ALASKA LEGISLATURE COMMITTEE FILES 1993-1994 8672
8435 SENATE RESOURCES

the department determines that the program is being implemented in a manner that fails to meet the terms of the cooperative agreement or is otherwise being inappropriately administered, the department shall give written notice, setting out its determination, to the municipality or local air quality district. Within 45 days after giving written notice, the department shall conduct a public hearing on the matter.

(b) If, after the hearing, the department upholds the determination made in the written notice, the department shall provide the municipality or local air quality district with a written finding setting out the nature of the deficiencies and a description of the necessary action to be taken in order for the program to prevent or control air pollution. The department shall provide its finding to the municipality or district within 45 days after the closure of the public hearing record. The department shall set a reasonable period of time for the municipality or local air quality district to take corrective action in response to the department's finding.

(c) If the municipality or local air quality district fails to take corrective action within the time period set by the department under (b) of this section, the department shall terminate the cooperative agreement and resume management of the program in the affected jurisdiction. If the municipality or the local air quality district partially remedies, to the department's satisfaction, the deficiencies found in the determination, the department shall amend the cooperative agreement to reflect a modified allocation of responsibilities between the department and municipality or the local air quality district.

(d) A municipality or local air quality district that has had its cooperative agreement terminated may resume, with the department's approval, a local air quality control program if the municipality or district agrees to comply with AS 46.14.500 and with any corrective action plan required by the department.

(e) If the department finds that control of a particular class of facility or source, because of its complexity or magnitude is beyond the reasonable capability of the municipality or the local air quality district or may be more efficiently and economically controlled at the state level, the department may assume and retain jurisdiction over the class of facility or source. Classifications under this subsection may be based on the nature of facilities or sources involved, their size relative to the size of the communities in which they are located, or other basis established by the department.

Sec. 46.14.520. STATE AND FEDERAL AID. (a) A municipality or local air quality district with a local air quality control program may apply for, receive, administer, and spend state aid for the control of air emissions or the development and administration of the program if an application is first submitted to and approved by the department. Subject to available money appropriated by the legislature, the department may approve an application if it is consistent with the terms and conditions of the applicable cooperative agreement and meets the requirements of this chapter.

(b) A municipality or local air quality district with a local air quality control program may apply for, receive, administer, and spend federal aid for the control of air emissions or the development and administration of the program.

ARTICLE _. CRIMINAL PENALTIES FOR AIR POLLUTION

Sec. 46.03.791. CRIMINAL PENALTIES FOR AIR POLLUTION. (a) After receiving a certified notice from the department that such conduct is punishable by criminal sanctions, a person is guilty of a Class A misdemeanor if the person, with criminal negligence

(1) fails to provide essential information or provides false material information, or makes a false material statement or certification in an application, notice, record, report, permit, or other document filed, maintained, or used for purposes of compliance with AS 46.14 or a regulation adopted under AS 46.14;

(2) falsifies, disables, or fails to install any monitoring device required to be maintained under AS 46.14, a regulation adopted under AS 46.14, or a permit issued by the department or a local air quality control program under 46.14; or

(3) violates any material condition of a permit issued under AS 46.14 not otherwise included in (1) or (2).

(b) A person is guilty of a Class A felony if the person knowingly releases, or causes to be released into the ambient air, an air contaminant without a permit issued

under AS 46.14, or in excess of permitted levels, and who knows at the time that he thereby places another person in imminent danger of death or serious bodily injury.

(c) A person is guilty of a Class C felony if that person recklessly releases or causes to be released into the ambient air an air contaminant without a permit issued under AS 46.14 or in excess of permitted levels and he thereby recklessly places another person in imminent danger of death or serious bodily injury.

(d) A person is guilty of a Class A misdemeanor if that person with criminal negligence emits or causes to be emitted air contaminants without a permit required under AS 46.14 or other authorization issued by the department or established in law.

(e) Each day on which a violation described in this section occurs is considered a separate violation.

(f) In this section,

(1) "criminal negligence" has the meaning given in AS 11.81.900(a)(4);

(2) "recklessly" has the meaning given in AS 11.81.900(a)(3);

(3) "knowingly" has the meaning given in AS 11.81.900(a)(2); provided however, that in determining whether a person acted knowingly,

(A) the person charged is responsible only for actual awareness or actual belief possessed; and

(B) knowledge possessed by a person other than the defendant, but not by the defendant, may not be attributed to the defendant; except that in proving a person's possession of actual knowledge, circumstantial evidence may be used, including evidence that a defendant took affirmative steps to be shielded from relevant information.

(4) It is an affirmative defense to a prosecution that the conduct charged was freely consented to by the person endangered and that the danger and conduct charged were reasonably foreseeable hazards of-

(A) an occupation, a business, or a profession; or

(B) medical treatment or medical or scientific experimentation conducted by professionally approved methods and such other person had been made aware of the risks involved prior to giving consent. The

defendant may establish an affirmative defense under this subparagraph by a preponderance of the evidence.

(g) For purposes of (a), a person is deemed to have received notice if the certified notice was signed by a responsible corporate official or other official who, with apparent or actual authority, represents the person. The certification shall include a representation that the notice will be displayed and communicated by the official.

(h) Notwithstanding AS 12.55.035(b), upon conviction of an offense under subsection (a), a defendant who is not an organization may be sentenced to pay a fine of not more than $ 10,000 for each separate offense.

ARTICLE _. GENERAL PROVISIONS

Sec. 46.14.900 DEFINITIONS. (DEFINITIONS AS NECESSARY TO BE TAKEN FROM CS FOR SENATE BILL NO. 388 (RESOURCES) BY AK DEPT. OF LAW)

ATTACHMENT #2

MISSION STATEMENT

for

AIR QUALITY LEGISLATIVE WORKING COMMITTEE

The Department's air quality management goal is to safeguard public health and the environment by fostering the use of technology and education which enables economic development with minimal degradation to the air and preserves the high level of existing air quality for the enjoyment and well being of all Alaskans.

The mission of this committee is to work cooperatively to recommend to the Administration and the Legislature proposed changes to state law that: comply with the provisions of the 1990 Clean Air Act; foster air quality programs based on sound science; and retain accountability and responsiveness to the guidance and direction of our citizens through recognition that the state and local governments are the appropriate entities to manage and protect the air resources of Alaska.

adopted 9/22/92

ATTACHMENT #3

AIR QUALITY LEGISLATIVE WORKING COMMITTEE

MEETING PROTOCOL

I. GENERAL MEETING CRITERIA

1. Public Meetings:

All committee meetings will be open to the general public. Meeting dates, times and locations will receive prior public notice and special notice will be sent to all members of the legislature. Ad-hoc subcommittee sessions are not an official function of the committee, but are generally sessions that will allow individual groups to discuss the bill or issues germane to the bill with DEC to foster a greater understanding of the Clean Air Act or issues of importance to a specific group as related to the bill. These meetings will generally be informal and not publically noticed, but will be open meetings.

2. Public Participation:

Specific times will be established on meeting agendas for public question and answer sessions and for public testimony.

3. Amendments to the Draft Legislative Bill:

Following discussion and debate, any proposed amendment will be subject to committee vote. Committee approval of any amendment requires a 2/3 majority vote of all members present and voting for both the "first consideration" vote and the "reconsideration" vote. Reconsideration voting shall not occur on the same day as the first consideration vote and only after legal review by the Dept. of Law and review by the DEC Commissioner's Office. Every effort will be made to expedite this review. An Assistant Attorney General and/or a representative of the Commissioner's Office will be present at many of the meetings and available for council.

Committee approval by 2/3 majority vote is to be viewed as a primary, but not sole indication of support or dissention concerning a provision of the draft bill. It is anticipated that unanimous support of a given provision of the draft bill will be rare. Committee members who vote in opposition to a provision will be provided an opportunity to present the reasons for dissention. Further, the committee will determine if a conflict resolution session would be fruitful in reconciling the objection(s) to the provision. Regardless, positions of dissention by members will be part of the

committee record and specifically brought to the attention of the Legislature.

4. Record of Meetings:

Each meeting will be recorded in audio, with a transcription of the proceeding produced. Unless unique conditions prevail, the meetings will generally not be open to teleconferencing.

5. Duties of the Committee Chair:

The committee chairman is generally responsible for the execution of all meetings in a professional and orderly manner. The committee chair will provide printed materials as necessary to inform participants and carry out the agenda.

The chair will work in good faith to assist the committee in developing amendments that will meet the requirements of the Clean Air Act, federal regulations in 40 CFR 70, and Department policy. The chair can not assure that the Department will approve the actions or amendments proposed by the committee. The chair will promptly notify the committee when committee proposals appear to diverge from requirements of law or the generally policy of the Department.

6. Committee Member Alternates:

In the event that a committee member is unable to attend a meeting(s), the member shall notify the committee chair if another individual is to serve as an alternate in their behalf.

7. Committee Action:

Unless otherwise specifically provided for, any action of the committee which receives a majority vote of all attending members shall be considered an approved action of the committee. Absentee voting will not be conducted.

8. Ad-hoc Subcommittees:

Ad-hoc subcommittee meetings are to be held as a non-official function of the Air Quality Advisory Committee. The purpose of these meetings is to provide an opportunity for each of the representatives to conduct a work session between their constituent members and DEC staff to obtain a broader understanding of the Clean Air Act requirements, how these

requirements may directly affect their activities or functions and to discuss conceptual ideas that may be brought to the Committee for further discussion. Interested parties are to arrange specific meeting times and locations with the chair within the reserved time blocks.

Official subcommittees may be appointed by the chairman with the consent of the committee to perform functions germane to the mission of the committee.

II. AGENDA SPECIFIC FEATURES

1. Sequence of Actions for Amendments:
   - Chair to open meeting agenda to proposed amendments on a specific subject
   - Committee to select a "set" of proposed amendments for consideration
   - Discussion and debate of selected amendments
   - Opportunity for public question and answer
   - Public testimony
   - First consideration vote
   - DEC and DOL review
   - Reconsideration vote prefaced by discussion if necessary
   - Resolution of objections to amendments if necessary

2. Agenda Items:

In addition to evaluating proposed amendments, the meeting agenda will include other subjects as may be deemed necessary or appropriate by the chair to meet the overall goal of producing a draft legislative bill that best serves the interests of the State.

3. Meeting General Sequence of Business:

   - Open meeting
   - Consideration of requests for agenda changes if any
   - Reconsideration vote(s) if any pending
   - Continuation of old business from previous mtg.
   - Conclude committee action on previous business
   - Begin new business
   - Close meeting

amended 10/2/92

AIR QUALITY LEGISLATIVE WORKING COMMITTEE

TRANSMITTAL DOCUMENT ATTACHMENT #4

SUMMARY OF PRINCIPAL ISSUES OF DEBATE

1/04/92

INTRODUCTION:

The purpose of this document is to present a summary of the discussion, the debate and the compromises reached on the most salient issues before the committee in developing a proposed legislative bill. Attachment #6 entitled "Excerpts of Transcripts" provides identification of locations within the transcripts for individual discussions and statements mentioned here. The committee transcripts reflect that issues of substantive debate fall within several somewhat distinct categories. This document is structured with respect to those categories which are:

1. Agreements on Protocol, Agenda and Initial Language;
2. The Small Business Assistance Program
3. Fees Paid by Permit Holders
4. The Dedicated Fund & Special Account
5. The Permit Program Components
6. Local Air Quality Programs
7. Criminal Penalties for Air Pollution
8. Public Involvement in Permits

ISSUE #1: AGREEMENTS ON PROTOCOL, AGENDA AND INITIAL LANGUAGE

Overview: Committee members were concerned that 1) the process of adopting language for a draft bill be designed to allow issues to be resolved through open debate and compromise, while also enabling dissenting and minority positions to be carried forward to the legislative forum, 2) that the committee work focus on those issues necessary to receive federal delegation of the permit program and 3) that the initial language for discussion (CS FOR SENATE BILL NO. 388 (RESOURCES) work draft of 5/8/92) is a document that incorporates previous agreements and compromises. Unavoidably, this document is flavored by the participants and subjects of those previous negotiations. Some committee members were concerned that using this document would result in unconsciously carrying forward language and concepts into a committee product that wasn't an accurate reflection of the intent of this group.

Substance of Discussion & Resolutions:

Protocol- ADEC developed a draft meeting protocol, proposing a committee voting process to adopt language for inclusion in a committee product. The environmental community advocated that the 2/3 majority vote concept be replaced with a consensus process whereby unanimous support by members would be the criteria for accepting language into a committee draft bill. The environmental community thought that consensus was the only appropriate process for decision making by this committee as more than 2/3 of the committee representatives were from industry or other entities needing air quality permits. Several of the members, including ADEC, were of the opinion that a 2/3 supporting vote was an adequate "bright line" test. Depending upon the subject matter, it was believed by several members that for some issues it would be impossible to obtain a unanimous vote. In general, all members believed it was in the common interest to provide a mechanism for dissenting and minority views to be carried forward as part of the committee record and made readily available to the legislature. The matter was resolved by committee adoption of the meeting protocol that incorporates the 2/3 vote process with a reconsideration vote (note: a representative of the environmental community was not yet serving on the committee when this motion was made). Additionally, it was clarified that a verbatim record of all meetings would be made and a transmittal document would be prepared to enable the legislature to be aware of the dissenting views on the controversial subjects of the proceedings.

When the committee was first formed, the department identified one seat for the environmental community. The environmental community specifically requested in writing the creation of additional seats to bring greater diversity to the committee (enclosed). Specifically, they sought positions for the general public, tourism industry, wildlife experts and public health specialists, and small business as well as the environmental community. The department agreed to one more seat for a representative of the general public. The environmental community put forward the nomination for that seat.

Agenda- Lengthy discussions during the first few meetings focused upon what subjects should be deliberated by the committee, which subjects are required to be in statute for federal approval of the permit program and what order they should be addressed. The committee was briefed on all of the sections contained within the CS FOR SENATE BILL NO. 388 (RESOURCES) work draft dated 5/8/92 and which of those subjects are either directly required by federal law or are generally viewed to be essential to the efficient and responsive execution of the permit program in Alaska. Overall, the views of the committee members reflected that the committee agenda should focus only on subjects germane to the permit program. Within that framework, first deliberation would be devoted to subjects that were absolutely required to receive federal delegation, followed by those viewed as essential for state flexibility and efficiency and if time remained the agenda would be opened to non-essential subjects but still limited to the permit program. The Committee chair would develop detailed meeting agendas prior to each meeting, but the agenda would generally follow the order of subjects put forward in an ADEC handout entitled "Alaska Air Statutes Required and Essential Features" (enclosed).

Initial Language- ADEC requested that the committee use the document entitled CS SENATE BILL NO. 388 (RESOURCES) work draft dated 5/8/92 (hereafter referred as CS Work Draft) as starting language for the committee's deliberations. It was the department's position that this document reflected to a large extent the culmination of work performed on the "Air Bill" during the period of the 1992 legislative session. This particular draft did not receive legislative committee debate or action. Some committee members expressed concern as to why this particular document was being recommended by ADEC since it was not a product of the legislature and other alternative legislative committee drafts were available. Although there were discussions to the contrary, in general, the committee realized that it must begin with some previously drafted language. To create new language from scratch would require far too much time in light of the goal to have a draft bill prepared prior to the upcoming legislative session. Two committee members suggested that the committee use the language of House Bill 377 which was subject to extensive legislative debate. The debate was resolved when the committee decided to adopt the language of the CS Work Draft for consideration. However, it was clarified that under the adopted protocol, language would not become a committee product until the specific language for a section of the bill was adopted by both first consideration vote and reconsideration vote. Further, for purposes of examining alternative language, other versions of the 1992 session bills could be used by committee members. Copies of HB 377 House Judiciary Committee bill were distributed.

ISSUE # 2 : SMALL BUSINESS ASSISTANCE PROGRAM

Overview: The small business assistance program is a required feature of any state permit program to aid small businesses in understanding and complying with the requirements of the Clean Air Act. The program as described by Congress will probably

be quite small in Alaska. Alaska has some unique small businesses that do not fit the federal definition of small business, yet will exhibit the situation that Congress intended to address by the program. These Alaska small businesses are the many small electric power generators. The language in the bill is crafted to address this Alaska situation by allowing the small business program to be expanded to other entities. If the expanded services are provided, federal law prohibits the use of permit fees to fund the activity. Other funds must be used. The federally described small business program is to be fully funded by the permit fees.

It is the committee's desire that the 'purposes' section of the bill include language to indicate that the small business assistance program be located within the air quality management section of the department.

Substance of Discussion and Resolutions:
As part of the tasks authorized under the section entitled **Scope of Program**, the committee supports the agency audit concept mentioned in Sec. 507(a) of the Act to assist small businesses in complying with the Act, provided that certain protections can be accomplished to keep the audit records as confidential information. To accomplish the agency "complimentary" or non-enforcement audit in a confidential manner, additional changes in law would be necessary concerning the provisions of public records. This change was not accomplished as part of the draft bill due to time limitations. The committee discussed the concept that information learned in an audit would be held confidential for a specified period of time viewed to be adequate for the operator to take corrective action. The confidentiality of the audit inspections is not intended to disguise violations nor are the audits to replace or reduce performance of compliance inspections.

The **Compliance Advisory Panel** is a mandatory provision of the program to serve as an aid in assuring that the program meets the needs of the effected small businesses. This language describes the minimum sized panel, however, it is designed so that members have staggered terms of service in order to preserve a corporate memory during periods of member turnover.

ISSUE # 3: FEES PAID BY PERMIT HOLDERS

Overview: The Clean Air Act requires that permit fees fund 100% of the direct and indirect costs of executing the permit program. Because fees are such a critical subject to the regulated community, more than three of the nine committee meetings were dedicated to this subject. Crafting language to achieve equity between all permittees on their respective fee burden was the greatest single issue of debate and compromise for the committee.

To achieve specific advantages, the fee structure is a bifurcated approach: one fee,

"permit administration fees", to address funding those tasks that are performed to directly serve a permit applicant or permittee and another fee, "emission fee", to fund what may be called indirect costs of executing the permit program. The initial emission fee rate authorized in the proposed statute is to be valid for only the first two years of the permit program. After that date, the agency must adopt a rate or formula in regulation based upon the experience of the first two years and further research. Although the statute purposely does not set the fee amounts, the permit administration fee rate is expected to be about $64 per hour with the emission fee rate anticipated to be about $5 to $7 per ton of air contaminant emitted.

Agreement to fee language was adopted only after, and premised upon, ADEC presented a draft program plan which indicated probable costs of the permit program, the number of staff required and how permit fees would breakout for various types of facilities located in Alaska. Regardless that unanimous support for the language was obtained, some committee members expressed reservation that this fee structure would carry increased accounting costs vs. other alternative fee structures and may also result in not collecting fees for all expenses incurred by the department.

Background Information - ADEC distributed an agency document entitled "AIR QUALITY STATUTORY LAWS: A COMPARISON OF 10 STATES" to assist the committee members in examining various fee structures and rates adopted by other states. Additional research was done to examine the permit program budgets and staffing of these ten states for comparative purposes. Beginning in the summer of 1992, the agency initiated a "permit search project" by contacting some 8000 businesses and industries in Alaska to determine who would need permits under the expanded requirements of the Clean Air Act. This information served as part of the foundation in enabling the committee to develop language on permit fees.

Substance of Discussion & Resolutions:

Evaluation of Alternative Concepts - The fee concept contained in the draft bill represents a refinement of the first official fee proposal presented to the committee. Prior to this proposal, several alternative fee structures adopted by other states were discussed by the committee. While the first proposal was being refined by language changes, the agenda remained open to introduction of other alternative proposals. At meeting # 6, five other fee concepts were introduced and discussed. One of these alternatives could be viewed as a detailed proposal. The other four were intentionally brief in recognition of the desire to have a simplified fee concept that would minimize the department's administration costs for fee billing, collection and dispute resolution. Fee alternatives based on emission quantities were introduced for the purpose of providing a direct incentive to reduce emissions. The simplified fee proposals were made in-part with the intent to help keep overall fees lower. Another ancillary benefit to this approach would be to keep the text of the bill trim. The alternatives are enclosed. The majority of committee members found that these alternative fee proposals did not provide the specific

accountability or equity features that were accomplished by the then refined original fee proposal. However, a concept from one of the alternatives was molded into the final fee language.

Permit Administration Fee -
The language on permit administration fees is developed on the policy premise that a cost generator is to be a cost bearer. By setting this fee rate on a basis of dollars per hour of agency service provided, accountability for cost control within government and the regulated community will provide a strong motivation to foster program efficiency. For clarification, the "cost" to be funded is the costs incurred by the agency in reviewing, issuing and maintaining the permit. This "cost" is not in any manner intended to address any environmental impact cost of the emitted air pollutants. The language lists the specific tasks for which permit administration fees will be collected.

Several concerns were raised with respect to the fee structure. First, the increased administration burden of tracking hours spent on each permit would probably increase the overall program costs. Second, inequities among similar facilities could arise. Early permit applicants may bear greater fees relative to later applicants as agency personnel gain experience and improve efficiency. A facility that happens to be located further from an agency office could bear greater permit administration fees because of increased travel time and costs. Solutions to many of these were incorporated into the final language or as intent for the supporting regulations.

In certain respects, facilities regulated under general permits would be serviced in a collective effort with the associated permit administration fees being equitably shared. Specifically, the development costs of a general permit would be shared by those that would be issued that permit. Where the agency can perform a reduced level of effort on inspection and compliance tasks, the costs of the reduced or "representative" type inspection would be shared by the larger group who benefit from that approach in comparison to the costs of individual inspections at each facility.

To clarify the probable permit administration costs for certain normal or regular service tasks, the department will prepare estimated fee costs for various types and sizes of facilities. It is intended that these lists will be readily available for permittees and permit applicants. Such a listing would indicate the amount of retainer normally required when services are provided prior to the submittal of a permit application. The proposed language would allow persons to challenge unreasonable permit administration fees.

Regarding language in subsection (d), if the department were to secure contractual assistance for permit administration tasks, the contractual services would be billable to the applicant in the same manner as accomplished if the department staff performed those services.

Emission Fee -
The purpose of the emission fee is to distribute the costs of performing those functions of the permit program that benefit or assist all permit holders through execution of a state permit program. These cost items include such things as program development and management, utilities, accounting and administration and the small business assistance program. If the fee rate is a function of the quantity of air pollutants emitted from a facility, larger facilities would carry larger portion of the burden. There was a concern that ADEC carefully consider what cost items are to be included in the emissions fee. Supporting regulations are to identify tasks that incur costs to the permit program.

There was a strong view by several committee members that there should be "caps" or reduced fee rates at both the high and low end of facility size relative to emission quantities. Other incentives such as reduced fees if pollution prevention actions are taken or higher rates for emissions of hazardous air pollutants were also discussed. Fee incentives to accomplish pollution prevention was strongly favored by the environmental community. As a compromise, the adopted language reflects that the committee could not determine equity at this time and therefore established a structure that initiates a two year emission fee rate incorporating no incentives or rate reductions with the provision that ADEC must evaluate parameters that can lead to fee equity and establish a new fee rate prior to year three that examines all factors including caps, incentives or reduced rates.

During the reconsideration of the fee language a representative of Unocal Chemicals Division spoke to the committee regarding their concern for the fee language. Essentially, Unocal highlighted that the flat fee rate would result in their company paying a much higher emission fee in comparison to other large facilities throughout the state. The reason was that emissions of ammonia gas, which is not a federally regulated air pollutant, would result in annual fees of tens of thousands of dollars more than other large facilities. The company did not object to paying emission fees for ammonia emissions, but due to the quantity of emissions involved, believed they would carry a disproportionally higher burden. Language was proposed and adopted to provide a cap on fees above 4000 tons per year if the contaminant is a chemical compound not regulated under the Clean Air Act (ammonia and hydrogen sulfide are the only compounds). Unocal indicated that this fee adjustment would be acceptable. This change in language was adopted as a separate amendment to the section and adopted unanimously under first consideration vote.

Upon reconsideration of the amendment to the fee language, opposition was voiced by the large electric utility group because this fee cap would result in an additional fee burden to all other emission fee payers. Although the increase would be relatively small, the position was that any additional burden resulting from one party obtaining a reduced assessment would be unacceptable. The small electric utility group, the oil & gas representative and several other members retained their support for the amendment.

Subsection (f) of this section creates a mechanism whereby permittees would not be paying for emissions that they either don't emit (within the margin of error for calculations) or do not reasonably anticipate being emitted. Further, it is expressly not the intent of the committee or the department to impose new operational restrictions upon owners and operators of air pollution generating equipment by adoption of this language on "assessable emissions". It is intended that a facility owner who exceeds his assessable emissions, but not his permit allowable emissions, would simply pay for the additional assessable emissions. For the converse, an action that resulted in dramatic reductions of assessable emissions would be eligible for a credit toward future assessable emissions. These issues would be fully addressed in the subsequently adopted regulations.

ISSUE # 4: THE DEDICATED FUND AND SPECIAL ACCOUNT

Overview: The Clean Air Act requires that the air quality permit program be fully self-sustained from the collected permit fees. Further, the Act specifies that the permit fees can be used **solely** to fund the permit program. A dedicated fund is allowed under the Alaska Constitution, but only if such a fund is required as a condition of approval in implementing a federal program. This is such a case.

Language creating a special account was drafted to enable the department to earmark funds that may be collected from litigation or from other enforcement settlements involving the air quality laws. These monies would be accounted separately within the general fund. Such an account would create a mechanism for the department to request a re-appropriation of the monies back to the department for use in the air quality program.

Substance of Discussions and Resolutions:

The regulated community is strongly interested in being able to monitor the expenditures of monies deposited into the dedicated fund. There was discussion of an annual report being produced as a mechanism for all to provide input to the budget setting process and evaluate agency efficiency, accountability and expenditures. The report requirement would be addressed in regulation.

Language adopted elsewhere in the draft precludes local government air pollution programs from collecting permit fees. All fees would be collected by the state in cooperation with any local agency. Monies from the fund would then be passed back to local agencies to support the staffing and other reasonable expenditures of state approved local programs performing permit tasks.

It is important to note that funds deposited into the special account may be one of the likely sources to fund the expanded small business assistance program.

ISSUE # 5 : PERMIT PROGRAM COMPONENTS

Overview: There are several sections of the draft bill which address features of the permit program. Each are addressed separately below. Overall there are a few sections which garnered considerable debate. It is also important to note that the committee, due to lack of time, was not able to address all of the individual subjects contained within the CS Work Draft desired to be contained in statute. The agenda was focused upon discussing and resolving features which must clearly be in statute to obtain federal approval of the permit program. This goal was accomplished. Those features of the permit program which must be part of a final complete permit program, yet are not essential statutory features, were incorporated into the section entitled Emission Control Permit Program Regulations. This referencing in statute will enable these elements to be addressed in regulation. None-the-Less, there is an expressed desire of many committee members to continue to convene in order to address some of the individual subjects for possible later incorporation into the legislative bill. Should ADEC find it advantageous to the legislative review, the committee would be willing to convene in order to discuss selected subjects.

Substance of Discussion and Resolutions:

Section entitled **CLASSIFICATION OF FACILITIES OR SOURCES; REPORTING** - This section serves two purposes. First, it enables the language in the bill to be succinct by allowing certain facility types identified in federal law to be classified and listed in regulation rather than statute. Secondly, it enables the department to request information from any generator of air pollution in order to assess whether that activity potentially endangers public health or air resource standards.

Section entitled **PERMITS FOR CONSTRUCTION, MODIFICATION, OR OPERATION** - The section contains the basic authority to require construction and operating permits for subject facilities that have air pollution generating equipment. The focus of debate was subsection (e). This subsection describes under what conditions a source or facility may be exempted from the permit program. Under federal law there is a very small set of sources that may ever be considered for exemption. An example is residential wood stoves. The federal administrator has exempted wood stoves from the permit program, but each state must then follow through on the state level to exempt wood stoves. The substance of debate focused upon the issue of under what circumstances should the state continue to regulate a source under the permit program if the federal administrator has exempted the source.

The language in the draft bill reflects a compromise between mandating that the state exempt the source and providing an unencumbered option for the state to either exempt or regulate the source. The adopted language provides the ability to continue to regulate a source that is federally exempted but caveated with certain provisions. Under first consideration vote, this language was unanimously adopted. During reconsideration an

amendment to further refine the provision failed. This failed amendment proposed to replace "issue a similar determination unless" with "make a finding as to whether". This debate was the principal reason for the split vote on reconsideration.

To clarify, the words "other determination" in subsection (e) is intended to address situations where the Administrator may provide partial exemptions or other alternatives to being regulated by the permit program.

Section entitled **FACILITIES REQUIRING PERMITS** - The purpose of this section is to delineate which facilities need either construction permits or operating permits. To keep the text of this section brief, the section calls upon the authority of another section to enable classification or grouping of facility types that are either unique relative to the need to acquire a permit under state or federal law or must be subject to a specific type of review under federal law as part of the permit review.

Sources or facilities classified under the authority of CLASSIFICATION OF FACILITIES OR SOURCES; REPORTING would be so indicated in the department's regulations such that all sources or facilities required to obtain a permit would be clearly listed for the regulated community. Further, those regulations would indicate which subset of facilities would be required to go through the federally mandated prevention of significant deterioration (PSD) review.

Subsection (a)(3)(II) was an issue of debate with the committee. The purpose of this subsection was to give the department some flexibility if there was a need to regulate a source that presented a potential danger to health, but there was not an ambient air quality standard set for that air contaminant. Contaminants classified as hazardous air pollutants are such an example.

Section entitled **EMISSION CONTROL PERMIT PROGRAM REGULATIONS** - This section was only briefly discussed at meeting #8 (12/17) due to lack of time. This was the last meeting for introduction of new material. Several amendments were accomplished relative to the contents of the CS Work Draft. The principal reason for most of these amendments was to clearly identify subjects that must be addressed in regulation in order to make the permit program approvable by EPA. Committee members understand and support the purpose for the amendments in order to conclude the committee's current task of putting forward a complete bill within the fall season time limitations. However, there is an expressed concern that many of the members would desire to address some of the individual subjects now referenced in this section and have those subjects be individual sections of the proposed legislation.

Section entitled **ADMINISTRATIVE ACTIONS REGARDING PERMITS** - The language

in this section specifies the timeliness for permit decisions. During discussion, several committee members expressed a concern that the department needs to have the ability in emergencies to rapidly authorize the operation of an air pollution source in order to contain, prevent or abate a larger environmental or public health situation. This discussion resulted in the creation of the section entitled AUTHORITY OF THE DEPARTMENT IN CASES OF EMERGENCY.

Another item of discussion focused upon the need to be able to issue permits for temporary operations in a more expedient fashion than the 12 months indicated for operating permits.

Section entitled **AUTHORITY OF THE DEPARTMENT IN CASES OF EMERGENCY** - This section provides a mechanism for the Commissioner of ADEC to authorize the immediate operation of a source or facility either without a permit or in contravention with the terms of a permit when such actions are deemed necessary in an emergency situation.

Section entitled **GENERAL OPERATING PERMITS** - Many general or "master" permits will be developed, each tailored to fit a number of individual but similar equipment installations. Once developed, an individual general permit can be issued very quickly. Issuance of general permits is one of the key elements in enabling the revised permit program to be efficient. It is anticipated that many of the small facilities such as rural electric power plants will operate under the authority of a general permit.

Upon reconsideration, discussion focused upon whether general permits would provide inadequate opportunities for public comment. This subject was the reason for the split vote at reconsideration.

Specifically, a concern was expressed that parties interested or potentially effected by the installation of a particular new air pollution source may find that the public comment opportunity had long since past. This situation may arise because the comment period on general permits are conducted when the permit is first developed and not when it is individually issued. A potentially interested party may not necessarily be concerned about the operation of a source until they become aware that such source would be located within their immediate proximity. Since general permits, as a practice, are to be issued to small air pollution sources, many committee members were of the opinion that small facilities generally do not represent a potential danger to health and welfare. The language in the section entitled "Review of Permit Action" provides that a party who is aggrieved by the issuance of a general permit to an individual facility can, with certain qualifications, appeal the permit action (see Issue # 8). The department can take other actions or precautions to avoid or mitigate some of these possible problems. Enhancing public awareness of public comment opportunities for general permits would be of assistance. The department should evaluate which sources or facility types are to be eligible for general permits with consideration given to possibly precluding general permits

for facility types which may exhibit unexpected impacts or those that may have significant impacts within certain types of locales this would assist in avoiding potential problems.

Another somewhat associated point of discussion is that there may exist certain local conditions that would preclude the issuance of a specific general permit within a certain geographic locale due to unique conditions (such as nonattainment areas or areas where pollution levels are already high). In this situation, the department could develop an alternative and somewhat different general permit for the same facility type if it were to locate within a unique locale.

Section entitled **AIR POLLUTION FROM OUTER CONTINENTAL SHELF ACTIVITIES** - This section would provide the ability for the department to regulate mineral and oil & gas extraction activities located between the coast and 25 miles seaward. State authority is normally limited to that area within three miles of the coast. Section 328 of the Clean Air Act provides a mechanism to obtain delegation of federal authority and thereby extend the geographic range of authority for certain activities. The oil & gas community favors adoption of this language because they would prefer to receive all air permits from the department rather than some from the EPA (offshore) and some from ADEC (onshore).

Committee discussion also focused on whether federal provisions could be applied toward sources that are located between 25 and 200 miles offshore. Since there does not appear to be a clear indication or reference in the federal regulations for applicability of Section 328 for sources beyond 25 miles, the adopted language only addresses air pollution sources located between the coast and 25 miles offshore.

Committee discussion also addressed whether seafood processing facilities located offshore could be regulated by authority of this provision. The federal regulations adopted under Section 328 of the Act do not regulate seafood processing facilities. The seafood processing industry would desire to obtain parity between onshore and offshore facilities with respect to environmental regulation. It may be possible to regulate movable offshore seafood processors under existing state law if the facility is located within three miles of the coastline. This is currently under investigation by the Department of Law.

Section entitled **RESPONSIBILITIES OF OWNER AND OPERATOR** - The development of this section grew out of discussion on other sections of the bill; notably those describing who needs permits. Committee discussions focused upon the need for ADEC to be able to enforce upon a real entity in recognition of possible corporate maneuvers and also the concern of industry whereby owners of a property or facility may indeed not be knowledgeable or legally responsible for the day to day functioning of a facility which is under the control of a lessee or contractor.

ISSUE # 6 : LOCAL AIR QUALITY CONTROL PROGRAMS

Overview: The following three sections address how local government air pollution control efforts work in conjunction with the department's efforts and programs. These sections address the full range of air quality management programs such as motor vehicle emission controls, open burning activities, activities directed toward compliance with public health air quality standards and the stationary source permit program. The language in these sections would replace existing statutes AS 46.03.210, AS 46.03.220, and AS 46.03.230.

Substance of Discussion and Resolutions:

Section entitled **LOCAL AIR QUALITY CONTROL PROGRAMS** - This section establishes that local programs are approved by the department through a cooperative agreement which delineates the responsibilities of both agencies. Committee members were concerned that in many cases local governments are not in a position to maintain either a competent or efficient permit program because of the limited number of air sources within their jurisdiction and the difficulty of obtaining adequately skilled staff in this area of expertise. There is a high demand and expectation for efficiency because this permit program is user funded and also requires a central core of staff with a specialized expertise. The adopted language places the responsibility upon the department to make appropriate judgements regarding when local governments can best accomplish the permit program requirements while also being efficient and competent. However, the participants of the program (permittees and others) will have opportunities to provide comment to ADEC in these matters. It was the committee's concern that the costs of inefficient local programs would be unduly born by the entire community of permit holders.

Another concern was the possibility of local programs to use authority provided under local ordinances to accomplish non-air objectives, such as land use objectives. Consequently, the language in subsection (f) somewhat restricts the ability of local governments to set requirements that may be more restrictive than state regulations. This restrictive language would only apply to activities associated with the stationary source permit program. Supporting regulations would exemplify the criteria of subsection (f). It is specifically intended not to include such things as open burn approvals or automotive emission requirements. This compromise language was opposed by two members at the time of reconsideration vote.

Language in subsection (h) was created to avoid a potential equity problem if local government programs were to collect permit fees. This language precludes local governments from collecting air permit fees. All fees would be collected by the state with financial assistance provided from the state to the local program for execution of the permit program. This language would also prevent local governments from initiating a permit program solely as a revenue source or job generator.

Section entitled **INADEQUACY OF LOCAL PROGRAMS** - This section specifies the process for identifying and rectifying deficiencies in executing the terms of the interagency cooperative agreement. There was relatively little debate concerning the provisions of this section.

Section entitled **STATE AND FEDERAL AID** - The language in this section is the principal authority for local programs to receive air permit funds collected by the state to support the staff and other expenditures of executing a permit program at the local level. Changes were made relative to CS Work Draft and relative to existing AS 46.03.230 to provide for local programs to receive federal funds without approval of the department. In the case of Clean Air Act Section 105 grant funds, EPA as part of the State-EPA Agreement will request state review of grant applications submitted by the local government programs. The section 105 federal grants are the main, but not sole source of federal funds for executing state and local air programs.

ISSUE # 7 : CRIMINAL PENALTIES FOR AIR POLLUTION

Overview: The committee discussed the criminal penalty provisions at some length during three meetings or more. This language would create a new section applicable to criminal penalties for violation of air pollution laws. At the beginning of discussion, the committee first considered a proposal to amend existing AS 46.03.790. Several desired options only became available to the committee if a new stand alone section applicable to air quality was created. The minimum changes required in Alaska statute to comply with the Act is the substance of what is now contained in subsections (a)(2) and (h).

The draft language reflects an overall concern by the committee that statutory provisions be explicit to match the severity of a penalty with the damage caused by a criminal action and the state of mind of the person performing the crime. To achieve this goal, the committee looked to the framework of language that exists in Section 113 of the Clean Air Act which specifies penalty gradations that are used in federal court if EPA is taking the enforcement action aided by the U.S. Department of Justice.

Following this framework, the penalties of a Class A misdemeanor were linked with a criminal negligence state of mind when an action is performed that does not impair life or cause serious bodily injury. Potential penalties of a Class C felony were linked with a reckless state of mind when the action places a person in imminent danger of death or serious bodily injury. Potential penalties of a Class A felony were linked with a knowing state of mind when the person knows that he places another in imminent danger of death or serious bodily injury.

As a further aid to the committee, the assistant attorney general informed the committee

that existing law contains other provisions on criminal sanctions that can be used in cases where air pollution incidents have caused harm to individuals or property. The committee recognizes that these other provisions are available to enforcement officers.

To aid the reader, the following table lists the maximum penalties for the identified offenses.

POTENTIAL MAXIMUM CRIMINAL PENALTIES

	FOR INDIVIDUALS		FOR ORGANIZATIONS	
CRIME	FINE ($)	JAIL TERM	FINE ($)	JAIL TIME
Class A Misdemeanor	5,000	1 yr.	200,000	1 yr.
Class C Felony	50,000	5 yrs.	500,000[1]	5 yrs.
Class B Felony	50,000	10 yrs.	500,000[1]	10 yrs.
Class A Felony	50,000	20 yrs.	500,000[1]	20 yrs.

1. $ 500,000 or twice damages caused.

Substance of Discussion and Resolution:
There was a lengthy discussion on the certified notice concept of (a)(1). This concept grew from the idea that several committee members believed it to be very important that operators of air pollution generating equipment be fully informed that they could be subject to criminal sanctions for certain actions regarding that equipment. Since criminal sanctions are viewed as quite serious, the committee was concerned that an overt action should be taken to assure that operators become knowledgeable through a communication that may be viewed as equivalent to a warning. It is the committee's intent that the certified notice would be executed prior to authorized operation of the facility, not after a criminal action could possibly occur. One member believed strongly that the certified notice element should be deleted because it unnecessarily increases requirements for ADEC and the regulated community, and creates considerable ambiguity over who has received notice and whether a regulated company has issued proper notice to all of its employees. Immediately prior to first consideration vote, a motion was made to delete the certified notice concept. The motion failed in a split vote of 4 favoring the deletion, 3 opposed and one abstaining.

The committee was concerned that minor, technical, and immaterial violations of the statute not expose persons to criminal prosecution. As a result, the committee's proposed language requires certain violations to rise to the level of "materiality".

Several committee members expressed that they were not knowledgeable in the area of criminal law. At least one member and perhaps others felt that the committee should not propose any language other than that which is required for EPA to approve the state's program.

There was some concern by committee members that the potential maximum fine for a misdemeanor described in subsection (a) does not comport with what EPA interprets the law to be. Upon review of both federal statute and supporting regulation, the assistant attorney general's counsel on this subject indicated that the language of this subsection is in compliance with both the Act and the federal regulation.

ISSUE # 8: PUBLIC INVOLVEMENT IN PERMITS

Overview: The public and other interested parties can raise their objection on a permit action to either the department or the U.S. Environmental Protection Agency (EPA). However, for most situations, the opportunity to continue to contest a permit action is predicated on having raised the issue of concern during the public comment period for the permit. The Clean Air Act requires that the state provide an opportunity for an aggrieved party to carry their objection to court. The Act also requires that EPA has an opportunity to review each permit prior to issuance and that EPA may object to and prevent the issuance of a permit that does not meet all applicable requirements of federal law. Two sections in the draft bill are crafted to address these federal requirements. There is additional discussion within ISSUE #6 of this document pertaining to the section entitled GENERAL OPERATING PERMITS which addresses concerns about public participation in the development and issuance of these permits.

The department's previously adopted Administrative Procedures in 18 AAC 15 provides administrative appeal through an adjudicatory hearing as a mechanism to object to permit actions. The administrative appeal is more responsive and a less expensive alternative to judicial review. Under current state law, judicial review is currently available for any party with "standing" under state law.

Under existing Alaska law the term "standing" has a broader interpretation that its counterpart in federal law. This avails the judicial process to a larger spectrum of potentially aggrieved parties in the state appeal process.

There was substantial debate among committee members regarding the opportunities for an aggrieved party to request an adjudicatory hearing and obtain judicial review of a

permit action. The language adopted by the committee regarding who has an opportunity to appeal can be viewed as more of a parallel to federal law than current state law. In a split vote by the committee, the adopted language, which is germane only to air quality permits, would arguably have the effect of narrowing those who would have "standing" in state court.

Substance of Discussion and Resolution:

Section entitled **REVIEW OF PERMIT ACTION** - Upon reconsideration of this language, committee members representing the general public and the environmental community argued that it was not appropriate to reduce existing statutory opportunities for public participation in the permit review process. The committee sought the counsel of the assistant attorney general as to whether the words "who has private, substantive, legally protected interest under state law" is potentially more restrictive regarding who can obtain judicial review in comparison to federal law or existing state law. Counsel advised that it appears that this language could be argued as being more restrictive than "a person with standing" under state law (see State v. Enserch Alaska Const. Inc., 787 P.2d 624, 630 (Alaska 1989)). In comparison, when examining "standing" under federal law, this language appears to be comparable regarding who would be able to obtain judicial review (see Lujan, Secretary of the Interior v. National Wildlife Federation et. al., 497 U.S. _____ 110 S.Ct. 3177, 111L.Ed.2d 695 (1990)).

The environmental community and the representative of the general public argued strongly that the committee should not take an action that would narrow what is now existing Alaska law concerning who may obtain standing for judicial appeal. Committee members who supported the words "private, substantive..... protected interest" argued that it is not appropriate to expend state and other resources hearing arguments that potentially delay closure of a permit action when the objection either was not raised at the provided comment period or is otherwise not a private and substantive issue germane to air quality impacts and applicable laws.

An amendment was offered that would replace "who has a private, substantive and legally protected interest under state law" with "with standing under state or federal law". Under the proposed language, a judge of the court would make the final determination regarding if the person has standing. The motion to amend the language failed on a vote of 3 supporting, 6 opposed and one abstaining.

Perhaps it is of value to convey to readers other pertinent factors on this discussion. The issue of debate did not arise until the language was under reconsideration. Reconsideration occurred on the last meeting date of the committee, when all members were sensitive that the agenda items must move fairly rapidly in order to conclude the committee's work prior to onset of the legislative session. Those members who offered the amended language, still hold their views quite strongly that the committee is

unnecessarily adopting language which arguably restricts a widely applicable criteria of state law when the subject of contention is air quality permits. Throughout the committee's deliberations, the committee was quite successful in striving towards compromise language that ameliorated, as best as possible, strong opposing views. At this closing meeting, time constraints became a factor which perhaps shunted the opportunity to reach better compromise language.

Another point of clarification regarding the language of this section, but unrelated to the previous discussion, is that for purposes of this section "final agency action" is the issuance of an adjudicatory hearing decision.

Section entitled **OBJECTION BY THE FEDERAL ADMINISTRATOR** - This language indicates that the Environmental Protection Agency has veto authority on each and every operating permit. This is a mandatory provision if the state is to receive federal approval of the permit program. This feature only applies to operating permits, not construction permits.

Alaska Center for the Environment

519 West 8th Avenue, Suite 201 • Anchorage, Alaska 99501 • (907) 274-3621

PARTICIPATION OF THE ALASKAN ENVIRONMENTAL COMMUNITY
ON ALASKA'S DEPARTMENT OF ENVIRONMENTAL CONSERVATION'S
AIR QUALITY ADVISORY COMMITTEE

October 1, 1992

The Alaskan environmental community has agreed to find one, or potentially two members to sit on DEC's Air Quality Advisory Committee. We would like to have more seats, however our decision was based on the following understandings, and made with the following reservations:

Understandings:

I. Most significantly, citizen nonprofit groups can only afford to participate in this type of committee if all meetings are held in the city in which they reside, or if they state provides them with travel funds. It is not appropriate for industry representatives to pay for citizen travel. If the state truly desires citizens and nonprofit representatives as voting committee members, they will pay for our travel or hold all meetings in Anchorage.

II. We understand that the purpose of this committee is to draft an advisory statement on the Clean Air Act for the State of Alaska. We have been told that the committee will work on only the required sections of the bill to allow the state to retain primacy in air quality regulation of this state, and the right to set standards more stringent than the federal minimums. To work on controversial sections, beyond the required minimum, may result in gridlock among committee members (in the committee or during the legislative session). In addition, some significant groups (including the environmental community, citizen groups, small businesses and industry, and tourism representatives) are under-represented on the committee and their concerns will not appropriately be heard on the controversial sections.

III. We understand, after the assurance from Janice Adair, Tom Chapple and Robert Regis, that dissenting opinions or votes will be carried to the legislature, articulated comprehensively within the advisory statement or bill. This will allow legislators to understand the concerns of all committee members, rather than just the voting majority.

IV. We understand, that we are not using the version of last session's bill as provided in the committee by DEC as a working draft. Rather, this was used only to highlight required sections of the bill. No part of this version of the bill will

be carried further than that point by this committee.

Reservations:

I. The decision-making process for this committee, a 2/3 vote, is inappropriate. This committee is not comprised of elected officials, nor is it the final decision maker on this bill. Rather, it was claimed to be established as an advisory body to negotiate between interests to create a cooperative bill. The best forum for this type of negotiation and cooperation is a consensus process with an independent, non-voting chairperson mediating. Our desire for this committee to work within the consensus forum as stated above, has been suggested repeatedly in letters to DEC during the summer before the committee first met, and in the first two meetings as public testimony. A 2/3 voting process is particularly inappropriate in light of the following reservation.

II. The committee's member composition is inadequate. Citizen, environmental, public health, and clean air groups and terribly under-represented with only one seat offered. We requested more seats, by letter, before the committee began meeting. Our request received no response. During the first meetings, when we repeated our request, we were offered three seats - but no travel money for the citizen participants. In addition, small businesses who will also be affected by the new Clean Air Act are not appropriately represented on the committee. This is a gross oversight as both the groups (citizen and small business) cannot well afford to lobby the legislature in Juneau either.

Signed,

Aimee R. Boulanger

Aimee R. Boulanger
Community Coordinator for Pollution Issues

ALASKA AIR STATUTES

REQUIRED & ESSENTIAL FEATURES

Exclusive Fund for Air Permit Program

Create Small Business Assistance Program
- Create Advisory Panel
- Provide Assistance to Larger Group

Modify Criminal Provisions and Fines

Construction Permits v. Operating Permits
- Agency/Operator Emission Limits to Avoid Need for Permit

General Permits

Flexibility for Permit Fee Structure

Ability to Implement New Federal Rules in Permits
- Reopening of Permits

Emission Limits Based on Health Risks or Available Technology

Local Governments to be Implementing Partners

Administrative Penalties for Violations
- Deter EPA Intervention

Public Involvement in Permits
- Public Review of Permits
- Appeal through Adjudication
- Judicial Review
- EPA Review
- Public to Petition EPA

Retain & Update Existing Statutes

AIR PERMIT FEE STRUCTURE I.

Sec. 46.14____PAYMENT OF FEES AND FEE STRUCTURE

All costs of the air permit program under AS 46.14.200, direct and indirect, shall be allocated among all permittees pursuant to a formula, adopted in regulation, that divides the sum of all costs expected to be incurred for that billing year by the sum of all tons of contaminants permitted to be emitted that year and applies the per ton amount to a facility according to the tons per year that facility is permitted to emit.

This is the simplest way of allocating the costs of the program. It means that those facilities that bear the greatest responsibility for impact on the total air quality in terms of quantity of emissions pay the greater share of the costs.

This structure has the added advantage of being an incentive to facilities to make rational investments to reduce their total emissions.

AIR PERMIT FEE STRUCTURE II.

Sec. 46.14____ PAYMENT OF FEES AND FEE STRUCTURE

The department shall, by regulation, establish a graduated fee structure for the permit program pursuant to AS 46.14.200 based upon:

(a) the public health risk of the facility's permitted emissions as determined by a ranking system developed by the department;

(b) the tons per year of permitted emissions released by the permitted facility.

This structure requires two considerations of the department when assessing the permit fee. First, how hazardous is the emission? Obviously, small amounts of extremely dangerous emissions present a greater threat to the public health than relatively large amounts of less toxic emissions. It would require the department to develop a hazard ranking model for air emissions.

Secondly, the total amount of emissions, based on a ton per year computation, would be the major consideration for permit fees for most facilities.

Clearly, this system puts the greatest burden on facilities that pose the greatest potential threat or diminution of air quality. Once again, there is a built in incentive to reduce both quantity and toxicity of air emissions.

AIR PERMIT FEE STRUCTURE III.

Sec. 46.14____PAYMENT OF FEES AND FEE STRUCTURE

(d) Fees for direct costs, as defined in (__), shall be established by the department in regulation and shall be based on the previous fiscal year's gross operating revenues of the facility requiring a permit under AS 46.14.200. The fee structure shall be graduated in such a manner that facilities generating the greatest amount of annual gross revenues pay a proportionately greater share of the total permit program costs. In the case of a non-revenue generating facility, the permit fee shall be based on the gross operating revenues of the parent company that owns or operates the facility.

(e) For publicly owned or public service facilities as defined in (___)* direct cost fees, as defined in (___) shall not exceed $100.00.

(f) Fees for indirect costs, as defined in (___), shall be allocated among all permittees pursuant to a formula, adopted in regulation, that divides the sum of all indirect costs expected to be incurred for that billing year by the sum of all tons of contaminants permitted to be emitted that year and applies the per ton amount to a facility according to the tons per year that facility is permitted to emit.

This structure graduates the permit fee (for direct costs) according to the gross revenues generated by the permitted facility. The fee could be established as a straight percentage or facilities could be grouped in different classes according to revenues with all facilities in same class paying the same flat rate.

Publicly owned or public service facilities are billed a single flat rate that does not exceed $100.00. This way consumers of regulated utilities (sanctioned monopolies) do not bear the direct cost of regulation.

Indirect costs are allocated on tons per year of emissions with no cap on charge per ton of emissions. All facilities pay this portion of the fee structure on the basis of emissions per year, supporting the principle of equity and encouraging a reduction of emissions.

*Publicly owned=municipally owned utilities, schools, state and federal facilities etc.

Public service facility=utility providing service to public at no profit.

AIR PERMIT FEE STRUCTURE IV.

Sec. 46.14___PAYMENT OF FEES AND FEE STRUCTURE

(a) The department shall, by regulation, establish a fair and equitable fee structure, that in no way penalizes a facility because of geographic location or lack of technical expertise or resources.

(b) The permit fee structure shall be established by regulation in a manner that provides resources from a tons of permitted emissions per year fee sufficient to fund technical assistance programs to facilities that qualify.

This language will give the department the greatest flexibility to develop a fee structure in an open public forum pursuant to the Administrative Procedures Act. All interests, including the general public, would have an opportunity to testify and participate.

There are two major requirements:

1. That no facility would be economically penalized (charged more for a permit) simply because they are located farther from DEC regional or district offices or because they have neither the resources or technical expertise necessary to complete a permit application requiring minimum department attention. This eliminates the inherently unfair and impractical concept of an hourly charge for processing permits.

2. The second part establishes in statute the intent to fund technical assistance programs with revenue generated from the tons per year fee. "Sufficient" shall be taken to mean that the department will have a program that is adequate to meet the demand from qualifying small operators throughout the state.

Offered by C. Harmon

Operating Permit Program Fee Schedule Recommendations
DRAFT: November 17, 1992
Draft Language

Additions in Redline
Deletions in ~~Strikeout~~

Sec. 46.14.___. PERMIT FEES.

(a) The department shall determine, assess and collect from all owners or operators of facilities that are required to apply for a permit under AS 46.14.205 fees sufficient to cover the costs of a state operating permit program approved by the United States Environmental Protection Agency under Title V of the federal Clean Air Act. The department shall develop by rule a fee schedule allocating among permit program facilities the department's permit administration costs and permit program development and oversight costs.

(1) Permit administration costs are ~~those~~ the reasonable permit-specific costs incurred by the department in administering and enforcing the operating permit program. Costs associated with the following activities are permit administration costs:

[SPECIFY COSTS IDENTIFIED IN 40 CFR § 70.9(b)]

(2) Development and oversight costs are the reasonable program-wide costs incurred by the department in developing and administering the state operating permit program. Costs associated with the following activities are development and oversight costs, as these activities relate to the operating permit program:

[SPECIFY COSTS IDENTIFIED IN 40 CFR § 70.9(b)]

(b) The fee schedule shall recover from the permit program facilities the department's permit administration costs and the department's development and oversight costs according to the following formula:

1. Fifty percent of the department's costs shall be divided equally among all facilities;

2. Twenty-five percent of the department's costs shall be divided among all facilities in proportion to their complexity. In determining the complexity of a facility, the department shall consider

(A) the size, number, and geographic proximity of individual sources covered by the facility's permit;

(B) the amount of hazardous air pollutants emitted by the facility;

(C) whether the facility is covered by an individual or general permit;

(D) whether the facility is an "eligible electric utility", as defined in AS 44.83.162, entitled to receive power cost equalization; and

(E) any other factors that ensure the fair distribution of the department's costs attributable to each permit.

3. Twenty-five percent of the department's costs shall be divided among all facilities in proportion to the total of all assessable emissions of all regulated pollutants, as defined by Section 502(b)(3)(B)(ii) of the federal Clean Air Act, for each facility. The "assessable emission" of each regulated pollutant is the lesser of

(A) the annual rate of emissions (in tons per year) of each regulated pollutant authorized by the facility's operating permit;

(B) the actual annual rate of emissions (in tons per year) of each regulated pollutant by the facility over the preceding calendar year, if the facility can demonstrate its actual annual rate of emissions to the department through monitoring, modelling, calculations, or any other method acceptable to the department; or

(C) 4,000 tons per year of each regulated pollutant.

(c) The department shall, by regulation, establish a process for development and review of its operating permit program fee schedule, a methodology for tracking program revenues and expenditures, and a system of annual program audits and reports.

(1) The fee schedule development and review process shall include the following:

[SPECIFY]

(2) The methodology for tracking revenues and expenditures shall include the following:

[SPECIFY]

(3) The system of periodic reports and audits shall include the following:

[SPECIFY]

ATTACHMENT #5 - COMMITTEE VOTING RECORD

ALASKA AIR STATUTES REQUIRED & ESSENTIAL FEATURES	BILL SECTION TITLE	1ST CONSIDERATION VOTE	RECONSIDERATION VOTE	NOTES
Exclusive Fund for Air Permit Program	Clean Air Protection Fund	unanimous	unanimous	
	Special Account	unanimous	unanimous	
Create Small Business Assistance Program	Development of Program	unanimous	unanimous	
Create Advisory Panel	Scope of Program	unanimous	unanimous	
Provide Assistance to Larger Group	Power to Limit Program	unanimous	unanimous	
	Compliance Advisory Panel	unanimous	unanimous	
Modify Criminal Provisions and Fines	Criminal Penalties for Air Pollution	7 to 1	0 to 1	
Construction Permits v. Operating Permits	Classification of Facilities or Sources, Reporting	unanimous	unanimous	
Agency/Operator Emmission Limits to	Permits for Construction, Modifications or Operations	unanimous	6 to 3	Subsection (e) issue of debate
Avoid Need for Permit	Reponsibilities of Owners and Operators	unanimous	8 to 1	
	Facilities Requiring Permits	unanimous	unanimous	
	Administrative Actions Regarding Permits	unanimous	unanimous	
	Emissions Control Permit Program Regulations	unanimous	unanimous	
	Air Pollution from Outer Continental Shelf Facilities	unanimous	8 to 0 w/1 abstention	
	Authority of the Department in Cases of Emergency	unanimous	unanimous	
General Permits	General Operating Permits	unanimous	8 to 1 w/1 abstention	
Flexibility for Permit Fee Structure	Payment of Fees and Fee Structures	7 to 2	unanimous	Amendment to (c)(4) adopted unani on 1st consideration, 7 to 1 w/2 abst on reconsidera
Ability to Implement New Federal Rules in Per	Incorporated into other sections			
Reopening of Permits				
Emmission Limits Based on Health Risks	Existing Statute			
or Available Technology				
Local Governments to be Implementing	Local Air Quality Control Programs	unanimous	8 to 2	subsection (f) issue for split vote
Partners	Inadequacy of Local Program	unanimous	unanimous	
	State and Federal Aid	unanimous	unanimous	
Administrative Penalties for Violations	Not Scheduled for Agenda			Not in Final Product
Deter EPA Intervention				
Public Involvement in Permits				
Public Review of Permits	Review of Permit Action	unanimous	8 to 2	
Appeal through Adjudication				
Judicial Review				
EPA Review	Objection by Federal Administration	unanimous	unanimous	
Public to Petition EPA				
Retain & Update Existing Statutes				

(h:\air\melodyb\excel\aqhwcgf)

Larger size available upon request

AIR QUALITY LEGISLATIVE WORKING COMMITTEE
TRANSMITTAL DOCUMENT ATTACHMENT #6

1. Agreements on Protocol, Agenda and Initial Language
   A. Protocol
      Meeting #1: Pages 21-39
      Meeting #2: Pages 10 and 199-201
   B. Agenda
      Meeting #1: Page 25
      Meeting #2: Pages 1-2
   C. Initial Language
      Meeting #1: Pages 39-43
      Meeting #2: Page 27 and 124-127

2. The Small Business Assistance Program
   Meeting #1: Pages 89-90 and 134
   Meeting #2: Pages 41,103 and 104
   Meeting #3: Pages 29-44, 57-61, and 124-184
   Meeting #4: Pages 14-15, and 140-145

3. Fees Paid by Permit Holders
   Meeting #2: Pages 204-239
   Meeting #3: Pages 184-221
   Meeting #4: Pages 148-207
   Meeting #5: Pages 5-145
   Meeting #6: Pages 2-197
   Meeting #7: Page 91-129
   Meeting #9: Pages 3-13

4. The Dedicated Fund & Special Account
   Meeting #1: Pages 146-147
   Meeting #3: Pages 14-71
   Meeting #4: Pages 145-148

5. The Permit Program Components
   Meeting #3: Pages 72-104 and 107-124
   Meeting #4: 2-139
   Meeting #7: Pages 8-80, and 129-136
   Meeting #8: Pages 40-52, and 71-85
   Meeting #9: Pages 14-40, and 74-77

6. Local Air Quality Programs
   - Meeting #8: Pages 106-178
   - Meeting #9: Pages 77-100

7. Criminal Penalties for Air Pollution
   - Meeting #5: Pages 145-173
   - Meeting #7: Pages 136-170
   - Meeting #8: Pages 8-40, 91-106, and 179-210
   - Meeting #9: Pages 63-74

8. Public Involvement in Permits
   - Meeting #8: Pages 52-58
   - Meeting #9: Pages 40-62 and 76-77

SB 104

STATE OF ALASKA

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

400 WILLOUGHBY AVENUE
JUNEAU, ALASKA 99801-1796
PHONE: (907) 465-2400
FACSIMILE: (907) 586-2754

July 9, 1992

David L. Highers, General Manager
Chugach Electric Assn., Inc.
5601 Minnesota Drive
P.O. Box 196300
Anchorage, Alaska 99519-6300

Dear Mr. Highers:

Thank you for your letters of May 27 and June 15, 1992 to the Governor and me expressing concern regarding the impact of the State of Alaska's (State) decision to seek additional royalties derived from federal oil and gas leases located in the Beluga River gas field. Governor Hickel asked me to prepare a detailed response to your letter. I have discussed the issue with the Governor, and have given the matter a great deal of thought.

Your letter of May 27, 1992 asked that the Department of Natural Resources (DNR) withdraw an appeal filed with the federal government seeking to recover royalties due the State. These royalties are from federal leases located in the Beluga River gas field and indirectly affect Chugach Electric Association, Inc. (Chugach). The withdrawal of this appeal would not be in the best interest of the State. Essentially, the DNR believes that the federal government has ignored its own statutes and regulations to deprive the State of over $5,198,883 in lost royalties and $5,236,002 in interest.

Under the Minerals Leasing Act and the Alaska Statehood Act, the State is entitled to ninety percent of all royalties received from federal oil and gas leases in Alaska. The federal government, however, initially determines the amount of royalties due, collects the monies, and then forwards the State's share to the State. Under the applicable statutes and regulations, royalties are to be paid on the "value of production." Although Chugach believes that the production is valued according to the contract price received by a lessee on the sale of gas, this is not the law. The contract price sets a minimum value according to the statutes and regulations. Where the contract price is not a fair value, a reasonable value will be determined by looking to the median price paid by other purchasers of gas

LH

in the same market area. In other words, just because the lessees elected to enter into long term contracts at a low price should not deprive the federal government and the State of its right to receive a fair royalty for its gas. The Beluga River lessees elected to sell their gas to Chugach for $.21 per Mcf while the median price in the area was higher. Chugach is mistaken in the assumption that $2.26 per Mcf is the highest price paid. The highest price paid during the time frame studied in the majority price analysis is over $3.57 per Mcf. In addition, month by month, most median values claimed by the State are well below the alleged $2.26 per Mcf as stated in your letter.

In 1985, the federal government considered this same issue involving other federal oil and gas leases in the Kenai field where gas was being sold at a low price pursuant to a long term contract. The federal government determined that the contract price was not a fair value for royalty purposes and required that royalty be paid on the median price. The State received substantial additional royalties as a result of that audit.

Ignoring its own precedent, statutes, and regulations, the federal government has arbitrarily determined that the contract price constitutes a reasonable value for Beluga River gas. The state appealed this determination. The DNR has supplied supporting information for its royalty valuation position and the federal government is currently reviewing the appeal.

The State's position should be no surprise to the lessees and Chugach. The State's position is the same position it took in 1985 in the Kenai gas matter. Moreover, both Chugach and the lessees were aware at the time that they entered into their contract that the "reasonable value" could be different than the contract price since their contract contains a "pass through" provision to deal with this eventuality.

It is my obligation to ensure that the State receives fair value for its mineral interests. The State believes that the federal government has not used a "fair value" upon which to base the royalty payments for these federal leases. If I were to have the State withdraw its decision to seek fair royalty valuation through the legal appeal process when it held this belief in good faith, I would be neglecting my duties.

Although I share your concern that southcentral Alaskans may have to pay higher electric rates in the short term if the State prevails, the benefits of the State's royalties belong equally to all citizens of the state. I cannot favor one group over another. The legislature and the administration share the responsibility to determine how the revenues from the State's mineral resources are allocated and

spent as part of a public process and review. Thank you for sharing your views and concerns.

I realize that this will not be a popular decision with southcentral and interior power users and that it will place an additional burden on Chugach Electric.. In the past, Chugach and the State have been able to successfully resolve their differences concerning Beluga River gas royalties. I hope that spirit of cooperation can be continued.

Sincerely,

Glenn A. Olds
Commissioner

ER J. HICKEL
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

July 16, 1992

David L. Highers, General Manager
Chugach Electric Assn., Inc.
5601 Minnesota Drive
P.O. Box 196300
Anchorage, Alaska 99519-6300

Dear Mr. Highers:

Thank you for your letter dated May 27, 1992 requesting my help and intervention on behalf of Chugach. Assuring a reliable and affordable power supply for interior and south central Alaska benefits all of us in the short term and in the long term. I have asked Commissioner Olds to prepare a detailed response to your letter and to continue to work with Chugach to better understand it's concerns and hopefully resolve our differences.

Administration of oil and gas leases and valuation of gas royalties is a complicated matter. There will always be a natural tension between the lessor and the lessee concerning the royalty value, but, if the two sides are willing, they should be able to reach an acceptable compromise. I hope that will be the case in this instance.

Sincerely,

Walter J. Hickel
Governor

CORRESPONDENCE:
GOVERNOR/DNR TO CHUGACH/DAILY NEWS

WALTER J. HICKEL, GOVERNOR

DEPT. OF NATURAL RESOURCES

P.O. BOX 107034
ANCHORAGE, ALASKA 99510-7034
PHONE: (907) 762-2538

DIVISION OF OIL AND GAS

October 8, 1992

Post-it™ brand fax transmittal memo 7671 | # of pages ▸ 2

To Dave McCaleb	From Lisa Parker
Co. Anchorage Daily News	Co. DNR
Dept.	Phone #
Fax #	Fax #

Mike Carey, Editor
Anchorage Daily News
P.O. Box 149001
Anchorage, AK. 99514

Dear Mr. Carey:

I would appreciate the opportunity to respond to a recent series of advertisements in the Anchorage Daily News pertaining to Chugach Electric's potential payment of additional royalties on gas produced from federal oil and gas leases. I think it is important to clarify the Department of Natural Resources' position regarding the collection of royalty revenues and, at the same time, eliminate any misconceptions created by the Chugach advertisements.

It is the duty of the Department of Natural Resources to collect gas royalties due all Alaskans - not just for those living in Anchorage. The benefits of the State's royalties, whether those royalties come from state leases or from the state's share of federal lease revenues, belong equally to all citizens of the State. It is for that reason that, under state law, revenues collected by the department are deposited in the Permanent Fund, the General Fund and the School Fund.

Alaska receives 90 percent of the royalties paid to the federal government by lessees of federal leases within the state. It is the department's belief that the lessees from whom Chugach purchased its gas underpaid their federal royalties during the period of 1984 to 1987. Under the applicable federal statutes and regulations, royalties are to be paid on the "value of production." Chugach, under its gas contract with the lessees, agreed to reimburse the lessees for any additional royalty the lessees owe. This fact in itself suggests that both Chugach and the lessees were aware of their potential exposure to additional royalty payments. Although Chugach believes that the gas it purchased should be valued according to the contract price it paid the lessee, this is not the law. The contract price sets a minimum value according to the statutes and regulations.

Where the contract price is not a fair value, federal law and regulation provide that a reasonable value will be determined by looking to the median price paid by other purchasers of gas in the same market area. In other words, the fact that the lessees and

Chugach elected to enter into long term contracts at a low price should not deprive the royalty owners--in this case, all Alaskans--of their right to receive a fair royalty.

Contrary to Chugach's claims, Enstar Natural Gas Company and Municipal Light and Power are not involved in this royalty dispute, and will not "be in line for an additional royalty surcharge." Nor is the department asking Chugach to pay royalties which are up to 17 times higher than the Beluga royalties reported by the lessees. The department is asking the federal government to follow its own precedents, law and regulations to ensure that the state receives its fair share of their royalties.

While Chugach would urge us to turn a blind eye to the federal government's under collection of royalties in order to benefit Chugach's customers, we simply cannot. Under state law, our obligation is to ensure the collection of all oil and gas revenues for the benefit of those in Barrow and Ketchikan, as well as in Anchorage. Any subsequent decision to subsidize one area's utility costs relative to others is the responsibility of the legislature.

Sincerely,

James E. Eason
Director
Alaska Division of Oil and Gas

GOLDEN VALLEY ELECTRIC ASSOCIATION INC. Box 71249, Fairbanks, Alaska 99707-1249, Phone 907 452-1151

February 23, 1993

Mr. Dave Highers
General Manager
Chugach Electric Association
P.O. Box 196300
Anchorage, Alaska 99519-6300

SUBJECT: Royalties for Natural Gas

Dear Dave:

At their meeting on February 22, 1993, the Board of Directors of Golden Valley adopted the following resolution:

> WHEREAS, House Bill 116 has been introduced to amend AS 38.05.180 (An Act directing the commissioner of natural resources to accept, under certain circumstances, the contract price agreed to between a lessee of federal land and a gas or electric utility as the value of the federal government's royalty share from natural gas production when royalty is payable to the state under applicable federal law; and providing for an effective date.); and
>
> WHEREAS, Golden Valley Electric Association supports this legislation;
>
> THEREFORE, BE IT RESOLVED, that the Board of Directors of Golden Valley Electric Association, Inc. encourages the Fairbanks/Interior legislators to support House Bill 116.

We will contact the Interior legislators regarding this resolution.

Best regards,

Robert Hansen

Robert Hansen
Acting General Manager

Homer Electric Association, Inc.

CORPORATE OFFICE
3977 Lake Street
Homer, Alaska 99603-7680
Phone (907) 235-8167
FAX (907) 235-3313

Central Peninsula Service Center
[illegible] Airport Way
Box 5280
[illegible] Alaska 99611-5280
Phone (907) 283-9831
FAX (907) 283-7122

February 25, 1993

Mike Miller, Chairman
Senate Resources Committee
Alaska State Senate
PO Box V
Juneau, AK 99811

Dear Chairman Miller:

RE: SB 104, STATE SHARE OF FEDERAL GAS ROYALTIES

Homer Electric Association serves over 18,000 consumers on the Kenai Peninsula. Most of the power that was previously used and the power that is currently used is supplied by gas-fired turbines.

SB 104 will stop the Department of Natural Resources' attempt to collect its gas royalties on gas previously used and would eliminate future collection attempts via repricing gas and assessments of royalties. This will guarantee that HEA consumers will not be unfairly assessed for gas royalties in the future.

On behalf of HEA, I ask that your committee favorably report SB 104.

Sincerely,

HOMER ELECTRIC ASSOCIATION, INC.

N. L. Story/lwb

N. L. Story
General Manager

NLS\SRC.ltr/lwb
cc: Senator Drue Pearce
Dave Highers, CEA
Dan Bloomer, CEA
Dave Hutchens, ARECA
HEA Board of Directors
NLS-rf H/K

— LETTER OF SUPPORT: HOMER ELECTRIC ASSOCIATION —

FISCAL NOTE

STATE OF ALASKA
1993 LEGISLATIVE SESSION

BILL NO. SB104

Revision Date: Original
Department Affected: Natural Resources
Title: "State Share of Federal Gas Royalities"
BRU: Resource Development
Components: Oil & Gas Development
Sponsor: Senator Pearce
Requestor: Senator Pearce
Component Serial No. 439

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 94	FY 95	FY 96	FY 97	FY 98	FY 99
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS,CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL						
REVENUE fund source:						

FUNDING: (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year (FY93) impact: $ See attached page

ANALYSIS: (Attach a separate page if necessary)

SEE ATTACHED PAGE

Prepared by: Jim Eason, Director
Phone: 762-2547
Division: Oil & Gas
Date: 18-Feb-93
Approved by Commissioner: Glenn A. Olds (for)
Date: 18-Feb-93
Agency: Department of Natural Resources

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE
For further distribution information call the Governor's Legislative Office

[redacted]

The retroactive application provisions of the bill make it difficult to evaluate the fiscal impact of the bill. It is not known, at this time, if any refunds, except for the one described below, will be due the federal lessees because of the proposed retroactive change in state policy. An audit of past federal/state royalty collection policies beginning in 1959, which will require a considerable amount of time and resources, would have to be completed in order to determine the full fiscal impact of this bill.

What is known today is that if the bill becomes law, the state will be barred from advocating for higher royalty values for gas production from federal leases in the Beluga River field for past production periods. The state believes that as of April 15, 1992, approximately $10.4 million is owed for the audit period between October 1, 1984 through June 30, 1987. Because interest continues to accrue on the past due principle, the amount of the claim continues to grow.

At this point in time, the amount owed is based on a claim by the state. However, the state's position in support of the area pricing theory or median value pricing theory, and the amount sought may or may not be sustained by a court with jurisdiction for this issue.

Alaska State Legislature

3111 C Street, Suite 150
Anchorage, Alaska 99503
(907) 561-2038

During Session:
P.O. Box V
Juneau, Alaska 99811
(907) 465-4993

Senator Drue Pearce
District G

Sponsor Statement for SB-104
Senate Resources Committee

Mr. Chairman, and members of the Committee, this bill, if passed, would require the Department of Natural Resources to use the same standards for valuation of natural gas on federal lands as it currently uses for gas from state lands.

If enacted it would constrain the Department of Natural Resources from abandoning the contract price as the means of determining gas royalty value on federally leased land.

Currently, the Department of Natural Resources is interpreting its obligation to adopt an average Cook Inlet area price as the gas royalty price on federal leases, and wishes to apply the standard retroactively.

This legislation is directed at changing the statute and thus relieving the Department of Natural Resources from its perceived obligation.

If not enacted, the financial impacts of royalty revaluation could impose a considerable burden on consumers. Gas lease owners would have to pay roughly $5 million in retroactive royalties and an estimated $5 million in interest. Utility and gas lease owner contracts provide for such costs to be passed on. Ultimately, utility consumers would end up carrying this burden.

The fiscal note attached to this proposed legislation is a zero fiscal note.

In 1985, the Department of Resources stated that the department was comfortable with the use of the contract price for the following reasons:

1. DNR believed that it was pennywise and pound foolish to extract a few extra royalty dollars at the price of burdening Southcentral's economy.

2. DNR concluded that accepting the utilities' contract price would yield the state full "value" for its royalty gas, and

therefore accepting that price was in the "best interest" of the state.

3. DNR argued that utilities' sales contracts presented a unique situation requiring tailored royalty treatment.

4. DNR wanted to avoid the uncertainty caused by a rejection of the utilities' contract price.

5. DNR wanted to avoid an adversarial relationship with the Railbelt's principal utility.

6. DNR opposed the assessment of royalty delinquencies involving utility contracts retroactively.

The legislation that I am proposing is designed to further clarify statute 38.05.180(aa) so that the uncertainty that arises with different interpretations of the statute can be put to rest.

Chugach Electric Association, Inc.

An Analysis of the Department of Natural Resources' Demand for Additional Beluga River Royalty Payments from Railbelt Utility Consumers

An Analysis of the Department of Natural Resources' Demand for Additional Beluga River Royalty Payments from Railbelt Utility Consumers

Prepared for Chugach Electric Assn., Inc

by

BIRCH, HORTON, BITTNER and CHEROT
Jon K. Tillinghast
Juneau, Alaska

January, 1993

I. Introduction

The Alaska Department of Natural Resources ("DNR") has asked the federal Minerals Management Service ("MMS") to retroactively assess additional royalties against natural gas production from federal leases in Cook Inlet's Beluga River Unit. [1]/ Chugach Electric Association, Inc. purchases gas from the Beluga River producers; would likely be liable for those royalties under its purchase agreements; and would necessarily pass any resultant costs on to its Railbelt consumers, probably through some form of rate surcharge. [2]/

For the period covered by DNR's demand--October, 1984 through June, 1987 (the "demand period")--the estimated amount of the potential royalty assessment, and hence the potential rate surcharge on Railbelt consumers, is $12.4 million. [3]/ An additional $9 million surcharge could result if DNR makes a similar demand for subsequent years. [4]/

This paper discusses the history of the Cook Inlet gas royalty controversy, as it applies to public utilities, as well as the impact of DNR's current demand on Railbelt consumers. The point here is that DNR's actions are irreconcilably inconsistent with longstanding state policy favoring the acceptance of the contract price as the "value" of royalty gas when that gas is purchased by a public utility at arm's-length.

That policy is engrained in AS 38.05.180(aa), a 1986 statute which generally requires DNR to accept the utilities' contract price for state royalty purposes. DNR vigorously supported that legislation. As DNR itself explained, the legislation was

---

[1]/ The state would receive 90% of those federal royalties through the revenue-sharing provision of 30 U.S.C. §191.

[2]/ Any rate surcharge would need to be approved by the Alaska Public Utilities Commission.

[3]/ This figure includes the principal amount the retroactive royalties, as well as interest through December 31, 1992.

[4]/ Estimating the potential cost of retroactive royalty demands for subsequent years is difficult because of DNR's methodology for computing those royalties (*see* Section IV, *post*).

warranted because, in the case of sales to utilities, the long-term contract price actually represented the gas' "value"; accepting the contract price was in the public interest; and a higher "value" assessment would both unduly harm Railbelt consumers and inject damaging uncertainty into utilities' fiscal planning.

In 1986, DNR advanced seven different reasons why Alaska was best served by accepting the contract price when gas was sold to public utilities, and this paper is subdivided into those same seven themes. Subsections III(A)-(G) look back to 1986, recounting DNR's words on each of these seven policies. Subsections IV(A)-(G) then apply each of those policies to DNR's current initiative.

The lesson of that exercise is obvious: public utilities, and indeed the legislature, thought they had settled the Cook Inlet royalty gas issue with the 1986 legislation. DNR, however, feels it has found a loophole in that law, allowing it to resurrect the dispute for federal Beluga gas royalties. In so doing the agency is both disavowing a position that has survived three successive administrations, and threatening to cause the same unpleasant impacts on the Alaska economy that it fought so hard, in 1986, to avoid.

All of which suggests the need for clarifying legislation to ensure that the 1986 law achieves its intended purposes. Leaving aside royalty "valuation" issues generally, the issue of valuing Cook Inlet royalty gas raises special concerns that, as DNR itself has long maintained, demand tailored treatment. This subset of Cook Inlet gas production represents a minute fraction of the state's royalty receipts; however, to Railbelt consumers, the financial impacts of royalty revaluation would impose a considerable burden on an already fragile regional economy.

II. The Nature of the Current Controversy

This is an unusual royalty dispute. Although nominally imposed on the Beluga River producers, DNR is well aware that these retroactive royalties, if assessed, will be paid by individual Alaskans. As a result, this is not so much a demand for more royalties, but rather an effort to impose a hidden tax--one levied without public or legislative involvement.

DNR's theory is that the "value" of Beluga gas is higher than the price at which royalties were originally paid, and that royalties are due on the higher amount. Chugach has purchased Beluga gas from the unit's three producers--ARCO Alaska, Inc.; Chevron U.S.A. Inc.; and Shell Oil Co.--under long-term sales contracts since 1965. During the demand period, gas was sold under those contracts at $.21/mcf, and royalties were paid on that amount. [5]/ DNR is asking MMS to retroactively value the Beluga River royalty gas that was sold to Chugach at over $2/mcf.

There is a good reason why Beluga actually sold for $.21/mcf during the demand period. The Beluga River field was discovered in 1962, but there was no available market for it. Unlike oil, natural gas can't easily be stored or transported, but requires a costly gathering and distribution system. No prospective purchaser would invest in such a system unless it is assured of a long-term supply of gas at what are then-reasonable prices. As a result, purchasers needing to construct such a system normally require long-term purchase contracts. [6]/

The need for such a contract was particularly acute at Beluga. Chugach proposed to build a generating facility at Beluga, and then transmit the electricity

---

[5]/ "Mcf" means "thousand cubic feet."

[6]/ *See* Foster v. Atlantic Refining Co., 329 F2nd 485, 488 (5th Cir. 1964) ("The practicalities of the gas industry require that gas be sold under long-term contracts because the pipelines must have a committed source of supply sufficient to justify financing, construction, and operation.")

to Anchorage. The capital investment for that facility has been about $130 million, and the contract price ($.16\mcf originally, and increased to $.21\mcf in 1973) was an integral part of the financial prospects justifying that investment.

At all times, the long-term contracts between Chugach and the producers were negotiated at arm's length. Both won considerable value. Chugach received a long-term price that justified financing of power generation facilities. The producers won an otherwise non-existent market for their gas.

Railbelt Alaskans, of course, also benefitted considerably from that contract. As Chart I shows, during the period at issue here--the mid-1980's--Chugach, despite the higher cost of providing virtually any service in Alaska, was able to supply power to Railbelt Alaskans at less than the national average.

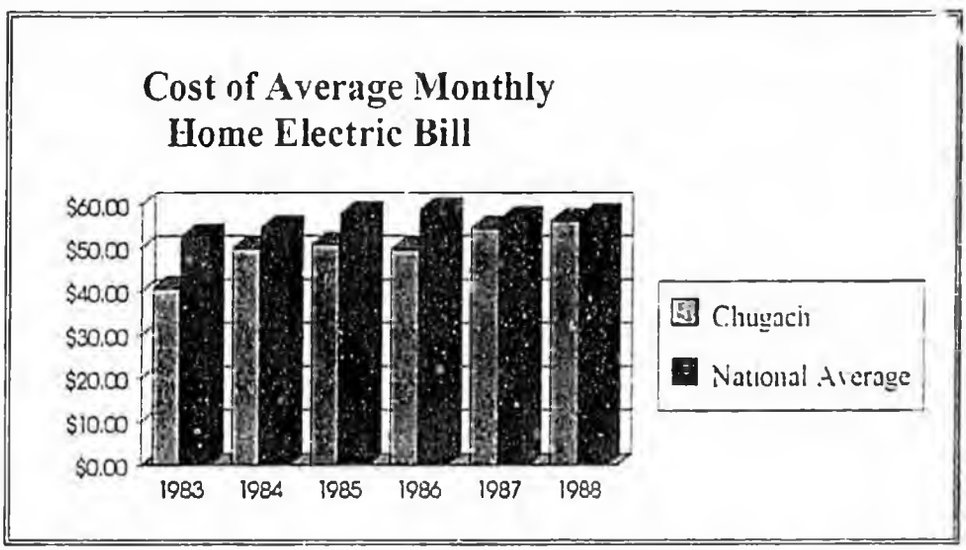

CHART 1: SOURCE: Chugach Electric retail rate history; Energy Information Administration--Typical Electric Bills

It is this contract, and the benefits that flowed from it, which DNR now wishes MMS to disregard, imposing royalties instead at about 10 times the price actually paid by Chugach to the producers.

To date, MMS has refused DNR's demand, because federal law generally fixes royalty payments at the sales contract price, particularly where--as here--the

contract was arm's length. DNR has, however, appealed MMS' position to a higher level within that agency.

III. Since 1986, DNR and the Legislature have pursued a consistent state policy of accepting the long-term sales price to public utilities as the "value" of royalty gas

As Chart 2 shows, Cook Inlet gas is sold for a variety of purposes, under a variety of very different contracts. The prices charged under those contracts are dependent on a range of factors, including: the existence (or nonexistence) of competing buyers; contract volume and term; when the contract was entered into; the purchaser (whether or not related to the seller); and the purpose and destination of the sale.

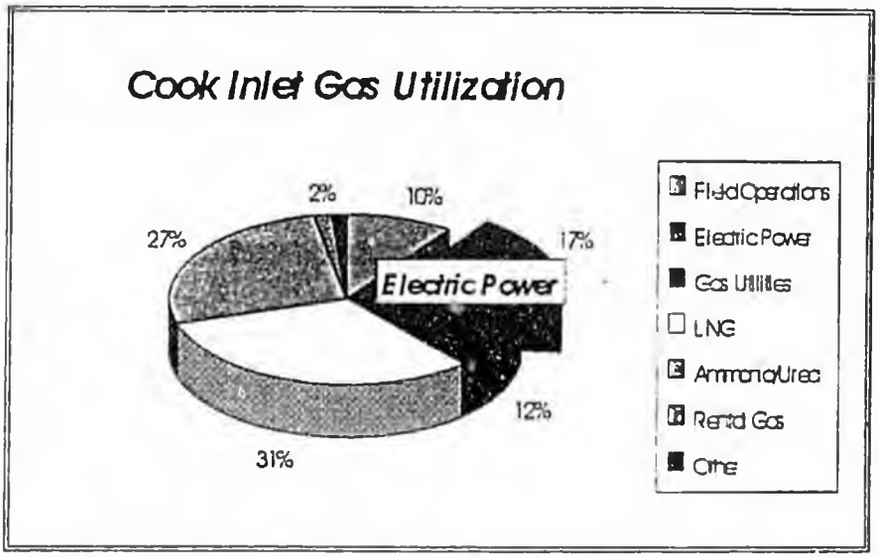

CHART 2. SOURCE: Ak. Dept. of Natural Resources, "Historical and Projected Oil and Gas Consumption," April, 1992.

The four major gas producing fields in the Inlet are North Cook Inlet, Beluga, McArthur River and Kenai. The principal historical producers and purchasers of those fields are displayed in Chart 3.

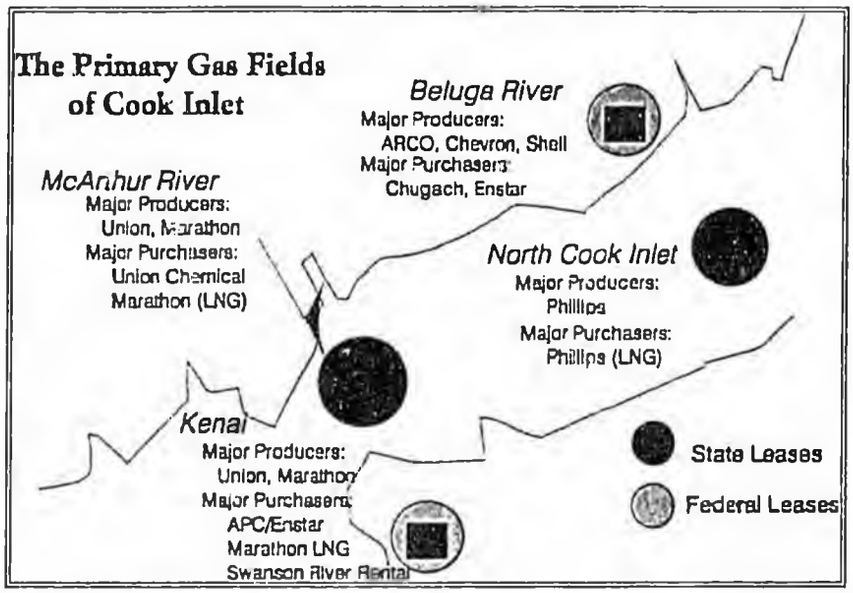

CHART 3

DNR or MMS, as the case may be, generally holds a 1/8th royalty on leases in these fields. Rather than take that royalty gas "in kind," DNR and MMS require the producers to pay them for 1/8th of total production from the field. And historically, producers have paid those royalties based upon the price that they received from buyers of that gas.

Beginning in the mid-1980's, MMS began revaluing Cook Inlet royalty payments, focusing on Union and Marathon's production from the Kenai field. And in 1984, the state entered into a valuation agreement for Phillips' LNG sales from the North Cook Inlet field.

Then, on March 18, 1985, DNR issued a "Notice to Lessee," announcing that, prospectively, it would no longer accept the long-term contract price for Cook Inlet gas production, including that from Beluga River. Attachment 1. DNR believed that it was required to assign a higher "value" to royalty production as a matter of law. "This is a lease enforcement action," DNR said, "and it is not optional." [7]/

---

[7]/ Statement by Esther C. Wunnicke, Commissioner, DNR, to Anchorage Caucus, April 2, 1985 at 4. Attachment 2.

Later in 1985, the MMS and DNR settled much of the Kenai field controversy. Royalties due on Union's Kenai dispositions to its chemical plant, and to the Swanson River field under a rental agreement, were settled with both governments in November, 1985; and royalties due on Union and Marathon's contract with Alaska Pipeline Company were settled the next month. Also in 1985, Marathon settled with DNR on royalties due from Kenai LNG sales.

The dispute over royalties due on sales of Beluga River gas to Chugach Electric Assn., however, did not settle. Royalties had been paid on that gas at the contract price of $.21/mcf; the state, conversely, asked for prospective royalties of $2.05/mcf. In response, Chugach, and the Beluga producers, filed suit in state superior court. [8]/

DNR Commissioner Wunnicke conceded at the time that DNR's new position "is not a popular decision." Attachment 2 at 1. Although technically imposed on the Beluga producers, DNR's proposed new royalties would actually fall on Chugach because of a "pass through" clause in Chugach's purchase contracts. *See, e.g.*, Attachment 3. And those costs in turn would be passed to Chugach's consumers. At the time, Chugach estimated a $3 million/year rate increase from DNR's proposal. [9]/

The legislature's response to the agency was SB 309, introduced by Senators Vic Fischer, Kelly and Faiks. As originally drafted, the bill would require acceptance of the contract price for ***all*** long-term gas sales--not just those to utilities. Attachment 5. For that reason, DNR opposed it. [10]/

---

[8]/ ARCO Alaska, Inc, *et al.* v. State of Alaska, 3AN-85-6218, 7617, 7633 (Consolidated) Civ., Ak. Superior Ct., Third Judicial Dst.

[9]/ Presentation of Chugach Electric Assn. to Senate Resources Committee, 1986 at 1. Attachment 4.

[10]/ Letter, Commissioner Wunnicke to Drue Pearce, April 28, 1986 (Attachment 6). The letter explains why DNR opposed original SB 309, but supported subsequent committee substitutes. The principal reason, according to Wunnicke, was that while it was "appropriate to accept a

The Senate Resources Committee, however, confined the legislation to royalties on gas sold to regulated utilities, and DNR enthusiastically embraced the bill. DNR had always wanted, according Wunnicke, to accept the contract price when utilities were involved; the problem, she said, was that it was "constrained even in that kind of settlement talk by the legislative directive that they obtain fair market value." [11]/

Throughout legislative deliberations on SB 309, DNR continually stressed seven themes:

A. DNR believed that it was pennywise and pound foolish to extract a few extra royalty dollars at the price of burdening Southcentral's economy. Accepting the contract price as the royalty value for public utilities was good policy, DNR said, "because Alaska consumers would be the direct beneficiaries of any royalties lost to the state as a result of using solely the contract price to establish royalty value." [12]/ The Attorney General agreed:

> SB 309 is intended to directly benefit Alaska consumers by providing additional price certainty for gas sold to consumers and for gas sold to generate electricity for consumers. The Alaska consumers would also be the beneficiaries of any royalties foregone by the state, because the lower royalties would result in lower electric and gas bills.

Letter, Atty. General Brown to Gov. Sheffield, May 28, 1986 at 2 (Attachment 8); *see also* Minutes, Senate Rules Committee, Feb. 27, 1986 at No. 155 (Attachment 9) ("Kay Brown says that the Department of Natural Resources policy has been to benefit consumers."); Minutes, House Finance Committee, May 10, 1986 at 051086 (Attachment 10) ("Ms. Brown said with the House Finance proposed

---

contract price as the royalty value for arms-length sales to regulated utilities," the original bill did "not distinguish between consumer and industrial uses."

[11]/ Minutes, Senate Resources Committee, 2/10/86 at No. 353. Attachment 7.

[12]/ Attachment 6 at 1-2.

Committee Substitute, the state was giving up some contract rights in order to benefit consumers directly. She said the department feels that is proper because any of the royalties that are lost would go directly to benefit citizens in Alaska."); Letter, Wunnicke to Rep. John Sund, May 18, 1986 (Attachment 11) ("The department believes it is appropriate to accept a contract price as the royalty value for arms-length sales to regulated utilities...because Alaska consumers would be the direct beneficiary...").

As Commissioner Wunnicke summarized in a letter to Rep. Richard Shultz:

> The Department ***strongly supports*** the bill as it has come to the Committee. [The benefits of accepting the utilities' contract price] will affect up to 270,000 gas and electric customers in Alaska and in future years if gas production occurs elsewhere in the state, we can expect even broader benefits from use of the state's royalty gas.

April 22, 1986 (Attachment 12) at 1; emphasis added.

B. DNR concluded that accepting the utilities' contract price would yield the state full "value" for its royalty gas, and therefore accepting that price was in the "best interest" of the state. As we have seen, DNR explained its 1985 Notice to Lessee by arguing that it was legally compelled to seek full "value" for its royalty gas. However, in legislative debates on SB 309, the agency conceded that accepting the utilities' contract price would yield the state full "value," since any lost royalties would flow directly to Alaska consumers:

> Commissioner Wunnicke stated that since the beneficiaries of the legislation are in-state, nonprofit, or government owned utilities or cooperatives, the state would not lose its fair value for its resources.

Minutes, Senate Resources Committee, Feb. 19, 1986 at No. 180 (Attachment 13); *see also* Attachment 10 at 051086. For this reason, in the final legislation the legislature made the finding that:

> ...the best interest of the state will be served if the commissioner of natural resources is authorized to establish the in-value royalty for gas sold to a gas or electric utility by using the contract price between the lessee of the state and the utility, whether or not the gas lease establishes a different standard for the valuation...

Sec. 1, Ch. 55, SLA 1986. In its March 3, 1986 analysis of the legislation, DNR concurred with that finding. Attachment 14. And the Attorney General, in his review of the legislation, concluded that the legislation offended no constitutional mandate to receive "full fair market value" for the royalty gas. Attachment 8 at 2.

C. DNR argued that utilities' sales contracts presented a unique situation requiring tailored royalty treatment. Over the years, DNR has devoted considerable effort, and achieved considerable success, revaluing other royalties based upon the "value" concept. And DNR fought hard during the 1986 legislative session to retain the authority to pursue that general state policy--indeed, and as we have seen, DNR opposed original SB 309 because it would have required acceptance of the contract price for a broader range of royalty controversies.

The agency, however, strongly believed that an exception should be made for utilities' contracts, and that sound public policy warranted that distinction. In explaining her department's opposition to original SB 309, and its support for later substitutes, Commissioner Wunnicke explained:

> The [original] bill does not distinguish between consumer and industrial uses...The effect of the bill would be to require use of a contract price in virtually all cases.

> The department believes it is appropriate to accept a contract price as the royalty value for arms-length sales to regulated utilities...because Alaska consumers would be the direct beneficiaries of any royalties lost to the state...The department is not persuaded that industrial gas uses should receive the same exemption, since the likely effect would be to increase the profits of industrial concerns without a corresponding public benefit.

Attachment 6 at 1-2; *see also* Attachment 10 at 051086 (DNR "did not believe it was a good idea to forego the contract rights, or forego the intent [sic] of future income, for other types of sales."); Attachment 12 at 1.

The limited application of the bill, DNR stressed, did not make this "special interest" legislation:

> The Bill is not a "special interest" rewrite of the state's royalty valuation policy. The benefits that would accrue under the Bill would benefit more than three-quarters of the state's citizens.

Letter, Wunnicke to Sen. Sackett, March 3, 1986 at 4 (Attachment 22).

Apart from the logical distinction between royalty settlements that would benefit Alaskans dollar-for-dollar, and settlements that would not, the limitations of SB 309 minimized its fiscal impact. Indeed, DNR gave the legislation a "zero" fiscal note. *Id.*

D. DNR wanted to avoid the uncertainty caused by a rejection of the utilities' contract price. Even in its internal deliberative process leading to the 1985 Notice to Lessee, DNR acknowledged that, by refusing to accept the contract price for utilities' sales, the agency was injecting damaging uncertainty into utility planning:

> The fluctuation of royalty value independently of the contract price under which gas is sold injects uncertainty into the long-term planning by oil companies and utilities. This uncertainty (and higher

> royalty rates) may reduce incentives to invest capital in oil and gas and utility enterprises, or affect the timing or structuring of such enterprises.

Kay Brown to Wunnicke memo, Nov. 6, 1984 at 3. Attachment 15.

In its testimony on SB 309, Chugach stressed the uncertainty created by DNR's 1985 Notice to Lessee, which announced for the first time that the state would no longer base royalties on the contract price:

> Our commitment to build generation facilities at the Beluga gas field back in 1965 was able to occur only because we had signed long-term contracts ensuring the stability of the price for that Beluga River gas. In fact, had we been unsuccessful in obtaining long-term contracts ensuring stable fuel prices, we would have been unable to make that plant investment.

Testimony of Dr. Joyce N. Murphy, Senate Resources Committee, Feb. 10, 1986 at 4 (Attachment 16). As a result, Chugach stressed the need for a full and final legislative settlement of "the underlying royalty policy question." *Id.* at 6. ***"A lasting solution"*** is what Chugach sought. *Id.*; emphasis added.

DNR agreed. In fact, Commissioner Wunnicke warned the Senate Resources Committee that "***there is some urgency*** in passage of this bill as the utilities are already in negotiations for future long-term contracts." Attachment 13 at No. 103; emphasis added.

Thus, DNR frequently cited the price "certainty" resulting from accepting the contract price--both to utilities and their customers--as a principal reason for its support of the bill. Attachment 14 at 1 (SB 309 "will allow the state to provide certainty in royalty gas valuation for Alaska consumer uses..."); Attachment 11 at 1 ("Alaska consumers would be the direct beneficiaries of the certainty of price..."); Attachment 8 at 2 ("SB 309 is intended to directly benefit Alaska consumers by providing additional price certainty...").

And, the legislature itself thought the bill would provide that certainty. According to the Senate floor statement, SB 309 would "provid[e] long term price stability for southcentral and railbelt electric consumers." Attachment 20 at 1.

E. DNR wanted to avoid an adversarial relationship with the Railbelt's principal utility. As discussed earlier, Chugach sued the state in response to the 1985 Notice to Lessee. Chugach and DNR settled that dispute "in principle" at a royalty price of $.75/mcf--a number closer to the long-term contract price than the $2.05/mcf sought by DNR through its "value" methodology. Attachment 17. [13]/ However, that settlement was contingent on passage of SB 309. *Id.* The bill was needed to effectuate that settlement, DNR said (*id.*); and, as the Attorney General advised, the legislation "will eliminate the expenses and uncertainty of that litigation for the state, Chugach Electric Association, Inc., and consumers." Attachment 8 at 2.

F. DNR believed that AS 38.05.180(aa) created a legislative definition of value for royalty gas sold to utilities, even if the particular controversy was not within the scope of the statute. The significance of this position will become apparent when we explore DNR's recent about-face in the next section of this paper.

As finally enacted by SB 309, AS 38.05.180(aa) required acceptance of the utilities' contract price only when the purchase contract was "entered into on or after the effective date of this Act." Sec. 5, Ch. 55, SLA 1986. But the Chugach purchase contract which was the subject of the settlement described in (E), *ante*, pre-dated the statute. By a strict reading of its terms, then, SB 309 would not "authorize" the Chugach settlement.

---

[13]/ *See also* Attachment 13 at No. 103; Minutes, House Rules Committee, May 11, 1986 at No. 128 (Attachment 18).

But DNR, as we know, said it would--and for good reason. Whether or not the particular controversy was within the scope of the new statute, said DNR, new AS 38.05.180(aa) provided a legislative definition of "value" for ***all*** gas royalty controversies involving long-term sales contracts to utilities. In response to a question from Senators Fahrenkamp and Sturgulewski as to how a prospective bill could help settle a dispute over a pre-existing contract, Commissioner Wunnicke explained:

> The commissioner stated that the agreement they have made [with Chugach] is in settlement of litigation and should not be seen as a difference in policy. She said it is DNR's responsibility to get fair market value. Efforts to reach agreement in the litigation have been constrained by this responsibility. ***If the legislation under discussion passes, she will interpret that as direction that a long-term contract entered into with a nonprofit electrical cooperative or municipal utility will be guidance for determining market value.***

Attachment 13 at No. 068; emphasis added.

G. DNR opposed the assessment of royalty delinquencies involving utility contracts retroactively. If DNR revalued royalties paid in previous years on the basis of a long-term utility contract, a troubling unfairness would result. The customers who consumed that royalty gas would have paid for the gas at the lower rate. But any rate surcharge imposed to compensate for a royalty revaluation would be paid for by today's consumers. Simply put, today's customers would be required to pay for other people's prior use of electricity.

DNR recognized that unfairness as early as its March 18, 1985 Notice to Lessees--the one announcing the agency's short-lived policy of disregarding the contract price. The effective date of that Notice was April 1, 1985, the agency explaining:

> ...[T]he state has elected to enforce this policy prospectively only in order to reduce conflicts and to avoid certain difficulties associated with retroactive adjustments of these royalties.

Attachment 1 at 1. DNR then postponed the effective date yet another two weeks, and explained why to the Anchorage Caucus:

> I decided not to seek retroactive royalty payments based on current market values. For both the retroactive and prospective periods, the gas sales contracts between the producers and the utilities provide that royalty adjustments will be passed through to Enstar and Chugach Electric. Prospective collection can be implemented in an orderly fashion. However, retroactive collection would create significant legal and financial risks for the state's utility companies, including Chugach--a consumer cooperative. In particular, it is uncertain how, and to what extent, retroactive royalty collections could be passed through to consumers.

Attachment 2 at 3.

H. Post-enactment events seemingly put the Cook Inlet gas issue to rest. With the enactment of SB 309, and subsequent Cook Inlet settlements, it seemed as though the disruption caused by DNR's 1985 Notice to Lessee had finally been laid to rest. On September 26, 1986, Chugach and the producers settled with DNR on the value of royalties from state leases at Beluga River. In 1989, Chugach and the Beluga producers entered into a new long-term contract, and on December 4, 1989, DNR Commissioner Gorsuch agreed to use that contract's price to determine royalty values. Attachment 19.

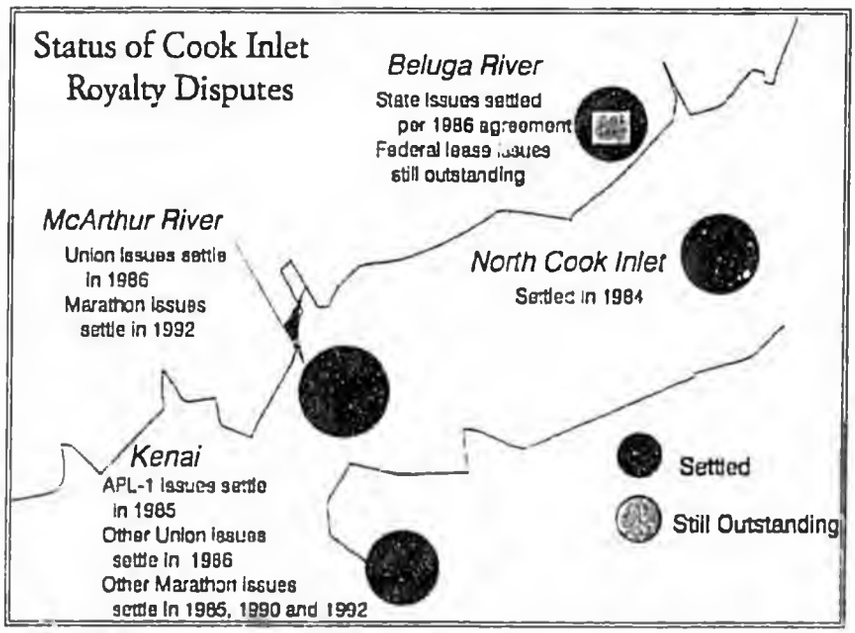

CHART 4

This, combined with settlements involving the other major Cook Inlet gas fields, laid the entire region's royalty disputes at rest, save for a routine federal audit of the royalties paid on MMS leases in the Beluga River Unit. *See* Chart 4. It is through this last vestige of a once-divisive controversy that DNR has now chosen to disown long-standing state policy on Cook Inlet gas sales to utilities, and pick a fight.

It is to that recent action that this paper now turns.

IV. DNR's current initiative against Chugach is contrary to every principal adopted by the agency in 1986.

From October, 1984 through June, 1987, the Beluga River producers (and hence Chugach and Railbelt consumers) paid royalties to the federal government on two federal Beluga River Unit leases according to the long-term contract price established in the Chugach contract--$.21/mcf. This was the same amount paid to the state--with its acquiescence--until the April 15, 1985 effective date of the Notice to Lessee. [14]/

This was also the amount called for by federal law. DNR concluded long ago that "[t]he federal lease forms are different from the state forms, and different standards and procedures apply." [15]/ Whatever state leases might require (absent AS 38.05.180(aa)), federal law generally accepted arm's-length long-term contract prices during the 1984-86 demand period. [16]/

---

[14]/ After that date, and pursuant to the Chugach/DNR settlement of state lease royalties, DNR received $.75/mcf for Beluga River state leases.

[15]/ DNR, "Questions and Answers on Cook Inlet Royalty Gas," April 11, 1985 at 7. Attachment 21.

[16]/ A 1977 U.S. Geological Survey Notice to Lessee, NTL-5, generally required the federal government to accept the intrastate Chugach contract price, as long as it exceeded $.18/mcf. 42 *Fed. Reg.* 22610. While NTL-5 also contained a provision for increasing the royalty above the contract price when market conditions demanded, that Notice was modified by the federal "NTL-5 Act of 1987" for any production between 1982 and July 31, 1986. P.L. 100-234. Under that Act, MMS could, and in most cases should, accept as royalty value contract prices which were dictated by the market and which would be lower than the highest price paid for a major portion of production." *Cong. Rec.* S18631, *daily ed.*, Dec. 21, 1987.

For production subsequent to July 31, 1986, MMS issued new regulations. In explaining those regulations, MMS stressed that, even for prior production, "it was the Department's intent to recognize contract price as the value for [intrastate sales under pre-1977 contracts]...MMS believes that it would be inequitable to rescind these provisions and possibly subject such sales to significantly increased royalty values." 51 *Fed. Reg.* 26760 (July 25, 1986). MMS' current regulations, effective March 1, 1988, straightforwardly provide that royalties shall be based on "the gross proceeds accruing to the lessee," as long as the contract proceeds were negotiated at arm's-length. 30 C.F.R. §206.152(b)(1)(i). *See* Mandell-Rice, *Federal Gas and Gas Products Valuation Regulations*, Paper No. 5, Royalty Valuation and Management, Rocky Mountain Mineral Law Foundation (1988).

In 1989, MMS began a routine audit of the producers' royalty payments. In late 1989, DNR informed MMS that it wished to participate in that audit, and in 1991 wrote MMS a lengthy letter demanding that the federal agency disregard the Chugach contract price, and retroactively assess over $10 million in additional royalties on the basis of a higher royalty "value." MMS rejected the state's demand, and the state, on March 11, 1992, appealed to a higher level within the agency. [17]/

DNR's Royalty Theory, and Its Overreaching Use of that Theory

DNR would recompute Beluga River royalties based on the so-called "median value analysis." Under this analysis, MMS would find "the highest price ***paid*** *for a majority of like quality gas produced in the* ***field or area.***" 42 Fed. Reg. 22611, May 4, 1977; *emphasis added. In other words, MMS would find that price at which, or below which, more than half of the gas in the "field or area" was sold. That would become the royalty "value."*

In its arguments to MMS, DNR would use all of Cook Inlet as the "field or area" from which to find this "value." Far more troubling are the "prices" that DNR would use. DNR would not use the prices actually "paid" at the time for other gas. Rather, it would use the settlement value for this other gas achieved through after-the-fact litigation. In other words, DNR, having forced other producers into settlements favorable to the agency, would then bootstrap those settlements by using them as the measure of Beluga River royalties.

DNR's appeals are currently awaiting a preliminary determination by MMS as to whether the state may appeal an audit determination. MMS' regulations make no provision for third party appeals--the audit being a matter between MMS and the lessee. 30 C.F.R. §290.2. The initial question, then, is whether DNR is being officious.

The most troubling aspect of DNR's attempted appeals, however, is that they offend clear legislative direction given the agency in 1986--direction that DNR has

---

[17]/ The March 11, 1992 Notice of Appeal was with reference to ARCO's royalty liability. Another appeal was filed with reference to Chevron's liability on July 2, 1992.

not only acknowledged, but heretofore supported. Let's examine DNR's current initiative against the seven policies that it and the legislature mutually endorsed in SB 309:

A. DNR's initiative would materially burden Railbelt consumers. DNR's demand of MMS--to ***retroactively*** increase three years' royalty ten-fold--would fall even harder on Railbelt consumers than its 1985 Notice to Lessees, which applied only prospectively.

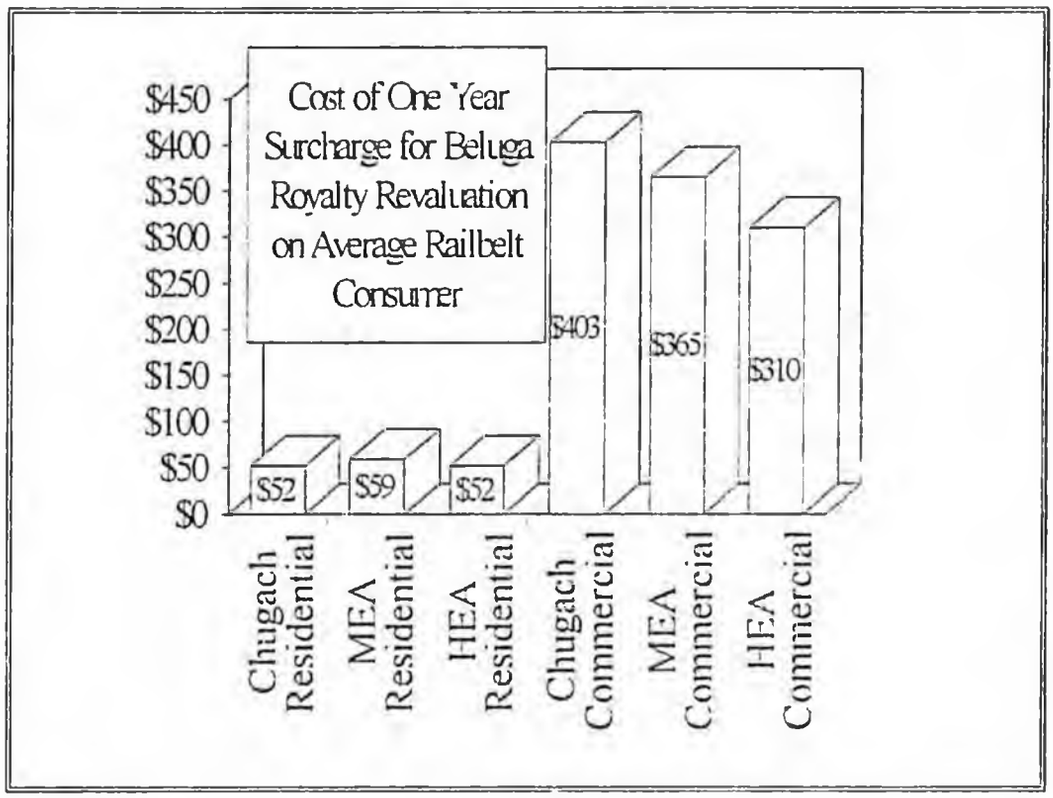

CHART 5

While it is difficult to predict precisely how the APUC would structure the surcharge necessary to allow Chugach to recover DNR's additional royalties, Chart 5 illustrates the impact on Railbelt consumers from a one-year surcharge on electric rates. Moreover, these are just averages. Chugach estimates that some of its largest commercial consumers, such as Carrs, Liquid Air, and the state and federal governments, would pay a surcharge of ***over $40,000*** each.

Moreover, Chugach customers won't bear the burden alone. Chugach sells power wholesale to other electric utilities, and, as Chart 6 shows, those other

utilities will bear a material part of the $12.4 million surcharge occasioned by DNR's demand:

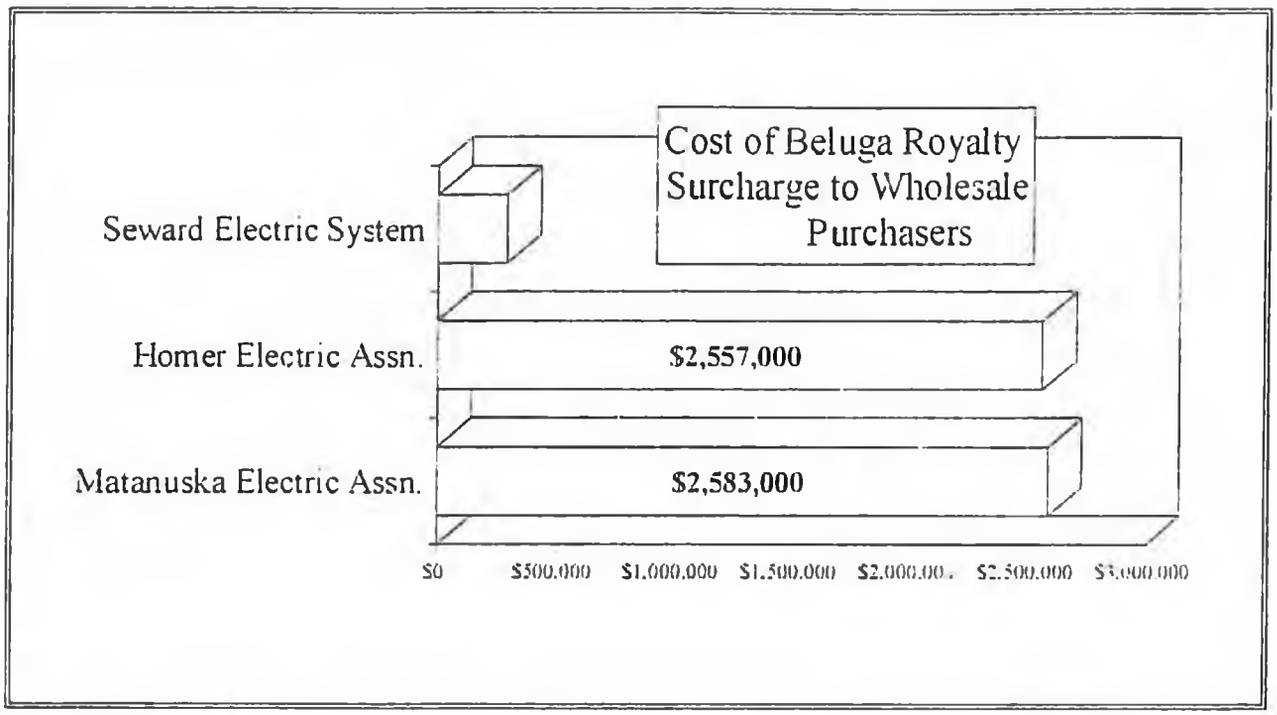

CHART 6

B. DNR has forgotten its findings that accepting the contract price in the case of sales to public utilities yields the state "full value" for its royalty gas, and therefore it is in the "best interest" of the state to accept that price. DNR has defended its demands upon MMS on the theory that it is legally obliged to seek full value for state resources--the same rationale that the agency once used to apologize for its 1985 Notice to Lessee. The agency, however, hasn't explained where that obligation comes from--after all, these are federal lands, and there is no statutory or constitutional provision forcing DNR to tell the federal government how to manage its property.

But jurisdictional issues aside, DNR has forgotten its words in 1986--that, because any "reduced" royalty occasioned by accepting the utilities' contract price for royalty purposes will be passed on directly to Alaska consumers, the state is

therefore receiving full "value" by accepting that contract price. For that reason, the legislature has already found that it is in the "best interest of the state" to accept the utility contract price [18]/--a finding in which, as we have seen, DNR enthusiastically concurred.

C. DNR forgets that gas sales to utilities require tailored treatment. Over the past years, DNR has been remarkably successful in winning retroactive oil royalty payments on the "value" theory. That policy existed back in 1986, and DNR recognized then that, as sound a policy as the "value" concept might generally be, it shouldn't apply to royalty gas sold to public utilities, which in turn is used to directly benefit Alaska consumers.

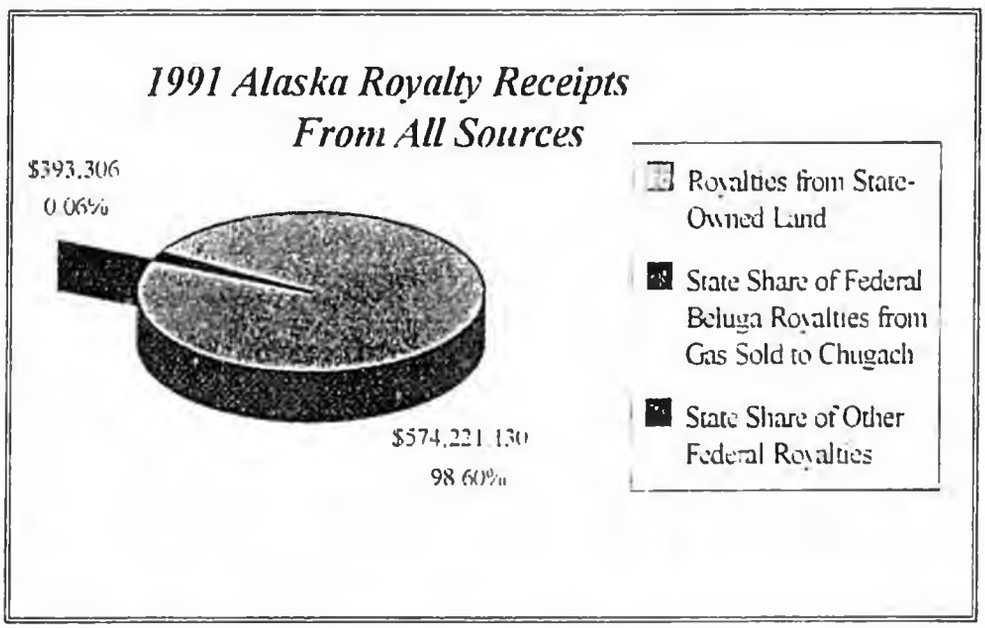

CHART 7 [19]/

Recall that DNR supported SB 309 in part because, by tailoring a policy to royalty gas sales to utilities, the fiscal impacts of that policy would be inconsequential. As Chart 7 shows, the state's take from federal Beluga River royalties on gas sold to Chugach is only a tiny slice of the state's royalty income. Requiring DNR to abide by existing legislative royalty gas

---

[18]/ Sec. 1, Ch. 55, SLA 1986.

[19]/ SOURCE: State and Other Federal royalties: Ak. Dept. of Natural Resources, Royalty Management. Beluga Royalties: Beluga producers. The figures for the state's 90% share of federal royalties are based on MMS reports of producers' unaudited payments for 1991. The figures also include any interest and penalties; therefore, they are only an approximation of the state's actual 90% share for that year.

policy will have no impact outside that slice, because that policy is confined to ***gas*** sales to ***utilities***, and because all other consequential royalty gas controversies have already been settled. *See* Chart 4, *ante*.

But while the Beluga gas controversy is of little consequence to the state treasury, it is of considerable importance to both Chugach and Railbelt energy consumers. As Chart 8 shows, over three quarters of Chugach's power is generated from Beluga River gas. And, as Chart 9 shows, nearly half of the Railbelt's electric power comes from Chugach's generation of electricity from the Beluga River field.

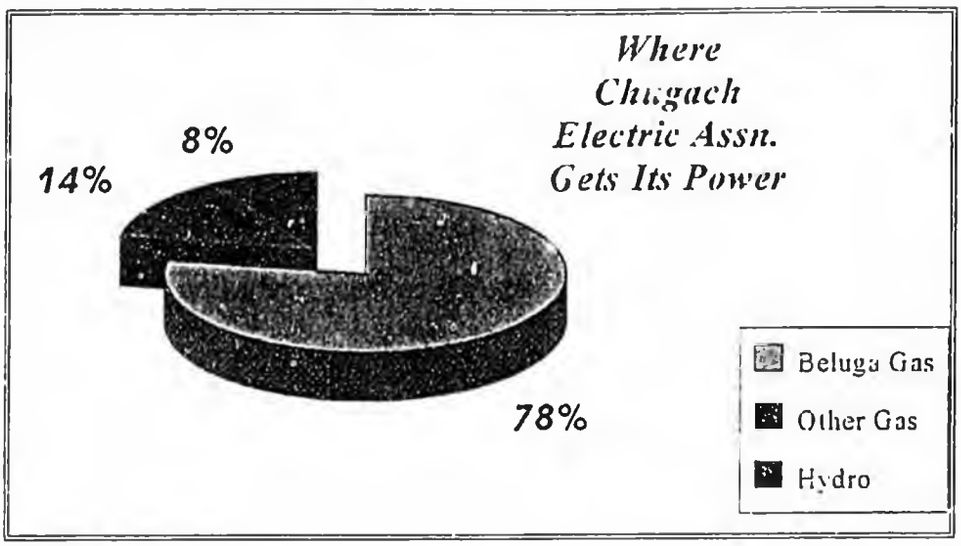

CHART 8

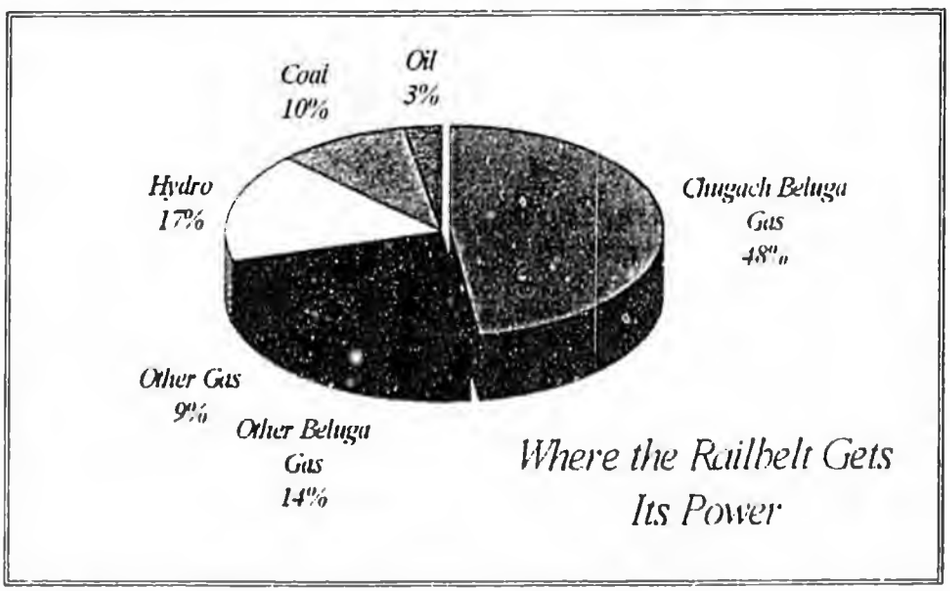

CHART 9

Little wonder

that DNR, and the legislature, have heretofore found the public interest in reasonably priced Beluga River power generation to outweigh any arguable impact on the state treasury. [20]/

D. DNR's actions are causing severe budgetary uncertainty to public utilities. DNR's $12.4 million claim is a considerable contingent liability for Chugach--one impairing both its budgetary planning and financial soundness. And should DNR eventually succeed, Chugach would then face continued uncertainty over how the APUC will structure any resultant rate surcharge.

But the problem is worse than that. Not only must Chugach face perhaps years of litigation over DNR's federal demands--litigation with an uncertain outcome--but it must also fear similar demands from DNR for ***subsequent*** years. Remember that DNR's current appeals cover only 1984-87. Chugach estimates that, if the same "value" demands are made for 1987-92, Chugach (and hence its customers) could owe ***an additional $9 million***. While federal law for those subsequent years even more clearly favors acceptance of arms-length contract prices (*see* n. 16, *ante*), DNR refuses to assure the company that its demands will stop with 1987.

E. DNR is needlessly provoking litigation with Chugach. Given that:

(1) DNR is under no legal obligation to attempt to shape federal law;

(2) federal law generally favors acceptance of the contract price, and DNR is asking that an exception be made to that policy; and

(3) third parties aren't normally allowed to participate in MMS audit proceedings.

---

[20]/ The only adverse fiscal impact of adhering to existing state policy with respect to federal Beluga River royalties is the loss of the state's speculative claim to a higher "value" from that production. But as we have seen, DNR's position, under federal law, is doubtful.

it seems that DNR is going out of its way to provoke a costly lawsuit.

F. DNR's view that the 1986 legislation does not prevent it from rejecting the contract price for federal royalties–ignores Commissioner Wunnicke's promise to the legislature that the new statute would govern all gas royalty disputes. DNR explains its recent conduct by pointing out that the 1986 legislation--AS 38.05.180(j)--applies only to state leases, and thus it remains compelled to seek out a higher "value" for federal leases. But recall what Commissioner Wunnicke told the legislature: if the bill passed, DNR would use the legislation as a legislative definition of "value" when royalty gas was sold to utilities at arm's length, ***even if the controversy was outside the scope of the statute itself.*** Section III(F), *ante*. That is why DNR believed that the 1986 legislation would authorize the agency to settle with Chugach on its then-existing long-term contract, even though that contract was outside the statute's reach. *Id.*

In sum, DNR has heretofore maintained ***both*** that: (1) it believes that, when savings through a long-term contract are passed on to Alaska utility consumers, any resultant "lower" price still yields the state full "value" (section III(B), *ante*); and (2) the legislature has defined "value" to equal the long-term contract price, whether or not the contract or lease at issue is within the scope of AS 38.05.180(aa).

G. DNR has forgotten its policy against retroactive assessments. Even in 1985, when DNR felt itself legally constrained to seek a higher "value" for all royalty gas, it refused to seek those assessments retroactively because of the hardship that it would cause to utilities. Here, DNR's retroactive demands are far more burdensome, since utilities, after 1986, have planned their affairs on the reasonable assumption that the royalty gas issue had settled, and that contract prices would henceforth be used for royalty valuation.

DNR, after all, had both settled the 1986 Chugach litigation on that basis, and had, in 1989, accepted Chugach's new long-term contract price for future state royalties. DNR's recent initiative was utterly unpredictable, and at irreconcilable odds with a policy firmly implanted in both legislative and administrative precedent.

V. The Need for Legislation

The statutory policy engrained in AS 38.05.180(aa) is a sound one. And as DNR itself has stressed, it is a policy that applies beyond the technical reach of the statute itself. The statute, as we have seen, was supposed to provide a "lasting solution" to the "underlying royalty policy question." Attachment 16 at 4, 6. The legislature itself stressed that the legislation would "provid[e] long term price stability for southcentral and railbelt electric consumers." Attachment 20 at 1.

As a result, additional legislation shouldn't be necessary to achieve that goal. DNR's protest--that it is involuntarily compelled to tell the federal government to make Beluga River a special case, and impose a higher royalty--is feigned.

But feigned or not, it is a reality nonetheless--both for Chugach and every Railbelt consumer. As a result, a technical amendment to AS 38.05.180(aa) is necessary--not to change the statute's meaning, but to remind the agency of its purpose, as once defined by DNR itself.

Attached to this paper are two appendices: (1) proposed legislation; and (2) a technical explanation of that legislation. By making minor changes to the statute, the legislature can assure itself that the 1986 law cannot be undermined either directly or indirectly, and the controversy that the legislature thought settled in 1986 can finally, seven years later, be laid to rest.

Introduced:
Referred:

IN THE _____ **BY:** _____

IN THE LEGISLATURE OF THE STATE OF ALASKA

EIGHTEENTH LEGISLATURE -- FIRST SESSION

A BILL

For an Act entitled: "An Act relating to the authority of the Commissioner of Natural Resources to accept the contract price between a federal lessee and a gas or electric utility as the value of the federal government's royalty share for natural gas production; and providing an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

*Section 1. AS 38.05.180(aa) is amended to read:

(aa) Within 90 days after the written request of a lessee of a lease issued under this section, or a lessee of federal land under applicable federal law, the commissioner shall enter into an agreement with the lessee to use or accept the price for the gas established in the contract between the lessee and a gas or electric utility as the value of the state's royalty share of gas production sold by the lessee under the contract unless the commissioner makes a written finding, based on clear and convincing evidence, that

(1) the contract price is unreasonably low;

ATTORNEYS AT LAW
ONE SEALASKA PLAZA, SUITE 301
JUNEAU, ALASKA 99801
(907) 586-2890

(2) the [PROSPECTIVE] reduction in royalty receipts would not be balanced by increased benefits to in-state gas and electric consumers;

(3) the lessee and the utility are related in management, ownership, or other aspect; and

(4) the contract price is not in the best interest of the state.

*Sec 2. AS 38.05.180(bb)(3) is amended to read:

(3) "state's royalty share of gas production" <u>includes payments on federal leases under 30 U.S.C. 191, but</u> does not include the state's royalty share of gas production from land patented to the state under

(A) P.L. 84-830, 70 Stat. 709 (Alaska Mental Health Enabling Act);

(B) 38 Stat. 1214 (Act of March 4, 1915); or

(C) 43 U.S.C. 1635 in settlement of the claims of the state under 38 Stat. 1214.

*Sec 3. Section 5, Chapter 55, SLA 1986 is amended to read:

*Sec. 5. [AS 38.05.180(AA), ENACTED BY] <u>S</u>ec. 2 of this Act [,] applies to agreements to establish for a lease issued under AS 38.05.180 the in-value royalties on gas production that is sold under a contract entered into on or after the effective date of this Act between the state's lessee and a gas or electric utility.

*Sec. 4. This Act applies to any lessee of oil and gas rights under applicable federal law irrespective of whether the federal lease, or the federal lessee's natural gas sales contract with a gas or electric utility, occured before, on or after the effective date of this Act.

[illegible]
[illegible]
ONE SEALASKA PLAZA, SUITE 301
JUNEAU, ALASKA 99801
(907) 586-2890

*Sec. 5. This Act takes effect immediately in accordance with AS 01.10.070(c).

BIRCH, HORTON, BITTNER AND CHEROT
ATTORNEYS AT LAW
ONE SEALASKA PLAZA, SUITE 101
JUNEAU, ALASKA 99801
(907) 586-2690

Section-by-Section Analysis of _B ____

Section 1. In 1986, the legislature directed the Department of Natural Resources ("DNR") to use, except in certain circumstances, the contract price of natural gas sold by a lessee to a gas or electric utility as the value of the state's royalty share of production from that lessee. AS 38.05.180(aa). Cook Inlet lessees sell natural gas to these utilities, and have historically paid royalties based upon that contract price. In March, 1985, DNR demanded that its lessees begin paying additional gas royalties, on the theory that the contract price did not represent the gas' "value." Had DNR prevailed, the liability for those additional royalties would have fallen on the utilities. That's because the utilities, as part of their contracts with the lessees, agreed to pay any additional royalty assessment made by the state.

Ultimately, of course, that would have meant that any additional royalties would be paid by the utility's customers.

The possibility of additional royalty demands therefore created considerable uncertainty and threatened to impose substantial burdens on consumers. These burdens, the legislature believed, outweighed any revenues the state might recieve from a higher valuation of these royalties. Even DNR, which supported the 1986 legislation, concluded that "it is appropriate to accept a contract price as the royalty value for arms-length sales to regulated utilities...because Alaska consumers would be the direct beneficiaries of the certainty of the price provided by such a contract...," but felt that legislation was necessary to permit it to use the utility contract price.

The 1986 law was intended to remove these uncertainties and potential burdens by establishing (except in limited circumstances) the utility contract price as the "value" of the state's royalty share. The law, however, applied only to ***state*** leases. The state also receives 90% of natural gas royalties paid under ***federal*** leases, and the 1986 law neglected to resolve the problem with respect to the state's share of federal royalties. As a result, DNR currently feels obligated to encourage the federal government to reject the utility contract price as the "value" of royalty gas, even though the agency is compelled (absent special circumstances) to accept that price for state lease purposes.

Since substantial quantities of gas are sold to utilities from federal leases, this has created precisely the uncertainty and potential consumer liability that the 1986 law was intended to prevent.