

1 •PRESENTATION TO THE LEGISLATURE ON ALABAMA'S
FINANCIAL CONDITION

2 JANUARY 12, 2009

3 I. Introduction

A. Today, I will discuss with you the revenue and appropriation structure of the state; the status of the General Fund and the Education Trust Fund for FY 2008; the revised LFO revenue estimates for FY 2009; the LFO revenue forecasts for FY 2010; and a few general fiscal issues

B. I will not discuss agency specific issues today because this Committee will talk with agency directors directly later this week

4 II. Revenue and Appropriation Structure of the State

A. Exhibit 1 shows the appropriation of all state funds for FY 2009 (prior to proration)

1. for FY 2009, the General Fund appropriations total \$2.1 billion of the grand total of \$11.5 billion in state appropriations
2. the ETF appropriations total \$6.4 billion and other earmarked appropriations total \$3 billion
3. the Alabama Medicaid Agency will receive the largest amount of General Fund appropriations-\$623.8 million or 30% of the entire fund for FY 2009
 - a. Medicaid also receives other earmarked state funds in FY 2009 totaling \$602.9 million (excluding departmental transfers)
 - i. this is also the largest amount of earmarked funds outside of the Education Trust Fund
 - ii. Transportation is second with \$567.9 million (primarily gasoline and motor fuel tax receipts)
 - b. Medicaid has a total of \$1.2 billion in state funds

which is used to match federal funds primarily at the rate of \$2.12 in federal funds for every \$1 in state funds

- c. Medicaid expenditures are a major economic factor in Alabama and are a driving force in the General Fund budget

B. Exhibit 2 shows the percentage that certain revenue sources contributed to the General Fund in FY 2008

1. insurance premium taxes accounted for the largest single source of revenue at approximately 14.4% of the fund (this tax is in lieu of income taxes for insurance companies)

- a. CAPCO credits

- i. Act 2002-749 created the CAPCO program which allowed the Alabama Development Office to allocate up to \$100 million in insurance premium tax credits to insurance companies making investments in ADO certified venture capital firms
- ii. the maximum amount of credits available in a fiscal year under this act was \$12.5 million
- iii. the negative effect of these credits on the General Fund were first realized in FY 2006
- iv. Act 2007-742 extended the CAPCO program by allocating an additional \$100 million of insurance premium tax credits (the maximum amount of credits in any one year allowable under this act will be \$17.5 million)
- v. the negative effect of these additional credits will first be realized in FY 2011; it is projected that \$3.5 million in additional credits will be taken in FY 2011

2. interest income accounted for 9.5% of the General Fund

- a. this includes interest on regular state deposits and interest earned on the Alabama Trust Fund

- b. the recent interest rate reductions by the Federal Reserve Board will negatively affect this revenue source to the General Fund and will be accounted for in the LFO revised estimates
 3. oil and gas severance taxes accounted for 8.1% of the fund as the result of high prices for most of FY 2008, although those prices are significantly lower now
 4. property taxes accounted for 7.2% of the fund-the General Fund receives 2.5 mills of the state's 6.5 mills of ad valorem tax (most property taxes are levied by local governments)
 5. one-time receipts accounted for 14.9% for a total of \$271 million which I will detail later
 6. you can see the other major sources of revenue to the General Fund on this pie chart
- C. Exhibit 3 shows the percentage that certain revenue sources contributed to the ETF for FY 2008
1. income taxes (both corporate and individual) accounted for approximately 54.1% of the ETF
 2. sales taxes accounted for approximately 26.7% and
 3. utility taxes accounted for 6.4%
 4. the other category accounted for 8.8% which is a higher percentage than usual because of the transfer of \$439 million from the statutory proration prevention account and the \$32 million repayment from the PSCA bond issue
 5. there are fewer sources of revenue to the ETF than the General Fund but most of the growth taxes are earmarked to the ETF
 6. this is a double-edged sword; these revenue sources respond quickly to shifts in the economy
 - a. the downward shift in the economy was evidenced in the last several months of the fiscal year that ended September 30, 2007 and fully evidenced in FY 2008

7. I have asked the Legislature each year to spend less than LFO revenue estimates in respect for economic cycles which affect the ETF very quickly
 - a. this Legislature provided a mechanism in the last several years of high growth for setting aside funds in the statutory Proration Prevention Account which allowed the state to avoid cuts to educational entities in FY 2008



III. Economy

A. National economy

1. according to the National Bureau of Economic Research, the current recession began in December, 2007
2. the U.S. economy began losing jobs in June of 2008
3. the decline in jobs accelerated in the fall
 - a. in June 115,000 jobs were lost
 - b. in December 2008, 524,000 jobs were lost
 - c. in calendar year 2008, 2,600,000 jobs have been lost
 - d. this is the largest decline in jobs since 1945
4. the collapse of the credit markets this fall clearly made the recession much worse
5. most economists are predicting that the economy will remain in a recession throughout 2009, some are predicting even longer
 - a. if the recession lasts through 2009, it will be the longest recession since the end of World War II

B. Alabama's economy

1. the growth in employment in Alabama began to decline in February, 2008; however, Alabama continued to add jobs at a slower rate through August, 2008
2. in September, the state had a decline of 1500 jobs, the first decline since December, 2003


3. the preliminary November job numbers showed a dramatic decline of 15,400 jobs, the largest decline since September, 2002
4. aggregate state sales tax receipts have been negative for the past 24 months and the decline appears to be deepening
 - a. adjusted gross sales tax receipts have declined by 7% in the last 3 months
- C. Economists do not know where this economy is headed and trying to forecast revenue in this uncharted environment is difficult at best

6 IV. Exhibit 4 shows the Condition of the General Fund for FY 2008

- A. the General Fund began the fiscal year with a balance of \$239 million
- B. actual receipts for the year were \$1.5 billion
 1. in addition, there were \$5.3 million in transfers from state agencies' earmarked funds to the General Fund
 - a. the Public Service Commission-\$3.8 million and
 - b. the Securities Commission-\$1.5 million
 2. there was a \$15 million extra transfer from the abandoned property escrow account to the General Fund and
 3. a \$19 million transfer from the business privilege tax above the regular estimates
 4. there was \$17 million transferred from Corrections land sales
 5. a \$12.2 million appropriation from tobacco revenues to the General Fund
 6. \$85.8 million was transferred from Exxon litigation funds
 7. \$4.7 million was transferred from pharmaceutical litigation settlements in FY 2008
 - a. 2 (Dey and Takeda) of the more than 70

pharmaceutical companies sued by the state of Alabama for alleged overpricing of prescription drugs sold to Medicaid clients settled with the state; I will discuss this litigation further in this presentation

8. \$117.3 million in capital gains in the Alabama Trust Fund recognized by the Alabama Trust Fund Board and transferred to the General Fund in October, 2007
 9. that made a total of \$1.8 billion in receipts for FY 2008
- C. with the addition of the beginning balance, there was a total of \$2.1 billion available for expenditure in FY 2008
- D. there were total expenditures of \$1.8 billion from the General Fund net of reversions
- E. therefore, FY 2008 ended with a balance of \$219 million in the General Fund

7  IV. Exhibit 5 shows the LFO Projected Condition of the General Fund for FY 2009 and FY 2010

- A. the General Fund began FY 2009 with a balance of \$219 million; revenues in FY 2008 were \$24 million more than anticipated and appropriated for FY 2009
1. the LFO revised revenue estimates for the General Fund for FY 2009 are \$1.4 billion
 2. this is \$92 million less than LFO's original estimates due mainly to
 - a. a decrease in the estimate for interest income on state deposits of \$57 million
 - i. this reduction is the result of lower interest rates and the loss of balances in the various funds to invest and
 - b. a major reduction in the transfer from the abandoned property reserve of \$25 million
 - i. the State Treasurer has informed this office that she expects to be able to transfer only \$20 million from the abandoned property reserve fund rather than the \$45 million that the FY 2009

budget was based upon

3. just as the Legislature did in FY 2008, \$5.3 million was transferred from the Public Service Commission and the Securities Commission
4. the Governor proposed transferring an additional \$19 million from the business privilege tax escrow account
5. the Legislature transferred an additional \$107 million from that account during the budget process (for a total of \$126 million)
 - a. that account has been used to pay refunds from the old franchise tax
 - b. based on LFO estimates, this fund will end FY 2009 with a balance of \$16 million available to pay refunds
6. in December, 2008 the Attorney General announced additional settlements with 8 other pharmaceutical companies in the Medicaid litigation in the amount of \$28 million of which \$13.8 million will be deposited into the General Fund in FY 2009
 - a. Medicaid will receive \$323,800 from these settlements
 - b. the remainder goes to
 - i. Federal Centers for Medicare and Medicaid Services (CMS)-\$5.7 million
 - ii. the Attorney General's Office-\$700,000 and
 - iii. attorney fees and expenses-\$7.4 million
7. there was an appropriation of \$12.9 million from tobacco revenues to the General Fund
8. and \$15.5 million was included as a transfer from the Incentives Financing Authority
 - a. the ability to make this transfer depends upon the opportunity to refinance the Authority's bonds because the excess reserve has been pledged for the current bonds and
 - b. the current bond market makes refinancing more

difficult

9. the total receipts now estimated by the LFO to the General Fund for FY 2009 are \$1.6 billion
10. when estimated receipts are added to the beginning balance, there is a total available of \$1.8 billion
11. the current estimated appropriations from the General Fund total \$2 billion
12. the Legislature included a provision in the FY 2009 budget that reappropriated any reverted balance that a state agency might be able to save in FY 2008
 - a. those amounts totaled \$42.3 million
13. that makes a total of \$2.1 billion in appropriations from the General Fund for FY 2009
14. based on LFO estimates, the General Fund will be \$253 million (12.2%) short for the current fiscal year
15. the Governor announced his Deficit Prevention Plan on December 15, 2008 that included
 - a. a hiring freeze
 - b. a freeze on merit raises for state employees
 - c. state agencies were told to reduce spending by 10% which the Governor estimated would save General Fund agencies an estimated \$200 million
 - d. to accomplish this level of savings every agency would be required to save the full 10%, including Medicaid and Corrections and it is unlikely that all agencies will be able to realize a full 10% savings
16. in November, 2008 the voters ratified the Constitutional Amendment (No. 803) that established a General Fund Rainy Day Account within the Alabama Trust Fund
 - a. the amendment provided that up to 10% of the previous year's appropriations could be available to prevent proration of the General Fund-that equates to approximately \$190 million for FY 2009
 - b. the amendment also provides that any monies

borrowed be paid back within 10 years

B. LFO projected receipts for FY 2010 are \$1.4 billion

1. this is \$630 million less to appropriate than actually appropriated for FY 2009 and \$377 million less than LFO's projection of total available revenue in FY 2009

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V. Federal Economic Stimulus and Recovery Efforts

A. Congress and President-Elect Obama have talked about an additional federal economic stimulus package

1. the first stimulus package last spring consisted mainly of a tax rebate for individuals and an accelerated depreciation deduction for businesses
2. in the fall of 2008, Congress passed a \$750 billion economic recovery bill (known as TARP) which was initially designed to buy distressed mortgage-backed securities; however most of the \$350 billion has been expended to provide liquidity to banks and the credit markets
3. there seems to be general agreement that the proposed economic recovery plan will target spending, tax cuts and other programs to insure the dollars will get into the economy quickly
4. I have no idea at this point which programs will be funded and the amount of those funds that Alabama will receive
5. some of the programs that are being discussed include
 - a. flexible grants to states for their discretionary use
 - b. infrastructure grants for highways, mass transit and other "shovel ready" infrastructure projects
 - c. foster care, adoption assistance funds and unemployment compensation
 - d. increasing the federal Medicaid match
 - i. the increase in the federal match that has been talked about is 5.5%
 - ii. if that occurs, Alabama will receive \$398 million

over a two year period and I read some reports that would extend the increase even longer

- a) Medicaid-\$335 million
 - b) Public Health-\$14.3 million
 - c) Mental Health-\$39.4 million
 - d) Senior Services-\$3.4 million
 - e) Human Resources-\$2.6 million
 - f) Rehabilitation Services-\$1.8 million
- e. although I do not know the size of a possible economic stimulus package, as much as \$1.3 trillion has been discussed by various economists and politicians
6. to put that in perspective, I looked back to the federal assistance plan to states in FY 2003 and FY 2004
7. the entire federal plan was approximately \$20 billion and Alabama received about \$270 million in assistance
8. the size of the plan being talked about this time is much larger

9 VI. Projected Outlook for the General Fund for FY 2010

A. employee benefit increases

- 1. the employers' retirement rate will increase from 11.88% to 11.94% for FY 2010
 - a. for a total increased cost of \$5.5 million with the General Fund's share being \$2 million
- 2. the employers' rate for health insurance is estimated to increase from \$775 (although the effective rate is actually \$710 because the SEIB granted a one-month premium credit) to \$805 per employee per month
 - a. for a total cost of \$43 million
 - b. the General Fund agencies share is \$15.5 million

10 VII. Exhibit 6 shows the Condition of the ETF for FY 2008

- A. the ETF began FY 2008 with a balance of \$275.7 million plus \$4.3 million in a debt service reserve for a bond

payment due on October 1, 2008 for a total beginning balance of \$280 million

1. however this balance was \$118 million less than was anticipated when the budget was enacted
- B. actual receipts to the ETF for the fiscal year were \$5.943 billion
1. this was \$120 million less than LFO estimates for FY 2008 and \$145 million less than contemplated in the FY 2008 legislative budget
 - a. this represented a growth rate of 1.52% and receipts needed to grow 5.4% to fund the FY 2008 budget
 2. the major revenue sources that did not meet projections were income taxes and sales taxes
 3. the \$32 million that was appropriated directly to the Enterprise School System for rebuilding the schools damaged and/or destroyed by the March 1, 2007 tornado was repaid to the ETF from the \$1 billion bond issue
 4. the entire balance of \$439 million in the statutory proration prevention account was needed to avoid proration in FY 2008
 - a. this balance accumulated over a 3-year period (FYs 2004, 2005 and 2006) mainly as the result of this Legislature setting aside 75% (instead of the statutory requirement of 20%) of unanticipated and unappropriated beginning balances
 - b. that 75% requirement was enacted into statute in last year's Special Session
 - c. that accounted for \$366 million of the \$439 million in the account
 - d. the Legislature appropriated \$18 million in FY 2006 and another \$16 million in FY 2007 directly into the account
 - e. and the account earned \$39 million in interest
 5. the total available for expenditures in FY 2008 was

\$6.695 billion

C. the amount actually expended was the entire \$6.695 billion

1. in addition, an estimated \$40 million that would have been deposited into the ETF in FY 2009 was prepaid into the ETF in FY 2008
 - a. \$16 million in sales taxes
 - b. \$16 million in utility tax receipts and
 - c. \$8 million in corporate income tax receipts
 - d. this allowed the ETF to finish the year without any proration but will impact the receipts into the ETF for FY 2009

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VIII. Exhibit 7 shows the LFO Projected Condition of the ETF for FY 2009 and FY 2010

A. the ETF began FY 2009 with no beginning balance

B. LFO revised receipts for FY 2009 are \$5.6 billion

1. this represents a negative growth rate of 6%
2. this is \$552 million less than LFO original estimates for FY 2009 due mainly to
 - a. a reduction in gross individual income tax growth rate from 4.5% to 0%
 - b. a reduction in gross sales tax growth rate from 3% to -4% and
 - c. a reduction in gross corporate income tax growth rate from 4% to -30%
 - d. these are drastic reductions, but looking at the first quarter's actual receipts they are justified
 - i. individual income tax receipts are a negative .18% for the quarter but a negative 14.6% for the month of December
 - ii. corporate income taxes are a negative 35% for the quarter and a negative 31% for December
 - iii. sales tax receipts are a negative 10% for the

- quarter and a negative 12% for December
- iv. so LFO estimates actually forecast a moderation in the negative growth pattern
- 3. there is a reduction in receipts of \$82.6 million that was anticipated for payment of debt service for the \$1.07 billion bond issue authorized in Act 2007- 415
- 4. this makes a total available for expenditure of \$5.59 billion
- C. current estimated appropriations from the ETF for FY 2009 are \$6.36 billion
- D. in addition, the Legislature reappropriated any reverted funds from FY 2008-this amounted to \$31.4 million
- E. making total appropriations for FY 2009 to be \$6.39 billion
 - 1. the ETF would need to grow 7.6% for the year to fund this level of expenditures
- F. based on LFO revised estimates, there will be a deficit of \$801 million
- G. Exhibit 8 shows the status of the constitutional Rainy Day Account
 - 1. the voters approved Amendment 1 in November
 - 2. that amendment repealed Amendment 709 that created an ETF Rainy Day Account of \$248 million
 - 3. it created a new ETF Rainy Day Account
 - a. based on 6.5% of the previous year's appropriation (approximately \$437 million for FY 2009) which
 - b. must be repaid in 6 years
 - c. in future years withdrawals are limited to the average of available revenue certified by the Finance Director and the Legislative Fiscal Officer
- H. the Governor has declared proration of 12.5% in the ETF for FY 2009
 - 1. he withdrew \$221 million from the Rainy Day Account in December and announced that he would withdraw the balance of the funds in the Rainy Day Account

- during the remainder of the year
- 2. based on the announced 12.5% proration by the Governor, the Rainy Day Account would absorb approximately 7% of the proration leaving the educational agencies to cut 5.7% (\$364 million) from their appropriations
- I. the LFO revised projections for FY 2009 would also account for 12.5% proration so this office agrees with the reduction level the Governor has provided for
- J. going back to Exhibit 7
 - 1. LFO revenue projections would have no beginning balance for FY 2010
 - 2. estimated LFO receipts are \$5.7 billion for FY 2010 (representing a 1.72% growth rate)
 - a. most of this growth can be attributed to adjusting for the \$40 million that was prepaid from FY 2009 into FY 2008
 - b. LFO estimates assume only a 1% growth in individual income taxes; no growth in corporate income taxes; and a 1% increase in state sales tax receipts
 - c. so LFO is projecting a slow beginning recovery in FY 2010
 - 3. this amount is \$96 million more than the projected receipts for FY 2009
- K. the appropriations from the ETF in FY 2008 were \$6.7 billion and the amount projected to be available for appropriations in FY 2010 is \$5.7 billion
 - 1. that is a reduction of \$1 billion from that level of appropriations in FY 2008
- L. what this means for an agency for FY 2009 and FY 2010
 - 1. real cuts in FY 2009 (after release of the Rainy Day Account) will be \$364 million or 5.7%
 - 2. additional cuts for FY 2010 using LFO estimates will be \$341 million or another 5.7%

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IX. Outlook for the ETF for FY 2010

A. teacher and education employee benefits

1. the TRS employer rate for FY 2010 will increase from 12.07% to 12.51%
 - a. the total cost of the TRS rate increase is \$28 million with the ETF share being \$20 million
2. the PEEHIP employer rate for FY 2010 will increase from \$752 to \$805 per employee per month for a total cost of \$66 million (with the ETF share being \$53 million)
 - a. the cost to the ETF for K-12 entities is estimated to be \$48 million
 - b. and the cost to the ETF for the 2-year college system is estimated to be \$2.8 million

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X. General Fiscal Issues

A. Alabama Trust Fund history

1. in 1982, the state received \$467 million from off-shore oil and gas leases that were deposited into the Heritage Trust Fund
2. Amendment 450 to the Alabama Constitution ratified in 1985 established the Alabama Trust Fund (ATF) which was funded with \$333.6 million received by the state from off-shore oil and gas leases
3. the Heritage Trust Fund merged with the ATF in 2001
4. the assets in the ATF have grown to \$3.2 billion as of September, 2008
5. the assets of the ATF are held in perpetual trust and cannot be appropriated, expended or disbursed except as provided by constitutional amendments such as the one that created the Alabama Capital Improvement Trust Fund (ACITF)

B. Alabama Capital Improvement Trust Fund

1. this trust fund was established by Constitutional Amendment 666 ratified in November, 2000 and is

funded with 28% of the royalties deposited into the Alabama Trust Fund in the previous fiscal year

- a. \$618.5 million has been deposited into the ACITF since its inception
2. the amendment created a Bond Commission with authority to issue up to \$350 million in economic development bonds
 - a. a Constitutional amendment was ratified by the voters in June, 2007 to increase this authority to \$750 million
 - b. \$710 million in bonds have been issued
 - c. the remaining bonding authority is approximately \$40 million
 - d. royalties are used to pay debt on these bonds
 - e. the remaining royalties in the ACITF may be used for other debt of the state or for economic development purposes
3. Exhibit 9 shows the history and status of the ACITF
 - a. the beginning balance in the Alabama Capital Improvement Trust Fund for FY 2008 was \$39.3 million
 - b. the 28% of royalties deposited into the Capital Improvement Trust Fund in FY 2008 amounted to \$71.7 million
 - c. expenditures from the ACITF for FY 2008 were \$92.9 million
 - d. the ending balance in the ACITF for FY 2008 was \$18.1 million
 - e. the royalties for FY 2009 are \$96.7 million; the ending unobligated balance in the ACITF for FY 2009 will be \$31.6 million if additional bonds are not issued by the Commission; the Legislature does not make any additional appropriations from the ACITF; and the State Docks expends the remainder of its allocation in FY 2009

4. of the amount appropriated from the ACITF to date
 - a. \$287.6 million has been appropriated for new economic development projects and
 - b. \$299.3 million has been appropriated to pay existing debt service payments
 - i. in FY 2009, the Legislature appropriated \$24.6 million for existing debt service
 - c. the LFO projections for FY 2010 would allow enough revenue to continue to supplant \$24.8 million in existing debt; fulfill the obligations of debt on bonds issued by the Commission; pay the \$2 million earmarked for the Industrial Development Authority; and leave a balance of \$19.9 million
- C. Public Road and Bridge Fund Status
1. Exhibit 10 shows you receipts to the Public Road and Bridge Fund for 12 years
 - a. the fund is made up of gasoline taxes, motor fuel taxes and related fees and inspection fees
 - b. you can see that the fund showed an actual decrease in FY 2008 over FY 2007 of approximately \$22 million
 - i. the Department of Transportation (DOT) is projecting further decreases in FY 2009 and FY 2010
 - ii. Alabama's gasoline tax is based on volume rather than price so it is influenced by consumption and not the price at the pump
 - iii. DOT has traditionally used state funds in the Public Road and Bridge Fund to match federal transportation funds available to Alabama
 - a) the remainder of state funds were used for maintenance of state roads
 2. a component of the Federal Economic Stimulus Package being discussed is "shovel-ready" infrastructure projects including roads and bridges

- a. Alabama's DOT was unable to provide a current list or value of projects that might be considered "shovel-ready"

D. Tobacco settlement revenues

1. the Master Settlement Agreement (MSA) that Alabama entered into in 1998 with the major tobacco manufacturers has resulted in \$979 million in payments to Alabama since FY 2000
2. FY 2006, 2007 and 2008 payments were affected, and future payments will be affected, by arbitrations between states and participating manufacturers over whether states have diligently enforced the MSA
3. a provision in the MSA specifies that the amount paid to states would be reduced if
 - a. the participating manufacturers' market share fell more than 2 percent as compared to 1997 and
 - b. a determination was made by an independent auditor that the MSA was a significant factor in that decline of market share
4. however, a state's payment is exempt from the reduction if the state "diligently enforced" its statute that requires companies not participating in the MSA to create escrow accounts to pay judgments in any future litigation
5. in March, 2006 an independent auditor determined the participating manufacturers' market share for 2003 had fallen more than 2 percent and that the MSA was a significant factor, but also determined that all states qualified for the "diligent enforcement" exemption because they were "presumed" to have diligently enforced their statutes
 - a. several tobacco companies filed a motion in circuit court in Montgomery asking the court to enforce the mandatory arbitration provision of the MSA on the question of whether Alabama diligently enforced its statute

- b. in March, 2007 the circuit court ordered arbitration but the Attorney General appealed that decision to the Alabama Supreme Court
 - c. in March 2008 the Alabama Supreme Court held that MSA required arbitration and that the arbitration should be national in scope
 - d. 7 states formed an arbitration group in 2007 to work with participating manufacturers; 26 states have joined that group to date; Alabama has not joined
 - e. participating manufacturers have offered incentives to states that join by January 31, 2009
 - f. negotiations are expected to begin in January 2010
6. the amount this office projects the state to receive in FY 2009 is \$108.4 million
7. Exhibit 11 shows FY 2009 appropriations from tobacco revenues of \$118.5 million
8. if we assume that all the companies, except Philip Morris, will escrow the disputed amount in April 2010 rather than pay it to the states, our current estimate for FY 2010 from tobacco revenues is \$109.2 million
- E. Governmental Accounting Standards Board (GASB) rule
- 1. historically, state and local governments have funded retiree healthcare benefits on a “pay-as-you-go” or cash basis
 - 2. the Governmental Accounting Standards Board adopted Rule 45 that requires governments to begin providing information about these incurred costs when they issue their financial statements; Alabama is required to provide this information beginning with its financial statement for FY 2008
 - 3. in the Special Session of 2007, the Legislature authorized the PEEHIB Board and the SEIB Board to create health care trust funds which they did in March, 2007
 - 4. the PEEHIB has transferred a total of \$651 million into the trust

- a. the unfunded liability for PEEHIP was valued at \$12.6 billion at the end of September, 2007
- 5. the SEIB has transferred a total of \$77 million
 - a. the unfunded liability at the end of September, 2007 was valued at \$3 billion

F. Gulf of Mexico Energy Security Act

- 1. Congress passed an act that opened over 8 million acres of deepwater areas in the Gulf of Mexico for energy production and sends 37.5% of federal royalties from the new energy exploration to the four Gulf states of Alabama, Louisiana, Mississippi and Texas
- 2. the 37.5% will be allocated among the 4 states based on each state's proximity to the center of the leased tract, however, each state will receive at least 10% of the amounts available each year
 - a. 20% of each state's share will be paid directly to the coastal political subdivisions
- 3. the states receive funds in 3 ways
 - a. the bonus bid which is the up-front amount the winning bidder pays for the lease
 - b. annual rent that the lessee must pay until production begins and
 - c. the royalties once production begins
- 4. there are 4 purposes within the federal law for which these funds may be expended
 - a. projects and activities for the purpose of coastal protection
 - b. mitigation of damage to fish, wildlife or natural resources
 - c. implementation of a federally-approved marine, coastal or comprehensive conservation management plan
 - d. mitigation of the impact of Outer Continental Shelf activities through funding of onshore infrastructure projects

5. beginning in 2017, the four Gulf states will receive 37.5% of royalties from all Gulf leases entered into beginning in 1982
 6. and beginning in 2022, the states share in all lease revenue from all blocks in the Gulf
 7. according to the Minerals Management Service, the first leases that are affected by this law went out for bid in March, 2008 and bids totaling nearly \$65 million were received
 8. Alabama's share of the bonus bid payments total approximately \$7 million of which 20% will be split between Baldwin and Mobile counties in FY 2009
 9. the larger lease tract is scheduled to go out to bid in the spring of this year
 10. there is no estimate for the amount Alabama will receive because
 - a. there is no way to know what blocks will be bid on
 - or
 - b. the amount of the bids or
 - c. the proximity to Alabama
- G. Status of selected pending litigation
1. Line-item veto litigation
 - a. the Governor vetoed Section 4 of the FY 2009 General Fund appropriation bill by an attempted line-item veto under Section 126 of the Alabama Constitution
 - b. Section 4 made 17.75% of the appropriations made elsewhere in the bill conditional to agencies other than the appropriations to
 - i. Medicaid
 - ii. Mental Health
 - iii. Public Health
 - iv. Human Resources
 - v. Senior Services and
 - vi. Child Abuse and Neglect Prevention

- c. Section 4 required the Governor to certify in October, 2008 the revised revenue available and allowed him to release those conditional appropriations proportionately across-the-board based on the certified available revenue
- d. at the time the General Fund budget was being drafted, 2 potential revenue sources were in doubt
 - i. \$63 million in interest payments from the Exxon lawsuit that was being disputed by the company in court which was later secured for the General Fund and
 - ii. \$117 million estimated by the Governor to be available from capital gains to be transferred from the Alabama Trust Fund which did not materialize
- e. the effect of the Governor's veto was to make absolute the \$180 million in conditional appropriations enacted by the Legislature
- f. the Joint Fiscal Committee filed a legal complaint seeking a Summary Judgment that the Governor's veto did not constitute an "item or items of any appropriation bill embracing distinct items" and that his message failed to "set out in full" the language that he intended to line-item veto and was therefore unconstitutional
- g. on August 25, 2008 the Governor moved to dismiss the complaint on grounds that the plaintiffs lacked standing, the case was not ripe for review and that the case was not justiciable (not appropriate for the court to review)
- h. the trial court denied the motion to dismiss and set a hearing for September 24, 2008
- i. the Governor petitioned the Alabama Supreme Court for a writ of mandamus
- j. the Alabama Supreme Court stayed proceedings and heard oral arguments only on the issue of

ripeness

- k. on December 17, 2008 the Alabama Supreme Court denied the Governor's petition for a writ of mandamus
 - l. the trial court heard arguments on the plaintiffs' motion for summary judgment on January 9, 2009 and indicated that he might issue a ruling as early as late this week
2. Medicaid Pharmaceutical litigation
- a. in addition to the 10 settlements reached in the last 2 years, 3 cases have actually gone to trial
 - b. the state won each case against AstraZeneca, GlaxoSmithKline, and Novartis
 - i. AstraZeneca was ordered to pay \$40 million in compensatory damages and \$120 million in punitive damages
 - ii. GlaxoSmithKline was ordered to pay \$81 million in compensatory damages and
 - iii. Novartis was ordered to pay \$33 million in compensatory damages
 - c. each company has appealed
 - d. there is a controversy over when and how settlements or damages are distributed to CMS
 - i. CMS sent a letter to State Medicaid Officers stating that states are required to return the FMAP portion on all state recoveries without deduction of legal expenses or administrative costs and before the appeals are finalized and the states have actually received the funds
 - ii. Alabama's Attorney General has filed a lawsuit seeking to invalidate the requirements of the CMS letter
 - iii. On January 5, 2009, CMS filed a motion requesting that the case be dismissed
3. VFJ Ventures Inc. v. Alabama Department of Revenue

- a. this is a case of first impression and other states with add-back statutes are watching the resolution of this dispute
 - b. in 2001, Alabama passed the “add-back statute” that requires companies to add back to their income any deductions that they take for royalty and interest payments made to related companies
 - c. VFJ made royalty payments to other members of the VFJ company for the use of the Lee and Wrangler trademarks
 - d. the Alabama Department of Revenue added back the royalty payment to VFJ’s Alabama income
 - e. VFJ challenged the constitutionality of the add-back statute and the application of the statute by the Department
 - f. the trial court ruled in favor of the taxpayer on statutory grounds and did not address the constitutional question
 - g. the Department appealed the decision to the Court of Civil Appeals in March, 2007 and the Court overturned the trial court and also held that the statute was constitutional
 - h. the Alabama Supreme Court in September, 2008 upheld the Court of Civil Appeals decision
 - i. the taxpayer has indicated that it will ask the U.S. Supreme Court to rule on the issue
4. ExxonMobil v. Department of Revenue
- a. the state of Alabama levies a tax for the removal of oil and gas from its soil and water
 - b. that tax is levied on the value of the raw product at the point of production and this dispute involves the proper method to be used to calculate the value
 - c. the Department of Revenue administrative law judge ruled in September, 2007 that all required costs of bringing the product to market should be allowed as deductions in calculating the taxable

value

- d. in the last Regular Session, a bill was introduced to change the tax base from the value of the oil or gas to the amount of oil or gas produced
- e. the Department of Revenue is hopeful that it can settle these cases without a significant impact on the FY 2009 or FY 2010 budgets and that legislation will be enacted to clarify the issues associated with the litigation

14 XI. Closing Remarks

A. Website

- 1. outline
- 2. exhibits
- 3. budget hearings schedule and
- 4. tax guide