

HB

57

HFIN

FILE

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: CSHB57(FIN)
 () Publish Date: _____

Revision Date/Time (Note if correction): 3/25/2003 Dept. Affected: Natural Resources
 Title Royalty Gas Contracts BRU Resource Development
 Component Oil and Gas Development
 Sponsor Chenault
 Requester House Finance 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						
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CHANGE IN REVENUES (GF 1004)	(98.0)	(130.3)	(938.8)	(2,438.9)	(3,476.4)	(4,462.7)
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FUND SOURCE (Thousands of Dollars)

FUND SOURCE	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
1002 Federal Receipts						
1003 CF 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)

** Fiscal Note prepared for House Finance Committee Work Draft

This bill amends AS 38.05.180(aa) requiring DNR to enter into agreements with lessees to use the price for gas established in contract(s) entered into on or after the effective date between the lessee and a manufacturer of agricultural chemicals as the value of the state's royalty share. HB 57 will result in a loss of state revenues. Should lessees supplying gas to only one agricultural manufacturer apply under AS 38.05.180(aa), the state could lose an estimated \$11.5 million in cumulative royalties over the period FY 2004-09; an average of about \$1.9 million per year (see Table 1, below).

Prepared by: Mark D. Myers Phone 269-8800
 Division Oil and Gas Date/Time 3/25/2003
 Approved by: Tom Irwin, Commissioner Date 3/25/2003
 Agency Natural Resources

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(FIN) wk dr

ANALYSIS CONTINUATION

Table 1. Impact of HB 57 on State Royalty Revenue: FY 2003 - 2009

New Gas Produced from Other 3rd-Party Producers - State Lands								
FY	Total (1000 Cubic Feet per Year)	State Leases (1000 Cubic Feet per Year)	Non-State (1000 Cubic Feet per Year)	State Royalty Share	Contract	Royalty	Diff	Royalty Foregone (\$ per Year)
					Value (\$ per Mcf)	Value (\$ per Mcf)		
2004	1,728,506	1,728,506	-	230,583	2.00	2.43	0.43	(98,033)
2005	1,728,506	1,728,506	-	230,583	2.00	2.57	0.57	(130,287)
2006	14,900,000	9,983,000	4,917,000	1,331,732	2.00	2.70	0.70	(938,763)
2007	32,300,001	21,641,001	10,659,000	2,886,909	2.00	2.84	0.84	(2,438,869)
2008	39,500,000	26,465,000	13,035,000	3,530,431	2.00	2.98	0.98	(3,476,367)
2009	44,400,000	29,748,000	14,652,000	3,968,383	2.00	3.12	1.12	(4,462,725)

Estimated Total Royalty Losses Under New gas Supply 3rd-Party Contracts (FY 2004-09) = (11,545,044)
Total Royalty Losses (Discounted) = (7,619,642)

The analysis in Table 1 illustrates the yearly potential royalty revenue impacts taking into account the decline in gas to be supplied by Unocal to Agrium under a pre-existing contract after FY 2005. The implied yearly gas shortfall during FY 2006-09 is, by assumption, supplemented with new gas from 3rd-party producers. Royalty production from new gas would post date the Act and be eligible for (aa) treatment under HB 57. It is further assumed that Agrium would realize 100 percent of the benefits. Table 1 indicates that the state would forego a total of about \$11.5 million in royalty revenue or about \$1.9 million per year (undiscounted) over the period FY 2004-09. Detailed assumptions used for the estimates in Table 1, plus several sensitivity scenarios, are described below.

Assumptions

1. Annual gas consumption at the fertilizer plant is equal to about 53 billion cubic feet per year (Bcf), based on historic rates of gas usage over the past five years.
2. The analysis in Table 1 draws from the "Annual Contract Quantity" (ACQ) commitments contained in the existing Unocal-Agrium gas supply contract. During the later years of the contract, the ACQ falls from the approximate plant capacity of about 53 Bcf per year in FY 2005 to 9.1 Bcf per year in FY 2009.
3. Based on representations made to the Division of Oil and Gas by Agrium, the analysis in Table 1 assumes that the state's royalty share on ACQ volumes deliverable from state leases under the current contract between Unocal and Agrium will not be subject to the bill. Agrium and Unocal are currently in litigation regarding that contract. If Agrium and Unocal negotiate a new, low-price contract to replace the current contract in connection with the ongoing litigation, the royalties foregone could nearly triple, from \$11.5 to \$29.5 million. Agrium has assured the Division of Oil and Gas that it does not intend to renegotiate its contract with Unocal in a manner that would subject volumes deliverable under the current contract to the provisions of this bill.
4. State leases would account for approximately two-thirds of the total gas usage at the plant from new, 3rd-party gas supply contracts after 2005; the remaining one-third is new gas production from private and federal lands.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(FIN) wk d.

ANALYSIS CONTINUATION

5. The average state royalty share for gas dispositions to the plant is 13.34 percent.
6. Royalty value is indexed to the Alaska Department of Revenue prevailing value for Cook Inlet Gas (DOR PV). The Division of Oil and Gas forecasts DOR PV to increase from about \$2.50 per Mcf today, to \$3.12 per Mcf in FY 2009, based on the historic trend observed during 1995-02.
7. The implied gas shortfall in ACQ commitments is made up of new gas from 3rd-party producers but at a cost of \$2.00 per Mcf. This is considerably higher than the current \$1.20 benchmark input gas price in the existing Unocal-Agrium contract.

Sensitivity Analysis

Three alternative gas-supply scenarios are considered. **Case A:** Assume that the average formula-driven, gas-supply contract value is \$2.25 per Mcf instead of \$2.00 (see assumption #7). All else equal, this would lower estimated royalties foregone from \$11.5 million to \$8.5 million. **Case B:** By comparison, if the average formula-driven, gas-supply contract value is \$1.20 per -- equal to the current Unocal benchmark -- the royalties foregone would nearly double from \$11.5 to 21.3 million.) **Case C:** If the fertilizer plant operates at 75% capacity due to input gas supply shortages from both existing and 3rd-party producers then, assuming \$2.00 per Mcf input gas cost, estimated royalties foregone would fall from \$11.5 million to \$8.7 million. **Cases A and C combined** would reduce cumulative royalties foregone from \$11.5 million to about \$6.4 million.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: CSHB57(FIN)
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Revision Date/Time (Note if correction): 4/4/2003 Dept. Affected: Natural Resources
 Title: Royalty Gas Contracts BRU: Resource Development
 Component: Oil and Gas Development
 Sponsor: Chenault
 Requester: House Finance Component No. 439

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

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Equipmen..						
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CAPITAL EXPENDITURES						
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CHANGE IN REVENUES (GF 1004)	*(98.0)	*(130.3)	*(938.8)	*(2,438.9)	*(3,476.4)	*(4,462.7)
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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)

This bill amends AS 38.05.180(aa) requiring DNR to enter into agreements with lessees to use the price for gas established in contract(s) entered into on or after the effective date between the lessee and a manufacturer of agricultural chemicals as the value of the state's royalty share. HB 57 will result in a loss of state revenues. Should lessees supplying gas to only one agricultural manufacturer apply under AS 38.05.180(aa), the state could lose an estimated \$11.5 million in cumulative royalties over the period FY 2004-09; an average of about \$1.9 million per year (see Table 1, below).

*If a contract does not meet any one of the four criteria under AS 38.05.180(aa)(2)((B)(i)-(iv), the Commissioner would deny the (aa) treatment. Under this scenario, the fiscal impact to the state would be less although the amount is impossible to predict.

Prepared by: Mark D. Myers Phone 269-8800
 Division: Oil and Gas Date/Time 4/4/2003
 Approved by: Tom Irwin, Commissioner Date 4/4/2003
 Agency: Natural Resources

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2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(FIN)

ANALYSIS CONTINUATION

Table 1. Impact of HB 57 on State Royalty Revenue: FY 2003 - 2009

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The analysis in Table 1 illustrates the yearly potential royalty revenue impacts taking into account the decline in gas to be supplied by Unocal to Agrium under a pre-existing contract after FY 2005. The implied yearly gas shortfall during FY 2006-09 is, by assumption, supplemented with new gas from 3rd-party producers. Royalty production from new gas would post date the Act and be eligible for (aa) treatment under HB 57. It is further assumed that Agrium would realize 100 percent of the benefits. Table 1 indicates that the state would forego a total of about \$11.5 million in royalty revenue or about \$1.9 million per year (undiscounted) over the period FY 2004-09. Detailed assumptions used for the estimates in Table 1, plus several sensitivity scenarios, are described below.

Assumptions

1. Annual gas consumption at the fertilizer plant is equal to about 53 billion cubic feet per year (Bcf), based on historic rates of gas usage over the past five years.
2. The analysis in Table 1 draws from the "Annual Contract Quantity" (ACQ) commitments contained in the existing Unocal-Agrium gas supply contract. During the later years of the contract, the ACQ falls from the approximate plant capacity of about 53 Bcf per year in FY 2005 to 9.1 Bcf per year in FY 2009.
3. Based on representations made to the Division of Oil and Gas by Agrium, the analysis in Table 1 assumes that the state's royalty share on ACQ volumes deliverable from state leases under the current contract between Unocal and Agrium will not be subject to the bill. Agrium and Unocal are currently in litigation regarding that contract. If Agrium and Unocal negotiate a new, low-price contract to replace the current contract in connection with the ongoing litigation, the royalties foregone could nearly triple, from \$11.5 to \$29.5 million. Agrium has assured the Division of Oil and Gas that it does not intend to renegotiate its contract with Unocal in a manner that would subject volumes deliverable under the current contract to the provisions of this bill.
4. State leases would account for approximately two-thirds of the total gas usage at the plant from new, 3rd-party gas supply contracts after 2005; the remaining one-third is new gas production from private and federal lands.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(FIN)

ANALYSIS CONTINUATION

5. The average state royalty share for gas dispositions to the plant is 13.34 percent.
6. Royalty value is indexed to the Alaska Department of Revenue prevailing value for Cook Inlet Gas (DOR PV). The Division of Oil and Gas forecasts DOR PV to increase from about \$2.50 per Mcf today, to \$3.12 per Mcf in FY 2009, based on the historic trend observed during 1995-02.
7. The implied gas shortfall in ACQ commitments is made up of new gas from 3rd-party producers but at a cost of \$2.00 per Mcf. This is considerably higher than the current \$1.20 benchmark input gas price in the existing Unocal-Agrium contract.

Sensitivity Analysis

Three alternative gas-supply scenarios are considered. **Case A:** Assume that the average formula-driven, gas-supply contract value is \$2.25 per Mcf instead of \$2.00 (see assumption #7). All else equal, this would lower estimated royalties foregone from \$11.5 million to \$8.5 million. **Case B:** By comparison, if the average formula-driven, gas-supply contract value is \$1.20 per – equal to the current Unocal benchmark – the royalties foregone would nearly double from \$11.5 to 21.3 million.) **Case C:** If the fertilizer plant operates at 75% capacity due to input gas supply shortages from both existing and 3rd-party producers then, assuming \$2.00 per Mcf input gas cost, estimated royalties foregone would fall from \$11.5 million to \$8.7 million. **Cases A and C combined** would reduce cumulative royalties foregone from \$11.5 million to about \$6.4 million.

adopted 4/2/03

23-J.S0303\W
Chenoweth
4/2/03

CS FOR HOUSE BILL NO. 57()

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY

**Offered:
Referred:**

Sponsor(s): REPRESENTATIVES CHENAULT, Whitaker

A BILL

FOR AN ACT ENTITLED

1 **"An Act amending the manner of determining the royalty received by the state on gas**
2 **production as it relates to the manufacture of certain value-added products."**

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

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

5 (aa) Within 90 days after the written request of a lessee of a lease issued under
6 this section or of a lessee of federal land from which the state is entitled under
7 applicable federal law to receive a share of the royalty on gas production, the
8 commissioner shall enter into an agreement with the lessee to use or accept the price
9 for the gas established in the contract between the lessee and a gas or electric utility,
10 or, for a contract that is entered into on or after the effective date of this Act, to
11 use or accept a price for the gas established in the contract between the lessee and
12 a manufacturer of agricultural chemicals, as appropriate, as the value of the state's
13 royalty share of gas production sold by the lessee under the contract

14 (1) but only if

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

9 (B) for a contract between the lessee and a manufacturer of
10 agricultural chemicals, the primary function of the manufacturer is to
11 engage in the production of a value-added product, and the manufacturer
12 with which the lessee has entered into the contract is not affiliated with the
13 lessee or with a subsequent purchaser of more than 10 percent of the
14 manufacturer's value-added product; for purposes of this subparagraph,
15 the parties to a contract or purchase are affiliated if, in the judgment of
16 the commissioner, one of the parties to the contract or purchase exercises
17 substantial influence over the policies and actions of the other as
18 evidenced by relationship based on common ownership or family interest
19 or by action taken in concert without regard to whether that influence is
20 based upon stockholdings, stockholders, officers, or directors; and

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

23 (A) for a contract entered into for a circumstance described
24 in (1)(A) of this subsection

25 (i) the contract price is unreasonably low;

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

29 (iii) [(C)] the lessee and the utility are related in
30 management, ownership, or other aspect; and

31 (iv) [(D)] the contract price is not in the best interest of

1 the state;

2 (B) for a contract entered into under (1)(B) of this
3 subsection between a lessee and a manufacturer of agricultural chemicals,

4 (i) the contract price is unreasonably low;

5 (ii) the prospective reduction in royalty receipts
6 would not be balanced by employment opportunities or other
7 tangible benefits to the state;

8 (iii) the lessee and the manufacturer are related in
9 management, ownership, or other aspect; or

10 (iv) the contract price is not in the best interest of
11 the state.

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

13 (2) "price for the gas established in the contract" includes tax
14 reimbursement amounts, deliverability and other charges, and other forms of
15 consideration paid by the gas or electric utility or by the manufacturer of
16 agricultural chemicals, as appropriate, under the contract;

17 * Sec. 3. AS 38.05.180(bb) is amended by adding a new paragraph to read:

18 (4) "manufacturer of agricultural chemicals" means a person that is a
19 business entity primarily engaging in the manufacturing of nitrogenous and phosphatic
20 based fertilizers, mixed fertilizers, pesticides, and similar chemicals for agricultural
21 purposes.

22 * Sec. 4. The uncodified law of the State of Alaska is amended by adding a new section to
23 read:

24 APPLICABILITY. The provisions of this Act apply to determine the price received
25 by the state on royalty gas production as it relates to the sale of the gas to a manufacturer of
26 agricultural chemicals based on contracts under AS 38.05.180(aa) that are entered into on or
27 after the effective date of this Act.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: CSHB 57(O&G)
 (H) Publish Date: 2/26/03

Revision Date/Time (Note If correction): 2/11/2003 Dept. Affected: Natural Resources
 Title: Royalty Gas Contracts BRU: Oil and Gas Development
 Component: Oil and Gas Development
 Sponsor: Chenault
 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						
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CHANGE IN REVENUES ()		**See Revenue Impact Analysis Below**		
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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)

**This bill amends AS 38.05.180(aa) requiring DNR to enter into agreements with lessees to use the price for gas established in contract between the lessee and a manufacturer as the value of the state's royalty share. HB 57 will result in a loss of state revenues. Should only one manufacturer apply under AS 38.05.180(aa), the state could lose an estimated \$33.4 million in royalties over a period of seven years (see Table 3, below). However, proposed amendments in HB 57 are worded more broadly than just one company. Interpretation of "manufacturer" may be broadly interpreted to apply to disposition of all royalty gas subject to in-state processing (e.g. LNG, NGIs). Therefore, this \$33.4 million could significantly understate the total revenue impact of HB 57. Furthermore, a much larger revenue impact could occur with a major sale of North Slope royalty gas, since both Prudhoe Bay's existing Central Gas Facility and any new gas treatment facilities are apt to add value to gas treated in these facilities.

Prepared by: Mark D. Myers Phone 269-8800
 Division: Oil and Gas Date/Time 2/11/03 1:09 PM
 Approved by: Tom Irwin, Commissioner Date 2/11/2003
 Agency: Natural Resources

FISCAL NOTE #1

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(O&G)

ANALYSIS CONTINUATION

The estimates in Table 1 show the impact HB 57 would have had on the value of royalty gas dispositions to the Nikiski fertilizer plant operated by Agrium U.S. Inc., had HB 57 been in effect during the period 2000-02. The cumulative impact would have been approximately \$8.2 million in nominal dollars.

The estimates in Table 2 illustrate the forward impact of HB 57 on state royalty revenue based on the assumption that Unocal supplies all of the input gas requirements to the Nikiski fertilizer plant through FY 2009. The estimates in Table 2 indicate that the state would forego approximately \$36.6 million in royalty revenue or about \$5.2 million per year over the period FY 2004-09. The benefit to Agrium would be half of these amounts because the Unocal-Agrium gas supply contract requires that both parties share equally in any royalty adjustments.

Table 1. Impact of HB 57 on State Royalty Revenue, 2000 - 2002

	Gas Production from State Leases (Thousand Cubic Feet per Year)	State Royalty Share	State Royalty Percent (%)	Contract			Royalty Foregone (\$ per Year)	Discount/Compound Factor 0.08	Discounted Royalty Foregone (\$ per Year)
				Value	Royalty Value	Diff			
2000	26,337,176	3,431,229	13.03%	\$1.20	\$1.70	\$0.50	\$ 1,715,614	121.2%	\$ 2,079,597
2001	27,004,457	3,573,255	13.23%	1.38	2.20	0.81	2,907,105	112.2%	3,262,844
2002	24,315,609	3,353,117	13.79%	1.47	2.55	1.08	3,621,743	103.9%	3,763,826
Average				\$1.35			\$8,244,462		\$9,106,267

**Table 2. Impact of HB 57 on State Royalty Revenue: Fixed Supply
FY 2003 - 2009**

FY	Gas Production from State Leases (Thousand Cubic Feet per Year)	State Royalty Share	State Royalty Percent (%)	Contract			Royalty Foregone (\$ per Year)	Discount/Compound Factor 0.08	Discounted Royalty Foregone (\$ per Year)
				Value	Royalty Value	Diff			
2003	25,885,747	3,452,534	13.34%	\$1.20	\$2.37	\$1.17	\$ 4,045,087	96.2%	\$ 3,892,387
2004	25,885,747	3,452,534	13.34%	1.20	2.43	1.23	4,219,421	89.1%	3,759,389
2005	25,885,747	3,452,534	13.34%	1.20	2.57	1.37	4,701,181	82.5%	3,878,355
2006	25,885,747	3,452,534	13.34%	1.20	2.70	1.50	5,182,941	76.4%	3,959,069
2007	25,885,747	3,452,534	13.34%	1.20	2.84	1.64	5,664,700	70.7%	4,006,545
2008	25,885,747	3,452,534	13.34%	1.20	2.98	1.78	6,146,460	65.5%	4,025,264
2009	25,885,747	3,452,534	13.34%	1.20	3.12	1.92	6,628,220	60.6%	4,019,226
							\$36,588,010		\$27,540,236

The analysis in Table 3 is similar to Table 2 except that the current contractual gas supply commitment to the plant declines sharply after FY 2005. Cumulative royalties foregone for this supply of gas would be \$22.0 million (as before, this benefit would be shared equally between Agrium and Unocal). The implied yearly gas shortfall during FY 2006-09 is supplemented with *new gas* from 3rd-party producers. Royalty production from new gas also would be eligible for cumulative HB 57 benefits equal to \$11.4 million. In this situation, Agrium is assumed to realize 100 percent of the benefits. Table 3 indicates that the state would forego a total of about \$33.4 million in royalty revenue or about \$4.8 million per year (undiscounted) over the period FY 2004-09. Detailed assumptions used for the estimates in Tables 2 and 3, plus several sensitivity scenarios, are described below.

FISCAL NOTE #1

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(O&G)

ANALYSIS CONTINUATION

Assumptions (Continued)

6. The underlying analysis in Table 2 is built on the assumption that Unocal supplies 100% of plant input-gas requirements through FY 2009. The analysis in Table 3 draws from the "Annual Contract Quantity" (ACQ) commitments contained in the existing Unocal-Agrium gas supply contract. During the later years of the contract, the ACQ falls from the approximate plant capacity of about 53 Bcf per year in FY 2005 to 9.1 Bcf per year in FY 2009.
7. The implied gas shortfall in Table 3 is made up of *new gas* from 3rd-party producers but at a higher cost of \$2.00 per Mcf. This implies a smaller contract-price differential for new gas dispositions to the plant when compared with the forecast of DOR PV. It is further assumed that about 2/3 of new gas is produced from state leases that are subject to the provisions of HB 57; the remaining 1/3 is new gas production from private and federal lands.

Sensitivity Analysis

Several alternative gas-supply scenarios are considered. **Case A:** Assume that the average formula-driven, gas-supply contract value is \$1.35 per Mcf instead of \$1.20 (see assumption #4). All else equal, this would lower the estimate of royalties foregone from \$33.4 million to \$31.0 million. **Case B:** If the fertilizer plant operates at 75% capacity due to input gas supply shortages from both existing and 3rd-party producers then, all else equal, estimated royalties foregone would fall from \$33.4 million to \$25.0 million. **Cases A and B combined** would reduce royalty foregone from \$33.4 million to \$23.3 million.

Testimony on HB 57/SB 50
Gary Carlson
Senior Vice President, Forest Oil Corporation
3/26/03

Gas exploration is only a recent focus in the Cook Inlet outside the companies that controlled the market. You now have companies like Aurora, Evergreen and Forest Oil, beginning to invest in gas exploration and development with the anticipation of supply gaps in current markets. There is a small, but expanding demand by the utilities, and an anticipated large gap in the amount of gas committed to keep the Agrium plant at capacity. Forest Oil is actively investing in gas prospects in part due to this anticipated market.

Field size distribution analysis suggests that there are 100 BCF to 500 BCF accumulations yet to be discovered in the Inlet. The current annual production rate of 200 BCF can be broken down into service to various markets. A rough estimate would be 35% LNG, 25% fertilizer feedstock, 30% utilities and 10% fuel in oil and gas facilities.

The commerciality of the projects is tied to capital required, rate that the asset can produce, and price. As an industry, we are working hard to drive down the costs using new technology and innovative utilization of current

infrastructure. The gap in supply for the fertilizer plant is a key driver for the anticipated market. I will not try to address the price Agrium can afford to pay for its feedstock except to say that it ranges from \$1.50 - \$2.00 MCF depending upon fertilizer prices.

Under current law, these low product prices coupled with the potential of a 20% royalty burden would limit the number of small or moderate gas development projects that would be considered commercial. The other threat facing potential upstream investors in gas potential is the partial idling or shutting in of the fertilizer plant for Cook Inlet gas, thus eliminating the near term market.

The timeframe from exploration to first production can exceed 5 years; therefore, some degree of certainty is essential to encourage investment. Currently, the States ability and willingness to negotiate an equitable royalty settlement is a possible solution to this critical problem; however, there still remains a degree of uncertainty in the process.

As an upstream investor in the Cook Inlet, Forest Oil supports SB 50. I would be happy to answer any questions.

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DOCUMENT(S)
ARE
POOR
ORIGINAL
COPIES



The Alaska Farm Bureau



Colleen Wright, Project Coordinator
Post Office Box 55149 Fax: (907) 488-6179
North Pole, AK 99705-0149 E-mail: akfarmus@hotmail.com
or cwrite@ptialaska.net

Robert Franklin, President
Fax: (907) 488-3184
E-mail: akbfrank@pci.net

March 27, 2003

Representative Charles Chenault
Fax 465-2833

Dear Representative Chenault,

HB 57, commonly referred to as the "Agrium bill", would provide for consideration in the price paid for natural gas used in the production of agriculture fertilizer. Agrium and its predecessors have provided a valuable service to the agriculture industry in Alaska. The Alaska Farm Bureau supports the efforts of this legislation in maintaining the operation of a fertilizer production plant in Alaska.

There are other "tangible benefits", as noted in Section 1aa(2)Bii, that should be considered in the legislation. In Alaska, fertilizer accounts for about 25% of the cost of production for crops. About half of the fertilizer that is used is in the form of urea as produced by the Agrium facility. The price paid by Alaska farmers for urea has a significant impact on the profitability of agriculture.

When that fertilizer plant was originally built, the Kenai Borough provided tax relief for a period of time. One of the considerations during that period of tax relief was a substantial reduction or waiver of price for urea fertilizer sold to Alaska farmers. That offering of good will had a minimal impact on the cost of operations but it provided enormous help to agriculture in Alaska.

If the State provides relief to Agrium in the cost of natural gas, it would be appropriate to include a provision that reduces the cost of urea sold to Alaska farmers. The amount of fertilizer sold in Alaska is extremely small compared to their total production and the effect on their cost of operations would be insignificant. On the other hand, the good will would be positive and the economic benefit to Alaska agriculture would be substantial.

I would request that you add language to HB57 that provides a price reduction for fertilizer sold in Alaska for agriculture production. Feel free to contact me if you have any questions or need additional information.

Signed:

Robert Franklin - pres.
Phone 488-7738

Considerations in amending HB57 to reflect an Alaska fertilizer price

- 1) About 1,200-1400 tons of urea is sold annually in Alaska as agriculture fertilizer.
- 2) There are just two dealers for Agrium fertilizer in Alaska.
Alaska Mill & Feed – Anchorage
Alaska Farmers Coop – Delta Jct.
- 3) Additional urea is sold through the dealers for retail home lawn/garden and government sales.
- 4) An agriculture price could be administered by the dealers signing an end user certificate verifying the sale to agriculture production.
- 5) A reduction in urea pricing would help offset the high cost of imported phosphorus/potash used in agriculture production.
- 6) Lower fertilizer costs will make Alaska agriculture producers more competitive and profitable.
- 7) Lower fertilizer costs will encourage landowners to apply proper soil amendments, thereby promoting adequate plant cover and reduced soil erosion.
- 8) Consideration by the state in reducing natural gas pricing should be offset by a reduction in the end product that is sold and utilized in Alaska.

I provided this information to Pete Fellman in Rep. John Harris's office. Pete has expressed interest & knowledge on the subject.

March 31, 2003

To Whom It May Concern,

Pelican Hill Oil & Gas, Inc. is an independent oil and gas company with a history of successful operations in Kansas. We are now actively pursuing the exploration and development of oil and natural gas prospects on our leases in the Cook Inlet Basin. These are primarily gas prospects on the West Side of the inlet.

For all operators, and especially the smaller independent companies like Pelican Hill, the investment of time, money and resources that are required by such exploratory ventures can only be compensated by the prospect of discovering volumes of natural gas that are economically viable. There is always an inherent amount of risk associated with such ventures and the operator is never assured that the original investment will ever be returned, let alone any profit from the ventures if oil or gas are discovered. Upon discovery of such deposits, the immense amount of risk involved may significantly decrease as development operations continue.

Entering into a gas sales agreement with a gas purchaser should not involve an amplification of the inherent risk for the producer or the purchaser that may arise long after a sales agreement has been executed and production has been initiated. This type of amplified risk would accompany any sales agreement between Pelican Hill Oil & Gas, Inc. and Agrium U.S. Inc, should this practice be applied. Solidifying an agreement with a purchaser must be accomplished without the likelihood of future State of Alaska royalty claims. Such claims made at a later date due to higher subsequent gas prices than those initially negotiated in an arms length contract is not a desired situation. In that case the royalty, as well as the interest the State would claim

The potential for this scenario to occur is high and would be a mitigating factor for Pelican Hill or any other producer to not enter into a gas sales agreement with Agrium.

For this reason, Pelican Hill Oil & Gas, Inc. endorses HB 57 entirely. We further endorse the concept that royalties should be paid on the original arms length negotiated contract foundation without any financially devastating changes. We soundly support draft resolution HB 57 and urge you to do the same.

Allen J. Gross
President
Pelican Hill Oil & Gas, Inc.
(949) 498-2101

*adopted
3/25/03*

23-LS0303NS
Chenoweth
3/12/03

Rep. Williams

CS FOR HOUSE BILL NO. 57(FIN)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY THE HOUSE FINANCE COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVES CHENAULT, Whitaker

A BILL

FOR AN ACT ENTITLED

1 "An Act amending the manner of determining the royalty received by the state on gas
2 production as it relates to the manufacture of certain value-added products."

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

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

5 (aa) Within 90 days after the written request of a lessee of a lease issued under
6 this section or of a lessee of federal land from which the state is entitled under
7 applicable federal law to receive a share of the royalty on gas production, the
8 commissioner shall enter into an agreement with the lessee to use or accept the price
9 for the gas established in the contract between the lessee and a gas or electric utility,
10 or, for a contract that is entered into on or after the effective date of this Act, to
11 use or accept a price for the gas established in the contract between the lessee and
12 a manufacturer of agricultural chemicals, as appropriate, as the value of the state's
13 royalty share of gas production sold by the lessee under the contract

14 (1) but only if

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

9 (B) for a contract between the lessee and a manufacturer of
10 agricultural chemicals. the primary function of the manufacturer is to
11 engage in the production of a value-added product, and the manufacturer
12 with which the lessee has entered into the contract is not affiliated with the
13 lessee or with a subsequent purchaser of more than 10 percent of the
14 manufacturer's value-added product; for purposes of this subparagraph,
15 the parties to a contract or purchase are affiliated if, in the judgment of
16 the commissioner, one of the parties to the contract or purchase exercises
17 substantial influence over the policies and actions of the other as
18 evidenced by relationship based on common ownership or family interest
19 or by action taken in concert without regard to whether that influence is
20 based upon stockholdings, stockholders, officers, or directors; and

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

23 (A) the contract price is unreasonably low;

24 (B) the prospective reduction in royalty receipts would not be
25 balanced in a contract entered into for a circumstance described

26 (i) in (1)(A) of this subsection by increased benefits to
27 in-state gas and electric consumers; or

28 (ii) in (1)(B) of this subsection by employment
29 opportunities or other tangible benefits to the state;

30 (C) the lessee and the utility or manufacturer of agricultural
31 chemicals, as appropriate, are related in management, ownership, or other

1 aspect: and

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

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

4 (2) "price for the gas established in the contract" includes tax
5 reimbursement amounts, deliverability and other charges, and other forms of
6 consideration paid by the gas or electric utility or by the manufacturer of
7 agricultural chemicals, as appropriate, under the contract;

8 * Sec. 3. AS 38.05.180(bb) is amended by adding a new paragraph to read:

9 (4) "manufacturer of agricultural chemicals" means a person that is a
10 business entity primarily engaging in the manufacturing of nitrogenous and phosphatic
11 based fertilizers, mixed fertilizers, pesticides, and similar chemicals for agricultural
12 purposes.

13 * Sec. 4. The uncodified law of the State of Alaska is amended by adding a new section to
14 read:

15 APPLICABILITY. The provisions of this Act apply to determine the price received
16 by the state on royalty gas production as it relates to the sale of the gas to a manufacturer of
17 agricultural chemicals based on contracts under AS 38.05.180(aa) that are entered into on or
18 after the effective date of this Act.

Lisa Parker
Corporate Community Relations
Agrium U.S. Inc.
P.O. Box 575
Kenai, Alaska 99611-0575

Dear Ms. Parker

As you requested, we have reviewed the fiscal note prepared by the Alaska Division of Oil and Gas for House Bill 57. The note hypothesizes certain revenue impacts from passage of the bill. The note does not, however, provide a complete picture of the Bill's potential economic benefits to the State of Alaska. The economic benefits of Agrium's Kenai operations were summarized in our report, *The Economic Impacts of Agrium Kenai Nitrogen Operations in Alaska, 2001*, dated October, 2002. This letter describes elements of that analysis that we find particularly relevant to HB 57.

In 2001 the Agrium Nikiski plant purchased 53 billion cubic feet of Cook Inlet natural gas worth approximately \$80 million. The plant's value-added processing used this raw material to create \$333 million in total economic output (the value of the finished product plus the indirect and induced economic impacts of plant operations (those that are *in excess of* Agrium's direct spending for goods and services). This \$6.28 of total economic output per Mcf is more than four times the value of the raw gas.

Another way of saying this is that the plant represents more than \$300 million each year in Alaska economic activity that would not otherwise have occurred. This is because there is currently no other high-value-added use for the Cook Inlet gas purchased by Agrium. In fact, the economic loss, should Agrium cease operations, would be somewhat greater, since the state would also lose its 90 percent share of the federal royalty associated with that portion of Agrium's feedstock that comes from federal leases.¹ The magnitude of the economic benefits to the state compared with the cost in "royalty foregone" under HB 57 is notable. The royalty foregone "cost" is only about 6% of the more than \$50 million per year that the plant creates in payroll and less than 1% of the plant's total economic output.

HB 57 is important because, by your description, loss of the Agrium economic engine appears a real possibility. The current royalty structure is indexed not to actual Cook Inlet gas transactions, but to those in the Lower 48, where market exchanges are facilitated by a broad network of transportation pipelines. The resulting high royalty values are helping to push the total effective cost of Agrium's natural gas feedstock toward a point at which the Nikiski plant will become uneconomic to operate. If that happens, unless there is an alternative buyer for the gas (currently unidentified), there will be little or no incentive either to produce the gas that Agrium currently buys or to

¹ Other factors also would come into play in the event of a plant shut-down, such as devaluation of local real estate, etc. However, these effects are beyond the scope of this discussion.

explore for more. As a result, the value to Alaska of the state gas that Agrium now purchases would decline to the net present value of that gas at some point in the future (i.e., when and if a new purchaser materializes). The value of all the gas that could be produced and sold to Agrium in the meantime would be lost forever.²

The accompanying table shows the projected value to the state of imposing the higher royalty structure compared with the value of uninterrupted Agrium operations using a royalty structure based on actual contract value. (All figures in nominal dollars).

Please let us know if we can provide any further information.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim Calvin", with a long horizontal flourish extending to the right.

Jim Calvin
Partner

² More precisely, that unsold gas would remain in the ground until such time as a means exists for production and sales *in excess of* what Agrium would have used in the interim (and, one must presume, for a purpose other than production of ammonia and urea). The expected net present value of these market conditions seems likely to approach zero.

SOLDOTNA CHAMBER OF COMMERCE

RESOLUTION 2003-02

A RESOLUTION IN SUPPORT OF "AN ACT AMENDING THE MANNER OF DETERMINING THE ROYALTY RECEIVED BY THE STATE ON GAS PRODUCTION AS IT RELATES TO THE MANUFACTURE OF CERTAIN VALUE ADDED PRODUCTS"

WHEREAS, the manufacturing of value added resources in the State of Alaska serve as a catalyst to economic development in Alaska; and

WHEREAS, one of the state's premier value added manufacturing industries is located on the Kenai Peninsula; and

WHEREAS, this industry, Agrum Kenai Nitrogen Operations, is exceptional for its combination of high pay levels, amount and concentration of expenditures in Alaska; and

WHEREAS, Agrum Kenai Nitrogen Operations is one of the few industries adding value to Alaska's natural resources using Cook Inlet natural gas to create anhydrous ammonia and two forms of urea; and

WHEREAS, Agrum Kenai Nitrogen Operations purchases natural gas from producers in Cook Inlet; and

WHEREAS, Agrum Kenai Nitrogen Operations markets its products around the world competing against major world competition which is primarily based upon the monetization of trapped gas resources; and

WHEREAS, Agrum Kenai Nitrogen Operations is the Kenai Peninsula's third largest private employer and accounts for an additional 700 jobs in Alaska and the Kenai Peninsula; and

WHEREAS, Agrum Kenai Nitrogen Operations expenditures in Alaska are spread to over 250 businesses statewide with 118 companies located on the Kenai Peninsula; and

WHEREAS, House Bill 57 has been introduced which will provide for the State of Alaska to enter into agreements with non-affiliated natural gas producers to accept as the price for the State's royalty share the price established in an arm's length contract negotiated between the natural gas producer and a manufacturer of value added products; and

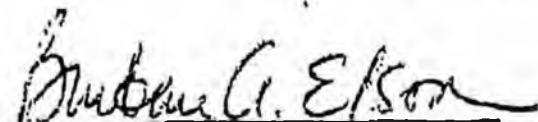
NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF DIRECTORS OF THE SOLDOTNA CHAMBER OF COMMERCE:

SECTION 1: That the Soldotna Chamber of Commerce urges the 23rd Alaska State Legislature to enact HB 57, "An Act Amending The Manner Of Determining The Royalty Received By The State On Gas Production As It Relates To The Manufacture Of Certain Value Added Products."

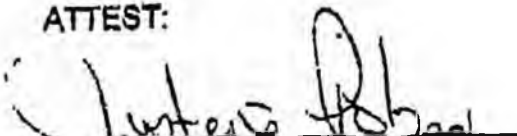
SECTION 2: That copies of this resolution shall be sent to all members of the 23rd Alaska State Legislature.

SECTION 3: That this resolution takes effect immediately upon its enactment.

ADOPTED BY THE BOARD OF DIRECTORS OF THE SOLDOTNA CHAMBER OF COMMERCE THIS 14th Day of MARCH 2003.


Barbara Elson, President

ATTEST:


Justine Polzin, Executive Director



Kenai Chamber of Commerce
402 Overland
Kenai, Alaska 99611

(907) 283-7989
(907) 283-7183 (Fax)

RESOLUTION 2003-01

A RESOLUTION IN SUPPORT OF "AN ACT AMENDING THE MANNER OF DETERMINING THE ROYALTY RECEIVED BY THE STATE ON GAS PRODUCTION AS IT RELATES TO THE MANUFACTURE OF CERTAIN VALUE ADDED PRODUCTS"

WHEREAS, the Kenai Chamber of Commerce has over 350 business members, and

WHEREAS, the manufacturing of value added resources in the State of Alaska serve as a catalyst to economic development in Alaska; and

WHEREAS, one of the state's premier value added manufacturing industries is located on the Kenai Peninsula; and

WHEREAS, this industry, Agrium Kenai Nitrogen Operations, is exceptional for its combination of high pay levels, amount and concentration of expenditures in Alaska; and

WHEREAS, Agrium Kenai Nitrogen Operations is one of the few industries adding value to Alaska's natural resources using Cook Inlet natural gas to create anhydrous ammonia and two forms of urea; and

WHEREAS, Agrium Kenai Nitrogen Operations purchases natural gas from producers in Cook Inlet; and

WHEREAS, Agrium Kenai Nitrogen Operations markets its products around the world competing against major world competition which is primarily based upon the monetization of trapped gas resources; and

WHEREAS, Agrium Kenai Nitrogen Operations is the Kenai Peninsula's third largest private employer and accounts for an additional 700 jobs in Alaska and the Kenai Peninsula; and

WHEREAS, Agrium Kenai Nitrogen Operations expenditures in Alaska are spread to over 250 businesses statewide with 118 companies located on the Kenai Peninsula; and

WHEREAS, House Bill 57 has been introduced which will provide for the State of Alaska to enter into agreements with non-affiliated natural gas producers to accept as the price for the State's royalty share the price established in an arm's length contract



Kenai Chamber of Commerce
402 Overland
Kenai, Alaska 99611

(907) 283-7989
(907) 283-7183 (Fax)

negotiated between the natural gas producer and a manufacturer of value added producers; and

NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF DIRECTORS OF THE KENAI CHAMBER OF COMMERCE:

SECTION 1: That the Kenai Chamber of Commerce urges the 23rd Alaska State Legislature to enact HB 57, "An Act Amending The Manner Of Determining The Royalty Received By The State On Gas Production As It Relates To The Manufacture Of Certain Value Added Products."

SECTION 2: That copies of this resolution shall be sent to all members of the 23rd Alaska State Legislature and Governor Frank Murkowski.

SECTION 3: That this resolution takes effect immediately upon its enactment.

UNANIMOUSLY PASSED BY THE KENAI CHAMBER OF COMMERCE OF THE CITY OF KENAI ALASKA, this 7th day of February, 2003.

Cherie L. Brewer

Cherie L. Brewer
Chamber Board President

>>> "G. Scott Pfoff" <gspfoff@aurorapower.com> 02/11/03 10:14AM >>>
To whom it may concern,

Aurora Gas, LLC is aggressively pursuing the development of natural gas producing properties, primarily on the West side of Cook Inlet. Oil and Gas exploration and development is a high cost, high risk endeavor. As a producer looking to market our natural gas, there is great hesitation to enter into a gas sales agreement with a purchaser such as Agrium because it adds yet another layer of risk to the producer. A producer selling gas to Agrium runs the risk, in fact the probability, that several years after selling its gas to Agrium, the State will assert a claim that royalty needs to be paid on a value higher than the arms length negotiated contract price. This additional royalty, plus interest accrued at a higher-than-market rate, would have to be born by the producer and/or by the purchaser.

It is for this reason that Aurora Gas, LLC and its natural gas marketing affiliate, Aurora Power Resources, Inc. strongly endorse HB57 and the concept that royalty should be paid on the basis of arms length negotiated contract prices. Accordingly, we salute and support the draft resolution in support of HB57 and urge the Kenai City Council to adopt same.

G. Scott Pfoff
President,
Aurora Power Resources, Inc
(713) 977-5799

To: Pete Sprague, Assembly President

Assembly Members

Thru: Dale L. Bagley, Mayor

From: Bill Popp, Oil & Gas Liaison

Date: February 6th, 2003

Subject: House Bill 57 and Senate Bill 50

The Administration requests the support of the Assembly for House Bill 57 and Senate Bill 50. These companion pieces of legislation would allow the Commissioner of the Department of Natural Resources the discretion to enter into agreements with non-affiliated natural gas producers to accept as the price for the State's royalty share of natural gas the price established in an arm's length contract negotiated between the natural gas producer and Agrium Kenai Nitrogen Operations and any other manufacturer that uses Alaska natural gas to create value added products. Currently, under AS 38.05.180, this type of fixed royalty pricing arrangement is allowed only for public electrical utilities as a means of offering price certainty for natural gas for use in power generation.

Traditionally, the State of Alaska usually takes 12.5% of most produced natural gas as its royalty share of the resource, most of which is sold through an "in-kind" agreement where the producer acts as the selling 'agent' for the State. Further, the State of Alaska maintains an expectation that it will receive the highest prevailing value for its royalty share of natural gas sold. This value is calculated on a quarterly basis. Using this method has resulted in broad fluctuations in the value of royalty natural gas.

Agrium has requested this legislation to provide for a more stable cost structure for the natural gas it relies on as a feedstock for its Nikiski facility. Under the current system, Agrium faces the potential for broad future price swings and retroactive royalty payment demands from the State for past royalty payment adjustments. This lack of price certainty makes it very difficult for Agrium to establish sound business planning for future production and capital investments.

It should be noted that the proposed legislation will apply to any non-affiliated manufacturer of value-added products that use natural gas as a feed stock. Affiliated companies such as the ConocoPhillips LNG facility, where the supplier of natural gas also owns the value-added manufacturing facility, will not qualify for this kind of royalty gas pricing agreement.

**THE ECONOMIC IMPACT OF
AGRIUM KENAI NITROGEN OPERATIONS
IN ALASKA, 2001**

EXECUTIVE SUMMARY

PREPARED FOR:

**RESOURCE SOLUTIONS
ANCHORAGE, ALASKA**

PREPARED BY:



ANCHORAGE • JUNEAU

October 2002

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EXECUTIVE SUMMARY

Agrium Kenai Nitrogen Operations contracted with Resource Solutions and the McDowell Group, Alaska research and consulting firms, to quantify the economic impact of Agrium Kenai Nitrogen Operations on the Kenai Peninsula Borough and the Alaska economy during calendar year 2001. This report details the study findings of the economic impacts of Agrium's production on the Kenai Peninsula and Alaska. Findings are expressed in terms of direct, indirect, and induced impacts, which are explained below.

Agrium Kenai Nitrogen Operations is one of Alaska's few major manufacturing operations and contributes to Alaska's economy by adding value to Cook Inlet natural gas production. The Agrium complex is located near Nikiski, 10 miles north of Kenai and directly employs close to 300 people. The plant is the United State's second largest producer of ammonia and urea. It consists of two urea and two ammonia plants, a tidewater port facility, and a power cogeneration facility. The Agrium Kenai Nitrogen Operations complex has an annual production capacity of nearly 2 million tons. In 2001, the Kenai plants produced 1.4 million metric tons of anhydrous ammonia and urea. For feedstock, the plant uses approximately 155 million cubic feet of Cook Inlet natural gas daily. Virtually all of Agrium's Kenai production is destined for overseas markets. Agrium's total gross sales in 2001 were \$210 million.

Direct economic impacts. Direct impacts are the initial expenditures by Agrium Kenai Nitrogen Operations. These initial impacts include the amount directly spent by Agrium to purchase goods and services (such as materials, utilities, construction services, and transportation), payments to government (such as taxes and fees), cash contributions to membership organizations and charitable organizations, and the wages paid to Agrium employees.

Indirect and induced economic impacts. Indirect impacts result from Agrium's spending on goods and services that in turn circulate through the economy as Agrium's suppliers in the Borough and in Alaska conduct their business with Agrium's initial dollars. Induced impacts result from the spending of Agrium (and suppliers') payroll dollars by employee households. For instance, when Agrium employees and employees of Agrium suppliers spend money in the regional economy, induced impacts accumulate as these dollars continue to circulate. These indirect and induced impacts are estimated using econometric model multipliers developed specifically for Alaska and refined by McDowell Group for use in this study.

Summary of Economic Impacts

Agrium's total economic output in Alaska was \$333 million in 2001. Economic output is the gross sale value of Agrium's production (\$210 million) plus the impacts of spending in support of Agrium's operations (\$123 million). Total impacts include 1,000 Alaska jobs (292 direct plus 700 indirect and induced jobs), \$50 million in Alaska payroll (\$25 million in Agrium payroll plus indirect and induced payroll), and charitable support by Agrium of 87 organizations and programs, almost all of them in the Kenai Peninsula Borough.

The Kenai Peninsula Borough receives \$2.4 million in industrial property tax from Agrium, an estimated minimum of \$212,700 in residential property tax from Agrium employees' dwellings and \$1.4 million in state funding support for Agrium family school-age children's education - a total of \$4.0 million in direct revenue. The Agrium operation also accounts - directly and indirectly - for an estimated 5 percent of the population, 6 percent of employment, and 9 percent of wage and salary income in the Kenai Peninsula Borough.

Table 1
Summary of Agrium Kenai Nitrogen Operations Economic Impacts, 2001

Economic Activity	Direct Impacts	Multiplier Effect	Indirect and Induced Impacts	Total Impacts
Economic Impacts				
Output	\$210 million	1.6	\$123 million	\$333 million
Economic value of Agrium production per Mcf of natural gas feedstock				\$6.28/Mcf
Employment	292 jobs	3.5	700 jobs	992 jobs
Payroll	\$25 million	2.0	\$25 million	\$50 million
AK goods & services purchased	\$95 million			
Employment (% of KPB total)				5.5%
Wage and salary income (% of Kena: Peninsula Borough total)				8.8%
Revenue to Kenai Peninsula Borough (KPB)				
Agrium industrial property tax	\$2.4 million			
Agrium employee property tax	\$212,700			
State revenue to KPB School District for Agrium dependents	\$1.4 million			
Total revenue to KPB	\$4.0 million			
Social Impacts				
Total population impacts (direct and indirect)				2,150 total 4.5% of KPB
Student enrollment (Agrium children as % of total KPB District enrollment)	3.3%			
Number of charities supported	87			

Major Findings

By Alaska economic standards, the Agrium operation is exceptional for its combination of high pay levels, amount and concentration of expenditures in the local area, and the degree of value-added manufacturing that occurs in Alaska prior to export. The result is a high multiplier impact.

Per one thousand cubic feet (Mcf) of Cook Inlet natural gas used by Agrium for feedstock and power generation, \$6.28 in total Alaska economic output is generated.

Figure 1
Total Output Impact per One Thousand
Cubic Feet (Mcf) of Natural Gas Used, 2001



Source: Agrium U.S. Inc., McDowell Group compilations

Agrium Kenai Nitrogen Operations is the Kenai Peninsula's third largest private employer with direct employment of 292 in 2001. Only Peak Oilfield Services Company (367) and Safeway/Eagle Stores (342) employ more.

- If Peak Oilfield Services employees under contract to Agrium are included in Agrium's employment figures, Agrium becomes the #1 private employer in the Kenai Peninsula Borough. In terms of payroll (not available for individual private companies), Agrium has either the largest or the second largest private payroll in the Kenai Peninsula Borough.
- All of Agrium's employees live in the Kenai Peninsula Borough, increasing their local economic impact.

Multiplier impacts of Agrium Kenai Nitrogen Operations account for an additional 700 jobs in the Alaska and Kenai Peninsula Borough economies.

- Agrium spending on goods and services generates an additional 700 indirect and induced Kenai Peninsula Borough jobs. The secondary impacts of Agrium employee payroll spending bring the total employment impact to approximately 1,000 jobs.

- Agrium's total direct, indirect, and induced employment impacts account for 5.5 percent of the Kenai Peninsula Borough's total employment, and 8.0 percent of jobs in the Central Kenai Peninsula area (the area north of the Kasilof River and west of Skilak Lake).

Agrium Kenai Nitrogen Operations provides high-paying jobs in the value-added manufacturing sector.

- Agrium payroll average of \$83,865 per employee is more than double the average regional salary.
- Agrium Kenai Nitrogen Operations' \$25 million in direct payroll generates additional indirect and induced earnings of \$25 million, a total of \$50 million in salaries and wages in the Kenai Peninsula Borough economy.
- Agrium's total direct, indirect, and induced earnings account for 8.8 percent of Kenai Peninsula Borough's total wage and salary payroll, and 13.4 percent of payroll in the Central Kenai Peninsula area.

**Figure 2
Comparison of Average Annual Earnings,
Agrium Kenai Nitrogen Operations Employees vs.
Kenai Peninsula Borough Average, 2001**



Source: Agrium U.S. Inc., Alaska Department of Labor and Workforce Development

Virtually all of Agrium's vendor spending in Alaska (95 percent of the amount purchased) is spent with companies based in the Kenai Peninsula Borough.

- In 2001, Agrium spent \$90.5 million on goods and services provided by 118 Kenai Peninsula companies. The remaining purchases of goods and services in Alaska (\$4.7 million) were made to 129 companies in Anchorage, Fairbanks, Wasilla, and Palmer. The variety of the almost 250 businesses from which Agrium made its purchases include gas producers, construction contractors, engineering firms, environmental service firms, utility companies, retail and wholesale businesses, and other types of businesses.

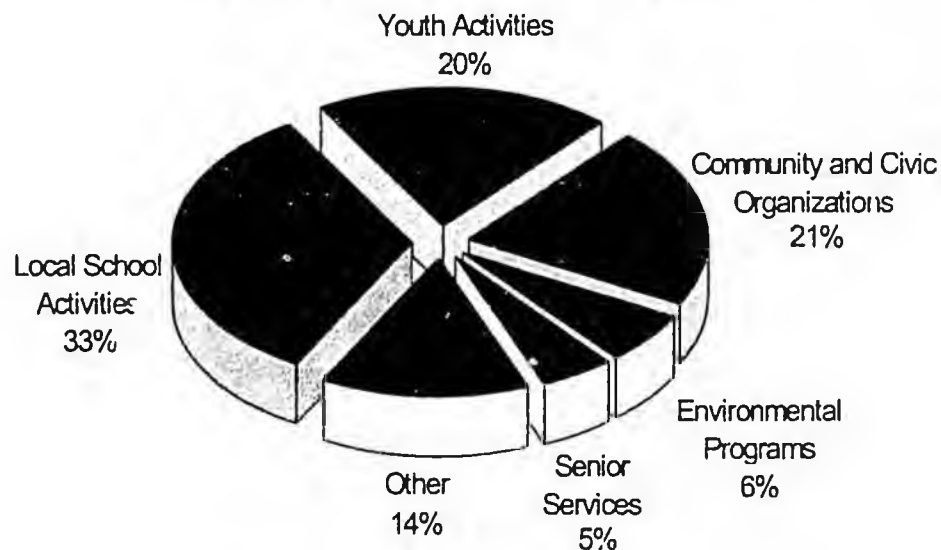
In 2001, the Kenai Peninsula Borough received \$4.0 million in Agrium-related revenues.

- In 2001, Agrium paid \$2.4 million in industrial property taxes to the Kenai Peninsula Borough, representing 8.8 percent of the Borough's total property tax receipts.
- Agrium families pay at least \$212,700 in residential property taxes exclusive of service area and city taxes on property (assuming an average KPB dwelling value of \$112,000). Because of the high average wage for Agrium employees, the actual figure, if known, likely would be significantly higher.
- Children of Agrium employee families account for \$1.4 million in state school funding support received by the Kenai Peninsula Borough School District.

Agrium is highly involved in the local community, supporting 87 membership and charitable organizations and events.

- In 2001, Agrium contributed \$138,329 to 87 non-profit organizations or programs, most of them located in the Kenai area.
- Charitable giving was provided to local schools athletic and academic programs, youth activities, community services and civic organizations, environmental programs, senior services, and other health and economic development programs.

Figure 3
Agrium's Charitable Contributions,
by Type of Organization or Program, 2001



Note: Percentages do not add up to 100 percent due to rounding.
Source: Agrium Kenai Nitrogen Operations

Agrium household incomes are supported by year-round, full-time, high-skilled, and professional positions.

- Home ownership and real estate value tend to be significantly higher among families with an income profile enjoyed by Agrium households.
- Higher salaries tend to attract stable, long-term, skilled professionals to the region.
- The high amount of discretionary income translates into a wider variety and volume of local expenditures on local household goods and services.
- Agrium's work force is 100 percent resident in the Kenai Peninsula area. This fact, in turn, directs household spending locally, as opposed to other income sectors that have significant non-resident components. According to the Alaska Department of Labor and Workforce Development, in 2000, non-residents held 19.7 percent of the private sector jobs in Kenai Peninsula Borough.

Based on the relationship between the employment and population on the Kenai Peninsula Borough, the 1,000 Agrium-related jobs support a population of 2,150.

- This population impact accounts for 4.3 percent of the Kenai Peninsula Borough's total population and 7.0 percent of the Central Kenai Peninsula population.

Agrium's families accounted for 3.3 percent of Kenai Peninsula Borough School District student enrollment and \$1.4 million of the \$42.5 million in state revenue support to the District in the 2001/2002 school year.

- Agrium dependents account for approximately 4.9 percent of student enrollment in the Central Peninsula area.

Agrium

kenai

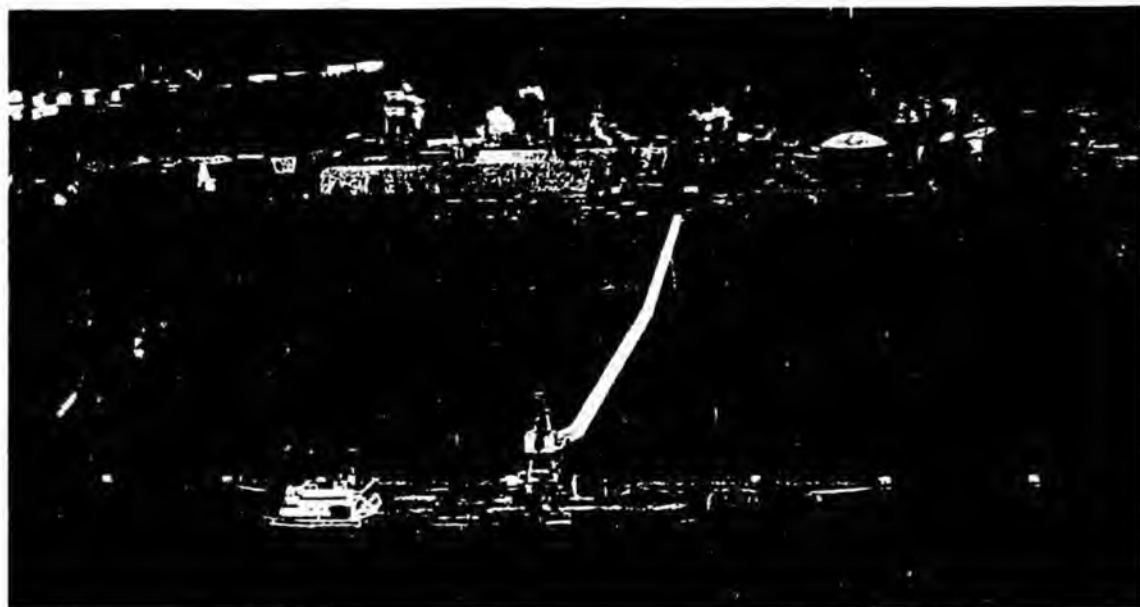
nitrogen operations

Agrium Inc. produces more than 11 million tons (10 million tonnes) of fertilizers annually. Nitrogen fertilizer products account for some 8.2 million tons (7.5 million tonnes) of that total. Potash fertilizers account for 1.7 million tons (1.5 million tonnes) and phosphate fertilizers for 1.1 million tons (1 million tonnes).

Agrium is also one of the largest agricultural retailers in the United States, supplying products and related services to growers in 24 states under the retail banners of Crop Production Services and Western Farm Service. We are also a leading fertilizer retailer in Argentina, with outlets operating under the trade name Agroservicios Pampeanos.

Agrium's commitment to the communities where we operate is actively demonstrated through open and honest communications, responsible environmental stewardship, putting safety first and by investing in a bright tomorrow.

From our
facilities in
North and
South America,
more than 5,000
Agrium employees
supply growers
around the world
with fertilizers
to sustain the
production of
nutritious and
safe food for
millions of
people



Kenai Nitrogen Operations is located 10 miles (16 km) north of the City of Kenai, Alaska on Cook Inlet. Accessible by air, water and land, the complex is made up of two ammonia plants and two urea plants. The ammonia plants have a combined annual production capacity of about 700,000 (net) tons (630,000 tonnes) of anhydrous ammonia and 1.1 million tons (1 million tonnes) of urea per year. That's enough to fertilize a strip of farmland 16 miles (25 km) wide stretching from Los Angeles to New York.

The principal raw materials for the ammonia and urea fertilizers manufactured by the Kenai plant are natural gas, water and air. Natural gas is piped to the facility from nearby gas fields.

The facility consists of two separate ammonia/urea production and utility plants. The original plant was completed in 1968. Its size was approximately doubled in 1977.

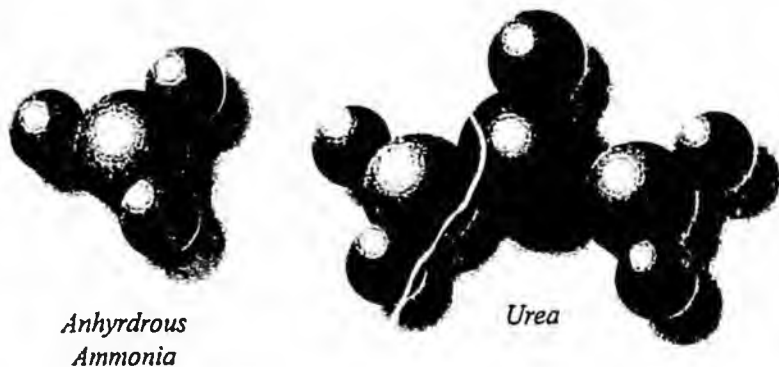
Due to its proximity to Asia, much of the fertilizer produced at Kenai is exported to Pacific Rim nations. In 2000, more than \$154 million worth of products were sold to overseas markets.

Nourishing a Growing World

Agrium

Fertilizer Products

It is estimated that 50 percent of the food production in North America is the direct result of nitrogen-based fertilization. Nitrogen is the plant nutrient most commonly deficient in western agriculture. The ammonia and urea fertilizers produced at Kenai Nitrogen Operations play a major role in promoting high yields of nutritious food crops. Without them, not only would food prices rise, but food quality would also diminish.



- Hydrogen
- Nitrogen
- Carbon
- Oxygen

Ammonia and urea are found in nature. Without them, life as we know it would not be possible. Ammonia is a vital part of every living cell, and urea is a natural byproduct of the breakdown of protein in the digestive system.

In terms of their nutrient content, the nitrogen fertilizer products produced at Kenai Nitrogen Operations are identical to 'organic' fertilizers. The source of plant nutrients is irrelevant to the yield or quality of the fruit, grain or vegetable matter produced by the plant.

Anhydrous ammonia is a liquid fertilizer, manufactured by combining nitrogen gases from the atmosphere with hydrogen derived from natural gas and water. The natural gas reacts with superheated steam (between 1300°F (700°C) and 1400°F (760°C)) in the presence of a catalyst to separate hydrogen, from the natural gas, reacts with nitrogen from the atmosphere to form anhydrous ammonia. The word "anhydrous" simply means "without water."

Urea is a solid fertilizer, made by reacting carbon dioxide and ammonia under extreme pressure at 375°F (190°C). The resulting molten mixture is then processed into small, white, crystalline spheres, called prills or granules. Urea is the major fertilizer traded in international commerce, accounting for approximately 50 percent of the nitrogen fertilizer traded around the world.

Ammonia and urea are also used in many other applications including cattle feed, paper, synthetic fibers, resins, refrigeration, waste treatment, rocket propellants, household cleaners, even medicines.

Environment

We are continually working to reduce emissions with state and federal environmental considerations are a part of all our business.

Our environmental protection begins with the safety of a safe workplace, which comes from careful preparedness and preventative maintenance. The safety of our employees could impact the environment.

Since 1996 we have reduced hazardous waste generation by replacing a process solution that produced hazardous waste, and by replacing solvent and caustic dip tanks.

We have an aggressive pollution prevention plan in place to reduce the volume and toxicity. Our waste minimization efforts are a part of Environmental Conservation and have been successful.

We continually implement efficiency improvements to reduce fossil fuel. In spring, 2001, the start-up of an electrical generator reduced (455 tonnes) per year of nitrogen oxide emissions.



Kenai

nitrogen operations

Stewardship

Environmental impact of our operations. Complying with regulations is just a beginning. Environmental decisions.

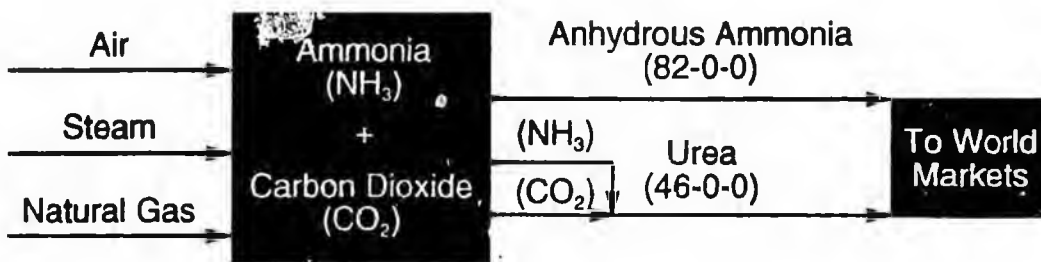
Our employees. Everyone benefits from having a strong commitment to safe operating procedures, emergency procedures reduce the potential for plant upsets which

reduced at the plant by 99 percent. We accomplished this by replacing hazardous byproduct with one that generates no waste. We replaced part washers that use hot water and soap.

We continually look for opportunities to reduce waste and have received praise from the Alaska Department of Environmental Conservation by Alaska's Green Star Program.

To reduce atmospheric emissions and burn less natural gas, our cogeneration facility eliminated more than 500 tons

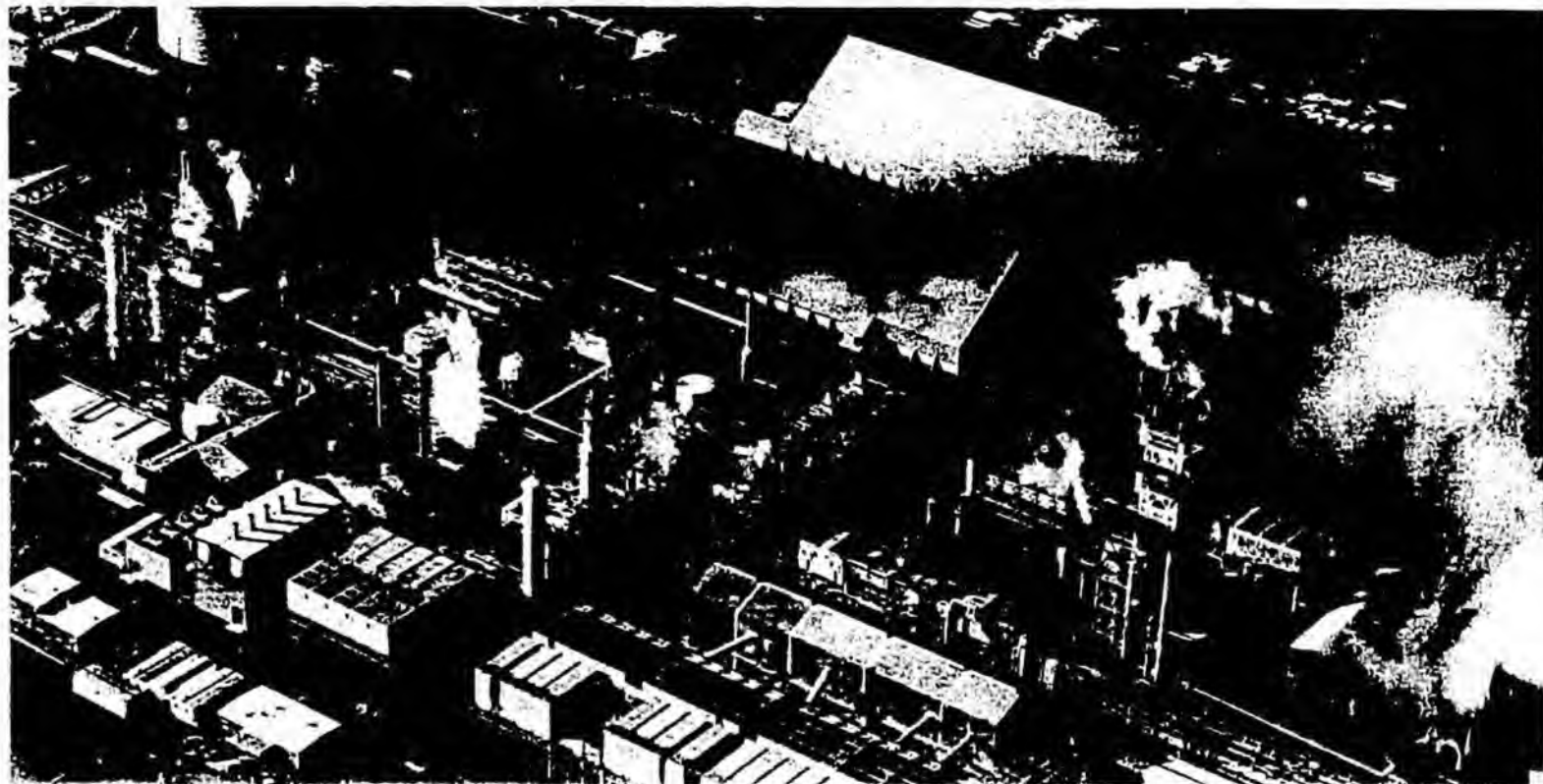
Raw Materials and Products



Best Management Practices

To ensure that our customers always receive safe, competitively-priced products, Agrium is committed to best management practices in the production, distribution and use of everything we make. For the grower, getting the best value for every dollar spent on crop production is more important today than ever before.

The proper use of Agrium anhydrous ammonia and urea fits well into Best Management Practices. The fertilizers produced at the Kenai plant are an effective aid in helping growers achieve maximum efficiency while minimizing environmental impact.



kenai

nitrogen operations

Impact on Local Economy

The Kenai Operation provides employment for more than 296 full time employees who earn approximately \$26 million in wages and benefits. The plant also pays about \$3.6 million in local property taxes and spends more than \$14 million a year to buy local goods and supplies.

Caring for the Kenai

We also are proud to sponsor the nationally acclaimed Caring for the Kenai environmental awareness contest that annually challenges local high school students to answer the question "What can I do, create, invent or improve to better care for the environment of the Kenai Peninsula?" The program has not only raised the level of environmental awareness on the Kenai, but has also generated many practical ideas that have improved our environment.

In April, 2001, President George W. Bush honored Kenai Peninsula youth by presenting a President's Environmental Youth Award to three young people who had participated in our "Caring for the Kenai" environmental awareness program. In return, the students gave the President a "Caring for the Kenai" jacket.

Caring for the Kenai - President George W. Bush presented with a "Caring for the Kenai" jacket.



Partners in the Community

Agrium employees live and work on the Kenai Peninsula, and they are deeply involved in activities that enrich the lives of all its citizens. They coach hockey, soccer, football, basketball and Little League baseball. Many serve in leadership roles in organizations such as Boys and Girls Clubs, 4-H, Girl Scouts and Boy Scouts. Others participate as teachers at the Kenai Peninsula College, as advisors in the Junior Achievement program, as first aid instructors and as Sunday school teachers.

Kenai Nitrogen Operations is a strong supporter of the United Way, with Employee donations matched dollar for dollar by the Company. And we are active volunteers on business and professional organizations as well as government boards and commissions.

"More than seventy years in the fertilizer business have taught us how to compete and stay ahead of the competition."

Agrium

Kenai
Nitrogen Operations
P.O. Box 100
Mile 21
Kenai, Alaska
99811
Phone: 907-335-1111
Fax: 907-335-1112
<http://www.agrium.com>

Agrium

Kenai Nitrogen Operations

February 2003



Summary of

Alaskan Direct Economic Impacts

"By Alaska economic standards, the Agrium operation is exceptional for its combination of high pay levels, amount and concentration of expenditures in the local area, and the degree of value added manufacturing that occurs in Alaska prior to export. The result is a high multiplier impact."

- McDowell Group, October 2002

A study completed by Resource Solutions and the McDowell Group in October 2002 identified the following direct impacts of Agrium's Kenai Nitrogen Operations:

- \$95 million in purchases of goods and services from 250 Alaskan businesses
- \$24.6 million in direct payroll; including benefits, expenditures exceed \$35 million
- \$2.5 million in taxes and lease payments
- \$140,000 in charitable donations to 87 non-profit organizations and groups

Summary of

Alaskan Indirect Economic Benefits

For every one thousand cubic feet of Cook Inlet natural gas used by Agrium for feedstock and power generation, \$6.28 in total economic output is generated.

- Agrium employees have 326 school age dependents or about 5.0 percent of the Central Peninsula student enrollment
- Agrium's total direct, indirect, and induced payroll impacts support 8.8 percent of the total Kenai Peninsula payroll
- Agrium total direct, indirect, and induced employment accounts for 5.5 percent of the total employment on the Kenai Peninsula
- The 1,000 Agrium related jobs support a population of 2,150. This accounts for 7.0 percent of the Central Peninsula population

Did You Know?

Agrium's Kenai Nitrogen Operations is the third largest private employer in Alaska.

Agrium's Kenai Nitrogen Operations provides 700 jobs in Alaska.

Agrium's Kenai Nitrogen Operations spent \$90.5 million in 2001 on goods and services from Alaskan businesses.

Agrium's Kenai Nitrogen Operations has provided financial support to 87 non-profit organizations, schools and youth centers. Charitable contributions accounted for 53% of the company's charitable contributions.

Agrium's Kenai Nitrogen Operations is the second largest nitrogen production complex in the U.S.A.

Agrium's Kenai Nitrogen Operations accounts for about 6 percent of North America's nitrogen production.

In 2001, Agrium's Kenai Nitrogen Operations exported 1.5 million tons of ammonia and urea to 17 countries valued at \$190 million.

Agrium's Kenai Nitrogen Operations is one of Alaska's largest value added manufacturers.

**REPRESENTATIVE
MIKE CHENAULT**

STATE OF ALASKA



Interim:
145 Main St. Loop, Second Floor
Kenai, Alaska 99611
(907) 283-7223
Fax: (907) 283-3075

HOUSE OF REPRESENTATIVES

Official Business

Session:
Capitol Building, Room 432
Juneau, Alaska 99801-1182
(907) 465-3779
Toll Free: (800) 469-3779
Fax: (907) 465-2833

SPONSOR STATEMENT HOUSE BILL 57

This bill proposes to add "manufacturer" as a further entity that may claim that benefit of the contract price as the basis for determining royalty due to the state of the gas production.