

HB

1988

ALASKA STATE LEGISLATURE

Interim:

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Session:

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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.

Changes made to SSHB 198 by CSSSHB 198 (O&G)

These changes were primarily technical in nature. They were overlooked in the Sponsor Substitute:

Page 2, line 2...delete [field or]

Page 2, line 30...delete [the field or]

Page 3, line 7...change (vii XTO.B to XTO.C) corrects name of platform

Page 3, line 26...delete [platform], insert field

Page 3, line 29...delete [or platform]

Page 4, line 2...delete [platform], insert field

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Journal Text



04-28-2003

House Journal

1154

HB 198

The House Special Committee on Oil & Gas has considered:

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 198

"An Act providing for a reduction of royalty on certain oil produced from Cook Inlet submerged land."

and recommends it be replaced with:

CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO.

198(O&G)

(same title)

04-28-2003

House Journal

1155

The report was signed by Representative Kohring, Chair, with the following individual recommendations:

Do pass (6): Holm, Fate, Crawford, Kerttula, McGuire, Kohring

The following fiscal note(s) apply to CSSSHB 198(O&G):

1. Fiscal, Dept. of Natural Resources

SSHB 198 was referred to the Resources Committee.

Bill Root: 

TO REPORT PROBLEMS WITH BASIS INQUIRY

LIVE KTOO STREAMS



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FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: CSSSHB 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 the state 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.

Union Oil Company of California
Testimony on HB 198
House Resources Committee
May 6, 2003

Mr. Chairman and members of the House Resources Committee--My name is Kevin A. Tabler, Manager of Land and Govt. Affairs for Union Oil Company of California (Unocal) in Alaska. I appreciate this opportunity to be heard today and to present a few comments regarding House Bill 198. As previously testified in earlier Oil and Gas Committee hearings, we are encouraged with the positive atmosphere and efforts made by the Legislature and Administration to craft legislation to encourage further exploration and development and to protect our states most prolific revenue generating industry. We appreciate your consideration of HB 198 which specifically targets those endangered oil fields and platforms which are rapidly approaching their economic life.

Unocal is the predominant operator in Cook Inlet and where our infrastructure base and manpower are best defined. It's also a place where our infrastructure, manpower and capital investments are continually threatened by internal global competition for investment dollars. For the last several years, Unocal has consolidated and restructured its Alaskan operations and focused on becoming the safest lowest cost producer in Cook Inlet. We have, either through purchase and/or exchange of properties, positioned ourselves to have the most cost effective operation possible. The Cook Inlet, with its mature and declining fields, low margin properties, high operating costs and regulatory uncertainty, is a challenging environment in which to stay profitable, let alone risk capital. Cost cutting in and of itself is only a temporary fix. The only sustainable solution to longevity is to increase the reserve base.

Although HB198 will not necessarily increase the reserve base of a field or platform, it will extend economic viability and prolong the utility of the existing infrastructure, leading to the ultimate recovery of more reserves and have an offsetting effect on any reduction awarded. Equally as important is the possibility for royalty reduction to increase the attractiveness for making additional investment in a field which might lead to an increase in the overall recoverable reserve base of that field.

One thing is certain, if the economic viability of the field or platform is left unchecked, shutdown will be accelerated and lead to a lower tax base, unemployment and loss of monetary cycling throughout a community. Such events are beginning to occur with Unocal's recent announcement to suspend production on the Dillon Platform. Layoffs have occurred and it is a short period of time before additional platforms will be suspended.

With mature fields, such as those in Cook Inlet, when royalty relief is justifiable and needed, the volumes of production and corresponding royalty associated

therewith are such that life extension of the facility and that facilities importance to the overall infrastructure is the primary benefit. If you wait until the field is truly uneconomic to qualify, there is little benefit to the state or the producer since royalty relief does not generate enough revenue to significantly extend field life but merely prolong the inevitable.

In reviewing the language of this bill, we appreciate the recognition that different platforms and fields have different thresholds for economic viability. Although each platform is different, we must not lose sight of the overall economics of the Cook Inlet. These economics are extremely sensitive, not only to price but, to the impact of cost sharing. As each platform or facility becomes uneconomic, the remaining facilities must absorb more of the overall costs of the Cook Inlet operation. Such additional costs place an increased burden on the remaining facilities and therefore shorten their life. The time to get relief is when you are still economic and there is potential to extend field life by investing more capital or expense dollars to increase production, or implement systematic process changes if necessary in an operation. With such an extension you have the ancillary benefits of jobs, taxes and the multiplying effect of money in a community. With royalty reduction, it truly is a case of sooner is better than later.

HB 198 is a very specific, clear, concise, automatic and easily understood and administered vehicle for delaying the inevitable elimination of jobs, extending the life of critical infrastructure which will support future development and exploration projects and creating certainty around investment strategies for producers.

In conclusion, we believe the necessity for and utility of HB 198 is well overdue in Cook Inlet and therefore encourage passage out of this committee. I'd be happy to answer any questions

Thank You
Kevin A. Tabler



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 dark ink and is positioned above the printed name and title.

Tadd Owens
Executive Director