

# ALASKA BUDGET REPORT™

April 7, 2011

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Volume 21, No. 12

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Rebecca Braun, publisher and editor  
Gregg Erickson, editor-at-large  
Stefan Milkowski, reporter  
Judith Erickson, reporter

ABR Company, 319 Seward St. Suite 7, Juneau, AK 99801  
Phone: 907.523.2122 Fax: 907.586.1987  
E-mail: rbraun@alaska.com

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# ALASKA BUDGET REPORT

April 7, 2011

## OVERVIEW

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### Oil in everything

At the outset of the session Speaker Mike Chenault said there might not be much legislation coming out of the first session, and his prediction is proving correct. But the few bills that those in powerful positions have identified as priorities are politically entangled with each other, with the outcome uncertain.

**Oil taxes.** Gov. Sean Parnell's proposed oil tax cut has produced the biggest force field. Parnell and a few House Republican leaders insist they want the bill this session. Senate leaders have publicly declared that all but impossible, and are raising new questions on the measure almost every day. For example, some point out that when Standard & Poor's raised the state's bond rating to triple-A in December, the rating agencies cited the ACES law as one of the reasons. Would the Parnell change threaten the rating? Administration officials dismiss the concern, but expert testimony is lacking. Sen. Hollis French, an attorney and leading critic of the governor's proposal, has challenged Parnell to a debate, apparently with no response.

**Capital budget.** The spring revenue forecast released this week shows \$3.4 billion in additional revenue this fiscal year and next. Considering the added money, Parnell said yesterday Alaska can afford a \$2.8 billion capital budget, the same amount as legislators approved last year, and the largest capital budget in a decade. But Parnell has threatened major capital budget vetoes if the Senate doesn't approve his tax cut.

Senate leaders were dismissive of the governor's threats. Senate President Gary Stevens suggested Parnell had his logic backwards: "It's sort of odd ... if we don't pass the bill that gives away \$2 billion dollars, then the governor will cut the capital projects list. That's a little hard to get my mind around."

Senate Finance Co-chair Bert Stedman also sought to win the war of words, suggesting the governor might abuse his veto power: "The governor with his constitutional authority to run his veto pen can certainly exercise it and he can be abusive with it if wants to, but we are not going to use the capital budget to buy votes as long as I am chairman."

**Education funding.** The Senate this week approved SB 97, a bill by Sen. Finance Committee Co-chair Lyman Hoffman giving schools and local governments extra state aid when oil prices are high. While House leaders signaled they might support the concept, House Speaker Mike Chenault slapped three committees of referral onto the bill after the Senate President sent the oil tax bill to three Senate committees.

The money in SB 97 for school districts is about half what would be provided in SB 84, a bill increasing the base student allocation and providing extra funding intended for vocational education.

As originally written the bill provided three years of increases; Senate Finance stripped the out-years from the bill and added a provision extending tax credits for qualified educational contributions. The Senate passed SB 84 yesterday on a vote of 18-0. Senate leaders do not expect both SB 97 and SB 84 to pass. If a bill makes it through the House, there's no guarantee the governor won't veto it.

**Coastal zone management.** Extension of the coastal zone management program is about the only major non-budget issue still in play. Hoffman on Tuesday expressed optimism that lawmakers and the governor can reach a compromise before the session ends. In the past, the governor insisted on no changes to the current program, which is set to expire at the end of the fiscal year, taking with it 33 state employees charged with helping coastal communities have a voice in development projects that impact them. The governor wanted to extend the program in its current form – which coastal lawmakers say does not give local communities an adequate role – for six years. Hoffman introduced a bill extending the program for just one year, in hopes of returning next year to work out a compromise with the governor. On Tuesday he told reporters the administration is now open to compromise, and he's optimistic the program can be extended with changes this year.

**Sunset bills.** While none are as controversial as the coastal zone program, a variety of other programs and agencies are set to expire, absent legislative action, at the end of the fiscal year. The House this week passed HB 126, a bill extending the authority for the Board of Nursing, Board of Dental Examiners, and Board of Barbers and Hairdressers. Other entities set to expire include the Regulatory Commission of Alaska and the Alcoholic Beverage Control (ABC) Board. A proposal to move the ABC board from the Department of Public Safety to the Department of Commerce, Community and Economic Development remains in the House Finance Committee. Keeping it company is a simple extension bill that does not move the board. While House leaders want to move the board, some senators have balked at the proposal and the governor has been mum [see **Lawmakers seek to move alcohol board out of Public Safety**, *ALASKA BUDGET REPORT*, January 27, 2011].

**Operating budget and the “24-hour” rule.** A few operating budgets issues are still simmering, including the level of subsidies for the tourist industry, University of Alaska appropriations, and needs-based versus merit-based scholarship aid. But overall, there are few significant differences between House and Senate.

With the Senate's appointment yesterday of conference committee members, the so-called 24-hour rule kicks in, when lawmakers need only give one day's notice before hearing a bill for the first time. Despite the name's implication, legislators often give notice of a bill in the afternoon or evening before a morning hearing where the bill will be heard.

This year lawmakers will be under the 24-hour rule for 11 days, assuming the Legislature adjourns on the statutory deadline of April 17. This is the same amount of time as 2010. In 2009 lawmakers were under the 24-hour rule for seven days, and in 2008 for 10 days. In 2007, the last year of the 121-day session, the 24-hour rule kicked in 19 days before adjournment. In 2005 legislators were under the 24-hour rule for 32 days.

## CAPITAL SPENDING

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### Senate Finance questions “roads to resources” zeal

Top officials at the Department of Transportation and Public Facilities say they’ve tightened up the process for establishing “roads to resources” priorities, and promise increased accountability. The program, first proposed by Gov. Frank Murkowski, refers to proposed roads whose primary purpose is to provide access to resources such as oil, gas and mineral deposits for development purposes.

“It was pretty loose,” newly appointed Deputy Commissioner Pat Kemp said of the process for picking projects. “I believe most of the projects were worthwhile, but we didn’t keep track of them very well,” Kemp told the Senate Finance Committee on March 31. “We’re going to put a stop to that now.”

Kemp showed the committee an idea for a decision-making matrix that includes such factors as direct and indirect jobs expected, revenues to the state, the number of communities accessed, and so on. “We are going to get our arms around this process and start delivering real projects that bring in real revenues to the state,” he said. “We’re attempting to fulfill the governor’s goal of filling the [trans-Alaska oil pipeline] and creating jobs.”

Top on Gov. Sean Parnell’s list of roads to resources is the Foothills West project, a 102-mile road stretching from the Dalton Highway north and west into the oil and gas-rich Gubik Gas Fields and then on to Umiat, the site of a former Air Force station, and the National Petroleum Reserve-Alaska. Parnell is seeking \$8 million in the FY 12 capital budget for preliminary engineering and to produce an environmental impact statement.

Parnell is also requesting \$1.25 million to continue studying a road to Nome (also known as the Western Access Project) and \$1.25 million to study potential impacts on caribou from a road west from the Dalton Highway to the Ambler mining district.

“Some of these are substantial projects, are they not?” asked Co-chair Bert Stedman, tossing out a preliminary estimate of \$1 billion to build the road to Nome.

Yes, Kemp agreed. “We’re planning on using the Alaska Highway model, when they constructed the Alaska Highway in eight months during World War II,” he said. The state would get an initial roadway in, then build it up to public standards over the next 50 years or more, possibly with the help of private industry or user fees. The estimated cost of the road to Nome – \$3 billion, he said – reflects the costs of a “finished superhighway.”

DOTPF budget documents project the department will need \$369 million between FY 12 and FY 17 for its three roads-to-resources priority projects: Foothills West, the Nome road, and the Ambler mining district road.

Will the department go back and plug the three projects into its new project evaluation matrix? Stedman asked.

“Probably not,” Kemp replied. He said the road to Umiat is very desirable because it would provide access to significant oil and gas resources, and he predicted the three projects would rank as the top three anyway.

Stedman noted that other big-ticket items are also being discussed, including an in-state natural gas pipeline and a large hydroelectric project on the Susitna River, and said lawmakers are being cautious in how they use the state’s savings.

“We can’t just build a road to somewhere without good justification,” Kemp replied, noting that federal permitting processes would not allow it. “There has to be like a pot of gold at the end of the road for us to justify it.”

Stedman asked if it wouldn’t make sense to withhold funding until projects were ranked.

“I truly believe Umiat will rise to the top no matter what,” Kemp replied. “I think the news is only going to get better with that particular project.”

Kemp said the department signed a contract two weeks earlier to begin an environmental impact statement for the project and would have to cancel the contract if FY 12 funding is not approved.

Al Clough, DOTPF’s roads-to-resources project manager, said the Umiat road would access oil reserves that could provide 50,000 barrels of oil a day for 30 years. He said there’s a chance oil explorer Renaissance Alaska would partner with the state on a road project. A road to the Ambler mining district would help companies access an estimated 120 million tons of copper, lead, gold, silver and zinc resources, he said.

Sen. Donny Olson, who represents northern and northwest Alaska, asked how the department plans to pay for maintenance and operation of new roads, especially if Parnell succeeds in reducing oil taxes. He said people along the Yukon River complain about a 17-mile road between St. Mary’s and Mountain Village that has deteriorated from lack of upkeep. And he referred to resolutions from the tribal government in Anaktuvuk Pass opposing coal mining along a potential route to Umiat and from the North Slope Borough’s Fish and Game Management Committee opposing the road itself. “I haven’t heard a lot of support from the local people out there,” Olson said.

Kemp replied that he wasn’t aware of the resolutions, but said gathering public input would be a big part of environmental permitting. “That’s what this next stage of the project does.”

If the department isn’t aware of local opposition, it hasn’t done its homework, Olson charged. “I would recommend that we hold off on any funding of these until the homework is done.”

Sen. Johnny Ellis of Anchorage asked DOTPF how much of the roads’ cost would be paid by the companies that benefit from them. “I have a lot of constituents who call this corporate welfare,” he said. Kemp and Clough offered few details.

According to a DOTPF breakdown, the state has spent \$35.8 million on roads to resources to date – all in state funds – and has encumbered an additional \$9.4 million.

“How were those expended and what will they purchase?” Co-chair Lyman Hoffman asked of the encumbered dollars.

Kemp promised to gather the information.

“Maybe you could try to expedite that,” Stedman said.

The Senate Finance Committee has yet to release a substitute version of the governor’s capital budget, SB 46.

### **KABATA seeks \$150 million and state backstop**

The Knik Arm Bridge and Toll Authority (KABATA) is seeking a \$150-million state appropriation and legislation that would put the state on the hook for money a private entity will borrow to build and operate a proposed bridge spanning the Knik Arm.

“This project will benefit generations of Alaskans,” said Kevin Hemenway, KABATA’s chief financial officer, at a March 10 House Transportation Committee hearing. The authority was established in 2003 legislation to finance and construct a bridge from Anchorage to Point Mackenzie in the Matanuska-Susitna Borough. In 2006, lawmakers cleared the way for a public-private partnership to advance the project [see **Sale of toll concession to play key role in financing Knik Arm crossing**, *ALASKA BUDGET REPORT*, September 19, 2006].

The KABATA board, whose members include two Mat-Su area Republican legislators – Rep. Mark Neuman and Sen. Linda Menard – this year is seeking to amend its governing statutes through HB 158 (by Neuman) and companion SB 80 (by Menard).

The legislation would:

- Provide a state guarantee for KABATA’s liabilities, on a subject-to-appropriation basis;
- Create a project reserve fund to provide a backstop in case toll revenues fail to generate sufficient money to make bond payments;
- Increase KABATA’s bonding authority from \$500 million to \$600 million; and
- Clarify that the crossing and associated facilities are exempt from state and local property taxes.

The proposed span is one of the controversial “bridges to nowhere” that sparked national ridicule in 2005, when a \$229 million federal earmark for the project was granted. The earmark was later removed under public pressure, though the money was not [see **DOTPF defends bridges; lawmakers remain leery**, January 19, 2006 and **“Bridge to nowhere” seeks image makeover**, April 19, 2007].

The Federal Highway Administration granted final approval for the project in December, KABATA Executive Director Andrew Niemiec told the House Transportation Committee. The authority plans to contract with a private company that will finance, build, operate and maintain the bridge for about 35 years. Under a public-private partnership or “3P” agreement, the state would make annual “availability” payments to the private builder-operator and would maintain ownership of the bridge.

KABATA has consistently maintained that the bridge will be self-sustaining, but officials now say toll revenues in the early years will be insufficient to cover the state’s payments. KABATA is seeking \$150 million in state appropriations (via Neuman’s HB 159 and Menard’s SB 79) to capitalize a reserve fund in case of such shortfalls, and plans to borrow additional money to cover payments in the early years.

The increased bonding authority, revenue fund and state backstop will allow a private partner to borrow under more favorable terms, KABATA says, thus lowering the cost of capital for the project and ultimately lowering the cost to end users. KABATA anticipates drivers will pay a \$5 one-way toll to use the bridge.

Over time, Hemenway told committee members, the bridge will generate surplus toll revenues, which can be used to support transportation projects around the state.

Critics say project proponents are changing the rules of the game in seeking to shift the finance risk from the private partner to the state. Under the proposed legislation, the state would offer its pledge to repay the bonds, subject to legislative appropriation.

Jamie Kenworthy, a longtime critic of the project, told the House Finance Committee that under the proposed legislation, a private partner would not bear the risk of a shortfall in toll revenue – that

risk now falls to the state. The only risk to the private partner is the risk that the state would stop making its promised payments to the private partner. “That’s not what I call ‘finance risk’ in any standard meaning of the term.”

Under the proposed legislation, failure to make payments would put the state’s credit rating at risk, potentially increasing the cost of future borrowing.

Kenworthy, a retired state employee who ran the erstwhile Alaska Science and Technology Foundation, called the legislation a blank check from the state of Alaska. “The state bears the full downside of the project,” he asserted, claiming:

- The project anticipates borrowing \$40 million in capital accretion bonds to pay interest on the bonds in the early years; it will cost \$208 million to pay off the \$40 million.
- Instead of flat annual payments as other states have negotiated with private partners, the state of Alaska anticipates making “balloon payments” that increase from \$35.7 million the year the bridge opens to \$141 million before all the bonds are paid off, for a total of \$3.2 billion over 36 years.
- Traffic and hence toll projections rely on Mat-Su population growth projections that are higher than projections by the University of Alaska Institute of Social and Economic Research and by the state demographer, and KABATA has not factored in the impact of a toll on driver behavior.

Only two committee members, Chair Peggy Wilson and Rep. Eric Feige, were present for Kenworthy’s testimony, which came late in the day.

KABATA disputed Kenworthy’s assertions at a March 24 House Transportation hearing.

Hemenway said KABATA’s traffic advisor is in fact using numbers based on ISER’s projections, and said ISER’s population estimate for the Mat-Su is already 9,000 below the newly released U.S. Census count.

He said capital accretion bonds are common in public-private partnerships, and account for only 5 percent of KABATA’s hypothetical capital structure. KABATA’s “base-case” projections show toll revenues more than sufficient to make its annual payments, he said, and the state could still make the payments if traffic is two-thirds lower than projected.

Jeff Ottesen, program development director for the Department of Transportation and Public Facilities, said DOTPF’s projections, completed separately, show KABATA’s traffic estimates to be “conservative.” Without the bridge, he said, the state would need additional lanes on the Glenn Highway, at a cost of about \$400 million, not including bridges.

In an interview this week, State Debt Manager Deven Mitchell said the legislation gives KABATA authority to enter into contracts that would be guaranteed by the State of Alaska on a subject-to-appropriation basis:

“That’s the same type of commitment that the state gives for supplying its credit to purchases such as the Atwood Building through [the Alaska Housing Finance Corporation] ... or Goose Creek for that matter. It’s a double-A type of credit commitment from the State of Alaska to whatever entity the KABATA folks were to enter agreement with.”

Mitchell noted that the bill language is very broad. “As it’s written, it would be a type of flexibility that hasn’t been given to any other state agency at any point.”

Asked if he sees similarities in the proposed financing mechanism to the mechanism used for construction of the budget-busting Goose Creek Correctional Center, Mitchell said, “It’s similar in as much as it’s a commitment of the state’s general funds subject to appropriation, but broader because it doesn’t have a limitation as far as size of annual payment.” [See **Senators steam about Goose Creek costs, inaction on other prisons**, *ALASKA BUDGET REPORT*, March 3, 2011.]

In both cases, the state is on the hook to repay bonds that another entity issued. Mitchell says there may be good reasons for using a public-private partnership – such as improved project management – but financially it makes more sense for the state to issue the bonds itself. “Just from a financial perspective, I don’t think there is a situation where somebody can leverage the state’s credit better than the state.”

Mitchell concurred with Kenworthy’s assessment that capital accretion bonds introduce unnecessary costs because they generally require a higher rate of interest. “So you could be layering on a fairly significant amount of costs.” It would be cheaper, Mitchell suggested, “if the state were able to just pony up the money.”

The initial KABATA enabling legislation, like the legislation authorizing construction of the Goose Creek prison, was approved in 2003. At that time the state was facing chronic deficits and was looking for creative ways to finance large projects. With six consecutive years of surpluses, the state has now amassed \$12 million in reserves and anticipates a \$1.9 billion surplus in FY 11. If the bridge is a priority, Mitchell suggested, there are other options for building it:

“This obviously is a complex transaction to achieve a goal, and if this is a goal that is important to leaders in the state, the state is in a position that it could either pay for this directly or borrow the money to pay for it, and simplify it greatly.”

Mitchell has not testified on the bill. He was asked once, he said, but was out of town.

During public testimony, Anchorage resident Bob French described the financing scheme as foolish. “It doesn’t make sense to spend \$3.2 billion just to get a \$700 million bridge.”

In an interview last week, Ottesen said KABATA’s estimate for bridge construction – \$716 million – has been independently verified, but said DOTPF has not studied long-term maintenance and operation costs in a way that would allow a comparison between a state-funded bridge and one built with a private partner. “To do that kind of analysis ... costs money and we don’t have an appropriation for a capital project to do that analysis,” he said.

HB 158 moved from House Transportation with no “do pass” recommendations. SB 80 moved from Senate Transportation with one “do pass,” from bill sponsor Menard. Both bills are in their respective Finance committees, along with the KABATA appropriation bills. None of the bills has been scheduled for a Finance hearing.

Senate Finance Co-chair Bert Stedman, who schedules legislation in his committee, said Tuesday he’s not very familiar with the bills. “I think that project is not ripe to move forward at this time.”

Asked if he has concerns that the proposed financing plan echoes the Goose Creek situation, Stedman nodded gravely. “We need to be careful with large projects ... We try to be good stewards of the treasury.”

As to the governor’s position on the KABATA legislation, Press Secretary Sharon Leighow said, “The bills are currently under review.”

## Parnell boosts capital budget ceiling and savings target

At a press conference Wednesday morning, Gov. Sean Parnell gave legislators the green light to boost 2011 capital spending by 40 percent above the administration’s previous capital request.

Parnell offered a spending plan in December calling for a \$1.6 billion capital budget, including \$645 million from the state general fund [see **Parnell proffers spending plan, few new proposals**, *ALASKA BUDGET REPORT*, December 22, 2010]. Amendments submitted quietly since then – the latest on March 17 – have increased the total to \$2.0 billion.

Yesterday Parnell announced he would have no problem if legislators add an additional \$800 million, raising this session’s capital spending to \$2.8 billion, equal to the legislature’s “robust” capital appropriations in 2010. The table below shows how 2010 session capital appropriations compare with Parnell’s changing capital spending plans.

| <b>Capital Appropriations:<br/>Actual, Proposed and Revised</b> |              |                          |                                  |
|---|--------------|--------------------------|----------------------------------|
| (billions)  |              |                          |                                  |
|   | 2010 Session | 2011 Session             |                                  |
|   | Actual       | Parnell's March proposal | Parnell's revised April proposal |
| General funds   | \$1.2        | \$0.8                    | \$0.8*                           |
| Other state funds   | \$0.6        | \$0.1                    | \$0.1*                           |
| Federal funds   | \$1.0        | \$1.1                    | \$1.1*                           |
| <b>Total</b>  | <b>\$2.8</b> | <b>\$2.0</b>             | <b>\$2.8</b>                     |

\* Plus additions that do not cause total to exceed \$2.8 billion.

Parnell said his acceptance of \$2.8 billion in new capital is contingent on legislative agreement to “save at least \$2.5 billion for the future.”

Legislators say they expect little resistance to Parnell’s proposed savings target. The Senate Finance Committee has already proposed savings of \$1.4 billion [see **Supplemental: Senate Finance makes “a few small changes,”** *ALASKA BUDGET REPORT*, March 24, 2011]. The more difficult question may be where the “saved” dollars will be stashed. The Senate, for example, proposes to put \$400 million in the power cost equalization endowment, a fund used to offset the high cost of rural power. The governor wants to put \$400 million toward a new endowment to pay for merit scholarships. The House has thus far stayed out of the slowly-brewing debate, but House Speaker Mike Chenault regularly propounds the need for an in-state gas pipeline and may want to set aside “savings” toward such plans.

In reality, there’s probably enough money available that everyone can get what they want, as long as it’s something money can buy.

## OPERATING BUDGET

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### Senate adds \$40 million in floor amendment, adopts budget

The Senate on April 1 approved its version of the operating budget and sent it to the House on a 20-0 vote after adopting a \$40 million amendment by the Senate Finance co-chair, and rejecting two amendments offered by minority members.

Sen. Charlie Huggins of the Matanuska-Susitna Borough, home of the nearly-completed Goose Creek Correctional Center, offered an amendment adding \$3.6 million Gov. Sean Parnell requested to begin a phased opening of the prison in the spring of 2012. The House included the money in its budget plan, but the Senate stripped it amidst a flurry of outrage over runaway costs [see **Senators steam about Goose Creek costs, inaction on other prisons**, *ALASKA BUDGET REPORT*, March 3, 2011.]

Huggins argued that the additional money it will cost to run Goose Creek over continuing to house overflow prisoners out of state is worth it because it will reduce recidivism. Noting that the state releases 24,000 prisoners a year, he said, “What we are funding is a robust rehabilitation program because these people will be our neighbors.”

It’s also important to begin occupying and using the prison, he said, in order to “validate” a one-year warranty on the facilities, which are designed to function as a mini-city. “This is a city, you can’t just go in and check that faucet, see if it works,” Huggins asserted.

Sen. Johnny Ellis, who chaired the Corrections budget subcommittee, reiterated Senate leaders’ concern that the project has exceeded the cost parameters legislators specified in law for the project. “The per bed costs for Goose Creek appear to have exceeded what was authorized by the legislature.”

The amendment failed, 5-15, with Mat-Su Sen. Linda Menard joining the four minority members in support.

Sen. Cathy Giessel offered an amendment adding \$335,600 to the Alaska Oil and Gas Conservation Commission budget, as requested by Parnell. The money is needed to lease and reconfigure additional space for the commission, she said. The added space will provide for secure storage of confidential materials in its possession – now stacked in boxes on the floor of the library, she said – and a larger hearing room for the many proceedings the commission, as a quasi-judicial agency, holds. The additional space will also help accommodate the two new staff members the Senate authorized. The state entity that calculates the amount of office space an agency needs found AOGCC’s space is about half what it needs, she said.

“This is a one-time opportunity,” Giessel said, because space is about to become available near the AOGCC’s current offices.

Ellis, who chaired the Department of Administration budget subcommittee, which includes AOGCC budget, said the subcommittee voted unanimously to reject the request. He said a 60 percent expansion in space is excessive, and that AOGCC wasn’t open to working out a compromise. “Every agency of government would like their own conference room of larger size, but we noted there are reasonable accommodations elsewhere,” Ellis said. He noted that the money requested to renovate the space is more appropriate for the capital budget.

Sen. Lesil McGuire, a majority member and Finance Committee member, made a strong case for the money, affirming Giessel’s contentions that the office is crowded, the commission holds numerous hearings, the availability of nearby space is a rarity, and confidential data are at risk due to the space shortage. That said, McGuire noted the budget process is ongoing, adding, “I will be voting

against this amendment in keeping with my team.” The money is included in the House budget, so the item will be decided by a conference committee.

Huggins pointed out that the Legislature bought itself a “whole new building next door,” and suggested lawmakers treat others as they treat themselves.

The amendment failed on a 4-16 vote.

Hoffman offered an amendment adding \$40 million to be split between school districts and local governments, contingent on passage of Hoffman’s SB 97, which provides for extra appropriations to school districts and municipal governments based on high state revenues [see story elsewhere in this issue]. There was no objection, explanation, or discussion associated with the amendment.

Hoffman offered another amendment, also adopted without objection, establishing a separate budget unit for the governor’s merit scholarship program. The amendment does not change any numbers, he said. Parnell requested \$8 million for a merit-based scholarship program he ushered into law last year. The Senate budget provides only \$1.1 million for the merit-based program, shifting \$7 million to a needs-based scholarship program. Hoffman’s amendment may be designed to ensure that the Parnell administration can’t move money from the needs-based program into the governor’s preferred merit-based program [see **Senate resuscitates pre-K pilot, shifts scholarship money**, *ALASKA BUDGET REPORT*, March 17, 2011].

In debate on final passage of the bill, Hoffman detailed the process the committee had undertaken. He said the committee responded to public testimony, citing the committee’s addition of \$380,000 for the Best Beginnings pre-K learning program, \$326,000 for a University of Alaska nursing workforce diversity program, and \$392,600 for UA health sciences building staffing.

The committee also addressed some of the governor’s concerns, he said, adding \$400,000 for oil and gas projects the governor requested and \$2.7 million for the Department of Law for legal work related to natural gas projects.

Hoffman noted that some budget increases originated from the committee, notably \$1.2 million for the Department of Fish and Game’s Wildlife Division. “I wanted to spotlight this because we have a constitutional requirement to manage our resources on a maximum sustained yield basis. ... What we’re trying to do with these appropriations is get back to a situation in the state where we’re not fighting about our resources, get them as abundant as possible.”

Huggins said the budget provides for a new regional Fish and Game headquarters in Mat-Su and some money for a proposed Knik Arm crossing. “I say thanks to the body for that and I’ll be supporting the budget.”

McGuire said as a first-year member of the Finance Committee, she wanted to commend the co-chairs for their commitment to savings, and for their transparency. McGuire detailed appropriations to various reserves and said the committee wanted to set aside money for savings before approving its spending bills. “It is absolutely the most dedicated commitment to savings. It’s not rhetoric, it’s actual work.”

The Senate also approved HB 109, the mental health budget bill, by unanimous vote. Apart from a brief statement by Hoffman, there was no discussion on HB 109.

The House on Tuesday voted against concurrence in the Senate amendments and appointed Finance Co-chairs Bill Thomas and Bill Stoltze and minority Democrat Les Gara to a conference committee. The Senate on Wednesday voted not to recede from its amendments, and appointed as conferees Finance Co-chairs Hoffman and Bert Stedman and Joe Thomas, a majority Democrat from

Fairbanks. Thomas will chair the conference committee. [For differences between the Senate and House operating budget plans, see **House and Senate budgets compared**, *ALASKA BUDGET REPORT*, March 31, 2011.]

### **Senate okays bill sending extra aid to districts and municipalities**

The Alaska Senate increased its proposed FY 12 state operating budget by \$40 million on April Fools Day, dividing the money equally between school districts and municipalities to help offset rising costs. The action came on a Senate floor amendment by Finance Committee Co-chair Lyman Hoffman to the operating budget bill, HB 108. The amendment passed unanimously, as did the bill.

The House version of the operating budget does not contain the extra school or municipal aid appropriations. A conference committee will negotiate a compromise between the House and Senate versions of the operating budget.

The Senate passed Hoffman's amendment with neither debate nor explanation. A little-noticed provision makes the \$40 million contingent on passage of SB 97. That's Hoffman's bill to provide local governments and school districts additional aid when high prices for Alaska crude pump more money into the state treasury than is needed to pay for the current-year state budget [see **Hoffman bill links state aid to oil tax revenue**, *ALASKA BUDGET REPORT*, March 24, 2011].

Also on April 1, the Senate approved a revised version of SB 97. The bill takes effect in FY 13; the FY 12 money is in the operating budget. This ensures there's no ambiguity about the amount of FY 12 aid, Hoffman said.

The \$20 million for municipal revenue sharing would be distributed according to a formula lawmakers adopted in 2007. The \$20 million for school districts would be distributed according to the K-12 foundation formula. The increase equates to an increase in the base student allocation of about \$82, according to this newsletter's calculations.

#### ***Hoffman's strategy***

At a March 30 Senate Finance hearing on SB 97, Legislative Finance Director David Teal testified that the new version of the bill bases the payment on the prior-fiscal-year surplus. "What happens is you take the surplus for one year, FY 12 for instance, which will determine the amount to be handed out in FY 13." The FY 11 surplus won't be known exactly until the end of the fiscal year in June, but Teal indicated he was reasonably confident in estimating the amount that would have been distributed in FY 12 – if the bill applied that year – at \$40 million.

Statements this week by key senators and representatives in separate press conferences suggest that Hoffman's SB 97 has become a key element in this session's adjournment calculus.

Asked on Tuesday, April 5, about the prospects for additional school aid, either through SB 97 or a separate bill, SB 84, which increases the base student allocation (BSA) in the state's education aid formula, Senate President Gary Stevens said, "I don't see both as occurring." It'll be one or the other.

Asked the Senate's must-pass priorities, Stevens mentioned one bill – legislation extending the coastal zone management program.

Hoffman added another priority: "I'd like to see [SB] 97 passed."

On Wednesday the Senate approved SB 84, increasing the base student allocation by \$110 in FY 12 and adding extra aid intended to support vocational education. Prospects for the bill in the House are uncertain, and Gov. Sean Parnell has hinted he might veto that bill if it reaches his desk: "I don't want to continue funding ever larger amounts into the same system that is producing results that are

less than expected,” Parnell told this newsletter last month [see **Senate committee approves K-12 increases**, *ALASKA BUDGET REPORT*, March 24, 2011].

### *Oil tax linkage*

House Rules Chair Craig Johnson, asked about his position on SB 97 at a House majority press availability on April 4, said he’s not opposed adding extra money to help schools offset increasing fuel costs. “We want to make sure that we at least address that.”

But Johnson expressed concern that the added aid in SB 97 is linked to money collected from the progressivity provisions of the current ACES (“Alaska’s Clear and Equitable Share”) oil tax law.

“I’m curious if it’s the progressivity of [HB] 110, ... or the progressivity of the old ACES bill,” Johnson said. “I want to make sure that it is tied to [HB] 110.” [See **Parnell tax cuts clear House Finance, and Fiscal note offers no scenario where Gov’s oil tax recoups losses**, *ALASKA BUDGET REPORT*, March 31, 2011.] Senate leaders have said their chamber won’t approve that bill during this legislative session.

Payments under SB 97 are linked to the progressivity provisions of the oil tax, but the amount of added aid would be no different in FY 12 and FY 13 regardless of whether HB 110 becomes law. In later years, however, passage of HB 110 would raise the minimum oil price needed to trigger payments under the SB 97 formula.

The trigger price for payments under SB 97 would currently be \$93 per barrel, according to spreadsheets Teal provided Senate Finance members. Assuming passage of HB 110 reduces annual revenue by \$2 billion, this newsletter calculates that House-passed tax reductions would raise the trigger price to about \$112 per barrel if applied in FY 11, and reduce the amount of new state aid from \$40 million to less than \$15 million. Last week’s average price for Alaska crude was \$116 per barrel.

HB 110 could also reduce money available under the regular municipal revenue sharing program approved in 2007 [see **Revenue sharing clears Senate, faces uncertain fate in House**, *ALASKA BUDGET REPORT*, May 10, 2007]. Approximately \$60 million has been distributed to municipalities annually since the program took effect. Money for that distribution comes from a fund that is replenished every year with \$60 million from the general fund, or 20 percent of the amount collected under the progressivity provisions of the oil tax, *whichever is less*. The amount each year has been approximately \$60 million, thanks to ample progressivity-generated revenues. Because HB 110’s progressivity collects less than current law, under HB 110 the fund would be more likely to fall short of \$60 million.

In addition to these technical linkages, SB 97 and HB 110 have become politically entangled. When SB 97 arrived in the House on Monday, Speaker Mike Chenault gave it a single committee referral, to Finance. At about the same time, HB 110 reached the Senate where Senate President Gary Stevens referred it to three committees. Chenault soon added two more referrals to Hoffman’s bill.

House and Senate leaders met privately on Tuesday. On Wednesday, Hoffman said House leaders said the House majority is steadfastly behind HB 110, but he doesn’t take that claim too seriously. “How can it be a leadership position when only 20 [members] of the majority voted for it?”

(Reps. Kyle Johansen and Charisse Millett, Republicans who walked out of the caucus in December during an organizational dispute, provided the two non-majority-member votes.

Regardless of what happens to HB 110, Hoffman believes there is plenty of room for negotiations on the school funding issue. He said House members have understandable questions about what SB 97 does. “I probably didn’t do as good a job as I should have in explaining the bill.”

“I get the feeling that many of the new [House] members are more conservative, and are not interested in giving school districts additional money when we are in the tail end of [adding] over a quarter billion dollars [over the last three years] in [annual school aid appropriations],” Hoffman said. “They want to see some measure of improvement.”

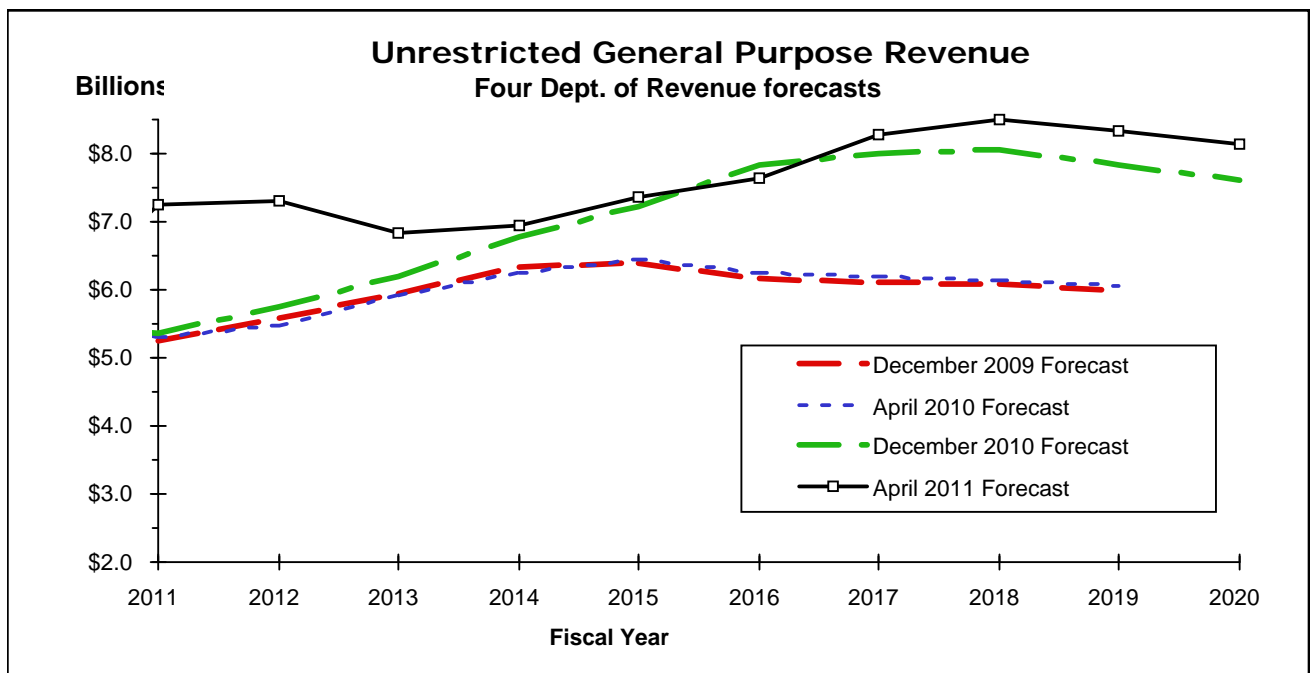
He said most of their concern seems centered on efforts to increase the base student allocation (BSA) in the state’s education foundation aid formula, as proposed in SB 84. “I don’t think they’ve considered any other form of funding to assist municipalities or school districts,” Hoffman added. “I think [SB] 97 gives them an option.”

## REVENUE

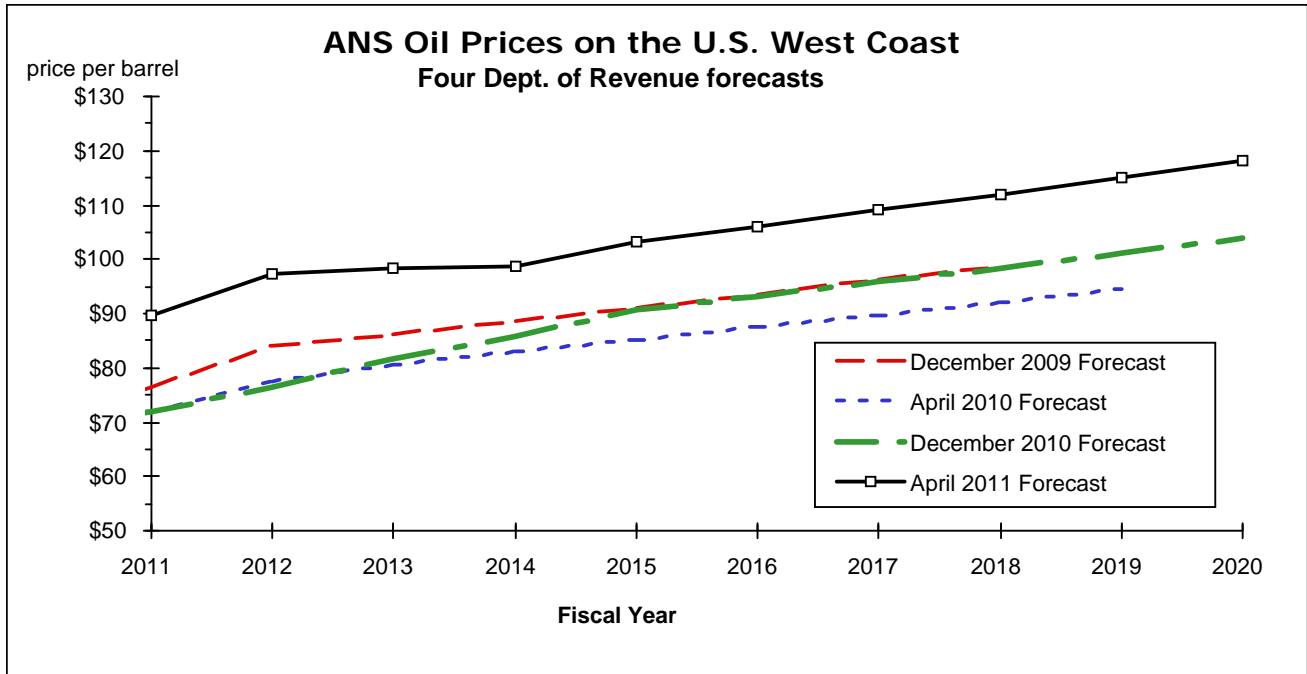
### Forecast predicts \$3.4 billion more FY 11-FY 12 revenue

The spring forecast released Wednesday by the Department of Revenue says the state will receive \$1.9 billion more general fund revenue in this fiscal year, FY 11, than the department predicted in December.

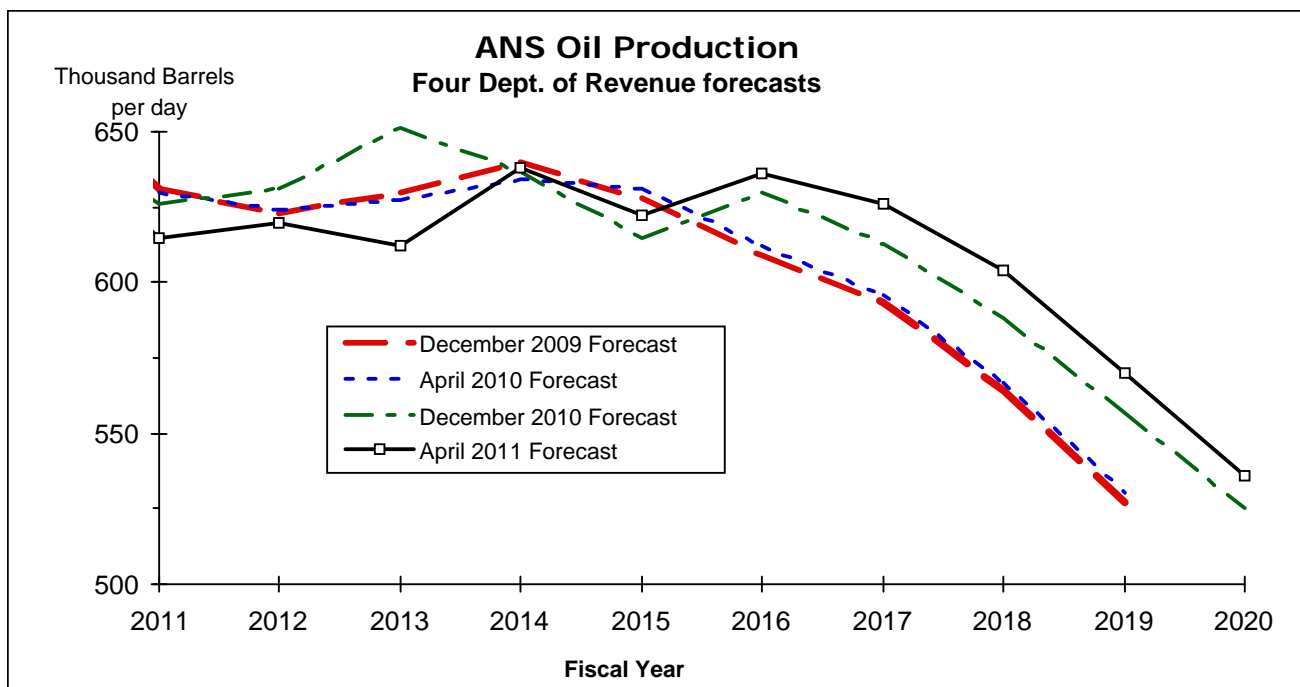
Revenue in FY 12 is expected to exceed December projections by \$1.6 billion. The chart below shows the new revenue forecast and how it compares with the three prior forecasts.



The increased revenue is wholly due to a dramatic increase in expected prices, which more than offset continued declines in predicted production. The chart below shows the current and previous price forecasts.



Once again the department has revised downward its near-term forecast of oil production. Revenue Commissioner Bryan Butcher, speaking at a Wednesday press conference called to release the new forecast, said the department is aware that its forecasts have systematically overestimated oil production, and is working to correct the problem. The newest production forecast and the three previous forecasts are shown in the chart on page 15.



## OIL TAXES

### Oil tax studies unused in House debate

Many lawmakers, particularly critics of Gov. Sean Parnell's proposed oil tax reduction, have touted the value of data from outside experts, but interviews with legislators suggest few have availed themselves of the information the Legislature has received to date.

Senate Finance Co-chair Bert Stedman has repeatedly said it would be irresponsible to approve Parnell's bill before lawmakers have a chance to review the studies they've purchased. The Legislative Budget and Audit Committee in December agreed to purchase two comprehensive studies, portions of which are not yet available.

"It's pretty difficult to expect, in my opinion, the elected officials to make decisions dealing with billions of dollars worth of our resources and then in the next breath tell us don't worry about the technical details of the analysis, just vote for the bill," Stedman told reporters on Tuesday.

One study is an interactive database compiled by the energy research firm Wood Mackenzie, Ltd. titled *Petroleum Fiscal Systems*, which LB&A purchased for \$60,000. It has been available to legislators since March 13.

The other is a six-part study by the Van Meurs Corporation in conjunction with PFC Energy and Rodgers Oil & Gas Consulting, purchased for \$32,250. Van Meurs' rating of North American oil and gas wells, excluding the Arctic, has been available to legislators since March 13. A second report, due this week, covers "deep water" oil and gas terms worldwide. The more relevant rating of Arctic oil and gas terms is due out May 6, and the last installment, a summary report, is due September 16.

Only seven senators and four representatives have signed up to access the information, and not all of them have looked at it.

“I have not looked at them,” said Sen. Charlie Huggins, who signed up for the reports. He said he wants to have the information fresh in his mind when the Senate considers the legislation – something that’s not likely to happen this session.

Sen. Bill Wielechowski said he read the Wood Mackenzie study but said the data were from 2007. According to LB&A Chair Rep. Mike Hawker, the new Wood Mackenzie survey was produced in 2010.

Wielechowski said the report he read was “very technical” and was useful despite being compiled before Alaska’s current oil production tax was put in place. He said he hadn’t accessed the Van Meurs report. “I tried to look at it on the computer, and I wasn’t able to.”

House Resources Committee Co-chair Paul Seaton, who signed up to see the Van Meurs report, said he didn’t know the Wood Mackenzie survey was available. “I didn’t get an email on that one.” Seaton, a critic of Parnell’s plan, said it was frustrating not to have the information while HB 110, the oil tax bill, was in his committee.

Seaton’s Resources Co-chair, Rep. Eric Feige, said he didn’t sign up for the Wood Mackenzie survey because he didn’t have time, but did look at the Van Meurs report. “It gave me a better understanding of the issue,” he said. “It supported my decision.” Feige was a strong backer of HB 110.

Rep. Beth Kerttula said she hadn’t reviewed the reports and didn’t think she could discuss them if she had.

Lawmakers and staff are required to sign a confidentiality agreement to access the surveys, a fact that has dissuaded some from looking at them and others from discussing any insights they may glean.

The confidentiality agreement lawmakers and staff must sign states, “I will make every reasonable effort to safeguard any copies of the Reports and any Information in my possession against disclosure to or use by any other person.”

Hawker said he believes the agreement bars legislators from presenting a graph from the report to a committee, for instance.

Asked what he learned from the data, Stedman joked, “I’d have to cut your throat if I told you.”

But lawmakers may be going overboard in their caution, rendering the studies less useful than they could be. The Wood Mackenzie agreement suggests information may be used in the context of legitimate legislative business: “I agree that I will not use any of the Reports ... except for the benefit of the State of Alaska and in connection with legislative proceedings of the State of Alaska.”

During the 2007 legislative oil tax debate, Wood Mackenzie explicitly said the state could make public some information from its *Government Take* study, which the Palin administration had purchased. In a letter to then-LB&A Chair Rep. Ralph Samuels, the company wrote, “[W]e generally have no objection to some limited material (such as selected graphs) being used within [subscribers’] submissions to the session to illustrate points or opinions.”

Hawker described the Wood Mackenzie survey as a valuable database that’s not particularly user-friendly: “It’s just a huge, huge, huge amount of data. It is intended to be used by very sophisticated petroleum system analysts.”

He said the survey has “limited utility” for the Legislature’s purposes, and asserted that Wood Mackenzie had overstated its value.

Stedman, who is vice-chair of LB&A, said the information covers both fiscal regimes and prospectivity – a measure of how much oil and gas a given region has. Using an interactive model, he said he was able to see how the difference in government take between Alberta and Alaska grew as the price of oil increased.

“I think Hawker and myself could make use of this information more than most,” he said. Hawker is a certified public accountant and Stedman is a financial services professional.

Lawmakers who signed confidentiality agreements to view one or both surveys are Sens. Stedman, Huggins, Wielechowski, Fred Dyson, Cathy Giessel, Hollis French, and Lesil McGuire and Reps. Hawker, Kerttula, Seaton and Mia Costello.

One staffer per legislator is allowed to see the reports. Ten staff members have signed up to access one or both surveys.

## LEGISLATURE

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### Senators consider relaxing ethics provisions

In 2007, in the wake of political scandals that had elected officials scrambling to out-ethical each other, lawmakers passed sweeping legislation meant to close loopholes and reduce opportunities for legislators to commit real or perceived ethical lapses [see **Senate poised to vote on ethics reform**, *ALASKA BUDGET REPORT*, February 15, 2007].

But the pendulum swings, and lawmakers are beginning to chafe against what some view as over-zealous or counterproductive restrictions. Sen. John Coghill this year introduced legislation relaxing certain rules. The most controversial provision would allow legislators to engage in some partisan activity while on state-sponsored travel. The Legislative Ethics Act bars lawmakers from campaigning or engaging in other partisan activity while on a trip paid for by the state. Many senators embrace the new proposal.

“To expect me to go to Anchorage, take care of some business, fly all the way back to Sitka, then turn around, fly back to Anchorage, fly back home – it’s ludicrous,” Sen. Bert Stedman of Sitka told reporters Tuesday. Stedman said last fall, when he was not even campaigning, the law prevented him from stopping by Lisa Murkowski’s campaign headquarters while he was in Anchorage on state business.

Sen. John Coghill, a member of the Senate’s four-person Republican minority, introduced SB 89 in February. As introduced, the bill

- allows lawmakers to engage in partisan activity while on state travel as long as the partisan activity doesn’t cost the state extra money, isn’t done during regular business hours or within 30 days of an election, and doesn’t include fundraising,
- allows lawmakers to use legislative mailing lists for campaign purposes,
- allows people who aren’t lobbyists to give lawmakers tickets to charitable events worth more than \$250,
- bars lawmakers in most cases from helping constituents with certain proceedings once the constituent’s case has been appealed to an administrative officer,
- extends the timeline for reporting gifts of travel from 30 to 60 days, and

- changes how alternates for the Select Committee on Legislative Ethics are chosen and when they can participate.

The Senate State Affairs version of the bill removed the first two provisions, leaving in place the ban on use of state resources for partisan or campaign business.

“I have big concerns ... over allowing political activities while your trip is funded by the state,” State Affairs Chair Bill Wielechowski, an Anchorage Democrat, said in an interview Tuesday. “If you want to engage in political activities, then you pay for it yourself, or out of your campaign fund.”

The State Affairs substitute also stripped language explicitly allowing lawmakers to use their legislative mailing lists for campaign purposes.

At a hearing March 31, Wielechowski suggested the mailing list provision is unnecessary because the Select Committee on Legislative Ethics issued an advisory opinion that lawmakers may use the lists for campaign purposes. Coghill expressed concern the ethics committee might rescind its opinion if lawmakers strip the language from SB 89.

In an interview, Coghill offered an example to support his case for relaxing the travel rules. If legislators meet in Anchorage for an interim committee hearing, the Anchorage members can skip out for a Republican Party luncheon, while a member flying in from Fairbanks can't. “It's *unethical* for [the Fairbanks legislator] to do that?” Coghill said. “There's a problem there.”

“Somehow we've lost common sense in the whole process,” Senate President Gary Stevens of Kodiak told reporters Tuesday. He commended Coghill for carrying the controversial legislation.

Sen. Donny Olson of Golovin has complained that he's had to dip into his legislative office expense account for trips that include both state and partisan business [see **Lawmakers double their office expense accounts**, *ALASKA BUDGET REPORT*, March 3, 2011].

At the State Affairs hearing, Ethics Committee Administrator Joyce Anderson said her committee has struggled with the travel question since 1993. “The Ethics Committee feels it is the Legislature that needs to decide if they want to change this policy or keep it as it is,” she said.

The Select Committee on Legislative Ethics has five public members and four legislative members and is responsible for administering the Legislative Ethics Act. Coghill and Stevens are the two Senate members on the committee.

In a 2009 letter to the Alaska Public Offices Commission (APOC), the committee wrote that the Legislative Ethics Act imposes an “absolute restriction” and recommended lawmakers adopt legislation allowing for *de minimis* use of state resources for non-state business.

In May 2010, the legislative ethics committee reversed its stance in an advisory opinion. Under the opinion, lawmakers were free to campaign during state-sponsored travel as long as the primary purpose of the trip was state business. “In short, we believe that the nature of the business rather than whether it is paid for with state resources should be the governing standard in determining whether an ethical violation has occurred,” stated the opinion.

The four legislative members of the committee and one public member concurred in the opinion; three public members, including the chair, objected. One public member was absent. The opinion was rescinded two weeks later, based on advice from legislative attorneys, according to Coghill.

Coghill's approach in SB 89 is more permissive than what the ethics committee proposed in its 2009 letter to APOC. The letter explained that a *de minimis* use provision would require that state business be the primary purpose of a trip, and that a legislator reimburse the state for a portion of

travel costs commensurate with the time spent on partisan business. That's similar to the standard that governs executive branch use of state aircraft for partisan political purposes (AS 39.52.120(f)). Coghill's SB 89 would require no determination about the primary purpose of the trip, and no reimbursement.

The State Affairs Committee added two new provisions to the bill, waiving financial disclosure requirements for legislators whose profession requires them to keep certain information confidential, such as lawyers; and allowing volunteers working less than 30 days to skip legislative ethics training.

The committee moved the bill with a "do pass" recommendation from Sen. Kevin Meyer and no recommendations from Sens. Wielechowski, Albert Kookesh, Joe Paskvan and Cathy Giessel. The bill has further referrals to the Judiciary and Finance committees. Coghill said he doesn't expect it to pass this year.

## TRANSITIONS

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### Staff changes

**Bill McAllister** has announced his intent to resign his position as communications director at the Department of Law. He has said he plans to work for KTVA Channel 11 in Anchorage.

McAllister's return to journalism follows a wild ride on the other side. After covering the Minnesota Legislature for many years and the Alaska Legislature for seven years, in July 2008 McAllister took a job as then-Gov. Sarah Palin's communications director, just days before the "Troopergate" controversy broke and weeks before Palin was catapulted to national prominence as the Republican vice presidential nominee [see **Governor's Office staff changes**, *ALASKA BUDGET REPORT*, October 31, 2008].

McAllister's stint with Palin ended in June 2009 when Palin replaced him as communications director (with an even shorter-lived appointee named David Murrow). McAllister was transferred to a vacant special assistant position at the Department of Law, taking a \$17,000 pay cut. His duties were to serve as the department's communications director [see **Staff changes**, June 21, 2009].

Law's Administrative Services Director Dave Blaisdell said the attorney general had not made any decisions about how the special assistant position will be used once McAllister leaves. "I do expect we'll fill it, though."

McAllister's current salary and anticipated separation date were unavailable at deadline. McAllister's salary at Law in June 2009 was range 23F (\$87,192).

At KTVA, McAllister may be replacing reporter and anchor **Matt Felling**, who left the station to take a job, effective April 4, as Sen. Lisa Murkowski's communications director. [He replaces a non-Alaskan named Mike Brumas who left Murkowski's staff to take a promotion with Sen. Mitch McConnell.] Felling came to Alaska in 2008 from Washington, D.C., where he worked as a blogger for CBS and prior to that, as media director of the non-profit Center for Media and Public Affairs.

### Quotable

"You're a fly looking for a fly swatter on this one."

—Sen. John Coghill, acknowledging the controversial nature of his proposal to allow legislators to engage in some partisan activity while traveling on state-sponsored business