SB 61 – Oil/Gas Lease; DNR Modifying Net Profit Share

ALASKA DIVISION OF OIL AND GAS

Purpose of the Proposed Legislation

Allow the Department of Natural Resources ("DNR") to modify the profit share percentage of Net Profit Share Leases ("NPSLs").

What are NPSLs?

NPSLs are State oil & gas leases that include a net profit share in addition to a traditional royalty share. The net profit share is calculated as a percentage of the net profits from the lease. A producer is allowed to recover capital expenditures for exploration and development (along with interest on those capital costs) before net profit share payments begin. Additionally, profits are calculated as net of operating expenses, transportations costs, taxes, and royalties.

NPSL Modification Mechanism

The bill would insert NPSLs into DNR's existing statutory authority to modify royalty rates (AS 38.05.180(j). This would allow DNR to modify NPSLs under the same circumstances in which DNR may modify royalty rates for existing leases.

Presently, statute allows DNR to modify royalty rates in order to make economic new production, extend production in existing fields, or return suspended fields to production. Under each of these scenarios, the applicant must demonstrate that the proposed project would not be economic without royalty modification. Applicants are required to meet a heightened standard of proof to show that a project is not economic without royalty modification.

A royalty modification may not reduce State royalties below a certain minimum (3% or 5%, depending on the basis for royalty modification). The legislation proposes a similar 10% minimum for modified NPSLs. Additionally, both current royalty modifications and the proposed NPSL modification are subject to legislative notice and hearings.

Why Allow NPSL Modifications?

Allowing NPSL modifications may assist in extending the life of certain fields that might otherwise become uneconomic over time or require additional capital investments to remain in production. Additionally, it allows DNR flexibility to choose between NPSL or royalty modifications when it may be advantageous to preserve royalties over net profit shares, or to increase net profit shares to craft "payback" scenarios.

Other Changes

In addition to allowing modification of NPSLs, the bill proposes to provide a new basis for royalty or NPSL modifications for enhancing production. Currently, royalty modifications are allowed if operating expenses make a field uneconomic, and the new basis would provide a similar basis for fields where additional capital investments are needed to enhance or extend production. Additionally, the bill clarifies an ambiguity by specifying that test production (during exploration) does not disqualify a field from "new production" royalty or NPSL modification consideration.