unalaska - Boat Harbor	
	2000 Bond Funds \$2,000,000
AP Tongass Coast Aquarium, Inc.	
	2000 Bond Funds \$100,000
	<b>General Fund Total: 0</b>
	<b>Federal Total: 0</b>
	<b>Other Total: \$2,350,000</b>
	<b>Department Total: \$2,350,000</b>

**Department of Corrections**

<u>AP/AL Project Title</u>	<u>Fund Source Total</u>
AP Institution Closed Circuit TV System Recording	
	2000 Bond Funds \$2,500,000
AP Deferred Maintenance, Repair, and Renovations	
	2000 Bond Funds \$8,000,000
AP Statewide Equipment Replacement	
	2000 Bond Funds \$450,000
AP Community Jails Life, Safety and Security Renovations and Miscellaneous Equipment	
	2000 Bond Funds \$100,000
	<b>General Fund Total: 0</b>
	<b>Federal Total: 0</b>
	<b>Other Total: \$11,050,000</b>
	<b>Department Total: \$11,050,000</b>

\* Indicates an appropriation with allocations (amounts not included in totals)

**Project Review Listing  
FY06 Governor's Capital Budget**

**Multiple User Selected Fund Codes**

**Department of Fish and Game**

<u>AP/AL Project Title</u>			<u>Fund Source Total</u>
AP Deferred Maintenance Facilities	2000	Bond Funds	\$400,000
AP Fairbanks Infrastructure Renewal and Replacement Upgrades	2000	Bond Funds	\$200,000
AP Vessel and Aircraft Repair and Maintenance	2000	Bond Funds	\$278,500
AP DIDSON Sonar Equipment Purchase	2000	Bond Funds	\$500,000
AP Westward Region Chignik Weir Improvements and Repairs	2000	Bond Funds	\$121,500
<b>General Fund Total:</b>			<b>0</b>
<b>Federal Total:</b>			<b>0</b>
<b>Other Total:</b>			<b>\$1,500,000</b>
<b>Department Total:</b>			<b>\$1,500,000</b>

**Office of the Governor**

<u>AP/AL Project Title</u>			<u>Fund Source Total</u>
AP Governor's House Maintenance	2000	Bond Funds	\$100,000
<b>General Fund Total:</b>			<b>0</b>
<b>Federal Total:</b>			<b>0</b>
<b>Other Total:</b>			<b>\$100,000</b>
<b>Department Total:</b>			<b>\$100,000</b>

**Department of Health and Social Services**

<u>AP/AL Project Title</u>			<u>Fund Source Total</u>
AP MH Crisis Treatment Facility - Phase 2	2001	Bonds MH	\$2,500,000
AP Bethel Youth Facility Security Improvements	2000	Bond Funds	\$233,900
AP Anchorage Pioneer Home Emergency Generator Replacement	2000	Bond Funds	\$600,000
AP Juneau Pioneer Home Roof Replacement	2000	Bond Funds	\$1,000,000
AP Deferred Maintenance, Renovation, Repair and Equipment	2000	Bond Funds	\$1,500,000
AP Pioneer's Homes Deferred Maintenance, Renovation, Repair and Equipment	2000	Bond Funds	\$2,500,000
AP Emergency Medical Services Ambulances and Equipment - Statewide - Match for Code Blue Project	2000	Bond Funds	\$425,000

\* Indicates an appropriation with allocations (amounts not included in totals)

**Project Review Listing  
FY06 Governor's Capital Budget**

**Multiple User Selected Fund Codes**

**Department of Health and Social Services**

<u>AP/AL Project Title</u>		<u>Fund Source Total</u>
AP Juvenile Offender Management Information System Software Upgrade	2000 Bond Funds	\$325,000
AP MH: Alaska Psychiatric Institute Automation Project	2001 Bonds MH	\$674,200
AP Senior Centers Deferred Maintenance, Construction, Renovation, Expansion and Equipment	2000 Bond Funds	\$1,000,000
AP MH: Deferred Maintenance and Accessibility Improvements	2001 Bonds MH	\$150,000
	<b>General Fund Total:</b>	<b>0</b>
	<b>Federal Total:</b>	<b>0</b>
	<b>Other Total:</b>	<b>\$10,908,100</b>
	<b>Department Total:</b>	<b>\$10,908,100</b>

**Department of Labor and Workforce Development**

<u>AP/AL Project Title</u>		<u>Fund Source Total</u>
AP Alaska Vocational Technical Center Deferred Maintenance	2000 Bond Funds	\$2,500,000
	<b>General Fund Total:</b>	<b>0</b>
	<b>Federal Total:</b>	<b>0</b>
	<b>Other Total:</b>	<b>\$2,500,000</b>
	<b>Department Total:</b>	<b>\$2,500,000</b>

**Department of Law**

<u>AP/AL Project Title</u>		<u>Fund Source Total</u>
AP Management Information System	2000 Bond Funds	\$1,000,000
	<b>General Fund Total:</b>	<b>0</b>
	<b>Federal Total:</b>	<b>0</b>
	<b>Other Total:</b>	<b>\$1,000,000</b>
	<b>Department Total:</b>	<b>\$1,000,000</b>

**Department of Military and Veterans Affairs**

<u>AP/AL Project Title</u>		<u>Fund Source Total</u>
AP Anchorage Army Expansion	2000 Bond Funds	\$500,000
AP Military Youth Academy Joint Facility Renovation and Repair	2000 Bond Funds	\$276,000

\* Indicates an appropriation with allocations (amounts not included in totals)

**Project Review Listing  
FY06 Governor's Capital Budget**

**Multiple User Selected Fund Codes**

**Department of Military and Veterans Affairs**

<u>AP/AL Project Title</u>	<u>Fund Source Total</u>
AP Army Guard Deferred Maintenance, Renewal, and Replacement	
	2000 Bond Funds \$500,000
	<b>General Fund Total: 0</b>
	<b>Federal Total: 0</b>
	<b>Other Total: \$1,276,900</b>
	<b>Department Total: \$1,276,900</b>

**Department of Natural Resources**

<u>AP/AL Project Title</u>	<u>Fund Source Total</u>
AP State Park Emergency Repairs	
	2000 Bond Funds \$400,000
AP Forestry Buildings Repairs to Correct Fire and Life Safety Deficiencies Phase 2	
	2000 Bond Funds \$276,400
AP Forestry Area Offices Hazmat Storage Facilities	
	2000 Bond Funds \$90,000
AP State Park Deferred Maintenance	
	2000 Bond Funds \$300,000
AP Fire Suppression Engine and Truck Replacements	
	2000 Bond Funds \$400,000
AP Replace Forestry Trailers at Copper River and Delta	
	2000 Bond Funds \$233,600
AP Rehabilitation of Anchor Point Campgrounds for Private Operations	
	2000 Bond Funds \$150,000
AP Byers Lake Campground Rehabilitation	
	2000 Bond Funds \$100,000
AP Nancy Lake Campground Rehabilitation	
	2000 Bond Funds \$300,000
AP Harding Lake Campground Rehabilitation	
	2000 Bond Funds \$200,000
	<b>General Fund Total: 0</b>
	<b>Federal Total: 0</b>
	<b>Other Total: \$2,450,000</b>
	<b>Department Total: \$2,450,000</b>

**Department of Public Safety**

<u>AP/AL Project Title</u>	<u>Fund Source Total</u>
AP Firefighting Engines and Equipment	
	2000 Bond Funds \$500,000
AP Statewide Facilities Maintenance	
	2000 Bond Funds \$718,000

\* Indicates an appropriation with allocations (amounts not included in totals)

**Project Review Listing  
FY06 Governor's Capital Budget**

**Multiple User Selected Fund Codes**

**Department of Public Safety**

<u>AP/AL Project Title</u>			<u>Fund Source Total</u>
AP Electronic Fingerprint Services-Live Scan	2000	Bond Funds	\$465,000
AP Aircraft and Vessel Repair and Maintenance	2000	Bond Funds	\$2,314,300
AP Law Enforcement Equipment Replacement	2000	Bond Funds	\$1,177,100
AP Live Burn Building at Fairbanks Fire Training Center	200J	Bond Funds	\$150,000
AP Burn Panel Installation at Juneau Fire Training Center	2000	Bond Funds	\$150,000
	<b>General Fund Total:</b>		<b>0</b>
	<b>Federal Total:</b>		<b>0</b>
	<b>Other Total:</b>		<b>\$5,475,200</b>
	<b>Department Total:</b>		<b>\$5,475,200</b>

**Department of Transportation and Public Facilities**

<u>AP/AL Project Title</u>			<u>Fund Source Total</u>
* AP Governor's Transportation Initiative	2000	Bond Funds	\$108,000,000
AL Anchorage Mid-Town Congestion and Truck Route Improvements	2000	Bond Funds	\$29,000,000
AL Glenn Highway Corridor	2000	Bond Funds	\$30,500,000
AL Kenai Peninsula Kalifornsky Beach Road Rehabilitation	2000	Bond Funds	\$11,000,000
AL Mat-Su Congestion Improvements	2000	Bond Funds	\$21,000,000
AL Richardson Highway Passing Lanes Segments	2000	Bond Funds	\$5,000,000
AL Fairbanks University Avenue-Gust-Johansen Intersection Improvements	2000	Bond Funds	\$3,500,000
AL Cordova Copper River Highway Rehabilitation	2000	Bond Funds	\$4,000,000
AL McCarthy Road Major Maintenance	2000	Bond Funds	\$2,000,000
AL Seward Road Improvements AFD to B	2000	Bond Funds	\$5,000,000
* AP Governor's Transportation Access to Resources Initiative	2000	Bond Funds	\$37,000,000
AL Richardson Highway Shaw Creek Bridge	2000	Bond Funds	\$2,500,000
AL Elrod Highway Wainwrights Creek Bridge Replaced for Gas Pipeline	2000	Bond Funds	\$3,500,000

\* Indicates an appropriation with allocations (amounts not included in totals)

**Project Review Listing**  
**FY06 Governor's Capital Budget**

**Multiple User Selected Fund Codes**

**Department of Transportation and Public Facilities**

<u>AP/AL Project Title</u>			<u>Fund Source Total</u>
AL Fairbanks: Richardson Highway - Northbound Chena Overflow Bridge for Gas Pipeline	2000	Bond Funds	\$11,000,000
AL DeLong Mountain: Port Expansion EIS Completion	2000	Bond Funds	\$2,000,000
AL North Slope: Foothills West Road EIS	2000	Bond Funds	\$4,000,000
AL North Slope: Bullen Point EIS	2000	Bond Funds	\$5,000,000
AL Dalton Highway: Surfacing Upgrades	2000	Bond Funds	\$9,000,000
AP Industrial Road Program	2000	Bond Funds	\$10,000,000
AP Airport Deferred Maintenance	2000	Bond Funds	\$1,500,000
AP Highway Deferred Maintenance	2000	Bond Funds	\$3,000,000
AP Facilities Deferred Maintenance and Critical Repairs	2000	Bond Funds	\$8,000,000
AP Emergency and Non-Routine Repairs	2000	Bond Funds	\$500,000
AP Alaska Marine Highway System - Vessel and Terminal Overhaul and Rehabilitation	2000	Bond Funds	\$5,500,000
AP Material Stockpiles - Dalton Highway, Glenn Highway, Richardson Highway and Tok Cutoff	2000	Bond Funds	\$600,000
AP Harbor Deferred Maintenance	2000	Bond Funds	\$3,000,000
AP Hoonah Harbor Deferred Maintenance and Transfer	2000	Bond Funds	\$3,500,000
AP Petersburg North Harbor Deferred Maintenance and Transfer	2000	Bond Funds	\$2,500,000
AP Statewide Airport Lease Lots Development	2000	Bond Funds	\$1,000,000
AP Willow Maintenance Station Replacement	2000	Bond Funds	\$350,000
AP WAN Infrastructure Upgrade	2000	Bond Funds	\$185,000
* AP Statewide Federal Programs	2000	Bond Funds	\$56,500,000
AL Federal-Aid Aviation State Match	2000	Bond Funds	\$14,500,000
AL Federal-Aid Highway State Match	2000	Bond Funds	\$42,000,000

\* Indicates an appropriation with allocations (amounts not included in totals)

**Project Review Listing  
FY06 Governor's Capital Budget**

**Multiple User Selected Fund Codes**

**Department of Transportation and Public Facilities**

<u>AP/AL Project Title</u>	<u>Fund Source Total</u>
AP Congressional Earmarks	
	2000 Bond Funds \$15,000,000
	<b>General Fund Total: 0</b>
	<b>Federal Total: 0</b>
	<b>Other Total: \$260,135,000</b>
	<b>Department Total: \$260,135,000</b>

**University of Alaska**

<u>AP/AL Project Title</u>	<u>Fund Source Total</u>
AP Strategic Land and Property Acquisitions	
	2000 Bond Funds \$2,150,000
AP Systemwide Minor Renewal and Renovation	
	2000 Bond Funds \$6,886,500
AP Integrated Science Complex	
	2000 Bond Funds \$21,600,000
	<b>General Fund Total: 0</b>
	<b>Federal Total: 0</b>
	<b>Other Total: \$30,636,500</b>
	<b>Department Total: \$30,636,500</b>

**Alaska Court System**

<u>AP/AL Project Title</u>	<u>Fund Source Total</u>
AP Bethel Courthouse	
	2000 Bond Funds \$825,000

\* Indicates an appropriation with allocations (amounts not included in totals)

**Project Review Listing  
FY06 Governor's Capital Budget**

**Multiple User Selected Fund Codes**

**Alaska Court System**

<u>AP/AL Project Title</u>	<u>Fund Source Total</u>
AP Deferred Maintenance Projects	
	2000 Bond Funds \$300,000
	<b>General Fund Total: 0</b>
	<b>Federal Total: 0</b>
	<b>Other Total: \$1,125,000</b>
	<b>Department Total: \$1,125,000</b>

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<b>General Fund Grand Total:</b>	<b>0</b>
<b>Federal Grand Total:</b>	<b>0</b>
<b>Other Grand Total:</b>	<b>\$340,506,700</b>
<b>Grand Total:</b>	<b>\$340,506,700</b>

\* Indicates an appropriation with allocations (amounts not included in totals)