

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

February 4, 2003

3:21 p.m.

MEMBERS PRESENT

Representative Vic Kohring, Chair
Representative Mike Chenault, Vice Chair
Representative Hugh Fate
Representative Norman Rokeberg
Representative Harry Crawford
Representative Beth Kerttula

MEMBERS ABSENT

Representative Lesil McGuire

COMMITTEE CALENDAR

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."

- HEARD AND HELD

HOUSE BILL NO. 61

"An Act establishing an exploration and development incentive tax credit for persons engaged in the exploration for and development of less than 150 barrels of oil or of gas for sale and delivery without reference to volume from a lease or property in the state; and providing for an effective date."

- BILL HEARING CANCELED

OVERVIEW: DEPARTMENT OF NATURAL RESOURCES, DIVISION OF OIL & GAS, BY DIRECTOR MARK MYERS

- OVERVIEW POSTPONED

PREVIOUS ACTION

BILL: HB 57

SHORT TITLE:ROYALTY GAS CONTRACTS

SPONSOR(S): REPRESENTATIVE(S)CHENAULT

Jrn-Date	Jrn-Page		Action
01/21/03	0047	(H)	PREFILE RELEASED (1/17/03)
01/21/03	0047	(H)	READ THE FIRST TIME - REFERRALS
01/21/03	0047	(H)	O&G, RES
01/21/03	0047	(H)	REFERRED TO OIL & GAS
01/31/03	0107	(H)	COSPONSOR(S): WHITAKER
02/04/03		(H)	O&G AT 3:15 PM CAPITOL 124

WITNESS REGISTER

MIKE NUGENT, General Manager
 Agrium Kenai Nitrogen Operations
 Kenai, Alaska

POSITION STATEMENT: Testified on HB 57; provided the history of his company and answered questions; related the desire to pay a fair price for natural gas and have the price be predictable.

TADD OWENS, Executive Director
 Resource Development Council for Alaska, Inc.
 Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 57; said it strikes an appropriate balance between providing incentives for manufacturers of value-added products and protecting the state's interests.

LISA PARKER, Government & Community Relations Advisor
 Agrium U.S.
 Kenai, Alaska

POSITION STATEMENT: In answer to questions about DNR's fiscal note for HB 57, pointed out that Agrium isn't privy to negotiations between the producer and the state.

ACTION NARRATIVE

TAPE 03-2, SIDE A

Number 0001

CHAIR VIC KOHRING called the House Special Committee on Oil and Gas meeting to order at 3:21 p.m. Representatives Kohring, Chenault, Fate, and Kerttula were present at the call to order; Representatives Rokeberg and Crawford arrived soon thereafter.

HB 57-ROYALTY GAS CONTRACTS

[Contains brief discussion of HB 69 by Chair Kohring]

CHAIR KOHRING announced that the committee would hear 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."

Number 0173

REPRESENTATIVE CHENAULT, sponsor, explained that HB 57 proposes to add "manufacturer" as a further entity that may claim the benefit of the contract price as a basis for determining royalty due to the state for gas production. It amends AS 38.05.180(aa) by allowing the commissioner of [the Department of Natural Resources (DNR)] to enter into an agreement to accept a gas price established in a contract "between a lessee and/or utility" as the price for the state's royalty share. He said this amendment would apply a similar condition to manufacturers of value-added products in Alaska, which to his belief will allow manufacturers of value-added products in Alaska to know up front what their costs are. The way royalty is valued and arranged currently, by contrast, up to five years later [a manufacturer] could be hit with a higher cost for royalty gas than what is basically agreed on in a contract. He explained that manufacturers are looking for certainty with regard to price, in order to determine what their costs are.

Number 0359

REPRESENTATIVE KERTTULA paraphrased the analysis in the fiscal note from the Division of Oil & Gas, which read in part:

Should only one manufacturer apply under AS 38.05.1880(aa), the state could lose an estimated \$36.6 million in royalties over a period of seven years. However, proposed amendments in HB 57 are worded more broadly than just one company. Interpretation of "manufacturer" may be broadly interpreted to apply to disposition of all royalty gas subject to in-state processing (e.g. LNG). Therefore, this \$36.6 million could significantly understate the total revenue impact of HB 57. Furthermore, a much larger revenue impact could occur with a major sale of North Slope royalty gas.

REPRESENTATIVE KERTTULA asked how the division came up with that amount. She also expressed concern about the definition of "manufacturer". She surmised that it isn't the sponsor's intent

to include LNG [liquefied natural gas], a gas pipeline, and so forth, but that it is specifically for one manufacturer to be able to apply.

REPRESENTATIVE CHENAULT clarified that it isn't necessarily for one manufacturer, and that he thinks others possibly could qualify. He added, "It is not the intent to apply this to a gas pipeline or to an LNG facility. If ... they meet the criteria, then that would open the door for the commissioner of Department of Natural Resources to enter into an agreement. And ... that's our interpretation of it."

Number 0481

REPRESENTATIVE KERTTULA said it sounds as though the commissioner has some authority, but as the bill is written, the commissioner "shall" do that. She asked whether there is a possibility under this, if [a manufacturer] met the criteria of "value-added," that a gas line or LNG would fit under this and, therefore, the state would give up more royalties. She also asked whether that is the intent.

REPRESENTATIVE CHENAULT replied that the intent is not to extend it to a gas pipeline or "another LNG facility" unless it meets the criteria stated in the legislation. Rather, the intent is to allow manufacturers to know their costs up front for royalty gas over time, in order to make decisions that affect their businesses. He expressed interest in 1) keeping Alaskans working, and 2) promoting in-state, value-added products for Alaska's gas, to better promote Alaska's resources and for the state to get "more bang for our royalties."

Number 0637

REPRESENTATIVE CHENAULT returned attention to the fiscal note, saying it had been given to him that morning. He told members that he didn't know how the department determined the \$36 million and hadn't heard an explanation or seen the numbers on which it is based. He speculated that perhaps the numbers were derived from what utilities currently pay versus what the industry pays on the average. He added that he doesn't believe [HB 57] says a manufacturer will get the same price as a utility; rather, it says that once the producer and a manufacturer agree to a price, the commissioner would approve that price relating to royalty.

CHAIR KOHRING offered his understanding that the commissioner would have discretion to disapprove such an agreement. If information suggested it would be a major financial loss to the state, for example, [the commissioner] could certainly say no. In response to Representative Kerttula, he asked whether anyone was present or on teleconference from the division. He remarked that he'd been given the fiscal note a short time beforehand and would have expected someone from the division to defend the analysis.

Number 0811

REPRESENTATIVE CRAWFORD offered his reading that the bill doesn't seem to specifically rule out LNG or NGLs [natural gas liquids]. He suggested a smart lawyer possibly could argue that once gas is turned into NGLs it becomes a value-added product. He proposed that the committee could establish an intent to remove that ambiguity. Representative Crawford declared that he wholeheartedly agrees with the bill, but wants to ensure that it does "what we intend it to do."

REPRESENTATIVE CHENAULT asked whether the preference is to have LNG manufactured in Alaska or have raw gas shipped Outside via pipeline in order to have value-added processing done elsewhere. He also asked, if that were the case, what "number would that incorporate, to want to see value added in the state."

Number 0952

REPRESENTATIVE KERTTULA suggested it will boil down to how much it costs [the state]. She noted the need to hear testimony from the division about that, and from the other testifiers.

REPRESENTATIVE ROKEBERG said he shared Representative Kerttula's concern. He agreed with the need to hear from the division, and said he wanted to know more about what the bill does.

Number 1103

MIKE NUGENT, General Manager, Agrium Kenai Nitrogen Operations, informed members that his company's Kenai operation uses natural gas, which it upgrades along with water and nitrogen from the air to make ammonia and urea - referred to as nitrogen products - that are sold in the Pacific Rim. As the company looks to the future and develops natural gas supplies from a variety of producers in Cook Inlet, it will be highly valuable to know what

that future price is, in order to determine profitability. He explained:

These would be arrangements that we would establish at an arm's length with another producer, and ... having knowledge of what the state's share is also valued at would be very valuable in making decisions. Our ... margins are fairly thin, just like any other manufacturer.

Number 1265

MR. NUGENT, in response to Representative Rokeberg, offered the following history. The facility was built in 1968, with a major expansion in 1977. It was owned then by Unocal; because Unocal also was the supplier and producer of the natural gas that fed the facility, there was a "state royalty gas-valued formula" that valued the state's portion of the natural gas supplied to the plant and that was hooked to the value of the end products. In fall 2000, the upgrade facility was sold to Agrium; thus there were two different owners: the producer and supplier of the gas, and the operator of the plant.

MR. NUGENT explained that at the time of sale, Unocal was Agrium's sole gas supplier and Agrium was Unocal's sole large industrial user of that gas. However, Unocal has been unable to deliver the full amount of gas needed [by Agrium] in order to operate at capacity. Therefore, [Agrium] is starting to develop relationships with other gas producers and suppliers in order to meet both short-term and long-term needs. The importance of knowing the future costs of those gas supplies has become apparent. Noting that the state is a 12.5-percent owner of most of that gas, Mr. Nugent said the inability to predict gas prices accurately adds risk to any arrangements between the company and the producer. He highlighted some aspects of risk:

We're open to audit for long periods of time to where we could have to pay more for the gas than we originally intended. ... Recently, a contract developed between ENSTAR [Natural Gas Company] and Unocal to supply gas to ENSTAR starting in 2004. And this is an example of what some of that future risk might be: that gas contract values gas at the NYMEX [New York Mercantile Exchange] value. And NYMEX value of gas today is about \$5.50, but we could not afford to purchase gas for \$5.50 ... and make a profit. So

that's an example ... of what some of the potential risk might be to a facility like ours.

Number 1525

REPRESENTATIVE ROKEBERG referred to the foregoing example and suggested [such a situation] could be problematic. He asked whether such a contract would be adjusted for NYMEX value periodically.

MR. NUGENT indicated that basically the contract has a "floor" of \$2.75 and is the NYMEX value of gas. He said he wasn't sure whether it is adjusted monthly or annually.

REPRESENTATIVE ROKEBERG asked whether typically there is some type of periodic adjustment for the NYMEX or fair market value.

MR. NUGENT said relationships like that would be very risky or would make [Agrium] nervous. He pointed out that Cook Inlet gas isn't hooked to any system in the Lower 48. Therefore, if Cook Inlet gas were hooked by pipeline to the Lower 48, it wouldn't trade at the NYMEX value but at the NYMEX value discounted for the pipeline-system cost to get it to the Lower 48. Again noting that the state is a 12.5-percent owner in that gas, he said arrangements like that "by people other than us could have a detrimental impact on our business." He added that [Agrium] is interested in paying a "fair value" for the gas and having that price be predictable.

Number 1704

TADD OWENS, Executive Director, Resource Development Council for Alaska, Inc. (RDC), testified in support of HB 57. He informed members that RDC is a private nonprofit trade association representing individuals and companies from Alaska's oil and gas, mining, timber, tourism, and fisheries industries; its mission is to help grow Alaska's economy through responsible development of the state's natural resources. He recalled that in 2001 the legislature adopted a declaration of state economic development policy, which in part asserts that it is state policy to encourage value-added processing in Alaska. Offering the belief that HB 57 advances this policy, he explained:

By establishing the contract price as the basis for determining the state's royalty share on natural gas, this legislation provides both producers and manufacturers of value-added products with greater

certainty regarding their costs. Reducing the risk associated with the state's royalty share indirectly reduces the overall risk of gas exploration in Alaska.

Cost certainty and risk reduction are two important factors in encouraging private-sector economic development in the state. And it's important to note, I think, that we believe the proposed legislation provides the state - through the commissioner of DNR - with the authority needed to reject any request that would be detrimental to the State of Alaska's interests. In other words, House Bill 57, in our opinion, finds an appropriate balance between providing incentives for manufacturers of value-added products and protecting the interests of the state.

Number 1858

REPRESENTATIVE KOHRING asked whether anyone else wished to testify; there was no response.

MR. NUGENT, in reply to Representative Rokeberg, agreed that the legislation would only [apply to] the portion of the gas owned by the state.

Number 1916

REPRESENTATIVE ROKEBERG asked whether Mr. Nugent knew the current amount of RIK gas available in the Cook Inlet area, and asked about the allocation now.

MR. NUGENT offered his understanding that the state owns 12.5 percent of any gas sold, whether to a utility or [Agrium], and receives the revenues from that stream. He added that the state's gas is not specifically targeted to [Agrium], a utility, or any one special [entity].

REPRESENTATIVE ROKEBERG said he'd assumed the legislation related to RIK gas. He asked whether, instead, it is just a benchmark price for anybody who establishes a price, without "reopeners" after the price is established.

MR. NUGENT clarified that this isn't gas the State of Alaska is taking in kind. Rather, it is gas that the producer markets for the state.

REPRESENTATIVE ROKEBERG explained that his concern is with regard to the [\$36-million] fiscal note from the Division of Oil & Gas, which claims loss of state revenue. Although he offered his view that [the division's estimate] may be off the mark, he indicated the need to understand it better.

MR. NUGENT [who was testifying via teleconference and presumably hadn't seen the fiscal note] said he didn't have any knowledge of what is behind that number, either, because it would basically require predicting a future value for the gas.

REPRESENTATIVE ROKEBERG indicated that if the price were lower and there couldn't be a "reopener" for a price adjustment, there would be a loss of anticipated future income. He said he was disturbed by it.

MR. NUGENT said he'd have to see the detail as well.

REPRESENTATIVE ROKEBERG added that it scares the daylights out of him.

Number 2057

REPRESENTATIVE KERTTULA concurred. Referring to the fiscal note, she suggested that in order for the committee to make a good decision, and to avoid possible unintended consequences that could cost the state \$36 million, the following must be understood: 1) exactly how the royalty would be figured on this gas, 2) what Agrium or like businesses pay in royalties right now, and 3) what the reasonable likelihood is that [Agrium or like businesses] would pay in the future under current law versus what this new legislation would do.

Number 2141

REPRESENTATIVE KERTTULA requested that Mr. Nugent or Ms. Parker testify about [the division's calculations on page 2 of the fiscal note analysis, in the portion addressing 2000-2002, rather than the projections for 2003-2009]. She observed that on page 2 it says, "The cumulative impact would have been approximately \$8.2 million in nominal dollars." She asked Mr. Nugent what he pays in royalty right now, as a starting point.

MR. NUGENT indicated that is a subject of discussion between Unocal - Agrium's producer - and DNR. He added that [Agrium's] "total gas bill to the facility" was \$80 million; in 2002, it

was approximately \$70 million. He reiterated that the state is only a 12.5-percent owner.

Number 2214

REPRESENTATIVE KERTTULA asked whether 12.5 percent of [Agrium's] \$80 million would be the state's royalty share and, therefore, it totaled \$8 million over the last two years in royalties.

MR. NUGENT answered:

We paid our producer, in 2001, \$80 million for the gas. And that was in one year. Last year, it was closer to \$70 million because we didn't consume quite as much gas. ... The royalty payment is a subject of discussion for those two years right now between Unocal and the state. But if it was 12.5 percent of what we paid our producer, then it doesn't even come close to ... \$36 million.

REPRESENTATIVE KERTTULA acknowledged that Mr. Nugent didn't have [the fiscal note]. She said [the calculation] was averaged over a period of five years, to her belief. If it was 12.5 percent of the amount he'd just stated, she suggested, it might be about right.

Number 2273

MR. NUGENT added:

I guess another way to look at it, if I might: when we were part of Unocal, what we paid Unocal in 2001 and 2002 basically followed the state royalty formula that was in existence when Unocal owned the property. So had that remained one entity, ... the royalty payment would have been a clear 12.5 percent ... of that amount.

Number 2310

REPRESENTATIVE ROKEBERG referred to Table 1 on page 2 of the fiscal note. He pointed out that it indicates that if this bill had been in effect, the total would have been \$8.2 million [in foregone royalties for 2000-2002]. For 2000, it shows a contract value of \$1.20 and a royalty value of \$1.70, for a 50-percent difference and \$1.7 million [in foregone royalties]. For 2001, it shows a contract value of \$1.38 and a royalty value of

\$2.20. He asked Mr. Nugent whether those numbers meant anything to him in terms of the contract value and the royalty value.

MR. NUGENT replied that \$1.38 is "within a couple cents" and is about what [Agrium] paid per thousand cubic feet both in 2001 and 2002. He said it is based on "the same formula that would have set the state royalties value, had we still been a part of Unocal, because it was based on the value ... of our end product."

REPRESENTATIVE ROKEBERG again mentioned the figures [for 2001]: a royalty value of \$2.20 and [a contract value of] \$1.38, for an 81-cent difference and \$2.9 million in royalty foregone.

MR. NUGENT surmised that the \$2.20 might be the current posted value of Cook Inlet gas for utilities; he asked Ms. Parker to help him out.

REPRESENTATIVE ROKEBERG pointed out that the footnote [page 2 of the fiscal note] says the forecast [by the Division of Oil & Gas] is for \$2.50 per [thousand cubic feet (Mcf)] today, with \$3.12 for fiscal year (FY) 2009, which is a DOR [Department of Revenue] present value (PV) calculation, to his belief.

Number 2464

LISA PARKER, Government & Community Relations Advisor, Agrium U.S., suggested the need to ask DNR where those numbers came from. She added that the State of Alaska, under "paragraph (36)," is supposed to get the highest value it can for its royalty share. She pointed out that Agrium is a consumer of the product and isn't engaged in negotiations, or privy to them, with regard to what price the producer pays to the state for the state's royalty share of the gas. The company is only privy to negotiations between it and the producer when buying gas.

REPRESENTATIVE ROKEBERG replied that this legislation endeavors to remove that uncertainty. He offered his understanding that [Agrium] is suggesting there should be a stable price for a longer period of time; typically, however, there are "reopeners" or adjustments for "market-value considerations" in the negotiations between a producer and the state. He asked whether he was on the right track.

MS. PARKER affirmed that and added, "But that's between the producer and the State of Alaska. And we just want a mechanism where the producer can ... request of the state that they

establish, as their royalty price, the price that they've negotiated with us ... as a consumer."

Number 2598

REPRESENTATIVE ROKEBERG expressed concern about Mr. Nugent's remarks regarding the arrangement between ENSTAR and Unocal, and an inability to operate under \$5.50. Noting that the "NYMEX price for future contracts" was in the \$5.70 range on the [news] this morning - which he said is an extremely high price that may be seasonal and war-related, for example - Representative Rokeberg asked whether there is a certain price at which Agrium's operations will be in jeopardy and no longer be able to produce profitably. He said he didn't want to pry into Agrium's business, but that Agrium was asking [the legislature] to make a policy call here. He said he believes the public should be aware that there are realistic limits to what [Agrium] can do to operate profitably.

MR. NUGENT answered that it depends on the value of the company's product at the time, which over the last several years has been priced fairly low because of various economic conditions in the world and drought in agricultural areas of North America. In order for the company to survive during those low-price cycles, he reported, its economic model generally says it shouldn't pay more than \$2.00 [per Mcf] for gas.

Number 2697

REPRESENTATIVE ROKEBERG asked whether Mr. Nugent believes the export value of Alaska's gas may be overstated if Lower 48 measures of valuation are used, because those haven't been discounted for the costs of transportation and conditioning necessary for transport.

MR. NUGENT replied:

Yes. I guess I was trying to use that as an example of one of the extreme cases that could take place that we have no control over, and that was an arrangement agreed to between ENSTAR and Unocal. And it doesn't have a lot of logic on NYMEX value of gas because even if our Cook Inlet system was hooked into the Lower 48, it would be discounted backwards up the system to Cook Inlet, and it would never have a value that equaled NYMEX value. So ... the arrangement I've ... referred to doesn't have clear logic to it, and I think that's

a good example of some of the uncertainty that we don't want to expose ourselves to.

Number 2755

REPRESENTATIVE ROKEBERG asked: If Alaskan companies are making these apparently arm's-length transactions and agreements to reflect a higher value, isn't that somewhat driven by the fact that there's a perceived shortage of natural gas in the Cook Inlet basin? He said there is a general recognition of greater supply there [than previously thought], although it is debatable that more production is needed in Cook Inlet to help moderate prices. He also asked, "Are they using these Lower 48 and worldwide standards to kind of drive their negotiations?"

MR. NUGENT responded:

I think there's a "yes" answer to both of your questions. The ... supply in Cook Inlet has diminished over the years to where it ... now matches the demand, and it's time for producers to go bring new supplies to market. ... That contract between Unocal and ENSTAR really is for a small percentage of the production from Cook Inlet, but because of the current royalty arrangement it can start to ratchet up the value of gas in the entire region.

Number 2833

REPRESENTATIVE ROKEBERG asked whether [Agrium] ever conducts its own exploration and production anywhere in the world, or if it simply goes to the market for buying raw materials.

MR. NUGENT answered, "At the present time, we just go to the market to buy our raw materials." He added that it has become a critical issue, however, especially in Cook Inlet, and that the company is exploring all possibilities to bring some long-term, reliable natural gas supplies. "So at the present time we are not a producer, but we don't intend to leave any stone unturned in our search for natural gas," he concluded.

CHAIR KOHRING responded that [the company] might find a source of natural gas in the near future if HB 69 passes, since it hopefully will spur more development in the shallow gas fields, for which he said there is phenomenal potential in the Kenai Peninsula. He acknowledged that it is a side issue.

Number 2952

REPRESENTATIVE KERTTULA referred to item 5 in the footnote on page 2 of the fiscal note, acknowledging that Mr. Nugent didn't have a copy. Item 5 read:

Royalty value is indexed to the Alaska Department of Revenue prevailing value for Cook Inlet Gas (DOR PV). DOR PV is forecast by the Division of Oil and Gas to increase from about \$2.50 per Mcf today, to \$3.12 in FY 2009, based on the historic, long-term trend observed over the period 1995-02.

REPRESENTATIVE KERTTULA expressed her understanding that the royalty currently is based on value and the value to the state, but that Mr. Nugent's concern is that the cost not go so high that the company is forced out of business. She asked whether that is the bottom line.

MR. NUGENT answered in the affirmative, suggesting it is very important to the state as well, because [Agrium] adds value to the natural resource before it leaves Alaska. He said if gas becomes unaffordable to the company and it isn't in business anymore - to take it to an extreme - that will be a big revenue hit for the state too.

TAPE 03-2, SIDE B

REPRESENTATIVE KERTTULA questioned, if gas prices skyrocket, how the state could correctly base its return.

Number 2933

REPRESENTATIVE ROKEBERG asked whether the company can find producers at a price around \$2.00 per Mcf.

MR. NUGENT said he thinks so, since there are producers supplying gas to the company for less than that right now. He added, "We're very encouraged with discussions we've had with a number of potential producers in Cook Inlet, that they could supply gas to us ... for that price." He pointed out another value his company brings to natural gas producers in Cook Inlet. The utility market there is seasonal, with high wintertime demand and almost no demand in the summer. His company is an industrial user that brings steady consumption to a gas producer year-round, which is valuable to a producer.

Number 2868

CHAIR KOHRING announced that the bill would be held over in order to hear from DNR about the fiscal note. He expressed doubts about the amount and said he wanted to hear the justification for such a high number.

Number 2835

REPRESENTATIVE ROKEBERG noted that both he and Representative Kerttula had a concern about the definition of "manufacturer". He asked Representative Chenault to review that to see what possible negative impacts might exist. Suggesting that the definition appears too broad, he asked whether Representative Chenault had considered putting some "geographic sideboards around a particular area" that would accomplish his goal, as sponsor, without opening Pandora's box [with regard to Alaska North Slope (ANS) gas].

REPRESENTATIVE CHENAULT said he'd look into it.

REPRESENTATIVE ROKEBERG suggested that if ANS gas goes through a non-LNG pipeline "over the highway," there is an issue of potential in-state petrochemical value-added manufacturing, which could have an impact on the whole financing of a gas pipeline. He cautioned against doing something that inadvertently would even slightly impact that, and yet expressed the desire to accommodate [Agrium] as a "fine member of the Alaska business community and a job provider of high-paying, non-Wal-Mart jobs."

Number 2720

CHAIR KOHRING suggested that there would be incredible economic benefits [to HB 57], particularly to Kenai. He expressed appreciation for [Agrium's] investment in the community, as highlighted in a handout in committee packets: 700 jobs; \$90 million in expenditures in the Kenai area that involve 118 different companies; production, including value-added products, of \$190 million annually; and that it is the third largest private employer on the Kenai Peninsula. He said the goal of this legislation is to help this company and future companies of this nature to feel that they can operate profitably in Alaska, resulting in a great stimulus to the economy. He suggested that the committee needs to draw that line with regard to what is being given up in terms of future state revenues versus potential economic benefits. After receiving the explanation

for DNR's fiscal note, he said, the committee needs to decide whether the gain is enough to offset any loss.

Number 2661

REPRESENTATIVE FATE asked Mr. Nugent whether he was free to tell the committee what the company's needed return on investment is relative to the percentage of netback, and what percentage [Agrium] would pay to stabilize that gas price to the company. He said he understood the calculations [in the fiscal note], although he didn't know what figures had been used [as a basis]. He said it relates to how gas is priced, which is "at the netback." He elaborated:

Have you figured out what percentage of the present netback they're enjoying as a profit to the present facility? Are you prepared to ... equate a certain percentage to stabilize that ...? So, are you allowed to compute what your new return on investment would have to be if you stabilized that at a lower price and, therefore, a lower netback to the producers ... who eventually make the money?

Number 2571

REPRESENTATIVE FATE, in response to Mr. Nugent, further clarified his question by posing a situation in which [a producer] has a wellhead price of \$3.50 per Mcf and sells it to Agrium at \$5.50 per Mcf; the netback is \$2.00. If Agrium wants to stabilize that price over the long term at \$4.50 and "tap out of it" 20 Mcf, that leaves the producer 80 Mcf at a lower price than the \$5.50; therefore, the netback to the producer is about \$360, whereas before it was \$550. That is where the state would realize its loss, he said. The only way the state wouldn't realize a loss is if the price were stabilized at the \$5.50. If the price of gas went up then, which it may, the state again would take a loss, he suggested, saying it is really based on 1) the price of gas at the market, 2) the netback, and 3) how much royalty gas is taken out, because it is taken out in kind, "which is another argumentative issue in the gas industry."

CHAIR KOHRING asked Mr. Nugent whether that had provided clarification to the point where he could answer.

MR. NUGENT replied:

I think somewhat. I think ... what's important to understand, the situation we might be in, just say we were paying \$1.50 for state royalty gas now, for discussion purposes; so the state isn't losing any money in that situation. Then someone comes along and ... pays a much higher price - say, the \$5.50. What the current law would do, then, would ratchet up all the state royalty gas we presently purchase to that new value. And in that particular case, we couldn't be able to afford that gas, so we wouldn't buy any of it. ... We weren't paying the difference in the first place between the \$5.50 and the \$1.50. So I think in that extreme example, then, what ... the state would ... lose if we couldn't buy it anymore, they'd lose the \$1.50 we were paying in the first place, and they wouldn't make any sale, then, to our facility at \$5.50.

Number 2372

REPRESENTATIVE ROKEBERG said he appreciated Representative Fate's line of thinking, but that Mr. Nugent's point is important: at some point [Agrium's] operation will be unprofitable, and it will stop buying [gas] and shut down operations. Looking at the big picture of taxation and benefits, he said there is no question Agrium pays local and borough taxes, as well as state corporate income tax, presumably. In terms of total benefit, he suggested the need to take into account not only potential foregone royalty payments to the state, but also the potential loss of "other revenue sources in a more broad manner." He proposed looking beyond the fiscal note, therefore, for an economic analysis. He mentioned impact to the community, employment levels, and federal [income tax] as far as public benefits.

CHAIR KOHRING agreed with the need to weigh the economic benefit. He added that he doesn't necessarily see this as a loss to the state, just less revenue generated from sale of the gas, countered by a gain in economic benefit; furthermore, local governments will be improving their tax bases and so forth. He said he does support the legislation.

Number 2230

CHAIR KOHRING asked whether there were further questions or comments. Hearing none, he announced that HB 57 would be held

over in order to hear from [the Division of Oil & Gas] about the fiscal note.

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 4:25 p.m.