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**FILE**

# HOUSE COMMITTEE REPORT

(11)

Date Referred: February 25, 1993

FURTHER REFERRALS:

Date of Committee Action: 3/10/93

The FINANCE Committee considered:

HB 116

HOUSE BILL NO. 116

STATE SHARE OF FEDERAL GAS ROYALTIES

"An Act directing the commissioner of natural resources to accept, under certain circumstances, the contract price agreed to between a lessee of federal land and a gas or electric utility as the value of the federal government's royalty share from natural gas production when royalty is payable to the state under applicable federal law; and providing for an effective date."

RECOMMENDATIONS:

be replaced with CS HB 116 (Fin)  the same title  a new title

have attached amendments(s)

do pass

do not pass

no recommendations

individual recommendations

additional referral to the \_\_\_\_\_ Committee

ADOPTS: \_\_\_\_\_ letter of Intent

ATTACHES NEW FISCAL NOTE(S): \_\_\_\_\_ (Dept)

APPROVES PREVIOUS: \_\_\_\_\_ (Dept/Date)

fiscal impact \_\_\_\_\_

fiscal note(s) \_\_\_\_\_

zero fiscal note DNR

zero fiscal note(s) \_\_\_\_\_

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	DNP	NR	AM
<i>Ronald J. Larson</i>	X	<i>Eileen P. Machean</i>		X	
<i>Mark P. Hanley</i>	X	<i>Ben Sanderson / Grosser</i>			
<i>Terry Martin</i>		<i>Lay Brown</i>			✓
<i>Sean Pargell</i>					
<i>Mike Davara</i>					
<i>James Theobault</i>					
<i>Richard Jones</i>	X	<i>Foster</i>			

*Ronald J. Larson*  
CHAIRMAN'S SIGNATURE

# FISCAL NOTE

## STATE OF ALASKA 1993 LEGISLATIVE SESSION

BILL NO. CSHB116 (FIN)

Revision Date 10-Mar-93 Department Affected: Natural Resources

Title: "State Share of Federal Gas Royalties" FRU: Resource Development

Components: Oil & Gas Development

Sponsor: Representative Hanley

Requestor: House Finance

Component Serial No. 439

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 94	FY 95	FY 96	FY 97	FY 98	FY 99
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS,CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL						
---------	--	--	--	--	--	--

REVENUE fund source:						
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FUNDING: (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year (FY93) Impact: \$ See attached page

ANALYSIS:	(Attach a separate page if necessary)
SEE ATTACHED PAGE	

Prepared by: Jlm Eason, Director

Phone: 762-2547

Division: Oil & Gas

Date: 10-Mar-93

Approved by Commissioner: Glenn A. Olds

Date: 10-Mar-93

Agency: Department of Natural Resources

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March 10, 1993

The retroactive application provisions of the bill make it difficult to evaluate the fiscal impact of the bill. It is not known, at this time, if any refunds, except for the one described below, will be due the federal lessees because of the proposed retroactive change in state policy. An audit of past federal/state royalty collection policies beginning in 1959, which will require a considerable amount of time and resources, would have to be completed in order to determine the full fiscal impact of this bill.

What is known today is that if the bill becomes law, the state will be barred from advocating for higher royalty values for gas production from federal leases in the Beluga River field for past production periods. The state believes that as of April 15, 1992, approximately \$10.4 million is owed for the audit period between October 1, 1984 through June 30, 1987. Because interest continues to accrue on the past due principle, the amount of the claim continues to grow.

As to the allocation of any royalty revenues which may be foregone as a result of the application of this proposed legislation, for leases issued on or before December 1, 1979, 74.5% would be allocated to the General Fund, 25% to the Permanent Fund, and 0.5% to the Public School Trust Fund. In the event of leases issued after December 1, 1979, 49.5% would be allocated to the General Fund, 50% to the Permanent Fund, and 0.5% to the Public School Trust Fund.

At this point in time, the amount owed is based on a claim by the state. However, the state's position in support of the area pricing theory or median value pricing theory, and the amount sought may or may not be sustained by a court with jurisdiction for this issue.

8-LS04420  
Chenoweth  
3/10/93

CS FOR HOUSE BILL NO. 116( )

IN THE LEGISLATURE OF THE STATE OF ALASKA

EIGHTEENTH LEGISLATURE - FIRST SESSION

BY

Offered:  
Referred:

Sponsor(s): REPRESENTATIVES HANLEY, Phillips, Larson, Green, Parnell, Navarre

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to royalty gas contracts, amending the manner of determining  
 2 the royalty received by the state on gas production, and directing the  
 3 commissioner of natural resources to accept, under certain circumstances, the  
 4 contract price agreed to between a lessee of federal land and a gas or electric  
 5 utility as the value of the federal government's royalty share from natural gas  
 6 production on federal land from which the state is entitled under applicable  
 7 federal law to receive a share of the royalty on gas production; and providing  
 8 for an effective date."

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

10 \* Section 1. AS 38.05.180(aa) is amended to read:

11 (aa) Within 90 days after the written request of a lessee of a lease issued under  
 12 this section or of a lessee of federal land from which the state is entitled under

1 applicable federal law to receive a share of the royalty on gas production, the  
 2 commissioner shall enter into an agreement with the lessee to use or accept the price  
 3 for the gas established in the contract between the lessee and a gas or electric utility  
 4 as the value of the state's royalty share of gas production sold by the lessee under the  
 5 contract

6 (1) but only if the primary function of the utility with which the  
 7 lessee has entered into the contract is to provide, either directly or by selling at  
 8 wholesale to another utility, gas or electricity to the general public, including  
 9 residential consumers, within the utilities' service areas, and the utility with which  
 10 the lessee has entered into the contract is not an affiliated interest, as that term  
 11 is defined in AS 42.05.990, with the lessee or with a subsequent purchaser of more  
 12 than 10 percent of the utility's gas or electricity; and

13 (2) unless the commissioner makes a written finding, based on clear  
 14 and convincing evidence, that

15 (A) [(1)] the contract price is unreasonably low;

16 (B) [(2)] the prospective reduction in royalty receipts would not  
 17 be balanced by increased benefits to in-state gas and electric consumers;

18 (C) [(3)] the lessee and the utility are related in management,  
 19 ownership, or other aspect; and

20 (D) [(4)] the contract price is not in the best interest of the  
 21 state.

22 \* Sec. 2. AS 38.05.180(bb) is amended to read:

23 (bb) In (aa) of this section,

24 (1) "gas or electric utility" includes an electric cooperative organized  
 25 under AS 10.25, a municipal utility, and a gas or electric utility regulated under  
 26 AS 42.05; provided that if the contract gas is transmitted to consumers through a  
 27 pipeline and the gas utility either owns the pipeline or is related in ownership to the  
 28 owner of the pipeline, then the gas utility qualifies as a "gas or electric utility" within  
 29 the meaning of this paragraph only if it is bound or agrees to be bound by the  
 30 covenants set out in AS 38.35.120;

31 (2) "price for the gas established in the contract" includes tax

1 reimbursement amounts, deliverability and other charges, and other forms of  
2 consideration paid by the gas or electric utility under the contract;

3 (3) "state's royalty share of gas production"

4 (A) includes payments on federal leases made to the state  
5 under 30 U.S.C. 191;

6 (B) does not include the state's royalty share of gas production  
7 from land patented to the state under

8 (i) [(A)] P.L. 84-830, 70 Stat. 709 (Alaska Mental  
9 Health Enabling Act);

10 (ii) [(B)] 38 Stat. 1214 (Act of March 4, 1915); or

11 (iii) [(C)] 43 U.S.C. 1635 in settlement of the claims of  
12 the state under 38 Stat. 1214.

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

14 (cc) The provisions of (aa) of this section do not prohibit the commissioner  
15 from accepting any payment on a federal lease tendered by the federal agency  
16 responsible for determination and transmittal of the payment to the state under 30  
17 U.S.C. 191 or otherwise due the state as the state's royalty share of gas production  
18 irrespective of the state's acceptance of the use of the contract price for purposes of  
19 determining royalty share on gas production under that subsection.

20 \* Sec. 4. APPLICATION TO ROYALTY FROM EXISTING FEDERAL LEASES. (a)  
21 Notwithstanding AS 38.05.180(aa) and 38.05.180(bb), the provisions of this section apply to  
22 the state's share of royalty production of gas produced after January 2, 1959, and before the  
23 effective date of this section from a lease of oil or gas rights entered into under applicable  
24 federal law.

25 (b) If a lessee of a lease for federal land from which the state is entitled under  
26 applicable federal law to receive a share of the royalty on gas production makes a written  
27 request within 90 days of the effective date of this section, the commissioner shall enter into  
28 an agreement with the lessee to accept the price for the gas established in the contract between  
29 the lessee and a gas or electric utility as the value of the state's royalty share of gas  
30 production sold by the lessee under the contract

31 (1) but only if the primary function of the utility with which the lessee has

1 entered into the contract is to provide, either directly or by selling at wholesale to another  
2 utility, gas or electricity to the general public, including residential consumers, within the  
3 utilities' service areas, and the utility with which the lessee has entered into the contract is not  
4 an affiliated interest, as that term is defined in AS 42.05.090, with the lessee or with a  
5 subsequent purchaser of more than 10 percent of the utility's gas or electricity; and

6 (2) unless the commissioner makes a written finding, based on clear and  
7 convincing evidence, that

8 (A) the contract price is unreasonably low;

9 (B) the reduction in royalty receipts is not balanced by increased  
10 benefits to in-state gas and electric consumers;

11 (C) the lessee and the utility are related in management, ownership, or  
12 other aspect; and

13 (D) the contract price is not in the best interest of the state.

14 (c) The provisions of (a) and (b) of this section do not prohibit the commissioner from  
15 accepting any payment on a federal lease tendered by the federal agency responsible for  
16 determination and transmittal of the payment to the state under 30 U.S.C. 191 or otherwise  
17 due the state as the state's royalty share of gas production irrespective of the state's  
18 acceptance of the use of the contract price for purposes of determining royalty share on gas  
19 production under those subsections.

20 (d) In this section,

21 (1) "gas or electric utility" includes an electric cooperative organized under  
22 AS 10.25, a municipal utility, and a gas or electric utility regulated under AS 42.05; however,  
23 if the contract gas is transmitted to consumers through a pipeline and the gas utility either  
24 owns the pipeline or is related in ownership to the owner of the pipeline, then the gas utility  
25 qualifies as a "gas or electric utility" within the meaning of this paragraph only if it is bound  
26 or agrees to be bound by the covenants set out in AS 38.35.120;

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

30 (3) "state's royalty share of gas production" includes payments on federal  
31 leases made to the state under 30 U.S.C. 191.

1 \* Sec. 5. RETROSPECTIVE EFFECT OF SECTION 4. Section 4 of this Act is  
2 retroactive to January 3, 1959, and applies to the federal government's royalty share from  
3 natural gas production due the state after January 2, 1959.

4 \* Sec. 6. This Act takes effect immediately under AS 01.10.070(c).

A Hahnunt + 2

3/1/93

8-LS0442J.2.

HB 116

Chenoweth

3/1/93

AMENDMENT I

OFFERED IN THE HOUSE

BY REPRESENTATIVE BROWN

TO: CSHB 116(RES)

Page 1, line 1, after "An Act":

Insert "relating to computation of the state's royalty share of natural gas production, and"

Page 2, lines 2 - 3:

Delete ", based on clear and convincing evidence,"

Insert "[, BASED ON CLEAR AND CONVINCING EVIDENCE,]"

Page 2, line 6:

After "and":

Insert "residential"

After "consumers;"

Insert "and"

Page 2, lines 7 - 9:

Delete "the lessee and the utility are related in management, ownership, or other aspect; and

(4)"

Insert "[THE LESSEE AND THE UTILITY ARE RELATED IN MANAGEMENT, OWNERSHIP, OR OTHER ASPECT; AND

(4)]"

Page 3, line 12:

Delete ", based on clear and convincing evidence,"

Attachment #3  
3/1/93  
8-LS0442N.4  
Chenoweth  
3/1/93  
HB 116

A M E N D M E N T I

OFFERED IN THE HOUSE  
TO: CSHB 116(RES)

BY REPRESENTATIVE BROWN

Page 1, line 1, after "An Act":

Insert "relating to computation of the state's royalty share of natural gas production, and"

Page 1, line 9 - page 2, line 2:

Delete "Within 90 days after the written request of a lessee of a lease issued under this section or of a lessee of federal land from which the state is entitled under applicable federal law to receive a share of the royalty on gas production. the commissioner shall enter into an agreement with the lessee to use or accept the price for the gas established in the contract between the lessee and a gas or electric utility as the value of the state's royalty share of gas production sold by the lessee under the contract unless"

Insert "The [WITHIN 90 DAYS AFTER THE WRITTEN REQUEST OF A LESSEE OF A LEASE ISSUED UNDER THIS SECTION, THE] commissioner shall enter into an agreement with the lessee to use the price for [THE] gas established in a [THE] contract between the lessee and a gas or electric utility as the value of the state's royalty share of gas production from a field that, on the effective date of this bill section, is in production, and that is sold by the lessee under the contract. In addition, the commissioner shall enter into an agreement with the lessee of a lease of federal land from which the state is entitled under 30 U.S.C. 191 to receive a share of the royalty of gas production to use or accept the price for gas established in a contract between the lessee and a gas or electric utility as the value of the state's royalty share of gas production from a field that, on the effective date of this bill section, is in production, and that is sold by the lessee under the contract. To obtain the benefit of this subsection, a lessee shall make a written request to the commissioner. When the commissioner receives the request, the commissioner shall enter into the agreement within 90 days. However, the commissioner

## ***Section-by-Section Analysis of HB 116***

**Section 1.** In 1986, the legislature directed the Department of Natural Resources ("DNR") to use, except in certain circumstances, the contract price of natural gas sold by a lessee to a gas or electric utility as the value of the state's royalty share of production from that lessee. AS 38.05.180(aa). Cook Inlet lessees sell natural gas to these utilities, and have historically paid royalties based upon that contract price. In March, 1985, DNR demanded that its lessees begin paying additional gas royalties, on the theory that the contract price did not represent the gas' "value." Had DNR prevailed, the liability for those additional royalties would have fallen on the utilities. That's because the utilities, as part of their contracts with the lessees, agreed to pay any additional royalty assessment made by the state.

Ultimately, of course, that would have meant that any additional royalties would be paid by the utility's customers.

The possibility of additional royalty demands therefore created considerable uncertainty and threatened to impose substantial burdens on consumers. These burdens, the legislature believed, outweighed any revenues the state might receive from a higher valuation of these royalties. Even DNR, which supported the 1986 legislation, concluded that "it is appropriate to accept a contract price as the royalty value for arms-length sales to regulated utilities...because Alaska consumers would be the direct beneficiaries of the certainty of the price provided by such a contract..." but felt that legislation was necessary to permit it to use the utility contract price.

The 1986 law was intended to remove these uncertainties and potential burdens by establishing (except in limited circumstances) the utility contract price as the "value" of the state's royalty share. The law, however, applied only to *state* leases. The state also receives 90% of natural gas royalties paid under *federal* leases, and the 1986 law neglected to resolve the problem with respect to the state's share of federal royalties. As a result, DNR currently feels obligated to encourage the federal government to reject the utility contract price as the "value" of federal royalty gas, even though the agency is compelled (absent special circumstances) to accept that price for state lease purposes.

Since substantial quantities of gas are sold to utilities from federal leases, this has created precisely the uncertainty and potential consumer liability that the 1986 law was intended to prevent.

Section 1 of HB 116 closes that unintended loophole by extending the reach of the 1986 legislation to the state's share of federal royalty gas. The

inserted words "*or a lessee of federal land for which state royalty share of gas production is payable under applicable federal law*" extend the section's protections to federal lessees. The inserted words "or accept" reflect the fact that the federal government will ultimately set the royalty "value" for its leases; DNR, however, would be required (under the standards of the section) to "accept" the federal government's use of the utility contract as the measure of "value," if the federal government itself proposed to use that value.

In fact, the Department of Interior's Minerals Management Service ("MMS"), in two recent audit decisions, decided to use arms-length utility contract prices as the value of Beluga River Field gas for the period 1984-87. DNR is attempting to appeal those rulings, claiming a higher "value" exists. Under Section 1 of the bill, and upon the lessee's application, DNR would be required (except in the circumstances articulated in existing §180(aa)) to withdraw those appeals and "accept" MMS' decision.

**Section 2.** AS 38.05.180(aa) requires the use of the utility contract price as the value of "the state's royalty share of gas production," a term defined in existing §180(bb)(3). In order to extend that valuation rule to the state's share of federal royalties, it is necessary to amend that definition to include "payments on federal leases under 30 U.S.C. 191." 30 U.S.C. §191 is the federal statute under which 90% of federal gas royalties are distributed to the state.

**Sections 3.** Section 5 of the 1986 law (Ch. 55, SLA 1986) made it clear that, as to state leases, DNR was only required to use *new* utility contracts as the royalty "value." This was done for three reasons: (1) DNR, in its March, 1985 announcement, proposed to reject utility contracts as the royalty value only prospectively--beginning April 15, 1985; (2) DNR, during the 1986 session, had already settled with all its lessees under the then-existing utility contracts, pending passage of the law; and (3) even though the law applied prospectively only, DNR assured the legislature that it would use enactment of the law as statutory justification for completing its settlements under existing utility contracts.

In other words, the "valuation" issue with respect to then-existing utility contracts had already been taken care of amicably, and there was no need to reopen those matters.

None of those considerations exist with respect to the valuation of federal royalties. DNR is currently attempting to compel MMS to retroactively reject utility contract prices as far back as 1984. It has engaged in no settlement discussions that might amicably dispose of prior-year valuation issues. And, it has taken the position that, unless AS 38.05.180(aa) is amended to require use of the utility contract price for prior year federal royalties, it must continue to urge rejection of that price for those years.

As a result, Section 3 of HB 116 applies the rules of AS 38.05.180(aa) (as amended by Sections 1 and 2 of this bill) to gas production from federal leases that occurred prior to the effective date of this legislation. The wording used in Section 3 is identical to amended §180(aa) and (bb), except that

(1) the word "prospective" is deleted from subsection (b)(2). That's because this section is concerned not with prospective reductions in royalty due to accepting new contract prices, but rather with acceptance of the contract price for prior production from federal leases; and

(2) the definition of "state's royalty share of gas production" references only the federal revenue sharing provision of 30 U.S.C. §191, rather than also referencing revenues from state leases, because this special section is concerned solely with prior production from **federal** leases.

Section 3 has a very limited reach. It does not affect prior production from state leases at all--the introductory language of the section makes this clear by stating that it applies solely to leases "entered into under applicable federal law." Moreover, all significant federal royalty disputes involving Cook Inlet gas have already settled, and this legislation will not have any effect on binding settlement agreements. As a practical matter, the effect of Section 3 will be confined to federal royalty gas from the Beluga River Field that is sold to Chugach Electric Assn., Inc. for Railbelt power generation.

**Section 4.** Under AS 01.10.090, "no statute is retrospective unless expressly declared therein." Because Section 3 is intended to define what the state must accept (under certain conditions) as its share of **past** federal royalty production, an explicit retroactivity clause is necessary.

Section 4 should create no legal problems. Governmental policies towards defining royalty "value" have changed over the years, without any serious argument that the changes constitute unilateral amendments to pre-existing leases. Moreover, here the use of the utility contract price is at the lessee's option.

**Section 5.** This section gives the legislation an immediate effective date.



## **Representative Mark Hanley**

### **Alaska State Legislature**

#### Memorandum

To: Rep. Ron Larson  
Rep. Eileen MacLean  
Co-Chairs, House Finance Committee

From: Rep. Mark Hanley

Re: Request to schedule a hearing for CS for HB 116, (Resources)  
"An act directing the commissioner of natural resources to accept, under certain circumstances, the contract price agreed to between a lessee of federal land and a gas or electric utility as the value of the federal government's royalty share from natural gas production when royalty is payable to the state under applicable federal law; and providing for an effective date."

Date: February 24, 1993

This memo is to respectfully request that CS for House Bill 116 be scheduled for a hearing in the Finance Committee at your earliest possible convenience.

CS HB 116 is necessary because the Department of Natural Resources is pressuring the federal government to retroactively increase the value of the gas it sold to a level above the price agreed to in long term contracts signed by the utilities. The higher price would immediately be passed along to consumers in the form of higher utility rates.

This bill will require the Department of Natural Resources to use the same standards for valuation of natural gas from federal lands as it currently uses on gas from state lands. Under existing law, the Department uses the contract price of natural gas sold to a gas or electric utility as the value for figuring the state's royalty on production from state leases. This bill would require the Department to also use the contract price when determining the value of gas sold to utilities from federal leases.

Attached with this memo is a copy of the bill, a brief sectional analysis, and a comprehensive briefing paper prepared by Chugach Electric. Also included is a copy of all the attachments for the briefing paper.

I would appreciate your consideration on scheduling this bill for a hearing as promptly as possible.

# STATE OF ALASKA

## DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

WALTER J. HICKEL, GOVERNOR

400 WILLOUGHBY AVENUE  
JUNEAU, ALASKA 99801-1796  
PHONE: (907) 465-2400  
FACSIMILE: (907) 586-2754

February 23, 1993

The Honorable Bill Williams, Chairman  
House Resources Committee  
Alaska State Legislature  
State Capitol Building, Room 128  
Juneau, Alaska 99801-1182

Dear Representative Williams:

I am responding to your request for additional information concerning whether HB 116 is precedential in any nature and how any royalty revenues that might be foregone through implementation of that legislation would otherwise have been distributed.

The proposed legislation is precedential on at least two points. First, passage of this legislation would result in the requirement that the department accept contract prices for certain gas produced from federal leases regardless of whether or not those values represent the full royalty value to which the state would otherwise be entitled absent this legislation. Secondly, to the best of my knowledge, making the effective date of HB 116 retroactive to January 3, 1959 would also be precedential.

The 1986 amendments to AS 38.05.180 were similar to the proposed legislation in their effect on the royalty valuation for production from state-owned lands. However, the 1986 amendments differ in the timing of their applicability. Unlike the proposed amendments, the 1986 amendments were not retroactive. The contract price for the gas was not binding for royalty purposes until a new contract was negotiated, in this case after 1986. The 21 cents per MCF contract price in effect in 1986 was not accepted as the royalty value. Rather, a settlement value of 75 cents per MCF was used as the royalty value until 1989 when Chugach negotiated a new contract with the Beluga River field lessees.

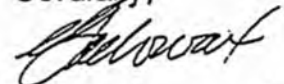
The Honorable Bill Williams, Chairman  
House Resources Committee

February 23, 1993  
Page 2

Finally, as to the allocation of any royalty revenues which may be foregone as a result of the application of those proposed legislation, 74.5% would be allocated to the General Fund, 25% to the Permanent Fund, and 0.5% to the School Fund.

Please feel free to call if you have any additional questions.

Cordially,



Glenn A. Olds  
Commissioner

GAO/sf

cc: House Resource Committee members  
Representative Mark Hanley

Back-up



# CHUGACH ELECTRIC ASSOCIATION, INC.

January 25, 1993

Representative Bill Williams  
Alaska State Legislature  
Capitol Room 128  
State Capitol  
Juneau, AK 99801-1182

Dear Representative Williams:

Chugach is seeking to introduce legislation that will help resolve a royalty dispute that we are involved in with the Department of Natural Resources (DNR) concerning the valuation of federal royalties for natural gas that Chugach purchased at the Beluga River field. Chugach thought that this issue had been resolved in 1986 when legislation (AS 38.05.180(aa)) was passed. That legislation provides legislative guidance to DNR in valuing royalties for gas and electric utilities. Unfortunately, the current DNR administration has chosen to interpret the statute verbatim and is now disregarding the legislative intent that was behind the law. In so doing, the current DNR administration has flip-flopped the agency's position and is now apparently in disagreement with the intent behind the legislation that it fully supported in 1986.

If DNR prevails in its pursuit of increasing federal royalties for Beluga gas for prior years (1984-1992), electric rate-payers from Homer to Fairbanks will be asked to pay more than \$21 million dollars in additional royalties. At issue today are the federal royalties for the years 1984-87 totaling \$12.4 million. However, if DNR applies the same logic to future years (1988-1992), Chugach rate-payers would be liable for an additional \$9 million. Chugach, which is a member-owned cooperative, will have no choice but to pass these additional costs on to our ratepayers (roughly two-thirds of the states population) through some type of rate surcharge. Unfortunately, today's customers would be forced to pay additional royalty payments for inexpensive natural gas that they may not have been here to use. This is not reasonable, and Chugach firmly believes that by making royalty demands that they know will simply be passed on to the consumers that the agency is actually trying to impose a tax on the Alaska public without any notice to them, and without the legislature's involvement.



## Homer Electric Association, Inc.

CORPORATE OFFICE  
3977 Lake Street  
Homer, Alaska 99603-7680  
Phone (907) 235-8167  
FAX (907) 235-3313

Central Peninsula Service Center  
260 Airport Way  
Douch, 99800  
Kenai, Alaska 99811-5280  
Phone (907) 243-5831  
FAX (907) 243-7122

February 18, 1993

William K. Williams, Chairman  
House Resources Committee  
Alaska State House of Representatives  
PO Box V  
Juneau, AK 99811

Dear Chairman Williams:

RE: HB 116, STATE SHARE OF FEDERAL GAS ROYALTIES

Homer Electric Association serves over 18,000 consumers on the Kenai Peninsula. Most of the power that was previously used and the power that is currently used is supplied by gas-fired turbines.

HB 116 will stop the Department of Natural Resources' attempt to collect its gas royalties on gas previously used and would eliminate future collection attempts via repricing gas and assessments of royalties. This will guarantee that HEA consumers will not be unfairly assessed for gas royalties in the future.

On behalf of HEA, I ask that your committee favorably report HB 116.

Sincerely,

HOMER ELECTRIC ASSOCIATION, INC.

*N L Story*  
N. L. Story  
General Manager

NLS\HRC.ltr/lwb

cc: Representative Mark Hanley  
Representative Gail Phillips  
Representative Mike Navarre  
Representative Ron Larson  
Representative Parnell  
Representative Joe Green  
Dave Highers, CEA  
Dave Hutchens, ARECA  
HEA Board of Directors  
NLS-rf H/K



**Matanuska Electric  
Association, Inc.**

P.O. Box 2929  
Palmer, Alaska 99645  
Telephone: (907) 745-3231  
Fax: (907) 745-9328

February 18, 1993

The Honorable William K. Williams  
House of Representatives  
State Capital Building  
Juneau, Alaska 99801-1182

Dear Representative Williams:

Thank you for the opportunity to testify on behalf of House Bill 50 and 51 last week. The interties are important to continuing the quality of electric service to over 70 percent of this state's citizens.

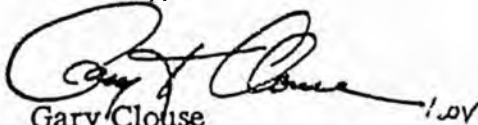
Likewise, we are writing today to support House Bill 116 to resolve a retroactive gas royalty issue for those citizens as well. We understand this Bill will come before the House Labor and Commerce Committee this week.

The Department of Natural Resources has been seeking to retroactively assess several million dollars in added royalties to the Cook Inlet field natural gas consumers. As you know, the electric utilities are big users of this natural gas. These added charges will create a tremendous burden on our electric customers. Our nonprofit status and the state rate making rules require us to pass along these wholesale power costs directly to our customers.

Some large loads, like the State of Alaska, school districts, local governments, and businesses will see large increases in their electric costs should the DNR procedure be allowed to stand. For example, the electric costs to the state would be increased several hundred thousands of dollars. On behalf of our customers, we ask your support of the amendments to the Alaska statute proposed in House Bill 116. The passage of this Bill will keep us from making large changes in the cost of electricity sold several years ago to citizens, government agencies, and businesses within the state.

Thank you for your continued support on these vital issues of legislation. Please share this letter with the members of the House Labor and Commerce Committee, as we are unable to testify in Juneau this week.

Sincerely,

  
Gary Clouse  
President

sv  
101.930218.390

cc: Members of the House Labor and Commerce Committee  
David Highers, CEA  
Norm Story, HEA  
David Hutchens, ARECA



GOLDEN VALLEY ELECTRIC ASSOCIATION INC. Box 71246, Fairbanks, Alaska 99707-1246, Phone 907 452-7161

February 23, 1993

Mr. Dave Highers  
General Manager  
Chugach Electric Association  
P.O. Box 196300  
Anchorage, Alaska 99519-6300

SUBJECT: Royalties for Natural Gas

DEAR DAVE:

At their meeting on February 22, 1993, the Board of Directors of Golden Valley adopted the following resolution:

WHEREAS, House Bill 116 has been introduced to amend AS 38.05.180 (An Act directing the commissioner of natural resources to accept, under certain circumstances, the contract price agreed to between a lessee of federal land and a gas or electric utility as the value of the federal government's royalty share from natural gas production when royalty is payable to the state under applicable federal law; and providing for an effective date.); and

WHEREAS, Golden Valley Electric Association supports this legislation;

THEREFORE, BE IT RESOLVED, that the Board of Directors of Golden Valley Electric Association, Inc. encourages the Fairbanks/Interior legislators to support House Bill 116.

We will contact the Interior legislators regarding this resolution.

Best regards,

Robert Hansen  
Acting General Manager

WALTER J. HICKEL, GOVERNOR

## DEPT. OF NATURAL RESOURCES

P.O. BOX 107034  
ANCHORAGE, ALASKA 99510-7034  
PHONE: (907) 762-3353

## DIVISION OF OIL AND GAS

October 8, 1992

Post-It™ brand fax transmittal memo 7671		# of pages	2
To	Diane McLeod		
Co.	Chugach Electric		
Dept.	6		
Fax #			
From	Jim Linn		
Co.	DNR		
Phone #			
Fax #			

Mike Carey, Editor  
Anchorage Daily News  
P.O. Box 149001  
Anchorage, AK. 99514

Dear Mr. Carey:

I would appreciate the opportunity to respond to a recent series of advertisements in the Anchorage Daily News pertaining to Chugach Electric's potential payment of additional royalties on gas produced from federal oil and gas leases. I think it is important to clarify the Department of Natural Resources' position regarding the collection of royalty revenues and, at the same time, eliminate any misconceptions created by the Chugach advertisements.

It is the duty of the Department of Natural Resources to collect gas royalties due all Alaskans - not just for those living in Anchorage. The benefits of the State's royalties, whether those royalties come from state leases or from the state's share of federal lease revenues, belong equally to all citizens of the State. It is for that reason that, under state law, revenues collected by the department are deposited in the Permanent Fund, the General Fund and the School Fund.

Alaska receives 90 percent of the royalties paid to the federal government by lessees of federal leases within the state. It is the department's belief that the lessees from whom Chugach purchased its gas underpaid their federal royalties during the period of 1984 to 1987. Under the applicable federal statutes and regulations, royalties are to be paid on the "value of production." Chugach, under its gas contract with the lessees, agreed to reimburse the lessees for any additional royalty the lessees owe. This fact in itself suggests that both Chugach and the lessees were aware of their potential exposure to additional royalty payments. Although Chugach believes that the gas it purchased should be valued according to the contract price it paid the lessee, this is not the law. The contract price sets a minimum value according to the statutes and regulations.

Where the contract price is not a fair value, federal law and regulation provide that a reasonable value will be determined by looking to the median price paid by other purchasers of gas in the same market area. In other words, the fact that the lessees and

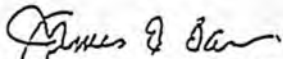
Mike Carey, Editor  
Anchorage Daily News  
October 8, 1992  
Page 2

Chugach elected to enter into long term contracts at a low price should not deprive the royalty owners--in this case, all Alaskans--of their right to receive a fair royalty.

Contrary to Chugach's claims, Enstar Natural Gas Company and Municipal Light and Power are not involved in this royalty dispute, and will not "be in line for an additional royalty surcharge." Nor is the department asking Chugach to pay royalties which are up to 17 times higher than the Selugi royalties reported by the lessees. The department is asking the federal government to follow its own precedents, law and regulations to ensure that the state receives its fair share of their royalties.

While Chugach would urge us to turn a blind eye to the federal government's under collection of royalties in order to benefit Chugach's customers, we simply cannot. Under state law, our obligation is to ensure the collection of all oil and gas revenues for the benefit of those in Barrow and Ketchikan, as well as in Anchorage. Any subsequent decision to subsidize one area's utility costs relative to others is the responsibility of the legislature.

Sincerely,



James E. Eason  
Director  
Alaska Division of Oil and Gas

David L. Highers.

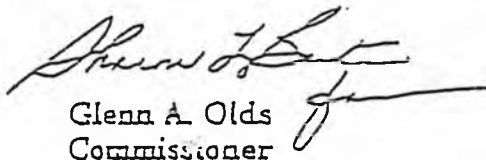
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July 9, 1992

spent as part of a public process and review. Thank you for sharing your views and concerns.

I realize that this will not be a popular decision with southcentral and interior power users and that it will place an additional burden on Chugach Electric. In the past, Chugach and the State have been able to successfully resolve their differences concerning Beluga River gas royalties. I hope that spirit of cooperation can be continued.

Sincerely,

  
Glenn A. Olds  
Commissioner

# STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

WALTER J. HICKEL, <sup>fil</sup> GOVERNOR

400 WILLOUGHBY AVENUE,  
JUNEAU, ALASKA 99801-1796  
PHONE: (907) 465-2400  
FACSIMILE: (907) 586-2754

July 9, 1992

David L. Highers, General Manager  
Chugach Electric Assn., Inc.  
5601 Minnesota Drive  
P.O. Box 196300  
Anchorage, Alaska 99519-6300

Dear Mr. Highers:

Thank you for your letters of May 27 and June 15, 1992 to the Governor and me expressing concern regarding the impact of the State of Alaska's (State) decision to seek additional royalties derived from federal oil and gas leases located in the Beluga River gas field. Governor Hickel asked me to prepare a detailed response to your letter. I have discussed the issue with the Governor, and have given the matter a great deal of thought.

Your letter of May 27, 1992 asked that the Department of Natural Resources (DNR) withdraw an appeal filed with the federal government seeking to recover royalties due the State. These royalties are from federal leases located in the Beluga River gas field and indirectly affect Chugach Electric Association, Inc. (Chugach). The withdrawal of this appeal would not be in the best interest of the State. Essentially, the DNR believes that the federal government has ignored its own statutes and regulations to deprive the State of over \$5,198,883 in lost royalties and \$5,236,002 in interest.

Under the Minerals Leasing Act and the Alaska Statehood Act, the State is entitled to ninety percent of all royalties received from federal oil and gas leases in Alaska. The federal government, however, initially determines the amount of royalties due, collects the monies, and then forwards the State's share to the State. Under the applicable statutes and regulations, royalties are to be paid on the "value of production." Although Chugach believes that the production is valued according to the contract price received by a lessee on the sale of gas, this is not the law. The contract price sets a minimum value according to the statutes and regulations. Where the contract price is not a fair value, a reasonable value will be determined by looking to the median price paid by other purchasers of gas

David L. Highers

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July 9, 1992

in the same market area. In other words, just because the lessees elected to enter into long term contracts at a low price should not deprive the federal government and the State of its right to receive a fair royalty for its gas. The Beluga River lessees elected to sell their gas to Chugach for \$21 per Mcf while the median price in the area was higher. Chugach is mistaken in the assumption that \$2.26 per Mcf is the highest price paid. The highest price paid during the time frame studied in the majority price analysis is over \$3.57 per Mcf. In addition, month by month, most median values claimed by the State are well below the alleged \$2.26 per Mcf as stated in your letter.

In 1985, the federal government considered this same issue involving other federal oil and gas leases in the Kenai Field where gas was being sold at a low price pursuant to a long term contract. The federal government determined that the contract price was not a fair value for royalty purposes and required that royalty be paid on the median price. The State received substantial additional royalties as a result of that audit.

Ignoring its own precedent, statutes, and regulations, the federal government has arbitrarily determined that the contract price constitutes a reasonable value for Beluga River gas. The state appealed this determination. The DNR has supplied supporting information for its royalty valuation position and the federal government is currently reviewing the appeal.

The State's position should be no surprise to the lessees and Chugach. The State's position is the same position it took in 1985 in the Kenai gas matter. Moreover, both Chugach and the lessees were aware at the time that they entered into their contract that the "reasonable value" could be different than the contract price since their contract contains a "pass through" provision to deal with this eventuality.

It is my obligation to ensure that the State receives fair value for its mineral interests. The State believes that the federal government has not used a "fair value" upon which to base the royalty payments for these federal leases. If I were to have the State withdraw its decision to seek fair royalty valuation through the legal appeal process when it held this belief in good faith, I would be neglecting my duties.

Although I share your concern that southcentral Alaskans may have to pay higher electric rates in the short term if the State prevails, the benefits of the State's royalties belong equally to all citizens of the state. I cannot favor one group over another. The legislature and the administration share the responsibility to determine how the revenues from the State's mineral resources are allocated and