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STATE OF ALASKA
THE LEGISLATURE

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May, 1988

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Mary Van Nimwegen

House Rules 5-11-86 12:08pm

Offered: 2/28/86

~~IV~~

Original sponsors: Faiks, Kelly
and V.Fischer

1 IN THE SENATE

BY THE RULES COMMITTEE

2

CS FOR SENATE BILL NO. 309 (Rules)

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FOURTEENTH LEGISLATURE - SECOND SESSION

5

A BILL

6

For an Act entitled: "An Act relating to royalty gas contracts; and providing for an effective date."

7

8

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

9

* Section 1. FINDINGS. (a) The legislature finds that the best interest of the state will be served if the commissioner of natural resources is authorized to establish the in-value royalty for gas sold to a gas or electric utility by using the contract price between the lessee of the state and the utility, whether or not the gas lease establishes a different standard for the valuation and if the lessee and the utility are not related to each other. The legislature finds that this authorization should apply prospectively and does not intend the authorization to apply to the valuation for royalty purposes of gas sold by a lessee under a gas sales contract entered into before the effective date of this Act.

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(b) The legislature finds that it is also in the best interest of the state to give the commissioner explicit discretionary authority to sell royalty gas received in kind by the state to gas or electric utilities at a price that is below market value.

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(c) The legislature finds that the proper exercise of the discretion conferred on the commissioner by this Act would support and complement the other programs that assist the citizens of the state with their long-term gas and electrical needs, including the power cost equalization program under AS 44.83.162 - 44.83.165 and hydroelectric and other programs for the generation of electricity.

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(d) The legislature finds that the state should adopt a policy for

1 the sale of royalty gas to gas or electric utilities for in-state consumer
2 use and in-state generation of electricity that is fundamentally different
3 from the policies of the state for the sale of royalty oil and for the sale
4 of royalty gas for export from the state or for uses other than in-state
5 consumer use and in-state generation of electricity.

6 (e) The legislature finds it is in the state's best interest to
7 facilitate the financing and construction of a pipeline and increased gas
8 production from the Prudhoe Bay reservoir by establishing a procedure by
9 which the state could commit itself to a royalty valuation methodology for
10 as long as the state takes its royalty share of gas production in value.

11 * Sec. 2. AS 38.05.180 is amended by adding new subsections to read:

12 (aa) Within 90 days after the written request of a lessee of a
13 lease issued under this section, unless the commissioner makes a
14 written finding based on clear and convincing evidence that the con-
15 tract price is unreasonably low and that a prospective reduction in
16 royalty receipts would not be balanced by increased benefits to in-
17 state gas and electric consumers, the commissioner shall enter into an
18 agreement with the lessee to use the price for the gas established in
19 the contract between the lessee and a gas or electric utility, if the
20 lessee and the utility are not related in management, ownership, or
21 other aspect, as the value of the state's royalty share of gas produc-
22 tion sold by the lessee under the contract to the utility. In this
23 subsection

24 (1) "gas or electric utility" includes an electric coopera-
25 tive organized under AS 10.25, a municipal utility, and a gas or
26 electric utility regulated under AS 42.05; and

27 (2) "price for the gas established in the contract" in-
28 cludes tax reimbursement amounts, deliverability and other charges,
29 and other forms of consideration paid by the gas or electric utility

1 under the contract.

2 (bb) In the event of a contract between parties that are unrelat-
3 ed in management, ownership, or other aspect for the sale of gas from
4 Prudhoe Bay reservoir gas leases by means of delivery of the gas
5 through a pipeline for export out of the state, and within 90 days
6 after the written request of a lessee of a lease issued under this
7 section, unless the commissioner makes a written finding that the
8 contract price does not assure the maximum benefits to the people of
9 the state in return for the state's gas resources, the commissioner
10 shall enter into an agreement with the lessee to use the price for the
11 gas established in the gas sales contract as the value of the state's
12 royalty share of gas production sold by the lessee under the gas sales
13 contract. The lessee shall have the burden of providing all informa-
14 tion necessary for the commissioner to make an informed decision, and
15 shall provide clear and convincing evidence that the value of the gas
16 is reflected by the gas sales contract price rather than being attri-
17 buted to transportation, marketing, or other profit or cost centers.
18 In this subsection, "price for the gas established in the gas sales
19 contract" includes tax reimbursement amounts, deliverability and other
20 charges, and other forms of consideration received by the lessee under
21 the gas sales contract.

22 * Sec. 3. AS 38.05.183 is amended by adding a new subsection to read:

23 (h) The commissioner may enter into a contract to sell royalty
24 gas taken in kind by the state to a gas or electric utility at less
25 than the market value of the royalty gas if the commissioner, after
26 considering the consumer benefits, other benefits, and detriments of
27 the sale, makes a written finding that the sale is in the best inter-
28 est of the state. In this subsection, "gas or electric utility"
29 includes an electric cooperative organized under AS 10.25, a municipal

1 utility, and a gas or electric utility regulated under AS 42.05.

2 * Sec. 4. AS 38.05.810(a) is amended to read:

3 (a) Except as otherwise provided in AS 38.05.183(h), the [THE]
4 lease, sale, or other disposal of state land or resources may be made
5 to a state or federal agency or political subdivision, or the lease,
6 sale, or disposal of coal deposits suitable for mining may be made to
7 a utility owned and operated by a government agency or nonprofit
8 cooperative association organized to participate under the Federal
9 Rural Electrification Act for the purpose of generating electric power
10 and energy or the production of process steam, or both, for less than
11 the appraised value as determined by the director and approved by the
12 commissioner to be fair and proper and in the best interests of the
13 public, with due consideration given to the nature of the public
14 services or function rendered by the agency, subdivision, or utility
15 making application, and of the terms of the grant under which the land
16 was acquired by the state.

17 * Sec. 5. AS 38.05.180(aa), enacted by sec. 2 of this Act, applies to
18 agreements to establish for a lease issued under AS 38.05.180 the in-value
19 royalties on gas production that is sold under a contract entered into on
20 or after the effective date of this Act between the state's lessee and a
21 gas or electric utility.

22 * Sec. 6. This Act takes effect immediately in accordance with AS 01.-
23 10.070(c).

II

LETTER OF INTENT

TO HCS CS SB 309 (Rules)

HCS CS SB 309 (Rules) sets out the circumstances under which the Commissioner of Natural Resources is required to use the contract price as the value of the state's royalty gas share, when the contract involves a regulated gas or electric utility. The bill, is intended to specify only those circumstances under which the Commissioner "shall" accept the contract price. It is not intended, in any way, to limit the Commissioner's discretion to use the price term of a contract entered into by entities other than gas or electric utilities.

STATE OF ALASKA 1986 LEGISLATIVE SESSION
FISCAL NOTE

III

Revision Date: 5-9-86

REQUEST page 1 of 4

FISCAL DETAIL

Bill/Resolution No. HCSCSSB 309 (Finance)
Title: An Act relating to royalty gas contracts

Agency Affected: Natural Resources
BRU: Petroleum Management

Sponsor: Faiks
Requestor: House Finance
Date of Request: 5-9-86

Components: _____

EXPENDITURES/REVENUES : (Thousands of Dollars)

| OPERATING | FY 86 | FY 87 | FY 88 | FY 89 | FY 90 | FY 91 |
|-------------------|-------|-------|-------|-------|-------|-------|
| PERSONAL SERVICES | | | | | | |
| TRAVEL | | | | | | |
| CONTRACTUAL | | | | | | |
| SUPPLIES | | | | | | |
| EQUIPMENT | | | | | | |
| LAND & STRUCTURES | | | | | | |
| GRANTS, CLAIMS | | | | | | |
| MISCELLANEOUS | | | | | | |
| TOTAL OPERATING | | | | | | |

| | | | | | | |
|---------|--|--|--|--|--|--|
| 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

The fiscal impact of this proposal is indeterminate. For explanation, see attached Supplemental Information.

Prepared by: Kay Brown
Division: Oil and Gas

Phone: 762-4241
Date: 5-9-86

Approved by Commissioner: *Esther A. Hennrich*
Agency: Natural Resources

Date: 5-9-86

Distribution (by Agency preparing fiscal note):

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

SUPPLEMENTAL INFORMATION

Fiscal Note page 2 of 4
proposed House CS for CS for SB 309 (Finance)

Alaska Department of Natural Resources

The potential fiscal impact of the proposed House CS for CS for SB 309 (Finance) cannot be precisely specified, because it is unknown at this time how often the new valuation mechanism would be applied in the future and to what extent future contract prices would deviate from market value.

The impact of the proposed House Finance CS is limited to gas sold to regulated gas and electric utilities. The royalty share of gas sold to regulated gas and electric utilities would be valued using solely the contract price, unless the commissioner finds, based on clear and convincing evidence, that the price is unreasonably low, the prospective reduction in royalty receipts would not be balanced by increased benefits to in-state gas and electric consumers, the lessee and the utility are related to each other, and the contract price is not in the best interest of the state. (All four conditions would have to clearly and convincingly exist in order not to use the contract price.) Thus, the contract price would be used in virtually all foreseeable instances involving sales to regulated gas or electric utilities.

The fiscal impact of Section 2 of the bill would depend on the extent to which contract prices differ from value in the future. Gas that will be sold to regulated gas and electric utilities is likely to come primarily from Cook Inlet, at least in the near term. The state's royalty share of Cook Inlet gas reserves not presently committed to a contract is about 190 billion cubic feet (BCF), of which some portion would likely be sold for local consumer uses. If value is higher than contract price by 10¢, 25¢ and \$1.00 per mcf for half of the state's share of Cook Inlet royalty gas not presently committed to a contract, then state revenues would be reduced by \$9.5 million, \$23.75 million and \$95 million, respectively, as a result of basing the royalty payment on the contract price rather than on the market value of the gas. Any royalty income lost to the state as a result of using solely the contract price to determine the royalty payment would go directly to benefit local gas and electric consumers.

Sections 3 and 4 of the bill give the commissioner authority, upon legislative approval, to enter into an in kind royalty gas sale to a gas or electric utility "at a negotiated price." It is implied but not expressly stated that the sale may be at a price below market value. The fiscal impact of these sections would be considered by future legislatures reviewing an in kind sale proposed by the commissioner. If the commissioner proposed to sell royalty gas at a price below market value, and the legislature approved it, future royalty income would be reduced.

The proposed House Finance CS would allow implementation of the department's preliminary settlement agreement with Chugach Electric, which would value Beluga field production purchased by Chugach under existing contracts at 75¢/mcf, subject to the passage of the legislation. This value is one-half the state's January offer to settle the pricing dispute at \$1.50/mcf, which was rejected by the Beluga producers who sell to Chugach. If the dispute had been settled at \$1.50/mcf under existing law, the state would have received \$1.9 million/year in new royalty income from the Beluga field. Settlement at 75¢/mcf, as will occur if the proposed House Finance CS is adopted, will increase state royalty revenues from Beluga production by about \$810,000/year, because the state's share of this production is currently valued at 21¢/mcf by the producers. This increase in state royalty revenues is less than would have been expected if 1) the state's \$1.50/mcf settlement offer had been accepted, or 2) the state had successfully pursued its legal arguments regarding the value of the state's royalty share under the existing lease terms and existing law.

SUPPLEMENTAL INFORMATION

Fiscal Note for Amendment #1 page 4 of 4
of proposed House CS for CS for SB 309 (Finance)

Alaska Department of Natural Resources

The potential fiscal impact of Amendment #1 (related to valuation of North Slope royalty gas) of the proposed House CS for CS for SB 309 (Finance) cannot be precisely specified, because it is unknown at this time how often the new valuation mechanism would be applied in the future and to what extent future contract prices would deviate from market value.

The proposed amendment provides that, for North Slope gas that will be exported out of state, the commissioner may enter into an agreement with the lessee to use a contract price if the commissioner makes a written finding that the contract price assures the receipt of maximum benefits to the people of the state in return for the state's resources. The lessee must demonstrate by clear and convincing evidence that the value of the gas is reflected by the gas sales contract rather than being attributable to transportation, marketing, manufacturing, or other profit or cost centers.

The standard articulated above (maximum benefits to the people of the state) could allow the commissioner to purposely forgo potential royalty income in return for other benefits to the people of the state.

Under the proposed amendment, the commissioner would have the discretion to use a contract price rather than relying on the standards in the lease form to establish value. To the extent that a contract price differs from market value over time, or from the value established in other sales from the field, royalty income would be reduced.

The state's royalty share of North Slope gas reserves is about 4.5 trillion cubic feet (TCF). Assuming value is higher than contract price by 10¢, 25¢ and \$1.00 per mcf for the entire North Slope royalty share, royalty revenues to the state would be reduced by \$450 million, \$1.1 billion and \$4.5 billion, respectively, as a result of basing the royalty payment on the contract price rather than the market value of the gas.