

HB

28

ALASKA STATE LEGISLATURE

Interim:

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Session:

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REPRESENTATIVE VIC KOHRING DISTRICT 14

SPONSOR STATEMENT

SSHB 28

House Bill 28 will take a royalty adjustment system that has not been used and put in its place an understandable and usable adjustment method for fields that might otherwise prove to be uneconomic. It will provide a usable system for reduction of royalties belonging to Alaska so that the State can encourage production of oil and gas fields that might be marginal or not economically feasible were it not for such reductions.

As has been pointed out so many times, in this global market, Alaska needs to remain competitive in order to encourage development of its oil and gas resources. Development of these resources will provide a broader economic base, more employment for Alaskans and a safer, more stable environment for all concerned.

The 19th Alaska Legislature amended AS 38.05.180(j) and put in place, the current system. Unfortunately, the calculation contained in the current law is arguably unintelligible to many. The implementation of the current statute is too limiting in the flexibility allowed to the Commissioner to craft a deal acceptable to individuals and in the best interest of Alaska. Additionally, the process review put forth in the 1995 legislation is too burdensome and costly for the private sector and thus discourages people from making application. The end result is that oil is left in the ground that could be extracted and adding to the State's economic base.

Although the idea behind HB 28 is not new, it sets forth an understandable modification formula; protecting the public's interest in such proceedings and maintaining the public's ability to comment on the preliminary findings and determination made by the Commissioner. This legislation further maintains the involvement of the Legislature through the Legislative Budget and Audit Committee, a committee that holds meetings year round. HB 28 is consistent with the Governor's goal of increasing oil and gas production and increasing Alaska's resource revenue.

THE
FOLLOWING
DOCUMENT(S)
ARE
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Kevin A. Tabler, Manager
Land/Government Affairs

March 7, 2003

Representative Norman Rokeberg
State of Alaska Legislature
State Capitol
Juneau, Alaska 99801-1182

Re: Oil and Gas Royalty Modification
Information

Representative Rokeberg:

During my recent visit to Juneau, March 4, 2003, you asked me for certain background information regarding Union Oil Company of California's (Unocal) application to the Department of Natural Resources (DNR) for royalty relief under HB 207. Specifically, you asked two (2) questions:

1. You wanted to know our opinion and experience with the application process and as an applicant, our thoughts on the applicant for a royalty modification having input into the selection of a contractor; and
2. Information regarding the availability of certain data that may be requested by DNR in the application approval process, particularly over a property that was previously owned by another company.

Attached to this letter are copies of testimony I provided during the 1995 hearing process partially addressing the issues above. I also participated in answering questions at several hearings wherein I expressed Unocal views not specifically stated in the attached testimony. I hope the attached will provide some context to the following comments. It's clear from the outcome of the legislation in 1995 that some of the concerns expressed thru testimony and subsequent non-use of HB207 were proven correct. We applaud your efforts to correct these deficiencies.

UNOCAL Support

Concern over contractor selection was intensely debated in 1995. Unocal expressed concern over the necessity of adding additional costs to the process by not using DNR personnel to evaluate the applicant's submittal. It was felt then, and we continue to believe, DNR has the personnel to make the evaluation. Applicants may choose to contract the services of contractors or consultants to help in the analysis and preparation of an application only later to find the dollars expended will be of no value or duplicated in the DNR application approval process without selection input from the applicant; only the duty to pay for such additional services.

During the Unocal application process, we spent approximately \$250,000.00 in consulting fees when the total resulting benefit to Unocal would have amounted to around \$600,000.00. We hired Gaffney Cline as our consultant because the State of Alaska had just used them for a reserve study in Cook Inlet. The thought here was that Gaffney Cline would provide credibility and DNR would be comfortable with their work and our analysis. We ultimately pulled the application because we had over 12 months and too many man-hours involved to justify the time and expense for such a nominal benefit. The biggest problem with the process was that the requirements for justifying royalty reduction were undefined so the applicant did not know what criteria they were trying to satisfy. The process has to be simple, predictable, easily understood and administered. It can't be a process for DNR to try and get into the financial workings of a company in order to make a determination of what the DNR believes a reasonable rate of return should be. Additionally, it can't be a process where any relief is tied somehow to the state being made whole in the future. The reality may be the State won't be made whole in terms of royalty revenue receipts from future production but compensated through ancillary benefits.

With mature fields in Cook Inlet, when a royalty application is needed, the volumes of production and corresponding royalty associated therewith are such that life extension of the facility is the primary benefit. If you wait until the field is truly uneconomic to apply or qualify then there is very little benefit to the applicant since royalty relief does not really add enough revenue to significantly increase field life. The time to get relief is when you are still economic and there is potential to increase field life by investing more capital or expense dollars to increase production. With such an extension you have the ancillary benefits of jobs, taxes and the multiplying effect of money in a community.

Although we understood the concerns expressed in 1995 regarding contractor selection, if we have to have a selection process, a process where the DNR provides a list of approved contractors and the applicant can pick from the list and negotiate the price seems most fair. The criteria would be determined up front and the costs would be established to provide certainty to the process. The applicant can then decide if the cost is justified in proceeding with the application.

Secondly, the issue of data availability is an important one. Not all data that may be requested by the DNR is available for all facilities. In past years, properties have exchanged hands on a number of occasions and the resulting effect is each company has different policies for retaining, evaluating, maintaining and storing data. Historical data,

in particular financial and production data, is often lost, determined to be confidential or not provided at all.

In one Unocal transaction, the selling party decided to make duplicate copies of the files for their records. Labeled file jackets were removed and retained for the selling parties duplicate files. The original contents were bound by rubber bands, unidentified and placed in boxes for shipping. Upon arrival, we had no transmittal verification of what was sent. The selling company was later acquired by another company and the duplicate set of files destroyed. It took a year to sort out what was sent, and in the process, paperwork and files determined at the time to be of no value were destroyed.

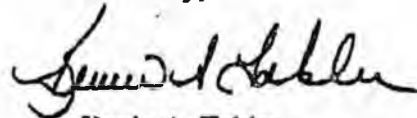
In another case, a property transferred to Unocal years ago, involved a Purchase and Sales Agreement and a Bill of Sale. No operational, financial or production data was ever received by Unocal. Additionally, it is not uncommon for geological and geophysical data licenses to be non-transferable. Unless the selling party has an ownership in the data, or the data is proprietary to the selling company, the purchaser may not be entitled to certain data requested or required by DNR for its royalty modification application review.

Finally, data acquired today has a better chance of being retained, inventoried and located due to electronic imaging. Historical information is bulky, cumbersome, requires storage and often destroyed as standard past operating procedure.

The issues of data availability and contractor selection become less problematic if the application process is clear and concise and the qualifying criteria quickly and automatically administered.

Hopefully, the foregoing answers your questions.

Sincerely,



Kevin A. Tabler

Attachments

Union Oil Company of California
Testimony on HB207
House Committee on Oil and Gas
March 16, 1995

Mr. Chairman and members of the Oil and Gas Committee--My name is Kevin A. Tabler, Land Manager for Union Oil Company of California (Unocal) in Alaska. I appreciate this opportunity to be heard today and to present Unocal's comments on House Bill 207. First I'd like to say, we are very encouraged with the positive atmosphere and effort expended, thus far, by the Legislature and Administration in trying to develop incentive legislation to enhance and stimulate further exploration and development throughout the State. We recognize and appreciate the concerted in-depth effort being made by your committee to fully assess the utilization and applicability of this Bill prior to subsequent referral. This time, spent early on, understanding the implications of the Bill, and providing the opportunity for intended users to clarify and augment specific sections, will greatly enhance its acceptability and help ensure its passage into legislation.

By broadening the applicability of AS 38.05.180 (j), we believe this Bill is a step in the right direction toward revising existing Statutes. This approach provides additional opportunity for certain marginally economic fields to compete both, internally within a company and externally on a global basis. But, before I address specifics under Section 2., I would like to make a brief comment about Section 1.

Unocal is taking a neutral position on the appropriateness or need to revise the funding mechanism previously established for the Alaska permanent fund under AS 37.13.010(a). The sharing of revenues and proceeds derived through leasing, exploration and development of the States mineral wealth, split between the permanent fund and general fund, is not the focus of our analysis of this Bill. Our focus and concern of the Bill is one of clarification, administration and utilization as it pertains to our Cook Inlet operations.

Section 2.

Last Thursday, I listened to a discussion during the first hearing on this Bill regarding the need to define the term "field". Bill Van Dyke did an excellent job of explaining the differences between fields, pools, horizons, and the delineation of same, in the context of the applicability of each, regarding this Section. To help clarify and more accurately describe the aerial extent of an accumulation for which this Section would apply, we offer the following suggestions. On line 29, page 2 after the word field, insert ", pool or portion of a field or pool". On line 30, we would suggest that the word "an" be eliminated and the words "a producing" be inserted between "of" and "oil". The same wording suggested on line 29, would apply after the word "field" on line 30. The application here is that the

AOGCC has clearly defined pools and separate horizons or zones associated with any recognized field. Similar testimony was provided Tuesday by DNR and we support their modification.

Our second comment is related to lines 8 thru 10 on page 3. As a condition of evaluating an application and data, the commissioner may require the lessee to pay the costs of contractors selected by the commissioner to assist in the evaluation. We feel all attempts should be made to utilize existing DNR staff wherever possible to reduce costs. On Thursday, the commissioner indicated the intent of this subsection was to have mutual agreement between the applicant and the commissioner as to the selection of contractors. We believe it is important to spell this out in the Bill. Equally important is the need to mutually agree on the costs contemplated for expenditure by lessee, prior to the hiring of a contractor. For extremely marginal properties, such as our Stump Lake Unit, the cost of hiring a consultant (at say \$20,000 – a likely amount) could eliminate most of the benefit derived from royalty reduction. This Bill currently has no control over costs. Alternatively we heard from commissioner Dave Johnston of AOGCC on Tuesday, recommending that the applicant hire and pay for the contractor in support of its application to control costs. The commissioner of DNR would provide a list of contractors that would be acceptable to DNR and the applicant would then have the ability to select one for the analysis. This approach makes the most sense, in that the company would then be able to negotiate the best price possible and thereby have some control on costs. We would support this concept. This preferred approach would also eliminate the need for the costly and time consuming RFP process DNR would have to employ.

The elimination of the reasonable rate of return criteria on lines 13 thru 17 page 3 is a positive step in cleaning up the Statute. This determination is too subjective and open to debate. It is unrealistic to think that common agreement will ever be reached by any two parties. This requirement is unnecessary and therefore is better left out.

We need a very clear understanding that modifications made to existing Statutes do not inadvertently have a debilitating or limiting effect on the mature, marginally economic future development of Cook Inlet. There is a monumental difference between the exhausted fields typically found in Cook Inlet as opposed to those on the North Slope.

The next two comments are very important to Unocal and it's operations in Cook Inlet, but first, let me give you an example of one economic scenario involving our platform operations:

Four (4) of the ten (10) Unocal operated producing platforms produce less than 2,000 BOPD each. One (1) produces less than 900 BOPD. Expenses on all of these properties make them marginally profitable. In an effort to increase

production, Unocal committed over \$80 million in capital investments over the last two years, with the potential to spend an additional \$31 million in 1995 on these four (4) platforms. At this point, it is difficult to commit additional capital to develop these properties due to their short remaining platform lives and marginal profitability. Reducing or eliminating the state's royalty on these marginal properties could make the projects economically viable and significantly increase the economic life of the platforms, thereby maintaining employment and the associated community benefits. For fields or platforms facing abandonment today, such as a platform with less than 1000 BOPD, complete royalty relief is warranted. These properties provide minimal income to the state and complete royalty relief will extend field life and employment by about years.

Lines 17 thru 21 provide for a modification and change to the existing Statute, limiting the commissioners ability to reduce royalty by specifying certain limits. We propose this additional language and limitation be taken out in its entirety. We believe it is in the state's best interest for the commissioner to have the flexibility to reduce royalty down to 0, as currently provided, given a finding on the part of the commissioner, supported by financial and technical data which demonstrates the benefits of such action is warranted.

Lines 23 and 24 need revisions to eliminate the unilateral right of the commissioner to increase royalty beyond the state's original royalty share prior to any reduction on a previously producing mature field or re-establishment of commercial production of shut-in oil or gas. The big upside potential of a field, as discussed last Thursday and again at Tuesday's hearing, only applies to delineated but not previously produced fields where one may reasonably expect a pleasant surprise. A previously negotiated change in royalty at the time of the initial reduction, under strict criteria, may be warranted in the case of a delineated but not previously produced field. Bids were made on leases and evaluated on known parameters and an economic analysis at the time of bidding. Companies need the opportunity to evaluate any royalty change upward in light of field economics and overall company economics, and agree to any royalty modifications prior to committing manpower and capital to a project. It's not realistic to anticipate that mature producing fields hold the same type of promise. For the commissioner to have unilateral authority to increase the royalty rate to whatever level beyond the royalty originally specified in the lease, is not warranted in these mature fields. For mature fields, the impact of price only effects extending field life. If we are opening ourselves to the possibility of higher future royalty by applying for a reduction today, we may be eliminating the incentive to apply. Companies need certainty for planning and capital commitment purposes.

Line 1 on page 4 indicates the commissioner's decision regarding a request is final and not appealable. This really is no change from the current Statute. If this provision is of concern to the committee or the Legislature, then perhaps a peer review of the decision could be conducted. In Tuesday's hearing, the

AOGCC provided a couple of alternative approaches to address the concern of oversight and appealability, both of which are acceptable to Unocal.

In conclusion, We believe this Bill has the potential to add certain attractive parameters to the administration of the royalty reduction process. For Unocal, at this time, this Bill has application only to our existing producing fields. Page 3 changes proposed in the bill, further restrict Unocal's ability to seek royalty relief beyond what is currently in Statute and make it difficult to support in its current form. With the changes we have proposed, we believe the interests of all parties are protected while at the same time afford the commissioner the discretion he is entitled under current Statute.

Unocal already has in place a vehicle under current Statute to address the concerns of its marginal fields in Cook Inlet, as they reach their economic limit. Albeit not an ideal vehicle, at least one which is less onerous than that which is proposed. Although we like the ability to expand the applicability of this Statute, and eliminate the requirement for a subjective reasonable rate of return determination, the potential for increased royalty beyond that which was originally agreed and an arbitrary floor placed on the amount royalty may be reduced, eliminates flexibility and hurts our efforts toward field life extension in Cook Inlet.

We look forward to working with the Legislature as this Bill progresses through the legislative process.

Thank You

Union Oil Company of California
Testimony on CS HB 207
Senate Resources Committee
April 28, 1995

Mr. Chairman and members of the Resources Committee—My name is Kevin A. Tabler, Land Manager for Union Oil Company of California (Unocal) in Alaska. I appreciate this opportunity to be heard today and to present Unocal's comments on CSHB 207. I would like to begin my testimony by saying that the Sectional Analysis provided after the April 26, 1995 Hearing was particularly helpful in making a more informed analysis of the Bill. Some of the concerns I expressed in Wednesday's Hearing have been clarified by the Analysis and therefore the enclosed testimony more accurately reflects Unocal's view and opinion of the Bill.

Subsection (j)(1)

From purely a Unocal perspective, based on its present acreage position, Unocal is not directly impacted by paragraph (A). Most of the Unocal leases held today are located within producing fields, some of which are nearing the end of their economic viability. We have however, testified in earlier hearings on this Bill that we have not endorsed the concept of Sunset Provisions.

Subsection (j)(3)

Paragraph (B) appears to be a reopener. As long as it is clear the conditions of any future adjustments are determined at the time of royalty reduction and not intended to be a unilateral determination on the part of the Commissioner, we don't have an objection. I believe the wording should be changed to make this point absolutely clear. }

Subsection (j)(4)

We believe the requirement for legislative approval under paragraph (A) will be a time consuming and unnecessary requirement resulting in an administratively burdensome process. Under the House Finance version of the Bill, adequate Commissioner oversight is provided under Subsection (j)(8).

In reading the provisions of paragraph (B) of this Subsection, it is unclear to me as to the intent of the language "in amount or value of the Production". If this is to mean a net 3% floor or a maximum 76% reduction of the current royalty rate, than Unocal is opposed to this revision. Under the House Finance version of the Bill, the floor established for producing and shut-in fields is 90%. There needs to be clarification on this point. Any increase in the floor reducing flexibility would be inconsistent with our position and prior testimony.

Subsection (j)(5)

The assignment of all right, title and interest in a lease is a fundamental principle in the oil industry. Property trades will be greatly restricted if assignability of a royalty adjustment is not allowed. The ability and desire to acquire a lease that has favorable royalty terms may be the catalyst and incentive for a company to invest capital and employ new ideas in fields where the current owners may be less inclined. Companies are rationalizing properties and focusing investments in core areas to take advantage of their particular operational, infrastructure or informational strengths. Lost opportunity for earlier development of a lease or field is sure to occur if this limitation is imposed. The intent of this legislation should be to create opportunity with certainty, not further limit the creativity of the industry.

Subsection (j)(7)

This issue was thoroughly discussed in prior hearings with what we thought was an equitable compromise and consensus opinion of the parties testifying. We see no advantage to changing this Subsection and would prefer to see Subsection (6) of the House Finance version reinstated.

Subsection (j)(8)

Thirty (30) days rather than sixty (60) days is an appropriate time period for public comment. The whole review process needs to be streamlined wherever possible.

Subsection (j)(9)

Reviewing and addressing all the requirements under this Subsection will be very expensive, time consuming and may not be applicable in all circumstances. We believe the Commissioner should have the discretion to provide for the contents of the best interests finding and determination. The Department of Natural Resources is well equipped for this process. We feel it is unnecessary for this Subsection to be in the Bill, and in fact, the degree to which each of these conditions are to be investigated will be the subject of much debate. If the committee and legislature feel the need to include the details of the finding and determination in this Bill, then paragraphs (A) through (G) should only be suggestions of issues the Commissioner may consider in a royalty adjustment application.

Subsection (j)(12)

We have a similar comment in this Subsection as in Subsection (j)(4) in that legislative approval is unnecessary and administratively burdensome. We contend that Subsection (j)(10) of the House Finance Bill is more appropriate and should replace this Subsection.

We look forward to working with the Legislature as this Bill progresses through the legislative process.

Thank You

Union Oil Company of California
Testimony on CS HB 207
Senate Resources Committee
May 1, 1995

Mr. Chairman and members of the Resources Committee--My name is Kevin A. Tabler, Land Manager for Union Oil Company of California (Unocal) in Alaska. I appreciate this opportunity to be heard today and to present Unocal's comments on CS HB 207. I would like to begin my testimony by saying that the Sectional Analysis provided with the Bill is particularly helpful in making a more informed analysis of the Bill. Some of the concerns I expressed in last Wednesday's Hearing have been clarified by the Analysis and therefore the enclosed testimony more accurately reflects Unocal's view and opinion of the Bill today.

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From purely a Unocal perspective, based on its present acreage position, Unocal is not directly impacted by paragraph (A). Most of the Unocal leases held today are located within producing fields, some of which are nearing the end of their economic viability. We have however, testified in earlier hearings on this Bill that we have not endorsed the concept of Sunset Provisions.

Subsection (j)(4)

We believe the requirement for legislative approval under paragraph (A) will be a time consuming and unnecessary requirement resulting in an administratively burdensome process. Under the House Finance version of the Bill, adequate Commissioner oversight is provided under Subsection (j)(8).

In reading the provisions of paragraph (B) of this Subsection, it is unclear to me as to the intent of the language "in amount or value of the Production". If this is to mean a net 3% floor or a maximum 76% reduction of the current royalty rate, then Unocal is opposed to this revision. Under the House Finance version of the Bill, the floor established for producing and shut-in fields is 90%. There needs to be clarification on this point. Any increase in the floor reducing flexibility would be inconsistent with our position and prior testimony.

Subsection (j)(5)

Although we appreciate the attempt in this CS to address the assignability question, we believe a strong argument still exists for elimination of this restriction all together. The assignment of all right, title and interest in a lease is a fundamental principle in the oil industry. Property trades will be greatly restricted if assignability of a royalty adjustment is not allowed. Because of the confidential nature of property transactions, companies are not going to disclose their intent to the public in asking for permission to assign until negotiations are complete and commitments have been made. Prior approval does not work in this situation. A negative response to a request for assignment could jeopardize a potentially beneficial trade to the state. The ability and desire to acquire a

lease that has favorable royalty terms may be the catalyst and incentive for a company to invest capital and employ new ideas in fields where the current owners may be less inclined. Companies are rationalizing properties and focusing investments in core areas to take advantage of their particular operational, infrastructure or informational strengths. Lost opportunity for additional development of a lease or field is sure to occur if this unnecessary limitation is imposed. The intent of this legislation should be to create opportunity with certainty, not further limit the creativity of the industry. The state's best interest will not be served with this restriction.

Subsection (j)(7)

This issue of contractor selection was thoroughly discussed in prior hearings with what we thought was an equitable compromise and consensus opinion of the parties testifying. We see no advantage to changing this Subsection and would prefer to see Subsection (6) of the House Finance version reinstated.

Subsection (j)(9)

Reviewing and addressing all the requirements under this Subsection will be very expensive, time consuming and may not be applicable in all circumstances. We believe the Commissioner should have the discretion to provide for the contents of the best interests finding and determination. The Department of Natural Resources is well equipped for this process. The degree to which each of these conditions are to be investigated will be the subject of much debate. If the committee and legislature feel the need to include the details of the finding and determination in this Bill, then paragraphs (A) through (D) should only be suggestions of issues the Commissioner may consider not requirements in a royalty adjustment application.

Subsection (j)(12)

We have a similar comment in this Subsection as in Subsection (j)(4) in that legislative approval is unnecessary, time consuming and administratively burdensome. We contend that Subsection (j)(10) of the House Finance Bill is more appropriate and should replace this Subsection.

In conclusion, we want and need a Bill and process that is, clear, fair, flexible and equitable, otherwise we will end up with a piece of legislation that is under utilized.

We look forward to working with the Legislature as this Bill progresses through the legislative process.

Thank You

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REPRESENTATIVE VIC KOHRING DISTRICT 14

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LEGAL SERVICES

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MEMORANDUM

May 7, 2003

SUBJECT: CSSSHB 28 (Resources) -- a note on the treatment of the material added by the Resources Committee (Work Order No. 23-LS0177\W)

TO: Representative Hugh Fate
Chair of the House Resources Committee

FROM: Jack Chenoweth
Assistant Revisor of Statutes



Rather than give the new material adopted by the Resources Committee, communicated in Jim Pound's memo of this date, a paragraph of its own and to spare further paragraph renumbering within AS 38.05.180(j), I have added the new material to paragraph (6) as a new subparagraph (B). It appears in the accompanying "V" version at page 5, line 27 - page 6, line 8.

JBC:lmb
03-177.lmb

Enclosure

Insert new section after (6):

(7) may, with the mutual consent of the lessee or lessees making application for the royalty reduction under (1)(B) or (1)(C) of this subsection, request payment for the services of an independent contractor, selected from a list of qualified consultants to evaluate hydrocarbon development, production, transportation, and economics by the commissioner to assist the commissioner in evaluating the application and financial and technical data; if, under this paragraph, the commissioner requires payment for the services of an independent contractor, the total cost of the services that may be paid for by the lessee or lessees may not exceed \$150,000 for each application, and the commissioner shall determine the relevant scope of the work to be performed by the contractor; selection of an independent contractor under this paragraph is not subject to AS 36.30;

23-LS0177\U
Chenoweth
4/30/03

CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 28()

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY

**Offered:
Referred:**

Sponsor(s): REPRESENTATIVES KOHRING AND ROKEBERG

A BILL

FOR AN ACT ENTITLED

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

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

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

5 (j) The commissioner

6 (1) may provide for modification of [AN INCREASE OR
7 DECREASE OR OTHERWISE MODIFY] royalty [, TO ALLOW FOR
8 PRODUCTION THAT WOULD NOT OTHERWISE BE ECONOMICALLY
9 FEASIBLE,] on individual leases, leases unitized as described in (p) of this section,
10 leases subject to an agreement described in (s) or (t) of this section, or interests
11 unitized under AS 31.05 [; THE COMMISSIONER MAY ACT UNDER THIS
12 SUBSECTION TO MODIFY THE ROYALTY]

13 (A) [AFTER JUNE 20, 1995 AND NOT LATER THAN JULY
14 1, 2015, SO LONG AS THE AUTHORITY TO MODIFY ROYALTY

1 UNDER THIS SUBPARAGRAPH HAS BEEN AUTHORIZED OR
2 REAUTHORIZED BY LAW WITHIN THE TEN YEARS PRECEDING THE
3 COMMISSIONER'S ACTION TO MODIFY THE ROYALTY,] to allow for
4 production from an oil or gas field or pool if

5 (i) the oil or gas field or pool has been sufficiently
6 delineated [SUFFICIENTLY] to the satisfaction of [ALLOW] the
7 commissioner [TO CONDUCT THE ANALYSES AND MAKE THE
8 FINDINGS REQUIRED BY THIS SUBSECTION]; [AND]

9 (ii) the field or pool has not previously produced oil or
10 gas for sale; and

11 (iii) oil or gas production from the field or pool
12 would not otherwise be economically feasible;

13 (B) to prolong the economic life of an oil or gas field or pool as
14 per barrel or barrel equivalent costs [PER BARREL OR BARREL
15 EQUIVALENT] increase or as the price of oil or gas decreases, and the
16 increase or decrease is sufficient to make future production no longer
17 economically feasible; or

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

20 (2) may not grant a royalty modification unless the lessee or lessees
21 requesting the change [MODIFICATION] make a clear and convincing showing that
22 a modification of royalty meets the requirements of this subsection and is in the best
23 interests of the state;

24 (3) shall provide for an increase or decrease or other modification
25 of the state's royalty share by a sliding scale royalty or other mechanism that
26 shall be based on a change in the price of oil or gas and may also be based on
27 other relevant factors such as a change in production rate, projected ultimate
28 recovery, development costs, and operating costs

29 [(A) CONDITION ANY ROYALTY MODIFICATION
30 GRANTED UNDER THIS SUBSECTION IN ANY WAY NECESSARY TO
31 PROTECT THE STATE'S BEST INTERESTS;

1 (B) DESCRIBE, IN THE FINDINGS AND
2 DETERMINATIONS REQUIRED BY THIS SUBSECTION, THE
3 RELEVANT FACTORS, INCLUDING PRICE, PROJECTED
4 PRODUCTION RATE OR VOLUME, PREDICTED ULTIMATE
5 RECOVERY, AND DEVELOPMENT, OPERATING, AND
6 TRANSPORTATION COSTS, UPON WHICH THE MODIFICATION IS
7 BASED;

8 (C) FOR A MODIFICATION UNDER (1)(A) OF THIS
9 SUBSECTION, SET OUT THE TERMS AND CONDITIONS, WHICH

10 (i) MUST INCLUDE A MECHANISM FOR
11 ADJUSTING ROYALTY PERCENTAGE BASED ON PRICE;
12 USING FORECASTS OF THE RANGE OF FUTURE PRICES AND
13 THEIR PROBABILITIES, THE MECHANISM MUST PROVIDE
14 THAT THE VALUE OF THE POTENTIAL REVENUE INCREASES
15 RESULTING FROM ROYALTY PERCENTAGE INCREASES
16 MUST EXCEED THE VALUE OF THE POTENTIAL REVENUE
17 LOSSES RESULTING FROM ROYALTY PERCENTAGE
18 DECREASES; AND

19 (ii) MAY INCLUDE, IN ADDITION TO THE
20 ROYALTY PERCENTAGE ADJUSTMENT BASED ON PRICE,
21 WHICH MUST MEET THE CONDITIONS SPECIFIED IN (i) OF
22 THIS SUBPARAGRAPH, A FURTHER ADJUSTMENT BASED ON
23 PRODUCTION RATE OR VOLUME FROM THE FIELD OR POOL;
24 AND

25 (D) FOR A MODIFICATION UNDER (1)(B) OR (1)(C) OF
26 THIS SUBSECTION, SET OUT THE TERMS AND CONDITIONS, WHICH
27 MAY INCLUDE SUBSTITUTION OF A SLIDING SCALE ROYALTY OR
28 OTHER MECHANISM TO MODIFY THE ROYALTY IF THERE IS A
29 CHANGE IN THE RELEVANT FACTORS, SUCH AS PRICE, PROJECTED
30 PRODUCTION RATE OR VOLUME, PREDICTED ULTIMATE
31 RECOVERY, AND DEVELOPMENT, OPERATING, AND

1 TRANSPORTATION COSTS, UPON WHICH THE MODIFICATION IS
2 BASED];

3 (4) may not grant a royalty reduction [MODIFICATION] for a field
4 or pool

5 (A) under (1)(A) of this subsection if the royalty modification
6 for the field or pool would establish a royalty rate of less than five percent in
7 amount or value of the production removed or sold from a lease or leases
8 covering the field or pool;

9 (B) under (1)(B) or (1)(C) of this subsection if the royalty
10 modification for the field or pool would establish a royalty rate of less than
11 three percent in amount or value of the production removed or sold from a
12 lease or leases covering the field or pool;

13 (5) [MAY NOT GRANT A ROYALTY MODIFICATION UNDER
14 THIS SUBSECTION WITHOUT INCLUDING AN EXPLICIT CONDITION THAT
15 THE ROYALTY MODIFICATION IS NOT ASSIGNABLE WITHOUT THE PRIOR
16 WRITTEN APPROVAL OF THE COMMISSIONER; THE COMMISSIONER
17 SHALL, IN THE PRELIMINARY AND FINAL FINDINGS AND
18 DETERMINATIONS, SET OUT THE CONDITIONS UNDER WHICH THE
19 ROYALTY MODIFICATION MAY BE ASSIGNED;

20 (6)] shall require the lessee or lessees to submit, with the application
21 for the royalty reduction [MODIFICATION], financial and technical data that
22 demonstrate that the requirements of this subsection are met; the commissioner
23 [SHALL]

24 (A) may require disclosure of only the financial and technical
25 data related to development, production, and transportation of oil and gas from
26 the field or pool that are reasonably available to the applicant
27 [NECESSARY TO MAKE A DETERMINATION AS TO WHETHER OR
28 NOT TO GRANT THE REQUEST FOR ROYALTY MODIFICATION]; and

29 (B) shall keep the data [DESCRIBED IN (A) OF THIS
30 PARAGRAPH] confidential under AS 38.05.035(a)(9) at the request of the
31 lessee or lessees making application for the royalty reduction

1 [MODIFICATION; THE CONFIDENTIAL DATA MAY BE DISCLOSED
2 BY THE COMMISSIONER TO LEGISLATORS AND TO THE
3 LEGISLATIVE AUDITOR AND AS DIRECTED BY THE CHAIR OR
4 VICE-CHAIR OF THE LEGISLATIVE BUDGET AND AUDIT
5 COMMITTEE TO THE DIRECTOR OF THE DIVISION OF LEGISLATIVE
6 FINANCE, THE PERMANENT EMPLOYEES OF THEIR RESPECTIVE
7 DIVISIONS WHO ARE RESPONSIBLE FOR EVALUATING A ROYALTY
8 MODIFICATION, AND TO AGENTS OR CONTRACTORS OF THE
9 LEGISLATIVE AUDITOR OR THE LEGISLATIVE FINANCE DIRECTOR
10 WHO ARE ENGAGED UNDER CONTRACT TO EVALUATE THE
11 ROYALTY MODIFICATION, IF THEY SIGN AN APPROPRIATE
12 CONFIDENTIALITY AGREEMENT];

13 (6) [(7)] may require the lessee or lessees making application for the
14 royalty reduction under (1)(A) of this subsection [MODIFICATION] to pay for the
15 services of an independent contractor, selected from a list of qualified consultants to
16 evaluate hydrocarbon development, production, transportation, and economics [,WHO
17 IS SELECTED] by the commissioner to assist the commissioner in evaluating the
18 application and financial and technical data; if, under this paragraph, the
19 commissioner requires payment for the services of an independent contractor,
20 the total cost of the services to be paid for by the lessee or lessees may not exceed
21 \$150,000 for each application, and the commissioner shall determine the relevant
22 scope of the work to be performed by the contractor; selection of an independent
23 contractor under this paragraph is not subject to AS 36.30;

24 (7) [(8)] shall

25 [(A)] make and publish a preliminary findings and
26 determination on the royalty reduction [MODIFICATION] application, [; IF
27 THE PRELIMINARY FINDINGS AND DETERMINATION CONCERNS A
28 ROYALTY MODIFICATION UNDER (1)(A) OF THIS SUBSECTION, THE
29 PRELIMINARY FINDINGS AND DETERMINATION SHALL ALSO BE
30 PRESENTED TO THE GOVERNOR FOR THE GOVERNOR'S APPROVAL
31 OR DISAPPROVAL; THE GOVERNOR MAY NOT DELEGATE A

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DETERMINATION TO APPROVE OR DISAPPROVE A PRELIMINARY FINDINGS AND DETERMINATION UNDER THIS SUBPARAGRAPH;

(B) FOR A ROYALTY MODIFICATION UNDER (1)(A) OF THIS SUBSECTION, IF THE GOVERNOR APPROVES THE PRELIMINARY FINDINGS AND DETERMINATION UNDER (A) OF THIS PARAGRAPH,

(i)] give reasonable public notice of the preliminary findings and determination, [;

(ii) CONCURRENTLY WITH THE ISSUANCE OF THE PUBLIC NOTICE, UNLESS DIRECTED BY THE LEGISLATIVE BUDGET AND AUDIT COMMITTEE TO DO OTHERWISE, MAKE AVAILABLE COPIES OF THE COMMISSIONER'S PRELIMINARY FINDINGS AND DETERMINATION ON THE ROYALTY MODIFICATION APPLICATION AND THE SUPPORTING FINANCIAL AND TECHNICAL DATA, INCLUDING THE WORK PAPERS, ANALYSES, AND RECOMMENDATIONS OF ANY CONTRACTORS RETAINED UNDER (7) OF THIS SUBSECTION, TO PERSONS AUTHORIZED UNDER (6)(B) OF THIS SUBSECTION TO REVIEW THE DATA;] and

[(iii)] invite public comment on the preliminary findings and determination during a 30-day period for receipt of public comment;

[(C) FOR A ROYALTY MODIFICATION UNDER (1)(B) OR (C) OF THIS SUBSECTION, IF THE PRELIMINARY FINDINGS AND DETERMINATION APPROVES A ROYALTY MODIFICATION,

(i) GIVE REASONABLE PUBLIC NOTICE OF THE PRELIMINARY FINDINGS AND DETERMINATION; AND

(ii) INVITE PUBLIC COMMENT ON THE PRELIMINARY FINDINGS AND DETERMINATION DURING A 30-DAY PERIOD FOR RECEIPT OF PUBLIC COMMENT;

1 (9) SHALL ADDRESS IN ANY FINDINGS AND
2 DETERMINATIONS REQUIRED UNDER THIS SUBSECTION THE
3 REASONABLY FORESEEABLE EFFECTS OF THE PROPOSED ROYALTY
4 MODIFICATION ON THE STATE'S REVENUE;]

5 (8) [(10)] shall offer to appear before the Legislative Budget and Audit
6 Committee on a day that is not earlier than 10 days and not later than 20 days
7 after giving public notice under (7) of this subsection, to provide the committee a
8 review of the commissioner's preliminary findings and determination on the royalty
9 reduction [MODIFICATION] application and administrative process [THE
10 SUPPORTING FINANCIAL AND TECHNICAL DATA]; if the Legislative Budget
11 and Audit Committee accepts the commissioner's offer, the committee shall give
12 notice of the committee's meeting to all members of the legislature; [IF, UNDER
13 (6)(B) OF THIS SUBSECTION, THE FINANCIAL AND TECHNICAL DATA
14 MUST BE KEPT CONFIDENTIAL AT THE REQUEST OF A LESSEE OR
15 LESSEES MAKING APPLICATION FOR THE ROYALTY MODIFICATION, THE
16 COMMISSIONER MAY APPEAR BEFORE THE COMMITTEE IN EXECUTIVE
17 SESSION;]

18 (9) [(11)] shall make copies of the preliminary findings and
19 determination available to

20 (A) the presiding officer of each house of the legislature;

21 (B) the chairs of the legislature's standing committees on
22 resources; and

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

25 (10) [(12)] shall, within 30 days after the close of the public comment
26 period under (7) [(8)] of this subsection,

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

29 (B) make a final findings and determination [AND PRESENT
30 IT TO THE GOVERNOR FOR THE GOVERNOR'S APPROVAL OR
31 DISAPPROVAL; THE GOVERNOR MAY NOT DELEGATE A DECISION

1 TO APPROVE OR DISAPPROVE A FINAL FINDINGS AND
2 DETERMINATION PRESENTED UNDER THIS SUBPARAGRAPH]; the
3 commissioner's final findings and determination prepared under this
4 subparagraph regarding a royalty reduction [MODIFICATION, IF
5 APPROVED BY THE GOVERNOR,] is final and not appealable to the court;

6 (C) transmit a copy of the final findings and determination
7 [PREPARED UNDER (B) OF THIS PARAGRAPH] to the lessee [OR
8 LESSEES MAKING APPLICATION FOR THE ROYALTY
9 MODIFICATION];

10 (D) with the applicant's consent [OF THE LESSEE OR
11 LESSEES APPLYING FOR THE ROYALTY MODIFICATION], amend the
12 applicant's lease or unitization agreement [OF THE LESSEE OR LESSEES
13 APPLYING FOR THE ROYALTY MODIFICATION] consistent with the
14 commissioner's [APPROVED] final decision [FINDINGS AND
15 DETERMINATION]; and

16 (E) make copies of the final findings and determination
17 available to each person who submitted comment under (7) [(8)] of this
18 subsection and who has filed a request for the copies;

19 (11) [(13)] is not limited by the provisions of AS 38.05.134(3) or (f) of
20 this section in the commissioner's determination under this subsection.

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

22 (p) To conserve the natural resources of all or a part of an oil or gas pool,
23 field, or like area, the lessees and their representatives may unite with each other, or
24 jointly or separately with others, in collectively adopting or operating under a
25 cooperative or a unit plan of development or operation of the pool, field, or like area,
26 or a part of it, when determined and certified by the commissioner to be necessary or
27 advisable in the public interest. The commissioner may, with the consent of the
28 holders of leases involved, establish, change, or revoke drilling, producing, and
29 royalty requirements of the leases and adopt regulations with reference to the leases,
30 with like consent on the part of the lessees, in connection with the institution and
31 operation of a cooperative or unit plan as the commissioner determines necessary or

1 proper to secure the proper protection of the public interest. The commissioner may
2 not reduce [DECREASE] royalty on leases in connection with a cooperative or unit
3 plan except as provided in (j) of this section. The commissioner may require oil and
4 gas leases issued under this section to contain a provision requiring the lessee to
5 operate under a reasonable cooperative or unit plan, and may prescribe a plan under
6 which the lessee must operate. The plan must adequately protect all parties in interest,
7 including the state.

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

9 (s) When separate tracts cannot be individually developed and operated in
10 conformity with an established well-spacing or development program, a lease, or a
11 portion of a lease, may be pooled with other land, whether or not owned by the state,
12 under a communitization or drilling agreement providing for an apportionment of
13 production or royalties among the separate tracts of land comprising the drilling or
14 spacing unit when determined by the commissioner to be in the public interest.
15 Operations or production under the agreement are considered as operations or
16 production as to each lease committed to the agreement. The commissioner may not
17 reduce [DECREASE] royalty on leases in connection with a communitization or
18 drilling agreement except as provided in (j) of this section.

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

20 (t) The commissioner may prescribe conditions and approve, on conditions,
21 drilling, or development contracts made by one or more lessees of oil or gas leases,
22 with one or more persons, when, in the discretion of the commissioner, the
23 conservation of natural resources or the public convenience or necessity requires it or
24 the interests of the state are best served. All leases operated under approved drilling or
25 development contracts and interests under them, are excepted in determining holding
26 or control under AS 38.05.140. The commissioner may not reduce [DECREASE]
27 royalty on a lease or leases that are subject to a drilling or development contract except
28 as provided in (j) of this section.

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

LEGAL SERVICES

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

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

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

MEMORANDUM

February 14, 2003

SUBJECT: Draft SSHB 28 -- sectional analysis
(Work Order No. 23-LS0177\D)

TO: Representative Vic Kohring

FROM: Jack Chenoweth
Assistant Revisor of Statutes

Per Ben Grenn's request, set out below is an overview by bill section of draft SSHB 28, a measure relating to adjustments to royalty reserved to the state to encourage otherwise uneconomic production of oil and gas. The bill, as introduced, would replace the text of current AS 38.05.180(j). That subsection was last amended for other than stylistic reasons by ch. 85, SLA 1995 (SCS CSHB 207 (Finance) am S of the 1995 regular session). Proposed in this bill is replacement of much, but not all, of the current text of subsection (j) with the text of a House-passed predecessor version of the 1995 Act, CSHB 207 (Finance) am. The bill also makes conforming changes in three related subsections of AS 38.05.180.

Bill section 1. The provisions set out a series of changes to subsection (j). The principal substantive changes are as follows:

Paragraph (1) -- circumstances allowing for royalty modification:

-- at page 1, lines 6 and 7: explicit authority to change royalty by "an increase or decrease" is here deleted, retaining only the more generic reference to "modification";

-- at page 1, line 13 - page 2, line 3: the condition on modification that tied to authorization or reauthorization by law in a preceding 10 year period is removed as is the July 1, 2015, cutoff date authorizing royalty modifications;

-- at page 2, lines 12 - 14, 17 - 19, and 20 - 21: with respect to an oil or gas field or pool or portion of an oil or gas field or pool, additional conditions, all relating to a determination on the part of the commissioner of natural resources of economic "feasibility", are added for circumstances involving requests for royalty reductions involving new production, or for those sought "to prolong the economic life" of a field or pool or portion of either when decreasing oil or gas prices influence future production, or for those sought to reestablish production of shut-in oil or gas production;

Paragraph (2) -- showing required; applicable standard:

-- at page 2, lines 22 - 25: no substantive change is made in this paragraph; the insertion and deletion restores the choice of term first set out in the 1995 House-passed version;

Paragraph (3) -- conditions to be attached to requested royalty modification:

-- at page 2, line 26 - page 4, line 4: explicit authority to change royalty by "an increase or decrease or other modification" is added; specific detailed requirements relating to descriptions accompanying findings that support a royalty modification and detailed terms and conditions applicable to a modification, distinguishing in their terms as between modification of royalty to support new production versus modification relating to prolonging the life of a field or pool or modification to reestablish production of shut-in oil or gas, are replaced by a more generic, universally applicable, single standard ("*sliding scale royalty or other mechanism that shall be based on a change in the price of oil or gas and may also be based on other relevant factors . . .*"); the standard described is not new but its invariable application to *all* royalty modification-related change requests apparently would be;

Paragraph (4) -- limits on royalty modification:

-- at page 4, lines 5 - 14: modifies the application of the terms of the existing condition of paragraph (4) to have it apply only in the event of a royalty "reduction"; limits on the amount of the royalty that may be determined for new production versus modification relating to prolonging the life of a field or pool, or modification to reestablish production of shut-in oil or gas set out in current law are retained;

Paragraph (5) -- assignability of royalty modification:

-- at page 4, lines 15 - 21: eliminates the requirement of existing paragraph (5) that a royalty modification must be accompanied by a provision allowing the royalty modification to be assigned only with consent of the commissioner of natural resources;

Existing paragraph (6) -- procedures applicable to supporting data:

-- at page 4, line 22 - page 5, line 14: revises the text on public disclosure of information submitted to support an applicant's request for a reduction of royalty;

Existing paragraph (7) -- hiring and use of consultants:

-- at page 5, lines 15 - 23: revises the set of circumstances under which the commissioner may require evaluation by an independent contractor to limit it to instances of requested royalty reductions,

Existing paragraph (8) -- preliminary findings and determination; public notice and comment; procedures applicable to preliminary approval of governor and legislative review:

-- at page 5, beginning at line 24: amends the set of circumstances under which the commissioner must make and publish preliminary findings to limit it to instances of requested royalty reductions, and substitutes a common, more simplified public notice and comment process for all applications;

Existing paragraph (9) -- disclosure of the effects of royalty reduction:

-- at page 7, lines 1 - 4: eliminates the requirement of existing paragraph (9) obligating the commissioner of natural resources to include in the findings "the reasonably foreseeable effects of the proposed royalty modification on the state's revenue";

Existing paragraph (10) -- opportunity for and procedures applicable to Legislative Budget and Audit Committee review of preliminary findings and determination:

-- at page 7, lines 5 - 17: reinserts a deadline for the commissioner's appearance before the Legislative Budget and Audit Committee and eliminates explicit authority for the commissioner to appear before the committee in an executive session insofar as discussion may involve disclosure to the committee of confidential financial and technical data that support the commissioner's preliminary findings and determination;

Existing paragraph (11) -- transmittal of preliminary determination to legislature:

-- at page 7, lines 18 - 24: although renumbered, no change is made in this paragraph;

Existing paragraph (12) -- final action:

-- at page 7, beginning at line 25: eliminates the requirement that the governor approve the final findings and determination that are prepared by the commissioner; makes other word changes consistent with amendments set out earlier in the bill;

Existing paragraph (13) -- certain related provisions made inapplicable to limit the commissioner's authority to modify royalty under subsection (j):

-- at page 8, lines 19 and 20: no change is made in this paragraph.¹

¹ The provisions referenced in the text of this paragraph provide as follows:

Sec. 38.05.134. Conversion to lease. If the licensee requests and the commissioner determines that the work commitment obligation set out in an oil

and gas exploration license issued under AS 38.05.132 has been met, the commissioner shall convert to one or more oil and gas leases all or part, as the licensee may indicate, of the area described in the exploration license that remains after the relinquishments, removals, or deletions required by AS 38.05.132(d)(2). A lease issued under this section

...

(3) must be conditioned upon a royalty in amount or value of not less than 12.5 percent of production, except that the lessee who, proceeding under AS 38.05.131 - 38.05.134, under a lease issued in the Cook Inlet sedimentary basin who is the first to file with the commissioner a nonconfidential sworn statement claiming to be the first to have drilled a well discovering oil or gas in a previously undiscovered oil or gas pool and who is certified by the commissioner within one year of completion of that discovery well to have drilled a well in that pool that is capable of producing in paying quantities shall pay a royalty of five percent on all production of oil or gas from that pool attributable to that lease for a period of 10 years following the date of discovery of that pool, and thereafter the royalty payable on all production of oil or gas from the pool attributable to that lease shall be determined and payable as specified in the lease; the payment of the five percent royalty under this paragraph is authorized only to a holder of a lease who meets the requirements of AS 38.05.180(f)(4);

.....

[AS 38.05.180. Oil and gas leasing.] (f) Except as provided by AS 38.05.131 - 38.05.134 and 38.05.177, the commissioner may issue oil and gas leases on state land to the highest responsible qualified bidder as follows:

(1) the commissioner shall issue an oil and gas lease to the successful bidder determined by competitive bidding under regulations adopted by the commissioner; bidding may be by sealed bid or according to any other bidding procedure the commissioner determines is in the best interests of the state;

(2) whenever, under any of the leasing methods listed in this subsection, a royalty share is reserved to the state, it shall be delivered in pipeline quality and free of all lease or unit expenses, including but not limited to separation, cleaning, dehydration, gathering, salt water disposal, and preparation for transportation off the lease or unit area;

(3) following a pre-sale analysis, the commissioner may choose at least one of the following leasing methods:
of not less than 12.5 percent in amount or value of the production removed or sold from the lease;

(A) a cash bonus bid with a fixed royalty share reserved to the state;

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

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

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

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

(F) a cash bonus bid with a fixed royalty share reserved to the state based on a sliding scale according to the volume of production or other factor but in no event less than 12.5 percent in amount or value of the production removed or sold from the lease;

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

(4) notwithstanding a requirement in the leasing method chosen of a minimum fixed royalty share, on and after March 3, 1997, the lessee under a lease issued in the Cook Inlet sedimentary basin who is the first to file with the commissioner a nonconfidential sworn statement claiming to be the first to have drilled a well discovering oil or gas in a previously undiscovered oil or gas pool and who is certified by the commissioner within one year of completion of that discovery well to have drilled a well in that pool that is capable of producing in paying quantities shall pay a royalty of five percent on all production of oil or gas from that pool attributable to that lease for a period of 10 years following the date of discovery of that pool, and thereafter the royalty payable on all production of oil or gas from the pool attributable to that lease shall be determined and payable as specified in the lease; for purposes of this paragraph, the reduced royalty authorized by this paragraph is subject to the following:

(A) only one reduction of royalty authorized by this paragraph may be allowed on each lease that qualifies for reduction of royalty under this paragraph;

(B) if, under this paragraph, application is made for a royalty reduction for a lease that was entered into before March 3, 1997, the commissioner may approve the application only if, on that date, the lease was a nonproducing lease that was not committed to a unit approved by the commissioner under (m) of this section, that is not part of a unit

Bill sections 2 - 4. These provisions make conforming amendments to subsections (p), (s), and (t) of AS 38.05.180, substituting "reduce royalty" for "decrease royalty" in places indicated.

Bill section 5. Under the referenced paragraph², there is in the State Procurement Code an exemption for contracts with experts retained by the commissioner of natural

under (p) or (q) of this section, and that has not been made part of a unit under AS 31.05;

(C) if application for a royalty reduction is made under this paragraph for a lease on which a discovery royalty was claimed or may be claimed under the discovery royalty provisions of former AS 38.05.180(a) in effect before May 6, 1969, the commissioner shall disallow the application under this paragraph unless the applicant waives the right to claim the right to a reduced royalty under the discovery royalty provisions of former AS 38.05.180(a) in effect before May 6, 1969; and

(D) the commissioner shall adopt regulations setting out the standards, criteria, and definitions of terms that apply to implement the filing of applications for, and the review and certification of, discovery oil and gas royalty certifications under this paragraph;

(5) notwithstanding and in lieu of a requirement in the leasing method chosen of a minimum fixed royalty share, or the royalty provision of a lease, for leases unitized as described in (p) of this section, leases subject to an agreement described in (s) or (t) of this section, or interests unitized under AS 31.05, the lessee of all or part of an oil or gas field identified in this section that has been granted approval of a written plan submitted to the Alaska Oil and Gas Conservation Commission under AS 31.05.030(i) shall, subject to (dd) of this section, pay a royalty of five percent on the first 25,000,000 barrels of oil and the first 35,000,000,000 cubic feet of gas produced for sale from that field that occurs in the 10 years following the date on which the production for sale commences; the fields eligible for royalty reduction under this paragraph, all of which are located within the Cook Inlet sedimentary basin, were discovered before January 1, 1988, and have been undeveloped or shut in from at least January 1, 1988, through December 31, 1997, are

- (A) Falls Creek;
- (B) Nicolai Creek;
- (C) North Fork;
- (D) Point Starichkof;
- (E) Redoubt Shoal; and
- (F) West Foreland.

² The text of the material to be repealed, paragraph (33) of AS 36.30.850(b), reads as follows:

Representative Vic Kohring
February 14, 2003
Page 7

resources to help evaluate the request for a royalty modification. One of the changes made in the bill shifts the contracting obligation from the department to the applicant. Repeal of the paragraph would eliminate the Procurement Code exemption for the retention of experts.

Bill section 6 gives the measure an immediate effective date.

JBC:med
03-152.med

(b) This chapter (i.e. the State Procurement Code) applies to every expenditure of state money by the state, acting through an agency, under a contract, except that this chapter does not apply to

. . . .

(33) contracts between the Department of Natural Resources and contractors qualified to evaluate hydrocarbon development, production, transportation, and economics, to assist the commissioner of natural resources in evaluating applications for oil and gas royalty increases or decreases or other oil and gas royalty adjustments, and evaluating the related financial and technical data, entered into under AS 38.05.180(j);

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: CS SS HB 28(O&G)
 () Publish Date: _____

Revision Date/Time (Note if correction): 4-10-03 Dept. Affected: Natural Resources
 Title Oil & Gas Royalty Modification BRU Resource Development
 Component Oil and Gas Development
 Sponsor Kohring, Rokeberg
 Requester House Resources 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 ()						
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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 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
 Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

POSITIONS	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

HB 28 would amend AS 38.05.180(j) which addresses oil and gas royalty modifications. None of the amendments in CSSH 28(O&G) would provide additional fiscal impacts to the state beyond that already existing in statute.

Prepared by: Mark D. Myers Phone 269-8800
 Division: Oil and Gas Date/Time 4/10/2003
 Approved by: Tom Irwin, Commissioner Date 4/10/2003
 Agency: Natural Resources

Unocal Alaska
Union Oil Company of California
808 West 9th Avenue, P.O. Box 196247
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Telephone (907) 278-7600
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Kevin A. Tabler, Manager
Land/Government Affairs

March 7, 2003

Representative Norman Rokeberg
State of Alaska Legislature
State Capitol
Juneau, Alaska 99801-1182

Re: Oil and Gas Royalty Modification
Information

Representative Rokeberg:

During my recent visit to Juneau, March 4, 2003, you asked me for certain background information regarding Union Oil Company of California's (Unocal) application to the Department of Natural Resources (DNR) for royalty relief under HB 207. Specifically, you asked two (2) questions:

1. You wanted to know our opinion and experience with the application process and as an applicant, our thoughts on the applicant for a royalty modification having input into the selection of a contractor; and
2. Information regarding the availability of certain data that may be requested by DNR in the application approval process, particularly over a property that was previously owned by another company.

Attached to this letter are copies of testimony I provided during the 1995 hearing process partially addressing the issues above. I also participated in answering questions at several hearings wherein I expressed Unocal views not specifically stated in the attached testimony. I hope the attached will provide some context to the following comments. It's clear from the outcome of the legislation in 1995 that some of the concerns expressed thru testimony and subsequent non-use of HB207 were proven correct. We applaud your efforts to correct these deficiencies.

UNOCAL Support

Concern over contractor selection was intensely debated in 1995. Unocal expressed concern over the necessity of adding additional costs to the process by not using DNR personnel to evaluate the applicant's submittal. It was felt then, and we continue to believe, DNR has the personnel to make the evaluation. Applicants may choose to contract the services of contractors or consultants to help in the analysis and preparation of an application only later to find the dollars expended will be of no value or duplicated in the DNR application approval process without selection input from the applicant; only the duty to pay for such additional services.

During the Unocal application process, we spent approximately \$250,000.00 in consulting fees when the total resulting benefit to Unocal would have amounted to around \$600,000.00. We hired Gaffney Cline as our consultant because the State of Alaska had just used them for a reserve study in Cook Inlet. The thought here was that Gaffney Cline would provide creditability and DNR would be comfortable with their work and our analysis. We ultimately pulled the application because we had over 12 months and too many man-hours involved to justify the time and expense for such a nominal benefit. The biggest problem with the process was that the requirements for justifying royalty reduction were undefined so the applicant did not know what criteria they were trying to satisfy. The process has to be simple, predictable, easily understood and administered. It can't be a process for DNR to try and get into the financial workings of a company in order to make a determination of what the DNR believes a reasonable rate of return should be. Additionally, it can't be a process where any relief is tied somehow to the state being made whole in the future. The reality may be the State won't be made whole in terms of royalty revenue receipts from future production but compensated through ancillary benefits.

With mature fields in Cook Inlet, when a royalty application is needed, the volumes of production and corresponding royalty associated therewith are such that life extension of the facility is the primary benefit. If you wait until the field is truly uneconomic to apply or qualify then there is very little benefit to the applicant since royalty relief does not really add enough revenue to significantly increase field life. The time to get relief is when you are still economic and there is potential to increase field life by investing more capital or expense dollars to increase production. With such an extension you have the ancillary benefits of jobs, taxes and the multiplying effect of money in a community.

Although we understood the concerns expressed in 1995 regarding contractor selection, if we have to have a selection process, a process where the DNR provides a list of approved contractors and the applicant can pick from the list and negotiate the price seems most fair. The criteria would be determined up front and the costs would be established to provide certainty to the process. The applicant can then decide if the cost is justified in proceeding with the application.

Secondly, the issue of data availability is an important one. Not all data that may be requested by the DNR is available for all facilities. In past years, properties have exchanged hands on a number of occasions and the resulting effect is each company has different policies for retaining, evaluating, maintaining and storing data. Historical data,

in particular financial and production data, is often lost, determined to be confidential or not provided at all.

In one Unocal transaction, the selling party decided to make duplicate copies of the files for their records. Labeled file jackets were removed and retained for the selling parties duplicate files. The original contents were bound by rubber bands, unidentified and placed in boxes for shipping. Upon arrival, we had no transmittal verification of what was sent. The selling company was later acquired by another company and the duplicate set of files destroyed. It took a year to sort out what was sent, and in the process, paperwork and files determined at the time to be of no value were destroyed.

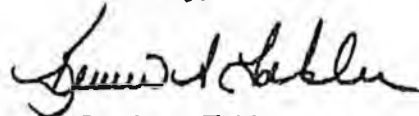
In another case, a property transferred to Unocal years ago, involved a Purchase and Sales Agreement and a Bill of Sale. No operational, financial or production data was ever received by Unocal. Additionally, it is not uncommon for geological and geophysical data licenses to be non-transferable. Unless the selling party has an ownership in the data, or the data is proprietary to the selling company, the purchaser may not be entitled to certain data requested or required by DNR for its royalty modification application review.

Finally, data acquired today has a better chance of being retained, inventoried and located due to electronic imaging. Historical information is bulky, cumbersome, requires storage and often destroyed as standard past operating procedure.

The issues of data availability and contractor selection become less problematic if the application process is clear and concise and the qualifying criteria quickly and automatically administered.

Hopefully, the foregoing answers your questions.

Sincerely,



Kevin A. Tabler

Attachments

Union Oil Company of California
Testimony on HB207
House Committee on Oil and Gas
March 16, 1995

Mr. Chairman and members of the Oil and Gas Committee--My name is Kevin A. Tabler, Land Manager for Union Oil Company of California (Unocal) in Alaska. I appreciate this opportunity to be heard today and to present Unocal's comments on House Bill 207. First I'd like to say, we are very encouraged with the positive atmosphere and effort expended, thus far, by the Legislature and Administration in trying to develop incentive legislation to enhance and stimulate further exploration and development throughout the State. We recognize and appreciate the concerted in-depth effort being made by your committee to fully assess the utilization and applicability of this Bill prior to subsequent referral. This time, spent early on, understanding the implications of the Bill, and providing the opportunity for intended users to clarify and augment specific sections, will greatly enhance its acceptability and help ensure its passage into legislation.

By broadening the applicability of AS 38.05.180 (j), we believe this Bill is a step in the right direction toward revising existing Statutes. This approach provides additional opportunity for certain marginally economic fields to compete both, internally within a company and externally on a global basis. But, before I address specifics under Section 2., I would like to make a brief comment about Section 1.

Unocal is taking a neutral position on the appropriateness or need to revise the funding mechanism previously established for the Alaska permanent fund under AS 37.13.010(a). The sharing of revenues and proceeds derived through leasing, exploration and development of the States mineral wealth, split between the permanent fund and general fund, is not the focus of our analysis of this Bill. Our focus and concern of the Bill is one of clarification, administration and utilization as it pertains to our Cook Inlet operations.

Section 2.

Last Thursday, I listened to a discussion during the first hearing on this Bill regarding the need to define the term "field". Bill Van Dyke did an excellent job of explaining the differences between fields, pools, horizons, and the delineation of same, in the context of the applicability of each, regarding this Section. To help clarify and more accurately describe the aerial extent of an accumulation for which this Section would apply, we offer the following suggestions. On line 29, page 2 after the word field, insert ", pool or portion of a field or pool". On line 30, we would suggest that the word "an" be eliminated and the words "a producing" be inserted between "of" and "oil". The same wording suggested on line 29, would apply after the word "field" on line 30. The application here is that the

AOGCC has clearly defined pools and separate horizons or zones associated with any recognized field. Similar testimony was provided Tuesday by DNR and we support their modification.

Our second comment is related to lines 8 thru 10 on page 3. As a condition of evaluating an application and data, the commissioner may require the lessee to pay the costs of contractors selected by the commissioner to assist in the evaluation. We feel all attempts should be made to utilize existing DNR staff wherever possible to reduce costs. On Thursday, the commissioner indicated the intent of this subsection was to have mutual agreement between the applicant and the commissioner as to the selection of contractors. We believe it is important to spell this out in the Bill. Equally important is the need to mutually agree on the costs contemplated for expenditure by lessee, prior to the hiring of a contractor. For extremely marginal properties, such as our Stump Lake Unit, the cost of hiring a consultant (at say \$20,000 – a likely amount) could eliminate most of the benefit derived from royalty reduction. This Bill currently has no control over costs. Alternatively we heard from commissioner Dave Johnston of AOGCC on Tuesday, recommending that the applicant hire and pay for the contractor in support of its application to control costs. The commissioner of DNR would provide a list of contractors that would be acceptable to DNR and the applicant would then have the ability to select one for the analysis. This approach makes the most sense, in that the company would then be able to negotiate the best price possible and thereby have some control on costs. We would support this concept. This preferred approach would also eliminate the need for the costly and time consuming RFP process DNR would have to employ.

The elimination of the reasonable rate of return criteria on lines 13 thru 17 page 3 is a positive step in cleaning up the Statute. This determination is too subjective and open to debate. It is unrealistic to think that common agreement will ever be reached by any two parties. This requirement is unnecessary and therefore is better left out.

We need a very clear understanding that modifications made to existing Statutes do not inadvertently have a debilitating or limiting effect on the mature, marginally economic future development of Cook Inlet. There is a monumental difference between the exhausted fields typically found in Cook Inlet as opposed to those on the North Slope.

The next two comments are very important to Unocal and it's operations in Cook Inlet, but first, let me give you an example of one economic scenario involving our platform operations:

Four (4) of the ten (10) Unocal operated producing platforms produce less than 2,000 BOPD each. One (1) produces less than 900 BOPD. Expenses on all of these properties make them marginally profitable. In an effort to increase

production, Unocal committed over \$80 million in capital investments over the last two years, with the potential to spend an additional \$31 million in 1995 on these four (4) platforms. At this point, it is difficult to commit additional capital to develop these properties due to their short remaining platform lives and marginal profitability. Reducing or eliminating the state's royalty on these marginal properties could make the projects economically viable and significantly increase the economic life of the platforms, thereby maintaining employment and the associated community benefits. For fields or platforms facing abandonment today, such as a platform with less than 1000 BOPD, complete royalty relief is warranted. These properties provide minimal income to the state and complete royalty relief will extend field life and employment by about years.

Lines 17 thru 21 provide for a modification and change to the existing Statute, limiting the commissioner's ability to reduce royalty by specifying certain limits. We propose this additional language and limitation be taken out in its entirety. We believe it is in the state's best interest for the commissioner to have the flexibility to reduce royalty down to 0, as currently provided, given a finding on the part of the commissioner, supported by financial and technical data which demonstrates the benefits of such action is warranted.

Lines 23 and 24 need revisions to eliminate the unilateral right of the commissioner to increase royalty beyond the state's original royalty share prior to any reduction on a previously producing mature field or re-establishment of commercial production of shut-in oil or gas. The big upside potential of a field, as discussed last Thursday and again at Tuesday's hearing, only applies to delineated but not previously produced fields where one may reasonably expect a pleasant surprise. A previously negotiated change in royalty at the time of the initial reduction, under strict criteria, may be warranted in the case of a delineated but not previously produced field. Bids were made on leases and evaluated on known parameters and an economic analysis at the time of bidding. Companies need the opportunity to evaluate any royalty change upward in light of field economics and overall company economics, and agree to any royalty modifications prior to committing manpower and capital to a project. It's not realistic to anticipate that mature producing fields hold the same type of promise. For the commissioner to have unilateral authority to increase the royalty rate to whatever level beyond the royalty originally specified in the lease, is not warranted in these mature fields. For mature fields, the impact of price only effects extending field life. If we are opening ourselves to the possibility of higher future royalty by applying for a reduction today, we may be eliminating the incentive to apply. Companies need certainty for planning and capital commitment purposes.

Line 1 on page 4 indicates the commissioner's decision regarding a request is final and not appealable. This really is no change from the current Statute. If this provision is of concern to the committee or the Legislature, then perhaps a peer review of the decision could be conducted. In Tuesday's hearing, the

AOGCC provided a couple of alternative approaches to address the concern of oversight and appealability, both of which are acceptable to Unocal.

In conclusion, We believe this Bill has the potential to add certain attractive parameters to the administration of the royalty reduction process. For Unocal, at this time, this Bill has application only to our existing producing fields. Page 3 changes proposed in the bill, further restrict Unocal's ability to seek royalty relief beyond what is currently in Statute and make it difficult to support in its current form. With the changes we have proposed, we believe the interests of all parties are protected while at the same time afford the commissioner the discretion he is entitled under current Statute.

Unocal already has in place a vehicle under current Statute to address the concerns of its marginal fields in Cook Inlet, as they reach their economic limit. Albeit not an ideal vehicle, at least one which is less onerous than that which is proposed. Although we like the ability to expand the applicability of this Statute, and eliminate the requirement for a subjective reasonable rate of return determination, the potential for increased royalty beyond that which was originally agreed and an arbitrary floor placed on the amount royalty may be reduced, eliminates flexibility and hurts our efforts toward field life extension in Cook Inlet.

We look forward to working with the Legislature as this Bill progresses through the legislative process.

Thank You