

HB

246

<TARGET><BILL>HB 246</BILL><SUBJECT>HB
246</SUBJECT><COMM>HRES29</COMM></TARGET>



House Bill 246

AIDEA Oil and Gas Infrastructure Development Program; Fund; amendments to the SETS and Arctic Infrastructure Development programs; authorizing variable program interest rates and adjusting loan limits

Sectional Analysis

Sections 1 through 3: Sections 1 through 3 amend the language of AS 44.88.088, to include payment of a dividend from the proposed new oil and gas infrastructure development fund.

Sections 4 through 9: Sections 4 through 9 amend subparts of AS 44.88.159, which governs the interest rates AIDEA charges under its loan participation program and its SETS and Arctic infrastructure Development programs. These sections of the bill use many of the same interest rate provisions applicable to any loans provided through the SETS and the Arctic infrastructure program and fund. In essence, the interest rate provisions require a minimum interest rate that ensures AIDEA does not lose money on its loans, and the interest rates AIDEA uses in these programs are more or less in line with the rates commercial lenders offer. Sec. 9 adds a new section (h) to AS 44.888.159, so that the authority may by regulation establish differing interest rates, as well as for methods for setting interest rates, based on the risk of the financing and the security provided.

Section 10: Section 10 amends AS 44.88.690(a) to increase the loan limit from one-third to 50% of the capital cost of a qualified energy development and increases the limit of a loan guarantee to \$25 million under the sustainable energy transmission and supply (SETS) fund.

Section 11: Section 11 amends AS 44.88.840(a) to increase the loan limit to 50% of the capital cost of an Arctic infrastructure development and increases the limit of a loan guarantee to \$25 million under the Arctic infrastructure development fund.

Section 12: Section 12 is the heart of the bill, and it adds a new chapter to AIDEA's statutes to create the oil and gas infrastructure development program and separate fund. The new statutory provisions the bill adds do the following:

AS 44.88.850 creates the oil and gas infrastructure development program within AIDEA.

AS 44.88.860 creates the oil and gas infrastructure development fund within AIDEA separated from Authority's existing Revolving Fund. The new fund will consist of money the legislature appropriates to it, money AIDEA transfers into it, and investment returns obtained from money in the fund. AIDEA is authorized to pledge the fund to the payment of bonds issued to finance oil and gas infrastructure development.

AS 44.88.870 authorizes AIDEA to use the money in the oil and gas infrastructure development fund to finance oil and gas infrastructure development.

AS 44.88.880 specifies AIDEA's powers and duties with respect to the oil and gas infrastructure development program and fund, and requires AIDEA to adopt regulations to implement the new program. These regulations must contain a process sufficient to confirm the existence of proven reserves sufficient to justify proposed project financing.

AS 44.88.890 establishes limitations on the financing AIDEA can provide through the oil and gas infrastructure development program and fund. Without getting legislative approval, AIDEA cannot make a loan through the oil and gas infrastructure development fund for more than one-half of the capital cost of any project, or issue a loan guarantee for more than \$25 million. AIDEA may not utilize this new oil and gas financing program unless all participants in the proposed development agree they will not take, apply for, or accept any exploration and development tax credit under AS 43.20.043; production tax credit under AS 43.55.023 or production tax credit for exploration expenditures under AS 43.55.025. Finally, any financing under the new program must be for the expected life of the project, but not for more than 30 years.

Section 13: This section sets out the definition of the terms "oil and gas infrastructure development" and "proven reserves".

It amends AS 44.88.900 by adding a new Paragraph (20) that defines the term "oil and gas infrastructure development" to mean "the acquisition, construction, or installation of and engineering for the construction or installation of a road, pad, camp, processing facility, gathering system, or other on-site improvement or equipment for an oil or gas field, or an oil and gas field, located in the state that has been explored and for which proven reserves have been established;

In addition it amends AS 44.88.900 by adding a new Paragraph (21) that the defines "proven reserves" to mean "those quantities of petroleum which, by analysis of geological and engineering data, can be estimated with reasonable certainty to be commercially recoverable, from a given date forward, from known reservoirs and under current economic conditions, operating methods, and government regulations; "proven reserves" can be categorized as developed or undeveloped."

Fiscal Note

State of Alaska
2016 Legislative Session

Bill Version:	HB 246
Fiscal Note Number:	1
(H) Publish Date:	1/19/2016

Identifier: DCCED-AIDEA-1-14-16
 Title: AIDEA: FUNDS; LOANS; PROGRAMS; DIVIDEND
 Sponsor: RLS BY REQUEST OF THE GOVERNOR
 Requester: Governor

Department: Department of Commerce, Community and
Economic Development
 Appropriation: Alaska Industrial Development and Export
Authority
 Allocation: Alaska Industrial Development and Export
Authority
 OMB Component Number: 1234

Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2017 Appropriation Requested	Included in Governor's FY2017 Request	Out-Year Cost Estimates					
			FY 2017	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
OPERATING EXPENDITURES								
Personal Services								
Travel								
Services								
Commodities								
Capital Outlay								
Grants & Benefits								
Miscellaneous								
Total Operating	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Fund Source (Operating Only)

None								
Total	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Positions

Full-time								
Part-time								
Temporary								

Change in Revenues								
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Estimated SUPPLEMENTAL (FY2016) cost: 0.0 *(separate supplemental appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2017) cost: 0.0 *(separate capital appropriation required)*
(discuss reasons and fund source(s) in analysis section)

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? Yes
 If yes, by what date are the regulations to be adopted, amended or repealed? 12/31/16

Why this fiscal note differs from previous version:

Not applicable, initial version.

Prepared By: <u>John Springsteen, Director</u>	Phone: (907)771-3000
Division: <u>Alaska Industrial Development and Export Authority</u>	Date: 01/14/2016 06:00 PM
Approved By: <u>Catherine Reardon, Director</u>	Date: 01/14/16
Agency: <u>Division of Administrative Services, DCCED</u>	

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2015 LEGISLATIVE SESSION

Analysis

This bill establishes the Oil and Gas Infrastructure Development program and a fund associated with that program. The program and fund will provide the Alaska Industrial Development and Export Authority with new tools to support the development of the oil and gas sector of the economy. Specifically, the new fund provides the authority to finance oil and gas infrastructure development through project financing, issuing bonds, bond guarantees, and other beneficial financial mechanisms. The new fund will allow AIDEA to make needed investments in the oil and gas sector, particularly to small and medium-sized companies, and provide capital needed for continued infrastructure development while earning a return for the agency. Implementing the program will involve minor modification of regulations, which will be carried out in-house as was done with the Arctic Infrastructure Development Fund. The establishment of this fund and the modification of regulations will not require additional budgetary authority.

Proposed ways to address concerns expressed on HB 246

Concern 1

Concern exists that there may be confusion on page 7, line 17 of the bill regarding whether use of the word “reserves” refers to economic reserves or oil and gas reserves.

Response

Ambiguity in this section can be clarified by adding the following language:

Page 7, line 17

Following the word “established”

Insert

“financial”

Concern 2

There is a concern that AIDEA financing may leave the Authority and the state responsible for dismantlement, removal or remediation obligations.

Response

AIDEA does not intend to take on these responsibilities and believes this concern can be addressed with the following language:

Page 8, line 25

Insert a new subsection to read

“(d) The authority may provide financing for an oil and gas development only if the authority will not be responsible for the dismantlement, removal or remediation cost of the oil and gas development.”

Concern 3

Concern was expressed that the definition of “proven reserves” on page 8, line 31 is a Society of Petroleum Engineers definition, which focuses on technical ability to produce hydrocarbons, and not a U.S. Securities and Exchange Commission definition, which would focus more on the economics of production. If the SPE definition is retained, there is a concern whether the definition of “commercially recoverable” on page 9, line 2 adequately focuses on the long term economics of the proposed activity.

Response

To strengthen the economic focus of the determination of commercially recoverable, HB 246 could be amended as follows:

Page 8, line 24

At the end of the existing sentence, add

“In providing financing under AS 44.88.880, the authority shall require a loan to value ratio of 75 percent or greater and, if proven reserves constitute a portion of the value, the proven reserves shall be reduced by ten percent in calculating the value of the proven reserves and the reduced quantity shall be valued based on the average price of oil or gas actually paid during the preceding 12 month period, or if less, the price the Department of Revenue forecasts for the next succeeding 12 month period.”

Concern 4

Concern has been expressed that if AIDEA is given a new tool to invest in oil and gas infrastructure, this tool could be misused by an administration to unilaterally advance a Trans Alaska natural gas pipeline project.

Response

When the SETS Fund was established in AIEDA, language was inserted into the definition of a qualified energy development to exclude a natural gas pipeline for transporting natural gas from the North Slope or Cook Inlet to market. Similar language could be considered for the definition of allowable projects for the Oil and Gas Infrastructure Fund established by HB 246 as follows:

Page 8, line 30

Following the word “established”

Insert

“, but excluding a natural gas pipeline project, thirty inches in diameter or larger, for transporting natural gas from the North Slope or Cook Inlet to market”

Concern 5

There is concern with the language on page 6, lines 25 – 29 which allows AIDEA to transfer assets between funds, including the proposed oil and gas fund. The language in the HB 246 reads as follows:

Proposed Oil and Gas Fund language

The fund consists of appropriations made to the fund by the legislature, money or other assets transferred to the fund by a majority vote of the members of the authority under AS 44.88.050 from any other fund controlled by the authority, and unrestricted loan repayments, interest, or other income earned on loans, investments, or assets of the fund.

Response

The existing language in the bill is similar to the language in SETS and identical to language in the Arctic Fund. We would ask that this program be treated similarly.

Existing SETS Language

The development fund consists of appropriations made to the development fund by the legislature, money or other assets transferred to the development fund by the authority, and unrestricted loan repayments, interest, or other income earned on loans, investments, or assets of the development fund.

Existing Arctic Fund Language

The fund consists of appropriations made to the fund by the legislature, money or other assets transferred to the fund by a majority vote of the members of the authority under AS 44.88.050 from any other fund controlled by the authority, and unrestricted loan repayments, interest, or other income earned on loans, investments, or assets of the fund.

Concern 6

There is concern that page 7, lines 26 – 28 propose language that is materially different regarding the services of an attorney or bond council under the proposed Oil and Gas Infrastructure Development Fund.

Response

SETS and the Arctic Fund use the following language to secure outside council and expertise:

“contract for services with a professional advisor, including an attorney, bond counsel, engineer, or other technical expert necessary to fulfill the purpose of the program”

In order to use the same language, HB 246 could be amended in the following manner:

Page 7, line 23 through line 28

Delete

all material

Insert

“(4) contract for service with a professional advisor, including an attorney, bond counsel, engineer, or other technical expert necessary to fulfill the purposes of the program; and”

Concern 7

Questions were raised regarding the necessity of Sections 10 and 11 of the legislation which would adjust the current SETS and Arctic Fund loan participation and loan guarantee limits to match those of the proposed Oil and Gas Infrastructure Development Fund.

Response

AIDEA believes its investment and financing tools would be more easily understood if they have consistent participation limits above which legislative approval is required. However, this separate policy call is distinct and separate from creation of the Oil and Gas Infrastructure Development Fund.

ADOPTED

AMENDMENT # 1

29-GH2613\A.1
Shutts
5/28/16

AMENDMENT

OFFERED IN THE HOUSE

BY REPRESENTATIVE HERRON

TO: HB 246

1 Page 6, lines 26 - 28:

2 Delete ", money or other assets transferred to the fund by a majority vote of the
3 members of the authority under AS 44.88.050 from any other fund controlled by the
4 authority,"

ADOPTED

AMENDMENT #2

29-GH2613VA.12
Shutts
5/30/16

AMENDMENT

REP. CHENAULT

OFFERED IN THE HOUSE

TO: HB 246

- 1 Page 7, line 24:
- 2 Delete "engineer or other technical expert, as the authority determines is"
- 3 Insert "attorney, bond counsel, engineer, or other technical expert"
- 4
- 5 Page 7, lines 26 - 28:
- 6 Delete "(5) with the approval of the attorney general, contract for the services of an
- 7 attorney or bond counsel as the authority determines is necessary to fulfill the purposes of the
- 8 program"
- 9
- 10 Renumber the following paragraph accordingly.

ADOPTED

AMENDMENT #3

29-GH2613VA.10
Shutts
5/28/16

Seaton

AMENDMENT

OFFERED IN THE HOUSE

TO: HB 246

- 1 **Page 8, line 11, following "than":**
- 2 **Insert "(A)"**
- 3
- 4 **Page 8, line 12, following "or":**
- 5 **Insert a new subparagraph to read:**
- 6 **"(B) \$100,000,000; or"**

ADOPTED

AMENDMENT #4

29-GH2613/A.3
Shutts
5/29/16

Seaton

AMENDMENT

OFFERED IN THE HOUSE

TO: HB 246

1 Page 8, lines 15 - 22:

2 Delete all material and insert:

3 "(b) The authority may not provide financing for an oil and gas infrastructure
4 development unless all participants in the oil and gas field covenant with the authority
5 that

6 (1) the authority will not be responsible for costs incurred in connection
7 with dismantlement, removal, or remediation of the oil and gas infrastructure
8 development; and

9 (2) after the date of the authority's financing commitment, the
10 participants will not take, apply for, or accept a tax credit for expenditures on the oil
11 and gas field under AS 43.20.043, AS 43.55.023, or 43.55.025."

ADOPTED

AMENDMENT #5

29-GH2613VA.16
Shuts
5/31/16

Seaton

AMENDMENT

OFFERED IN THE HOUSE

TO: HB 246

- 1 Page 8, following line 24:
- 2 Insert a new subsection to read:
- 3 "(d) The authority may not provide financing under AS 44.88.880 if the loan-
- 4 to-value ratio at the time of financing exceeds 75 percent; the value of proven reserves
- 5 that are included in the value must be calculated using the lesser of
- 6 (1) the average price of oil or gas actually paid during the 12-month
- 7 period immediately preceding the time of financing, reduced by 10 percent; or
- 8 (2) the price of oil or gas forecast by the Department of Revenue for
- 9 the 12-month period immediately following the time of financing, reduced by 10
- 10 percent."

WITHDRAWN AMENDMENT #6

29-GH2613VA.13
Shutts
5/30/16

AMENDMENT

REP. CHENAULT

OFFERED IN THE HOUSE
TO: HB 246

- 1 Page 8, following line 24:
- 2 Insert a new subsection to read:
- 3 "(d) The authority may not provide financing for a natural gas pipeline project
- 4 for transporting natural gas from the North Slope or Cook Inlet to market."

Alaska Oil and Gas Association



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Phone: (907) 272-1481 Fax: (907) 279-8114
Kara Moriarty, President/CEO

May 28, 2016

Representatives Nageak and Talerico
House Resources Committee Co-Chairs
Alaska State Legislature
Juneau, AK 99801

Dear Representatives,

HB 246 would establish an oil and gas infrastructure development fund, which may sound like a good idea on the face of it. So I would like to explain briefly why we oppose it.

AOGA is a diverse group, ranging from producers and explorers to refineries and pipeline companies. But even with all the challenges our industry has been facing the past year, not one of my member companies has ever voiced concern about a shortage of state loans to weather this downturn.

If there isn't a clear unmet need, why expand loan programs? There are better things to do with the money.

Through the collective voice of AOGA and individually, active explorers and producers across Alaska have testified repeatedly that the incentives and tax policies Alaska already has are working — they are doing exactly what they were supposed to do, and frankly, accomplishing the very intent set out for HB 246 in AIDEA's presentation dated March 16, 2016.

For instance, the current fiscal system is attracting small and medium sized companies to Alaska, production has increased from last year to this, and new fields have come online. The current system is attracting new investment, resulting in more jobs, more production and, yes, even more state revenue than what there would have been without that investment. Utilities have testified that increased investment and production have resulted in more short-term energy supply contracts for Southcentral Alaska.

If necessary, small producers have secured existing loans from third-party lenders. These third-party loans were typically designed to cover the producer's portion

of development costs that would be in addition to the amounts funded by the current tax credit laws. These third-party lenders typically hold a first-lien position on all assets. In order for the state to obtain a first-lien security for any state-funded loan, the state must either: a) fund a large enough amount to replace and pay off the existing first-lien loans; or b) the parties who already have a first-lien on the security must surrender their position to the state. The first option would likely require very large funding amounts by the state, and the second option is highly unlikely.

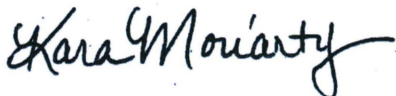
Moreover, even if more state loans were beneficial for the State, it would be taking on greater risk about the creditworthiness of borrowers and the soundness of the loans. And here's where HB 246 is fatally flawed — its definition of "proven reserves" in Section 13.

The Securities and Exchange Commission spent years developing a definition of "proven reserves" that would work with respect to honest "proven reserves," but would prevent charlatans and hucksters from scamming the public with oil and gas "prospects" with no reserves, or without any truly "proven" ones as industry uses the term.

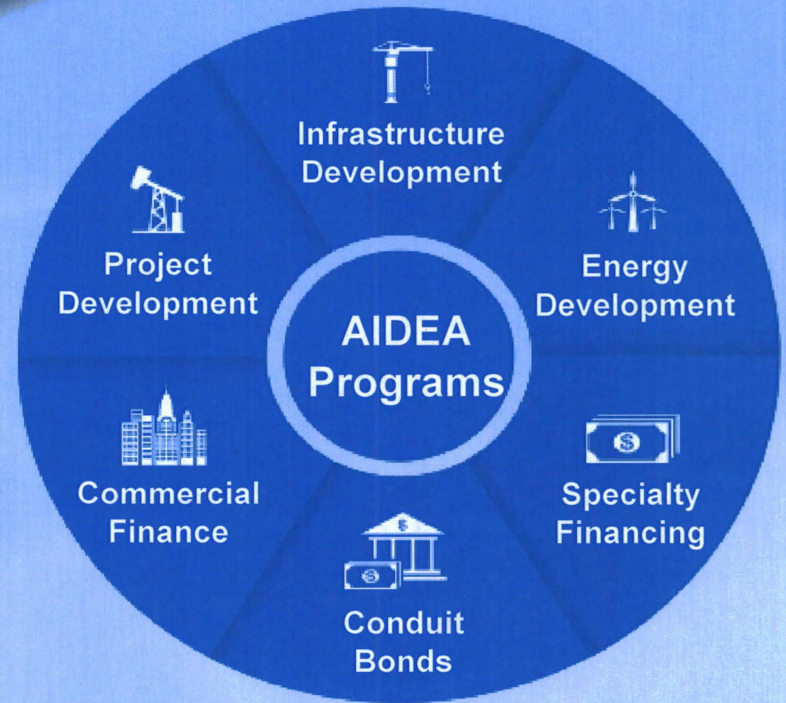
AOGA says this with absolutely no intent to disparage or impugn the character or motives of anyone who has been supporting HB 246. But we have to say this because — if you don't get "proved reserves" right — real charlatans and hucksters will come to try to borrow from you with their own version of "proved reserves" as collateral. If the State is going to make any of these loans at all, it must use the safe definition that the SEC developed — which would also let the SEC investigate and prosecute suspected abuses without having to hire a squad of state investigators and prosecutors to do it.

In closing, we would advocate for the state to retain its current fiscal system, versus creating a new and expanded loan program. Why create a new program when the current system is already achieving the desired results of the proposed oil and gas investment fund?

Sincerely,



Kara Moriarty
President/CEO



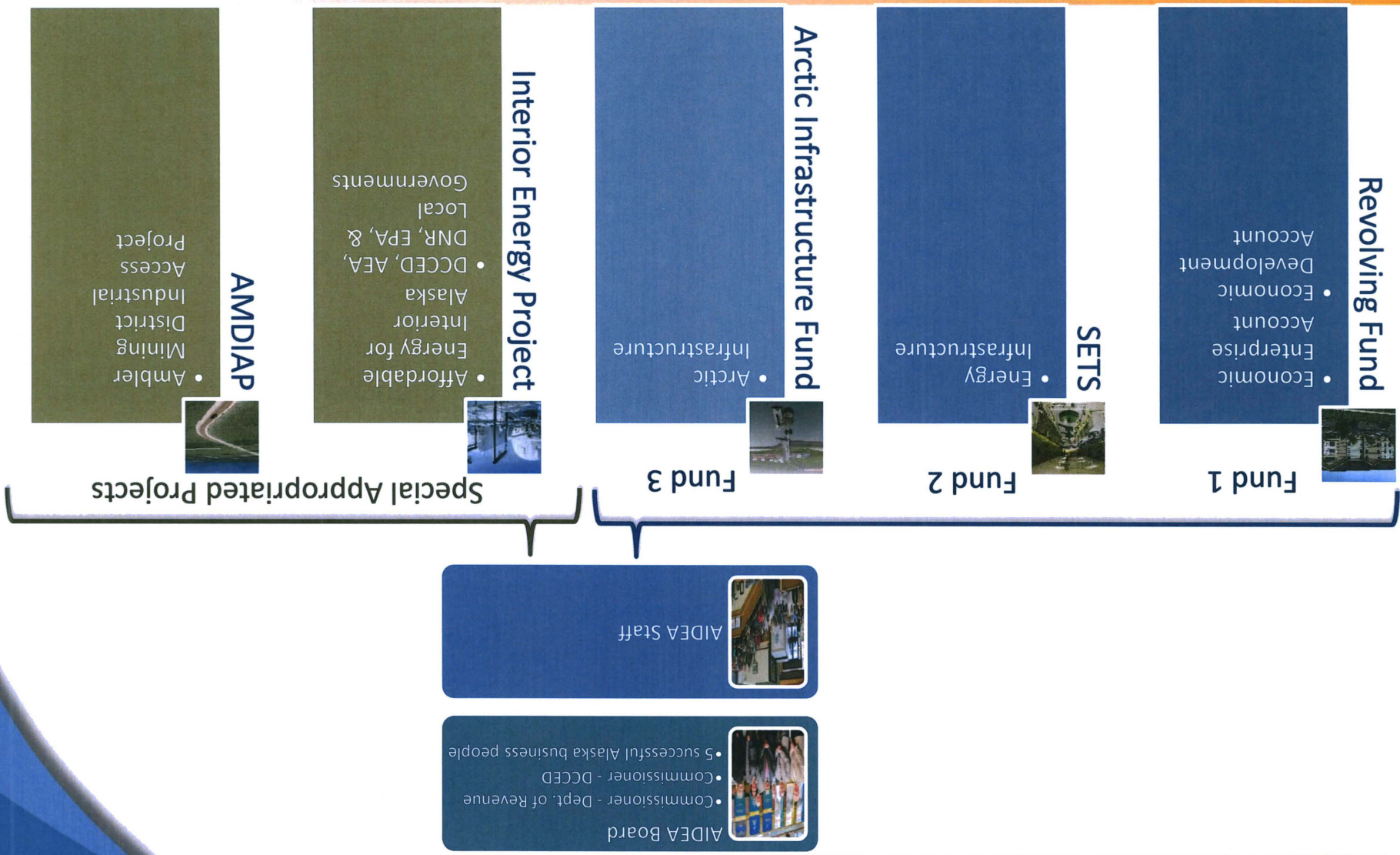
AIDEA Oil and Gas Infrastructure Development Fund HB 246

House Resources Committee

March 16, 2016

Investing in Alaskans

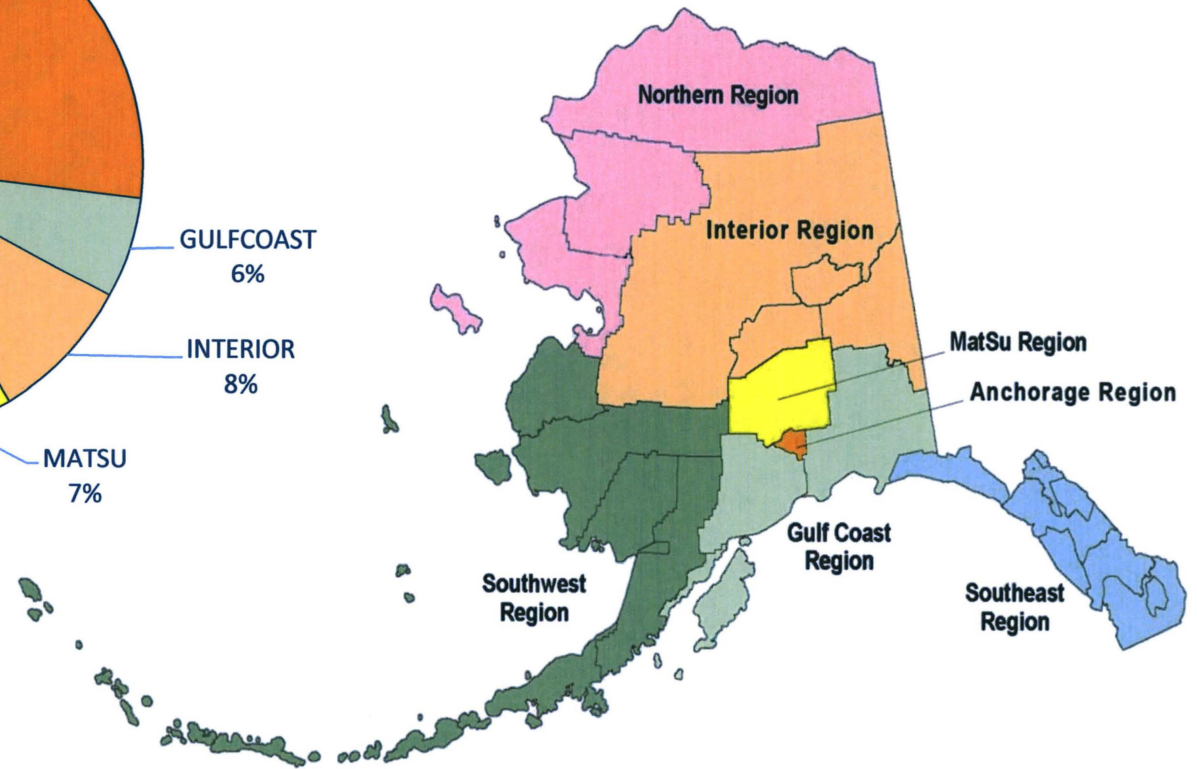
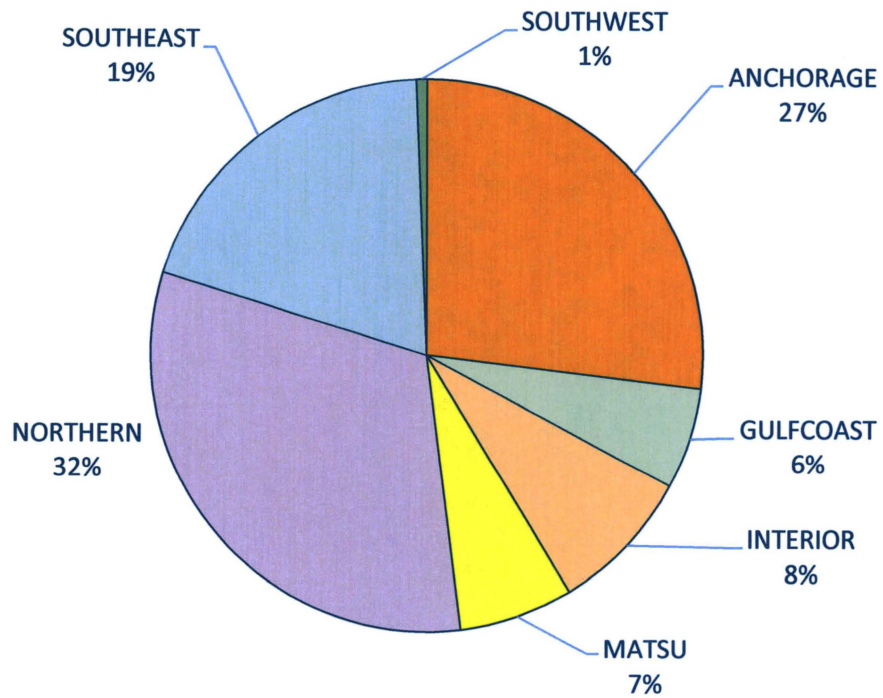
Current AIDEA Financing Tools



Geographic Project Diversity



AIDEA Projects and Loans

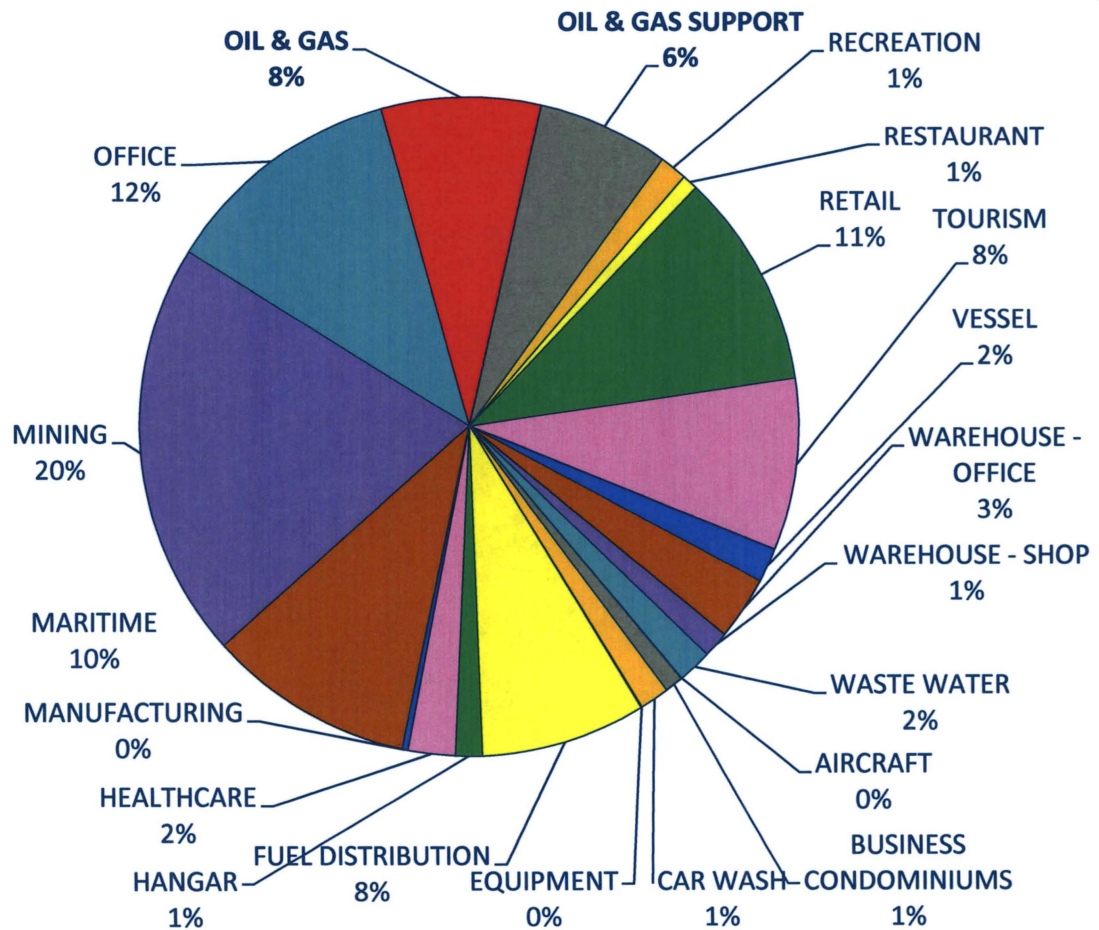


Industry Diversification



Total Existing and Approved Capacity Projects and Loans as of 10/31/15


Oil and Gas (including support) account for 14% (\$110 million) of AIDEA's financing.



AIDEA Financing Tools after HB 246



Proposed legislation would create "Fund 4" Oil and Gas Infrastructure Development Fund

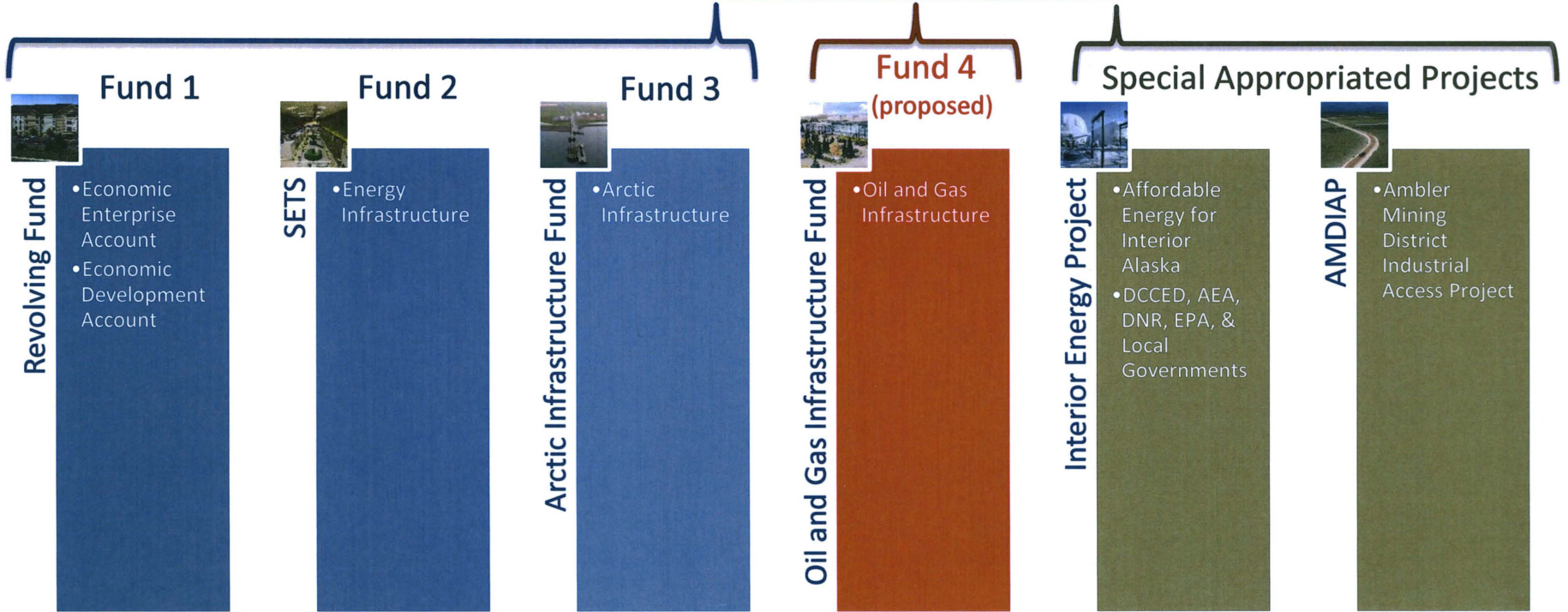


AIDEA Board

- Commissioner - Dept. of Revenue
- Commissioner - DCCED
- 5 successful Alaska business people



AIDEA Staff



Intent of HB 246



Continue infrastructure financing to:

- Support small and medium sized oil and gas developers statewide
- Increase production and bring new fields online
- Attract new investment
- Increase future State oil and gas revenues
- Support investment for energy security

Eligible Oil and Gas Infrastructure Projects



- Oil & Gas Development Infrastructure defined as:
 - Investment: acquisition, construction or installation (including engineering)
 - Projects: road, pad, camp, processing facility, gathering system or other-site improvement or equipment
- Projects must support fields with proven reserves
- Proven Reserves defined as:
 - Analysis of geological and engineering data
 - Commercially recoverable under current economic conditions, operating methods, and government regulations
 - Can be categorized as developed or undeveloped

Financing and Tax Credits



- After opting to use AIDEA financing, projects may no longer use:
 - Exploration & Development tax credit (AS 43.20.043)
 - Production tax credit (AS 43.55.023)
 - Production tax credit for exploration expenditures (AS 43.55.025)
- Projects with past tax credits still eligible for AIDEA financing

Market Based Interest Rates



- AIDEA will base interest rates on:
 - Project risk
 - Borrower creditworthiness
 - Owner and financing partner commitments
 - Benefit to the State
- Interest rates may be higher for oil and gas infrastructure projects due to the inherent industry risk

Other Bill Components



Modifies financing limits of SETS and Arctic Infrastructure development funds

- Proposes that all 3 funds be allowed to loan up to 50 percent of an eligible project or offer a loan guarantee up to \$25,000,000
- Amounts in excess of these limits would require prior legislative approval

Sectional Analysis



- A separate sectional analysis is in each committee member's bill file.

AIDEA Due Diligence



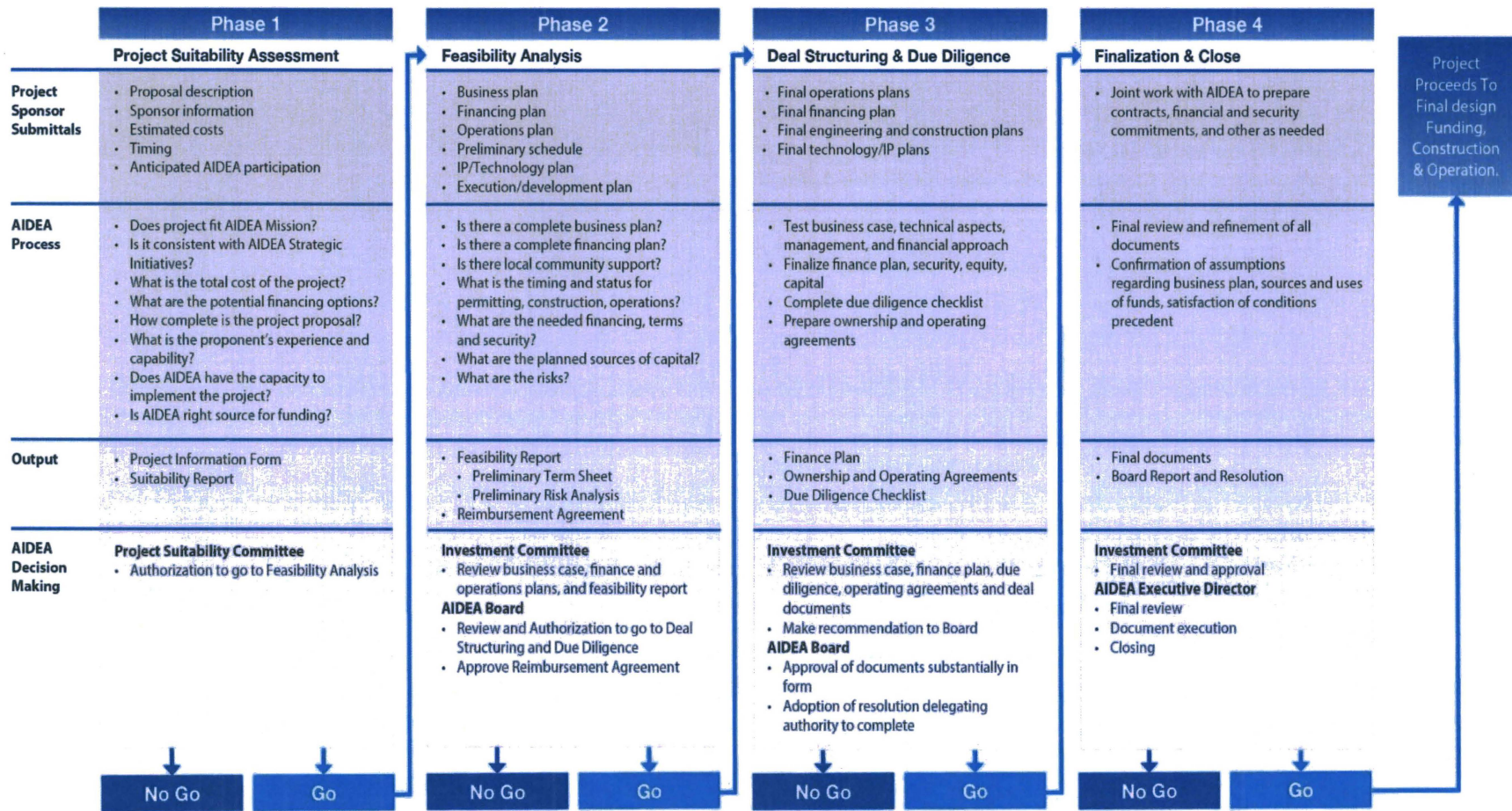
Established analysis and decision making process

- Technical due diligence
 - AIDEA sets procedure for verifying proven reserves
- Financial due diligence
 - Review developer creditworthiness and financing partner commitments
 - Analysis of economics, including oil price stress tests
- Analysis of benefit to State
 - Jobs created and petroleum revenues created
- Managed by AIDEA staff with hired consultants/specialists
- AIDEA Board makes final investment decision

Analysis & Decision-Making



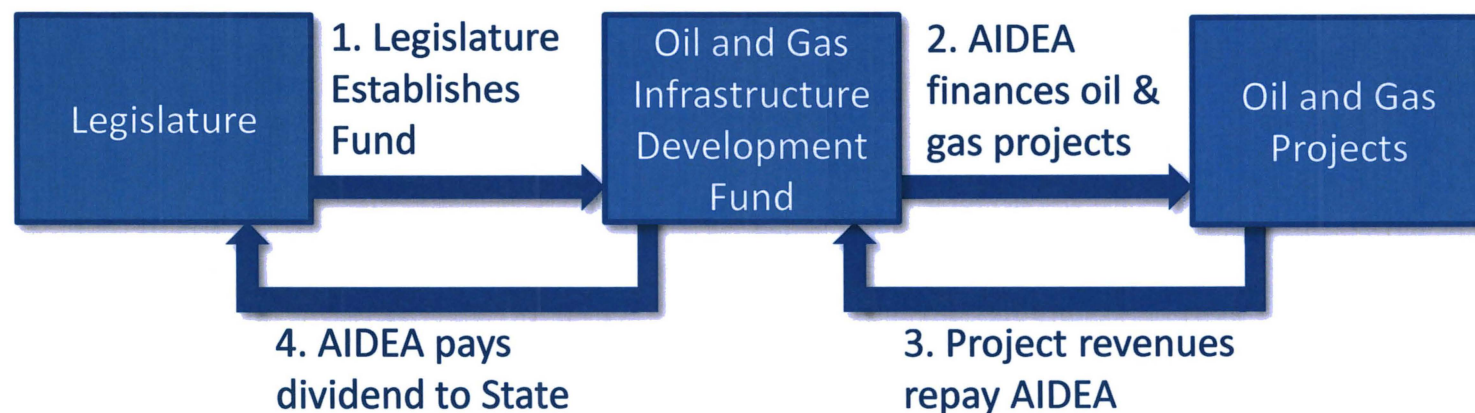
Established analysis and decision making process



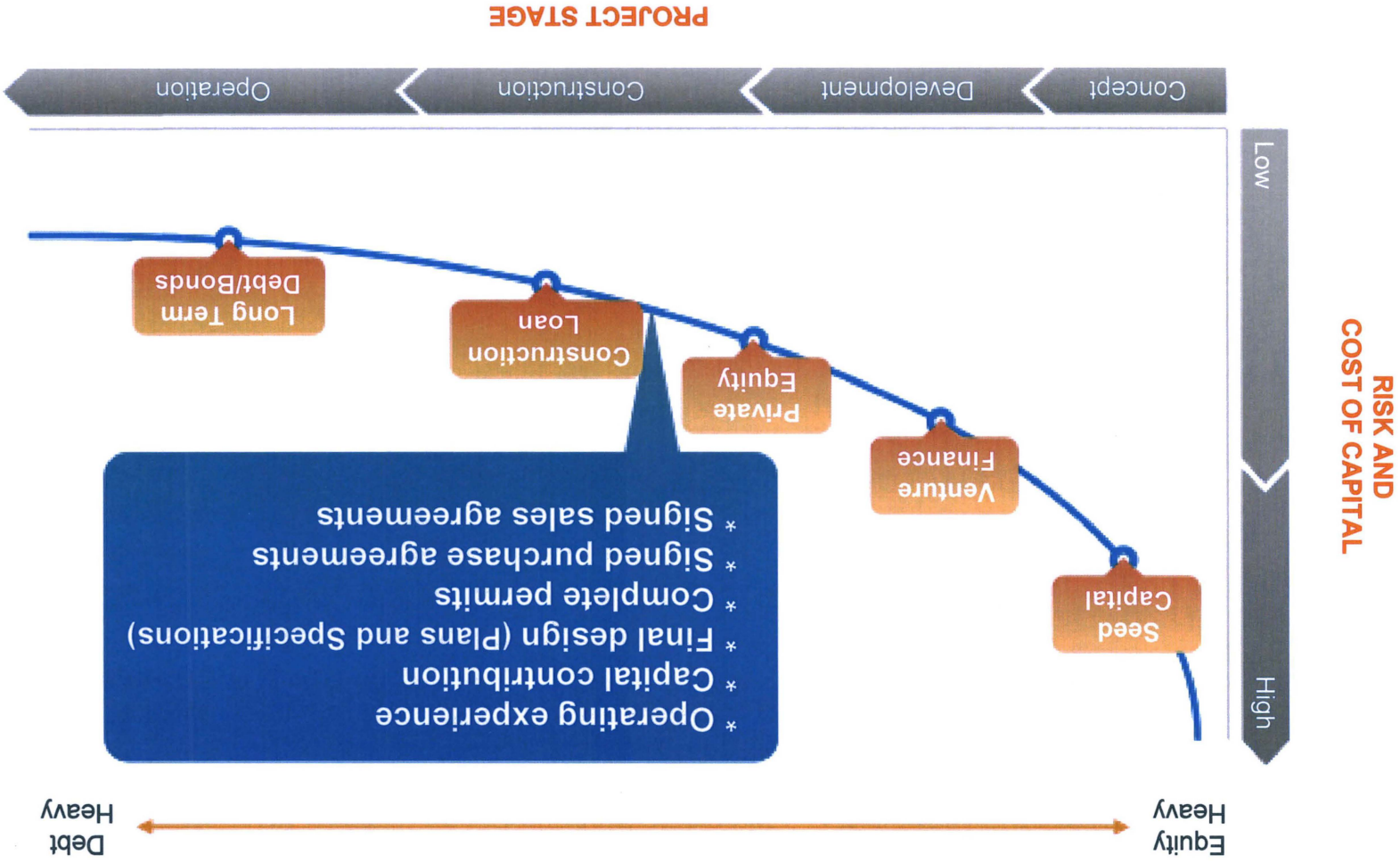
Financing Repayment



- AIDEA financing at market-based rates to reflect individual project risk
- Loans repaid with interest
- AIDEA will earn revenue
 - Some earnings to the State as a dividend
 - Some earnings to fund future projects



AIDEA Entry Point & Criteria



Summary



- Provides AIDEA a specific program to finance oil and gas infrastructure
- Eligible oil and gas infrastructure must have proven reserves and undergo established due diligence review
- Finance terms will be market based

Implementation Cost



- Implementing the program will involve minor modification of regulations, which will be carried out in-house
- Program implement cost will be absorbed
- Program management cost will be absorbed
- Modified fiscal note submitted to acknowledge potential fund capitalization



Alaska Industrial Development and Export Authority

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#AIDEA



www.aidea.org

