

HB

1988

HFIN

FILE

ALASKA STATE LEGISLATURE

Interim:
600 East Railroad Avenue
Wasilla, Alaska 99654
(907) 373-1842
Fax (907) 373-4729



Session:
State Capitol Building
Juneau, Alaska 99801-1182
(907) 465-2186
Fax (907) 465-3818

REPRESENTATIVE VIC KOHRING DISTRICT 14

SPONSOR STATEMENT

HB 198

ROYALTY REDUCTION ON CERTAIN OIL

The goal of House Bill 198, which amends existing statutes in Title 38, is to provide for a narrowly defined and specifically targeted reduction of royalty on oil produced from Cook Inlet fields and platforms as they approach the end of their economic lives. Recent plans to idle two of the 13 current oil producing platforms in the Inlet serve as a reminder of the certainty of the decline and ultimate end of production for these fields.

However, premature abandonment of these fields is not in the state's best interest, as the infrastructure that was created to serve these fields is extensive, and in some cases, irreplaceable. Decreasing the State's royalty share from 12.5% to 5% near the end of field life, improves the economics of these aging platforms. These may result in an extension of production from these platforms of up to 14 months.

Prolonging production will help to achieve several important policy objectives, including use of critical infrastructure to support new exploration or development of adjacent lands, delaying loss of industry jobs and increasing the total amount of oil and gas produced through these aging facilities.

To protect the State's economic interest, royalty reduction to five percent on oil produced from these targeted fields and platforms is designed to occur only when production declines below 1,200 barrels per day for the Dolly, Grayling, King Salmon, and Steelhead Platforms, and to continue at that level only so long as production does not go above that threshold. For any quarter, should production go above 750 barrels per day, the State's royalty share would increase one percent with each additional 100 barrels up to 1,200. Royalty share for production over 1,200 barrels would be 12.5%. For the Granite Point, Anna, Bruce, Baker, Dillon, XTO A & C platforms the royalty reduction is triggered at 750 barrels per day. These trigger production rates generally correspond to the different economics of these two sets of platforms.

By encouraging continued production of marginal fields, HB 198 will benefit the state and local economies through taxation and royalties, encourage future development of new oil discoveries by lowering the costs of industry infrastructure, as well as taking care of job number one -- preserving jobs for Alaskans.

FY2004 SL .EMENTALS

	A	B	C	D	E	F	G	H	I
1	Soc. No.	Department	BRU or Component	Supplemental Need	General Funds	Federal Funds	Other Funds	Fund Source	Total Funds
2	FAST TRACK SUPPLEMENTAL								
3	1	Administration	ETS	Appropriates the ACS disentanglement settlement of \$3,447,647 from the General Fund to the Information Services Fund	3,447.6				3,447.6
4	2	Law	Environmental Law	Exxon Valdez Oil Spill ongoing costs for experts and outside counsel to analyze continuing injury and develop restoration options; June 30, 2005 lapse date.			100.0	EVOS Restoration	100.0
5	3	Fish & Game	Capital	Receipts from City & Borough of Juneau to complete work at the indoor rifle range in Juneau. These receipts have already been received, and work at the rifle range is scheduled to start early spring.			75.0	Statutory Des Prgm Rcpls	75.0
6	4	Governor	Elections	General funds needed for the Help America Vote Act (HAVA) fund maintenance of effort. Some work on the upcoming primary and general elections will take place during FY 04.	180.0				180.0
7	5(a)	Health & Soc Svcs	Capital	Add the capital project for the State veterans' home conversion in Palmer to speed up the design work and take advantage of the summer construction season. A corresponding FY 05 capital amendment will also be submitted to delete the project from the FY 05 budget.	459.2	2,275.0	765.8	ASLC Dividend	3,500.0
8	5(b)	Health & Soc Svcs	Alaska Senior Assistance Program	Reduce excess federal fiscal relief funds		-3,334.0		Fed Unrestricted Rcpls	(3,334.0)
9	5(c)	Health & Soc Svcs	Senior Care	Use excess federal fiscal relief funds for FY 04 costs for Senior Care program		3,334.0		Fed Unrestricted Rcpls	3,334.0
10	5(d)	Health & Soc Svcs	Senior Care	FY 04 costs for Senior Care program	154.0				154.0
11	5(e)(1)	Health & Soc Svcs	Alaska Longevity Programs Mgmt	FY 04 costs for Senior Care program	46.0				46.0
12	5(e)(2)	Health & Soc Svcs	Health Purchasing Group	FY 04 costs for Senior Care program	85.0				85.0
13	5(e)(3)	Health & Soc Svcs	Public Assistance Administration	FY 04 costs for Senior Care program	25.0				25.0
14	5(e)(4)	Health & Soc Svcs	Public Assistance Data Processing	FY 04 costs for Senior Care program	6.8				6.8
15	6(a)	Natural Resources	Recorder's Office	Increased costs to process heavy volume of mortgage refinance activity			300.0	Receipt Supported Services	300.0
16	6(b)	Natural Resources	Office of Habitat Mgt. and Permitting	Replace unrealized inter-agency receipts in order to fulfill workload requirements	150.0				150.0
17	6(c)	Natural Resources	Capital	Increased activity in Remote Recreational Cabin Site Survey Contracts			119.0	Land Disposal Income Fund	119.0
18	7	Public Safety	Capital	Scope change for the Ketchikan Public Safety Building appropriation, sec. 1, ch. 82, SLA 2003, pg. 33, ln. 22, to include a purchase of a building and adjacent lot and improvements.					0.0
19	8(a)	Revenue	Alaska Permanent Fund Corp.	Increased costs to advocate for POMV			300.0	Perm Fund Rcpls	300.0
20	8(b)	Revenue	Alaska Permanent Fund Corp.	Authorization that APFC may advocate for POMV					0.0
21	9(a)	Transportation	Anchorage Airport Administration	Tenant improvement inspection oversight. DOT will contract out management of the extensive tenant building activity for the few months prior to opening the terminal. Internal staff cannot handle this level of one-time activity. Cost will not affect FY 05 budget.			200.0	Internal Airports Revenue Fund	200.0

FY2004 SUPPLEMENTALS

	A	B	C	D	E	F	G	H	I
22	9(b)	Transportation	Anchorage Airport Facilities	Concourse C operations costs of planning and implementation of the consultant contract (to be hired in March) and the first month (June) of operations and maintenance.			1,500.0	Internat'l Airports Revenue Fund	1,500.0
23	9(c)	Transportation	Capital	Federal contract to perform maintenance and operation for 5 years at Adak air facility. Interest earnings must be spent on the Adak air facility.		10,000.0		Adak Airport Operations	10,000.0
24	10(a)	Transportation	Capital	Earmarked projects passed in January's federal omnibus bill which must all be obligated before September 30, 2004:					0.0
25	10(a)(1)	Transportation	Capital	Alaska Statewide Airports Runway and Related Improvements (ED 99)		3,000.0	157.9	AIDEA Dividend	3,157.9
26	10(a)(2)	Transportation	Capital	Fairbanks Terminal Redevelopment (ED 60)		1,000.0	52.7	Intern'l Airport Revenue Fund	1,052.7
27	10(a)(3)	Transportation	Capital	Kodiak Terminal Improvements (ED 36)		1,000.0	26.4	AIDEA Dividend	1,026.4
28	10(a)(4)	Transportation	Capital	University of Alaska Transportation Research Center (ED 99)		2,000.0			2,000.0
29	10(a)(5)	Transportation	Capital	Circumpolar Infrastructure Task Force, Arctic Council and Northern Forum (ED 99)		1,000.0			1,000.0
30	10(a)(6)	Transportation	Capital	Kotzebue Dust and Persistent Particulate Abatement Research (ED 40)		1,000.0	250.0	AIDEA Dividend	1,250.0
31	10(a)(7)	Transportation	Capital	Coffman Cove/Wrangell/Petersburg Ferries and Ferry Facilities (ED 1-5)		2,000.0	500.0	AIDEA Dividend	2,500.0
32	10(a)(8)	Transportation	Capital	Arctic Winter Games Transportation Improvements (ED 99)		1,000.0			1,000.0
33	10(a)(9)	Transportation	Capital	Fl. Wainwright Alternative Access and Chena River Crossing (ED 60)		5,700.0	565.8	AIDEA Dividend	6,265.8
34	10(a)(10)	Transportation	Capital	Big Lake to Wasilla Pedestrian Trails (ED 70)		500.0			500.0
35	10(a)(11)	Transportation	Capital	Kincaid Park Trail Connection (ED 50)		900.0			900.0
36	10(a)(12)	Transportation	Capital	Funny River Bridge Crossing (ED 90)		5,000.0			5,000.0
37	10(a)(13)	Transportation	Capital	Glacier Creek/Nome Bypass (ED 39)		3,000.0			3,000.0
38	10(a)(14)	Transportation	Capital	McCarthy Creek Tram (ED 6)		200.0			200.0
39	10(a)(15)	Transportation	Capital	Bartlett Access Intersection Safety Improvement (ED 50)		500.0			500.0
40	10(a)(16)	Transportation	Capital	Nome Bypass Road (ED 39)		2,000.0			2,000.0
41	10(a)(17)	Transportation	Capital	C Street Railroad Bypass (ED 50)		2,000.0			2,000.0
42	10(a)(18)	Transportation	Capital	Chenega Road system (ED 5)		850.0			850.0
43	10(a)(19)	Transportation	Capital	Craig Road Improvements (ED 5)		1,000.0			1,000.0
44	10(a)(20)	Transportation	Capital	Donlin Creek Road (ED 6)		10,000.0			10,000.0
45	10(a)(21)	Transportation	Capital	False Pass Causeway and Road to the Terminus of the South Arm Breakwater (ED 37)		3,000.0			3,000.0
46	10(a)(22)	Transportation	Capital	Fairbanks Transit Bus Replacement (ED 60)		3,000.0			3,000.0
47	10(a)(23)	Transportation	Capital	Girdwood Project (ED 32)		1,000.0			1,000.0
48	10(a)(24)	Transportation	Capital	Hydaburg Road Improvement (ED 5)		2,000.0			2,000.0
49	10(a)(25)	Transportation	Capital	Keystone Drive and Related Improvements (ED 90)		1,500.0			1,500.0
50	10(a)(26)	Transportation	Capital	Lucille Street and Mack Drive Improvements-Wasilla (ED 14)		1,000.0			1,000.0
51	10(a)(27)	Transportation	Capital	Mat-Su Roads Improvement (ED 70)		3,000.0			3,000.0
52	10(a)(28)	Transportation	Capital	North Pole Roads Lighting ((ED 11)		950.0			950.0
53	10(a)(29)	Transportation	Capital	North Slope Borough Road Improvements (ED 40)		3,000.0			3,000.0
54	10(a)(30)	Transportation	Capital	Port of Ketchikan Ferry Facility (ED 1)		1,000.0			1,000.0
55	10(a)(31)	Transportation	Capital	Seldovia-Homer-Jakobof Bay Halibut Cove Ferry Planning and Design (ED 35)		2,000.0			2,000.0
56	10(a)(32)	Transportation	Capital	Seward Road Improvements (ED 35)		2,000.0			2,000.0
57	10(a)(33)	Transportation	Capital	Ship Creek Improvements (ED 50)		1,000.0			1,000.0
58	10(a)(34)	Transportation	Capital	Sitka Road Improvements (ED 2)		1,500.0			1,500.0
59	10(a)(35)	Transportation	Capital	University of Alaska Transportation Research Center (ED 99)		2,000.0			2,000.0
60	10(a)(36)	Transportation	Capital	Williamsport/Pile Bay Road Kenai (ED 90)		3,000.0			3,000.0
61	10(a)(37)	Transportation	Capital	Winner Creek Trail Improvements (ED 50)		1,000.0			1,000.0
62	10(a)(38)	Transportation	Capital	Yakataga River Bridge (ED 5)		3,000.0			3,000.0
63	10(a)(39)	Transportation	Capital	Alaska Mobility Coalition Bus Replacement (ED 79)		500.0			500.0

FY2004 SUPPLEMENTALS

	A	B	C	D	E	F	G	H	I
64	10(a)(40)	Transportation	Capital	Coffman Cove Inner Island Ferry/Bus Terminal (ED 1-5)		1,500.0	375.0	AIDEA Dividend; ASLC Dividend	1,875.0
65	10(a)(41)	Transportation	Capital	Mobility Coalition (ED 99)		500.0			500.0
66	10(b)	Transportation	Capital	Fund source section for projects listed in section 10(a)					0.0
67	11			Lapse of Appropriations					0.0
68	12			Contingency Effect and Contingent Effective Date					0.0
69	13			Effective Date					0.0
70									
71				FAST TRACK BILL TOTAL	4,553.6	93,375.0	5,287.6		103,216.2
72									
73	REGULAR SUPPLEMENTAL								
74	1(a) and (b)	Administration	OPA	FY 04 projected caseload and case cost growth.	600.0		300.0	Statutory Des Prgn Rcpts	1,100.0
75	1(c)	Administration	Public Defender	FY 04 projected caseload and case cost growth.	650.0				650.0
76	2(a)	Community	Regulatory Commission of Alaska /udits & Investigations	Additional funds for expert witness costs are required for a) completion of Alaska Communications Systems cases (\$20.0), b) Enstar case participation (\$15.0), c) assistance on the telecom regulations preceding responsive to HB 111 (\$20.0), d) participation in other cases (\$60.0).			115.0	RCA Rcpts	115.0
77	2(b)	Community	Regulatory Commission of Alaska	Due to major developments in Cook Inlet and the Trans Alaska Pipeline System, the Regulatory Commission of Alaska's effort in regulating pipelines has significantly increased. To provide the necessary expertise two new positions, a range 21 Research Analyst IV and a range 19 Utility Financial Analyst are requested. Funds for additional office space, furniture and equipment are also requested.			114.6	RCA Rcpts	114.6
78	2(c)	Community	Capital	Repeal of funds to Saxman for Public Safety Bldg sec. 87, ch. 1, SSSLA 2002, pg. 138, ln. 9. Actual grant amount is \$1,074,341.	(1,074.3)				(1,074.3)
79	2(d)	Community	Power Cost Equalization	PCE Endowment fund appropriation to PCE fund to replace the general funds requested in FY 05 budget. This is the balance of the statutory 7% limit of the PCE Endowment monthly average market value available for appropriation in FY 04. An FY 05 budget amendment will also be submitted.			4,581.0	PCE Endowment Fund	4,581.0
80	3(a)	Corrections	Inmate Health Care	The cost of drug and scientific supplies continue to rise annually and contractual costs have increased due to eight catastrophic cases, each costing in excess of \$100.0.	1,100.0				1,100.0
81	3(b)	Corrections	Out of State Contracts	Due to increases in population and subsequent management of placement of prisoners, the out of state contracts and related travel costs are increasing from the budgeted 650 prisoners to in excess of 775 by the end of FY 04.	920.0				920.0
82	4(a)	Education	Foundation	FY 04 foundation program entitlement adjustment based on actual student count.	(3,654.0)				(3,654.0)
83	4(b)	Education	Pupil Transportation	Pupil transportation program adjustment based on actual student count	(788.4)				(788.4)
84	5(a) - (d)	All	Federal and Other Program Receipts	Technical correction to the LB&A language in FY 02-04 which changes "shall be reduced" to "may be reduced".					0.0
85	6	Fish & Game	Capital	Language change to FY 02 appropriation relating to use of the proceeds from sale of vessels to also include repair and maintenance of vessels					0.0
86	7	Governor	Elections	Additional Election Funds for Improving accessibility to voting locations.			100.0	Election Fund	100.0
87	8(a)	Health & Soc Svcs	Pioneer Homes	Transfer within H&SS to cover projected funding shortfall as part of net-zero general fund supplemental.	711.9				711.9
88	8(a)	Health & Soc Svcs	Pioneer Homes	Excess authority from discontinued Longevity Bonus payments relating to failed SB 117.			(775.0)	Receipt Supported Services	(775.0)
89	8(b)	Health & Soc Svcs	Alcohol Safety Action Program	Operating expense belt tightening to achieve net-zero general fund supplemental	(42.1)				(42.1)
90	8(b)	Health & Soc Svcs	Behavioral Health Medicaid Services	Increased federal receipts for Medicaid		6,669.0			6,669.0
91	8(c)	Health & Soc Svcs	Community Action & Prevention Grants	Grant savings due to belt tightening	(50.2)				(50.2)

By Chenault

1

05-09-03 in House Finance

Proposed amendment to CS SS fir HB 198 (O&G)

Because Oil and Gas Royalties are reported by the month rather than the day I would like to propose an amendment:

Page 2 line 15

Insert "first" after the

Insert "day of the month following the month" after the and before the increased.

Page 3 line14

Insert "first" after the

Insert "day of the month following the month" after the and before the increased.

Page 4 line

Insert "first" after the

Insert "day of the month following the month" after the and before the increased.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: CCSSHB 198(O&G)
 (H) Publish Date: 4/28/03

Revision Date/Time (Note if correction): _____ Dept. Affected: Natural Resources
 Title: Royalty Reduction on Certain Oil BRU: Resource Development
 Component: Oil and Gas Development
 Sponsor: Kohring, Rokeberg
 Requester: House Oil and Gas Component No.: 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
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 ()	(220.9)	(358.5)	(591.4)	(589.5)	(561.5)	(485.1)
-------------------------------	----------------	----------------	----------------	----------------	----------------	----------------

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
 Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*
 HB 198 amends AS 38.05.180(f)(5) to permit reduced royalty rates to as low as 5 percent for oil production from submerged lands in Cook Inlet. This royalty reduction would apply primarily to oil produced from offshore platforms and is tied to the daily rate of oil production. While HB 198 will result in a net loss in state revenues, it is expected to extend the field or platform life, thereby increasing future field or platform production and revenues in the out-years beyond what is likely to occur otherwise. Cumulative estimated net royalty revenue lost over the six-year forecast horizon FY 2004-09 is estimated to be (\$2,807) thousand or about (\$468) thousand per year (undiscounted). These estimates include cumulative undiscounted royalty revenue benefits of about \$800 thousand (\$570 thousand when discounted) from field-life extension that could arise as a result of royalty relief of the type offered in HB 198. These fiscal impacts do not consider the broader employment and regional economic effects from extended platform life. Also, field-life extension also provides an opportunity for additional exploration from existing platforms.

Prepared by: Mark D. Myers Phone: 269-8802
 Division: Oil and Gas Date/Time: 4/23/2003
 Approved by: Tom Irwin, Commissioner Date: 4/23/2003
 Agency: Natural Resources

FISCAL NOTE #1

**STATE OF ALASKA
2003 LEGISLATIVE SESSION**

BILL NO. CSSSHB 198(O&G)

ANALYSIS CONTINUATION

HB 198 recognizes two broad groups of platforms, distinguished primarily by economic attributes associated with the degree of water handling and water injection. Platforms with major water handling and/or injection include: Dolly, Grayling, King Salmon, Steelhead, and Monopod. When oil production on these platforms falls below 1,200 barrels of oil per day (BPD) for at least one calendar quarter as certified by AOGCC, then the royalty percentage associated with that production would fall from whatever rate applies under the lease to a rate of 5 percent "for as long as the volume of oil produced from the platform remains less than 1,200 barrels a day." If average production from the field or platform that had declined below 1,200 BPD rises above this threshold for a period of at least one calendar quarter, then the bill provides for a schedule of up-ward royalty adjustments to production beyond the one-quarter term.

Platforms that do not presently employ substantial water handling and/or injection include: Granite Point, Anna, Bruce, Baker, Dillon, XTO.A and XTO.C. HB 198 provides for 750 barrels of oil per day as the economic limit rate of production for this group of platforms that would trigger royalty reduction from whatever rate applies under the lease to 5 percent. Royalty percentage upward adjustments, similar to those described under the 1,200 BPD threshold apply when oil production recovers for a sustained period of at least one calendar quarter. Note, the 750 BPD economic-limit rate of production also, applies to the West McArthur River field.

Over the past three-to-four decades, fifteen offshore, oil-production platforms have facilitated oil and gas operations in six offshore oil fields in the Cook Inlet Basin. Oil production on most of these platforms began around 1965-to-1967. The Osprey Platform, owned by Forest Oil, started continuous oil production in December 2002. Oil production from the Spark and Spurr platforms was shut-in in January 1992 and July 1992, respectively. The Dillon Platform, which served the Middle Ground Shoal oil field since September 1967, was shut-in by Unocal in January 2003. At present, twelve platforms support oil-production operations in the Cook Inlet Basin.

Three of the twelve active platforms currently produce oil at daily rates below the 750 barrels of oil per day (BPD) threshold contained in HB 198. These platforms, and the dates that corresponding production fell below 750 BPD are:

Platform	Field	Operator	Gross Production FY2002 / FY2003 (BPD)	Date Production falls below 750 BPD
Bruce	Granite Point	Unocal	619 / 476	July 1987
Dillon	Middle Ground Shoal	Unocal	423 / 374	March 1987
Baker	Middle Ground Shoal	Unocal	723 / 558	June 2002

The royalty revenue loss to rate would be approximately \$1.03 million FY 2002 and \$0.9 million in FY 2003 had HB 198 been in effect during these periods.

FISCAL NOTE #1

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO.

CSSSHB 198(O&G)

ANALYSIS CONTINUATION

Several platforms would be expected to trigger royalty relief under HB 198 during the FY2004 – FY2009 forecast horizon. If the rates of platform production continue to follow the historic patterns of decline, then the rate of production is expected to fall below 1,200 BPD for the King Salmon Platform in August 2004 and Steelhead in April 2005; platform production for XTO.C is expected to fall below 750 BPD in May 2007, as indicated in the following table:

Platform	Field	Operator	Gross Production (BPD) FY2002 / FY2003	Expected Date Production falls below	
				750 BPD	1,200 BPD
King Salmon	McArthur River	Unocal	7,468 / 3,891		Aug 2004
Steelhead	McArthur River	Unocal	1,914 / 1,584		April 2005
XTO.C	Middle Ground Shoal	XTO	1,047 / 1,099	May 2007	

The Dillon platform was shut-in in January 2003 and Baker is subject to imminent shut-in based on representations made by Unocal. These platforms are assumed to be shut-in for purposes of the forward fiscal impact analysis. The value of Cook Inlet crude oil in future years is assumed to be \$20.00 per barrel. The estimated cumulative gross royalty revenue loss is (\$3.6) million undiscounted over the six-year forecast period (equals (\$2.8) million when discounted at 8% per year), based on the difference between expected royalty revenue with and without the provisions contained in HB 198, not counting potential incremental production from extended field or platform life. When the cash-flow impact of royalty reduction under HB 198 is taken into account, delayed platform shut-in is expected for four platforms (including Bruce, described above) during the forecast horizon. The shut-in deferment would range between 2 and 14 months for a given platform. The resulting shut-in delays would generate between 500-to-700 thousand barrels of total incremental production (includes working-interest and royalty), of which approximately one-third would occur in the FY 2005-06 timeframe. The remainder of incremental production would occur during FY 2008-09 and beyond. The cumulative, upside royalty impact of the expected incremental production would range between \$400-to-\$800 thousand, depending on assumptions regarding threshold rates of production, discounting, and timing of ultimate platform shut-in.

Taking all short- and long-run factors into consideration, the overall royalty revenue impact of HB 198 would be approximately (\$2.8) million [(\$3.6) million in royalty foregone plus about \$0.8 million in royalty gain from extended platform life] or about (\$468) thousand per year (net) over the six-year period, FY 2004-2009. Note that these fiscal impacts do not consider the broader employment and regional economic effects from extended platform life.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX: (907) 465-2029
Mail Stop 3101


State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

May 7, 2003

SUBJECT: CSSSHB 198(O&G) -- sectional analysis
(Work Order No 23-LS0727I)

TO: Representative Vic Kohring
Chair of the House Special Oil and Gas Committee

FROM: Jack Chenoweth
Assistant Revisor of Statutes 

Per Ben Grenn's request, set out below is an overview of CSSSHB 198 (O&G), a measure reducing royalty on certain oil produced from Cook Inlet submerged land. The measure adds a new paragraph to AS 38.05.180(f). To shorten the measure's length, omitted from the text of the measure is the general lead-in language for subsection (f), which reads as follows:

(f) Except as provided by AS 38.05.131 - 38.05.134 [*these provisions deal with exploratory licenses*] and 38.05.177 [*this section deals with shallow natural gas development*], the commissioner may issue oil and gas leases on state land to the highest responsible qualified bidder as follows:

The following paragraphs in subsection (f) describe, among other provisions, state royalty due on production from the leases.¹

In bill section 1,

-- subparagraphs (A) and (B), read together, first reduce the royalty payable from the platforms enumerated in (A)(i) - (v) to a rate of five percent if platform production declines to less than 1,200 barrels per day for at least one calendar quarter and remains below that level, then provides for a stepped increase in the royalty rates, as described in

¹ In the existing paragraph immediately preceding the material addressed in this measure, paragraph (f)(5), the statute describes a temporary reduction of royalty due on oil and gas produced for sale from certain fields within the Cook Inlet sedimentary basin that were discovered before January 1988 and that were undeveloped or shut in from that time through December 1997. Drawing from that model, this measure directs certain royalty reductions for oil produced from platforms or fields offshore in Cook Inlet based on reduced quantities of production.

Representative Vic Kohring

May 7, 2003

Page 2

(B)(i) - (iv), for production from those platforms based on increases above 1,200 barrels per day to the ranges described in each of those provisions;

-- subparagraphs (C) and (D), read together, first reduce the royalty payable from the platforms described in (C)(i) - (vii) to a rate of five percent if platform production declines to less than 750 barrels per day for at least one calendar quarter and remains below that level, then provides for a stepped increase in the rates, as described in (D)(i) - (iv), for production from those platforms based on increases above 750 barrels per day to the ranges described in each of those provisions;

-- subparagraphs (E) and (F), read together, first reduce the royalty payable from the West MacArthur River field to a rate of five percent if production from that field declines to less than 750 barrels per day for at least one calendar quarter and remains below that level, then provides for a stepped increase in the rates, as described in (F)(i) - (iv), for production from that field based on increases above 750 barrels per day to the ranges described in each of those provisions; and

-- subparagraph (G), applicable to all the preceding, specifies how daily production from the platforms or fields is to be calculated (that is, generally "based on reservoir conditions" and "without consideration" of short-term production declines or temporary shutdowns due to factors enumerated in (G)(ii)).

JBC:lmb

03-179.lmb

**Royalty Reduction Incentive for Aging
Cook Inlet Oil Fields**

Royalty Reduction Incentive for Aging Cook Inlet Oil Fields:

"An Act providing for the reduction of royalty on oil produced from certain leases covering submerged lands of Cook Inlet to encourage otherwise uneconomic production, to promote continued employment and to prolong the useful life of vital oil production facilities and infrastructure; and providing for an effective date."

Amend AS.38.05.180 to add a new subsection "g" and renumber the remaining subsections.

(g) Notwithstanding and in lieu of a requirement in the leasing method chosen of a minimum fixed royalty share, or the royalty provision of a lease, for leases unitized as described in (p) of this section, leases subject to an agreement described in (s) or (t) of this section, or interests unitized under AS 31.05, the lessee of all or part of an oil field located offshore beneath the submerged lands of Cook Inlet shall pay a royalty of five percent on oil produced from that platform, field or pool when the volume of oil produced from that platform, field or pool has declined below 1,200 barrels per day, as certified by the Alaska Oil and Gas Conservation Commission, and for so long thereafter as the volume of oil produced remains below that threshold level. (It seems to me that "Pool" needs to be deleted, since most platforms produce from multiple pools, and we do not want to imply that production from a platform will be segregated by pool, and this royalty reduction applied on that basis.)

Purpose of the legislation

Many of the oil fields in the Cook Inlet are approaching the end of their economic lives. The recent announcement by Unocal concerning their plans to idle two of the 13 current oil producing platforms in the Inlet is a reminder of this. The infrastructure that was created to serve these fields is extensive and in most cases irreplaceable if idled prematurely.

By decreasing the State's royalty from 12 ½% to 5% as the platform or field nears the economic limit, additional field life can be achieved. It is anticipated this field life extension will be on the order of 1-3 years. The value of this approach would be as follows:

- Delays impending elimination of jobs

- Prolongs utility of critical infrastructure that could be used to support future new development or exploration

- Royalty payments over extended field life offset the reduction in royalty share

- Property tax payments are extended

Any legislation to accomplish this needs to possess the following elements to be successful in providing sufficient incentives to motivate the operators/owners to participate: (1) needs to be predictable so as to allow the operators to plan maintenance and staffing in advance,(2) needs to be simple and easy to administer, and (3) needs to be in place soon to maximize its impact.

To accomplish this, we make the following suggestions:

- Limit the incentive to currently producing oilfields only in submerged waters of the Inlet. Gas economics are more complex. Issues related to determining gas field economic limits are very different than those related to determining oil field economics. Accessible onshore oil fields can be shut-in gradually. A remote oil field or platform, or group of platforms will be idled abruptly when the total production rate fails to support the complete operating entity; therefore, issues related to the end of field life of remote oil fields should be treated differently.
- It is important that the operator know the program in advance. Specification of a fixed rate (such as of 1200 BOPD per field, pool or

platform) will allow the operator to plan maintenance and staffing to handle the additional field life and probably further extending field life by being able to further reduce costs because of the certainty in planning. Unocal did a study in 1997 and arrived at an economic limit of 1000 BOPD/platform. We would recommend using 1200 BOPD today due to inflation.

- Tying the incentives to separate economic limit rates for each platform will not work due to complex operating cost issues. It should be based on oil rate only.
- A possible safety valve for the State could be a provision that if investments resulted in the field, pool or platform rate increasing after the royalty reduction is in place, then the royalty rate could return to 12 ½%. We would recommend a 2400 BOPD field, pool, or platform rate over a continuous 3-month period as the trigger. This would protect the State in case of an unanticipated success and still provide some incentive for the operator to further invest, looking for upside potential. The royalty volume to the state at-risk if the trigger was doubled to 2400 BOPD, is only 90 BOPD.

- An oil price trigger could also be implemented. We recommend against such a trigger because the incentive is marginal already and installing an oil price threshold would complicate the process and further undercut the value of the incentive. History demonstrates that oil price spikes are followed by precipitous drops in oil prices. Eliminating the potential of an operator to benefit from oil price spikes undercuts the future value of the oil and of the already marginal operation, and an operator's willingness to weather periods of low prices.

- The State's concern over an operator "gaming" the system by keeping the rate just under the return threshold should not be an issue. The operator's share is 95% of each barrel anyway; therefore, gaming the 7.5% of a barrel doesn't make sense.

- We recommend that the program start in July 2003, based on the prior quarter's oil rate.

- The following are the fields and platforms that would be affected and their current rates:

<u>Field/Platform</u>	<u>BOPD 12/02</u>
Middle Ground Shoal	
Baker	520
A	3500
C	1800
Dillon	shut-in
Granite Point Field	
Anna	1170
Bruce	500
Granite Point	1670
Trading Bay Field	
Monopod	2310
North Trading Bay	
Spark	shut-in
Spurr	shut-in
McArthur River Field	
King Salmon	4100
Grayling	3440
Dolly Varden	3050

Steelhead (oil only)	1640
West McArthur Field	2790
Redoubt Unit	2550

The incentive of the 7 ½% royalty reduction may in itself not be enough to keep the operator producing past the anticipated limit, but it sends the right message at no cost to the State. We would recommend resisting many bill additions as it is critical that the program be clear, predictable, and timely.



RESOURCE DEVELOPMENT COUNCIL

Growing Alaska Through Responsible Resource Development

May 5, 2003

Representative Hugh Fate, Chair
House Resources Committee
Alaska State Capitol
Juneau, Alaska 99801-1182

Re: House Bill 198 — Royalty Reduction on Certain Oil

Dear Representative Fate:

On behalf of the Resource Development Council for Alaska, Inc. (RDC), I am writing in support of HB198 — Royalty Reduction on Certain Oil. RDC is a private, non-profit, business association representing individuals and companies from Alaska's oil and gas, mining, timber, tourism and fisheries industries. Our mission is to help grow Alaska's economy through the responsible development of the state's natural resources. HB198 encourages development of Alaska's resources while protecting the interests of the State. The bill deserves your committee's strong support, and we urge you to move it forward.

As you are well aware, many of the oil fields in Cook Inlet have begun to reach the threshold of economic productivity. UNOCAL's recent decision to close two of its Cook Inlet platforms is evidence of this trend. Because the Cook Inlet basin is a maturing oil province, it is appropriate for the State to consider incentives designed to prolong the life of existing fields, protect critical infrastructure and encourage opportunities for future investment. HB198 addresses each of these goals.

HB198 creates a royalty reduction schedule triggered by specific production volume levels — 1,200 barrels per day and 750 barrels per day depending upon the field. By establishing a fixed royalty reduction schedule this legislation provides operators with an economic incentive that is predictable, simple and can be put into place quickly. In other words, it is something companies can count on when making investment decisions. The bill also protects the State by increasing the royalty rate if production from a participating field subsequently increases above either 750 or 1,200 barrels per day.

If passed this bill will generate a host of benefits. Most importantly HB198 will add one to three years of life to several Cook Inlet oil fields. Extended life for these fields will in turn prolong the utility of critical infrastructure and offset the State's reduced royalty share. It is important to note that maintaining Cook Inlet's existing infrastructure may facilitate future exploration, development and production of currently undiscovered reserves. At a

community level HB198 will delay workforce reductions and help maintain the region's property tax base.

Thank you for considering our position on this important piece of legislation. Please feel free to contact me with any questions.

Sincerely,

RESOURCE DEVELOPMENT COUNCIL
for Alaska, Inc.

A handwritten signature in cursive script that reads "Tadd Owens". The signature is written in black ink and is positioned above the printed name and title.

Tadd Owens
Executive Director