

**SENATE  
JOURNAL SUPPLEMENT**

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**April 26, 1996**

**Friday**

**No. 13**

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**FINDINGS OF FACT  
SENATE RESOURCES COMMITTEE  
REGARDING  
SENATE BILL NO. 318  
Dated April 24, 1996**

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**April 26, 1996  
Juneau, Alaska**



FINDINGS OF FACT OF THE SENATE RESOURCES COMMITTEE REGARDING SB 318, DATED APRIL 24, 1996. Based upon extensive public testimony, as well as the review of the written documents and presentations made by BP Exploration (Alaska) Inc. (BPXA), the Department of Law, and the Department of Natural Resources related to the proposal of BP Exploration (Alaska) Inc. and the Department of Natural Resources to amend certain of the lease terms of State of Alaska oil and gas leases within the Northstar Unit (NSU), the Senate Resources Committee makes the following findings of fact:

ARTICLE 1. THE STATE'S NET PROFIT SHARE AND HISTORY OF THE NORTHSTAR LEASES BEFORE UNITIZATION.

(1) The net profit share provision of four of the five state leases now included in the Northstar Unit was the competitively bid variable when the leases were originally offered for lease. The leases were offered with a fixed per acre cash bonus and a fixed royalty of 20 percent, and bidders were asked to submit sealed competitive bids based upon the percentage of net profits that the bidder would share with the state. According to the Department of Natural Resources, the average of the winning net profit share bids for these leases was "about 89 percent." As to the fifth state lease, the net profit share and royalty were fixed by the Department of Natural Resources at 40 percent and 12 1/2 percent, respectively, and the competitively bid variable was the amount of bonus offered by the bidders.

(2) The leases for which the net profit share was the bid variable, ADL Nos. 312798, 312799, 312808, and 312809, were offered for lease in State of Alaska Competitive Oil and Gas Lease Sale 30, that was held in December 1979. These four leases were issued in 1980 for a primary term of 10 years. The fifth lease, ADL 355001, was offered in State of Alaska Competitive Oil and Gas Lease Sale 39 in May 1983, and was issued in June 1983. The primary term of ADL 355001 was also 10 years.

(3) The original lessees of the Northstar leases included Amerada Hess Co., Shell Oil Co. (Shell), Enterprise Oil Co. (Enterprise), and Murphy Oil Co. In 1990, Amerada Hess Co. bought Enterprise's interest in the leases for \$2,000,000.

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(4) Three years after the initial four state leases were issued, Shell Oil Co. discovered the Northstar oil field while drilling the Seal Island No. 1 Well. Thereafter, during the period 1984 - 1986 additional wells were drilled to delineate the Northstar field. Those wells included Shell Seal Island No. 2 (1984); Shell Seal Island No. 3 (1985); Shell Seal Island No. 4 (1985); Amerada Hess Co. Northstar No. 1 (1985); and Amerada Hess Co. Northstar No. 2 (1986).

(5) Near the end of the 10-year primary term for the initial four state leases and the two Outer Continental Shelf (OCS) leases that later came to be included in the Northstar Unit, Amerada Hess Co. and its partners approached the Department of Natural Resources and the federal Minerals Management Service with a proposal to form the Northstar Unit.

### ARTICLE 2. FORMATION OF THE NORTHSTAR UNIT AND ACTIVITIES UNDER THE INITIAL PLAN OF DEVELOPMENT.

(1) Instead of attempting to take back the four leases that were due to expire so that they could be competitively leased again, division director James Eason of the Department of Natural Resources along with the Minerals Management Service approved formation of the Northstar Unit and its initial Plan of Development, thereby extending the ten-year primary term of the leases committed to the unit. The Department of Natural Resources' action in approving this exploratory unit which effectively extended all four state leases beyond their primary term (and effectively precluding competitively releasing them) without any certainty of production was consistent with the department's actions on a multitude of units including: Prudhoe Bay/Niakuk deferral, Prudhoe Bay/Pt. McIntyre deferral, Milne Point formation, Milne Point expansion, Duck Island, Point Thomson, Point Thomson expansion, Thetis Island, Hemi Springs, Big River, Astosch, Badami, Kuukpuk, Northstar formation, North Fork, Nicolai Creek, Kavik, Jones Island, Falls Creek, West McArthur River, and Gwydyr Bay. There has been no evidence that the Department of Natural Resources sought the Department of Law's advice about taking back the leases without certified wells and forcing the leases with certified wells into production in connection with its 1990 decision.

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(2) The term of the Northstar Unit was five years, from January 24, 1990, until January 23, 1995.

(3) According to the Department of Natural Resources, as a condition of its approval of the initial five-year Plan of Development for the unit, "[t]he state lessees were permitted to make progressively larger annual payments to the state in lieu of drilling a well in the Plan of Development. The extension fee payments were to be paid by the State lessees to the State under the following schedule: January 31, 1991—\$1 million; January 31, 1992—\$2 million; January 31, 1993—\$2 million; January 31, 1994—\$3 million and January 31, 1995—\$4 million, unless the fee obligation was extinguished by the drilling of a well in the unit area." As further conditions of its approval, the Department of Natural Resources also required Amerada Hess Co. and its partners to conduct certain petrological and petrophysical analyses, to gather an additional 250 line-miles of geophysical (seismic) data over the unit area, and to complete facilities design and reservoir engineering studies (pre-production studies) during the initial Plan of Development. The Plan of Development did not require Amerada Hess and its partners to begin production during the five-year initial term.

(4) Amerada Hess Co. and its partners made the scheduled "in lieu of drilling" payments for the first three years of the five-year Plan of Development period, with payments totaling \$5 million. Amerada Hess Co. then elected to drill the Amerada Hess Co. Northstar No. 3 Well in 1994, extinguishing its remaining financial obligations to the state under the terms of the Plan of Development for the Northstar Unit. Amerada Hess Co. and its partners also timely complied fully with each of the other conditions set out by the Department of Natural Resources in its approval of the initial Plan of Development. The Plan of Development had succeeded in getting one well drilled and in Amerada Hess Co. and its partners' completing certain other work commitments including petrological/petrophysical studies, production facilities design, seismic surveys, seismic analysis and interpretation, and reservoir engineering studies. However, no production from the unit occurred during the five-year period of the initial Plan of Development.

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(5) Following the drilling of the Amerada Hess Co. Northstar No. 3 Well earlier in 1994, Amerada Hess Co. met with representatives of the Department of Natural Resources and the Minerals Management Service in June 1994, to inform the agencies of its decision not to proceed with development of the Northstar Unit. The Department of Natural Resources has indicated that Amerada Hess Co. believed that the development costs for the Northstar Unit leases would exceed \$1,400,000,000. Assuming that the state could have gotten the leases back, because of their \$1,400,000,000 development cost, the Department of Natural Resources believes that the leases would have had little value and would most likely have been re-leased for a nominal bonus bid.

(6) Under the terms of the Northstar Unit Agreement, Amerada Hess Co. and its partners were required to submit a proposed Plan of Development to the Department of Natural Resources late in October 1994, 90 days before the expiration of the first Plan of Development, or the unit, which had already extended the Northstar Unit leases five years beyond their initial primary term, would terminate.

(7) Having made the decision not to proceed with development of the unit, Amerada Hess Co. did not submit a proposed second Plan of Development, and under the terms of the unit agreement and the department's regulations, the Department of Natural Resources issued a Notice of Default to Amerada Hess Co. and its partners on November 3, 1994.

(8) By subsequent letter dated December 12, 1994, the Department of Natural Resources amended its November 3, 1994, Notice of Default to provide that Amerada Hess Co. could cure the default either by providing an updated Plan of Development within 90 days or by voluntarily agreeing to terminate the Northstar Unit Agreement. The Department of Natural Resources' December 12, 1994, letter concluded "[f]inally, if the NSU terminates, three State of Alaska leases will continue beyond their primary term pursuant to paragraph 5(d) of the lease. The three leases are ADLs 312798, 312799 and 312809. This is further notice that within 90 days of termination of the NSU the lessees shall file a Plan of Development in compliance with the requirements set forth in paragraph 17 of the lease."

(9) Amerada Hess Co. and Shell began efforts to sell their respective interests in the Northstar Unit leases. Neither the exact timing nor the details of Amerada Hess Co.'s and Shell's efforts to market the leases are a matter of public record.

(10) Amerada Hess Co. and Shell subsequently sold their interests in the Northstar Unit leases to BP Exploration (Alaska) Inc. early in 1995. BP Exploration (Alaska) Inc. has characterized the terms of its purchase of the Northstar Unit lease interests as a "competitive process." However, BP Exploration (Alaska) Inc. has declined to make public the terms of its purchase or the identity of its competitors for the purchase of Amerada Hess Co.'s and Shell's interest in the Northstar Unit leases, citing a confidentiality agreement between the parties that prohibits its doing so. The state played no role in the offering or selling of Amerada Hess Co.'s and Shell's interest in the Northstar Unit leases to BP Exploration (Alaska) Inc. Lessees commonly sell interests in leases without the state's involvement other than approving assignments resulting from the sale.

(11) In its purchase of the Northstar Unit leases from Amerada Hess Co. and its partners, BP Exploration (Alaska) Inc. acquired the net profit share development accounts for those leases.

The amount of accrued costs in the Northstar Unit net profit share development accounts has been estimated by BP Exploration (Alaska) Inc. to be \$262,000,000. Under the terms of the leases and the Department of Natural Resources' regulations, although BP Exploration (Alaska) Inc. did not actually spend the \$262,000,000 in the development accounts, it would be entitled to recover those costs, plus its actual future costs of development, with interest, before it would be obligated to pay the state a share of net profits from the development of the Northstar Unit leases.

(12) Department of Natural Resources Commissioner Shively has testified that "[T]he implications for the state in that is the longer the development is delayed, the less money the state is going to get in net profits leasing. And so timing was critical to me as we negotiated this deal with BP."

(13) BP Exploration (Alaska) Inc.'s president, Mr. John Morgan, has testified "[I]n making that acquisition (purchase of the Northstar leases) we did understand and it was clear to us that the

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issue of net profit leases represented a problem, and a problem that would need to be overcome with the state, if development was to proceed."

(14) BP Exploration (Alaska) Inc.'s president, Mr. Morgan, also has testified that ". . . part of the risk we took when we acquired the leases was that the State of Alaska may not agree to a modification of the terms that would allow us to go forward with development, and we did that knowingly and clearly."

### ARTICLE 3. BP EXPLORATION (ALASKA) INC.'S SUCCESSION AS NORTHSTAR UNIT OPERATOR AND THE DEPARTMENT OF NATURAL RESOURCES' APPROVAL OF THE 2ND PLAN OF DEVELOPMENT FOR THE NORTHSTAR UNIT.

(1) On January 13, 1995, BP Exploration (Alaska) Inc. wrote the Department of Natural Resources and the Minerals Management Service to request that the agencies approve a 90-day extension to the Department of Natural Resources' earlier Notice of Default for the Northstar Unit.

(2) Effective January 19, 1995, then-director Eason approved assignment of the state Northstar Unit leases to BP Exploration (Alaska) Inc. as had been requested earlier, and on January 20, 1995, both then-director Eason of the Department of Natural Resources and the Minerals Management Service approved BP Exploration (Alaska) Inc. as the successor operator of the Northstar Unit.

(3) On January 23, 1995, the day the Northstar Unit was scheduled to terminate under the Department of Natural Resources' Notice of Default for failure of the operator to provide a proposed Plan of Development, BP Exploration (Alaska) Inc., in its capacity as the new unit operator, submitted a proposed two-year Plan of Development for the Northstar Unit. According to documents in the Department of Natural Resources' unit files, BP Exploration (Alaska) Inc. indicated "that with more time it could submit a more detailed and decisive plan."

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(4) The following day, on January 24, 1995, then-director Eason of the Department of Natural Resources approved BP Exploration (Alaska) Inc.'s request for a 90-day extension to submit a new plan of development because, according to director Eason, it was "in everyone's best interest to allow BP additional time to conclude its acquisition and to formulate a new Plan of Development." On January 24, 1995, the Minerals Management Service also approved BP Exploration (Alaska) Inc.'s request for an extension to file a more detailed Plan of Development until April 30, 1995.

(5) On March 30, 1995, BP Exploration (Alaska) Inc. submitted a revised and more comprehensive Plan of Development and a request to extend the Northstar Unit Agreement for a three-year term coincident with its revised Plan of Development. Importantly, the revised plan included sanction within the last year. The plan included the following specific activities: (A) data gathering and project development including environmental data gathering and studies, promulgation of marine mammal incidental take regulations, and a cooperative agreement with the Alaska Eskimo Whaling Commission; (B) 3-D seismic acquisition, including the appropriate government permits and seismic processing, pipeline and facility engineering and reservoir descriptions; (C) project sanction including project construction permits, integrated 3-D seismic and reservoir descriptions, permit approvals, and finally, sanction by BP Exploration (Alaska) Inc.'s headquarters. The revised Plan of Development added the steps required by BP Exploration (Alaska) Inc. to take the Northstar development to project sanction. The estimated cost of these activities was \$12,000,000. In the two-year plan, the estimated cost was \$10,000,000.

(6) The term of the second Plan of Development was increased from the originally proposed two-year term to a three-year term because of increased commitments by BP Exploration (Alaska) Inc.

(7) On May 1, 1995, the Minerals Management Service approved the revised plan concluding that the "new schedule of activities are deemed necessary to bring the unit into production." On June 2, 1995, the Department of Natural Resources "conditionally"

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approved BP Exploration (Alaska) Inc.'s revised three-year Plan of Development. Division director Ken Boyd approved the plan because, "in his judgment, it was a reasonable one that allowed the new operator, BP Exploration (Alaska) Inc., adequate time to interpret the existing geological, geophysical, and engineering data, shoot what he considered important 3-D seismic data, begin work on development options, define the scope of reservoir/conceptual engineering, and submit permits with the ultimate goal of getting internal BP Exploration (Alaska) Inc. sanction in the fourth quarter of 1997." It was director Boyd's belief that "[t]he plan was tailored to the shortest deadlines that an operator could reasonably be expected to meet." The plan explicitly stated that sanction would "depend on economic competitiveness of the project compared to other BP Exploration (Alaska) Inc. projects worldwide, the business climate (oil price, etc.), and the status of the external permitting processes." It also noted that the risks included "[d]evelopment and production economics."

(8) According to the Department of Natural Resources, "[a]s part of the conditional approval, BPXA was required to submit annual program reports and a final report to the agencies that synthesizes the data and studies performed by BPXA during the extension period and BPXA's conclusions and recommendations regarding the development of the NSU. The POD does not require BPXA to start production during the three year term. Assuming BPXA complies with the conditions of the second POD, the unit will not expire until April 30, 1998."

### ARTICLE 4. BP EXPLORATION (ALASKA) INC.'S INITIAL EFFORTS TO AMEND THE NET PROFIT SHARE LEASE TERMS.

(1) Both BP Exploration (Alaska) Inc.'s President, Mr. Morgan, and Department of Natural Resources Commissioner Shively have testified that at sometime between January and April 1995, before the Department of Natural Resources' approval of BP Exploration (Alaska) Inc.'s revised Plan of Development and extension for the Northstar Unit, BP Exploration (Alaska) Inc. approached the administration, asking that it support the incorporation of provisions that would allow the commissioner of the Department of Natural Resources to modify net profit share terms of oil and gas leases in the royalty modification legislation that the administration requested last session (HB 207). Mr. Patrick Coughlin, petroleum

investment manager for the division of oil and gas, testified that BP Exploration (Alaska) Inc. requested incorporation of the net profit provisions sometime in late January or early March (1995) during the drafting of the original version of HB 207.

(2) Testimony before the committee by both BP Exploration (Alaska) Inc. and the Department of Natural Resources reflects that the parties decided, however, not to pursue authority to amend the terms of net profit share leases in that legislation. According to Commissioner Shively, ". . . I felt, and ultimately I think BP felt, that adding another issue to the mix was probably not appropriate."

(3) Commissioner Shively testified that, after having decided not to pursue incorporation of the net profit share amendment provisions within the framework of HB 207, "he committed to BP at the time to discuss Northstar, but under the conditions that I believed, at the time, that I probably did not have the legal authority to make a deal with them on Northstar. And so therefore, that the individual deal itself would have to come to the legislature. That was always part of the discussions."

(4) Based upon testimony by both Commissioner Shively and BP Exploration (Alaska) Inc.'s Mr. Morgan, it is clear that even had HB 207 been amended to include explicit authority for the commissioner to reduce the state's net profit share under the same circumstances as the commissioner was ultimately authorized to reduce the state's royalty share under the terms of HB 207, to encourage production that otherwise would not be economically feasible, the commissioner could not have done so in this instance because production from the Northstar Unit is forecast to be economic without amendments to the net profit share provisions.

**ARTICLE 5. THE ECONOMICS OF DEVELOPING THE  
NORTHSTAR LEASES UNDER THEIR EXISTING TERMS.**

(1) The director of the division of oil and gas, Ken Boyd, has testified that "BPXA currently estimates that 76.8% of the recoverable reserves underlie the state leases in the Northstar Unit (NSU). The Division's Resource Evaluation Group has reviewed this estimate and other confidential estimates, and believes the 75 to 80% is a reasonable range. This range could be slightly higher if BPXA develops the known reserves to the Northwest."

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(2) Both the Department of Natural Resources and BP Exploration (Alaska) Inc., have testified that BP Exploration (Alaska) Inc.'s development of the Northstar Unit leases under the original lease terms would be economic. According to BP Exploration (Alaska) Inc.'s President, Mr. Morgan, "[W]e have never argued that the development of Northstar could not be profitable under the terms including the net profit arrangements. In profitability in terms of return on capital, this would be possible. This is not a marginal oil field."

(3) The Department of Natural Resources' independent analysis of the Northstar Unit economics comes to a similar conclusion. Commissioner Shively has testified "[t]oday both we, and I think British Petroleum, estimate that around 135 mm barrels of oil could be recovered from this field. It is not a marginal field; it is not the kind of field we talked about last year with HB 207. It is a field fully capable of carrying its own under the appropriate economic conditions."

(4) BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has testified ". . . that with the net profit arrangement in place, at the level that it exists, BP would not be prepared to go ahead with the development of a Northstar project, even though, if you run the economics, you can show that the return on investment for the project is a sound sort of return on investment."

(5) Based upon BP Exploration (Alaska) Inc.'s own analysis, development of the Northstar project "would have an estimated BP Net Revenue of approximately \$485 million and a full project Rate of Return (ROR) of around 21%."

(6) BP Exploration (Alaska) Inc. has testified that its rate of return for a "hypothetical incremental investment" later in field life (2007) would be 21 percent without the net profit share lease terms versus 10 percent with the net profit share lease terms.

(7) In its September 1995 report to the Governor's Oil and Gas Policy Council entitled "Review of International Competitiveness of Alaska's Fiscal System" (Little Report), the Arthur D. Little Co. concluded "[O]il companies generally look for a rate of return of about 15% . . . Projects with lower returns usually do not generate enough profits to encourage companies to commit time and resources to their development."

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(8) Commissioner Shively testified "I do not believe that no oil company in the world could develop this field under the current provisions. When we did the economic analysis, we believe the rate of return is sufficient for somebody to want to do it. On the other hand, BP has told us that they would not do it, and therefore, I cannot make a finding that under the current situation the development of the field is not economically feasible. It, in my mind, is economically feasible under both considerations. Both of the considerations of the net profits and using the supplemental royalty. BP has said for them it is not developable under the net profit conditions."

(9) Based upon BP Exploration (Alaska) Inc.'s estimates of the recoverable reserves and project development costs, the Northstar Unit has a per barrel development cost of \$2.90. For comparison, other North Slope projects which BP Exploration (Alaska) Inc. has sanctioned (approved and committed the funding to develop), the year in which the developments were sanctioned and BP Exploration (Alaska) Inc.'s estimated per barrel cost of developing each are: Kuparuk (1982) - \$6.65 per barrel; Endicott (1985) - \$5.40 per barrel; Prudhoe Bay Unit: GHX-2 (1992) - \$4.45 per barrel; Pt. McIntyre (1992) - \$2.30 per barrel; and Niakuk (1992) - \$2.50 per barrel.

(10) BP Exploration (Alaska) Inc. estimates the per barrel development costs for both the Milne Point Unit - Schrader Bluff development and the Northstar project, neither of which have yet been sanctioned by BP Exploration (Alaska) Inc. management, to be \$1.80 per barrel, and \$2.90 per barrel, respectively.

### ARTICLE 6. REVENUE TRADE-OFFS FROM THE LEASING OF THE NORTHSTAR LEASES WITH THE NET PROFIT SHARE AS THE COMPETITIVE BID VARIABLE.

(1) The decision by the commissioner of natural resources to offer the Northstar Unit leases with the net profit share as the competitive bid variable in 1979 resulted in a trade-off of larger immediate bonus payments for the speculative potential to receive a share of the lessees' net profits from the development of any field subsequently discovered. Since oil and gas exploration is inherently risky, with commercial discoveries occurring far less frequently than dry holes, the commissioner's bid strategy entailed risk

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sharing with the lessees. Compared to other bidding terms available to the commissioner, the selection of net profit share terms allowed successful bidders to obtain the leases for less cash than would otherwise have been required.

(2) Interpolating revenue received for the federal leases within the Northstar Unit, which were leased with a 16 2/3 percent sliding scale royalty and the bonus as the bid variable and making many speculative assumptions, the Department of Natural Resources estimates the state's Northstar Unit leases could have brought \$268,406,052, as opposed to the \$15,469,000 actually received, had the leases been offered with a 12 1/2 percent royalty, no net-profit share and with the bonus as the bid variable.

(3) Assuming the Department of Natural Resources' estimate of bonuses is correct and based upon the annual realized rate of returns reported by the Alaska Permanent Fund Corporation in its 1995 report, the balance of the 50 percent of the \$268,406,052 that would have been deposited to the permanent fund would have been \$704,588,494 at year-end 1995.

(4) The Department of Natural Resources has provided estimates of the expected mean value to a bidder of the Northstar Unit leases. If the Northstar Unit leases were returned at one time to the state for reoffering in a competitive sale with bonus as the bid variable, with royalty set at 12 1/2 percent or 20 percent, with no net profit share and with estimated recoverable reserves, capital and operating costs as estimated in its economic modeling of the agreement with BP Exploration (Alaska) Inc., the estimated expected mean value, in the view of the Department of Natural Resources, would represent the most a bidder would bid. The Department of Natural Resources further qualifies its estimates by noting that the bidder would have had to make the same economic assumptions about the Northstar Unit leases as were used by BP Exploration (Alaska) Inc. Further, the division of oil and gas has testified that "if a sale of the Northstar Unit leases were conducted in the future, the division would expect bonus bids to range from a nominal amount to something less than \$225,000,000, depending upon the royalty rate and the discount rate." For a 12 1/2 percent royalty and at discount rates of 10 percent and 15 percent, the Department of Natural Resources estimates that the expected mean value to a bidder would be \$225,000,000 and \$130,000,000, respectively. For

a 20 percent royalty and at discount rates of 10 percent and 15 percent, the Department of Natural Resources estimates the mean value of anticipated bonuses would be \$182,000,000 and \$98,000,000, respectively.

**ARTICLE 7. BP EXPLORATION (ALASKA) INC.'S REFUSAL TO DEVELOP THE NORTHSTAR UNIT LEASES UNLESS THE NET PROFIT SHARE PROVISIONS ARE AMENDED.**

(1) Notwithstanding the acknowledged forecasted profitability of developing the Northstar field under its existing lease terms, BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has testified that BP Exploration (Alaska) Inc. will not develop the Northstar Unit leases unless the State of Alaska agrees to eliminate the net profit share provisions of the leases.

(2) There is no precedent, nor is there explicit legislative authority for the commissioner of natural resources to retroactively change the competitively bid variable of a state oil and gas lease.

(3) The Department of Natural Resources has testified that BP Exploration (Alaska) Inc. did not inform the state of its unwillingness to develop the Northstar Unit leases without amendment of the net profit share terms until some time after the department had approved the current Plan of Development and the three-year extension of the unit term.

(4) The Department of Natural Resources has testified that there is an implied covenant for lessees of Alaska's oil and gas leases to diligently explore and develop their leases. The Department of Natural Resources also has testified, however, that since the department has approved a three-year Plan of Development for the Northstar Unit leases that does not explicitly require development of the field, it believes that so long as BP Exploration (Alaska) Inc. meets the requirements of that plan, it would be seen as fulfilling its obligation to develop, and cannot be forced to proceed with production during the term of the current plan which does not expire until April 30, 1998.

(5) The Department of Natural Resources has testified that BP Exploration (Alaska) Inc.'s refusal to develop the Northstar Unit leases represents the first occasion in which a state oil

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and gas lessee has confirmed that it could develop an oil field economically, but that it is unwilling to do so unless the state renegotiates the competitively bid terms of the leases.

(6) The Department of Natural Resources has testified that if the department had not approved a further three-year extension for the Northstar Unit in June 1995, the two leases within the unit that did not have wells upon them certified to be capable of production in paying quantities would have reverted to the state, becoming available for releasing. Under the lease provisions and the regulations, the department could then have given notice to BP Exploration (Alaska) Inc. to begin production from the three leases that did have wells certified as capable of production in paying quantities within a reasonable time to do so, that could not have been less than six months. The department has indicated that it has never previously given such a notice to any lessee and there could be litigation over what constitutes "reasonable time" on the North Slope to put a well into production. Furthermore, the leases provide that the leases with certified wells cannot be terminated without "an appropriate judicial proceeding."

(7) As to why the Department of Natural Resources did not insist on a firm commitment from BP Exploration (Alaska) Inc. last year that it would develop the Northstar Unit leases before the department agreed to extend the Northstar Unit for three years, Commissioner Shivley has testified ". . . [I]f we had all the information in the spring of last year that we had today, we might have made another decision; we did not have that information."

(8) The Department of Natural Resources' approval of the second Plan of Development, and the resulting three-year extension, effectively eliminated any short-term leverage the department might have had otherwise to expedite BP Exploration (Alaska) Inc.'s development of the Northstar Unit leases without amendment of the leases. The Department of Natural Resources believes its approval was in keeping with the department's approval of other Plans of Development in the recent past.

(9) Both the Department of Natural Resources and the Department of Law have testified that the Department of Natural Resources did not consult with the Department of Law regarding whether the state might have any legal basis for moving earlier than 1998 to force production under the lease terms. The Department of

Natural Resources has indicated that it saw nothing unique about this case that would have justified consulting the Department of Law.

ARTICLE 8. THE DEPARTMENT OF NATURAL RESOURCES'  
AND BP EXPLORATION (ALASKA) INC.'S NEGOTIATIONS  
TO AMEND THE NORTHSTAR UNIT LEASES.

(1) Based upon BP Exploration (Alaska) Inc.'s representation that it would not develop the Northstar Unit leases under their existing terms, the Department of Natural Resources entered into confidential negotiations with BP Exploration (Alaska) Inc. in the fall of 1995 to amend the state's oil and gas lease terms.

(2) As its principal reason for proceeding with the negotiations to amend the leases, the Department of Natural Resources cited its desire to assure that production begins earlier than it otherwise would under the timeline estimated by the Department of Revenue. The Department of Natural Resources maintains that, if the legislature does not pass SB 318, the department could not force BP Exploration (Alaska) Inc. to develop the field until after the expiration of the current Plan of Development.

(3) Department of Natural Resources' Commissioner Shively has testified that, "[t]he negotiations were long--longer than I had hoped. I had hoped to have this agreement to the legislature earlier; they were at times very difficult, but I believe that we have negotiated a deal that is in the best interests of the state."

(4) BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has testified that ". . . I can't stress enough, that from BP's perspective, this was a long and very formal negotiating process, that I don't see the agreement contained in this bill as in any way being an incentive to BP; I see it as a very balanced agreement coming out of that negotiation."

(5) Under the terms of the agreement negotiated by BP Exploration (Alaska) Inc. and the Department of Natural Resources, the state agrees to waive its net profit interest in the leases, and in return is to receive an increased royalty rate on one of the five leases, from 12 1/2 percent to 20 percent, as well as the potential to receive a "supplemental royalty" on all of the leases, depending upon whether oil prices rise sufficiently in the future beyond a specified threshold (trigger) price. In addition, BP

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Exploration (Alaska) Inc. has made certain nonbinding commitments to increases in state employment, conditional commitments to construct certain undefined modules, and facilities necessary to develop the Northstar Unit within Alaska and has agreed to relinquish the Northstar Unit leases if BP Exploration (Alaska) Inc.'s management does not sanction the project within one year after the effective date of legislation ratifying amendment of the leases.

### ARTICLE 9. LEGAL ANALYSIS BY THE DEPARTMENT OF LAW.

(1) As to whether the commissioner has the authority to amend the state's net profit share lease terms in a situation where those terms were the competitive bid variable in a sale, the Attorney General has testified that "Clearly what we are faced here is with a diminution of revenues that would come to the state . . . and that would require the commissioner in order to make the changes to make a finding that this project otherwise would not be economically feasible. And that was a conclusion which the commissioner would not and could not make. And once again, whether 180 (AS 38.05.180) would apply, in this instance it could not apply. And again, our reasoning supports the need to put this matter before the legislature."

(2) As to whether legislative ratification of a negotiated agreement between the commissioner of the Department of Natural Resources and BP Exploration (Alaska) Inc. to modify the terms of the Northstar Unit leases would violate the Constitution of the State of Alaska's prohibition against local or special legislation, the Department of Law representative has testified that "[I]t will be the department's responsibility to carefully articulate the state's interest during legislative hearings on the bill proposing the net profit share reduction. This must be done with the goal in mind of establishing a detailed legislative history supporting the interests of the state. The legislative history will be important because the ultimate decision 'whether a general act can be made applicable' rests with the Alaska Supreme Court." (3) The Department of Law representative has testified that "[i]f there is valuable consideration received by both the state and the leaseholder, the benefit to the state may be characterized as direct."

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(4) The Department of Law representative has also testified that "[b]ecause the State leased the oil rights at the Northstar field pursuant to the constitutional mandate to obtain the maximum public benefit, an effort to expedite production vitally affects the public interest."

(5) The Department of Law has also testified "[w]e believe that a compelling case can be made that there is adequate consideration to support a finding of a direct and substantial public benefit flowing from the reduction of the net profit share."

(6) As to whether the promises of local manufacture and assembly of facilities must be binding terms of the Northstar Agreement in order to meet the "statewide significance" test, the Department of Law representative has testified "[t]hat there needs to be a record made here in the legislature of the State interests that are behind this very narrowly focused piece of legislation. As far as the promises to be binding I think it is enough that there's some good and sound reason for this kind of legislation."

(7) The Department of Law representative has testified that "[w]hether the agreement bears fruit I don't think is as important as the fact that you are doing it in good faith belief that it will happen. I don't know if I can tell you that it has to be binding. That's not a consideration of our opinion. It's merely a fact that there must be some sound reasonable basis for making this legislation as narrow as it is."

(8) The Department of Law representative has testified "[w]e think this transaction has state-wide significance because of the amount of revenue that's involved, the fact the major population center of the railbelt area would be the beneficiary of some of the economic activity connected with the development of the Northstar Unit, that fact that petroleum revenues form such a large percentage of the total revenues to the State. It makes this a very good case for being a matter of state-wide significance."

(9) As to whether the expenditures (loss of state revenues) under the Northstar Agreement meet the "public purposes" test under art. IX, sec. 6, of the Alaska Constitution, the Department of Law representative has testified "[i]t's been our opinion in the past that the courts will generally find a public purpose if the legislature declares it to be a public purpose. That's been the reasoning of the courts. From our side, analyzing it even further than that, because

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we don't like to stop there sometimes being the executive branch. We also analyze it as this mutually of consideration that there has to be some equal exchange in order for there to be a public purpose."

(10) As to the consideration which the state must receive under the Northstar Agreement, the Department of Law representative has testified "[t]here has to be, in order to satisfy the public purpose doctrine, a direct public benefit and not an indirect public benefit--when you're giving up public revenues or foregoing some debt that's owed you by some third party. There has to be a direct public benefit and not an indirect benefit. The direct benefit cannot only flow to the other interest and there appears to be direct public benefit here in connection with the way this agreement is structured."

(11) As to whether the consideration which the State expects to receive under the Northstar Agreement actually must be received, the Department of Law representative has testified "[n]o, I don't think so, not under the public purpose doctrine. The public purpose doctrine is the one legal issue that worries me the least. I think this transaction easily passes the public purpose doctrine test. The courts have been very deferential to legislative determinations of what is in the best interests of the State to expend its money on or to forego its revenues on or to receive additional revenues on. The courts have been very deferential in that regard and I don't see that as being a major factor influencing the validity of this particular transaction."

(12) As to whether an aggrieved bidder may have standing to challenge the Department of Natural Resources' negotiated amendments to the competitively bid lease terms, the Department of Law representative has testified "We note that the issue is present, that someone can raise this as a means of attacking the validity of the lease amendments. What we conclude is that if the legislature were to enact specific authorization, both ratifying and approving the contract, and authorizing the department to undertake the lease change, that, we think, would overcome the competitive bidding argument."

(13) The Department of Law representative has testified that "[o]ther persons who competed for the leases may claim that since the net profit share was the sole variable in the lease sale, it is such a material term that a change cannot be made without

violating the competitive bidding statute. Uncertainty concerning the state's prospects for prevailing on any litigation on this issue gives an additional basis for our advice that the department seek independent statutory authority for the Northstar transaction."

(14) As to whether the legislature's passage of SB 318 will effectively shield the Department of Natural Resources' negotiated amendments to the Northstar Unit leases from legal challenge, the attorney general has testified "I guess my own judgment on this . . . we can't give you the certainty that absent this kind legislation, we would prevail on the argument. That's precisely, again, I think one of the reasons we brought this to the legislature, and Jim's (Assistant Attorney General Jim Baldwin) comments earlier about seeing legislative action as being an effective vaccination, as it were, against that kind of challenge."

(15) The attorney general has testified that "[w]ith legislative action, I think we have a high degree of confidence that we would prevail on this issue."

ARTICLE 10. THE DEPARTMENT OF NATURAL  
RESOURCES' AND BP EXPLORATION (ALASKA) INC.'S  
VIEW OF THE LEGISLATURE'S ROLE IN RATIFICATION  
AND PASSAGE OF SB 318.

(1) Although both BP Exploration (Alaska) Inc.'s President, Mr. Morgan, and Commissioner Shively have testified that they believe legislative approval of the amendments is necessary, both have confirmed their intent that the legislature's role in reviewing the negotiated amendments should be limited to voting for or against ratification of the agreement that they have negotiated, and should not include amending the terms of the agreement. Commissioner Shively testified "[w]ell, Mr. Chairman, as John Morgan just said, we have presented this as an up or down vote. And we did it for a variety of reasons. One, the negotiations we went through were long and complex. It is late in the session. On the other hand, if there are things that BP believes that they would like to agree to, we will certainly look at them."

(2) BP Exploration (Alaska) Inc.'s President, Mr. Morgan, testified "I have to say that from our perspective, we have in good faith reached a negotiated agreement with the administration, and I believe that any variation of those terms would cast that whole

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negotiating process into doubt. So it's both my belief that that was the intent of the administration in introducing the bill, and it would certainly be my very strong preference that this should be handled essentially on an approval or disapproval basis, without the introduction of any significant or material changes."

### ARTICLE 11. THE EFFECTS OF THE AMENDMENTS ON THE STATE'S SHARE OF REVENUE FROM THE DEVELOPMENT OF THE NORTHSTAR UNIT.

(1) The Department of Natural Resources cannot precisely define the state's future revenue losses. Commissioner Shively noted that "the only thing we know about all these numbers (the DNR's economic modeling of the effects of amending the NSU leases), is since they are projections, is that they are wrong, we just don't know how wrong."

(2) The Department of Natural Resources' Mr. Coughlin has testified regarding potential state revenue loss that "[i]f you look at it as if they (BP Exploration (Alaska) Inc.) would go ahead and develop it because it's, they say, an economic field, the state loses, in essence, \$48 million by trading a net profit share for the supplemental royalty." Mr. Coughlin has noted on the other hand, if full production does not begin until after 2002, the state could lose money if the amendments are not accepted.

(3) The Department of Natural Resources' representative has testified that its evaluation of the economic consequences to the state of amending the Northstar Unit leases to remove the net profit provisions is based upon the assumption that the "mean" recoverable oil reserves from the Northstar Unit are likely to be 130,000,000 barrels, and that there is a 90 percent probability that recoverable reserves will be greater than 105,000,000 barrels and a 90 percent probability that recoverable reserves will be less than 160,000,000 barrels."

(4) The Department of Natural Resources has testified that its analysis of the economic consequences to the state of amending the Northstar Unit lease terms to remove the net profit provisions is based upon an assumed peak production rate from the field of 50,000 barrels per day.

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(5) As to whether the Department of Natural Resources, in the course of its negotiations with BP Exploration (Alaska) Inc. had considered whether to add some sort of corrective factor to the agreement to compensate if the reserves ultimately prove to be considerably larger than estimated, Commissioner Shively has testified "[w]e did have a proposal at one time on the table that would have taken that into account. That's not where we ended up. It was part of a more complicated formula that was developed by our division of oil and gas that was part of one of our counter-offers."

(6) The Department of Natural Resources' petroleum economist, Mr. Kevin Banks, who was responsible for evaluating the economic effects of the Northstar Unit lease amendments, has testified that the negotiated agreement is an "okay" deal rather than a "good" deal for the state. In response to the question of why he characterized the deal as "okay" rather than "good", Mr. Banks, testified "I think it has to do with the fact that the net profit share has considerable up-side for the state. If there's any change in the economics of the field that improves, if prices are considerably higher, for example, or if production is any higher. As some of the materials we sent over to you earlier would indicate, the net profit share really pours in. By the same token, it's exactly the problem that BP has with it: that for any increase in the "benefits" that might be associated with the higher production rates or higher prices, or some other economic feature, the state gets all of it, virtually all of it. And it has a fairly serious impact on the economics and the incentives for incremental kinds of projects for the company. And that's why I say it's "okay." There is a high side to this that I think we can't ignore." Additionally, Mr. Banks has provided the committee with information that under low side cases, the state's revenues from the net profit share are substantially reduced while the supplemental royalty may still pay something, and the longer the project is delayed, the more likely the payout from the net profit share will be reduced.

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**ARTICLE 12. THE NONMONETARY TERMS OF THE  
DEPARTMENT OF NATURAL RESOURCES/BP EXPLORATION  
(ALASKA) INC. NEGOTIATED AMENDMENTS TO THE  
NORTHSTAR UNIT LEASES AND THE ENFORCEABILITY  
OF THOSE TERMS.**

(1) As to whether the terms in the negotiated agreement between the Department of Natural Resources and BP Exploration (Alaska) Inc. regarding local hire and local contracting are enforceable, Commissioner Shively has testified "I do not believe we could--that that language allows us to enforce to the extent BP is morally committed to do, and I don't think you can write language to do that."

(2) Although the agreement to amend the Northstar Unit leases purportedly provides for automatic termination of the leases, making them available for releasing under the state's competitive oil and gas leasing program, should BP Exploration (Alaska) Inc. not sanction the project within 12 months, Commissioner Shively has testified that the agreement contains a provision that allows the state to waive the obligation by prior written consent.

(3) The Department of Law has testified that any waiver of BP Exploration (Alaska) Inc.'s commitment to perform under the sanction schedule would have to be done "reasonably and not arbitrarily," and Commissioner Shively has testified "I have no intention of waiving that. I mean that's a very important part of the arrangement, and I mean, I think that if we cannot get this project going, then we need to reassess those leases and get them back out onto the public market."

(4) In response to the question of how would the administration, or a court if the need should arise, measure compliance given the number of disclaimers and qualifiers, and the lack of any specific performance measures in the agreement, Commissioner Shively has testified "I think we have stated this before. What we are asking BP to do, and what they have committed to do, I do not believe is enforceable by law."

**ARTICLE 13. POLICY IMPLICATIONS OF THE PASSAGE OF  
SB 318.**

(1) As to where the state ultimately ends up if, as a matter of precedent, it has to negotiate against itself in other instances to encourage its existing lessees to honor the terms of their competitively bid contracts, Commissioner Shively has testified "[A]ny of these things puts the state in a difficult position. We've, on the other hand, there have been provisions that allow the state to modify lease terms in the law and in the lease since Statehood. This is not a new concept. I was actually just reading an article the other day about the recent leases or arrangements that were made between the Venezuelan government and a number of private companies, and one of the conclusions of that article was that the first thing the companies were going to do down there was go back in and renegotiate their terms. And so, it does put the government in a difficult position. It's why I think in things like this and also like heavy oil, we need to do some economic and other analyses, which we did. But I think in this day and age this is part of how the government manages its resources. But it is not new. We've made changes to the leases before. We have not made changes in this particular way, but we have done these before, and once you start down that road, which we started down years ago, yes, the state does put itself in a difficult position, but not an impossible position."

(2) In response to the question of how the commissioner can test whether, and to what extent the state must give up public resources to promote the development of the state's resources, if, as here, there are no standards and no rules, Commissioner Shively has testified "When you make these decisions, it's like anything else, you have to use your best judgment. I happen to believe that one of the problems with government is that we try to set all of these sorts of rules and guidelines, and it's what makes government unworkable. What you need is people that can make judgments, that can look at difficult situations, assess the information, and say this is a good idea or a bad idea. I see nothing wrong with that. I think that's better government, but this idea that we have now that if you just have enough rules and enough regulations, everything

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is going to be perfect is nuts. I mean, even the bidding process doesn't necessarily guarantee the state that you get your full value for your resources. You get the most somebody wants to pay for it. That may or may not be full value."

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