FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: SCS HB57(FIN)
(S) Publish Date: 5/14/03

Revision Date/Time (Note if correction): 5/1/2003
Title: Royalty Gas Contracts
Sponsor: Chenault
Requester: Senate Finance

Dept. Affected: Natural Resources
BRU: Resource Development
Component: Oil and Gas Development
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						
TOTAL OPERATING	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES (GF 1004)	**	**	**	**	**	**

FUND SOURCE (Thousands of Dollars)

FUND SOURCE	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

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

POSITIONS	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Full-time						
Part-time						
Temporary						

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

This bill amends AS 38.05.180 to include subsection (ee), which allows the DNR Commissioner to enter into agreements with lessees to establish the value of the state's royalty share for gas that is used in contract(s) entered into on or after the effective date between the lessee and a manufacturer of agricultural chemicals. The royalty value may not be less than the price used in contracts (floor) but may not exceed the amount that would otherwise be due under the lease (ceiling). HB 57 gives the commissioner discretion to determine and use the value that is in the best interest of the state and may or may not result in state revenues losses. The state could see lower revenues between an estimated $0-to-$11.5 million in cumulative royalties for the only known potential applicant over the period FY 2004-09 or an average of about $0-to-$1.9 million per year (see Table 1, below). However, the effects of the loss could be mitigated by other factors.

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Division: Oil and Gas — Date/Time 5/5/2003

Approved by: — Date 5/1/2003
Agency: Natural Resources

(Revised 9/2002 OMB)

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ANALYSIS CONTINUATION

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

	New Gas Produced from Other 3rd-Party Producers - State Lands							
	Total	State Leases	Non-State	State Royalty Share	Contract Value	Royalty Value	Diff	Potential Royalty Foregone
FY	(1000 Cubic Feet per Year)				($ per Mcf)			($ per Year)
2004	1,728,506	1,728,506	-	230,583	2.00	2.43	0.43	$0 -to- (98,033)
2005	1,728,506	1,728,506	-	230,583	2.00	2.57	0.57	$0 -to- (130,287)
2006	14,900,000	9,983,000	4,917,000	1,331,732	2.00	2.70	0.70	$0 -to- (938,763)
2007	32,300,001	21,641,001	10,659,000	2,886,909	2.00	2.84	0.84	$0 -to- (2,438,869)
2008	39,500,000	26,465,000	13,035,000	3,530,431	2.00	2.98	0.98	$0 -to- (3,476,367)
2009	44,400,000	29,748,000	14,652,000	3,968,383	2.00	3.12	1.12	$0 -to- (4,462,725)

Estimated Total Royalty Losses Under New gas Supply 3rd-Party Contracts (FY 2004-09) = **$0 -to- (11,545,044)**
Total Royalty Losses (Discounted) = **$0 -to- (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 3rd-party producers. Royalty production from new gas would post date the Act and be eligible for (ee) 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 from $0-to-$11.5 million in royalty revenue or about $0-to-$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. State leases would account for approximately two-thirds of the total gas usage at the plant from new, 3rd–party gas supply contracts after 2005; the remaining one-third is new gas production from private and federal lands.
4. The average state royalty share for gas dispositions to the plant is 13.34 percent.
5. 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.
6. The implied gas shortfall in ACQ commitments is made up of new gas from 3rd-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.

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ANALYSIS CONTINUATION

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 #6). All else equal, this would lower maximum 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 maximum 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 3rd-party producers then, assuming $2.00 per Mcf input gas cost, maximum royalties foregone would fall from $11.5 million to $8.7 million. ***Cases A and C combined*** would reduce cumulative maximum royalties foregone from $11.5 million to about $6.4 million.