

HB

2017

HFIN

FILE

HOUSE COMMITTEE REPORT

(11)

Date Referred: March 30, 1995

FURTHER REFERRALS:

Date of Committee Action: 4/13/95

The FINANCE Committee considered:

HB 207

HOUSE BILL NO. 207

ADJUSTMENTS TO OIL AND GAS ROYALTIES

"An Act relating to adjustments to royalty reserved to the state to encourage otherwise uneconomic production of oil and gas; relating to the depositing of royalties and royalty sale proceeds in the Alaska permanent fund; and providing for an effective date."

recommends it be replaced with the following committee substitute

CSHB 207 (FIN)

the same title
 a new title

additional referral to _____ Committee

attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept)

fiscal note(s) _____

zero fiscal note(s) _____

APPROVES PREVIOUS:

Revenue 3/22/95 (Dept/Date)

fiscal note(s) _____

DNR 3/8/95

zero fiscal note(s) _____

Revenue 2/27/95

SIGNING WITH RECOMMENDATIONS	DP	DNP	NR	AM
<i>[Signature]</i> Kelly	<input checked="" type="checkbox"/>			
<i>[Signature]</i> Martin	<input checked="" type="checkbox"/>			
<i>[Signature]</i> Navarre	<input checked="" type="checkbox"/>			
<i>[Signature]</i> Thumrait	<input type="checkbox"/>			
<i>[Signature]</i> Brown				<input checked="" type="checkbox"/>
<i>[Signature]</i> Kohring	<input checked="" type="checkbox"/>			
<i>[Signature]</i> Hanky	<input checked="" type="checkbox"/>			
<i>[Signature]</i> Foster	<input checked="" type="checkbox"/>			

20 CHAIR'S SIGNATURE

[Signature] Hanky *[Signature]* Foster

FISCAL NOTE

BD

STATE OF ALASKA
 1995 LEGISLATIVE SESSION

Revision Date: 3/14/95 Dept. Affected: Revenue
 Title: Adjustments to Oil and Gas Royalty BRU: Revenue Operations
 Component: Oil & Gas Audit
 Sponsor: (#) Rules
 Requester: Governor COMPONENT SERIAL NO. 115

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()See Analysis.....

FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY95) cost: \$ _____

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

This Bill would grant the Commissioner of Natural Resources broad authority to reduce the royalty terms of an oil and gas lease if such reduction would allow new commercial development, prolong field life, or reestablish commercial production from idle leases. The reduction could be no greater than the percentage required to deposit royalty income under the initial lease terms into the permanent fund. The net impact of this provision will be to insure that the permanent fund share under the original lease terms will be covered in the event of reduction in royalty rate. In theory, the ability to grant royalty relief should raise the cash bids on new leases.

New production from this royalty reduction would most likely pay little severance tax because the Economic Limit Factor is designed to provide almost total tax relief to the kind of marginal fields this legislation is aimed at benefiting. Each new barrel of production would be subject to the \$.05/bbl or \$.03/bbl hazardous release surcharge (depending on the balance in the 470 fund) and the \$.004/bbl conservation tax. The impact on the corporate income tax would be too small to measure because of the world-wide apportioned tax base and since bbl definition these fields would have marginal profitability.

Prepared by: Chuck Loasdon Phone: 277-5627
 Division: Oil and Gas Audit Division Date: 3/14/95
 Approved by Commissioner: Deborah Vogt Date: 3/15/95
 Agency: Revenue

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE

COMMITTEE COPY
 (Rev. 10/94) 95shsho.xls D&R

FISCAL NOTE

No. 1
 Bill Version: HB 207
 (H) Publish Date: 2/27/95

STATE OF ALASKA
1995 LEGISLATIVE SESSION

Revision Date: Original
 Title: Amend APA Hearing Procedures
 Sponsor: _____
 Requestor: Governor

Dept Affe:
 BRU:
 Compon:
 Compon:

Please ignore this fiscal note as it belongs to HB234 NOT HB207. It was incorrectly published and for numbering purposes it will remain in the file, even though it does NOT apply.

Expenditures/Revenues	FY96	FY97	(Thou) FY9
OPERATING EXPENDITURES			
PERSONAL SERVICES			
TRAVEL			
CONTRACTUAL			
SUPPLIES			
EQUIPMENT			
LAND & STRUCTURES			
GRANTS, CLAIMS			
MISCELLANEOUS			
TOTAL OPERATING	0.0	0.0	
CAPITAL EXPENDITURES	0.0	0.0	0.0
CHANGE IN REVENUES ()	0.0	0.0	0.0

FUND SOURCE	(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

Estimate of any current year (FY95) cost: \$ None

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

ANALYSIS: (Attach a separate page if necessary)

There is no anticipated fiscal impact for the Department of Natural Resources with implementation of this legislation.

Prepared by: Nico Bus, Acting Legislative Liaison Phone: 465-2406
 Division: Support Services Date: 22-Feb-95
 Approved by Commissioner: Nico Bus for John Stuebel Date: 2-22-95
 Agency: Natural Resources

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FISCAL NOTE

No. PR 3

Corrected

STATE OF ALASKA
1995 LEGISLATIVE SESSION

Bill Version: HB 207
(H) Publish Date: 3/8/95

Revision Date: Original Dept Affected: Natural Resources
 Title: An Act relating to adjustments to royalty reserved to the state to encourage otherwise uneconomic production of oil and ... BRU: Resource Development
 Component: Oil & Gas Development
 Sponsor: House Rules Committee
 Requestor: Governor Knowles Component Serial No. 439

Expenditures/Revenues	(Thousands of Dollars)					
OPERATING EXPENDITURES	FY96	FY97	FY98	FY99	FY00	FY01
PERSONAL SERVICES	90.6	94.0	97.5	101.2	105.0	108.9
TRAVEL	5.0	5.0	5.0	5.0	5.0	5.0
CONTRACTUAL	5.0	5.0	5.0	5.0	5.0	5.0
SUPPLIES	5.0	5.0	5.0	5.0	5.0	5.0
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	105.6	109.0	112.5	116.2	120.0	123.9
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES ()	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE	(Thousands of Dollars)					
1002 Federal Receipts						
1003 GF Match						
1004 GF	105.6	109.0	112.5	116.2	120.0	123.9
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	105.6	109.0	112.5	116.2	120.0	123.9

Estimate of any current year (FY95) cost: \$ None

POSITIONS	FY96	FY97	FY98	FY99	FY00	FY01
FULL-TIME	11	11	11	11	11	11
PART-TIME	01	01	01	01	01	01
TEMPORARY	01	01	01	01	01	01

ANALYSIS: (Attach a separate page if necessary)

SEE ATTACHED

Prepared by: Ken Boyd, Acting Director *Ken Boyd* Phone: 762-2547
 Division: Oil & Gas Date: 3-Mar-95
 Approved by Commissioner: *John P. Kelly* Date: 3-7-95
 Agency: Natural Resources

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ATTACHMENT FOR FISCAL NOTE - HB207
REDUCE ROYALTY SHARE/HOLD PERMANENT FUND "HARMLESS"

Implementation of this legislation will create an increased workload for the Division of Oil & Gas. We anticipate that some of the applications will be analyzed within the Division and many will require analysis by third parties (the bill provides that third-party costs will be paid for by the companies). Because of the extremely sensitive and confidential nature of the data a considerable amount of interaction between the third-party contractor and the state will be needed. Furthermore, the bill requires that applicants make a clear and convincing showing of the need for royalty reduction, so the Division will need to evaluate the economic, geological and engineering data submitted for compliance with the law prior to seeking the assistance of a third party.

Because this legislation contains provisions that may cause the terms of the application to vary over time, any approved application will need to be monitored on a continuing basis. We expect this program to have broad appeal, however, we cannot anticipate how many applications will be submitted or when they will be submitted.

An exempt Petroleum Engineer, Range 26A, will provide the broad background that will be needed to evaluate these proposals effectively. This position will need to be skilled not only in Petroleum Engineering, but will also need to have extensive knowledge of petroleum geology and petroleum economics. The salary cost of this position will be approximately \$90.6 the first year, including benefits. Additional, minor expenses such as travel, contractual and supplies will be required which we estimate will not exceed \$15.0. This position and the associated costs are our estimates of the funding needed to get the program started; if many applications are received, other positions may be required. We assume that each application will take between 4-6 employee-months to evaluate.

This legislation will effect state operating revenues in an unquantifiable manner (the Permanent Fund share is not affected by this legislation). This legislation gives the commissioner authority to grant royalty reduction which, on its face, would seem to indicate a decrease in revenue. However, since the purpose of this legislation is to promote development of fields that would not otherwise be produced, the net effect on state revenues should be positive. As a result of this legislation we are gaining new revenues based on this new production (albeit at a somewhat reduced rate from currently producing fields).

FISCAL NOTE

Version: 2 print
 HB 207
 (H) Publish Date: 2/27/95

STATE OF ALASKA
1995 LEGISLATIVE SESSION

Revision Date: _____ Dept. Affected: Revenue
 Title: Reduce Royalty Share/Hold Permanent Fund BRU: APFC
 Component: APFC
 Sponsor: GOV
 Requester: GOV COMPONENT SERIAL NO. 109

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
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 EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (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

Estimate of any current year (FY95) cost: \$ _____

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

No additional costs or significant impact is anticipated with the implementation of this proposed legislation upon the Alaska Permanent Fund Corporation .

Prepared by: Martin Pihl, Acting Executive Director Phone: 465-2047
 Division: APFC Date: 2/23/95
 Approved by: _____
 Commissioner: Deborah Vogt Date: 2/23/95
 Agency: Revenue

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9-GH0039\H ✓
Chenoweth
4/12/95

CS FOR HOUSE BILL NO. 207()

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): HOUSE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to adjustments to royalty reserved to the state to encourage
2 otherwise uneconomic production of oil and gas; and providing for an effective
3 date."

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

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

6 (j) The [TO PROLONG THE ECONOMIC LIFE OF AN OIL AND GAS
7 FIELD OR TO REESTABLISH COMMERCIAL PRODUCTION OF SHUT-IN OIL
8 OR GAS THAT WOULD NOT OTHERWISE BE ECONOMICALLY FEASIBLE,
9 THE] commissioner

10 (1) may [SHALL ADOPT REGULATIONS TO] allow reduction of
11 royalty on individual leases, leases unitized ^{UNDER} ~~as described in~~ (p) of this section,
12 leases subject to an agreement described in (s) or (t) of this section, or ^{LEASES} interests
13 unitized under AS 31.05

14 (A) to allow for production from an oil or gas field, pool, or

1 portion of a field or pool if

2 (i) the oil or gas field, pool, or portion of the field or
3 pool has been sufficiently delineated to the satisfaction of the
4 commissioner;

5 (ii) the field, pool, or portion of the field or pool has
6 not previously produced oil or gas for sale; and

7 (iii) oil or gas production from the field, pool, or
8 portion of the field or pool would not otherwise be economically
9 feasible;

10 (B) to prolong the economic life of an oil or gas field, pool,
11 or portion of a field or pool as per barrel or barrel equivalent costs
12 increase or as the price of oil or gas decreases, and the increase or
13 decrease is sufficient to make future production no longer economically
14 feasible; or

15 (C) to reestablish production of shut-in oil or gas that would
16 not otherwise be economically feasible;

17 (2) [. THE COMMISSIONER] may not grant a reduction of royalty
18 unless the lessee or lessees requesting the reduction make [MAKES] a clear and
19 convincing showing that a reduction of royalty meets the requirements of this
20 subsection and is in the best interests of the state;

21 (3) shall [THE REVENUE FROM THE LESSEE'S SHARE OF ALL
22 HYDROCARBONS PRODUCED FROM THE FIELD IS AND IS LIKELY TO
23 CONTINUE TO BE INSUFFICIENT TO PRODUCE A REASONABLE RATE OF
24 RETURN WITH RESPECT TO THE LESSEE'S TOTAL INVESTMENT IN THE
25 FIELD. THE COMMISSIONER MAY] condition any [A] royalty modification
26 [REDUCTION] granted under this subsection in any way necessary to protect the
27 state's best interests; the commissioner shall provide for an increase or decrease
28 or other modification of the state's royalty share by a sliding scale royalty or
29 other mechanism that shall be based on a change [INTEREST, INCLUDING
30 RESTORATION OF THE STATE'S ROYALTY SHARE IN THE EVENT OF AN
31 INCREASE] in the price of oil or gas and may also be based on other relevant

1 factors such as a change in production rate, projected ultimate recovery,
2 development costs, and operating costs;

3 (4) may not grant a royalty reduction for a field, pool, or portion
4 of a field or pool

5 (A) under (1)(A) of this subsection that exceeds 75 percent
6 of the royalty originally specified in a lease entered into under the
7 provisions of (f) of this section or AS 38.05.134;

8 (B) under (1)(B) or (1)(C) of this subsection that exceeds 90
9 percent of the royalty originally specified in a lease entered into under the
10 provisions of (f) of this section or AS 38.05.134;

11 (5) shall require the lessee or lessees to submit, with the application
12 for the royalty reduction, financial and technical data that demonstrates that the
13 requirements of this subsection are met; the commissioner

14 (A) may require disclosure of only the financial and
15 technical data relating to production that is reasonably available to the
16 applicant; and

17 (B) shall keep the data confidential under AS 38.05.035(a)(9)
18 upon the lessee's request;

19 (6) may require the lessee or lessees making application for the
20 royalty reduction to retain and pay for the services of a contractor, selected by
21 the lessee or lessees from a list of qualified consultants in hydrocarbon production
22 and economics provided by the commissioner, to assist the commissioner in
23 evaluating the application and financial and technical data; when the
24 commissioner requires the lessee or lessees to retain the services of a contractor,
25 the commissioner shall determine the relevant scope of the work to be performed
26 by the contractor;

27 (7) shall make and publish a ~~written~~ preliminary findings and
28 determination on the royalty reduction application, give reasonable public notice
29 of the ~~written~~ preliminary findings and determination, and invite written public
30 comment to the ~~written~~ preliminary findings and determination during a 30-day
31 period for receipt of public comment;

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(8) shall, within 30 days after the close of the public comment period under (7) of this subsection,

(A) prepare a written summary of the public response to the commissioner's written preliminary findings and determination;

(B) make ~~a~~ ^{AND PUBLISH A} written final findings and determination; ~~the~~ ^{WHICH IS} ~~commissioner's written final findings and determination prepared under this subparagraph regarding royalty reduction is final and not appealable~~ to the court; and

(C) with the applicant's consent, amend the applicant's lease or unitization agreement consistent with the commissioner's final decision;

(9) shall

(A) transmit a copy of the ~~written~~ final findings and determination to the lessee; and

(B) make copies of the ~~written~~ final findings and determination available to

(i) a person who submitted written comment under (7) of this subsection and who has filed a written request for the copies;

(ii) the presiding officer of each house [BEFORE APPROVING A ROYALTY REDUCTION, THE COMMISSIONER SHALL MAKE A WRITTEN FINDING THAT THE STATE HAS OBTAINED THE MAXIMUM POSSIBLE ECONOMIC RETURN THAT IS COMPATIBLE WITH ALLOWING A REASONABLE RATE OF ECONOMIC RETURN FOR THE LESSEE, AND SEND COPIES OF THE FINDING TO ALL MEMBERS] of the legislature;

(iii) the chairs of the legislature's standing committees on resources; and

(iv) the chairs of the legislature's special committees on oil and gas, if any;

(10) is not limited by the provisions of AS 38.05.134(3) or (f) of this section in the commissioner's determination under this subsection.

1 * **Sec. 2.** AS 38.05.180(p) is amended to read:

2 (p) To conserve the natural resources of all or a part of an oil or gas pool,
3 field, or like area, the lessees and their representatives may unite with each other, or
4 jointly or separately with others, in collectively adopting or operating under a
5 cooperative or a unit plan of development or operation of the pool, field, or like area,
6 or a part of it, when determined and certified by the commissioner to be necessary or
7 advisable in the public interest. The commissioner may, with the consent of the
8 holders of leases involved, establish, change, or revoke drilling, producing, and royalty
9 requirements of the leases and adopt regulations with reference to the leases, with like
10 consent on the part of the lessees, in connection with the institution and operation of
11 a cooperative or unit plan as the commissioner determines necessary or proper to
12 secure the proper protection of the public interest. The commissioner may not
13 reduce royalty on leases in connection with a cooperative or unit plan except as
14 provided in (i) of this section. The commissioner may require oil and gas leases
15 issued under this section to contain a provision requiring the lessee to operate under
16 a reasonable cooperative or unit plan, and may prescribe a plan under which the lessee
17 must operate. The plan must adequately protect all parties in interest, including the
18 state.

19 * **Sec. 3.** AS 38.05.180(s) is amended to read:

20 (s) When separate tracts cannot be individually developed and operated in
21 conformity with an established well-spacing or development program, a lease, or a
22 portion of a lease, may be pooled with other land, whether or not owned by the state,
23 under a communication or drilling agreement providing for an apportionment of
24 production or royalties among the separate tracts of land comprising the drilling or
25 spacing unit when determined by the commissioner to be in the public interest.
26 Operations or production under the agreement are considered as operations or
27 production as to each lease committed to the agreement. The commissioner may not
28 reduce royalty on leases in connection with a communization or drilling
29 agreement except as provided in (i) of this section.

30 * **Sec. 4.** AS 38.05.180(t) is amended to read:

31 (t) The commissioner may prescribe conditions and approve, on conditions,

1 drilling, or development contracts made by one or more lessees of oil or gas leases,
2 with one or more persons, when, in the discretion of the commissioner, the
3 conservation of natural resources or the public convenience or necessity requires it or
4 the interests of the state are best served. All leases operated under approved drilling
5 or development contracts and interests under them, are excepted in determining holding
6 or control under AS 38.05.140. The commissioner may not reduce royalty on a
7 lease or leases that are subject to a drilling or development contract except as
8 provided in (j) of this section.

9 * Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

No objection

9-GH0039H.5 ✓
Chenoweth
4/12/95

A M E N D M E N T |

OFFERED IN THE HOUSE

TO: CSHB 207() Version "H" Dated 4/12/95

Brown

1 Page 3, following line 31:

2 Insert

3 "(8) shall make copies of the written preliminary findings and
4 determination available to

5 (A) the presiding officer of each house [. BEFORE
6 APPROVING A ROYALTY REDUCTION, THE COMMISSIONER SHALL
7 MAKE A WRITTEN FINDING THAT THE STATE HAS OBTAINED THE
8 MAXIMUM POSSIBLE ECONOMIC RETURN THAT IS COMPATIBLE
9 WITH ALLOWING A REASONABLE RATE OF ECONOMIC RETURN
10 FOR THE LESSEE, AND SEND COPIES OF THE FINDING TO ALL
11 MEMBERS] of the legislature;

12 (B) the chairs of the legislature's standing committees on
13 resources; and

14 (C) the chairs of the legislature's special committees on oil
15 and gas, if any;"

16 Renumber the following paragraphs accordingly.

17 Page 4, lines 14 - 29:

18 Delete

19 "(B) make copies of the written final findings and
20 determination available to

21 (i) a person who submitted written comment under
22 (7) of this subsection and who has filed a written request for the
23 copies;

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(ii) the presiding officer of each house [. BEFORE APPROVING A ROYALTY REDUCTION, THE COMMISSIONER SHALL MAKE A WRITTEN FINDING THAT THE STATE HAS OBTAINED THE MAXIMUM POSSIBLE ECONOMIC RETURN THAT IS COMPATIBLE WITH ALLOWING A REASONABLE RATE OF ECONOMIC RETURN FOR THE LESSEE, AND SEND COPIES OF THE FINDING TO ALL MEMBERS] of the legislature;
(iii) the chairs of the legislature's standing committees on resources; and
(iv) the chairs of the legislature's special committees on oil and gas, if any;"

12 Insert

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"(B) make copies of the written final findings and determination available to a person who submitted written comment under (7) of this subsection and who has filed a written request for the copies;"

Failed
3-6

A M E N D M E N T 2

OFFERED IN THE HOUSE

TO: CSHB 207() Version "H" Dated 4/12/95

Brown

1 Page 3, after line 31:

2 Insert:

3 "(8) shall offer to appear before the Legislative Budget and Audit
 4 Committee on a day that is not earlier than 10 days and not later than 20 days
 5 after giving public notice under (7) of this subsection, to provide the committee,
 6 in executive session, a review of the commissioner's written preliminary findings
 7 and determination on the royalty reduction application; if the Legislative Budget
 8 and Audit Committee accepts the commissioner's offer, the committee shall give
 9 notice to all members of the legislature of the committee's meeting in executive
 10 session with the commissioner, and any member of the legislature may attend the
 11 executive session;"

12 Renumber the following paragraphs accordingly.

Paula
1-8

A M E N D M E N T 3

OFFERED IN THE HOUSE

TO: CSHB 207() Version "H" Dated 4/12/95

Brown

- 1 Page 4, lines 5 - 8:
2 Delete "the commissioner's decision prepared under this subparagraph regarding
3 royalty reduction is final and not appealable to the court;"
4 Insert "the commissioner's decision prepared under this subparagraph
5 (i) is, as to the applicant, final and not appealable to
6 the superior court;
7 (ii) may be appealed to the superior court by a
8 person who submitted written comment under (7) of this section,
9 but the appeal is limited to a determination that the
10 commissioner's decision is constitutional and was not arbitrary,
11 capricious, or confiscatory;"

AMENDMENT

4

Failed 2/7

OFFERED IN THE HOUSE

TO: CSHB 207() Version "H" Dated 4/12/94

Brown

1 Page 4, line 7, after "reduction":

2 Insert

3 "(i) may not approve a royalty reduction unless the
4 commissioner finds that the proposed royalty reduction will
5 provide the state the maximum economic return that is possible
6 under the circumstances; and

7 (ii)"

Failed 1-7

9-GH0039NH.6 ✓
Chenoweth
4/12/95

AMENDMENT 5

OFFERED IN THE HOUSE

TO: CSHB 207() Version "H" Dated 4/12/95

Brown

1 Page 3, line 16:

2 Delete "and"

3 Page 3, line 18, after "request:":

4 Insert "and

5 (C) shall prepare and make public a summary of the
6 economic, financial, and technical data on which a royalty modification is
7 based that enables the public to evaluate whether the commissioner's
8 decision serves the best interests of the state;"

Fauld

1-8

9-GH0039\H.1 ✓

Chenoweth

4/12/95

AMENDMENT 4

OFFERED IN THE HOUSE

TO: CSHB 207() Version "H" Dated 4/12/95

Brown

- 1 Page 3, line 5:
- 2 Delete "75 percent"
- 3 Insert "60 percent"

Sec. 38.05.180. Oil and gas leasing. (a) The legislature finds that

- (1) the people of Alaska have an interest in the development of the state's oil and gas resources to

- A) maximize the economic and physical recovery of the resources;
- B) maximize competition among parties seeking to explore and develop the resources;

- C) maximize use of Alaska's human resources in the development of the resources;

- (2) it is in the best interests of the state to encourage an assessment of its oil and gas resources and to allow the maximum flexibility in the methods of issuing leases to

- A) recognize the many varied geographical regions of the state and the different costs of exploring for oil and gas in these regions;

- B) minimize the adverse impact of exploration, development, production, and transportation activity.

(b) The commissioner shall biennially prepare and submit to the legislature, between the first and the 15th day of the first regular session of each legislature, a five-year proposed oil and gas leasing program consisting of a schedule of proposed lease sales and specifying as precisely as practicable the location of tracts proposed to be offered for oil and gas leasing during the calendar year in which the proposed program is submitted to the legislature and the following four calendar years.

(c) Except as provided in (d) and (w) of this section, an oil and gas lease sale may not be held unless it was included in the proposed leasing programs submitted to the legislature during the two calendar years preceding the year in which the sale is held. A lease sale may not be held before the date it is scheduled in the proposed oil and gas leasing program.

(d) The commissioner may issue oil and gas leases in an area that has not been included in a leasing program submitted, in accordance with (b) of this section, to the legislature if the land to be leased

- (1) was previously subject to a valid state or federal oil and gas lease;

- (2) is contiguous to land already under state, federal or private lease and the commissioner makes a written finding, after hearing, that leasing of the land would result in a substantial probability of early evaluation and development of the land to be leased;

- (3) is adjacent to land owned or controlled by another party on which a discovery of commercial quantities of oil or gas has been made, and the commissioner finds, after hearing, that there is a reasonable probability that the land to be leased contains oil or gas in communication with the oil or gas discovered on the land of the other party;

- (4) is adjacent to land included in the federal five-year Outer Continental Shelf leasing program under 43 U.S.C. 1344, and the commis-

sioner makes a written finding, after hearing, that coordinated or simultaneous leasing with the federal government is in the public interest; or

(5) is the subject of an oil and gas exploration license issued under AS 38.05.131 — 38.05.134.

(e) Simultaneously with submission of the leasing program required under (b) of this section, the commissioner shall submit to the legislature a report containing the following:

(1) the schedule of all lease sales held during the preceding calendar year, the bidding method or methods utilized and an analysis of the results of the bidding;

(2) if determined, a description of the bidding methods to be used for all lease sales to be held during the current and next two succeeding calendar years;

(3) the reasons a particular bidding method has been selected.

(f) Except as provided by AS 38.05.131 — 38.05.134, the commissioner may issue oil and gas leases on state land to the highest responsible qualified bidder determined by competitive bidding under regulations adopted by the commissioner. Bidding may be by sealed bid or according to any other bidding procedure the commissioner determines is in the best interests of the state. Whenever, under any of the leasing methods listed in this subsection, a royalty share is reserved to the state, it shall be delivered in pipeline quality and free of all lease or unit expenses, including but not limited to separation, cleaning, dehydration, gathering, salt water disposal, and preparation for transportation off the lease or unit area. Following a pre-sale analysis, the commissioner may choose at least one of the following leasing methods:

(1) a cash bonus bid with a fixed royalty share reserved to the state of not less than 12.5 percent in amount or value of the production removed or sold from the lease;

(2) a cash bonus bid with a fixed royalty share reserved to the state of not less than 12.5 percent in amount or value of the production removed or sold from the lease and a fixed share of the net profit derived from the lease of not less than 30 percent reserved to the state;

(3) a fixed cash bonus with a royalty share reserved to the state as the bid variable but no less than 12.5 percent in amount or value of the production removed or sold from the lease;

(4) a fixed cash bonus with the share of the net profit derived from the lease reserved to the state as the bid variable;

(5) a fixed cash bonus with a fixed royalty share reserved to the state of not less than 12.5 percent in amount or value of the production removed or sold from the lease with the share of the net profit derived from the lease reserved to the state as the bid variable;

(6) a cash bonus bid with a fixed royalty share reserved to the state based on a sliding scale according to the volume of production or other

factor but in no event less than 12.5 percent in amount or value of the production removed or sold from the lease;

(f) a fixed cash bonus with a royalty share reserved to the state based on a sliding scale according to the volume of production or other factor as the bid variable but not less than 12.5 percent in amount or value of the production removed or sold from the lease.

(g) The share of the net profit derived from a lease reserved to the state under (f) of this section is royalty sale proceeds for the purposes of the Alaska permanent fund under AS 37.13.010.

(h) The commissioner may include terms in any oil and gas lease imposing a minimum work commitment on the lessee. These terms shall be made public before the sale, and may include appropriate penalty provisions to take effect in the event the lessee does not fulfill the minimum work commitment. If it is demonstrated that a lease has been proven unproductive by actions of adjacent lease holders, the commissioner may set aside a work commitment. The commissioner may waive for a period not to exceed one two-year period any term of a minimum work commitment if the commissioner makes a written finding either that conditions preventing drilling or exploration were beyond the lessee's reasonable ability to foresee or control or that the lessee has demonstrated through good faith efforts an intent and ability to drill or develop the lease during the term of the waiver.

(i) The commissioner may provide for the establishment of an exploration incentive credit system under which a lessee of state land drilling an exploratory well on that land may earn credits based upon the footage drilled and the region in which the well is situated. The commissioner may also provide for credits to be earned by persons performing geophysical work on state land, if that work is performed during the two seasons immediately preceding an announced lease sale and on land included within the sale area and the geophysical information is made public following the sale. Credits may not exceed 50 percent of the cost of the drilling or geophysical work. Credits may be used during a limited period established by the commissioner and may be assigned during that period. Credits may be applied against (1) oil and gas royalty and rental payments payable to the state or (2) taxes payable under AS 43.55. A credit may not exceed 50 percent of the payment toward which it is being applied. Amounts due the Alaska permanent fund (AS 37.13.010) shall be calculated before the application of credits under this subsection.

(j) To prolong the economic life of an oil and gas field or to reestablish commercial production of shut-in oil or gas that would not otherwise be economically feasible, the commissioner shall adopt regulations to allow reduction of royalty on leases. The commissioner may not grant a reduction of royalty unless the lessee requesting the reduction makes a clear showing that the revenue from the lessee's share of all hydrocarbons produced from the field is and is likely to

continue to be insufficient to produce a reasonable rate of return with respect to the lessee's total investment in the field, the commissioner may condition a royalty reduction granted under this subsection in any way necessary to protect the state's interest, including restoration of the state's royalty share in the event of an increase in the price of oil or gas. Before approving a royalty reduction, the commissioner shall make a written finding that the state has obtained the maximum possible economic return that is compatible with allowing a reasonable rate of economic return for the lessee, and send copies of the finding to all members of the legislature.

(k) The commissioner shall define all terms and adopt all regulations necessary for a reasonable understanding and evaluation of a particular bidding method before the public announcement of the terms of proposed sale employing that method.

(l) 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, 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.

(m) An oil and gas lease must cover a reasonably compact area not exceeding 5,760 acres, and may be for a maximum period of 10 years, except that the commissioner may issue a lease for a period not less than five years upon a finding that it is in the best interests of the state. An oil and gas lease shall be automatically extended if and for so long thereafter as oil or gas is produced in paying quantities from the lease or if the lease is committed to a unit approved by the commissioner. A lease issued under this section covering land on which there is a well capable of producing oil or gas in paying quantities does not expire because the lessee fails to produce oil or gas unless the lessee is allowed reasonable time to place the well on a producing status. Upon extension, the commissioner may increase lease rentals so long as the increased rental rate does not exceed 150 percent of the rate for the preceding year. If drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, including such operations as redrilling, sidetracking, or other means necessary to reach the originally proposed bottom hole location, the lease continues in effect until 90 days after drilling has ceased and for so long thereafter as oil or gas is produced in paying quantities. An oil and gas lease issued under this section which is subject to termination by reason of cessation of production does not terminate if, within 60 days after production ceases, rework-

ing or drilling operations are commenced on the land under lease and are thereafter conducted with reasonable diligence during the period of nonproduction.

(n) The commissioner may establish by regulation that after a well has been plugged and abandoned, the rental rate which was in effect during the year of abandonment is maintained for the remainder of the term. Rental is payable in advance and continues until income to the state from royalty or net profit share exceeds rental income to the state for that year. Oil and gas leases shall provide for payment to the state of rental on the following basis:

- (1) for the first year, \$1.00 per acre;
- (2) for the second year, \$1.50 per acre;
- (3) for the third year, \$2.00 per acre;
- (4) for the fourth year, \$2.50 per acre;
- (5) for the fifth and following years, \$3.00 per acre.

(o) Upon timely application as provided by regulation, the state may issue to the holder of a federal or private lease, a state shoreland lease covering land within the exterior boundaries of the federal or private lease which has been excluded on the basis of navigability or which is later administratively or judicially determined to be shoreland. The term of such a state shoreland lease shall be the same as the term of the federal or private lease.

(p) To conserve the natural resources of all or a part of an oil or gas pool, field, or like area, the lessees and their representatives may unite with each other, or jointly or separately with others, in collectively adopting or operating under a cooperative or a unit plan of development or operation of the pool, field, or like area, or a part of it, when determined and certified by the commissioner to be necessary or advisable in the public interest. The commissioner may, with the consent of the holders of leases involved, establish, change, or revoke drilling, producing, and royalty requirements of the leases and adopt regulations with reference to the leases, with like consent on the part of the lessees, in connection with the institution and operation of a cooperative or unit plan as the commissioner determines necessary or proper to secure the proper protection of the public interest. The commissioner may require oil and gas leases issued under this section to contain a provision requiring the lessee to operate under a reasonable cooperative or unit plan, and may prescribe a plan under which the lessee must operate. The plan must adequately protect all parties including the state.

(q) A plan authorized by (p) of this section, which includes land owned by the state, may contain a provision vesting the commissioner, or a person, committee, or state agency, with authority to modify from time to time the rate of prospecting and development and the quantity and rate of production under the plan. All leases operated under a plan approved or prescribed by the commissioner are excepted in de-

termining holdings or control under AS 38.05.140. The provisions of this section concerning cooperative or unit plans are in addition to and do not affect AS 31.05.

(r) Producing acreage on a known geologic structure of a producing oil or gas field is excluded from chargeability as against the acreage limitation provisions of AS 38.05.140.

(s) When separate tracts cannot be individually developed and operated in conformity with an established well-spacing or development program, a lease, or a portion of a lease, may be pooled with other land, whether or not owned by the state, under a communization or drilling agreement providing for an apportionment of production or royalties among the separate tracts of land comprising the drilling or spacing unit when determined by the commissioner to be in the public interest. Operations or production under the agreement are considered as operations or production as to each lease committed to the agreement.

(t) The commissioner may prescribe conditions and approve, on conditions, drilling, or development contracts made by one or more lessees of oil or gas leases, with one or more persons, when, in the discretion of the commissioner, the conservation of natural resources or the public convenience or necessity requires it or the interests of the state are best served. All leases operated under approved drilling or development contracts and interests under them, are excepted in determining holding or control under AS 38.05.140.

(u) To avoid waste or to promote conservation of natural resources, the commissioner may authorize the subsurface storage of oil or gas whether or not produced from state land, in land leased or subject to lease under this section. This authorization may provide for the payment of a storage fee or rental on the stored oil or gas, or, instead of the fee or rental, for a royalty other than that prescribed in the lease when the stored oil or gas is produced in conjunction with oil or gas not previously produced. A lease on which storage is so authorized shall be extended at least for the period of storage and so long thereafter as oil or gas not previously produced is produced in paying quantities.

(v) *[Repealed, § 36 ch 94 SLA 1980.]*

(w) Notwithstanding any other provisions of this section, land which has been offered for lease within the previous five years and which received no bids at competitive sale or for which no bid was accepted may be, at the discretion of the commissioner, immediately offered for lease, under regulations adopted by the commissioner, upon terms appearing most advantageous to the state; however, non-competitive leasing is prohibited. The commissioner shall establish a royalty determined to be in the public interest but not less than 12 1/2 percent. A lease must provide for payment to the state or rental but need not adhere to the rental schedule in (n) of this section nor to the

5,760-acres-per-lease limitation in (m) of this section. The lease term may not exceed 10 years, except as provided in (o) of this section.

(x) A lessee conducting or permitting any exploration for, or development or production of, oil or gas on state land shall provide the commissioner access to all noninterpretive data obtained from that lease and shall provide copies of that data, as the commissioner may request. The confidentiality provisions of AS 38.05.035 apply to the information obtained under this subsection.

(y) A noncompetitive lease existing at October 10, 1978 shall be extended for a period of two years and so long thereafter as oil and gas is produced in paying quantities. A noncompetitive lease extended under this subsection is subject to the regulations in force at the expiration of the initial five-year term of the lease. No extension may be granted, however, unless within a period of 90 days before the expiration date an application for extension is filed by the record title holder or an assignee whose assignment has been filed for approval, or an operator whose operating agreement has been filed for approval.

(z) No leases may be issued under this section without the inclusion of the following language: "The landowners' royalty share of the unit production allocated to each separately owned tract shall be regarded as royalty to be distributed to and among, or the proceeds of it paid to, the landowners, free and clear of all unit expense and free of any lien for it." Leases issued in violation of this subsection shall, for all purposes, be construed as containing the language required by this subsection.

(aa) 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

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

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

(A) the contract price is unreasonably low;

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

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

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

(bb) In (aa) of this section,

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

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

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

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

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

(i) P.L. 84-830, 70 Stat. 709 (Alaska Mental Health Enabling Act);

(ii) 38 Stat. 1214 (Act of March 4, 1915); or

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

(cc) The provisions of (aa) of this section do not prohibit the commissioner from accepting any payment on a federal lease tendered by the federal agency responsible for determination and transmittal of the payment to the state under 30 U.S.C. 191 or otherwise due the state as the state's royalty share of gas production irrespective of the state's acceptance of the use of the contract price for purposes of determining royalty share on gas production under that subsection. (§ 3(7) art VIII ch 169 SLA 1959; am § 18 ch 61 SLA 1960; am § 1 ch 124 SLA 1962; am §§ 4 — 7 ch 30 SLA 1964; am § 20 ch 70 SLA 1964; am § 2 ch 91 SLA 1967; am § 1 ch 65 SLA 1969; am § 1 ch 86 SLA 1970; am § 1 ch 155 SLA 1978; am § 16 ch 160 SLA 1978; am §§ 3, 4 ch 65 SLA 1979; am § 6 ch 18 SLA 1980; am § 36 ch 94 SLA 1980; am §§ 1 — 5 ch 111 SLA 1980; am §§ 11, 12 ch 161 SLA 1984; am § 1 ch 89 SLA 1985; am § 2 ch 55 SLA 1986; am §§ 3, 4 ch 124 SLA 1990; am § 5 ch 134 SLA 1990; am §§ 1 — 3 ch 53 SLA 1993; am §§ 5, 6 ch 35 SLA 1994; am § 1 ch 36 SLA 1994)

Revisor's notes. — In 1990, a reference to (m) of this section was deleted from the last sentence of (w) of this section to correct a manifest error in § 4, ch. 124, SLA 1990.

Cross references. — For legislative findings in connection with the 1986

amendment to this section, see § 1, ch. 55, SLA 1986, in the Temporary and Special Acts.

For provisions superseding (aa) and (bb) of this section that are applicable to the state's share of royalty production of gas produced after January 2, 1959 and before

June 12, 1993 from certain federal leases. See § 4, ch. 5J, S.L.A. 1993 in the Temporary and Special Acts.

Effect of amendments. — The first 1990 amendment rewrote subsection (j) and substituted "10 years" for "five years" in the last sentence of subsection (w).

The second 1990 amendment substituted "biennially" for "annually" and "15th day of the first regular session of each legislature" for "fifteenth day of each regular legislative session" in subsection b.

The 1993 amendment, effective June 12, 1993, in subsection (aa), inserted "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" and "or accept," added

paragraph (1), added the paragraph (2) designation, and redesignated former paragraphs (1)-(4) as present subparagraphs (2)(A)-(2)(D), respectively; in subsection (bb), rewrote paragraph (3); and added subsection (cc).

The first 1994 amendment, effective August 7, 1994, in subsection (d), made minor stylistic changes and added paragraph (5); and, in subsection (f), substituted "Except as provided by AS 38.05.131 - 38.05.134, the" for "The" at the beginning and made minor stylistic changes.

The second 1994 amendment, effective May 10, 1994, in subsection (c), deleted the former second and third sentences, relating to lease sale delays and reschedulings, respectively.

NOTES TO DECISIONS

Purpose of section.

The assessment of the state's oil and gas resources serves at least two legitimate government objectives. First, knowledge of the production potential of state land in various areas is critical to the determination of where development should occur

and where preservation is appropriate. Second, knowledge of the oil and gas production potential of the state's lands promotes the state's economic welfare by maximizing the amount it receives for the lease of its lands. *State v. Arctic Slope Regional Corp.*, 834 P.2d 134 (Alaska 1991).

Sec. 38.05.183. Sale of royalty. (a) The sale, exchange or other disposal of a mineral obtained by the state as a royalty under AS 38.05.182, or the sale, exchange or other disposal in whole or in part of a right to receive future mineral production under a state lease under this chapter, shall be by competitive bid and the sale, exchange or other disposal made to the highest responsible bidder, except that competitive bidding is not required when the commissioner, after prior written notice to the Alaska Royalty Oil and Gas Development Advisory Board under AS 38.06.050, determines that the best interest of the state does not require it or that no competition exists.

(b) When competitive bids are required, the commissioner, after prior written notice to the Alaska Royalty Oil and Gas Development Advisory Board, may reject all bids on a determination that because of the amount of the bids, the lack of responsibility on the part of the bidders, or for reasons consistent with the criteria set out in AS 38.06.070, the acceptance of the bids would not be in the best interest of the state.

(c) If the commissioner determines that a sale, exchange or other disposal of a mineral obtained by the state as a royalty under AS 38.05.182 or of a right to receive future mineral production under a state lease under this chapter shall be made otherwise than by competitive bid, and the Alaska Royalty Oil and Gas Development Advi-

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February 14, 1995

MEMORANDUM

TO: Representative Joe Green

FROM: Gordon S. Harrison, Director 

RE: Oil and Gas Incentive Programs
Research Request 95.072

You asked for information on state statutory provisions designed to provide an incentive for companies to explore for, develop, and produce oil and gas resources in Alaska. Specifically, you asked for a report that includes "analysis of which incentives have been used, and why, along with analysis of why the others have not been used; and any and all memoranda, findings of fact, or written determinations related to any approval or rejection of an application by a producer to use one of the incentive programs." This memorandum describes the major statutory incentives and presents basic information on their use. We obtained the information primarily from the administrators of the incentive programs. Included is a documentary record of all denials by the Department of Natural Resources of applications for the benefits of an incentive provision. This documentary record, with an accompanying letter, was provided by Jim Eason, outgoing director of the Division of Oil and Gas. We have had neither the time nor staff resources to undertake an independent assessment of the reasons why companies have used or not used the various incentives. Presumably companies have sought the benefit of an incentive when they thought their projects met the basic statutory criteria for eligibility. Whether the state agencies administering the incentives have unreasonably impeded access to them, or the incentives themselves are inherently ineffective in stimulating oil and gas projects, are questions beyond the scope of this memorandum.

Statutory oil and gas incentives and incentive programs involving exploration and royalties are administered by the Department of Natural Resources (DNR). Incentives involving taxes are administered by the Department of Revenue (DOR).

Tax Incentives Administered by the Department of Revenue

Two major tax incentives for oil and gas projects are administered by DOR: the economic limit factor (ELF) and the enhanced oil recovery (EOR) tax credit. Until December 31, 1994, when the provision died by way of an automatic "sunset" clause, the department also administered a special industrial investment tax credit for gas processing facilities and mineral developments.

Economic Limit Factor (ELF)

In Alaska, the nominal severance (production) tax rate on oil and gas is 15 percent of the gross value at the point of production, except for properties initially coming into commercial production after June 30, 1981, which pay 12.25 percent for the first five years of production. Under AS 43.55.013, these nominal rates are multiplied by a factor that varies from 0 to 1 depending upon the productivity of wells in the field and the overall productivity of the field. This factor is the ELF, and it is derived from a complex formula that includes the average number of barrels produced daily by each well, and the number of barrels produced daily by the entire field. If, for example, the ELF calculation results in a factor of .6 on a field paying a nominal severance tax of 15 percent, the effective tax rate is 9 percent. The accompanying table shows the average daily production, the nominal tax rate, the ELF, and the effective tax rate for all producing oil fields in Alaska for calendar year 1994.

The ELF derives its name from a basic purpose of the provision: it is intended to prolong production from a declining field by reducing the tax burden as the field approaches its "economic limit," which is the point at which operating costs (including taxes) equal gross revenue. However, because the ELF comes into play well before a field is in the vicinity of its economic limit, it does more than merely prevent the premature shutdown of a field. It also imparts to the basic severance tax structure a progressive character. That is, it produces a higher tax on larger fields, which are presumably more lucrative, and a lower tax on smaller fields, which are presumably more of a marginal economic proposition. In this respect it mimics in an imperfect but general way a tax on income, which economists usually consider to be the most efficient form of taxation. Therefore, the ELF is a basic feature of the state's severance tax structure, rather than an addendum designed to provide a special incentive. Nonetheless, the ELF creates a particularly strong set of economic incentives for the oil and gas industry, and for that reason it is included in this overview.

DAILY GROSS PRODUCTION and SEVERANCE TAX RATES for ALASKA OIL FIELDS CALENDAR YEAR 1994				
FIELD	Daily Gross Production (bbls)	Nominal Severance Tax Rate (%)	Average Economic Limit Factor (ELF)	Effective Severance Tax Rate (%)
NORTH SLOPE				
Prudhoe Bay	971,000	15.00	.986	14.79
Kuparuk	305,400	15.00	.864	12.96
Pt. McIntyre	100,600	12.25	.907	11.11
Endicott	90,400	15.00	.751	11.26
Lisburne	19,200	15.00	.000	0.00
Milne Point	12,200	15.00	.006	0.08
Niakuk	9,000	15.00	.035	0.53
Schrader Pluif	2,900	15.00	.000	0.00
North Prudhoe Bay	2,300	12.25	.000	0.00
West Beach	1,500	12.25	.000	0.00
Sag Delta	900	12.25	.000	0.00
COOK INLET				
McArthur River	36,300	15.00	.000	0.00
Middle Ground School	6,700	15.00	.000	0.00
Granite Point	6,000	15.00	.000	0.00
Swanson River	4,400	15.00	.000	0.00
West McArthur River	2,400	15.00	.000	0.00
Trading Bay	2,100	15.00	.000	0.00
Beaver Creek	400	15.00	.000	0.00

Source: Department of Revenue

The table shows that only large North Slope fields pay a significance severance tax: in 1994, production from the Prudhoe Bay field was taxed at an effective rate of 14.79 percent; Kuparuk at an effective rate of 12.96 percent; Endicott at an effective rate of 11.26 percent; and Pt. McIntyre at an effective rate of 11.11 percent. Two smaller fields paid virtually no severance tax in 1994: Milne Point production paid an effective severance tax of 0.08 percent, and Schrader Bluff production paid an effective rate of 0.53 percent. The other twelve producing fields paid no severance tax. Clearly the ELF creates an incentive for oil companies to explore for and develop small pools of oil in the vicinity of existing oil production infrastructure, such as around Prudhoe Bay and Cook Inlet. More generally, the progressive nature of the severance tax created by the ELF reinforces this favoritism of small fields (i.e., those with production under 150,000 bbls/day). While large and prolific fields pay a comparatively high tax, these fields are presumed to be sufficiently robust to bear the burden of the tax¹.

Application of the ELF formula is automatic--that is, it does not depend on a discretionary decision of the commissioner. Taxpayers determine their tax liability on the basis of production statistics which are reported to the state. Returns filed by taxpayers are subject to audit by DOR.

Enhanced Oil Recovery (EOR) Credit

To encourage oil production from declining fields in the United States, Congress in 1990 authorized a 15 percent federal income tax credit for the cost of tertiary EOR projects (Title 26 U.S.C. 43). The federal code is adopted by reference in Alaska's corporate income tax law (AS 43.20.021). To qualify for the credit, a tertiary EOR project must begin after December 31, 1990, and it must significantly increase the ultimate amount of crude oil recovered from a drilling operation located in the United States. Taxpayers take the state credit when they submit their corporate income tax return to DOR. The department is prevented by confidentiality statutes from revealing information about individual tax returns, and it therefore may disclose only aggregate data (and this only to the extent that the number of taxpayers is large enough to conceal the tax payment of an individual company). According to the Alaska DOR, for tax years 1991 through 1993, at least \$21 million in credits were claimed on initial tax returns. These returns are subject to audit.

¹Future production from the West Sak field may present an exception, as costs there are expected to be inordinately high. However, the ELF formula is sensitive to two threshold values--300 bbls/day/well and 150,000 bbls/day/field--so it is difficult to predict how the formula will work for this field in the absence of actual well and field production statistics.

Special Industrial Incentive Investment Tax (Expired)

In 1984 the Alaska Legislature created a special credit against a company's state corporate income tax for investments made after December 31, 1984 in a "gas processing project" and in "exploration, drilling of wells, development, or mining of minerals or other natural resources ... other than sand or gravel." The original legislation (Chapter 60 SLA 1984) prohibited credits on investments made after December 31, 1994, although it allowed unused credits to be carried forward through 1999. Thus, this provision expired at the end of last year. The department would not provide an estimate of the value of credits taken and would say only that "several corporations" took the credit during the last decade for projects that include an oil and gas production project in Cook Inlet and several natural gas and gas liquids projects on the North Slope. According to Bob Bartholomew, Deputy Director of the Division of Income and Excise Audit, DOR, the credit was not claimed for any non-oil and gas mining projects.

Exploration and Royalty Incentives Administered by Department of Natural Resources

State law authorizes the commissioner of DNR to include certain exploration incentives in state oil and gas leases, and to approve a reduction of the royalty terms of an oil and gas lease under certain circumstances. The discretionary character of these statutory programs, which require the commissioner to make a determination of the state's best interest before offering or approving a benefit, differentiate them from the incentive programs under the purview of DOR, which are self-executing. Statutory provisions for reducing royalties have changed over the years; however, repealed provisions may still be "alive" in active leases issued when the provisions were current, and they therefore remain relevant today.

Below is a brief discussion of exploration and royalty reduction provisions. Additional discussion and pertinent records submitted by Mr. Eason follows as an attachment.

Royalty Reduction Provisions

Currently, AS 38.05.180(j) authorizes the commissioner of the department to reduce the royalty on a producing oil field if the reduction is necessary to "prolong the economic life of an oil and gas field." Thus, this provision is designed to accomplish for royalties what the ELF is designed to accomplish for severance taxes: to prevent the premature shutdown of a producing field by "reducing costs in the later stages of production decline." The statute specifies that "the commissioner may not grant a reduction of royalty until two years' initial production from the field

has occurred and each lessee requesting the reduction has made a clear showing" that continued production is uneconomic.

The section of the state oil and gas leasing law which authorizes the commissioner to unitize leases, AS 38.05.180(p), also authorizes the commissioner to "establish, *change* or revoke drilling, producing, and *royalty* requirements of the leases. . ." being unitized (emphasis added). Companies have applied to the department for a reduction of the royalty terms of their leases under this provision. The department has rejected such applications on the grounds that it may only entertain applications for royalty reduction under the terms of AS 38.05.180(j), because the latter is a specific statute governing royalty reduction and AS 38.05.180(p) is a general provision authorizing "change" in the context of unitization. According to the legal interpretation of the department, a specific statute takes precedence over a general one. Use of AS 38.05.180(p) to change royalty terms is an issue in the current effort of British Petroleum to unitize the area of the Badami discovery.

Alaska Statutes 38.05.140(d) authorizes the commissioner to reduce royalties on certain minerals. Until 1978, the list included oil and gas. However, oil and gas were removed from this provision in 1978 (Chapter 155 SLA 1978). According to Mr. Eason's letter, the department never received an application for royalty reduction on an oil and gas lease under the provision, but a number of active leases today contain language from the statute prior to its amendment in 1978.

Until 1969, state law granted a five-year royalty reduction from 12.5 percent to 5 percent for the holder of a lease "who shall drill and make the first discovery of oil or gas in commercial quantities in any geologic structure. . ." (AS 38.05.180[a]). This discovery royalty reduction was included in all leases, and it was nondiscretionary in the sense that it did not require a finding of the commissioner that approval was in the best interest of the state. However, it did require the commissioner to decide whether production was from a new geologic structure or the extension of a known structure, and on this basis several applications were denied. Although repealed in 1969 (Chapter 65 SLA 1969), this provision was included in all leases issued up to that time. According to Mr. Eason's letter, two producing leases on the North Slope are currently enjoying the benefits of the discovery royalty reduction. Also, some 340 active leases contain the provision, "an indeterminable number of which could potentially produce future discovery royalty applications."

Exploration Incentives

Alaska Statutes 38.05.180(i) authorizes the commissioner to establish an exploration incentive credit (EIC) system for exploratory wells and geophysical work. The law permits up to half of the cost of the exploratory work to be taken as a credit against royalties, rentals, or severance taxes

Representative Green

February 14, 1995

Page 7

due to the state. The department includes an EIC provision in leases that may need the additional enticement for companies to explore. Leases of attractive prospects do not carry an EIC provision. According to Mr. Eason's letter, there are currently 187 active leases with EIC provisions; 20 applications for EICs have been granted, and 1 denied. Apparently no lease sale since 1991 has included EIC provisions. The value of credits taken to date is about \$58.7 million.

Last session, the legislature adopted SB 151 (Chapter 39 SLA 1994) that created additional exploration incentives that are "distinct from the exploration incentive credit authorized by AS 38.05.180(i). . . ." The new law, AS 41.09.010 applies to exploratory drilling and geophysical work "regardless of whether the land is state-owned land." Up to 50 percent of the cost of qualifying activity on state land may be taken as a credit against oil and gas corporate income taxes and lease bonus payments; 25 percent of the cost of qualifying activity on private land may be taken as a credit. No single project may receive a credit in excess of \$5 million, and no more than \$30 million in credits may be claimed during the ten-year life of the program. A company taking a credit must share with the state the raw data obtained from the exploratory well or geophysical survey. Regulations to implement this program have not yet been adopted.

The foregoing royalty reductions and exploration credits are addressed in more detail in the letter and documentary material from Mr. Eason, which is attached. I hope this overview of oil and gas incentives is helpful. If you have any questions or would like additional information, please call

Attachments

ATTACHMENTS

Letter and Documents from James E. Eason to Gordon S. Harrison, February 8, 1995

STATE OF ALASKA

TONY KNOWLES, GOVERNOR

DEPT. OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

PO BOX 107034
ANCHORAGE, ALASKA 99510-7034
PHONE (907) 762-2353

February 8, 1995 (replaces January 30, 1995 letter)

Gordon S. Harrison, Director
Legislative Research Agency
Alaska State Legislature
130 Seward St., Suite 218
Juneau, Alaska 99801-2196

Dear Gordon:

As you requested in your January 23, 1995 letter, I am forwarding a number of documents related to oil and gas incentives applicable to state leases. Some of these incentives, such as the Discovery Royalty, were authorized under statutes which subsequently have been repealed. However, there are many active leases which were issued prior to the repeal of the authorizing statute, and which are thus, as a technical matter, still candidates for Discovery Royalty applications. One other class of incentives mentioned in your request, Exploration Incentive Credits under AS 41.09.100, were authorized by statute only last session, and will not be available to applicants until implementing regulations have been adopted. Each type of incentive is addressed below in the order they appeared in your letter, with two exceptions. I have included a discussion of "Royalty Amendments" under the provisions of AS 38.05.180(p) and Royalty Reduction under AS 38.05.140(d), neither of which were addressed in your request.

Royalty Reduction under AS 38.05.140(d): AS 38.05.140(d) grants the commissioner authority to reduce the royalty for certain minerals. Before a 1978 amendment, that authority extended to oil and gas. The Division's records reflect that there has never been a royalty reduction application for oil or gas under the former provisions of AS 38.05.140(d). However, a number of older leases still in existence contain language similar to the former provisions of AS 38.05.140(d).

Royalty Reduction under AS 38.05.180(j): The Division's records reflect that only three applications have ever been submitted for royalty reduction under AS 38.05.180(j). Two applications related to the Milne Point Unit. These applications, submitted by Conoco and by Oxy, related to oil production from the Milne Point Unit. The applications were denied by the department, leading to litigation in which the lessees filed both original complaints and administrative appeals in Superior Court. Ultimately, the Alaska Supreme Court ruled against Conoco and Oxy, holding that they had no right to maintain an independent lawsuit. Their administrative appeal, however, was never decided by a Court because the parties settled before any decision was reached.

Enclosures 1 through 12 relate to the applications, the subsequent decisions, and the settlement between the parties. The administrative and legal proceedings related to these applications spanned

almost a decade, and because of employee attrition at the Department of Law, ultimately involved at least three attorneys. If you have additional questions on these records, I suggest you contact Assistant Attorney General Patrick Coughlin. He is the state's attorney most familiar with the Conoco and Oxy appeals and settlements.

One lessee, Texaco, filed an application under AS 38.05.180(j), but failed to follow through with data required to adjudicate the application. In addition, I recall that Marathon approached the department regarding potential royalty reductions at one or more of its respective Cook Inlet properties in the early to mid 1980s. Both parties expressed concern that they could not reconstruct the documentation of historical investments and revenues required to support an application under the then existing statutes. It is my impression that this concern was the principal impediment to Texaco's completing its application or Marathon's submitting a formal application. Ms. Pete Nelson represented Texaco in their discussions; I cannot recall who represented Marathon. You may want to contact both companies directly for their views on royalty reduction. Enclosure 12A is a copy of the Texaco application and a cover letter from Ms. Mary Weisenberger, a former Land Management Officer for the division.

Royalty Amendment under AS 38.05.180(p): AS 38.05.180(p) provides the commissioner's statutory authority to enter into unitization agreements "...when determined and certified by the commissioner to be necessary or advisable in the public interest..." In exercising that authority, the commissioner "...may with the consent of the holders of the leases involved, establish, change or revoke drilling, producing and royalty requirements of the leases..." (emphasis added) Historically, this provision has been used by the department to raise royalty rates at the time of unitization, as at Milne Point Unit, and, more recently, at Thetis Island. It has never been used, however, to lower royalty rates.

Both Conoco and Oxy (in the mid-1980s) made the argument that the commissioner, upon unitization, has the authority to reduce royalties, or to adopt alternative royalty provisions which would have that effect. The statutes suggest otherwise. This issue has been addressed several times since the mid-1980s. For your review of this issue, I have enclosed a number of documents. Enclosures 10, 11, and 12 are letters from former Commissioners Wunnicke and Brady, as well as former Director Kay Brown, respectively. Enclosures 13 through 16 are copies of recent correspondence between BP representative, Mr. Terry Obeney, and me on Badami related issues, including BP's proposed "sliding scale" royalty amendment.

Exploration Incentive Credits under AS 38 05 180(i): The department authorized the use of EICs under this provision for seven competitive oil and gas lease sales during the period 1982-1991. A total of 705 tracts potentially eligible for EICs were offered in those sales. By potentially eligible, I mean eligible, presuming compliance with the specific lease provision and the terms of the applicable regulations. Enclosure 17 is a summary of lease sales that offered EICs.

As of January 23, 1995, there were 187 active leases with EIC provisions. Historically, the department has granted applications for EICs on 20 wells. It has denied the request for one EIC.

That request was submitted by ARCO on behalf of itself and Union Texas Petroleum Alaska Corporation for an EIC for the drilling of the Kuukpik Unit No. 3 well. Enclosure 18 is a copy of ARCO's request. Enclosure 19 is an edited version of former Commissioner Noah's decision denying the request. The copy has been edited to redact materials that are confidential under the provisions of AS 38.05.035 and 11 AAC 82.810.

The total value of EICs awarded to date is slightly more than \$58.66 million. Credits awarded may be taken against certain taxes or royalties owed the state or they may also be assigned. The award of credits is conditioned upon subsequent audit and is subject to potential adjustment. Enclosure 20 is a summary of EICs awarded as of November 1994. The summary includes the lease ADL number, the well name, a listing of working interest owners (lessees) for each lease, the EIC certification date and the respective amounts of each EIC attributable to the respective working interest owners. Exploration incentive credits are also available for geophysical work, but to date no applications have been made for these credits. See Enclosure 21. Based upon personal conversations I have had over the years with geophysical contractors and companies, those companies feel that the "disincentive" of having to make public data qualifying for an EIC outweigh the financial incentive of the EIC.

Exploration Incentive Credits under AS 41.09.100: AS 41.09.100, which was enacted last session, expanded the DNR commissioner's discretionary authority to award EICs for qualifying exploration activities on lands other than state-owned, leased lands. The incentive was designed to encourage exploration of private and federal lands within the state from which the state would in turn receive geological and geophysical information to which it otherwise would not be entitled. Implementing regulations have not yet been adopted; however, draft regulations are under review by the Department of Law.

Although the legislative record is clear that EICs under AS 41.09.100 were not intended to be used for activities conducted on state-leased lands, some companies apparently continue to believe otherwise. Enclosure 22 is a copy of a request from ARCO for approval of EICs for operations proposed to be conducted on two of its North Slope leases. The leases in question were issued in a competitive sale which did not provide for EICs. Enclosure 23 is a copy of former Commissioner Noah's denial of ARCO's request. In addition to the ARCO request, representatives of BP have made recent inquiries of the division as to the availability of EICs under this statute for certain of its North Slope leases, if you need additional background information.

Discovery Royalty: I have enclosed several tables pertaining to Discovery Recovery applications for fields on the North Slope and in the Cook Inlet region. Enclosure 24 is a summary of Cook Inlet Discovery Royalty applications and their disposition. According to division records, 13 applications related to Cook Inlet discoveries were filed. Of those applications, the department approved 8 and denied 5. I presume most of the non-confidential documentation for those decisions is available in the state archives.

February 8, 1995


Enclosure 25 provides a summary of North Slope Discovery Royalty applications. To date, six applications have been submitted. Five of those applications were approved; one application, that for Milne Point G-1 Well, was denied (enclosures 26 and 27). In addition, between 1968 and 1977 nine additional Notices of Discovery Application were filed, but the applicants never completed the applications, and the applications subsequently expired.

There are currently two North Slope leases producing under Discovery Royalty terms. Those leases are ADL 34635 (Niakuk #5) and ADL 28297 (Pt. McIntyre #3). Discovery Royalty eligibility for the Niakuk lease expires in April 1995, and for the Pt. McIntyre lease in May 1999. As an example of the magnitude of the combined effect of royalty reduction for these two leases, Enclosure 28 summarizes the lessees' "savings" through reduced royalties for the sample month of July 1994. The division can provide more detailed historical summaries if you desire.

As noted earlier above, the Discovery Royalty statute was repealed in 1969. However, prior to the statute's repeal, hundreds of leases which contained discovery royalty provisions were issued. As of January 26, 1995, there were 340 such leases active, an indeterminable number of which could potentially produce future discovery royalty applications.

Hopefully, I have provided all the information you need. However, if I missed anything or if you need more information, please feel free to call. As I mentioned by telephone last week, this is the last report I will be transmitting to you, Gordon, as I am leaving state service. It has always been my pleasure to work with you and your staff. Please give everyone my regards, and take care.





Sincerely,

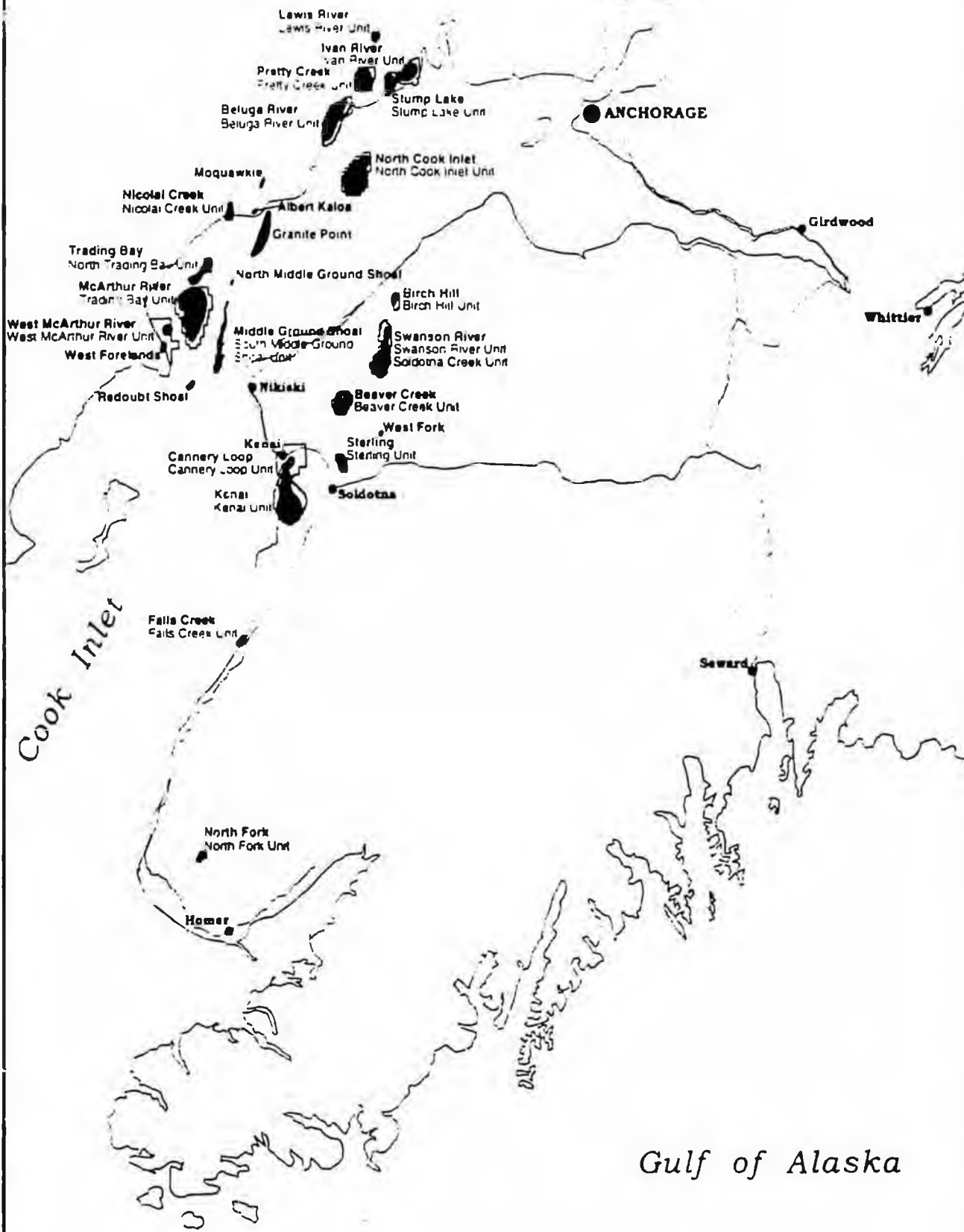

James E. Eason
Director

cc: Marty K. Rutherford, Acting Commissioner
Ken Boyd, Deputy Director
Patrick Coughlin, Department of Law
Bill Van Dyke, Petroleum Manager

COOK INLET OIL & GAS MAP




ALASKA DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL AND GAS
MARCH 1975

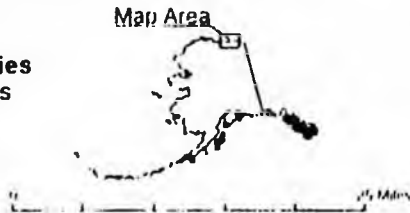
-  Pool Boundaries
-  Unit Boundaries
-  Oil Fields
-  Gas Fields



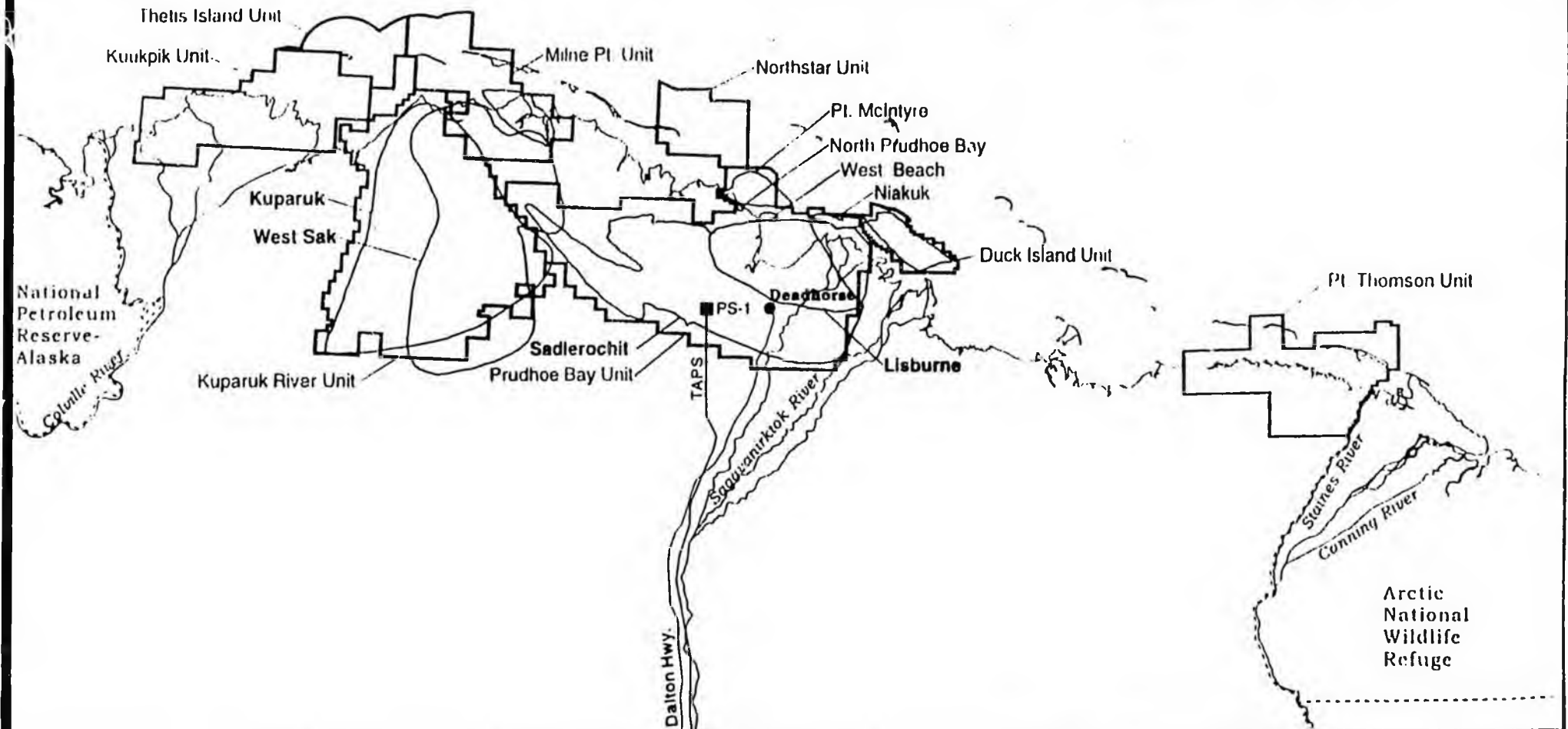
NORTH SLOPE OIL & GAS MAP

ALASKA DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL AND GAS
MARCH 1995

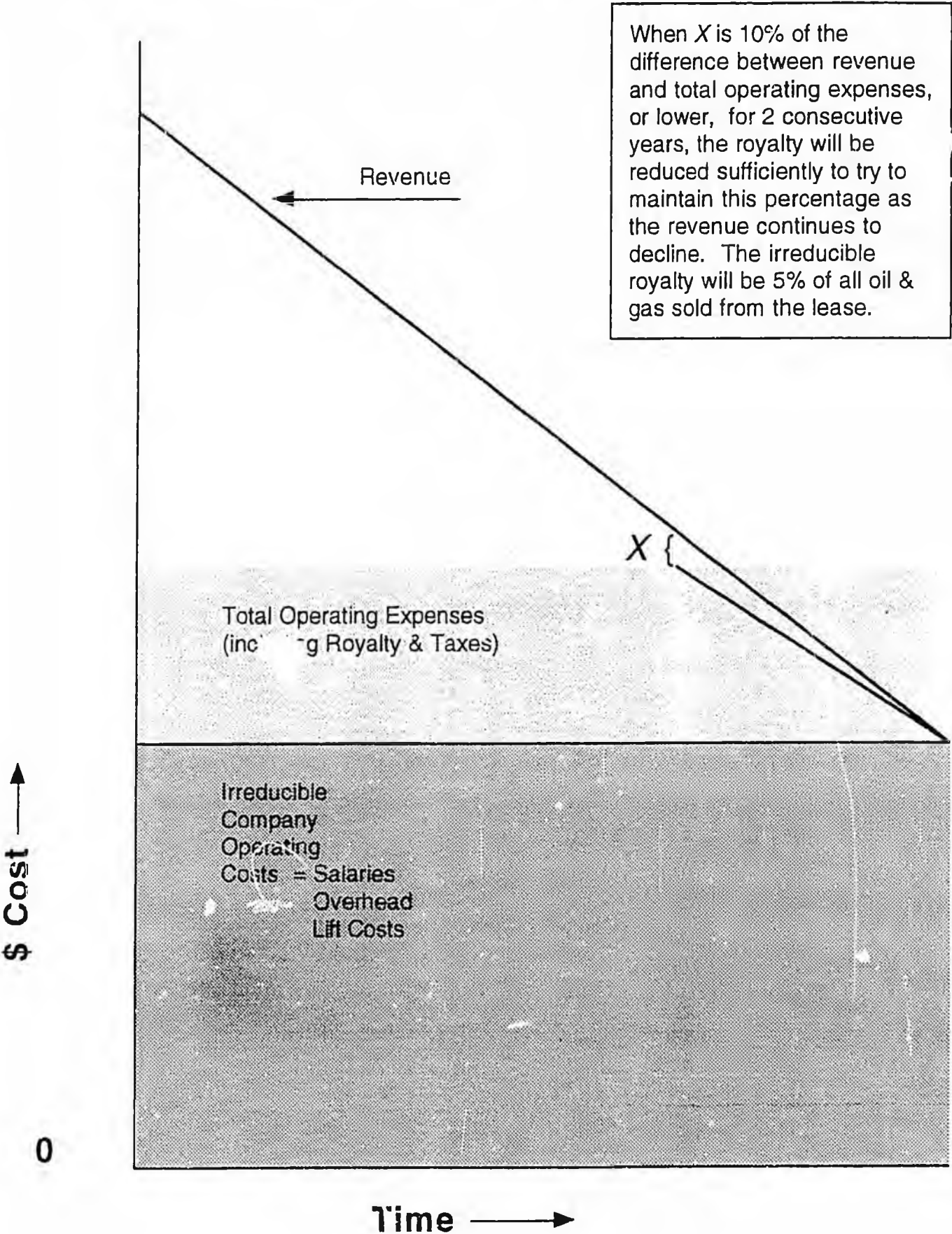
-  Pool Boundaries
-  Unit Boundaries
-  Pump Station #1



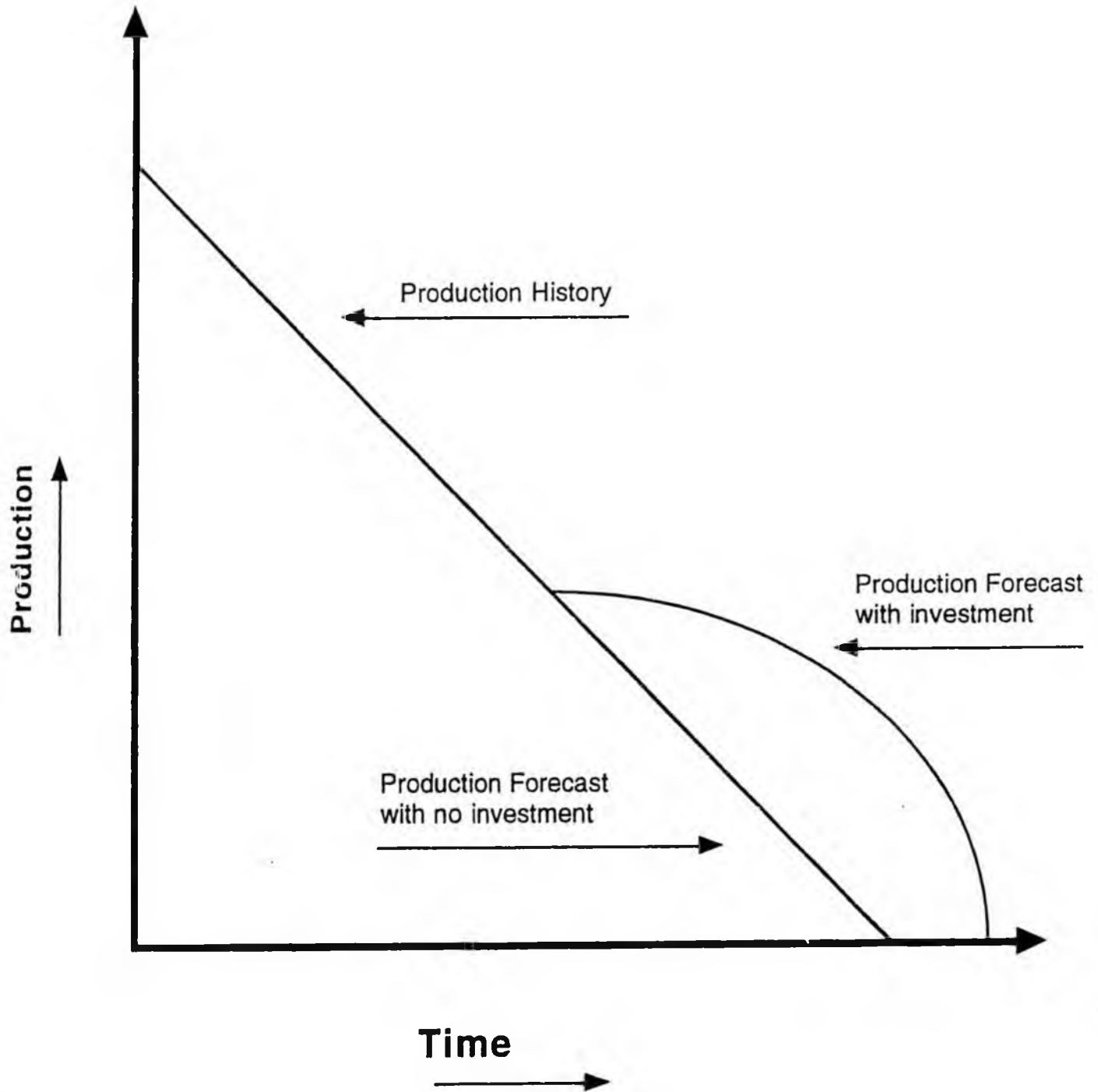
Beaufort Sea



Mature Fields Illustration #1



Mature Field Illustration # 2



Testimony on CSHB 207 (O&G) before the House Resources Committee

Richard A. Fineberg
 Research Associates
 P.O. Box 416
 Ester, Alaska 99725

March 23, 1995

I. Overview

CSHB 207 (O&G) and CSHB 207 (3/23/95 Work Draft 9-GH0039AK) have significant substantive defects that would seriously hamper the efforts of the State of Alaska to manage this important resource wisely and in the best interests of all Alaskans. Even if those problems were corrected, a strong material case for easing the state's existing royalty relief provisions has not been made.

II. Comments on Specific Provisions of CSHB 207 (O&G)

For the specific reasons described below, I believe the committee substitute and the work draft before you are misguided. CSHB 207 (O&G) would make a bad bill worse by adding to a bill that deliberately shields the Commissioner's actions from the public review that normally safeguards the public interest provisions giving the Commissioner of Natural Resources new powers to grant royalty relief that are ill-conceived and unprecedented.

(Heading page and line numbers refer to CSHB 207 [O&G]; asterisk [] indicates language in the O&G CS that does not appear in the original bill; parentheses at end of paragraph indicates position in 3/23/95 Work Draft #9-GH0039AK; italicized comments refer to language in that work draft only.)*

A. Page 1, line 10. This measure destroys regulations governing existing royalty relief provisions that provide rational limits to arbitrary or unwise administrative action. *(Work Draft, page 2, line 4.)*

B. Page 2, lines 6, 11. In view of the fact that industry statements about profitability fly in the face of every published report of which I am aware,¹ criteria

¹ Last May, in an "Open Letter to the People of Alaska" published in major Alaskan newspapers, BP Alaska President John Morgan stated that BP has paid more in taxes and royalties than it has taken out in profits or cash flow. This statement flies in the face of every public study of which I am aware. See: Deakin (1989), Oil Industry Profitability in Alaska, 1969 through 1987, p.2 (industry profit \$42.6 billion, state share \$29.3 billion); Legislative Research Agency (1993), Distribution of Income from Alaska Oil and Gas Operations . . . p. 14 (1985 industry net income \$5.6 billion, 1985 state net revenue \$3.3 billion); Fineberg (1992), p. 43, Alaska North Slope Oil Profits . . . (1991 West Coast industry profits \$4.95 per barrel, state share \$3.82); Wilson-Gilletic (1994), Consequences of Exporting Alaska Crude Oil, p. 36 (April 1994 West Coast major field

*Fineberg / Testimony on CSHB 207 (O&G and Work Draft)
March 23, 1995 (Page 2)*

for economic feasibility should be clearly defined and part of the public record. This bill does the opposite. (*Work Draft, page 2, lines 15-16, 20-21 and 23.*)

C. Page 2, lines 7-9. Section 1(B) would appear to allow royalty relief "to prolong the life" of any field, regardless of profitability. Clearly, royalty relief would accomplish this statutory purpose. But whether or not such relief is necessary to prolong production is an altogether different -- and arguable -- proposition.

(*Work Draft, page 2, lines 17-21. The attempted cure to this problem couples "increase" with the phrase "is sufficient to" at line 20; this does not make sense. [See also B., above.]*)

D. Page 2, lines 15, 22. The legislation's reliance on the requirement that the Commissioner must find such relief in the best interest of the state is so broad as to be virtually meaningless. It is generally assumed as a matter of law that public officials act in the best interest of the state unless it is proven to the contrary. In this case, because the material is held confidential and virtually unappealable, this bill fails to ensure that royalty relief will be in the state's "best interests." (*Work Draft, page 2, line 27; page 3, line 4.*)

E. Page 2, lines 27-29.* This portion mandates consideration of factors such as capital investment in the field but may be read to exclude investment in pipelines, which are a major factor affecting both the development of new fields and the continued production in existing fields. Moreover, guaranteed profits to the pipeline owners are a significant factor influencing production decisions that this language arguably requires the Commissioner to ignore.

(*Work Draft, page 2, lines 10-12. The work draft resolves this ambiguity by excluding consideration of factors such as pipeline economics. The State may choose to forego consideration of significant portions of the economic rent; industry officials, responsible to stockholders to maximize their profits, will not make this mistake.*)

wellhead profits \$2.66 per barrel, state share \$2.63 per barrel [excludes estimated TAPS industry profits of \$1.00 per barrel v. state taxes of approximately \$0.30 per barrel]). BP has refused repeated requests to put on the public record information that would substantiate its claim. (Copies of correspondence with BP and additional information on profitability provided to House Oil & Gas Committee March 16, 1995; see testimony of Richard A. Fineberg).

*Fineberg / Testimony on CSHB 207 (O&G and Work Draft)
March 23, 1995 (Page 3)*

F. Page 3, lines 6-11.* Subpar. (5)(a) sets a potentially dangerous precedent by encouraging companies to trade properties in declining production to avoid disclosing relevant facts of production economics to the state.

(Work Draft, page 3, lines 17-19. Language cures this defect.)

G. Page 3, lines 12-13. The requirement that the Commissioner shall hold application material confidential at industry request contravenes the state's sunshine laws, common sense and jurisprudence. In 1992 the Alaska judge who has probably reviewed more oil industry documents than any other specifically ruled, on his own initiative, that such a blanket grant of confidentiality was not justified. In view of the clearly established right of the public to know what its officials are doing, he said, the industry must make a showing that it is necessary to hold documents confidential.² *(Work Draft, page 3, lines 20-21.)*

H. Page 3, lines 16-17. It is easy to see why the industry would like to remove judicial review; in view of the long history of increased revenues the state has obtained through the courts, one wonders why the stewards of public resources would recommend this course of action. *(Work Draft page 3, lines 23-25.)*

I. Page 3, lines 18-24.* Apparently throwing in the towel on a 20-year endeavor to attain the expertise in the state system to protect the public interest in the inevitable and perfectly legitimate dialogic between the industry and the stewards of the public interest, this bill sets up an unprecedented system in which the Commissioner will rely instead on a contractor to the industry. *(Work Draft, page 3, lines 27 through page 4, line 2.)*

J. Page 3, lines 28-31 and p. 4, through line 18.* In groping for some group to bless the Commissioner's actions, the CS relies on approval by 3 of 5 members of a group called the Royalty Oil and Gas Development Advisory Board. The Royalty Oil and Gas Development Advisory Board appears to be a rubber stamp. Further, with all due respect, the submission of the near-moribund Royalty Oil and Gas Development Advisory Board finding to legislative leaders

² "Memorandum Opinion and Order No. 92-71 (Denying Motions by BP Exploration [Alaska], Inc. for Continued in camera Treatment of Certain Documents in Court Record)," ANS Royalty Litigation, 1JU-77-847 Civil, May 27, 1992 (19 pp.). The court specifically refused to hold material confidential merely at the request of the industry because "the public's right to know what the executive branch is about" outweighed the industry's speculative assertion of possible damage resulting from the release of information about its business.

*Fineberg / Testimony on CSAB 207 (O&G and Work Draft)
March 23, 1995 (Page 4)*

hardly substitutes for thorough executive review before a course of action is recommended.³

(Work Draft, page 4, lines 7-24, I do not believe AOGCC has the resources or economic background to evaluate such a proposal; from the phrase "if any" at line 13, it appears that the AOGCC response does not have to be in writing.)

C. Production Forecasts Demonstrate This Bill May Be Unnecessary

On reviewing North Slope production forecasts for 1985, 1990 and 1995, a clear trend is evident: the North Slope production decline, although real, consistently plays out in a more benign manner than forecasted. If you compare 1985 forecasts to the current forecast through 2010, you will find that we now expect to produce 3.75 billion more barrels of oil through 2010 than forecasted in 1985. Put otherwise: Over the last ten years, the current tax and royalty regime has generated five years more of production at two million barrels per day than was forecasted in 1985. Every two years, we booked an additional year of forecasted production at TAPS' maximum throughput. This trend of increasing production (i.e., slowed decline in production) was established in the face of declining prices. Most importantly, the phenomenon of increasing production continues today, despite dire predictions by the industry in the late 1980's that we had seen the last of such increases.⁴

D. Conclusions

It is self-evident that any bill that increases industry revenue at the expense of the State Treasury will tend to stimulate production. The industry will, of course, advocate such a measure. But it remains to be demonstrated that this legislation is necessary, or

³ According to the Dept. of Natural Resources, the Royalty Oil and Gas Development Advisory Board has met twice in the last five years, has no chair and may have one vacancy (one member's seat has expired). It is my understanding that since the mid-1980's this board, of which the Commissioner of DNR is a non-voting sixth member, has always supported the department's actions unanimously.

⁴ Based on Dept. of Natural Resources forecasts (see: Richard A. Fineberg, Alaska North Slope Production Prospects: Preliminary Analysis [a report prepared for the Northern Alaska Environmental Center, et al.], Feb. 22, 1995). For past warnings that production increases would not continue, see Richard A. Fineberg, An Overview of North Slope Production Prospects, 1990-2010 (prepared for the Alaska State Legislature), Dec. 15, 1990), pp. 23-28, and North Slope Profits and Production Prospects [prepared for the Alaska State Legislature], Nov. 12, 1992, pp. 13-14.

*Fineberg / Testimony on CSFB 207 (O&G and Work Draft)
March 23, 1995 (Page 5)*

that it reflects the wise stewardship of public resources mandated by the Alaska Constitution. Particularly in view of the well-documented history of abuses of confidentiality that have found their way into the public record⁵ and current disagreement over the basic facts of North Slope profitability,⁶ it makes little sense to allow the lessees, at their own initiative, to prevent the bases for granting royalty relief from seeing the light of day.⁷ Even if that rather astounding defect — and the others listed above — were corrected, the case for the proposed incentives would have yet to be made.

⁵ In a current case whose very existence would be hidden from the public had Exxon Corp. not been required to make some documents public in the United States Tax Court, Exxon is asking for retroactive tax deductions that the Internal Revenue Service has said could ultimately be worth \$18 to 25 billion if applied to all North Slope producers. Exxon argues that ultimate abandonment of costs of Prudhoe Bay are deductible for federal tax years 1977 through 1984 under federal tax law because those claims are both knowable and fixed (United States Tax Court Dockets No. 18618-89 and 18432-90). In December 1994, the Alaska Oil & Gas Association recommended that the state should clarify what it might require for the abandonment of Prudhoe Bay. Ironically, Exxon was identified as the lead source for that recommendation ("AOGA Briefing Paper: Lease Closure," presented to Knowles-Ulmer Transition Team Dec. 28, 1994). The blatant contradiction between Exxon's position in separate arenas is indicative of the kind of inconsistency that can contaminate public policy made under the cloak of confidentiality.

A second example of public policy abuses flourishing behind the veil of confidentiality is the 1985 TAPS tariff settlement. Due to confidentiality, key elements of that sorry record were not available to the public until after the settlement had been formally approved. In one instance during the latter stages of the TAPS saga, the Governor was briefed on an erroneous document that was subsequently removed from files and replaced with an altered document, in apparent violation of Alaska statutes. (See Richard A. Fineberg, The 1985 TAPS Settlement: A Case Study in the Effects of Confidentiality on Information Available to Decision Makers in Oil and Gas Revenue Disputes (prepared for the Alaska State Legislature), Feb. 5, 1990), pp. 30-36. For a later study of a TAPS settlement defect with enormous state and federal revenue consequences that was mis-stated and therefore overlooked during the flawed 1985 settlement review process, see Richard A. Fineberg, Hidden Billions: The TAPS DR&R Provision (report prepared for Stan Stephens, Valdez, Alaska), August 21, 1992.

⁶ See note 1, above.

⁷ As the U.S. Supreme Court has observed, "People do not demand infallibility from their institutions, but it is difficult for them to accept what they are prohibited from observing." (*Richmond Newspapers, Inc. v. Virginia*, 448 U.S. 555, 572 [1980]; quoted in Memorandum 92-71, *op. cit.*, cover page). To accomplish his well-intentioned desire to reduce needless litigation, the Governor might consider introducing legislation that puts more information on the public record — not less.

Table Y-1.

Research Associates 2/95

1985 Production Forecast for 1995-2010 (Alaska Dept. of Natural Resources)
(000 bbls)

(000 Barrels per day)

Year	Eteld>=	Prudhoe	Kuparuk	Lisburne	Pt. McIntyre	Endicott	Milne Pt.	Other	W. Sak	Beaufort	Total
1995		575	145	65		70	10	100	<=====		965 000 bpd
1996		510	120	60		65	0	125	<=====		880 "
1997		460	100	55		60		125	<=====		800 "
1998		420	80	50		55		125	<=====		730 "
1999		380	75	40		50		125	<=====		670 "
2000		340	65	30		45		120	<=====		600 "
2001		300	55	20		40		115	<=====		530 "
2002		270	50	10		20		110	<=====		460 "
2003		240	40	0		10		105	<=====		395 "
2004		210	35			0		100	<=====		345 "
2005		180	30					95	<=====		305 "
2006		160	25					90	<=====		275 "
2007		140	20					80	<=====		240 "
2008		110	15					70	<=====		195 "
2009		80	10					60	<=====		150 "
2010		50	0					50	<=====		100 "
Total Barrels:		1,615,125	315,725	120,450	0	151,475	3,650	582,175	<=====		2,788,600 (000 bbls.)

Source: Alaska Dept. of Natural Resources, "Historical and Projected Oil & Gas Consumption," January 1985, p. 13 (Table 2.2: Estimated Availability of N. Slope Oil For Sale).

Research Associates 2/95

Table V.-2.

1990 Production Forecast for 1995-2010 (Alaska Dept. of Natural Resources)
(000 bbls)

Year	100 Barrels per day:										Total	000 bpd
	Field =>	Prudhoe	Kuparuk	Lisburne	Pt. McIntyre	Endicott	Milne Pt.	Niagak	W.Sak	Beaufort		
1995		857	190	37	60	65	10	20	12		1,251	"
1996		789	175	34	54	60	8	17	12		1,149	"
1997		726	150	31	49	55	7	14	25		1,057	"
1998		668	125	28	44	50	6	12	25	0	958	"
1999		614	105	25	39	45	5	10	50	60	893	"
2000		553	90	21	35	40	5	9	50		863	"
2001		498	75	19	32	20	5	7	75	51	785	"
2002		448	65	13	29	10	0	6	75	49	695	"
2003		403	55	9	26	0		5	100	44	642	"
2004		363	45	5	23			5	100	39	580	"
2005		326	35	0	21				150	35	567	"
2006		284	30		19				150	32	515	"
2007		247	25		17				150	29	468	"
2008		215	20		15				150	26	426	"
2009		187	15		14				140	23	379	"
2010		163	10		12				120	21	326	"
Total Barrels:		2,679,465	441,650	81,030	178,485	125,925	16,790	38,325	505,160	150,380	4,217,310	(000 bbls.)

Source: Alaska Dept. of Natural Resources, "Historical and Projected Oil & Gas Consumption," January 1990, p. 10 (Table 2.2: Production Forecast and Available Royalty Oil).

Research Associates 2/95

Table V.3.

1995 Production Forecast for 1995-2010 (Alaska Dept. of Natural Resources)
(000 bbls)

000 Barrels per day:

Year	Field =>	Prudhoe	Kuparuk	Lisburne	Pt. McIntyre	Endicott	Milne Pt	Other	W. Sak	Beaufort	Total
1995		980	310	20	115	94	30	23		0	1,572 000 bpd
1996		921	305	20	115	83	40	23			1,507 "
1997		857	300	20	109	72	40	22			1,420 "
1998		788	300	18	98	63	45	22			1,334 "
1999		717	295	15	88	55	50	19	0		1,239 "
2000		646	285	13	79	47	45	16	6		1,137 "
2001		581	256	10	71	40	40	14	21		1,033 "
2002		523	231	10	64	34	36	11	27		936 "
2003		471	208	10	61	29	33	10	25		847 "
2004		423	187	10	54	24	30	9	26		763 "
2005		381	168	10	46	21	27	7	35		695 "
2006		343	143	10	39	18	24	6	59		642 "
2007		309	122	9	33	16	20	5	58		572 "
2008		278	103	8	28	13	17		49		496 "
2009		250	88	7	24	10	15		41		435 "
2010		225	75	6	21		12		35		374 "
Total Barrels:		3,172,945	1,232,240	71,540	381,425	225,935	183,960	68,255	139,430	0	5,475,730 (000 bbls.)

Source: Alaska Dept. of Natural Resources, "Historical and Projected Oil & Gas Consumption," February 1995 (in press). (Table 2A: Estimated Availability of N. Slope Oil For Sale).

Table V-4

Research Associates 2/95

1985 North Slope Production Forecast for 1986-94 v. Actual Production (ADNR)

(000 Barrels)

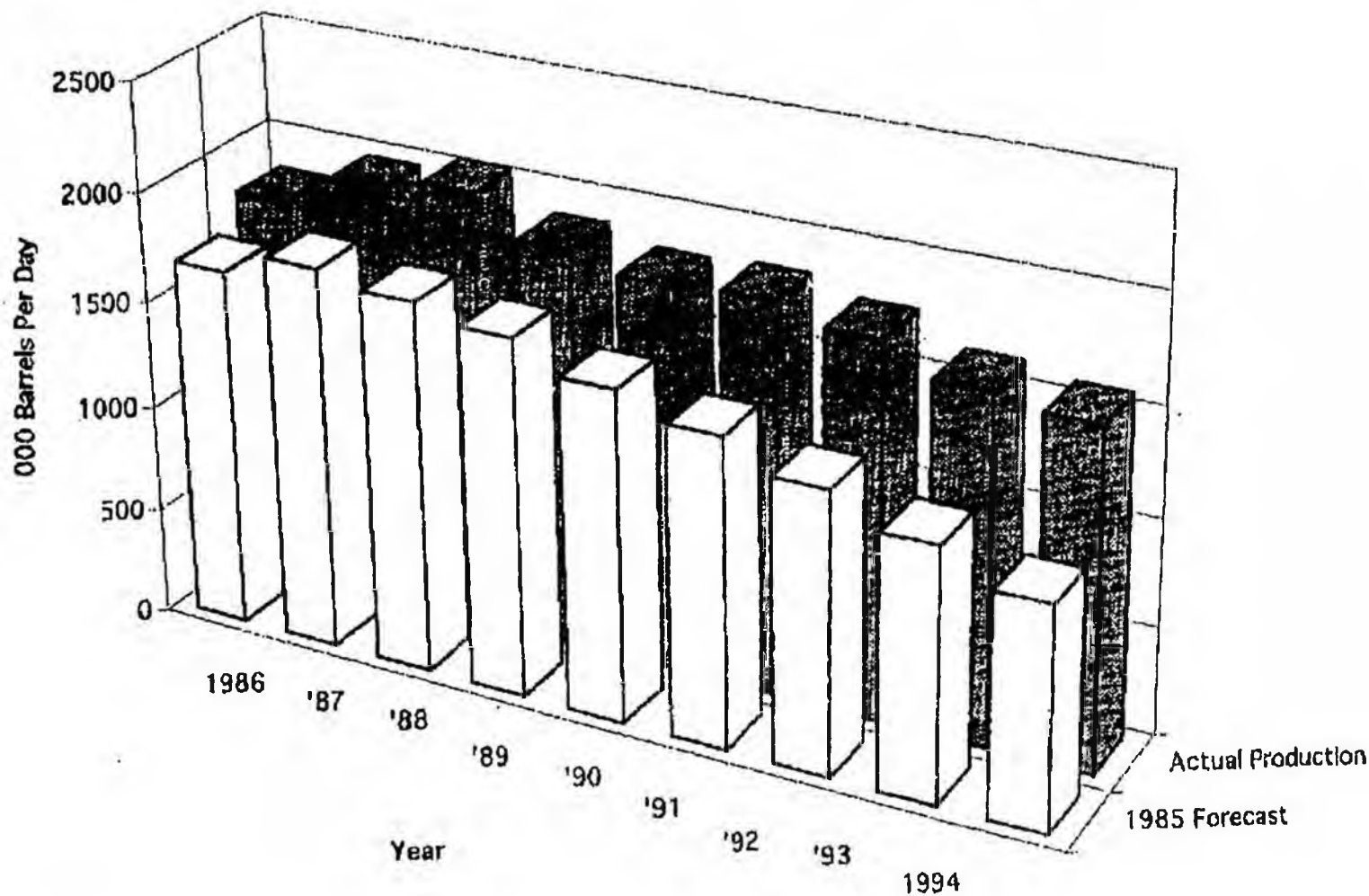
1985 Production Forecast (1)										
Barrels per day:										
Field:	Prudhoe	Kuparuk	Lisburne	Pt. McIntyre	Endicott	Milne Pt.	Other	W.Sak	Beaufort	Total
1986	1,500	180	0	0	0	0	0	<=====		1,680 000 bpd
1987	1,475	180	75		0	30	30	<=====		1,790 000 bpd
1988	1,325	200	100		50	30	30	<=====		1,735 000 bpd
1989	1,175	200	120		100	25	50	<=====		1,670 000 bpd
1990	1,050	200	120		100	20	50	<=====		1,540 000 bpd
1991	950	200	120		100	15	50	<=====		1,435 000 bpd
1992	850	200	90		100	13	50	<=====		1,305 000 bpd
1993	750	200	75		85	10	50	<=====		1,170 000 bpd
1994	650	170	70		75	10	50	<=====		1,025 000 bpd
Total Barrels:	3,549,675	631,450	281,050	0	222,650	56,575	131,400	<=====		4,872,750 000 Bbl. (Forecast)
Actual Production (2)										
Field:	Prudhoe	Kuparuk	Lisburne	Pt. McIntyre	Endicott	Milne Pt.	Other	W.Sak	Beaufort	Total
1986	1,539	260	10		0	13		<=====		1,822 000 bpd
1987	1,608	284	46		24	0		<=====		1,962 000 bpd
1988	1,585	304	40		103	0		<=====		2,033 000 bpd
1989	1,427	297	41		98	5		<=====		1,868 000 bpd
1990	1,340	294	43		106	18		<=====		1,801 000 bpd
1991	1,333	311	40		117	20		<=====		1,822 000 bpd
1992	1,251	325	38	0	118	19		<=====		1,751 000 bpd
1993	1,126	316	27	21	112	19	0	<=====		1,619 000 bpd
1994	1,024	305	22	97	97	18	9	<=====		1,572 000 bpd
Total Barrels:	4,465,457	983,919	111,941	42,857	282,405	40,899	3,463	<=====		5,930,941 000 Bbl. (Actual)

(1) Alaska Dept. of Natural Resources, "Historical and Projected Oil & Gas Consumption," January 1985, p. 13 (Table 2: Estimated Availability of N. Slope Oil For Sale).

(2) Alaska Dept. of Natural Resources, "Historical and Projected Oil & Gas Consumption," February 1995 (in press), (Table 3: Historical Oil Production).

Graph V.-1

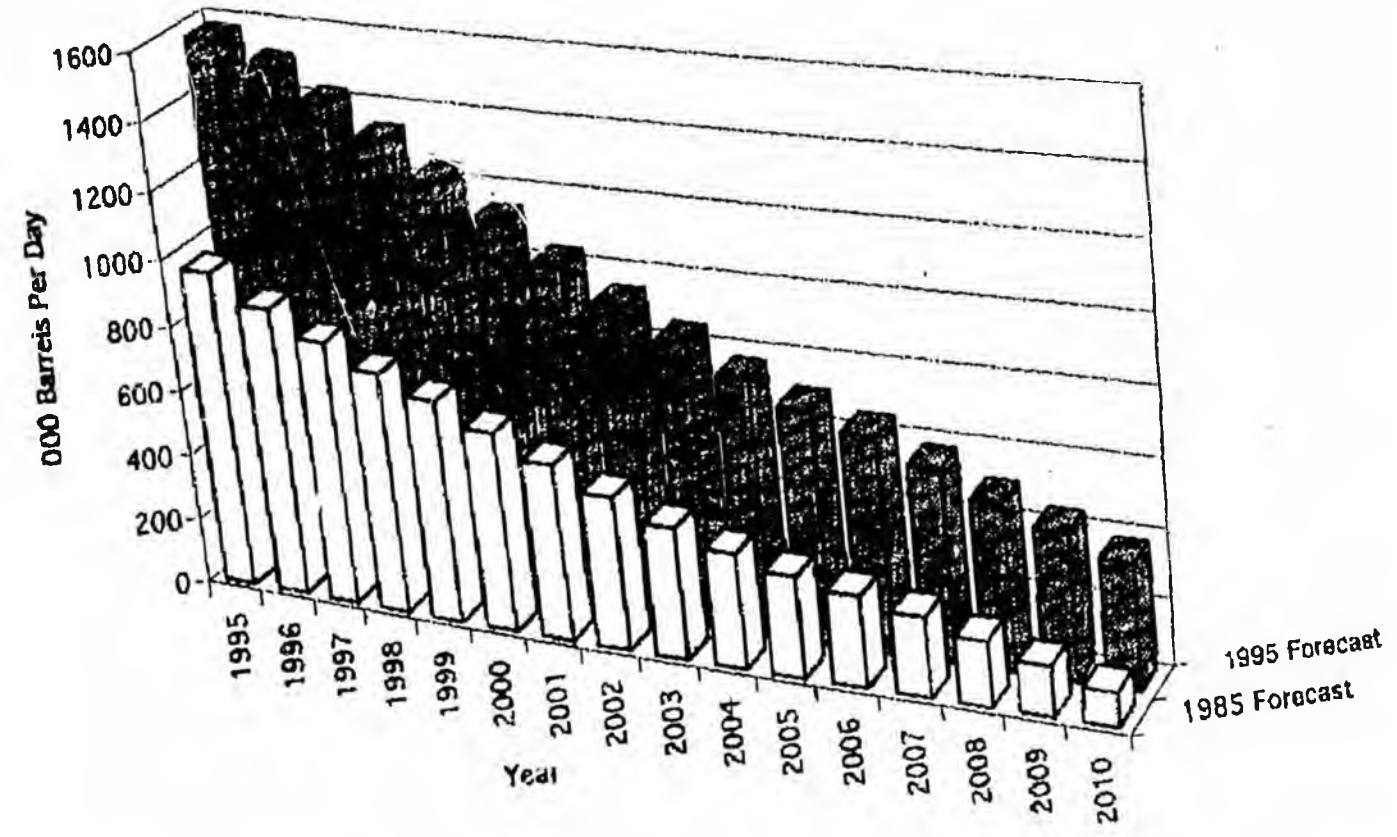
North Slope Production, 1986-1994: 1985 Forecast v. Actual



Source: Alaska Dept. of Natural Resources
(See Table V.-4)

Graph V.-2

North Slope Production Forecasts, 1995-2010 (1985 v. 1995 Forecast)



Source: Alaska Dept. of Natural Resources
(See Tables V.-1, V.-3)

EIID



BP EXPLORATION

BP Exploration (Alaska) Inc.
900 East Benson Boulevard
P.O. Box 196612
Anchorage, Alaska 99519-6612
(907) 561-5111

March 3, 1995

Mr. Richard Fineberg
P. O. Box 416
Ester, Alaska 99725

Dear Mr. Fineberg:

This letter is in response to your request during our telephone conversation of February 15th. that I confirm in writing that BP does not intend to respond to your last set of questions regarding the company's accounting for its Alaskan profits for the 1977-93 period.

The financial information included in John Morgan's "Open Letter to the People of Alaska" was derived from the published financial statements of the Standard Oil Company and the British Petroleum Company plc for the period 1977-93. It was necessary to restate some of these data because Sohio and BP's results from Alaska operations are not reported separately in the companies' published financial statements. For the most part this restatement involved the separate identification the profits, cash flow and tax payments associated with BP's share of TAPS and the separation of the companies' financial results from exploration and production in Alaska from those results in the rest of the world. This source data was derived in accordance with generally accepted accounting principles and we believe it provides a fair basis for comparison with the financial results of other enterprises.

We appreciate your interest in BP. However, we believe we have provided to you all the public information available to our investor and public constituencies and do not intend to provide additional information.

Sincerely,

A handwritten signature in cursive script, appearing to read 'Paul D. Wessells'.

Paul D. Wessells
Director of Tax

PDW/jp

cc: John Morgan
Jim Palmer

Testimony to the House Oil & Gas Committee on HB 207

Richard A. Fineberg
Research Associates
P.O. Box 416
Ester, Alaska 99725

March 15, 1995

A. A strong substantive case for easing the state's existing royalty relief provisions, as the Administration proposes in HB 207, has yet to be made.

At this point we appear to be making policy not on substantive information, but on empty rhetoric. Consider production trends and profitability.

1. Production Trends. On reviewing North Slope production forecasts for 1985, 1990 and 1995, a clear trend is evident: the North Slope production decline, although real, consistently plays out in a more benign manner than forecasted. If you compare 1985 forecasts to the current forecast through 2010, you will find that we now expect to produce 3.75 billion more barrels of oil through 2010 than forecasted in 1985. Put otherwise: Over the last ten years, the current tax and royalty regime has generated five years more of production at two million barrels per day than was forecasted in 1985. Every two years, we booked an additional year of forecasted production at TAPS' maximum throughput. This trend of increasing production (i.e., slowed decline in production) was established in the face of declining prices. Most importantly, the phenomenon of increasing production continues today, despite dire predictions by the industry in the late 1980's that we had seen the last of such increases.¹

2. Profitability. We are told repeatedly that "[t]he target is to get Arco Alaska and BP Exploration to divert exploration and production dollars from foreign areas and put them into marginal areas on the North Slope."² But the dialogue is bereft of facts. We are being asked to buy (or trade away) a pig in a poke. The economics of North Slope production are unique and dimly understood. Arco's North Slope profits are so unusual, in fact, that in considering the flight of domestic capital in 1991, a First Boston report isolated Arco's results from other companies in a separate box. In that same study, BP

¹ Based on Dept. of Natural Resources forecasts (see: Richard A. Fineberg, Alaska North Slope Production Prospects: Preliminary Analysis [a report prepared for the Northern Alaska Environmental Center, et al.], Feb. 22, 1995).

² "Tapping New Oil," Anchorage Times, March 2, 1995, p. B-7.

was alone among the internationals in bucking the trend of greater returns overseas than in the U.S.³ In Alaska, we just don't get it. Consider the color, front-page graph in the Anchorage Daily News last spring showing a slide in Arco Alaska's profits from \$700 million in 1990 to \$225 million in 1993. The graph excluded Arco's Alaska pipeline profits, estimated at over \$100 million per year. Even more important, the accompanying story failed to note that in 1993 Arco's Lower-48 and overseas production endeavors lost \$180 million. Far from being a millstone around Arco's neck, from this perspective Alaska appears to be Arco's lifeboat.

In fact, N. Slope profitability is apparently sufficient to induce the consistent production increases (i.e., slowed decline) identified above. But the public dialogue in this area is blunted because North Slope producers steadfastly refuse to disclose information that would justify its petition for royalty relief and other goodies.⁴

B. HB 207 contains serious structural defects

1. I believe that it is not wise to grant royalty reduction without providing for clear and unambiguous clarification on the public record of the necessity for that assistance. Instead of making the case for royalty relief public, the bill calls for the crucial information to be held confidential at the request of the lessee. In a 1992 decision, the Alaska judge who has probably reviewed more confidential oil industry documents than any other ruled that the producer's efforts to bar public access to documents batch-stamped "confidential" without review both unwarranted and contrary to the public interest.⁵ It has been clearly and convincingly documented in other North Slope revenue disputes that public policy evils flourish where confidentiality erodes the

³ First Boston Equity Research, "Assessing the Domestic Operations of International Oil Companies: Explaining the Exodus of Capital," September 5, 1991, pp. 2-13. (See Richard A. Fineberg, North Slope Profits and Production Prospects [prepared for the Alaska State Legislature], Nov. 12, 1991, pp. 25-27.)

⁴ Last May, in an "Open Letter to the People of Alaska" published in major Alaskan newspapers, BP Alaska President John Morgan stated that BP has paid more in taxes and royalties than it has taken out in profits or cash flow. This statement flies in the face of every public study of which I am aware. BP has refused repeated requests to put on the public record information that would substantiate its claim (see attached letters).

⁵ "Memorandum Opinion and Order No. 92-71 (Denying Motions by BP Exploration [Alaska], Inc. for Continued in camera Treatment of Certain Documents in Court Record)," ANS Royalty Litigation, 1JU 77-847 Civil, May 27, 1992 (19 pp.). The court specifically refused to hold material confidential merely at the request of the industry because "the public's right to know what the executive branch is about" outweighed the industry's speculative assertion of possible damage resulting from the release of information about its business.

checks and balances and balances that normally protect the public interest and keep the public process on a steady course.⁶

2. At this time the terms "economically feasible" and "commercially viable" are the subject of some dispute in the public policy arena, while the term "best interest" is, at best, an overly broad term.

3. In my estimation, no valid public purpose is served by granting relief without appealability.

C. The current approach to incentives is flawed.

In the policy arena, where the mission is to protect the public interest in both the revenue stream and the environment, industry desires must be balanced against these concerns. To do this, measures such as royalty relief should be viewed in their broad administrative and economic context. Two factors here are particularly worth noting: The companies that bid on these leases did so with the expectation that they would pay the nominal royalty they now wish to reduce. Second, producers look at the bottom line. To effect balanced public policy, it is necessary to consider measures such

⁶ In a current case whose very existence would be hidden from the public had Exxon Corp. not been required to make some documents public in the United States Tax Court, Exxon is asking for retroactive tax deductions that the Internal Revenue Service has said could ultimately be worth \$18 to 25 billion if applied to all North Slope producers. Exxon argues that ultimate abandonment of costs of Prudhoe Bay are deductible for federal tax years 1977 through 1984 under federal tax law because those claims are both knowable and fixed (United States Tax Court Dockets No. 18618-89 and 18432-90). In December 1994, the Alaska Oil & Gas Association recommended that the state should clarify what it might require for the abandonment of Prudhoe Bay. Ironically, Exxon was identified as the lead source for that recommendation ("AOGA Briefing Paper: Lease Closure," presented to Knowles-Timer Transition Team Dec. 28, 1994). The blatant contradiction between Exxon's position in separate arenas is indicative of the kind of shoddiness that takes place under the cloak of confidentiality.

A second example of public policy abuses flourishing behind the veil of confidentiality is the 1985 TAPS tariff settlement. Due to confidentiality, key elements of that sorry record were not available to the public until after the settlement had been formally approved. In one instance during the latter stages of the TAPS saga, the Governor was briefed on an erroneous document that was subsequently removed from files and replaced with an altered document, in apparent violation of Alaska statutes. (See Richard A. Fineberg, The 1985 TAPS Settlement: A Case Study in the Effects of Confidentiality on Information Available to Decision Makers in Oil and Gas Revenue Disputes (prepared for the Alaska State Legislature), Feb. 5, 1990), pp. 30-36. For a later study of a TAPS settlement defect with enormous state and federal revenue consequences that was mis-stated and consequently overlooked during the flawed 1985 settlement review process, see Richard A. Fineberg, Hidden Billions: The TAPS DR&R Provision (report prepared for Sam Stephens, Valdez, Alaska), August 21, 1992.

as royalty relief in the context of the tax and pipeline regulatory regimes, where powerful incentives for development of marginal fields already exist.

In the tax regime, Milne Point, Niakuk, Lisburne and several satellite fields are already virtually exempt from production taxes at current prices, thanks to the working of the modified Economic Limit Factor (ELF) the industry so staunchly opposed in 1989.

Regarding pipelines: There was discussion in committee Wednesday of BP's success at Milne Point without royalty relief. One might ask, why is BP increasing production at Milne Point when Conoco (who traded the property to BP in 1993) apparently could not make a go of it? The most obvious difference between the two companies is this: Conoco was the lone North Slope field operator that did not share ownership of TAPS. Consequently, Conoco paid BP approximately \$1.00 per barrel in pipeline profits for every barrel of oil that it produced. While discussion of pipeline economics is beyond the scope of this hearing, I submit that one of the most important factors affecting North Slope development may be the control and operation of TAPS.

D. Concluding Remarks

It is self-evident that any bill that increases industry revenue at the expense of the State Treasury will tend to stimulate production. The industry will, of course, advocate such a measure. But even if the rather astounding provision that automatically grants confidentiality at lessee (producer) request were removed or replaced with language that guarantees public access to information necessary to evaluation of public policy, it remains to be demonstrated that this legislation is necessary, or that it reflects the wise stewardship of public resources mandated by the Alaska Constitution.

In view of the well-documented history of abuses of confidentiality that have found their way into the public record, it makes little sense to allow the lessees, at their own initiative, to prevent these materials from seeing the light of day.⁷ Were that defect corrected, the case for the proposed incentives would have yet to be made.

⁷ As the U.S. Supreme Court has observed, "People do not demand infallibility from their institutions, but it is difficult for them to accept what they are prohibited from observing." (*Richmond Newspapers, Inc. v. Virginia*, 448 U.S. 555, 572 [1980]; quoted in Memorandum 92-71, *op. cit.*, cover page). To accomplish his well-intentioned desire to reduce needless litigation, the Governor might consider introducing legislation that puts more information on the public record — not less.

From the desk of

Richard A. Fineberg
Ester, Alaska 99725

P.O. Box 416
Phone / Fax (907) 479-7778

Return Receipt Requested

January 17, 1995

John C. Morgan, President
BP Exploration
P.O. Box 196612
900 E. Benson Blvd.
Anchorage, Alaska 99519-6612

[COPY]

Dear Mr. Morgan:

More than seven months after I wrote you concerning assertions about North Slope profits you published in various Alaska newspapers in a May 12 "Open Letter to the People of Alaska," I am still waiting for substantive reply. In that open letter, you stated:

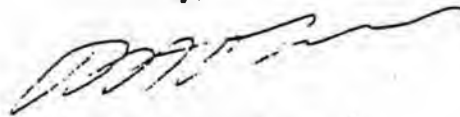
BP has paid \$20 billion to the state in taxes and royalties since 1977. This exceeds our total profits and cash flow from Alaska for the period.

Your statement appears to contradict all systematic published analyses of North Slope profitability of which I am aware.¹ I therefore asked you May 14 to document your claim. To help identify the differences in existing estimates, I submitted my year-by-year breakdown of estimated production and pipeline profits and a line-by-line worksheet establishing the basis for my most recent (1993) profit estimates. I requested your equivalent figures, as well as your analysis of the significant differences.

You responded July 14 with a short letter repeating that BP paid more in taxes and royalties than it earned in Alaska from 1977 through 1993. You lowered your estimated state taxes and royalty payments to \$19.3 billion, which you compared to "after tax book income for Alaska in 1977-93" of \$17.6 billion. You also stated that BP disagrees with my figures and those of a 1989 profitability study by Edward Deakin, C.P.A., then Price-Waterhouse Professor of Petroleum Accounting, University of Texas. For the second time, on July 25 I requested substantive information, noting that your letter did not provide documentation for your revised numbers or deal with the specific differences between your figures and the two tables I had presented. I received no response.

Careful analysis indicates that the North Slope continues to be one of the most profitable industrial ventures in the United States. Following my letters of May 14 and July 25, 1994, again I ask your cooperation in providing the public with accurate, sourceable data capable of supporting intelligent public policy debate on North Slope development policy.

Sincerely,



Richard A. Fineberg

¹ For example: Deakin (1989), *Oil Industry Profitability in Alaska, 1969...1987*, p.2 (1969-87 industry profit \$42.6 billion, state share \$29.3 billion); Legislative Research Agency (1993), *Distribution of Income from Alaska Oil and Gas Operations...*, p. 14 (1985 industry net income \$5.6 billion, state net revenue \$3.3 billion); Fineberg (1992), p. 43, *Alaska North Slope Oil Profits...* (1991 West Coast industry profits \$4.95 per barrel, state share \$3.82); Wilson-Gillette (1994), *Consequences of Exporting Alaska Crude Oil*, p. 36 (April 1994 West Coast major field wellhead profits \$2.66 per barrel, state share \$2.63 [excludes estimated TAPS industry profits of \$1.00 per barrel v. state taxes of approximately \$0.30]).

Testimony to the House Finance Committee on CSHB 207(RES)

Richard A. Fineberg
Research Associates
P.O. Box 416
Ester, Alaska 99725

April 5, 1995

A. A strong substantive case for easing the state's existing royalty relief provisions, as proposed in all versions of HB 207 to date, has yet to be made.

1. Production Trends. On reviewing state North Slope production forecasts for 1985, 1990 and 1995, a clear trend is evident: the North Slope production decline, although real, consistently plays out in a more benign manner than forecasted. Comparing 1985 forecasts to the current forecast through 2010, you will find that we now expect to produce 3.75 billion more barrels of oil through 2010 than forecasted in 1985. Put otherwise: Over the last ten years, the current tax and royalty regime has generated five years more of production at two million barrels per day than was forecasted in 1985. Every two years, we booked an additional year of forecasted production at TAPS' maximum throughput. This trend of increasing production (i.e., slowed decline in production) was established under the current tax and royalty regime and in the face of declining prices. This phenomenon of increasing production continues today, despite dire predictions by the industry in the late 1980's that we had seen the last of such increases.¹

2. Comments on Production Trends. Reviewing the data presented above, one analyst commented that these data suggest that "[forecasters tend] to under-forecast production from large, well-known fields and overestimate the production from smaller or undeveloped fields."² The commentator looked only at historical data; to extrapolate from past data alone may over-weight the assumption that the future will be like the past. Because long-range forecasting is a risky business (that's one of the reasons forecasters tend to build in conservatism), I shortened my time-frame to consider production forecast totals through the year 2000. Regrouped Table 1-A, attached, covers 1985 through 2000

¹ See attached tables V-1 through V-4 and graphs V-1 through V-4 summarizing Dept. of Natural Resources forecasts (Richard A. Fineberg, Alaska North Slope Production Prospects: Preliminary Analysis [a report prepared for the Northern Alaska Environmental Center, et al.], Feb. 22, 1995).

² Alaska Budget Report, 3/22/95, pp. 3-4.

and suggests that state forecasters tend to under-forecast production from producing fields but over-estimate production from some undiscovered or undeveloped fields. The regrouped analysis indicates that of the five major fields producing now that were recognized in 1985, four showed increases in real and forecasted production, while only one — Lisburne — showed decline. Another significant point emerges from the regrouping: The overestimation of undeveloped fields for this period was almost balanced by the underestimation of Pt. McIntyre, which was developed without royalty relief. This discussion indicates the importance of choosing carefully the parameters of analysis. For example, I chose 1985, 1990 and 1995 for forecast analysis because it gave me two completed five-year blocks of production data, starting with the last year before oil prices crash. If a strong, substantive case for royalty relief is to be made, I believe these basic data indicate that a much closer look should be taken at the potential production and revenue effects of royalty relief on specific prospects such as Badami, North Star and West Sak .

3. Profitability. We are told repeatedly that "[t]he target is to get Arco Alaska and BP Exploration to divert exploration and production dollars from foreign areas and put them into marginal areas on the North Slope."³ This dialogue is wierdly bereft of facts. Alaska's interaction with its meal-ticket and the economics of North Slope production are unique and dimly understood. Arco's North Slope profits are so unusual, in fact, that in considering the flight of domestic capital in 1991, a First Boston report isolated Arco's results from other companies in a separate box. In that same study, BP was alone among the internationals in bucking the trend of greater returns overseas than in the U.S.⁴ In Alaska, we just don't get it. Consider the big, front-page presentation in the Anchorage Daily News last spring, one of many on the hard times theme. That one had a color graph showing a slide in Arco Alaska's profits from \$700 million in 1990 to \$225 million in 1993. The graph excluded Arco's Alaska pipeline profits, estimated at over \$100 million per year. Even more important, the story failed to note that in 1993 Arco's Lower-48 and overseas production endeavors lost \$180 million. Far from being a millstone around Arco's neck, from this perspective Alaska appears to be Arco's lifeboat.

³ "Tapping New Oil," Anchorage Times, March 2, 1995, p. B-7.

⁴ First Boston Equity Research, "Assessing the Domestic Operations of International Oil Companies: Explaining the Exodus of Capital," September 5, 1991, pp. 2-13. (See Richard A. Fineberg, North Slope Profits and Production Prospects [prepared for the Alaska State Legislature], Nov. 12, 1992, pp. 25-27.)

In fact, N. Slope profitability is apparently sufficient to induce the consistent production increases (i.e., slowed decline) identified above. But the public dialogue in this area is blunted because North Slope producers steadfastly refuse to disclose information that would justify its position.⁵

B. HB 207 contains serious structural defects

I believe it is unwise to grant royalty reduction without providing for clear and unambiguous clarification on the public record of the necessity for that assistance. Instead, CSHB 207 (RES) deliberately shields the actions of the Commissioner of Natural Resources from the public review that normally safeguards the public interest provisions giving the Commissioner of Natural Resources new powers to grant royalty relief that are ill-conceived and unprecedented. It has been clearly and convincingly documented in other North Slope revenue disputes that public policy evils flourish where confidentiality erodes the checks and balances and balances that normally protect the public interest and keep the public process on a steady course.⁶

⁵ Last May, in an "Open Letter to the People of Alaska" published in major Alaskan newspapers, BP Alaska President John Morgan stated that BP has paid more in taxes and royalties than it has taken out in profits or cash flow. This statement flies in the face of every public study of which I am aware. BP has refused repeated requests to put on the public record information that would substantiate its claim. (See attached correspondence; in 1992 and again in 1993, the importance of BP's refusal to provide clear public data on its North Slope operations were clearly delineated for the Legislature in my 1992 report, North Slope Profits and Production Prospects [prepared under contract to the Senate Finance Committee], Nov. 12, 1992, and by the Legislative Research Agency, Distribution of Income from Alaska Oil and Gas Operations . . . [Report No. 93.001], Sept. 15, 1993.)

⁶ In a current case whose very existence would be hidden from the public had Exxon Corp. not been required to make some documents public in the United States Tax Court, Exxon is asking for retroactive tax deductions that the Internal Revenue Service has said could ultimately be worth \$18 to 25 billion if applied to all North Slope producers. Exxon argues that ultimate abandonment of costs of Prudhoe Bay are deductible for federal tax years 1977 through 1984 under federal tax law because those claims are both knowable and fixed (United States Tax Court Dockets No. 18618-89 and 18432-90). In December 1994, the Alaska Oil & Gas Association recommended that the state should clarify what it might require for the abandonment of Prudhoe Bay. Ironically, Exxon was identified as the lead source for that recommendation ("AOGA Briefing Paper: Lease Closure," presented to Knowles-Ulmer Transition Team Dec. 28, 1994). The blatant contradiction between Exxon's position in separate arenas is indicative of the kind of games that takes place under the cloak of confidentiality.

A second example of public policy abuses flourishing behind the veil of confidentiality is the 1985 TAPS tariff settlement. Due to confidentiality, key elements of that sorry record were not available to the public until after the settlement had been formally approved. In one instance during the latter stages of the TAPS saga, the Governor was briefed on an erroneous document that was subsequently removed from files and replaced with an altered document, in apparent violation of Alaska statutes. (See Richard A. Fineberg, The 1985 TAPS Settlement: A Case Study in the Effects of Confidentiality on Information Available to Decision Makers in Oil and Gas Revenue Disputes (prepared for the Alaska State Legislature), Feb. 5, 1990), pp. 30-36. For a later study of a TAPS settlement defect with enormous state and federal revenue consequences that was mis-stated and consequently overlooked during the flawed 1985 settlement review process, see Richard A. Fineberg,

1. Procedures for Royalty Relief Should Be Clearly Framed and the Need for Royalty Relief Should Be Clear to the Owners of the Resource. (CSHB 207[RES] Page 2, line 1.) Particularly in view of the production trends discussed above and the fact that industry statements about profitability fly in the face of every published report of which I am aware,⁷ the process, the criteria and the case for royalty relief should be clearly defined and the case should be part of the public record. This bill does the opposite. For example, where the existing statute requires regulations to make procedures clear, this bill removes that requirement.

2. Economic Considerations Should Include Analysis of Pipeline Profits. (CSHB 207[RES], Page 3, lines 2-7.) This bill mandates consideration of factors such as capital investment in the field but may be read to exclude investment in pipelines, which are a major factor affecting both the development of new fields and the continued production in existing fields. Moreover, guaranteed profits to the pipeline owners are a significant factor influencing production decisions that this language arguably requires the Commissioner to ignore. You may choose to ignore this important aspect of North Slope production economics; prospective producers will not.

3. Blanket Confidentiality. (CSHB 207[RES], Page 3, lines 23-24.) The requirement that the Commissioner shall hold application material confidential at industry request contravenes the state's sunshine laws, common sense and jurisprudence. The Alaska judge who has probably reviewed more oil industry documents than any other has ruled against blanket grants of confidentiality on industry request. In view of the clearly established right of the public to know what its officials are doing, he said, the industry should make a showing that it is

Hidden Billions: The TAPS DR&R Provision (report prepared for Stan Stephens, Valdez, Alaska), August 21, 1992.

⁷ See: Deakin (1989), Oil Industry Profitability in Alaska, 1969 through 1987, p.2 (industry profit \$42.6 billion, state share \$29.3 billion); Legislative Research Agency (1993), Distribution of Income from Alaska Oil and Gas Operations . . . , p. 14 (1985 industry net income \$5.6 billion, 1985 state net revenue \$3.3 billion); Fineberg (1992), p. 43, Alaska North Slope Oil Profits . . . (1991 West Coast industry profits \$4.95 per barrel, state share \$3.82); Wilson-Gillette (1994), Consequences of Exporting Alaska Crude Oil, p. 36 (April 1994 West Coast major field wellhead profits \$2.66 per barrel, state share \$2.63 per barrel [excludes estimated TAPS industry profits of \$1.00 per barrel v. state taxes of approximately \$0.30 per barrel]).

necessary to hold documents confidential.⁸ As recently as 1990, after careful review in three committees and despite strong industry opposition, the Alaska State House voted unanimously to prohibit oil and gas settlements from extending confidentiality beyond that already required by law.⁹ This bill reverses both precedents.

4. Contractor Analysis. (CSHB 207[RES], Page 3, line 25 through Page 4, line 1.) Apparently throwing in the towel on a 20-year endeavor to attain the expertise in the state system to protect the public interest in the inevitable dialogue between the industry and the stewards of the public interest, this bill sets up an unprecedented system in which the Commissioner will rely instead on a contractor to the industry.

5. Judicial Review. (CSHB 207[RES], Page 4, line 31 through Page 5, line 1.) It is easy to see why the industry would like to remove judicial review; in view of the long history of increased revenues the state has obtained through the courts, one wonders why the stewards of public resources would recommend this course of action.

C. The current approach to incentives is flawed.

In the policy arena, where the mission is to protect the public interest in both the revenue stream and the environment, industry desires must be balanced against these concerns. It is self-evident that any bill that increases industry revenue at the expense of the State Treasury will tend to stimulate production. The industry will, of course, advocate such a measure. But even if the startling provision that automatically grants confidentiality at lessee (producer) request were removed or replaced with language

⁸ The court specifically refused to hold material confidential merely at the request of the industry, without a showing for the need for confidentiality, because "the public's right to know what the executive branch is about" outweighed the industry's speculative assertion of possible damage resulting from the release of information about its business. "Memorandum Opinion and Order No. 92-71 (Denying Motions by BP Exploration [Alaska], Inc. for Continued in camera Treatment of Certain Documents in Court Record)," ANS Royalty Litigation, 1JU-77-847 Civil, May 27, 1992 (19 pp.). The judge reaffirmed that order last month. "Order [Denying Motions to File Documents Under Seal]", ANS Royalty Litigation, 1JU-77-847 Civil, March 20, 1995.

⁹ HB 541, 1990. Majority and minority members of the current House Finance Committee voted for the provision limiting settlement confidentiality.

that guarantees public access to information necessary to evaluation of public policy, it remains to be demonstrated that this legislation is necessary, or that it reflects the wise stewardship of public resources mandated by the Alaska Constitution. In view of the well-documented history of abuses of confidentiality that have found their way into the public record, it makes little sense to allow the lessees, at their own initiative, to prevent these materials from seeing the light of day.¹⁰

Even if the defects discussed above were corrected, the case for the proposed incentives would have yet to be made.

¹⁰ As the U.S. Supreme Court has observed, "People do not demand infallibility from their institutions, but it is difficult for them to accept what they are prohibited from observing." (Richmond Newspapers, Inc. v. Virginia, 448 U.S. 555, 572 [1980]; quoted in Memorandum 92-71, op. cit., cover page). To accomplish the Governor's well-intentioned desire to reduce needless litigation, the Legislature might consider introducing legislation that puts more information on the public record — not less.

Table Y-1.

Research Associates 2/95

1985 Production Forecast for 1995-2010 (Alaska Dept. of Natural Resources)

(000 bbls)

000 Barrels per day:

Year	Field \geq	Pridmore	Kuparuk	Lisburne	Pt. McIntyre	Endicott	Milne Pt.	Other	W.Sak	Beaufort	Total
1995		575	145	65		70	10	100	<=====		965 000 bpd
1996		510	120	60		65	0	125	<=====		880 "
1997		460	100	55		60		125	<=====		800 "
1998		420	80	50		55		125	<=====		730 "
1999		380	75	40		50		125	<=====		670 "
2000		340	65	30		45		120	<=====		600 "
2001		300	55	20		40		115	<=====		530 "
2002		270	50	10		20		110	<=====		460 "
2003		240	40	0		10		105	<=====		395 "
2004		210	35			0		100	<=====		345 "
2005		180	30					95	<=====		305 "
2006		160	25					90	<=====		275 "
2007		140	20					80	<=====		240 "
2008		110	15					70	<=====		195 "
2009		80	10					60	<=====		150 "
2010		50	0					50	<=====		100 "
Total Barrels:		1,615,125	315,725	120,450	0	151,475	3,650	582,175	<=====		2,788,600 (000 bbls.)

Source: Alaska Dept. of Natural Resources, "Historical and Projected Oil & Gas Consumption," January 1985, p. 13 (Table 2.2: Estimated Availability of N. Slope Oil For Sale).

Table V-2.

1990 Production Forecast for 1995-2010 (Alaska Dept. of Natural Resources)
(000 bbls)

<i>(000 Barrels per day)</i>											
Year	Field =>	Pudhoe	Kuparuk	Lisburne	Pt. McIntyre	Endicott	Milne Pt.	Niakuk	W. Sak	Beaufort	Total
1995		857	190	37	60	65	10	20	12		1,251 000 bpd
1996		789	175	34	54	60	8	17	12		1,149 "
1997		726	150	31	49	55	7	14	25		1,057 "
1998		668	125	28	44	50	6	12	25		958 "
1999		614	105	25	39	45	5	10	50	0	893 "
2000		553	90	21	35	40	5	9	50	60	863 "
2001		498	75	19	32	20	5	7	75	54	785 "
2002		418	65	13	29	10	0	6	75	49	695 "
2003		403	55	9	26	0		5	100	44	612 "
2004		363	45	5	23			5	100	39	580 "
2005		326	35	0	21			0	150	35	567 "
2006		284	30		19				150	32	515 "
2007		247	25		17				150	29	468 "
2008		215	20		15				150	26	426 "
2009		187	15		14				140	23	379 "
2010		163	10		12				120	21	326 "
Total Barrels:		2,679,465	441,650	81,030	178,485	125,925	16,790	38,325	505,160	150,380	4,217,210 (000 bbls.)

Source: Alaska Dept. of Natural Resources, "Historical and Projected Oil & Gas Consumption," January 1990, p. 10 (Table 2.2: Production Forecast and Available Royalty Oil).

Table Y-3.

Research Associates 2/95

1995 Production Forecast for 1995-2010 (Alaska Dept. of Natural Resources)
(000 bbls)

000 Barrels per day:

Year	Eldredge	Prudhoe	Kuparuk	Lisburne	Pt McIntyre	Endicott	Milne Pt.	Other	W.Sak	Beaufort	Total
1995		980	310	20	115	94	30	23		0	1,572 000 bpd
1996		921	305	20	115	83	40	23			1,507 "
1997		857	300	20	109	72	40	22			1,420 "
1998		788	300	18	98	63	45	22			1,334 "
1999		717	295	15	88	55	50	19	0		1,239 "
2000		646	285	13	79	47	45	16	6		1,137 "
2001		581	256	10	71	40	40	14	21		1,033 "
2002		523	231	10	64	34	36	11	27		936 "
2003		471	208	10	61	29	33	10	25		847 "
2004		423	187	10	54	24	30	9	26		763 "
2005		381	168	10	46	21	27	7	35		695 "
2006		343	143	10	39	18	24	6	59		612 "
2007		309	122	9	33	16	20	5	58		572 "
2008		278	103	8	28	13	17		49		496 "
2009		250	88	7	24	10	15		41		435 "
2010		225	75	6	21		12		35		374 "
Total Barrels:		3,172,945	1,232,240	71,540	381,425	225,935	183,960	68,255	139,430	0	5,475,730 (000 bbls.)

Source: Alaska Dept. of Natural Resources, "Historical and Projected Oil & Gas Consumption," February 1995 (in press). (Table 2A: Estimated Availability of N. Slope Oil For Sale).

Table V-4.

Research Associates 2/95

1985 North Slope Production Forecast for 1986-94 v. Actual Production (ADNR)

(000 Barrels)

1985 Production Forecast (1)

Barrels per day:

Field:	Prudhoe	Kuparuk	Lisburne	Pt McIntyre	Endicott	Milne Pt.	Other	W.Sak.	Beaufort	Total	
1986	1,500	180	0	0	0	0	0	<=====		1,680	000 bpd
1987	1,475	180	75		0	30	30	<=====		1,790	000 bpd
1988	1,325	200	100		50	30	30	<=====		1,735	000 bpd
1989	1,175	200	120		100	25	50	<=====		1,670	000 bpd
1990	1,050	200	120		100	20	50	<=====		1,510	000 bpd
1991	950		120		100	15	50	<=====		1,435	000 bpd
1992	850		90		100	15	50	<=====		1,305	000 bpd
1993	750	200	75		85	10	50	<=====		1,170	000 bpd
1994	650	170	70		75	10	50	<=====		1,025	000 bpd
Total Barrels:	3,519,625	631,450	281,050	0	222,650	56,575	131,400	<=====		4,872,750	000 Bbl. (Forecast)

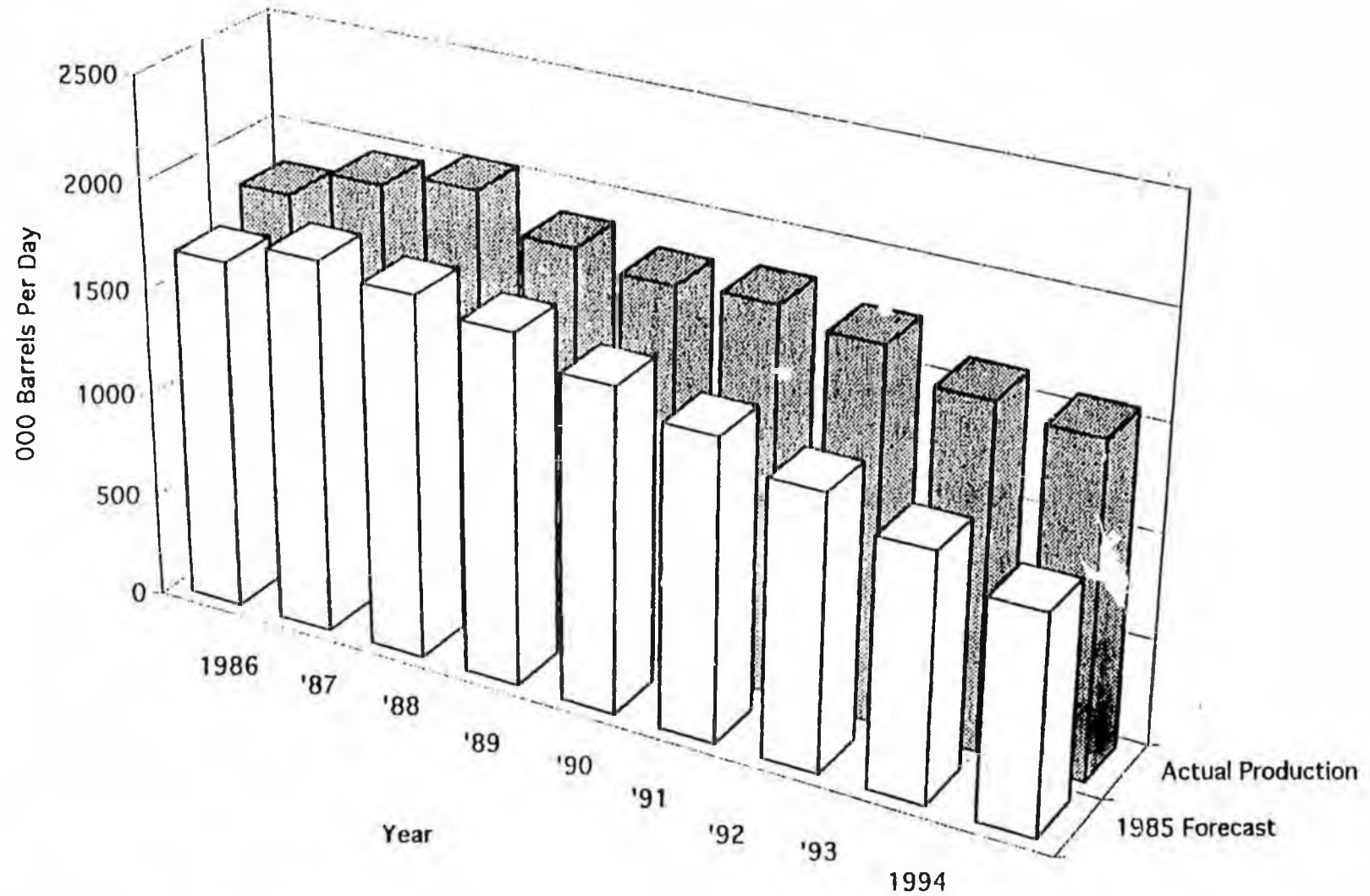
Actual Production (2)

Field:	Prudhoe	Kuparuk	Lisburne	Pt McIntyre	Endicott	Milne Pt.	Other	W.Sak.	Beaufort	Total	
1986	1,539	260	10		0	13		<=====		1,822	000 bpd
1987	1,608	284	46		24	0		<=====		1,962	000 bpd
1988	1,585	304	40		103	0		<=====		2,033	000 bpd
1989	1,427	297	41		98	5		<=====		1,868	000 bpd
1990	1,340	294	43		106	18		<=====		1,801	000 bpd
1991	1,333	311	40		117	20		<=====		1,822	000 bpd
1992	1,251	325	38	0	118	19		<=====		1,751	000 bpd
1993	1,126	316	27	21	112	19	0	<=====		1,619	000 bpd
1994	1,024	305	22	97	97	18	9	<=====		1,572	000 bpd
Total Barrels:	4,465,457	983,919	111,941	42,857	282,405	40,899	3,463	<=====		5,930,941	000 Bbl. (Actual)

(1) Alaska Dept. of Natural Resources, "Historical and Projected Oil & Gas Consumption," January 1985, p. 13 (Table 2.2: Estimated Availability of N. Slope Oil For Sale).

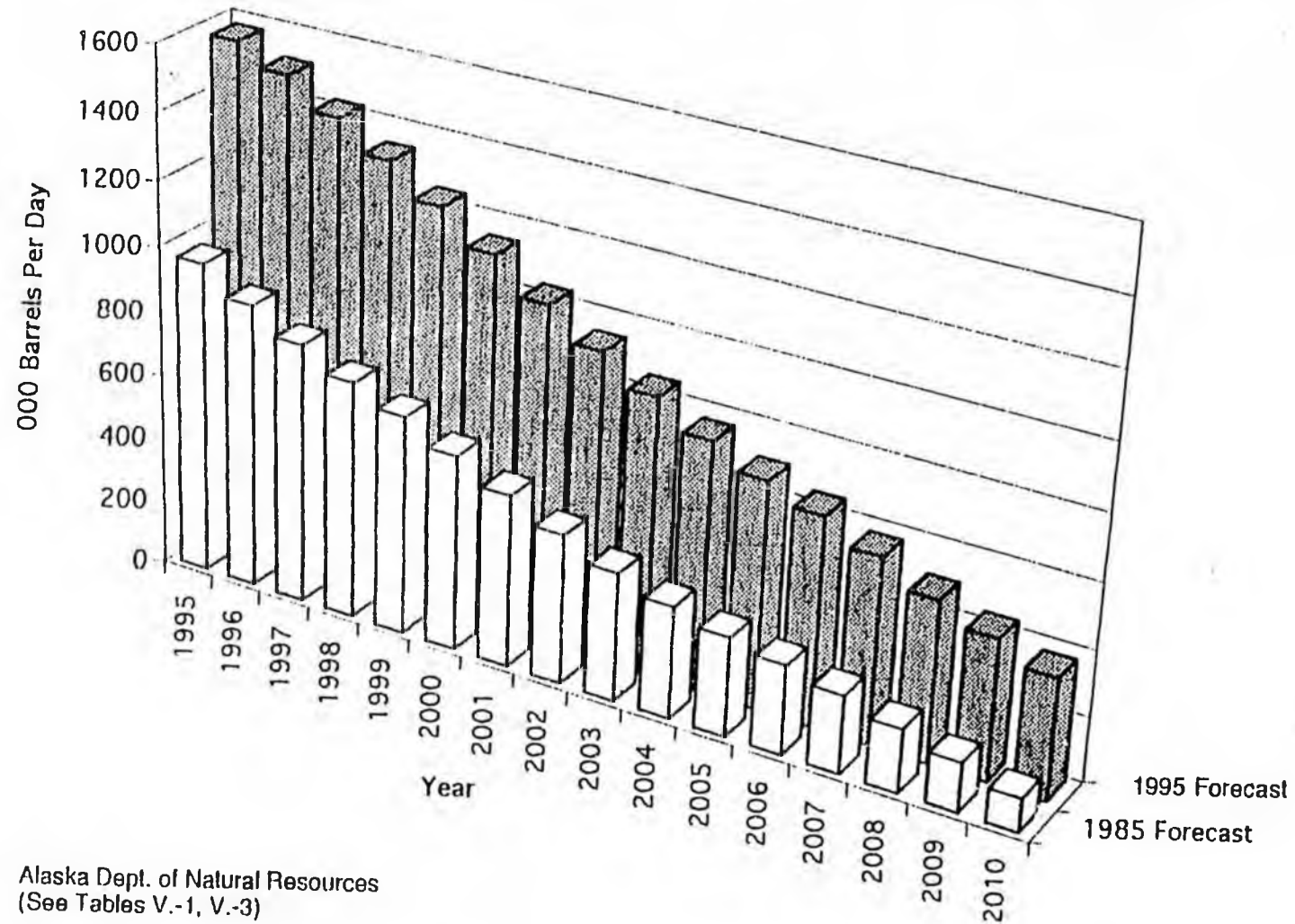
(2) Alaska Dept. of Natural Resources, "Historical and Projected Oil & Gas Consumption," February 1995 (in press), (Table 3: Historical Oil Production).

North Slope Production, 1986-1994: 1985 Forecast v. Actual



Source: Alaska Dept. of Natural Resources
(See Table V.-4)

North Slope Production Forecasts, 1995-2010 (1985 v. 1995 Forecast)



Source: Alaska Dept. of Natural Resources
(See Tables V.-1, V.-3)

[Rev.]

Regrouped Analysis of 1985 and 1995 DNR Production Forecasts for 1986-2000

Fields	(A)	(B)	(C)	(D)	(E)
	000 barrels			Percent (rounded)	
	1985 Forecast	1986-94 Actual + 1995 Forecast for 1995-2000	Net Change (Col. [B] - Col. [A])	Contribution to Forecast change	Col. (C) as % of Col. (A)
Prudhoe & Kuparuk	5,374,625	7,896,276	2,521,651	106.9%	46.9%
Other Fields:					
Endicott	348,575	433,515	84,940	3.6%	24.4%
Milne Pt.	60,225	132,149	71,924	3.0%	119.4%
Pt. McIntyre	0	263,317	263,317	11.2%	n.a.
Lisburne	390,550	150,631	(239,919)	(10.2%)	(61.4%)
Other*	394,200	51,278	(342,922)	(14.5%)	(87.0%)
Total Barrels, 1985-2000	6,568,175	8,927,166	2,358,991	100.0%	35.9%

* Niakuk, W. Sak and Beaufort Sea included in this category.

From: Department of Natural Resources, Historical and Projected Oil & Gas Consumption, 1985 and 1995
(Reprinted in Alaska North Slope Production Prospects: Preliminary Analysis)

3/27/95 Table 1

[Rev.]

Research Associates 3/27/95

Analysis of 1985 and 1995 DNR Production Forecasts for 1986-2000

	(A)	(B)	(C)	(D)	(E)
	000 barrels			Percent (rounded)	
<i>Fields</i>	<i>1985 Forecast</i>	<i>1986-94 Actual + 1995 Forecast for 1995-2000</i>	<i>Net Change (Col. [B] - Col. [A])</i>	<i>Contribution to Forecast change</i>	<i>Col. (C) as % of Col. (A)</i>
Prudhoe & Kuparuk	5,374,625	7,896,276	2,521,651	106.9%	46.9%
Lisb., Pt. McInt., Endcrt., M. Pt.	799,350	979,612	180,262	7.6%	22.6%
Unidentified*	394,200	51,278	(342,922)	(14.5%)	(87.0%)
Total Barrels, 1985-2000	6,568,175	8,927,166	2,358,991	100.0%	35.9%

* Niakuk, W. Sak and Beaufort Sea included in this category.

From: Department of Natural Resources, Historical and Projected Oil & Gas Consumption, 1985 and 1995
(Reprinted in Alaska North Slope Production Prospects: Preliminary Analysis)