FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSSSHB 198(O&G)
(H) Publish Date: 4/28/03

Revision Date/Time (Note if correction):
Title: Royalty Reduction on Certain Oil
Sponsor: Kohring, Rokeberg
Requester: House Oil and Gas

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 ( )	**(220.9)**	**(358.5)**	**(591.4)**	**(589.5)**	**(561.5)**	**(485.1)**

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)						
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 proposa [ ]

POSITIONS

Full-time						
Part-time						
Temporary						

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

HB 198 amends AS 38.05.180(f)(5) to permit reduced royalty rates to as low as 5 percent for oil production from submerged lands in Cook Inlet. This royalty reduction would apply primarily to oil produced from offshore platforms and is tied to the daily rate of oil production. While HB 198 will result in a net loss in state revenues, it is expected to extend the field or platform life, thereby increasing future field or platform production and revenues in the out-years beyond what is likely to occur otherwise. Cumulative estimated net royalty revenue lost over the six-year forecast horizon FY 2004-09 is estimated to be ($2,807) thousand or about ($468) thousand per year (undiscounted). These estimates include cumulative undiscounted royalty revenue benefits of about $800 thousand ($570 thousand when discounted) from field-life extension that could arise as a result of royalty relief of the type offered in HB 198. These fiscal impacts do not consider the broader employment and regional economic effects from extended platform life. Also, field-life extension also provides an opportunity for additional exploration from existing platforms.

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Division: Oil and Gas — Date/Time 4/23/2003

Approved by: Tom Irwin, Commissioner — Date 4/23/2003
Agency: Natural Resources

(Revised 9/2002 OMB)

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ANALYSIS CONTINUATION

HB 198 recognizes two broad groups of platforms, distinguished primarily by economic attributes associated with the degree of water handling and water injection. Platforms with major water handling and/or injection include: Dolly, Grayling, King Salmon, Steelhead, and Monopod. When oil production on these platforms falls below 1,200 barrels of oil per day (BPD) for at least one calendar quarter as certified by AOGCC, then the royalty percentage associated with that production would fall from whatever rate applies under the lease to a rate of 5 percent "for as long as the volume of oil produced from the platform remains less than 1,200 barrels a day." If average production from the field or platform that had declined below 1,200 BPD rises above this threshold for a period of at least one calendar quarter, then the bill provides for a schedule of up-ward royalty adjustments to production beyond the one-quarter term.

Platforms that do not presently employ substantial water handling and/or injection include: Granite Point, Anna, Bruce, Baker, Dillon, XTO.A and XTO.C. HB 198 provides for 750 barrels of oil per day as the economic limit rate of production for this group of platforms that would trigger royalty reduction from whatever rate applies under the lease to 5 percent. Royalty percentage upward adjustments, similar to those described under the 1,200 BPD threshold apply when oil production recovers for a sustained period of at least one calendar quarter. Note, the 750 BPD economic-limit rate of production also, applies to the West McArthur River field.

Over the past three-to-four decades, fifteen offshore, oil-production platforms have facilitated oil and gas operations in six offshore oil fields in the Cook Inlet Basin. Oil production on most of these platforms began around 1965-to-1967. The Osprey Platform, owned by Forest Oil, started continuous oil production in December 2002. Oil production from the Spark and Spurr platforms was shut-in in January 1992 and July 1992, respectively. The Dillon Platform, which served the Middle Ground Shoal oil field since September 1967, was shut-in by Unocal in January 2003. At present, twelve platforms support oil-production operations in the Cook Inlet Basin.

Three of the twelve active platforms currently produce oil at daily rates below the 750 barrels of oil per day (BPD) threshold contained in HB 198. These platforms, and the dates that corresponding production fell below 750 BPD are:

Platform	Field	Operator	Gross Production FY2002 / FY2003 (BPD)	Date Production falls below 750 BPD
Bruce	Granite Point	Unocal	619 / 476	July 1987
Dillon	Middle Ground Shoal	Unocal	423 / 374	March 1987
Baker	Middle Ground Shoal	Unocal	723 / 558	June 2002

The royalty revenue loss to the state would be approximately $1.03 million FY 2002 and $0.9 million in FY 2003 had HB 198 been in effect during these periods.

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ANALYSIS CONTINUATION

Several platforms would be expected to trigger royalty relief under HB 198 during the FY2004 – FY2009 forecast horizon. If the rates of platform production continue to follow the historic patterns of decline, then the rate of production is expected to fall below 1,200 BPD for the King Salmon Platform in August 2004 and Steelhead in April 2005; platform production for XTO.C is expected to fall below 750 BPD in May 2007, as indicated in the following table:

Platform	Field	Operator	Gross Production (BPD) FY2002 / FY2003	*Expected* Date Production falls below	
				750 BPD	**1,200 BPD**
King Salmon	McArthur River	Unocal	7,468 / 3,891		Aug 2004
Steelhead	McArthur River	Unocal	1,914 / 1,584		April 2005
XTO.C	Middle Ground Shoal	XTO	1,047 / 1,099	May 2007	

The Dillon platform was shut-in in January 2003 and Baker is subject to imminent shut-in based on representations made by Unocal. These platforms are assumed to be shut-in for purposes of the forward fiscal impact analysis. The value of Cook Inlet crude oil in future years is assumed to be $20.00 per barrel. The estimated cumulative gross royalty revenue loss is ($3.6) million undiscounted over the six-year forecast period (equals ($2.8) million when discounted at 8% per year), based on the difference between expected royalty revenue with and without the provisions contained in HB 198, not counting potential incremental production from extended field or platform life. When the cash-flow impact of royalty reduction under HB 198 is taken into account, delayed platform shut-in is expected for four platforms (including Bruce, described above) during the forecast horizon. The shut-in deferment would range between 2 and 14 months for a given platform. The resulting shut-in delays would generate between 500-to-700 thousand barrels of total incremental production (includes working-interest and royalty), of which approximately one-third would occur in the FY 2005-06 timeframe. The remainder of incremental production would occur during FY 2008-09 and beyond. The cumulative, upside royalty impact of the expected incremental production would range between $400-to-$800 thousand, depending on assumptions regarding threshold rates of production, discounting, and timing of ultimate platform shut-in.

Taking all short- and long-run factors into consideration, the overall royalty revenue impact of HB 198 would be approximately ($2.8) million [($3.6) million in royalty foregone plus about $0.8 million in royalty gain from extended platform life] or about ($468) thousand per year (net) over the six-year period, FY 2004-2009. Note that these fiscal impacts do not consider the broader employment and regional economic effects from extended platform life.