

# FISCAL NOTE

**STATE OF ALASKA**  
**2003 LEGISLATIVE SESSION**

Fiscal Note Number: 2 CORRECTED  
 Bill Version: CSHB 57(FIN)  
 (H) Publish Date: 4/7/03

Revision Date/Time (Note if correction): 4/4/2003 Dept. Affected: Natural Resources  
 Title: Royalty Gas Contracts BRU: Resource Development  
 Component: Oil and Gas Development  
 Sponsor: Chenault  
 Requester: House Finance Component No. 439

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

CAPITAL EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009

CHANGE IN REVENUES (GF 1004)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
	*(98.0)	*(130.3)	*(938.8)	*(2,438.9)	*(3,476.4)	*(4,462.7)

**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

**POSITIONS**

Full-time						
Part-time						
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)

This bill amends AS 38.05.180(aa) requiring DNR to enter into agreements with lessees to use the price for gas established in contract(s) entered into on or after the effective date between the lessee and a manufacturer of agricultural chemicals as the value of the state's royalty share. HB 57 will result in a loss of state revenues. Should lessees supplying gas to only one agricultural manufacturer apply under AS 38.05.180(aa), the state could lose an estimated \$11.5 million in cumulative royalties over the period FY 2004-09; an average of about \$1.9 million per year (see Table 1, below).

\*If a contract does not meet any one of the four criteria under AS 38.05.180(aa)(2)((B)(i)-(iv), the Commissioner would deny the (aa) treatment. Under this scenario, the fiscal impact to the state would be less although the amount is impossible to predict.

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 Division: Oil and Gas Date/Time 4/4/2003  
 Approved by: Tom Irwin, Commissioner Date 4/4/2003  
 Agency: Natural Resources

**ANALYSIS CONTINUATION**

**Table 1. Impact of HB 57 on State Royalty Revenue: FY 2003 - 2009**

New Gas Produced from Other 3rd-Party Producers - State Lands								
FY	Total	State Leases	Non-State	State Royalty Share	Contract Value	Royalty Value	Diff	Royalty Foregone
	(1000 Cubic Feet per Year)				(\$ per Mcf)			(\$ per Year)
2004	1,728,506	1,728,506	-	230,583	2.00	2.43	0.43	(98,033)
2005	1,728,506	1,728,506	-	230,583	2.00	2.57	0.57	(130,287)
2006	14,900,000	9,983,000	4,917,000	1,331,732	2.00	2.70	0.70	(938,763)
2007	32,300,001	21,641,001	10,659,000	2,886,909	2.00	2.84	0.84	(2,438,869)
2008	39,500,000	26,465,000	13,035,000	3,530,431	2.00	2.98	0.98	(3,476,367)
2009	44,400,000	29,748,000	14,652,000	3,968,383	2.00	3.12	1.12	(4,462,725)

Estimated Total Royalty Losses Under New gas Supply 3rd-Party Contracts (FY 2004-09) = **(11,545,044)**  
 Total Royalty Losses (Discounted) = **(7,619,642)**

The analysis in Table 1 illustrates the yearly potential royalty revenue impacts taking into account the decline in gas to be supplied by Unocal to Agrium under a pre-existing contract after FY 2005. The implied yearly gas shortfall during FY 2006-09 is, by assumption, supplemented with new gas from 3<sup>rd</sup>-party producers. Royalty production from new gas would post date the Act and be eligible for (aa) treatment under HB 57. It is further assumed that Agrium would realize 100 percent of the benefits. Table 1 indicates that the state would forego a total of about \$11.5 million in royalty revenue or about \$1.9 million per year (undiscounted) over the period FY 2004-09. Detailed assumptions used for the estimates in Table 1, plus several sensitivity scenarios, are described below.

**Assumptions**

1. Annual gas consumption at the fertilizer plant is equal to about 53 billion cubic feet per year (Bcf), based on historic rates of gas usage over the past five years.
2. The analysis in Table 1 draws from the "Annual Contract Quantity" (ACQ) commitments contained in the existing Unocal-Agrium gas supply contract. During the later years of the contract, the ACQ falls from the approximate plant capacity of about 53 Bcf per year in FY 2005 to 9.1 Bcf per year in FY 2009.
3. Based on representations made to the Division of Oil and Gas by Agrium, the analysis in Table 1 assumes that the state's royalty share on ACQ volumes deliverable from state leases under the current contract between Unocal and Agrium will not be subject to the bill. Agrium and Unocal are currently in litigation regarding that contract. If Agrium and Unocal negotiate a new, low-price contract to replace the current contract in connection with the ongoing litigation, the royalties foregone could nearly triple, from \$11.5 to \$29.5 million. Agrium has assured the Division of Oil and Gas that it does not intend to renegotiate its contract with Unocal in a manner that would subject volumes deliverable under the current contract to the provisions of this bill.
4. State leases would account for approximately two-thirds of the total gas usage at the plant from new, 3<sup>rd</sup>-party gas supply contracts after 2005; the remaining one-third is new gas production from private and federal lands.

**ANALYSIS CONTINUATION**

5. The average state royalty share for gas dispositions to the plant is 13.34 percent.
6. Royalty value is indexed to the Alaska Department of Revenue prevailing value for Cook Inlet Gas (DOR PV). The Division of Oil and Gas forecasts DOR PV to increase from about \$2.50 per Mcf today, to \$3.12 per Mcf in FY 2009, based on the historic trend observed during 1995-02.
7. The implied gas shortfall in ACQ commitments is made up of new gas from 3<sup>rd</sup>-party producers but at a cost of \$2.00 per Mcf. This is considerably higher than the current \$1.20 benchmark input gas price in the existing Unocal-Agrium contract.

**Sensitivity Analysis**

Three alternative gas-supply scenarios are considered. **Case A:** Assume that the average formula-driven, gas-supply contract value is \$2.25 per Mcf instead of \$2.00 (see assumption #7). All else equal, this would lower estimated royalties foregone from \$11.5 million to \$8.5 million. **Case B:** By comparison, if the average formula-driven, gas-supply contract value is \$1.20 per – equal to the current Unocal benchmark – the royalties foregone would nearly double from \$11.5 to 21.3 million.) **Case C:** If the fertilizer plant operates at 75% capacity due to input gas supply shortages from both existing and 3<sup>rd</sup>-party producers then, assuming \$2.00 per Mcf input gas cost, estimated royalties foregone would fall from \$11.5 million to \$8.7 million. **Cases A and C combined** would reduce cumulative royalties foregone from \$11.5 million to about \$6.4 million.