

HOUSE FINANCE COMMITTEE  
March 25, 2003  
1:41 P.M.

TAPE HFC 03 - 38, Side A  
TAPE HFC 03 - 38, Side B

CALL TO ORDER

Co-Chair Williams called the House Finance Committee meeting to order at 1:41 P.M.

MEMBERS PRESENT

Representative John Harris, Co-Chair  
Representative Bill Williams, Co-Chair  
Representative Kevin Meyer, Vice-Chair  
Representative Mike Chenault  
Representative Eric Croft  
Representative Richard Foster  
Representative Mike Hawker  
Representative Reggie Joule  
Representative Bill Stoltze  
Representative Jim Whitaker

MEMBERS ABSENT

Representative Carl Moses

ALSO PRESENT

Larry Dietrick, Director, Spill Prevention and Response, Department of Environmental Conservation; Mike Nugent, General Manager, Agrium Kenai Nitrogen Operations, Kenai; Eric McDowell, Partner-McDowell Group, Resource Solutions, Juneau; Lisa Parker, Government & Community Relations Advisor for Agrium U.S., Kenai

PRESENT VIA TELECONFERENCE

Marilyn Crocket, Deputy Director, Alaska Oil and Gas Association (AOGA), Anchorage; Mark Meyers, Director, Division of Oil and Gas, Department of Natural Resources, Anchorage; Bill Popp, Oil and Gas Liaison, Kenai Peninsula Borough, Kenai

SUMMARY

HB 57        An Act amending the manner of determining the royalty received by the state on gas production as it relates to the manufacture of certain value-added products.

HB 57 was HEARD and HELD in Committee for further consideration.

CS SB 74(RES) am

An Act extending the renewal period for oil discharge prevention and contingency plans; and providing for an effective date.

CS SB 74 (RES) am was reported out of Committee with a "do pass" recommendation and with fiscal note #1 by the Department of Environmental Conservation.

#SB74

CS FOR SENATE BILL NO. 74(RES) am

An Act extending the renewal period for oil discharge prevention and contingency plans; and providing for an effective date.

LARRY DIETRICK, DIRECTOR, SPILL PREVENTION AND RESPONSE, DEPARTMENT OF ENVIRONMENTAL CONSERVATION, stated that SB 74 would streamline the permitting process by lengthening the time for renewal of oil discharge prevention and contingency plans from three to five years.

A five-year renewal period would streamline the contingency review process for industry while maintaining Alaska's strong spill prevention and response standards. Oil Discharge Prevention and Contingency Plans are public noticed and then reviewed and approved by the Department of Environmental Conservation.

Mr. Dietrick continued, the Oil Discharge Prevention and Contingency Plans are required for operators of oil terminals, refineries, crude oil transmission pipelines, oil exploration and production facilities, oil tank vessels, oil barges, non-tank vessels of over 400 gross tons and railroad tank cars.

Mr. Dietrick emphasized that the bill would provide multiple benefits from the proposed change:

- The bill furthers the goal of permit streamlining with no loss of environmental protection and complements initiatives currently being undertaken by the Department to shift the emphasis away from the administrative review and approval process to field verification of response capability.
- The bill would significantly reduce the administrative burden on the regulated

community and shift the emphasis from paperwork to performance.

- The reduction in paperwork would increase the ability of operators and the Department to focus on spill prevention and facility operation.
- The change would allow operators more time to make practical enhancements to their spill prevention and response capabilities.
- The change would improve environmental protection and preparedness through increased field presence and the ability to work directly with operators to ensure response readiness through on-site facility and vessel inspections, spill drills and exercises.
- Finally, the change would make the State renewal cycle consistent with the five-year renewal cycle for the federal oil spill contingency plans required under the Oil Pollution Act of 1990, as well as those of other West Coast states.

Co-Chair Harris clarified that the legislation proposes to change the time period for the contingency plan from three to five years. He referenced the zero fiscal note, commenting that the review and approval process should consume less time for the Department given the longer extension. Co-Chair Harris thought that information should reduce costs to the Department.

Mr. Dietrick responded that the Department had looked at that closely, however, the trade off was a reduction in litigation which the Department presently is under. He emphasized the "extraordinary" workload assumed by the Department. Additionally, there could be a fundamental shift in field verification. The intent was not to lower the standard of protection but rather to make a shift from the time spent on paperwork to the time spent with operators working on the standards. He continued, the focus would be on exercising drills with additional time guaranteeing that the readiness is maintained.

Co-Chair Harris reiterated that the intent was only to extend the time period with no regulatory function. Mr. Dietrick acknowledged that was correct and that there would be no other change in the statutory requirements or lessening of any of the current environmental protection measures.

Co-Chair Harris asked if any comments had been submitted from local regional citizen advisory councils. Mr. Dietrick advised that the Prince William Sound Regional Citizens Advisory Committee had provided a letter dated February 26th, 2003. (Copy on File). He added that Cook Inlet Regional Citizens Advisory Committee had not provided testimony or comments to the Department to date, however, understood that they had indicated three points of concern:

- Extending the time frame;
- Reducing the frequency of the technology reviews; and
- Reducing agency and plan familiarization with the contingency plans.

Representative Hawker questioned the context of these contingency plans and who would be impacted by the changes. Mr. Dietrick responded that the categories of facilities are the same categories regulated under current statute. Under that statute, they are required to have oil discharge prevention contingency plans with the thresholds varying a little. Generally speaking, if there is a crude oil terminal with a total volume of over 5,000 barrels, they then are required to submit a plan.

Representative Stoltze questioned if the proposed legislation would include railroad tankers, of which some pass through some of his neighborhoods. Mr. Dietrick advised that this plan is not required for the Alaska Railroad.

MARILYN CROCKET, (TESTIFIED VIA TELECONFERENCE), DEPUTY DIRECTOR, ALASKA OIL AND GAS ASSOCIATION (AOGA), ANCHORAGE, testified that AOGA is a trade association whose 17 member companies account for the majority of oil and gas exploration, development, production, transportation, refining and marketing activities in Alaska.

Every AOGA member conducting activities in Alaska is required to have an Oil Spill Prevention and Contingency Plan (or C-Plan) approved and in place. Therefore, AOGA has a significant interest in SB74, and encourages the Committee to report it out.

Ms. Crocket stated that AOGA spent a considerable amount of time over the past 12 months identifying permitting programs that were in need of updating and streamlining. Initially, AOGA adopted a principle to guide them through the process. That principle reads:

"To accomplish updates and streamlining without compromising environmental protection or safety standards".

Ms. Crocket commented that SB 74 fits perfectly within that principle. The bill would extend the renewal cycle for C Plans from the current period of three years to five years, the cycle required by the federal government, west coast states and other oil producing states.

She added that preparation and processing of a renewal application is an expensive endeavor. Renewal costs can average between \$60,000 and \$100,000 dollars for just the renewal. Additionally, the renewal process is time-intensive. Experience has shown that for some plans, approvals can average 360 days, essentially meaning that once a renewal is complete, the work must begin on the next renewal.

Ms. Crocket pointed out that it is important to recognize what the purpose of the C Plan serves. It is a "blueprint", describing how an operator responds. The proof of the effectiveness of the plan is whether the response identified in the Plan can be delivered as promised. Demonstration of effectiveness has been accomplished through drills. That area should be the largest benefit of the extended renewal cycle, shifting the focus away from administrative processing to field performance.

Representative Stoltze MOVED to AMEND the bill on Page 2, Line 2, deleting "five years" and inserting "three years". Co-Chair Williams OBJECTED for the purpose of discussion.

Mr. Dietrick explained that there is one renewal time frame set in statute that applies to all facilities. The change from three to five years would need to apply to all other facilities. Under the current bill, if the change is made, it would apply to all categories.

Co-Chair Harris asked if Representative Stoltze's intent was that the Alaska Railroad be required to go through a full compliance review on oil discharge every three years, while other facilities covered by the legislation would then be every five years. Mr. Dietrick thought that was correct.

Co-Chair Harris asked if the Department of Environmental Conservation provides reviews of existing contingency plans on a year-to-year basis. Mr. Dietrick responded that the Department has looked at the process for renewals and updates currently in the Alaska Statutes. In 1990, when the Legislature made the updates, they did provide many mechanisms in Statute that spell out an "evergreen type process" with a requirement for non-notification for readiness. If at any time, the capability is diminished, they would be required to immediately notify the Department. The Legislature had built in a strong continuous process for the notification including routine plan updates. The intent

of the years involved supercedes the fact that there are strong mechanisms in place to provide for the continuous update and refreshing of the plan.

Co-Chair Harris asked what would be the "down side" for the State in implementing three rather than five years. Mr. Dietrick observed that the renewal process itself is not as important as the ability to routinely check the test capability base for inspection as well as increased emphasis on prevention. With the mechanisms currently in statute, the Department believes that the State could go to a five-year plan and not sacrifice anything while at the same time provide greater efficiency in reducing paperwork.

Representative Stoltze thought that the amendment was arbitrary, noting that many people in his district live on the railroad line. He identified the need to make the Railroad more responsive to the public.

Representative Hawker voiced his support for the concept of the amendment. He noted that he had received comments regarding the non-responsiveness of the Alaska Railroad and that they do not act as a "team-player". He noted that he would not favor passing the amendment at this time, however, suggested that further consideration regarding these concerns be brought forward.

Representative Stoltze WITHDREW the MOTION to adopt the amendment.

Co-Chair Harris echoed concerns voiced by Representative Stoltze, agreeing that they would be addressed later.

Representative Foster MOVED to report CS SB 74 (RES) am out of Committee with individual recommendations and with the accompanying fiscal note. There being NO OBJECTION, it was so ordered.

CS SB 74 (RES)am was reported out of Committee with a "do pass" recommendation and with zero fiscal note #1 by the Department of Environmental Conservation.

#HB57  
HOUSE BILL NO. 57

An Act amending the manner of determining the royalty received by the state on gas production as it relates to the manufacture of certain value-added products.

REPRESENTATIVE MIKE CHENAULT MOVED to ADOPT work draft #23-LS0303\S, Chenoweth, 3/12/03, as the version of the bill before the Committee.

Representative Croft OBJECTED in order to hear the changes made to the previous bill.

Representative Chenault explained that changes had been made to address concerns regarding a windfall/profit made for the gas contract between the Agrium facility and Unocal. Language was added to guarantee that the legislation would not apply to Unocal.

Representative Croft noted that he would WITHDRAW his OBJECTION to passage of the committee substitute. There being NO further OBJECTION, the work draft was adopted.

Co-Chair Williams interjected that it was not his intent to move the bill out of Committee at this time. He referenced the draft fiscal note.

Representative Chenault stated that HB 57 would allow the manufacturers and producers to know the basis upon which royalty would be calculated before entering into a contract. He believed it would help the acceleration of business for oil and gas production companies. The companies currently can be subject to audits as much as five years after the sales have been completed. Adoption of the proposal could promote development and would provide producers with the knowledge that they would not have to pay additional royalties at some point in the future. With a fixed royalty rate, it would benefit the State of Alaska and its residents by providing local manufacturing industries with a solid foundation providing stable jobs, increased sales and a greater investment in the local communities.

MIKE NUGENT, GENERAL MANAGER, AGRIMUM KENAI NITROGEN OPERATIONS, KENAI, spoke in favor of HB 57. He stated that the legislation was a "piece of the pie", which would provide producers in Cook Inlet with stability and Agrium with certainty of what the costs are to manufacturer the products. He stated natural gas is the major raw material used by Agruim.

Mr. Nugent continued, Agrium's Kenai Nitrogen Operations is one of Alaska's few major value added manufacturing operations. The Kenai plant is the second largest producer of nitrogen products in the United States. From Kenai, 6% of the total nitrogen products in North America is manufactured. The majority of the product is exported to the Pacific Rim countries including Korea, Taiwan, Mexico, Thailand, and Australia. He added that Kenai has been competitive in the world markets because of its location and the skilled workforce and stable government.

Mr. Nugent listed the countries that compete with Kenai to sell fertilized products: Russia, Indonesia, Saudi Arabia, and Venezuela; however, none have the same attributes, in

particular a stable government but they do have extremely low natural gas prices. That situation puts Kenai at a disadvantage in marketing their product. The disadvantage is partly due to provisions in State contracts, which require the State of Alaska to receive the highest prevailing price for the State's royalty gas.

HB 57 could help in that it would allow the Department of Environmental Conservation's Commissioner to accept a price paid to the State for gas, a price negotiated between Agrium and the producer. He noted that over the past few weeks, there have been questions regarding the fiscal impact of the bill. He offered the following comments:

- The Department of Natural Resources has supplied a fiscal note. It does not consider the other economic impacts such as wages, purchases of goods and services, taxes, and new developments, to the State of Alaska. It only considers the impact of natural gas value.
- The analysis is based on forecasts and the forecasts involve several variables such as volume, price, and ownership, all of which are difficult to predict. The analysis also assumes full capacity operations or consumption of maximum volumes of natural gas.
- As opposed to forecasting the future, the reality is that Agrium's Kenai operation is currently curtailed due to the inability of suppliers to deliver adequate natural gas supplies. The plant is operating on average at 75% capacity making a revenue reduction to the State, Agrium, and the local economies, regardless of which price forecast is used.
- Unless the State can find a producer who can provide a large quantity of natural gas at a competitive price in the future, the curtailment will last for several years and/or could result in a shutdown. Agrium has had repeated discussions with the producers in Cook Inlet. The concern is the additional royalties that the producer is currently subject to.
- The development of new natural gas reserves is more difficult because of the risk of unknown State royalty gas values. The risk is associated with the value or price being set by others in a process not participated in.
- If the State is not successful in developing

additional competitive gas reserves, Agrium will not survive as a business. As a result, revenues to the State from royalty gas sales could be zero.

- Natural gas has a different value to different consumers. One price does not fit all.

Co-Chair Harris inquired how many employees did Agruim have and what was their average salary. Mr. Nugent replied that there were approximately 292 full time employees with an average salary of \$84,000 dollars a year. If the legislation does not passed, the organization would not be able to operate at capacity, raising the unit cost of the product. If there are no additional reserves, then Agrium cannot help other producers in the Cook Inlet area develop their resources. He emphasized that Agrium could go out of business without the requested reserves. He stated that HB 57 would help to reduce the risk that producers see as they go to develop natural gas reserves in Cook Inlet.

Co-Chair Harris inquired how much can the State expect to receive from gas royalties versus Agrium would going out of business. The fiscal note assumes that the State should receive a certain royalty; however, if the gas is not sold, the State will loose much more revenue. He understood that the fiscal note indicates that by FY 2009, the State might loose up to \$4.5 million dollars in revenue. He asked how much gas that would represent. Mr. Nugent replied that the gas stream would be approximately 34.4 billion cubic feet a year.

Co-Chair Harris inquired the amount of revenue that Agrium provides the Kenai Peninsula Borough. He stated that the Committee was looking at benefits for a specific area versus the benefits to the entire State.

Mr. Nugent responded that taking the total economic value of the facility's impact on the economy, dividing it by the billions of cubic feet of gas equals the economic impact at approximately \$6.28 dollars per cubic foot, which is higher than what is paid for the gas.

ERIC MCDOWELL, PARTNER-McDOWELL GROUP, RESOURCE SOLUTIONS, JUNEAU, commented that his company had analyzed many entities across the State, noting that the situation is unique in regard to value added and overall benefits. He added that there are varying numbers regarding how this would affect the Kenai economy.

Mr. McDowell referenced the fiscal note, pointing out that the State would be gaining approximately \$6-\$7 million dollars a year over a seven year period. Additionally, it

would be a good investment of the State's resources to have the use of policy force stability and resources to enhance the economy, keeping the costs private rather than going public. He added that would not assure the State of a revenue stream from the manufacturing operation of Agrium. Mr. McDowell stressed, "Agrium more than carries its own weight" and concluded that the stability policy assures Alaska of revenue and economic benefit.

Representative Stoltze commented on how the loss of 300 jobs would affect the Kenai community and economy. He hoped there was some way to quantify the fiscal note.

Representative Croft inquired if the State was pricing the royalty gas too high and questioned making statutory changes that results in a loss of money. Mr. Nugent guaranteed that the agreement between the producer and the user would be a fair economic value for that gas. Representative Croft pointed out that over a period of time, it could be a lower price. Mr. Nugent interjected that there is a possibility that over time, the value price could increase in value.

Representative Croft questioned why the market has not operated to address this concern. Mr. Nugent responded that Cook Inlet is in the stranded gas system with five producers and three major consumers. Representative Croft mentioned that there are seven other producers to buy from. Mr. Nugent corrected that there are only five producers in Cook Inlet.

LISA PARKER, GOVERNMENT & COMMUNITY RELATIONS ADVISOR FOR AGRIMUM U.S., KENAI, advised, currently, Alaska has stipulated that the highest paying rate should be paid for natural gas in Cook Inlet. The State has never received the "higher-of" in any of the gas that they have sold. The utilities right now have the ability to negotiate and get between the price that they and the producer have negotiated. The State could accept that as the price. Currently, the State of Alaska, through their process, negotiates settlement agreements with the company following an audit years past to negotiate that price. The "higher up" price has actually never been paid to the State of Alaska in the Cook Inlet.

Representative Croft stated that the fiscal note indicates that the State will lose some revenue on the arrangement. He questioned if that was appropriate in order to protect three hundred jobs, and asked why the State is not able to buy from someone that is not inflating the price.

Mr. Nugent spoke to the fiscal note, claiming that it acts as a forecast and that the nature of a forecast makes assumptions. Predictability and stability are the goals.

Agrium believes that they will be able to strike a deal that is fair to both Agrium and the State of Alaska.

Representative Croft questioned if it could be lower.

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Mr. Nugent responded that compared to today's value, it could be a lower price.

Co-Chair Williams recommended that Representative Croft get together with the Agrium staff to discuss these concerns. He recommended that the Committee could further discuss these ideas at the next scheduled meeting.

Representative Croft asked why Agrium was not buying from the other producers. Mr. Nugent responded that they do buy gas from producers on property that does not have State ownership. He noted that there are several private individuals who would like to develop their natural gas fields. Agrium would like to receive definition and predictability around the wells and properties owned by the State.

Representative Whitaker inquired about future production and contracts. He asked about the royalty certainty on all State leased lands regardless of the producer. Given additional gas supply, he assumed that it would be probable that production would increase. Mr. Nugent advised that in the current situation, the gas in Cook Inlet has reached a point where the demand exceeds supply. Currently, they are at a 75% capacity. He stated that it would be difficult to get back to capacity during the next two years.

Representative Whitaker asked if given the "feed stock", could the market bear productivity increases. Mr. Nugent thought it would. Representative Whitaker asked if it was fair to assume that there would be an increased supply.

Representative Whitaker inquired how long after the fact could an audit appear for royalty charges. Mr. Nugent stated that it could take place four or five years after the fact. Representative Whitaker advised that a company might not know their full cost until after royalty charges, which could be four or five years after the fact.

Co-Chair Williams inquired how the federal royalty system works for Agrium. Ms. Parker explained that the manner in which the State gets their royalty is based on the costs which the producer and consumer have negotiated. That is the manner in which royalties are calculated. She added that the proposed legislation would establish that standard.

MARK MEYERS, (TESTIFIED VIA TELECONFERENCE), DIRECTOR, DIVISION OF OIL AND GAS, DEPARTMENT OF NATURAL RESOURCES, stated that the federal system was based on market value, which is similar to the State's prevailing or market value. Mr. Meyers commented that it is difficult to determine arms length contracts with many factors involved and added that a company could be audited up to six years. In most cases, the audits are done to ensure proper royalties are paid based on the allocation and that the transportation costs are reasonable. He noted that due diligence was standard as with any business.

Mr. Meyers recognized the value of the Agrium plant, which adds value to the gas and the high paying jobs available. No one wants to threaten that business or industry. He voiced a concern regarding the effectiveness of the relief provided. He pointed out the volatility of gas prices, noting that in Cook Inlet, it rests in smaller amounts.

Mr. Meyer observed that one of the challenges is to determine how to provide effective relief. To close down the business would be value and economy lost to the State for the short term. Additionally, he asked if shutting them down would deter gas exploration throughout the State. All explorers want the highest value contract. There are natural market economics occurring in the market. He suggested that the situation could be remedied if the balance of gas in the Cook Inlet area would change. The State does need more offshore exploration and ways to stimulate it.

The legislation provides some certainty in terms of audit cases. Mr. Meyer commented on the fiscal note, based on creating many different scenarios at various capacities. The fiscal note attempts to encompass all reasonable outcomes. Clearly, if the plant were to close down, it would be devastating to the local community and would defer gas there. That consideration was not taken into account when preparing the note.

Representative Croft inquired if the demand for Cook Inlet gas exceeds the current supply. Mr. Meyers replied that it is about even now. People are not willing to pay less for the gas because of the problems getting it, which has created a "squeeze" on those that cannot pay the high utility market value. In previous years, there has been a surplus. He noted that the gas price in general has a lot of volatility. There are few long-term fix contracts anymore based on a market value approach. Representative Croft asked if that applied more broadly to Cook Inlet and the risk to the North Slope's collateral value.

Mr. Meyers replied that it was limited to utilities that manufacture the agricultural chemicals. He noted that the original bill could have applied to any value added manufacturer but the bill was amended to limit that to manufacturers of agricultural chemicals.

BILL POPP, (TESTIFIED VIA TELECONFERENCE), KENAI PENINSULA BOROUGH, OIL AND GAS LIAISON, KENAI, spoke in support of the bill. He commented that the legislation would be a step in providing a stable business environment for the value added manufacturing industry in the Cook Inlet basin. There are various value added industries located within that borough.

HB 57 address issues faced by the Agrium facility. Agrium is a key component of the borough's economy as the third largest local employer accounting for \$25 million payroll annual dollars. Agrium generates about \$2.5 million dollars in property taxes annually. Mr. Popp stated that the bill addresses the issues of planning stability by providing for a consistent and reliable price structure. He urged passage of the bill.

Representative Stoltze asked what percent of royalty payments were made for the Cook Inlet gas production going to Anchorage. Mr. Meyer responded that he did not know at that moment, the value of AA treatment for utilities. Vice Chair Meyer inquired if that reference was to the one-third ownership that the City of Anchorage has.

Representative Stoltze responded that there had been legislation passed in the early nineties, which benefited Anchorage consumers and royalty rate in terms of a "long-term dependable" gas supply.

In response to Vice Chair Meyer's, Mr. Meyers explained that they would qualify for AA treatment and would be receiving that value on the royalty. The lessee would be receiving the benefit and hopefully they would pass that on to their contract, but they are not required to. Many utilities value from 1991 to 1999 was about \$6 million dollars. The value of the incentive has declined because of the price paid for gas, becomes prevailing value over time. Last year's average was less than anticipated.

Representative Whitaker asked if AA treatment was determined by a contract price between a producer and a gas or electric utility. He commented that with the State involved, would they be providing more value. He suggested that an insertion that AA should not be a give away.

Representative Joule commented that there are always accommodations made so that projects can have some validity. He recommended another revenue generation discussion in the Committee, determining when it becomes a "tradeoff". He

agreed that the bill would stimulate economy, however, it is important to understand the State's need for revenue generating capabilities.

Co-Chair Williams noted that work would be done on the fiscal note during the following week. He voiced his support for the bill.

HB 57 was HELD in Committee for further consideration.  
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ADJOURNMENT

The meeting was adjourned at 2:56 P.M.