

HFB

103

NO - PROPOSER Amendment to
~~SB~~ HB 103 -
VERY SIMILAR TO SB 309

* Sec. 3. AS 38.05.180 is amended by adding a new subsection to read:

(aa) For the purpose of determining the value of the state's royalty share of gas taken in value and sold pursuant to a long term contract, the commissioner shall apply said contract price.

* Sec. 4. This Act applies to leases issued before or after the effective date of this Act.

1) Would junk bill from committee

2) BAD Public Policy - ^{gas-} would apply to Prudhoe Bay -
_{oil-} undermining states positions in Amerada Hess case - (hundreds of millions at stake)

3) Dept of Law and DNR would both recommend veto - Gov's Office (Ray Gillispie) confirmed they would veto.

Changing position from legislation will impact Prudhoe Bay gas

Changing position

1) legal issue not directly on point oil value of oil not direct

Fisher has approved

State has taken consistent position re Amerada Hess - could undermine states case -

Sellinghart has been talking to people (Fisher approved) & has not found anyone who plans to support.

Larry Varnal - man on parking
Julie Quinn - Roda Evans (Shel) advised not supporting

NO

Proposed
Amendment

SB 309.
LANGUAGE

* Sec. 3. AS 38.05.180 is amended by adding a new subsection to read:

(aa) Notwithstanding other provisions of this section, if the royalty share of natural gas reserved to the state under a lease issued [under (f) of this section] or acquired by the state is taken in value, the value of production sold under a long-term sales contract may not be greater than the price received for the production under the long-term sales contract unless it is shown by clear and convincing evidence that the long-term contract price was unreasonably low at the time of contract.

* Sec. 4 This Act applies to leases issued before or after the effective date of this Act.

* Sec. 3. AS 38.05.180 is amended by adding a new subsection to read:

(aa) For the purpose of determining the value of the state's royalty share of gas taken in value and sold by the lessee as a first sale under the federal Natural Gas Policy Act pursuant to a long term contract entered into at arm's length and between unrelated parties, the Commissioner shall apply said contract price. ✓

* Sec. 4. This Act applies to leases issued before or after the effective date of this Act.

This is Chugach's attempt to find acceptable language. It would cut out Union and ~~unit sweetheat~~ ~~deals~~. Chugach feels it would not have the same impact on Amerada Hess, but DNR feels it would. I haven't been able to find Maynard.

MEMORANDUM

State of Alaska

TO: The Honorable Jay Kerttula
The Honorable Rick Halford

DATE: May 7, 1985

FILE NO:

TELEPHONE NO: 465-2400

FROM: Kay Brown
Director
Division of Oil and Gas

SUBJECT: Proposed Underlift
Amendment

An amendment is needed to AS 38.05.180(1) to give more flexibility to resolve a dispute over the value of Cook Inlet royalty gas.

The Department of Natural Resources recently informed Cook Inlet gas lessees that it would no longer accept long-term contract prices as the value for royalty gas taken in-value. Under the leases, the State is entitled to get current market value for the royalties. The department took the action to fulfill its responsibility under the law and the leases to obtain full value for the State's resources.

One consequence of the lease enforcement action is that consumer prices for electricity and gas in Southcentral will go up by small amount (no more than 4 percent).

One lessee -- ARCO -- recently sued the State over the action, and the other lessees have indicated they will also fight the action in court.

A representative of one of the Beluga gas field lessees suggested a few days ago that the State consider an "underlift" of its royalty share as a possible way to resolve the dispute. Under this approach, the State's gas could be kept in the ground and recovered at a later date.

The current statute authorizes trades of current royalty production for future production, but provides that the traded royalty share must be recovered during the first half of the field life or within 15 years from the start of production, whichever is sooner.

Both the Kenai gas field and the Beluga gas field are more than 15 years into production. The Beluga field, which began production in 1968, has about 80 percent of its recoverable reserves remaining to be produced after 17 years of production. The Kenai field, which began production in 1962, has about 34 percent of its recoverable reserves remaining, but the State's effective royalty share is only about 2 percent in that field. To ensure that the State receives its share before the end of

*Cherem - } Lute
Shell
Marathon }
Univ - } Univ Lute
Arco } Univ Lute*

the field life, gas from other nearby fields could be pledged as a backup mechanism.

The possibility of arranging a trade of current production for future production holds promise as a way to resolve the current dispute without compromising the state's position in other royalty litigation or the lease enforcement process. However, we cannot pursue this possibility unless the statute is amended.

We think the underlift approach could be attractive to all parties because:

- o Consumer rates in Southcentral would not be affected;
- o Lengthy litigation could be avoided;
- o All future options for disposition of the gas would remain open;
- o The Legislature would have more time to consider the issue of using royalties to provide consumer energy subsidies;
- o The state would be banking the resources until a local or foreign export market develops for the gas; and
- o If the Legislature does desire to subsidize Southcentral utility rates through in-kind royalty sales in the future, more gas would be available to offset large price increases that will occur in the early 1990s when long-term contracts expire.

The expected fiscal impact of an underlift in the Beluga and Kenai fields, if they could be negotiated, would be a loss of about \$1.5 million in FY 86.

A suggested amendment is attached. Thanks very much for your consideration.

KB/bb

Attachment

Proposed amendment to AS 38.05.180(1).

(1) Subject to the provisions of AS 31.05, the commissioner has discretion to enter into an agreement whereby, with the consent of the lessee, all or part of the state's royalty share of oil and gas production may be stored or retained in storage by the lessee, or the commissioner may enter into an agreement with one or more of the affected field lease holders to trade all or part of current royalty production from a field for a like amount, kind, and quality of future production, [ON THE CONDITION] if the commissioner makes a written finding that the state will receive[S] back its stored or traded royalty share [DURING THE FIRST HALF OF THE ESTIMATED FIELD LIFE OR NO LATER THAN 15 YEARS AFTER THE START OF PRODUCTION, WHICHEVER IS SOONER.] before the end of the estimated field life, considering engineering constraints, whether reserves from other fields are pledged to protect the royalty amount, and other relevant factors.

funds which are appropriated annually and not to earmarked funds that have been appropriated.

I respectfully dissent.

DOOLIN, Justice, dissenting in part:

I dissent in part to the prospective application in the majority opinion of the *Sunburst Doctrine*, 287 U.S. 358, 53 S.Ct. 145, 77 L.Ed. 360 (1932).

The duty to certify by the Board of Equalization is applicable, yesterday, today and tomorrow; for so long as the Constitution remains unchanged.

I am authorized to state that WILLIAMS and SIMMS, JJ., support this dissenting position.



TARA PETROLEUM CORPORATION,
Jarrett Oil Company, Appellants,

v.

Chester HUGHEY, Individually and as Administrator of the Estate of William F. Hughey, Deceased, Coy Brown, W. E. Pugh, James D. Howard, Dick Steelman, and Wilcoy Petroleum Company, Appellees.

No. 53585.

Supreme Court of Oklahoma.

June 9, 1981.

Rehearing Denied July 28, 1981.

Lessee of gas production rights and purchaser of gas appealed from judgment of the District Court, Greer County, Charles M. Wilson, J., awarding additional royalties under oil and gas lease to lessors. The Supreme Court, Lavender, J., held that: (1) when gas producer's lease calls for royalties to be paid to lessor based on market price at

well and producer enters into arm's length, good-faith gas purchase contract with best price and term available to producer at the time, such price is the "market price" and payment of royalties based on such price will discharge the producer's gas royalty obligation; (2) since producers made best deal they could to market gas, "market price" in gas royalty clause of lease was same as "contract price" of gas purchase contract, and therefore lessors were not entitled to additional royalties from producers; (3) lessors failed to show common control of lessee and purchaser so as to be entitled to royalty share of higher resale price; and (4) since producers appeared from record to be completely independent of original lessee and of purchaser, and since there was no indication that producers ever acted under direction or influence of either original lessee or purchaser, original lessee and purchaser were not liable for any additional royalties.

Reversed.

Irwin, C. J., and Williams, J., dissented.

1. Mines and Minerals ⇐78.1(8)

Once producing gas well is drilled, producer has duty to market the gas.

2. Mines and Minerals ⇐79.3

When gas producer's lease calls for royalties to be paid to lessor based on market price at well and producer enters into arm's length, good-faith gas purchase contract with best price and term available to producer at the time, such price is the "market price" and payment of royalties based on such price will discharge the producer's gas royalty obligation.

See publication Words and Phrases for other judicial constructions and definitions.

3. Mines and Minerals ⇐78.1(8)

If gas purchase contract is not reasonable when entered into, if it is not at a minimum fair and representative of other contracts negotiated at time in the field, then lessee of gas production rights has not protected his lessor in discharging his duty

to market gas, and courts are not required to protect lessee in interpreting the lease.

4. Mines and Minerals ⇨79.7

Burden of proving that gas purchase contract between producer and purchaser was unfair or unreasonable at time it was entered into is on lessor of gas production rights seeking additional royalty from producer.

5. Mines and Minerals ⇨79.3

Where gas producers who had leased production rights made best deal they could to market gas, negotiated highest price being paid in field at the time, negotiated escalator clause, obtained short-term contract, acted in good faith and represented their lessors well, dealt at arm's length with purchaser, terminated contract after two years when gas prices had increased and did not themselves profit in any way from increases in gas prices, "market price" in gas royalty clause of lease was same as "contract price" of gas purchase contract.

6. Mines and Minerals ⇨79.1(1)

In ordinary circumstances, when lessors of gas production rights are not entitled to additional royalties from producers, they will not be entitled to additional royalties from any other party.

7. Mines and Minerals ⇨79.3

Courts should take care not to allow lessors of gas production rights to be deprived or defrauded of royalties by their lessees entering into illusory or collusive assignments or gas purchase contracts.

8. Mines and Minerals ⇨79.3

Whenever a lessee of gas production rights or assignee of such rights is paying royalty on one price, but on resale a related entity is obtaining higher price, lessors are entitled, to their royalty share of the higher price.

9. Mines and Minerals ⇨79.7

Lessors of gas production rights in action for additional royalties under lease failed to demonstrate common control of lessee and purchaser of gas so as to be entitled to royalty share of price obtained by purchaser on resale of gas.

10. Corporations ⇨171

Speculation on ownership of corporation is not function of court.

11. Corporations ⇨1.6(8)

In order for court to ignore separate legal existence of corporate lessee or assignee of gas production rights and of corporate purchaser of gas, so as to entitle lessor to additional royalties on purchaser's resale of gas, it must appear from examination of entire facts either that the separate corporate existence is a design or scheme to perpetrate fraud, or that one corporation is so organized and controlled and its affairs so conducted that it is merely an instrument or adjunct of the other corporation, i. e., it must appear that one corporation is merely a dummy or sham.

12. Mines and Minerals ⇨79.1(1)

Where assignees of lease of gas production rights appeared from record to be completely independent of original lessee and of purchaser of gas, and where assignees did not act under direction or influence of either original lessee or purchaser, original lessee and purchaser should not have been held liable to lessors for additional royalties on resale of gas by purchaser.

13. Mines and Minerals ⇨79.1(1)

Fact that purchaser of natural gas made royalty payments for producers, following common practice in the industry, had no effect on whether purchaser and producers were under common control so as to entitle lessors of gas production rights to additional royalties on resale of gas by purchaser.

Appeal from the District Court of Greer County; Charles M. Wilson, Trial Judge.

The assignee-producers under a 1973 oil and gas lease sold natural gas pursuant to a two-year gas purchase contract from 1976 to 1978. During that time the purchaser of the gas, a middleman with a contract to resell the gas at the ceiling price allowed by the Federal Power Commission, received

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substantially more for the gas than it paid the producers. The royalty owners' royalties were based on the lower price. They sued the original lessee, the first purchaser of the gas, and the producers for additional royalties. Judgment was taken against the original lessee and the first purchaser, who appeal.

REVERSED.

Sparks & Sparks, Tulsa, for appellants.

Yonne P. McDaniel, Mangum, for appellee, Chester Hughey, Individually and as Administrator of the Estate of William F. Hughey, Deceased.

John C. Buckingham, Oklahoma City, for appellees, Coy Brown, W. E. Pugh, James D. Howard, Dick Steelman, and Wilcoy Petroleum Company.

LAVENDER, Justice:

This appeal is from a judgment of the District Court of Greer County, Oklahoma, awarding \$18,000 in additional royalties under an oil and gas lease to the plaintiff-lessee.

The property involved is described as lots 3 and 4 and the south half of the northwest quarter of section 5, township 5 north, range 23 west of the Indian Meridian, Greer County, Oklahoma. It contains some 161 acres.

In 1973 the four lessors, as the sole heirs of William F. Hughey, deceased, executed the lease to Tara Petroleum Corporation ("Tara"). Six months later Tara assigned the lease to an individual, Coy Brown, reserving an overriding royalty of $\frac{1}{8}$ of the $\frac{3}{8}$ working interest and reserving the right to purchase any gas produced at 31¢ per mcf.

In 1974 Coy Brown drilled a well on the property,¹ but it was not a producer. Then in February of 1976 he assigned the lease to Wilcoy Petroleum Company ("Wilcoy"), a corporation owned by him, his wife Wilma, his brother-in-law W. E. Pugh, and Pugh's wife Maudine. In addition to the one to

Wilcoy, there also appears of record another assignment of the lease from Coy Brown, this one dated and filed May 19, 1976, in which Brown reserved an interest in the lease and assigned decimal interests to W. E. Pugh, Dick Steelman, and James D. Howard.²

Wilcoy—apparently with the financial help of Steelman and Howard—drilled a producing gas well on the property in February 1976. In that same month Wilcoy, as seller, entered into a gas purchase contract with Jarrett Oil Company ("Jarrett") as the buyer. The contract was for two years and extended automatically from year to year thereafter. It could be terminated at the end of the two-year period or on any anniversary of that date upon ninety days notice by either party.

Production from the Hughey well began in March of 1976. Although the gas purchase contract called for the seller, Wilcoy, to pay "all royalties, overrides and production payments," the buyer, Jarrett, made the actual payments. At the end of the two-year period, Wilcoy terminated the contract.

It is the royalties for those two years—March 1976 through February 1978—that concern us in this action. They were based on the contract price Jarrett paid Wilcoy for the gas: 32¢ per mcf the first year, 33¢ the second, adjusted for BTU content. During that time Jarrett sold the gas from the Hughey well, and other gas it purchased in the field, to El Paso Natural Gas Company. Jarrett's contract with El Paso Natural Gas provided for Jarrett to receive for its gas the ceiling price permitted by the Federal Power Commission. Nearly five months after Jarrett began purchasing gas from the Hughey well, the Federal Power Commission substantially raised the ceiling price. Thereafter Jarrett received much more from El Paso Natural Gas than the 32¢ or 33¢ it paid Wilcoy for the gas from the Hughey well. The price went as high as nearly \$1.00 per mcf.

1. There is an indication in the record that Brown was joined in this drilling venture by his brother-in-law, W. E. Pugh.

2. These conflicting assignments are not explained, but they evidently have not caused any confusion or problems for the parties.

The lessors felt that they were owed additional royalties for this two-year period. Their lease has a more or less standard "market price" royalty clause for gas. It reads:

In consideration of the premises the said lessee covenants and agrees:

2nd. To pay lessor for gas of whatsoever nature and kind produced and sold or used off the premises, or used in the manufacture of any products therefrom, one-eighth (1/8) at the market price at the well for the gas sold, used off the premises, or in the manufacture of products therefrom, said payments to be made monthly. . . . [Emphasis added.]

Under this clause the lessors asserted that they were entitled to have their royalties measured by the price El Paso Natural Gas paid Jarrett, rather than the contract price Jarrett paid Wilcoy.

The lessors sued the original lessee (Tara), the first purchaser of the gas (Jarrett), and Wilcoy, Brown, Pugh, Steelman, and Howard (collectively referred to as the "producers"). Another defendant, Falcon Oil and Gas Company, was let out of the suit, and all but one of the original plaintiff-lessors dismissed their actions. The trial court held for the remaining plaintiff against Tara and Jarrett, awarding a joint and several judgment for \$18,000 for additional royalties. The court held for the

producers on the plaintiff's actions against them. Tara and Jarrett appeal.

I.

Disputes between lessors and lessees over the amount of royalty to be paid on gas production have become relatively common. The kind of dispute we have before us today arises because lessees, in order to market the gas, must ordinarily enter into long-term gas purchase contracts. As the current price of gas increases, lessors with more recent leases, more recent wells, and more recent gas purchase contracts receive royalty on higher prices than their counterparts with older production. Understandably, this seems unfair to the lessors.

Here the plaintiff did not ask for additional royalties based on a price that other lessors received for their gas, he asked for additional royalties based on what was actually paid for his gas. A middleman—Jarrett Oil Company—is present here. Nevertheless, the question is the same: Is a lessor with a "market price" gas royalty clause³ entitled to have his royalty calculated on the highest current price in the field? Put another way, is the "contract price"—the price the producer gets according to the gas purchase contract—the "market price" under the lease?

We hold that it is. In doing so, we recognize at the outset that some other jurisdictions have held otherwise. They are the Fifth Circuit,⁴ Texas,⁵ Kansas,⁶ and Montana.⁷ The cases from these jurisdictions

3. Other typical gas royalty clause types are "market value," "proceeds" ("gross" and "net"), and "in kind" clauses. See generally R. Hemingway, *Oil and Gas* § 7.4, at 316-21 (1971); Ashabranner, *The Oil and Gas Lease Royalty Clause—One-Eighth of What?*, 20 *Rocky Mtn.Min.L.Inst.* 163, 168-88 (1975); Fischl, *Ascertaining the Value or Price of Gas for Purposes of the Royalty Clause*, 21 *Okl.L. Rev.* 22, 22-32 (1968); Morris, *Taking Royalty Gas in Kind*, 22 *Rocky Mtn.Min.L.Inst.* 993, 994-97 (1976); Comment, *Vela: Legacy of Conflict Over Determination of Market Value for Royalties on Intrastate and Interstate Gas and Continued Controversy With the Natural Gas Policy Act of 1978*, 11 *St. Mary's L.J.* 502, 502 n.4 (1979). We limit our decision today to the effect of a "market price" gas royalty clause.

4. *Foster v. Atlantic Refining Co.*, 329 F.2d 485 (5th Cir. 1964); *J. M. Huber Corp. v. Denman*, 367 F.2d 104 (5th Cir. 1966). These are the seminal cases.

5. *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866 (Tex.1968). This is the original Texas case. It spawned a number of later Texas state and federal cases.

6. *Lightcap v. Mobil Oil Corp.*, 221 Kan. 448, 562 P.2d 1, cert. denied, 434 U.S. 876, 98 S.Ct. 228, 54 L.Ed.2d 156 (1977).

7. *Montana Power Co. v. Kravik*, 586 P.2d 298 (Mont.1978).

have generated a fair amount of comment,⁸ including comment by Oklahoma authors.⁹ By and large, the results in those cases have been criticized.¹⁰

[1] Once a producing well is drilled, a producer has a duty to market the gas.¹¹ In order to market gas it is usually necessary to enter into a gas purchase contract—frequently a long-term one, much longer than the term of the contract involved in this case. We have recognized this necessity of the market,¹² and we believe that lessors and lessees know and consider it when they negotiate oil and gas leases. Lessors and lessees also know that during the term of a gas purchase contract gas prices may increase, perhaps substantially. During the term a producer's revenues, fluctuations in production aside, will not increase. Yet if royalty must be paid on the basis of a "current," steadily-increasing "prevailing" price, then the lessor's share will take an ever larger and larger proportion of the producer's revenues. Consider for example the situation in this case: Under their contract the producers received 32¢ per mcf the first year. The royalty share of that amount, one eighth, is 4¢. Yet by the end of the first year the first purchaser, Jarrett, was receiving nearly \$1.28 for the gas. One eighth of \$1.28 is 16¢. So if royalty were measured by the price El Paso Natural Gas paid Jarrett, the lessors' royalty would have quadrupled in one year—to one half of the

producers' revenues. And all the while, of course, the producers' revenue per mcf remained constant.

[2] This would not be fair to the producers. We do not believe that the lessors in this case, the original lessee, or the assignee-producers ever contemplated that the lessors' royalty could be half of what the producers received for the gas. The better rule—and the one we adopt—is that when a producer's lease calls for royalty on gas based on the market price at the well and the producer enters into an arm's-length, good faith gas purchase contract with the best price and term available to the producer at the time, that price is the "market price" and will discharge the producer's gas royalty obligation.¹³ As one respected author has said:

Conceding that competent parties should be held to their agreements even though improvident, the typical clause, as a minimum, seems to be freighted with inherent ambiguity when it is remembered that gas must be sold by long term contracts in which buyers have been able to obtain schedules of prices almost certain to get out of line with contemporary contracts being negotiated. It was this consideration which caused gas sellers, where they were able, to insist on the "most favored nations" clauses now outlawed by the Federal Power Commission

8. Hamilton, J., dissenting in *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866, 879-80 (Tex. 1968); Preslar, C. J., dissenting in *Butler v. Exxon Corp.*, 559 S.W.2d 410, 418-20 (Tex.Civ. App.1977); 3A W. Summers, *Oil and Gas* § 589 (2d ed. W. Flittle Supp. 1980); 3 H. Williams, *Oil and Gas Law* § 650.4 (1977); Harmon, *Vela Today: Market Value Royalty Problems*, 27 *Oil & Gas Tax Q.* 185, 189-204 (1978).

9. Ashabranner, *The Oil and Gas Lease Royalty Clause—One-Eighth of What?*, 20 *Rocky Mtn. Min.L.Inst.* 163, 175-85 (1975); Fischl, *Ascertaining the Value or Price of Gas for Purposes of the Royalty Clause*, 21 *Okl.L.Rev.* 22, 30-32 (1968); Morris, *The Gas Royalty Clause—What Is Market Value?*, Sw. Legal Foundation 25th Ann. Inst. on Oil & Gas L. & Tax. 63, 66-79 (1974).

10. Hamilton, J., *supra* note 8; Preslar, C. J., *supra* note 8; 3A W. Summers, *supra* note 8;

Fischl, *supra* note 9, at 34-36; Harmon, *supra* note 8, at 205-08; Morris, *supra* note 9, at 75-83.

11. *McVicker v. Horn, Robinson & Nathan*, 322 P.2d 410, 414 (Okl.1958). See generally Annot., 71 *A.L.R.2d* 1219 (1960).

12. *Apache Gas Products Corp. v. Oklahoma Tax Commission*, 509 P.2d 109, 113 (Okl.1973). Texas courts have as well. *Gex v. Texas Co.*, 337 S.W.2d 820, 828 (Tex.Civ.App.1960); *Texas Oil & Gas Corp. v. Vela*, 405 S.W.2d 68, 73 (Tex.Civ.App.1966), quoted in *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866, 878-79 (Tex. 1968) (Hamilton, J., dissenting).

13. Fischl, *Ascertaining the Value or Price of Gas for Purposes of the Royalty Clause*, 21 *Okl.L.Rev.* 22, 29 (1968).

in current contracting of jurisdictional sales by the device of refusing filing to such contracts. (In *Vela*, a life of the lease sales contract at 2.3¢ per MCF, conceded to be reasonable in the circumstances of 1935 when made, had gotten approximately 11¢ out of line by 1960.) Add to this well-known reality of the business the lessee's implied covenant obligation to market with dispatch, and in the opinion of the writer the ambiguity should be resolved in favor of the lessee as a matter of law, with inquiry restricted to whether the sale was a reasonable contract when made.¹⁴

[3] We believe that our interpretation of "market price" is consonant with the intent and understanding of parties to oil and gas leases. And it is the only interpretation that would operate fairly for producers. Moreover, it is not unfair to lessors. Quite naturally lessors want to receive as much royalty as possible, but lessees in their own interest seek as good a price as they can get for gas. As long as the contract was reasonable when entered into, and as long as our law recognizes long-term gas purchase contracts as binding . . . the face of escalating prices, the law should not penalize the producer who was forced into the contract in large measure by his duty to the lessor. Now if the contract was not reasonable when entered into, if it is not at a minimum fair and representative of other contracts negotiated at the time in the field, then a different result obtains. Then the lessee has not protected his lessor in discharging his duty to market the gas, and there is no policy in the law requiring the courts to protect the lessee in interpreting the lease.

[4, 5] The burden of proving that a gas purchase contract was unfair or unreasonable at the time it was entered into is on

14. 3A W. Summers, Oil and Gas § 589 (2d ed. W. Flittie Supp. 1980, at 22-23).

15. 509 P.2d 109 (Okl.1973).

16. Section 1009 was amended in 1979, 1979 Okl.Sess.Laws ch. 88, § 2, but the language of subsection (f) was not changed.

the lessor seeking additional royalty. In this case there is no hint that the contract was unfair or unreasonable. The gas from the Hughey well is low in BTU content. In 1976 there were three gas purchasers in the field, but only one—Jarrett—was buying low-BTU gas. The producers made the best deal they could to market the gas. The price they negotiated was the highest being paid in the field at the time. They negotiated an escalator clause, and they obtained a short contract term: two years, as opposed to the ten-year term that was standard with Jarrett's contracts at the time. Of course, the producers were themselves concerned with making the best deal possible, but they acted in good faith and represented their lessors well. They dealt at arm's length with Jarrett. They terminated the contract after two years, when gas prices had increased. And they did not themselves profit in any way from the increases in gas prices. Under these circumstances, we hold that the "market price" in the gas royalty clause of the lease is the same as the "contract price" of the gas purchase contract.

Our holding today is consistent with our holding in an earlier case, *Apache Gas Products Corp. v. Oklahoma Tax Commission*,¹⁵ in which we were construing one of our gross production tax laws, 68 O.S. 1971 § 1009(f).¹⁶ That statute allows the Tax Commission to assess gross production taxes on the "prevailing market price" when the price of gas sold under a gas purchase contract does not represent "the cash price thereof prevailing for . . . gas . . . of like kind, character or quality in the field from which such product is produced . . ." We held that when the contract price for gas "was the highest and best price obtainable for gas in the field producing it, under the circumstances prevailing at the time the

17. That term, along with "prevailing field price," "prevailing price," and "gross value," was used throughout *Apache Gas* as shorthand for the statutory language in section 1009(f): "the prevailing price then being paid at the time of production thereof in said field for . . . gas . . . of like kind, quality and character."

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contract was entered into,"¹⁸ for purposes of the gross production tax the contract price is the market price. *Apache Gas* was followed by the Tenth Circuit in a 1976 case, *Pierce v. Texas Pacific Oil Co.*¹⁹

[6] Since here the contract price is the market price, the lessors were not entitled to additional royalties from the producers. As we have said, the plaintiff did not get any additional royalties from them. His claim against them was denied, and he has not appealed that denial. The plaintiff did, however, get judgment against the producers' original assignor, the original lessee, Tara, and the first purchaser, Jarrett. In the ordinary circumstance, when the lessors are not entitled to additional royalties from the producers they will not be entitled to additional royalties from any other party. That brings us to the plaintiff's equitable argument.

II.

The plaintiff in this case and the producers have joined on appeal as appellees; they have filed one brief. In it they argue that "equity and fairness will not permit the enrichment of [Tara and Jarrett] to the detriment of the royalty owners" They assert that Tara and Jarrett are jointly owned by and subject to the common control of two men, Joe Bob Brown (no relation to Tara's assignee Coy Brown) and Dean McNaughton.

[7, 8] Courts should take care not to allow lessors to be deprived or defrauded of their royalties by their lessees entering into illusory or collusive assignments or gas purchase contracts. Whenever a lessee or assignee is paying royalty on one price, but on resale a related entity is obtaining a higher price, the lessors are entitled to their royalty share of the higher price. The key is common control of the two entities.

18. 509 P.2d at 109 (syllabus ¶ 1).

19. 547 F.2d 519, 521 (10th Cir. 1976).

20. *Gulf Oil Corp. v. State*, 360 P.2d 933, 936 (Okla. 1961); *Wallace v. Tulsa Yellow Cab Taxi & Baggage Co.*, 178 Okl. 15, 18, 61 P.2d 645, 648 (1936).

[9, 10] The problem in this case is that common control of Tara and Jarrett was not shown. The record before us shows only two things: (1) at the time Tara took the original lease (April 1973) and at the time Tara assigned the lease to Coy Brown (October 1973), Joe Bob Brown and Dean McNaughton each owned 50% of Tara, and (2) at the time of trial (March 1979) Brown owned 100% of Tara and was president of both Tara and Jarrett. There is no indication in the record of the ownership of Jarrett at any time. Obviously we can speculate on Jarrett's ownership, but that is not the function of a court.

[11] Besides the lack of proof of common control in this case, we believe that a different matter is presented when an assignment has been made to or a gas purchase contract negotiated with an independent third party. To be entitled to additional royalties in that instance, we hold that the plaintiff must meet a higher burden of proof. As is ordinarily required for a court to ignore the separate legal existence of two corporate entities, in that instance it must appear

from an examination of the entire facts, either (1) that the separate corporate existence is a design or scheme to perpetrate fraud, or (2) that one corporation is so organized and controlled and its affairs so conducted that it is merely an instrumentality or adjunct of another corporation. In other words, it must appear that one corporation is merely a dummy or sham.²⁰

[12, 13] Nothing of the sort appears in this case. Coy Brown, who took the original assignment from Tara, and the later assignees of Brown, the producers, appear from the record to be completely independent of Tara and Jarrett. Except that Brown was required to drill a well, the assignment was unconditional.²¹ At the

21. Tara did reserve a $\frac{1}{4}$ of $\frac{1}{4}$ override and an option to purchase any gas produced at 31¢ per mcf. The option was never exercised. We expressly decline to decide what the result would have been if Tara had exercised the option.

time of the assignment, there was no well on the property. Tara could not have known that a producing well would be drilled, and in fact Brown's first well was not a producer. There were three companies with pipelines purchasing gas in the field—Tara, Jarrett, and Rimrock Gas Company—and Brown would have been under no obligation to sell gas to any particular one of them. As it happened, however, when the Hughey well did come in the gas was of low BTU content, and only Jarrett had enough of a market to purchase all of the gas. But that appears to have been a matter of circumstance, not contrivance. There is no indication that the producers ever acted under the direction or influence of either Tara or Jarrett. And the fact that Jarrett made the royalty payments for the producers—a common practice in the industry—is not significant. Under these circumstances, Tara and Jarrett should not have been held liable for any additional royalties.

III.

We reverse the judgments against Tara Petroleum Corporation and Jarrett Oil Company. Several other issues were raised on appeal. They concern Tara and Jarrett's cross-claim against the producers for indemnity, which was denied by the trial court. Ruling as we have, we have not found it necessary to decide those questions.

Tara and Jarrett are awarded their costs.
 REVERSED.

BARNES, V. C. J., and HODGES, SIMMS, DOOLIN, HARGRAVE and OPALA, JJ., concur.

IRWIN, C. J., and WILLIAMS, J., dissent.



Colleen MUGGENBORG and Letha Haynes, Petitioners,

v.

The Honorable William C. KESSLER, the District Judge of the Court, Oklahoma County, Seventh Judicial District, Respondent.

No. 56620.

Supreme Court of Oklahoma.

June 9, 1981.

Rehearing Denied July 28, 1981.

Maternal and paternal grandparents of two minors, both of whose parents were deceased, sought to prohibit judge from enforcing, by contempt, trial court decree which, without any prior notice of either of them, allowed divorced maternal grandfather to become adoptive parent of minors. The Supreme Court, Opala, J., held that: (1) maternal and paternal grandparents of minors were affected or interested parties who were entitled to notice of adoption proceeding brought by divorced maternal grandfather, and (2) prohibition was proper to arrest judicial enforcement, by contempt, of adoption proceeding found to be ineffective for want of advance notice to affected or interested parties.

Ordered accordingly.

1. Adoption ⇌ 12

Maternal and paternal grandparents of minors whose parents were deceased were affected or interested parties entitled to notice of adoption proceeding brought by divorced maternal grandfather. 10 O.S. Supp.1974, § 60.5(3)

2. Parent and Child ⇌ 2(7)

When both parents are either dead or their parental rights have been severed, a

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STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY
LEGISLATIVE REFERENCE LIBRARY

FOUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

May, 1986

Copies of minutes listed below were originally included in this file. The minutes are available on the STAIRS date base CM 14. In order to save space copies of minutes have not been left in the files.

Jeanie Henry

SENATE RESOURCES COMMITTEE, 4/1/85, 1:35

AMENDMENT #2

OFFERED IN THE SENATE:

By: RAY

To: _____ SENATE BILL No. _____

CS HOUSE BILL No. 103

PAGE: _____

LINE: _____

AMENDMENT TO AM. NO 1 BY KENTUCKY

Delete last sentence of the amendment

No

STATE OF ALASKA
THE LEGISLATURE

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907 465 3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

May 12, 1985

SUBJECT: Constitutionality of amendment to
 CSHB 103 (Fin)

TO: Senator Arliss Sturgulewski

FROM: Randall J. Moen *RJM*
 Legislative Counsel

You have requested an opinion on whether two proposed amendments may be added to CSHB 103 (Finance), "An Act relating to the prerequisites for the disposal of royalty oil and gas". Under Article II, Section 13, Constitution of the State of Alaska, "The subject of each bill shall be expressed in the title".

The two proposed amendments relate to the value of the royalty share of gas reserved to the state under a gas lease located on state land. The title of CSHB 103 (Finance) relates to the requirements for the disposal of royalty oil and gas. The question is whether the language or subject matter of the amendments are expressed in the title.

In my opinion, the subject matter of the amendments to CSHB 103 (Finance) are not expressed in the title because there is a distinction between the requirements for an effective disposal of royalty and the value of royalty received from a disposal.

A prerequisite to disposal is a condition that must be met if the disposal is to be valid.

Since the value of royalty gas and the validity of a disposal of royalty gas and oil are two distinct subjects, I conclude that an adoption of the proposed amendments under CSHB 103 (Finance) would violate Article II, Section 13 of the Alaska Constitution because the subject of value of

Senator Arliss Sturgulewski

Page 2

May 12, 1985

royalty gas would not be expressed in the title of CSHB 103 (Finance) which relates to another subject, the requirements for the disposal of royalty oil and gas.

RJM:lmb

J15/009

Chugach² ELECTRIC ASSOCIATION, INC.

5601 MINNESOTA DRIVE • P.O. BOX 6300 • ANCHORAGE, ALASKA 99502-0300 • PHONE 907-563-7494

TELEX: CHUGACH AHG

(090) 25 265

TELECOPIER:

907-564-0632

FOR IMMEDIATE RELEASE:
May 1, 1985

FOR FURTHER INFORMATION CONTACT:
Lana Johnson, 564-0736, or
Bonnie Jack, 564-0766

A state decision to collect higher royalty payments from Cook Inlet natural gas producers sets the stage for similar increases by the federal government and Cook Inlet Region, Inc. (CIRI).

If the two follow suit, Chugach Electric Association's gas bill could more than double, and electric bills in Southcentral Alaska could rise an average of 6.41 percent.

Chugach is Alaska's largest electric utility, serving approximately 60,000 consumers in Anchorage and the Upper Kenai Peninsula areas. In addition, it supplies the power needs of its wholesale customers -- Matanuska Electric Association (MEA), Homer Electric Association (HEA) and the City of Seward.

Last month the state Department of Natural Resources ordered Cook Inlet lessees to collect the state's one-eighth royalty gas share based on market value rather than contract price. In Cook Inlet, the state said, market value was set by a contract Enstar Natural Gas Co. signed in 1982. The Enstar contract ties the price of its gas to the price of No. 2 fuel oil delivered at Nikiski, a price that presently amounts to \$2.05 per thousand cubic feet (mcf).

In the case of Chugach, that decision raises the price of royalty gas from about 25 cents per mcf to about 35 cents per mcf.

The state, however, owns only 60 percent of the Beluga River Field where Chugach purchases a major portion of its gas. The remaining 40 percent is owned by the federal government and CIRI.

Already CIRI and the federal government have raised their royalty share to market value in another Cook Inlet field, the Kenai gas field. Union Oil Co., the field's producer, has sued over the decision and the case is presently in federal district court.

If CIRI and the federal government decide to increase their royalty share throughout Cook Inlet, the price of Chugach's Beluga gas would rise to 44 cents per mcf.

Complicating the issue is the method by which the state Department of Revenue collects its production (severance) tax. State statute allows it the option of collecting a flat rate per mcf or 10 percent of value, whichever is higher.

Currently, the state collects a flat rate which averages 3.5 cents per mcf. Collecting the tax based on what the state calls market value would increase the tax to almost 10 cents per mcf.

When added together, these factors represent a substantial increase in the electric bills of the approximately 250,000 residents of Southcentral Alaska.

Bob Martin, Jr., Chugach's general manager, said Chugach "vigorously opposes these increases and is exploring all avenues to protect its customers -- both retail and wholesale -- against their impact."

The average Chugach consumer pays \$57.34 per month for 805.4 kilowatt hours (kWh) of electricity. That bill could increase by 5.56 percent (\$3.21) to \$60.55 per month.

The average Homer Electric consumer pays \$73.58 per month for 860 kWh of electricity. That bill could increase by 4.4 percent (\$3.25) to \$76.83.

The average Matanuska Electric consumer pays \$107.80 per month for 1,200 kWh of electricity. That bill could increase by 4 percent (\$3.90) to \$111.70.

Collectively, these increases would amount to more than \$56 million over the next decade, the remaining life of Chugach's gas contracts at Beluga.

-end-

#1

A M E N D M E N T

Offered in the SENATE

TO: CSHB 103 (Finance)

Page 1, after line 9 insert a new bill section to read:

"* Section 1. AS 38.05.180(1) is amended to read:

(1) Subject to the provisions of AS 31.05, the commissioner has discretion to enter into an agreement whereby, with the consent of the lessee, the state's royalty share of oil and gas production may be stored or retained in storage by the lessee, or the commissioner may enter into an agreement with one or more of the affected field lease holders to trade current royalty production from a field for a like amount, kind, and quality of future production. An agreement for storage may be made only [,] on the condition that the state receives back its stored [OR TRADED] royalty share during the first half of the estimated field life or no later than 15 years after start of production, whichever is sooner. An agreement to trade all or part of current royalty production for future production may be made only if the commissioner makes a written finding that the state will receive back its traded royalty share before 80 percent of the estimated field reserves are depleted, considering engineering constraints, whether reserves from other producing fields are pledged to protect the traded royalty share, and other relevant factors. An agreement to trade current production for future production entered into under this subsection must contain a provision holding the lessee harmless in the

event that, without the fault of the lessee, the state is unable to receive its traded royalty share because of unanticipated depletion of the field and any other pledged producing fields."

Page 1, line 10, delete "* Section 1." and insert "* Sec. 2."

Renumber remaining bill section accordingly.

UNDERLIFT LANGUAGE

OK

A M E N D M E N T

Offered in the SENATE

TO: CSHB 103 (Finance)

Page 1, after line 9 insert a new bill section to read:

"* Section 1. AS 38.05.180(1) is amended to read:

(1) Subject to the provisions of AS 31.05, the commissioner has discretion to enter into an agreement whereby, with the consent of the lessee, all or part of the state's royalty share of oil and gas production may be stored or retained in storage by the lessee, or the commissioner may enter into an agreement with one or more of the affected field lease holders to trade all or part of current royalty production from a field for a like amount, kind, and quality of future production, if the commissioner makes a written finding [ON THE CONDITION] that the state receives back its stored or traded royalty share before 80 percent of the estimated field life is depleted, considering engineering constraints, whether reserves from other producing fields are pledged to protect the stored or traded royalty share, and other relevant factors [DURING THE FIRST HALF OF THE ESTIMATED FIELD LIFE OR NO LATER THAN 15 YEARS AFTER START OF PRODUCTION, WHICHEVER IS SOONER]."

Page 1, line 10, delete "* Section 1." and insert "* Sec. 2."

Renumber remaining bill section accordingly.

A M E N D M E N T #1*by Senator Kerstula*

Offered in the SENATE

TO: CSHB 103 (Finance)

Page 1, after line 9 insert a new bill section to read:

"* Section 1. AS 38.05.180(1) is amended to read:

(1) Subject to the provisions of AS 31.05, the commissioner has discretion to enter into an agreement whereby, with the consent of the lessee, the state's royalty share of oil and gas production may be stored or retained in storage by the lessee, or the commissioner may enter into an agreement with one or more of the affected field lease holders to trade current royalty production from a field for a like amount, kind, and quality of future production. An agreement for storage may be made only [,] on the condition that the state receives back its stored [OR TRADED] royalty share during the first half of the estimated field life or no later than 15 years after start of production, whichever is sooner. An agreement to trade all or part of current royalty production for future production may be made only if the commissioner makes a written finding that the state will receive back its traded royalty share before 80 percent of the estimated field reserves are depleted, considering engineering constraints, whether reserves from other producing fields are pledged to protect the traded royalty share, and other relevant factors. An agreement to trade current production for future production entered into under this subsection may contain a provision holding the lessee harmless in the

event that, without the fault of the lessee, the state is unable to receive its traded royalty share because of unanticipated depletion of the field and any other pledged producing fields.

Page 1, line 10, delete "* Section 1." and insert "* Sec. 2."

Renumber remaining bill section accordingly.

AMENDMENT #1

Offered in the SENATE BY KERITLLA

TO: CSHB 103 (Finance)

Page 1, after line 9: Insert a new bill section to read:

"* Section 1. AS 38.05.180(1) is amended to read:

(1) Subject to the provisions of AS 31.05, the commissioner has discretion to enter into an agreement whereby, with the consent of the lessee, all or part of the state's royalty share of oil and gas production may be stored or retained in storage by the lessee, or the commissioner may enter into an agreement with one or more of the affected field lease holders to trade all or part of current royalty production from a field for a like amount, kind, and quality of future production, if the commissioner makes a written finding [ON THE CONDITION] that the state receives back its stored or traded royalty share before 80 percent of the estimated field life is depleted, considering engineering constraints, whether reserves from other producing fields are pledged to protect the stored or traded royalty share, and other relevant factors [DURING THE FIRST HALF OF THE ESTIMATED FIELD LIFE OR NO LATER THAN 15 YEARS AFTER START OF PRODUCTION, WHICHEVER IS SOONER].

Page 1, line 10: Delete "* Section 1" and insert "* Sec. 2"

Renumber remaining bill section accordingly

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

BILL SHEFFIELD, GOVERNOR

POUCH M
JUNEAU, ALASKA 99811
PHONE: 907-465-2400

May 8, 1985

The Honorable Jalmar Kerttula
Alaska State Senate
Pouch V
Juneau, AK 99811

Dear Senator Kerttula:

The Department of Natural Resources has proposed an amendment to AS 38.05.180(1) that I believe deserves your support. The proposed amendment is needed to give the State more flexibility to resolve a dispute over the value of Cook Inlet royalty gas.

The Department of Natural Resources recently informed Cook Inlet gas lessees that it would no longer accept long-term contract prices as the value for royalty gas taken in-value. Under the leases, the State is entitled to get current market value for the royalties. The department took the action to fulfill its responsibility under the law and the leases to obtain full value for the State's resources.

One consequence of the lease enforcement action is that consumer prices for electricity and gas in Southcentral will go up by a small amount (no more than 4 percent).

One lessee -- ARCO -- recently sued the State over the action, and the other lessees have indicated they also will fight the action in court.

A representative of one of the Beluga gas field lessees suggested a few days ago that the State consider an "underlift" of its royalty share as a possible way to resolve the dispute. Under this approach, the State's gas could be kept in the ground and recovered at a later date.

The current statute authorizes trades of current royalty production for future production, but provides that the traded royalty share must be recovered during the first half of the field life or within 15 years from the start of production, whichever is sooner.

need on my desk for 10/3
MAY 09 1985

Both the Kenai gas field and the Beluga gas field are more than 15 years into production. The Beluga field, which began production in 1968, has about 80 percent of its recoverable reserves remaining to be produced after 17 years of production. The Kenai field, which began production in 1962, has about 34 percent of its recoverable reserves remaining, but the State's effective royalty share is only about 2 percent in that field. To ensure that the State receives its share before the end of the field life, gas from other nearby fields could be pledged as a backup mechanism.

The possibility of arranging a trade of current production for future production holds promise as a way to resolve the current dispute without compromising the State's position in other royalty litigation or the lease enforcement process. However, we cannot pursue this possibility unless the statute is amended.

We think the underlift approach could be attractive to all parties because:

- Consumer electric and gas rate increases that would otherwise occur could be avoided (or at least postponed for perhaps 5-7 years);
- The State would be banking the resources until a local or foreign export market develops for the gas;
- Lengthy litigation could be avoided;
- All future options for disposition of the gas would remain open;
- The Legislature would have more time to consider the issue of using royalties to provide consumer energy subsidies;
- If the Legislature does desire to subsidize Southcentral utility rates through in-kind royalty sales in the future, more gas would be available to offset large price increases that will occur in the early 1990s when long-term contracts expire.

The expected fiscal impact of underlifting in the Beluga and Kenai fields, if agreement could be reached by the State, lessees, and utilities to allow that arrangement, would be a loss of about \$1.5 million in FY 86.

May 8, 1985

The State's options for disposition of the gas are limited at this time. Immediate local needs appear to be satisfied by existing contracts between the utilities and gas producers. Certain contractual provisions in those contracts may make in-kind royalty gas sales unattractive to the utilities at this time. For example, the Chugach Electric contract for Beluga Gas contains a "most favored nation" provision which would jeopardize the utility's favorable long-term contract price if it purchases gas from that field at a higher price. Enstar also would have no incentive to purchase royalty gas from the Kenai field because any such purchase would reduce the volume of gas Enstar is entitled to receive under its 61¢ long-term contract with Union and Marathon.

It is our expectation that the amendment will be proposed during Senate floor debate on CSHB 103(Finance). In addition to the underlift amendment, I urge your support of that bill. The bill would remove possible legal impediments to renewing with the same purchaser short-term, competitively bid royalty oil contracts.

If you have any questions, please call.

Sincerely,



Esther C. Wunnicke
Commissioner

Attachment

ZUMON! Perilla

MEMORANDUM

DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL AND GAS
TO: Senator Jalmar Karttula

State of Alaska

DATE: May 9, 1985

FILE NO:

TELEPHONE NO: 276-2653

SUBJECT: Underlift Amendment

FROM: Kay Brown, Director

Here is some additional background for your information.

	<u>Kenai gas field</u>	<u>Seluga gas field</u>
Date of first production	1962	1968
Years produced	23	17
Total recoverable gas	2410 BCF	985 BCF
Total production to date	1560 BCF	185 BCF
Percent of total recoverable gas produced to date	65	19
Average annual production	108 BCF	19 BCF
Years of production remaining (at current rates)	8	42
Year that 80% of recoverable gas will have been produced (at current rates)	1989	2016

1657K

Handle ASAP. Press Comments

DELIVER TO: <u>Ned Farquhar</u>	LOCATION: <u>465-2400</u>
FROM: <u>Kay Brown</u>	LOCATION: <u>265-4241</u>
TELEPHONE/TELECOPIER # _____	TOTAL NUMBER OF PAGES: <u>61</u>
TRANSMITTING ON SPEED _____	DATE: <u>5/9</u> TIME: <u>10 am</u>
NAME AND PHONE NUMBER: <u>265-4244 - Ballin</u>	

Introduced: 5/4/85
Referred: Resources

1 IN THE SENATE

BY FAIKS, KELLY AND V.FISCHER

2

SENATE BILL NO. 309

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 the royalty value of a natural gas lease on state land; and providing for an effective date."

7

8

9

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

10

* Section 1. FINDING. The legislature finds that to provide for the utilization, development and conservation of gas resources for the maximum benefit of the people of the state, the value of production of gas for purposes of computing the royalty reserved to the state must be based primarily on the contract price of gas rather than the current market value of the gas. This will encourage stable markets, promote investment, assure reasonable energy prices and provide the maximum benefit to the people of the state.

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* Sec. 2. AS 38.05.180 is amended by adding a new subsection to read:

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(aa) Notwithstanding other provisions of this section, if the royalty share of natural gas reserved to the state under a lease issued under (f) of this section is taken in value, the value of production sold under a long-term sales contract may not be greater than the price received for the production under the long-term sales contract unless it is shown by clear and convincing evidence that the long-term contract price was unreasonably low at the time of contract.

* Sec. 3. This Act applies to leases issued before or after the effective date of this Act.

* Sec. 4. This Act takes effect immediately in accordance with AS 01.-10.070(c).

Introduced: 4/10/85
Referred: Resources

1 IN THE SENATE

BY P.FISCHER AND KELLY

2

SENATE BILL NO. 276

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 the lease, sale, or disposal of
7 natural gas for a public use."

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

9 * Section 1. AS 38.05.810(a) is amended to read:

10 (a) The lease, sale, or other disposal of state land or re-
11 sources may be made to a state or federal agency or political subdivi-
12 sion, or the lease, sale, or disposal of coal deposits suitable for
13 mining or of natural gas may be made to a utility owned and operated
14 by a government agency or nonprofit cooperative association organized
15 to participate under the Federal Rural Electrification Act for the
16 purpose of generating electric power and energy or the production of
17 process steam, or both, for less than the appraised value as deter-
18 mined by the director and approved by the commissioner to be fair and
19 proper and in the best interests of the public, with due consideration
20 given to the nature of the public services or function rendered by the
21 agency, subdivision, or utility making application, and of the terms
22 of the grant under which the land was acquired by the state.

Offered: 3/8/85
For Today's Calendar

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
royalty oil and gas; and providing for an effective
date."

7

8

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
read:

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(g) AS 38.05.035(e) does not apply to a sale, exchange, or other

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disposal of oil or gas under this section.

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

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(c) A sale, exchange, or other disposition of oil or gas [MADE]

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under (b)(1) of this section may not be continued after the end of one

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year or renewed with the same party [TO PROVIDE RELIEF FOR MARKET OR

18

STORAGE CONDITIONS] without the prior approval of the legislature

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under (a) of this section. This subsection does not apply to a se-

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quential competitively bid sale of oil or gas made with the same party

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under (b)(1) of this section.

22

* Sec. 3. This Act takes effect immediately in accordance with AS 01.-

23

10.070(c).

allows for emergency if it occurs in future

Alaska State Legislature

ARLISS STURGGULEWSKI Chairman
BETTYE FAHRENKAMP Vice Chairman
JACK COGHILL
DICK ELIASON
MIC FISCHER
RICK HALFORD
FRED ZHAROFF



POUCH V
JUNEAU, ALASKA 99811
(907) 465-4907

Senate Committee on Resources

MEMORANDUM

April 1, 1985

TO: Senate Resource Committee Members

FROM: Senate Resource Committee Staff

RE: CS for House Bill No. 103 (Finance)
"An Act relating to prerequisites for the disposal of
royalty oil and gas and providing for an effective date."

Enclosed in this packet is:

- 1) A copy of the Governor's transmittal letter.
- 2) A zero fiscal note from the Department of Natural Resources.
- 3) A fact sheet from the Department of Natural Resources.
- 4) A letter from Kay Brown, Director of the Division of Oil and Gas, DNR, to Representative Pignalberi discussing the bill.
- 5) A chart prepared by DNR setting out the notice requirements for royalty oil sales.
- 6) A letter to Representative Adams from Kay Brown discussing the House Finance Committee Substitute.
- 7) A copy of the bill history.



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

HB103

January 23, 1985

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

Texico

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 38.05.0.5(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

STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date: _____

REQUEST

Bill/Resolution No.: HB 103
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 Phone: 265-4241
Division: Oil and Gas Date: December 7, 1984

Approved by Commissioner: William D. Amodeo, Deputy Date: December 10, 1984
Agency: Natural Resources

Distribution (by Agency preparing fiscal note):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

DNR 3/18/85

BACKGROUND INFORMATION ON CS HB 103 (FINANCE)
AN ACT RELATING TO PREREQUISITES FOR DISPOSAL OF ROYALTY OIL & GAS

Section 1 of the bill addresses a problem related to emergency sales of royalty oil and gas.

Under present law and procedures, and assuming the requirements of AS 38.05.035(e) apply to royalty oil and gas sales, it takes at least 60 days to make a sale. 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; it may not be possible to wait 60 days. It is not clear that AS 38.05.035(e) applies; the bill makes clear that it does not. Other statutes (AS 38.05.182-.183 and AS 38.06) require a detailed process for royalty sales. For additional background, see attached letter to Rep. Pignalberi.

Section 2 of the bill is needed to allow the Department of Natural Resources to conduct additional short-term competitive royalty oil sales 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 competitive 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 for a competitive bid contract of one year or less would defeat the entire purpose of that type of short-term competitive sale.

The bill was amended in the House Finance Committee at the Department's request. See attached letter to Rep. Adams for additional background.

Attachments as stated

1621K

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

1600K

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

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

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.

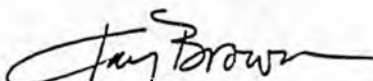
Nevertheless, we believe the bill could be improved and an unintended construction could be prevented by adoption of the following language for Section 2 of the bill (substitute beginning on line 14):

*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

HB 103

MEASURE HISTORY

PAGE 01 OF 02

CSHB 103(FIN)

AN ACT RELATING TO PREREQUISITES FOR THE DISPOSAL OF ROYALTY OIL AND GAS; AND PROVIDING FOR AN EFFECTIVE DATE.

PRIME SPONSOR: RULES COMMITTEE

BY REQ OF THE GOVERNOR

CO-SPONSORS:

\$000 GENERAL(FNOTE)

\$000 OTHER(FNOTE)

CURRENT STATUS: (S) RES

DATE		PAGE	ACTION
01/23/85	(H)	113	READ THE FIRST TIME - REFERRAL(S)
01/23/85	(H)	113	GOVERNOR'S TRANSMITTAL LETTER
01/23/85	(H)	113	FISCAL NOTE ZERO
02/15/85	(H)	359	O&G RPT W/CS(NEW TITLE) SDP INR
02/25/85	(H)	432	RES RPT W/CS(O&G) SDP INR
03/08/85	(H)	538	FIN RPT W/CS,NEW TITLE SDP INR
03/08/85	(H)	539	RLS TO CALENDAR 3/8/85
03/08/85	(H)	545	READ THE SECOND TIME
03/08/85	(H)	545	CSHB 103(FIN) ADOPTED UNAN CONSENT
03/08/85	(H)	546	AM NO 1 FAILED Y7 N28 X5

HB 103

MEASURE HISTORY

PAGE 02 OF 02

DATE		PAGE	ACTION
03/08/85	(H)	546	ADVANCED TO THIRD READING UNAN CONSENT
03/08/85	(H)	546	READ THE THIRD TIME
03/08/85	(H)	546	PASSED Y32 N3 X5
03/08/85	(H)	547	EFFECTIVE DATE SAME AS PASSAGE
03/08/85	(H)	547	MARTIN NOTICE OF RECONSIDERATION
03/11/85	(H)	569	RECONSIDERATION NOT TAKEN UP
03/11/85	(H)	569	TRANSMITTED TO (S)
03/12/85	(S)	516	READ THE FIRST TIME
			RESOURCES
			FINANCE
			RULES

* ORIGINAL *
* SENT: 05/03/85 TIME: 08:28 *
* FROM: LANA TRUJILLO *
* SUBJECT: POM *
* PRINT DATE: 05/03/85 TIME: 08:28 *
*

TO: ALL LEGISLATORS

FROM: JIM ESTES, 1512 OTTER, ANCHORAGE, 99504, 337-3839(HM),
276-1640(WK)

RE: HB 103, BINDING ARBITRATION

AS DISTRICT 14 DEMOCRATIC CHAIRMAN, I HAVE BEEN ASKED BY 131
TEACHERS OF THE 250 THAT LIVE IN THIS DISTRICT, TO ASK YOU TO
PLEASE SUPPORT HB 130 DEALING WITH BINDING ARBITRATION.