

Protective Orders

HB330

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*House Judiciary Committee
February 16th, 2018*



ROYALTY AUDIT SECTION

- The Division of Oil and Gas collects **royalty and Net Profit Share payments** from producers through the **Royalty Audit Section**
- The **Royalty Audit Section** audits those payments to **ensure accuracy**
- The Royalty Audit Section was **realized in its current form in 2003** by HB246, which moved audit functions from the Department of Revenue back to the Department of Natural Resources.
- The Royalty Audit Section conducts audits of **state royalty and net profit payments**, as well as **Federal royalties** received from leases within Alaska
- **Since FY03**, the section has conducted **91 audits** and collected an additional **\$270.6 million** as a result of audited payments
- The most common audit issues found during a royalty audit include **incorrect marine/pipeline deductions, incorrect starting values, and “higher of”** calculation

COMPUTING ROYALTIES

Royalty Rate and Calculation

- The **royalty rate** and the **method** for calculating **royalty payments** to the state is **laid out in leases** signed between lessees and the state
- A 12.5% minimum **royalty rate** is set in statute
- All leases define **value** in relation to the sales of other producers
- Part 36 of the new-form leases lays out **four computations** that may be used to calculate royalties, with the **highest being the determining value**, commonly referred to as the “**higher of**”
- The Royalty Audit Section most often uses the **first and second computation methods** which are based on “**field price**”

36. **VALUE.** (a) For the purposes of computing royalties due under this lease, the value of royalty oil, gas, or associated substances shall not be less than the highest of:
(1) the field price received by the lessor for the oil, gas, or associated substances;
(2) the volume-weighted average of the three highest field prices received by other producers in the same field or area for oil of like grade and gravity, gas of like kind and quality, or associated substances of like kind and quality at the time the oil, gas, or associated substances are sold or removed from the leased or unit area or the gas is delivered to an extraction plant if that plant is located on the leased or unit area; if there are less than three prices reported by other producers, the volume-weighted average will be calculated using the lesser number of prices received by other producers in the field or area;

- The other two computation methods are based on “**posted price**”
 - In oil provinces like Texas, whose production is close to infrastructure and transportation, **sellers post prices** to alert buyers
 - Posted prices were more often used in Alaska when **Cook Inlet production was significant**
 - **DL-1 leases** refer to **price paid at the well, posted price**, and prevailing price in the field

WHY HB330 ?

- Lessees are **obliged to share price information** with the Division through lease provisions
- When auditing royalty payments, the Royalty Audit Section looks at and **relies on confidential sales information** from other producers
- When an audited producer appeals to the Commissioner, DNR needs to provide access to the confidential information as part of the record, in order to provide **due process**
- In recent years, producers have **refused to allow the Division** to share confidential price information with other producers in connection with royalty audits
- There are currently seven royalty audits that are pending due to confidentiality concerns, totaling **\$39.2 million**
- Occasionally, there are also appeals where the Commissioner needs to provide access to confidential geological, geophysical, or engineering data

WHAT ARE PROTECTIVE ORDERS

- The mechanism to allow for sharing of confidential information is a “**protective order**” issued by the Commissioner of Natural Resources.
- Protective orders are **common tools** used by courts, arbitrators, and certain agencies
- A typical protective order **limits access** to confidential information to **just the people litigating a case**, for the limited use of that case, with protections for **destroying or returning copies when a case is resolved**
- Departments like Fish and Game and Administration **routinely issue** protective orders to allow confidential information to be shared
- The Commissioner shall make a determination that **disclosure is necessary**
- **Notice** will be given to those whose information is considered for disclosure
- Once complete, the Commissioner **may issue a protective order** limiting the persons who may have access to the information and purposes for which it may be used
- Without passage of the bill, the Department will be forced to continue a **lengthy process** of asking courts to review each issue individually and issue a court protective order

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Section 1:

New provision adding to the Commissioner of Natural Resources duties and powers to include determining whether a disclosure is required for a royalty audit, appeal or reconsideration

Mandates that if the commissioner determines disclosure is necessary, notice and opportunity to be heard by those affected must be provided

Allows the commissioner to issue a protective order limiting the persons who may have access to the information and the purposes for which it must be used

Section 2:

Conforming language to allow protective order to be issued as it relates to cost data and financial information submitted in support of applications, bonds, leases and similar items

Section 3:

Conforming language to statutes dealing with punishment for divulging confidential information allowing for protective orders to view confidential information during lease royalty audits or appeals