

060
HB 103

STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date: _____

REQUEST

Bill/Resolution No.: OS HB 103(FIN)
Title: An Act relating to royalty

FISCAL DETAIL

Agency Affected: Natural Resources
Program Category Affected: NRMEC

Sponsor: _____
Requestor: _____
Date of Request: _____

BRU, Program or Subprogram(s) Affected: _____
Minerals and Energy Management

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90
OPERATING						
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 SUPPLIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS						
800 MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: Attach a separate page if necessary

No fiscal impact.

Prepared By: Kay Brown
Division: Oil and Gas

Phone: 265-4241
Date: December 7, 1984

Approved by Commissioner: Ummé D. Amund, Deputy
Agency: Natural Resources

Date: December 10, 1984

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

7/1/84

Moer

Original sponsor: Rules/Governor

1 IN THE HOUSE BY THE FINANCE COMMITTEE
 2 CS FOR HOUSE BILL NO. 103 (Finance)
 3 IN THE LEGISLATURE OF THE STATE OF ALASKA
 4 FOURTEENTH LEGISLATURE - FIRST SESSION
 5 A BILL

6 For an Act entitled: "An Act relating to prerequisites for the disposal of
 7 royalty oil and gas; and providing for an effective
 8 date."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. AS 38.05.183 is amended by adding a new subsection to
 11 read:

12 (g) AS 38.05.035(e) does not apply to a sale, exchange, or other
 13 disposal of oil or gas under this section.

14 * Sec. 2. AS 38.06.055(c) is amended to read:

15 (c) A sale, exchange, or other disposition of oil or gas [MADE]
 16 under (b)(1) of this section may not be continued after the end of one
 17 year or renewed with the same party [TO PROVIDE RELIEF FOR MARKET OR
 18 STORAGE CONDITIONS] without the prior approval of the legislature
 19 under (a) of this section. This subsection does not apply to a se-
 20 quential competitively bid sale of oil or gas made with the same party
 21 under (b)(1) of this section.

22 * Sec. 3. This Act takes effect immediately in accordance with AS 01.-
 23 10.070(c).

KEY
— additions to this
[] deletions from old

Original sponsor: Rules/Governor

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13 disposal of oil or gas under this section.

14 * Sec. 2. AS 38.06.055(c) is amended to read:

15 (c) A sale, exchange, or other disposition of oil or gas ^[other than by competitive bid] [MADE]
16 under (b)(1) of this section may not be continued after the end of one
17 year or renewed with the same party [TO PROVIDE RELIEF FOR MARKET OR
18 STORAGE CONDITIONS] without the prior approval of the legislature
19 under (a) of this section. This subsection does not apply to a se-
20 quential competitively bid sale of oil or gas made with the same party
21 under (b)(1) of this section.

22 * Sec. 3. This Act takes effect immediately in accordance with AS 01.-
23 10.070(c).

REMARKS

by

KAY BROWN, DIRECTOR, DIVISION OF OIL & GAS

on

CS HB 103 (Oil and Gas)

to

HOUSE RESOURCES COMMITTEE

February 25, 1985

Thank you Mr. Chairman. For the record, I'm Kay Brown, Director of the Division of Oil and Gas for the Alaska Department of Natural Resources. I appreciate the opportunity to address the committee on CS HB 103.

This bill makes two technical changes to the royalty oil and gas disposal statute.

SECTION 1 of the bill would remove royalty oil and gas disposals from the procedures that govern all disposals of interest in state land or resources under AS 38. It is unclear whether AS 38.05.035(e) applies to royalty oil and gas sales. Royalty oil and gas sales have detailed finding and notice requirements under AS 38.05.182, 183 and AS 38.06. Although we believe that .035 is not presently applicable to royalty oil and gas sales, the possibility that it does apply would cast a cloud over sales that had to be entered into because of an emergency situation. Further, elimination of the .035 requirement streamlines the procedural requirements by removing conflicting timelines for disposal.

SECTION 2 of the bill would allow continuing competitive royalty oil sales

for terms of less than one year to be conducted without legislative approval of those sales. AS 38.06.055(a) provides that the legislature will approve all royalty oil and gas sales. Subsection (b) of that section sets out several exceptions for short-term and small volume sales which do not require legislative approval. Subsection (b)(1) makes an exception for sales of one year or less to relieve storage or market conditions, and this is the section under which we held the competitive sale in December 1984. Subsection (c), which is the section being amended in CS HB 103, goes on to say that a sale made under (b)(1) may not be continued after the end of one year or renewed with the same party without the prior approval of the legislature under (a) of the statute.

The Department of Law has advised us that there is a serious question as to whether a party who gained royalty oil under one competitive sale could re-bid in a subsequent royalty oil sale if the combination of the two sales would lead to that particular buyer receiving oil for more than a one-year period.

We see no reason why a company which bids and wins in one competitive sale should not be able to bid again the next year and again win the right to receive oil if it bids the highest price.

To await legislative approval under a competitive bid situation for contracts of one year or less would defeat the entire purpose of that type of short-term competitive sale.

Although it has been the consistent position of this and previous

administrations that the requirement of legislative approval is unconstitutional, administrations have always, as a matter of comity, respected the legislature's desire to be consulted in long-term or negotiated royalty oil contracts. Further, the presence of the statute, whether constitutional or not, could cast a cloud on any subsequent competitive sale.

Mr. Chairman, while we have not yet made a firm decision on whether continuing competitive sales would be beneficial to the state, we would like to have that option available for consideration at the same time we are considering the new proposals for in-state use.

That concludes my remarks Mr. Chairman. Thank you very much for your time.

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STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

BILL SHEFFIELD, GOVERNOR

POUCH 7-034
ANCHORAGE, ALASKA 99510

DIVISION OF OIL AND GAS

March 5, 1985

The Honorable Al Adams, Chairman
House Finance Committee
Alaska State House of Representatives
Juneau, AK 99811

Dear Representative Adams:

CSHB 103 (Oil and Gas), which relates to prerequisites for disposal of royalty oil and gas, is scheduled for a hearing tomorrow in your committee.

At the House Resources Committee hearing on February 25, 1985, the question was raised as to whether the proposed amendment in Section 2 of the bill would allow a competitive bid sale of one year or less to be continued or renewed beyond one year without legislative approval and without going to competitive bid.

While the language could possibly be interpreted to allow that outcome, I am informed by the Attorney General's Office that the case law on competitive bidding would preclude it, since a competitively-bid contract cannot be materially amended after it is awarded.

Nevertheless, we believe the bill could be improved and an unintended construction could be prevented by adoption of the following language for Section 2 of the bill (substitute beginning on line 14):

*Sec. 2. AS 38.06.055(c) is amended to read:

(c) A sale, exchange, or other disposition of oil or gas [MADE] under (b)(1) of this section may not be continued after the end of one year or renewed with the same party [TO PROVIDE RELIEF FOR MARKET OR STORAGE CONDITIONS] without the prior approval of the legislature under (a) of this section. This subsection does not apply to contracts awarded to the same party in sequential competitive sales of oil or gas under (b)(1) of this section.

Thank you for your consideration.

Sincerely,


Kay Brown
Director

cc: House Finance Committee Members
Commissioner Esther C. Wunnicke

CSHB 103
ANALYSIS
REPRESENTATIVE MARCO A. PIGNALBERI

SECTION 1

- AS 38.05.183 (a) Oil and gas royalties shall be by competitive bid.
- (c) If oil and gas royalty sale is by other than competitive bid, then Commissioner shall make public, written justification.
- (e) If oil and gas royalty sale is other than competitive bid, Commissioner shall award to buyer who proposes maximum benefits to state.

HB103 would add new section, (g), as follows:

- (g) AS 38.05.035(e) does not apply to a sale of oil and gas under this section.

AS 38.05.035(a) Director may approve contracts for sale of land and resources with consent of Commissioner.

Analysis: This is a housekeeping amendment. It is not clear that 38.05.035(e) applies to royalty oil and gas. Its thrust is definitely land sales. In order to eliminate confusion, this section specifically excludes oil & gas.

SECTION 2

- AS 38.06.055 (a) Requires legislative approval for royalty oil and gas contracts by enactment of legislation.
- (b) Exceptions to legislative approval
- (1) if sale is less than one year to relieve storage or market conditions
- (2) "small amounts"
- AS 38.06.055 (c) Present language says contracts that are exempt from legislative approval because they're for less than one year to relieve storage or market conditions, may not be continued or renewed beyond one year.

The proposed AS 38.06.055 (c) would allow a competitive bid sale that is less than one year to be continued or renewed without legislative approval. But it would not allow a negotiated sale to be renewed without legislative approval.

Analysis: Summarily, the protection of the public interest afforded by legislative review and approval is replaced by competitive bid procedures. However, the proposed change in AS 38.06.055 (c) does not limit the frequency or duration of renewals and continuances that may be made without the legislature's approval.

Conclusion: This amendment may have the effect of circumventing the legislature by transitioning all short-term, "market conditions" contracts to long-term contracts. I believe this flaw is serious, especially in light of DNR's position that legislative approval is an unconstitutional burden.

In addition, I suggest you delete the phrase beginning on line 17 and ending on line 18 that says [to provide relief for market or storage conditions].

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

POUCH 7-034
ANCHORAGE, ALASKA 99510

March 4, 1985

The Honorable Marco Pignalberi
Alaska State House of Representatives
Pouch V
Juneau, AK 99811

Dear Representative Pignalberi:

This letter responds to your request for information on the procedural requirements for royalty oil and gas sales. Specifically, you asked that I further address the time savings that would accrue and the deadline conflicts that would be averted by the passage of CSHB 103 (Oil and Gas).

Under Section 1 of the bill, AS 38.05.035(e) would not apply to a sale of royalty oil or gas under AS 38.05.183. Therefore, AS 38.05.945 would not apply either since it requires notice of actions under AS 38.05.035(e).

The attached chart shows the major actions presently required to sell royalty oil, the timing of those actions, and the statutory, regulatory or contractual basis for the actions. The requirements differ for the four broad categories of royalty sales: (1) long-term competitive; (2) short-term competitive; (3) long-term negotiated; and (4) short-term negotiated. Each short-term sale is assumed to fall within AS 38.06.055(b)(1) as a sale of one year or less to relieve storage or market conditions.

As the chart shows, even if AS 38.05.035(e) and AS 38.05.945 were eliminated from the process, other provisions would require written findings and notice to the public.

Our biggest concern relates to sales necessary to relieve an emergency storage situation. If the state were suddenly to find itself without a buyer for already nominated in-kind royalty oil, a new sale would have to be arranged immediately. In that event, it might not be possible to wait the roughly 60 days necessary to accomplish a short-term non-competitive sale under the present procedures.

The Honorable Marco Pignalberi
Page 2
March 4, 1985

It is not the Department's intention to reduce the level of public participation prior to royalty sales. If the bill passes, it is our intention to continue using a "preliminary" and "final" format for notice and findings except in emergency situations where time does not permit, and we would revise the regulations to incorporate this change.

If you have other questions please let me know.

Sincerely,



Kay Brown
Director

Attachment as stated

cc: Representative Davis
Representative Shultz
Representative Adams
Representative Martin
Commissioner Esther C. Wunnicke
Assistant Attorney General Steve Porter

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MAJOR ACTIONS REQUIRED TO SELL ROYALTY OIL

Minimum Time Required	Action	Authority (Mandatory or Discretionary)		Long Competitive	Short Competitive	Long Non-competitive	Short Non-Competitive
1 - 6 months	Issue solicitation for proposals	AS 38.05.182-.183	D			X	X
	Select buyer		M			X	X(D)
	Negotiate terms of contract					X	X(D)
	Draft required findings:		M	X	X	X	X
	o The oil is surplus to in-state needs	AS 38.05.183(d)	M/ export	X	X	X	X
	o Competitive bidding is waived	AS 38.05.183(a), (c)	M			X	X
	o The sale is in the best interest of the state	AS 38.05.182(a) AS 38.05.035(e)	M	X	X	X	X
o The proposal offers maximum benefits to state citizens	AS 38.05.183(e)	M			X	X	
Day 1	Publish Preliminary Notice of Intent to Make Findings under AS 38.05.035	AS 38.05.945(a) (3)	M	X	X	X	X
	Issue solicitation for backup contracts	AS 38.05.183	D		(back-up)		X
	Notify Royalty Board of intent to waive competitive bidding	AS 38.06.050(c) AS 38.05.183(c)	M		(back-up)	X	X

Minimum Time Required	Action	Authority (Mandatory or Discretionary)		Long Competitive	Short Competitive	Long Non-competitive	Short Non-Competitive
	Preliminary findings & contracts are available to public & mailed to Royalty Board; notice to mailing list	AS 38.05.183(c),(d); AS 38.05.035(e); AS 38.05.945	M	X	X	X	X
Day 14	Deadline for submission of backup contract proposals		D		(back-up)		X
Day 18	Notice of Royalty Board public hearing	3 AAC 56.051	M	X	X(D)	X	X(D)
Day 30	Comments due on preliminary findings		M	X	X	X	X
Day 32	Royalty Board public hearing	AS 38.06.050(a)	M	X	X(D)	X	X(D)
Day 37	Comments from Royalty Board & public are incorporated into final findings; findings made public; Final Notice of Competitive Sale	AS 38.05.945(a)(4), AS 38.05.035(e)	M	X	X	X	X
Day 38	Backup purchasers selected and notified		D		(back-up)		X
Day 53	Backup contracts executed and returned to DNR		D		(back-up)		X
Day 58	Execute contracts; mail to Royalty Board	3 AAC 56.220(a)	M		(back-up)	X	X
Day 60	Nominate oil	Unit agreement/ leases; AS 38.05.182			X		X

Minimum Time Required	Action	Authority (Mandatory or Discretionary)		Long Competitive	Short Competitive	Long Non-competitive	Short Non-Competitive
Day 60	Publish Notice of Royalty Board public hearing	3 AAC 36.051				X	
Day 75	Royalty Board public hearing; Royalty Board signs resolution	AS 38.06.050	M			X	
Day 81	Applications received for qualification to bid	11 AAC 03.160; Invitation	D	X	X		
Day 88*	Introduction of bill in Legislature approving sale of royalty oil	AS 38.06.050-055	M			X	
Day 88	Supply-Demand report to Legislature	AS 38.05.183(d)	M/ export	X	X	X	X
Day 100	Commissioner determines which applicants are eligible to bid	11 AAC 03.160; Invitation	D	X	X		
Day 125	Competitive sale	AS 38.05.183(a)		X	X		
Day 127	Deadline to request conference with Commissioner	11 AAC 03.230; Invitation to bid	M	X	X		
Day 132	Competitive sale award notice issued	11 AAC 03.220	M	X	X		
Day 140	Deadline to return executed contracts	Invitation	M	X	X		
Day 141	Royalty Board public hearing; Royalty Board signs resolution	AS 38.06.050(a)	M	X			

Minimum Time Required	Action	Authority (Man- datory or Discretionary)		Long Com- pet- itive	Short Com- pet- itive	Long Non- com- pet- itive	Short Non-Com- petitive
Day 171	Introduction of bill in Legislature approv- ing sale of royalty oil	AS 38.06.050-055	M	X			
Day 208	Legislature approves contract	AS 38.06.055	M	X		X	
Day 215	Nominate in-kind oil	Unit agreement/ leases; AS 38.05.182		X		X	
Day 240	Date of first delivery				X		X
Day 395	Date of first delivery			X		X	

* Assumed to be Day 1 of the Legislative session.

March 4, 1985
Page 4

1603K

best interests determination described in 11 AAC 03.010(d). (Eff. 12/12/80, Reg. 76)

Authority: AS 38.05.020
AS 38.05.183
AS 38.06.070

11 AAC 03.070. REJECTION OF PROPOSALS. (a) If the commissioner has either (1) solicited proposals for the noncompetitive sale of royalty oil, gas, or gas liquids, (2) issued a written determination to dispose of royalty oil, gas, or gas liquids by a method other than by competitive bid, or (3) issued written procedures for the noncompetitive disposal of royalty oil, gas, or gas liquids as described in 11 AAC 03.050, and the commissioner proposes to reject any proposal or application received as a result of the solicitation, determination, or written procedures, the commissioner will notify the Alaska Royalty Oil and Gas Development Advisory Board in writing before rejecting the proposal or application.

(b) The notification required by (a) of this section will consist of a list of the names of the prospective buyers whose proposals are rejected along with their proposals and any correspondence received from the prospective buyers.

(c) The commissioner will, in his or her discretion, reject unsolicited or uninvited proposals for the noncompetitive disposal of royalty oil, gas, or gas liquids without notifying the Alaska Royalty Oil and Gas Development Advisory Board. (Eff. 12/12/80, Reg. 76; am 8/8/84, Reg. 91)

Authority: AS 38.05.020
AS 38.06.050

11 AAC 03.080. STORAGE CONDITIONS. The commissioner disposes of royalty oil, gas, or gas liquids to relieve storage conditions when

(1) the royalty oil, gas, or gas liquids have either been noticed for a taking in-kind or are being taken in-kind or are being taken in-kind by the state; and

(2) the disposition planned for the oil, gas, or gas liquids at the time of the notice to take the oil, gas, or gas liquids in-kind can no longer be effectuated for any reason, or the disposition is

no longer in the best interests of the state. (Eff. 12/12/80, Reg. 76; am 8/8/84, Reg. 91)

Authority: AS 38.05.020
AS 38.05.183
AS 38.06.055

11 AAC 03.090. MARKET CONDITIONS. The commissioner disposes of royalty oil, gas, or gas liquids to relieve market conditions when

(1) in a noncompetitive disposition of royalty oil, gas, or gas liquids the price to be received under the noncompetitive disposition is higher than the amount being received by the state, either in-value or in-kind, at the time of the disposition and the commissioner estimates that the sale price will be higher than the in-value amount throughout the term of the contract for disposition;

(2) in a disposition by competitive bid the commissioner determines, at the time of issuance of the invitation to bid, that there is a substantial probability that the state will receive more than the in-value price as a result of the disposition by competitive bid;

(3) the royalty oil, gas, or gas liquids disposed of will be used to meet in-state needs for crude oil, gas, or gas liquids or petroleum products and the sale price of that royalty oil, gas, or gas liquids is at least equal to the in-value amount which would have been received by the state during the same period; or

(4) there is or will be an emergency in-state need for crude oil, gas, or gas liquids or petroleum products, which could be alleviated by the sale of the royalty oil, gas, or gas liquids. (Eff. 12/12/80, Reg. 76; am 8/8/84, Reg. 91)

Authority: AS 38.05.020
AS 38.05.183
AS 38.06.055

11 AAC 03.091. PROVISIONS APPLICABLE TO ROYALTY CONTRACTS. (a) Within 10 days after receiving written notice from a royalty purchaser of its intent to renegotiate price, as provided for by the terms of that purchaser's state royalty contract, or within 10 days after giving a royalty purchaser written notice of the state's intent to renegotiate price, as provided for by the terms of that purchaser's state royalty contract,

or before the adoption of any material amendment to a royalty contract which appreciably reduces the consideration received by the state, the commissioner will publish notice of the intent to renegotiate price or amend the contract in a newspaper of general statewide circulation. In addition, the commissioner will, in his or her discretion, publish notice by radio, television, or other electronic media. The notice will include

(1) a summary of information pertinent to the royalty contract, including quantity, current price, and termination date;

(2) a statement indicating where copies of the contract may be obtained; and

(3) a statement that any person may file written comments on the notice with the commissioner within 30 days after publication of the notice.

(b) In establishing or renegotiating the price of a royalty contract, the commissioner will obtain a price at least equal to the price that would have been received had the oil, gas, or gas liquids been taken in-value, plus field costs incurred by the royalty share, unless the commissioner determines that a lower price for the royalty gas would best serve the state's interests.

(c) The commissioner will submit to the legislature for approval any material amendment to a royalty contract which appreciably reduces the consideration received by the state. (Eff. 8/8/84, Reg. 91)

Authority: AS 38.05.020
AS 38.05.182
AS 38.05.183

11 AAC 03.100. DISPOSITION BY COMPETITIVE BID. (a) A disposition of royalty oil, gas, or gas liquids by competitive bid will, in the commissioner's discretion, be made without a written determination by the commissioner that the disposition of royalty oil, gas, or gas liquids by competitive bidding is in the best interests of the state.

(b) A disposition of royalty oil, gas or gas liquids by competitive bid will, in the commissioner's discretion, be made by the commissioner without notice to the Alaska Roy-

alty Oil and Gas Development Advisory Board; however, the commissioner will follow the procedures set out in 11 AAC 03.210 and 11 AAC 03.240. (Eff. 12/12/80, Reg. 76; am 8/8/84, Reg. 91)

Authority: AS 38.05.020
AS 38.05.183

11 AAC 03.110. SEALED BIDS. A disposition of royalty oil, gas, or gas liquids by competitive bid will be by sealed bid. The bids must be addressed to the commissioner and must be delivered in the manner, to the place, and by the date and time specified in the invitation to bid. Bids will be opened in public at the date, time, and place specified in the invitation to bid, unless the commissioner designates a later time for opening. (Eff. 12/12/80, Reg. 76; am 8/8/84, Reg. 91)

Authority: AS 38.05.020
AS 38.05.183

11 AAC 03.120. INVITATION TO BID. A disposition of royalty oil, gas, or gas liquids by competitive bid will be initiated by the commissioner by issuance of an invitation to bid. The invitation to bid will specify the quantity of oil, gas, or gas liquids to be sold, the term of disposition, the point of delivery, and any other terms and conditions of the disposition considered necessary by the commissioner. The commissioner will, in his or her discretion, include a form contract in the invitation rather than specifying terms and conditions. The invitation will specify qualifications of bidders and, if a determination of the qualification of a bidder by the commissioner is required, an explanation of the procedure for qualification. If priorities among bidders are to be assigned, the invitation will include an explanation of the procedure for obtaining a priority designation. The invitation will specify where, when, and how bids may be submitted to the commissioner and will specify the bond or other security which must accompany the bid. The invitation will specify the date, time, and place of bid opening, and the procedures under which the royalty oil will be awarded and contracts for disposition executed. (Eff. 12/12/80, Reg. 76; am 8/8/84, Reg. 91)

Authority: AS 38.05.020
AS 38.05.183

11 AAC 03.130. SECURITY. The commissioner may require that security, which in his

State of Alaska
Department of Natural Resources
Supplemental Findings
Competitive Royalty Oil Sale
(Prudhoe Bay and Kuparuk River Units)

November 28, 1984

Supplemental Findings
Competitive Royalty Oil Sale
(Pruchoe Bay and Kugaruk River Units)

AS 38.05.183(a) states that oil and gas taken in-kind as the state's royalty share of production may not be sold or otherwise disposed of for export from the state until the Commissioner of Natural Resources determines that the royalty in-kind oil or gas is surplus to the present and projected intrastate domestic and industrial needs for oil and gas. I find that the 90,000 bpd scheduled for competitive sale on December 11, 1984 is surplus to present and projected intrastate domestic and industrial needs for oil.

AS 38.05.183 also requires the Commissioner to submit an annual report to the state legislature "showing the immediate and long-term domestic and industrial needs of the state for oil and gas and an analysis of how these needs are to be met." The Department of Natural Resources, Division of Oil & Gas (the Department) complies with that requirement by preparing a document, published each January, entitled Historical and Projected Oil and Gas Consumption (also called the Supply/Demand study). The January 1984 Supply/Demand study concluded, as it has in previous years, that in-state supplies of both oil and gas far exceeded the immediate and long-term domestic and industrial needs of the state for oil and gas.

Due to the absence of any new information concerning the immediate and long-term domestic and industrial needs of the state for oil and gas, the Department again concluded, both in the Preliminary Findings and Determination to Negotiate Backup Royalty Oil Contract(s) and Conduct a Competitive Royalty Oil Sale (July 12, 1984) and the Final Findings and Determination to Conduct a Competitive Royalty Oil Sale for In-kind Oil from the Pruchoe Bay and Kugaruk River Units (October 10, 1984), that the 90,000 bpd of state royalty oil to be sold competitively on December 11, 1984 is surplus to in-state needs. Consequently, upon the publication of the Preliminary Finding and execution of contracts with backup purchasers, the state gave a six-month notice to the North Slope producers of its intent to take 90,000 bpd of royalty oil in-kind (as provided by procedures in the Pruchoe Bay and Kugaruk River Unit Agreements).

The Department's conclusion was and is based in part on the interpretation of AS 38.05.183 stated in each Supply/Demand study since 1982. In that year, the study first gave specific definitions to certain phrases in that statute. Since 1982, the first chapter of every Supply/Demand study has contained a list of possible definitions for some of the imprecise clauses of AS 38.05.183, such as "how these needs are to be met". The Supply/Demand study definition of that phrase specifies the Department's long-standing position that the state's present and projected intrastate domestic and industrial needs for oil and gas may be met from a variety of sources, including state royalty oil. See 1984 Supply/Demand study page 1.7.

The intent of the statute should not be regarded as complete state self-sufficiency in refined products from state royalty oil. Rather, the Department believes the legislature was aiming at ensuring adequate overall oil and gas supplies for the state. The 1984 Supply/Demand study states that, "Under reasonable assumptions about recoverable reserves and Alaskan consumption, the current inventory of both oil and gas is more than sufficient to meet the presently identifiable needs of Alaskans for the next 15 years." Presently, the Department of Revenue's most recent crude oil price forecasts remain conservative due to the continued surplus in world supplies. While unfavorable from a revenue standpoint, that surplus will likely translate into dampened crude oil prices for Alaska consumers and industrial users. Only if the cost of imported products were significantly above the cost of products which could be refined in Alaska (e.g. when oil is not available to local refiners at the market price), or if Alaska users were suffering from an absolute shortfall in petroleum products, would the Department not consider the royalty oil to be sold at the competitive sale as "surplus" to present and projected in-state needs. Neither of these was found to be the case.

The Department's view of the purpose of AS 38.05.183 stems first from the atmosphere of absolute shortage, particularly in motor fuels, which prevailed at the time the statute was written. The statute was adopted in 1974, when the worldwide oil crisis and the imposition of federal oil contract controls raised the spectre of product shortages in Alaska despite North Slope crude oil production. The Department's view stems second from the apparent paradox of continued imports into regions such as Southeast Alaska, where the landed cost of such imports from Puget Sound undercuts the cost of delivered refined products to Southeast from Railbelt refiners. Under the most constrained interpretation of the statute, the Department would be obliged to promote in-state refining with royalty oil for the sake of absolute self-sufficiency, even when this resulted in higher prices for Alaskans. Clearly, this was not the intent of the statute. Intrastate needs for oil and gas are presently being met from a variety of sources, including state royalty oil. As charged, the 1984 Supply/Demand study identifies those sources and discusses how in-state needs are to be met, given the total supply of hydrocarbons within the state. In terms of total present and projected demand vs. total present and projected supply, intrastate refined product needs can be met with ease by the unprecedented production of crude oil from the North Slope, which is available to any purchaser willing to meet the market clearing price for that oil. For these reasons, the Department determined in the 1984 Supply/Demand study that the state enjoys a surplus of hydrocarbons relative to present and foreseeable demand.

Even if AS 38.05.183(d) were interpreted to require all intrastate needs to be satisfied by royalty oil before export could occur, I would find that the competitive sale amounts are surplus to present and projected intrastate domestic and on industrial needs for two reasons. First, persons who have a demand for oil as a result of current in-state processing or supply activities are granted priority rights to purchase royalty oil at the competitive sale. Second, during the term of the competitive sale contracts, royalty oil will remain in-value and will be available for disposition in-state.

The Department has provided for satisfaction of demand for royalty oil on the part of in-state refiners and in-state suppliers by giving them priority rights to purchase oil at the competitive sale. A priority will be offered to bidders which have sold an average of at least 5,000 bpd of refined petroleum products to distributors or consumers within the State of Alaska during the twelve-month period beginning June 1, 1983 and ending May 31, 1984, and which possess the ability to process crude oil into refined petroleum products at a processing facility owned by the bidder. Priority status will enable the in-state supplier to meet the highest winning bid in each of the three categories of royalty oil to be competitively sold. That right extends to the number of lots remaining in each category after the first round award of lot(s) to the highest winning bidder(s) in each category and priority bidders who have been posted as apparent high bidders. Consequently, in the first round of awards, priority bidders enjoy the possibility of receiving oil at the lowest price posted in each category. In addition, in-state suppliers are reasonably assured of receiving the desired volume of oil in the second round of awards, provided they are willing to meet the competitively established price. 11 AC 03.250(5) states that:

"present or projected intrastate domestic and industrial needs" means in-state domestic and industrial demand at a competitive market price for the royalty oil, gas, or gas liquids. "Competitive market price" includes, but is not limited to, a price established by competitive bid.

Thus, in-state refiners and suppliers will have the first right to royalty crude at a competitive market price so that their supply is assured.

At the present time the state leaves approximately 104,735 bpd of royalty oil in-value with the North Slope lessees. The lessees export this oil from Alaska and tender the reported netback sale proceeds to the state. During the first six months of the term of the competitive sale contracts, April 1985 to September 1985, approximately 26,013 bpd of royalty oil will remain in-value. During the following six months of the term, October 1985 to March 1986, approximately 41,013 bpd of royalty oil will remain in-value. These amounts will remain available for disposition in-state if the Department finds the disposition(s) to be in the State's best interest. (If a contract currently being negotiated with Golden Valley Electric Association is approved, future amounts available for disposition would be reduced by 5,000 bpd.)

Several parties have recently expressed an interest in purchasing royalty oil from the State. Our conclusion that the competitive sale amounts are surplus to present and projected needs was drawn with the knowledge that all in-state refiners do not have 100% of their projected capacity supplied by state royalty oil. For example, as mentioned in the Preliminary Finding, the Department has conducted negotiations for the sale of royalty oil to MAPCO Inc. to fuel a proposed refinery expansion. The successful outcome of those negotiations is not, however, regarded by the Department as prerequisite to the possible export of the state's royalty oil in the planned competitive sale. First, MAPCO representatives indicated to the Department that the proposed refinery expansion may not be built, throwing the question of MAPCO's projected needs into doubt. Second, if MAPCO had a projected demand for royalty oil at a competitive price, it could have availed itself of its

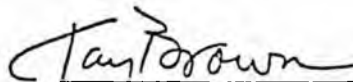
opportunity to purchase oil at the competitive sale, as a priority bidder. Since it is a current in-state refiner, MAPCO would have been entitled to all the priority rights discussed above. Third, by virtue of its proximity to the Trans Alaska Pipeline (TAPS), MAPCO has unique opportunities to supply its refinery with North Slope oil. MAPCO currently receives 35,000 bpd of royalty oil directly from the State. MAPCO also receives 5,000 bpd of royalty oil through its agreement with another state royalty oil purchaser - the Golden Valley Electric Association. In addition, about 60% of the oil run through the MAPCO refinery is, with a minor quality penalty, reinjected into TAPS to re-emerge as whole oil at Valdez. That oil, which is the property of MAPCO, may be exchanged for more oil from the North Slope and again withdrawn from TAPS at Fairbanks. One of the several advantages that MAPCO enjoys with its state royalty oil contract, relative to other in-state refiners, is this absence of any state control over the return oil. MAPCO could also purchase oil directly from the North Slope lessees to satisfy any demand not met through the purchase and exchange of royalty oil. Finally, MAPCO's location on TAPS allows it to enter into "in-transit stop" arrangements in which MAPCO "borrows" oil from other TAPS shippers. The borrowed oil is processed in MAPCO's refinery with the full amount returned to the original shipper at Valdez through a combination of return oil and quality bank payments. This in-transit stop arrangement remains feasible so long as MAPCO's current contract which does not expire until 2003, remains in effect. The Department believes that any failure by MAPCO to secure oil through these possible sources of supply indicates that MAPCO's demand may exist only so long as it believes the State is willing to supply it with oil at a price below competitive prices. As explained above, 11 AAC 03.250(5) provides that projected needs means in-state demand at a competitive price.

Since the Department made its most recent finding of ample in-state hydrocarbon supplies, published in the Final Finding of October 10, 1984, several Alaskan parties in addition to MAPCO have expressed interest in purchasing royalty oil. Chevron has requested further volumes of royalty oil to meet a possible increase in "throughput" at its 18,000 bpd Nikiski Refinery. Chevron owns and exports 12,000 bpd of North Slope production in addition to the 18,000 bpd of royalty oil which it processes at Nikiski. New parties also propose to create additional new refineries in Alaska. Because these proposals were not known to the Department at the time of the most recent determination of an in-state hydrocarbon surplus, the state has decided to reduce the one-year term of those lots offered in the Kuparuk River oil category (category A) to six months. This will enable the state to have an additional 15,000 bpd of royalty oil available in the fall of 1985 for those who offer to purchase state royalty oil at terms which lead the Department to find that the disposition(s) would be in the state's best interest.

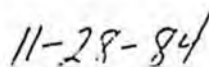
As stated, the impressive quantities of oil available within the state, which are the highest in the nation on a per-capita basis, diminish the likelihood of an actual "need" by these groups in the sense of supply availability. However, given the very recent nature of the new proposals received, the Department will further review their merits, as well as supply alternatives in addition to royalty oil. It has been the Division's experience that the term "need" is perceived differently by prospective in-state royalty oil

purchasers. Rather than the physical unavailability of oil due to world shortages or the unwillingness of North Slope producers to sell ANS crude at the market clearing price, prospective in-state royalty oil purchasers often view their feedstock needs in terms of the royalty oil price and terms they require for economic viability. While the Department recognizes that there are a host of oil-related economic activities which can be made viable should the state choose to undercut the market clearing price of Alaska North Slope oil for specific parties, this is not seen as the definition of "need" in AS 38.05.183, nor is it clearly in the State's best interest to do so.

Given the short-term nature of the proposed competitive sale, the consideration extended to in-state refiners and suppliers through the priority bidding system, the lack of demonstrated current need on the part of other potential in-state purchasers, and the amounts of oil remaining in-value available for disposition, I find pursuant to AS 38.05.183 that the royalty oil to be disposed of at the competitive sale is surplus to present and projected intrastate domestic and industrial needs.



Kay Brown, Director
Division of Oil & Gas
Department of Natural Resources



Cate

BILL SHEFFIELD
GOVERNOR



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

January 23, 1985

The Honorable Ben Grussendorf
Speaker of the House
Alaska State Legislature
Pouch V
Juneau, AK 99811

Dear Representative Grussendorf:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to royalty oil. The bill would (1) clarify and streamline procedural requirements for royalty oil and gas sales by expressly providing that the best-interest finding set out in AS 38.05.035(e) does not apply to those sales; and (2) enable the Department of Natural Resources to establish a regular program of short-term competitive royalty oil sales.

It is unclear whether AS 38.05.035(e) applies to royalty oil and gas sales. Royalty oil and gas sales have detailed finding and notice requirements set out in AS 38.05.182, 38.05.183, and AS 38.06, and are expressly committed to commissioner actions. AS 38.05.035(e), on the other hand, is essentially duplicative of those other processes and concerns actions taken by the director of the division of lands. Although we believe that the provisions of AS 38.05.035(e) are not presently applicable to oil and gas sales, such confusion does cast a cloud over royalty oil sales (particularly those that are entered into because of an emergency situation). The amendment in sec. 1 of the bill resolves the issue.

The second change, in sec. 2 of the bill, would allow competitive royalty oil sales for terms of less than one year to be conducted without legislative approval of those sales. To await legislative approval under a competitive bid situation for contracts of one year or less would defeat the entire purpose of that type of short-term competitive sales. Under the present statutory scheme, however, there is a serious question as to whether a party who gained royalty oil under one competitive sale could re-bid in a subsequent royalty oil sale if the combination of the two sales would lead to that particular buyer receiving oil for more than a one year period. Although it has been the

consistent position of this and previous administrations that the requirement of legislative approval is unconstitutional, administrations have always, as a matter of comity, respected the legislature's desire to be consulted in long-term or negotiated royalty oil contracts. Further, the presence of the statute, whether or not constitutional, would cast a cloud on any sale. Thus we believe that a clarification to allow short-term competitive royalty oil sales would be in the best interests of all.

Sincerely,

A handwritten signature in cursive script, appearing to read "Bill Sheffield".

Bill Sheffield
Governor

Offered: 2/15/85
Referred: Resources and
Finance

Original sponsor: Rules/Governor

1 IN THE HOUSE
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BY THE HOUSE SPECIAL COMMITTEE
ON OIL AND GAS

CS FOR HOUSE BILL NO. 103 (Oil & Gas)

IN THE LEGISLATURE OF THE STATE OF ALASKA

FOURTEENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to prerequisites for the disposal of
royalty oil and gas; and providing for an effective
date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 38.05.183 is amended by adding a new subsection to
read:

(g) AS 38.05.035(e) does not apply to a sale, exchange, or other
disposal of oil or gas under this section.

* Sec. 2. AS 38.06.055(c) is amended to read:

(c) A sale, exchange, or other disposition of oil or gas, other
than by competitive bid, made under (b)(1) of this section may not be
continued after the end of one year or renewed with the same party to
provide relief for market or storage conditions without the prior
approval of the legislature under (a) of this section.

* Sec. 3. This Act takes effect immediately in accordance with AS 01.-
10.070(c).

Introduced: 1/23/85
Referred: House Special Committee on
Oil & Gas, Resources and Finance

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

1 IN THE HOUSE

2 HOUSE BILL NO. 103

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FOURTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6 For an Act entitled: "An Act relating to royalty oil; and providing for an
7 effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 38.05.183 is amended by adding a new subsection to
10 read:

11 (g) AS 38.05.035(e) does not apply to a sale, exchange, or other
12 disposal of oil or gas under this section.

13 * Sec. 2. AS 38.06.055(c) is amended to read:

14 (c) A sale, exchange, or other disposition of oil or gas, other
15 than by competitive bid, made under (b)(1) of this section may not be
16 continued after the end of one year or renewed with the same party to
17 provide relief for market or storage conditions without the prior
18 approval of the legislature under (a) of this section.

19 * Sec. 3. This Act takes effect immediately in accordance with AS 01.-
20 10.070(c).