

HB

325

SFIN

FILE

SENATE FINANCE COMMITTEE

HB 325 NORTH SLOPE HEAVY OIL ROYALTY MODIFICATION

PLEASE SIGN-IN BELOW

NAME: Joe Green - SPONSOR

Co./Dept/Title: _____ Phone: _____

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond to Questions

NAME: Ed Behm

Co./Dept/Title: CXY Heavy Oil Team Leader Phone: 915 685-5693

Address: Box 50250 Midland Texas Zip: 79120

Do you wish to testify? Yes No Respond to Questions

NAME: KEN BURKE

Co./Dept/Title: General Manager The Alliance Phone: 907-563-2226

Address: 4220 B St. Sitka Alaska Zip: 99703

Do you wish to testify? Yes No Respond to Questions

NAME: Buzz Otis

Co./Dept/Title: Pres. Great Northwest Inc Phone: 452-5617

Address: PO Box 74646 Fairbanks AK Zip: 99707

Do you wish to testify? Yes No Respond to Questions

NAME: _____
Co./Dept/Title: _____ Phone: _____
Address: _____ Zip: _____
Do you wish to testify? ___Yes ___No ___Respond to Questions

NAME: KEVIN BOYD
Co./Dept/Title: DIRECTOR - OIC of GAS Phone: 269-8800
Address: _____ Zip: _____
Do you wish to testify? Yes ___No Respond to Questions

NAME: _____
Co./Dept/Title _____ Phone: _____
Address: _____ Zip: _____
Do you wish to testify? ___Yes ___No ___Respond to Questions

NAME: _____
Co./Dept/Title: _____ Phone: _____
Address: _____ Zip: _____
Do you wish to testify? ___Yes ___No ___Respond to Questions

NAME: _____
Co./Dept/Title: _____ Phone: _____
Address: _____ Zip: _____
Do you wish to testify? ___Yes ___No ___Respond to Questions

HB 325

Mike Bruner
341 E. 23 rd Ave
Anch.. Ak. 99503

4/28/96

Dear Legislator:

Does the Northstar legislation resemble the Teapot Dome oil scandal?

From: The Worldbook Encyclopedia 1996, "Teapot Dome was one of the most notorious government scandals in United States history. It occurred in the Administration of President Warren G. Harding and contributed to his low standing among U.S. Presidents.

Committees of the U.S. Senate and a special commission investigated the scandal from 1922 to 1928. The investigators found that Secretary of the Interior Albert B. Fall had persuaded Harding to transfer control of three naval oil reserves from the Navy Department to the Department of the Interior in 1921. Fall leased the reserves, at Elk Hills, Calif., and Teapot Dome, Wyo., mostly *without competitive bidding* to the private oil companies of Edward L. Doheny and Harry F. Sinclair in 1922. For helping to arrange the Elk Hills transfer, Fall received a "loan" of \$100,000 from Doheny. For the Teapot Dome transfer, Fall received more than \$300,000 in cash, bonds, and valuable livestock from Sinclair. Fall resigned in 1923 and joined Sinclair's oil business.

In 1927, the government successfully sued to cancel the leases. In 1929, Fall was convicted of accepting a bribe, fined \$100,000, and sentenced to a year in prison. He was the first Cabinet member ever to go to jail for crimes committed while in office." end of quotation.

Facts and history: the Northstar oil leases were competitively leased between 1979 and 1983. The leases were set up with fixed cash bonuses of \$875 per acre, \$3 million per lease or \$15 million was required for all the leases as a fixed bid bonus. The sole competitive bid variable was how much the winning bidder was willing to give the state. The winning bidders agreed to give this state an average of 90% of the net profits from the Northstar oil field. One year ago British Petroleum entered into the contract with the state when it acquired the leases from Amerada Hess.

Some direct quotes from the Senate Resources Committee Substitute for SB 318 (Northstar Lease Amendment) : BP Exploration (Alaska) Inc's, president Mr. Morgan, has testified, "In making that acquisition [purchase of the Northstar leases] we did understand and it was clear to us that the issue of net profit leases presented a problem, and a problem would need to be overcome with the state if development was to proceed." (Page 5 draft). "Both BP Exploration (Alaska) Inc.'s President, Mr. Morgan, and Department of Natural Resources Commissioner Shively have testified that at sometime between January and April 1995, *before the Department of Natural Resources' approval of BP Exploration (Alaska) Inc.'s revised Plan of Development and extension for the Northstar Unit, BP Exploration (Alaska) Inc. approached the administration, asking that it support the incorporation of provisions that would allow the commissioner of the Department of Natural Resources to modify net profit share terms of oil and gas leases in the royalty modification legislation that the administration had requested last session (HB 207).*" (Page 11 draft). However, under

the bill, this strategy only works if the oil company shows clear and convincing evidence that development would be uneconomically feasible. "According to BP Exploration (Alaska) Inc.'s President, Mr. Morgan, "We have never argued that development of Northstar could not be profitable under the terms including the net profit arrangements. In profitability in terms of return on capital, this would be possible. This is not a marginal oil field." (Page 8 draft). BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has testified " ... that with the net profit arrangement in place, at the level that it exists, BP would not be prepared to go ahead with the development of a Northstar project, even though, if you run the economics, you can show that the return is a sound sort of return on investment." (Page 8 draft). Does this sound like bargaining in good faith and honoring their contract or a premeditated breach of contract to you?

Our Governor and BP entered into an agreement that must then be ratified by our legislature. The original contract is to be replaced. Alaska will give up all of the net profit share in return for replacing our current royalty share of 20% for a new royalty share of 20% escalating upto 27.5% based upon oil price increases. "As to whether the Department of Natural Resources, in the course of its negotiations with BP Exploration (Alaska) Inc. had considered whether to add some sort of corrective factor to the agreement to compensate if the reserves ultimately prove to be considerably larger than estimated, Commissioner Shively has testified "we did have a proposal at one time on the table that would have taken that into account. That's not where we ended up." (Page 17 draft). The Federal Government owns two of the leases in the Northstar Unit. These Federal Government oil leases require BP to give them a 16 2/3% royalty escalating upto a maximum of a 65% royalty as the price of oil increases. Northstar is estimated to contain 130 million barrels of oil, if the field yields 180 million barrels and were produced under the existing profit-sharing provisions the state would receive \$900 million dollars, or 50 % more than the \$600 million under the BP - Knowles proposed agreement. The BP - Knowles legislation represents a potential loss to the state of \$300 million.

What happens if the price of oil or production goes up? Kevin Banks, state petroleum economist, explained that the net-profit sharing arrangement would be a gusher for the state if Northstar does better than expected - if oil prices should head skyward or if the field produced a lot more oil than the 130 million barrels projected. "The net-profit share really pours in," Banks said. (Page 18 Draft). For example, 130 million barrels of oil multiplied by each \$10 price increase in oil yields \$1.3 billion dollars. Alaska would get 90% (after BP's expenses) of any increases in the price of oil if the original contract remains in place. This new Northstar legislation proposed by the administration and the commissioner of revenue clearly fails to protect the states upside and therefore best interests.

What happens if the state does nothing and waits for BP's new development agreement to expire in April of 1998? Alaska could require BP to develop the leases and either start producing oil or the leases would revert back to the state. How much money would Alaska make if we released Northstar? Alaska originally charged a fixed bonus of \$15 million for the leases. Without this fixed bonus amount, and with a competitively bid bonus: Alaska can make an analogy based upon the \$81 million dollars the Federal Government received as a competitively bid bonus in 1980 for its two Northstar leases. "Based upon its review of the bonus revenue received for the

federal leases within the Northstar Unit, which were leased with a 16 2/3 percent sliding scale royalty and the bonus bid as the variable, the Department of Natural Resources estimates the state's Northstar Unit leases could have brought \$268,406,052, as opposed to the \$15,469,000 actually received, had the leases been offered with a 12 1/2 percent royalty, no net-profit share and with the bonus bid as the bid variable." (Page 10 Draft). Ken Boyd, the director of the division of oil and gas, has testified that "BPXA currently estimates that 76.8 % of the recoverable reserves underlie the state leases in the Northstar Unit (NSU)." (Page 8 Draft). Then based upon the \$81 million the federal government received for 23.2 % of the oil, the state could receive three times the competitive bonus bid that the federal government's leases brought in 1980 or \$242 million under the same terms. The Northstar Legislative Bill, by request of the governor, states, "The legislature finds that because of the development account provisions of the net profit share leases, the later that these leases are developed, the less "net profits" the state receives." This statement is refuted in an April 3, 1996 memorandum from Kevin Banks, state petroleum economist, to Ken Boyd, director of division of oil and gas, "In response to Senator Halford's request about the effect on the economic benefits if a lawsuit delays development of the Northstar Unit, I analyzed the effect on economic benefits caused by a delay for any reason. *In short, any delay increases the economic benefits to the state while decreasing the economic benefits to BPXA.*" Besides the development account of \$262 million drawing interest at the prime rate of 8.25 % amounts to \$21 1/2 million. If BP jeopardizes oil production until their development plan expires in April of 1998, the future bonus bids will more than make up for the state's loss of \$43 million in interest accruing over these two years. Plus the state has the option of suing BP to recover this money, since BP obviously did not come into the contract they entered into with the state in good faith. BP is merely attempting extortion - by holding the state hostage unless we renegotiate these lease contracts for BP's further benefit. On page 122 of the 1995 report, "Review of International Competitiveness of Alaska's Fiscal System" (Little Report), the Arthur D. Little Co. concluded "[Oil] companies generally look for a rate of return of about 15 %..." (Page 8 Draft). Then Alaska could definitely rebid these oil leases for a 20 % royalty with 80 % - 85 % of the net profits going to the state. This would give any oil company over 15 % of the net profits. However, since it is a matter of record that two other oil companies besides BP entered into negotiations with Amerada Hess for the Northstar leases - oil companies are willing to develop and accept a profit of "10 % with the net profit share lease terms." (Page 10 Draft) Once again the administration and the commissioner of natural resources have failed to protect this state's best interests. The question is if the legislature is going to join them?

Are Alaska's oil fields competitive and profitable to the oil industry in a global environment? Alaska's oil fields are virtually the most profitable in the world because most of them were leased for only a 1/8 th share or a 12 1/2% state royalty with no net profits going to the state. Let's compare Alaska to Kuwait: Alaska produces almost 1.8 million barrels of oil per day and Kuwait produces 1.8 million barrels of oil per day. Alaska has a population of 600,000 people and Kuwait has a population of 2 million people, but only (39 %) 780,000 of them are Kuwaiti nationals. Kuwait offers its citizens free medical, college and government jobs etc.. Alaska now denies its impoverished senior citizens state funded eye glasses, hearing aids and dentures. Oil

companies can now make windfall profits by selling Alaska's oil in overseas markets like Japan where gasoline now retails for \$4.14 per gallon, since the export ban on Northslope crude oil was lifted. One third, but upto 1/2, of Alaska's oil is typically refined into gasoline. Over 50% of Alaskan crude is refined into gasoline, jet fuel and diesel fuel which all sell for over \$1.00 per gallon. BP, Arco and Exxon are all vertically integrated oil companies - meaning they make profits every step of the way in shipping, refining and marketing petroleum, upto and including when it reaches the consumer at the gasoline pumps. The amount of oil exported out of Alaska per day (1.8 million barrels) divided by its population (600,000 people) equals 3 barrels or 126 gallons of oil produced for each Alaskan every day. Furthermore, "Based upon BP Exploration (Alaska) Inc.'s estimates of recoverable reserves and project development costs, the Northstar Unit has a per barrel development cost of \$2.90. For comparison ... BP Exploration (Alaska) Inc.'s estimated per barrel costs of developing each are: Kuparuk (1982) - \$6.65 per barrel; Endicott (1985) - \$5.40 per barrel; Prudhoe Bay Unit: GHX (1992) \$4.45 per barrel ..." (Page 9 Draft). The fact that Northstar oil is lighter crude oil, being almost half of the density of Prudhoe Bay crude also must be taken into consideration - this greatly enhances oil production and recoverability. A study published in 1993 by Richard Fineberg states, "If these operations were controlled by one firm (in fact, three companies control more than 90 % of Alaska's production and pipeline facilities), that company would rank among the five most profitable industrial corporations in the nation."

Is the Northstar legislation even legal? If this legislation is enacted, the Northstar oil leases change from being competitively bid oil leases to uncompetitively bid sole source awards of special interest legislation by the legislature. It will discourage independent oil companies because Alaskan oil leases are given to politically connected oil companies - oil companies that were outbid. If these initial oil companies whose bids would have brought the state more money than BP's proposed renegotiation litigate - then Alaska is liable to pay stupendous damages. How will the legislature reconcile the Northstar legislation with the Alaska Statutes? Will they put a BP disclaimer (ie. except BP) in the following statutes? AS 38.05.180 (a) The legislature finds that (1) the people of Alaska have an interest in the development of the states oil and gas resources to (B) maximize competition among parties seeking to explore and develop the resources. AS 38.05.920 Assignment. (b) ...the assignee or sublessee is subject to the provisions of laws and regulations applicable to the contract or lease. AS 38.05.180 (w) ... noncompetitive leasing is prohibited.

Is the Northstar legislation unconstitutional? Ak. Const.; Article 8; Sec. 2: "*The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for the maximum benefit of its people.*" In the aforementioned, shall does not mean may and conservation means wise use. The state leased the oil rights at the Northstar field pursuant to the constitutional mandate to obtain the maximum public benefit. There has to be some some equal exchange - or mutuality of consideration - in order to make a material change in a competitively bid contract, the benefits can not be one sided. *The test is that if the people of Alaska receive the maximum public benefit then it is constitutional and if BP receives the maximum benefit from renegotiating these*

leases then it is unconstitutional. There can be no loss of state revenues. The Alaska Legislature has sworn to uphold the Alaska Constitution. Ak. Const.; Article 2; Sec. 19: "The legislature shall pass no local or special act if a general act can be made applicable." "Alaska's Constitution: A Citizen's Guide," by Gordon S. Harrison states, "For the most part, special and local acts amounted to legislative dispensation of favors and preferences to powerful interests - private, corporate, or municipal." "Laws should apply uniformly throughout the state. Provisions to ensure that they do not selectively benefit or discriminate against a particular community, corporation, or individual, are found in many state constitutions." Ak. Const.; Article 8; Sec. 8: "The legislature may provide for the leasing of the public domain ... and for forfeiture in the event of breach of conditions."

Was our now deceased former U.S. Senator and statesman clairvoyant? From, "Alaska's Constitutional Convention", by Victor Fisher (also a delegate to Alaska's constitutional convention and former state senator) at page #130 and 131, "Bartlett, Alaska's delegate in Congress, urged the convention to protect Alaska from the robber baron philosophy ... that had worked against Alaska in the past. He pointed out that while Alaska had experienced exploitation on a grand scale, the potential for future exploitation of natural resources of was infinitely greater than anything the state had ever seen to date. ... Two very real dangers are present. The first, and most obvious, danger is that of exploitation under the thin guise of development. *The taking of Alaska's mineral resources without leaving some reasonable return for the support of Alaska's governmental services and the use of all the people in Alaska will mean a betrayal in the administration of the people's wealth. The second danger is that outside interests, determined to stifle any development in Alaska which might compete with their activities elsewhere, will attempt to acquire great areas of Alaska's public lands in order NOT to develop them until such time as, in the omnipotence and the pursuance of their own interests, they see fit.*"

Does the uncompetitive bidding in the Teapot Dome oil scandal compare to the uncompetitive bidding in the Northstar oil scandal? Does it take a Harvard MBA to see the corruption involved? Rep. Kay Brown amply described the correct sentiment in a similar piece of oil legislation in a floor debate when she said, *Madam speaker, this is not a partnership. This is what a bull does to a cow!*"

Mike Bruner

Mike Bruner

(Reply requested.)

APR 25 1996

Alaska State Legislature

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CO CHAIR, RESOURCES COMMITTEE
VICE CHAIR, JUDICIARY COMMITTEE
MEMBER, STATE AFFAIRS COMMITTEE

FINANCE SUBCOMMITTEES:
DEPT. OF NATURAL RESOURCES
DEPT. OF COMMERCE & ECONOMIC DEVELOPMENT
DEPT. OF ENVIRONMENTAL CONSERVATION

Representative Joe Green

District 10

TO: Senator Rick Halford, Co-Chairman
Senator Steve Frank, Co-Chairman
Senate Finance Committee

FR: Representative Joe Green *Joe*

RE: HB 325 - Heavy Oil Royalty Holiday

DATE: April 24, 1996

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Please schedule HB 325 at the earliest opportunity.

Thank you for your consideration.

*NOTE: A PACKET OF
BACKUP MATERIALS
IS AVAILABLE FROM
THE COMMITTEE SECRETARY.*

4/13/96 RES, FIN

FISCAL NOTE

STATE OF ALASKA
1996 LEGISLATIVE SESSION

BILL NO. CSHB325(FIN)AM

Revision Date: Original Dept Affected Natural Resources
 Title: An Act authorizing suspension of payment BRU: Resource Development
of a portion of the royalty due the state for initial production... Component: Oil & Gas Development
 Sponsor: Representative Green
 Requestor: _____ Component Serial No. 439

Expenditures/Revenues (Thousands of Dollars)

	FY97	FY98	FY99	FY00	FY01	FY02
OPERATING EXPENDITURES						
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	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES (1004)	(172.5/well)	(172.5/well)	(172.5/well)	(172.5/well)	(172.5/well)	(172.5/well)

FUND SOURCE (Thousands of Dollars)

	FY97	FY98	FY99	FY00	FY01	FY02
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 (FY96) cost: \$ none

POSITIONS

	FY97	FY98	FY99	FY00	FY01	FY02
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)

It is not possible at this time to accurately predict the number of new wells that will be drilled that will qualify for the proposed royalty suspension. Nor is it possible to accurately predict the timing of the drilling of any of these new wells. For each new qualifying well that is drilled, if it produces at a rate of 450 barrels per day and oil is valued for royalty purposes at \$10 per barrel, and the royalty is reduced from 12.5% to 2.0%, then the annual royalty suspension will be \$172,500 per year for each of the first five years of well life. Assuming that the well produces at the 450 b/d rate for five years and oil prices stay flat, the total royalty suspension would amount to \$862.5 per well. For a new demonstration project equal in size and scope to the existing Milne Point Schrader Bluff heavy oil project, the royalty suspension would range from \$1.25 million per year at current well rates to \$2.76 million per year at well rates of 450 b/d/well.

Long term production behavior also is unknown for these wells. It is suspected that the wells will produce at a fairly constant rate for at least five years then production decline will begin. Behavior of the Milne Point Schrader Bluff wells is being analyzed to determine if any production trends are evident to date.

Prepared by: Ken Boyd, Director Phone: 269-8800
 Division: Oil & Gas Date: 17-Apr-98
 Approved by Commissioner: _____ Date: 17-Apr-96
 Agency: Natural Resources

FISCAL NOTE

STATE OF ALASKA
1996 LEGISLATIVE SESSION

BILL NO. SCSCSHB325(RES)

Revision Date: Original Dept Affected Natural Resources
 Title: An Act relating to modification of royalty to BRU: Resource Development
encourage production from an oil pool containing heavy oil... Component: Oil and Gas Development
 Sponsor: Representative Green
 Requestor: Senate Finance Component Serial No. #439

Expenditures/Revenues	(Thousands of Dollars)					
	FY97	FY98	FY99	FY00	FY01	FY02
OPERATING EXPENDITURES						
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	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES ()	[(172.5/well)*	[(172.5/well)*	[(172.5/well)*	[(172.5/well)*	[(172.5/well)*	[(172.5/well)*

FUND SOURCE *assumes a 12.5% base royalty--see notes below	(Thousands of Dollars)					
	FY97	FY98	FY99	FY00	FY01	FY02
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

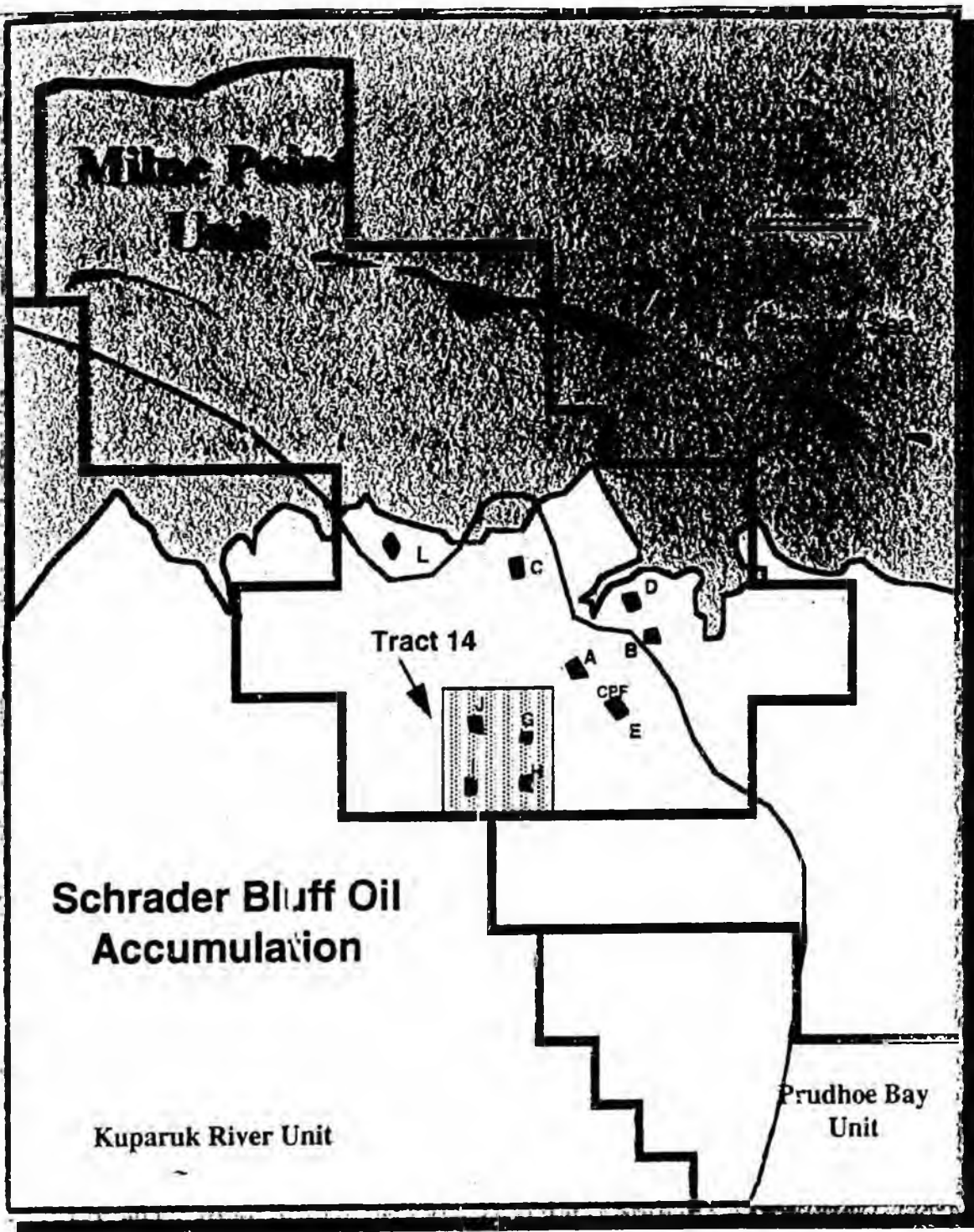
Estimate of any current year (FY96) cost: \$ none

POSITIONS	FY97	FY98	FY99	FY00	FY01	FY02
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)

It is not possible at this time to accurately predict the number of new wells that will be drilled that will qualify for the proposed royalty suspension. Nor is it possible to accurately predict the timing of the drilling or the exact lease location of any of these new wells. For each new qualifying well that is drilled, if it produces at a rate of 450 barrels per day and oil is valued for royalty purposes at \$10 per barrel, and the royalty is reduced from 12.5% to 2.0%, then the annual royalty suspension will be \$172.5 per year for each of the first five years of well life. The Schrader Bluff pool includes leases with royalty rates of 12.5% and 20%. If the base royalty rate is 20%, then the annual suspension is \$295.7/well. Assuming that the well produces at the 450 b/d rate for five years and oil prices stay flat, the total royalty suspension would amount to \$862.5 per well (\$1,478.0/well at the 20% base royalty rate). For a new demonstration project equal in size and scope to the existing Milne Point Schrader Bluff heavy oil project, the royalty suspension would range from \$1.25 million per year at current well rates and assuming a 12.5% base royalty to \$2.76 million per year at well rates of 450 b/d/well. The weighted average Schrader Bluff base royalty currently is 14%. Long term production behavior also is unknown for these wells. It is suspected that the wells will produce at a fairly constant rate for several years, then production will begin to decline. Behavior of the Milne Point Schrader Bluff wells is being analyzed to determine if any production trends are evident to date.

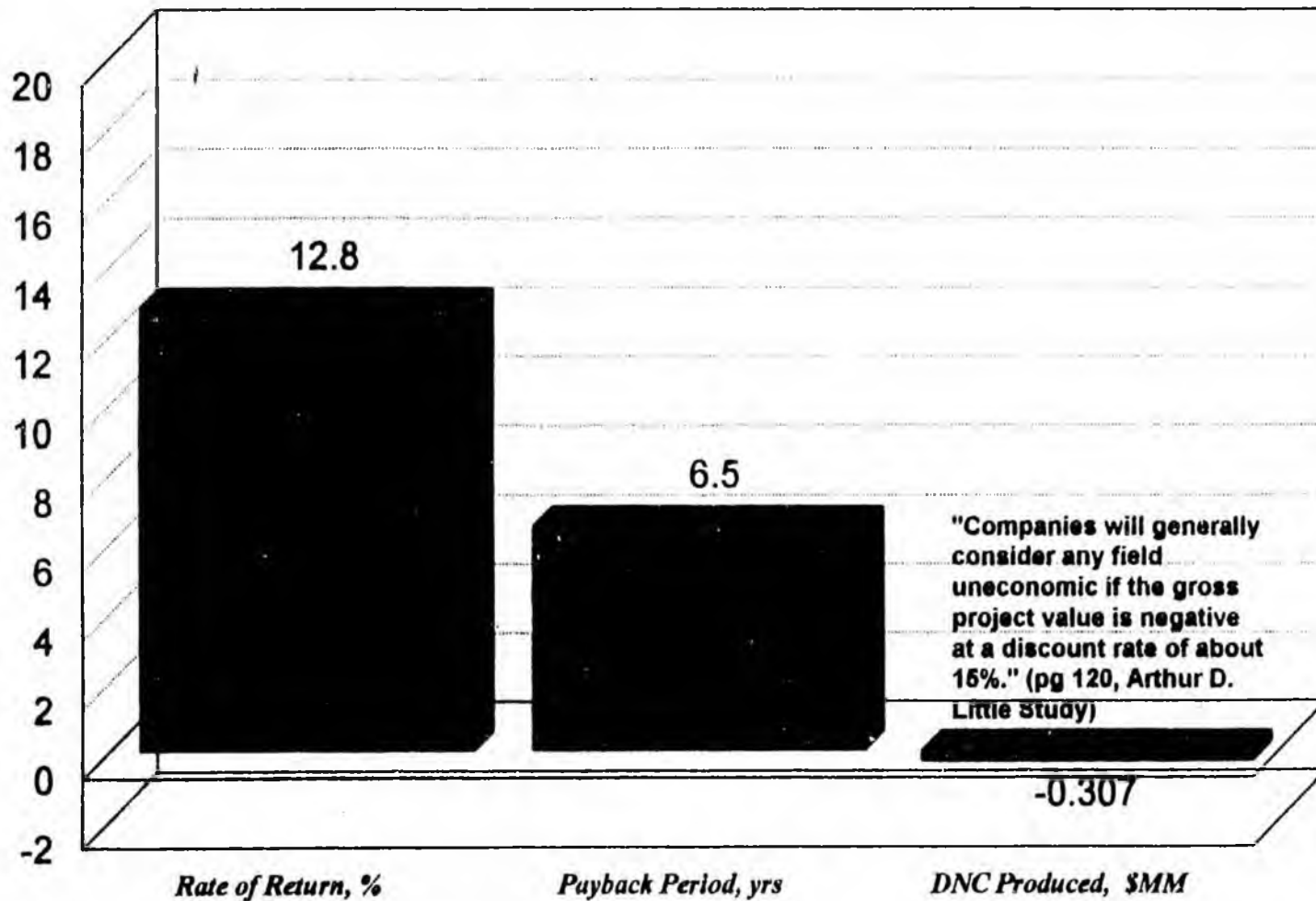
Prepared by: Ken Boyd, Director *Ken Boyd for* Phone: 269-8800
 Division: Oil and Gas Date: 24-Apr-96
 Approved by Commissioner: *Ken Boyd for* Date: 24-Apr-96
 Agency: Natural Resources



Schrader Bluff Oil Accumulation

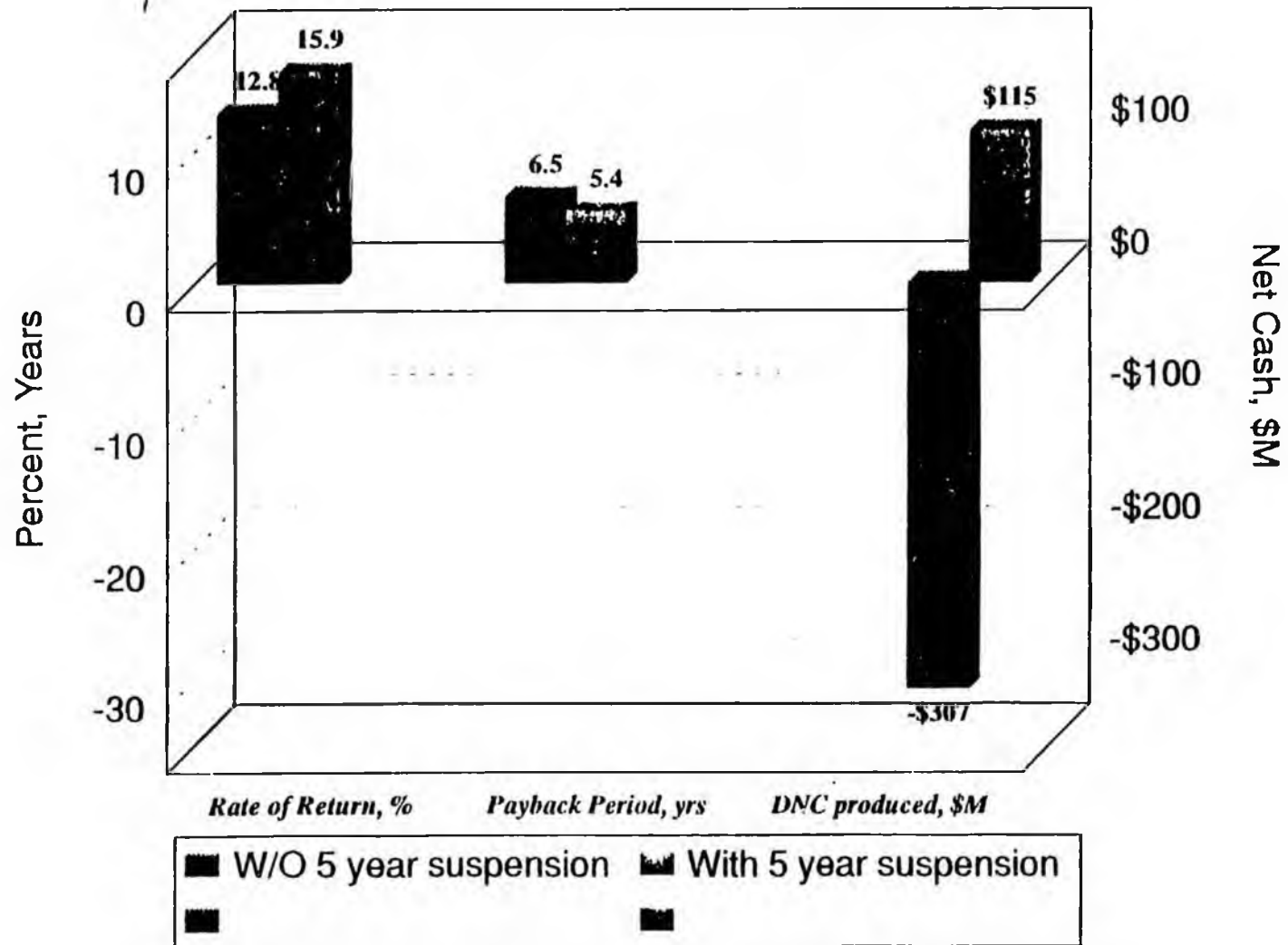
Typical Heavy Oil Well Economics

Based on the 5 best wells to date in Tract 14



Little, A.D. and Gault, L.: "Review of International Competitiveness of Alaska's Fiscal System," Report to the Oil & Gas Policy Council 8/11/85

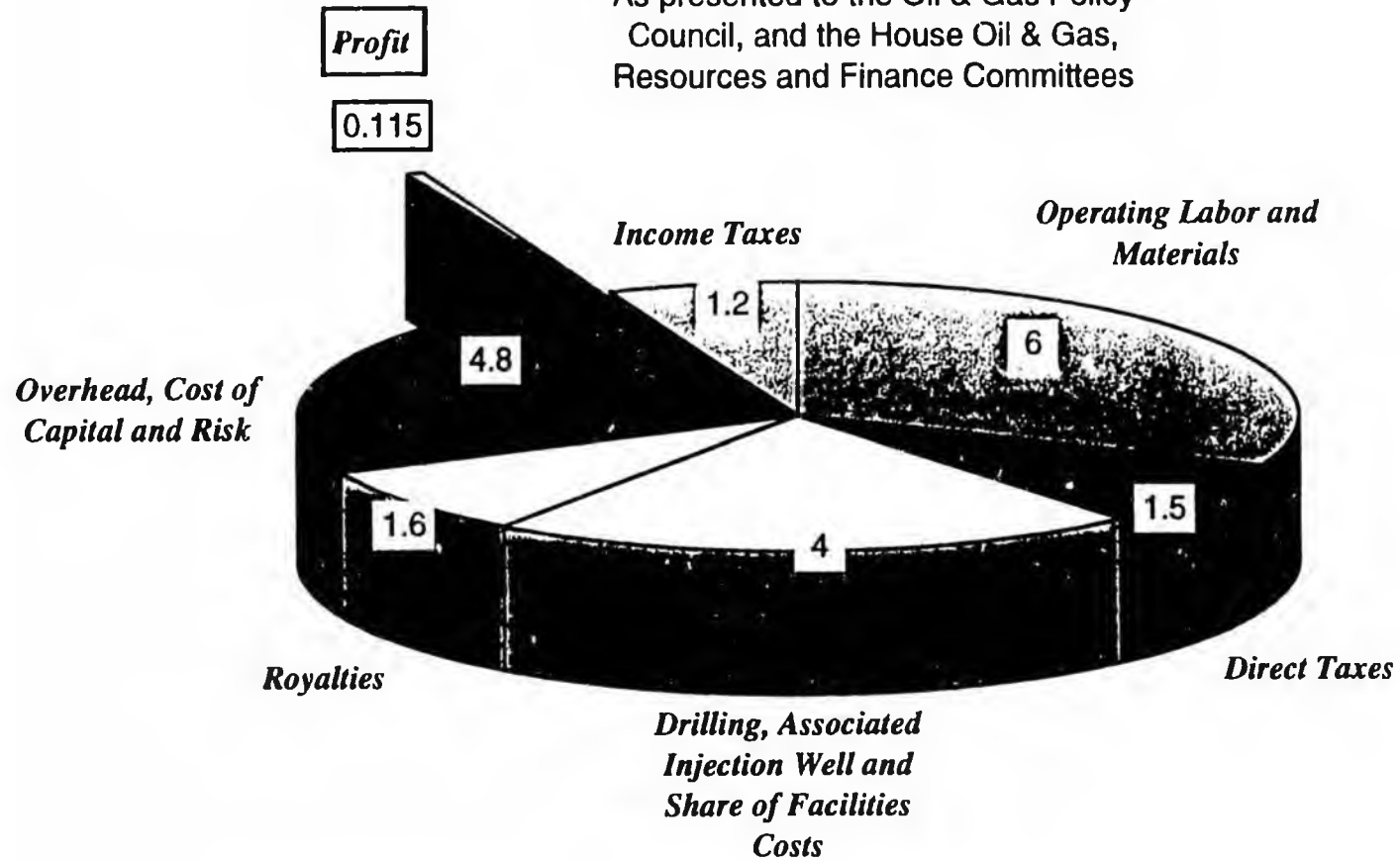
The Effect of Royalty Suspension on Schrader Bluff Economics



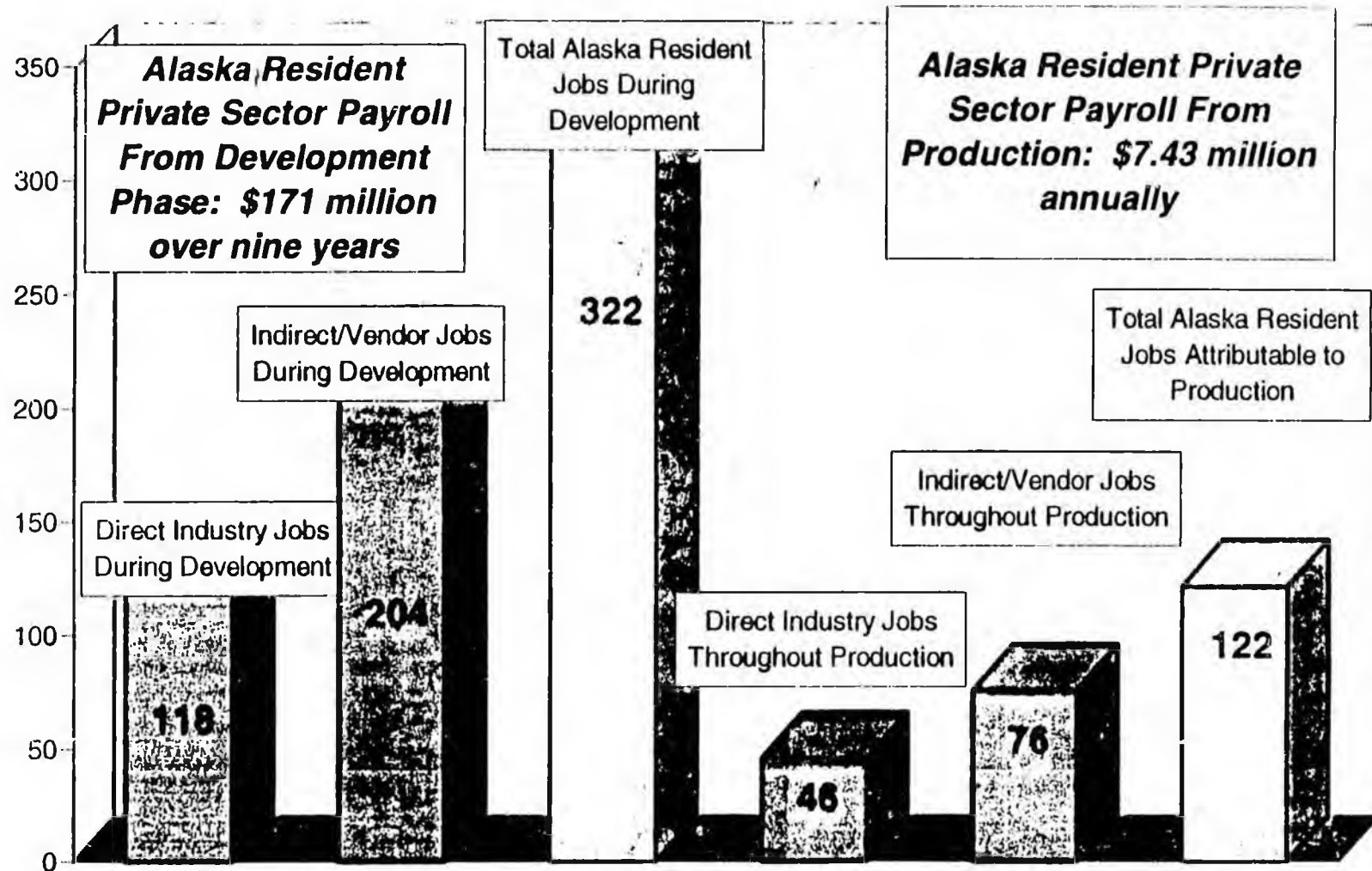
Where the Revenues from Heavy Oil Development Go

OXY Per Well Economics (in millions)

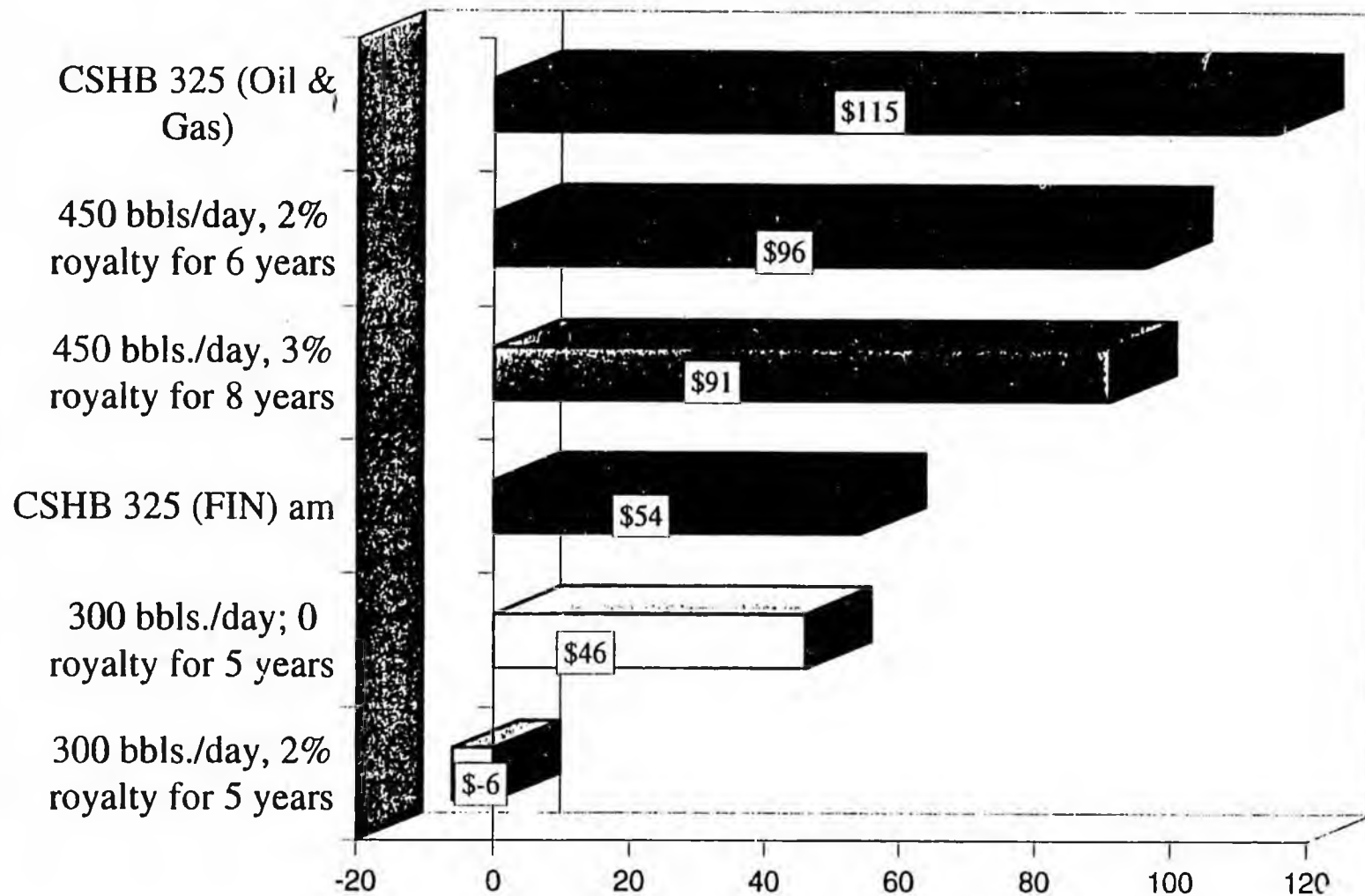
As presented to the Oil & Gas Policy Council, and the House Oil & Gas, Resources and Finance Committees



Alaska Resident Private-Sector Jobs Created by Schrader Bluff Development

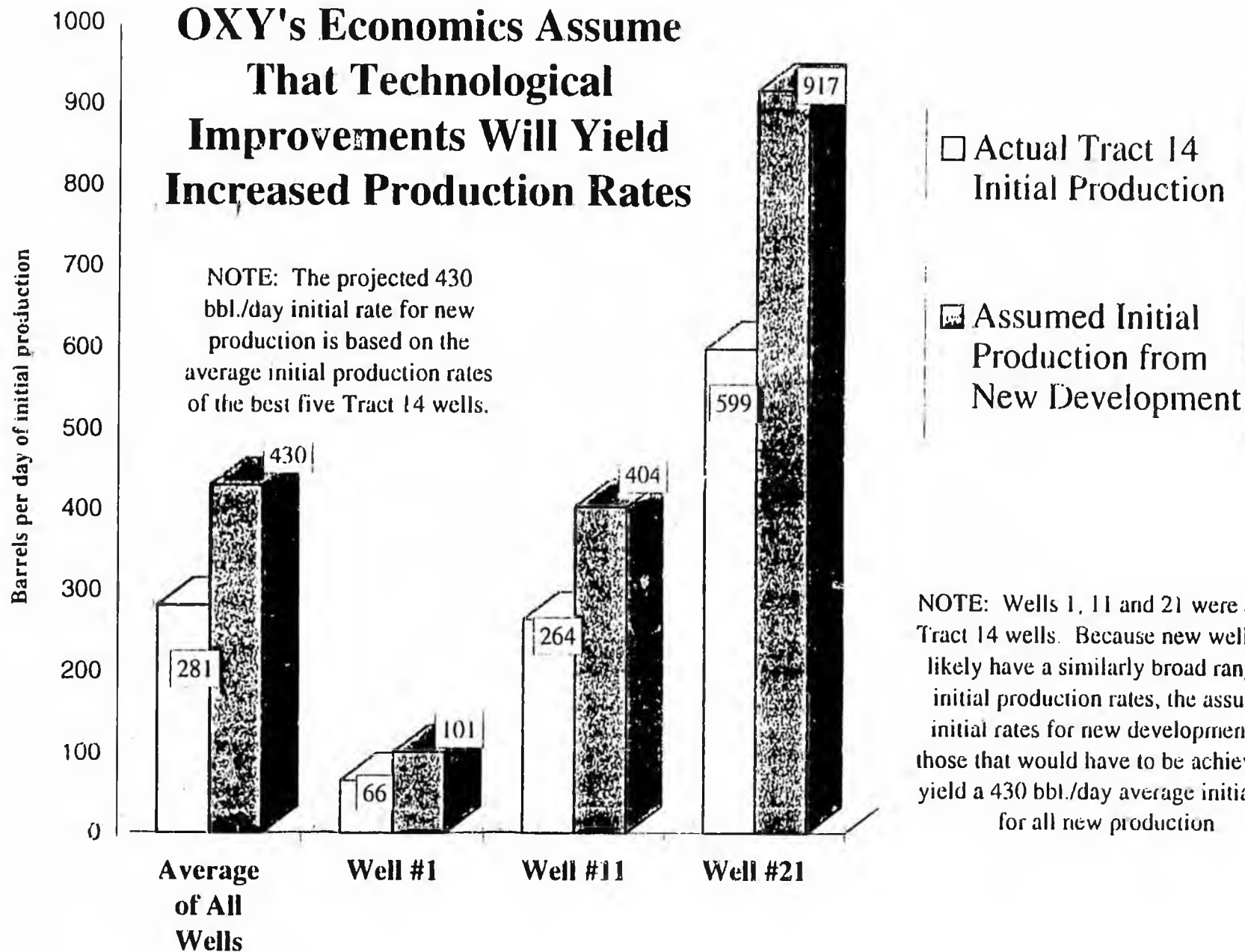


Projected Profit from Each \$4 Million Well and Facility Investment Under Various Scenarios



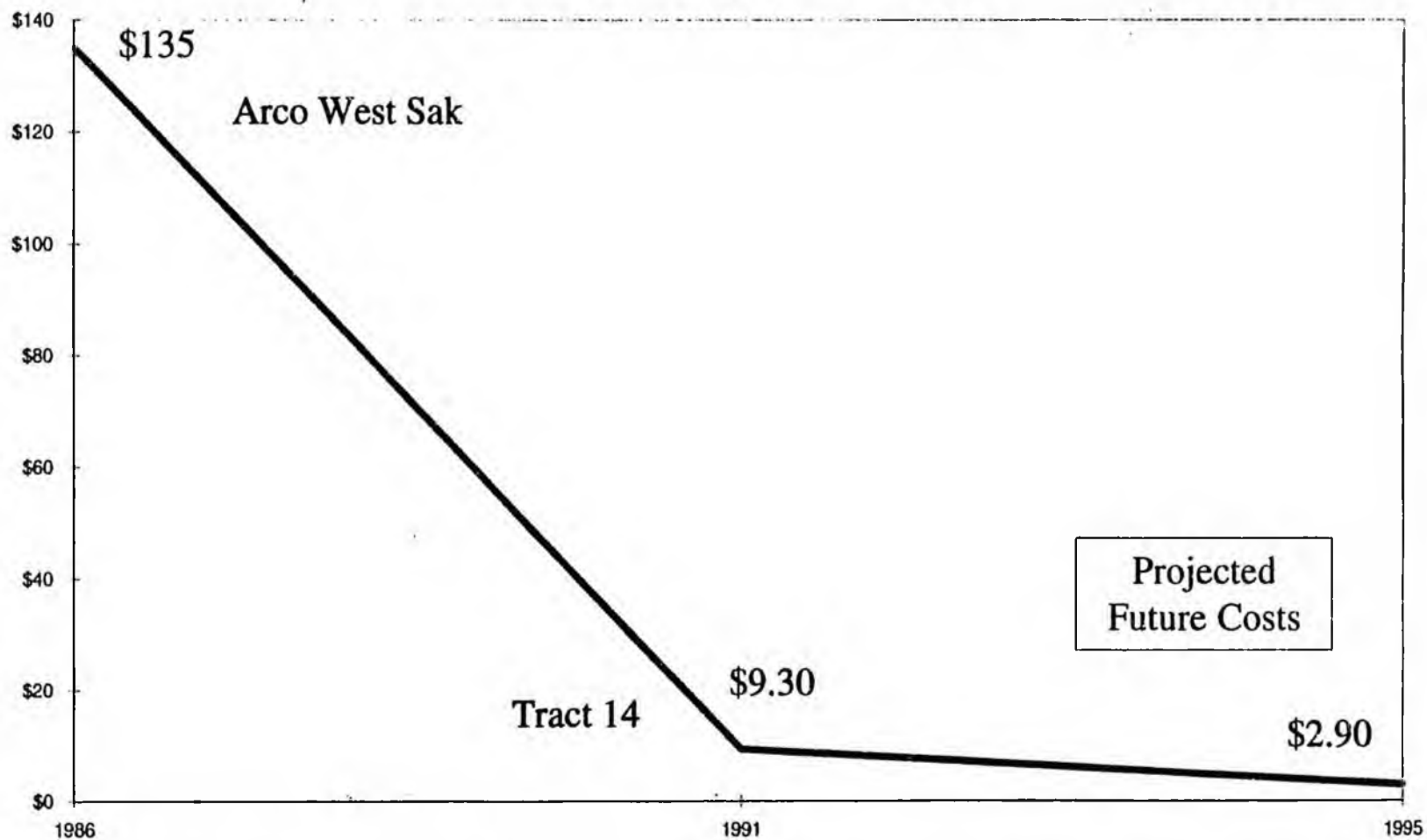
In thousands of dollars @ a 15% discount

OXY's Economics Assume That Technological Improvements Will Yield Increased Production Rates

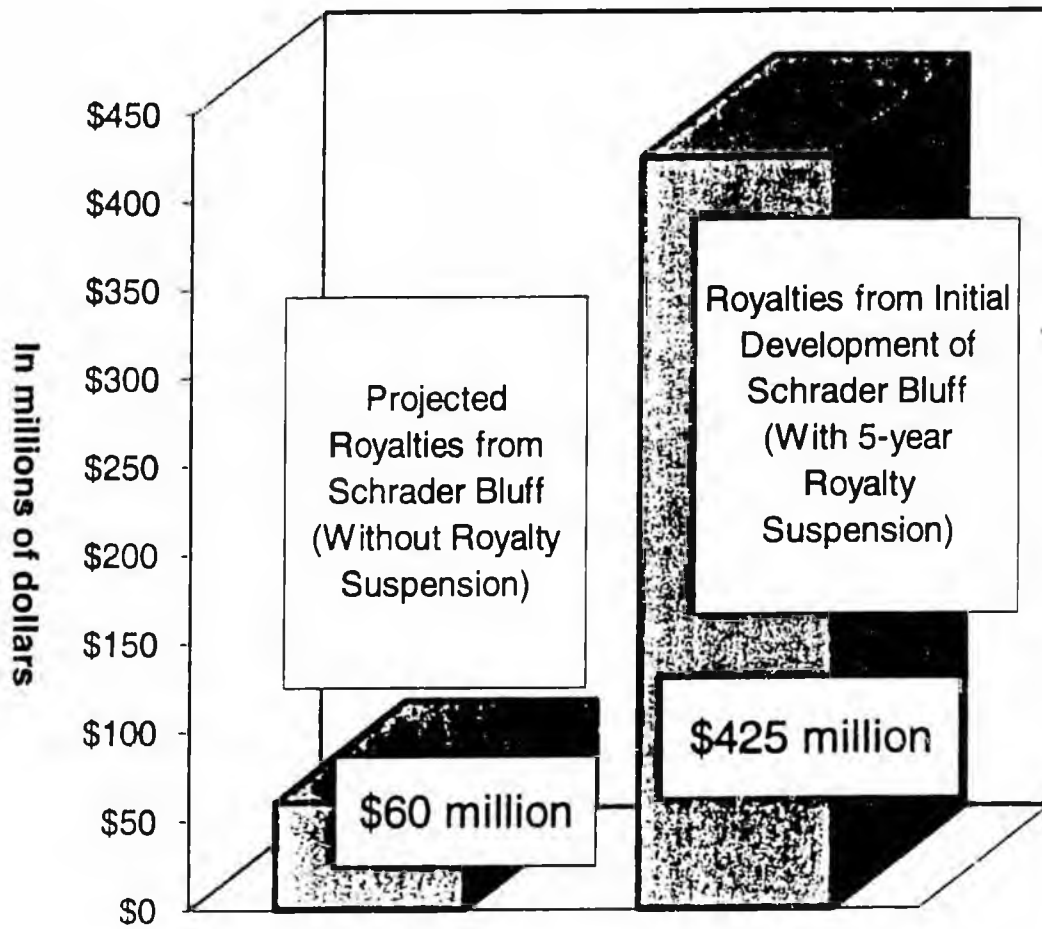


History of ANS Heavy Oil Development Costs

In dollars per barrel



Two Paths for Schrader Bluff



FISCAL NOTE

Revision Date: _____ Dept. Affected: Revenue
 Title: Royalty Suspension: N. Slope Heavy Oil BRU: Revenue Operations
 Component: Oil and Gas Audit
 Sponsor: Representative Green
 Requestor: (H) Finance COMPONENT SERIAL NO. 115

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
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						
CHANGE IN REVENUES ()	0.0	0 - (300.0)	0 - (2,000)	0 - (7,000)	0 - (13,000)	0 - (19,000)

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY96) cost \$ _____

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

(See Attached Analysis)

Prepared by: Chuck Logsdon Phone: (907) 276-1363
 Division: Oil and Gas Audit Date: February 13, 1996
 Approved by Commissioner: Wilson F. Condon Date: February 13, 1996
 Agency: Department of Revenue

Analysis of Bill/Program Effects

This revised fiscal note is prepared to illustrate more specifically the potential revenue impacts of the bill. To a large extent the revenue outcome of any legislation which is designed to promote a particular economic activity is uncertain. This revised fiscal note presents two alternative outcomes for heavy oil royalty holiday as applied to the Schrader Bluffs using the Department of Revenue Fall 1995 forecast production, wellhead price and well assumptions. This analysis does not include the West Sak heavyoil production from the Kuparuk unit which in the Fall Forecast is assumed to begin in a small way (.012 million ob/day) in FY 2003.

Scenario #1
 Holiday Ensures Large Scale Heavy Oil
 Development Which would Otherwise
 Not Occur

Scenario #2
 Development Would Have Occurred
 Without Holiday

	Incremental Royalty Impact (Millions \$)	Incremental Royalty Impact (Millions \$)
1997	0	0
1998	0	-0.3
1999	0	-2
2000	0	-7
2001	0	-13
2002	0	-19
2003	1	-22
2004	2	-25
2005	7	-21
2006	12	-15
2007	19	-10
2008	19	-7
2009	23	-3
2010	25	-1

Clearly if the holiday is needed to attract the investment, the payoff to the State is long term since no significant added royalty income will flow into the treasury until well into the next decade. At the same time Scenario #2 could be characterized a potential revenue loss scenario and effectively puts a price tag on the likely subsidy to Schrader heavy oil production using the Department of Revenue production assumptions.

Note neither of these scenarios is based on the maximum potential oil production scenarios presented in industry documents during testimony on this legislation.

FISCAL NOTE

No. 1
 Bill Version: CSHB 325(O&G)
 (H) Publish Date: 1/24/96

STATE OF ALASKA
1996 LEGISLATIVE SESSION

Revision Date: Original Dept Affected Natural Resources
 Title: An Act authorizing suspension of payment BRU: Resource Development
of a portion of the royalty due the state for initial production... Component: Oil & Gas Development
 Sponsor: Representative Green
 Requestor: _____ Component Serial No. 439

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY97	FY98	FY99	FY00	FY01	FY02
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	0.0	0.0	0.0	0.0	0.0	0.0
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CHANGE IN REVENUES (1004)	(228.0/well)	(228.0/well)	(228.0/well)	(228.0/well)	(228.0/well)	(228.0/well)
----------------------------------	---------------------	---------------------	---------------------	---------------------	---------------------	---------------------

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 (FY96) 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)

It is not possible at this time to accurately predict the number of new wells that will be drilled that will qualify for the proposed royalty reduction. Nor is it possible to accurately predict the timing of the drilling of any of these new wells. For each new well that is drilled, if it produces at a rate of 500 barrels per day and oil is valued for royalty purposes at \$10 per barrel, then the annual royalty reduction will be \$228,000 for each of the first five years of well life. Assuming that the well produces at the 500 b/d rate for five years and oil prices stay flat, the total royalty reduction would amount to \$1.14 million per well – close to the cost to drill the well. For a new demonstration project equal in size and scope to the existing Milne Point Schrader Bluff heavy oil project, the royalty reduction would range from \$1.5 million per year at current well rates to \$3.7 million per year at well rates of 500 b/d/well. Long term production behavior also is unknown for these wells. It is suspected that the wells will produce at a fairly constant rate for at least five years then production decline will begin. Behavior of the Milne Point Schrader Bluff wells is being analyzed to see if any production trends are evident to date.

Prepared by: Ken Boyd, Director Phone: 269-8800
 Division: Oil & Gas Date: 18-Jan-96
 Approved by Commissioner: _____ Date: 18-Jan-96
 Agency: Natural Resources

COMMITTEE COPY

SENATE COMMITTEE REPORT

First Committee of Referral

DATE: 4/2/96

FURTHER: Finance

DATE TURNED INTO OFFICE: 4-22-96

The Resources Committee considered CS FOR HOUSE BILL NO. 325(FIN) am
 Relating to modification of royalty to encourage production from an oil pool containing heavy oil; efd.

Ø J Foy

and recommends:

- be replaced with SEN CS HB325 (RES)
- adopt previous _____ CS _____ (_____)
- attached amendment(s)
- adopt Letter of Intent by _____ Committee
- further referral to the _____ Committee

- Senate Bill:**
- same title
 - new title
- House Bill:**
- same title
 - technical title
 - new: SCR# _____

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	NR	DNP	AM
<i>Rich Hattad</i>	<input checked="" type="checkbox"/>	<i>[Signature]</i>			<input checked="" type="checkbox"/>
<i>Deane</i>	<input checked="" type="checkbox"/>	<i>Chris L. Taylor</i>			<input checked="" type="checkbox"/>
<i>[Signature]</i>	<input checked="" type="checkbox"/>	<i>John Frank</i>			<input checked="" type="checkbox"/>
<i>[Signature]</i>	<input checked="" type="checkbox"/>				
CHAIR: <i>Screw D. Hansen</i>	<input checked="" type="checkbox"/>	CHAIR:			

NEW FISCAL NOTE(S):

Department	Date	Zero	Fiscal

PREVIOUS FISCAL NOTE(S):*

Department	Date	Zero	Fiscal
Revenue	3/25/96	<input checked="" type="checkbox"/>	
ENR - O+G	4/24/96		(2280)

FN to CS, plus

APPROPRIATION -- no fiscal note

*include fiscal notes accompanying Governor's bill